Global Asset Management

Shifting strategies:

How the world's largest institutions are embracing fixed income hedge funds

Full report

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Key insights

With economists expecting interest rates to remain elevated in the medium term and market volatility to persist, what are the views of some of the world's largest investors on fixed income and, in particular, alternative fixed income strategies?

To find out, RBC Global Asset Management gathered insights from senior investment decision-makers at global institutional investors across the US, Europe, and Asia.

This report explores the trends and priorities shaping investor sentiment, including their allocation plans, performance expectations, key fund selection criteria, and the extent to which macroeconomic conditions influence their decisions.

82% are considering alternative types of fixed income exposure

- Investors are closely monitoring geopolitical tensions (60%) and changes in interest rate policies (58%) as the primary drivers of fixed-income markets over the next three to five years [page 4].
- In anticipation of the impact of these factors on macroeconomic conditions 55% are diversifying their portfolios against recession risk [page 4].
- Most investors are turning to higher-yielding assets (42%) when considering alternatives [page 5].

61% of hedge fund investors expect to increase their allocation in the next 12 months

- Increasingly, investors are focusing on private debt (with 61% allocating funds to this asset class), hedge funds (60%), and private credit (59%) to enhance portfolio yields and improve alignment with their macroeconomic expectations [page 7].
- The popularity of these alternative fixed income strategies continues to rise, with over half of investors planning to increase their exposure in the next 12 months [page 8].

63% expect fixed income hedge funds to deliver 10% or more per annum

- Positive investor sentiment, driven by robust performance (cited by 65%), lower fees (48%), and improved market liquidity (45%), has made fixed income hedge funds a core component of global portfolios [page 10].
- Currently, half of investors allocate to fixed income hedge funds, with the largest institutions being the most engaged (70%) [page 9].
- Performance expectations are high, with 15% aiming for annual returns exceeding 20% [page 10].

61% rank AUM as a priority when selecting a hedge fund manager

- Investors prioritize the asset class and predictability of returns when considering fixed income hedge funds [page 11].
- A small fund AUM and a lack of track record can be deal-breakers, with only 25% of investors globally willing to back first-time funds, highlighting a preference for established managers [page 12].
- New inflows are the primary source of funding, with some reallocations coming from equities and other alternative strategies, confirming a pivot toward fixed income strategies [page 11].

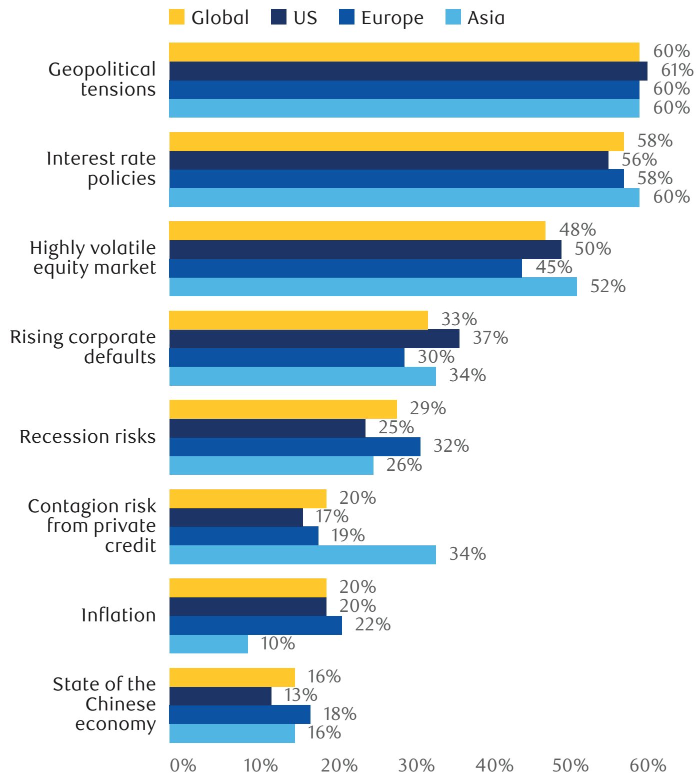
Fixed income market sentiment and allocation drivers

Macroeconomic conditions are shifting fixed income exposures

Investors remain highly attuned to the ongoing pressures on fixed income markets, including unresolved conflicts in the Middle East and Eastern Europe and macroeconomic factors such as sustained high interest rates intended to curb inflation. Asked to specify the principal factors that will impact the fixed income asset class over the next three to five years, investors most frequently cite geopolitical tensions (60%) and interest rate policies (58%). They are also concerned about the effect of high volatility in equity markets (48%).

Geopolitical tensions and interest rates are top of mind for investors globally

What do you think will be the main factors impacting fixed income over the next three to five years?



The desire to build resilience against potential future shocks is guiding investors toward alternative assets: 55% report that they are diversifying their portfolios to mitigate recession risks.

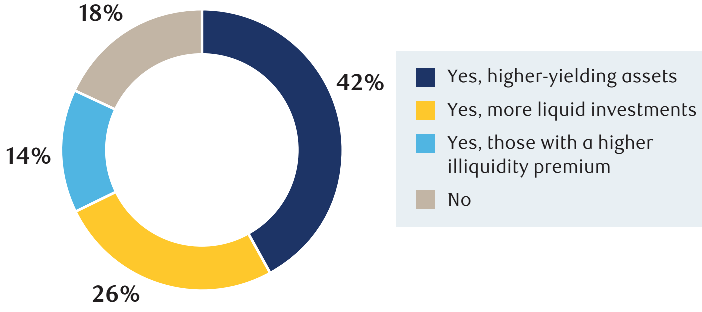
The desire for higher yield drives the search for alternative fixed income

In light of their macroeconomic outlook,
82% of investors say they are considering alternative types of fixed income exposure.

Consistently across regions, the highest proportions of investors (42% globally, rising to 46% in Asia) are turning to higher-yielding assets. However, 26% globally see the liquidity aspect as critical, especially European investors (32%). Confirming this, a smaller number of investors are prioritizing assets with a higher illiquidity premium (14%).

Investors are turning to higher-yielding assets

Are your macroeconomic expectations leading you to consider other types of fixed income exposure in your portfolio – and if so, which ones?



The results of our research, which was conducted just after the November 2024 US presidential election, signal an optimistic overall investor outlook for the economy despite the challenges mentioned above, with a majority (56%) turning to riskier assets (higher-yielding assets or those with an illiquidity premium). However, 49% of respondents were concerned about the impact of rising corporate defaults on their fixed income portfolios.

Perception of best risk-return opportunities varies between regions

When asked which fixed income asset class they expect to deliver the highest risk-adjusted returns, investors highlight US fixed income, leveraged finance, and emerging market (EM) debt. However, preferences vary significantly across regions.

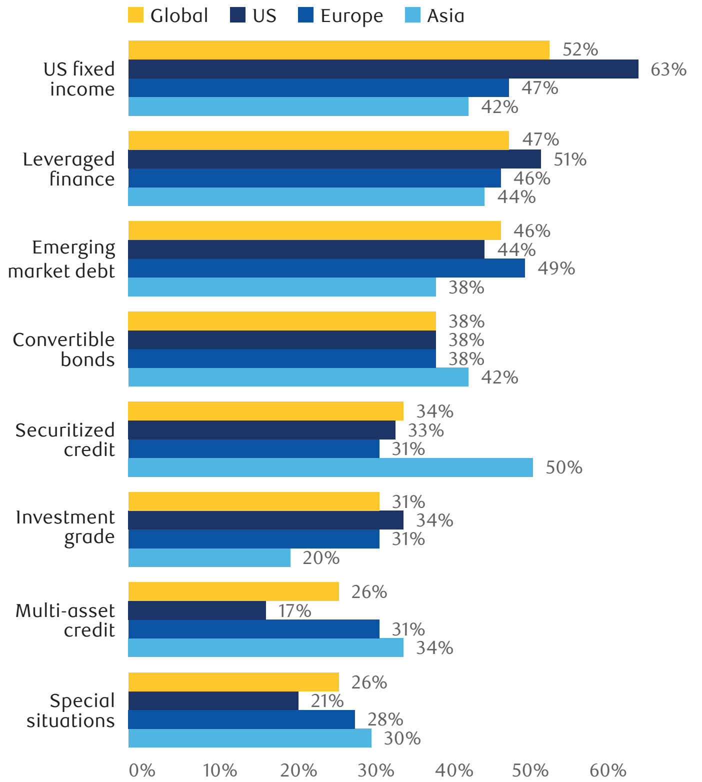
In the US (which makes up one-third of the research sample), investors are most enthusiastic about local fixed income (63%), due to its combination of strong yields, potential for capital appreciation, and defensive qualities in an uncertain economic and geopolitical environment.

While they are also drawn to US fixed income (47%), European investors make EM debt their top pick (49%). EM debt offers high yields, diversification benefits, and higher value compared with European and other developed markets. Also, many EM countries are issuing green and sustainable bonds, allowing Europe's ESG-focused investors to align their investments with sustainability goals.

Asian investors also focus on high yields and diversification, with half (50%) seeing significant upside in securitized credit. Instruments such as mortgage-backed securities (MBS), asset-backed securities (ABS), and collateralized loan obligations (CLOs) provide steady US-dollar-denominated cash flows. Their layered structure also offers flexibility, allowing investors to tailor exposure to meet diverse risk appetites and portfolio requirements.

Investors see the greatest returns from US fixed income, leveraged finance, and EM debt

Which fixed income asset class do you expect to generate the highest risk-adjusted returns in the next five years? (Ranked 1–3)



The evolving role of alternative fixed income

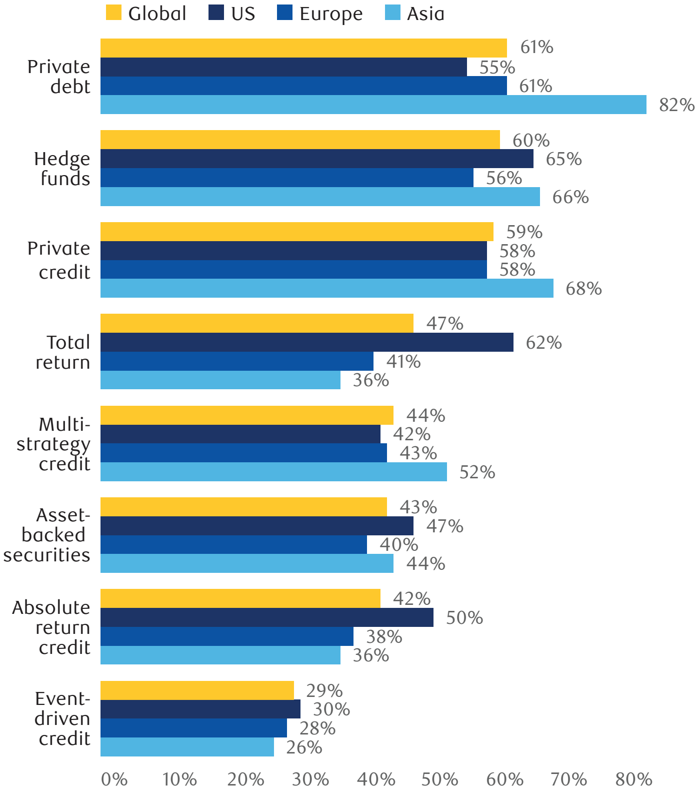
Current allocation trends show that fixed income is reshaping investor portfolios. Notably, there is a focus on alternative forms of fixed income, which provide investors with higher-yielding opportunities that align with their macroeconomic expectations.

Hedge funds and private markets take center stage

Investors appear drawn to private markets. Asian investors, in particular, have strong exposure to private debt (82%) and private credit (68%). Hedge funds are equally in demand, particularly in Asia (66%) and the US (65%), where total return strategies (62%) are also popular.

Private markets and hedge funds have a strong appeal

In which of the following do you currently invest?

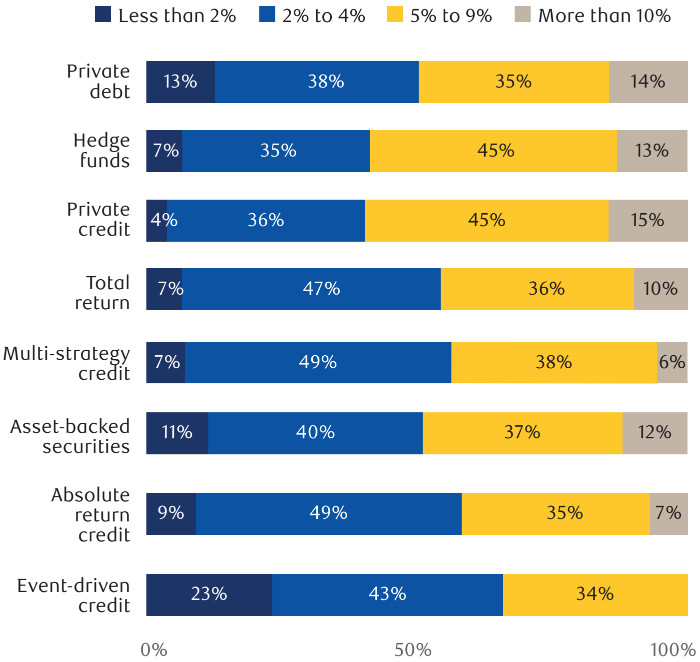


For all strategies except private credit and hedge funds, the highest proportion of investors report exposure of 2%–4%. Mean allocations (in ascending order) are between 4% and 6% for event-driven credit (3.9%), absolute return credit (4.9%), multi-strategy credit (4.9%), total return (5.2%), asset-backed securities (5.4%), and private debt (5.5%).

Mean allocations are highest for hedge funds (5.9%) and private credit (6.1%). For these strategies, a majority of investors – 60% and 58%, respectively – report exposure of 5% or above.

Allocations are highest for private credit and hedge funds

To the best of your knowledge, what is the exposure to the following within your portfolio?



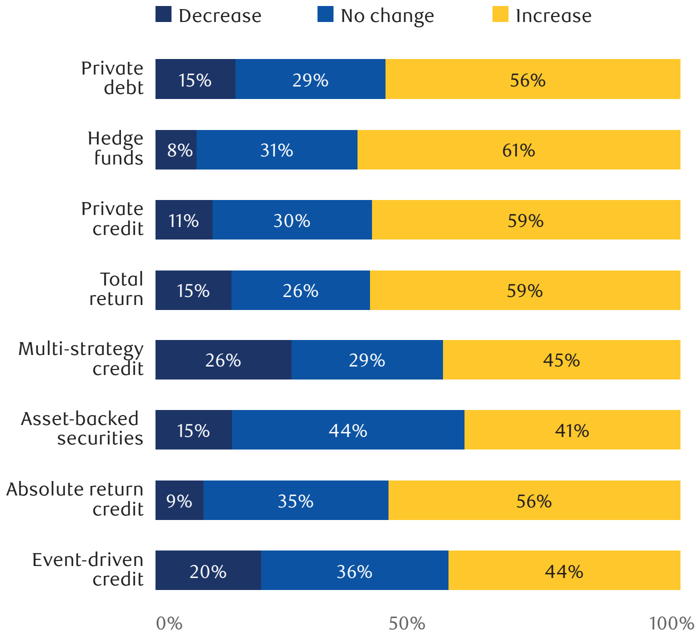
Investors are likely to increase alternative fixed income exposure

Alternative fixed income strategies are popular, with private debt, private credit, and hedge funds the most sought-after investment strategies among the options offered in our research, as around 60% of investors are already allocating to these.

And allocations are set to grow further. In the coming year, more than half of respondents plan to increase their exposure to hedge funds, private credit, and private debt. In fact, investors are more than seven times as likely to increase their exposure to hedge funds than to decrease it over the next 12 months. For private credit, they are more than five times as likely to increase their exposure and for private debt, more than three times as likely.

Investors plan to increase exposure to alternative fixed income strategies

How do you expect your exposure to the following to evolve over the next 12 months?

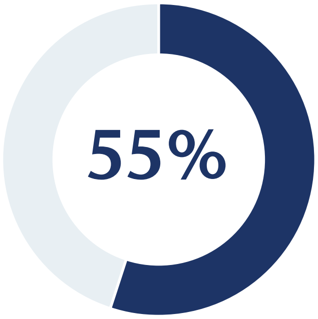


Renewed confidence in fixed income hedge funds

As investors turn to alternative investment strategies to generate returns, fixed income hedge funds, in particular, have become a core component of global asset allocation strategies.

Positive sentiment and impressive performance have led to mainstream adoption

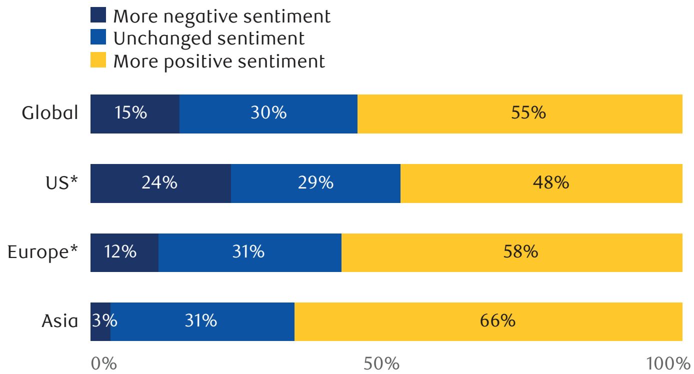
Globally, investor sentiment toward fixed income hedge funds has improved: 55% of those investing in such funds say they have taken a more positive view of them over the past three to five years, compared with 15% whose opinion has worsened and 30% whose opinion has not changed. This means that investors are three-and-a-half times as likely to have a positive opinion on fixed income hedge funds than to have a negative opinion.



of fixed income hedge fund investors say they have taken a more positive view.

Investors are nearly four times as likely to report improved than deteriorated sentiment about fixed income hedge funds

How has your view of hedge funds evolved over the past three to five years?



*Totals do not add up to 100% due to rounding

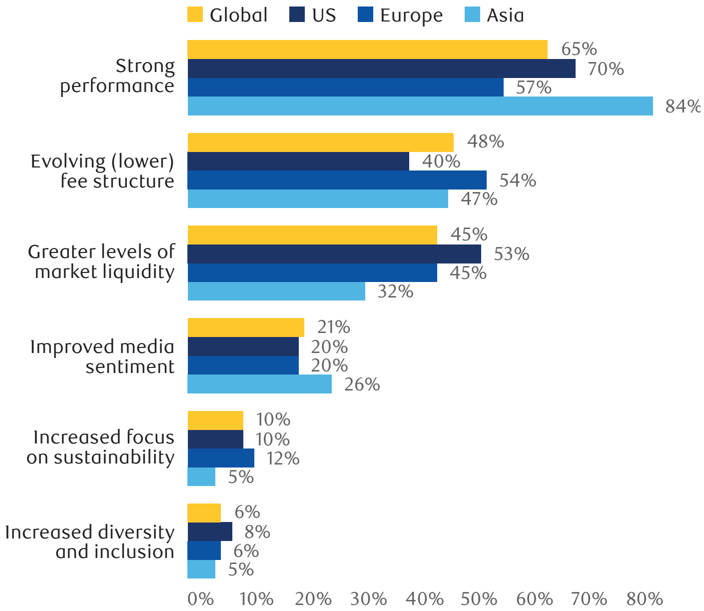
This may explain why, among the 60% of hedge fund investors, 84% invest specifically in fixed income hedge funds – effectively, around half of all participant investors across regions. Institutions with more than US$100 billion in AUM are most engaged, with 70% of them investing in fixed income hedge funds. These companies have greater resources that naturally endow them with enhanced risk tolerance, and the expertise to navigate complex strategies.

Among investors with more positive opinions of fixed income hedge funds, 65% say this is because of strong financial performance. This is more keenly felt in Asia (84%) and in the US (70%) than in Europe (57%).

63% of fixed income hedge fund investors expect returns of 10% or higher per annum

Performance is investors' top reason for feeling positive about fixed income hedge funds

What are the main reasons for the improvement in your sentiment on hedge funds?



With more managers willing to be flexible in terms of fee structure (notably moving away from the traditional "2% management fee + 20% performance fee" arrangement), this is investors' second-most important reason to be positive about fixed income hedge funds (48%). Wealth managers (69%) and smaller institutions with AUM of between US$5 billion and US$29 billion (67%) value this especially.

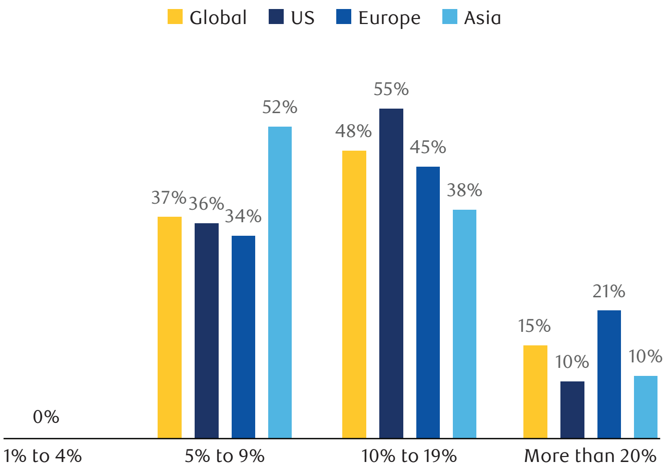
Investors' third-most important reason to be positive about fixed income hedge funds is liquidity. Increased competition has led managers to introduce more flexible redemption terms, improving the liquidity profile of the asset class, which is a benefit for 45% of investors. This rises to 53% of US investors and 55% of institutions with AUM of between US$30 billion and US$74 billion.

The majority of investors expect double-digit returns

Investors have elevated expectations of annual returns from fixed income hedge funds: 63% aim for returns of 10% or higher. This increases to 75% among wealth managers. At the higher end, 15% of investors globally expect returns to exceed 20%, with European investors the most bullish (21%).

Nearly two-thirds of fixed income hedge fund investors expect returns of 10% per annum or above

When allocating per annum to hedge funds, what target returns do you expect from your manager?



*Totals do not add up to 100% due to rounding

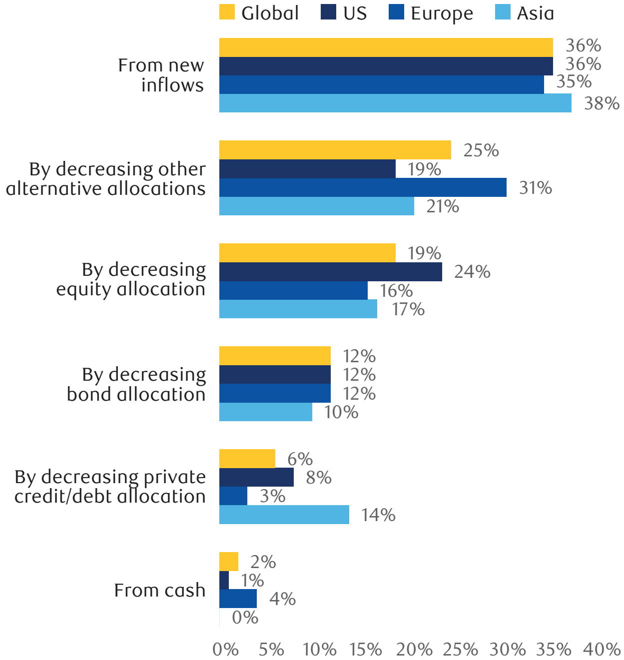
While 62% of investors worldwide say that the past performance of their portfolios has met or exceeded their future return expectations, 38% say it has fallen short. US investors (44%) and institutions with AUM of between US$30 billion and US$74 billion (46%) are the most likely to report a negative disparity.

Nevertheless, the outlook remains optimistic. With interest rates high, investors anticipate greater yields from fixed income instruments and opportunities for skilled hedge fund managers to exploit pricing inefficiencies.

This leads investors to direct new capital raised toward fixed income hedge funds or to reallocate capital from other strategies, notably equities and other alternative strategies such as private equity, real estate, or infrastructure.

Investors are primarily funding their fixed income hedge fund allocations from new inflows

How are you mainly planning to fund your allocation to hedge funds?



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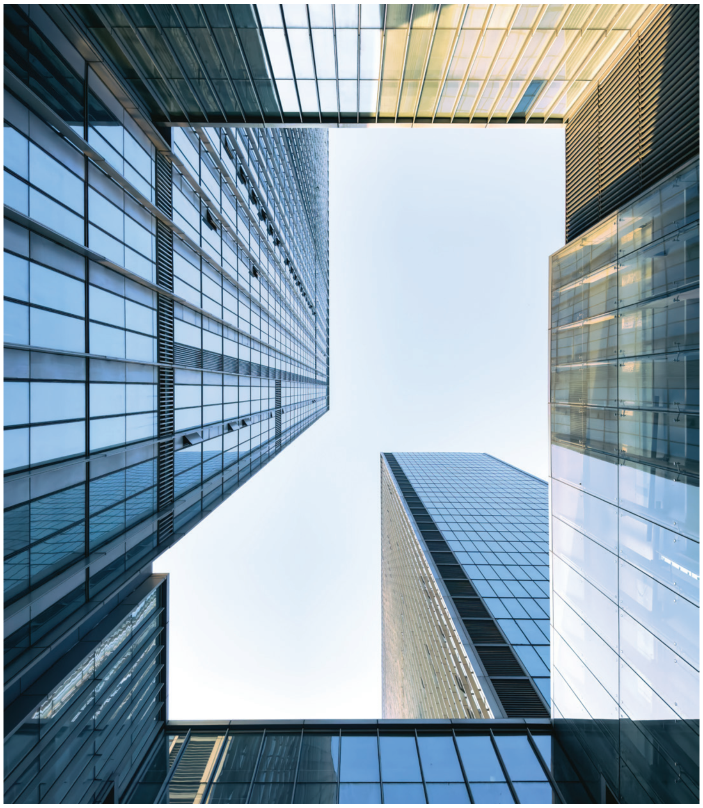


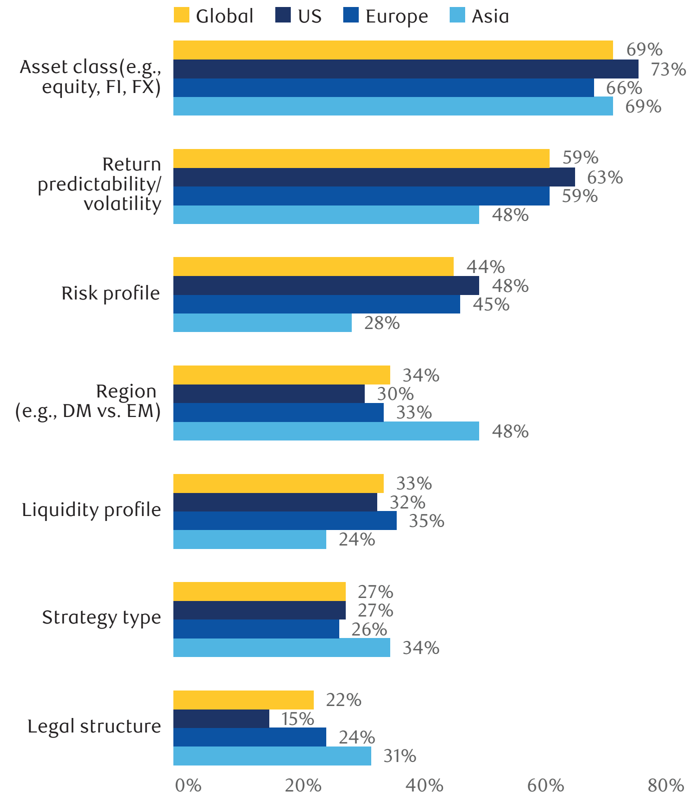
Smaller fund sizes and the lack of a track record can be deal-breakers

When assessing potential allocations to fixed income hedge funds, investors across regions and investor types consistently prioritize two factors: the asset class and a fund's predictability/volatility of returns.

These factors are especially significant for wealth managers, who use them to align investments with client objectives and risk tolerances while ensuring consistent performance: 77% of wealth managers (vs. 69% across investor types) prioritize the asset class, and 69% (vs. 59%) focus on predictability of returns.

Globally, asset class and predictability of returns are main factors

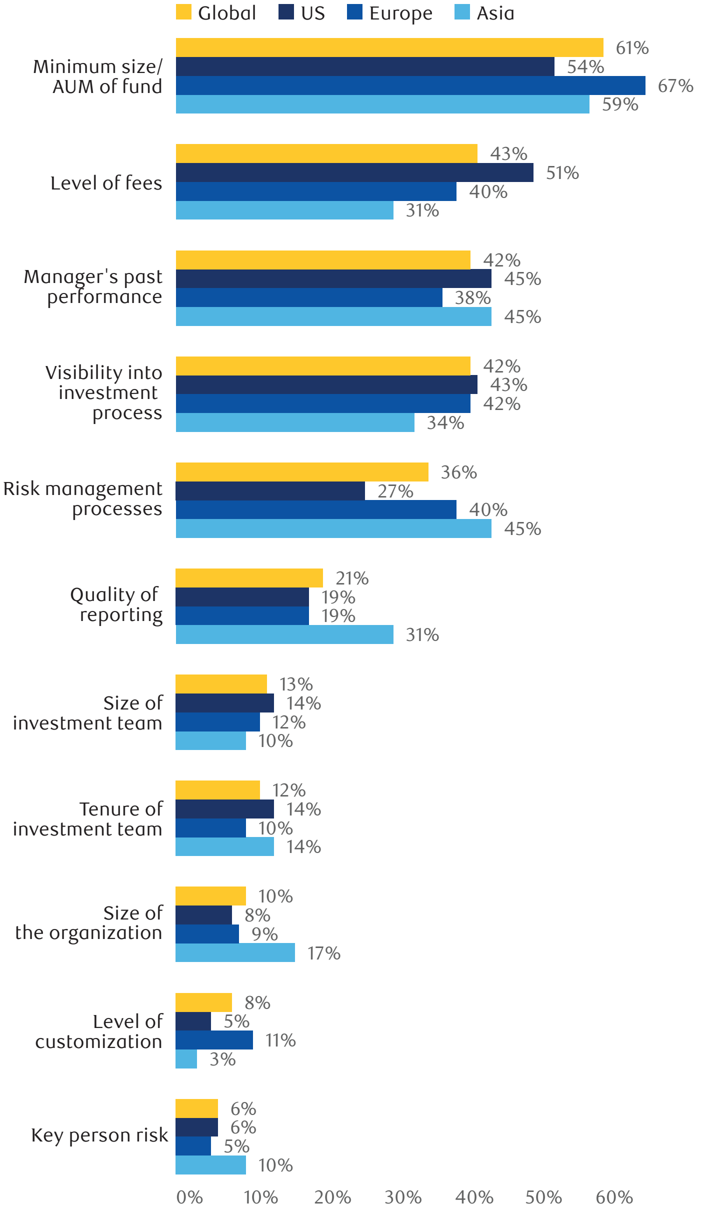
Which of the following factors are most important to you when considering an allocation to hedge funds?



When selecting managers, investors say that size of fund AUM is a crucial criteria: 61% say this is their top priority, ahead of a fund's fees and manager's past performance. This is an especially decisive factor in Europe, where investors traditionally focus on stability, operational robustness, and risk management. This means a larger AUM size will tend to align better with their regulatory, cultural, and institutional priorities.

Size of fund AUM carries more weight than fees or performance

Which of the following criteria do you prioritize when choosing a hedge fund manager?



A long track record is also paramount when investing in fixed income hedge funds; only 25% of investors say they are willing to consider a first-time fund. Enthusiasm is lowest in this respect in the US, where only 20% appear ready to back a newcomer.

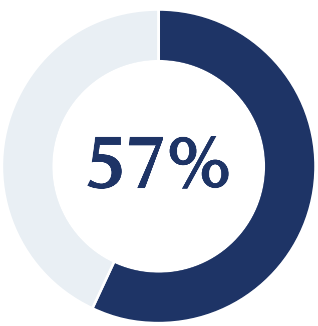
These preferences underscore investors' demand for large-scale, established, and reliable investment strategies when it comes to fixed income hedge funds.

The regional and investor-type view

US

Looking at investors by region, US respondents are particularly highly invested in hedge funds, with 65% currently investing, compared with 60% globally. This trend is likely to continue, with 61% planning to increase their exposure, including 20% who plan a significant increase. Among those investing in hedge funds, nearly 9 in 10 (87%) invest in fixed income hedge funds, meaning 57% of the US investors participating in our research allocate to the asset class, despite a higher number reporting that returns from fixed income hedge funds were lower than expected (44% vs. 38% globally).

US investors are slightly less enthusiastic than those elsewhere about fixed income hedge funds, with only twice as many investors reporting improved rather than deteriorated sentiment, compared with a global ratio of 3.6. However, return expectations were slightly higher than across regions, particularly for the 10%–19% expectation bracket, which 55% targeted (compared with 48% globally). These high yet unmet return expectations may explain why US investors appear highly sensitive to pricing: 51% (vs. 43% across regions) say the level of fees is a top consideration in selecting a hedge fund, just behind AUM size (54%).

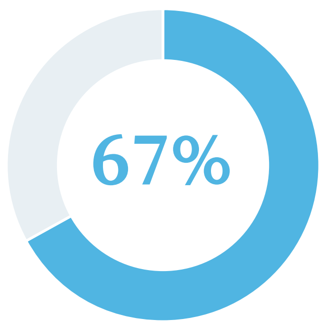


of US investors allocate to fixed income hedge funds.

Asia

The region whose investors are most enthusiastic about hedge funds is Asia. The underperformance of local equity markets compared with those in the US is most likely to drive this, prompting Asian investors to adopt alternative investment strategies. Currently, nearly two-thirds (66%) of these investors allocate to hedge funds, with 58% specifically investing in fixed income hedge funds. While the average allocation to hedge funds in Asia (5.2%) is slightly below the global average (5.9%), 67% of Asian investors plan to increase their exposure, representing the highest proportion worldwide.

Overall sentiment among Asian investors is bullish: they are 22 times more likely to report an improved than a deteriorated opinion of fixed income hedge funds. Owing to lower-than-average return expectations, Asian investors are notably more inclined than those in other regions to say that actual returns met or exceeded expectations (72% compared with 62%). Asian investors are also more likely to consider a fund's region of focus (emerging markets vs. developed markets, 48%) as a main factor than investors in other regions, which may indicate a bias toward investing in local growth markets.



of Asian investors plan to increase their allocation to hedge funds, the highest proportion by region

Europe

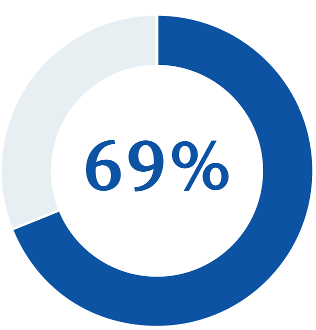
In Europe, investors in Switzerland (64%), the UK (62%) and the Nordic countries (58%) are the most likely to invest in hedge funds, while those in Germany (34%) are the least inclined. Among hedge fund investors in those countries, around four in five invest in fixed income hedge funds.

German investors are slightly more concerned about interest rates (64% vs. 58% globally) than geopolitical tensions (59% vs. 60%) when it comes to impact on fixed income. They are also unique in prioritizing more liquid investments (42%) over higher-yielding assets (32%) based on their macroeconomic outlook. Additionally, the largest share of investors (58% vs. 46%) believe emerging market debt will offer the highest risk-adjusted returns over the next three to five years.

UK investors are also particularly aware of the impact of interest rates on fixed income (62% vs. 58% globally). Their return expectations are also higher than in other regions, with 71% (vs. 63% globally) targeting annual returns above 10%, though only 53% report actually achieving this. This could explain why slightly fewer UK investors (49% vs. 55% globally) say their view of hedge funds has become more positive. When selecting a fixed income fund, UK investors place greater emphasis on AUM size (69% vs. 61%) but are less focused on fee levels (33% vs. 43%).

With mean allocations at 7.1% (vs. 5.9% globally), Nordic investors have a high exposure to hedge funds. They are twice as likely (28% vs. 13% globally) to report allocations exceeding 10%. This trend is set to grow, as Nordic investors are the most eager among European investors to further increase their hedge fund exposure, with 69% planning to do so.

Swiss investors are the only ones globally to identify convertible bonds (48% vs. 38%) as the fixed income asset class most likely to deliver the highest returns over the next three to five years. They also have the highest exposure to private debt (70% vs. 61%), while their average allocation to hedge funds (5.8%) aligns closely with the global average (5.9%).



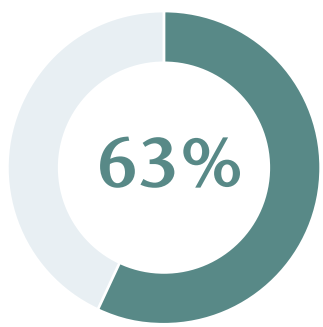
of Nordic investors plan to increase their hedge fund exposure, the highest proportion among European investors.

Asset owners vs. wealth managers

Asset owners — including pension funds, insurance companies, endowments, family offices, and sovereign wealth funds — have slightly lower hedge fund exposure than wealth managers (59% vs. 64%). However, they are eager to close the gap, with 63% planning to increase their allocations.

Wealth managers' enthusiasm for fixed income hedge funds, in particular, may be due to this asset class historically meeting their high return expectations: 75% (vs. 60% of asset owners) were aiming for annual returns above 10%, with 67% (vs. 42% of asset owners) claiming this was actually achieved. This may explain why more than two in five (42%) wealth managers are shifting their allocations from other alternative strategies to fixed income hedge funds.

Asset owners are planning to fund their fixed income hedge fund allocation with new inflows (36%, on par with the global average). They are three times more likely than wealth managers to consider the tenure of a fixed income hedge fund's investment team or the overall size of an organisation when making their selection, while wealth managers appear particularly sensitive to pricing, fund AUM size, and visibility into investment processes.



of asset owners plan to increase their allocation to hedge funds.

Conclusion

Amid intensifying geopolitical tensions, high interest rates, and market volatility, investors globally are recalibrating their portfolios to balance risk and return. The findings of this report highlight a strong and growing appetite for alternative fixed income strategies, driven by the potential for higher yields, diversification benefits, and resilience in the face of macroeconomic challenges.

Hedge funds and private markets have become central pillars of fixed income allocations, with a majority of investors planning to increase exposure in the coming year. The enthusiasm for fixed income hedge funds, in particular, highlights their mainstream adoption as a core component of global investment strategies. Robust performance, competitive fee structures, and enhanced liquidity drive improved sentiment toward these funds. Despite concerns about unmet return expectations, the overall outlook remains positive, with many investors targeting double-digit returns from their fixed income hedge fund investments.

There is a clear emphasis on scale and track record. Larger, more established funds with transparent processes and sizeable AUM are preferred options, reflecting investors' cautious yet optimistic approach. There are regional and investor-type variations, with wealth managers leading the way in enthusiasm, US investors focusing on cost-efficiency, and European investors prioritizing stability and regulatory alignment. Together, these preferences underscore the demand for established, reliable, and well-structured options in the alternative fixed income space.

"We believe we are in the golden age for fixed income hedge funds. Geopolitical tensions and interest rate policies continue to be top of mind for investors, and the resulting uncertainty is likely to create volatility in the markets. We believe funds that can play the markets from both the long and short side are particularly well placed to capitalize on the mispricings and inefficiencies created by this volatility to deliver positive returns, regardless of the market direction".

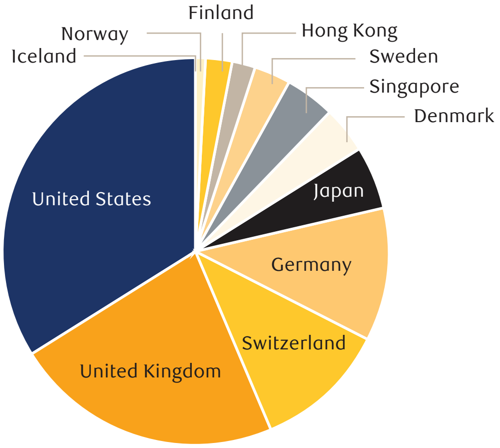
Polina Kurdyavko
Hedge Fund Manager
Head of BlueBay Emerging Market Debt
at RBC Global Asset Management

Research specifications

The research team implemented a targeted outreach using a Computer Assisted Telephone Interviewing methodology. There is a 95% confidence level in the accuracy of the findings, with a sampling tolerance of +/- 4.6%. We completed the research study in November 2024 after the US presidential elections according to the following specifications:

Demographics

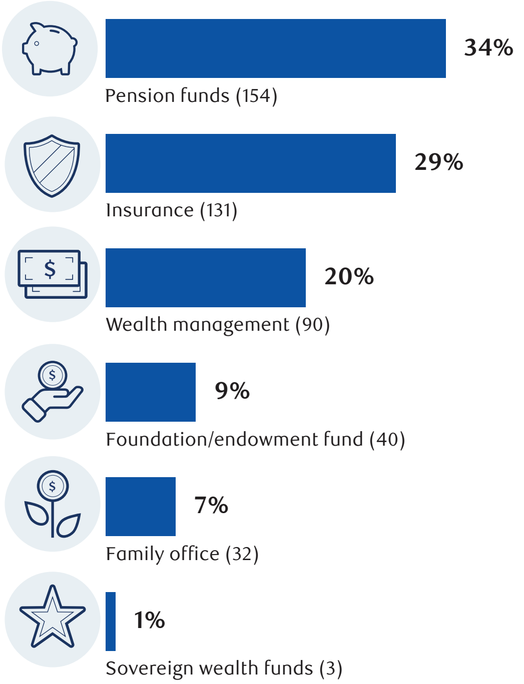
450 senior investment decision-makers located in the US (150 respondents: 33%), **Europe** (250 respondents: 56%), **and Asia** (50 respondents: 11%)

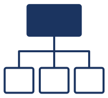


- 33% United States (150)
- 22% United Kingdom (100)
- 11% Switzerland (50)
- 11% Germany (50)
- 5% Japan (23)
- 4% Denmark (20)
- 4% Singapore (17)
- 3% Sweden (15)
- 2% Hong Kong (10)
- 2% Finland (10)
- 1% Norway (4)
- 0% Iceland (1)

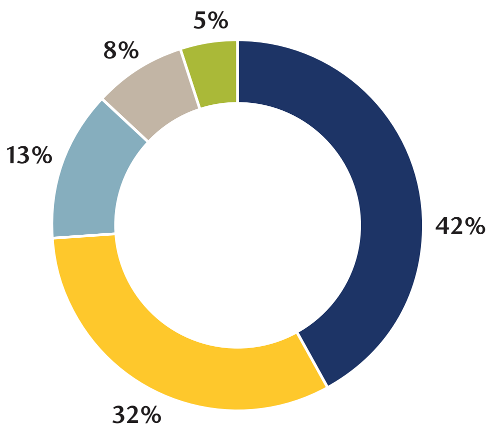
*Totals do not add up to 100% due to rounding

85% were working in financial services (insurance, pension funds, wealth management, foundation/endowment, family office, sovereign wealth funds), with 15% being trustees from corporate pension funds.



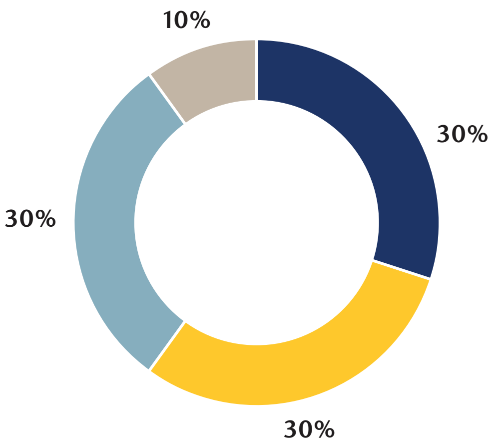


42% C-suite, 58% C-1 level



C-suite | Senior director/director | Head of department | Board member | Senior vice president/vice president

AUM ranging from US$5 billion to more than US$100 billion



$100bn + | $75bn–$99bn | $30bn–$74bn | $5bn–$29bn

Source: RBC Global Asset Management as at November 2024

The BlueBay fixed income alternatives platform brings over 20 years of experience and a strong track record of performance. Our expertise is built on a credit alternatives heritage, specialist teams within a robust infrastructure, and a performance-driven culture. Our alternatives span the spectrum across absolute return and total return strategies, both liquid and illiquid.

RBC Global Asset Management