

## Liquid Alts - Will the Cream Rise to the Top?

In a complex and competitive market, alternative investments continue to gain traction as a tool for hedging against the traditional 60/40 portfolio. Through a wide range of investment types, alternatives claim to provide a hedge when traditional approaches fail to produce yield. Are these investments actually increasing in assets under management? How can asset managers stay informed about benchmarks and predicted flows in this space? [Flowspring](#), our predictive analytics tool for asset flows, can serve as an integral part in answering these questions, leading to faster and more accurate decision-making.

## Defining the Market for Alternatives

We see alternative investments falling into two main categories: illiquid and liquid alts, followed by sub-categories based on underlying asset type or strategy. It could be argued, however, that all alternative investments are illiquid given the longer time horizons required for many of these assets to realize their stated yield objectives. Most illiquid alts are defined by their longer lock-up periods.

Liquid alts, on the other hand, are predominately run as hedge fund strategies on underlying stocks and bonds, which lend themselves to being easily liquidated. In a recent ISS MI research study which surveyed 810 US-based financial advisors, liquidity was shown to be a key determinant and potential hurdle to the increased use of alternatives by both advisors and investors in client portfolios\*.

**Figure One - Alternative Asset Types**

### Illiquid Alternatives

1. Real Estate
2. Venture Capital/Private Equity
3. Hedge Funds
4. Private Credit
5. Natural Resources
6. Infrastructure
7. Special Purpose Acquisition Company
8. Cryptocurrency
9. Artwork

### Liquid Alternatives

1. Equity Market Neutral
2. Event Driven
3. Macro Trading
4. Multistrategy
5. Options Trading
6. Relative Value Arbitrage
7. Systematic Trend
8. Digital Assets

**Note:** Liquid Alternative Categories as defined by [Morningstar](#)

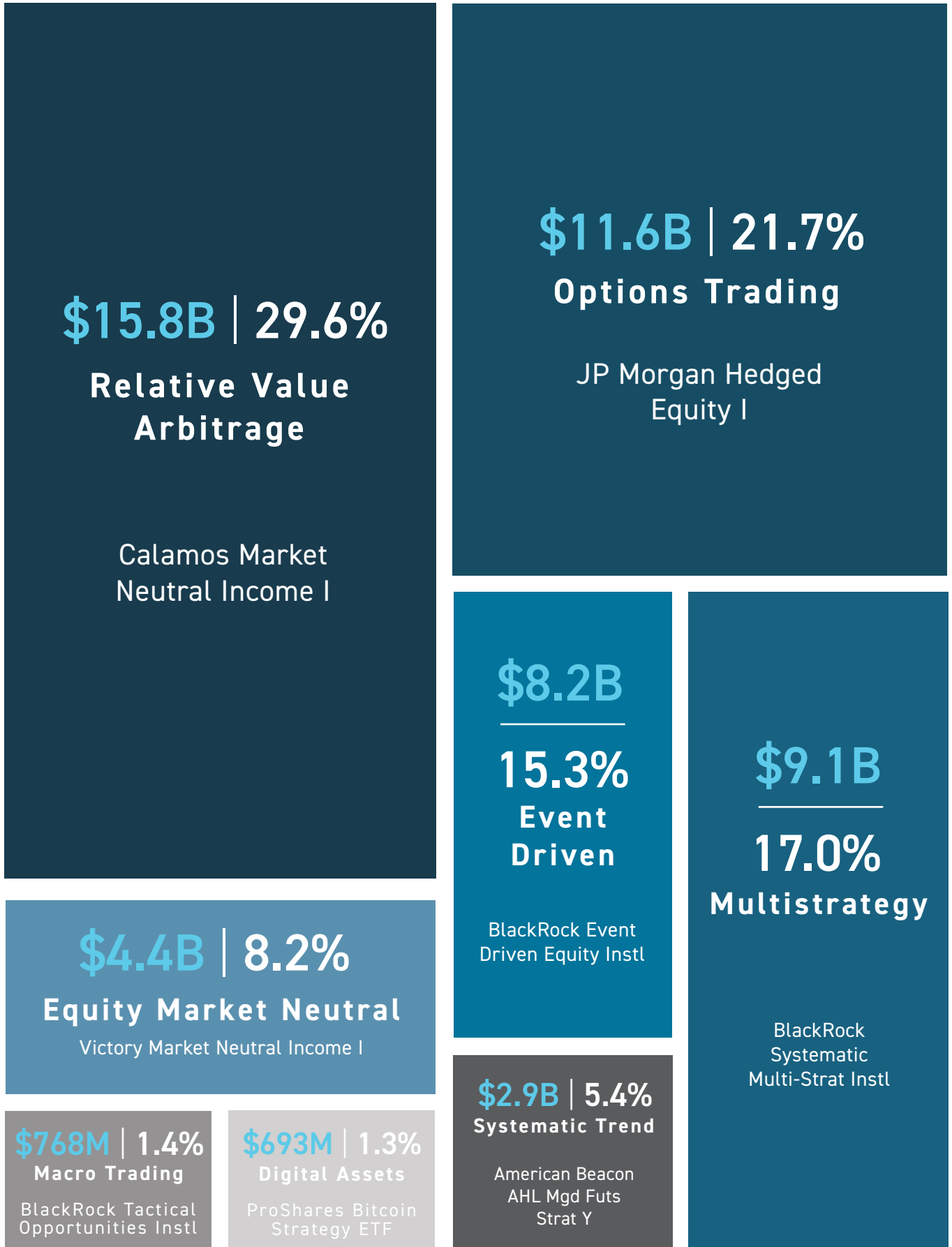
**\*Source:** Market Metrics Survey: Selling Retail Investment Products Through Intermediaries, September 2022

## Liquid Alternative - A Deeper Dive

Liquid Alternatives are characterized by their ability to take both long and short positions, remain unconstrained by traditional benchmarks and generate an absolute return. Many of these assets employ proprietary hedge fund strategies to reach their fund objectives. These products are typically sold to investors in a mutual fund or ETF.

While Liquid Alts are still a relatively small part of the overall mutual fund and ETF market, we do see flow growth trending positive. All liquid alt categories we track saw a net positive inflow over the past 12 months (*note: data as of Oct. 2022 and is illustrative*). The current share class leaders for each category collectively manage \$53.4B in AUM. Their relative percentage of holdings can be seen in the table below.

Figure Two - Liquid Alt Share Class Leaders by AUM - As of 10/2022



It should also be noted that despite net positive inflows over the last 12 months, there has been a deceleration of inflows over the past 6 months for most categories. We see deceleration in most categories and net negative inflows for Event Driven and Relative Value Arbitrage. The bright spot however is that we do see the Systematic Trend strategy holding its ground.

As reported within [Flowspring](#), fees are starting to compress slightly. Overall fees have compressed by 1 basis point over the past 12 months relative to the average. The average fees over the trailing 12 months for all liquid alts are 1.27%, with Event Driven strategies taking the clear lead as of October 2022 at 1.84%. Event Driven strategies account for a 0.58% premium over the average for liquid alts and a 1.08% premium over Options Trading strategies, which are currently the lowest fee.

*Figure Three - Average Fees by Strategy 1*

Strategy Type	Average Fees*	Current Average Fees**	Fee Compression/Expansion
Macro Trading	1.20%	1.27%	0.06%
Digital Assets	0.82%	0.85%	0.03%
Multistrategy	1.56%	1.59%	0.03%
Event Driven	1.83%	1.84%	0.01%
Options Trading	0.76%	0.76%	-0.01%
Equity Market Neutral	0.91%	0.89%	-0.02%
Systematic Trend	1.61%	1.57%	-0.04%
Relative Value Arbitrage	1.14%	1.07%	-0.07%
<b>WTD AVERAGE</b>	<b>1.27%</b>	<b>1.26%</b>	<b>-0.01%</b>

\*Average for the 12-month period from 10/2021-10/2022

\*\*Current averages as of 10/2022

## Where Are We Headed?

Flowspring uses a proprietary machine learning model that has a proven ability to accurately predict directionality of asset flows. Flowspring's predictive analytics leverage a decision tree algorithm which captures non-linear relationships between fund flows and 40+ factors that drive fund flows. These factors reflect investor preferences and are derived from a rich cleansed dataset and incorporate various dimensions of funds, including performance, brand, distribution, and many product characteristics including category, fees, and asset allocations.

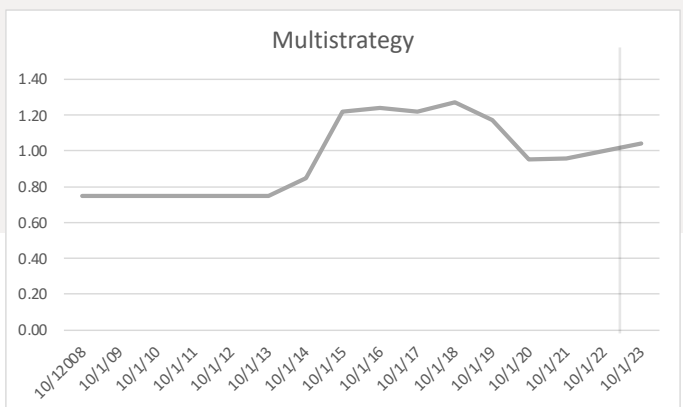
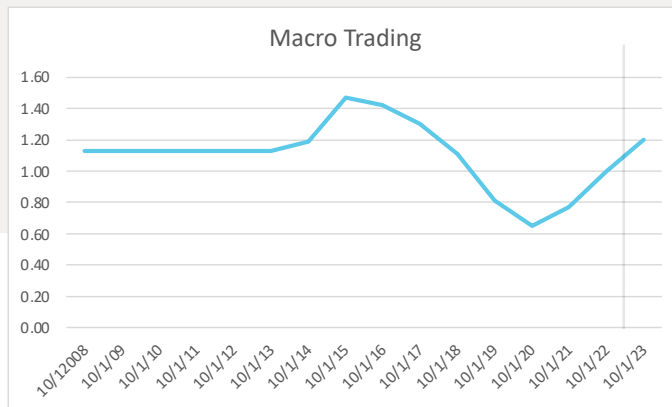
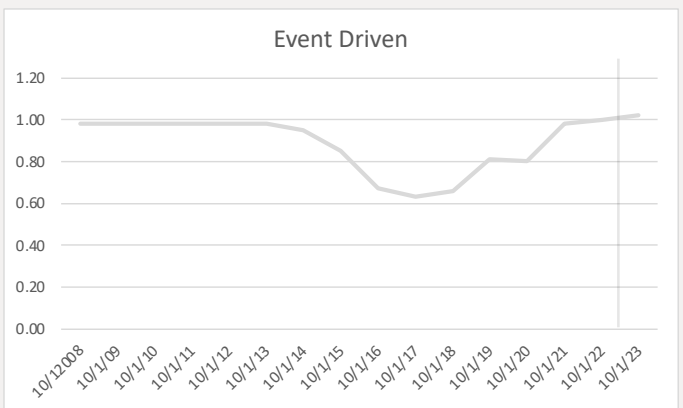
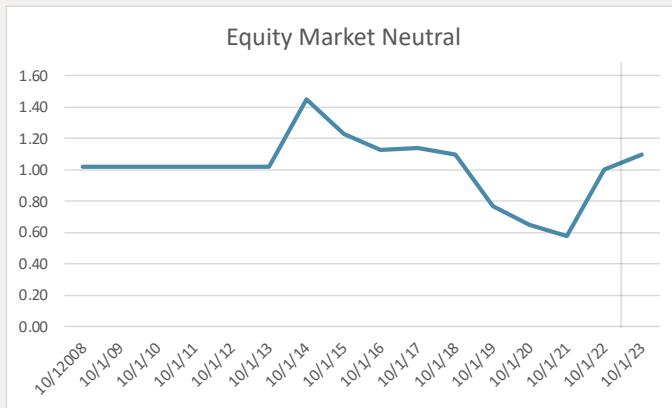
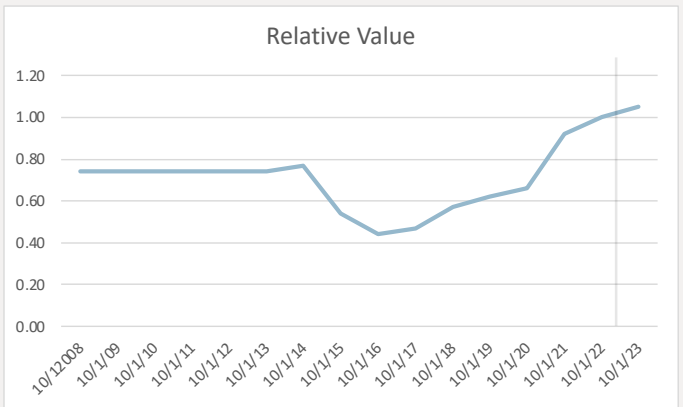
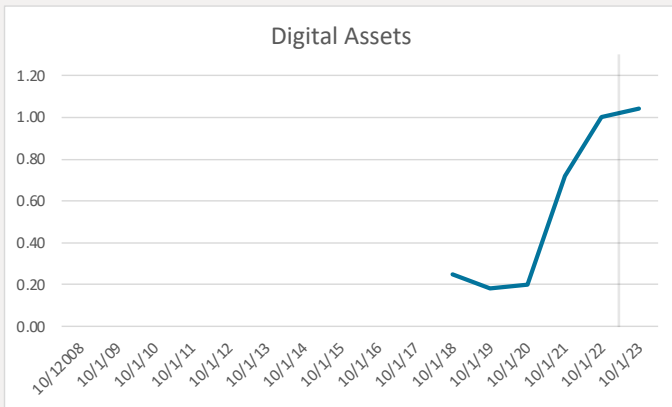
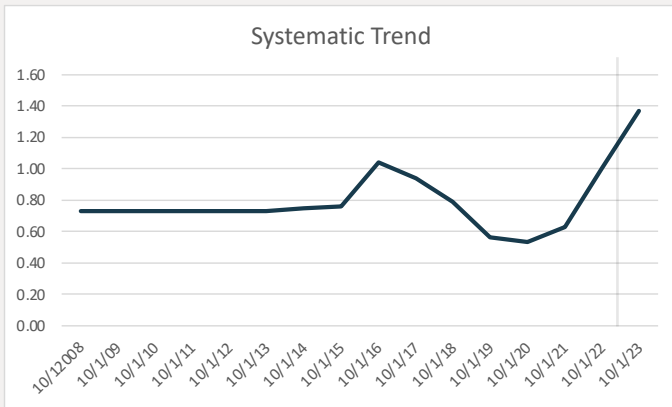
Across the board, we are predicting an increase in inflows to continue for all liquid alternative categories. Our model is predicting modest growth for most categories over the next 12 months compared to the trailing 13 years of flows. However, we do see that Systematic Trend and Macro Trading will be the fastest growing product types from an inflow perspective (*note: data as of October 2022*).

While our model looks at multiple factors when assessing net flow predictions, we can infer that in the current macro environment Systematic Trend may be attractive because of its stated objectives of having low correlation to other asset classes and its ability to profit in both rising and falling markets.

With respect to fees our models are also predicting sizable increases in fee revenues for both Systematic Trend and Macro Trading. Each respective category will effectively grow by 67 and 21 bps relative to the previous year. These increases in fees revenues will be driven by a market need for diversification as well as the potential for these investments to provide uncorrelated yield.

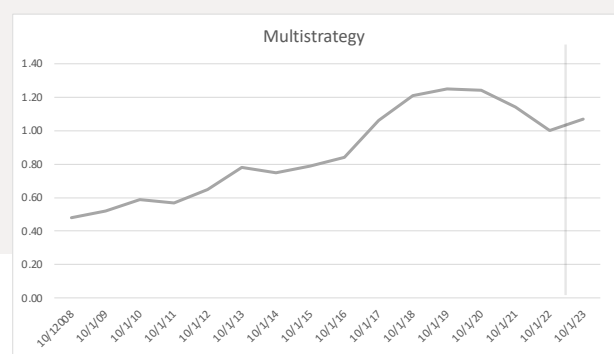
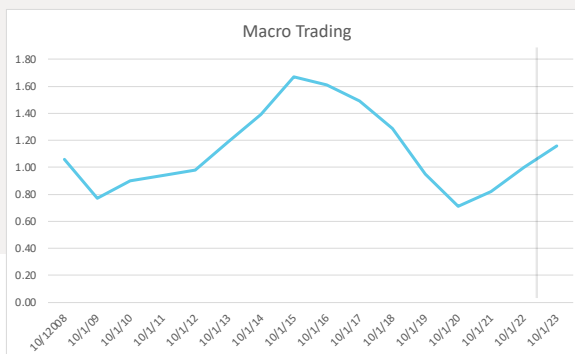
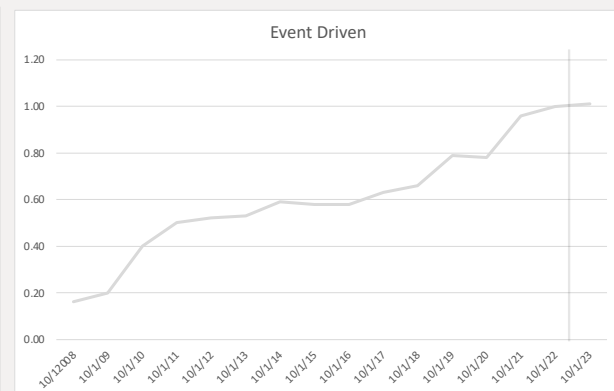
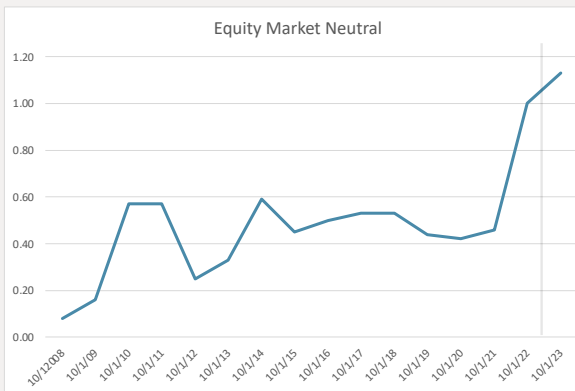
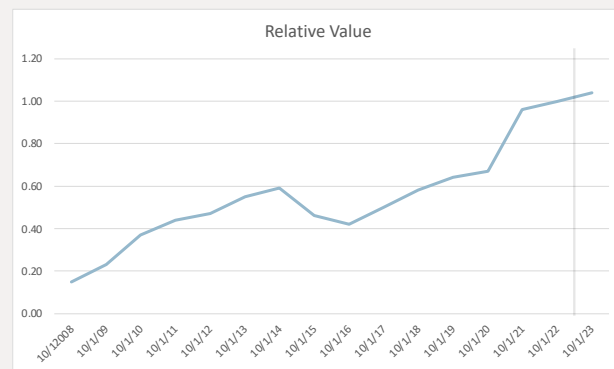
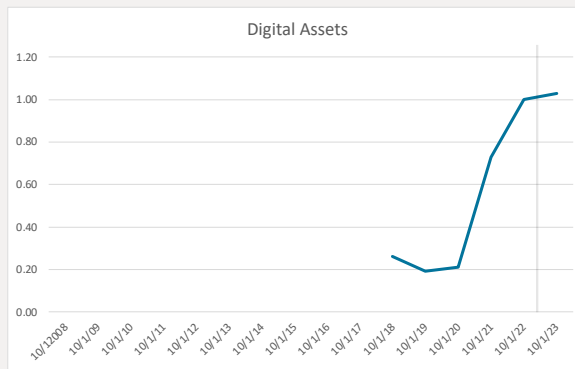
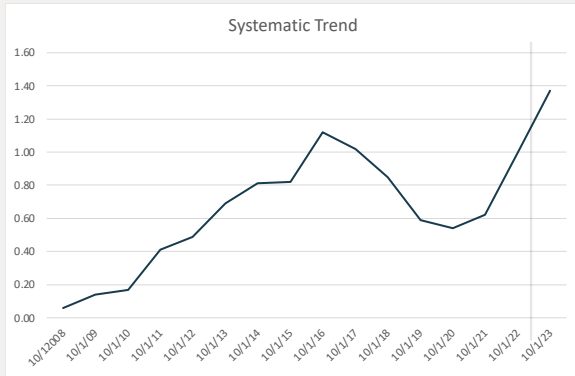
As you can see, Flowspring provides asset managers focused on strategic product and pricing decisions product manufacturers the ability to examine historical fund performance and, more importantly, understand where fund flows are headed. In complex and competitive markets, this information should be an integral part of any asset manager's toolbox when determining their product strategy, leading to greater agility, speed-to-market and improved decision making.

HISTORICAL YEARLY FEE REVENUE CHANGES



\*Digital Assets had an inception date in 2018

**HISTORICAL YEARLY NET FLOWS**



\*Digital Assets had an inception date in 2018

Learn more about asset flows and fee compression/expansion for liquid alts by signing up for a free trial of **Flowspring**. Please note: The data and forecasts run within this article were conducted as of October 2022 and are illustrative of the forward-looking predictive capabilities of Flowspring. The forecast results may change at different points in time and can be further explored by [contacting us directly here](#) or at [sales@issmarketintelligence.com](mailto:sales@issmarketintelligence.com).