

New York Trip Report

November 26 - 30, 2018

Executive Summary

2017, the year of calm, where every month was positive for the S&P 500 TR Index, was followed by the worst year since 2008

There was a wide dispersion among the 2018 returns of the funds we met on this trip

Multi-PM funds posted solid returns and have been reducing exposures in Q4 as markets continued to sell-off despite solid economic data in the US

Macro funds are largely positioned for higher rates and believe that the markets are underpricing the hiking path of the Fed for 2019

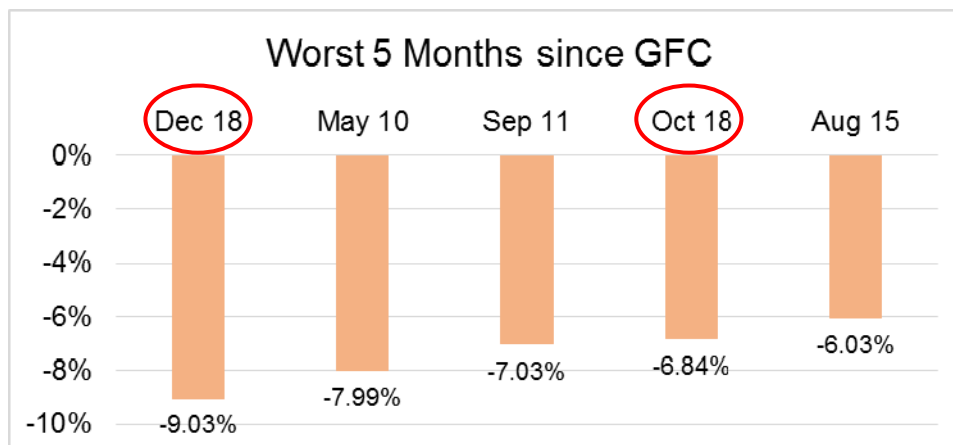
Volatility funds are finally seeing the end of the tunnel, they expect more opportunities from a pick-up in realized volatilities across asset classes

As global central banks retreat from QE, the price and cost of risk will continue to normalize in 2019 from the depressed levels post financial crisis

The stimulus from the corporate tax cut may be wearing off as US corporate earnings growth comes back to earth

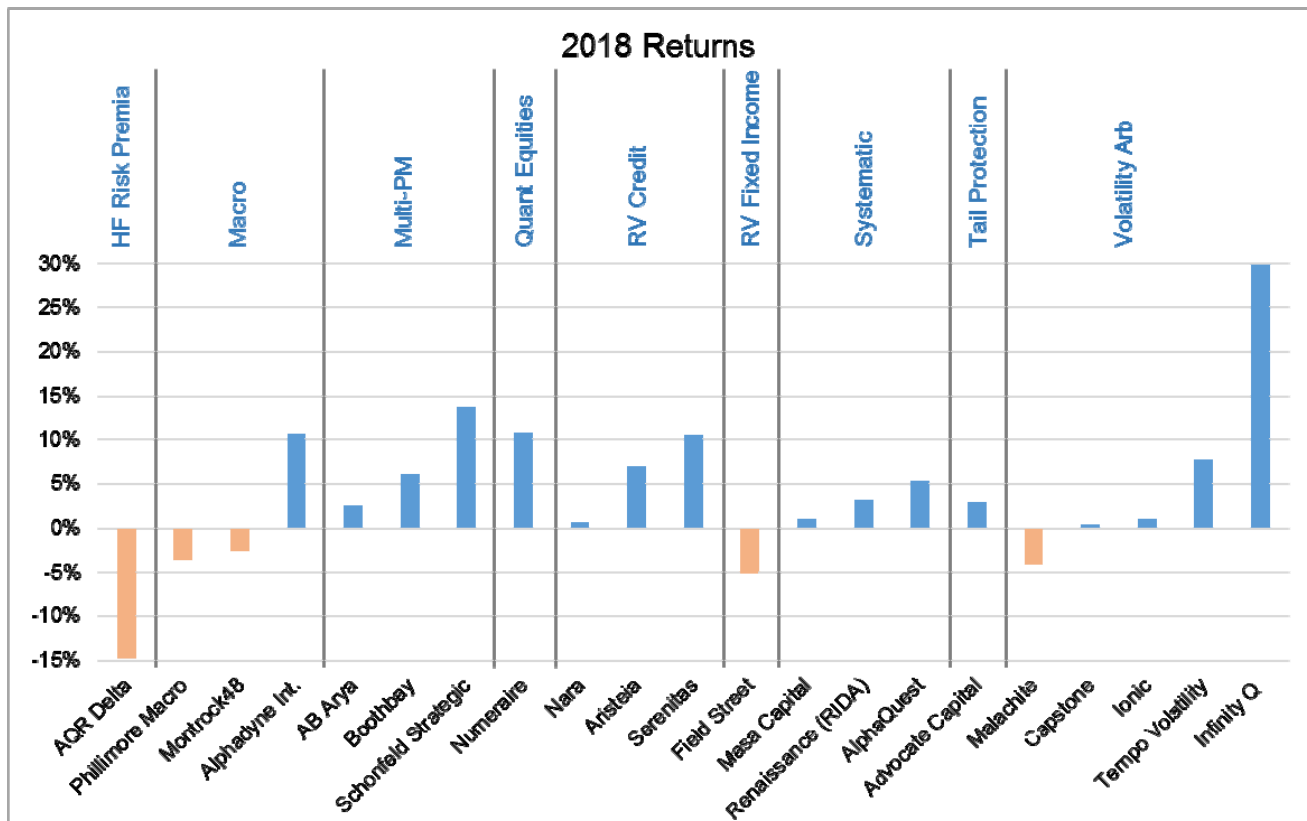
From the Trading Pit

2018 started with a buying frenzy of equities across the globe which led billionaire hedge fund manager Ray Dalio state the now famous quote at the World Economic Forum in Davos: “If you’re holding cash, you’re going to feel pretty stupid”. Only a few days later the VIX futures experienced their largest daily spike in history. The average VIX future rose over 96% - almost a 24 standard deviations move using all previous VIX futures history. To put this into perspective, the second largest increase ever was 33%. Eventually markets calmed down and certain indices reached all-time highs again a couple of months later only to experience the second large drop of the year in the 4th quarter. 2018 was the first negative year for S&P 500 Total Return Index (-4.38%) since 2008. Actually, in 2018 the index experienced two of its worst five monthly drops since the 2008 global financial crisis:



Source: Bloomberg

Interestingly, most of the managers we met on this trip have not been very substantially affected by the two volatility spikes this year, except for **Malachite**, which has been hurt on the short volatility component of its portfolio. While some funds were able to benefit from the elevated volatility levels in 2018, others had more idiosyncratic issues with their performance. In the end, there was a wide dispersion (ca. 45% in absolute terms between best and worst fund) of annual performance among the funds that we saw on this trip:



Source: Funds and Crossbow / Note: Inyo is expected to launch in 2019

The fund with the largest drawdown in 2018, **AQR Delta**, is currently suffering its worst drawdown since inception, as 6 out of 9 strategies were down for the year with value factors in equity market neutral strategies being the worst contributor. Their team spent a lot of effort researching the causes for the losses. They concluded that there are times in markets when those anomalies last longer than expected, meaning that there are no adjustments needed to the strategy, as market will eventually “normalize” and the strategies rebound. Investors in their UCITS vehicle have been much faster to push the redemption button than their peers in the offshore fund. Within the Macro style, **Alphadyne** was able to post its second double digit return year in a row, which has never happened before. Hopefully, they will be able to continue to deliver strong risk-adjusted returns with an increased asset base, as they are taking in another USD 1 bn in the next couple of months. They are generally constructive on EM and believe that given strong US growth dynamics the market is underpricing the hiking path of the Fed. “Start-up” **Phillimore Macro** launched in March 2008 and is run by ex-Brevan Howard PM Giles Coppel. The PM predominantly trades FX options and ended the year slightly down, which is something that has not happened to him in his previous career at Brevan Howard, where he managed to outperform the main fund every year since 2006. He believes Trump will continue to put pressure on the Fed as Trump is an “LBO guy” who likes low rates. Also, he sees a large likelihood of a weaker US dollar down the road, as president Trump will want a weak dollar to support the US economy going into the 2020 elections. The Multi-PM group had a strong year on a relative basis. Out of the 3 funds we saw, **AB Arya** was the only one focusing on pure fundamental L/S equity and bearing the netting risk itself. Their PMs have been in protecting-capital-mode, as evidenced by the low capital utilization rates (50% vs usually 75%). **Schonfeld Strategic** continued to increase their assets after they first opened to outside capital in 2016. They employ 65 PM teams on their platform and have a large share of quant teams (21) which seems to work quite well for

them. The co-CIO himself was impressed with the strong performance of his PMs coming into Q4 and expected some form of mean-reversion in the returns, which “partially” happened in Q4. Artificial intelligence-driven **Numeraire** continues to successfully run its entirely AI-driven investment approach. They have expanded to Japanese equities which provide diversification benefits and are looking to add European equities in the near future. Most institutional investors have avoided them so far given their small size and the fact that they are essentially a 2-men team. However, CIO Daniel Fernholz is of the opinion that the models are very robust and self-adapting and that he does not need 20 computers to run them. All he needs is a PC with a cloud-based back-up solution that is encrypted and protected with a 30-character password. **Serenitas Credit Gamma** was another interesting fund we met. The team is very experienced and worked together for a long time, has substantial own money invested in the fund and pursues a strategy that is uncorrelated to equity and bond markets. **Field Street** downsized its team after the loss in May. They laid off all directional macro PMs and are going back to basics – trading fixed income relative value, which is what they have been always doing quite successfully. CIO Rod Gancas can now dedicate all of his time to the core book which he co-runs with Dan Hoehn. On the Systematic side, **Renaissance** is clearly in a different league. They seem to have very loyal employees who on average spend about 20 years at the company. One could argue that the loyalty is partly driven by the success of the Medallion Fund, where employees are the only investors allowed in the fund. In the past 12 years it only had 1 negative quarter on a gross basis and continues to serve as the ATM machine, where employees receive a check every time the fund has to be rebalanced to about USD 10 bn. Employees can keep the money or reinvest in the institutional funds. Current internal money is about USD 25 bn! The firm’s RIDA fund has performed well in 2018, but the futures portion has continued to be a drag on performance, which is why they are reducing it to 2% only. Among the 5 Volatility Arbitrage managers that we met, **Infinity Q** undoubtedly stands out. The fund has experienced an exceptional run since inception and has delivered strong returns in low volatility and high volatility markets as well while delivering protection to investors – which is truly amazing. It might be worth following up with them, however the fact that they sit within a family office could be viewed as a small negative. **Capstone** is the most diversified and institutional fund among the volatility funds. They continue to shift money to equity volatility-oriented opportunities. **Ionic** on the other hand prefers to focus on the credit and fixed income vol space, where they expect a lot of action to happen given continued Fed balance sheet tightening. **Advocate** has a fairly interesting approach to risk hedging. They aim to offer protection, not only during tail events but also during smaller shocks without the use of options-heavy strategies. Their goal is to select the strategies with the best protection versus associated carry. They don’t expect a recession in 2019, but a further tightening of financial conditions, once the ECB joins the Fed in raising rates, which means that the price and cost of risk will continue to normalize from the depressed levels after the global financial crisis.