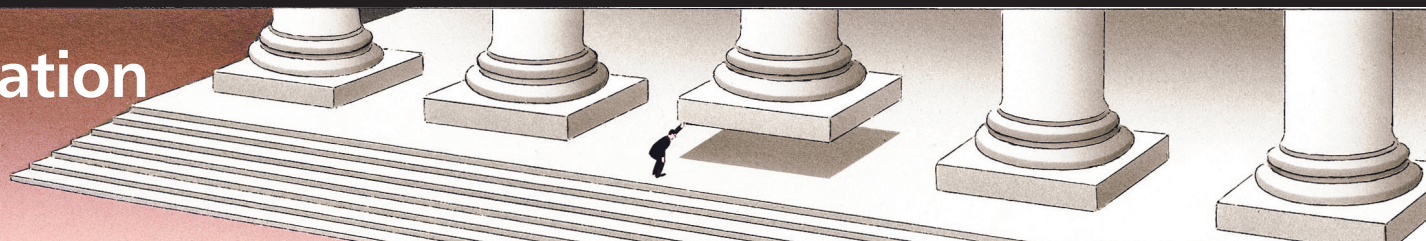


Fund of Information



Event-Driven Funds Built for All Seasons

by Eric Uhlfelder

WHEN AN ICELANDIC VOLCANO BLEW UP IN THE SPRING OF 2010, it spewed ash across the skies of Northern Europe for months and forced most regional air travel to shut down. Shares of **Ryanair Holdings**, the Continent's leading low-cost airline, plummeted 25% in less than two months.

Because there was no fundamental change to the airline's long-term outlook, a sooty atmosphere created a buying opportunity. By late July, Ryanair (ticker: RYAAAY) had fully recovered, rewarding event-driven hedge funds who'd bought on the bad news.

While Ryanair's problems were external, most event-driven investing is focused on internal corporate events, such as bankruptcies, recapitalizations, spinoffs, asset sales, leadership changes, litigation, or regulatory shifts. These events can occur in any market cycle, which makes the funds particularly attractive when stocks and bonds are richly valued.

In spite of the strategy's logic, event-driven assets represent only about 5% of all hedge fund dollars and were falling until recently. One reason for investor reticence: Most event-driven managers underperform in bull markets. Over the past year, data tracker BarclayHedge reports that the average event-driven fund was up 11.18% through July, while the Standard & Poor's 500 index had total returns of more than 16%.

The strategy's appeal, especially now, is being market-agnostic, targeting more modest but consistent returns. Most managers keep a tight rein on risk, which means that to be successful, a manager needs to be right only slightly more than half the time. "A .750 batting average isn't required," explains Ron Weiner, managing director of RDM Financial Group, an investment advisor that runs \$800 million in assets. He sees the strategy as one of the tools in his arsenal. "Making the strategy even more attractive at this time is the rise in geopolitical risks, which should generate a number of external opportunities," says Weiner. He also

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believes that a highly valued market will be especially prone to an event that could increase both volatility and opportunity. Michael Rothenberg's \$674 million Moab Partners fund, a member of *Barron's* Penta's 2017 Top 100 Hedge Funds, has generated 9% annualized returns since its launch more than a decade ago. Over the same time, Moab's volatility has run just about 7%, compared with 19.9% for the S&P 500 index. Like many funds, Moab charges a 2% management fee and 20% of profits. It requires a \$2 million minimum.

Most important about the fund: It has topped the market in 44 of the 45 months the S&P 500 was down. How? By focusing on smaller, undercovered companies that are undergoing changes not yet reflected in their prices. "Targeting these obscure shares avoids what many event-driven manag-

ers face when crowding into more popular trades," says Rothenberg. In those cases, "when folks all try to sell, pricing can get ugly."

Another key to Moab's success is understanding each investment's downside risk and parsing out money in amounts that won't jeopardize the overall fund. Also, the fund seeks investments with yields that provide ballast during rough patches. And Rothenberg keeps an active book of potential investments to ensure that capital is virtually always invested.

Another event-driven manager, KG Investments, has generated annualized returns of nearly 18% since its founding in January 2009, with 13.2% volatility, by running a high-conviction, concentrated portfolio with positions typically held for several years.

KG's team selects what it believes is a group of high-quality, high-growth companies, and then waits for events such as regulatory changes, an announced deal, or a contract loss, which the market may misinterpret. "These are times when knee-jerk selling occurs," explains manager Ilya Zaides. "If we believe the events haven't altered a firm's outlook and finances," the fund buys, expecting growth to continue.

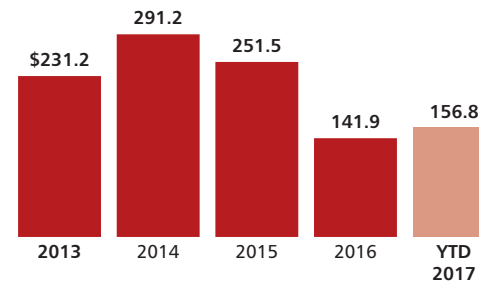
Jeff Gates, a managing partner of the \$1.2 billion Gates Capital ECF Value Fund II, targets corporate dislocation events, including asset sales, spinoffs, and financial reorganization, to find when investors have sold off equities and credits for reasons other than valuation.

When specialty-chemicals firm W.R. Grace spun off its specialty construction-material maker **GCP Applied Technologies** (GCP) in February 2016, investors dumped GCP shares at about \$17. But Gates saw GCP as an industry leader in a solid, fragmented business, generating strong returns on invested capital with a free-cash-flow yield of more than 9%. After GCP sold off its slowest-growing unit and consolidated its leading industry position with three small acquisitions, its shares soared to \$34 in spring 2017. Gates' fund has been able to generate annualized returns of 12.7% since it launched more than 13 years ago, compared with 8.27% for the S&P 500. That makes it worth considering. ■

Event-driven hedge funds are particularly attractive when stocks and bonds are richly valued.

Will Event-Driven Funds Revive?

Assets Under Management (bil)



Source: BarclayHedge