

Navigating the new normal: Hedge funds and the end of the Alpha Winter

Summary

The end of summer marks a change of season and with that a chance to reflect. For our investment team, it's an opportune moment to consider the hedge fund industry's recent evolution. We have witnessed the end of the "Alpha Winter" — a period marked by suppressed traditional sources of alpha — and the beginning of a new season of opportunity. As market conditions continue to shift, the environment is once again conducive for hedge funds to thrive.

After analyzing 30 years of J.P. Morgan Alternative Asset Management (JPMAAM) hedge fund platform returns*, we identified three primary drivers of hedge fund alpha: risk-free rates above 2%, moderate-to-high equity volatility and low intra-stock correlations. The period from 2011 to 2019 — which we refer to as the Alpha Winter — was a historical anomaly, as extraordinary monetary policy simultaneously suppressed all three factors for an extended period. Since 2020, market conditions have shifted, more closely resembling the environment that supported strong hedge fund outperformance prior to 2011. This has coincided with a notable resurgence in hedge fund alpha, with excess returns over equity beta nearly doubling since the end of the Alpha Winter — reaching over 7% per annum since the start of the new regime (see Exhibit 1).

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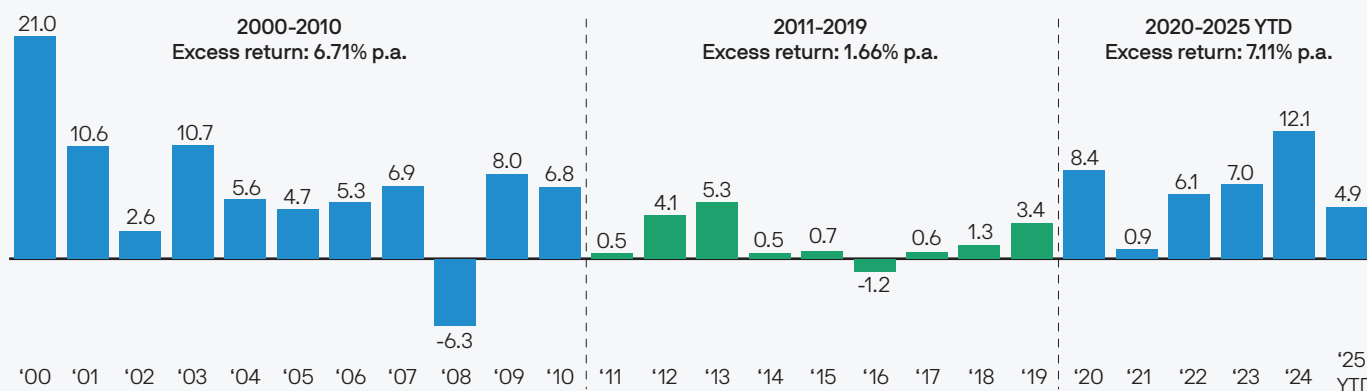


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Exhibit 1: JPMAAM platform hedge fund excess returns (%), 2000-2025 YTD



Past performance is not indicative of current or future results. Source: Bloomberg, J.P. Morgan Alternatives Solutions, J.P. Morgan Asset Management; as of June 2025. Hedge fund excess return represents the JPMAAM hedge fund platform annualized net returns calculated using monthly data minus the contribution from equity beta to MSCI for that month, measured on a rolling 24-month basis. JPMAAM hedge fund platform is an asset-weighted composite of all the funds invested in over the period excluding liquid alternatives. 2025 return is a cumulative figure representing the six months from January to June 2025 of the JPMAAM hedge fund platform. Performance is net of JPM fees and net of manager fees. Favorable metrics used: one-month lagged realized volatility is above the median intra-stock correlation is below the median, and risk-free rate is > 2%, while unfavorable are the opposite.

*JPMAAM's 30-year track record dates to its inception in April 1995. The analysis in this paper draws on platform data beginning in 2000.

When two or more of the three key alpha drivers above align favorably — as is currently the case — hedge funds have historically delivered strong performance, generating average excess returns over equity beta of 6.6% in the following 12 months. With favorable conditions expected to persist, investors face a strategic imperative to capitalize on what represents the strongest alpha generation opportunity since the early 2000s.

The three fundamental drivers of hedge fund alpha

Hedge funds are best understood as an industry rather than a single asset class. The space encompasses a broad spectrum of strategies, each with distinct objectives and risk profiles, which makes broad generalizations challenging. However, analysis of JPMAAM's hedge fund platform returns over the past three decades highlights three consistent drivers of alpha that have persisted across market cycles.

These factors cut across strategies and underpin alpha generation throughout the industry. The following sections examine each driver's impact and analyze hedge fund returns over different market regimes, illustrating how these dynamics have shaped outcomes over time.

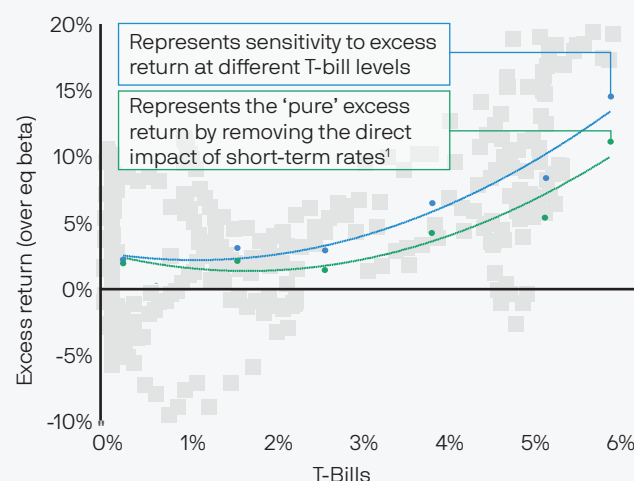
Driver #1: Risk-free rate above 2%

Higher cash rates have historically translated to higher hedge fund excess returns, independent of equity market movements (see **Exhibit 2**). In a higher rate environment, hedge funds benefit directly — through increased earnings on cash balances, short-interest rebates and floating-rate securities — and indirectly, as higher rates often coincide with increased market volatility and therefore an improved opportunity set. For more information on this topic, refer to the research paper previously published by our team titled [“Interest Rates and Hedge Fund Returns Historically Rise in Tandem.”](#)

Our analysis defines an attractive alpha environment for hedge funds as one in which the risk-free rate exceeds 2%, a threshold that closely aligns with the central bank's long-term inflation target and is often used as a

Exhibit 2: Approximate excess hedge fund returns under different interest rate regimes

% over equity beta, 1995–present



Source: J.P. Morgan Asset Management; as of July 2025. Monthly excess (or “residual”) returns are plotted within their respective grid lines based on actual rates at the start of the month. Return data are net of fees. Treasury bill returns are monthly averages.

proxy for the nominal neutral rate. Across our dataset, average monthly platform performance in months when the risk-free rate exceeds 2% is more than double the performance in months when the rate falls below this threshold (0.82% vs 0.34%).²

Driver #2: Equity volatility in line with pre-GFC levels

Higher volatility tends to increase price dispersion across related securities and sectors over different time periods, creating inefficiencies that skilled managers can exploit and increasing the magnitude of trading opportunities.

Although initial volatility spikes may present short-term challenges, significant alpha generation typically occurs in the subsequent months as managers capitalize on market dislocations (see **Exhibit 3**).

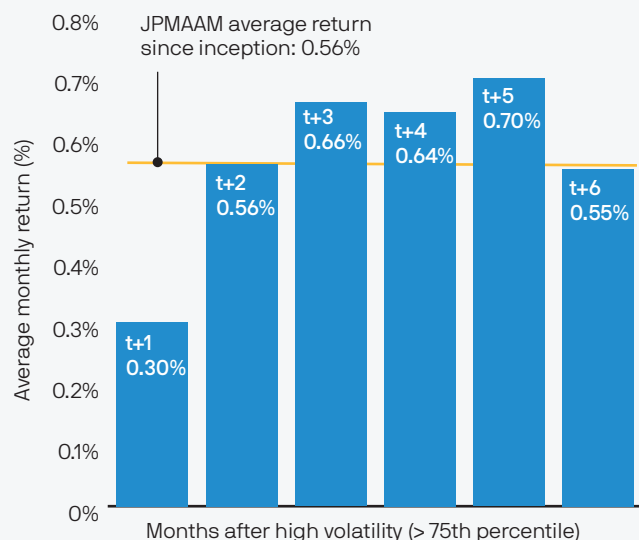
Our analysis uses one-month lagged volatility measures, which captures this dynamic — the lag reflects the time needed for managers to position portfolios to exploit opportunities created by volatility events while avoiding noise from immediate market reactions.

¹ Assumes 60% of rates fall to the bottom line of hedge fund returns.

² Represents period from January 2000 through June 2025.

Exhibit 3: JPMAAM monthly hedge fund platform returns following a high volatility month

t= months with top quartile volatility (realized equity volatility > 20%)



Past performance is not indicative of current or future results. A high volatility month is defined as a month with realized equity volatility > 20%. Source: J.P. Morgan Alternatives Solutions, J.P. Morgan Asset Management. Performance estimated since January 2000 as of June 2025. Returns are net of underlying manager fees and JPMAAM fees.

Driver #3: Low intra-stock correlation

While elevated equity volatility increases the magnitude of trading opportunities, lower intra-stock correlation increases their frequency. In a period of low intra-stock correlations, individual stocks respond more idiosyncratically to events rather than moving in tandem with the broader market, resulting in greater dispersion of returns. This provides hedge funds with more opportunities to identify and capitalize on stock-specific movements, leading to stronger returns (see Exhibit 4).

Although this analysis uses equity-related indicators to measure intra-stock correlation and volatility, the findings are applicable across other asset classes where hedge funds operate as well, including currencies, commodities and fixed income markets, all of which benefit from the same fundamental drivers of reduced intra-asset correlation and elevated volatility.

The Alpha Winter: Understanding the Ice Age for hedge funds

From 2011 to 2019, hedge funds experienced an Alpha Winter — a prolonged period of depressed alpha due to uniquely inhospitable market conditions.

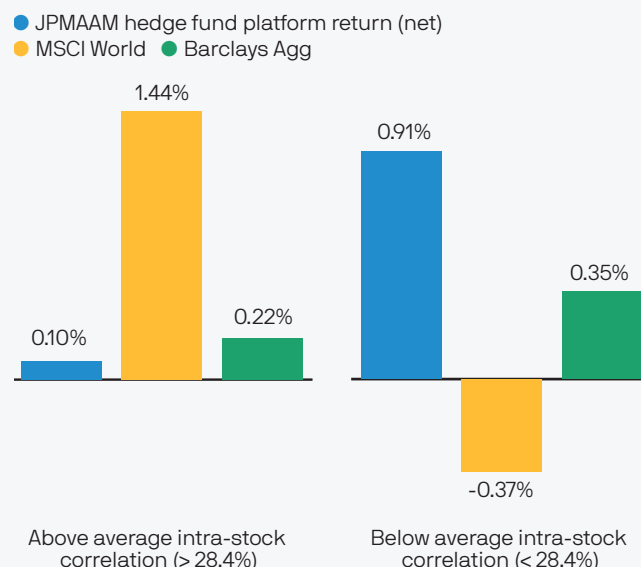
The Alpha Winter resulted from unprecedented global policy responses to the 2008 financial crisis. Quantitative easing (QE) drove risk-free rates to near zero, freezing a key source of hedge fund returns.

Simultaneously, QE compressed volatility across asset classes and elevated correlations, reducing market inefficiencies and limiting opportunities for alpha generation.

Globalization enabled these conditions to persist by shifting production to lower-cost countries, counteracting the inflationary effects of QE. This supported the “Fed Put” — the market’s confidence that the Federal Reserve could supply massive liquidity without triggering inflation. While such monetary policies

Exhibit 4: Hedge fund performance in favorable vs. unfavorable intra-stock correlation environments

Average monthly return



Past performance is not indicative of current or future results. Source: J.P. Morgan Alternatives Solutions, J.P. Morgan Asset Management. Performance estimated since January 2000 as of June 2025. Returns are net of underlying manager fees and JPMAAM fees. Barclays Agg represents Barclays Capital Global Aggregate Bond Index and MSCI World represents MSCI The World Index – Net LCL Currency.

were essential in stabilizing the economy after the GFC, their unprecedented scale and duration created an environment that is unlikely to be repeated.

The persistence of these policies — quantitative easing suppressing real rates, the Fed Put compressing volatility and ample liquidity elevating intra-stock correlations — impacted all three key drivers of hedge fund returns over this period, as seen in **Exhibit 5**. The severity and duration of these conditions across all three factors suggests this period was more than just an Alpha Winter. It was an Alpha Ice Age: a rare phenomenon caused by extraordinary external forces that fundamentally altered the investment landscape.

By 2020, the ice sheets began to crack. The COVID-19 pandemic introduced genuine economic uncertainty that created an environment where highly predictable monetary policy became impossible to maintain. Interest rates eventually rose from their artificial floor, volatility returned to more natural levels and correlations began to subside as markets differentiated between winners and losers in the post-pandemic economy.

Historical analysis confirms that the 2011-2019 period represented an anomaly. As seen in **Exhibit 6**, 52% of months from 2000 to 2010 and 64% of months since 2020 have experienced favorable conditions across two or more factors, versus a mere 19% experienced during the Alpha Winter. Never before had all three alpha drivers

simultaneously reached such extreme levels for such an extended period, and the specific combination of post-crisis emergency monetary policy, globalization-driven disinflation and coordinated central bank intervention that enabled such extreme conditions is unlikely to reoccur.

Importantly, hedge funds do not require all three drivers to be simultaneously favorable in order to generate alpha. As long as two of the three factors are positive the majority of the time, hedge funds typically deliver strong performance.

The seasons ahead: The new normal is a return to the old normal

Looking ahead, multiple indicators suggest a sustained period of favorable alpha generation, with all three key drivers expected to remain supportive.

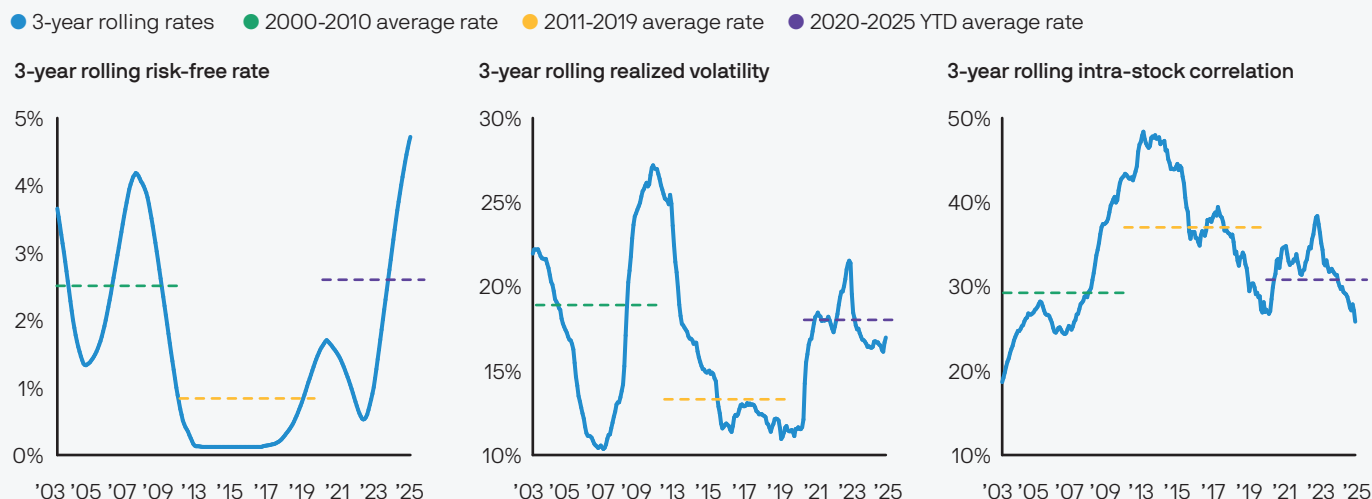
Rates will remain above alpha-generating threshold

In the United States, three factors support sustained rates at or above 2%:

1. **Fed long-run projections have increased** from 2.50% to 3.25% during this cycle.

Exhibit 5: Historical trends in key alpha generation metrics

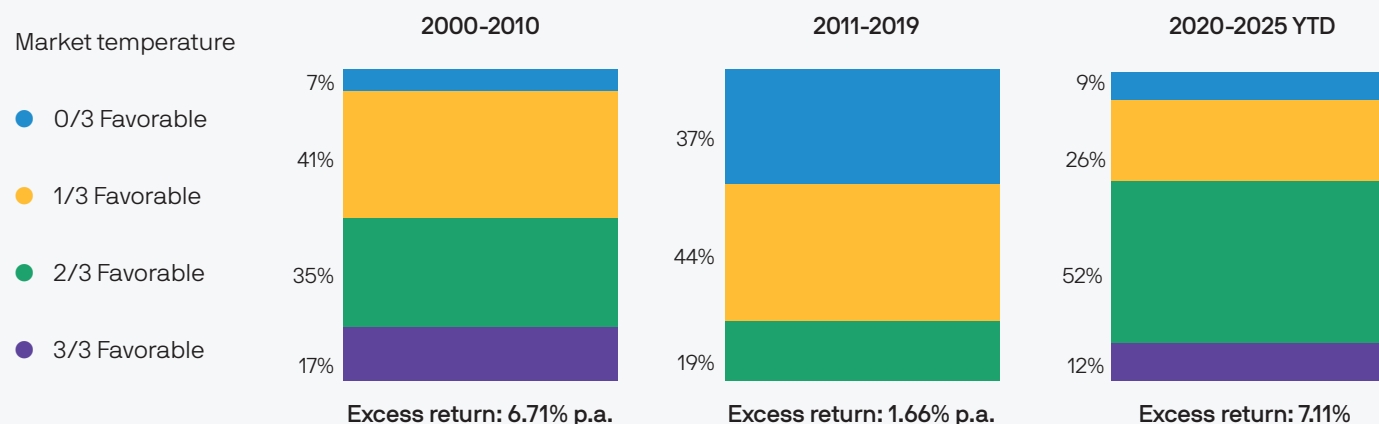
3-year rolling returns vs. average over market regime, 2000–present



Source: Bloomberg, J.P. Morgan Alternatives Solutions, J.P. Morgan Asset Management; as of June 2025. Volatility: realized 30-day SPX volatility, intra-stock correlation: one-month intra-stock SPX correlation and risk-free rate: three-month T-bills.

Exhibit 6: Alpha climate conditions

Historic frequency of market favorability, 2000-present



Past performance is not indicative of current or future results. Source: Bloomberg, J.P. Morgan Alternatives Solutions, J.P. Morgan Asset Management; as of June 2025. Hedge fund excess return represents the JPMAAM hedge fund platform annualized net returns calculated using monthly data minus the contribution from equity beta to MSCI for that month, measured on a rolling 24-month basis. JPMAAM hedge fund platform is an asset-weighted composite of all the funds invested in over the period excluding liquid alternatives. The 2025 return is a cumulative figure representing the six months from January through June 2025 of the JPMAAM hedge fund platform. Performance is net of JPM fees and net of manager fees. Favorable metrics used: one-month lagged realized volatility is above the median, intra-stock correlation is below the median and risk-free rate is > 2%, while unfavorable are the opposite.

2. **Inflation expectations have normalized**, with the five-year breakeven rate averaging 2.25% since 2020 — well above the average during the 2011-2019 period (1.74%) and the long-term historical average (1.94%³).
3. **Treasury market dynamics**, including budget deficits exceeding 6% of GDP and a shift from price-insensitive to price-sensitive buyers, are expected to constrain rate declines and keep long rates anchored at pre-GFC levels.

More broadly, the pattern of artificially suppressed interest rates during the 2011-2019 period and subsequent return to pre-GFC levels since 2020 holds true across all developed countries, not just the United States.

Volatility normalization will persist due to structural changes

The 2010-2019 period represents a clear statistical anomaly in market volatility patterns, with 30-day rolling realized volatility spending an unprecedented 71% of days below the historical median of 14.57% — nearly double the 37% of days spent below this threshold from 1997 to 2010.

Consider 2017: An extraordinary 83% of days experienced realized volatility of 8% or less, compared to just under 5% of days pre-2000 and 4% since 2020. Post-2020 volatility reflects underlying economic reality rather than artificial suppression, with 30-day rolling volatility now above the historical median for more than half of the days. Average volatility has risen to 18.29% — levels that closely mirror the pre-2010 environment.

This normalization is particularly evident in the volatility distribution: the 2010-2019 period was heavily skewed toward low volatility, while today's distribution is more balanced and indicative of normal market functioning.

We believe this normalization will persist due to structural factors: reduced central bank QE capacity after balance sheet expansion, deglobalization creating supply chain volatility and high debt levels constraining coordinated fiscal responses. Treasury market liquidity deterioration⁴ is expected to further amplify price fluctuations and reduce market stability.

³ Represents period from 2003, when the five-year breakeven data was first made available, through August 2025. The five-year breakeven rate is a measure derived from the difference between the yields of nominal Treasury bonds and TIPS of the same maturity. The rate reflects the average annual inflation that investors anticipate over the next five years.

⁴ As measured by average yield error, defined as an aggregate measure for dislocations in Treasury securities across the curve.

Volatility statistics included above reflect the daily 30-day rolling realized SPX volatility. Source: Bloomberg, JPMAAM as of August 11, 2025. Historical median represents average over the time period beginning January 2nd, 1997.

Intra-stock correlation will continue enabling alpha opportunities

Before COVID-19, zero interest rate policies and QE suppressed return dispersion and increased overall equity beta performance. Easy monetary policy allowed poorly managed companies and underperforming assets to refinance cheaply, eliminating natural market forces that separate winners from losers. Recent intra-stock correlation levels (2020-present: 30%) reflect a return to “normal” correlations experienced prior to 2011 (2000-2010: 29%), moving away from the previous “rising tide lifts all boats” environment. As market conditions remain uncertain and economic policies vary across regions, correlations should remain low going forward. Emerging risk factors like trade tensions, coupled with unprecedented debt levels across developed economies, are likely to sustain market instability and keep intra-stock correlations at favorable levels for alpha generation.

Portfolio implications for investors

The end of the Alpha Winter and the return to normalized market conditions present a compelling opportunity for investors to capture meaningful alpha, yet many remain significantly underallocated to hedge funds — often relying on outdated performance data from an anomalous period and overestimating the diversification benefits of bonds as stock-bond correlations normalize. Hedge funds, particularly relative value and macro strategies, are well positioned to deliver uncorrelated returns and superior volatility reduction compared to the traditional 60/40 framework, especially in the face of emerging risks such as AI disruption and tariff uncertainty. However, with the industry now highly

competitive and performance dispersion between managers more pronounced than ever, careful due diligence is essential. Investors must understand not only which hedge fund managers to select, but also what each strategy is designed to achieve within the broader portfolio, ensuring alignment with long-term objectives and resilience in a changing market environment. JPMAAM’s deep industry relationships and decades of experience enable us to identify, access and partner with exceptional managers (many of who have capacity limits), helping clients build resilient, well-diversified portfolios that are positioned to potentially maximize alpha in a changing market.

Ready to dive deeper?

Check out additional research published by our team on these topics.

[“Building a Hedge Fund Allocation: Integrating Top-down and Bottom-up Perspectives”](#)

Published in partnership with GIC, this piece presents a hedge fund allocation framework that depends not on traditional strategy classifications but on identifying managers whose specific characteristics align with their intended portfolio role.

[“30 Pearls of Wisdom”](#)

Drawing on lessons learned navigating multiple market regimes over the last three decades, this piece distills critical lessons on due diligence techniques, risk assessment and strategic evolution that have shaped our success and remain central to our investment philosophy.

In conclusion

The combination of normalized rates, appropriate volatility levels and low correlations has historically coincided with hedge funds’ strongest performance periods. While past performance cannot guarantee future results, the structural nature of these changes suggests institutional investors may be entering the most favorable hedge fund environment since the early 2000s. As we enter a new season —both literally and figuratively —it’s important to recognize that whilst the calendar may be turning toward winter, the Alpha Winter for hedge funds appears to be behind us.

Now may be the time for investors to reassess asset allocations and consider hedge funds, which have proven their ability to navigate complexity and potentially deliver superior risk-adjusted returns. The investment landscape of the next decade will look markedly different from the post-GFC to 2020 period, with rates and inflation expected to find more balanced footing amid normalized economic growth. As a result, the definition of portfolio resilience must evolve, and hedge funds are well-positioned to play a central role in this new era.

Disclaimers

Hedge Fund Excess Return represents the JPMAAM hedge fund platform annualized net returns calculated using monthly data minus the contribution from equity beta to MSCI for that month, measured on a rolling 24-month basis. JPMAAM hedge fund platform is an asset-weighted composite of all the funds invested in over the period excluding liquid alternatives. 2025 return is a cumulative figure representing the six months from January to June 2025 of the JPMAAM hedge fund platform. Performance is net of JPMAAM fees and net of manager fees.

Three key favorable metrics used: realized one-month lagging volatility is $\geq 13.42\%$ (above the median), intra-stock correlation is $< 28.41\%$ (below the median), and risk-free rate $> 2\%$, while unfavorable are the opposite. Source: Bloomberg, JPMAAM; as of June 2025.

One-month realized correlation is calculated using the Bloomberg SPX 1M RC BVOL Index, using data since its inception in January 2011. Before this, it was manually calculated using the 30-day rolling average of daily return correlations for all stock pairs in the S&P 500.

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