

# **APPLYING ALTERNATIVES**

## **AN ESSENTIAL PLAYER IN THE MODERN PORTFOLIO**

# INVESTOR EDUCATION

Looking back, the past 35 years have generally been a good ride for investors holding a traditional portfolio of 60% global stocks and 40% bonds, known as the 60/40 portfolio. Historically, these two asset classes have been a lucrative combination providing enough diversification to weather volatility.

However, that diversification benefit has eroded in recent years due to economic factors, such as inflation, which seem to have caused stocks and bonds to behave similarly. As these two asset classes become increasingly correlated in today's markets, a traditional portfolio's diversification diminishes, potentially leaving you open to increased risk and reduced risk-adjusted returns.

In today's market environment, you may be looking for **strategies to increase diversification, mitigate risk or increase returns** to help your portfolio thrive.

**Alternative investments** may be the solution you are looking for.

**IN THIS ARTICLE, WE'LL  
EXPLORE THE WHAT,  
WHY AND HOW  
OF ALTERNATIVE  
INVESTMENTS...**

# WHAT ARE ALTERNATIVES?

To understand what alternatives are, compare them to traditional investments. You're probably most familiar with stocks (owning a portion of publicly-traded companies), bonds (debt securities issued by governments and/or companies), and cash and cash equivalents (such as money market funds).

## ALTERNATIVE ASSETS CAN INCLUDE:



**Alternative assets** have not traditionally been reflected in broad investor portfolios. In the early days of alternatives, real estate and infrastructure were considered alternative for their seeming uniqueness. However, it's important to keep in mind that some alternative asset classes have **performance drivers similar to those of traditional assets**. For example, real estate and infrastructure are driven by interest rates, just like traditional investments.

## ALTERNATIVE INVESTMENTS CONSIST OF BOTH ALTERNATIVE ASSETS AND STRATEGIES.

## ALTERNATIVE STRATEGIES CAN INCLUDE:



**Alternative strategies** aim to lower risk or enhance returns. Although alternative strategies can often use traditional assets as the underlying instruments, it's the manager's skill in wielding a more expanded toolkit that drives returns.

# WHY IS IT IMPORTANT TO INCLUDE ALTERNATIVES?

## THAT WAS THEN...

Historically, stocks and bonds have generally provided uncorrelated sources of return; that is, the factors that drove returns for these two asset classes were different enough that stocks and bonds provided excellent portfolio diversification, especially during periods of market turbulence and high volatility.

Think of them as pistons in an engine: when stocks are making positive returns, bonds have typically returned less. That is diversification – and it makes the total return experience a smoother, less volatile ride.

## THIS IS NOW...

However, in early 2018, as well as more recently, both stocks and bonds experienced losses simultaneously, causing the general performance of a simple 60/40 portfolio to fall considerably in a short period of time. Having a third piston that moved differently could have helped your portfolio mitigate risk and provided a smoother investing journey.

Then, in January 2019, something unprecedented happened: **Regulatory changes finally allowed investors like you access to alternative investments** that had previously only benefited institutional investors for years. This new regulation opened a whole new world of alternatives opportunities for the average investor.

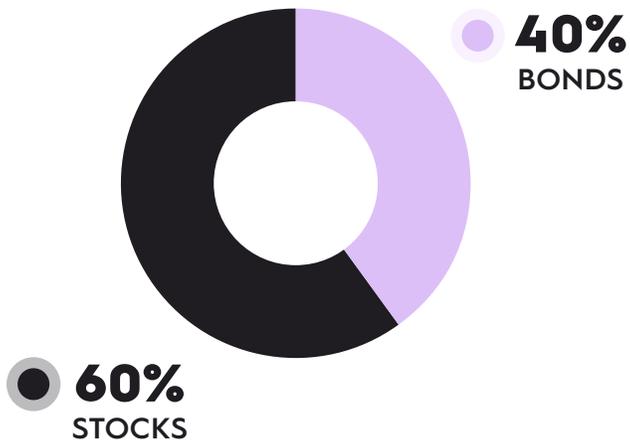
**AS ALTERNATIVE STRATEGIES OFTEN SHOW LOWER CORRELATION TO TRADITIONAL ASSET CLASSES AND EACH OTHER, THEY CAN HELP YOUR PORTFOLIO HAVE BETTER QUALITY OF RETURNS BY AIMING TO:**

**1** Better weather volatility

**2** Achieve better risk-adjusted returns

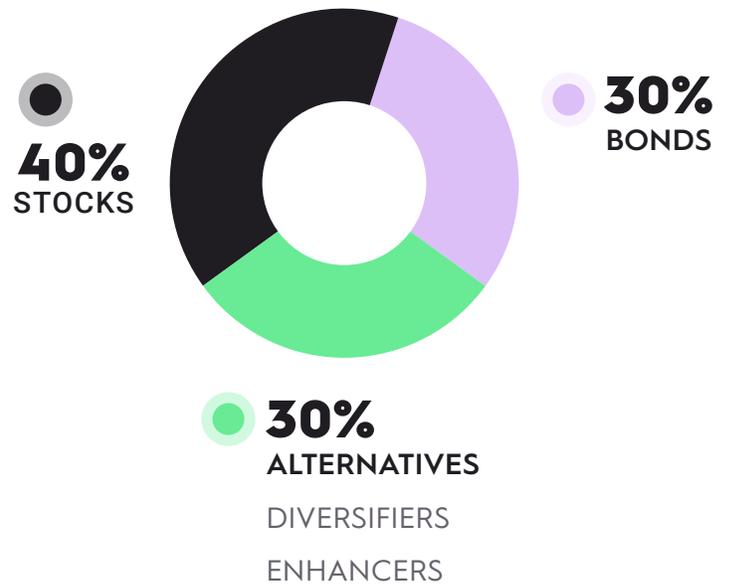
# HOW CAN ALTERNATIVES FIT INTO YOUR PORTFOLIO?

## TRADITIONAL PORTFOLIO 60 / 40



A traditional 60/40 portfolio made up of stocks and bonds is shown in the chart on the left. However, given the current market environment, the 60/40 portfolio no longer appears to be keeping up.

## AN ALTERNATIVE APPROACH 40 / 30 / 30



The chart on the right shows what your portfolio could look like if you add a third sleeve of alternative investments to create what we call the **40/30/30 portfolio** – made up of **40% stocks, 30% bonds and 30% alternatives**.

## BREAKING THEM DOWN EVEN FURTHER, ALTERNATIVES CAN BE CLASSIFIED AS EITHER DIVERSIFIERS OR ENHANCERS.

### **DIVERSIFIER ALTERNATIVES**

seek to meaningfully outperform cash without taking on market risk. They are designed not to be sensitive to changes in equity or fixed income markets.

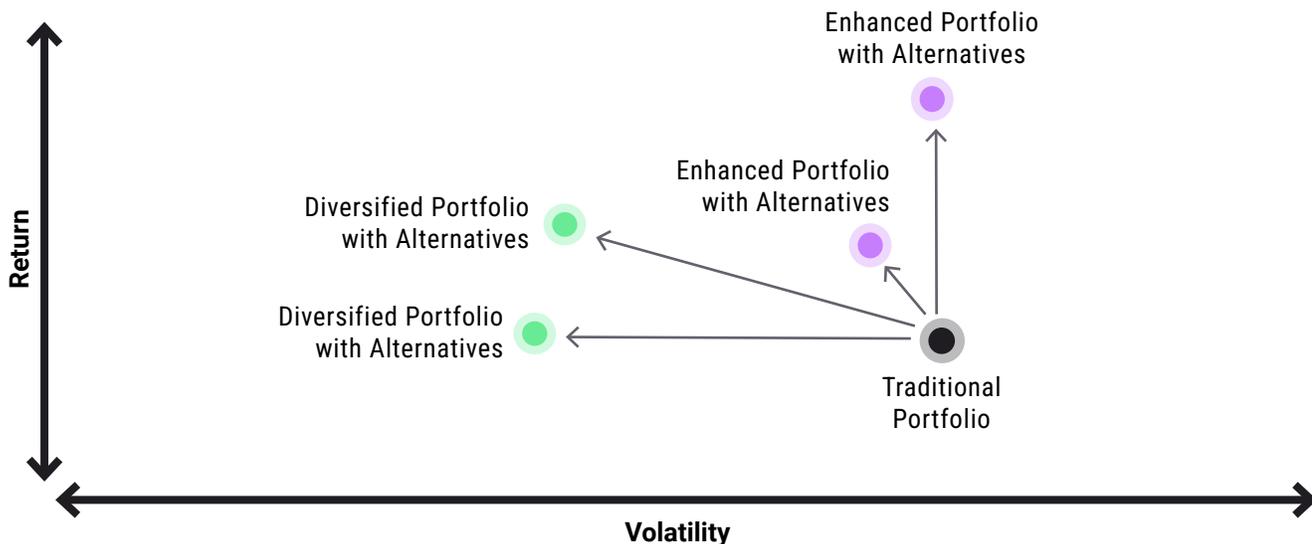
You can see in the graph below that adding diversifier alternatives to a traditional portfolio can reduce its volatility with similar returns.

### **ENHANCER ALTERNATIVES**

generally take on the same market risk as stocks or bonds, but seek to deliver a better outcome for you, either by amplifying the return or by mitigating the downside risk.

The graph below illustrates how adding enhancer alternatives to a traditional portfolio can help increase returns while maintaining similar or lower levels of volatility.

### Adding Alternative Solutions to a Traditional Portfolio\*



\*For illustrative purposes only. This is an illustration of the target risk/return profile when adding alternative solutions to a traditional portfolio. Actual portfolios can differ significantly.

Ready to learn more about how alternatives can help reduce total portfolio risk or increase returns?  
Speak with your financial advisor today.



#### **Disclosure**

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