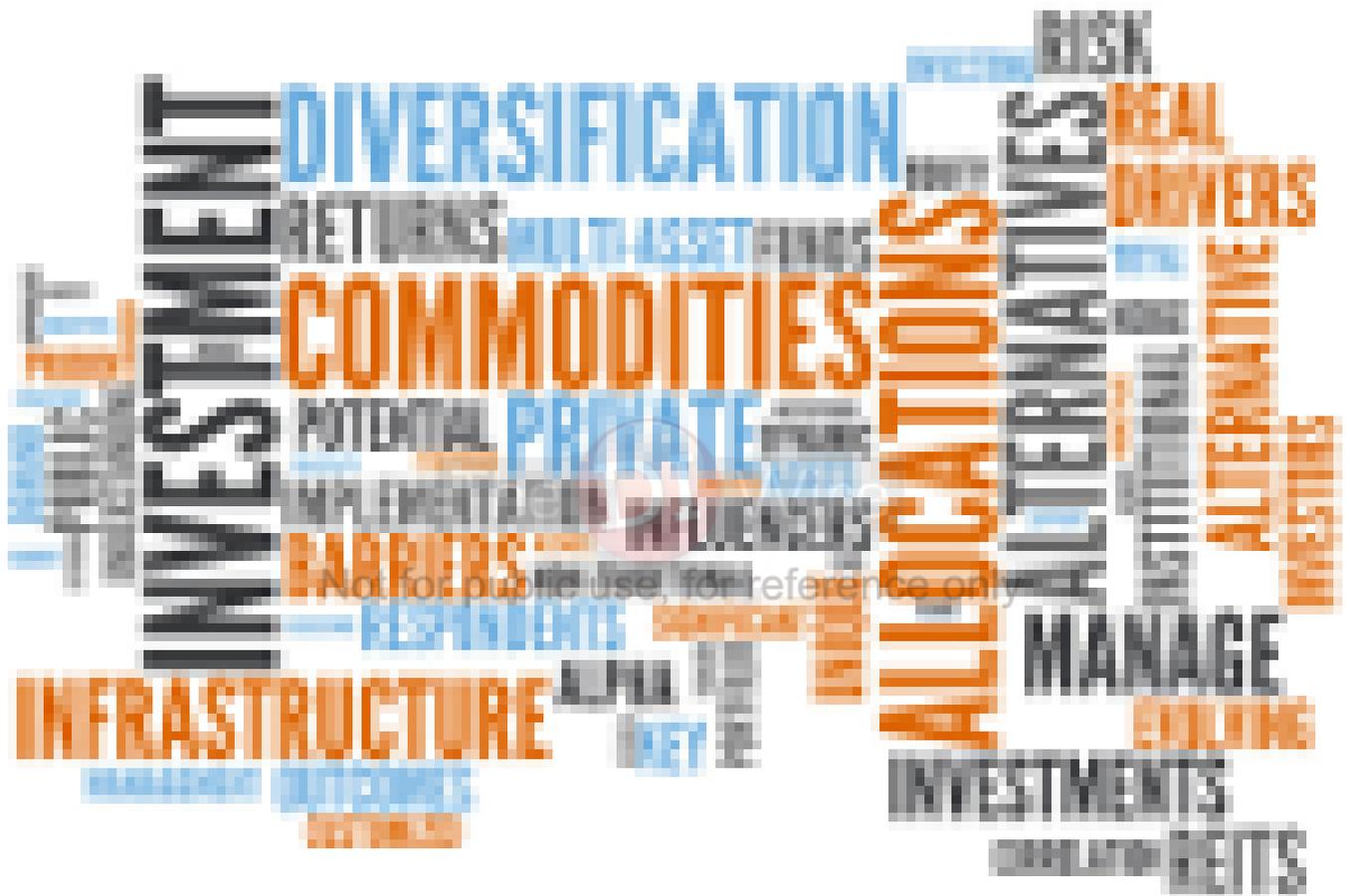


# Alternative Investments 101

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In 2008 the global financial system melted down destroying a lot of wealth and investor goodwill in the process. Since the spring of 2009, the stock markets have risen, and with that rise brought a lot of that goodwill back. However many investors are still weary of traditional investments. This has given rise to interest in a new type of investment, alternative investments. But are alternative investments really new?

## What is an alternative investment?

The term alternative investment does not have a traditionally defined meaning. It can loosely be used to describe investments other than publicly traded stocks, bonds or cash. Examples of alternative investments are: rental real estate, private mortgages, tax liens, timberland, farmland, horses, stamps, gold and silver, commodities, private equity, venture capital, artwork, wine, horses, and more. There is virtually no limit to what could be called an alternative investment.

The term alternative investment tends to be a bit confusing for most people since there are a number of definitions floating around. This is mainly due to the marketing efforts of different segments of the financial services industry trying to capitalize on the popular use of the word “alternative investment”. Given Wall Street’s propensity to engage in trendy ideas, it is highly likely that even more investments and strategies will be pushed under this umbrella down the road.

## What is a Liquid Alternative (liquid alt) investment?

Liquid Alts have gained in popularity

Since 2010, Wall Street has been buzzing about Liquid Alternatives (liquid alts). Liquid Alternative investments, or as they are commonly referred to as Liquid Alts, are typically pooled investment vehicles, such as Mutual Funds, Exchange Traded Funds (ETFs), and Closed-End funds which hold alternative investments or use an alternative investment strategy. Due to the nature of the pooled investment vehicle (fund) being liquid, or actively traded on a daily basis, it requires the investments inside the fund to be liquid as well. This narrows down the types of investment which can be held in the fund.

A Liquid Alt fund would find it challenging to invest in rental real estate if daily liquidity is required. Therefore the types of assets which fit in this category can be narrowed down to ones which are traded on public markets. Examples of these assets would be: futures, foreign exchange, derivatives such as options, structured products, and more.

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Liquid Alts are not just limited to a certain type of investment in order to characterize it as a liquid alt. Liquid Alts can also include different strategies which might mimic a hedge fund, such as a long-short strategy. The long-short fund would qualify even if the strategy included assets such as stocks.

Lastly, Exchange Traded Notes (ETNs) qualify as a liquid alt. ETNs are different from an ETF in that they are not a pooled investment vehicle. They are an obligation of the sponsoring institution, which creates the ETN. The goal is to have the ETN mimic the returns of a specific asset, strategy, or index. The ETN is not backed by any assets, rather it is backed by the faith and credit of the issuer.

## Alternative investment vs alternative investment strategy

- Alternative investments are assets such as a plot of farmland, multi-family rental property, or gold coins.
- Alternative investment strategies are typically strategies which are anything other than buy and hold or long-only. Examples such as: long-short, hedged investments, or alt trading strategies.

The major difference between an alternative investment and an alternative investment strategy is that an alternative investment strategy can be invested in any type of asset including traditional ones such as stocks. Examples of these alternative investment strategies are hedge funds, commodity trading, and long-short funds.



## How are alternative investments different from traditional investments?

The one main difference between the two types of investment is the liquidity. Liquidity is a double-edged sword. It provides one of the reasons that make alternative investments attractive, and it also provides one of the drawbacks. Investments such as real estate, which have a fragmented marketplace mainly due to geographical limitations, can provide investors the opportunity to find real estate at a price below the market average. If a property is on the market to be sold, and there are no offers, then either no one knows about the property being for sale or the price is too high. Discount or negotiated pricing is an advantage for the astute and resourceful buyer of real estate.

Alternatively, when someone is looking to sell real estate, they will potentially have the same issue. This problem could be magnified if the property needs to be sold quickly.

## How can I invest in alternative investments?

Alternative investments are available through a variety of sources. If you have a Registered Rep, who works for a broker dealer or has any affiliation with a broker dealer, then your options to alternative investments will be limited to what is allowed by that broker dealer's business model, due diligence and/or compliance requirements. Some broker dealers have a wide selection of choices and some have a narrow selection. If you are seriously interested in alternative investments and want to stay at your current broker dealer, then consider having a conversation with the compliance department to see if they would consider adding the alternative investment to their platform.

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If you are an Investment Advisor who works at an independent Registered Investment Advisor, then you may have a lot more choices. Ultimately it may still be your RIA's business model, due diligence and compliance department which gives you a thumbs up or thumbs down on the investment.

In November I [wrote about self directed IRAs](#) and how they could be used to invest in alternative investments which are not publicly traded. Retirement accounts are a part of your, or your client's portfolio that should not be ignored when it comes to diversifying through alternative investments. Learn more about [self directed IRAs](#).

Whether you are looking to invest in liquid alts, hedge funds, managed futures, gold coins, private mortgages, or horses, you will need to determine what role they will play in your total portfolio and what effect the liquidity will play with the investment or strategy itself.

If you want to learn more about [alternative investments](#) and [self directed IRAs](#), you can follow my column, [RIA Perspectives from Kirk Chisholm here on The DI Wire](#), or my company's blog at [Innovative Advisory Group Blog](#).