

# A primer on liquid alternatives



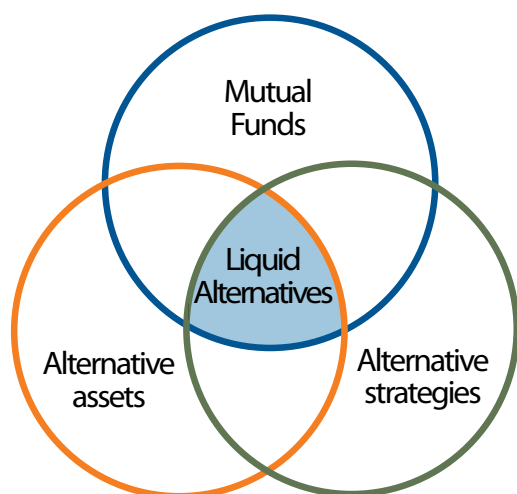
Canadian investors face greater challenges now than ever. Equity market volatility and low fixed-income yields mean investors have to take on greater risk for potentially lower rates of return. Add in longevity trends and reduced pension coverage, and it becomes clear that traditional investment portfolios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

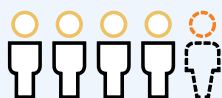
Leverage includes total cash borrowing, physical short sales, and the use of derivatives\*. These strategies can magnify gains and losses.

### LIMITED TRACK RECORD

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

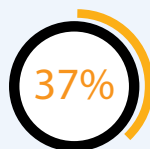
\*Risk of derivatives include a fall in the value of the underlying assets

## 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.<sup>1</sup>



### Financial Security

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



### Longevity

Canadians turning 65 today can expect to live until age 86.<sup>3</sup>

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

	TRADITIONAL MUTUAL FUNDS	LIQUID ALTERNATIVE FUNDS	HEDGE FUNDS
<b>Offering document</b>	Simplified Prospectus	Simplified Prospectus	Offering Memorandum
<b>Liquidity</b>	Daily	Daily	Varied redemption periods
<b>Short-selling</b>	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.	
<b>Borrowing</b>	5% of NAV. (As temporary measure)	50% of NAV, provided lender is qualified custodian or sub-custodian.	Varies by individual fund
<b>Leverage (gross aggregate exposure)</b>	None	300% of NAV	
<b>Concentration in one issuer</b>	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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Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

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Alternative mutual funds are offered under the new National Instrument 81-102 Investment fund ("NI 81-102") rules. As such, some of the rules applicable to alternative mutual funds differ from conventional mutual funds, however, except to the extent they are given special treatment under NI 81-102, alternative mutual funds otherwise must follow the same rules as conventional mutual funds.

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