

A night sky with the Milky Way galaxy and a road leading into the distance.

The Stevanovic Metz Group

**ALTERNATIVE
INVESTMENTS**



WHAT ARE ALTERNATIVE INVESTMENTS?

Alternative investments (often referred to simply as ‘alternatives’) are typically defined as investments that may perform independently of stock or bond markets because they generally aim to achieve outcomes uncorrelated with the overall markets.ⁱ

Alternatives utilize a different approach to investing than do traditional equity or fixed income investments. Strategies employed may include hedging, holding private securities, or holding both long and short positions.ⁱⁱ

CHARACTERISTICS OF ALTERNATIVES

Liquidity

Alternative investments tend to be less liquid than traditional investments, meaning they cannot always be easily bought or sold on public markets. Many alternatives, such as private equity, hedge funds, and real estate, have longer lock-up periods, requiring investors to commit their capital for several years. This illiquidity can provide potential benefits, such as a long-term investment approach and reduced market volatility, but it also means investors must plan for limited access to their funds.

Leverage

Many alternative investments utilize leverage—borrowed money or financial derivatives—to amplify potential returns. While leverage can enhance gains, it also increases risk, as losses can be magnified beyond the initial investment. Private equity firms, hedge funds, and real estate investors frequently use leverage in an attempt to enhance performance, requiring careful risk management. Investors should be aware of the potential for increased volatility and the need for a disciplined investment strategy.

Long & Short Strategies

Unlike traditional investments, which typically focus on long-only positions (buying assets in hopes they appreciate), alternative investments often employ both long and short strategies. Short selling allows investors to profit from declining asset prices, providing opportunities to hedge risk and generate returns in volatile and down market environments. Hedge funds and certain private investment strategies frequently use long-short approaches to enhance portfolio diversification and manage market exposure. This flexibility can be advantageous in volatile or uncertain economic conditions. Buy-and-hold strategies risk prolonged exposure to market downturns, while short-selling carries the danger of unlimited losses if prices rise instead of fall.



TYPES OF ALTERNATIVES

Private Equity

Private equity is a broad term for investing in a privately owned company rather than owning shares in a public company that can be traded on an exchange. The strategy seeks to participate in the growth of private companies through long-term investments in private securities globally. Commonly known categories of private equity include buyouts, venture capital, growth equity, secondaries, and distressed.ⁱⁱⁱ

As the number of publicly traded companies decreases, more companies are choosing to stay private for longer. As a result, investors may seek to diversify their portfolios by allocating money towards an alternative source of growth outside of public markets.

Private Debt

Broadly, private debt (or private credit) refers to loans that are privately negotiated between two parties, as opposed to traditional syndicated loans or bond issues that are widely available to fixed income investors.^{iv} The term 'private debt' is typically applied to debt investments that are not financed by banks, nor traded or issued in an open market.^v Private debt can provide a differentiated source of returns for a portfolio through a variety of structures and strategies. Private debt funds often have a shorter fund life, due to shorter maturity dates or prepayment priorities.

Private Real Estate

Private real estate investments can be made through a direct transaction for a single property, direct acquisition of a portfolio of assets or through a diversified commingled fund. Generally, private real estate investments are less liquid than public real estate options, such as real estate investment trusts (REITs), which can be traded on equity exchanges.^{vi} Common classifications of property include: industrial, retail, multi-family, office, and additional niche categories.

Hedge Funds

The term 'hedge fund' comes from the strategy of 'hedging' against market movements to reduce risk and maximize returns by choosing either long (buy) or short (sell) positions on stocks. Funds are typically managed portfolios of investments that use advanced investment strategies such as leveraged, long, short and derivative positions in potentially both domestic and international markets with the goal of generating strong returns, reducing volatility or both.^{vii} As private investments, hedge funds are generally subject to less regulation than many traditional investments, potentially giving them more flexibility in terms of the assets they can invest in, their investment style, and the management of the fund.

Precious Metals

Precious metals, such as gold, are an alternative investment that are tangible assets that have historically acted as a hedge against economic uncertainty.

BENEFITS & RISKS OF ALTERNATIVES

BENEFITS

Diversification. Highly correlated investments tend to react similarly to the events that move the market, which can lead to big swings in portfolio performance. Alternative investments often respond to those market forces differently, increasing your diversification and potentially lowering your risk.

Volatility Reduction. Due to a low correlation to other asset classes, alternatives can help smooth returns during periods of market turbulence.

Inflation Hedge. By including assets like real estate, commodities, or infrastructure that tend to increase in value when inflation rises, alternatives can help preserve purchasing power during inflationary environments.

Reliable Income Stream. Assets like private credit, real estate, or infrastructure often provide consistent payouts that can enhance overall portfolio income, especially during low-yield environments.

The potential to enhance returns, diversify your portfolio, lower volatility, and hedge against inflation.

RISKS

Higher Fees. Alternative investments often come with higher management and performance fees compared to traditional assets.

Less Liquidity. Many alternative assets are not easily bought or sold, making them less liquid than publicly traded investments.

More complex. Alternatives can involve complex structures and strategies that may be difficult for investors to fully understand.

Less transparency. These investments typically offer less regulatory oversight and disclosure, leading to reduced transparency for investors.

**Risks are not limited to those listed above; all investments carry inherent risks, and past performance does not guarantee future returns.*

REFERENCES

ⁱ Seeking Alpha, “Alternative Investments,” 2022. CAIS IQ.

ⁱⁱ Baird Private Wealth Management, “The Role of Alternative Investments in a Diversified Investment Portfolio.”

ⁱⁱⁱ CAIS, IQ, Prequin, “Global Private Equity Report,” 2022.

^{iv} Mercer, “Foundations of Alternative Investments: Private Credit,” 2021.

^v Prequin, “What Are Alternative Assets? Introduction to Alternative Assets,” 2024.

^{vi} Mercer, “Real Estate as an Asset Class,” 2019.

^{vii} *Id.*

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