For the third year in a row the Top 50 funds collectively demonstrated asset managers, relying on a variety of strategies, generating net returns comparable to the S&P 500 with significantly less risk and perfor-

mance that was largely independent of the market. Hedged equity, multistrategy, and global macro funds led the way with more than half the funds in the Top 50 managing less than $1 billion.

by Eric Uhlfelder

Hedge Fund Investing During The Time of Covid-19: Part II

Active fund management—with a big assist from central banks and government stimulus—smoothed the ride over last year's turbulent markets, and this year's volatility is providing more opportunities and new risks.

> **"The test of a first-rate intelligence is the ability to hold two opposed ideas in mind at the same time and still retain the ability to function."**
> **- F. Scott Fitzgerald**

What a difference a year makes.

Last spring, this survey was focused entirely on what everyone felt: the world had suddenly changed. A deadly pandemic was metastasizing at warp speed across the planet.

Economies and societies locked down, unemployment soared, real interest rates turned negative, stocks collapsed, and the exponential spread of Covid-19 led to more US deaths related to Covid-19 than in all the major wars fought in the 20th and 21st centuries.

When central banks and governments unleashed unprecedented liquidity, investors looked past the trauma that was unfolding, which sent equity markets soaring. Further, the fear of cascading business failures hasn't materialized. By the second half of 2020, investors decided nothing really had changed.

Economist David Rosenberg put the market recovery in simple terms. "Over the past 40 years, the difference between monetary and economic growth has been about 1%. In 2020, this spread gapped to

Image Courtesy of the Federal Reserve Bank of New York

around 30%. Excess liquidity that's not being absorbed by the economy is finding a home in the financial markets." [See Rosenberg's Q&A on pp. 17-18.]

With bond yields and spreads at record lows, equities were the primary beneficiary of this excess investment liquidity.

With economies reopening and pent up demand unleashed, the growth outlook looks robust. In April, the International Monetary Fund projected global growth of 6% in 2021 and 4.4% in 2022.

The Economist magazine recently reported,"businesses are starting to invest in huge numbers. In America, capital spending is rising at an annual rate of 15%, both on hard stuff, such as machines and factories, and intangibles, like software. Firms in other parts of the world are also ramping up spending. Forecasts for business investment have never looked so rosy."

While Giovanni D'Alesio, head of alternative investment research at the $132 billion Swiss-based asset manager GAM, is well aware of these trends, he believes, "equity fundamentals don't make any valuation sense." Broadly speaking, he sees multiple, not real earnings, expansion driving markets higher. As a result, "many investors are looking away from the essential indicators and more towards technical analysis and sheer momentum which isn't sustainable," explains D'Alesio.

Uncertainty and volatility that characterized 2020 was a boon for many hedge funds. Last year's Top 50 funds delivered collective returns that were in line with the market, but they did so with far less drawdown and volatility.

And this year's Top 50, two-thirds of which made the leap from the 2020 survey, did even better. They averaged gains of more than 24% in 2020 versus the S&P 500 Total Returns of 18.40%. And they more than doubled the hedge fund industry average gains of 11.14%.

And positive results have continued through the first quarter of 2021, with the S&P 500 up 6.2%, the average hedge fund appreciating by 4.8%, and the Top 50 returning 5.4%.

But making the cut for this survey involved more than having thrived last year. The Top 50 represented broad strategy funds with

About This Year's Survey

My 18th annual global hedge fund survey is being published under my own banner--Global Investment Report. The 17 previous editions were commissioned by *The Financial Times, Barron's, The Wall Street Journal*, and last year by SALT.

This year's survey continues improvements I've been making on methodology and reporting, which I initiated in the 2019 *Wall Street Journal* version.

This included extending the period for which performance is ranked to the trailing 5 years. Further enhancements included tracking worst drawdown, standard deviation, Sharpe Ratio, and market correlation over the same period to gain a more complete understanding of performance.

With the exception of market correlation, I also tracked these metrics since the inception of each fund—which was never done in any previous survey. With the average fund age being nearly 15 years, this revealed performance consistency that extends back to when each qualifying fund was launched.

Combining this extensive statistical study with qualitative overview of the hedge fund industry as observed by leading global allocators, economists, consultants, and managers who made the Top 50 presents a comprehensive assessment of what the most consistent performing hedge funds can deliver and what they expect may play out for the rest of 2021.

the highest trailing 5-year annualized returns through 2020.

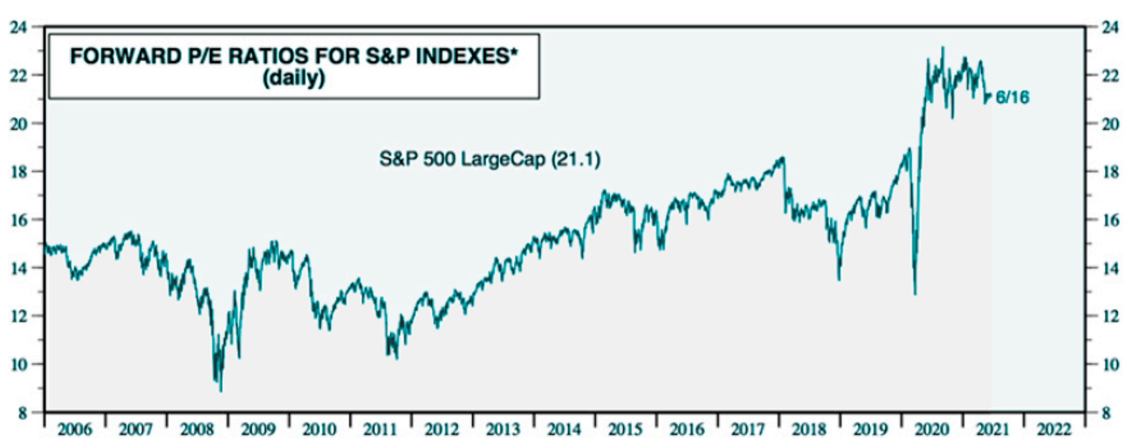
Collectively they generated:

- 5-year net annualized returns of 14.81% versus the S&P 500 Total Returns of 15.22%. The hedge fund industry average gains over this period was 6.41%;
- Average worst drawdown over this period was -12.2% versus the market's -19.60% decline. The industry average drawdown was -11.9%;
- Annualized standard deviation was 11.17% versus the market's 15.13%. The industry average was 7.18%;
- Average Sharpe Ratio was 1.57 versus the market's 0.93, and the industry's average of 0.73; and
- These funds delivered this performance with only limited correlation to the S&P 500—just 0.31. The industry's correlation to the market—suggesting how much the average fund tracks the main holdings of the S&P 500—was 0.92.

As a group, these alternative investments—reflecting the performance of a variety of strategies—delivered market-like performance by being far more than just long equities.

Takeaway: While the majority of hedge funds do not deliver solid, consistent performance, there are a select number of managers that do through a well-established record of proven active management.

Forward P/E divided by LTEF, which is 5-year forward consensus expected annual earnings growth.
Monthly through 2005, then weekly.
Note: Shaded red areas are S&P 500 bear market declines of 20% or more. Yellow areas show bull markets.
Source: I/B/E/S data by Refinitiv.



Source: Yardeni Research, 16 June 2021

METHODOLOGY

The 50 funds that made this survey are not reflective of the hedge fund industry. They are outliers, revealing the industry's promise.

They defy the averages. Their mean age is 14.5 years—nearly triple the life expectancy of the average fund. Their returns have collectively kept up with a raging bull market while exposing investors to less risk.

The initial search started in early February with various databases, including BarclayHedge and Preqin, casting a wide net across the industry. They initially screened for broad strategy funds, excluding sector, country, specialized strategies (e.g., FX, metals, and commodities) and those applying exogenous leverage to a flagship portfolio. The purpose: to identify managers whose performance is independent of narrow trends.

A key screen that helps ensure reliability of data is to target funds managing at least $300 million. When funds reach that size, they frequently retain top-tier service providers—administrators, prime brokers, accountants, and lawyers—whose involvement may help deliver best-in-class practice.

The survey provides another layer of due diligence by contacting each manager to confirm their numbers. While each fund is feeding data directly into databases, mistakes can happen, and individual numbers may have been revised since submission. This process also eliminates UCITs and other non-hedge fund entities that slip into the databases.

There are always a handful of managers who will not verify their data. This does not mean their numbers are wrong. But it reinforces the need for perspective investors to do their own due diligence. The data provided here should be considered only a starting point.

Perhaps the survey's most unusual filtering is the use of performance hurdles for each of the last three years. This has raised the threshold for making the

> "With global debt-to-GDP levels approaching 400% and pandemic-related public expenditures set to increase without restraint almost everywhere, the world's financial system is more than usually fragile at this moment and will become even more so."
>
> - Eric Knight, Knight Vinke

HEDGE FUND STRATEGY PERFORMANCE: JAN 2016 - MAR 2021
Ranked by 2020 Returns

Strategy	YTD Net Returns (%) thru March 2021	2020 Net Returns (%)	3-Year Net Annualized Returns (%) thru 2020	5-Year Net Annualized Returns (%) thru 2020	10-Year Net Annualized Returns (%) thru 2020
Equity Long Bias	8.76	16.31	6.92	7.96	6.08
Volatility Trading	1.31	15.87	2.14	2.09	1.61
Convertible Arbitrage	4.79	15.53	7.77	6.18	4.88
Emerging Markets	3.12	15.52	5.07	8.65	3.51
Distressed Securities	8.97	13.18	5.10	6.70	4.51
Event Driven	7.30	11.12	5.18	7.01	4.68
Fixed Income Arbitrage	2.34	10.46	4.35	4.53	5.30
Global Macro	4.34	10.06	3.94	3.48	2.71
Equity Long/Short	6.45	9.27	4.14	4.50	4.27
Merger Arbitrage	4.77	9.18	5.23	5.41	4.72
Asset-Backed Loans	2.21	7.01	5.56	6.61	7.08
Commodity Trading Advisers	2.38	5.43	2.40	1.32	0.61
Fixed Income Diversified	-0.21	5.31	3.44	3.83	5.67
Credit Long/Short	0.57	5.18	3.20	3.77	3.63
Credit Long-Only	-1.21	4.43	3.38	3.65	4.46
Multistrategy	4.15	4.23	1.41	2.91	3.37
Fixed Income Relative Value *	3.67	3.38	3.41	4.59	4.41
Mortgage Backed Securities	1.8	2.04	2.64	3.63	4.58
Equity Market Neutral	2.55	-1.29	-1.19	-0.02	2.00
Asset Backed Securities	4.44	-1.83	2.80	5.40	9.92
Collateralized Debt Obligations	5.99	-3.17	1.27	6.88	14.16
Top 50 Averages	5.40	24.20	17.26	14.93	NA
Backstop BarclayHedge Index	4.79	11.14	5.23	6.41	4.79
S&P 500 Total Return Index	6.18	18.40	14.19	15.22	13.89

Source: Backstop BarclayHedge
* Source of Fixed Income Relative Value is HFR

list, enhancing the value of this survey as a source of consistently performing managers.

This was initiated in the 2019 survey I prepared for *The Wall Street Journal*, which tracked performance over a trailing five-year period through 2018.[1] Because 2018 was the first year in a decade when the market had lost money, setting a performance hurdle of 5% for that year was a clear way to see which funds delivered some form of alpha—without support of a buoyant market. Paraphrasing Warren Buffett, the hurdle helped reveal which swimmers had shorts on when the tide went out in 2018.

That hurdle was again maintained in this year's survey for 2018 and 2019. For 2020, it was lowered to 4.5%, reflecting the decline in risk-free interest rates. The reasoning: requiring funds to generate only several hundred basis points of returns above the risk-free interest rate seems modest for any manager collecting management and performance fees.

> "Over the past 40 years, the difference between monetary and economic growth has been about 1%. In 2020, this spread gapped to around 30%. Excess liquidity that's not being absorbed by the economy is finding a home in the financial markets."
>
> - David Rosenberg, Economist

Maintaining hurdles over the last three years, while identifying the best trailing five-year returns, helps this survey highlight managers that are generating consistent absolute returns while containing downside risk, eliminating funds whose performance bounces all over the place.

Further, while not appearing to be a demanding performance threshold, these modest hurdles recognize the fortunes of many strategies are not tied to a roaring stock market.

SURVEY RESULTS

With the exception of Millstreet Credit and the macro shop Haidar Jupiter, the top 10 funds in the survey based on the highest 5-year annualized trailing returns were equity. All delivered returns of more than 19% a year over that period, well above the market's annualized gains of 15.22%.

No surprise the top spot was earned by an equity long bias fund. What is remarkable is the fund's trailing 5-year annualized returns were more than 46%, and that the manager runs his fund in such an idiosyncratic way that makes stock selection his prime risk management tool.

Sosin Partners led the survey for the second year in a row, despite experiencing one of the most tumultuous years ever witnessed. In 2020, this concentrated equity fund of 8 companies—currently all long positions—was at one point down -55% in March. By the end of the year, Sosin was up net 96.5%.

With his investments selected for their long-term growth potential, manager Clifford Sossin looked past the chaos that quickly enveloped the markets. He didn't sell. He didn't hedge. He actually added to some collapsing positions with new monies that were coming in.

Two core positions that tried to trigger manager angina was Carvana—the hip online used car shop, which bottomed at $30 in March 2020 and is now trading at $300—and the brick-and-mortar home décor firm, At Home, which traded below $2 before rocketing ahead to the mid-$30s.

Three years ago, Sosin Partners didn't qualify for the survey because fund assets were below $300 million. Today, its assets are nearly $1 billion—over $2 billion when counting other *pari passu* managed vehicles—and the fund is closed to new investors.

Strategies

While strategy-level performance may provide a base guide to what hedge funds have done, Sam Monfared, hedge fund research specialist at Preqin, observes "they tell little about the wide range of fund performance within each strategy."

That's certainly evident in the historical performance of the 21 strategies this survey tracks, which reveals a narrow range in returns over the trailing 3-, 5-, and 10-year periods. [See table on p. 4.] During these three periods, the industry on average generated gains that were one-third the returns of the S&P 500.

While looking at a single year can also be misleading, 2020 revealed extraordinary breadth of performance by strategy. Equity long bias, volatility trading, convertible arbitrage, and emerging market funds delivered gains in excess of 15%. At the bottom, equity market neutral, asset-backed securities, and collateralized debt obligation funds were down slightly.

Structured credit strategies were the hardest hit by the pandemic as investors worried about the reliability of interest payments and

Commitment To Concentration: North Peak Capital

Only through a call to a Swiss-based hedge fund industry analyst did the details of this unique fund become clear: a hedged equity shop managed by two brothers whose investment approach recalls the heady days from decades past when hedge funds sought outperformance rather than cautious pursuit and retention of institutional allocators.

This was made evident right after the fund was launched in August 2015 when it proceeded to rack up losses over five of its first six months in business. Many managers who found themselves down one-third before they even put art up on their walls may well have closed up shop and started over.

North Peak, instead, remained committed to its convictions and investment strategy. By the end of its first full calendar year in 2016, the fund was up more than 36%, outpacing its benchmark Russell 2000 by nearly 15%. And the fund has maintained this average annual rate of return through 2020, which earned it the 2nd place ranking in this year's survey.

"Our strategy is simple," explains co-portfolio manager Jeremy Kahan. "We apply private equity style due diligence in constructing a concentrated portfolio of 10-12 dynamic businesses trading at attractive prices. We typically invest in companies worth between $1 billion to $10 billion that are generating strong free cash flow and high returns on invested capital, benefitting from strong secular tailwinds, operating in large markets with substantial moats, proven business models, exceptional unit economics, and talented management."

Jeremy Kahan

Michael Kahan

Focused on technology, media, and consumer discretionary businesses, including hotel, restaurants, and leisure, North Peak's top five positions make up 75% of its long book. This reflects a deep commitment to the firm's research and selection process.

North Peak's short book is comprised of six to ten smaller opportunistic holdings that are dealing with high fixed-costs and shrinking revenues.

Jeremy and Michael Kahan's attention are caught by corporate events, such as IPOs and spinoffs, mergers, management changes, the release of a major product or service, as well as stocks hitting their 52-week highs or lows.

While these search parameters may not seem particularly novel, North Peak's 27% annualized net returns since inception through 2020 certainly are, revealing a process that's doing a much better job than most funds in seeking out under-researched, under-valued firms poised to soar.

While a look at the fund's performance grid reflects high monthly volatility, it's bent is toward the upside. This is borne out by a 5-year Sharp Ratio of 1.50. And returns have been only half-correlated to the market.

Further distinguishing North Peak was a recent commitment, made this past February, that was as idiosyncratic as many of its investments: the fund is donating half of its management and performance fees on new allocations to various charities.

[1] Uhlfelder, Eric. "As Hedge Funds Struggle, These Are Standing Out," The Wall Street Journal, 6 May 2019. This survey of 60 funds was based on the same methodology as the current survey.

2021 SURVEY OF THE MOST CONSISTENT PERFORMING HEDGE FUNDS

RANKINGS 2018 WSJ*/ 2019 SALT*	GIR 2020 Ranking	Fund	Launch Date	Strategy	Fund Assets ($ Millions)	Firm Assets ($ Millions)	2018 Net Returns	2019 Net Returns	2020 Net Returns	2021 1Q Net Returns	3-Year Annualized Net Returns (%) Thru 2020	5-Year Annualized Net Returns (%) Thru 2020	Annualized Net Returns Since Inception Thru 2020	Worst 5-Year Draw Down (%) Thru 2020	Worst Draw Down (%) Since Inception Thru 2020	5-Year Standard Deviation Thru 2020	Annualized Standard Deviation Since Inception Thru 2020	5-Year Sharpe Ratio Thru 2020	Sharpe Ratio Since Inception Thru 2020	5-Year Fund Correlation vs S&P 500 TR Thru 2020
-- / 1	1	Sosin Partners LP (New York)	Oct-12	Equity Long-Bias	965	2,006	29.79	64.48	96.50	6.34	61.28	46.37	39.50	-45.59	-45.59	40.54	33.93	1.14	1.13	0.81
-- / NA	2	North Peak Capital Partners--Class E1 (New York)	Aug-15	Equity Long-Short	823	875	30.99	40.76	24.60	4.90	31.95	35.88	26.80	-18.70	-29.65	21.50	22.79	1.50	1.10	0.53
7 / 3	3	Woodson Capital Partners (New York)	Jan-10	Equity Long/Short	1,819	1,819	20.72	20.90	118.84	-22.90	47.27	33.47	19.68	-9.95	N/A	14.18	N/A	1.30	N/A	0.21
16 / 6	4	Millstreet Credit LP (Boston)	Jun-10	Credit Long/Short	337	607	15.79	15.85	21.38	7.62	17.65	26.56	11.72	-4.39	-33.26	8.40	8.79	3.00	1.27	0.11
-- / NA	5	Tenzing Global Investors I LP (San Francisco)	Jan-12	Equity Long/Short	380	380	10.23	19.03	33.95	4.93	20.68	23.83	15.30	-11.33	-33.00	17.24	16.92	1.32	0.87	0.33
-- / 26	6	Cadian LP (New York)	Oct-07	Equity Long/Short	1,612	3,045	20.07	17.71	55.48	-20.48	30.01	22.46	13.95	-14.60	-27.31	15.88	15.96	1.63	1.05	0.38
21 / 19	7	Haidar Jupiter Int'l (New York)	Nov-03	Global Macro	704	704	8.02	31.36	27.01	32.92	21.69	22.12	18.01	-32.15	-32.15	27.40	18.67	0.77	0.88	-0.22
-- / NA	8	Strategos LP (Seattle, WA)	Jul-04	Equity Long/Short	401	401	32.91	29.12	47.86	8.58	36.40	21.51	19.70	-38.13	-38.13	23.00	19.43	0.89	0.95	0.58
34 / 14	9	Tiger Global Investments (New York)	Mar-01	Equity Long/Short	21,000	45,000	13.60	32.70	48.40	0.30	30.79	19.42	NA	NA	NA	NA	NA	NA	NA	NA
-- / 5	10	Kerrisdale Partners Offshore (New York)	Nov-11	Equity Long/Short	456	742	35.81	21.20	25.12	-4.33	27.23	19.33	20.51	-16.13	-17.31	13.79	13.19	1.32	1.51	0.42
		BarclayHedge Hedge Fund Index	Jan-97		N/A	N/A	-5.23	10.64	11.14	4.79	5.23	6.41	8.21	-11.90	-24.09	7.27	7.18	0.73	0.86	0.92
		S&P 500 Total Return Index	Jan-80		N/A	N/A	-4.38	31.51	18.40	6.18	14.19	15.22	11.92	-19.60	-50.95	15.13	15.12	0.93	0.52	1.00

* The Wall Street Journal survey of 60 funds and the SALT survey of 50 funds were based on the same methodology as the current survey. When a fund doesn't show a ranking in either of the previous two surveys, it means either fund data was not available or that it did not qualify for inclusion.

N/A = data not available.

potential impairment of underlying assets—both of which support these financially-engineered vehicles. This is most evident by the failure of a single such fund to qualify for this year's Top 50.

Mortgage-backed securities, for example, had been among the most consistent performing funds for many years running. They, along with other structured credit funds, had made up 25% of the Top 50 over the previous two years. With a dozen such funds dropping off the survey, this significantly altered the composition of this year's list.

The remarkable outliers that comprise this survey are evident when comparing their performance with their respective strategy averages.

There are 15 equity long-short funds in the Top 50—the highest number of any strategy—that collectively returned nearly 19.5% per year over the past 5 years through 2020. But the strategy average return over the same period was a paltry 4.5%..

The top-performing equity long-short manager over the past 5 years was North Peak Capital (No. 2), which generated annualized returns of nearly 36% over that period. Driving performance of this $823 million fund, explains it's co-manager Jeremy Kahan, is "application of private-equity style due diligence in constructing a concentrated portfolio of 10-12 dynamic businesses trading at attractive prices." The fund typically targets companies worth between $1 billion to $10 billion that are generating strong free cash flow and high returns on invested capital. [See profile on p. 6.]

Woodson Capital Partners (No. 3) has also generated strong gains, averaging 33.47% over the past 5 years through 2020. The fund's 11-year track record delivered annualized gains of nearly 20% through 2020, buoyed by performance over the past 4 years.

Since the start of 2016, its worst drawdown was less than 10%. But as is possible with any high-flying fund, Woodson took a sharp hit in the first quarter of 2021 when it lost nearly 23%.

Manager James Davis recently explained, "many growth stocks that led the market higher in 2020 have lagged it year-to-date in 2021 due to a confluence of factors, such as rising inflation expectations, a growth-to-value rotation, and a post-Covid market reversion." (Through May, Woodson has pared its 2021 losses to -19%.)

The survey's 8 multistrategy funds also show substantial collective outperformance versus its peer strategy average return

2021 SURVEY OF THE TOP 50 HEDGE FUNDS

GLOBAL INVESTMENT REPORT

RANKINGS 2018 WSJ*/ 2019 SALT*	GIR 2020 Ranking	Fund	Launch Date	Strategy	Fund Assets ($ Millions)	Firm Assets ($ Millions)	2018 Net Returns	2019 Net Returns	2020 Net Returns	2021 1Q Net Returns	3-Year Annualized Net Returns (%) Thru 2020	5-Year Annualized Net Returns (%) Thru 2020	Annualized Net Returns Since Inception Thru 2020	Worst 5-Year Draw Down (%) Thru 2020	Worst Draw Down (%) Since Inception Thru 2020	5-Year Standard Deviation Thru 2020	Annualized Standard Deviation Since Inception Thru 2020	5-Year Sharpe Ratio Thru 2020	Sharpe Ratio Since Inception Thru 2020	5-Year Fund Correlation vs S&P 500 TR Thru 2020
36 / 32	11	Mudrick Distressed Opp. Ltd B (New York)	Jul-09	Event Driven	500	900	16.45	22.24	11.28	15.02	16.57	18.60	11.22	-16.32	-31.31	16.83	12.89	1.04	0.83	0.16
3 / 4	12	MAK One (New York)	Mar-04	Opportunistic Distressed & Equity	613	633	51.40	5.00	13.20	14.11	21.62	18.08	15.00	-15.37	-18.43	18.06	20.41	0.86	0.95	0.25
-- / 23	13	Old Kings Capital LP (Darien, CT)	Oct-02	Equity Long/Short	1,025	1,025	6.32	29.81	23.12	9.64	19.33	17.04	9.48	-22.39	-22.94	17.28	12.21	0.92	0.67	0.79
-- / 27	14	Legion Partners Commingled (Los Angeles)	Jan-14	Small-Cap Activist	439.0	459	5.10	17.25	21.93	15.52	14.54	16.47	9.06	-33.77	-33.77	23.38	21.63	0.73	0.47	0.61
-- / NA	15	G2 Investment Partners Series B (New York)	Oct-09	Small-Cap Equity Long/Short	362	615	5.62	14.26	47.01	9.50	21.06	15.80	13.01	-9.30	-11.96	12.49	10.54	1.22	1.18	0.52
-- / NA	16	Braddock Partners LP (Middleburg, VA)	Oct-93	Equity Long-Bias	861	16,900	5.00	27.86	18.45	5.43	16.71	14.52	15.49	-15.49	-52.00	12.85	15.77	1.04	0.83	0.90
10 / 8	17	Element Capital (New York)	Apr-05	Global Macro	18,200	18,200	17.30	12.12	18.80	-9.71	16.02	14.48	NA	-7.46	NA	9.39	NA	1.42	NA	0.29
-- / NA	18	HEC Master LP (New York)	Aug-15	Equity Long-Bias	618	618	6.16	52.17	6.74	10.08	19.92	14.23	10.37	-35.25	-35.25	22.21	21.87	0.59	0.43	0.72
15 / 12	19	Citadel Wellington (Chicago) **	Nov-90	Multistrategy	23,600	33,748	9.03	19.32	24.51	6.00	17.44	13.98	18.94	-6.98	NA	5.45	NA	2.16	NA	-0.01
-- / 43	20	HGC Arbitrage (Toronto)	Jun-13	Merger Arbitrage	686	686	7.54	9.01	38.02	7.51	17.40	13.74	14.92	-4.82	-4.82	8.01	7.24	1.58	1.96	0.33
		BarclayHedge Hedge Fund Index	Jan-97		N/A	N/A	-5.23	10.64	11.14	4.79	5.23	6.41	8.21	-11.90	-24.09	7.27	7.18	0.73	0.86	0.92
		S&P 500 Total Return Index	Jan-80		N/A	N/A	-4.38	31.51	18.40	6.18	14.19	15.22	11.92	-19.60	-50.95	15.13	15.12	0.93	0.52	1.00

* The Wall Street Journal survey of 60 funds and the SALT survey of 50 funds were based on the same methodology as the current survey. When a fund doesn't show a ranking in either of the previous two surveys, it means either fund data was not available or that it did not qualify for inclusion.

** Citadel AUM data is as of 1 January 2021.
N/A = data not available.

Long Rationality--Barnegat Fund

This little known fund has perennially made my annual surveys with annualized net returns of more than 15% a year since its launch in 2001. Bob Treue, the fund founder and manager of the 42nd ranked fund, runs $740 million, looking at markets around the globe to find small temporary pricing anomalies between comparable securities, which he believes will correct.

In 2009, when the Bank of England initiated quantitative easing in response to the Great Recession, it announced it was buying maturities ranging from 5 to 25 years. Treue saw this purchasing demand was producing a kink in the yield curve: 4 3/4-year gilts were yielding 3 per cent where 5-year gilts (whose prices were rising due to demand) were paying 2.8 per cent. Treue bought the slightly shorter maturities and shorted the slightly longer maturities. A year later in March 2010, when the Bank eased quantitative easing, yields realigned.

This past April, Barnegat initiated a trade based on the yield and pricing gap between Japanese Treasuries (JGB) and their inflation-protected versions (JGBi). Treue identied bonds with the same coupons of 0.1%, both due in March 2029. He bought JGBi at 99.756, which was yielding 0.129%. He then shorted the nominal Treasurys at a price of 101.747. This has produced a negative yield of -0.095%.

"In effect," Treue explains, "the market is paying us 0.224% a year and offering a free option on Japanese inflation being greater than 0." The manager plans on holding this trade through early 2029 when both bonds will mature at 100, producing an additional 2% return.

To materially profit from these small spread trades, the manager relies on significant gross leverage, typically between 15 to 25 times his net assets. To help manage leverage risk, Treue keeps more than half of his assets in cash to be able to meet margin calls, allowing him to stay in positions until more rational pricing returns. The lowest his cash position has ever fallen to was during 2008 when it hit 37% as he was forced to meet margin calls.

The manager doesn't have a near-term outlook. "Whether we're in an up or down market, I'm focused more on when volatility leads to mispricing," says Treue. Uncertainty, which fuels volatility, never seems to be far away, explaining why the manager has enjoyed a long track record of finding opportunities.

Barnegat Founder and Manager Bob Treue

over the past 5 years: 11.42% versus 2.91%. The venerable $23.6 billion Citadel Wellington (No. 19) was the strategy's top-performing fund with annualized returns of 14%. (Citadel declined to comment for this survey.)

Hong-Kong based Segantii Asia-Pacific Equity Multistrategy fund (No. 48), which was managing $4.8 billion at the end of last year, has also delivered annualized returns of 14% since its launch 13 years ago. As its assets have grown, Segantii appears to have become a less volatile, steadier absolute return oriented fund, producing net annualized returns of 8% over the last 5 years with no correlation to the market.

Segantii's success, explains founder and chief investment officer portfolio Simon Sadler, was founded on the gradual liberalization of regulatory and corporate standards of the Eastern world. At the same time, Sadler seeks to exploit short-term pricing inefficiencies, especially during sharp bouts of turbulence, that persist across much of the Asian-Pacific region because local markets are often dominated by mercurial retail investors, fluctuating liquidity and restricted capital flows.

2021 SURVEY OF THE TOP 50 HEDGE FUNDS

RANKINGS 2018 WSJ*/ 2019 SALT*	GIR 2020 Ranking	Fund	Launch Date	Strategy	Fund Assets ($ Millions)	Firm Assets ($ Millions)	2018 Net Returns	2019 Net Returns	2020 Net Returns	2021 1Q Net Returns	3-Year Annualized Net Returns (%) Thru 2020	5-Year Annualized Net Returns (%) Thru 2020	Annualized Net Returns Since Inception Thru 2020	Worst 5-Year Draw Down (%) Thru 2020	Worst Draw Down (%) Since Inception Thru 2020	5-Year Standard Deviation Thru 2020	Annualized Standard Deviation Since Inception Thru 2020	5-Year Sharpe Ratio Thru 2020	Sharpe Ratio Since Inception Thru 2020	5-Year Fund Correlation vs S&P 500 TR Thru 2020
-- / 28	21	Intrinsic Edge Capture LP (Chicago)	Jan-07	Equity Long/Short	394	954	7.82	6.67	15.32	9.62	9.86	13.47	13.89	-12.24	-15.97	10.94	13.25	1.13	0.98	0.58
11 / 15	22	Waha MENA Equity (Abu Dhabi, UAE)	Jan-14	Emerging Market Equity Long-Bias	433	920	6.62	19.74	14.07	5.47	13.37	13.15	14.27	-14.20	-14.20	10.28	10.01	1.35	1.49	0.63
-- / NA	23	Citadel Tactical (Chicago) **	Jan-08	Quantitative Equity	1,554	33,748	8.88	20.30	20.24	5.00	16.35	12.70	20.13	-7.43	NA	5.76	NA	1.86	NA	0.04
-- / 11	24	Covalis Capital Master A (Georgetown, Cayman Islands)	Oct-12	Equity Long/Short	427	763	7.30	8.24	17.55	7.32	10.93	12.44	13.87	-8.78	-8.78	8.33	8.28	1.36	1.59	0.26
-- / 29	25	Boothbay Absolute Return Strategies LP (New York)	Jul-14	Multistrategy	824	1,154	6.07	11.80	25.24	3.86	14.09	12.33	11.25	-2.41	-2.41	4.66	4.25	2.41	2.44	0.41
27 / 49	26	Anson Investments Master LP (Toronto)	Jul-07	Equity Market Neutral	541	852	19.28	10.10	44.52	28.89	23.82	12.15	13.86	-17.36	-17.36	12.13	10.36	0.91	1.27	0.17
-- / 20	27	Global Sigma Group (AGSF) (Boca Raton, FL) ***	Apr-13	Options Strategies	301	301	15.84	10.11	7.20	2.32	11.01	12.07	12.49	-3.14	-13.42	2.41	5.79	4.54	2.03	-0.13
-- / NA	28	FengHe Asia Ltd (Singapore)	Dec-12	Emerging Mkts. - Asia	1,137	1,195	10.38	6.47	19.11	12.80	11.86	11.87	14.32	-9.89	-9.89	8.53	11.10	1.26	1.23	0.51
-- / 34	29	Alphadyne International Master (New York)	Apr-06	Global Macro	5,900	7,800	10.68	17.46	20.60	-0.11	16.17	11.80	9.49	-5.59	NA	5.03	NA	2.12	NA	0.07
-- / 24	30	D.E. Shaw Composite (New York)	Mar-01	Multistrategy	19,200	55,000	11.20	10.40	19.14	4.97	13.49	11.32	11.70	-2.80	NA	3.76	NA	2.71	NA	0.16
		BarclayHedge Hedge Fund Index	Jan-97		N/A	N/A	-5.23	10.64	11.14	4.79	5.23	6.41	8.21	-11.90	-24.09	7.27	7.18	0.73	0.86	0.92
		S&P 500 Total Return Index	Jan-80		N/A	N/A	-4.38	31.51	18.40	6.18	14.19	15.22	11.92	-19.60	-50.95	15.13	15.12	0.93	0.52	1.00

* The Wall Street Journal survey of 60 funds and the SALT survey of 50 funds were based on the same methodology as the current survey. When a fund doesn't show a ranking in either of the previous two surveys, it means either fund data was not available or that it did not qualify for inclusion.

** Citadel AUM data is as of 1 January 2021. *** $34M of the AGSF fund is run pari passu but with 10% less leverage. N/A = data not available.

The contrast between the average global macro fund performance and the 7 that made this year's survey is also striking: 12.13% versus 3.48%. Over the last 5 years, the $704 million Haidar Jupiter (No. 7) and $18.2 billion Element Capital (No. 17) generated gains of 22.1% and 14.5%, respectively--the highest returns of all global macro funds in the Top 50.

Both funds declined to comment for this report. But these two funds reflect how disparate underlying performance actually can be within the same strategy. The unsurprising takeaway: greater returns often come with greater risk.

Several numbers jump out. Haidar Jupiter's worst drawdown over the last 5 years was over -32%, while Element's was a much more constrained -7.5%.

Standard deviation can be misleading because it reflects both upside and downside movement. Haidar Jupiter's 5-year volatility was over 27, while Element's was 9.4. This helps explains the wide gap in the two funds' risk-adjusted returns. Haidar Jupiter's Sharpe Ratio was

Consistent Debt Returns: Arena Investors LP

In the 63 months since Arena's launch, the 49th-ranked fund has experienced just 3 down months. The worst was a Covid-induced decline of -1.63% in March 2020.

Some debt managers control drawdown by only recognizing it when loan values break below the asset value against which it's being lent. Arena portfolio manager, Dan Zwirn, explains the fund marks it loans' values more accurately based on impairment of expected rates of return—making the fund's limited drawdown even more compelling.

"We're not looking for large gains," quips the manager, "but we will bore you to death with consistent, repeatable steady returns." The fund has been averaging net gains of around 8% over the last 5 years. This point is also borne out by the fund's low level of volatility.

Arena invests in under-researched opportunities, making more idiosyncratic loans that are high in the capital structure to help reduce impairment risks. Its diversified sub-investment grade loan book is set against real estate, corporate credit, and commercial and industrial assets. Arena invests predominantly in developed markets worldwide where there are well-established regulations and litigation processes in place.

Loans range in size from $5 to $50 million, and the number of outstanding loans are between 100 and 120. Loan-to-value ratios are typically 60% with short-term maturities ranging from one to three years. Heavy reliance on floating rates helps mitigate hits to loan valuations.

Another key to the fund's steady returns and low volatility is it hedges many risks. For instance, when lending to oil and gas concerns, it will require borrowers to enter into swaps to lock in the underlying value of the loan. With 20% of the Arena's NAV involving foreign exposure of some kind, the fund hedges FX risk.

Zwirn sees expanding distressed opportunities in aviation and commercial real estate, and long opportunities in beneficiaries of the pandemic such as e-commerce, digital factoring and "software as a service" businesses.

Arena PM Dan Zwirn

2021 SURVEY OF THE TOP 50 HEDGE FUNDS

GLOBAL INVESTMENT REPORT

RANKINGS 2018 WSJ*/ 2019 SALT*	GIR 2020 Ranking	Fund	Launch Date	Strategy	Fund Assets ($ Millions)	Firm Assets ($ Millions)	2018 Net Returns	2019 Net Returns	2020 Net Returns	2021 1Q Net Returns	3-Year Annualized Net Returns (%) Thru 2020	5-Year Annualized Net Returns (%) Thru 2020	Annualized Net Returns Since Inception Thru 2020	Worst 5-Year Draw Down (%) Thru 2020	Worst Draw Down (%) Since Inception Thru 2020	5-Year Standard Deviation Thru 2020	Annualized Standard Deviation Since Inception Thru 2020	5-Year Sharpe Ratio Thru 2020	Sharpe Ratio Since Inception Thru 2020	5-Year Fund Correlation vs S&P 500 TR Thru 2020
31 / 10	31	Omni Event (London)	Sep-13	Event Driven	853	853	14.64	11.15	8.73	5.83	11.48	11.22	10.18	-15.12	-15.12	9.52	8.87	1.07	1.06	0.43
51 / 40	32	Citadel Global Fixed Income (Chicago) **	Aug-12	Macro/Fixed Income	2,261	33,748	6.74	5.49	17.53	9.09	9.79	11.05	9.78	-3.37	NA	5.48	NA	1.66	NA	-0.22
60 / 44	33	Wolverine Flagship Trading Ltd (Chicago)	Sep-01	Multistrategy	3,335	3,335	5.13	10.88	13.62	4.27	9.81	10.94	8.08	-10.74	-25.97	6.63	6.68	1.48	1.02	0.68
-- / NA	34	Aristeia International Ltd A (New York)	Aug-97	Fixed Income - High Yield	1,721	3,753	6.78	6.12	21.81	4.12	11.34	10.53	12.03	-4.30	-30.20	4.74	8.12	1.98	1.24	0.50
58 / 47	35	Owl Creek Credit Opp. LP (New York)	Jul-12	Event Driven	442	2,067	6.54	9.22	10.52	9.84	8.75	10.23	8.09	-15.09	-15.09	8.54	7.14	1.07	1.04	0.68
37 / NA	36	Millennium USA LP (New York)	Jan-94	Multistrategy	15,256	38,941	5.75	9.73	25.28	2.99	13.28	10.21	13.78	-3.74	-7.01	4.20	4.31	2.16	2.60	0.30
-- / NA	37	Mariner Atlantic Multistratgy (New York)	Oct-95	Multistrategy	1,100	5,900	9.81	10.35	10.32	5.35	10.16	10.03	7.85	NA	-7.24	NA	4.41	NA	1.30	NA
-- / NA	38	Brook Absolute Return Focus USD I (London) ^	Nov-15	Equity Long/Short	770	3,228	12.07	12.41	47.11	4.35	22.77	10.00	9.42	-24.32	-24.32	23.80	23.64	0.46	0.44	0.48
-- / 39	39	ChapelGate Credit Opportunity Ltd--B (Singapore)	Dec-05	Credit Multistrategy	1,080	6,625	5.18	12.56	8.41	0.93	8.67	9.87	8.56	-7.33	-7.33	5.50	4.83	1.09	1.56	0.70
8 / 18	40	John Street Capital Vantage Strategy (London)	Jul-13	Systematic Macro	2,786	2,786	13.28	13.14	5.64	0.70	10.64	9.87	10.76	-10.85	-19.54	14.18	15.29	0.62	0.65	-0.01
		BarclayHedge Hedge Fund Index	Jan-97		N/A	N/A	-5.23	10.64	11.14	4.79	5.23	6.41	8.21	-11.90	-24.09	7.27	7.18	0.73	0.86	0.92
		S&P 500 Total Return Index	Jan-80		N/A	N/A	-4.38	31.51	18.40	6.18	14.19	15.22	11.92	-19.60	-50.95	15.13	15.12	0.93	0.52	1.00

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** Citadel AUM data is as of 1 January 2021.

^ Brook Absolute Return Focus Fund was formerly Odey Absolute Return Focus Fund and fund assets include $770M that are run separately as a UCITS with +90% of the same holdings, but with different weightings.
N/A = data not available.

0.77; Element's was a more impressive 1.42.

All that said, Haidar Jupiter bolted out of the gate in 2021, up nearly 33% in the first quarter while Element slipped by nearly -10%.

Size

Some very large funds are strong, consistent performers, including Tiger Global, Citadel, D.E. Shaw, and Element Capital. The seven biggest funds that made the survey are collectively managing $108 billion, more than double the assets of the other 43 smaller funds that comprise the survey. However, 10 of the top 15 funds on this survey each ran less than $900 million in assets.

This annual survey has regularly identified smaller funds as being more consistent long-term top performers than their larger brethren, with 28 of the Top 50 managing less than $1 billion, 20 ran less than $725 million, and 13 had assets of less than $500 million.

Panayiotis Lambropoulos, a hedge fund portfolio manager at the $32 billion pension fund ERS Texas, believes "in the merit of proven, smaller, institutional-caliber managers to help potentially achieve long-term investment goals." His pension fund has teamed up with the funds of funds manager PAAMCO-Prisma to underwrite small, emerging managers to help boost returns.

"Because of their size," explains Eric Costa, global head of the hedge funds investment group at the consultancy Cambridge Associates, "smaller man-

> "Equity fundamentals don't make any valuation sense. Many investors are looking away from the essential indicators and more towards technical analysis and sheer momentum which isn't sustainable"
>
> - Giovanni D'Alesio, GAM

agers have the ability to invest meaningfully across a wider universe, compared with larger peers, and move in and out of positions more nimbly, without impacting prices."

Another quality sometimes revealed among successful smaller funds that have been around for a while is they are less concerned about asset gathering and more focused on fund management. Bob Treue's Barnegat Fund is an extreme example. The fund regularly qualifies for this survey, and has a 20-year track record with net annualized returns of 15%. "I don't have anything like a full-time marketer. It's not who I am," explains the Hoboken, NJ-based manager, who clearly moves to a different beat. (See profile on p. 9.)

2021 SURVEY OF THE TOP 50 HEDGE FUNDS

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28 / 18	41	Twin Tree Capital Master (Dallas)	Jan-13	Volatility Trading	821	821	11.45	5.49	16.84	2.21	11.17	9.53	11.47	-3.24	-6.59	5.09	5.99	1.65	1.79	-0.15
33 / 48	42	Barnegat Ltd (B) (Hoboken, NJ)	Jan-01	Fixed-Income Relative Value	722	722	5.26	8.24	11.67	0.93	8.36	9.50	15.04	-9.47	-55.86	7.96	16.17	1.05	0.85	0.61
17 / 25	43	Blue Diamond Non-Directional (Pfaffikon, Switz.)	Oct-11	Statistical Arbitrage	1,210	1,210	17.27	5.09	11.78	7.67	11.27	9.08	14.87	-9.70	-9.70	8.14	11.23	1.12	1.32	0.04
-- / 31	44	Ninepoint TEC Private Credit Class F (Toronto) ^^	Jan-12	Asset-Backed/ Enterprise Loans	995	6,023	10.64	8.69	5.72	3.27	8.33	9.00	9.69	-1.86	-1.86	1.70	2.12	4.62	4.02	0.11
-- / NA	45	Hudson Bay International (New York)	Jun-06	Multistrategy	5,073	7,971	5.93	8.03	16.30	9.02	10.00	8.82	8.90	-2.88	-6.09	2.83	4.37	2.72	1.80	0.33
-- / NA	46	Brevan Howard Master - Class A (London)	Mar-03	Global Macro	4,700	12,231	12.39	8.47	27.40	2.13	15.81	8.65	8.96	-5.96	N/A	10.31	6.12	0.73	1.21	-0.32
-- / NA	47	BTG Pactual Rates ^^^	Jan-16	Fixed-Income Arbitrage	309	72,000	6.78	11.28	7.77	2.46	8.59	8.08	8.08	-1.71	-1.71	2.36	2.36	2.87	2.87	-0.16
4 / 13	48	Segantii Asia-Pacific Equity Multistrategy (Hong Kong)	Dec-07	Multistrategy	4,842	4,842	11.34	5.52	7.87	7.53	8.22	7.98	13.99	-3.45	-10.16	4.59	8.34	1.74	1.68	0.03
-- / NA	49	Arena Special Opportunities Onshore (New York)	Oct-15	Special Debt Opportunities	1,000	2,026	8.00	8.14	5.75	2.10	7.28	7.95	7.57	-1.63	-1.63	2.50	2.48	2.73	2.61	0.26
52 / NA	50	Episteme (ESQ Composite) (London)	Sep-09	Systematic Macro	711	881	13.82	14.47	4.50	4.35	10.83	6.97	5.30	-9.95	-9.95	8.50	7.79	0.68	0.61	0.29
		Top 50 Averages	14.5 Years		3,122	8,842	12.81	16.16	24.20	5.41	17.26	14.81	13.34	-12.22	-19.62	11.17	11.57	1.56	1.35	0.31
		BarclayHedge Hedge Fund Index	Jan-97		NA	NA	-5.23	10.64	11.14	4.79	5.23	6.41	8.21	-11.90	-24.09	7.27	7.18	0.73	0.86	0.92
		S&P 500 Total Return Index	Jan-80		NA	NA	-4.38	31.51	18.40	6.18	14.19	15.22	11.92	-19.60	-50.95	15.13	15.12	0.93	0.52	1.00
		JPMorgan Global Gov't Bond Index (USD)	Jan-85		NA	NA	1.02	6.05	5.55	-3.42	4.18	3.36	6.99	-4.51	-8.43	3.28	5.85	0.68	0.65	-0.28

* The Wall Street Journal survey of 60 funds and the SALT survey of 50 funds were based on the same methodology as the current survey. When a fund doesn't show a ranking in either of the previous two surveys, it means either fund data was not available or that it did not qualify for inclusion. ^^ Prior to Jul 2016, when the TEC Private Credit Fund Series F was created, performance and risk data were based on the Trust vehicle that was launched in Jan 2012 which ran pari passu with the present Fund. ^^^ Prior to April 2016, BTG Pactual Rates was a Yen-denominated Fund of One for a single investor. Data cited for the first three months of 2016 relates to the Fund's investment activities under its prior name--Focus Fund.

N/A = data not available.
Fund Ranking is based on 5-Year Net Annualized Returns Thru 2020. For inclusion, a fund must have assets of at least $300 million as of the end of 2020, pursuing a broad strategy, and generated minimum returns of 5% in both 2018 and 2019, and 4.5% in 2020.
Sources: Backstop BarclayHedge, Preqin, and various proprietary and online sources.

OPPORTUNITIES & RISKS

Pleased with how his hedge funds have been performing, Marc Sbeghen, co-founder and co-portfolio manager of the Swiss-based alternative investment specialist Iteram Capital, expects to maintain two-thirds of his exposure in the asset class. "Experienced, well-managed hedge funds," explains the former executive of Banque Privée Edmond de Rothschild, "can control their directionality and exposure in response to changing economic and market conditions better than mutual funds, private equity and credit, venture capital, and real estate, whose orientation is pretty well set when they're launched."

This is one of several common sentiments expressed by a host of allocators interviewed for this survey.

Most allocators generally believe the risk of the pandemic to economies and markets is mostly behind them. Mohamed Farid, a principle portfolio manager at the World Bank, who's managing over $3 billion in absolute return strategies, thinks, "unless something unexpected occurs, the market impact of Covid-19 for the rest of the year looks benign, as vaccines prove effective, their rollout expands across the country, and economic stimulus continues to prime spending and growth. I expect these forces collectively will drive market prices."

While he acknowledges the risk posed by variants and the virus' persistence in hard-hit places like India, he notes stock markets even in India remain strong.

Most allocators believe current inflation fears seem to be transient--caused by bottlenecks resulting from economies reopen-

David Rosenberg: An Economist's Cautionary Thoughts

EU: How do you explain markets soaring during the pandemic and how do you see 2021 as we get the pandemic under control?
DR: The best way to understand what's going on is in terms of liquidity. I think what we witnessed was one of the most impressive liquidity bubbles of all time. Fundamentals or valuations don't really count for much in this massive money creation environment. Of course, we also had the huge fiscal support, the vaccinations and the reopening of the economy. But now that these have happened, their incremental impact on the markets is likely to dissipate.

EU: What are the main risks investors are facing in 2021?
DR: The major risks are excessive valuations and perhaps earnings expectations that may not end up getting fulfilled. While the Covid-hit service sector will rebound sharply with the pandemic largely behind us, there is going to be a significant payback in the durables goods sector from the unprecedented expenditure growth of the past year. This is a $2 trillion consumer market or 10% of GDP. The surge in raw material prices is great for commodity producers but will pose a margin squeeze for a wide swath of industries.

EU: I guess then you're feeling cautious about the market?
DR: The complexion of the market has already changed. Growth has given up leadership to value stocks, but we need ever-higher interest rates and inflation to make this more than just a trade. So I am skeptical. Small-cap stocks, which provide the pulse over the domestic economic outlook, peaked three months ago, and, all of a sudden, Treasury yields have stopped going up and, in fact, real rates have started to decline. Valuations overall are too extreme and credit spreads are far too tight. I do think there is going to be increased movement back into bonds and into gold, and this may have already started. Just as the stimulus checks and the huge spending from them have borrowed growth from the future, the massive stock market gains this past year have also robbed us of future returns.

Photo credit: Courtesy of Max Rosenstein

EU: Are you then concerned about a market sell-off?
DR: A new corrective phase could remedy this, and so I think treating cash right now as a source of liquidity for later to buy risk-assets at more appropriate valuations makes perfect sense to me. Of course, this also means preaching patience and discipline, which is a tough sell for the current "get me rich" investor mindset, but which is what I am advising nonetheless. I am sensing the broad indices are forming a topping pattern and being forewarned means being forearmed.

EU: What else are you most afraid of?
DR: First, I'm afraid of rising social tensions here and abroad. Second, I'm worried about China's relationship with the rest of the world, which is likely to undergo a major transformation after the pandemic has passed. And third, we're facing massive public deficits and debt and expanding government regulations, and how all this is going to play out for the economy is also very unclear.

EU: What government regulatory shifts are you concerned about?
DR: I'm worried about new regulations pertaining to the financial, energy, and technology sectors. And we're also uncertain about what fiscal policy is going to look like. Who is going to pay for these massive public deficits and debt? How will bloated government and Federal Reserve balance sheets get resolved? I think this means we're going to have to move to a world of higher taxation, and this will likely pinch future economic growth.

ing—and central banks will not be raising interest rates this year. Toward the end of 2021, however, they expect these banks to start tapering their quantitative easing.

Allocators agree valuations are high and will likely go even higher, because as GAM's Giovanni D'Alesio explains, "most investors don't see any other place to go." But he notes not all sectors and industries are overvalued.

One main reason allocators remain keen on hedge funds is their various strategies extend well beyond high-priced stocks. That said, hedged equity funds remain in vogue. But allocators are increasingly seeking managers focused on delivering uncorrelated

> "Because of their size, smaller managers have the ability to invest meaningfully across a wider universe, compared with larger peers, and move in and out of positions more nimbly, without impacting prices."
>
> \- Eric Costa, Cambridge Associates

Alpha.

This has been a priority of the World Bank after its hedge fund book took a significant hit in 2008 due to material exposure to market beta and illiquid investments. "Since then," explains Farid, "we have constructed a pure alpha portfolio that targets consistent absolute performance irrespective of what the market may be doing through a portfolio of funds that seek to deliver average volatility of 3% and net returns of 5-6%.

With the tremendous rally in growth shares, allocators last year started to rotate into value. Vincent Berthelemy, cross asset strategist and portfolio manager at the $7.1 billion alternative investment joint venture Investcorp-Tages, explains his firm has so far moved around 6 percentage points of exposure from growth-focused hedged equity funds to more value-oriented special situations and event driven managers. "If we see a pullback in value triggered by a reversal of flows into the space," explains Berthelemy, "we'll treat this as a buying opportunity to add more value."

Discretionary global macro is also attracting allocator attention as economies move out of the shadow of the pandemic. The strategy can offer investors a prompt response to unexpected turns in bond and equity indices, interest rates, commodity prices, and volatility.

Fixed-income relative value

Why Good Funds Didn't Make the List

The common reason a hedge fund doesn't make this survey is due to inconsistent or lackluster returns.

But some very good funds have been excluded because they didn't straddle the minimum performance hurdles that have been in place for each of the last three years. The survey initially established these hurdles in 2018 to spotlight funds that made money when the market was down.

Marshall Wace's $16.5 billion Eureka equity long-short fund has delivered positive returns over each of the last five years through 2020. Paul Marshall's fund has generated annualized returns of 12.5% since it launched in 1998 with annualized volatility of a little over 8%. Its returns in 2018 were marginally in the black, outperforming the industry and the market, which were down about -5%. But its gains didn't meet the survey's +5% hurdle for that year.

The $4.6 billion Linden Capital, a multistrategy fund, also delivered positive gains over each of the last five years. Since its inception in May 2003, Joe Wong's fund has delivered annualized gains of 11.6% with volatility that's been averaging less than 9.5%. But it was up only 9 basis points in 2018.

Sierra Europe, a hedged equity fund, is intriguing for more than its historical returns of more than 9% a year (in US dollar terms) and volatility of 8.2% since it launched nearly a quarter century ago. It has delivered these gains by contrarily focusing on a region that has unified its currency, interest-rates, and many regulations while much of the world is being pulled by growing nationalism in the opposite direction. Also noteworthy: Sierra experienced its worst selloff of 17% when the Tech Wreck struck at the beginning of the century, which was less than half of what the S&P lost during the same period.

Charles Michaels' fund has easily exceeded the survey's hurdles over each of the last three years, soaring 25% in 2020. However, fund assets were only $154 million--below the survey's minimum of $300 million.

is also being embraced by many allocators as a means to gain uncorrelated returns through leveraged exposure to corporate and sovereign debt spreads, assets that otherwise are offering virtually no returns and capital risk if interest rates begin to rise.

Allocators are also hedging inflation risk by moving into commodities (including industrial and precious metals, grains, and fuel) real estate, and businesses protected by large moats that have the ability to pass on higher costs, like some of the big name tech giants.

Sbeghen explains Iteram is not geographically centric. But he sees a special opportunity in the UK as the country deals with Brexit-related issues, the severe hit it took from Covid-19, and a significant sell-off in mid-caps. "We believe these UK shares are fertile for M&A and related activity," says Sbeghen.

While allocators are globally diversified, this exposure is tilted toward the US. Cedric Dingens, head of investment solutions and alternative investments at the CHF 10 billion asset manager Notz Stucki, says his firm has "more than half of its exposure in the US, a quarter in Asia and about 20% in Europe. We are partial to American markets because of the depth of opportunity in the states and its significant retail activity, which can create volatility and momentum."

> "Most of the country is functioning as if the pandemic is in the rearview mirror, but as of mid-June, the country's vaccination rate seems stalled in the mid-60%. And only 16% of the global population has been fully vaccinated."
>
> - Panayiotis Lambropoulos, ERS Texas

And while many allocators are looking at China as a source of outsized gains, including Dingens who thinks the country will see the fastest economic growth over the near term, down the road others see the country as the leading source of geopolitical risk.

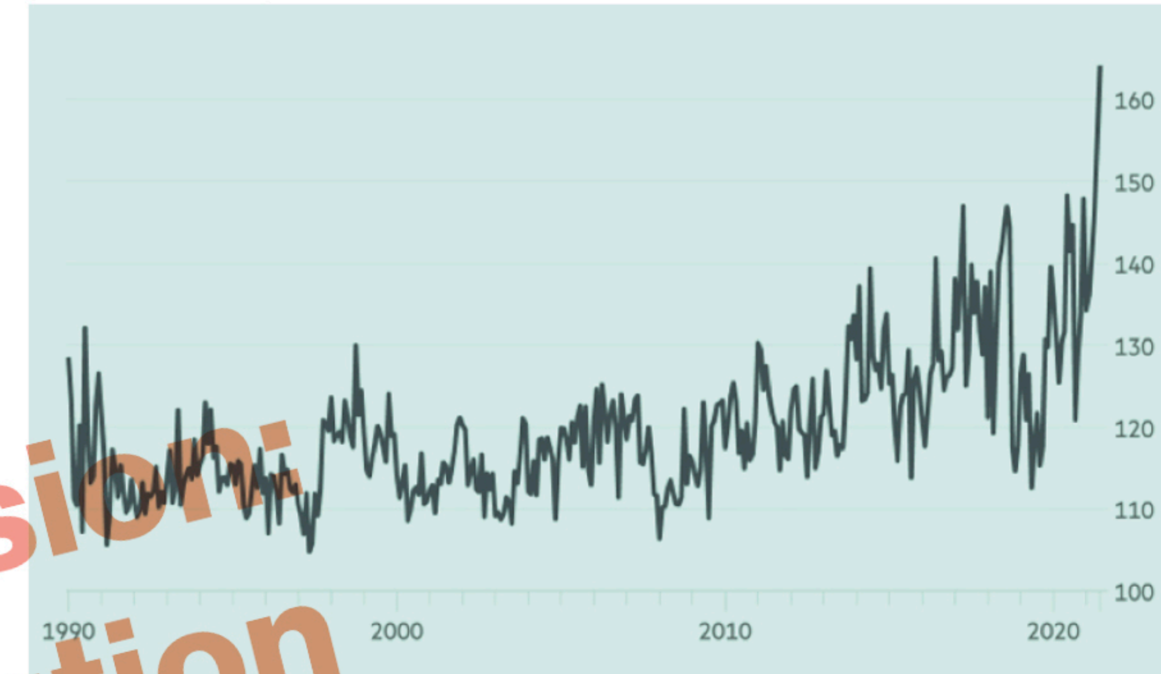
Divergence

Allocator opinions diverge on several key issues. While ERS Texas' Panayiotis Lambropoulos predicts economic data for the rest of 2021 will likely surprise on the upside, he remains cautious about Covid-19.

"Most of the country is functioning as if the pandemic is in the rearview mirror," explains Lambropoulos. But as of mid-June, the country's vaccination rate seems stalled in the mid-60%." While transmission, hospitalization, and death rates are all trending in the right direction, he wants to see if these numbers hold past summer and into winter (when people are back inside) to have a clearer understanding where we are in the pandemic, especially as the more virulent Delta variant takes hold even in vaccinated places around the world."

Moreover, the manager sees serious gaps in vaccination and recovery across a good portion of the emerging world where transmission rates don't stop at their borders, especially as travel and business continue to open up worldwide. According to recent data, Lambropoulos says only "around 38% of all available vaccine doses have gone to just 16% of the global population." And that worries him.

CBOE SKEW INDEX: RISING HEDGING COSTS



Investors who purchase options to partially insure against a market sell-off seem to agree that lately owning unhedged equity positions may be a bridge too far.

Source: Wigglesworth and Mackenzie, "Record Highs for Skew Index Show nagging investor nerves, The Financial Times, p. 10, 2 July 2021,

With hedge fund assets approaching $4 trillion and a limited number of high quality, consistently performing managers, Giovanni D'Alesio thinks allocators need to pay careful attention to managers' stated capacity limits.

"When a manager starts exceeding that number," says D'Alesio, "investors should request to see its analysis that shows why higher fund capacity is possible without compromising investment process and performance." D'Alesio would want to know what specifically changed in a manager's calculus. If a fund believes, for example, increasing liquidity is enabling it to manage greater assets, D'Alesio says there's a clear risk that central banks and governments may pull back on liquidity.

He also cautions small-cap managers may allow positions to appreciate into mid-caps and may venture into the pre-IPO market to expand their investment universe, both of which introduce new risks and performance expectations.

Two allocators think Europe offers a solution to overvalued US markets. Elisabetta Manuli, vice president and fund manager at the Milan-based fund of funds Hedge Invest, "thinks European opportunities are more attractively valued than US shares,

How To Mitigate Emerging Market Risk: Waha MENA

Waha Mena Portfolio Manager
Mohamed El Jamal

Thinking about the investment universe as a large commercial airliner, emerging markets occupy the tail end of the plane. They have plenty of potential to jet ahead. But when there's turbulence, they feel it the most, making them notoriously volatile, exposed to forces typically beyond their control.

Lead portfolio manager Mohamed El Jamal's investment approach has moved his Waha MENA equity long bias fund towards the business class section, and the 23rd spot in this year's survey.

Since its launch in the beginning of 2014, the fund has realized annual net returns of more than 14% and never had a down year. Its annualized volatility has been 10%, its worst drawdown was -14.2%, and its historical Sharpe Ratio was 1.5.

According to El Jamal, the Abu-Dhabi-based fund has delivered consistent performance by its independent, in depth understanding of inefficient Middle East/North African markets, finding under-researched companies across the region.

Investing primarily in nine countries, ranging geographically from Morocco on the Atlantic Ocean to Oman on the Indian Ocean, the fund combines macro views and bottom-up company analysis in constructing and managing its portfolio.

For example, in late 2015, due to El Jamel's strong bearish view of oil, the fund shifted half its portfolio into cash, significantly sidestepping the impact wrought by the subsequent collapse of petroleum prices. And starting in January 2020, again sensing growing risk of a global pandemic, it cut its net long exposure from 75% to 35%. While the MENA index fell 30% during the first quarter of the year, the fund's losses were just half that.

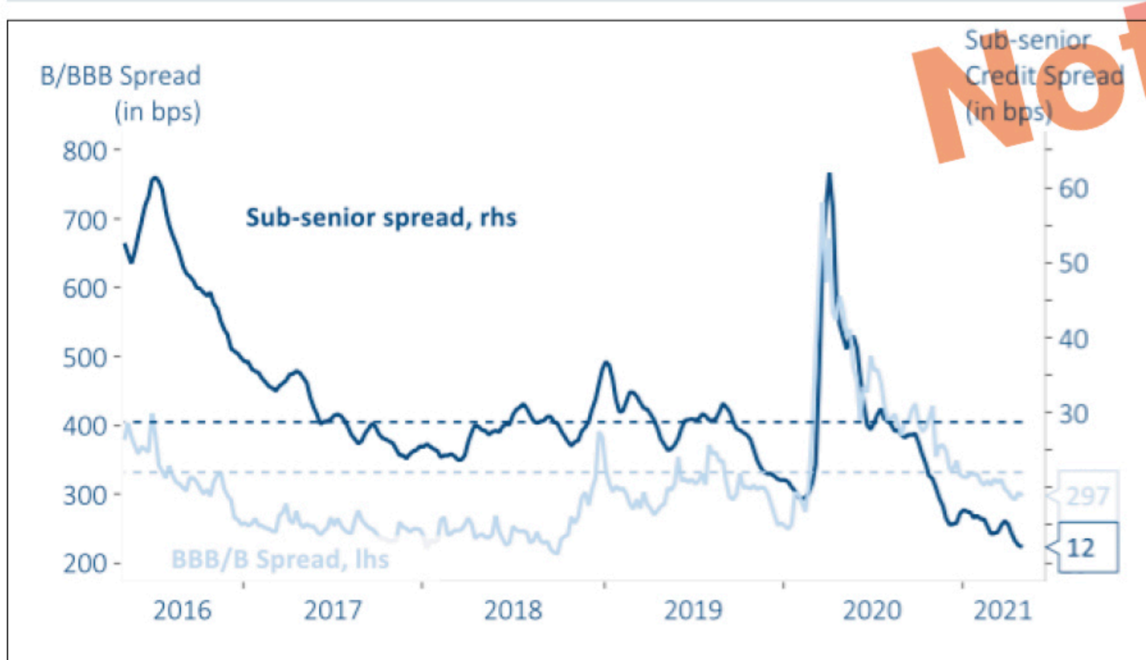
When El Jamal saw central banks and government spending committed to meeting the challenges posed by economic shutdowns, he ratcheted up net exposure. He believes for the rest of 2021, "Value will outperform in our region, involving banks, petrochemicals, real estate, industrial materials, and mining. So we boosted our long book to 105% and reduced our short exposure to 25%."

Waha often targets little known, well-managed companies that deftly allocate capital, with compelling business models that have healthy balance sheets. They are domiciled in countries with substantial sovereign wealth and government spending, and whose currencies are generally pegged to the US dollar.

The fund avoids momentum plays and limits purchases to undervalued shares at prices that are less likely to materially sell-off. It diversifies holdings across 50 to 60 stocks, with weightings typically between two and four percent of NAV. A select number of high conviction investments can top out at 10 to 12%. El Jamal argues these characteristics collectively can help mitigate losses.

Country rotation is also an essential part of El Jamal's fund management. Over the past seven years, Waha has benefitted from Saudi Arabia, Qatar, UAE, and Kuwait having moved from being nearly closed markets to being nearly completely open to foreign investors. "That still leaves potential room for further market opening and improved liquidity," posits the manager. And the fund alters country exposure as nations evolve from frontier to emerging market status, which increases asset flows through re-indexing.

CREDIT SPREADS



The collapse in credit spreads and low default rates do not likely reflect risks facing investors, especially when government begins pulling back on liquidity and market behavior trends back to its pre-pandemic state.

Source: Investcorp Tages

especially since continental recovery is about 6-12 months behind the States." She says the rotation into less crowded European shares appears to have started.

This shift is further stimulated by the continent's embrace of ESG, along with the increasing potential of European restructuring, Green technology, and positive market changes—like greater acceptance of M&A as companies have begun selling underperforming businesses post-Covid. And if Germany's forthcoming elections bring Green leadership to the continent's largest economy, Manuli argues that could be a further boost to European exposure.

GAM's Giovanni d'Alesio also likes Europe. But he notes any shocks that hit US markets are very likely to reverberate across to Europe.

Structured credit strategies remain risky plays. Because Vincent Berthelemy believes there's still plenty of dislocation in the space, he thinks certain mortgage-backed securities and collateralized loan obligations can attractively compensate investors for related liquidity risks as housing prices continue to improve.

Last year, ERS' Lambropoulos expected distressed opportunities would start looking attractive by this time. However, "government monetary and fiscal intervention appears to have contained the economic fallout and bankruptcy rate," he explains.

The World Bank's Farid and GAM's D'Alesio think meaningful distressed opportunities will still evolve. "So far, troubled companies have been able to survive because economies have been pumped full of liquidity and interest rate spreads have not widened, which would trigger borrowing stress," explains D'Alesio. [See table on opposite page.] "However, over the next two to three years, rates may climb and this could generate a rise in defaults."

> "European opportunities are more attractively valued than US shares, especially since continental recovery is about 6-12 months behind the States."
>
> - Elisabetta Manuli, Hedge Invest

Debt

Several allocators express concern about rising margin debt related to investments. "Just as it helps elevate the market," observes Lambropoulos, "margin trends can quickly reverse course if companies fail to meet lofty growth expectations. Increased selling could cascade, leading to margin calls and additional forced selling."

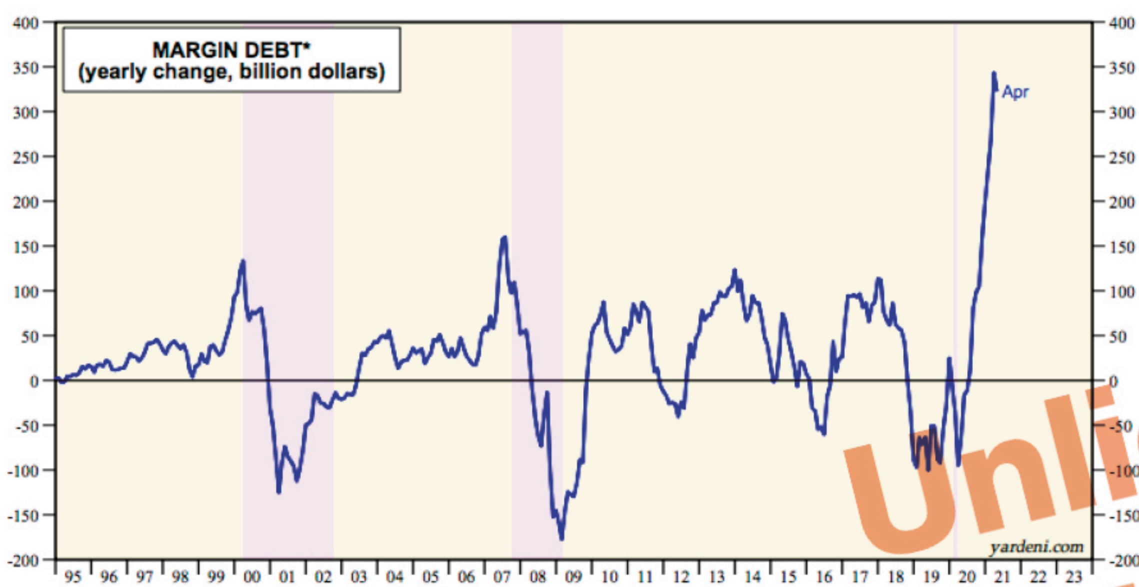
Soaring debt that's been piling up in response to the pandemic worries Eric Knight, CEO and CIO of the Swiss-based asset manager Knight Vinke. "With global debt-to-GDP levels approaching 400% and pandemic-related public expenditures set to increase without restraint almost everywhere," cautions Knight, "the world's financial system is more than usually fragile at this moment and will become even more so."

He finds primary risks in the financial sector where leverage has been rising, contrary to regulatory metrics, counters the impression of strong balance sheets. And he sees anecdotal evidence suggesting the level of distress in some countries is completely at odds with popular rebound scenarios.

Knight is worried about southern Europe, including France, and believes the US market is trading--on a debt-adjusted basis--10% above its valuation at the peak of the dot-com bubble. [See table at bottom left.]

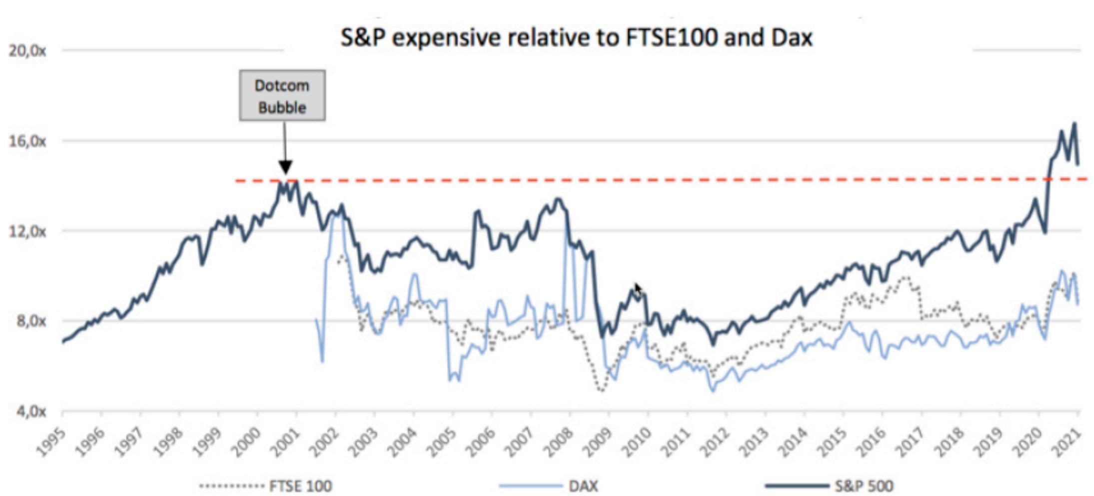
"The value investor in me feels that a correction is long overdue," explains Knight. But he admits the euphoria driven by vaccinations, government handouts and the lifting of restrictions on travel and social interaction is hard to ignore. "Dealing with this contradiction is hard for many asset managers and often leads to paralysis," says Knight, especially as the music plays on. ■

MARGIN DEBT



Debt balances in margin accounts at broker/dealers.
Note: Shaded red areas are S&P 500 bear market declines of 20% or more. Yellow areas show bull markets.
Source: "Stock Market Indicators: Margin Debt," Yardeni Research, 7 June 2021.

DEBT ADJUSTED MARKET VALUATION (EV / Est. EBITDA)



Source: Knight Vinke

Better Understanding Volatility: G2 Investment Partners

G2 Manager Josh Goldberg

"During our first half dozen years as our assets grew," recalls manager Josh Goldberg, "our investment decisions increasingly sort to balance long-term growth with capital preservation." Ironically, instead of dampening volatility, this more micro-managed approach had the opposite effect, preventing his investments from realizing their potential.

When a potential major allocator took a deep dive into the G2's investment selection and management processes in 2016 involving several dozen core positions, it found Goldberg's team was successfully targeting young micro- and small-cap companies that were under-researched and undervalued in technology, healthcare, and consumer goods and services.

After discussing its findings with Goldberg, the investor and manager determined performance could be significantly enhanced by giving stocks more time to perform and enhancing gross leverage from around 90% to up to 140%, while keeping net exposure under 50%. When the investor came on board in 2017, that's exactly what the fund did.

Making these relatively minor adjustments to portfolio management, which cut the fund's pace of trading in half, doubled the fund's annualized returns to 21% over the next four years through 2020. It boosted G2's Sharpe Ratio from 1.0 to 1.56. This meant the fund (No. 15) was generating significantly greater gains without having taken on materially more risk.

"We have retained our objective of finding stocks that are steady compounders, not homeruns," explains Goldberg. Because of his stock selection approach, he believes his long positions "hold up better during downturns because they are strong, resilient growth companies that have attracted more astute investors who may be more inclined to buy on dips, helping to support prices."

This was evident during the last two major market drawdowns. In the fourth quarter of 2018 when the Russell 2000 lost more than 21%, the fund had declined by less than 6%. And during the first quarter of 2020 when the pandemic struck, the small-cap index collapsed by nearly one-third, while G2 again limited losses to less than 5%.

The takeaway, Goldberg notes, is "partnering with perceptive investors can be very helpful in realizing a manager's full potential."

Looking ahead, the manager has a generally positive outlook. But he's concerned about the combination of growing volatility, a market that's richly valued, and investors that are showing little fear. So toward the end of last year, G2 boosted its shorts by 25% and starting harvesting profits, replacing some long positions that had rallied past their target prices with younger companies whose valuations, Goldberg believes, do not yet reflect their longer-term potential.

This independent study is not a recommendation to invest in any of the funds cited, an action that requires extensive due diligence before allocations are made. Special thanks to Marina D'Angiolillo, research and professional services manager at Backstop BarclayHedge, for her extraordinary help for initially screening through thousands of funds in the firm's database and performing specific fund analysis. Additional thanks are extended to the very helpful folks at Preqin's communication team, who also screened through 1000s of funds for this survey.

Eric Uhlfelder covers global capital markets from New York over the past 30 years for various major publications, including The Financial Times, The Wall Street Journal, Institutional Investor, Pensions & Investments, The New York Times, The International Herald Tribune, and BusinessWeek. He wrote the first book on the advent of the euro post currency unification, "Investing in The New Europe," for Bloomberg Press. And he has earned a National Press Club Award. His website is www.globalinvestmentreport.net.