# Alternatives - What Role Should Alternatives Play Today and in the Years Ahead in Asia's Private Client Portfolios?

The world of alternative investments has been both expanding and moving increasingly centre stage for some years already, and the theme has most definitely caught on in Asia in more recent times. For our Digital Dialogue discussion of December 9, Hubbis assembled a panel of experts to review this expanding universe of alternative investments and to analyse why, for Asia's HNW and UHNW investors, alternatives offer an increasingly appealing range of opportunities for investors to set alongside their core mainstream public financial market assets in their portfolios. For the purposes of the discussion, the panel included private assets of all types, which means the full spectrum of private equity, private debt, real estate, precious metals, cryptocurrencies and other digital assets, including the growing world of tokenised assets. Experts clearly remain generally optimistic about the growing appeal of alternatives, with key driving factors including the ongoing hunt for yield, concern about the uncertainty in public markets, in economies, government finances and geopolitical instabilities. Alternatives therefore offer an interesting and increasingly diverse range of opportunities for wealthy Asian investors who increasingly understand their attractions and who have seen the performance of many of such assets through the good and weaker mainstream market performance of recent years. Accordingly, the wealth management industry has adapted its products, services, talent and strategies to capture more of this business and in anticipation of even more interesting and exciting times ahead.

## SPEAKERS

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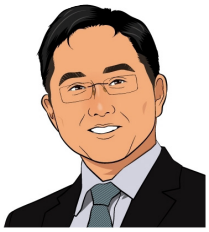

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## THESE ARE SOME OF THE QUESTIONS ADDRESSED BY THE PANEL:

- Are alternative investments now a core portion of the portfolio for Asia's wealthy investors? Why or why not, and should they be?
- Given the world's economic outlook, the troubled fiscal positions of most governments, the highly valued mainstream equity markets and the prospects for inflation and possibly rising interest rates, what impact are all these factors having on the alternative assets markets worldwide?
- Have alternative assets been performing well, and what is their outlook broadly?
- How should investors look at alternatives - for yield, gain, risk mitigation, downside protection, and in terms of the maturity profile of their investments?
- Why are the private equity and debt markets continuing on their headlong expansion, which has been accelerating for most of the past decade?
- Does investing in private markets especially resonate with the second generation especially given their growing interest in impact investing and the wider topic of ESG?
- What are the liquidity and time horizon trade-offs investors need to make to obtain higher yield or higher gains from private equity and private debt?
- What types of portfolio allocations have HNW and UHNW investors made to alternatives thus far, and what positioning should they adopt for the future?
- What alternative assets should they be buying, or considering, and why?
- How do these clients buy into alternatives, and have the wealth management advisors and intermediaries been able to fulfil this demand and these expectations thus far?
- What is the wealth management community doing in Asia to cater to the growing demand and the potential for significantly greater allocations to alternatives amongst Asia's wealthier clients?
- How about the online/digital platforms? Are they boosting their curation and delivery of alternatives for intermediaries and for private clients directly?
- What types of investors in Asia are gravitating most actively towards alternatives, and is the wealth industry catering to these buyers properly?
- Where are the best opportunities ahead - in private equity, private debt, hedge funds, real estate/infrastructure, precious metals, other commodities, cryptocurrencies/tokenised assets?
- What are the obvious and less apparent dangers of the global drive towards alternative assets and private markets, and is there a danger of demand driving dangerous excess and over-optimism?

## Alternatives have evolved from niche but nice to have to widespread and must have

An expert opened proceedings by commenting that 15 or 20 years ago, an investor could obtain a stable, very low risk return of 50% annually just by putting 50% in fixed income, 20% in cash and 30% in solid equities. A decade ago, that same return required more than 50% in equities, but now with considerably higher volatility. "But going into 2022, if we want to get a 5% return, you need very little fixed income, other than possibly some high yield or emerging market paper, then you need a load of equity and alternatives maybe of around 25% to get that diversified portfolio," he said. "In short, alternatives are now essential; they offer low correlation to traditional asset classes, they provide alpha, and the extra income enhancement that you're not going to get elsewhere."

## But getting into the right alternatives and finding the right balance are not easy

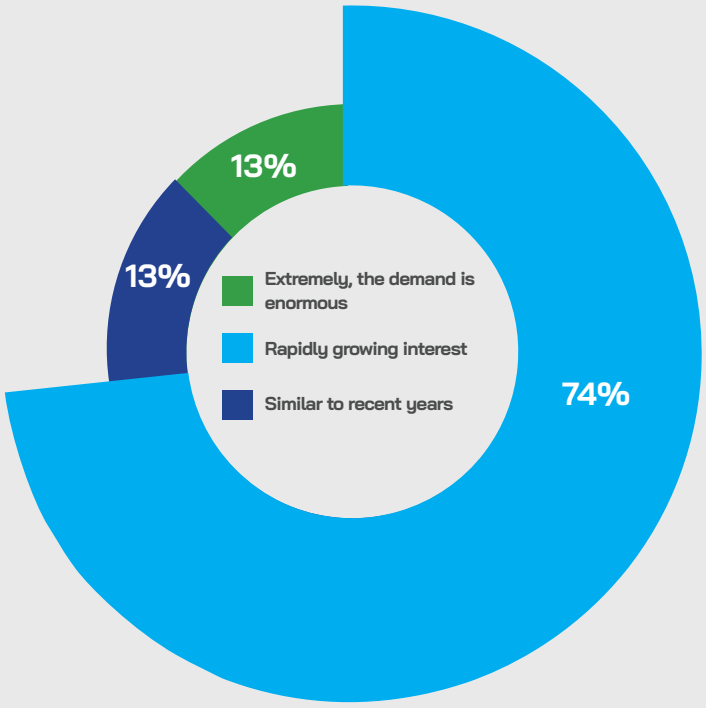
The same guest remarked that it is far from easy to access the right types of alternative assets. "Finding the right managers is essential, finding the right tailwinds for the deals is vital," he stated. But this is not easy he cautioned, so investors much choose the intermediaries and managers and deal sourcing networks carefully, so as to procure the best opportunities.

## The power and reach of private assets and private markets, as well as their allure, have expanded dramatically in the past couple of decades

A guest highlighted his firm's significant and growing presence

*The Hubbis Post-Event Survey*

### CAN YOU CHARACTERISE HOW INTERESTED ASIA'S WEALTHY PRIVATE CLIENTS ARE TODAY IN ALTERNATIVE ASSETS OF ALL TYPES?




*Expert Opinion*

**GARETH NICHOLSON, CIO and Head Discretionary Portfolio Management, Nomura**

"Generating private equity return opportunities is no longer about buying cheap and heaping on leverage: it requires earnings growth. Private assets, like public assets, aren't cheap anymore. That's one reason why the focus is now on the execution plan for taking advantage of growth opportunities. The main difference between public and private investing is that there is much more you can do as a private owner to ensure that the risk you take is business execution risk and not valuation risk. We believe that, in today's environment, the ability to tilt the playing field in that way is meaningful. Besides private equity deals with strong execution focused on growing businesses, we like businesses aligned with our mega-trend and sustainable growth theme programme, which aim to ride the big global tailwinds."

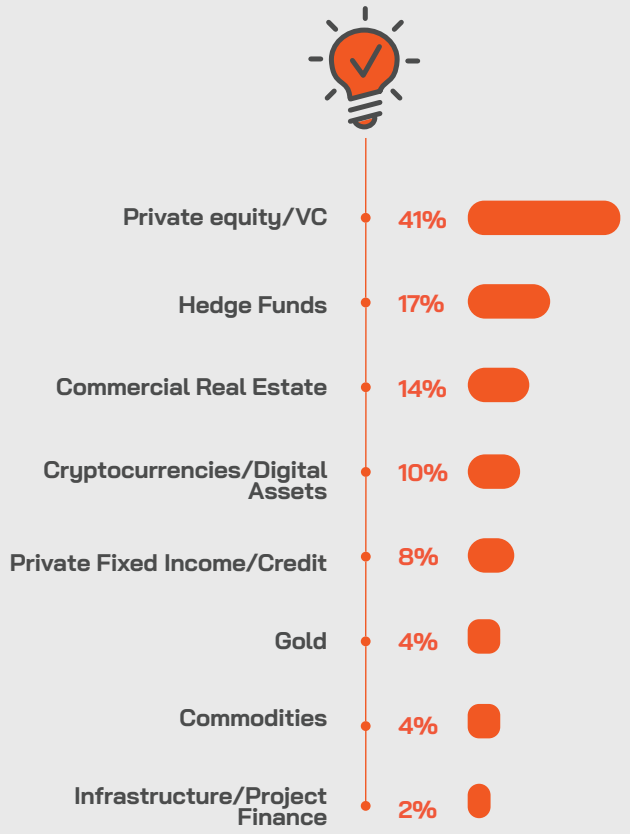
in the alternatives and private market space. "What we consider alternatives includes private markets, private capital, anything that's not listed. My own view is that alternatives and alternative investing is really not that alternative anymore. Take the universe of listed equities in the US, for example, which has fallen some 50% since 1996. Meanwhile, the private assets market capitalisation is increasing at a rate of four to one versus the growth of traditional markets over the same period."

He explained that there is an amazing and rich array of opportunities, including of course hedge funds, infrastructure, it's real estate, agriculture assets and so forth. "As to allocations, you see a lot of variation – for example, Yale apparently has 77% in alternatives, while some sovereign wealth funds, including GIC would be around the 20% mark," he reported. "I looked at research from the Global Family Office and they're saying that global family offices are around the 30%, which seems to be dominated by real estate and private equity. All the data says to me that private capital and alternatives do really offer a rich source of diversified return for many investors, not just high net worth investors."

## Alternatives can provide an ever-bigger bedrock within the portfolios of private investors

A panellist reported that alternatives can today be considered part of the bedrock for the wealthy private investor and advised that the core allocations could be directed to real estate, private equity, private debt and hedge funds. All of these have performed well during the years of declining or super low rate

### WHAT ARE THE MOST RELEVANT AND IMPORTANT ALTERNATIVE ASSETS FOR ASIA'S WEALTHY PRIVATE CLIENTS?




*Expert Opinion*

**GARETH NICHOLSON, CIO and Head Discretionary Portfolio Management, Nomura**

"The data show clearly that we need to embrace alternatives in this increasingly complex investment environment in order to maintain an acceptable level of return. Alternatives have become an essential way to achieve this. As to whether alternative assets been performing well, and their outlook, the past year's significant equity outperformance and continued low rate environment, despite a strengthening economic cycle and heightened inflation expectations, reinforce the essential and expanded role we see for alternatives in a diversified multi-asset portfolio. We anticipate improving opportunities for alpha generation within private equity and hedge funds, and continuing yield premiums for direct lending over public markets."

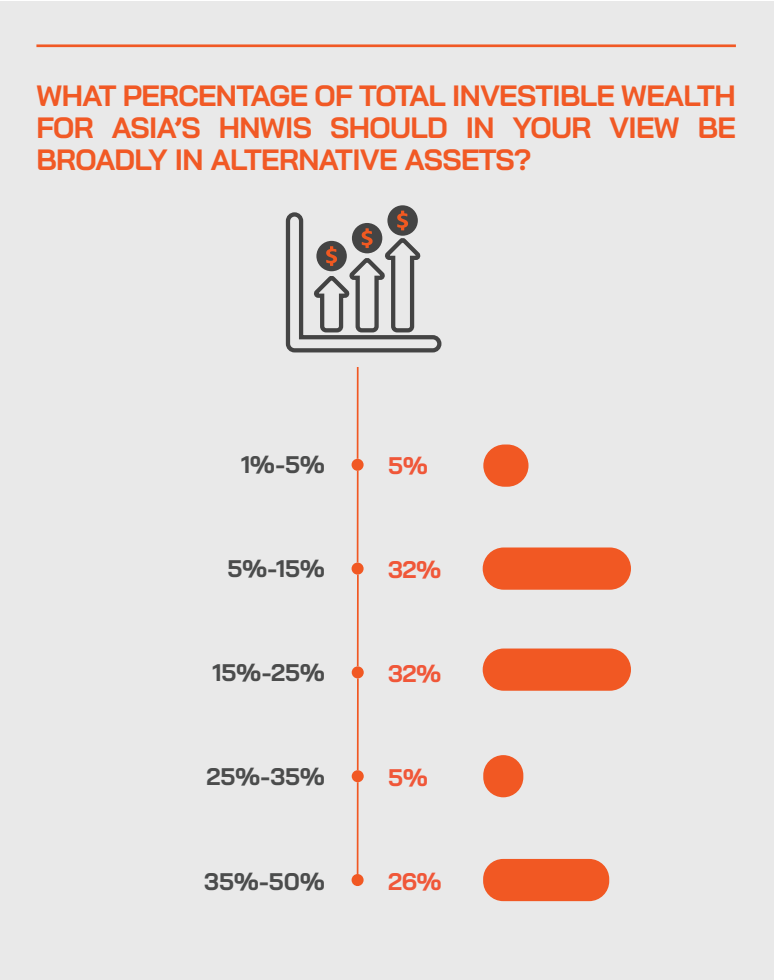
rates, providing the allocation is smartly assembled. He added the cryptocurrencies and digital assets had performed well, but allocations must be carefully chosen and sized, and volatility understood and absorbed.

## Private equity is pulling in vast sums of money, and justifiably so from their performance in recent years

A panel member observed that private equity was no longer about buying broadly and adding on leverage for additional return. "We really need to find the right companies with the right growth potential," he said. "Public and private equity is not cheap today, so we need to dive deeper and find the opportunities that will perform in an environment where things are really only getting more difficult, including what is gradually a tighter money situation."

## But the right access to the right opportunities is vital and investors need to understand what they are buying, why and how long they must hold the assets

"Specialists such as ourselves are working hard to expand access to these types of opportunities, which can of course include open-ended fund structures, for example, amongst others," another guest reported. "Liquidity is also important, and investment minimums. Traditionally, these assets and markets have been more the preserve of larger investors including very large and sophisticated family office or multifamily offices. So, we for example, have created a diversified real assets portfolio that allows an investor to get access to infrastructure, agriculture, and real estate, and we'll expand that menu of options over time, as this allows a smaller investor to gain access to a diversified portfolio on day one with smaller minimum commitments and with liquidity. Moreover, you get access to the same skills and expertise for one combined price, and it allows them to access different opportunities at the same time. We definitely think we as an investment industry need to promote fairness around access and create the types of solutions to encourage more investors, particularly in the high net worth space, to be able to access these exciting sources of risk and return."




*Expert Opinion*

**GARETH NICHOLSON, CIO and Head Discretionary Portfolio Management, Nomura**

"There are two key reasons to consider private markets right now. First, it's an abundant source of opportunistic investments. Second, execution risk, not market risk, is most likely to determine success."

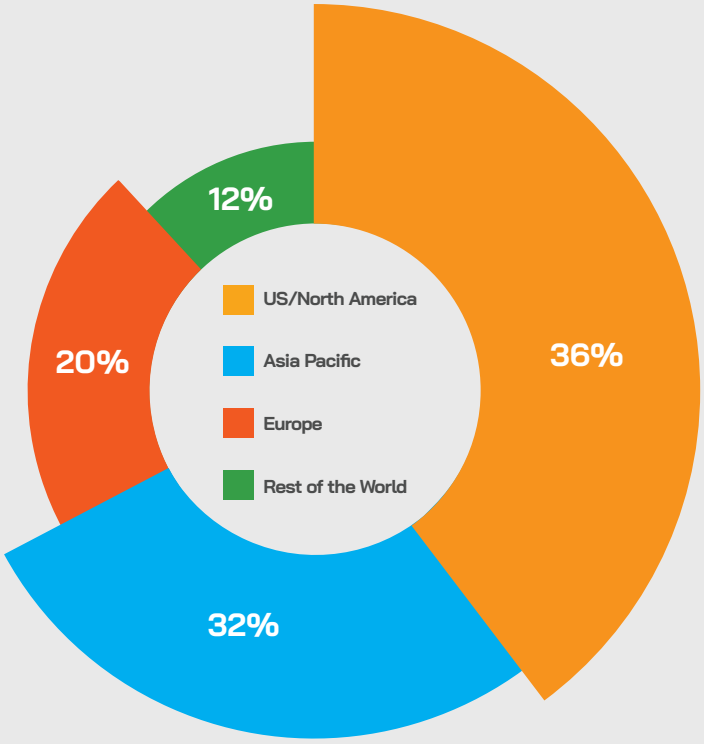
He explained that it is incumbent upon the industry to come up with these innovative solutions to solve that problem of accessibility because private capital is increasingly interested in this arena – in fact, he said there the estimates are that there is some USD7 trillion of private assets allocated right now compared to around USD90 trillion of public market equities globally, but the private capital is growing very rapidly, which the number of public stocks is shrinking, very markedly so in the US.

"And if you look across the different asset classes, be it private debt, be it infrastructure, real estate and so forth, there are literally hundreds of billions of dollars waiting to be invested," he said. "And increasingly, start-up companies are going to the private markets to get their financing and to fuel their business growth. So, it's really a place I'd encourage all high net worth investors to be looking to enhance their overall portfolio returns."

## Hedge fund strategies exploiting dislocations and expressed across key thematics can provide robust returns

An expert reported niche hedge fund investment strategies to exploit market dislocations and relative value anomalies can provide excellent returns. "We also see a lot of opportunities in the derivative markets when flows are huge, and there is also the retail market coming into derivatives, creating distortions and therefore a lot of arbitrage opportunities." He reported that one of their strategies was up 64% last year. However, he reported that equity long-short was performing far less well.

### IN TERMS OF GEOGRAPHIC ALLOCATION TO ALTERNATIVE INVESTMENTS, ROUGHLY WHAT PERCENTAGE SHOULD BE ALLOCATED TO THESE REGIONS?




*Expert Opinion*

**GARETH NICHOLSON, CIO and Head Discretionary Portfolio Management, Nomura**

"There are some key characteristics of solid alternative investments. They generally exhibit a number of attributes. They have low correlations with traditional assets – which can make them good diversifiers of traditional portfolios. They deliver returns that are driven by income and/or alpha, making them potentially good stabilizers and/or return enhancers. They also tend to have higher fees than traditional stocks and bonds. This adds emphasis to the vital importance of manager selection – skilled and experienced managers are able to exploit market inefficiencies, bring about operational improvements and deliver enhanced returns."

## Monetisation options in private equity extend far beyond the IPO markets today

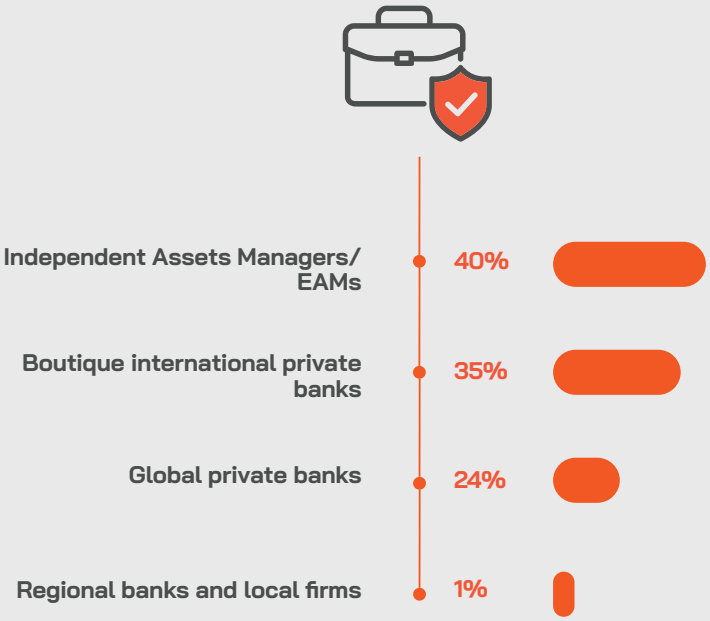
Another guest felt that the best opportunities are in mid-market companies where they can be developed further, not so much for IPO exits but for purchase by the larger private equity funds once they reach the size requirements, often at the mega-cap level. Those mega funds would then hold on to those investments through to the IPO of M&A events.

He explained that there is a much more developed market today for liquidity of these investments. "There is a whole phenomenon of secondary markets and co-investment markets in private equity developing in a huge way, particularly with continuation funds and co-investments in secondaries," he reported. "This is very valuable particularly when you're growing companies from the mid-market up, and where you have real quality companies where even if the public markets are not paying that valuation, you are able to achieve the valuation premium by keeping it in the private markets longer, rather than suddenly needing to go to the IPO market."

## There is a significant threat of persistent or rising inflation, and alternatives can provide some mitigation against these risks

Investors needs to be diversified, a guest reported. "Inflation is potentially persistent, or potentially transitory, time

### WHICH ORGANISATIONS ARE DOING THE BEST JOB AT PROMOTING AND DELIVERING ALTERNATIVE INVESTMENTS IN ASIA?




*Expert Opinion*

**GARETH NICHOLSON, CIO and Head Discretionary Portfolio Management, Nomura**

"Given the world's economic outlook, the troubled fiscal positions of most governments, the highly valued mainstream equity markets and the prospects for inflation and possibly rising interest rates, it is essential to diversify portfolios against the potential downside risk in equities at a time of low and rising core government bond yields. Inflation adds another layer of complexity: many investors are looking for assets that can diversify potential downside equity risk, mitigate the impact of inflation, or both. Moreover, some assets have been effective against short-term inflation spikes while others have done a better job of outperforming more persistent inflation. The result is that we see many investors lengthening their menu of alternatives and allocating more to them."

will tell and there are very different opinions amongst the economists," he observed. "For those thinking inflation might slow, they believe the supply chain disruptions will improve in 2022 and beyond. Anyway, this is certainly something that preoccupies us pretty much all the time every day. But we are in the right segment, as we think private capital offers the chance to have inflation protection embedded into the investment portfolio. For example, our infrastructure portfolio has got 100% inflation protection built in at varying levels. Agriculture has performed well and is another a pretty good hedge towards inflation. And real estate portfolios, the long income ones, very often have inflation linkers into their rental agreements. So, yes, inflation is a core concern and something we are thinking about constantly as we curate our portfolios and as private capital shifts more towards private capital."

## Agriculture assets can offer excellent diversification, significant inflation-proofing and outstanding returns

Another guest agreed with the comment son agriculture as an outstanding opportunity. He reported that they had invested heavily and very successfully – and continue to do so today - in agriculture and livestock in Australia, which had performed exceptionally well. At the same time, they had been investing in sustainability around these assets, especially the carbon footprint and carbon capture.

*Expert Opinion*

**GARETH NICHOLSON, CIO and Head Discretionary Portfolio Management, Nomura**

"As to why investing in private markets especially resonates with the second generation, we believe this is a key area for Asian investors given the truly vast demand for sustainable power in the region alone. Asia is mission critical to address climate change and other mega-trend problems. We see sustainability investing as a huge UHNW partnership."

## ESG-driven investing and impact investments are very much central to many asset management groups and pension funds, sovereign funds, and increasingly to family offices and private clients; private capital and alternatives can help drive into these key trends and themes

An expert observed that the whole vision of ESG-driven investing and sustainability in capital allocation had grown dramatically. "This whole broad topic seems to be of increasing importance every day, particularly in Europe with fund classifications like SFDR, from the public markets' perspective," he reported. "And certainly in the private markets perspective, we contribute to the Global ESG Benchmark for Real Estate, or GRESB, which provides an external assessment of the ESG credentials of your private capital portfolio in real estate, but it's now extended into infrastructure now as well; you get a score every year, in terms of an absolute measure as to how E, S and G you are, and then you can rank your performance relative to your peers and other funds. But all of this has not yet become true 'table stakes' so to speak, but I believe it's heading that way, certainly amongst investors based in Europe and increasingly in North America, and I'm starting to see it in pockets of investors in Asia as well."

"I would say we have always had this view that sustainability and returns are not mutually exclusive," he added. "Moreover, private capital's focus on both returns and sustainability are well embedded these days, so this rapidly growing private market is delivering on both elements of investors' aspirations. We all feel like we should be more responsible citizens in terms of investments, and we certainly do in managing such investments. For example, in our agriculture investments, we've have backed the implementation of a camera spraying system for an Australian cropping business, and thereby indirectly helping reduce pesticides by up to 90%. We are also helping through investments on water conservation, and we have a mantra of cutting the drop per crop. And all those things ultimately feed into the bottom-line, the return that investors want and expect. We are very conscious that it's not our money, that we're acting on behalf of investors, be it the high

net worth, be it the pension funds, be it the endowments, or other private investors, so our job is to be a very good fiduciary of that capital. Be E, S and G responsible is truly and genuinely embedded within how we approach the management of our private portfolio irrespective of be infrastructure, agriculture, or real estate."

## Looking for access to interested private equity opportunities? Think mid-market, where there is less crowding from the mega-cap fund

An expert explained that their core focus in midmarket, which means equity investments typically below USD250 million for infrastructure, and below USD100 million for agriculture, for example. "This is a way of slicing the market to target access to smaller private capital investment opportunities across the different private capital asset classes.," he said. "If you look at private capital more generally, there's a lot of bifurcation - you get very large funds and you get very large commercial investment managers now across infrastructure, real estate, and private equity. Midmarket captures small to midcap investment opportunities, perhaps businesses with an enterprise value up to a billion dollars across different private asset classes."

He explained that the reason his firm likes is that they believe there's a structural inefficiency that exists within that market segment. "And it's all about connectivity to those different markets," he observed, "irrespective of the asset class be it private equity, be it agriculture or perhaps infrastructure. This essentially symbolises a deal sourcing advantage. When you get markets growing very rapidly, there's a wall of capital heading into alternatives, but if the vast bulk chases the big end of the market, it leaves a lot of inefficiencies at the smaller end. So, if you've got teams of intelligent investors, irrespective of where they work, or what discipline they're from, and they've got great connection to the market, then it allows them to access those potentially higher value creation opportunities."

*Expert Opinion*

**CLEMENT LETURGIE, 1798 Alternatives - Head of Product Specialists, Lombard Odier Investment Managers**

"Equity Long/Short performance has been decent this year but most of the returns are coming from beta exposure while alpha generation has been challenged. And we find attractive opportunities in the Relative Value space where investors can receive carry and have a defensive stance, making a good alternative to fixed income."

## Asia offers more and more opportunities in mid-market assets and is a hotbed of supply chain dynamism and diversification, but research and analysis is key

Another guest concurred with these views, adding that it is important to give more access to clients to these new innovative ideas, and midmarket smaller companies. "I think that is where Asia is very exciting and interesting; there are so many initiatives, new start-ups, new ideas coming through. What we find really exciting from our side is we're using the one bank solution, the investment bank, right across all the different departments, the research really to find these companies, do the due diligence, build up the understanding, and then also find the clients that can fit with them," he reported.

"And they don't have to be the half a billion deals that can be much smaller," he added. "We believe that a lot of the business models are going to be supported by tailwinds such as government policies and regulation, especially in the more sustainable space. They don't just have to be like electric vehicles, they can be components in supply chain, and on that front, there is growing diversification as producers put their factories in a variety of locations, for example not only China now, but in Vietnam and Malaysia and so forth, so that logistics are better, and risks are lower. In Asia, there is much more scope for these kinds of deals, new start-ups, new businesses, and finding solutions to finance them and to give them a kickstart, is great. And we can put these opportunities in front of our clients, high net worth and ultra-high net worth private investors."

## The experts zoom in on the key elements in hedge fund investments

A guest highlighted the vital importance of choosing the right hedge funds with the right investments, pointing to top talent, the right compensation schemes, and diversification with uncorrelated returns. "We see clients want to diversify fixed income and they tend to go for lower vol, lower returns on more defensive strategies, and here the relative value strategies I mentioned earlier are the most interesting in my opinion, because they tend to be low vol, and they can also provide that defensive positioning in case of a shock. We also see some investors who want to try to achieve higher returns, but they want to decrease the beta of their equity book, so they tend to be going for equity long-short strategies; they still have some beta, but lower beta and retaining the ability to get higher returns. If you look at event driven space, today, the opportunity set is not super attractive, so it might make sense to be patient there."

## Yes, you generally need to give up some liquidity to diversify broadly in alternatives, but the rewards are worthwhile

A panellist highlighted the need to build diversified portfolios, and observed that although there is some reduction in liquidity in bigger allocations to alternatives, many of the wealthier clients are not that worried about liquidity in significant portions of their portfolios. "The core-satellite approach which might have been 80/20 in favour of mainstream or public assets is now more like 70/30, sometimes even more, sometimes less, but the shift is gradually taking place," he reported.

He added that accessing such opportunities required to fill the heightened allocation to alternatives is the key to successfully building a portfolio. "We see a lot more clients wanting to outsource their investment decisions, particularly when they look at the complexity out there," he reported. He said preserving income and returns ahead might be more difficult in a more complex environment, and therefore clients want people on their side 24/7, they want the sophistication, they want the access to partnerships. "For us it is about partnering," he said. "We work with a host of partners to bring the expertise together and to be able to provide solutions across the space. So, there will be managed solutions from third parties, there will also be some of our high conviction calls, for instance, around sustainable investments, which is an area we spend a lot of time and money on, generating lots of ideas for clients."

*Expert Opinion*

**TUCK MENG YEE, Partner, JRT Partners**

"With valuations high and uncertainty in rate policy adjustment and the inflation outlook, we are focusing on inflation-aligned investments (eg. real estate), businesses going through temporary correction (such as China tech, Asia high yield) and markets going through structural growth (clean energy transition, carbon capture for agriculture)."

## Tokenisation is opening the door to a wider array of assets in the alternative assets universe

A guest remarked on the rise of digital assets, and their growing role in the world of alternatives. He explained they had been seeing a lot more tokenization, an interesting asset class for clients, and derivatives of cryptocurrencies becoming more mainstream. The past couple of years in the mainstream markets and private assets have been very good, he said, but looking ahead, investors and advisors need to think harder

*Expert Opinion*

**CLEMENT LETURGIE, 1798 Alternatives - Head of Product Specialists, Lombard Odier Investment Managers**

"The more capital chasing an opportunity, the lower the returns. We believe niche and capacity constrained managers will continue to perform better than larger managers."

about diversified income solutions. So, for example, there are some interesting inflation hedges, such as art, for years an interesting albeit illiquid market, but with tokenisation potentially a market in which investors can participate more widely.

## Final words – remember that the growth and potential also come with some risks and possibly diminishing returns

"I want to comment on the growth of alternative investments, and the risks that come along to them," one expert said. "I think the main risk is that we could see returns starting to diminish. For example, if you look at hedge funds, there's been a trend amongst investors going with the most established and largest managers, and the truth is, they have underperformed, they are less agile, less hungry, and they are more risk averse, so they perform less well. And the worst is, they're starting to deteriorate the terms that they are offering to investors because the power is in their hands."

He extrapolated to the broader universe of private assets as well. "The more capital chasing an opportunity, the lower the returns you will get," he cautioned. "Moreover, there's also a chance that the quality of trades will deteriorate. That is why we tend to focus on niche strategies that are less crowded, and that are capacity constrained to ensure that the quality of our investments remains high, and that we focus on performance and not on asset gathering. It is very important to really be focused on performance and be cognisant of your capacity and how much you want to deploy." ■