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Restoring Diversification

Functional Allocation

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About the authors.

Pieter-Jan Inghelbrecht

Quantitative Research Analyst

Pieter-Jan is a Quantitative Research Analyst at Candriam, where he works in Alternative Investment Strategies.
He is currently develops long/ short equity strategies.

Since joining in 2020, he has contributed to several teams within Candriam, including CTA and absolute return strategies, with experience in equity market neutral models and cross-asset research.

He holds degrees in Computer Science Engineering (KU Leuven), Statistical Data Analysis and Business Administration (Ghent University), and completed the Executive Programme in Asset Management at Vlerick Business School.

Johann Mauchand

Senior Systematic Fund Manager

Johann Mauchand has been a Systematic Portfolio Manager at Candriam since 2013, leading research within the Systematic Multi-Asset business unit.
He joined Candriam in 2005 as a quantitative alternative management analyst.

Previously, he was statistical arbitrage analyst at HSBC

He holds a Master's degree in Artificial Intelligence and Data Science from Paris Dauphine-PSL University, a Master's degree in financial engineering from the University of Evry Paris Saclay, and a research-oriented Master's degree in mathematics from the University of Dijon in France.

Steeve Brument

Global Head of Alternative Investments, Member of the Executive Committee

Steeve Brument has been Global Head of Alternative Investments since 2023, and Head of Quantitative Multi-Asset Strategies since 2019. Joining Candriam as a Systematic Fund Manager in 2001, he conducted extensive research on trading systems and systematic portfolio allocation. In 2007, he became Head of Systematic Funds, diversifying its CTA from traditional trend-following models to a blend of trend-following, pattern-recognition and counter-trend methodologies.

He began his career in 1997 within the private client group of Merrill Lynch, moving to Refco Securities as a Futures and Equity Derivatives Broker before joining Candriam.

Steeve holds a Masters degree in Finance from the PSB Paris School of Business.

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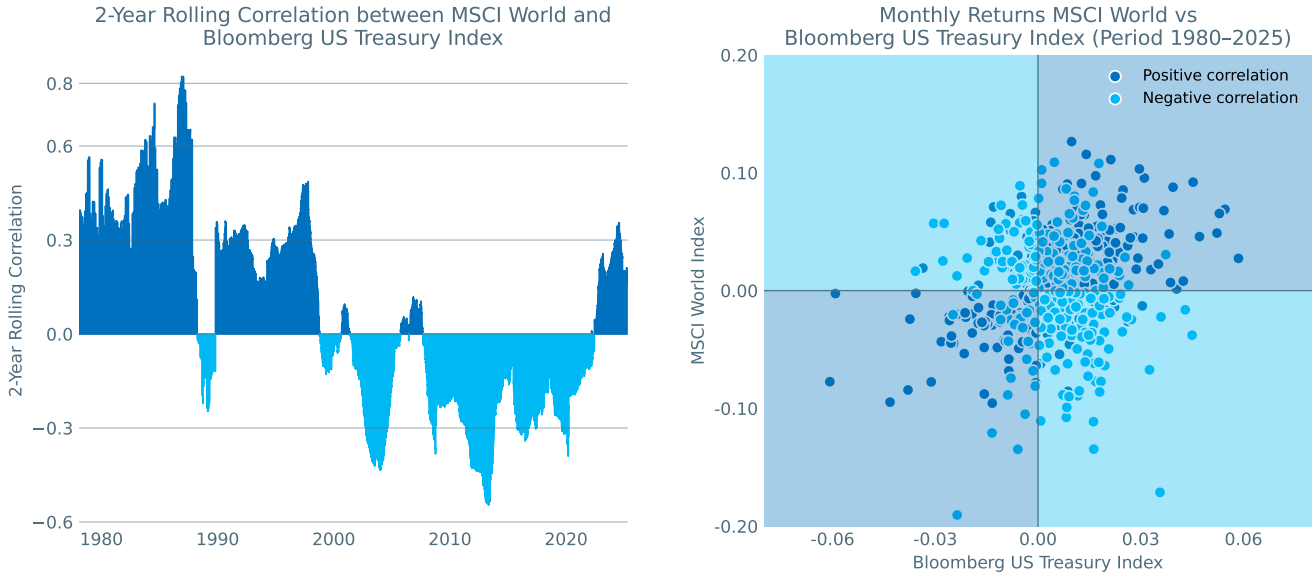
Executive Summary: Restoring Diversification.

In recent years, traditional portfolio constructions -- most notably the classic 60/40 equity/bond allocation -- have served investors well. They are simple, have been effective over the long term, and have historically offered diversification.

The macroeconomic environment presents notable challenges -- persistently volatile inflation expectations, structurally higher interest rates, and elevated geopolitical tensions -- highlighted by ongoing trade conflicts and rising protectionist policies. **The increased correlation between equities and bonds fundamentally alters the effectiveness of traditional portfolio construction.**

Investors who relied on bonds for downside protection have seen this assumption fail, as demonstrated by simultaneous losses in both traditional asset classes, equity and bonds, in 2022. Increasing correlations (Figure 1) suggest that relying solely on traditional allocation models may leave portfolios more vulnerable to risks that these approaches were once able to mitigate.

Figure 1: Equity/Bond Correlation and Its Impact on Return Regime.
1980 to 1Q 2025



Source: Candriam, Bloomberg

Equity returns were strong in 2023 and 2024 as inflation eased, but forward-looking expectations are muted. Elevated interest rates continue to affect equity valuations and the future returns for bonds, reinforcing the need for complementary sources of return. This breakdown in diversification is clearly visible in Figure 1, which shows that since 2022, correlations between equities and bonds have turned positive, undermining one of the core principles of the 60/40 portfolio. Historically, negative correlation between equities and bonds allowed fixed income to act as a natural hedge during equity downturns. However, with rising interest rates and inflationary pressures, bonds have failed to provide this protection.

Despite the commendable long-term return that 60/40 has delivered over the past 25 years (Figure 2), its risk profile suggests cause for concern. Historically, a notionally allocated 60/40 portfolio has exhibited a correlation close to 1 with equities.[1] In other words, ***the classic equity/bond allocation has largely behaved as an equity proxy,*** meaning that during severe downturns, it offers little genuine diversification. This became evident during the Global Financial Crisis in 2008 and again during Covid-19 in 2020, when equities declined sharply, and the 60/40 allocation failed to provide meaningful downside protection.

While some investors with high risk tolerance may accept these large drawdowns in exchange for long-term returns, we believe most would prefer to avoid losses exceeding 30%. This underscores the need to enhance diversification beyond the traditional bonds and equities asset class allocation.

This paper includes scenarios which reflect the hypothetical historical performance of combinations of indices, not all of which can be replicated. This example is hypothetical and is for illustrative and educational purposes only; it does not reflect actual investment results.

1 - This applies not just during the 25 years on which our 40/30/30 analysis is based, but also during the full period from 1980 to 2025 show in Figure 1.

Increasing Portfolio Resilience: the 40/30/30 Approach

As the limitations of the traditional 60/40 portfolio become increasingly apparent, investors have turned to alternative strategies to restore diversification and improve risk-adjusted returns. Our 2024 white paper, *Alternative Strategies: Is 40/30/30 the new 60/40?*, demonstrated that incorporating a diversified allocation to alternatives[2] meaningfully strengthens portfolio resilience.

To illustrate this, we replace 30% of a traditional 60/40 portfolio with a simplistic exposure to alternatives, represented by the Credit Suisse Hedge Fund Index (HEDGNAV Index), a widely- used benchmark of hedge fund strategies. While not directly investable, the index serves as a proxy to evaluate the potential role of alternatives in a diversified portfolio.

As shown in Figure 2, the resulting 40/30/30 portfolio delivers higher returns, reduced volatility, and improved drawdown protection compared to the traditional 60/40 mix. Figure 2B quantifies these improvements across key metrics, including a 40% improvement in the Sharpe ratio. This suggests that even **a static index-based allocation to alternatives can enhance long-term portfolio stability.**

2 - For alternatives, we use hedge funds as our asset class index. For this paper, we do not include real assets such as real estate, or very long-term alternatives such as private equity, in our study.

Figure 2A: Added Value of a 30% Allocation to Alternatives.

MSCI World Equities, Bloomberg US Treasury Index, Credit Suisse Hedge Fund Index, 1999 to 1Q 2025

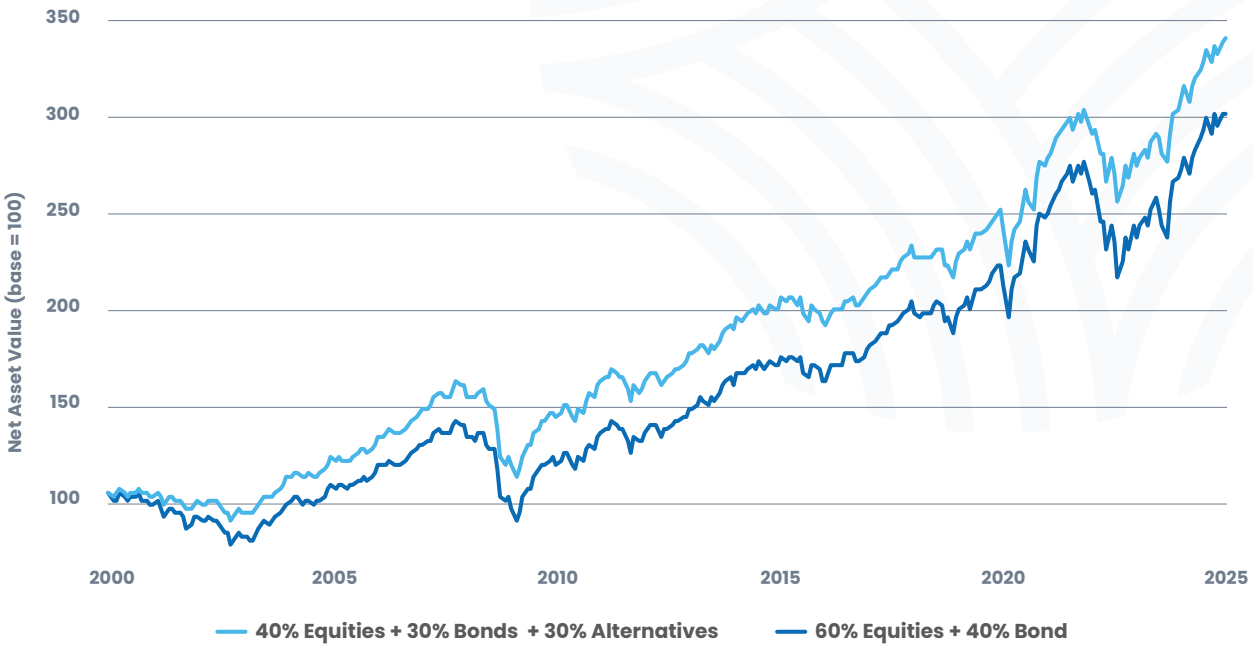


Figure 2B: Performance Statistics of adding 30% Alternatives to the 60/40 Portfolio.

Period 1999 to 1Q 2025

	60% Equities + 40% Bonds	40% Equities + 30% Bonds + 30% Alternatives
% Return (Annualised)	4.5	5.0
% Volatility (Annualized)	9.7	7.8
Sharpe Ratio	0.46	0.64
Max. drawdown (%)	36.1	30.2

Past performance is not a guarantee of future performance. Markets could develop very differently in the future.

Source: Candriam, Bloomberg.

Charting a New Direction

However, using a broad index as a proxy also underscores a key challenge: the hedge fund/ alternatives universe is diverse, and performance across strategies can vary widely. Depending on their exposures, structure, and sensitivity to market conditions, which alternative strategies should be included in a portfolio?

To address this, we propose a functional allocation framework for the alternatives asset class. **Rather than viewing alternatives as a single block, we classify alternative strategies by their functional role — whether they provide downside protection, deliver uncorrelated returns, or capture upside potential.** This role-based framework supports better diversification by aligning strategy selection with specific investment objectives.

Our structured definitions also enable greater capital efficiency. By recognizing that many alternatives are implemented via cash-efficient instruments, this approach allows for dynamic rebalancing as macro conditions change. To determine how this framework can improve control over risk exposures while enhancing responsiveness and transparency in portfolio construction, we examine:

- **Dispersion in behaviour** across commonly-grouped hedge fund strategies
- **A practical classification** into three intuitive buckets: *long/short directional, market neutral, and upside alpha* -- based on empirical return patterns
- **A dynamic,** centralized allocation process
- **Performance potential**

Asset Allocation Implications

We believe that a more thoughtful, but still relatively simple, allocation approach can improve outcomes across the three critical metrics – returns, risk, and maximum drawdown.

Previously, we demonstrated the advantages of a 40/30/30 portfolio of equities, bonds, and alternatives over the traditional 60/40 portfolio. We make two further modifications, also straightforward. We include those alternatives which perform one of the three functional roles in our classification. Our second is to re-balance dynamically as macroeconomic and market conditions favour one of the functional types.

Each of these two steps makes a meaningful difference to return, risk, and drawdown over a long-term (25 year) backtest.

Alternative Strategies: Classify to Demystify.

The alternatives asset class encompasses a wide range of strategies designed to deliver returns independent of traditional equity and bond markets. The complexity of this universe often makes it difficult for investors to determine how to allocate effectively among these.

Although alternative strategies are frequently labelled or described as 'market neutral' or 'uncorrelated', their realized behaviour can differ meaningfully from these descriptions, especially during periods of market stress. It is therefore not enough to simply diversify across categories. Investors must also evaluate how each strategy behaves in practice and understand its functional role within a broader portfolio.

Industry classifications such as those provided by the HFR indices[3] offer a useful starting point, grouping strategies into broad categories such as *macro, relative value, event-driven*, and *equity hedge*. But while these labels help organize the hedge fund landscape, they can also obscure key differences in return dynamics. Relying solely on these groupings risks misaligning portfolio construction with the actual behaviour of strategies.

To illustrate, we compare the monthly return patterns of the MSCI World Equity Index with two strategies from different HFRI categories: *systematic diversified futures* (within *macro*) and *equity market neutral* (within *equity hedge*). Though both fall under the broad 'alternatives' umbrella, their behaviour diverges in important ways.

Strategy Name, or Strategy Behaviour?

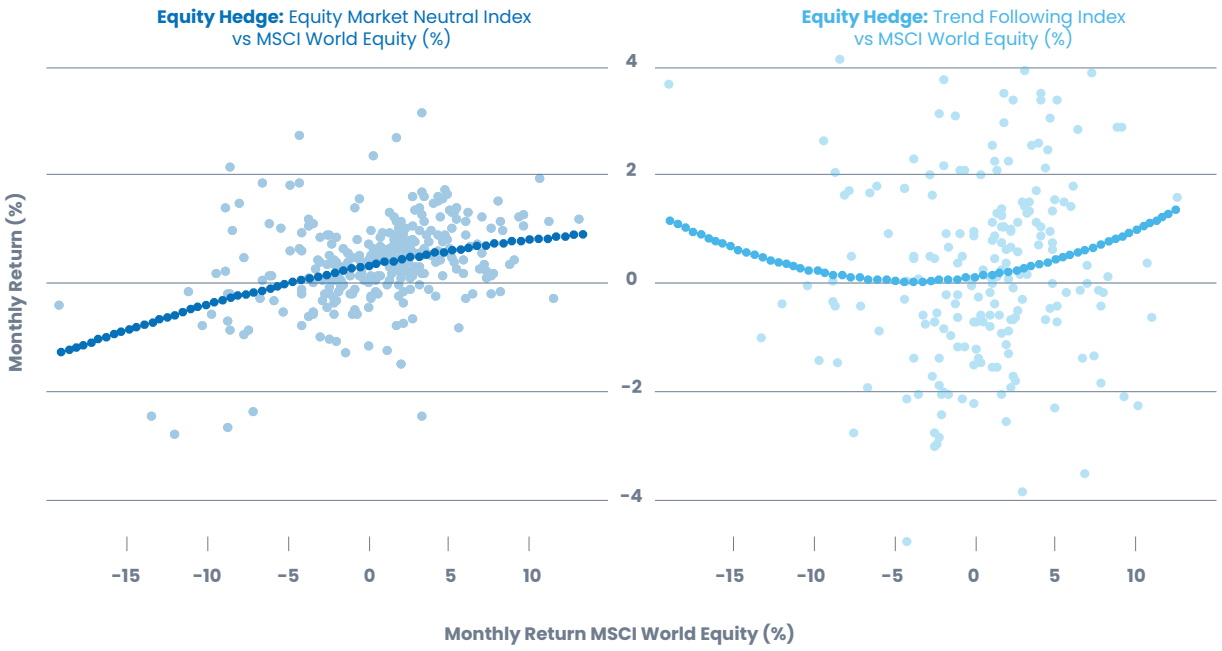
Figure 3 shows the monthly returns of *trend following* and *equity market neutral* strategies versus global equities. The *trend following* series is represented by the HFRI Macro: Systematic Diversified Index (HFRIMTF), while the Equity Market Neutral series corresponds to the HFRI Equity Market Neutral Index (HFRIEMNI). A curved trend line—a second-order polynomial—is added to each chart to help capture the overall shape of the relationship in each case.

Trend following exhibits a convex profile. It tends to hold up in normal conditions and often performs best during sharp market moves—both up and down. This makes it a potential source of crisis protection. Equity Market Neutral, in contrast, shows a mild positive relationship to equities. Despite the "neutral" label, it behaves more like a low-beta equity strategy, with limited downside protection.

3 - Hedge Fund Research, Inc.

This example highlights the broader issue: labels describe how strategies are managed, but behaviour shows how they actually perform. If we rely only on categories, we may misjudge the role a strategy plays in a portfolio.

Figure 3: Dispersion Classification of Trend-Following and Equity Market Neutral Indices
Monthly Returns versus MSCI World (Equity) Index, 2000 to 2024



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Equity market neutral by HFRI Equity Market Neutral Index (HFRIEMNI) ;
Trend-following is represented by HFRI Macro: Systematic Diversified Index (HFRIMTF).

Source: Candriam, HFR, Bloomberg

This is why we advocate a different approach, one which classifies strategies based on their return behaviour, not their standardised category label. We propose a simple framework to help build more resilient portfolios grounded in the risk/return profiles that the strategies actually deliver.

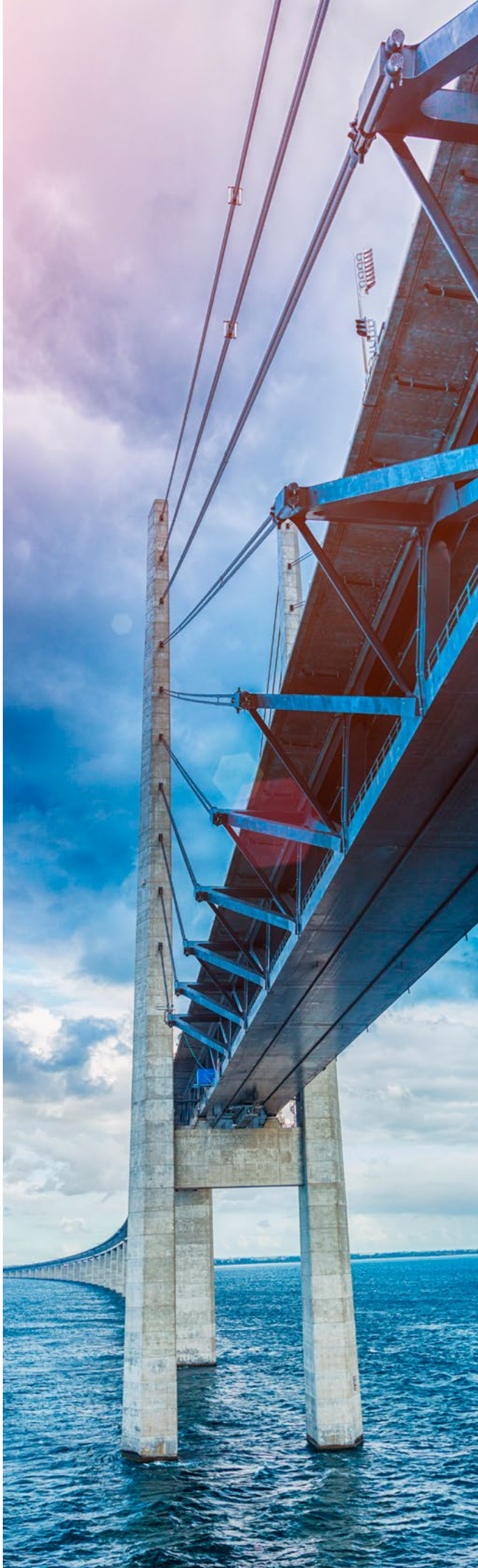
Implications for Portfolio Construction

To aid in constructing a diversified allocation, we propose classifying alternative strategies based on their functional role in the portfolio. That is, what they are designed to deliver and how they behave across different market environments.

We group alternative strategies into three intuitive buckets:

- ***Long/Short Directional*:** Seeks to generate alpha by selectively taking long and short positions, often providing downside protection in stressed markets
- ***Market Neutral*:** Aims to deliver stable, uncorrelated returns with minimal market exposure
- ***Upside Alpha*:** Focused on capturing enhanced risk-adjusted returns in supportive market conditions, often with more directional exposure

This role-based, functional framework offers a more practical and transparent way to allocate across alternatives. It aligns strategy selection with portfolio objectives and allows for better control over exposure. However, the effectiveness of this approach depends on how it is implemented -- particularly in adapting to changing market regimes.



Data and Strategy Classification

The data used in this analysis is sourced from HFRI Indices (Hedge Fund Research, Inc., www.hfr.com). All strategy-level returns are taken at a monthly frequency and cover the period from 1995 to 2025. Portfolio-level results are based on index-level returns unless otherwise specified.

To better capture the true role alternative strategies play in a portfolio, we classify them based on their observed return behaviour rather than on industry category labels. This behaviour-based grouping aims to reflect how strategies actually interact with broader market conditions and how they contribute to diversification.

The classification is structured into three strategic buckets:

- **Long/Short Directional:** Includes HFRIMSR, HFRIMTI, HFRIMTF, and HFRIMCUR . These strategies typically seek to profit from directional market movements and macro trends, and are often associated with downside protection in periods of market stress.
- **Market Neutral:** Comprises HFRIFIMB, HFRIMCOM, and HFRIEMNI. These strategies aim to deliver stable, uncorrelated returns by exploiting relative value opportunities and market inefficiencies.
- **Upside Alpha:** Includes HFRISRE, HFRIMDD, HFRIMMS, HFRIEDI, HFRIEDSS, HFRIEDMS, HFRIELD, HFRIEHI, HFRIENHI, HFRIEHFG, and HFRIEHFV. These strategies are more return-seeking in nature and tend to benefit from supportive market environments by capturing alpha and risk premia.

Each strategy within a bucket is combined using equal weighting. For portfolio construction, each bucket is then scaled to a common volatility target to allow comparability before aggregation.

Long/Short Directional/Macro:	Market Neutral	Upside Alpha	
HFRIMSR HFRI Macro Systematic Directional Index	HFRIFIMB HFRI Relative Value: Fixed Income – Asset Backed Index	HFRISRE HFRI Relative Value: Yield Alternatives Index•	HFRIELD HFRI Equity Hedge: Long/ Short Directional Index
HRFIMTI HFRI Macro: Systematic Diversified Index	HFRIMCOM HFRI Macro: Commodity Index	HFRIMDD HFRI Macro: Discretionary Directional Index	HFRIEHI HFRI Equity Hedge: Total Index
HFRIMTR HFRI Macro: Trend Following Directional Index	HFRIEMNI HFRI Equity Hedge: Equity Market Neutral Index	HFRIMMS HFRI Macro: Multi-Strategy Index	HFRIENHI HFRI Equity Hedge: Quantitative Directional Index
HFRIMCUR HFRI Macro: Currency Index		HFRIEDI HFRI Event-Driven: Total Index	HFRIEHFG HFRI Equity Hedge: Fundamental Growth Index
		HFRIEDS HFRI Event-Driven: Special Situation Index	HFRIEHFV HFRI Equity Hedge: Fundamental Value Index
		HFRIEDMS HFRI Event-Driven: Multi-Strategy Index	

Empirical Evidence: How Alternative Strategies Behave in Practice.

Based on this functional, role-based framework, how do these buckets behave in practice? How can return patterns guide a more dynamic and responsive allocation process?

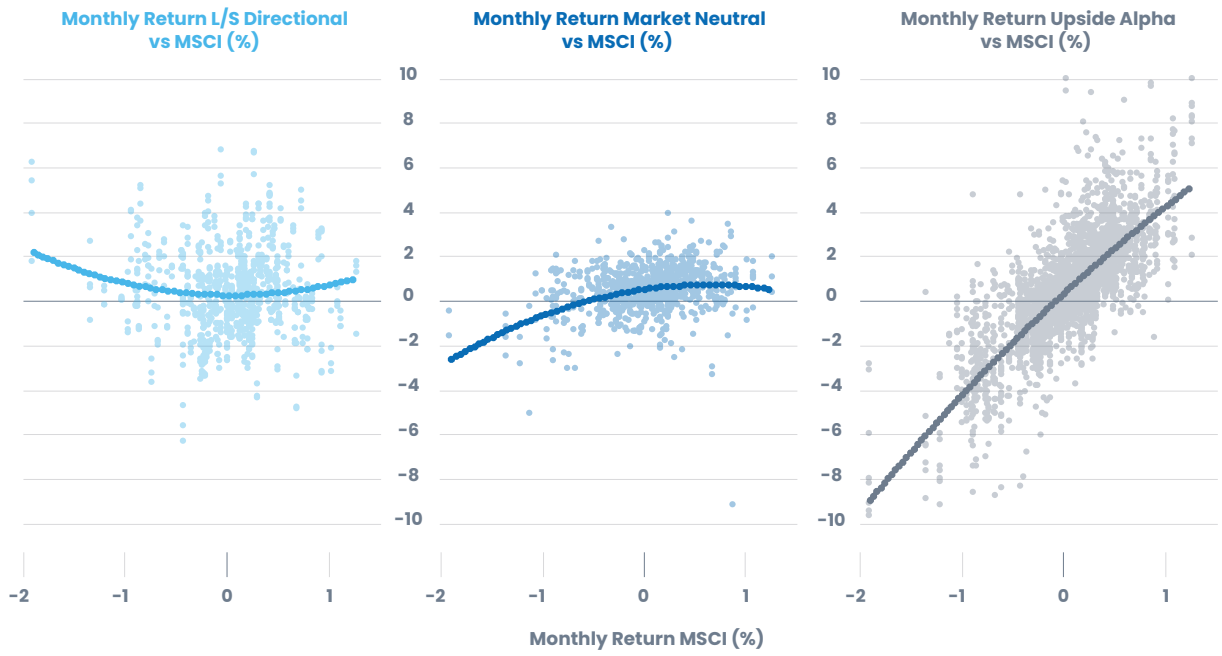
Using index-level proxies for each of the three groups, we show how these strategies have historically performed relative to global equity markets. This empirical view helps validate the functional roles we assign and provides a clearer picture of how each group may contribute to portfolio diversification.

Return Profiles and Interaction with Equity Markets

Figure 4 plots the monthly returns of each individual strategy within the three alternative buckets -- *long/short directional, market neutral, and upside alpha* -- against the broad equity market. Each chart shows all constituent strategies for a given index bucket, illustrating how return patterns vary within and across groups. A second-degree polynomial regression is fitted to describe the overall historical relationship between each bucket and equity market performance. The composition of each bucket is based on a the HFRI indices, as described in the Box.

Figure 4: Functional Alternative Categories versus Global Equities

Monthly returns of individual strategies versus MSCI World Index, 2000 to 2024



Past performance is not a guarantee of future performance. Markets could develop very differently in the future.

Left: Long/short directional; Centre: Market neutral; Right: Upside alpha. Each point represents a single monthly return observation per strategy. Bucket composition based on HFRI indices; see box on page 11 for details.

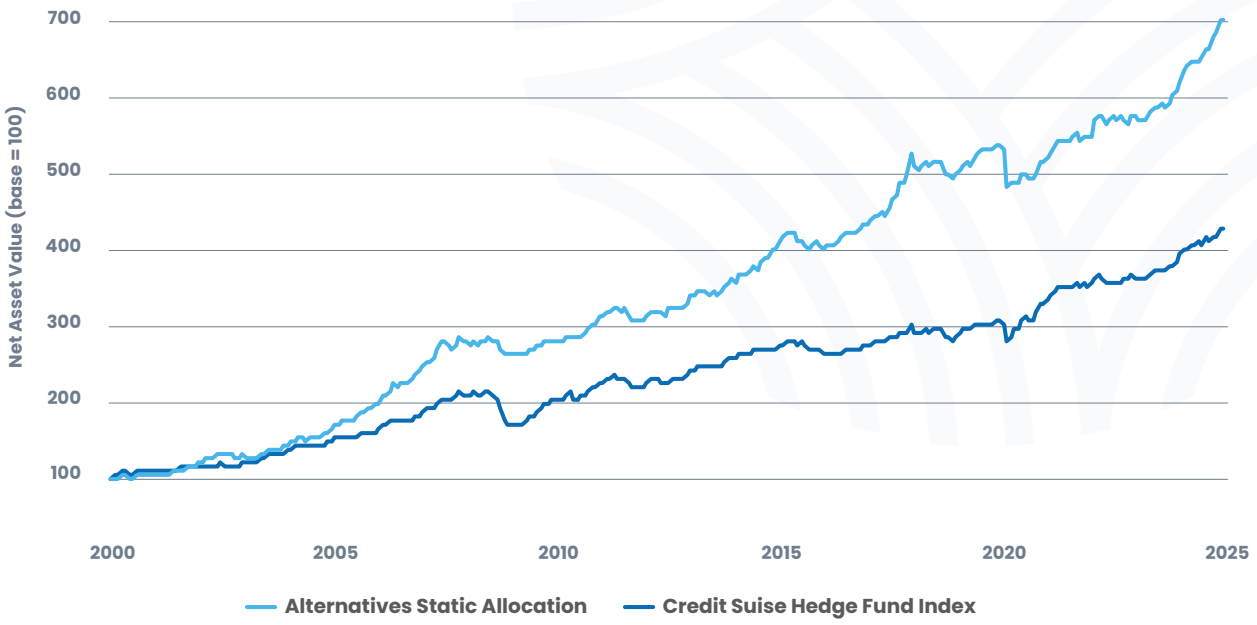
Source: Candriam, HFR, Bloomberg

- ***Long/short directional* shows a convex return profile.** This demonstrates that historically, this strategy has provided a hedge against extreme market conditions.
- ***Market neutral* shows a flat or slightly tilted profile.** Their stable returns across environments and their limited sensitivity to equity market direction demonstrate their history as providers of steady, uncorrelated performance.
- ***Upside alpha* displays a positively sloped profile.** Historically, these strategies participated in market upside while often containing downside risks. This behaviour adds value through risk-adjusted exposures beyond simple equity beta.

The analyses in Figure 4 demonstrate the benefits of a structured, role-based classification of alternative strategies in providing insight to investors into their expected behaviour. Figure 5 shows the extra performance that could have been generated by choosing functional strategies. We compares the performance of an equal-risk-weighted allocation to these three strategic functional buckets, *long/short directional, market neutral,* and *upside alpha*, to a traditional hedge fund index (Credit Suisse Hedge Fund Index). The strategy-level returns are combined using a 1/n allocation, and then scaled to a common target volatility to show comparability across buckets. We then assign one-third of the portfolio to each bucket, creating a balanced allocation across complementary roles.

Figure 5A: Static Allocation: Hedge Funds versus Functional Alternatives

Credit Suisse Hedge Fund Index, versus Portfolio of Role-Based Alternatives, 1999 to 1Q 2025
Risk-Adjusted Portfolio of Long/Short Directional, Market Neutral, and Upside Alpha



Bucket composition based on HFRI indices; see box on page 11 for details.

Figure 5B: Performance Statistics

Period 1999 to 1Q 2025

	Credit Suisse Hedge Fund Index	Static Role-Based Allocation to Three Functional Alternative Indices
Return (Annualised)	6.0%	8.0%
Volatility (Annualized)	5.5%	5.1%
Sharpe Ratio	1.08	1.57
Max. Drawdown	19.7%	10.4%

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Source: Candriam, HFR, Bloomberg

In this backtest, an equal-risk-weighted role-based approach generated a materially higher annualized return (8.0% versus 6.0%), lower volatility (5.1% versus 5.5%), and a strongly improved Sharpe ratio (1.57 versus. 1.08) relative to the hedge fund representation of a 'typical' alternative investment. Maximum drawdown is also reduced nearly by half, from 19.7% to 10.4%, underscoring the value of combining differentiated strategies in a simple but structured way.

Dynamic Allocation

Understanding these return dynamics is key to effective portfolio construction. Rather than holding static allocations, investors can use this knowledge to adjust exposures as market conditions evolve—allocating more to *long/short directional* strategies during periods of heightened uncertainty, and leaning into Upside Alpha when markets are stable or trending upward. This forms the basis for a dynamic extension of the role-based framework, allowing portfolios to adapt more effectively to changing environments.

Our Multi-Asset Team has demonstrated how a static allocation can be improved upon *(Asset Allocation: Finding the Right Balance for your Portfolio)*. Historically, many practitioners of the simple 60/40 allocation have rebalanced, simply by selling equities after a good equity performance took ownership beyond a certain proportional allocation, and adding to them after a correction. Today we have more tools at our disposal.

From Classification to Dynamic Allocation: Building an Enhanced Alternative Portfolio.

While the behavioural buckets help clarify the role of each strategy, our earlier analysis combined them using a static, equal-weight allocation. This improved diversification and risk-adjusted returns. The next step is to make the allocation more adaptive—shifting weights as market conditions evolve.

Doing this in a systematic way raises important questions: how should exposures adjust over time? What signals should guide these shifts? And how can we maintain consistency with portfolio objectives while preserving diversification?

To answer these, we introduce a centralized, dynamic allocation framework that builds on the static version—using a market risk indicator to adjust role-based exposures over time.

Centralized and Dynamic Allocation

Building upon our previous work outlined in *Alternative Strategies: Is 40/30/30 the New 60/40?*, we propose a centralized, dynamically-managed allocation approach that systematically adjusts exposures across *long/short directional, market neutral,* and *upside alpha* strategies based on real-time market conditions.

We establish balanced risk contributions across strategies by calibrating each bucket to the same volatility level. This equal-risk approach prevents any single strategy group from disproportionately influencing portfolio performance or risk, facilitating effective diversification and dynamic adjustments.

To guide dynamic reallocation, we utilize a proprietary market risk indicator derived from the cross-asset volatility of equities, bonds, currencies, and credit, as illustrated in Figure 6. This indicator classifies market environments into three distinct regimes—risk-on (declining volatility), risk-off (rising volatility), and transitory (mixed signals)—enabling systematic shifts in strategy allocations detailed explicitly in Table 2:

- **Risk-on periods** (declining or stable volatility): Emphasis shifts toward *upside alpha* and *market neutral* strategies, increasing the portfolio's growth orientation.

- **Risk-off periods** (rising volatility): The allocation becomes defensive, raising exposure to *long/short directional* and maintaining *market neutral* strategies to mitigate downside risk.
- **Transitory periods** (mixed or uncertain volatility signals): The portfolio evenly balances exposure across all three buckets, preserving stability and limiting unnecessary turnover.

The practical implementation of this approach is detailed in the backtest results in Figure 6, illustrating how portfolio allocations could have explicitly responded to changing market regimes.

Figure 6: Adapting the Portfolio Allocation to the Market Environment

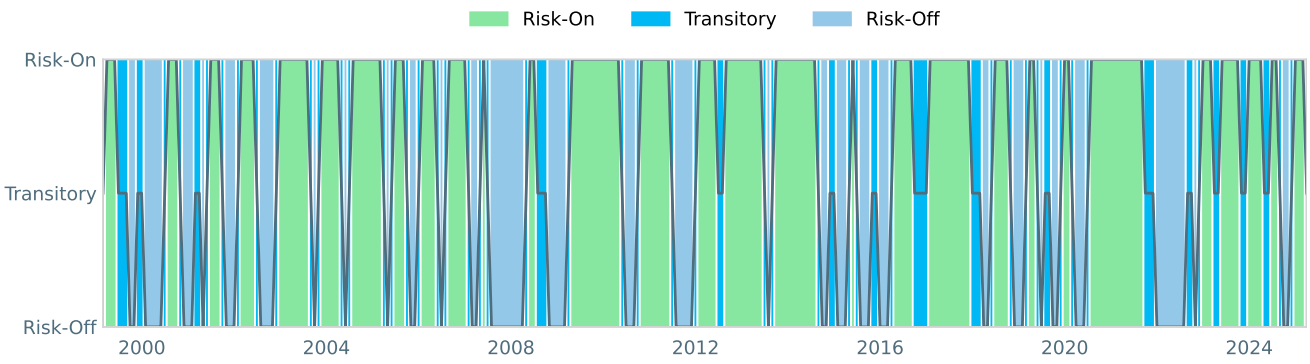
Phase	L/S Directional	Market Neutral	Upside Alpha
Risk-on (Expansion)	16.7%	33.3%	50%
Risk-off (Recession)	50%	33%	16.7%
Transition	33.3%	33.3%	33.3%

Past performance is not a guarantee of future performance. Markets could develop very differently in the future.

Source: Candriam

By continuously aligning allocations with prevailing market conditions, this centralized framework attempts to provide forward-looking risk management, reduce unintended exposures, and enhance portfolio resilience.

Figure 7: Candriam Proprietary Market Environment Model



Source: Candriam, Bloomberg

Backtest Results: Assessing the Value of a Dynamic Role-Based Allocation.

To evaluate the full impact of our allocation framework, we examine the effectiveness of this dynamic approach both in isolation, and within the context of a broader multi-asset portfolio.

- We begin by extending the performance comparison in Figure 5 to three standalone alternative allocations: the broad hedge fund index, our static role-based portfolio, and our dynamic role-based alternative allocation that adjusts exposures based on market signals.
- We then test how these alternative allocations improve outcomes when integrated into a traditional 60/40 portfolio as a 40/30/30 allocation.

Standalone Performance: Static versus Dynamic Role-Based Strategies

Having examined the benefits of a static role-based allocation (Figures 2 and 5), we now evaluate whether dynamic reallocation could further enhance portfolio outcomes. This dynamic extension adjusts exposures across *long/short directional, market neutral,* and *upside alpha* based on a proprietary market risk indicator derived from the cross-asset volatility introduced above (Figure 7).

Figure 8 compares three reasonably straightforward methods for an allocation to alternatives: the broad-based hedge fund index (used earlier in Figure 2 as a benchmark for alternatives), our static role-based allocation, and our dynamic version. To aid risk/reward comparability, each bucket within both the static and dynamic role-based allocations is scaled to the same target volatility before aggregation.

The static allocation to functional alternatives already improves meaningfully on the hedge fund benchmark, with higher returns, lower volatility, and better drawdown control. The dynamic allocation builds on this by adjusting exposures in response to market conditions—tilting defensively in risk-off periods and leaning into growth when volatility subsides.

The potential for added value is clear: in the backtest, the dynamic portfolio achieved an annualized return of 8.9% versus 8.0% for the static allocation and 6.0% for the hedge fund index. Volatility is also lower (4.9% versus 5.1% and 5.5%, respectively), and the Sharpe ratio improves to 1.81—well above both alternatives. Maximum drawdown is reduced to 8.9%, nearly half that of the hedge fund index.

These results demonstrate that a dynamic, macro-aware allocation can meaningfully enhance performance and reduce risk, building on the strength of a static framework and delivering greater resilience across market regimes.

Figure 8A: Alternatives – Hedge Funds, Role-Based Allocation, Dynamic Role-Based Allocation.
Performance from 1999 to 1Q 2025

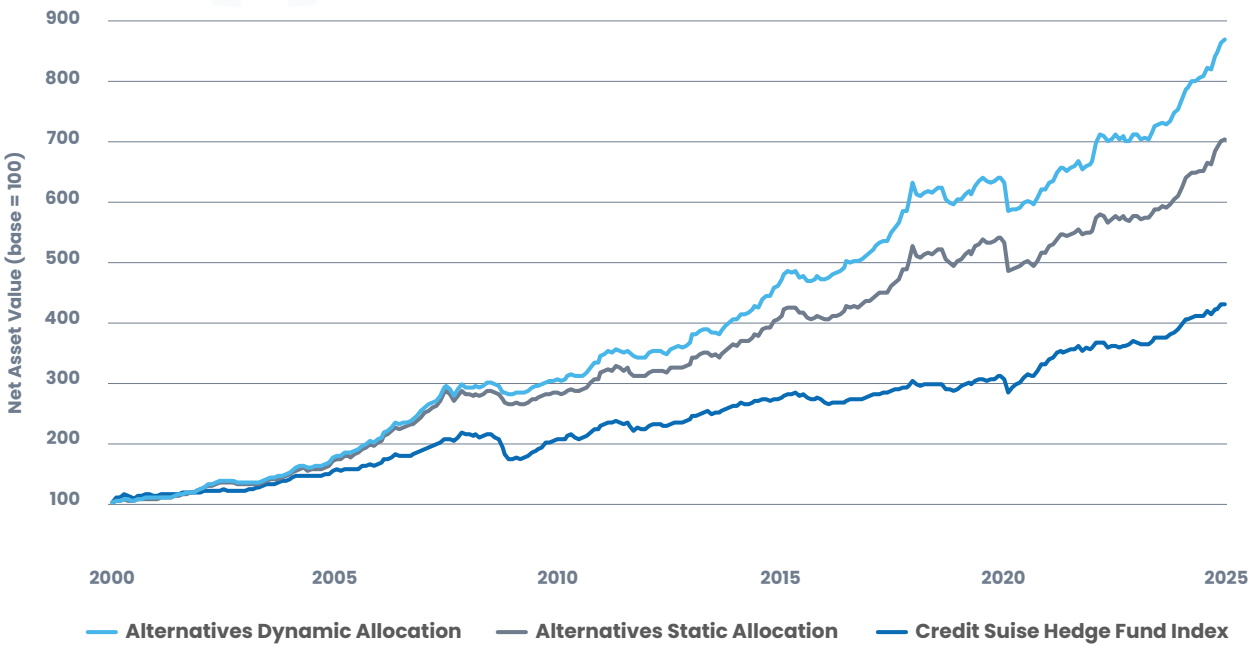


Figure 8B: Performance Statistics of Three Types of Alternative Allocations
Statistics for Hedge Funds, Role-Based Allocation, Dynamic Role-Based Allocation, 1999 to 1Q 2025

	Credit Suisse Hedge Fund Index	Static Role-Based Allocation	Dynamic Role-Based Allocation
% Return (Annualised)	6.0	8.0	8.9
% Volatility (Annualized)	5.5	5.1	4.9
Sharpe Ratio	1.08	1.57	1.81
Max. drawdown (%)	19.7	10.4	8.9

Past performance is not a guarantee of future performance. Markets could develop very differently in the future.

Source: Candriam, HFR, Bloomberg

Integration into a Broader Portfolio

To place these results in a broader investment context, Figure 9 compares the performance of a traditional 60/40 allocation with two 40/30/30 alternative-enhanced versions. The first alternative allocation replaces 30% of the portfolio with a static allocation to the broad hedge fund index, consistent with our first step in Figure 2. The second alternative allocation applies the same 30% to the alternatives, but instead allocates to three functional categories of alternatives, using our dynamic role-based framework.

Over the 25-year period, the baseline 60/40 portfolio would have delivered an annualized return of 4.5%, with 9.7% volatility, a Sharpe ratio of 0.46, and a maximum drawdown of 36.1%. Adding a static hedge fund allocation would have improved outcomes across the board: returns rise to 5.0%, volatility falls to 7.8%, and drawdown is reduced to 30.2%. The strongest results, however, would have been achieved through a dynamic approach using functional alternatives, with further gains in annualized return (to 5.9%), the lowest volatility of the three (7.4%), and a materially improved Sharpe ratio of 0.79. Drawdown would have been further cut to 26.5%.

These results suggest that *even a modest allocation to well-structured alternatives* -- particularly when dynamically managed -- *can meaningfully enhance the resilience and efficiency compared to a traditional 60/40 portfolio.*

Figure 9A: Portfolio Performance of 60/40 Traditional, 40/30/30 with Hedge Funds, an 40/30/30 with Enhanced Alternatives
Period 1999 to 1Q 2025

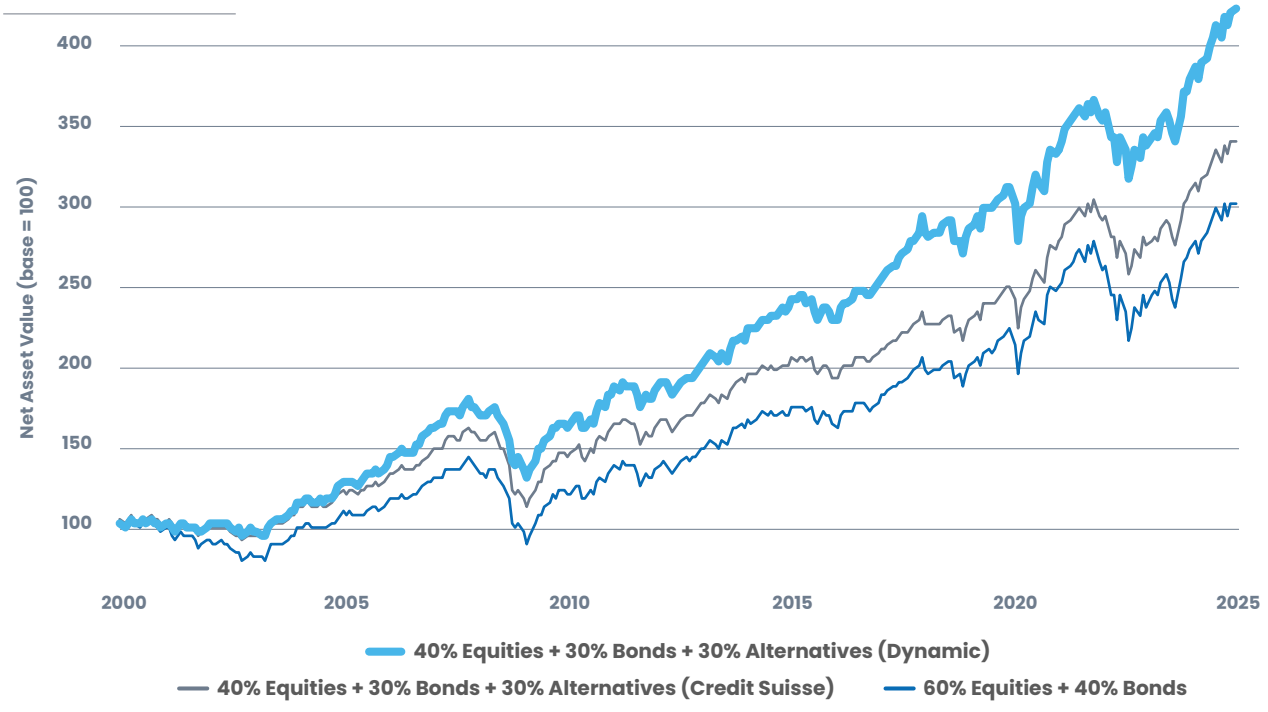


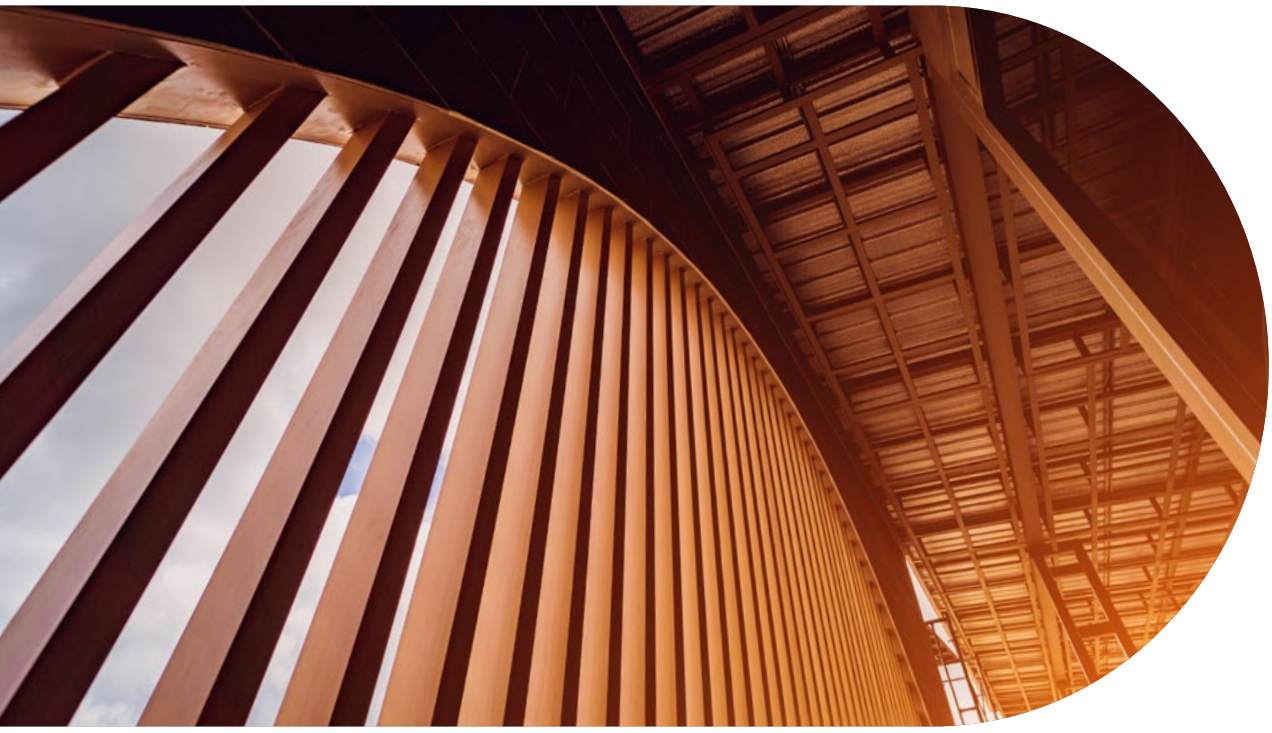
Figure 9B: Performance Statistics 1999–2025

Statistics for the Three Types of Portfolios in Traditional 60/40 Equity Bonds, 40/30/30 Static Allocation to Hedge Funds, 40/30/30 Dynamic Allocation to Role-Based Alternatives

	60% Equities + 40% Bonds	40% Equities + 30% Bonds + 30% Alternatives (Credit Suisse)	40% Equities + 30% Bonds + 30% Alternatives (Dynamic)
% Return (Annualised)	4.5	5.0	5.9
% Volatility (Annualized)	9.7	7.8	7.4
Sharpe Ratio	0.46	0.64	0.79
Max. drawdown (%)	36.1	30.2	26.5

Past performance is not a guarantee of future performance. Markets could develop very differently in the future.

Source: Candriam, HFR, Bloomberg



Conclusion: Back to the Future.

In the next section, we summarize the key takeaways and discuss broader implications for portfolio construction

While individual alternative strategies certainly can add value, their breadth and complexity present real challenges for effective portfolio allocation. Labels such as 'market neutral' or 'uncorrelated' often mask the true behaviour of strategies, particularly during market stress. Recent dynamics -- including trade conflicts, protectionist shifts, and abrupt policy changes -- have exposed the limitations of traditional diversification approaches. Typically built around equity and bond allocations, we believe the data highlights the need for a more structured and responsive allocation framework.

Our analysis shows that over the last years, a dynamic role-based approach -- built on clear strategy classification and informed by changing market conditions – would have meaningfully improved portfolio resilience and efficiency. Compared to a traditional 60/40 portfolio, the dynamic allocation raises pro forma annualized returns from 4.5% to 5.9%, lowers volatility from 9.7% to 7.4%, and improves the Sharpe ratio from 0.46 to 0.79. Maximum drawdown is also reduced from 36.1% to 26.5% (Table 7). Relative to a static role-based allocation, the dynamic version delivered further gains across all dimensions: stronger returns (8.9% versus 8.0%), lower volatility (4.9% versus 5.1%), and better drawdown control (8.9% versus 10.4%) (Table 6).

These improvements are not just statistical -- they reflect a more thoughtful way to structure diversification. By explicitly categorizing strategies into *long/short directional* for crisis resilience, *market neutral* for stable performance, and *upside alpha* for growth participation, investors gain greater control and flexibility. Allocations can be adjusted in line with macroeconomic regimes, allowing portfolios to remain balanced and responsive rather than static and vulnerable.

Looking ahead, implementing this approach within a centralized, internally-managed multi-strategy framework could unlock additional benefits, such as lower implementation costs, greater transparency, and more rapid rebalancing. While this is just one possible path, integrating strategy selection, risk balancing, and macro-sensitive signals into a cohesive process offers clear advantages. As global markets continue to evolve, moving beyond static diversification is no longer a theoretical preference -- it may prove essential for building portfolios that are truly resilient, adaptive, and fit for the future.

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