

# Absolute Return

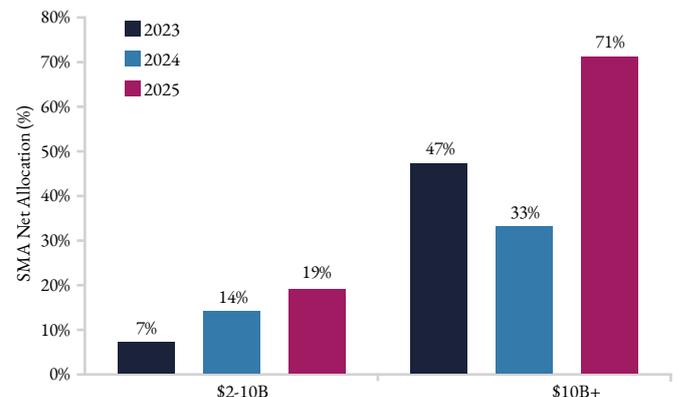
## Major Trends

**Macro dispersion supports active trading.** Monetary policy divergence, shifting tariff regimes and uneven global growth created meaningful cross-asset dispersion in 2025. Hedge funds benefitted from volatility around the Federal Reserve’s rate path and ongoing policy uncertainty in Europe and China, which provided a fertile backdrop for active trading. This environment supported positive alpha generation across most hedge fund strategies. Our Absolute Return managers captured these opportunities effectively and we believe stand to deliver strong risk-adjusted returns.

**Systematic strategies experienced cyclical weakness before recovery.** While most active trading strategies generated positive results in 2025, systematic approaches, particularly those relying on medium- to longer-term signals, faced a more challenging backdrop. Rapid shifts in market direction and short-lived trading cycles made it difficult for slower-moving models to adapt. Despite this, these strategies remain a component of the Absolute Return portfolio, offering diversification and the potential to protect during periods of market or hedge fund stress. In our view, the early-year weakness reflects the natural cyclical nature of systematic alpha rather than a structural change in opportunity. As market dynamics settled later in the year, signals stabilised and returns improved, underscoring the value of maintaining exposure through periods of temporary dislocation.

**Separately Managed Accounts (SMAs) continue to grow as a share of the hedge fund industry.** Traditionally, investors have gained exposure to hedge fund strategies by investing in fund vehicles managed by hedge fund managers. An alternative that has gained more interest over recent years is allocating to these managers via SMAs, where managers sub-advise a portion of capital that remains under the control of the investors. These SMAs continue to grow as a share of the hedge fund industry, most notably among larger allocators who are using them more than at any point in the past (see Exhibit 1), while smaller investors have more measured usage. Partners Capital recognised the advantages of the structure (primary enhanced transparency, better cash efficiency and more ultimate control over the underlying assets) early and has been deploying it successfully since 2020. In parallel, we remained cognisant of the value in allocating through typical commingled fund formats for new launches, as demonstrated by two recent investments where we were able to partner with managers that launched at scale and actively decided not to accept capital in SMA format. Investing through SMAs places greater responsibility for risk management on the investor, given the ability to employ greater leverage within these structures, and we remain alert to the broader increase in leverage in the hedge fund industry overall as adoption continues to grow.

**Exhibit 1**  
**Investments via Separately Managed Accounts grow, especially among larger allocators**



Notes: Net Allocation defined as % of respondents that plan to increase / increased allocations minus % of respondents that plan to decrease / decreased allocations

Source: Bank of America

**The war for talent remains a defining feature of the hedge fund industry.** Multi-PM platforms have continued to be successful in aggregate, capturing a growing share of industry assets and attracting a significant portion of the available talent pool. The result is continued demand for skilled portfolio managers, whether within established platforms or externally through SMA structures. Independent funds must therefore remain focused on defending and developing talent through greater autonomy, investment in professional development and partnership-like economics. That said, the return of capital of a well-known platform earlier this year, which Partners Capital was not invested in, serves as a reminder that the high expense base associated with retaining talent sets a high bar for performance to remain attractive for investors.

**AI adoption is reshaping hedge fund processes.** Artificial intelligence has moved from early experimentation to broad integration across hedge fund strategies. Over two-thirds of managers now employ AI tools across investment and operational workflows, up sharply from prior years. Applications range from trade idea generation and alternative data analysis to compliance and operational due diligence. For allocators, the key focus has shifted from whether managers use AI to assess the real value add of different AI implementations and how they are governed, with attention on data quality, oversight and integration into decision-making.

## Golden Rules

1. Diversification across strategy, investment universe, and manager, is essential to deliver sustainable risk-adjusted absolute returns across market environments.
2. Focus on managers that target high-quality, idiosyncratic risk taking as the source of their returns rather than exposure to lower-quality, market and factor sources of risk
3. Utilise customised structures, including separately managed accounts and fund-of-ones, which can significantly enhance the risk-return characteristics of the portfolio through capital efficiency, strategy refinement, improved transparency and enhanced liquidity.
4. Explore investment strategies that focus on niche, inefficient markets, as they can provide better potential for generating attractive, uncorrelated returns.
5. Drive aligned and strategic relationships with managers through scale and thought partnership, passing through benefits directly to our clients.

**Past performance is not indicative of future returns, your capital is at risk and you may not get back the full amount invested.**

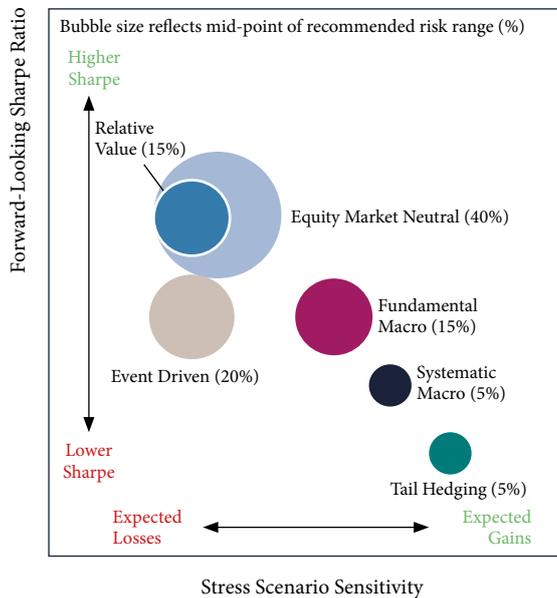
## Sub-Asset Class Positioning

Our Absolute Return programme is designed to deliver consistent and meaningful risk-adjusted returns with a return profile that is lowly correlated with major traditional asset classes. The design of our programme results in diversification benefits that can increase overall portfolio returns and provide a source of liquidity for rebalancing risk-exposures during market drawdowns. We continue to believe the most effective way to achieve this is by diversifying across multiple complementary sources of return, each largely market neutral and lowly correlated to one another.

We access these complementary sources of return through a combination of multi-strategy managers, which are internally diversified across strategies managed by independent trading teams, and specialist managers focused on narrower strategies and opportunity sets. This approach allows us to balance structural diversification with targeted expertise. Our approach to portfolio construction, formed through significant experience investing across hedge fund strategies, is informed by a rigorous assessment of each manager's ability to generate sustainable outperformance across a range of market regimes, combining quantitative analysis with qualitative judgement. In addition, our recommended manager sizing also reflects the level of diversification within each strategy, ensuring the overall programme remains balanced and no single source of return dominates portfolio outcomes.

History has shown that outperformance across hedge fund strategies is cyclical, but the length and depth of cycles tend to vary over time. As a result, attempts to time these cycles rarely produce attractive risk-adjusted results. While we may make incremental adjustments to risk allocations to different strategies, we do not believe in making significant shifts in strategy exposure on a yearly basis. The targeted strategy allocations within our Absolute Return programme are determined by our forwarding-looking, long-term expected risk-adjusted return and volatility, expected correlation dynamics across strategies – especially with regard to stress scenarios – and the availability of high-quality manager partnerships within the strategy as seen in Exhibit 2.

**Exhibit 2**  
**Continued recommendation of diversified strategy allocation, but with higher exposure to strategies with higher expected, long-term Sharpe ratios**



Source: Partners Capital internal analysis

**Focus areas for 2026:**

- Discretionary Macro:** We are shifting capital into fundamental macro strategies that can benefit from continued cross-asset class volatility driven by geopolitical, monetary, market structure and economic factors. Compared to the past, when our allocations were largely to directional, single portfolio manager strategies with higher volatility, our recent allocations look to take a differentiated approach. By partnering with managers that take positions across rates, FX and commodities, we look to build exposure to a broad set of potentially lowly correlated, relative value opportunities independent of market direction. Directional themes are typically a smaller part of these managers’ risk but can be more meaningful when particularly attractive opportunities arise. Our expectation is that these managers should be able to generate more consistent, but potentially lower absolute returns compared to their more directional counterparts, allowing for larger position sizing and lower probability of severe drawdowns.

- Quantitative Equity Market Neutral:** We are looking to increase our allocation to quantitative equity market neutral strategies. Stock-level dispersion remains elevated, which is supportive for quantitative equity market neutral approaches, particularly higher trading frequency strategies, who can apply disciplined risk control with a particular focus on exposure to common styles and holdings across the industry. While quantitative managers have been using machine learning and large language models for years, more recently these managers have been active in utilising generative artificial intelligence (“GenAI”) in their investment processes, which could further enhance their risk-adjusted returns. Examples of this include utilising artificial intelligence to streamline parts of their research process across data collection, code generation and simulation of trading strategies. We anticipate that future developments will include leveraging GenAI to independently develop signals, with little-to-no human oversight in the process and, eventually, repeating this process to build diversified, risk-managed and optimised portfolios of signals.
- Single-Strategy Equity Market Neutral:** Whilst the programme has seen success with diversified multi-PM implementations that draw on multiple sources of return and maintain balanced exposures, the bar remains high for more concentrated approaches. These focused implementations often exhibit weaker risk-adjusted outcomes, though they can also offer higher potential outperformance. Within this space, our attention is on managers operating in segments under-represented within large multi-PM platforms, where inefficiencies and capacity constraints may provide more differentiated opportunities.
- Systematic Macro:** Systematic macro strategies use rules-based strategies to invest long and short across various asset classes, often implementing positions based on signal groups such as value, momentum or carry. We had historically observed that risk-adjusted returns of these strategies were not as high as those of other strategies in our Absolute Return programme. However, the tendency of these strategies to generate strong returns during periods of market stress nevertheless made them attractive from a portfolio perspective. Our analysis suggests that over more recent years, these attractive return characteristics have been less present in the strategy. As a result, we look to de-prioritise systematic macro strategies in our programme and instead get exposure to positive left-tail strategies via discretionary macro, trend followers or dedicated tail hedging strategies.

## Strategic Priorities

- **Further enhance our SMA capabilities:** As detailed in Exhibit 1, hedge fund investing via SMAs continues to expand across the industry. We believe the full benefits of the structure are most evident within Absolute Return strategies, where SMAs combine transparency and control with the additional advantage of high cash efficiency. This enables more effective portfolio diversification and risk management. The growing prevalence of SMAs in new hedge fund launches has also created an attractive pathway for high-calibre investment talent to manage capital independently. For investors, the SMA landscape increasingly rewards scale through differentiated access to these managers and the ability to negotiate more aligned economics.

Partners Capital has been investing through SMAs since 2020, developing meaningful experience in the structure. Our multi-PM Absolute Return SMA strategy was established to provide investors with access to multi-strategy returns in a more aligned manner. We continue to build on this foundation by dedicating additional resources to enhance the operations, risk management and portfolio optimisation of our platform. In 2025, we advanced this effort by consolidating our SMA capabilities within a dedicated subsidiary, opening the programme to external investors to increase scale and further strengthen our SMA platform.

- **Selectively partner with high quality new commingled fund launches:** We aim to identify and partner with high-conviction new launches and capacity openings before they become constrained. Our dedicated Absolute Return research team, supported by specialist networks, provides visibility into opportunities at an early stage, where our scale and experience allow us to be a meaningful and value-adding LP. Through active engagement and early commitment, we can often negotiate preferential terms, including fee discounts and long-term capacity rights, which enhance net return potential and strengthen alignment with managers over time.

- **Deepen sourcing in capacity-constrained and niche strategies:** We aim to broaden access to managers operating in less efficient or constrained markets. While we continue to see a major portfolio role for multi-strategy hedge funds, we believe that allocating to more specialised investors operating in areas of the market that are not well covered by the large multi-strategy funds can add further diversification benefits to our programme and deliver differentiated return streams less exposed to industry crowding.
- **Evaluate differentiated approaches to tail hedging:** We're exploring more efficient tail hedging strategies with a focus on mitigating potential drawdowns in a forced selling environment for levered hedge fund strategies. The increased capital flows and strong performance of multi-strategy managers has resulted in firms with stylistically similar approaches to generating return representing a large portion of average daily trading volume across all hedge fund strategies. Our focus has been on strategies which can be implemented outside of a traditional fund structure, which should result in better capital efficiency, liquidity that can be utilised during a period of stress and lower fees. In particular, dispersion strategies that benefit from a widening spread between single stock and index volatility in times of market stress are a new area of focus for our programme.

The estimates of fee savings are based upon certain assumptions which should not be construed to be indicative of actual events that will occur. There is no assurance that the fee savings presented will be achieved.