What are Alternative Investments?

Worksheet

Alternative investments are non-traditional assets like hedge funds, private equity, and real estate that seek higher returns but carry higher risk and less liquidity.

Questions

1. What is a key difference between stocks and hedge funds?

A) Hedge funds are always safer
B) Stocks are illiquid
C) Hedge funds use derivatives and leverage; stocks are simpler
D) Hedge funds have no fees

2. What does '2 and 20' mean?

A) Return of 20% per 2 years
B) 2% annual management fee + 20% performance fee
C) $20K minimum investment
D) 2% return guaranteed

3. Why is liquidity important for alternative investments?

A) It doesn't matter
B) Low liquidity means you can't quickly sell if you need cash
C) Hedge funds are always liquid
D) Real estate is instantly sellable

4. What is private equity?

A) Investment in public companies only
B) Investment in private companies to improve and sell at profit
C) Government bonds
D) Cryptocurrency

5. An investor puts 100K into a hedge fund charging 2% management fee and 20% performance fee. If it gains10K, what are total fees?

6. A private equity firm buys a company for 5M, improves it, then sells for12M (5 years later). What is the return on investment?

7. A real estate investor buys a rental property for 300K, rents it for1,500/month. What is the annual rental yield?

8. Define: What are alternative investments?

9. Define: Why are hedge funds risky?

10. Define: What is private equity?

Answer Key

1. C) Hedge funds use derivatives and leverage; stocks are simpler — Hedge funds employ leverage, short-selling, and complex strategies; stocks are simpler and more transparent.

2. B) 2% annual management fee + 20% performance fee — Hedge funds charge 2% of assets annually plus 20% of profits earned.

3. B) Low liquidity means you can't quickly sell if you need cash — Low liquidity = slow to sell; you're locked in for years, risking losses if you need quick exit.

4. B) Investment in private companies to improve and sell at profit — Private equity firms buy private companies, improve operations, then exit via sale or IPO.

5. Management fee = 2% × 100K =2,000 Performance fee = 20% × 10K =2,000 Total fees = 2,000 +2,000 = $4,000

6. Profit = 12M −5M = 7M ROI = (7M / $5M) × 100 = 140% over 5 years Annual return ≈ 19% per year (compound)

7. Annual rental income = 1,500 × 12 =18,000 Yield = (18,000 /300K) × 100 = 6% per year

8. Non-traditional assets like hedge funds, private equity, real estate, commodities — seeking higher returns with higher risk.

9. They use leverage, derivatives, short-selling, and concentrated bets — amplifying gains and losses.

10. Investment in private (non-public) companies to improve operations and sell at profit.