Alternative Investments

Alternative Products/ Investments

Alternative products and investments are assets which do not count among the traditional investments (equities and fixed income securities). Generally, a distinction is made between unregulated - in other words not subject to special regulatory supervision - partnerships or corporations which serve the purpose of collective investment (hedge funds, real estate, private equity and venture capital funds), and non-homogeneous asset classes. Non-homogeneous asset classes include commodities and currency investments which do not relate to classic asset classes such as equities and fixed income securities. The aim of Alternative Investments is to offer opportunities for capital appreciation independently of the equity and fixed-income markets. They are therefore suitable for portfolio diversification. This modifies the overall return and risk profile.

Hedge funds

Hedge fund managers pursue an investment style of their own. The basic idea is to generate a positive absolute return irrespective of market trends. They can use the whole spectrum of financial instruments including futures contracts, options and securities of diverse asset classes. Most managers concentrate on specific investment strategies and processes. To simplify matters, the investment strategies can be divided into five broad categories: Relative Value, Event Driven, Global Macro, Equity Hedge and Short Selling.

Private equity funds

Investments in private equity funds represent entrepreneurial equity stakes in portfolios of young, usually unlisted companies. The equity stakes serve to finance the growth of young companies or special situations such as restructuring measures. By subscribing a specific sum, investors acquire an ownership interest in the private equity company and share in the assets of the fund. The income, which mainly represents gains realized upon the sale of the equity stakes, is usually distributed to the individual investor after it is received by the fund and after deducting the investment manager's success fee and is not reinvested.

Venture capital funds

Venture capital funds are very similar to private equity funds. The main difference is that for the most part they invest in companies which are at a very early stage of development. They are mainly active in growth sectors such as the internet, information technology and biotechnology.

Portfolio constructions (so-called funds of funds and special index certificates) provide an opportunity for investing indirectly in hedge funds, private equity funds and venture capital funds. In the case of funds of funds, investors acquire units in a fund which in turn invests in funds. This gives the investor access to a diversified investment, whose individual assets may require high minimum investment sums. However in such cases there is very limited public information available in such cases.

Commodities

The term commodities relates to commercial products traded on the markets. Commodities are divided into three broad categories: minerals (e.g. oil, gas, aluminium and copper), agricultural products (e.g. wheat and maize) and precious metals (e.g. gold, palladium and platinum). Another class are so-called soft commodities such as coffee, cocoa, sugar or orange juice concentrate. "New" commodities include electricity, weather and catastrophe derivatives.

Oil is the most important asset class among the mineral commodities. The oil price reacts quickly and sharply to supply shocks and geopolitical events, and is therefore regarded as a crisis barometer. This class also includes cyclically-sensitive metals such as aluminium and copper whose price development is strongly correlated with economic cycles.

Demand for agricultural products is less cyclical and price fluctuations are mainly due to changes in supply conditions which are difficult to predict such as weather factors. However, prices can also be influenced by long-term factors such as increase in demand as a result of population growth or changes in eating habits (e.g. switch from vegetarian foods to non-vegetarian foods as people become more affluent).

Gold, which is still regarded as a crisis currency and “safe haven”, plays the most important role among the precious metals.

Soft commodities are acquiring greater importance in the international markets in recent times as they are being used more and more as substitutes for the traditional commodity classes.

Most commodities are traded on specialized exchanges, or directly between market players around the globe in the form of OTC (over-the-counter) transactions, as largely standardized contracts. Commodities are mainly added to portfolios to improve the risk structure as they are only weakly or negatively correlated with traditional asset classes such as equities or fixed income securities.

Real Estate

Real estate is an asset class which offers a wide variety of investment opportunities. Basically, a distinction can be made between directly and indirectly owned real estate. The main forms of indirectly owned real estate are real estate company stocks, including Real-estate Investment Trusts (REITs), and open and closed-end real estate funds – whereby the individual categories differ widely from country to country. Directly owned real estate assets are investments in apartments or office properties. However, this mostly requires a large amount of capital to be invested, and is therefore not attractive for most investors, and is a less liquid form of investment compared with traded instruments and fund units.

Real estate assets can also be differentiated according to regional focus or different types of use. Finally, it is customary to categorise real estate investments according to different investment styles based on their risk-return profile. On a broad definition real estate investments also include property finance, mortgage loans, securitized forms such as mortgage backed securities and mezzanine capital, which is a hybrid form of debt and equity capital.

Currencies

The prices traded in the foreign exchange market are rates of exchange between two currencies. The motivation for investors to engage in the foreign exchange market is usually to make a profit as a result of short to mid-term fluctuations in exchange rates. It should be noted that in this case the gains are generally achieved from short-term changes in value and not in the form of interest income.

Another possibility is so-called “carry trades” where the investor seeks to exploit the interest rate spread between two currencies, in other words borrowing money in a low-interest currency and reinvesting it in a high-interest currency.

Currencies can be traded in a number of ways. The most common are trading on a cash or spot market basis (with settlement following as a rule two business days later) in the form of currency futures contracts (settlement at a future date) or a currency option.
With a daily trading volume of more than 1 trillion US dollars, the international foreign exchange market is the world’s biggest market.