

Revisiting Hedge Funds: Separating Myth from Reality, One Year Later

Q&A with David Richter, Managing Director,
Absolute Return Strategies



Introduction

One year ago, GCM Grosvenor's Absolute Return Strategies team published *Hedge Funds: Separating Myth from Reality*, addressing common assumptions about performance, access, and the role hedge funds play in institutional portfolios.

Today, with industry assets approaching a record \$5 trillion, David Richter, Head of Absolute Return Strategies, revisits the paper's central themes, exploring how recent market dynamics have reinforced the case for hedge funds, and why the asset class remains a critical component of diversified portfolios in 2025 and beyond.



Industry Growth: HFR reports that global hedge fund AUM reached an all-time high of nearly \$5 trillion in Q2 2025. What market, macro, or structural forces drove this growth—and how does it support your view that hedge funds remain a durable, value-adding component of institutional portfolios?

The reasons hedge fund assets have reached an all-time high are fairly straightforward: hedge funds have performed well, mitigated the downside, and have displayed limited correlation with traditional risk assets. Moreover, stocks and bonds are expensive by virtually every valuation measure—P/E ratios, credit spreads, market-cap-to-GDP—supporting the desire among institutional and individual investors to look for diversifiers. The return/risk profile of hedge funds provides a strong “portfolio fit” for those seeking to reduce sensitivity to broad market dynamics.

Structurally, we're also seeing investors lean more heavily into alternatives overall—greater institutionalization, improved transparency, and the continued growth of high-quality managers have made hedge funds an increasingly durable part of long-term portfolio construction.

Together, those factors reinforce what we outlined in last year's whitepaper: in markets defined by elevated valuations and uncertainty, hedge funds can play a critical and enduring role in delivering diversification and risk-controlled returns.

Select risks include: macroeconomic risk, sourcing risk, investment selection, portfolio diversification, management risk, execution of value creation plan, risks related to reliance on third parties, and risks related to the sale of investments.

Past performance is not necessarily indicative of future results. No assurance can be given that any investment will achieve its given objectives or avoid losses. Unless apparent from context, all statements herein represent GCM Grosvenor's opinion.



Alpha Drivers in a Normalized Environment: Last year you highlighted that hedge funds tend to thrive when interest rates are non-zero and dispersion is healthy. How have those dynamics evolved, and what does that mean for alpha generation across equity, credit, and macro strategies today?

What we said last year has largely played out. The opportunity set has improved significantly, returns have been strong over the last year, and downside mitigation has held up well.

The biggest shift has been the persistence of a normal interest-rate environment. The precise level of rates (e.g. 3% or 4%) matters less than the fact that they aren't zero. When rates were anchored near zero, dispersion was limited and it was difficult to generate alpha, particularly on the short side. With higher rates, dispersion typically increases—among companies, sectors, countries, currencies, which creates room for skilled managers to add value.

At the same time, uncertainty has risen—geopolitics, inflation, the impact of AI, employment dynamics. Uncertainty tends to be a tailwind for hedge funds. Add periodic bouts of volatility, and you have an environment where managers can both protect capital when markets pull back and then capitalize on the recovery.

We've seen results in line with that view—strong absolute returns and attractive alpha generation over the past several years.



The Role in Modern Portfolios: With equity–bond correlations rising, many allocators are rethinking the classic 60/40 mix. Are hedge funds increasingly viewed as core return drivers rather than just diversifiers?

It's really both. Hedge funds continue to be valued as diversifiers, but because returns have been attractive, allocators are also looking at them as core contributors. When public markets are up sharply—as they have been this year—it's easy to overlook the significance of hedge funds generating 10–11% with lower market sensitivity. But that profile is meaningful.

We saw an inflection roughly three years ago. The asset class moved from being viewed primarily as a diversifier to being recognized as a consistent return engine, as well. Strong double-digit returns over that period have reinforced that perception, and the momentum has only continued.



Access, Skill, and Concentration: The paper also challenged the notion that hedge funds are overly diversified or difficult to access. Given today's concentration among multi-manager platforms and the steady pace of new launches, how should investors think about sourcing and scaling skill?

In alternatives broadly—and in hedge funds especially—manager selection is the single most important driver of outcomes. It matters even more than strategy allocation. A portfolio of top-quartile managers outperforms the median across all strategies and time periods.

Identifying those managers requires sophisticated analytical tools and detailed transparency to distinguish skill from luck. That's where experience and access matter. Partnering with a firm like GCM Grosvenor is like having a large and specialized team of hedge fund investment professionals on staff, and the potential excess return from a portfolio of top-tier managers can far outweighs the cost of accessing that expertise.

Our 50-year history in hedge funds, combined with our scale and reputation, gives us access to many of the industry's most skilled managers, including many of whom are capacity-constrained or closed to new investors. We view that as a core part of our edge.

Moreover, our approach enables exposure across strategies and manager types: including established multi-manager platforms, high conviction single-PM specialists, regional and sector specialists, diversifying strategies and sub-strategies, early life cycle managers, and new launches.



The Road Ahead: As hedge fund AUM continues to grow, where do you see the next phase of opportunity—in terms of strategy, innovation, or allocator behavior?

We see three key areas of opportunity moving forward:

1. Fundamental research-driven long/short strategies

Long/short equity and credit—particularly low-net and market-neutral approaches—stand out. Greater dispersion allows skilled security selection to shine. There are also meaningful themes to capture on both the long and short sides: AI, technology, industrial, energy transition, health care and consumer changing trends, and opportunities in Asia.

2. Diversifying strategies

Global macro, quantitative, and relative-value strategies continue to benefit from higher volatility and low correlation to markets. In an uncertain world, these strategies play an increasingly important role.

3. Potential stressed and distressed opportunities

If we see a downturn or meaningful widening in credit spreads or share prices, hedge funds will be well positioned. Historically, periods of stress have created strong forward-return environments for managers with liquidity, expertise, and dry powder.

On the allocator side, we're seeing increasing use of flexible mandates, customized accounts, and broader multi-strategy portfolios. Institutions are looking for solutions that combine downside protection, differentiated alpha, and the ability to adapt quickly to shifting market conditions—so allocator behavior itself is becoming a significant source of innovation.

Closing Thoughts

For more than 30 years, hedge funds have delivered healthy spreads over cash with lower sensitivity to broad markets. In an environment characterized by elevated valuations and ongoing uncertainty, the ability to produce attractive, lower-risk returns is especially valuable. The themes we highlighted in last year's whitepaper—normal interest rates, greater dispersion, and higher uncertainty—have only become more pronounced, reinforcing why hedge funds continue to play a critical role in institutional portfolios.

Today, allocators aren't just seeking diversification—they're seeking resilience. That's why high-quality hedge fund managers have been gaining momentum across the institutional community, and why we believe the asset class will remain a core component of modern portfolios in 2026 and beyond.

About GCM Grosvenor

GCM Grosvenor (Nasdaq: GCMG) is a global alternative asset management solutions provider with approximately \$87 billion in assets under management across private equity, infrastructure, real estate, credit, and absolute return investment strategies. The firm has specialized in alternatives for more than 50 years and is dedicated to delivering value for clients by leveraging its cross-asset class and flexible investment platform.

The firm is headquartered in Chicago, with offices in New York, Toronto, London, Frankfurt, Tokyo, Hong Kong, Seoul and Sydney.

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