Alternative investing goes mainstream

DAVID PETT | February 21, 2014 4:00 PM ET
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Alternative strategies are gaining in popularity because they are important diversifiers from traditional stocks and bonds

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It might be time to take the alternative out of alternative investing strategies considering their tremendous growth over the past few years. Non-traditional investment assets under management now exceed US$6-trilllion globally after growing more than US$600-billion in 2013, and investors are only planning to increase that amount this year.

"Investors' perceptions of each alternative asset class and their satisfaction with the performance of previous portfolio investments remains largely positive," said London-based Preqin Ltd., one of the world's top alternative asset research firms, in its first-half 2014 outlook. "With a large proportion of investors remaining satisfied with their investments in each asset class and perceiving the industry positively, it is likely that many will look to allocate further capital to alternative assets funds in 2014."

Prequin's study examined the investment plans and views of 430 institutional investors around the world, and noted a particular preference for private-equity funds.

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Almost two-thirds (63%) of those polled have a positive perception of the asset class, while 45% of investors believe it offers the best opportunity in 2014.

As such, 36% are expected to commit more capital to private equity in 2014 than they did last year and 53% are expected to keep their capital commitment the same. In addition, 39% of investors plan to increase their portfolio allocation to private equity this year, with only 8% expected to decrease such allocations.

Private-equity flows are expected to favour traditional markets in North America and Europe, while emerging markets have "fallen out of favour," the study said.

John Nicola, chief executive at Nicola Wealth Management Inc. in Vancouver, said alternative strategies are gaining in popularity because they are important diversifiers from traditional stocks and bonds. But this is true mainly among institutional investors, he added, while retail investors have been less quick to follow suit.

"That's largely due to opportunity, but things are improving," he said. "There are more pooled funds and a few new exchange-traded funds now available for investors."

Prequin also found that investors are also relatively bullish on hedge funds, listing it as the second-best opportunity ahead of private real estate and infrastructure.

Hedge funds posted double-digit returns in 2013 for the second year in a row and 21% of hedge-fund investors stated their investments had exceeded expectations, the study said.

Infrastructure and private real estate, however, don't get quite the same love from investors. One-third are expected to commit more capital to infrastructure this year compared to 31% who plan to commit less, and while 18% are expected to commit more capital to real estate, 24% are expected to do just the opposite.

Private real estate investors headquartered in Asia seem set to be very active in the asset class over the next 12 months, with 70% of investors there expected to make new commitments in 2014. By comparison, only a quarter of Europe-based investors and 34% of those surveyed in North America plan to do the same.

For retail investors interested in the alternative space, Mr. Nicola suggests carefully considering potential fees. Generally speaking, he believes the cost of private equity and infrastructure pools are mostly justified because of the expertise and labour involved in picking investments, but the typical 2/20 fee structure for hedge funds seems expensive.

"I'm sure there are many exceptions, but, generally speaking, the hedge fund industry is overpriced," he said.

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