The Role of Alternative Investments for Financial Advisors: A Qualitative Analysis of Retail Investors and Independent Financial Advisory Practices

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Introduction

After 15 years of the "ZIRP" zero interest rate policy, the Federal Reserve increased interest rates at its fastest pace in over 30 years in 2022. An increase in interest rates brought about a simultaneous decline in stocks and bonds, causing casualties from regional banks like Silicon Valley Bank.

The simultaneous decline of stocks and bonds in 2022 left many investors questioning the viability of an only stock and bond portfolio. Many financial advisors have used the 60/40 portfolio model as a benchmark to grow client wealth. A 60/40 portfolio is a portfolio mix of 60% stocks and 40% bonds. The idea is that when the stock market has volatility, the 40% bond allocation will act as a hedge in volatile years. After declining stocks and bonds in 2022, many financial advisors and portfolio allocators searched for ways to differentiate their services and build a more robust portfolio allocation.

Since 2022, there has been an increased interest in using alternative investments in retail portfolios. Financial advisors are using alternative investments to enhance their practice and organizational strategy. The shift in financial advisors and investor preferences has created a heightened awareness of the use and benefits of diversification using alternative investments. More alternative investment products that are retail investor-friendly have come to market since 2022. Allowing more noninstitutional clients to invest in asset classes such as private equity, private credit, venture capital, and oil and gas. This research will examine how financial advisors adjust their organizational strategy to meet the demands of investors and bridge the gap between institutional-grade portfolio strategies and retail advisory services. This research aims to identify qualitative themes of alternative investments in growing independent wealth advisory firms. This research examines portfolio diversification, risk and return of alternative investments, and liquidity and market constraints. The research objective is to show common themes in alternative investments and how alternative investments can create a strategic competitive advantage for financial advisors.

A table was created that outlines all the common themes throughout the research, a checkmark was placed to indicate if that theme is included in a given research document, and a red circle for those not included. The table below is a straightforward graphical representation of the common themes throughout the sampled research articles. The three most common themes this qualitative analysis will explore are the use of alternative investments for

portfolio diversification, risk and return of alternative assets, and liquidity and market constraints. Financial advisors may use these themes to improve their strategic organizational approach toward portfolio management.

Common Themes	Single Family Offices	Diversifying Portfolios	CAIA Alternatives	Family Office Research	Financial Advice & Retail Investors	Sovereign Wealth Funds	Search for Yield
Alternative Investments	✅	✅	✅	✅	✅	✅	✅
Portfolio Diversification	✅	✅	✅	✅	✅	✅	✅
Risk and Return	✅	✅	✅	✅	✅	✅	✅
Private Equity & Venture Capital	✅	✅	✅	✅	⛔	⛔	✅
Hedge Funds & Active Management	✅	✅	⛔	✅	⛔	⛔	✅
Real Assets	⛔	✅	✅	⛔	⛔	✅	✅
Institutional vs. Retail Investors	✅	✅	⛔	✅	✅	✅	✅
Liquidity & Market Constraints	✅	✅	✅	✅	✅	✅	✅
Macroeconomic Impact on Investing	✅	✅	⛔	✅	⛔	✅	✅

Why Alternatives?

Alternative investments can include a wide range of investments, including any investment, that is not a traditional stock or bond. For this research, alternative investments will reference the alternative asset classes of Private Equity, Venture Capital, Private Credit, Hedge Funds, Private Real Estate, and Commodities. These asset classes have provided diversification benefits from stocks and bonds and may act as a tool to lower volatility in a portfolio. As technology has advanced, investing has become more accessible to a larger audience of investors. Retirement plans have transitioned from defined benefit plans to largely self-managed plans since the 1980's adoption of the 401(k) plan.

With future retirement left to the individual rather than the corporation, the wealth management industry has increased to provide comprehensive investment services. Until recently, retail investors have been largely left out of private markets due to a lack of information and high barriers to entry. Investors with long horizons are willing to trade liquidity for higher returns and lower volatility. A consistent theme throughout the research is the evidence that including alternative assets in a well-balanced portfolio increases diversification, which may lower the portfolio's risk and potentially increase long-term returns.

As stocks and bonds have become more correlated, alternatives are necessary to lower the overall portfolio risk. Empirical evidence provided by Ang et al. (2012) and Jagannathan et al. (2010) supports the notion that alternative assets can enhance portfolio efficiency and mitigate downside risks (Ang et al., 2012; Jagannathan et al., 2010, as cited in *View of Diversifying Portfolios: Exploring Investment Strategies and Alternative Assets in Modern Markets*, 2025).

Financial advisors seek to lower portfolio risk to provide a safer, less volatile experience for clients who may make emotional decisions during volatile market periods. The goal of an independent investment advisor is to help clients reach their financial goals without unnecessary risk and volatility in the portfolio. Diversification is a strategy that may increase client retention and satisfaction but also encourages further allocation to the financial advisor, allowing the business an increased strategic advantage over advisors not using alternative asset classes. Although it is said that diversification is the only free lunch in investing, in the case of alternatives, the added benefits of diversification do not come without its costs and tradeoffs. Investors considering adding alternative investments to their portfolios should also consider other considerations, such as fees, share restrictions, and increased complexity (Kräussl, Lehnert, & Rinne, 2025).

A Changing Marketplace

Financial advisors have recently adopted alternative investments for retail clients and family offices. Due to higher fee structures, liquidity constraints, higher investment minimums, and high barriers to entry, alternative assets were reserved for institutional investment only. Since the transition and adoption of private markets for retail investors switching from strictly institutional limited partners, financial advisors are using alternatives to strategically position their practice for portfolio needs post the 2022 interest rate hikes. With the Zero Interest Rate Policy expected to be a policy of the past, financial advisors need strategies to navigate the complexity and volatility of the current market environment. Although alternative investments may add diversification and performance benefits to the portfolio, the unique complexities that we will explore in this research are nuanced and require financial advisors to be equipped with the proper tools and resources to implement private market strategies.

Liquidity and market constraints were themes in all the research examined. Retail investors tend to overvalue liquidity premiums, but liquidity cannot be understated as retail investors and institutions have different goals and mandates. To get the added benefit of increased returns and diversification, investors must be long-term focused, willing to part ways with liquidity and accept certain restrictions to their investment. These restrictions may include a lack of transparency, long redemption periods, and a lack of control over the investment fund.

Although many retail investors view the lack of liquidity as a trade-off and should be compensated for the lack of liquidity in long-term returns, the lack of liquidity may also be a positive attribute for investors. Encouraging retail investors to be long-term focused and prevent emotional buying and selling. Many of the mistakes that plague retail investors are the frequency of transactions and emotional buying and selling. "Small retail investors pursue a momentum trading style, i.e., buying high and selling low, which demands liquidity and potentially leads to lower future returns. Institutional investors, on the other hand, follow a contrarian pattern, i.e., buying low and selling high, which provides liquidity to the market and is likely compensated positively"(Tan, Zhang, & Zhang, 2024).

When financial advisors include alternative investments in retail client's portfolios, it, in essence, "forces" clients to remain in a strategy for its long-term benefit and upside potential and removes the emotional connection to the investment, preventing unforced errors of buying and selling at the wrong market period. Institutions have used this liquidity premium and disciplinary approach to improve long-term performance. Many pension plans and endowments use alternative asset classes rather than large bond allocations to improve their portfolios' strategic long-term performance. By sacrificing liquidity, investment managers expect a longer-term return profile that aligns with the portfolio goals. Individually, alternative investments can be more risky than publicly traded assets due to the lack of information, liquidity, and complexity. In a well-balanced portfolio, these risky assets become de-risked, improving investors' long-term expected return as the assets perform in a balanced manner. Defined benefit pension funds seem to search for higher yields. Andonov et al. (2017) find that U.S. public pension funds invest more in risky assets, including alternative investments, when Treasury rates decrease (Kräussl, Lehnert, & Rinne, 2025).

Alternatives At Work

An example of this balance in the 2022 stock market decline was the simultaneous invasion of Ukraine from Russia. The invasion spurred geopolitical tensions that affected the oil and gas market. Russia is a large oil and gas producer and supplies Europe with oil and gas. Due to the geopolitical tensions, oil saw a drastic price increase. Investors who owned a well-balanced portfolio saw their stock investments decline in 2022, offset by a significant increase in commodities prices. This balance is an example of decorrelation. Financial advisors do not need to predict what will happen in the future; a well-balanced and diversified portfolio removes the need to predict event-driven investing and instead adds strategic quantitative balance to probable outcomes.

A well-thought-out investment plan by a financial advisor cannot ignore the risk of alternative investments. The relationship between risk and return is a persistent theme throughout the research. Many advisors rule out alternatives altogether under the guise of being *too risky*.

There is no denying that private markets come with a heightened level of risk at the individual investment level. Alternative assets are not subject to the exact strict SEC reporting requirements as publicly traded assets. In a situation where investors examine the choice between bonds and private credit, there is no denying that a loan to a private borrower is much riskier than a loan to the United States government.

Financial advisors should quantify what risks are acceptable, even if that means an increase in risk, and what risks are logically worth the possible reward in a well-balanced portfolio with correct position sizing. The historically low bond yields have brought new challenges to many investors in their search for yield, and led many of them to look outside traditional asset classes (Kräussl, Lehnert, & Rinne, 2025). Since 2008, investors in a 60/40 portfolio received historically low returns in bonds that marginally beat inflation rates. This allocation was a low-risk option. After these low-risk investments saw a drastic decline in value with the increase in interest rates in 2022, financial advisors were left searching for better options to meet their client's income and portfolio goals. The fallacy of a de-risked 60/40 portfolio concludes that an increase in individual investment risk if deemed worth the return and trade-off in a well-balanced portfolio, is acceptable. Institutional investors have long been ahead of retail investors and financial advisors in understanding this asset-class risk trade-off. Institutional investors' ability to adjust risk exposures based on market conditions has been well documented in financial literature, demonstrating their ability to outperform retail investors in volatile environments (Kräussl, Lehnert, & Rinne, 2025).

Therefore, financial advisors seeking to gain a strategic organizational advantage for their practice must not view risk at the individual investment level only, but consider the individual investment's portfolio level de-risking. The decline in interest rates has forced institutional investors such as pension funds, endowments, and insurance companies to take on more risk to maintain their return objectives. Financial advisors and retail investors should be willing to take on more risky alternative investment allocations and balance this risk through diversification to increase the potential long-term success of the portfolio. The most significant risk to investors is not an individual alternative investment but rather the risk of running out of income before death due to underperformance.

The Modern Advisor

Based on the qualitative thematic research analysis, the significance of these themes to a financial advisor's organizational strategy allows for three important business operational improvements. First, the advisor may enhance client retention levels. Alternative investments create sticky assets for financial advisors because of the lack of liquidity and complexity. Many alternative asset managers are business-to-business only, creating the need for advisors for the client to access the investments, unlike in publicly traded assets. Second, alternative assets offer a competitive differentiation. Investment advisors can compete with traditional wirehouses by offering sophisticated solutions unavailable at the wirehouses. Many wirehouses choose not to use alternative assets because of custodial bottlenecks and the lack of an ability to charge assets under management fees. Alternative investments give the individual investment advisor a distinct competitive advantage. Third, alternative investments offer strategic portfolio design. Using alternatives to build an institutional-grade portfolio for high-net-worth clients allows for greater flexibility and creativity.

Based on the research conducted, there are strengths and limitations to the qualitative thematic methodology. This method systematically identifies common investment trends and uses multi-source validation. The research is limited because qualitative research lacks empirical testing of alternative investment performance for retail investors. The key finding from this thematic analysis is that alternative investments are becoming necessary in modern portfolio construction. Institutional strategies are trickling down to independent wealth advisors, and advisors who lack the tools for implementation are at a strong strategic disadvantage. Advisors must also be strategic about liquidity management when implementing alternatives and manage position sizing accordingly.

Implications for investment advisors is the increased need for education and training in alternative investment products. Advisors need the proper resources and tools to understand implementation and regulatory considerations when offering alternatives to retail clients. Alternative investments are also limited to accredited investors and qualified purchasers, which sometimes may not fit an investment advisor's current clientele. As shown in the following research, the themes of portfolio diversification, risk, and liquidity are persistent in alternative asset classes. In order to create an organizational strategy for the individual, RIA advisors should have a strong understanding of those three themes. As alternative investments grow, portfolio managers must continue to adopt a renewed acceptance of the modern portfolio.

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