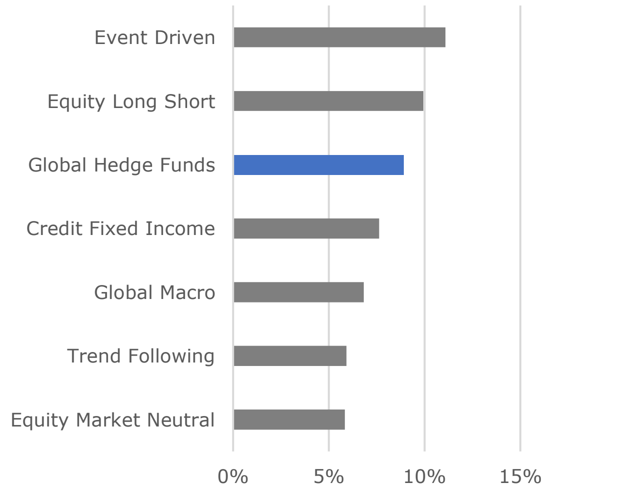

# Hedge Funds Review & Outlook

**Investment Insight | Series X**

## Hedge Funds Review 2021

Hedge funds delivered a solid positive performance in 2021 across all sub-strategies. From a long-term historical perspective, the returns were all above average, benefitting not only from the benign market sentiment, but also from the generally positive market environment for active hedge fund managers. Overall, strategies with higher market exposure outperformed over the year. However, a certain decoupling from this tendency has been noticed during the last few months of the year. Distinct trends, for example on the commodity, currency or interest rate side, shaped the market. An ideal environment for global macro managers and trend followers (data as per November 21). 2021 has proved once again that it is not enough to determine the right hedge fund portfolio mix based on a "top-down" decision alone. It is vital to identify the manager strategies "bottom-up", ensuring that the return target and diversification characteristics can be achieved. The chart on the next page at the top demonstrates, how the dispersion within the strategies, thanks to lower volatility, unsurprisingly decreased compared to 2020. Nevertheless, performance within the same individual sub-strategies highly differed among the sub-managers.

**Chart 1: Hedge Funds Performance Nov 2021 YTD**



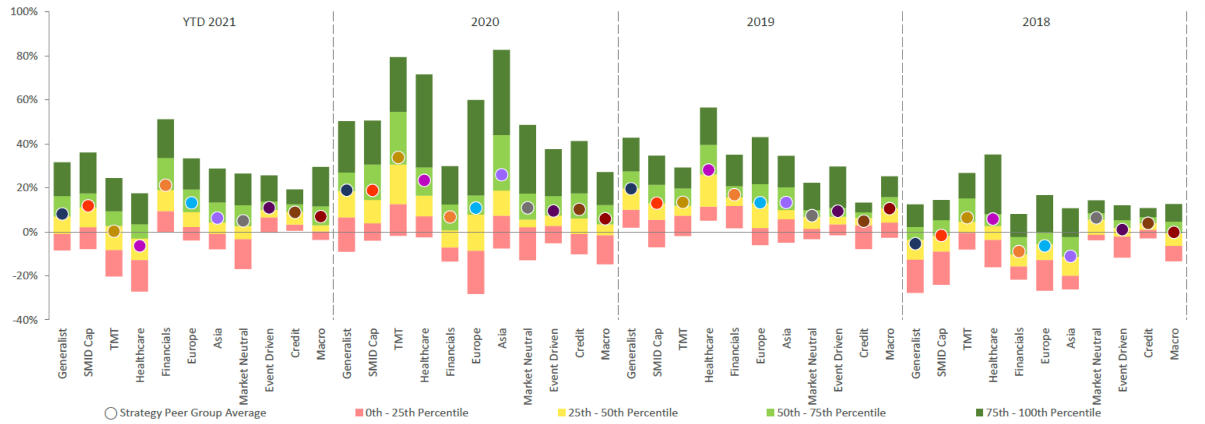

Source: Bloomberg Finance L.P., HFR, Alpinum IM

**Chart 2: Hedge Funds Performance 2018 – 2021**

| | YTD-Nov | 2020 | 2019 | 2018 |
|---|---|---|---|---|
| HFRI Global Hedge Funds | 8.9% | 11.8% | 10.4% | -4.7% |
| HFRI Equity Long Short | 9.9% | 17.9% | 13.7% | -7.1% |
| HFRI Equity Market Neutral | 5.8% | 6.3% | 6.5% | 0.0% |
| HFRI Event Driven | 11.1% | 5.4% | 6.5% | -4.1% |
| HFRI Credit Fixed Income | 7.6% | 3.1% | 7.1% | -5.5% |
| HFRI Global Macro | 6.8% | 9.3% | 7.5% | -2.1% |
| HFRI Trend Following | 5.9% | -0.1% | 2.3% | -1.0% |

Source: Bloomberg Finance L.P., HFR, Alpinum IM

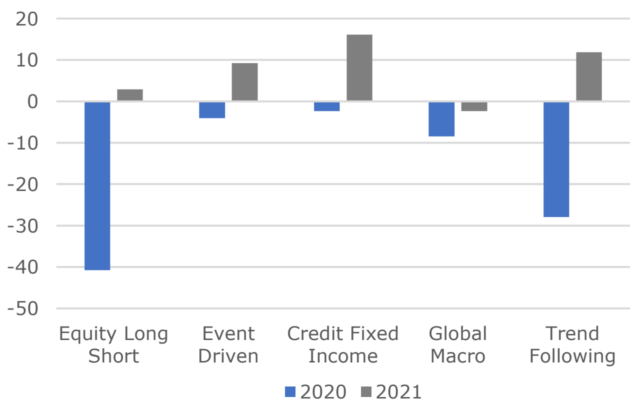
**Chart 3: Calendar Return Quartiles – Strategy Average vs Peer Group**




Source: Cowen

## Hedge Fund Flows & Launches

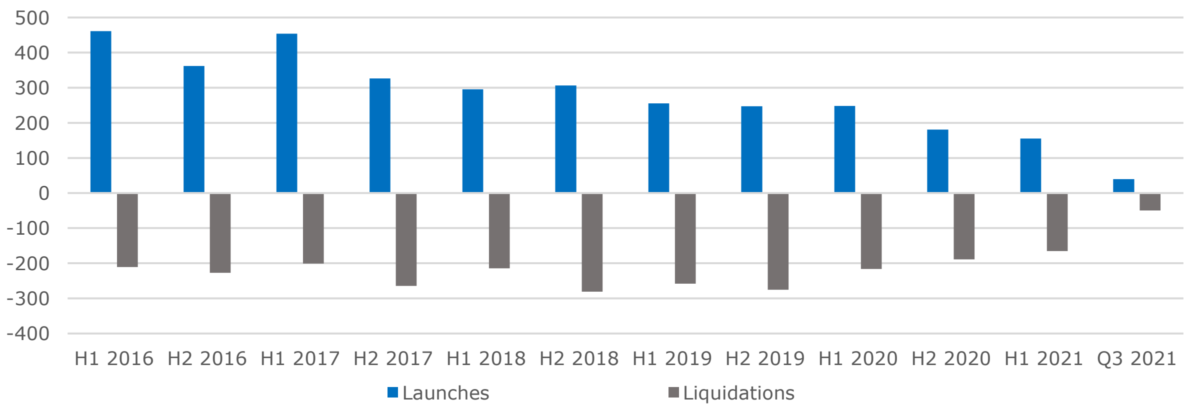
**Chart 4: In- and Outflows in Hedge Funds**




Source: Eurekahedge, Alpinum Investment Management

Comparing Eurekahedge's data on HF in- and outflows on a YTD basis through October 2021, the hedge fund industry benefitted of a net inflow of USD 90.7 bn. A respectable reversal from the roughly USD 91.5 bn outflows in 2020. In particular Credit Fixed Income, Trend Following and Event Driven managers attracted most of the new capital in 2021. We noted that the beneficiaries of the inflows were mainly larger HF managers with portfolios of USD 1 bn plus. The decrease of new fund launches (launches minus closures; net -20 funds) underlines our observation. Thus, the trend towards larger, more established managers continued, further fueled by limited global travel activities. Investors tended to refrain from making additional investments in new managers. Instead, they preferred to remain with well-known, reputable companies.

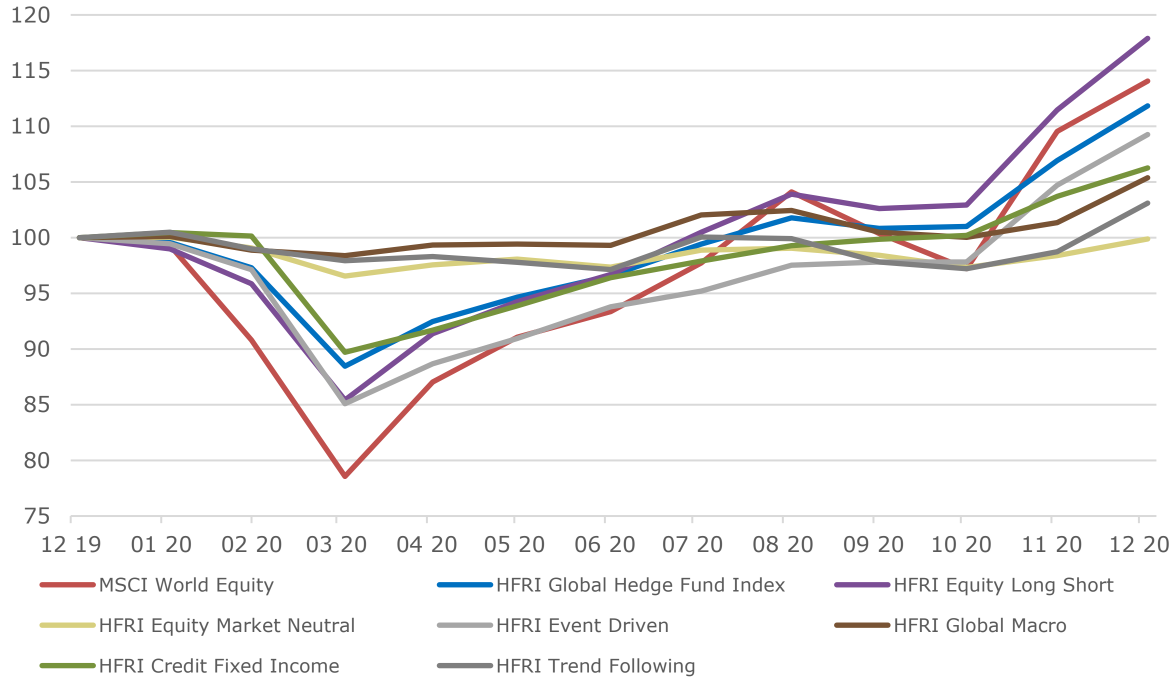
**Chart 5: Hedge Funds Launches and Liquidations**




Quelle: HFM, Alpinum Investment Management

## Diversification and Active Management as Source of Success

**Chart 6: Various Hedge Fund Strategies in 2020**



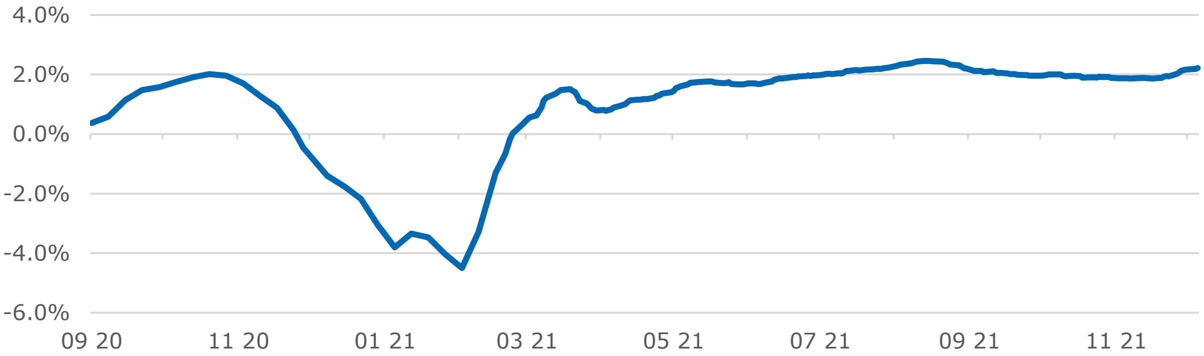

Source: Bloomberg Finance L.P., HFR, Alpinum Investment Management

The composition of a robust hedge fund portfolio is optimally achieved by applying diversity across several dimensions. From a top-down perspective, the first thing to do is to diversify asset classes and, within these, combining various single hedge fund strategies with different risk/return profiles. Other dimensions include investment styles, regions, size of the management company, experience and strategic as well as tactical allocations. In addition, niche managers can not only add spice to the whole portfolio, but also make an important contribution in the correlation behavior pattern. Key metrics such as risk, return, correlations and market beta act as an important guide to any allocation in a portfolio context - but looking at these and other key figures is always a matter of looking in the rear-view mirror. Besides the importance of properly aligning all these standard measures is knowing and understanding each manager's current portfolio and anticipating its behavior in a variety of scenarios. The aim is not only to diversify the sources of returns, but also to capitalize on differing trading styles and implementation tactics. In a nutshell, an ideal hedge fund portfolio should not surprise negatively in any environment and should generate alpha as independently of the market as possible. Active management of positions helps the portfolio to adjust to ever-changing market opportunities, as illustrated by the chart of various hedge fund strategies in 2020.

## Hedge Fund specific Observations

**SPACs:** By the middle of the year, SPAC euphoria subsided and the market normalized, as indicated in the below SPAC Yield to Maturity chart. With the return to normal, these instruments now show the favored optionality for hedge funds again: uncorrelated yield income and additional return on (a potential) successful market placement.

**Chart 7: SPAC Yield to Maturity**




Source: SI, Alpinum Investment Management

**Speculators Positioning:** The Commitment of Traders Report lists the speculative futures positions of hedge funds. We see annual highs for longs in the S&P 500, while shorts at the back end of the maturity in US Treasuries are massive.

**Chart 8: Commitment of Traders Report**

| | Positioning in USD bn nominal | Increase/ decrease 1 month |
|---|---|---|
| S&P 500 | 39.7 | 10.4 |
| Nasdaq | 11.0 | 1.8 |
| Russell | -3.1 | -0.7 |
| 10Y Treasury | -35.8 | 6.5 |
| 30Y Treasury | -57.8 | -0.1 |
| EURO | -1.7 | 0.6 |
| YEN | -5.9 | 4.8 |
| Gold | 36.1 | -5.7 |
| Copper | 0.7 | -0.7 |
| Crude Oil (WTI) | 24.9 | -4.3 |
| Nat Gas | -5.1 | 0.3 |

**Chart 9: S&P 500 Futures Positioning**

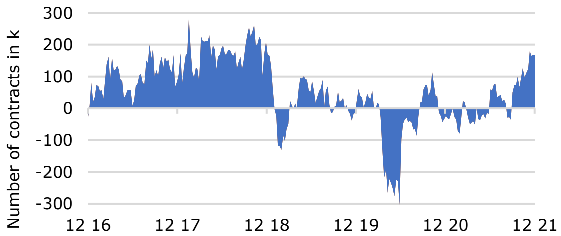
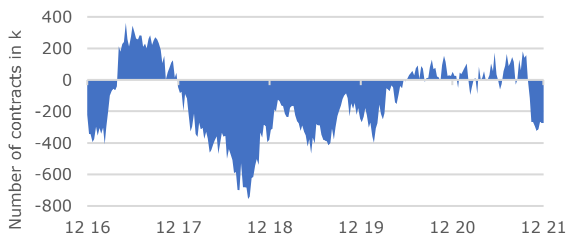


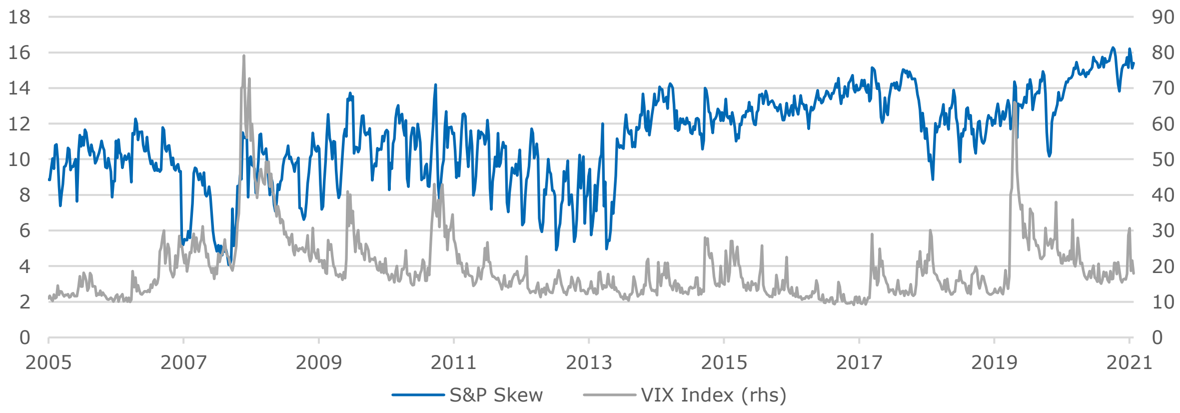

**Chart 10: US 10Y Treasury Futures Positioning**




Source: CFTC, Bloomberg Finance L.P., Alpinum Investment Management

**Options market:** The skew in put options in the S&P 500 (measures the price of an option) is at an all-time high - thus hedging costs with options are currently disproportionately high compared to the past. Other solutions to protect a portfolio are required.

**Chart 11: Skew in Put-Options**




Source: CBOE, Bloomberg Finance L.P., Alpinum Investment Management

## Outlook Hedge Fund Strategies

Global growth was experiencing a strong but uneven recovery, leading into a 'normalizing' transition in many countries. While the economical healing process will still take a long time, accompanied by several imponderables, such as the renewed current rise in infection numbers or inflationary pressures. This upheaval will continue to create periods of heightened volatility in financial markets. Based on the current macroeconomic environment, we identify many interesting "alpha opportunities" or ways to generate returns that are less dependent on the positive performance of the equity and bond markets.

Equity Long Short: Positive environment, as the outlook for normalized economic growth means that selective fundamental stock and corporate analysis might gain once again more weight than investing in pure beta strategies. While "long biased" Long Short strategies are heavily dependent on the positive performance of equity markets, the environment for market neutral strategies should improve, as "alpha shorts" will once again have more chance of success due to the generally high equity price valuations, while at the same time being somewhat less vulnerable to short squeezes.

**Chart 9: Conviction Level over 6 Months**

| | | | Conviction Level over 6 Months | | |
|---|---|---|---|---|---|
| **Hedge Fund: Strategien** | **Underweight** | ← | **Neutral** | → | **Overweight** |
| Global Hedge Funds | ☐ | ☐ | ☐ | ☑ | ☐ |
| Equity Long Short | ☐ | ☐ | ☐ | ☑ | ☐ |
| Equity Market Neutral | ☐ | ☐ | ☐ | ☑ | ☐ |
| Event Driven | ☐ | ☐ | ☐ | ☐ | ☑ |
| Credit Fixed Income | ☐ | ☐ | ☐ | ☑ | ☐ |
| Global Macro | ☐ | ☐ | ☐ | ☐ | ☑ |
| Trend Following | ☐ | ☐ | ☑ | ☐ | ☐ |

Source: Alpinum Investment Management

Event Driven (M&A, Corporate Actions): Very attractive environment for merger arbitrage and special situations strategies. The positive economic and market environment, which will not change in the short term, is also driving up M&A transactions. The euphoria in this sector is also fueled by the opportunities of uncomplicated stock exchange listing implemented by "SPAC investments". There is also likely to see an increasing proportion of hostile takeovers, which are riskier on the one hand but also promise a higher return profile on the other (e.g. via financing by private equity companies).

Credit Fixed Income: Still positive with a stronger focus on relative value strategies. Credit spreads should remain stable under "mid-cycle" conditions or even widen slightly if interest rates rise, which would create new trading opportunities, especially in the "short book". Large trading opportunities therefore arise in relative value strategies, but not only in the credit but also in the rates markets, where the diverging inflation and interest rates in the different currency zones provide interesting opportunities.

Global Macro: Very positive environment. While global top-down strategies usually struggle during an economic turnaround, they benefit even more once a trend is established. With the return to more "normal" economic growth rates, the forecasting ability also increases again and enables specialists to detect valuation anomalies by applying profound economic analysis of fundamental data, converting them into profitable trades. Regionally varying inflation scenarios as well as decreasing fiscal and monetary support measures reinforce this trend and lead to directional as well as relative value trading opportunities in different yield curves, currencies and commodities. Options are currently very expensive in the US and the EU, but not so in Asia. Volatility managers are taking advantage of this, profiting from the "high skew" and selling volatility or playing the regions for relative value. Although short volatility seems attractive right now, unexpected market setbacks carry disproportionately high risks.

Trend Following/CTAs: Slightly positive assessment. In the short term, there are no signs of an imminent reversal of the key investment trends that often cause temporary damage to CTAs. The market structure remains solid, and many existing trends have even been confirmed in their short-term expectations. If, on the other hand, markets were to turn around abruptly, medium- to long-term CTA strategies would show temporary weakness, unless the reversed trends were quickly gaining strength. For the time being, however, several strategies continue to benefit from existing or new trends in the interest rate, FX and commodity markets.


## Disclaimer



Contact Information:
Alpinum Investment Management AG
Talstrasse 82
CH-8001 Zurich
Tel: +41 43 888 79 33
Fax: +41 43 888 79 31
alpinumim.com