

Why consider alternative investments?

The future might not look
like the past

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“Over the past decade, there has been a collective effort across wealth and asset management firms to broaden access to alternative investments for individual clients. Yet there’s still a lot of room for growth when you look at current average allocations relative to those found in institutional portfolios.”

Aaron Filbeck

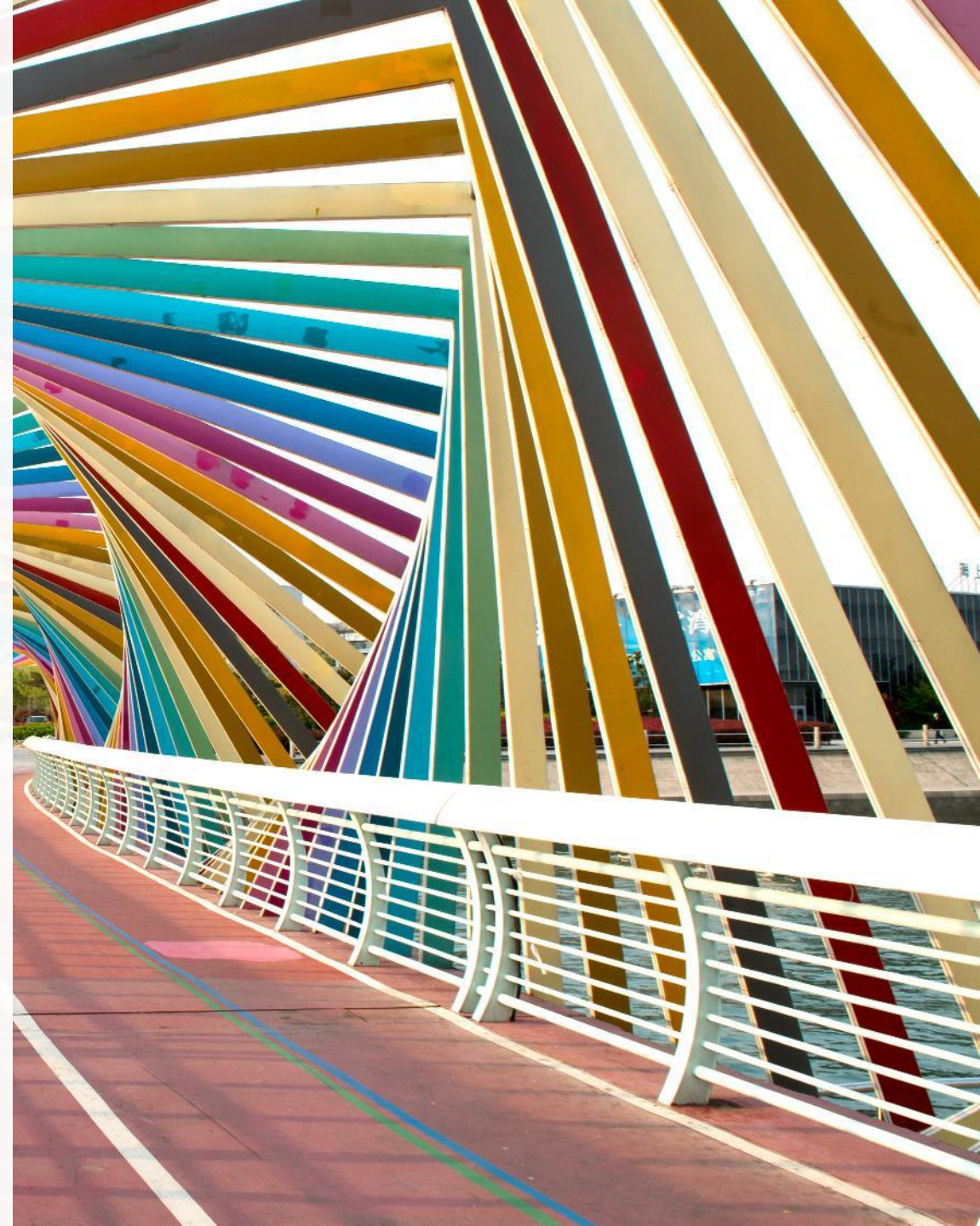
CAIA, CFA, CFP®, CIPM, FDP, Managing Director, Head of UniFi by CAIA™, CAIA Association.

“The Second Wave of Democratization Has Begun”, Marketwatch, 2024.

What you will learn

By the end of this module, you will be able to:

- Describe the current market environment and the impact on advisors and investors.
- Define alternative investments.
- Explain why financial professionals require a new playbook for the markets of tomorrow.
- Describe the role and use of various types of alternative investments.
- Define QP funds, feeder funds and registered funds.



Why alternatives? Why now?

Today's market environment

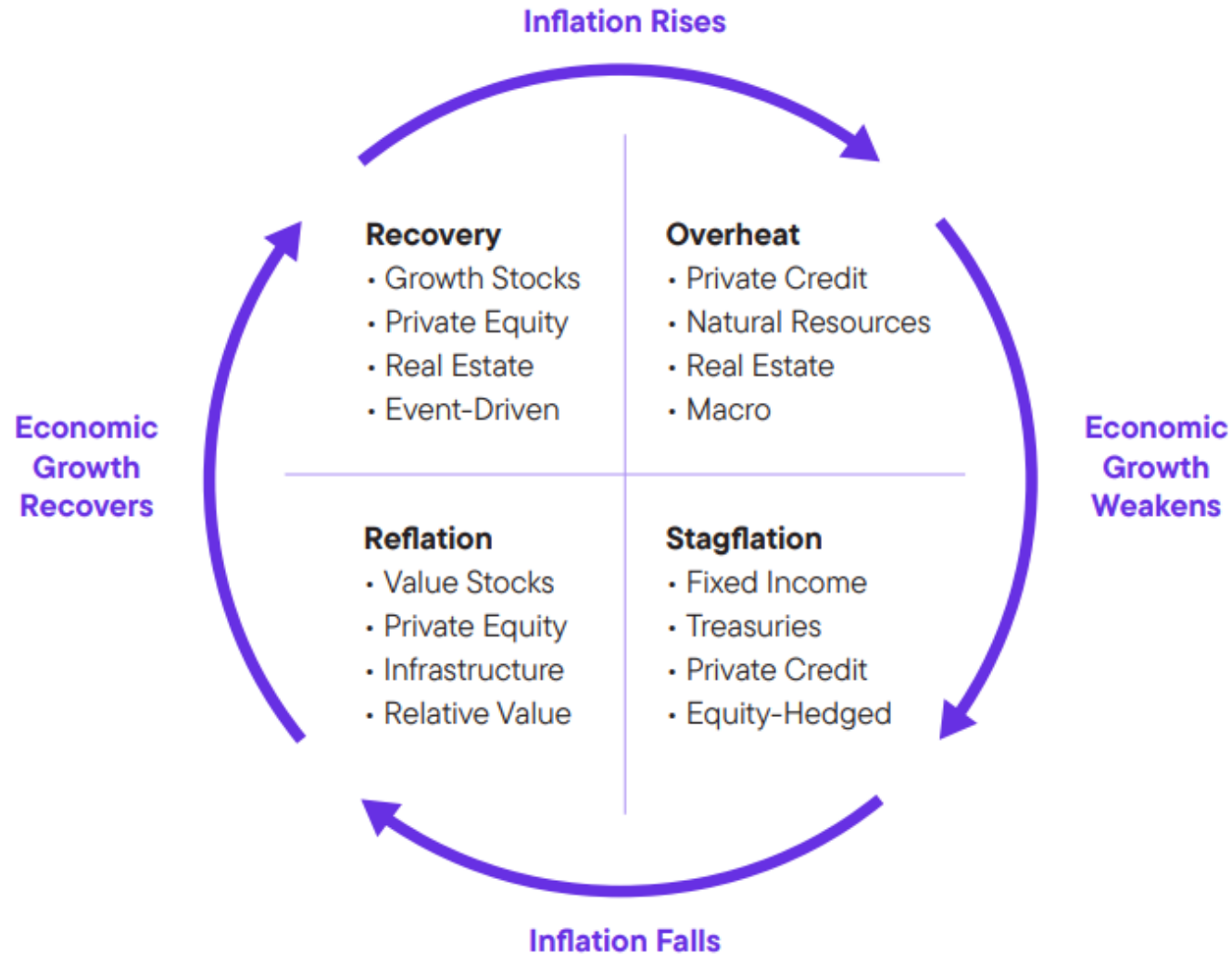
- Equity returns are expected to be lower in the future
- Advisors are seeking alternative sources of income
- Correlations remain elevated due to interconnectivity of global markets
- Elevated geopolitical risks remain present
- Global elections can create market volatility



MARKET ENVIRONMENT

The US and world economies have remained resilient despite monetary policy tightening and have continued to grow at a greater-than-anticipated rate.

Asset class performance through economic cycles



We are moving from an economic environment with rising inflation to one with weakening economic growth and falling inflation.

Advisor attitudes towards alternatives



According to the 2023 CIAS | Mercer Advisor survey, **85%** of advisors are looking to increase their allocations to alternatives.



83% believe alternatives give them a competitive advantage, saying that this access differentiates their practice from peers.



A majority also looked to access alts to win new clients (**59%**) or gain wallet share with existing clients (**51%**).



66% of advisors with clients who have less than \$5 million in total investable assets intend to allocate more than 10% to alternatives by the end of 2025; 90% of advisors whose clients have more than \$50 million in investable assets said they would allocate more than 10%.



Discussion

What comes to your mind when you think of “alternatives?”



ALTERNATIVE INVESTMENT

The industry uses the term loosely, often referring to any investment that isn't considered mainstream as an alternative investment.



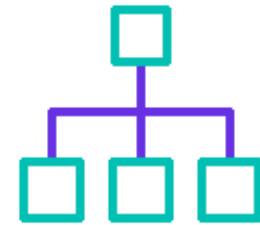
Defining alternative investments



Asset class



Strategy



Structure



How can alternative investments be used in today's market environment?

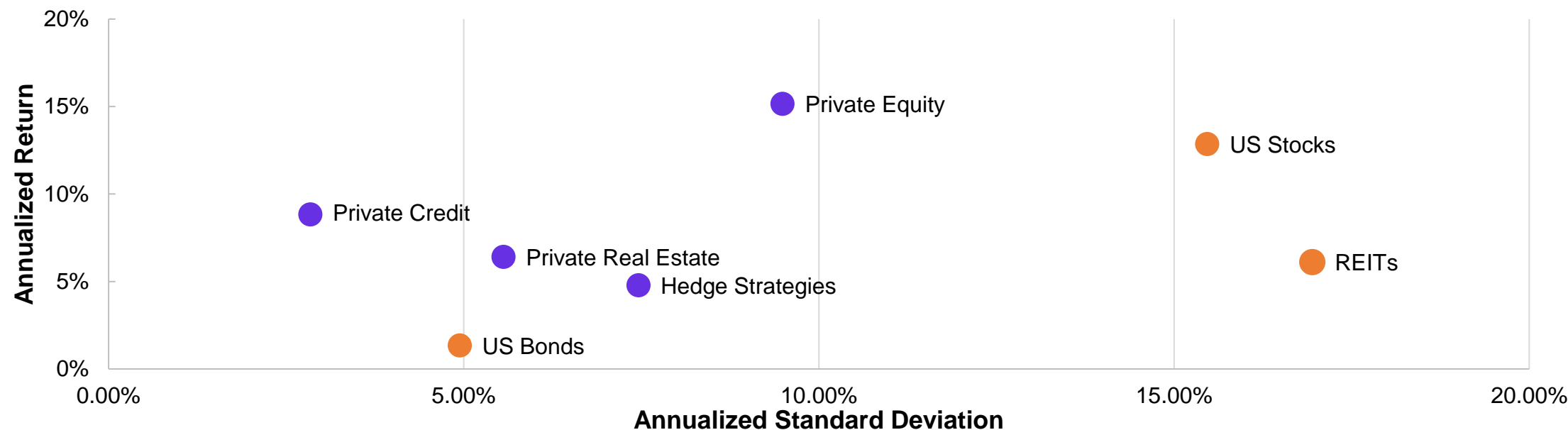
Alternatives investments are versatile and valuable tools for today's market environment that can provide **growth** and **income**, **diversification** and **inflation hedging**. These tools have been used extensively by institutions for decades.

Why invest in private market?

Private markets have historically delivered attractive risk-adjusted returns

Annualized Return vs. Risk

10 years ending 6/30/2024



This chart is for illustrative purposes only and does not reflect the performance of any Franklin Templeton fund.

Past performance is not an indicator or a guarantee of future results.

Sources: PitchBook, Bloomberg, Cliffwater, NCREIF, FTSE, SPDJI, Burgiss, Morningstar, Macrobond, Analysis by Franklin Templeton Institute.

Notes: Location/Region: United States. Indexes used: Private Real Estate Debt: PitchBook fund search results for US Real Estate Debt funds; Private Real Estate Equity: NCREIF Fund Index Open End Diversified Core Equity (ODCE) Index; Private Equity: Burgiss' fund search results for US Private Equity funds (all categories); Private Credit: Cliffwater Direct Lending Index; Public Stocks: S&P 500 Total Return Index, US Bonds: Bloomberg US Aggregate Index (Total Return), REITs: FTSE NAREIT All Equity REITs Index. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. Important data provider notices and terms available at www.franklintempletondatasources.com.

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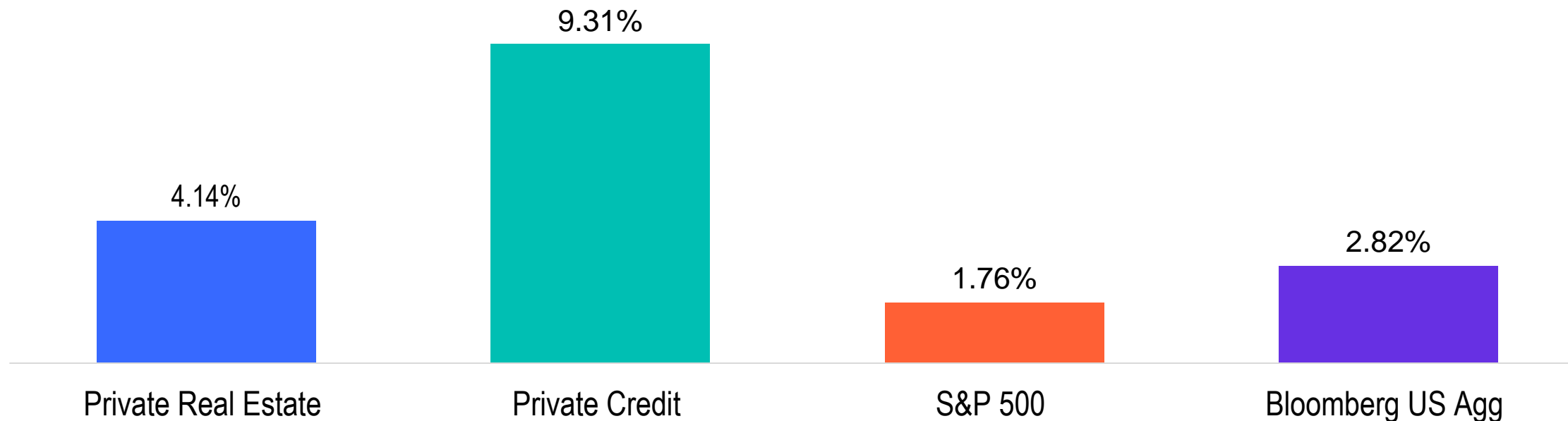
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Why invest in private market?

Alternative sources of income

10 Years Average Yields

As of 6/30/2024



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Past performance is no guarantee of future results.

Sources: NCREIF, Cliffwater, SPDJI, Bloomberg. Analysis by Franklin Templeton Institute.

Notes: Private Real Estate: 10-year average income return for NCREIF ODCE as of 6/30/2024, Private Credit: Cliffwater Direct Lending index current yield as of 3/31/2024; S&P 500: S&P Dow Jones Indices 10-year average dividend yield as of 3/31/2024; Bloomberg US Agg 10-year average yield to maturity as of 6/30/2024. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. Important data provider notices and terms available at www.franklintempletondatasources.com.

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Why invest in private market?

Diversification

Correlation to Traditional Assets

10 years ending March 31, 2024

	US Equities	US Bonds
Private Credit	0.67	-0.05
Private Real Estate	-0.30	-0.37
Private Equity	0.68	0.12
Hedge Strategies	0.89	0.13

This table is for illustrative purposes only and does not reflect the performance of any Franklin Templeton fund.

Sources: Burgiss, SPDJI, NCREIF, Bloomberg, Cliffwater, FTSE, HFRI, Macrobond, Morningstar. Analysis by Franklin Templeton Institute
Notes: Indexes used: Private Credit: Cliffwater Direct Lending Index; Private Real Estate: NCREIF Fund Index Open End Diversified Core Equity (ODCE) Index, US Stocks: S&P 500 Total Return Index, US Bonds: Bloomberg US Aggregate Index (Total Return); Hedge Strategies: HFRI Fund Weighted Composite; Private Equity: Burgiss' fund search results for US Private Equity funds (all categories); REITs: FTSE NAREIT All Equity REITs Index. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.** Important data provider notices and terms available at www.franklintempletondatasources.com.

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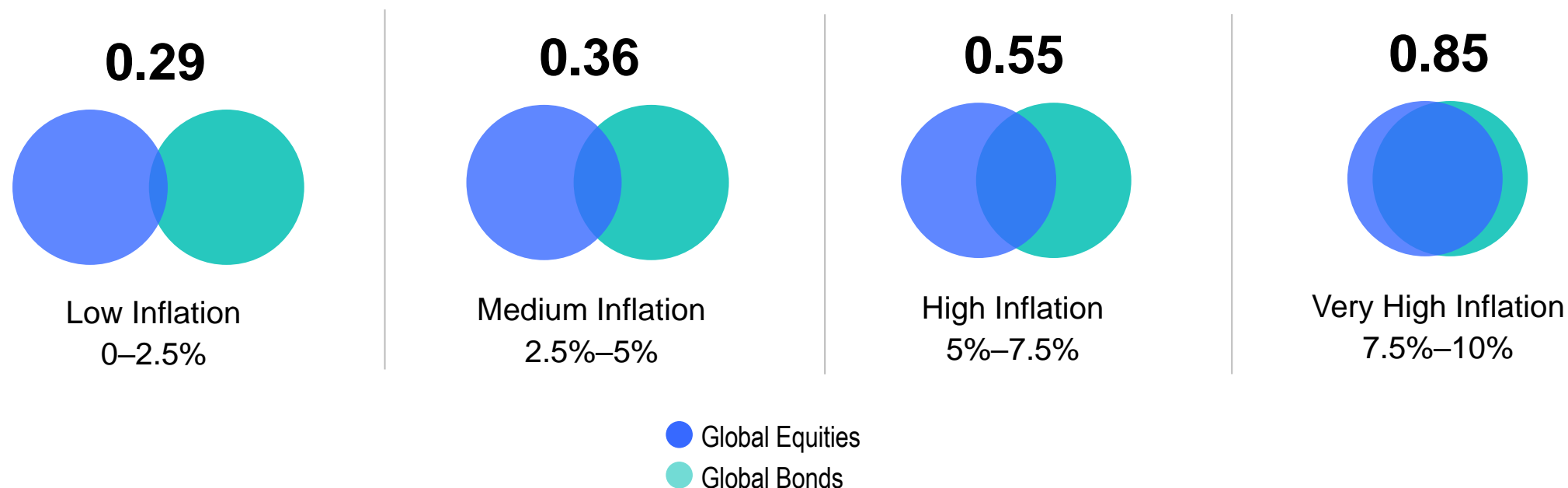
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Why invest in private market?

Correlation

Global Equity and Bonds Correlation in Various Inflationary Regimes

1985–2024 (9/30/2024)



Past performance does not guarantee future results.

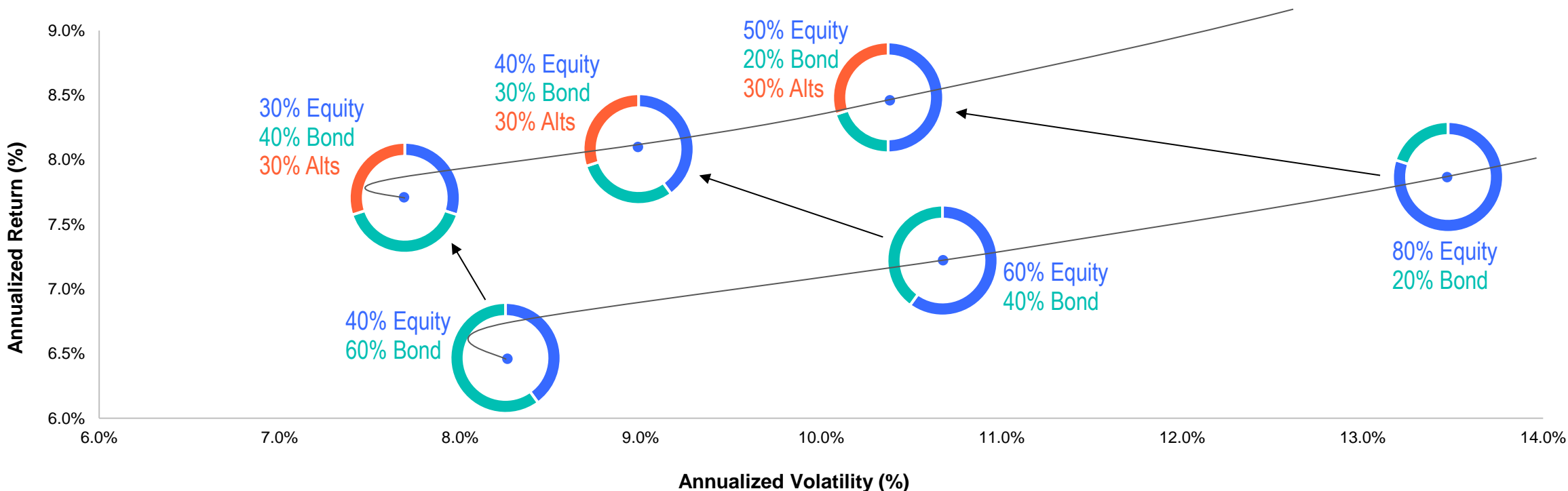
Source: MSCI, Bloomberg, Morningstar Direct. Bonds measured by FTSE World Global Bond Index 1/1985-1/1990; Bloomberg Global Agg TR USD 2/1990-today (7 May 2024); Global Equities measured by MSCI World Growth Index.

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Efficient frontier analysis

Annualized Volatility and Returns

1990 Q2 – 2024 Q2



Sources: Burgiss, SPDJI, NCREIF, Bloomberg, Cliffwater, Macrobond, Morningstar. Analysis by Franklin Templeton Institute

Notes: Quarterly data analysis from Q2 1990 to Q2 2024; 30% allocations to Alternatives split evenly among Private Real Estate, Private Equity and Private Credit.

Indexes used: Private Credit: Cliffwater Direct Lending Index; Private Real Estate: NCREIF Fund Index Open End Diversified Core Equity (ODCE) Index, US Stocks: S&P 500 Total Return Index, US Bonds: Bloomberg US Aggregate Index (Total Return); Private Equity: Burgiss' fund search results for US Private Equity funds (all categories). Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.** Important data provider notices and terms available at www.franklintempletondatasources.com.

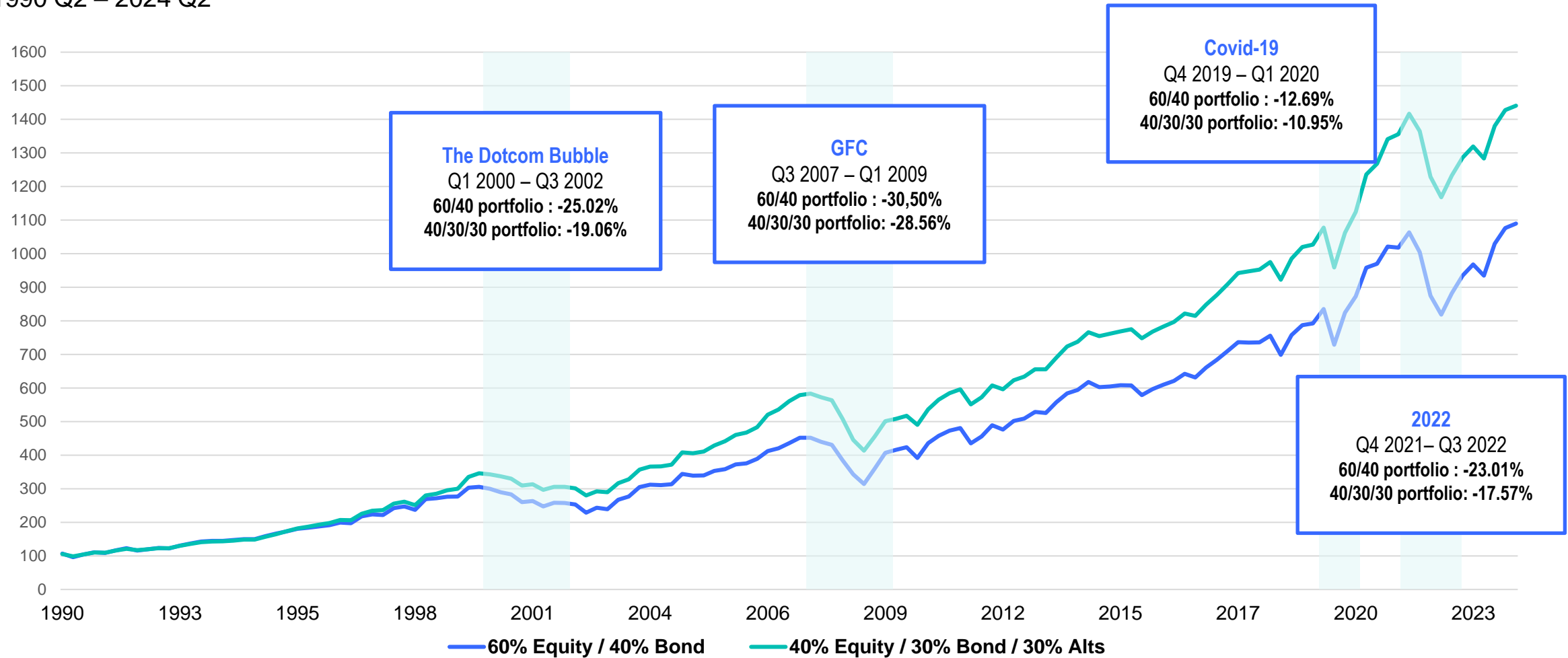
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Historical results of a diversified portfolio

Growth of Global Asset Classes (USD)

1990 Q2 – 2024 Q2



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Past performance does not guarantee future results.

Source: Prepared by Franklin Templeton Capital Market Insights Group. Burgiss, HFRX, MSCI, Bloomberg, Morningstar Direct, Macrobond.

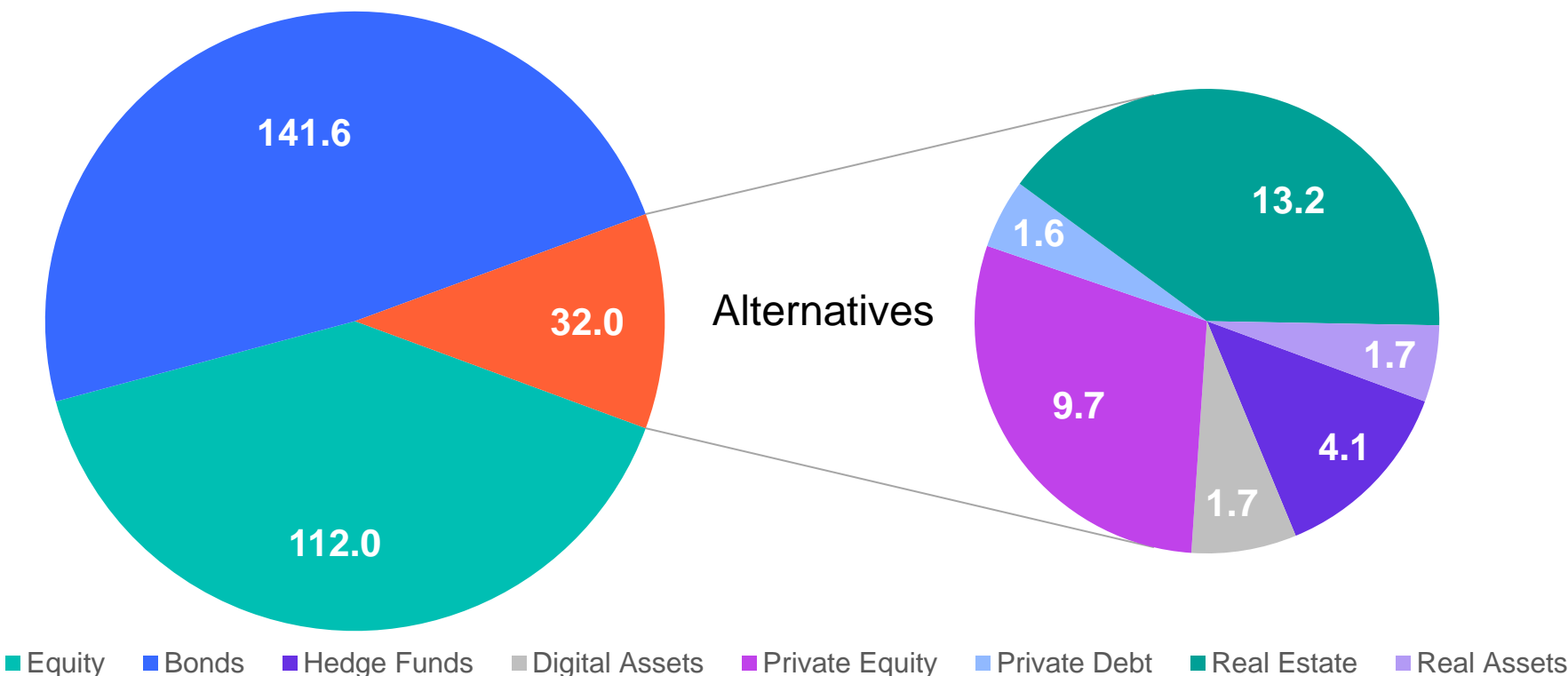
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Democratizing alternative investments

Democratizing alternative investments

Global Total Market Cap Share by Asset Class (\$T)

As of 6/30/2024*



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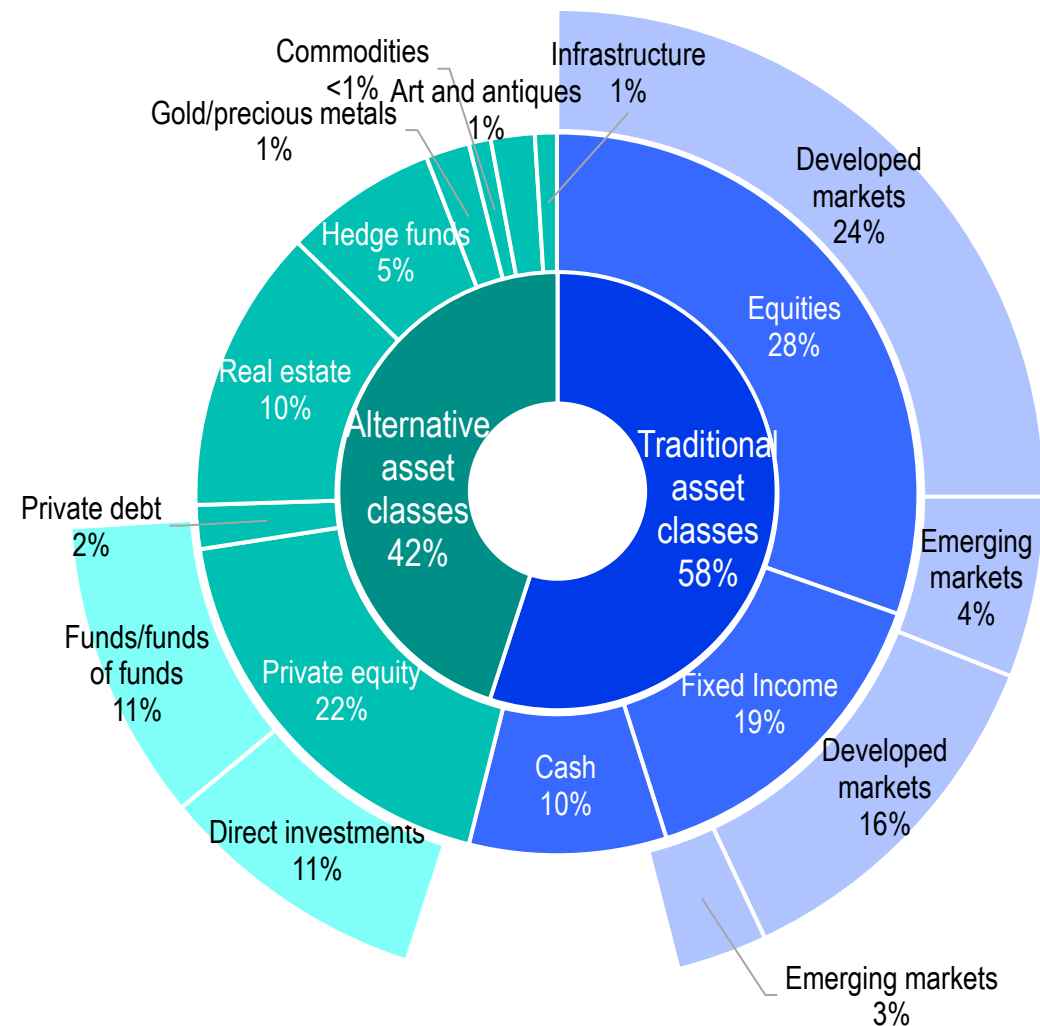
Source: Prepared by Franklin Templeton Capital Markets Insights Group. Equity – World Federation of Exchanges (WFE) Total Equity Market – Market Capitalisation; Bonds – BIS (Bank for International Settlements) – Debt Securities Statistics; Hedge Funds – HFR Global Hedge Fund Industry Report; Digital Assets – Overall cryptocurrency market capitalization; sources: CoinGecko, BitInfoCharts via Statista; Private Equity – Preqin; Private Debt – Preqin; Real Estate – MSCI Real Estate Market Size report – data as of 12/31/2023*; Real Assets – Preqin.

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Global family office allocations

Asset Allocation of HNWI

As of 2024



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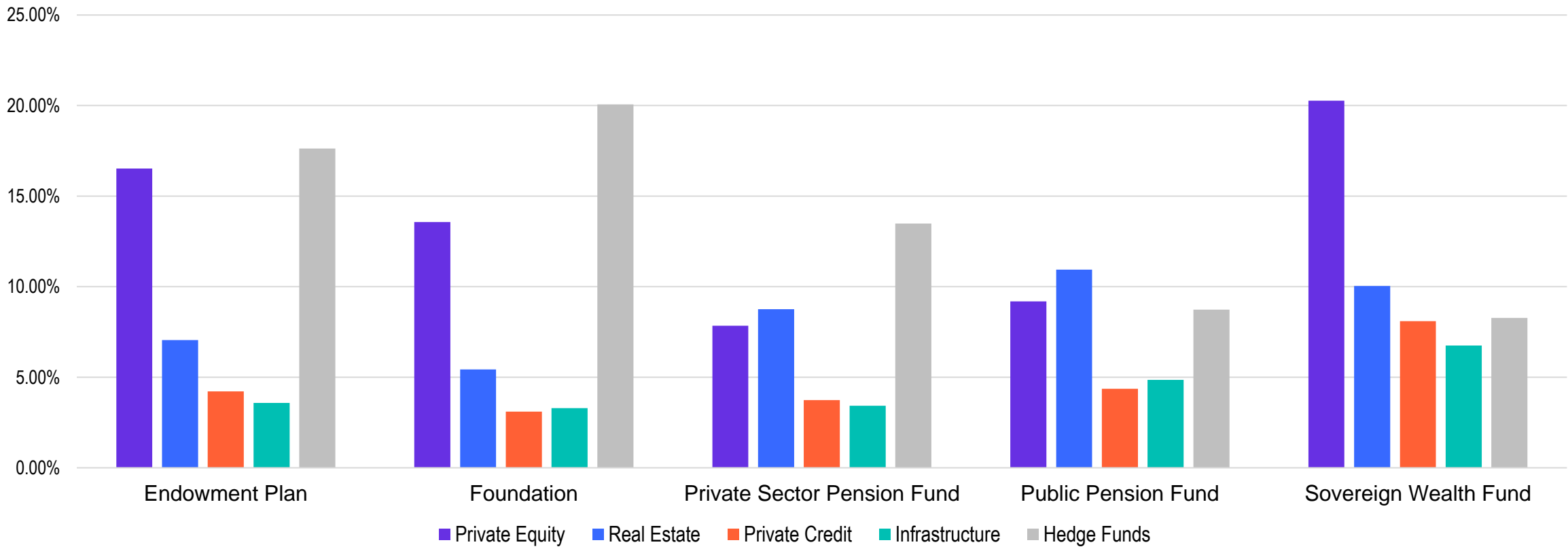
Source: 2024 UBS Global Family Office Report.

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How institutions allocate to alternatives

Asset Allocation by Institutional Segment

As of 2/5/2023



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Past performance does not guarantee future results.

Sources: Preqin, CAIA Association (2023).

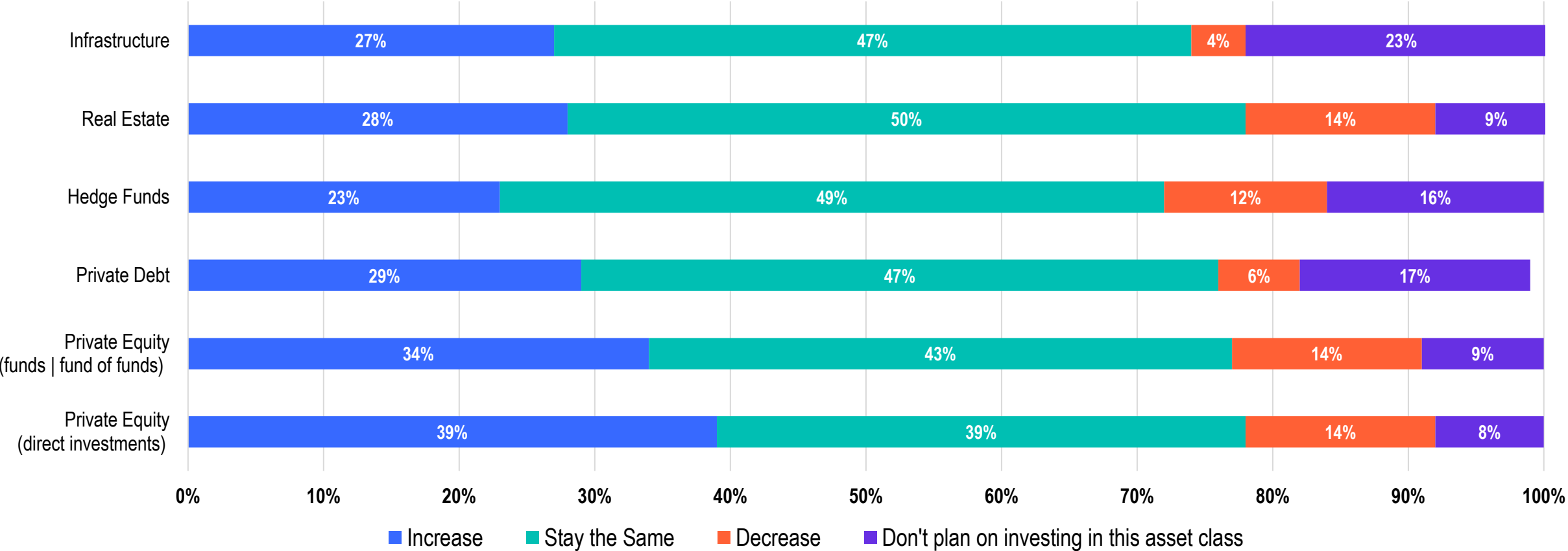
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Family offices plan to increase their allocations to alternatives



The Academy

Family Offices’ Plans for Allocating to Alternatives over the Next Five Years, by Asset Class



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Past performance does not guarantee future results.
Source: Global Family Office Report 2024. Data may not sum up to 100% due to rounding.
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Poll question

Roughly, what portion of your client base has expressed interest in or is already investing in alternatives?

- A) Less than 10% of client base**
- B) 10%–45%**
- C) 50%**
- D) More than 50%**



The role of alternatives

Roles of alternatives

In a client's portfolio



Private equity

*Potential for higher
returns*



Private credit

*An alternative source
of income*



Real assets

*Portfolio diversification and
inflation protection*

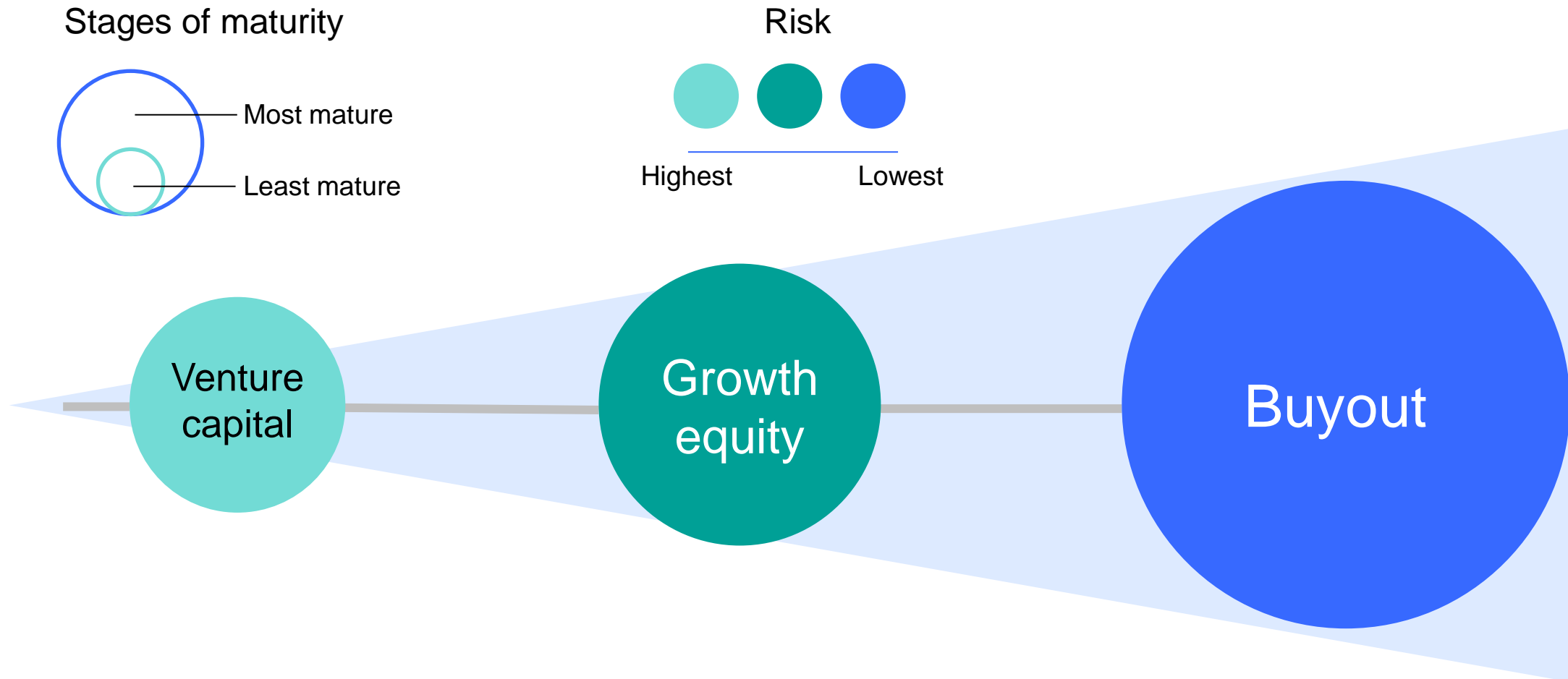


Hedge funds

*Multi-purpose tools serving
multiple roles*

Private equity

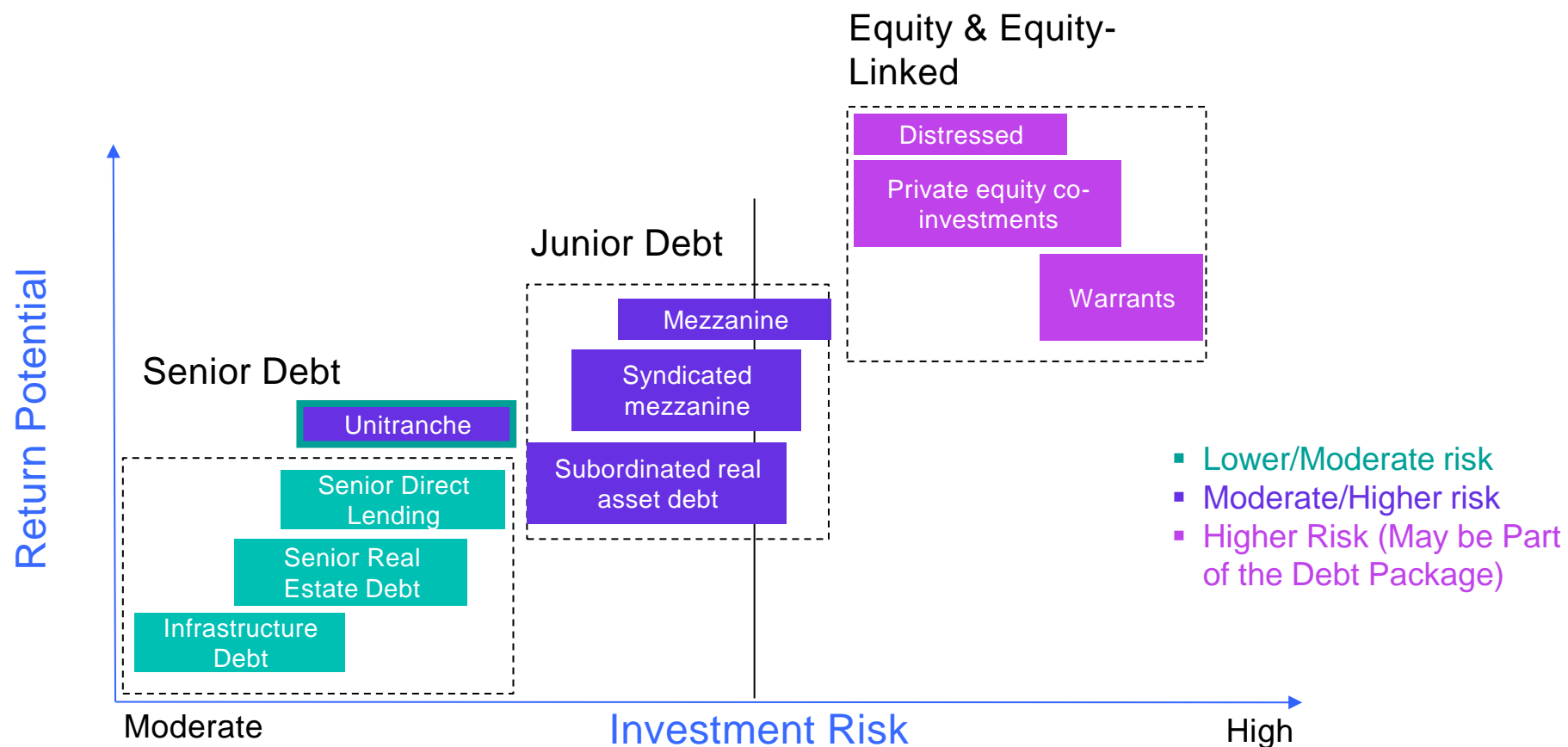
A range of opportunities across stages of development



Private credit

The risk-return spectrum

The broad private credit universe allows investors to structure a portfolio, that meets their individual risk/return objectives, benefiting from an illiquidity premium and further diversification.



Private credit represents a diverse set of strategies from **Direct Lending** to **Mezzanine** and **Distressed**, each with their own risk, return and income profile.

Private credit

Addressing today's market challenges



Interest rates

Private credit loans are predominantly **floating rate**, offering a natural hedge in a rising rate environment.



Income

Private Credit has historically offered **enhanced yield** relative to traditional fixed income investments.



Inflation

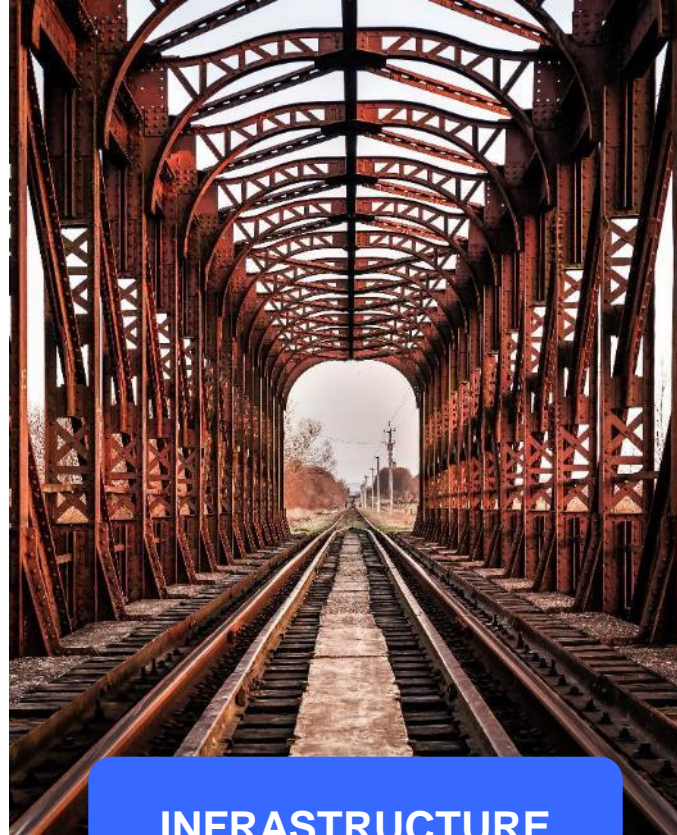
Inflation risk is managed by conducting in-depth due diligence of costs and **ongoing monitoring of interest** coverage ratios.

Real assets

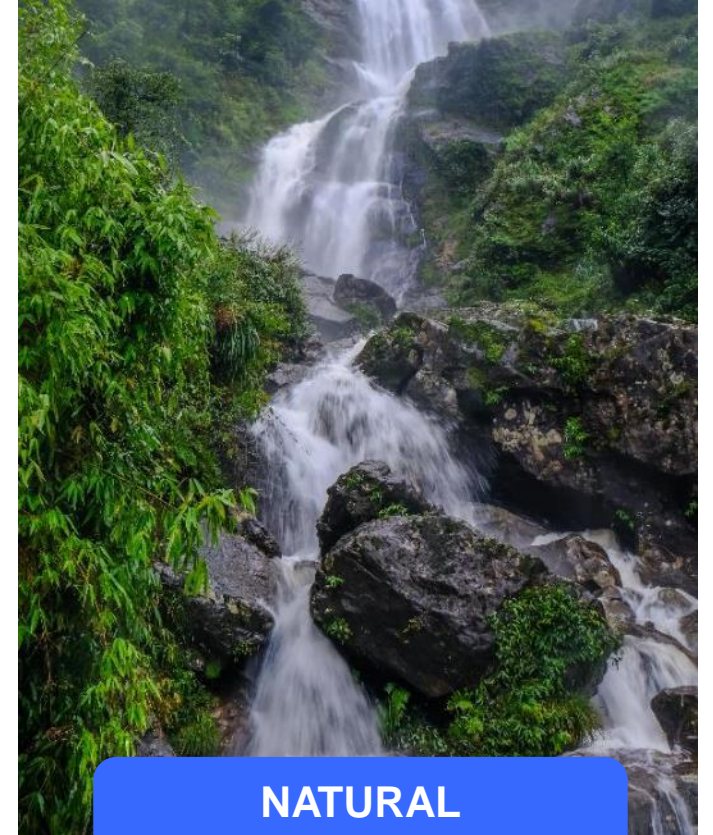
Divided into three sub-classes



REAL ESTATE



INFRASTRUCTURE



NATURAL
RESOURCES

Real assets

Divided into three sub-classes



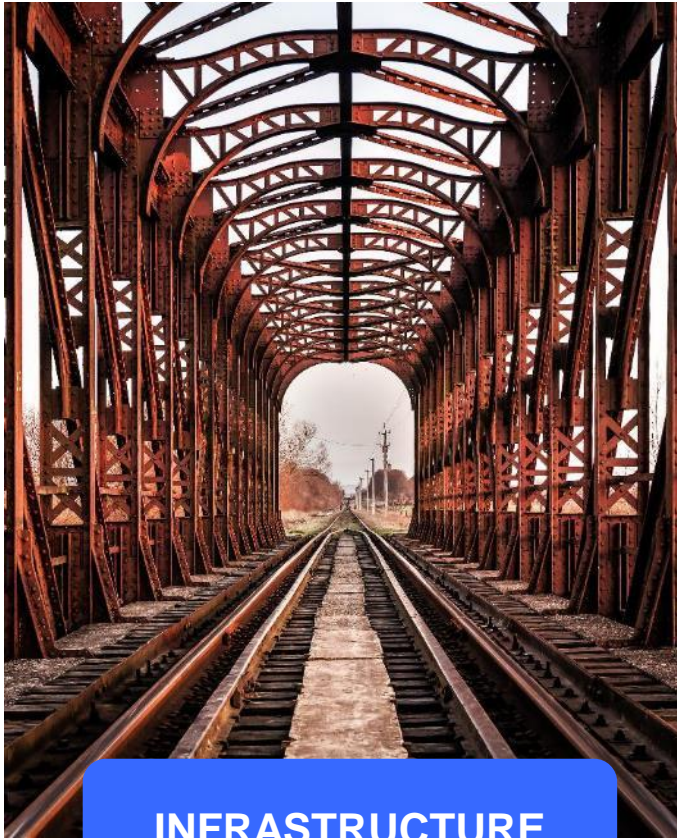
REAL ESTATE

Real estate

- Historically, seen as a source of growth and income.
- REITs are one common example.
- Real estate has also been an effective hedge against rising inflation
- There are substantive differences between public and private real estate

Real assets

Divided into three sub-classes



INFRASTRUCTURE

Infrastructure

- Infrastructure projects are generally large, fixed, long-term assets providing essential services to a society or business sector.
- Generally, less sensitive to the business cycle than public equities and fixed income.
- Cash flows linked directly or indirectly to inflation.

Real assets

Divided into three sub-classes

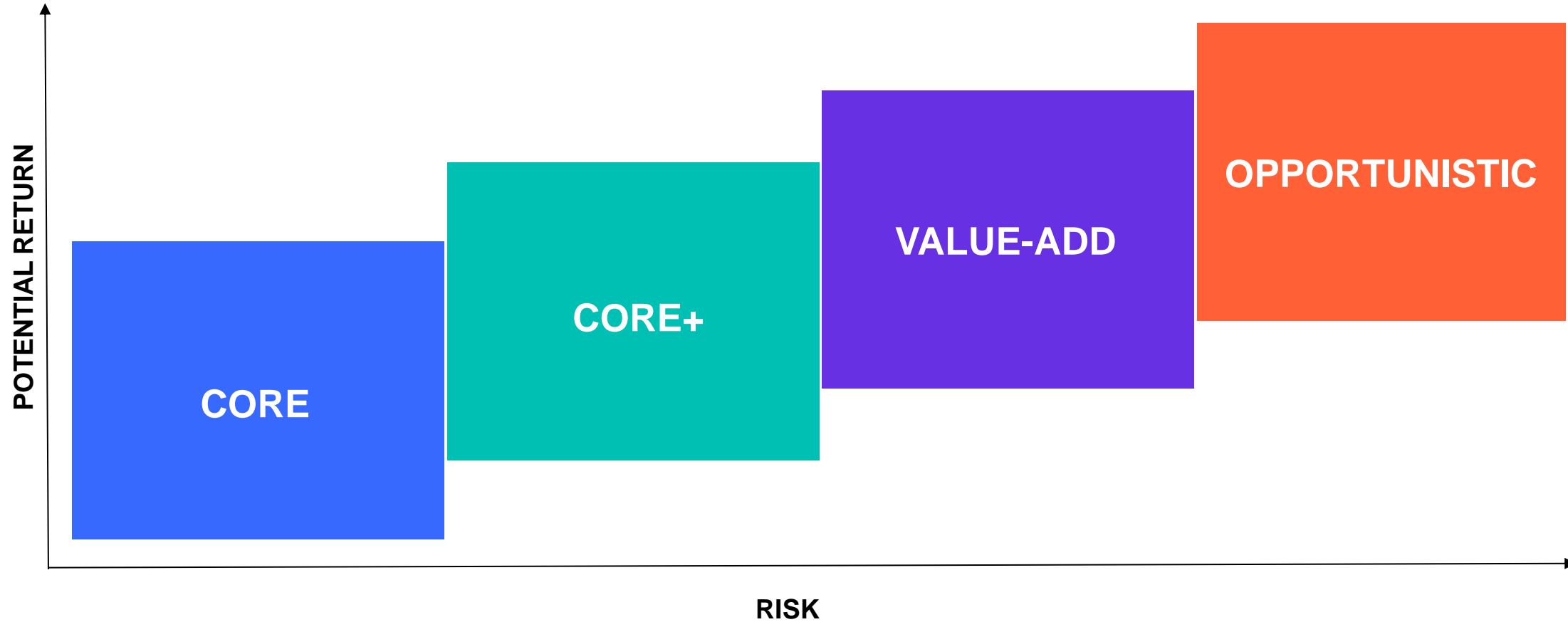


**NATURAL
RESOURCES**

Natural resources

- Energy, agriculture, timber, and minerals and mining.
- Provide the opportunity for higher returns, serve as a hedge for rising inflation and provides valuable diversification benefits.

Risk and return characteristic of real asset



Hedge funds

Strategy	Sub-Strategy	Role
Equity-Hedge	Long/short, Market-Neutral, & Short-Biased	Growth / Equity-Oriented
Event-Driven	Activist, Merger-Arbitrage, & Distressed Investing	Growth / Equity-Oriented
Relative Value	Fixed Income Arbitrage, Convertible Arbitrage, & Pairs Trading	Wealth Preservation
Macro	Global Macro, Managed Futures, & Currency Trading	Defense / Non-Correlating
Multi-Strategy	Equity-Hedge, Event-Driven, Relative Value & Macro	Defense / Opportunistic

Hedge funds represent a diverse group of strategies that may serve multiple roles



Discussion

What do you see as potential benefits of incorporating alternatives into a portfolio?



A new toolbox

The background of the slide is a composite image. The upper portion shows a dark night sky filled with stars and the glowing band of the Milky Way galaxy. A bright, out-of-focus star is visible in the upper left. The lower portion of the image shows a silhouette of a tree against a bright orange and yellow sunset sky.

THE OPPORTUNITY

Acknowledging the cyclical nature of traditional investments emphasizes the importance of integrating private investments into financial strategies as crucial elements of a well-diversified portfolio.

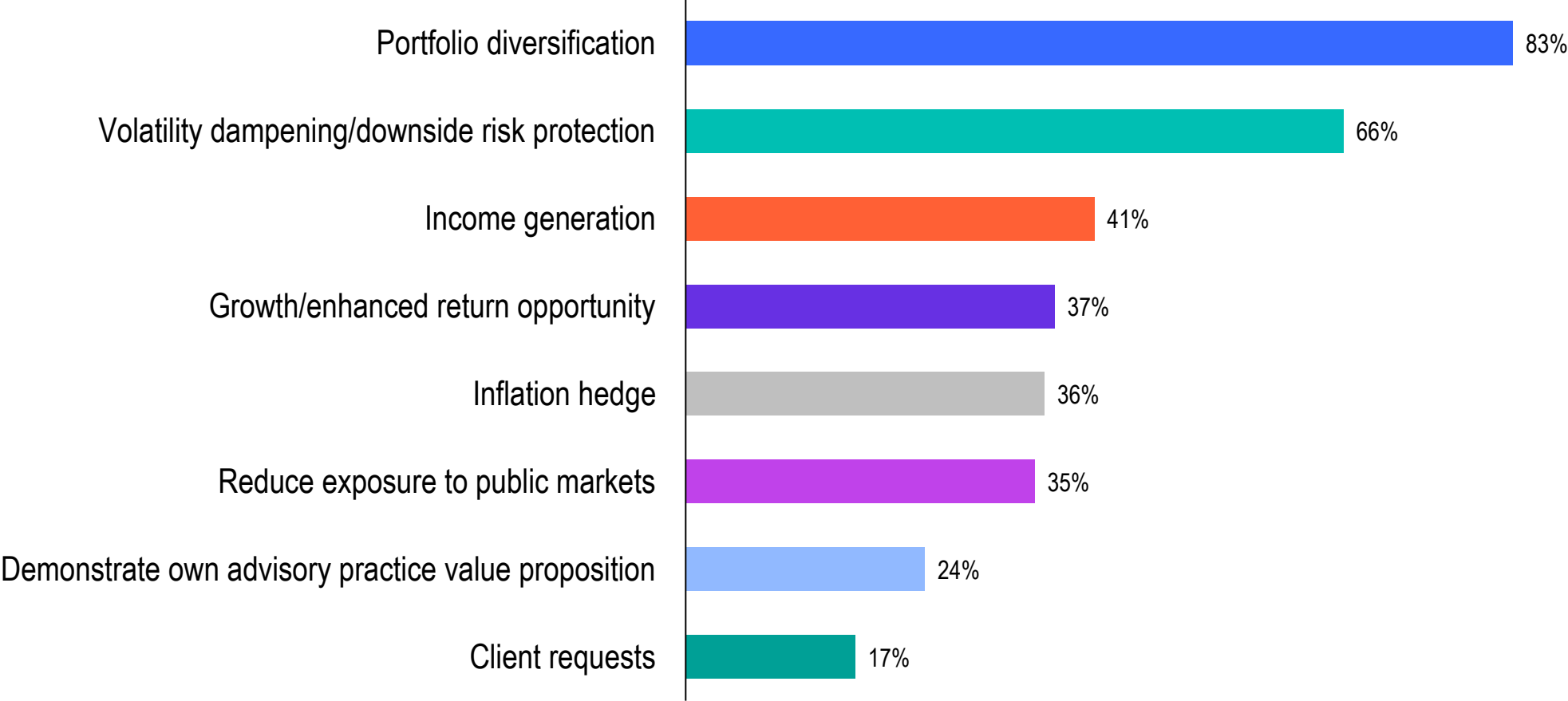
HNW investors expect access to alternative investments

- Investors can easily access stocks, bonds, mutual funds and model portfolios without an advisor
- HNW investors need guidance in the evaluation and selection of alternative investments.
- Wealth advisors serving HNW families must possess an understanding of the broad array of alternative asset classes, strategies and structures.
- This represents an opportunity to elevate your practice and enhance your value proposition.



Goals of alternative investments

Advisor-Reported Goals of Alternative Investment Allocations, 2024



Source: Cerulli Associates.
Notes: Advisors who reported an allocation to alternative investments for moderate-risk clients were asked to select all choices that applied.
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The role of alternative investments



Private equity

- Historical illiquidity premium of 300–500 basis points compared to S&P 500, over time.¹
- Illiquidity premium is the excess return for locking-up capital for a period of time.



Private credit

- Historically has delivered an illiquidity premium compared with its public market equivalent.
- Has delivered higher income than traditional fixed income options.



Real assets

- Represents a diverse set of strategies.
- May provide enhanced return, increased income, diversification and inflation hedging.

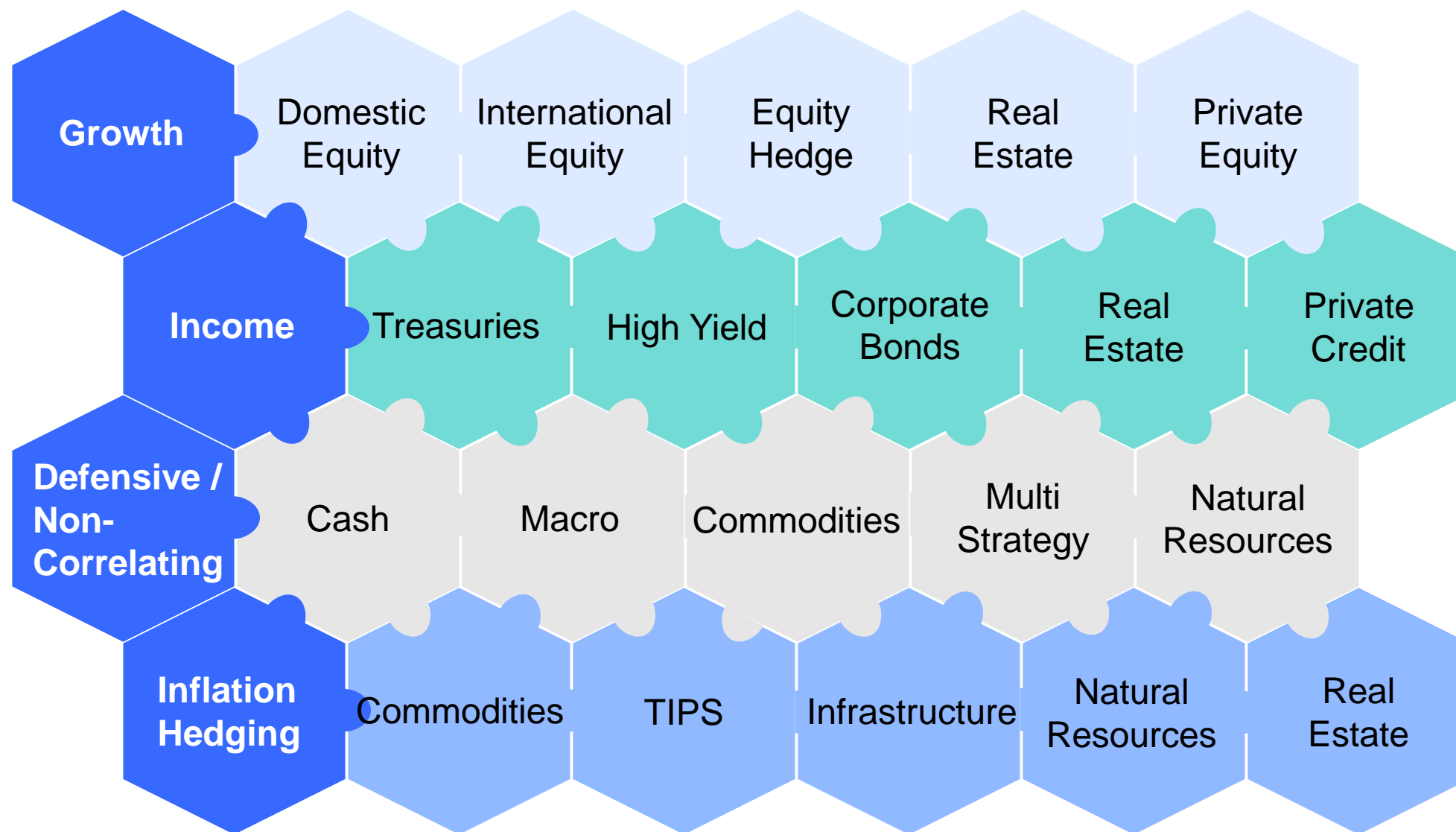


Hedge funds

- Multi-faceted tools that can serve multiple roles in a portfolio.
- May help increase returns, dampen portfolio volatility and provide positive returns in rising and falling market conditions.

¹ Source: Long-Term Private Equity Performance: 2000 to 2023, CAIA Association, 2024.

The role asset classes play in portfolio



Structural considerations

Investor qualifications



Qualified Purchasers (QPs)

- \$5+ million investable assets, not including primary residence
- Around 2.7 million people in US qualify as QP investors



Qualified Clients (QCs)

- \$1.1+ million assets under management with an investment adviser after having made an investment in a registered fund, or
- Net worth of at least \$2.2 million, excluding primary residence



Accredited Investors (AIs)

- Annual income of at least \$200,000 (\$300,000 in combination with spouse) in each of the last two years, or
- Household net worth of \$1 million, excluding primary residence

Structural considerations

REGISTERED FUNDS				
	Mutual Funds, Liquid Alternatives	Interval Funds	Tender-Offer Funds	Traditional Private Market Funds
Eligibility	All	Broad, though varies by fund and distributor	Broad, though varies by fund and distributor	Qualified Purchasers
Investments	Public	Public and Private Investments	Public and Private Investments	Private Investments
Continuous Offering	Yes	Yes	Yes	No
Daily Valuations	Yes	Yes	Yes	No
Min Investment	\$1,000–\$5,000	\$2,500–\$25,000	\$2,500–\$25,000	\$1M–\$10M
1099 Tax Treatment	Yes	Yes	Yes	K-1
Capital Calls	No	No	No	Yes
Cash Drag	Yes	Yes, but to a lesser extent	Yes, but to a lesser extent	No
Liquidity Provisions	Daily	Quarterly	Quarterly (at board discretion)	10+ Year Lockup.

Tender-offer and Non-traded REITs typically offers quarterly liquidity at board discretion, while interval funds quarterly liquidity provisions are mandatory.

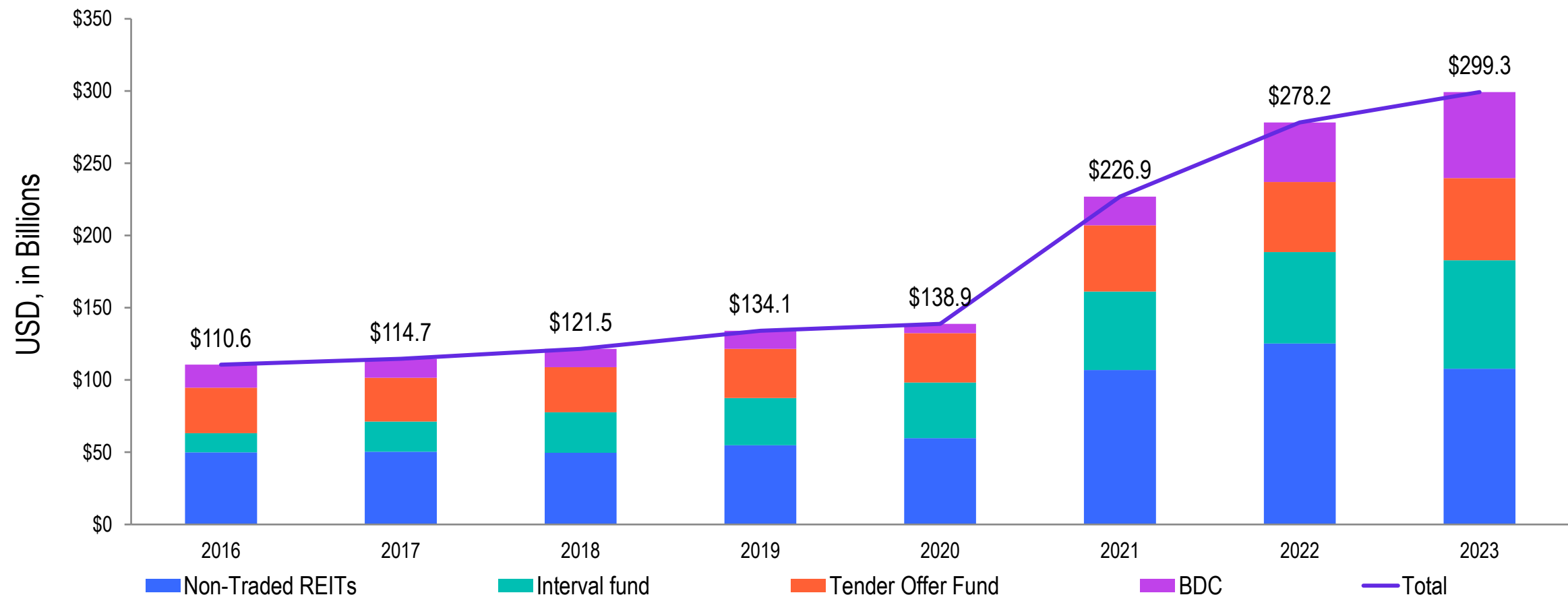
Source: Interval Fund Tracker 2021. Investment Company Institute, Interval Funds: Operational Challenges and the Industry's Way Forward, p.7 [PDF], (accessed January 17, 2022).

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Growth of registered funds

Combined Asset Growth, by Structure (USD, Billions)

As of 12/31/2023



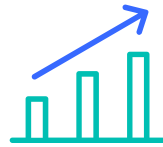
Sources: Blue Vault, Interval Fund Tracker, Cerulli Associates.
Notes: Blue Vault, Interval Fund Tracker, Cerulli Associates. All funds are presented on a net assets basis.
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Alternative investments are unique tools to meet your client needs



Enhanced returns

Many strategists predict lower equity returns over the next 10–15 years, creating a need to identify additional sources of returns.



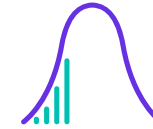
Increased income

Fixed income yields have been on the rise, but are still at historical lows, and investors are seeking alternative sources of yield.



Diversification

Correlations have risen due to the interconnectivity of global markets, making it more vital than ever for broader diversification.



Inflation hedging

Now more than ever, investors need to identify investments that help buffer the corrosive impacts of inflation.

These unique investments can help you in distinguishing your investment approach from a cookie-cutter robo-offering and allow you to pursue more HNW families.

Key takeaways

CONSIDER THIS

The successful wealth advisor will use these once elusive investments to elevate their practices. HNW families expect their advisors to have access to a menu of alternative investments geared towards their needs.



Key takeaways

- Private equity has historically delivered an illiquidity premium, and diversification benefits, compared to public market equivalents.
- Private credit has historically delivered an illiquidity premium, and higher yield, than traditional fixed income investments.
- Real assets have historically provided attractive returns and income, lower correlation and inflation hedging.
- Hedge fund strategies represent a diverse set of strategies designed to multiple goals in a portfolio including increased returns, dampening volatility, and delivering positive results in rising and falling markets.
- Registered funds are designed to meet the needs of a broader group of investors, at lower minimums, and more flexibility.



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All investments involve risks, including the possible loss of principal.

Investments in alternative investment strategies are complex and speculative investments, entail significant risk and should not be considered a complete investment program. Depending on the product invested in, an investment in alternative investments may provide for only limited liquidity and is suitable only for persons who can afford to lose the entire amount of their investment. An investment strategy focused primarily on privately held companies presents certain challenges and involves incremental risks as opposed to investments in public companies, such as dealing with the lack of available information about these companies as well as their general lack of liquidity.

Private equity investments involve a high degree of risk and is suitable only for investors who can afford to risk the loss of all or substantially all of such investment. Private equity investments may hold illiquid investments and its performance may be volatile. The risks associated with a real estate strategy include, but are not limited to various risks inherent in the ownership of real estate property, such as fluctuations in lease occupancy rates and operating expenses, variations in rental schedules, which in turn may be adversely affected by general and local economic conditions, the supply and demand for real estate properties, zoning laws, rent control laws, real property taxes, the availability and costs of financing, environmental laws, and uninsured losses (generally from catastrophic events such as earthquakes, floods and wars). The value of most bond funds and credit instruments are impacted by changes in interest rates; bond prices generally move in the opposite direction of interest rates. Investing in lower-rated or high yield debt securities ("junk bonds") involve greater credit risk, including the possibility of default, which could result in loss of principal – a risk that may be heightened in a slowing economy. Investments in derivatives involve costs and create economic leverage, which may result in significant volatility and cause the fund to participate in losses (as well as gains) that significantly exceed the fund's initial investment in such derivative. An investment in alternative securities or vehicles which invest in them, should be viewed as illiquid and may require a long-term commitment with no certainty of return. The value of and return on such investments will vary due to, among other things, changes in market rates of interest, general economic conditions, economic conditions in particular industries, the condition of financial markets and the financial condition of the issuers of the investments. There also can be no assurance that companies will list their securities on a securities exchange, as such, the lack of an established, liquid secondary market for some investments may have an adverse effect on the market value of those investments and on an investor's ability to dispose of them at a favorable time or price.

Alternative Investments such as derivatives, hedge funds, private equity funds, and funds of funds can result in higher return potential but also higher loss potential. Changes in economic conditions or other circumstances may adversely affect your investments. Before your clients invest in alternative investments, they should consider their overall financial situation, how much money they have to invest, their need for liquidity, and tolerance for risk.

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