NAPLES GLOBAL ADVISORS

# MARKET INSIGHTS

**THIRD QUARTER 2021**

> ***Complexity is your enemy. Any fool can make something complicated. It is hard to keep things simple.***
> \- Richard Branson, Founder of the Virgin Group of companies

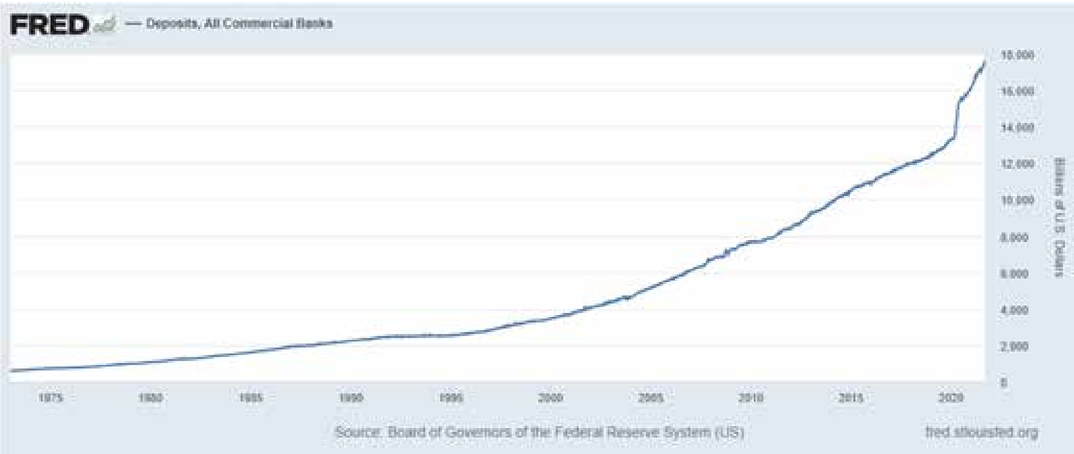
Michael H. Morris

***Chief Executive Officer***

## An Alternative to Alternatives

If your bank has lowered the interest rate they pay you for deposits in savings, money market accounts and even CDs, don't take it personally. It's not you; it's them. Check your most recent statement and pay particular attention to the placement of zeroes and decimal points. They matter a lot as there is quite the difference in yield between the .05% we're experiencing, the .50% we might be expecting, or the 5.0% we recall. Suffice it to say, bank deposit rates have dropped across the board over the past several years, and they're likely to stay historically low for a while longer. U.S. Commercial Bank deposits increased from $12 trillion pre-pandemic to more than $17 trillion today. This clearly illustrates the extent of pent-up cash in the hands of consumers and companies and why your friendly banker has little incentive to pay you more for your precious deposits.

We don't typically invest client funds in bank deposit products- and publicly traded bonds are certainly different in many respects than bank deposits- but we are facing a similar rate conundrum with the cash equivalent and fixed income segments of our client portfolios. Money market funds and T-Bills are generally yielding less than .10%. The rates being paid on U.S. Government bonds remain near historical lows, and it is unusual to find a yield exceeding 2% among Investment Grade Corporate bond offerings, even for maturities beyond 10 years. Looking outside the U.S., there continues to be greater than $13 trillion in negative yielding worldwide debt, validating that at least some investors have not only accepted low interest returns, but are even tolerating a reduced return of principal.




These are times when the benefit of sticking with an asset class like cash reserves or fixed income may not be readily apparent, but that doesn't change the purpose or importance of the asset class. Yield is only one component of an asset, and rate of return should generally not be pursued to the absolute exclusion of other important features like access, liquidity and principal stability. We are troubled by the investment managers whose answer to persistently low fixed income yields is to heartily suggest allocations to "non-conventional investments." Some even suggest much of the allocation that has historically been dedicated to fixed income must now and in the future be directed to "Alternative Investments" to have any chance of reaching historically average returns. To be clear, we're all for maximizing returns by being open minded to various options, but we're cautious when the effort to maximize returns results in the inadvertent consequence of a change in the risk profile.

**Summary Listing of Recognized/Common Alternative Investments**

| Alternative Investments: | 2020 Data | One-year change | Five-year change |
|---|---|---|---|
| Real estate equity | $379,743 | -13.7% | -1.4% |
| Venture Capital | $3,555 | -10.0% | 2.0% |
| Buyout funds | $29,366 | -1.4% | 67.2% |
| Infrastructure | $39,898 | 0.3% | 120.8% |
| Private securities | $119,883 | -2.7% | 2.1% |
| Private equity | $34,166 | -1.7% | -15.1% |
| Privately placed debt | $85,717 | -3.1% | 11.1% |
| Timber | $6,402 | -55.3% | -58.2% |
| Energy | $2,426 | 34.0% | -42.9% |
| MLPs | $913 | 5.5% | -86.6% |
| Direct lending | $975 | -47.3% | N/A |
| Distressed debt | $13,726 | 42.6% | -1.7% |
| Mezzanine debt | $4,954 | 21.2% | 39.9% |
| Commodities | $23,204 | -7.8% | 1.7% |
| Hedge funds | $77,454 | 45.4% | -16.5% |

*data from Pension & Investments Magazine, 4.2021

Alternative Investments is a generically labeled asset class that encompasses a wide variety of public and private market strategies. The underlying holdings are often recognizable public market securities, which you may already own, but they are typically embedded within complex products or funds that usually are accompanied by higher fees, lower liquidity, and at times, subjective mark-to-market pricing. Hedge funds, private equity, and real estate are recognizable examples of non-conventional investments that generally are considered Alternative Investments. According to *Pensions & Investments*, global alternative assets under management currently exceed $10 trillion, and those balances are growing exponentially. No wonder. A representative sampling of the asset allocation targets of the largest wealth managers in the world shows "non-traditional" investments comprising a prominent 20-30% position. As referenced earlier, the new Alternative Investments allocation comes mostly at the expense of former allocations to fixed income. Yet, at NGA we have chosen another path. Our lack of direct exposure reflects unfavorable past experiences, higher embedded costs, inherent conflicts of interest, and lock-up requirements that are inconsistent with the time horizon found to be acceptable to most of our clients.

For the more than 10 years since our inception, we have focused our investment selection process on the pillars of transparency, liquidity, and anti-complexity along with the old-fashioned notion that costs matter. These principles have resonated with our clients and at least some portion of our growth to more than $1 billion in assets under our care is certainly attributable to clients embracing these maxims. It's not that we don't recognize the allure of specialty segments like private equity, private debt, direct real estate, commodities, and infrastructure assets. We would just prefer to participate through publicly traded assets. We've done so for some time with direct investments in the major asset management firms who make a substantial amount of their living in this space. Instead of investing in the fund or product, we would rather buy shares in the company that sells and makes profits from the funds and products being sold. That said, if you look a little deeper inside our typical portfolio, you'll see "Alternative Investment" *representation*, just not through the typical costly and opaque wrapper. Like the old Prego spaghetti sauce tag line…"It's in there!"

Several of the large cap companies in which we invest are using retained earnings to fund their own venture capital and private equity investments from within the packaging of the larger organization. Commodity exposure into Lithium and precious metals is easily gained through direct ownership of publicly traded miners. Participation in real estate is realized through certain publicly traded REITs active in development and real estate management. Ownership of shares of companies operating ports, airports, pipelines, and toll roads constitutes commitments to infrastructure. Our direct investments in micro-cap companies represent about as near to private equity-type opportunity as you can get within the public markets. In the end, we would argue we don't invest in the "black box". Instead, we invest in the light of day and own directly and less expensively the actual individual companies from inside the box.

While there has been no associated political drama or trillion-dollar price tag, we've been busily beefing up our own "human infrastructure" to match growth of clients with growth in advisors and to insure we remain competently capable of serving you for years to come. Joining the portfolio management team earlier in 2021 was Kent Cheesborough. Kent served as our very first intern when he was still in college at Miami (Ohio) University, and after several years of seasoning, most recently with a firm in Chapel Hill, North Carolina, Kent has "come home". We hope to introduce you to our newest teammate sometime soon and look forward to all of us benefitting from the fresh perspectives.

We are grateful for the confidence that our clients continue to express in our firm and our principles. As proud as we are of our origins and past, we are steadfast and committed to our future and to you.

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