Q2 2017

The iSelect Approach to Venture Capital:
A Key Component of Your Asset Allocation Strategy

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Introduction

Investment in entrepreneurship is the single most effective wealth producer the world has ever known. **American entrepreneurs use "creative destruction" to transform economic structures, advance technologies and raise living standards worldwide. And they generate tremendous profits in doing so**. Want to create the next blockbuster drug or medical device? Pick an entrepreneur. Want to transform our energy landscape? Pick an entrepreneur. Want to create jobs? Pick an entrepreneur. The resilience of our global economy comes from customers eager for better answers, entrepreneurs bold enough to think differently, and investors willing to fund new ventures.

Entrepreneurs make America great. Investing in entrepreneurs, via venture capital, makes the wealthiest Americans even wealthier. Yet this asset class has historically been unavailable to investors at lower wealth levels. In addition, even high net worth investors, family offices and small institutions, may have limited access to the best funds, or may wish to have more direct control over how their capital is deployed. Fortunately, recent legislative changes, such as the JOBS Act, are changing this, opening up the venture capital asset class to a wider array of American investors.

This paper will outline the historical advantages of including venture capital in your portfolio, and outline how investors can utilize the iSelect Fund structure to overcome most of the traditional investment challenges of this asset class.

The Case for Venture Investing

Venture capital, the process of investing in emerging companies, has outperformed every other asset class, over most holding periods, since it was first institutionalized in 1946 by George Doriot. Doriot formed American Research and Development (ARD) and generated the first true home run of the asset class with his $70,000 investment in Digital Equipment Corporation (which was subsequently worth over $400 million* when the position was eventually liquidated). In addition, in a seminal report sponsored by the Kauffman Foundation, an analysis of over 3,000 early stage investments, by over 500 individuals, resulted in over 1,000 exits and generated a 27% Internal Rate of Return over a 3.5 year period.** This return is well above public market average returns.

* "Forbes Greatest Investing Stories", 2001, page 190
** "Returns to Angel Investors in Groups", Kauffman Foundation, November 2007

Figure 1: Historically outsized returns (%)
Top quartile

Asset	5-year	10-year	15-year	20-year	25-year
Venture capital	48	38	29	92	57
Private equity	25	22	27	31	31
Real estate	27	24	26	24	24
Large-cap equity	12	7	5	8	10
High yield bonds	5	6	7	6	8
Aggregate core bond	4	5	5	5	6

Source: Cambridge Associates Global Venture Capital, Global Private Equity, and Global Real Estate Benchmarks Return Report. Private equity asset class excludes venture capital. 5-, 10-, 15-, 20-, and 25-year returns representative of average pooled IRR for vintages dating back from 2014. Top quartile returns for all asset classes shown. Large-cap equity proxy is Lipper aggregated US large-cap equity fund performance. High yield bond proxy is Lipper aggregated high yield bond fund performance. Aggregate core bond proxy is Lipper aggregated core bond fund performance. Returns as of Dec. 31, 2015. Sample size for each asset listed is as follows: venture capital: 91-440; private equity: 174-630; real estate: 71-207; large-cap equity: 62-674; high yield bonds: 30-421; and aggregate core bond: 22-385. Past performance is not a guarantee of future results.

Institutional investors have known for decades that an allocation to venture capital, private equity, real estate or other illiquid investments generally provides higher long-term returns*, and lower short-term volatility, than other more liquid portfolio constituents (such as public equity, bonds, etc.). As of 2016, venture capital as a percentage of investable assets, averages around 5% of institutional portfolios.*

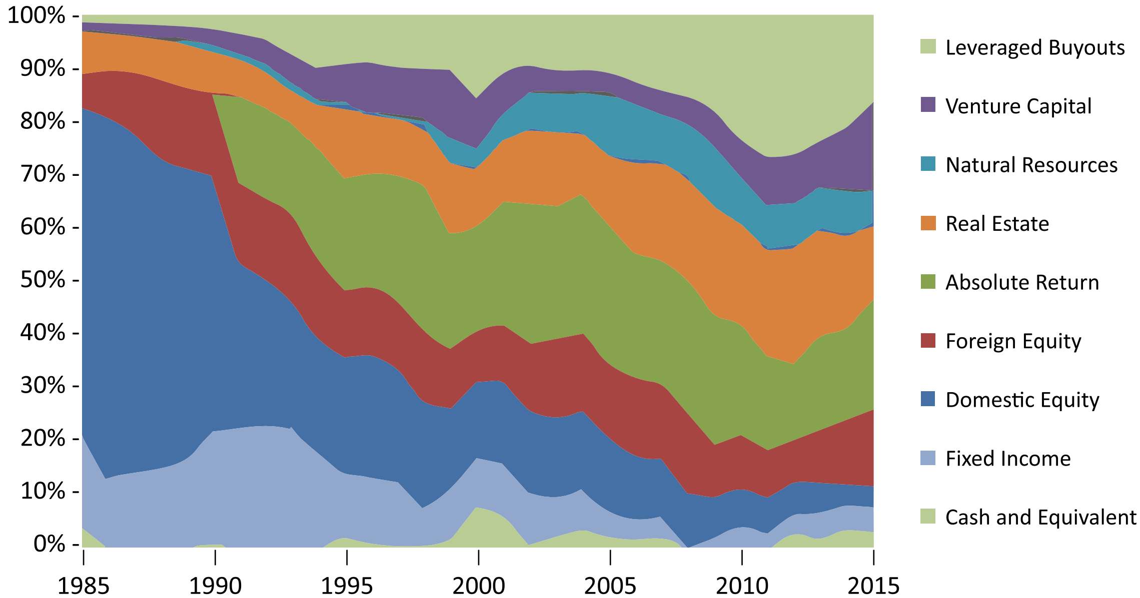
Figure 3: Endowment asset allocations
Detailed asset allocatioins for fiscal year 2015 (%)

	Total Institutions 812	Over $1B 94	501M-$1B 77	$101-$500M 261	$51-$100M 167	$25-$50M 117	Under $25M 96
Domestic equities	16	13	21	27	33	40	42
Fixed income	9	7	9	13	17	20	24
International equities	19	19	20	21	20	18	15
Alternative strategies	52	57	44	34	25	16	11
Private equity	10	12	7	5	3	2	0
Marketable alternatives	20	21	22	17	13	8	7
Venture capital	5	7	3	1	1	0	0
Private equity real estate	6	7	4	3	2	2	0
Energy	6	6	4	3	2	1	1
Commodities and managed futures	1	1	1	1	1	1	1
Distressed debt	2	2	1	1	0	0	0
Alternatives not broken out	2		2	3	3	2	2
Short-term/other	4	4	6	5	5	6	8
Short-term securities/cash	3	2	4	3	3	4	4
Other	1	1	2	2	1	2	3
Short-term not broken out	0	1	0	0	1	0	1

Source: NACUBO-Commonfund Study of Endowments', 2015. NACUBO, www.nacubo.org.

*The Case for Venture Capital, Invesco, 10/2016

In some cases, an increased allocation to venture has resulted in performance that far exceeds both the public markets and peer institutions, as is the case with the Yale University Endowment. Yale started investing in venture in 1976 and has achieved a 33.8%* annualized IRR on its investments since inception. Overall, as a result of this asset allocation model, Yale has achieved an average 12.9%** return per annum over the last 30 years (ending fiscal year June 2016)* vs. 7.68%*** for the S&P (not including reinvested dividends). That is an almost 70% outperformance.



As highlighted in this chart, Yale's allocation to venture, as of year-end fiscal 2016, now exceeds 16% of the fund.** What is also striking is the dramatic decline in exposure to U.S. stocks and fixed income over time (shown above in dark and light blue).

It is true there have been certain periods during which venture has underperformed public markets and other asset classes, occasionally by a significant amount. It is also true that most individual venture investments do not achieve a positive return. Inevitably, all asset classes will underperform periodically due to poor economic conditions, out of favor sentiment, declining business cycles, poorly performing managers, etc. But as outlined above, this asset class, when properly diversified, has consistently outperformed all other asset classes over the *long-term*. And that is the crucial point. The ability to be largely shielded from the effects of public market volatility, monetary policy, real estate crashes, etc., creates the potential for a certain number of companies in a diversified venture portfolio to nevertheless create significant value over time even when other asset classes are underperforming.

Further, venture capital as an investment has shown significant non-correlation with other asset classes.* Despite generally benefitting from cyclical upswings in the economy/market and being negatively affected by downturns, the process of solving substantive long-term issues (curing cancer, addressing climate change, etc.), the long-term nature of the harvesting period, and longer-term pricing mechanisms, allows venture capital investments to be substantially uncorrelated with other investments in one's portfolio.

*The Case for Venture Capital, Invesco, 10/2016
**Yale Investment Office, http://investments.yale.edu/
***iSelect calculation

Figure 2: Modest correlation with other asset classes
Correlation among asset classes' quarterly returns

	Venture capital	Private equity	Real estate	Large-cap equity	High yield bonds	Aggregate core bond
Venture capital	1.00	0.71	0.69	-0.06	-0.13	-0.13
Private equity	0.71	1.00	0.65	0.46	0.33	-0.06
Real estate	0.69	0.65	1.00	0.13	0.03	-0.11
Large-cap equity	-0.06	0.46	0.13	1.00	0.73	0.13
High yield bonds	-0.13	0.33	0.03	0.73	1.00	0.35
Aggregate core bond	-0.13	-0.06	-0.11	0.13	0.35	1.00

Source: Cambridge Associates Global Venture Capital, Global Private Equity, and Global Real Estate Benchmarks Return Report. Venture capital, private equity and real estate data from Cambridge Associates. Private equity asset class excludes venture capital. Large-cap equity proxy is Lipper aggregated US large-cap equity fund performance. High yield bond proxy is Lipper aggregated high yield bond fund performance. Aggregated core bond proxy is Lipper aggregated core bond fund performance. Returns for period dating 1990-2014, as of Dec. 31, 2015. Sample size for each asset listed is as follows: venture capital: 771; private equity: 932; real estate: 309; large-cap equity: 674; high yield bonds: 421; and aggregate core bond: 385. Past performance is not a guarantee of future results.

The Illiquidity Premium

The higher returns attributed to venture capital and private equity are also generally attributed to what's called, the "illiquidity premium." In general, the more liquid an investment, the less risk is involved and the lower the required return. Examples of highly liquid, low return assets include cash, Treasuries, large-cap equities, etc. Less liquid, potentially higher risk assets like venture, private equity, real estate, etc. call for larger required returns. The Blackstone Group calls this the "Illiquid Opportunity and Illiquid Advantage" for "Patient Capital" * - i.e. capital that is invested for the longer term.

In Blackstone's words, "The lack of a public market for these assets and their resulting illiquidity is the primary source of both the benefits and challenges they present."* So what does this mean? Blackstone goes on to say (elaborating to some extent on the Efficient Capital Market Hypothesis) that in a developed public market, information discovery is generally in real time and assets can be traded immediately. This can create opportunities for profit, but it also creates a relatively uniform market with equal chances of profit and loss for most participants. While information (and trading) advantages can be attained by earnest due diligence, true corporate insider information is illegal to obtain, and cannot be legally traded upon. This transparency in the markets inherently (and usually, but not always) delivers a return that is symmetric across most marketable security holders.

In private markets, asymmetric information advantages exist. There is generally no requirement for private companies to disclose corporate information to the public. As a result, investors in these companies have superior information than others - access to company management, company financials, sales pipelines, and strategies. This information allows for an advantaged analysis of the investment vs. those that do not have this information. The important distinction of course, is that this is perfectly legal in the private markets.

*The Case for Venture Capital, Invesco, 10/2016

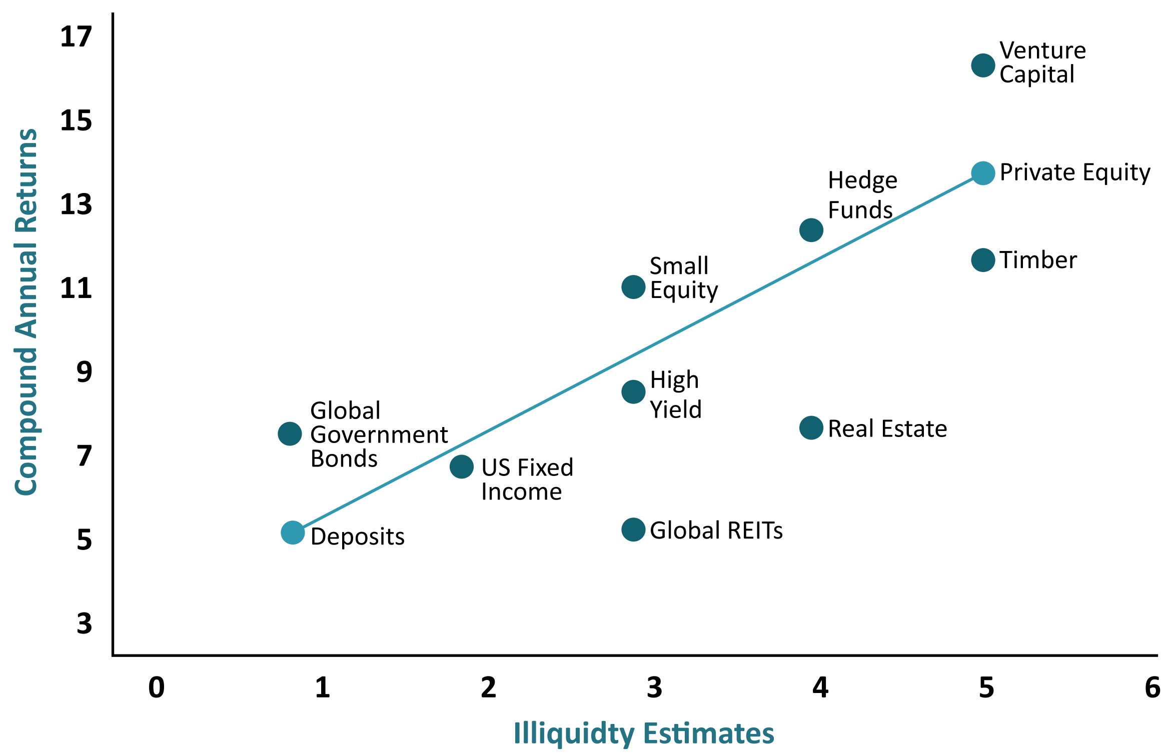
A Natural Complement: Private and Public Market Investments

Public Markets	Private Markets
➔ Frequent transactions	➔ Infrequent transactions
➔ Information widely and quickly shared	➔ Asymmetric information
➔ Performance generally in line with markets	➔ Performance premium to liquid markets

Note: For illustrative puposes only. There can be no assurance that an allocation to alternatives would provide higher real returns. Please consult your own third-party advisor before making any investment decisions based on this information.

As outlined above, longer term oriented investors such as endowments and pension funds, have long known these advantages exist. As opposed to individual investors, their percentage of alternative and less liquid assets (venture capital, private equity, real estate, hedge funds) has increased from 4-5% in 1990 to 20-30% in 2010.* Meanwhile, most individual investors rarely allocate more than 5% of their liquid and investable wealth in these asset classes. As Blackstone states, "Having a long horizon, may give more patient investors a natural edge, for harvesting this premium. They are rewarded for sacrificing this liquidity that they simply do not need." *

A Natural Complement: Private and Public Market Investments

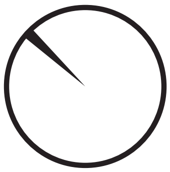


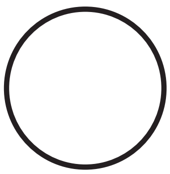
From: "Expected Returns," by Antti Illmanen, 2011. Scatterplotting average asset returns 1990-2009 on (subjective) illiquidity estimates. Sources: Bloomberg, MSCI Barra, Ken French's website, Citigroup, Barclays Capital, JP Morgan, Bank of America Merrill Lynch, S&P GSCI, MIT-CRE, FTSE, Global Property Research, UBS, NCREIF, Hedge Fund Research, Cambridge Associates.

*Patient Capital, Private Opportunity, Blackstone Group, 9/2014

Over time, the outsized return generated by this illiquidity premium, even if it comprises a small portion of the portfolio, can have a considerable effect on the overall returns of the investor.*

The Hypothetical Impact of 5% VC Allocation





Portfolio Allocation:	Start:	10-Year:	20-Year:	30-Year:
5% VC - 95% S&P	$1.0M	$2.6M	$11.6M	$87.3M
VS.				
100% S&P	$1.0M	$2.1M	$5.9M	$23.4M

S&P 500 return data calculated using the Cambridge Associates LLC U.S. Venture Capital Index (2015) for the period ending 12/31/2014. VC return data calculated using Kauffman Foundation data from "Returns to Angel Investors in Groups," (2007) for the period 1990-2007.

Challenges to Venture Investing

Despite the many attributes of venture investing, it also comes with many challenges. If one were to invest on one's own, proper deal flow and deep due diligence can both be issues. If you are not seeing enough deal flow, then you cannot build a properly diversified portfolio. Deep due diligence is time consuming and difficult, even if one has the proper expertise to evaluate companies. But do you have enough expertise to conduct due diligence on many deals? In different industries? Are you willing to spend the time needed to conduct such diligence or the ongoing operating capital to fund an in-house management team?

An alternative is to invest in a fund. Traditional funds often have high minimums - $1 million or more - if you can even get an allocation. In order to be continuously invested in the asset class and avoid the risks of a particular business cycle, you must "ladder" funds over a number of years (often 5), requiring more diligence on the fund, subjecting you to more fund manager risk, and multiplying the minimum investment by 5 - again if you can even get in. And, what do you do about sector diversification? Do you pick a generalist or a specialist? Or stage diversification? Should you choose Seed, Series A, Series B or even later stage growth capital?

*iSelect calculation utilizing above referenced data

And then there are the capital calls. Often you must allocate a portion of the capital upfront and pay a fee on it even though it has not been invested. Additional capital will be demanded when investments are actually made. Unfortunately, the timing of these capital calls has nothing to do with your availability of cash, so often you must overweight in cash or near cash securities to have cash available, suboptimizing the return on your overall portfolio.

While we are clearly strong advocates for early stage venture capital investments, it is also clear that traditional investing in this asset class does pose considerable challenges.

To cite a few:

- ➔ Minimum investments are generally $1 million or more. Larger funds may demand higher amounts.
- ➔ Access to the best managers may be difficult or, many times, impossible
- ➔ These managers may be "hot" today, with everybody piling in, but there is no guarantee this outperformance will last. Thus investors are exposed to single manager risk or multi-manager due diligence.
- ➔ Virtually all traditional venture funds have a 10-year investment period - thus locking up capital for at least ten years (some utilize provisions to extend this period). The actual investment period may only last for the first 5 years or so, with the remaining years dedicated to harvesting the companies. This limits the number of opportunities a fund can invest in.
- ➔ Set fund vintage years (the year first investments are made) can expose an investor to business or investment cycle risk. One is locked into this specific 10-year period.
- ➔ Blind pool. In a traditional VC, an investor will allocate a set amount of capital and it will be distributed at the will of the manager. The investor has no control over which companies or sectors receive its capital.

It is possible to act on one's own as a direct investor in companies, an angel investor, a participant in crowdfunding platforms, or even as an investor in venture capital fund of funds. While these are all viable options, they too come with various challenges:

- ➔ Securing adequate and high quality deal flow to diversify away the inherently risky profile of early stage investing
- ➔ Limited time and expertise in evaluating companies within your limited deal flow universe
- ➔ Limited time and expertise in due diligence. Once companies are chosen, few individuals or even family offices have the expertise and in-house team members to conduct the extensive due diligence that is required to properly analyze a company, its prospects, its industry, its competitors, etc.
- ➔ Limited time and expertise to properly monitor and assist the company once the investment is made.
- ➔ Funds of funds provide diversification and can provide limited access to "name" funds, but also layer on extra fees, generally concentrate on past performers who invest in a limited number of industries, and still maintain high minimum investment thresholds.

While it is clearly possible to generate higher returns by investing as outlined above, we believe there is a better way. A hybrid approach that combines the best attributes of a traditional early stage fund, with the freedom of direct investing. A way that provides diversification exposure to companies, funds, industries, and stages. A way that in effect, creates a venture capital fund of funds, but without the extra layer of fees and high investment minimums. A way called - <u>iSelect Fund</u>.

The iSelect Approach

iSelect Fund was founded on the belief that qualified investors should have access to early stage venture capital in a more "personalized" manner. As the first build-your-own venture fund, iSelect addresses all of the challenges to venture investing outlined above. We believe our structure provides the ideal pathway for accredited investors, family offices and institutions to add or increase their exposure to venture capital.

iSelect Fund invests in the agriculture, medical, technology and energy sectors. We invest primarily, but not solely, in between the coasts. We believe there are a considerable number of extremely high quality companies emerging in areas that are not usually targeted by the coastal VCs. If you already invest in venture, this is a source of further diversification. If you are not already allocated to venture, we believe these regions also provide access to opportunities that are not as crowded or as highly valued as the emerging companies on the coasts.

iSelect also allows you to stage your investments over time, only paying fees when your capital is actually deployed. We allow you to "curate" your investments - picking which companies, sectors or stages you'd like to invest in. In addition, our fund is an evergreen fund, meaning we do not have a set investment period or vintage year, and your capital is not tied up for a mandatory period of time. We also co-invest with many prominent regional and national VCs, thus guaranteeing our investors access to a broad range of funds and companies. Finally, and very importantly, we conduct one of the most thorough, multi-level due diligence processes in the industry - typically only accepting 2-3% of all deals we see*.

iSelect can be viewed as a hybrid approach to venture - between direct investing and placing your capital in a fund's blind pool. You get to select your investments, but we do all of the work! With iSelect Fund, investors benefit from:

Deal Flow / Diversification

iSelect sources hundreds of venture investments each year from proprietary deal sources across the U.S., but with a focus on underpenetrated regions. iSelect then selects the very few of those deals[1] that meet strict qualifying criteria for investment. This provides you with the ability to curate a diversified portfolio.

Due Diligence

Each company in the iSelect portfolio is subjected to an extensive three-tiered due diligence regime, including review by a FINRA compliant broker-dealer, taking the hard work of vetting potential investments off of fund investors. Once selected for review by our Venture Team, potential companies are studied by an industry-specific Selection Committee that is composed of independent entrepreneurs, business executives, world renowned scientists and researchers, and accomplished venture investors. Only after this extensive process, is the investment then brought before iSelect's Investment Committee for final review.

[1] Typically as few as 2%-3%, but this number varies up and down depending on quality of VC partners and syndicate

Access

iSelect typically invests alongside other marquee venture funds and joins the investment round syndicate. While we always conduct our own extensive due diligence on target companies, we also leverage the considerable work undertaken by regional and national venture capital firms. This provides our investors with access to funds they may otherwise not be able to secure, as well as providing not one, but multiple levels of due diligence on target companies conducted by all members of the syndicate.

The Flexibility to Specialize or Diversify

Want to invest across multiple stages or just one? You can do it within the iSelect platform. Get access to Seed, Series A, Series B, and sometimes later stage companies. Want to invest in multiple sectors or just one? Either way, you can choose a diversified portfolio across our four main areas of focus, or pick just one sector that is particularly attractive to you.

Pro-Rata Participation Rights

These rights are typically negotiated as part of an early stage investment, giving Seed investors the opportunity to continue to invest in later rounds so that they can maintain their ownership stake as the company grows. They give an investor the option, but not the obligation, to invest additional capital in follow-on rounds of fundraising. As a result, the investor is able to effectively “double down” on the most successful companies in their portfolio without dilution in later rounds, maintaining their stakes even over the long timeline of today’s venture-backed companies. iSelect allows investors access to these participation rights in later-stage deals.

Evergreen Fund Structure

As an evergreen fund, investors can invest whenever they want. They do not need to ladder multiple funds in order to stay fully invested at all times. This not only makes oversight easier for fund managers, but it also eliminates the risk of missing out on full investment down the road due to fluctuating availability or oversold rounds.

No Vintage Year Risk

With iSelect, you don’t need to worry about the impact of investment cycles or the business cycle to your venture investments. You can spread your investment across multiple years and multiple companies, allowing you to maximize potential returns while minimizing the downside risk of investing in venture-backed companies.

Investor-Friendly Terms

In addition to lower minimums than traditional funds — accredited investors can commit as little as $5,000 per company, allowing for the creation of a diversified venture portfolio of 20 companies for as little as $100,000 — iSelect offers additional benefits for investors who are able to make larger commitments, including specialized deal flow review and other services. The fund also does not issue capital calls, allowing investors to put money to work as it comes available, and enables all investors to specialize in the types of deals that are right for them by diversifying their holdings across companies, industries and deal terms.

Informed Decisions

Our investors have access to all of the research we conduct, in the form of a summarized and packaged diligence file that is made available to our limited partners. Post-investment, companies provide quarterly reports so that investors can monitor the progress of their portfolio, all in an effort to help individual and institutional investors to more easily evaluate, understand, and manage their personalized series of early-stage venture securities.

Conclusion

Empirical evidence has shown that over the long term, exposure to venture capital adds considerable return performance to an investor's portfolio, while reducing overall risk. As outlined, however, there are many challenges to incorporating venture into your portfolio. iSelect is a hybrid fund that provides access to this exciting asset class, yet also allows the investor to have significant control over how their assets are deployed. We believe this new, investor-friendly approach will not only broaden overall exposure to venture, but will also benefit the entrepreneurs who are taking risks, innovating, and creating new companies that will improve our quality of life, and ensure the future financial health of our world.