The best of both worlds:

The role listed alternatives can play in a balanced allocation to alternatives

What can listed alternatives offer within a broader portfolio? In this piece, portfolio manager Ryan Boothroyd discusses the different structures as well as the opportunity, risks, and costs.

At a recent industry event, I mentioned the launch of our new Listed Alternatives Fund to a fellow attendee. His reply surprised me: *"Listed Alternatives? I prefer the real thing"*.

This viewpoint is relatively common among institutional investors who have historically preferred to invest in private market alternative assets via unlisted funds. Listed alternatives are rarely considered as a core part of an alternative strategy and some question whether they are *"alternative"* at all.

In this blog, I explain how listed assets can play an important role in a well-structured alternatives strategy by providing allocation flexibility, an expanded investment universe, the potential for improved risk and return outcomes, reduced costs, and greater transparency. Moreover, I dispel the myth that listed alternatives are not truly alternative. They are simply the same type of assets in a different structure.

Same assets, different structure

Alternative assets are a rapidly growing segment of institutional portfolios and typically include infrastructure, real estate, private equity, and alternative credit. While each sub-asset class has its own nuances, they share common traits such as being difficult to buy and sell, because of their illiquid nature, and requiring specialist resources to effectively analyse and manage. In theory, the specialist nature of the alternatives sector attracts a return premium relative to traditional assets over time.

> *"Alternative assets are a rapidly growing segment of institutional portfolios and typically include infrastructure, real estate, private equity, and alternative credit. While each sub-asset class has its own nuances, they share common traits…"*

Investors can access alternative assets directly through unlisted private assets, or through listed assets such as investment trusts or listed equities. Ultimately, the underlying assets are of a similar nature. Indeed, in some cases, listed vehicles may even share ownership of the same asset with a private fund, and transactions that move assets between public and private markets are increasingly common.

A fundamental difference between unlisted alternatives or listed alternatives is that listed funds can be traded on a daily basis, while assets accessed in an unlisted format are typically locked-up within a fund for multiple years and priced less frequently. The short-term differences in returns and volatility are simply manifestations of accounting that largely net out over the long-term time horizons common to LGPS funds.

Allocation flexibility

While unlisted alternatives are always likely to form the core of an alternatives allocation, one widely acknowledged limitation is the difficultly in making allocation changes, given the time taken to invest new commitments and the lengthy lock-up periods for redemptions.

Adding exposure to listed alternatives can significantly improve the flexibility of an overall allocation to alternatives. It can be deployed quickly, allowing quick and efficient changes in strategic allocation following an asset allocation review.

Moreover, rebalancing out of another asset class into listed alternatives does not incur the same cash drag or require overcommitments. Instead, investors can purchase a diversified portfolio that is fully invested on day one.

Proceeds from the listed portfolio can also be used to meet capital calls if an investor's strategic preference is for unlisted funds. While this remains only suitable for long-term shifts in allocation, ultimately this can lead to a more robust and flexible toolkit for investors.

Broadening horizons

A more tangible reason that investors could consider listed alternatives is that it broadens the potential universe of investible assets. There are a huge variety of different alternative assets that are not available in an unlisted format. A few examples from the Border to Coast Listed Alternatives fund portfolio include Union Pacific (owner of America's premier rail franchise, including 32,000 miles of track and 7,600 locomotives), National Grid (owner of the UK electricity transmission and distribution network) and Vinci (owner of European infrastructure, including 4,000km of toll roads and 53 airports). Asset portfolios of this scale would be extremely difficult to amass privately given their scale and monopolistic nature.

> ***"A key benefit of including a listed alternatives allocation within the broader alternatives' strategy is that it increases the proportion of the portfolio subject to transparency measures. In particular, external ESG ratings, carbon output data and underlying financial metrics for the asset portfolio..."***

If investors wish to have the full opportunity set of global alternative assets, they should consider both private and public markets to achieve this. The world's top private investors are leading by example as illustrated by the rising proportion of major unlisted fund investments that have been sourced from the public markets (examples include the take-private of Sydney Airport and Anaplan).

Looking at investment outcomes

The most common pushback against listed alternatives is that they don't provide the same volatility-cushioned return as their unlisted counterparts. However, this is an accounting anomaly. Unlisted private funds don't benefit from lower cashflow volatility than their listed peers as they broadly invest in similar underlying assets . They simply benefit from infrequent pricing. The two are often conflated.

Over long time periods, returns and risk are broadly comparable between listed and unlisted alternatives. This is to be expected given the similarity in underlying assets. As real estate manager Nuveen notes in its report *Listed vs. private infrastructure: Why not both?* and contrary to common belief, *"there exists no return premium for locking up capital in an unlisted vehicle"*. Indeed, the risk return profiles of listed and unlisted alternatives are arguably diversifying and investors can benefit from the combination.

Cheaper and more transparent

Two major forces in the institutional investment market over the past five years have been investor demand for lower fees and greater transparency. The epitome of this being the multitude of industry groups lobbying for enhanced disclosure around climate risk.

Public markets have long been required to produce high-quality, audited financial reporting for investors. A key benefit of including a listed alternatives allocation within the broader alternatives' strategy is that it increases the proportion of the portfolio subject to such transparency measures. In particular, external ESG ratings, carbon output data and underlying financial metrics for the asset portfolio.

Moreover, as many listed alternatives are direct investments, there are often few or significantly lower fees payable, reducing the blended average cost of the allocation. Our medium-term expectation is for the underlying fees on Border to Coast's Listed Alternatives Fund to be in the region of 0.5-0.6% a year, significantly less than even the most cost competitive unlisted funds.

Best of Both Worlds

In summary, we believe there are a multitude of benefits to investors with a long-term outlook who mix an allocation to listed alternatives within their strategic unlisted alternative allocation. By considering a balanced and diversified approach to both listed and unlisted alternatives, we believe we can unlock the best of both worlds.

Ryan Boothroyd
Lead Portfolio Manger, Listed Alternatives Fund

Important information

FOR PROFESSIONAL INVESTORS ONLY. NOT FOR USE WITH OR BY PRIVATE OR RETAIL INVESTORS. CAPITAL AT RISK. ALL FINANCIAL INVESTMENTS INVOLVE TAKING RISK WHICH MEANS INVESTORS MAY NOT GET BACK THE AMOUNT INITIALLY INVESTED.

REFERENCE TO SPECIFIC STOCKS SHOULD NOT BE TAKEN AS ADVICE OR A RECOMMENDATION TO INVEST IN THEM.

THE INTENTION OF BORDER TO COAST'S ARTICLES IS TO PRESENT OBJECTIVE NEWS, INFORMATION, DATA AND GUIDANCE ON FINANCE TOPICS DRAWN FROM A DIVERSE COLLECTION OF SOURCES. CONTENT IS NOT INTENDED TO PROVIDE TAX, LEGAL, INSURANCE OR INVESTMENT ADVICE AND SHOULD NOT BE CONSTRUED AS AN OFFER TO SELL, A SOLICITATION OF AN OFFER TO BUY, OR A RECOMMENDATION FOR ANY SECURITY OR INVESTMENT BY BORDER TO COAST OR ANY THIRD-PARTY. POTENTIAL INVESTORS SHOULD CONSIDER THE NEED FOR INDEPENDENT FINANCIAL ADVICE. ANY RESEARCH OR ANALYSIS HAS BEEN PROCURED BY BORDER TO COAST FOR ITS OWN USE AND MAY BE ACTED ON IN THAT CONNECTION. THE CONTENTS OF ARTICLES ARE BASED ON SOURCES OF INFORMATION BELIEVED TO BE RELIABLE; HOWEVER, SAVE TO THE EXTENT REQUIRED BY APPLICABLE LAW OR REGULATIONS, NO GUARANTEE, WARRANTY OR REPRESENTATION IS GIVEN AS TO ITS ACCURACY OR COMPLETENESS. ANY FORWARD-LOOKING STATEMENTS ARE BASED ON BORDER TO COAST'S CURRENT OPINIONS, EXPECTATIONS AND PROJECTIONS. ARTICLES ARE PROVIDED TO YOU ONLY INCIDENTALLY, AND ANY OPINIONS EXPRESSED ARE SUBJECT TO CHANGE WITHOUT NOTICE. THE SOURCE FOR ALL DATA IS BORDER TO COAST, UNLESS STATED OTHERWISE. THE VALUE OF AN INVESTMENT, AND ANY INCOME FROM IT, CAN FALL AS WELL AS RISE AS A RESULT OF MARKET AND CURRENCY FLUCTUATIONS AND YOU MAY NOT GET BACK THE AMOUNT ORIGINALLY INVESTED.

Border to Coast Pensions Partnership Ltd is authorised and regulated by the Financial Conduct Authority (FRN 800511). Registered in England (Registration number 10795539) at the registered office 5th Floor, Toronto Square, Leeds, LS1 2HJ