CHART OF THE MONTH

WHEN ALPHA MEETS A CROWDED MARKET



Source : GS HF PB Desk.

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Long/Short Equity: Alpha Survives the Squeeze

The chart highlights a key feature of fundamental equity long/short investing: while short-term results can be affected by positioning and factor rotations, long-term alpha is ultimately driven by stock selection.

Since 2022, long/short managers have generated approximately 25-30% cumulative alpha on their long books despite several periods of market stress. Over the same period, the MSCI World Index gained more than 60%, demonstrating that strong stock-picking can continue to create value even in rising markets.

Short positions are not intended to be a persistent source of returns but rather a risk management tool that helps reduce volatility and preserve capital during market dislocations.

What Changed Since the Summer?

Over the past two years, investors heavily favored themes linked to artificial intelligence, semiconductors and infrastructure spending, creating increasingly crowded positioning across the market.

As concerns emerged over the sustainability of AI-related spending, these crowded trades unwound sharply. What began as a sector correction quickly evolved into a broader factor reversal affecting growth, momentum and many businesses viewed as indirect beneficiaries of the AI investment cycle.

As a result, even well-diversified portfolios suffered as a wide range of holdings became exposed to the same underlying market theme.

October 2026: The Correlation Trap

October proved particularly challenging for hedge funds. The unwind of crowded AI and semiconductor exposures, combined with widespread de-risking, drove correlations sharply higher and reduced the benefits of diversification.

Technology stocks weakened, market leadership reversed and many defensive positions failed to provide protection. Importantly, most managers entered the period with moderate market exposure. The weakness was therefore driven less by excessive beta and more by an abrupt factor rotation and highly correlated market moves.

Why We Remain Constructive

History shows that crowding events and factor reversals can create temporary setbacks, but they rarely undermine the long-term value of disciplined stock selection.

Today, many companies held by leading long/short managers continue to deliver solid fundamentals despite significant share-price corrections. Valuations have become more attractive, while long-term earnings prospects remain largely intact.

The recent drawdown serves as a reminder that alpha generation is rarely linear. While positioning can temporarily overwhelm fundamentals, long/short equity remains one of the most effective strategies for capturing stock-specific alpha over a full market cycle.

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