# Wealthy investors shift from MFs, PMS to Cat-III AIFs in hedge against volatility

This shift towards AIFs is a relative movement of capital away from traditional, long-only products such as mutual funds and PMS into hedge-style, long-short, quant and absolute-return funds, that offer lower volatility, downside protection and more stable returns.

Wealthy Indians are pouring more money into Category III Alternative Investment Funds (AIFs) this year, driven by a volatile market that has delivered disappointing returns and growing comfort with hedge fund-styled strategies.

AIFs are private investment instruments that pool money to invest in a wider range of assets compared to traditional stocks and bonds.

Sebi data reviewed by Moneycontrol has shown that Cat III AIFs have mobilized commitments worth Rs 62,471 crore during the first half of FY26, already touching nearly 70 percent of the full-year tally of FY25, which saw inflows of Rs 89,587 crore. This sharp acceleration comes at a time when the benchmark indices have delivered muted returns over the past one year and large parts of the market, especially the mid and smallcaps have seen periods of sharp correction.

Wealth managers said this shift reflects a relative movement of capital away from traditional, long-only products such as mutual funds and PMS strategies into hedge-style, long-short, quant and absolute-return funds, that offer lower volatility, downside protection and more stable returns.


## Muted Market Returns: Push to AIFs?

A major part of the surge is being driven by the market backdrop. "Investors—particularly HNIs and ultra-HNIs—are reallocating meaningfully towards Category III AIFs because public market returns have been muted over the past year. Equity indices across large, mid and small caps have either been flat or negative, and many portfolios have underperformed," said Ajay Vora, Head of Equities at Nuvama Asset Management.

When markets appear fully priced, and forward returns look subdued, investors seek products that provide better visibility, said Vora.

"When markets look slightly over-priced and returns are subdued, investors tend to shift allocation to products that give them better visibility of returns. Cat-III vehicles fit that need by offering strategies with more predictable outcomes and lower volatility than traditional long-only equity products."

This has reflected in the fund-raising trend this year.

Sebi data showed that Cat III commitments have risen quarter-on-quarter through the first half of FY26, underscoring a growing investor urgency to hedge equity exposure. Wealth advisers said that after nearly a year of sideways markets, many HNIs have started trimming mutual fund and PMS allocations while leaning into long-short products for stabilising their portfolios.

## Rise of Hybrid and Absolute-Return Strategies

Another structural tailwind for AIFs is the innovation within Cat III strategies. Ajay Vora said that hybrid funds blending listed equities with unlisted or pre-IPO exposure have gained traction.

"A major driver has been the rise of innovative hybrid strategies, particularly funds that combine listed equities with pre-IPO or unlisted exposure in structures such as 70:30 or 51:49. These portfolios offer stability because the unlisted component does not fluctuate daily. Cat 3 structures also allow thematic plays that PMS or mutual funds cannot execute."

The strongest demand, however, is coming from absolute-return funds, widely marketed as "fixed-income-plus-plus" products that deliver returns superior to debt while keeping volatility low.

"When the markets are volatile and sideways, the strategy can generate anything between 8–10% post-fees, post-tax depending on manager to manager. With the Nifty delivering flat or negative returns over the last year, absolute-return funds offering ~8-10% with much lower volatility have become especially attractive to family offices and corporate treasuries."

## Awareness Driving Adoption

The AIF industry has also seen a trend of rising financial sophistication among Indian HNIs, with investor comfort growing as more Cat III managers build multi-year track records.

On increasing awareness, Vora said that several managers have now demonstrated 2-4 years of performance, which has improved the comfort levels with Cat III structures, even if the strategies remain relatively complex.

Vaibhav Sanghavi, CEO of ASK Hedge Solutions said the shift is being powered by a deeper understanding of risk-adjusted returns.

“One of the driving factors on the increase in allocation is the increasing awareness on ‘Risk Adjusted Returns’ along with the operational ease. Investors in their portfolios are looking at uncorrelated returns to give stability on their portfolio with potential alpha within their respective buckets.”

He added that conversations with clients have evolved significantly. “It is very heartening to see investors asking questions on standard deviation, drawdowns, tail risks etc., inferring much evolved understanding of financial products.”

Sanghavi said this is part of a broader shift in portfolio construction, not a temporary trend triggered by short-term uncertainty or global rate pivots.

“In our view it is more structural than the temporary movement and volatility of the markets. Though, the intermittent volatility helps in the pace of fund raising. Portfolios in India have on an overall basis much lesser allocation to these strategies when compared with global standards.”

## Shift Away From PMS and MFs?

While PMS and equity mutual funds continue to dominate domestic equity flows, market participants are seeing a growing subset of wealthy investors diversifying towards differentiated strategies.

While each product class has its place, Cat III funds offer tools unavailable in traditional equity vehicles, said Vaibhav Sanghavi.

“Category III funds, which have the ability to leverage and flexibility to go short, can add a lot of value to the portfolio by mitigating risk and enhancing returns by generating alpha with a well-laid-out process,” he added.

This flexibility of going long on expected winners and short on potential underperformers is one of the key reasons why many clients are trimming long-only exposure after a year of flat returns in equity markets.

## Taxation Still a Pain Point

Despite the strong inflows, taxation continues to be a barrier for broader adoption. “Taxation continues to be a challenge, especially on the derivatives in an AIF,” said Sanghavi.

The industry has been lobbying for pass-through taxation to bring Cat III funds at par with other investment vehicles, a move that would help attract more domestic and global investors.

## Way Forward

Even if equity markets rebound later this year, wealth advisers expect the structural demand for low-correlation, lower-volatility and hybrid strategies to sustain.
“As markets normalise, some money may move back to long-only equity, but the absolute-return and hybrid Cat-III space will remain and continue to grow, supported by investor appetite for risk-adjusted returns and lower-volatility yield-style products,” said Nuvama’s Vora.