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The current global investment environment can be summarized as follows:

- Interest rates are at historical lows
- Equity markets are rich by historical standards
- Credit spreads are narrow by historical standards
- Inflation rates are at historical lows
- Monetary policy is highly accommodative.

It appears that the upsides for most asset classes are rather limited and with monetary policy showing no sign of being tightened, investors and asset allocators have to wonder where the returns will come from. If the upsides are rather limited, a more important issue for investors should be how to protect their hard-earned gains against potential risks that lie on the horizon.

The loose monetary policies of the last eight years may lead to run-away inflation. Which asset classes are likely to suffer the most and which ones are likely to provide maximum protection? While cash might be king during periods of financial stress, it will provide no protection against inflation. Even equities, which represent claims to cash flows from real assets and operations, have suffered in the face of an unexpected increase in inflation. Inflation-protected bonds and commodities are the two asset classes that can provide effective hedges against unexpected inflation. The problem is that real returns on inflation-protected bonds are close to zero and commodities do not provide any intermediate cash flow. But at least they will provide effective protection against inflation.

Other real assets such as real estate, farmlands, timber, and arts may provide some hedge against inflation in the long run, but each represents a basket of complex risks and returns, one of which is inflation. Still, a diversified portfolio of real assets with proper understanding and even hedging of the unwanted risks could provide effective protection against inflation.

Current valuations of equity markets are relatively rich by historical standards. Of course, this does not mean that there has to be a crash or that the market will not go up. It only means that the double-digit gains of the last few years are less likely to be repeated. To protect the substantial gains of the last several years, investors may decide to reduce their allocations to the riskiest segments of the equity markets and create more balanced portfolios (e.g., using a risk parity approach). Also, more capital may be allocated to more active managers; not in the hope of beating a rising stock market but rather to limit the damage should the markets enter an extended bear market.

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In short, in the coming months and years capital preservation may become more important than capital appreciation in developing and implementing asset allocation programs.

The current issue of *The Journal of Alternative Investments* covers three topics related to the above discussion. In "On Rarity Premium and Ownership Yield in Art" Geman and Velez explain why recent prices for rare pieces of art reported by auction houses have exceeded the ex ante estimates published by auction houses. The authors define this difference as a *rarity premium* and build a "Rarity Index." They investigate the benefits outside financial performance associated with art ownership and introduce the term of *ownership yield*, meant to encapsulate both aesthetic yield and "conspicuous possession." This ownership yield may account for the large values of the Rarity Index.

In "How Active is Your Real Estate Fund Manager?" Cremers and Lizieri use a holdings-based measure of active management to show that commercial real estate portfolios that are more active—i.e., have segment weights that are least like those of the index—have outperformed their benchmark. Employing proprietary data for 256 U.K. real estate funds over 2002–2011, the authors find that more active funds on average outperformed the real estate market by 1.9% per year.

Zhang and Jaffry examine volatility spillover in "Can Chinese Stock Index Future and Spot Markets Influence Each Other's Volatility? *Evidence from Both Conditional Volatility and Realized Volatility*." The article explores the volatility spillover effect between the Chinese stock index futures and spot markets using intraday high-frequency data from April 19, 2012 to April 19, 2013. The results are mixed. In some instances, the results indicate strongly bidirectional volatility transmission at the intraday high-frequency level while in other cases, there is no evidence of daily realized volatility transmission.

In "Toward Conditional Risk Parity: *Improving Risk Budgeting Techniques in Changing Economic Environments*," Martellini, Milhau, and Tarelli argue that risk parity portfolios are traditionally constructed by choosing historical volatility as the risk measure, and in an asset allocation context, this results in a substantial overweighting of bonds versus more volatile asset classes such as stock. This "overallocation" to bond is a concern in a low bond yield environment. The authors introduce three distinct conditional risk parity strategies, explicitly designed to respond to changes in interest rate levels. The results indicate that these strategies deliver higher returns when interest rates start to increase back to their long-term levels.

"Is Financialization Killing Commodity Investing?" Although the financialization of commodity markets has recently become a broadly discussed phenomenon, its implications for commodity investors remains unknown. Zaremba attempts to answer this question and examine its implications for investors. The article concentrates on the benefits of passive investment strategies on commodity markets in the context of financialization. The author first performs a regression analysis to examine the link between financialization and disappearance of roll yields. The computations indicate that the market financialization may significantly contribute to the decrease of the expected roll returns. Moreover, because of the drop in the roll yields, the inclusion of the commodity futures in the traditional stock-bond portfolio may not provide the benefits that investors have come to expect.

Miffre and Fernandez-Perez present strong evidence in favor of long-short (as opposed to long-only) commodity investments in the article titled "The Case for Long-Short Commodity Investing." The authors show that long-short fully collateralized commodity portfolios based on momentum, term structure, or hedging pressure present higher Sharpe ratios, lower volatility, and lower correlation with the S&P 500 index than long-only commodity portfolios. Besides, long-short hedging pressure portfolios serve as partial hedge against extreme equity risk as they present decreasing correlations with the S&P 500 index in periods of heightened equity volatility. This is good news for equity investors: it is precisely when the volatility of equity markets is high that the benefits of diversification are most appreciated.

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