

# Beyond Traditional Asset Allocation: Diversification with Liquid Alternatives.

The traditional balanced portfolio framework is not obsolete, but it is no longer structurally sufficient. In a regime characterised by higher nominal rates, elevated asset dispersion, and shifting correlations, liquid alternatives are re-establishing their role as essential portfolio stabilisers.

## A Regime Shift, Not a Cyclical Correction

For several decades, the 60/40 portfolio delivered robust risk-adjusted returns, as equity-driven capital appreciation was effectively cushioned by long-duration sovereign bonds. This paradigm relied on a structural tailwind: a persistent negative correlation between equities and fixed income that provided automated portfolio immunisation.

That covariance structure has fundamentally inverted. Since 2022, the stock-bond correlation has turned positive, fluctuating around 0.5. Consequently, fixed income no longer reliably dampens equity drawdowns. While resilient equity markets and compressed credit spreads have temporarily masked these vulnerabilities, risk premia across public assets remain historically tight, and extreme index concentration further amplifies systemic risk. Relying solely on beta co-movement leaves global portfolios exposed to unhedged tail events.

## The Macroeconomic Case for Liquid Alternatives

Mitigating this risk does not require a complete divestment from traditional asset classes, but rather a strategic allocation to uncorrelated return streams. While private assets offer diversification, their inherent illiquidity, extended J-curves, and rising default risks in a higher-for-longer rate environment pose distinct structural challenges.

Conversely, the current macroeconomic backdrop is highly favourable for liquid, low net exposure solutions, such as equity market neutral and statistical arbitrage strategies. Higher risk-free rates directly enhance the short rebate and cash carry yields embedded in market neutral architectures, structurally elevating their baseline risk-adjusted return profile. Furthermore, divergence in global central bank policies and idiosyncratic corporate performance have driven macro and micro dispersion to multi-year highs. This dispersion serves as the primary performance catalyst for relative value strategies.

## Monetising Dispersion via Relative Value

Equity market neutral strategies, a sub-category of relative value, isolate the price discrepancies between fundamentally strong and weak companies while eliminating directional market exposure. In periods of macroeconomic uncertainty, these cross-sectional spreads widen as investors reprice asset-specific risks rather than allocating to broad market indices.

Several systematic equity market neutral strategies complement fundamental valuation metrics with statistical arbitrage opportunities that capitalise on short-term pricing inefficiencies. This process blends two uncorrelated performance engines, which may lead to a more robust outcome that tends to exhibit low dependence – even a negative relationship at times – to both equities and sovereign debt. Within a multi-asset framework, this may provide structural diversification that traditional allocations currently lack.

“The 60/40 framework remains a core foundation, but positive asset covariance demands a secondary layer of structural diversification. Equity market neutral strategies, underpinned by enhanced cash carry and genuine decoupling from equity and bond beta, represent an efficient way of contributing to an enhanced portfolio risk/return profile.”



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