# Newsletter January 2019
## Overview Alternative Investments

Crossbow Partners
Experience & Discipline

### Outlook 2019

October and December 2018 showed what will happen when the market starts to price in a recession. So far, just slowing growth in the large economic blocs has been forecasted. In the USA, the effect of the tax reform is decreasing. In China, credit growth through multiple sources is being streamlined and of course, it is getting more difficult to achieve historical growth rates given the size of the economy today. And in Europe, Brexit as well as the inability of reforms paralyzes the growth dynamics. Corporate earnings are still okay and therefore the markets are torn between hope and fear. After an equity bull market for 10 years, especially in the USA, the consolidation has started and will ultimately result in a correction. What we have seen in 2018 is just the beginning of a longer process. For quite some time, we recommend shifting from passive instruments to active managers. Active managers will do better in difficult markets, especially if they have the possibility of hedging market risks as it is the case with hedge funds. Our uncorrelated multi-manager portfolios were able to preserve the capital in 2018. We expect volatility to remain high and will continue to invest in trading-oriented and market-neutral managers that will have a good chance of beating traditional markets. Market corrections always last longer than you think and are deeper than expected. At the end of this re-rating process of the equity markets, we expect the S&P to hit 2'000, with the possibility to re-test the highs of 2000 and 2007 at 1'500. This could pan out over a couple of years and will bring us back to the level of the election night of Donald Trump in November 2016.


Stefan Steiner

*Please contact ss@cb-partners.com if you wish to discuss investment ideas for the current market environment.*

| Fixed Income (USD) | 2018 | 2017 | 2016 | 3Y CAGR | 5Y CAGR | 5Y Std Dev |
|---|---|---|---|---|---|---|
| Switzerland Gov Bonds 1-10Y TR | 3.52% | 1.49% | 1.31% | 2.10% | 2.37% | 1.79% |
| FTSE WGBI (ex-Citi WGBI All Maturities) | -0.84% | 7.49% | 1.60% | 2.69% | 0.77% | 5.29% |
| Barclays Global HY TR | -4.06% | 10.43% | 14.27% | 6.58% | 3.33% | 5.40% |
| HFRI Event-Driven Index | -2.35% | 7.59% | 10.57% | 5.12% | 2.52% | 4.38% |
| HFRI Relative Value Index | -0.24% | 5.14% | 7.67% | 4.14% | 3.21% | 2.69% |
| Crossbow Credit Distressed Portfolio | -0.75% | 3.51% | 5.74% | 2.80% | 1.69% | 3.17% |
| Crossbow Alpha Portfolio | 1.77% | 3.94% | 1.29% | 2.33% | 3.16% | 1.94% |
| **Equities (USD)** | **2018** | **2017** | **2016** | **3Y CAGR** | **5Y CAGR** | **5Y Std Dev** |
| SMI TR Index | -4.17% | 20.25% | -1.90% | 4.18% | 5.53% | 11.49% |
| MSCI AC World TR | -9.41% | 23.97% | 7.86% | 6.60% | 4.26% | 10.87% |
| MSCI EM TR | -14.57% | 37.28% | 11.19% | 9.25% | 1.65% | 15.19% |
| HFRI Equity Hedge Index | -6.94% | 13.29% | 5.47% | 3.60% | 2.31% | 5.86% |
| HFRI Macro Systematic Diversified Index | -6.02% | 2.12% | -1.37% | -1.81% | 0.45% | 7.26% |
| Crossbow Equity Hedged Portfolio | -3.83% | 7.86% | -6.24% | -0.92% | 1.32% | 5.33% |
| Crossbow Trading Portfolio | 1.70% | 5.94% | 3.88% | 3.82% | 5.15% | 3.43% |
| Crossbow Trendfollowing Portfolio | -1.66% | 4.45% | 0.36% | 1.02% | 3.31% | 5.69% |
| **Others (in USD)** | **2018** | **2017** | **2016** | **3Y CAGR** | **5Y CAGR** | **5Y Std Dev** |
| BVG-25 Plus | -0.13% | 7.31% | 4.95% | 4.00% | 4.81% | 3.03% |
| BVG-40 Plus | -1.49% | 9.72% | 5.74% | 4.55% | 5.32% | 4.45% |
| BVG-60 Plus | -3.31% | 13.17% | 6.66% | 5.28% | 5.99% | 6.60% |
| SXI Real Estate Funds TR Index | -2.40% | 8.75% | 8.48% | 4.81% | 6.93% | 6.97% |

## China A-Shares

China A-shares, i.e. the shares of mainland-based companies that trade in CNY at the mainland stock exchanges, endured tumultous times in 2018. After spectacular gains in 2017, Chinese stocks were also expected to be the darling of investors in 2018. Yet, the Chinese mainland exchanges fell on hard times and the CSI 300 Index declined 27.6% - one of the worst performing stock markets in the world.

## Homemade headwinds

Our fund managers entered 2018 with optimism with regards to the Chinese economy. They expected that the growth momentum would be sustainable and strong corporate earnings would continue to underpin stock markets. Yet later in the course of the year, investors realized that they had significantly understimated the highly negative impact of the government‘s push to clean up the shadow banking system. In order to tackle the high debt levels and in an effort to prevent a systemic crisis, the authorities stepped up their campaign to rein in the lending boom. The government notably took aims at the shadow banking sector that provided financing to small and medium-sized enterprises and to private individuals. While the authorities have succeeded in draining the huge shadow banking swamp, the (unintended?) collateral damage was also massive and has started to derail the economy. The private sector is desperately struggling to find alternative sources of finance, as the state-owned large commercial banks rather prefer to lend to other state-owned enterprises than to private sector companies that are considered riskier. As the deleveraging took place at an aggressive pace in the centrally managed command economy, it quickly caused a credit crunch, especially for the SMEs. This was the main reason for the economic slowdown in 2H.

The clampdown on the shadow banking system also extended to the P2P lending platforms, which have become the largest source of car financing for low-end cars in China over the last two years. As a result, the Chinese car market experienced its first annual decline (-4%) in 20 years. As car sales account for about 20% of total consumption, this contraction had a significant impact on economic growth. Suddenly, consumer spending was collateral damage in the deleveraging process.

## External effects

When President Trump unleashed a trade war that culminated in severe punitive tariffs on Chinese imports, it did not only hurt China‘s economy, but also affected international trade, global supply chains, capital spending, and the risk appetite of investors. The situation was exacerbated by a strong US dollar and rising oil prices that weighed on global growth in the first three quarters of the year.


Franz Odermatt

## What next after the steep decline of 2018?

Key economic indicators continue to paint a gloomy picture of China‘s economy, as the trade war with the U.S. and the restrained consumer spending hamper growth. Growth rates of retail sales in China recently slowed to its lowest pace in the last 15 years and the Purchasing Managers‘ Index dropped below the key threshold of 50 in December. Yet the continued slowdown and the prospect of a trade war with the U.S. prompted the government to react, as economic stability is one of the central tenets for the Communist Party. The Chinese government is now remedying its policies, especially its focus on deleveraging. In an effort to check the downturn, policymakers promised further tax cuts, increased infrastructure spending, an „appropriate“ monetary easing, and an improved access to credit markets for small and medium-sized enterprises. The structural growth perspectives of China‘s economy continue to look attractive, as a rapidly growing middle class increasingly focuses its consumption on higher value goods and services. At the same time the government seeks to modernize the economy, pushing it towards a globally leading high-tech industry under the label „Made in China 2025“. Another priority is to refocus the economy to an ecologically compatible model. Moreover, China A-shares are historically moderately valued after the recent sell-off, as a lot of negativity is already priced in. Our fund managers contend that earnings expectations are still too high for now, but the A-shares will positively surprise in 2H 2019, when the mainland stock exchanges will also be supported by a significant expansion of China‘s representation in the MSCI Emerging Markets Index - provided that the Sino-US trade war does not escalate. As the saying goes, „Bull markets are born out of pessimism“.

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## Slowing growth likely to change hedge fund priorities

According to the BarclayHedge MPI hedge fund investor survey of 116 institutional investors and fund of hedge fund managers, the slowing economic growth could drive a shift by hedge fund investors towards global macro, managed futures and fixed income strategies and away from equity strategies in the year ahead.

The survey also found that:

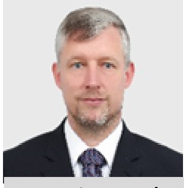
- Low correlation is expected to be the hedge fund characteristic that delivers the highest investor value in 2019.
- Among newer hedge fund strategies, investors are considering allocating to funds using artificial intelligence or machine learning.
- More than a third of investors think hedge fund allocations will increase in 2019.

More than a third (38%) of respondents listed slower growth as the biggest risk in 2019, a significant jump from March of last year, when only 12% of respondents listed this as the top risk. The two other top investor concerns for 2019 are rising interest rates (29%) and negative stock markets (21%).

## Increasing demand in alternative UCITS strategies

Deutsche Bank today published its biennial Alternative UCITS Survey, with its findings suggesting that the alternative UCITS market is set for further growth. Over half of the responding alternative UCITS allocators are planning to increase their existing allocation. Deutsche Bank estimates that these investors collectively will invest USD13.7bn in new capital to alternative UCITS, having already invested USD9.5bn in the first three quarters of 2018.
Highlights of the survey are:

**Minimum fund AUM requirements are trending downwards**…: The percentage of investors who require a minimum AUM of less than USD 50mn has increased to 24% from 15% in 2016. At the same time, the percentage of investors who require AUM of over USD 50mn has fallen from 43% to 35% over the same period.


Armin Vogel

**However, investors want to see longer track records:** The proportion of allocators who require a track record of over two years has increased more than threefold to 26% from 8% two years ago.

**Asia alternative UCITS strategies increasingly popular but difficult to source**: Asia alternative UCITS strategies have seen a significant increase in popularity over the past two years. 25% of investors are planning to allocate to Asia, up from 15% 2016. But offering is limited.

**ESG is a focus:** Another theme from this year's survey is that 29% of respondents are looking to increase their allocation to Environmental Social and Governance (ESG) strategies within an alternative UCITS format.

**Performance:** Most respondents indicated that they were likely to increase their allocation, despite 62% stating that they felt their UCITS allocations had underperformed year to date.

**Alternative Risk Premia (ARP):** Nearly half of the responding investors currently allocate to alternative risk premia UCITS funds. Of these investors 59% expect to increase their allocation in the next twelve months, with almost a third expecting this increase to be over USD 100mn.

## Save the Date - next Crossbow event

On Wednesday, 10th April 2019 starting at 4 pm we will host our next event at the Zunfthaus zur Waag in Zurich. The subjects as well as speakers will be announced at a later stage. Please save the date in your agenda.

*Please contact mm@cb-partners.com in case you wish to read one of the abovementioned studies or if you want to register for the event.*