CIBC
Asset Management

GUIDE TO PORTFOLIO CONSTRUCTION

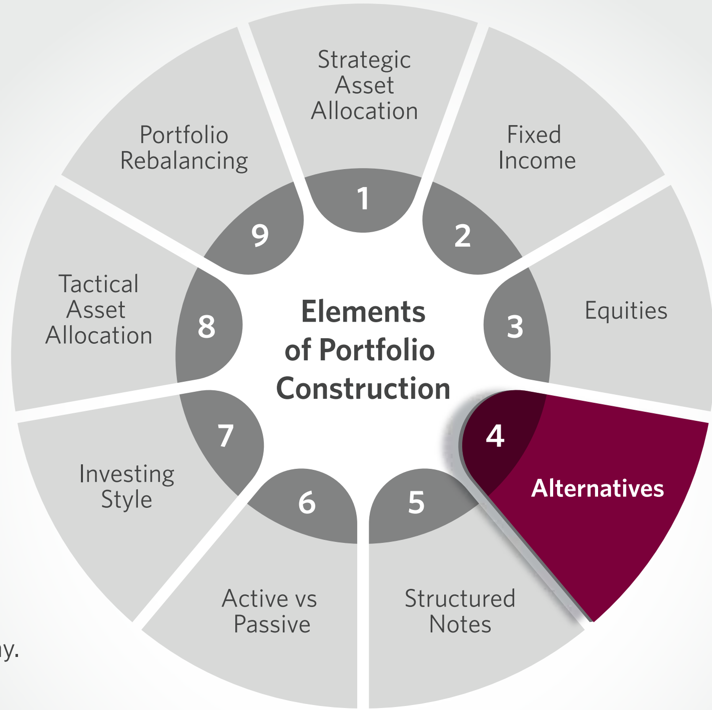
The role of alternative investments

Guide to portfolio construction

Market and economic uncertainty, combined with relatively low expected returns for many asset classes, are making it harder for individuals and institutions to reach their financial goals. A thoughtfully designed portfolio that helps you embrace market opportunities while preparing for the unexpected has never been more important.

There are several components of a well-constructed portfolio, including a robust strategic asset allocation that's consistent with your long-term goals and objectives. A mix of asset classes such as equities, fixed income and alternatives, and strategies such as tactical asset allocation, active versus passive investing, and portfolio rebalancing all have a role to play.

This guide highlights how alternative investments can help improve portfolio performance and smooth the path to achieving your ambitions.



Alternatives—Assets and strategies to take you beyond traditional investments

Investors in traditional assets such as equities and bonds face two important challenges—relatively low expected returns and concentrated portfolio risks. One potential way to alleviate the impact of these challenges is to include alternative investments within a portfolio.

Explore this guide to learn more about alternatives

- What are alternative investments?
- Expected benefits of investing in alternatives
  - Increased portfolio diversification
  - Enhanced expected long-term returns
  - Downside protection

What are alternative investments?

Alongside traditional assets such as equities and bonds, alternatives represent an important component in the search for portfolio balance. The descriptor 'alternatives' encompasses a broad range of asset classes and strategies, as well as distinct risks, and sources of diversification, income, and expected return. In the past, alternative investments were mainly a tool for institutional and accredited investors—they are now increasingly available to a wider range of investors.

Alternative assets

- Assets that can't be classified as one of the conventional investment types such as equities, bonds and cash
- Returns of these alternative assets are often uncorrelated or less correlated with traditional assets

Liquid assets
- Currencies
- Commodities

Illiquid assets
- Real estate
- Infrastructure

Alternative strategies

- Investment vehicles structured to hold a wide range of financial assets—both traditional and non-traditional—that are managed using non-conventional methods (e.g. short selling)

Liquid assets
- Multi-strategy / absolute return
- Global macro
- Event-driven strategies
- Unconstrained bond strategies
- Equity market-neutral
- Long/short equity

Illiquid strategies
- Private equity
- Private debt

Source: CIBC Asset Management

Expected benefits of alternatives

Alternative investments can provide a number of benefits, including:

- Increased portfolio diversification
- Enhanced expected long-term returns
- Downside protection

Each alternative asset class and strategy offers a unique combination of these attributes (Figure 1). By providing additional diversification, alternatives can also improve the ability of investor portfolios to perform well under many different market conditions (Figure 2).

Figure 1 – Potential benefits of alternatives

Illiquid assets

For example: real estate, private debt and infrastructure

- Smoothed returns that can help investors stay invested and look through short-term volatility in public markets
- Stable and predictable income streams, and enhanced expected returns
- A hedge against the risk of a return to higher inflation

Illiquid strategies

For example: private equity and hedge funds

- Smoothed returns that can help investors stay invested and look through short-term volatility in public markets
- Diversification: hedge funds, for example, can exploit a wide variety of strategies from both the long and short sides
- Enhanced expected returns: illiquidity may be associated with a return premium, relative to public securities

Liquid strategies

For example: active currency, emerging local debt and multi-strategy

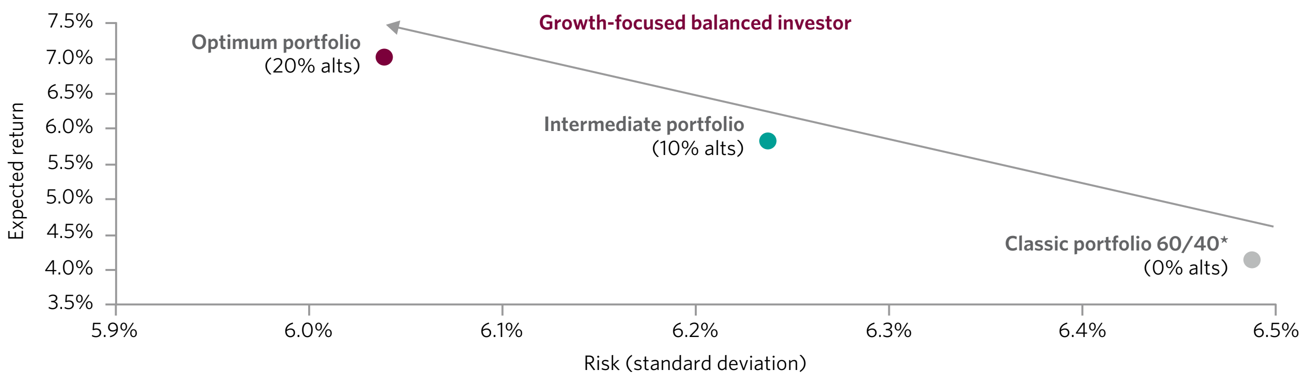
- Enhanced, diversifying expected returns, liquidity, transparency, low fees
- Can help protect portfolios during periods of equity market stress
- Equity substitute: diversify growth risk, tail-risk protection
- Complement allocation to illiquid alternatives

Source: CIBC Asset Management

Increased portfolio diversification

It's important to choose the right alternative investments—they're not all alike. Different alternatives can be evaluated within an investor's broader portfolio by considering risk tolerance, capital growth and income objectives. Investors should determine how an allocation to a specific alternative, or group of alternatives, would contribute to achieving these objectives.

Figure 2 – Allocating to alternatives can boost the performance of traditional portfolios



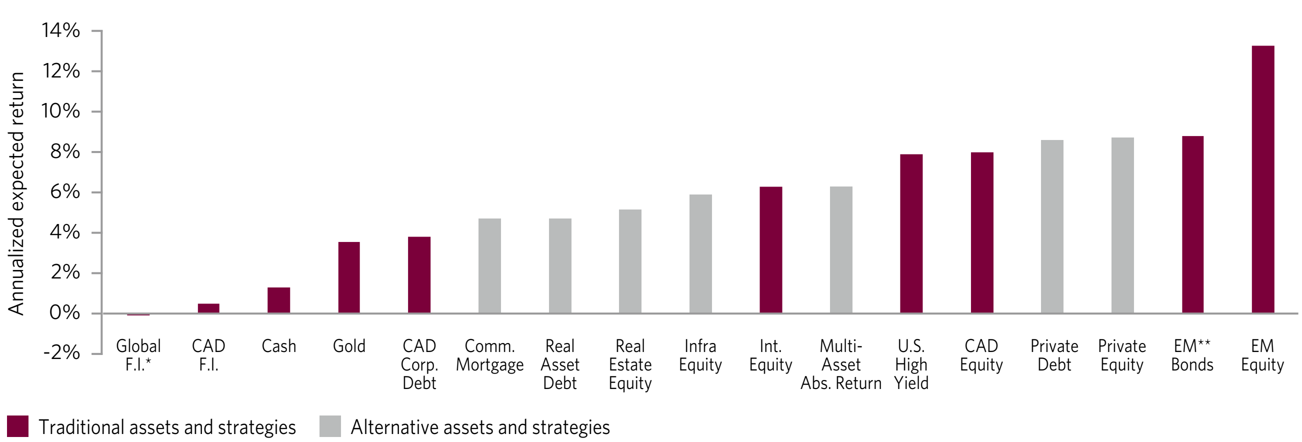
Source: CIBC Asset Management calculations, Bloomberg. Illustrative example. Data as at August 2020. *Classic portfolio allocates 60% to equities and 40% to bonds.

Enhanced expected long-term returns

Alternative asset classes and strategies can act as both substitutes and complements to public market securities, depending on the investor's current allocations. The expected long-term (10-year) returns are also relatively attractive compared to traditional assets and strategies (Figure 3). For example:

- **Private equity.** This illiquid alternative strategy provides exposure to similar risks and cash flows as public securities but may also enhance expected returns, albeit with reduced portfolio liquidity.
- **Real estate and infrastructure.** These alternative assets also exhibit a relatively high correlation to public equities but offer exposure to relatively stable income-producing assets and better protection against any future risk of rising inflation.

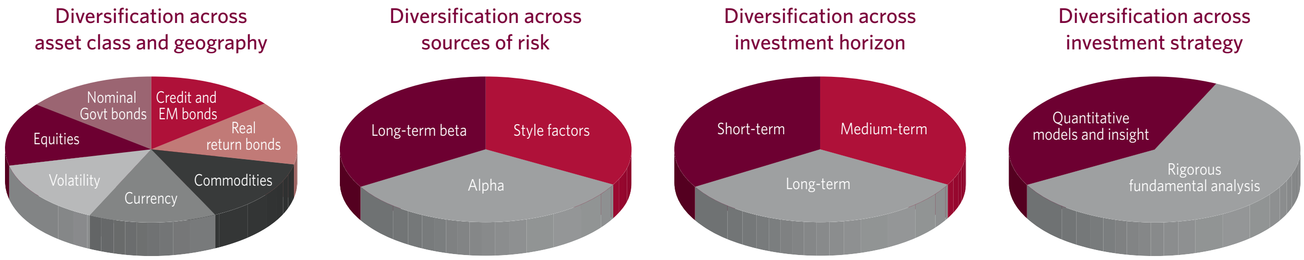
Figure 3 – Alternative vs traditional expected long-term (10-year) returns



Source: CIBC Asset Management. Data as at March 31, 2020. *F.I. = Fixed Income. **EM = Emerging Market.

- **Liquid Multi-Asset Absolute Return strategies.** In some cases, alternatives complement traditional investments by providing access to additional sources of diversified returns. A concentration on economic growth can be problematic during periods of economic recession when equity markets, particularly, can experience deep capital losses. Liquid alternatives shift risk away from a narrow concentration on economic growth to a broader, more diversified set of risks and opportunities.

Figure 4 – Multi-Asset Absolute Return strategies embrace a broad investment universe and many layers of diversification



Source: CIBC Asset Management. Illustrative example.

Key alternative investment considerations:

Adding a mix of complementary liquid and illiquid alternatives to an existing portfolio of traditional equities and bonds can be an effective strategy for suitable investors. It can help achieve a well-balanced portfolio and offer enhanced expected returns, attractive income streams, appropriate diversification, and adequate liquidity consistent with an investor's particular goals and needs.

Let's partner on your portfolio construction

Changing market conditions don't change your goals, whether it's saving for a home, a child's education or investing for retirement. Careful portfolio construction that helps you embrace market opportunities while preparing for the unexpected has never been more important.

Your CIBC advisor can help you develop a targeted investment approach using the multi-asset solutions that work best for you.

Contact us today to tailor your portfolio and help you get where you want to be.

To learn more, contact your CIBC advisor.

1125 / E11/2020