Equity market neutral (EMN) strategies try to make money through mispricing between stocks, regardless of market direction. (UBS)

# Can hedge funds help navigate choppier markets?

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**Markets have become more volatile over the past month amid concerns over the pace of US rate cuts and elevated geopolitical uncertainty. But we see opportunities to use hedge funds—especially equity market neutral strategies—to generate positive returns through stock selection while carefully managing market risks.**

Hedge funds come with their own unique opportunities and risks.

**Markets have experienced bigger swings in recent months due to higher economic and geopolitical uncertainty.**

- Investor sentiment has continued to shift over the timing and pace of rate cuts.
- The geopolitical outlook has also remained fluid. While an exchange of attacks between Israel and Iran did not escalate, the conflict in the region shows few signs of being resolved.
- The S&P 500 fell 4.2% in April, ending a five-month string of gains. Sentiment has recovered in May, and the index again stands close to a record high.

**But certain hedge funds—like equity market neutral strategies—can help when markets are bumpy.**

- Equity market neutral (EMN) strategies try to make money through mispricing between stocks, regardless of market direction.
- Typically EMN managers buy undervalued stocks and sell overvalued ones, "hedging" away exposure to the overall market (making them "beta neutral").
- EMN managers delivered an estimated 4.1% in annualized returns in the first quarter of this year, above the long-run trend given favorable market dynamics (based on HFRI Equity Market Neutral Index data).

**So, we think now is a good time to put money to work in this strategy.**

- EMN funds tend to have great flexibility to switch positions when economic growth and rate expectations change—finding opportunities while limiting volatility.
- Adding EMN strategies to a balanced 60/40 portfolio historically has improved the return per unit of risk for an investor.

## Did you know?

- Equity long/short strategies have historically delivered excess returns over the S&P 500 (alpha) of 5.2% a year in periods where correlation between stocks is low and dispersion of stock returns is high, as it is today.
- Based on data between 1990 and 2024, EMN funds have demonstrated limited losses—performing positively on average during equity sell-offs—but captured 14% of the broad market gains.

## Investment view

Alongside equity market neutral funds, we also like specialist credit hedge fund strategies and discretionary macro funds to navigate market shifts in growth, inflation, and monetary policy. Investors should understand the inherent risks with hedge funds, including illiquidity, a lack of transparency, and the use of leverage.

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