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# Multi-Asset Alternatives as a Public Equity Replacement

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An Obsiido Whitepaper

## SUMMARY

Heightened market volatility and rising stock-bond correlations caused by the regime shift in interest rates have triggered an increased focus by many investment advisors on evaluating the diversification merits of alternative investments. But, given the proliferation of products now available across the alternative investment universe, it is quite challenging for advisors to determine the most effective way to use them in conjunction with traditional public market investments.

Consider the following alternative asset classes – private equity, private debt, real estate, infrastructure, natural resources, and hedge funds - asset classes with distinct risk/return profiles and liquidity characteristics relative to traditional stock and bond investments. These are the core alternative asset classes that are widely held in institutional investment portfolios, and where extensive historical data is available, which may be relied upon to model these allocations in a well-diversified portfolio.

Institutional investors have long since relied upon alternative investments to diversify their portfolios. While investment advisors are increasingly coming around to this viewpoint, many still grapple with the fundamental question, what role should alternatives play in a portfolio and what parts of an existing portfolio should they replace?

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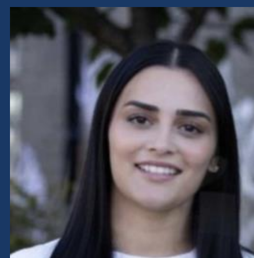

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This paper is divided into two parts:

**Part 1** explores the merits of considering a core multi-asset alternatives allocation as a replacement for a component of an equity portfolio.

**Part 2** transitions to the implementation phase of the investment process and how an advisor might introduce an alternatives strategy in a client portfolio.

# PART 1

One idea that has had merit is the case for a core multi-asset alternatives allocation as a replacement for a component of an equity portfolio. In a multi-asset approach, a portfolio is suitably constructed with exposures to a diverse mix of core alternative asset classes. Given the many uncorrelated return streams that are embedded within such a portfolio, this approach offers the potential to generate an public equity-like return stream with less risk than the public equity markets.

### Historical Performance of a Diversified Alternatives Portfolio[1]

What follows is a summary of the historical performance of a hypothetical Diversified Alternatives Portfolio ("DAP") relative to the S&P 500 for the 15-year period ending December 2022. The DAP is constructed as follows: 30% Private Equity; 30% Private Debt; 30% Real Assets (10% Infrastructure, 10% Real Estate, 10% Farmland); and 10% Hedge Funds.[2] The results are compelling and supportive of a multi-asset alternatives allocation as a partial equity replacement.

### Exhibit 1[3]

| | 15-Yr Return | Risk | Sharpe Ratio | Beta | Up Capture | Down Capture |
|---|---|---|---|---|---|---|
| DAP | 8.79% | 6.23% | 1.30 | | | |
| S&P 500 | 8.81% | 17.70% | 0.46 | 0.29 | 48.79% | 16.52% |

*As of December 31, 2022*

**Source: Obsiido Alternatives Investments Inc. The performance of the DAP is net of all fees and in USD. Past performance is not indicative of future returns.**

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1 The analysis is a hypothetical back-test using mixes that are not investable and is for illustrative purposes only. Past performance is not indicative of future returns. No representation is being made that any investment will or is likely to achieve profits or losses similar to those achieved in the past, or that significant losses will be avoided. The information does not constitute, and should not be construed as, investment advice or legal, accounting, financial or tax advice, nor is it tailored to the circumstances and needs of each prospective investor.

2 The DAP consists of 30% Pitchbook Private Equity, 30% Pitchbook Private Debt, 10% Pitchbook Real Assets - Infrastructure, 10% NFI ODCE, 10% NCREIF Farmland Property, 10% HFRI Fund Weighted Composite. The Pitchbook Private Equity and the Pitchbook Private Debt indexes are constructed using aggregate cash flow and net asset value based quarterly returns of private equity and private debt funds that report performance into the Pitchbook database. The NFI ODCE Net is a capitalization-weighted, net of fee, time-weighted return index of open-end commingled funds pursuing a core investment strategy operating within the United States. The Pitchbook Real Assets – Infrastructure is constructed using aggregate cash flow and net asset value based quarterly returns of infrastructure, oil and gas, timber, natural resources, metals & mining and agriculture funds that report performance into the Pitchbook database. The NCREIF Farmland Property Index is a quarterly time series composite return of investment performance of a large pool of individual privately held farmland properties. The HFRI Fund Weighted Composite is a global, equal-weighted index of single-manager funds that report to the HFR Database. The S&P 500 Index is a broadly quoted index representing the 500 largest publicly listed companies in the United States.

3 Quarterly historical returns streams were used for the DAP and the S&P 500. The methodology for the calculation of the portfolio returns is a weighted average of the underlying benchmark's quarterly returns.

- While the DAP performed in line with the S&P 500 over the 15-year period, it did so with considerably less risk, as evidenced by its positioning in the left-hand quadrant of the scattergram in Exhibit 1 and higher Sharpe Ratio. The Sharpe Ratio is a measure of risk-adjusted excess return - it measures the extent to which an investor has been rewarded for the level of risk they have taken in their investment. It is a relative measure - the higher the number, the better, as it demonstrates one investment is adding more return per unit of risk than another.

- The beta of the DAP to the S&P 500 was low at 0.29, underscoring its diversification qualities. Beta is a measure of the return sensitivity of an investment portfolio, in this case the DAP, relative to the market portfolio, in this case the S&P 500. A beta of 1 would mean that two assets move in lockstep with one another, both up and down, on average.

- The Up/Down Capture Ratio of the DAP to the S&P 500 has an attractive asymmetrical relationship. On average, when the S&P 500 was up 1%, the DAP was up 0.49%, but when the S&P 500 was down 1%, the DAP declined by 0.17%. This further highlights the diversification benefits of the DAP over this period.

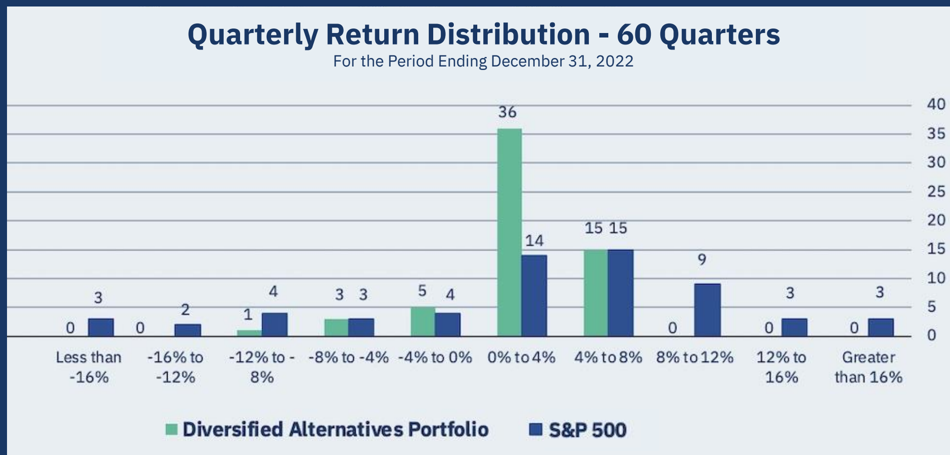
## Deeper Dive Risk Assessment

The following three charts provide a closer assessment of the risk characteristics of the DAP and S&P 500 with respect to their variability of returns and drawdown risk. An important part of the value an investment advisor can provide is educating their clients about the risk characteristics of a particular investment, which means looking at risk from multiple different perspectives.

Exhibit 2 shows the distribution of quarterly returns for the DAP and S&P 500 for the same 15-year period ending December 2022. This period includes the Global Financial Crisis ("GFC") from 2008-09 which is highly appropriate for the purposes of this risk analysis as the GFC represented a worst-case-scenario stress test for any investment portfolio. Over this period, not only did the DAP experience a higher number of positive quarters (50 vs. 44) and a lower number of negative quarters (10 vs. 16) than the S&P 500, the highs and lows of the DAP's quarterly returns were far less extreme.

While we know both portfolios delivered similar annualized return over this 15-year period (as shown in Exhibit 1), the DAP did so with a more stable and predictable return stream than the S&P 500, an attractive proposition to most investors. Looked at another way, the emotional rollercoaster ride of the DAP was less wild!

### Exhibit 2




**Last 60 Calendar Quarters Performance (15-Years)**

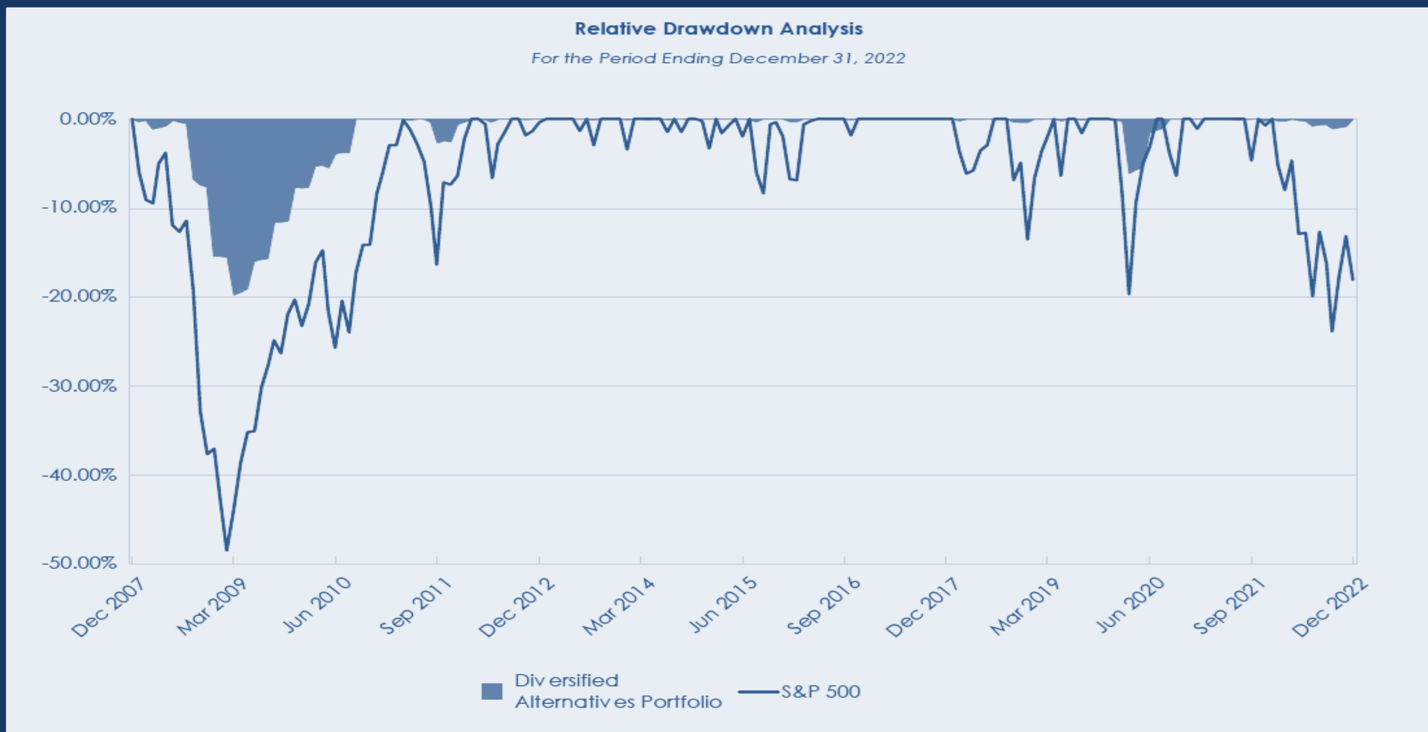
| | # Positive | # Negative | Best Return | Worst Return |
|---|---|---|---|---|
| DAP | 51 | 9 | 7.91% | -9.31% |
| S&P 500 | 44 | 16 | 20.54% | -21.94% |

*As of December 31, 2022*

**Source: Obsiido Alternatives Investments Inc. The performance of the DAP is net of all fees and in USD. Past performance is not indicative of future returns.**

Exhibit 3 shows the drawdown risk of the two portfolios over this 15-year period. Understanding the drawdown risk of a particular investment is a relevant data point for any investor. During the GFC, the S&P 500 suffered a maximum drawdown of close to 50%, while the DAP suffered one that was less than half that. During other periods of extreme market volatility over this period, while the S&P 500 suffered at times notable declines in value, the DAP barely declined in value. The DAP has proven to be far more resilient in periods of market distress than the S&P 500.

## Exhibit 3[4]




**Source: Obsiido Alternatives Investments Inc. The performance of the DAP is net of all fees and in USD. Past performance is not indicative of future returns.**

4 For period December 2007 to December 2022 using quarterly data to calculate annualized returns and annualized standard deviation (risk).

# PART 2

## Putting Things Into Practice

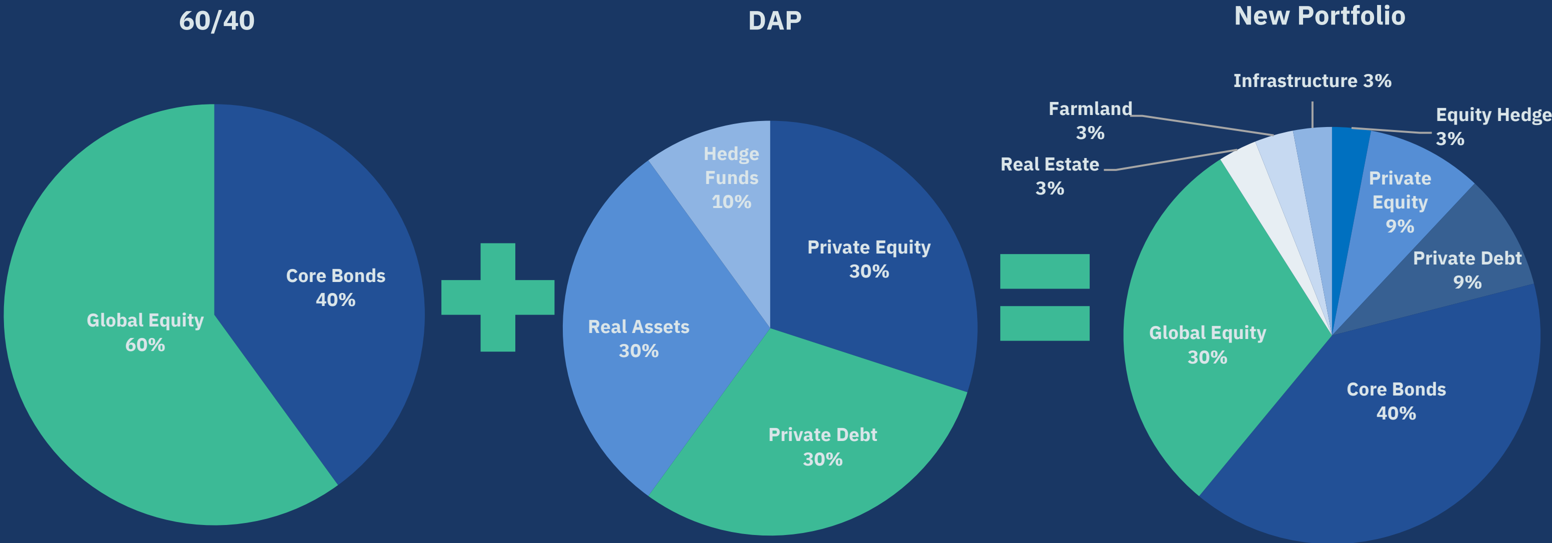
The forward-looking analysis summarized in Exhibit 4 - using the 2024 capital market assumptions of Obsiido's investment consultant - shows how a 60/40 Portfolio might improve its risk-adjusted return by replacing half its equity allocation with an equivalent allocation to the DAP to create the "New Portfolio".

### Exhibit 4

| | Return | Risk | Sharpe Ratio | Drawdown Risk |
|---|---|---|---|---|
| 60/40 Portfolio | 7.11% | 10.97% | 0.43 | -21.18% |
| New Portfolio | 7.51% | 8.45% | 0.58 | -13.25% |

**Source: Obsiido Alternatives Investments Inc. The performance of the DAP is net of all fees, and all figures are shown in USD. Forward-looking statements are not guarantees of performance, and are inherently subject to, among other things, risks, uncertainties, and assumptions.**

The 60/40 Portfolio has an expected return of 7.11% vs. an expected return for the New Portfolio of 7.51%. The New Portfolio's higher expected return, adjusted for its materially lower risk than the 60/40 Portfolio, translates into a superior Sharpe Ratio i.e., the New Portfolio has a significantly more attractive risk-adjusted return profile. It also has far less drawdown risk, that is its downside risk potential in a stressed market environment (defined as a peak to trough decline that could be experienced over any 12-month period).




**Obsiido 2024 Capital Market (Return) Assumptions in USD**

Core Bonds = 5.4%, Global Equity = 8.95%, Private Equity = 12.88%, Private Debt = 10.19%, Core Real Estate = 6.76%, Unlisted Infrastructure = 7.25%, Farmland = 6.76%, Hedge Funds = 7.50%.

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All investing, including the alternative asset classes discussed in this publication, involves risk. The risk and return profile for each asset class can vary. Investors should consult their investment advisor, tax, legal, accounting, or other advisors about such information before making any investment decisions.

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Obsiido is a technology enabled investment management firm that specializes in researching, structuring, and enabling investments in core alternative investment opportunities within private markets and hedge funds. Obsiido is registered as an investment fund manager in Ontario and as a portfolio manager and exempt market dealer in Ontario, British Columbia and Alberta.

Obsiido is a wholly-owned subsidiary of Obsiido Capital Management Ltd.

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