# Why Alternatives?

**INVESTMENT STRATEGY**

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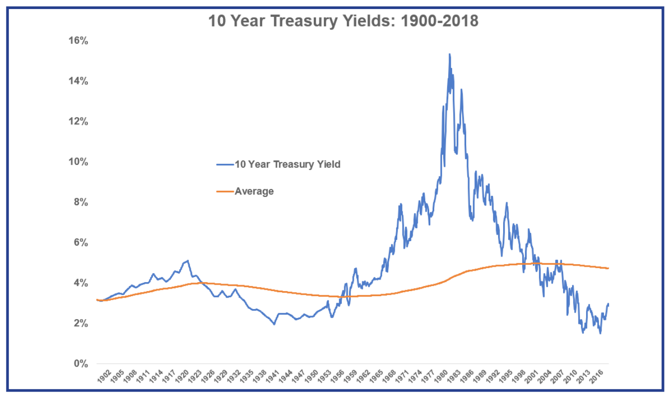
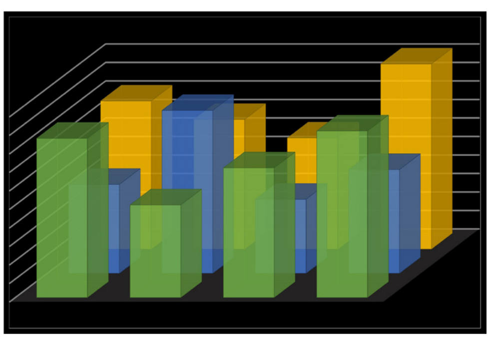
Alternative investments are commonly used by institutional investors to diversify an investment portfolio with the intention of reducing the volatility of the investment portfolio as a whole. Individuals who have been comfortable investing in the more traditional asset classes like stocks and bonds often wonder why people invest in alternative investments. We see three primary reasons to include alternative investments in an investment portfolio.

***1. Reducing Portfolio Volatility:*** One of the primary reasons that alternative investments are included as a complement to traditional stocks and bonds is because they can reduce the overall volatility of a diversified portfolio. Many Institutional investors know that if two investment portfolios with the same investment return are compared, the portfolio with less volatility (more consistent returns) will likely have the greater compounded returns over time. They use alternative investments as a possible way to reduce the standard deviation of the investment returns.

***2. Reducing Investment Risk Related to Low Interest Rates:*** The second reason to include alternative investments is that they may help mitigate the higher than normal investment risk for traditional stock and bond investments caused by the historically low interest rate environment. In particular, the low interest rate environment creates a significantly higher interest rate risk for bond investors if interest rates increase in the coming years towards their higher historical averages. An inverse relationship often exists between bond prices and interest rates—as interest rates rise, bond prices typically fall.[1]




Source: https://awealthofcommonsense.com[2]



***3. Identifying New Streams of Expected Returns:*** The third reason to include alternatives is that traditional investment options alone may not provide the returns you need to achieve your financial goals. The historically low interest rate environment has helped to create lower future expected returns from the traditional asset classes of stocks and bonds. The historical decline in interest rates since 1980 has led many sophisticated institutional investors to reduce their future expected returns from the traditional asset classes. New sources of expected returns, particularly from alternative investment strategies, complement traditional asset allocation models to help increase expected returns from the portfolio and provide diversification benefits.[3]

A diversifying alternative investment seeks to produce returns that are different (less correlated) than the returns of the stock and bond market. When the stock market falls, a diversifying investment with low correlation may move independently, producing either positive or negative returns. Alternative investments (including both alternative assets and alternative strategies) could help to reduce portfolio volatility, reduce portfolio drawdowns, reduce interest rate risk and improve the potential performance characteristics of a diversified portfolio.

1. Hall, M. (2019). How do interest rates affect the stock market? Retrieved https://www.investopedia.com/investing/how-interest-rates-affect-stock-market/
2. Carlson, B. (2018). Mean Reversion & The Placebo Effect. Retrieved from https://awealthofcommonsense.com/2018/07/mean-reversion-the-placebo-effect/
3. Yang, G. (2019). Investing in a low interest rate environment. Retrieved http://www.investmentreview.com/news/investing-in-a-low-rate-environment-9004