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The rise of alternative assets

Australia's sovereign wealth fund, the Future Fund, is often viewed by investors and advisers as the gold standard of successful investing. The fund, founded by former Treasurer Peter Costello, has grown to $154 billion and recorded 10-year returns of over 10%. It is a remarkable effort. But its success isn't due to stock picking or timing the market. In fact, Australian equities only make up 6.5% of the fund at the end of March this year. That's a mere $10 billion. So how do they do it?

The recipe for success appears to lie in asset allocation. The Future Fund differentiates itself by gaining exposure to various asset classes such as infrastructure and private equity, diversifying away from equity and fixed interest markets. There's a lot to learn from this style of investing. Instead of allocating a large portion of a portfolio into domestic stocks and bonds, advisers are now starting to look at 'alternative assets' in an effort to model the Future Fund way. The real challenge that advisers may face in taking this approach however is the ability to gain access to these type of investments through their investment platform.

Firstly, what are alternative assets? These are investments which do not fit within the traditional broad asset classes i.e. shares, property, fixed interest and cash. In general, there are two main types of alternatives. The first are funds that invest in non-traditional assets i.e. infrastructure, real estate and private debt or equity. The second type of alternative assets invest in traditional assets using non-traditional methods, such as short-selling and leverage, for example a long short fund.

Historically low interest rates at a time when markets are expensive has pushed advisers to look elsewhere for the higher returns that their investors demand. This is where alternative assets come into their own. Not only do these investments provide a hedge against inflation and have a low correlation to the stock market, they also give an investor exposure to real estate, infrastructure and private debt/equity. These assets have the potential to achieve returns that are much higher than the standard benchmark market index.

Sourcing, then including these assets in an investor portfolio can be complicated and time consuming for an adviser to manage. Given wealth management platforms are known to be an efficient way to manage multiple assets classes for investors, this would seem to be a logical solution. Unfortunately, many platforms in the Australian market today do not offer access to a wide range of alternative assets. This is because they can be equally as challenging to administer from a platform perspective.

Platforms such as Powerwrap that are more targeted to high net worth investors identified this growing demand early and has been silently growing this part of the business at a rapid rate. These types of assets are typically held directly in the name of the investor, with the platform operating as the back office and mail house. Powerwrap can facilitate clients having direct ownership in the underlying assets because of the way the platform is structured, thereby allowing non-custodial alternatives to be held. It also has data feeds to facilitate access to pricing for these types of funds. This is a huge differentiator for wholesale investors looking for that 'niche' type of investment.

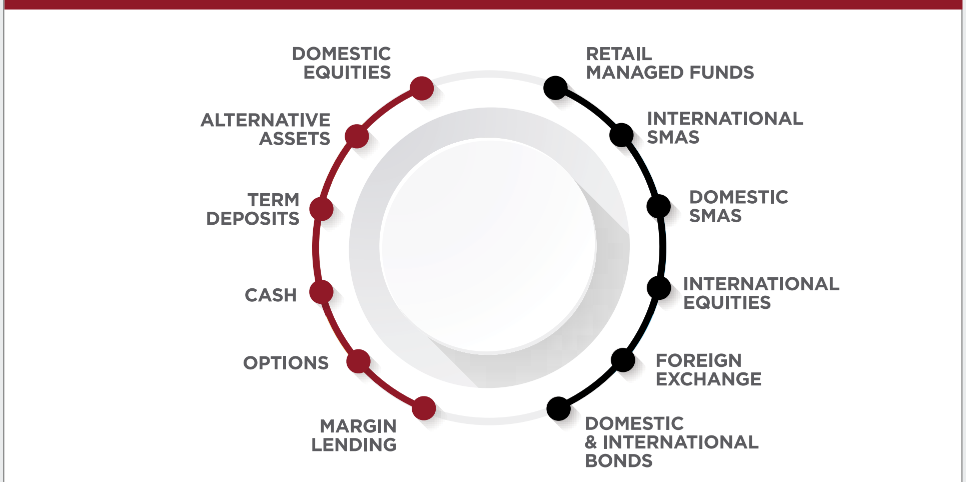
Following on from the Royal Commission, Powerwrap's suite of non-custodially held funds has grown substantially to over 400 funds. Private debt and equity funds have risen to fill in the gap after banks adopted a more conservative and risk averse lending profile. At a time where markets are widely seen as expensive, the benefit of holding such funds is clear. You only have to look back to the time of the Global Financial Crisis when alternatives managed to retain their value while all other assets fell.

Powerwrap's product list is demand driven by advisers; as a result, this is not limited to the mainstream assets such as real estate and infrastructure. Powerwrap is currently looking at a range of 'next generation' investments in the alternative space that go beyond the mainstream. These include crypto currency-based funds, impact investing, a female leader-based fund, venture capital, start-up funds and solar power funds.

Looking forward, it does not appear that rates will increase for the foreseeable future. The 20-year bull market is looking fairly overheated and GDP forecasts are being revised down. What does this all mean? It means we could be towards heading towards the end of the equity boom cycle. The global economy is slowing and there are unprecedented levels of economic uncertainty creeping into markets and causing real angst among policymakers and investors. Earlier in the year the US banned Chinese telecom giant Huawei from operating in the country. This came on-top of $200 billion in tariffs charged on Chinese imports and the $60 billion China charged on US exports. Trade war together with weak economic growth confirms that there is real uncertainty in equity markets.

Irrespective of this, investors will be on the hunt for growth and yield now more than ever. If equity markets remain or turn volatile, where else can investors turn? Potentially the answer lies within alternative assets. Trying to generate alpha is getting harder and harder because the environment is becoming more challenging. Advisers will be forced to generate alpha from higher return alternative assets and the place this asset class adopts in an investor portfolio will become increasingly important. **FS**

ASSETS USED BY HIGH NET WORTH INVESTORS



Pop quiz. Name a fund that had more than 90% of its portfolio in alternatives as at March this year and boasted a 10-year return of over 10%.

If you answered the 'Future Fund', then that is correct. If you're scratching your head, that's alright, too. The Future Fund's relatively low asset allocation of 6.5% in Australian equities is an unusual approach, but its long term results suggest there's more to alternative investing than meets the eye.

In this issue, Powerwrap's chief executive Will Davidson explains how the rise of alternative assets has reshaped the business, with plans to offer cryto-currency based funds, impact investing and female leader-based funds on the group's platform in the not-so-distant future. Find out why in this article.

Michelle Baltazar
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Director of Media & Publishing

The quote

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Watch the video on www.fsitv.com