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RESEARCH ARTICLE

ALTERNATIVE INVESTMENTS- THE GAME OF [UN] - KNOWNS

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ABSTRACT

Alternative Investments is an emerging market. In recent years, alternatives have become a prevalent aspect of multi-asset investing. It includes investments ranging from private, commercial, real estate, hedge funds, liquid alternatives to illiquid private equity funds, and real assets. The alternative investments industry is rapidly expanding and increasing its ability to provide durable investment strategies, and hence is attracting a growing number of individual investors. Due to extended periods of very low interest rates and rising volatility on equity markets around the world, traditional investments have left many investors with inadequate return. Therefore, the need for alternative investments is crucial but the greatest problem investors face is evaluating and allocating these alternatives in proper proportion to get maximum returns. The following paper assesses the primary factors that influence investors as they evaluate and make decisions about alternative investments and how adding them to portfolios can improve returns and reduce risks.

INTRODUCTION

An investment is a present and certain sacrifice for a future and uncertain benefit, where risk plays an important role due to the uncertainty that the future holds (Hirshleifer, 1965). Investments are assets or items acquired with the goal of generating income or appreciation. The investment process must be well-structured to ensure that the risk of any investment is properly understood before decisions are made. It is a mix of both qualitative and quantitative information that forms the basis of these investment decisions (Chan *et al*., 2002), going beyond basic accounting information and including aspects such as the market and risk profiles (Jagongo & Mutswenje, 2014). This paper will focus on one of these investment classes, known as alternative investments. The concept of alternative assets as a desirable investment class has grown tremendously over the past few decades, with characteristics that are distinctive from other more common forms of investment (Kitces, 2012). As defined by Robertson, Wielezynski (2008) and Groot (2014), alternative investments:
i.) Are assets other than domestic and global stocks and fixed income assets. ii.) Includes private equity, real estate, commodities, hedge funds, foreign currencies and derivatives. For many, one way to obtain financial security is saving and investing for a long period of time. In simple terms, having your money work for you is investing. Alternative investments help diversify portfolio and manage risk. They also tend to act independently to the standard assets i.e. how stocks and bonds act in the market have little to no impact on the value of alternative investments. But in recent years, extended periods of very low interest rates around the world have left investors with inadequate returns on their bonds and virtually no return on their cash investments. Rising volatility on equity markets has also left many of the more adventurous institutional investors bruised and disillusioned. Most alternative investments are held by institutional investors or individuals accredited to high-net-worth because of their complex nature, degree of risk and lack of regulation. Due to their complexity in terms of how they react differently in a range of economic environments, they are not accessible publicly like stocks and bonds are (Kitces,2012), meaning it is a greater challenge to understand all aspects of them. There are many different types of alternative asset investments that have been widely studied, such as Hedge funds (Capocci and Hübner, 2004; Billio *et al*., 2010), Venture Capital (Gompers and Lerner, 2001; Fried and Hisrich, 1994) and Private Equity (Fenn *et al*., 1997; Kaplan and Strömberg, 2009).

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REVIEW OF LITERATURE

A comprehensive review of theoretical and factual studies in the areas related to alternative investments , traditional investments, mindset of investors, risk of investments, investment decisions, determinants of these decisions, the mindset of risk and return and investment satisfaction was carried out. The following review is a result of systematic search of relevant literature. Library of CMS, Jain University was used and multiple web resources including Investopedia, websites of reputed financial institutions, Regulators and Boards were extensively used as major sources to go through several related published articles, books and journals. In his book titled A Random Walk Down Wall Street, Malkiel states "A blindfolded monkey throwing darts at a newspaper's financial pages could select a portfolio that would do just as well as one carefully selected by experts" (Malkiel, 1973).

After the Financial Crisis of 2008, many investors lost faith in the overall financial system and started seeking investment opportunities that mitigated risk. These investors began researching several other investment vehicles, including alternatives. Due to the fickleness and underachieving performance of the public markets, new forms of investment emerged. The asset class became an increasingly relevant option for investors due to its resilient nature in times of economic turmoil. With private equity buyouts and hedge funds paving the way, alternative investments have proved to have played an integral role in shaping the modern economy. "Overall, allocations to a wide range of alternative investments soared from 15% to 37%, whilst the share of cash and bonds fell to less than 4%" from 2005-2014 (World Economic Forum, 2015). Although many alternative investment strategies had existed throughout the modern era of investing, rapid activity in this space did not occur until the mid-2000s. Furthermore, "Total assets under management soared from $1 trillion in 1999 to more than $7 trillion in 2014…and PWC expects the industry to nearly double again to $13 trillion by 2022" (World Economic Forum, 2015).

During the alternative's peak, which took place between the years of 2005 and 2007, global alternative assets under management (AUM) nearly doubled (McKinsey & Company, 2012). The developing space not only survived the Financial Crisis in 2008, but it grew stronger than it was prior to the recession. Thus, alternative asset investment maintained its rapid growth, unlike its traditional counterparts. "To a lesser extent, high-profile initial public offerings of leading alternative asset management companies, as well as small investors' greater access to the market, have contributed to industry growth" (Gambardella, 2017). It is also a suitable investment option to the small and medium investors because it satisfies all the criteria required by Indian investors. The fund invested in small savings schemes will yield good results not only individual investors but also to the nation. Small savings schemes are designed to provide safe & attractive option to the public and at the same time to mobilize resources for development of the nation. (R. Kasilingam and G. Jayabal, 2009). "Incorporating alternative investments into a traditional portfolio may help you to reduce overall volatility while increasing portfolio diversification, all with a typically lower correlation to the market movements of traditional investments such as stocks and bonds" (Morgan 7 Stanley, 2014).

By diversifying an individual's portfolio, one could invest in several different markets, strategies, and styles. This increased flexibility provides potential for strong risk-adjusted returns (Morgan Stanley, 2014). (PRNewswire, Jan. 16, 2019) "The need for accurate alternatives investment direction, guidance and perspective may never be greater," (Christopher Hayward, J.P. Morgan Global Alternatives.) "In the late-cycle, investors are increasingly looking beyond traditional asset classes to achieve their objectives, recognizing that a sizable allocation to alternatives can be additive to their portfolios." (Anton Pil, J.P. Morgan Global Alternatives.). "In the current environment, investors can look to increase returns and reduce risk by focusing on assets that generate stable streams of income, and on strategies that benefit from the rising volatility."

(David Kelly, Chief Global Strategist) says, "With expected returns from traditional asset classes under pressure, investors have been forced to look elsewhere to reduce volatility and enhance returns. "Institutional investors currently have about $24 trillion under management globally" (McKinsey & Company, 2012). Subsequently, the alternative investments space is becoming a larger portion of the U.S. GDP as they encourage increased competition between industries. (Preqin, 2018) Alternative investments will be significantly larger than today i.e. by 2023 global assets under management at $14tn (+59% vs. 2017); 34,000 fund management firms active globally (+21% vs. 2018)

RESEARCH METHODOLOGY

The proposed research is Descriptive, Informative, Quantitative, Qualitative and Co-relative. In this research, primary data were collected through the method of questionnaires. Between the months of June - July 2019, 54 respondents from a universe of business professionals, students of management colleges, institutional investors, private investors from India, completed an online survey that aimed to understand their use of alternative investments. Because the topic of alternative investments includes a considerable subjective component, and given that sample sizes are in some cases limited, Survey results may not necessarily be representative of a larger population. Nonetheless, we believe the quantitative and qualitative interpretation of the data provides some indication of trends and implications for a broader investor base. Participation was voluntary. In all cases the individuals surveyed were qualified to represent the investment activities, decisions and views of their respective organizations. The surveys were taken anonymously to maintain the confidentiality of our respondents.

DATA COLLECTION

During the period of our data collection for the 2019 Survey, respondents were managing portfolios affected by events and developments as varied and far-reaching as geopolitical tensions, US - China tensions trade wars, Brexit, future of Iran and North Korea's nuclear program, 2019 General elections in India. It was clear that respondents were trying to shepherd their portfolios in an environment that is no longer positioned to offer protection against the risk of every short-term market trend. And since India has lesser uncertainty avoidance, respondents expressed greater acceptance that shocks to portfolios will continue, & that volatile and uncertain markets are the new normal. Respondents reflected a sophisticated understanding that portfolios should be structured to prudently manage risk, even as they also seek to achieve returns in a variety of potential market environments. The data collected was through primary and secondary source. Primary data was collected through surveys and questionnaires and secondary data was collected through various journals and websites that are mentioned accordingly.

Analysis And Interpretation: Through an online survey with a focus on alternative assets : hedge funds, private equity, real estate, infrastructure, commodities and other real assets, we asked these investors to share where they are now, where they are headed over the next few months and what their strategic investment objectives are. Tables 1 to 4, provides a breakdown of the total sample set by age group, profession and their knowledge of alternatives. The survey was answered by people ranging from age group 20 and above. From Chart 1, we can see that people from age group 40 & above participated the most in the survey standing at 57.4%, followed by the millennials at 24.1%.

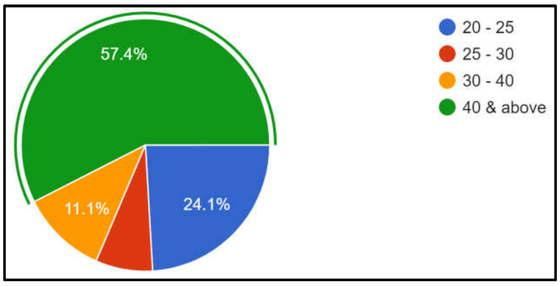

Chart 1. Age classification

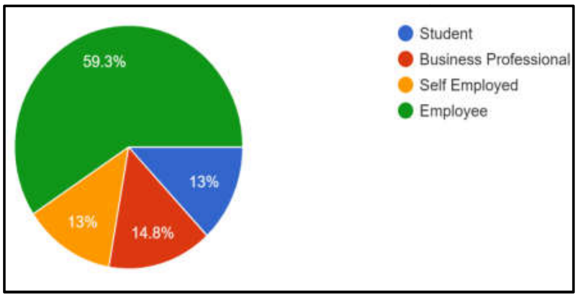

Chart 2. Profession classification

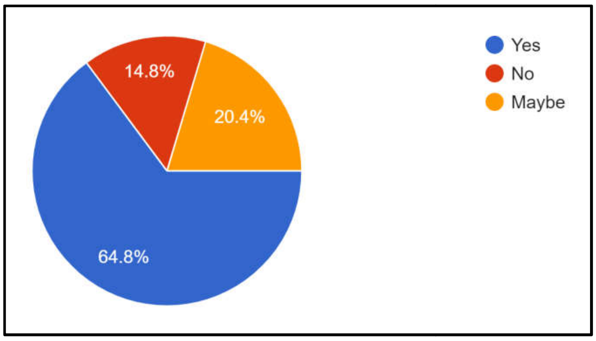

Chart 3. Knowledge about Alternative

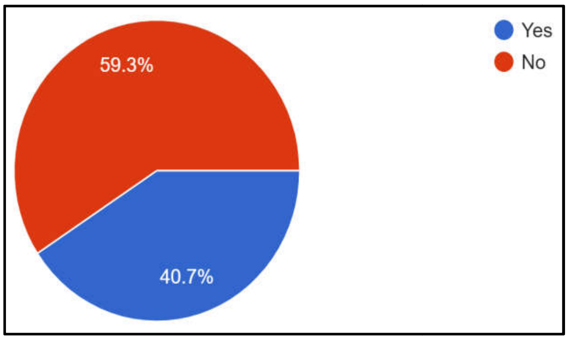

Chart 4: Exposure to Alternative Investments

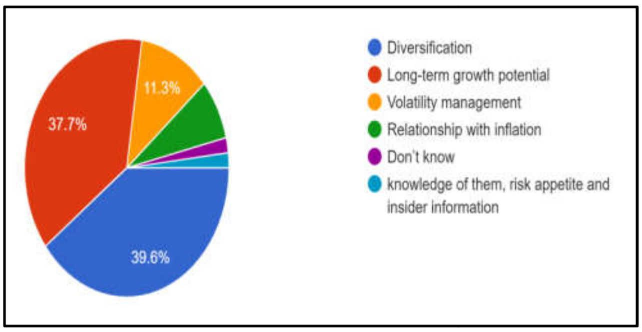

Chart 5. Reasons investor utilize Alternative Investments

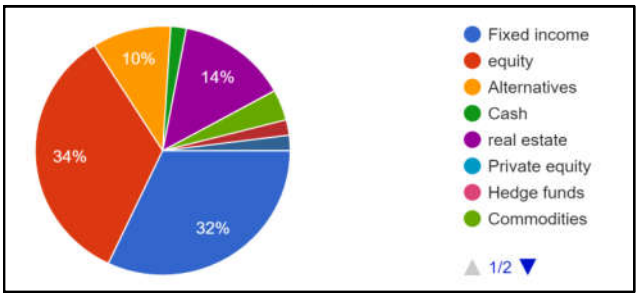

Chart 6. Asset class held

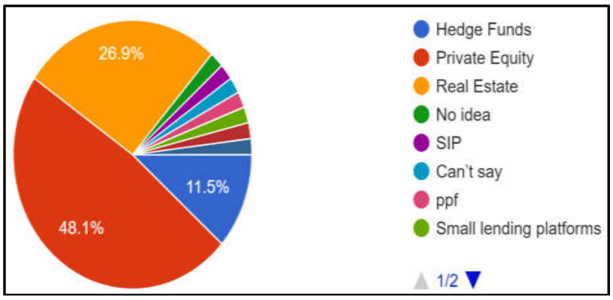

Chart 7. Future Trends

As seen from Chart 2, most of these survey respondents were employees. Business professionals, Students of management colleges and also self-employed people responded to the survey but considerably less in number. A total of 64.8 % of Survey respondents have basic knowledge about what is alternatives, however only a total of 40.7% of Survey respondents currently have exposure to at least one type of alternative investment - hedge funds, private real estate, private infrastructure, private equity, commodities, real estate, infrastructure or other. The survey showed that 14.8% of investors do not currently know about alternative Investments. (Chart 3). Chart 4 shows that 40.7% of the investors have traded in alternative investments and a whopping 59.3% haven't. Diversification potential is the primary reason for investing in alternatives. It was clearly shown that the respondents are driven to alternative investments for their diversification benefits. We asked the respondents to rank their reasons for investing in alternatives. As shown in Chart 5, 39.6% of respondents indicated diversification as their primary reason. Closely aligned with that is the long-term return potential of alternative assets highlighted by 37.7% of respondents. Also, the consequent reduction in portfolio volatility that may be achieved; 11.3% of survey respondents indicated Volatility management for including alternatives in a portfolio. Chart 6 confirms the relevance of the Survey questions: Over 90% of respondents invest in some form of instruments including alternatives: private real estate (14%), private equity (32%) and hedge fund assets (10%). Alternatives is slowly becoming a standard choice as a component of a total portfolio. Many investors believed the outlook across most alternatives would improve in the ensuing years, with the most positive outlook for private equity (48.1%). Others also saw the greatest opportunities over the intermediate term in real estate (26.9%) and hedge funds (11.5%). When investors were asked to choose the alternative with the greatest investment opportunities three to five years out, private equity was a top choice (Chart 7). The world keeps changing, there are many problems and challenges faced by modern investors. Investors have to keep up with the constant stream of updates and make on-the-spot decisions based on sudden turnarounds.

Table 1. Top advantages and disadvantages

ADVANTAGES	PERCENTAGES %
Diversification	25.5
Returns	52.9
Inflation Protection	21.6
DISADVANTAGES	
Fees	26.9
Transparency	36.5
Liquidity	36.5

Table 2. Outlook for various alternative investments

Outlook	Improving %	Worsening %	No Change %
Real Estate	38.9	22.2	38.9
Private Equity	56.6	15.1	28.3
Hedge Funds	43.1	11.8	45.1
Commodities	56.9	11.8	31.4

Investors need to know about changes in value minute by minute, as well as keeping up with relevant economic and political news. Making such decisions require thorough understanding of the markets. 72.2% of the survey respondents have said that they require an active and careful research before investing. Whereas, regulations and tax issues do not bother them much. Investors also are facing increasing competition and are making decisions with the full knowledge that every other investor out there is doing the same thing. Most people think of investment risk as: How likely am I to lose money?, Am I willing to accept more risk to achieve higher returns? Generally, the higher the potential return of an investment, the higher the risk. However, there is no guarantee that you will get a higher return by accepting more risk. All investors need to find their own comfort level with risk and construct an investment strategy around that level. Apart from careful understanding and research required, a major factor that influences one's decision is their ability and willingness to take risks.40.7% of the respondents are willing to take risks. However, 35.2% of the respondents prefer less risk, due to their risk aversion preference, are not willing to take high risks. Around 22.2% are willing to entertain high risk while investing. Around 48.1% of respondents are not sure about what level of risk they should take. They might be willing to take high risks proportionate to high returns based on the type of investments and the trend going on. 35.2% prefer low-risk investments, where there is a guarantee that you are unlikely to lose money.

Only 16.7% of the respondents are willing to gamble and play with risk and returns. Making allocations to alternative investments is a resource-intensive activity, and there is no question that due diligence is not an essential component of successful investing. Respondents increasingly require comprehensive due diligence from both the investment and operational perspectives. 84.9% of respondents have responded in favor whereas 13.2% have disagreed. Most investors have increased their operational perspectives as due diligence resources because they recognize potential operational challenges as being an uncompensated risk. Multi-strategy approaches, with managers vetted through consultants with deep resources and expertise, are being recognized as an attractive solution. Every investor has his own set of unique investment objectives. Investors today choose from a wide selection of investment options through financial institutions and online investment firms. Investors need to analyze the investment factors carefully using the reasonable business knowledge before making an investment decision. Absolute returns (33.3%) is a major factor that helps to make an investment choice. Investors also consider the valuation (27.5%) and past performance (23.5%) before arriving at a decision. While private equity funds (52.8%) continue to be the cornerstones of investors' alternatives portfolios, investors allocate to a myriad of products. Real estate (37.7%) continues to grow in importance. Whether it be credit, real estate, real assets, hedge funds, venture capital, commodities, Investors are eager for these exposures. However, hedge funds (From 7.5% to 15.4%) and commodities (11.3% to 23.1%) are pushing forward slowly as investor demand continues to grow. Investors who are currently not investing stand at 24.5%, however the number reduces to 19.2% indicating their desire to enter into Investments. The advantages of the most established categories of alternatives are by now well known among institutional investors: return enhancement, diversification and, in the case of real estate, inflation protection. However, as with most asset classes, investors have also underlined their disadvantages—less liquidity, transparency and higher fees than traditional strategies (Table 1). Yet, our results suggest that, given recent experiences and lessons learned, investors have maintained their faith in alternatives and overall, are expanding allocations to these strategies, seeking greater diversification and a more optimal alpha/beta mix.

Private equity (39.2%), real estate (33.3%) along with other asset classes (15.7%) are expected to participate in the growth of alternative allocations over the next coming years. At the same time, infrastructure, commodities and hedge funds, currently representing only a small portion of alternative portfolios overall, are expected to attract new investors. Table 2 shows where respondents expect to increase allocations, keep the same allocations, or decrease allocations over the next few years. Hedge funds and private equity lead the way, with 43.1% and 56.6% of respondents respectively, indicating they may make increased allocations. Other categories targeted for meaningful anticipated allocation and positive outlook were real estate and commodities (56.9%). It is interesting to note that 38.9% of respondents feel that real estate outlook will either improve or remain the same. Fewer respondents expect a negative outlook in Private Equity (15.1%), Hedge funds (11.8%) , Commodities (11.8%), with the highest worsening for real estate (22.2%). This may be due to the sector grappling with various issues, namely liquidity deficit, high cost of capital, below-par sales and a string of stalled projects.

Conclusion

This research has provided valuable perspectives on the practices and attitudes of investors around the world in regard to alternatives. A growing alternatives industry, helps to illuminate trends and recent changes. The current environment of alternative investments have increased stability, with alternatives widely viewed by the 2019 survey respondents as an area that will continue to increase in allocations, visibility and importance. As investors continue to mitigate potential risk, more individuals & investors are investing in various alternative asset classes to diversify their portfolios even though the nature of the Alternative industry makes it challenging to learn about how investment opportunities are evaluated, despite there being a recognised importance for having a set of investment criteria. However, the Research has helped to define the key drivers, influencers, barriers and implementation methods that are shaping alternative investment strategies. Technological innovation has played a vital role in the progression of investing over the years. This research helps to clarify investor expectations and requirements.

Limitations

The limitations of the study are as follows: The first was the inability to include all criterias under Alternatives and, building on this, the inability to study all papers on Alternative Investments. A study such as this would exceed the time constraints of this paper and require a more extensive survey. Whilst confidence intervals, indicating the population mean, were accounted for, it is argued that the results of this paper could have been more reliable with a greater number of participants. We have excluded from this study: A detailed functional assessment of the systems and solutions used to support multi-asset products.

Further scope of studies

This paper was focused on understanding alternative industry, decipher emerging trends and anticipate changes. A study focused purely on the 'Quality of management of alternatives by individuals as well as teams' should be conducted. Due to its importance in the investment decision, it is recommended that investors should look more extensively at the facets determining which aspects are of higher importance. Due to time constraints on current findings, it is suggested that this study should be conducted on a larger scale. This would allow for the inclusion of more criteria; It would be interesting to understand how results differ with a greater choice of criteria, seeing where additional variables fit in with those already considered. Research should be conducted, looking at the differences between criteria importance when they are measured individually versus together. In an investment proposal it is unlikely that all criteria are of a high standard, so it leads to question whether the presence of one alternative with high importance outweigh the absence of two lesser alternatives?

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