# Truth & Lies

## in Alternative Investments

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# What is an Alternative Investment?

Whenever the Dow falls over 100 points, people tend to go Google "Alternative Investments." But just what are they looking for, exactly?

Something which isn't going down with the stock market... that day? Something which can make money if there is an extended down move? Something which has different return drivers than the stock market – thus don't rely on stocks going up or down over the long term? Hedge Funds? Commodities? Real Estate? Put option protection? Inverse ETFs? Art? Classic Cars? Wine?

Turns out the term 'alternative investments' has been adopted as a marketing term by all types of "investments", even though most of these so called alternatives are not what you're going to see covered on the Chartered Alternative Investment Analyst Curriculum.

Indeed, a Russell survey found that institutional investors running pensions and endowments really only consider four types of investments 'alternative' (source: CAIA). So much for retiring off the cases of wine in the cellar.

| | |
|---|---|
| Private Equity | Commodities |
| Hedge Funds | Real Assets |

Now, these four types of investment may be considered "alternative" by many, but it seems they are labeled as such not because they zig when the stock markets zag; but more so because they just aren't all that common in the typical investor portfolio.

Let's take a closer look at just what these Alternative Investments do, and point out one that truly does something different.

# Real Assets

If you haven't seen 'Real Assets' up on CNBC or in the asset class performance table in the WSJ, don't worry… it's sort of an inside baseball term.

What is it? Real assets can include land and production plays like farmland, timber, and oil & gas wells; but the main 'real asset' investment involves property developments, buildings, warehouses, and homes – otherwise known as real estate.

Real estate is definitely different than the stock market and squarely in the alternative investment camp in terms of its price movement. But it isn't all that alternative. The biggest investment most people have is their home, after all.

And unlike some other types of alternatives, real estate is pretty closely tied to how the global economy is performing.

Turns out people need money to buy houses and keep paying their mortgages and stuff, and that the money comes from their jobs, which are sort of tied to how well companies are doing, which is sort of tied to how a company's future prospects are, which is what their stock price is based on….causing a sneaky link between stocks and real estate prices.

Yep – real assets (particularly real estate) are alternative right up until they aren't – at which point they can become highly correlated with the stock market (see 2008).

| 2008 Real Asset Performance | |
|---|---|
| Real Estate ETF (IYR) | -61.47% |
| Timber ETF (PCL) | -39.72% |
| S&P 500 ETF (SPY) | -48.22% |

(Disclaimer: Past performance is not necessarily indicative of future results).

# Commodities

Commodity markets sure seem like a slam dunk, no brainer alternative investment. After all, what does Soybean Oil have to do with Microsoft's earnings and stock price?

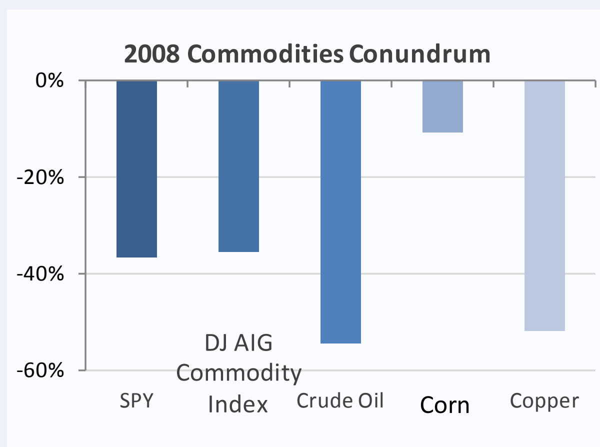
And most of the time, commodities are definitely an alternative investment doing things much differently than the stock and bond markets.

Corn, Cattle, Natural Gas and Crude Oil all respond to price drivers such as: crop reports, weather, the Middle East, and the economics of supply and demand.

But upon closer inspection – the stock market is somewhat infested with commodity based companies: the ExxonMobils, Alcoas, ADMs, Monsantos of the world, and slew of other companies dependent on the farming, mining, and shipping of commodities (Caterpillar, John Deere, CSX, etc).

This blurring of lines between commodities and commodity companies tends to cause some higher than normal correlation between commodities and traditional investments.

But the real danger is something much simpler. The real danger is we use more of these commodities in the boom times than we do in recessions. This became known as the risk on/risk off trade in 2008 and 2009 – when Crude Oil, Copper, Corn, and other commodities sold off right along with stocks.

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# Private Equity

Private Equity is a bit of a hybrid. On the one hand, it is a bit of an odd investment to call 'alternative' – with 'equity' in the name.

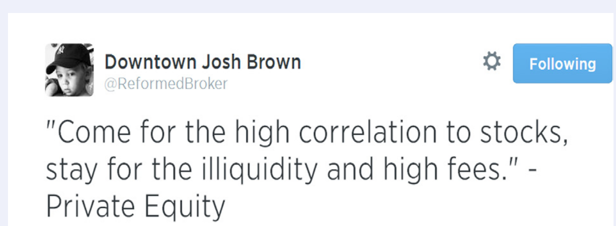
Its investment strategy is to acquire shares (equity) in privately held companies via outright purchases, debt deals, financing, and more; looking to off-load those shares to someone at a higher price at a later time. That sure sounds like the same model as the stock market.

On the other hand, private equity is usually investing in private companies, not publicly traded ones; and may be in those companies at the very beginning so they're able to capitalize on the rapid growth of a company in its early stages (which can decidedly be outside of whatever the general market is doing), or coming in and making significant changes to improve the value of the company.

The excellent book 'The Invisible Hands' by Steven Drobney gets into the love affair between institutional investors (i.e. pensions and endowments) and Private Equity investments, explaining that much of the return in private equity comes not from different return drivers or alternative strategies – but from an illiquidity premium.

That is, investors in private equity expect to earn returns above that of the normal stock market in exchange for giving up the ability to get their money out quickly.

We'll sum up private equity with the words of tweeter extraordinaire Josh Brown:



# Hedge Funds

And then there are the many layers of hedge fund categories which are marketed as alternative investments, but which in actuality are just more sophisticated (or complex, or both) ways to access the return stream of private and public companies around the world (i.e. the same thing which drives the stock market).

In addition, many hedge funds rely on access to the credit markets to amplify their returns or even as part of their overall investment strategy, meaning any stock market decline caused by tightening credit markets is going to cause problems at the hedge funds as well.

All of these factors combined to leave nearly all hedge fund strategies, be it long/short equity or merger arbitrage or event driven, down in 2008 when the stock market crashed....so much for 'alternative'.

Now, they still did better than the equity markets themselves... which makes them a better risk adjusted investment for those wanting stock market exposure, in our opinion – but whether better at controlling risks or not – it is still stock market exposure, the good and the bad.

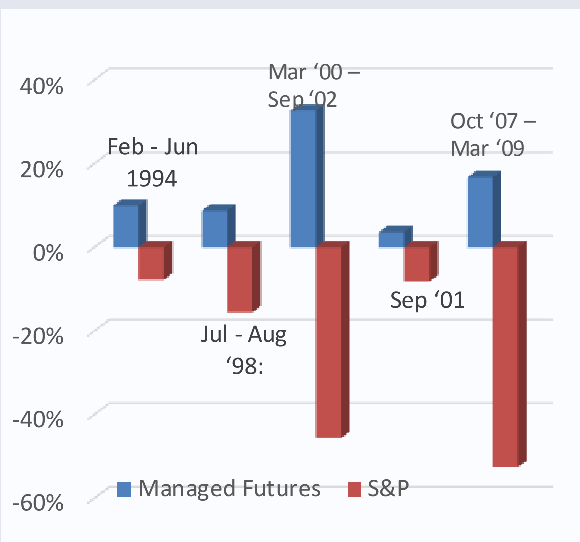
| Hedge Fund Strategy | 2008 |
|---|---|
| Managed Futures | 18.23% |
| Dedicated Short Bias | 13.87% |
| Global Macro | -4.69% |
| Event Driven | -16.91% |
| Long/Short Equity | -19.92% |
| Multi-Strategy | -23.74% |
| Fixed Income Arbitrage | -27.72% |
| Emerging Markets | -30.38% |
| Convertible Arbitrage | -31.79% |
| Equity Market Neutral | -39.44% |

(Disclaimer: Past performance is not necessarily indicative of future results).

# Managed Futures

Which leads us to our favorite alternative investment; one which is at different times considered part of the commodities or hedge fund world.

We're talking Managed Futures and their hedge fund cousin global macro, both of which actually do what one would expect out of an alternative – something different. You can see their decidedly different pattern of performance during market crisis periods below:




Past performance is Not Necessarily indicative of future results. Managed Futures = DJCS Managed Futures Index

This outperformance can be explained by What they Trade, How they Trade it, and When they Trade.

**'What they Trade':** managed futures trade essentially all major market sectors – including commodities (grains, energy, metals, meats, softs), currencies, stock indices, and bonds – meaning they are not reliant on any one of those sectors to move a certain direction for their returns.

**'How they Trade it':** managed futures have the ability to go both long and short; meaning they can make just as much money from Crude Oil going from \$120 to \$90, as from a \$70 to \$100 move.

**'When they Trade':** managed Futures programs continuously analyze all market sectors, entering into nearly all breakouts higher and lower – resulting in a lot of small losses when the trends don't materialize; but also insuring that the program is involved in the outlier trade when it does happen.

# What are you using Alts for?

In the end, what type of alternative investment you want depends on what you want it for.

If you're looking for returns, period; and not so concerned with how correlated it is to the stock market – the equity like returns of private equity or a long/short equity hedge fund may be appealing.

If you want the returns, with no correlation to the stock market – a specialty managed futures program such as a short term program or Ag Trader may fit the bill.

If you are looking for a diversifier or even outright hedge against stock market exposure,  then the majority of so called alternative investments won't work. The grand majority, including private equity, hedge funds (most), real estate and commodities (in extreme examples) will show equity like returns during a crisis, because they are reliant on global demand, which can quickly go on strike as we saw in 2008.

You can buy put options on your stock portfolio, or exit your stock portfolio altogether to hedge against a stock decline – but those come with real costs such as premiums and more nuanced opportunity costs.  You can be in cash or bonds… but that is hardly alternative, that should already be part of a diversified portfolio.

Or you can look at managed futures as your diversifier, trying to find a program which provides the crisis period performance when it is needed – while also having the ability to perform some in a rallying stock market in a sort of a best of both worlds.

An imperfect option on a market crash, but one which also allows for the ability to get paid on the hedge before it is needed – a sort of insurance policy that can pay for itself. Of course, the insurance policy could also lose before its needed, but nobody said this was easy.  That's why **we're here to help.**

# Disclaimer

The information contained in this report is intended for informational purposes only. While the information and statistics given are believed to be complete and accurate, we cannot guarantee their completeness or accuracy. RCM has not undertaken to verify the completeness or accuracy of any of the information and statistics provided by third parties.

As past performance does not guarantee future results, these results may have no bearing on, and may not be indicative of, any individual returns realized through participation in this or any other investment. The risk of loss in trading commodity futures, and an investment in this fund is speculative, as are the investments made by the underlying manager. The fund trades in a variety of futures markets in the U.S. and abroad. Futures trading is highly leveraged, and as a result, returns may be volatile. Leverage increases both the Fund's upside and downside potential. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. You may sustain a total loss of the investment.

Any specific investment or investment service contained or referred to in this report may not be suitable for all investors. You should not rely on any of the information as a substitute for the exercise of your own skill and judgment in making such a decision on the appropriateness of such investments. Finally, the ability to withstand losses and to adhere to a particular trading program in spite of trading losses are material points which can adversely affect investor performance.

We recommend investors visit the Commodity Futures Trading Commission ("CFTC") website at the following address before trading: http://www.cftc.gov/cftc/cftcbeforetrade.htm

# About RCM Alternatives

**RCM Alternatives ("RCM")** is a registered commodity brokerage firm which helps high net worth individuals, registered investment advisors, and institutional investors identify and **access top alternative investments** focused in commodities and managed futures.

In addition to assisting end investors, RCM's **low cost, consultative, education based approach** to alternative investments is a natural fit with investment advisors, while a professional services desk assists hedge funds, commodity trading advisors, and mutual funds set up and efficiently access markets around the world.

RCM's asset management arm, **registered Commodity Pool Operator** Attain Portfolio Advisors, aids investors and their advisors in accessing select managers which have been filtered through our real time due diligence process at lower investment levels via institutional grade fund vehicles structured as Limited Liability Companies.

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