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Long-Short Equities

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Traditional long-only equity managers seek to add value by identifying securities expected to outperform their benchmarks. However, long-only mandates generally limit a manager's ability to profit from declining security prices and provide few tools to mitigate losses during broad market downturns.

Long-short equity strategies seek to address these limitations by allowing managers to establish both long positions in securities expected to appreciate and short positions in securities expected to decline. This broader opportunity set enables managers to express positive and negative investment views, potentially generate returns from a wider range of outcomes, and manage portfolio risk more actively.

Although often classified as a subset of hedge funds, long-short equity strategies remain fundamentally linked to equity markets. Their return profile is influenced by security selection, short positioning, portfolio construction, and market exposure, resulting in performance characteristics that differ from traditional long-only equity portfolios.

This paper examines the evolution of long-short equity investing, historical performance characteristics, potential sources of return, implementation considerations, and the role the strategy may play within an institutional portfolio.

Key Takeaways

- Long-short equity is best understood as a more flexible form of equity management rather than a separate source of portfolio risk. Aggregate returns remain closely tied to equity markets, but lower net exposure means the strategy typically participates in only a portion of market gains and losses.
- The strategy's most consistent portfolio benefit has been risk reduction rather than long-term outperformance of broad equities. Historical results show materially lower volatility and shallower losses in severe downturns, but also meaningful lag during sustained bull markets and sharp rebounds.
- The broader toolkit available to long-short managers, including short selling, leverage, derivatives, and tactical exposure changes, can expand the opportunity set for skilled investors. The same flexibility also increases financing, liquidity, operational, and positioning risks, so outcomes depend heavily on disciplined portfolio construction and risk management.
- Manager selection is especially important because performance dispersion among long-short funds has been substantially wider than among traditional long-only equity managers. Past performance offers limited evidence of persistence, and a meaningful share of reported returns may reflect systematic market, size, momentum, or thematic exposures rather than durable security-selection skill.
- An allocation to long-short equity can be used to adjust the beta, volatility, and drawdown profile of an equity portfolio, as well as a means of potentially adding alpha. The appropriate size and implementation vehicle depend on the investor's risk tolerance, confidence in manager selection, fee sensitivity, liquidity needs, and willingness to accept benchmark-relative tracking error.

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History

Seeking to profit from a drop in prices is not a new concept. Holland's seventeenth-century tulip mania resulted in an early example of a futures market. Such markets today allow investors to, among other things, "short" assets expected to fall in value.[1] The modern form of a long-short equity fund traces its lineage to 1949 when Alfred Winslow Jones founded The Jones Fund. Jones sought to reduce risk by shorting stocks, thereby *hedging* against the effects of market declines. This desire to balance return generation and risk management remains one of the defining characteristics of the strategy today.

Jones also charged a performance fee that sought to align the interests of the portfolio manager and the investors, with each profiting from the fund's success. Both the long-short equity portfolio structure and the performance fee concept proved durable.

The long-short equity concept was gradually applied to other asset classes. Starting in the late 1980s, several endowments began investing in long-short equity "hedge funds." Preservation of capital, not just increased returns, was an essential consideration for many of these early long-short equity investors. Others were seeking exposure to a larger opportunity set and specifically to managers who they perceived had better stock picking skills.

Today, long-short equity strategies are a significant part of the investment landscape and a meaningful portion of total hedge fund assets. Institutional investors may access the strategy through dedicated single-manager allocations, hedge fund-of-funds, or multi-manager portfolios. As of year-end 2025, approximately $1.57 trillion was allocated to the broader "equity hedge" category, which spans long-short equity along with closely related equity hedge fund strategies, making it one of the largest segments of the global hedge fund industry.[2]

Additional Flexibility

Investment flexibility makes long-short equity managers different from long-only managers. The loosening of investment constraints results in a broader opportunity set and a larger "toolkit" with which to work. A typical long-short manager has the latitude to invest in companies throughout the world, often regardless of market capitalization, sector, or liquidity constraints. The table below provides a brief overview of the tools available to long-short equity managers, as well as the potential benefits and risks.

This additional flexibility allows managers to express both positive and negative investment views more directly. However, allowing a manager more freedom is also a double-edged sword because poor investment decisions may be amplified by looser constraints and the use of these tools.

Figure 1
The Long-Short Equity Toolkit

	Potential Benefit	Potential Risk
No Relative Benchmark	Manager focuses on producing absolute versus relative returns	May prove difficult to distinguish manager skill
Short Selling	Can make money when markets or individual stocks fall	Can lose money when markets rise
Hedging with Derivatives	Derivatives can provide downside protection	Derivatives can introduce counterparty risk
Leverage	Magnifies gains	Magnifies losses
Tactical Decisions	Can adjust market exposure to benefit from (or hedge against) both bull and bear markets	Manager assessment of market behavior can be wrong or poorly timed

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Active, Unconstrained Portfolios

Though many investors classify long-short managers as "alternatives" or assign them to a hedge fund "bucket," most long-short equity managers represent a form of equity management along the spectrum of active investment management. This classification is appropriate because the primary source of returns and volatility in long-short equity portfolios is the equity market unless the portfolio is truly "market neutral."[3]

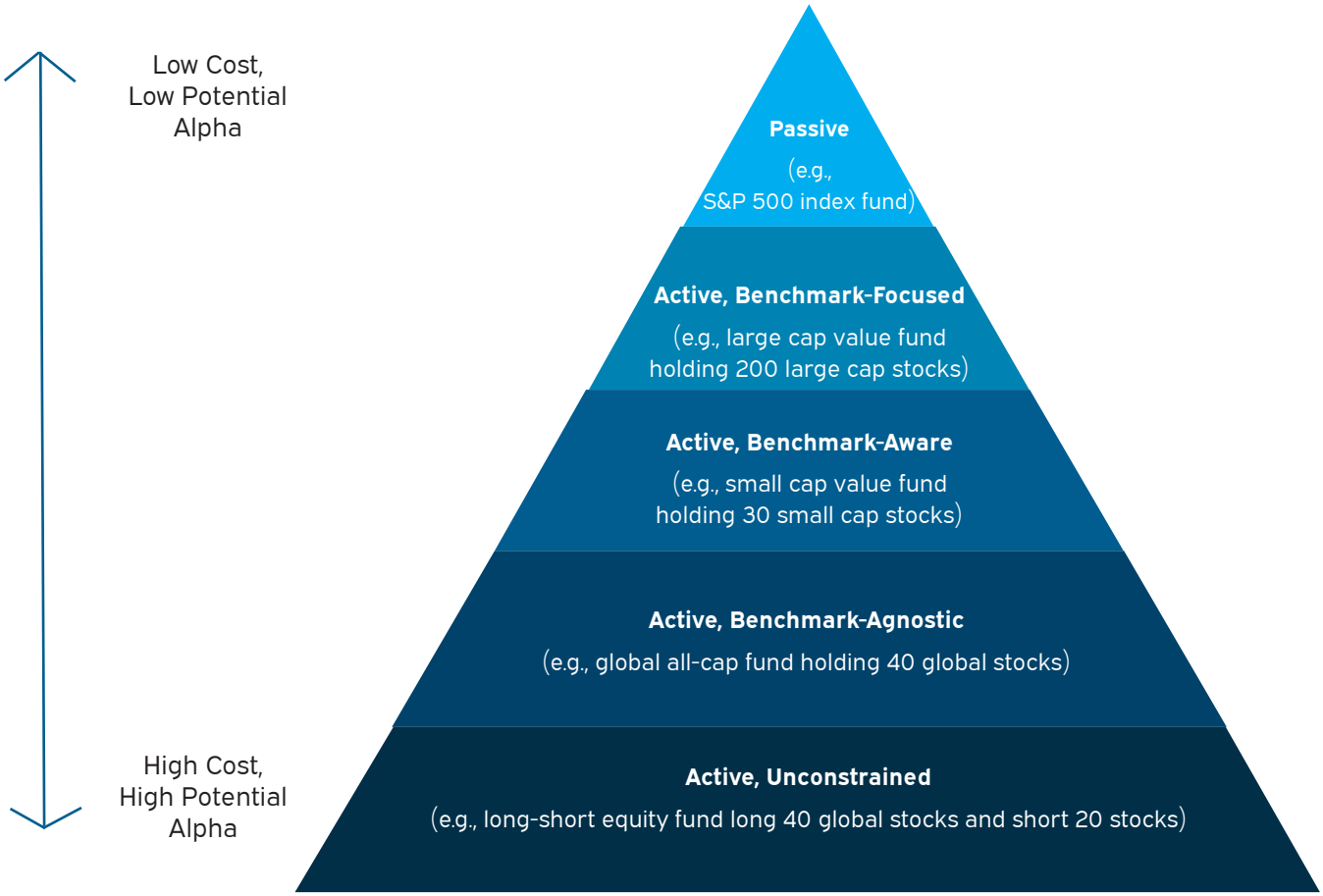
The following illustration provides an overview of the spectrum of portfolio management. Passive management strategies, or index funds, seek to provide low-cost exposure to a particular asset class or market segment. They seek to replicate the return of their benchmark and do not attempt to add value (i.e., seek positive "alpha").[4] Traditional long-only active managers invest primarily in the asset class that constitutes their mandate, and they seek to add value over their benchmark. These managers try to achieve this goal by holding securities in different weightings relative to their benchmark and perhaps holding some securities outside their benchmark. Long-short managers may identify a certain benchmark as their opportunity set, but they do not necessarily seek to manage portfolios relative to that benchmark. Given an ability to hold both long and short positions, performance is unlikely to closely track that of a long-only benchmark.

Potential Sources of Return

Investors considering long-short managers must believe both in the efficacy of active management and, critically, that they can identify skilled managers or hire an advisor who can identify skilled managers. At the very least, active managers are generally expected to produce returns that justify the fees they charge. Positive alpha may be a function of luck or skill, yet the flexibility available to long-short equity managers provides several potential sources of return not available to long-only investment managers. In environments where return dispersion is elevated and company-specific outcomes are more differentiated, long-short managers arguably have a larger opportunity set for security selection on both the long and short sides.

Figure 2

Illustration of the Active-to-Passive Portfolio Management Spectrum



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Long Positions

Long positions provide exposure to companies the manager expects to outperform, either because the company's fundamentals are improving, its valuation appears attractive, or the market has not fully recognized a change in the company's prospects.[5] Returns from these holdings depend on the manager's ability to identify securities that appreciate in value or perform better than the benchmark.

Compared with long-only managers, long-short equity managers may have more flexibility in how they size and combine long positions. They are not necessarily compelled to hold securities in benchmark-like weights, which can allow a larger share of the long portfolio to be allocated to higher-conviction ideas. The benefit of this flexibility depends on the accuracy of the manager's security selection and the discipline used in portfolio construction.

Short Positions

Managers with short positions seek to profit from a stock falling in value. Short positions can be executed for individual securities or for a broader basket of stocks. The effectiveness of short positioning is linked to the degree to which outcomes vary across companies, as greater differentiation in fundamentals can create more distinct opportunities to identify and position against weaker businesses.

For example, managers may engage in "basket shorting" whereby they short exchange-traded funds (ETFs) to reduce sector-specific or market risk within the portfolio.[6] Alternatively, they can buy put options (e.g., on the S&P 500) or engage in other, more complex, risk mitigation strategies.

The following are characteristics associated with short positions for a long-short equity portfolio:

Lower Volatility Profile: The addition of short positions may reduce net exposure to the equity market, which can lower portfolio volatility relative to long-only equities, depending on portfolio construction.

Additional Costs: When managers execute short sales, they must borrow the securities they intend to short. There is a cost associated with borrowing each security. This cost will vary depending on the stock's liquidity, the supply and demand for the security, and prevailing interest rates.

Greater Complexity: It is more complex for managers to sell securities that they do not own than it is for them to sell securities that they do own. The accounting, custody, and trading can be complicated and require more sophisticated trading and portfolio management systems.

A Second Source of Gains (or Losses): Short positions profit if a security falls in value. However, a short sale theoretically exposes a portfolio to infinite losses because the security sold short may increase in value to infinity before the manager can "cover" the short position.

Crowding and Squeeze Risk: A short position can also be "squeezed" when coordinated buying, whether from other investors, market makers hedging option exposure, or retail traders organizing through social media, drives the price of a heavily shorted security sharply higher over a short period. This type of risk is distinct from a security's price rising on fundamental news and reflects the extent to which crowded short positioning can itself become a source of loss.

Leverage

Leverage is a form of borrowing. Borrowing capital can amplify returns by exposing a portfolio to higher highs and lower lows.[7] A manager using leverage must maintain sufficient liquidity to mitigate the forced sale of securities.

Leverage is divided into two categories, implicit and explicit (see Figure 3). Implicit leverage is a function of the derivatives market in which posting a mandated "margin" amount enables the investor to gain control over a larger amount of assets.[8] Explicit leverage comes from actual borrowing. It generally refers to borrowing or financing arrangements used to increase investment exposure beyond the capital contributed by investors. Leverage used explicitly has a specific interest rate associated with the investment. For leverage to be beneficial, managers must produce a return on the leveraged investment that exceeds the borrowing cost (i.e., the interest rate of the credit extended to them).

In either case, investors should focus on the resulting gross exposure, net exposure, liquidity needs, and financing terms. The type of leverage is less important to the investor than is the net exposure that results from each. Most long-short equity managers typically maintain a net long exposure of between 0% and 100%.

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Long-short equity portfolios are commonly described in terms of gross exposure, which measures the total value of long and short positions expressed as a percentage of capital, as well as net exposure, which reflects the portfolio's directional market exposure after offsetting long and short positions (see the Appendix for additional detail and examples of these measures).

Tactical Decisions

Long-only managers typically remain close to being fully invested to ensure continuous exposure to a particular market (e.g., large cap US equities). In contrast, long-short managers may frequently change their "net market exposure." That is, their net exposure can vary over time. This change can be either intentional or result from the knock-on effect of their views on individual stocks.

For example, shorting stocks they expect will fall in price will also reduce market exposure. Alternatively, a long-short equity manager may alter their overall market exposure based on what kind of market environment (e.g., favorable versus unfavorable) they anticipate. Long-short equity managers can change the net market exposure of their portfolios by holding more or less cash, by adjusting "long" and "short" positions, or by using derivatives (e.g., options or futures on the S&P 500 index). Note that such changes have implications for an investor from a portfolio construction standpoint, as they must consider the impact of the manager's positioning on their broader portfolio.

Historical Performance

Performance for long-short equity managers was not tracked until the early 1990s, and it began as a fairly small universe (e.g., roughly 50 long-short equity managers were tracked by HFRI initially). Importantly, most hedge fund return composites are self-reported (i.e., managers are not required to provide data), which means they are subject to significant survivor and selection bias, and should therefore be viewed skeptically.

With this caveat, long-term reported performance has been strong (see Figure 4). Over the period from December 1991 through April 2026, the long-short equity composite produced an annualized return of approximately 10.0%, compared to 11.0% for US equities and 7.0% for international equities, with lower volatility (8.8% versus 15.1% and 16.3%, respectively). Long-short equity managers exhibited volatility profiles comparable to portfolios composed of 60% stocks and 40% cash. This is broadly consistent with the structural characteristics of the strategy, given that long-short managers typically maintain partial net market exposure.

While it is generally helpful to have more data over a longer horizon when making assessments of performance, there are multiple reasons to view this track record with a grain of salt. Several factors warrant caution when interpreting long-term hedge fund performance data.

First, survivorship bias becomes increasingly problematic over longer measurement periods, as databases often exclude funds that closed or ceased reporting, thereby overstating the returns of the surviving universe. Second, hedge fund database reporting practices were less standardized during the industry's early years; because participation is voluntary and most commercially available databases did not emerge until the mid-1990s, pre-1994 returns are especially susceptible to reporting and selection biases.[9] Third, technological advances (e.g., the internet) and the adoption of Regulation FD reduced the information asymmetries that historically benefited some active managers, making proprietary research more of a commodity than it was in the 1990s.[10] Finally, return opportunities available to investors can evolve over time as market conditions, valuations, and investor expectations change. As a result, returns observed during earlier periods may not be representative of the return environment facing investors today.[11]

Figure 3

Illustration of Explicit and Implicit Leverage

Leverage	Long Position	Short Position	Gross Exposure	Net Exposure
Implicit	Purchase 1 share of Stock A, margin posted in cash	Short 1 share of Stock B, proceeds invested in cash	200%	0%
Explicit	Purchase 2 shares of Stock A	Short 1 share of Stock B, proceeds used to purchase the second share of Stock A	300%	100%

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Figure 4
Historical Performance Characteristics

	Long-Short (net of fees)	US Stocks	International Stock	60% Stocks / 40% Cash
December 1991 – April 2026				
Annualized Return	10.0%	11.0%	7.0%	6.6%
Standard Deviation	8.8%	15.1%	16.3%	9.0%
Correlation with US Stocks	0.83	1.00	0.82	0.94
Beta vs. US Stocks	0.49	1.00	0.88	0.56
Sharpe Ratio	0.84	0.56	0.27	0.45
May 2006 – April 2026 (Twenty Years)				
Annualized Return	5.6%	10.7%	5.8%	6.1%
Standard Deviation	8.8%	15.8%	17.2%	9.6%
Correlation with US Stocks	0.89	1.00	0.86	0.96
Beta vs. US Stocks	0.50	1.00	0.94	0.58
Sharpe Ratio	0.45	0.57	0.24	0.46
May 2016 – April 2026 (Ten Years)				
Annualized Return	8.8%	14.8%	9.6%	8.8%
Standard Deviation	8.9%	15.8%	15.0%	8.8%
Correlation with US Stocks	0.90	1.00	0.83	0.97
Beta vs. US Stocks	0.51	1.00	0.79	0.54
Sharpe Ratio	0.73	0.79	0.49	0.73
November 2007 – February 2009 (GFC)	-26.4%	-46.0%	-51.7%	-28.2%

Source: HFRI Equity Hedge Index, Russell 3000 Index, MSCI ACWI ex USA Index, and Bloomberg US Treasury Bills 1–3 Month Index, as of April 30, 2026. The GFC refers to the Global Financial Crisis.

For these reasons, we have a higher degree of confidence that the relative performance of long-short equity managers during the past two decades is more representative of what investors should expect from them in the future. These figures are more modest than the full-period numbers, which is consistent with the structural characteristics of the strategy. Since long-short strategies are designed to have exposure to the equity market while mitigating risk, it is intuitive that over the long run, and during bull markets in particular, they will produce lower absolute returns than a long-only equity benchmark. If the market is fairly efficient, an index composed of 60% stocks and 40% cash should serve as a reasonable guide to the expected return for the universe of long-short managers.[12]

Several longer-term developments help explain why long-short equity has trailed long-only equities over the trailing ten- and twenty-year periods. US equities delivered an unusually strong and sustained advance, an environment that favors portfolios carrying fuller market exposure. Return dispersion between the strongest and weakest performing stocks was also generally compressed over much of this span, narrowing the opportunity to add value through security selection on either the long or the short side. In addition, many long-short managers maintain meaningful non-US exposure, and non-US equities lagged US equities for the better part of the period. Finally, policy rates were held near zero for much of the decade following the Global Financial Crisis, meaning the cash held within long-short portfolios earned materially less than it did in higher rate environments such as the 1990s. These represent structural features of the period rather than a single short-term cycle, although the subsequent normalization of interest rates has removed at least one of these headwinds.

Potential to Add Value

The freedom available to long-short equity managers may provide skilled managers with greater opportunities to add value, but not all unconstrained managers are equally skilled. Moreover, one of the most important determinants of the opportunity set available to active managers is the level of dispersion among individual securities. For equity investors, dispersion measures the degree to which returns differ across companies and directly influences the potential value of security selection. When dispersion is elevated, the range of outcomes across companies widens, increasing the potential for managers to generate value through both long and short positioning. If dispersion is low, manager skill offers less upside than if dispersion is high.

One way to measure the opportunity for skilled managers to add value in an asset class is by looking at the interquartile spread, which is the difference in annualized returns between the manager at the 25th percentile and the 75th percentile.

Figure 5

Interquartile Spreads for Long-Only and Long-Short Equity Managers

Equity Composite	Interquartile Spread
Long-Short Equity	15.1%
US Large Cap Equity	5.0%
US Small Cap Equity	6.3%

Source: HFRI and eVestment. Represents the interquartile spread for the ten-year period ending April 30, 2026. The interquartile spread is calculated as the difference in average annualized return between the managers whose performance is at the 25th and 75th percentiles over the full period.

Historically, there has been a much larger spread between the stronger and weaker performing long-short managers than for long-only US large cap and small cap equity managers (see Figure 5). This implies that there is a greater reward for picking superior long-short equity managers. However, the wider difference in manager returns is not good news for investors in sub-par strategies, as weak long-short managers can detract significantly more value than long-only public market equity managers. Choosing genuinely skilled active equity managers for a long-short mandate is therefore critical.

Empirical research on the return drivers of long-short equity hedge funds points to a small number of factors accounting for the bulk of return variation. Specifically, exposure to the broad equity market, combined with a persistent spread position between small cap and large cap stocks, together explained more than 80% of the variation in long-short equity hedge fund returns.[13] Price momentum and overall market trading activity contributed additional, secondary explanatory power. Taken together, these findings suggest that a meaningful share of what may appear to be manager skill in long-short equity portfolios can instead be attributed to systematic exposures rather than security selection alone. While the source of variation may change (e.g., exposure to foreign equities or AI-related companies), it often reflects a systematic theme based on what is in or out of favor.

Persistence?

Identifying superior managers ex-ante is no easy task. An impressive track record is not enough to conclude that a manager possesses skill. Academic studies examining the performance persistence of hedge funds (i.e., the probability of a manager who has done well in the past continuing to perform well in the future) have produced mixed results. More recent research supports this conclusion, suggesting that while some persistence may exist, it is generally limited, varies across market environments, and has weakened over time as the industry has grown and become more competitive.[14] The challenge of relying on past performance is made even more difficult by the fact that hedge fund data often suffers from severe biases, including survivorship and backfill bias.[15]

Where persistence has been identified, it tends to be concentrated among smaller and younger funds rather than the industry as a whole. Several explanations have been offered for this pattern, including capacity constraints that limit how much capital a strategy can absorb before returns erode, and a tendency for funds to become more closely benchmarked to peers and less differentiated as they age and grow.[16] For an investor, this suggests that a manager's size and stage, not just their historical track record, are relevant considerations when assessing the likelihood that past performance will continue.

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The Asset Allocation Decision

This section examines the potential benefits of adding long-short equity from several perspectives within the overall asset allocation framework. First, we review the logic of considering long-short equity within an investor's equity allocation, as opposed to an alternative classification. Second, we discuss the benefits of using long-short equity to reduce portfolio-wide risk.

Long-Short as Equity

Many investors have categorized long-short equity funds with other hedge funds and sometimes within a broader "alternatives" bucket. The classification of a strategy or asset class on paper is less important than the risk factors that it introduces to an investor's portfolio. In any reasonably diversified portfolio, market risks, as opposed to idiosyncratic risks, will be the primary driver of returns. The chief economic and market risks in a long-short equity portfolio are the same as those for equity markets broadly – poor or negative economic growth and a weak stock market. Using this logic, long-short equity managers most appropriately belong to a broad equity category with other equity strategies that exhibit similar market and economic sensitivity.

Long-short equity managers (as a whole) exhibit characteristics consistent with reduced net exposure to the broad equity market. Over the trailing ten years, their aggregate correlation with the US stock market has been high, although their beta versus the market has been more modest (see Figure 6).[17] They produced much better returns during the Global Financial Crisis, but then lagged significantly during the subsequent rebound, both consistent with lower net market exposure.

Figure 6

Performance of Long-Short, US Equities, and Foreign Equities

	Long-Short (net of fees)	US Stocks	International Stocks
Annualized Return	8.8%	14.8%	9.6%
Modeled Return based on Beta[18]	8.8%	-	-
Beta vs. Russell 3000	0.51	1.00	0.79
Correlation with Russell 3000	0.90	1.00	0.83
Return during the GFC (Nov '07 – Feb '09)	-26.4%	-46.0%	-51.7%
Return in year post-GFC (Mar '09 – Feb '10)	25.9%	52.2%	67.6%

Source: Historical analysis based on the Hedge Fund Research HFRI Equity Hedge TR Index, the Russell 3000 TR, and MSCI ACWI ex USA Net Total Return USD Index, for the period May 2016 through April 30, 2026.

In our capital markets expectations modeling, Meketa forecasts long-short equity returns based on a beta-weighted blend of equity and cash exposure. Applying this approach over the past ten years produces a modeled return of approximately 8.8%, matching the 8.8% return actually generated by the long-short universe, implying that a simple beta-adjusted combination of equity and cash has been a reasonable proxy for aggregate long-short performance.

Beta and correlation are useful indicators of how closely a long-short portfolio is likely to track a long-only benchmark. Correlation measures the extent to which returns move in the same direction as the market, while beta measures the magnitude of that movement. A high correlation combined with a beta well below 1.0, as shown above, describes a portfolio that generally moves with the equity market but participates in only a portion of its gains and losses. Investors should therefore expect long-short equity to follow the broad direction of a long-only benchmark while diverging meaningfully in the size of those moves, which is a primary source of the tracking error that a long-short allocation introduces.

Reducing Volatility and Drawdown Risk

Many investors seek to mitigate risk in their portfolio by reducing volatility or the maximum loss (i.e., "drawdown") they might experience.[19] Reducing the level of drawdown also reduces the amount of time and size of return needed to recover from the drawdown (see Figure 7).

Figure 7

Illustrative Drawdown and Recovery

Drawdown Scenario (%)	Required 1-Year Return (%)	Recovery Time Period Assuming an 8.5% Annualized Return (Years)
-10	11.1	1.3
-20	25.0	2.7
-30	42.9	4.4
-40	66.7	6.3

The recovery periods shown are a mathematical illustration only, assuming a constant hypothetical annualized return of 8.5%. This rate is not a projection, forecast, or guarantee of future performance and does not represent the return of any actual account, index, or composite. Actual recovery periods will vary depending on realized returns.

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Dedicating part of a portfolio to high quality bonds and cash has traditionally been the most common way for investors to hedge the downside risk of the equity markets. However, the effectiveness of traditional hedges such as bonds can vary across market environments. Therefore, investors may seek other ways to reduce volatility without sacrificing potential return. This is where the possibility of shifting part of an equity allocation to long-short equities comes into play. Historically, long-short equity has reduced drawdowns and the time to recover for the most extreme downturns, though the impact during less severe declines has been less substantial (see Figure 8).

The long-short equity composite generally preserved more capital than broad US equities across the drawdown periods shown, although the magnitude of downside protection and speed of recovery varied by episode. Hence, an investor who allocated some of their equities to long-short would have reduced their volatility as well as their susceptibility to fat tail losses (i.e., significant losses of capital). However, the difference in returns among long-short managers can be quite large, so there is no guarantee that any one manager or group of managers will exhibit performance that replicates the composite.

The ability to protect capital during downturns can increase the odds of an investor meeting their long-term goals. However, this assumes that an investor is able to produce solid returns under normal or bullish conditions, as well. Any portfolio that is not 100% invested in equities will lag the broad stock market during a bull market. Hence, cash, bonds, and long-short equities (assuming they are not 100% net long) will fail to keep pace when stocks are producing double-digit returns.

How Much to Allocate?

There is an inherent trade-off in shifting assets from long-only to long-short strategies, as reduced equity market exposure typically leads to lower expected long-term returns alongside lower risk. While manager skill can influence outcomes, results vary meaningfully across the opportunity set. As such, long-short equity can be used as a means of adjusting the overall risk and return profile of an equity allocation rather than as a direct substitute for long-only equities.

The preceding data demonstrate that long-short equity can be used for risk reduction. Allocations to long-short equity may represent a portion of an investor's broader equity allocation, depending on objectives and risk tolerance. Allocating a higher proportion of an equity portfolio to long-short equity will reduce overall market exposure (i.e., it will lower the overall beta), while lower allocations preserve greater participation in equity market returns. Moreover, allocating to long-short strategies may result in higher tracking error relative to policy benchmarks and peers.

Since larger allocations to long-short equities involve higher fees and lower market exposure than a long-only portfolio, a significant amount of alpha would be required to offset these considerations. But the potential for alpha is a key reason why many investors allocate to long-short strategies. That is, they believe long-short equity offers a favorable environment for skilled managers to add value and they further believe they can identify those managers. Investors who want to use long-short for this reason but do not want to sacrifice the potential of higher returns that is typically expected with higher equity market exposure can use an equity overlay to maintain the overall equity portfolio beta at the desired level.

Figure 8

Historical Drawdowns for US Equity and Long-Short Equity

Time Period	US Stocks (%)	Time Needed to Recover (Months)	Long-Short Equity (%)	Time Needed to Recover (Months)
April 2000 to September 2002	-43.1	49	-8.9	10
November 2007 to February 2009	-46.0	37	-26.4	24
February 2020 to March 2020	-35.0	4	-10.9	4
January 2022 to October 2023	-11.6	2	-8.3	5

Source: Historical analysis based on the Hedge Fund Research HFRI Equity Hedge TR Index and the Russell 3000 TR Index, as of April 30, 2026.

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Implementation Options

Investors who seek exposure to long-short equity managers have several available options. An institutional investor may choose to invest through a fund-of-funds manager, through a single manager, or directly into a customized program of long-short managers. Long-short exposure is also available through registered vehicles, including 1940 Act mutual funds and hedge fund replication strategies, which are outside the scope of this paper.

Single Manager

Using a single long-short equity manager is similar to using a single equity manager to gain exposure to other broad equity classifications like small capitalization or international equity. Most traditional long-only managers track their benchmarks fairly closely, so investors have a reasonable idea of the performance to expect. In contrast, even a well-diversified long-short manager is likely to display significant tracking error versus the stock market as well as the broad universe of long-short equity managers.[20]

The single manager approach has the appeal of being straightforward, easy to implement, and lower cost than a fund-of-funds. Management fees usually range from 1% to 2%, and performance fees are typically 10% to 20%.[21] As of mid-2026, the median long-short equity manager charged a 1.5% management fee and a 20% incentive fee, with roughly a quarter of managers charging 2.0% or more in management fees.[22] While competition among managers, greater fee transparency, and the growing bargaining power of large institutional allocators have created downward pressure on fees in parts of the industry, the trend has been uneven.

Individual funds tend to offer limited liquidity, though the terms can vary widely depending on the investment philosophy of the manager. Some funds impose no lock-up at all, while others require capital to be locked up for a year or longer from the time of the initial investment. A fund may also offer a trade-off between liquidity and fees, with an investor accepting a longer lock-up in exchange for a lower fee schedule. Redemption frequency varies just as widely. Terms can range from daily to annual, though monthly, quarterly, semi-annual, and annual redemptions are the most common.

Investors typically also review whether a fund employs gates, which limit the amount of capital that may be withdrawn on a given redemption date. Gates may be applied at the fund level, restricting total redemptions across all investors, or at the investor level, restricting the portion any single investor may withdraw. In either case, the effect is to extend the period over which capital is returned, allowing a manager to maintain the positions they wish to hold and reducing the risk that concentrated investor withdrawals force the liquidation of the strategy. Because a gate can apply even where a fund's stated redemption frequency appears accommodating, these provisions are generally reviewed alongside the lock-up and redemption terms rather than considered in isolation.

Institutional investors may seek to achieve the "best of both worlds" by constructing a diversified roster of individual long-short equity managers. The use of a direct program increases an investor's control and ability to customize the portfolio to best meet their goals. Building and maintaining a direct program requires significant expertise, time, and resources on the investor's part, both in the initial planning and implementation stage, as well as in the ongoing monitoring.

Multi-Strategy Platforms

Over the past decade, a growing share of long-short equity capital and talent has moved into multi-strategy platforms, sometimes called "pod shops." These platforms allocate capital across dozens or hundreds of internal teams, each running a discrete strategy, including long-short equity, under centralized risk limits and a shared infrastructure for financing, technology, and risk management.[23]

For an institutional investor, this development is worth understanding for two reasons. First, multi-stratgegy platforms have become an important segment of the long-short equity market, affecting how managers are organized, evaluated, and compensated. Second, many platforms use a pass-through expense model, in which investors bear not only a management fee and performance fee but also a share of the platform's operating costs, including technology, data, and compensation.[24] These pass-through costs can raise the effective, all-in cost of the investment above what the stated fee schedule suggests, and investors evaluating multi-strategy platforms may find it useful to obtain a clear accounting of expected pass-through charges as part of the due diligence process.

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Liquidity terms also warrant attention. Platforms frequently require multi-year commitments, with capital returned in installments rather than the liquidity terms typically offered by single-manager funds described above, and many of the largest platforms are closed to new capital or maintain lengthy queues. An investor evaluating a platform should therefore weigh access and redemption terms alongside the cost considerations noted above.

Fund-of-Funds

A fund-of-funds that is focused on long-short equity provides an investor exposure to a broad group of long-short equity single or multi-strategy managers, generally using five to thirty investment managers. This provides broad diversification by manager and, presumably, by strategy. A diversified fund-of-funds also provides the benefit of volatility reduction within an investor's portfolio of long-short equity managers. This diversification is an important benefit because any one long-short manager may exhibit far more volatility than a composite of long-short funds.

The minimum allocation amount for a fund-of-funds investment is usually $1.0 million. This minimum may be lower than that for many individual funds, thus potentially making fund-of-funds accessible to investors whose smaller size may not otherwise allow them to access the long-short market. Per HFRI, fund-of-funds have historically charged management fees of approximately 1% and incentive fees in the mid-single digits, although actual fee arrangements vary across managers and may be negotiated.[25] These fees are in addition to the management and performance fees of the underlying investment managers.[26]

Like an individual fund, a fund-of-funds provides limited liquidity, typically on lock-up and withdrawal terms similar to those of the underlying funds in which it invests. Using a fund-of-funds may also limit an investor's ability to control allocations to specific capitalization segments, styles, and regions.

Conclusion

Long-short equity does not eliminate the basic economics of equity investing; it changes how those economics are expressed. By combining long and short positions, variable market exposure, and a broader set of portfolio tools, the strategy gives managers more ways to shape outcomes than a traditional long-only mandate. That flexibility is valuable only when it is supported by repeatable investment judgment, disciplined risk controls, and an operating platform capable of managing the added complexity.

The aggregate historical record suggests that investors should set expectations from the strategy's structure rather than from its strongest early results. A portfolio with partial net equity exposure should generally move with stock markets while capturing less of both their upside and downside, and its return should be evaluated in that context. Reported hedge fund composites provide useful perspective, but database biases, changing industry conditions, and the growing influence of systematic exposures limit the conclusions that can be drawn from headline performance alone.

Accordingly, the central underwriting question is not whether long-short equity is attractive in isolation, but whether a particular allocation improves the broader portfolio after accounting for fees, liquidity, financing terms, and benchmark (e.g., risk budgeting) implications. Investors should examine the sources of a manager's returns, the stability of gross and net exposures, the capacity of the strategy, and the organization's ability to manage shorting and leverage through stressed markets. This work is especially important because wide manager dispersion makes implementation choices at least as consequential as the decision to allocate.

For institutions that can conduct this level of diligence and tolerate the accompanying complexity, long-short equity can serve as a deliberate component of the equity program rather than a generic alternatives allocation. The appropriate structure may be a single manager, a diversified direct program, a multi-strategy platform, or a fund-of-funds, with each offering a different balance of control, diversification, access, cost, and liquidity. The ultimate measure of success is whether the chosen implementation delivers the intended portfolio behavior across market cycles, not whether it outperforms long-only equities in every period.

Appendix: Terms and Mechanics

Service Providers

Long-short equity investment managers introduce additional terms and specific mechanics with which investors may not be familiar. The following table provides an overview of service providers typically included in a long-short equity offering and their role.

Gross vs. Net Exposure

The relaxed constraints of long-short equity managers introduce leveraged investments. A long-short equity manager will have a figure representing their gross long, gross short, total gross, and net exposure. The table below compares the exposure of a fully invested long-only manager with that of a long-short manager.

The figure for gross long exposure is the total capital invested in long positions. The figure for gross short represents the total capital invested in short positions. Total exposure adds gross long and gross short together while net is gross long minus gross short. These figures describe the positioning of the investment manager.

Short Selling Mechanics

When a long-short equity manager executes a short sale, the manager borrows the security through a prime broker. The manager sells the security and receives proceeds from the sale. The long-short equity manager intends to repurchase the security at a lower cost and deliver the security back to the prime broker.

Figure 9

Types of Service Providers Involved in Long-Short Equity

	Comparable Long-Only Counterpart	Description of Role
Prime Broker	Custodian and broker	Facilitates short sales and margin accounts, and extends lines of credit.
Administrator	Custodian and pricing service	Evaluates position-level security prices, sets the Net Asset Value (NAV) of the fund.
Auditor	Same	Performs an annual audit of the partnership.
Legal	Same	Drafts all legal documents including offering memorandum and subscription agreements. May provide support for external ISDA[27]/privately negotiated transactions.

Figure 10

Illustrative Gross and Net Exposures

	Long-Only (%)	Long-Short Equity (%)
Gross Long	100	100
Gross Short	0	50
Total (Gross Exposure)	100	150
Net Exposure	100	50

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Appendix: Biases

Hedge fund data is prone to various biases that impact the data at the surface level and hence the conclusions that an investor might draw when examining the data. Therefore, it is important to be skeptical when looking at the historical returns of hedge fund indices.

Survivorship Bias

Longer-term time periods are generally preferable when analyzing performance, to account for market cycles, short-term trends, or other sources of end-point bias. However, the longer the time period, the greater risk there is of survivorship bias impacting the data.

Survivorship bias occurs when databases exclude the returns of funds that have closed or gone out of business. Much as survivorship bias is present in the returns of mutual fund indices and peer manager indices, it exists for hedge fund indices. Moreover, because of the high mortality rate of hedge funds (estimates in some early research were that up to 20% went out of business each year)[28], survivorship bias is particularly endemic to hedge funds. Independent research suggests that survivorship bias alone boosted hedge fund index returns by 3% to 4% per year during the 1990s.[29]

Both intuition and past research imply that the majority of managers who dropped out of a universe were underperforming.[30] Hence, their exclusion upwardly biases the results relative to what an investor in the median fund would truly have received.

Self-Selection and Backfilling

Returns are also self-reported, meaning that a manager experiencing poor returns may choose to stop reporting. The bias from these unreported final months is not quantifiable, although for failed funds it must be substantial. However, industry insiders claim that many funds stop reporting their returns because they are doing well (i.e., they do not need to attract any more capital) rather than doing poorly. This implies that the self-selection bias causes the index returns to be understated. Additionally, funds that have built a successful track record prior to joining a database may report their prior returns, while start-ups that do not build a similarly good track record do not have the same desire to provide backfilled returns. The backfilling bias in one database was estimated at around 4%.[31] The true effect and amount of these combined biases are difficult to estimate.

Smoothing

Another potential problem with the data is that hedge fund returns are smoothed, due in part to stale asset pricing. This has two consequences. First, volatility appears smaller than the actual risk level. For example, if the price of an illiquid security remains unchanged by the manager while the prices of similar liquid securities gyrate, volatility will be dampened. Second, because the prices of these illiquid securities are not changing when the stock and bond markets move, the reported correlations between hedge funds and equities and bonds may be understated.

One study found that the beta versus the stock market for the aggregate CSFB/Tremont index increased from 0.37 to 0.84 when adjusted for stale pricing.[32] Another study determined that, even for relatively liquid strategies like long-short hedge funds, smoothing causes an upward bias in excess performance measures (i.e., alpha) and a downward bias in risk measures.[33]

Making Adjustments

One approach is to measure the performance of fund-of-funds, as these should provide a cleaner estimate of the actual experience of long-short equity focused hedge fund investors.[34] However, there is no composite of long-short equity fund-of-funds currently available.

Summary

Hedge fund data is prone to many biases that impact historical returns, and long-short equity is no different. Survivorship bias, self-selection, backfilling, and smoothing are all likely present, and artificially inflate reported returns while putting a downward bias on risk measures, especially prior to 2000. Hence, it is important to be skeptical when looking at the historical returns of hedge fund indices.

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End Notes

[1] To "short" an asset (or take a short position) means selling an asset the investor does not own (after borrowing it) with the intent to buy it back later at a lower price, profiting from the difference if the price falls.

[2] Source: HFR, "Global Hedge Fund Industry Capital Surges Past Historic $5 Trillion Milestone," January 22, 2026.

[3] Market neutral strategies are constructed to be neutral to one or multiple benchmarks or variables, such as the equity market. Market neutral strategies typically maintain net equity market exposure no greater than 10% long or short.

[4] Alpha is the difference between the return of a portfolio and its benchmark. A positive alpha indicates that a manager outperformed, while negative alpha indicates underperformance. Alpha can be adjusted for risk (e.g., beta) to better measure the value added by a manager due to skill rather than luck (or randomness).

[5] To "go long" or take a long position means to buy/own a security (i.e., it is the opposite of a short position).

[6] Basket shorting is the process of shorting an ETF (or other group of securities) to reduce sector-specific or broad market risk within a portfolio.

[7] Leverage is the use of borrowed money to gain additional exposure to an investment.

[8] Margin is the amount of equity contributed (and that must be maintained) as a percentage of the current market value of the securities being purchased or held within a leveraged portfolio.

[9] Source: William Fung and David Hsieh, "Hedge-Fund Benchmarks: Information Content and Biases," Financial Analysts Journal 58, no. 1 (2002): 22–34.

[10] On August 15, 2000, the SEC adopted Regulation FD to address the selective disclosure of information by publicly traded companies and other issuers. Regulation FD provides that when an issuer discloses material nonpublic information to certain individuals or entities—generally, securities market professionals, such as stock analysts, or holders of the issuer's securities who may well trade on the basis of the information—the issuer must make public disclosure of that information. See: US Securities and Exchange Commission, Selective Disclosure and Insider Trading, Release Nos. 33-7881; 34-43154 (August 15, 2000).

[11] For example, some strategies may become more widely adopted, perhaps leading to arbitrage of opportunities that has diminished the return available to these strategies.

[12] The weights between stocks and cash should vary depending on what the average net long position of the universe is expected to be. Similarly, the geographic weighting (e.g., using the MSCI USA vs the MSCI ACWI as the equity proxy) should depend on the anticipated composition of the universe.

[13] Source: Fung, William, and David Hsieh. "The Risk in Hedge Fund Strategies: Theory and Evidence from Long/Short Equity Hedge Funds." Journal of Empirical Finance, vol. 18, no. 4 (2011): 547-569.

[14] Sources: Bollen, Joenväärä, and Kauppila (2026) and Stafylas, Andrikopoulos, and Tolikas (2023); Gonzalez, Papageorgiou, and Skinner (2016); Boyson, Nicole M. "Hedge Fund Performance Persistence: A New Approach." Financial Analysts Journal, vol. 64, no. 6 (2008): 27-44.

[15] Source: Almeida, Ardison, and Garcia (2018).

[16] Sources: Nicole M. Boyson, "Hedge Fund Performance Persistence: A New Approach," Financial Analysts Journal 64, no. 6 (2008): 27-44; David Forsberg, David R. Gallagher, and Geoffrey J. Warren, "Capacity Constraints in Hedge Funds: The Relation between Fund Performance and Cohort Size," Financial Analysts Journal 78, no. 2 (2022): 57-77.

[17] Beta is a measure of the systematic, non-diversifiable risk of an investment. Specifically, beta measures the volatility of an investment (e.g., a manager's portfolio) compared to the market. A beta above 1.0 is more volatile than the market, while a beta below 1.0 is less volatile.

[18] Hypothetical figure derived from a model based on Meketa's capital markets expectations methodology (B × equity + (1-B) × cash) using beta for long-short equity versus the Russell 3000 index. Shown for long-short equity only, as the approach is designed to approximate reduced-net-exposure strategies.

[19] A drawdown refers to the cumulative loss experienced over a particular time frame.

[20] Tracking error is the amount by which the performance of the manager typically differs from that of the benchmark. Tracking error is calculated as the standard deviation of the difference in returns between the manager and the benchmark.

[21] Source: eVestment/HFR, as of July 2026 (HFR Equity Hedge universe; n = 731 for management fees, 724 for incentive fees). The median management fee was 1.5% and the median incentive fee was 20%; the average management fee was approximately 1.5%, with management fees ranging from 1.0% at the 75th percentile to 2.0% at the 25th percentile, and incentive fees ranging from 10% to 20% over the same range.

[22] Source: eVestment/HFR, HFR Equity Hedge universe, as of July 2026.

[23] Source: Barclays Prime Services Capital Solutions, "Performance by Fee Type and Level," July 2022; SEC, Private Fund Statistics, Table 8.10 (Qualifying Hedge Fund NAV by Strategy), data through Q3 2025.

[24] Source: Morgan Stanley Investment Management, "How Multi-Manager Platforms Find Strength in Numbers," July 2024; SS&C Technologies, "Rapid Growth for Multi-Manager Platforms: Trends and Technology," October 28, 2024.

[25] Source: Hedge Fund Research, Inc. Fund-of-funds fees are assessed in addition to the fees charged by the underlying hedge fund managers, creating an additional layer of expenses for investors. Fee structures vary by manager, strategy, mandate size, and investor terms.

[26] Note that these additional fees are not factored in the performance comparisons shown earlier in this paper.

[27] ISDA: The International Swaps and Derivatives Association (ISDA) is a trade organization of participants in the market for over-the-counter derivatives.

[28] Sources: Fung and Hsieh, "Empirical Characteristics of Dynamic Trading Strategies: The Case of Hedge Funds," 1997; Brown, Goetzmann, and Ibbotson, "Offshore Hedge Funds: Survival and Performance, 1989–1995," Journal of Business, 1999.

[29] Sources: Liang, "Hedge Fund Performance: 1990–1999" (2001); Fung and Hsieh, "Performance Characteristics of Hedge Funds and Commodity Funds: Natural vs. Spurious Biases" (2000); Ibbotson, Chen and Zhu, "The ABCs of Hedge Funds: Alphas, Betas, and Costs" (2011).

[30] See Carhart, Carpenter, Lynch, and Musto (2002), "Mutual Fund Survivorship," and Barrett and Brodeski (2006), "Survivor Bias and Improper Measurement."

[31] Source: Van der Sluis & Posthuma, "A Reality Check on Hedge Fund Performance," 2003.

[32] Source: Asness, Krail & Liew, "Do Hedge Funds Hedge?," 2001.

[33] See Huang, Liechty, and Rossi (2018), "Return smoothing and its implications for performance analysis of hedge funds."

[34] This approach was suggested in Fung and Hsieh's "Hedge-Fund Benchmarks: Information Content and Biases" (2002) and is broadly consistent with later work examining hedge fund performance measurement and database biases.

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