CION INVESTMENTS

Alternative Approaches to Achieving Portfolio Goals

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The classic “60/40” portfolio of US stocks and bonds has been a staple of retirement planning for decades, but many investors do not believe that a traditional approach of equities and bonds within a portfolio allocation is the best way to pursue returns and manage investments. Today’s market environment has investors seeking solutions outside of stocks and bonds to build a portfolio that could help achieve their growth, income, and diversification goals.

Income Alternatives

Current income is vital to a portfolio, particularly for investors at or near retirement, providing a steady stream of payments to meet monthly expenses or work towards longer-term goals.

Some alternative investment options which may offer investors increased monthly income by investing in private, less liquid assets include:

- **Senior Secured Loans:** Loans to private companies which are secured by the borrower’s assets (cash, receivables, inventory, property, and equipment). Although loans can be structured as fixed or floating rate, senior loans are typically structured as floating rate loans, which means the interest paid on the loans will move with interest rate changes.
- **Opportunistic Credit:** Investments made in the debt of private companies going through an acquisition, merger, expansion, or reorganization. These corporate events can create pricing inefficiencies which opportunistic managers seek to take advantage of.
- **Real Estate Debt:** Investments in corporate real estate which seek to pass on income generated from rental or mortgage interest payments.

As with any income investment, one of the primary risks facing income-focused alternative investments is default risk: the chance that the borrower will be unable to fulfill their debt obligation and make the required interest payments. Managers utilizing income focused alternative investments must be especially diligent as they typically lend to companies with credit ratings considered below investment grade.

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Increased Volatility – Reduced Stability

Both public equity and bond markets have been experiencing increased levels of volatility. Changes in investor sentiment, often fueled by human emotion rather than investment fundamentals are causing markets to move more aggressively in both directions more frequently than ever before.

A couple of examples of alternative investments which focus on minimizing the impact of public equity and bond market volatility in a portfolio include:

- **Long/Short Equity:** A stock investment strategy that involves buying equities that are expected to increase in value and selling short equities that are expected to decrease in value. This strategy aims to create a "market neutral" portfolio by diversifying or hedging positions across individual regions, industries, sectors and market capitalization.
- **Managed Futures:** An investment program which employs a similar strategy to long/short equity but with futures contracts rather than stocks. These futures contracts may include precious metals (gold, silver), grains (soybeans, wheat, or corn), equity indices (S&P 500, Dow, and NASDAQ futures), soft commodities (coffee, sugar, or cotton) as well as U.S. government bond futures.

While these "market neutral" strategies can help smooth out the peaks and valleys of equity and commodity markets respectively, they do involve short selling of securities which carries unlimited downside risk if market prices should rise. These strategies are typically only utilized by highly sophisticated institutions and hedge funds because they require constant monitoring particularly on the short exposures.

High Correlation – Harming Diversification

Since the 2007 financial crisis, markets have become increasingly correlated with one another. When the S&P 500 moves up or down for example, bonds and other assets are now more likely to move in the same direction. In portfolios seeking growth, diversification has proven especially difficult with traditional asset classes moving together.

Some examples of alternative investments which seek growth through capital appreciation with reduced correlation include:

- **Private Equity:** Private equity funds are typically only available to high net worth or institutional investors. These funds purchase private companies in an effort to expand or improve their operations before selling them at a profit.
- **Distressed Debt:** Private companies who are perceived to have difficulty fulfilling their debt obligations are labeled "distressed". These bonds and loans trade at sharp discounts because monthly income payments are not expected to be made. Investors profit if the companies can recover to meet their obligations.

Investments in Private Equity and Distressed Debt carry significant risks as they are generally made in companies that are experiencing difficulties, major changes, or new management. As such, the risk of bankruptcy and default is higher than public equity and debt products and requires diligent management of the underlying companies by the investing company.

More Options – More Opportunities

The range of alternative investments offers various features which differentiate them from traditional investments. Depending on their investment objectives, investors may look to alternative investments for options to complement capital preservation, growth, or interest income. Institutional investors have used alternative investments for many years. Today, new and innovative fund structures have reduced the barriers to entry, making these strategies an investment option for individual investors.

To learn more, please contact your financial professional.

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