GLOBAL INVESTMENT REPORT

2021 GLOBAL SURVEY OF THE TOP 50 HEDGE FUNDS: FOURTH QUARTER MARKET AND PERFORMANCE UPDATE

The S&P 500 soared nearly 29% in 2021, nearly half of which was generated just in the 4th quarter in spite of clear threats to growth. It was during these last 3 months of the year when the gap between the index and the Top 50 Hedge Funds drastically expanded from nearly 5% to more than 18%. While most of the 50 sustained their historical annualized returns, two basic factors drove last year's performance gap. One: the 10 largest contributors to the S&P 500's returns were responsible for more than one-third of the index's total gains. Two: the reversal in fortunes suffered by a handful of veteran hedged equity and global macro managers who had a long history of consistent solid returns. This report will explore why this occurred. Note: two thirds of the 4th-quarter gains linked to the index's top contributors' were lost during the first 7 weeks of 2022—before Russia invaded Ukraine.

by Eric Uhlfelder
25 Feb 2022

NON-FUNGIBLE SCOTOMA

"Reality cannot be ignored except at a price; and the longer the ignorance is persisted in, the higher and the more terrible becomes the price that must be paid."

Aldous Huxley

The Economist ran an article in the beginning of the year that made me scratch my head. It likely tells us a bit about the current state of markets and investing.

"Ridiculous and cool. That is the architectural brief for a new office tower under construction in the Crypto Valley, a business district of Decentraland, a virtual platform built on the Ethereum blockchain . . . The tower's purpose—to provide office leases for firms and event space for crypto conferences.

Gamers have traded pixelated property and other digital assets for years. Now the activity has been turbo-charged by the growth of unique digital artifacts known as non-fungible tokens (nfts), and by the hype around the metaverse—an emerging virtual market which could, depending on whom you ask, ultimately generate revenues of between $1 trillion and $30 trillion."

Non-fungible tokens, as Reuters explains, "are a type of digital asset that exist on the record-keeping technology blockchain." The news agency reported NFT sales was around $25 billion in 2021, "leaving many baffled as to why so much money is being spent on items that do not physically exist . . . Further, scams, counterfeits and 'wash trading' have become commonplace."

The expansion of such alternative universes recalls an idea from Dan Brown's *Da Vinci Code*. In the movie version, Ian McKellum's and Tom Hank's characters discuss the artist's *Last Supper* and agree on at least one thing: people see what they want to see—calling this bias, scotoma.

Our vision is increasingly challenged by trying to separate what's substantive from what's not. And somewhere in this haze formed by various colliding "realities" may be reasons why there's been substantial disconnect in 2021 between the performance of some very proven and astute hedged equity and macro asset managers versus the market.

Seth Klarman, founder of the $30 billion hedge fund Baupost, puts it plainly: "Against a backdrop of relentless money printing, a very active Federal Reserve, and fiscal

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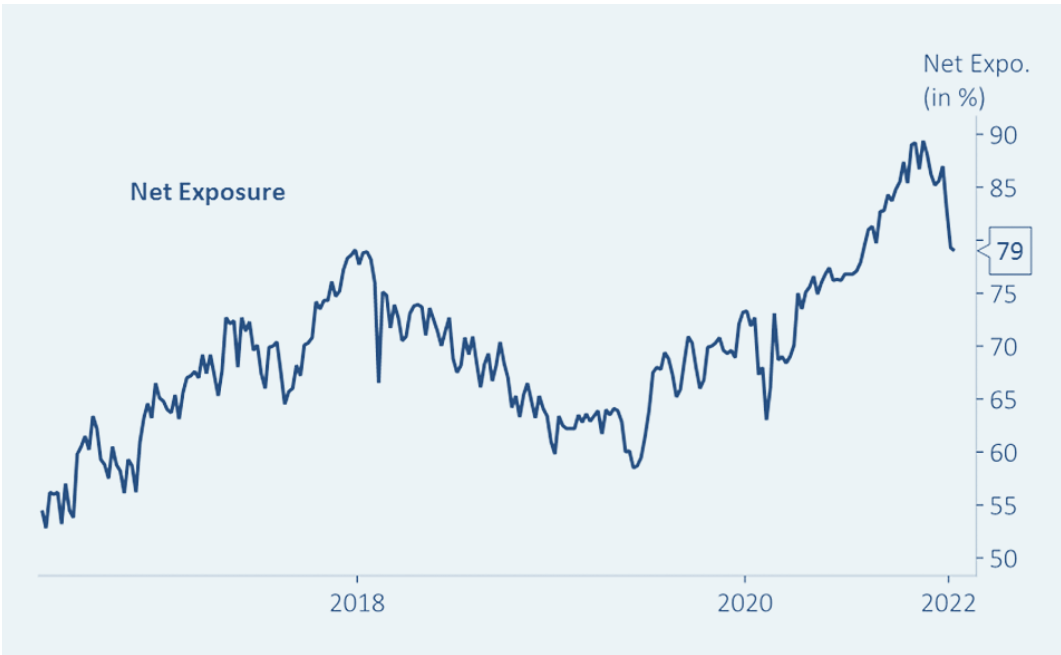
HEDGE FUND STRATEGY PERFORMANCE THRU DECEMBER 2021
Ranked by 2021 Returns

Strategy	1Q2021 Net Returns (%)	1H2021 Net Returns (%)	YTD Returns (%) thru 3Q21	2021 Net Returns (%)	2020 Net Returns (%)	3-Year Net Annualized Returns (%) thru 2020	5-Year Net Annualized Returns (%) thru 2020	10-Year Net Annualized Returns (%) thru 2020
Distressed Securities	8.97	15.73	19.09	20.35	13.18	5.10	6.70	4.51
Equity Long Bias	8.76	14.61	14.17	17.13	16.31	6.92	7.96	6.08
Collateralized Debt Obligations	5.99	10.65	12.51	16.25	-3.17	1.27	6.88	14.16
Asset Backed Securities	4.44	7.31	10.97	13.06	-1.83	2.80	5.40	9.92
Event Driven	7.30	10.90	10.78	12.35	11.12	5.18	7.01	4.68
Equity Long/Short	6.45	8.83	10.25	10.62	9.27	4.14	4.50	4.27
Multi Strategy	4.15	7.08	7.67	10.07	4.23	1.41	2.91	3.37
Global Macro	4.34	7.63	7.59	8.53	10.06	3.94	3.48	2.71
Asset-Backed Loans	2.21	4.08	6.71	8.38	7.01	5.56	6.61	7.08
Equity Market Neutral	2.55	4.76	6.18	8.05	-1.29	-1.19	-0.02	2.00
Merger Arbitrage	4.77	7.34	6.98	7.65	9.18	5.23	5.41	4.72
Convertible Arbitrage	4.79	4.76	5.30	7.43	15.53	7.77	6.18	4.88
Volatility Trading	1.31	4.15	3.92	6.96	15.87	2.14	2.09	1.61
Commodity Trading Advisers	2.38	4.53	5.08	5.29	5.43	2.40	1.32	0.61
Emerging Markets	3.12	8.12	5.56	4.46	15.52	5.07	8.65	3.51
Mortgage Backed Securities	1.8	2.67	3.31	3.37	2.04	2.64	3.63	4.58
Credit Long/Short	0.57	1.98	2.11	1.38	5.18	3.20	3.77	3.63
Fixed Income Arbitrage	2.34	2.31	1.92	0.98	10.46	4.35	4.53	5.30
Credit Long-Only	-1.21	1.56	0.61	0.49	4.43	3.38	3.65	4.46
Fixed Income Diversified	-0.21	1.35	0.82	0.26	5.31	3.44	3.83	5.67
Top 50 Averages	5.41	9.23	11.06	10.43	24.20	17.26	14.81	NA
Backstop BarclayHedge Index	4.79	8.86	8.75	10.20	11.14	5.23	6.41	4.79
S&P 500 Total Return Index	6.18	15.25	15.93	28.72	18.40	14.19	15.22	13.89
JPMorgan Global Gov't Bond Index	-3.42	-2.56	-2.68	-2.54	5.55	4.18	3.36	3.63

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

NET EQUITY EXPOSURE—HEDGE FUNDS (GS)



Source: Investcorp-Tages

largesse, many investors have been lulled to sleep, unaware of and unfocused on risk. No one reasonably laments having paid a modest insurance premium for a casualty that didn't occur. You don't hedge or insure to achieve gains, but rather to hang on to what you have. It only takes one moment of overconfidence, distraction, or sloppiness to undo a lifetime of painstaking compounding."

Digging deeper, Cedric Dingens, head of investment solutions and alternative investments at the CHF 11.2 billion Swiss-based asset manager NS Partners, believes many hedged equity funds that struggled last year likely failed to rebalance their books, especially after registering remarkable profits over the previous years.

Moreover, he cites "growing complacency with past performance that fed excessive sector and stock concentration, a difficult shorting environment, failing to recognize a swiftly changing macro environment, the contagious nature of rising uncertainty, and discounting the value of proactive risk management," as leading reasons behind poor fund performance.

Dingens believes what managers should be doing during especially uncertain times is to "pare back net exposure and short targeted indices that better correspond to their actual long risk while increasing diversity and raising cash, which then can be redeployed into more reasonably valued and evolving opportunities."

Marc Sbeghen, co-founder and co-portfolio managers of the $400 million alternative investment firm Iteram Capital, also based in Switzerland, says it was extremely clear that many managers were hurt by how challenging the search for Alpha was last year (see chart on p. iv).

"Poor Alpha performance can be explained by intensely beta-driven markets," explains Sbeghen, "that left stock pickers struggling in both their long and short books." It was costly to be long growth in crowded TMT shares, and short value positions hit many managers hard, explains Sbeghen. "Highly priced growth shares seemed vulnerable especially with the likelihood that central banks would raise rates while more attractively priced value stocks–which rallied as economies reopened, inflation soared, and interest rates began rising–continue to look more appealing."

Macro managers on the whole turned in a reasonable year gaining 8.5%, according to BarclayHedge. But Vincent Berthelemy, cross-asset strategist and portfolio manager at the $7.5 billion global alternative investment firm Investcorp-Tages, observed several prominent macro funds were tagged by crowded curve trades in developed countries. "The steepener trade in particular," notes Berthelemy, "was one that hurt managers as some managers misread the risks of persistent inflation and sharp policy turns." (See interview of Bob Treue, manager of the Barnegat Fund, on p. ix.)

Macro funds that lost money likely didn't have significant exposure to rallying global equities and commodities.

STRATEGY PERFORMANCE

Hedge fund strategy returns were even more dynamic in 2021 than they were in 2020 when most broke out of a narrow historical performance range (see table on pg. ii).

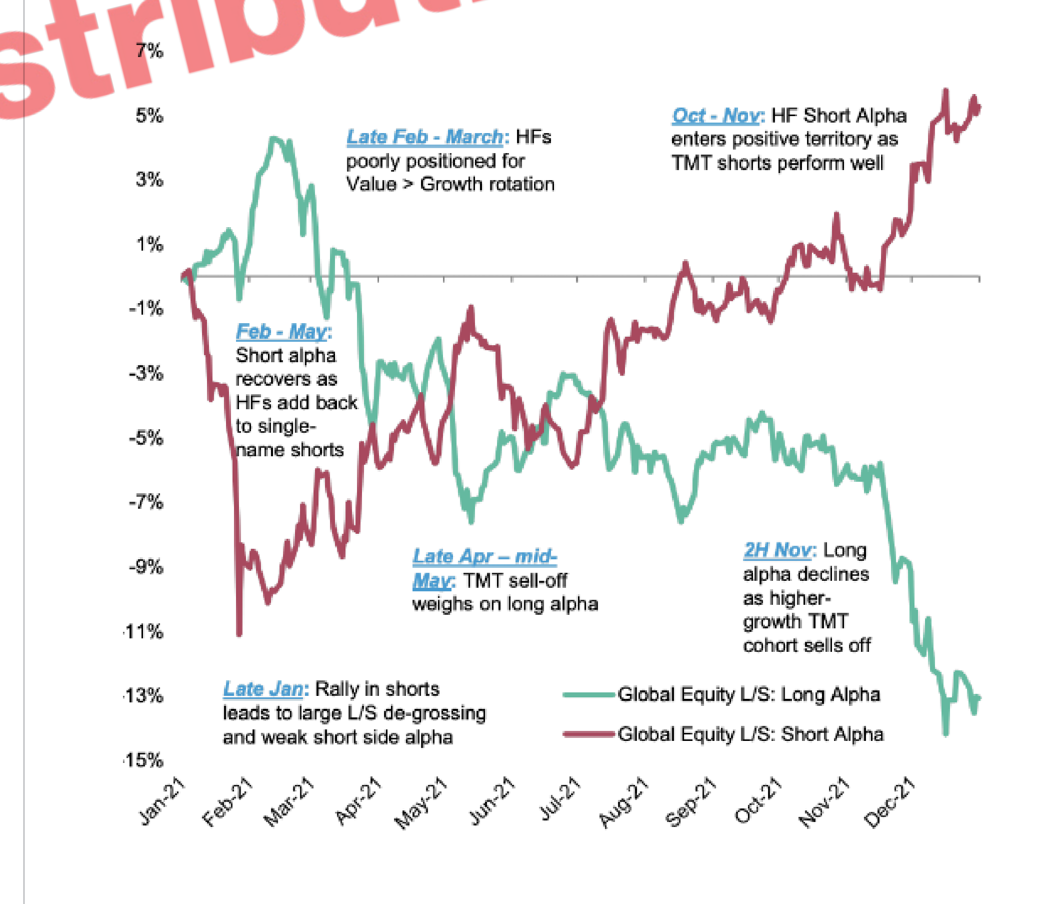
Distressed securities enjoyed a second straight strong year. In generating average gains of more than 20%, distresssed was the best-performing strategy in 2021. The reasons include continued availability of financing and liquidity, spread compression, the lack of compelling investment-grade fixed-income investments, limited corporate failures, and the continued improvement of the US economy that's lifting most boats.

Given the Fed is poised to make a series of rate hikes, distressed securities may turn more vulnerable as spreads will likely expand along with yields. At the same time, fundamentals and credit ratings may take on greater importance to investors.

With the market having been up big last year, it's no surprise that equity long bias strategies enjoyed the second best performance in 2021, up more than 17%, after having turned in the top performance in 2020. Beta-focused managers helped drive these returns.

2021 GLOBAL EQUITY L/S LONG & SHORT ALPHA

Long Alpha (Long Appr. – MSCI) vs. Short Alpha (MSCI – Short Appr.)



Source: Bloomberg, Morgan Stanley Prime Brokerage, data as of Jan 28, 2022

The two biggest turnaround stories in 2021 included collateralized debt obligations, which gained more than 16% after shedding more than -3% in 2020. And asset-backed securities bounced back from being down nearly -2% in 2020, rising more than 13% last year. Forces driving the revival of these two strategies were improving financial conditions of underlying assets along with healthy liquidity and the search for yield.

Equity market neutral strategies also rebounded gaining more than 8% in 2021 after having lost -1.3% in 2020.

The sharpest reversals were in convertible and fixed-income arbitrage, volatility trading, and emerging market strategies.

DATA FORENSICS

Nearly half of the S&P's 28.7% gains of last year were realized in the 4th quarter. This was when inflation was taking off along with rising fear and volatility as interest rates were turning higher. As of the end of the 3rd quarter, the gap between the market and Top 50 returns was 4.9%. By the end of the year, the Top 50 underperformed the market by 18%.

The *Financial Times* reported many leading hedge funds lagged the market "because they tended not to hold large positions in the small number of mega-cap stocks that drove index gains." Many funds were also hurt by sharp market rotations and shorting became more uncertain, especially when betting against soaring meme stocks.

According to Howard Silverblatt, senior analyst at S&P/Dow Jones Indices, pulling out the top 10 contributors from the market's 2021 performance reduced the S&P 500 total returns by 10 percentage points—from 28.7% to 18.7%.

10 Largest Drivers of S&P 500 Performance in 2021 and their Market-Cap Ranking

No. 1 Apple
No. 2 Microsoft
No. 4 Alphabet Class A
No. 5 Tesla
No. 6 Alphabet Class C
No. 7 Meta Platforms
No. 8 NVIDIA
No. 9 Berkshire Hathaway Class B
No. 10 UnitedHealth Group
No. 13 Home Depot

Source: S&P/Dow Jones Indices

Reflecting unexpected asymmetry, performance of the Top 50 funds as a whole was impacted by the underperformance of 5 very experienced fund managers: Cadian (No. 6), Tiger Global (9), Element Capital (17), Alphadyne (29), and Barnegat (42). The Top 50 ranking is not based on fund assets but five-year trailing net returns through 2020. And managers are equally weighted in determining the bottom-line performance.

During its long celebrated history, venerable Tiger Global with $21 billion in assets had only a limited number of down years. And through October, Chase Coleman's flagship fund was up 13% only to end the year down -7.4%, according to Bloomberg. While its portfolio is thought to have extensive private holdings (whose valuations are unknown by this report), the fund's year-end performance suddenly moved inversely to the broad market. More confounding, given the fund's size, it's hard to imagine recent trades were behind this sharp sudden loss.

Stripping out these five funds from the Top 50 along with the S&P index's top performers reduces the performance gap to 3.5%. It's worth noting that these 10 S&P stocks have collectively given back two-thirds of their 4Q21 gains as of the third week in February.

This certainly doesn't mitigate the 2021 performance of this survey's select funds. But it largely explains the deviation between the two benchmarks. It also makes the point that some proven veteran asset managers made uncharacteristic mistakes during key inflection points. Only these PMs can explain why this happened.

THE TOP 10 AND BEYOND

The top 10 funds also revealed softness. These leading funds' 2020 returns were even stronger than their 5-year trailing annualized returns through 2020, which determined their rankings. Further, these funds have been around for a while. Their average age was more than a dozen years during which time they had consistently generated market-like returns with significantly less risk and low market correlation.

But 7 of these 10 funds experienced a thorough reversal of fortunes in 2021. Two barely registered gains; the other five lost money with two of the five having declined by more than 30%.

The common thread of these 7 funds : they were all hedged equity. But with the market having been up nearly 30% in 2021, odds were these funds should have enjoyed a decent year.

Two proven global macro funds also had lousy years: Element Capital lost nearly 9% and Alphadyne collapsed by more than 21%.

However, the vast majority of the Top 50 generally kept pace with their historical returns.

Three funds in the top 10 generated strong returns in 2021, led by the macro specialist Haidar Jupiter (7), which had one its best years ever during its nearly two decades in business having soared by nearly 70%.

Millstreet Credit (4), which has been around for more than a decade focusing on sub-investment grade debt, backed up a strong 2020, when it rose 21.4%, by gaining more than 20% in 2021, matching it's 5-year trailing returns. The fund's idiosyncratic investment approach continued to deliver uncorrelated gains compared to its benchmark while controlling risk.

Especially noteworthy about Millstreet is that it delivered these returns while having lowered its net exposure over the year from 58.7% to 46.3%. The reason: the team saw valuations having become stretched across most asset classes. "Seeing significant froth across asset markets," comanagers Craig M. Kelleher and Brian D. Connolly "believe the Partnership is better served with a lower net exposure in the current environment."

Also intriguing is that other funds in the Top 50 that significantly outpaced their 2020 returns in 2021 were not developed market equity long-short funds. They included:

No. 12 MAK One — Opportunistic distressed and equity
No. 14 Legion Partners — Small-cap activist
No. 22 Waha MENA Equity — Emerging markets
No. 28 FengHe Asia — Emerging markets
No. 35 Owl Creek Credit Opportunities — Event driven
No. 40 John Street Capital Vantage — Systematic macro
No. 43 Blue Diamond Non-Directional — Statistical arbitrage
No. 49 Arena Special Opportunities — Special debt opportunities

Equity market neutral Anson Investments stands alone in not only having an extraordinary 2020, when it gained 44.5%, but then delivered an equally impressive 45.5% gain in 2021.

Venerable multistrategy funds Citadel Wellington (19) and DE Shaw Composite (30) both turned in strong years that significantly outpaced their trailing 5-year net annualized returns through 2020.

2021 FEATURED FUNDS

To dig deeper into the performance of the Top 50, I revisited the five funds that were profiled in last year's survey. This review provides a detailed look at what was driving the success of most of the Top 50 funds—including two hedged equity shops--and the challenges a handful of funds faced in 2021. Managers also shared their thoughts about what may lay ahead for the rest of 2022.

A newcomer to the survey, launched more than 6 years, is **North Peak Capital** (2).

"Growing complacency with past performance that fed excessive sector and stock concentration, a difficult shorting environment, failing to recognize a swiftly changing macro environment, the contagious nature of rising uncertainty, and discounting the value of proactive risk management, were leading reasons behind poor fund performance."

- Cedric Dingens, NS Partners

VALUE VS. GROWTH RELATIVE PERFORMANCE

Source: Investcorp-Tages

Though a number of funds that run concentrated books got hit last year, North Peak showed it was possible to continue to succeed by maintaining a deep conviction to a handful of stocks. The fund returned more than 20% percent in 2021.

The same reasons why the fund thrived over the past 5 years going into 2021 are the same reasons it held up better than any other hedged equity fund in the survey—a diversified book comprised of less crowded idiosyncratic plays. The portfolio includes non-tech, attractively priced companies—in business and web services, finance, building materials and home goods that are value investments poised to rapidly expand.

Abu Dhabi-based **Waha Mena Equity** (22), a regional emerging market fund, more than doubled its 2020 returns, rallying by nearly one-third in 2021.

Portfolio manager Mohamed El Jamal explains the region's emphasis on value over growth helped performance, especially the fund's sustained bullish stance on energy, with oil having increased by 50% last year. Other commodities the manager remains positive about include urea, phosphate, and aluminum, which he believes will continue to be driven by multiple tailwinds.

More broadly, Waha's book is also benefitting from the continued improvement of regional economies' macro balances and their above average growth. "Many have successfully implemented structural reforms to increase non-oil revenues, contain fiscal spending, and continue to diversify their economies away from oil," says El Jamal.

The manager is sanguine about the year ahead as increasing oil revenues are boosting FX reserves, regional liquidity, and economic growth. And he believes this may make most of the region's value-oriented economies, which are dollar pegged, "a good place to hide for emerging markets investors nervous about local EM currency in the context of tighter monetary conditions."

Credit investor **Arena Special Opportunities** (49), which takes a disciplined approach to eek out modest but steady gains through sub-investment grade exposure, delivered above average returns of 9.6%. That was nearly 4 full percentage points better than its 2020 performance.

Nearly two-thirds of Arena's gains last year were derived from underwriting small private convertible bonds to emerging firms, including those in the electric vehicle, fintech, and biotech industries. This involves negotiating the conversion of the bonds into company stock at a discount, and then crystallizing the spread by selling the convertible into the open market. Those transactions often include warrants that further boosted 2021 returns.

"This approach limits capital risk," explains fund manager Dan Zwirn. He explains this strategy was bolstered by "strong issuing demand for convertibles, especially in the micro- and small-cap space where firms aren't typically supported by investment bankers or sell-side coverage."

Real estate lending contributed another 15% to the fund's returns, propelled by a strong property market and secured lending against performing hard assets.

While Arena's book is predominantly long, it hedges some risk by occasionally identifying attractive relative value trades, e.g., going long senior debt and shorting subordinated debt (when similarly priced) in the same capital stack of a firm to which the fund is not lending.

Zwirn thinks overnight rates could rise above 1.75% and 10-year rates could hit 4%. "The Fed has been behind in responding to inflation which we never believed would be transitory. And combined with high levels of government spending, we fear inflation will be sustained or possibly morph into stagflation."

Rising interest rates will increase the fund's universe of potential lending opportunities as the market experiences significant repricing and increased stress.

"However, the fund won't be taking on more risk," says Zwirn. It will continue to manage this factor by maintaining sizable cash balances, staying short duration, and relying on floating rate loans that are well collateralized. Zwirn still knows if conditions significantly break down, the fund won't be immune. But he's projecting normal returns in 2022 from 8% to 12%.

The Financial Times reported many leading hedge funds lagged the market "because they tended not to hold large positions in the small number of mega-cap stocks that drove index gains."

G2 Investment Partners (15), a small-cap focused hedge equity fund, outpaced its 5-year annualized returns by nearly 6 percentage points, having returned nearly 22%.

After soaring 47% in 2020, G2 was anything but complacent in 2021. In constantly reviewing its book, half of which is typically comprised of technology shares, the fund did three things that distinguished its performance from other hedged equity shops that struggled last year.

First, it reassessed its Covid-inspired holdings it added in 2020 to benefit from the new world that had been forced upon us. G2 sold off shares it believed had thrived primarily due to lockdown and maintained positions it believed would sustain growth beyond the pandemic's initial shock. This is reflected in the fund having significantly reduced or sold 5 out of its top 10 long holdings and actually ended up shorting several of its former top long positions which it believed had become substantially overvalued.

A current long example includes a profitable online car parts store. Portfolio manager Josh Goldberg believes the stock will continue to rally as an increasing number of consumers opt to repair their vehicles rather than to replace them given the soaring price of new and used cars—a condition that will likely persist for some time.

A broadband play that thrived due to the expansion of services in smaller towns, triggered by a Covid-driven influx of residents from big cities, will likely continue to do well with the passage of President Biden's new infrastructure program. Goldberg thinks more demand and money will be flowing into these places to finance further broadband improvements.

"A twist on the lesson learned from the Long Term Capital Management mess, central banks can stay irrational longer than some investors can stay liquid."

- Bob Treue, Barnegat Fund

Second, G2 continues to invest in smaller sized under-researched and less crowded investments that not only thrived in 2021 but shelter the fund against the current selloff of more crowded shares. "We're attracted by idiosyncratic opportunities we discover through proprietary research that identifies firms being driven by their own fundamentals," explains Goldberg.

This same focus on less well-known companies also paid off in many of the fund's IPO and SPAC trades during the first three quarters of the year. Goldberg observed 2021 was the first year in the last 20 where there were more public companies than which existed the year before, i.e., new issues came to market in greater numbers than existing issues were taken out via buyouts or bankruptcy.

The third factor that continues to sustain G2's performance is its active portfolio management. This helped propel its long book (+19%) and its short book (+3%)—contrary to what many hedge equity funds experienced in 2021. "We succeeded on the long side because of our research in evolving small-cap firms," explains Goldberg, "and we apply the same discipline to shorting—diversifying our exposure and limiting our losses when these shorts don't pan out."

The manager expects 2022 to be a challenging, volatile year due to soaring inflation, rising interest rates, and uncertainty they bring to markets. But he sees opportunities not only in his current universe of stocks the firm tracks but also in solid businesses whose stocks

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have been oversold and where active insider buying reflects a recommitment by its leadership.

The Hoboken, NJ-based **Barnegat** (42), the most veteran of all five funds profiled, was the one that stumbled. Bob Treue, the long-term fixed-income relative value manager went into 2021 with a 20-year track record having delivered average annual returns of 15 percent.

Treue has demonstrated patience and commitment to well-conceived out-of-favor bets pays off over the long run, even adding to positions as spreads move against him.

By the end of last year, Barnegat was down more than -12% because his book was hit by spreads that continued to expand more than they contracted.

One such trade Barnegat has been in for a while involves being short British interest-rate swaps and long UK inflation-rate swaps both based on 30-year maturities. Prices of these swaps, that are marked-to-market every day, move like bonds in response to interest and inflation rate changes. There's no currency risk because being on both sides of the trade balances that out.

In 2021, the logic behind this leveraged relative value trade was simple: the fund should benefit more from rising interest rates (falling interest swap value) than it would be losing from the eventual decline in inflation (rising inflation swap value).

> "Raising cash at this time will enable managers to take advantage of dislocation that will likely continue through this year."
>
> **- Vincent Berthelemey. Investcorp-Tages**

The manager expected the Bank of England was going to aggressively hike rates to fight inflation, which ended the year at 7.5%. Rising rates would in turn bring down inflation.

But the BoE actually kept rates around 0% for most of last year and did not taper quantitative easing. As a result, the 30-year interest-rate swap yield fell during the year from a peak of 1.40% to 0.80%. Meanwhile, Treue's inflation exposure suffered because the 30-year inflation-rate swap rose from 3.13% to 3.5%. Barnegat was getting squeezed on both sides of the trade.

On Dec 24, 2021, the BoE finally raised rates 25bps and then again by the same amount in February 2022.

The takeaway from this trade reminded the manager of the lesson he learned long ago from the Long Term Capital Management mess, but with a slight twist: Central Banks can stay irrational longer than some investors can stay liquid. Fortunately for Barnegat and its investors, the fund keeps the vast majority of its assets unencumbered to meet margin calls and maintain positions it believes will eventually pan out.

LOOKING AHEAD

Anthony Novara, Research Director of global hedge fund strategies and capital markets at the $250 billion Chicago-based advisory Fiducient Advisors, remains concerned about funds straying from their established disciplined investment approach. "We believe managers should embrace the lessons of 2021," explains Novara, "especially not allowing outsized performance to alter risk management." He believes taking profits and rebalancing portfolios are two of the more straightforward ways a fund can sustain performance.

In seeing a more challenging equity environment with greater performance dispersion, Novara thinks 2022 presents opportunities for proven hedged equity managers who focus on fundamentals. He also believes global macro managers can excel given shifting yield curves and a dynamic commodity market. And the continued M&A activity may likely benefit certain event driven managers.

Globally, Novara thinks we may see higher long-term return prospects offshore, especially in Asia and emerging markets. "Investors may be fearful of rising interest rates which typically don't bode well in EM countries, but rising commodity prices may improve prospects and a steepening yield curve can benefit regional financials."

Despite a new paradigm shift triggered by higher interest rates which has already slashed nearly half the value of high beta stocks, Investcorp-Tages' Berthelemy sees "fundamentals remaining robust and supporting solid economic growth in the coming quarters." He continues to recommend value industries in this reflationary environment, which should further boost the prospects of energy, financials, and materials.

EQUITY L/S VALUE VS. GROWTH EXPOSURES VS. RETURNS

Factor Net Exp Difference; Value - Growth   MSCI World Value vs. Growth

Value vs. Growth: Global Equity L/S Factor Net Exp (lhs)

MSCI World Value vs. MSCI World Growth (rhs)

Source: Investcorp-Tages

Specific strategies he believes will excel include equity market neutral, which are well positioned "to deliver performance with rising dispersion and greater diversification across factors."

He also thinks event driven managers can thrive by targeting M&A and special situations. And he believes discretionary and diversified macro funds can find ways to profit from policy-driven volatility.

Berthelemey also thinks raising cash at this time will enable managers to take advantage of dislocation that will likely continue through this year.

A less sanguine view comes from the equity and distressed manager Michael Kaufman of 12th-ranked MAK One Capital. He sees "many similarities between the 2022 and the 2000 stock markets. Valuations are in many cases as extreme, and investor exuberance and retail participation in the stock market has hit similar levels."

While he believes the current economy and the market benefit from improved business models and faster pace of innovation, Kaufman fears the Fed will struggle to bring inflation back under control without causing a recession if not a financial crisis.

To contend with this outlook, Kaufman "plans to continue to own our cash-generative, reasonably valued secularly growing businesses that can take advantage of inflation, while remaining short highly overvalued securities. We may likely see a tremendous amount of capital destruction by the time this cycle is done."

Before we went to press, a sampling of allocator sentiment about a potential Russian invasion of Ukraine seemed to show limited investment concern as if it was largely a regional matter.

However, the global economics correspondent for *The New York Times*, Patricia Cohen, recently noted: "The fallout . . . depends on how an invasion plays out: whether Russian troops stay near the border or attack the Ukrainian capital, Kyiv; whether the fighting lasts for days or months; what kind of Western sanctions are imposed; and whether Mr. Putin responds by withholding critical gas supplies from Europe or launching insidious cyberattacks."

As the last two years of Covid has taught us, Cohen cautions, "minor interruptions in one region can generate major disruptions far away. Isolated shortages and price surges--whether of gas, wheat, aluminum or nickel--can snowball in a world still struggling to recover from the pandemic." ■

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2021 GLOBAL SURVEY OF THE TOP 50 HEDGE FUNDS: THIRD QUARTER MARKET AND PERFORMANCE UPDATE

Third quarter volatility ended up sending many trends sideways, leaving the market and the hedge fund industry flat for the period. Meanwhile, hedged equity, macro, and emerging market managers helped the Top 50 funds add nearly two full percentage points during the quarter. This select group outperformed the BarclayHedge average hedge fund return by 2.3% through the first 9 months of 2021, narrowing the amount by which it trails the market.

by Eric Uhlfelder
15 Nov 2021

MIND THE GAP

A look at markets, allocator thinking, and how the Top 50 Funds performed through the first three quarters of 2021

A Dickensian sounding article in *The New York Times* caught my attention. Written by the paper's senior economics correspondent Neil Irwin, it started off saying, "Americans are, by many measures, in a better financial position than they have been in many years. They also believe the economy is in terrible shape."

This got me thinking of other paradoxes.

The flagship gap--triggered by consumer and corporate demand colliding with clogged supply chains--sits off southern California's ports with dozens of massive, fully loaded container ships waiting to dock.

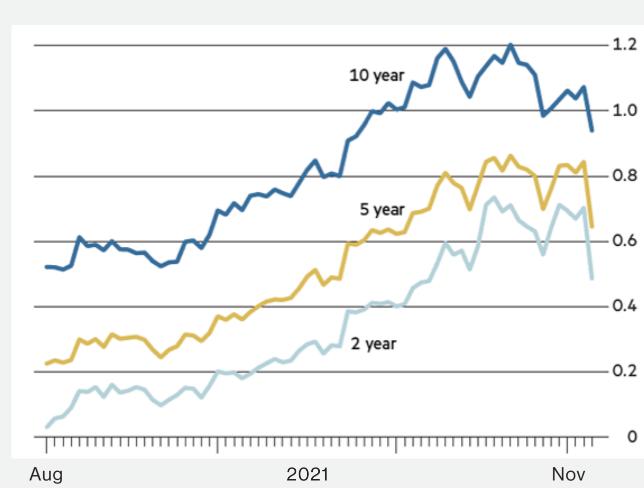
Then there's the great macro divide: many economists and asset managers see inflation, which in October hit an annual rate of 6.2% (the highest since 1990), as more than a response to economies reopening. They are increasingly fearful of how far the Federal Reserve may be falling behind the inflation curve. Fed Chair Jerome Powell finally announced a start to tapering the bank's $120 billion monthly bond purchases. But as of mid-November, Powell was against directly raising rates, believing this will not address the underlying issues driving inflation, despite overnight rates remaining at crisis-level lows.

The Fed's fear of letting the bond market adjust to a vastly improved economy since Covid struck nearly two years ago has created sharp imbalances reflected most clearly in negative real returns across the yield curve. Fearful of the recovery's fragility, European and Japanese monetary policies remain even more accommodating. And the Bank of England just spooked bond markets on both sides of the Atlantic when it suddenly yanked back on a proposed rate hike (see chart below).

Ultra low rates continue to fuel capital flows into higher risk assets, keeping the junk bond rally going. According to ICE Data Services, soaring issuances has pushed the high-yield debt market above the $1.5 trillion mark for the first time. The *Financial Times* reported a record 149 companies have tapped into the junk bond market so far this year, including the likes of the cryptocurrency exchange Coinbase and gaming platform Roblox, the latter paying less than 4% for $1 billion. (See table on p. iii.) The gap between risk and return on sub-investment grade debt has rarely been so wide, pushing bond prices even higher while major equity markets continue to rally, even after the S&P 500 has doubled since March 2020.

Then there's the polar divide between the world's two largest markets. Through September, US stocks gained more than 15%, according to MSCI. China was down more than -16% in Yuan terms as local authorities pursue actions that have chilled investor sentiment. And this perfor-

When market expectations and policy diverge
UK Government Bond Yields (%)



Source: Financial Times

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HEDGE FUND STRATEGY PERFORMANCE THRU SEPTEMBER 2021
Ranked by 2020 Returns

Strategy	1Q2021 Net Returns (%)	1H2021 Net Returns (%)	YTD Net Returns (%) thru 3Q21	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	14.61	14.17	16.31	6.92	7.96	6.08
Volatility Trading	1.31	4.15	3.92	15.87	2.14	2.09	1.61
Convertible Arbitrage	4.79	4.76	5.30	15.53	7.77	6.18	4.88
Emerging Markets	3.12	8.12	5.56	15.52	5.07	8.65	3.51
Distressed Securities	8.97	15.73	19.09	13.18	5.10	6.70	4.51
Event Driven	7.30	10.90	10.78	11.12	5.18	7.01	4.68
Fixed Income Arbitrage	2.34	2.31	1.92	10.46	4.35	4.53	5.30
Global Macro	4.34	7.63	7.59	10.06	3.94	3.48	2.71
Equity Long/Short	6.45	8.83	10.25	9.27	4.14	4.50	4.27
Merger Arbitrage	4.77	7.34	6.98	9.18	5.23	5.41	4.72
Asset-Backed Loans	2.21	4.08	6.71	7.01	5.56	6.61	7.08
Commodity Trading Advisers	2.38	4.53	5.08	5.43	2.40	1.32	0.61
Fixed Income Diversified	-0.21	1.35	0.82	5.31	3.44	3.83	5.67
Credit Long/Short	0.57	1.98	2.11	5.18	3.20	3.77	3.63
Credit Long-Only	-1.21	1.56	0.61	4.43	3.38	3.65	4.46
Multistrategy	4.15	7.08	7.67	4.23	1.41	2.91	3.37
Fixed Income Relative Value *	3.67	6.24	7.67	3.38	3.41	4.59	4.41
Mortgage Backed Securities	1.8	2.67	3.31	2.04	2.64	3.63	4.58
Equity Market Neutral	2.55	4.76	6.18	-1.29	-1.19	-0.02	2.00
Asset Backed Securities	4.44	7.31	10.97	-1.83	2.80	5.40	9.92
Collateralized Debt Obligations	5.99	10.65	12.51	-3.17	1.27	6.88	14.16
Top 50 Averages	5.41	9.23	11.06	24.20	17.26	14.81	NA
Backstop BarclayHedge Index	4.79	8.86	8.75	11.14	5.23	6.41	4.79
S&P 500 Total Return Index	6.18	15.25	15.93	18.40	14.19	15.22	13.89
JPMorgan Global Gov't Bond Index	-3.42	-2.56	-2.68	5.55	4.18	3.36	3.63

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

GLOBAL INVESTMENT REPORT

mance gap drastically widened by early November as US stock returns surged to nearly 26% for the year as Sino shares have remained unchanged.

Despite the broad sense Covid-19 is finally coming under control, we're seeing disturbing infection spikes among the large percent of the unvaccinated as the weather turns cold, leading to lockdowns. That indicates we'll likely see another wave of the pandemic hit developed nations this winter.

In seeing stocks and bonds (not to mention real estate) at record highs, Yale economics professor, Robert Shiller, recently noted, "these three asset classes have never been this overpriced simultaneously in modern history."

That said, Howard Silverblatt, senior analyst at S&P/Dow Jones Indices, recently reported third-quarter sales of the companies comprising the benchmark 500 index hit a record high of $3.3 trillion and operating margins are still near all-time highs at 13.17%. At the same time, 80% of the firms are reporting earnings that have topped expectations.

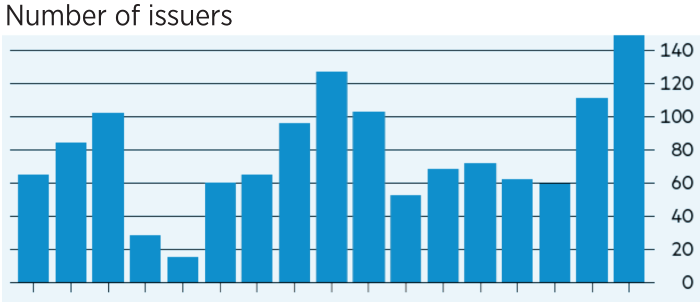
Michael Mauboussin, a managing director of Counterpoint Global at Morgan Stanley and a long-time well-respected market observer, doesn't believe stocks are generally mispriced. While there are pockets of speculation, Mauboussin thinks markets have been acting rationally over the past 18 months.

So while there are plenty of provocative schisms, what do they mean? Maybe tipping points? Maybe opportunities?

Said Haidar, manager of the highly volatile and profitable global macro fund Haidar Jupiter (No. 7 in this year's rankings starting on p. 7), appears to have rallied from these current imbalances and dislocation, with his fund having soared by more than 70% year-to-date through September.

Debut companies in the US junk bond market reach new record

Number of issuers



Source: LCD

The manager wouldn't comment for this report. But a clue about his exposure may have been revealed in his recent investor letter obtained by *Institutional Investor*. Haidar believes the global transition towards renewable energy has resulted in underinvestment in fossil fuels. Along with rapid economic recovery, this has contributed to significant tightness in energy markets. Then add supply chain problems, rising labor costs, and other issues. Together this makes him think central banks may be forced to acknowledge high inflation is likely to be less transitory than they had originally forecasted. And to this macro manager, this suggests equities are vulnerable.

Uncertainty borne out of these and other concerns may be why some hedge fund managers are pulling back a bit on leverage and risk from their books (see graph on p. v).

Appaloosa Management's founder David Tepper is more blunt. "I don't love stocks. I don't love bonds. I don't love junk bonds," says the hedge fund manager. Not particularly concerned about a crash and still substantially exposed to the market, Tepper says he "just doesn't know how interest rates are going to behave next year." And this is what's giving him and many other managers pause as the rally continues.

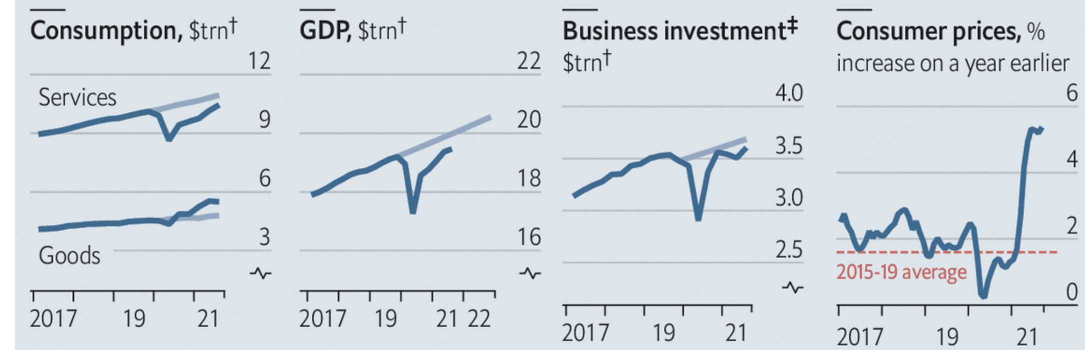
STRATEGIES & FUNDS

Through the first 9 months of the year, hedged equity strategies performed in line with the market. (See Strategy Performance table on p. ii.) Equity long bias led the pack, returning more than 14%, followed by event driven funds (up an average of 10.78%) and equity long-short funds (which gained 10.25%).

The biggest turnaround from a year ago have been asset-backed securities and collateralized debt obligations, fueled by return of credit confidence, an abundance of liquidity, and the search for yield. While they both ended 2020 down more than -2%, through the first three quarters of 2021, ABS strategies rallied 11% while CDOs did even better, up 12.5%.

But the strategy that continues to thrive above all others is distressed securities. "This has been a remarkable period for funds investing in struggling companies," explains Tilo Wendorff, managing director of absolute returns at the $10 billion German Alternative Investment firm Prime Capital.

Returning to form
United States



*Based on average quarterly growth rate for the five years prior to the pandemic. †2012 prices ‡Net private domestic business investment
Sources: BEA; Haver Analytics; *The Economist*

Wendorff explains the distressed rally has been driven by the rapid recovery of the economy along with many of the same factors that have propelled ABS and CDOs. Distressed managers bottom-fed on corporate debt most exposed to the pandemic and shutdowns. And as the demand for secondary and new debt offerings helped repair broken balance sheets as the economy rallied, the price of distressed legacy debt has greatly improved.

As of the end of September, distressed funds were up more than 19%, topping both the market and every other strategy by a wide margin. Wendorff expects the strategy to continue to thrive as economies recover into 2022.

Credit strategies, however, have struggled the most this year. Long credit and fixed-income diversified returns haven't cracked 1%; credit long-short managed gains of 2.1%. The primary issue: figuring out interest rate trends has been tough. And this was most evident early into the 4th quarter when fund managers across developed markets misread central bankers from the US, the UK, to Australia. Bloomberg reported substantial losses "show how even some of the most sophisticated traders have been caught flat-footed by the rapid shift in sentiment that has raced through markets."

THE TOP 50

Through the first nine months of the year, the Top 50 funds have shown tremendous performance dispersion, ranging from a loss of -20% to a gain of 70%. However, the strength of the group's overall performance is most evident with 26 funds registering double-digit gains compared to only 3 funds logging double-digit losses.

Supply and demand gaps, dislocation, and confusing trends may be the source of opportunities, enabling many fund managers to uncover alternative, uncorrelated idiosyncratic investments.

Waha MENA emerging market equity fund (No. 22) has benefitted from resurging Middle Eastern economies as they fully reopen supported by high levels of vaccination, rebounding energy prices, and soaring travel. The fund has surged nearly 22% through the first three quarters of 2021.

Manager Mohamad El Jamal remains upbeat for the near term believing energy prices will continue to rise along with corporate earnings. He also expects valuations to receive "a boost from rising multiples as emerging market investors rotate into dollar-pegged economies, especially energy-oriented MENA markets."

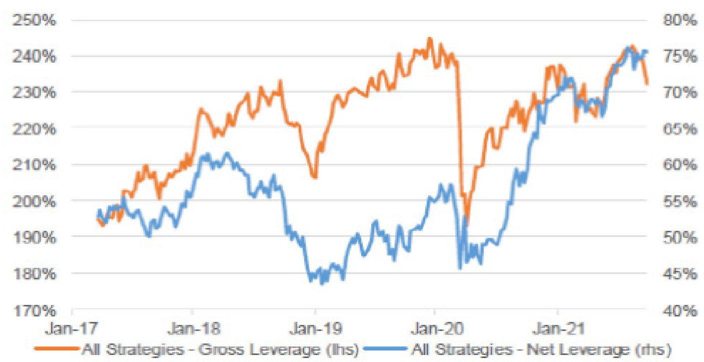
His largest concern? The gap between rising US inflation and interest rates. "Aggressive Fed intervention is the key risk," El Jamal explains, "especially in our region where energy prices are quoted in dollars and our local currencies are also pegged to the Greenback. Fed decisions are the most impactful of all central banks, and if it plays catch-up and starts moving aggressively, then this will likely shock financial markets."

Over in Asia, China's disruption of markets and the global economy has blurred thinking about the region's near-term investment prospects. But some active fund managers are profiting around the confusion.

Hong Kong-based Segantii Asia-Pacific Multistrategy (No. 48) is having one of its best years in a while because of various emerging opportunities. Year-to-date through September, the fund has gained more than 12%. Singapore-based emerging market fund FengHe (No. 28) is up 24.5%.

Chinese policy hasn't prevented corporations in the

Net & Gross Leverage (JPM)



Source: JP Morgan

region from being active in capital markets and pursuing M&A in response to the pandemic, supply chain problems, Beijing's market interference, inflation and projected rising interest rates.

Asset managers are targeting new listings and secondary offerings along with convertible and credit issuances. They're establishing positions in targeted and acquiring companies, and arbitraging the gaps forming between legacy and new secondary offerings.

Having so far effectively navigated this year's unique dynamics, FengHe's founding partner and CIO Matt Hu doesn't seem particularly surprised by the Chinese government's recent behavior. "Markets have been shocked by various policy announcements and events in China, from K12 education reforms to Internet crackdowns to a common prosperity drive to the Evergrande problems to power cuts," observes Hu. But he views "such changes as normal and not unexpected."

NY-based macro manager Said Haidar is far more worried seeing China's "crackdown of numerous industries threatening to slow Chinese growth significantly, further weighing on emerging markets."

Back in the States, small-cap activist fund Legion Partners (No. 14) was up 17.3% during the first three quarters of the year as the fund's targeted companies continue to rally with the economy and adjusting to an evolving reality related to supply chain backlogs, inflation, and anticipated rise in interest rates."

Managing director Ted White sees dealing with these matters as part of navigating Covid. "We believe many of the changes that companies have been forced to make," explains White, "are often simply expediting what was likely to happen further down the road, demanding disciplined responses in making firms stronger."

One such response to supply chain challenges is diversifying the number and geography of suppliers. In addition to targeting suppliers in Central and Eastern Europe and shifting deliveries to US east coast ports, White also believes there will be increased demand for domestically produced parts and products, in spite of their higher prices. A portion of these costs may be passed on to consumers, but he does expect margins to tighten. Overall, White remains constructive about near-term economic and market outlook well into 2022.

LOOKING AHEAD

European prospects recently received a dose of bad news with new Covid-19 cases surging in Germany that's threatening consumer demand and further exacerbating supply chain issues that have been weighing on the country's industrial output. (The *Financial Times* reports only two-thirds of Germany has been vaccinated.)

In response, the German Council of Economic Experts lowered its 4th quarter growth projections to 0.4%, a large drop from last quarter's 1.8% expansion. Being Europe's largest economy, this slowdown will hit the continent's near-term growth prospects.

Neighboring Austria just announced a lockdown of all unvaccinated citizens, which is an even larger percent of the public than in Germany.

Such COVID spikes may temporarily ease inflation worries, supporting the European Central Bank's loose monetary policy. But rising prices remains a top concern globally.

Prime Capital's Wendorff doesn't know if inflation is a temporary or more systemic concern. If it's the latter, he believes it could create more uncertainty and volatility from which hedge funds can profit.

Waha MENA's El Jamal takes some comfort in past Fed behavior. "Every time the central bank started moving overnight rates back up, they've peaked at sequentially lower levels," observes El Jamal. And each time investors have panicked in response to tighter Fed policy, the central bank has backed off, quickly stimulating shaky growth and markets. "And the stimulus response has gotten larger each time around," notes El Jamal.

Some asset managers are less optimistic about lagging monetary policy.

Vincent Berthelemy, cross-asset strategist and portfolio manager at the $7.5 billion global alternative investment firm Invest-corp-Tages, is less certain of market response to central bank policy playing catch up with inflation. But he thinks it might be wise to start raising cash to deploy when markets sell off. He recommends to "be tactical in risk taking, buying on dips (especially value) & selling on rips."

But overall, Berthelemy remains positive about the broad economic backdrop, anticipating further healthy growth. Given the market's prolonged rally, he recommends staying defensive with below average beta exposure. "Valuations and positioning leave little room for error even in the absence of major risk catalysts ahead," notes Berthelemy, "so we prefer to proceed carefully with neutral exposure across markets."

Strategically, as dispersion increases he favors proven equity market neutral managers with wide industry reach. He also sees event driven managers well positioned to play mergers and special situations. And he believes quality discretionary macro and relative value managers will be able to respond to evolving central bank-driven markets.

> **The strength of The Top 50 Funds is most evident with 26 funds registering double-digit gains through the first three quarters of 2021 compared to only 3 funds logging double-digit losses.**

Key to matters of global supply chain and growth, China is the other big unknown. Noted economist Mohamed El-Ehrain, now president of Queen's College at Cambridge, says, "government actions during the past few months (has triggered) a real concern about the investability of the (Chinese) market." He surmises Western investors may be "treated as the equivalent of a high-risk junior tranche . . . the first to be hit by any shock." El-Ehrain explains the split in investor sentiment with some seeing the recent sell off as a rare buying opportunity, while others think this is the calm before another storm.

In its recently released 2022 Outlook, the Economist Intelligence Unit believes a property crash in China as a leading global risk that could trigger a sharp economic slowdown. "Chinese property giant Evergrande has already missed some repayments on debt totaling about $300 billion," states EIU, "and given exposure to the company across much of China's economy, its potential default represents a serious risk of financial contagion."

It fears a string of defaults across China's real estate sector could substantially weaken the country's banks, wealth, investment and growth prospects, potentially "instigating a global economic downturn." Commodity exporters (and we can assume prices) would be particularly affected by a period of much weaker demand from China.

Concluding on an upbeat note, accounting and consulting advisory Deloitte paints an especially benign domestic picture. Senior manager, Daniel Bachman believes greater vaccination should allow the US to continue to recover, stimulated by pent-up demand across consumer sectors.

The approved infrastructure package and the likely passage of Biden's Build Back Better bill should propel further growth in 2022 around the same time consumer and housing demand and capital investment may begin to ease back to pre-pandemic levels.

Bachman expects improved productivity growth and improving supply chain performance will help reduce inflation pressures. He also surmises unemployment will continue to fall to around 4%, the Fed will likely hold rates close to zero until late 2023, and long-term rates should remain constrained.

So what does this all mean for the various economic, monetary, budgetary and performance gaps? A major event will likely be required to narrow some of these imbalances. But over the near term, they will probably remain with us into next year--sources of uncertainty, confusion, risk, and opportunity. So probably best to mind the gaps. ▪

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2021 GLOBAL SURVEY OF THE TOP 50 HEDGE FUNDS: MID-YEAR UPDATE

The 2021 hedge fund survey published in June, which ranked the 50 top-performing funds over the trailing five years through 2020, found as a group they continued to outperform their peers and kept pace with the market during the first quarter. Through the 2nd quarter, the Top 50 again outperformed the hedge fund industry, led by distressed securities and hedged equity managers. But a relentless bull market surged ahead, ignoring inflation fears, unanticipated rise in 10-year Treasury prices, a flattening yield curve, and a rising dollar--factors that weighed on fixed-income, credit and macro returns.[1]

by Eric Uhlfelder

And The Band Plays On

A look at markets, allocator thinking, and how the Top 50 Funds performed through the first half of 2021

I often like what Charlie Munger has to say. One quote in particular has stuck: "I seek good judgment mostly by collecting instances of bad judgment, then pondering ways to avoid such outcomes."

How does this thinking apply to today's markets?

Last year, before vaccinations allowed economies to reopen, skeptics thought market momentum was largely being fueled by massive liquidity, real negative interest rates, and the sense that investors had no place else to go but into stocks.

But there's clearly an extraordinary earnings story going on in the country's largest companies.

During the first half of the year, Standard and Poors just released data showing 87% of constituent S&P 500 earnings beat consensus estimates, way up from the historical rate of around two-thirds. And Howard Silverblatt, senior analyst at S&P/ Dow Jones Indices, adds operating margins are running above 13%--a record high.

Reasons behind these numbers, explains Silverblatt, include enormous consumer spending unleashed by pent-up demand and a rising stock market that helped buyers ignore the impact of rising prices. And this propelled the market to more than 50 record highs this year through August.

However, stocks are not booming around a Goldilocks economy, but one forged by extraordinary monetary and fiscal policy, and post-lockup explosion in consumption that's creating a bifurcated recovery.

"The economy's rebound this year has been stronger than almost anyone predicted last winter," reported The New York Times, "growing at its fastest clip in a quarter-century .... yet, it remains far from normal." The story highlights increasingly tough times many small businesses are having. An indicator of this point and future economic activity, the Russell 2000 small-cap index has been stalled since early February 2021. (See graph on p. iii.)

[1] See pages 3-5 in the original report for the methodology used in objectively identifying the Top 50 funds. See pages 7-16 for historical data of each of these funds, including net returns for the first half of 2021.

The *Times* also found the University of Michigan's Consumer Sentiment Index suffered one of its largest monthly losses in 40 years in August, driven by the rapidly spreading Delta variant and high inflation.

While believing "the backdrop for risk assets remains constructive," Third Point's Daniel Loeb notes "second quarter market volatility increased materially with wild swings in sentiment and factors, which we expect to continue throughout the third quarter." So far in the 3rd quarter, not so much.

Junk bond yields are now less than the inflation rate. And Treasury TIPS pricing continues to downplay inflation risks, with yields not much more than their nominal brethren.

If one assumes inflation is due largely to bottlenecks caused by economies reopening, then it's likely the pandemic will continue to affect work and supply chains around the world for the next couple of years.

This is a concern Panayiotis Lambropoulos, a hedge fund portfolio manager at the $34 billion pension fund Employees Retirement System Texas of Texas, voiced much earlier in the year when most observers felt vaccinations were going to turn the tide. "While I don't yet expect a return to lock downs in the world's major economies," he explains, "the Delta variant is clearly introducing far greater economic uncertainty and questions about how we will escape the pandemic's hold."

Also, how long will debt investors across all maturities accept sub-inflation interest rates before demanding greater compensation for lend-

> "Trying to time a market peak is just as hard as trying to figure a bear market's bottom."
>
> - Jon Feeney, Investcorp-Tages

S&P 500 QUARTERLY OPERATION MARGINS AVERAGE 8.07%; Q2,'21 EST 13.56%

Source: S&P/Dow Jones Indices

GLOBAL INVESTMENT REPORT

Russell 2000 (^RUT)

Chicalo Options - Chicago Options Delayed Price Currency in USD

Source: Yahoo Finance

ing money, especially to the most vulnerable risk assets? Ultra-low rates have kept many troubled companies afloat, constraining bankruptcies and investment losses from hitting the rest of the economy.

This is more than an academic concern as the fortunes of the stock market are linked to the performance of the debt market.

But as Jon Feeney, head of tactical strategies at Investcorp-Tages, which manages $7.5 billion in alternative investments, so aptly puts it: "Pessimism has an intellectual appeal that can misread the opportunities that are right in front of us."

ALLOCATORS

For allocators trying to calibrate exposure, 2021 has been a more challenging year than 2020, says Cedric Dingens, head of investment solutions and alternative investments at the CHF 11.2 billion asset manager Notz Stucki. "After the sudden sell off in March 2020 and massive central bank and government response," explains Dingens, "there was an argument for bullishness. Now it's more difficult to distinguish between sustainable trends and sentiment."

A foreign headwind Dingens is particularly concerned about is coming out of China, with increasing regulations over IPOs and technology companies. This has sent mainland shares tumbling. And he thinks this portends more near-term problems for Chinese stocks.

Marc Sbeghen, co-founder and co-portfolio managers of the Swiss-based alternative investment Iteram Capital, shares Dingens' broad sentiment. The firm, with AUM of over $400 million, tends to be defensive, relying on discretionary global macro, systematic CTAs, and multistrategy managers. Sbeghen, sees a slew of risks that keeps Iteram cautious, including stretched monetary policy, inflation, leverage, and a fourth wave of Covid-19. Seeing less robust European profits, he questions the sustainability of strong US corporate earnings growth.

Craig Kelleher, co-manager of Millstreet Credit (No. 4 in this year's survey), believes fundamentals will eventually win out. When? He doesn't know. But the fund is running at the same low net exposure, 50%, as it did in early 2020 when it feared a market that was also priced to perfection. In spite of its more defensive stance, the fund was up nearly 15% during the first half of 2021.

Takeaway: Allocators and managers interviewed acknowledge the conundrum: asset prices well beyond reasonable and the need to keep up with the relentless bull run.

PERFORMANCE

All that said, the reopening play that's been driving stocks this year continued at a rabid pace through the second quarter of 2021. The S&P 500 is up more than 15% during the first six months of the year--and 21.6% through August.

The robust market helped hedged equity funds, which all generated healthy returns. Equity long bias fared nearly as well as the market, gaining 14.6% through June. Event driven rose nearly 11%, equity long-short gained 8.8%, and emerging markets returned more than 8%.

Small-cap equity activist fund Legion Partners (No. 14) gained more than 28% as the fortunes of its more obscure turnaround plays continued to rally after getting smacked hard during last year's sell-off when the fund's book lost one-third of its value in the first quarter of 2020. (See pages 7-16 for mid-

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Ranked by 2020 Returns

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Global Macro	4.34	7.63	10.06	3.94	3.48	2.71
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Merger Arbitrage	4.77	7.34	9.18	5.23	5.41	4.72
Asset-Backed Loans	2.21	4.08	7.01	5.56	6.61	7.08
Commodity Trading Advisers	2.38	4.53	5.43	2.40	1.32	0.61
Fixed Income Diversified	-0.21	1.35	5.31	3.44	3.83	5.67
Credit Long/Short	0.57	1.98	5.18	3.20	3.77	3.63
Credit Long-Only	-1.21	1.56	4.43	3.38	3.65	4.46
Multi Strategy	4.15	7.08	4.23	1.41	2.91	3.37
Fixed Income Relative Value *	3.67	6.24	3.38	3.41	4.59	4.41
Mortgage Backed Securities	1.8	2.67	2.04	2.64	3.63	4.58
Equity Market Neutral	2.55	4.76	-1.29	-1.19	-0.02	2.00
Asset Backed Securities	4.44	7.31	-1.83	2.80	5.40	9.92
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Source: Backstop BarclayHedge
* Source of Fixed Income Relative Value is HFR

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year returns for each of the Top 50 funds.)

Top-ranked Sosin Partners, an equity long bias fund, climbed 27.6% during the first six months of the year. Emerging Markets Asian fund, FengHe Asia (No.28) rose 21%. And Waha MENA (No. 22), a Middle-East North African emerging market hedged equity fund, increased by nearly 15%.

> "We are seeing liquidity in the absence of solvency."
>
> **- Dan Zwirn, Arena Special Opportunities**

The biggest surprise is the performance of equity market neutral fund Anson Investments (No. 26). In returning 36% during the first half of the year, it doubled the market's return. Remarkable, considering this balanced strategy's average return was just 4.8% over this period.

Amin Nathoo, co-portfolio manager, explains the fund has realized strong long gains from PIPEs and convertible debt financing. It has also profited substantially from exploiting near-term idiosyncratic short opportunities related to meme stock mispricing.

Most other hedge fund strategies, however, delivered far more modest returns in the low- and middle single digits, reflecting challenges and concerns many managers are seeing.

One manager who has no problem generating small steady gains is Dan Zwirn. His Arena Special Opportunities fund (No. 49) was up 4.9% through June. While he sees plenty of opportunity, he's concerned about bank debt being grossly overpriced, new bond issuances paying virtually nothing, and the high cost of volatility protection, making it hard to hedge. Zwirn quips, "we are seeing liquidity in the absence of solvency." And he fears inflation is more than transitory, believing there's a significant chance of seeing the Fed shift rates higher, especially as government spending is set to rise sharply.

LOW HIGH YIELDS

Investcorp-Tages' Jon Feeney explains fixed-income, credit strategy, and discretionary macro performance has been constrained by unanticipated rise in 10-year Treasury prices, flattening of the yield curve, and a rising dollar--moves that have upended many consensus reflation trades and have increased uncertainty.

The chase for yield has sent the junk bond prices higher and their interest rates to record lows, according to ICE Bank of America. And this trend is likely fueling the surprise of the first half: Distressed securities were the top-performing hedge fund strategy and the only one to outpace the market, returning 15.7% versus the S&P 500's gain of 15.3%

This is eye-catching since before the pandemic, during the trailing five years ending in 2019, the strategy's annualized return was just 1.9%. Massive monetary and fiscal stimulus breathed life back into the space, helping it to surge more than 13% in 2020.

Several funds in this year's top 50, while not categorized as distressed, have significant distressed exposure. Millstreet Credit (No. 5) was up 14.8% during the first half of this year. Mudrick Distressed Opportunities (No. 11, which considers itself event driven) was up nearly 17%.

The opportunistic distressed and equity fund MAK One (No. 12) gained more than 19% during the first half of the year. While manager Michael Kaufman currently has little exposure to distressed, he believes, "one reason distressed may be excelling is the availability of cheap money has limited the number of distressed opportunities, pushing up valuations."

He adds, "it takes a seriously troubled business to fall into distress today when credit markets are so exuberant." But he believes there will be an explosion of opportunities in the space.

Because of the massive market distortions created by the aggressive monetary intervention and many underpriced risks, Kaufman expects tapering and interest rate increases will be met with increasing market volatility. And he fears if inflation proves systemic, it will hit most asset classes and securities prices hard.

Millstreet Credit's co-portfolio manager Brian Connolly agrees current trends are not sustainable over the long haul. "High yield is in uncharted territory," explains Connolly, "with the average yield-to-worst well inside of 4%. Even more disconcerting is over one-third of the space is trading inside of 3%." But he is more sanguine than Kaufman, still seeing long as well as short opportunities.

Millstreet invests exclusively in high-yield shorter-term debt. Its research team is finding fundamentally sound small- and mid-cap underpriced debt, which may benefit from the continuing economic rebound over the next 12 months.

To avoid getting hurt shorting, given the unpredictable meme craze, the fund primarily targets 144A private placement debt that can only be purchased by institutions. And with cheap interest rates likely to remain around for a while, the team also sees opportunities shorting callable high-yield debt "whose upside is pinned against the call price, with risk more likely limited, unlike an equity short."

So what to think about prospects for this rest of this year?

After seeing the S&P 500 double in value in just one year, Iteram's Marc Sbeghen thinks over the near term the market will more likely correct than add another 20%. "Historical data bears this out," explains Sbeghen. (See chart below.)

By nature thoughtful and cautious, Jon Feeney is a bit more upbeat. He says overall it's hard to be bearish in this environment with so many positive forces clearly supporting higher asset prices, in spite of how frothy they are getting. "And trying to time a market peak," concludes Feeney, "is just as hard as trying to figure a bear market's bottom." ■

S&P 500: RECENT CORRECTIONS FROM 2003-2021

Source: Bloomberg

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 performance 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 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.]

Image Courtesy of the Federal Reserve Bank of New York

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.

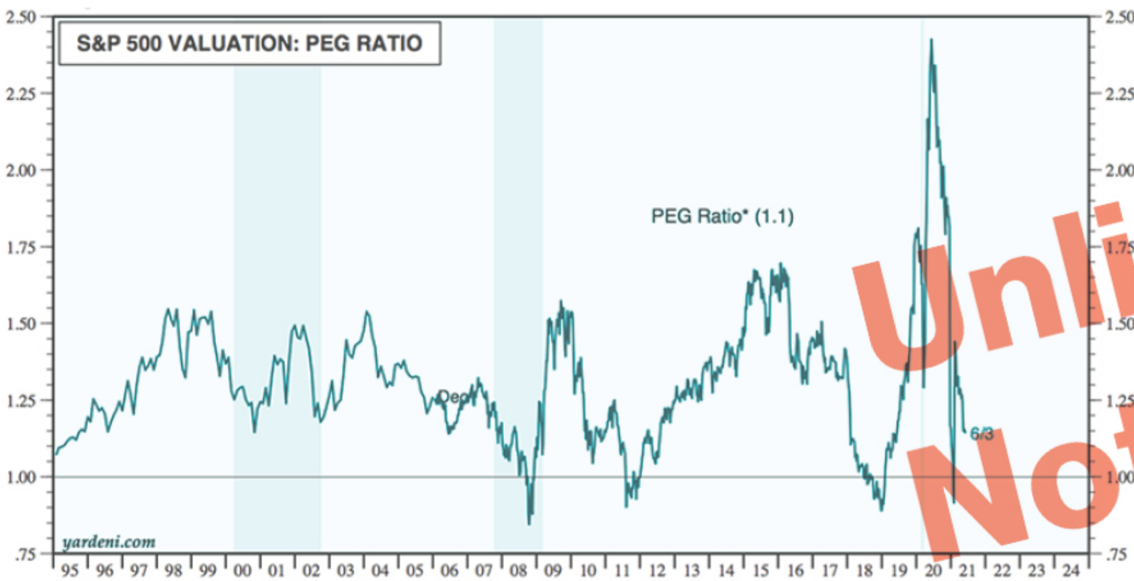
the highest trailing 5-year annualized returns through 2020.

Collectively they generated:

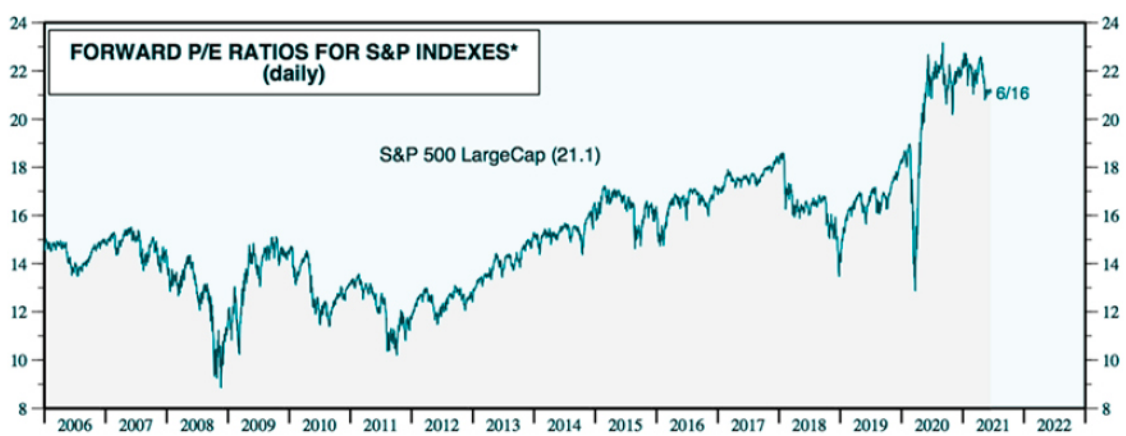
- 5-year net annualized returns of 14.81% versus the S&P 500 Total Returns of 15.22%. The hedge fund industry average gains over this period was 6.41%;
- Average worst draw-down over this period was -12.2% versus the market's -19.60% decline. The industry average drawdown was -11.9%;
- Annualized standard 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.

> "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

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

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.

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.

> "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**

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 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	3.90	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	29.20	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	-34.40	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	20.20	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	-2.89	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	-30.70	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	69.52	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	0.62	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	-7.40	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	-5.67	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	10.24	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	28.72	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

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 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	7.94	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	21.20	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	15.45	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	34.60	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	21.90	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	19.87	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	-8.86	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	-5.46	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	26.26	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	8.32	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	10.24	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	28.72	14.19	15.22	11.92	-19.60	-50.95	15.13	15.12	0.93	0.52	1.00

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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 GLOBAL 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 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	13.65	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	32.91	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	21.55	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	-0.81	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	11.37	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	45.50	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	7.60	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	27.21	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	-21.37	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	18.35	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	10.24	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	28.72	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. *** $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 GLOBAL SURVEY OF THE TOP 50 HEDGE FUNDS

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31 / 10	31	Omni Event (London)	Sep-13	Event Driven	853	853	14.64	11.15	8.73	9.14	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	12.86	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	10.75	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	8.28	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	17.26	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	13.33	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	7.56	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	6.00	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	5.11	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	23.77	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	10.24	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	28.72	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 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."

> "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

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 GLOBAL 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 Net Returns	3-Year Annualized Net Returns (%) Thru 2020	5-Year Annualized Net Returns (%) Thru 2020	Annuazized 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 / 18	41	Twin Tree Capital Master (Dallas)	Jan-13	Volatility Trading	821	821	11.45	5.49	16.84	7.78	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	-12.43	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	16.37	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	10.47	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	13.49	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	2.08	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	3.82	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	9.81	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	9.56	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	7.03	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	10.43	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	10.24	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	28.72	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	-2.54	4.18	3.36	6.99	-4.51	-8.43	3.28	5.85	0.68	0.65	-0.28

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^^ 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,

Photo credit: Courtesy of Max Rosenstein

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.

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.

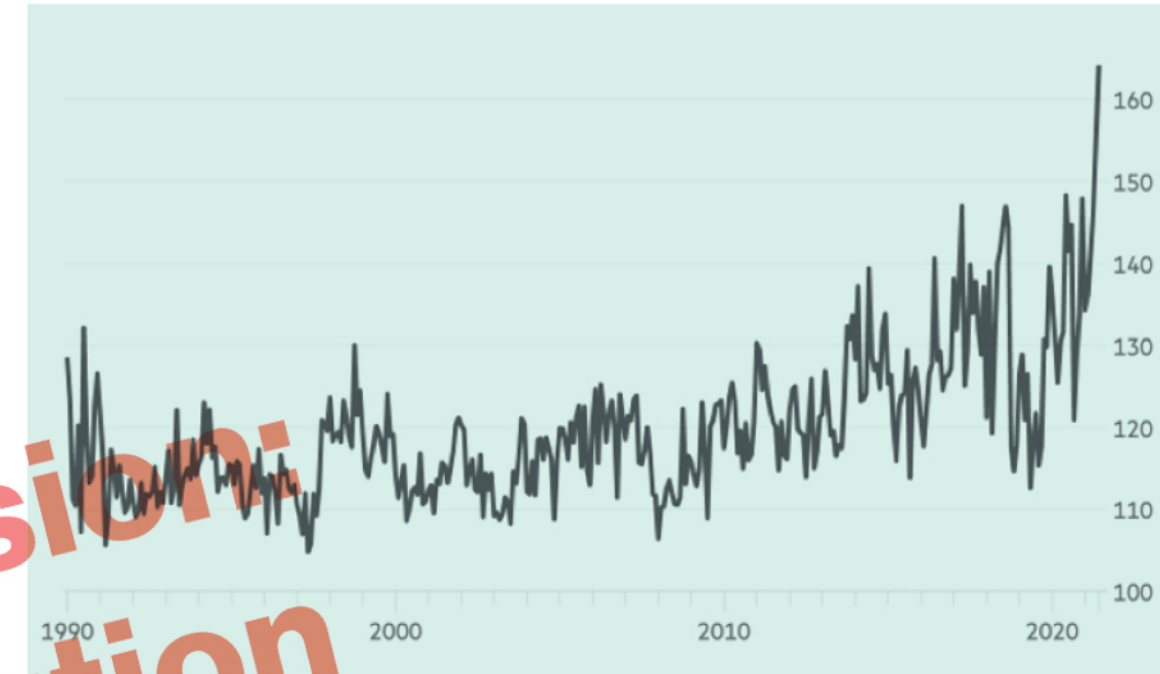
Divergence

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.

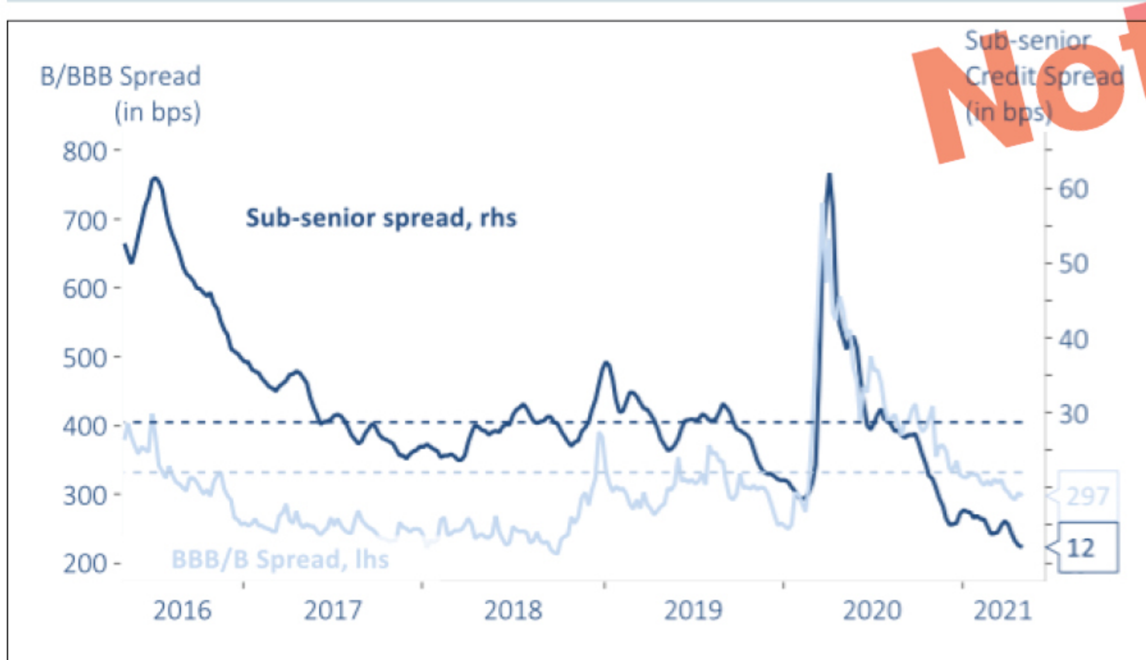
When El Jamal saw central banks and government spending committed to meeting the challenges posed by economic shutdowns, he ratcheted up net exposure. He believes for the rest of 2021, "Value will outperform in our region, involving banks, petrochemicals, real estate, industrial materials, and mining.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

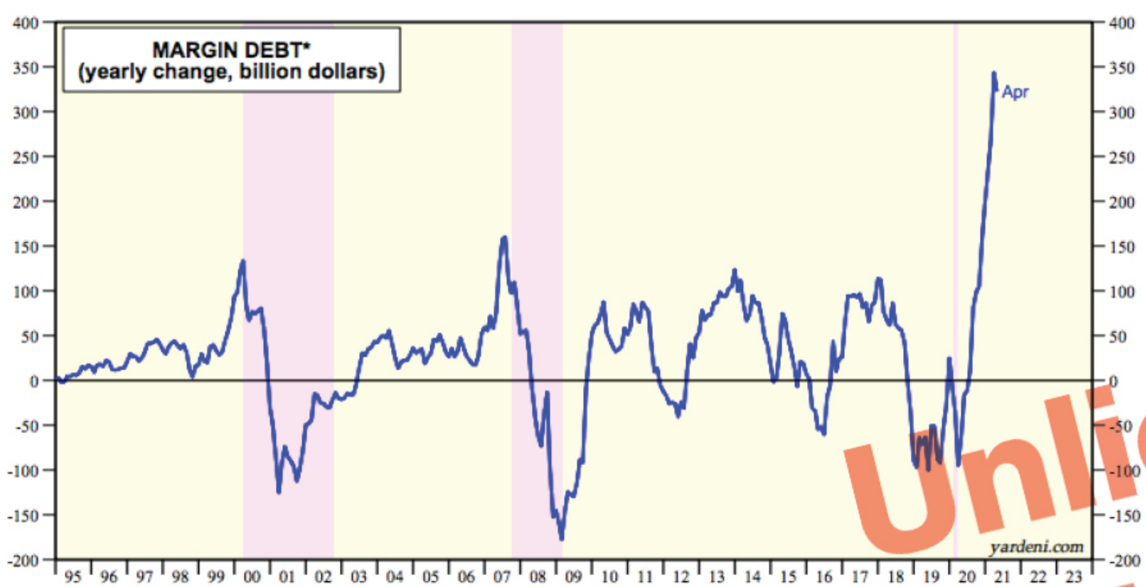
Soaring debt that's been piling up in response to the pandemic worries Eric Knight, CEO and CIO of the Swiss-based asset manager Knight Vinke. "With global debt-to-GDP levels approaching 400% and pandemic-related public expenditures set to increase without restraint almost everywhere," cautions Knight, "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.]

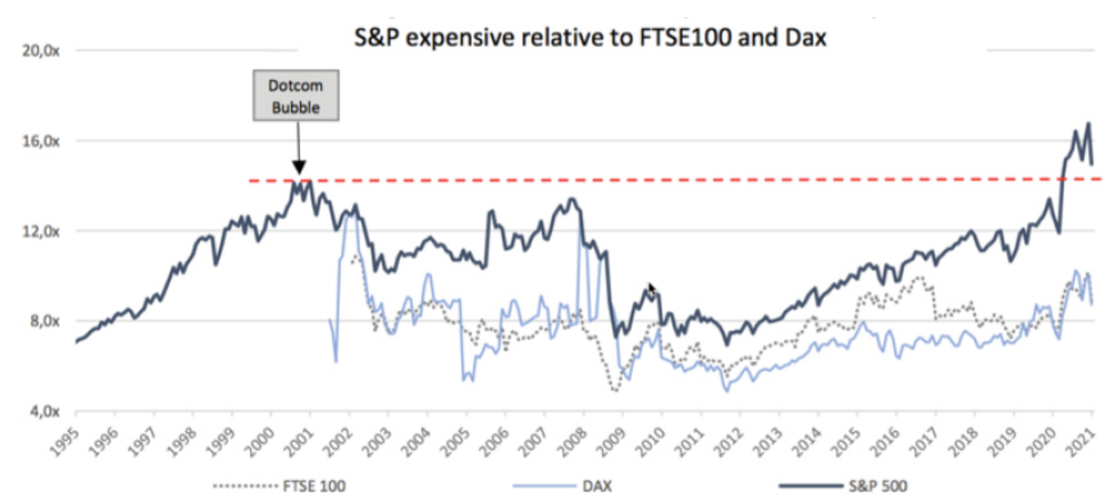
"The value investor in me feels that a correction is long overdue," explains Knight. But he admits the euphoria driven by vaccinations, government handouts and the lifting of restrictions on travel and social interaction is hard to ignore. "Dealing with this contradiction is hard for many asset managers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

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