

## What is an Alternative Investment?

Alternative investments (commonly known as “alts”) are a diverse category of financial assets that fall outside of what most people consider the traditional, typically more liquid classes of investing: stocks and bonds.

### Types of Alternative Investments

The universe of alts is broad, encompassing various assets and strategies. Common examples include:

- **Hedge Funds:** Investments in actively managed funds that employ diverse investment strategies (including use of leverage, short selling, derivatives) to generate returns.
- **Private Credit / Debt:** Investments in non-bank, non-publicly traded loans extended directly to companies or borrowers outside of traditional lending channels, potentially offering higher yields and flexible terms.
- **Private Equity & Venture Capital:** Investments in privately held companies. Private equity typically invests in mature companies looking for scale or growth, while venture capital invests in early-stage, high-growth companies.
- **Real Assets and Commodities:** Investments in physical assets or raw materials. Common investments include:
  - **Real Estate:** Investments in land holdings such as residential, commercial, industrial, hospitality, healthcare, logistics, and retail buildings.
  - **Infrastructure:** Investments in essential physical assets such as ports, toll roads, energy generation or transmission, and telecommunications assets.
  - **Commodities:** Investments in trusts which hold physical assets or futures contracts in metals (precious and industrial), energy and agriculture.
- **Collectibles:** Investments in tangible assets that are chosen for their rarity or appreciation such as art, wine, and antiques.
- **Cryptocurrencies:** Investments in digital currencies known for their use of blockchain technology.

### Key Distinctions and Risks

Alternative investments often bring risks or distinctions that set them apart from traditional stocks and bonds, including:

- Private Nature: Many alts are privately negotiated and subject to individualized contracts and circumstances.
- Limited regulatory disclosure: Alts are often less regulated than publicly traded securities, necessitating more careful due diligence.
- Higher minimums and accreditation requirements: Alternative transactions can be administratively complex and subject to minimum investment amounts or accreditation requirements, limiting public investor access.
- Less frequent valuation: Without active public trading, many of these assets are not as easily valued and monitored. Infrequent valuation may contribute to lower perceived short-term volatility, but this can change significantly at the next valuation date.
- Liquidity risk: Many alts, including private equity and venture funds, cannot be readily traded and require long commitments (potentially 10+ years), before the investments are closed out.
- Fees: Alts, especially those in fund structures, may have higher fees including management fees (for managing the investment) and incentive fees (tied to performance).
- Tax reporting complications: Most alts generate K-1 tax reports (as opposed to 1099s), often preventing a full tax filing by April 15<sup>th</sup>, and potentially driving accounting costs higher.
- Leverage: In efforts to enhance or protect returns, many alts use leverage (borrowed money), but this can also amplify losses.

### **Benefits of Low Correlation**

A primary benefit of many alternative investments is their historically low correlation with traditional asset classes like stocks and bonds. This can benefit an investment portfolio by increasing its overall diversification across asset classes and strategies. When stocks decline, some alts may remain stable or appreciate, buffering portfolio losses. Some alternatives (e.g., distressed debt and arbitrage strategies) seek to exploit inefficiencies not available in public markets, while other alternatives such as real estate and commodities can act as a hedge during inflationary periods. Generally, alts are added to a portfolio to help reduce overall risk by spreading investments across different asset classes and strategies and offering enhanced return potential.

### **Are Alternatives Right for You?**

Alternative investments can be a valuable tool for diversifying portfolios and enhancing risk-adjusted returns, but they are not for everyone. The appropriate allocation will vary by investor and circumstances. Alts are often favored by high-net-worth individuals and institutional investors. Some endowment models which emphasize diversification advocate for a 20-50% allocation to alts, depending on unique constraints and objectives.

The decision to include alternative investments in a portfolio is often guided by key factors, including:

- 1) Investor objectives: Alts can be tailored to specific investment goals such as generating income, preserving capital, or maximizing growth. Alts can also provide access to unique opportunities and markets.
- 2) Time horizon: Most alts are illiquid and cannot be easily sold or converted to cash quickly. Therefore, alts are often suited for investors with a long-time horizon (often 10+ years).
- 3) Risk tolerance: Alts can offer higher return potential, but this may come with increased risk, volatility and lower liquidity.

Alts offer attractive benefits, but their complexities mean they are not suitable for all investors. Careful consideration of individual financial objectives, time horizon, risk tolerance, and consultation with a qualified financial advisor is essential before making decisions about whether and where to invest.

Have questions? We would love to talk with you about alternative investments and determine if there is a place for them in your portfolio.

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