Active Alpha

A Portfolio Approach to Selecting and Managing Alternative Investments

ALAN H. DORSEY

BICENTENNIAL 1807 WILEY 2007

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John Wiley & Sons, Inc.

Published by John Wiley & Sons, Inc., Hoboken, New Jersey.
Published simultaneously in Canada.

Wiley Bicentennial logo: Richard J. Pacifico.

Library of Congress Cataloging-in-Publication Data

Dorsey, Alan H.
Active alpha : a portfolio approach to selecting and managing alternative investments / Alan H. Dorsey.
p. cm.
Includes bibliographical references and index.
ISBN-13 978-0-471-79132-4 (cloth)
1. Portfolio management. 2. Investments. 3. Factor analysis. I. Title.
HG4529.5.D675 2007
332.63—dc22

2007007058

Printed in the United States of America.

10 9 8 7 6 5 4 3 2 1

I dedicate this book to my wife, Missy, who is the center and warmth of my life; my daughter Ellie, who is the style and grace in my life; my daughter Emily, who is the inspiration and creativity in my life; and my youngest daughter Greta, who is the compassion and joy in my life.

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Preface

This book was written to solve a dilemma for institutional and high-net-worth investors. How should an investor move beyond token allocations to alternative investments in an integrative fashion with traditional asset classes that is grounded in sound portfolio construction methodology? Once initial allocations have been made to hedge funds, private equity, real estate, and other types of alternative assets, a large number of investors find themselves at a loss as to how to proceed.

Many investors have added alternative investments to their portfolios in a haphazard fashion, because alternative investments are not well suited to traditional portfolio construction approaches. Investors frequently cap the use of alternative investments in their portfolios, but do so using artificial constraints. Establishing constraints is done for a combination of reasons that often are qualitative in nature, rather than derived from objective quantitative analysis. Although the return enhancement and diversification attributes of these investments are readily observable, all but the largest investors lack a legitimate quantitative process and organizational capacity to integrate them into vastly larger allocations that exist for traditional asset classes. The utilization of factor analysis can foster a more integrated approach to the use of alternative investments in conjunction with traditional asset classes. With the help of regressions, multiple betas can be identified across a diverse portfolio. Efficient portfolios can be considered in terms of optimizations of factors rather than asset classes, which often provide no definitional inclusion of many types of alternative investment strategies. Investors then are free to focus their attentions on the identification of managers who can generate unique sources of return, the evaluation of investments on an equal footing across numerous alternative investment types, the comparison and negotiation of terms and fees across investments, the creation of synthetic portfolios of passive benchmarks, and the isolation of alpha and its active component.

This book's introduction, contained in Chapter 1, states its thesis, which is that all alternative investments can be evaluated using factor analysis. This approach provides for a more efficient construction of portfolios and more readily identifies potential factor redundancies and deficiencies. It presents a quantitative road map for investors seeking a pathway to emulate the experience of successful endowments in using alternative investments.

A benefit from this methodology is enabling the greater use of alternative investments in portfolios that seek their benefits but may have a limited ability to increase allocations to them beyond placeholder amounts. Through this, multiple factor betas can be used in portfolio construction and alpha can be more precisely measured.

Chapter 2, "Investors in Alternative Investments and the Necessary Ingredients for a Successful Program," compares different types of investors and their use of alternative investments. High-net-worth investors, endowments, foundations, pension plans, and insurance companies each have different considerations when utilizing alternative investments. This chapter reviews the necessary ingredients for creating and managing a successful alternative investment program. This includes organizational management, strong governance, the proper setting and management of expectations, and division of duties among participants to the process. The role of portfolio management is described in its component features, including: adhering to an investment policy statement, maintaining diversification and a growth orientation, having fidelity to rebalancing the portfolio, being aware of most-favored-nation issues, and making careful moves when changing strategic target allocations.

Implementation issues are described as they pertain to asset allocation and manager selection, assessment, due diligence, and monitoring. In some cases, these skills can be augmented with assistance from investment management and consulting firms, which can provide fiduciary support, expertise, experience, consolidated reporting, risk management, and economies of scale as it pertains to investing in alternative investments. Nevertheless, not all investors are well suited to broadening their alternative investment programs. Such instances are identified as it pertains to investor skill, manager access, staff depth for handling alternative investment mechanics, and a lack of quantitative methodology. Moreover, the perception of risk and organizational discomfort can define investor suitability. Some investors have a structural mismatch with alternative investments, because of the investor's size and portfolio reliance. Others may have difficulty integrating with the liquidity, lockups, and duration of alternative investments.

Chapters 3 through 6 provide a detailed overview of hedge funds, private equity, real estate, currencies, commodities, timber, and oil and gas. The discussion of these alternative investments entails a description of underlying strategies, their basic attributes, and their qualitative return drivers. The attraction for investors to each strategy as well as the investment risks are identified. Also provided are illustrations of portfolios constructed solely using the alternative investment strategies described in each of these chapters. An application for portfolios using isolated alternative investment strategies is provided through a description of funds of funds and investors considering the construction of their own internal portfolios of hedge funds, private equity, or real estate. This approach is focused on strategy-specific combinations through optimization, rather than the factor analysis approach detailed in Chapter 11.

A trend for hedge funds to invest across asset classes makes an analysis of hedge funds difficult by historical methods. Chapter 7, "The Migration of Hedge Funds into the Private Equity Realm," discusses this issue. Hedge funds may be gaining market share from private equity funds. The infiltration by hedge funds into private equity is changing the shape of the private equity industry. Elements of change that hedge funds may be causing or contributing to private equity include potentially reducing expected returns, increasing competition for deals, impelling a migration to larger-sized buyout deals, and lengthening duration of investments. Although there are certain inefficiencies for hedge funds to make this transformation, their robust fee structures increasingly provide them with the financial wherewithal to add resources to do so. Hedge funds tend to have greater expertise at making secured private equity investments than equity-driven investments that require a great deal of company building. Furthermore, from an investor's perspective, there are certain inefficiencies in hedge fund fee structures versus private equity fee structures. This chapter details an analysis of this fee comparison, noting the valuable clawback feature that is present for many private equity funds.

Chapter 8, "Cash Flow Forecasting and Its Implications for Rebalancing," provides a detailed review of the cash flow aspect of alternative investments and the implication it can have for rebalancing portfolio allocations to hedge funds, private equity, real estate, and other alternative investments. Also discussed is the requirement for an overcommitment to private equity in order to achieve invested amounts that approximate portfolio allocations. Two additional areas examined in detail are cash flow models and the utilization of proxies to emulate certain alternative investments. In its totality, this chapter focuses on the following three topics: (1) the forecasting of cash flows to manage alternative investment liquidity, (2) the ability of an investor to meet strategic asset allocations for alternative investments and effectively rebalance these allocations, and (3) quantitative tools to help with these tasks, including cash flow models and the use of alternative investment proxies during periods of mismatched cash flows.

Chapter 9, "Leverage and Portable Alpha," considers leverage as a potential source of risk and identifies the portable alpha strategy as a form of leverage. When mixed with illiquidity and directionality, leverage can be more combustible than expected. If alpha generators in portable alpha become correlated to the asset classes to which they are ported, an investor must possess staying power in order to ride out mark-to-market losses. There are approaches other than portable alpha to capture beta and alpha in an efficient manner. One of those approaches is alpha core, which uses uncorrelated, alpha-producing strategies at the core of a portfolio and augments these holdings with allocations to increasingly risky but higher-returning assets. Leverage also is depicted as a structural component of some strategies, where it is not an accurate measure of risk.

Furthermore, leverage is described in terms of notional leverage through derivatives contracts and organizational leverage. Leverage provides risks and opportunities for investors, depending on how it is defined and applied. The returns that an investor experiences from alternative investments may be more attributable to leverage than to either discrete sources of alpha or factor betas. It is difficult to separate the degree to which index returns for alternative investments are proportioned between leveraged and unleveraged sources. An explicit understanding of the leverage used in an alternative investment and its perceived versus real risks must be determined by an investor.

Factor analysis is evaluated both in Chapters 10 and 11. Chapter 10, "Factor Analysis: The Rationale," reviews of the basic supporting methodologies and quantitative building blocks that underpin factor analysis when applied to investment management. This chapter identifies quantitative factors as components of alternative investments through regression analysis. It also describes the definitional qualities of asset classes and the limiting effect that asset-class definitions can have on portfolio construction. Qualitative factors, such as illiquidity and counterparty risks, also are defined as characteristics that affect many alternative investments regardless of their type. This chapter reviews the marketplace changes that warrant factor analysis as a technique for the construction of portfolios using alternative investments. Processes are described for risk budgeting using investment factors, organizational considerations, systemic views, and managers.

Chapter 11, "Factor Analysis: The Findings and Discovering Active Alpha," is a quantitative illustration of factor analysis applied to the major strategies for hedge funds, private equity, real estate, currencies, commodities, timber, and oil and gas. It supplies the reader with a methodology for conducting factor analysis on a blended portfolio of alternative investments and traditional asset classes, such that factor diversification and efficient exposures can be attained. A benefit of this approach is the consideration of alternative investments on an equal factor basis. This provides an objective footing for judging investment vehicles by their terms and fees. It also enables an investor to more clearly measure alpha that is unaffiliated with factor betas as well as identify the active and passive components of alpha. A further by-product is the ability to create passive beta benchmarks for disparate factors and therefore offer the possibility to create synthetic alternative investment portfolios. This chapter concludes with a discussion of ongoing factor measurement through investment manager portfolio transparency for risk monitoring and portfolio rebalancing.

Acknowledgments

Foremost, I wish to thank my wife, Missy, and daughters Ellie, Emily, and Greta for their patience and sacrifices in enabling me to write this book. The support and foundation they have given has enabled me to realize my dreams. My thanks also go to Tim Barron, who gave me the latitude to pursue intellectual creativity. I also would like to thank George Walker for his wisdom and guidance. My sincerest appreciation extends to those who were helpful in commenting on aspects of this book or were instrumental in the creation of figures and tables, including: Steve Case, Srivatsa Kilambi, Adam Kimball, Alan Kosan, Linda McDonald, Soonyong Park, Donna Rosequist, John Ross, Cynthia Steer, Brooke Stiver, Kenneth Voon Keat Sui, Andrew Taylor, Michael Crook, Juliana Davydov, and Rafael Aussie Haryono Putro. I also would like to thank Bill Falloon, my editor at John Wiley & Sons, for his care and advice from start to finish of this project. Finally, I would like to extend my thanks to the following individuals for their comments on the drafts of this work: John Aiello, Stephen Grobman, Aaron Gurwitz, Brian Hayes, Brian Kriftcher, Dan Murphy, Marc Nuccitelli, Doug Hepworth, and Sharon Robinson.

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PART

One

Alternative Investments and Investors

Alternative investments do not belong in every investor's portfolio. Some investors are not well suited to these assets, despite their attractive features. This potential misfit tends to center either on an investor's inability to manage these assets or the irregular characteristics of the investments. Part One discusses both of these considerations as well as the investor ingredients that are necessary for a successful alternative investment program, which can be augmented by full-service investment management firms or consultants. The suitability of alternative investments for investors depends on the characteristics of the investors. One qualitative artificial constraint to employing alternative investments is a general lack of experience or level of comfort in their use by some investors. Clearly, many investors have gained comfort in some level of use of these investments, but not to the degree that they have in their traditional assets. These issues will be examined more carefully in this section.

Furthermore, investors are required to have a certain size of assets to be able to qualify as an investor in various private placement vehicles. Alternative investments generally are seen as diversifiers in portfolios of traditional asset classes. This diversification benefit and the performance enhancement that alternative investments can provide may be less valued at the margin by investors with smaller-sized assets. Furthermore, alternative investments can be complex in their traits. This complexity is seen in difficult benchmarking, illiquidity, and nontraditional sources of return. Some alternative investments can be volatile. In the context of a diversified portfolio with low correlation among assets, incidental volatility is tolerable. However, volatility in an asset about which an investor has only partial understanding can lead to misgivings.

Topics in Part One comprise the organizational and implementation issues for investors adopting alternative investments, including capabilities, staffing, governance, due diligence, and access to funds. Chapters are devoted to hedge funds, private equity, real estate, and other alternative investments such as currencies, commodities, timber, and oil and gas. Sections that pertain to a type of alternative investment detail the basic attraction of each as well as the qualitative return drivers that tend to affect them. Alternative investment strategies are fully described along with their various tactics, substrategies, and forms of fund. Each chapter on individual alternative investments concludes with considerations for the construction of portfolios dedicated solely to each type of alternative investment.

CHAPTER 1

Introduction

There is a developing trend among investors to consider alternative investments (hedge funds, private equity, real estate, currencies, commodities, timber, and oil and gas) as a group of assets driven by a series of measurable return and risk factors. Heretofore, many investors have added these alternative investments purely on the initial merits of diversification and return potential, without a sophisticated approach to integrating them into a portfolio construction process. However, there is a more elegant way to conduct this implementation using factor and cash flow analysis, in order to identify common investment and structural factors and more accurately depict the correlations among these investments. This approach leads to improved veracity of portfolio construction with fewer redundancies and greater efficiency.

Potential benefits include more precise answers to the quantity of each type of alternative investment to use during the construction of a portfolio, in what combinations, and how rebalancing should occur based on forward-looking factor views for each alternative investment. Resolution of these issues provides a road map with quantitative and qualitative underpinnings for the migration of investors to the promise that they recognize in alternative investments but many have yet organizationally to achieve. In this fashion, the effectiveness exemplified by sophisticated endowments that have ample allocations to alternative investments is attainable by a much broader range of investors.

INTEGRATION OF ALTERNATIVE INVESTMENTS AND TRADITIONAL ASSET CLASSES THROUGH FACTOR ANALYSIS

Alternative investments keep creeping into many portfolios with little more portfolio cognition than for the sake of diversification. As these token allocations to nontraditional investments mature across a broader range of investor portfolios, a deeper contemplation of their merits and risks is being sought by investors, trustees, and other fiduciaries. The turning point for most traditional investors in considering an increase in allocations to these investments often results from a desire for improved investment performance or from the persuasion of a trustee or adviser. Then, the desire for a quantitative understanding of the portfolio role for individual alternative investments is brought into the bright light of day. A problem many investors face is how to move beyond initial allocations to alternative investments in a holistic way that integrates these investments into traditional asset-class exposures and enables efficient portfolio construction. The thesis of this book is that this dilemma can be resolved through the practical application of factor analysis. Factor analysis can be applied both to alternative investments and to traditional asset classes when constructing efficient portfolios. This approach reveals the unique factors that drive returns, volatility, and correlation for alternative investments and their overlap with traditional asset classes.

Traditional style analysis, such as small versus large capitalization or growth versus value investing, is fairly limited in its explanation of investment choices within asset classes. Given the efficient nature of traditional asset classes, such as equity and fixed income, it perhaps is surprising that there is a litany of descriptors for styles. If styles are members of the same asset class, then they likely have high correlations to one another. In contrast, alternative investments not only have a range of types (such as private equity, real estate, and commodities) and a range of strategies (such as leverage buyouts, mezzanine debt, and venture capital), but also an entire genus of factors (such as credit spreads, volatility, and liquidity) that determine their outcome. However, the traditional investment world tends not to think about alternative investments in these terms. Investors have been slow to broaden their understanding of the unique drivers of return and risk for alternative investments. This stonewalling seems to be on the precipice of change.

APPROACHES TO PORTFOLIO CONSTRUCTION

A yearning for how alternative investments truly fit in the context of portfolio construction initially has led to the recognition that they do not fit well into traditional methodologies. For instance, when considering alternative investments in the framework of mean variance optimization, many practitioners realize that this tool is not completely accurate and assumes the expectation for a normal distribution of returns for each asset class, which often is not the case for alternative investments. A user of mean variance optimization also often is forced to constrain allocations to various asset classes, in order to artificially maintain diversification. While mean variance analysis may continue to be used as an informative tool, it can be augmented by regressions that identify factor sensitivities of alternative investments. This tactic provides a better understanding of the sources of return and risk that underlie alternative investments.

There are winners and losers from the use of this methodology and the knowledge that it provides. Winners include investment managers who really do generate their returns from unique sources of returns. Losers are investors who may be slow to recognize an alternative investment manager that generates a majority of its returns from multiple beta exposures to traditional asset classes. Some factors that drive returns for alternative investments can be associated with traditional asset classes. A hedge fund that derives its returns from volatility, credit spreads, and some equity beta is not necessarily deceptive. It is only that those are the key factors from which that fund generates profits and losses. It should be relieving once those factors are established, so that they can be monitored and estimates for their direction can be determined by the fund manager and its investors. Conversely, a large-capitalization equity fund ostensibly derives the vast majority of its returns from a beta to only one factor—the equity market. The separation of alpha from beta should be no different for alternative investment managers, except they may have exposures to a larger number of factor betas. Alpha can become quite small once a more careful analysis is conducted and multiple factor betas are used to explain returns.

Nevertheless, an investor may be likely to find a greater opportunity for alpha in less efficient alternative investment areas than traditional asset classes. The smaller alpha becomes, it may begin to be rivaled in size by the error term in a regression calculation, which seeks to divine factor betas and alpha for an investment.

THE IDENTIFICATION OF ALPHA AND BETA IN NEW INVESTMENT STRATEGIES

Discussing alternative investments in terms of two simple subcomponents—alpha and beta to the equity market—is woefully inadequate. Alpha often is a virtual catchall for the return generated by an alternative investment that is not considered to be related to equity beta. However, there are many types of betas to various factors that can be present in alternative investments. The ability to identify a greater number of factor betas provides a better explanation of a new investment strategy and renders its alpha less mysterious. Whether it is unique factor betas or unique alpha that a new investment strategy provides, both are of value to an investor. Still, the process of identifying the unique sources of returns for new strategies is helpful when combining a range of investments in an effort to ensure that a portfolio is optimized.

Beta is the amount of return for a security or fund that is explained by its benchmark or component benchmarks. A high beta for a fund is a measure of its directional movement with its benchmarks. In a traditional sense, nondirectional hedge funds should have betas near zero and generate returns that are unrelated to the returns of traditional market benchmarks, and alpha is a measure of a fund's return that is independently generated from the beta return that is influenced by the fund's benchmark. However, this rationale presumes single independent variable regressions where there is only one beta, presumably to the equity market. Many investors in low-beta hedge funds seek an independent alpha return that these investments are capable of generating. When added to a diversified portfolio, these uncorrelated returns may improve overall returns and reduce volatility. Nevertheless, the alpha from these funds can be deconstructed into numerous additional factor betas.

Alpha is the value added by an investment manager. It is the component of return that is unrelated to the manager's association with any market or beta. The importance of identifying alpha and multiple betas from new investment strategies is twofold. First, idiosyncratic alpha represents a new source of absolute return relative to a new investment strategy and is different from alpha generated by other investment strategies in an investor's portfolio. Second, new betas often are uncorrelated with betas generated by other asset classes. However, the identification of alpha is never as easy as it appears. This is particularly true as more independent factors are added to a multivariable regression analysis. As independent variables are identified, they represent new unique sources of return and risk with low correlation to other independent variables.

For example, consider the financing of imported goods as a new hedge fund strategy. Assume that this strategy is based on a lack of effective local banking support in an emerging country to pay local exporters for their goods while in transit to a developed nation. The developed country importer of the goods does not wish to pay until receipt, and then on a 60- or 90-day-payable basis. Therefore, an opportunity exists for financing the period of shipment. In this instance, a benefit for the financial firm filling this void is financing a strong credit from a developed country importer. A key to such a strategy is the velocity of transactions, or having multiple turnovers of these transactions annually. Another benefit should be repeat transactions with importers that have strong credit ratings and are located in developed countries. The risk-free rate might be the base price above which the facilitator prices its service, thereby creating a spread equaling a risk premium.

In this example, one might ask: What is alpha and what is beta for this strategy? If there is only one player in this scenario, it is tempting to say that there is no beta and that the entirety of net returns above the risk-free rate is alpha. Beta requires more than one player in a unique investment strategy in order to measure returns that may deviate from the mean experience. Furthermore, beta to mean index returns potentially presumes that the index is investable and offers a passive investment alternative to selecting an active manager. The beta of a manager's performance in this example might be associated with the strategy's average return, which equals the risk-free rate plus a risk premium. Manager returns that fall above or below this can be attributed to the manager's positive or negative alpha, respectively. However, the unique return drivers associated with this strategy and the strategy's low correlation to other strategies may be more important than determining beta and alpha for a manager operating in the strategy. Simply identifying the attributes of a new strategy will result in new beta through the selection of any manager to execute the strategy. Incremental alpha may be negligible relative to the benefit of adding the new independent drivers of returns to an investor's portfolio. Over time, the absolute-return margin above the risk-free rate may decline as more participants enter a new strategy and push down returns through their competitive pressures. Not only can alpha be converted to beta over time for new absolute-return strategies, total returns can evaporate. This concept is quite different than considering a manager's beta to the S&P 500, which has return characteristics in its own right.

Another area of examination when accepting a new investment factor is sustainability. This analysis can identify some faulty assumptions about alpha and beta as they relate to a new unique investment factor. This is not an issue of the sustainability of alpha for a manager. Nor is it an issue of alpha becoming beta for managers in a strategy over time. Certain return drivers, or independent factors, disappear over time. The lack of sustainability of return may result from increased competition, changes in marketplaces, or regulation. Using the example of export receivables financing, this market opportunity could evaporate over time as local banks offer credit to the exporters, the costs of growing crops in one country make it less competitive with another country, or new duties by developed nations cause a reduction in imports.

Historically, diversification has been considered in the light of adding as many unique asset classes as possible. The archetypal return features of asset classes are generalized by their benchmark returns. An investor has the choice of passively replicating these asset classes through investable indexes or employing active management of asset classes to attempt to generate positive returns above the asset-class benchmarks, net of fees. The appropriate measure of success for active management is generating positive incremental returns above a benchmark, otherwise known as positive alpha. Within the context of active management, diversification can be rendered through exposure to multiple-asset-class or independent factor betas, as well as to multiple sources of manager alphas. The greater the number of discrete alphas that can be added to a diversified portfolio, the better. When evaluating discrete returns that are separate from a benchmark's beta (independent investable factors), more idiosyncratic return (alpha) is desirable. In light of the fact that asset-class and factor betas can be passively replicated, it behooves investors to focus their attentions on ways to generate independent alphas from an array of asset-class managers. Accumulated alphas minus the risk-free rate, which is a form of passive alpha, may then be depicted as active alpha. Successful investors increasingly are taking a portfolio approach to selecting and managing alternative investments through attention to generating active alpha.

WHAT THE FUTURE HOLDS

The future for success in the alternative investment realm may increasingly rely on methodologies for the accurate estimation of the future direction for these factors, their volatilities, and their correlations to each other. A full appreciation of alternative investment characteristics may ultimately lead to a renaissance for classical economists. Indeed, portfolio managers of the future may likely find their success measured by an ability to forecast the factors that are chief drivers of return and risk in their portfolios. Successful forecasting of these factors and applying accurate weightings for the optimization of these factors in a diversified portfolio should be at the heart of portfolio construction using alternative investments. Furthermore, investors should focus on identifying investment managers who are creative and capable enough to identify new investment opportunities.

SUMMARY

The use of factor analysis in determining the drivers of return and risk for alternative investments should enable a more accurate appraisal of these investments and lead to their broader use. The quantitative pathway exists through factor analysis to give investors a more explicit risk and return interpretation of their portfolios when alternative investments are employed. This approach moves beyond traditional methods such as mean variance optimization and style analysis. The description of investment returns by their factor betas provides better delineation in portfolio construction. The identification of returns that are unaffiliated with traditional or exotic beta factors leads to a more accurate depiction of alpha generation by individual investment managers who operate in each asset class. This also enables a deciphering of the active component of alpha in total returns. Factor analysis also provides investors with a framework to include and measure new alternative investment strategies, rather than avoiding them because they do not fit within the context of historical analytical techniques. This process should liberate investors to focus their attentions on identifying investment managers who truly have access to unique sources of returns, which are ever more valued in an increasingly competitive investment landscape.

CHAPTER 2

Investors in Alternative Investments and the Necessary Ingredients for a Successful Program

Successful investment in alternative investments can be attained by many different types of investors, as long as they are willing to set parameters and live by them. Virtually all successful investment programs utilizing alternative investments have a unified culture that enables them to create and support an organizational management structure, a portfolio construction methodology, and a system for implementation. Often, the linchpin in keeping such a program on track is the existence and maintenance of a well-designed investment policy statement. This governing document should contain well-defined policies and procedures that delineate division of duties and enable the utilization of alternative investments. Once the organizational management structure is in place, including education of constituents and the appropriate setting of expectations, it frees the investment staff or agents to execute their primary tasks of portfolio construction and implementation. The key elements of portfolio construction are accomplishing diversification, maintaining a growth orientation, and ensuring fidelity to rebalancing.[1] Implementation of an alternative investment program entails asset allocation and investment manager selection based on due diligence. Monitoring of the program and investment managers is an ongoing commitment to ensuring that investment goals are met and guidelines are maintained. Some investors find themselves unable to attain a level of expertise in each of the tasks required to implement alternative investments. For these investors, outside resources from investment management and consulting firms can be employed to augment required capabilities. Nevertheless, investors must conduct a candid appraisal of their suitability for a meaningful allocation to alternative investments. Limitations to moving beyond token allocations to alternative investments are found in an organization's or an investor's perception of its own capabilities, risk tolerance, and structural fit with the terms and illiquidity of alternative investments.

TYPES OF INVESTORS AND THEIR APPROACHES TO ALTERNATIVE INVESTMENTS

Investors who use alternative investments in their portfolios can be defined both by their categorization and their organizational capabilities. These investors may be endowments, foundations, pension plans, insurance companies, family offices, or high-net-worth individuals. However, regardless of investor type, some have common characteristics in length of duration of liabilities, taxable or nontaxable status, and a need to conform to certain regulatory oversight. Most investors who consider the use of alternative investments do so in hopes of accomplishing one or all of the following potential benefits from these investments: diversification brought to a portfolio that is populated with traditional investments, by virtue of the low correlation of alternative investments to traditional investments; reduction in volatility for a portfolio of traditional investments, because of the diversification benefits of the alternative investments; and enhancement of performance in a diversified portfolio that is populated by both alternative and traditional investments.

High-Net-Worth Investors

Any addition of new alternative investments must be considered within the existing asset framework of a high-net-worth individual or family. A principal consideration for most high-net-worth investors is taxation. Some alternative investments, such as higher-turnover hedge funds or trading strategies, can be tax inefficient for tax-paying investors. These strategies generate the majority of their profits through short-term gains. In contrast, other types of alternative investments can be very tax efficient and pass through tax-deductible operating expenses to the limited unit holders in investment trusts and master limited partnership structures, which is the case for certain oil and gas, timber, and real estate investments. Furthermore, private equity investments in venture capital and leveraged buyouts can have favorable tax treatment through generating the majority of their profits in the form of long-term gains.

Wealthy individuals and families may have concentrated positions in either private or public equity holdings and, possibly, direct real estate investments. These assets, many of which represent the core wealth of these