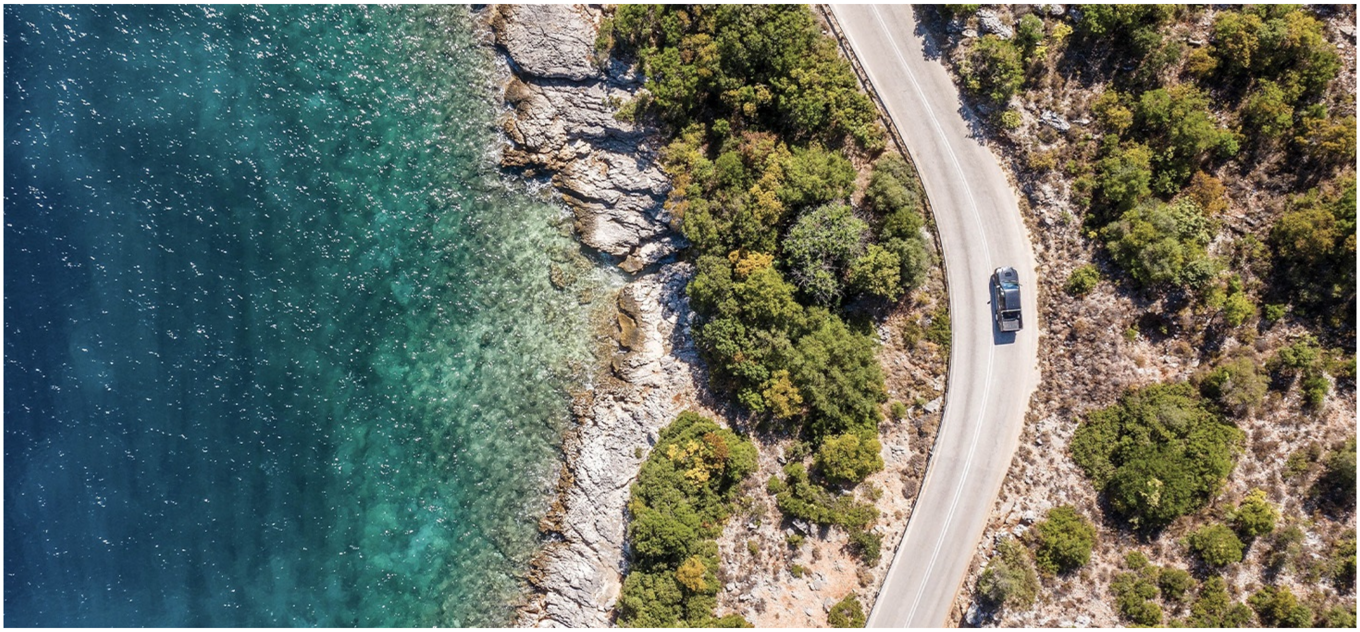

No single hedge protects investors against all risks, but a range of strategies can help mitigate volatility or drawdowns for portfolios. (UBS)

How can I hedge market risks?

08 February 2024, 4:23 pm CET, written by UBS Editorial Team

Markets—after a briefly shaky start to 2024—have appeared to regain their footing. Both bonds and equities have resumed their climb, with 10-year Treasury yields falling to 3.94% and the S&P 500 back at levels last seen in March 2022.

Excessive optimism over the timing and pace of Federal Reserve easing is perhaps the most serious near-term threat to confidence and risk appetite, in addition to the wars in Eastern Europe and the Middle East. While no hedge works for all risks, we see various ways investors can reduce threats to their portfolios, especially sticking to quality bonds, which are typically resilient across a range of market scenarios.

Equity and bond markets have resumed their climb amid dovish Fed expectations.

- The S&P 500 has rebounded 2% from 4 January, and 16% from 27 October as Fed expectations turned dovish.
- US 10-year yields are back to 3.94% from a 2024 peak of 4.04% and a 16-year peak of 5% in late October.
- Markets are now pricing more than 160bps of cuts in 2024, with a 75% chance of cuts starting as early as March. We expect cuts to only begin in May, and amount to 100bps.

Potential correction to Fed policy expectations could spur drawdowns and volatility.

- The US labor market and core inflation both remain resilient and suggest that expectations may need to correct.
- The wars between Russia and Ukraine and Israel and Hamas have the potential to trigger volatility spikes.
- The US presidential election takes place against an increasingly fraught fiscal situation.

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

- Structured strategies can be helpful when stocks fall. Macro hedge funds can navigate periods of economic uncertainty.

- Oil would likely spike higher if the Israel-Hamas war escalates. And gold has proven its value as a portfolio hedge in recent months.
- Despite yield volatility, we expect positive returns for quality bonds across a range of market scenarios in 2024.

Did you Know?

- The World Bank said that the price of Brent could rise to more than USD 150 a barrel (versus around USD 75–80 at present) 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 be heading 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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*Investors should understand the inherent risks of hedge funds, including illiquidity, lack of transparency, and use of leverage.