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Clients clamoring for alternative investments — and advisers obliging

More than three-quarters of retail advisers say they have put clients into nontraditional assets; ‘huge opportunity'

By Liz Skinner
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More than three-quarters of retail advisers use alternatives in their client portfolios, with an average of 11% of their book invested in venture capital, private equity, hedge funds, structured products and other such investments.

Of the 78% of advisers who told Cogent Research that they use alternatives, 8 in 10 said they use the nontraditional investments for diversification. About the same percentage cited risk management as a reason they use alternatives. Over half said alternatives helped them achieve absolute returns.

Independent advisers are the heaviest users of alternatives. Those advisers prefer venture capital, private equity and hedge funds, according to the national survey of 1,643 retail investment advisers. Bank advisers most commonly use limited partnerships, while registered investment advisers lean towards structured products and notes, the survey found.

“Most of our clients are retired and more of them seem anxious with the general stock market so they are using more and more alternatives,” said Erin Scannell, an adviser with Johnson Scannell & Associates, which manages about $500 million for clients.

He said many clients are looking to invest close to 20% of their portfolios in alternatives.

About 83% of advisers who do put their clients into alternatives said they use venture capital, followed by private equity (72%), hedge funds (64%), exchange-traded notes (59)%, limited partnerships (49%) and structured products/notes (43%), the research report showed.

Advisers are least likely to seek alternative strategies through exchange-traded funds and mutual funds that invest in non-traditional assets. That may be about to change, however.

Over the next year, 41% of advisers using alternatives said they will hike their use of ETFs. More than a quarter of that same group said they will boost their use of mutual funds that access alternatives, the report said. About 18% of advisers said they plan to increase their use of structured products/notes in the next 12 months.

“Advisers of all stripes and tenure have embraced the notion that managing client portfolios in today's environment requires the tools to provide greater asset class diversification and better risk management strategies,” said John Meunier, a Cogent principal and author of the report.

The research suggests a “huge opportunity” for firms that provide mutual funds and ETFs to meet what will be a growing demand “for institutional-quality alternative investment strategies that are both scalable within their practices and palatable to skeptical investors,” he said.

Of the 22% of advisers who aren't using alternatives, about 47% blamed their lack of knowledge about the investments, according to the research. Of those advisers who do use alternatives, half said a “lack of client knowledge and sophistication” stops them from using alternatives further.