

# Introduction to Alternative Investments: Strategies & Benefits

## Manager Working Group in Support of Wealth Advisors



Contributions by:



# Speakers



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# Alternative Investments Profile



# Profile

## Alternative Investments



Alternative investments are differentiated from traditional investments by:

- Short selling
- Leverage
- Greater derivative use
- Risk profile
- Liquidity
- Absolute vs relative returns
- Performance fees
- Offering Memorandum

**Note:** Liquid Alternatives (Alternative Funds) are alternative investment type strategies in a mutual fund wrapper (discussed later)





# Service Providers



- **Prime Broker:** securities finance, trade execution, clearing & settlement, capital introduction services
- **Custodian:** holds assets, settlement of securities, collateral management, securities lending
- **Fund Administrator:** NAV calculation, shareholder reports, payment of fund expenses, filing of reports/statements, return calculations
- **Auditor:** review of fund financial statements, tax services, verify NAV & AUM
- **Legal:** Set up legal structure, offering documents, general counsel

# Benefits of Investing in Alternatives



# Benefits of Alternative Investments

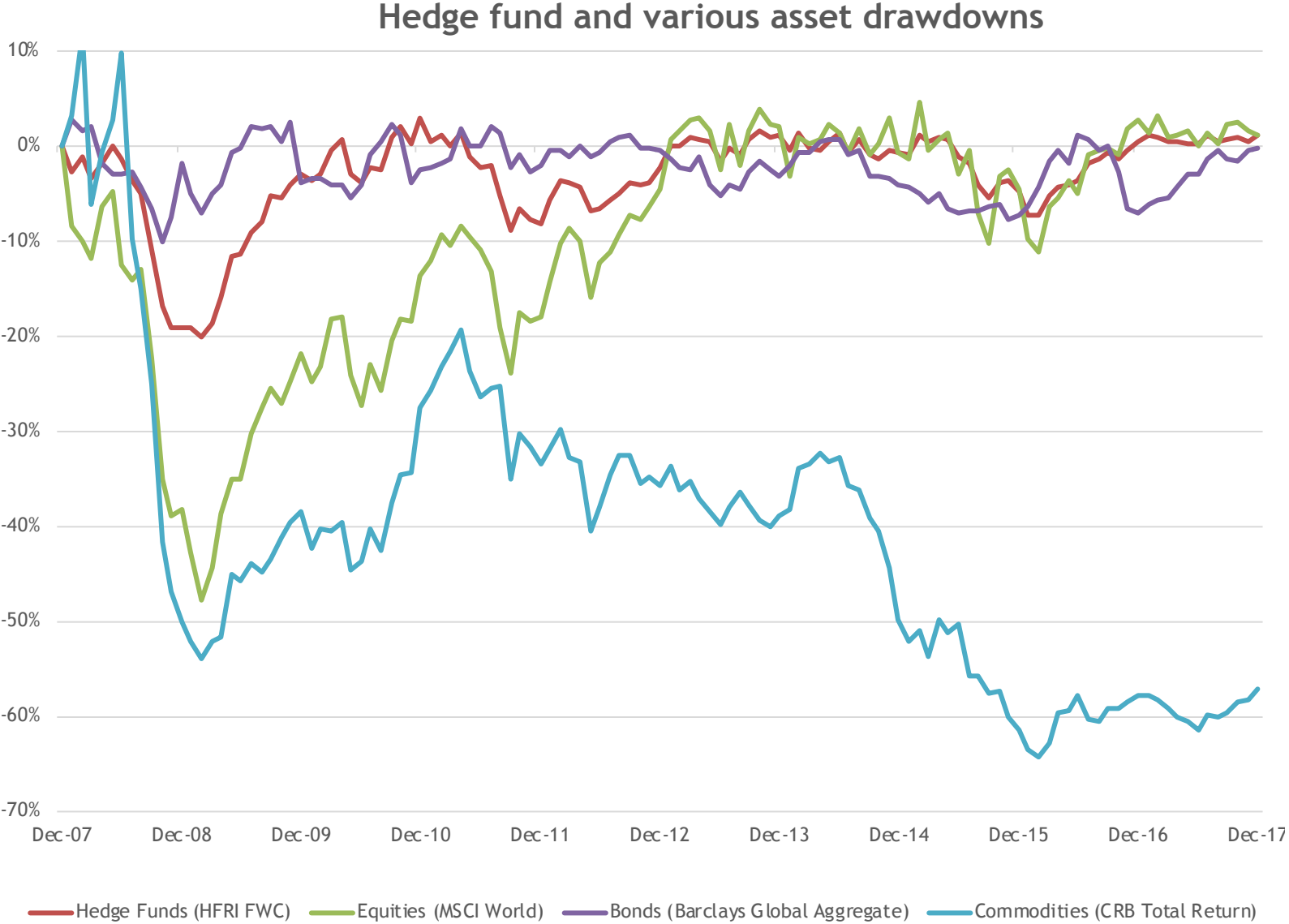


- ▶ Diversification
- ▶ Risk reduction & volatility reduction
- ▶ Downside protection & capital preservation
- ▶ Low to non-correlated returns
- ▶ Return enhancement
- ▶ Niche access to different investment opportunities
- ▶ Protection from rising interest rates & inflation

Smoother  
Return  
Experience



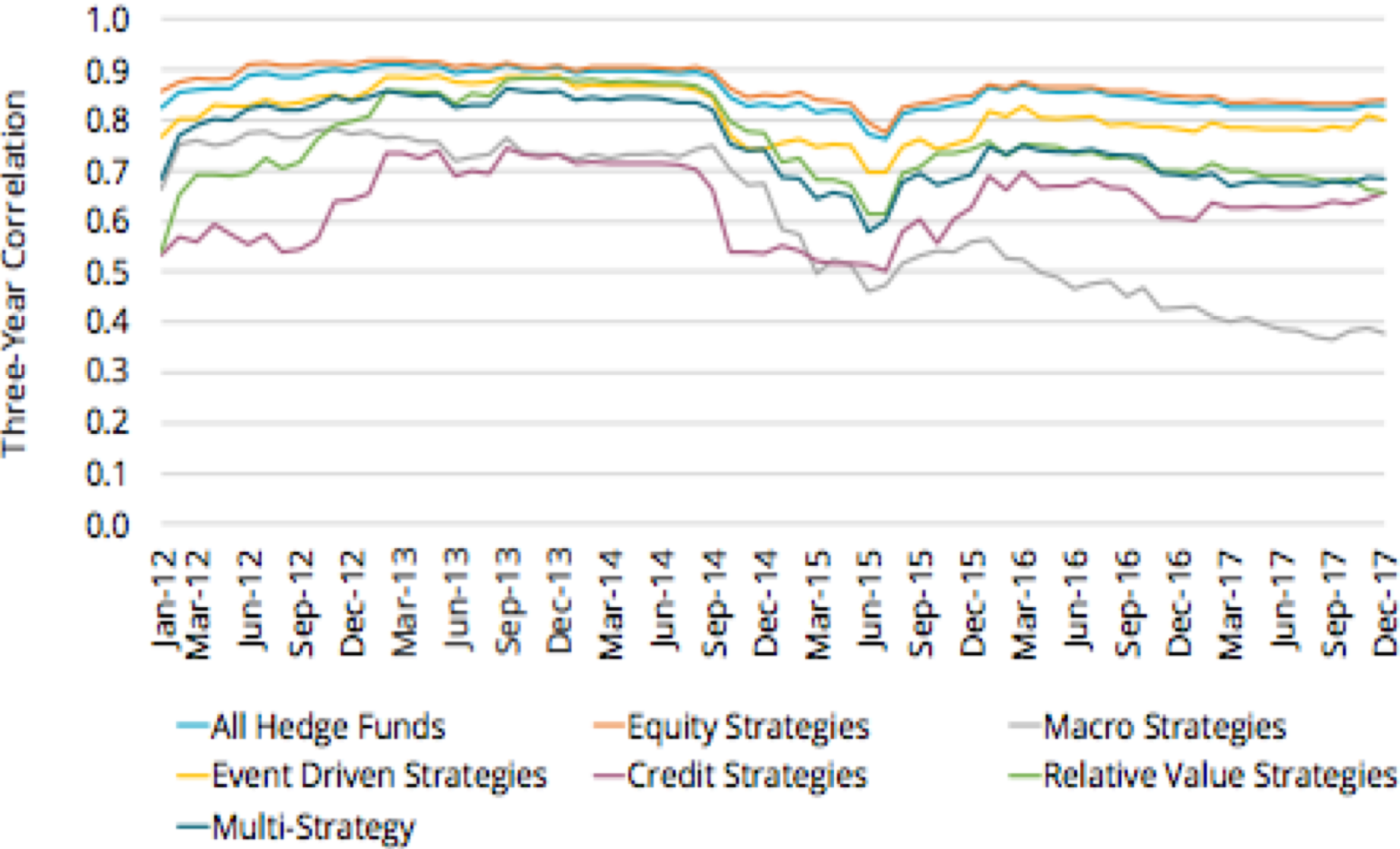
Lower  
Drawdowns



# Correlations

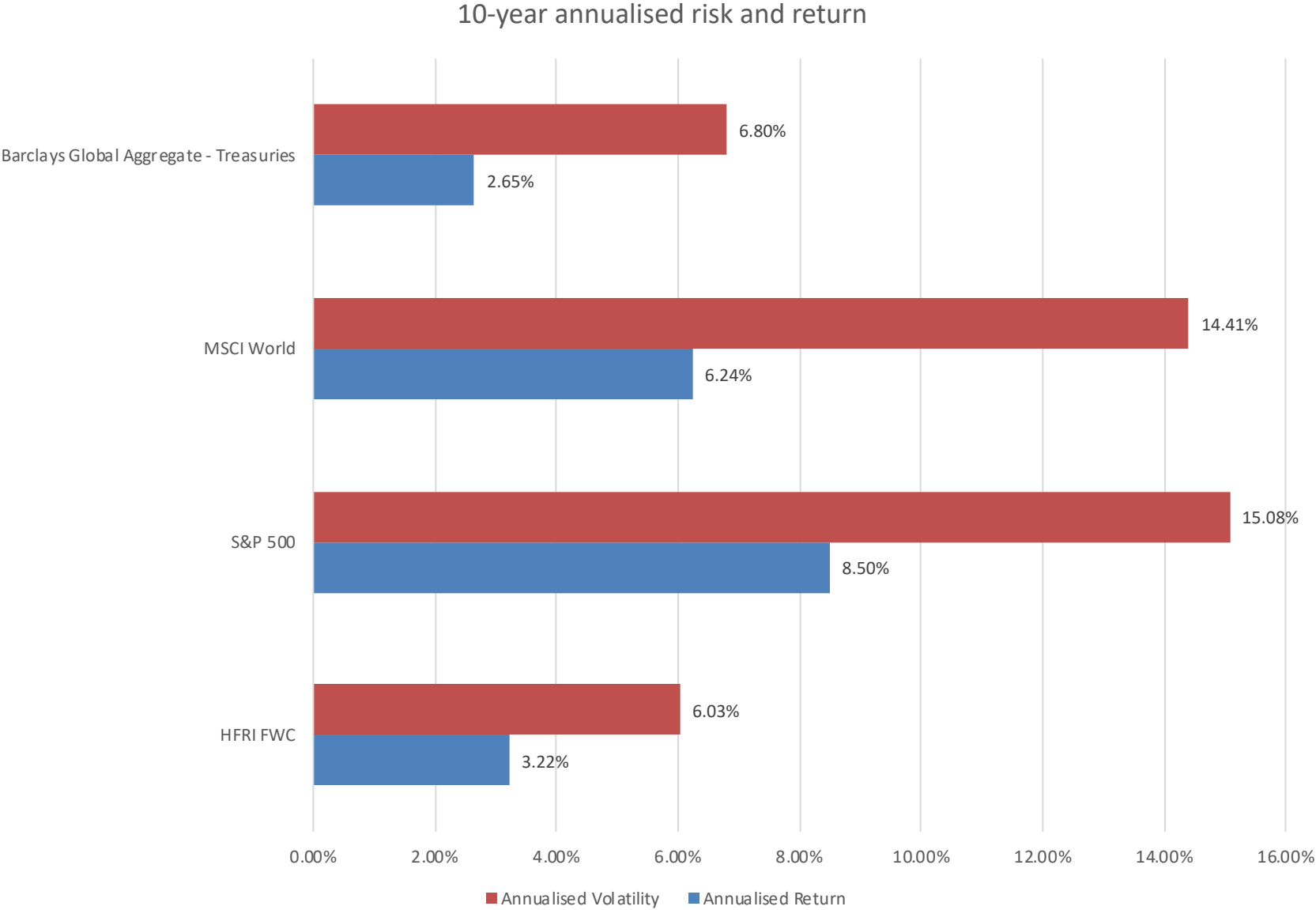



Fig. 4.9: Rolling Correlation of Hedge Funds to the S&P 500 PR Index, 2012 - 2017



Source: Preqin Hedge Fund Online

# Annualised Risk & Return



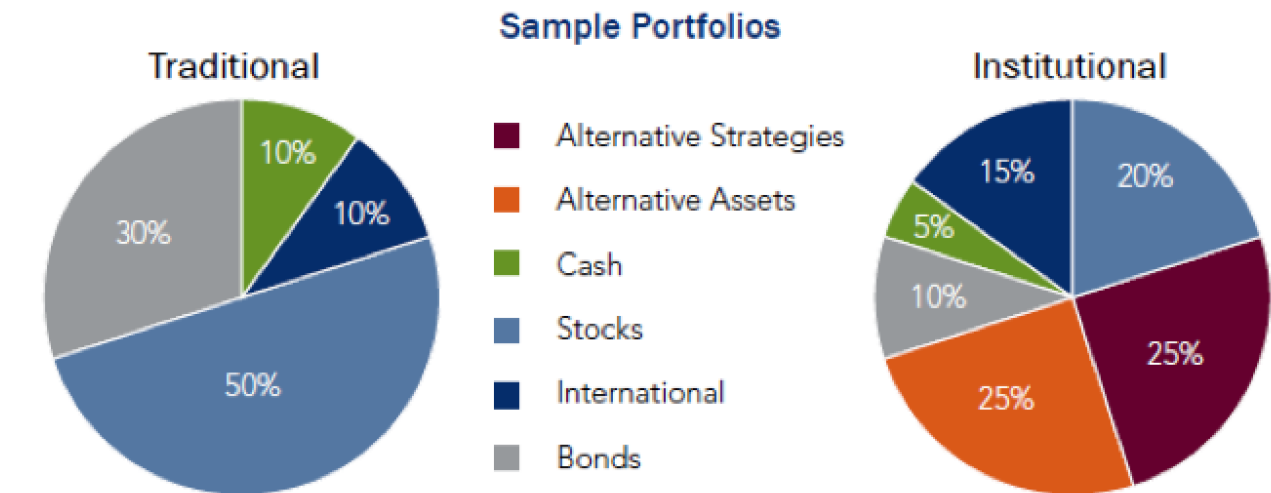
# **Role of Alternative Investments In Asset Allocation**





# Endowment Model

No longer: 60-40

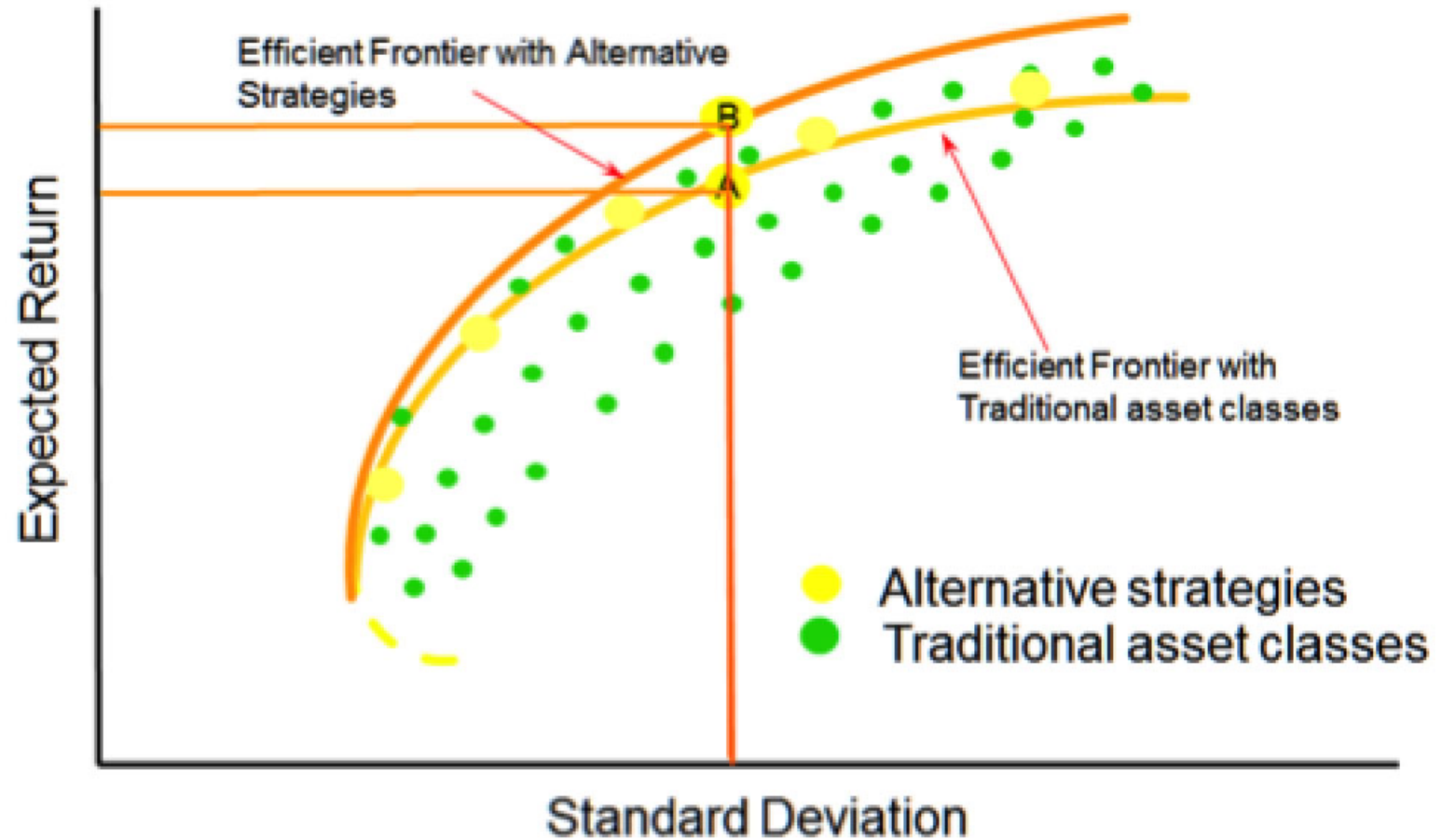


	TRADITIONAL	INSTITUTIONAL
Allocation	Static allocation targets—50/30/10/10 “typical” moderate portfolio	Adjustable allocations—driven by market environment and risk targets
Exposure	Uses traditional stocks, bonds, international and cash	Blend of traditional assets, alternative assets and alternative strategies
Risk	Result of market conditions	Focus on controlling risk by adjusting to market conditions
Rebalance	Rebalanced quarterly/annually	Ongoing allocation adjustments and rebalancing

The portfolios are hypothetical examples provided for illustration purposes only. No assumptions should be made that similar asset allocations will be profitable, suitable or perform as indicated above. Allocations and their percentages should change based on an individual investor’s needs.

## Extending the Efficient Frontier with Addition of Alternative Strategies

Extend the  
Efficient Frontier



# Investment in Alternatives



**51%**

of public pension funds actively invest  
in hedge funds.



**\$2.06tn**

Amount of capital invested in hedge  
funds by institutional investors.

## Institutions & Endowments

Nearly infinite time horizon, low appetite for risk, enhance risk adjusted returns to fund long term liabilities

Low or negative correlation to the rest of their investments

## Family Offices

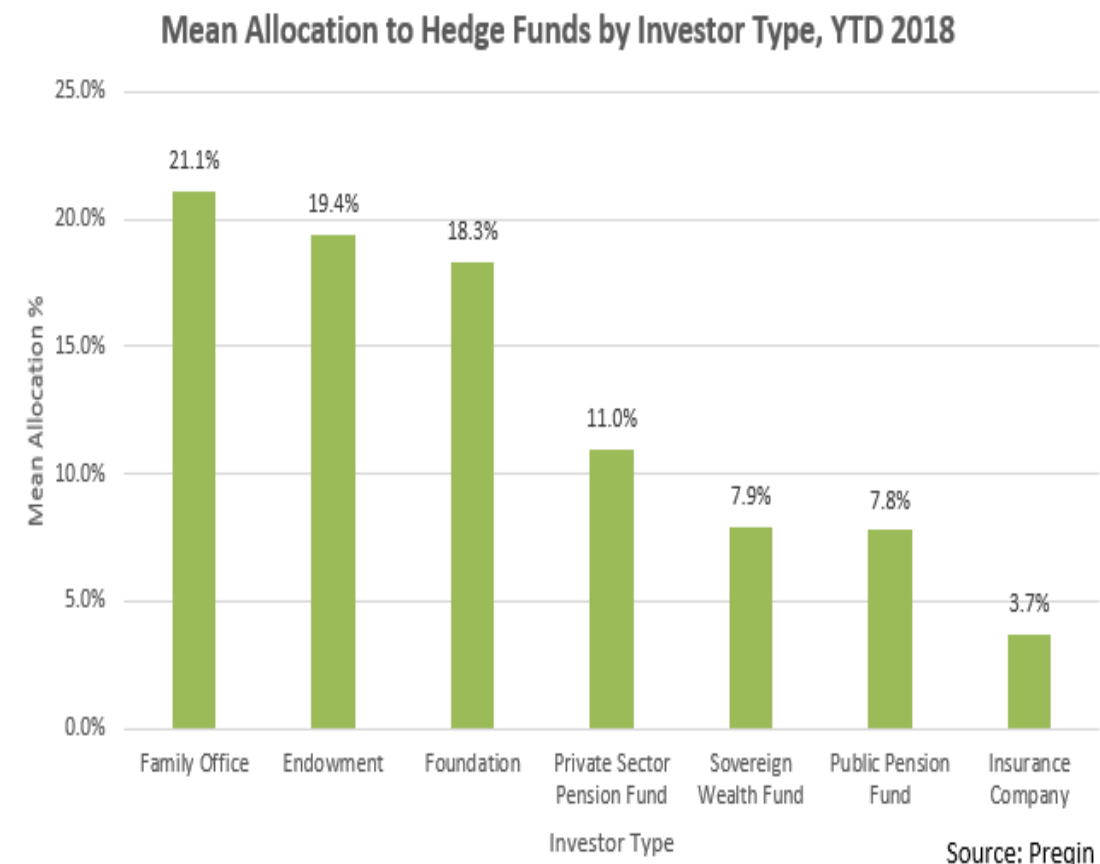
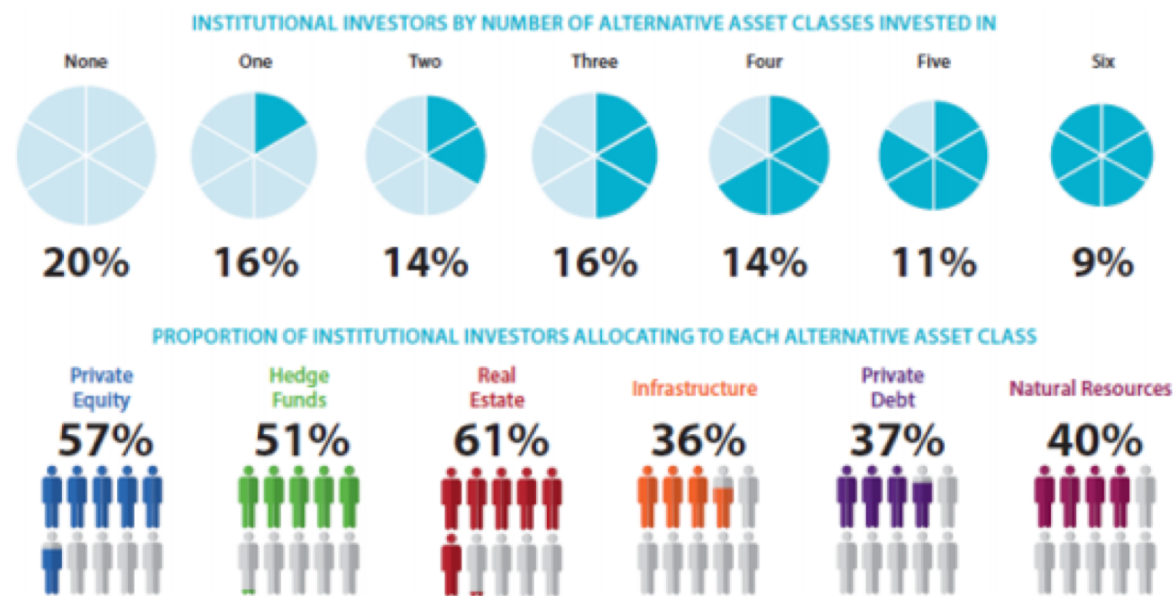
As a way to gain access to the best minds in the investment universe

Enhance diversification to increase total returns over time by reducing overall volatility

Consistency and reliability of returns

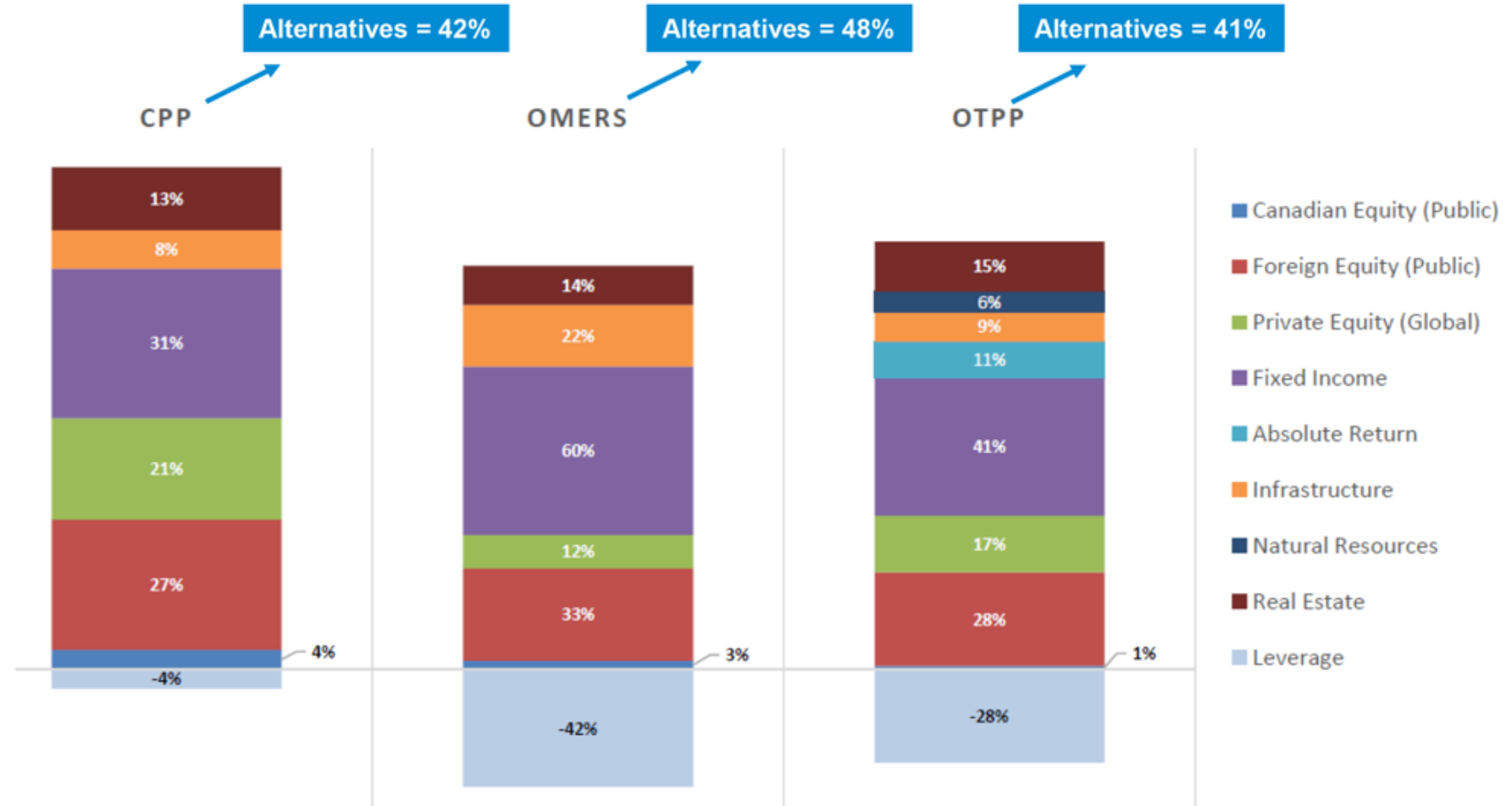
# Alternative Allocations

What Professional Investors want to accomplish



# Canadian Pensions

Fiscal Year End December 31 2015 (CPPIP Fiscal Year End March 31 2016)

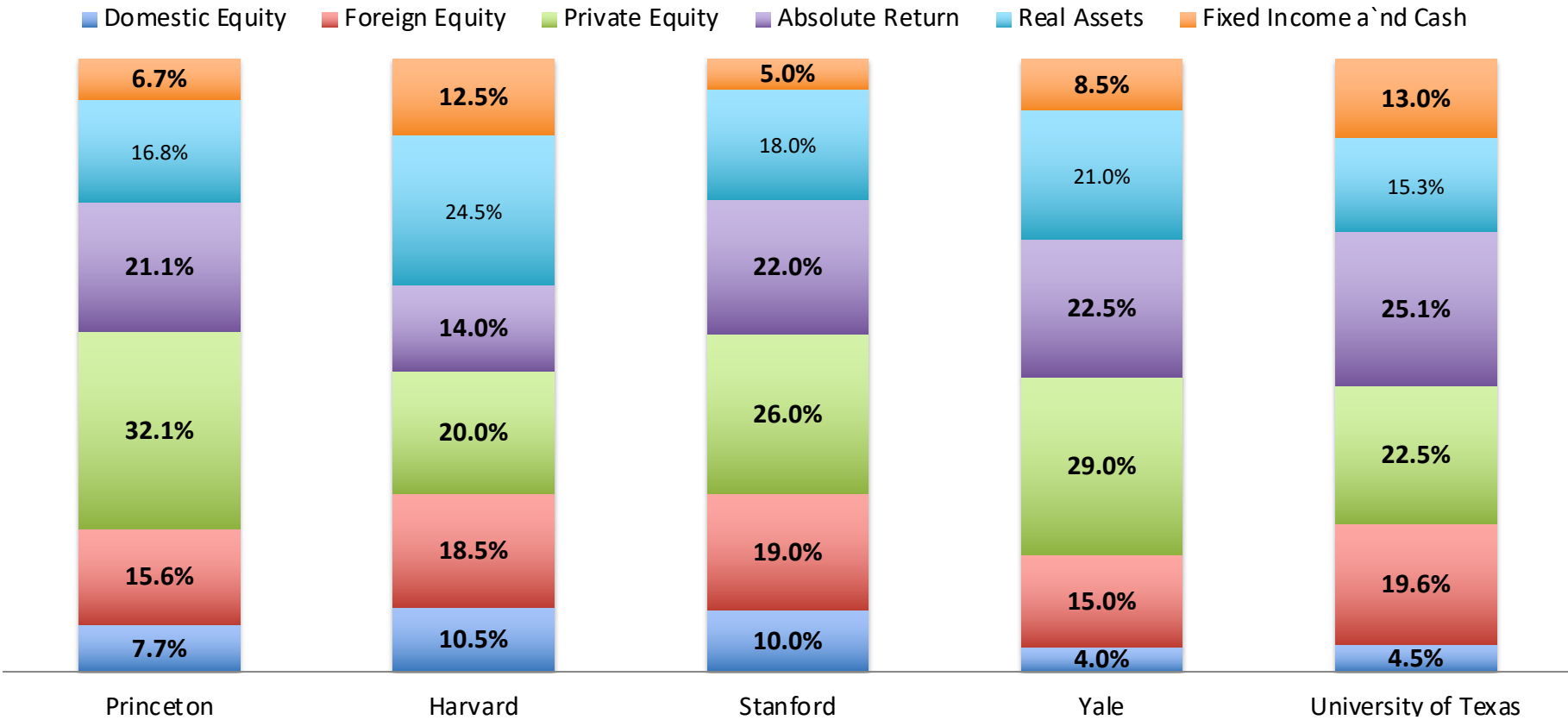


Notes: Asset allocation presentation is designed for illustrative and comparative purposes only. Most recent asset allocations used.

Source: CPP Investment Board 2016 Annual Report, OMERS 15 Annual Report, Ontario Teachers Pension Plan 2015 Report

CPP - Canadian Pension Plan Investment Board, OMERS - Ontario Municipal Employees Retirement System, OTPP - Ontario Teachers Pension Plan

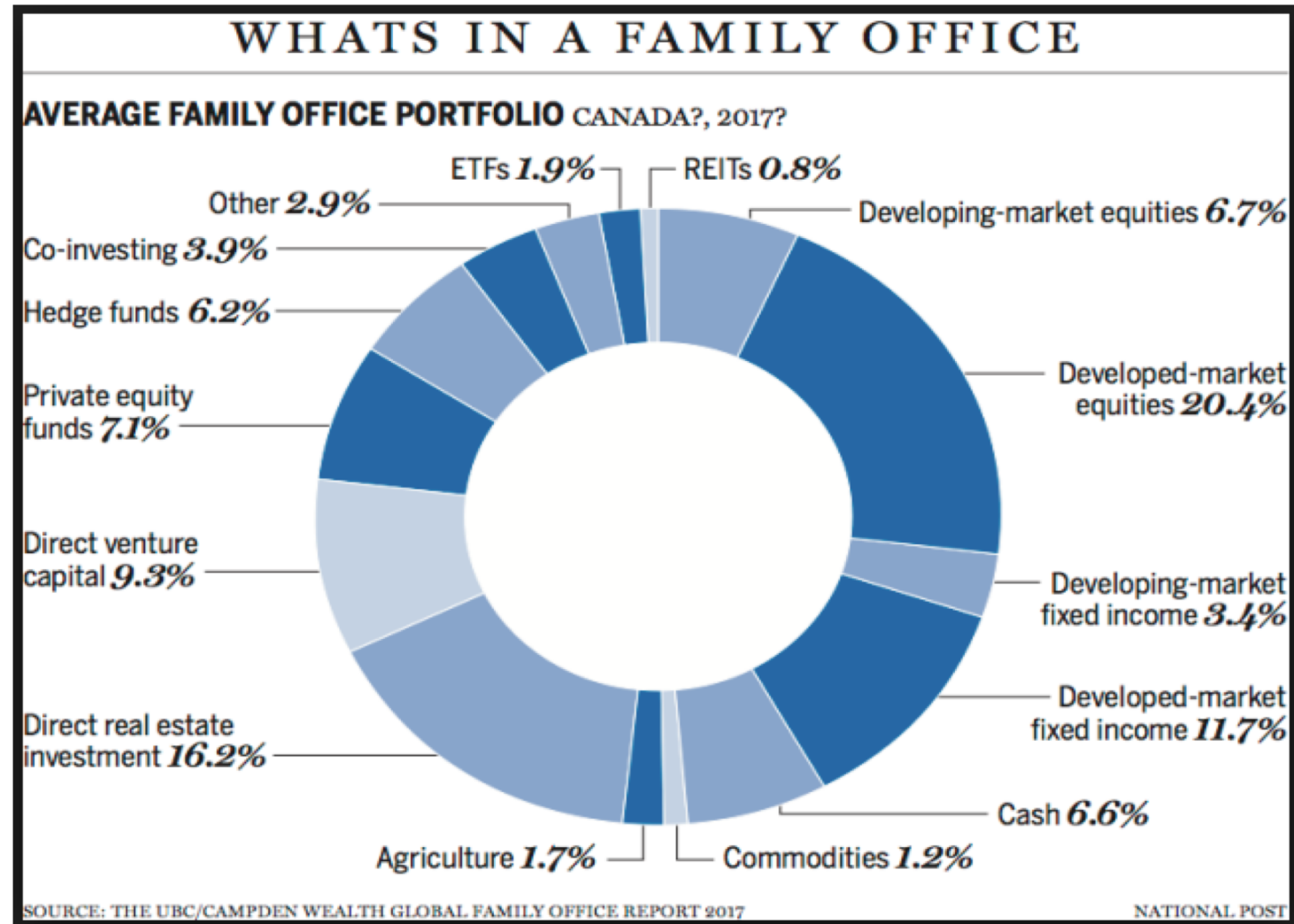
# US University Endowment Portfolio Asset Allocation



**Source:**  
Princeton: Report to the Treasurer 2014 - 15, Princeton University.  
Harvard - A Letter from Stephen Blyth PhD 92', President and CEO of Harvard Management Company, September 2015. Harvard University  
Stanford - Stanford Management Company Annual Report June 2015  
Yale - 2014 The Yale Endowment (report used for Asset allocations). <http://news.yale.edu/> (Used for Returns)  
\*University of Texas - <http://www.utimco.org/>, Audited Financial Statements - Year End August 31.

**Notes:**  
Asset allocations are for illustrative and comparative purposes only.  
Target allocations presented vs actual allocations where available (Princeton, Stanford, Yale)  
Harvard asset allocation presented as average of target range  
\*University of Texas allocations based on average from the Permanent University Fund and the General Endowment Fund.  
\*University of Texas endowment total size is the sum of Permanent University, General Endowment, Permanent Health, and Long Term Funds  
\*\* Princeton University does not report real estate and natural resource allocation breakdowns. Reports total "Real Asset" Allocation.

# Canadian Family Offices



# Wealth Managers

Why do they invest in alternatives



## Investment Advisors

### Client Experience

- Whether to enhance returns, dampen volatility or smooth out returns
- HNW/UHNW or sophisticated client base client-base
- Reduce statement shock

### Value Proposition

- Unique story that not all advisors are telling
- Engage conversations with HNW or UHNW families

Grow a stable, differentiated business with off-the-run solutions that appeal to wealthy clients/prospects

### Private Banks i.e.: JP Morgan, Citi, Morgan Stanley

- Cater to UHNW individuals who want downside protection and to partially participate rising markets
- Seek protection and growth of wealth for today and for future generations



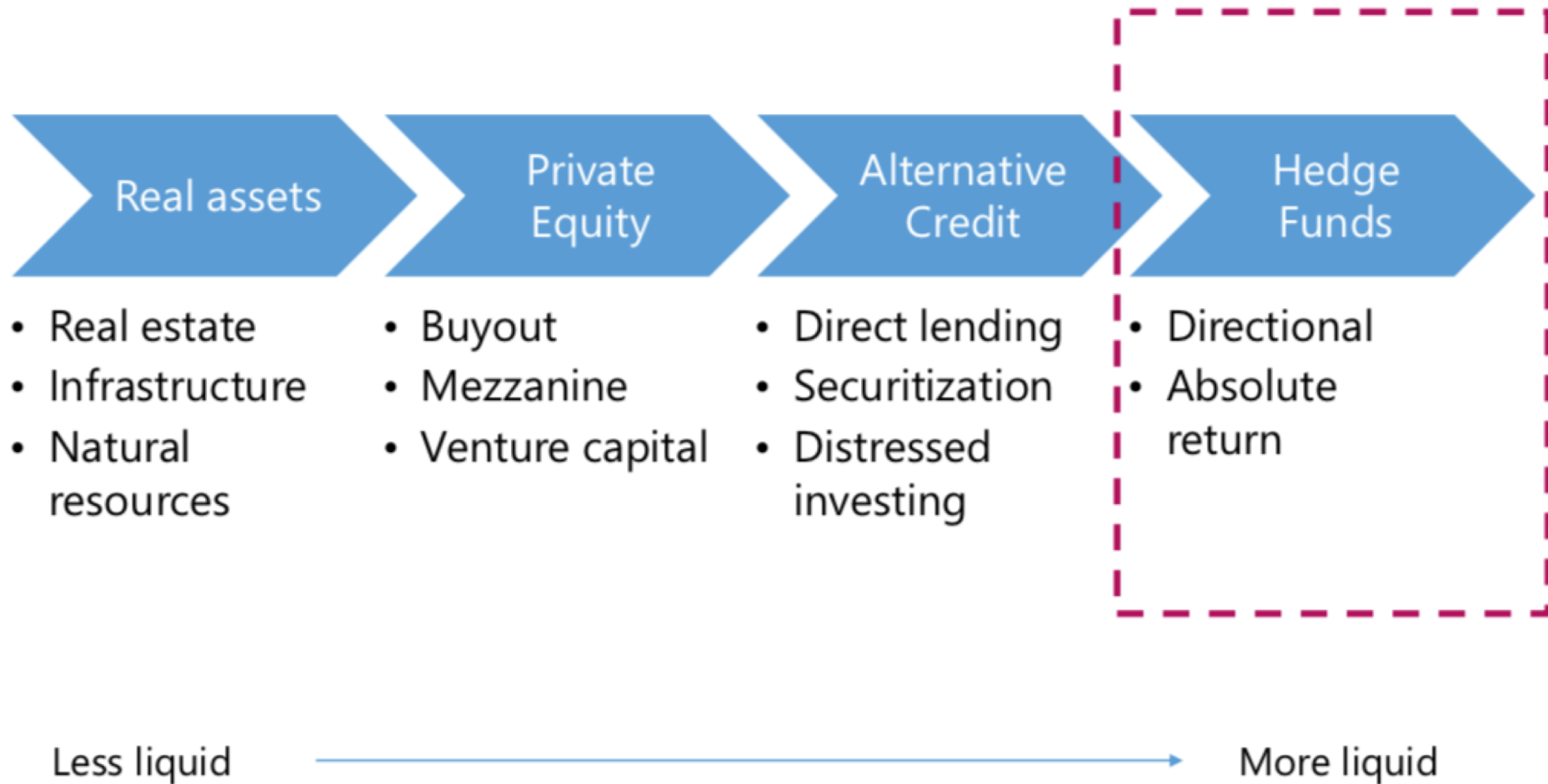
## Hedge Fund Allocations: Substitutes & Diversifiers

Substitute	Diversifier
Long/Short Equity	Global Macro
Long/Short Income	Managed Futures/CTA
Event driven	Equity Market Neutral
Fixed income arbitrage	
Convertible arbitrage	
Emerging markets	

# Types of Alternative Investment Strategies & Asset Classes



# Alternatives Investments



# Asset Classes & Strategies



	MACRO STRATEGIES	EQUITY STRATEGIES	MULTI-STRATEGY	RELATIVE VALUE STRATEGIES
Industry Assets by Strategy	\$1,054bn	\$894bn	\$485bn	\$354bn
Change over 2017	▲ 8%	▲ 9%	▲ 14%	▲ 4%

## Real Estate

- Private Equity
- Public Equity
- Private Debt
- Public Debt

## Private equity, lending & credit

- Venture Capital
- Mezzanine
- Leveraged Buyout
- Leveraged Loans

	CTAs	CREDIT STRATEGIES	EVENT DRIVEN STRATEGIES	NICHE STRATEGIES
Industry Assets by Strategy	\$279bn	\$251bn	\$206bn	\$24bn
Change over 2017	▲ 11%	▲ 6%	▲ 17%	▲ 64%

## Hedge funds

- Fixed Income /Credit Arbitrage
- Market Neutral Strategies & Long/ Short
- Risk/Merger Arbitrage
- Event Driven
- Multi Strategy
- Global Macro
- Managed futures

Source: Preqin Online Products

# Real Estate



Investors looking for income, inflation protection & diversification can access RE via Private, direct properties, debt instrument and/or publically traded REITs

- **5,191** Number of completed PERE transactions in 2017, worth an aggregate \$287bn.
- **\$811bn** Private real estate assets under management reached a new record in June 2017.
- **573** Record number of closed-end private real estate funds in market as at January 2018, collectively targeting \$191bn.

# Fixed Income/Credit Alternatives



Fig. 8.20: Performance of Credit Strategies Funds by Sub-Strategy (As at December 2017)\*

Q1 2017	Q2 2017	Q3 2017	Q4 2017	2017	3-Year Annualized	3-Year Volatility
Specialist Credit 4.07%	Mortgage-Backed Strategies 2.64%	Fixed Income 2.13%	Specialist Credit 1.84%	Specialist Credit 9.46%	Specialist Credit 7.85%	Asset-Backed Lending Strategies 0.85%
Fixed Income 2.77%	Asset-Backed Lending Strategies 1.92%	Long/Short Credit 1.66%	Fixed Income 1.59%	Mortgage-Backed Strategies 8.54%	Asset-Backed Lending Strategies 7.41%	Mortgage-Backed Strategies 2.17%
Mortgage-Backed Strategies 2.69%	Specialist Credit 1.75%	Asset-Backed Lending Strategies 1.55%	Long/Short Credit 1.58%	Fixed Income 8.18%	Mortgage-Backed Strategies 6.66%	Fixed Income 2.26%
Long/Short Credit 2.63%	Fixed Income 1.45%	Specialist Credit 1.50%	Mortgage-Backed Strategies 1.51%	Long/Short Credit 7.17%	Fixed Income 6.64%	Long/Short Credit 2.62%
Asset-Backed Lending Strategies 2.26%	Long/Short Credit 1.12%	Mortgage-Backed Strategies 1.45%	Asset-Backed Lending Strategies 1.00%	Asset-Backed Lending Strategies 6.90%	Long/Short Credit 5.15%	Specialist Credit 3.92%

Source: Preqin Hedge Fund Online

\*Please note, all performance information includes preliminary data for December 2017 based on net returns reported to Preqin in early January 2018. Although stated trends and comparisons are not expected to alter significantly, final benchmark values are subject to change.

- Absolute returns in falling & rising interest rate environment
- Outright value, Relative Value & Active Trading
- Currency hedging
- Invest long and short in credit securities & sectors

# Market Neutral & Long/Short Equity



**Seeks to eliminate or minimize the impact of market risk on portfolio returns**

- ▶ Heavily reliant on the portfolio manager's skill and/or supportive technology
- ▶ Managers take long and short positions in related financial securities that appear to be mispriced and hedge out undesired market exposures
- ▶ Broad spectrum of strategies like equity pairs, fixed income spreads, quant models, fundamental, global macro, directional, low net etc..

# Managed Futures



- Active trading of futures and forward contracts on physical commodities, financial assets and exchange rates to earn the risk and return of active management within the futures market
- Also known as CTA funds (Commodity Trading Advisor)
- Tend to be based on systematic trading more than discretionary trading
- Generally categorized into three groups:
  - Trend-following
  - Non-trend following
  - Relative value



# Global Macro



- Managers research global economic landscape for best ideas
- Seek to profit from any macro-economic imbalances and/or geopolitical events
- Often no limitation in terms of the types of instruments, asset classes, markets and geographies that they can invest in
- Broadest investment mandate of major hedge fund strategies

## Event Driven, Risk/Merger Arbitrage, Distressed Securities, Special Situations



Risk/Merger Arb attempts to benefit from a corporate merger or acquisition by taking a long position on the target company and, if applicable, short selling the acquiring company capturing the spread between the prices as the market reacts to a given deal

Event-Driven strategies identify specific corporate events as they occur in the markets attempting to profit from trading in and around the capital structure of these special situations in a corporate life cycles (acquisitions, spin-offs, changes in capital structure, etc.).

# Relative Value



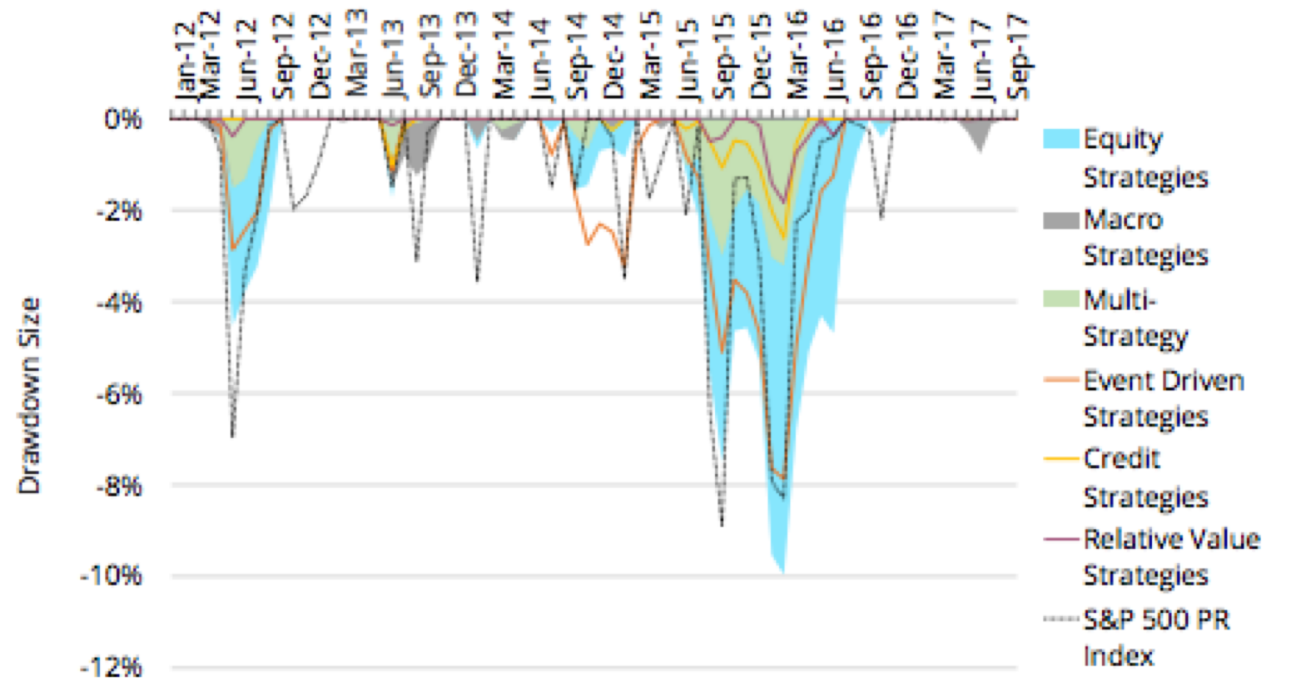
- Seek to take advantage of differences in the pricing of related financial instruments
- Typically have less exposure to underlying equity or bond market than long/short strategies
- Objective is to extract or capture value from any structural anomalies that exist in the markets between related securities

# Multi-Strategy



- ▶ Portfolio of strategies to create a stream of returns that is relatively uncorrelated to major asset classes which helps smooth returns, reduce volatility and decrease asset-class and single-strategy risks
- ▶ Capital is allocated dynamically to exploit investment opportunity sets
- ▶ Strategies may include (and are not limited to)
  - Convertible Bond Arbitrage
  - Equity Long/Short
  - Merger Arbitrage
  - Event-Driven
  - Fixed Income Arbitrage
  - Systematic Strategies
  - Private Credit

Fig. 4.10: Drawdowns of Hedge Funds vs. S&P 500 PR Index, 2012 - 2017

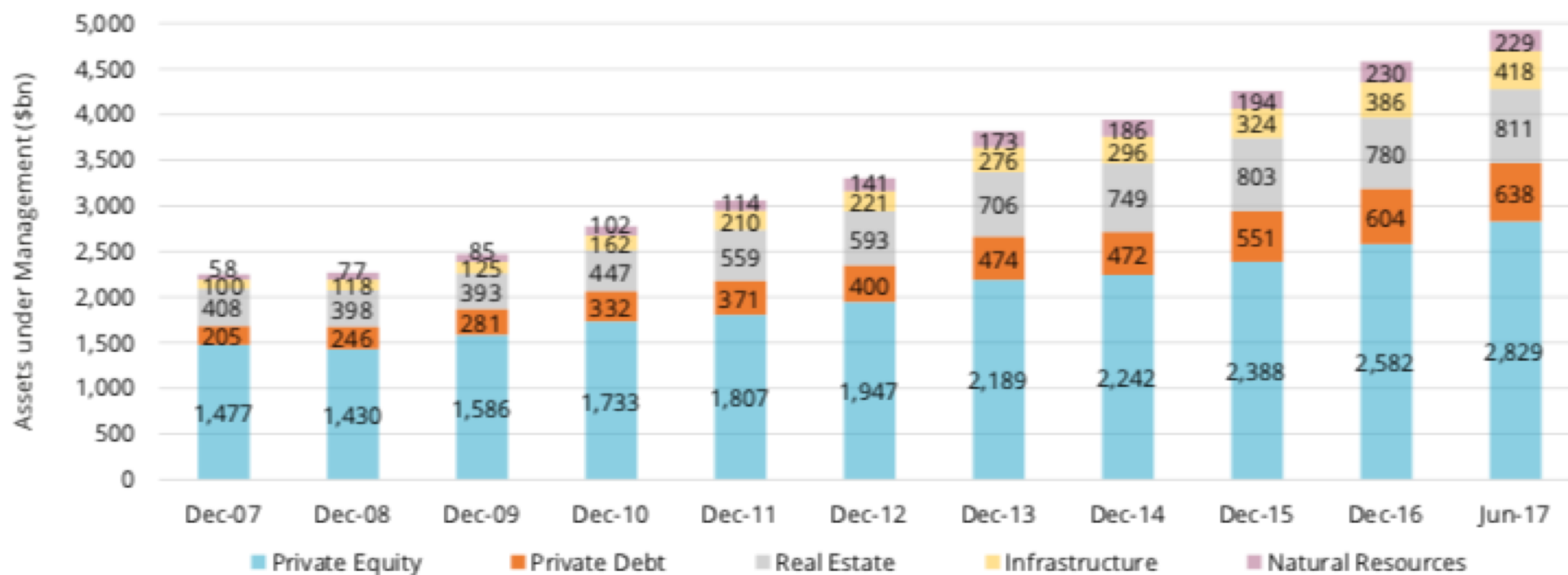


Source: Preqin Hedge Fund Online

## Private Credit, Private Equity, Real Estate, Infrastructure, Resources



Fig. 2.1: Private Capital Assets under Management by Asset Class, 2007 - 2017



Source: Preqin Online Products

# Private Equity



**\$453bn**

Aggregate capital raised by 921 private equity funds closed in 2017.



**\$2.83tn**

Private equity assets under management as at June 2017, an all-time high.



- ▶ Venture Capital invests in start-up companies hoping to gain when eventually company goes public
- ▶ Leveraged buyout borrows money to buy listed companies, takes them private and restructures them, usually hoping to sell and make a profit

# Private Debt



## SIZE OF THE INDUSTRY



**\$638bn**

Private debt assets  
under management  
as at June 2017.



**\$236bn**

Dry powder held by  
private debt funds  
as at December 2017.

## Mezzanine (subset of Private Equity)

Funds that provide short term financing to companies going through transformation and venture companies who have a hard time receiving financing from banks

## Leveraged Loans

One or more investment banks arrange a loan to a borrower and then sell it to a group (syndicate) of commercial bank and investors

## Private Credit

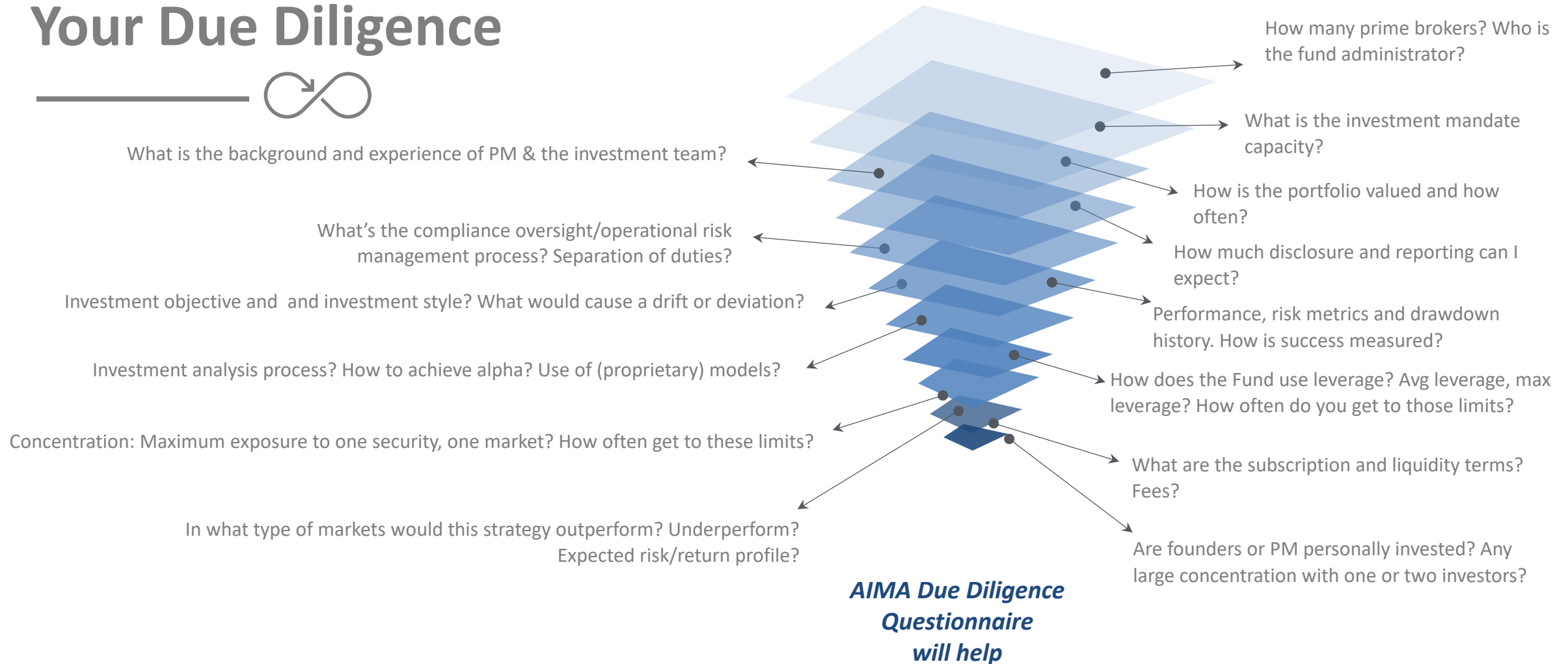
Fund lends to borrowers who cannot access bank either due to riskiness (distressed) or urgency

# Due Diligence of Alternative Investments





# Your Due Diligence

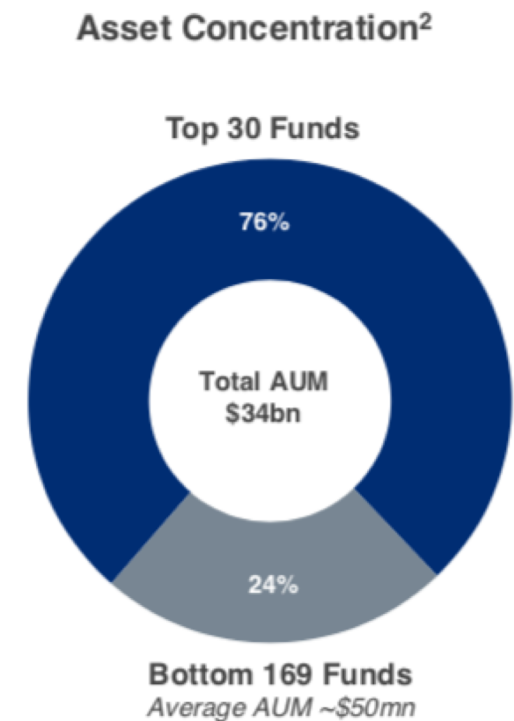
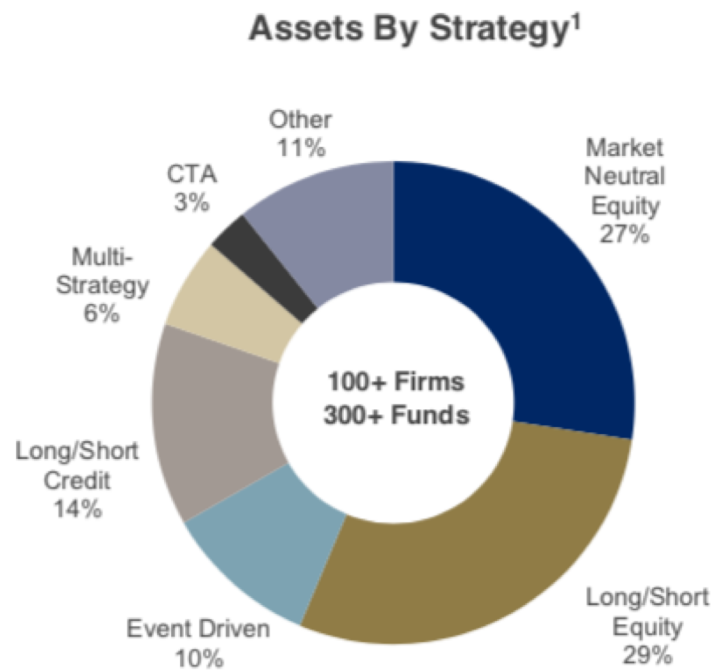


# Alternatives Industry In Canada



# Alternatives in Canada

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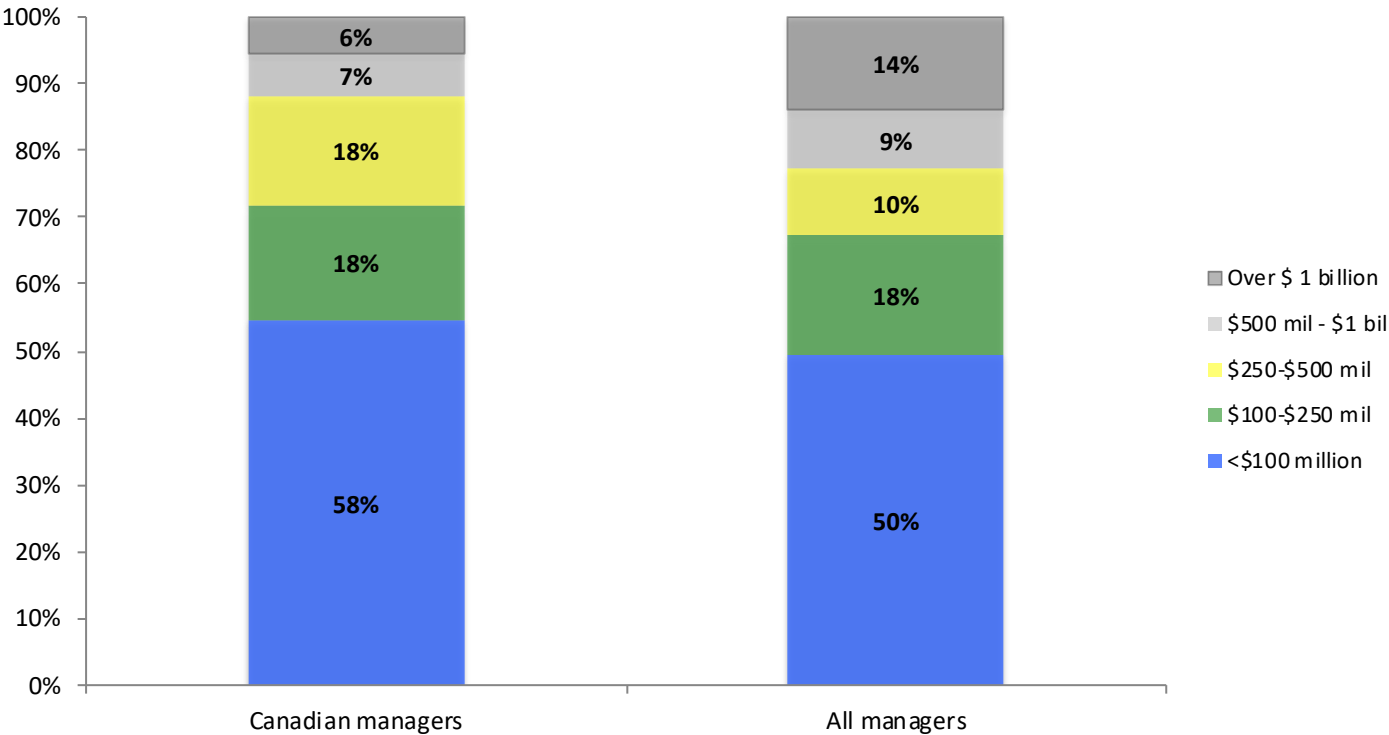
**Median Fund Size: \$41 Million**

1. Source: Preqin  
2. Based on AUM of reporting funds as of February 28, 2018

# Canada Alternatives Similar to the World

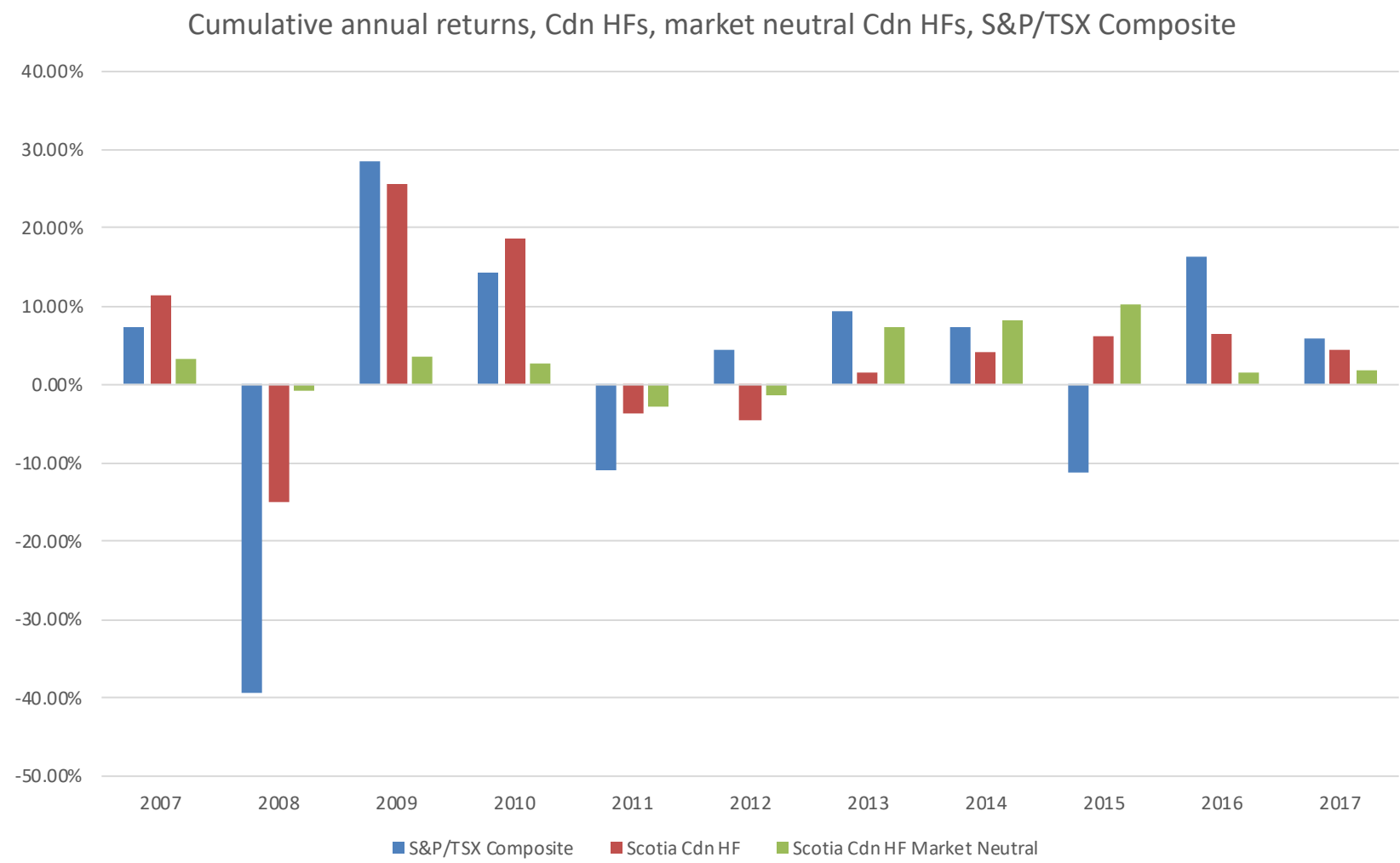


- Globally, hedge funds under \$100 million AUM are 50% of funds.
- In Canada, 58% of hedge funds have AUM under \$100 million.

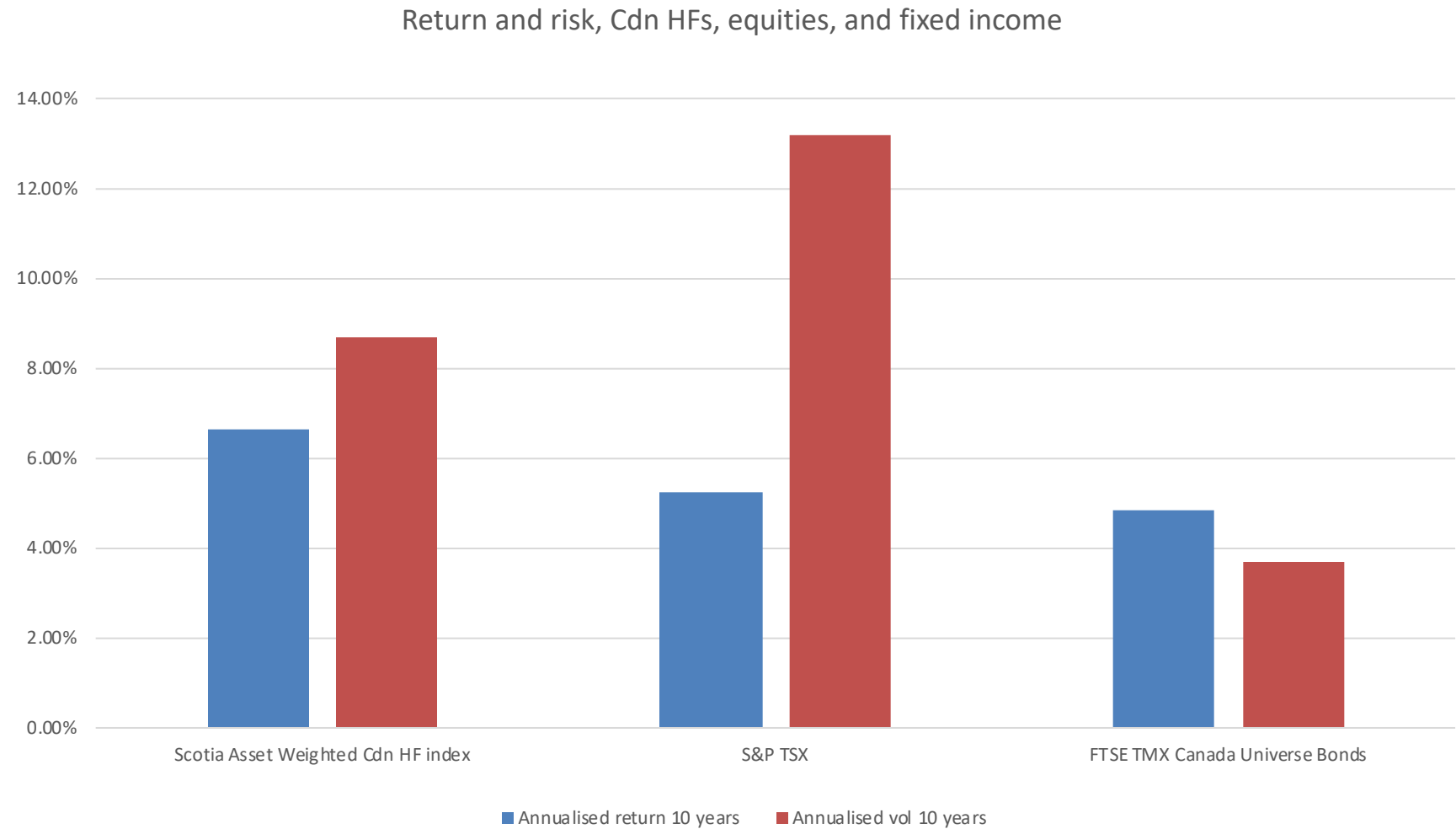


# Canadian Alternatives

Cumulative Annual Returns



# Risk & Returns, Canadian Hedge Funds & Securities



Source: Bloomberg & Morningstar, as at December 31 2017.

## NI 81-102 Alternative Mutual Funds



Restrictions & Obligations	Alternative Mutual Funds
Eligible Investors	Available to the mass market
NAV Calculation	Daily
Redemption Rights	Daily (most common), weekly & monthly could apply as well
Initial Holding Period	Maximum 6-month (at option of manager)
Redemption Proceeds	T+2
Performance Fees	Permitted
Borrowing (cash and / or securities)	Limited to 50% of NAV (Borrowing + Short Selling cannot exceed 50% of NAV)
Short-selling	Limited to 50% of NAV, no cash cover required
Leverage	Maximum of 3X leverage defined as (total short securities + short cash + notional size of derivatives*)/ NAV) *excludes derivatives used for hedging
Concentration Limit – issuer level	20% of NAV, subject to carve-outs
Illiquid Assets	10% of NAV at initial investments, 15% hard-cap
Disclosure requirements	Publicly-filed financial statements Top 25 holdings disclosed quarterly Leverage disclosure in annual and interim financial reports

## Summary & Other Resources





## Summary



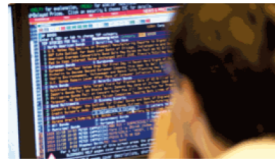
- Alternatives play key role in asset allocation for institutional and retail investors
- Alternatives offer important benefits to investor portfolios:
  - Diversification
  - Risk reduction
  - Non-correlated returns
- Alternative strategies are diverse
  - Evaluate as separate products, not as one “hedge fund” bucket
- Due diligence important, as with any investment
- Canada has robust market of Alternatives managers

# AIMA.org



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## About Alternatives



### Factsheets

Who invests in alternative investment funds? What contribution do alternative asset management businesses make to the real economy? How many people work in the industry? Click on the link above for a series of short articles covering these and other topics that reveal the value of alternative investment funds to investors, financial markets and the economy.



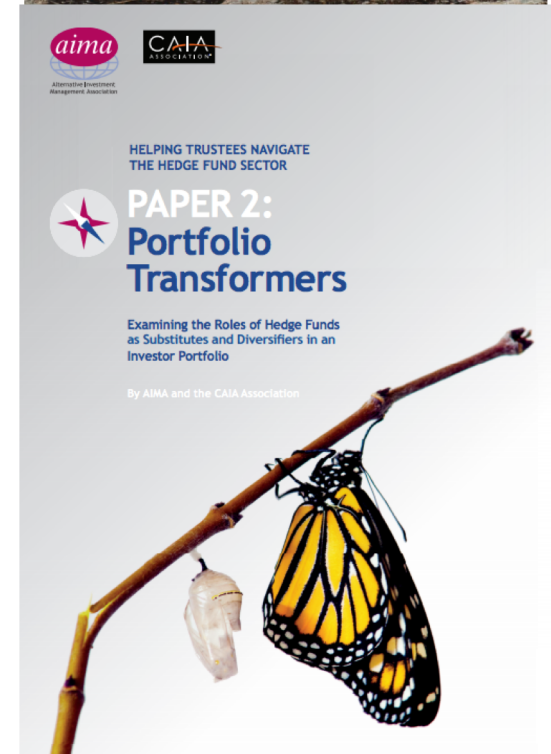
### Six ways the alternative investment industry benefits savers and the economy

AIMA has produced a short series of graphics about the industry - from the number of pensions with hedge fund investments to the contribution that private credit funds are making to the real economy.



### Frequently-asked questions

AIMA represents alternative asset management businesses that manage hedge funds and private credit funds. The FAQs on this page cover a range of issues relating to the overall sector and these types of investment funds. If you have further questions you would like us to answer, contact us at [info@aima.org](mailto:info@aima.org).



## About AIMA



- AIMA is the global trade association for the alternative fund industry
  - UK, Europe, USA, Canada, Hong Kong, Singapore, Japan, China, Australia, Cayman, Brazil, Middle East, Bermuda
- Core objectives: **Education, Advocacy & Communication**
  - Provide leadership to the industry and to be its pre-eminent voice
  - Provide an interactive and professional forum for our membership and act as a catalyst and promoter of the industry's global development
  - Develop sound practices, enhance industry transparency and education
  - Liaise with the wider financial community, institutional investors, the media, regulators, governments and other policy makers

## CAIA Fundamentals



### Program Info:

- **20 one-hour online video modules**, each concluding with a 10 question self-study quiz.
- Video content is **delivered online**, making it accessible according to your timeframe.
- Modules are **split into brief, digestible sections** and focus on specific subcategories within that module's scope, allowing you to **learn in a manner that fits your schedule**.
- **Topics Include:** Alternative Investment Basics, Hedge Funds & Managed Futures, Private Equity & Venture Capital, Real Assets including Infrastructure & Timberland, & Structured Products
- **Continuing Education:** The CAIA Fundamentals certificate program is CECAP accredited for 20 hours of CE.



### AIMA Member Discounts

- As an AIMA Member, you are eligible to receive a \$100 USD discount towards the CAIA Fundamentals Program by using the code '**AIMA**' at checkout:  
<https://fundamentals.caia.org>
- AIMA Members are eligible to receive a 25% discount off the registration costs towards their CAIA Level 1 or Level 2 registration fee.  
<https://caia.org/registration-and-fees>

## About CAIA Association



- Chartered Alternative Investment Analyst Association
- Global Leader in Alternative Investment Education
- Non-profit established in 2002, based in Amherst, MA, with offices in Hong Kong and London
- Over 9,000 current charter holders in more than 90 countries
- 30 vibrant chapters located in financial centers around the world
- More than 150 educational and networking events each year
- Offers education through the CAIA designation and the Fundamentals of Alternatives certificate program

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