CIBC GLOBAL
ASSET MANAGEMENT

Liquid alternatives and absolute return strategies

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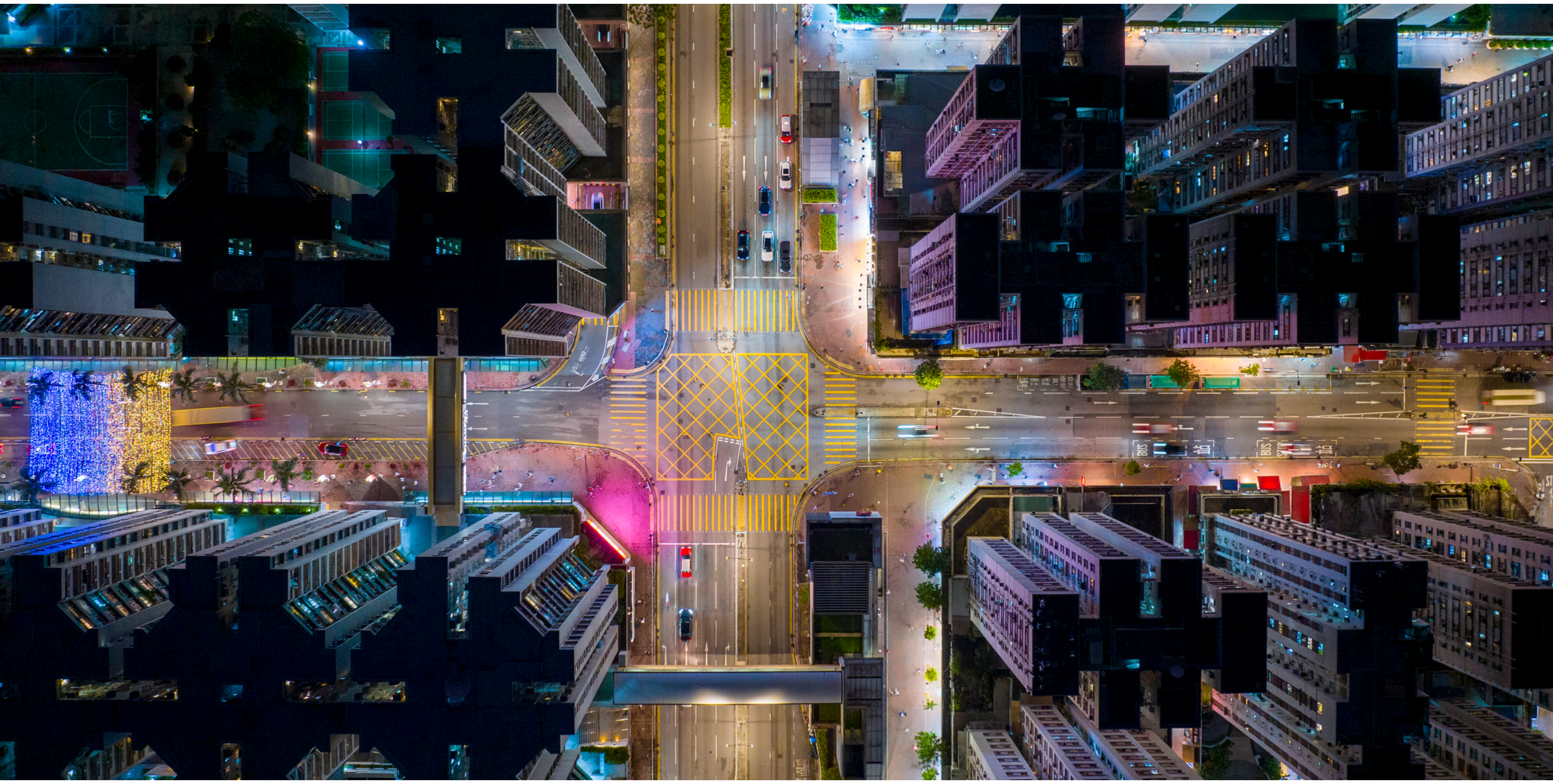

Absolute return strategies and liquid alternatives are increasingly recognized as essential tools for building resilient, diversified portfolios. These strategies aim to generate positive returns regardless of market direction, offering investors both downside protection and the potential for uncorrelated performance alongside traditional asset classes. To help advisors and investors better understand the role, benefits, and considerations of these investments, CIBC Global Asset Management convened a panel discussion with two of its senior leaders:

- **Michael Sager:** Managing Director, Chief Investment Officer of Multi-Asset & Currency
- **Giuseppe Pietrantonio:** Director & Vice President, Currency Multi-Asset Solutions, CIBC Global Asset Management

What are liquid alternatives and absolute return strategies? How do they fit in portfolios?

Sager: Absolute return strategies are a broad set of approaches that aim for a specific return target, not tied to a benchmark index. They range from daily liquid strategies to less liquid ones, and can cover public markets, more eclectic strategies, and beyond. The goal is to build a core, accretive component to traditional portfolios—equities, fixed income, and private markets—by adding diversification and targeting returns using tools like leverage, arbitrage, short selling, and derivatives.

Pietrantonio: Liquid alternatives and absolute return strategies are designed to diversify portfolios, especially those with large allocations to equities and fixed income. They offer exposure to different risks and asset classes, so you're not just taking one risk bet. These strategies help portfolios be more resilient, especially during market selloffs, by using approaches like market neutral, long-short equities, long-short credit, and active currency. Their ability to diversify when it's needed most is a key benefit.

How are liquid alternatives different from private markets or hedge funds?

Sager: Liquid alternatives are more active and have more subcomponents than direct private investments. They offer daily liquidity, transparency, and lower fees compared to hedge funds. The strategies are similar—long-short, global macro, currency, and more—but liquid alts are more accessible and regulated, making them suitable for a broader range of investors.

Liquid alternatives and private markets are complementary. Liquid alts provide a source of liquidity and diversification to balance the less liquid private market holdings. Together, they help optimize the risk-return profile of a portfolio.

What is the process of constructing a liquid alternatives portfolio?

Sager: Building these strategies is challenging. In equity market neutral, for example, you need to be right on both your long and short positions, while keeping market beta close to zero. Portfolio construction is sophisticated and focused on identifying idiosyncratic opportunities, not just market exposure. In currencies, you want to minimize market beta and focus on unique opportunities within asset classes. It's all about rigorous process, quantitative research, and disciplined risk management.

What are realistic return expectations for liquid alternatives?

Sager: The standard target is around 5% above cash (for example, 3-month T-bills) over the long term. This is similar to public equity returns, but with a focus on diversification and lower correlation to traditional markets. The aim is to deliver positive returns even when equities or bonds are down, but not to match strong bull market years. Consistency and diversification are key.

What are the liquidity and time horizon considerations for investors?

Pietrantonio: Since regulatory changes in 2018, liquid alternatives have become much more accessible to Canadian investors. This democratization means that both retail and institutional investors can benefit from these strategies.

Liquid alternatives typically offer daily liquidity, unlike private markets or hedge funds. Investors can usually redeem in T+2 days, which is much faster than other alternatives. The time horizon for returns is generally over a market cycle, and strategies can have both short- and long-term positions. The key is that you're not locked in for long periods, but you should still approach these as long-term strategic allocations, reviewing your portfolio every three to five years or as your circumstances change.

How much should investors allocate to liquid alternatives?

Sager: We typically suggest 5–10% of a portfolio, spread across different liquid alternative strategies. The exact allocation depends on the investor's goals, risk tolerance, and the overall portfolio. The focus should be on building a diversified mix of strategies—macro, equity long-short, credit, currency, and more—to achieve consistent, uncorrelated returns.

How important is manager selection and due diligence?

Sager: Manager due diligence is critical. You need to understand the manager's process, risk controls, and how they achieve returns. Look for repeatable strategies, robust risk analytics, and oversight. Multi-strategy approaches, where a manager can allocate across several sleeves, can help smooth performance and manage risk. Transparency and ongoing oversight are essential.

The evolution from single-strategy to multi-strategy liquid alts requires more sophisticated infrastructure for trading, risk management, and compliance. Success isn't just about forecasting returns—it's also about measuring and managing risk efficiently and effectively.

What are your final thoughts for advisors and investors?

Sager: Education is vital. Advisors and investors should focus on how liquid alternatives fit into the total portfolio, what outcomes they are expected to deliver, and who is best positioned to provide them. Purpose, structure, and fulfillment are the key pillars.

Pietrantonio: Liquid alternatives can be a first step into alternatives for many clients, providing liquidity, diversification, and a smoother introduction to non-traditional strategies.

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Across a spectrum of investment solutions, we commit to robust research. Dedicated sector and regional analysts focus on industry research and security-specific idea generation. Our investment professionals leverage deep and diverse expertise by sharing proprietary research across asset-class teams. By sharing insight across asset class teams, we maximize opportunities to add value to our client portfolios.

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