The Association of Investment Companies

Something a bit different?

A guide to alternative assets

November 2017

www.theaic.co.uk

Whether you are looking to diversify your existing portfolio, boost your income or maximise long-term capital growth, investment companies can provide the best way to access alternative asset classes as part of a long-term balanced portfolio.

This guide looks at some of the main types of alternative assets, and explains the key benefits and risks.

New to investment companies?
Read ‘A guide to getting started’ to learn the basics

Available at www.theaic.co.uk or by calling 0800 707 707

Introduction

When people first begin to save, they normally start with cash and deposit type investments. Once they have built up a 'rainy day' fund, and can afford to take on more risk over the long term, they might move into equity investment, perhaps starting with a general equity fund. These funds normally invest in a wide range of shares and securities which are traded on stock markets and so invest in the largest and most well-known public companies, government stocks etc.

The term 'alternative' is used to cover many other types of investments that are not traded on stock markets. These might include the shares in private companies, physical property or infrastructure projects.

In this guide, we will be looking at some of the most popular alternative assets, and why investment companies are particularly suited to accessing them. We will also consider the benefits that they can bring to your portfolio, and the risks involved.

Whatever asset class you are considering, you should bear in mind that your money is exposed to risk. You should not invest in these investment companies if you need a guaranteed income or if you cannot afford to lose your capital. If you are not sure whether, or which, investment companies are suitable for you, you should consider taking independent financial advice.

Think differently
Alternatives offer opportunities beyond public stock markets

Types of alternative assets

There are many types of alternative asset classes.
Here are just some of the most popular:

Property

There are a wide range of investment companies investing in property. Some specialise in investing in commercial property, others in residential. Some specialise in particular types of property (such as healthcare). Some invest primarily in the UK, others in Europe or even further afield. Property investment companies might own the property directly, or alternatively invest in the shares of property companies.

Private equity

Private equity means investing in the shares of private companies, as opposed to companies whose shares are traded on stock markets. Private equity often involves investing in companies with the aim of helping them grow and eventually selling them for a profit. These companies can be riskier in the short term, but can deliver strong returns over the long term.

Hedge funds

A hedge fund is a fund that employs a wide range of sophisticated investment techniques, including derivatives, often with the aim of producing positive returns in all markets. In a 'feeder fund', the investment company invests in a single hedge fund run by the same manager. In a 'fund of funds', the investment company invests in a range of different hedge funds run by different managers.

Infrastructure

Infrastructure investment companies invest in contracts to develop and run long-term capital expenditure projects in public sectors such as transport, healthcare, schools and renewable energy. These contracts are for the long term (20-50 years) and aim to deliver a stable income over the period of the contract, often linked to inflation.

Specialist debt

Investment companies can also invest in a wide range of specialist forms of debt, such as asset-backed securities, distressed and sub-investment grade debt and peer-to-peer loans. These types of instruments tend to provide a high level of income, but can also be more risky than other forms of debt.

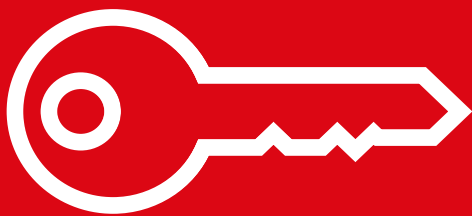
Take your pick
Alternatives range from investing in private companies to backing huge infrastructure projects

Why consider investment companies for alternative assets?

In addition to spreading your risk, there are a number of other reasons why investment companies are particularly suitable for alternative assets.

Access to a wider range of investments

Many open-ended funds are restricted to investing in listed shares and securities, and so cannot invest in most alternative asset classes. Investment companies have no such restrictions and can invest in almost anything.



Access for smaller investors

Many alternative asset classes are quite specialist and illiquid, or require sizeable minimum investments, making them difficult for ordinary investors to invest in directly. Investment companies enable smaller investors to access these asset classes more easily, as you can buy shares in the investment company on the stock market like any other listed company.

Closed-ended structure

Open-ended funds are constantly expanding and contracting as investors move their money in and out. This means fund managers have to manage the fund to be able to meet the demands of investors who may want their money back at any time. Because of this, open-ended funds are often restricted to investing in liquid assets.

A closed-ended investment company has a fixed number of shares in issue at any one time. These are traded backwards and forwards on the stock market, which has no impact on the underlying portfolio. This makes them very suitable for illiquid assets such as property, private equity and infrastructure.

More choice for a higher income

Many alternative asset classes seek to provide a high level of income. Investment companies have some unique advantages over other funds when it comes to maintaining or growing the income they pay you in the form of dividends. They can hold back some income in good times to pay out in later years or pay dividends out of the capital profits they make when they sell investments.

Want to know more?

Read 'Looking for a little bit more?' to learn about the unique income advantages of investment companies

The risks

As with all investment companies, investment companies investing in alternative assets come with risks to your income and capital. You should make sure you are happy with the amount of risk you are taking on before you invest.

Valuations

Unlike listed shares and securities, many alternative assets do not have a precise market value. Though the methodologies used to value them are robust and well-established, they can only be an approximation and, where assets are illiquid, they may only be valued on a quarterly basis.

Gearing

Investment companies investing in alternative asset classes will often use gearing. This can help to boost your immediate income and long-term capital growth, but will also increase any losses that you might make.

Expert selection
An independent financial adviser can help identify alternatives that best fit your needs and risk profile

Discounts/premiums

In recent times, due to the fall in interest rates, many income-orientated investment companies are standing ‘at a premium’. This means that you are paying more for the shares than the value of the underlying assets. This may be a price you are prepared to pay for an attractive level of income, but you should bear in mind that, over time (e.g. if interest rates rise), these premiums may fall and could move to a discount. This means that the share price performance will be worse than that of the portfolio, and could increase any losses you make.

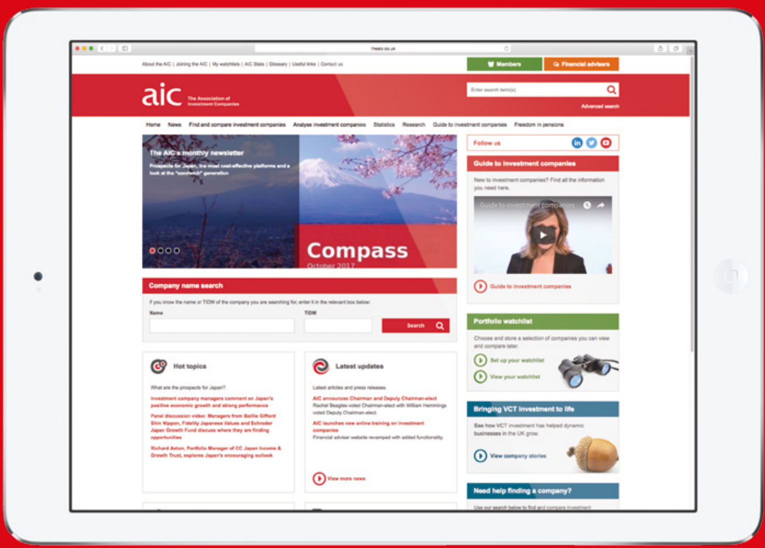
Key things to remember

- Alternative assets are something you should consider only after you have built up a 'rainy day' fund and have a solid core of other investments.
- Investment companies, being closed-ended, are particularly suited to alternative assets, as many of these assets are illiquid in nature.
- Investment companies' unique advantages when it comes to delivering income are particularly suited to alternative assets, which often aim to deliver a high and/or growing income.
- All investment companies are intended as long-term investments and you should therefore be prepared to invest for at least 5 years, and preferably 10 or longer.
- Your income, and capital, are at risk, and can fall as well as rise, and so they are not a substitute for deposit type investments and annuities.
- You should not invest in investment companies if you need a guaranteed income or if you cannot afford to lose your capital.

Don't forget
Investment companies are long-term investments and you should be prepared to hold them for at least 5 years, and preferably 10 or longer

Visit the AIC website to learn more about investment companies, find and compare companies and create your own ‘Watchlist’

www.theaic.co.uk



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