

Preface

In recent decades, the financial system has undergone a significant transformation. The change in its architecture resulted in the emergence and rapid development of numerous financial innovations that at present are an integral part of the financial market. In addition, the location of finances at the centre of economics and their significant impact on potential economic growth increases the importance of financial innovation. Despite the extremely long history of financial market innovation, it can be observed that the 1970s and 1980s were characterized by an intensification of the development of new products and services. An extensive literature appeared, in which contemporary financial innovations were discussed. Innovation is important both on a microeconomic and macroeconomic scale.

The consequence of globalization and the liberalization of capital flows, as well as of increased competition in the international financial market, is the emergence of more and more complex forms of investment. The development of alternative investments is a response to investors seeking other forms of investment that will generate attractive returns. Therefore, alternative investments are a modern financial innovation. They appeared in the financial market relatively recently. Visible growth in interest in the category of alternative ways to invest capital was particularly apparent in the years 2000–2002. This period was characterized by a tendency of falling prices in financial markets. The monetary policy conducted by the Fed in the USA since 2000 caused a reduction in the level of interest rates to the lowest level in the last 40 years. The decrease in interest rates on short-term treasury securities in the USA to a level of 1 % in 2003, and the reduction in interest rates on government bonds below 4.2 % in 2005, induced investors to look for forms of investment that gave an opportunity to achieve higher incomes. Poor results of the standard investment funds limited investors' confidence in this form of investment.

Additionally, alternative investments are a new segment of financial products in which creation of income is assumed, regardless of current market trends. On the one hand there are indications that the primary benefits of alternative investments include the following: reducing the volatility of the portfolio, and its possible diversification through the use of low correlation or lack of correlation of rates of

return on these investments with returns of traditional asset classes. On the other hand, there are dangers of a very dynamic market development of alternative investments. Undoubtedly, these investments are characterized by a high degree of complexity. Moreover, they are concluded in markets with reduced disclosure requirements and low transparency as well. The consequence of this is the lack of a reliable assessment of the risks that these transactions could cause. The use of complex investment strategies through the usage of leveraging, which triggers a significant amount of capital, constitutes an important challenge for the security of the entire financial system.

The emergence of alternative investments is also indirectly the result of the enrichment of society and the evolution of the requirements of the wealthiest clients. This group of investors was no longer satisfied by simple opportunities to invest financial surpluses. It was thus primarily for the wealthiest and most demanding customers that alternative investments were designed. In addition, they widened the range of Wealth Management services, which includes not only the management of assets, but also selected tax consultancy services, or even management of clients' personal affairs.

The changing demand for investment products is also the result of demographic structural changes in society, as well as the changing expectations of entities involved in the process of transfer of capital. Changes in economic conditions lead to changes in the preferences of both capital givers as well as its recipients.

The purpose of this work is to present alternative investments in Wealth Management. The choice of subject has its practical justification. Alternative investments, which are often forgotten in the analysis of this investment category, are designed for specific categories of customers. Wealthy investors are willing to accept the high risks which these investments carry in the hope of gaining above-average income. In addition, they often possess adequate knowledge on these investments, becoming a partner for those managing the assets. Moreover, they take advantage of alternative investments to diversify their investment portfolio. Group-specific enrichment has an impact on the growth of demand for innovation that would offer more opportunities to invest cash to entities that are more willing to incur increased risk.

The first chapter of the book presents the origins of the financial innovations market starting with the history of ancient civilizations. This part presents a number of definitions of financial innovation from the world literature. Moreover, classifications are presented that enable the ordering and systematization of the concepts discussed. Definitions of financial innovation, indicating their characteristics, are also presented in this section, while the outcome of these works is to develop definitions of my own – these provide a coherent theoretical concept that does not limit the further development of innovative forms of investment. Additionally, this chapter also highlights the key factors that have a significant impact on the development of the financial innovation market. These include globalization, liberalization of capital flows, as well as technical and technological progress.

The second chapter is a logical continuation of the first one. Its purpose is to present the concept of alternative investments as contemporary innovations in the

securities market. This chapter shows the various, often differing, concepts of alternative investments appearing in the world literature. They formed the basis for defining the conditions that must be met in order for a specific type of investment to be included in a particular category. Moreover, this section discusses the characteristics of alternative investments that distinguish them from traditional forms of investment, which include the pursuit of absolute returns as well as active management of managers mostly investing their own funds in these investments. In addition, diverse investment strategies were characterized along with their essence in pursuit of the so-called absolute profit. At the same time, attention was paid to the possibilities offered by alternative investments in portfolio diversification and the use of methods of arbitration. It also presents the mechanism of a two-tier remuneration system for managers which is used in the management of hedge funds, which are a very important category of alternative investments.

This chapter also highlights the specificity of regulation of the alternative investment sector. Their dynamic development surprised supervisory bodies, while the crisis that took place in 2008 accelerated efforts to regulate this market segment both in the USA and in the EU. In the literature there are different approaches to the regulation of the financial innovation sector. The issue of increasing regulation of the sector is generally perceived negatively – too high a level of regulation may in fact inhibit innovation and be a factor significantly limiting development of the alternative investment sector.

The third chapter begins with an introduction to the definition and concept of risk, which can mean both an opportunity and a threat. In the financial market, the neutral definition of risk is usually applied, indicating the opportunity offered by the risks to achieve above-average income. The risk of alternative investments well exceeds the risk associated with traditional types of investments. Due to the complexity of these investments it is much more difficult to analyze the risk factors associated with this segment of the market. Moreover, this part of the work includes a discussion on specific risks which affect alternative forms of investment. Methods to assess the effectiveness of selected alternative forms of investment which are known in the subject literature are also presented. Among the methods of measurement included are: the Sharpe Ratio, the Treynor Ratio, Jensen's Alpha or Sharpe's Alpha. Moreover, the following measures are described in the work: the Sortino Ratio, or an alternative measure to the Sharpe Ratio presented by Leah Modigliani and Franco Modigliani – M^2 . Due to the nature of alternative investments in private equity/venture capital and the usually long-term nature of these investments, other measures are used to evaluate their effectiveness including the internal rate of return, IRR.

The fourth chapter presents the concept of Wealth Management services and characterizes the areas of the investment process WM. They have a significant impact on the development of an appropriate customer base and determine the success of these services among investors. In addition, the categories of entities operating in the alternative investment market are described. This chapter also presents a forecast of the growth in wealth of individual investors in the next few years as estimated by the EIU's Business Environment Rankings. Statistics show

that in 2016, fully 19.5 million households worldwide will have assets in excess of 1 million USD, and about 5.5 million households will possess assets in excess of 3 million USD (Barclays Wealth Insight). These investors will generate demand for alternative investments.

Furthermore, selected studies on risk, wealth and the attractiveness of the alternative investment sector in the world are presented. The rapid development of alternative investments in the international financial market suggests that the process of implementation of global solutions is only a matter of time. This chapter also examines the statistics that confirm the attractiveness of Central and Eastern European Countries, including Poland primarily, for the development of services for the wealthiest clients. Rating wealth in selected countries was carried out based on the evaluation of the assets of individuals and households, the Lorenz curve and the level of the rate of savings in the surveyed countries. In addition, a forecast of GDP growth, the rate of population growth and predictions related to the assessment of the condition of the financial market were taken into consideration.

The fifth chapter is empirical: it presents the results of research on the sector of alternative forms of investment in Poland. As a part of the research project a survey was conducted of a representative sample of Polish society. The standard techniques and research tools were used. The aim of the research project was to verify the level of knowledge of Polish citizens on alternative investments and to diagnose the directions of development of alternative forms of investment. Next, an association study of some personal characteristics of the respondents was conducted, with a variant of the reply to the questions contained in the questionnaire. In the study of associations (counter-associations) of specific personal characteristics with the variant of the answer to the question, Wiśniewski's quotient for the association of characteristics was used. Moreover, conducting surveys allowed potential gaps in knowledge to be identified and priorities to be determined for educational activities which would enable faster and more flexible adaptation of society to change. This chapter also provides recommendations for managing financial investments.

The work ends with a summary of the new elements. The need for further research is highlighted as well as the directions of research which are associated with the development of innovative instruments and institutions of the still developing financial market. Their improvement has significant implications for all participants of the financial market.

Sopot, Poland
Spring 2014

E. Sokołowska

Alternative Investments in Wealth Management
A Comprehensive Study of the Central and East
European Market

Sokolowska, E.

2014, X, 134 p. 5 illus., Hardcover

ISBN: 978-3-319-08074-1