



As Stocks Continue to Roil, Alternative Investments Gain Appeal

Prolonged stock market volatility has prompted many investors to look for alternatives to equities as they build a portfolio. Alternative investments -- such as real estate investment trusts, commodities, private equity, and hedge funds -- may have appeal for certain individuals.

Callout:

Hedge funds typically are engineered to seek a more favorable risk-adjusted return than their investors might obtain from a fund that follows a standard market benchmark.

Social Media Message:

See why market volatility has prompted many investors to look for alternatives as they build their portfolios.

Prolonged stock market volatility has caused many investors to question how much of their portfolios should be allocated to equities. If the stock market is making you nervous, it's important to understand that there are alternatives, which, when used along with stocks, may increase diversification and potentially lessen volatility.¹ However, it's just as important to understand that alternative investments also come with risks.

Alternative Investments Defined

Alternative investments take many forms. Here is a look at several common investment types.

- Real estate investment trusts (REITs). REITs invest in groups of professionally managed properties such as office buildings, apartments, warehouses, or health care facilities. To qualify as a REIT, a company must invest at least 75% of its total assets in real estate, must derive at least 75% of gross income from rents or mortgage interest, and must pay at least 90% of its taxable income in the form of shareholder dividends. REITs trade on major exchanges and can be bought or sold as you would trade a stock.
- Commodities.² These investments include metals such as gold or silver, oil, and agricultural products. In the case of gold or silver, there are dealers who trade these precious metals. If you take physical possession of gold or silver, you will need to arrange for storage and insurance.

Because many investors do not want to make these arrangements, exchange-traded funds (ETFs) have become a popular way to access commodities.

- Private equity. Major categories of private equity include venture capital, leveraged buyouts, and mezzanine financing. Investors participate in private markets through collective vehicles such as partnerships that actively manage the investment assets on the investors' behalf. Successful investing in this area requires the ability to assess complex financial structures, assume outsized risk in pursuit of superior reward, and tolerate extended periods of illiquidity. Private equity firms frequently require investors to make commitments ranging from \$5 million to \$10 million or more.
- Hedge funds.³ The term hedge fund is a catch-all phrase describing funds that follow aggressive investment strategies such as intensive use of derivatives and proprietary computerized trading. Hedge funds typically are engineered to seek a more favorable risk-adjusted return than their investors might obtain from a fund that follows a standard market benchmark. These funds are typically offered to investors whose portfolios include more than \$1 million in financial assets.

All investing involves risk, including loss of principal; and alternative investments by themselves can be highly volatile. But when used in combination with stocks or other assets, they may help to smooth out long-term returns and provide an alternative when stock returns are choppy. Be sure to consult with your financial professional before investing.

Source/Disclaimer:

¹There is no guarantee that a diversified portfolio will enhance overall returns or outperform a nondiversified portfolio. Diversification does not ensure a profit or protect against a loss in a declining market.

²Exposure to the commodities market may subject investors to greater volatility as commodity-linked investments may be affected by changes in overall market movements, commodity index volatility, changes in interest rates, or factors affecting a particular industry or commodity.

³Hedge funds often engage in speculative investment practices that may increase the risk of investment loss. Hedge funds can be highly illiquid; are not required to provide periodic pricing or valuation information to investors; may involve complex tax structures and delays in distributing important tax information; are not subject to the same regulatory requirements as mutual funds; and often charge high fees.

###

January 2012 — This column is provided through the Financial Planning Association, the membership organization for the financial planning community, and is brought to you by Paul Lemon, CPA/PFS, CFP®, a local member of FPA.

Required Attribution

Because of the possibility of human or mechanical error by McGraw-Hill Financial Communications or its sources, neither McGraw-Hill Financial Communications nor its sources guarantees the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. In no event shall McGraw-Hill Financial Communications be liable for any indirect, special or consequential damages in connection with subscriber's or others' use of the content.

© 2011 McGraw-Hill Financial Communications. All rights reserved.