Mithibai College of Arts,
Chauhan Institute of Science &
Amrutben Jivanlal College of Commerce and Economics
(AUTONOMOUS)
NAAC Reaccredited 'A' Grade, CGPA : 3.57 (February 2016)
GRANTED UNDER FIST-DST & STAR COLLEGE SCHEME OF DBT, GOVERNMENT OF INDIA
BEST COLLEGE (2016-17), University of Mumbai

PROJECT REPORT ON : FUTURE OF ALTERNATIVE INVESTMENTS

Bachelor of Commerce (Financial Markets)

Semester (V)

(2020-2021)

Submitted

In Partial Fulfillment of the requirements

For the Award of Degree of

Bachelor of Commerce (Financial Markets)

By:

NAME – PRANAAV RAI

ROLL NUMBER – A034

SAP ID – 40308190026

Mithibai College of Arts, Chauhan Institute of Science & Amrutben Jivanlal College of Commerce and EconomicsBhaktivedanta Swami Marg, Gulmohar Road, Suvarna Nagar, Vile Parle (W), Mumbai, Maharashtra 400056

ACKNOWLEDGEMENT

To list who all have helped me is difficult because they are so numerous, and the depth is so enormous.

I would like to acknowledge the following as being idealistic channels and fresh dimensions in the completion of this project.

I take this opportunity to thank Mithibai College for giving me chance to do this project.

I would like to thank my I/c Principal, **Dr. Krutika Desai** for providing the necessary facilities required for completion of this project.

I take this opportunity to thank our Head of Department **Mr. Mandar Thakur**, for his moral support and guidance.

I would also like to express my sincere gratitude towards my project guide **Asst. Prof. MR. ROHAN KORGAONKAR** whose guidance and care made the project successful.

Lastly, I would like to thank every person who directly or indirectly helped me in the completion of the project especially my Parents and Peers who supported me throughout my project.

DECLARATION

I, **PRANAAV RAI** the student of T.Y.B.F.M. Semester V (2020-2021) hereby declare that I have completed the project on **15-09-2021.**

The information submitted is true and original to the best of my knowledge.

PRANAAV

(PRANAAV RAI)

Roll No: **(A34)**

SAP ID: **40308190026**

Mithibai College of Arts, Chauhan Institute of Science & Amrutben Jivanlal College of Commerce and Economics

Bhaktivedanta Swami Marg, Gulmohar Road, Suvarna Nagar, Vile Parle (W), Mumbai, Maharashtra 400056

CERTIFICATE

This is to certify that **PRANAAV RAI**, Roll No: **(A34)** of Third Year B.F.M., Semester V (2020-2021) has successfully completed the project on

FUTURE OF ALTERNATIVE INVESTMENTS

Under the guidance of **Asst. Prof. MR. ROHAN KORGAONKAR**

Project Guide/ Internal Examiner

MR. ROHAN KORGAONKAR

I/c Principal

DR. KRUTIKA DESAI

External Examiner

Head of Department

MR. MANDAR THAKUR

Executive Summary

Formerly restricted to high-net-worth individuals and institutional investors, alternative investments are becoming increasingly accessible to retail, or individual, investors as part of a diversified investment strategy.

What driving forces led investors to flock to alternatives in the past decade and a half, and what does the future have in store for this asset class? Here's a look at the rise of alternative investments and the road ahead so you can prepare yourself and your clients for success.

Alternative investments are any investments besides stocks, bonds, and cash, which are considered traditional investments. While this asset class comprises various investment types—each with its own investment process, risk profile, and potential rewards—there are a few characteristics most alternatives share. They are:

- Relatively illiquid, or not easily sold or converted into cash due to their long time horizons and the sheer difficulty of selling the assets
- Unregulated by the United States Securities and Exchange Commission (SEC)

Some of the most popular types of alternative investments include:

- Private equity (venture capital, growth equity, and buyouts)
- Debt investing (private and distressed)
- Real estate
- Hedge funds
- Commodities
- Collectibles
- Structured products
-

Options for investing in alternatives include direct investing, in which the investor invests capital into an asset themselves, or indirect investing, in which the investor goes through an intermediary—such as a private equity firm or real estate investment trust (REIT)—that pools multiple investors' capital and invests on their behalf.

The alternative investments industry has grown in popularity and accessibility for the last decade and a half, largely spurred by the global economic downturn in 2008.

When the public markets crashed, individuals who had previously heavily relied on traditional investments saw the value of their investments plummet, leading many to look into the world of alternatives. Alternatives tend to have a low correlation with traditional assets, meaning they trend in opposite directions. This makes them wise additions to the portfolios of investors who are looking to diversify, spread out risk, and increase returns.

After the recession, three trends emerged:

- A shift from indirect investing to direct investing
- A shift of companies from public to private
- A shift from active investing to passive investing

As a new wave of investors entered the alternative investments space, investors increasingly opted for direct rather than indirect investing. This may have been due to the increased sense of control over investments that comes with direct investing.

Additionally, a wave of public companies went private after the recession, perhaps to restructure and rebuild before going public again. This shifted investment opportunities into the private market, making alternatives an attractive option for many who hadn’t considered them before.

Finally, investor behavior shifted from a preference for active investing to passive investing—a “set it and forget it” mentality. Traditional investments, such as publicly traded stocks, are highly liquid and constantly fluctuating in value. The “active” part of traditional investing comes with the decision of when to buy and sell and is the investor's responsibility. Alternative investments, however, have much longer time horizons and are typically illiquid—they won’t provide returns for months, possibly years, and there’s not much you can do as an investor until that time. While you need to wait to be paid out, alternative investments can provide peace of mind that you didn’t miss out on your chance to buy or sell.

These three trends continue to persist and set the stage for the industry’s future.

Looking ahead, the alternative investments industry has huge potential to continue growing but also shift in response to several timely stimuli, ranging from the all-encompassing (such as the COVID-19 pandemic) to the seemingly unrelated (for instance, the advancement of 3D printing technology). While investors must always be prepared for the unexpected, there are several factors that have already begun impacting the industry that wise investors should factor into future plans.

Here's an exploration of several stimuli expected to impact the alternative investments field in the near future.

Globalization & New Alternative Investment Types

Alternative investments is an ever-evolving industry, and opportunities emerge regularly. The industry is expected to see new opportunities for international investment as well as new types of alternatives to invest in.

Harvard Business School Professor Randolph Cohen, one of three faculty who teaches the online course Alternative Investments, describes in a recent webinar how new opportunities in the field cause new strategies to emerge, which are eventually accounted for by the market. His advice? Keep looking for emerging opportunities and ways to use old strategies.

"Each new market that opens up not only is a place that enables you to look for opportunities," Cohen says, "but some of the specific strategies that worked in developed or older markets will work for a while in new markets until there's enough competition from sophisticated funds to drive those out."

The alternative investments industry took root in the United States in 1852 with investments made into the building of the Transcontinental Railroad. In recent years, it's branched out into an international market, creating new opportunities to use strategies that have already run their course in the United States. According to research firm Preqin, international alternative investments markets to keep an eye on include Southeast Asia, China, India, and Brazil.

Cohen also highlights the expansive nature of the alternative investment asset class, noting that new types of alternative investments crop up each year, such as the decentralized digital currency Bitcoin.

"There are new things coming all the time," he says. "Both from globalization and from increasing ideas and technology, there are always new opportunities to make money. That's what makes the world of alternatives so exciting because those new ideas for making money are almost always going to be couched in the language of alternative investments."

Technological Advancements & the COVID-19 Pandemic

Technological advancements are continually reinventing the way humans interact with the world, and the field of alternative investments is no exception. In Alternative Investments, HBS Professor Arthur Segel uses the development of 3D printing technologies as an example.

The cost of 3D printing a two-bedroom home is around $4,000, which is inexpensive in comparison to building that home using manual labor. In geographic areas that need a lot of housing for a low cost, this technology is a game-changer. It can—and is predicted to—impact the real estate investment space, a major subset of alternative investments.

Additionally, the transition of in-person activities to the digital space is predicted to impact the real estate field. Segel presents the launch of Amazon.com as an example, which was quickly followed by a sharp decline in US shopping malls.

Nothing forced the switch to the digital space quite like the COVID-19 pandemic, which required lockdowns, quarantines, event cancellations, and a worldwide switch to remote work to mitigate the virus's spread. The realization that business can proceed as usual without using in-person workspaces has prompted many companies to reassess whether renting office space is necessary, or if downsizing is a better option to allow a fraction of employees to work in person at a given time. This is predicted to cause a ripple effect throughout the real estate investment space as the demand for office space and office-accessible homes decrease.

The COVID-19 pandemic has also impacted investing behaviors, which Cohen commented on in the aforementioned webinar. He notes that, as people felt unsafe and unsure as the pandemic unfolded, they made "safer" investment decisions and held back from trying new things, such as alternatives.

Cohen predicts that as people begin to feel more secure about the state of the world, their investment behaviors will reflect that comfort by reintroducing riskier or new investment types.

Because the alternatives space is heavily reliant on personal relationship management, the pandemic may have made investing in alternatives difficult because it was unsafe to meet with others. Cohen notes that this is especially true for venture capital or other private equity investments, in which the potential investor typically has several face-to-face meetings, in-person pitches, and office visits before deciding to invest in a company. With COVID-19 cases rising in many parts of the world, this could continue to be a hurdle for investors.

Environmental, Social, and Governance (ESG) Considerations

With the climate change crisis growing ever dire, the alternative investments industry is expected to reflect the need for more sustainable use of natural resources, lower carbon emissions, and plans to offset the damage that’s already been done.

In his recorded webinar, Cohen encourages investors to consider ways they can leverage capital to positively impact the environment:

- Invest in companies that are actively implementing sustainable practices
- Divest from companies doing damage to the environment
- Invest in companies doing damage to the environment so you can leverage your power as a shareholder to influence their actions

“I would like people to think more broadly about the best way to make a difference,” Cohen says.

In 2018, the United Nations gave the world an ominous deadline (pdf) to reverse climate change, which is now less than a decade away. As this continues to be a topical, pressing issue, the field of alternatives is expected to reflect investors’ motivations to drive down climate change’s negative impacts.

Additionally, the recent surge in human rights activism has prompted investors to take a closer look at the supply chains and employee rights of companies they invest in. Investment banking company JP Morgan Chase issued a statement in its 2021 Global Alternatives Outlook report (pdf) that says its investors will “use proprietary metrics to track and rank our target investments’ staff diversity, and a raft of other ESG factors, to help us invest in ESG winners and avoid or short the losers.”

As ESG factors continue to be important to investors, companies’ actions around these issues will help shape their investments.

CONTENTS

1.INTRODUCTION:

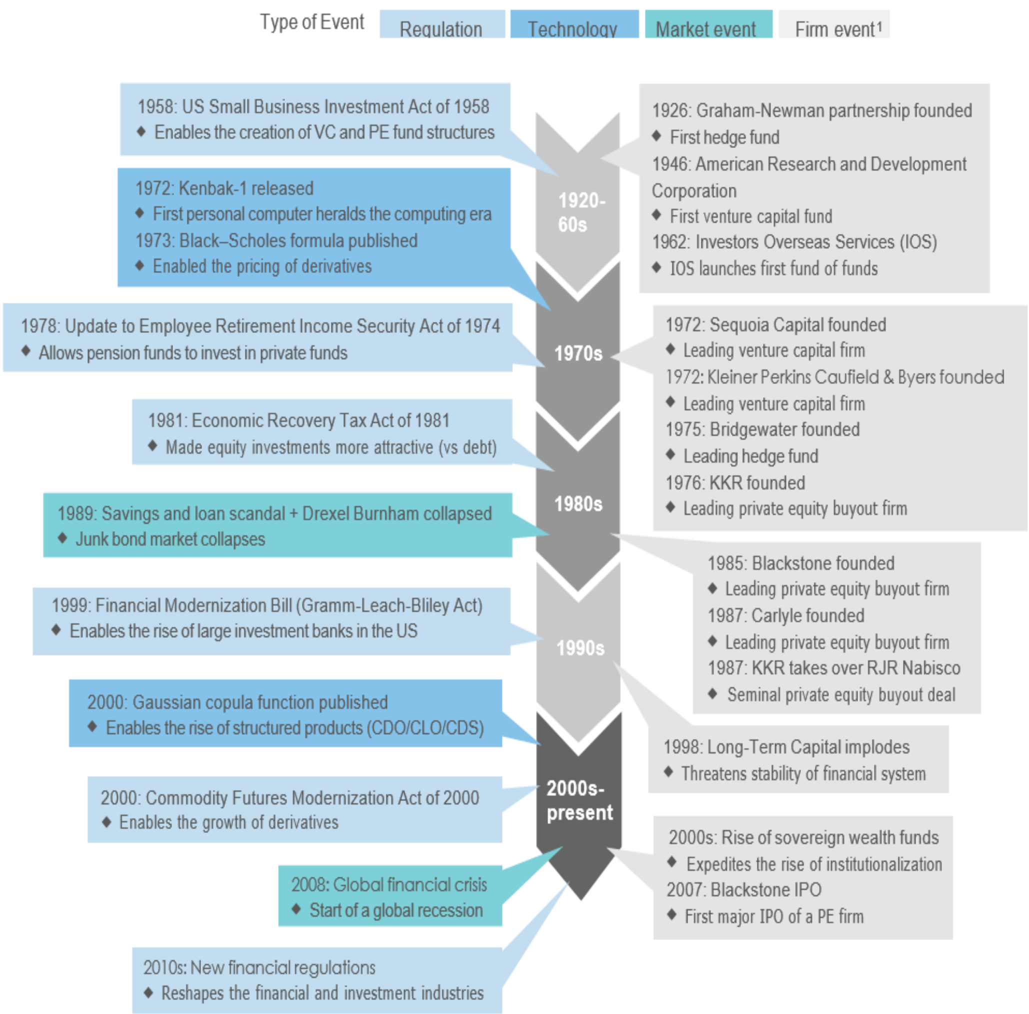
The alternative investment industry is deeply embedded in the global financial system and economy, with investment decisions affecting capital markets, companies, and individuals across the world. This stands in stark contrast to its origins. The industry has grown from a handful of private investors making relatively small investments in companies and start-ups, to one that covers a wide array of asset classes and encompasses thousands of firms managing and investing trillions of dollars globally on behalf of institutional and individual investors alike. It not only survived the financial crisis but emerged stronger and more important to stakeholders than ever before. The new economic and regulatory environment is impacting relationships with capital providers, while new business models are fundamentally challenging the competitive landscape. The goal of this report is to provide readers in the global investment and financial services industries with a perspective on the future of the alternative investments. The report is broken into three parts.First, we identify and assess the macro level trends that will affect the alternative investment ecosystem. These will include the rise of emerging markets, structural changes to retirement systems, and monetary policy amongst leading central banks. Second, we will focus on the industry-level drivers of an increase in institutionalization, the rise of retailization, and changes to the regulatory climate. Third, we will analyse these trends and provide an outlook on how the industry may evolve over the coming decade. We will identify the business and investment models that successful alternative investors and capital providers will employ to navigate the changing ecosystem. For clarity, we will use the nomenclature below to describe capital providers and alternative investors:

Term	Description
LPs (Limited partners)	Asset owners that provide capital to alternative investment firms or divisions to invest on asset owners' behalf
GPs (General partners)	Firms that deploy capital in companies or securities on behalf of LPs/capital providers (such as private equity buyout or venture capital firms, or hedge funds)
Institutional investors	A subset of LPs comprised of institutions that invest capital with GPs (such as pension funds, endowments and foundations, and financial institutions)
Retail investors	A subset of LPs comprised of individuals that invest capital with GPs (such as high net worth or non-wealthy individuals or family offices)
Investors	An inclusive term that includes both GPs (who invest in securities and companies) and LPs (who may invest with GPs or directly in securities or companies)

2.MACRO TRENDS:

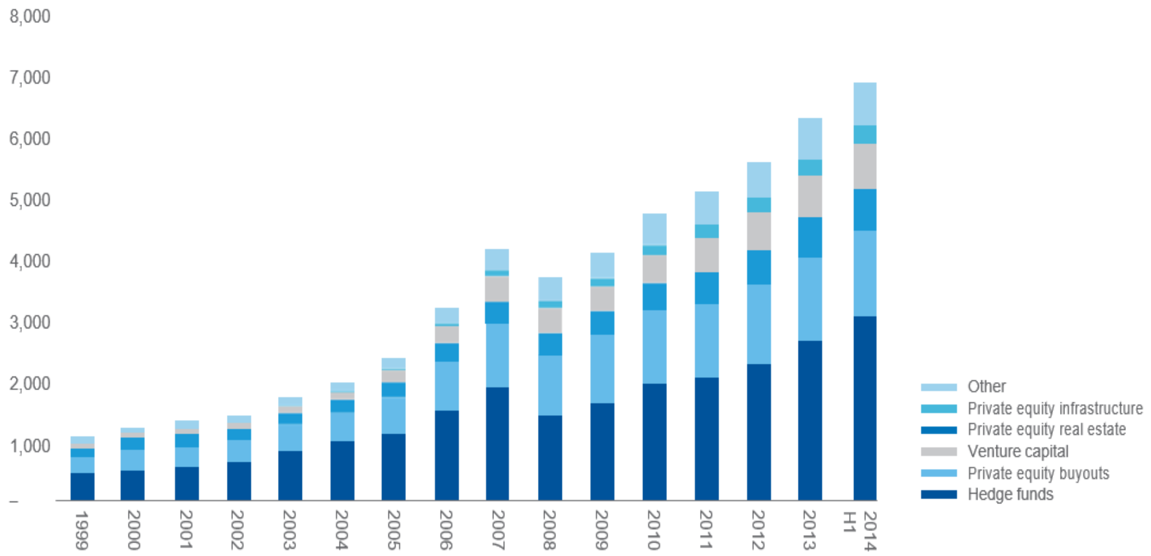
The alternative investment industry has evolved over three decades to become an important part of the financial system and global economy. Its growth can be traced to a range of external factors, with regulatory changes, economic cycles, and technological developments, all playing critical roles. Within this macro context, entrepreneurs founded a range of firms utilizing a diverse mix of value sources to generate returns for investors. Below figure summarizes influential factors and events in the history of alternatives. The future of the industry also be affected by a range of macro factors- of which the rise of emerging markets, ageing in developed economies and monetary policy will prove particularly influential.

Figure 1: Key moments in the history of alternative investments



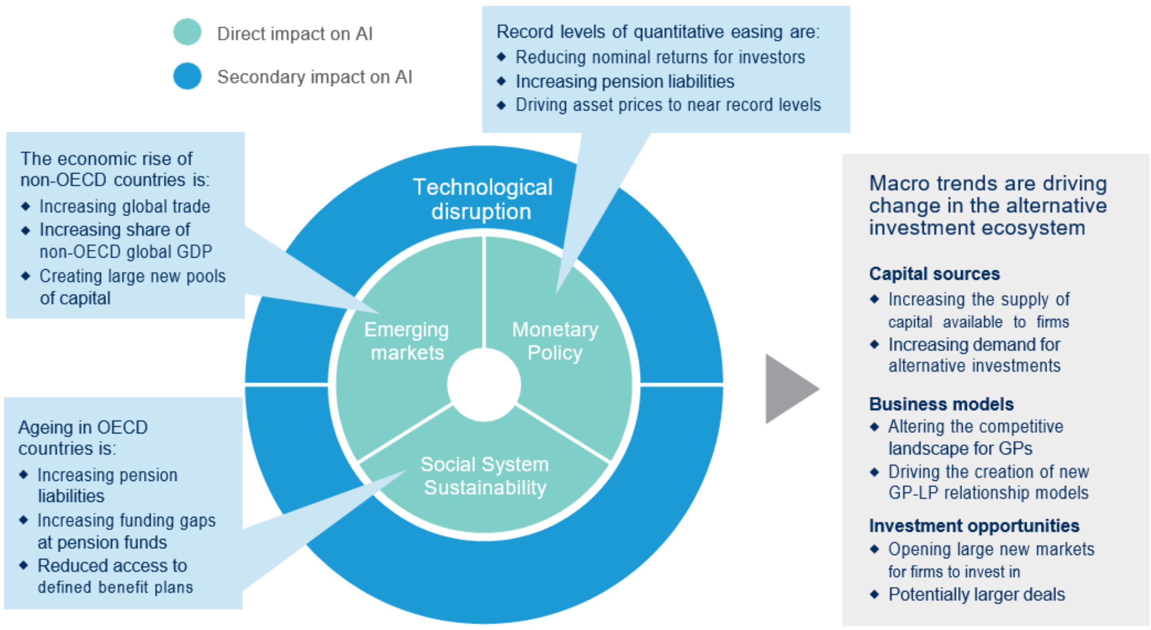
After representing a relatively small part of the financial system in the 20th century, the industry emerged highly relevant for the global economy in the 21st century. The dotcom crash and the financial crisis led many to question the relevance of alternatives, but they proved resilient and emerged stronger following both events. Demand for alternatives has been robust. Total assets under management soared from $1 trillion in 1999 to more than $7 trillion in 2014, twice the rate of traditional assets from 2005-2013, and PWC expects the industry to nearly double again to $13 trillion by 2020. Moreover, its influence on the economy, the broader financial system, and society, has expanded dramatically. Researchers have been able to identify how asset classes such as private equity buyouts, hedge funds, and venture capital impact a wide range of factors, both positively and negatively as well as the different sources of value that firms use to generate returns for investors.

Figure 2: Growth in assets under management by asset class[3,4]
Total alternative assets under management, $ billions



The future of the industry will also be affected by a range of macro factors of which the rise of emerging markets, ageing in developed economies and monetary policy, will prove particularly influential. Whilst technological disruption is undoubtedly an important trend impacting the world, we believe that it will only have a secondary impact on the core business models of the alternative investment ecosystem (as opposed to those of investee companies) and thus it will not be covered in detail in this report. However, it is proving influential within certain subsegments , such as capital for entrepreneurs.

Figure 5: Overview of key macro trends affecting the alternative investment ecosystem



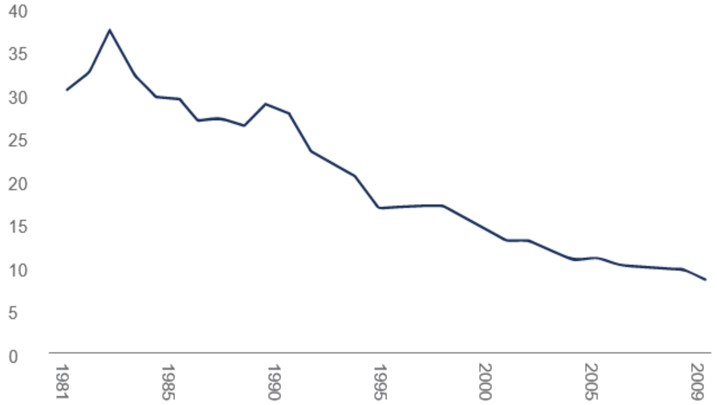
Source: World Economic Forum Investors Industries

3.GROWING INFLUENCE OF THE DEVELOPING WORLD:

Emerging market countries will play a central role in the global economy of the 21st century. Shifts in demographics and economic policy are reshaping the economic landscape. The alternative investment industry is already affected by some of the consequences. Improvements in global health have led to a dramatic increase inlife expectancy in emerging markets with the total and working population increasing in absolute terms and relative to developed nations.At the same time, many countries have adopted more liberal economic policies , such as a notable reduction of tariffs in emerging nations with the overall freedom of trade continuing to increase following the financial crisis . The result has been a significant increase in trade and GDP, with emerging nations accounting for 30% of global GDP in 2006, but 50% by 2016. Driving this is the emergence of a robust middle class in emerging nations now, accounting for $6.9 trillion in annual spending. With large-scale economic reforms underway in countries such as China , the rebalancing of the global economy is likely to continue for quite some time. The shift has created new opportunities for alternative investors, with private equity investments in emerging markets increasing by ten times between 2000 and 2013.

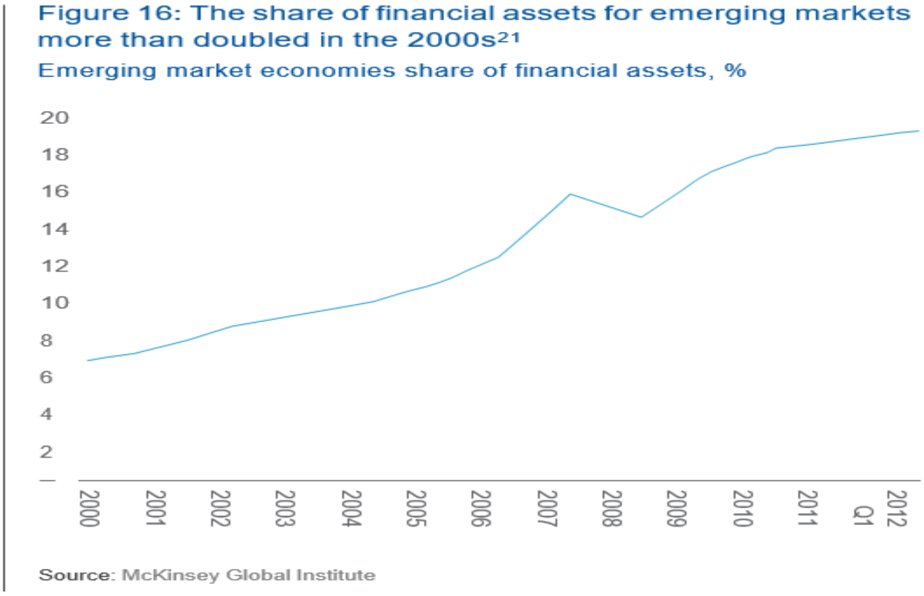
Figure 9: Trade tariffs in emerging markets have fallen significantly over the past 30 years[9]

Average tariff for developing countries, %



Source: World Bank

Emerging markets are also an increasingly important source of capital for alternative investment firms, as strong economic growth leads to a commensurate growth in financial markets and national wealth. The share of global financial assets held by emerging nations more than doubled from 7% in 2000 to 18% in 2010 and is continuing to rise. Importantly, the accumulation of assets is not necessarily balanced within such societies, as state entities and the wealthiest individuals in society often hold and manage a disproportionate share of financial assets. In addition, forecasts say that during the 2014- 2024 period some 40-45% of new ultra-high net worth ($30M+) and centa-millionaires and some 60% of new billionaires will come from emerging markets. High-net worth individuals and family offices may only own some 2.5% of global assets but they have historically been an important source of capital for new funds and for alternative investments overall, accounting for 11% of private equity buyout AUM and 35% of hedge fund AUM.Assets under management by sovereign wealth funds have grown more than 3 times to $7 trillion from 2004-2014, a rate nearly double that of pension funds over the same period. The majority of those Sovereign Wealth Fund assets is based in emerging markets – reinforcing the demographic trends and driving changes to both the business model of alternative investment firms and their relationship with institutional investors.



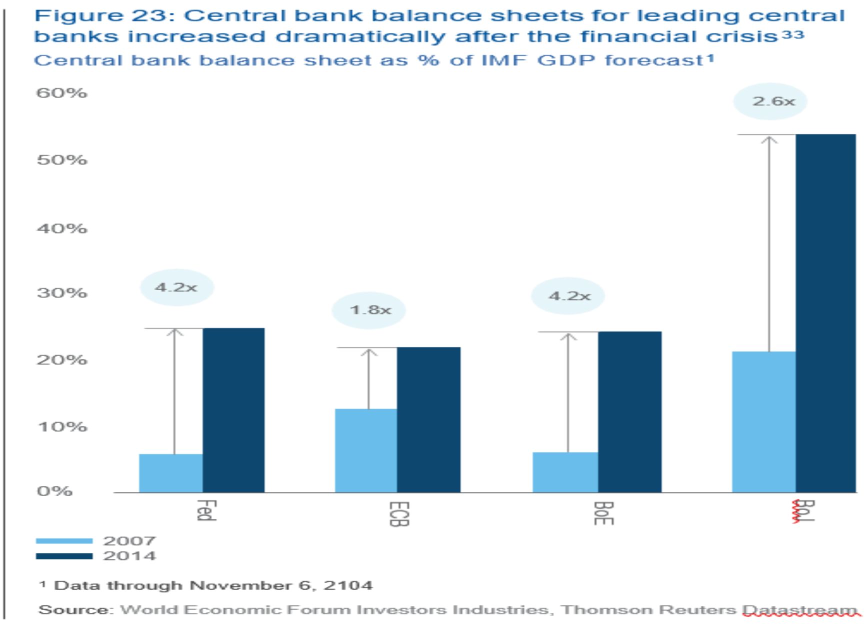
The funding gaps are leading public pension funds to allocate larger shares of capital to alternative investments. Recent research has demonstrated that underfunded US and UK public pension plans typically seek to increase their exposure to risky assets, with their associated higher expected returns, in an attempt to close the funding gap. Not surprisingly, there has been a dramatic increase in the amount of capital allocated to alternative investments . The growing importance of institutional investors can also be seen at the asset class level, with 74% of hedge fund capital projected to come from institutions by 2022

4.MONETARY POLICY:

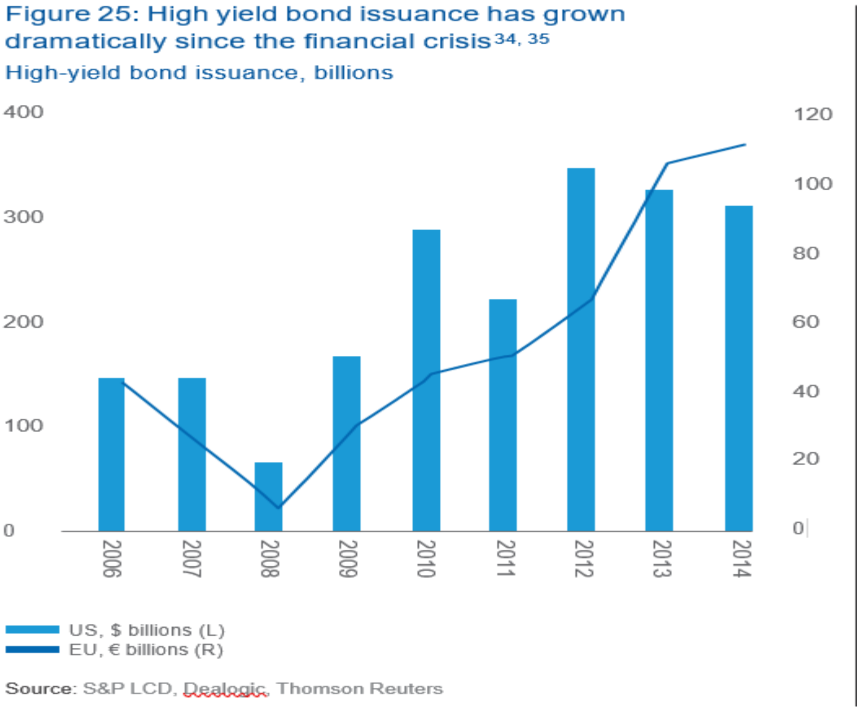
The extraordinary monetary policies enacted by the United States, United Kingdom, European Union and Japan in the wake of the global financial crisis are having an immense influence on capital markets and the investment system, and this will continue for the foreseeable future. The introduction of quantitative easing has dramatically increased the size of balance sheets at leading central banks, with combined assets at the Federal Reserve, European Central Bank, Bank of England, and Bank of Japan alone exceeding $10 trillion.

Institutional investors with outstanding liabilities are acutely affected, as quantitative easing reduces the expected returns from fixed- income products and increases the likelihood of funding gaps emerging or growing. The challenge is expected to continue into the foreseeable future, given the slow recovery and a desire by leading central banks to keep benchmark interest rates near 0%.

This is leading to a substantial increase in the demand for assets that offer higher expected returns, particularly by retirement systems in developed countries. A flood of capital has helped the US stock market hit record highs in relative terms, reaching the fourth highest cyclically adjusted price/earnings (CAPE) ratio since 1881. The search for yield is also increasing demand for high yield bond issuance and real estate in the United States and Europe. The effect can be seen in alternative investments, as debt and private equity buyout purchase price multiples reach pre-crisis levels.



Faced with difficult decisions about whether to reduce expected retirement outlays, raise retirement ages, make additional contributions to retirement funds, raise taxes, or increase the risk profile of investments in pursuit of higher returns, stakeholders have chosen to incorporate the last into the mix, which is resulting in increased demand for alternatives. Historically, alternatives have been viewed as adding value mainly through diversification. Today, 54% of institutional investors consider the return potential of asset classes like private equity buyouts to be their main objective, with only 12% listing diversification as the top attraction. That said, as governments seek to reduce the strain on budgets during economic downturns, they seek assets reducing portfolio volatility.

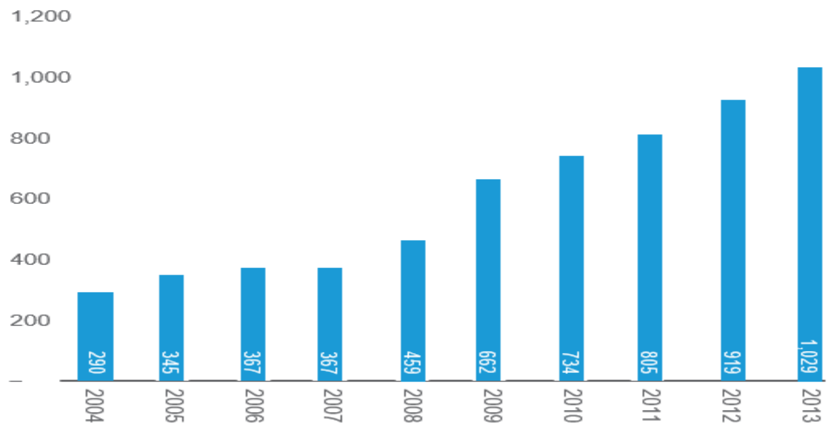


5.ECOSYSTEM CHANGES:

The alternatives industry is also undergoing tremendous change. Three trends in particular stand out for their ability to shape the structure of the industry. The first is driven by regulation, which either affects alternative investment firms directly or changes the way they engage withthe broader financial industry. The second is institutionalization, which is structurally changing how many capital providers invest in alternatives.Third, retailization has the potential toredefine and broaden the pool of investors in alternatives. The wave of new banking and investment regulations introduced by governments around the world following the financial crisis will shape the industry for years to come. Below figure shows which area of finance is affected by each reform and maps which actors in the financial industry are affected by the law.

Figure 19: The funding gap for US state pension plans soared following the financial crisis[28]

Actuarial value of assets needed to equal liabilities, $ billions



[1] 131 US state retirement systems

Source: Wilshire Consulting

6.BANK REGULATIONS:

Within the financial industry, Basel III, the Volcker Act, Dodd-Frank, Solvency II, and the European Market Infrastructure Regulation (EMIR) are at various stages of implementation. Collectively, the reforms cover a wide range of issues including bank capital requirements; the risks banks are incentivized to take on; collateral requirements; new liquidity rules; new rules governing derivatives; increased transparency requirements; and a delineation of the businesses that institutions are allowed to engage in.

Key bank reforms that affect the alternative investment ecosystem: Bank capital reforms and bank risk taking: Banks are required to hold more and higher quality capital. They are also being incentivized, through capital risk weightings, to hold lower risk assets that are less likely to plummet in value during a crisis (to limit liquidity or solvency issues for the institution). Importantly, these incentives discourage banks from investing in alternatives or the related debt by reducing the profitability of engaging in such transactions.

Collateral requirements: Similarly, the risk weightings applied to collateral requirements for banks have been tightened. Regulators are incentivizing banks to hold instruments that have historically been low in risk as well as liquid across market cycles. The result is an incentive for banks to reduce their support for many types of alternative investments (which are not liquid or considered low risk).

Liquidity rules: Regulators are now requiring banks in the United States and Europe to maintain a 30-day supply of cash and liquid securities. Moreover, they must adhere to the updated International Financial Reporting Standards (IFRS) guidelines that define whether assets can be counted towards the liquidity requirements. Given that effectively no alternative asset meets the liquidity standards, the result is a reduced incentive for banks to hold these assets on their books.

Derivatives requirements: The Dodd-Frank Act and EMIR in the United States and Europe, respectively, have led to the emergence of central derivatives exchanges intended to provide greater transparency in the market, reduce counterparty risk, and prevent contagion from the failure of a systemically important institution. Derivatives must be marked to market each day and firms are required to post collateral that meets requirements similar to those imposed on banks. Hedge funds are thus affected by the need to meet the compliance and reporting requirements and by a reduction in their ability to employ bespoke contracts that closely match their trading strategies.

Transparency: Regulators are further trying to enhance the transparency of the financial system by imposing additional reporting requirements through reforms such as Basel III, Dodd-Frank, and the Markets in Financial Instruments Directive (MiFID II). Regulators will require more information about the activities of financial institutions, helping them to assess the stability of individual firms and the system as a whole. The requirements will likely affect private equity firms and hedge funds in particular, as both will be required to invest more in reporting functions in order to comply with the laws.

Permissible bank activities: Many banks have long had internal alternative investment arms that invested directly in private equity buyouts or real estate, or that traded on behalf of the firm in a manner akin to a hedge fund. These activities are being phased out by banks in the United States, following the Dodd-Frank Act and Volcker rule. They are also strongly discouraged in Europe by the new Basel III capital requirements and would be phased out if the Liikanen proposals are adopted.

Some of the reforms have already impacted the alternative investment industry. For example, some segments of the hedge fund industry have relied on banks as a major source of short-term funding to carry out their trading strategies.

New bank capital and liquidity rules have made banks much more reluctant to advance those funds at cheap rates, forcing affected hedge funds to reduce their activity.

Many of the banking reforms have complex positive and negative effects for the alternatives industry. For example, the shuttering of high risk business lines is encouraging some banks to grow their lower risk asset management divisions. Within these divisions, banks are likely to make use of their existing alternative investment skills to develop a retail alternatives capability, with J.P. Morgan Asset Management, Goldman Sachs Asset Management, and Morgan Stanley Investment Management already among the top 10 providers of liquid alternatives products.

The increase in capital and collateral requirements for risky assets has led banks to reduce their lending to SMEs and infrastructure. However, the withdrawal of the banks is also creating major new opportunities for alternative investment funds dedicated to investing in private debt.

Finally, the financial crisis and the new regulatory restrictions have led to a major and probably long-term downturn in the banking labour market. In spite of introducing a range of new benefits, investment banks have struggled to recruit and retain talent from elite undergraduate and graduate institutions. This at first had a positive effect on the alternatives industry, as institutional investors and private equity buyout firms found it easier to poach talent from investment banks.[41, 42] In the longer term, the smaller pool of talent attracted to investment banking and the early career stage at which talent is hired away from banks may well reduce the supply of innovation flowing to the industry and require alternative investment firms to rethink their talent development models. The investment industry in the United States and Europe is also experiencing tremendous change as a result of regulatory reforms enacted following the financial crisis, notably the Foreign Account Tax Compliance Act (FATCA) in the United States; the Retail Distribution Review (RDR) in the United Kingdom; and the Undertakings for Collective Investment in Transferable Securities (UCITS V), MiFID II, EMIR, Packaged Retail Investment Products (PRIPS) and Alternative Investment Fund Managers Directive (AIFMD) in the European Union.

Politicians and regulators, seeking to protect the financial system from systemic risks and the public from fraud, are requiring investment firms to provide greater transparency into their operations, upgrade their risk and governance structures, and utilize third-party vendors to maintain client deposits and record keeping.

The sheer scale and breadth of new guidelines and regulations have forced alternative investors on both sides of the Atlantic to upgrade their institutional architecture and processes in order to comply with the new reporting and depository requirements. According to surveys, alternative investment firms believe that the most important driver of change in the industry will be the increased demand for transparency by regulators and investors.[43, 44, 45] Moreover, 44% believe that they report more information to their investors now than before the crisis and 32% do so more often than before, with both totals expected to increase over the next five years, particularly given that 48% of institutional investors are still dissatisfied with the level of reporting by the industry.

The transformation from a lightly regulated niche to a large and well-regulated part of finance will permanently change the industry. Firms will need to invest in building the institutional infrastructure necessary to meet the new regulations. The cost of establishing and maintaining such a system could affect the industry in four critical ways. First, the increased costs would likely reduce returns. Second, it could serve as a barrier to entry for new firms. Third, it could advantage existing leaders and drive consolidation in the industry, as larger firms would find it easier to distribute the costs across a larger pool of assets. Finally, it could reduce innovation in the industry, likely negatively affecting returns over the long-term. This should be of particular interest to the pensions sector, which is trying to close its funding gaps by increasing allocations to alternative investments. More positively, the greater transparency brought about by the new reporting requirements plays to a broader movement in the industry towards greater openness and the need to build trust between investing institutions and alternative investment firms. In order to be considered for large mandates or as a key potential partner, an investment firm must now meet a long list of institutional and governance requirements aimed at piercing the veil of alternative investments. Edi Truell, chairman of the London Pensions Fund Authority, reflected this investor desire for increased transparency when he noted that, "It's no longer the case that LPs [such as large institutions] are happy to sit back and let their managers get on with it as long as the returns are coming in. I need to understand why the returns are good – what did they get right and what did they get wrong?" Ultimately, the improvements in alternative investment firms' infrastructure and reporting may help increase the depth, health and diversity of relationships between GPs and LPs, which would aid in attracting greater allocations to alternative investments.

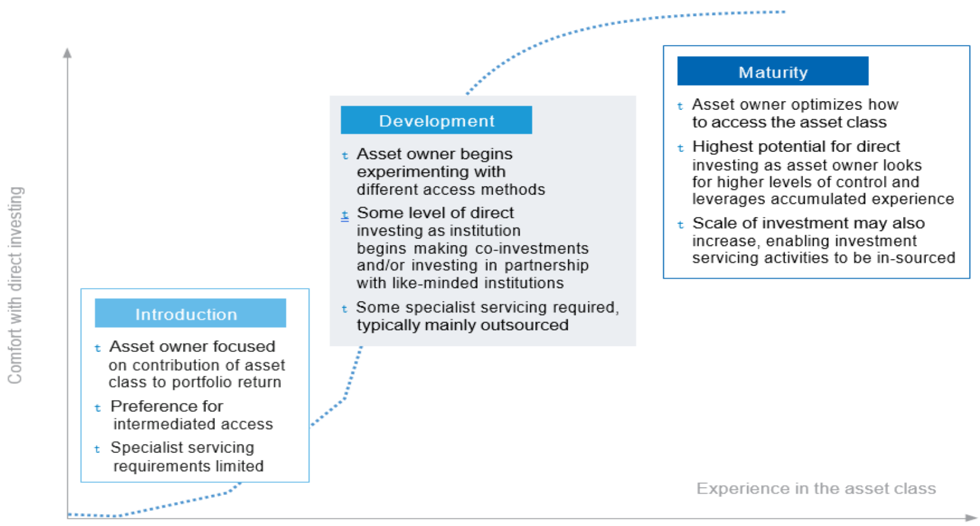
7.INSTITUTIONALISATION:

Institutional investors were critical to the emergence of the modern alternative investment industry, historically as relatively passive investors. However, a number of factors, including a growth in the scale of their investing and in the experience they have accumulated in alternative asset classes, has led some institutions to build up their in-house expertise and capabilities.This in turn allows them to take a more active role in shaping their own investment strategies. Given the immense scale of many of these investors, their actions are also helping to shape and influence the wider alternative investing ecosystem. We will first review drivers of institutionalization and then consider the impact they are having on the industry, including major upgrades of institutional capabilities (e.g. to support direct investing at some institutions), changes in industry core economics (e.g. improved deal terms) and greater public and regulatory scrutiny (leading to calls for greater transparency). Most importantly, institutionalization and its drivers have made alternative investing much more important to wider society, helping to move alternative investments – sometimes seen as the preserve of wealthy individuals – into the mainstream over the last decade. A range of factors, including the scale of the profits, the size and high profile nature of many deal targets, and legal scandals, have thrust the industry into the public and political spotlight like never before. Meanwhile, the 2008 financial crisis led regulators to investigate whether alternatives were systemic in nature (and thus needed further regulatory oversight) and also led investment committees around the world to review their own experience and that of their peers. The industry, on the whole, was able to withstand the scrutiny and emerge stronger, with institutional investors giving the ultimate vote of confidence by increasing allocations to alternatives significantly in the post-crisis years.

Drivers

The key drivers of institutionalization include the growing scale of institutional investment in alternatives; the growing institutional experience with alternatives as an asset class; the increasing maturity of the alternative investment firms that investing institutions could partner with; and, more recently, the way the global financial crisis has made it easier for institutions to expand internal capabilities by hiring key staff from the banking industry.

Figure 31: Overview of how an institution's experience with direct investing might evolve[55]



8.THE EVOLVING ALTERNATIVE INVESTMENT LANDSCAPE:

The forces likely to shape the size and character of the alternative investment industry in the future include fundamentalmacro trends, financial services regulationand the two key industry dynamics of institutionalism and retailization

While the future looks bright for the alternative investments industry, the next decade will also bea time of major change The industry will reacha whole new scale in terms of assets undermanagement, developnew business models and negotiate new relationships

We will now take a look at how that future affects existing GPs in 3 ways New business models for alternative investment firms: Institutionalization and retailization are altering the competitive landscape. We forecast the business models that successful GPs will use to thrive in the coming years .New relationship models for GPs and LPs: Institutionalization is driving the emergence of a wide range of relationship models, beyond simply investing in a fund. We examine how this is transforming part of the industry. Rising impact of retailization: We explore the implications of the retailization trend for all of the key stakeholders in the alternative investment ecosystem.

While the future looks bright for the alternative investments industry, the next decade will also be a time of major change. The industry will reach a whole new scale in terms of assets under management, develop new business models (e.g. retail alternative investment managers) and negotiate new relationships (e.g. joint ventures between GPs/LPs and LPs/LPs). It will also need to forge an increasingly complex relationship with regulators wary about financial product innovation and retail sales practices in the financial industry, as well as raise the level of trust and transparency.

New business models for alternativeinvestment firms:

The growing sophistication of institutional investors and the increasing importance of retail investors is shifting the balance of power between LPs and GPs. The result is a reshaping of the competitive landscape and the business models that will likely prove successful in the future.

Ultimately, the change in the nature of the capital base will drive both industry consolidation and an increasingly marked bifurcation of the industry into supermarkets and boutiques. In this sense, the alternative investment landscape is about to undergo the same maturation process that investment banking and asset management have already been through.

The new landscape will align along two axes. The first is by scale and specialization of the GP. The second defines the size and sophistication of the LP providing the capital to be invested. The largest GPs will continue to expand their organizational and operational capabilities in order to invest in new regions and asset classes and to better serve a broader base of LPs At either end of the scale/specialization axis, GPs will either leverage economies of scale by offering a wide range of products, or seek to leverage their expertise within a particular niche GPs that fail to adapt to the new competitive landscape could find it increasingly difficult to raise capital. Meanwhile, decisions about the type of LP to raise capital from will determine the strategic options available to the GP. For example, in order to access retail investors, GPs must contend with an array of regulatory measures aimed at protecting consumers, with the laws often differing from one jurisdiction to another. Almost by definition, the costs of serving a retail base are much higher than those associated with institutional investors. There are other differences that will help separate the business models of retail-focused GPs from those of their institution-focused peers. The amount of capital that individual retail investors can invest in any given fund is relatively small, which means that investment firms will be in a strong position to dictate how the economic benefits will be split. However, the small scale also means that firms will find it much costlier to serve retail investors for any given amount of capital raised. Together, these two structural differences mean that retail investors can expect to pay higher management fees than institutional investors. Raising retail capital will mean building large distribution chains and investing in marketing and branding to help turn the firm into a trustworthy household name. In this regard, retail-focused GPs will be following the path already taken by asset managers such as Fidelity and Vanguard. We also expect some firms to follow a hybrid strategy. Some large GPs, on the back of a strong reputation and returns track record, may decide to build a greater presence in terms of retail distribution. The inverse may be true for traditional asset managers, who may decide to offer alternative investment products to both retail and institutional investors. They would then serve as both a retail alternative investment manager and compete for the space historically occupied by funds of funds.

We segment the future industry landscape into five core models:

A) global alternative asset managers;

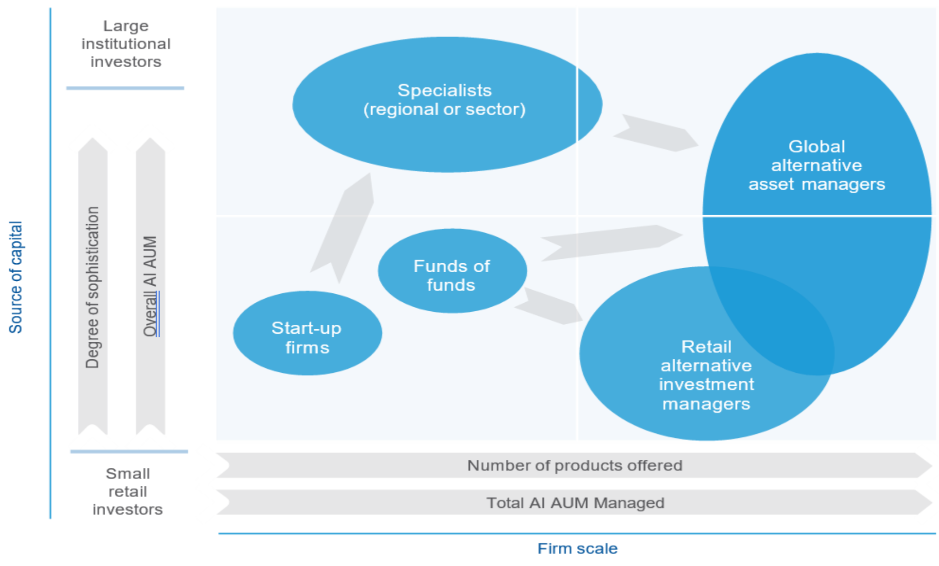
B) specialists (regional or sector).

C) retail alternative investment managers.

D) start-up firms; and

E) funds of funds.

Figure 33: The future landscape will support five core investment models



Source: World Economic Forum Investors Industries

Global alternative asset managers:

Global alternative asset managers invest directly in a range of asset classes on behalf of both institutional and retail investors. They create the complex (and likely costly) internal infrastructure to serve institutional and retail investors and to meet the consequent regulatory requirements. In order to address the needs of institutional investors, global alternative asset managers will typically emphasize their ability to create alpha, e.g. through developing in-house operating teams.[110] These investments may also benefit retail investors, though the firm will likely try to capture as much of the margin as possible for itself in this segment, e.g. through distribution-related fees. The type of infrastructure that global alternative asset managers build also distinguishes them from traditional asset managers. Only the former have the capability to source and invest directly in private deals and to directly add value to assets post-acquisition. The distinction is particularly strong in private equity related asset classes or distressed situations. The focus on alpha generation may be diluted when such firms go public, as doing so notably alters the incentive framework. The unpredictability of profits generated from exits, relative to stable fee related income, increases the volatility of quarterly earnings for GPs and depresses the value of share prices relative to traditional asset managers. Blackstone's Stephen Schwarzman recently highlighted this fact when he noted that "traditional asset managers are on average still trading at a 50 per cent premium to us. Management of publicly listed firms face pressures to reduce such volatility by increasing the share of earnings attributed to management fees, which often translates into a focus on increasing total assets under management. This can jeopardize alpha generation, as assets under management and value add returns (returns in excess of the respective benchmark) have historically been inversely correlated for asset classes such as private equity buyouts (Figure 34). For this reason, global alternative asset managers often strive to increase the number of product lines they offer, helping them to avoid crowded trades and strategies.

Specialists (regional or sector)

Specialists typically focus on generating alpha in a related set of regions or sectors and usually within a single asset class.

Prominent examples include Silver Lake Partners and Providence Equity Partners (sector specialists) and The Abraaj Group and Actis (emerging market specialists). The scale and scope of these firms ranges from a deliberate focus on a single sector or region to an expanded focus on several closely related sectors or plays across regions (e.g., growth markets).

The structure of the specialist model means that institutional investors are the natural source of capital. Specialists focus almost exclusively on maximizing returns, whilst minimizing non-investment related expenses. Most do not seek to expand beyond their core expertise by offering LPs a range of products, as this would undermine their primary value proposition. Unlike global alternative asset managers, they do not typically invest significantly in developing the institutional infrastructure necessary to be publicly listed, to provide investment opportunities to retail investors, or to engage in brand building outside the investment sphere.

The growing scale and sophistication of LPs is increasing the pressure on specialist

GPs. The result is a steady consolidation of the segment, driven by institutional investors concentrating larger allocations with firms that perform.[125] While this trend puts pressure on incumbents, it also reduces the amount of competition from new entrants (which often compete in the specialist model)LPs set high minimum investment levels and like to invest with firms that have extensive track records. A recent survey of institutional investors found that only 18% were interested in investing with first-time funds over the coming year.

Retail alternative investment managers: Unlike the other strategies, this model is still in the early stages of development. Structurally, it is similar to global alternative asset managers, in that it seeks to leverage economies of scale by offering alternative products across multiple geographies and asset classes. However, this model reverses the value chain. Retail alternative investment managers are first and foremost about providing convenient access to alternatives for a large pool of anonymous retail investors – with the underlying deals and investment teams being treated as fungible. This is in contrast to global alternative asset managers, who focus first and foremost on the underlying deals and investment teams as a source of competitive advantage creating a closer alignment with institutional LPs that have the resource for detailed investment team due diligence. From this perspective, the model of retail alternative investment managers is close to the focus on access that funds of funds have historically offered – and it is not inconceivable that the largest funds of funds could capture this space. It is also a business model that might be appropriate for some banks' asset management divisions, leveraging the strong infrastructure and brand they already have. The shift in emphasis leads to a business model that is both differentiated and sustainable, not least because a dense thicket of consumer and financial regulations serves as a barrier to entry. Tim Hames, director general of the British Venture Capital and Private Equity Association (BVCA), has spoken of, "a fear that AIFMD will come in and be followed by increasing levels of regulation comprising a gruesome collection of acronyms…We are in danger of regulating ourselves out of being attractive to investors, particularly at a time when illiquidity is an issue.As this implies, successful retail alternative investment managers will need to develop the institutional capacity to continuously craft products in compliance with changing legal statutes and guidelines, so they can sell products to retail investors around the world. The nature of the underlying investment model will play a key role, as the regulatory requirements surrounding issues such as liquidity and transparency may have a different effect on, for example, hedge fund, private equity, and credit strategies.
Retail alternative investment managers competing at a global scale will have to invest heavily in the marketing services required to elevate their brand equity. Howard Groedel, partner at Ulmer & Berne, notes that this "will essentially change the competitive landscape." They must also develop or deploy large distribution

networks to deliver the products and incur substantial marketing and brokerage expenses, though these and branding costs will both serve as a protective barrier against new entrants.

Established retail alternative investment managers may be able to pass on a large share of their administrative costs to investors who lack the scale for effective negotiation – as long as overall returns do not fall below those of traditional investments as a consequence. Ultimately, the reduced return profile may not undermine the model, as leading firms utilizing this model may very likely be traditional asset managers, whether stand-alone or as divisions of a bank. In such a scenario, alternative products are not the only product offered, but merely one of a broader package of investments offered to a client. In contrast to most alternative investment firms, traditional asset managers are already well positioned to serve as retail alternative investment managers, given their extensive distribution networks, experience in marketing similar products, and expertise in managing regulatory complexity across geographies and client types.

Moreover, as was noted earlier in the discussion of the retailization trend, traditional asset managers are aggressively seeking to expand into the alternatives space, with BlackRock, Affiliated Managers, Invesco, Franklin Resources, and AllianceBernstein all offering retail alternative products.

Start-up firms:

New firms with a well-defined value proposition will continue to enter the alternative investment ecosystem, though doing so will be increasingly difficult. Firms that focus on investing in illiquid assets, which require capital to be locked up for many years, will find it particularly difficult to raise funds.

Most will not have extensive track records and will need to seek to raise capital directly from high net worth individuals or indirectly through a fund of funds manager or a wealth or asset manager (either as an investment in the fund or as a regulatory-driven product class such as UCITS or a mutual fund).

Following this path will allow funds to by-pass the challenge of raising money from large institutions, which as noted earlier, are not inclined to support new firms. The extent of this challenge can be seen in the fact that just nine private equity buyout firms in Europe attracted 71% of all funds raised and nearly 50% of all private equity funds raised in Europe during the first half of 2013.[130] Bonham Carter, CEO of Jupiter Asset Management, recently noted that, “A few years ago, people all wanted to set up their own boutiques or hedge funds, but the barriers to entry to that are higher now. It’s much harder. Most start-up firms can be expected to utilize this model, with spin-out funds managed by teams with long track records being a notable exception. However, firms that are able to consistently outperform will have a natural incentive to scale up their funds by pursuing institutional investors, thus shifting out of the start-up model and into the specialist category. Those that are unable to distinguish themselves through their performance will either struggle to raise new funds from sophisticated investors or may seek to partner with retail alternative investment managers in order to obtain access to less sophisticated retail investors.

Funds of funds:

Funds of funds have historically offered institutions and high-net worth retail investors an easy way to access alternative investments. However, the segment has come under intense pressure in recent years, with the number of firms and the assets under management falling in recent years for asset classes such as private equity buyouts and hedge funds.

The key reason is the growing familiarity of institutional LPs with alternative investing: they now have the ability to invest directly with their preferred GPs and prefer doing so without paying another layer in management costs. The impact can be readily seen in the hedge fund space, which has seen capital allocated to hedge funds of funds fall from 45% of all hedge fund capital in 2006 to just 25% in 2013.[134] The future is no brighter, as a recent Russell survey found that only 17% of investors plan on using hedge funds of funds over the next three years and when they do invest, they expect to pay significantly lower fees.

Funds of funds of all types now need scale to survive. Volkert Doeksen, CEO of AlpInvest, a leading private equity fund of funds, highlights: “If you are sub €1 billion and you are trying to collect new clients and raise new funds, then you will find funds of funds a challenging model… [for] the larger players, though, there is plenty of scope to create interesting solutions with LPs.

Funds of funds remain dynamic and are evolving with the changing landscape. One industry trend that bodes well for their future is the falling correlation between past and future performance by GPs.[138] LPs will no longer be able to rely primarily on past performance, but will need to conduct extensive diligence on individual managers, which is a skill that funds of funds specialize in.

The retailization trend might support future growth for funds of funds, replacing some of the capital lost due to the institutionalization of LPs. Morningstar notes that the growing importance of the retail investor means, “hedge fund [of funds] managers are getting access to a whole new pool of capital.”[139] Legal restrictions in the US currently prevent funds of funds from charging performance fees, but Morningstar projects that they will compensate for this by raising management fees to two or three percent.

However, the tide of retail capital is also attracting traditional asset managers and encouraging the emergence of retail alternative investment managers. These competitors will put pressure on the funds of funds segment which will find it difficult to compete with the range of products, vast distribution network, and household name that traditional asset managers can offer retail investors.

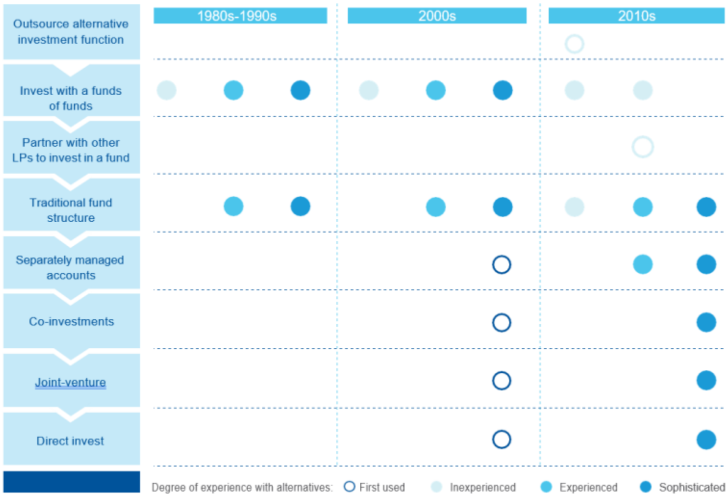
Traditional financial institutions have partnered with fund of funds managers to introduce a range of new products with similar attributes to funds of funds. One such example is Fidelity partnering with fund of hedge funds manager Arden Asset Management.[141] Morningstar reports that "five of the six largest alternative mutual launches last year were in the multi-alternative category."[142] Institutions such as Morgan Stanley, Blackstone, and Russell Investments have all recently launched new products that could remove the need for funds of funds vehicles. Under pressure from both ends of the spectrum, many funds of funds will struggle to maintain their economics. They are responding with a number of different strategies. Some are seeking to become divisions of other asset managers to expand their alternative product portfolio. The acquisition of AlpInvest by Carlyle, the global alternative asset manager, in 2013 and the purchase of a majority stake in Euro Private Equity by Natixis, a traditional asset manager, in 2013, are two examples of this strategy.

Others are seeking to maintain their value proposition by specializing in regions or assets that might be too costly to access otherwise. For instance, AlpInvest CEO Volkert Doeksen says that: "In Europe…the market has remained fragmented and there are many niches. It is difficult to cover all these without having a significant, focused team. This is where we see funds of funds continuing to play a role in the future."[147] The 2013 merger of the Partners Group and the Italy based Perennius Capital Partners is one such example.[148] Some firms have responded by introducing innovative new business models. One such example is the seeding of new hedge funds by a funds of funds firm or division, which allows them to offer investors unique access to new managers. Examples of this include: Blackstone's Hedge Fund Solutions division; the partnership between Deutsche Bank and Financial Risk Management, a fund of funds; and the partnership between IMQubator and Synergy Fund Management, an Asia focused hedge fund of funds. Another new model is funds of funds as a dynamic allocator of capital, with SkyBridge providing a leading example of a firm that has grown rapidly whilst using this model. In contrast to traditional firms, which offer investors the ability to invest in a fixed life fund, this model dynamically reallocates capital in a portfolio according to a proprietary algorithm.

The hard fact is that allocations to funds of funds fund have fallen significantly during the last decade. David Jeffrey, head of Europe for $50 billion fund investor StepStone Global believes that the 250 or so global funds of funds in the market today could fall in number to as few as 20 or 25, with a few niche players to support the industry.[150] The future of the funds of funds industry may not turn out to be that dire, but a reordering of the segment seems certain New relationship models for asset owners and managers

Over the years, most LPs have allocated capital to alternatives by investing in an alternative investment fund, or by investing even less directly through a fund of funds. However, the macro and industry trends we have described are driving very large institutional LPs and larger GPs to seek new relationship structures that move far beyond this norm.Entirely new relationship models are emerging and becoming relatively common, particularly within the private equity buyout and hedge fund segments. Figure 36 shows how the process of institutionalization has progressively led institutional investors to broaden the range of relationship models they use to invest in alternatives. Figure 37 provides a comparative overview of the different investment structures, whilst Figure 38 shows who is responsible for each step in the investment process. At the extreme, the change in the relationship allows large investors to disintermediate traditional GPs entirely by having their own internal teams invest directly in selected types of assets

Figure 36: The type investment models used by institutional investors has expanded over time



Source: World Economic Forum Investors Industries

The change may not affect smaller investors pursuing a traditional model of fund investment, but it is already revolutionizing the approaches taken by many of the largest or most sophisticated LPs. The push to rethink the traditional “2/20” model, rather than merely reduce management fees, is driven by the desire to generate higher returns and the increasing capabilities of LPs as a result of institutionalization. Faced with demographic and fiscal pressures on one side and caught in a low yield environment, institutional investors are under intense pressure to reduce costs and increase returns.

This has had broad ramifications. A recent survey found that 62% of LPs have increased the length of their due diligence on GPs and that they are reducing the number of relationships they maintain.[152] Some have even gone so far as to cease investing with an entire asset class, with CalPERS announcing that they would no longer invest in hedge funds.[153] Much of the concern stems from the belief that fees are too high. Research on private equity buyouts finds that two thirds of profits come in the form of fixed fees. It also suggests that alternative investments can generate risk-adjusted returns in excess of public benchmarks, but they accrue only to investors in top funds.

Thus, it is no surprise that some institutions are ending unproductive relationships and finding new ways to deepen relationships with their top-performing investment firms, while simultaneously reducing the share of gross returns paid in the form of fixed fees. Margot Wirth, director of private equity at the California State Teachers Retirement System (CalSTRS), says, "Post financial crisis, leverage has clearly swung in the direction of the LPs [institutional investors]" and 56% of these investors believe that the use of alternative fund structures will increase over the next three years.

The trend of institutionalization has left larger institutions in a better position than ever before to build a new set of relationship models. The result has been strong LP interest in direct investing, co-investment, joint ventures, and separately managed account (SMA) models. However, many LPs will continue to face internal constraints on their ability to develop in-house teams, with limits on compensation, poor governance, political considerations, risk aversion, and institutional culture, limiting their ability to move beyond the traditional fund structure.

Change may come slowly for institutional investors that are particularly responsive to public opinion, such as pension funds in the US and Europe. Investing directly is difficult for many LPs because of their mandates and their governance structures. For example, it can be impossible for an LP to compete with a GP in terms of the level of incentives they offer to internal investment managers. Dutch pension funds Stichting Pensioenfonds ABP (ABP) and Stichting Pensioenfonds Zorg en Welzijn (PFZW - formerly PGGM) were forced to sell AlpInvest to Carlyle in 2010 due to criticism over compensation structures and Harvard Management Company's star portfolio manager departed in 2005 amidst similar outcries.[160] Josh Lerner, professor of investment banking at Harvard Business School, notes that, "Many LPs [institutional investors] have tried to replicate the payment structure seen among independent managers and it has proven very controversial and almost impossible to do."[161]

In response, investors such as Jagdeep Bachher, CIO of the University of California (UC) Board of Regents, have argued that institutional investors will need to craft unique strategies to attract and retain high quality talent.

In spite of the long-term nature and investment horizon of pension funds and sovereign wealth funds, such government backed funds may be subject to headline risk and other short-term oriented political pressure that can affect investment policy. The decision by the China Investment Corporation, a sovereign wealth fund backed by China, to become a more "passive" investor was a direct response to intense criticism by the public with regard to the short-term losses that it suffered when it invested $3 billion in the Blackstone Group IPO.

The political pressure generated by headline risk is felt by public institutional investors across the world and can influence the countries, sectors, companies, and risk profiles that they invest in. Investing in relatively illiquid investments or those which are not easily or regularly marked to market can serve to mitigate some of the risk, particularly with regard to short-term performance volatility, but it cannot eliminate it entirely.

Figure 39: Investor scale and direct investing approach[164]

Investor segment	AuM	Typical approach to direct investing
"Mega" investors	Over ~$50BN	• Have often already built internal investing capabilities • Full range of models often used, including solo direct investing
Very large investors	~$25 to 50BN	• Overall investment strategy and governance frameworks similar to mega investor segment • Lower scale means co-investing is typically the primary direct investing model used
Large investors	~$5 to 25BN	• Generally less developed than mega and very large investors in their approach to direct investing • Greater focus on co-investing as a percentage of total direct investing than larger institutions • Increasing focus on mandates where strategic investment decisions are controlled by a small highly qualified in-house team, but implementation itself is delegated to asset managers (and internal team does not invest directly)
Medium-sized investors	~$1 to $5BN	• Typically use intermediaries • Lack scale to cover all asset classes internally, so gain advice from external experts on most investment decisions

Source: Oliver Wyman interviews and analysis; SWF Institute rankings 2014; P&I/Towers Watson Global 300 Investment Funds 2013.

Direct investing:

One model being pursued by some institutional investors is investing directly in deals. Several variables determine which institutions are likely to pursue this route, as well as which types of asset classes and geographies they are likely to bring in-house. This report will only provide an overview of the trend, but readers interested in an extensive analysis of the topic can refer to the recently released report by World Economic Forum on the subject, *Direct Investing by*

Institutional Investors: Implications for Investors and Policy-Makers.

The nature of the LP and its investment needs and constraints are key determinants of whether it is in a good position to pursue direct investing. Since one of the primary goals is to reduce costs, and fixed costs in particular, having the scale necessary to deploy large amounts of capital in a given asset class is critical. Maintaining an internal investment team is quite expensive, which means that direct investing is usually only an option for the very largest institutional investors. However, smaller institutions that maintain high allocations to alternatives, such as endowments and foundations, may be able to support internal investment teams as well.

LPs must also consider their ability to attract and retain an in-house team capable of investing in alternative investment classes. The degree of complexity associated with analysing and possibly managing and operating different forms of alternative investments varies wildly by asset class and region. The ability to source, analyse, acquire, manage, and operate private equity assets, including the acquisition of whole companies, is incredibly demanding at each stage of the process and requires a large team of professional investors. For some firms, direct investing introduces a special set of political, legal, and tax considerations that have the potential to influence the performance of the overall fund. A pension fund may need to adhere to politically motivated constraints, such as not investing in certain sectors (i.e., military arms or tobacco related investments) or countries (i.e., those that have human rights concerns). LPs may also need to incorporate certain values into the process, such as requiring investments to adhere to environmental sustainability guidelines. Conversely, many nations may prohibit certain types of institutions, such as their sovereign wealth funds, from investing directly in certain assets. An institutional investor will also need to consider the legal and tax implications when structuring a deal, as they can materially affect the value proposition of an investment.[171] Beyond the appropriateness or legal issues, LPs must also be aware of unconscious biases with regard to investing locally or being beholden to local interests, since any doubt may lead to significant media and social pressures. Historically, LPs have exhibited an in-state bias when allocating to GPs and research has exhibited notably lower returns.[172] However, recent research involving a select set of large institutional investors engaged in direct investing has shown enhanced returns through possessing local knowledge.[173] The key differentiator between these circumstances is the proximity of the LP to the final investment. With direct investing, an LP may be able to generate unique insight on a specific investment, which is not the case when investing through a GP. Overall, the direct investing model will be adopted by a growing share of institutional investors, but its use is likely to be quite severely restricted and tempered by the limitations noted above.

Co-investing:

The co-investment model provides an avenue for institutions that would like to be more actively involved in deals, but do not want to fully insource investing in a particular asset class. Co-investing augments the traditional “2/20” relationship, in that it allows LPs to selectively deploy equity directly alongside GPs that it has relationships with.

The model offers two advantages relative to the traditional and direct investing models. First, co-investing is an efficient way to reduce the average cost of investing with any given GP, as the LP is not typically charged management or performance fees on co-investments. The co-investment right serves as an option, whose full value is only captured when an LP elects to exercise it. The option value is greatest for LPs that have the capability to conduct due diligence on co-investment opportunities and respond to a proposed deal in a reasonable period of time. There are some restrictions on who can conduct co-investments. In order to engage in co-investing, the institution must develop an internal team capable of conducting due diligence on target assets and companies (not just on fund managers). At present, some 38% of LPs note that they would be willing to invest in a specific deal.[177] A similar number of private equity buyout firms, 35%, plan on explicitly providing co-investment opportunities as part of their fund raising efforts, with 60% citing them as an important tool in enticing institutions to commit to a fund.[178] Whilst obtaining the option to co-invest may be relatively easy for many LPs to secure, their ability to exercise it will remain limited to those with strong in-house investment teams. Dennis McCrary, head of co-investments at Pantheon, says, “One of the key issues for a GP is to know the LP [limited partner, usually an institution] will be responsive when reviewing a co-investment. Some LPs who ask to be shown these investments do not have the manpower, the expertise or the inclination to deliver in the way the GPs would like.”[179] In contrast to direct investing, co-investing allows institutions to outsource the more difficult and complex investment tasks, e.g. sourcing, closing, and exiting deals and managing and operating assets during the ownership phase, while capturing some of the upside in the form of lower fees. Maintaining a passive minority stake also allows large institutions to avoid many of the internal and external political considerations associated with direct investments. However, the added costs of conducting diligence on an investment mean that co-investing may only make sense when deploying large sums of capital. Edi Truell, chairman of London Pensions Fund Authority (LPFA), believes that an institution needs £2 billion or more in private equity allocations before an in-house team can actively add value.[180] The fundamentals of co-investing make it best suited to large-ticket single transactions such as private equity buyouts, real estate, and infrastructure. Whilst the model may not be suited for venture capital or hedge funds, it is expected to continue to grow. A recent survey by Russell Investments found that, "Co-investments...are expected to show the largest increases in commitments over the next one to three years."[181] Similarly, a survey by data providers Preqin indicated that 43% of investors plan to increase the capital they put into co-investments.[182] Recent research focused on private equity buyout co-investments by large institutional investors has indicated that co-investing is at an early stage, as the ability of institutional investors to capture the theoretical benefits of the model have proven limited thus far in practice. It has also shown that co-investments underperform benchmarks, with poor deal selection and timing by institutional investors being the likely drivers.[183] Still, co-investing remains popular with LPs. A 2014 report by Preqin, the data provider, found that 52% of LPs reported that their co-investment returns were better than their fund returns and more than half of the 77% of LPs that already co-invest plan on doing more in the future.[184] With large institutions under incessant pressure to increase returns, reduce fees, and allocate ever growing sums of capital, the co-investment model provides a middle ground between existing models and the more daunting task of investing directly. The flexibility of the model, limited intrinsic constraints, and notable upside in the form of reduced fees and large blocks of capital deployed with preferred GPs, provide ample reason for LPs with large allocations to alternatives to pursue this route more aggressively in the coming years.

Joint ventures:

Formal joint ventures are a third possible new structure, usually between a GP and an LP. Relative to co-investing, a joint venture offers a much greater degree of permanence and flexibility. An LP is able to both partner with a preferred GP and retain control over an individual investment and the timing of its acquisition and sale.

The JV model offers many distinct advantages over both the traditional "2/20" and co-investing models. It eliminates all the management and performance fees that traditionally flow to an external manager, because the GP and LP share the management duties through the joint venture. In exchange, the LP must pay for a portion of the fixed cost associated with maintaining the joint venture's permanent investment team.

LPs have flexibility on how much of the investment process they are responsible for. In contrast to direct investing, in which the LP would be responsible for all aspects of an investment, JV's allow the LP to pick and choose which parts to in-source and which aspects to outsource to its partners.

There are other advantages to utilizing this structure. An arm's length JV can help LPs to hire talent that would otherwise be subject to institutional constraints on compensation. A JV can also serve to complement an LPs core alternative investment portfolio, as the LP can control investment choices at the deal level and not merely at the fund level.

Similarly, LPs are involved in the decisions about when to acquire or sell an asset. Forecasting the scale and timing of exits (and the resulting cash flows) has always been a source of frustration for LPs, as they have little control over these decisions when taken by commingled funds. The structure also gives LPs the option of maintaining a stake in an investment well beyond the investment horizon offered by the traditional fund model because the LP does not have to sell its shares at the same time as the other partners in the JV. The inherent mismatch between the 3-5 year investment cycle of a 10-year legally limited fund and the ideal holding period for many types of assets has long bedevilled institutional investors. The advantage of JVs is particularly strong in the case of long- term assets such as private equity real estate or infrastructure, but holds true for many investments in private companies as well.

A joint venture can also deploy large sums of capital relatively easily and efficiently, which is a clear benefit for large LPs. The simple math associated with traditional fund relationships is such that any given LP will have a limited stake in an investment, as there are often dozens of other LPs investing in the same fund. The ability to deploy larger sums through JV's is particularly attractive to large LPs, with 67% of institutions with more than $10 billion in assets expressing an interest in private equity real estate or private equity buyout JV's against just 21%

for those with under $1 billion of assets.

The open-ended architecture of joint ventures means that the model can be used to invest in any alternative asset class, unlike the co-investment model. For example, JV's can be used for deal-oriented investments (private equity buyouts, real estate, or infrastructure) as well as asset classes focused on trading securities (hedge funds).

The clear drawback to JV's is the difficulty of actually implementing and maintaining a successful partnership over time. Relative to co-investing, they require far more coordination with partner on issues such as operational integration, organizational management, financial commitments, deal selection, and the timing of exits. Moreover, such alignment must be maintained over multiple years and across many deals. For these reasons, the number of JVs in practice is far fewer than theory would imply, with institutional investors often limiting their JV contribution to financial capital and oversight of the enterprise.

Still, there are a number of examples of institutional investors partnering with GPs shown in Figure 41. In addition, the Russian Direct Investment Fund (RDIF), a Russian sovereign wealth fund, has entered into partnership agreements with more than 20 LPs and GPs to invest in assets ranging from infrastructure to private debt to companies. In other instances, institutional investors are partnering with one another to invest in traditionally structured GPs, with the goal of using economies of scale to reduce their cost of investing. One example is the creation of a separately managed account overseen by Pantheon Ventures that would invest in private equity buyout funds on behalf of multiple government pension funds.[186, 187] Another is the creation of a fund that would pool capital from government pensions in the UK, including the Greater Manchester Pension Fund and the London Pensions Fund Authority, in order to invest in infrastructure assets.

An increasing number of large institutions will likely enter into joint ventures over the coming decade, in pursuit not only of lower costs and higher net returns but also investment scale and flexibility.

Separately managed accounts:

The final emerging option for large institutions seeking to change their alternative investment portfolio is that of the alternative mandate or separately managed account (SMA) model. The model is a blend of traditional equity or fixed income mandates and alternative investment structures. An LP retains full ownership of the funds in the account and has the right to add or withdraw funds at its discretion. It pays both management and performance fees to a GP to oversee and invest the capital, with the LP retaining the ability to replace the GP at will. The result is a model that is more flexible, cost effective, and scalable than the traditional “2/20” fund investment model.

The SMA structure enables an institution to maintain more control over which assets it owns and thus enhances its ability to incorporate alternative investments into its overall portfolio. A key driver behind this is the separation of the *ownership* of assets from the *management* of the assets. Traditional fund structures are based on the idea that a GP manages a vehicle that acquires assets on behalf of multiple LPs for a prolonged period of time, typically ten to fifteen years. Under the SMA model, the LP retains ownership of the assets at all times, but contracts out the investment and management decisions to a GP. The LP, usually a large institution, can choose how broad or specific the mandate should be, down to the individual asset level. Thus, a pension fund could allocate $1 billion to a private equity buyout firm to invest in buyout deals in the US and $500 million to a hedge fund to invest in securities in Asia.

The SMA model offers benefits somewhat similar to those of joint ventures. Retaining direct ownership of the assets allows the LP to decide when and how, if ever, they would like to dispose of an asset. The liquidity and specificity of the assets increase, compared to traditional fund investment, since the LP can sell a stake in a specific asset. This helps to build a more enduring relationship with the GP, as LPs using SMAs no longer face the binary choice of keeping or selling all their investments with a given GP. The SMA model is also well suited to managing assets over different investment horizons and long-term investments in particular. For example, investors with long investment horizons, such as pension funds and sovereign wealth funds, can invest in assets such as private equity infrastructure and private equity real estate without being compelled to exit each investment within a three-to five-year horizon. Meanwhile, LPs can focus on selecting the right GP to add value at each stage of the life of an asset without having to exit the investment and the GP simultaneously. Maintaining direct ownership of the assets at all times also strengthens the risk management capabilities of the LP, particularly in the case of trading-based asset classes. It permits LPs to better understand the risk associated with the asset in real-time and how this relates to their broader strategy and investment mandate. Of course, in-house capability to conduct the analysis is required, which will generate additional internal expenses for the LP. SMAs allow LPs to manage capital more efficiently than with a traditional fund investment. Unlike with traditional fund investments, LPs can determine how long they would like a GP to manage a pool of capital for them. If the LP is not satisfied with the terms and conditions, or the fees at the end of the mandate, they can renegotiate them without having to wait three to five years for a new fund raising cycle to begin. The increased competitive pressure on the GP managing the investment allows the LP to demand lower fees and negotiate bespoke structures. The SMA model will primarily be attractive to relatively large private equity related firms and hedge funds, as they have the scale and institutional infrastructure necessary to support bespoke accounts.

Basing the structure on a well-known and tested model makes it much easier for LPs to adopt for several reasons. First, unlike direct or co-investing, SMAs do not require an LP to overcome the operational challenge of developing a large and sophisticated internal investment team. Second, since the SMA model does not require significant new internal capabilities, it is much easier to receive approval from the governing board. Third, LPs can benefit from owning specific assets over long horizons, but not be subject to the headline risk associated with acquiring the asset directly Fourth, the model can be scaled easily and does not require an LP to wait for a preferred GP to raise a new fund before allocating to them.

The SMA model is poised for greater adoption by a broader set of LPs than any other model over the next decade. A recent survey found that 14% of investors with $1 billion in hedge fund investments were seeking managed accounts and 10% were looking to develop managed accounts for funds of hedge funds, whilst 35% of investors in private equity buyouts are considering awarding an SMA and 64% believe that it will become a permanent part of their investment strategy in the future.[189, 190, 191] In addition, a recent survey of GPs found that 26% have introduced managed accounts since the financial crisis and another 18% expect to over the next five years.

Large LPs across the world are already paving the way. Pensioenfonds Zorg en Welzijn in Holland and Ontario Teachers' Pension Plan in Canada are already using this type of account, with others, such as California Public Employees' Retirement System (CalPERS), considering doing so.[193] CalPERS will be able to draw on the relatively long experience of the Teacher Retirement System of Texas (TRS), which established two

$3 billion accounts as early as 2011 with the global buyout firms KKR and

Apollo.

9.RISING IMPACT OF RETAILIZATION:

The growing importance of retail capital presents many challenges and opportunities for GPs, LPs, financial institutions, and regulators:

The alternatives industry can expect retail investors to become a growing source of capital

Traditional asset managers will significantly expand their engagement with alternative investments and see increased revenues and profits as a result

Retail investors will be presented with, and will need to select between, a far broader array of products and managers

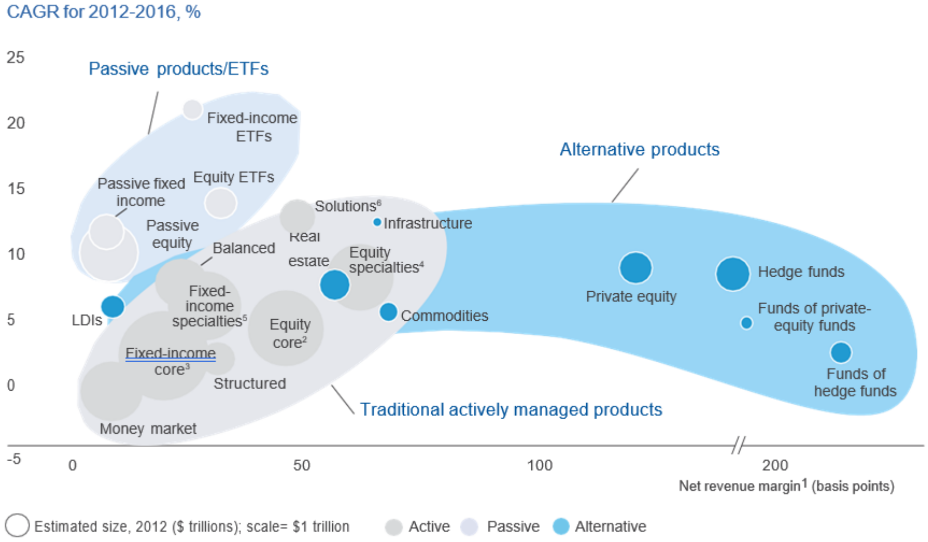
The regulatory landscape will evolve to respond to retailization. Below we look in turn at the scale and character of each of these key changes from the perspective of different industry players

Implications for alternative investment firms

The alternative investment industry can expect to receive record net new inflows of capital from retail investors. This is something of a coming of age: having weathered multiple business cycles spanning decades and with more than $7 trillion under management, the industry has finally reached a maturity that allows it to pursue retail capital.

How large could the market become? Allocations to alternative investments by retail investors are soaring. Consultancies such as McKinsey, Casey Quirk, and Cerulli Associates find that access to alternatives by non-high net worth individuals rose from $800 billion in 2005 to $2 trillion by 2013,[223] with net inflows driven by retail sources forecasted to exceed $1 trillion over the five years between 2012 and 2017,[224] and reaching 15.8% of all mutual fund allocations by 2021.[225] Still, institutional capital will remain the dominant source for the industry for some time, given the regulatory barriers that largely limit retail alternatives to relatively liquid asset classes such as hedge funds. The asset management space is fiercely competitive, with downward pressure on margins for traditional products being the result. The shift from DB to DC in many pension systems may have resulted in a relative increase in margins for comparable products, but overall margins have been under intense pressure due to the rise of exchange-traded funds (ETFs) and index funds and the increased competition brought by the banks seeking to expand their asset management divisions. Overall, global asset managers saw median margins erode by 14% from 2005 to 2011, falling from 37% to 32%.[227] According to BCG, most traditional equity and fixed-income products carry net revenue margins of 10-50 bps.[228] In contrast, alternative products typically yield margins of 100-200 bps.[229] Figure 43 shows how traditional actively managed products (and their managers) are now under pressure from both passive and alternative products. Passive products are challenging the margins on traditional products, as they offer similar attributes at a lower cost – and with their high growth rate erode the market share of traditional active products. In contrast, alternative products offer much higher margins, which results in lost revenue opportunities for firms that only offer traditional products

Figure 43: Traditional assets and their managers will continue to be squeezed by new faster-growing asset classes[230]



Source: BCG Global Asset Management Market-Sizing Database, 2013; BCG Global Asset Management Benchmarking Database; ICI; Preqin; HFR; Strategic Insight; BlackRock ETP report; IMA; OECD; Towers Watson; P&I; Lippers/Reuters; BCG analysis.

Note: ETFs = exchange-traded funds; LDIs = liability-driven investments.

Implications for banks:

The regulatory aftermath of the financial crisis is leading many global banks to actively expand their asset management businesses. Regulations such as the Dodd-Frank Act in the United States and Basel III in Europe are dramatically reducing the ability of banks to pursue high-risk, high-reward strategies, whilst shareholders are demanding more consistent earnings. Relative to their investment bank trading units, asset management is far less capital intensive, provides opportunities to cross-sell products with other divisions, and produces revenue streams that are much less volatile. Many leading banks, such as Morgan Stanley, Goldman Sachs, Credit Suisse, UBS, J.P. Morgan, and others have responded by seeking to expand their wealth and asset management divisions. Banks are uniquely positioned to provide alternative products through their asset management divisions. Many have long had internal alternative investment arms that invested directly in private equity buyouts or real estate or traded on behalf of the firm in a manner akin to a hedge fund. These activities are being phased out by banks in the United States, following the Dodd-Frank Act, and are also strongly discouraged in Europe by the new Basel III capital requirements. However, banks with such investment arms have historically worked closely with their existing wealth and asset management divisions, particularly with regard to providing opportunities for their clients to invest in their internal funds. Whilst they may spin-out their investment arms, the in-house knowledge and customer base of banks such as J.P. Morgan, Bank of America, and UBS will remain, in contrast to standalone asset managers that need to develop retail alternative teams organically (or through acquisition).

Implications for retail investors:

The non-high net worth retail investor of the future will be able to select from a very broad array of alternative products and managers, and will cease to think of alternatives as a novelty. Indeed, today's markets are already taking retail investors down this path.

Over the last few years, there has been an explosion in the diversity of products available to retail investors, which now provide access to alternative investments such as hedge funds, real estate, and infrastructure. The range of options and channels available to investors includes:

- standalone products that offer exposure to a single manager
- funds of funds style multi-manager products for a single asset class or a blend of different alternative asset classes
- open or closed-end funds
- products that offer varying degrees of exposure to leverage, derivatives, and/or shorting. Individuals can already access alternative products through various channels such as wealth and asset managers, banks, and brokerages (online or in-person), 401k or related retirement accounts.
- The structure and target demographic of the different product classes varies, but alternative assets are proving popular with retail investors. In Europe, demand for alternative UCITS products, a highly regulated

structure available to all investors, has skyrocketed. Total assets under management grew from €5.4 billion in 2002 to €37.6 billion by 2009, and then grew again to €150 billion in October 2011.[238] In the US, demand gave rise to a similarly regulated set of alternative mutual funds and ETFs structured to adhere to the ’40 Act. Such funds are available to virtually all investors, helping to explain the rapid rise in assets from $236 billion in 2008 to $554 billion in 2012.[239] Collectively, these two structures alone were expected to experience net growth of some $700 billion between 2010 and 2016.

Implications for regulators:

The retailization trend has many implications for regulators, and the regulatory landscape has already begun to evolve as a result. Politicians, recognizing the challenge that individuals face when saving for retirement, are seeking simultaneously to provide retail investors with more investment options, while continuing to protect them from fraudulent investors.

The US is taking the lead, with three legal adjustments making it easier for alternative investors to reach potential high net worth individuals, while also promoting the transparency of alternative investment funds and making it harder to defraud unsophisticated individuals:

— In 2011, an amendment to the Dodd-Frank Act required most private investment firms in the United States to register with the SEC,[241] providing greater transparency into the operations of GPs. The following year the JOBS Act was announced, which removed the long-running restriction on marketing by private investment firms imposed by Regulation D of the Securities Act of 1933. The growth of target date funds (mutual funds that rebalance over time based on the expected retirement year) may provide another vehicle for retail investors to gain exposure to alternative investments. Structuring an alternative investment product that adheres to consumer protection laws remains difficult, particularly since funds must provide daily liquidity. However, Pantheon Ventures and the Partners Group, two private equity focused firms, have launched alternative products that could be included in retail retirement plans.[247] Secondary private equity buyout players, such as Pomona Capital, are also exploring the retail retirement space with targeted products. With the alternative investment world turning to retail investors for capital, the future is likely to bring additional legislation and further attempts to clarify and refine existing laws. Like the current regulatory response, this is likely to be characterized by an uneasy trade-off between improving market access and protecting retail investors from fraud and unnecessary levels of risk.

10.CONCLUSION:

The future of the alternative investment industry seems likely to be one of both growth and significant structural change, accompanied by an increasing maturity of the industry's infrastructure, regulation, and investment relationships. Growth seems reasonably assured, given the continuing demand for the above-average returns associated with the sector, increasing allocations from many large institutions, new capital flows from emerging markets, and the unfolding process of retailization, as well as the quest for yield pushed by pension funds that are facing adverse demographics. The wild card here is whether the industry can continue to deliver above-average returns to all these constituents.Structural change also seems inevitable, as more capital begins to flow from an almost entirely new source: retail investors.Retailization, in particular, seems likely to prompt a new set of business models as alternatives are introduced to the mass affluent through new products distributed by retail alternative investment managers and other providers.Institutionalization, greater regulation and public and academic scrutiny, are speeding up the maturation of the industry by establishing a greater depth and complexity of relationship between large or sophisticated LPs and GPs. It is also driving GPs and LPs alike to upgrade their institutional infrastructure, at a cost, and generating a deeper understanding of how and when the sector can succeed in delivering above-average returns. This combination of industry growth, structural change and maturation has some important implications for GPs, LPs, regulators and policy makers, and wider society, as we highlight below.

Alternative investment firms: Rethinking the competitive landscape Over the coming decade, alternative investment firms will need to negotiate a new competitive landscape. They will need to make conscious decisions about what kind of firm they are, how much they intend to grow, and what core business model they intend to adopt. One important decision will be the degree to which they seek to expand their capital base beyond institutional investors by pursuing retail investors. Another decision is whether to continue to focus entirely on generating alpha in a particular asset class, or to begin to offer a wider range of products and services. As GPs refocus, they will begin to take on very different characteristics. For example, those that pursue retail capital will gain some of their market power from mastering the thicket of related regulations and from investing in marketing and branding, rather than relying solely on their investment prowess. Larger GPs may face a binary decision on whether to build their businesses into global alternative asset managers and compete with the largest alternative firms in the world or remain a specialist player. GPs that continue to focus on large institutional LPs may need to consider the range of products and services that they offer in addition to traditional fund structures. The largest GPs, in particular, might need to consider how they can support institutional direct investing efforts, develop co-investment strategies, manage joint ventures and offer new investment management accounts such as SMAs. The maturing of the industry and the impact of new investment regulations may benefit some incumbents, in the sense that GPs investing heavily in key infrastructure and compliance capabilities will, in effect, also be erecting barriers to entry for competitors. However, the long-term cost implications may also work against them if they eat too heavily into returns. All GPs are likely to have to deal with a much larger amount of scrutiny from regulators and from the market more generally as improved reporting and transparency in the industry, together with new academic studies, combine to lift the veil that has traditionally obscured how the industry delivers above-average returns.

Capital providers: Choosing new relationship models and products The key change for sophisticated institutional investors is the increased numberof choices they have to access alternatives. Rather than simply trying to invest with the most successful GPs, which are becoming harder to identify, leading institutional investors now have a series of decisions to make. For example, what kind of GPs will make the best partner? Should the LP spread capital across many funds that focus exclusively on generating returns in a specific region or industry? Or rather allocate larger amounts to fewer firms, but those that can provide a balance of returns and the ability to invest in many regions, industries, or alternative assets classes simultaneously? How many relationships with GPs should they maintain and how deep or broad should those relationships be? Many will continue to invest in traditional fund structures, perhaps because they lack the investment mandate or operating environment to make radical changes. However, others will follow some of their peers along the evolutionary path that leads from asking for co-investment opportunities to developing entirely new kinds of relationship (e.g. SMAs) or even building the capabilities necessary to engage in direct investing. Institutions will also need to monitor whether their chosen strategy is delivering the returns that they need. There will be a lot of new capital chasing alternative investment opportunities over the next few years, and not all of it will flow through firms with a dependable track record. Higher compliance costs, industry consolidation, and a slower rate of innovation may eat into returns.Retail investors will be welcomed to the industry for the first time, as new avenues for accessing alternatives open up in the US and Europe. The market is immature, but many other new types of products can be expected in the coming years, within a fast-evolving regulatory framework. There will be problems, and occasional scandals on the way, but retail investors and their advisors are likely to be faced with an ever-growing set of options and strategies to consider.Finally, the growth of interest in alternative investments will increase capital inflows, but also the nature and origin of competitors. We expect an increase of the competitive overlap between previously separate segments. The process of going public, and the subsequent focus on growing assets under management by such firms, will only exacerbate this trend.

Regulators and policy makers: balancing concerns with alternative investment benefit . A key theme of the Alternative Investments 2020 series has been to stress the many connections between alternatives and the rest of the financial industry, and how major changes in one part of the financial system nearly always have some effect – often unintended – on the alternatives industry. As the industry matures, and the global financial system evolves as a result of macro and industry drivers, understanding these interconnections and their ramifications is becoming more important. Regulators and policy makers outside the alternatives industry may therefore want to explore the likely future trajectory of the industry and map out how it connects with their particular responsibilities and constituents. As we have seen, new regulations in one area of the financial industry can both unintentionally raise costs and curb markets in the alternatives industry and spark growth in new markets (e.g., private debt funds and retailization). They can also unintentionally erode the returns passed through to key investors such as pension funds, potentially causing problems for society in the future. As well as understanding financial industry connections to the alternatives industry, policy makers may therefore also want to:monitor changes in the industry, including unexpected growth of subsectors, that occur as a result of regulatory reforms design suitable reforms that support investment in innovation and long-term investment in the real economy

Wider society: A new appraisal of the alternative investment industry. Alternative investors perform many functions that benefit the wider economy and society and that cannot easily be replicated by other kinds of investor. They support long-term, illiquid, and risky investments of the kind that can transform real economies around the globe, through venture capital and private equity related (buyouts, infrastructure, debt, real estate, etc.) investments. Hedge funds also serve as an important source of liquidity for financial markets and help to impose discipline and better operating practices on the corporate world by forging closer links between the interests of investors and corporate management teams. At the same time the above-average returns associated with the sector have the potential to help mend the funding gaps in many public and private pension systems, and to allow sovereign wealth funds to deliver on their long-term commitments to nations around the world. However, there remain concerns about how rewards from such activities are shared with LPs and how they are taxed. These need to be part of the assessment of how public investors engage with alternative investors. The opacity and unwarranted complexity that surrounds the industry and the manner in which GPs operate is another area that will need to change in coming years. In the future, the importance of the alternatives industry is likely to become even more apparent to the broader public, as individuals begin investing in the sector through retail alternatives, with the aim of bolstering the value of personal long-term investment portfolios. Ultimately, consistently demonstrating the value-add that the industry generates and doing so in a transparent fashion will be the key to the industry being accepted by the public and policymakers.

11.REFERENCES:

1) **https://www.investopedia.com/**
2) **https://corporatefinanceinstitute.com/**
3) **https://ift.world/**
4) **https://www.preqin.com/**
5) **https://caia.org/**

THANK YOU