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Strategic: Diversify with alternatives

Diversify with alternatives

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Why? (1) Hedge funds have demonstrated the ability to limit losses during downturns while maintaining exposure to potential market gains; (2) Private infrastructure is generally less correlated with traditional asset classes, with return correlation ranging from -0.2 to +0.6 according to Cambridge Associates; (3) Middle-market buyout targets in the US may be a fertile ground for value creation.

Source: Maggie Yap_Unsplash

Hedge funds can offer attractive returns for the level of risk taken by identifying promising opportunities across markets while managing the risk of potential market downturns. In an environment of AI market leadership and more concentrated markets, we focus on strategies such as equity market neutral funds, which seek to profit from both rising and falling stocks by balancing long and short positions; discretionary macro funds, where managers invest based on their views of global economic trends; and multistrategy funds that combine several approaches. We also see fresh opportunities in merger arbitrage, a strategy that aims to profit from price changes in companies involved in mergers and acquisitions (M&A), supported by a resurgence in M&A activity.

Private equity stands to benefit from lower interest rates, reduced regulation, and more appealing entry valuations. According to the latest MSCI Burgiss pricing data, global LBO (leveraged buyout) multiples were revised higher, reaching approximately 11.5x EV/EBITDA at the end of the first quarter of 2025. This is broadly in line with 2022 levels but below public market valuations. We expect an acceleration in distributions—cash returned to investors—and exits, meaning sales of portfolio companies, which should help ease the buildup of aging holdings. Our preference is for middle-market, value-oriented buyout strategies and secondaries funds, which purchase existing private equity investments, with an emphasis on regional diversification in Europe and Asia.

Private credit continues to offer compelling long-term income, though tighter credit spreads and pockets of financial stress or defaults warrant an up-in-quality bias and increased selectivity. We prefer sponsor-backed loans, which are made to companies owned by private equity firms, as well as senior loans that have priority in repayment if a company faces financial trouble. Our focus is on the most fundamentally sound loans in the larger mid-sized company segment and in less cyclical sectors.

Infrastructure assets remain a compelling opportunity in our view. Their high barriers to entry, monopolistic positioning, and strong ability to pass on costs make them resilient to economic slowdowns and positively correlated with inflation. Private infrastructure investments have historically demonstrated resilience, with annualized returns of 7.1% in 2024 and 10.9% on a 10-year rolling basis, based on Cambridge Associates data. We favor diversified, core and core-plus assets—meaning infrastructure with stable or moderate growth in cash flows—in non-cyclical sectors, focusing on predictable income streams that rise with inflation.

Real estate in the US is showing signs of stabilization and recovery, with net asset values holding steady since late 2024 and investment activity picking up. Overall, we see further improvement ahead for the asset class, with core/core-plus strategies in logistics, data centers, and living sectors offering the most robust fundamentals and attractive risk-adjusted returns.

Before investing, we recommend investors consider the risks associated with alternatives, including illiquidity, limited transparency, and the use of leverage.

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Private Markets Extended

CIO View - Hedge funds

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.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

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

- Hedge Fund Risk: There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, “junk bonds,” derivatives, distressed securities, non-U.S. securities and illiquid investments.
- Managed Futures: There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.
- Real Estate: There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.
- Private Equity: There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
- Foreign Exchange/Currency Risk: Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in U.S. dollars, changes in the exchange rate between the U.S. dollar and the issuer’s “home” currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a U.S. investor.

Appendix

Risk information
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