Financial Planning

Advisors' Use of Alternatives Broad, Not Deep: Study

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The vast majority of retail advisors now use alternative products or strategies for their clients -- but that number is a bit misleading, a new study finds.

While 78% of all retail advisors use alternatives within client portfolios, nearly half of that group are light users, said John Meunier, principal with Cogent Research, in Cambridge, Mass.

"Just 1% to 4% of all the assets they manage fall into the 'alternative' bucket," Meunier, who authored the report, said.

Just a quarter of the advisors who use alternatives assign them 15% or more of the assets within client portfolios, he adds. Still, it's clear that advisors believe today's investing environment requires alternative tools for asset-class diversification and risk management, he said

A big hurdle in the use of alternatives appears to be education. Among the 22% of advisors not currently using alternatives, 47% admitted in Cogent's study that their own lack of knowledge was a reason.

And 52% of current alternative investment product users indicated that a lack of client knowledge and sophistication is preventing them from embracing alternatives further.

Why specifically are advisors using alternatives?

Further diversifying portfolios was cited by 83% of the respondents in Cogent's study. Eighty percent cited a desire to help manage risk, and 54% use alternatives to achieve absolute returns.

Meanwhile, just 20% of advisors reported using alternatives in an effort to deliver returns above a benchmark, and just 19% said they use them for tax management purposes.

Cogent found that advisors now allocate an average of 11% of their book to alternatives spread across a variety of different products.

Independent advisors, the heaviest overall users of alternatives, show the strongest preference for venture capital, private equity and hedge funds, while bank-based advisors prefer limited partnerships and RIAs tend to use structured products and structured notes.

The findings were compiled in the 2011 Advisor Brandscape report, based on a survey of 1,643 retail investment advisors.

Among eight separate types of investment vehicles, advisors said they are least likely to access alternative asset classes and strategies through mutual funds and ETFs. Yet more advisors expect to increase their use of alternatives and ETFs than any other product or vehicles: 41% of advisors currently using alternatives indicated they will increase their use of ETFs, while 28% said they intend to increase their use of mutual funds.

Meunier said the trend is evidence of the “retailization” of alternatives.

“Advisors are realizing they need more liquid, accessible and understandable products,” he says. “And they need education, both to share with investors, and for themselves as far as how to position products and strategies in portfolios.”