



# AIMA Japan Forum

William Kelly, CEO

## Obstacles to a More Efficient Frontier

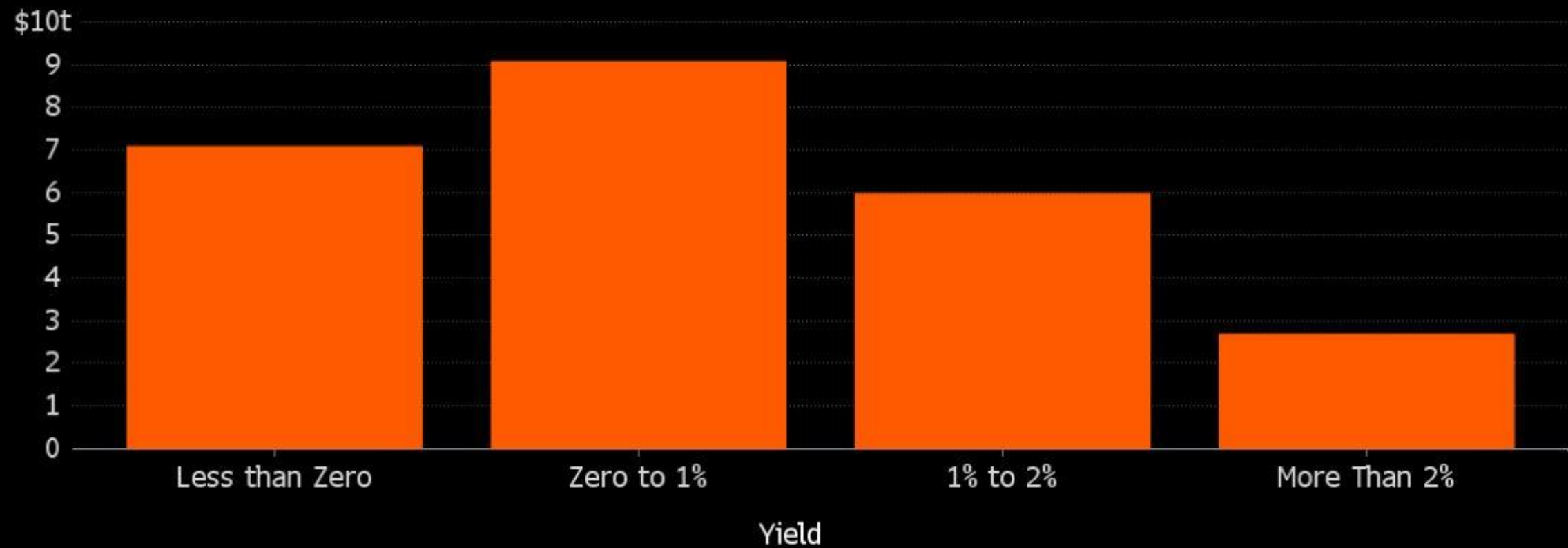
# Opening Statement

- 60/40 model may be obsolete
- Obstacles to be overcome; real and perceived
  - Media bias
  - Fees
  - Performance dispersion
  - Correlations going up
  - Perceived desire for liquidity
- A path to better risk-adjusted returns

# What happened to my risk-free rate?

## \$7 Trillion of Negative-Yielding Bonds

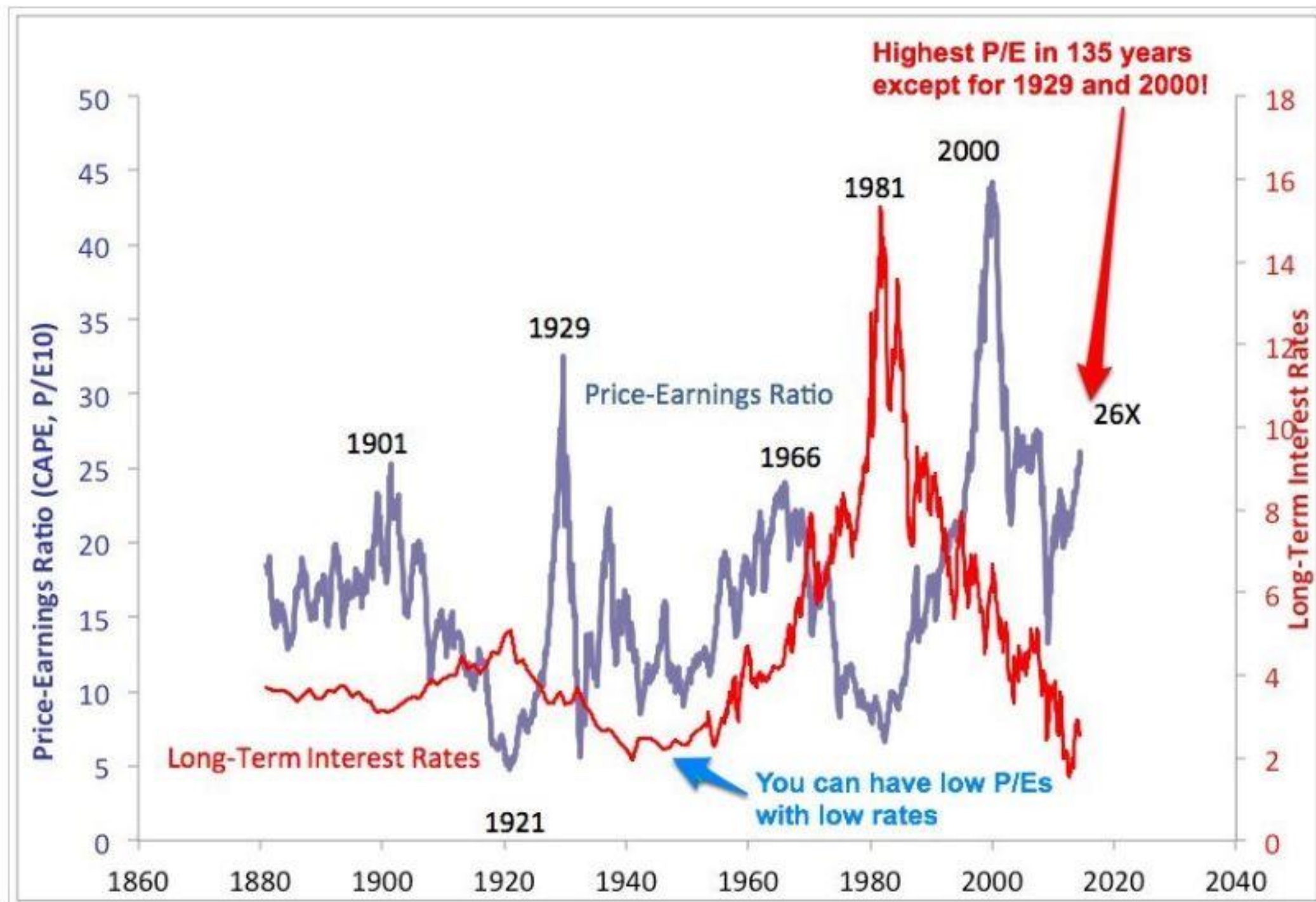
Amount of debt with sub-zero yields swells



Source: Bloomberg Global Developed Sovereign Bond Index

Bloomberg

# Equity valuations looking very rich...



Robert Shiller

# Out of bounds?

## Here's How Golf Star Phil Mickelson Got Caught in an Insider Trading Case

by Reuters

MAY 20, 2016, 4:18 AM EDT

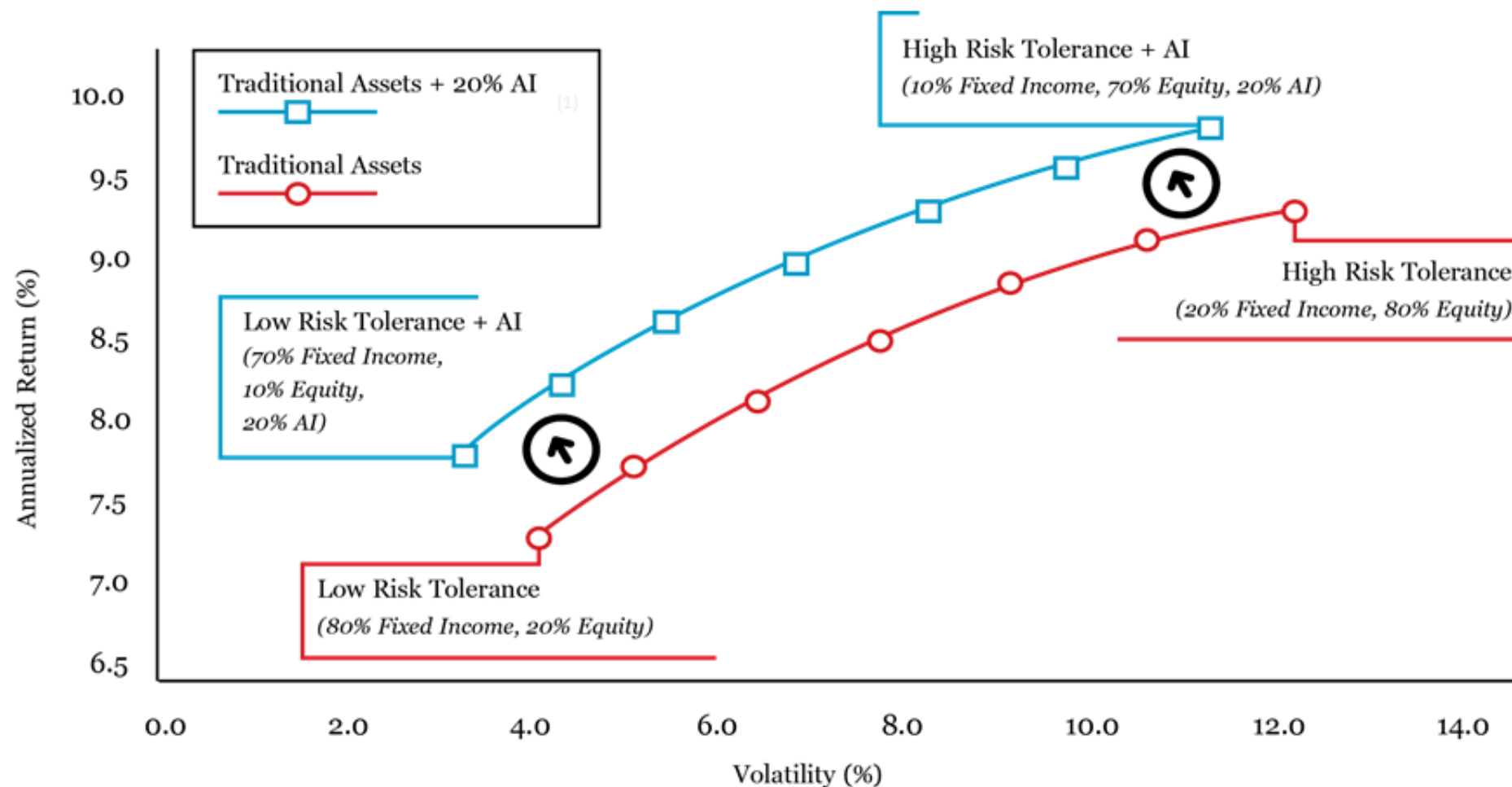


**Phil Mickelson**

Photograph by Ross Kinnaird — Getty Images

# Case for Alts (NOW!) is pretty compelling

## Alternatives May Improve the Efficient Frontier Regardless of Risk Tolerance (4/1/95 through 3/31/15)




Graph illustrates a 20 year investing period from 4/1/95 through 3/31/15. Other time periods can be analyzed upon request.

Note: There can be no assurance that an allocation to alternatives would provide higher real returns. Please consult your own third-party advisor before making any investment decisions based on this information.

(1) Source: Morningstar. Traditional Assets comprised of Equity (S&P 500) and Fixed Income (Barclays Aggregate). Blackstone used these indices as a proxy for traditional assets given these indices are typically used by the market. 20% Alternative Investments comprised of: 5% Private Equity (Cambridge Associates PE); 5% Distressed (HFRI ED Distressed Restructuring); 5% Real Estate (NCREIF Fund Open End Diversified Core Equity) and 5% HFRI Fund Weighted Composite. This mix was used to capture alternative investments broadly across the major alternative assets classes: Private Equity, Private Real Estate, Distressed Debt and diversified hedge funds.



# Sensationalism doesn't help...

 **REUTERS** Share  

**TOP NEWS**

Thu Apr 14, 2016 | 7:05 PM EDT

## 'Let them sell their summer homes': NYC pension dumps hedge funds



Apr 14, 2016 | 01:13  
New York City public pension dumps hedge funds

... but neither does this!

**FUND***fire*

A Financial Times Service

## Och-Ziff Borrowed for Jet Amid Bribery Investigation

May 20, 2016 |

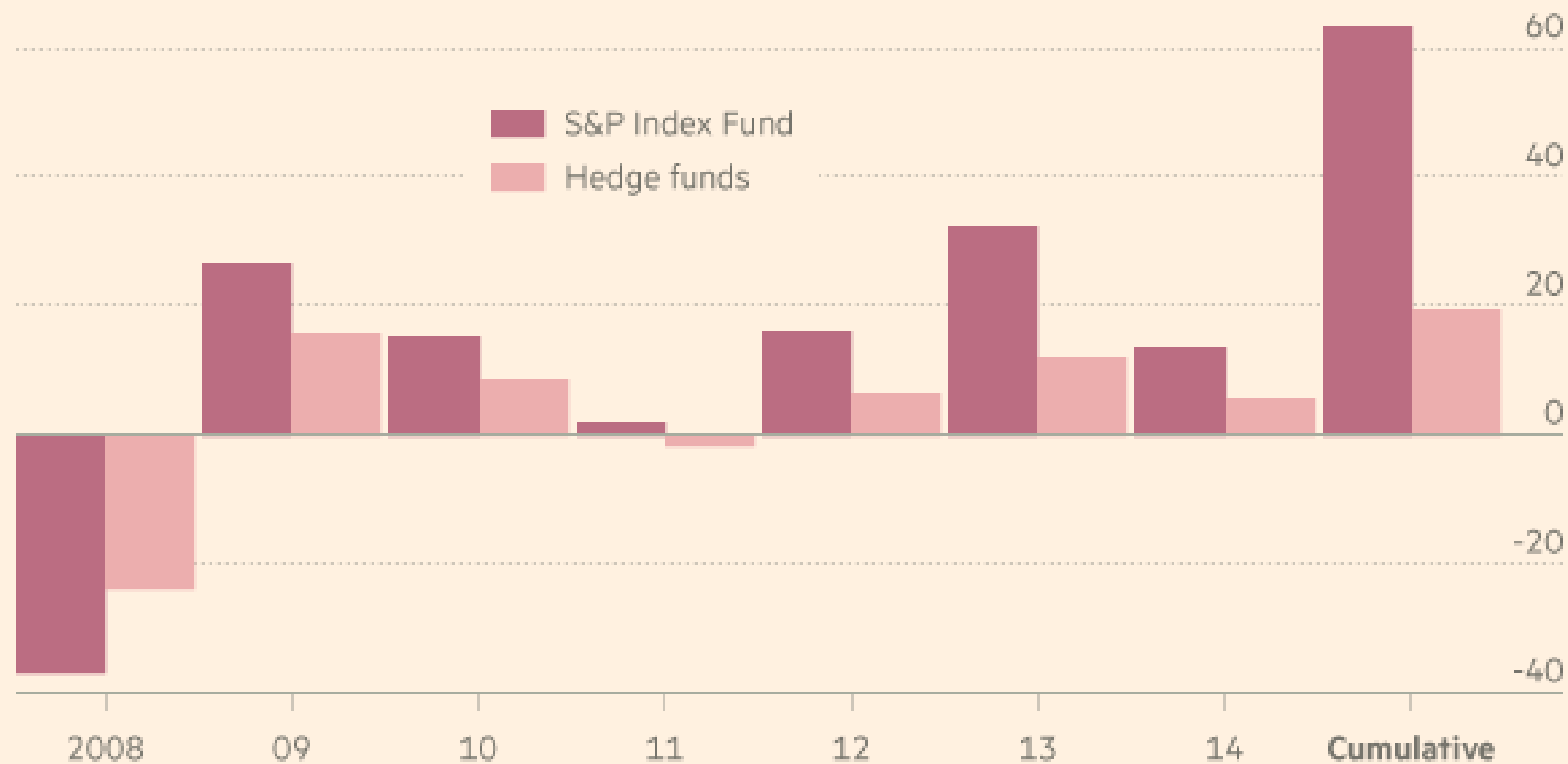
**Och-Ziff Capital Management** borrowed \$49 million to buy a corporate jet at the same time it was trying to come up with around \$200 million to settle allegations it had bribed African officials, the *Financial Times* reports.



# Buffett bet more harmful than fun

## Buffett's bet

Protégé Partners hedge fund selection v S&P 500 index fund (%)



Source: RIAA

FT

# Dispersion of returns widens with alts

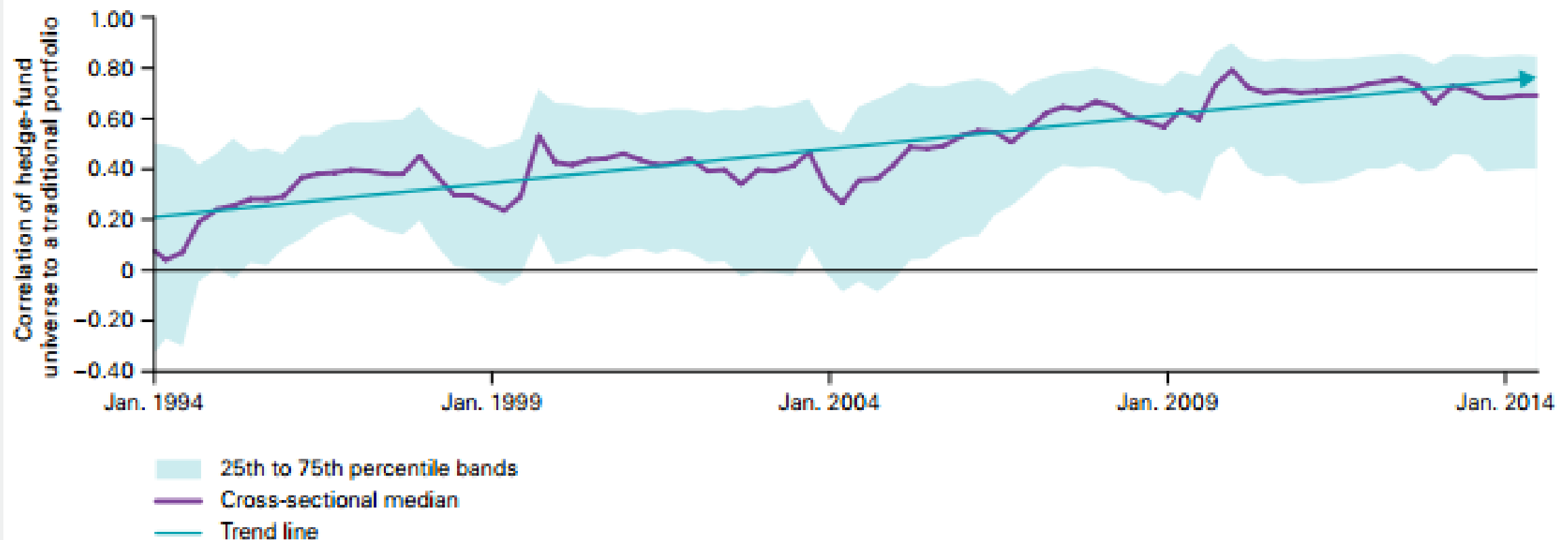
## HUGE DIFFERENCE BETWEEN GOOD AND BAD HEDGE FUND MANAGERS PERFORMANCE SPREAD BETWEEN TOP AND BOTTOM-DECILE MANAGERS (2005 – 2014)



\*Source: Morningstar, Lipper TASS database. Past performance and correlation are no guarantee of future results. Stocks represented by Morningstar US Large Cap Core Funds. Bonds represented by Morningstar US Core Bond Funds. Alternative categories represented by the following TASS fund classifications: Fixed Income Arbitrage (representing Long/Short Credit); Convertible Arbitrage (representing Relative Value); Long/Short Equity; Event Driven; Global Macro; Managed Futures. For illustrative purposes only.

# Growth of HFs sapping the value proposition?

Figure 7. Diversification benefit of hedge funds has declined significantly over 20-plus years through 30 June 2014



Past performance is not an indicator of future performance.

Notes: All hedge-fund categories in the Lipper TASS database were considered for this analysis. To be included in the sample of 5,460 hedge funds, each fund had to have at least 60 months (20 quarters) of continuous history. All funds were compared to a 60% stocks/40% bonds balanced portfolio. The 60%/40% balanced portfolio excludes cost. Stocks were apportioned 70% domestic stocks/30% international stocks, as follows: Domestic equity represented by Spliced Total Equity Market Index (Dow Jones US Total Stock Market Index — formerly known as Dow Jones Wilshire 5000 Index — through 22 April 2005; MSCI US Broad Market Index through 2 June 2013; and CRSP US Total Market Index through 30 June 2014). International equity represented by Spliced Total International Equity Index (Total International Composite Index through 31 August 2006; MSCI EAFE and Emerging Markets Index through 15 December 2010; MSCI ACWI ex USA IMI Index through 2 June 2013; and FTSE Global All Cap ex US Index through 30 June 2014). Fixed income represented by Barclays US Aggregate Bond Index. Purple line shows median rolling correlation against all funds that existed in each time period, and blue shading is the 25th to 75th interquartile range. Each cross-section represents a distribution of correlations across all funds in existence for that period. The analysis spans 1 January 1994 through 30 June 2014, using a rolling 12-quarter period for each fund. Trend line is based on ordinary least squares (OLS) regression of cross-sectional medians.

Sources: Vanguard calculations, using data from Lipper TASS.

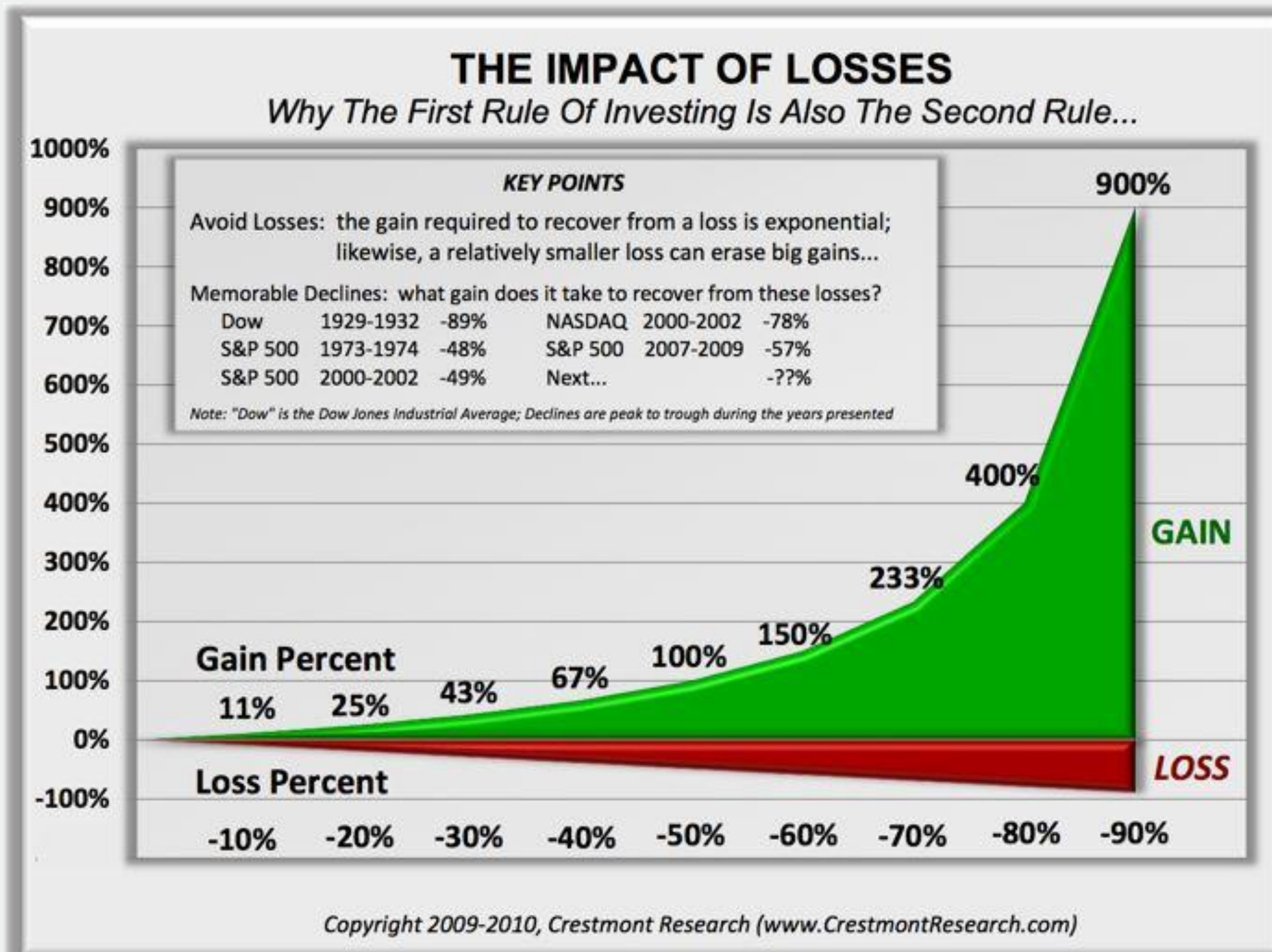
# Buffett: “Our favorite holding period is forever”

## S&P 500 10 Years Ending October 21, 2015



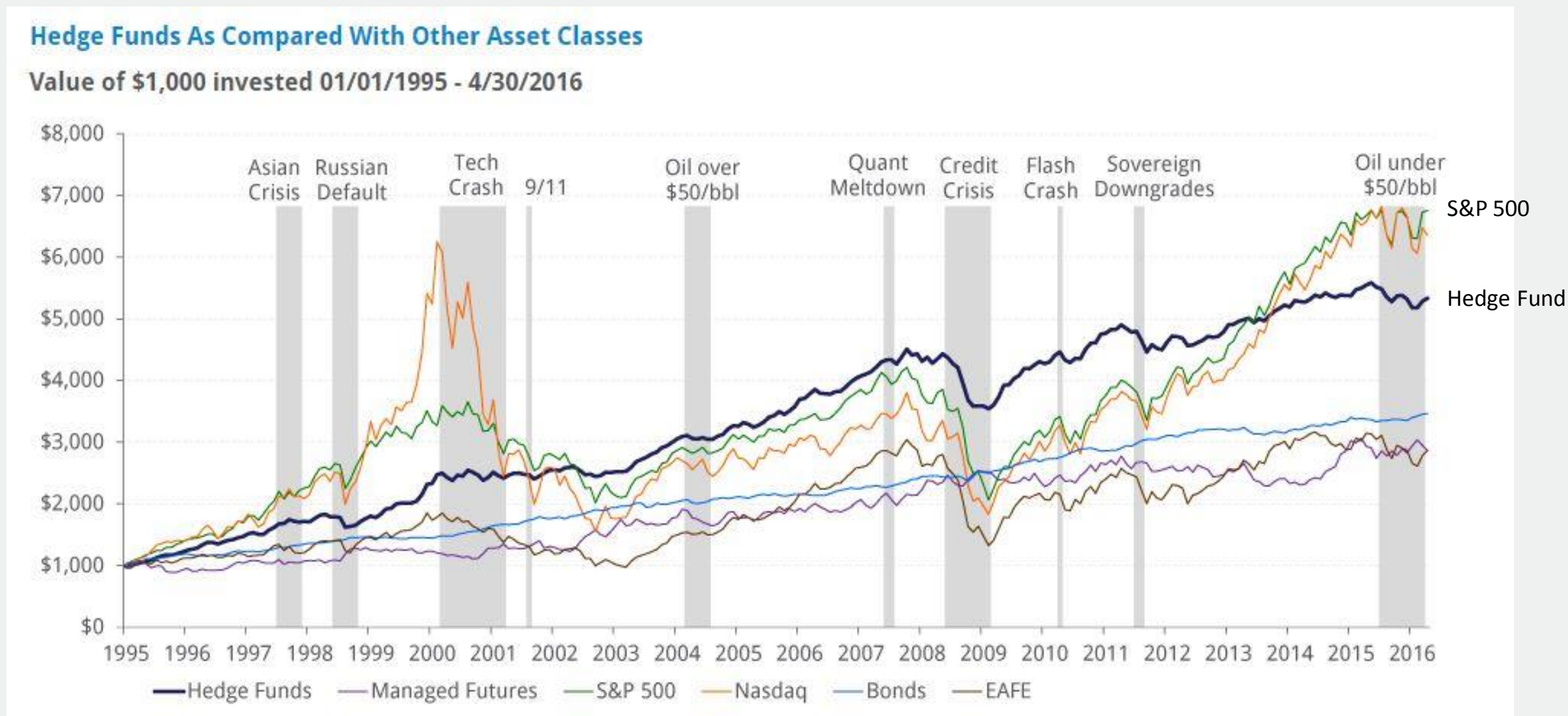
*Source: FactSet. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.***

# “Forever” is a long time





# Why not dampen down volatility?

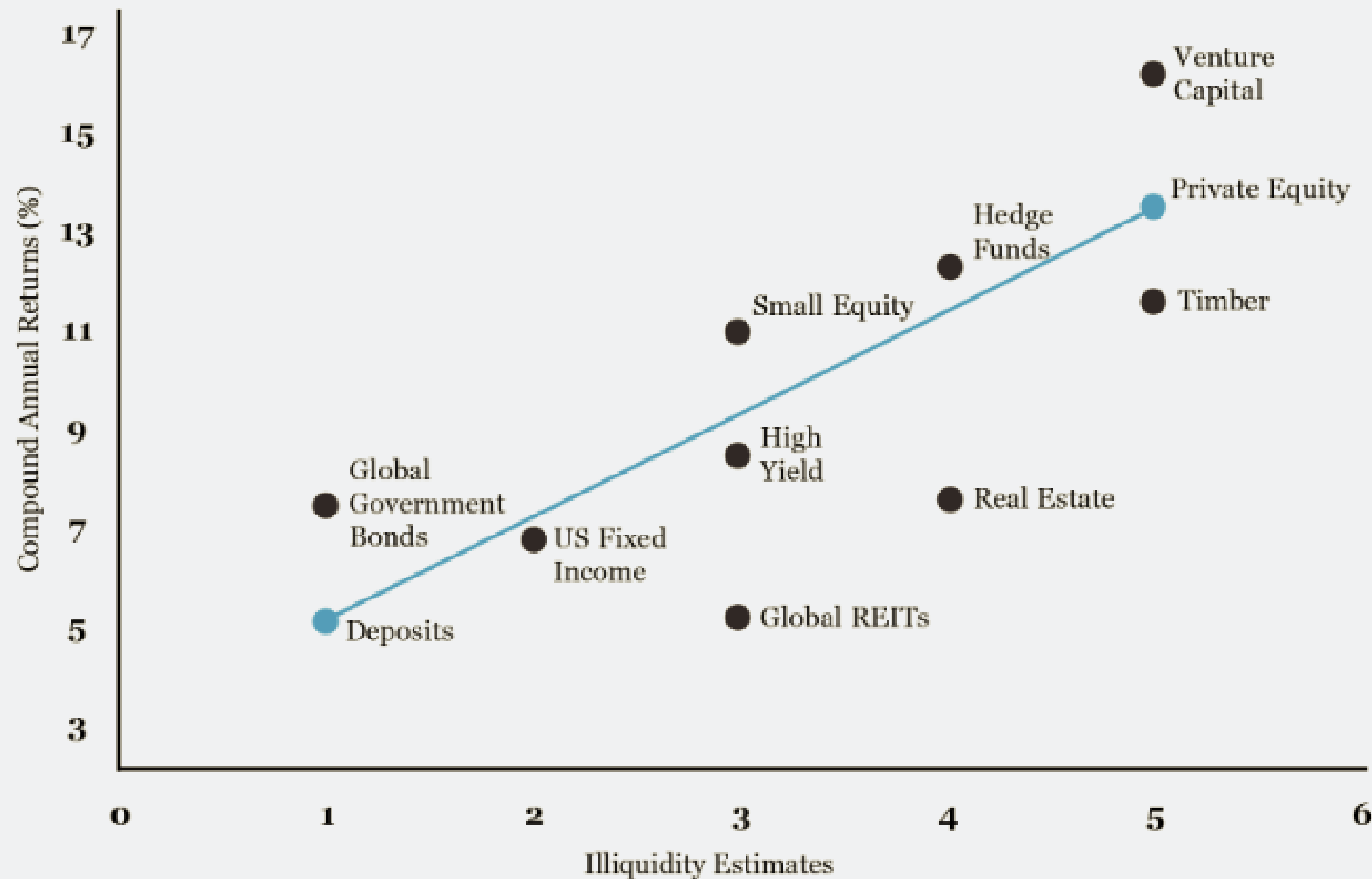


Source: [collinsalternativefunds.com/why\\_alternatives](http://collinsalternativefunds.com/why_alternatives)



# Also, why the fixation on liquidity?

## Investment Returns Generally Increase with Degree of Illiquidity

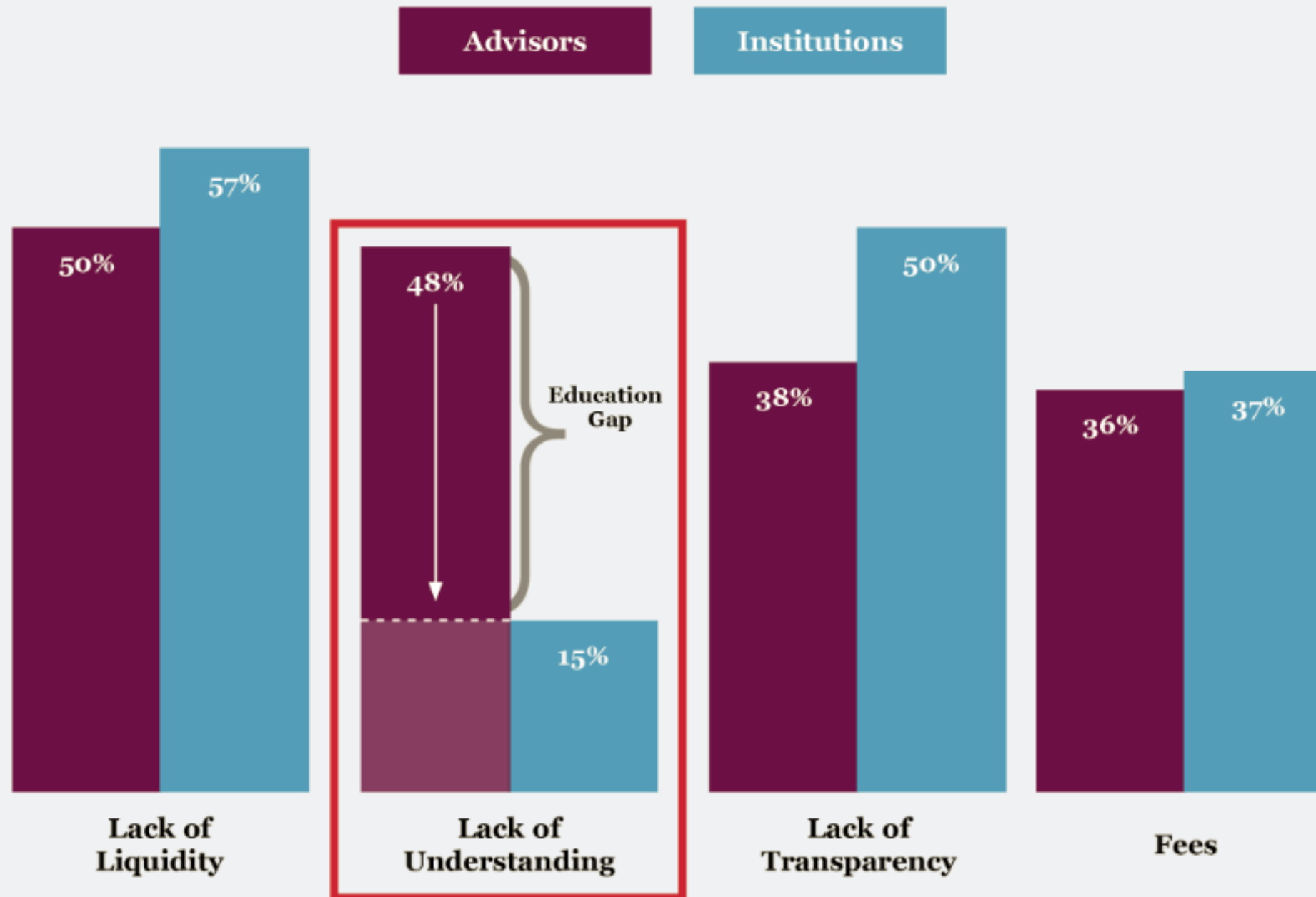


Source: "Expected Returns," by Antti Ilmanen, 2011. Scatterplotting average asset returns 1990-2009 on (subjective) illiquidity estimates. Sources: Bloomberg, MSCI Barra, Ken French's website, Citigroup, Barclays Capital, JP Morgan, Bank of America Merrill Lynch, S&P GSCI, MIT-CRE, FTSE, Global Property Research, UBS, NCREIF, Hedge Fund Research, Cambridge Associates.

# The missing link is education

## Advisors Need Greater Familiarity with “Alts”

### Top Reasons to Hesitate Investing in Alternatives



Source: Morningstar Survey 2012.

# In Summary

- The Alts value proposition is compelling
- Be clear about your investment process
- Explain how it fits into a broader portfolio
- Propose solutions vs. distributing product
- Professionalism and education matter (a lot!)

# A picture is worth a thousand words

The advertisement features a central image of a pencil with a red eraser and a red lead tip, positioned as if it has just drawn a thin orange line across a gap between two dark, jagged rock formations. The background is a light, cloudy sky. The CAIA Association logo is in the top left, and a list of asset classes is on the right. The slogan 'Mind the Gap' is centered below the pencil. A footer bar at the bottom contains the text 'CAIA EXAM REGISTRATION OPENS APRIL 1. LEARN MORE AT CAIA.ORG'.

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