Absolute Return Strategies
Navigating Market Turmoil

The world and investment landscape continue to evolve at a rapid pace. Here, we address some of our clients' most-often asked questions regarding absolute return strategies in the current environment.

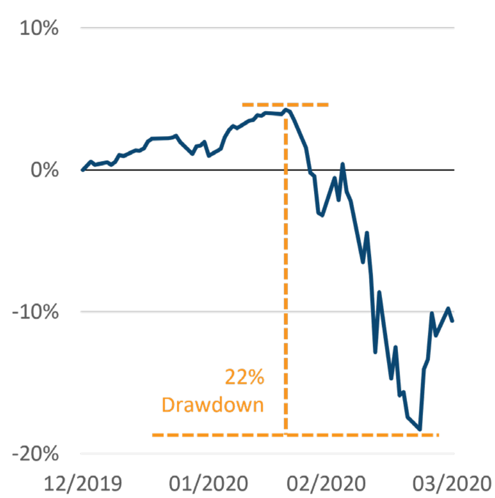
Q The investment landscape has changed materially, and risk levels have increased meaningfully, first due to the pandemic, and now due to geopolitical turmoil. How do you expect absolute return strategies to navigate this new environment?

We recognize that the world is more complicated and volatile today than it has been in many years, and recent events have intensified the stress on investors. We have observed over many years, and strongly believe today, that the value of absolute return strategies and active management are greatest during times of rapid and extreme changes like those we are seeing.

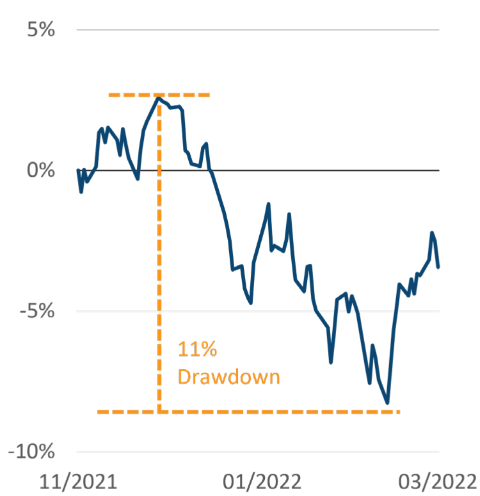
For example, the ability for hedge fund investors to be nimble and responsive to the risks during the Covid-19 pandemic allowed many of them to avoid holding investments in businesses that proved to be structurally impaired, and take advantage of businesses whose growth would be accelerated. And today, amid the Russia-Ukraine conflict, rising interest rates, rising inflation, and elevated risk of recession, we believe actively managed absolute return strategies are well-positioned to withstand the tumultuous markets due to their ability to mitigate (and/or profit from) downside risks and avoid being in “stranded” assets.

In short, we believe turmoil can upend or exacerbate existing economic and behavioral trends in any environment, and absolute return strategies are built to adapt to changing conditions. Conversely, traditional long-only allocations and “autopilot” strategies have proven to be less resilient during such periods.

Q1 2020: COVID-19 Crisis
Bloomberg U.S. 60/40 Index
December 31, 2019 – March 31, 2020



Q1 2022: Inflation and War
Bloomberg U.S. 60/40 Index
November 30, 2021 – March 31, 2022



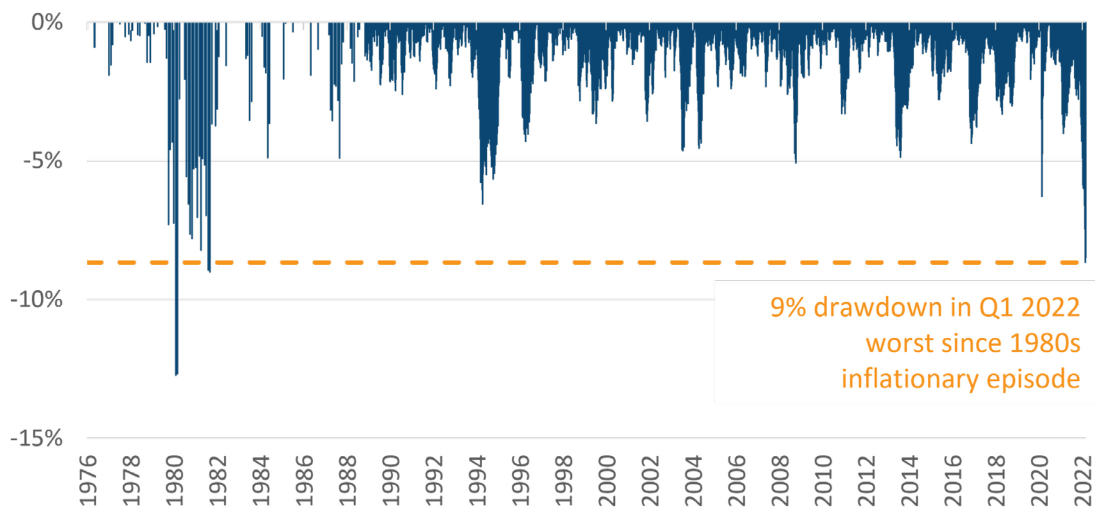
One particularly risky aspect that has emerged from recent events has been the trend of “deglobalization” – the movement toward a more local supply chain at the expense of global trade. This shift toward the domestic production of goods and services is contributing to inflation by creating higher costs, and thus adversely affecting businesses and investments. These inflationary pressures are likely to persist (exacerbated by high energy costs) and investors should consider this new paradigm in adjusting their portfolio positioning. As discussed further below, we believe absolute return strategies are an effective tool for this purpose.

Q Inflation and interest rates are both rising; how will this impact the various absolute return strategies and the opportunity set?

Both rising rates and rising inflation are typically headwinds for financial assets. Price/earnings ratios for stocks typically decline during such periods, while long-only fixed income investments struggle as rising rates impair the value of existing holdings. This has recently led to one of the worst fixed income drawdowns on record.

Historic Drawdowns in Fixed Income

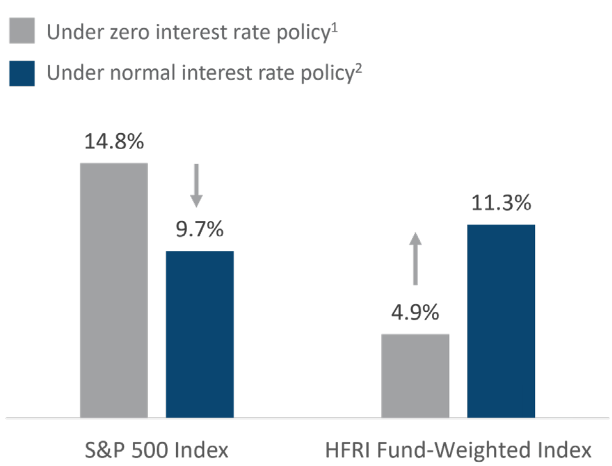
Bloomberg U.S. Aggregate Bond Index Peak-to-Trough Drawdowns



While absolute return strategies are not immune to broad market movements, the performance of such strategies has generally been better in higher rate environments than in low-rate ones, such as the near zero interest rate policy (ZIRP) environment we have experienced frequently since the global financial crisis.

Zero Interest Rate Policy and Performance

Annualized returns during ZIRP and non-ZIRP (or "normal interest rate") periods (1990 – 2021)



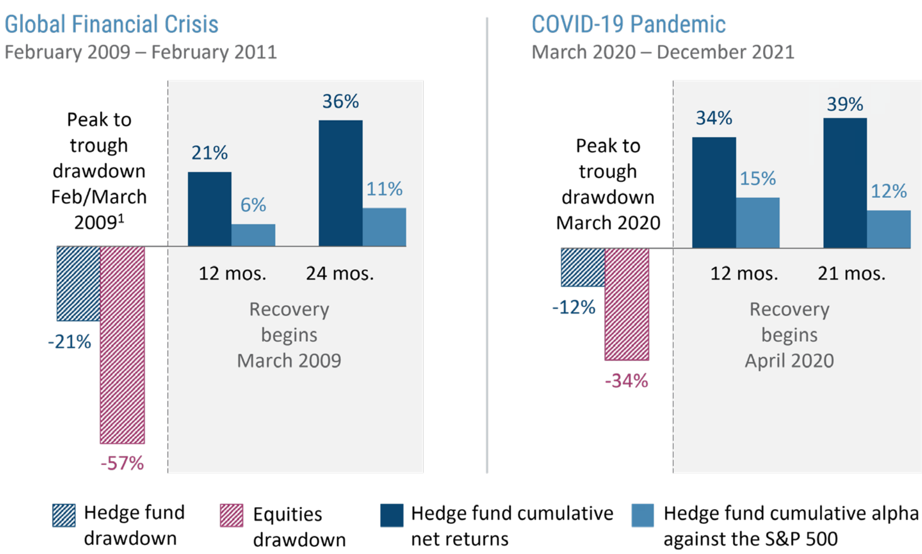
1 Zero interest rate policy is defined as a period where the effective federal funds rate is less than 50bps.
2 Normal interest rate policy is defined as all periods where the effective federal funds rate is greater than 50bps.
Data as of December 31, 2021.
Source: **HFR, Inc.**, www.HFR.com
Unless apparent from context, all statements herein represent GCM Grosvenor's opinion. **Past performance is not necessarily indicative of future results.**

The reasons for this improved performance are identifiable and consistent, and we believe will be similar as we go forward in 2022 and beyond:

- Higher rates provide additional interest income and short rebates to most hedge fund strategies
- Higher rates typically lead to increased volatility and dispersion in equity and credit markets, providing more fertile opportunities for long/short strategies
- Higher rates often lead to higher corporate defaults in credit markets, enabling distressed securities focused managers to capitalize
- Higher rates and volatility cause more frequent dislocations (in sectors, regions, or individual companies) and thus an improved opportunity set for hedge funds

Q What are the most important trends you are seeing in the hedge fund industry?

We continue to see the resiliency of absolute return strategies, particularly regarding downside migitation. In the last few market drawdowns, including the two highlighted below, these strategies have delivered on their value proposition to mitigate downside while capturing meaningful upside relative to long-only strategies.



1 Trough drawdown date occurs for hedge funds in February 2009 and for equities in March 2009.
Hedge funds are represented by the HFRI Fund Weighted Composite Index, and equities are represented by the S&P 500 Index.
Source: **HFR, Inc.**, www.HFR.com
Past performance is not necessarily indicative of future results.

As a result, many institutional investors are increasing allocations to absolute return strategies. Industry assets climbed to an all-time high at the end of 2021, with over $4 trillion.[1] This level of investment bears-out the fact that that absolute return strategies are a global and robust industry.

Other trends we are seeing:

- Despite the proliferation of assets, there is increasingly **limited capacity** among top managers, as investors place more value on accessing peak assets, and such managers remain disciplined around asset growth in seeking to preserve returns.

1 Source: **HFR, Inc.**, www.HFR.com

- Hedge funds have become quite **transparent**. Today, investors can see through to their underlying positions and holdings in many funds like never before, and thus make better and more informed decisions.
- The industry is **stable**. Banks with healthy balance sheets are providing financing (and leverage) with attractive terms to hedge funds, and high-quality managers have diversified their counter-party exposure.
- Institutional-quality hedge funds are deploying **robust risk management** frameworks to measure, mitigate, and report key portfolio, operational, and tail risks. They are using sophisticated systems to monitor asset class and factor sensitivity, gross and net exposures, value at risk, leverage, and scenario analyses, especially potential impacts from extreme market movements.

For more about why we believe absolute return investments are particularly important components of a properly diversified portfolio, read our Case for ARS series.

For more on GCM Grosvenor's absolute return strategies capabilities visit our website.

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<u>Data sources</u>

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