



A bull market evokes a mixture of optimism and excitement. Yet it can also bring a sense of unease about what to do next. (UBS)

Monthly letter: Four things no great portfolio can do without

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US equities continue to set record highs, with tech leading the advance. Despite the recent big gains, we think a core allocation to US large-caps remains a key building block for portfolios. But it's not the only one: we think a balance of US large-caps, international and small-cap stocks, quality bonds, and alternative assets can allow investors to position for long-term returns while navigating near-term risks.

A bull market evokes a mixture of optimism and excitement. Yet it can also bring a sense of unease about what to do next. Those sitting on paper gains wonder whether it's time to realize profit, while those holding high levels of cash may fear either missing out or losing out if they buy now after such a strong run.

These emotions are very relevant today. The S&P 500 is up by around 40% since its October 2022 lows, while the tech-related "Magnificent 7" stocks are up by close to 140% on average over the same period.

Dealing with this requires keeping a strong focus on strategy as well as tactics. In that context, in our monthly letter we discuss why, despite these big gains, investors should keep a core allocation to US large-cap stocks. Yet, with the future for many portfolios being increasingly dependent on developments at only a handful of highly valued companies, we also discuss why US large-caps represent just one of four building blocks investors should hold in their portfolios.

Technological change, overconcentration, shifting rate expectations, and geopolitical uncertainty mean now is a critical time for investors to review their allocations to these four building blocks—and address shortfalls or excesses where they exist. We believe that the right balance of US large-caps, international and small-cap stocks, quality bonds, and alternative assets can allow investors to position for long-term returns while navigating near-term risks:

US large-caps. The US makes up almost two-thirds of the global equity market by market capitalization (based on MSCI indexes), and is home to the companies at the forefront of the AI revolution. We expect generative AI to be the growth theme of the decade, with AI revenues set to grow by around 70% a year until 2027. Many of the US tech giants are already involved in multiple stages of the AI value chain. With such an advantage, we believe the biggest are likely to get even bigger, and investors need exposure to this trend.

Diversified equity exposure. Stock market returns outside of US large-caps haven't been strong in recent years. But historically, market leadership has rotated over time, and exposure to international stocks helps ensure investors don't miss out on potential future growth drivers. We see a broad range of opportunities, from US small-caps, to high-quality stocks and small- and mid-caps in Europe, to emerging markets including India.

Quality bonds offer reliable income streams, diversification benefits, and can help smooth portfolio returns. At 4.3%, the 10-year US Treasury yield is appealing, and we see the potential for capital appreciation as inflation recedes, growth slows, and the Federal Reserve cuts rates this year. In our base case, we expect the US 10-year yield to fall to 3.5% by year-end, and we recommend that investors act soon to lock in yields.

Alternative assets do come with inherent risks, like illiquidity and long lock-up periods. But they can potentially help enhance portfolio returns, and enable investors to diversify their sources of return at times when equities and bonds are moving together. Alternatives also provide access to investments that can't be found in public markets. Today, for example, private-equity-backed companies outnumber publicly listed firms by three to one. Only by allocating across all these components can investors most effectively position themselves for our base-case soft-landing scenario, as well as upside and downside scenarios.

Read more in the latest monthly letter, "[Four things no great portfolio can do without](#)," and watch a short video on these themes [here](#).

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