

PICTON
INVESTMENTS

PORTFOLIO CONSTRUCTION TRENDS

THE 2026 PICTON REPORT

Robert Wilson,
CFA, CAIA

Head of Innovation,
Portfolio Strategist,
2ND ENGINE

Pawan Vatvani,
CFA, FRM

Head of Portfolio
Construction, Portfolio
Strategist, 2ND ENGINE

PORTFOLIO CONSTRUCTION IN 2026

THE MINDSET SHIFT: FROM STATIC ALLOCATIONS TO TOTAL PORTFOLIO THINKING

An Evolving Framework for Portfolio Construction

Across institutional investors, asset owners, and advisory platforms, portfolio construction continues to evolve in response to increasingly complex market conditions.

Persistently higher macro uncertainty, concentration risk, and regime shifts have challenged traditional allocation frameworks and reinforced the need for more resilient portfolio design.

Within this context, the Total Portfolio Approach (TPA) has emerged as a durable framework that reframes how capital and risk are allocated.

Rather than treating portfolios as collections of discrete asset-class sleeves, TPA views the portfolio as a single, integrated system.

Allocation decisions are evaluated based on their contribution to overall portfolio behaviour and outcome resilience, rather than their role within a predefined strategic mix.

This evolution reflects a broader institutional shift away from label-based diversification toward a more granular understanding of underlying risk drivers.

By focusing on how exposures interact across the full portfolio, TPA seeks to improve diversification quality, manage drawdowns more effectively, and enhance the probability of achieving long-term objectives.

At its core, TPA could be a “next best dollar” framework built around 4 key tenets:



01.

Goal-based Portfolio Construction

Each decision is made based on the impact it will have on the portfolio achieving its overall goal.



02.

Competition for Capital

All investment opportunities compete for allocation based on their ability to contribute to portfolio goals, rather than by asset class label.



03.

Total Portfolio View of Risk

A single unified risk framework is applied across fixed income, equity and alternatives.



04.

A Dynamic and Flexible Approach

Exposures can be meaningfully adjusted when market conditions change.

CAPITAL ALLOCATION THROUGH A TOTAL PORTFOLIO LENS

The “Next Best Dollar” Framework in Practice

The “next best dollar” framework is the principle that guides capital allocation under TPA.

It means every new potential investment (or adjustment) should be evaluated by its marginal contribution to the total portfolio’s objectives, not by its stand-alone return or by its position within an asset-class silo.

Ask Yourself This Question:

“If I had one more dollar (or one more unit of risk) to allocate, instead of allocating it according to a set split between asset classes, where would it add the most value to the total portfolio, after considering diversification, liquidity, and objectives?”



“Great portfolio construction begins with the right mindset: **Goals first, everything else follows.**”

WHY STRATEGIC ASSET ALLOCATION IS LOSING ITS EDGE

Structural Limitations in a More Uncertain Market Regime

The Strategic Asset Allocation (SAA) framework is built on the assumption that the law of large numbers will prevail and that over the long run, outcomes will converge toward expected returns.

This assumption may not hold true for individual investors whose outcomes can diverge meaningfully from the average due to time horizon and cash flow needs.

“
*Strategic asset allocation is comfortable governance **but clunky portfolio management.***
”

– Roger Urwin, Co-Founder, Thinking Ahead Institute

5 reasons SAA is no longer enough:

01. Averages over Outcomes

Traditional frameworks aim for average returns instead of maximizing the probability of achieving client goals.

02. Ignores Sequencing Risk

Portfolios often overlook the impact of return timing which can be a key determinant of long-term success.

03. Lacks a Shared Risk Language

Different asset classes are analyzed in silos, making it difficult to view total portfolio risk holistically.

04. Static in a Dynamic Market

Fixed allocation models could struggle to adjust as markets, opportunities, and risks evolve.

05. Diversifies by Label, Not Exposure

Asset classes may look diverse on paper but often share the same underlying economic drivers.

THE EVOLVING ROLE OF ALTERNATIVES IN PORTFOLIO CONSTRUCTION

From Tactical Add-Ons to Structural Portfolio Building Blocks

Under a TPA framework, alternatives are not merely add-ons; they can be core components that can reshape the portfolio’s risk profile.

They can offer the opportunity to incorporate diversifying assets and strategies with the potential to broaden the array of risk factors in a portfolio. In this way, true diversification can be achieved.

At PICTON Investments we have decades of experience running hedged equity, income, merger arbitrage and multi-strategy mandates.

We have spent years researching better ways to incorporate these strategies into portfolios by classifying them as enhancers, diversifiers, and inflation protectors.

Enhancers

Strategies that target exposure to similar risk profiles of traditional portfolios, but seek to deliver better return outcomes. They aim to amplify return or mitigate risk to provide **enhanced risk-adjusted returns**.

Diversifiers

Strategies that are generally uncorrelated to or **diversify from traditional assets**. They seek to provide excess returns without exposure to the risks of traditional equity or fixed income assets.

Inflation Protectors

Strategies that invest in assets that tend to **benefit from rising inflation** and can further diversify portfolios and mitigate losses in inflationary environments.

Category	Sub-Category	Correlation	Volatility	Target Beta	Goal
ENHANCERS	Return Amplifier	HIGHER	HIGHER	HIGH	Provide exposure to similar risk profiles that are in traditional portfolios, while seeking to enhance return or yield. Examples of strategies include 130/30, Private Equity, Private Credit
	Risk Mitigator	HIGHER	LOWER	LOW TO MODERATE	Provide exposure to similar risk profiles that are in traditional portfolios, while seeking to mitigate downside risk. Examples of strategies include Long Short Equity, Long Short Credit
DIVERSIFIERS	Alpha Generator	LOWER	HIGHER	ZERO TO LOW	Provide diversification to the risks in traditional portfolios as they have no (or low) beta. Seek to increase portfolio diversification while generating moderate to high returns. Examples of strategies include Multi-Strategy
	Diversifying Stabilizer	LOWER	LOWER	ZERO TO LOW	Provides diversification to the risks in traditional portfolios as they have no (or low) beta. Seeking to reduce portfolio risk while generating low to moderate returns. Examples of strategies include Merger Arbitrage, Market Neutral Equity

THE PATH FORWARD FOR PORTFOLIOS IN 2026

Redefining Success Through Resilience, Adaptability, and Total Portfolio Thinking

As 2026 approaches, investors face a market shaped by concentration risk, persistent inflation uncertainty, and shifting global growth dynamics.

From elevated equity valuations and tighter credit conditions to geopolitical and liquidity risks, portfolios must be built to withstand a broader range of outcomes. A total portfolio approach provides a more resilient framework for navigating this environment.

The traditional 60/40 portfolio has long served as a foundational allocation model.

However, today's market conditions call for a more flexible structure: one that looks beyond asset labels and focuses on how each exposure contributes to overall portfolio behavior.

That's why investors should consider a diversified allocation that blends growth, income, and uncorrelated return sources:

- **Equities** for long-term growth, with broader geographic diversification
- **Fixed income** for income, stability, and capital preservation
- **Diversifiers and alternatives** to manage inflation risk, volatility, and market regime shifts

01.

Start Taking a Total Portfolio View

Use a broad reference portfolio to assess the overall value add of your portfolio. Use tools like the **2ND ENGINE Portfolio Analyzer** to take a total portfolio view of risk.

03.

Build a Shadow Portfolio

Build a "shadow portfolio" that simulates a partial implementation of TPA. Observe how the portfolio behaves differently than your current allocation.

05.

Think Ahead

Consider building a playbook ahead of time for how you can dynamically adjust the portfolio in different economic scenarios.

02.

Encourage Competition for Capital

Reorganize your manager monitoring lists by getting rid of labels and considering investments based on their ability to contribute to portfolio goals.

For example, evaluate traditional equity, equity hedge funds and private equity hedge funds strategies that may play a similar role within the portfolio – assess each against one another.

04.

Identify Implementation Priorities

Sequence your implementation intelligently. Address high-impact areas first and defer more complex changes until later.

For example, if your portfolio currently lacks diversifying risk exposures, consider building out that allocation before fine-tuning your exposure to equity or fixed-income risk.

2026 OUTLOOK: PUTTING TOTAL PORTFOLIO THINKING TO WORK IN 2026

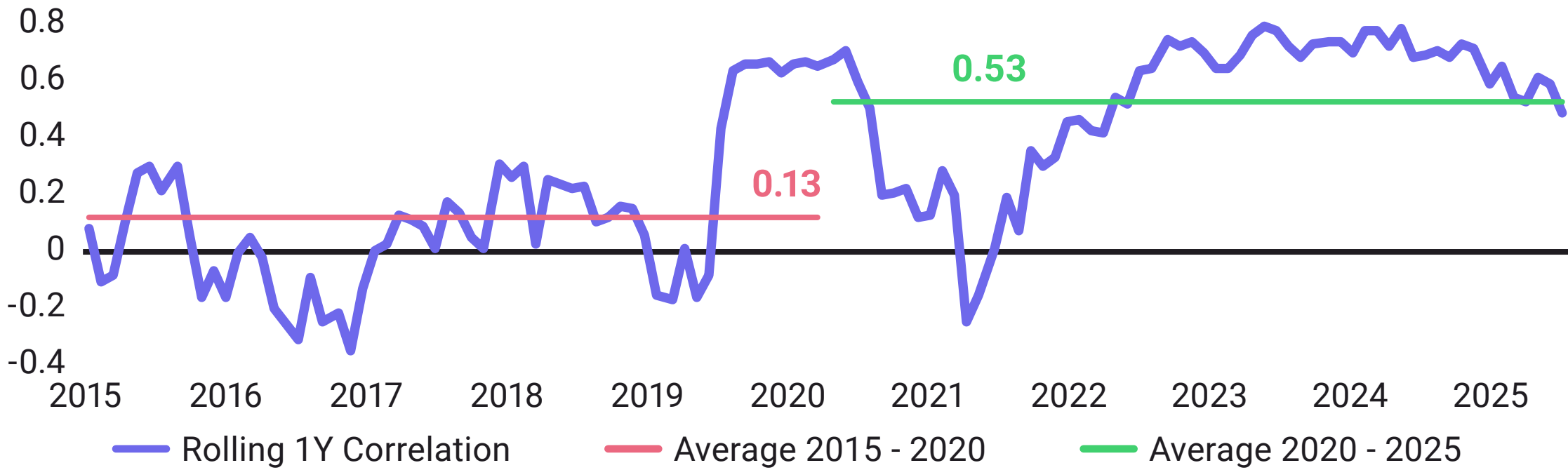
The Regime Has Shifted So Standing Still Is No Longer Neutral

Equity–bond correlations remain elevated and “sticky,” eroding the diversification benefits of a traditional 60/40 portfolio. Portfolios that have remained unchanged in recent years may have implicitly assumed more risk than intended. A 60/40 portfolio today carries approximately 10% higher total volatility, driven by a material shift in the sources of risk.

Five years ago, interest-rate risk contributed little to total portfolio risk and acted as a volatility dampener. Today, interest-rate risk accounts for roughly 30% of total risk in the same 60/40 portfolio, a material increase.

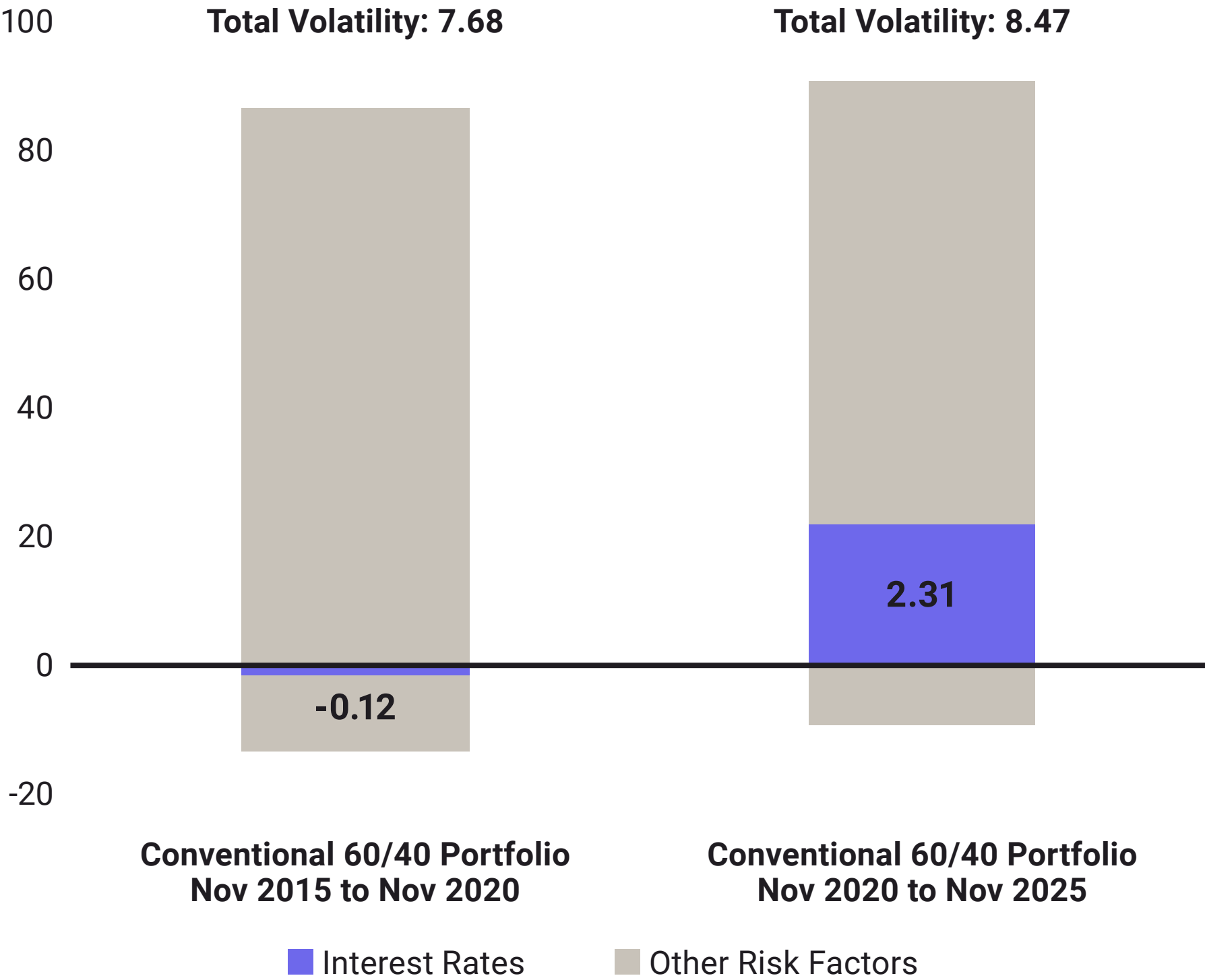
In this environment, inaction is not neutral. Maintaining legacy allocations may represent an active decision to accept higher volatility, weaker diversification, and potentially deeper drawdowns than the portfolio was originally designed to tolerate.

FIGURE 1
Rolling 12m Correlation Between Canadian Equity and Bond



Source: Period from January 1, 2008 to November 30, 2025. Canadian equity is represented by S&P/TSX Composite Index, Canadian bond is represented by FTSE Canada Universe Bond Index.

FIGURE 2
Factor Volatility Contribution (%)



For illustrative purposes only; does not represent an actual portfolio. Period from November 31, 2015 to November 31, 2025. Hypothetical 60/40 Portfolio is comprised of 40% iShares Core Canadian Universe Bond Index ETF, 15% iShares Core S&P/TSX Capped Composite Index ETF, and 45% iShares Core MSCI All Country World ex Canada Index ETF. The above table is used to illustrate that in the same hypothetical portfolio, interest rates factor has contributed more volatility for the period between 2020 to 2025 than the period between 2015 to 2020.

WHAT THIS MEANS FOR ADVISORS

Portfolio Construction Is Shifting From Static Allocation to Deliberate Risk Design

- **Be deliberate about duration and the role of fixed income**

As interest-rate sensitivity has increased and equity–bond correlations remain elevated, advisors are increasingly adopting an active approach to fixed income, with caution around materially extending duration or allocating heavily to the long end of the curve. Fixed income is generally being used to manage risk, preserve flexibility, and complement equity exposure, rather than serve as the sole source of diversification.

- **Reinforce diversification beyond stocks and bonds**

As bonds have become less reliable shock absorbers, advisors are increasingly supplementing traditional fixed income with portfolio diversifiers and alternatives strategies with the goal to diversify equity risk, dampen volatility, and mitigate downside risk across market regimes.

- **Address inflation risk deliberately, not redundantly**

With the prospect of easier monetary policy, large fiscal deficits, and potential currency debasement, inflation risk remains a structural concern. Dedicated inflation-sensitive assets (e.g., commodities) can play a role, but implementation matters. The objective is to mitigate against inflation without duplicating equity beta or interest-rate risk already embedded elsewhere in the portfolio.

A Question for Advisors

Are you thinking 30 years ahead? Success in the next era of wealth management won't come from predicting markets, but from designing portfolios that can perform in different market conditions.



Head Office

33 Yonge Street, Suite 320
Toronto, Ontario
M5E 1G4

Telephone: 416-955-4108

Toll Free: 1-866-369-4108

Retail Sales: 1-833-955-1344

General Inquiries

invest@pictoninvestments.com

Vancouver

Four Bentall Centre
1055 Dunsmuir Street, Suite 3370
Vancouver, British Columbia
V7X 1L3

Calgary

Bankers Hall, West Tower
888 3rd Street SW, Suite 1015
Calgary, Alberta
T2P 5C5

Montréal

1155 Metcalfe Street, Suite 1529
Montréal, Québec
H3B 2V6

[pictoninvestments.com](https://www.pictoninvestments.com)

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