UNDER THE SOPTLIGHT

ALTERNATIVES

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Alternatives assets are defined as those assets that do not belong to the traditional categories (bonds and equities).

Within this asset class are categories such as: Private Debt, Private Companies, Commodities, Infrastructure, Hedge Funds and Real Assets (Real Estate, Forestry, etc.).

These can be classified into two broad categories, private assets and uncorrelated strategies.

Private assets include:

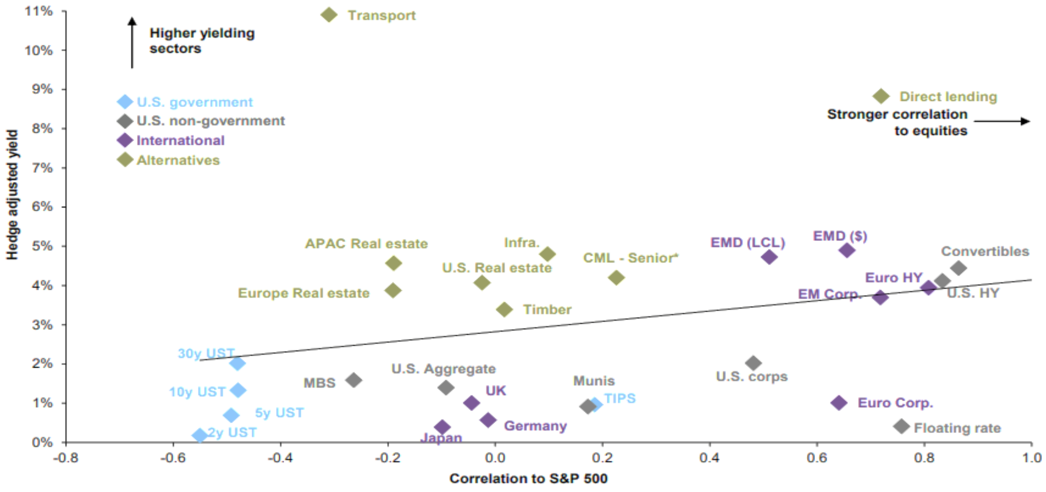
- -Private equity firms
- -Private Debt (Private Credit)
- -Real Economy:
  - -Infrastructure Projects
  - -Forestry Projects
  - -Real Estate Projects

Uncorrelated Strategies include:

- -Long/Short Strategies
- -Managed Futures

Stock market correlations and returns

Hedged-adjusted return, last 12 months



Source: JP Morgan

PRIVATE ASSETS - CHARACTERISTICS:

There are different ways to invest in this classification, but in general terms they offer a higher expected return than traditional assets, with high investment minimums and low liquidity.

- **Private equity companies:** consists of investments in companies not listed on the stock exchange, and the investment stage may vary from its beginnings as a business idea to a consolidated company that does not find it attractive to go public. It has similar characteristics to public shares, but with lower liquidity and higher minimum investment amounts. Private companies provide an illiquidity premium to the investor and allow the company to focus on long-term objectives since it is not exposed to public scrutiny.

- **Private Credit:** This subclass involves loans that are issued directly to companies but are not listed on a formal market. This allows the issuer to obtain debt with lower costs and information requirements and allows the investor to obtain a premium in the rate received. This market shares characteristics with traditional fixed income, but like private equity it has lower liquidity and higher minimum amounts.

- **Real Economy:** Includes all projects that invest in the economy directly (Infrastructure, Farmland, Real Estate, etc). This subclass has long investment periods and low liquidity. Generally, capital is called during the investment period and then repaid as the project progresses. The return of this class offers an illiquidity premium and a return that is decorrelated to the public markets. Generally, the investment minimums are high, these characteristics make it more attractive to institutional clients.

UNCORRELATED STRATEGIES - CHARACTERISTICS:

There are multiple strategies of this style, Hedge Funds represent the majority of them. Generally speaking, these strategies have low investment minimums and an adequate level of liquidity. Their main objective is to provide a return that presents a lower correlation with the market in general and that allows to protect the portfolio from market corrections.
Today we are going to put *under the spotlight* those that are easily accessible through mutual funds.

- **Long/Short Strategies:** The strategy consists of taking long and short positions in public assets, either directly or through derivatives. Depending on the net position between long and short positions, the objective of the strategy will be defined.
  - Strategies with long bias, will allow to obtain a return correlated to the market but with hedges against corrections.
  - Neutral strategies (Market Neutral) will seek to obtain a return in the selection of long and short positions, but independent of the market.
  - Strategies with short bias, their objective is to be contrary to the market trend.

  Whenever we access hedges to mitigate corrections, we must sacrifice part of the potential return.

- **Managed Futures:** This strategy consists of investing in futures contracts managed by professional managers who will seek to obtain a return that is decorrelated to the market, with high liquidity and versatility to manage the strategy. Futures may be obtained on commodities, stock markets, currencies, among others.

TRENDS

The trend in recent years shows a growing attraction for this type of asset. Institutional funds were the first to set their sights on them, and over time accessibility for the retail investor has become easier.

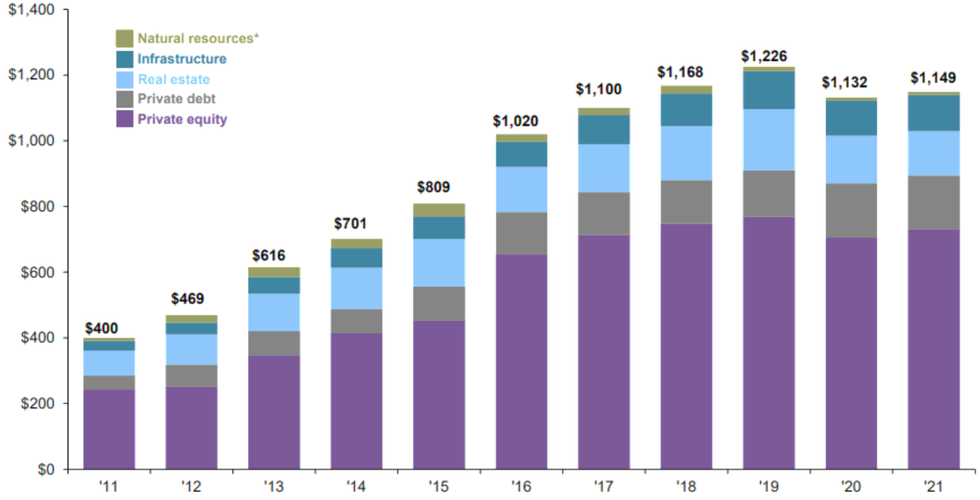
What is the reason for this?

The global equity market is trading at high valuations, although this does not mean a direct correction, it does imply that expected long-term returns may be lower than those obtained in recent years.

The fixed income market has reached the end of what was a bull market, reaching low rates and high inflation levels. The economic recovery puts the necessary rate hike on the horizon, which will have a negative impact on this asset.

Global private equity fundraising

Billions USD



Source: Preqin, J.P. Morgan Asset Management.

These expectations mean that fixed income does not provide the necessary protection, that equities provide meager returns and that the risk assumed is high for investors with a moderate and conservative profile.

Alternatives provide that diversification and uncorrelated return that offers a solution for the investor.

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ADVANTAGES

The inclusion of these assets in the portfolio produces advantages and efficiencies.

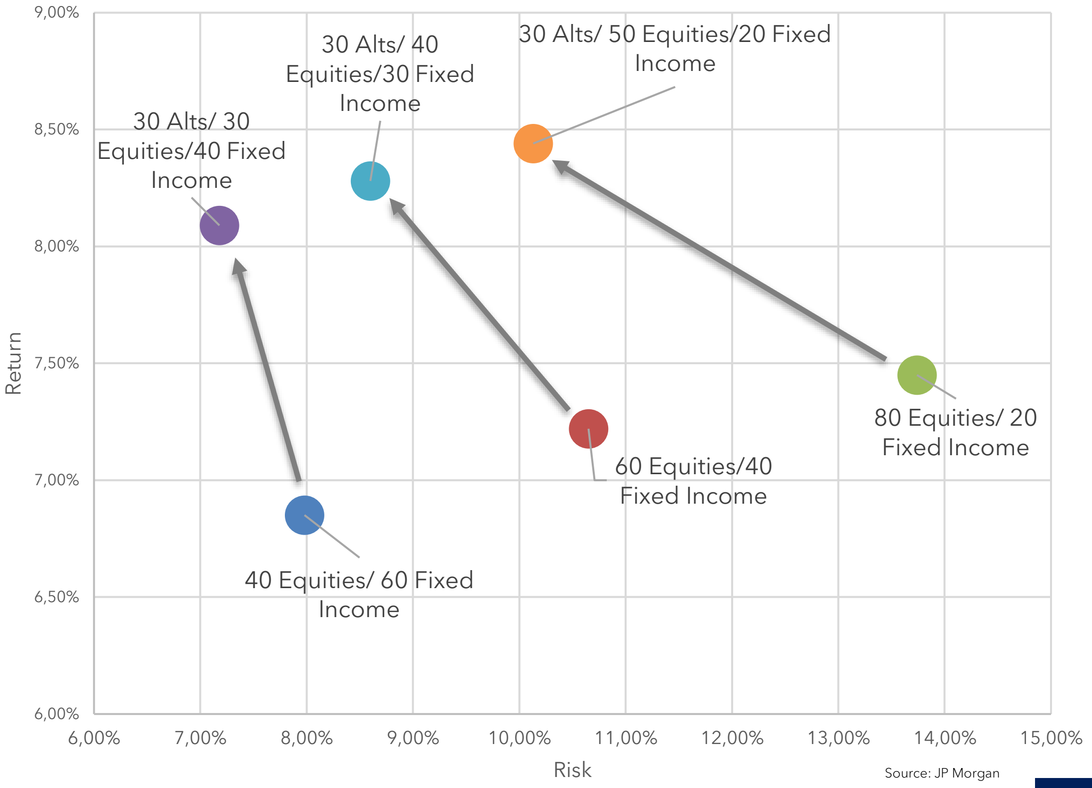
As they are assets with lower correlation with the current assets in the portfolio, they increase the diversification of the portfolio by reducing risk. This can be seen in the graph, where the portfolios shift to the left.

In turn, by obtaining a higher expected return than traditional assets, the portfolios move upwards.

In all circumstances we obtain portfolios with a better risk-return.

Incorporation of alternatives in traditional portfolios

Annualized volatility and returns ,1989 - June 2021



Source: JP Morgan

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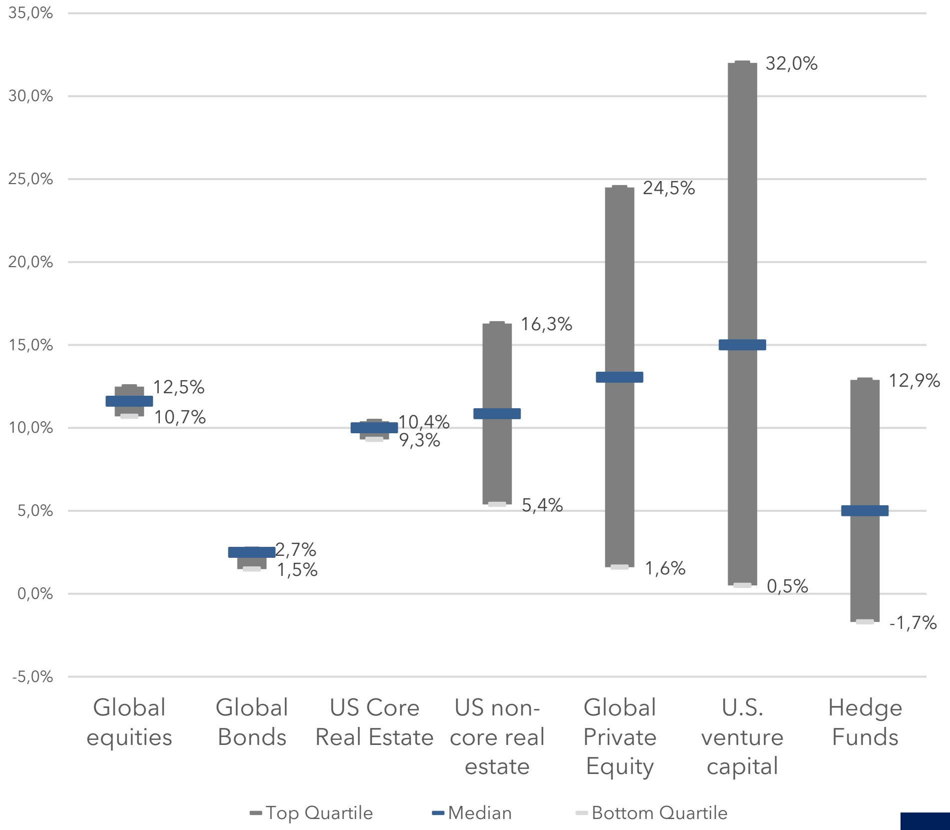
RISK

Two main aspects to consider about alternatives:

-iliquidity: This type of assets is usually less liquid than traditional assets, therefore the investor will be able to withdraw the money only after advance notice and it will be delivered after a set period.

- Dispersion of returns: It is very important to select the right manager for this type of assets since the variability of returns is higher than in traditional assets. Selecting a bad manager could imply returns well below expectations.

Spread of returns between public and private markets



Source: JP Morgan

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For invesvmet ideas please contact your Financial Advisor
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