

# Guide to Alternatives

# Your guide to alternatives

This guide will answer:

- **What are alternatives?**
- **What can alternatives do for your portfolio?**

Alternatives, including private markets assets and hedge funds, have long been a meaningful component of institutional, family office and ultra-high net worth investors' portfolios. These investors allocate a significant portion of their portfolios to alternatives because they have historically improved risk-adjusted performance.

At BMO Global Asset Management, we are designing solutions that help all investors achieve their investment objectives. This guide will explain what alternatives are, how they can benefit your portfolios and how to access them.

## Who are we?

Your destination of choice for alternative solutions

With C\$158+ billion<sup>1</sup> in assets under management, BMO Global Asset Management has helped Canadian investors achieve their financial goals by offering a range of solutions that suit investors' needs and preferences.

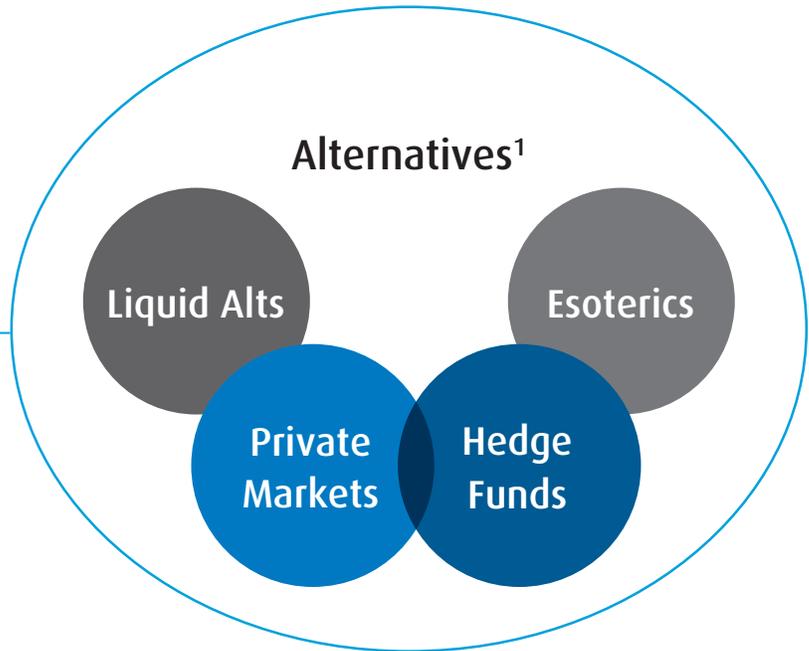


<sup>1</sup>As at March 31, 2023.

# What are alternatives?

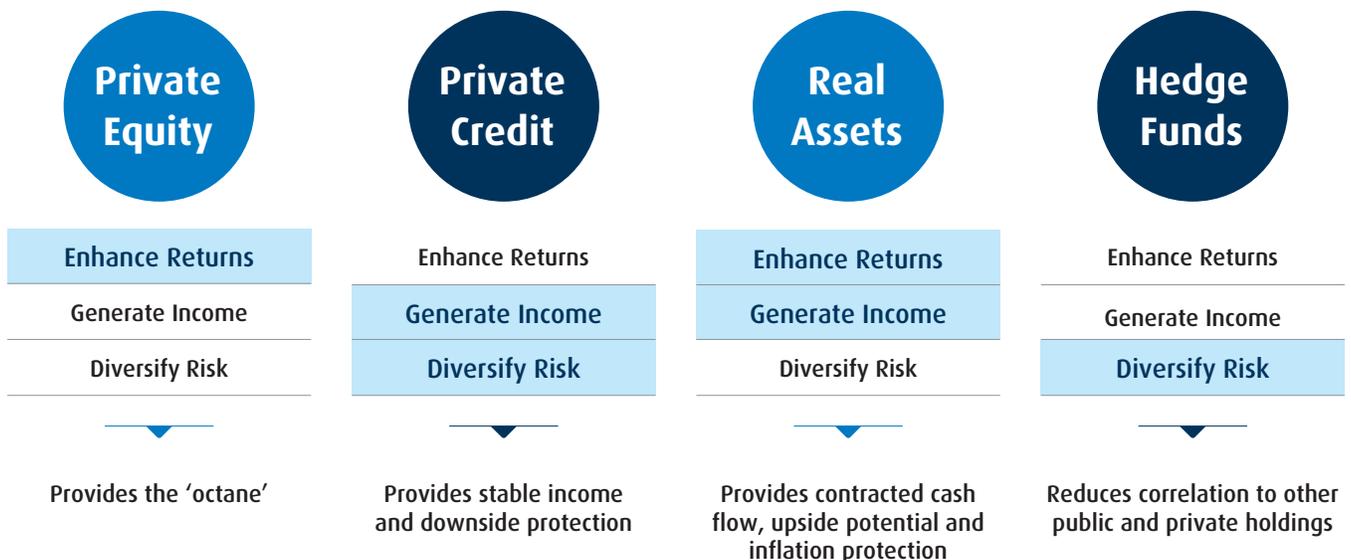
Alternatives generally include assets that are either not traded publicly or a method of investing using non-traditional strategies. There are a broad range of asset types, even within alternatives as a category.

BMO Global Asset Management is focused on developing solutions that make private markets and hedge funds more accessible to a wider set of Canadians.



## Each asset class can play a different role within a portfolio

See page 9 for a deeper dive into private markets (i.e., private equity, private credit and real assets) and hedge funds.



<sup>1</sup>Liquid Alts are NI 81-102 "Alternative Mutual Funds" while Esoterics include assets such as crypto or wine.

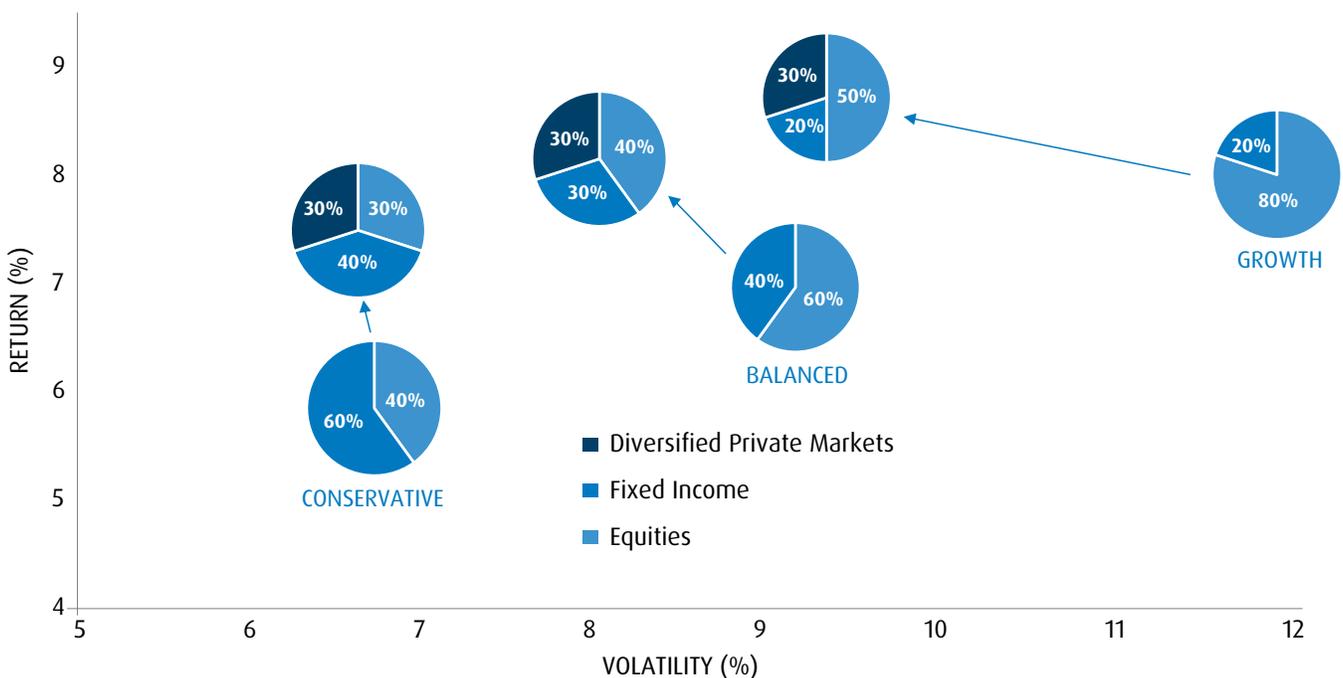
# Why use alternatives in your clients' portfolios?

Alternatives can play a complementary role to the stocks and bonds within a traditional portfolio. Key benefits include:

 <h3>Enhance Returns</h3>	 <h3>Generate Income</h3>	 <h3>Diversify Risk</h3>
<p>Investments like Private Equity, on average, generate higher returns than public market equivalents. These investments may also carry more risk than their public market equivalents.</p>	<p>Investments like Private Credit and Real Assets can produce stable, floating rate income.</p>	<p>Diversified Private Markets and Hedge Funds can provide outcomes with limited connection to public markets that may increase the consistency of the overall portfolio returns</p>

## Alternatives improve risk-reward outcomes vs. traditional allocations

From 2002 to 2022, a 30% allocation to diversified private markets improved the risk-reward outcomes for investors that were fully invested in public markets. This impact was realized for investors of varying risk profiles, whether the starting point is growth, balanced or conservative.



Portfolio breakdowns with Diversified Private Markets  
 Equities: S&P/TSX Composite Index  
 Fixed Income: S&P Canada Aggregate Bond Index  
 Diversified Private Markets: Preqin Private Capital Index

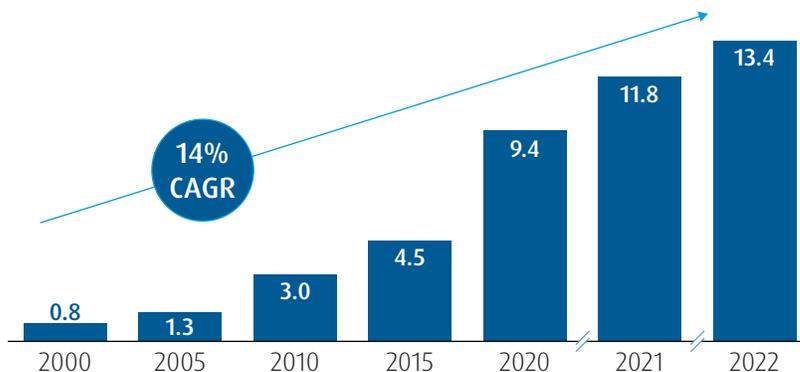
Diversified private markets, as measured by Preqin's Private Capital Index, is a benchmark calculated using performance information for over 10,000 private capital funds including asset classes such as Private Equity, Private Credit, Infrastructure and Real Estate.

# Who uses alternatives today?

Assets Under Management (AUM) held in private markets, a key subset of alternatives, have been concentrated with institutional investors to date.

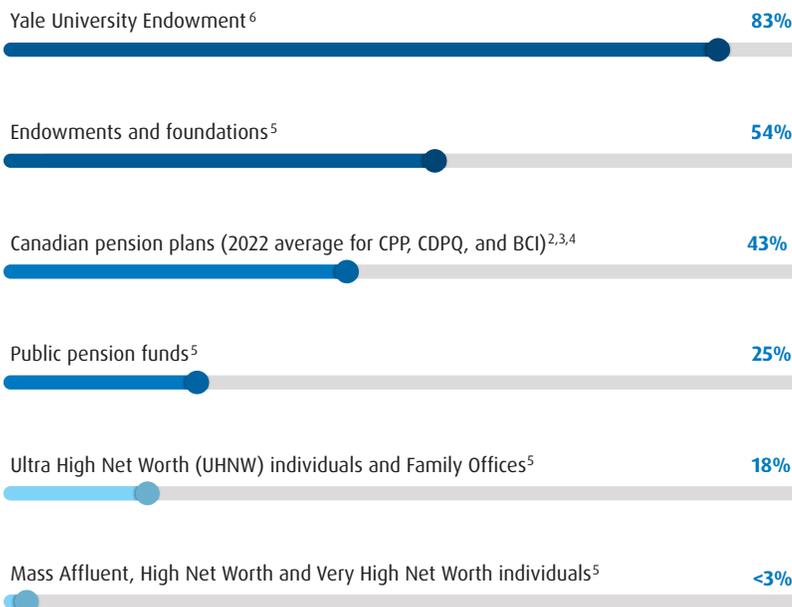
Future growth is expected to be driven by individual investors as innovative fund formats and features improve access for a wider group of investors.

Growth in Private Markets AUM<sup>1</sup> (US\$ Trillions)



## Who invests in alternatives?

Institutional investors, such as pension funds and endowments, are significant investors in alternatives. Individual investors have lagged by comparison.



<sup>1</sup>Source: Preqin.

<sup>2</sup>CPP Annual Reports (2019, 2022) (CPP 2022 private credit percentage is from the total in figure 10.3.2: Terms to Maturity).

<sup>3</sup>CDPQ Annual Reports (2016, 2019, 2022). While CDPQ does not divide private credit from public credit, it has noted private credit was a key driver of positive fixed income performance in 2016 and 2022 (cdpq.com).

<sup>4</sup>BCI Annual reports (2015-16, 2018-19, 2021-22). While BCI does not divide private credits from public fixed income, it has noted that a net \$2.1Bn was deployed into private credit in 2021-22.

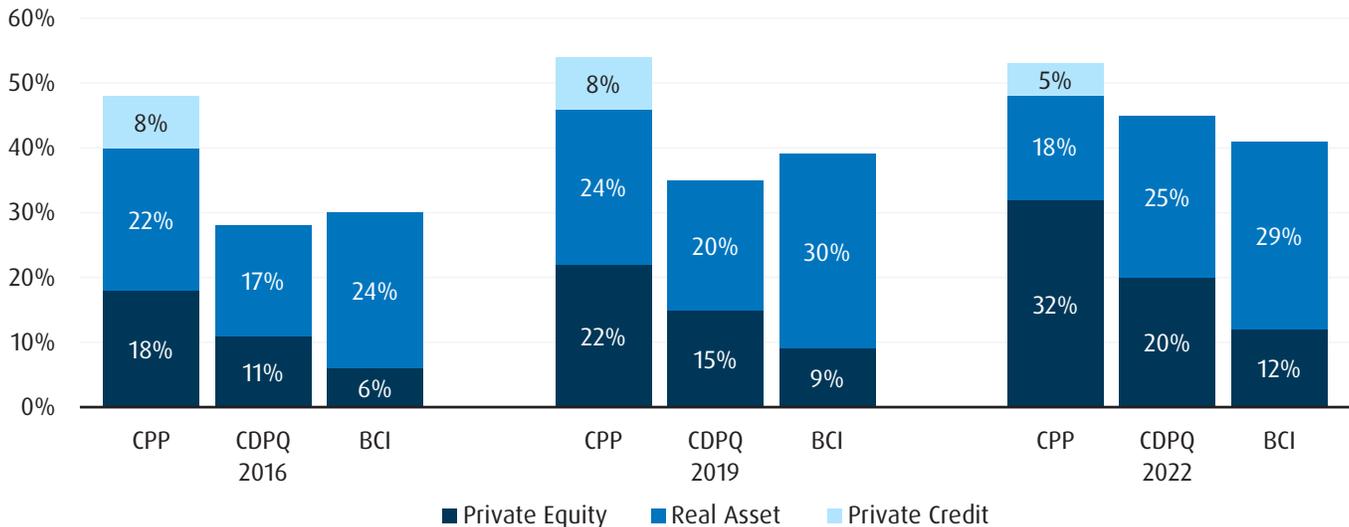
<sup>5</sup>Bain & Company, Global Private Equity Report 2023; Preqin, GlobalData.

<sup>6</sup>Yale University, Financial Report 2021-2022 (based on % of total investment at NAV for leveraged buyouts, marketable alternatives, real assets, venture capital).

# Canadian pensions have significant allocations to alternatives

In Canada, the largest public pension plans have steadily increased their allocation to alternatives over the past decade, with a specific emphasis on private markets.

CPP/CDPQ/BCI - Private Assets % of Total AUM<sup>1,2,3</sup>



## CPP Investments<sup>4</sup>

“Our investments in **Private Equity** continued to drive growth in the Fund with additional contributions from our investments in **Real Assets** and **Credit Investments**, despite volatility in public markets which impacted our equity investments.”

— John Graham, President and CEO<sup>5</sup>

## CDPQ<sup>4</sup>

“Equities class also posted a negative return, but resisted better given the preponderance of quality stocks in the Equity Markets portfolio and the good operational performance of companies **held in Private Equity. Activities in Real Estate and Infrastructure performed very well against rising inflation.**”

—News Release, February 23, 2023<sup>6</sup>

## BCI<sup>4</sup>

“All parts of our business contributed to the strong results, however the **performance of our private market assets is notable.** We had a **banner year in private equity** delivering a total return of 29.7 per cent — well ahead of the benchmark. This success demonstrates the team’s deep industry expertise and ability to identify sources of potential value and work alongside management teams to bring it to fruition.”

— Gordon J. Fyfe, CEO/CIO<sup>7</sup>

<sup>1</sup>CPP Annual Reports (2019, 2022) (CPP 2022 private credit percentage is from the total in figure 10.3.2: Terms to Maturity).

<sup>2</sup>CDPQ Annual Reports (2016, 2019, 2022). While CDPQ does not divide private credit from public credit, it has noted private credit was a key driver of positive fixed income performance in 2016 and 2022 (cdpq.com).

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<sup>4</sup>CPP Investments, CDPQ and BCI are the registered trademarks of Canada Pension Plan Investment Board, Caisse de dépôt et placement du Québec, and British Columbia Investment Management Corporation, respectively. All logos and trademarks of other companies are the property of those respective companies.

<sup>5</sup>CPP Annual Report (F2022).

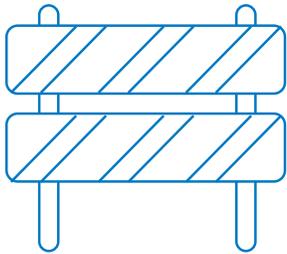
<sup>6</sup>CDPQ F2022 Financial Results press release, 23 Feb 2023.

<sup>7</sup>BCI Annual Report (2021-22)

# Breaking down the barriers to alternatives

Historically, there have been barriers for Canadian investors in accessing alternative products. As a result, many investors have not been able to obtain the benefits of these types of investments.

## Traditional barriers to alternatives



### Due diligence on managers

Wide dispersion in outcomes between top and bottom quartile managers.

### Fund structure

Funds generally designed as closed end with capital calls, limiting liquidity available to investors.

### High minimums

Accessing proven managers in their top strategies could require a large minimum investment, typically >\$2MM.

## Our approach

BMO Global Asset Management uses two approaches to provide access to alternatives for Canadian accredited investors.



### Create proprietary products

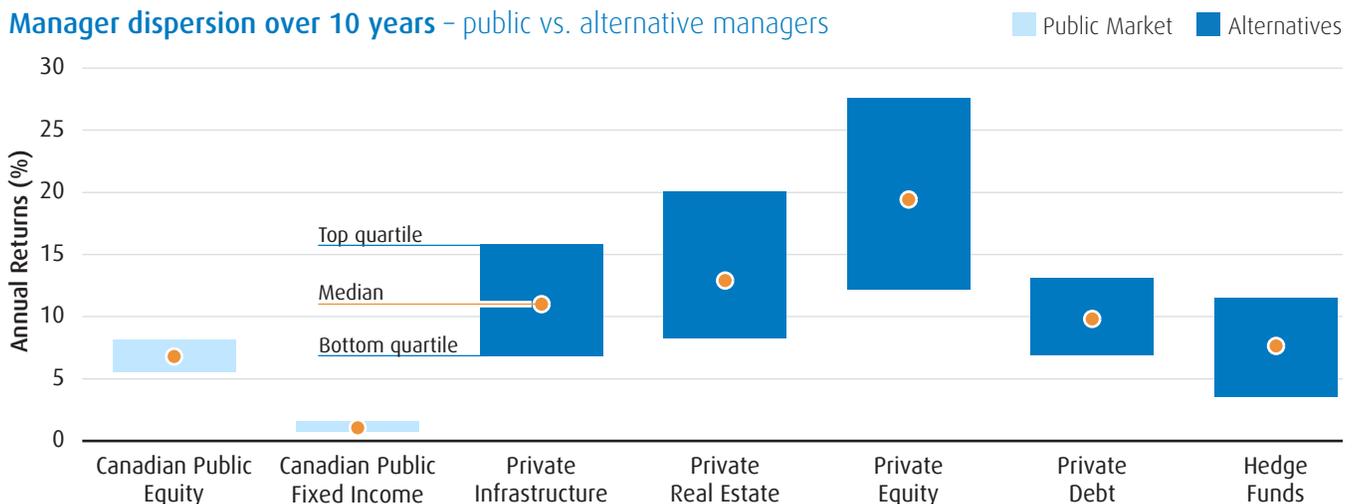
Where we have expertise and a demonstrated track record, we develop in-house solutions.



### Find the best managers

Where we don't have proprietary products, we take a research-first approach to identify strong global managers, and partner with them to fit the needs of Canadian accredited investors. Manager selection is critical when investing in alternatives, as evidenced by the dispersion of returns cited in the chart below.

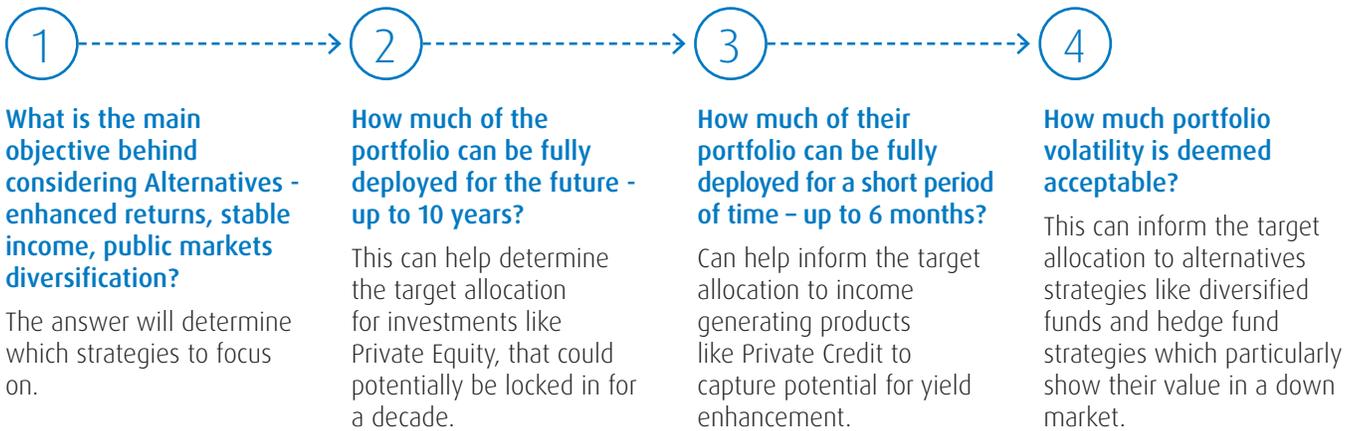
## Manager dispersion over 10 years – public vs. alternative managers



Sources: Public markets: Morningstar data; results are based on 10-year total returns as of April 30, 2023. Alternatives: Preqin data; based on IRRs from global managers from 2011-2020. Based on chart from JP Morgan.

# Implementing an allocation to alternatives

The appropriate alternatives allocation will vary based on a number of factors. Key questions to consider when determining an allocation to alternatives include:

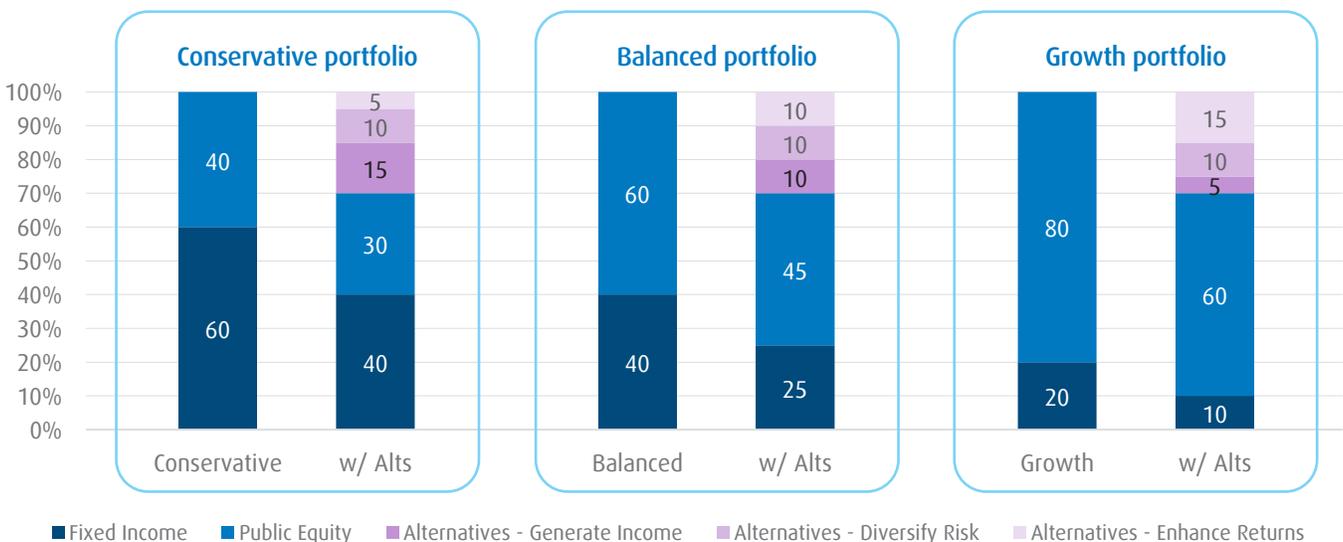


The answers to these questions can help define a target allocation. A simple approach to achieving that allocation would have purchases, over time, funded by assets that play a similar role in an investor's portfolio (e.g., selling return enhancers like public equity could fund a private equity allocation).

## How to structure your asset allocation

The investor's investment objectives and risk appetite should be the basis of any decisions for adding alternative assets into their portfolio.

Here are illustrative examples of how to add<sup>1</sup> a 30% alternatives allocation to a conservative, balanced or growth portfolio.

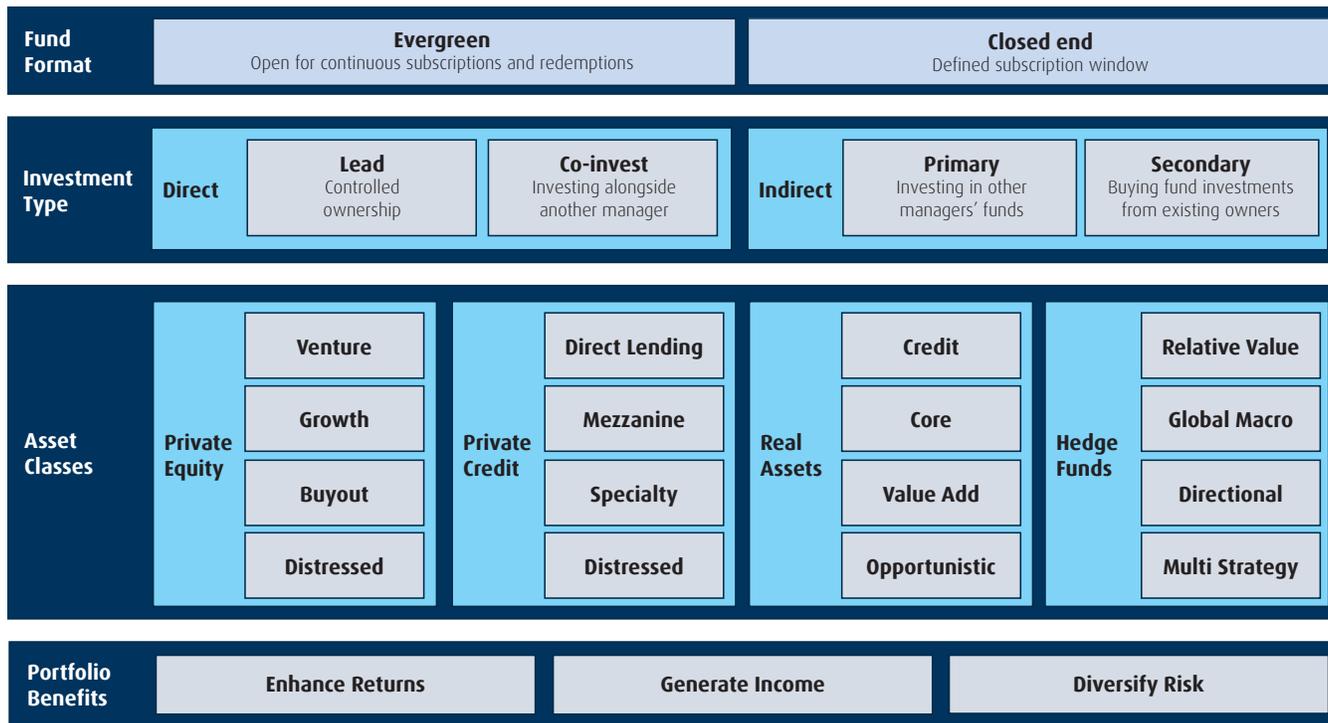


<sup>1</sup>Assume "Alternatives - Enhance Returns" is fully funded by "Public Equity", "Alternatives - Generate Income" is fully funded by "Fixed Income" and "Alternatives - Diversify Risk" is funded in equal parts by "Fixed Income" and "Public Equity."

# Navigating the world of alternatives

## The broad universe of alternatives

Within the alternative investment space, there are two main fund formats (evergreen and closed-end) and a diverse range of investment types.



## Select funds recently launched by BMO GAM

These alternative vehicles are designed to target specific investment outcomes

Fund name	Fund format	Investment type	Asset classes	Portfolio benefits
BMO Partners Group Private Markets Fund <sup>1</sup>	Evergreen	Blend of Lead, Co-Invest, Primary and Secondary	Blend of Private Equity, Private Credit and Real Assets	Diversify Risk
BMO Georgian Alignment II Access Fund LP <sup>1</sup>	Closed End	Lead	Private Equity (Growth)	Enhance Returns
First Canadian Commercial Real Estate Fund I/II <sup>1</sup>	Closed End	Lead	Private Credit (Specialty)	Generate Income

<sup>1</sup>See the Fund's specific offering memorandum for further details.

# A deeper dive into private markets and hedge funds

Private equity involves buying or selling shares of private companies.

Private equity	
<b>Venture</b>	Investing in early-stage companies that have high potential but also high risk.
<b>Growth</b>	Investing in companies that need more capital to expand their business.
<b>Buyouts</b>	Buying companies to improve their performance and sell them for a profit.
<b>Distressed</b>	Buying shares of struggling companies at a discount and helping them recover.

Private credit involves directly lending to companies where the debt is not issued or traded on the public markets.

Private credit	
<b>Direct lending</b>	Providing loans to companies that need funding for various purposes.
<b>Mezzanine</b>	Providing higher risk loans (e.g., subordinated to senior lenders) to companies that in ways that may include the option for equity.
<b>Specialty</b>	Niche credit strategies, including risk transfer from credit holders and structured credit.
<b>Distressed</b>	Purchasing debt of under-performing companies to improve performance or gain an equity position in the event of default.

Real assets involve investing in physical assets (e.g., real estate, infrastructure) that can generate income, appreciate in value, or both.

Real assets	
<b>Credit</b>	Investing in debt that finances the purchase or capital improvement of real asset investments.
<b>Core</b>	Investing in well-maintained properties with high occupancy levels that provide steady income from rents.
<b>Value add</b>	Purchasing assets with existing cash flows, but where there is room for additional improvement.
<b>Opportunistic</b>	Investing in significant development or renovation projects that aim to increase their value.

Hedge funds are investment partnerships that use complex trading strategies to earn active risk-adjusted returns on public securities.

Hedge funds	
<b>Relative value</b>	Aims to realize a valuation discrepancy and pricing differentials by buying and selling different securities.
<b>Global Macro</b>	Take positions and risk across geographies and products while employing a wide range of trading styles, based on top-down views of the world.
<b>Directional</b>	Investing on the moves of the market (short or long) as they expect a trend to continue or reverse.
<b>Multi strategy</b>	Combines different hedge fund strategies into one portfolio.

# Key members of the Alternatives team

The team brings together significant industry and investing experience to help Canadians with solutions to meet their diverse investment needs.



**Adam Abitbol**  
Vice President,  
Alternatives,  
Specialized Solutions



**Natalie Camara**  
Director, Alternatives,  
Specialized Solutions



**Lillian Ferndriger**  
Director,  
Alternatives Distribution



**Guillaume Lagourgue**  
Managing Director,  
Alternatives,  
Specialized Solutions



**Jeffrey Shell**  
Head, Alternatives,  
Commercial ESG & Innovation



**Alex Singh**  
Lead, Alternatives  
Partnerships



**Mark Jarosz**  
Lead,  
Private Credit



Connect with us to learn more about alternatives.

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\*Risk tolerance measures the degree of uncertainty that an investor can handle regarding fluctuations in the value of their portfolio. The amount of risk associated with any particular investment depends largely on your own personal circumstances including your time horizon, liquidity needs, portfolio size, income, investment knowledge and attitude toward price fluctuations. Investors should consult their financial advisor before making a decision as to whether this Fund is a suitable investment for them.

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