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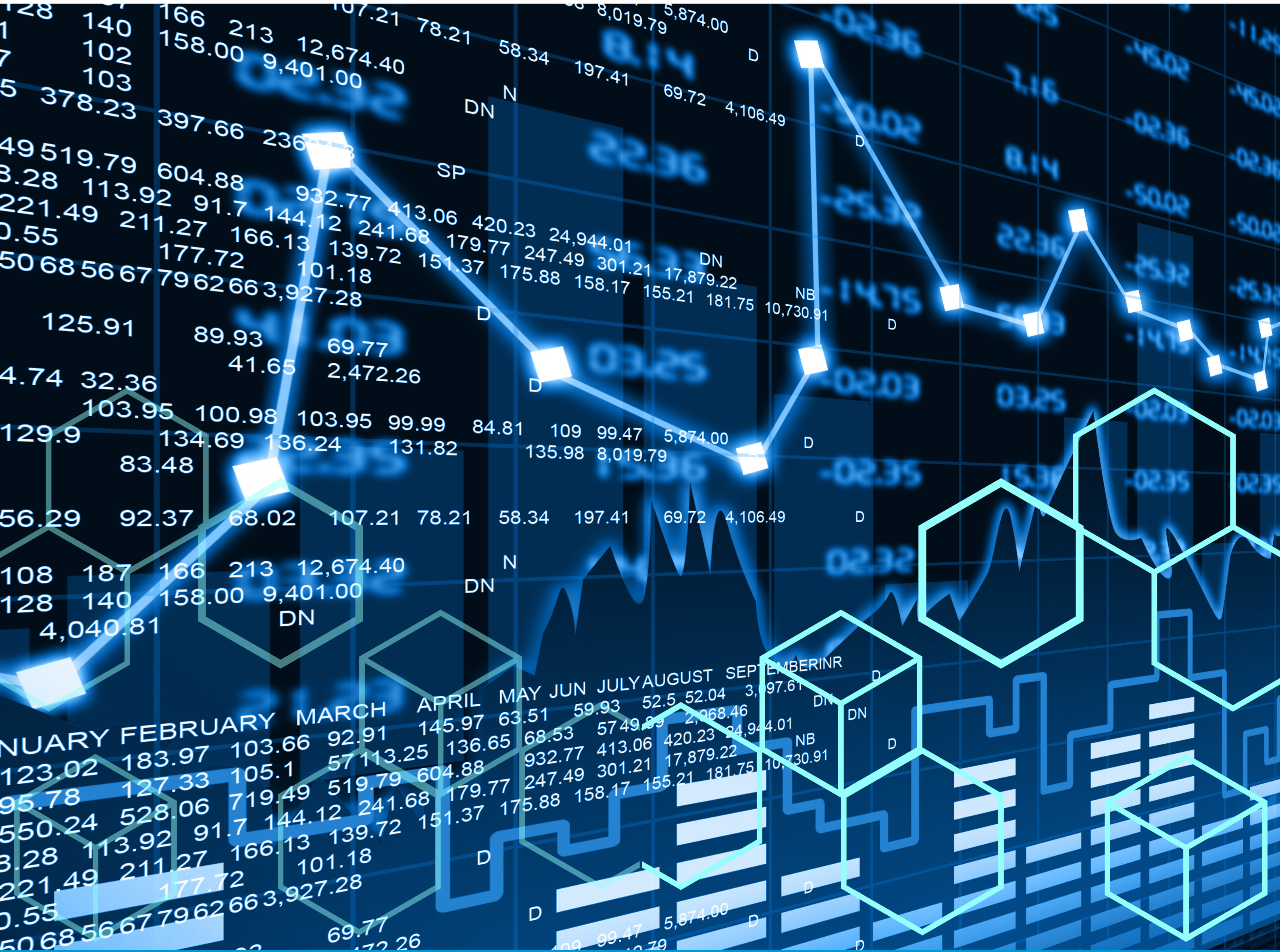

Alternative Investments

The Key for Boosting Investors' Returns

SMART IDEA & PRACTICE

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Introduction

Investors have diversified *their portfolios* **for years** *by owning* **two asset classes:** *stocks* **and bonds.**

In general, these two forms of assets differ significantly. Bonds, for instance, have historically provided some protection in the case of an equity market sell-off. Nevertheless, investors have recently begun to consider a third asset class, alternative investments, as a strategy for improving diversification and enhancing portfolio returns.

Any investment that does not fall under the traditional equity or bond category is referred as an alternative investment. It comprises assets that are generally simple to comprehend, like commodities, as well as tangible assets, such as real estate and infrastructure. Hedge funds and private equity funds are examples of more complicated unconventional techniques that lay under the same umbrella. The return profile of alternative investments is not correlated to traditional equities and fixed income assets. This implies that they may not always move in the same direction. [1]

Alternative asset classes are increasingly being perceived as a way to protect against geopolitical risks, which have historically hit more on bonds, stocks, and conventional commodities like oil, than on alternative investments. Additionally, many scientific reports and studies suggest that investors are becoming more interested in alternative assets as a method to manage the present market volatility caused by the Covid-19 outbreak. Investors are diversifying into alternative asset classes to safeguard their portfolios from market volatility caused by the pandemic, and regulators are following up with new investor expectations and trends as well.

1. Cahill, M. (2018, August). The role of alternative investments. Davy.

Furthermore, regulatory transparency standards are, in some ways, a free pass to strengthen discussion and interact with possible alternative asset investors. As a consequence of official organizations' dominance in the credit markets, smaller institutional and retail investors are now being forced into other parts of the capital markets, driving higher demand for alternative assets that can offer passive income and superior alpha in portfolio returns. As the capital markets adjust to the aftermath of Covid-19, alternative assets are poised for increased growth. Despite falling returns in traditional markets, boutique asset managers should be prepared to fulfill investors' new needs and expectations. [2]

Hedge fund managers believe that 2021 has been a great year for alternatives. Although with the majority of the pandemic-related disruption behind us and typically increased prices, analysts foresee a strong potential for growth. The macroeconomic environment is generally favorable, with ongoing fiscal stimulus, anticipated above-trend growth, and, most importantly, recovering economies. Analysts believe that, given today's ultra-low interest rates, hedge funds can be an excellent portfolio component.

Investors will place their bets on global megatrends like sustainability, emerging market consumers, and technology, especially health care technology like telemedicine. There are also chances in special purpose acquisition companies (SPACs), which are booming in terms of transaction volume. Finally, analysts recommend discounted high-quality and value stocks, that are supposed to gain as economies adjust as a result of vaccination efforts. [3]

2. Oskui, A., M. (2020, August). The rise of alternative investments: How Central Bank Stimulus has forced a rethink. Nasdaq Inc.

3. JP Morgan Chase & Co. 2021: Global Alternatives Outlook. Alternatives: From optional to essential.

SECTION 1

Understanding the value of Alternative Investments

Any investment that is not made with publicly traded stocks, bonds, or cash is referred to as an alternative investment. Hedge funds, private equity, venture capital, private debt, real assets, and real estate are examples of these types of investments. The need for diverse and compatible assets drives institutional and individual investors to alternative strategies as they try to build strong portfolios that can survive different economic and market conditions. [4]

More precisely, even in times of market instability, this venture model can present an exciting opportunity for investors to diversify their portfolios, mitigate the impact of market volatility, and help them accomplish their long-term investment goals. Added to this, some alternative assets are exceedingly illiquid and have extremely intricate valuations. As a result of these factors, financial institutions and high-net-worth people are increasingly interested in this emerging type of investments. Alternative investments could be an excellent complement to a portfolio. When compared to standard investing, many of their categories offer much higher returns. Furthermore, regardless the investor's risk tolerance or market perceptions, alternatives are a good choice due to the large number of options available. They are made up of a variety of assets and methods. ***They are, nevertheless, distinguished in general by:***

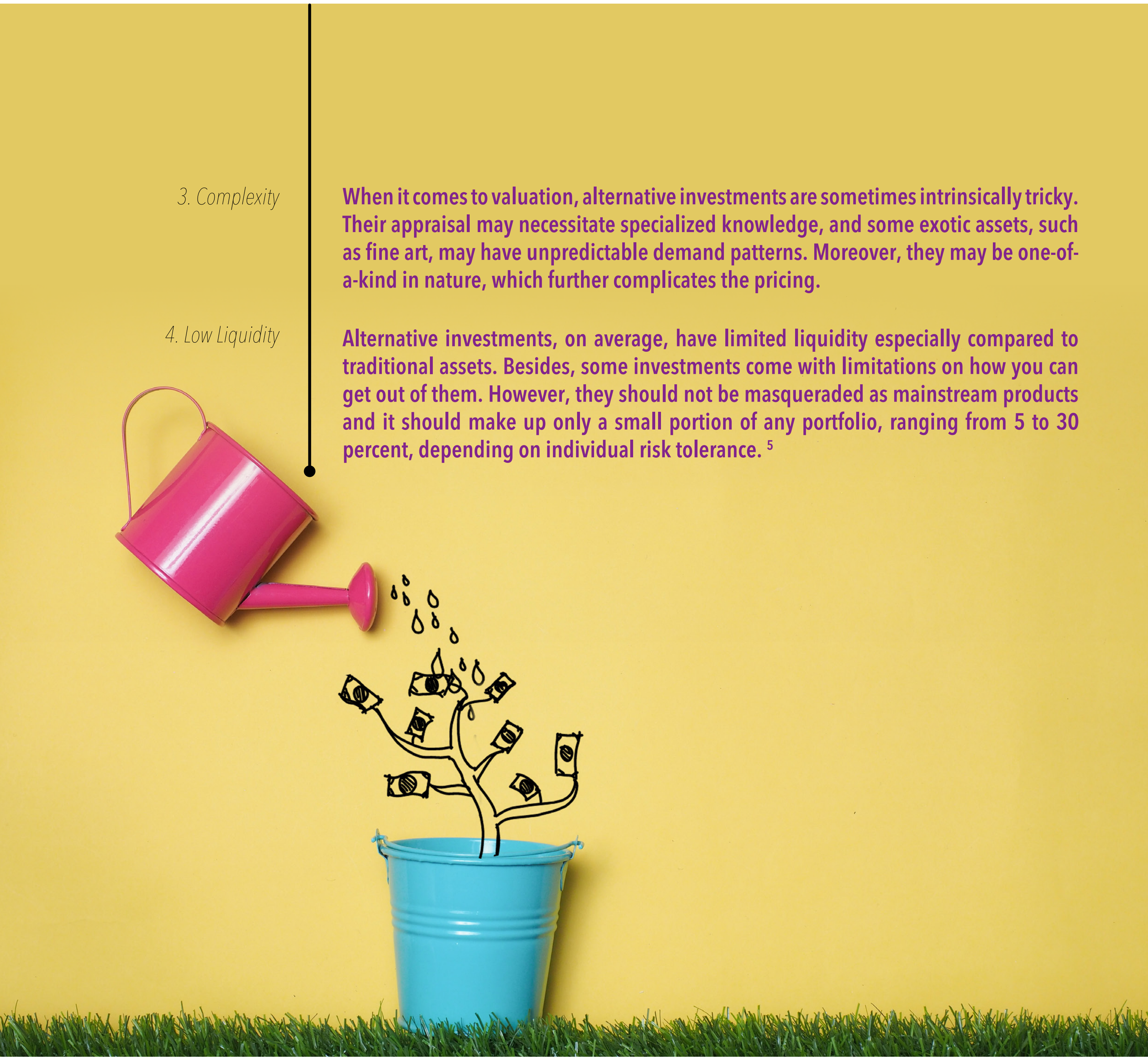
1. High purchase costs

Alternative investments are usually linked to high initial investment costs. Hedge funds, for example, have a minimum investment requirement and also a charge.

2. Low correlation with traditional ways of investment

This could be quite advantageous to potential investors because the minimal relevance with other assets promotes the diversification of the portfolio.

4. Oppenheimer & Co. Inc (2020, July). Understanding Alternative Investments.



3. Complexity

When it comes to valuation, alternative investments are sometimes intrinsically tricky. Their appraisal may necessitate specialized knowledge, and some exotic assets, such as fine art, may have unpredictable demand patterns. Moreover, they may be one-of-a-kind in nature, which further complicates the pricing.

4. Low Liquidity

Alternative investments, on average, have limited liquidity especially compared to traditional assets. Besides, some investments come with limitations on how you can get out of them. However, they should not be masqueraded as mainstream products and it should make up only a small portion of any portfolio, ranging from 5 to 30 percent, depending on individual risk tolerance. [5]

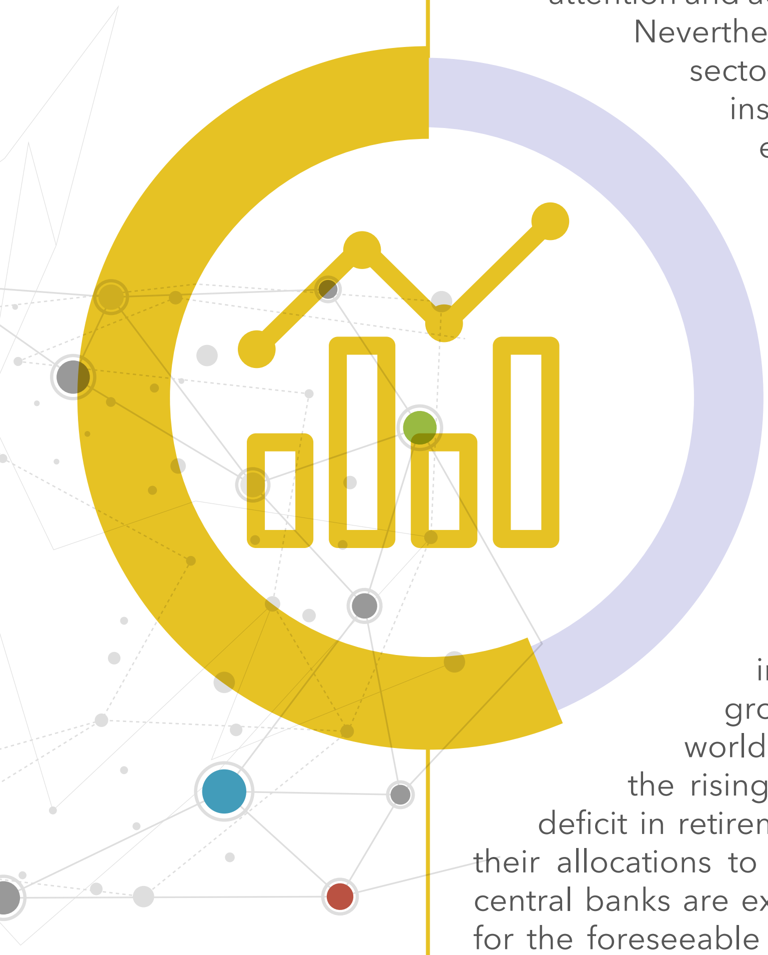
Returns on small-cap stocks in the United States are also likely to fall. Long-term investors may look for better opportunities elsewhere. Traditionally, several alternative investments have delivered high returns. Tax exempt and less volatile than stokcs and shares, fine wine investments are less risky. To be more precise, they often provide returns ranging from 10% to 12% per annum, while long-term investors have managed to outperform these figures over extended periods. From 2001 and onwards wine has significantly reached annual returns of 16 percent in western markets. [12]

In terms of farmland investments, cccording to the US Department of Agriculture (USDA), there are approximately 911 million acres of cropland in America with farmers and ranchers owning 61 percent of the land they use and renting from third-partly landlords. More and more investors acquire productive farmland as part of their income streams and portfolios to ensure solid returns which come into two forms: (a) increase in cropland value and (b) crop yields or case rental payments. Over the last 50 years the American farmland has risen by 6.1 percent per year and since 1991 it has yielded an average of 11.5 percent annually. [13]

12. Decanter. (2008, December). Decanter's wine investment guide, part 2.

13. DiLallo, M. (2021, July). Investing in farmland: A real estate investor's guide. The Motley Fool LLC.

Conclusion



Alternative investing has evolved in recent years, and it is gradually becoming a part of the mainstream financial industry, attracting more attention and acceptance from regulators and the general public. Nevertheless, macroeconomic factors, post-crisis financial sector regulation, and two crucial industry trends: institutional investors' rising knowledge and the emergence of individual investors as a vital source of capital, are entering a time of significant development and change. The growth of emerging market economies is the most important macroeconomic factor, leading the pathway for new investment opportunities, becoming the ultimate source of funding.

Most emerging market capital currently flows into alternative investments through sovereign wealth funds. Nevertheless, the growing number of high net worth individuals in those markets, alongside their willingness to invest in alternatives, is bound to gain significant ground in the near future. In the industrialized world, demographics are especially important, since the rising tide of retirees is causing a widening financial deficit in retirement systems. Many pension funds are boosting their allocations to higher return alternative assets since the main central banks are expected to hold benchmark interest rates at zero for the foreseeable future, assuring poor returns from fixed-income investments.

Institutional investors are the primary source of capital for alternative investments at the moment, and their growing confidence and investment capabilities after investing across multiple economic cycles, a complex phenomenon known as 'institutionalization, is a key driver of many future industry trends.

Investment choices impacting capital markets, firms, and individuals all across the world are firmly ingrained in the global financial system and economy. The sector has evolved from a few private investors making small investments in companies and start-ups to hundreds of firms managing and investing billions of dollars on behalf of institutional and individual investors throughout the world. It did not only make it through the financial crisis, but it also emerged stronger and more essential to its stakeholders than ever before.

By 2025, hedge fund assets under management will continue to increase at a solid but moderate pace. With a 3.6 percent annual growth rate to USD 4.28 trillion, hedge funds will maintain their position as the second-largest asset class among alternatives. Traditional hedge fund development is being stifled by investor desire for liquid alternatives such as certain ETFs funds. With a forecasted CAGR of 3.4 percent by 2025, growth in private real estate assets will be muted as well. [57]

57. Guzun, E. (2020, November). Alternatives and hedge funds in 2025. Nordic Business Media AB.

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