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Strategic: Diversify with alternatives

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Why? 1) We see low stock correlation and high return dispersion as continued drivers of hedge fund returns and should support performance in 2026. 2) Hedge fund strategies like global macro can shield portfolios in periods where bonds and equities sell off together. 3) Private real estate and infrastructure may diversify long-term income sources while offering exposure to structural trends like electrification.


Source: Pexels

Video: Diversify with alternatives

Hedge funds

The environment of low stock correlation and high return dispersion—drivers of strong hedge fund returns since 2010—remains in place and should support performance in 2026. We believe that equity market neutral strategies can enhance portfolios due to their ability to generate returns in both rising and falling markets, while limiting directional exposure. We also see appeal in global macro and multi-strategy funds.

Global macro tends to benefit in periods of high uncertainty and volatility, including heightened geopolitical risk. Indeed, fom 1997 to November 2025, discretionary macro traders have posted an average annualized performance of 7.0% based on the BarclayHedge Global Macro Index, with a volatility of 5.5%. This performance is comparable with that of equities, while showing less than half of the volatility. The maximum drawdown over this period is the lowest of all hedge fund strategies at 8.1%, and markedly lower than the maximum drawdown of developed market equities (MSCI World) at 54% over the past two decades.

We believe multi-strategy funds can benefit from their flexibility to position around economic trends and risks like persistent inflation, trade tensions, or debt sustainability concerns.

Meanwhile, the resurgence in M&A activity is creating fresh opportunities for merger arbitrage strategies.

Private equity

With central banks easing and fiscal policy remaining pro-growth, we expect increased distributions and exits, supporting private equity returns. Mega-deals have returned and global private equity (PE) deal flow between January and September 2025 stood 14.5% higher than 2024, according to Pitchbook.

Raising fresh capital remains challenging and timelines are extended—especially for smaller funds—but the outlook on increasing exits and a more favorable macroeconomic environment are supportive of new capital flows in the coming quarters.

In a world of lower rates and high public market valuations, we focus on middle-market, value-based buyouts, complex carveouts, and secondary funds, with a preference for regional diversification in Europe and Asia to mitigate local risks.

Select direct lending

Private credit headlines highlight the need for quality and selectivity. While direct lending remains relatively small compared to broader credit markets, and risks to overall financial stability appear moderate, investors should recognize that the market is not uniform.

Recent data suggest that asset quality is not deteriorating at the industry level, but there is growing bifurcation: Stress is more evident among smaller, lower-middle-market borrowers and certain sectors and vintages, while more recent, larger sponsor-backed loans have generally shown more resilience.

Our analysis of US listed and non-traded business development companies (BDCs; a vehicle through which investors can access direct lending) finds that most private loans are valued in line with public market standards, with average price discrepancies below 1%. However, valuation differences can occur—especially for weaker or distressed loans—and the absence of transparent market pricing means investors must rely on manager judgment.

While tighter spreads and Federal Reserve rate cuts have moderated returns, we believe direct lending still offers attractive income and diversification for underallocated investors. Risks are mainly contained to lower-middle-market borrowers; senior, sponsor-backed loans to larger, less cyclical companies remain resilient, in our view.

For those considering private credit, robust positioning is key: Regularly review liquidity needs, prioritize quality, and exercise selectivity in manager and deal choice. Diversification across private market strategies may help manage risk, but investors must be prepared to tolerate illiquidity and limited transparency in both good and more challenging market conditions.

Private real estate and infrastructure

Reliable, inflation-linked cash flows and exposure to structural trends make these appealing portfolio assets in our view.

Infrastructure assets stand out as a compelling opportunity in today's investment landscape. Their high barriers to entry, monopolistic positioning, and strong cost passthrough mechanisms make them uniquely resilient to economic slowdowns and positively correlated with inflation—offering a potential hedge in uncertain times.

Infrastructure-linked assets returned 7.1% in the first half of 2025 and have averaged 10.8% annually over the past 10 years (Cambridge Associates). Recent fundraising has rebounded sharply, led by core-plus funds and robust deal activity in renewables, while valuations remain attractive and competition is limited, in our view.

In global direct real estate, we estimate that transaction volumes ended 2025 up roughly 20%, to around USD 850bn. We anticipate further growth in 2026 as financing and opportunity costs decline. Performance has varied across sectors, with industrial and logistics largely outperforming, though capital gains in these segments have been volatile. Looking ahead, we expect total returns to be primarily driven by income, with a smaller contribution from capital gains as rental growth continues but at a slower pace.

We favor digital infrastructure, renewables, logistics, living sectors, and data centers, with a preference for core and core-plus assets that derive a greater share of returns from income rather than capital appreciation.

Alternatives carry unique risks that investors must be aware of before investing, including limited transparency, potentially high fees, and illiquidity.

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

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