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Interactive Session Overview

Plan sponsors discuss concerns, opportunities with alternatives.

2002 AIC CONFERENCE ■ Queen's Landing, Niagara-on-the-Lake, Ontario

Since this year's conference posed the question, "Is Alpha the Answer?" we felt it was important to ask the delegates what they thought. So Bill Rentz from the University of Ottawa and I hosted an interactive session based on that very theme. The goal was to ask them directly about the challenges and opportunities they face when considering alternative investment strategies. To that end, we presented plan sponsors with three key questions:

1. What are the most important ways plan sponsors can become more knowledgeable about different types of alternative investments?
2. What are the most compelling reasons for considering alternative investments?
3. What are the greatest concerns related to alternative investments, and what possible solutions are available in order to overcome them?

Responses varied among participants, often according to the size of plan sponsors' assets. While the session by no means constituted a formal survey, some of the answers given are of interest to all sponsors, as well as money managers and consultants.

Education is key

Suggestions for gaining more knowledge in the area of non-traditional investments included reading related materials, searching alternative investment Web sites such as the Alternative Investment Management Association's site (www.aima.org), speaking directly with managers and, of course, attending conferences. Sponsors also cited the need to focus on the ultimate decision-makers—the board of directors—and target education toward directors' backgrounds.

The requisite knowledge clearly goes beyond understanding alpha or return possibilities. It includes understanding the numerous risks associated with alternative investments such as legal, regulatory, operational and 'headline' concerns. As one participant noted, there are "lots of banana peels" out there.

Why alternatives?

Overall, the conference presented some compelling reasons for considering alternative investments. Plan sponsors are expressing concern with total fund management and matching assets with liabilities. Alternative investments offer diversification and promising risk-reward tradeoffs. In addition, today's outlook for traditional asset classes such as stocks and bonds is not as rosy as it was in the past decade. Alternative investments appear to be able to provide the increased flexibility needed to meet sponsors' needs.

Some investments, such as hedge funds, provide additional flexibility by relaxing the short-selling and leverage constraints associated with long-only equity strategies. But it was noted that the alpha associated with alternative investments has a distribution—including some negative returns—just like the returns associated with other asset classes. Accordingly, alternative investments, alone, are not the answer to the industry's return concerns.

What are the barriers?

Plan sponsors heavily involved with alternative investments and those considering taking the plunge did share some reservations with these strategies. They said it is often difficult to gauge the track record of the investment managers, particularly hedge fund managers. In addition, benchmarking and education at the board level can be challenging and a lack of transparency is also a concern. Management fees, in particular those related to fund-of-fund managers, was another topic of debate, as sponsors questioned how best to align the incentives of investors and managers. As well, sponsors of smaller plans cited a lack of resources as a major challenge.

While the search for alpha continues and reservations about alternative investments remain, this conference helped to make the path a bit clearer for plan sponsors. ■