

Absolute Insight:

The Restoration of Alpha: An Environment That Rewards Selectivity and Favours Absolute Return Strategies

Lloyd Blankfein recently observed that the US economy feels "late cycle." It is an assessment that resonates, and should be noted by investors everywhere. Historically, late-cycle regimes are notoriously less forgiving; financial conditions tighten, refinancing risks rise, and the earnings leadership that sustained the previous bull run begins to rotate. At this stage of the cycle, complacency is rarely rewarded.

For much of the past decade, investing felt deceptively straightforward (if not somewhat frustrating for believers in active management). Passive exposure delivered strong returns, US equities dominated global indices, and a narrow group of mega-cap technology stocks drove both the performance and the narrative. Market weakness was brief, liquidity was abundant, and central banks were predictable. In that environment, the "buy the dip" mentality became cultish in its intensity, a collective suspension of disbelief that rewarded blind momentum and punished anyone still concerned with valuations.

It has, in many respects, been too easy.

Easy come, not so easy go, perhaps

But late cycles change the rules. Growth is moderating, inflation remains uneven, and fiscal deficits are elevated. We are witnessing monetary policy move in divergence rather than lockstep, as the Fed, the ECB, and the Bank of England navigate differing domestic pressures. What we are experiencing is not simply a bout of volatility; it is a meaningful, structural shift in regime.

This shift, however, should not be feared, but it must be respected and embraced. Periods of greater differentiation and more normalised volatility are uncomfortable for those used to the sedative of the post-GFC era, yet they are also constructive. Opportunity is no longer concentrated in a single theme. Relative value is returning, and company-specific fundamentals matter again.

This is the environment in which alpha can be found in plentiful supply, and therefore the perfect environment for absolute return strategies to thrive.

The Temptation of the Old Playbook

Faced with uncertainty, the instinct is often to revert to familiar tools: reduce equity exposure and extend duration as a "flight to safety." That approach worked when falling inflation and aggressive rate cuts made duration a powerful hedge. However, the current backdrop is fundamentally messier.

Duration is no longer a guaranteed one-way hedge and carries significant risk if the "higher for longer" structural pressures persist. Similarly, corporate credit can feel defensive, yet tight spreads offer a limited margin for error. When growth slows and refinancing pressures rise, the income yield can quickly be offset by widening spreads. The tools remain familiar, but the environment has changed; investors are effectively using a map of the 2010s to navigate the terrain of the 2020s.

Illiquidity is Not a Synonym for Safety

Investors have recently sought diversification through increased allocations to private credit, infrastructure, and private equity. However, many have been seduced by the smoothing effect of private markets, and here there is potential for some disappointment.

While the surface remains calm, the first cracks are appearing in private markets via suspended redemptions and rising default warnings. This is potentially a problem for tomorrow, not for today, but investors should be very wary of illiquidity right now.

Illiquidity does not remove risk, it merely delays its recognition. This "mark-to-model" mirage, and sometimes, let's be honest, it is even marked-to-myth, suggests that if we don't observe a price movement, the value hasn't changed.

We saw this before the 2008 crisis. Many structured instruments were considered stable until funding conditions tightened. In a late-cycle environment that tests balance sheets and exposes leverage, flexibility, the ability to rebalance, hedge, and adjust in real time, is an undervalued asset. Illiquidity removes that option exactly when it is needed most.

Finally, the Good News: The Triple Catalyst for Alpha Generation

To understand why alpha managers are witnessing their most compelling opportunity set in over a decade, we must look at the structural decay of the post-GFC "goldilocks" environment. Research from J.P. Morgan Asset Management highlights three distinct structural pillars that have moved in favour of alpha generation which underpins absolute return strategies.

1. The Return of the Hurdle Rate Between 2011–2019, the 3-year rolling risk-free rate averaged roughly 0.6%. Today, that rate has surged toward 5%, with the 2020–2025 average resetting to 2.5%.

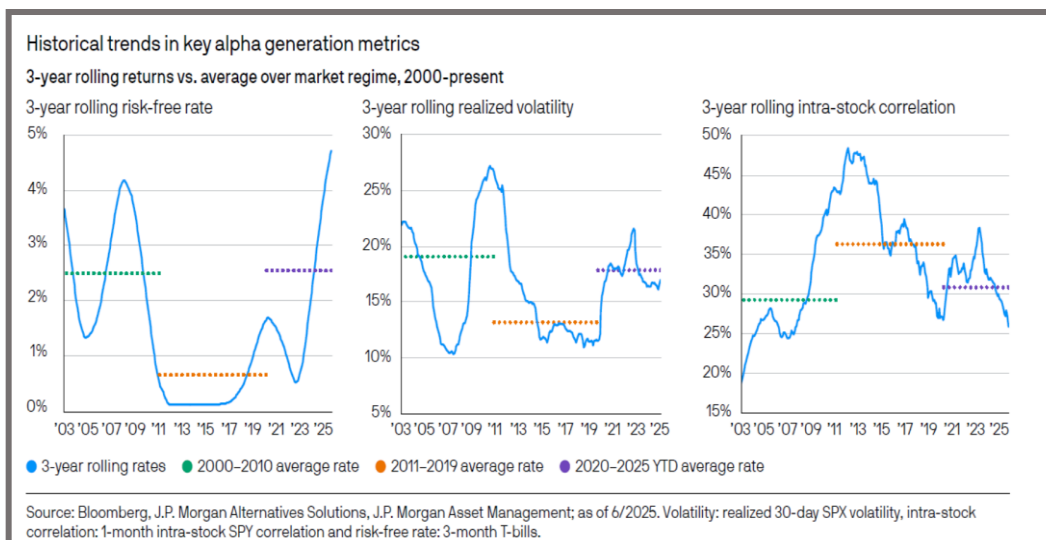
Impact: Cash finally offers a decent hurdle rate which, when combined with alpha generation, creates a compounding effect that allows investors to finally capture a meaningful absolute return

2. The Normalisation of Realised Volatility Post-GFC, volatility was artificially dampened, averaging just 13.2%. We have since seen a breakout, with the 2020–2025 average rising to 17.8%.

Impact: A higher level of realised volatility is not a "crisis"; it is a market functioning without the stabilisers of a toddler's bike. It creates the price movement necessary for active managers to enter and exit positions at attractive valuations.

3. The Breakdown of Correlation The 3-year rolling intra-stock correlation has dropped from a previous decade peak of 36.3% to a current average of 30.8%.

Impact: In the passive boom, a rising tide lifted all boats. Today, stocks are behaving independently. This widening dispersion allows managers to harvest idiosyncratic risk by going long on quality and short on laggards.



Redefining Opportunity: Harvesting Idiosyncratic Risk

The era of the narrow market, where five stocks effectively were the world's stock market, has reached its logical conclusion. In its place, we are witnessing a regime break: the birth of a more typical, disperse, and uncorrelated financial landscape.

While traditional portfolios suffer from systematic beta that drags all boats down, absolute return strategies thrive on idiosyncratic risk, the risk specific to an individual asset, uncoupled from macro noise. By going both long and short, managers can harvest these specific opportunities regardless of the direction of the S&P 500 or the FTSE 100.

As correlations break down, diversification returns. We are seeing policy divergence between nations and performance divergence between companies. In this environment, the ability to bet on a winner while simultaneously hedging against a loser is the only way to generate true, uncorrelated returns.

Uncertainty does not eliminate opportunity. In the absolute return asset class, it enhances the toolkit.

Why Liquid Alternatives Matter Now

Liquid alternatives struggled during the liquidity-suppressed decade where scale mattered more than selectivity. But as macro conditions become less predictable, simply owning the index is no longer enough. Policy divergence and refinancing pressures introduce a level of complexity that passive vehicles cannot adapt to.

Active managers are starting to see outperformance, and within that cohort, absolute return managers are thriving. These strategies are designed for markets where differentiation and dynamic risk management are the primary drivers of return. They do not rely on falling rates or expanding multiples; they are built to operate within volatility, not wait for it to subside.

Conclusion: Making Uncertainty Work

The dominance of the passive era may not end with a bang, but with a fade as the conditions that sustained it evaporate. Zero rates, suppressed volatility, and elevated correlation formed a powerful tailwind that has now turned into a headwind. Incorporating liquid alternatives is not a rejection of passive investing. It is a recognition that as regimes evolve, diversification must evolve with them.

Macro complexity reinforces this shift. Monetary policy is no longer synchronised; fiscal dynamics differ materially between economies. These forces introduce dispersion not just within equities, but across currencies, yield curves, and credit markets. Strategies capable of navigating across asset classes and exploiting relative moves are inherently better suited to this environment than static allocations designed for uniform policy.

For asset allocators willing to look beyond what has worked for the last fifteen years, this is a meaningful moment. We are moving into a more disciplined, more differentiated environment where volatility creates entry points and mispricing becomes more visible. This is precisely the backdrop in which alpha and the targeting of idiosyncratic risk can flourish.

The real question is no longer whether uncertainty exists. It is whether your portfolio is built to make use of it.

APOLLO MULTI ASSET MANAGEMENT

Absolute Vision: A Smarter, More Resilient Way to Invest

At Apollo Multi Asset Management, we believe in Absolute Vision—the ability to see beyond short-term market noise and invest with clarity, conviction, and discipline. The financial world is evolving, and traditional investment models are no longer fit for purpose. The once-reliable 60/40 portfolio—built on the assumption that bonds will always hedge equity risks—has failed to deliver real returns in an era of inflation, rising interest rates, and geopolitical uncertainty.

Apollo stands apart as a firm built for the future. We are not bound by benchmarks or outdated conventions. Instead, we take a forward-thinking, multi-asset approach alongside absolute return investing—targeting consistent, risk-adjusted performance throughout the full market cycle.

Founded during the 2008 financial crisis, Apollo has consistently demonstrated the ability to thrive in uncertainty—because we see what others don't.

For professional advisers only

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If you require investment advice you should contact an authorised financial adviser.

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