WhittierTrust

ALTERNATIVE REALITY

Considerations for Investing in a Unique Asset Class

A Value-Add Tool

Access Matters

Alternatives are not Mythical Creatures

Athough the term alternative investment may sound foreign, you have likely heard it from a friend or in the media. They include anything from a venture capital fund investing in biotech companies to a fund buying minority interests in professional sports teams. According to RIA Intel, 45% of wealth advisors invest client money into alternatives, which includes any investment that does not fall into traditional asset classes such as cash, stocks, or bonds. While wealth advisors have various reasons for recommending them, you should consider the following before investing.

A Value-Add Tool

Wealth advisors invest in alternative assets to enhance a portfolio's goals and objectives. They can leverage these investments to improve risk/adjusted returns, diversification, cash yields, and unique attributes, such as social and environmental considerations, that may not be available in public markets. As an example, an advisor might add venture capital to increase the expected return of an equity allocation or add private debt to augment the cash yield of a fixed-income allocation.

Access Matters

There is significant performance dispersion across alternative assets. While the top tier managers tend to outperform public markets, average ones often underperform. A wealth advisor's ability to identify and invest with high-quality managers is critical to success. This is particularly important in venture capital where high-quality managers consistently produce top-tier funds.

Alternatives are not Mythical Creatures

Alternatives are impacted by the same economic factors as traditional asset classes. For instance, private equity and public equity are both influenced by economic growth and market multiples (i.e. valuations) while public and private debt are both impacted by interest rates and the credit cycle. Wealth advisors should evaluate alternatives relative to public market equivalents to ensure the portfolio is achieving the best risk-return

outcome and not over-exposed to an economic risk factor. For example, you might not want to add private equity if you are already overweight public equities.

Additionally, alternatives are much more complex than public securities. Investments may be subject to long lock-ups, capital commitments, and limited liquidity windows. They may generate significant short-term gains, ordinary income, and expensive fees - the manager should not be the only one making money. There may be conflicts of interest between you and your wealth advisor who may receive placement fees from the manager for investing. Wealth advisors should be able to evaluate and justify these complications.

In Summary

Adding alternative assets can enhance your portfolio's goals and objectives by offering higher risk-adjusted returns, diversification, and cash yield. However, alternatives should be evaluated relative to their public market equivalents, and their portfolio contributions should more than compensate for the illiquidity, complexity, and higher fees. Partnering with an unconflicted wealth advisor who has access to top-tier alternatives and the expertise to evaluate them both on a standalone and relative basis to public securities is essential to successfully invest in this asset class.

WHITTIER TRUST COMPANY

South Pasadena 1600 Huntington Dr., South Pasadena, CA 91030 | 626.441.5111
Newport Beach 4695 MacArthur Ct., Ste 1500, Newport Beach, CA 92660 | 949.216.2200
San Francisco 505 Montgomery St., Ste 1200, San Francisco, CA 94111 | 415.283.1850

THE WHITTIER TRUST COMPANY OF NEVADA, INC.

Reno 100 W. Liberty St., Ste 890, Reno, NV 89501 | 775.686.5400
Seattle 520 Pike St., Ste 1415, Seattle, WA 98101 | 206.332.0836
Portland 111 S.W. Fifth Ave., Ste 3150, Portland, OR 97204 | 503.444.3428

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