

JuiceNotesTM

Alternative Investments

CFA Level 1
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Alternative Investment Features, Methods, and Structures

FinTree Fruit 1: ALTERNATIVE INVESTMENT FEATURES

- Alternative investments are **non-traditional assets**, distinct from stocks, bonds, and cash, **characterized by unique structures and investment approaches**.
- Sophisticated investors with the **longest investment time horizons**, such as large pension funds, sovereign wealth funds, and not-for-profit endowments, tend to **allocate a larger share** of their portfolio to these assets.
- **An investment in a hedge fund**, even one that purchases traditional exchange-traded assets, is considered an alternative investment.
- Alternative investment categories include **private capital, real assets, and hedge funds**.

Alternative Investments features & characteristics :



Alternative Investments Categories :

1. Private Capital

- Private capital refers to funding for companies sourced outside public equity and debt markets.

PRIVATE EQUITY

- Capital that is provided in the form of equity investments is called private equity.
- Private equity refers to investment in privately owned companies or in public companies with the **intent to take them private**.
- It is used in the mature life cycle stage or for firms in decline, with **leveraged buyouts**.
- **Venture capital** is a type of private equity that funds early-stage, non-public companies with limited operations or customer bases.

PRIVATE DEBT

- Capital that is provided as a loan or other form of debt is called private debt.
- It includes private loans, bonds, and other non-public financing options.
- **Venture debt** funds early-stage firms with minimal cash flow.
- **Distressed debt** funds financially troubled companies, often trading at a discount, with potential for restructuring or turnaround.

2. Real Assets

- Real assets are tangible assets like real estate, infrastructure and natural resources, as well as intangibles such as patents, intellectual property, and goodwill.
- It either generates current or expected future cash flows and/or is considered a store of value.

Real Estate

- Real estate includes borrowed or ownership capital in buildings or land.
- **Commercial real estate** includes land and buildings where private business activity is the primary cash flow source.
- **Residential real estate** includes single-family homes, multi-family properties, and rental housing, where cash flows stem from rents or mortgage payments.
- **REITs** are publicly traded real estate which are issuers of equity, and mortgage-backed debt securities.

Infrastructure

- It involves land, buildings and other long-lived fixed assets that are intended for public use and provide essential services.
- Examples of tangible infrastructure assets : bridges and toll roads.
- It generates cash flows through fees, leases, or access rights and indirectly by boosting economic growth and tax revenue.
- **Public-private partnerships (PPPs)** involve private investors partnering with governments to develop infrastructure.
- **Concession Agreement** outlines a private investor's duty to build, maintain, and operate infrastructure while earning fees for a set period.

Natural Resources

- It includes undeveloped land, such as farmland and timberland which hold economic value or extracted commodities like minerals and energy.
- It generates returns through price appreciation and cash flows.

Commodities

- These are standardized, traded goods which include plant, animal, energy, and mineral products used in goods and services production.
- It does not generate cash flows directly but is sold by producers to consumers for economic use.
- Investors seek to profit from price fluctuations driven by commodities' future economic use.
- It has low correlation with other assets, making them effective countercyclical holdings and inflation hedges.

Other Real Assets

- It includes collectibles like fine art, wine, and rare coins, as well as intangibles like patents, litigation claims, and digital assets.
- Digital assets are electronically created, stored, and transferred with ownership or usage rights.

3. Hedge Funds

- Hedge funds are private investment vehicles that invest across asset classes but are defined by their investment strategies rather than the assets they hold.
 - It uses leverage, derivatives, and short selling, creating risk-return profiles distinct from traditional buy-and-hold strategies.
 - Investors may also invest in a portfolio of hedge funds, often referred to as a fund of funds.
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