According to CIO, holding a well-diversified portfolio, including allocations to alternatives, remains the most effective way to manage short-term risks while growing long-term wealth. (UBS)

Navigating geopolitical risks with diversified portfolios

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Tensions in the Middle East remain elevated, with Israel striking multiple targets in southern Lebanon over the weekend after it assessed that an attack by Hezbollah was imminent. Hezbollah then launched missile and drone attacks toward Israel. Both Israel and Hezbollah indicated that operations were completed after the exchange of fire on Sunday.

The latest developments came at a tense moment for the region. After the assassinations of Hezbollah commander Shukr in Lebanon and Hamas's political leader Haniyeh in Teheran in late July, Iran and Hezbollah vowed retaliation, with Iran's Supreme Leader Ayatollah Ali Khamenei promising "harsh punishment." A precedent of direct attacks between Israel and Iran was set in April.

While previous statements by Israel and Iran seemed to indicate that neither side was inclined to let the conflict escalate further, they were also fully prepared to respond to any aggression. In an environment where all actors appear to feel inclined to retaliate, miscalculations may occur amid possible further attacks in the coming days and weeks.

For investors, we continue to advise against exiting risk assets in response to immediate geopolitical uncertainty, as selling is often counterproductive.

Market shocks from war and geopolitical crises have historically had only temporary effects on asset prices and long-term market growth. The effects of international conflicts on financial markets typically fade fast. Since the attack on Pearl Harbor in 1941, the S&P 500 has been higher two-thirds of the time 12 months after the start of a crisis. Half the time, markets have only taken a month to recover. In the case of the Israel-Hamas war, oil remains a key transmission mechanism from the conflict into global markets, and oil supply has not yet been affected.

Macroeconomic dynamics and secular growth trends will likely play a more important role for globally diversified portfolios. As we have seen this year, geopolitical worries may dent investor sentiment and contribute to broader risk-off market moves, but macroeconomic developments and structural growth stories could quickly take over. We continue to believe that the Federal Reserve's imminent policy easing is among the most important market drivers, while advances in artificial intelligence technology should drive growth in the years to come.

Panic-selling locks in otherwise temporary losses and hampers investors' ability to participate in the next market recovery. The market rewards patience. When one has a long investment time horizon, market losses are far rarer, and it becomes clearer that market volatility is an opportunity rather than a threat. Ultimately, time in the market, not timing the market, is what delivers the most powerful results.

So, we favor strategies to improve the resilience of portfolios and remain invested. In our view, holding a well-diversified portfolio, including allocations to alternatives, remains the most effective way to manage short-term risks while growing long-term wealth. We also recommend investors consider structured strategies for more defensive exposure, as well as gold, oil, and the Swiss franc as portfolio hedges.

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