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# Every adviser should be invested in alternatives: Investment experts

Paramount to generate returns even in down markets; higher management costs worth it

By Lavonne Kuykendall
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Alternative investments have become compulsory in recent years as investors have sought gains in all kinds of markets, according to investment experts.

“Every adviser should allocate some capital to hedged equity,” said James K. Dilworth, founder and president of Simple Alternatives LLC, an institutional alternative-investment manager, at Sunday's keynote panel of InvestmentNews' Alternative-Investments Conference in Chicago. “Any investor can buy cheap beta. It is important to generate return on the down side, too.”

Investing for market-based returns, or beta, can end up producing losses in down markets. Sophisticated investors always have sought alpha — that is, investments that generate return even in down markets. The traditional way to generate alpha has been through investing in hedge funds. That strategy has spread to the retail market in the last few years, driven by investor disappointment over poor investment performance during the 2008 market downturn, which hit equity and bond investments, the panel said.

The keynote discussion panel discussed the growth of hedge fund strategies and their availability to retail investors, typically through mutual funds that mimic hedge fund long-short equity strategies and commodities and other non-market-correlated investments. Pension funds and other big investors always have allocated a portion of their money to hedge funds, and advisers are increasingly looking for hedge-fund-type investments, said John Brynjolfsson, managing director of investment manager Armored Wolf LLC.

Before launching Armored Wolf, Mr. Brynjolfsson spent 19 years at Pacific Investment Management Co. LLC, where he launched the Real Return platform and oversaw its growth from scratch to $80 billion in third-party assets. “The industry is becoming more focused on generating absolute return, and coming up with investment products that do that,” he said.

Phil DeMuth, managing director of advisory firm Conservative Wealth Management LLC, said the market rout of 2008 pushed him to begin researching Morningstar Inc.'s hedge fund database. He said he wanted an investment manager that followed a consistent process over time.

“I didn't want a Jim Cramer type, somebody who is watching the screen all day,” Mr. DeMuth said. “I want someone who follows a mechanical, boring process and gives me what a hedge fund will do at a good price point and who is reliable.”

One thing he quickly learned is that shopping for a good hedge fund means accepting a higher fee. “In the retail world, you can get an S&P index fund for 8 basis points,” he said. On equity mutual funds, low expense ratios are one of the best predictors of better returns, he said. “But not on the hedge funds. They pay smart people who don't work cheap," Mr. DeMuth said. "And this is what translates to better returns,” Mr. DeMuth said.

Eventually, he plans to invest about 25% to 30% of his equity allocation to alternatives. As of now, however he doesn't have enough trust "at the personal level” and is therefore 20% allocated to hedge funds. He suggests putting about 6% of equity allocations into alternative investments as a start, gradually building up.

“‘Don't drive beyond the headlights' is a concept that works with alternative investments,” he said. “You need to educate yourself.”