

## PERSPECTIVES

# Mutual funds + alternatives = How individuals can invest like institutions

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Originally published on [fsinvestments.com](https://fsinvestments.com)

Some of the greatest innovations result when enterprising minds find fresh ways to remove barriers between consumers and time-tested or new products.

Consider how the pastime of shopping has evolved. Amazon created a single virtual storefront that provides consumers anywhere, anytime access to millions of products. Capitalizing on the advent of the internet, Amazon's platform removed barriers for individuals across the globe looking to find, compare and purchase goods.

Think, too, of how dramatically access to entertainment has changed. Netflix wasn't the first company to combine consumers' love of watching movies at home with the rising trend toward renting rather than buying goods. But it did so in a manner and on a scale that ultimately transformed the way individuals consume media.

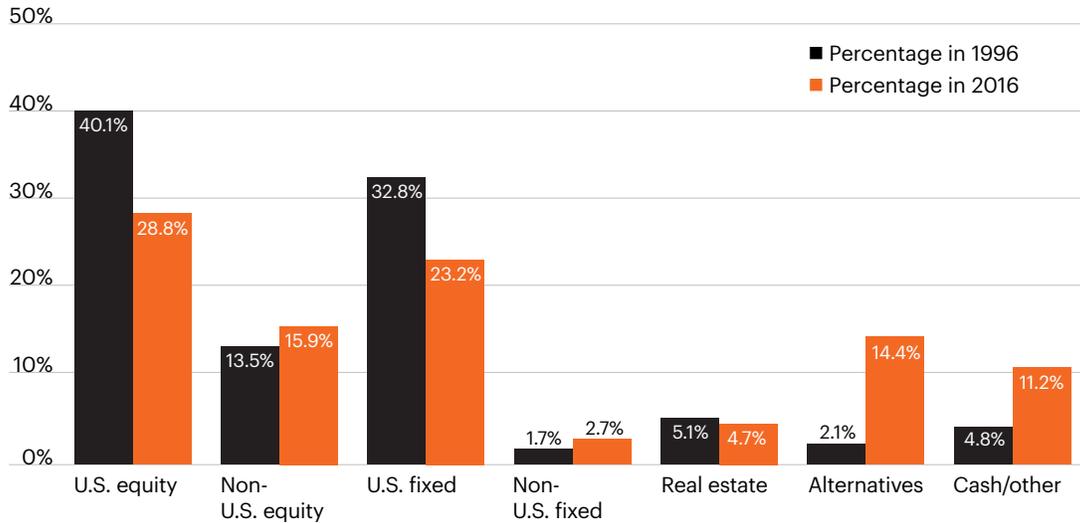
In relation to access, the asset management industry has its own game-changers. An important one has been the marriage of the mutual fund structure with alternative investment strategies to remove barriers between individual investors and diversified sources of returns.

**“Finding the best match between an alternative strategy and structure can provide a critical access point for individual investors to reap the same investment benefits afforded for years to institutional investors.”**

### **A strategic union: liquid alternative mutual funds**

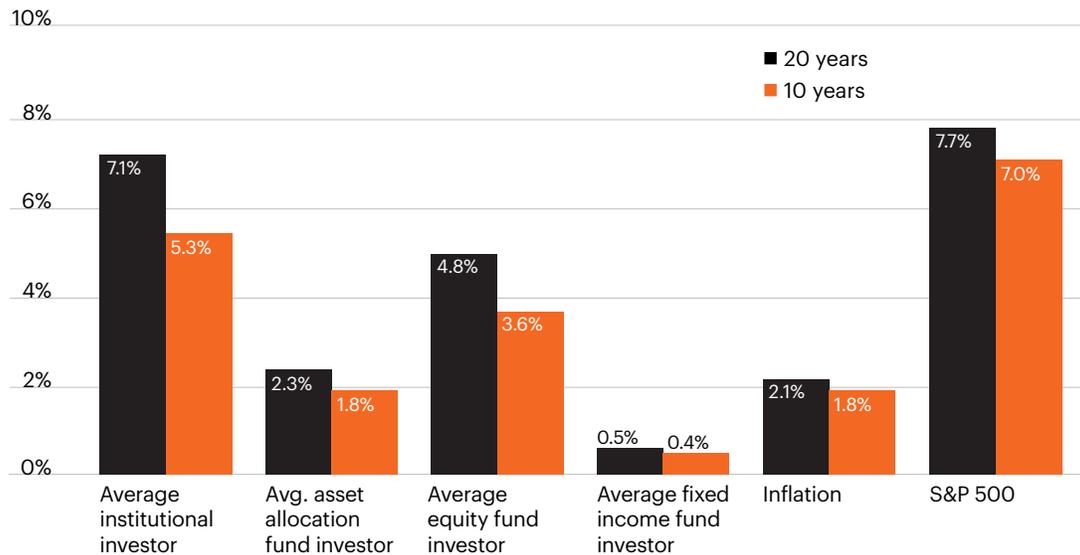
Alternatives are investments in assets other than stocks, bonds and cash, or investment strategies that differ from long-only investing. In the last 20 years, institutional investors have increased their allocation to alternatives to help diversify their portfolios, manage risk and generate differentiated returns. Individual investors' access to alternatives has historically been more limited.

### INCREASING ALTERNATIVE ALLOCATIONS AMONG INSTITUTIONAL INVESTORS



Source: Wilshire TUCS® data for public plans over \$1 billion allocations to investments over one percent.

### 10-YEAR AND 20-YEAR ANNUALIZED RETURNS FOR AVERAGE AND INSTITUTIONAL INVESTORS



Source: DALBAR and Wilshire TUCS®. Average equity fund investor, average fixed income fund investor, asset allocation fund investor and inflation data from the DALBAR report, based on data supplied by the Investment Company Institute, as of 11/30/16. Average institutional investor data from Wilshire TUCS® is represented by the median total returns of master trusts—all plans, as of 12/31/16.

What are some of the barriers that have traditionally limited individual investors' ability to access and benefit from these strategies? In short, there are number of structural limitations inherent in hedge funds/private funds, including regulatory requirements, high investment minimums, long lock-up periods and a lack of transparency. However, many of these challenges can be overcome by matching alternative strategies with a fund structure familiar to most investors.

Mutual funds are time-tested vehicles for investors seeking access to a broad range of asset classes. Today, there's over \$50 trillion in mutual fund assets held by investors worldwide, 51% in the Americas, 36% in Europe and 13% in Africa and the Asia-Pacific region.<sup>1</sup> For decades, mutual funds have provided investors access to traditional investments, namely stocks and bonds. Liquid alternative mutual funds have emerged as a way to provide individual investors access to alternative strategies they may not have been able to utilize in the past.

Investing in liquid alternatives provides individuals access to a wide range of asset classes and strategies, each with their own unique benefits and risks. Institutions have historically used hedge funds, which may offer a greater return, to access alternative investments. By comparison, mutual funds are available to the public and can potentially have lower fees, lower investment minimums and regulatory safeguards, including higher transparency and limitations on illiquid investments. Mutual funds may also offer investors the ability to diversify by spreading the risk of investing across different types of assets, including stocks, bonds and cash. Diversification does not ensure profitable returns or protection against loss, as a mutual fund's performance relies heavily on market conditions, the expertise of the manager and the strategy they implement. Alternative mutual funds may have higher expenses than their traditional mutual fund peers and other investment structures.<sup>2</sup>

## **“Finding the best fit between strategy and structure is important to help ensure individual investors gain their desired exposure.”**

### **A guide for finding the right match**

Deciding which lightning deal to order on Amazon or what classic TV show to binge-watch on Netflix requires little deliberation. The stakes are much higher when it comes to choosing investments. Finding the best fit between strategy and structure is important to help ensure individual investors gain their desired exposure. The following considerations can help equip investors to identify a strong strategy-structure match:

- **Investor objectives:** A critical match must be made between the investor's objectives, the alternative strategy and the characteristics of the mutual fund structure. Regarding the strategy, is the investor seeking inflation protection, absolute returns, downside protection, income stabilization, returns enhancement or some other investment objective? In terms of structure, can the investor withstand longer periods without access to the funds or must they be available for possible short-term needs?
- **Strategy liquidity:** While some alternative strategies lend themselves to more-liquid holdings, others, like distressed debt, do not. Widespread perception is that traditional hedge funds are illiquid due to less-liquid portfolio holdings. However, in practice, their illiquidity often stems from the limits that managers have placed on the frequency of investor redemptions—typically quarterly. Investors must evaluate whether the liquidity of the structure is aligned with the liquidity of the underlying strategy to determine the suitability of an alternative mutual fund.

- **Manager quality:** Another element of the match is manager quality. What is their area of expertise and professional pedigree? Have they run the strategy with a long, successful track record with daily liquidity? Does the manager have sufficient experience, infrastructure, personnel and bandwidth to successfully implement the strategy?
- **Fees and expenses:** Mutual funds, like all other investment vehicles, exhibit a wide dispersion of fees and expenses among providers and funds. Investors should evaluate a fund’s management fees, gross/net expense ratios and other expenses associated with the investment. Many alternative mutual funds enable individual investors to gain access to alternative strategies in a liquid, transparent vehicle with generally lower costs than many institutional investment vehicles like hedge funds, which are often characterized by higher management fees plus incentive fees.<sup>2</sup>

Finding the best match between an alternative strategy and structure can provide a critical access point for individual investors to reap the same investment benefits afforded for years to institutional investors. Just as Amazon and Netflix transformed shopping and media consumption by providing consumers game-changing access, the combination of alternatives and mutual funds lays the foundation for continued innovation in investment management for the broader investing public.



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Greg serves as Managing Director and Head of Liquid Alternative Strategies, overseeing the development and management of the firm’s liquid alternatives platform. As a pioneer and thought leader in this space, he looks to the future of investing trends with a focus on creating access to alternative strategies that can help investors design better, more diversified portfolios. Greg has been recognized for leadership and innovation in financial services and asset management and has been honored for his longtime civic work. He continues to give back to the community through board service and leadership at several local and national civic organizations.

1 The Investment Company Institute (ICI), Worldwide Regulated Open-End Fund Assets and Flows, December 2017.  
 2 SEC, [https://www.sec.gov/oiea/investor-alerts-bulletins/ib\\_altmutualfunds.html](https://www.sec.gov/oiea/investor-alerts-bulletins/ib_altmutualfunds.html).

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