

# How Smart Money Really Invests

Alternative Investments and  
Why You Need Them in Your  
Portfolio

➔ [hudsonpoint.com](https://hudsonpoint.com)

☎ 888-544-5244

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In the last decade, the stock market has seen its **largest rally in history** (11 years and counting)<sup>1</sup>. Historically speaking, there has only been one other instance of a bull run exceeding seven years, and that began in 1949 thanks to the post-boom economic success following World War 2.<sup>2</sup> We're in the midst of a pretty good run.

But nothing good lasts forever.

Within the last year, we've seen a lot of volatility in the market, with daily falls of 600 points (or more). Many investors are fearful of our immediate future, with countless reputable sources hinting at another recession on the way.<sup>3</sup>

To protect themselves, many savvy investors and institutions are turning to uncorrelated investments (i.e. investments that don't rise and fall with the S&P 500). And with recent legislative changes, like the **JOBS Act**, there are more options than ever to reduce an investor's dependence on the stock market.

One such avenue is **Alternative Investments**.

*For illustrative purposes only and does not represent performance of any asset.*

1. <https://www.cbinsights.com/research/best-venture-capital-investments/>

2. <https://www.cbsnews.com/news/whats-a-bear-market-and-how-long-might-it-last/>

3. <https://www.bloomberg.com/graphics/us-economic-recession-tracker/>

# 1 What Are Alternative Investments?

Alternative investments are financial assets that do not fall neatly into conventional investment categories, like stocks, bonds, and cash. The most common alternative investments include pre-IPOs, or real estate, private equity/venture capital, hedge funds, loans, and contracts like futures:

## Most investors don't explore alternative investments

### Traditional Investments



Stocks



Bonds



Cash

### Alternative Investments



Real Estate



Private Equity/  
Venture Capital



Commodities  
& Managed Futures



Private Loans



Hedge Funds



Energy

Alternative Investments listed above are for illustration purposes only and represent several common alternative investments.

Alternative investments are attractive to many institutional investors because they are usually uncorrelated, meaning they do not follow the stock market. And because they do not follow the stock market, they have the potential to provide very different returns.

There is also a bit of fear and misinformation with alternative investments. Some investment advisors claim that alternative investments should make up less than 10% of your portfolio.<sup>4</sup> And you may have heard about pre-IPOs and hedge funds that are completely out of reach for anyone who is not an accredited investor?

Let's try to dispel most of the confusion and misinformation around alternative investments, share some compelling statistics, and showcase one of our favorite alternative investment case studies.

4. [https://www.investopedia.com/terms/a/alternative\\_investment.asp](https://www.investopedia.com/terms/a/alternative_investment.asp)

# Less Volatility, Lower Drawdowns, & Higher Returns

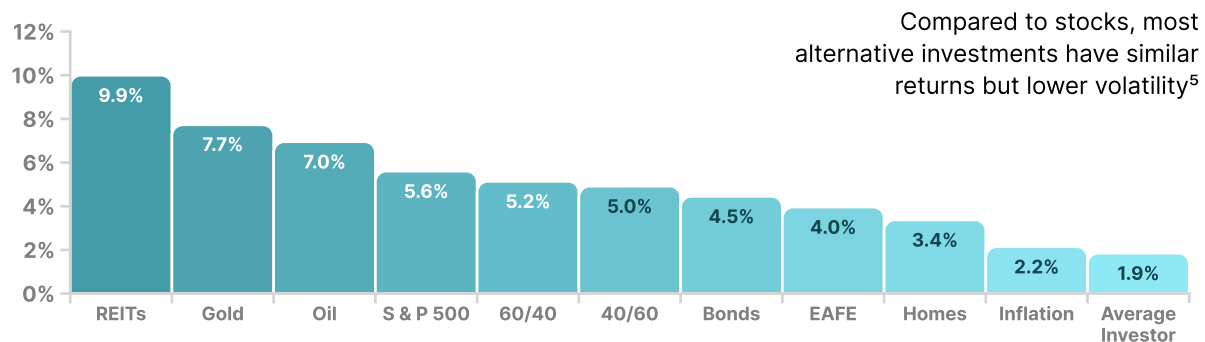
One of the biggest reasons people avoid alternative investments is because they think they are “volatile” or “high-risk”.

In reality, alternative investments have the potential to provide similar or higher returns than stocks and bonds, but with opportunity to achieve lesser volatility (see chart below). Historically, the price swings of alternative investments are not as dramatic as those of stocks. This means that when alternatives lose value, they may not lose as much value as stocks do during a market downturn.

## Potential for lower volatility and enhanced returns

20-year annualized returns by asset class (1999–2018)

**J.P.Morgan**  
Asset Management



Source: J.P. Morgan Asset Management: (Top) Barclays, Bloomberg, FactSet, Standard & Poor's; (Bottom) Dalbar Inc. Indices used are as follows: REITs: NAREIT Equity REIT Index; EAFE: MSCI EAFE; Oil: WTI Index; Bonds: Bloomberg Barclays U.S. Aggregate Index; Homes: median sale price of existing single-family homes, Cold USDY/DT04; Inflation: CPI; 60/40: A balanced portfolio with 60% invested in S&P 500 Index and 40% invested in high-quality U.S. fixed income, represented by the Bloomberg Barclays U.S. Aggregate Index. The portfolio is rebalanced annually. Average asset allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized (and total return where applicable) and Guide to Markets – U.S. Data are as of March 31, 2019.

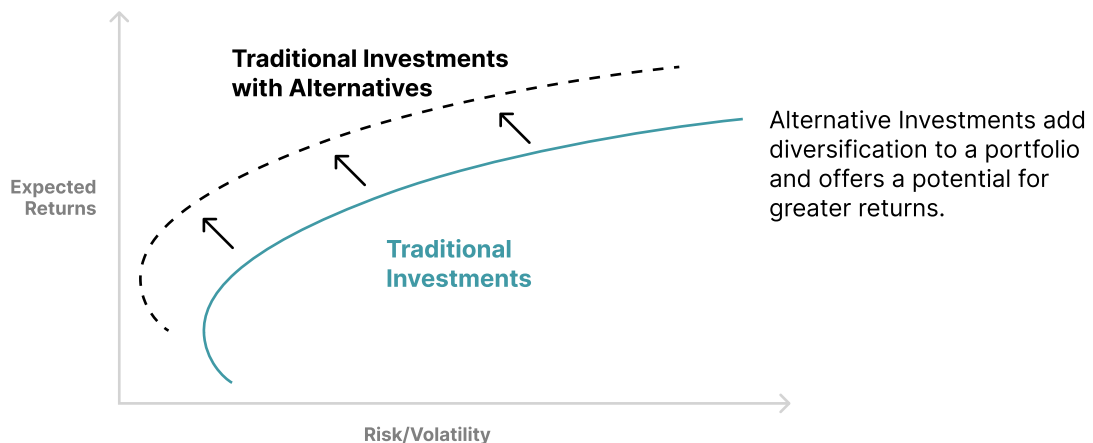
And because alternative investments tend to have lower volatility as a whole compared to stocks, they could also suffer smaller drawdowns. And with less volatility and lower drawdowns comes more stable returns.<sup>6</sup>

5. <https://www.blackrock.com/us/individual/library>

6. <https://www.blackrock.com/us/individual/investment-ideas/alternative-investments>

This is demonstrated by “efficient frontier movement,” which measures how an investment behaves compared to traditional investments. A portfolio that combines both traditional and alternative investments is expected to significantly outperform traditional investments alone (please see chart below).

### Efficient Frontier Movement



*Most investors don't explore alternative investments<sup>7</sup>*

## The Challenge With Alternative Investments

When it comes to the average investor, the **liquidity** of alternative investments is one of the main barriers to entry. Some alternative investments offer daily liquidity, while others are restricted and can be sold only months or years after the initial investment.

**Real estate**, for example, is very illiquid compared to stocks and bonds. The average investor might buy and sell 20 different stocks in one year, but it is unlikely they would do that with 20 houses. A homeowner is much more likely to buy and hold a home for decades before selling.

7. <https://www.advisorperspectives.com/commentaries/2016/12/12/alternative-investments-incorporating-a-turnkey-solution>

This brings up another barrier to entry with alternative investments: price. Whether you're looking to invest in a mutual fund or a house, the minimum investment tends to be much higher. Typically, you can't buy a home at all unless you're willing to put down 20 percent up front.

And then there is the risk factor to alternatives investments. While different alternative investments vehicles have different levels of risk, like with all investments, as your potential return rises, so does your potential risk.

That's why investors in less liquid investments, like alternatives, expect to be compensated with improved returns, which they often achieve by diversifying into **uncorrelated investments**.

This tradeoff between lower liquidity and better returns often makes sense for long-term investors. There are also newer alternative investment “containers” that provide greater liquidity for the average investor. As an example, alternative mutual funds can trade daily.

Historically, institutional investors have relied on alternatives to outperform the market because of a restriction in supply, and also because alternative investments were only readily available to accredited investors.<sup>8</sup> Everyday investors who were not accredited were not legally able to access these types of investments.

Fortunately for non-accredited investors, more and more alternative investment products are making these types of investments available to the public. This is in large part thanks to the **JOBS Act**, which was a game-changer for non-accredited investors who wanted to access alternative investments but didn't have the capital.

At HUDSONPOINT capital, we offer alternative investments to suit all kinds of investors, including accredited and non-accredited investors.

8. <https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins/updated-3>

## 2 The Value of Alternative Investments

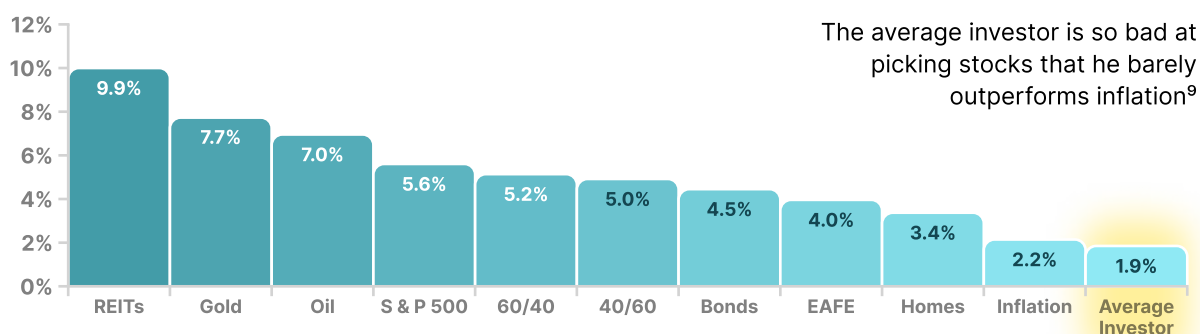
The conventional wisdom expressed in most financial literature is that buying index funds is the best strategy for long-term growth investing, while stock picking is reserved for risk-takers looking for higher returns.

For the most part, statistics show that this is accurate. The average investor (and nearly every non-professional investor) has proven time and again that he has no business picking stocks. In fact, he'd be better off leaving his savings in his bank account to collect interest:

### Potential for lower volatility and enhanced returns

20-year annualized returns by asset class (1999–2018)

**J.P.Morgan**  
Asset Management



Source: J.P. Morgan Asset Management: (Top) Barclays, Bloomberg, FactSet, Standard & Poor's; (Bottom) Dalbar Inc. Indices used are as follows: REITs: NAREIT Equity REIT Index; EAFE: MSCI EAFE; Oil: WTI Index; Bonds: Bloomberg Barclays U.S. Aggregate Index; Homes: median sale price of existing single-family homes, Cold USDY/DT04; Inflation: CPI; 60/40: A balanced portfolio with 60% invested in S&P 500 Index and 40% invested in high-quality U.S. fixed income, represented by the Bloomberg Barclays U.S. Aggregate Index. The portfolio is rebalanced annually. Average asset allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized (and total return where applicable) and Guide to Markets – U.S. Data are as of March 31, 2019.

Indexing is a much more stable and less volatile strategy than individual stock picking, potentially producing better returns because indexes attempt to track entire segments of the market.<sup>10</sup> As of 2019 the 20-year return for the famous 'Three-fund Portfolio' comprised entirely of three Vanguard funds is 5.80 percent.<sup>11</sup> This is certainly an acceptable return for a risk-averse long-term investor. Compare this to the overall stock market, which grew 7.68% over the same time period.

9. <https://franklyfinancial.com/average-investor-vs-market/>

10. <https://www.investopedia.com/terms/i/indexfund.asp>

11. <https://www.bogleheads.org/blog/2020/01/03/three-fund-portfolio-2019-update/>



But for investors looking to outperform the markets, indexing alone isn't enough. That's where alternative investments come in. Their returns can be consistently higher than those from the market over a period of decades.<sup>12</sup>

There are many types of alternative investments to choose from, but not all of them may make sense for your investing strategy or portfolio. Let's review the most common alternative investment classes that the average investor can access:

## Real Estate

Real estate has historically been a good hedge against unexpected inflation that doesn't sacrifice expected returns.<sup>13</sup> And in some 'hot' markets, like New York and San Francisco, real estate values can increase dramatically over time.<sup>14</sup>

Investments in real estate can provide much-needed diversification to the average portfolio. Most people 'invest' in real estate by owning a home, which makes real estate the most common and most trusted type of alternative investment.

Real estate has often favored as an alternative investment because it is uncorrelated, tends to go up in value, isn't too volatile, and doesn't suffer from cyclical ups and downs. But this isn't a hard and fast rule (in investing, no rules ever are).

## Private Equity or Venture Capital

If you had bought Amazon, Google, or Apple at their initial public offerings (IPO), you would have made between 400 to 11,000 percent returns. But if you had been able to invest in these companies before they IPO'ed, through private equity or venture capital investments, you would have made far more.<sup>15</sup>

Venture capital investments in private startups and growing companies can provide very compelling returns. And while these investments were once exclusively reserved for institutional investors and the ultra-wealthy, new venture capital investment vehicles give everyday investors unprecedented access to pre-IPO companies.

12. [http://www.bairdfinancialadvisor.com/schmidtvanleestwenzelgroup/mediahandler/media/163794/The\\_role\\_of\\_alternative\\_invst.pdf](http://www.bairdfinancialadvisor.com/schmidtvanleestwenzelgroup/mediahandler/media/163794/The_role_of_alternative_invst.pdf)

13. <https://www.mynd.co/knowledge-center/what-happens-to-real-estate-during-inflation>

14. <https://millersamuel.com/change-is-constant-100-years-of-new-york-real-estate/>

15. <https://www.ft.com/content/efee9ee6-8685-11e8-96dd-fa565ec55929>

Private equity investment may offer higher potential returns compared to an investment in an index, but it also has a much higher degree of risk. If a venture-funded startup fails or goes bankrupt, for example, investors lose all their money. Usually, private equity investment is at minimum reserved for accredited investors only.

## **Commodities and Natural Resources**

Investments in natural resources—such as oil and gas, precious metals, gold, timberland, and agriculture—are typically made by purchasing stock-like equities. Commodities have historically had periods of time with uncorrelated performance.

Commodities may be used as hedge against unanticipated inflation. They may also provide diversification with attractive returns. But they are cyclical, and may be too complex for the average investor's taste.

## **Hedge Funds**

A hedge fund is, by nature, a high-risk operation. Using borrowed money, a small group of professional investors attempt to not just beat the market, but make profound, non-correlated returns. Hedge funds are all different; they each have a unique strategy for success. Investing in the right fund involves careful analysis of their structure, strategy, and historic success.

The opportunity and risk are high, and so is the cost to entry. Investing in a hedge fund can require a baseline contribution of \$1 million and can be as high as \$10 million (or even more).

**Now that we've reviewed the most common types of alternative investments, let's take a look at how a famous alternative investment portfolio has performed over the last few decades.**

### 3 Case Study: The Yale Endowment

Totaling **\$30.3 billion** on June 30, 2019, the Endowment contains thousands of funds with a variety of purposes and restrictions. Approximately three-quarters constitute true endowment - gifts restricted by donors to provide long-term funding for designated purposes. The remaining one-quarter represents quasi-endowment, monies that the Yale Corporation chooses to invest and treat as endowment.

How has well the Yale Endowment performed? Over the past three decades, it has outperformed the markets and most investment banks and hedge funds (which regularly underperform the S&P 500).<sup>16</sup>

Why is the Yale Endowment Model so successful? The answer is simpler than you might think.

## Historic Success Of The Yale Endowment

In 1718, Elihu Yale made an initial investment of £562 into Yale's Endowment. In 1985, after 267 years, the Endowment was valued at \$1.4 billion, mostly due to compound interest and centuries of gifts and donations.

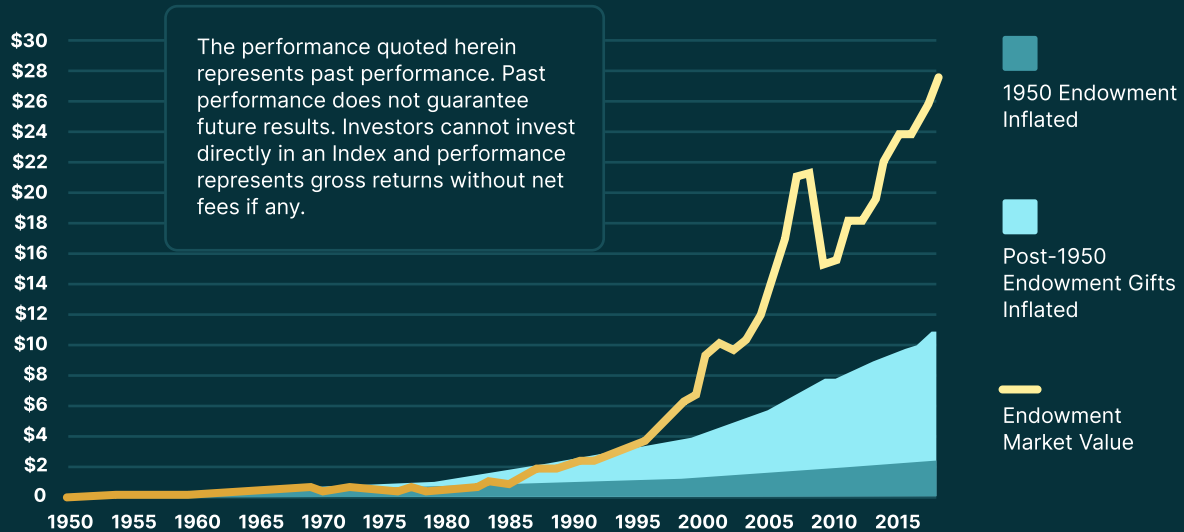
Yet, over the past 33 years—since current Chief Investment Officer David Swensen took over management of The Endowment—it has grown to 30.3 billion.<sup>17</sup> Over half of this growth can be attributed to The Endowment's successful investment strategy (see chart below). At one point, Swensen had a 20-year winning streak (with no years in the red) from 1988–2007.<sup>18</sup>

16. <https://www.cnn.com/2019/01/08/hedge-funds-beat-the-sp-500-for-the-first-time-in-a-decade.html>

17. <https://news.yale.edu/2019/09/27/investment-return-57-brings-yale-endowment-value-303-billion>

18. <https://www.yalealumnimagazine.com/articles/2398-david-swensen-s-guide-to-sleeping-soundly>

## Endowment Growth Outpaces Inflation 1950-2018



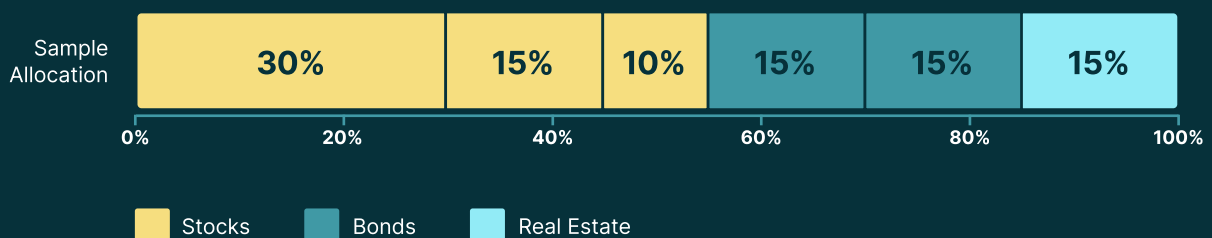
Adjusted for inflation, the Endowment's gifts account for only about \$12 billion.<sup>19</sup>

## How Does David Swensen Invest?

David Swensen has been so historically successful at navigating the markets that a model portfolio is named after him (see below). He has also written books<sup>20</sup> on how individual investors can avoid the risky volatility of stocks and attempt to duplicate his stable but attractive returns.

In a 2015 interview with NPR,<sup>21</sup> Swensen described a model portfolio for the average investor. Called the "Swensen Model Portfolio," it consists of the following asset allocation:

### Swensen's Model Portfolio



19. [https://www.investmentoffice.com/Pension\\_Funds/Yale\\_Endowment\\_Growth\\_Outpaces\\_Inflation.html](https://www.investmentoffice.com/Pension_Funds/Yale_Endowment_Growth_Outpaces_Inflation.html)

20. [https://www.goodreads.com/en/book/show/17371.Pioneering\\_Portfolio\\_Management](https://www.goodreads.com/en/book/show/17371.Pioneering_Portfolio_Management)

21. <https://www.npr.org/2015/10/17/436993646/three-investment-gurus-share-their-model-portfolios>

Type of Investment		Share
<b>Stocks</b>	<b>Domestic equity:</b> Stocks in U.S. -based companies listed on U.S. exchanges	<b>30%</b>
<b>Stocks</b>	<b>Foreign developed equity:</b> Stocks listed on major foreign markets in developed countries, such as the United Kingdom, Germany, France and Japan	<b>15%</b>
<b>Stocks</b>	<b>Emerging market equity:</b> Stocks from emerging markets around the world, such as Brazil, Russia, India and China	<b>10%</b>
<b>Bonds</b>	<b>U.S. Treasury inflation-protected securities (TIPS):</b> Special types of Treasurys that offer protection from inflation, as measured by the consumer price index.	<b>15%</b>
<b>Bonds</b>	<b>U.S. Treasury securities:</b> Fixed-interest U.S. government debt securities. The income is only taxed at the federal level.	<b>15%</b>
<b>Real Estate</b>	<b>Real estate investment trusts (REIT):</b> Stocks of companies that invest directly in real estate through ownership of property	<b>15%</b>

*The Swensen Model Portfolio for the average investor<sup>22</sup>*

What's interesting about the Swensen Model Portfolio is that it is heavier on equities. In fact, stocks comprise 70 percent of this portfolio, and bonds make up the other 30 percent.

But when you take a look at the Yale Endowment Model in 2019,<sup>23</sup> Swensen's strategy for large-scale, high-return investing looks very different from what he recommended to the average investor of 2015: →

Asset	Allocation
<b>Absolute return</b>	<b>26.0%</b>
<b>Venture capital</b>	<b>18.0%</b>
<b>Foreign equity</b>	<b>15.5%</b>
<b>Leverages buyouts</b>	<b>15.0%</b>
<b>Real estate</b>	<b>9.5%</b>
<b>Bonds and cash</b>	<b>6.5%</b>
<b>Natural resources</b>	<b>6.5%</b>
<b>Domestic equity</b>	<b>3.0%</b>

In Yale's 2019 asset allocation, less than 20 percent of the Endowment is invested in equities, and only 3 percent is invested in U.S. stocks. Less than 7 percent is stashed away in bonds and cash, but a whopping 75 percent of Yale's Endowment is in alternative investments.

And it's not just Yale that's investing like this. Across the board, university endowments from Harvard to Columbia are following a similar asset mix.

22. <https://www.npr.org/2015/10/17/436993646/three-investment-gurus-share-their-model-portfolios>

23. <https://news.yale.edu/2018/10/01/investment-return-123-brings-yale-endowment-value-294-billion>

## 4 Finding the Right Alternative Investment Strategy For You

You're probably wondering how you can access alternative investments, which alternative investments are right for your portfolio, and whether some alternatives are 'better' than others. The truth is that there is no one-size-fits-all solution. If investing were that easy, everyone would be making money.

Everything from your financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, current portfolio, and even your age plays a factor in determining your ideal investment strategy. This is why having a financial advisor can be helpful.

At HUDSONPOINT capital, we often act as the advisor to help investors navigate (and gain access to) the world of alternative investments.

### Why Do You Invest?

When you were younger, you started investing your money with a few specific goals in mind. They may have been moonshot goals at the time, like saving up enough to buy three homes or a garage full of sports cars.

But as you get closer to retirement age, you've probably thought over your goals several times and decided on ones that are most realistic. By the time you retire, you probably want to...

- Have a regular and stable income stream
- Be free to make choices in retirement without worrying about money
- Enjoy life without worrying about global changes that may affect your portfolios
- Grow or maintain your savings without being stressed out by stock market fluctuations

Whatever your goals, you must deal with an obstacle that all investors face — risk. The most common challenges and concerns for investors include:

- Uncertainty over where to invest due to a lack of knowledge
- Concern that you aren't checking your investments often enough
- Fear of making bad decisions and losing money in the stock market
- Worry about being too busy to give your portfolio the time it deserves

The biggest problem with being an individual investor is a lack of time and knowledge. It doesn't matter how smart you are—there is only so much time in the day. If you're working a 9-to-5 job and have a family to take care of, your portfolio will be neglected.

Keeping track of and managing traditional investments like stocks and bonds is difficult enough already. Having to consider alternative investments, which require even more know-how, seems out of the question.

## The Problem Of Access

Unlike traditional stocks and bonds, alternative investments are usually less liquid, require larger upfront investments and are typically available only to accredited investors.<sup>24</sup> That's why institutional investors with deep pockets — like university endowments, banks, and funds—can access these types of investments. For the average investor, it's not so easy.

Historically, large institutions, endowments, and pensions have had access to alternative investments. This is because they manage portfolios worth billions and can easily write a check for **\$50 or \$100 million** dollars to invest in a single product (like real estate, hedge funds, or pre-IPOs).

However, thanks to the **JOBS Act**, there are now products that pool investor money together into an Special Purpose Vehicle (SPV) or funds for as low as a \$50k or \$100k investment. How does it work? That entity then acts as the "institution" and buys the \$50 or \$100 million block, obtaining access for all its pooled investors.

HUDSONPOINT capital does just that, using SPVs or other sources to provide access to alternative investments for our clients.

24. <https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins/updated-3>



5

## HUDSONPOINT capital Seeks to Help Investors Make Better Decisions

At HUDSONPOINT capital, we have been serving accredited and non-accredited investors for over 20 years. Our mission has always been to help guide our client's towards meeting their **retirement goals**. This led us to work in alternative investment strategies and vehicles, which we help our clients access.

We make recommendations to your traditional investment portfolio. We also introduce qualified investors to different alternative investments, such as real estate and private equity. And we utilize asset allocation models to manage **risk exposure**.

Over several meetings, we help you identify the gaps in your family's current investment strategy and recommend multiple options to address shortfalls. Our vast platform allows us to provide our clients with a diversified investment portfolio that is suitable for each client's investment goals and risk tolerance.

Together, we agree on an investing strategy. We want to ensure that, as our client, you are comfortable with your strategy, confident in your choices, and not double-checking or second-guessing anything.

Securities offered through Arete Wealth Management, LLC, members FINRA and SIPC. Investment advisory services offered through Arete Wealth Advisors, LLC an SEC registered investment advisory firm.

### Return potential

- Absolute return performance objectives
- Often not market dependent
- Illiquidity premium

### Diversification

- Allocate to a variety of asset classes and managers
- Typically low correlation to public markets and traditional asset classes

### Special opportunities

- Strategies and asset classes that may not be available in traditional investments
- Specialized investment managers that you otherwise may not be able to access

Ultimately, our goal is to give you the freedom to live your life now without worrying about your savings later. That's our job.






# Isn't It Time For Your Investments To Work Hard For You, Too?

Too many investors are underperforming the markets and mistakenly believe that high returns are solely for institutional investors, banks, and the ultra-wealthy.

But this doesn't have to be the case. Individual investors can unlock better-than-expected returns by learning about and leveraging alternative investments that best suit their needs.

If you've been saving up for years and are getting closer to retirement, but aren't seeing the kinds of returns you believe you deserve, maybe it's time for a different approach.

**Let's Identify Your Goals Together**

 **888-544-5244**

 **[info@hudsonpoint.com](mailto:info@hudsonpoint.com)**

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