



Investment Insight

Friday, 16 January 2015

What's the alternative? So called "alternatives" are increasingly being prescribed as the panacea for investors seeking diversification. However, in reality "alternatives" is really just a convenient descriptor for anything that isn't linked to equity or bond indices. In other words, it can mean vastly different things to different people.

Combining a variety of carefully chosen alternatives can provide a different source of returns than those generated by more traditional investments and should improve the risk characteristics of a portfolio, especially in more volatile markets. However, as not all alternatives are born equal, and because they are often inherently more complex than "conventional" investments, most investors should seek professional advice before signing up for a quotient of alternatives. To illustrate the point, in **The Inside Track** this week we consider the contrasting fortunes in 2014 of some common "alternatives".

A load of bulls: Bloomberg compiles data from Wall Street strategists about their expectations for the performance of the S&P 500 each year. This time last year a 6.8% rise was predicted and this figure gradually rose as the year progressed. Ultimately, the outcome was an 11.4% rise.

It would seem, therefore, that the predictive powers of the strategists are not all that reliable. However, what the forecasts do demonstrate is the level of optimism among strategists which, in itself, can contribute to performance. In **Pic of the Week** we take a look at current forecasts for 2015.

The Inside Track

"Alternatives" is not an asset class. As an investment strategy or categorisation it is probably best described as those investments whose returns tend to have a low correlation with the returns of traditional asset classes. However, this is a very broad descriptor, and returns from "alternative strategies" can vary vastly. Using definitions and data Hedge Fund Research (HFR), the following are a few examples that help to illustrate the point.

Event Driven strategies involve taking positions in companies currently or prospectively involved in corporate transactions such as mergers, restructurings, financial distress, capital structure adjustments, etc. Event Driven exposure includes a combination of sensitivities to equity markets, credit markets and idiosyncratic, company specific developments. Investment theses are typically predicated on fundamental characteristics (as opposed to quantitative), with the realisation of the thesis based on a specific development exogenous to the existing capital structure. **2014 performance: -4.1%**

Managed Futures strategies use the global futures and options markets to implement quantitative investment strategies. Decisions are often guided by models developed from scientific research and mathematical analysis. A managed futures fund often seeks to identify trends in asset classes and invest accordingly seeking to benefit from rising or falling prices. **2014 performance: +15.7%**

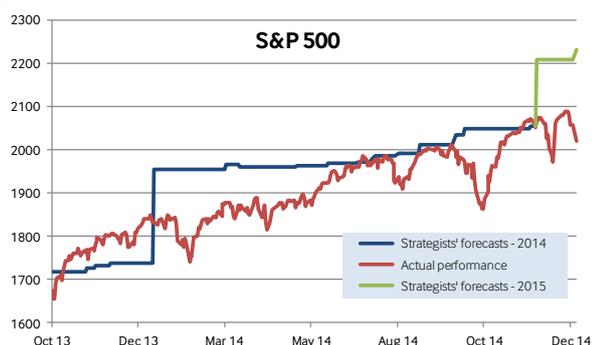
CTA strategies trade a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed income, hard currency and commodity markets. Managers employ a variety of techniques, both discretionary and systematic analysis, combinations of top down and bottom up theses, quantitative and fundamental approaches and long and short term holding periods. The overriding investment thesis is driven by the impact movements in underlying macroeconomic variables may have on security prices. **2014 performance: +5.3%**

Equity Market Neutral strategies are constructed to be neutral to one or multiple variables, such as broader equity markets, and leverage is frequently employed to enhance the return profile of the positions identified. Equity Market Neutral Strategies typically maintain net equity market exposure no greater than 10% long or short. **2014 performance: +3.6%**

Convertible arbitrage strategies are predicated on the realisation of a spread between related instruments. They try to isolate attractive opportunities between the price of a convertible security and the price of a nonconvertible security, typically of the same issuer. Convertible arbitrage positions maintain sensitivities to credit quality, the issuer, implied and realised volatility of the underlying instruments, levels of interest rates and the valuation of the issuer's equity, among other more general market and idiosyncratic sensitivities. **2014 performance: -9.4%**

Pic of the Week

This week's chart shows how 2014 forecasts by Investment Strategists were consistently revised upwards during the year, ending up at nearly double the level they started. While their forecasting ability is debatable, what the data demonstrates is strategists' level of bullishness or bearishness, which can sometimes become a self-fulfilling prophesy. For 2015, they are currently forecasting an 8% rise in the S&P500, a lower return than 2014 but higher than was predicted at the outset of 2014. So, with the market down over 2% year-to-date at this early stage, the bulls have some catching up to do.



Market View

	Last 7 days	YTD	5Y Ann.
Global equities	-2.1%	-2.1%	+7.3%
US equities	-3.4%	-3.2%	+11.9%
European equities	+1.7%	+1.7%	+5.9%
Emerging market equities	-0.1%	+0.4%	-1.0%
Irish equities	+2.3%	+0.7%	+11.2%
Commodities	-1.8%	-2.5%	-5.9%
Hedge funds	+0.1%	-0.5%	+0.7%

Economic indicators	Bond yields	Inflation	GDP YoY
Ireland	+1.3%	-0.3%	+3.5%
Germany	+0.5%	+0.2%	+1.2%
USA	+1.7%	+1.3%	+2.7%
China	+3.5%	+1.5%	+7.3%
Currencies	Current	YTD Δ	
EUR:USD	1.16	-3.8%	
EUR:GBP	0.77	-1.2%	
EUR:CNY	7.23	-4.2%	
GBP:USD	1.52	-2.6%	
Bitcoin	216.86	-31.7%	

Week ahead: Key events

19/01 UK House Prices
19/01 EU Current Account
20/01 China GDP & Industrial Production
20/01 EU ZEW Expectations
21/01 Japan All Industry Activity Index
21/01 UK Jobless Claims & US Housing Starts
22/01 US Initial Jobless Claims
23/01 EU Manufacturing & Services PMIs
23/01 UK Retail Sales
23/01 US Existing Home Sales & Leading Index

Commodities	<i>Current</i>	<i>YTD Δ</i>
Gold	1,259.68	+6.3%
Copper	5,681.00	-10.8%
Oil	48.34	-17.0%
Wheat	535.50	-9.2%

Central Bank rates	<i>Current</i>
Eurozone	0.05%
USA	0.25%
UK	0.50%

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