

BREAKWATER CAPITAL'S GUIDE TO

# *Alternative Investments*

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Investing in Assets  
Outside the Market and  
Residential Real Estate

# The Term, Alternative Investments, Includes Financial Assets Such As:



Despite unique risks and considerations, alternative investments can be useful tools to improve the risk-return characteristics of an investment portfolio. They can increase diversification and reduce volatility, given low correlations to more traditional investments; they can offer the potential for enhanced returns due to the wider investment opportunity set; and they can hedge certain portfolio exposures, thereby reducing concentration risk.

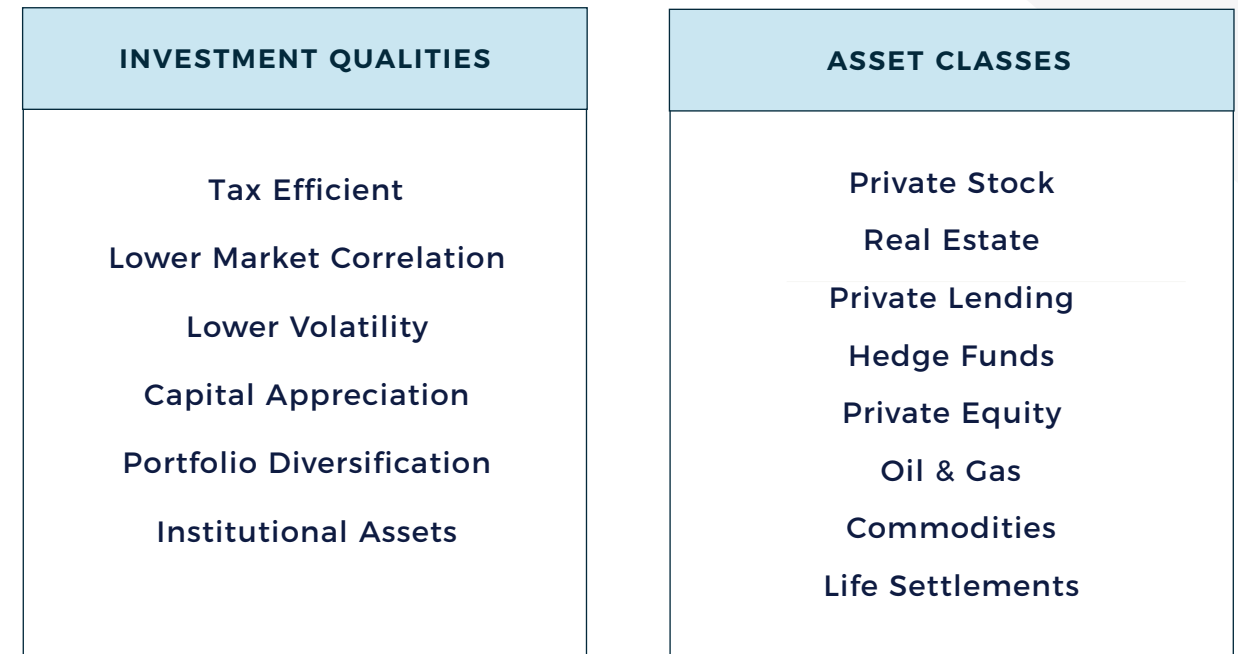
The question then becomes why are investors unwilling to include alternatives in their portfolios. Is it because they do not fully understand the benefits, risks, costs, and liquidity of the opportunities? While the answer is different for every investor, the principals of Breakwater Capital can help you determine if alternative investments are right for you.

*Given the potential benefits of alternative investments, we find it interesting that the typical individual investor has little to no exposure to alternatives. Whereas large institutions have a significant portion of their portfolios allocated to alternatives.*

*One reason for this may be that while many investors will acknowledge that they are worried about losing money due to market volatility they are still unwilling to consider alternative investments even though their portfolios might benefit from their inclusion.*

# What is an Alternative Investment?

An alternative investment is an investment in asset classes other than stocks, bonds, and cash.



# The Upside & Downside of Alternative Investments



# Common Alternative Investments

## REAL ESTATE

This includes real estate funds, property portfolios, and individual properties. Real estate funds typically focus on one or more property types such as multi-family, student housing, retail, office, healthcare, assisted living, self storage, industrial, and parking facilities. Fund strategies may include acquiring existing properties, ground-up development, and value-added whereby the goal is to increase rents/occupancy and ultimately value by repositioning the property. If your preference is to invest directly into one or more single properties or if you are looking to defer capital gains through a 1031 exchange, we can provide a number of choices for you to evaluate.

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## OIL & GAS

Investments in this area can offer the opportunity for attractive returns and significant tax benefits. Opportunities include drilling (developmental, working interest, enhanced recovery) and royalties whereby an investor receives a percentage of any revenues generated from production. Investing in oil and gas royalties can include funds that participate in royalty interests as well as directly purchasing individual royalties. The direct purchase of royalties may be eligible for a 1031 exchange.

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## PRIVATE EQUITY

An asset class focused on equity and debt securities in private companies oftentimes associated with leveraged buyouts. In reality, private equity is much more complicated and has significant risk as well as the opportunity for generating substantial returns which is why institutions and wealthy individuals have been participating in private equity funds for years. Recently, new funds have been developed allowing a wider range of investors the opportunity to participate in private equity.

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## PRIVATE LENDING

Small business lending by banks has been declining for many years. Because of this trend, there are short-term opportunities to lend to small businesses in addition to firms looking for pre-IPO funding.



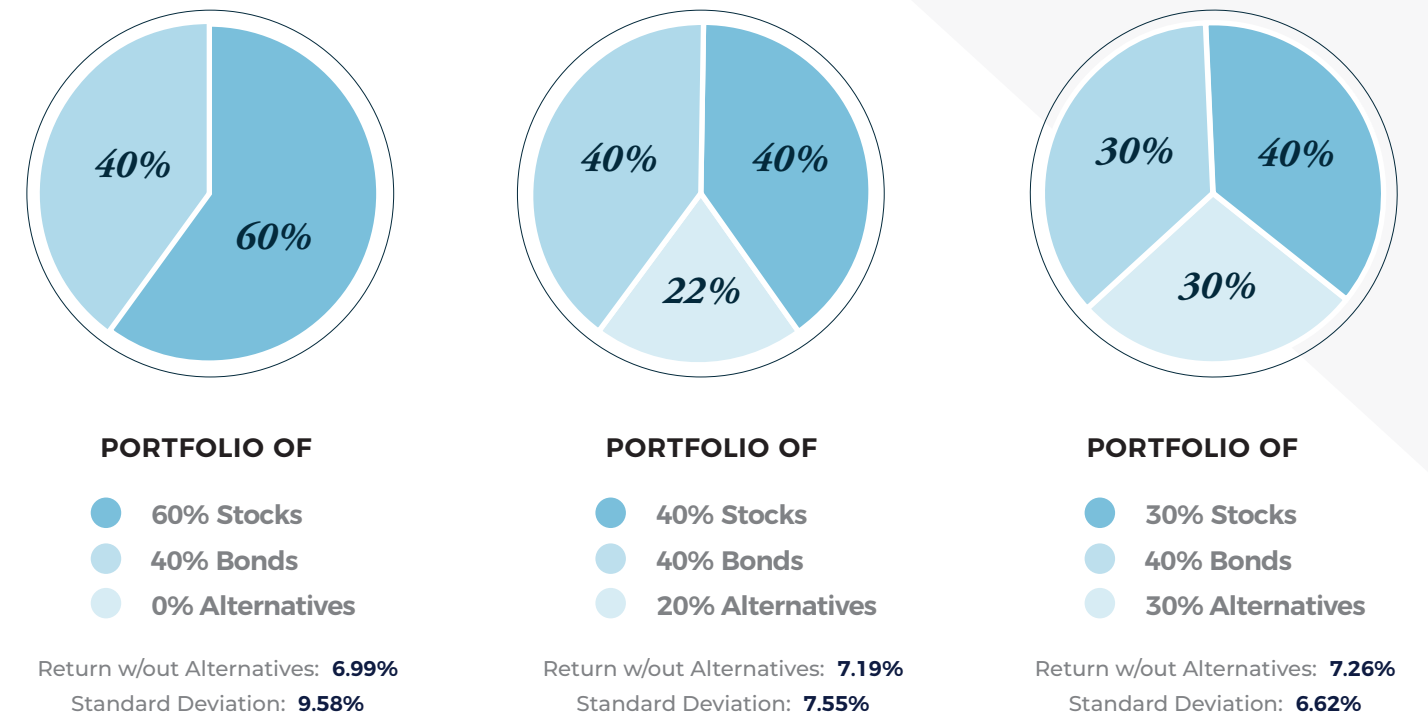
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*Alternative investments can increase diversification, offer the potential for enhanced returns, and hedge certain portfolio exposures, thereby reducing concentration risk.*

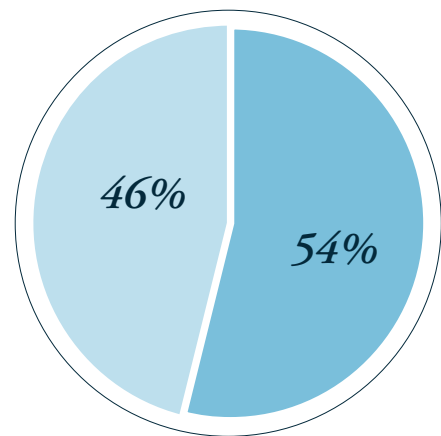
# Invest Like The Most Successful Institutions And High Net Worth Investors

FUND	% PUBLIC ASSETS	% PRIVATE ASSETS	10 YEAR	20 YEAR
YALE ENDOWMENT FUND	22%	78%	11.0%	13.5%
HARVARD ENDOWMENT FUND	54%	36%	9.4%	12.0%
S&P 500 INDEX			7.28%	8.63%

# Institutional Style Investing Scenarios

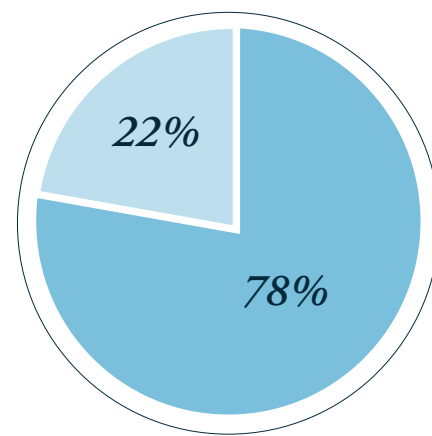


Results show funds with the highest percentage of assets in alternative investments perform the best over 10 and 20 year periods



**HARVARD ENDOWMENT FUND ASSETS**

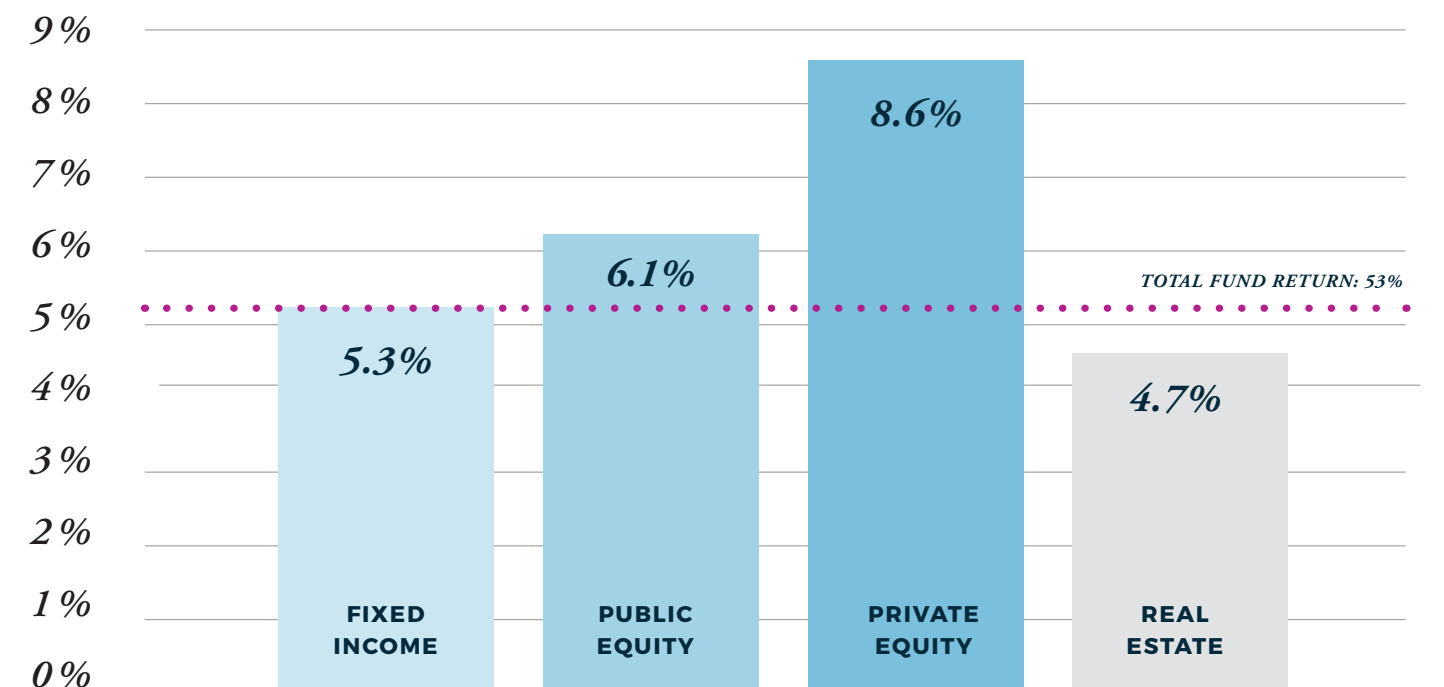
- Public Investments
- Private / Alternative Investments



**YALE ENDOWMENT FUND ASSETS**

- Public Investments
- Private / Alternative Investments

# Private Equity Investments Outperform Other Asset Classes Based On 10-Year Annualized Returns



# Lower Correlations For Diversification\*

Correlation is a measure of how two securities move in relation to each other, and ranges from +1 (they always move together) estate has historically been less correlated to most major asset classes. For example, by moving across the first row, you can see that direct real estate has a -.34 relationship to U.S. corporate bonds, meaning that historically 34% of the time these two asset classes have moved in opposite directions. Please mindful that diversification does not assure better performance

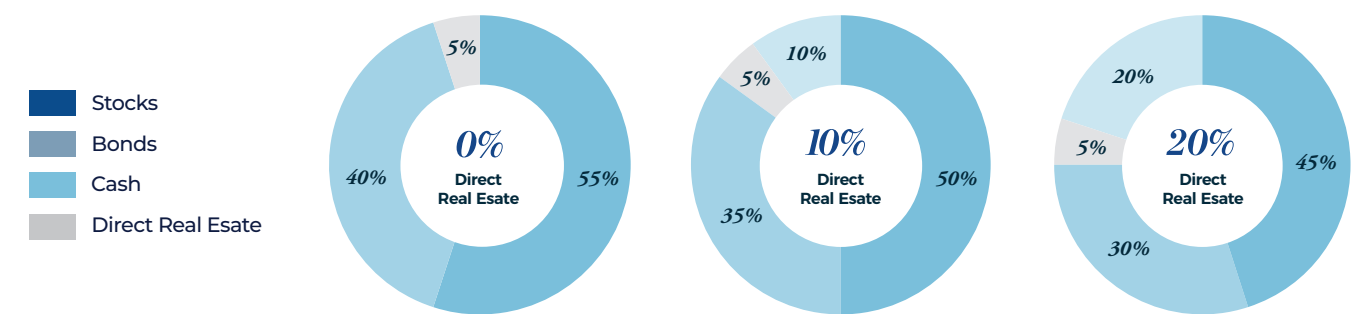
	10YR TREASURY	U.S. CORPORATE BONDS	INT'L EQUITIES	DOMESTIC STOCKS	TRADED REITs	DIRECT REAL ESTATE
DIRECT REAL ESTATE	-09	-.34	.04	.12	-.02	1.0
TRADED REITs	-.14	.04	.62	.661	.0	
DOMESTIC STOCKS	-.44	.03	.84	1.0		
INT'L EQUITIES	-.54	.081	.0			
U.S. CORPORATE BONDS	.061	.0				
10YR TREASURY	1.0					

### RETURN CORRELATIONS: QUARTERLY ANNUALIZED EXCESS RETURNS 1Q03 - 1Q18

Source: Rosen Consulting Services. Indices measured – International Stocks – NASDAQ, Domestic Stocks – Dow Jones Industrials, Traded REITs – NAREIT, Direct Real Estate – NCREIF Property Index (NPI).

# Higher Total Return, Lower Volatility\*

This chart illustrates how adding a direct real estate allocation of 10% and 20% to a traditional stock, bond and cash portfolio has boosted returns slightly while, more importantly, reducing overall risk. The Sharpe Ratio is a way to examine the performance of an investment while adjusting for its risk. **You will notice a significant increase in the Sharpe Ratio** below as more real estate is added to the portfolio.



	0% Direct Real Estate	10% Direct Real Estate	20% Direct Real Estate
AVG. ANNUAL RETURN	8.5%	8.6%	8.7%
CUMULATIVE RETURN	213.5%	222.3%	230.6%
SHARPE RATIO	0.48	0.54	0.61

### TOTAL & CUMULATIVE RETURN 2003 - 2017

Source: Rosen Consulting Services. Total and cumulative returns measured for 15-year period – January 1, 2003 through December 31, 2017. Stocks are represented by a blended portfolio of 70% S&P 500, 20% EAFE and 10% NASDAQ. Bonds are represented by the BofA Merrill Lynch Corporate Master Bond Index. Direct Real Estate is represented by the NCREIF Property Index (NPI). Cash is measured by the three-month U.S. Treasury bill rate. Portfolios with and without commercial real estate are hypothetical and do not represent an investment recommendation.

\* An investment in real estate investment vehicles, including non-traded REITs, is not a direct investment in real estate, and is subject to certain fees and expenses, as well as certain risks specifically applicable to an investment in such vehicles, which may adversely impact the value of the investment. For more information, please refer to applicable offering materials.





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1031 Risk Disclosure: There is no guarantee that any strategy will be successful or achieve investment objectives; Potential for property value loss – All real estate investments have the potential to lose value during the life of the investments; Change of tax status – The income stream and depreciation schedule for any investment property may affect the property owner's income bracket and/or tax status. An unfavorable tax ruling may cancel deferral of capital gains and result in immediate tax liabilities; Potential for foreclosure – All financed real estate investments have potential for foreclosure; Illiquidity – Because 1031 exchanges are commonly offered through private placement offerings and are illiquid securities. There is no secondary market for these investments. Reduction or Elimination of Monthly Cash Flow Distributions – Like any investment in real estate, if a property unexpectedly loses tenants or sustains substantial damage, there is potential for suspension of cash flow distributions; Impact of fees/expenses – Costs associated with the transaction section may impact investors' returns and may outweigh the tax benefits.

