(UBS)

Why diversifying across alternative assets makes sense

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Private credit remains in focus amid headlines about AI-driven disruption in the software sector, defaults, and some managers enforcing contractual liquidity restrictions. While not necessarily a direct reflection of loan book credit quality, investors must be prepared to tolerate illiquidity in both favorable and challenging conditions.

CIO maintains a Neutral view on direct lending, as we see a balanced risk-return outlook in the near term.

Private credit investors have been worried about several recent developments.

- Investors have grown concerned that AI developments may disrupt legacy enterprise software companies, including those to which direct lenders have provided loans.
- Risks are rising, especially among lower-middle-market borrowers and loans that originated in 2021-22, which have seen higher defaults and non-accruals.
- Several evergreen funds have limited redemptions to protect asset values.

Late-cycle dynamics and an increasingly split market support a selective approach.

- The asset class still offers long-term yield and diversification benefits, but in the short term, we see a more balanced risk-return outlook and more moderate returns.
- Since September, we have recommended that investors consider biasing exposure toward funds focusing on senior, sponsor-backed, upper-middle-market loans in non-cyclical sectors, which are proving more durable.

Diversifying across alternative assets makes sense amid the current uncertainty.

- Investors with an overallocation to direct lending should consider broadening into diversified alternative strategies, including private infrastructure; seeking proxy hedges; or reducing exposure to high yield credit or equities in favor of quality bonds or low-correlation hedge funds to balance risks.

Investment view

CIO continues to believe a diversified allocation to direct lending can add value to a well-diversified portfolio over the longer term, but the risk-return outlook in the near term has become more balanced.

Original report – **Should investors worry about private credit?, 4 May 2026.**

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.

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