Overweight Global Equity Long/Short Hedge Funds/Underweight 40% Equities/60% Bonds

Recommended since September 30, 2025

Investment thesis: We expect equity long-short (ELS) hedge funds to outperform a 40/60 stock/bond blend, as increased equity dispersion—driven by rapid advances in AI, blockbuster tech IPOs, and heightened geopolitical risks—should create more opportunities for ELS managers to generate differentiated returns. ELS funds also benefit from a positive short rebate, which should remain supportive and above previous low-rate levels.

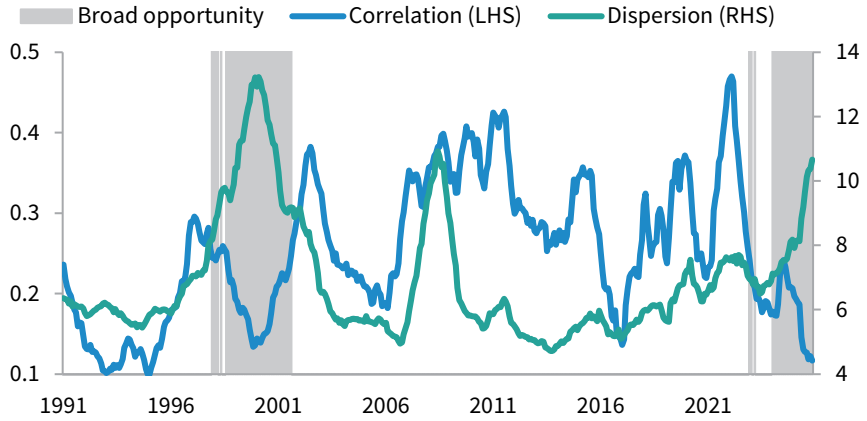
Key support 1: Elevated dispersion in stock returns creates a more favorable environment for stock-pickers like ELS hedge funds, offering greater potential for differentiated performance on both long and short trades. While periods of higher dispersion and lower correlations have historically coincided with stronger ELS results—such as 1.1% average monthly returns versus 0.4% for a 40/60 stock/bond blend—research shows that dispersion, rather than correlation, is the meaningful driver of active manager opportunity.

Key support 2: ELS hedge funds earn a short rebate—the interest on cash collateral from short sales, net of broker fees. From 2010–21, this rebate was minimal or even negative due to low rates. Today, it is much higher, boosting ELS baseline returns and supporting outperformance versus a 40/60 stock/bond blend. Moreover, the recent uptick in inflation stemming from the Iran War supports rates and thus the short rebate.

Key risks: ELS may underperform if lower dispersion limits stock-selection opportunities or a broad rally favors market exposure. Recent deleveraging and forced selling in crowded AI-related positions highlight how concentrated thematic exposure can amplify losses, even in portfolios with low net market exposure. Additionally, if economic growth weakens and prompts central banks to cut rates, ELS hedge funds could underperform both equity and bond markets during a policy-driven rebound, as their short exposures may constrain upside participation.

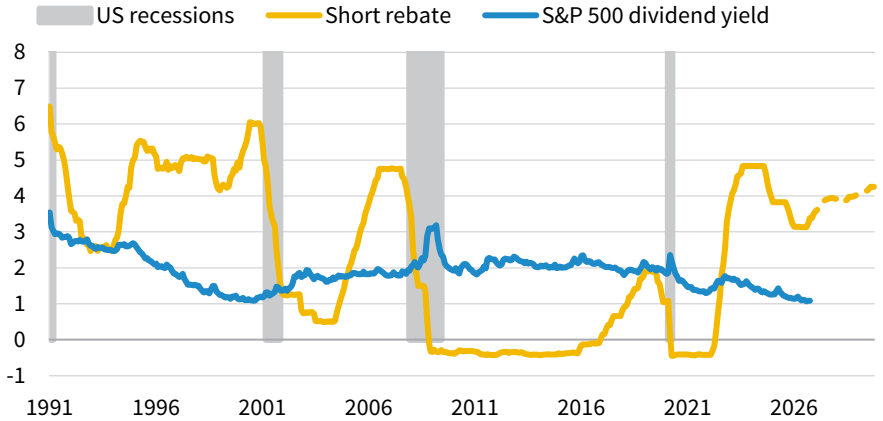
Rolling 12-month S&P 500 correlation & dispersion

December 31, 1991 – October 31, 2026



Short rebate versus dividend yield

January 31, 1991 – October 31, 2029 • Percent (%)



Sources: CBOT, Federal Reserve, Standard and Poor's, and Thomson Reuters Datastream.
Notes: Correlation is calculated as the weighted average pairwise correlation across the stocks in the index over one month. Dispersion is calculated as the weighted cross-sectional standard deviation of the performance of stocks within the index for one month. Board opportunity reflects periods of above average dispersion and below average correlation. The short rebate is represented by the effective federal funds rate minus a 50-bp spread. Dashed line reflects short rebate expectations based on fed funds futures.

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