Long-Short Equity Strategies Capitalize on Correlation Collapse

Stockholm (HedgeNordic) – Stock pickers in the hedge fund world enjoyed promising returns during the first eight months of the year, as correlations between both sectors and companies have fallen significantly compared to the previous year. Long-short equity hedge funds are reveling in the de-correlated environment, gaining 7.52% year-to-date through the end of August.

According to data provided by eVestment, equity-focused hedge funds are outperforming nearly all hedge fund strategies this year, as markets, asset classes, and individual securities move more independently of each other. The de-correlation phenomenon, also referred to as "the Great Correlation Collapse", appears to be particularly powerful in the U.S. stock market, which could possibly explain why Rhenman Healthcare Equity L/S, Borea Global Equities and other Nordic hedge fund players with exposure to the U.S. stock market performed so well thus far in 2017. The realized cross-correlations for S&P 500 constituents is below 20% this year, compared to 60% a year ago. In fact, the roughly 18% realized correlation of the benchmark's constituents is one of the lowest readings since 2004, according to Morgan Stanley.

While more than 93% of fund managers benchmarked against the S&P 500 underperformed the market during 2013-2016, more than half of these managers beat their benchmarks in the first half of 2017. This is the first time in Bank of America Merrill Lynch's data history when more than half of funds managers outperformed their benchmarks in the first half of the year. Should fund managers sustain this performance through the end of the year, active stock fund managers are likely to enjoy their best year since 2007. The first half of the current year was the best for classic long-short equity hedge funds since 2010, Morgan Stanley's prime brokers reckon.

Whilst most long-biased and long-short equity hedge funds generated hefty returns so far in 2017, systematic and commodities funds delivered lackluster performance. For instance, CTAs, as measured by the HFN CTA/Managed Futures Index provided by eVestment, returned a negative 1.24% in the first eight months of 2017. Meanwhile, a high-ranked employee at JPMorgan Asset Management was quoted by Financial Times as saying that they are bullish on equity long-short funds "given the improving fundamentals and rising dispersion across stocks and sectors."