

summaries



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Understanding Alternatives

With interest rates near their lows, investors have been looking for ways to increase income in their portfolios. This has driven many investors towards an asset class known as alternative investments. An alternative investment is a broad term that basically covers any investment in something that is not stocks, bonds, or cash. This can include real assets such as precious metals, real estate, art, wine, stamps or antiques, as well as financial assets such as private equity, hedge funds, indexed annuities, microloans, and financial derivatives.

Alternative investments are often used as a tool to reduce overall investment risk by further diversifying a portfolio. They often do not correlate with traditional stock and bond investments. Increased diversification can be a good thing in an investment portfolio. Sigma Investment Counselors often advises their clients on various alternative investments outside of our normal portfolio management including real estate deals, investing in collectibles, and private equity deals.

Historically, alternative investments were marketed to very high net worth fully accredited investors as well as large institutions. The increased interest in alternative investments as an asset class has led to many new ways for the average person to invest in these assets. Examples of these new products include mutual funds that trade currencies, long/short hedge funds, managed futures funds, and precious metals funds. According to Morningstar, the number of alternative mutual funds has grown to 402 in 2013 from 77 in 2003. Assets in these funds soared to a whopping \$216 billion in 2013 from \$11 billion in 2003.

Most of these alternative funds are very complex with investment characteristics that are not easily understood by

investors or sometimes even their advisors. For instance, it can be difficult to determine the current market value of an alternative asset. Think about real estate - you don't really know what your house is worth until you actually sell it. Alternative investments often do not trade on an exchange and are not valued on a daily basis. Also similar to real estate, alternative investments can be difficult to sell when cash is needed. Hedge funds often only have certain times of the year when you are allowed to sell your shares. Alternatives are also generally expensive investments. The commission to buy or sell an alternative investment can be very high, and the annual expenses can sometimes be more than ten times those of traditional mutual funds.

Alternative investments are designed to produce a different return than stocks. Many of these investment products are sold with intent to offer higher returns and lower volatility than stocks. This can be somewhat misleading since most of the investment products have been developed in the past few years and do not have long track records through various market cycles. It can be very difficult to gauge how they will behave and where all of their risks lie.

With the Federal Reserve targeting low rates for the considerable future, it is easy to understand why the average investor can find the potential income of alternatives to be attractive. Financial firms are also eager to increase their own revenue by selling high commission alternative investment funds. This combination can lead to investors significantly over weighting their positions in alternative investments.

The asset allocation mix of stocks, bonds, and cash can be enough of a struggle for investors and their advisors to get right. Sticking with the right asset allocation over

the long term is the most important piece of a successful overall investment strategy. Alternative investments can be a worthy addition to a portfolio; however investors need to work closely with their advisors to make sure the risks are understood and in line with their overall investment objectives.

Marisa A. Lenhard, CFA, CFP®

Coming Soon - Lunch and Learn: How to have the “Uncomfortable Conversation” with your family

One of our duties to our clients is to ask the tough questions. What would happen if you had a horrible accident tomorrow and were not able to make decisions? Does the right person have the ability to authorize the appropriate medical care? Would your spouse/children know who to call to make sure the bills are paid on time? These questions should be a part of your financial planning process. Items like medical power of attorney forms, and making sure your family knows where your safety deposit box is located are simple things that can make a world of difference during what can be very stressful times.

Sigma offers educational luncheons on various topics that are of concern to a number of our clients and friends. In the next few weeks we will be hosting one of these luncheons. The topic will be planning for future responsibilities,

including medical and financial. This luncheon would be ideal for children who are concerned about the financial situation of their parents, parents who are concerned that their children or spouses are not informed about their responsibilities, or for anyone who wants to make sure if something happens to them, things will be handled according to their wishes.

Some of the topics that will be discussed include -

- Organization - Do you have your important documents accessible?
- Consolidation - Are your accounts spread out at various places? Do they need to be?
- Who will be in charge of your medical decisions? Are your wishes clear?
- Have you communicated your wishes to your family? What is the best way to have this conversation?

Failing to plan for future responsibilities may make a difficult situation even more challenging; treading softly around “uncomfortable” issues results in worries and complications. Minimize last minute scrambling and avoid future family tensions and financial strain by planning now so the recipients of future care needs can make their choices and voices heard.

Watch your email and our website for more information about the upcoming luncheon on this topic. Please let us know if there are any other topics you would like us to present on for future luncheons!

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