



## Widening your diversification armoury to withstand 2025's global complexity

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This year's investment landscape has been marked by significant complexity and volatility. The election of President-elect Trump has introduced policy uncertainty at a scale not often seen, particularly regarding international trade relations. With tariffs on key trading partners, such as Canada and Mexico, and tariffs already imposed on China, as well as steel and aluminium, the global economic environment faces potentially severe disruption.

While US markets benefit from robust economic conditions and strong corporate earnings, particularly in mega-cap technology stocks, there's a growing recognition that risks may be underestimated. Europe faces multiple crises, warranting caution towards European assets, while China's economic momentum remains uncertain despite recent stimulus measures. It's clear the global economy has entered a new phase of post-pandemic expansion, characterised by heightened macroeconomic and geopolitical tensions.

In response to these challenges, spreading risk across geographies and assets becomes increasingly crucial. While traditional diversification strategies, such as investing in conventional listed asset classes, remain fundamental, a more sophisticated approach to risk management and return generation is also advisable.

Increasingly, sophisticated investors are tapping into an expanded diversification toolkit that includes private credit, private equity, infrastructure investments and hedge funds. These alternative assets can provide additional layers of diversification and potential downside protection, thereby offering the potential for enhanced returns and reduced correlation with public markets.

Catastrophe bonds are one diversification tool we include in our clients' portfolios. These investment instruments are a specialist sub-sector of the insurance-linked securities (ILS) market, offering premium income from weather-related risks, such as floods and hurricanes. These specialist bonds delivered impressive returns of approximately 13.5% in 2024, benefiting from elevated yields following Hurricane Ian in late 2022. Despite being a risk asset, catastrophe bonds' uncorrelated returns and attractive yields add important attributes to a multi-asset class portfolio.

Small-cap stocks, which are undervalued compared to their larger peers, present another opportunity for diversification and growth potential. This segment of the listed market is poised to benefit from two significant trends: the US manufacturing resurgence and the expansion of AI infrastructure. The proposed reshoring of US manufacturing capabilities, supported by government stimulus through the Infrastructure Investment Act and Chips Act under former US President Joe Biden and now a top priority for President Donald Trump, creates opportunities in the industrial and technology sectors. Additionally, smaller companies involved in data centre hardware supply and AI infrastructure development offer exposure to the growing AI sector at more attractive valuations than mega-cap tech stocks. These stocks will also broadly benefit from President Trump's deregulation drive, even if potential trade tariffs provide a short-term headwind.

As financial advisors guide clients through the complex investment landscape of 2025, it's crucial to ensure that clients are leveraging all sources of diversification to ride out the volatility and uncertainty. Investing in funds that incorporate alternative investments, such as catastrophe bonds and targeted exposure to small caps, can enhance portfolio resilience, enabling investment strategies to deliver compound returns that exceed inflation while withstanding the elevated volatility expected for the foreseeable future.



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