US Rates Strategy

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Hedge fund liquidity

Hedge fund balances have grown rapidly in the past year. Regulators have focused on leverage and certain types of relative value trades. We examine recent trends in the liquidity of their portfolios and financing.

- **Hedge fund gross assets have risen 16% in the past year**. The ratio of gross to net asset values rose to 2.53 in March.[1] This rough measure of industry leverage has been above its 2019 peak since September 2019.

- Hedge fund repo borrowings are top-heavy; the top ten largest funds account for about 57% of this borrowing. Most of hedge funds' secured borrowing is provided by domestic and non-US GSIB banks.

- **As of March 2025, just over half of their financing was in tenors under 7d**. The remainder was at longer maturities so the that the estimated WAM of their overall borrowings in about 54d.

- Portfolio liquidity reflects how quickly the funds can liquidate their assets without a price discount. Nearly 65% of their assets could be monetized within a week as of last March.

- **The ratio of hedge funds' weekly portfolio to funding liquidity (in dollar terms) is about 2**. Similarly, hedge funds hold about $4.12trn in assets that can be monetized within a day compared to $2.61trn in overnight financing. In a pinch, funds can raise significantly more money from their assets than their financing needs at both overnight and one-week tenors.

Rising balances and repo borrowings

At the end of March hedge funds gross asset values were up 16% from a year earlier. Excluding their liabilities, net asset values were up more modestly. As a result, the ratio of gross to net asset values moved higher, rising from 2.30 to 2.53. **This rough measure of hedge fund industry leverage has been above its 2019 peak since September 2023** (Figure 1). Large hedge funds (those with holdings more than $500mn) have increased their long Treasury positions by 38% or $620bn in the last year. This has been accompanied by an increase their overall repo borrowing (against all collateral types) of 43% or $800bn (Figure 2).

The increase in both Treasury longs and repo borrowings has drawn the attention of regulators focused on certain types of relative value trades that require high amounts of leverage. Although estimates of the size of the cash-futures basis trade are imprecise, regulators are concerned that a

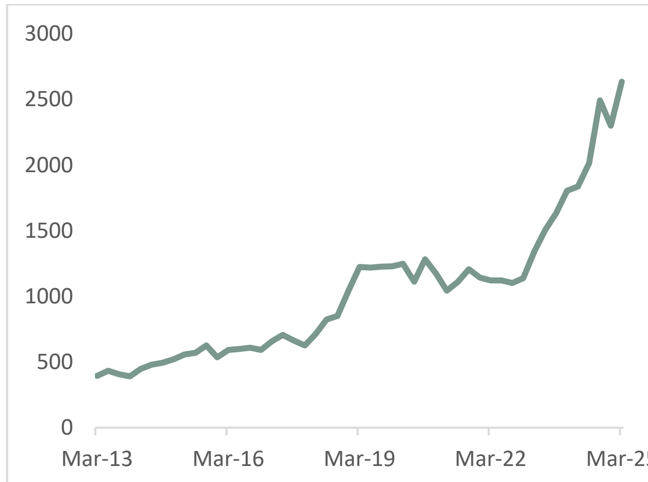
[1] This is across all strategies – some strategies and portfolios use significantly more leverage.

spike in repo rates could trigger the same destabilizing unwind as in late 2019.[2] This is especially concerning since, like now, the Fed was nearing the end of its balance sheet unwind. That said, while hedge fund Treasury selling contributed to the secondary market illiquidity, they were not the only sellers. Mutual funds and foreign official institutions were also heavy sellers.

Figure 1: Hedge GAV/NAV

Source: SEC, SMBC Nikko

Figure 2: Hedge fund repo borrowing ($bn)



Note: This is against all collateral types. Source: SEC, SMBC Nikko

Hedge fund repo borrowing is concentrated at the larger funds. Of the roughly $2.6trn in hedge fund repo, about $1.5trn was borrowed by the ten largest funds by gross assets. However, these funds also source their credit from a wider mix of providers than smaller funds. They have an average of 21 counterparties compared to 12 or fewer for the smaller funds. Hedge funds' borrowing comes mostly from banks. US GSIBs account for 51% and non-US GSIBs provide another 36% of their funding. Hedge funds' secured borrowings are overcollateralized by about 11%. It is not clear how much of the recent decline reflects a shift in the *type* of collateral being pledged; overcollateralization might decline if activity has shifted more toward Treasury positioning since these trades have lower haircuts.

Liquidity management

While much of the focus on hedge funds' activity centers on their use of leverage, their liquidity management may be just as significant. Hedge funds must be able to balance their portfolio and funding liquidity without triggering asset fire sales.[3]

We examine the ratio of hedge funds' portfolio to financing liquidity. **Portfolio liquidity measures the proportion of the hedge fund's portfolio can be sold without loss over different maturities**. Less liquid assets require more time to monetize and, correspondingly, more term financing. As of March 2025, hedge funds reported that they could liquidate 63% of their holdings in a week without incurring losses (Figure 4). By contrast, roughly half of their funding comes due without a week. **In dollar terms, however, the ratio of portfolio to funding liquidity is about 2**. That is, in a crunch hedge funds can

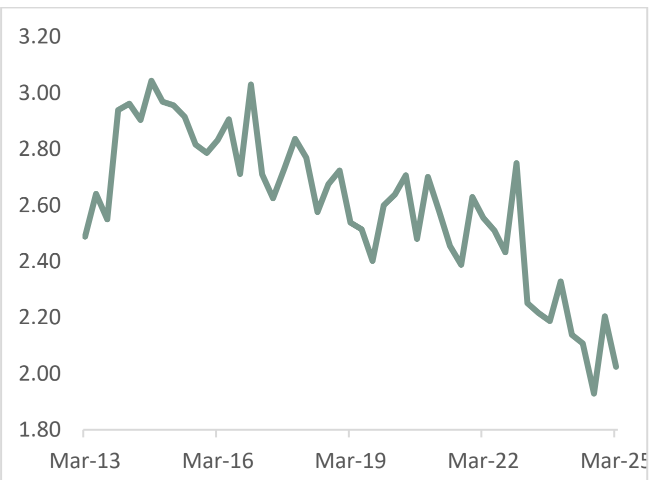
[2] See, "Quantifying Treasury Cash-Futures Basis Trades", J. Gilcoes, B. Iorio, P. Monin, L. Petrasek, Federal Reserve Board, March 8, 2024.
[3] See, "Hedge Fund Liquidity Management", G. Aragon, A.T. Egun, M. Getmanksy, G. Girardi, SEC Department of Economic and Risk Analysis, May 2017.

raise twice as much money from selling their holdings as their weekly financing need (Figure 3). This is also true with respect to their overnight liquidity. Industry-wide, hedge funds hold about $4.12trn in assets that can be monetized within a day compared to $2.61trn in overnight financing (1.58).

Because most hedge funds have fairly long redemption waiting periods, the proportion of industry NAVs that can leave within 7d is only 9% compared to the 66% that cannot be withdrawn for 90d or longer.

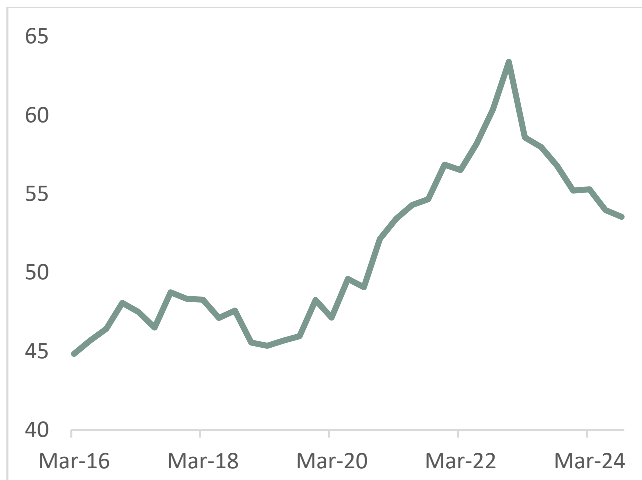
Following Aragon et al, we calculate rough estimates of hedge fund portfolio and liquidity weighted average maturities (WAMs). Since the SEC data are only available as percentages across maturity buckets we have to make two assumptions. First, for each bucket we assume the maturity is the mid-point and second, we assume any maturity longer than 1y is 365d. The data are not granular enough for us to determine if the midpoint assumption is a fair approximation of maturity distributions. In addition, the SEC data are released with a long lag so our WAM snapshot is only through September 2024. Finally, the Aragon et al, analysis was done at the individual hedge fund level. By contrast we are working with industry averages. **With these limitations in mind, the estimated portfolio WAM is 118d while the WAM on hedge funds' financing is shorter at 54d** (Figure 4). The latter has fallen about 10d since 2022. Finally, as noted above, investors liquidity is long; the WAM on their redemptions is about 214d.

Figure 3: Weekly portfolio-to-funding liquidity



Source: SEC, SMBC Nikko

Figure 4: Estimated financing WAM (d)



Source: SEC, SMBC Nikko

Our sense is that the *trends* in portfolio and funding liquidity may matter more than the actual day count. In the last year, portfolio WAMs have been lengthening alongside a shortening in financing tenors. Nevertheless in absolute dollar terms hedge funds still have significantly more monetizeable assets than their immediate liquidity needs.

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