PARAGON Alpha

HEDGE FUNDS REPORT

PAST YEAR TRENDS AND WHAT TO EXPECT IN 2025

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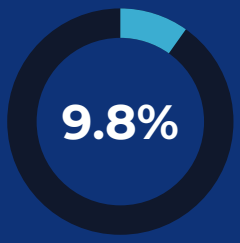
Hedge fund performance in 2024

Hedge funds navigated a dynamic market environment in 2024, marked by shifting macroeconomic conditions, persistent inflation concerns, and geopolitical uncertainty. Despite these challenges, the industry demonstrated resilience, with several strategies delivering strong returns.
Quant and macro funds capitalized on volatility and central bank policy shifts, while event-driven and merger arbitrage strategies saw increased deal flow and regulatory clarity. Equity long/short funds faced mixed performance amid sector rotations, whereas multi-strategy platforms continued to attract talent and capital, leveraging diversified approaches to generate steady gains. Overall, hedge funds remained a key player in global markets, adapting to evolving risks and opportunities while solidifying their role as essential portfolio diversifiers for institutional investors.



In 2024, the hedge fund industry achieved a 9.83% gain, as reported by the HFRI Fund Weighted Composite Index. This performance, while positive, lagged behind the S&P 500's 23.3% return for the same period.

$10.47 B

Hedge funds experienced a notable shift in investor sentiment, recording net inflows of $10.47 billion—the first positive calendar year for inflows since 2021. This resurgence indicates renewed confidence in hedge fund strategies among investors.

$4.51 T

The hedge fund industry saw assets under management grow by 9.75%, reaching $4.51 trillion by year-end, marking the largest annual increase since 2021. Institutional confidence in alternative investments led to net inflows of $10.47 billion, reversing prior years of outflows.

Kenneth J. Heinz, president of HFR, said portfolio managers are "preparing for a wide range of market cycles, with the possibility for volatility and dislocations as investors adapt to new policies regarding interest rates/inflation, legislation and tariffs" in 2025.

"Total global hedge fund industry capital rose to a fifth consecutive quarterly record as managers, institutions and investors positioned for sweeping policy changes which are likely to have significant and far-reaching implications for U.S. and global financial market structure, regulation and capital,"

Market overview

Performance across strategies

52%

Macro funds

These funds capitalized on global economic shifts, interest rate fluctuations, and geopolitical events. For instance, Discovery Capital achieved a 52% return, leveraging diverse gains in equities, currencies, credit, and rates.

28.7%

Equity long/short funds

Performance was mixed within this category. While some funds faced challenges, others excelled; Dan Loeb's Third Point reported a 28.7% return, benefiting from strategic equity positions.

36%

Merger arbitrage & event-driven strategies

These strategies benefited from increased M&A activity. DE Shaw's Oculus fund, for example, had its best year ever with a 36% increase, capitalizing on event-driven opportunities.

60%

Digital assets funds

Digital Funds experienced a resurgence, driven by institutional adoption of cryptocurrencies and blockchain-related investments, particularly after key regulatory approvals and ETF launches. Performance-wise, the average crypto hedge fund achieved a nearly 60% return, significantly outperforming the broader hedge fund industry's average return of 10%.

Regulatory & macroeconomic influences

Several key factors shaped hedge fund performance and investor sentiment in 2024:

Interest rates & inflation

Central banks maintained a cautious stance, influencing fund positioning in rates and macro strategies.

Geopolitical risks

Tensions in global markets, including trade policies and elections, created both risks and opportunities.

Regulatory developments

Increased scrutiny on short selling, ESG compliance, and private fund disclosures impacted fund structures and investor allocations.

Market liquidity & volatility

Hedge funds thrived on pockets of volatility, with certain strategies outperforming during periods of market dislocation.

Major trends from the past year

Quantitative strategies: How systematic funds performed

In 2024, quantitative hedge funds leveraged AI-driven models and systematic trading to capitalize on market volatility. Renaissance Technologies' flagship Medallion Fund posted a **30% gain**, while its **Institutional Equities and Diversified Alpha funds returned 22.7% and 15.6%**, respectively. Systematic funds outperformed during turbulent periods, such as the DeepSeek AI-driven volatility, gaining 1.7% while traditional long/short funds declined 1.1%. However, quant funds saw mixed results overall, with a -2.3% return in Q3, slipping from their position as top performers earlier in the year.

Private credit & alternative lending

With banks tightening lending standards, hedge funds expanded their role in private credit markets, capitalizing on demand for alternative financing. Direct lending strategies delivered strong risk-adjusted returns, particularly in distressed debt and structured credit. This shift reinforced hedge funds as key liquidity providers in private markets, offering institutional investors access to yield-generating assets outside traditional fixed-income markets.

Commodities & macro strategies: Impact of geopolitical tensions and inflation

Commodities trading surged amid geopolitical uncertainty, supply chain disruptions, and fluctuating inflation rates. **Macro hedge funds that correctly positioned for rate changes and currency shifts capitalized on volatility, with energy and metals markets experiencing significant price swings.** Inflation-sensitive assets, including gold and agricultural commodities, saw heightened hedge fund interest as investors sought inflation hedges. A notable example is **the surge in gold prices, which achieved a 28% year-to-date return**, reaching multiple record highs. This increase was driven by factors such as geopolitical instability, declining interest rates, and central bank purchases. Hedge funds significantly contributed to this trend, with many increasing their bullish positions on gold as a hedge against economic uncertainties. **The "debasement trade"—a strategy where investors seek assets like gold and Bitcoin to protect against currency devaluation—gained traction**. JPMorgan strategists noted that this approach was fueled by geopolitical uncertainties, long-term inflation concerns, and reduced confidence in fiat currencies. Hedge funds participated in this trend, viewing these assets as effective hedges against potential economic instability

M&A arbitrage: deal volume, spreads, and regulatory hurdles

Merger arbitrage strategies benefited from a rebound in global M&A activity, with increased deal volume driving trading opportunities. However, regulatory scrutiny from U.S. and European antitrust bodies introduced new challenges, widening deal spreads and delaying high-profile transactions. Event-driven hedge funds adapted by identifying opportunities in special situations and distressed takeovers.

ESG & sustainable investing

Hedge funds continued to integrate ESG principles into their investment processes, with some launching dedicated sustainable strategies. While regulatory clarity improved in some regions, concerns over greenwashing led to heightened investor due diligence. ESG-focused funds saw mixed returns, with performance largely dependent on sector allocations and macroeconomic tailwinds.

The role of automation and machine learning

The hedge fund industry saw a significant shift towards artificial intelligence and machine learning, with approximately **56% of hedge funds utilizing AI to inform investment decisions**, **nearly triple the adoption rate from the previous year**. A notable example is Numerai, a San Francisco-based hedge fund that crowdsources AI models from data scientists worldwide. Numerai's unique approach involves providing encrypted data to participants, who then develop predictive models. This collaborative strategy has contributed to the fund's positive returns since its inception. DeepSeek, an AI startup founded by former hedge fund manager Liang Wenfeng, developed an advanced AI model that rivals leading U.S. counterparts. Remarkably, DeepSeek achieved this with a fraction of the budget, highlighting the efficiency and potential of innovative AI applications in finance.

Key challenges in 2025

Hedge funds must navigate a volatile market in 2025, shaped by macroeconomic uncertainty, central bank policies, and geopolitical tensions. **While some funds capitalize on market swings, erratic conditions may challenge long-term strategies. Regulatory pressures are intensifying, with the SEC increasing disclosure requirements, Europe tightening short-selling rules, and ESG compliance evolving.** These changes demand greater transparency and operational adjustments.
Investor expectations are shifting, with increasing pressure on traditional **"2 and 20" fee models.** Allocators seek lower fees, performance-based structures, and deeper insights into fund strategies and risk management. Competition from private equity and venture capital is rising as institutional investors allocate more capital to longer-term, illiquid strategies. To stay competitive, hedge funds must innovate with hybrid models and differentiated investment approaches. Adapting to these challenges will be key for hedge funds looking to attract capital and generate consistent returns in 2025.

Opportunities & what to expect in 2025

Growth areas and potential high-return strategies

Increased market volatility, driven by geopolitical events and policy shifts, presents opportunities for hedge funds to generate alpha through tactical asset allocation and dynamic trading strategies. According to Agecroft Partners, heightened volatility can benefit skilled managers adept at exploiting price distortions. The resurgence of U.S. value stocks, bolstered by pro-business policies, offers the potential for significant returns. The valuation gap between growth and value stocks is near historic highs, suggesting a possible reallocation favoring value-oriented investments.

Institutional adoption and changing LP preferences

Institutional investors are demonstrating renewed interest in hedge funds, with a focus on diversification and risk-adjusted returns. 36% of allocators plan to commit new capital to hedge funds in 2025, with an additional 43% considering opportunistic investments. Investors are increasingly favoring hedge funds that offer transparency, robust risk management, and alignment with environmental, social, and governance (ESG) principles. This shift necessitates that hedge funds adapt their strategies and operations to meet evolving limited partner (LP) expectations.

Hedge Funds' role in the evolving digital asset ecosystem

The blockchain and cryptocurrency sectors are poised for substantial growth, with hedge funds increasingly integrating digital assets into their portfolios. Supportive regulatory environments and technological advancements have led to the emergence of crypto-specific funds and the inclusion of cryptocurrencies in various hedge fund strategies. Notably, some investment funds are introducing Bitcoin-denominated share classes, facilitating direct capital allocation into digital assets and reflecting the mainstream acceptance of cryptocurrencies.

Emerging markets and niche strategies

Emerging markets present attractive opportunities due to favorable demographics, economic reforms, and growth potential. Hedge funds are exploring investments in regions such as Brazil, China, Turkey, and South Africa, capitalizing on undervalued assets and market inefficiencies. Niche strategies, including sector-specific funds and thematic investments, are gaining traction as investors seek targeted exposure to high-growth areas like technology, healthcare, and renewable energy.

Meet the team from Paragon Alpha and connect with some of the best experts for trading and technology talent in the hedge fund industry

Colin McGhee

Founder and Managing Director

colin@paragonalpha.com

Jamie Jeffery

Managing Director UK

jamiej@paragonalpha.com

Rob Stubbs

Head of USA Quant Portfolio Management

robert@paragonalpha.com

Harriet Potter

Principal Consultant

harriet@paragonalpha.com

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