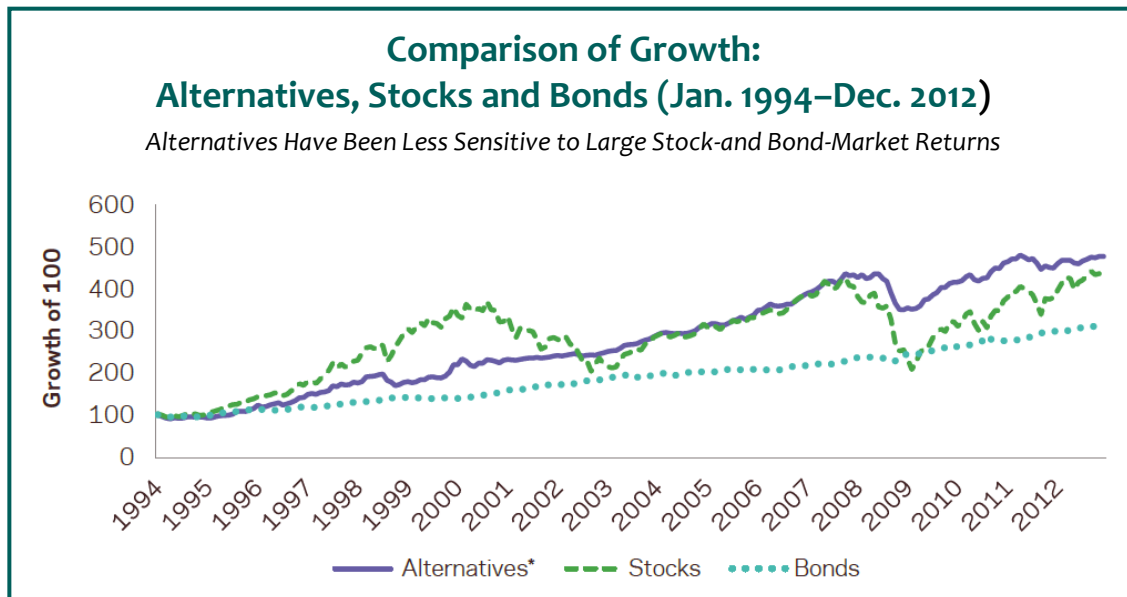


“Diversified alternatives” seek to provide sources of returns different from those of traditional stocks and bonds by investing in absolute return strategies to generate returns by exploiting market inefficiencies while minimizing exposure and correlation to traditional stock and bond investments. As shown in the chart below, these strategies have historically delivered solid performance in both up and down markets, and provided a nice complement to the volatile swings of equities and the stable, low returns of bonds.



*Past performance does not guarantee future performance. Alternatives are represented by the Dow Jones Credit Suisse Hedge Fund Index; stocks are represented by the S&P 500 Index, and bonds by the Barclays U.S. Aggregate Bond Index. Sources: Datastream, Dow Jones Credit Suisse, AQR. Source: Adapted with permission from AQR Capital Management, LLC, Investor Guide Style Premia Alternative Strategy

How Do They Work?

A wide variety of strategies exist within the diversified alternatives space and little uniformity exists from one fund manager to another. What is typical, though, is the ability of managers to take both long and short positions within various asset classes such as stocks, bonds, commodities, and currencies. Compared to hedge funds that employ similar strategies and are expensive, illiquid, and secretive, these strategies have gained popularity as they’ve become available within mutual funds that offer lower expenses, transparency, and daily liquidity.

This chart illustrates several major asset classes and their correlation to stocks of large U.S. companies. As you can see, diversified alternatives offer some diversification benefits in that their returns are less correlated to stocks than those of traditional asset classes.

Correlation between Asset Class and U.S. Large Cap Equities

Asset Class	U.S. Large Cap Equities
U.S. Large Cap Equities	—
U.S. Small Cap Equities	0.77
Int’l Large Cap Equities	0.81
Emerging Market Equities	0.72
Taxable Bonds	(0.01)
International Bonds	(0.03)
Diversified Alternatives	0.54
Managed Futures	(0.08)
Hedged Equities	0.74
MLPs	0.36
Commodities	0.31
REITs	0.51

Source: LPL Research, FactSet, Morningstar, Standard & Poor’s, Russell, MSCI, Barclays 05/14/15.

Continued on reverse side

“Low Correlation”—Why It’s Important

Many investors, especially those focused on the long-term, understand that the goal is not simply to maximize return, but to achieve the best return for a given level of risk. The easiest way to improve your odds towards these goals is through diversification. If a portfolio holds several assets that each react in the same way, this “diversification” isn’t doing much to reduce risk.

Instead, a key to diversification is to blend assets that do not all move in the same direction at the same time. A measurement for this is “correlation.” A correlation score of 1 means the two assets move in unison, a score of 0 means the assets move independently of one another, and a score of -1 means the two assets move directly opposite to one another.

Conclusion

Diversified alternatives have been shown to improve diversification and reduce downside risk, while still providing attractive returns. Given the ability to invest in the asset class through mutual funds with daily liquidity, we believe there is a compelling case to use them as part of our client’s investment strategy and can help meet their objectives over the long run.

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