Truist Advisory Services, Inc.

Portfolio Perspective from the Investment Advisory Group

Periods of market volatility highlight the benefits of alternative investments as a portfolio diversifier

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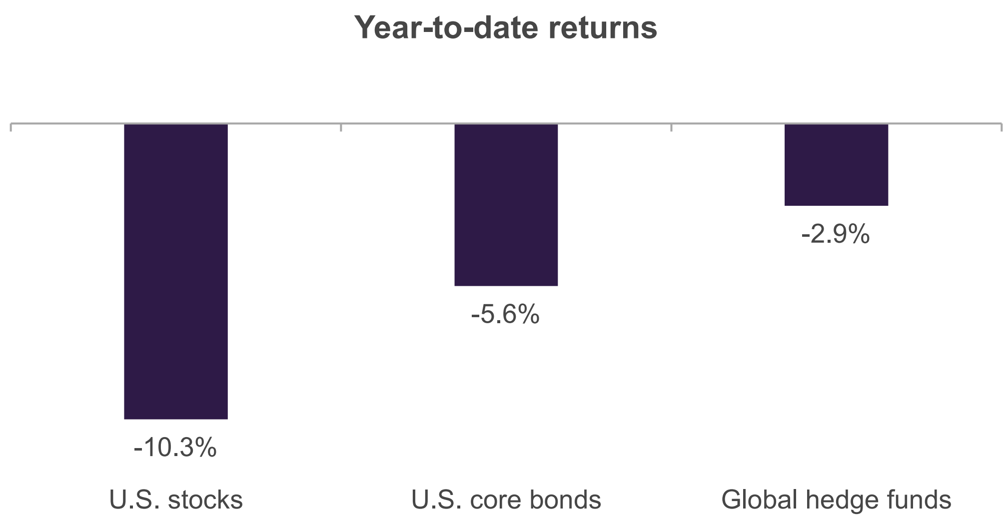
Key takeaways

- With both U.S. stocks and core bonds in negative territory year to date, global hedge funds have held up relatively well.
- Certain strategies have been able to take advantage of dislocations created by heightened market volatility and higher rates.
- Hedge funds can provide differentiated return streams and flexibility in different market environments, offering some portfolio diversification benefits.
- Manager selection is of paramount importance given the dispersion of fund returns.
- Alternatives can have benefits but may not be appropriate for all clients.

What happened

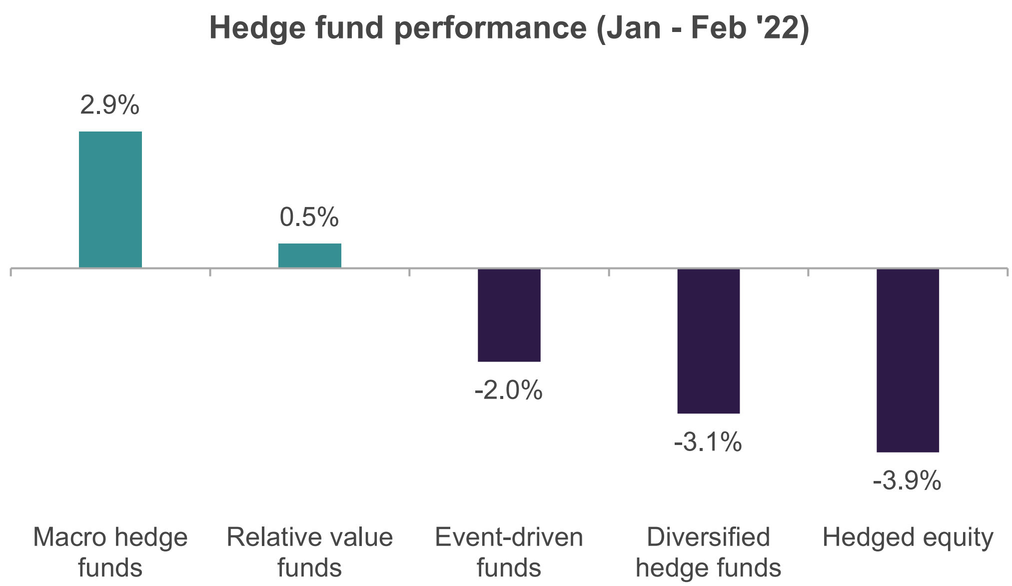
Coming into the year, our view was that select alternative strategies were incrementally more attractive given our expectations for higher interest rates. With both U.S. stocks and core bonds in negative territory year to date, global hedge funds are outperforming on a relative basis. Certain strategies have been able to take advantage of dislocations created by heightened volatility. This underscores the importance of diversification and the role that alternative strategies can play within portfolios during more volatile market environments.



Data Source: Truist IAG, Bloomberg, Hedge Fund Research. Data through 3/15/22. U.S. stocks = S&P 500, U.S. core bonds = Bloomberg U.S. Aggregate, Global hedge funds = HFRX Global Hedge Fund.

The complexity of the current market environment has had a differentiated impact on alternative strategies, with those more tied to the equity market, such as hedged equity, seeing weaker performance while those that tend to benefit in periods of market dislocations like macro funds performing well. Still, in aggregate, each of the strategies are outperforming the broader equity market, and hedged equity is down less than half compared to the S&P 500 through February.

Strategies that tend to benefit during periods of market dislocations, like macro funds, have performed well year to date.



Data Source: Truist IAG, Morningstar, Hedge Fund Research. Monthly data through 2/28/22. U.S. stocks = S&P 500, U.S. core bonds = Bloomberg U.S. Aggregate, Diversified hedge funds = HFRI FOF Diversified, Hedged equity = HFRI Equity Hedge (Total), Event-driven funds = HFRI Event-Driven (Total), Relative value funds = HFRI Relative Value (Total), Macro hedge funds = HFRI Macro (Total).

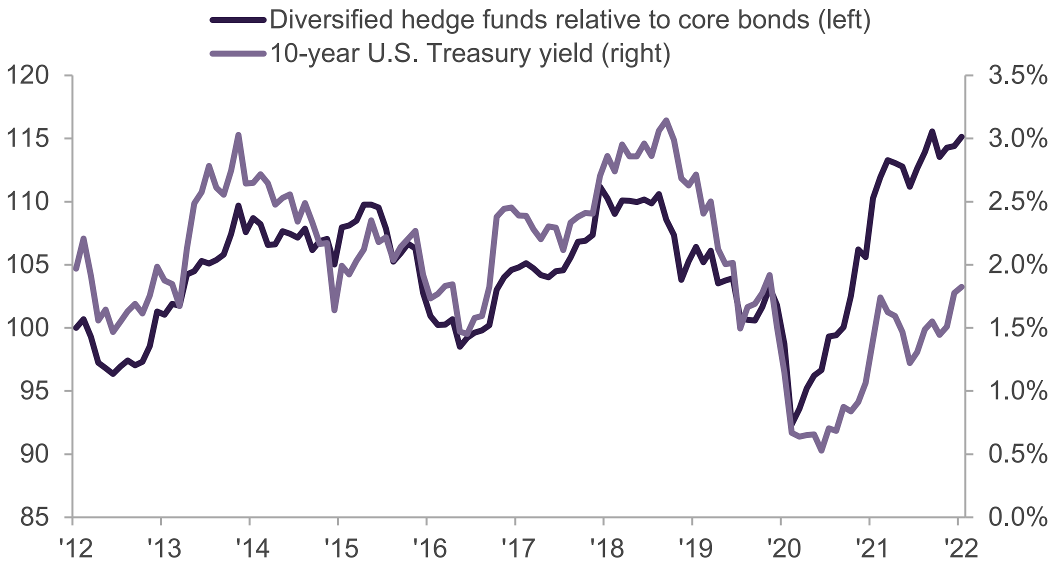
Higher rates and higher volatility have benefitted alternative strategies

Our work suggests that recent market volatility as well as higher interest rates have been a driver of the strong relative performance from alternative strategies compared to U.S. stocks and bonds. On the interest rate front, higher inflation and uncertainty around the path of Federal Reserve (Fed) policy has pushed yields and credit spreads higher, bringing the price return of fixed income assets into negative territory. Looking at the stock market, Fed policy uncertainty and the war in Ukraine has fueled risk-off sentiment and caused a correction in the S&P 500. International equities have been hit even harder.

Our work generally suggests that as interest rates move higher, certain alternative strategies tend to outperform core bonds as the rising rates tend to weigh on bond prices, mirroring what we have seen so far this year.

Interest rates boost diversified hedge funds relative to core bonds

Higher interest rates have tended to boost diversified hedge funds relative to core bonds like we have seen year to date.

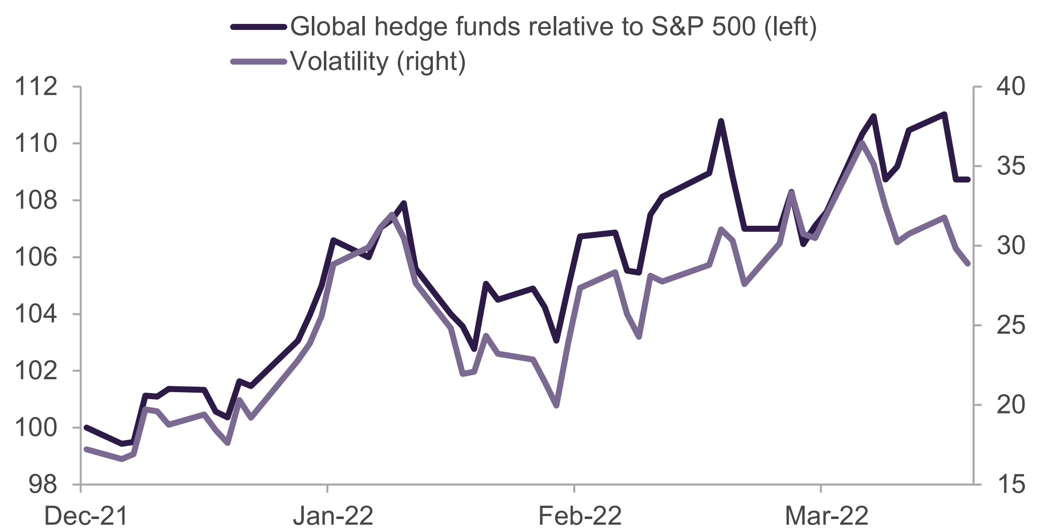


Data Source: Truist IAG, Bloomberg, Hedge Fund Research. Past performance does not guarantee future results. Monthly data through 2/28/22. U.S. core bonds = Bloomberg U.S. Aggregate, Diversified hedge funds = HFRI FOF Diversified.

Furthermore, alternative strategies have been able to take advantage of the bouts of volatility in the equity market and outperform the S&P 500 year to date given their ability to adjust to market volatility, use different types of securities, and their ability to go short and long these securities.

Global hedge funds have outperformed as volatility has risen

As volatility has increased year to date, global hedge funds have outperformed the S&P 500.

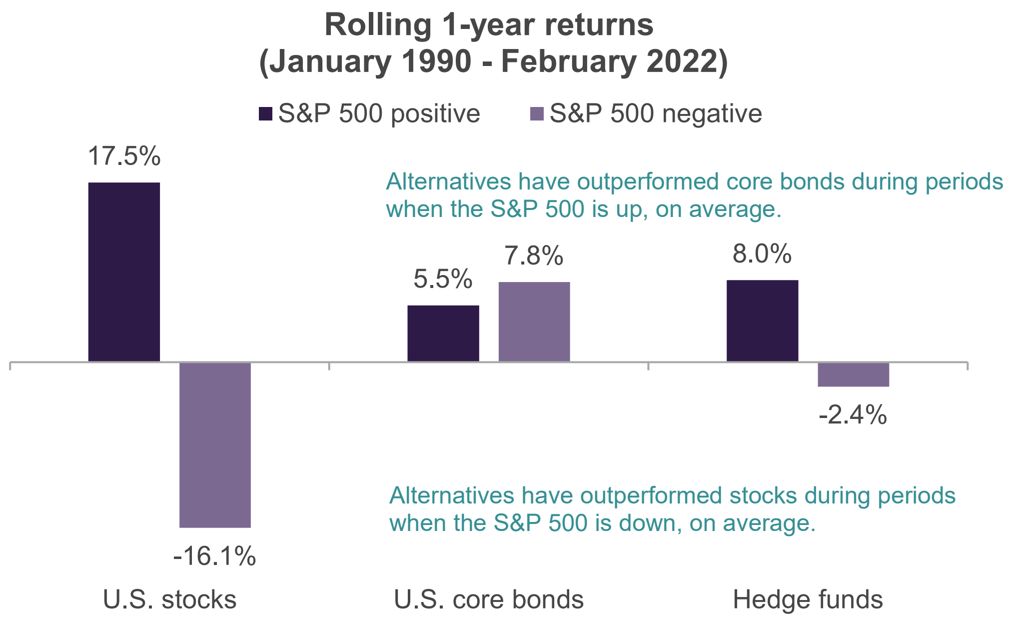


Data Source: Truist IAG, Bloomberg, Hedge Fund Research. Past performance does not guarantee future results. Data through 3/15/22. U.S. core bonds = Bloomberg U.S. Aggregate, Global hedge funds = HFRX Global Hedge Fund. Volatility = VIX Index.

Alternative strategies as a portfolio diversifier

Due to their idiosyncratic risk taking and ability to adjust exposure across a wide range of asset classes and securities in times of volatility, alternative strategies can offer differentiated returns. Additionally, the strategies employ a wide range of investment techniques that give them flexibility in different market environments.

Our research shows that historically during periods of time when the S&P 500 has fallen, alternatives have outperformed stocks on average. Conversely, when the S&P 500 has risen, alternatives have outperformed bonds on average. Lower levels of volatility and lower interest rates relative to history have challenged this relationship, but our view is that the current market environment is more supportive of this historical relationship.

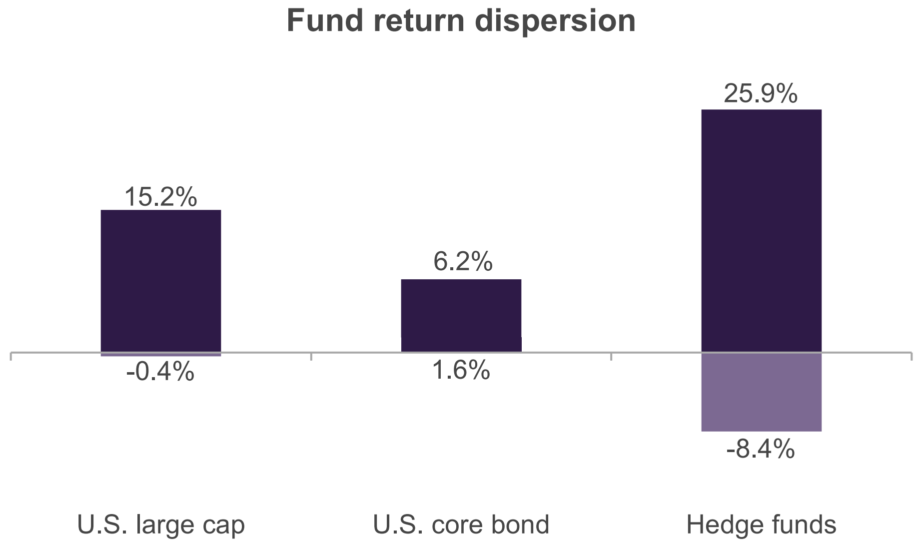


Data Source: Truist IAG, Morningstar, Hedge Fund Research. Past performance does not guarantee future results. Monthly data through 2/28/22. U.S. stocks = S&P 500, U.S. core bonds = Bloomberg U.S. Aggregate, Hedge funds = HFRI FOF Diversified.

Manager selection is key within the alternatives space

Manager skill is of paramount importance for alternative investments. The difference between the top and bottom performing funds is large when compared to the traditional investment manager space. Additionally, the alternatives space is complex, with the managers of these strategies employing a wide range of investment techniques, securities, and methods of risk taking. This also underscores the importance of making sure the strategies perform in the intended manner in a portfolio.

The dispersion in performance between top performing and bottom performing funds in the hedge fund space is larger than it is for traditional investments.



Data Source: Truist IAG, Morningstar, Hedge Fund Research. Past performance does not guarantee future results. Fund dispersion for the period 2011-2020, which measures the 10-year annualized performance of the top and bottom performing managers. U.S. bond and equity categories use Morningstar categories U.S. intermediate core bond and U.S. large cap blend. Hedge fund managers are included in the HFRI Fund Weighted Composite Index.

Bottom line

Alternative strategies have held up well year to date relative to both stocks and bonds due to higher interest rates and the higher levels of market volatility. As a result of their idiosyncratic risk taking and ability to adjust exposure using a wide range of securities in times of volatility, alternative strategies can offer differentiated returns in portfolios, but manager selection is key given the wide dispersion in performance.

It’s also important to consider suitability when investing in alternative strategies since they are not appropriate for all clients. Moreover, there are different fund structures available that can change the risk/reward profile within portfolios.

Hedge fund investing involves substantial risks and may not be suitable for all clients. Hedge funds are intended for sophisticated investors who can bear the economic risks involved. Hedge funds may engage in leveraging and speculative investment practices that may increase the risk of investment loss, can be illiquid, and are not required to provide periodic pricing or valuation information to investors. Hedge funds may involve complex tax structures, have delays in distributing tax information, are not subject to the same regulatory requirements as mutual funds and often charge a higher fee.

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The CBOE Volatility Index® (VIX®) is a measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices.

Bloomberg U.S. Aggregate Index measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market and includes Treasuries, government-related, mortgage-backed, asset-backed, and corporate securities.

HFRX Global Hedge Fund Index measures the overall composition of the hedge fund universe.

HFRI Equity Hedge (Total) Index measures investment managers who maintain both short and long positions in equity and equity derivative securities.

HFRI Macro (Total) Index measures investment managers whose process is predicated on movements in underlying economic variables

HFRI FOF Diversified Index measures strategies that invest in a variety of strategies among multiple managers, has a historical risk/return or close performance and return distributions close to the HFRI Fund of Fund Composites index.

HFRI Event-Driven (Total) Index tracks investment managers who maintain positions in companies currently or prospectively involved in corporate transactions of a wide variety.

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