

JOURNAL REPORT | INVESTING IN FUNDS & ETFS

ALTERNATIVE INVESTMENTS

Hedge Funds Nearing A Bad 10-Year Streak

The funds continue to lag behind the stock market, despite a record level of assets. But a few managers are delivering.

BY ERIC UHLFELDER

HEDGE FUNDS were finally hoping the return of volatility in 2018 was going to revive their fortunes.

But no such luck. Hedge funds are well on their way to their 10th straight year of underperforming U.S. stocks.

To assess what happened in the first half of 2018, global industry data tracker BarclayHedge ran a broad screen of several thousand hedge funds for The Wall Street Journal. BarclayHedge found the average hedge fund return to be a paltry half percent while the S&P 500 rose more than 2.5%. Incomplete returns through July so far show a significant widening of the year-to-date performance gap, with the market up nearly 6.5% while hedge funds gained 1.10%.

The Wall Street Journal sorted the funds by strategy, identifying the weakest first-

half performers. They were led by emerging markets, commodity trading advisers, or CTAs, and global macro, which were down 4.7%, 2.2%, and 1.1%, respectively (see table).

"Emerging markets are being hurt by an appreciating U.S. dollar, the rising specters of trade wars and protectionism, political discord and macroeconomic turmoil, especially in Turkey, Argentina and Brazil," says Carl Tohme, manager of Jabre Capital EMEA fund, which outperformed the BarclayHedge EM index by 5.5 percentage points.

Global Macro funds and CTAs—which both target broad asset-class exposure such as interest rates, currencies, stocks, bonds and commodities—took two major hits: the February reversal in the U.S. stock rally, and the return of volatility in European debt after the Italian election results in May.

A global macro fund that

stood out for its first-half performance was AlphaQuest Original of Quest Partners LLC, which climbed nearly 21%. The fund uses quantitative models to target periods of rising volatility and short-term trade exposure. Quest President Prashant Kolluri says the fund's returns in the first half were boosted by quickly moving in and out of the U.S. stock rally that followed the tax-overhaul passage, and by being short Italian bonds and long safe-haven bonds, such as German bunds. Bets on rising crude-oil futures also helped.

Still popular

Despite dull industry performance, investors still haven't lost their taste for hedge funds. According to Hedge Fund Research, assets grew to a record \$3.236 trillion as of June, up from \$3.211 trillion at the end of 2017, supported by some massive fund launches. These include Steve Cohen's



One first-half winner is the global macro fund from Quest Partners in New York, up nearly 21%. The firm's management team, from left, Robert Toth, head of trading; Prashant Kolluri, president; Paul Czkwianianc, head of research; and Nigol Koukajian, founder and chief investment officer.

\$13 billion Point72, former Millennium Management executives Michael Gelband's and Hyung Soo Lee's \$8 billion ExodusPoint, and former Viking Global CIO Daniel Sundheim's \$4 billion D1 Capital.

While most strategies continue to struggle, the several that did outperform the market in the first half were led by distressed securities. Funds in this category, which generally focus on companies suffering from poor mergers, loss of industry leadership, shifting demand or restructuring, were up an average 6.26%. While the category is up more than 10% over the past year, this follows several years of lackluster returns.

One leading hedge-fund manager in this category is \$281 million Man GLG European Distressed. Its U.S. Dollar Class A fund was up 11% for the first half, and nearly 15.5% over the past 12 months. Though it has an annualized rate of return of more than 11% since its launch a decade ago, with volatility under 9.5%, the fund is also recovering from sluggish performance over the past several years. A representative for the fund says it declines to comment.

While fixed-income funds as a whole didn't do much during the first half, several specialty fixed-income strategies managed decent returns, led by collateralized debt obligations, up 6.24%, asset-backed loans, which tacked on nearly 4%, and asset-backed securities, up 3.44%.

A lead performer in funds specializing in CDOs continues to be Hildene Opportunities Master. The \$1.8 billion fund, launched a decade ago, has generated gains of nearly 23% a year with volatility of 8.4%. Hildene is keeping pace with its historic returns, with gains of over 10% through June.

A key driver of performance, says Hildene co-CIO Brett Jef-

The top leading hedge-fund strategy so far in 2018 is distressed securities.

erson, has been targeting exposure to specific, undervalued, trust-preferred CDOs of regional banks that are benefiting from improving credit conditions and ratings, and anticipated eligibility for auction.

European plays

The third leading strategy, only marginally trailing the broader market, is European hedged equities, or funds that are both long and short European shares. These managers registered gains of 2.51%, an improvement over the past five years. These managers have so far been outpacing the BarclayHedge Equity Long/Short Index, which has a strong bias toward U.S. stocks, and which returned 1.63%.

Leading the continental

pack is the \$234 million Odey European Equity, a fund from London-based Odey Asset Management that uses long and short strategies. Its Sterling class was up 24% for the first six months, helped by two bets: shorting the pound and U.K. government bonds on the premise that Britain's exit from the European Union will harm the U.K. economy, and a long position in British telecom and media company Sky PLC, which is the target of a three-way bidding war.

But Odey's surge reflects the challenges of assessing funds by what they've done lately. Over the past three calendar years, the fund has lost more than 20% annually.

"Broad market dynamics have broken down," says Panayiotis Lambropoulos, portfolio manager of hedge-fund investments at the \$28 billion Employees Retirement System of Texas. He notes there has been an explosion of debt issuance and soaring equity valuations along with plenty of events to move prices, but a surprising lack of dispersion among assets.

"There seems to be a new rulebook out there," Mr. Lambropoulos says, "but its content, typically informed by established financial theories and experience, has turned increasingly indecipherable."

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Hard to Beat the Market

First-half 2018 performance of various hedge-fund strategies, in percentage returns

	Jan-June 2018 Net Returns	1-Year Net Returns	3-Year Annualized Net Returns	5-Year Annualized Net Returns
Distressed Securities	6.26	10.26	4.51	4.39
Collateralized Debt Obligations	6.24	12.34	8.00	11.07
Asset-Backed Loans	3.96	9.11	7.78	9.39
Asset-Backed Securities	3.44	7.62	8.26	7.90
European Equities (hedged)	2.51	4.60	2.65	4.70
Mortgage-Backed Securities	2.49	5.16	4.66	6.17
Equity Long/Short	1.63	6.47	3.61	4.94
Event Driven	1.55	4.97	4.98	5.01
Convertible Arbitrage	1.08	1.56	2.24	2.72
Equity Long Bias	1.04	9.26	4.94	6.68
Fixed-Income Arbitrage	0.59	1.19	3.37	4.66
Credit Long/Short	0.47	2.46	3.14	3.80
Equity Market Neutral	0.28	2.46	2.25	3.58
Merger Arbitrage	0.18	1.59	4.86	4.55
Multistrategy	-0.27	2.90	2.98	4.52
Global Macro	-1.06	2.48	1.87	2.69
Commodity Trading Advisers	-2.19	0.15	-1.25	0.54
Emerging Market	-4.65	4.62	4.55	4.26
Barclay Hedge Fund Index	0.48	6.26	4.43	5.28
S&P 500 Total Return Index	2.66	14.38	11.93	13.42

Source: BarclayHedge

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