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FRC Projects Liquid Alternative Assets Will Double by 2017, But Only If Managers Educate Advisors and Investors

BOSTON —Assets in '40 Act alternatives funds have nearly doubled since 2007, and could do so again in the next five years, according to a new study by Financial Research Corporation (FRC). But continued growth will require managers to make a significant commitment to educating advisors and investors about the products.

FRC projects that total assets in registered alternative mutual funds and exchange-traded funds will grow to \$330 billion by the end of 2012, up from \$169 billion in 2007. If the industry can raise the comfort level of advisors and their clients with liquid alternatives, that figure could reach \$650 billion by 2017.

For its study, titled *The FRC Encyclopedia of '40 Act Alternatives: A 360-Degree View of Products, Performance, Distribution and Actionable Recommendations for Fund Providers*, FRC surveyed a total more than 1,000 consumers, advisors and industry executives. One key finding in the 130-page study was that there is a significant disconnect between what liquid alternatives are designed to provide, and investor and advisor awareness of the products.

“Investors remain extremely risk averse and continue to place a high value on portfolio diversification and volatility management,” said Robert J. Martorana, CFA, lead author of the study and a financial advisor who specializes in alternative investments at Right Blend Investing, LLC. “Registered alternative funds have demonstrated a track record of providing effective diversification, but product providers clearly need to commit more time and resources to getting that message across to consumers and their advisors.”

Education Is Needed to Bridge the Gap

In its consumer survey, FRC found that nearly half of respondents said “reducing portfolio volatility” is an important financial objective. But while '40 Act alternative funds are designed to provide more of the portfolio stability that investors say they want, most are reluctant to move money from more familiar investments.

“Despite their focus on risk and volatility, consumers show a great deal of skepticism towards alternative investments,” said Alan Hess, FRC Research Associate and study co-author. “In our survey, more than 40% said that liquid alts ‘seem risky.’ That indicates that consumers aren’t familiar with how alternatives work, and the irony is that this risk aversion means that investors are missing out on products that are designed to limit volatility.”

FRC also found that about one-third of financial advisors are comfortable including them regularly in client portfolios, but most want more education before increasing their use of the products.

“When advisors understand how alternatives work, they use the products more often and in a way that brings the most benefit to their clients,” said Martorana. “But only about one-third of the advisors we surveyed said they use liquid alts regularly. When we asked the group what it would take for them to increase their use of ’40 Act funds, ‘education’ was the clear preference.”

“Advisors in our survey made it clear that they prefer face-to-face training (from product provider wholesalers, for example), with the opportunity to ask questions. And they need plain-English sales material to help them explain alternatives to their clients,” Hess said.

Categories and Confusion

FRC’s study looked at the characteristics of 11 broad categories of registered alternative funds tracked by Strategic Insight, and made five-year growth projections for each category. Translating a broad range of strategies under the ’40 Act alternatives umbrella into easily understood benefits for investors is a key to continued sales and assets growth.

“These days, the spirit of the times is risk aversion. Liquid alternatives can provide the diversification and non-correlation with traditional assets to fill that role,” said FRC’s Martorana. “Education of both advisors and investors on the benefits and uses of registered alternative funds is the foundation of future portfolio construction.”

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About Financial Research Corporation (FRC)

FRC is a research firm focusing on the investment and asset management industry for more than 20 years. The company, which is a division of Strategic Insight, provides investment professionals with unique and compelling data and analysis of industry trends and financial product performance.

FRC's research studies and analysis, along with access to its analysts and subject matter experts, help executives and senior management to make better product, strategy and distribution decisions. One of the greatest values FRC provides its clients is an independent and unbiased view of the current competitive landscape and an assessment of future market opportunities.