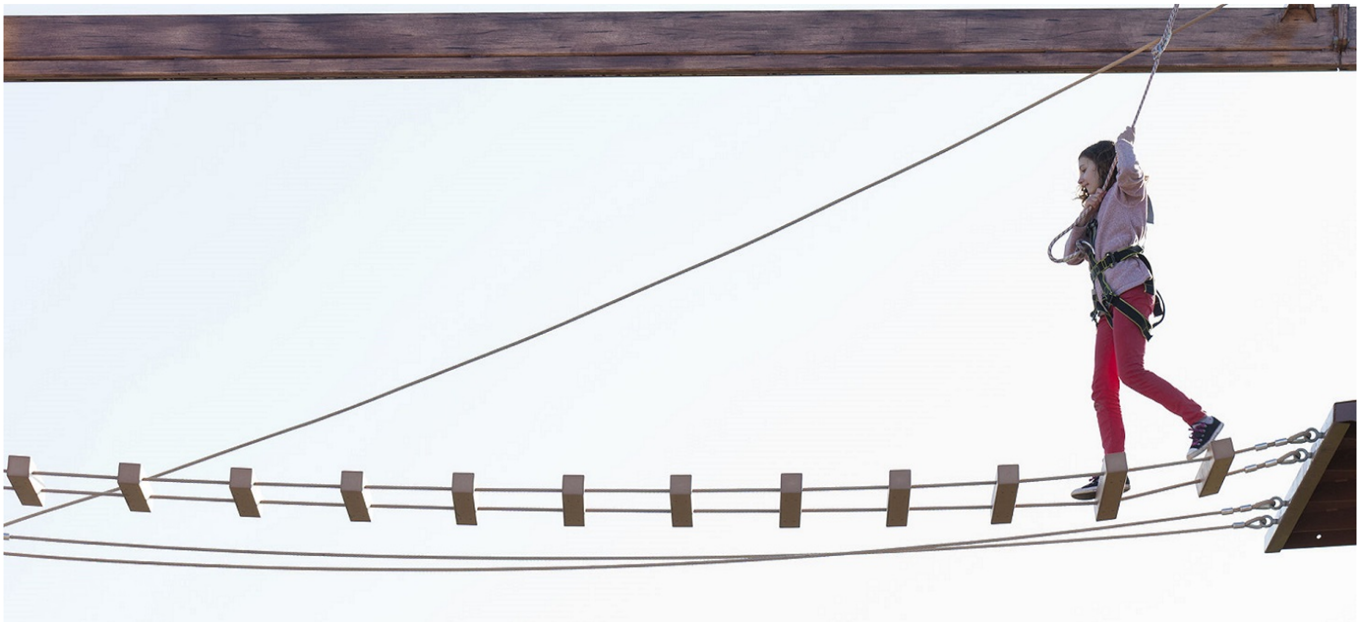

Over the longer term, CIO remains convinced that a diversified portfolio of equities, bonds, and alternatives is the best way for investors to balance growth and preservation. (UBS)

What are the merits of a balanced portfolio today?

15 January 2024, 1:37 pm CET, written by UBS Editorial Team

In the final two months of 2023, balanced portfolios of equities and bonds delivered one of the strongest two-month runs of performance in more than 30 years (comparable with the post-COVID and post-global financial crisis rallies).

CIO continues to believe that holding a core position in a balanced portfolio is the most effective way for investors to preserve and grow wealth over time.

What are the merits of a balanced portfolio today?

First, we continue to expect further downside for bond yields and upside for equity markets, and see upside over the next year for balanced portfolios in both our base case and upside scenarios. While parts of the US equity market are expensive, most global markets are not overpriced, in our view, and we expect earnings growth to be positive in all regions.

In our base case scenario, we expect a 60-40 portfolio of global equities and 10-year US Treasuries to potentially deliver a return of 8.1%. In an upside scenario, returns could rise to 10.7%. In a downside scenario, we would expect strong returns from bonds to partially offset equity market declines, potentially limiting portfolio downside to –3.4%.

Second, holding a disciplined and balanced allocation to a broad range of companies, sectors, and asset classes can facilitate steady upward progress, even as market narratives chop and change. By contrast, investors with concentrated exposure in individual asset classes are at risk of experiencing higher volatility, and investors trying to trade between asset classes are at risk of being “whipsawed.”

Third, the sharp fall in interest rate expectations in the past couple of months has made the potential reinvestment risk of holding too much cash very clear. With rates likely to fall in the next year, and potentially sharply, investors will need to find a way to get invested in longer-duration assets. But trying to time entry can be challenging. Balanced portfolios, and phased approaches to market entry, can help reduce market timing risk relative to trying to go "all in" either in equities or bonds.

Fourth, after a sharp rally in traditional equity and bond market indexes, the need for investors to earn alternative sources of return is greater. A balanced portfolio, including a mix of passive and active funds, and an allocation to alternative investments (including hedge funds, private markets funds, and risk parity) can enable investors to tap into a broader range of returns.

Fifth, amid sharp moves in equity and bond markets, and the potential for additional volatility in the months ahead as markets trade around potential scenarios, the potential for a disciplined rebalancing process to add to portfolio performance is greater. For example, Vanguard research estimates that rebalancing can add about 14bps to annualized returns (for a 60% stock, 40% bond portfolio), as well as reducing the portfolio's expected risk.

Finally, over the longer term, we remain convinced that a diversified portfolio of equities, bonds, and alternatives is the best way for investors to balance growth and preservation. In our capital market assumptions, using equilibrium return assumptions, we estimate that a portfolio of 45% stocks, 35% bonds, and 20% alternatives could deliver a return of around 5% in excess of cash annually over the longer term, with an annualized standard deviation of around 9%. That translates into an expected return of 2.7–4.3x versus cash over a 20–30-year timeframe.

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Read the original report : **Year Ahead 2024: Scenario update, 5 January 2024.**

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.