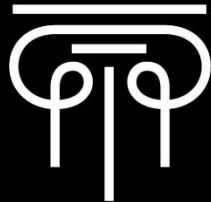

2 May 2019

Alternative investments: **What, how and why?**

Graham Rich, Managing Partner & Dean
Portfolio Construction Forum



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CORE BELIEF

Quality portfolio construction is built on a contemporary and defensible philosophy

so practitioners can know, grow and show the value they add.



Challenging your portfolio construction beliefs.



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ALTERNATIVE INVESTMENTS: WHAT?

"Alternative investments are often defined not by what they are, but by what they are not. This is, an alternative investment is in a position in something other than a long position in either equity or debt."

- Anson, 2006 – Handbook of Alternative Investments



ALTERNATIVE INVESTMENTS: WHAT?

- The main high-level alternative investment “asset classes” include:
 - **hedge funds** (i.e. single strategy and multi strategy from either relative value arbitrage or directional categories); and,
 - **private markets** (e.g. private equity, venture capital and buyouts, private credit, real estate and infrastructure, commodities, specialities)
- Across each of the asset classes, and even within each asset class, there is wide variation of risk and return characteristics and then a wide variation of fund manager skill in selecting the assets and asset classes to deliver optimal and superior adjusted returns over reasonable time periods, and performance.



ALTERNATIVE INVESTMENTS: WHAT?

To be considered an alternative investment asset class, an investment must demonstrate one or both of the following:

Alpha-based ("skill" e.g. **hedge funds**) via:

- A different approach to trading in traditional markets
- A "niche" risk premium exploited by active trading/management
- An exploitation of cracks in the financial markets
- A tactical application to add excess return

and/or

Beta-based ("market" e.g. **private markets**) via:

- A systematic risk premium different to that derived from stocks and bonds
- A premium to listed markets that wholly or partly reflects illiquidity risk



ALTERNATIVE INVESTMENTS: WHAT?

Alpha-based vs beta-based

Alpha



- Single strategy hedge funds (e.g. long/short equity; equity market neutral; global macro; event driven; convertible arbitrage; distressed high-yield securities; managed futures (CTA))
- Multi strategy hedge funds (FoF, single manager)
- Private equity
- Private venture capital
- Private credit
- Real estate
- Infrastructure
- Commodities
- Specialities (e.g. timber, agribusiness, art, gold)

Beta



ALTERNATIVE INVESTMENTS: HOW?

Manager selection is important – questions to consider:

- What is the real evidence of inefficiency in the asset class?

Then

- How is the inefficiency cost-effectively captured by a fund manager?

Then

- Can the fund manager demonstrate the skill and repeatable ability to cost-effectively capture alpha through different cycles and events?

Then

- Is the strategy suitable for the portfolio objectives?

If these questions can be answered satisfactorily through quality primary and secondary research, there is arguable value in including appropriate alternative investments in a well constructed multi-manager portfolio.



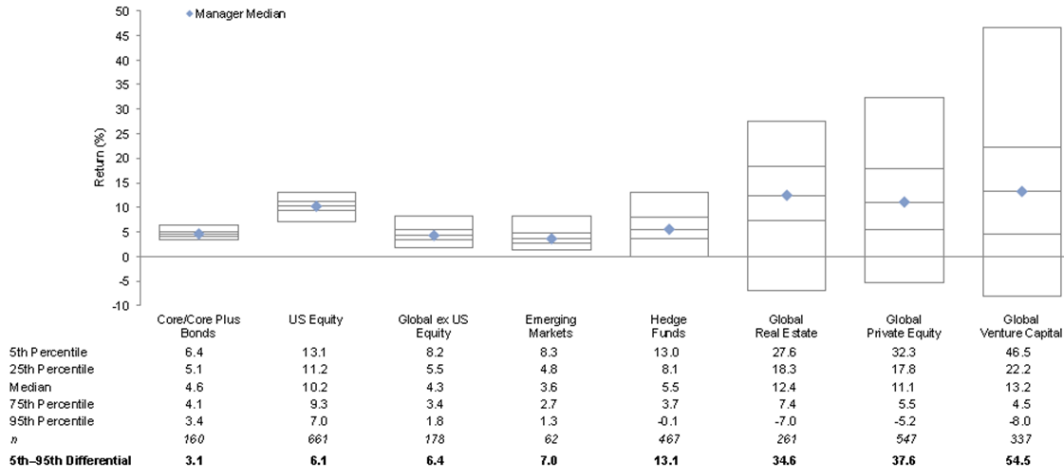
ALTERNATIVE INVESTMENTS: HOW?

Track record differs by asset class & manager

Manager selection is important

Comparing Manager Return Dispersion Across Asset Classes

USD Terms • Percent (%)



Source: Cambridge Associates LLC.

Illustrative only



ALTERNATIVE INVESTMENTS: WHY?

The verdict on quality alternative investments

- Asset allocation is improved with alternative investments.
- The adoption of alternative investments will not guarantee stellar or even necessarily improved returns, but will ensure strategic diversification.
- Alternative investments shift the efficient frontier in the northwesterly direction.
- Alternative investments allow an investor to reduce risk for a given level of return or increase return for a given level of risk.

Or, alternatively:

- Without access to best-of-breed alternative investment managers, asset allocation improvement and flow on effects may be modest, at best.



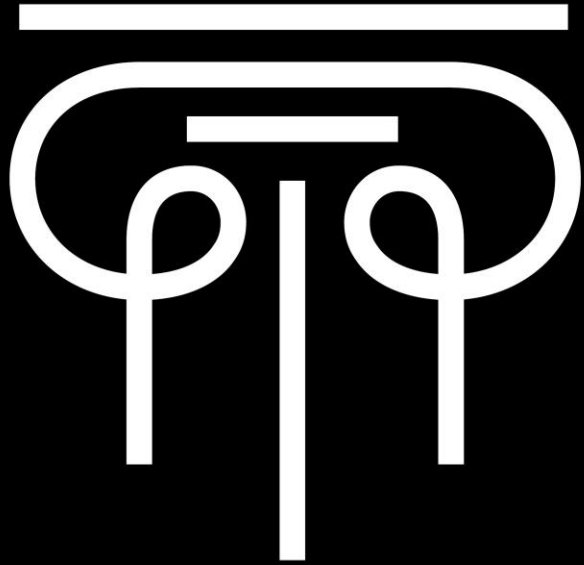
PHILOSOPHY

Firmly held views... yet simultaneously open-minded

As time goes by, as we change, as the world changes, targets alter and the viewpoints shift. For a point of view to be of any use at all, one must commit oneself totally to it, one must defend it to the very death. Yet, at the same time, there is an inner voice that murmurs: **Hold on tightly, let go lightly.**

– Peter Brook





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