Consider the alternative

These assets boost the diversification benefit and provide an inflation hedge in retirement portfolios, writes **Pedro van Gaalen**

Volatility in global and local markets and the economic headwinds that South Africa faces have retirement investors concerned about the impact on their nest eggs.

With real returns from traditional investments under pressure due to rising inflation and sustained volatility, investors are considering alternative investments to boost returns, generate income and diversify portfolios to achieve their retirement investment goals.

According to the PwC "Asset & Wealth Management Revolution: Embracing Exponential Change" report, global assets under management (AUM) in alternative investments will reach $21.1-trillion by 2025.

"Trustees have a duty to allocate member funds responsibly, and this responsibility is even more pronounced in the current environment, where traditional asset classes have come under pressure," says Ria Papier, client director of Old Mutual Private Equity, a division of Old Mutual Alternative Investments.

Findings from the Westbrooke Alternative Asset Management "Investing in Alternatives 2022 Wealth Partner Survey" reveal a preference among investors for private debt, structured products and hedge funds, followed by private equity and

Ria Papier ... responsibility.

venture capital. According to the findings, 61% of respondents plan to increase their allocation to alternatives in future, with a considerable proportion (28%) allocating up to 20% of their portfolios to these investments – 16% indicated that they would allocate 30% or more. A significant proportion (55%) allocated 60% or more of their portfolios to offshore markets.

"The survey confirmed growing interest among retirees to consider private debt investments as a means to mitigate risks through direct security and a lack of mark-to-market volatility while offering higher and more reliable income streams that increase absolute value returns relative to comparative investments such as fixed income," says Dino Zuccollo, head of distribution and product development at Westbrooke Alternative Asset Management.

Monika Kraushaar, senior consultant at RisCura, says alternative assets are popular because they offer retirement portfolios uncorrelated returns and risk profiles to traditional assets, boosting the diversification benefit and providing an inflation hedge.

"In the context of inflation, investors need to preserve the purchasing power of their investment-derived income during retirement, and alternative assets can play a role as an inflation hedge."

From a diversification standpoint, a portfolio with the appropriate blend of assets can often outperform one made up of only one asset class in terms of delivering long-term returns and lower volatility, says Earl van Zyl, head of product development at Allan Gray.

"Alternative assets that generate returns that are uncorrelated with traditional asset classes therefore serve as a valuable addition to a retirement portfolio."

Alternative investments also suit longer-term investment horizons. "Retirement investing is inherently long term in nature, with liabilities that require a suitable asset match. In this regard, the longer-term investment horizons from alternative assets are ideal," says Kraushaar.

When selecting alternative assets, the opportunity set in the unlisted space in South Africa is significant.

"For instance, the listed market has about 300 companies, whereas there are thousands of private companies being run by talented entrepreneurs that are hungry for capital to grow," says Papier.

In this regard, private equity can play a significant role in delivering financial outcomes for investors by providing solid investment returns over the long term.

"Historically, private equity has proved resilient. It is able to ride out market cycles as the asset class takes a long-term view. It can move the needle on solid returns during times like these and provides diversification benefits."

Unsurprisingly, allocations to traditional private equity have grown to about 14% of AUM globally.

"This is compared to just an anecdotal 2% locally. However, we see impetus for change," says Papier. "Regulatory authorities have recognised the opportunity, with the latest amendments to Regulation 28 of the Pension Funds Act increasing the private equity limit from 10% to 15% and decoupling it from hedge funds."

However, investors should be aware of the trade-offs that often accompany alternative assets, such as illiquidity and the lack of price discovery provided by listed markets, both of which are particular features of unlisted investments, cautions Van Zyl.

"Typical ways to deal with these drawbacks include lower allocations to private equity than listed equities, for example, and to ensure your total portfolio allocation to alternative assets is rightsized for the risks relative to listed assets in general."

Kraushaar recommends that investors consider all the characteristics of alternative assets before including them.

"Investors should specifically consider risk, regulatory limit compliance, the lower liquidity levels, cost and the return profile." ●

Earl van Zyl ... rightsized.