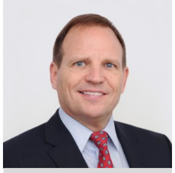
Crossbow Partners
Experience & Discipline

Newsletter October 2022

The Return of Hedge Funds


Stefan Steiner

The capital markets are experiencing the worst year in recent history. In contrast to 2002 and 2008, stocks and bonds collapse simultaneously due to rising interest rates and geopolitical problems. This time, private markets and real estate investments will also follow, because the new interest rate environment will lead to a revaluation that will last for a longer period of time. Even gold as portfolio insurance does not help and also loses significantly in value. Traditional portfolios with a mixed investment concept are ytd at -15%, or even at -20%, as the equity allocation has been gradually increased in recent years.

Hedge funds are doing very well in comparison. Macro, commodity and trend-following strategies are even having one of their best years and are double-digit positive. But other strategies are also positive or can at least preserve capital because the short positions compensate for losses from the long portfolio, such as for example in L/S Equity. The insurance component of the shorts comes into play this year because it is a prolonged correction and trends are emerging for hedge fund managers to take advantage of. For example, as market volatility increased, gross exposure, and therefore leverage, was reduced very quickly. In addition, managers have sharply reduced net exposure or even gone net short as problems with inflation and the Russian war in Ukraine worsened.

This led to pleasing results in our customer portfolios. Clients who are more invested in macro or multi-PM funds are enjoying a positive return this year. But even customers with a high proportion of L/S equity funds have lost practically no money. We believe that this volatile and difficult market environment will continue for some time as the excessive central bank policies of recent years will have long-lasting effects. Therefore, it still makes sense to reduce passive investment strategies and invest in active managers who will be better able to cope with the challenges ahead. After 10 years of favoring ETF investing, the pendulum is swinging back and will give hedge funds an edge for years to come.

For more information please contact Stefan Steiner at ss@cb-partners.com.

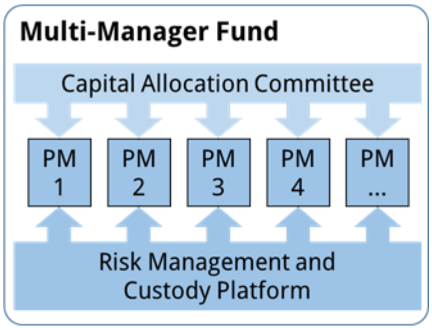
Crossbow Solutions

Strategy	Solution	Currency	NAV	Mid-Oct	YTD	2021	2020	Factsheet September
Alpha Strategies - Fixed Income Complement	Liquid Alpha	CHF	1021.22	-0.34%	-0.41%	2.12%	9.26%	
	Liquid Alpha	EUR	1000.23	-0.37%	0.39%	1.88%	9.56%	
	Global Trading	USD	1118.55	0.04%	10.81%	0.75%	3.62%	
	Equity Arbitrage	EUR	976.76	-0.21%	-1.99%	4.45%	7.49%	
Portfolio Diversifiers	Global Commodity 0.5/5	USD	1166.23	1.58%	17.76%	26.36%	27.57%	
	Global Commodity 1.5/0	USD	1157.67	1.40%	14.63%	28.24%	28.13%	
	Digital Asset	USD	720.25	-	-44.95%	234.07%	166.91%	
	Digital Alpha	USD	978.62	-	-4.46%	46.40%	45.46%	
Equity Themes - Equity Complement	Global Growth	USD	936.09	0.31%	-8.26%	3.19%	20.49%	
	Energy Transition	USD	1051.39	0.04%	12.42%	6.91%	29.10%	
	Greater China	USD	966.56	-0.34%	-5.67%	14.43%	19.18%	

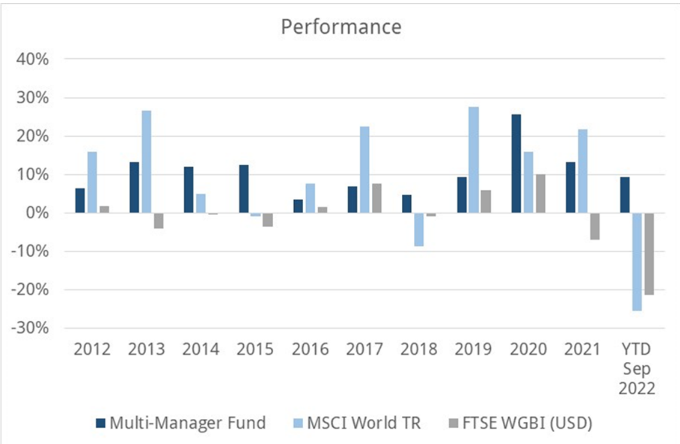
For more information please contact Armin Vogel at av@cb-partners.com.

Multi-Manager Hedge Funds

Some of the largest hedge funds today are so-called multi-manager hedge funds. These funds hire portfolio managers and have these teams manage money on a common custody and risk management platform.



Multi-manager funds have become core allocations for clients looking for stable returns. In many cases they are complemented by single-manager hedge funds which have higher return potential or add additional diversification.



Source: Crossbow Partners, Bloomberg

What have been the key success factors of multi-manager funds?

Multi-manager funds are able to attract talent. Not all hedge fund managers want to have their name on the door. Some are happy to manage money and not have to worry about managing a company, employees and investors. Multi-manager funds allow these people to earn comparable salaries without the additional responsibilities. In the "war for talent" funds seek to distinguish themselves by culture.

Managers are hired to add diversification across the platform. Multi-manager funds hire active managers with different geographic exposure, investment styles and return profiles to maximize diversification and produce stabile returns.

Peter Rice

The Capital Allocation Committee can dynamically adjust allocations to managers quickly, thus shifting capital to improving opportunity sets.

The risk management team sits with the Capital Allocation Team and has oversight over the portfolio managers. The common custody platform allows them to enforce risk management rules independently.

The potential disadvantages

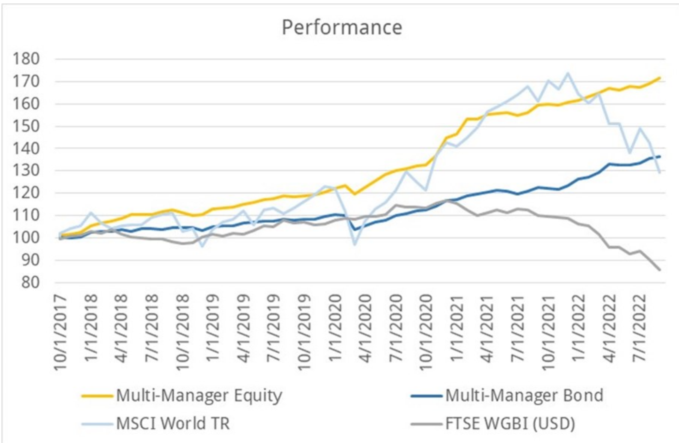
Multi-manager funds typically run with higher leverage. Their size and diversification allow them to run higher leverage than most single hedge funds would do. As a result, many multi-manager funds have restrictive liquidity terms such as investor level gates.

In order to pay competitive salaries, most multi-manager funds have pass-through fee structures. That means salary and performance fee of individual portfolio managers are charged to the fund, irrespective of the overall performance of the fund.

It can be hard to understand performance drivers because of their size and the number of strategies they employ. The funds have hundreds or thousands of individual positions which adds to complexity.

Portfolio benefits

Multi-manager funds can be a core allocation within either equity or fixed income allocations and provide stabile returns with low correlation to bonds or equities, thus improving the risk-adjusted return and downside performance of the portfolio.



Source: Crossbow Partners, Bloomberg

For more information please contact Peter Rice at par@cb-partners.com.

Did they live happily ever after?

Jongha Lim and Wonik Choi form California State university, Fullerton analyze the long-term effect of hedge fund activism on distressed firms by tracing the post-emergence performance of firms that successfully resolved distress. They find that the firms restructured with hedge funds' intervention, compared to their counterparts that emerged without such intervention, are more likely to lose their public status, enjoy higher financial stability, and invest more. Notably, the gap in financial strength lasts at least three years after emergence. These findings suggest that the efficiency gains brought by hedge fund activism during the restructuring process tend to positively impact the restructured firms' financial soundness in the post-intervention period.

Source: Ingram Pin, Financial Times

Luck or skill: What drives hedge fund performance persistence?

Ekatarina Ipatova and Mamata Parhi from University of Roehampton together with Tapas Mishra from Southampton Business School and Kaizad Doctor produced multiple fund-of-funds' portfolios based on sorting and a novel non-parametric approach to lend in-depth insights into the extent hedge fund returns display higher order (non-linear) persistence patterns. By exploiting monthly data from Hedge Fund Research Database between Jan 1999 to Dec 2015, an out-of-sample exercise provides robust evidence of performance persistence over the time horizon. However, up to 80% of hedge funds appear to be 'lucky' performers, confirmed upon undertaking a battery of robustness measures. They name those 'lucky' hedge funds, which pass the classical persistence selection procedure and are selected 'by accident' with regard to funds with persistent returns. They argue that these funds are unlikely to experience significant outperformance in the future. Their non-parametric identification mechanism allows for a reduced number of persistent funds, enabling practitioners to focus on a few with meaningful qualitative scrutiny. Moreover, they expand the debate in the literature by analyzing post-crisis data and demonstrating that after the 2008 crisis, the proportion of genuinely persistent funds got significantly reduced.

Armin Vogel

Investing in carbon credits

Compliance carbon allowances and voluntary carbon credits are important tools to reduce carbon emissions and align production and consumption with the Paris Agreement. The four sizable compliance carbon allowance markets accessible to investors are those of the European Union, United Kingdom, California, and the Regional Greenhouse Gas Initiative in the United States.

Source: Robecco, Bloomberg, InterContinental Exchange

Laurens Swinkels (Erasmus University Rotterdam) and Jieun Yang (Robeco Institutional AM) document the liquidity of futures traded on the carbon allowances of these four markets. Return correlation between these markets is limited, leading to diversification benefits of global carbon investors.

	EUA	CCA	RGGI	UKA	NZU
EUA	43.4%	15.5%	11.9%	55.8%	7.1%
CCA	22.2%	33.9%	26.9%	20.4%	0.8%
RGGI	22.2%	43.2%	20.8%	15.8%	14.7%
UKA	55.8%	20.4%	15.8%	54.7%	-2.8%
NZU	8.5%	1.0%	14.3%	-2.8%	27.0%

Source: Robeco, Bloomberg, InterContinental Exchange

Global carbon market returns also provide diversification opportunities for investors in conventional asset classes such as stocks, bonds, and commodities.

If you wish the above mentioned paper, please contact Armin Vogel at av@cb-partners.com.