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Years in the industry
18

Fast fact
In January, the one-of-a-kind Scotiabank Alternative Mutual Fund Index was launched to help investors track the performance of Canadian liquid alternative products

Q&A

Early days for Canadian liquid alternatives

From your perspective, how has the performance of Canadian liquid alternative products been so far?
It's still early days for the space, but we see three interesting observations at this point. First, in May, the [Scotiabank Alternative Mutual Fund Index] fell 1.2% while the TSX Composite fell 3.3%, suggesting that alternative mutual fund strategies offered protection to investors in a down period of the market.

Second, the monthly return numbers have exhibited a lower level of volatility than the broader equity markets, which can help reduce risk in a portfolio.

Third, for the year to June, the Scotiabank Alternative Mutual Fund Index generated positive performance of 3.6%. As one would expect of strategies that hedge, this lags broader markets, which have been on a strong bull run. Hence, to date, I would say alternative mutual fund strategies are performing as expected, and the index reflects that.

Are you noticing any trends in the types of products or strategies that are entering Canada's liquid-alt fund landscape?
The regulatory changes have allowed additional investment flexibility for asset managers and have broadened the investment options available to end investors. So far, just under 40 alternative mutual funds have launched, with total assets under management of about $3.5 billion. The majority of these funds are equity-focused, with some multi-strategy and a few credit-focused funds as well.

What headwinds and tailwinds do you expect alternative mutual funds and ETFs to encounter in the coming months and years?
Alternative mutual funds offer investment managers more flexibility in deploying capital than their traditional counterparts. This allows for strategies that can enhance portfolio diversification and potentially better optimize risk and return for investors. Investors can use alternative strategies to supplement their traditional portfolio holdings and target risk-return profiles they otherwise may not have been able to achieve.

The most significant headwind is likely the educational process. Investors and their advisors need to understand the strategy employed by a specific alternative mutual fund before investing, and this will take some time.

There may be some additional headwinds, including additional proficiency requirements for MFDA-licensed financial planners to sell the products, disparate risk rating and product shelf approval processes by IIROC investment dealers, and the lack of long-term track records. And the strong bull market we are experiencing – which is certainly welcome – arguably makes it harder for the hedging strategies employed by alternative funds to demonstrate their value.