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Acknowledging Alternative Investments: Alternatives is Not a Dirty Word

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Let's look ahead to the inevitable market downturn which could be as soon as 2020, according to some experts. Advisors with traditional asset management models and no exposure to investments showing little correlation to the S&P are in for a rough ride and some tough conversations with clients.

Recently, most advisors have had a good few years, growing their AUM and working with satisfied clients. Even advisors who have made some poor investment decisions for their clients will likely have been saved by a buoyant market. A typical 60/40 portfolio has performed well and everything is rosy at present.

It is common to see an advisor wince when alternatives are mentioned, as this category can include some high-octane and the associated high risk, investments. However, that is a very small sub-section of this category and far from the norm. Alternatives have their own spectrum of risk profiles and to dismiss alternatives as all high risk is doing this type of investment an incredible disservice. In fact, in a tumbling market, the argument can be made that an investment uncorrelated to the market is far less risky than a direct public equity investment.

"Investors are drawn to the idea of investing in something that is unique and different; however the general investing public continues to perceive alternative investments as more risky than the traditional

portfolio," says Jeff Eizenberg, Executive Director, RCM Alternatives. "Our research suggests quite the opposite – that in fact, alternatives can act as a volatility reducer in a portfolio."
Real estate is an alternative investment. Buying a single property in the hope of renovating and flipping could be considered very speculative. Allocating to a portfolio of commercial triple net lease properties with tenants tied in for 10 years at the investment grade level and a history of rental income could be a very conservative investment.

Oil and gas are also alternative investments. An exploration or drilling project is generally considered a risky investment. Investing in a property with proven production or buying producing mineral rights might be much more conservative.

Over the last few years, the industry has seen the trend of Family Offices gravitating toward alpha from private equity investments and other alternatives to complement their traditional portfolio allocation. The private client is not far behind. Gone are the days when private equity and alternatives were solely for the ultra-high net worth, black card investor. The mass affluent are demanding access to the type of investments which were out of reach until recently. With these alternative investment opportunities now presenting themselves to the wider population, advisors need to be armed with access to quality alternative investments to maintain their competitive edge.

If a competitor is offering access to these types of investments and an advisor is not, the latter risks having to share client holdings with another advisor. The advisor that cannot adequately service 100% of a client's wealth could experience reduced AUM, or worse, losing that client completely. *According to Cerulli Associates, nearly 40% of advisors in the US are using alternative investments in their portfolios and the percentage of advisor AUM allocated to alternatives is increasing.*

Not all clients are sophisticated investors who are demanding access to this type of products. Some clients are happy in their comfort zone and less open to exploring non-conventional investments. In these cases our role is not to be heavy handed, but to educate and have the options readily available. A client may consider their portfolio conservative, but without asset classes less correlated to equity markets, their portfolio will carry a disproportionate equity risk, much more than the 60% from the oft cited 60/40 model portfolio. One of our partners, Christopher Geczy, Ph.D, CEO of Forefront Analytics, LLC., wrote a very interesting piece on this phenomenon US 60/40 Portfolio Expectations – Today vs. Historical Average, November 27, 2017.

"About 67% of advisers say lack of understanding is one of the main reasons why they don't invest more heavily in alternatives," Frederick Gabriel, *InvestmentNews* editor.

In a world where fee compression and robo advisors are the growing trend, an advisor has two choices – compete on price or compete on quality. Some advisors are happy to do less work, allocate to a robo and reduce their fee. Others are driven to improve their offering and work even harder to justify their fee. If an advisor falls into the latter category, the challenge is to continually strive to be able to cater to client needs; to get access to better product; and to be knowledgeable about different asset classes, thus giving clients the best possible chance of success.

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