# Media Coverage

## Fortifying your investments with alternatives

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Alternative investments ("alternatives"), once the exclusive domain of institutional investors, are increasingly gaining traction among more sophisticated high net worth investors.

Eager to chase returns uncorrelated to the market, these sophisticated investors are starting to turn to alternatives to diversify risk, to protect against inflation, generate income and cushion rising interest rates.

According to a 2014 McKinsey report, investors have been tilting money in recent years into alternatives with global assets hitting an all-time high of US$7.2 trillion in 2013.

The report also added that global alternatives under management is also growing at an annualised pace of 10.7%, twice the growth rate of traditional investments, the report added.

However, alternatives which broadly comprise hedge funds, private equity and real estate-related investments are not without risks.

They are highly speculative long term investments which are less transparent, less liquid and less regulated and with less frequent pricing and reporting. They are therefore more suited for sophisticated and experienced high net worth investors willing to bear the risks including loss of the entire investment.

Hedge funds

Hedge funds – unlike mutual funds which focus mostly on stocks and bonds – invest in a wider and more diversified pool of asset classes and financial instruments such as currencies, commodities and derivatives.

They also adopt less conventional strategies not normally available to mutual funds such as leveraging with borrowed money.

As its name implies, hedge funds are useful as a defensive investment because they aim to hedge against downside risks and generate consistent returns regardless of market conditions.

For example, as they are not constrained by an index, hedge funds are in a better position to take advantage of market dislocations such as uncertain interest rate environment in the markets that they trade.

This helps to shield investors from downside volatility, diversify risks, preserve capital and potentially increase upside returns.

From an investor's point of view, one of the most distinguishing features of hedge funds is being able to access strategies and markets that may be outside of the range that the investor may have access to. For example, they can 'short sell' assets and mitigate losses when markets fall by borrowing and selling overvalued stocks, then buying them back later when prices drop.

Conversely, they can take a 'long' position when the market rises by purchasing undervalued stocks which are likely to increase in value later.

They can apply unique techniques such as merger arbitrage by buying the securities of the company for sale and simultaneously selling those of the acquirer during mergers and acquisitions.

Hedge funds can also provide access to distressed securities, usually deeply discounted, during company bankruptcy.

As prospective returns from equities and bonds decline and volatility remains elevated, we are overweight in hedge funds in portfolio allocation, in particular, multi-strategy hedge funds as they have the ability to switch between different investment strategies using the same pool of capital.

They respond to market movements by allowing portfolio managers to shift risk and allocate capital away from less attractive strategies to those that offer superior opportunities.

Investors should be aware that hedge funds do not have the liquidity of mutual funds as they typically allow redemptions only on a monthly or quarterly basis. They are also less transparent than traditional funds in the strategy and positions they take, and pose leverage risk which may result in loss of investment.

Private equity

Private equity, regarded as a type of alternative asset class, is capital invested in companies that are, in most cases, not publicly listed on a stock exchange.

Typically, private equity firms will raise working capital for the company for various reasons such as restructuring, expansion or business re-engineering.

Ultra high net worth and institutional investors will be invited to put their money into a fund set up and managed by the private equity firm.

Private equity investments are generally illiquid and require long holding periods of eight to ten years or more.

This is because the private equity firm will invest in the company over the first half of the term, and then aim to sell or exit the company for a profit over the second half.

This horizon enables the portfolio manager to time his entry and exit, and not be subject to the market gyrations faced by listed companies.

In return, investors can be rewarded by the illiquidity premium.

Investors will receive the return of capital plus a capital gain when the private equity firm exits the portfolio company. In some cases, a current yield may also be paid along the way.

We focus on private equity with exposure to emerging markets and energy sectors for reasons of falling entry prices and strong historical performance respectively.

Real estate-related investments

Investors are most familiar with real estate, be it acquiring a piece of residential property or accessing it through listed products such as real estate investment trusts (REITs).

With soaring property values and huge demand, fund managers can provide investment access to real estate deals sourced from around the world that typically are the preserve of institutional investors.

For instance, there is rising interest from fund managers in commercial buildings with high calibre tenants that offer the potential to deliver competitive returns from different geographies and markets. This can increase diversification and returns to the wider portfolio.

Also, since the 2008 financial crisis, as traditional bank lending has contracted, there has been a shift towards specialty financiers providing debt and loan facilities to industries such as real estate that are looking for fresh capital.

This may give investors a slightly diversified form of high yield income – through funds participating in these restructured real estate debt – rather than simple capital gains from bricks and mortar.

Because of improving economic cycle and financing conditions in the Eurozone, we are positive about the real estate-related investments in that market.

Conclusion

The alternatives market is beginning to compete with traditional asset classes for funds, at a time when investors are growing in sophistication and seeking ways to increase the resilience of their portfolios and fortify against market swings.

With their growing popularity, it is not surprising that the McKinsey report projected that alternatives could comprise 15% of global industry assets and produce up to 40% of industry revenues by 2020.

That said, only experienced high net worth investors with the appropriate risk appetite and financial sophistication casting sights at longer term liquidity and investment horizon should consider alternatives, but not without first considering their personal circumstances, consulting their professional advisors and understanding the product features and risks.