# ALTERNATIVE INVESTMENTS INSIGHTS

November 2017

# REVIEW OF THE ALTERNATIVE UNIVERSE

## HIGHLIGHTS

- Positive performance for hedge funds so far in 2017
- Macro: mixed returns, compressed volatility and preference for macro systematic
- Equity: good performance, reduced stock correlation increasing dispersion and expected returns
- Event Driven: stable performance, and interesting opportunities in corporate activity
- Relative Value: muted returns, but positive outlook
- Our quantitative risk management tools, a competitive edge

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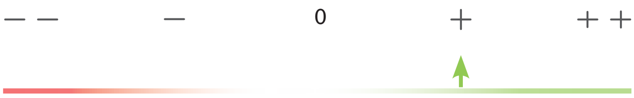
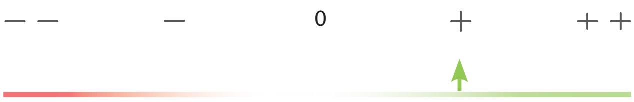
## Strategies outlook

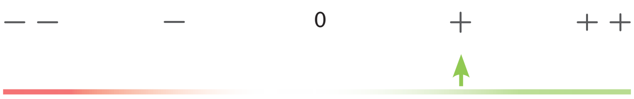
**Macro**



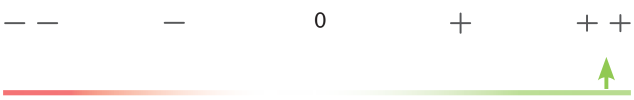

**Equity Hedge**




**Event Driven**




**Relative Value**




## THE SITUATION SO FAR

The period was characterised by strong performance across the hedge fund industry. We were especially glad to see our equity long bias allocation benefiting from the equity rally, while dedicated strategies extracted alphas too. Investors were focused more on fundamentals such as earnings, rather than on the macroeconomic environment. It is a welcome change in dynamic compared to previous years, with markets switching back and forth from risk-on to risk-off on the back of central banks' interventions or wording.

So far in 2017, we are observing a reduction of the intra-stock correlation and rising dispersion, both creating a wealth of additional opportunities. The Fed's balance sheet reduction, tightened policy and the ECB's tapering getting closer should all continue to improve the environment.

We are working to develop our hedge fund strategy allocation, focusing in particular on new technologies, namely quantitative machine learning and more broadly on all systematic methodologies, moving away from the classical price and fundamental data analysis. The technology is in its early days but we think it might develop quickly.

At the end of this document, we are sharing with you our conviction on portfolio risk management and the need for a strong quantitative analysis system.

## MACRO

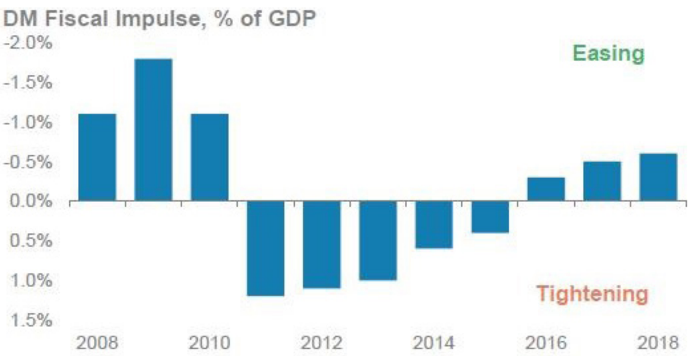
The down trend continued for the discretionary macro managers unwinding their post US election trades. Likewise, and with the exception of June when some managers outperformed due to their FX exposure while others underperformed on the back of the month-end bond sell-off, the period was relatively uneventful. Managers want to believe in the likelihood of US fiscal reforms, but we are observing a growing lack of conviction. Positioning is idiosyncratic across managers with long Eurozone and tactical short S&P500.

Unlike discretionary managers, systematic models were finally successful in extracting alpha, especially in August with sustainable trends in metals and bonds. July saw some medium-term trends emerge allowing some managers to deliver gains, while the bond sell-off of June, combined with a reversal in the commodity complex, was detrimental. Over the review period, there were no significant shifts in allocation with the bulk of risk implemented within equities, fixed income and commodities for those not fed up with the lack of consistency and sharp reversals.

### OUR OUTLOOK

Even if the set of opportunities is relatively supportive with an increasingly lower cross-asset correlation and increasing divergence in monetary policies, compressed volatility remains a drag to risk utilisation. In regards to systematic models, we remain concerned about trend reversals and reiterate our bias toward macro systematic

**Fiscal Policy is Also Easing**




Sources: IMF, Morgan Stanley Research forecasts
Data as of: October 2017

## EQUITY HEDGE

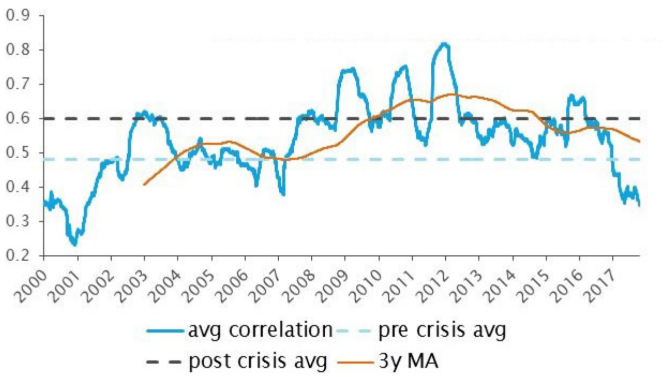
Equity Hedge managers posted positive numbers as markets continued to climb over the period, despite being handicapped by losses on their short books. In the US, stock market gains have been led by large cap growth stocks, namely the FAANG's*. This has been very profitable for managers with tech exposure, but detrimental to managers with a value bias. The rally in growth stocks can be attributed to the reversal of the "Trump trade" due to tax reform being postponed and healthcare reforms being delayed. Traders were caught in a rotation out of financials into technology stocks. Furthermore, significant inflows in passive investments that are more growth heavy have added to the rotation. Elsewhere, European managers displayed good results in the midcap space, but large cap managers haven't taken advantage of the improved macro environment in Europe yet. Asian managers posted strong gains, with consumer discretionary and tech driving performance as the Chinese economy continued to surprise on the upside eschewing any fears due to mounting geopolitical risk.

*FAANG: Facebook, Apple, Amazon, Netflix, and Alphabet's Google

### OUR OUTLOOK

We remain confident in Equity Hedge strategies. Our outlook remains positive as we expect tailwinds for the strategy to materialise on the macro side as well as in the markets. Stock correlations have already dropped significantly this year and with rising rates looming on the horizon we expect dispersion to rise as well.

**126-Day Intra-Stock Correlation: S&P 500**




Sources: Bloomberg, SYZ Asset Management
Data as of: October 2017

## EVENT DRIVEN

The second part of the year offered a relatively easy and benign environment for Event Driven hedge funds, and return dispersion within funds dropped during that period. All Event Driven indices but one posted positive returns. Special situations equities led, followed by merger arbitrage and then credit opportunities, which is typical in a risk on environment. Earnings were strong in the U.S., led by the big technology companies. Corporate event activity was stable, and CEO confidence was just off the peak reached earlier this year. The implementation of U.S. tax reforms remains the hot topic, which could continue to push the market up. Populist risk in Europe decreased as the centrist pro-Europe candidate won the French presidential election. Still, a number of European managers mention the potential for an increase in European merger arbitrage volumes, which was witnessed earlier this year.

### OUR OUTLOOK

The outlook remains bright. Analysts are divided on the implementation of tax reform in the U.S. It is hard to know whether prices of securities reflect a cautious or optimistic stance on that front. At this stage, we anticipate corporate activity to continue to offer interesting opportunities for the final part of the year.

## RELATIVE VALUE

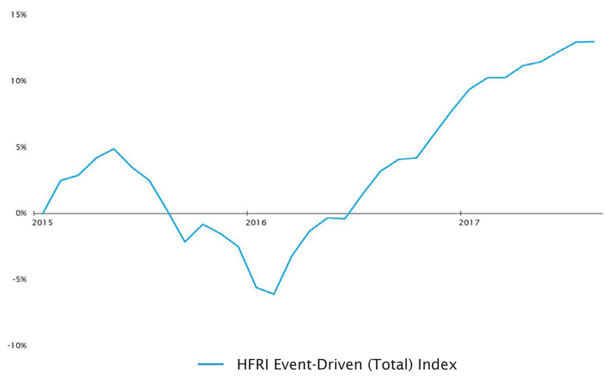
Returns were somewhat muted over the period, even if they were overall positive across the credit spectrum (i.e. US and Europe), with the lower tranches outperforming. Some managers reported losses on energy names as stub and some post-reorganisation names were more difficult to negotiate. Once again the major catalyst was crude oil, with the rally in July pushed spreads tighter even if a number of events acted as drags (such as Venezuelan instability, North Korea’s missile launch), testing market sentiment.

There were no specific changes worth mentioning in regards to fixed income arbitrage managers who kept capitalising on German bonds basis with marginal bets on swap spreads and yield curves. Over the review period, volatility stayed stuck at historic lows with the volatility premium behaving unfavourably for volatility premium arbitrageurs, with equity markets reaching new all-time highs too. For those with a tilt to sovereign fixed income RV trades, they managed to continue to post performance. Even if we are disappointed by the performance of our directional delta hedged managers, we are cautious that the environment could have been worse.

### OUR OUTLOOK

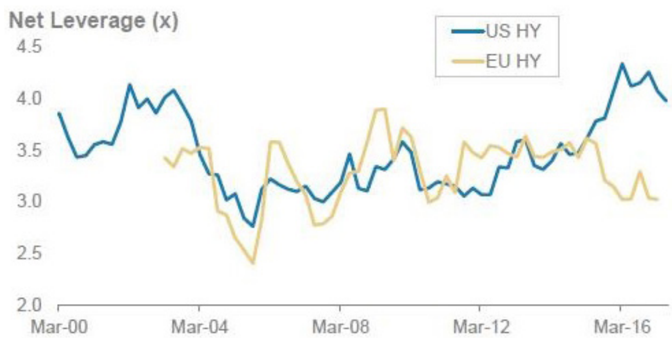
Aligned with the ever increasing dispersion in high yield, we stress our preference toward capital arbitrage allocation, especially in G-3 as the emerging market corporate credit rally has stretched over the last three years. Our outlook continues to be positive and aligned to that of dedicated managers as mentioned in previous letters.

**HFRI Event-Driven Performance Stabilized in H2 2017**




Sources: Bloomberg, SYZ Asset Management
Data as of: October 2017

**High Yield Leverage: US vs. European Divergence**




Sources: Morgan Stanley Research, Bloomberg Finance LP, Citigroup Index LLC, Thomson Financial, company data
Data as of: October 2017

## OUR CONVICTIONS

Risk management has become an unavoidable part of the portfolio construction process in the post-financial crisis environment, requiring asset managers to rethink their approach, to get an in-depth understanding of the risk metrics of the portfolio itself and its underlying constituents.

We believe that our proprietary risk management framework, internally built, provides us with a broad array of the most relevant quantitative metrics needed to assess and anticipate the behaviour of our portfolios. The models were tested in real market conditions and improved accordingly over the years.

The set of risk management tools we use comprises advanced quantitative metrics such as stress tests, portfolio diversification evolution and multi-variate analysis, allowing us to identify the most robust risk and return factors as well as potentially uncover hidden tilts in our portfolios. Once flagged, these biases can then be mitigated by appropriate portfolio rebalancing.

We believe that a sound and tight control of the exposure of our portfolios to can helps to limit the drawdowns in unfavourable market environments. An important edge is the ability to backtest a multitude of risk profiles. Hence, when a new position is added, we know how it should affect the overall portfolio from day one.

In this respect, we believe that we have a competitive advantage over our rivals in the portfolio management of hedge funds.

**Stress Tests**


Source: SYZ Asset Management
Data as of: October 2017