

A primer on liquid alternatives



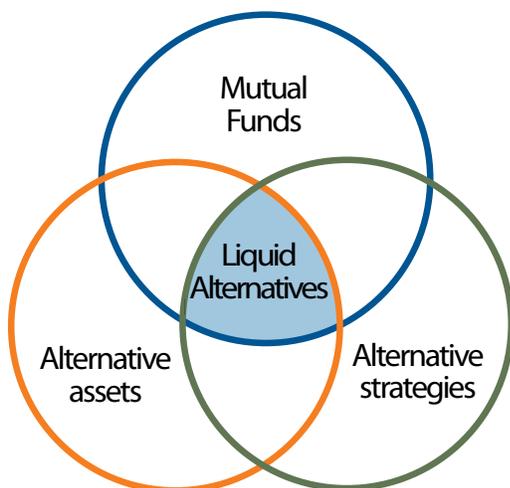
Canadian investors face greater challenges now than ever. Equity market volatility and low fixed-income yields mean investors have to take on greater risk for potentially lower rates of return. Add in longevity trends and reduced pension coverage, and it becomes clear that traditional investment portfolios need to evolve.

Owing to regulatory changes, individuals are permitted to access alternative investment strategies that are commonly utilized by large institutional investors such as the Canada Pension Plan Investment Board (CPPIB). Known as “liquid alternatives”, these types of investment funds can provide retail investors with greater diversification, downside protection and additional sources of income.

What are liquid alternatives?

Liquid alternative funds typically invest in non-traditional asset classes and/or use alternative strategies that were once the exclusive domain of hedge funds and institutional investors. They may offer the opportunity for improved returns across a range of economic and market environments, while providing new ways to manage risk.

- **Alternative asset classes** include examples such as infrastructure, real estate, commodities, private equity, currencies and non-traditional fixed income such as structured credit
- **Alternative strategies** include examples such as short-selling, leverage and derivatives



Liquid alternatives can be accessed like a mutual fund, offer the diversification benefits of alternative assets, and the investment capabilities of alternative strategies.

The benefits



DIVERSIFICATION

Alternative asset classes have historically had low correlation to traditional stocks and bonds so they can help smooth out returns



DOWNSIDE PROTECTION

Alternative assets often have less volatility than equities, and real assets have an intrinsic value that allows them to rise in value with inflation



INCOME

Opportunities in structured credit, infrastructure and real estate markets represent income alternatives

The risks

USE OF ALTERNATIVE ASSETS

Real assets such as infrastructure and real estate have greater exposure to adverse economic, financial, regulatory, and political risks. Other alternative assets may be exposed to greater liquidity or operational risks than traditional securities.

USE OF ALTERNATIVE STRATEGIES:

Short selling exposes the fund to the possibility the share price may increase rather than decline, or the fund may have problems purchasing or returning borrowed securities.

Leverage includes total cash borrowing, physical short sales, and the use of derivatives*. These strategies can magnify gains and losses.

LIMITED TRACK RECORD

As liquid alternative funds are relatively new to Canada, there is limited historical performance.

*Risk of derivatives include a fall in the value of the underlying assets

Why now?



Retirement

One in every five people of working age (15-64) in Canada was between 55 and 64 in 2016. By the middle of this decade, nearly five million people will be nearing or entering retirement.¹



Financial Security

In 2019, only 37% of Canadian employees were covered by a pension plan.²



Longevity

Canadians turning 65 today can expect to live until age 86.³

Differences between traditional mutual funds, liquid alternative funds and hedge funds.

	TRADITIONAL MUTUAL FUNDS	LIQUID ALTERNATIVE FUNDS	HEDGE FUNDS
Offering document	Simplified Prospectus	Simplified Prospectus	Offering Memorandum
Liquidity	Daily	Daily	Varied redemption periods
Short-selling	20% of Net Asset Value (NAV) in total, single issuer limited to 5% of NAV. Cash cover 150%.	50% of NAV in total, single issuer limited to 10% of NAV. No cash cover.	
Borrowing	5% of NAV. (As temporary measure)	50% of NAV, provided lender is qualified custodian or sub-custodian.	Varies by individual fund
Leverage (gross aggregate exposure)	None	300% of NAV	
Concentration in one issuer	10% of NAV	20% of NAV	

Total cash borrowing and short-selling must be less than 50% of NAV

1-Statistics Canada 2016 census.

2-Statistics Canada. Pension Plans in Canada Survey as of January 1, 2020; <https://www150.statcan.gc.ca/n1/daily-quotidien/210629/dq210629c-eng.htm>

3-Statistics Canada. Life expectancy and other elements of the life table 2019

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