GCM GROSVENOR

THE CASE FOR ABSOLUTE RETURN STRATEGIES

In this series, we discuss why we believe absolute return investments are particularly important components of a properly diversified portfolio in today's investment climate. We explore:

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.

Select risks include strategy risks, manager risks, market risks, and structural/operational risks.

PART ONE

CHALLENGES FACED BY TRADITIONAL "60/40" ASSET ALLOCATION STRATEGIES*

In this installment, we look at indicators of how asset markets are highly valued and future returns appear constrained, particularly in bonds.

Near record valuations are challenging return expectations for long-only investments. Easy financial conditions and expectations for a strong economic rebound have pushed valuations among risk assets towards record levels. But while long-only returns over the past decade have been exceptional amid a prolonged period of rising valuations and declining interest rates, forward returns appear challenged.

These high valuations are occurring at a particularly risky time for financial markets due to risks such as virus variants, inflation, elevated sovereign debt levels, and excessive risk taking in certain segments.

In equities, valuations are coming off their highest levels in 30 years.

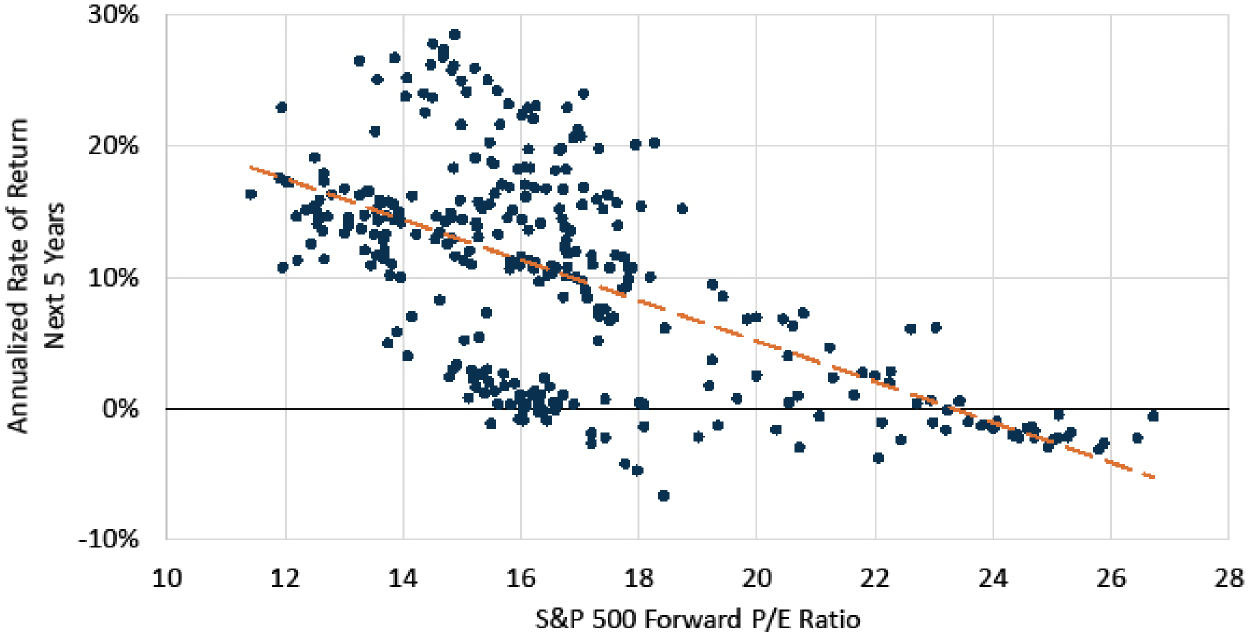
Exhibit 1: S&P 500 forward P/E ratio, 1991-2021

Source: Bloomberg, GCM Grosvenor.

* Forecast returns are constructed assuming a 60% equity, 40% fixed income portfolio in which the returns of each component are based on the outputs of a linear regression of the realized 5-year forward S&P 500 returns relative to the initial 1-year forward price to earnings ratio from 1990-2016 for equities, and a similar regression of the realized 5-year forward returns of the Bloomberg Barclay's US Aggregate Bond Index against the initial interest rate on the U.S. 10-year Treasury from 1976-2016 for fixed income. These time frames were chosen based on the availability of forward S&P earnings estimates (initially becoming available in 1990), the available history of the Bloomberg Barclay's US Aggregate Bond Index, and the availability of – year realized returns. Recent period in which forecasts returns fall below zero are driven by negative expected returns within the equity component in the 60/40 portfolio, as the regression model assumes negative 5-year annualized returns in equities following periods where starting P/E multiples exceed 23.2x.

Historically, we have observed that high starting valuations have been a headwind for future long-only equity returns, as illustrated by comparing historical future annualized returns relative to their initial one-year forward price-to-earnings ratio.

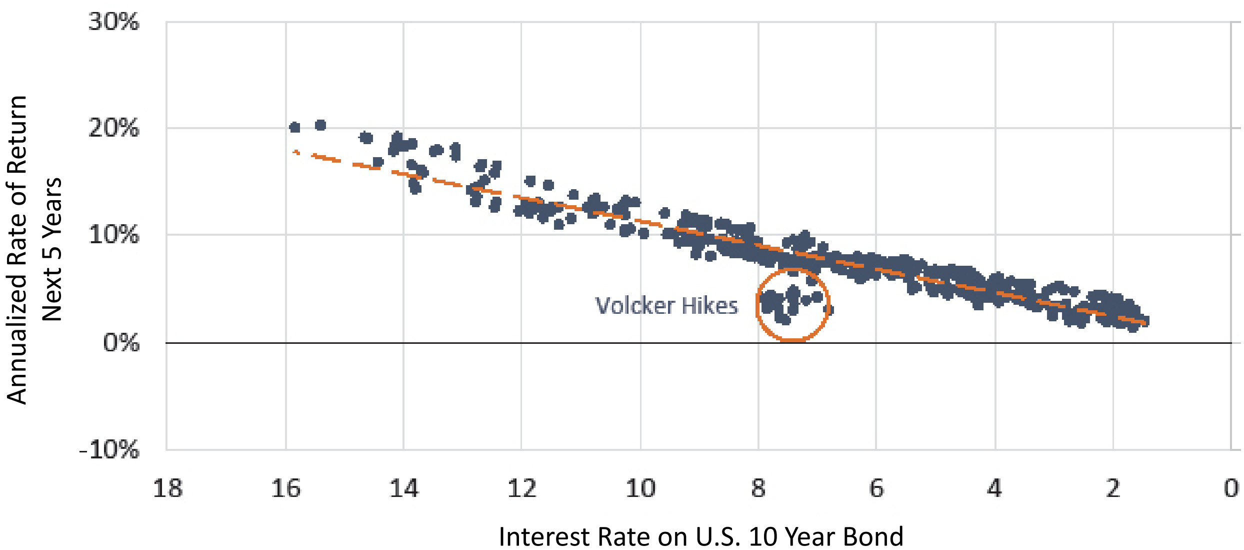
Exhibit 2: S&P 500 annualized returns (next 5 years) vs. initial 1-year forward P/E ratio, 1990-2016



Source: Bloomberg, GCM Grosvenor.

Similarly, the relationship between starting yield and future returns is even tighter for long-only credit and fixed income investments, where low starting yields inherently have limited the potential for forward returns.

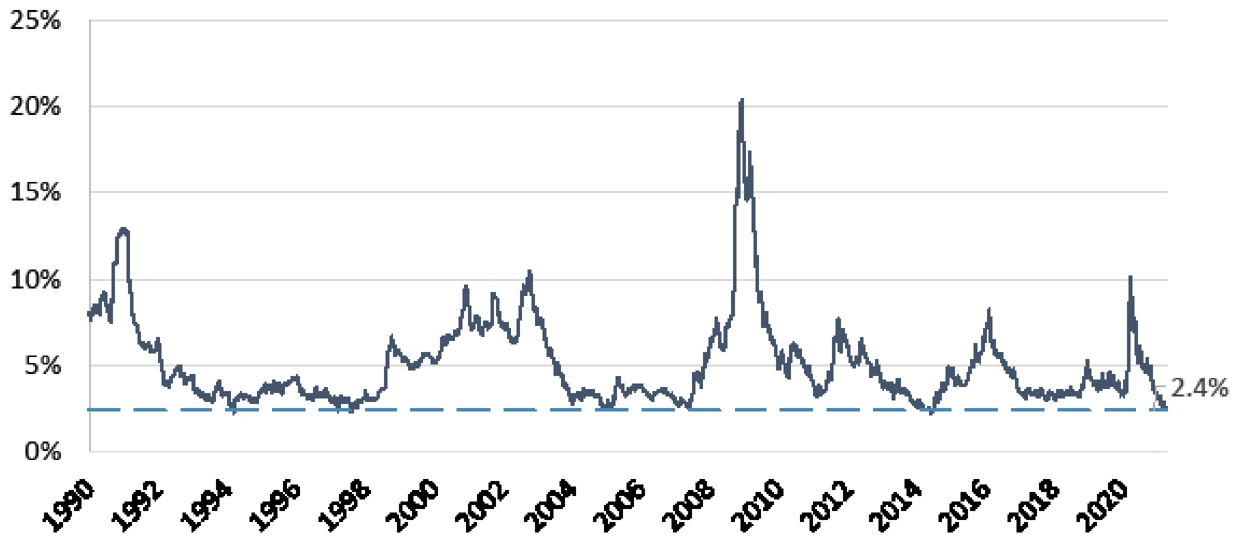
Exhibit 3: Bloomberg Barclays U.S. Aggregate Bond Index ann. ROR (next 5 years) vs initial 10-year interest rate, 1976-2016



Source: Bloomberg, GCM Grosvenor.

Not only are absolute yields low in credit as a function of low government bond rates, but the spread for riskier credits relative to government bonds is at historically low levels. This implies that lenders are receiving comparatively little extra return in exchange for taking on default risk in lower quality credits.

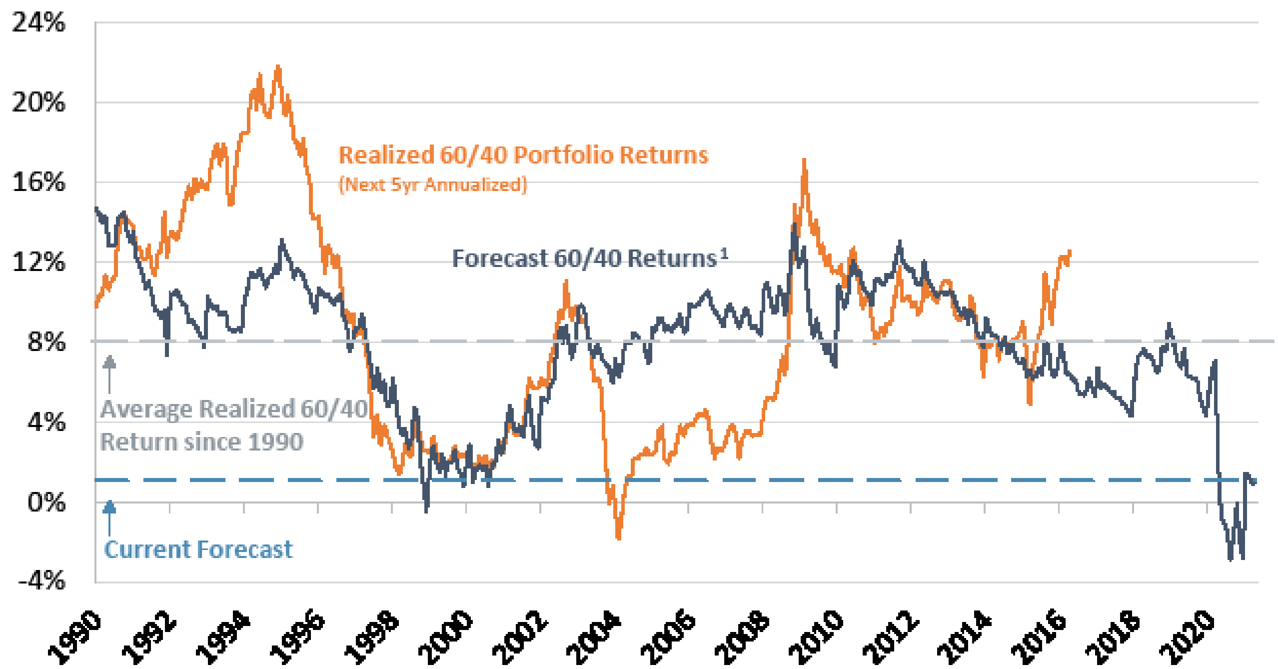
Exhibit 4: Barclays U.S. corporate high yield spread to 10-year treasuries, 1990-2021



Source: Bloomberg, GCM Grosvenor.

Return expectations for traditional 60/40 portfolios are declining. The net effect of current valuations has been to reduce long-run forward return expectations for traditional diversified long only portfolios in most asset allocation model.

Exhibit 5: Realized 60/40 portfolio returns (next 5-year annualized) vs. forecast 60/40 returns



1 Forecast is based on the regression outputs from the scatterplots shown on the prior charts.
Source: Bloomberg, GCM Grosvenor.

PART TWO

TAILWINDS FOR ABSOLUTE RETURN STRATEGIES

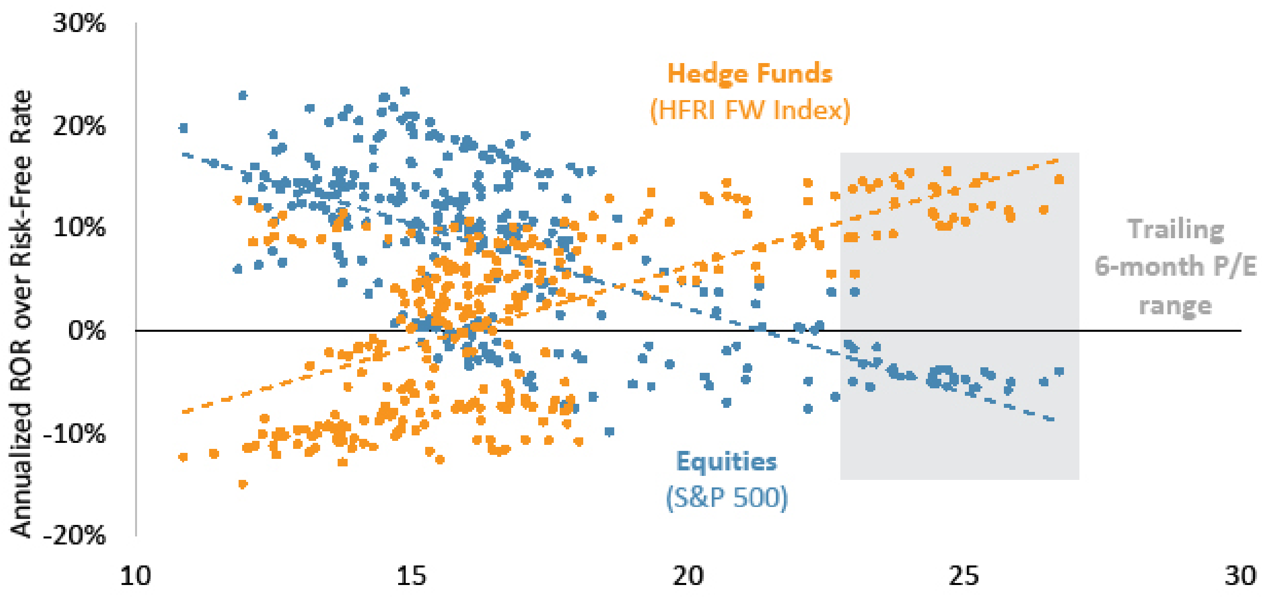
In the second part of the series, we observe that despite these challenges for traditional investments, tailwinds exist that we believe can contribute to alpha within absolute return strategies.

In our view, such tailwinds include higher levels of dispersion, the growing incidence of "two- way" markets, occasional periods of dislocation, as well as the record-high issuance of tradeable securities (both stocks and bonds), and are contributing factors to the improved environment for alpha generation. Additionally, we note the historical resilience of hedge fund alpha through inflationary environments.

As shown here, although elevated multiples are historically a headwind for forward equity returns, they have tended to correspond with strong returns and alpha for absolute return strategies.

In the first half of 2021, the S&P 500's forward P/E ratio remains near its highest levels in the last 30 years.[1]

Exhibit 6: 5-year forward returns over the risk-free rate relative to starting S&P 500 forward P/E multiples, 1990-2016

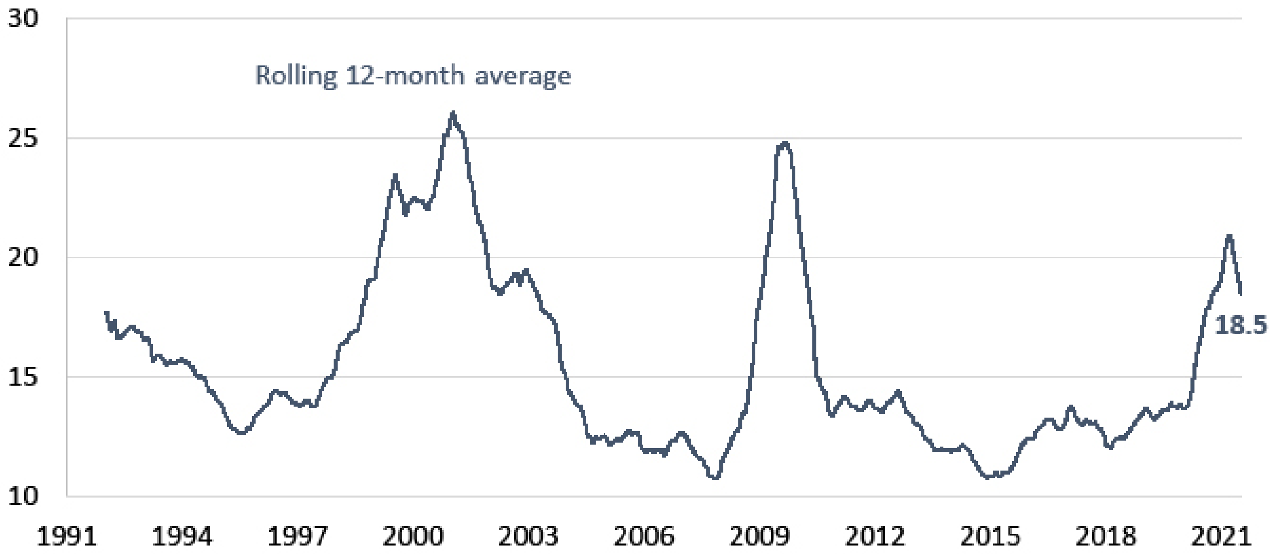


Source: Bloomberg; GCM Grosvenor; HFR, Inc. www.HFR.com

1 X-axis is the P/E ratio for the S&P 500 Index / HFRI FW Index on the first day of that 5-year period. Y-axis represents the annualized return of equities / hedge funds over the risk-free rate for the following 5-year period.

Markets are currently exhibiting high levels of dispersion. We view the transition from a low dispersion regime throughout much of the past decade toward the high dispersion regime we have seen in 2020 and 2021 as fundamentally supportive of alpha generation from research-driven stock selection strategies.

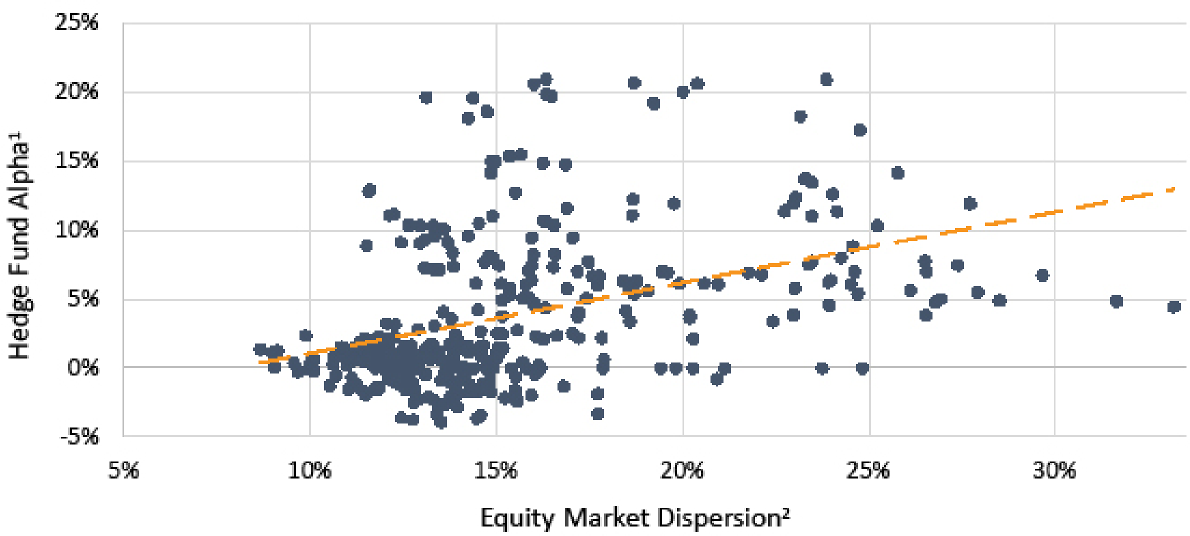
Exhibit 7: Spread between top and bottom quartile total returns of underlying S&P 500 stocks



Source: Bloomberg, GCM Grosvenor.
Data as of June 28, 2021.

As shown below, higher rates of equity market dispersion have historically benefitted hedge fund alpha generation.

Exhibit 8: Next 24-month HFRI FW Index annualized alpha vs. trailing S&P 500 dispersion, 1990-2021



1 HFRI FW Index annualized alpha next 24 months.
2 Trailing 3-month total return defferential between top & bottom quartile individual stocks in S&P 500.
Source: HFR, Inc. www.HFR.com

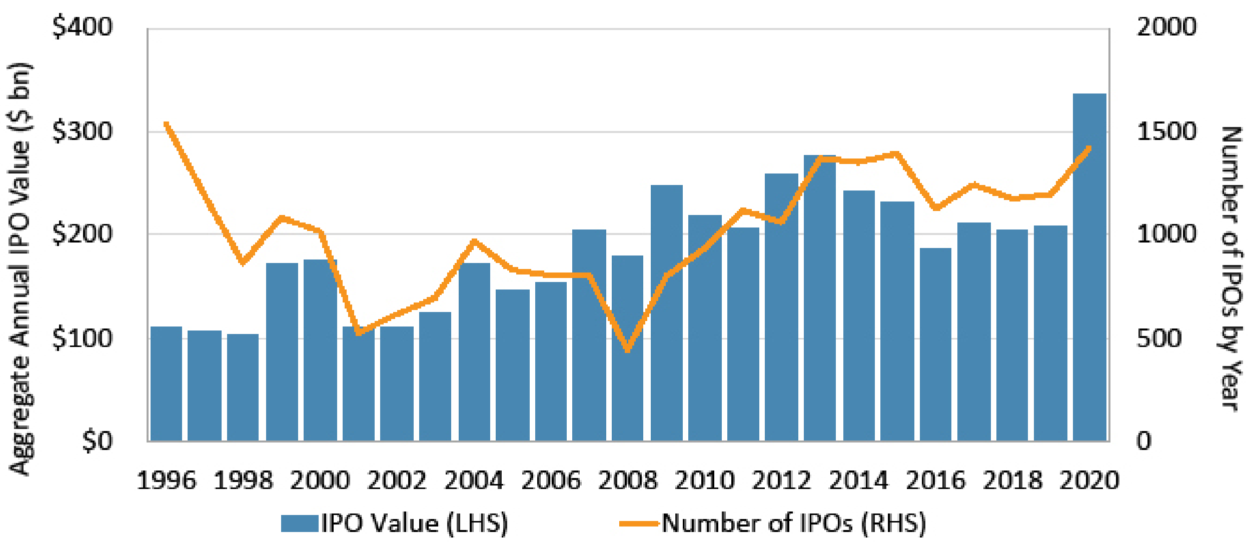
Dispersion in valuations has risen as well, as divergent growth prospects and investor perceptions of various business models have led to widening gaps between firms. We believe this wide dispersion in valuations creates ample long and short opportunities, as those businesses that can meet or exceed growth expectations are rewarded by the market, while underperformance can lead to a deterioration in share price.

Exhibit 9: Dispersion between top quartile and bottom quartile P/E ratios of S&P 500 constituents

Source: Bloomberg, GCM Grosvenor.
Data as of June 28, 2021.

There has been strong growth in the new issuance of a wide range of securities, including debt, equity, and hybrid instruments. The increases in the number of stocks (via IPOs, SPACs, secondaries), bonds (corporate investment grade, high yield, etc.), and complex hybrid securities in recent years creates a sizable playing field in which managers can seek to extract alpha from mispricings in markets.

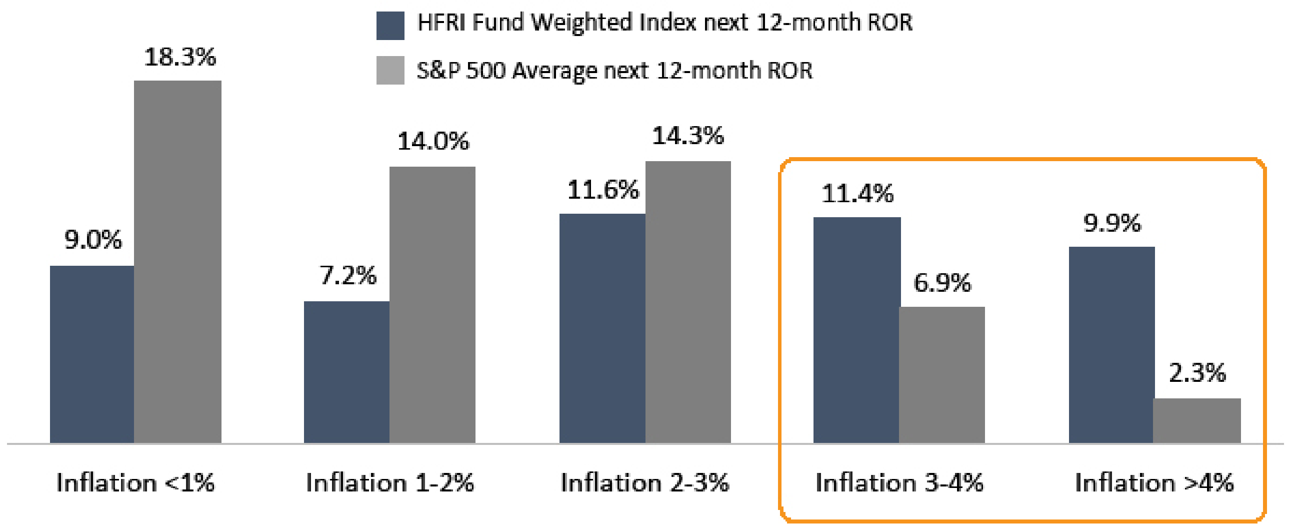
Exhibit 10: Number of U.S. IPOs and capital raised per calendar year



Data source: Bloomberg, includes all IPOs by calendar year excluding closed-end funds, REITs, special purpose entities, and SPACs. Data as of December 31, 2020.

Today, inflation risk is significant, as recent data points have indicated that year-on-year consumer price increases are at their highest point in over a decade. However, returns from absolute return strategies have historically been resilient across a range of inflation environments – notably, in prior periods when inflation has exceeded 2%-3%, absolute return strategies have outperformed equities.

Exhibit 11: Performance in various inflation environments, 1990-2021



Source: Bloomberg; GCM Grosvenor; HFR, Inc. www.HFR.com.

Part One

Part Two

Part Three

Part Four

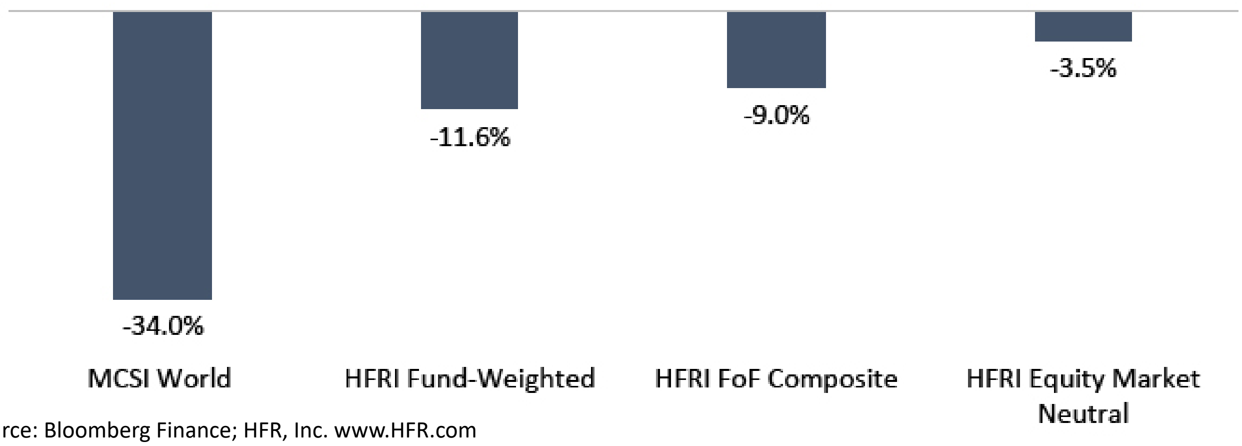
PART THREE

THE IMPORTANCE OF SELECTING ELITE MANAGERS

In this installment, we present our view that top decile hedge fund managers remain among the best available investments globally, without regard to the name "hedge fund." We also look at how top managers continue to attract talent and capital, while underperforming managers contract, underscoring the importance of manager selection.

A key characteristic of both absolute return strategies and top-tier managers within the space is the emphasis on loss mitigation and capital preservation during down markets. Recently, during the sharp market downturn in the first quarter of 2020, hedge funds mitigated losses effectively, particularly in lower net and market neutral strategies.

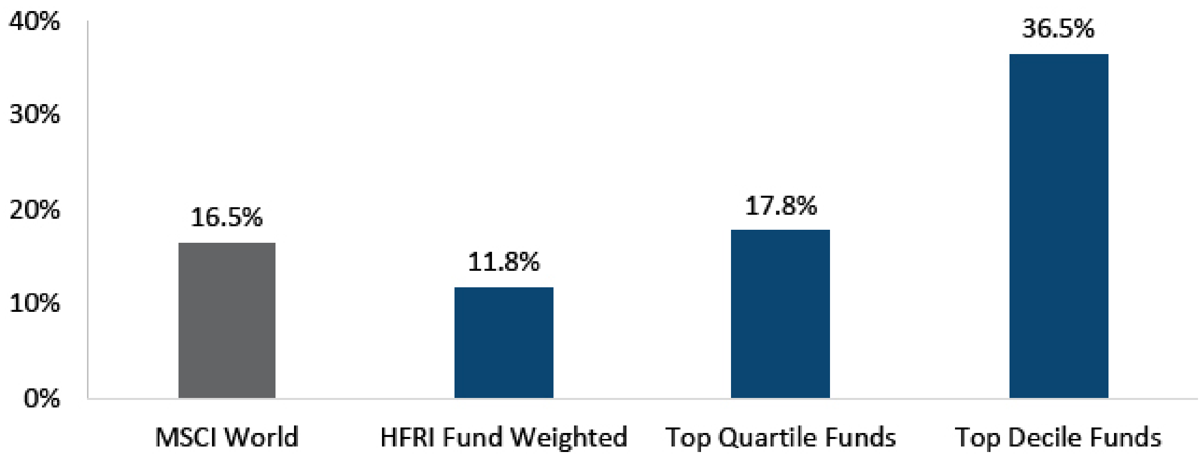
Exhibit 12: Peak to trough drawdown: January 2020 to March 2020



Source: Bloomberg Finance; HFR, Inc. www.HFR.com

However, elite fund managers must not only protect downside, but also generate strong returns across a range of market environments. The market in 2020 provided both bear and bull market environments for managers to navigate. It was in this choppy environment that we observed the best managers materially outperform their peers.

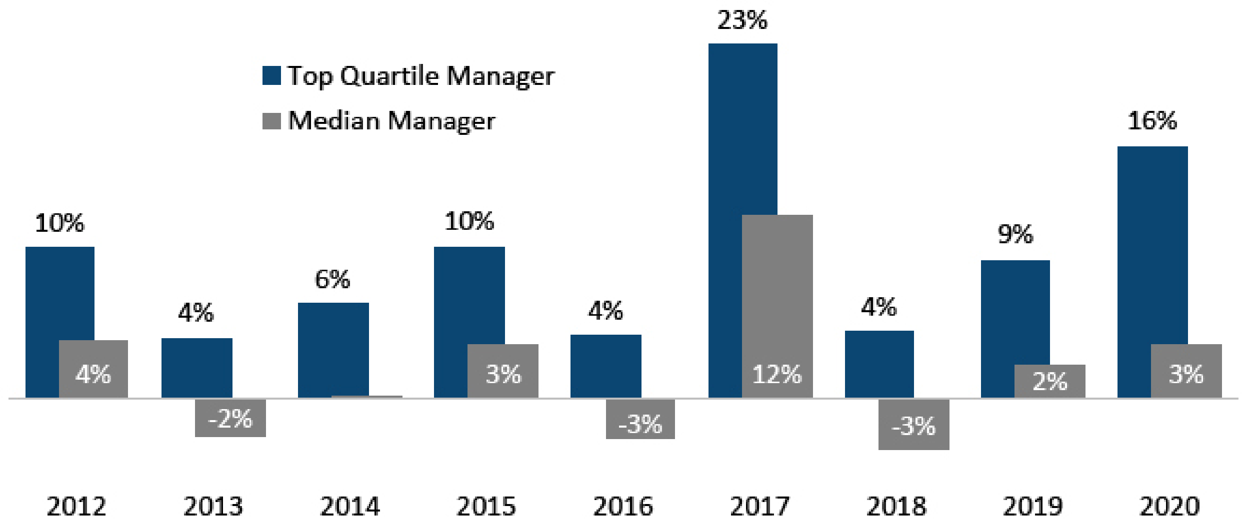
Exhibit 13: Trailing 12-month returns as of December 31, 2020



Source: HFR Market Microstructure Hedge Fund Industry Report – Fourth Quarter 2020 – © HFR, Inc. 2021, www.HFR.com.

At GCM Grosvenor, we focus not only on a manager's capital preservation and return generation capabilities but also, importantly, on the alpha generation of a manager's approach. In our experience, top managers generate stronger and more consistent alpha than their median peers, over time.

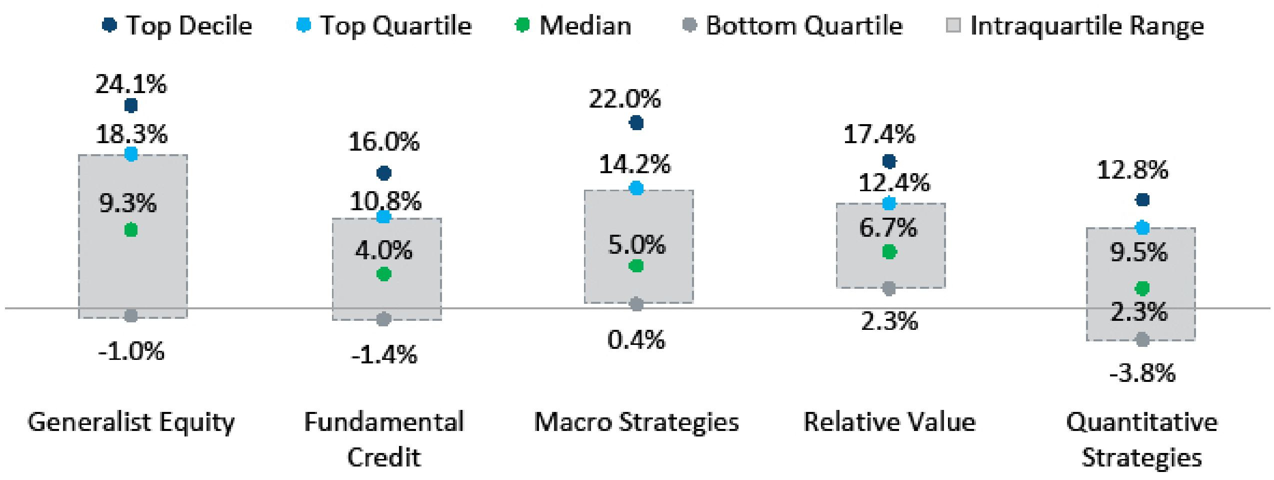
Exhibit 14: GCM Grosvenor generalist equity universe alpha percentile by calendar year



Alpha is calculated against the S&P 500 index on a calendar year basis for each year in the period 2012 – 2020.
Source: GCM Grosvenor (December 2020). Property of GCM Grosvenor.

Because of the high dispersion of returns between top- and bottom-performing managers over time (across all strategies), we believe manager selection is a critical component of investing in absolute return strategies.

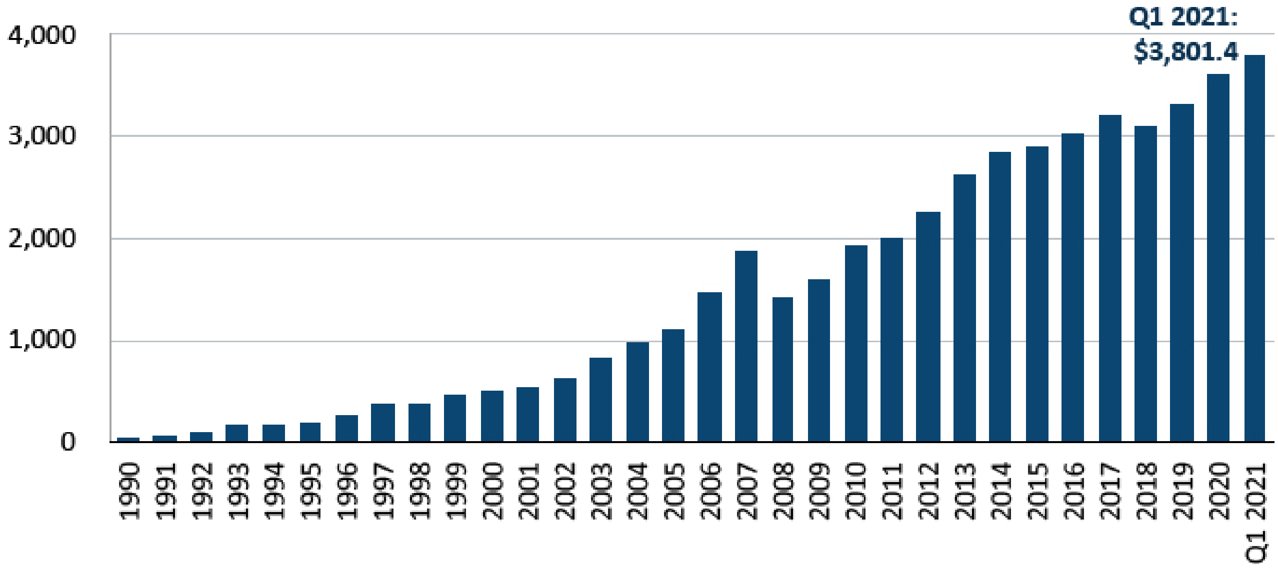
Exhibit 15: Trailing 3-year performance of GCM Grosvenor-defined strategy peep groups: January 1, 2018 to December 31, 2020



Source: GCM Grosvenor.
Strategy peer groups consist of all funds tracked by GCM Grosvenor with available returns for the period 12/31/2017 – 12/31/2020; strategy classification is determined on a discretionary basis by GCM Grosvenor's Absolute Return Strategies Research Department. Additional information is available upon request.

Investors continue to recognize the value proposition of hedge funds. Industry asset levels are currently at all-time highs, as quality firms continue to attract capital and talent.

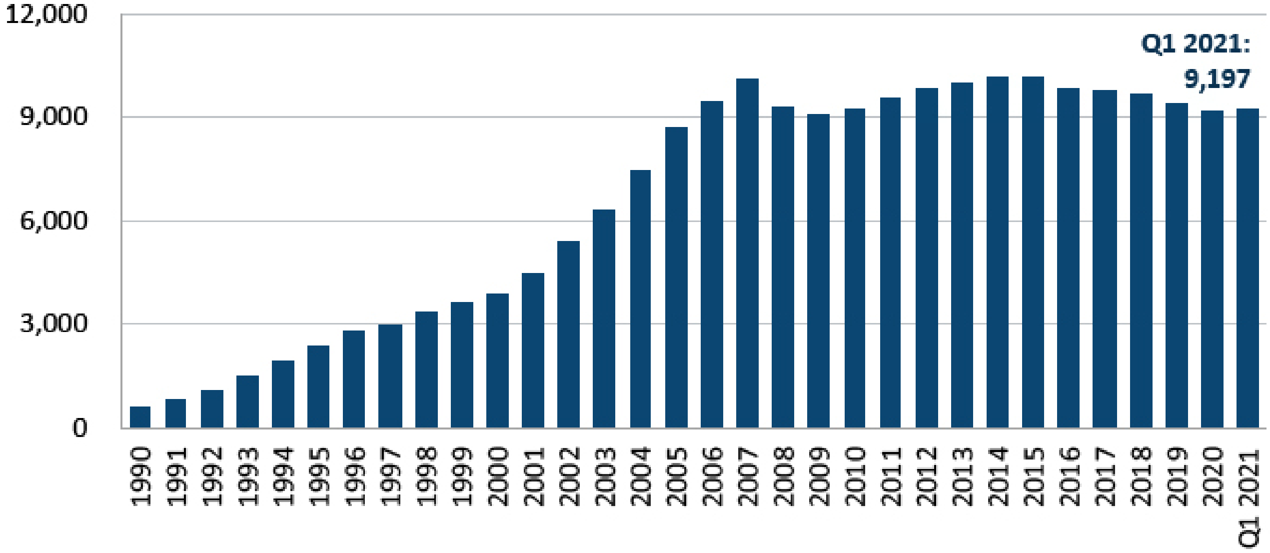
Exhibit 16: Estimated hedge fund industry AUM ($ billions)



Source: HFR Market Microstructure Hedge Fund Industry Report – First Quarter 2020 – © HFR, Inc. 2021, www.HFR.com.

Importantly, as the industry matures and weaker participants exit, growth in the number of funds has moderated, often strengthening the competitive "moats" of incumbents, and benefitting those firms with established capacity in higher alpha generating strategies.

Exhibit 17: Estimated number of hedge funds



Source: HFR Market Microstructure Hedge Fund Industry Report – First Quarter 2020 – © HFR, Inc. 2021, www.HFR.com.

PART FOUR

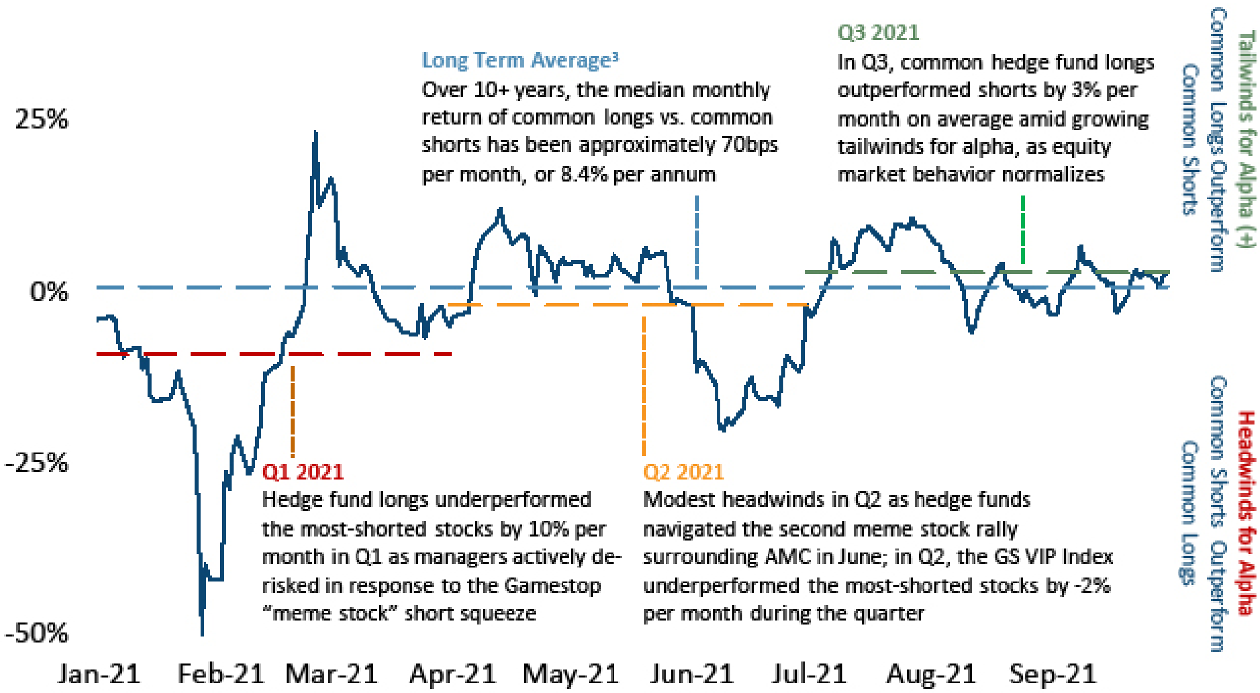
THE CURRENT OPPORTUNITY SET FOR HEDGE FUNDS

In this fourth and final installment, we look at a variety of more specific opportunities we are seeing across absolute return strategies today.

Long/Short Equities

Amid tailwinds for stock selection, we saw continued improvement in alpha generation from equity strategies in the third quarter, as evidenced by the positive spread between commonly held long and commonly held short positions.

Exhibit 18: Rolling 1-month ROR of Common Hedge Fund Longs[1] vs. Common Hedge Fund Shorts[2]

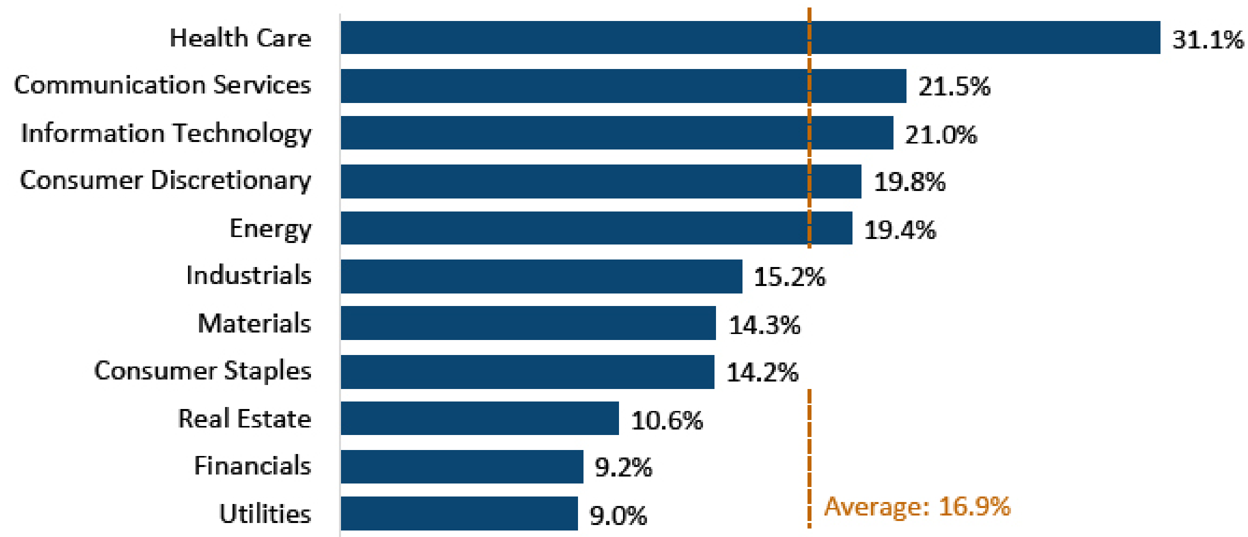


Data source: GCM Grosvenor, Goldman Sachs Investment Research; January 31, 2021 – September 30, 2021.
1 Common Hedge Fund Longs represented by the GS Hedge Fund VIP Index.
2 Common Shorts represented by the GS Most Short Rolling Index.
3 Performance data begins in September 2008, the earliest available date for the Most Short Rolling Index.

Many managers are finding certain sectors – notably health care, technology, and consumer-facing businesses – to be experiencing elevated dispersions in fundamentals and valuations, as innovation and "creative destruction" create ample opportunities for idiosyncratic stock selection, both long and short.

Exhibit 19: Variable Return Dispersion Across Sectors

Trailing 90-day total return dispersion by GICS sectors of Russell 3000 Index constituents



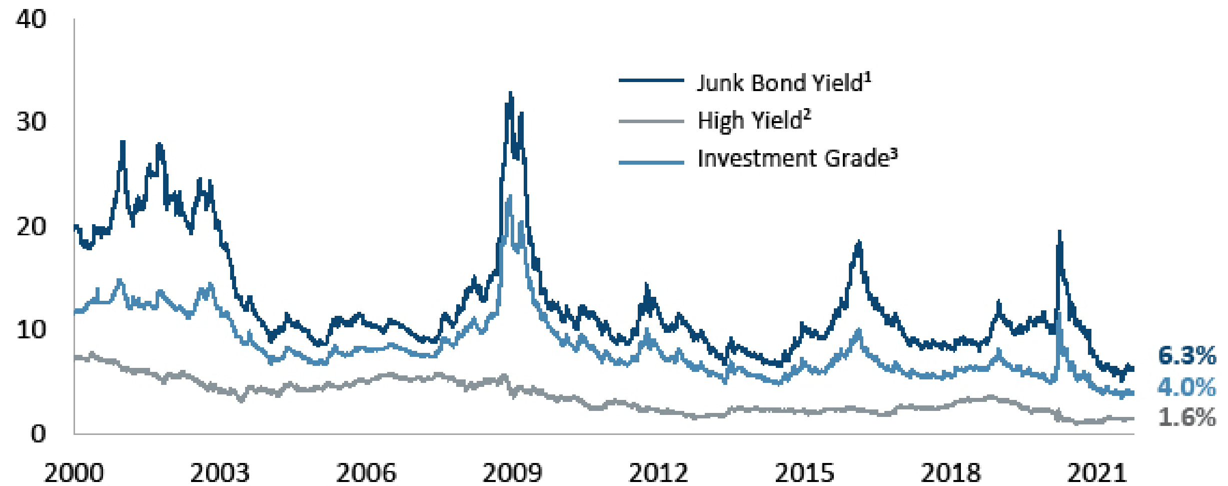
Data source: Bloomberg Finance L.P. Data as of September 30, 2021.

Credit

Today's ultra-compressed yields and low rates make long-only credit unattractive in our view, but strategies focused on origination and capital markets activity appear well-positioned, as new issuance volumes reach highs.

Exhibit 20: Absolute yields are compressed...

Yield-to-worst (2000-2021)

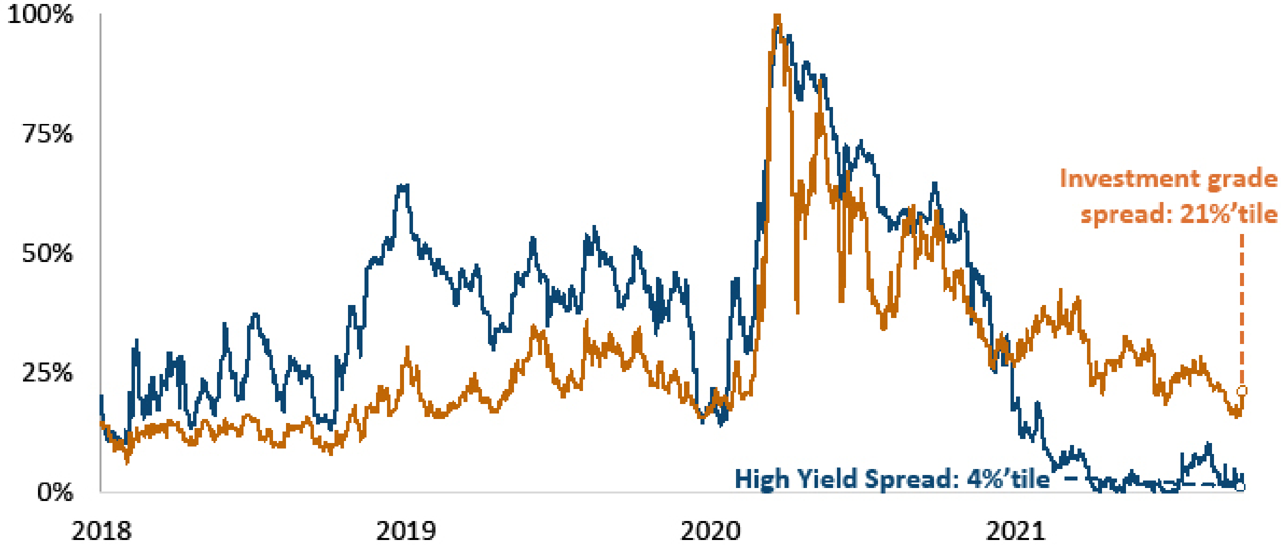


Data source: Bloomberg Finance L.P. Data as of September 30, 2021.

Indices: (1) Junk bonds represented by the Bloomberg Barclays CCC Index; (2) High Yield represented by the Bloomberg U.S. Corporate High Yield Bond Index; (3) Investment grade represented by the Bloomberg US Aggregate Bond Index.

Exhibit 21: ...and spreads are historically tight

Spread to 10-year treasury, percentile rak over the past 30 years (2018-2021)

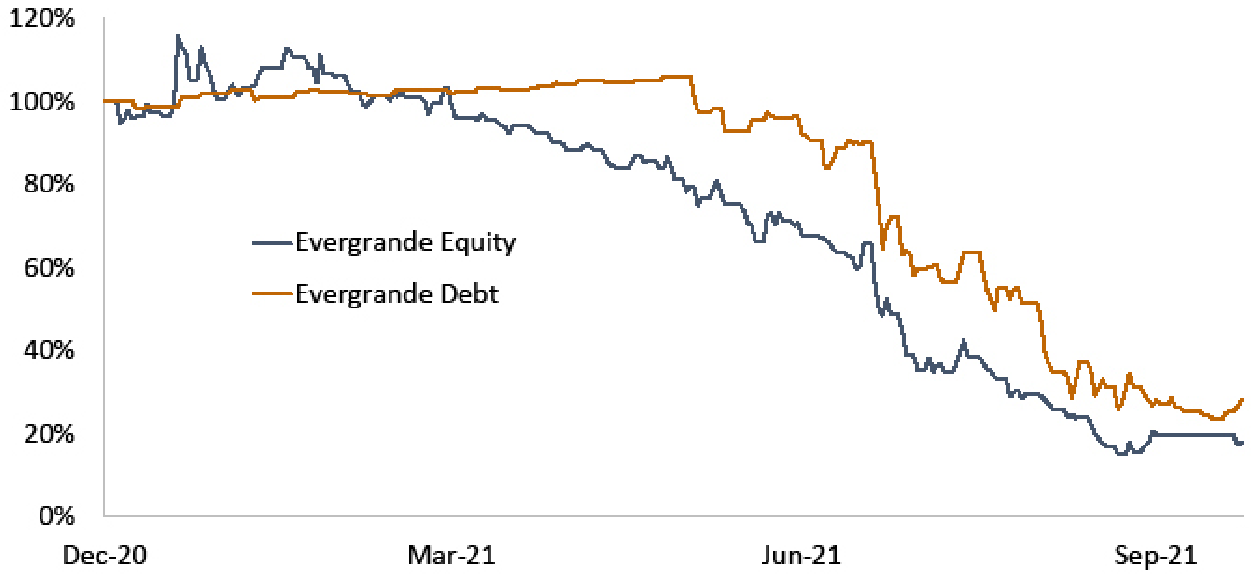


Data source: Bloomberg Finance L.P. Data as of September 30, 2021.

Geopolitical, macroeconomic, and regulatory risks, among other factors, are causing sector dispersion in China and sharply widening risk premia in Asian credit, particularly in China, amid the Evergrande corporate distress and property sector contagion.

Exhibit 22: In China, Evergrande distress is a major risk...

Value of Evergrande debt and equity as a percent of January 1, 2021 levels



Data source: Bloomberg Finance L.P. Data as of September 30, 2021.

Many research-oriented Asia-focused long/short equity managers are finding interesting opportunities among broader-based investor reaction, and some managers are exploring capital vacuums in Asia distressed credit.

Exhibit 23: ...though yields in the region are offering attractive potential returns

Bloomberg Asia Ex-Japan USD Credit China High Yield Index – yield-to-worst

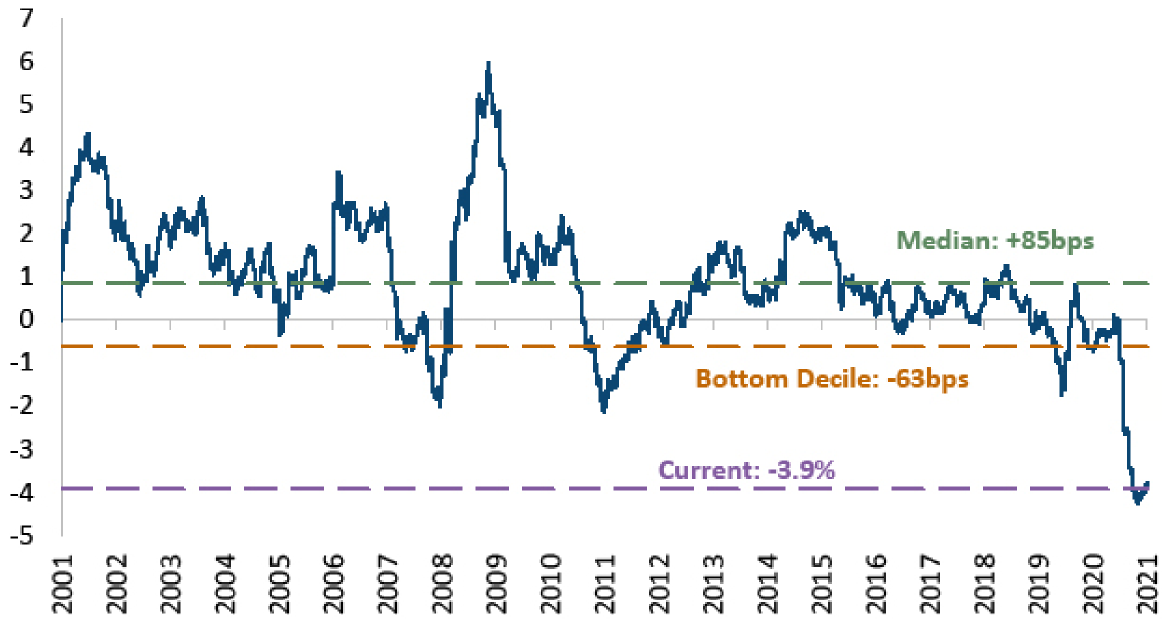
Data source: Bloomberg Finance L.P. Data as of September 30, 2021.

Diversifying Strategies

The significant gap between inflation and interest rates, combined with expectations for interest rate hikes and reduced central bank asset purchases, is creating a more robust trading environment among macro strategies.

Exhibit 24: Spread between interest rates and inflation is historically wide

U.S. 10-Year Government Bond Yield minus year-on-year urban CPI inflation, 2002-2021

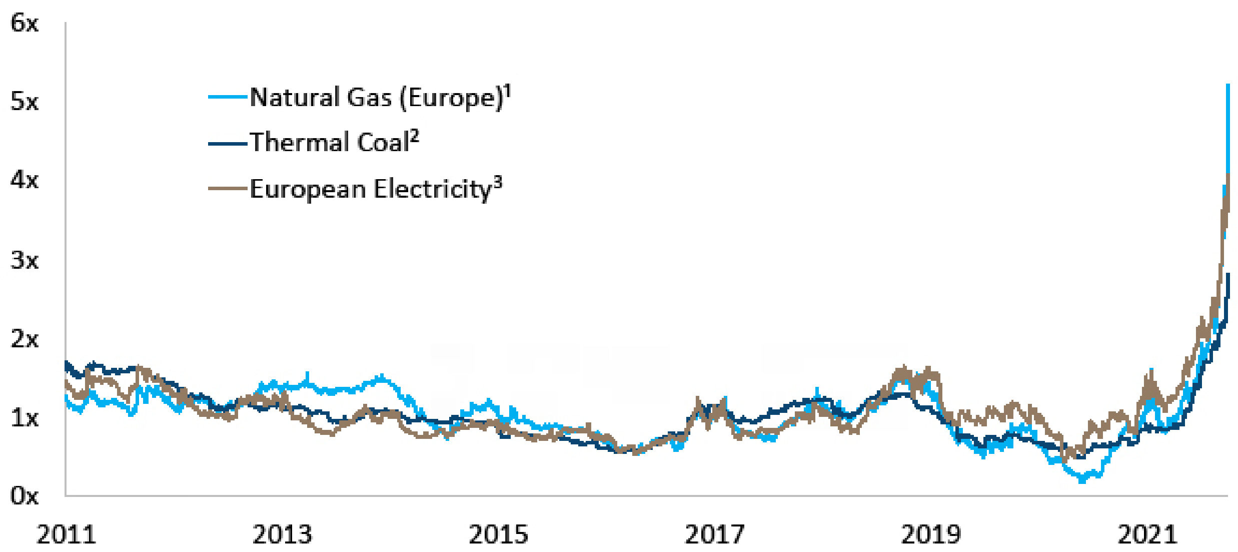


Data source: Bloomberg Finance L.P. Data as of September 30, 2021.

Additionally, volatility in commodities markets has reached historically high levels and several implementation strategies (both long and short) are available to sophisticated and experienced firms amid a rapidly evolving supply/demand environment.

Exhibit 25: Fuel shortages have driven a surge in power prices

European power benchmark prices vs. 10-year average levels (2011 – 2021)



Data source: Bloomberg Finance L.P. Data as of September 30, 2021.
Benchmarks: (1) ICE UK Natural Gas rolling generic 1st month future contract; (2) Rotterdam coal futures rolling generic 1st month futures contract; (3) Bloomberg OTC composite German power baseload 1-month forward prices.
All prices are shown as a multiple of their average price level over the 10 years from 1/1/2011 to 1/1/2021.

Conclusion

We believe that opportunities to generate attractive returns and alpha in absolute return strategies are as strong as they've been in years. The value proposition of these strategies for our clients remains compelling at a time when traditional long-only returns appear historically challenged.

Read more about GCM Grosvenor's Absolute Return Strategies.

ABOUT GCM GROSVENOR

GCM Grosvenor (Nasdaq: GCMG) is a global alternative asset management solutions provider with approximately $70 billion in assets under management across private equity, infrastructure, real estate, credit, and absolute return investment strategies. The firm is in its 50th year of operation and is dedicated to delivering value for clients in the growing alternative investment asset classes. Our experienced team of over 500 professionals serves a global client base of institutional and high net worth investors.

OUR OFFICES

Headquarters
Chicago
900 North Michigan Ave.
Suite 1100
Chicago, Illinois 60611
+1 312 506 6500

New York
+1 646 362 3700

Los Angeles
+1 310 651 8270

Toronto
+1 647 417 7361

London
+44 (0) 20 3727 4450

Frankfurt
+49 69 5899 6526

Tokyo
+81 3 5573 8110

Hong Kong
+852 3420 1777

Seoul
+82 2 2158 8500

For more information: inquiries@gcmlp.com | gcmgrosvenor.com

GCM GROSVENOR

Important Disclosures

For illustrative and discussion purposes only. The information contained herein is based on information received from third parties. GCM Grosvenor has not independently verified third-party information and makes no representation or warranty as to its accuracy or completeness. The information and opinions expresses are as of the date set forth therein and may not be updated to reflect new information.

Investments in alternatives are speculative and involve substantial risk, including strategy risks, manager risks, market risks, and structural/ operational risks, and may result in the possible loss of your entire investment. Past performance is not necessarily indicative of future results. The views expressed are for informational purposes only and are not intended to serve as a forecast, a guarantee of future results, investment recommendations or an offer to buy or sell securities by GCM Grosvenor. All expressions of opinion are subject to change without notice in reaction to shifting market, economic, or political conditions. The investment strategies mentioned are not personalized to your financial circumstances or investment objectives, and differences in account size, the timing of transactions and market conditions prevailing at the time of investment may lead to different results. Certain information included herein may have been provided parties not affiliated with GCM Grosvenor. GCM Grosvenor has not independently verified such information and makes no representation or warranty as to its accuracy or completeness.

Grosvenor Capital Management, L.P. is not affiliated in any manner with Grosvenor Group Limited, a company that is headquartered in the United Kingdom. This report has been prepared by Grosvenor Capital Management, L.P. and GCM Customized Fund Investment Group, L.P. (which, together with their affiliates, are referred to herein as "GCM Grosvenor"). GCM Grosvenor®, Grosvenor®, Grosvenor Capital Management®, GCM Customized Fund Investment Group®, Customized Fund Investment Group®, and Consortium™ are trademarks of GCM Grosvenor and its affiliated entities.

GCM Grosvenor (Nasdaq: GCMG) is a global alternative asset management solutions provider across private equity, infrastructure, real estate, credit, and absolute return investment strategies.

For any questions, please contact GCM Grosvenor Investor Relations at investorrelations@gcmlp.com.

Data Sources

Bloomberg Finance L.P.
S&P. S&P and its third-party information providers do not accept liability for the information provided and the context from which it is drawn.
HFR, Inc. www.HFR.com. The HFRI Fund-Weighted Index, HFRI FoF Composite Index, and HFRI Equity Market Neutral Index are being used under license from HFR, Inc, which does not approve of or endorse any of the contents in this report.

Original post dates
Part 1: June 1, 2021
Part 2: June 30, 2021
Part 3: July 28, 2021
Part 4: October 29, 2021