While CIO continues to see a supportive backdrop for risk assets, they think having portfolio hedges is important for investors amid elevated uncertainty. (UBS)

Consider portfolio hedges amid macro uncertainty

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US equities have been inching toward their all-time highs ahead of the release of inflation data this week, with the S&P 500 Index just 0.6% away from its record high.

The consecutive gains over the past three weeks have come amid solid first-quarter earnings and softer economic data, which reignited hopes that the Federal Reserve will eventually start easing monetary policy this year.

However, with markets seemingly priced for perfection, any disappointment in the US inflation print is likely to lead to pullbacks that may be disproportionate to what the overall macro environment suggests. While we expect disinflation to resume in the coming months based on recent economic indicators, we also think investors can take action to protect their portfolios amid macro uncertainty.

Gold typically acts as a haven asset, while oil can help insulate portfolios from certain risks. Gold may face some headwinds if markets further scale back Fed rate-cut expectations, but we retain our bullish price forecast of USD 2,500/oz by year-end 2024 on robust central bank and investor demand. In addition to providing a measure of diversification and reducing overall volatility within a portfolio context, gold's utility as a geopolitical hedge has underpinned its price rise this year. Oil, in the meantime, should also serve as a portfolio hedge if attacks in the Middle East escalate further. We expect Brent crude to trade at USD 91/bbl over the coming months amid healthy demand and efforts by OPEC+ countries to keep the oil market in balance, and we advise investors with a high risk tolerance to sell the risk of Brent prices falling.

Hedge funds may help stabilize portfolio exposures and improve overall risk-adjusted performance for risk-tolerant investors. Hedge funds have historically exhibited an ability to capture tactical dislocations across sectors and asset classes to generate alpha, while still adhering Main contributors—Global economy, Equities, Markets—to strict risk limits. Indeed, certain hedge fund strategies have historically demonstrated their ability to benefit in periods of central bank monetary policy transitions. For investors willing and able to manage the risks associated with alternatives (e.g., illiquidity), we believe an allocation to hedge funds provides a source of uncorrelated returns that can help insulate portfolios from potential losses.

Structured investments can help investors gain exposure in a more defensive manner. The current environment of high interest rates and modest market-implied volatility presents an opportunity to use structured strategies to position for further equity upside while protecting against downside. For those looking to add more cautious exposure to markets, we also see opportunities in yield-generating and capital preservation strategies.

So, while we continue to see a supportive backdrop for risk assets, we think having portfolio hedges is important for investors amid elevated uncertainty.

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Non-Traditional Assets

Non-traditional asset classes are alternative investments that include hedge funds, private equity, 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.
- 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.