CPW Spotlight

The Rise of Alternative Investments & An “Absolute Return”

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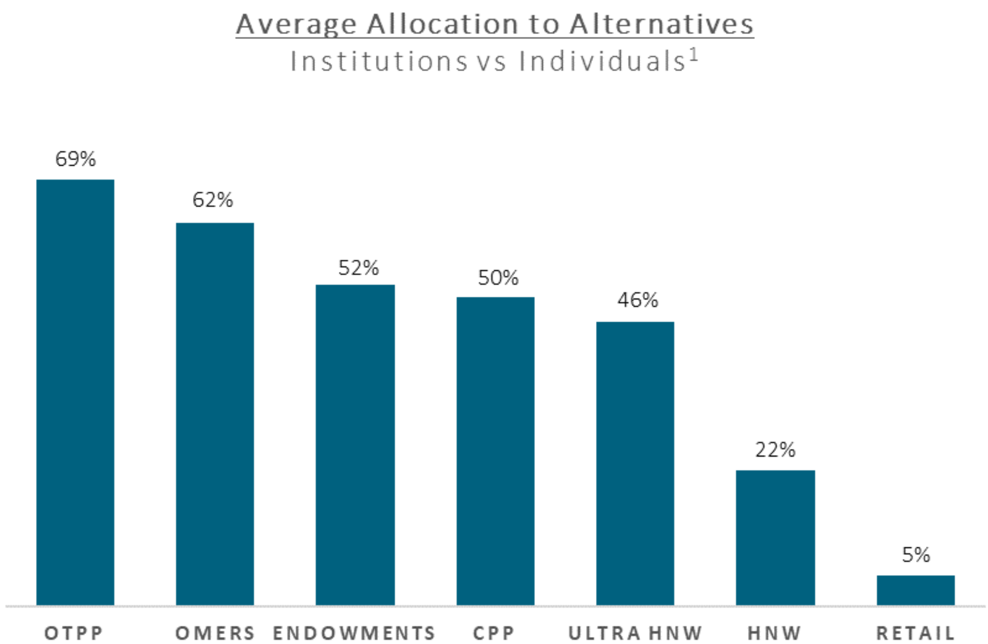
We currently sit at a point in time with a mature economic cycle, equities trading near all-time highs and interest rates delivering negative real returns. History tells us this is not an overly positive outlook for traditional asset classes over the next five-year period.

Alternative investments are increasingly playing a critical role in the portfolios of institutional investors, family offices and high-net worth individuals as they look to achieve more consistency in returns.



While many investors may believe they have a sufficiently diversified portfolio through a traditional allocation of publicly traded stocks and bonds – new research shows that **smart diversification includes having an allocation to alternative assets, to truly reduce risk and attain excess returns.**

When we refer to alternative assets, we include both non-traditional assets such as infrastructure and real estate, as well as non-traditional methods of investment such as the use of short-selling and leverage. Given the diverse nature of alternatives, there are several reasons investors seek to gain exposure to them.

1. *Additional Diversification Tool*: No different than when investors look to fixed income to diversify their equity portfolio, alternative investments can be used as an enhanced diversification strategy to reduce portfolio risk.

2. *Uncorrelated Return Stream*: As globalization increases, we've seen equities and fixed income become more correlated over time and therefore inadequately protecting your capital throughout downturns. Alternative investments – which exhibit limited or no correlation to traditional investments – can greatly assist in wealth preservation.

3. *Reduced Drawdowns (Losses):* The low correlation and additional diversification of alternatives can reduce drawdowns within portfolios though market downturns and therefore lead to enhanced performance over the long-term. In simple terms, a drawdown is the loss experienced from the highest value of your portfolio to its lowest, over a period of time.

4. *Improved Investment Experience*: By introducing uncorrelated assets, bringing down volatility and creating a more consistent return stream, the investor experience and commitment to your long-term investment strategy is significantly improved. This means investors can achieve their financial goals with greater certainty.

5. *Enhanced Risk Adjusted Returns*: Lastly, through all the benefits detailed above including additional diversification, uncorrelated returns and reduced drawdowns, the risk adjusted return profile of your portfolio is greatly improved. A portfolio with alternatives assets may achieve an equal return to a traditional portfolio over a period of time, but hold lower risk and therefore, a more preferable risk adjusted return profile.

Given that we are now late cycle and with so many potential advantages to holding alternatives, it is not surprising that investors are becoming increasingly drawn to these products. We are seeing institutions embrace alternative strategies as a core part of their portfolio, in a significant way.

BlackRock's global head of alternative investments, Edwin Conway, recently stated that private market exposure of the firm's institutional client base has climbed to about 25% of their portfolios already and it is expected to increase further to about 30% to 40%. He also noted that retail investors of the firm are targeting a 25% allocation to alternatives, which currently stands at just 3% to 4%.

"We've enjoyed 10 years of an extraordinary bull run and just being passive had produced phenomenal returns. But that's the past."

Edwin notes this is being driven by the ongoing hunt for yield and the rising correlation of traditional asset classes.

While alternatives have so many benefits to offer investors, it is important to make note of their unique risks as well. Appropriate due diligence is always required with a focus on risk management and compliance. Given that the investments may be private in nature, liquidity is also a key factor to consider.

Ultimately, the use of alternatives within portfolios can be extremely powerful in providing an opportunity to gain additional diversification, reduce risk within your portfolio and unlock potential to generate higher returns than a portfolio constrained to traditional investments. While the space is currently garnering great attention and continually evolving, it is imperative to be fully aware of the unique nature of the products and specifically how they may be used to enhance your traditional portfolio.

Should you have any questions at all, I'd be pleased to chat.

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