BEYOND THE FRINGE: HOW ALTERNATIVE INVESTMENTS BECAME MAINSTREAM

It wasn’t too long ago that investments in commodities, real estate or a hedge fund were viewed as somewhat exotic. This perception may be about to change, if recent survey results prove predictive.

According to InvestmentNews’ Alternatives in the Mainstream, “Traditionally ‘alternatives’ meant assets and asset classes that had negative or very low correlations to the traditional asset classes of equities, fixed-income securities and cash. In simple terms, when traditional stocks and bonds zigged, alternatives were understood to zag.”¹

Because of some of the shared impact of public trading on both the traditional and alternative marketplaces, the line may be getting fuzzier.

For example, the paper continued, “If an office building is part of a real estate investment trust whose shares are traded publicly does that make it an alternative – or more similar to a traditional equity investment?”

ALT ALLOCATIONS LIKELY TO RISE

Alternatives in the Mainstream noted that average allocations to alternatives could increase from 10% to 14% of a client’s portfolio within three years (by 2020). Such a shift could represent nearly $150 billion in net flows to alternatives among independent advisers alone.

Also citing the positive climate for alternative asset growth, McKinsey & Company pointed out in Thriving in the New Abnormal,² the “global growth in alternatives continues to outstrip that of traditional assets.”¹

OVERCOMING DISCONNECTS

Alternatives in the Mainstream, however, pointed out that individuals have still sunk more than 90% of their money in traditional stocks, bonds and mutual funds.³ This relatively narrow range of choices proved vulnerable

SUMMARY

Independent of investment recommendations, discussions with clients about the role of diversification in retirement strategies may help manage their long-term expectations.

What follows is an exploration of current information about why some broker-dealers, advisers and investors are taking a closer look at the potential role that alternative investments can play in diversifying a retirement portfolio. It is not a recommendation for any investment or strategy.

With education and understanding, advisers who provide a broader picture of the investment universe can help build their client relationships.

This paper explores:

• The changing nature of “what’s an alternative”
• Factors behind rise of alternative allocations
• Retirement challenges may require greater diversification approaches
• Fixing the disconnects in the educational process
• Aspects of a quality custodial relationship that can improve the adviser and client experience with alternatives
Beyond the Fringe: Alts and the Mainstream

The report highlighted some surprising disconnects between investors and advisers on the subject of alternative investments:

- 83% of clients are interested in alternatives
- Yet 67% of advisers say that clients’ “lack of understanding is a key impediment” to adding alternative allocations
- 51% of advisers said they themselves had “a need for more insight into portfolio construction with alternatives”

TO THRIVE IN RETIREMENT

For the 10,000 baby boomers a day entering retirement over the next four years, the implications of economic policies on their retirement security are especially time-sensitive. Few 65-year-olds will have time or demographics on their side if their assets are hit by another correction like global recession of 2007-2009.

“For the retirement-minded, alternative opportunities can be accessed through individual retirement accounts such as Self-Directed IRAs,” said Jeffrey Kelley, Senior Vice President of Equity Institutional. “The power of a Self-Directed qualified retirement account comes from its broad access to investment options like private equity, real estate, precious metals or other alternative to traditional investment choices.”

With 20 years of experience in financial services operations management, Mr. Kelley is adept in handling the administrative complexities of alternative investing. Equity Institutional, through Equity Trust Company, offers IRAs, qualified retirement plans and non-retirement accounts for alternative and traditional assets.

SELF-DIRECTED RETIREMENT ACCOUNTS: ALTERNATIVE INVESTING THE TAX-ADVANTAGED WAY

Choosing an advisor that works with a self-directed custodian may allow investors to gain access to the potential benefits of alternatives on a tax-advantaged basis, Mr. Kelley said.

While generating adequate income for clients during their retirement may be increasingly a challenge for financial advisers, alternatives offer some attractive tax efficiencies.

ALTERNATIVES IN RETIREMENT INCOME STRATEGIES

Longer life-spans, rising health costs and ineffective safety nets continue to exacerbate this challenge. Increasing allocations to alternative assets is one approach used in today’s low-yield environment to provide much-needed diversification as part of a proactive risk-management strategy.

Billions: Projected Allocation Increase to Alts Across Independent Advisory Channel

Currently: 9.8% allocated to alternatives
Three years from now 13.8% allocated to alternatives

Source: Alternatives in the Mainstream; Cerulli Edge Advisor Edition
Note: The median AUM for survey participants is $130,000,000
According to Jeffrey Kelley, “Alternative assets such as real estate investment trusts, mortgage notes, limited partnerships, limited liability corporations, precious metals, joint ventures, actively managed funds and private equity can be less tax-efficient when held in standard portfolios, because they are taxed at short-term capital gains or ordinary income-tax rates. Moving these assets into tax-exempt vehicles, such as IRAs and other qualified retirement plans, can potentially increase net income.”

“Self-Directed IRAs invested in alternatives may provide a way for investors to diversify a portfolio beyond traditional equity, bond and mutual fund choices,” said Paul D. McConville, president of Quincy Capital Partners, LLC, which serves a range of alternative investment managers. “In effect, with a Self-Directed IRA, investors may gain a wider scope of action for how, when, and where to invest their retirement assets.”

WANTED: ALTERNATIVE EDUCATION

Perhaps most important, say advisers, is that investors — often unprompted — are expressing more interest in alternatives. Addressing the educational link between advisers and investors, William Kelly, CEO of the Chartered Alternative Investment Analyst Association, recently said, “Education will continue to be very important as mass affluent and other retail oriented investors enter the brave new world of alternative investments, many for the very first time.”

“The true value proposition for alternatives is the role that they can play toward providing better risk adjusted returns over the long run,” he added.

Alternatives in the Mainstream noted that advisers primarily need support in four key areas in order to increase their diversification to alternatives.

While greater insight into portfolio construction leads the way, support for client education, administrative simplification and access to investment issuers follow closely.

BEYOND PRODUCT RECOMMENDATIONS

Advisers who develop a discipline in educating clients about alternatives could use that skill as a powerful way to build more valuable client relationships — independent of the actual product recommendation itself.

ALTERNATIVE EDUCATION MADE EASIER WITH EQUITY INSTITUTIONAL

“While we provide educational resources on topics related to alternatives and Self-Directed retirement accounts,” Jeffrey Kelley added, “Investors, as well as their advisors, must undertake their own review and analysis of alternative investment choices.” Equity Institutional provides a wide range of educational information on various aspects of alternative investing, but does not offer investment advice. To view our entire library of content, please click here.
ALTERNATIVES REQUIRE AN ALTERNATIVE CUSTODIAN

With alternative investments like real estate, precious metals, private equity, private debt and investment crowdfunding opportunities on the rise, broker-dealers are also becoming aware of the importance of utilizing the services of more specialized custodians.

According to Mr. Kelley of Equity Institutional, “We are seeing tremendous growth in tax exempt vehicles. Qualified custodians in this area require an understanding of complex transactions and tracking capabilities for both contributions and distributions.”

EQUITY INSTITUTIONAL: THE RESOURCES YOU NEED FOR THE RELATIONSHIPS YOU WANT

Equity Institutional (through Equity Trust Company) offers IRAs, qualified retirement plans and non-retirement accounts for alternative and traditional assets. They service Registered Investment Advisors, registered representatives, broker-dealers, investment issuers, precious metals dealers and other financial professionals. Equity Trust Company is one of the largest

CONCLUSION

Recent studies have indicated, that financial advisers at firms of all sizes are likely to increase their use of alternatives over the next three years. Primarily motivated by the need to diversify portfolios, advisers view the need to acquire educational resources and provide them to their clients to be a critical requirement for their success.

Accordingly, advisers who develop a real specialty in alternatives and are able to give better advice as a result of this knowledge may be in a position to build stronger, more valuable relationships with clients over the long term.

Beyond simply recommending securities, better advisers will learn to excel in their ability to communicate the potential value of alternatives as a diversification tool to clients and prospective clients.
passive custodians of alternative assets with the goal to make alternative investing easy, and to help financial professionals and their clients achieve the diversification they are seeking. Perhaps the best reason to choose Equity Institutional is that they handle administrative details so that the focus of financial professionals can remain where it should be -- on their clients.

EXPERIENCE EQUITY INSTITUTIONAL

Contact us today at 855-355-ALTS (2587) or www.equityinstitutional.com

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