



A Primer on Alternative Investments

June 13, 2023

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Section 1: What are Alternative Investments?

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What are alternative investments?

- An alternative investment is an asset that is not one of the conventional investment types, such as stocks, bonds, and cash.
- “Non-traditional”
- Assets and investment strategies that are not typically utilized in the traditional investment portfolios (e.g., 60/40 portfolio, etc.)

What are alternative investments?

- Most alternative investment assets are held by institutional investors or accredited, high-net worth individuals because of the complex nature and limited regulation of the investments.
- Top institutional categories:
 - **Private Equity** – includes Buyouts, Venture Capital, Secondaries, etc.
 - **Private Credit** – includes Direct Lending, etc.
 - **Hedge Funds** – includes long-short equity, event driven, arbitrage, and managed futures, etc.
 - **Real Assets** – includes private real estates, etc.

Alternatives tend to have different attributes to typical stock and bond investments from a risk return and time horizon perspective, so adding them to a portfolio may provide broader diversification, reduce risk, and enhance returns.



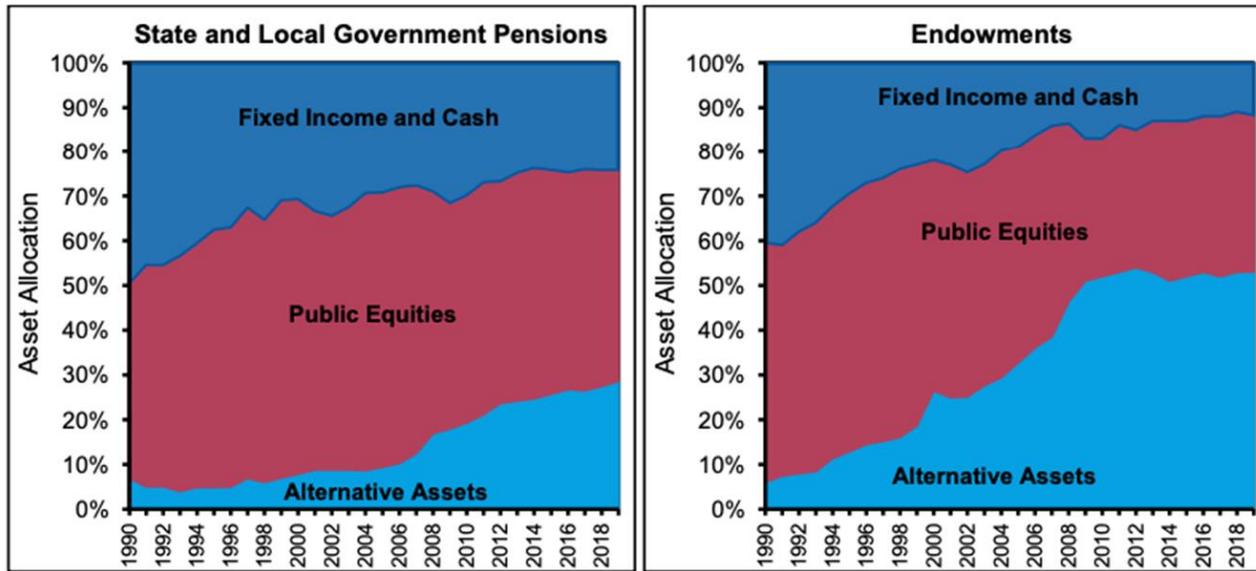
Section 2: History of Alternative Investments

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History of Alternative Investments

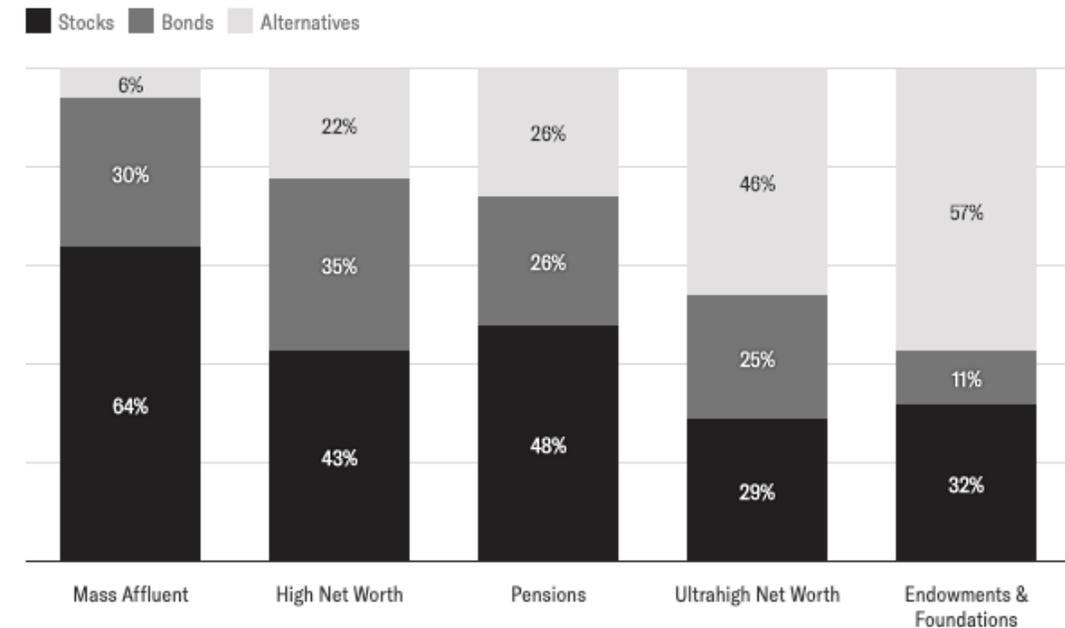
- The use of Alternative Investments is nothing new, particularly among the more sophisticated institutional and ultra high net worth investors.



Source: Public Plans Database; Ronald J. Ryan and Frank J. Fabozzi, "The Pension Crisis Revealed," Journal of Investing, Fall 2003, 43-48; National Association of College and University Business Officers (NACUBO); and "Stephen G. Dimmock, Neng Wang, and Jinqiang, Yang, "The Endowment Model and Modern Portfolio Theory," Working Paper, April 23, 2018.

Note: Asset-weighted.

Where Investors Put Their Money



Source: Personal Capital; KKR; Pew Charitable Trusts; Nacubo.

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History of Alternative Investments

- The “Yale Endowment Model” helped pioneer alternative investing - In 1990, Yale became the first institutional investor and university endowment to define “absolute return” strategies (hedge funds) as a distinct asset class. Specifically, the Yale Model favor heavy exposure to the less liquid, alternative asset classes for **return enhancement and diversification.**

Asset allocation

Yale continues to maintain a well-diversified, equity-oriented portfolio, with the following asset allocation targets for fiscal year 2021:

ABSOLUTE RETURN	23.5%
VENTURE CAPITAL	23.5%
LEVERAGED BUYOUTS	17.5%
FOREIGN EQUITY	11.75%
REAL ESTATE	9.5%
BONDS AND CASH	7.5%
NATURAL RESOURCES	4.5%
DOMESTIC EQUITY	2.25%



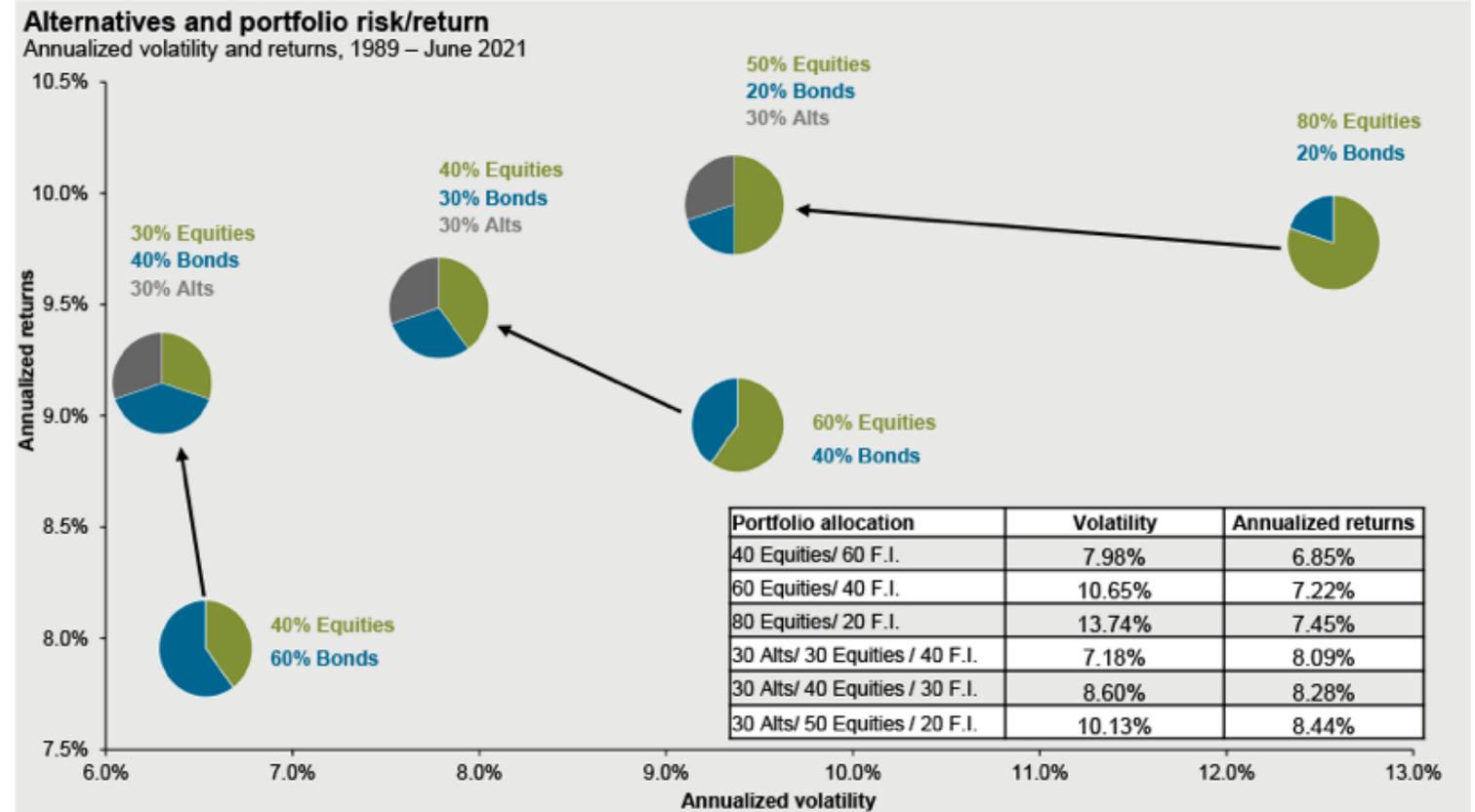
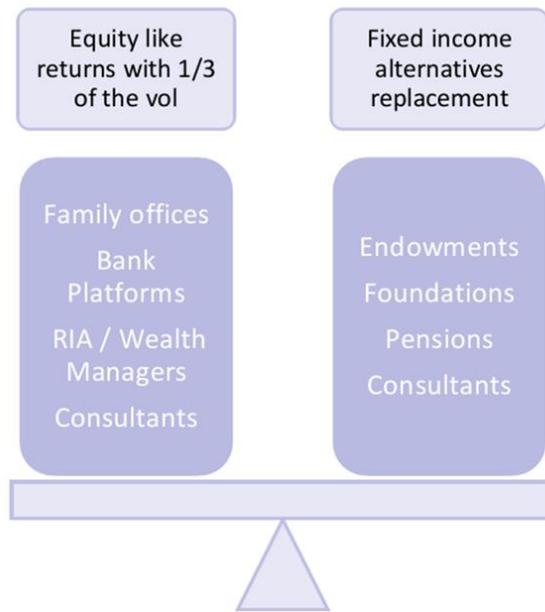
Section 3: Benefits of Alternative Investments

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Why alternatives?

- A primary goal of investing in alternatives is to produce better risk-adjusted return



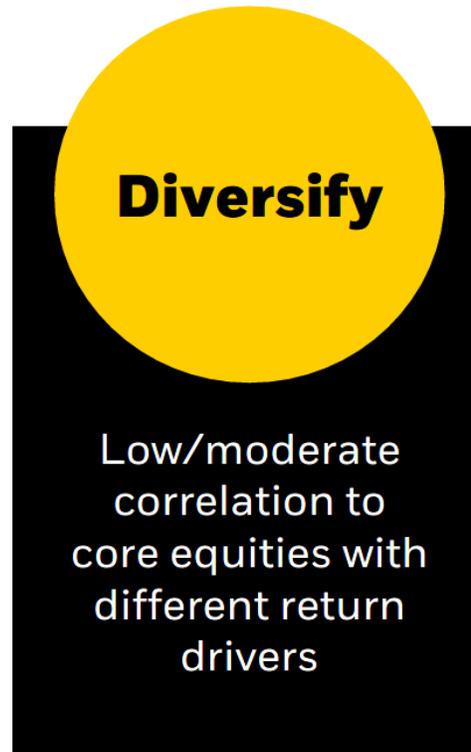
Source: Bloomberg, Burgiss, HRFI, NCREIF, Standard & Poor's, FactSet, J.P. Morgan Asset Management. Alts include hedge funds, real estate, and private equity, with each receiving an equal weight. Portfolios are rebalanced at the start of the year. Data is based on availability as of November 30, 2021.

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Why alternatives?

- Superior risk-adjusted return is achieved through **(2) diversification** and **(2) return enhancement**

A graphic for 'Diversify' featuring a yellow circle with the word 'Diversify' in bold black text. Below the circle, the text 'Low/moderate correlation to core equities with different return drivers' is written in white on a black background.

Diversify

Low/moderate correlation to core equities with different return drivers

A graphic for 'Amplify' featuring a yellow circle with the word 'Amplify' in bold black text. Below the circle, the text 'Seek higher returns than core equities in less liquid markets' is written in white on a black background.

Amplify

Seek higher returns than core equities in less liquid markets

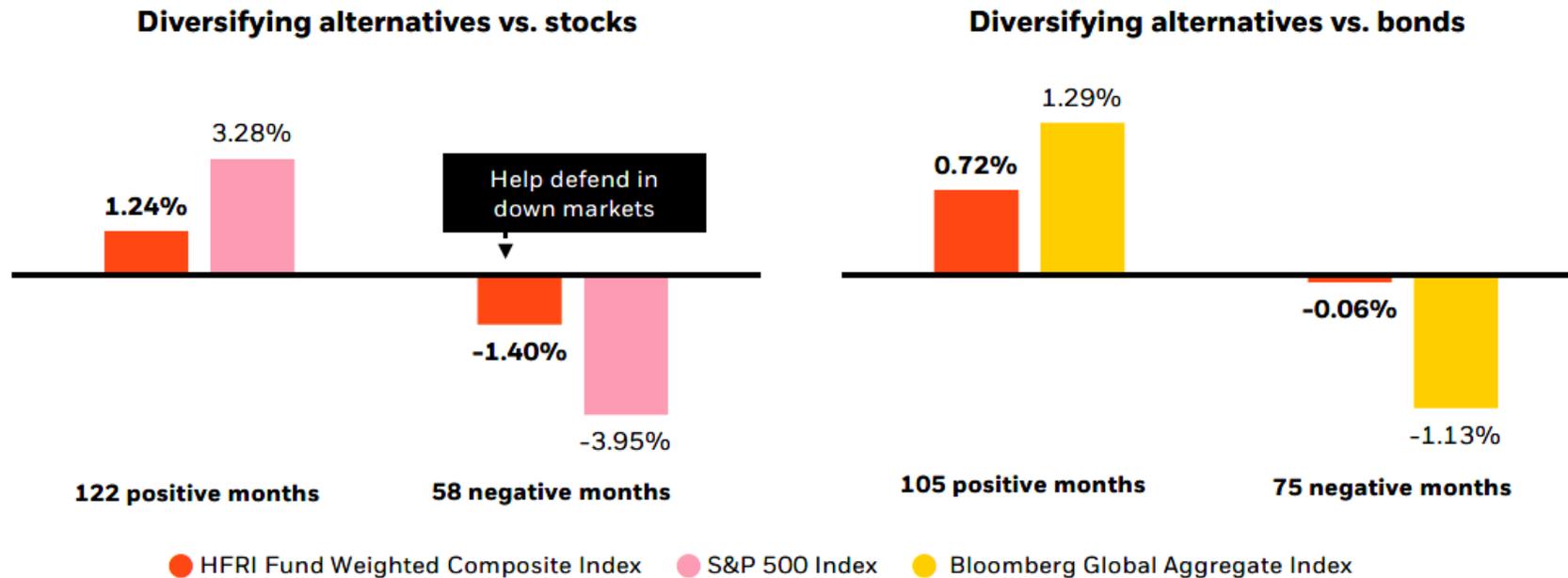
Source: BlackRock

Diversify for the long haul

- Alternative investments can provide unique exposures, different from traditional stocks and bonds, and provide the potential for persistent, less-correlated returns.

Average index returns during up/down months

15-year snapshot (January 2007 – December 2021)



Source: BlackRock

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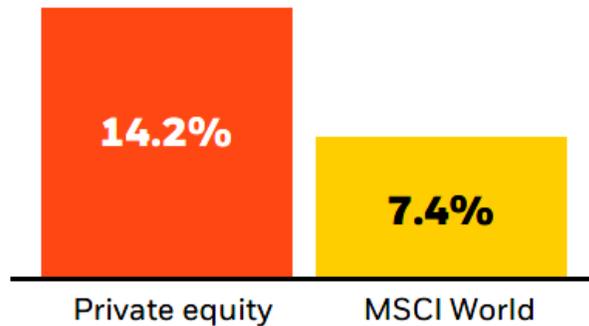
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Private markets can amplify returns

- Taking advantage of both (1) Illiquidity premium and (2) Complexity premium embedded in Private Markets

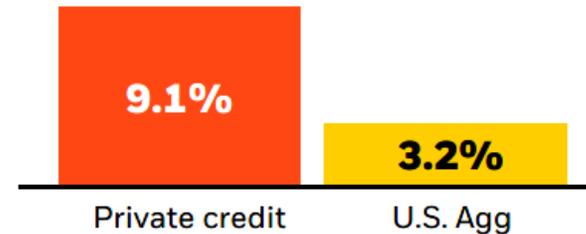
Private equity

Annualized return of private equity vs. global equities



Private credit

Annualized return of private credit vs. U.S. bonds



Source: BlackRock

Private Equity represented by Burgiss PE Index (Buyouts) for the 15-year period 9/2006 to 12/2021. Private Credit represented by the Cliffwater Direct Lending Index from 9/2015 to 12/2021

Two premiums drive the outperformance

Illiquidity premium

Expectation of higher return, in exchange for less liquidity and lower frequency of trading.

Complexity premium

Compensation associated with negotiating, structuring and underwriting private deals.

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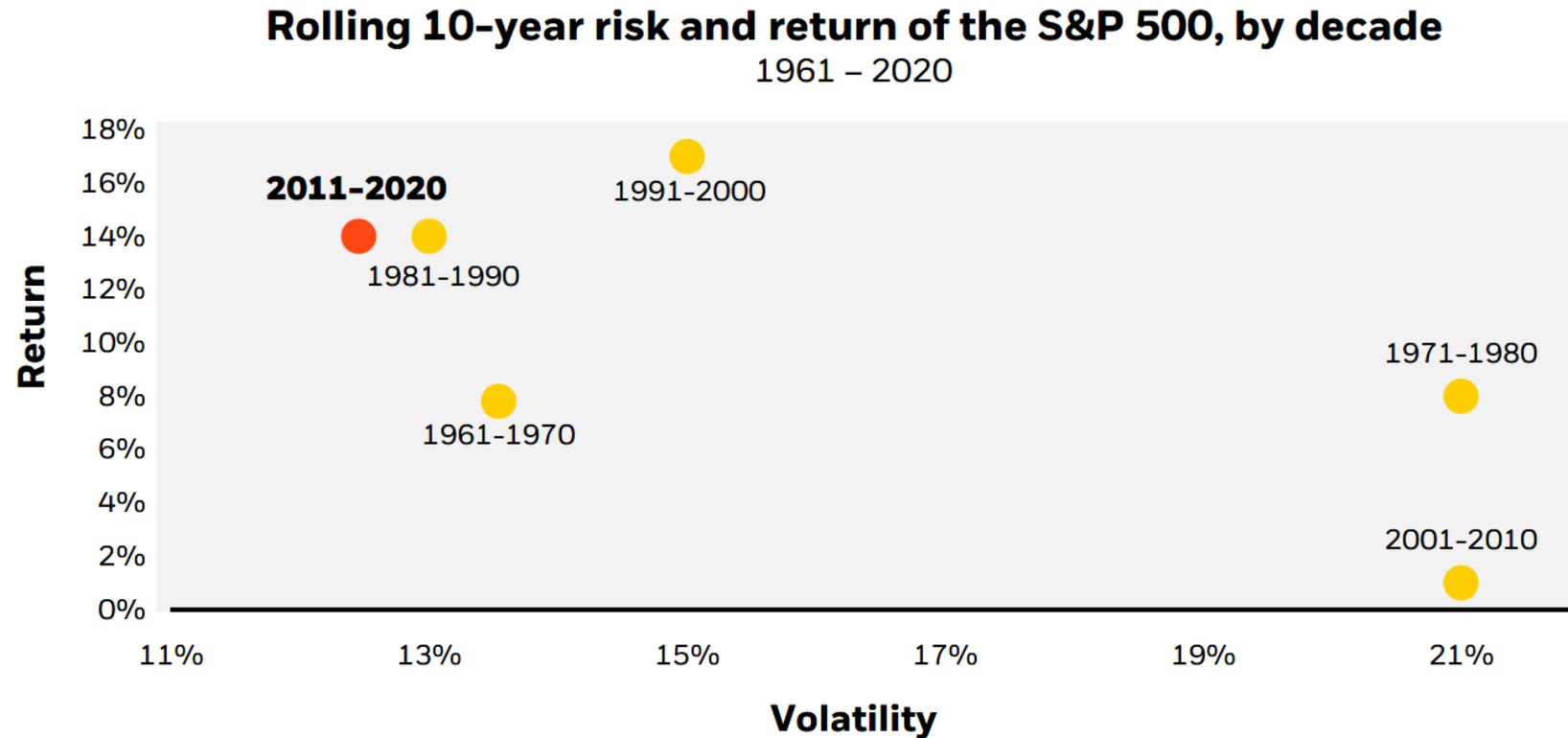
Section 4: Why alternative investments now?

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Why alternatives now?

The decade ending 2020 was an outlier for stocks – The past year/2022 was a wakeup call.



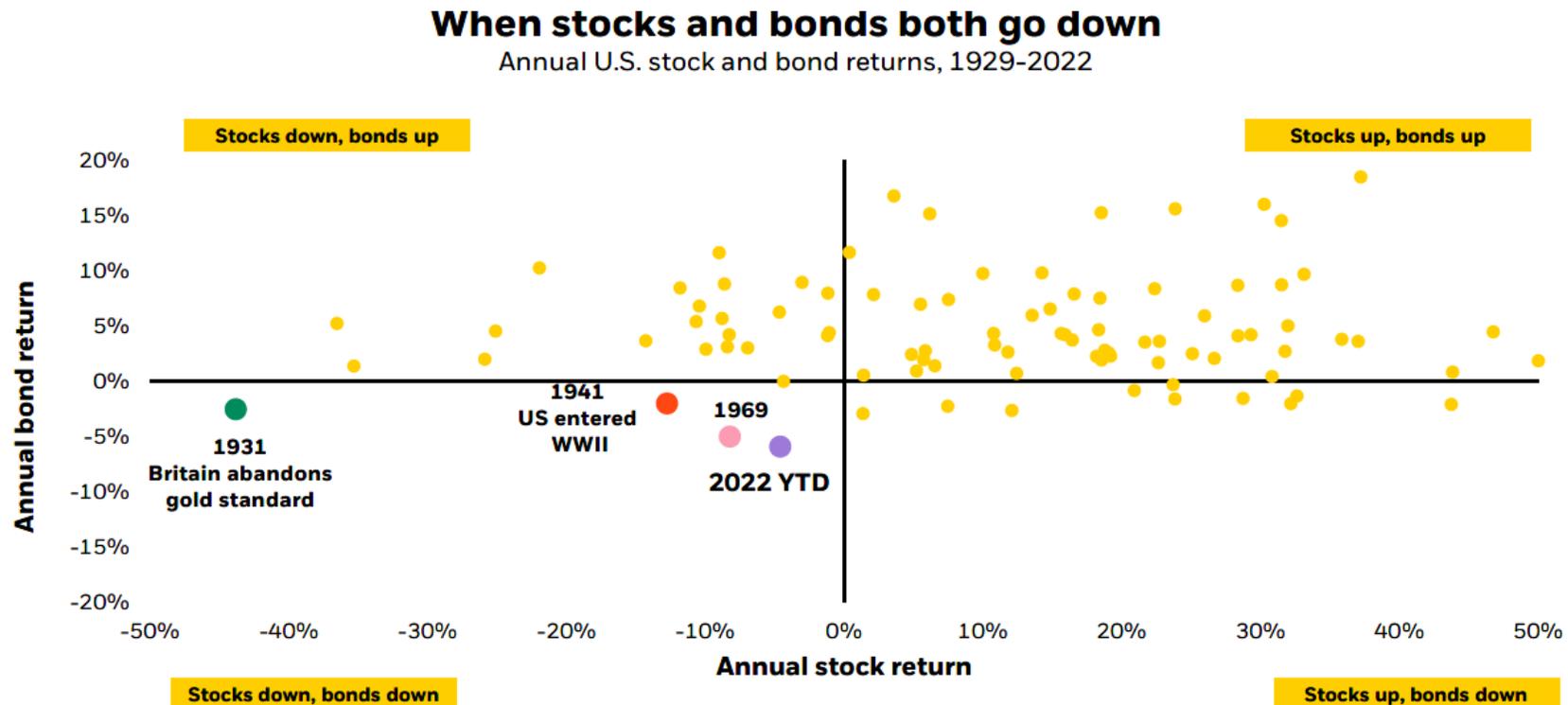
Source: BlackRock;
Bloomberg, as of
3/31/2022

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Why alternatives now?

Historically, bonds have been a reliable diversifier when stocks are falling. However, bonds have failed to serve that role in 2022 and in 2023 YTD



Past performance is not a reliable indicator of future results. Source: Bloomberg, as of March 31, 2022. Notes: The return of bonds are based on the annual return of Bloomberg U.S. Aggregate Bond Index from 1976 to 2022. Prior to 1976, the returns are based on the 10-year U.S. Treasury Bond. Stocks are represented by the S&P 500 Index from 1957 to 2022. Prior to 1957, the returns are based on the S&P Composite.

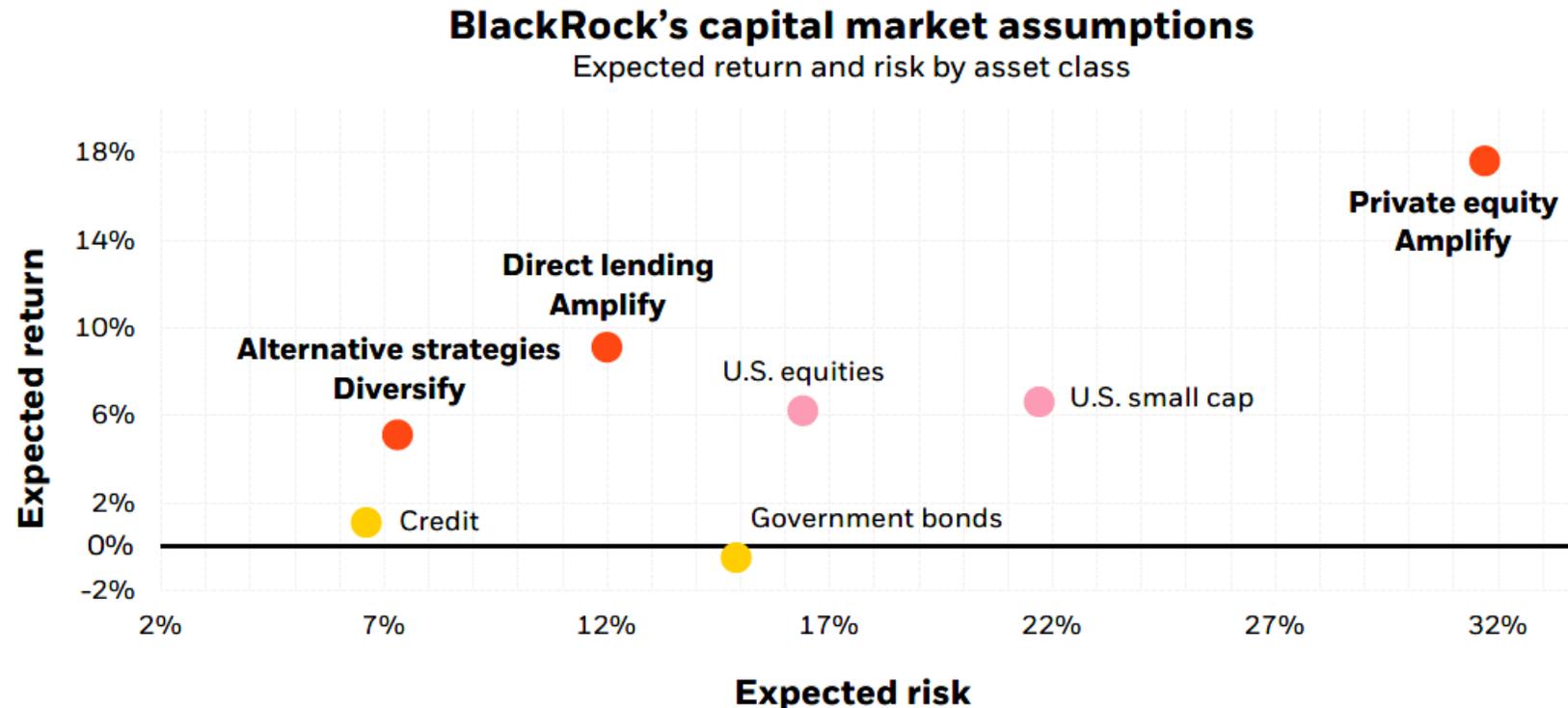
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Why alternatives now?

As returns for traditional asset classes are expected to come under pressure with greater risk, alternative investments can be used to can achieve better risk-adjusted returns.



Source: BlackRock

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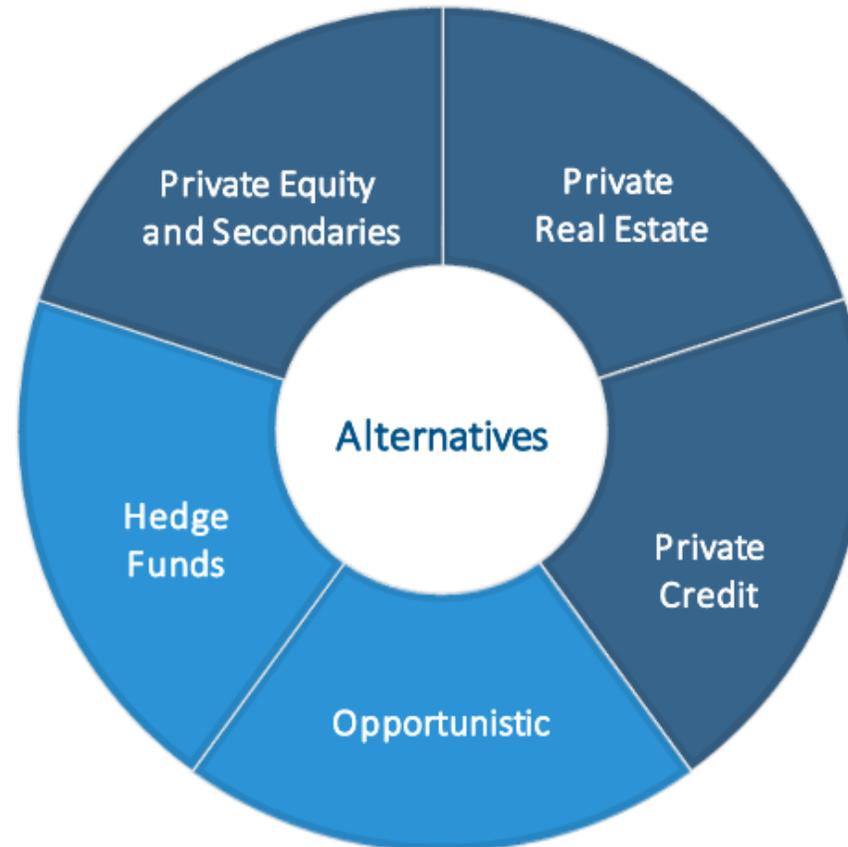


Section 5: Types of Alternative Investments

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Types of Alternative Investments:



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Types of Alternative Investments:

	Private Equity and Real Estate	Secondary Transactions	Private Credit	Hedge Funds	Opportunistic
ABOUT	Equity investments in private companies and real estate. Access through direct investments/co-investments.	Equity investments in existing portfolios of private companies with attractive early performance. Access by negotiated purchase.	Investment in loans made to private companies. Access through purchase of senior, second lien, and mezzanine offerings.	More complex investment strategies in relatively liquid assets. This may involve leverage, a more esoteric return structure, active trading, short-selling and or risk management techniques.	Specific investments with unique characteristics. Publicly available alternatives, Master Limited Partnerships. Real Estate Investment Trusts
PURPOSE IN PORTFOLIO	Enhancement of investment returns.	Enhancement of investment returns for shorter time horizons. Immediate diversification.	Downside risk mitigation, increased yield, investments for shorter duration, greater liquidity, often with floating rates.	Generally different return stream with the ability to be more market neutral than traditional equity and debt investments.	Enhancement of investment returns greater liquidity and flexibility.

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Private Equity Strategy Examples:

A buyout is generally the acquisition of an established & mature company with positive cashflows. Buyouts of such companies normally include change of control & ownership to the new owner. Buyouts can span investments in small, mid-sized or large companies.

Buyout Investment Strategy

A buyout is typically when a private equity firm comes in and take ownership of a public or private company by buying part or all of its equity. The PE firm's aim is to improve how a company is managed during their ownership and provide resources & guidance for long-term strategic planning and execution.

Venture capital is financing that investors provide to startup companies and small businesses that are believed to have long-term growth potential. Venture capital generally comes from well-off investors, investment banks and any other financial institutions. However, it does not always take just a monetary form; it can be provided in the form of technical or managerial expertise. Though it can be risky for the investors who put up the funds, the potential for above-average returns is an attractive payoff.

Venture Capital

In other words, venture capital typically involves investing money into early stage companies/start-ups in order to help them grow and become profitable. At the time of investment, venture-backed companies often do not have revenues and/or positive cash flow and may require more capital (/rounds of financing) prior to the company being sold or taken public. These investments involve a substantial element of risk.

Growth equity investors pursue companies at a development stage between venture capital (early stage businesses with limited historical financials) and leveraged buyouts (mature companies with a long track-record of cash generation).

Growth Equity

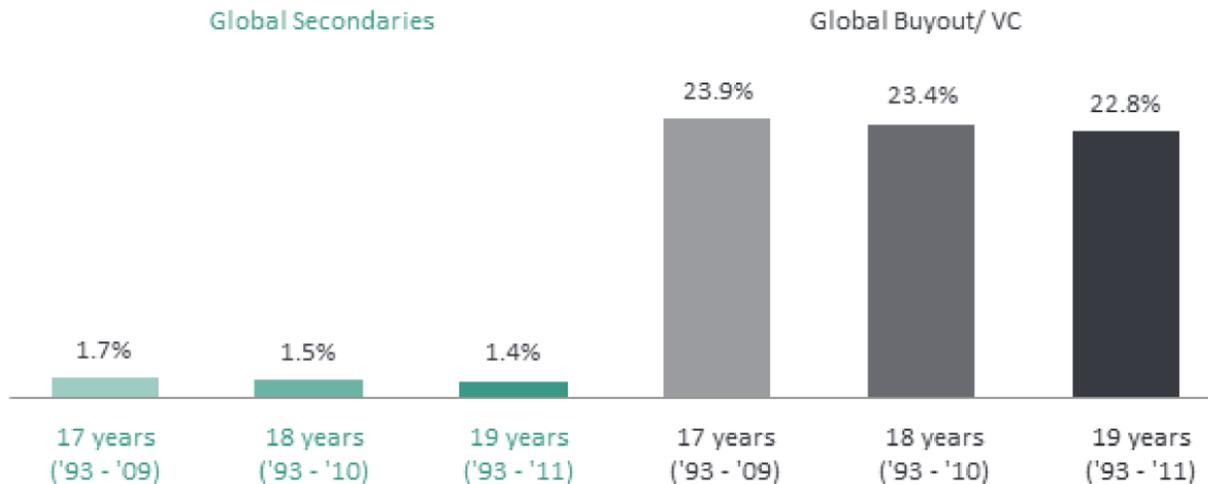
Growth equity investors seek to invest in well-run companies with proven business models (established products and/or technology and existing customers) and a history of significant and rapid revenue growth, which minimize the technology adoption risks often associated with venture capital investing. Growth equity investments can be minority or majority in nature (historically these were minority positions but this has shifted in recent years), and typically use little to no debt.

Source: iCapital

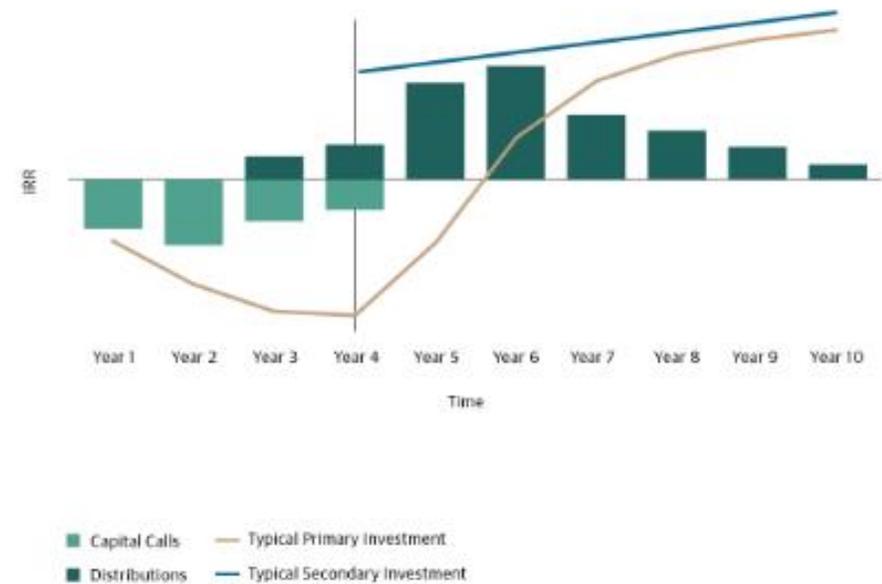
Secondary Strategy – Advantages:

- Shallower (or no) J-curve
- Lower loss rates and return variability

Exhibit 15: Percentage of Funds Returning Less than 1.0x
 Source: Preqin, performance data as of December 31, 2015.⁶



Primary & Secondary Investment Lifecycles



Source: BlackRock; CAIA

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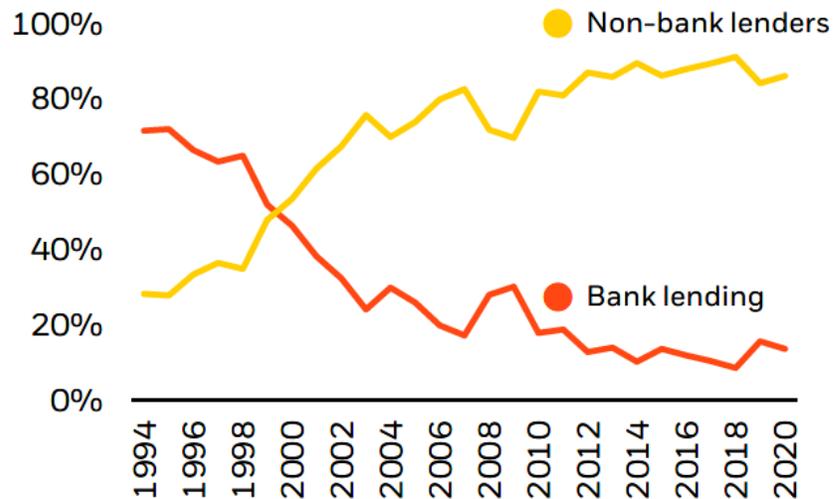
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Private Credit - Background:

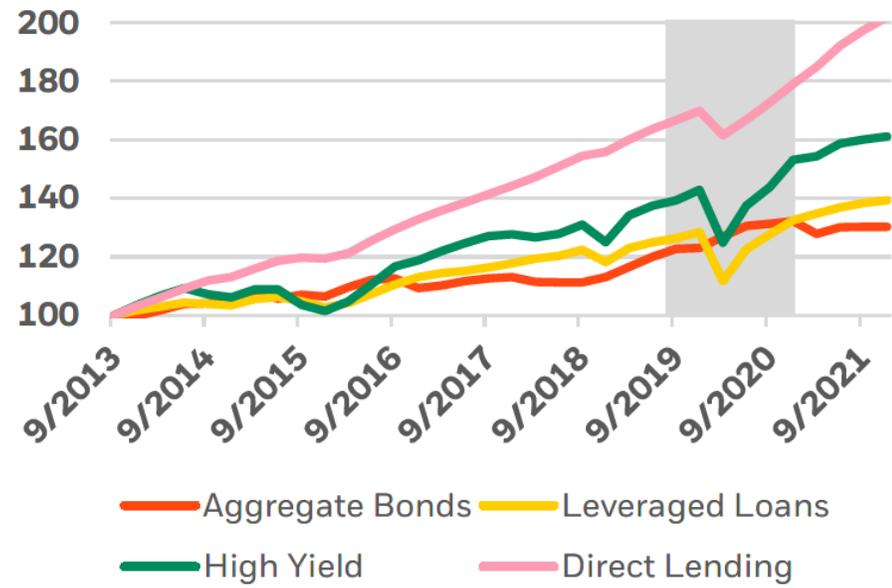
- Global Financial Crisis 2008 spawned new regulations that drove banks to shrink balance sheets and pull back on lending. Non-bank lenders, such as private credit funds, have filled the void.

...Non-bank lenders have stepped in

Market share, leveraged loan market, 1994-2020



Private Credit's Relative Resiliency



Source: BlackRock, Preqin, Bloomberg. As of December 31, 2021.

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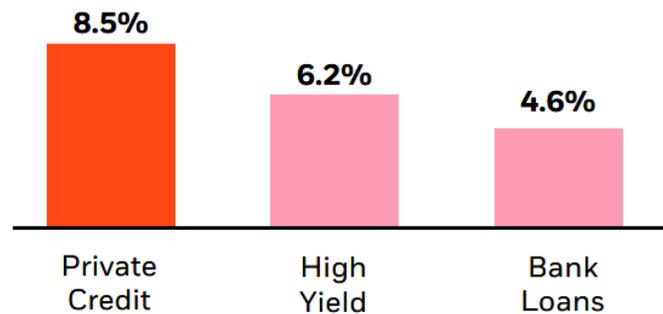
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Private Credit – Advantages:

- Private Credit can deliver attractive yield and total return, many of the loans are secured and may pose lower default risk than comparative public bonds

Not all credit is created equal¹

Fixed income yields



Private credit can offer better protection

Stronger structural protections and company performance can mean lower defaults and loss rates

	Direct lending ²	High yield bonds ³	Bank loans ³
Historical default rate	✓ 0.2%	2.7%	2.6%
Historical recovery rate ⁴	✓ 80%	42%	65%

Covenants: protections for lender in a debt agreement
 On average, only **13%** of recently issued liquid market loans have covenants vs. **78%** of private middle market loans.⁵

Source: BlackRock

¹ Private credit is a 50/50 Blended Index – Cliffwater Direct Lending Index and S&P MML Index Bank loans are represented by S&P/LSTA Leveraged Loan Index. High Yield is represented by Bbg Barclays US Corporate High Yield Index. Reflects most recent yield to maturity of selected asset categories as of 3/31/22. Private credit yield reflects most recent yield available as of 12/31/21. ² Reflects BlackRock aggregate direct lending track record from June 2000 to September 2021 comprising 927 total deals, approximately \$27.5 billion of invested capital. Reflects latest available data as of 3/31/22. ³ Source: BlackRock, JP Morgan, Moody's Investors Service, Markit, S&P LCD. Represents 20 years of data from 2002-2021. ⁴ Recovery rate is the extent to which principal and accrued interest on defaulted debt can be recovered, expressed as a percentage of face value. ⁵ Source: Covenant Review, January 2021. Reflects the percentage of deals identified as covenant rich or covenant loose in 4Q 2020. Historical recovery rate is the extent to which principal and accrued interest on

Hedge Fund Strategy Examples:

- Long/Short Equity – Investment manager maintains long and short positions in equity and equity derivatives.
- Long/Short Credit – Investment manager maintains long and short positions in credit and credit derivatives.
- Event Driven – Investment manager maintains positions in companies involved in corporate transactions including mergers, restructuring, distressed, tender offers, shareholder buybacks, and debt exchanges, etc.
- Global Macro/CTA – Investment manager aims to profit from top down/macro trends that involve interest rates, sovereign bonds, currencies, and commodities, etc.
- Market Neutral/Relative Value/Arbitrage – Investment manager aims to profit from realization of a spread between related instruments without taking a bet on general market directions.

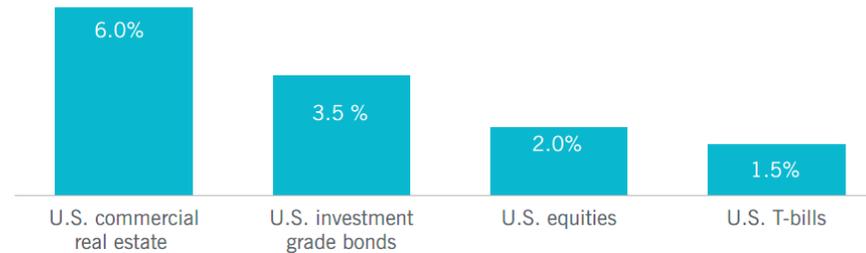
Private (direct) Real Estate - Advantages:

1

Income

Average annual income, 2000-2021

Real estate has traditionally offered investors a higher level of income compared to other asset classes.

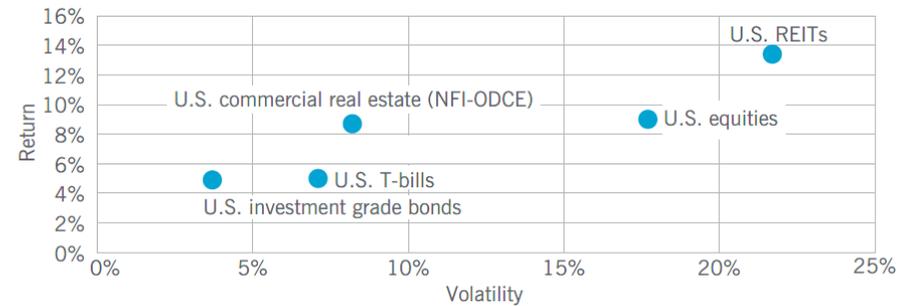


2

Risk-adjusted returns

Asset class returns and volatility, 2000-2021

Historically, real estate has offered investors both strong total return and lower volatility than many other asset classes.*



Source: Nuveen

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Private (direct) Real Estate - Advantages:

3

Volatility management

Rolling quarterly total returns: 2000-2021

Strategic allocation to direct real estate can help reduce portfolio volatility and can smooth a portfolio's return profile.*



4

Diversification

U.S. commercial real estate correlations 2010-2021

Commercial real estate may provide portfolio diversification for enhanced market resilience.

	U.S. Real Estate	Listed REITs	U.S. Equities	Fixed Income	10 YR Treasuries
US Real Estate	1.00	0.16	0.19	-0.28	-0.13
Listed REITs	0.16	1.00	0.54	0.09	-0.14
US Equities	0.19	0.54	1.00	-0.08	-0.29
Fixed Income	-0.28	0.09	-0.08	1.00	0.86
10YR Treasuries	-0.13	-0.14	-0.29	0.86	1.00

5

Potential inflation hedge

U.S. real estate income and inflation growth 1994-2021

Real estate has often been an inflation hedge.



Source: Nuveen

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Section 6: Q&A/Discussion

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