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# The role of Alternatives in a world of elevated valuations

January 2026



WS Global CIO Office

# The case for Alternatives

As we discuss in our cross-asset Outlook 2026 publication, speculation about an equity market bubble is increasing. While we believe there are key differences between the tech bubble of the late 1990s and the AI-led rally today, elevated valuations make the case for increased diversification even stronger.

The case for including Alternatives in a portfolio is twofold. First, there are structural, long-term benefits of adding them to portfolios to increase risk-adjusted returns. Second, there are cyclical reasons why this is even more important today.

## Structural

The case for diversifying across different asset classes is well-understood. In finance theory, diversification is often referred to as the only ‘free lunch’. This is inaccurate in terms of pure expected returns as diversification among traditional asset classes generally reduces theoretical expected returns compared with a 100% equity allocation. However, it does increase the expected return for the amount of risk being taken. This can have important impact of practical returns as it helps investors stay invested through the market cycle<sup>1</sup>.

However, once you expand the analysis to alternative assets, expected returns can increase with additional diversification, leading to a significant improvement in the expected return for the level of risk being taken.

This rationale is well-understood by institutional investors and sovereign wealth funds, which deploy capital aggressively into the Alternatives space. For instance, we have seen significant flow from Gulf sovereign wealth funds into the private market and AI space, supporting valuations and deal flows. Such flows continue to support alternative asset demand and valuations.

Fig. 1

## Adding Alternatives increases risk-adjusted returns

Foundation (traditional) and Foundation+ (including Alternatives) expected returns, volatility and risk-adjusted returns using our latest 5-year Capital Market Assumptions

Foundation	Moderate	Balanced	Aggressive
Expected return	5.7%	6.2%	6.6%
Volatility	7.7%	10.4%	13.3%
Risk-adjusted return	0.75	0.59	0.49
Foundation+	Moderate	Balanced	Aggressive
Expected return	6.5%	7.0%	7.4%
Volatility	8.2%	10.7%	13.0%
Risk-adjusted return	0.79	0.65	0.57

Source: Standard Chartered

## Why today?

The key premise of a 60:40 equity-bond portfolio is the correlation between equities and bonds, in particular government bonds, is negative – especially when equities fall. This means when equities fall, bonds rally, reducing the volatility of the portfolio, but the reality of the situation is more complex. If you look at the chart of the equity-bond correlation (Fig. 2), you can see that the correlation changes over time and is quite elevated today. As such, the benefits of adding bonds to a portfolio have been lower since the pandemic.

<sup>1</sup> As important as the theoretical returns is the behavioural dynamics element. Investors are generally risk averse, having a greater emotional reaction to losses rather than gains. This can lead to sub-optimal investment decisions. This means investors actual returns deviate significantly from the theoretical returns. Meanwhile, there is strong evidence that the narrower the exposure, the greater the underperformance is (see Morningstar’s ‘Mind the Gap’ report, which examines this in more detail).

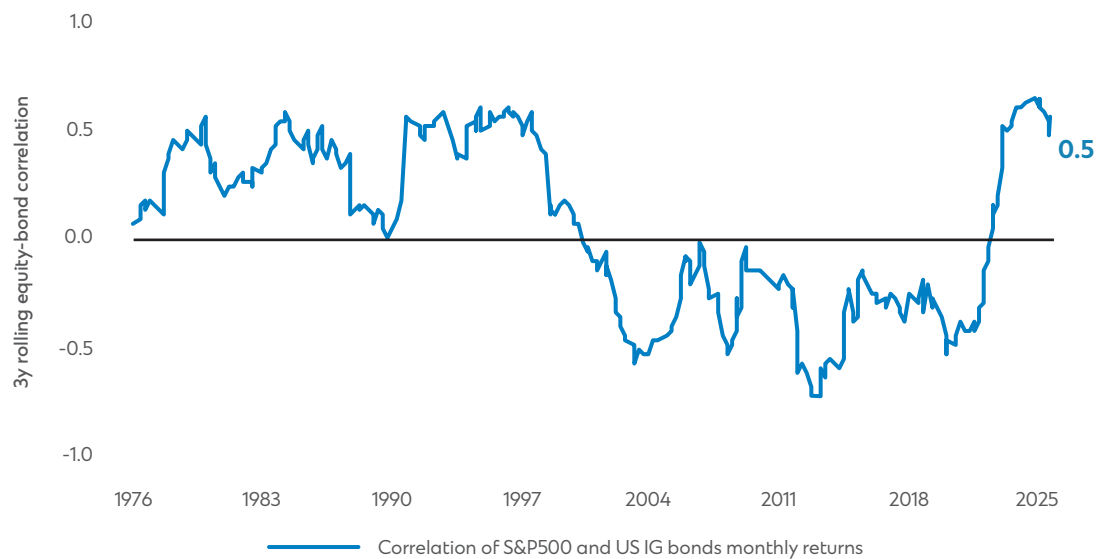
## Steve Brice

Global Chief Investment Officer

Fig. 2

## Elevated equity-bond correlation argues for even more diversification than normal

Rolling equity-bond correlation



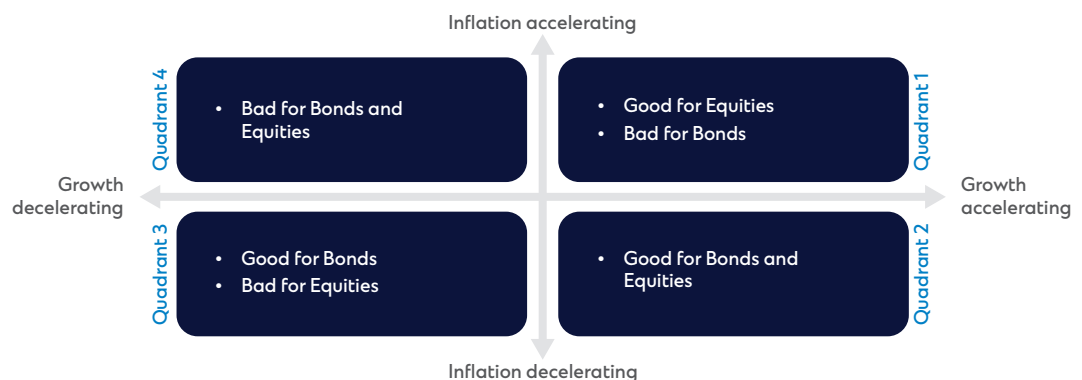
Source: Bloomberg, Standard Chartered

A simple stylistic two-by-two matrix of growth and inflation from an accelerating-decelerating perspective (Fig. 3) helps illustrate what market performance would be expected to be across different growth and inflation scenarios.

Fig. 3

## Which quadrant the US economy is in seems to fluctuate month to month

Stylistic view of bond and equity market performance in different macro regimes



Source: Standard Chartered

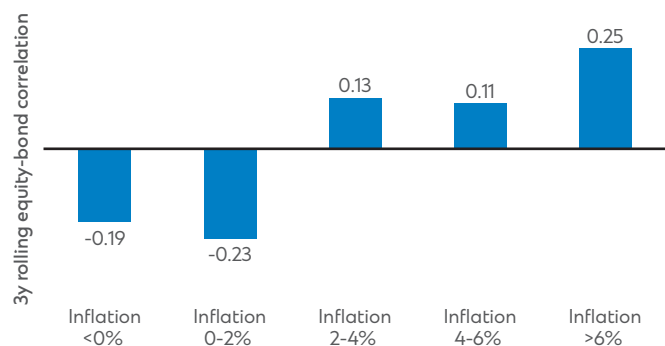
The caveat here is the real world is messier than this simplistic lens would suggest and is also dependent on the starting levels of growth and inflation. For instance, in quadrant 1, there is a big difference between growth and inflation both accelerating from 1% to 2% (healthy) and from 3% to 4% (overheating), but this relates largely to the likely monetary policy response and the potential transition to a different quadrant.

What is clear, though, is that at higher levels of US inflation, the correlation between equities and bonds is higher. For the 10 years following the 2008 Global Financial Crisis (GFC), the challenge for the US Federal Reserve was trying to support inflation to keep it close to 2%, ie, avoid deflation. Since COVID, the challenge has changed to trying to cap inflation against the backdrop of the COVID supply disruptions, Russia-Ukraine conflict, deglobalisation and the aggressive use of trade tariffs to rectify global imbalances.

Fig. 4

## Equity-bond correlation generally increases with inflation

Average equity-bond correlation by different inflation buckets

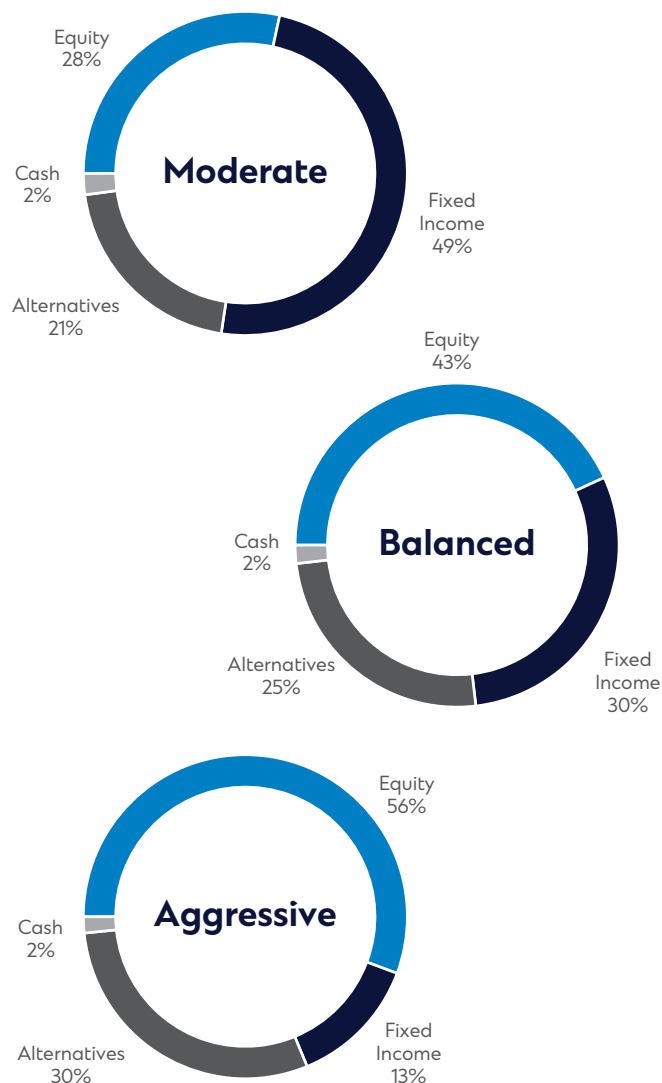


Source: Bloomberg, Standard Chartered

This means that a 60:40 equity bond portfolio might be less effective at managing portfolio volatility than it has been in the past. This just increases the incentive for investors to increase their allocation to non-traditional asset classes where possible. To us, this means up to a 30% allocation (including gold) to Alternatives across different risk profiles.

Fig. 5

## Level 1 asset allocation pie charts across different risk profiles



Source: Standard Chartered

From a definitional perspective, we consider four broad sub-asset classes in the Alternatives space:



### Private assets

Private equity, Private credit/debt and Private real assets



### Hedge fund strategies

including liquid Alternatives



### Gold



### Digital assets

In the rest of this report, we will cover each of these areas to cover why an allocation to these sub-asset classes makes sense and key considerations for investors given the current macroeconomic, geopolitical and market landscape.

# The outlook for Private Assets



## **Private credit – still offering relative value amid the negativity**

Private credit is probably one of the most contentious areas given different perspectives. There are two main concerns when it comes to private credit. The first is the lack of transparency. This is largely levelled at the asset class by regulators or those who are paid to worry about potential crises and instability. For instance, in its latest Global Financial Stability Report, the IMF notes that non-bank financial intermediaries' increasing size and involvement in the provision of funding to the economy could, due to their relationships with banks, be a source of vulnerability for the banking sector and the economy.

Ironically, the rise of private credit as an asset class is a direct result of increased regulation following the GFC. As one would expect, when banks were required to protect capital and liquidity ratios more rigorously after the GFC, the need for funding did not go away. Private credit was one of the major answers to this need.

Comparing now with then, while banks' leverage ratios were in some cases astronomical in the run-up to the GFC, this appears to be much less so in the private credit space today (although there are signs that it is edging higher). This means the contagion risk to the banking system should be relatively contained.

The words ‘appears to be’ are what regulators seem to be worried about when it comes to the stability of the financial system and, thus, the economy. Hence their call for more transparency and regulation of this sector of the economy before it gets to a more material size. Interestingly, the UK has launched a stress test to cover the private credit space, which many private asset managers have signed up for on a voluntary basis. This should lead to greater transparency in the months ahead.

The second concern is the dramatic inflows into the asset class could encourage asset managers to spend less time on due diligence and deploy more haphazardly. This is where the recent issues with certain large borrowers defaulting comes into play, leading to fears that there are more ‘cockroaches’ out there. We would not necessarily disagree with this risk.

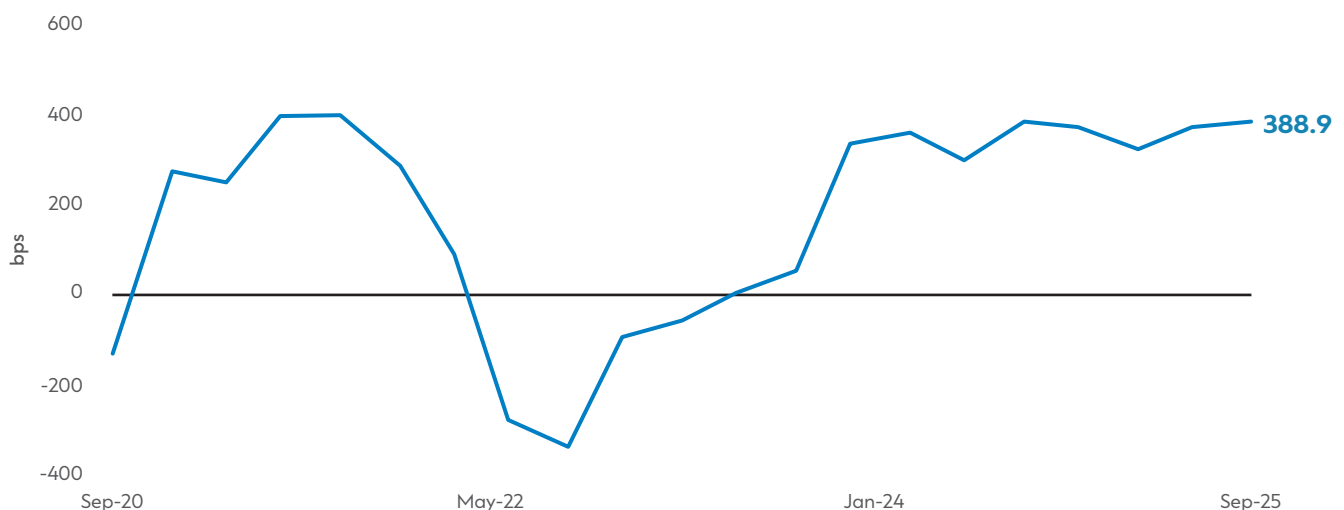
However, it is misplaced to lay this solely at the door of private credit for two reasons. First, these were not predominantly private credit deals, and the banks were generally the lenders that lost money.

Second, the question is not just whether credit quality has peaked, but also what is priced. In this regard, public credit markets have priced in a much more benign credit outlook than private credit. Therefore, while we have become more cautious on public credit markets in recent months, we believe that private credit is likely to be more resilient. This relatively benign view is backed up by the fact that credit defaults are well controlled, with interest coverage and the debt-EBITDA ratios actually improving.

Fig. 6

**Private credit remains relatively attractive compared to public credit, although implementing via a strong, first-tier manager is key**

Yield spread between Cliffwater Corporate Lending Fund (CCLFX) and US corporate high yield



Source: Bloomberg, Standard Chartered

Of course, the above backdrop does not suggest we should be gung-ho in private credit. Instead, we prefer to be cautiously optimistic in this space, preferring high-quality managers who get the first look at deals and, therefore, have a bigger opportunity set and can cherry-pick more.

When investing, it is also important to take into account the vintage of the underlying book. As the saying goes, ‘the worst of loans are made in the best of times’. We saw a dramatic acceleration of deals over 2020-21 before interest rates rose sharply. Among these vintages, there are clearly signs of stress with loan management exercises spiking, which are likely a precursor to increased defaults.

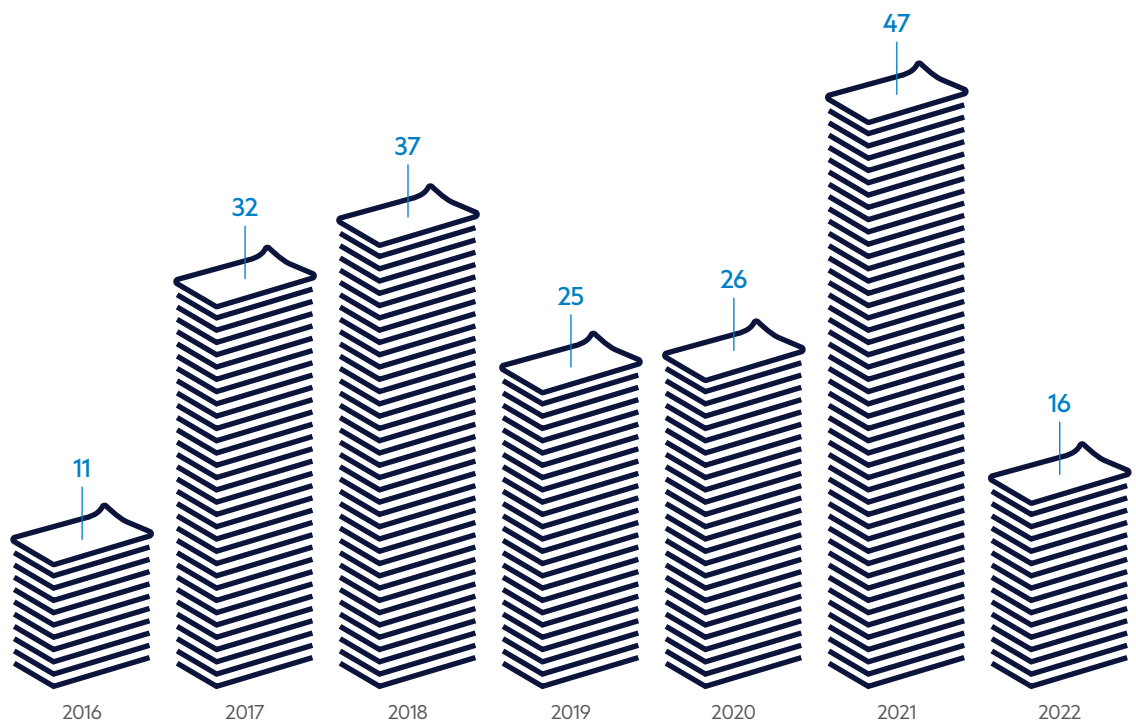
From a regional perspective, while much of the focus is on the US market, we believe Europe also offers attractive opportunities as private credit faces less competition from banks than in the US. Asset-backed lending is also growing strongly, spurred in part by huge demands for credit in the AI space. While this is a huge growth area, technology is obviously moving very quickly. Therefore, investors need to understand the asset manager’s approach to managing the risk that the underlying assets will become obsolete, undermining both the borrower’s ability to service the debt and the value of the collateral held.

In summary, we believe private credit remains relatively attractive compared to public credit, although implementing via a strong, first-tier manager is key.

Fig. 7

### 2022 clearly created a reset for private credit as companies adjusted to higher base rates

Number of amend and extend (A&E) loans by year of origination (by organisation in Europe)



Source: Pitchbook, Standard Chartered

## Private equity

The benefits of having private equity in a portfolio, especially from an expected returns and portfolio diversification perspective, are clear. Private equity adds value, purely on an expected return perspective. The trade-off here, of course, is that the holding period for private equity is much longer than for traditional investments. However, in our experience, investors generally have greater capability to take on illiquidity risk than their behaviours would suggest.

At least part of the diversification benefits come from the infrequent reporting of valuations. Meanwhile, valuations in the private equity world are as much of an art as they are a science. This means private equity 'marks' might lag reality, especially during a period of economic or market stress.

On balance, having an allocation to private equity should help boost portfolio returns for the same or even a lower level of volatility.

One key to successful investing in private equity, apart from selecting a good investment manager, is to identify the right vintages for different investments. In hindsight, the 2020-22 vintage was particularly challenging as the deals were initiated when financial conditions were extremely loose. This was then reset in 2022 when the US Federal Reserve realised the error of its 'transitory' inflation diagnosis and hiked interest rates dramatically.

Fast forward to today, we see the environment as more conducive. Monetary policies are being eased and tighter credit spreads are usually conducive for the asset class. Despite this, there are few signs of frothiness in the private equity space. Indeed, many private equity investors are liquidity constrained as the route from private equity to initial public offering (IPO) has been more limited than in previous cycles.



This is leading to a shift towards private equity continuation funds (secondaries), which buy assets from private equity managers and take them on the next stage of their growth journey. We believe this is a very interesting area to consider as an investor today as the initial owner of the assets is under significant pressure to return capital to investors. This means the secondaries' manager is in a good negotiation position when it comes to valuing the assets.

The main risk here comes from a re-opening of IPO markets. While there are limited signs of this happening in the near term, history shows that this can change very quickly. That said, while this would be bad for secondaries, in terms of potentially reducing its bargaining position, it would be good for the private equity asset class overall.

When it comes to investing in private equity, the usual advice applies – avoid excessive concentration in any given vintage, diversify across different investment styles and themes, and identify managers who have a good track record in delivering strong returns to investors and have demonstrable strong governance practices.

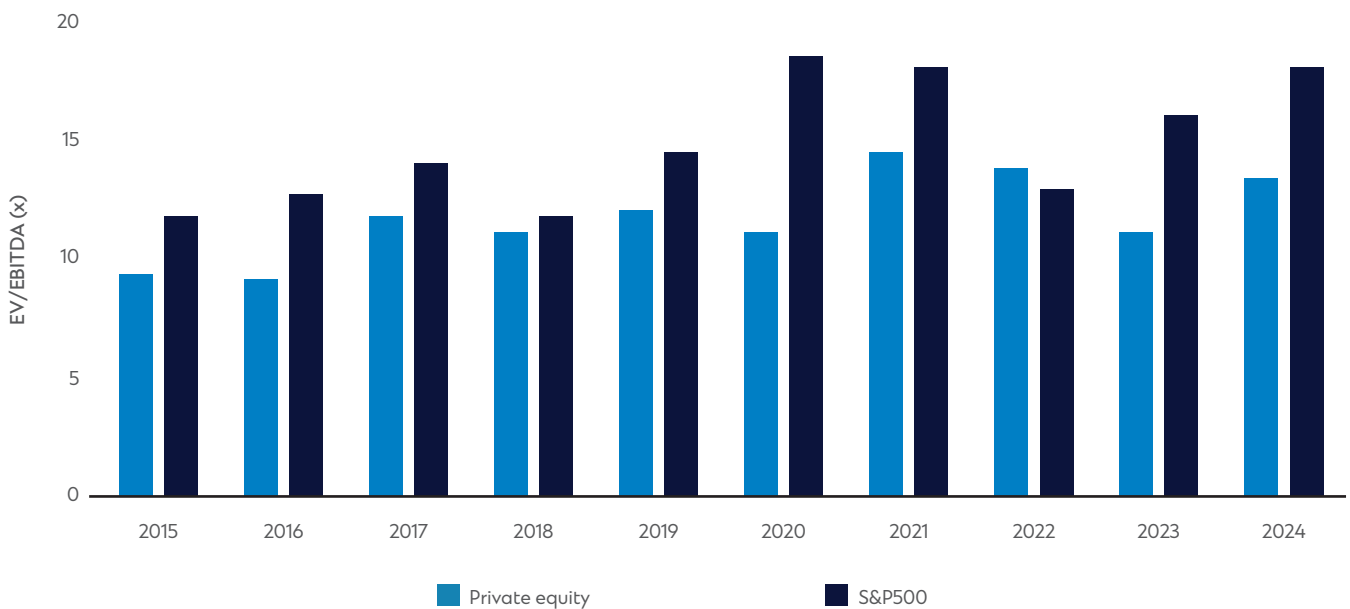
Of course, the ongoing 'new economy' boom is creating significant opportunities in the venture capital and private equity spaces. Areas we find particularly interesting include digital transformation, cloud software, energy transition and AI-enablement.

Naturally, there is a wide dispersion of returns – especially in the AI space – which means that identifying true expert asset managers is key to harnessing the opportunities on offer.

Fig. 8

### Private equity trades at a discount to public equity

EV/EBITDA multiples: Private equity vs S&P 500 index



Source: Evercore, Standard Chartered



## Private real assets

Private real assets are great inflation hedges. Both the income and capital values generally increase over the long term, albeit with cycles around this trend based on the interest rate and credit cycle, and the underlying demand-supply dynamics of the different areas. There are two key areas in the private real estate space, real estate and infrastructure.

**Real estate** as an overall asset class, both public and private markets, went through a torrid time after COVID as the real estate dynamics changed dramatically. The changing work-from-home, work-from-office dynamics and the sharp increase in interest rates in 2022 hit the asset class hard. However, we have seen this situation stabilise and improve over the past 12-18 months.

Looking forward, we see a continued improvement in the outlook for private real estate. We believe the US and global economy will avoid a recession, and monetary policies are still biased towards easing. The US Federal Reserve appears set to look through the rise in inflation and cut interest rates, while the outlook for a weak USD should give flexibility to other central banks around the world to counter the disinflationary impact of increased protectionism.

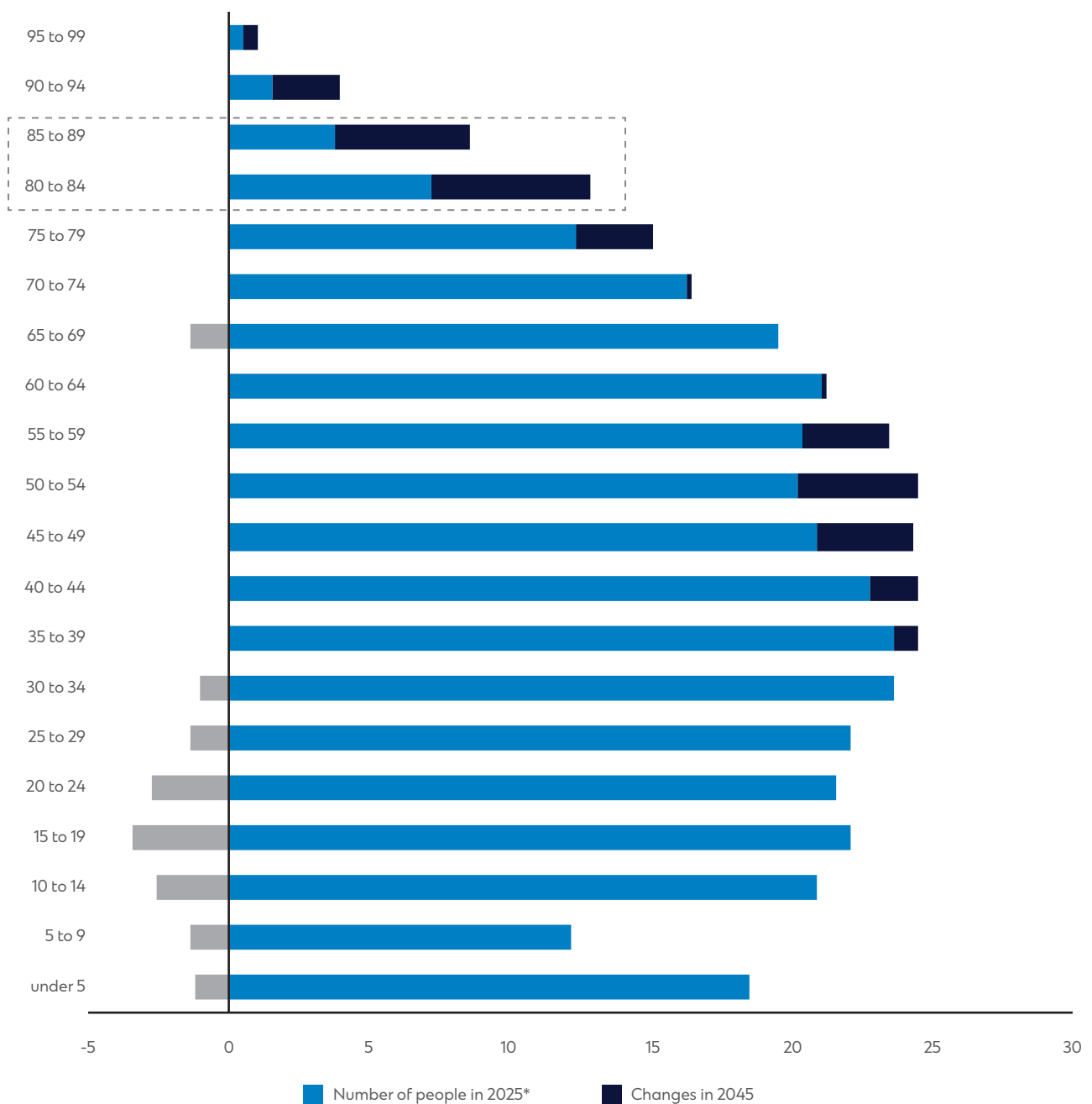
Monetary policy easing and tightening credit spreads should gradually free up the real estate market as it supports capitalisation rates.

Meanwhile, the US residential market should be supported by constrained supply as mortgage rates had surged in 2022. Senior housing is also an area with significant opportunities, but it involves significant regulatory and reputational risks. The structural demographic trends are obvious to all, but we have also seen a slowdown in supply growth, which is likely to lead to increased pricing power and the need for greater financing.

Fig. 9

## Ageing population creates opportunity in senior housing, but reputational/regulatory risks are high

Projected US demographic breakdown by age range



Source: US Census Bureau, Standard Chartered  
Note: \*number of people in millions

The world's **infrastructure** needs are immense. The McKinsey Global Institute estimates over USD 100trn of infrastructure investment is required by 2040. Areas of specific need includes power capacity given the rapid development of data centres, modernisation of the power grids in order to handle an increased reliance on renewable energy, improved water supplies in a world facing more extreme weather patterns and expanded and improved road and rail networks.

For investors, the key benefits of private infrastructure are stable, predictable and inflation-protected cash flows, a low correlation with equities and bonds and a lower volatility relative to public markets.

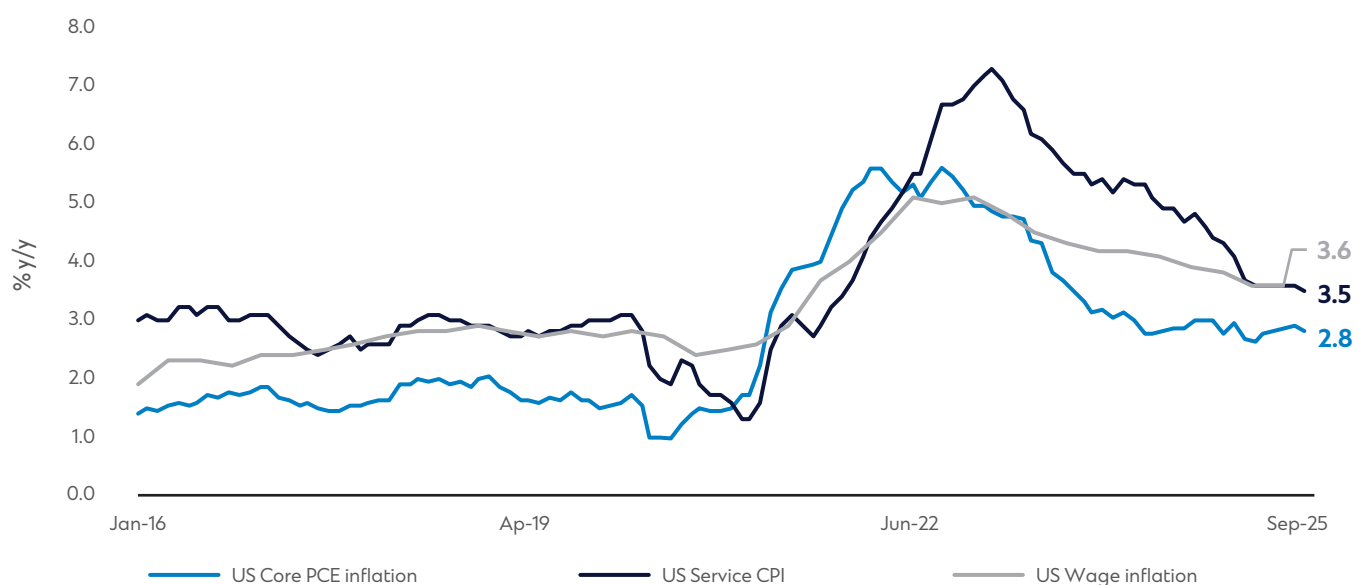
The outlook for inflation to remain relatively elevated is a positive backdrop for this sub-asset class. Moreover, the rise of AI investments, and the associated increase in data centres and energy demand, has increased the focus on the outlook for power demand. Indeed, for investors worried about the valuation of AI plays in equity markets, private infrastructure can offer a lower risk avenue to still benefit from the massive AI revolution via data centres, power, GPU partnerships and adjacent industries such as fibre connectivity and cooling solutions.

However, there are a lot of areas that are less attractive, but very interesting from a long-term investment perspective. These include waste, water and the circular economy. Meanwhile, the shock to supply chains from the changing geopolitical landscape will mean different transportation links will need to be formed across the world.

Fig. 10

## The new normal: Trying to cap inflation

Different US inflation measures



Source: Bloomberg, Standard Chartered

# Hedge fund strategies

We view hedge funds positively as they can serve as powerful diversifiers to traditional assets. However, it is important to note that within each hedge fund strategy, risk and return profiles can vary widely. Talent can significantly impact performance, leading to substantial deviations from the category's average.

## Global macro/CTA – a key insurance policy

### Description

Managers in this space go long and short across different asset classes, such as equity markets, bond markets, commodities and currencies. They have an absolute return objective and often employ significant leverage to achieve their targeted returns.

Therefore, global macro strategies can be a great diversifier in a long-only portfolio as they can also go short different asset classes. However, they generally perform poorly in environments where markets are either rangebound, generating false breakouts or in a temporary correction. For instance, in 2025, the diversification benefit from macro-CTA (vs. equities) has come from the lower volatility of the asset class rather than the correlation as the directional performance has been similar to equities through the year.

### Outlook

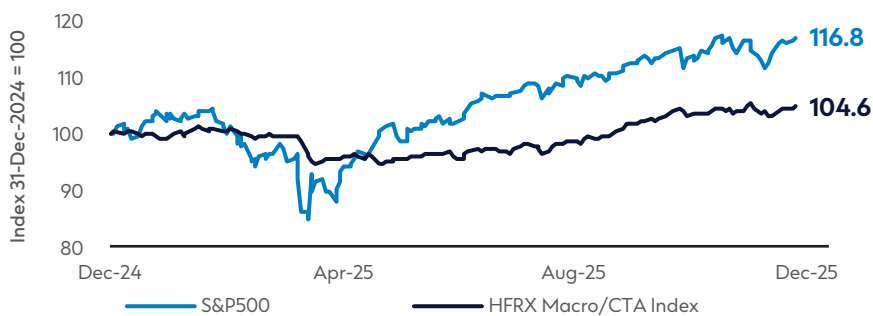
Based on historical analysis, there are three factors that are significant variables that can help explain the performance of global macro – commodities, Emerging Market (EM) equities (positive influence) and the US dollar (inverse relationship). Implied equity market volatility is also a significant variable, but its effect on performance can swing from positive to negative based on different macro environments.

Given our Overweight to EM assets overall and our expectation for a weak USD over the coming 12 months, one would expect us to really like this space. However, high valuations, together with erratic policymaking, make the risk of being whipsawed higher than normal.

Fig. 11

### SPX vs HFRX Macro/CTA in 2025

S&P 500 and HFRX Macro CTA Index



Source: Bloomberg, Standard Chartered

## Equity long-short – risk-adjusted returns

### Description

Hedge funds in this space look for pricing anomalies between different stocks, such as buying an undervalued stock and selling an overvalued stock.

### Drivers

At the overall asset class level, there is generally a strong correlation between the equity market and equity-long short strategies, but with lower volatility. The simple reason for this is very few managers in this space are truly market neutral. This means their performance relies both on beta – the performance of the stock market – and alpha – their ability to pick relative winners and losers.

In terms of alpha, the efficiency of the equity markets targeted is key. The US market is notoriously difficult to deliver sustainable alpha, for instance, whereas China and India have been alpha-rich target environments, in our experience. That said, the low correlation between sector performance in the US is a positive for equity long-short managers.

A second thing to note with this area is that the rise of meme stocks has required long-short managers to adjust the approach. That is because the fundamentals of a company are less important to meme stock investors, and this can drive significant outperformance of fundamentally weak stocks. Indeed, there is some evidence that online community identify stocks that are shorted by hedge funds in order to create a short squeeze and outsized upside moves.

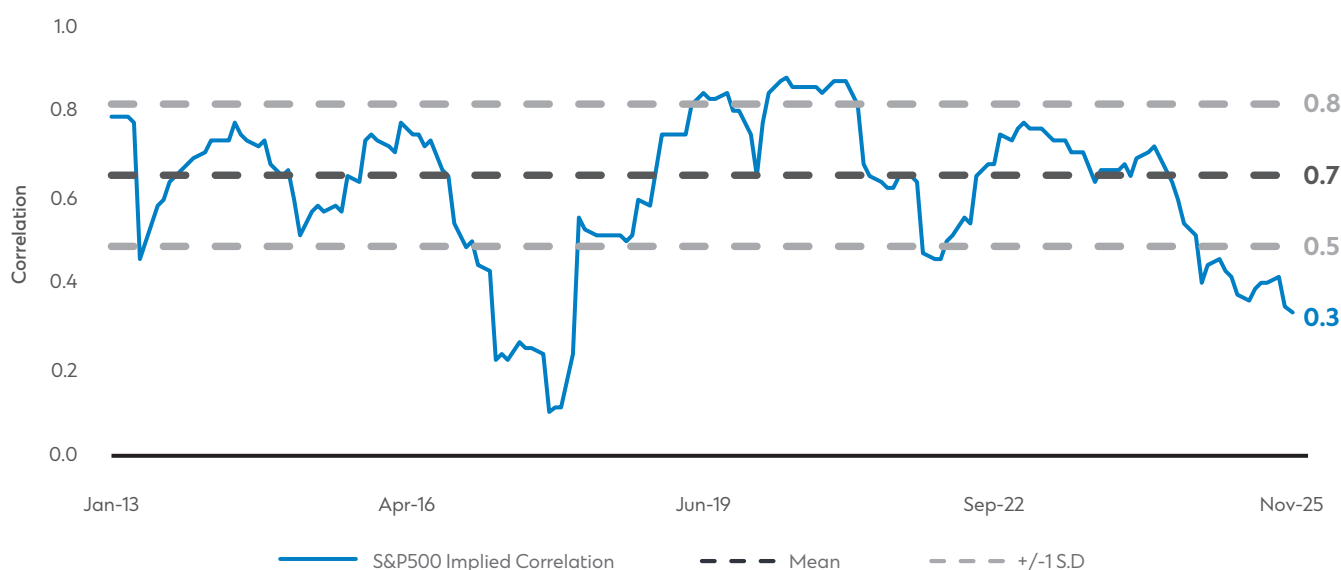
### Outlook

We remain Overweight equities in our Foundation portfolios, which is a positive for Equity long-short strategies. High valuations and valuation dispersion suggest managers should have opportunities to deliver both alpha and beta. Therefore, this is a space that we like for 2026.

Fig. 12

### Sector correlation is low, increasing the opportunity set for equity long-short managers

Average historical 12-month correlation across US sectors (monthly data)



Source: Bloomberg, Standard Chartered

## Event-driven – positioning for an increase in M&A activity

### Description

Managers in this space are focused on significant company developments. The most obvious example is a corporate merger or acquisition. A manager will assess the likelihood of the deal going through and then see whether the current market pricing reflects this probability. Another situation could be where there is a distressed company that presents an opportunity from either an equity or a debt perspective.

### Drivers

The key drivers here are positive equity market performance across a broad spectrum of sectors, reduced financing costs on the form of tightening credit spreads and a rising cross-asset correlation.

### Outlook

We remain positive on most equity markets and expect the stock market performance to broaden out to different sectors. Additionally, while we doubt that credit spreads will narrow materially from here, we are not expecting a blowout in spreads going forward. We also expect a rise in mergers and acquisitions (M&A) activity in the coming months as the pace of policy changes slows and deregulation helps boost activity. Pharma is one sector that is providing significant opportunities in this space. Therefore, we have a constructive view on the outlook for this strategy in 2026.

Fig. 13

A pick-up in M&A activity should be positive for event-driven strategies

Global M&A transactions



Source: Bloomberg, Standard Chartered

## Relative value

### Description

Relative value is similar to the equity long-short, but in public credit markets instead.

### Drivers

Therefore, relative value generally does well when credit spreads are narrowing and equity markets are rallying. Greater credit spread dispersion would also be positive for the strategy as it creates opportunities for managers to deliver alpha.

### Outlook

We are cautious on the outlook for public credit with spreads very tight relative to history. This means the cushion for any economic weakness or default mishaps is very limited. Meanwhile, this spread compression also means that spread dispersion is low. Overall, this leads us to be Underweight relative value within our Alternatives sleeve.

Fig. 14

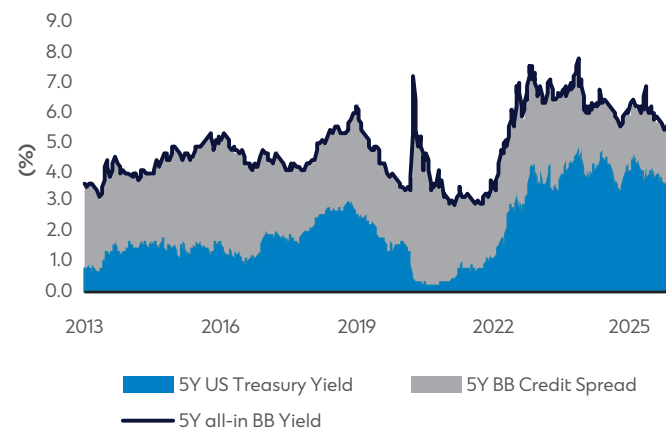
Tight spreads reduce the opportunity set for relative value managers

Investment grade cost of funding



Source: Bloomberg, Standard Chartered

High yield cost of funding



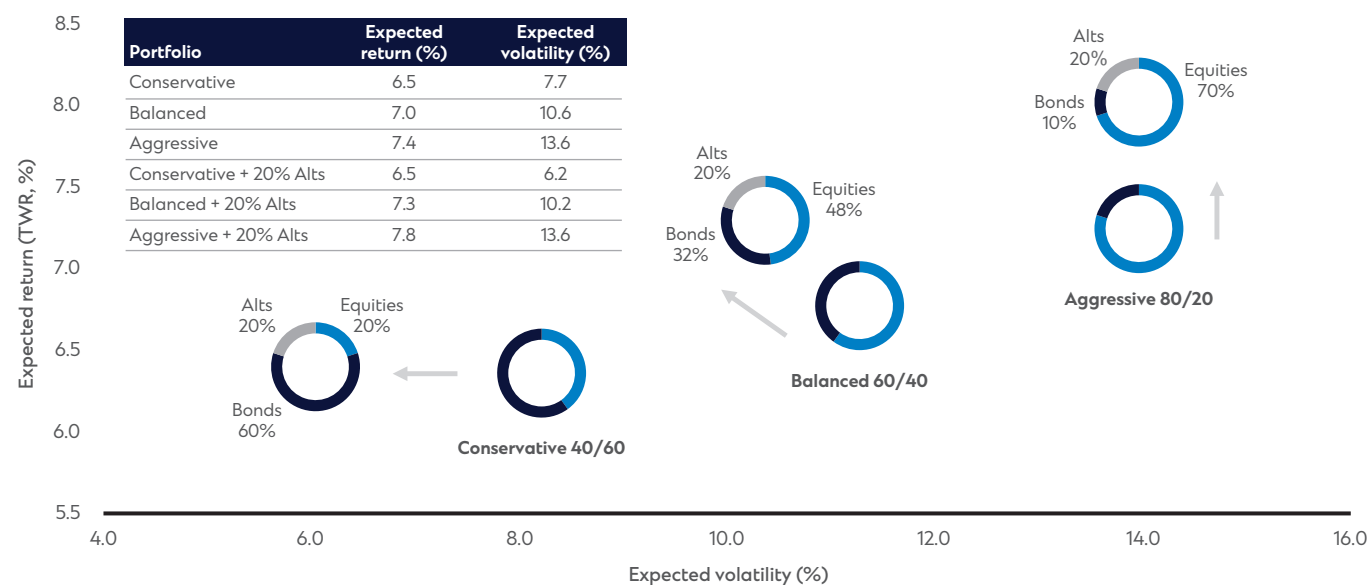
Source: Bloomberg, Standard Chartered



Fig. 15

## Alternatives can reduce risk and improve returns

Long-term capital market assumptions



Source: JP Morgan Asset Management (2024), Standard Chartered

Fig. 16

## Correlations between equities and different strategies

Returns, volatility and cross-asset correlations; monthly returns over 2013-2022

Asset Classes	Historical return	Historical volatility	US Equities	World (ex-US) Equities	MSCI World Small Cap	Emerging Markets Equities	Global Bonds	US TIPS	US High Yield	USD Cash	Digital Asset	Freight	Timber and Forestry	Frontier Equities	Distressed Opportunities	Wine	Catastrophe Bonds
US Equities	13.6%	15.7%	1.00														
World (ex-US) Equities	5.3%	14.9%	0.87	1.00													
MSCI World Small Cap	9.5%	17.8%	0.92	0.90	1.00												
Emerging Markets Equities	3.4%	16.5%	0.70	0.80	0.74	1.00											
Global Bonds	2.2%	3.2%	0.18	0.16	0.15	0.21	1.00										
US TIPS*	1.7%	4.5%	0.28	0.34	0.29	0.38	0.78	1.00									
US High Yield	3.9%	7.5%	0.76	0.80	0.83	0.73	0.37	0.47	1.00								
USD Cash	0.9%	0.2%	-0.08	-0.07	-0.11	-0.02	0.15	0.07	-0.03	1.00							
Digital Asset	294.2%	1150.2%	0.11	0.08	0.09	0.05	0.05	0.03	0.09	-0.05	1.00						
Freight	70.3%	179.1%	0.07	0.07	0.10	0.10	-0.08	0.02	0.07	-0.05	0.00	1.00					
Timber and Forestry	6.6%	20.8%	0.78	0.80	0.85	0.70	0.08	0.28	0.70	-0.12	0.05	0.02	1.00				
Frontier Equities	4.1%	16.8%	0.67	0.74	0.73	0.70	0.15	0.24	0.73	-0.11	0.11	0.07	0.58	1.00			
Distressed Opportunities	4.1%	5.8%	0.66	0.73	0.76	0.57	0.01	0.13	0.71	-0.17	0.13	0.07	0.59	0.68	1.00		
Wine	2.9%	4.6%	0.07	0.06	0.11	0.13	0.01	0.14	0.23	-0.12	-0.06	0.13	0.14	0.08	0.12	1.00	
Catastrophe Bonds	4.8%	3.1%	0.19	0.16	0.18	0.21	0.17	0.14	0.27	-0.13	0.05	0.01	0.21	0.18	0.20	0.15	1.00

Source: First Sentier Investors (2022), Bloomberg, Datastream, Standard Chartered. To be consistent across the historical data, we restrict data to the shortest history of the alternative assets, being a specific digital asset, which is from 28 February 2013 to 30 June 2022.

Past performance is not indicative of future performance. Historical returns are gross performance and do not take into account any fees.

Note: \*US Treasury Inflation Protected Securities

# Commodities



## **Gold – a hedge against monetary debasement**

When constructing our Foundation portfolios, the only commodity that we include in our asset allocation approach is gold. We see other commodities as being volatile and do not consistently contribute to better investment outcomes on a risk-adjusted basis through the economic cycle. Commodities are often either a super-charged bet on different economic or sectoral dynamics that can change abruptly, or subject to significant swings in supply. Therefore, non-gold commodity investments need to be managed very carefully, and, therefore are a neater fit into our opportunistic portfolio sleeve.

Gold, on the other hand, has proven to be beneficial from a portfolio construction perspective.

## 2026 outlook and our positioning

We remain constructive on the outlook for gold in 2026. There are many reasons for this optimism.

First, the decision to sanction the Central Bank of Russia has encouraged EM central banks to increase their allocation to gold. It is unclear what different central banks are targeting as a percentage of reserves. However, there are few signs that they have reached the destination yet with central bank purchases continuing and survey data suggesting they will continue to increase allocations in the future. This demand is not totally price-inelastic, but it does seem to provide a floor consistent with a rising trend for the gold price.

Second, rising public debt levels in the major economies are raising concerns that monetary authorities will lean less against inflationary pressures. This could lead a slightly faster pace of monetary debasement than in previous years. Assets that are seen as a hedge against this, such as real assets, equities and gold, are potential beneficiaries of this trend.

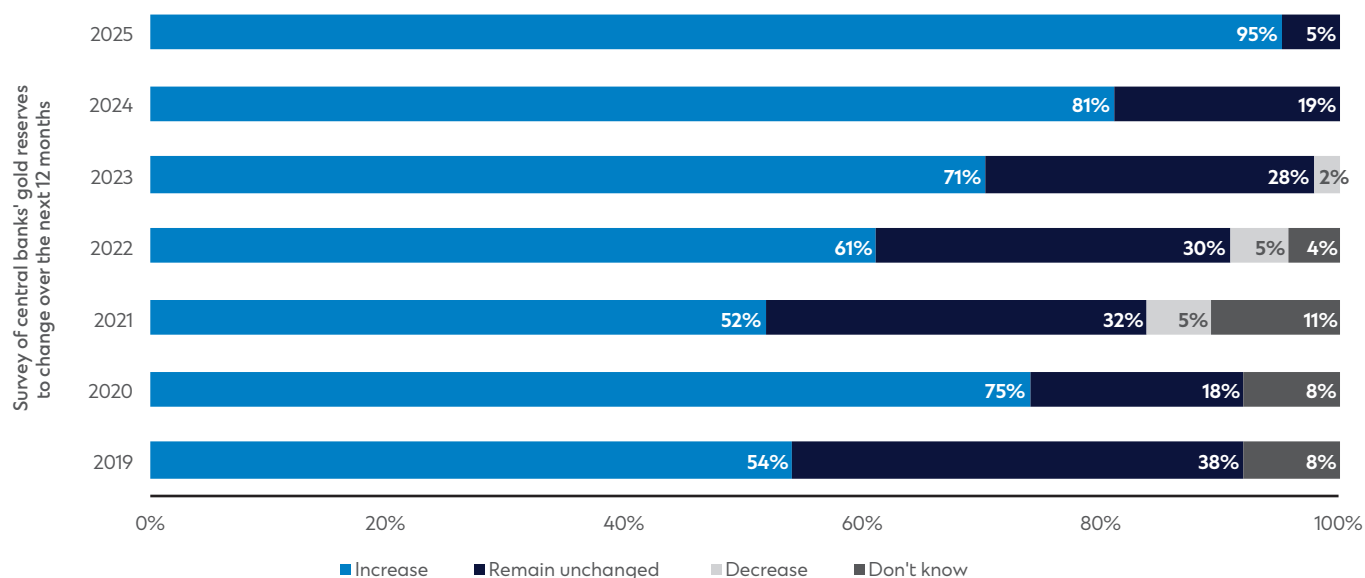
A corollary to the above is the fact that real interest rates are seen as being capped. This is a key input into most gold expected return models. As such, this should be another supportive factor for the gold outlook.

Against this backdrop, we enter 2026 with an Overweight allocation (5-7%) to gold in our portfolios.

Fig. 17

### Central banks still expected to increase gold holdings as a percentage of reserves

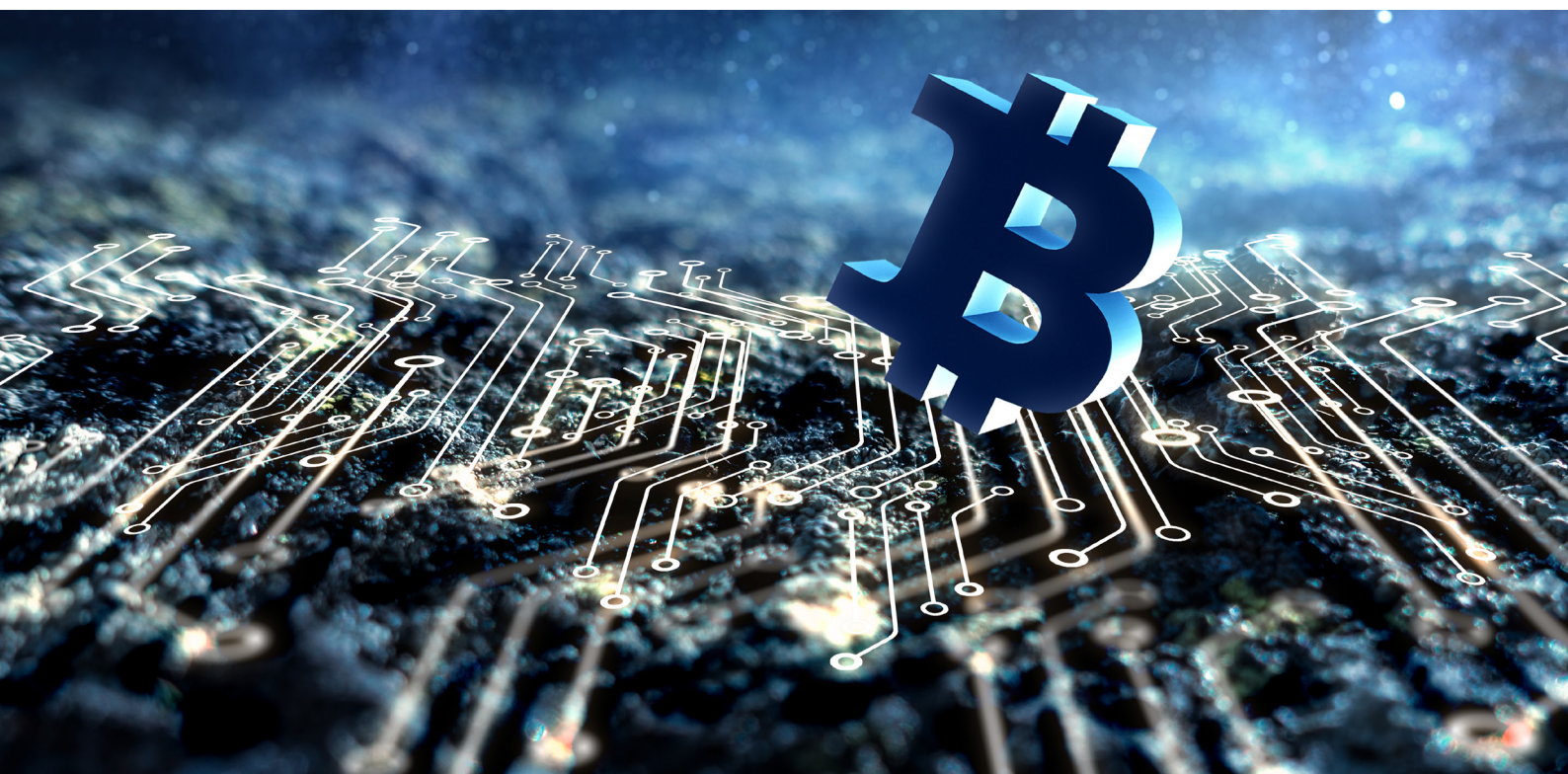
Central bank gold reserve intentions over the next 12 months



Source: World Gold Council, Standard Chartered

# Digital assets

We have added Digital Assets into our Strategic Asset Allocation (SAA) for 2026. This represents Digital Assets maturing as an asset class. Of course, there is still much uncertainty as to where the direction of travel is on a multi-year basis. However, we believe anybody hoping this asset class is just going to disappear is likely to be disappointed.



For now, we are focused on cryptocurrencies. The crypto space can be broken into two main areas – stablecoins and tokens. Stablecoins are likely to be revolutionary when it comes to the plumbing of the global financial system, but because they mimic a fiat currency, in themselves they are not interesting from purely an investment perspective (although the fact that the major stablecoins are USD-based could have implications for the USD and USD assets over time).

Tokens are potentially more interesting for investors. When deciding on the allocation to digital assets in our Foundation+ portfolios, we modelled different return, correlation and volatility assumptions. Our analysis shows a range of between 2% and 8% as the optimal allocation. We decided on the more cautious end of this range in our SAA but reserve the right to add to this allocation through opportunistic trade as and when opportunities present themselves.

## Disclosures

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