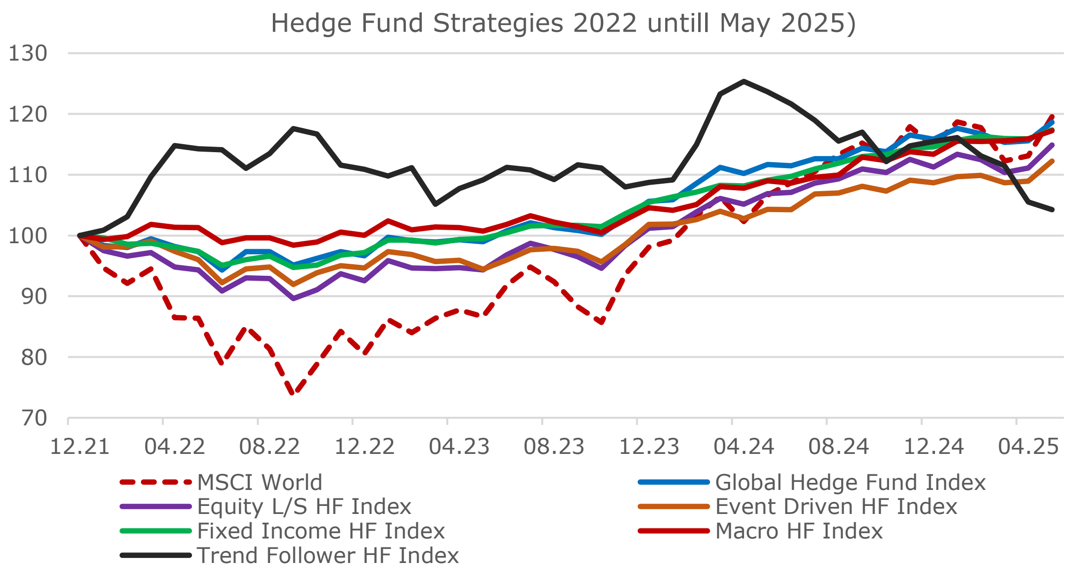
Hedge Funds Review & Outlook

1 Hedge Fund Review H2 2025

The broad hedge fund index gained +2.1% YTD 2025 (With Intelligence Hedge Fund Index including May), while traditional asset classes also ended the period in positive territory for the most part: Equities rose by +2.9% (MSCI World hedged), investment grade bonds increased in value by +1.8% (Bloomberg Global-Aggregate TR Index Value Hedged) and high yield bonds even gained +4.5% (ICE BofA Global High Yield). The resilience of hedge funds was only briefly tested in the first few weeks of April, and the subsequent market recovery masked the quality of the hedge funds. On average, the managers only suffered around one tenth comparing to the market (e.g. S&P500 -18.9%). In the current environment, we continue to consider hedge funds as an extremely valuable portfolio component for mitigating volatility.

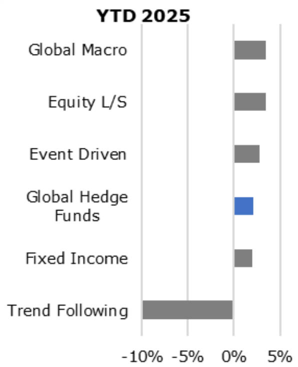
Chart I: Hedge Fund Strategies



(Source: Alpinum IM, With Intelligence)

Hedge funds started 2025 with strong gains, led by macro and equity strategies, despite volatility in both, the technology sector and the bond markets. February brought slight losses as inflation fears, and geopolitical tensions weighed on the markets. European managers outperformed, while US trend following strategies and US managers lagged behind. Equity strategies with low market exposure held up well, particularly in Asia and the energy sector. In March, the decline in equity indices continued as trade tensions between the US and China increased, with equity strategies underperforming. Hedge funds closed the month of April in slightly positive territory despite high volatility, but the picture among the strategies was mixed. Equity long-short strategies, particularly those with a market-neutral approach, benefited from increasing market dispersion, while credit and macro funds faced challenges due to the renewed widening of credit spreads and turmoil on the interest rate and currency side. In May, the asset classes normalised, spreads and volatility visibly decreased, which also boosted 'alternative investments', which closed the current year at around +2.1% (to May 2025).

Chart II: Performance Main Strategies (until May 2025)



	YTD	2024	2023	2022	2021
Global Hedge Funds	2.1%	9.7%	9.3%	-3.3%	11.4%
Equity L/S	3.4%	10.0%	9.3%	-7.5%	11.2%
Event Driven	2.8%	6.7%	7.5%	-5.3%	13.1%
Fixed Income	2.0%	8.7%	8.5%	-2.8%	5.9%
Global Macro	3.4%	8.4%	4.5%	0.0%	5.4%
Trend Following	-9.8%	6.2%	-2.0%	10.9%	7.5%

(Source: AlpinumIM, With Intelligence)

2 Strategy winners and losers

Equity long-short hedge funds started the year strongly, gaining in January despite a sell-off in the technology sector triggered by the DeepSeek announcement. Managers became more cautious, reducing their exposure and adding hedges in the face of rising volatility. This was followed by losses in the market in February and March, triggered by fears of an economic slowdown and Trump's tariff policy. Nevertheless, the hedge funds still outperformed the major equity benchmarks. In April, the managers of this strategy returned to positive territory with slight gains, despite an initially massive market correction. The positive trend continued in May, gaining +3.2% YTD so far. On the negative side, the trend followers should be mentioned. Their YTD performance is -9.8%. Since Donald Trump has been in the Oval Office for a second term, no stone has been left unturned politically, socially and economically. Established rules can become a thing of the past overnight. It is therefore not surprising that trend followers in particular find it extremely difficult to identify and capitalise on ongoing trends in such an environment. A quant system predicts the future allocation using historical data and naturally experiences difficulties in profitably anticipating the sometimes completely erratic, Trump-influenced movements. Discretionary managers on the macro side have a better starting position here if, for example, they bet on a structural weakness of the USD and realise this view with option strategies.

3 First resilience test for hedge funds in April

In the half-year review on a monthly basis, it is hard to see how sharply the markets corrected in April. In the wake of Liberation Day on April 2, the VIX volatility index shot up to 52 on April 8, a level last reached only in June 2008 and March 2020. The S&P 500 lost a considerable -18.9% from its high on February 19 to its interim low on April 8. On the credit side, the CDX spread jumped from below 300 to 479, a level that was never touched in the previous year. Hedge funds coped relatively well with this extremely stressful phase. This can be attributed to several factors. Firstly, data from various prime brokers showed that the majority of managers had already massively reduced their market risk before April. US managers reduced not only their gross exposure but also their net exposure to the market. While long-short equity managers had an average net exposure of 55% in January, this dropped steadily to 35% (data from Morgan Stanley), a level last seen in 2022. Secondly, the stress built up over weeks, giving portfolio managers the opportunity to adjust or additionally hedge exposed positions. And thirdly, because the correction was reasonably orderly, there were no 'accidents' - i.e. no well-known hedge funds had to meet 'messy' margin calls and fire sales in a weak market. This in turn often causes stress waves in the system in such situations and adversely affects other market participants.

However, the situation calmed down shortly after April 8, when signals from Washington and Beijing pointed to possible negotiations and de-escalation. After the sharp sell-off in the first week of April, many oversold positions were bought back (short covering), which further strengthened the upward trend. The mean reversion was particularly notable on the equity side, with the result that the indices have now almost reached their previous highs. As has often been observed, the recovery after a strong correction follows the waterfall principle. The most liquid markets recover first, followed more slowly by the fixed income and credit markets, for example. Despite the immense uncertainty, hedge funds held up well in the first half of the year. They proved once again that they are an excellent stabiliser in a portfolio.

4 Hedge fund focus topic: Dispersion

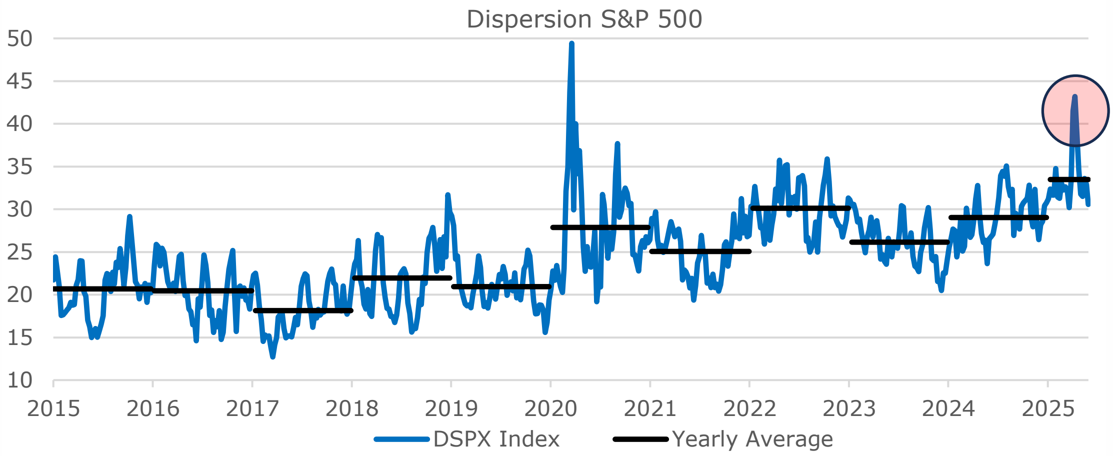
Is there a good or bad market environment for hedge funds and how can such an environment be identified? In general, it can be said that an environment with increased volatility tends to be helpful for active managers. Volatility means greater price fluctuations in equities, bonds, currencies, etc. Many hedge funds thrive on these price deviations, which create mispricing. Not only do long-short strategies benefit from a minimum of volatility, relative value and arbitrage strategies also need it. Statistical arbitrage or convertible arbitrage exploit interim price differences, which later normalise. In volatile markets, participants often behave irrationally. Hedge funds that act quick and have access to capital can profit from market inefficiencies in such phases, where others only see risks.

A second characteristic of an attractive hedge fund market environment is dispersion. Dispersion refers to the spread of returns of individual securities within a region, market or sector. High dispersion means that some stocks (or other assets) in an index perform well, while others perform poorly or less strongly - regardless of the general market level. In such a market phase, equity returns are idiosyncratic, bottom-up or sector-driven. Phases of macro uncertainty can also trigger high dispersion. With low dispersion, on the other hand, all stocks in an index move in the same direction; this often happens in a strongly momentum-driven environment or in strong bull markets.

The following reasons show why dispersion is an important feature for hedge funds: 1) High dispersion allows the active hedge fund manager to generate alpha through stock picking on the long and short side - i.e. to achieve an excess return regardless of the market. If all stocks go in the same direction, a typical long-short pair positioning is a zero-sum game. 2) Increased dispersion often goes hand in hand with lower correlations between individual assets. This facilitates risk management and portfolio construction as individual positions do not move in the same direction at the same time. 3) Market neutrality becomes more effective; this is only possible with a broad diversification of individual stock performance.

A high dispersion environment offers hedge funds more possibilities to differentiate, better risk diversification and greater potential for alpha. It is particularly favourable for long-short and market-neutral strategies that focus on the relative valuation of securities - regardless of the overall market direction.

Chart III: Increased dispersion



(Source: AlpinumIM, Bloomberg)

The Cboe S&P 500 Dispersion Index (DSPX Index) measures the expected short-term fluctuations between the S&P 500 stocks by analysing the prices of index and individual stock options using a VIX-based methodology. As Chart III shows, the dispersion in 2025 is at 33 on average, a peak compared to the last 10 years. In 2023, the dispersion fell sharply - the markets recovered from an extremely difficult environment in 2022. This 'beta rally' year was very challenging for active hedge fund managers, selection counted for little, symbolised by the emergence of the mega-cap bull phase of the 'Magnificent Seven'. A few stocks drove the markets upwards. Since then, the Dispersion Index has risen continuously to its current high. As described above, in addition to volatility, market dispersion is another feature that underpins the current attractive environment for hedge funds.

5 Outlook: Hedge fund strategies

Since President Trump returned to the White House, one certainty has been confirmed for market participants: the show will go on. Despite a highly uncertain environment, the economy is likely to maintain its slow growth trajectory - fuelled by a constructive outlook that extends beyond the current irritants and already beyond 2025. The development of the US economy will therefore remain burdened in the short term and the outlook for companies will be characterised by a high degree of uncertainty due to the vague tariff regime. New and higher tariffs will lead to a rise in prices and inflation, and some business models will falter.

In a medium-term perspective, which extends well into 2026, negative and positive measures as well as short and medium-term effects largely cancel each other out. At the same time, new positive influencing factors - such as falling energy prices or changes to tax laws - are added. Overall, this results in a much less negative and in some cases even constructive economic picture, from which various strategies can benefit. Fixed income traders, for example, thanks to positioning on the yield curve (by anticipating the change in the steepness of the curve). Should the economy actually return to calmer waters, active and fundamentally driven equity L/S managers will experience a major boost, both long-biased and strategies with low market exposure.

Some indices are close to their highs again after the April correction occurred. We do not expect market volatility to fall any further in the second half of the year. Coupled with increased dispersion, this is a good environment for hedge funds to trade future uncertainties and movements on the long, short or via relative value and arbitrage strategies - decoupled from the market direction - be it on the equity or bond side.

Chart IV: Strategy weightings

	Underweight		Neutral	Overweight	
	heavily	slightly		slightly	heavily
Global Hedge Funds					
Equity Long Short					
Event Driven					
Credit Fixed Income					
Global Macro					
Trend Following					

We have not made any changes to the weighting of the main hedge fund strategies. On the strategy side, Alpinum Investment Management continues to favour allocations in the credit fixed income segment. Due to the market uncertainty in March and April, credit spreads have widened significantly. The subsequent normalisation / narrowing is probably not yet complete - a slightly higher equilibrium may be sought as the 'new normal'. Active managers have used the volatility as an opportunity to rebalance their portfolios and take advantage of newly emerging attractive opportunities. The dispersion in the market is creating interesting opportunities to benefit from the continued elevated interest rate environment. Expertise pays off, active and agile managers are finding an excellent environment. However, it is all the more important to focus on quality managers with strong selection skills.

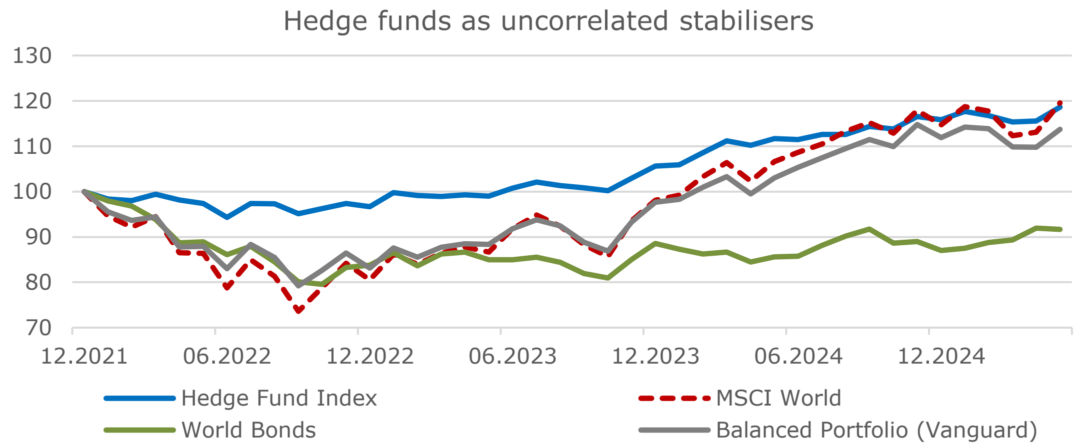
As mentioned, fundamentally orientated equity long-short managers enjoy a tailwind. Discretionary, fundamental-bottom-up managers can take advantage of opportunities on both the long and short side, while the increased dispersion provides active managers with an ideal environment.

Event-driven managers remain downgraded on the assumption that the political environment will remain uncertain. More clarity is needed from the US administration, which is actually seen as 'pro-growth', in order to stimulate the M&A market across borders again. However, as soon as the uncertainty factors are reduced, M&A activity will increase immediately and fuel the market, which will also drive the 'event managers'.

Even though the range of opportunities for the Global Macro strategy remains large, the mainly politically induced uncertainties and the high volatility on the markets make the positioning environment considerably more difficult. Although we generally consider this environment to be positive for the strategy, erratic trend reversals harbour a risk. We tend to favour managers with expertise in currency trading and know-how on the interest rate side.

The environment for trend followers has by no means changed for the better. Although we can certainly imagine a slight increase in volatility from the current level, we believe that the markets will continue to be driven by 'Washington news', which will make profitable positioning for trend followers more difficult, as constant repositioning is required. We are maintaining our underweight position in the strategy.

Chart V: Hedge fund resilience



(Source: AlpinumIM, Bloomberg With Intelligence)

In the current environment, we generally insist on favouring hedge fund managers with a flexible, opportunistic investment style and the ability to react quickly. They are preferable to dogmatic and fundamentally orientated managers.

As can be seen in chart V, hedge funds have kept their promise to decouple themselves from the difficult markets with uncorrelated trading approaches over the past three years. Once the markets had calmed down, they were still able to achieve considerable performance. If you compare hedge funds with a balanced portfolio or global bonds, it is precisely this quality that stands out.

We recommend that hedge fund investors focus on broad diversification, especially in this challenging environment. However, active management and maximum proximity to the manager are important. Thanks to access to non-traditional sources of return with low correlation to equity and bond markets, alternative investments will continue to serve as a valuable stabiliser in a portfolio for the remainder of 2025.

Disclaimer

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