Rethinking traditional portfolios:

The power of alternative investments

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HSBC Asset Management | Opening up a world of opportunity

Key takeaways

- Alternatives can potentially improve diversification, offer strong risk-adjusted returns, and provide exposure to sources of new value creation.
- Alternatives are no longer exclusive. Regulatory changes and digital platforms now grant eligible private wealth investors access to alternatives with lower minimum investments and partial liquidity.
- Investors should evaluate risk, liquidity needs, and manager expertise to build resilient portfolios, leveraging alternatives for growth and inflation protection.

Background

Investors have long considered a balanced portfolio of equities and bonds a cornerstone of prudent investing. The '60/40' portfolio promised growth from equities in good times, while bonds provide income and protection if markets turn volatile.

In recent years, this relationship has been upended. Since the COVID pandemic, inflation, interest rates, geopolitical tensions, and seismic technological progress have changed how assets behave. After the pandemic, global equities and bonds fell in tandem, leaving many investors to question the value of traditional diversification strategies.

In 2025, the safe-haven assets of the US dollar and US Treasuries have confounded expectations and shown weakness amid US tariff-related uncertainty. The result is that the modern investment landscape requires a broader toolkit, and alternative assets may play an increasingly important role in investor portfolios.

An evolving investment landscape

The macroeconomic environment has changed dramatically since 2022. After a decade of near-zero interest rates and abundant liquidity, investors now face higher inflation, greater geopolitical and policy uncertainty, and slowing global growth.

Equity valuations have reached record highs and while bond yields have increased, they're struggling to outpace inflation in real terms. All the while, megatrends like the rise of AI and the energy transition are creating new investment frontiers.

Private capital has emerged as a driving force behind many of these megatrends, funding the next generation of technology, healthcare, and infrastructure companies. Some of these companies – like OpenAI, SpaceX, and Stripe – are transforming the world. OpenAI sparked the AI revolution with the release of its ChatGPT large language model in 2022, and it remains a private company.

Investors can gain exposure to these themes through public markets, but increasingly it is private companies that are at the cutting edge. Indeed, public equity markets are capturing a shrinking share of global economic activity. Since 2000, the number of US-listed companies has halved, while the number of private venture capital-backed companies has risen 25 times [1]. Companies are also remaining private for longer [2], meaning that much of the value creation happens before a public listing.

These trends present an attractive opportunity set for private market investors to access fast-growing companies, including the sector specialists and upcoming technology platforms that are often absent from public market indices.

1 'Unicorns, Decacorns and Hectocorns: The Private Companies Primer', BofA Securities, Oct 2025

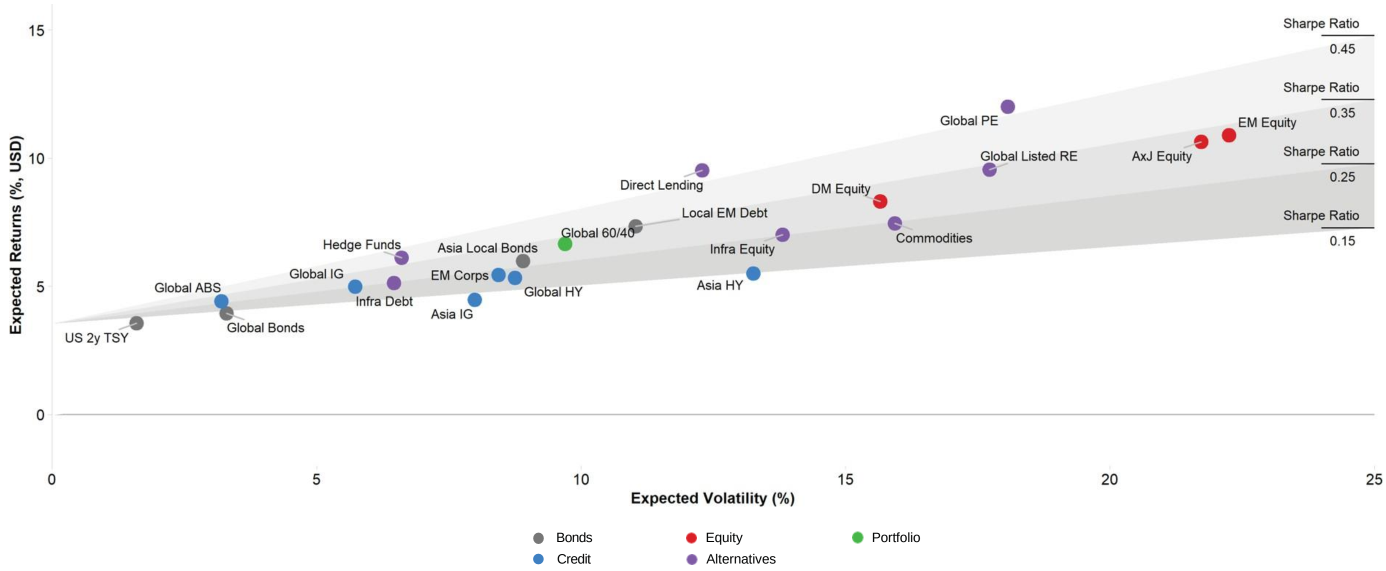
2 'The Rise of Unicorns', Morningstar, Jan 2025

Exploring alternative strategies

Alternative investments encompass investment in private assets (like private equity), or investment in publicly traded assets in non-traditional ways (such as through hedge funds). These investments can complement a portfolio of traditional assets by offering the potential for strong risk-adjusted returns, enhanced diversification, and access to sources of new value creation.

The chart below shows HSBC Asset Management's long-run expected return assumptions for various asset classes. Several alternative asset classes perform well on a risk-adjusted basis, including global private equity, direct lending (a form of private credit) and hedge funds.

HSBC AM long-term capital market assumptions [3]



Source: HSBC Asset Management as at August 2025.

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- **Private equity** is where a manager raise capital from investors to acquire and manage private companies or to take public companies private, with the goal of selling them for at a higher valuation. Managers work closely with companies to generate value over several years through methods including driving operational improvements, creating new revenue drivers, and making strategic acquisitions. Private equity managers have access to a large set of undervalued but innovative companies and the freedom to transform them. Given these benefits, global private equity funds have been shown to outperform listed equities over the long term [4].

3 Our expected return models are long horizon valuation models, derived from market indices. We use a building block approach, beginning with the cash rate, and adding respective risk premia for each asset class. For alternatives, we aim to align with how we build our public market expected returns, by making appropriate adjustments to represent the specific characteristics of each asset class:

- Hedge funds are modelled as strategies with exposure to market and specialist betas.
- Private equity internal rates of return (IRRs) are forecasted and combined with deployment/distribution assumptions.
- Direct lending return expectations follow our credit approach and assumed to be held on a hold-to-maturity basis.
- Listed real assets are modelled using an equity approach. Unlisted real assets are assumed to be held on a hold-to-maturity basis (debt) and using specialised data (equity).
- Commodity future returns reflect margin, roll yields, and spot moves

4 'Tracking Private Equity: Closing the Performance Gap', MSCI (2025) Tracking Private Equity: Closing the Performance Gap | MSCI.

- **Private credit** has emerged as a compelling alternative to traditional fixed income. In a higher-rate environment, direct lending funds (which provide loans to mid-sized private companies) can offer investors attractive equity-like yields, often with floating rates that protect against inflation. Loans are senior secured, providing downside protection and backed by strong collateral. These multiple benefits explain why investors have been drawn to private credit, seeing the market growing rapidly as banks retreat from middle-market lending.
- **Real assets** can offer investors several benefits. Infrastructure offers stable, predictable cashflows, hedged to inflation, arising from the essential – and often contracted – nature of these assets. Infrastructure investments are also aligned to key growth themes, such as renewable energy generation, which is essential for climate mitigation and a successful energy transition. Like infrastructure, real estate is an effective diversifier in a portfolio of stocks and bonds, offering access to contractual income streams from rents and capital appreciation largely tied to local, idiosyncratic factors. The tangible nature of real estate means it is less subject to the short-term sentiment that affects stocks and bonds. Real estate is also an effective inflation hedge, as rents usually rise in line with inflation.
- **Hedge funds** have also evolved, offering strategies with the potential for both outsized returns and diversification, particularly useful in volatile markets. Active hedge fund strategies like global macro and long/short equity can benefit from dispersion across assets, interest rates, and regions, to generate returns that are uncorrelated with traditional markets.

Widening access to private markets

Historically, alternatives were only available to large institutional investors. Minimum commitments were high, liquidity was limited, and access to top managers was restricted. Today, regulatory changes across the UK, Europe, and Asia, as well as the introduction of new investment structures, are making alternatives increasingly accessible and investable for sophisticated retail investors.

Open-ended funds, also called 'evergreen' vehicles, allow investors access to diversified portfolios of private assets with lower investment minimums (thousands, rather than millions), simplified reporting, and periodic liquidity. The rise of digital platforms is improving transparency, allowing investors to review fund performance, compare strategies, and understand underlying holdings more easily than before.

We welcome this 'democratisation' of alternatives, which will appeal to certain investors with liquidity and growth objectives. However, investors should conduct their own research and/or consult advisors before considering these investments.

Building smart, resilient portfolios

The complex interplay between macroeconomics, geopolitics, and megatrends presents challenges – but also opportunities. By selectively incorporating alternative investments, investors can build portfolios that are resilient, diversified, and better positioned to leverage uncertainty, innovation, and disruption.

Just as with public markets investing, understanding your risk tolerance and liquidity needs is essential. Overall, alternative investments are riskier and less liquid than public market investments.

Manager selection is also particularly important in alternatives, given the wide dispersion of returns between top- and bottom-performing managers. Investors should focus on managers with proven expertise and track records, disciplined underwriting practices, and strong governance. Working with an experienced advisor can help ensure alignment with your financial goals and risk appetite.

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Key risks

- **Alternatives risk:** There are additional risks associated with specific alternative investments within the portfolios; these investments may be less readily reliable than others and it may therefore be difficult to sell in a timely manner at a reasonable price or to obtain reliable information about their value; there may also be greater potential for significant price movements.
- **Equity risk:** Portfolios that invest in securities listed on a stock exchange or market could be affected by general changes in the stock market. The value of investments can go down as well as up due to equity markets movements.
- **Interest rate risk:** As interest rates rise debt securities will fall in value. The value of debt is inversely proportional to interest rate movements.
- **Counterparty risk:** The possibility that the counterparty to a transaction may be unwilling or unable to meet its obligations.
- **Derivatives risk:** Derivatives can behave unexpectedly. The pricing and volatility of many derivatives may diverge from strictly reflecting the pricing or volatility of their underlying reference(s), instrument or asset.
- **Emerging markets risk:** Emerging markets are less established, and often more volatile, than developed markets and involve higher risks, particularly market, liquidity and currency risks.
- **Exchange rate risk:** Changes in currency exchange rates could reduce or increase investment gains or investment losses, in some cases significantly.
- **Investment leverage risk:** Investment leverage occurs when the economic exposure is greater than the amount invested, such as when derivatives are used. A Fund that employs leverage may experience greater gains and/or losses due to the amplification effect from a movement in the price of the reference source.
- **Liquidity risk:** Liquidity risk is the risk that a Fund may encounter difficulties meeting its obligations in respect of financial liabilities that are settled by delivering cash or other financial assets, thereby compromising existing or remaining investors.
- **Operational risk:** Operational risks may subject the Fund to errors affecting transactions, valuation, accounting, and financial reporting, among other things.
- **Style risk:** Different investment styles typically go in and out of favour depending on market conditions and investor sentiment.
- **Model risk:** Model risk occurs when a financial model used in the portfolio management or valuation processes does not perform the tasks or capture the risks it was designed to. It is considered a subset of operational risk, as model risk mostly affects the portfolio that uses the model.

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