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Alternative Investments: 2021 Survey Shows Advisors Are Open to Increasing Allocations

By Daniil Shapiro, CFA®

INVESTMENTS & WEALTH INSTITUTE®

Alternative Investments

2021 SURVEY SHOWS ADVISORS ARE OPEN TO INCREASING ALLOCATIONS

By Daniil Shapiro, CFA®

Advisors recognize the benefits of allocating to alternative investments, whether it be for diversification and downside protection or income; however, barriers remain to their use. Advisors report that, because alternative allocations often are illiquid, expensive, and complex, they are less inclined to rely on such products. However, as retail investors gain greater access to institutional-caliber alternative offerings via products of varying liquidity—a trend often referred to as the "democratization of alternatives"—advisors will have more options for serving client needs.

ABOUT THE RESEARCH

In early 2021, Cerulli Associates, in partnership with Blue Vault, conducted an inaugural survey centered on advisor use of alternative investments. The survey sought to identify key alternative investment trends and advisor allocations to a comprehensive list of alternative exposures ranging from alternative securities to liquid alternatives and illiquid products. The survey received approximately 80 responses, heavily tilted toward advisors in the independent broker-dealer channel. These participants may have tilted responses toward non-traded real estate investment trust structures and shown more muted exchange-traded fund use as opposed to mutual fund use, but we still consider the survey sample to be representative overall. The findings are presented in combination with insights from broader Cerulli and Blue Vault research.

Our key findings include the following:

- Advisors report alternative allocations taking up 10.5 percent of their portfolios and expect this to increase to 11.8 percent in two years.
- The alternative investments value proposition of offering diversification is well understood (83 percent of advisors somewhat or strongly agree), yet advisors are less likely to agree that they perceive their existing allocations as low.
- Liquidity is exceptionally important to advisors and their clients; 54 percent report liquidity as a challenge to investing in illiquid alternatives. But advisors also list product cost (39 percent) and complexity (37 percent) as key barriers to greater use.
- Enhanced liquidity of alternatives as well as better performance likely would lead to heightened allocations (60 percent and 43 percent of advisors, respectively, report these would lead to higher allocations).
- Only a sliver of advisors currently use cryptocurrency products, but it's likely that more will use them due to client demand.

In 2021, advisors looking to meet client objectives faced new challenges. Low interest rates were making it difficult to generate the income investors need, and public equity markets—having rallied for years—were perceived as expensive. Advisors have long sought to allocate to alternative investments. Alternative exposures—ranging from liquid exchange-traded funds (ETFs) and mutual funds to illiquid private capital exposures and everything in between—have cemented their role in investor portfolios over decades. These allocations, however, are becoming more important due to the confluence of several important trends:

- Investors need diversification more than ever due to expensive public markets and low rates—they may by default be overallocated to traditional investments.
- As alternative categories such as private equity and private debt continue to quickly gather assets, such exposures are becoming the market. In other words, investors who don't allocate to them are making an active bet away from these types of exposures.
- The democratization of alternatives—with both traditional (e.g., Vanguard) and alternative investment managers (e.g., Blackstone) targeting retail investors for alternative allocations—means that retail investors increasingly will have access to institutional-caliber alternative investments.

CHALLENGES IN MEASURING ALTERNATIVE INVESTMENT ALLOCATIONS

Cerulli and Blue Vault rely on advisors to report their alternative investment allocations. This is not an easy task for the surveyors or the surveyed—alternative investments are a complex categorization. Key alternative subcategories often are heavily contested as to whether they represent alternative exposures. Cerulli notes that specific exposures may be alternatives when presented as one type of fund but not an alternative in another. The S&P 500, for example, allocates approximately 5 percent to energy and real estate securities, which investors are unlikely to label as part of an alternative allocation. If the same stocks were held by a stand-alone fund (e.g., a real estate investment trust or REIT), however, they arguably would represent an alternative exposure. Cerulli and Blue Vault presented advisors with comprehensive lists of examples of alternative exposures to encourage a holistic response.

Table 1

ADVISOR-REPORTED ALTERNATIVE INVESTMENT ALLOCATIONS, 2021

Advisors report modest alternative investment allocations and plan to increase them.

Allocations	Distribution in 2021	Expected Distribution in 2023
Non-alternative investments	89.5%	88.2%
All alternative investments	10.5%	11.8%

Sources: Cerulli Associates, in partnership with Blue Vault

Table 2

ADVISOR-REPORTED CHANGE IN ALTERNATIVE INVESTMENTS DUE TO COVID-19, 2021

Despite expectations of alternatives allocations skyrocketing, advisors appeared just as likely to decrease alternative allocations as to increase them due to the COVID-19 pandemic.

Investment Type	Do Not Use	Decreased	Neutral	Increased
Overall alternative investments exposure	10%	19%	53%	19%
Commodities ETF exposure (e.g., GLD)	48%	5%	26%	21%
Liquid alternatives exposure	24%	8%	50%	19%
Private equity exposure	43%	6%	36%	15%
Private debt exposure	48%	9%	34%	10%

Sources: Cerulli Associates, in partnership with Blue Vault

ADVISOR ALLOCATIONS TO ALTERNATIVE INVESTMENTS

Advisors indicate that they allocate 10.5 percent to alternatives and plan to increase this exposure to 11.8 percent in two years (see table 1). Cerulli notes that this allocation is slightly but not absurdly higher than the allocation reported by its unique advisor survey (7.3 percent), which asks advisors to report their alternative and commodity allocations for moderate risk clients relative to other asset classes.

Although some thought the coronavirus pandemic might allow alternative managers to distinguish themselves by providing downside protection and capturing flows through a tough market environment, this was not the case given the short-lived nature of the drawdown in early 2020. Instead, advisors were likely to report that their alternative allocations remained neutral, although many were drawn to commodity ETFs—whether it was oil products such as United States Oil Fund (USO) for speculation or precious metals ETFs for safety. SPDR Gold Shares (GLD) gathered $16.4 billion in flows in 2020 to grow to a $71-billion product (see table 2).

Advisors also used the pandemic to reposition their portfolios into attractive options-trading products, with several alternative funds from J.P. Morgan (e.g., JPMorgan Hedged Equity Fund) and BlackRock capturing particularly attractive flows. Cerulli believes that the products were in demand due to their attractive risk profiles and being less expensive than typical liquid alternative strategies (see table 3).

Although advisors' responses to some categories are aspirational—it's unlikely that more than one-third already are using private equity exposures—Cerulli believes that advisors increasingly are interested in and capable of investing across a broad range of alternative products. Platforms such as iCapital help connect them to institutional-quality alternative investment products, and brand-name asset managers are launching convergence zone products (non-traded REITs [NTRs], interval funds, and business development companies [BDCs]) that have some liquidity.

The alternative category continues to undergo significant change. Alternative mutual funds, which received tremendous attention after the Great Financial Crisis, have undergone rationalization, and specific alternative ETF categories, e.g., defined outcome and buffer ETFs, have sprouted. Meanwhile, investors have been lukewarm to hedge funds, whose assets under management have hovered at approximately $3 trillion for almost a decade. The most significant growth has been in private capital strategies, which as of Q3 2020 comprised

Table 3

ADVISOR-REPORTED ALTERNATIVE INVESTMENT PRODUCT USE, 2021

Advisors are most likely to use liquid alternative mutual funds and ETFs (e.g., commodity ETFs), but they also report heavy use of convergence zone products.

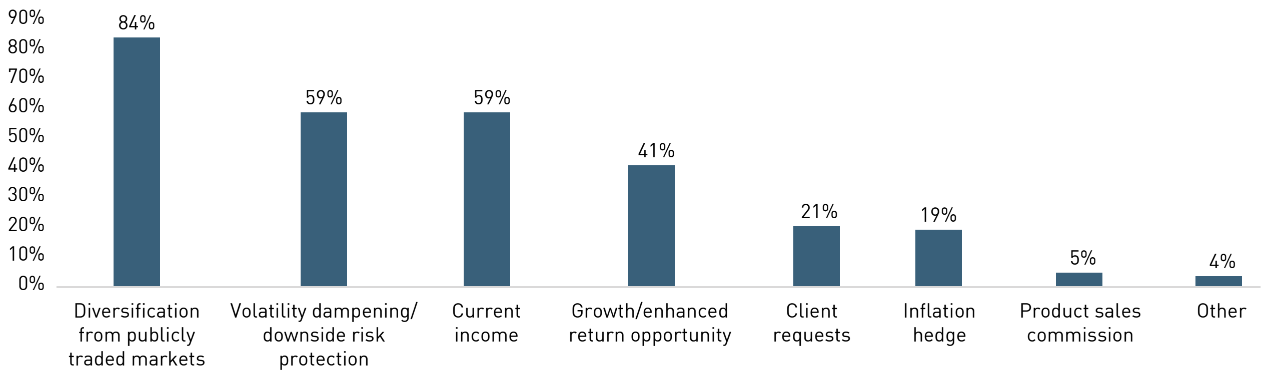
Product/Vehicle	Currently Use	Plan to Start Using	Used Previously But Not Currently	Do Not Use/Have Not Previously Used
Liquid alternative mutual funds (including REIT mutual funds)	66%	5%	6%	23%
Non-traded REITs (NTRs)	60%	3%	24%	13%
Liquid alternative ETFs (including commodities ETFs)	46%	8%	13%	33%
Non-traded business development companies (BDCs)	44%	1%	27%	28%
Private real estate	41%	4%	9%	47%
Private equity	37%	9%	5%	49%
Private debt	36%	3%	8%	54%
Interval funds	32%	14%	9%	46%
Private natural resources	13%	9%	8%	71%
Opportunity zone investments	13%	15%	6%	65%
Hedge funds	11%	8%	11%	70%
Private infrastructure	8%	12%	4%	77%
Special purpose acquisition companies (SPACs)	4%	15%	5%	76%

Sources: Cerulli Associates, in partnership with Blue Vault

Figure 1

ADVISOR-REPORTED GOALS OF ALTERNATIVE INVESTMENT ALLOCATIONS, 2021

Beyond diversification and volatility dampening, advisors look to alternatives for income and growth.



Sources: Cerulli Associates, in partnership with Blue Vault

$8 trillion in assets according to Preqin, with private equity and other offerings including private real estate and private infrastructure contributing to this total.

By encompassing a wider variety of exposures, private capital strategies have been able to meet a wider range of client needs beyond capital growth and diversification, including fixed income replacement, yield generation, and inflation protection. But it remains difficult for advisors in most channels—although wirehouses likely have improved access due to wealthier clients—to access such products. One stopgap on the product side has been an incremental proliferation of the aforementioned convergence zone structures, which can help shuttle client funds into strategies with intermittent liquidity that more closely reflect private capital strategies.

ROLE OF ALTERNATIVE INVESTMENTS

ADVISOR GOALS

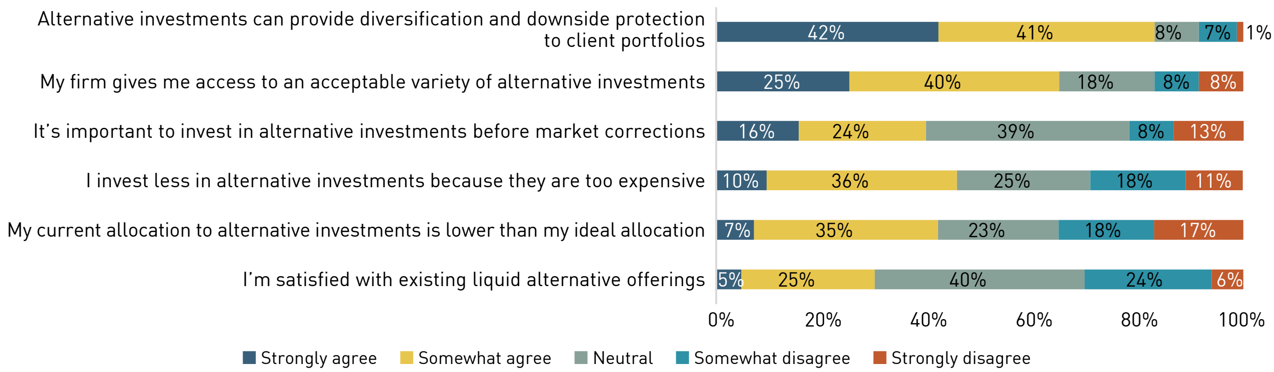
Advisors are most driven to alternative investment products by a need for diversification (see figure 1). With equity markets rallying in recent years, and therefore taking up larger portions of investor portfolios, fixed income exposures have yielded less and become more rate-sensitive. So, advisors are looking for investments that can offer some upside potential and meet client objectives without further subjecting the client to market risks.

Cerulli believes that, although advisors' ideal preference would be a liquid product with less volatility, advisors can be convinced to evaluate convergence zone or illiquid products to the extent that illiquidity is associated with true

Figure 2

ADVISOR SENTIMENT ON ALTERNATIVE INVESTMENTS, 2021

Advisors recognize that alternative investments offer diversification but disagree that their allocations are too low.



Sources: Cerulli Associates, in partnership with Blue Vault

Table 4

ADVISOR-REPORTED CHALLENGES TO INVESTING IN ILLIQUID ALTERNATIVE INVESTMENTS, 2021

Advisors list liquidity, high product fees, and complexity as top challenges to greater alternative allocations.

Challenge	% of Respondents
Lack of liquidity is not suitable for clients	54%
Products are too expensive to own (e.g., high management fees)	39%
Complexity of products makes due diligence difficult	37%
Product commissions/loads are too high	23%
My clients are not suited for alternative investments	23%
Not applicable—do not have challenges accessing illiquid alternatives	18%
Do not have access to attractive offerings	15%
Firm does not support investing in alternatives	8%
Other	6%

Sources: Cerulli Associates, in partnership with Blue Vault

alternative exposures. Another perceived benefit of illiquidity to advisors is the stable net asset value (NAV)—varying only on reporting dates—therein allowing advisors to report improved portfolio volatility measures.

ADVISOR SENTIMENT

As for the common industry refrain that alternative allocations are too low, Cerulli underscores that this is according to alternative investment managers, not advisors, who largely believe that their allocations to the products are right where they should be (see figure 2). This suggests that although increased accessibility to alternative investments—alongside attractive products—can drive growth, there is not necessarily a backlog of untapped opportunity to capture tremendous flows. Cerulli argues that to capture incremental flows, managers should offer products with features more attractive than those of current offerings—thereby overcoming the challenges typically associated with alternative investments.

ADVISOR CHALLENGES TO INVESTING

Liquidity considerations continue to be a critical component of investing in alternative investments (see table 4). On the one hand, the lack of liquidity theoretically should allow managers to carry out long-term strategies (e.g., private equity) that create value for investors, but on the other hand, advisors know that when their clients want to draw funds, it would be helpful to have had them yesterday.

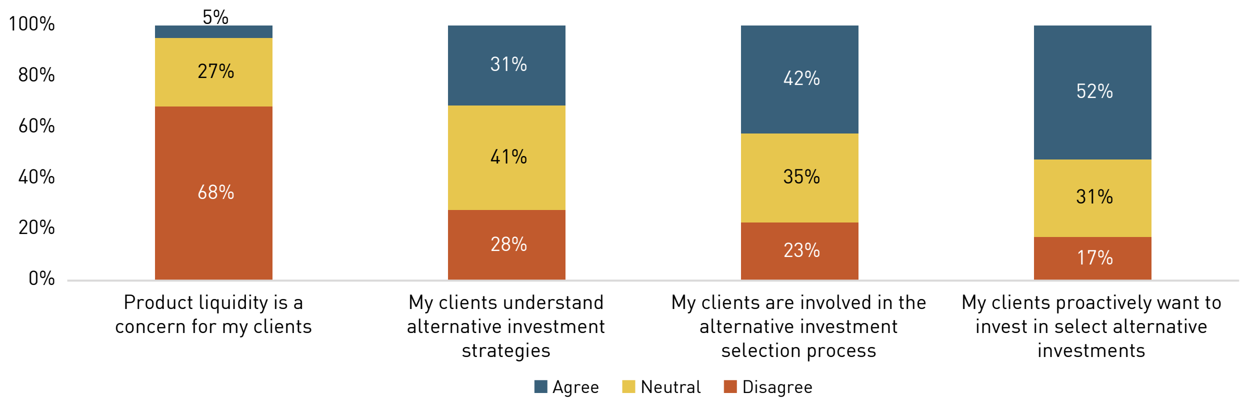
Advisors are caught in a conundrum where the liquid alternatives that are available to them are hedge-fund-type trading strategies and not the private equity offerings they seek, because the latter are largely unavailable to them. It's likely that convergence zone structures (i.e., interval funds) can somewhat allay the liquidity concerns, but even these structures have gates that can leave investors without access to funds during a drawdown, when investors need them most.

Beyond liquidity, advisors continue to find alternative investments to be expensive and complex. Allocating to alternative investments costs significantly more compared to low-cost or no-cost index funds, resulting in a fee that significantly cuts into returns. Alternative investments also can be notoriously difficult to explain to clients. This does not need to be the case. Key alternative exposures, including commodity products and real estate ETFs, for example, are available at low fees. Cerulli does acknowledge, however, that managers can do a better job of simplifying exposures and explanations for clients in a way that helps them identify strategy return drivers.

Figure 3

ADVISORS: CLIENT PERCEPTION OF ALTERNATIVE INVESTMENTS, 2021

Interest in alternatives is far more likely to be driven by advisors than by their clients.

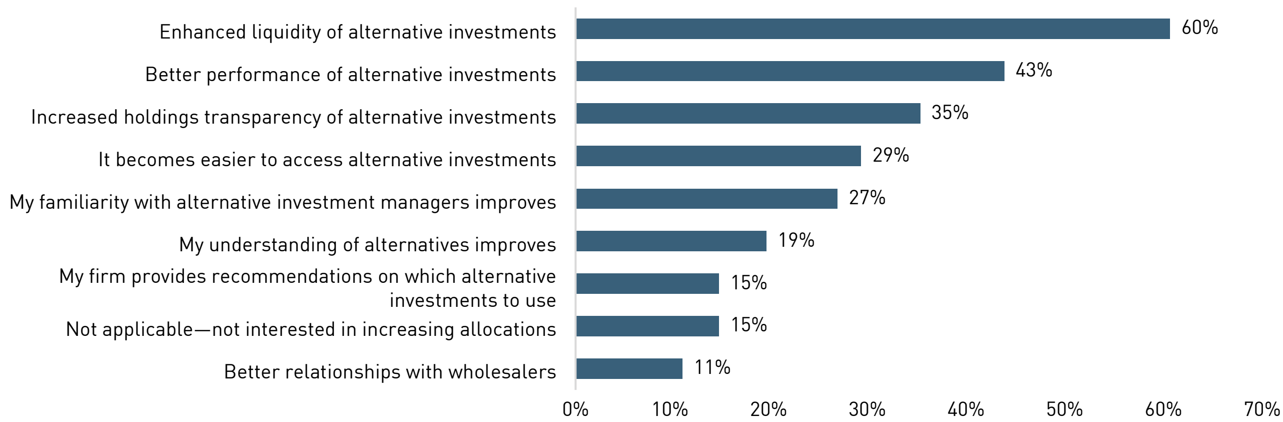


Sources: Cerulli Associates, in partnership with Blue Vault

Figure 4

ADVISORS: FACTORS THAT WOULD DRIVE INCREASED ALTERNATIVES ALLOCATIONS, 2021

Advisors consider liquidity, high product fees, and complexity as top challenges to greater alternative allocations.



Sources: Cerulli Associates, in partnership with Blue Vault

In evaluating the challenges, Cerulli believes that a clear alternatives playbook exists for managers and advisors. Both would benefit from a proliferation of quality alternative strategies but with some enhanced liquidity and certainly more attractive costs, which would in turn help those strategies post better performance.

CLIENT PERCEPTION

Alternative investments may be exciting for advisors to learn about and access; however, this is probably not the case for their clients. Only approximately one-quarter of advisors report that their clients either understand alternatives, are involved in the selection process, or proactively want to invest in select investments—underscoring that, for most practices, alternative exposures are advisor-driven and not client-driven (see figure 3). As opposed to being interested in the unique aspects of alternatives and accessing them, clients are more likely to be concerned about locking up funds.

TOP CHALLENGES TO INCREASED ALLOCATIONS

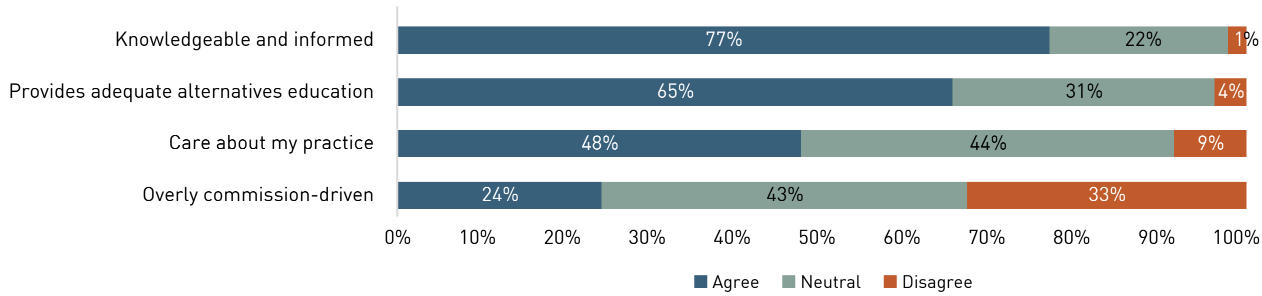
Although advisors are open to investing in alternatives, they resoundingly want the products to offer enhanced liquidity (one of the key success factors behind the Blackstone Real Estate Income Trust [BREIT] product). They also want to see better performance after many hedge-fund-like liquid alternative strategies and hedge funds themselves disappointed advisors with lower returns and higher fees while traditional markets rallied (see figure 4). Cerulli believes that many advisors also have been served poorly by legacy NTRs and other products, resulting in a wariness as new products come to market.

For managers, convergence zone structures present an interesting opportunity. Managers may be able to leverage their brands to offer attractive private exposures with intermittent liquidity. The recent launch of Blackstone's unlisted BDC product (BCRED) and KKR's

Figure 5

ADVISORS' PERCEPTION OF ALTERNATIVES WHOLESALERS, 2021

Advisors generally like their alternatives wholesalers.

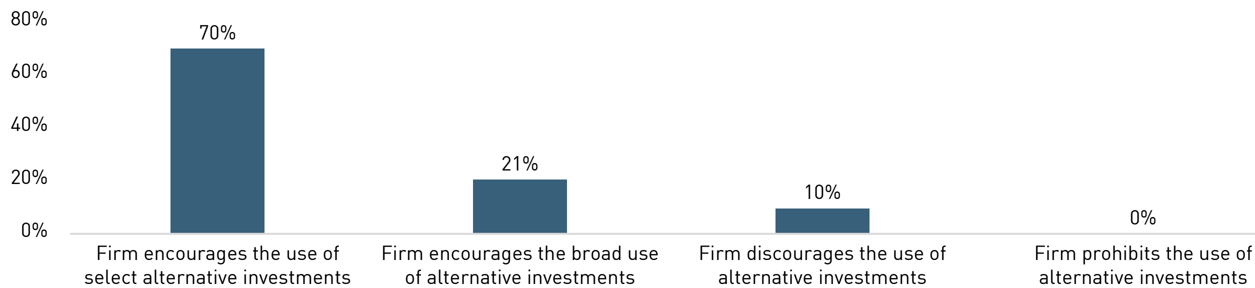


Sources: Cerulli Associates, in partnership with Blue Vault

Figure 6

ADVISORS: FIRM SUPPORT FOR ALTERNATIVE INVESTMENTS, 2021

Firms encourage the use of some but not all alternative investments.



Sources: Cerulli Associates, in partnership with Blue Vault

Table 5

ADVISORS' DISTRIBUTION OF ALTERNATIVE INVESTMENTS BY TYPE, 2021

Advisors lean strongly toward products with daily liquidity.

Alternative Investment Type	Distribution in 2021	Expected Distribution in 2023	Percentage-Point Change
Liquid alternative investments	28.2%	32.1%	3.9%
Convergence zone products	20.2%	19.0%	−1.2%
Illiquid private investments	19.6%	15.5%	−4.1%
Liquid securities holdings	15.9%	19.7%	3.8%
Illiquid securities holdings	12.1%	12.4%	0.3%
Other	4.0%	1.3%	−2.7%

Sources: Cerulli Associates, in partnership with Blue Vault

launch of a real estate tender-offer fund are promising examples of brand-name managers bringing convergence zone products to market.

PERCEPTION OF ALTERNATIVES WHOLESALERS

This refers to asset managers leveraging their own brands (e.g., Blackstone, Apollo) to sell products in convergence zone structures (e.g., interval funds, NTRs, BDCs).

The good news for wholesalers is that advisors generally perceive them as knowledgeable and informed—a must for products that require tremendous amounts of education in order to receive an allocation. Cerulli encourages wholesalers to use a consultative sales approach where they seek to understand advisor needs and requirements as opposed to pushing specific products (see figure 5). It's possible that the firms best placed to take advantage will be those with a full suite of alternative products that they can guide advisors to depending on clients' needs.

FIRM SUPPORT

Alternative investments can present a conundrum across key distribution channels where firms are responsible for ensuring that their advisors are offering products that meet fiduciary obligations. The function home offices play is exceptionally important, and it appears that most advisors agree that home offices are not overly restrictive in keeping them from investing in attractive alternative products (see figure 6 and table 5). Recently, JPMorgan Private Bank clients were given access to a Bitcoin fund created by NYDIG—with the fund priced significantly lower than pricing available via typical ways of accessing such products, e.g., Grayscale Bitcoin Trust (GBTC)—underscoring how home-office functions can add value.

ALLOCATIONS ACROSS THE LIQUIDITY SPECTRUM

LIQUID ALTERNATIVES

Liquid alternative investments represent a plurality (approximately one-third) of advisors' alternative investments allocation, with convergence zone products representing the next-largest slice. Across categories, advisors report that they plan to increase allocations to more-liquid products and reduce exposure to illiquid investments. The response reflects advisor interest in liquidity for these products, but Cerulli notes that liquid alternative products are facing rationalization (94 liquid alternative mutual funds closed in 2020) as managers continue to launch convergence zone products and platforms seek to connect advisors with illiquid allocations (see table 6). It's possible that true advisor allocations run counter to their response.

Table 6

ADVISORS' ACTUAL AND EXPECTED DISTRIBUTION OF CONVERGENCE ZONE ALTERNATIVE ASSETS, 2021 VS. 2023E

Non-traded REITs are the dominant convergence zone allocation, but advisors plan to increase interval fund allocations.

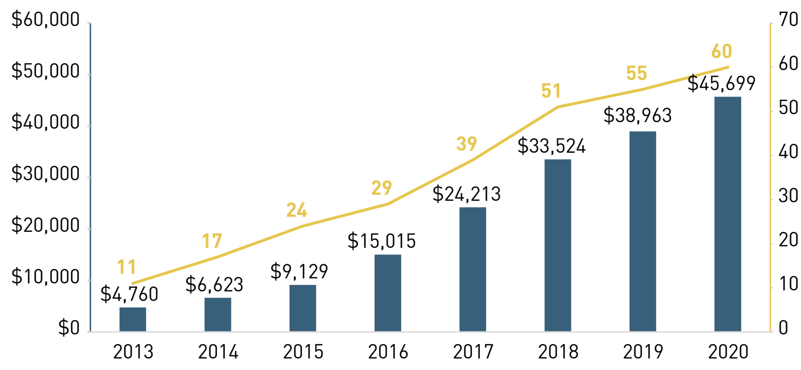
Alternative Asset Class	Distribution in 2021	Expected Distribution in 2023	Percentage-Point Change
Non-traded REITs	47.3%	39.0%	−8.3%
BDCs	19.8%	16.4%	−3.4%
Interval funds	18.4%	24.5%	6.1%
Non-traded preferred shares	6.9%	9.6%	2.7%
DST offerings (1031 exchange offerings)	6.0%	8.9%	2.9%
Tender-offer funds	1.6%	1.5%	−0.1%

Sources: Cerulli Associates, in partnership with Blue Vault

Figure 7

INTERVAL FUND ASSETS AND FUND COUNT, 2013–2020 ($ MILLIONS)

The interval fund universe has grown to $46 billion across 60 products as managers launched new funds.



Source: Blue Vault

CONVERGENCE ZONE PRODUCTS

A continuing trend in the convergence zone product landscape has been the replacement of legacy NTR sponsors with more innovative offerings via a NAV REIT structure. This avoids the large sales charges of a prior generation of products—as spearheaded by Blackstone's BREIT, now a $40-billion+ product that has triggered its own competition. Advisors' reported plans to trim the NTR portions of their convergence zone product exposures contradict their ongoing allocations to the new wave of NTR sponsors, including Blackstone and Starwood. Instead, this likely reflects advisors' dissatisfaction with legacy exposures.

Advisors also plan to significantly increase allocations to interval funds to reflect approximately one-quarter of their convergence zone product exposures, and managers are placing greater emphasis on these products. Interval funds are likely to be a particularly attractive area for growth because of their mix of intermittent liquidity (managers must repurchase some amount of shares, typically on a quarterly basis) and ability to hold a variety of exposures (including public securities as well as illiquid securities such as private real estate, private debt, venture capital, and private equity). Cerulli notes that interval fund assets have grown tremendously over the past several years, although some products have been more speculative exposures (e.g., ACAP Strategic Fund) to which advisors allocate based on strong prior performance (see figure 7). It's likely that a wave of lower-cost interval funds can drive greater familiarity, in turn leading to greater use (see figure 8).

ILLIQUID ALTERNATIVES

Even among illiquid exposures, advisors report private real estate making up their most significant allocations; private equity and private debt exposures are smaller but projected to increase (see table 7). Although infrastructure allocations reportedly will remain small, they are expected to almost triple from the current 1.4 percent. The interest in infrastructure likely is spurred by the progression of an infrastructure bill as well as the ability of the asset class to offer inflation protection.

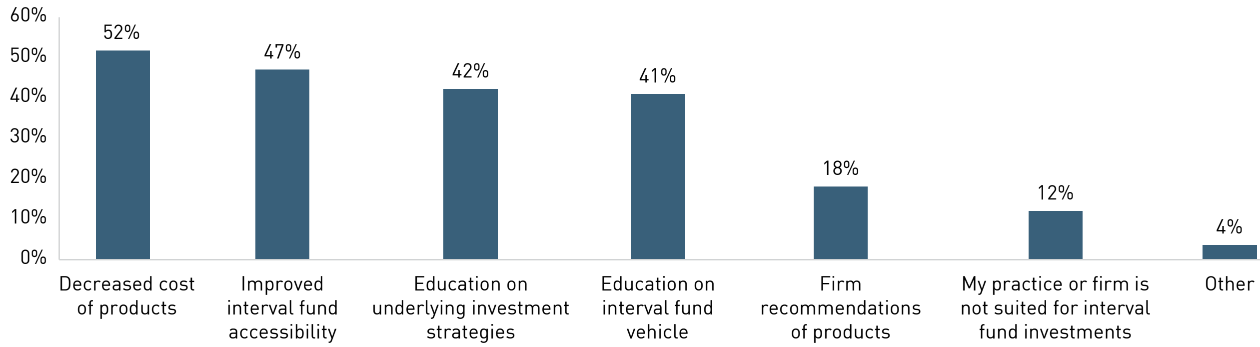
CRYPTOCURRENCY

With the initial public offering of Coinbase reaching a price of $60,000 in April 2021, and institutions such as MassMutual investing in cryptocurrency, it's about time for advisors to have an opinion on this emerging

Figure 8

ADVISORS: FACTORS THAT DRIVE GREATER INTERVAL FUND USE, 2021

Allocations to interval funds would benefit from lower costs, improved accessibility, and increased education.



Sources: Cerulli Associates, in partnership with Blue Vault

Table 7

ADVISORS' ACTUAL AND EXPECTED DISTRIBUTION OF ILLIQUID ALTERNATIVE ASSETS, 2021 VS. 2023E

Advisors report private real estate as their most significant illiquid allocation.

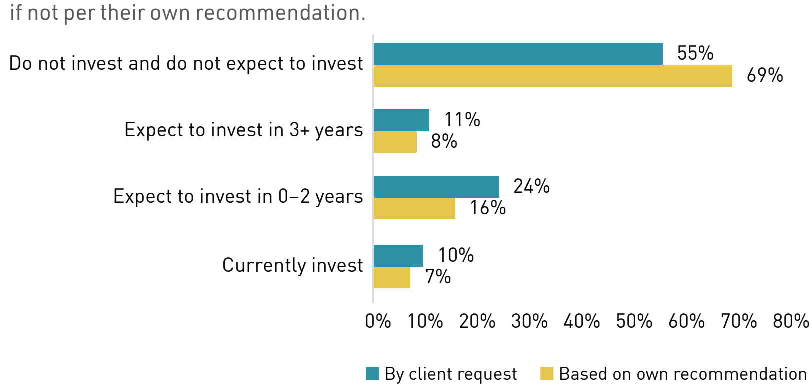
Alternative Asset Class	Distribution in 2021	Expected Distribution in 2023	Percentage-Point Change
Private real estate (e.g., via limited partnership structure)	42.1%	35.1%	−7.0%
Private equity	21.6%	22.6%	1.0%
Private debt	14.2%	16.3%	2.1%
Hedge funds	11.1%	11.2%	0.1%
Private natural resources	5.8%	7.0%	1.2%
Private infrastructure	1.4%	4.1%	2.7%
Other	3.8%	3.8%	0.0%

Sources: Cerulli Associates, in partnership with Blue Vault

Figure 9

ADVISOR-REPORTED USE AND EXPECTED USE OF CRYPTOCURRENCY, 2021

Advisors will increasingly allocate to cryptocurrency due to client demand if not per their own recommendation.



Sources: Cerulli Associates, in partnership with Blue Vault

asset class and to be able to respond to client questions (see figure 9). Cerulli's and Blue Vault's polling shows that only a sliver of advisors currently are recommending cryptocurrency exposures to clients or at their behest, but a notable portion plan to invest in such products in the next several years (more likely by client request).

Cerulli acknowledges that cryptocurrency remains an exceptionally speculative arena. But if advisors avoid offering advice on these exposures, it's possible for their clients to take matters into their own hands and potentially make outsized allocations into even into more speculative offerings. An appropriate middle ground may be for advisors to help clients make allocations of 1–2 percent toward cryptocurrency exposures, possibly via listed products such as GBTC.

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