



Season One: Episode Four
The Rearview Mirror Problem: Portfolio Discipline in a Changing Market
Launch Date: May 26, 2026

Kevin Rosenbaum: We often get asked, “Will this happen or won't this happen?” And unfortunately, markets aren't like that. It's all about probabilities. We have to assess the odds, but I think what's true also is there's gonna be winners and there will be losers. So, you have to be thoughtful about where you pick your bets.

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Willis Willson: The most important investment insights don't always come from charts or reports. They come from a good conversation. Welcome to Cambridge Conversations, a podcast from Cambridge Associates where we talk about what's really going on in institutional investing — the challenges, the opportunities, and the people making decisions that matter.

I'm Willis Wilson, an investment director here at CA. In my time working with private clients and institutions, one thing has become clear. Investing isn't just about the numbers. It's about relationships, trust, and the conversations that shape big ideas. And that's what we wanna share with you. Let's get started.

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Willis: For much of the last 15 years, investors were rewarded for following a similar playbook: stay concentrated in what was working, particularly in US equities and technology. But the market backdrop has shifted, and many portfolios may be carrying more risk, and less diversification, than investors realize.

In this episode, I am joined by two colleagues, Celia Dallas, our Chief Investment Strategist, and Kevin Rosenbaum, our Head of Global Capital Markets Research and Investment Communications. Together, we discuss why now is the moment to revisit past assumptions, to look carefully at portfolio risk, and think differently about diversification and what comes next.

Thank you, guys, for joining me here today.

Kevin: Happy to be here. Thank you.

Celia Dallas: Yeah, pleasure.

Willis: So first, Celia, can you kick us off? Briefly introduce yourself and talk a bit about your role at Cambridge Associates.

Celia: Sure. So, my role at Cambridge Associates as Chief Investment Strategist is to think through the macro environment, the market context, understand if things are changing, that should dictate changes in the portfolio, whether it's strategic, long-term, or short-term tactical positioning, and I am talking to you today as I celebrate my 30th anniversary at Cambridge.

Willis: Wow. 30 years at CA. When you think about your journey, what were some of the defining moments of your career beforehand, and what brought you to CA?

Celia: Well, the main thing that brought me to CA is my passion for research. When I graduated undergrad, I took a research job in competitive intelligence, and that got me interested in how companies compete. And there's a very small step from there to equity markets.

I then went to work for a think tank in DC and focused on retirement income security. And it was a very small bridge to then go to business school, meet the Director of Research at the time at Cambridge Associates, and think, "Wow. People are doing investment advice and portfolios for nonprofits and multi-families, some of which are philanthropically interested." So that drew me in.

I did my summer internship at Cambridge Associates.

Willis: Same, Same.

Celia: Yeah, I recall. I remember working with you on the training. And then, I got the job offer, and I thought, "This is fantastic. I'll do this for a while." And 30 years later, here we are.

Willis: How do you think that informs how you approach investing in your role today?

Celia: I'd say that the lessons that I learned in competitive intelligence consulting was really around how similar different markets can be. Things seem like they're very different, but they're actually based on the same economic principles and fundamentals, so it really got me thinking about what really matters.

Willis: Alright so Kevin, talk to me a little bit about your journey to CA and what your first role was.

Kevin: Sure, Willis. I cut my teeth in investment banking, and it was right before the global financial crisis. And at that time, my bank really was on the edge, and a lot of people started jumping ship. And that led me to go to grad school in the UK and eventually find myself in banking again in London, which I was really enjoying.

But several years prior to it, I had applied to work with the US government. I had a background both in economics on one side, but also a deep love and interest in politics and the government on the other.

And, while I was working in London, the US government came to me and asked if I was still interested in wanting to work for them and be an intelligence officer.

I opted to take that change and started working at US Central Command. And our job there was really to support the military leadership in understanding what's happening on the ground in the Middle East and helping them make the best decisions, both in terms of policy and how to position our military forces in the region.

Willis: So, from a career in defense to capital allocation, You know, that ties directly into your role today. I don't think people often think about a career in government and how that could pertain to something as specific as your role here at CA. Talk to me a bit about your role now at Cambridge Associates.

Kevin: I'm the head of Global Capital Markets Research and Investment Communications, and I've been at the firm for 12 years. And, really, my job is to help develop our asset allocation views, to communicate those views, and to ensure that all of our content, the views that we express there are consistent, rigorous, and thoughtful.

Willis: When you think about your background and where you sit today, how does that mindset carry over into the way you assess markets and think about geopolitical risk?

Kevin: I think it's definitely given me a lot of humility in understanding what we can predict in terms of what will happen in the future with geopolitics.

I did a deployment in Afghanistan and covered that area in South Asia for quite some time, and I think the lessons that I really took was just humility.

In my role, I had access to classified information, and our job was to understand what may happen in the future to better inform the policymaking process in the United States. And, it's hard to predict what's gonna happen, right? Even with the most classified information.

So again, I just come back to being really humble about what we can actually know and what we can't, and leaning hard on solid economic data, market data that is broader based and can get a better sense of what's happening and where

investments are potentially going, rather than anchoring to an expectation of where politics might be going.

Willis: This brings us to our main point of the conversation. Can each of you take a moment to think back to how things have evolved since the GFC and the various cycles that have come since?

Celia: If you think about the last 15 years or so, we saw low inflation, low and falling interest rates. We saw a strong dollar, and tech stocks do exceptionally well. That was a very good environment for equities and other US assets across all sectors and strategies.

It really set the stage for a change in the way a lot of assets were financed. One of the big turning points I would say of the post global financial crisis era was a meaningful regulation of banks that limited their ability to engage in certain sorts of loans that created an environment for private credit to grow and other sorts of non-bank financing.

The other thing that we saw was the increasing development in technology. So right now, the last few years really since Chat GPT was released at the end of 2022, we've seen AI being the key driver of technology, but you can think back to seven or eight years ago, and people were talking about just general digitization and consumer stocks and the cloud.

So even the acronyms and terms people used to describe the mega cap tech stocks have evolved from the old acronym FAANGs, now we're talking about the Mag seven, and now that's even evolving.

We've seen tech become a meaningful part of the equity ecosystem, especially in the US, and we've seen competing demand for resources across countries — that's created more geopolitical tensions. We've seen an increase in kinetic war in addition to competitive and tech wars. The environment has really evolved from the global financial crisis in pretty meaningful ways that it takes time for investors to react to.

Willis: It's funny when you mentioned FAANG... I forgot about that one. It seems like a whole lifetime ago.

Kevin: It does, it does. You know, I'll add one to Celia's great list there. The rise of passive investing also occurred during that period too, and I think it happened disproportionately in the US relative to outside the US; although, there was a clear trend there too. And that's one of the reasons I think you saw just tremendous outperformance of US equities. And what's amazing is almost half that outperformance is because US valuations increased at a higher, faster pace than world Ex US equities. And a quarter of that outperformance is due to the dollar strengthening. So really large contributions from valuations and the dollar, and I think those are things that aren't sustainable in the long run. It's not the case that valuations can just increase every year forever.

Celia: I think the concentration in US dollar assets is another aspect that has a lot to do with some of the trends that that Kevin articulated. But as we look through portfolios in the US, we find some of them are 90% plus in US dollar assets, and then outside of the US, it can be surprisingly high as well.

We've seen some portfolios that are maybe 75%, 80% US dollar oriented. So, there's now a bit of a mismatch between assets and liabilities in some cases that investors really need to think carefully about, and we're helping them do that.

Willis: Can you give an example of a case where you've helped clients think through that scenario?

Kevin: I was actually speaking to a family client of ours this morning, and they just wanted to understand the dynamics of the US government and its intentions with respect to NATO and its European allies, and how all of that seems to be evolving over last year and this year, particularly with everything that's going on with Iran currently.

So, part of that was just talking through those issues and, you know, communicating our views, but then it was discussing whether or not they should underweight US equities in their public equity book. And then thinking about where to commit greater exposure in the private book to commitments in ex US private funds.

Willis: Can you discuss the US NATO relations a bit and the implications of that in terms of US and Ex US investment opportunities and capital flows?

Kevin: I think it feeds into a lot of our views at the current moment. Right now, the NATO relationship, obviously, has been under some stress, right?

And as a result, we've seen relations between our European allies and the United States suffer to some extent. This comes on the heels of increased tariffs from the US on a lot of different countries. So, I think a lot of countries and investors outside the United States are reassessing whether it's appropriate to have as high level of US dollar exposure as they previously had.

So, I think what that means from a flow perspective and why this is very, very important to think about going forward is suppose that Ex US investors historically put 60 cents on the dollar in US assets. Maybe that value isn't 60 cents going forward. Maybe it falls to 50 cents. That has very big implications for both the dollar and asset prices outside the US relative to the US, and it's really supportive of our view that we think Ex US assets and equities will outperform US equities.

Celia: And I wanna make it explicit, it's not a "sell America" moment. It is a "put less capital into the US on a forward going basis", and you don't need to sell America outside the US in order to put pressure on the dollar.

Kevin: That's exactly right. Marginal changes in flows like that have really big implications.

Willis: This is a new step for Cambridge. We don't always say, take a step back and reconsider positioning. I guess the question is, why now? What are you seeing both looking backwards as you look in the rear view mirror and say maybe this isn't indicative of the future, and what's the future looking perspective?

Celia: For a while now we've been talking across the broader team of Cambridge investors about how concentrated the market has become, how much weight individual stocks in the index could have in a total portfolio because of the risk associated there. We've been seeing sort of a tighter coupling of themes where AI and software exposures cut across private credit, private equity, venture capital, public equity.

It's even starting to seep into investment grade credit. Not only that, but if you think about the infrastructure build out some of the real assets also start to be tied to the AI theme, and it started to remind me of a paper that my former mentor, Ian Kennedy, wrote in February of 2000 called *Diversification: A Warning Note*.

And I picked that paper back up and thought, "Wow, I could be writing most of that paper today, cross out internet, insert AI, and a lot of the same themes really resonated with me." Of course, this is not the same environment as that was, but it definitely has some similarities in terms of the markets being pretty tightly coupled to one or two themes that intersect each other really closely, suggesting you don't have as much diversification as you might think you have by looking at your allocation across security names and asset classes. And that rediversifying portfolios becomes essential to thinking about not only risk management, but generating the sorts of returns that we need to earn over the next decade.

Willis: I like your call out regarding risk management 'cause really what we're doing here is we're not making a prediction. What you're doing is recognizing that the probabilities and risks have shifted. Kevin, can you talk about this a little bit more and the distinction between the two?

Kevin: Yeah. If you think back to April of 2025, global equities were down 16%, right? As tariffs started to really bite into equity markets. But then the remaining eight months, global equities were up 40%, and it started to really raise concerns for us. Not only were there extraordinary equity returns, but there were high valuations, equity concentration. We knew retail investors had really, really high exposure to equities in their financial assets.

And then to your point Willis, I think for us, we often get asked, "Will this happen or won't this happen?" And unfortunately, markets aren't like that, right? It's all about probabilities. We have to assess the odds, and for the reasons that I just outlined, it looked like the distribution of expected outcomes was shifted to the downside. It wasn't the case that there's not a possibility of great returns out there — there

certainly is. I think just the distribution is not as great as it typically is. And so that led us to reassess asset allocations with that in mind.

Willis: You know, something that came up briefly in some of the things we've discussed so far is AI, and it's like you can't have a conversation without digging into AI. Celia, you talked about the internet boom and how this is similar but different

Celia: Yeah. We are very early stage in AI, so it's hard to know exactly how things are going to change. Thinking back to the late 1990s, one of the key differences that people remember about that period was that there were a lot of low-quality companies like Pets.com, where it really came out before the world was ready for it. But then Chewy comes out much later, and they're able to operate online.

People were valuing companies by eyeballs and clicks rather than revenue. A lot of speculative froth, and there are some similarities today. I would say that the big winners so far are companies that already had significant earnings and cash flows from existing businesses.

So the so-called "hyperscalers" that have been building out the cloud like, Amazon, Alphabet, Meta, Microsoft... most of them have meaningful free cash flow from their cloud business and other activities.

Another thing that's been quite different is that this year alone, they have announced plans to spend 700 billion in CapEx. That is a 75% increase from last year. That's something that rhymes with every single major technological evolution that we have seen since the beginning of time.

If you look back at the railroads, electrification, the internet, and now AI, there's a massive CapEx spend. It usually results in overbuilding. Have we overbuilt yet? We can't know, so this really shows the challenge investors have. There's a lot of promise here. This is very exciting, but where are valuations and how much do you want to invest today in what has already done quite well and is valued to continue to do well versus diversifying portfolios across other investment ideas.

Kevin: I think an aspect I also like to emphasize is that the marginal return on investment for incremental CapEx in any cycle... it tends to decline, right? So, to Celia's point, that's \$700 billion. The open question in markets right now is "What is the return on investment on that sort of investment?"

We know historically, if you look back at the companies that are conservative with their capital outliers, they tend to outperform those that are aggressive. So, we absolutely love the theme, and we think you should have really thoughtful exposure to AI across the portfolio. But I think what's true also is there's gonna be winners and there will be losers. So, you have to be thoughtful about where you pick your bets.

Willis: That makes a lot of sense. Something that we've been thinking about a lot is, what does valuation discipline look like when a technology theme feels

so powerful and feel so widely embraced? Something my team and I were talking about was around like how much of the potential is already priced in.

And so, I'm curious, how do you feel about this?

Kevin: On the private side, I think one, you have to partner with managers that you trust can implement a strategy that gets you the returns you're after. So being valuation discipline on that side.

On the public side where allocators like us have a little bit more flexibility, I think it's about being cognizant of the valuations in your book and trying to think about where you can take and lean into more attractively priced investments, such as having greater global Ex US exposure, having small cap exposure, tilting to other areas in the portfolio that are more attractively priced and that also add a bit of diversification versus a tech heavy US equity portfolio.

Celia: Equity, long, short hedge funds, I think is a very important component of a portfolio today that can capitalize on disruption not just going long the winners and short the losers, but also being thoughtful about losers that are priced too cheaply and still have a useful life, and winners that are priced too expensively and probably can be shorted for a while.

Another thing that we're thinking about in terms of manager selection is really where you wanna play in venture capital, both from a temporal perspective and a type of manager perspective.

So, if 2026 does turn out to be a bumper year for IPOs of SpaceX, Anthropic, Databricks, all of these companies that are anticipated to go public, investors should be careful in recycling that capital back into venture all at once. And instead, think about what offers value across the rest of the portfolio and putting some of that capital to work there.

Kevin: Celia makes an excellent point. I think one of the things that's true over the last few years is that the gains associated with AI most accrued to the large cap tech space. That doesn't have to be the case going forward. It could very well be the case that gains happen to these smaller, more decentralized companies across the spectrum that provide services somehow uniquely to different parts of the market.

This year, US earnings are expected to grow something like 18%, but a huge portion of that 18% is contributed from that small collection of AI-related companies. If those companies don't match expectations, you could very well see a re-rating of those expectations down that could then affect the broader US equity market and support the theme that we view as likely for the rest of this year and next year that Ex US equities would outperform.

Willis: **What a time to be alive. I know that I was fairly young during some of these other cycles, but this is starting to sound very reminiscent, hence the**

importance of looking back and understanding that maybe we need to adjust some things going forward. Celia, you talked about credit and that maybe credit is the early warning signal. What should allocators be paying attention to beneath the surface?

Celia: Yeah, we do focus on credit because it does have a tendency to be sort of an early indicator of stress in the system. There's default rates, and then there's adjusted default rates. And the adjusted default rates are what we're looking at because a lot of this credit was issued in a very competitive environment where covenants were extremely light, maybe no covenants, and there's an ability to do payment incline, to do various restructurings. So, when you adjust for those sorts of activities, default rates are following a similar trend but have increased higher. And it's very rare that you see default rates gently increase. They're either very low or very high, and they're a little higher when you adjust them today than would normally be the case in times of calm. So, we're watching that quite carefully.

I think another question that we often get is "Is there systemic risk in the private credit markets?" There would be some credit constraint if we saw a significant increase in defaults in private credit. But it doesn't have the sort of multiplier effect that bank lending has because banks are leveraged. And yes, there's some leveraged in the private credit system, but effectively the limited partners are providing the capital and their capital is at risk.

We're also looking at the insurance companies, which have been massive supporters of private credit, and they have relatively thin capital margins on their balance sheets. So, for some of those insurance companies that haven't been very careful and have loaded up significantly on private credit, that could cause some risk as well.

And even more specifically, the larger end of the market that has been much more squarely competing with syndicated loans for funding private equity investments, much of which were made during the zero interest rate environment of 2021 into early 2022... It was a different world back then, and if you're investing at zero rates and have to refinance at higher rates and your business model's threatened 'cause a good portion, maybe 20%, are also software companies... that layers on the risk.

Kevin: I do think it's the case that we're gonna see continued headlines about this issue. So, I think investors should prepare, but it doesn't mean that it's necessarily a systemic issue. Some of the issues that we've seen in the market have just been the time-old liquidity mismatch between retail investors and a private fund structure.

This has happened in other markets in other periods. Most recently in the UK market in closed-end real estate funds. I always find putting scale in the picture to help give context is helpful.

And the private credit market is something like two or \$3 trillion. Huge, huge market, no doubt. But global equities are about 120 trillion and global fixed income is about 150 trillion. So just a different level of magnitude.

Willis: Mhm. Where do you think investors may be underestimating the risk today?

Kevin: It's a good question. I think they're a bit too sanguine about equity risks. Frankly, equities have gone up a tremendous amount over the last 15, 20 year period since the global financial crisis. And that's really raised valuation multiples to near record levels in a lot of different markets.

And I think a lot of investors just kind of assume that because it's also true that the US remains the most dynamic and technologically forward market that's always gonna support US equities to go to even higher levels. And I think that's a little bit of a risk that people need to appreciate at a higher level than they currently do.

Willis: Mhm. You know, taking all this into consideration... Now we have to think about like, what do we actually do? So, Celia, what does rebuilding diversification actually look like in practice?

Celia: I think the place that you start is to take an honest review of your portfolio and look at the real exposures, not just the asset classes, not just the line items. It's to understand how much of your portfolio is dependent on US large cap growth, on a strong dollar, on falling rates.

Do you have any true diversifiers with really different economic basis of return in your portfolio that can provide ballast should the environment really be different? And I think, a great example, the 2022 period-Ukraine war, also following on the heels of significant monetary and fiscal stimulus following COVID, showed an inflation shock that hit stocks and bonds and really benefited having other diversifiers in portfolios.

And I think throughout this conversation, we've been talking about some of these areas that are not only attractively valued but can benefit ultimately from AI. And part of that is having the cheaper valuations that create less vulnerabilities because all you need is modest surprise. So, I think we can look across the portfolio and say, "Where are we very concentrated?" and add in some more resilience around value stocks, non-US, hedge funds, not just equity long short that I talked about earlier, but also things like trend following and global macro that offer more general stress protection in portfolios through active management.

Willis: That makes a lot of sense. We're getting into the closing part of the conversation; we definitely covered a lot of ground here. Celia, coming back to you, what is the one mindset shift you hope allocators will take away from this conversation?

Celia: The mindset shift that I would focus on is really to move from backward looking comfort to forward looking discipline. Investors shouldn't assume that the conditions that got us to where we are today, the level of concentration we're seeing today, are the conditions that are gonna persist over the next decade.

Willis: We spent a lot of time looking backwards and talking about the right now moment. Kevin, we'll start with you in thinking about okay, we took in all this information, and we looked at the past time periods and the different market dynamics. We're in this very unique time with these very unique constraints and circularity. How do we take that and play it forward?

Kevin: Yeah, I think if you are an investor that has high levels of equity exposure relative to history, now is the time to reassess whether that's a thoughtful allocation for your risk preferences. We tend to think that the risk reward benefits of equities right now aren't as attractive as they were several years ago.

Celia: I think we need to meet clients where they are on what they need because we have a wide range of experiences. Some of our clients have institutional continuity and family continuity where we've been working with them for decades, right? So, I think those sorts of clients who have experienced many cycles appreciate the long history and the value of studying the history.

The younger, less experienced investors really benefit from getting that perspective, And I think all of them really appreciate hearing our views, knowing that we're not tied to any particular product, but really thinking about what is it that we need to be doing in this moment for generating strong returns?

What have we learned from past cycles? Listening to them very carefully about what their concerns are and helping them work their way through it to understand why they own what they own, and if it's appropriate for the moment that we're in today.

Kevin: Looking forward, we don't know exactly what different investments are gonna bring us, right? That's why diversification is such a bedrock principle of portfolios. We can look back at history and have a sense for what returns tend to be. We know the sources of returns across various assets, but we need to build portfolios that have diversified sources of return to try to get to the return targets that we need to for those given portfolios. So we can't overload on any one risk 'cause that's just a recipe for potential disaster and bad outcomes.

Celia: And that's exactly the rearview mirror problem. If you just ride all of this, you end up pretty concentrated, and it shows up as concentration in the benchmarks that people are benchmarking their portfolios to. So, it takes action and thoughtful deliberation to be able to adjust away from that concentration to benefit over the long term.

Kevin: Investing is hard. It is a very hard profession, and you need to exercise discipline and careful risk management. And the way you do that is not by taking massive bets on one expected outcome. It's by taking small bets, thoughtful bets that are diversified from one another across the portfolio, and that's really how you deliver positive value add over the long term.

Willis: Absolute pleasure, and thank you guys for joining us on Cambridge Conversations. Until next time.

Kevin: Thank you.

Celia: Thank you.

To learn more about this episode, please visit us at cambridgeassociates.com/cambridgeconversations, or check out the show notes. If you like what you're hearing, please leave us a review and share the show with your friends and colleagues.

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Thank you so much for listening and being part of the conversation. Until next time!

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