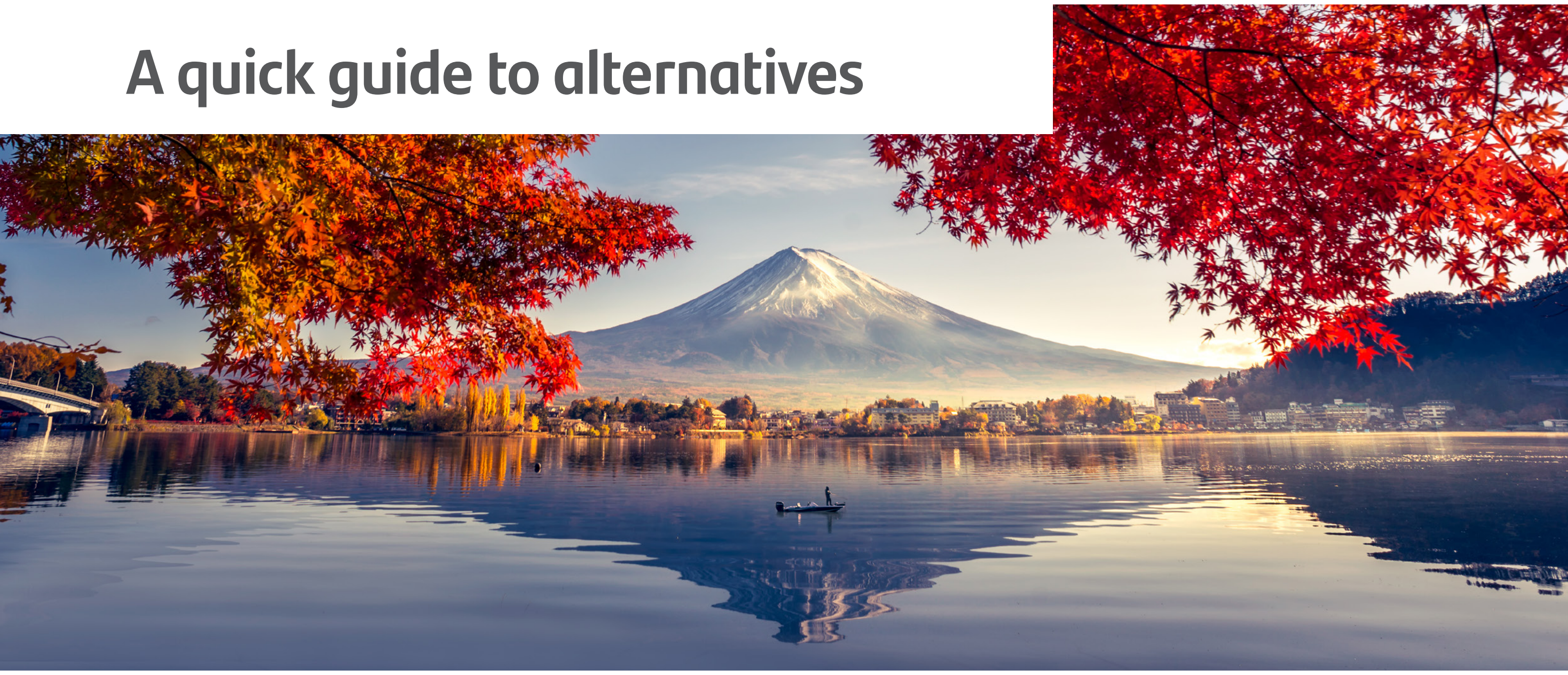
A quick guide to alternatives



If you are not already familiar with alternative investments it's worth being aware of them as they can play an important role in helping to create a balanced, diverse portfolio.

What counts as an alternative investment can depend on who you speak to, but very broadly any investment that falls outside of the core asset classes of Shares, Bonds and Cash might be considered one.

The main advantage of alternatives is that they tend to behave differently to those core asset classes. This is known as having a low (or even no) correlation and that can help to both manage investment risk and generate returns within a portfolio.

Professionals rule in the alternatives' world

Alternatives can potentially expose you to higher or more complex types of risk than Shares, Bonds or Cash, and you need to understand these to use them effectively. That's one of the reasons they tend to be more popular with institutional investors – those professionals who invest our money on our behalf through pension and investment funds.

Why leave it to the professionals?

Some other reasons alternatives tend to be more popular with institutional investors include:

- There can be very high minimum investment amounts.
- There can be relatively high fees.
- They can be more difficult to sell.
- With some types of alternative you may have to leave your money invested for long periods (5-10 years) without seeing any returns at all.

According to one global study, institutional investors held $10.3tn of alternative investments in 2019 with predicted growth to $14tn in 2023.[1] This means there's a good chance you may already be invested in them to some degree, for example through a workplace pension or a Multi-Asset fund you use that covers more than Shares, Bonds and Cash.

Some popular types of alternative

Some of the more popular types of alternatives used by institutional investors include:

Commercial Property	Investing either directly or indirectly (through a company or fund) in buildings such as hotels, offices or shopping centres.
Infrastructure	Investment in projects to deliver the systems and services which keep society functioning, from roads, water and wi-fi to schools and clean energy.
Venture Capital	Investment in either newer companies with the potential for substantial growth or those targeting rapid growth in an innovative area.
Private Equity	Investment in companies which are not publicly traded on an exchange.
Hedge Funds	Investment in funds aimed at achieving positive returns no matter what is happening in the markets. In other words, designed to 'hedge' against market changes.

A route to sustainable investment?

Sustainable investment involves making decisions based on environmental, social and governance factors, with the aim that your investment helps to do good in the world as well as delivering returns for you. It's a growing movement in the wake of issues which have challenged many of us in recent times, from reports of plastic suffocating the oceans to increases in social inequality.

Alternatives can form part of a sustainable investment strategy if that is something that is important to you, with Infrastructure investment an obvious example that can be a force for social good. Partly driven by customer demand and public policy, sustainable investment is becoming more important to institutional investors too.

One recent global survey found that 29% either already invest in socially responsible alternatives products or plan to do so.[2] Another found 85% of institutional investors agreeing in 2019 that sustainable investment is important to some degree, up from 68% in 2018.[3]

Learn more

You can learn more about sustainable investment in our introductory guide, **Sustainable Investment and You**.

An alternative history of investing

1949: Alfred Winslow Jones establishes the first hedge fund.[4]

1950s/60s: Modern Portfolio Theory sets out the idea that how different investments work together in a portfolio – how they are correlated - is the most important predictor of returns.

1980s/90s: Alternative investments begin to rise in popularity with institutional investors as a means to diversify and so manage risk in their portfolios.[5]

1990: The Alternative Investment Management Association (AIMA) is founded. Today it has 2,000 member firms around the world which are responsible for $2tn of investments.[6]

2007/8: Steep stock market falls during the Global Financial Crisis highlight the importance of low correlation between assets in a portfolio to help manage the risk of capital loss.

2020: Alternatives are once again in the spotlight as investors consider strategies for managing the economic impact of the COVID-19 pandemic on their portfolios.

Finding the alternatives route for you

If you are interested in the idea of investing in alternatives, there are specialist funds that you can invest in directly. But some of the potential risks and challenges we have already touched on mean these are not suitable for everyone.

Looking for a Multi-Asset Fund or Model Portfolio Service that includes some exposure to alternatives is another option you can consider. This way you can benefit from the expertise of a professional manager with the skills and experience to use alternatives effectively and in an appropriately risk managed way.

Either way it's important to make sure any investment you are considering is right for you. If you are not sure what to do or are looking for some support, a financial adviser can help you navigate the complexities and find the right alternatives route for you.

Find out more

Stay up-to-date with our latest **Markets and Insights** on our website.

[1] FT.com – Retail investors open to alternatives in the hunt for higher yields, 30/7/20
[2] EY – 2018 Global Alternative Fund Survey, 19/11/19
[3] Aon – 2019 Global Perspectives on Responsible Investing
[4] Medium.com – Alfred Winslow Jones: The Father of the Hedge Fund Industry, 3/10/18
[5] CF Institute Research Foundation – Alternative Investments: A Primer for Investment Professionals, 10/5/19
[6] AIMA – AIMA's Global Review of 2019, 18/12/19

Let’s be clear!

Investment terms explained

Absolute return funds: Investment funds which aim to achieve a positive investment return regardless of market conditions. They typically use either Shares or Bonds as their asset class and apply complex investment strategies.

Alternatives: Any investment other than Shares and Bonds, such as Property and Absolute Return funds.

Asset class: A group of investments with similar traits. Shares, Bonds, Property, Cash and alternatives are all examples of asset classes.

Bonds: A Bond is a loan issued by a government or a company. When you buy a Bond, the issuer promises to pay a certain amount of income until the Bond redeems and is repaid by the issuer. The strength of that promise varies by the issuer of the Bond. This is known as creditworthiness.

Diversification: Spreading your money across different investments to help manage risk.

Property: Property may be difficult to sell and can demonstrate significant declines in value due to changes in economic conditions and interest rates.

Portfolio: a group of investments that are managed together to meet a particular objective.

Shares (often referred to as Equities or Stocks): In investing, this is a share of ownership in a company. Investing in a fund gives exposure to underlying share prices without investors actually owning the Shares themselves.