Is ‘alternative’ investing right for you?

By **Karin Price Mueller/NJMoneyHelp.com** November 18, 2015 1:00 PM

Protecting your investments and building a nest egg. (Andrey Malinkin, ThinkStock)

What does it mean to invest in “alternatives?”
— New investor

A. Your portfolio should probably have some alternatives, but you need to understand what you’re buying.

“Alternatives” is a very broad term that refers to asset classes other than traditional investment vehicles like stocks, bonds, and cash, said Matthew DeFelice, a certified financial planner with U.S. Financial Services in Fairfield.

DeFelice said alternative investments can include hedge funds, long/short strategies, private equity, managed futures, derivative contracts, foreign currencies, **precious metals**, commodities, and **real estate**. Fine art, antiques, coins, stamps, collectibles, and even fine wine can also be considered alternative investments, he said.

“Does that mean you should count on that case of Silver Oak cabernet you’ve been aging to help fund your retirement? Not likely,” DeFelice said.

The more common “investable” alternatives are traditionally used in a portfolio as **adiversification technique** to spread risk and hopefully increase returns over time.

“Most alternatives tend to be non-correlated assets – in other words, their performance is not linked to what the stock or bond market is doing,” he said. “So when the stock market heads south or crashes, these non-correlated assets should help reduce the overall portfolio losses and smooth out the ride, eventually offering superior returns in the long run when compared to a traditional stock/bond mix.”

Higher returns and less risk. Sounds great. So how much should you allocate towards alternatives in your portfolio? That depends.

DeFelice said you need to know that during a straight up market — much like what we have seen since the 2009 bottom — your alternatives may not necessarily be moving higher at the same rate as your stocks and bonds. They may even produce negative returns, he said. So your overall portfolio performance can lag the general stock market when diversified with alternatives in bull markets.

Many alternative investments charge higher fees and required larger minimums relative to the typical mutual fund or exchange-traded fund, said Marnie Aznar, a certified financial planner with Aznar Financial Advisors in Morris Plains.

And, Aznar said, they are often subject to less regulation than these more traditional, plain vanilla type investment vehicles.

She said some alternatives are not available to small retail investors, but there are options for some smaller investors with mutual fund companies that offer exposure to some alternative asset classes through mutual funds and exchange-traded funds.

“For example, Vanguard offers a variety of `sector funds’ that provide retail investors access to some alternative asset classes, such as energy, precious metals and real estate,” Aznar said. “These funds are typically offered with a $3,000 minimum and levy significantly lower annual expenses than many of their peers.”

Many alternatives have long been the domain of the super-rich, DeFelice said. Traditional alternatives typically have limited liquidity and high net worth requirements in order to be eligible to participate.

While there are plenty of liquid alternative options available today, these are still complex products that are not suitable for everyone, DeFelice said.

“Some hedge funds and endowment models allocate as much as 50 to 60 percent of their assets to alternative-type investments, and often enjoy superior long term returns,” he said. “However, these large institutions have massive liquidity and staying power, and this is not at all practical or appropriate for the average retail investor.”

He said while the opinion varies greatly among advisors, the general consensus calls for a 5 to 15 percent portfolio allocation to alternatives when appropriate for individual investors. And that 5 to 15 percent should not be invested simply in a gold exchange-traded fund or a publicly traded Real Estate Investment Trust (REIT). It should be properly diversified across the different types of alternatives that are readily available, he said.

“Like any investment you make, you need to do your homework before jumping in, and this is especially true with alternatives,” DeFelice said. “This is not a do-it-yourself arena like buying a simple S&P Index Fund. Check with an advisor you can trust to review what options are available to you and determine the right mix that is appropriate for your portfolio.”

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