Our Recommendation

Pivoting in a Challenging Rate Environment and Bubbling Equity Market

Equity Bubble + Correlation Risk = The Case for Alternatives

In years past, the 60-40 portfolio may have been sufficient – where reasonably priced equities offered significant growth potential and bonds, meanwhile, acted as a portfolio stabilizer in periods of market volatility. Evidence is mounting for a needed shift.

Two reasons explain this shift. First, as we detail in our macro outlook, there is mounting evidence of a speculative bubble in equities. As such, the risk-reward for stocks in the short to medium term is skewed to the downside.

Second, we may have entered a period where stocks and bonds are becoming more positively correlated. Structurally higher inflation may put upward pressure on interest rates, leading to weaker fixed-income prices. Ballooning U.S. deficits and debt may exacerbate this trend.

The upshot is that bonds alone may no longer be as an effective haven when markets experience turbulence. Rather, it's possible that rising rates could be the cause behind equity weakness.

If bonds and equities continue to show positive correlation in the coming years, a new approach is needed to offset this risk.

Portfolio Positioning

In a world of constant change, a diversified portfolio 40/30/30 approach – 40% equities, 30% fixed income, and 30% alternatives – aims to provide greater certainty and adaptability.

In equities, we maintain a cautious risk stance, preserving flexibility to add exposure when market valuations or economic recovery signals warrant it. Given fully valued markets and slowing growth, we prioritize selectivity and agility.

In fixed income, we avoid index-based exposure, which offers a weaker risk-reward profile. Instead, we target front-end Canadian yield curve opportunities, where relative value is strongest. We avoid broad high-yield indices, opting for long-short credit strategies that manage credit risk while seeking alpha.

With inflation moderating – but still at risk of supply-side shocks, such as new tariffs or geopolitical disruptions – we prioritize strategies that could mitigate inflation risk. This reinforces the case for trend-following approaches that adapt to changing market conditions.

Asset Class Positioning

	FROM	TO
Shift from Core Bonds to Short-Duration Investment-Grade (IG) Credit	• Core bonds which face rising headwinds, with tight spreads, elevated duration risk, and yield curve steepening, making them less appealing in today's environment.	• Short-duration IG credit (3-5 years) which could offer attractive yields with reduced interest rate and credit risk. • This could serve as a smart cash alternative and "dry powder" for future opportunities, with low-cost ETFs providing efficient market access.
Shift from Long-Only Credit to Long/Short Hedged Credit	• Long-only credit, which faces challenges as tighter spreads and market complacency reduce opportunities, especially in U.S. index-linked credit and ETFs.	• Long-short hedged credit, which allows for greater flexibility, alpha generation, and mitigation from downside risk. • Focus on short-duration, high-quality coupon clippers and event-driven credit opportunities for lower volatility and enhanced returns.
Shift from Full Beta Equity Solutions to Long/Short Enhancer Solutions	• Full beta equity solutions, which offer broad market exposure but are more vulnerable to downturns, with limited downside risk mitigation.	• Long/short enhancer solutions that maintain core equity exposure while actively managing downside risk. • By incorporating long and short positions, these strategies could reduce volatility, limit drawdowns, and likely to deliver more consistent risk-adjusted returns.

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All figures provided are sourced from Bloomberg L.P. unless otherwise specified, and are based on data as at the dates indicated.

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