The Deception of Alternative Investments

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Alternative investing essentially relates to putting money in assets that are not traded on a regulated, public and liquid marketplace. It is that simple. No magic here.

Apple as a public company is considered a traditional equity asset. Apple as a private company is considered an alternative asset. This is pretty obvious, but I will write it down anyways: the same gross performance can be expected in both cases.

Wall Street, and its affiliates, have managed to sell this idea as an innovative approach that brings diversification and stable attractive returns.

I will start by listing advantages both traditional and alternative investments share:

- **Return on Investment:** Whether Apple shares trade on a public market or not, the gross return of this asset should be near-perfectly correlated with its profit-generating abilities over the long run. Historically speaking, all other things considered equal, the gross return of private companies and public companies seems to have been the same according to studies on the subject.

- **Risk:** If risk is defined as the probability of permanent capital loss vs *temporary paper loss*, the risk of owning Apple shares is the same whether the company is public or private.

- **Diversification:** If the risk is the same between owning *public* Apple or *private* Apple, diversification benefits are the same. No diversification benefits from owning Apple in a private or "alternative" structure.

- **Long-Term Strategy:** Both investing types can be approached with a long-term perspective. Investors may choose stocks or alternative assets with the plan of holding them over an extended period to benefit from long-term growth.

Now for the problems (they are all attributed to alternatives):

- **Performance calculations:** alternative investments are not traded on liquid exchanges. Therefore, their annual change in value is not based on the buying and selling of tens of millions of people on independent markets. The change in value of an alternative investment is based on an in-house estimate. This estimate must get a stamp of approval from auditors (paid for by the alternative fund manager) at least once a year. No regulators need to be involved. That is why *public* Apple can drop 30% in a year like 2022. If Apple had been held in an alternative investment setting, its stock may have only dropped 5% in 2022.

- **Fees:** since private Apple only fell 5% in 2022, this also means the alternative fund manager's fixed fees also only dropped 5%. The traditional public fund manager's fixed fees dropped 30%. That is before considering the fact that alternative investment funds command higher fees than traditional funds. Why? Because they are still sold on the idea of being for the privileged; of being exotic and better somehow (even though they're worse on average).

- **Opportunities:** Private owners of private businesses generally do not sell at a discount unless they have some issue like needing money. Private owners know their business and they know how much its worth. They usually get a fair price or a high price when looking at the recent past. Alternative funds market the idea that they have access to assets that public markets don't. Yet, there are tons of high quality companies in all sectors on public markets and every now and then these can sell at irrational prices. I don't think you get those as much in the private world.

- **Liquidity:** Stocks are generally more liquid than most alternative investments, meaning they can be bought and sold more quickly and with less cost. Alternative investment managers often impose stiff penalties if you want to sell your investment within a few years (and clients don't always know this).

- **Transparency:** Stocks traded on regulated stock markets are much more transparent with their reporting compared to most alternative investments. It is important to understand a company's economics in order to get a grasp of its true value and riskiness. This can be hard to do when you have very little data on your private (alternative) investments.

- **Regulation:** The stock market is heavily regulated with more safeguards everywhere while alternative investments are less regulated and offer a lot more possibility for deception and misleading information.

Be careful with this growing chorus chanting the magic of alternative investments. It is mostly a new marketing tactic to attract more and more assets under management and make more and more fees.