Alternative Investments: The Pros and Cons of Branching Out — Video Transcript

Alternative investing involves asset classes and strategies that go beyond the traditional mix of stocks, bonds, and cash that make up the core of most investor portfolios.

In fact, the term "alternative" may apply to almost any investment with a history of past performance that is not highly correlated with stocks and bonds. This means that the asset's value often moves in the opposite direction.

Depending on your financial goals and circumstances, adding alternative investments to your portfolio might be a way to increase diversification, help reduce the effects of market volatility, and potentially enhance performance.

Alternative assets span a wide variety of markets and vehicles. Here's an introduction to a few common strategies.

One approach is to make direct or indirect investments in physical assets such as real estate, precious metals, or commodities.

For instance, you might invest directly in real estate through the purchase, improvement, or rental of property, or indirectly through an entity that invests in property, such as a real estate investment trust, or REIT. REITs may be publicly traded or not.

It's also possible to invest directly in natural resources such as timber, oil, or natural gas through limited partnerships that are designed to provide income through the resources produced, or indirectly through publicly traded exchange traded funds, or ETFs.

Other types of alternatives utilize complex or proprietary investing methods.
Hedge funds, for example, may use trading techniques that are off-limits to most mutual funds. Venture capital, private equity, and private credit investments all rely on skilled fund managers to identify worthy businesses.

But not everyone qualifies to invest in hedge funds and other "private" vehicles, as they usually require very high minimum investments and are typically limited to "accredited investors," who must meet SEC-mandated levels of net worth and income. Even so, the average investor may have access to numerous alternative assets and strategies through mutual funds and ETFs.

Of course, it's important to have a clear-eyed understanding of the associated risks before jumping into any kind of alternative investment.

First, alternative assets can be less liquid than stocks or bonds. This means there may be restrictions on when you can sell, and you may or may not be able to find a buyer.
For example, many private equity and real estate funds could keep your money tied up for five to 10 years or longer.

Second, some alternatives are subject to less regulatory scrutiny than standard investments, and aggressive strategies could expose you to higher losses due to the use of leverage or concentrated positions.

Moreover, investment performance, values, and risks may be difficult to research and assess accurately.

If you are interested in exploring the expanding frontier of alternative investments, keep in mind that each opportunity comes with its own unique risks and may not be suitable for all investors. You might consider consulting a professional who can help guide your journey.

All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful. Asset allocation and diversification are methods used to help manage investment risk; they do not guarantee a profit or protect against investment loss. There is no assurance that working with a financial professional will improve investment results.

There are inherent risks associated with real estate investments and the real estate industry, each of which could have an adverse effect on the financial performance and value of a real estate investment. Some of these risks include: a deterioration in national, regional, and local economies; tenant defaults; local real estate conditions, such as an oversupply of, or a reduction in demand for, rental space; property mismanagement; changes in operating costs and expenses, including increasing insurance costs, energy prices, real estate taxes, and the costs of compliance with laws, regulations, and government policies. Real estate investments may not be appropriate for all investors.

Non-traded REITs are considered a high-risk investment and may not be suitable for all investors. There is no secondary market on which the shares trade. Redemption may be at less than the original amount invested.

Limited Partnerships are subject to special risks such as illiquidity and those risks inherent in the underlying investments. Individual investors must meet specific income and net worth suitability standards, which can vary by state. There are no assurances that the stated investment objectives will be reached. At redemption, the investor may receive back less than the original investment.

Before investing in a mutual fund or ETF, including one that invests in any kind of alternative asset class, carefully consider its investment objectives, risks, fees, and expenses, which can be found in the prospectus available from the fund. Read it carefully before investing. REITs and limited partnerships are also sold by prospectus.