Accessible Alternatives™

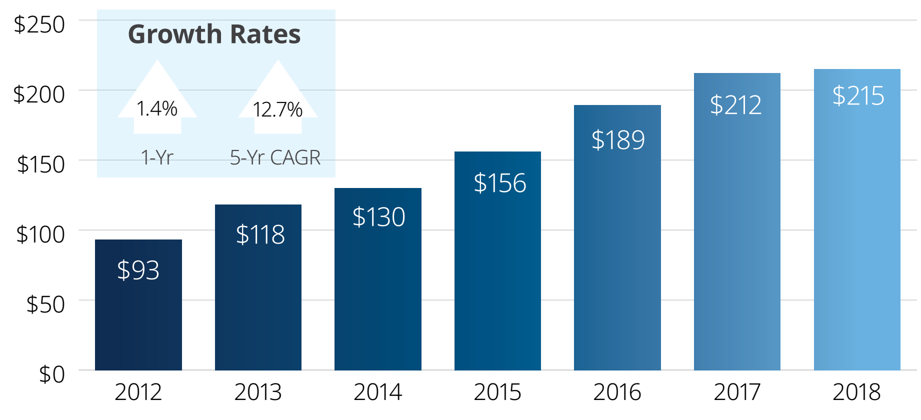
The opportunity with alternatives

Bringing you true diversification and increased stability

Alternative investments offer investors different kinds of assets and strategies to enhance their portfolios beyond traditional stocks, bonds and cash. Alternatives can be used in various ways: to try and generate higher returns, to reduce volatility, and/or to preserve capital over the long term.

To some investors, alternative investments are relatively new, but many Canadians are already exposed to these assets. For example, participants in the Canada Pension Plan are indirectly invested in alternatives because the CPP holds over 50% of its net investible assets in alternatives[1]. In fact, Canadian-managed alternative assets more than doubled from $93 billion in 2012 to $215 billion by December 2018.

Alternative assets managed in Canada ($ billions)



Source: Investor Economics, Managed Money Advisory Service as of December 2018.
This data accounts for all alternative strategies which include hedge funds, real estate, private equity and infrastructure.

[1]Canada Pension Plan Investment Board (CPPIB), Annual Report, 2016

Key takeaways

- Alternative investments can be designed to help lessen the negative impact of market volatility, enhance a portfolio's diversification and improve returns in a portfolio.
- More investors now have access to alternative investments, particularly those investors who work with professional financial advisors.
- A liquid alternative mutual fund is an efficient way to invest in a diversified range of alternative assets and strategies.

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Understanding alternative investing

Alternative investments are made up of both assets and strategies. Alternative assets may include commodities, infrastructure projects, vacant land and developed real estate. The values of these assets are generally less correlated (or not correlated at all) with the movements of traditional financial markets.

Examples of alternative assets:

1. **Commodities**
   Crude oil, gold bullion, livestock and agricultural products
2. **Infastructure**
   Airports, toll roads, small hydro-electric facilities
3. **Land**
   Agriculture and timber
4. **Real estate**
   Commercial buildings, condominium rental units

Alternative strategies use non-conventional methods to manage investment vehicles that may hold both traditional and alternative assets (specifically, the use of leverage and the ability to invest short as well as long).

Examples of alternative strategies:

1. **Long/short equity and Long/short credit**
   These strategies seek to profit from gains in the credit conditions of individual bond issuers and credit market segments, as well as from short positions where credit conditions are deteriorating.
2. **Market neutral**
   Market neutral strategies attempt to reduce or eliminate the systematic risk from overall market movements-- the "beta"-- on portfolios, leaving only the stock selection "alpha".
3. **Managed futures**
   Managed futures strategies trade a wide variety of liquid global futures, options, swaps and foreign exchange contracts, and aim to capitalize on price trends in either direction.
4. **Volatility**
   Volatility strategies trade volatility as an asset class. Volatility arbitrage seeks to profit from the implied volatility discrepancies between related securities.
5. **Macro**
   Macro strategies are predicated on movements in underlying economic variables and the impact these have on equity, fixed income, hard currency and commodity markets.

Advantages of liquid alternatives

Since the 2008-09 market downturn, many investors tried to limit risk by using investments that move less in sync with stock markets. The investment industry responded by developing more alternative products for investors. New mutual funds give investors access to alternatives without giving up liquidity, or the ability to buy or sell the fund quickly. These are called "liquid alternatives".

Liquid alternative funds give investors efficient access to diversified alternative investments, and offers advantages to investors:

- Easier to gain access to the alternative space and cash in investments
- Lower management fees and typically no performance fees
- Better transparency and reporting

"When markets are volatile, alternative investments tend to outperform more traditional vehicles."

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Investments

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The liquid alternatives difference

Alternative Mutual Funds - a category created in Canada in 2019 - contains mutual funds that are now permitted to avail themselves (in a regulated manner) of two new tools: shorting and leverage. It's these tools that enable portfolio managers to "shape" the pattern of returns so that they can be different from traditional assets, hence diversifying for investors.

> **"Liquid alternative funds are a viable solution to enhance diversification and potentially improve a portfolio's risk-adjusted return."**

Leverage

Leverage involves borrowing funds to invest and is common with alternative investments. The payoff from leveraging can be more significant than traditional investments, but downside risk is also amplified. The extent of leverage is limited by regulation in Canadian alternative mutual funds, and is often applied to boost returns on low volatility assets such as investment grade bonds.

Use of shorts

An investor will short a security when they believe that the price of the security will fall. Shorting involves borrowing a security and selling it in the open market. The investor repays the loan of the security by purchasing the security at a later time.

If the price of the security falls during that time, the investor earns a return; however, if the price has increased, the investor loses money and paying back the loan will now be more expensive. There is a limit to how much the investor can profit because the price of the security cannot fall any further than zero. On the other hand, the value of the security can continue to rise, meaning the investor can take on more losses. To address this risk, short portfolios are usually much more diversified than long portfolios.

Mitigate risks with derivatives

Derivatives are investment strategies that enable an investor to swap, buy or sell a security in the future at a price that is set today. They are classified broadly as options, forwards, futures or swaps, and are frequently used as part of alternative strategies. Derivatives allow managers to obtain a notional exposure to an asset class without having to allocate an equivalent amount of physical capital.

Summary: opportunities in the alternatives space

Growing interest in alternative investments is creating opportunities for retail investors. Liquid alternative funds are a viable solution to enhance diversification and potentially improve a portfolio's risk-adjusted return by providing more potential sources of return and increasing a portfolio's stability so investors are better positioned to reach their long-term goals.

**Explore whether alternative investments are an appropriate choice for you.
Speak to your financial advisor today.**

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