Why Investors Are Likely to Return to Hedge Funds

1. Equity and credit markets continue to fall.
2. Investors have shifted their allocation into cash and government bonds.
3. Correlations between assets is not 1. In fact, correlations between hedge funds and other asset classes such as equity have fallen from 95% in 2006 / mid 2008 to 70% currently.
4. Moving allocations into a risk free asset does not monotonically reduce portfolio risk. There comes a point at which adding to the risk free asset increases portfolio risk.
5. Moving capital en masse into any asset, even a risk free one, eventually increases the risk in the asset, and consequently in the portfolio.
6. If you do trust volatility as a risk measure, hedge funds have better Sharpe ratios which recommend overweighting them.
7. If you don’t trust volatility as a risk measure, the absolute loss incurred by hedge funds has been less than for long only passive strategies.