

Hedge Fund Performance April 2010



Year to date the top performing strategies have been Event Driven, Distress and Fixed Income Arb. The weakest strategies were Global Macro, CTAs, and Market Neutral. Over a 12 month period Convertible Arbitrage continues its strong run, followed by Distress and Emerging Markets. The weakest strategies year to date were also the weakest over a 12 month period.

Recent history has reinforced the fact that it is very hard to time hedge fund strategies. Event Driven strategies were least favoured in 2009 yet performed well this year. Global Macro and CTAs were most favored at the beginning of 2009 yet both have underperformed the other strategies by a convincing margin.

Market neutral strategies continued to struggle as equity markets have been driven mostly by macro risk factors and fundamentals have played little part in explaining price variation.

On the whole the value proposition of hedge funds has been reinforced. The HFRI has outperformed the MSCI World and Barclays Bonds convincingly both on the upside as well as protecting on the downside over a 6 month, 12 month and Year To Date basis.

Bearing in mind that the nature of hedge funds being skills based is such that a macro environment that holds potential for gain, holds equal potential for loss, and going against my own earlier observation that you cannot time strategies, here

are some predictions for the prospects of the various strategies.

Equity market neutral strategies will continue to struggle as markets will continue to be driven by macro factors, particularly monetary and fiscal policy, extraordinary policy and regulatory factors. I do not expect further crises or near crises as governments are already on high alert given the situation in Greece and the Eurozone. Markets are looking tired and looking for an excuse to correct, however, trading should be continuous.

Fixed income arbitrage is an interesting area where given the volatility and uncertainty in sovereign risk one would have expected more volatility. Instead performance has been consistent. Highly levered strategies have been extra careful and under levered despite a widespread recovery in available leverage to hedge funds.

The problem facing CTAs is that conditions have changed. Markets are driven by policy and politics which do not follow the set pattern of price evolution of the past 8 years. Prudent risk management may save some but the overall picture for CTA performance is likely to be further randomness.

The problem facing Macro is similar. Markets are not being driven by fundamentals, policy makers are not being driven by the usual state variables but by exogenous factors. The potential for gain is high as is the potential for loss. Unfortunately the talent that excels in these conditions is scarce.

Event driven managers were a favourite of mine coming out of 2008 and they continue to be. Often regarded as one of the more risky strategies, the fact that event driven is highly specific and doesn't try to diversify systemic risk but instead tries to isolate, assume and manage idiosyncratic risk makes it a safer strategy in these uncertain times.