*By Christian Betz, Jyske Capital*

# Alternative ways to achieve returns

Since 2009, the financial markets have been dominated by high returns on almost all asset classes, and we are currently in a situation characterised by record-low interest rates, significantly narrowed credit spreads and higher equity pricing. This is a challenge to future returns on the traditional asset classes, not least interest-bearing assets. Concurrently, the volatility level in the financial markets has been at a historical low for quite some time, yet with a steeply rising trend over the past six to eight months. Uncertainty about the generation of returns coupled with a risk that volatility in the financial markets will revert more permanently to former levels give rise to renewed focus on alternative ways to achieve returns. Whereas interest in alternative investment primarily used to be related to expectations of high returns, focus is now very much on the wish for absolute returns which are ideally generated independently of market trends.

## Alternatives

Non-traditional - or alternative - investment should in our view be included in the portfolio because:

- the investment adds other elements of return to the portfolio than the traditional asset classes;
- for certain types of alternatives, absolute generation of return is added;
- an element of low or no correlation with traditional assets is included.

Regardless of the alternative asset classes included in the portfolio, these should be characterised by no or low correlation with the other asset classes. This adds diversification and increases the likelihood of a positive return contribution in periods when traditional asset classes fail. A portfolio with an element of alternative investment may pave the way for a more balanced return / risk ratio over the business cycle and hence a more attractive risk-adjusted return. However, it should be noted that alternative investment may also result in lower liquidity since alternatives are - typically but not always - characterised by lower liquidity than traditional assets.

## Alpha vs beta investment

Alternative investment is a broad concept and two generic types may preferably be distinguished:

- Investment generating returns without being subject to a specific direction in the financial markets. Examples in the field of traditional asset classes are managed FX strategies and equity investment which are liquidity neutral or risk neutral with long / short exposure. These are occasionally termed "alpha strategies" and may build on alternative risk premiums / alternative beta based on traditional asset classes characterised by good liquidity. Examples in the field of non-traditional asset classes are also wind turbines, infrastructure investment (power lines, etc.) characterised by absolute returns with weak liquidity, for which the long-term investor is rewarded.
- Investment in alternative asset classes, generating returns dependent on market trends - e.g. commodities, properties, etc. These are typically termed "beta strategies".

## Alternatives in the portfolio

Alternative investment with alpha characteristics may preferably constitute a permanent but dynamic part of the portfolio as these will increase diversification through an absolute return flow. However, it is essential that the return flow is genuinely uncorrelated relative to the other asset classes. In 2008 and 2009, a certain disappointment was seen among investors with "market neutral" equity products which in the weak equity markets showed significantly higher-than-expected correlation with traditional equities. Weak liquidity followed in the wake of the loss-making investment. In other words, independence and portfolio protection were so-so.

For alternatives with beta characteristics, an active asset allocation perspective should be taken as the return depends on a specific market trend. Consequently, the timing of the investment will generally play a significant role. Nevertheless, alternatives such as commodities will over a business cycle add a positive diversification effect. This return flow is attractive in periods when traditional assets are weak.

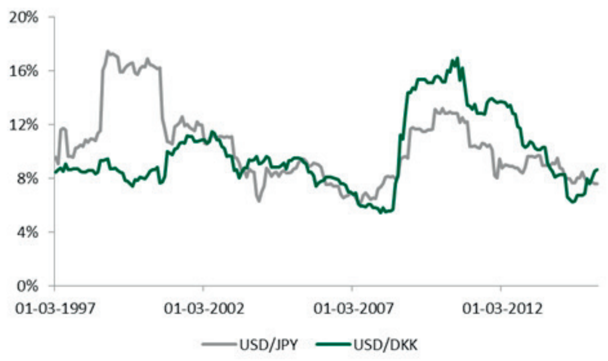
So, alternative investment in the alpha and beta categories is a significant part of the portfolio because:

- the investment enriches the portfolio with an additional attractive return;
- diversification is added which results in a higher risk-adjusted return;
- alternative investment generates a return flow which is absolute, and this is interesting in periods when the return from the traditional asset classes is uncertain and/or negative.

## Why alternatives now?

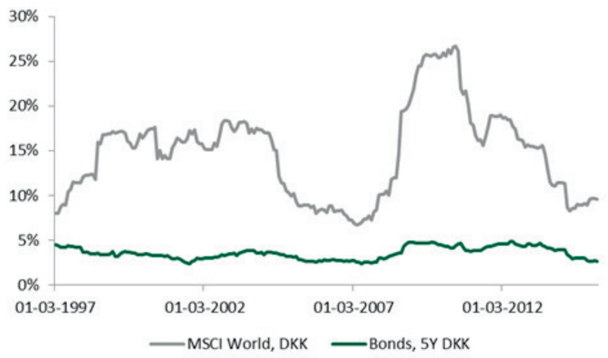
There are two major challenges in terms of return generation in the traditional asset classes. Partly the risk of rising and historically normalised volatility, partly general challenges regarding the long-term return generation (cf. below). The figures below illustrate the challenges via the falling trend in movements in the financial markets since 2008 (Figures 1 and 2) and the marked interest-rate decline coupled with a considerable equity return during the same period of time (Figure 3).

Figure 1: Volatility in USD/DKK and USD/JPY




Source: Jyske Capital and Bloomberg, May 2015

Figure 2: Volatility in equities and bonds




Monthly observations, moving two years.

Source: Jyske Invest and Bloomberg, February 2015

Figure 3: Performance of yields and equities


Source: Jyske Capital and Bloomberg, May 2015

*Secure bonds*
The yield level is historically low. This does not mean to say that it will not remain so, and it does not necessarily imply that it will not in future be possible to generate positive returns. But even given competent and active management of a bond portfolio, the consequence is that the return/risk ratio has grown much less attractive and much more asymmetrical.

*Corporate and mortgage bonds*
High yield as well as investment grade corporate bonds are challenged by the lower yields and the low credit spreads. The yield risk involved in corporate and mortgage bonds is a challenge, and the return/risk ratio looks poorer compared with previous periods of time. Yet, we still expect a fair carry on corporate and mortgage bonds.

*Equities*
Generally, we anticipate a reasonable return potential in the coming years, but the risk is higher in relative terms. The pricing has increased, and we see uncertainty about the strength of the upswing and whether growth will become self-sustained without stimuli.

## Conclusion

With the above expectations, dynamic asset allocation between the asset classes and selection of the correct strategy within the individual asset classes will increase in importance in the coming years.

In addition, allocation/increased allocation for alpha-seeking alternatives which are independent of the trend of the market will be an important factor in the return generation of the portfolio. We ascertain an increased demand for this type of financial solutions. We see great value in absolute return strategies with limited possibility of gearing/gross exposure as an alternative to bonds during a period of time with a rising volatility level and a record-low yield. Hence, we give higher weight to a balanced risk/return ratio over the business cycle than to high return expectations via high gross exposure.

None of the information in this document should be regarded as investment advice. Investors are advised to contact a personal advisor with respect to investment, tax issues, etc. before buying and selling. Past performance is not a reliable indicator of future performance and price development. Performance and / or price development may be negative.

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Jyske Capital
Vestergade 8-16
DK-8600 Silkeborg
Denmark

www.jyskecapital.com