

Alternative investments - can they win over advisers in the future?

Alternative investments have traditionally divided the financial advice market. Has their time come in an era of low returns?

STEPHEN LITTLE

Adviser attitudes towards alternative investments have changed considerably in recent years, but the market remains divided on how they should be used.

What was once seen as a niche market has now become far more prevalent and investors are increasingly looking towards alternative investments as a way of diversifying their portfolios and generating returns in a low-yield environment.

Yet there are still debates even about how alternatives should be defined, with investments ranging from antiques, art and wine through to hedge funds, property and commodities.

Many are cautious about whether any assets beyond more traditional equities and bonds should become mainstream. Money Marketing spoke with experts to find out what role alternative investments should play in a client's portfolio and what lies ahead for the future of the market.

Finding a place for the esoteric combined with a low-interest rate environment, pension rule changes and the shift away from traditional diversifiers such as bonds, creative investors are increasingly looking to put their money somewhere new.

But investments like buy-to-let property – often seen as easy money – have also suffered a raft of tax changes, which now means the sector is less profitable. So should advisers be turning to alternative investments for clients? Thameside Financial Planning director Tom Kean thinks they should play a role.

He says: "Most clients would expect their adviser to look at all possible avenues and prospects. If you are properly independent you will consider every option in the market.

"There is no wrong or right

answer for the role alternatives play in a client's portfolio. If they clearly understand the risk there is no reason why alternatives can't form a part of their investment."

Since the financial crisis many firms have recognised the importance of diversifying client portfolios.

Psigma head of investment strategy Rory McPherson says that one of the main challenges for advisers when selecting alternatives is that, with such a vast array available, it can be difficult for them to know where to start.

He says: "Alternative investments are not in nice boxes like other asset classes which are normally defined by how much risk you want to take.

"You have got to do a lot of looking under the hood of what you are buying.

"We definitely think that clients should be investing in alternatives. They help reduce risk and make the overall mix of assets in the portfolio more efficient, so you get more bang for your buck.

"They also help reduce volatility because they respond to different return drivers compared with what is in the bulk of your portfolio. However, we are very wary of unregulated products because they are higher risk and don't have the safety net of regulated products. For us they are a no-no."

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How do we solve the unregulated investments problem?

Alternative investments are subject to less regulation than traditional asset classes, making it more difficult to conduct due diligence. Kean says: "The more esoteric and exotic-sounding the investments are, the more due diligence you need to apply.

"I can look at the research, but there comes a point when I have to rely on the information readily accessible to me. If I don't understand something, should I be recommending it to my client? A lot of what advisers do is based on trust.

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"The main challenge is getting reliable data that you can trust so you can put together a due diligence document."

He suggests that outsourcing is a possible answer.

"Lots of advisers have recommended products to clients without understanding them because they incorrectly trusted the provider, so we pay for external compliance help."

Crypto crunch time

Cryptocurrencies may have been grabbing the headlines, but many wealth managers and financial advisers remain sceptical of them as an investment due to their volatility.

While the buzz around Bitcoin reached a crescendo last year, with investors pushing the digital asset to a record high of nearly \$20,000 (£13,962), since then the market has bottomed out.

The first European blockchain ETF recently launched, offering investors access to the much-hyped technology that underpins Bitcoin.

Informed Choice director Nick Bamford says that the volatile nature of Bitcoin highlights the risk of investing in alternatives.

He says: "While advisers need to be aware of the changing investment world, it doesn't follow that just because something is new and growing we necessarily need to be recommending it to the client."

Jacksons Wealth Management managing director Pete Matthew says that any adviser recommending their client invest in blockchain ETFs "needs their head examined".

He says: "You don't need to resort to weird and wacky stuff. I would never in a million years recommend someone move into a blockchain ETF.

"Going into a completely unregulated asset like blockchain is a bankruptcy waiting to happen.

Matthew says structured products have their place as a small part of a portfolio, but the client needs to understand what they are getting into. He says: "They are certainly not a panacea. Advisers should always model worst-case outcomes."

Wider opportunities

As the FCA has also warned that firms offering services linked to cryptocurrency derivatives will soon have to be regulated, with guidelines set to be published later in the year, are there future opportunities in alternatives that could mirror the striking early success of cryptocurrencies?

Wealth Club chief executive Alex Davies believes that as a result of reductions in high-end pension tax relief and support from the government in last year's Budget, venture capital trusts and enterprise investment schemes provide significant opportunities for advisers.

He says: "For clients who are relatively wealthy, the traditional means of saving simply and tax efficiently are being cut off one by one. Reduced pension limits for higher earners mean pensions can now only provide part of the solution.

EXPERT VIEW



Lauren Wilson

The investment story is clear

Alternatives is such a broad heading – encompassing anything that is seemingly not traditional – that it can appear like a frontier land.

The increased supply and availability of this asset type has certainly made fund selection a more arduous task, as there is a need to wade through a number of strategies which are often opaque and come with unnecessarily obtuse marketing materials. Many alternative strategies are pitched to us by managers highlighting the uncorrelated return aspect of the product, but we are mindful that just because something has low correlation with other markets it does not necessarily mean it is a great investment prospect. It is very likely that the pattern of rainfall in Glasgow is uncorrelated to returns from stocks and bonds, but

I somehow doubt the efficacy of a Glasgow Rainfall Volatility fund.

We maintain that an investment should be expected to provide a positive level of expected return, not just reduce risk.

That said, in today's investment landscape a traditional portfolio

One of the areas we find most interesting is infrastructure investment trusts, in particular renewables such as Greencoat UK

of bonds and regionally specific equities no longer provides sufficient diversification.

Equity markets are becoming increasingly correlated through globalisation and bond investors are forced to take greater risk in search of higher yields due

to artificially low interest rates and government asset purchasing programmes, which have inflated prices. We do utilise some alternative investments in order to increase diversity within our portfolios' return profiles and boost returns without increasing risk.

One of the areas that we find most interesting is infrastructure investment trusts, in particular renewables such as Greencoat UK Wind, where we see a potential for long-term demand growth.

In our opinion, the investment story is clear and their business model is simple and effective.

We also use private equity investment trusts, which allow us exposure to unquoted businesses which the average private investor would simply not have the skill set to do themselves.

Lauren Wilson is an investment analyst at Mattioli Woods

"The ever-increasing dividend tax means that investments held outside an Isa or pension are being punitively taxed and the changes to buy-to-let make this a much less attractive investment. So interest in VCTs and EISs is only going to grow. "For the client there are many ad-

vantages to holding them in their portfolio. They are highly tax efficient. The potential for growth with small businesses is very high and also it provides diversification."

However, he points out that traditionally the VCT and EIS industry is in the "dark ages" when it

comes to ease of doing business..

He says: "Much of this type of business still involves encyclopaedia-sized prospectuses and paper applications rather than simple online processes. In addition, compared with conventional investments such as unit trusts, VCTs and EISs are still relatively under-researched, therefore it is not as simple as it could be for advisers."

Holden & Partners financial adviser Andrew Johnston believes the alternatives market will tighten as investors become wary of volatility.

There is evidence to suggest smaller funds outperform larger ones over time, but you have to be acutely aware of the impact of costs

He says: "Fewer people are going to want to invest into this area because they are essentially going to have to take a higher risk, so the market might contract slightly."

Holden & Partners advises on alternative investments, with a focus on ethical and sustainable investing. In the past the company has recommended investments in the Wind Energy EIS, Ventus VCT, Quadris Environmental and The Wine Investment fund, as well as commercial property syndicates.

Johnston says that due to the nature of

the investments they are only available to high net worth clients, accounting for a maximum 25 per cent of a portfolio to limit shocks. As the investments are unregulated clients have to sign sophisticated investor forms.

Johnston says: "Alternatives are only really suitable for investors who are comfortable with the risks and understand them."

While Bamford believes greater regulation is needed to protect consumers, he thinks it is unlikely we will see a widespread clampdown by the FCA on alternative investments.

He says: "I think the regulator needs to look at how consumers are protected against scams right across the board. "But as the regulator has already got so much on its plate, it is probably something it is not going to be doing an awful lot about for alternatives."

"The regulator cannot protect everybody, but it has a job to tell the consumer to be careful.

"If a client wants to put a lot of their money into something that looks like a borderline scam, as advisers we have a duty to prevent them from doing that.

"Advisers should treat alternative investments as if they are regulated, making sure investors go in with their eyes open. As some alternatives are unregulated they are not covered by the Financial Services Compensation Scheme, but clients should have recourse back to the adviser." ●

ADVISER VIEW



Peter Chadborn
Director
Plan Money

Changes to pension contributions have started to affect more clients, who are now looking for tax-efficient alternatives. As a result, advisers should look to alternative investments to complement core holdings. If an adviser is considering a new area, they have to look beyond the shiny brochure; you can't rely on marketing material. We have to do our own research and due diligence to understand what we are recommending. I'm reluctant to call for any greater regulation in general, but consumers need to be protected. If not, there is a danger less scrupulous advisers will see them as an easy target and take advantage.



Jason Witcombe
Financial planning
director
Evolve

The problem with a lot of alternative investments is that charges can be very high and returns very unpredictable. We try to keep things as straightforward and low cost as possible. We don't want to gamble with clients' money. Apart from in a tongue-in-cheek way, no client has asked my view on Bitcoin. I don't know why an adviser would even think about recommending an unregulated product. Of all the alternative products there is a place for EISs and VCTs for certain clients. They have some decent tax breaks and it is a reasonably established market, but it is still a very niche area.