



# Private Investing the *“Right”* Way

- Right Investor
- + Right Amount
- + Right Security



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# Summary

In an era of low interest rates and volatile equity markets, more and more investors are compelled to explore alternatives offering consistently higher returns — the holy grail of investing.

The \$3 trillion+ private investment market offers an unlimited variety of alternative investments from which to choose. If selected wisely, these securities can provide an attractive complement to more traditional investment portfolios.

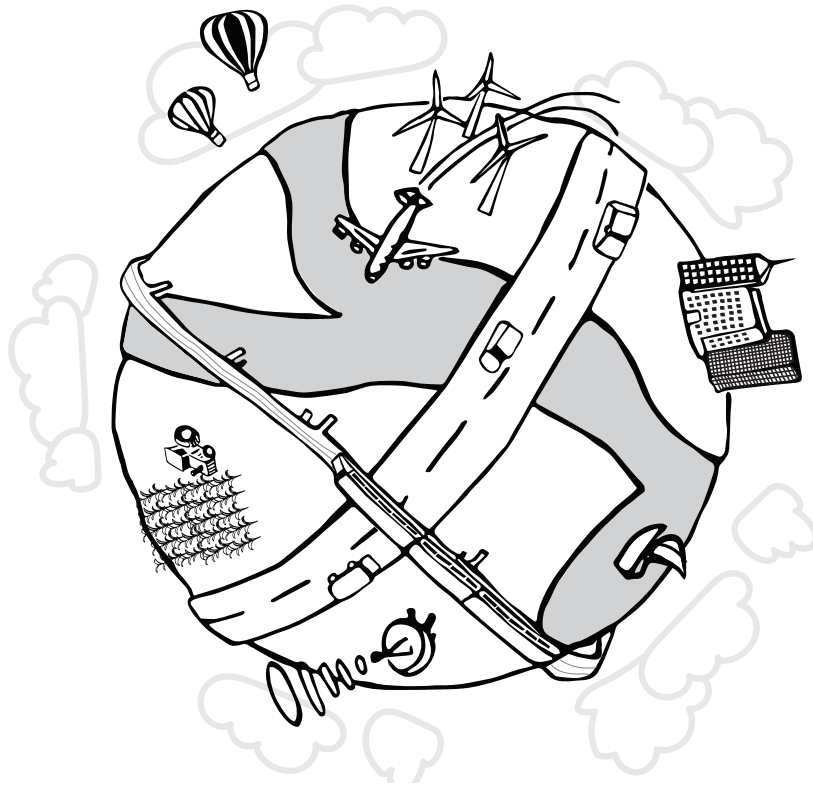
But, as our economists have told us for many years, **THERE IS NO FREE LUNCH**. You don't hear as much about the many private investments which lose money ...

The following are the essential guidelines for a prudent private investment program. This is based upon over \$1.2 billion of securities placed in over 200 private offerings by Carofin and its affiliates:

- » Assure that private investments are suitable to your circumstances;
- » Limit your overall exposure, and then invest small amounts in numerous private investments;
- » Match investments which have been thoroughly analyzed to your investment goals.

In short, follow these guidelines in your private investment process:

**Right Investor**  
**+ Right Amount**  
**+ Right Security**



## Are you the “Right Investor?”

Right Investor = Suitability + Accreditation

The first essential step to is to determine whether private investments are appropriate to your financial and other circumstances ... and also whether you are even legally allowed to participate in private placement transactions conducted under U.S. securities laws.

### SUITABILITY

Investor suitability encompasses:

*“the quality of being right or appropriate for a particular person, purpose, or situation.”*



Suitability relates to the personal circumstances of the investor. In determining appropriateness of private investing, you must consider the following:

- » **Risk tolerance** — Your willingness to risk losing some or all the original investment in exchange for greater potential returns
- » **Liquidity needs** — Your need to unilaterally (i.e., before a maturity or other liquidity event) convert an investment to cash through a secondary sale
- » **Investment time horizon**, such as the expected time available to achieve your financial goals

- » **Age** — If you are in a later stage of life, you should generally avoid riskier investments and invest within a shorter time horizon
- » **Investment experience** — Your familiarity with the basics of investments and risk/return concepts
- » **Financial situation and needs** — Your annual income, your liquid net worth, and your total investable net worth
- » **Tax status**, such as marginal tax rate
- » **Investment objectives**, which might include your need for current income, paying for education, funding retirement, buying a home, preserving wealth or speculating in the market
- » **Other investments** you currently hold (their liquidity, industry concentration, potential performance, etc.) and total investable net worth

## ACCREDITATION

This can be defined by answering the following question:

*Can you legally invest in a private security offering in the U.S.?*

It's likely you've heard about the need to be "Accredited" to invest in "Reg D" offerings.

Adopted in 1982, Regulation D specifies the Securities and Exchange Commission's (S.E.C.) "safe harbor" for conducting private securities transactions in the United States.

There are “Rules” within Reg D for different types of private placements of securities as well as for the types of investors allowed to participate in them (Rule 501). These offerings are limited to persons of greater financial means who can better withstand the potential losses associated with riskier investments.

An Accredited individual is anyone whose:

- » Earned income exceeded \$200,000 (or \$300,000 together with a spouse) in each of the prior two years and reasonably expects the same for the current year, **OR**
- » Net worth is over \$1 million, either alone or together with a spouse, excluding the value of the person’s primary residence.

Relatively new U.S. securities laws<sup>1</sup> allow certain Reg D offerings to advertise.<sup>2</sup> But Accredited Investors may invest only after the Issuer takes “reasonable steps” to verify an investor’s accreditation. This is usually satisfied by third-party verification of an investor’s financial status (e.g., verified by tax returns, bank statements, credit reports or by an accountant, lawyer or banker).

*As with other investment categories, it’s highly recommended that you engage an investment advisor qualified to help you determine whether private investments are appropriate for you.*

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<sup>1</sup> the Jobs Act of 2012 and the related Securities and Exchange Commission regulations in 2016

<sup>2</sup> “general solicitation” in regulatory-speak

## What's your “Right Amount?”

**Right Amount = Loss Tolerance + Portfolio Allocation +  
Diversification**

Once you know that private investments are an appropriate investment alternative for you, you need to determine amounts to invest, both across all private investments you will make and for each investment — with limits.

To include private investments (or other types of “alternative” investment) within your total portfolio, you should:

- » Respect the risks inherent to private investment relative to your personal risk tolerance; and
- » Apply portfolio management discipline to each investment you make.

Set limits for the amount you will commit to any specific investment. And, when investing again with an Issuer currently in your portfolio, limit your exposure.

### YOUR LOSS TOLERANCE

As discussed under Suitability, this means you are accepting a higher probability of loss for some amount of the private investments you make.

Even the most experienced venture capitalists regularly lose all their money on a significant number of investments (often 30% or more for early-stage venture investments). This is despite applying highly disciplined and experienced investment selection processes.

If you can't stand this type of heat, it's best you stay out of the private investment kitchen!

## LIMIT TOTAL PORTFOLIO ALLOCATION

Limit your overall exposure to illiquid private investments and other “alternatives,” like real estate.

While Carofin cannot define what level is specifically suitable for you, 20% is a relatively high percentage for most individuals<sup>1</sup>.

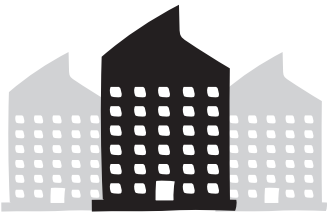
## DIVERSIFY WITHIN THE PRIVATE INVESTMENT ALLOCATION

Don't “place all your eggs in one basket.” Limit your exposure to any one deal.

Most private fund managers cap their investment exposure in any investment or Issuer to 10% of their private portfolio, if not a much lower percentage. Of course, this is fundamental to portfolio management for any investment.

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<sup>1</sup> calculated as a percentage of your total investment portfolio, excluding your home's value).





Within your private investment allocation (the “20%”), create and maintain diversification by making numerous smaller investments while following a well-reasoned deal selection process (see Right Investment below.)

What are we recommending? Without knowing the most appropriate percentage that suits your circumstances ...

- » Restrict the total private allocation within your overall investment portfolio (say, 20% +/-)
- » Limit each private investment within this allocation to no more than 10%

**As a result, each individual investment will only represent a modest percentage of your total investment portfolio (in this example, 2%).**

What does this achieve?

- » You will be better insulated from catastrophic losses across your overall allocation to private investments, and
- » It will produce a “blended” ROI to complement returns generated by your more traditional investments.

*As with other investment categories, we strongly recommend that you engage a qualified investment advisor to guide you through the many decisions affecting private investment allocations in your portfolio.*

## Is this the “Right Security” for you?

**Right Security = Return Characteristics + Investment Analysis**

Now you’re ready to start evaluating private investments to include within your investment portfolio!

### RETURN CHARACTERISTICS

What should an investor expect from each investment?

Will it generate current income (a high probability of an interest or dividend payment made monthly or quarterly) or a capital gain (the growth over time of the value of the equity or asset value)? Capital gains are realized by investors when they sell the private equity investment through a “liquidity event,” such as the sale of the company or an IPO.

As indicated above, investors must first determine their investment goals. Then they can decide whether they can achieve their goals through a particular private investment.

### INVESTMENT ANALYSIS

This is arguably the most challenging part of the private investment selection process – and it’s

different for a debt or an equity investment.

Distinct structures, terms, conditions within each of these classes of securities further challenge your understanding. Investment professionals spend careers specializing in single industries or types of security, so leverage the expertise of others for your analysis.

Carofin has created an extensive library of investor-oriented material within its [Knowledge Base](#). We provide it to aid investors with their private investment analysis. The following White Papers should help you evaluate debt and equity private investments:

- » [Primary Investment Considerations, or First Principles](#)
- » [Seven Key Questions for Evaluating a Private Company](#)
- » [Investing in Private Debt: What Can Go Wrong and How Can I Be Prepared](#)
- » [Nine Leaps of Faith – 9 Key Questions for Evaluating Venture-Stage Investments](#)

Our library of material in our [Knowledge Base](#) is continually expanding, so we invite to you to visit it regularly as you consider new private investments.

# Conclusion

Too often, private investments attract financing from individuals without adequate consideration to their broader investment profile. Our more formulaic approach should help you make consistent decisions that fit your financial circumstances, while better understanding the risks of the investment.

Feel free to make use of our [Knowledge Base](#). Improving investment standards for the Alternative Investment community is an important goal. Please tell us your experiences so we can share them with others.

Financial terms used herein are more fully defined in the Carofin's [Glossary of Investment Terms](#).



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As always, please reach out to schedule a call if you have questions. (828.393.5401)



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## Worksheet

**Right Investor**  
**+ Right Amount**  
**+ Right Security**

### INVESTMENT CONSIDERATIONS

### NOTES

#### Right Investor?

- Am I suitable?
- Am I an Accredited Investor?

#### Right Amount?

- Loss Tolerance Limit
- Total Private Investment Allocation
- Individual Investment / Issuer Limit

#### Right Security?

- Does it match Return Goals?
- Investment Analysis