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A further hawkish shift in Fed expectations and increased transmission to US equities are lingering risks to US equities. (UBS)

How can I hedge market risks?

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Although market pricing of US Fed hikes has fallen of late, the S&P 500 is still near all-time highs. A fading of AI-related optimism and more hawkish Fed expectations are the most present threats to risk appetite.

The wars in Eastern Europe and the Middle East linger as serious background risks. While no hedge works for all risks, CIO sees various ways investors can reduce threats to their portfolios, including maintaining exposure to quality stocks, which tend to perform well across business cycles.

US equities still near record highs, but VIX is rising

- The S&P 500 is up 24.3% from 27 October and the VIX has risen to 14.8, albeit still below the four-month high of 15.9.
- The 10-year US yield has climbed back to 4.3%, though still well below the 16-year peak of 5% reached in late October 2023.
- Markets are now barely pricing in a first full 25bps rate cut for July.

Market complacency could exacerbate spikes in geopolitical risk.

- Market expectations for total Fed cuts this year have fallen to just under 75bps, fairly in line with what we expect but not reflected in equity pricing.
- The wars in Ukraine and between Israel and Hamas still hold the potential to trigger volatility spikes and further dips in risk appetite.
- The US presidential election is set to add uncertainty to both the US fiscal situation and geopolitical tensions, especially with China.

We recommend a range of strategies for investors seeking to smooth out returns.

- Structured strategies can be helpful when stocks fall. Macro hedge funds can navigate periods of economic and policy uncertainty.
- Oil would likely spike higher if the Israel-Hamas war escalates or broadens. And gold has proven its value as a portfolio hedge in recent months.
- Global quality stocks—those with strong, consistent earnings growth and low leverage—tend to perform well across business cycles.

Did you know ?

- The World Bank said the price of Brent could rise to more than USD 150 a barrel (versus around USD 85 presently) if the conflict in the Middle East escalates, echoing the economic shock of the 1970s when major producers reduced output.
- 2024 will be a record-breaking year for elections. More than two billion voters in 50 countries will head to the polls. This could contribute to choppy returns in particular countries, sectors, and industries.

Investment view

No single hedge protects investors against all risks, but a range of strategies can help mitigate volatility or drawdowns for portfolios. Investors looking to hedge against the risk of losses can make use of structured strategies with capital preservation features. Investors worried about the potential market impact of further escalation in the Israel-Hamas or Russia-Ukraine wars can consider hedging portfolios through oil market investments or energy stocks. We also think gold can provide a potentially effective portfolio hedge against rising geopolitical tensions

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