Investors should consider a wide range of hedges to help reduce the threat from periods of risk aversion and volatility. (UBS)

How can I hedge market risks?

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2024 is shaping up to be a positive year for diversified portfolios—and we expect positive returns across a range of asset classes. But an unusually wide range of risks could spoil the outlook—from wars in Eastern Europe and the Middle East to the increasingly dysfunctional US budget process.

While no hedge works for all risks, we see various ways investors can reduce threats to their portfolios, including adding oil, gold, and structured solutions with capital protection features.

The outlook for diversified portfolios in 2024 is positive, in our view.

- Our base case for 2024 is that inflation will fall back toward central bank targets, allowing rates to fall. The earnings recession in the US is also over, in our view.
- This should create a supportive backdrop for both stocks and bonds, making it a good time to add to multi-asset portfolios.

But a range of risks—both geopolitical and economic—have the potential to cause drawdowns and volatility.

- While inflation is declining, markets could be unsettled by any slowing of this process. Stocks are already priced for a positive outcome, with the S&P 500 up 19.7% so far in 2023.
- The war in Ukraine, and between Israel and Hamas, both have the potential to trigger volatility. The US presidential election also takes place against an increasingly dysfunctional budget process.

So, we recommend a range of strategies for investors seeking to smooth returns.

- Structured solutions can include capital preservation features, helpful in the event of periods of ebbing confidence. Macro hedge funds are well-placed to navigate periods of economic uncertainty and even falling markets.

- Oil would likely spike higher in the event of an escalation of the Israel-Hamas conflict. And gold has proven its value as a portfolio hedge since the conflict started.
- Investors concerned about widening US fiscal deficits could consider a steepening trade on the US government bond yield curve, buying 5-year Treasury bonds and selling 10-year ones (on a duration-adjusted basis).

Did you Know ?

- The World Bank said that the price of Brent could rise to more than USD 150 a barrel (versus around USD 83 at present) if the conflict in the Middle East escalates, echoing the economic shock of the 1970s when major producers reduced output. The warning came in the organization's quarterly Commodity Markets Outlook. The World Bank observed that food and energy markets were still being impacted by the war in Ukraine, and so would be especially vulnerable to a spreading conflict that drew in Middle East oil producers.

Investment view

Investors can consider a range of strategies that have the potential to mitigate volatility or drawdowns for portfolios. Investors looking to hedge against the risk of losses can make use of structured investments 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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