ISSN PRINT 2319 1775 Online 2320 7876

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RISK AND RETURN OF ALTERNATIVE INVESTMENT OPPORTUNITIES AVAILABLE TO HIGH NET WORTH INDIVIDUALS

Dr. Mahima Singh[1], Dr. Shweta Jain[2], Gururaj Dangare[3]
Pratibha Institute of Business Management, Chinchwad, Pune, India

ABSTRACT:

An alternative investment is an investment in asset classes other than stocks, bonds, and cash. The term is a relatively loose one and includes tangible assets such as precious metals,[1] art, wine, antiques, coins, or stamps[2] and some financial assets such as real estate, commodities, private equity, distressed securities, hedge funds, carbon credits,[3] venture capital, film production,[4] financial derivatives, and crypto currencies. Investments in real estate and forestry[5] are also often termed alternative despite the ancient use of such real assets to enhance and preserve wealth. In the last century, fancy color diamonds have emerged as an alternative investment class as well.[6] Alternative investments are to be contrasted with traditional investments.

Keywords: Investment instrument, Crypto currency, High Net worth Individuals, Allocation

INTRODUCTION

IMPORTANCE OF THE STUDY

- An HNIs must know how risk is managed and how to utilize theire wealth.
- To make sure that plans of investment makes economic sense for investment.
- To study about handling the risks of alternative investment**.**

OBJECTIVES OF THE STUDY

- To study what factors attract HNI clients to invest.
- To know the awareness of HNI clients towards investment.
- To know the reasons behind investment of HNIs.
- To study the major sector of investment where returns will be high

INVESTMENT

To **invest** is to allocate money (or sometimes another resource, such as time) in the expectation of some benefit in the future.In finance; the benefit from investment is called a

return. The return may consist of capital gain and/or investment income, including dividends, interest, rental income etc. The projected economic return is the appropriately discounted value of the future returns. The historic return comprises the actual capital gain (or loss)

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and/or income over a period of time.Investment generally results in acquiring an asset, also called an investment. If the asset is available at a price worth investing, it is normally expected either to generate income or to appreciate in value, so that it can be sold at a higher price (or both). Investors generally expect higher returns from riskier investments. Financial assets range from low-risk, low-return investments, such as high-grade government bonds, to those with higher risk and higher expected commensurate reward, such as emerging marketsstock investments. Investors, particularly novices, are often advised to adopt an investment strategy and diversify their portfolio. Diversification has the statistical effect of reducing overall risk.

TYPES OF INVESTMENT

Bonds

Grouped under the general category called fixed-income securities, the term bond is commonly used to refer to any securities that are founded on debt. When you purchase a bond, you are lending out your money to a company or government. In return, they agree to give you interest on your money and eventually pay you back the amount you lent out. The main attraction of bonds is their relative safety. If you are buying bonds from a stable government, your investment is virtually guaranteed, or risk-free. The safety and stability, however, come at a cost. Because there is little risk, there is little potential return. As a result, the rate of return on bonds is generally lower than other securities.

Stocks

When you purchase stocks, or equities, as your advisor might put it, you become a part owner of the business. This entitles you to vote at the shareholders' meeting and allows you to receive any profits that the company allocates to its owners. These profits are referred to as dividends.

While bonds provide a steady stream of income, stocks are volatile. That is, they fluctuate in value on a daily basis. When you buy a stock, you aren't guaranteed anything. Many stocks don't even pay dividends, in which case, the only way that you can make money is if the stock increases in value - which might not happen. Compared to bonds, stocks provide

relatively high potential returns. Of course, there is a price for this potential: you must assume the risk of losing some or all of your investment.

Mutual Funds

A mutual fund is a collection of stocks and bonds. When you buy a mutual fund, you are pooling your money with a number of other investors, which enables you (as part of a group) to pay a professional manager to select specific securities for you. Mutual funds are all set up with a specific strategy in mind, and their distinct focus can be nearly anything: large stocks,

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small stocks, bonds from governments, bonds from companies, stocks and bonds, stocks in certain industries, stocks in certain countries, etc. The primary advantage of a mutual fund is that you can invest your money without the time or the experience that are often needed to choose a sound investment. Theoretically, you should get a better return by giving your money to a professional than you would if you were to choose investments yourself. **Alternative Investments: Options, Futures, FOREX, Gold, Real Estate, Etc.** So, you now know about the two basic securities: equity and debt, better known as stocks and bonds. While many (if not most) investments fall into one of these two categories, there are numerous alternative vehicles, which represent the most complicated types of securities and investing strategies.

The good news is that you probably don't need to worry about alternative investments at the start of your investing career. They are generally high-risk/high-reward securities that are much more speculative than plain old stocks and bonds. Yes, there is the opportunity for big profits, but they require some specialized knowledge. So if you don't know what you are doing, you could get yourself into a lot of trouble. Experts and professionals generally agree that new investors should focus on building a financial foundation before speculating.

TYPES OF RISK AND RETURN OF INVESTMENT

- **Systematic Risk** - Systematic risk influences a large number of assets. A significant political event, for example, could affect several of the assets in your portfolio. It is virtually impossible to protect yourself against this type of risk.
- **Unsystematic Risk** - Unsystematic risk is sometimes referred to as "specific risk". This kind of risk affects a very small number of assets. protect yourself from unsystematic risk
- **Credit or Default Risk** - Credit risk is the risk that a company or individual will be. This type of risk is of particular concern to investors who hold bonds in their portfolios. Government bonds, especially those issued by the federal government, have the least amount of default risk and the lowest returns, while corporate bonds tend to have the highest amount of default risk but also higher interest rates. Bonds with a lower chance of default are considered to be investment grade, while bonds with higher chances are considered to be junk bonds
- **Country Risk** - Country risk refers to the risk that a country won't be able to honor its financial commitments. When a country defaults on its obligations, this can harm the performance of all other financial instruments in that country as well as other countries it has relations with. Country risk applies to stocks, bonds, mutual funds, options and futures that are issued within a particular country. This type of risk is most often seen in emerging markets or countries that have a severe deficit.

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- **Foreign-Exchange Risk** - When investing in foreign countries you must consider the fact that currency exchange rates can change the price of the asset as well. Foreign-exchange risk applies to all financial instruments that are in a currency other than your domestic currency. As an example, if you are a resident of America and invest in some Canadian stock in Canadian dollars, even if the share value appreciates, you may lose money if the Canadian dollar depreciates in relation to the American dollar. **Interest Rate Risk** - Interest rate risk is the risk that an investment's value will change as a result of a change in interest rates. This risk affects the value of bonds more directly than stocks.

- **Political Risk** - Political risk represents the financial risk that a country's government will suddenly change its policies. This is a major reason why developing countries lack foreign investment.

- **Market Risk** - This is the most familiar of all risks. Also referred to as volatility, market risk is the the day-to-day fluctuations in a stock's price. Market risk applies mainly to stocks and options. As a whole, stocks tend to perform well during a bull market and poorly during a bear market - volatility is not so much a cause but an effect of certain market forces. Volatility is a measure of risk because it refers to the behavior, or "temperament", of your investment rather than the reason for this behavior. Because

market movement is the reason why people can make money from stocks, volatility is essential for returns, and the more unstable the investment the more chance there is that it will experience a dramatic change in either direction.

Needs of alternative investment

- **Safety**

Perhaps there is truth to the axiom that there is no such thing as a completely safe and secure investment. Yet we can get close to ultimate safety for our investment funds through the purchase of government-issued securities in stable economic systems, or through the purchase of the highest quality corporate bonds issued by the economy's top companies. Such securities are arguably the best means of preserving principal while receiving a specified rate of return.

- **Income**

The safest investments are also the ones that are likely to have the lowest rate of income return or yield. Investors must inevitably sacrifice a degree of safety if they want to increase their yields. This is the inverse relationship between safety and yield: as yield increases, safety generally goes down and vice versa.

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- **Growth of Capital**

This discussion has thus far been concerned only with safety and yield as investing objectives, and has not considered the potential of other assets to provide a rate of return from an increase in value, often referred to as a capital gain. Capital gains are entirely different from yield in that they are only realized when the security is sold for a price that is higher than the price at which it was originally purchased. Selling at a lower price is referred to as a capital loss.

Tax Minimization

An investor may pursue certain investments in order to adopt tax minimization as part of his or her investment strategy. A highly-paid executive, for example, may want to seek investments with favorable tax treatment in order to lessen his or her overall income tax burden. Making contributions to an IRA or other tax-sheltered retirement plan, such as a 401(k), can be an effective tax minimization strategy.

Marketability / Liquidity

Many of the investments we have discussed are reasonably illiquid, which means they cannot be immediately sold and easily converted into cash. Achieving a degree of liquidity, however, requires the sacrifice of a certain level of income or potential for capital gains.

- **RISK- RETURN TRADEOFF**

The risk-return tradeoff could easily be called the iron stomach test. Deciding what amount of risk you can take on is one of the most important investment decisions you will make.

The risk-return tradeoff is the balance an investor must decide on between the desires for the lowest possible risk for the highest possible returns. Remember to keep in mind that low levels of uncertainty (low risk) are associated with low potential returns and high levels of uncertainty (high risk) are associated with high potential returns.

The risk-free rate of return is usually signified by the quoted yield of "U.S. Government Securities" because the government very rarely defaults on loans. Let's suppose that the risk-free rate is currently 6%. Therefore, for virtually no risk, an investor can earn 6% per year on his or her money. But who wants 6% when index funds are averaging 12-14.5% per year? Remember that index funds don't return 14.5% every year, instead they return -5% one year and 25% the next and so on. In other words, in order to receive this higher return, investors much also take on considerably more risk.

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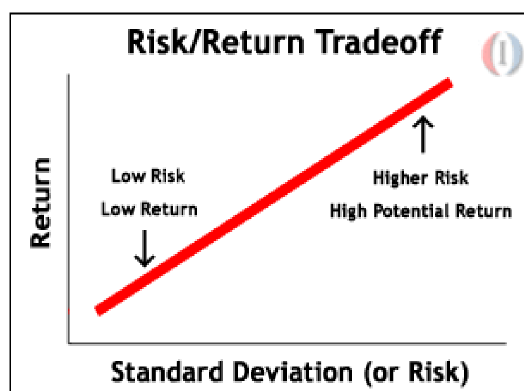

Investment options of HNI's:

There are many investment tools an HNI can add to his/her investment portfolio. The investment avenues suitable of each individual will be different. The investment type undertaken by a person can be explained with the help of the risk-return trade off. Risk-return trade of can be defined as "The balance an investor must decide on between the desire for low risk and high returns, since low levels of uncertainty (low risk) are associated with low potential returns and high levels of uncertainty (high risk) are associated with high potential returns".

Most investors take into consideration this trade-off before making their investments. An investor who seeks higher returns would generally venture into the stock markets, while one seeking stable and secure returns is likely to stick to fixed income securities. This depends upon the person's social background, age, sex, work designation, family, running income, future monetary requirements and various fixed commitments in life. If you're investing to accumulate wealth by buying individual securities, there are two questions you need to answer in order to limit your risk while seeking a satisfactory return:

1. What investment should you buy?
2. When should you buy
3. The only sound way to make these choices is to research the possibilities until you know as much as you can about:
   - Overall market
   - Various sectors of the market
   - The company issuing the individual stock or bond your considering
   - The supply and demand of the securities your considering

For a thorough investigation, you need to do both fundamental and technical analysis, either on your own or working with an adviser. Some of the techniques may seem intimidating, and the details overwhelming. But the information you need is readily available.

Every bank and financial institute provides investors with various instruments of investments. They are enumerated below:

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1. Mutual funds
2. Insurance policies
3. Government securities
4. Corporate bonds
5. Fixed deposits
6. Land and property
7. Gold
8. Equity
9. IPO's
10. Preference shares

High Net worth Individuals:

A high net worth individual is a person with large personal financial holdings. Traditionally the term used was millionaire, but in recent years the term High Net Worth individual (HNI) has become the descriptor of choice.

A classification used by the financial services industry to denote an individual or a family with high net worth. Although there is no precise definition of how rich somebody must be to fit into this category, high net worth is generally quoted in terms of liquid assets over a certain figure. The exact amount differs by financial institution and region. The categorization is relevant because high net worth individuals generally qualify for separately managed investment accounts instead of regular mutual funds. HNWI's are in high demand by private wealth managers. These individuals generally demand (and can justify) personalized services in investment management, estate planning, tax planning, and so on.

HNI's Investible assets refer to all fixed and current assets of the individual but exclude his primary dwelling. They include a simple savings or fixed deposit account with a financial institution, a securities account with a brokerage firm or an investment-linked policy with an insurance company. If the HNI has more than one account with the entity, the total net investible assets would mean the aggregate net invest able assets of the accounts.

India now is home to 83,000 millionaires and the country saw the world's second fastest growth, at 19.3 per cent, in the number of high net-worth individuals in 2005.

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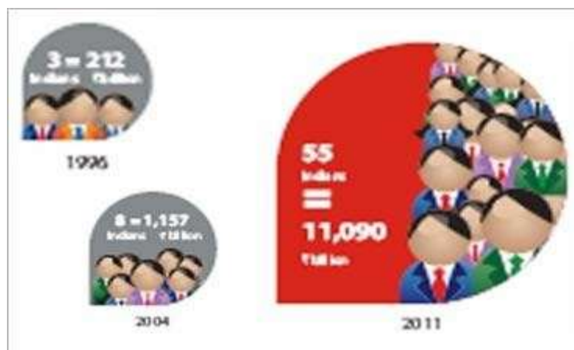
DATA ANALYSIS AND INTERPRETATION

Percentage of ultra high net worth individuals in India

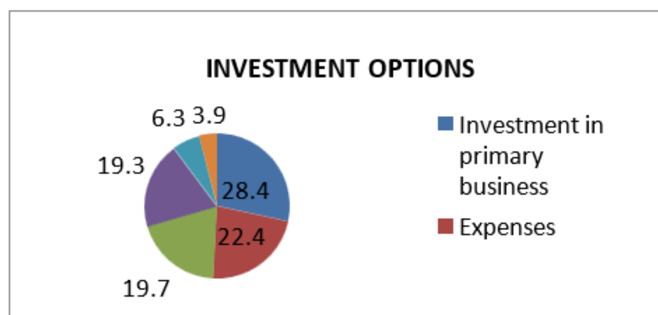


At present, India has 62,000 ultra-high net worth households, with an average net worth of Rs 75 crore (Rs 750 million).

In five years, the number of such households wills more than treble to 219,000, each with a net worth of about Rs 100 crore (Rs 1 billion).

According to this study, the fast growth in their ranks notwithstanding, the number of ultra wealthy households remains a mere 0.03 per cent of the total households in the country.

Investment options for HNIS



Further, ultra HNIs invest one-fifth of their income for growing their wealth. But they put a large proportion back into their business to fuel the engine of wealth creation.

More ultra HNIs are also now investing in vehicles that are generally considered to be risky, such as hedge funds, private equity, structured products and derivatives.

Of the three, inheritors ndicated that they distribute their investments across asset classes, with a greater emphasis on real estate - about 40 per cent - and equity - about 30 per cent.

While, the self-made organise the lowest proportion of their income on investments to grow their wealth, and the professionals deploy around 22 per cent.

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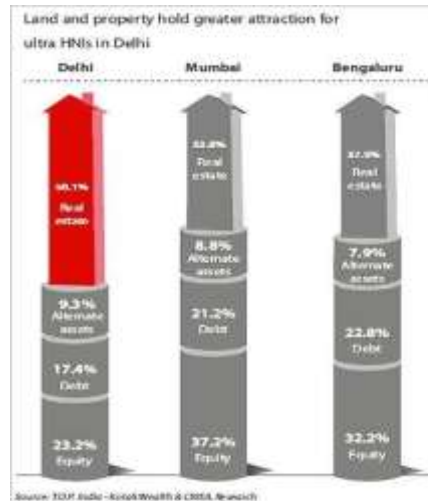
In terms of being involved in planning their investments, the self-made are also likely to be the most involved, among the three types, in planning their investments, followed by the professionals and then the inheritors.

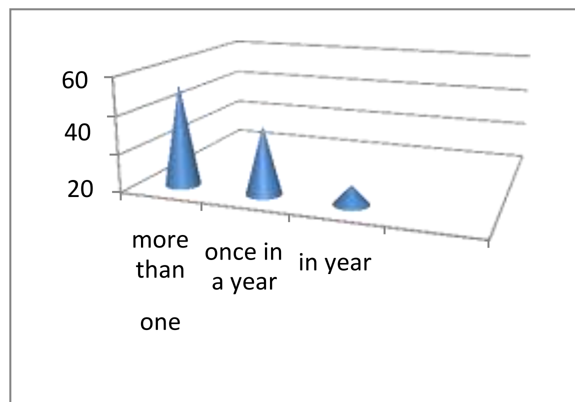
INVESTMENT PATTERN OF HNI



Wealthy investors in Delhi and Bengaluru are more focused on building portfolios in property (Delhi - 50 per cent of ultra HNI investment is in real estate followed by Bengaluru at 37 per cent) as indicated by their current investment pattern.

However, the ultra HNIs in Mumbai are far more likely to put money in equity (37.2 per cent of ultra HNI investment in equity).

LUXURY HOLIDAYS PROPORTION OF HNI



It is also observed that travel and holidays play a major part in the overall spending pattern of ultra HNIs.

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Nearly 67 per cent of the professionals said that their biggest weakness was exclusive luxury holidays, as compared to 65 per cent and 54 per cent respectively, for both the inheritors and the self-made.

A majority of the ultra HNIs travel at least twice a year, while about 15-20 per cent of the inheritors and the self-made travel thrice or more annually.

For the inheritors and the self-made, the most common reasons for travel abroad are family functions, business purposes, or leisure.

The total net worth of Indian ultra HNIs is expected to reach Rs 235 trillion in 2015-16 from an estimated Rs 45 trillion in 2010-11.

Presently, 90 per cent of the UHNIs wealth resides in the top ten cities of the country. However, going ahead, the growth will come more from smaller towns which constitute a minority now.

The report is based on analysis of government data and interviews of luxury brand managers and existing UNHIs says a majority (37.2 per cent) of the investible surplus is deployed in the real estate sector followed by equities (33.1 per cent), 20.4 per cent in debt and 9.2 per cent in alternate assets.

CONCLUSION

- HNIs have to make sure that their money is used properly.this means that the risk of their money positions have to be measured.
- Most of HNIs in India invest theire money in real estate they have to invest in lot of options like equity and derivatives to take risk efficiently.
- Compared to Investing in other sectors real estate and gold is the major portion of investing of HNIs

ISSN PRINT 2319 1775 Online 2320 7876

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