

June 30, 2021

# Alternative Investments



- **What are alternative investments, and are they right for you?**
- **In recent years, there has been an increase in accessibility to certain high net worth individuals**
- **Alternative investments can reduce market volatility and potentially generate higher returns during periods of low yields**
- **Alternative investments can be helpful for portfolio diversification and can aid in overall risk reduction**
- **Alternative assets require in-depth knowledge of sophisticated asset classes, which requires research and quantitative analysis**

## Following a volatile 2020 in stock and bond markets, interest in alternative investments continues to climb. But what are alternative investments, and are they right for you?

An alternative investment is a financial asset that does not fall into one of the conventional categories – stocks, bonds, or cash. Alternative investments can include hedge funds, private equity or venture capital, real estate, art & antiques, managed futures, and commodities. Most alternative investments are fairly illiquid, especially when compared to their conventional counterparts. Historically speaking, alternative investment solutions had only been available to pension funds, endowments, and ultra-high net worth individuals. This is due in part to the higher relative risk of these investments, as well as complexity and lack of regulation. In more recent times, we have seen an increase in accessibility to high net worth individuals falling into one of these two groups: accredited investors and qualified purchasers.



To be an accredited investor, an individual must have income exceeding \$200,000 (\$300,000 for joint filers) for the last 2 years with the expectation of earning the same or higher in the current year, or have a net worth exceeding \$1mm. To be a qualified purchaser, an individual must have \$5mm in investments (not including their primary residence).

One explanation for the increasing popularity of alternative investments is they offer the potential to both reduce market volatility and generate higher returns during periods of low yields. This is possible because alternative investments often move counter to the stock and bond markets. Additionally, many companies are choosing to remain private for longer periods of time, or even indefinitely, in order to maintain autonomy over their businesses. From a conventional standpoint, this leaves them inaccessible from an investment perspective; however, this seemingly closed door can be accessed through alternative (private) investments.

Alternative investments are also helpful for portfolio diversification. When paired with conventional investments, they can help aid overall risk reduction, given that alternative investments often react differently to market events than conventional investments. For instance, while fiat currency and purchasing power are prone to inflation, alternative investments in the form of hard assets like gold, oil, and real property are more defensive against inflation. Diversification of investments can both minimize risk and guide individuals in achieving long-range financial goals.

When deciding if an alternative investment is right for you, there are some factors to consider beyond the qualifying characteristics. First, alternative investments often require high minimum investments, and they can be illiquid relative to other investments. Typically, these investments are not required to register with the Securities and Exchange Commission, which oversees the United States' securities industry, including broker-dealers, investment advisers, mutual funds, and exchange-traded funds (ETFs), among other things. This lack of regulation brings additional risk relative to conventional investments. Since they are more difficult to regulate, alternative investments are more prone to investment fraud, and there is less verifiable performance data available to protect investors.

At HCR, we understand that alternative assets require in-depth knowledge of sophisticated asset classes. Our experienced investment committee helps minimize some of the risks that are inherent with alternative investments by conducting research and quantitative analysis of alternative investments options. Every alternative investment that we make available to our clients undergoes a multi-step review process. The team conducts independent due diligence, establishing preliminary interest, reviewing returns, fund processes, risk management policies, and compliance procedures.

Once an investment passes through our due diligence process, our work does not stop there. We monitor the investments and stay in contact with fund managers to help our clients stay aligned with changing market conditions by drilling down on market positioning, continued competitive advantages, and working to maximize results for our clients' evolving alternative asset portfolios.



Alternative investments, while they can bring more risk individually, allow for access to opportunities with high potential returns that are unavailable in the public markets, as well as chances to further diversify a portfolio. As the number of publicly traded companies has decreased significantly in the past couple of decades, the number of private firms has increased, providing more chances for those who are able to seek investments with these firms. It is important to consider the potential for risk and reward when choosing whether to pursue an alternative investment. HCR is prepared to help you navigate these factors when choosing which investments are right for you.