TD Global Investment Solutions

Investor Knowledge 20 Minutes

Find Your Strategy:

Investing in Private Alternatives for Small and Mid-Size Institutions

Key Takeaways

- Private alternatives can be an integral component of an institutional portfolio
- Private alternatives may help improve risk-adjusted returns
- The TD Greystone Balanced Plus Fund and TD Greystone Alternative Plus Fund are integrated solutions which provide access to private alternatives for small and medium-size institutions that are easy to implement and cost-effective

In Canada and globally, large pension funds, insurance companies, sovereign wealth funds, endowments and foundations have been increasing their allocation to real assets. However, gaining access to these assets is often challenging for small and mid-size institutional investors.

In this paper, we will discuss the current investment environment and the challenges all investors face. We will also address the benefits that private alternatives offer to overcome these challenges, ways that small and medium-size institutional investors can implement a diversified private alternative investment weighting in a cost-effective manner and key highlights of each private alternative strategy.

Executive Summary

The current investment environment has been challenging for institutional investors. Volatility is elevated in the face of persistent global economic uncertainty and inflation. Correlations between bonds and equities have risen, lessening total portfolio diversification.

To help meet return requirements while respecting risk budgets, institutional investors should consider an allocation to private alternative assets that can provide higher income, allow for growth in asset values and, notably, manage total portfolio risk through enhanced diversification .

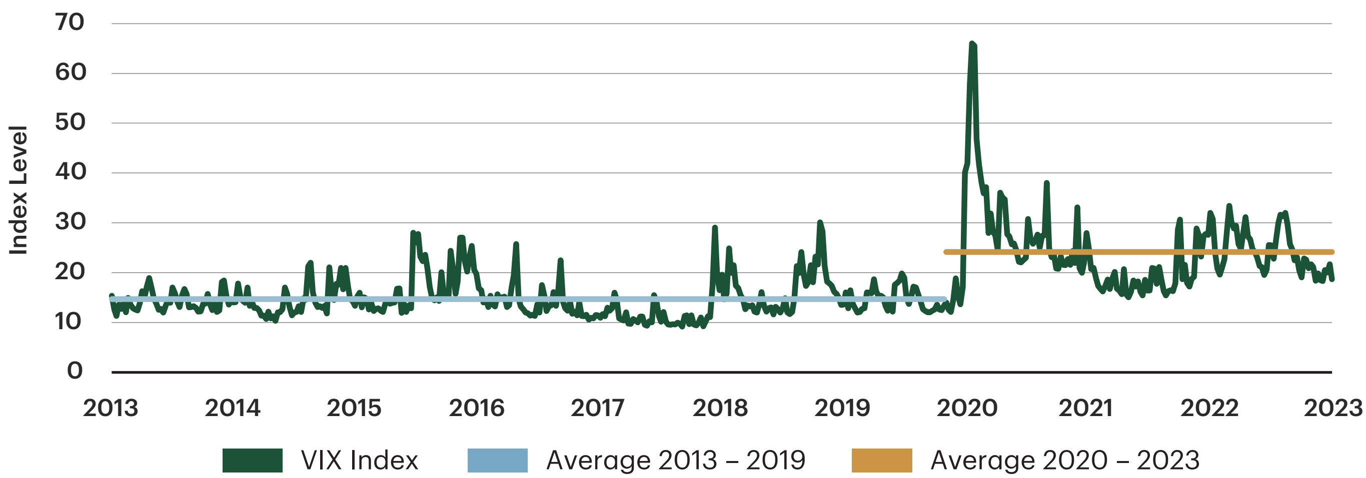
For small and medium-size institutions, accessing alternatives can be prohibitive due to minimum investment thresholds, costs and administrative requirements. To help investors overcome these challenges, TD Asset Management Inc. (TDAM) offers two uniquely designed solutions for institutions: TD Greystone Balanced Plus Fund and TD Greystone Alternative Plus Fund.

- For investors seeking holistic and integrated total portfolio management that includes public equities, fixed income and private alternatives, the **TD Greystone Balanced Plus Fund** offers a turnkey balanced solution.
- For investors managing their own asset mix who seek a diversified standalone alternatives allocation, the **TD Greystone Alternative Plus Fund** is a solution that offers a fully integrated approach to investing in private alternatives.

Challenging Investment Environment

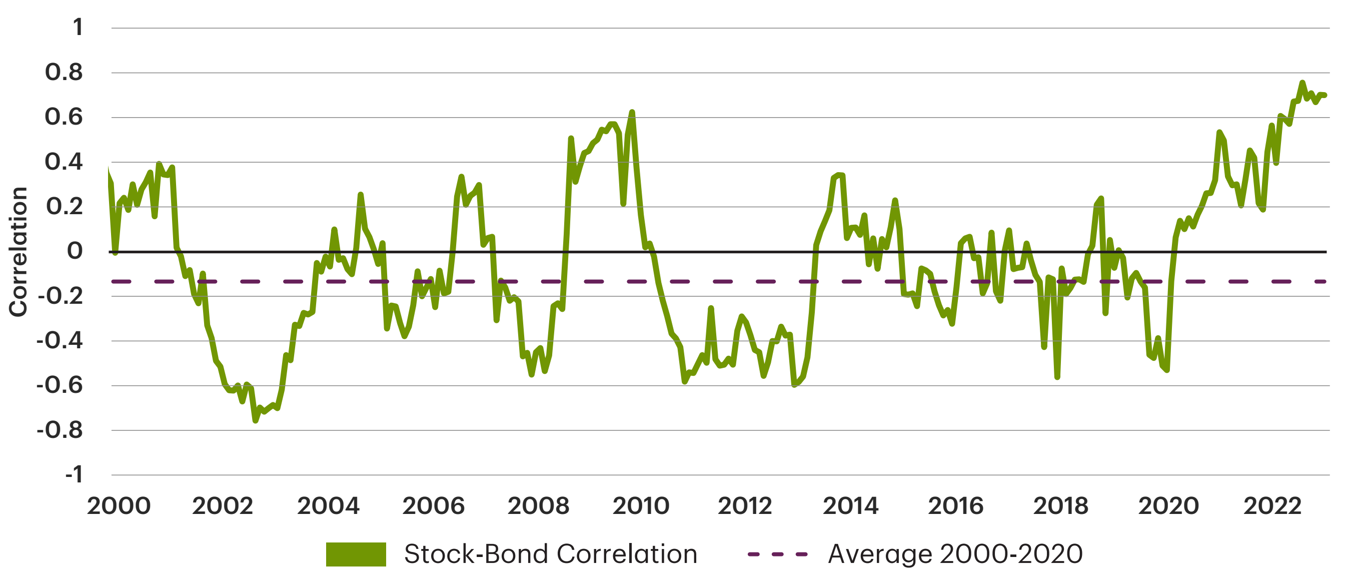
Amid persistent global economic uncertainty and inflation, volatility within both equities (**Figure 1**) and bonds remains elevated. In addition, the correlation between equities and bonds has increased, lessening total portfolio diversification benefits for public market investors (**Figure 2**).

Figure 1: Volatility of Stock Markets Has Increased



Source: Bloomberg Finance L.P. As of Mar 3, 2023.

Figure 2: Equity-Bond Correlations Have Increased



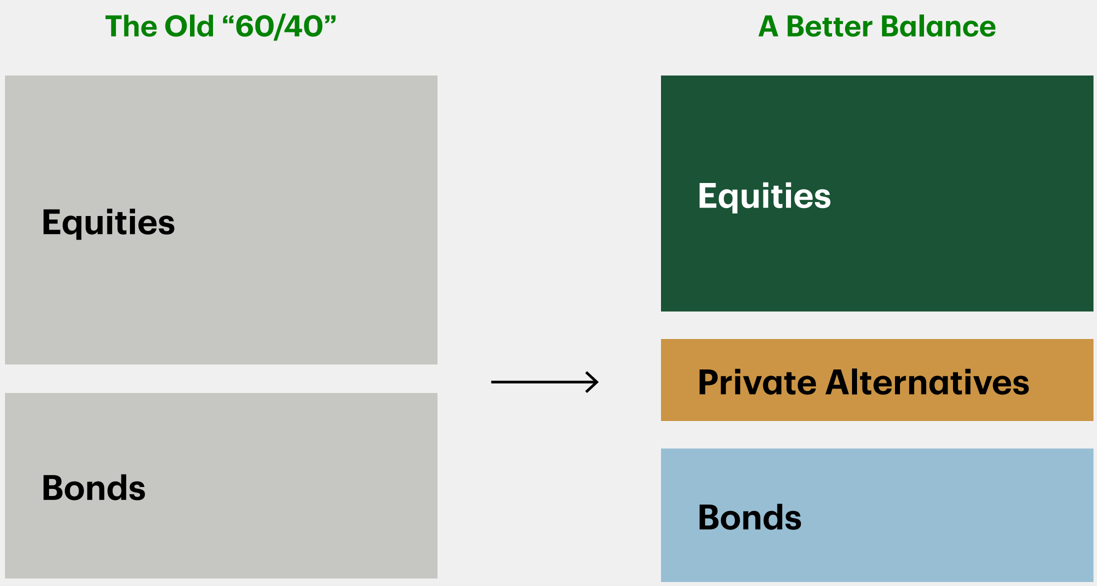
Source: Bloomberg Finance L.P., TDAM. Rolling 12 month correlation of S&P 500 and Bloomberg U.S. Aggregate TR Index. As of Feb 28, 2023.

Excessive volatility and reduced diversification can erode a traditional portfolio's value over time, particularly for investors with cash flow requirements, such as endowment spending and pension payments.

To overcome the higher volatility without sacrificing expected returns, many institutional investors are making allocations to alternatives. In particular, private commercial real estate, private credit and private infrastructure (collectively referred to as private alternatives) have several attractive characteristics for investors, including predictable income streams, stable long-term returns with low volatility, low correlation to traditional asset classes and inflation-hedging characteristics.

Integrating private alternatives into a diversified mix that contains only equities and fixed income can help reduce potential risks while enhancing the overall rewards (see **Figure 3**).

Figure 3: Improving Risk-Adjusted Returns



The Old "60/40" — Hypothetical Outcomes

Hypothetical Outcomes	
Expected Return	5.7
Standard Deviation	7.4

A Better Balance — Hypothetical Outcomes

Hypothetical Outcomes	
Expected Return	5.9
Standard Deviation	6.3

Expected returns and standard deviation are derived using TDAM's long-term asset class assumption methodology.
Source: TD Asset Management Inc. As of Dec 31, 2022.

Benefits of Private Alternatives

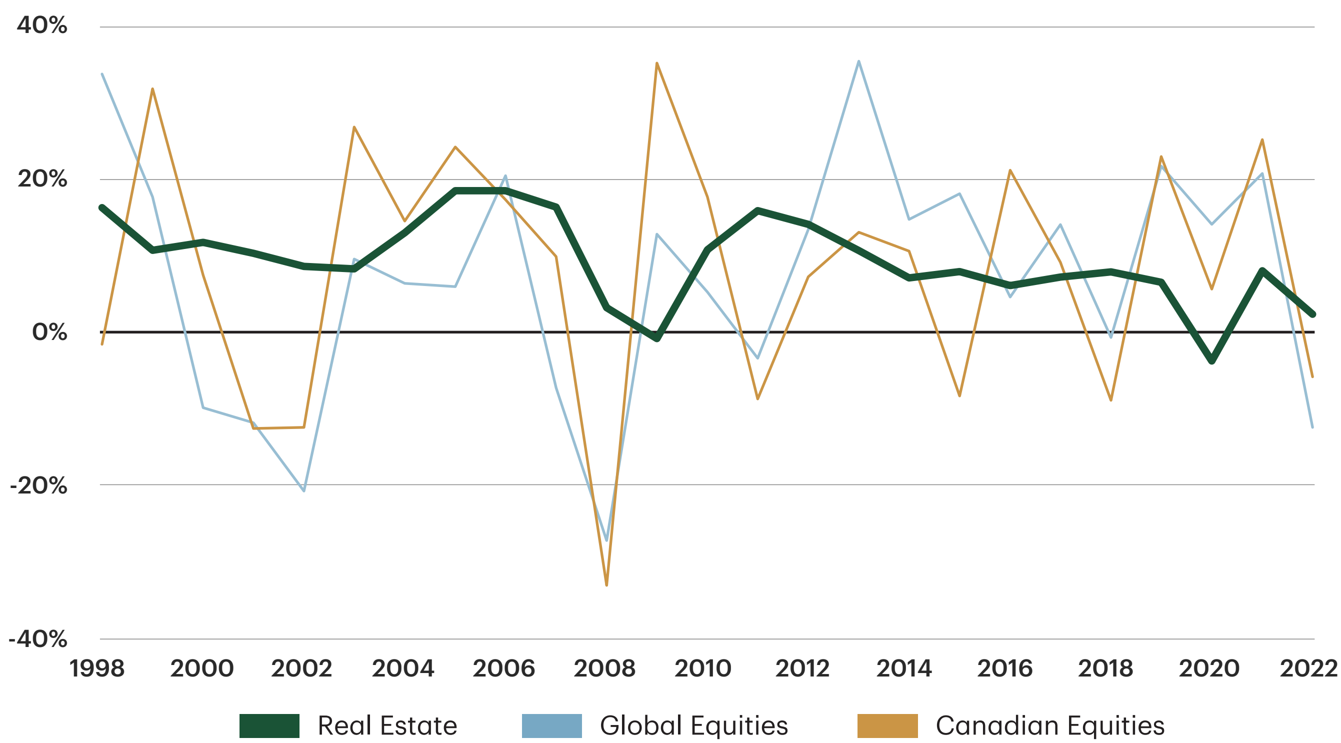
We believe that private alternatives might provide institutional investors with the following benefits:

- Improved diversification through lower volatility and lower correlation to traditional asset classes
- Stable long-term cash flows
- Inflation hedging

Improved Diversification, Lower Volatility and Lower Correlation

Private alternatives can offer portfolios investments with lower volatility. **Figure 4** provides a comparison of annual returns for public equities and alternatives. As shown by more extreme dips and peaks, equities demonstrate higher volatility, whereas private alternatives (as illustrated by real estate), demonstrate a more stable return pattern. This stable return pattern is attributed to a large portion of returns being driven by income – for example, rental income generated by a multi-unit residential complex.

Figure 4: Alternatives Can Offer a Stable Return Profile



Source: Rolling annual performance ending December 31, 2022. Bloomberg Finance L.P., MSCI/REALPAC Canada Annual Property Index[1] – All Assets.

In addition, the performance of private alternatives has typically exhibited low correlation with traditional asset classes - equity, fixed income or money market instruments.

The appealing risk characteristics (lower volatility and lower correlation) do not necessarily come at the expense of lower expected returns, making private alternatives a potentially attractive investment lever to help investors achieve their portfolio objectives (**Figure 5**).

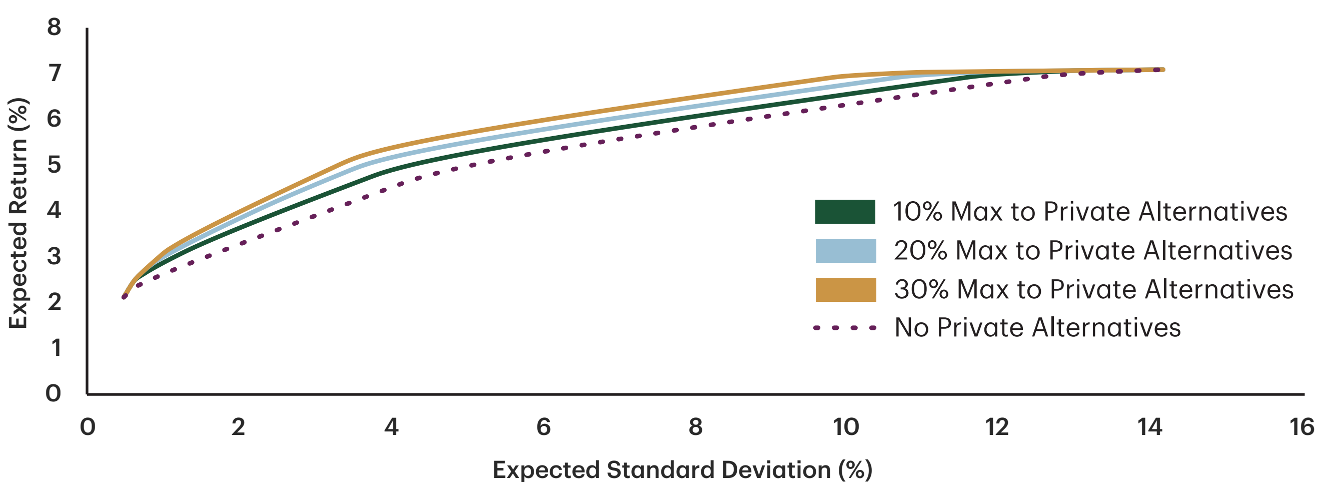
Figure 5: Expected Return and Standard Deviation

Private Alternatives	Expected Return[2]	Standard Deviation[2]
Money Market	2.2	0.5
Universe Bonds	4.2	4.1
Long Bonds	4.5	7.7
Canadian Equities	7.4	14.1
U.S. Equities	5.8	12.6
International Equities	7.1	12.8
Global Equities	6.2	12.2
Private Debt	5.9	4.2
Commercial Mortgages	5	2.9
Canadian Real Estate	5.2	8.5[3]
Global Real Estate	5	6.9[3]
Global Infrastructure	7.2	7.1[3]

Source: TD Asset Management Inc. Assumptions are updated annually. As of Dec 31, 2022.
[2] Expected returns and standard deviations use TDAM's long-term asset class assumptions.
[3] For real estate and infrastructure, standard deviations are adjusted to account for serial correlation.

From the lens of portfolio modelling, **Figure 6** illustrates the benefits of lower correlation and lower volatility associated with private alternatives. Private alternatives help to move the efficient frontier up and to the left. This means that a balanced portfolio which includes private alternatives has a better range of expected outcomes for a given level of risk than a traditional equity-and-bond-only portfolio.

Figure 6: Efficient Frontier with Varying Constraints to Private Alternatives

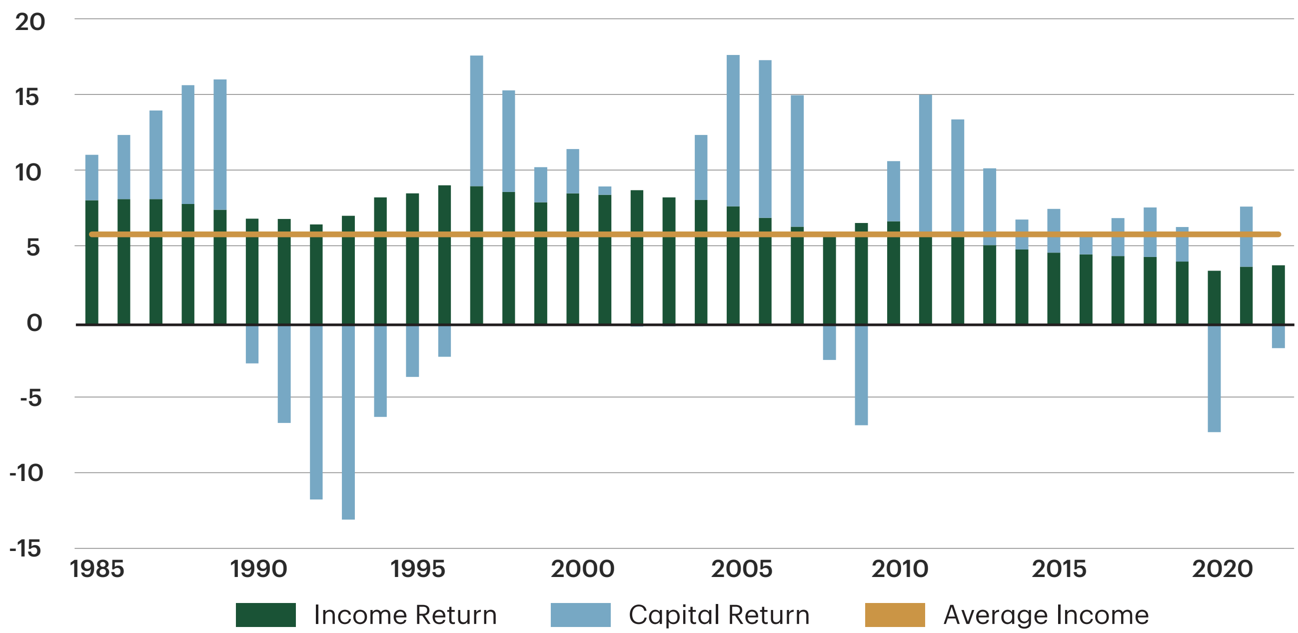


Note: Efficient frontier is derived using TDAM's long-term asset class assumptions.
Source: TD Asset Management Inc. Assumptions are updated annually. As of December 31, 2022.

Stable Long-Term Cashflows

Private alternatives could provide stable and reliable income over time. That is an advantage for asset-liability matching and meeting cash flow needs. History shows that real estate offers superior current income compared to stocks and bonds. As detailed in **Figure 7**, net operating income is not only historically the largest portion of total real estate returns, but also the most stable, varying only slightly from year to year.

Figure 7: Real Estate Income Stability



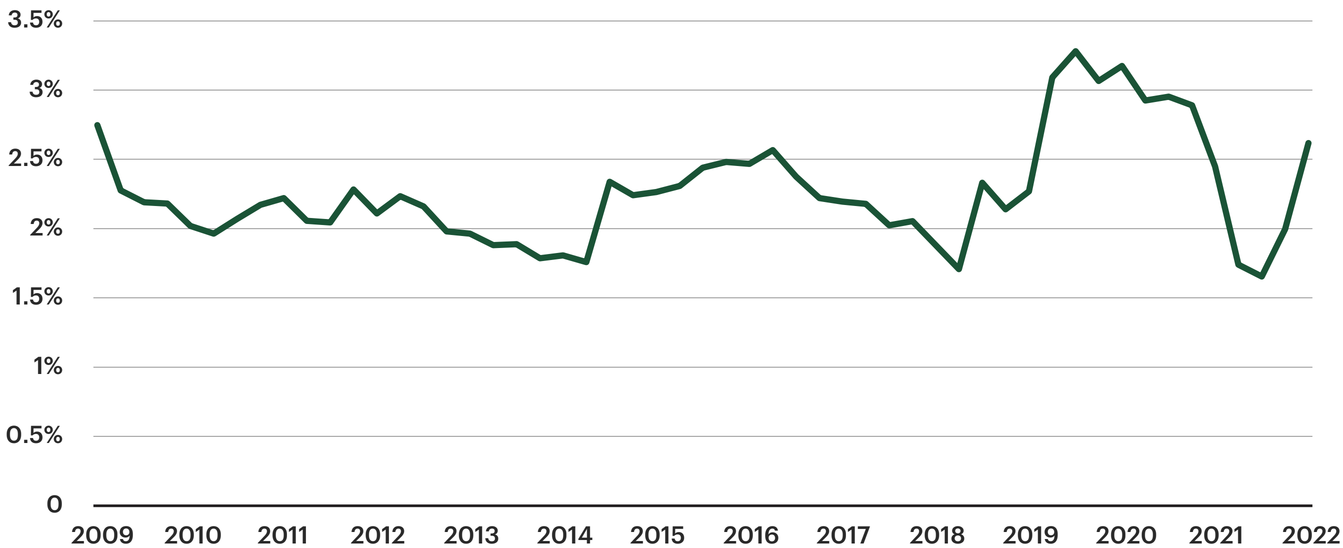
Source: MSCI/Realpac Canada Annual Property Index[4]. All assets' performance as presented may not match the official published data as MSCI may have updated previous quarterly returns to reflect data amendments provided by index participants and to account for the addition of new index participants. As of December 31, 2022.

Infrastructure assets by their nature can provide investors with the ability to capture predictable and sustainable current yield over the life of the assets. Core infrastructure assets are typically essential to a region's economic productivity. Further, these assets often portray competitive monopolistic traits and can often benefit from high barriers to entry based on financial, contractual, regulatory, environmental and geographical hurdles.

Income

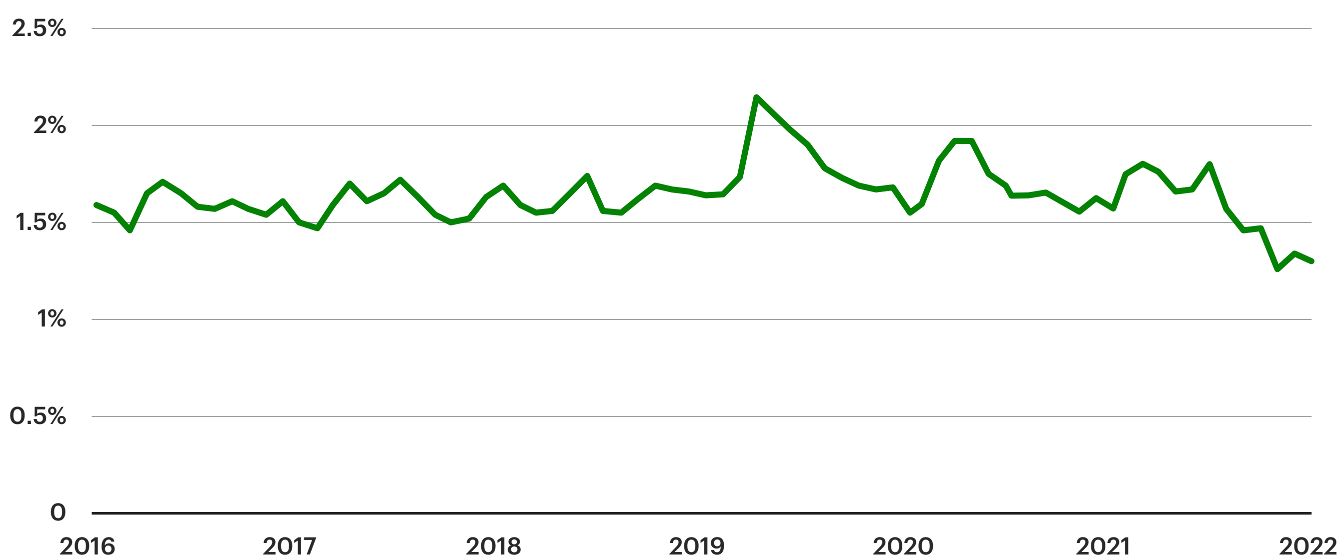
Private credit portfolios offer a yield that is about 2% higher than a well-diversified traditional bond portfolio (**Figure 8A** and **8B**). The added return is even more attractive when we consider that these investments exhibit lower volatility than more traditional fixed income instruments.

Figure 8A: Commercial Mortgage Yield Advantage Over Traditional Fixed Income



Source: TD Asset Management Inc. FTSE Russell. Commercial Mortgage Yield Advantage is TD Greystone Mortgage Fund yield less FTSE Canada Overall Duration Matched yield. As of Dec 31, 2022.

Figure 8B: Private Debt Yield Advantage Over Traditional Fixed Income

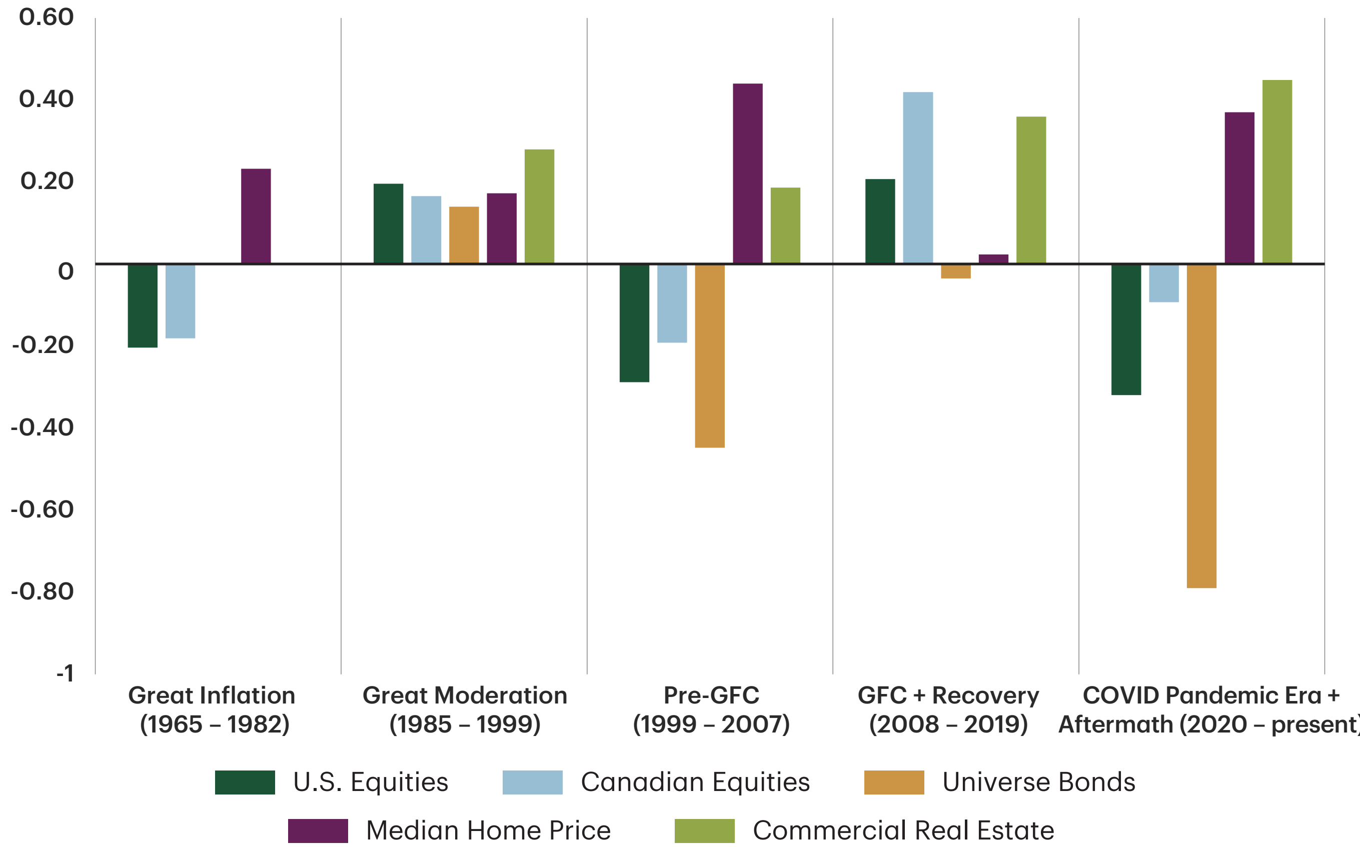


Source: TD Asset Management Inc. FTSE Russell. Private Debt Yield Advantage is TD Emerald Private Debt PFT yield less FTSE Canada Universe Bond yield. As of December 31, 2022.

Inflation Hedging

Private alternatives have historically demonstrated a higher correlation with inflation than other traditional asset classes (**Figure 9**).

Figure 9: Real Estate and Infrastructure Demonstrate Persistent Inflation Hedging



Note: Inflation as represented by Canada Headline CPI. Correlation calculated using quarterly returns. Commercial Real Estate one quarter lead. Canadian Equities and U.S. Equities coincident. U.S. Median Home Price two quarter lead. Source: Bloomberg Finance L.P., MSCI[5], St. Louis Fed, U.S. Department of Housing and Urban Development, TD Asset Management Inc. As of December 31, 2022.

Due to the structure of commercial leases, real estate can provide inflation protection not available from other asset classes. First, tenant leases usually cover higher building operating costs (utilities, etc.), protecting property owners from unexpected increases. Second, long-term leases have rental rate increases built into the lease period to compensate the owner for inflation, thus protecting income flows. Third, as inflation moves through the economy, a building's replacement cost also rises, thereby creating capital appreciation.

Infrastructure follows a similar model, where there is potential for inflation-linked returns through a combination of contractual and/or regulatory pricing considerations.

Private credit can also partially hedge inflation compared to the traditional bond universe. For example, variable rates are more prevalent in mortgages than in bonds. Due to amortization, monthly principal and interest repayments can be reinvested at higher rates. In addition, for commercial mortgages, the duration is typically lower than the traditional bond universe.

How can small and mid-size investors access private alts in an efficient way?

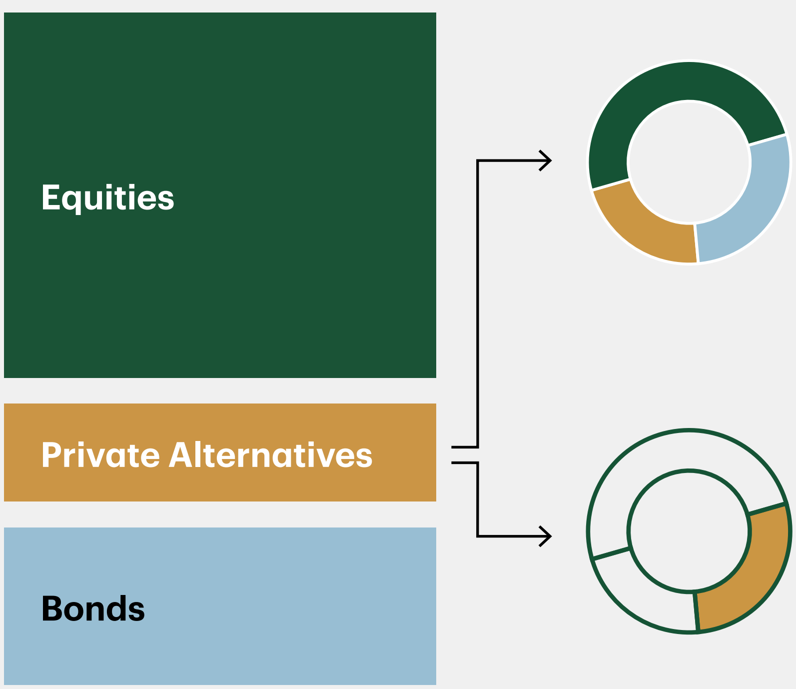
We believe that open-end fund structures work best in accessing real assets. This allows for cash/capital inflows and outflows on an ongoing basis. This is different from a closed-end fund structure where the pool of capital is locked in for a predetermined period, typically 8 to 10 years. Open-end fund structures are not subject to timing constraints, allowing investment managers to make prudent buy-and-sell decisions based on current market conditions.

Traditionally, when allocating to private alternatives, institutional investors select individual mandates with multiple investment managers. As a holistic solutions provider, TDAM can offer open-end solutions where clients have access to an integrated strategy that includes over 1300 globally diversified underlying investments in commercial real estate, infrastructure and private credit (**Figure 10**). Given that rebalancing between private alternatives takes longer than it does for publicly traded asset classes, monitoring the minimum and maximum ranges becomes paramount. The benefits of TDAM's solutions relative to standalone private alternative allocations include integrated cash and risk management processes, strong governance, reduced administrative needs, integrated reporting systems and active rebalancing.

Figure 10: Evolving to Meet Client Needs

A Better Balance

Integrated Solutions



Balanced Plus

- Diversified and integrated equities, bonds and private alternatives
- Turnkey single fund solution
- Management of all liquidity and cash flow considerations

Alternative Plus Fund

- Diversified and integrated private alternatives, including real estate, infrastructure, private credit
- Turnkey single fund solution
- Management of allocation across alternatives

TD Greystone Balanced Plus Fund

The TD Greystone Balanced Plus Fund takes advantage of our core expertise as a total portfolio solution-based manager, seeking to provide mid to high single-digit returns with a lower volatility than traditional balanced funds. Using our disciplined process, the Fund seeks long-term total returns by investing in a balanced portfolio of equity, fixed income and private alternatives.

The TD Greystone Balanced Plus Fund has a focused goal: capital appreciation and income while preserving the value of the original investments. Our investment teams do this through a quality-oriented investment program designed to reduce risk. It seeks to be more income-focused than typical balanced funds and to provide lower return volatility through greater diversification and lower correlation of its wider range of asset classes.

Many institutions do not have the resources or inclination to create a sizable separate portfolio on their own – especially one including real estate, infrastructure and commercial mortgage investments. Nor do they have the time to continually respond to ever-changing market conditions.

This pooled fund was created to give such investors an option that includes access to direct alternatives – an option that has not been readily available in the marketplace.

Features

- **Our best investment ideas integrated into a single comprehensive balanced portfolio.**
- **Equity, fixed income and private alternative allocations to enhance the expected risk-return profile compared to traditional balanced programs.**
- **Administrative ease for investors looking to add private alternatives in a single turnkey investment solution.**
- **Active asset allocation by portfolio managers who monitor the asset mix daily for tactical opportunities and optimal rebalancing.**
- **Daily liquidity at portfolio managers' discretion.**

TD Greystone Balanced Plus Fund – Strategic Asset Mix

Equities — 50%

- **17%** Canadian Equity
- **11%** U.S. Equity
- **11%** International Equity
- **11%** Global Equity

Alternatives — 28%

- **10%** Infrastructure
- **10%** Real Estate
- **8%** Commercial Mortgages

Bonds — 22%

- **22%** Canadian Bonds

TD Greystone Alternative Plus Fund

The TD Greystone Alternative Plus Fund allows investors to access TDAM's experience in executing and actively managing alternative investments through a combination of TDAM-managed pool fund investments that include real estate, infrastructure, and private credit.

The Fund seeks to provide sustainable long-term total returns through a diversified basket of private alternative funds and uses TDAM's disciplined top-down and bottom-up process. TDAM's use of an open-ended fund structure facilitates the ability to integrate alternative exposures.

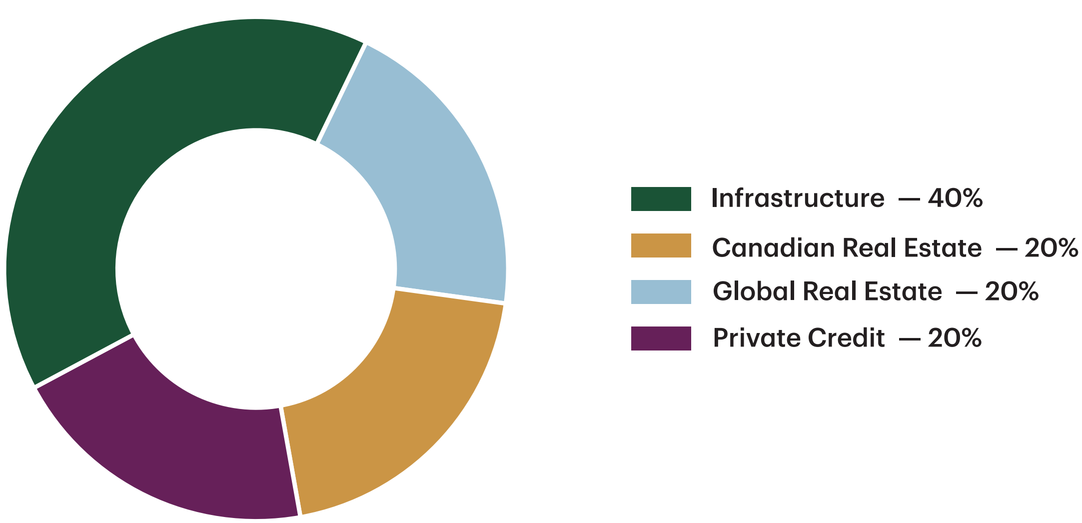
The Fund focuses on income-oriented private alternatives that aim to help meet institutional obligations. As a diversifying complement to existing equity and fixed income exposures, we believe the Fund also has the potential to improve the risk-adjusted return potential of institutional portfolios.

TDAM created the Fund to provide investors with a strategy that has the potential to reduce total portfolio volatility while providing the flexibility to allocate to multiple asset classes. A single strategy also reduces administrative burdens by allowing the investment manager to deploy capital holistically as a single strategy.

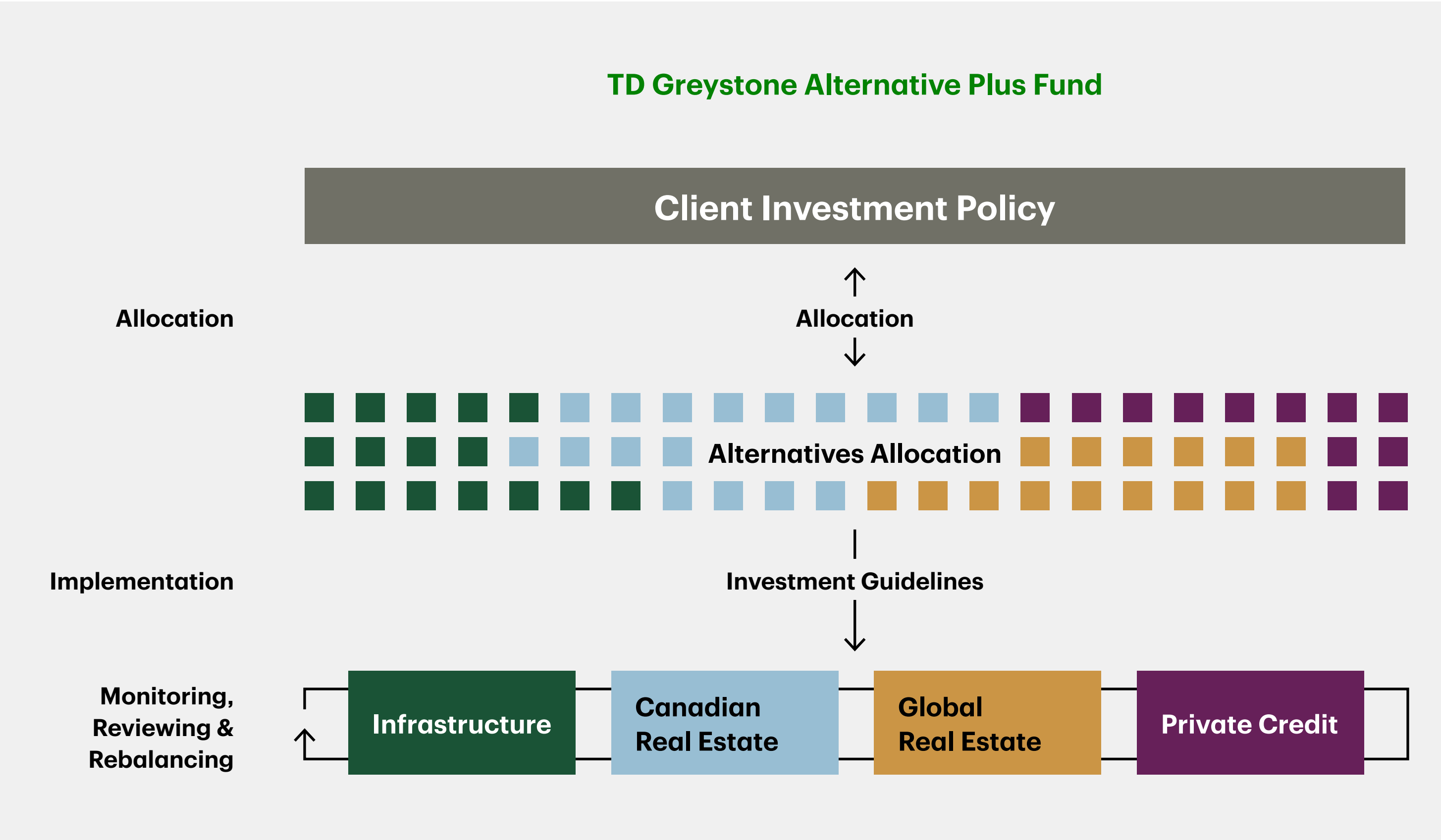
Features

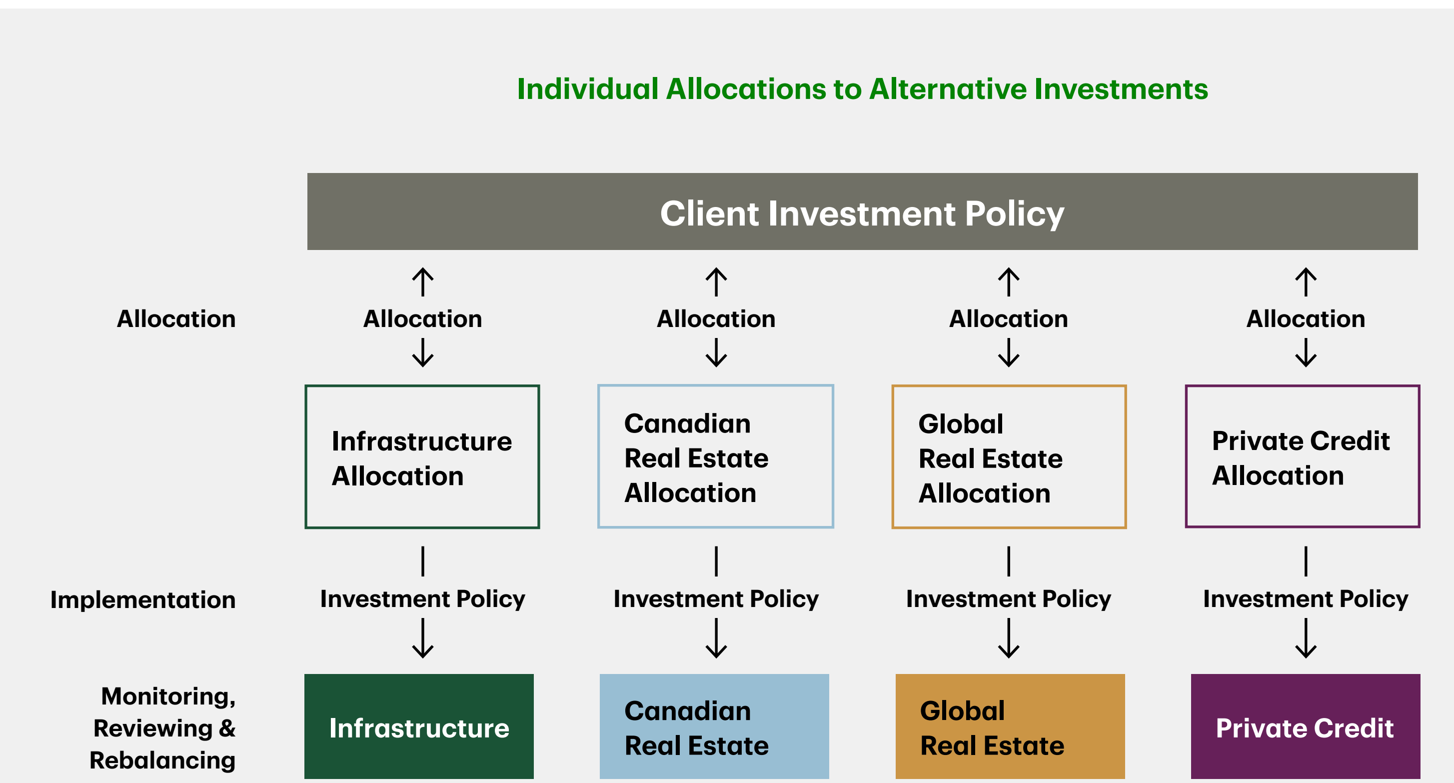
- **Our alternative strategies integrated into a single open-ended alternatives fund that is simple to access and to manage.**
- **Provides access to multiple direct real asset strategies in a manner that is less administratively burdensome.**
- **Over 30 years of experience in managing alternative assets and building private asset portfolios for institutional clients.**
- **Enhanced liquidity as the Fund is actively managed and able to opportunistically allocate to the underlying asset classes based on projected cash flows, liquidity requirements and diversification requirements.**
- **Provides investors with a strategy that has the potential to reduce total portfolio volatility while offering the flexibility to allocate to multiple asset classes.**

TD Greystone Alternative Plus Fund – Strategic Asset Mix



Benefits of Allocating through Alternative Plus Fund





Source: TDAM. For illustrative purposes only.

Strategy

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