New York Trip Report

Before the Storm

March, 2020

Executive Summary

The New York trip in the first week of March was at a time when the coronavirus had emerged in Italy but had not yet developed into a global pandemic. While it was already clear that we were in the later stages of the economic cycle, nobody could have predicted at the start of this year that large parts of the global economy would be brought to an abrupt halt by the COVID-19 pandemic.

Asian equity market had peaked mid-January. US and European equity markets held up a bit longer, peaking mid-February, but had their first leg down end of February. At the time of the trip it was uncertain how thing would unfold and there was a brief pause in the correction.

Events in March developed dramatically: the March correction was one of sharpest on record. Hedge funds held up better than markets albeit with some dispersion across regions, strategies and managers.

The recovery has also been unprecedented but has increased the disconnection between financial markets and the real economy.

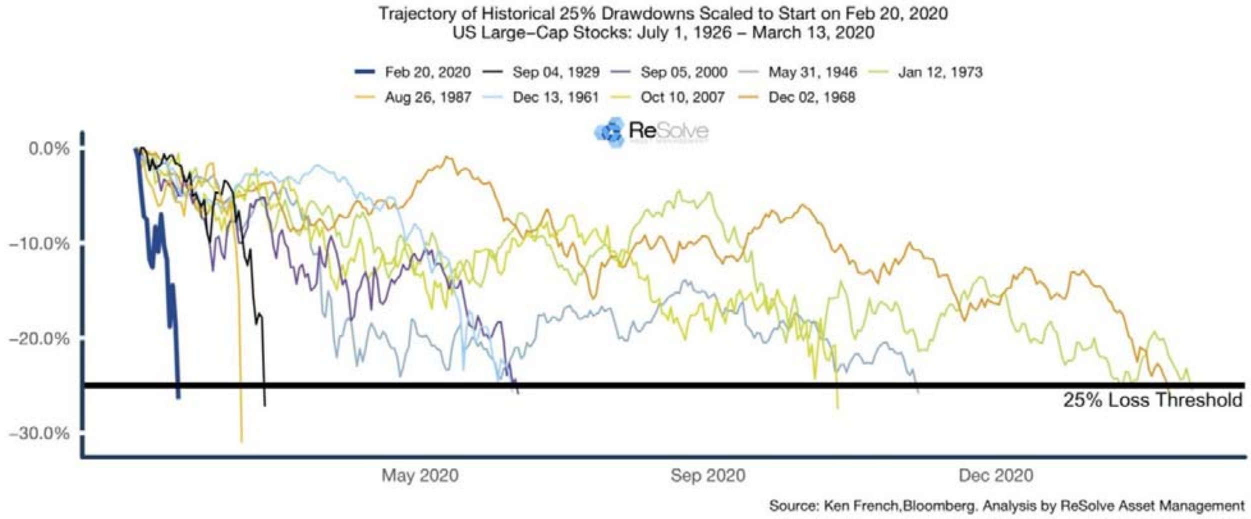
Hedge Fund Performance in the Corona-Crisis

Most managers started 2020 with a broadly constructive view on the global economy and global financial markets. At the beginning of the year US economic data was stable and unemployment was at a historic low. In the second half of January, however, mounting fears over the spread of coronavirus in China erased the early stock market progress. The Trump administration imposed a temporary travel ban upon non-US citizens travelling to the US from China. Investor concerns over disrupted supply chains and weakened demand led to fears that growth could slow.

The majority of diversified hedge fund portfolios were able to deliver positive returns in January as indicated by the HFRI Fund of Funds Composite that was +0.28% for the month. Fundamental Equity Long/Short broadly tended to perform positively with outperformance from the US vs. Europe and Asia. Technical equity strategies tended to suffer from Value themes and mean reversion technical strategies.

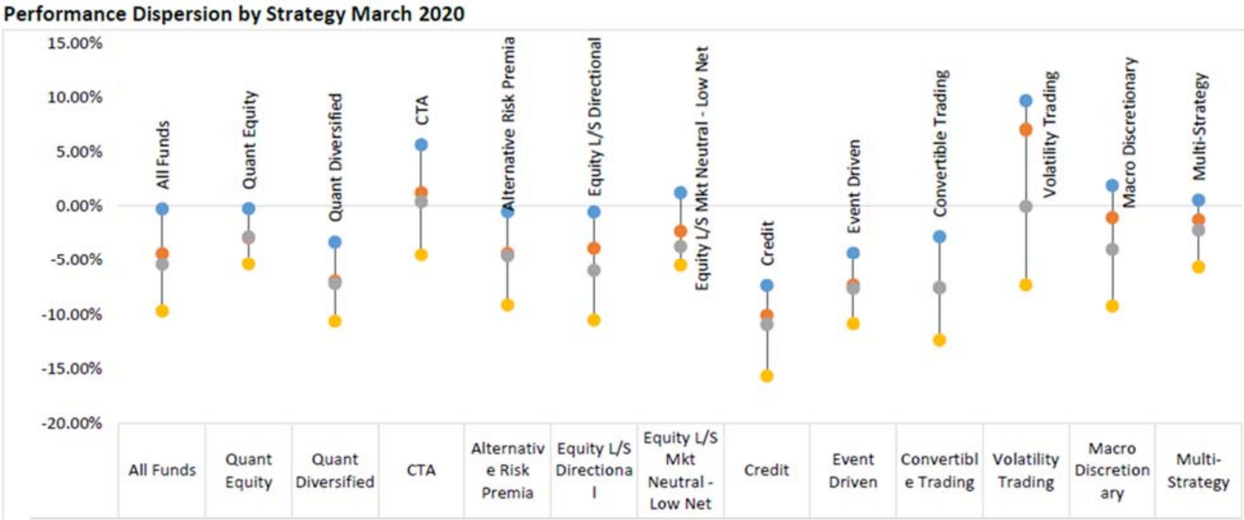
In the first couple of weeks of February, equity markets shrugged off concerns about the outbreak, supported by a better-than-expected US Q4 earnings season, improving business surveys for January, and the expectation that negative effects of the coronavirus would be temporary and localised. However, the increase in cases outside China led to a sharp selloff towards the end of the month.

Events unfolded quickly in February and March resulting in one of sharpest corrections across multiple asset classes in history. Equity markets, credit markets and commodities moved with unprecedented speed to levels last seen in the 2008 Global Financial Crisis. Second order measures such as volatility and correlations moved with similarly steep trajectories.



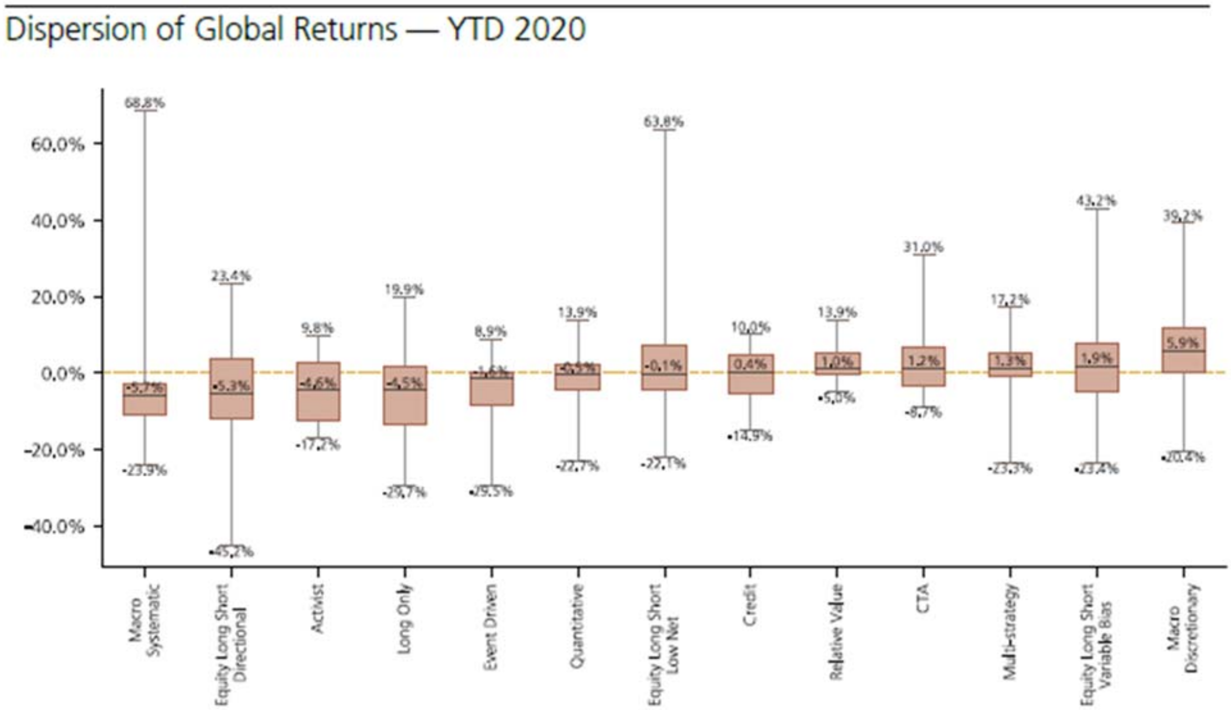
The moves were felt by hedge funds, who had one of the most turbulent months since the global financial crisis. There was material stress in individual strategies at different times.

On average, hedge funds were down, but portfolios of hedge funds experienced widely divergent returns depending on the specific strategies and managers held. There was very large dispersion within strategies between the better and the worse performing managers.



Hedge Fund Performance Dispersion March 2020
Source: Deutsche Bank GPTU Capital Introduction Group.
Tracks performance for 450 funds. As of 24 April 2020, 412 funds have reported on which the above chart is based.

In general trading oriented strategies fared better than more "investment" strategies. One exception to this is Quantitative Equity which found various value related measures challenged by the sell-off and recovery, which was stronger in sectors benefitting from the US Federal Reserve's (the Fed) unprecedented response and the trend to online retail and communication.



Hedge Fund Performance Dispersion YTD May 2020
Source: UBS Capital Introduction, Hedge Fund Research Inc. (HFR Inc.), Hedge Fund Intelligence (HFM Global), and Eurekahedge.

The Fed's response has been dramatic in both size and speed. The US central bank committed to unlimited government bond purchases as well as the purchase of investment grade corporate bonds, high yield bonds, corporate bond exchange-traded funds (ETFs) and some high yield ETFs.

Hedge funds captured a meaning portion of the rebound and manager selection has proven key to performance.