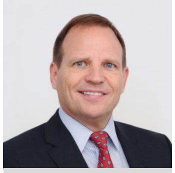
Market Update October 2024

Interest Income Switzterland

A solid US economy and falling interest rates in the largest economies mean that global economic growth should accelerate somewhat in the next few years and the risk of a deepened recession has decreased.

The interest rate markets have already priced in the central banks' interest rate cutting cycle. In Switzerland this leads to a Saron yield curve of 0.35% over 2 years to 0.55% over 10 years, with a stable trend. This results in a very low return potential for Swiss bonds or international bonds that are hedged in CHF. While the annualized return over the last 10 years has been around zero due to negative interest rates, this will not improve significantly in the next 10 years with an expected 0.5% per year.

Even credit risk from companies with poor credit ratings is hardly compensated and does not justify the additional risk for very little additional return.



Stefan Steiner

We recommend an absolute return, multi-strategy approach relying on various alternative niche strategies (fixed income arbitrage, convertible arbitrage, merger arbitrage, capital structure arbitrage, equity market neutral arbitrage, macro strategies).

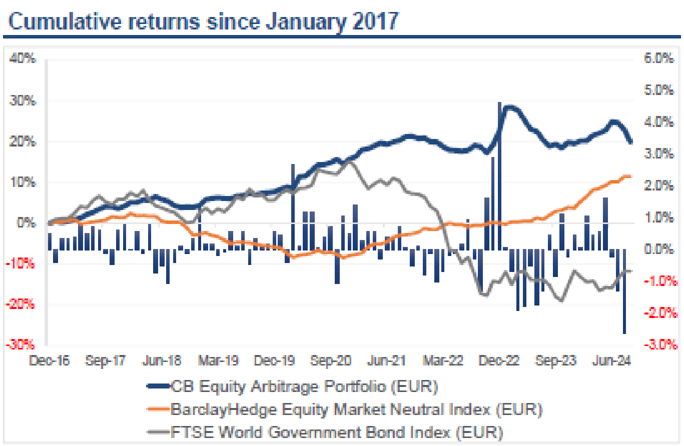
Of course, these very active investment strategies are more expensive in terms of fees than a passive bond strategy, but after deducting all costs, they generate an attractive additional return of 3-4% per annum, which benefits the investors and pension fund members. Such an additional return makes a huge difference over a period of 10 years due to the compounding effect and would bring billions in additional income to the portfolios of Swiss pension funds.

For a more detail discussion or more information by e-mail, please contact ss@cb-partners.com.

In the spotlight

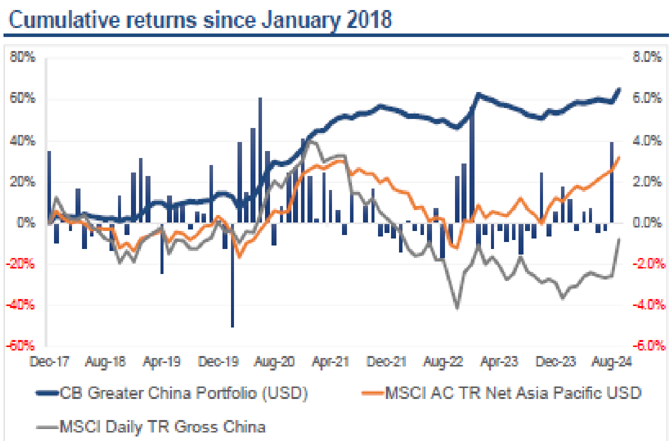
Equity Arbitrage

Equity arbitrage strategies struggle when there are violent market reversals or massive fund liquidations. In both cases, fundamentals do not play a role and stocks are bought or sold due to interventions or liquidations. These movements away from fundamental fair values are usually short-lived and the reality will bring such moves back to fair value over time. The CB Equity Arbitrage (EUR) Certificate suffered in August and September due to sharp market moves in China. Such events are usually a good entry point to a strategy that bets on mean reversion over time.



Greater China

The announcement of massive market support by the Chinese government led to higher prices across most markets in China and the part of Asia that directly benefits from China. While market neutral strategies struggled as the junk companies in their short book moved much more than their high quality longs, other managers benefitted from their long-biased exposure in equities and credit. The CB Greater China (USD) Certificate was nicely up in 3Q, 2024 and there is still room for more performance as China and Asia have been underperforming other regions massively over the past two years.

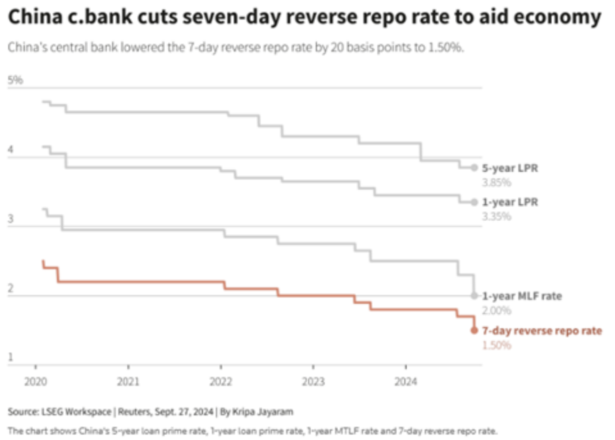


Sentiment on China is Changing

Sentiment on investments in China has seen a massive boost after the announcement of stimulus by the Chinese government. The outlook of more stimulus, in particular in the case of Trump winning the election and the need to counterbalance potential tariffs, is a catalyst for further support of the Chinese equity market. However, we expect market volatility to remain relatively high, and advise focusing on long short strategies to dampen volatility.

Background

The global easing cycle started after the US Fed announced a first rate cut. This gave China's central bank the opportunity to lower interest rates and inject liquidity into the banking system in September, as Beijing assembled a last-ditch stimulus assault to pull economic growth back towards this year's roughly 5% target.



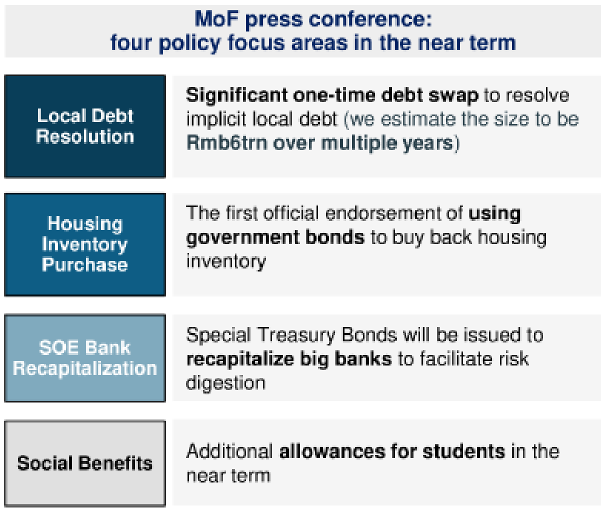
Hedge funds are also increasingly bullish on Chinese equities. Recently, net purchases of Chinese and Hong Kong stocks reached record levels. While optimism is evident, market volatility remains high, driven by geopolitical factors and economic uncertainty. Analysts recommend long-short strategies to manage risk and leverage high dispersion in asset returns.

Long/Short Investing

For hedge funds, however, the recent rally has provided substantial returns. The MSCI China Index surged by 23% in September, its highest monthly gain since 2022, with several funds reporting strong performance in technology and consumer sectors. This influx of investment reflects growing confidence in the undervalued nature of Chinese equities, as companies trade at significant discounts relative to U.S. and European counterparts. Despite the optimism, some funds remain cautious, managing exposure with hedging strategies and a measured approach to mitigate potential downside risks.


Peter Rice

Hedge funds play a pivotal role in reducing volatility and capturing equity dispersion, especially in uncertain markets like China's. By utilizing long-short strategies, hedge funds can mitigate downside risk and benefit from both appreciating and depreciating assets, essential in volatile environments where traditional long-only investments may struggle. With rising equity dispersion, hedge funds are positioned to capitalize on mispriced securities, capturing returns from both outperforming and underperforming assets. Their flexibility to adjust sector exposure and manage systemic risks linked to broader market movements enhances stability in otherwise turbulent markets. This adaptability, combined with sophisticated risk management, enables hedge funds to offer more stable, diversified returns, making them a valuable component in investor portfolios seeking exposure to high-dispersion equity landscapes.



The September market rebound has ignited optimism, though questions about sustainability remain. Continued support from Beijing will be crucial, with additional policy announcements expected later this year. For now, hedge funds are positioning for potential alpha-driven returns, leveraging discounted valuations and high equity dispersion as the government signals a commitment to economic stability and growth.

Source:s Crossbow Partners, Morgan Stanley, Bloomberg *For more information please an e-mail to Peter Rice at par@cb-partners.com.*

Growth of Alternative Investments Among U.S. Pension Funds

Juliane Begenau, Pauline Liang, and Emil Siriwardane examine in their paper "The Rise of Alternatives" the factors driving the increased involvement of U.S. public pension funds in alternative investments such as hedge funds, private equity, and real estate. Since the 2000s, the share of these investments in pension funds' riskier assets has significantly risen, from 14% in 2001 to 39% in 2021. This shift marks a fundamental change in the investment strategies of public pension funds over the past two decades.

A key driver of this trend has been the recommendations of investment advisors, whose favorable assessments of the alpha potential of alternatives have strongly influenced decision-making. These advisors highlight the superior risk-adjusted returns alternatives can offer compared to traditional equities, leading pension funds to adjust their portfolios to include more alternatives. Notably, this shift is observed not only among underfunded pension funds seeking higher returns but also among funds looking to optimize their performance relative to stocks and bonds.

The paper also discusses the impact of past experiences: pension funds that had weaker returns in the 1990s were more likely to increase their allocation to alternatives after 2000. Additionally, the macroeconomic environment—characterized by persistently low interest rates—made it more challenging to achieve adequate returns from fixed-income securities, further boosting the appeal of alternatives. The paper also suggests that this transition has been uneven across different states, with some pension increasing their allocations significantly more than others.

This combination of favorable advisor recommendations, changing market conditions, and regional differences has positioned alternatives as an essential component of modern portfolios. The perception of their advantages over traditional investments continues to shape pension fund strategies today, highlighting the ongoing evolution of risk management practices.

Hedge Funds on the Rise: Strength in Turbulent Times

A report by GCM Grosvenor highlights that hedge funds have proven their ability to deliver strong absolute and risk-adjusted returns over several decades, particularly during periods of market turbulence and economic uncertainty. The analysis underscores the role of hedge funds as effective risk management tools: in the worst quarters of a traditional 60/40 portfolio, hedge funds managed to limit losses to approximately 28%, which emphasizes their capacity for capital preservation during volatile times.

Armin Vogel

HEDGE FUND MARKET CAPTURE

HF Performance in Worst/Best Quarters for Traditional Assets	vs. 60/40	vs. S&P	vs. BB US Agg
Given benchmark <25th percentile			
Bmrk Return	-3%	-6%	-1%
HF Return	-1%	-1%	2%
HF Down Capture	28%	16%	--
Given benchmark >75th percentile			
Bmrk Return	7%	11%	4%
HR Return	5%	5%	2%
HF Up Capture	73%	50%	45%
HF Convexity			
Up Capture: Down Capture	2.6x	3.2x	--

Source: GCM Grosvenor, Bloomberg, S&P, HFR. Returns from January 1990 to March 2024. Reflects performance of HFRI Fund-Weighted Composite versus S&P 500 "S&P", Bloomberg

The report further illustrates that hedge funds' flexibility enables them to quickly respond to changing market conditions. By utilizing a range of strategies such as long/short equity, event-driven, or global macro, hedge funds can seize opportunities in diverse market environments. This breadth of strategies distinguishes them from traditional investment approaches and enhances their ability to generate alpha through various market cycles.

Additionally, hedge funds have a structural advantage, allowing them to exploit market inefficiencies and capitalize on return potential during periods of increased volatility. These features make them a valuable component of modern portfolios, which seek not only stability but also growth. Hedge funds provide investors with the opportunity to achieve steady returns across different market phases while simultaneously mitigating downside risks. This combination of attributes underscores their significance for balanced asset allocation and long-term portfolio resilience.

If you would like to receive the above mentioned papers, please contact Armin Vogel at av@cb-partners.com.