NATIXIS
INVESTMENT MANAGERS

FUTURE OF PORTFOLIOS SERIES

Q&A with James Beaumont

Head of Multi Asset Portfolio Management, Natixis Investment Managers Solutions

Q: Are alternative investments set to become more prominent in today's portfolios?

A: Liquid alternative investments first rose to popularity when the asset class demonstrated its worth to investors in the global financial crisis in 2008. In the following years the asset class attracted huge flows of money. However, the "easy money" bull market of recent years has seen alternative returns disappoint on a relative basis and, as a result, significant outflows have occurred for many liquid alternative funds. Going into 2020 we think this is set to change.

Given that bonds and equities have performed brilliantly over the past few years, investors have not needed to look to alternative assets to diversify their portfolios. However, we would argue that bonds are now at their lowest ebb, with many government bonds, particularly in Europe now sitting on negative yields. They have stopped playing the defensive role they used to play in an investor's portfolio, at a time where equities look to be coming to the end of a 10-year run. As a result, we think liquid alternatives are set to come back into fashion and those investors willing to get ahead of the wave and hold them now will be those who may benefit the most.

We think liquid alternatives are set to come back into fashion and those investors willing to get ahead of the wave and hold them now may be those who benefit the most.

Q: What types of assets are liquid alternatives?

A: There are a large number of disparate strategies within this classification. We split them broadly between two main buckets: alternative beta and alterna-

We believe demand for liquid alternatives is set to rise because investors continue to need parts of their portfolio to perform, when the rest of it isn't.

tive alpha. The alternative beta assets are straightforward directional investments but in a non-traditional asset class - so the likes of oil, gold and other commodities fit into this category. Conversely alternative alpha strategies look to isolate returns and generate excess returns from things not related to the direction of the market. Here we identify five classic strategies; equity long-short, credit long-short, macro, managed futures and special situations.

All of these strategies, both the alternative beta and alpha, are liquid investments which you can invest in UCITS form. This means you have fewer concerns regarding operational due-diligence and pricing that are heightened when investing in less liquid, less regulated hedge fund alternatives.

We believe demand for liquid alternatives is set to rise because investors continue to need parts of their portfolio to perform, when the rest of it isn't. We are moving into an environment where the correlations between Bonds and equities becomes positive but in a bad way with interest rates going up, and the value of equities going down. As a result, investors face losing out on both their defensive assets and their risk-on assets with liquid alternatives being a key diversifier to both.

Q: Is there also a case for illiquid alternatives to feature on the menu for investors?

A: Looking to illiquid alternatives, by which we mean assets such as real estate, infrastructure, private equity and private debt, investors need to adopt a very different mindset when holding these. You need to adopt a five-to-15-year investment horizon, whereas liquid alternatives can be held for much shorter-term periods. The core investment thesis is that you get an "illiquidity premium" for locking up your money over the longer term.

Within the Illiquid sphere there is also a key difference between illiquid debt – which may enable you to generate higher yield without necessarily reducing credit quality or increasing volatility vs liquid debt and private equity – which remains a risk on asset but hopefully with the benefit of generating higher returns that public equity. Historic data would back up these claims but it is crucial that you don't subject yourself to a liquidity mismatch in the process and the worst situation to be in is the position of a liquidity constrained forced seller.

Q: What roles can both liquid and illiquid alternatives play in client portfolios?

A: We specifically designed a fund of mixed liquid alternative funds to play the role of a risk reducing asset that acts as a replacement for fixed income. If you run a defensive or moderate risk portfolio, the chances are you may hold between 50-80% in fixed income. However, those bonds are likely to give investors very little in the way of income right

What are liquid and illiquid alternatives?

Liquid alternative assets fall into two buckets; alternative beta (oil, gold, other commodities) and alternative alpha (equity and credit long-short, macro, managed futures and special situations).

While liquid alternatives can be held for short time periods, we believe illiquids should be held for 5-15 years.

Illiquid alternatives include assets such as real estate, infrastructure, private equity and private debt.

In the past alternatives were considered risky asst classes, but going forward the expectation is they will form a core defensive asset of investor's portfolios.

> In the past investors viewed alternatives as risky asset classes, whereas going forward we think they are going to become a core part of the defensive, conservative area of people's portfolios.

now. Instead, they are going to provide both duration and default risk.

So investors are going to need to diversify the risk reducing part of their portfolio and we think liquid alternatives can help provide that. They provide different sources of alpha, whether it is equity market neutral, a macro fund or managed futures, each may provide returns in a manner that is negatively correlated to fixed income.

It is more difficult to create a fund of illiquid products, but for those investors who can handle the lack of liquidity, you can still get good quality assets that have a low chance of default but may pay a good income

Q: How do you see allocations to alternatives playing out in the future?

A: In the past investors viewed alternatives as risky asset classes, whereas going forward we think they are going to become a core part of the defensive, conservative area of people's portfolios. This is because they bring controlled levels of volatility and high levels of diversification. So, we think we will see lower percentages of liquid alternatives being used in higher risk portfolios, and higher percentages of them being used in lower risk portfolios.

In terms of illiquid alternatives, their use has always been higher among institutional investors as they are better equipped to handle that liquidity. However, I think we will increasingly see more in retail and wholesale portfolios investors become more willing to lock their money up for longer in payback for getting higher rates of comparative returns.

FOR INVESTMENT PROFESSIONALS ONLY

All investing involves risk, including the risk of capital loss. This material is provided for informational purposes only and should not be construed as investment advice. The analyses, opinions, and certain of the investment themes and processes referenced herein represent the views of Natixis Investment Managers as of November 2019. The views and opinions expressed may change based on market and other conditions. There can be no assurance that developments will transpire as forecast, and actual results may vary. The investment firms quoted in the article conduct regulated activities only in and from the jurisdictions in which they are licensed or authorized. Their services and the products may not be available to all investors in all jurisdictions.

In the UK: Provided by Natixis Investment Managers UK Limited (One Carter Lane, London, EC4V 5ER), which is authorised and regulated by the UK Financial Conduct Authority (register No. 190258). In France: Provided by Natixis Investment Managers International - a portfolio management company authorized by the Autorité des Marchés Financiers (French Financial Markets Authority - AMF) under no. GP 90-009, and a public limited company (société anonyme) registered in the Paris Trade and Companies Register under no. 329 450 738. Registered office: 43 avenue Pierre Mendès France, 75013 Paris. In the E.U. (outside of the UK and France): Provided by Natixis Investment Managers S.A. or one of its branch offices. Natixis Investment Managers S.A. is a Luxembourg management company that is authorized by the Commission de Surveillance du Secteur Financier and is incorporated under Luxembourg laws and registered under n. B 115843. Registered office of Natixis Investment Managers S.A.: 2, rue Jean Monnet, L-2180 Luxembourg, Grand Duchy of Luxembourg. In Switzerland: Provided by Natixis Investment Managers, Switzerland Sàrl, Rue du Vieux Collège 10, 1204 Geneva, Switzerland or its representative office in Zurich, Schweizergasse 6, 8001 Zürich.

Natixis Investment Managers is the holding company of a diverse line-up of specialised investment management and distribution entities worldwide.

For more information visit: For more information visit: www.im.natixis.com