

Daily: Strengthen portfolio defenses as volatility rises

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Thought of the day

Market volatility has increased over the past week as investors weigh questions about AI profitability in a higher-rate environment, while geopolitical conflicts remain unresolved. Brent crude oil was up 0.9% to nearly USD 110/bbl at the time of writing.

With the third-quarter earnings season now in full swing, further volatility is likely. Markets will be assessing hyperscalers' ability to generate returns on their substantial AI investment, the financing and execution risks associated with the AI buildout, and whether higher interest rates are weighing on business activity and consumer spending.

We still expect a robust reporting season, with AI-related growth helping drive overall S&P 500 earnings growth of 28%. But increasingly concentrated market performance and the potential for stock-specific volatility reinforce the importance of portfolio resilience. We see ways investors can further diversify their sources of return and strengthen portfolio defenses.

Structured strategies can tailor equity exposure to different market outcomes. Investors concerned about a correction but keen to retain equity exposure can consider put warrants, which may help limit losses on stocks they already own. For those looking to add exposure cautiously, capital preservation strategies can provide participation in a market recovery while seeking to protect some or all of the initial investment at maturity. Income-seeking investors may consider reverse convertibles in parts of the equity market where implied volatility remains elevated. These strategies can be tailored to investors' outlook, objectives, and risk appetite, but they carry risks including issuer default, limited liquidity, and potential capital losses.

Hedge funds may add differentiated sources of return as market dispersion increases. Higher interest rates can widen differences among companies, economies, and securities, giving active managers more opportunities to identify relative leaders and laggards. This may benefit equity market neutral strategies, while diverging central bank policies can expand the opportunity set for discretionary macro managers. Uneven moves across yield curves may also create opportunities for fixed income relative value strategies. We therefore believe diversified exposure to select hedge fund strategies can complement traditional portfolios, although manager and vehicle selection remain important given risks including leverage, limited transparency, higher fees, and illiquidity.

Commodities can diversify portfolios and provide insulation against supply-driven inflation. Their historically low correlations with equities and bonds can offer a differentiated source of return, while exposure to energy may help protect against supply disruptions and the resulting inflationary pressures. The longer-term outlook for broad commodities is also supported by rising power demand, AI infrastructure investment, electrification, and constrained supply across several markets, particularly copper. We favor diversified exposure across precious metals, energy, industrial metals, and agriculture, with an actively managed approach helping to navigate shifts in market leadership.

While we remain constructive on equities and believe investors should retain diversified core exposure, the case for broadening portfolio sources of return has strengthened amid concentrated market leadership, higher financing costs, and ongoing geopolitical risks. Investors should also take into account their objectives, risk tolerance, and liquidity needs.

Source: <https://www.ubs.com/global/en/wealthmanagement/insights/chief-investment-office/house-view/daily/2026/latest-21102026.html>