Strategic: Diversify with alternatives

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- **Why?** (1) Global macro hedge funds have historically fared well in geopolitical crises, navigating volatility with lower drawdowns than stocks. (2) We still see merit in investing in direct lending but favor strict selectivity and a bias to high-quality assets. (3) Private real estate and infrastructure can diversify long-term income sources, with inflation-linked cashflows potentially appealing if oil supply disruptions persist.

With the rate-cutting cycle ending and debt rising, broadening into diversified alternatives can help investors manage risk and access new sources of return.
Source: Sol Ponce_Unsplash

Video: Diversify with alternatives

Hedge funds

In our view, hedge fund strategies like discretionary macro, equity market neutral, and multi-strategy platforms are well placed to earn returns amid volatility.

From 1997 to March 2026, discretionary macro traders posted an average annualized return of 7.2% (BarclayHedge Global Macro Index) with volatility of 5.6%—comparable to equities but with less than half the volatility. Meanwhile, the maximum drawdown for macro strategies over the past two decades was 8.1% versus 54.0% for developed market equities (MSCI World).

We also see ongoing opportunities for equity market neutral and multi-strategy funds, which can generate returns in both rising and falling markets as they flexibly position around economic developments. We remain positive on merger arbitrage, though performance may soften if deal activity slows.

Investors seeking diversification, ways to limit portfolio losses, and access to unique return opportunities within a broader alternatives or multi-asset portfolio can also consider Asian hedge funds. Underresearch and high levels of retail participation may add to dislocations and dispersion that local hedge fund managers can exploit. While no guarantee of future returns, Asian hedge funds have historically delivered appealing returns. Over the past five years, Asian hedge funds have delivered returns broadly comparable to Asian equities and a global 60/40 portfolio, but with less than half the volatility of both. Relative to global hedge funds, returns and risk-adjusted performance have also been broadly comparable.

Private equity

Private equity returned around 8% through the end of the third quarter of 2025 (Cambridge Associates), underperforming public benchmarks, but we see signs of potentially improved performance going forward. US private equity deal value grew 36% year over year in 2025 (PitchBook), led by health care and technology. While raising fresh capital remains challenging—especially for smaller funds—and the outlook remains clouded by the ongoing Middle East conflict, we expect a gradually improving trend of exits and a resilient US macro environment to support the asset class.

We favor value-oriented, middle-market buyout strategies and secondaries, which should be less affected by volatility in the software sector. Select European and Asian assets are also increasingly attractive for diversification, especially in times of elevated geopolitical tension.

Select direct lending

For those considering adding to direct lending allocations, we continue to urge selectivity with a bias toward higher-quality, larger-cap, and sponsor-led deals and an avoidance of riskier and growth-sensitive underwriting in the lower-

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middle markets and below.

Risks are rising among lower-middle-market borrowers and 2021-22 vintages, with defaults rising to 2.46% in the fourth quarter.. Looking ahead, we expect returns to moderate, as spreads remain tight and default rates normalize.

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

We believe infrastructure assets are well-positioned to deliver resilient, inflation-linked returns. Current market conditions are favorable, in our view, with attractive valuations, solid fundamentals, and strong fundraising momentum, led by core-plus and digital infrastructure strategies. Infrastructure-linked assets returned 9.4% in the first three quarters of 2025 and have averaged 11% annually over the past decade (Cambridge Associates).

In the context of energy prices potentially remaining higher for longer, infrastructure assets may appear especially attractive as developed market core- and core-plus infrastructure assets tend to offer investors lower correlation, stable and often inflation-linked cash flows, and resilience in slower growth environments.

In global direct real estate, we expect total returns to be primarily driven by income, with a smaller contribution from capital gains, as rental growth slows. We favor core/core-plus strategies, especially in logistics, data centers, and living sectors offering robust fundamentals and attractive risk-adjusted returns.

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
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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
Note: For equities, we have a five-tier rating system with two additional preferences
Most Attractive: We consider this asset class to be among the most attractive. Investors should seek opportunities to add exposure.
Least Attractive: We consider this asset class to be among the least attractive. Seek more favorable alternatives opportunities.
When equities are included with the other asset classes in the three-tier rating system, we collapse "Most Attractive" with "Attractive" and "Least Attractive" with "Unattractive."

Appendix

Risk information
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