Strategic: Diversify with alternatives

Diversify with alternatives

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- **Why?** 1) Global macro hedge funds can be a resilient portfolio building block as growth, inflation, and interest rate trends diverge into the end of 2026. 2) Private infrastructure can diversify long-term income sources, with inflation-linked cash flows potentially appealing if oil supply disruptions persist. 3) Private equity offers the potential to capture long term growth and direct exposure to key themes such as tech, health care or energy. Investors must be prepared to tolerate unique risks when investing in alternatives such as illiquidity, high fees, and limited transparency.

Source: Sinitta Leunen_Unsplash

Hedge funds

Hedge fund strategies like discretionary macro, equity market neutral, and multi-strategy platforms are well placed to earn returns in the second half of 2026, in our view. We think they can build on their 7.5% return in the first half (initial HFRI data as of mid-July), which was the strongest first six months in five years.

From 1997 to June 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. Equity hedge was the top strategy first-half strategy returning +9.6% based on HFRI data, and has benefited from elevated stock dispersion and greater opportunities for security selection. Managers have shown early signs of positioning for a broadening of market leadership, though the rotation is still at an early stage. We continue to favor disciplined, lower net, and market-neutral managers who can monetize stock dispersion while actively managing concentration and factor rotation risks.

We remain positive on select event-driven strategies. Overall, the improving deal pipeline and broader number of sectors in which corporate activity takes place remain supportive. We continue to favor merger arbitrage and special situations, while maintaining a more selective stance toward credit arbitrage.

Private infrastructure

We believe infrastructure assets are well positioned to deliver resilient, inflation-linked returns through market cycles. Many infrastructure assets face limited competition and high barriers to entry, so owners can pass through cost increases to users. Infrastructure investments can help hedge against inflation because revenue streams are often tied to CPI, particularly for core strategies operating in regulated or contracted assets. Their income streams may therefore be more robust than other yielding assets to both economic volatility and inflation. Such qualities appear increasingly valuable in the current environment.

Infrastructure's returns have looked appealing relative to other parts of a well-diversified portfolio. Private infrastructure has delivered annualized returns of around 11% over the past decade, according to data from Cambridge Associates. But infrastructure also behaves differently to other assets, potentially helping steady portfolios. Recent years have seen the asset class's already low correlations with traditional stocks and bonds fall further. Infrastructure returns display only a 30% correlation with a standard 60/40 portfolio, and even less so with other diversifying assets like gold.

In the current climate, we believe investors who focus on diversified, core/core-plus assets in non-cyclical sectors —prioritizing predictable, inflation-linked cash flows—are best positioned to capture attractive, risk-adjusted returns, while supporting the essential modernization of the global economy.

Core and core-plus infrastructure strategies focus on already mature assets with stable income, potentially more matched to income-focused or balanced investors who want to generate the bulk of returns through yield. When observing historical performance of lower risk, core infrastructure strategies, more than 50% of total returns were derived from income. Investors overallocated to other private assets that pay income (private credit and real estate) could consider these types of assets.

Private equity

Investor appetite for private equity appears to be recovering. Global PE fundraising reached USD 262 billion in the first half of 2026, already more than 60% of the full-year 2025 total. Asia Pacific has led the rebound, with first-half fundraising running 30% above the full-year 2025 level, while the US and Europe are also tracking ahead of last year's pace.

There are also early signs that deal activity is broadening out. Europe's share of trailing 12-month global PE deal value grew from 31% in the second quarter of 2025 to 35% in the same period this year, indicating that momentum is starting to spread beyond the US. Activity is expanding beyond the megacap segment into the middle market, while sector leadership is becoming more balanced. Technology—and software in particular —is no longer dominating activity to the same extent, with increased interest instead in energy and in hard-asset-linked sectors with low obsolescence risk, such as materials, chemicals, and industrials. We view this broadening as a healthy and necessary condition for a more sustainable recovery in M&A activity.

Valuations remain attractive, with buyout entry multiples at 10.5x in the first quarter of 2026. Relative to public market valuations across both mid- and large-cap companies, we continue to see room for catch-up and, in some areas, attractive entry points.

We view managers with a value bias who are active in the middle market or skilled at executing complex transactions as best positioned. Meanwhile, the appeal of the secondary market remains intact, offering investors greater returns visibility and more defensive exposure to private equity. For thematic investors, the most compelling opportunities are in quality businesses with resilient growth, particularly in health care and new energy. Given concerns around AI-driven disruption, we recommend diversifying beyond technology and software to capture opportunities across the broader AI value chain.

Regionally, the US remains a core market, but European and select Asian assets are becoming increasingly attractive from a diversification perspective.

Select direct lending

Direct loan returns are moderating, coming in flat to slightly up in the first quarter of 2026 amid headwinds from public credit volatility, spread movements, and the potential for rising credit losses.

CIO continues to see merit in diversified allocations to direct lending, sized to investors' individual risk and liquidity preferences. However, CIO downgraded the asset class to Neutral in the third quarter of 2025, reflecting the growing gap between the strongest and weakest borrowers and our expectation that lower central bank rates, tight loan spreads, and competition from the syndicated loan market would lead to more moderate returns.

Since early 2026, investors have had further considerations including the potential disruption of AI on direct-lending-backed software businesses, and a broadening group of evergreen funds limiting redemptions.

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.

Investors subject to redemption restrictions in evergreen structures should:

- Review liquidity terms, redemption mechanics, and governance provisions.
- Pay particular attention to manager quality—including liquidity management, communication, and alignment—particularly in stress scenarios.
- Diversify across fund structures and liquidity profiles to help mitigate concentration risk.
- Ensure their own liquidity needs are compatible with their chosen vehicle's design and be prepared for periods of restricted access to capital.

Private real estate

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 moderates. We currently see core/core-plus strategies—particularly in logistics, data centers, and living sectors with robust fundamentals—as offering relatively attractive risk-adjusted returns.

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

Diversified private markets vehicles

Similar to public markets, we think allocation to private assets should be diversified across sectors, strategies, geographies, managers, and vintages. We view this approach as the best way to mitigate overconcentration to any specific theme, reduce localized disruption or currency risk, and enhance access to specialized expertise and other levers of value creation.

Building robust portfolios however requires time, consistency and institutional access to maximize chances of success. For first time investors, we see merit in considering diversified private market fund of funds.

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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