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Strategic: Strengthen your core

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- **Why?** 1) Building a core portfolio allows investors to navigate different market scenarios with confidence, rather than depending on one path for growth and rates. 2) A portfolio broadly diversified across and within asset classes, geographies, and sectors can consistently grow wealth, providing compounded returns. 3) This approach helps maximize the chance of meeting financial goals, allowing investors to pursue other interests or tactical opportunities with greater confidence and avoid locking in losses in downturns.



A robust core allocation can keep investors positioned for growth without depending on one region, sector, or market outcome. Source: Pexels

We believe investors will need to prepare portfolios for different scenarios and sources of uncertainty (and opportunity) in 2027, beyond the durability and profitability of artificial intelligence (AI).

Among other things, we expect markets to move based on how inflation, central bank policy, government debt, and geopolitics all evolve.

Our base case foresees economic growth and corporate earnings remaining resilient, AI investment continuing to rise, and inflation following a moderating path. In such a scenario, we see a constructive return outlook for stocks and bonds—but with enough variation between and within markets to underscore the need for diversification and a robust financial plan.

But a base case is not a guarantee. The wide range of credible alternatives matters for portfolio construction.

Favorable scenarios could include stronger AI productivity, lower inflation, and easier monetary policy that supports broad equity gains, credit, industrial commodities, and infrastructure. Adverse scenarios such as persistent inflation could force rates higher, putting pressure on equities and government bonds while favoring select assets in energy, materials, and infrastructure.

The lesson is not that investors must identify the right scenario in advance. It is that different assets can perform different jobs across those scenarios.

What should be in a core portfolio?
Equities remain vital for long-term growth, but the sources of that growth should be diversified. With the largest companies representing around 40% of the S&P 500, a portfolio heavily dependent on US megacap technology is also heavily dependent on AI investment and earnings expectations being met. Broader exposure across regions, sectors, and investment styles can reduce this reliance and help eliminate home or sector biases. Industrial companies may benefit from spending on automation, defense, electrification, and infrastructure, while health care offers an earnings profile less dependent on the investment cycle.

The reset in yields has materially improved the role bonds can play in portfolios. After the global financial crisis, low interest rates left fixed income offering limited income and relatively little protection against an equity market drawdown, while exposing investors to the risk of rising yields. The repricing of bond markets since the pandemic, including the renewed rise in yields in 2026, has changed that calculation.

Higher starting yields matter in several ways. They increase the income available from bonds and provide a greater cushion against negative returns in case rates increase further. They also create scope for capital appreciation if inflation moderates, economic growth weakens, or central banks eventually reduce interest rates.

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The portfolio role of bonds extends beyond expected returns. High-quality bonds can help preserve capital and may diversify equity exposure when economic growth disappoints. Their senior position in the capital structure also generally makes them less risky than equities issued by the same issuer.

But not every bond plays the same role. High grade (HG) and investment grade (IG) bonds are generally better suited to capital preservation and equity diversification and are very much driven by the macroeconomic environment. On the other hand, high yield (HY) bonds behave more like stocks because their performance is more exposed to the health of the corporate sector, in general, and corporate default risk, in particular. Emerging market debt can add income and geographic diversification, but also introduces sovereign, credit, and liquidity considerations.

We currently view HG and IG bonds as Attractive. We favor selective exposure to short- and medium-duration high-quality bonds, while remaining more cautious on the longest maturities given fiscal concerns and elevated issuance. We also view HY and emerging market bonds as Attractive, supported by elevated yields and, in aggregate, resilient fundamentals.

This gives investors more options within the fixed income allocation. The bond component of a balanced portfolio can be designed around the required mix of income, capital preservation, duration exposure, credit risk, and liquidity rather than treated as a single undifferentiated block.

Why look beyond stocks and bonds?

But it is not guaranteed that bonds will offset every equity decline. In some markets, such as Switzerland, where local sovereign yields are low, it may make sense to consider diversified income generation approaches across equities, fixed income, and derivatives, where suitable, to generate meaningful yield. And with limited scope for falling yields and capital appreciation in adverse outcomes, looking at other diversifying assets such as gold or structured strategies with capital preservation features may be prudent.

The diversification benefit of bonds also depends partly on why equity markets are falling. High-quality bonds have historically been more effective equity diversifiers during periods of low or stable inflation. If growth weakens and inflation moderates, bond prices may rise as equities come under pressure. If inflation remains elevated and interest rates rise, stocks and bonds can decline together.

That distinction is important today. Investors face several plausible paths for growth, inflation, fiscal policy, energy prices, and geopolitical risk into the year ahead.

Uncertainty and the need to think in terms of market scenarios make the case for completion assets stronger. Completion assets can earn their place by doing a specific job that the core may not perform consistently. That might include generating differentiated returns, providing income, reducing sensitivity to equity markets, or helping preserve purchasing power during periods of elevated inflation.

Hedge funds may provide alternative sources of return when equities and bonds face pressure at the same time. Their value depends heavily on strategy and manager selection. Investors should not assume that every hedge fund will diversify a balanced portfolio or deliver positive returns during market declines.

Real assets can address a different set of risks. Commodities have historically displayed relatively low correlation with traditional asset classes and may benefit when physical supply is constrained or inflation remains elevated. Gold can potentially provide insulation against fiscal uncertainty, geopolitical disruption, and falling real interest rates.

Infrastructure may offer relatively predictable and potentially inflation-linked income, while providing exposure to long-term investment in electricity networks, data centers, electrification, energy security, and more resilient supply chains. Real estate can also generate income and may benefit from restricted new supply in selected sectors, including data centers, senior housing, multifamily housing, and high-quality offices.

These assets are not uniformly defensive. Cyclical commodities can suffer when growth slows. Higher interest rates can weigh on infrastructure and real estate valuations and raise refinancing costs. Private investments can involve illiquidity, limited disclosure, uncertain cash flows, leverage, capital calls, and blind-pool risk. Portfolio resilience comes from combining exposures with different economic sensitivities, not from placing every "alternative" asset in a single defensive bucket.

How to build and manage portfolios in 2027

The return of meaningful bond yields has made the traditional balanced portfolio relevant again. A diversified mix of equities and high-quality bonds can provide a more credible combination of growth, income, and capital preservation than it could during the low-yield era. But 60/40 is a foundation, not a complete answer.

We believe investors should start with a diversified and regularly rebalanced core, align the bond allocation with its intended role, and then add completion assets selectively. The priority is to ensure that these functions are integrated across the total portfolio rather than managed as disconnected allocations, or to make sure each satellite has a defined purpose, an appropriate size, and a clear relationship to the core.

Finally, portfolio discipline matters as much as portfolio design. A 60/40 US equity-bond portfolio invested in 2020 would have drifted to approximately 80/20 if left

untouched, reflecting the stronger performance of equities. Regular rebalancing helps restore the intended risk profile, reduce unintended concentrations, and prevent recent outperformers from determining the portfolio's future behavior.

A resilient portfolio will not perform best in every possible environment. That is not its purpose. Its purpose is to avoid requiring one company, asset class, economic forecast, or geopolitical outcome to be right. Investors may not know today which scenario 2027 will deliver. They can nevertheless ensure their portfolios contain several credible ways to generate growth and income, alongside assets capable of shielding portfolios when the base case comes under threat.

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 and commonly known indices, House View scenarios, and analyst convictions over the next 12 months.
Absolute view
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. 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."
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.
Relative preferences
For the multi asset view, we also include relative preferences to help investors compare between items.
Preferred: We view this item more favorably than others within its asset class.*
In line: We see this item similarly to others within its asset class.*
Least preferred: We view this item less favorably than others within its asset class.*
*In the case of cross-asset, compared to other asset classes.
Note: 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.

Appendix

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