

The April Outlook

Market Stance

MANAGING MULTI-ASSET PORTFOLIOS IN A CRISIS

What is really relevant?

Commentary

- The main article summarises how the Saranac investment team has managed multi-asset portfolios in the current period of very high volatility
- There have been no changes in high-level asset-class positioning, as we regard market moves as dominated for now by uncertain military outcomes and political strategies
- We have rebalanced portfolios where possible to assets with improved valuations on the sell-off
- Portfolio diversification helped protect asset values on the equity market sell-off

Upshot

- Large changes in portfolio positioning are not warranted in a world of binary outcomes

THE GLOBAL ECONOMY

Impact of higher energy prices

Commentary

- The current oil price, if sustained, is consistent with a rise in inflation of around 0.75% in the major economies
- Central banks may regard this rise as a one-off event, and not raise interest rates if other inflation components remain subdued
- Economic risks would become more significant if higher oil prices persist well into the second half of the year

Upshot

- Higher oil prices could deliver a difficult period for the global economy, but a full recession appears unlikely unless oil prices spike again

SUMMARY OF ASSET CLASS MOVES SINCE THE CRISIS BROKE

The market feels volatile short-term, yet asset-class movements remain limited since the Middle East crisis

Commentary

- Global bond and equity returns are now slightly positive for the year to date
- The oil price and energy stocks have risen significantly, but the oil price is now well off its previous high
- The Vix index of volatility has risen sharply, but is no longer at very elevated levels

Upshot

- The major shock to energy prices has not been matched by sustained pressure on other asset classes: in stressed periods, price moves have been material but not disorderly

EQUITY MARKET THEMES

Exploring sub-plots in equity markets

Commentary

- There has been a notable shift in global equity market leadership this year, driven partly but not entirely by energy sector outperformance
- In mid-2025, the outperforming companies were US megacap stocks with high valuations, high volatility and strong earnings
- More recently, value stocks have on average performed, and lower volatility stocks have delivered better relative performance
- US equities have continued to underperform other markets

Upshot

- A wide range of themes remain evident in equity markets, beyond oil and equity beta

 The Long Read

Managing multi-asset portfolios in stressed markets

SNAPSHOT

Disciplined principles over reaction: In recent market volatility driven by Middle East tensions, Saranac has focused on diversification, valuation discipline, predefined triggers for action, and avoiding over trading or reactive market timing.

Clear objectives, limited market timing: Portfolios aim to beat cash, inflation and peers over the long term, not to avoid all short term losses. Aggressive derisking has been avoided due to poor visibility, timing risk, and already moderate equity exposure.

Diversification stabilises portfolios: A mix of derivative protection, fixed income, hedge funds, gold, and minimum volatility equities has helped cushion returns, with gold and hedge funds in particular validating their role as diversifiers so far this year.

Selective reallocation opportunities: Market stress has created opportunities mainly in fixed income (UK credit, mortgage backed securities, structured products), while equities have seen fewer relative value shifts. Triggers have been defined for future increases in gold or equity allocations if valuations become more attractive.

1. Some basic principles

The past few weeks have seen a much higher level of market volatility, generated largely by heightened Middle East tensions. The prices of some assets, including many equity markets, declined significantly at one stage. In this article, we set out how the Saranac investment team responsible for multi-asset portfolios manages client assets in these more volatile periods. There are four basic principles:

- We target adequate level of portfolio diversification, to have positions in place which 'kick-in' to provide protection in difficult market environments;
- We evaluate changes in the relative attraction of a range of assets, seeking to identify assets where price changes in volatile markets seem to have outpaced fundamentals;
- We set criteria for price levels where relative valuations may provide signals for more aggressive portfolio changes, should they emerge.
- A further key principle is not to 'over-trade' on the basis of low-quality information, or simply to follow market moves.

The application of the principles above allows us not to be pressured by circumstances to gravitate from a fundamentally-based investment operation to delivering low-quality market-timing decisions. Of course, having principles is one thing, applying them in specific circumstances is another. In this note, we set out their application in the volatile market circumstances of the past few weeks. We illustrate how we targeted the appropriate balance between having sufficient diversification that only some of the capital invested is exposed to capital losses. We outline also how portfolios were restructured in response to new opportunities which materialised as asset values changed. We also explain how discipline in decision-taking was maintained by defining clearly the criteria for portfolio changes, and not over-trading by reacting to 'noise' or to events after they have happened.

 The Long Read**2. Investment objective and market timing**

In volatile markets, it is important to have a clear idea of the investment objectives we target for clients. Saranac's main objectives common across portfolios are to provide returns above cash, inflation and the competition over the long term. We also seek to protect against short-lived but significant market corrections where feasible. However, unlike a hedge fund, we do not target the avoidance of any capital losses in the short term. Such a strategy necessitates high turnover and high costs.

More fundamentally, derisking on every potential market correction also necessitates a decision as to when to re-risk. These timing decisions are notoriously hard to add value on consistently. They involve a material risk of being out of the market not just when asset values decline, but also as and when they rebound. Even if there were to be a very material market correction from here, re-establishing equity positions close to the bottom is difficult: market troughs are only clear after the event. Market timing calls are all the harder to make successfully when volatility is being driven primarily by uncertain military outcomes and the volatile strategic intentions of the main protagonists.

We have no comparative advantage here – we are neither armchair generals nor political strategists – but neither do other investors. We need to understand plausible outturns, but until one particular course of events comes to seem more probable, we remain reluctant to take aggressive asset-allocation decisions in a low-visibility world. More generally, we believe that it is important to differentiate between conflict in the Middle East in general, and the specific impact on the oil price. Oil is the main transmission mechanism between the conflict and global financial markets. Ongoing tensions in the Middle East, as have been continually evident for some years, have a much more limited effect on global markets if the oil keeps flowing. Ongoing tensions by themselves do not dictate a very defensive investment stance.

To date, the view not to make significant asset allocation moves in the face of greater market volatility has not had material consequences for performance. Equity markets fell sharply, and then rebounded. For all the volatility, in local currency terms, global equities are at present around their level at the start of the year.

There are of course respectable arguments that the global economic environment could be impaired for some time even on a near-term sustainable de-escalation of hostilities. This could, in principle, warrant a more fundamental de-risking at some stage. However, the most obvious investment decision is not always the smartest. Markets may well 'look-through' a difficult macro environment for a period if an exit from it were clearly identifiable down the road.

A further reason not to change Saranac's overall investment stance at present reflects our positioning prior to the emergence of recent market stresses. If an aggressive risk-on stance, with an elevated equity weight, had been in place, it might have been appropriate to reduce this exposure. However, this was not our starting point. In fact, the equity weight in portfolios is somewhat below where we would expect it to be on average over time, reflecting extended valuations in parts of the markets, and a sluggish global economic cycle. We have not therefore felt pressurised from a performance perspective to reduce risk overall.

3. Diversification provides stability

In stressed market conditions, it is important to have a diversified portfolio, so that key components of a portfolio 'kick-in' and help to add or preserve value when other assets may struggle temporarily. The whole point of these components is that they kick in automatically and do not require immediate decisions in a fast-moving environment. In Saranac multi-asset portfolios, there are five elements which at present perform this role, and have been moderately effective in recent weeks in protecting returns.

 The Long Read

First, derivative protection strategies have been in place. We do not target a permanent hedging overlay, rather protection is implemented opportunistically on attractive pricing. While there were hedges in place in the first phase of market stresses, their contribution to portfolio returns was, on this occasion, only marginal. These hedges have now expired, and we find current pricing insufficiently attractive to replace them.

Second, the 'stagflationary' nature of higher energy prices (lower growth and higher inflation) means that fixed income and equity returns have recently been more closely related than usual. In March, the value of both portfolios fell. However, fixed income returns so far this year have been broadly flat. There have been concerns that a stagflationary environment, as in 2022, could lead to a much more severe correction in bond markets. However, the starting position for yields in 2022 was much lower than today, and the higher initial starting level for yields provides an important degree of protection unavailable four years ago.

Third, the hedge fund exposure in multi-asset portfolios is designed to be broadly insensitive to bond and equity market returns. The expectation is not that it will go up in value significantly on a market correction. We do not view it as a 'tail-risk' hedge, rather that it will 'grind out' returns across a range of different market environments. This expectation has been met so far this year. Performance has been broadly flat since end-February, but the hedge fund portfolio has delivered a higher return than either fixed income or equities so far this year, and is continuing to deliver a return close to the cash plus 3% per annum objective.

Fourth, the gold allocation in multi-asset portfolios was increased significantly a couple of years ago, as a hedge against stagflationary risks. Following a substantial price rise earlier in the year, there has since been a significant correction. This is not unusual as an immediate reaction to equity market weakness, and a rebound has been underway more recently. We trimmed the gold allocation at much

higher levels earlier in the year and have since left the allocation untouched. The return of some 10% since the start of the year validates its role as a diversifier in the portfolio, the recent correction notwithstanding.

Fifth, in the equity allocation in multi-asset portfolios, an allocation to 'minimum volatility' equities is in place to provide additional diversification in the equity portfolio. The key aspect of this approach is that it has more exposure to companies with less cyclical earnings, and can deliver not only good returns in a 'normal' phase of a cycle, and very strong relative returns in a downturn. This was strongly accretive to equity market performance on the broader market correction.

4. Reacting to new opportunities

A further feature of Saranac's portfolio management in stressed market periods is to identify actual or prospective changes in security prices within asset classes which could warrant reallocations in capital. The recent focus here has been in fixed income, where higher yields have prompted increased allocations to UK credit, particularly at short maturities, and mortgage-backed securities. In addition, the much higher level of implied volatility has made some structured products more attractive, and we have raised exposure in this area.

Interestingly, there have been fewer opportunities for capital reallocation within equities. Energy equities have risen substantially, but at the sector level the falls in prices have been broadly equivalent, implying little change in relative values. Since the uncertainties about the future oil price map onto the same uncertainties about relative equity market performance, the energy/non-allocation has not been changed.

It is also important to identify asset price levels which could be triggers for potential portfolio changes in the event of a more aggressive risk-off phase in markets, and the pricing of some assets

 The Long Read

appeared more than to reflect a difficult environment. These triggers include a higher allocation to gold on renewed price weakness. More fundamentally, we acknowledge that there are circumstances in which equity markets could weaken more significantly. We would look on this as a more strategic opportunity to rebuild the equity exposure to a more normal level, if at some stage equity valuations were suggestive of more significant long-term returns.

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