July 2024

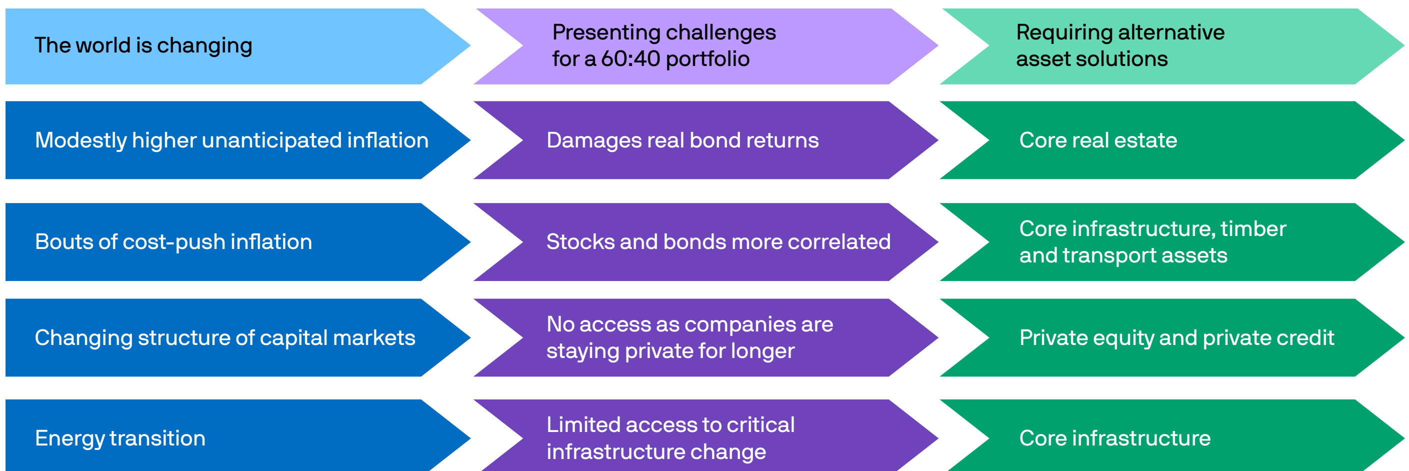
Why Alternatives?

What are alternatives?

"Alternatives" is often used as a catch-all phrase to mean any non-traditional asset class or investment strategy. Alternative investments include private equity and private credit; private real assets, such as real estate, infrastructure, transport and timber; and alternative investment strategies, such as those used by hedge funds.

Alternatives are required for a changing world

There are four ways in which the world is changing that, in our view, challenge the risk-adjusted returns investors might achieve by allocating solely to public market assets. These changes are modestly higher unanticipated inflation, bouts of cost-push inflation, the changing structure of capital markets and the energy transition.



Achieve broader diversification and protection from inflation

Inflation is likely to be higher and more volatile over the next decade, with more frequent bouts of cost-push inflation. As neither stocks nor bonds like unanticipated inflation, investors need to look beyond traditional markets to build diversified portfolios. Real assets, such as real estate, infrastructure, transport and timber have low correlations to traditional asset classes and can provide genuine inflation protection, at times when there are few places to hide.

Adapt to changing capital markets

The structure of capital markets is changing. More companies are choosing to stay private or are entering the public markets at a more mature age. Investors in the small cap equity space are therefore missing out on some of the early stage returns they might have once enjoyed, which makes private equity an important allocation decision. Many of the exciting new developments in AI and healthcare, for example, are gestating in private markets.

Gain exposure to the energy transition

Climate ambitions were already going to necessitate a dramatic overhaul of our domestic infrastructure. However, the current focus on energy security has injected a new sense of urgency to the energy transition. As many governments have limited fiscal space, there is likely to be plenty of regulation and subsidies to support private solutions, presenting numerous opportunities for investment in core infrastructure.

J.P.Morgan
ASSET MANAGEMENT

Why private real estate?

Private real estate typically refers to equity investments in real estate properties. Private real estate investments include assets such as office buildings, retail units, logistic warehouses, apartments and hotels.

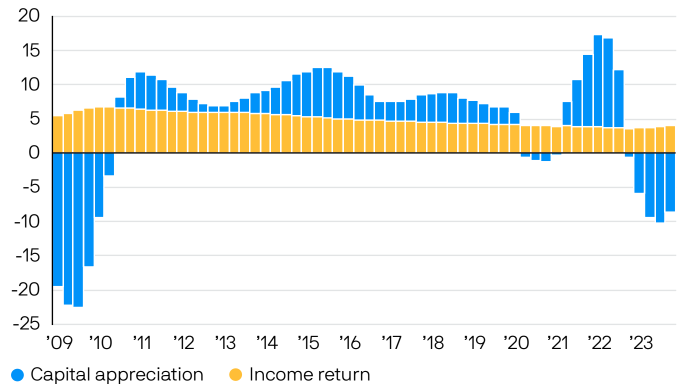
Real estate provides stable income

Core commercial real estate is often leased to high quality tenants on long-term leases and therefore provides investors with a stable source of income that has a low correlation to traditional fixed income investments. Over the last two decades, the income generated by real estate has been attractive, with property yields remaining high even when the yields available on fixed income fell to historically low levels. The stability and resilience of real estate income is particularly valuable in environments where conventional fixed income investments struggle to generate sufficient yield.

Source: MSCI, J.P. Morgan Asset Management. Commercial real estate returns represented by the MSCI Global Property Fund Index. The chart shows the full index history beginning 1Q09 and ending in 4Q23. Past performance is not a reliable indicator of current and future results. Data based on availability as of 31 May 2024.

Global commercial real estate returns

%, rolling four-quarter returns from income and capital appreciation



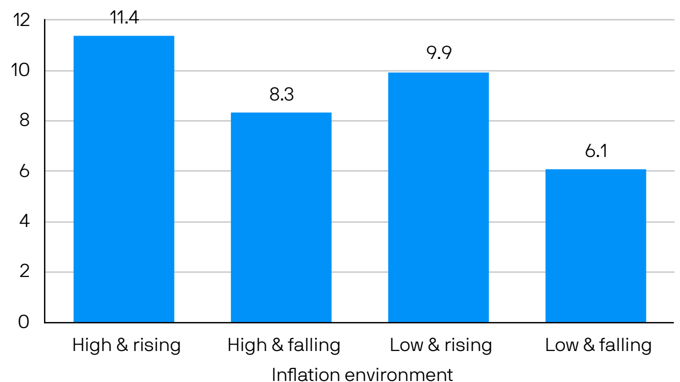
Real estate can provide protection from inflation

Commercial real estate can also provide a degree of protection from inflation. Many real estate leases contain clauses allowing property owners to increase rents periodically, either by a fixed amount or in line with a consumer price index. This built-in escalation helps cash flows to keep pace with inflation, preserving the value of the income stream over time and providing an inflation-hedging characteristic that distinguishes real estate from other asset classes, such as fixed income, where cash flows are more commonly fixed.

Source: BLS, FactSet, NCREIF, J.P. Morgan Asset Management. NCREIF ODCE is short for NCREIF Fund Index - Open End Diversified Core Equity. It is a capitalisation-weighted, gross of fee, time-weighted return index. Real estate performance is measured using total returns. “High” inflation is defined as any year-over-year headline CPI reading above the historical median, while “low” inflation is defined as any year-over-year headline CPI reading below the historical median. The median headline CPI between 4Q78 – 1Q24 is 2.84%. Data based on availability as of 31 May 2024.

US private real estate average returns in different inflationary environments

1Q78 – 4Q23, quarterly, headline CPI, NCREIF ODCE Index, y/y %



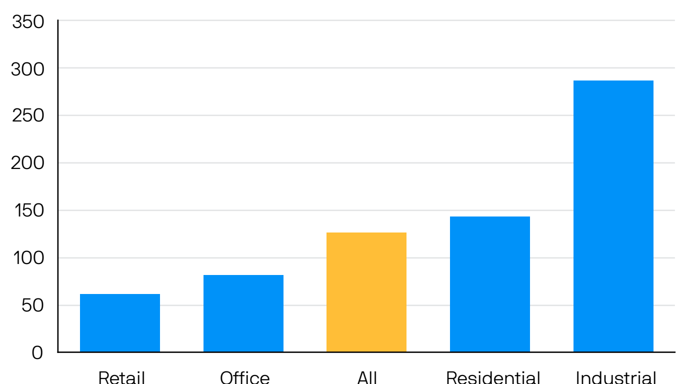
Real estate can benefit from structural trends

Commercial real estate is well positioned to capitalise on structural trends, as demand is derived from the way we live, work and shop. For example, the surge in ecommerce and the rising renter population has translated into recent outperformance in those two sectors. Other structural changes, such as the rise of artificial intelligence and advancements in biotech, are expected to fuel demand for data centres and cold storage facilities. Skilled managers who understand these long-term structural shifts will be better able to position portfolios to generate superior returns.

Source: MSCI, J.P. Morgan Asset Management. Commercial real estate returns represented by the MSCI Global Property Fund Index; weighted by market size. The chart shows the full index history beginning 1Q07 and ending in 4Q23. All returns shown are in USD. Past performance is not a reliable indicator of current and future results. Data based on availability as of 31 May 2024.

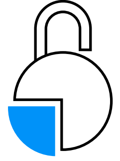
Global private commercial real estate performance by sector

%, cumulative total return, 1Q07 to 4Q23



Why private equity?

Private equity involves investments in companies that are not listed on public stock exchanges. The three broad categories of private equity – venture capital, growth equity, and buyouts – focus on different stages of a company's life.



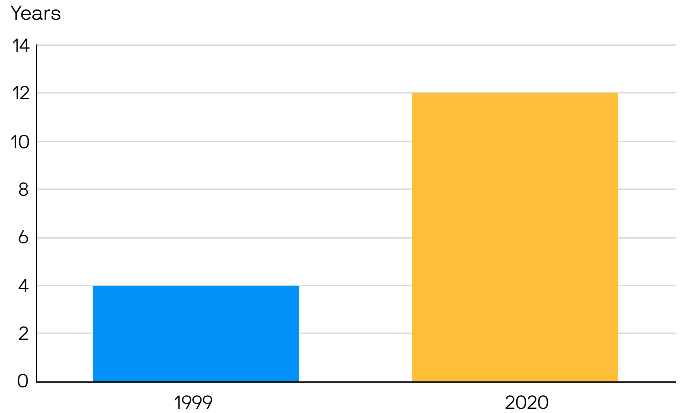
Companies are staying private for longer

Companies are increasingly choosing to stay private for longer than they used to. In 1999, the median age of a company at initial public offering (IPO) was just four years; by 2020, this had risen to 12 years. Several factors are driving this trend, including the depth and availability of private capital, the desire to avoid the disclosure and reporting requirements that come with being a public company, and the potential loss of control that results from going public.

Source: Initial Public Offerings: Updated Statistics, Jay R. Ritter (June 2021), J.P. Morgan Asset Management. Data as of 31 May 2024.

Median age of companies at IPO

Years

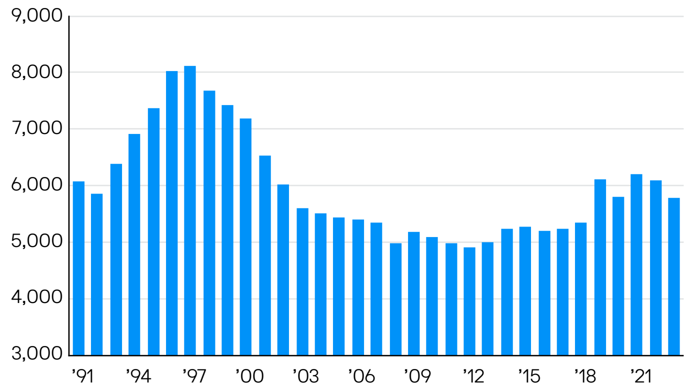


The public equity universe is declining

With companies staying private for longer and many established companies being taken private, the public equity universe is dwindling. Between 1997 and 2022, the number of publicly-listed companies has fallen by over 40% in the US and by over 60% in the UK. Consequently, public equity now represents only 15% of the total equity universe, with private equity comprising the remaining 85%.

Source: FactSet, Jay Ritter, University of Florida, Russell, World Federation of Exchanges, J.P. Morgan Asset Management. Number of listed US companies is represented by the sum of the number of companies listed on the NYSE and the NASDAQ. Data as of 31 May 2024.

Number of listed US companies



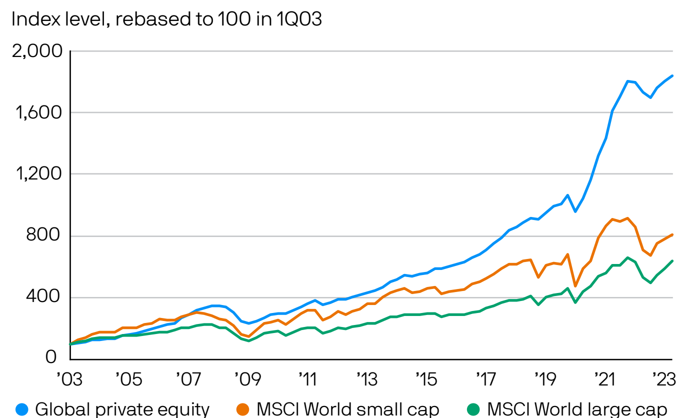
Private equity can provide enhanced returns

By investing in private companies, particularly at earlier stages, private equity firms capture the growth and value creation of these businesses in a way that is not available through public markets. This ability to invest in high-potential, fast growing businesses before they go public is a key driver of private equity's potential for enhanced returns.

Source: Burgiss, LSEG Datastream, MSCI, J.P. Morgan Asset Management. Global private equity shows a time-weighted return series from Burgiss. Equity indices are total returns in US dollars. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2024.

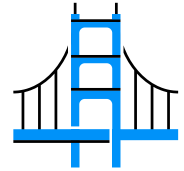
Cumulative performance since 2003

Index level, rebased to 100 in 1Q03



Why private infrastructure?

Private infrastructure typically refers to investments in infrastructure assets. Infrastructure investments include assets such as roads and bridges, power and water utilities, telecommunications and energy.



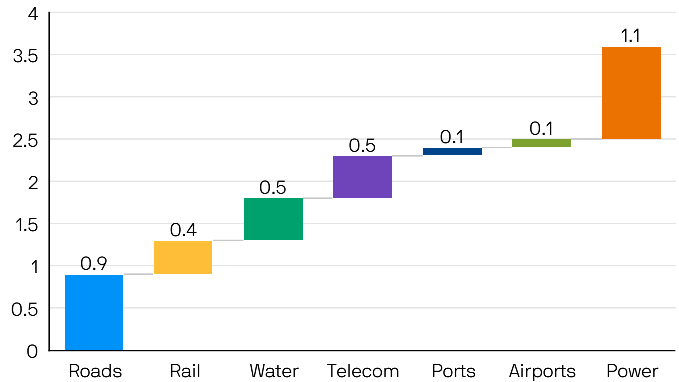
There is a significant need to upgrade our infrastructure

Each year, several trillion dollars in infrastructure investment is needed to establish and upgrade our core infrastructure. In addition, there is also growing demand for capital to fund the energy transition. With limited fiscal space for governments to act, there are likely to be plenty of regulation changes and subsidies to support private solutions, presenting numerous opportunities for private investment in core infrastructure.

Source: McKinsey Global Institute, J.P. Morgan Asset Management. Data based on availability as of 31 May 2024.

Average annual global infrastructure need by type

USD trillions, as of 2017



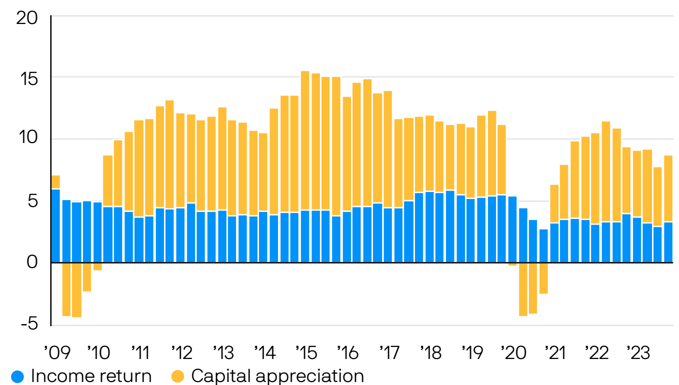
Infrastructure provides stable income

Private infrastructure assets often provide investors with stable and predictable income streams. Many infrastructure assets, such as utilities or transportation networks, offer essential services that remain in constant demand regardless of economic conditions. This inelastic demand has enabled core private infrastructure to generate stable income returns throughout the economic cycle, even as capital values vary.

Source: MSCI, J.P. Morgan Asset Management. Infrastructure returns represented by the MSCI Global Quarterly Infrastructure Asset Index. The chart shows rolling one-year returns from income and capital appreciation. The chart shows the full index history, beginning in 1Q09, and ending in 3Q23. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2024.

Global core private infrastructure returns

%, rolling four-quarter returns



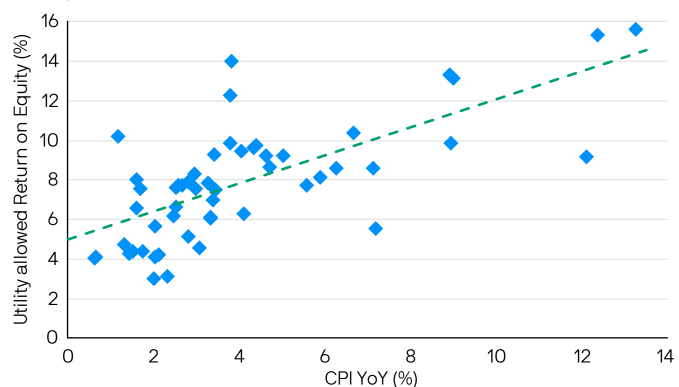
Infrastructure can act as an inflation hedge

In addition to stable income, infrastructure investments can serve as effective inflation hedges. Many infrastructure assets have long-term contracts with built-in inflation adjustments, ensuring that revenues keep pace with rising costs. Moreover, the essential nature of infrastructure services allows operators to pass on increased costs to end-users more easily than in other sectors of the economy.

Source: Bloomberg, Bureau of Economic Analysis, SNL, AEU, J.P. Morgan Asset Management. The chart shows the average allowed return on equities (RoEs) for Electricity and Natural Gas Utilities, from 1970 through December 2023, and annual inflation from 1968 through 2021. *Return on equity is lagged by two years. Utility spending is as of December 2023. Data as of 31 May 2024.

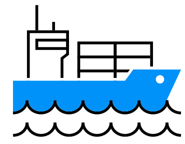
US utilities allowed returns vs. inflation

Average allowed return on equity*, annual



Why private transport?

Private transport refers to investments in transportation assets. Transport investments include assets such as ships, planes and trains, essential for facilitating global trade. Private transport is sometimes referred to as moving infrastructure.



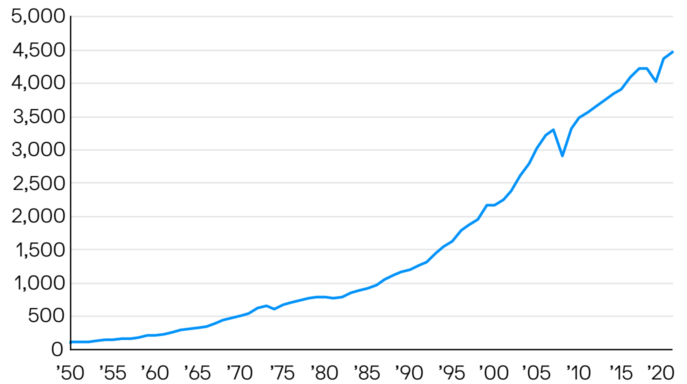
Transportation plays a vital role in the global economy

Since 1950, global trade volume has skyrocketed, growing almost 4,500%. This expansion has been made possible by transportation assets. From ships traversing vast oceans to trains crossing continents, these vital assets serve as the backbone of the global supply chain, efficiently moving goods and materials to every corner of the world. As the lifeblood of global trade, transportation assets play an indispensable role in connecting markets, driving economic growth, and enabling the modern, interconnected world we live in today.

Source: World Trade Organization (WTO), J.P. Morgan Asset Management. Data as of 31 May 2024.

Evolution of world trade

World trade volume, index 1950 = 100



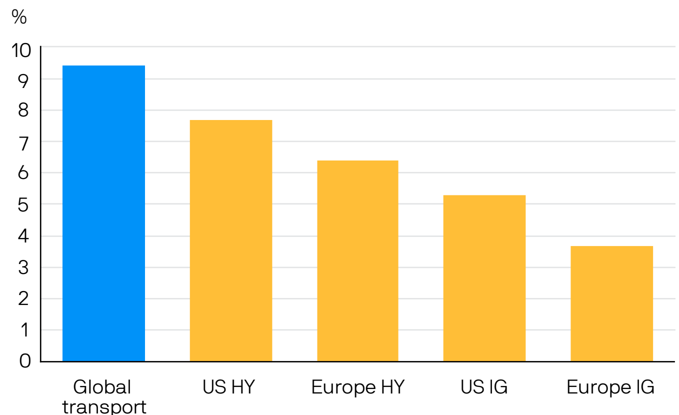
Transport offers attractive risk-adjusted yields

Transport assets offer investors the potential for attractive yields that compare favourably to traditional fixed income. Growing demand and a muted supply pipeline allow transport asset owners to generate high levels of income, often in the range of high-yield bonds, even though the counterparties are often investment grade. This combination of higher yields with relatively low credit risk makes transport an attractive alternative income source for investors with longer investment horizons.

Source: Bloomberg, LSEG Datastream, J.P. Morgan Asset Management. Global transport yields are derived from a J.P. Morgan Asset Management Index; US high yield: ICE BofA US High Yield Index – Yield to Worst; US IG: Bloomberg US Corporate Investment Grade USD - Yield to worst; Europe HY: ICE BofA Euro Developed Markets Non-Financial High Yield Constrained Index – Yield to Worst; Europe IG: Bloomberg Euro Aggregate: Corporates EUR - Yield to worst. Public market yields as of 1Q24; private market yields as of 4Q23. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2024.

Asset class yields

%



Transport has a low correlation to traditional assets

Transport assets can also serve as an important diversifying component within a portfolio due to their low correlation to traditional asset classes and other alternatives. By incorporating transportation alongside other alternative assets, investors can potentially enhance diversification, mitigate risk, and improve portfolio resilience, especially during periods of market volatility.

Source: Bloomberg, MSCI, NCREIF, J.P. Morgan Asset Management. Europe Core RE includes continental Europe. RE – real estate. Global equities: MSCI AC World Index. Global Bonds: Bloomberg Global Aggregate. Europe Core Real Estate: MSCI Global Property Fund Index – Continental Europe. Global infrastructure (Infra.): MSCI Global Private Infrastructure Asset Index. Timber: NCREIF Timberland Property Index (US). Transport: returns are derived from a J.P. Morgan Asset Management index. Returns are denominated in USD. Data as of 31 May 2024.

Public and private market correlations

Quarterly returns

	2008-2023	Global Bonds	Global Equities	Europe Core RE	Global Core Infra	Transport	Timber
Financial assets	Global Bonds	1.0					
	Global Equities	0.4	1.0				
Real assets	Europe Core RE	-0.2	0.1	1.0			
	Global Core Infra	-0.1	0.1	0.3	1.0		
	Transport	-0.2	0.0	0.0	-0.1	1.0	
	Timber	-0.2	-0.1	0.0	0.2	0.2	1.0

Why private credit?

Private credit, or direct lending, typically refers to non-traditional lenders (such as private credit funds or hedge funds) lending directly to small and medium-sized companies. This form of financing is often used by companies that may not have access to traditional bank loans.

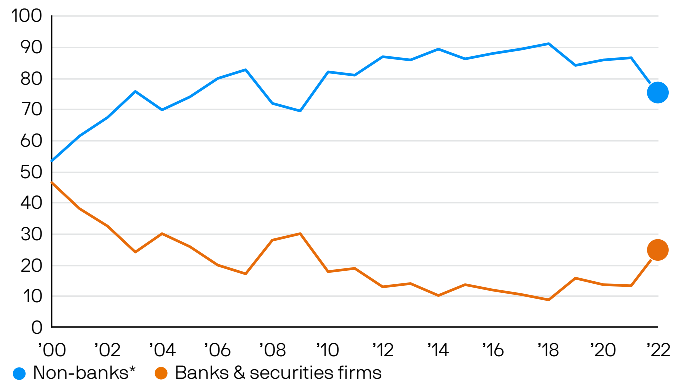
Banks have reduced their lending to small and medium-sized companies

Over the last two decades, regulatory changes and heightened capital requirements have led banks to reduce their lending to small and medium-sized companies. Back in 2000 the share of lending between banks and non-banks was roughly equal, whereas more recently, non-banks have issued almost three times the funding. Stricter regulations have made it less economical for banks to to serve this segment, creating a significant funding gap.

Source: FDIC, LCD, PitchBook, J.P. Morgan Asset Management. *Non-bank includes institutional investors and finance companies. Data as of 31 May 2024.

Primary market sources of financing

%, new-issue market for broadly syndicated loans, 1999-2022



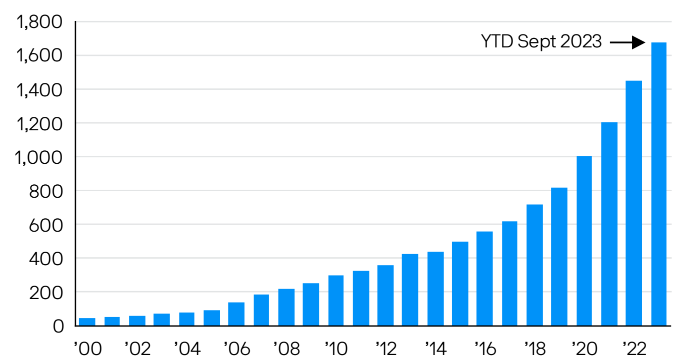
Private credit has been bridging the funding gap

An expansion in non-traditional lending has mirrored the decrease in bank lending. In fact, over the past two decades private credit has grown from a $40 billion market to one that's over a third of the size of the global high-yield bond market. Historically, private credit has served the middle market, providing loans directly to small and medium-sized companies. However, more recently private credit has also begun challenging banks in the larger broadly syndicated loan (BSL) market.

Source: Preqin, J.P. Morgan Asset Management. Assets under management is the sum of unrealised value and "dry powder" - capital that has been committed to a fund but not yet called. Data as of 31 May 2024.

Private credit assets under management (AUM)

USD billions



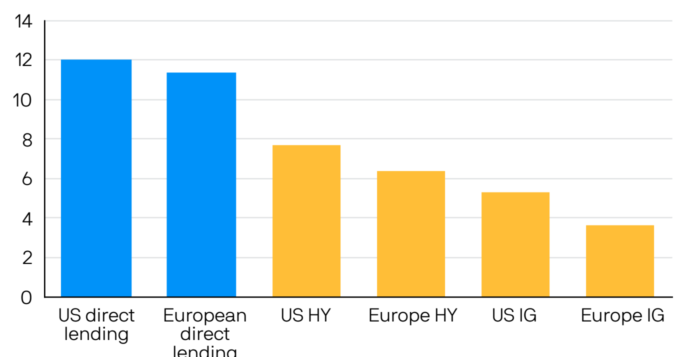
Private credit offers attractive risk-adjusted yields

For investors with long-term investment horizons, private credit offers attractive risk-adjusted yields. Direct lending yields are typically floating rate, and place stringent covenants on the lender to reduce the risk of default. For these reasons, direct lending is generally considered to have lower interest rate and default risk than high yield bonds. However, it also comes with lower liquidity compared to high yield bonds, which are publicly traded.

Source: Bloomberg, Cliffwater, Lincoln international, LSEG Datastream, J.P. Morgan Asset Management. US Direct Lending: Cliffwater CDLI-S index – YTM; European direct lending: Lincoln ESDI – YTM; US high yield: ICE BofA US High Yield Index – Yield to worst; US IG: Bloomberg US Corporate Investment Grade USD - Yield to worst; Europe HY: ICE BofA Euro Developed Markets Non-Financial High Yield Constrained Index – Yield to worst; Europe IG: Bloomberg Euro Aggregate: Corporates EUR - Yield to worst. Public market yields as of 1Q24; Private market yields as of 4Q23. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2024.

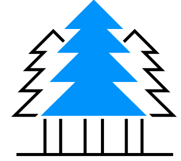
Asset class yields

%



Why timberland?

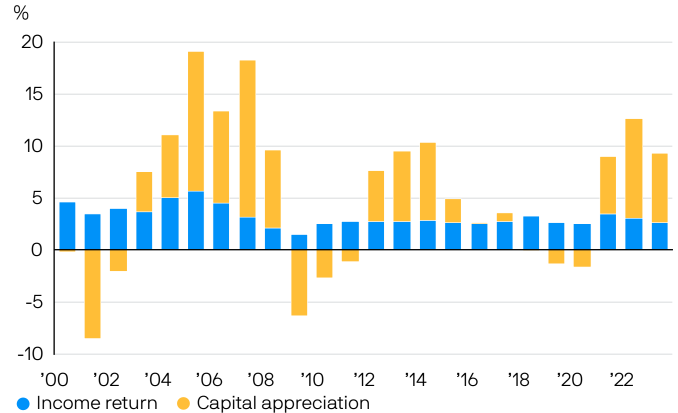
Timberland investing refers to the acquisition and management of forested land with the aim of generating financial returns primarily through the sale of timber.



Timber provides a stable source of income

Like other real assets, timber has generated very stable income returns over the last 25 years. Unlike other real assets, the stability of timber's income return stems from the fact that timber benefits from biological growth. Biological growth means that as trees grow, they increase in volume and density, making them more valuable. Because trees grow even in the most difficult economic times, timber also exhibits low correlations to traditional financial assets, making it an important source of diversification.

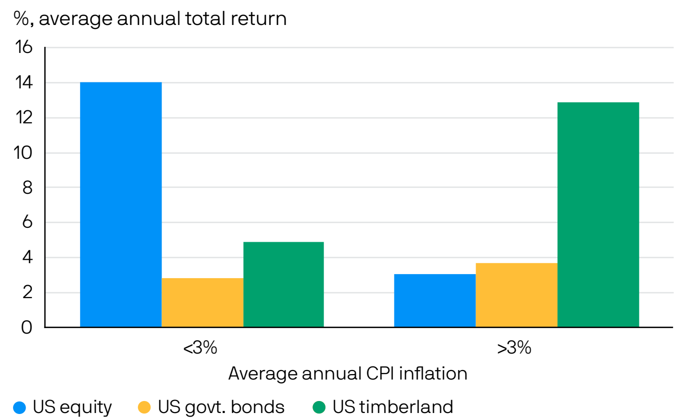
Source: NCREIF, J.P. Morgan Asset Management. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2024.



Timber is an effective inflation hedge

Biological growth, price appreciation and land appreciation also make timber an effective hedge against inflation. Over the last 30 years timber has generated very attractive real (inflation-adjusted) returns during high inflationary environments. The high inflationary period of 2022 was no exception. Between August 2021 and March 2022, lumber prices increased by over 250%. In a world where inflation is expected to be higher and more volatile on average, timber will become an important part of a well-diversified portfolio.

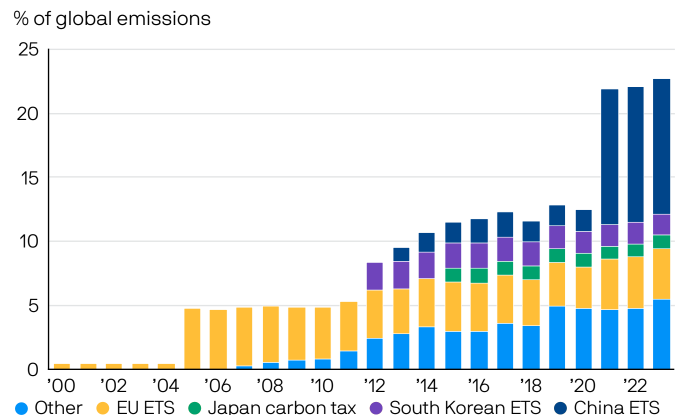
Source: Bloomberg, LSEG Datastream, MSCI, NCREIF, J.P. Morgan Asset Management. Sample size ranges from 1988 to 2023. US equity: MSCI USA; US govt. bonds: Bloomberg US Treasury Bond index; US timberland: NCREIF Timberland index. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2024.



Timber can help achieve sustainability goals

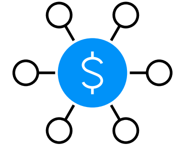
Timberland investing provides investors opportunities to align with their environmental, social and governance (ESG) goals while also generating financial returns. As trees grow, they absorb carbon from the atmosphere, allowing investors to offset or reduce their carbon footprints. Moreover, any additional carbon storage can be converted into verified carbon assets (VCAs) and sold in carbon credit markets. As more countries and companies make net-zero commitments, increased demand for carbon credits will likely boost their price, further enhancing the benefits of investing in timberland.

Source: World Bank, J.P. Morgan Asset Management. ETS is emissions trading system. Data as of 31 May 2024.



Why hedge funds?

Hedge funds are limited partnerships of private investors whose money is pooled together to invest in a wide variety of assets, often using complex strategies aimed at generating higher returns. As they are unlisted investment funds, hedge funds are less regulated than listed funds.



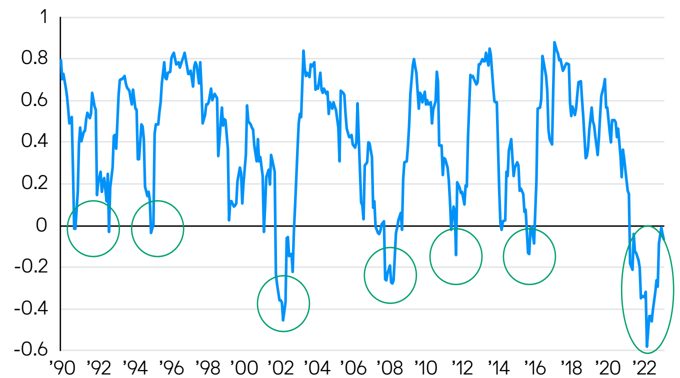
Hedge funds can provide broader diversification

By employing a wide range of investment strategies, from short-selling and leverage to complex derivatives, hedge funds can generate returns that are largely uncorrelated with traditional asset classes, such as stocks and bonds. Over the last 30 years, this ability to generate diversified sources of return, beyond just long-only exposures to public equity, has allowed hedge funds to provide broader diversification than public markets alone. In most of the periods of acute market stress, such as the dot-com recession, the great financial crisis and the high inflation of 2022, hedge fund correlation to a 60/40 stock-bond portfolio has fallen to zero or below.

Source: Bloomberg, FactSet, HFRI, S&P Global, J.P. Morgan Asset Management. *60/40 portfolio is 60% S&P 500 and 40% Bloomberg US Aggregate. Hedge funds are represented by HFRI Macro. Correlation is calculated on a 12-month rolling basis. Data as of 31 May 2024.

Hedge fund correlation with a 60/40 stock-bond portfolio*

12-month rolling correlation of monthly returns, 1990 - 2024



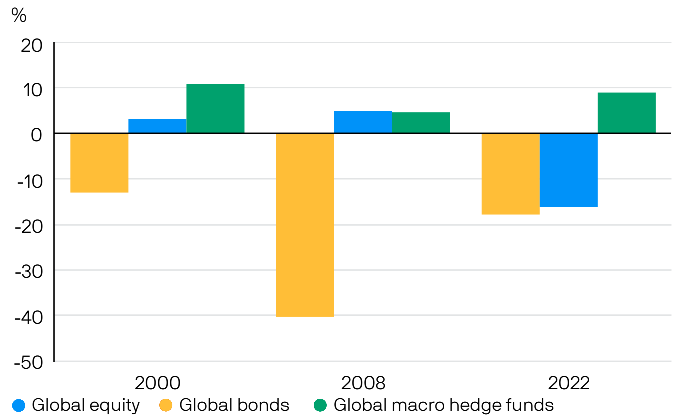
Hedge funds can limit downside risks

Hedge funds have the flexibility to employ defensive strategies, such as short selling and hedging, which can help to preserve capital in market downturns. By actively managing exposures and being flexible to changing market conditions, skilled hedge fund managers can mitigate losses and limit downside risks in portfolios. This flexibility has been evident in the last three downturns, with global macro hedge funds posting positive returns, even in 2022 when both stocks and bonds fell simultaneously.

Source: HFRI, LSEG Datastream, J.P. Morgan Asset Management. 2000 bear market is from 31 March 2000 to 31 October 2002, 2008 bear market is from 31 October 2007 to 28 February 2009, 2022 is calendar year. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2024.

Asset class returns

%



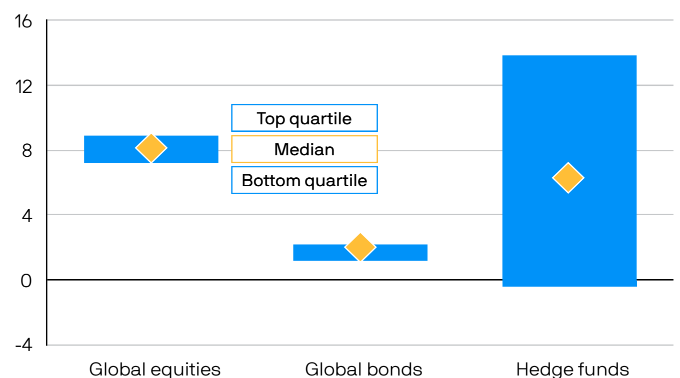
Skilled managers can generate alpha

Skilled hedge fund managers can generate alpha through their ability to exploit market inefficiencies and navigate complex market environments. However, performance varies widely between managers – the gap between the top and bottom quartile funds can be much wider than in public markets. This dispersion underscores the importance of manager selection.

Source: Burgiss, NCREIF, Morningstar, PivotalPath, J.P. Morgan Asset Management. Global equities and global bonds are based on the world large stock and world bond categories, respectively. *Manager dispersion is based on annual returns over a 10-year period ending 4Q23 for Hedge Funds and US Core Real Estate and 3Q23 for US Fund Global Equities and US Fund Global Bonds. Non-core Real Estate, Global Private Equity and Global Venture Capital are represented by the 10-year horizon internal rate of return (IRR) ending 3Q23. US Fund Global Equities and Bonds are comprised of US-domiciled mutual funds and ETFs. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2024.

Public and private market dispersion

%, based on returns over a 10-year window*



Explore more alternative insights

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