Advisors turn to alts in rocky 2020

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Stephanie Lang, chief investment officer of $6.9bn Homrich Berg, said that stocks are expensive but there's yield up for grabs in the alternatives space.

Months of pandemic-induced volatility in the equity markets have advisors and investors seeking more stable footing and new opportunities, including with alternative investments.

Client assets on Bank of America Merrill Lynch's alternative investment platform have doubled over the past five years, a senior executive at the wirehouse said on a Thursday call with reporters. He said sales of hedge fund offerings were up 20% year-to-date.

'We are seeing strong growth in alternative investments as more investors seek access to unique, high quality solutions on our alternative investments platform to put money to work in the current environment and diversify their portfolios,' Nancy Fahmy, head of alternative investments and capital markets for the bank's Global Wealth and Investment Management group, later said.

Stephanie Lang, chief investment officer of Homrich Berg, a $6.9bn Atlanta RIA and family office, said public-market valuations make alternative investments relatively more attractive right now. Simply put, stocks are expensive.

'There is a disconnect between what the stock market has done and what the fundamentals are showing,' she said. 'Of course, the stock market is looking ahead, but you're really not going to see any earnings growth until 2022. If this year's earnings are going to decline over 20% and rise over 20% next year, they're only going to get back to 2019 levels by the end of next year.'

Lang said alternatives have been a reliable source of yield throughout the recent market turbulence. 'In March, even going into April, it was like shooting fish in a barrel pretty much anywhere in the corporate credit space, although as equity markets rallied and the Fed stepped in to buy assets, we saw spreads in that space tighten significantly,' she said.

However, there were still a few areas of dislocation in the credit space where the Fed did not step in to buy assets and where Homrich Berg has found some opportunities. 'The non-agency mortgage sector is still attractive and prices are still dislocated,' Lang said. 'They've seen some recovery, but nowhere near to the extent we've seen elsewhere.'

Prices on commercial mortgage-backed securities remain attractive as well, she said, specifically those offered through Freddie Mac, the government-sponsored enterprise that largely lends to multi-family apartments and senior housing. 'It has historically been a very safe part of the market because there are very few defaults,' she said.

Investors can also step in to help companies affected by the Covid-19 pandemic secure the capital they need to get to the other side of the lockdown, Lang said.

'There's going to be opportunity on the credit side — more illiquid credit, typically — where there could be some rescue financing, or they're lending to otherwise healthy companies that need more capital to bridge them to the other side of demand,' Lang said. 'That might be in areas like travel and tourism, where there was a perfectly fine business before but there's obviously not much going on right now.'

For the most sophisticated qualified investors, Lang said there will also be opportunities in company restructuring, where certain managers can buy the debt and, after the restructuring, end up owning the company. 'That has typically been a good source of returns for certain managers who have the expertise to take companies through their restructuring,' she said.

Even before the pandemic put an end to the 11-year bull market, Lang had said her investment team believes investors can earn excess returns in private investments over the public market. The firm's clients typically have kept at least 5% of their portfolio in private alternatives, with some putting aside 10-15% of their portfolio in more illiquid investments.

'Most clients understood that typically when there's a big market sell off, especially so quickly, that volatility usually creates opportunity,' Lang said. 'We did see a lot of interest from clients wanting to take advantage of these dislocations.'

Stuart Katz, chief executive and chief investment officer of Robertson Stephens, a $1.2bn San Francisco RIA, said the growing demand for yield combined with the Fed's goal to keep rates lower for longer will motivate investors to look beyond traditional asset classes.

'[Q]ualified investors should consider complementing a core public investment portfolio with alternatives.' including distressed credit and private equity, he said in a note. Katz added that these markets are less efficient and offer investors opportunities to capture 'illiquidity premiums.'

Ken Van Leeuwen, managing director of Van Leeuwen & Co, a $260m Princeton, New Jersey-based RIA, said he wouldn't necessarily increase exposure to alternatives in the current environment, mostly due to their illiquidity, but that 5% to 10% of a client's portfolio should still include those investments.

Van Leeuwen, an active stockpicker, is still allocated to the 'big five' technology stocks — Apple, Microsoft, Google, Facebook and Amazon — although he's not necessarily dumping new money into them at the moment. He said he's also looking at stocks like Air Products and Chemicals, which sells gases and chemicals for industrial uses, and Union Pacific, a major railroad, as there are signs the industrial economy is strengthening.

But the firm is also looking at gold. 'We very much like gold as an investment, and we've actually held gold since last June,' Van Leeuwen said. 'We still believe in holding a gold position.'

The firm also views certain real estate investments favorably, such as Equinix, a real estate investment trust company that specializes in internet connection and data centers. Alexandria Real Estate Equities, which invests in office buildings and laboratories leased to pharmaceutical companies, is also a company that Van Leeuwen is following closely in the current environment.

‘They’re stocks but we consider them similar to alternatives,’ he said.

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