Federated®

Alternative Investing: It's an evolution, not a revolution

Mike Dieschbourg, managing director for the Alternatives/ Managed Risk Group at Federated Investors, talks about why alternative investing strategies are gaining increasing traction with investors.

What's behind the growth of alternative investment strategies? The investor, of course. If we go back over time, most innovation and change in investing strategies has come in response to what investors want. I realize this may sound simplistic, but think about it.

Before the dot-com collapse, investor expectations centered on more traditional approaches. Equity investors would split their allocations across small-, mid- and large-capitalization stocks using growth, value or blended strategies. Fixed-income allocations ranged from low- to medium- to high-grade bonds utilizing short-, intermediate- and long-duration strategies. It was style-box investing, with an allocation framework built around an investor's market and risk expectations—not liabilities, risk tolerance or funding objectives. A benchmark index would serve as the guidepost for each combined asset and strategy class. It did not correlate with investors' actual objectives or maximize the probability of reaching a stated objective, be it fully funding a pension liability or providing a secure retirement outcome.

The 2000s changed all that. As hard as the dot-com collapse hit, the global financial crisis was even worse. For stock investors in particular, there was no place to hide. Whether value or growth, small-cap or large-cap, traditional stock-investing strategies got clobbered. So much so that, even though the major equity indexes have fully recovered, investors are still shying away from stocks. Many got out at the bottom and have yet to fully come back, missing a recovery that has seen equity markets reach new highs, with the S&P 500 more than tripling from its 666 low in March 2009. Equity fund flows have been negative for most of the past seven years.

The fund flow data serve to buttress a point we have repeated ad nauseam: Research from psychologists Amos Tversky and Daniel Kahneman that shows investors feel the pain of losses far more than they do the benefits of gains. It is this aversion to losses in the aftermath of the past decade that has led to the rise of alternative investing strategies. Today's investors want returns, sure, but they also want to minimize losses, are less caught up with asset allocation than with outcomes, and care far less about benchmarks than with solutions that work.

Alternative-investing approaches capture this behavioral shift, moving from traditional, higher-risk approaches that take long equity positions and hope for the best to a dynamic approach that seeks to potentially generate higher returns by reducing losses. Investments are diversified across asset classes, regions and countries. Futures overlays take long and/or short positions depending on the macroeconomic and market environments. And the focus is on flexibility, with changes occurring like a GPS, helping navigate the markets as circumstances change. It is an approach unbeholden to benchmarks, with the goal of better serving the wary investor, not discouraging him or her. Columbia Business School professors Benjamin Graham and David Dodd actually promoted this type of portfolio management in 1934 when they wrote in their groundbreaking book "Security Analysis" that "the essence of investment management is the management of risks, not the management of returns." We agree it is better to lose less and compound more than to reach for excess returns and fail to reach your objective.

For more information contact:
mdieschbourg@federatedinv.com

Alternative investing, including use of futures and short positions, may involve risks different from or possibly greater than the risks associated with investing directly in securities and other traditional investments.

Q452588 (8/15)
Federated Equity Management Co. of Pennsylvania

Federated is a registered trademark of Federated Investors, Inc.
2015 ©Federated Investors, Inc.

SPECIAL ADVERTISING SECTION