Vidrio Views

Rising Inflation Expectations Serve as a Boon for Alternatives Allocations

Inflation expectations in the second half of 2021 have been moving higher, though whether this shift is temporary and range-bound is likely to become evident in the coming months as the Federal Reserve maintains its dovish accommodative monetary stance and market participants remain cautious that further upside is likely to be limited in US Treasury yields.

This shifting market environment has proven to be a boon for alternatives allocations according to the results of our inaugural Vidrio Views Survey of global allocators and LPs representing more than $100 billion in alternatives assets under management released this week.

Many large institutional investors have made shifts to their portfolios on the margin to counteract potential near-term inflationary issues with alternatives benefiting, though many allocators were sanguine that even after a 40-year bull run in Treasuries any rise in inflation would not have a significant impact on overall portfolio returns.

What we found in our analysis in late June was that investors are concerned in general about some pockets of inflation, though whether they are going to make any significant shifts in portfolio allocations has yet to be seen. However, what we did see in the survey results was this half year spike in inflationary forces further drive an uptick in allocations to alternatives that have historically outperformed in inflationary periods.

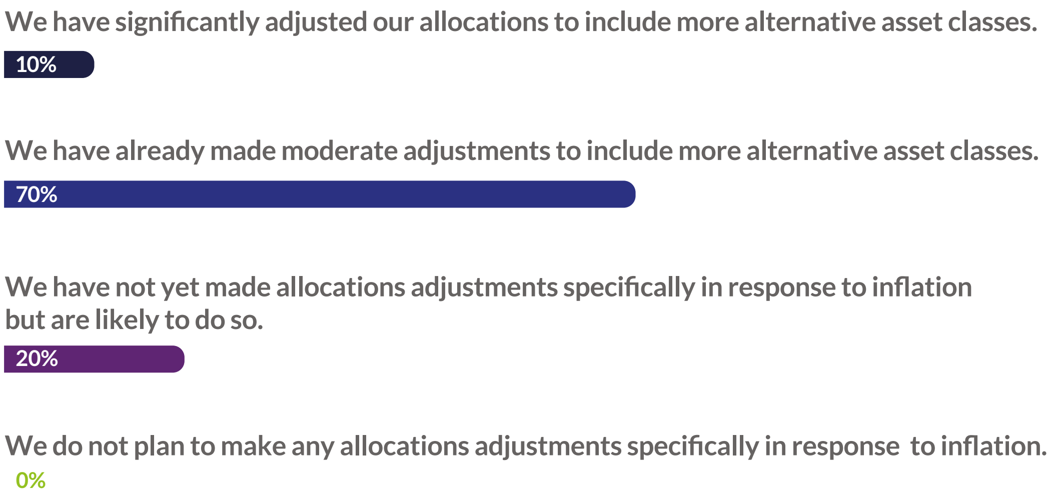
Gygmy Gonnot
Managing Director, Head of Vidrio Research.
July 13, 2021

About Vidrio Views

Vidrio Views is a series of monthly market surveys and corresponding reports that analyze the sentiment of leading institutional allocators and LPs in relation to the industry’s most pressing topics of the day.

Alternatives Benefit from Asset Mix Adjustments

In times of inflation, alternative asset classes have historically outperformed equity and fixed income. As we have seen a rise in near term inflation expectations what impact if any is this having on your asset allocation process?

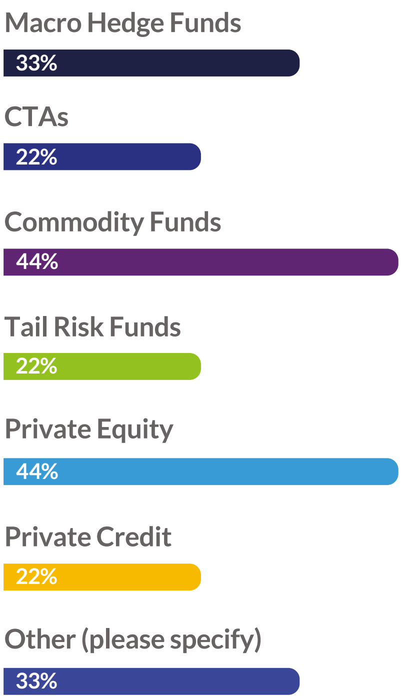


Source: Vidrio Financial

On the specific question of alternative asset classes historically outperforming equity and fixed income in times of inflation and what impact if any this has on asset allocation processes, 10% of investors surveyed stated they had significantly adjusted allocations to include more alts as a tool to protect portfolios, while 70% had made moderate adjustments to include more alts, and 20% had not yet made allocations adjustments, but plan to do so.

Interest in Private Equity Continues to Gain Attention

Against this backdrop of increased inflation, which type of funds do think are likely to see the largest increase in allocations this year?



Source: Vidrio Financial

On the specific question of alternative strategies likely to see the largest increase in allocations this year in response to inflation, commodity and macro hedge funds were popular choices with 44% and 33%, respectively of the multiple investment choices presented to investors in the survey.

Private equity, which is also seen as a diversifier from the equity markets and interest rates, also saw increased interest with 44% of surveyed investors expecting further growth for the asset class, even against a backdrop of rising inflation expectations.

This overall move to private equity was also supported by Vidrio's recent Investor Compendium findings it commissioned from AW Research that ranked the 10 most active allocators by assets to alternatives in 2020. The survey, which was published in June 2021 representing $1.4 trillion in institutional assets under management with $432 billion in alternative investments, found that private equity was the largest portfolio shift garnering $46 billion of a combined $103 billion allocated to alternatives. This far outstripped real estate which was second and gathered $28 billion.

Moreover, in our June survey we found that 22% of institutional investors thought tail risk funds would also benefit from these inflationary concerns. With a wide range of views on differing levels of apprehension regarding the intensity of inflation in the marketplace this percentage was not unexpected, and we anticipated we would see some sort of appetite for strategies that can potentially hedge in periods of spiking or hyperinflationary environments. The survey also saw increased interest in the areas of CTAs.

Similarly, private credit was also favored by 22% of investors and is becoming an increasing portion of allocators' portfolios generally, given that public market interest rates have remained artificially low. Returns in private credit have also been stable throughout the pandemic with annualized gains above 7% in both 2019 and 2020.

In addition, 33% opted for "other" as respondents additionally thought venture capital and private infrastructure equity strategies, which have gained traction with pension funds that are increasingly interested in infrastructure due to the predictability of cashflows and non-cyclical characteristics of the assets, would gain attention especially against the current inflationary backdrop.

Lastly, while real estate has seen pockets of weakness through 2020, the Vidrio survey found that in the "other" category investors were also eyeing real estate funds due to these strategies' historical inflationary protection characteristics.

Is your organization concerned in general about the potential impact of rising inflation on quantitative strategies and allocations?

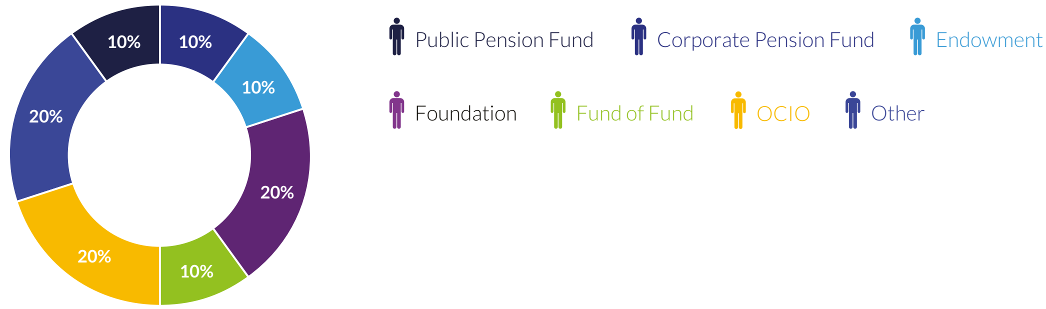
Source: Vidrio Financial

Taking a deeper dive on wider portfolio impact and whether investors were concerned about the potential influence of rising inflation on quantitative strategies and allocations generally, 50% of respondents expressed concern, while the other half of the global respondents fell in the camp of being somewhat concerned.

A bigger takeaway we saw through this data was that inflationary pressures have buoyed the trend of institutional allocators moving towards private investments over public markets. Inflationary forces at work seem to be supporting that course of action as investors look for pockets of investment opportunities that are uncorrelated from public markets and short-term rate movements--a trend we have been seeing for several years now among the large institutional investors Vidrio works with globally.

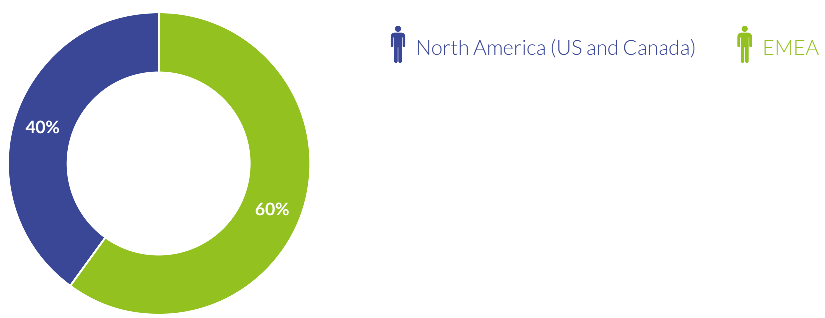
About the Respondents

Which of the following best describes your organization?



What is your current role?

What is your geographic location?



Among the survey respondents, most were primarily based in North America (U.S. and Canada), while 40% of the respondents were located in EMEA. Institutional investors surveyed globally included corporate pension funds, endowments/foundations, fund of funds, outsource chief investment officers, sovereign wealth funds and investment consultants.

In addition, approximately 40% of the respondents were also in portfolio management roles, with 20% holding research functions and 40% in executive positions.

About Vidrio Financial

Vidrio Financial is the first Technology Enabled Service for allocators — providing software and data services to institutional investors globally. Vidrio's data aggregation, analytics and applications help solve complex fund management problems, improve operational efficiency and reduce risk for multi-asset-class portfolio investors. Our clients are the world's premier allocators to external managers.

Contact info@vidrio.com to learn more.