

# On the Minds of Investors

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## Why invest in alternative assets?

### There is no alternative...really?

The post-crisis economic expansion has been long but relatively anaemic. In this environment, few central banks have been able to normalise either interest rates or their balance sheets, and investors have, as a result, struggled to achieve the desired yield on their investments. Frequently we hear investors state that there is no alternative but to stay exposed to risk assets at the expense of low yielding safe assets.

While this strategy worked well throughout most of the economic cycle, as the cycle ages we believe investors should be considering options to increase the resilience of their portfolios in order to be prepared for an eventual downturn.

We acknowledge that this is easier said than done in a world where core government bond yields are low, particularly here in Europe. The scope for government bond prices to rise to offset any decline in stock prices is more limited than it was in previous downturns. Cash in Europe—with negative real returns—is a similarly unattractive proposition.

As a consequence, investors might need to rethink diversification and expand their horizon beyond traditional asset classes in order to increase the resilience of their portfolio while generating positive real yields. The good news is that there are alternatives.

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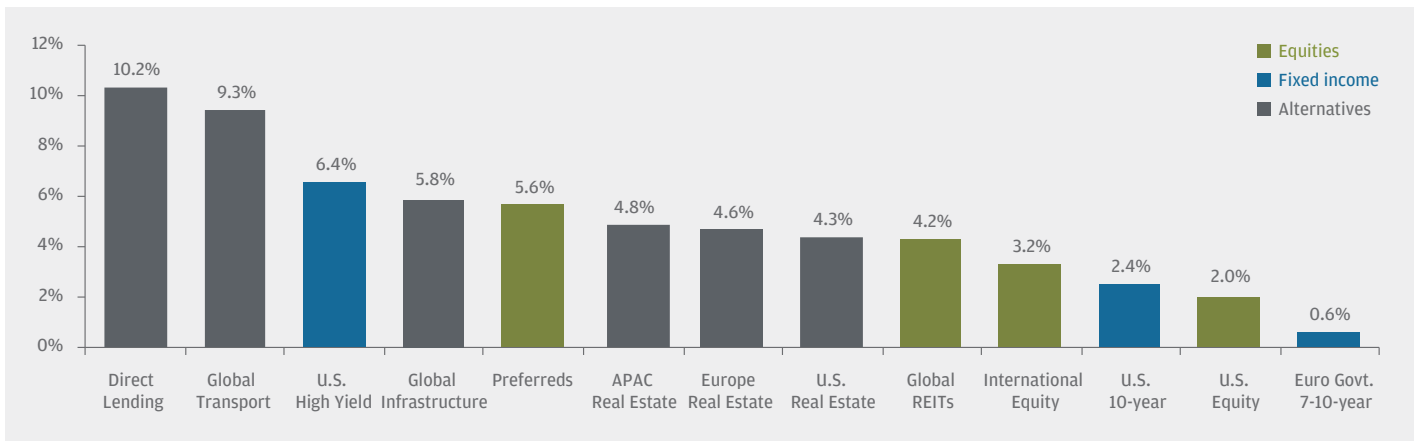
## What are alternative investments?

Alternative strategies are usually defined as investments in assets other than stocks, bonds and cash. They include investments in private assets (which are not publicly listed) or investment strategies that use non-traditional approaches, such as the ability to benefit if stocks fall. It is a broad and heterogeneous universe that can be divided into two main categories: the “return-enhancers” and the “diversifiers”.

**Exhibit 1**—taken from our recent publication *Guide to Alternatives*—shows the yield on offer in many of the core alternative markets. The “return enhancers” are strategies, such as private credit or private equity, which seek to generate returns in excess of public markets. There is of course no free lunch. The higher yield compensates investors for a lower level of liquidity in these markets. However, this may not be a problem for longer-term investors that can hold assets through the cycle.

### EXHIBIT 1: YIELD ALTERNATIVES

Asset class yields, %



Source: BAML, Barclays, Bloomberg, Clarkson, Cliffwater, Drewry Maritime Consultants, Federal Reserve, FTSE, MSCI, NCREIF, FactSet, J.P. Morgan Asset Management. Yields are as of 03/31/19, except Global Transport, Global Infrastructure (09/30/2018), Direct lending, EMEA, APAC and U.S. Real Estate (12/31/18). Global Transport: Levered yields for transport assets calculated as the difference between charter rates (rental income), operating expenses, debt amortization and interest expenses, as a percentage of equity value. Yields for each of the sub-vessel types above are calculated and respective weightings are applied to arrive at the current levered yields for Global Transportation; Preferreds: BAML Hybrid Preferred Securities; U.S. High Yield: Bloomberg US Aggregate Corporate High Yield; Global Infrastructure: MSCI Global Infrastructure Asset Index-Low risk; U.S. Real Estate: NCREIF-ODCE Index; Global REITs: FTSE NAREIT Global REITs; International Equity: MSCI AC World ex-U.S.; U.S. 10-year: 10-year U.S. Treasury yield; U.S. Equity: MSCI USA, Europe core real estate: IPD Global Property Fund Index - Continental Europe, Asia Pacific (APAC) core real estate: IPD Global Property Fund Index - Asia-Pacific. Euro Govt. 7-10-year: Bloomberg Barclays Euro Aggregate Government - Treasury (7-10Y). *Guide to Alternatives - 2Q 2019*. Data as of March 31, 2019.

**Exhibit 2** shows the correlation between the key alternative asset classes and traditional public markets. The “diversifiers” are strategies that generate returns with a low correlation to traditional assets, such as certain hedge fund strategies or real assets (tangible assets including real estate, infrastructure and

transportation assets). The addition of these assets to a portfolio might serve to not only cushion the value of a portfolio in a downturn but in some cases also enhance the portfolio’s yield.

EXHIBIT 2: PUBLIC AND PRIVATE MARKET CORRELATIONS

Since June 2008, quarterly returns

		Global Bonds	Global Equities	U.S. Core RE	Europe Core RE (Continental Europe)	APAC Core RE	Global Core Infra	Direct Lending	Venture Capital	Private Equity	Equity Long/Short	Relative Value	Macro
Financial assets	Global Bonds	1.0											
	Global Equities	0.3	1.0										
Global real estate	U.S. Core RE	-0.1	0.1	1.0									
	Europe Core RE (Continental Europe)	-0.2	0.3	0.8	1.0								
	APAC Core RE	-0.2	0.1	0.9	0.8	1.0							
Other real assets	Global Core Infra	-0.1	-0.2	0.3	0.1	0.2	1.0						
Private markets	Direct Lending	-0.1	0.6	0.4	0.5	0.3	0.1	1.0					
	Venture Capital	-0.2	0.5	0.6	0.7	0.5	0.1	0.6	1.0				
	Private Equity	0.0	0.8	0.4	0.6	0.4	0.1	0.9	0.7	1.0			
Hedge funds	Equity Long/Short	0.2	1.0	0.0	0.3	0.1	-0.1	0.7	0.5	0.8	1.0		
	Relative Value	0.1	0.9	0.0	0.2	0.0	-0.1	0.8	0.4	0.8	0.9	1.0	
	Macro	0.3	0.4	-0.1	-0.1	-0.2	-0.1	0.0	0.0	0.1	0.4	0.3	1.0

Source: MSCI, Bloomberg Barclays, NCREIF, Cliffwater, Burgiss, HFRI, J.P. Morgan Asset Management. RE - real estate. Global equities: MSCI AC World Index. Global bonds: Bloomberg Barclays Global Aggregate Index. U.S. core real estate: NCREIF Property Index - Open End Diversified Core Equity component. Europe core real estate: IPD Global Property Fund Index - Continental Europe. Asia Pacific (APAC) core real estate: IPD Global Property Fund Index - Asia-Pacific. Global infrastructure (infra.): MSCI Global Quarterly Infrastructure Asset Index (equal-weighted blend). U.S. direct lending: Cliffwater Direct Lending Index. U.S. private equity: Cambridge Associates U.S. Private Equity Index. U.S. venture capital: Cambridge Associates U.S. Venture Capital Index. Hedge fund indices include equity long/short, relative value, and global macro and are all from HFRI. All correlation coefficients are calculated based on quarterly total return data for the period 6/30/08 -12/31/18. Returns are denominated in USD. *Guide to Alternatives- 2Q 2019*. Data as of March 31, 2019.

How can alternatives complement a traditional portfolio?

For long term investors able to forego some liquidity, a strategic allocation to alternatives assets can help to improve the overall risk/return profile of their portfolio. The exact weight of the alternative bucket within a diversified portfolio will depend on individual return objectives, investment horizons and liquidity constraints.

For investors who do require daily liquidity the range of liquid alternative strategies investing in public markets has also increased in recent years.

Investors confronted with negative real cash yields and limited upside from government bonds in the event of a downturn may therefore want to look beyond a traditional 60:40 equity/bond portfolio. Adding alternatives can potentially help them achieve better risk adjusted returns, increase the yield and increase the resilience of their portfolio.

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