HEDGENORDIC

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RETHINKING THE 60/40 PORTFOLIO



Contents

4 Editor´s Note ...A Different Slice of the Pie

6 Folketrygdfondet on the Enduring Case for 60/40

10 Reinforce, Don't Replace: Carrying the 60/40 Through the Fragile Decade

18 Baillie Gifford: Emerging Markets Are Moving Beyond the Macro Cycle

22 The 60/40 Isn't Dead. But the 40 Is Changing

26 Thinking Outside the 60/40 Box: How Active and Dynamic Commodities Can Complement Bonds

30 AP3's Jonas Thulin: "The 60/40 Portfolio Has Run Its Course"

34 Varma: Practical Considerations for Embracing a Total Portfolio View

38 60/40 – Don't Count On It

42 Diversification That Comes From Somewhere Else

48 What Would a Totally Unconstrained Portfolio Look Like?

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INTRODUCTION

HedgeNordic is the leading media covering the Nordic alternative investment and hedge fund universe. The website brings daily news, research, analysis and background that is relevant to Nordic hedge fund professionals from the sell and buy side from all tiers.

HedgeNordic publishes monthly, quarterly and annual reports on recent developments in her core market as well as special, in-depth reports on "hot topics".

HedgeNordic also calculates and publishes the Nordic Hedge Index (NHX) and is host to the Nordic Hedge Award and organizes round tables and seminars.

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Editor's Note ...

A Different Slice of the Pie

When I started working in financial markets in the late 1990s, our bank had its model portfolios printed on laminated sheets of paper. There were neat pie charts, mostly in red and blue, showing clients how their money ought to be invested. Equities occupied one slice, bonds the other, and the great variable determining the appropriate split was, apparently, your age.

The older you became, the smaller the equity slice and the larger the bond allocation. Your wealth, income, risk tolerance, investment objectives or ability to withstand losses did not appear to trouble the pie very much. Age went in, asset allocation came out.

Even then, as a fairly junior participant in the financial world, I remember thinking this seemed rather crude. Surely there had to be a better way.

Nearly three decades later, the pie has become more sophisticated, but it has proved remarkably difficult to get rid of. The 60/40 portfolio remains one of the most recognisable conventions in investing, even where few institutional portfolios literally consist of 60 percent equities and 40 percent bonds. For a long time, that worked rather well. The question today is whether we have become too attached to the recipe for the purpose it was designed to serve.

That distinction runs throughout this publication. Kjetil Houg of Folketrygdfondet presents a robust defence of 60/40, pointing to transparency, low costs, disciplined rebalancing and, with yields having normalised, a more attractive role for fixed income. Jonas Thulin at AP3 reaches almost the opposite conclusion, arguing that fixed allocations and automatic rebalancing are poorly suited to a world in which correlations and opportunities constantly change. Kari Vatanen at Elo perhaps asks the most useful question of all: what exactly are the 60 and the 40 supposed to do?

That last question changes the discussion. If the 60 is there to generate long-term growth, equities remain difficult to replace. But even that slice need not look exactly as it did before. Baillie Gifford argues that emerging-market equities are increasingly less a macro bet on currencies, commodities and global growth and more a source of company-specific structural growth. In other words, perhaps the equity slice itself deserves to be cut differently.

The 40 is even more interesting. It has accumulated an impressive job description over the years: provide income, preserve capital, supply liquidity, diversify equity risk and preferably rescue the portfolio during a crisis. Asking one slice of the pie to perform all those functions may simply be asking too much.

Our contributors offer several ways of approaching that problem. Transtrend's Harold de Boer questions whether investors should count on the historical relationship between stocks and bonds continuing at all, arguing instead for active trend following capable of adapting when history takes another turn. Newfound Research and Return Stacked take a different route: rather than replace the 60/40, they propose reinforcing it, using capital-efficient implementation to retain the traditional core while stacking diversifying return streams on top.

Aspect Capital also looks beyond bonds, making the case for active and dynamic commodity exposure as a portfolio building block in a world of supply shocks, geopolitical tensions and inflationary risks. Importantly, its argument is not simply to buy commodities and hold them forever, but to treat them as a trading asset class in which exposures can adapt as opportunities and regimes change.

Then there are risks that come from somewhere else entirely. Our look at insurance-linked investments asks whether genuine diversification should be defined less by a historical correlation coefficient and more by what actually causes an investment to make or lose money.

Christoph Junge pushes the exercise further still by asking what the pie might look like if institutional investors were freed from the constraints that normally determine how it is sliced. His hypothetical unconstrained portfolio dramatically reduces traditional equity and fixed-income exposure in favour of private markets, real assets, CTAs and insurance-linked securities.

And perhaps the most fundamental rethink is not about individual slices at all. Varma's Markus Aho describes a more holistic approach in which public and private investments are considered as parts of the same underlying portfolio, teams are given broader mandates and the organisation itself is expected to evolve around the investment strategy rather than dictate it.

There is no consensus in these pages, and that is probably reassuring. The answer may be 60/40 or something that no longer fits neatly into two numbers at all. It may involve changing the ingredients, dynamically changing their weights, stacking additional exposures on top or abandoning the idea that asset-class buckets should determine portfolio construction in the first place.

Perhaps that is where my old laminated model portfolio really looks its age. Not because stocks and bonds have suddenly stopped being useful, nor because every portfolio now requires an exotic collection of alternatives. It looks dated because it started with the answer: here is the pie, here is how we slice it.

The more interesting portfolios today start with the questions. What return do we need? Which risks can we afford? Where does our diversification actually come from? How much liquidity do we genuinely require? What happens when the assumptions behind our allocations stop working?

Only then should we decide how to split the pie.

Kamran Ghalitschi
PUBLISHER, HEDGENORDIC



Kjetil Houg, CEO – Folketrygdfondet.

Folketrygdfondet on the Enduring Case for 60/40

By Eugeniu Guzun – HedgeNordic

The traditional 60/40 portfolio, combining the complementary roles of equities and bonds, remains a central reference point in institutional portfolio construction. Few investors have as much experience managing a portfolio around this framework as Folketrygdfondet, Norway's Government Pension Fund Norway, which manages more than NOK 400 billion. Kjetil Houg, CEO of Folketrygdfondet, believes the framework remains well suited to the fund's long-term investment horizon, particularly as higher interest rates improve the return potential of bonds.

A TRANSPARENT AND COST-EFFICIENT INVESTMENT FRAMEWORK

Folketrygdfondet's 60/40 allocation is set out in its mandate from the Norwegian Ministry of Finance. While the fund does not determine the strategic allocation independently, Houg says there has been no reason to recommend changing it. "There are several reasons why we have a 60/40 portfolio, but the main one is that it is mandated by the ministry. It is therefore not really our decision," he says. "At the same time, we have not seen any reason to advise the ministry to change the mandate. We support the framework and believe it works well."

The framework also aligns with Folketrygdfondet's emphasis on transparency. "As a sovereign wealth fund, we value the transparency of public markets. Markets are transparent, and shareholders and bondholders benefit from strong minority protections," Houg explains. "That appeals to our stakeholders, whether they are politicians, the ministry or the public. A portfolio that is open and easy to understand helps build trust over time."

Cost efficiency is another important consideration. Folketrygdfondet's predominantly public-market portfolio can be managed at a relatively low cost. "In terms of our fiduciary responsibilities, this is a very cost-efficient way of managing the portfolio," says Houg. "We manage the portfolio at a total cost of between six and seven basis points, all-inclusive, compared with at least 50 basis points for comparable sovereign wealth funds."

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A MORE BALANCED OUTLOOK FOR EQUITIES AND BONDS

The case for the 60/40 model ultimately rests on its ability to deliver attractive risk-adjusted returns over the long term. Houg acknowledges that the experience of the past decade has tested the model, particularly as fixed income delivered relatively weak returns for much of the period.

“What we have seen over the past decade is a remarkable excess return from equities over fixed income,” Houg says. In the Nordic region, the equity risk premium, the return on equities relative to bonds, has been around 10 percentage points over the past ten years. “That is quite remarkable and much higher than the equity risk premium normally is,” he notes. “This was an atypical period.” In his view, investors should not extrapolate the unusually large equity premium of the past decade into the next ten years.

The period was shaped by strong equity market performance and very low interest rates, particularly before the COVID-19 pandemic. The subsequent surge in inflation and the associated rise in interest rates altered the outlook for fixed income.

“We are now in a higher interest rate environment. That means you can expect higher returns from fixed income and greater protection from the income generated by the portfolio,” he says. A more normal relationship between equity and bond returns could strengthen the role of fixed income in a balanced portfolio.

THE LESSONS OF 2022

The events of 2022 presented a more direct challenge to the diversification assumptions behind the 60/40 portfolio. “2022 was the worst year for a 60/40 portfolio in decades, perhaps even centuries, because the correlation between equities and bonds was high and both portfolios suffered negative returns,” says Houg. He describes 2022 as a “perfect storm” but acknowledges that investors must expect periods when the two asset classes move in the same direction.

Houg considers the episode an important reminder that correlations can change, but does not believe it invalidates the model. We have to expect correlations to rise from time to time. However, they will very rarely reach one, if ever. As long as correlations remain below one, fixed income provides some degree of diversification.”

Folketrygdfondet’s long-term horizon and limited liquidity requirements also reduce the pressure to respond to short-term market fluctuations. “We have substantial risk capacity. Our liability is very limited: we deliver three percent every year to the ministry, and that is it,” Houg explains. “We can handle fluctuations in the portfolio’s market value, so we are not afraid of another 2022.”

ACTIVE MANAGEMENT WITHIN A 60/40 FRAMEWORK

Although Folketrygdfondet operates within a defined strategic allocation and invests primarily in Norwegian equities and bonds, the mandate leaves room for active management. The fund seeks to generate returns above its benchmarks through security selection, portfolio construction and rebalancing.

In equities, the scope for differentiation is relatively limited because the portfolio invests in public markets and remains closely aligned with its benchmark. “In the equity portfolio, things are relatively straightforward. We invest in public markets, and there are only so many ways to do things differently,” Houg says. “We generally stay very close to the index, with some enhancements.” Even so, Folketrygdfondet has managed to generate excess returns over its equity benchmark over time. “That is meaningful, particularly when the scope for deviating substantially from the benchmark is limited.”

CREDIT AS A KEY SOURCE OF EXCESS RETURNS

The fixed-income portfolio offers greater flexibility. “In fixed income, the situation is different. We have considerably more room to deviate from the benchmark,” Houg says. Credit exposure is a central component of Folketrygdfondet’s active fixed-income strategy, with the fund typically investing in smaller issuers and maintaining a significant allocation to high-yield bonds. “The portfolio is more diversified, and we typically invest in smaller names than those in the benchmark. We also have a significant allocation to high yield,” he says. Houg identifies these positions as the main drivers of the portfolio’s long-term excess return.

> “We have not seen any reason to advise the ministry to change the mandate. We support the framework and believe it works well.”

Historically, the fund has placed less emphasis on generating returns through duration positioning or trading different parts of the yield curve. More recently, however, the team has started taking somewhat larger positions on curve movements, while keeping the overall interest-rate exposure close to that of the benchmark. “We do not take a specific duration bet, and we do not take a currency bet either.”

REBALANCING AS A SOURCE OF VALUE

Beyond security selection and credit allocation, rebalancing is another important element of Folketrygdfondet’s approach. The fund’s strategic allocation requires it to adjust its equity and fixed-income exposures as markets move. “Where you rebalance and how frequently you do it can make quite a significant difference,” Houg explains. “Whether you rebalance every day, every month, or only when certain thresholds are reached matters. We tend to buy equities when they are cheap and sell them when they are expensive, and vice versa.”

For a large investor concentrated in relatively small domestic markets, however, the execution of rebalancing is as important. Folketrygdfondet therefore takes a gradual approach, seeking to limit its market impact and avoid disrupting prices when adjusting its exposures. “We try to move slowly and avoid breaking any eggs,” Houg says. “We have managed that quite well over time, and the results are encouraging. We have typically gained rather than lost from our rebalancing operations.”

A CONSTRUCTIVE OUTLOOK FOR THE 60/40 MODEL

For Houg, the combination of higher bond yields, a long-term investment horizon, active credit management and disciplined rebalancing support the continued relevance of the 60/40 framework. “We are now seeing quite attractive yield levels, which make fixed income more compelling,” Houg concludes. “You can also expect greater protection from the fixed-income portfolio because the return profile is less asymmetric. The normalization of interest rates has therefore strengthened the case for the 60/40 approach.”



By Steven Braun – Newfound Research and Return Stacked® Portfolio Solutions

www.hedgenordic.com – September 2026

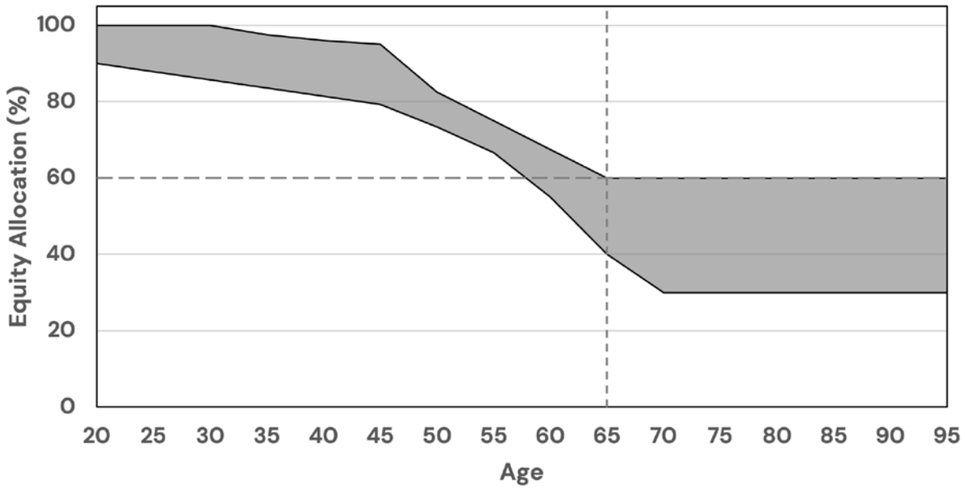
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Reinforce, Don't Replace:

Carrying the 60/40 Through the Fragile Decade

Despite its ambiguous origins, the 60/40 remains the default portfolio for investors approaching retirement, and something close to it is what most still hold when decumulation begins.

FIGURE 1: RANGE OF REPRESENTATIVE GLIDEPATH EQUITY ALLOCATIONS



SOURCE: VANGUARD; BLACKROCK; T. ROWE PRICE; STATE STREET GLOBAL ADVISORS; J.P. MORGAN. CALCULATIONS BY RETURN STACKED® PORTFOLIO SOLUTIONS. FOR ILLUSTRATIVE PURPOSES ONLY.

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The portfolio works mostly by simple de-risking. Sixty cents of every dollar is tied to equity risk. The rest is parked in bonds that pay a near-certain nominal return and have provided a meaningful offset to equity risk in past crashes like 2000 and 2008.

Inflation is the weak point. A sharp rise erodes the bond's promised return in real terms, and history says stocks usually fall alongside.

Explicit de-risking has a cost of its own, too. Portfolio growth still largely relies on the 60%, so if equities go nowhere for a decade, the total return of bonds may not deliver the performance that a given retirement plan has presupposed.

Shocks like these can arrive at any age. What changes near retirement is what they cost the portfolio in longevity. But rather than asking whether to bury the 60/40 – a portfolio investors have historically been able to hold through cycles – we ask whether we can reinforce it.

THE FRAGILE DECADE

Between ages 60 and 70 is sometimes referred to as 'the fragile decade'. It is when the 60/40's blind spots and the holder's vulnerability arrive together.

At 60, the portfolio – hopefully – sits near its lifetime peak, so a single percentage point of return moves more wealth than it ever has. The two remedies that carry a saver through earlier drawdowns, saving more and working longer, are both nearly spent.

Once withdrawals begin, a decline stops being something to ride out and becomes a liquidation: what is sold into a falling market is no longer there to participate in the recovery.

A portfolio earning a 5% real return that suffers a 30% real drawdown would be expected to recover to its inflation-adjusted high-water mark in just over seven years. Ongoing withdrawals, however, can extend that recovery period substantially, potentially beyond the investor's remaining lifetime.

The retirement literature calls the 5 years either side of retirement the retirement risk zone: the window with the greatest influence on whether a plan survives.

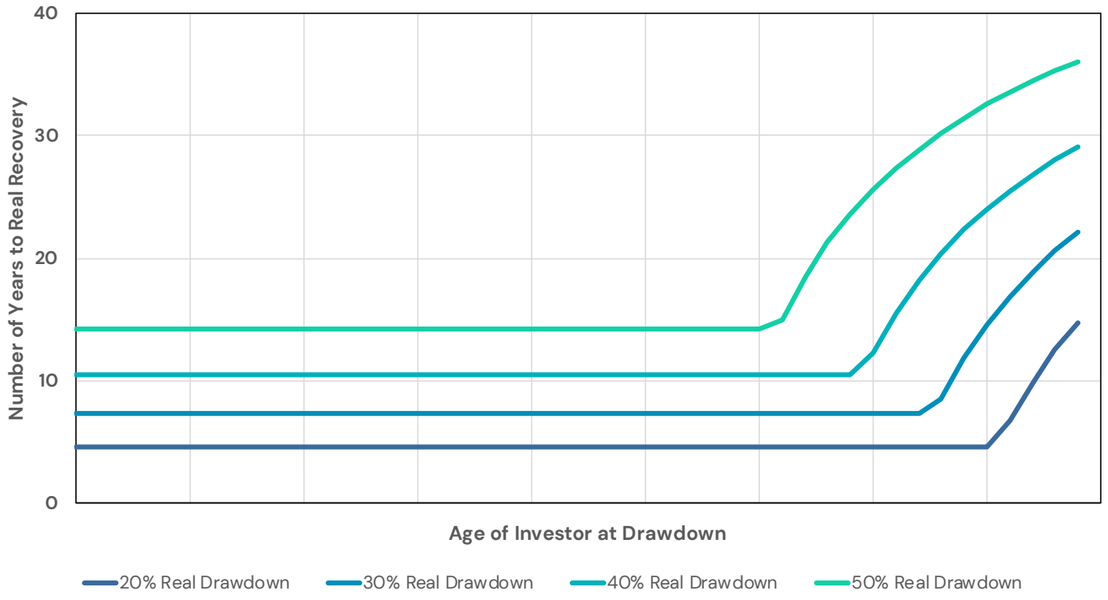
This is where the 60/40's inflation blind spot does its worst damage. An inflation shock can pull stocks and bonds down together while it erodes the real value of every dollar withdrawn. Inside the risk zone, that is the failure a retirement plan can least afford.

ADDING WITHOUT SUBTRACTING

One natural response is to add diversifying assets that do not share those same blind spots. But adding a diversifier to the 60/40 runs into a funding problem: the money allocated to the diversifier must come from selling existing stock or bond investments. Reducing equities gives up growth the investor still needs to hedge longevity risk; selling bonds gives up the ballast that works during growth shocks. In a 100% exposure portfolio, the net change must sum to zero.

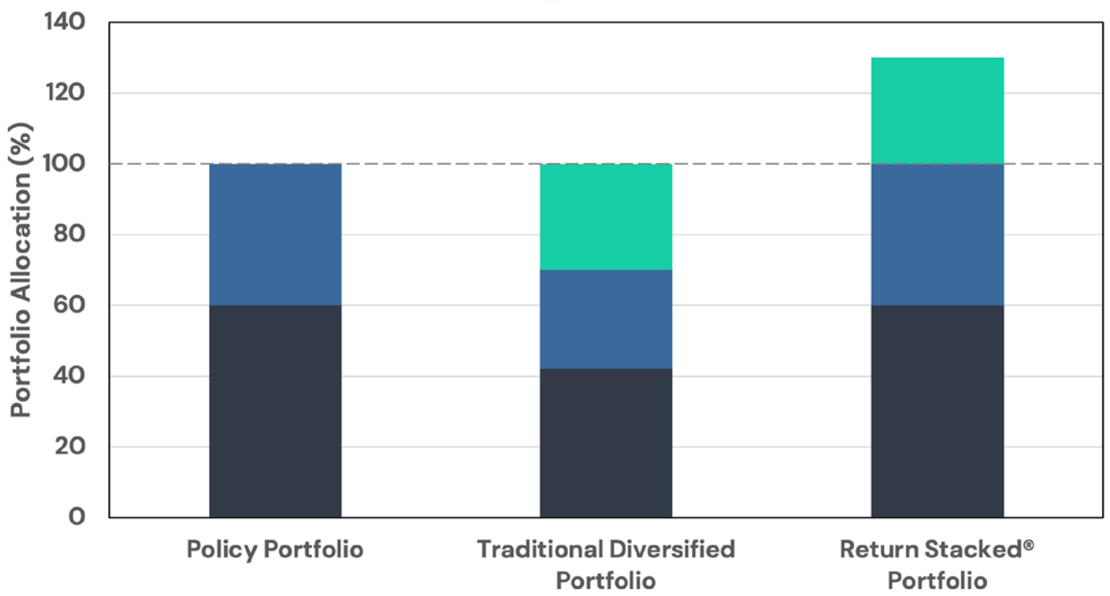
"But rather than asking whether to bury the 60/40 – a portfolio investors have historically been able to hold through cycles – we ask whether we can reinforce it."

FIGURE 2: DRAWDOWN IMPACT BY AGE WITH A 5% REAL RETURN



FOR ILLUSTRATIVE PURPOSES ONLY. CALCULATIONS BY RETURN STACKED® PORTFOLIO SOLUTIONS. THE ANALYSIS ASSUMES A PORTFOLIO EARNING A CONSTANT 5% REAL RETURN PER YEAR WITH NO CONTRIBUTIONS. A DRAWDOWN OF THE STATED SIZE (20% TO 50%) IS APPLIED IN A SINGLE YEAR AT EACH STARTING AGE SHOWN, AND THE RECOVERY AGE IS THE AGE AT WHICH THE PORTFOLIO REGAINS ITS PRIOR PEAK VALUE IN REAL (INFLATION-ADJUSTED) TERMS. WITHDRAWALS BEGIN AT AGE 65 AT 4% OF THE PORTFOLIO'S VALUE AT THAT DATE AND ARE HELD CONSTANT IN REAL TERMS THEREAFTER. WITHDRAWALS ARE BASED ON THE PORTFOLIO'S ACTUAL (POST-DRAWDOWN) VALUE AT 65.

FIGURE 3: ADDING VERSUS REDUCING



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Return stacking removes the tradeoff. By holding part of the core stock and bond exposure through capital-efficient derivatives, a portfolio can keep its 60/40 intact and use the freed capital to layer diversifiers on top. This is a playbook institutions have run for decades under the name portable alpha.

The 60/40 can stay a 60/40 while the overlay adds to it rather than carving room out of it.

What goes on top can then aim to address what the 60/40 is missing. For example, trend following and gold have historically performed well in the inflationary and crisis regimes that hurt both 60/40 legs at once; meanwhile, merger arbitrage and futures yield (carry) seek absolute returns that do not depend on equity beta.

OPTIMIZING IMPLEMENTATION

In adopting this approach, a primary question is how to size these stacks.

> "Adding a diversifier to the 60/40 runs into a funding problem: the money allocated to the diversifier must come from selling existing stock or bond investments."

Raising expected returns is the easy part: just stack more. But more exposure can mean more risk and an investor nearing or at retirement may have little tolerance for that (either in capacity or appetite).

If risk is the concern, the sizing should start there. For a guiding answer, we turn to a resampled optimization. It repeats its search across thousands of simulated market histories and averages the winners, so no single history drives the result.

We constrain the search in two ways. The stacked portfolio's volatility must stay near the original 60/40's, and total notional exposure must stay below 130%. Within those limits, the optimization seeks the highest expected return.

The optimization stops short of the full budget, settling at a 27.6% overlay: 14.2% trend following, 7.8% futures yield, 4.0% merger arbitrage, and 1.6% gold. The result, shown in Figure 4, is the same 60/40 carrying 127.6% in total notional exposure.

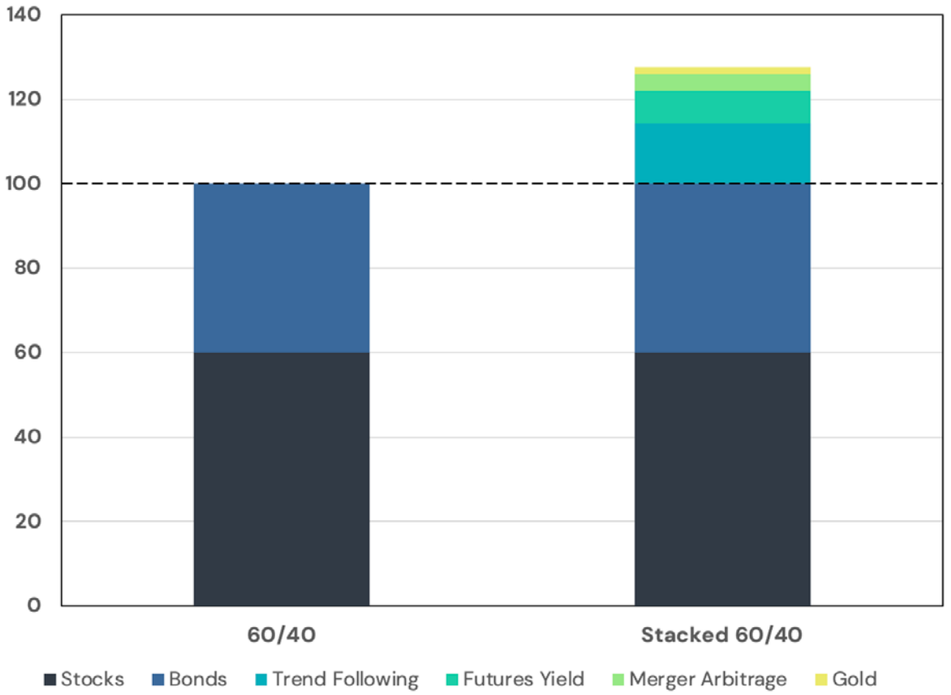
To assess how this overlay impacts a retirement plan, we simulate 2,000 retirement worlds by block-resampling monthly returns from 2000 through 2026 where each asset is recentered on a conservative forward-looking Sharpe ratio rather than its historical mean.

In each world the retiree holds the 60/40 from age 60 to 95, retires at 65, and withdraws 4% of age-65 wealth every year, adjusted by inflation[1]. Wealth is indexed to 100 at age 60 with no contributions, so every difference between the portfolios is strictly a portfolio effect.

BEFORE RETIREMENT: ARRIVING AT 65 WITH MORE

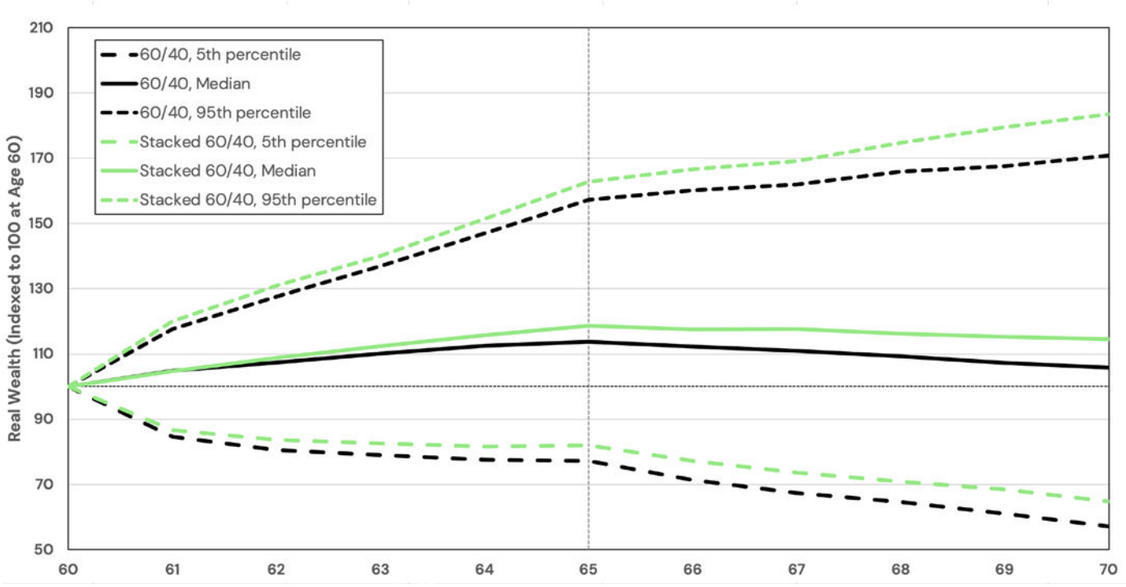
The five years before retirement are the most consequential accumulation years the investor has left. Whatever the portfolio is worth at 65 sets the withdrawal for every year that follows.

FIGURE 4: STACKED 60/40 ALLOCATIONS



SOURCE: BLOOMBERG. CALCULATIONS BY RETURN STACKED® PORTFOLIO SOLUTIONS. FOR ILLUSTRATIVE PURPOSES ONLY. SEE THE METHODOLOGY SECTION FOR ASSUMPTIONS AND CALCULATION DETAILS.

FIGURE 5: WEALTH THROUGH THE FRAGILE DECADE.



SOURCE: BLOOMBERG; PIVOTALPATH. CALCULATIONS BY RETURN STACKED® PORTFOLIO SOLUTIONS. 60/40 IS A 60% ALLOCATION TO MSCI ACWI AND A 40% ALLOCATION TO BLOOMBERG US AGGREGATE BOND INDEX, REBALANCED MONTHLY. STACKED 60/40 IS A 60% MSCI ACWI, 40% BLOOMBERG US AGGREGATE BOND INDEX, 14.2% SG TREND, 7.8% RESOLVE FUTURES YIELD LIQUID UNIVERSE, 4.0% EVENT DRIVEN:MERGER ARBITRAGE, AND 1.6% XAU/USD ALLOCATION REBALANCED MONTHLY. ANY EXPOSURE ABOVE 100% IS ASSUMED TO BE NET OF BLOOMBERG SHORT TREASURY US TOTAL RETURN INDEX PLUS A 50 BASIS POINT ANNUALIZED FINANCING SPREAD. GLOBAL EQUITIES, BONDS, T-BILLS, AND GOLD ARE GROSS OF MANAGEMENT FEES, PERFORMANCE FEES, AND TRANSACTION COSTS AND ASSUME THE REINVESTMENT OF ALL DIVIDENDS. TREND FOLLOWING, FUTURES YIELD, AND MERGER ARBITRAGE ARE REPORTED NET OF MANAGEMENT FEES, PERFORMANCE FEES, AND UNDERLYING TRANSACTION COSTS. ALL RETURNS ARE GROSS OF TAXES.

In the median outcome[2], the stacked portfolio outgrew the bare 60/40 by five percentage points over those five pre-retirement years and crossed the standard portfolio's age-65 wealth about a year and a half early.

The tails matter just as much. An unlucky retiree locks in a withdrawal off a diminished base. Even in the 5th percentile outcome, the stacked portfolio lost less: 18.0% in real terms against 22.8% for the 60/40.

AFTER RETIREMENT: SURVIVING THE SEQUENCE

Across all simulations, stacking lifted the odds of sustaining withdrawals to age 95 from 69% to 82% and raised the median sustainable withdrawal rate from the 60/40's 4.66% to 5.16%.

The harder test comes when the first years of retirement go badly.

When we sort the simulations on real equity returns from ages 65 to 70 and look inside the worst tenth, neither portfolio fared well. The bare 60/40 sustained its withdrawals in barely one retirement in six, and even with the overlay, two retirements in three still failed.

The odds of getting through nonetheless doubled, and the withdrawal rate those markets could support was higher as well. In these worlds the overlay did not merely postpone ruin, it converted failed retirements into funded ones.

The overlay also preserved capital along the way. Five years into a worst-decile retirement, the median stacked portfolio still held 77% of its age-60 wealth, against 66% for the bare 60/40.

Across all simulations, the median wealth remaining at 95 more than doubled, from 32% of age-60 wealth to 69%.

Interestingly, the outcomes did not come at the cost of more risk. From age 60 to 70, the stacked portfolio's worst drawdown was typically shallower than the bare 60/40's. It also spent less time below its prior peak: a median of 40 months, versus 46 for the 60/40.

TABLE 1: RETIREMENT OUTCOMES

Ages 60 to 95, wealth indexed to 100 at age 60	**60/40**	**Stacked 60/40**
Median cumulative real return, ages 60 to 65	13.7%	18.7%
Odds of sustaining withdrawals to 95	69%	82%
Odds of sustaining withdrawals, worst tenth of early-retirement markets	16%	34%
Median sustainable withdrawal rate	4.66%	5.16%
Median sustainable withdrawal rate, worst tenth of early-retirement markets	3.13%	3.68%
Median Max Drawdown (Ages 60 to 70)	-26.9%	-23.3%
Median Max Drawdown Duration, Months (Ages 60 to 70)	46 Months	40 Months

SOURCE: BLOOMBERG; PIVOTALPATH. CALCULATIONS BY RETURN STACKED® PORTFOLIO SOLUTIONS. 60/40 IS A 60% ALLOCATION TO MSCI ACWI AND A 40% ALLOCATION TO BLOOMBERG US AGGREGATE BOND INDEX, REBALANCED MONTHLY. STACKED 60/40 IS A 60% MSCI ACWI, 40% BLOOMBERG US AGGREGATE BOND INDEX, 14.2% SG TREND, 7.8% RESOLVE FUTURES YIELD LIQUID UNIVERSE, 4.0% PIVOTALPATH EVENT DRIVEN: MERGER ARBITRAGE, AND 1.6% XAU/USD ALLOCATION REBALANCED MONTHLY. ANY EXPOSURE ABOVE 100% IS ASSUMED TO BE NET OF BLOOMBERG SHORT TREASURY US TOTAL RETURN INDEX PLUS A 50 BASIS POINT ANNUALIZED FINANCING SPREAD. GLOBAL EQUITIES, BONDS, T-BILLS, AND GOLD ARE GROSS OF MANAGEMENT FEES, PERFORMANCE FEES, AND TRANSACTION COSTS AND ASSUME THE REINVESTMENT OF ALL DIVIDENDS. TREND FOLLOWING, FUTURES YIELD, AND MERGER ARBITRAGE ARE REPORTED NET OF MANAGEMENT FEES, PERFORMANCE FEES, AND UNDERLYING TRANSACTION COSTS. ALL RETURNS ARE GROSS OF TAXES. BOTH PORTFOLIOS RUN ON IDENTICAL SIMULATED RETURN PATHS, AND SIMULATIONS ARE RANKED ON CUMULATIVE REAL STOCK RETURN OVER AGES 65 TO 70. THE SUSTAINABLE WITHDRAWAL RATE IS THE CONSTANT REAL WITHDRAWAL RATE THAT WOULD HAVE EXACTLY EXHAUSTED WEALTH AT AGE 95. DRAWDOWN AND DRAWDOWN DURATION FIGURES REPORT THE MEDIAN ACROSS SIMULATIONS OF EACH SIMULATION'S WORST OUTCOME; DRAWDOWN DURATION MEASURES MONTHS FROM THE PRIOR PEAK UNTIL WEALTH REGAINS THAT PEAK

RETHINKING MEANS REINFORCING

Nothing here guarantees retirement success. The overlay did not rescue the worst retirement plans and no investment allocation can promise success. What it did change was the distribution of outcomes. The retiree had a better chance of arriving at 65 with more and of sustaining the withdrawal if the early years turn hostile. And when markets cooperate, stacking means more may be left at the end of retirement.

Challenging the 60/40 does not have to mean abandoning it. Return stacking keeps the core intact and layers diversifiers on top, so the period least able to absorb a shock gets the reinforcement it needs.

In the decade when the odds matter most, it is a way of stacking them in the retiree's favor.

Methodology: We simulate 2,000 return histories with a stationary block bootstrap. The bootstrap draws joint monthly index returns from January 2000 through April 2026, with an average block length of 12 months. Whole months are drawn together, which preserves cross-asset correlations. We adjust each asset's simulated mean so that its Sharpe ratio matches our forward assumptions: 0.30 for stocks, bonds, trend following, and futures yield; 0.20 for gold; and 0.50 for merger arbitrage. Volatilities and correlations come from the historical sample. We finance overlay exposures at the T-bill rate plus 50 basis points. In each simulated history, an optimization finds the overlay mix that maximizes return with two constraints: gross notional exposure stays at or below 130%, and portfolio volatility stays within 5% of the bare 60/40's in relative terms.

1) The 60/40 portfolio is held constant throughout retirement for comparison purposes. In practice, the allocation would most likely de-risk through retirement.

2 For a single lived path, an investor would expect their wealth to approach the median outcome, not the mean.

Index Definitions:

Global Equities – The MSCI ACWI Net Return Index (NDUEACWF Index)

Treasury Bills – The Bloomberg US Treasury Bills 1-3 Month Index (LD12TRUU Index).

Bonds – The Bloomberg US Aggregate Bond Index (LUATTRUU Index).

Managed Futures Trend Following – The SG Trend Index (NEIXCTAT).Futures Yield – The ReSolve Futures Yield Liquid Universe Index (ReSolve Asset Management SEZC).

Merger Arbitrage – The PivotalPath Event Driven: Merger Arbitrage Index (PivotalPath).

Gold – Spot Gold (XAU/USD).

Important Information

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FIGURE 6: SEQUENCE RISK IN RETIREMENT (PANEL A: ODDS OF SUSTAINING 4% WITHDRAWALS TO 95. PANEL B: MEDIAN SUSTAINABLE WITHDRAWAL RATE)



SOURCE: BLOOMBERG; PIVOTALPATH. CALCULATIONS BY RETURN STACKED® PORTFOLIO SOLUTIONS. 60/40 IS A 60% ALLOCATION TO MSCI ACWI AND A 40% ALLOCATION TO BLOOMBERG US AGGREGATE BOND INDEX, REBALANCED MONTHLY. STACKED 60/40 IS A 60% MSCI ACWI, 40% BLOOMBERG US AGGREGATE BOND INDEX, 14.2% SG TREND, 7.8% RESOLVE FUTURES YIELD LIQUID UNIVERSE, 4.0% PIVOTALPATH EVENT DRIVEN: MERGER ARBITRAGE, AND 1.6% XAU/USD ALLOCATION REBALANCED MONTHLY. ANY EXPOSURE ABOVE 100% IS ASSUMED TO BE NET OF BLOOMBERG SHORT TREASURY US TOTAL RETURN INDEX PLUS A 50 BASIS POINT ANNUALIZED FINANCING SPREAD. GLOBAL EQUITIES, BONDS, T-BILLS, AND GOLD ARE GROSS OF MANAGEMENT FEES, PERFORMANCE FEES, AND TRANSACTION COSTS AND ASSUME THE REINVESTMENT OF ALL DIVIDENDS. TREND FOLLOWING, FUTURES YIELD, AND MERGER ARBITRAGE ARE REPORTED NET OF MANAGEMENT FEES, PERFORMANCE FEES, AND UNDERLYING TRANSACTION COSTS. ALL RETURNS ARE GROSS OF TAXES.

Baillie Gifford: Emerging Markets Are Moving Beyond the Macro Cycle

By Eugeniu Guzun – HedgeNordic

For decades, emerging markets have largely been viewed through a macro lens: a bet on a weaker U.S. dollar, rising commodity prices and stronger global growth. Ben Buckler, investment specialist at Baillie Gifford, argues that this mindset is increasingly outdated. Instead, he sees emerging markets becoming less of a cyclical "beta" play on the global economy and more of a source of structural, company-specific growth. For a traditional 60/40 portfolio, where equity exposure is increasingly concentrated in developed markets, emerging-market equities could offer not only additional growth potential but exposure to a different set of structural growth drivers and sources of return.

"If we look at the trends reshaping the world, whether AI, electrification, changing supply chains or the emergence of a multipolar world, they are shifting the geoeconomic center of gravity," says Buckler. "All of these trends are shifting where growth and innovation are coming from, increasingly towards emerging markets." This shift, he argues, has important implications for how institutional investors should approach the asset class. Rather than starting with country or benchmark weights, investors should focus on identifying companies whose competitive advantages are positioned to benefit from these structural changes.

In the context of a traditional portfolio's 60 percent equity exposure, which is heavily weighted toward developed markets, Buckler points to missed growth opportunities in areas such as semiconductors, batteries, digital finance and consumer champions. "If you take all of the companies in the MSCI ACWI that are forecast to grow their revenues 20 percent a

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Ben Buckler, Investment Specialist – Baillie Gifford.

www.hedgenordic.com – **September 2026**
HEDGENORDIC

year for the next three years, then over 70 percent of them come from emerging markets," he says, noting that emerging markets account for only around 12 percent of the MSCI ACWI.

ECONOMIC WEIGHT IS NOT THE INVESTMENT CASE

Emerging markets now account for a growing share of both global GDP and the world's population, while faster economic growth, rising incomes and expanding middle classes are creating a broader and deeper pool of companies and investment opportunities. But for Buckler, the case is not simply that emerging markets represent a larger part of the world and therefore deserve a larger allocation. Their growing economic weight is changing the nature of the opportunity itself.

"I'm not in the camp that simply says emerging markets represent a big part of the world, so you need to put more money there," he says, pointing to countries such as Turkey and Argentina, where economies have grown while stock markets have gone backwards in hard-currency terms. Economic growth, in other words, does not automatically translate into attractive equity returns.

The opportunity, in Buckler's view, lies in the fact that emerging markets are increasingly both creating demand and developing the capabilities to meet it. As he puts it, these are areas "where emerging markets are not only generating the demand; they are also developing the capabilities and solutions needed to overcome the constraints." This dynamic fits naturally with Baillie Gifford's bottom-up approach, which focuses on identifying companies capable of benefiting from structural growth rather than positioning portfolios around broad macroeconomic trends.

BOTTOM-UP INVESTING, WITH COUNTRY CONTEXT

"Fundamentally, we are bottom-up driven, trying to identify companies with the growth profiles that 32 years of evidence have shown us can deliver outsized returns," explains Buckler. "That's Baillie Gifford's philosophy." However, he is quick to emphasize that a purely bottom-up approach is not sufficient in emerging markets. "Country analysis remains essential for us; inflation, currency pressure, regulation and political intervention all matter. All of those things can overwhelm a very strong company at times," he argues. "But when building a portfolio, the country provides the context for the investment decision; it doesn't necessarily provide the investment thesis itself."

The end goal for Buckler and the Baillie Gifford team is therefore to identify the strongest companies while overlaying an assessment of the broader forces that could support or constrain them, including governance, stakeholder considerations, regulation and geopolitics. The need for such selectivity is reinforced by what Buckler describes as the increasingly heterogeneous nature of emerging markets.

Consider semiconductor manufacturers in Taiwan, digital banks such as Nu Holdings in Brazil and industrial automation companies such as Midea in China. All may sit under the same emerging-markets label, but their economics are fundamentally different. "Their customers, competitive advantages and underlying growth drivers are all fundamentally different," argues Buckler.

CHINA: TOO IMPORTANT TO IGNORE

That distinction becomes particularly important when considering China. While some investors have adopted separate approaches to China, Baillie Gifford does not fundamentally treat the country differently from other markets. "We are focused on finding companies that can deliver earnings growth, while taking into account the risks and constraints," says Buckler. "In that context, we find China quite exciting. From a bottom-up perspective, China is clearly delivering some of the best companies in the world, globally relevant."

Excluding China, he argues, would mean giving up a substantial part of the emerging-markets opportunity set, including exposure to some exceptional world-leading companies. But the opportunity comes with a distinct set of risks. "We've got to recognize that China carries distinctive regulatory, governance and geopolitical risks," he acknowledges. "However excited we may be about individual companies, our positioning has to reflect those broader macroeconomic, geopolitical and regulatory risks."

The scale of the opportunity reinforces the need for selectivity. China faces significant state influence, which can create risks where government priorities are not aligned with shareholders. "That point of selectivity is really quite important, both to maximize the opportunity set, but also to minimize the risks that come from broader and thematic factors," says Buckler.

> "If we look at the trends reshaping the world, whether AI, electrification, changing supply chains or the emergence of a multipolar world, they are shifting the geoeconomic center of gravity [towards emerging markets]."

THE RISE OF DOMESTIC EMERGING-MARKET CHAMPIONS

More broadly, the emerging-markets opportunity stretches across vastly different countries, continents, religions, cultures and stages of economic development. Yet beneath that diversity, a common set of forces is reshaping consumer demand: rising incomes, expanding middle classes and growing populations. Together, these trends are creating increasingly attractive markets for financial services, healthcare, mobility, travel and discretionary goods.

"To some extent, 20 years ago, that would have been exciting if you were Porsche, Volkswagen, Coca-Cola or Louis Vuitton," says Buckler. Today, however, he sees a different opportunity emerging: the rise of domestic companies that understand and serve their own consumers. "It could be Nu Holdings or Natura in Brazil, BYD or Luckin Coffee in China," he says.

The shift matters because many emerging-market companies are no longer simply beneficiaries of global brands or suppliers to developed-market businesses. Increasingly, they are building their own brands, technologies and distribution networks to serve rapidly expanding domestic markets. "Emerging-market companies are increasingly delivering solutions designed specifically for emerging-market consumers," Buckler concludes. "That ecosystem is becoming far more important in emerging markets today, because the companies plugging into that fully understand emerging-market demand."

The 60/40 Isn’t Dead. But the 40 Is Changing

By Eugeniu Guzun – HedgeNordic

For decades, the 60/40 portfolio has served as one of the defining frameworks for portfolio construction. While few institutional investors adhere strictly to that allocation today, it remains a useful lens through which to evaluate the role different asset classes play within a portfolio. Discussing this framework, Kari Vatanen, Head of Allocation and Alternatives at Finnish pension insurer Elo, offers a perspective on how institutional investors assess the role and attractiveness of different asset classes in today’s market.

“When talking about a 60/40 portfolio, one first needs to think about what the function of the 60 is and what the function of the 40 is,” says Vatanen. “The solution depends entirely on what you’re trying to achieve.” For Vatanen, the equity side is the easier part of the equation. Despite concerns over elevated valuations, market concentration, and geopolitical uncertainty, he argues that listed equities continue to serve the same fundamental purpose they always have.

Institutional investors still require a meaningful allocation to equities to generate the long-term returns needed to meet pension liabilities and other investment objectives. “The function of the 60 percent is to seek returns over the long run and help meet return objectives,” explains Vatanen. “Nothing has really changed. We still need equities to generate those long-term returns, and I don’t think any other risky asset class can replace them.”

Although some investors worry that equity markets have become excessively concentrated, particularly in the U.S., where a handful of mega-cap technology companies account for a growing share of index performance, Vatanen cautions against letting those concerns dictate portfolio construction. “There are certainly reasons to be concerned about market concentration,” acknowledges Vatanen. “But it’s a double-edged sword. If investors had become too worried about those companies three years ago, they would have missed most of the market’s returns.”

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Kari Vatanen, Head of Asset Allocation and Alternatives – Elo

www.hedgenordic.com – **September 2026**
HEDGENORDIC

Rather than retreating from equities, Vatanen believes investors should recognize that the beneficiaries of artificial intelligence will broaden as the technology matures. While software developers and large technology platforms have led the first phase of the AI cycle, he expects the next stages to benefit a wider range of industries.

"I see three phases," says Vatanen. "First comes software and data centers, then the infrastructure build-out, which benefits industrial companies and equipment suppliers. The final phase is when companies integrate AI into their own operations, creating productivity gains. Every phase will have different winners and losers."

THE CHALLENGE OF THE 40

The more difficult question is how to build the other side of the portfolio. Bonds have traditionally provided the counterweight to equities, offering income, capital preservation and diversification. But with today's broader opportunity set, institutional investors can no longer assume that government and corporate bonds are the obvious answer. Cash, private credit, infrastructure, hedge funds and alternative risk premia can all play a role, depending on the specific role investors expect that allocation to fulfil within the broader portfolio.

"The important question is: what is the function of the 40 percent?" says Vatanen. "There can be several different answers. If the purpose is simply to lower equity risk, then the most straightforward solution may be to invest in money market instruments and earn the risk-free return available on cash," he argues. "But if you want higher returns, or a different return stream that genuinely diversifies equities, then you have to do something else. The solution depends entirely on what you're trying to achieve."

The return of positive interest rates has undoubtedly improved the attractiveness of cash compared with the previous decade, when investors were effectively penalized for holding liquidity. Yet Vatanen does not believe higher policy rates have automatically restored the appeal of traditional fixed income. Looking at government bonds, he questions whether investors are being adequately compensated for assuming duration risk when cash offers only slightly lower yields without the same exposure to rising long-term interest rates.

> "The function of the 60 percent is to seek returns over the long run and help meet return objectives. Nothing has really changed. We still need equities to generate those long-term returns."

"If long-term German government bonds yield around three percent, is that enough?" asks Vatanen. "I don't think so. I can earn around two percent from cash without taking duration risk. If we remain in a more inflationary environment, longer-term interest rates could still move higher. In that scenario, I don't think long-duration government bonds offer an attractive risk-reward profile."

Corporate credit presents a different challenge. Although higher base rates have lifted headline yields, Vatanen argues that compressed spreads have eroded the compensation for taking credit risk. In his view, credit markets offer little margin for error if economic conditions deteriorate or inflation remains elevated, making expected returns less compelling than headline yields suggest. "The risk premium for taking credit risk is too low at the moment," he says. "That means I'm not particularly happy with the expected returns from a traditional bond portfolio. If inflation stays higher for longer and longer-term rates continue rising, yield curves also look too flat for that kind of environment."

With government bonds and corporate credit offering limited appeal, investors are increasingly looking beyond traditional fixed income for income and diversification. Private markets, including private credit, real estate and infrastructure, have become natural alternatives. "If you're looking for cash-flow returns from that 40 percent of the portfolio, there are more attractive opportunities," says Vatanen.

"Directly owned real estate, for example, provides rental income that can be higher than bond cash flows." He also points to selected infrastructure assets as sources of resilient cash flows, although valuation concerns make parts of the real estate market less attractive than in previous years. Vatanen remains more cautious on private equity, where the return profile is less compelling in the current environment.

In Vatanen's view, private equity valuations have yet to fully adjust to the new market environment, while subdued transaction activity has slowed exits and capital deployment. Many institutional investors remain locked into existing portfolios, waiting for distributions. "Most investors are stuck in the private equity market," says Vatanen. "Activity has been low, there haven't been many distributions, and at the same time there haven't been many capital calls either. When the market is stuck, returns become relatively modest."

With interest rates likely to remain elevated, Vatanen sees little reason for private equity to regain its role from the low-rate era. "That kind of environment doesn't help private equity markets, which means I don't see private equity as the best diversifier in portfolios at the moment."

HEDGE FUNDS MORE APPEALING

With parts of private markets offering less compelling opportunities, Vatanen sees a more favorable environment for hedge funds. Higher rates, greater macroeconomic uncertainty and wider market dispersion have created more opportunities for active strategies than during the ultra-low-volatility regime of much of the 2010s. But before selecting strategies, he argues that investors should first determine what role they want hedge funds to play in the portfolio.

"The first question is what function I want the hedge fund portfolio to provide," says Vatanen. "If I'm looking for diversification, then I would focus on market-neutral strategies, global macro, quantitative strategies or relative-value managers," he explains. "If I want higher returns and I'm prepared to accept more market exposure, then long-short equity or event-driven strategies may be more appropriate."

"Demand for hedge funds has already increased because many of the other alternatives don't look particularly attractive today," concludes Vatanen. "Most hedge funds have still been able to deliver solid returns, and today's market offers many more opportunities than we had during the years of zero interest rates and very low macro volatility," he adds. Compared with some private asset classes, particularly private equity, he continues to see "a very important place" for hedge funds in institutional portfolios.



Razvan Remsing, Chief Product Strategist – Aspect Capital

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Thinking Outside the 60/40 Box:

How Active and Dynamic Commodities Can Complement Bonds

By Hamlin Lovell – HedgeNordic

"Real assets such as commodities should move from a peripheral role in portfolios to an increasingly important portfolio building block and strategic asset."

Bonds helped investors to diversify equity between about 2000 and 2021, which more than covers the entire career of many allocators. Since 2022 bonds recoupled with equities as the "Great Moderation" megatrends of globalization, substantially free trade and unfettered supply chains, free movement of labour and capital, peace in most places, abundant energy supply and low inflation have all reversed.

This may prove to be a structural shift that could persist for decades: between the 1970s and 1990s equities and bonds were positively correlated. Investors are rethinking where, how and in what size bonds fit into their portfolios.

Beyond diversifying equities, Aspect Capital's Chief Product Strategist, Razvan Remsing, decomposes the portfolio role of bonds into three other jobs: carry income, liquidity and recession insurance. All of them are open to question.

Though nominal yields are at 20-30 year highs, real yields of 1-2% fall short of many investors' return targets and inflation-linked bond yields are also rather low. Investors are demanding a higher risk premium from bonds because G7 governments are heavily indebted due to the long term trends of growing welfare, health and pension largesse as populations age; the hangover from Covid subsidies and most recently a sharp jump in defence spending. Developed countries are now more indebted than emerging sovereigns and debt sustainability arithmetic is not compelling given a vicious circle of sluggish growth and ballooning interest service costs.

The liquidity provision role of bonds is also now doubtful due to geopolitical tensions. Russia's bond holdings were frozen after it invaded Ukraine and China has been reducing US Treasury holdings. More recently some of the latest sanctions on Iran may also act as "secondary sanctions" applying to Iran's trading partners. Distrust does not just exist between the West and the so called "Authoritarian Axis" since there are increasingly differences of opinion between the US and Europe. A leading sovereign wealth fund, Norges Bank Investment Management – the Norwegian oil fund – also plans to cut government bonds from 70% to 50% of its bond index, which implies a large cut in Treasury holdings. The Netherlands central bank has as well scaled back Treasuries – and along with France has repatriated gold reserves from the US. The trade war has even raised fears of possible tariffs or taxes on US Treasuries. De-dollarisation and dollar depreciation spur investors to seek alternatives to (or at least hedge) USD cash and USD denominated Treasuries.

Hence central banks (and also some commercial banks) have diversified their holdings away from G7 sovereign debt and most notably into gold, which may now be the second largest aggregate central bank holding. The biggest stablecoin, Tether, is also a significant gold buyer as it recycles some of its

www.hedgenordic.com – **September 2026**
HEDGENORDIC

> “We do not advocate a passive buy and hold approach nor a constant portfolio weighting since a synchronised bull market across all commodities is not the base case scenario. Commodities are a trading asset class.”

Treasury income into the yellow metal. Gold (held with a friendly custodian) offers an asset without sovereign or counterparty risk.

The recession insurance function of bonds is also debatable as it depends on the type of recession or slowdown. Clearly, bonds could provide protection against a demand side and deflationary shock (as they did recently in China) but since 2022 shocks in the Western world have come from the supply side and inflation has overshot developed world central bank targets for five years. Germany’s energy-intensive economy has seen flat to slightly negative economic growth for the past three calendar years and German government bonds have not been a useful diversifier.

Commodities can add some symmetry to the protection equation since they have responded well to episodes such as the Ukraine war shock of 2022 and the Iran war in 2026. “Real assets such as commodities should move from a peripheral role in portfolios to an increasingly important portfolio building block and strategic asset,” argues Remsing.

Commodities provide direct exposure to resource scarcity and energy security concerns that have been heightened by geopolitical tensions. The asset class also taps into trends such as green energy transition shifts and AI mania increasing demand for electricity.

All of this is palpable, yet many asset owners remain severely underweight of commodities. Pension funds, endowments and foundations have often been increasing allocations to alternatives more broadly but commodities have been something of a Cinderella. “This is partly because they cannot identify clear risk premiums for a long-term strategy of buying and holding commodities. We have some sympathy with this view and do not advocate a passive buy and hold approach nor a constant portfolio weighting since a synchronised bull market across all commodities is not the base case scenario. Commodities are a trading asset class,” Remsing asserts.

Aspect can follow long and short trends in commodities, which is useful since the disruptive forces underway can generate strong and sustained moves as well as boom/bust cycles in both directions.

Aspect’s systematic programmes typically run significant commodity risk on average, though that exposure can be highly variable according to the opportunity set – allowing the strategies to dynamically lean in and out of commodity themes as they emerge. This dynamic and adaptive approach responds to changing patterns of trends and correlations.

Aspect has spent years broadening out its commodity investment universe to include a variety of energy and energy derivative products – such as butane, ethane and propane - as well as carbon emissions and multiple electricity markets. Aspect was also one of the first asset managers to trade Chinese commodities. These markets, which can include some dubbed “alternative markets”, provide additional sources of return and diversification.

“Bonds are not dead and 60/40 is not dead but investors need to broaden their horizons to navigate a wider range of shocks. Diversified, dynamic, trend following CTAs are a key building block for liquid alternative allocations. We can rapidly react to whatever emerges in the new regimes,” sums up Remsing.

Aspect Capital eyes its 30th anniversary in 2027 and its founders, Anthony Todd and Marty Lueck – who featured in The Hedge Fund Journal’s “50 Giants over 5 Decades series” – also traded similar strategies during the sorts of economic and financial market regimes that threaten to wrong-foot some investors today.

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Jonas Thulin, Chief Investment Officer – AP3.

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AP3's Jonas Thulin: "The 60/40 Portfolio Has Run Its Course"

By Eugeniu Guzun – HedgeNordic

"As soon as we go into the real world, where correlations change across different time horizons, the 60/40 portfolio is no longer relevant. It has run its course."

The 60/40 portfolio was built on a simple premise: equities drive long-term returns while bonds provide stability and diversification. But that relationship is no longer as reliable as it once appeared. Inflation, higher interest rates and shifting macroeconomic regimes have shown that correlations can change precisely when investors need diversification most. For institutional investors, the challenge is therefore to move beyond asset-class labels and consider how exposures interact across the portfolio. Sweden's AP3 offers one example. CIO Jonas Thulin has championed a Total Portfolio Approach that combines strategic asset allocation with tactical positioning, quantitative signals and a broader focus on portfolio-level risk and return.

Thulin is blunt in his assessment of the traditional 60/40 model. "As history has taught us, especially over the last five years, a 60/40 portfolio provides no diversification," says Thulin. In his view, the model may still have relevance in academia and research, where correlations can be treated within defined historical windows. "As soon as we go into the real world, where correlations change across different time horizons, the 60/40 portfolio is no longer relevant. It has run its course."

For Thulin, the problem goes beyond the changing correlation between equities and bonds. He also questions the mechanics of maintaining a portfolio built around fixed asset-class weights, particularly the requirement to rebalance at predetermined intervals. For a large institutional investor, those trades can become predictable and potentially costly. "If you run a 60/40 portfolio the size of an AP fund, everybody will know when you rebalance, and they will front-run you. You're fighting the market and widening spreads as soon as you want to do something."

FROM AUTOMATIC REBALANCING TO DYNAMIC ALLOCATION

This thinking was one of the reasons Thulin moved AP3 towards a Total Portfolio Approach and dynamic asset allocation after taking over the portfolio management role. One of his first decisions as CIO was to remove the automatic rebalancing exercises that had previously taken place every month.

"If I as a CIO am half-good at timing the market and understanding what's going to happen, I will outperform an automatic rebalancing scheme," says Thulin. AP3 made the decision to employ the Total Portfolio Approach and focus on the total return. "We want to achieve as high a return as possible given our mandate and our role in Swedish society, obviously under controlled and predetermined risk," he explains. "We can maximize that return more easily if we work dynamically with the portfolio."

STRATEGIC ALLOCATION AS A SET OF GUARDRAILS

At AP3, the strategic asset allocation remains an important part of the investment process, particularly through the fund's asset-liability and broader societal considerations. "For us, the strategic asset allocation

www.hedgenordic.com – **September 2026**

> “From a total portfolio approach, it’s about making sure we allocate capital to what is actually best for the overall portfolio.”

remains important through the ALM calculations,” explains Thulin. AP3 does not have conventional liabilities in the same way as a corporate pension scheme, but the fund has what he describes as a “liability to society,” the requirement to generate sufficient long-term returns for the Swedish pension system.

Pension funds such as AP3 must take broader demographic and economic factors into account, including the country’s birth and death rates, net immigration, tax revenues and future demographics. The strategic allocation exercise consequently establishes what Thulin calls a set of guardrails. AP3’s strategic capital allocation provides the broad parameters for the portfolio, including a reference point for equity exposure. AP3 currently has a benchmark allocation of around 55 percent to equities. “If we have 55 percent equities, we should make ends meet if nothing else happens,” says Thulin.

The CIO’s role then becomes to determine whether the portfolio can improve on that strategic baseline. “How can I beat the 55 percent equities and 45 percent interest rates?” asks Thulin. “Then we leave the strategic asset allocation behind, and all asset classes and investments compete with each other,” he explains. “From a total portfolio approach, it’s about making sure we allocate capital to what is actually best for the overall portfolio.”

COMBINING STRATEGIC CONVICTION WITH TACTICAL SIGNALS

AP3 distinguishes between strategic and tactical changes, although both are informed by a broad range of quantitative models. Thulin says the fund typically makes around one major strategic shift a year, alongside roughly 50 tactical trades. One strategic shift in 2026 was the decision to reduce equity exposure ahead of the U.S. attack on Iran. Thulin describes the decision not as a single prediction of an impending geopolitical event, but as the result of a series of signals emerging across financial and macroeconomic data.

“We were out before the war began because of our signals,” he recalls. “We could see in the data that some part (later revealed that it was Iran) was starting to hoard financial capital and foreign exchange.” According to Thulin, the signals were visible in financial stress indicators before the conflict became widely reflected in market pricing. The example illustrates the distinction AP3 makes between reacting to an event and identifying the underlying conditions that precede it.

DATA-DRIVEN DECISION-MAKING AND ORGANIZATIONAL CONTROL

The quantitative infrastructure behind these decisions is extensive. Thulin describes “thousands upon thousands of different models” contributing to different parts of the investment process, with some operating at a higher frequency for tactical decisions and others moving more slowly while looking further ahead. “It’s all data-driven,” he says. “We have to be able to derive and prove why we allocate or change an allocation, and we have to be accountable for those decisions. That means we can follow up, we can be transparent about what went well and what went badly, learn from it and move on.”

The distinction between strategic and tactical decisions is partly determined by the strength and persistence of the signals. Some models can move quickly into tactical positions, while strategic changes require a higher degree of confidence because they involve greater portfolio-level consequences. “When you build a model, you have to ask whether it should be used strategically or tactically. For a strategic shift, you slow down because you need to be certain the model is actually right. A strategic decision has much greater consequences and requires a lot more effort,” explains Thulin.

For AP3, however, a Total Portfolio Approach is not simply an investment philosophy or a matter of giving portfolio managers greater discretion. It requires an organizational infrastructure capable of monitoring and controlling the resulting portfolio.

Thulin rejects the idea of AP3 as a collection of portfolio managers making large bets independently. “What has worked really well for AP3 is the culture and also the, quote-unquote, middle and back office. We have the governance structure and the culture to make this work throughout the entire organization,” he says. The investment process therefore extends beyond the front office, with decisions and risks tracked across the organization.

That infrastructure allows AP3 to monitor the entire portfolio on an hourly basis and understand how positions affect aggregate risk. For Thulin, this is a critical, and sometimes overlooked, component of moving from a traditional strategic asset allocation framework towards a Total Portfolio Approach.

“Without that whole machinery behind it, we won’t be able to run a Total Portfolio Approach,” he concludes. “We often talk about the front office taking positions and timing the market because that’s the “cool” stuff. But equally important, if not more important, is control. I can’t just run around taking positions worth billions without someone looking at every step I take and making sure I stay within my guardrails and am stopped out when necessary.”



Markus Aho, Deputy CEO and CIO of Varma

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Varma's Practical Considerations for Embracing a Total Portfolio View

By Caroline Liinanki – HedgeNordic

Finland's Varma is one of several large Nordic asset owners that has been moving towards a more holistic view of the portfolio – some time before a total portfolio approach turned into a much-hyped concept. Varma's deputy CEO and CIO Markus Aho says that while the €71.4 billion Finnish pension company tries to stay clear of labels, he sees its investment framework as a semi-total portfolio approach with elements of a more traditional strategic asset allocation.

"We've already been very far in the TPA-type of thinking and I believe we will continue to have some kind of hybrid model," Aho says. "While we think and set the strategy like in the TPA, we still have an annual allocation as we need to have a way to allocate our capital and we need to be mindful of the solvency framework."

He observes that there are different strategies for managing the portfolio. "One is to have racehorses racing against each other and then you feed them based on their performance. We've decided that's not the way for us. We're one team and everyone is committed to making decisions that optimise the overall result. That might mean that some need to sacrifice their own result to achieve a better result for the total portfolio," he says.

From an organisational perspective, this has required adaptations. "We have tried to make the responsibilities of the teams sufficiently wide and not have people working across very narrow, specific asset classes," he says. Furthermore, Aho emphasises the need for a clear structure. "The larger and the more regulated you are, the more you need structure. At any given time, the team needs to have a clear mandate and clear responsibilities. I believe the organisation should be able to develop and evolve with the portfolio and the strategy that we want. I believe it is the wrong way round if the organisation dictates the portfolio," he comments.

www.hedgenordic.com – **September 2026**
HEDGENORDIC

“I believe the organisation should be able to develop and evolve with the portfolio and the strategy that we want. I believe it is the wrong way round if the organisation dictates the portfolio.”

This more holistic portfolio view is reflected in how Varma is approaching the increase in equity risk, which is the main objective of the current Finnish pension reform. The first stage of the reform came into force this summer, with the new regulation to be fully implemented by next summer. “At the moment, we think about equities quite holistically,” Aho notes. “We do believe we can have a portfolio that's way more diversified than just going all in on public equities. Within equity risk, we also include private equity and real assets, such as equity-type infrastructure investments and opportunistic global real estate. We are trying to optimise for having as diversified of a portfolio as possible without sacrificing the return expectations.”

The responsibilities on the private market side have also changed over time. Infrastructure started out as an asset class within private equity but later merged with real estate to allow the team to identify the best opportunities across both asset classes. “Now, we’ve brought infrastructure and global real estate back together with private equity to have a broader team with quite a big mandate to invest across that spectrum,” he says.

Varma has for some time encouraged internal rotation of its investment staff across asset classes. At the same time, Aho notes that there needs to be some balance as the execution within each asset class obviously requires special expertise. More recently, some staff members have moved from the traditional fixed income team to work with hedge funds focused on alternative credit, as the pension reform has reduced the need for lower-returning fixed income investments. “We continue to maintain quite a large hedge fund allocation. I think those returns can be competitive with what can be expected of the equity markets,” he says.

Having a manageable team size and working from the same location are other aspects that he believes can make it easier to keep a total portfolio perspective. “We basically sit in the same room and can talk to each other at any time. The decision-making chain is also very shallow and very nimble and the investment organisation has a lot of authority to make decisions. The board is very well up to date on what we do, but the organisation has a lot of freedom. Those are some of the things that make it possible for us, whereas it would be much more difficult for a larger organisation with hundreds or thousands of people working in different offices across the world,” he says. Varma has an investment department in Helsinki of around 80 to 90 staff members.

The pension company also has a remuneration policy that is aligned with a total portfolio view. “We don't disclose the exact kind of compensation models that we have, but we do have variable compensation for everyone in the investment organisation, which is based on one single compensation pool. If we are not performing well as a whole, the compensation will be lower,” he says.

Aho observes that the shift towards a more holistic view of the portfolio has been a gradual evolution over time, but not necessarily a given direction for a portfolio that has been increasing in size and sophistication. “Looking over a very long period, the portfolio has grown and become more diversified, more complex and more professional. As organisations grow and specialise more, there's a tendency to become more siloed and I think you need to fight that all the time. There was a point in time when we were a bit more siloed within the investment organisation, but the way we invested was different and the market and the world was different,” he says.

He notes that when he joined Varma in 2014 to work within its private equity team, the asset class was much more sidelined. “Back then, private equity wasn't considered the same asset class as we consider it today,” he recalls. “It was more like a black box in the corner. You produced good returns, so everyone was happy, but it wasn’t integrated. The listed side was obviously more mature and more transparent. Over time, there has been an evolution of the portfolio and our thinking. We now view all asset classes similarly and we try to manage the underlying portfolio regardless of the asset class. We want to understand the portfolio we have, whether that's public or private or direct or indirect.”

“Looking over a very long period, the portfolio has grown and become more diversified, more complex and more professional.”



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60/40 – Don't Count On It

By Harold de Boer – Transtrend

Cows produce milk. Every day again. That's the fixed income for the dairy farmer. Bulls don't produce milk. Yet, equity investors prefer bull markets. Until they crash.

The farmer combines them. Bulls reproduce the cows that produce the milk. Although a productive herd does not require anything close to a 60/40 split, a mixture of cows and bulls generally brings prosperity. Until their shared pasture is buried under hard-packed snow or withers in a prolonged drought.

Then the commodity trader enters the field. Add crops to the portfolio! For the average investor, this sounds unnecessarily complicated. There is grass to feed the cattle. There always has been. There always will be. Or so they assume. Only the more willingly aware dare not to count on that.

With this complexity come the quants. They relentlessly impress with stats proving how much less we will be hit by historical stock market sell-offs if we spread our investments over different mixtures of stocks and bonds. Or even better, mixtures of stocks and bonds and CTA-trend: 60/40, 50/25/25, 60/0/40 or even 75/0/50.

You name it, the quant produces the numbers. And let's be honest, such numbers feel more objective and surely more sophisticated than an obscure story about cows, bulls and feed. But every real quant can explain why, statistically, these numbers are not as solid as they appear. They assume that different historical stock market crashes are different observations drawn from the same stochastic process. In the absence of properly determined causality, such numbers are just numbers. They have no predictive value. So, it is better not to count on them. Instead, let's look at the foundation of the 60/40 success.

A few years ago, I was invited to give a lecture for a group of students. They essentially wanted to hear what they should do to be able to stop working at an early age. A good preparation starts in time, so in that sense these mostly still teenagers were off to a good start. I explained that there was no single way to accomplish that; historically every generation had

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“The ongoing success of our scheme, including the ongoing success of the 60/40 passive long stocks and bonds, is not dependent on its historical success. It depends fully on the willingness of the future, and increasingly already present, generation to keep executing it. Why would they?”

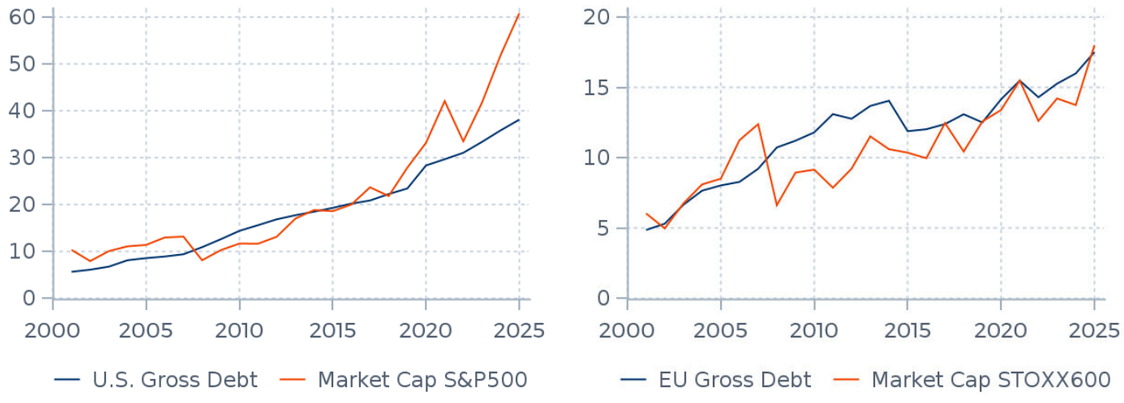
found its own way. When specifically asked about the strategy of my generation, I told them that this was supposed to be kept secret. But I was willing to reveal it to them under the condition that they would not tell anyone else. So they promised.

Since most of the readers of this piece will be part of my generation, I can write the same story here. Any younger readers are kindly requested to skip straight to the last two paragraphs.

My explanation started by showing an earlier version of the chart below. It shows the stock market value and the government debt in the United States. The European picture is not fundamentally different. Another part of the world; the same generation.

Our generation has massively invested in stocks. As a result, the value of stocks has gone up, providing the capital for our pensions. Our cunning trick is this: we did not invest our own capital. We borrowed the money. Or more precisely, our governments did. We have organized a convenient scheme, according to which our government spends more on us, on the various things our society needs, than we return to our government through taxes. This has resulted in explosively grown government debts. The official story is that all these government expenses have been used to build our societies and support our economies. In this story we use the grown stock market cap as proof of our economic success. But the true story is that we have grown our personal wealth at the expense of the next generation. We borrowed; our children and grandchildren will have to repay it. Or they must find another trick. That is up to them.

GENERAL DEBT AND FREE-FLOATED MARKET CAP IN TN USD



Source: IMF, Bloomberg.

Our scheme is quite artfully constructed. Every time we encounter adversity that causes stocks to fall, our governments respond by borrowing more money to support the economy and/or our central banks respond by cutting interest rates, causing bond prices to rise. This essentially is the grass that feeds our 60/40 stocks/bonds strategy.

A recent example was the COVID pandemic. Many people were surprised how fast stock markets recovered from the initial sell-off. But to us that was no surprise. It was part of my generation’s strategy. Our governments flooded society with support, officially meant to help us and our companies survive the lock-downs. But effectively it was used to save our capital. A lot of that money was used to invest. My generation benefited from that again. And the debt will be passed on to our descendants. They inherit it.

Somehow, not all students were enthusiastic about my generation’s strategy. One of them even mentioned a flaw. He said: “Your pension is dependent on us buying your stocks for their present value. What if we don’t buy those stocks, but prefer to invest in other companies? What if we start new companies?” I replied that this is precisely why our generation so passionately advocates passive investing. To make sure that our children spend most of their money on exactly those stocks on which we have already spent most of their money.

But the message is clear. The ongoing success of our scheme, including the ongoing success of the 60/40 passive long stocks and bonds, is not dependent on its historical success. It depends fully on the willingness of the future, and increasingly already present, generation to keep executing it. Why would they?

If we look back at stock market sell-offs over the last 50-plus years, we recognize a common denominator: many of them represent the bursting of a bubble. Could the current situation, a huge stock market cap founded on huge government debts, turn out to be a bubble too? If it implodes, will losses in stocks again be partially compensated by profits on the ”safe haven” bonds? We would not count on that.

In fact, we already experienced a situation like this after the COVID crisis. In 2022, falling stocks coincided with falling bonds. CTA-trend programs including Transtrend’s Diversified Trend Program performed very well during that period, profiting from trends in, among other things, commodities. Will our program automatically do the same the next time stocks and bonds fall together? We do not count on that. It again will require active management. A crucial element of our program is that we do not seek comfort in the past. Time and again, history takes a turn. We’ve learned to count on that.

“Will our program automatically do the same the next time stocks and bonds fall together? We do not count on that. It again will require active management. A crucial element of our program is that we do not seek comfort in the past.”

Diversification That Comes From Somewhere Else

By Kamran Ghalitschi – HedgeNordic



> “One should understand that what drives the return is uncorrelated with the stock market and the bond market.”
>
> Gustaf Hagerud,
> CEO - Finserve Nordic

Insurance-linked investments offer something increasingly difficult to find in institutional portfolios: return drivers that are fundamentally different from those behind equities and bonds. At HedgeNordic’s recent ILS Day in Stockholm, Gustaf Hagerud, aformer Alecta and AP1 allocator and former deputy CEO of AP3 argued that this distinction matters more than a low historical correlation coefficient, particularly when diversification is needed most.

For investors reconsidering the traditional 60/40 portfolio, adding another asset class does not necessarily mean adding another source of risk. Equity indices may contain hundreds or thousands of securities yet increasingly be dominated by a handful of companies. Credit, private equity, real estate and other seemingly distinct allocations can similarly retain substantial exposure to economic growth, financing conditions and interest rates.

For Gustaf Hagerud, CEO of Finserve Nordic and a previous allocator with around two decades of experience in strategic and tactical asset allocation at institutions including Alecta and AP1, this makes the distinction between statistical and fundamental diversification particularly important.

“When I say fundamentally uncorrelated, it is not just about looking at data, whether it is monthly data or daily data,” Hagerud told investors gathered at HedgeNordic’s ILS Day in Stockholm. “Rather, one should understand that what drives the return is uncorrelated with the stock market and the bond market.”

Hagerud identifies two dominant forces behind much of the return and risk in conventional financial assets: the global business cycle and monetary policy. Diversification becomes more meaningful, in his view, when investors introduce return streams whose underlying risks are not directly dependent on either. His presentation pointed to geopolitical tension, increasingly expansive fiscal policy, restrictive monetary policy and concentration in global equity markets as reasons for institutional investors to reconsider their allocation strategies.

His own interest in such return streams dates back to the global financial crisis. Starting a new role in September 2008, Hagerud recalled arriving just as “the entire portfolio fell out of bed.” The experience prompted a search for genuinely different sources of return. Insurance risk, including catastrophe risk and US life insurance, emerged among the candidates.

DIFFERENT RISK, NOT SIMPLY MORE RISK

The attraction of insurance-linked investments in this context is not that they are riskless. Quite the opposite. Investors are explicitly accepting risks that other parties want to transfer. The distinction is what causes those risks to materialise.

In catastrophe bonds, investors provide capital against defined insurance events such as hurricanes and earthquakes. The insurance industry compensates investors for assuming severe risks that could otherwise place significant pressure on insurers’ balance sheets.

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Life settlements approach insurance risk from almost the opposite direction. Investors acquire existing US life insurance policies from policyholders who no longer want or need them, continue paying the premiums and ultimately receive the insured amount when the policy matures.

The two strategies therefore involve very different risks, yet share an important portfolio characteristic: neither a hurricane making landfall nor the timing of an insured person's death is directly determined by GDP growth, corporate earnings or central-bank policy. Hagerud's presentation consequently describes the underlying risks of both strategies as fundamentally uncorrelated with the two primary risk factors he sees driving conventional financial assets.

PUTTING DIVERSIFICATION INTO THE PORTFOLIO

Hagerud illustrated the potential impact by starting with a conventional portfolio comprising 60 percent global equities and 40 percent global bonds.

Using ten years of historical data to derive return, volatility and correlation assumptions, the traditional portfolio produced an expected annual return of 8.4 percent with expected volatility of 11.1 percent.

He then introduced insurance-linked investments while adjusting the equity and bond allocations so that the expected portfolio return remained unchanged.

In one portfolio, a 20 percent allocation to catastrophe bonds reduced expected volatility from 11.1 percent to 9.6 percent. In another, ten percent was allocated to catastrophe bonds and ten percent to life settlements. Expected return again remained at 8.4 percent, while expected volatility declined further to 9.4 percent.

That represents a reduction in expected portfolio volatility of 13.3 percent and 15.3 percent respectively, without reducing the expected return in the exercise.

But average volatility was only part of Hagerud's argument. The more important test is what diversification does when conventional markets are under pressure.

> "If you want weekly liquidity, you're really looking at cat bonds. If you can accept monthly liquidity, then you can start blending in some of the private opportunities."
>
> Cahal Doris, CIO ILS
> Twelve Securis

"The interesting thing is to have diversification when the market goes down," he said. An analysis prepared for a large Nordic institutional investor showed the insurance-linked allocations cushioning portfolio losses during periods including the Covid shock in the first quarter of 2020 and the market disruption following Russia's invasion of Ukraine in 2022.

"You should be strong when everyone else is weak," Hagerud concluded.

The exercise also highlights why insurance risk need not be treated as one homogeneous allocation. Catastrophe bonds and life settlements have different underlying risks and different return characteristics. In Hagerud's assumptions, their expected correlation with each other was zero. Cat bonds also tend to have shorter duration, while he characterised the observed volatility of life settlements as primarily being on the upside.

CATASTROPHE RISK: BEYOND CAT BONDS

Cahal Doris, CIO ILS at Twelve Securis, took the discussion from portfolio theory into the catastrophe-risk market.

Cat bonds transfer defined insurance risks from insurers and reinsurers into capital markets. Investors provide fully collateralised protection and, in return, receive a floating cash return plus an insurance risk premium. Losses arise when specified insured events meet the contractual thresholds.

The return pattern therefore looks very different from that of conventional assets. Drawdowns are typically associated with insurance events – Hurricane Ian in 2022 or Hurricane Irma in 2017, for example – rather than recessions or changes in corporate earnings. Doris noted that the Swiss Re Cat Bond Index had returned around seven percent annually over the previous ten years, while the market itself has continued to grow.

For institutional investors, however, cat bonds represent only part of the opportunity.

Twelve Securis also invests in private ILS, including privately negotiated reinsurance transactions. Combining the two can expand the range of risks available and allow managers to move between markets as relative pricing changes.

The trade-off is liquidity. Cat bond funds commonly offer weekly liquidity, whereas portfolios incorporating private ILS may move towards monthly liquidity. The underlying private contracts are generally short-dated, however, with Twelve Securis typically limiting them to around one year.

Asked how a first-time investor might choose between pure cat bonds and a broader ILS strategy, Doris therefore started with liquidity.

"The first thought is liquidity," he said. Investors seeking a return above what the cat bond market can currently provide may consider blending cat bonds with private ILS, but must be prepared to accept less liquidity in return.

The broader opportunity set can also improve diversification within the ILS allocation itself. Access to private transactions allows managers to spread exposure beyond heavily represented catastrophe regions and to exploit differences in pricing between the public cat bond and traditional reinsurance markets.

LONGEVITY AS A RETURN DRIVER

RESS Capital approaches insurance-linked investing from a very different direction. Co-Founder Jonas Mårtenson focuses on the US secondary market for life insurance policies. Policyholders who no longer want or need a policy can sell it to an investor rather than surrendering it to the insurance company. The investor acquires the policy, continues paying its premiums and ultimately receives the death benefit.

For the investor, the central uncertainty is longevity. If an insured person lives longer than expected, additional premiums have to be paid and receipt of the insured amount is pushed further into the future, reducing the investment return. If the policy matures earlier than expected, the opposite occurs.

That creates a return stream that is not only largely detached from corporate earnings and economic growth, but also fundamentally different from

> “When you invest in cat bonds, you receive premiums, and when a hurricane strikes you have an event taking place. In our case, it’s the opposite: we pay premiums, and when an event occurs, we have positive upside volatility.”
>
> Jonas Mårtenson,
> Co-Founder - RESS Capital

catastrophe risk. Mårtenson sees the two as complementary within an insurance-linked allocation.

“When you invest in cat bonds, you receive premiums, and then a hurricane strikes and you have an event taking place. In our case, it’s the opposite,” he explains. “We pay premiums for a life insurance policy, and when an event occurs, a policy payout, we have positive upside volatility. So it’s really two different return streams which are quite complementary.”

For Mårtenson, longevity is therefore at the heart of the diversification argument. Looking at RESS Capital’s listed fund over its 15-year history, he says: “There is basically no correlation to any asset class, which, when you think about longevity – how long will that individual live – doesn’t really have any huge correlation.”

Life settlements are not, however, entirely insulated from financial-market conditions. Interest rates affect the present value of their long-dated cash flows and have influenced secondary-market pricing in recent years. RESS has responded by selling a substantial portion of its older portfolio and reinvesting the proceeds into newly acquired policies offering higher prospective returns. Mårtenson currently sees projected gross IRRs of approximately 15 to 20 percent on new purchases and targets a net return of around ten percent over the coming five years. These are prospective estimates rather than guaranteed returns.

The structure of the return stream is also unusual. Rather than experiencing a negative shock when an insured event occurs, as can happen with catastrophe bonds, a life-settlement portfolio receives its cash flow when a policy matures. “The volatility is much more on the upside,” says Mårtenson. “When a policy pays out, the net asset value may increase in a single month by one or two percent.” He consequently views life settlements as a medium- to long-term allocation, noting that some RESS investors have remained invested for more than a decade.

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What Would a Totally Unconstrained Portfolio Look Like?

By Christoph Junge

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Christoph Junge, Head of Fund Investments at EIFO

Over the course of my career working with strategic asset allocation and alternative investments, I've often found myself reflecting on a simple question: What would I do differently if there were no constraints? No regulatory hurdles, no governance committees, no cost ceilings, no need for liquidity. Just the freedom to build the most effective portfolio possible in pursuit of long-term, risk-adjusted returns.

This thought experiment is more than idle curiosity. Institutional investors operate within a highly structured framework of constraints, some explicit, others implicit. Regulations, internal guidelines, reputational considerations, fee sensitivities, and the practical realities of board-level governance all shape the investment architecture. Most of these constraints exist for good reasons: they safeguard solvency, protect clients, and promote transparency. Yet they also limit access to certain strategies, reduce flexibility, and can lead to suboptimal portfolio design. Others are self-imposed or at least accepted, like tremendous focus on fees.

By contrasting today's constrained reality with an unconstrained ideal, we can uncover the implicit trade-offs institutional investors make every day. What opportunities are we leaving on the table? Which constraints are genuinely necessary, and which are legacy artifacts that deserve to be re-examined?

In the following pages, I will outline the key constraints that shape institutional portfolio construction and then explore the design of a portfolio unconstrained by these limitations. The goal is not to disregard the realities of institutional investing, but rather to sharpen our understanding of how these constraints influence decision-making and identify opportunities to push boundaries in pursuit of maximizing the terminal wealth of beneficiaries.

As with any thought experiment, the true value lies not in the feasibility of the imagined outcome, but in the clarity, it brings to the world we live in.

To begin with, let us examine the most common constraints that shape institutional portfolios today, why they exist, how they influence portfolio construction, and what the landscape might look like if we could set them aside.

> "The most immediate shift in an unconstrained portfolio would be a significantly higher allocation to illiquid assets – not because I was Head of Alternatives in my previous role but because the capital market assumptions of leading institutions are highly favorable for these types of asset classes."

With the institutional constraints laid out, we now turn to the core of the thought experiment: If all those limitations disappeared, if we could construct a portfolio governed solely by investment merit, what would it look like?

The most immediate shift in an unconstrained portfolio would be a significantly higher allocation to illiquid assets – not because I was Head of Alternatives in my previous role but because the capital market assumptions of leading institutions are highly favorable for these types of asset classes. Without cost sensitivity, the need to meet short-term liquidity demands or comply with solvency metrics, one could allocate far more capital to private equity, venture capital, real assets, and private credit to harvest the complexity and illiquidity premia embedded in these types of investment.

Cost sensitivity is often framed as prudence. However, in a portfolio unconstrained by fee caps, implementation

TABLE 1: OVERVIEW OF COMMON INSTITUTIONAL PORTFOLIO CONSTRAINTS

Constraint	Rationale	Impact on Portfolio	Unconstrained Alternative
Cost Sensitivity	Pressure to minimize fees; belief in low-cost beta;	Underweights high-fee alpha strategies (e.g. hedge funds, private equity)	Willing to pay high fees for high alpha or differentiated exposures
Liquidity Requirements	Need for regular redemptions (e.g. daily NAV); regulatory liquidity rules	Avoidance of illiquid assets; shorter time horizon; limited private market exposure	Embrace of illiquid strategies (e.g. VC, real assets, private credit)
Governance Complexity	Senior Management or Board may lack time or expertise to assess complex products	Preference for simple, transparent strategies; benchmark-driven investing	Portfolio includes complex, opaque but effective strategies (e.g. ILS & CTAs)
Time Horizon Misalignment	Performance often judged on short-term results despite long-term liabilities	Herding behavior; aversion to short-term drawdowns and peer risk	Patience for long-term payoffs; tolerance for temporary underperformance
Regulatory Constraints	Investment restrictions (e.g. MiFID II, UCITS, Solvency II)	Limited alternative asset allocation due to prohibitive capital charge; limited product offering for private clients	No regulatory ceilings; free use of leverage, derivatives and alternative investments
Capacity Constraints	Too much capital to deploy efficiently in niche strategies	Underexposure to high-alpha, low-capacity strategies (e.g. small-cap value, frontier EM, certain hedge fund strategies)	Access to boutique managers and esoteric strategies
Benchmark Constraints	Career risk and evaluation against peers or indices	Benchmark hugging; constrained tracking error; reduced peer tracking error tolerance	Absolute return focus; no benchmark anchoring
Reputation / Headline Risk	Aversion to negative press or politically sensitive investments	Avoidance of controversial areas (e.g. ESG-sensitive sectors, hedge funds, commodities)	Opportunistic allocation, unconcerned with optics if risk-adjusted return justifies it

would prioritize net-of-fee outcomes over optics. For instance, a 2-and-20 buyout fund would be entirely justifiable if it delivered net returns exceeding those of listed equities. Even the Medallion Fund by Renaissance Technologies, despite its steep 5% management fee and 44% performance fee, would remain a compelling choice (if it was open to external investors), given its exceptional net-of-fee performance.

This opens the door to a full embrace of active management, especially in less efficient markets. In a truly unconstrained context, indexing would remain a useful tool for certain markets, but not a default. The implementation lens would shift from "How cheap is it?" to "How valuable is it?"

In parallel, we would likely see greater use of diversifying strategies with low correlation to traditional risk factors. CTAs (managed futures) and insurance-linked securities, often overlooked due to their complexity or headline risk, could play a central role as portfolio stabilizers.

In a constrained world, scale and simplicity often trump alpha. Large institutions cannot meaningfully deploy capital into small-cap value in emerging markets, niche hedge funds, or local distressed credit managers. But if capital and capacity constraints were lifted, these high-alpha, hard-to-access areas would gain prominence.

Institutional investors often claim to be long-term but operate under significant short-term pressures. Monthly performance rankings against peer groups, critical newspaper articles, rolling three-year track records and ultimately clients shifting to another provider after periods of underperformance. Freed from these pressures, an unconstrained investor could adopt genuine long-term patience. A long-horizon investor could allocate heavily into dislocated markets or out-of-favor sectors without fear of tracking error or career risk.

CHARACTERISTICS OF THE UNCONSTRAINED PORTFOLIO

To highlight the stark contrast between a typical institutional portfolio and an unconstrained portfolio, we can examine the figures in Tables 2 and 3.

It quickly becomes evident that institutional portfolios heavily allocate to equity risk, while real assets, an essential hedge against inflation, and strong diversifiers (CTAs and ILS) remain underweighted compared to an unconstrained approach. The unconstrained portfolio seems like a more balanced approach.

Having sketched the architecture of a portfolio free from institutional constraints, we now turn to its defining features.

HIGH TOLERANCE FOR COMPLEXITY

The unconstrained portfolio is unapologetically complex. It leverages a wide variety of strategies: private markets, insurance-linked securities, managed futures. This complexity is not pursued for its own sake, but because it expands the opportunity set and enhances risk-adjusted returns. Whereas constrained investors often favor simplicity for governance reasons (e.g., ease of explanation, board-level oversight), the unconstrained allocator can embrace complexity - as long as it is paired with genuine insight and manager oversight.

TABLE 2: ASSET ALLOCATION WEIGHTS OF UNCONSTRAINED PORTFOLIO VS. A TYPICAL INSTITUTIONAL PORTFOLIO

Asset Class	Category	Unconstrained Portfolio	Typical Institutional Portfolio
Buyout	Equity	20%	8%
Private Credit	Fixed Income	15%	5%
Venture	Equity	5%	1%
CTA	Diversifier	10%	0%
Insurance-Linked Securities	Diversifier	10%	0%
Global Fixed Income	Fixed Income	7%	27%
Global Equity	Equity	13%	50%
Real Estate	Real Assets	5%	6%
Timberland	Real Assets	5%	0%
Farmland	Real Assets	5%	0%
Infrastructure	Real Assets	5%	3%

TABLE 3: ASSET ALLOCATION GROUPED INTO CATEGORIES

	Unconstrained Portfolio	Typical Institutional Portfolio
Equity	38%	59%
Diversifier	20%	0%
Fixed Income	22%	32%
Real Assets	20%	9%

ILLIQUIDITY AS A FEATURE, NOT A BUG

Illiquidity is traditionally framed as a risk, but in the unconstrained portfolio, it is reframed as a source of return. The portfolio is not designed for daily mark-to-market pricing or redemptions; it is designed for long-term capital compounding. This allows it to harvest the illiquidity and complexity premia across private equity, real assets, and private credit in a size that is typically not possible to many institutions due to regulatory or internal constraints.

BENCHMARK AGNOSTIC

The unconstrained investor is not concerned with tracking error or peer group rankings. Success is not defined relative to a benchmark, but in terms of achieving absolute returns with favorable downside characteristics. The focus shifts from "how do I compare?" to "how do I compound?"

TRUE DIVERSIFICATION

Diversification is more than just spreading capital across traditional asset classes. The unconstrained portfolio actively seeks uncorrelated or counter-cyclical strategies, especially those with positive convexity in crisis periods, like managed futures. Unconventional strategies like insurance-linked securities may be difficult to govern or justify, but they can shine with uncorrelated returns when traditional portfolios suffer. This results in a portfolio that is better equipped for regime change and less reliant on central bank tailwinds.

These portfolio characteristics indicate theoretical advantages, but theory alone is not enough. To truly validate this approach, we must examine historical performance and assess how an unconstrained portfolio has fared in real-world market conditions.

The historical results are also in favor of the unconstrained approach, as shown in figure 1. The unconstrained portfolio outperforms the traditional portfolio by 72,8% since 2007, equal to 1,3% p.a. – and this is after fees for most of the alternative asset classes. To account for the few asset classes reporting gross of fees returns, we would have to subtract app. 25 bps. p.a. - still a massive outperformance.

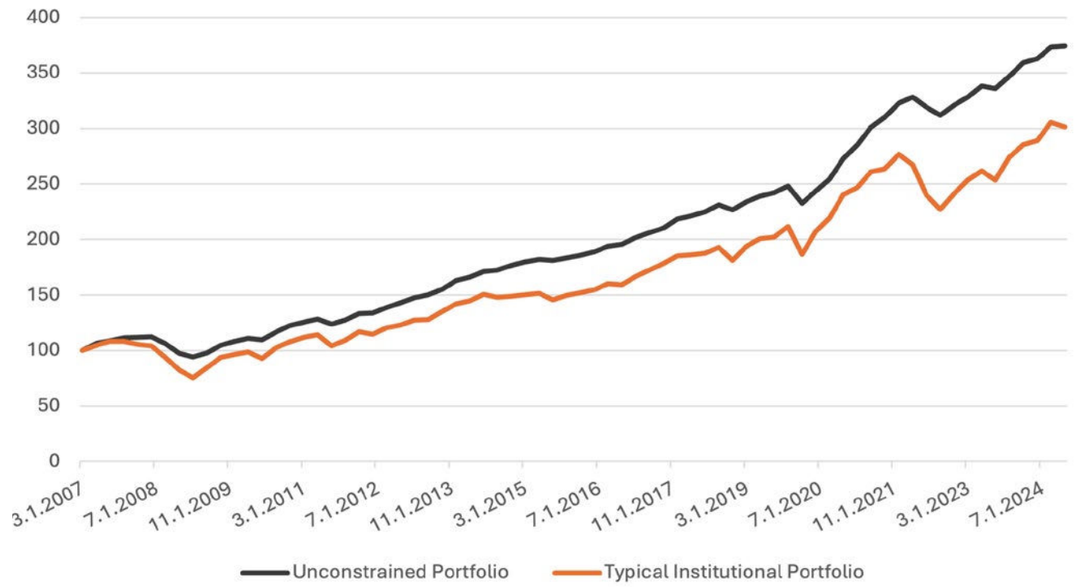
The standard deviation is nearly cut in half, but this must be taken with a large grain of salt as this is influenced by the smoothing effect of unlisted asset classes. However, not all downside protection comes from the smoothing effect as for example the diversifier bucket (which are liquid and hence not subject to smoothing) delivered outstanding returns in 2022 – a year where both equities and traditional fixed income suffered.

CONCLUSION

This thought experiment began with a simple question: What would an institutional portfolio look like if we removed all constraints? The answer, as we've seen, is not a fantasyland of speculative bets or unlimited risk-taking. On the contrary, it is a portfolio defined by better diversification and downside protection, delivering superior returns, albeit one unconstrained by the operational, political, and regulatory realities that shape most institutional mandates.

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FIGURE 1: HISTORICAL PERFORMANCE EVALUATION OF THE UNCONSTRAINED VS. THE TYPICAL INSTITUTIONAL PORTFOLIO



SOURCE: BLOOMBERG & OWN CALCULATIONS. PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

Of course, most institutional investors cannot (and should not) adopt a fully unconstrained approach. Regulations must be respected, governance frameworks upheld, and liquidity needs met. Yet the value of this exercise lies precisely in what it reveals: by stepping outside the current structure, we can see more clearly where that structure is helpful and where it may be unintentionally limiting.

What makes this exercise valuable is not the impracticality of the unconstrained ideal, but the contrast it provides. It shines a light on what we may be missing, what we might be overemphasizing, and where we could rethink legacy practices. In particular, it challenges us to ask:

- Are we forgoing long-term returns in pursuit of short-term optics?
- Are our governance processes enabling intelligent risk-taking or stifling it?
- Are we mistaking simplicity for prudence, and liquidity for safety?

Few institutions will ever operate without constraints, but every institution can benefit from periodically stepping outside its own mental models. The more clearly we understand the trade-offs we're making, the better we can decide which constraints to respect, which to challenge, and where we might push past convention to build better portfolios for the long term.

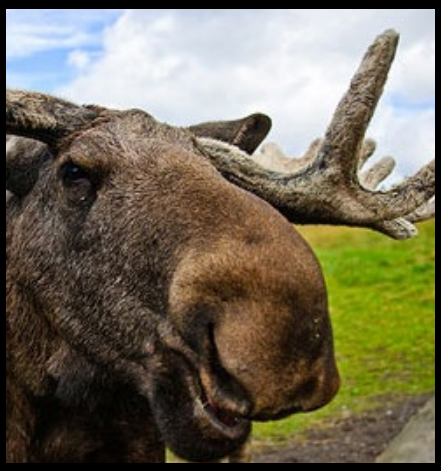
About the author

Christoph Junge is Head of Fund Investments at EIFO, the Danish Sovereign Wealth Fund, where he and his team are investing in Venture Capital with a dual mandate to generate attractive financial returns while at the same time also maximizing the societal return for Denmark. Previously, he served as Head of Alternative Investments at Velliv, a major Danish pension fund, and has extensive experience in Asset Allocation, Manager Selection, and Investment Advisory from roles at Nordea, Tryg, and Jyske Bank. Besides, Christoph is the founder of Alternative Investments Research & Education, providing courses and consulting services in Alternative Investments. He holds the Chartered Alternative Investment Analyst (CAIA) designation and brings more than two decades of experience from the financial sectors of Denmark and Germany. He is a sought-after speaker and advisor, known for combining deep industry expertise with a practical, forward-looking approach to investing.

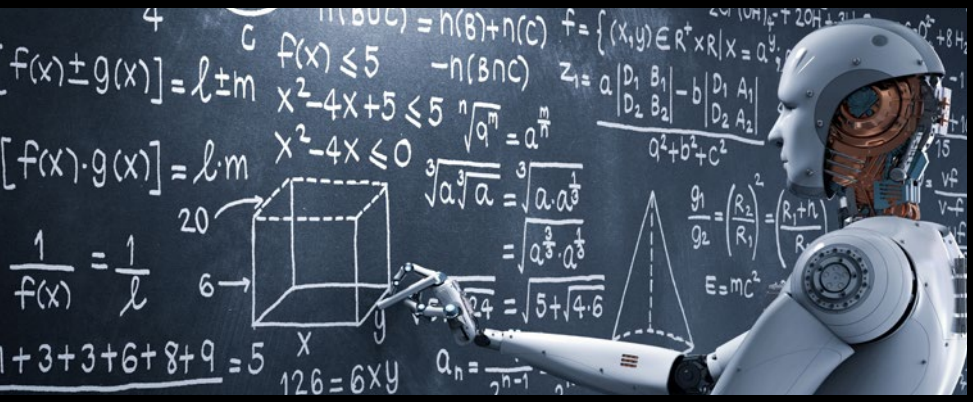


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