Hedge market risks

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Author: Sagar Khandelwal, Strategist, UBS Switzerland AG

- **Why?** 1) Diversifying across asset classes is the most effective long-term hedge against market shocks, such as AI disappointments, inflation, or debt-driven yield spikes. 2) A modest gold allocation can enhance diversification and help buffer portfolios against systemic risks. 3) Adding government bonds can provide stability, as they tend to rally during periods of slower growth.
- **Why now?** 1) Building a liquidity strategy allows investors to meet obligations without being forced to sell assets in adverse market conditions. 2) We recommend holding enough liquidity to cover up to five years of expected withdrawals, since bear markets can take time to recover. 3) Replacing some direct equity positions with capital preservation strategies can help limit downside risk while still allowing some participation in market upside.

We believe a diversified approach—incorporating liquidity, quality bonds, capital preservation strategies, and gold—is the most effective long-term hedge against market shocks. Source: Pexels

Video: Hedge market risks: Review your goals

Build a liquidity strategy

Holding cash or safe short-term instruments allows investors to meet obligations without selling assets at depressed prices—critical if markets tilt toward our downside scenarios. Liquidity also provides flexibility to seize opportunities and the confidence to invest for growth. We recommend holding enough liquidity to cover up to five years' expected withdrawals, since bear market recoveries can take time. Alternatively, investors may consider establishing a lending facility, which can provide access to funds without the need to liquidate investments during periods of market stress.

Get your asset allocation right, including quality bonds and alternatives

Strategic asset allocation is the most effective long-term hedge against market risk. Diversifying across equities, fixed income, and alternatives can help reduce portfolio volatility and limit the impact of shocks—whether from AI disappointment, inflation, or debt-driven yield spikes. We recommend adequate allocations to government bonds, which tend to rally during periods of lower growth, and alternatives with low correlation to equities for added stability.

Substitute direct equity exposure for capital preservation strategies

Capital preservation strategies can limit downside risk while allowing some participation in upside. While returns may be capped in strong markets, such strategies reduce drawdowns and support long-term wealth preservation. Replacing some direct equity positions with these strategies can make portfolios more resilient to volatility and shocks.

Include an allocation to gold

Gold has historically been an effective portfolio hedge during market stress, inflation fears, or geopolitical uncertainty. Its low correlation with equities and bonds means it can appreciate when risk assets decline, offsetting losses elsewhere. While gold does not generate income and its protective behavior is not guaranteed in every downturn, we believe a modest allocation—of up to a mid-single-digit

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percentage of total assets—can enhance diversification and buffer against systemic risks.

Appendix

Non-traditional asset classes are alternative investments that include hedge funds, private equity, private credit, 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.

- **Private Credit:** There are risks specifically associated with investing in private credit. This could include losses stemming from defaults on loans, which in significant adverse circumstances could result in a substantial 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.

Global asset class preferences definitions
The asset class preferences provide high-level guidance to make investment decisions. The preferences reflect the collective judgement of the members of the House View meeting, primarily based on assessments of expected total returns on liquid, commonly known stock indexes, House View scenarios, and analyst convictions over the next 12 months. Note that the tactical asset allocation (TAA) positioning of our different investment strategies may differ from these views due to factors including portfolio construction, concentration, and borrowing constraints.
Most attractive – We consider this asset class to be among the most attractive. Investors should seek opportunities to add exposure.
Attractive – We consider this asset class to be attractive. Consider opportunities in this asset class.
Neutral – We do not expect outsized returns or losses. Hold longer-term exposure.
Unattractive – We consider this asset class to be unattractive. Consider alternative opportunities.
Least attractive – We consider this asset class to be among the least attractive. Seek more favorable alternative opportunities.

Appendix

Risk information
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