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Editor's Letter

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This issue of the JAI covers three different topics: (a) private debt, (b) commodities and impact investing, and (c) volatility and option pricing. The first article, “BDCs: *The Most Important Commercial Lenders You’ve Never Heard About*,” authored by Andrea Beltratti and Jonathan Bock, deals with an interesting type of organization whose stocks are publicly traded in the U.S. and have the potential to provide investors with a liquid alternative to private equity. They are called business development companies (BDCs), which are closed-end mutual funds engaged in providing direct loans to small- and medium-sized enterprises. Shares of most BDCs are publicly traded and, therefore, provide investors with the possibility to invest, in a liquid way, into relatively illiquid assets. Andrea Beltratti and Jonathan Bock provide an excellent introduction by reviewing their main characteristics as financial intermediaries and then comparing their returns with those offered by other asset classes.

In “The Components of Private Debt Performance,” Margherita Giuzio, Andreas Gintchel, and Sandra Paterlini examine a segment of the credit market that has exploded in terms of popularity among institutional investors in the last few years. Due to the private nature of these markets, historical data are not available at a micro level to answer investors’ questions about risk-return characteristics of this asset class. The authors analyze private debt interest rates and the features that are relevant to asset allocation decisions using a mix of non-public data; snap-shot data; and publicly available, highly aggregated historical data on bank loans. They are able to disentangle the main components of private debt rates over time and assess the existence of a premium related to the illiquidity and complexity of private debt markets.

Concerns about climate change have had a meaningful impact on the asset management industry. Asset allocators have begun to apply various filters to understand the impact of climate change and regulations that are designed to address it on various asset classes. Impact investing is the next step in this process where investors move away from a playing a “negative” role in avoiding assets that negatively impact climate change to playing a more “positive” role by affecting change through their asset allocation decisions. In “‘Just Married’—Clean Energy and Impact Investing: *A New ‘Impact Class’ and Catalyst for Mutual Growth*,” Myles E. Mangram attempts to bring together two strands of research: clean energy and impact investing. The paper first provides a practical overview of the impact investing and the clean energy industries. The author goes on to discuss numerous synergies

between the two segments and the resulting opportunities for dynamic mutual growth. The paper identifies knowledge gaps and critical issues that need to be addressed before the lofty potential of this union can be fully realized.

The article entitled “Properties of Long/Short Commodity Indices in Stock and Bond Portfolios” focuses on second- and third-generation commodity indices and their roles in a portfolio of traditional asset classes. While long-only commodity products gained significant traction in the 1990s and early 2000s, investors’ recent experience with long periods of poor performance and significant drawdowns has led some commodity shops to create new generations of commodity products that move away from long-only positions. The purpose of this article is to analyze the performance effects of including long/short commodity indices in more conventional stock-bond portfolios using out-of-sample tests over different periods and by employing different asset allocation strategies. Tom Erik Sønsteng Henriksen identifies the benefits of commodity inclusion from 2002 to 2011, but finds that these benefits largely disappear from 2011 to 2015. Another important finding is that he observes a much lower risk-adjusted performance for the commodity indices after their launch date.

“Alternatives to Alternative Assets: *Assessing S&P 500 Index Option Strategies as Hedge Fund Replacements*” by Wei Ge examines whether investment strategies involving equity options can create products with risk-return properties that are similar to those of hedge funds. If such strategies are successful in creating these types of returns, then investors might be willing to consider them in order to avoid some of the negative aspects of hedge fund investing, including illiquidity and lack of transparency. This study examines whether

equity index option-based strategies may deliver return processes with good risk-adjusted returns, mitigated downside risk, and diversification benefits when added to portfolios of traditional assets. A total of seven S&P 500 Index-based generic option-writing strategies are analyzed and compared with a comprehensive set of fourteen Credit Suisse hedge fund indexes using volatility or beta as matching metrics. Three of these strategies can be viewed as liquid alternatives to hedge funds. These three option strategies are transparent, liquid, inexpensive, and easy to implement. They can achieve the same goals of hedge funds: attractive risk-adjusted returns, subdued risks, and added diversification. They may play multiple and important roles in institutional investors’ portfolios.

Finally, in “Price Change, Volatility, and Accurate VaR: *Evidence from the NSW and QLD Power Markets*,” Rangga Handika and Yusef Khudri point out that there are few research works discussing risk measurement using Value-at-Risk (VaR) in power markets. Historically, VaR has been used to measure tail risks in traditional and alternative financial assets, like stocks, bonds and hedge funds. However, because of the increased financialization of commodity markets, it seems that the power market can be treated like other financial instruments. As commodities have become increasingly important for institutional investors, the measurements of risk and return have become central to the discussion. The authors explain that market participants in the power market will likely incorporate VaR into their risk management systems, triggering a new research area.

Hossein Kazemi
Editor-in-Chief