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ALTERNATIVE INVESTMENTS: BLESSING OR CURSE?

Dynamic strategies can offer attractive returns, but this must be weighed against their inherent riskiness. Five managers share their thoughts on the sector

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As the economy faces a global growth slowdown and with investors fearing a recession, there is one type of asset that can provide shelter from the market's unfavourable developments: alternative investments.

Thanks to their lower correlation to other asset classes, they are one way to diversify a portfolio and can provide returns when volatility peaks and equities and fixed income are struggling. Deep fundamental research, dynamic investment strategies and active allocation are only some of the features allowing them to perform in turbulent market conditions.

The risks they present, however, are as high as the returns they can offer. Most of these instruments have much higher minimum investment fees than mutual funds and ETFs and are also normally much less liquid than traditional investments. A careful analysis and broad diversification are needed when entering the alternatives investment universe.

Yet Investors seem determined to find value in these instruments. According to a McKinsey report, private asset managers raised about CHF 744 billion globally in 2017 and the market has kept growing since.

Here, five wealth managers tell us why they find alternatives attractive – and reveal their secrets to making the most out of them.

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Keep your eyes open for the liquidity challenges

Recent surveys have shown that many institutional investors are putting more of their funds into so-called alternative investments such as private equity, hedge funds and real estate.

The origin for this move is most likely the quest for return, as bond yields are at an all-time low and many stock markets are getting a bit long in the tooth.

For the private investor, the situation is exactly the same. It is therefore a given that we recommend an allocation of 10% to 20% to alternative investments.

However, there is an important proviso. Most, if not all, of these investments are highly illiquid. The time frame for private equity is more likely to be 10 years, rather than just five. Even if some fund managers offer quarterly liquidity, investors have to be aware of the fact that, for some of these investments, a mark to market (ie. a fair valuation) can be very difficult under adverse circumstances.

We like private equity. But before making any such investments, we carefully discuss an investor's need for liquidity in the near and more distant future.

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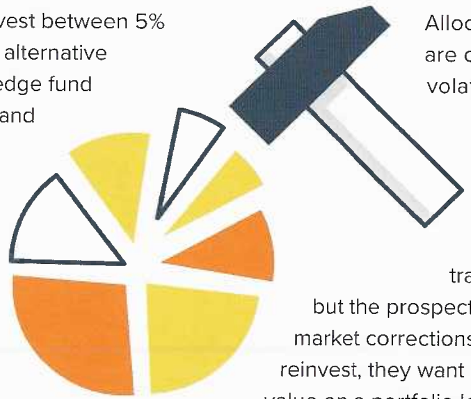
Don't dismiss diversification and downside protection

Our pension fund clients' portfolios invest between 5% and 15% of their assets across various alternative strategies. We advise them on their hedge fund investments, which are between 40% and 100% of their alternative allocation, depending on the client.

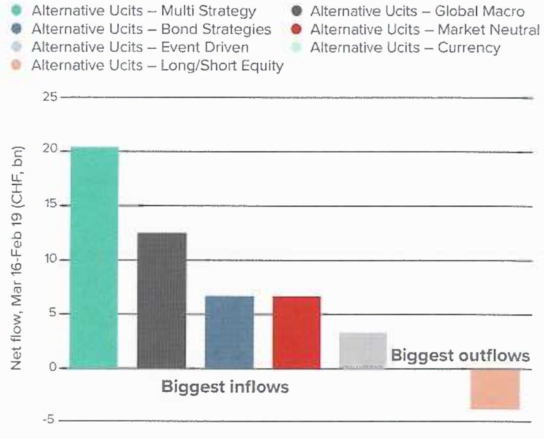
Most of our clients allocate to hedge funds to improve diversification and/or downside protection within their total portfolio. For clients focusing more on diversification, we have been overweighting strategies such as macro, equity market neutral, trading and, to some extent, alternative risk premia.



Allocations targeting downside protection are overweight macro, trading and long-volatility/volatility trading strategies.

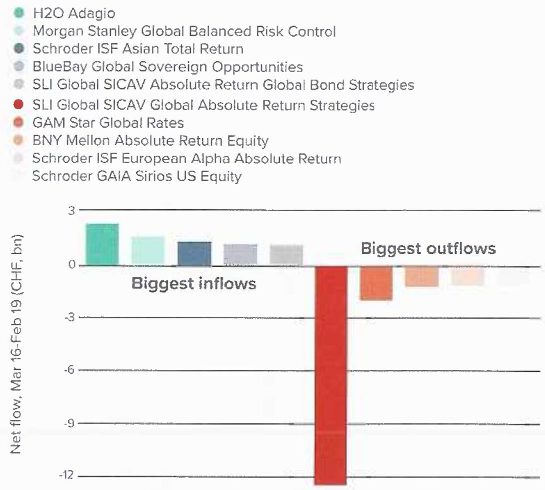
We are in discussions with various prospects that are reconsidering a hedge fund allocation. Many have left the space because of a combination of performance (versus traditional markets), fees and complexity, but the prospect of higher volatility and potential market corrections is making them reconsider. In order to reinvest, they want to see that the hedge funds are adding value on a portfolio level and versus a portfolio of alternative risk factors, and that fees are reasonable compared with the risk/return profile of other investments.

SECTOR WINNERS AND LOSERS



Source: Citywire Discovery

FUNDS BY FLOWS



Source: Citywire Discovery