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Diversification: The only “free lunch”

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Diversification remains our preferred way to reduce risk in a portfolio without sacrificing return opportunities. In our latest study, we show how family offices optimize this through significant allocations to alternative investments.

“Diversification is the only free lunch in investing”—this insight, attributed to Harry M. Markowitz, the father of modern portfolio theory, sums it up: Broad diversification is probably the best way to reduce portfolio risk without having to forgo return opportunities. Especially in today’s market environment, this lesson should be taken to heart.

Our latest *Global Family Office Report* provides insight into the actual state of diversification in investment portfolios. The responses of over 300 participants from nearly every continent offer fascinating insights and interesting conclusions. In addition to detailed information on asset allocation, the report also provides an overview of how family offices assess key topics such as risk appetite, professionalization and governance, costs, personnel structure, and succession planning.

With regard to geographic diversification, it is not surprising that a pronounced “home bias” shapes allocations in developed markets. This is particularly notable in the US, where family offices on average hold 86% of their investments in North America. In Switzerland and Europe, the share of domestic investments is 54% and 47%, respectively. Family offices in Latin America or the Middle East act quite differently: There, only about one-eighth of investments are made in their own region, while the majority—mainly due to more stable conditions—is invested in North America and Europe.

Unsurprisingly, (geo)political risks are the main reason why investment decision-makers are considering adjustments to geographic allocation. Following recent turbulence in currency markets, questions about currency allocation have also come into sharper focus. Volatile US trade policy, concerns over the independence of the Federal Reserve, and increasingly

undisciplined fiscal policy have recently put pressure on the US dollar. We therefore favor using periods of dollar strength to consider (partial) hedging of dollar-denominated assets.

Looking at asset allocation by asset class, it is striking that family offices hold a significantly higher proportion in alternative investments than private investors. In Switzerland, this share is around 44%, with private equity accounting for 16%—the largest portion—followed by real estate (12%), as well as hedge funds, art and antiques, private credit, gold, other commodities, and infrastructure investments. Even though many of these assets are not publicly traded and are therefore less liquid, we believe they are attractive due to their return potential and beneficial diversification properties—and are an important building block in portfolios for long-term oriented investors.

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Non-Traditional Assets

Non-traditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. An investment in an alternative investment fund is speculative and involves significant risks. Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

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In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

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