



Alternatives - The Good, the Bad, and the Ugly

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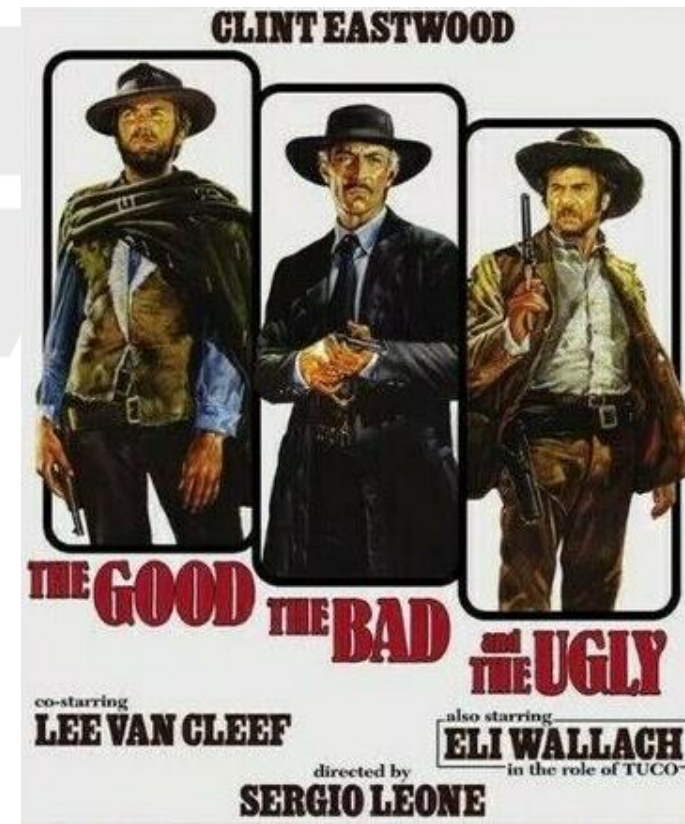


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Let's narrow the discussion

- I'm restricting myself to RETAIL
- You're retail if . . .
- \$1 million account minimum . . . or less
- Your end-client has investable assets of \leq \$30 million
- Your products are distributed through
 - RIAs
 - BDs
 - Trust departments
 - Insurance companies

- Mutual funds (daily access)
- Closed end funds
- Business development companies (BDCs)
- Structured notes
- Private non-traded REITs
- Low minimum limited partnerships
- Feeder funds
- Interval funds

The Good, the Bad, and the Ugly

The Ugly

- Grew too far too fast
- Misunderstanding of why they exist
- Execution failure - common and easy
- Liquidity
- Knockout

Growth - Why so much, so fast ?

- Demand
- Supply
- Facilitators

- Generally . . . no significant change
- More recently . . . Concern over extent to which interest rates have gone negative

- Huge increase in supply
- Mutual fund companies losing
 - Business to ETFs
 - Margins to fee competition
- Institutional investment managers
 - Disappearance of defined benefit pension plans
 - Di minimis growth across foundations/endowments

- Creation of powerful new intermediaries
- Feeder funds
- Alts TAMPS
 - “Aims to Democratize Alternative Investments”
 - iCapital, Artivest, CAIS, iFunds, Conway, Harbor, Alto
- Repackagers
 - FS Investments
 - Invesco (Caryle)

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- They said . . .
- “Because they are uncorrelated”
- “Because they make money in up-markets and in down-markets”

What's wrong with this ?

- Unfortunately, the real answer is . . .
 - They support higher profit margins for the manufactures
 - They support higher sales commissions for the distributors
 - Not or only partially marked-to-market
 - Offer awesome storytelling

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 - Higher return
 - Lower risk
 - Superior diversification

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- **30% of the work to avoid failure**
 - Find an alt that will actually work
 - Fire and replace it . . . before the meal is gone
 - Backoffice processing and regulatory burden
- **70% of the work to avoid failure**
 - Adviser management
 - Client management

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Fails 95% of the time

- Starts and ends with a good sales story
- Rarely adequately ask/answer *“Why will it work?”*

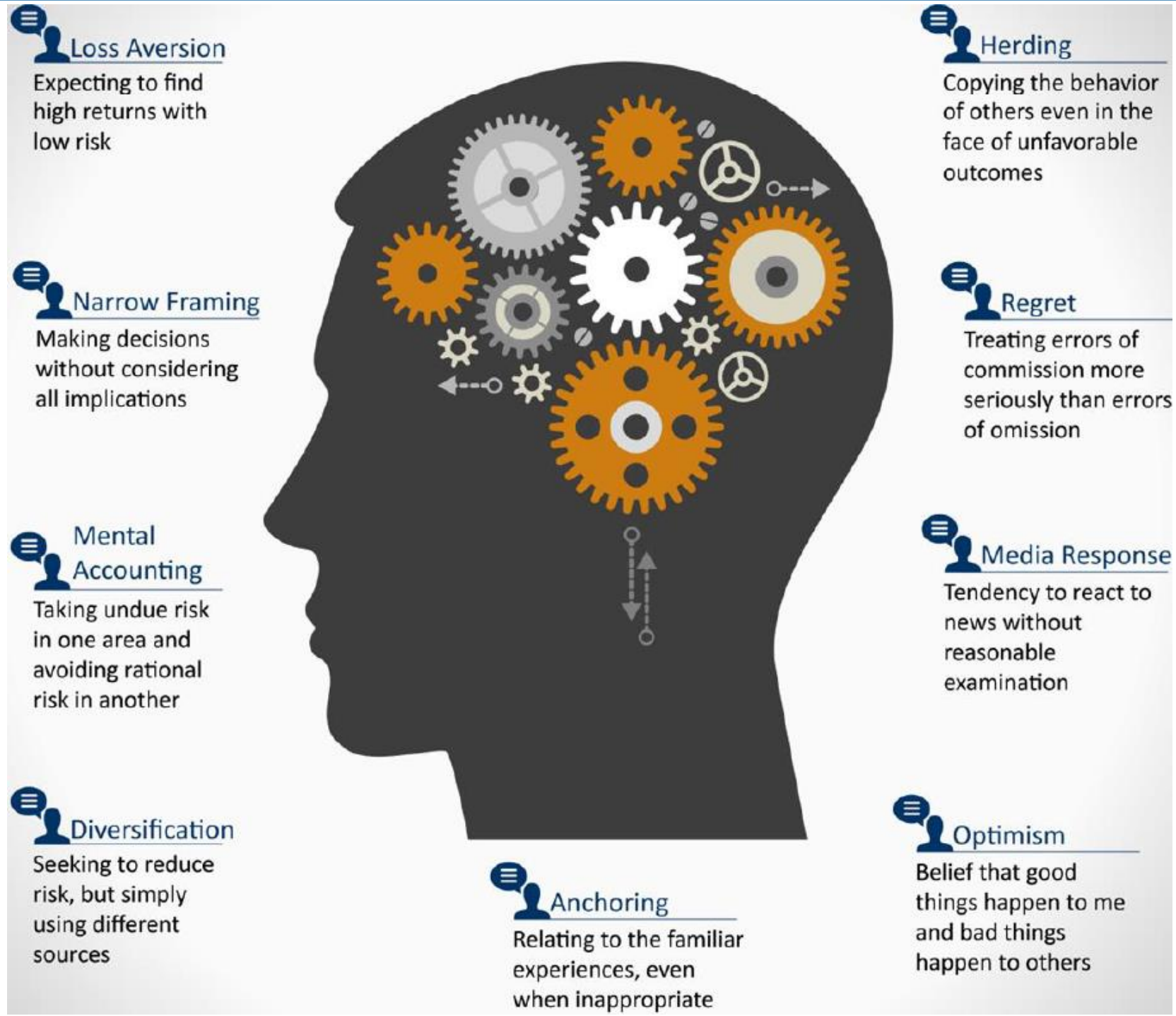
Trend chasing

Believe one can invest in the past

Recency

Recent success decides future decisions

Investing behavioral biases - Nine most common



- Also called confirmation bias
- Seeks information confirming current view while avoiding or rejecting conflicting views
- Buy crypto and only interact with supportive information sources and individuals
- Hear only things which confirm what our existing perception
- Makes decisions without considering all of the information and all of the implications

- Moving along with the herd/crowd
- Decisions are encouraged by the herd rather than being based on metrics
- Bernie Madoff, Enron, WorldCom, Meme stocks, SPACs, Crypto
- Herd behavior can create massive bubbles that eventually burst because prices are not justified by the asset but the investors' behavior
- You go with the group because you think the majority cannot be wrong or standing with the majority is a comfortable position

- Also called overconfidence
- Believe that they have more knowledge on a certain topic than they actually have
- Two types of overconfidence
 - Quality of information
 - Ability to act on this information for maximum gain
- Misinterpret beginner's luck . . . and consequently overestimate their skill
- Overconfident people often stop (or slow) learning . . . which undermines future performance . . . investors need to be humble, realizing they need to continuously learn about the markets whatever their experience level

Success requires set & maintain expectations for

- Liquidity, Tracking, Lockup Period, Measurements of success
- Patience (time to plant, sprout, grow, mature, and harvest)

- **70% of the work to avoid failure**

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Primarily a problem with daily-access product

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- When you're forced out of an attractive investment position
- One that you would benefit from . . . if you just had the ability to stick with it . . . through the current drama

- Causes of knockout
- Lenders supporting the position pull their money
- Investors in the product pull their money
- You pull your money because
 - Lack the required patience
 - Misunderstood
 - How to measure success
 - Tracking
 - Transitory nature of liquidity-driven pricing shocks

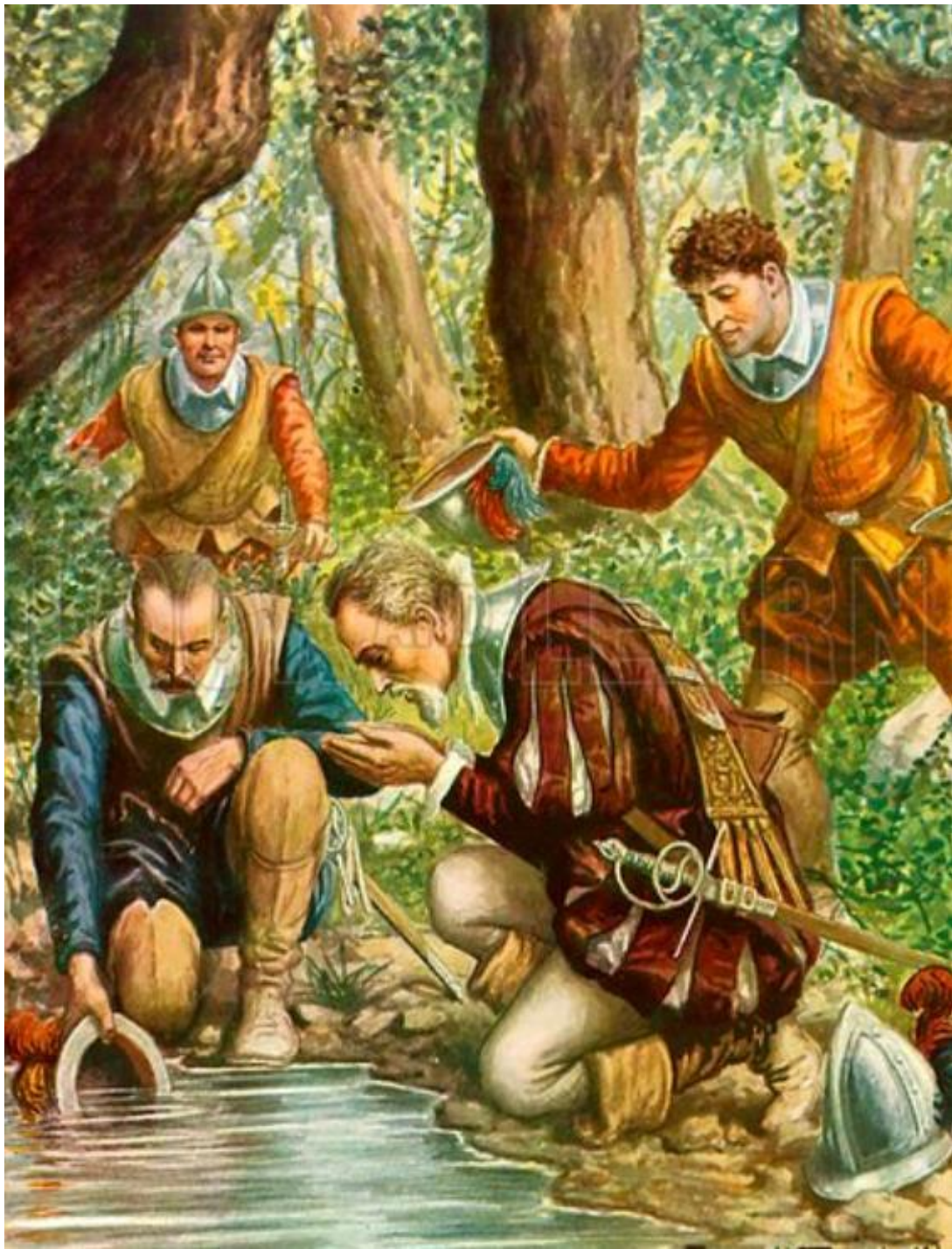
The Good, the Bad, and the Ugly

The Bad

- A lot of bad product out there
- Liquid alternatives
- False over-priced betas
- A different type of execution failure

- This is the worst product development cycle in modern history
- Due to the sheer volume of
 - Mis-sold
 - Overpriced product
 - That won't work

Ponce de León searched for the fabled Fountain of Youth





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PERSPECTIVES

The Myth of the Absolute-Return Investor

M. Barton Waring and Laurence B. Siegel

In meetings with clients and colleagues in the past few years, we have noticed that many otherwise hardheaded and clear-eyed investors are excited about “absolute return” investing. The notion is spreading like wildfire. Many institutional investors have already added, or are planning to add, an absolute-return “asset class” to their policy mix. At a time when pension funds, foundations, and endowments are under

both sensible and true to the sense of the term eluded us. That experience further piqued our interest in the idea.

So, let us explore the term a bit. It is widely used, and because words are chosen to a purpose, one can find some of that purpose by observing the context in which a term is used.

One important bit of context is that the word pair “absolute return” has been used most by those

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Why do Facilitators exist ?

- Pick the investments
- Complete the paperwork
- Deliver lower account minimums
- Perform due diligence . . . so as to fend off
 - Regulators
 - Litigators
- While still allowing the adviser to feel in control

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- **And they perform each of these functions**
 - **Do them well**
 - **Provided at a competitive and reasonable price**
 - **An attractive business model, one that will thrive**

But will the clients benefit ?

- Have clients benefited from the advent of TAMPS in the traditional long-only space
- NO
- So, why would you expect clients to benefit in the even more difficult alternatives space?

- Let me back up
- Answer the question “Why do alternatives work?”
- It staggers me how rare it is for advisers to adequately ask and answer
 - “Why does it exist?”
 - “Why will it work?”

The Good, the Bad, and the Ugly

The Good

Alternate betas

- Permanent, perpetual, durable risk factors that are non-diversifiable
- That are not captured (harvested) elsewhere
- These are NOT . . .

Stocks

Bonds

Commodities

Currencies

- We can't just recombine these . . . and magically create a new risk factor

- Physical reinsurance
- Financial market reinsurance
- Illiquidity premium
- Litigation claims
- Permanent, perpetual information advantage, one that continually renews itself

- All alternate betas become
 - Over-priced
 - Under-priced
 - Polluted . . . by bad product design and introduction
- Consider the current cycle with . . . private credit funds . . . “ugly and typical”

Alternate alphas

- Exist
 - Rare
 - Temporary
 - Transitory
 - Self-extinguishing
-
- The simple act of harvesting the alpha opportunity serves to eliminate the opportunity

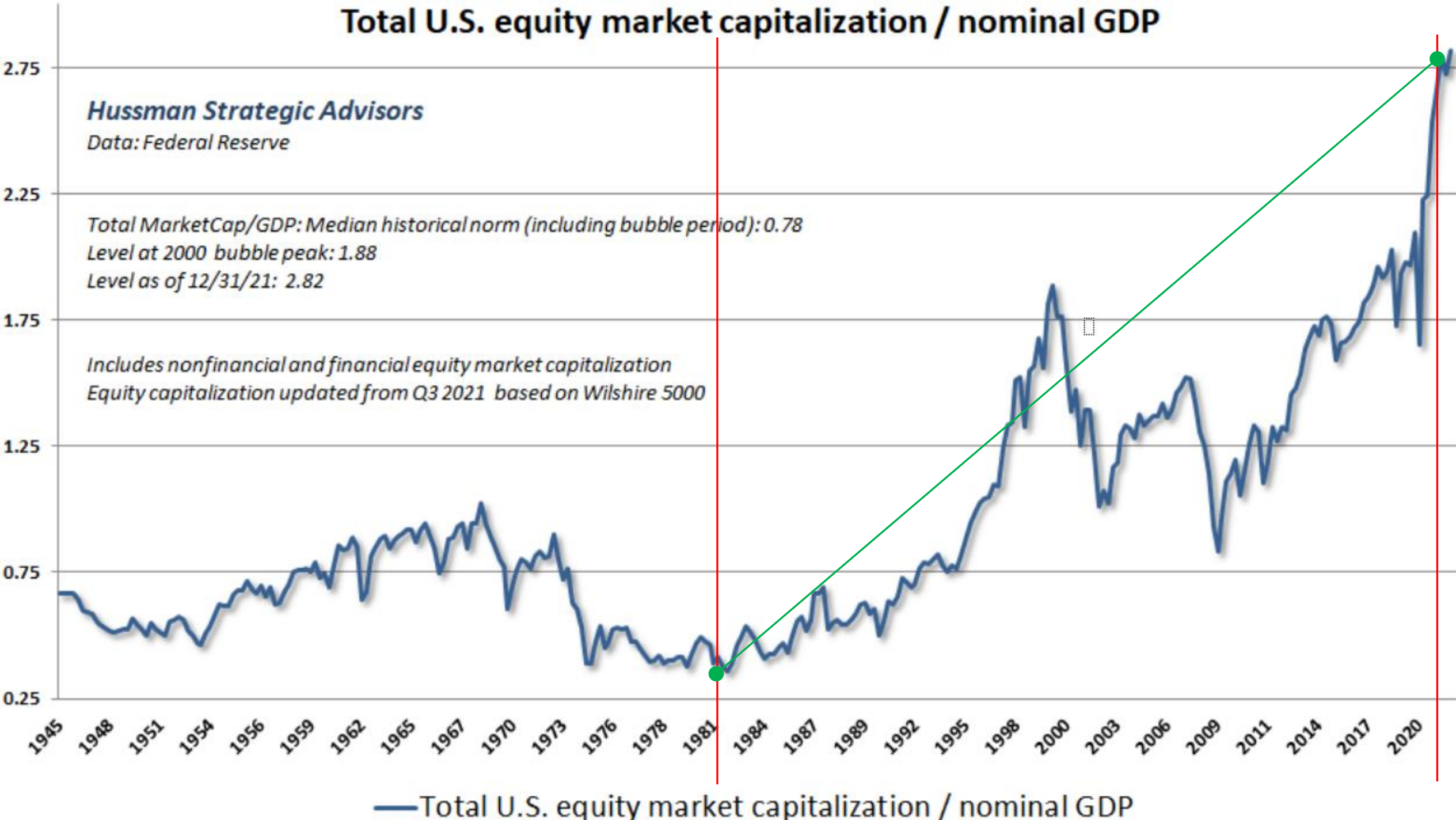
- If your objective is to catch fish . . .
- Fish in the right place
 - Large number of fish
 - Big fish
- Avoid competitors
 - Less to go around when faced with too many other fishermen
- Use better fishing equipment than your competitors
 - What's your edge . . . and is it sufficient
- Leave, move on . . . to another fishing pond
 - Before the fish are all depleted

So what is an alternative investment

@CharlieBilello	The Negative Bond Yield Matrix													
Country	1-Year	2-Year	3-Year	4-Year	5-Year	6-Year	7-Year	8-Year	9-Year	10-Year	15-Year	20-Year	30-Year	50-Year
Switzerland	-0.71	-1.04	-1.05	-1.05	-1.03	-0.98	-0.92	-0.89	-0.95	-0.87	-0.61	-0.49	-0.31	-0.19
Germany	-0.73	-0.81	-0.84	-0.82	-0.78	-0.75	-0.71	-0.66	-0.63	-0.52	-0.36	-0.22	-0.02	
Netherlands		-0.78	-0.79	-0.78	-0.71	-0.64	-0.59	-0.52	-0.48	-0.40	-0.26	-0.16	-0.01	
Denmark		-0.83	-0.78		-0.73			-0.62		-0.48		-0.26		
Japan	-0.19	-0.21	-0.24	-0.26	-0.27	-0.28	-0.28	-0.26	-0.22	-0.19	0.00	0.15	0.29	
Austria	-0.61	-0.75	-0.69	-0.69	-0.61	-0.56	-0.48	-0.44	-0.38	-0.29	-0.03	0.10	0.34	0.49
Finland		-0.73	-0.72	-0.70	-0.65	-0.60		-0.40		-0.26	-0.05		0.21	
Sweden		-0.62			-0.64		-0.45			-0.22	-0.05	0.23		
France	-0.62	-0.71	-0.75	-0.72	-0.64	-0.57	-0.49	-0.41	-0.33	-0.24	-0.07	0.29	0.62	0.81
Belgium	-0.63	-0.63	-0.73	-0.70	-0.64	-0.56	-0.42	-0.34	-0.30	-0.18	-0.05	0.32		
Slovakia	-0.39				-0.36	-0.63		-0.17	-0.08	-0.13			0.69	1.01
Ireland	-0.56		-0.52	-0.50	-0.43	-0.33	-0.24		-0.09	-0.01	0.36	0.55	0.91	
Slovenia	-0.07	-0.30	-0.51		-0.35		-0.24	-0.17		-0.03		0.70		
Spain	-0.49	-0.50	-0.48	-0.40	-0.26	-0.20	-0.08	-0.02	0.09	0.24	0.66	0.67	1.14	
Portugal	-0.40	-0.54	-0.38	-0.29	-0.23	-0.09	-0.02	0.08	0.19	0.28	0.66	0.84	1.18	
Malta	-0.29		-0.25		-0.25					0.30		0.91		
Cyprus	-0.07		-0.04		0.08		0.28			0.50				
Italy	-0.15	-0.04	0.33	0.57	0.85	0.99	1.11	1.26	1.30	1.54	2.06	2.24	2.59	2.80
Bulgaria	-0.20		0.30		0.18		0.37			0.45				
United States	1.76	1.60	1.56		1.56		1.65			1.76			2.31	

30% of all investment-grade securities now bear sub-zero yields, meaning that investors who acquire the debt and hold it to maturity are guaranteed to make a loss.

Or . . . a second graphic that simply nails the question



So what is an alternative investment

- It's the single most important thing we can do for our clients today
- Interest rates at a 600-year low
- P/E ratios at a 90-year high
- Economy at the tail-end of the longest growth-phase in 300 years

So what is an alternative investment

- It's the single most important thing we can do for our clients today
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- P/E ratios at a 90-year high
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BUT . . . Do you have access?
Will you do the work?
Will you ask:
- *Why does it exist?*
- *Why will it work?*

- Legit?

Investment scams have always been with us



A New York City swindler tries to cheat a man from the country, 1868.

But why?

Three factors must be present for scams/deceptions to continue

Presence of lions - those who

- Actively engage in deception
- Lost their moral compass, forgetting that *“ya can’t just make stuff up”*

Presence of sheep - those who

- Seek the next get-rich-quick scheme
- Base decisions on past returns (real or imagined)

Unwillingness to ask 3 simple questions and demand 3 simple answers

- Why does it exist?
- Why will it work?
- Why are the answers adequate?

- Legit?
- Beta . . . Genuine?

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- Beta . . . Genuine?
- Beta . . . Overpriced?

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- BD or a TAMP . . . if so, the cost and selection process will severely handicap the result

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- Liquidity, understand and provision for trauma-event
- Knockout, avoid
- Expectations, set and maintain

In brief

If you don't have seriously SUPERIOR selection ability . . . just stay away

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**IL
BUONO** **IL
BRUTTO** **IL
CATTIVO**

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IL BUONO IL BRUTTO IL CATTIVO

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A record level of bad product is appearing. This will undermine alternative's reputation . . . and its appropriate application

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Tactical asset allocation during RISING interest rates

Friday

Aug 26th

11:00 a.m. EASTERN

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