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Young, wealthy investors are flocking to alternative investments, study shows. What to know before adding to your portfolio

By Kate Dore, CFP

Source: Getty Images

Younger, wealthy investors are looking beyond the stock market for higher returns.

Some 75% of high-net-worth investors between the ages of 21 and 42, compared to 32% of investors over 43-years-old, don't expect "above-average returns" solely from traditional stocks and bonds, according to a Bank of America Private Bank study released Tuesday. The firm polled 1,052 high-net-worth investors with at least $3 million in investable assets - May to June, 2022.

What's more, 80% of those young investors are turning to so-called alternative investments, which fall outside of traditional asset classes, the study found. Younger investors are allocating three times more to alternative assets and half as much to stocks than other generations.

More advisors are using alternative investments

Alternative investments typically fall into four categories: hedge funds, private equity, "real assets" such as real estate or commodities and pre-packaged investments known as "structured products."

Amid double-digit losses in the stock and bond markets this year, there's been an uptick in advisors turning to alternative investments, as planners seek further diversification, according to a recent survey from Cerulli Associates.

The top reasons for alternative allocations were to "reduce exposure to public markets," "volatility dampening" and "downside risk protection," the Cerulli survey respondents said.

Scott Bishop, a certified financial planner and executive director of wealth solutions at Houston-based Avidian Wealth Solutions, said some clients use a portion of their portfolios to educate their adult children about investing. And these younger investors are increasingly eyeing alternative assets.

"I think everybody's very worried about the stock market, and if they're in their 40s, they've probably been burned a couple of times," he said.

'Know what you own and why you own it'

With more interest in alternative investments, experts say it's important to understand the risks — as well as the products themselves — before shifting portfolio allocations.

"First and foremost, know what you own and why you own it," said Ashton Lawrence, a CFP and partner at Goldfinch Wealth Management in Greenville, South Carolina.

There's a growing range of products falling under the umbrella of alternative investments, and it's critical to understand how an asset could perform through different market conditions, he said.

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"It's not really fair to compare a sports car to a minivan and question why the minivan isn't keeping up," Lawrence said. Of course, alternative investments may be the minivan or the sports car in that analogy, depending on the economic climate.

For client allocations, Lawrence uses stock alternatives to boost returns while reducing risk, and on the bond side, alternatives may provide a “stabilizer” for the portfolio.

“I don’t have to outperform on the upside,” he said. “But when that market pulls back, I don’t want to incur the full breadth of that pullback.”

For high-net-worth investors, alternative allocations may vary by portfolio size, goals and risk tolerance. However, a larger allocation may be riskier for do-it-yourself investors without professional guidance.