Commerce Trust Company
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2019 Outlook: Conversations with Commerce Trust
Alternative Investments Transcript

Chris Schildz: Welcome to Conversations with Commerce Trust. A podcast where various specialists discuss the latest research, insights and market news.

This is Chris Schildz with the Commerce Trust Company and joining us today, is Cindy Rapponotti in our investment management group. She's a Senior Portfolio Manager and holds the chartered alternative investment analyst designation along with a CFA and is here to talk a little bit about the outlook for 2019 with regards to alternative investments. Cindy, welcome. How are you today?

Cindy Rapponotti: Very well. Thank you. Chris.

Chris Schildz: What is Commerce Trust Company's perspective on having alternative investments reflected as some component in an investor's portfolio? Let's start there.

Cindy Rapponotti: We include alternative investments in many client portfolios to either reduce volatility or provide diversification. These investments have expected returns and risks that may be higher or lower than those of stocks and bonds in traditional markets, and they often do not move in sync with those markets. This may provide some protection from a sharp decline in stocks or a significant rise in interest rates. Hedge funds are an area where we have a current allocation. We prefer conservative hedge funds as we expect higher market volatility to continue in 2019 and investors may seek preservation of the wealth that they've built up over the last 10 years. These strategies are important for all clients regardless of their asset size. Liquid alternatives are available with daily liquidity, lower no minimums and competitive pricing.

Chris Schildz: If the Fed continues to hike interest rates, even if it's more cautiously in 2019, how will real estate investment trust and master limited partnership perform?

Cindy Rapponotti: While the conditions that drive their prices may differ, a real estate investment trusts also known as REITs and MLPs are really a subset of the stock market, and these asset classes are sensitive to changes in interest rates.

These industries use a lot of leverage, so as interest rates rise, their financing costs increase and that puts pressure on their operating margins. REITs and MLPs are sought by income-oriented, yield seeking investors, and when interest rates rise significantly, these investments become less attractive because investors can buy lower risk investments such as US treasuries or tax-free municipals at higher rates. We saw this recently as the two year US treasury rose to nearly a three percent yield and that made REITs and MLPs somewhat less competitive on a risk adjusted basis. With our expectation that the economic expansion continues for another couple of years and we have another one to two rate hikes in the next year, the risk is that REITs and MLPs, may underperform a traditional stock and bond balanced portfolio. Furthermore, REITs and MLPs have experienced recent structural changes that have led us to view them more as equities and less as alternatives. For example, REITs are now a formal industry classification in market indices and many MLPs have converted from the MLP structure to corporate structure as a result of the 2017 tax law change.

Chris Schildz: Cindy, if a client wanted to learn more about the alternative investments, what, what should they do?

Cindy Rapponotti: Talk to their portfolio manager. Here at Commerce, we have a large effort on the alternative investment front. We review all different strategies that we use or others that we might consider. We have pretty significant effort there. So your portfolio manager would be aware of what we use here at Commerce or maybe what we should be using and would start the discussion there.

Chris Schildz: Thank you very much.

Chris Schildz: Thank you for listening to this episode of Conversations with Commerce Trust. For more research, insights and market news, visit www.commercetrustcompany.com