Virtual Trip Report

Protective strategies in Q1 2020

August, 2020

Executive Summary

The COVID-19 pandemic led to an historical sharp market correction in Q1 2020, accompanied by a surge in market volatility. Also unprecedented was the market recovery that started towards the end of March, and that is still underway as of the time of writing.

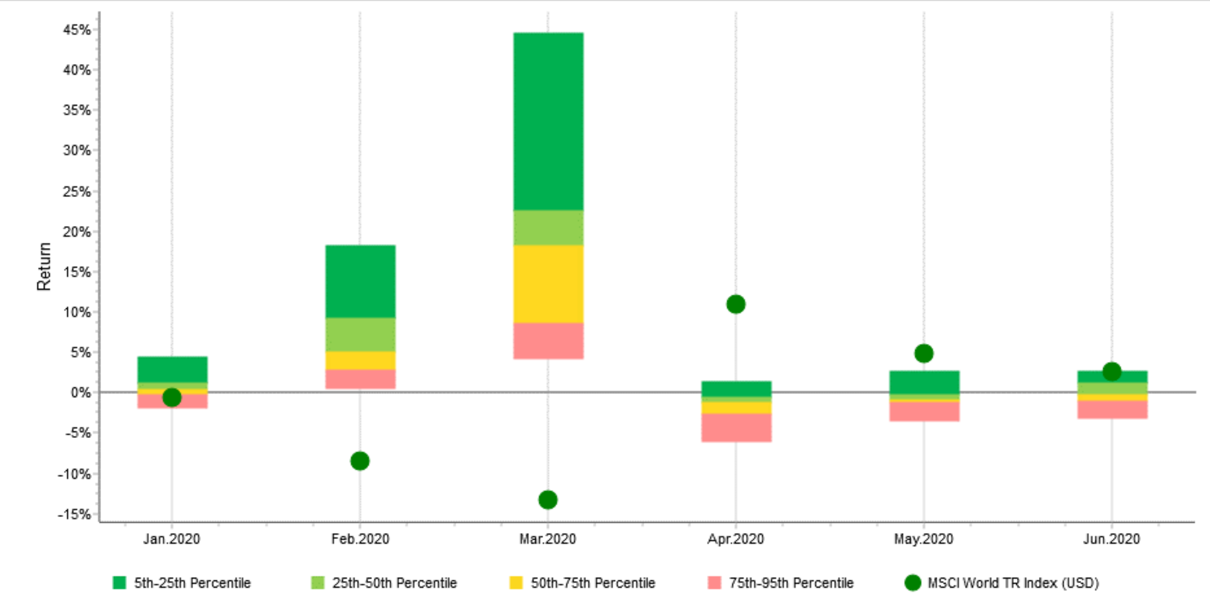
Hedge funds were not immune to these sharp market moves, however were able to limit losses in Q1 to half of the equity markets' losses, according to broad benchmarks.

In this report, we consider hedge funds designed to perform well during market corrections, shocks and / or dislocations. Those funds are typically classified within the Tail Risk and Long Volatility strategies, although some managers are using protective strategies that are not purely relying on options and higher volatility levels (we call these strategies "Other Protective Strategies").

Our Manager Reports relate to UCITS funds within Long Volatility and Other Protective Strategies. As the universe of UCITS hedge funds continues to expand, such specific strategies are now also available in UCITS format and actually delivered attractive results in Q1 2020.

Performance of protective hedge fund strategies during H1 2020

All hedge funds in our protective peer group performed positively in February and March 2020 when the MSCI World TR Index was significantly negative. Interestingly, those funds were able to realize most of their profits and were only slightly negative in Q2 2020 when markets recovered strongly. The 6 UCITS funds in our peer group of 17 funds had lower returns than the overall peer group in February and March, however still delivered attractive protection during those volatile months. According to Eurekahedge's hedge fund indices, Tail Risk funds had an explosive performance in March 2020.



Peer group's monthly performance from Jan 2020 to Jun 2020
Source: Crossbow Partners

Date	Peer Group average monthly performance	Peer Group's UCITS funds average monthly performance	CBOE Eurekahedge Long Volatility Hedge Fund Index	CBOE Eurekahedge Tail Risk Hedge Fund Index	MSCI World TR Index (USD)
Jan-20	0.72%	1.81%	0.36%	1.44%	-0.61%
Feb-20	7.13%	3.57%	9.27%	12.76%	-8.45%
Mar-20	20.60%	15.06%	20.21%	37.44%	-13.24%
Apr-20	-1.76%	-1.05%	-1.76%	-3.85%	10.92%
May-20	-0.74%	0.33%	-0.36%	-1.96%	4.84%
Jun-20	-0.12%	-0.86%	0.63%	0.77%	2.65%

Peer group's and UCITS subset's monthly performance from Jan 2020 to Jun 2020
Source: Crossbow Partners

Performance of protective hedge fund strategies since 2017

A longer-term view is obviously necessary to evaluate hedge funds with protective properties. We consider here the period January 2017 to June 2020, in order to keep the number of funds with an inception date after January 2017 reasonable (6 funds in our peer group started after that date) and as those years were quite relevant for protective strategies (2017: extreme low market volatility and no down month for MSCI World TR Index, 2018: large equity sell-off in Q4, 2019: strong equity markets, Q1 2020: historical equity sell-off).

Without too many surprises, most funds in our peer group were negative in 2017 and 2019 (two strong years for equities), while most funds were positive in 2018, as they benefited from higher volatility levels in Q1 and Q4. As expected, the UCITS funds had smaller losses in 2017 and 2019 as well as smaller gains in H2 2020 than the overall peer group, but had similar gains in 2018, producing and attractive protective return profile over these 3.5 years. Compared to our peer group, the Eurekahedge Long Volatility and Tail Risk indices had larger losses in 2017 and 2019 and lower performance in 2018 (market corrections in 2018 were not important enough for Tail Risk funds to perform well), but again had larger gains during the first half of 2020.

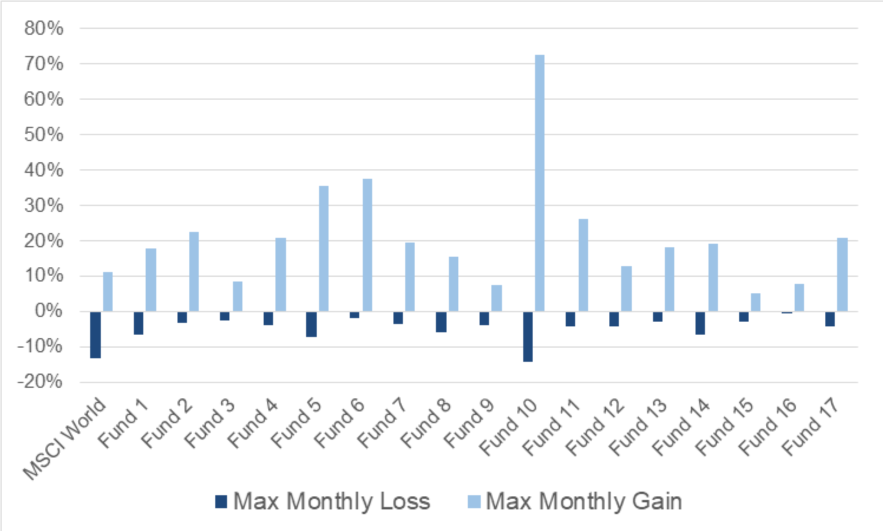
Peer group's performance from Jan 2017 to Jun 2020
Source: Crossbow Partners

Year	Peer Group average yearly performance	Peer Group's UCITS funds average yearly performance	CBOE Eurekahedge Long Volatility Hedge Fund Index	CBOE Eurekahedge Tail Risk Hedge Fund Index	MSCI World TR Index (USD)
2017	-8.02%	-4.66%	-10.95%	-14.22%	22.40%
2018	4.83%	5.00%	0.83%	-5.75%	-8.71%
2019	-8.59%	-4.09%	-10.87%	-10.40%	27.68%
H1 2020	27.60%	19.77%	29.85%	49.33%	-5.78%

Peer group's and UCITS subset's performance from Jan 2017 to Jun 2020
Source: Crossbow Partners

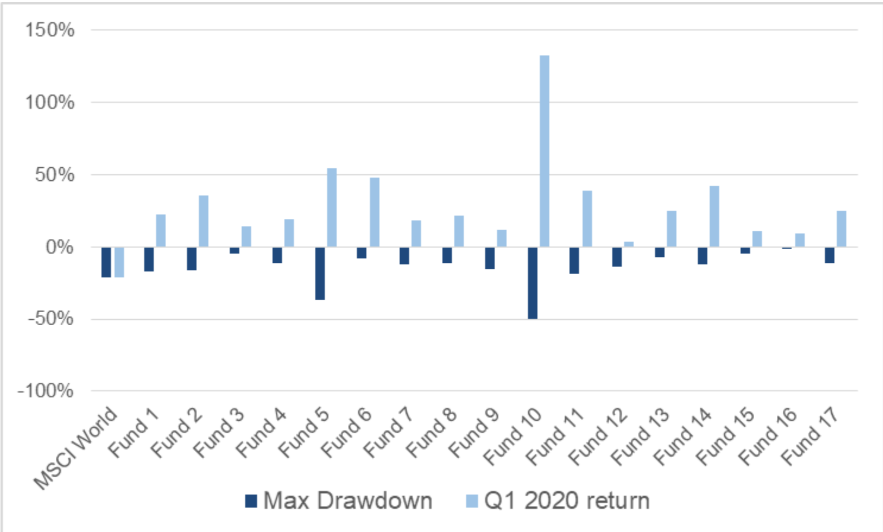
Protective strategies, in particular Tail Risk strategies, are known for their potential high costs of protection, i.e. their potential important negative returns during benign markets arising from the cost of carrying positions that should perform positively during market sell-offs, crashes and / or dislocations. To better assess this upside / downside relationship, we look at various gain to loss ratios during the January 2017 to June 2020 period.

All funds in the peer group had their best month larger (in absolute value) than their worst month, with a Tail Risk fund having by far the largest best month in March 2020 and still a relatively limited worst month. Long Volatility funds had the second and third best months and also had limited worst months. UCITS funds (Fund 1, 4, 14, 15, 16, 17 in the graphs) had mixed results, as some funds had relatively small gains in March 2020 (but with small worst months as well), while some others had quite attractive results in March 2020 and still with acceptable worst months. Looking at the best month / worst month ratio (not shown in graph), Long Volatility strategies, including a UCITS fund, had the top ranked ratios, slightly ahead of some Tail Risk funds, as those can have explosive positive months, but typically suffer more during benign markets, impacting the ratio and also the long-term compounding effect.



Peer group's funds best and worst month from Jan 2017 to Jun 2020
(MSCI World = MSCI World TR Index (USD))
Source: Crossbow Partners

Considering longer periods than monthly, the below graph shows the funds' return during Q1 2020 as well as their worst drawdown since January 2017. The largest gain in Q1 2020 is again delivered by a Tail Risk fund, however its max drawdown since January 2017 has been as large as 50% (i.e. had been the max drawdown immediately followed by Q1 2020, this fund would have slightly more than recouped its loss). The next best gains in Q1 2020 came from Long Volatility funds, followed by a UCITS fund, which actually had a rather limited max drawdown since its inception. Given the potential large drawdowns of some funds in our peer group, it is worth looking at the funds ranking when compounding a fund's Q1 2020 result with its max drawdown (not shown here), which is again favorable to a Long Volatility fund, followed by a UCITS fund deploying a mix of Long Volatility strategies together with Other Protective Strategies. Those two funds are also top ranked when considering the Q1 2020 return / max drawdown ratio, i.e. a gain / loss ratio rather than an absolute performance result.



Peer group's funds max drawdown from Jan 2017 to Jun 2020 and
Q1 2020 return (MSCI World = MSCI World TR Index (USD))
Source: Crossbow Partners

These considerations remind us that absolute performance results are most often not enough to evaluate hedge funds and that the analysis of a fund's upside performance per unit of risk can be of paramount importance. This is especially the case when it comes to analyzing hedge funds with highly asymmetric return profiles and that are expected to perform strongly during negative markets.