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To Understand the Consumer Preference between Traditional Investment vs. Alternative Investment

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ABSTRACT

The COVID-19 pandemic has significantly impacted traditional and alternative investments, with traditional investments experiencing the most impact. Liquidity, stability, diversification, regulation, and reduced costs are some benefits of traditional investments. However, they have drawbacks, such as passive investing, market volatility, and low returns. Commodities, real estate, hedge funds, and private stocks are examples of alternative investments that provide flexibility and capital growth possibilities. Alternative investments are riskier since they frequently produce better returns and have more intricate structures, even with higher fees and costs. A study surveyed 61 individuals aged 0 to 65+, with the largest age group being 18-25. The majority of respondents had invested in Traditional Investments, with 78.7% investing to increase income and capital appreciation. The most important factor for investment decisions was return, with 34 people valuing the safety of principal, 22 diversifying, and 1 seeking an adrenaline rush. The primary investment goals were growth of capital, income generation, capital preservation, and adrenaline rush. The majority of respondents invested in stocks, bonds, mutual funds, real estate, and fixed deposits, with a preference for traditional investments for 1- to 4-year periods. 63.9% of investors felt return was the most important factor for their investment decision.

Keywords: *Traditional Investment, Alternative Investment, Financial Markets*

OBJECTIVES

1. To understand the preferred investment option between Traditional Investment and Alternative Investment
2. To understand the investment objectives of the investor
3. To understand the impact of social and environmental factors on investments
4. To study the risk preference of the investor

HYPOTHESIS

H0 = Traditional Investments are preferred over Alternative Investments
H1 = Traditional Investments are not preferred over Alternative Investments
H0 = Alternative Investments are preferred over Traditional Investments
H1 = Alternative Investments are not preferred over Traditional Investments
H0 = In making financial and investment decisions, Investors are risk averse
H1 = In making financial and investment decisions, Investors are not risk averse
H0 = In making financial and investment decisions, Investors are risk tolerant
H1 = In making financial and investment decisions, Investors are not risk tolerant

REVIEW OF LITERATURE

1. Traditional Investments Vs Alternative Investments

Vinay V Deshmukh

Alternative investments, also known as financial engineering products, offer flexibility to Indian investors compared to traditional investments like stocks, bonds, and cash. These products include Dual Currency Deposits, Equity linked Notes, Tranche, Accumulators, and value-added businesses like wine, art, and antiques. Despite their high risk, these instruments provide flexibility, offering a range of possibilities beyond fixed income instruments and traditional investments. For example, using derivatives or structure wealth products allows investors to consider all options and potentially make more money in a short period.

Many potential users have yet to tap into these markets, largely due to the perceived difficulty and time-consuming nature of learning these instruments.

2. What Alternative Investments Add to a Traditional Investment Portfolio: A White Paper
Mark Murphy, CFA
Raffa Wealth Management's Investment Committee discussed alternative investment strategies for inclusion in the firm's overall strategy. The committee covered various investment styles, including managed futures, private equity, venture capital, and hedge funds. The committee discussed issues such as manager skill, risk analysis, benchmark biases, future opportunities, and counterparty and leverage risk. Long/short equity and market neutral were deemed insufficient alternatives due to their similarity to stock pickers, diminishing future potential, and high fees. Other hedge fund strategies, like fund of funds and multi strategy, were not approved due to high fees and potential lack of expertise. The committee decided that distressed securities, global macro, and managed futures would provide the most potential benefits for clients seeking alternative investment allocations. These strategies offer substantial diversification potential, historical performance, and can take advantage of trends and potential market inefficiencies.

SECONDARY DATA

Traditional Investments : Introduction
Traditional investment portfolio consists of cash, bonds, and stocks. Stocks are ownership stakes in publicly traded companies, and each share's worth is based on the company's performance and prospects for expansion. Economic shifts can affect stock prices; market performance is improved by economic growth, while recessions put pressure on prices. Governments and companies issue bonds and fixed-income investments, which are debt securities in which investors lend money to the issuer in return for interest payments and the repayment of the initial investment. The credit risk of a bond is determined by the bond's credit ratings. Bond pairs are prevalent because bond prices frequently increase in tandem with stock market decreases. Since cash does not generate a return without interest and may depreciate over time due to inflation, it is not regarded as an investment unless it is in an interest-bearing account.

Traditional Investments : Advantages
Traditional investments, such as stocks and bonds, are traded in financial markets, making them accessible and liquid. Because of their thorough regulation and lower minimum qualifications, these assets are widely accessible to retail investors. Conventional investments provide more security and dependability, particularly in unpredictable market situations and uncertain economic times. Achieving long-term financial goals might be facilitated by diversifying your portfolio using conventional assets. Traditional investing fees are typically lower than those of alternative investments, and many retirement accounts offer tax benefits. Conventional investments have lower entry hurdles and are more accessible to common investors. Up to a specific amount, federal insurance provides further security for investments made in financial institution products. Conventional assets have the potential to produce steady cash flow, contingent on the allocation of funds.

Traditional Investments : Disadvantages
Traditional investments, like bonds and cash, often have lower returns than alternative investments due to fees, commissions, and complexity. They may potentially suffer large losses as a result of market volatility. Conventional investments might not provide adequate diversity, which would raise risk and reduce possible returns. Accessing funds might be challenging for certain investments, such as real estate, due to their lower liquidity. Retail investors may find private equity and venture finance less accessible due to their high minimum requirements. Compared to alternative investments, traditional investments can have fewer tax advantages, require passive investing, and provide less innovation, which would limit possible profits.

Alternative Investments : Introduction
Alternative investments are financial assets that don't fit into traditional investment categories, such as commodities, managed futures, hedge funds, venture capital, private equity, art and antiques, and derivatives contracts. Real estate is another popular category, with investments in real estate aiming for operating income and capital growth. Commodities, such as gold, silver, oil, and agricultural products, are practical assets with practical applications. Farmland combines commodities and real estate, providing financial gains and tangible land advantages. Collectibles and artwork have historical or growing value over time, while cryptocurrencies provide passive income or capital appreciation. Investors can invest in start-ups or private businesses through venture capital or private equity. Peer-to-peer lending involves loans made through internet platforms, involving more private markets and riskier clientele.

Alternative Investments : Advantages
Alternative investments can help diversify portfolios and lower risk because they have minimal correlations, in contrast to standard investments like stocks and bonds. Because they are more profitable and come in a range of sizes and forms, investors can choose the one that best suits their goals and preferences. Alternative investments offer access to markets that traditional investments cannot, in addition to being less liquid and more intriguing. Price stability may be enhanced if there are less chances for investors to sell in a panic or take rash, emotional actions. All things considered, alternative investments provide more potential returns and flexibility.

Alternative Investments : Disadvantages
Alternative investments can help diversify portfolios and lower risk because they have minimal correlations, in contrast to standard investments like stocks and bonds. Investors can select the one that best fits their objectives and tastes because they are more profitable and available in a variety of sizes and shapes. In addition to being less liquid and more interesting, alternative investments provide access to markets that standard investments cannot.

If investors are less likely to sell in a panic or behave rashly and emotionally, price stability may be improved. All things considered, alternative investments offer greater flexibility and possible rewards.

DATA ANALYSIS

The study used quantitative methods for data collection, focusing on objective measurements and statistical analysis. Qualitative data was collected from text, audio, and images, and visualized using data visualization tools. The study was descriptive, examining client perspectives on Traditional and Alternative Investments in Mumbai. Random sampling was used to create an unbiased representation of the population, but it has disadvantages like time and capital requirements. Despite these, random sampling can help researchers arrive at accurate estimates when conducted methodically.

INTERPRETATION

1.Age

This study surveyed 61 people between the ages of 0 to 65+. The largest category was of people between the ages of 18 to 25 with 29 people followed by 15 people above 60, 14 people from 40 – 60 and 3 people between 25 – 40.

2.Gender

This study surveyed 61 people where 35 were male and 26 were female.

3.Occupation

This study surveyed 61 people where 22 were students, 21 were self-employed, 11 were salaried and 7 chose other.

4. What are your investment objectives ?

This study surveyed 61 people where the investment objective of 48 was Income and Capital Appreciation, 17 wanted to preserve their capital, 4 wanted to speculate, 1 did not have an objective and 1 wanted to gamble.

5. Which statement best describes your knowledge of investments ?

This study surveyed 61 people where 30 had a moderate level of knowledge of investments and financial market, 16 had extensive investment knowledge, understand different investment products and follow financial markets closely and 15 had very little knowledge of investments and financial markets.

6. On a scale of 1 - 5, How willing are you to take risks ?

1 - being the least and 5 - being the most

This study surveyed 61 people where 6 are risk averse, 5 are moderately risk averse, 23 are neutral, 22 are moderately risk seeking and 5 are risk seeking.

7. In the past, you have invested mostly in (write as many as applicable)

This study surveyed 61 people where 58 have mostly invested in Traditional Investments and 13 have mostly invested in Alternative Investments.

8. What are the important factors guiding your investment decisions ?

This study surveyed 61 people where the most important factor for investment decision for 39 people is return, for 34 it is the safety of principal, for 22 it is diversification and for 1 it is the adrenaline rush.

9. What is your primary Traditional Investment goal ?

This study surveyed 61 people where the primary traditional investment goal for 35 people is Growth of capital, 17 want income generation and 9 wish to preserve their capital.

10. What is your risk tolerance for Traditional Investments?

This study surveyed 61 people where 6 are risk averse, 9 are moderately risk averse, 26 are neutral, 13 are moderately risk seeking and 57 are risk seeking.

11. What type of Traditional Investments have you invested in previously?

This study surveyed 61 people where 45 people invest in Stocks, 16 in Bonds, 43 via Mutual Funds, 18 in real estate and 2 in Fixed Deposits.

12. What is your preferred investment horizon for Traditional Investments?

This study surveyed 61 people where 29 invest for 1- 4 years, 15 invest for 4 – 9 years, 11 invest for 10+ years and 6 invest for less than a year.

13. What is your primary Alternative Investment goal ?

This study surveyed 61 people where 29 invest for the growth of capital, 17 for income generation, 13 for capital preservation, 1 does not invest in alternative investments and 1 invests for adrenaline rush.

14. What is your risk tolerance for Alternative Investments?

This study surveyed 61 people where 10 are risk averse, 6 are moderately risk averse, 30 are neutral, 12 are moderately risk seeking and 3 are risk seeking.

15. What type of Alternative Investments have you invested in previously?

This study surveyed 61 people where 6 invest in Hedge Funds, 21 invest in Private Equity, 24 invest in Real Estate, 18 invest in Public Infrastructure, 5 do not invest in Alternative Investments, 1 takes advantage of the price discrepancies by profiting via arbitrages and 1 bets on sporting events.

16. What is your preferred investment horizon for Alternative Investments?

This study surveyed 61 people where 29 invest for 1- 4 years, 13 invest for 4 – 9 years, 10 invest for 10+ years and 9 invest for less than a year.

17. How do you allocate your investments between Traditional and Alternative investments?

This study surveyed 61 people where 35 allocate to both traditional and alternative investments, 21 allocate only to traditional investments, 1 allocates only to alternative investments and 1 does not allocate their investments.

18. On a scale of 1 to 5, How important is social or environmental impact in your investment decisions?

This study surveyed 61 people where 13 feel it is extremely important, 10 feel it is moderately important, 23 are neutral, 9 feel it is not very important and 6 feel it is not at all important.

FINDING/SUGGESTIONS

This research paper bases its conclusions after the analysis of data collected by 61 people across different age groups, occupations and investment patterns.

1. 78.7% of the respondents invest to increase their income and capital appreciation.
2. 49.2% have moderate level of knowledge of investments and financial markets.
3. 37.7% are risk neutral investors.
4. 95.1% have invested in traditional investments in the past.
5. 63.9% of investors feel return is the most important factor for their investment decision.
6. 57.4% primary traditional investment goal is growth of capital. 7. 42.6% are risk neutral towards traditional investments.
8. 73.8% have previously invested in Stocks.
9. 47.5% prefer to invest traditional investments for 1 – 4 years. 10. 47.5% primary alternative investment goal is growth of capital.
11. 49.2% are risk neutral towards alternative investments.
12. 39.3% have previously invested in Real Estate.
13. 47.5% prefer to invest alternative investments for 1 – 4 years.
14. 57.4% allocate their investments to both traditional and alternative investments.
15. 37.7% are neutral towards the impact of social or environmental impact on their investment decisions.

Hence, Investors prefer Traditional Investments over Alternative Investments, they are neither risk averse nor risk tolerant.

CONCLUSION

Traditional investment portfolios, including cash, bonds, and stocks, offer liquidity, stability, diversification, lower fees, tax benefits, accessibility, security, and steady cash flow. However, they also have disadvantages like limited returns, high fees, complexity, market volatility, and limited innovation. These investments are traded in financial markets, making them accessible and liquid for retail investors. Federal insurance provides additional security for investments in financial institution goods. Therefore, it's crucial to carefully evaluate the risks and benefits of traditional investments before investing.

Alternative investments are financial assets that don't fit into conventional categories, such as venture capital, private equity, hedge funds, managed futures, art and antiques, commodities, and derivatives contracts. Real estate investments involve investing in physical properties or property-based securities, while commodities like gold, silver, oil, or agricultural products are tangible goods with real-world uses. Farmland combines real estate and commodities, while art and collectibles can double as hobbies. Cryptocurrencies offer capital appreciation or passive income, while venture capital or private equity allows investors to invest in private companies or start-ups.

Thus, we can conclude that an investors investment preference depends on their investment goal, risk tolerance, knowledge of financial markets and available investments.

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