PenderFund Capital Management Ltd.

Liquid Alternative Strategies:

Benefits for a Diversified Portfolio

Alternative asset strategies are gaining popularity among investors. Here are some reasons why they could be included in a diversified portfolio.

What are alternative assets?

The terms “alternative assets” or “alternative investment strategies” are having a moment in the financial media with many articles referring to them. But what exactly are they and how can they benefit investors?

Traditionally, alternative assets are anything that is not a stock, bond, or a currency. This leaves a wide range of assets and investment strategies in the “alternatives” bucket, such as real estate, art, fine wines, jewelry, NFTs, fancy cars, various commodities like gold and oil, as well as derivatives, private equity, venture capital and hedge funds. Naturally, this abundance of choice leaves many investors confused about what kind of alternative asset is right for them.

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The benefits of liquid alternative investment strategies in a diversified portfolio

Until recently due to regulatory restrictions limiting access, alternative assets and alternative investment strategies have been available only to pension funds, family offices, foundations and endowments, and to high-net-worth investors. Today, loosened regulatory restrictions allow mutual funds to incorporate alternative investment strategies in their offerings because of their potential benefits in a well-balanced, diversified portfolio.

One key advantage is a low correlation to traditional assets like stocks, bonds, and cash. This means the market valuations of alternative assets often respond differently to the price fluctuations of these traditional asset classes. This feature is one reason why large institutions, such as pension funds, allocate a portion of their portfolios to alternative asset strategies.

For individuals, an allocation to alternative assets can smooth out market volatility thus making it more palatable for investors to stay invested even during market drawdowns. This is an important benefit because investors who exit the market due to feelings of anxiety and fear, may miss the subsequent recoveries and reinvest only after most of the gains have already been made.

One potential drawback of conventional alternative assets is their low liquidity. While it is relatively easy to sell 1,000 shares of Company XYZ on a large stock exchange, it will take a lot longer to sell an alternative asset such as a private company or a work of art, for that matter. Institutional investors have very long-time horizons, so liquidity is less of a concern for them. However, for regular investors, liquidity is far more important. "Liquid alternative strategies" address this need.

As their name implies, liquid alternative strategies provide the benefits of holding alternative assets in a diversified portfolio along with greater liquidity, which makes them attractive to both individual investors and institutions.

There are many different types of liquid alternative strategies. One type is risk arbitrage or merger arbitrage. This investment strategy seeks to generate profits during a merger and acquisition event or takeover deal. Typically, it involves purchasing the shares of the target firm during the interval between the announcement of a takeover and its completion. The difference, or spread, between the offer price and the market price represents the market's faith in the consummation of the deal. A wide spread indicates the market's assessment that the deal is at risk, either that the deal may take longer to close than expected or the deal may be terminated. Should the deal be completed, the investor will profit from the spread closing.

Another type of liquid alternatives strategy involves investing in quality, high-yield bonds to generate stable income along with a flexible mandate to employ hedges to manage market volatility, rising interest rates and widening credit spreads. The goal is to provide stable low-risk returns and be an alternative to traditional fixed-income in a portfolio.

Pender's liquid alternative strategies and how investors may benefit

Including an allocation to liquid alternative strategies in a portfolio may lower volatility and provide differentiated returns throughout the economic cycle.

Pender Alternative Arbitrage Fund (PAAF)

Since 2009, Pender has demonstrated core expertise in investing in small-to-mid capitalization companies through in-depth research and due diligence. We leverage this advantage in our arbitrage strategies. There is a higher probability of a successful merger between small-to-mid cap companies than among mega-caps which are more exposed to regulatory risks. Read about our track record of identifying catalysts here.

PAAF seeks to capture and profit from the spread at the time of the merger announcement, and, also after the merger is completed. Pender only invests in definitive merger agreements. We do not speculate on acquisitions. Average deal duration is approximately three to five months, hence the strategy provides good liquidity as capital is not tied up in regulatory compliance for years, as can sometimes be the case with larger takeovers.

Six benefits of merger arbitrage strategies:

1. Market neutral: goal of consistent and predictable absolute returns
2. Lower risk profile generally than traditional asset classes
3. Low correlation to traditional asset classes such as equities and bonds
4. Tax efficient: returns taxed as capital gains, not income
5. Interest rate hedge: return potential increases with rising interest rates since spreads are widened by an increase in the risk-free rate
6. Low duration: deals can be completed in as little as three to five months

Read more about the challenges and opportunities in M&As

To learn more about the Pender Alternative Arbitrage Fund, click here.

In September 2022, Pender launched a leveraged version of the Fund, the Pender Alternative Arbitrage Plus Fund. To learn more about this Fund, click here.

To learn more about the Pender Alternative Absolute Return Fund, click here.

Pender Alternative Absolute Return Fund (PAARF)

PAARF is a flexible, high-yield-focused alternative credit strategy that aims to produce positive returns during all stages of the economic cycle. This low-risk strategy can be used to provide diversification benefits due to its low correlation with equities and fixed income. A liquid alternative strategy can potentially provide the differentiation benefits of a hedge fund with the convenience of a mutual fund with lower fees than traditional hedge funds.

Five benefits of differentiated credit strategies:

1. Market neutral: goal of consistent and predictable absolute returns
2. Lower risk profile generally than traditional asset classes
3. Low correlation to traditional asset classes such as equities and bonds
4. Flexible mandate to employ hedges dynamically to manage risk and isolate market inefficiencies
5. A flexible, high-yield-focused strategy that aims to maximize absolute returns over a complete market cycle

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