TritonPacific
Capital Partners, LLC

THE GROWING POPULARITY OF ALTERNATIVE INVESTMENTS

Institutional investors have long recognized the potential advantages inherent in alternative investments. In more recent years, this asset class has witnessed an increasing level of popularity with financial advisors and retail investors as well.

Near the onset of 2022, financial advisors and their clients faced a near-zero interest rate environment and compelling valuations in both the stock and bond markets.

By the end of that year, however, the Fed had increased interest rates seven times, raising the target interest rate to 4.25% to 4.50%. Consequently, portfolios adhering to the traditional 60% equities and 40% fixed income allocation experienced a pronounced downturn of 16%, marking one of the worst years in market history.[1]

The 2023 market environment has been largely shaped by similar macroeconomic concerns. The Fed raised interest rates four more times to its current target rate, as of November 1st, 2023, of 5.25% to 5.50%, the highest rate in 22 years.[2] October's 3.2% inflation rate continues to exceed the Fed's target of 2%.[3] Simultaneously, global geopolitical tensions, exemplified by conflicts in Ukraine and the Middle East, continue to persist, contributing to an environment of heightened uncertainty.

It is during these times of volatility that asset managers may start to go beyond the traditional investments of stocks and bonds and start to look more at alternative investments, including private credit, private equity, and real estate alternatives. This may be why 81% of institutional investors intend to increase their allocation of funds to alternative investments by 2025.[4]

Against the backdrop of the challenges of the current macro-environment, and with true diversification becoming more difficult to achieve in the public markets, alternative investments and their potential advantages are becoming increasingly popular with financial advisors and retail investors. In fact, adoption of alternative investments by mass affluent investors (those earning between $250,000 to $1,000,000) is expected to increase to 32% by 2024, more than doubling its usage from 2021.[5]

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Net Worth Level	Usage Level of Alternative Investments in 2021	Estimated Usage 2024
Mass affluent	14%	32%
High-net-worth	29%	46%
Very-high-net-worth	55%	68%
Ultra-high-net-worth	81%	85%

1. Morningstar, as of December 31, 2022. The 60/40 portfolio is 60% allocated to the S&P 500 index and 40% is allocated to the Bloomberg US Aggregate Bond Index. The S&P 500 is an unmanaged group of securities considered representative of the U.S. stock market in general. The Bloomberg US Aggregate Bond Index is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States. Investors cannot invest directly in an index. Past performance is not a guarantee of future results.
2. Timiraos, Nick. "Federal Reserve Raises Interest Rates to 22-Year High." The Wall Street Journal. July 26, 2023. https://www.wsj.com/articles/federal-reserve-raises-interest-rates-to-22-year-high-3c3e499c
3. "United States Inflation Rate." November 14, 2023. https://tradingeconomics.com/united-states/inflation-cpi#
4. Caporal, Jack. "Alternative Investments of the Ultra-Wealthy in 2023." October 2, 2023. https://www.fool.com/research/high-net-worth-alternative-investments/
5. Ernst & Young defines wealth segments as follows (based on assets): mass affluent $250k-$1m; HNW $1m-$5m; VHNW $5m-$30m; UHNW $30m+. "Where Will Wealth Take Clients Next? 2021 EY Global Wealth Research Report." Ernst & Young. 2021. https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/wealth-and-asset-management/ey-2021-global-wealth-research-report-optimized-for-web-v2.pdf

ALTERNATIVE INVESTMENTS MAY OFFER FINANCIAL ADVISORS NEW SOLUTIONS

The surge in investor interest towards alternative investments is paralleled by a corresponding uptick in their adoption among financial advisors. In a market with high inflation and a tight monetary policy, many advisors "agree that the traditional 60/40 portfolio mix is no longer an effective investing strategy" and are searching for new solutions. 53% of financial advisors plan to raise their alternative investments allocations to more than 15% in the next two years, and more than 20% of advisors expect that their alternative investments allocations will be in excess of 25% of their portfolios.[6]

Simultaneously, alternative investments are becoming more accessible to financial advisors and investors. Certain legislation, such as the SEC's expanded definition of an "accredited investor" has helped to include more retail investors, while various tech platforms are helping to provide improved operational efficiencies to financial advisors. Such tech-driven enhancements include greater online educational resources, outsourced due diligence, and a variety of other time-saving services, which allow advisors to explore more alternative investment options and connect with more potential clients. Collectively, this may contribute to an environment more conducive to the broader integration of alternative investments into investors' portfolios.

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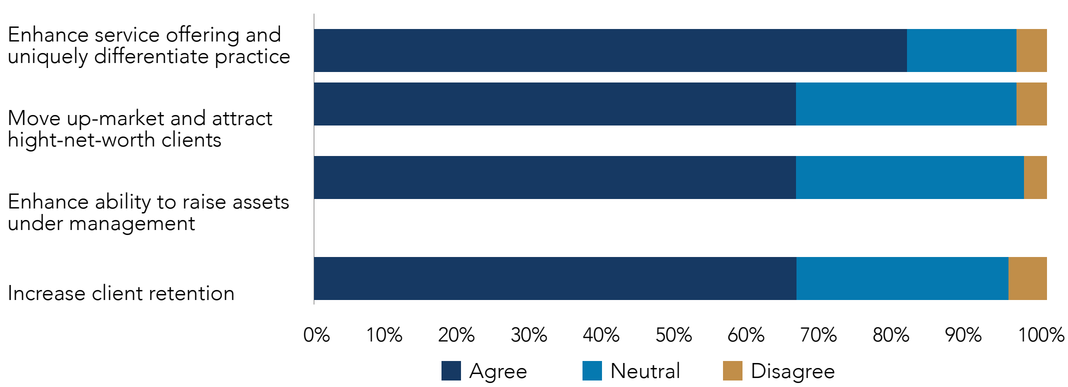
ALTERNATIVE INVESTMENTS MAY HELP FINANCIAL ADVISORS STAND OUT IN A CROWDED MARKET

Still, even with these enhancements, alternative investments are a complex, illiquid asset class that require financial advisors to perform comprehensive due diligence. For many advisors, offering these alternative asset classes is a way to differentiate their financial practices while also attracting high-net-worth individuals, improving their ability to attract and retain clients. This represents a substantial opportunity for advisors well-versed in the nuances of alternative investments. It is possible that up to $10 trillion could shift from stocks and bonds to alternative investments in the ensuing years.[6]

FINANCIAL ADVISORS AGREE THAT ALTERNATIVE INVESTMENTS MAY HELP DIFFERENTIATE THEIR PRACTICES[7]



Alternative investments often demand a high level of knowledge and expertise. For instance, delving into private equity requires an in-depth comprehension of a protracted and intricate cash flow process — from investors to general partners, then to portfolio companies, back to general partners, and ultimately back to investors. Financial advisors must not only understand the intricacies of their alternative products for themselves, but they are also tasked with effectively communicating these complexities to their clients. This involves concepts such as the implications of illiquidity, diverse value propositions, investment objectives, and the additional administrative procedures involved.

In essence, advisors may set themselves apart by seamlessly integrating this comprehensive education into their interactions, thereby offering a distinctive and tailored experience for each client.

6. Brown, Matt. "Alts Access Integral to Financial Advisor Success in 2023." December 12, 2022. https://www.wealthmanagement.com/alternative-investments/alts-access-integral-financial-advisor-success-2023
7. "How Are Your Peers Using Private Markets?" 2023. https://www.invesco.com/us/en/insights/private-market-trends.html

ALTERNATIVE INVESTMENTS OFFER A LONG-TERM OPPORTUNITY

In many ways, alternative investments are strategically structured to operate more efficiently within an extended timeframe. Characterized by a general lack of liquidity and a diminished correlation to the market, it is these factors that may contribute to their stability and their historic results. For example, over the last 25 years, private equity has returned 14% globally versus 7% for the MSCI World Index.[8] Alternative investments have also been shown to increase portfolio performance. From 1990 through 2022, portfolios with a diversified mix of 48% stocks, 32% bonds, and 20% alternative investments outperformed the traditional 60/40 portfolio with less volatility.[9]

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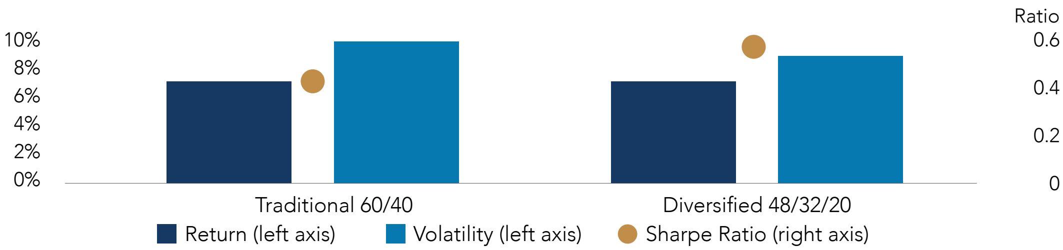
ALTERNATIVE INVESTMENTS MAY IMPROVE RISK-ADJUSTED RETURNS[10]

Q1 1990 – Q4 2022

	Return	Volatility	Sharpe	Max Drawdown
Traditional 60/40	7.07%	9.20%	0.49	-34.99%
Diversified 48/32/20	7.58%	8.44%	0.59	-32.40%

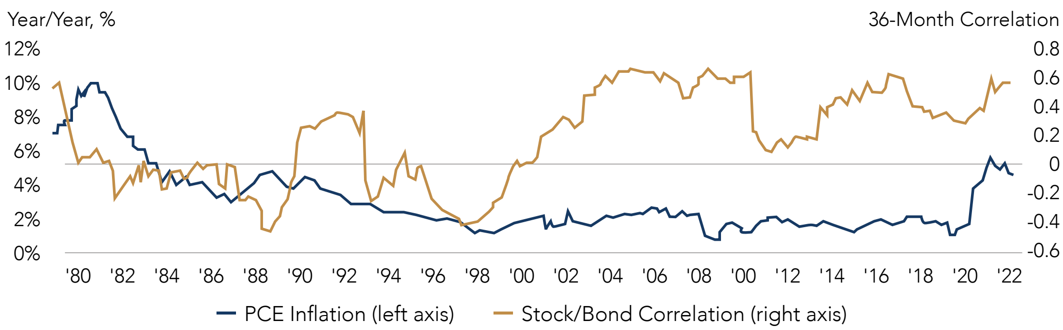


The Sharpe ratio measures the performance of an investment such as a security or portfolio compared to a risk-free asset, after adjusting for its risk. It is defined as the difference between the returns of the investment and the risk-free return, divided by the standard deviation of the investment returns. It represents the additional amount of return that an investor receives per unit of increase in risk. The MSCI World Index captures large and mid-cap representation across 23 Developed Markets (DM) countries. With 1,511 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. The Bloomberg US Aggregate Bond Index is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States. The HFRI Fund Weighted Composite Index is a global, equal-weighted index of single-manager funds that report to Hedge Fund Research (HFR) Database. Constituent funds report monthly net of all fees performance in US Dollar and have a minimum of $50 Million under management or $10 Million under management and a twelve (12) month track record of active performance. The HFRI Fund Weighted Composite Index does not include Funds of Hedge Funds. Hedge Fund Research, Inc. does not perform an audit in connection with any analyses and may, on occasion, rely on unaudited financial information. Any data presented may be changed, suspended, or withdrawn as a result of changes in, or unavailability of, such information, or based on other circumstances. Investors cannot invest directly in an index. Past performance is not a guarantee of future results.

Additionally, the risk of higher correlation between stocks and bonds during volatile periods may be a significant challenge for 60/40 portfolios, as seen in 2022 when both equities and bonds delivered negative returns. This may further increase the importance of strategies with low correlation to public markets and may underscore the added diversification benefits of alternative investments.

LONG-TERM TRENDS IN INFLATION AND STOCK/BOND CORRELATION[11]

1980 – 2022



8. Skolnik, Or, et. al. "Why Private Equity Is Targeting Individual Investors." Bain & Company. February 27, 2023. https://www.bain.com/insights/why-private-equity-is-targeting-individual-investors-global-private-equity-report-2023/. The Cambridge Associates Index is not transparent and cannot be independently verified because Cambridge Associates does not identify the funds in the index. Because Cambridge Associates recalculates the index each time a new fund is added, the historical performance of the Cambridge Associates Index is not fixed and will differ over time from the data presented in the chart. Funds included in the Cambridge Associates U.S. Private Equity Index report their performance are voluntary, are unidentified and unaudited and therefore the index may reflect a bias towards funds with track records of success. The returns reflect a combination of fees including carried interest and data sets change and therefore cannot be replicated. The MSCI World Index captures large and mid-cap representation across 23 Developed Markets (DM) countries. With 1,511 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. Investors cannot invest directly in an index. Past performance is not a guarantee of future results.
9. "Alter Your Trajectory. Eight Themes Changing the Course of the 60/40 Portfolio." BNY Mellon. 2023. https://www.bnymellonwealth.com/content/dam/bnymellonwealth/pdf-library/articles/bny_alt_inst_final_v2.pdf
10. Equity represented by MSCI World Index (USD Net Div); Fixed income represented by Bloomberg U.S. Aggregate Bond Index; 20% allocation taking proportionately from equity and fixed income to fund HFRI Fund Weighted Composite. The traditional and diversified portfolios presented herein are not representative of any specific strategy and are not intended to constitute an advertisement of a specific product or service; instead, all information, content and materials are for general informational purposes only. Past performance is no guarantee of future results.
11. Personal Consumption Expenditures Index (PCE), Bloomberg. Data as of December 31, 2022.

ALTERNATIVE INVESTMENTS OFFER UNIQUE POTENTIAL BENEFITS

Currently, 71% of advisors consider alternative investments to be a "good investment" for their clients.[12] This may be due to the host of potential benefits that alternative investments may offer, including:

POTENTIAL FOR POSITIVE ABSOLUTE RETURNS: In contrast to traditional long-only investments tied to bullish markets, many alternative investment strategies aim for positive returns irrespective of broader market performance.

POTENTIAL FOR UNCORRELATED RETURNS: Alternative investments often exhibit independence from the movements of stocks and bonds, offering valuable diversification benefits. By integrating uncorrelated assets into their portfolios, investors may effectively lower overall risk exposure.

POTENTIAL FOR MARKET HEDGE: Alternative investments historically have the potential to excel during market downturns, serving as a hedge against market risk. In a well-diversified portfolio, alternative investments may help to preserve capital during periods of market turmoil.

GREATER TRANSPARENCY: Investors in alternative investments may benefit from enhanced transparency compared to their liquid counterparts. Regular communication from sponsors, coupled with updates on interest rates and property markets, provide comprehensive information for alternative investors.

MAY BE WELL-SUITED FOR INVESTORS WITH LOWER RISK TOLERANCE: Highly illiquid investments, such as many alternative assets, often align well with investors seeking fewer surprises. The incremental changes in the value of these assets help contribute to a more predictable investment environment.

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LOOKING AHEAD - WILL ALTERNATIVE INVESTMENTS SUSTAIN THEIR POPULARITY?

A notable 60% of advisors are actively considering or likely to pursue the expansion of the alternative investment side in their business, according to a recent survey by Wealth Management.[12] "As more financial advisors expand their catalog to include a broader array of alternative investments, a larger segment of investors gain access to the potential benefits," said Brian Buehler, managing partner, Triton Pacific Capital Partners. "This, in turn, may help to catalyze an even broader adoption of alternative assets. This is not only good for retail investors, but it is also good for the industry as a whole." With the growing popularity of alternative investments, investors today have a wide spectrum of strategies to choose from, each designed to support different objectives and with a unique risk-return profile. Each investor must decide for themselves, or by working with a financial professional, which may be best for them.

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12. "Advisors and Alternative Investments: A Growth Opportunity" Wealth Management IQ research. 2023. https://images.go.informamail01.com/Web/PentonWRE/%7B5f241ace-aafe-4418-8e4d-164e21a479ab%7D_Advisors-and-Alternative-Investments-Growth-Opportunity.pdf

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