Opportunities Abound - The World of Alternative Investments

A Comprehensive Overview of Core Alternative Investments

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An Obsiido Whitepaper

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SUMMARY

This educational paper is intended to be of value to professional wealth managers and individual investors seeking to acquire a comprehensive understanding of alternative investments, what they are, why they have become so widely adopted by certain sophisticated investors, and the role they can play in investment portfolios.

The paper is divided into four sections covering a broad range of discussion points. Its intention is to provide the reader with a balanced perspective of the opportunities and risks associated with investing in alternative investments.

The following topics are covered in this paper:

Section 1. The Background

- Alternatives within the context of the overall investment markets
- The attractive features of alternatives
- Unique characteristics of alternatives vs. traditional investments

Section 2. The Role of Alternative Investments in a Diversified Portfolio

- The two main categories of alternative investments
- The importance of manager selection
- The risks associated with alternatives

Section 3. The Growing Accessibility of Alternative Investments

- Current ownership of alternatives by client type
- The emerging opportunity for the individual investor

Section 4. Building an Optimal Portfolio with Alternatives

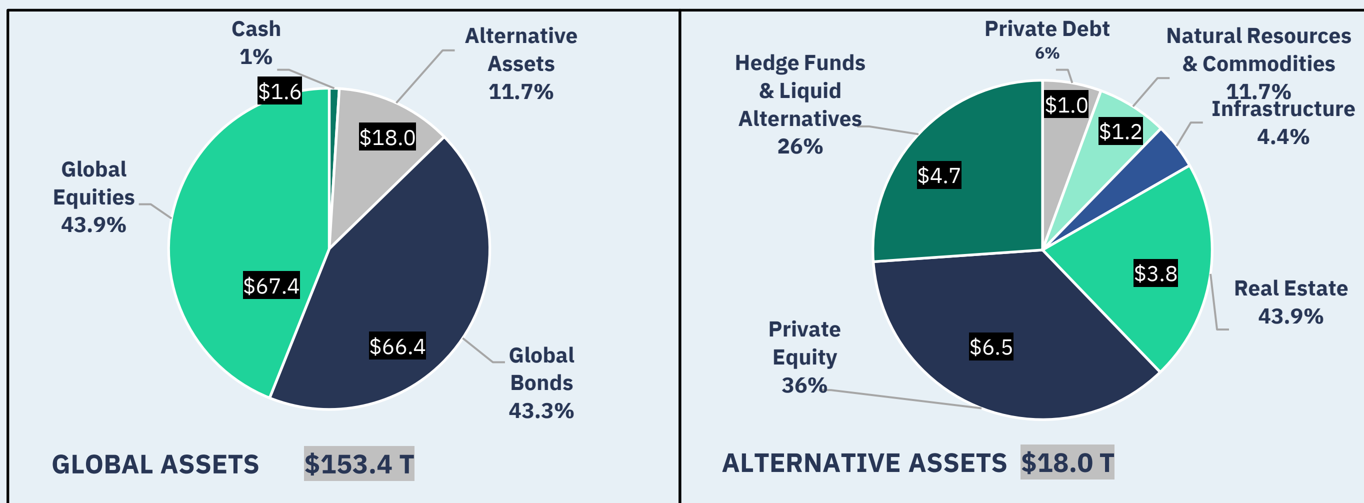
- The new macroeconomic regime for investing
- The latest thinking and research about the role of alternatives within a broader portfolio

Section 1. Background

As of the end of 2020, institutionally adopted alternative investments represented approximately $18 trillion in assets under management (AUM), or 12% of the $153 trillion global investable market. It is predicted that alternatives will be producing half of the revenue of the asset management industry in just a few years[1].

According to Preqin, a leading alternatives data provider, the fastest growth within alternatives over the coming years is expected to be in the Private Debt and Private Infrastructure asset classes, but the engine of growth will continue to be Private Equity because of its sheer size.

Exhibit 1[2]



Broadly speaking, alternative investments fall into two main categories.

1. **Private Market Investments** make up the lion's share of the universe and include asset classes such as private equity, private debt, real estate, infrastructure, and natural resources. These investments require a long-term time horizon and are illiquid in nature i.e., cannot be sold on a public exchange and turned into cash within a short period of time.

2. **Hedge Funds** make up around one-quarter of the overall opportunity set within alternatives. Hedge funds are not an asset class per se, rather they are flexible investment strategies that invest in underlying asset classes such as equities, bonds, commodities, and currencies. Typically, hedge funds are more liquid than private market investments.

As mentioned, private markets continue to drive the growth in alternative assets. Their share of US capital markets has increased substantially over the last twenty years, particularly in credit markets. This is not surprising since following the global financial crisis, traditional lenders such as banks have continued to de-risk their lending activities, meaning that more companies are having to rely on capital solutions from private capital providers.

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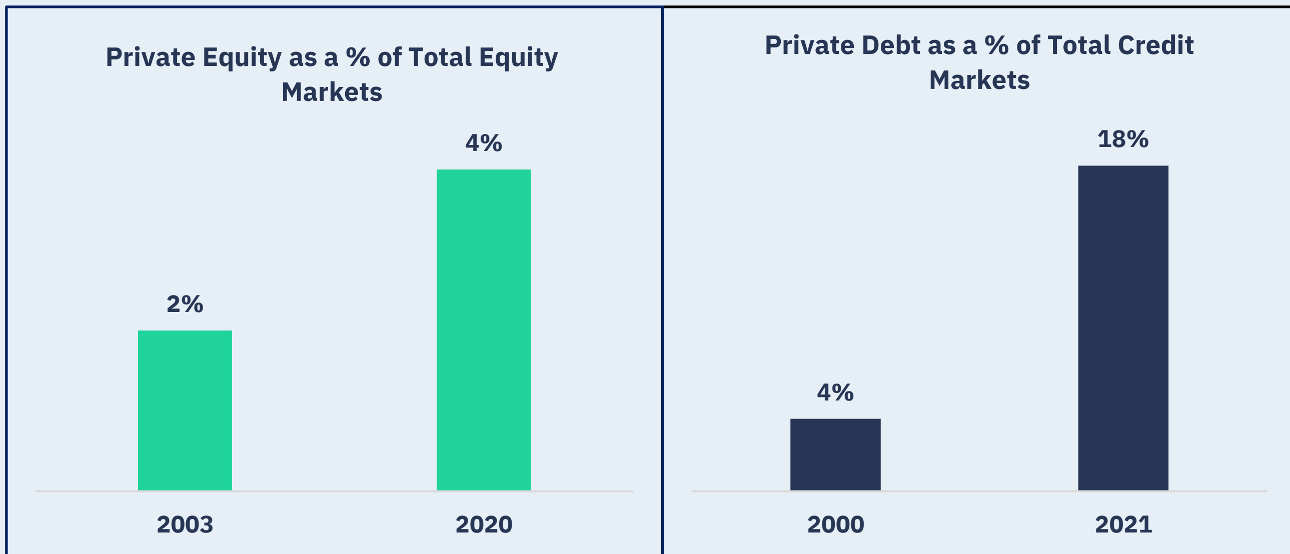
[1] Global Asset Management 2020: Protect, Adapt, and innovate - Boston Consulting Group

[2] CAIA Association, "Portfolio for the Future" Bloomberg, Preqin, MSCI, HFR, Bank for International Settlements Derivatives Statistics. Alternative Assets include private equity, hedge funds and liquid alternatives, real estate, natural resources and commodities and private debt.

Exhibit 2[3]



The attractive features that have fuelled the growth and adoption of alternatives can be summarized as follows:

- **Diversification Enhancement**
  A diversified portfolio of alternative investments, when added to a traditional portfolio of public equities and bonds, may offer considerable diversification benefits. The reason for this is that many alternative asset classes are not highly correlated to public equities and may produce different outcomes over time, including in stressed market conditions. Alternative investments such as private debt, real estate, infrastructure, and hedge funds can be excellent diversifiers against interest rate risk, inflation risk and equity market risk.

- **High Absolute Returns**
  Typically, alternative investments target a positive absolute return for their strategies over the long-term. These return targets are typically not benchmarked relative to the performance of a public market index such as the S&P 500[4], which is more the case with a traditional investment in stocks and bonds.

- **Superior Risk-adjusted Returns**
  Alternatives have delivered compelling risk-adjusted returns over time. They should be considered as an alternative to publicly traded stocks and bonds that seek to provide excess returns per unit of risk at every point along the risk-reward spectrum, from investment-grade credit to equity.

- **Smoothing of Returns**
  Unlike traditional investments in equities and bonds, alternative investments, particularly private market investments, are not priced in real time. They are typically valued on a monthly or quarterly basis by the manager. This has the effect of smoothing or dampening their volatility over time, which benefits the investor as they are less likely to get distracted by public market volatility.

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[3] Preqin, Bloomberg, Apollo Chief Economist; private equity data as of December 31, 2020; private credit data as of September 30, 2021.
[4] The Standard & Poor's 500 ("S&P 500") Index is a market-capitalization weighted index of the 500 largest US publicly traded companies by market value. The S&P 500 is a market value or market-capitalization-weighted index and one of the most common benchmarks for the broader US equity markets.

Unique Features of Alternatives versus Traditional Investments

	Public Market Asset Classes	Private Market Asset Classes
Liquidity	Marketable / Fully Liquid	Non-Marketable / Illiquid
Volatility	High	Lower
Time Horizon	Various	Long-Term
Return Potential	Market returns	Higher - Illiquidity Premium
Information Access	Freely available	Information is private
Pricing	Efficient	Less Efficient
Valuations	Instantaneous	Monthly / Quarterly
Leverage	Typically, no	Yes
Active Management	Yes - and passive options	Yes - focus on value creation
Fees	Lower	Higher - Performance Fees

Similarly, hedge funds share many of these differentiated characteristics relative to traditional investments. Hedge funds, while typically more liquid than private market investments, also offer the potential to earn an illiquidity premium. Hedge funds also employ leverage, actively use derivatives in the management of their portfolios and charge performance fees.

Section 2. The Role of Alternative Investments in a Diversified Portfolio

Given the breadth of the alternative investment universe across private markets and hedge funds, it is important for investors to understand the different roles that different alternative asset classes can play within their portfolio. In many instances, this requires the investor to go beyond the 'product label' of a given alternative investment to ensure they fully understand the underlying risk/reward characteristics of what they are investing in. Investors need to think about risk from a holistic and total portfolio perspective when investing in alternatives.

Take real estate, as an example. An investor in a Core Real Estate strategy, where most of the return comes from current yield in the form of rental income, is buying something quite different than an Opportunistic Real Estate strategy where a greater component of the return is coming from capital appreciation. Both these strategies invest in real estate, yet they belong in different parts of a portfolio. Core Real Estate is an excellent diversifier given its reliance on income generation, while Opportunistic Real Estate is a return enhancing investment like private equity with an accordingly higher risk profile.

Below we classify several categories of alternatives by their impact on investment portfolios:

1. **Enhanced Returns**
   - Private Equity, Private Opportunistic Real Estate, Distressed Equity/Credit

2. **Income**
   - Private Debt, Core Real Estate, Core Infrastructure

3. **Risk Reduction**
   - Hedge Funds*

**Note: We recognize that not all hedge funds serve to reduce portfolio risk and that, in fact, some hedge fund strategies may be focused on alpha generation and may be better suited to be included in the 'Enhanced Returns' category. For our purposes, we are focusing on hedge funds with net long exposure of less than 100% and who specifically look to reduce beta or market risk from their portfolios.*

Private Market Investments

I. Private Equity

The term "private equity" refers to the investment of capital that is executed outside of the public capital markets. While most private equity transactions involve investments in private companies, they can range from the financing of start-up entities, to injecting equity capital into an expanding company, to buying out mature public or private enterprises. Private equity benefits from attractive tax treatment, negotiated transactions, market inefficiencies and alignment of interest.

The number of US public companies has declined by about a third over the last twenty-five years to a little over 4,200 today.[5] This change has been driven primarily by changing dynamics in key sectors such as banking and technology, and a decreasing number of initial public offerings. The remaining pool of companies in the public domain is dominated by a handful of large technology firms that hold disproportionate sway over the indexes, making it increasingly difficult to find adequate diversification in the public markets.

Another dynamic favoring private equity is that more companies are choosing to stay private for longer due to the ample availability of financing in private markets and the increasing cost, scrutiny and regulatory burden that accompanies

[5] World Bank, World Federation of Exchanges, Apollo Chief Economist; as of December 31, 2019

going public. A greater amount of wealth creation is now occurring outside of the public markets, particularly in fast growing and innovative companies focused on the new economy.

The business life cycle provides a logical framework for discussing private equity, with each stage of the cycle requiring a specialized skill set. Most private equity strategies focus on a particular stage of the business life cycle.

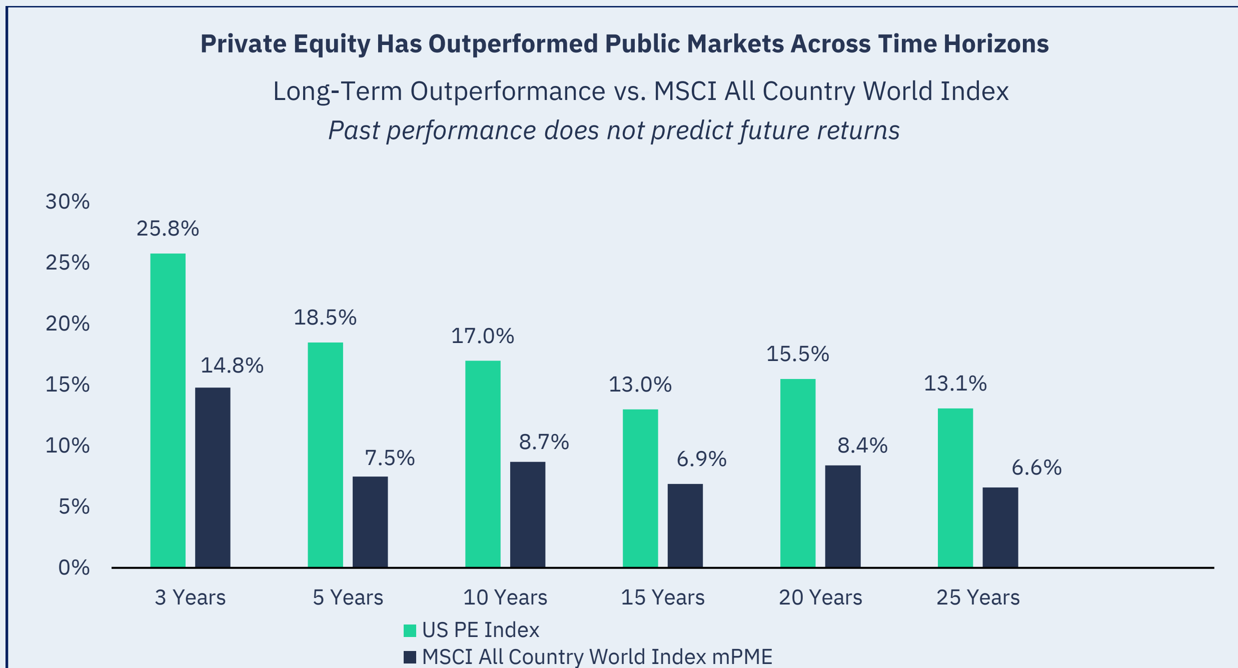
Business Life Cycle	Private Equity Strategy
Development/Early Growth	Venture Capital
Accelerated Growth	Growth Equity
Maturity	Buyout
Decline	Distressed

Some of the structural benefits of private equity as an asset class relative to investing in the public markets are as follows:

- Private equity is an inefficient asset class where due diligence is critical. Unlike the disclosure constraints facing the managers of publicly traded securities, private equity has unfettered access to company information.
- Private equity has far better alignment of incentives between General Partners (the private equity manager) and Limited Partners (the investor) than public companies have between shareholders and management, a key benefit of the private equity model.
- Anybody can buy a private company, but in private equity what matters is what you do to make a company better once you have bought it. Private equity managers take a "hands-on" approach with their investments, seeking to create value and enhance returns by directly influencing a company's strategy and performance.
- Private equity investors can do many things to assist management teams in creating value, including implementing operational best practices and providing the technology expertise necessary to assist companies with technological transformations.

Investors are attracted to private equity for the potential to earn the illiquidity premium, the additional compensation they seek above the public market equivalent investment for the added risk of locking up their capital for the long term. According to data provided by Cambridge Associates, global private equity has outperformed the public equity market by a wide margin over the long-term.

Exhibit 3[6]



The Cambridge Associates Modified Public Market Equivalent (mPME) replicates private investment performance under public market conditions. The public index's shares are purchased and sold according to the private fund cash flow schedule, with distributions calculated in the same proportion as the private fund, and mPME NAV is a function of mPME cash flows and public index returns.

II. Private Debt

Private debt is investing in directly originated loans to businesses that cannot or do not want to access public markets for their capital needs. Private credit offers investors various options for preserving capital, generating current yield, or benefiting from capital appreciation. Historically, private credit has offered higher income and lower losses than other fixed income segments, including senior loans and high yield bonds.

One feature that generally makes private debt compelling is the contractual return component it offers. There is a legal promise of return of capital and, in most strategies, a promise of payment of interest or other contractual return. For this reason, private credit should be viewed as a risk mitigation tool relative to holdings in equities.

Just like in private equity, private credit investors seek to earn an illiquidity premium over the public market equivalent investment. For example, an investor in a direct lending strategy would seek to earn a 2-4% premium over liquid senior bank loans, while an investor in mezzanine debt would look to earn a similar sized premium over liquid high yield bonds.

The chart below shows the risk-adjusted returns of different types of credit-related fixed income investments. Over the 15-year period ending December 2022, private credit has provided favorable returns with less volatility than other credit investments.

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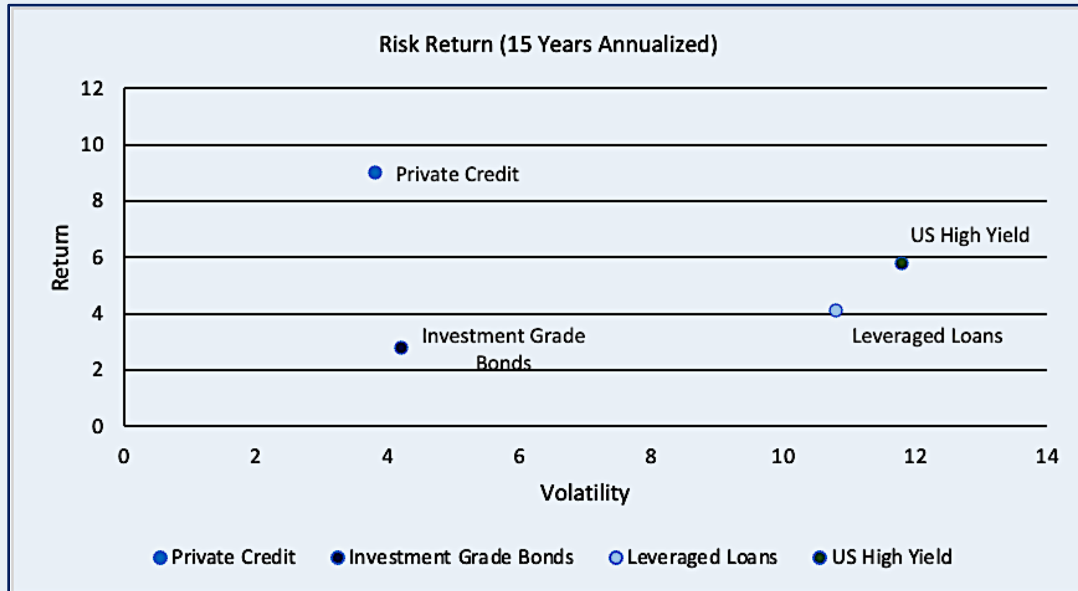
[6] Cambridge Associates as of March 31, 2023. Data reflects actual pooled horizon return, net of fees, expenses and carried interest. The US PE Index is a horizon calculation based on data compiled from 1,505 US private equity funds, including fully liquidated partnerships, formed between 1986 and 2023. The MSCI All Country World Index captures large and mid cap representation across 23 Developed Markets (DM) and 24 Emerging Markets (EM) countries.

Exhibit 4[7]



Private debt strategies include the following:

Strategy Type	Definition
Direct lending	These are middle-market loans that are senior secured that sit at the top of a company's capital structure with the first claim on a company's assets in bankruptcy (senior debt). Investors find these loans attractive because of their greater level of security, stronger covenant packages, floating rate nature and high levels of current income.
Mezzanine	This is the middle layer of capital that falls between secured senior debt and equity. This type of capital is usually not secured by assets, and it is lent strictly based on a company's ability to repay the debt from free cash flow
Distressed	Involves buying the debt of an issuer that is unlikely to meet its obligations as promised. A typical distressed strategy would buy the debt at deeply discounted prices that later gets converted into equity. Distressed investing requires significant restructuring expertise.

[7] Morningstar, as of December 31, 2022. Return and Volatility are based on quarterly returns and are annualized during the time period. Volatility is measured using standard deviation. "Private Credit" is represented by the Cliffwater Direct Lending Index. "Leveraged Loans" is represented by the Morningstar LSTA US Leveraged Loan Index. "US High Yield" is represented by the Bloomberg US Corporate High Yield Index. "Investment Grade Bonds" is represented by the Bloomberg US Aggregate Bond Index, which is a broad-based benchmark that measures the investment grade, U.S. dollar denominated, fixed-rate taxable bond market. This includes Treasuries, government-related and corporate securities, mortgage-backed securities, asset-backed securities and collateralised mortgage-backed securities.

III. Real Assets

Real assets are tangible assets that play an essential role in daily economic activity. They provide significant linkage to inflation due to the nature of the underlying investments. The unifying characteristic is that the investor has access to a defensible earnings stream and/or storage of value via a direct connection to a physical asset.

Real estate is the largest asset class within the real assets complex, while infrastructure has risen greatly in prominence over recent years given investor appetite for yield and the scale of private capital required to fund and replace infrastructure assets. Within natural resources, farmland is becoming an increasingly attractive investment opportunity given the increasing demand for agricultural products and fresh produce needed to feed the world's growing population.

Asset Class	Definition
Real Estate	Commercial properties including office, retail, multi-family, industrial, warehouses and logistics.
Infrastructure	Irreplaceable assets and networks used for transportation, renewable power, utilities, energy, data, and sustainable resources.
Natural Resources	Investments in a range of commodities, including energy products, agriculture products and land holdings, precious metals, and industrial metals.

Real assets have the potential to be an effective portfolio diversifier as they have historically exhibited lower levels of correlation to public equities.

Exhibit 5[8]

[8] Morningstar Direct, Average 12-month rolling annualized returns from December 31, 2002 to December 31, 2022. Returns in USD for representative indexes: Farmland: NCREIF Farmland; U.S. Real Estate: NCREIF US Real Estate; Infrastructure Equities: S&P Global Infrastructure TR Index, Timberland: NCREIF Timberland; Commodities: S&P GSCI TR Index; U.S. Bonds: Bloomberg U.S. Agg. Bond Index; U.S. Equities: S&P 500 TR Index; Direct Infrastructure: Burgiss Global Infrastructure Pooled Composite. Returns in CAD for representative indexes; Canadian Equities: S&P/TSX Composite TR Index; Canadian Bonds: FTSE Canada Universe Bond Index.

Investing in Secondaries

A fast growing, dynamic segment within private markets is the secondary market. A well-diversified private markets portfolio should consider the merits of allocating in part to secondaries. While the largest segment by far within the secondaries market is in private equity, an active secondary market exists in real assets and private credit.

Private equity secondaries are transactions in which an investor acquires an existing interest or asset from a private equity fund investor, or limited partner (LP). Secondaries provide the LP as they create a mechanism for generating liquidity in their portfolio. The benefits of investing in secondaries can be summarized as follows:

- The potential to buy a private equity fund at a discount to its stated net asset value (NAV).
- Purchase a portfolio of shorter-duration investments resulting in quicker return of capital.
- Enhanced visibility into the underlying portfolio or assets acquired i.e., no “blind pool” risk.
- Instant diversification as a secondary fund buyer is typically acquiring a diversified portfolio of existing seasoned positions, often represented by hundreds of underlying assets across sectors, stages, geographies, and vintage years.

According to Preqin, private equity secondary funds have historically generated a higher initial internal rate of return (IRR) than a typical private equity primary fund. Indeed, secondaries have proven to be one of the most consistently strong-performing private market asset classes across varying macroeconomic environments.

Hedge Funds

Hedge funds include a wide array of investment strategies that seek to address a range of different investor objectives. They employ a flexible management style to earn risk-adjusted excess returns for their investors. Hedge fund strategies typically invest in liquid asset classes such as equities, bonds, currencies, and commodities. They may also choose to invest in less liquid investments such as distressed securities. Hedge funds typically offer greater liquidity than do private market investments.

The exponential increase in hedge fund assets over the years is due to the following investment attributes:

- Low levels of correlation with traditional asset investment returns
- The potential to outperform traditional investments
- Ability to hold both long and short positions in securities
- Ability to apply leverage, use derivatives or utilize other investment instruments to implement their strategy

Hedge funds employ two primary trading methodologies:

1. Discretionary: A human system used to trade instruments, which is characterized by proprietary approaches combining technical and/or fundamental analysis
2. Systematic: A computerized system using proprietary computer models to generate buy and sell decisions. The models utilize quantitative analysis of different technical factors

The most popular hedge fund strategies are shown below and categorized according to the role they might play within a portfolio's diversification framework. As a rule, hedge fund strategies can be either less or more correlated to equity risk. Before investing in hedge funds, an investor should understand the underlying risk characteristics of a given strategy and its impact on the risk of their overall portfolio should they choose to invest in it.

Less Equity Correlated

Asset Class	Definition
Multi-Strategy	A single fund that has an investment strategy combining several different hedge fund strategies
Market Neutral	A strategy that seeks to exploit differences in stock prices by being long and short in stocks within the same sector, industry, market capitalization, country etc. This strategy creates a hedge against market factors
Global Macro	Aims to profit from changes in global economies, typically brought about by shifts in government policy that impact interest rates, in turn affecting currency, stock and bond markets. Participates in all major markets - equities, bonds, currencies, and commodities

More Equity Correlated

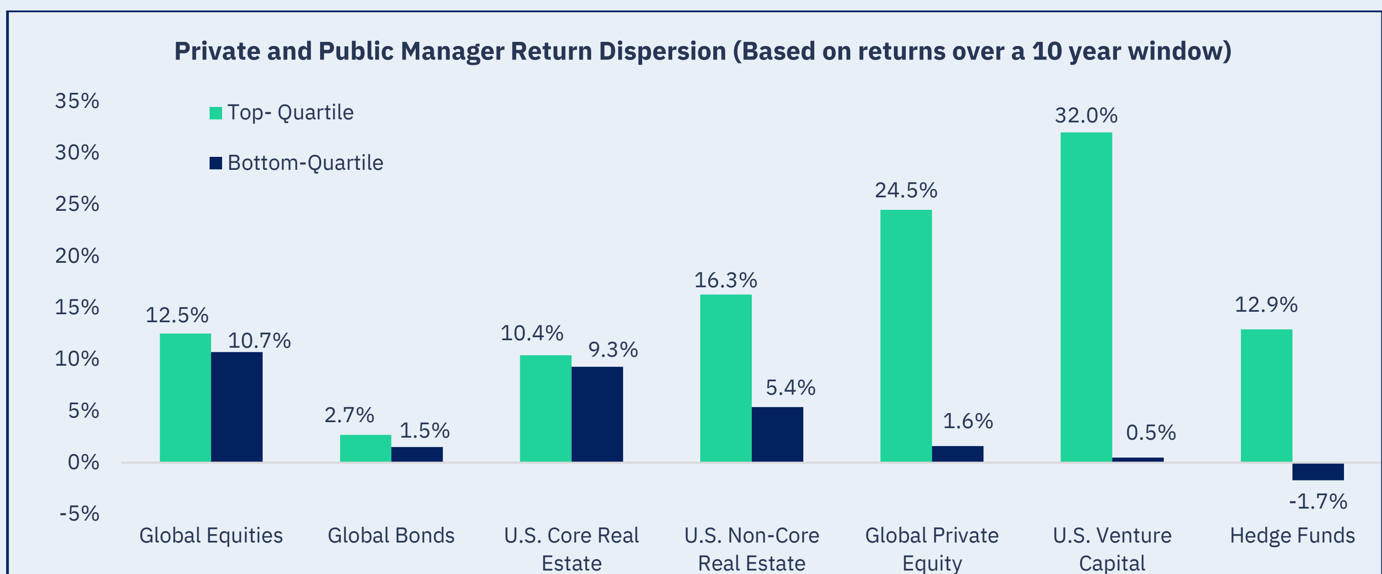
Asset Class	Definition
Equity Long/Short	A strategy that seeks to buy undervalued stocks and sell short those that are overvalued
Event Driven	A strategy that seeks to exploit pricing inefficiencies preceding or following corporate events such as bad news, distressed situations, mergers & acquisitions, recapitulations, or spin-offs
Distressed	A strategy that buys deeply discounted equity, debt, or trade claims of companies in or facing bankruptcy or reorganization

The Importance of Manager Selection

Once an investor has committed to making an allocation to alternatives, careful consideration must be given to the manager selection decision. Historically, within alternatives there has been a wide return dispersion between the top-quartile and bottom-quartile performing funds. Those investors able to select and access the better performing funds have generated returns significantly above the public markets.

The chart below shows the difference in return between the top-quartile and bottom-quartile performing manager in a range of alternative asset classes. Within global private equity, for example, the difference is 22.9%. Within hedge funds, the difference is 14.6%. Contrast this to the much narrower return dispersion within liquid and highly efficient asset classes such as global equities and global bonds.

Exhibit 6[9]



Risks Associated with Alternatives

1. The greatest risk of alternatives relates to liquidity. Alternatives are not liquid investments and investors need to ensure that they are positioned appropriately in their portfolio. Said differently, alternatives are only suitable for those investors that can forgo liquidity for a portion of their investment assets. This point cannot be overemphasized. Any investor seriously considering an allocation to alternatives must come to terms with the long-term nature of these investments and must be aligned with respect to investment time horizon.

2. As alternatives typically employ leverage in the management of their strategies, returns are amplified on both the upside and the downside. Aggressive use of leverage by the manager can lead to disastrous outcomes in a

[9]Lipper, NCREIF, Cambridge Associates, HFRI, J.P. Morgan Asset Management. Global equities (large cap) and global bonds dispersion are based on the world large stock and world bond categories, respectively. *Manager dispersion is based on the annual returns for global equities, global bonds, and U.S. core real estate over a 10-year period ending 3Q 2021. Hedge fund returns are based on annual returns from Nov. 2011 – Oct. 2021. U.S. non-core real estate, global private equity and U.S. venture capital are represented by the 10- year horizon internal rate of return (IRR) ending 2Q 2021. Data is based on availability as of November 30, 2021

sharply declining market. The use of leverage within an alternative strategy should be prudent and well managed.

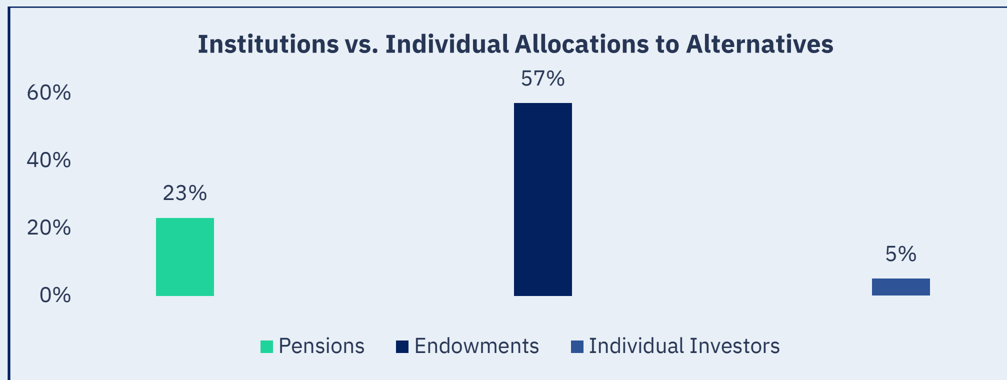
3. Given the higher fees associated with alternative investments (including performance fees), coupled with their illiquid nature, poor manager selection decisions pose a substantial risk. Put another way, the net-of-all-fees returns generated by a mediocre alternatives manager will be indistinguishable from returns generated in a portfolio of low-cost traditional investments.

4. Generally speaking, it is harder to access timely information on alternative investments from the manager, certainly intra reporting periods. There is also a greater level of opacity with alternatives given their greater level of complexity.

Section 3. The Growing Accessibility of Alternative Investments

Up until now, institutional investors have been by far the largest allocators to alternative investments. Pension funds and endowments allocate sizable parts of their portfolios to alternatives. By contrast, individual investors have far smaller allocations

Exhibit 7[10]



While in the past alternatives have been something of a closed shop for anyone other than the largest of investors, that is beginning to change. Individuals are increasingly drawn to alternative investments as they themselves look for new diversification options and better returns than they can get in the traditional public equity and debt markets.

Recognizing the vast untapped individual investor market and the growth opportunity it presents, many of the world's largest alternative asset managers are launching funds to provide individual investors with access to a range of alternative asset classes and opportunities. These funds typically require much lower investment minimums and provide liquidity features that are more flexible.

To facilitate and encourage the wider ownership of alternatives beyond the traditional institutional buyer base, regulators in both the US and Canada are becoming increasingly accommodative by tailoring new legislation to increase transparency in alternative investments. New alternative investment products targeting the individual investor must meet more stringent regulatory requirements with respect to liquidity management and governance features.

[10] Thinking Ahead Institute, "Global Pension Assets Study," 2023; National Association of College and University Business Officers, "2023 NACUBO-TIAA Study of Endowments," 2023; Cerulli, "U.S. Intermediary Distribution 2022," 2022. For Endowments, the alternative asset allocation is for the Public College, University or System only and represented by allocations to Alternative Strategies (includes marketable alternatives (hedge funds), private equity, private venture capital, and real assets). Averages provided are dollar-weighted. For Individual Investors, the alternative asset allocation includes "Alternatives" (e.g., liquid alternatives, real estate, hedge funds) and "Other" as defined as UITs, listed and unlisted closed-ended funds and private funds. Responses are weighted based on the average asset allocation of a moderate client. Percentages represent each investor type's average allocation to alternative investments.

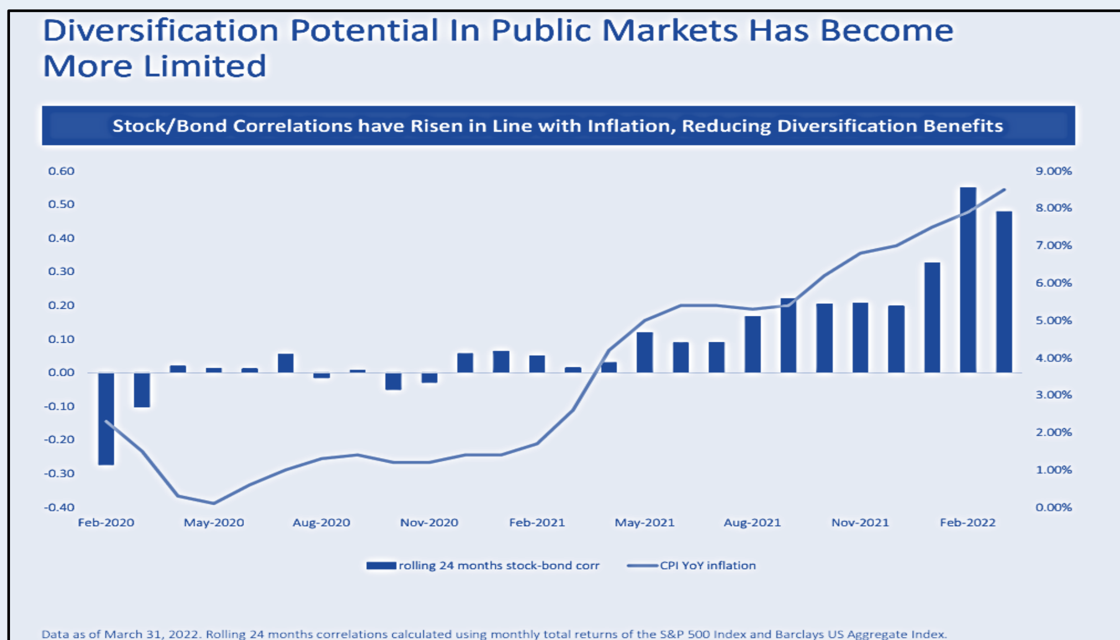
Section 4. Building An Optimal Portfolio with Alternatives

Obsiido believes that we are entering a new macroeconomic regime for investing that will require investors to reassess how they structure their investment portfolios. A world in which inflation is expected to remain at a higher resting rate represents a fundamental sea change in the investment landscape. Tighter monetary conditions will change what works and doesn't work in investing, making for a more challenging investment environment.

Against this backdrop of higher inflation and more elevated interest rates, the established relationship between stocks and bonds - where high-quality bonds have acted for many years as a reliable diversifier and ballast in the portfolio - has changed. Stock-bond correlations are rising which is making the traditional 60/40 portfolio a much riskier proposition for investors.

The chart below shows the extent to which stock-bond correlations have increased over the recent past.

Exhibit 8[11]



Data as of March 31, 2022. Rolling 24 months correlations calculated using monthly total returns of the S&P 500 Index and Barclays US Aggregate Index.

The case for allocating to a diversified portfolio of alternative investments in this new regime environment is compelling. Investments in real assets such as real estate and infrastructure are attractive as they often have inflation indexation embedded in their cash flows. Private debt investments which are typically structured as floating rate securities, boost the income-generating component of a portfolio's fixed income allocation in a rising rate environment.

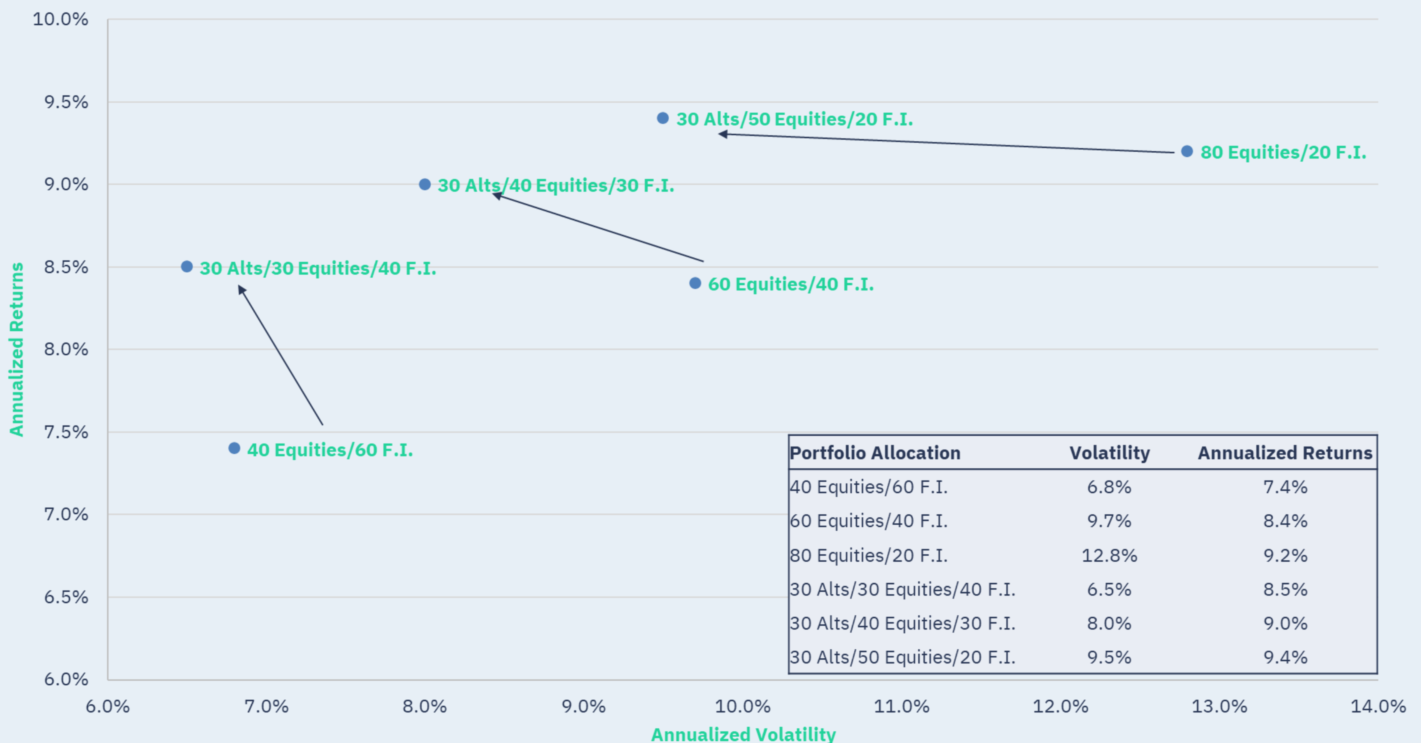
Obsiido believes investors are best served by taking a holistic approach to asset allocation where they are as diversified in their alternative investments as they are in their public market investments. This is the time to take advantage of the return and diversification opportunities that private equity, real assets, private credit, and hedge funds can provide.

[11] Morningstar, as of December 31, 2022. Stock-bond correlation represents the average trailing 12-month correlations over the indicated periods. Stocks are represented by the S&P 500 Index, which is described in Footnote 4. Bonds are represented by Bloomberg US Aggregate Bond index, which is described in Footnote 7.

A considerable amount of research, including from many of the world's leading investment organizations, has been produced on the impact of adding alternatives to an investment portfolio. It is widely considered to be beneficial to add a diversified portfolio of alternatives to an existing public stock-bond portfolio as it can result in higher investment returns for a lower level of risk.

In a recent paper entitled, "How alternatives can address your 60/40 portfolio blues", Apollo Global Management determined that a 60/40 allocation over the past three decades had generated annualized returns of 9.04% with annualized volatility of 9.33%. Adding incremental additions of alternatives to this baseline 60/40 allocation, improved the situation markedly, delivering potentially better returns while also dampening volatility. For example, a portfolio with a 30% allocation to diversified alternatives generated the same 9.04% annualized return as the 60/40 portfolio but with one-third less volatility. For the purposes of this analysis, the 60/40 portfolio is based on a 60% investment into the S&P 500 Index and a 40% investment into the Bloomberg US Aggregate Bond Index.

Exhibit 9[12]



Portfolio Allocation	Volatility	Annualized Returns
40 Equities/60 F.I.	6.8%	7.4%
60 Equities/40 F.I.	9.7%	8.4%
80 Equities/20 F.I.	12.8%	9.2%
30 Alts/30 Equities/40 F.I.	6.5%	8.5%
30 Alts/40 Equities/30 F.I.	8.0%	9.0%
30 Alts/50 Equities/20 F.I.	9.5%	9.4%

In their 2023 Long-Term Capital Market Assumptions research paper, JP Morgan came to a similar conclusion. They highlighted the merits of alternatives by saying, "Alternative allocations are essential as a means of managing volatility as well as providing a reliable source of high returns. A diversified portfolio of public and private strategies offers the best path to achieving long-term objectives. Alternative asset classes continue to offer a valuable source of return and risk management, along with a broad range of liquidity options." JP Morgan's research suggests that investors should allocate as much to alternative assets as their liquidity budgets prudently allow.

[12] Bloomberg, Burgiss, HRFI, NCREIF, Standard & Poor's, FactSet, J.P. Morgan Asset Management. Alts include hedge funds, real estate, and private equity, with each receiving an equal weight. Portfolios are rebalanced at the start of the year. Data is based on availability as of August 31, 2023. For illustrative purposes only. No representation is being made by the inclusion of any illustrative portfolio composition presented herein.

Section 5. In Conclusion

Alternative investments provide investors with an expanded toolkit to assist in the building of investment portfolios that are potentially more resilient with improved risk/return characteristics. Institutional investors have been investing in alternatives for many years for those very reasons. But for an individual investor to similarly benefit, they need to thoughtfully consider the design of their asset allocation strategy given the greater level of complexity and liquidity trade-offs associated with alternatives. Just like for traditional stock and bond investments, a balanced approach to investing in alternatives is the best path for most investors as it allows them to benefit from a diversified set of risk/return drivers. Investors should seek professional advice to ensure they are taking full advantage of the opportunities to diversify their portfolios, including those offered by alternative investments.

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