A Brodie Consulting publication in conjunction with RQC Group

June 2021

The Hedge

Looking back at the past month's news and views

Record year continues

May was the eighth consecutive month of positive performance for hedge funds, as the HFRI Fund Weight Composite (FWC) gained 1.7% and the Investable HFRI 500 Weighted Composite Index 1.5%. Year-to-date they are up 9.9% and 8.9% respectively.

According to ***Kenneth J. Heinz***, President of **HFR**, this has been the "strongest start since 1996."

Macro funds were the best performing of the FWC funds, up 2.3%, with discretionary managers outperforming systematic (Discretionary Thematic Index +3.7% vs Systematic Diversified Index +2.0%).

Equity was more of a mixed bag, for although the HFRI Equity Hedge (Total) Index was up 1.5%, led by Energy/ Basic Materials up 3.1%, Healthcare was down 1.8%.

In Event Driven, Credit Arbitrage struggled in May, with the index down 4.0% and Distressed/ Restructuring up 2.5%.

The HFRI Fund of Funds Composite Index was up 0.5%, led by the Strategic Index up 1.4%.

On the Thematic front, the HFRI Diversity Index was up 1.3%, taking the year's return to 9.2% and the HFRI Women Index up 1.4% and the year's return to 6.8%.

$1.1 billion

Ruffer's profit on November 2020 bitcoin investment

9.9%

HFRI Fund Weighted Composite performance YTD

Insurers prefer PE

The most recent **Goldman Sachs** insurance investor survey finds insurers are more interested in private equity than hedge fund investing.

The survey, which is now in its tenth year and represents around $13 trillion in assets, found private equity to be the most popular asset class, followed by middle market corporate loans and infrastructure debt.

Of the respondents, 38% planned to increase their allocation to private equity, compared with 5% to hedge funds, whilst 6% said they are looking to cut hedge fund allocations.

The same survey also revealed that risk appetite in the insurance community remains above average and a particularly high interest in ESG matters, with 83% of respondents saying that they are taking this into consideration when investing.

Investors turn to the big brands

Seward & Kissel's 2020 New Hedge Fund Study provides useful insight on the difficulties managers are facing when raising capital in this environment, with allocators favouring the big 'brand' funds.

To attract flows, according to the law-firm's report, managers are increasingly prepared to lower their management fees or reduce incentive allocation rates in founding share classes. This was the case in more than half of equity funds surveyed, a marginal increase on the 2019 numbers.

Other results included 66% of new launches having equity or equity related strategies. While lock-ups or investors gates were used by 79% of equity funds and 70% of non-equity funds, both figures that are similar to the 2019 findings.

Upcoming Events

22-24 June 2021

Super Return Emerging Markets • Super Return Series

23-24 June 2021

22nd Family Office and Investment Forum • Campden Events

23-24 June 2021

BDC Summit 2021 • HFM

6 July 2021

European Performance Awards 2021 • HFM

Click here to see full list

INVESTMENTS

SPACs disappoint investors

The start of this year was all about SPAC investing, particularly for those investors looking to up their exposure to the EV market and other start-ups.

PitchBook data reveals in the US 293 blank check vehicle listings (to 17 May) raising $19.2 billion. The European figures lag this figure, with just 17 vehicles listing, raising €2.2 billion. There were however a few sizeable start-ups, such as **Pegasus Capital** that raised €500 million in April.

Since then, performance has been poor, costs high and concerns over investor transparency - and regulatory interest - have all weighed on the space. This was particularly the case among institutional investors alongside the 'lack of interest from retail traders,' writes the Financial Times.

The **CNBC SPAC 50** index is down around 20% from its February highs (to 4 June).

If reports are to be believed, ***Gary Gensler,*** former head of the **CFTC** and the newly appointment Chairman of the **SEC**, has additionally positioned SPACs within his crosshairs.

Yet the deal machines continue to turn over, with the **Financial Times** reporting on 4 June that ***Bill Ackman*** is set to close a complex deal with **Universal Music Group** that would see his vehicle take a 10% stake in the record label.

Shorting ARKK

With fund assets rising from $1.9 billion at the end of 2019 to today's $22.3 billion, *Cathie Wood's* **ARK Innovation ETF (ARKK)** has moved into the firing line of multiple funds.

Bloomberg reports that around 'two dozen investment advisors including **Balyasny Asset Management** and a unit of **Blackstone Group Inc.** [have] bought... put options during the first quarter' on the ETF.'

The ETF is marginally down this year, but was up 153% in 2020, largely due to its sizeable holdings in **Tesla, Bitcoin** and **Zoom** .

Click here to see the latest holdings

Commodity bets being pulled

In early June, **Bloomberg** wrote that hedge funds have been pulling their long bets in commodities on 'everything from crops to copper to natural gas.' This follows a particularly good run in these markets and the good US weather, which has reduced the demand for natural gas, as well as providing the right conditions for a large harvest. While in oil, markets are 'bracing for bigger supplies.'

INVESTMENTS (cont.)

Tigers and Tech

The **Financial Times'** *Harriet Agnew* and *Laurence Fletcher* were given a rare interview with **Tiger Management's Julian Robertson** and his son **Alex**.

Their piece mainly focuses on Tiger's interest in technology stocks, with sizeable stakes in Alphabet, Facebook and Microsoft, a sector where they see further growth.

Ironically, you re-wind the clock to the late 90s and Tiger stayed clear of the dot.com/ tech hubris and although ultimately they were proved correct, it resulted in fund underperformance and the firm closing its doors to external investors.

The two offer a cautionary note, saying that they are "starting to see some signs of over exuberance throughout the entire investment world."

Today, Tiger manages around $4 billion and continues its programme of seeding a broad range of managers.

A follow-up article looks at the Tiger Cubs - former Tiger managers who learnt their trade from Robertson.

Reddit Trends

The rollercoaster ride of buying into **Reddit** trends (meme stocks) or being on the wrong end of the short squeeze, have been all too apparent this year.

According to the **Insider,** two Reddit favourites – **Gamestop** and **AMC** – lost their short investors more than $1billion in May.

Another recent short squeeze induced a buying frenzy in **Brooklyn Immuno Therapeutics (BTX)** that saw the stock spike tenfold in April - as volumes went through the roof - followed by a fall of over 50% in May.

David Einhorn, in his investor letter wrote about **Hometown International,** a penny share deli with around $14,000 in sales that saw its market rise to around $100 million. He quipped that the 'pastrami must be amazing.'

The Times writes that the latest meme 'stock pump' is **BlackBerry**. This is the second time this year, which in the Reddit world is referred to as the BANG rotation trade: in and out of **BlackBerry, AMC, Nokia** and **Gamestop**. This is not just a US phenomenon, with UK brokers reporting 'significant increased interest in these stocks' and **AJ Bell** saying that investors are suffering from FOMO, the fear of missing out.

A bond tantrum?

Investors have been making their highest 'collective bet against junk bonds since 2008,' with short positions on $55 billion of global high yield debt, reports **Bloomberg.**

There have already been prescient warnings from *Ray Dalio* and *Paul Singer* who have said that bonds today look anything but safe.

The report concludes that the bond markets are now looking 'increasingly vulnerable to a tantrum.'

Activism

Engine No. 1 punches above its weight

Activist hedge fund **Engine No. 1,** which describes itself as a long-term value investor seeking to drive positive impact through active engagement, has been making the headlines over the past few weeks, having won three seats on **ExxonMobil's** board.

Engine No. 1 has focused on Exxon's environmental credentials and in particular its failure to 'pursue aggregate emission reduction targets [that prevents it] from better positioning itself to create long-term shareholder value.'

Although a newcomer to the space, having only been launched in December 2020, the fund has a solid pedigree, having been set up by *Chris James*, who also founded **Partner Fund Management** and co-founded **Andor Capital**, and also includes former **Jana** partner *Charlie Penner*.

This has been, writes **TheStreet,** one of the most expensive proxy battles on record, and is described by **The Economist** as an 'awe inspiring feat.' Even more impressive is the small size of Engine No. 1, with only 22 employees and $240 million in assets. Multiple outlets have described it as 'David and Goliath.'

But it would not have been possible without the backing of major institutional investors, namely **BlackRock, Vanguard** and **State Street** with 20% of the voting shares, giving Engine No. 1 'powerful support,' adds the **NY Times**, particularly as the activist only holds 0.02% of the shares.

GSK on the rack

Elliott Management continues to turn the screw on **GlaxoSmithKline (GSK)** and there is a full PR fight underway, with attacks and counterattacks.

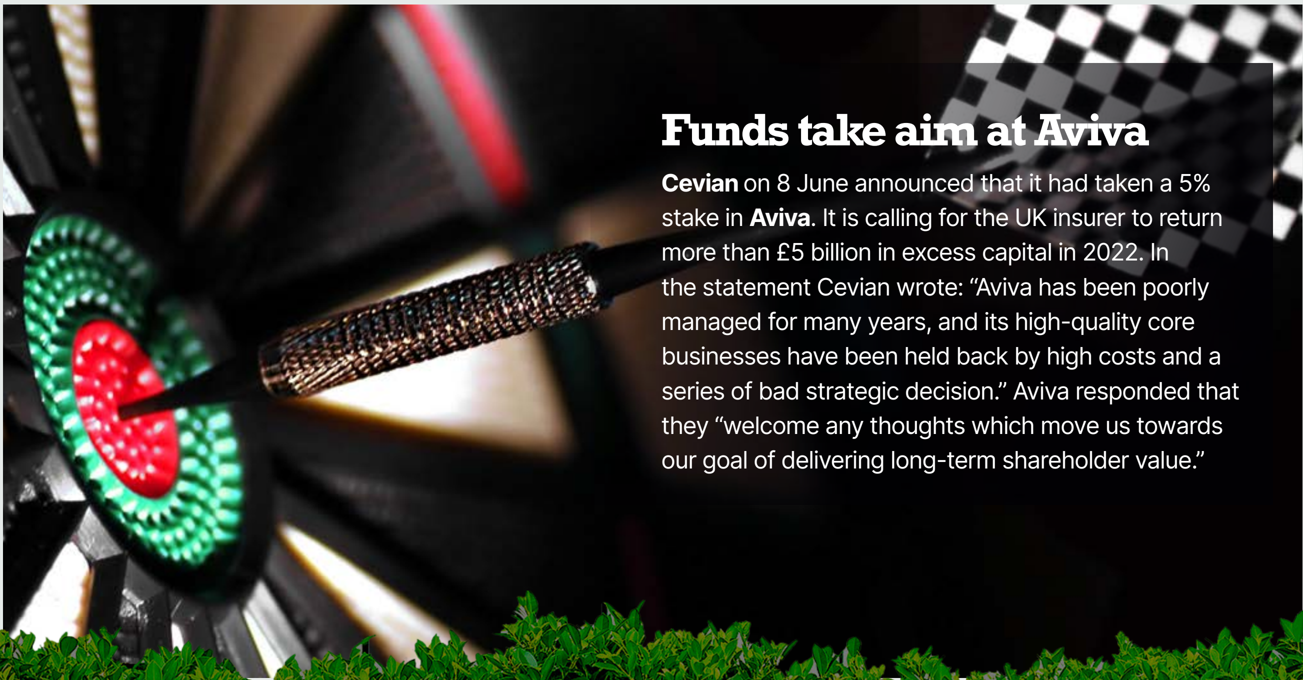
Multiple sources have reported that Elliott is in discussions with GSK's largest investors, with the **Daily Mail** (and others) writing that the future of the CEO, *Dame Emma Walmsley*, is at stake.

The **Daily Telegraph** adds that 'sources' have said the campaign "will not be passive... Change is coming and it's going to be action orientated."

Countering this, in the GSK corner, are the likes of **BlackRock, Dodge & Cox** and **Royal London** – all top shareholders – who have publicly backed the GSK board, providing a degree of comfort for the under-fire CEO.

Elliott's stake has not been disclosed and neither has their intentions, although according to a recent **Sunday Times** report, they want to 'unlock value' from the vaccines business, which accounted for almost a third of its earnings.

All eyes will be on the GSK shareholder meeting on 23 June when Walmsley sets out her plans for the future, unless of course Elliott gets in there first.



Funds take aim at Aviva

Cevian on 8 June announced that it had taken a 5% stake in **Aviva**. It is calling for the UK insurer to return more than £5 billion in excess capital in 2022. In the statement Cevian wrote: "Aviva has been poorly managed for many years, and its high-quality core businesses have been held back by high costs and a series of bad strategic decision." Aviva responded that they "welcome any thoughts which move us towards our goal of delivering long-term shareholder value."

ACTIVISM (cont.)

DropBox & Elliott

Elliott has taken a large stake in **DropBox, Barron's** reports. Their holding is over 10% and they are the second largest shareholder, after co-founder and CEO, ***Drew Houston.*** The activist's plans for the file sharing business remain, as yet, unclear.

Financial services get a break

According to data from **Activist Insight**, there were fewer activist campaigns this year against European based financial services companies. Through to May 27, there were only 15 campaigns underway in this space, compared to 27 in the same period last year.

Institutions support ESG actions

A **Morrow Sodali** survey reveals institutional investors are increasingly prepared to support activist campaigns, with poor financial performance and poor strategic decisions the key driving forces behind such moves.

This annual survey, comprising of 40 investors with $29tn in AUM, found - perhaps not surprisingly - ESG and climate change policies to be fundamental to their investment decisions.

The survey listed 'climate change, closely followed by human capital management, remuneration and board composition' as prompts behind their engagement.

These findings tie in with the recent US proxy season, with institutions willing to support activist shareholders and was evident at the recent **ExxonMobil** shareholder vote.

CRYPTO

US crypto ETFs on the cards?

It has been difficult to read the runes on US crypto ETFs, with a dozen or so filed (including **Fidelity, WisdomTree, Wilshire Phoenix, Van Eck** and **First Trust SkyBridge**) and plenty of reports pointing to a reluctant SEC.

***Gary Gensler,* SEC** Chairman, has already said very publicly that the crypto market "could benefit from greater investor protection."

Speaking on **CNBC's Squawk Box,** he added: "There is no federal authority to actually bring a regime to the crypto exchanges... There's a gap in the system."

Many in the market had been hoping Gensler, who has taught blockchain technology at **MIT,** would bring a new, more open, perspective.

Ben Johnson, **Morningstar Inc's** Global Director of ETF research believes that the SEC's attention is currently elsewhere and that the odds of a "Bitcoin ETF... in 2021 are very low." While the Financial Times writes that 'ETF applications [are gathering] dust.'

Having said that, according to **CoinDesk,** the SEC is in the process of looking at various bitcoin ETF applications, including Van Eck's filing later this month. SkyBridge's ***Troy Gayeski*** is quoted by Bloomberg as saying that he expects the SEC to approve their product in Q4 2021 or Q1 2022.

CRYPTO (cont.)

Ruffer, the London-based wealth manager, has exited its high-profile investment in bitcoin as the market became 'over extended', writes the **Financial Times**. Since it took the position in November 2020, the investment has netted Ruffer a $1.1 billion profit. This still does not mean that bitcoin is "off the menu," with ***Duncan MacInnes,*** Ruffer investment director, saying that the traditional 60:40 portfolio has been 'upended' and investors are now trying to "figure out what to do with the 40% of their portfolio that earns nothing."

Convergence with crypto

Convergence between alternatives and crypto is getting ever more apparent.

Peter Thiel, Louis Bacon and **Alan Howard** are just a few of the big named backers behind a new crypto asset exchange, **Bullish Global**, run by **Block.one**, which has been capitalised at more than $10 billion.

Senior hedge fund alumni are also making the transition from hedge to crypto. One of these names is ***James Dalby,*** CFO of **Bridgewater Associates** (and before that COO at **D.E. Shaw Renewables Investments**) who is set to join crypto firm **NYDIG** (a technology and financial services bitcoin firm) as CFO.

Interestingly, at the recent **Miami Bitcoin 2021 Conference**, which was billed as the largest 'crypto event of its kind,' it appears that Wall Street was very much in attendance – no doubt much to anti-establishment / counter-culture disgust.

According to ***John Wu,*** **Ava Labs President** (formerly **Tiger Management** and **Kingdon Capital**) these individuals used to turned up as "tourists" but are now "more engaged and they're actually participants."

Crypto turbulence

It has been an extraordinarily turbulent time for digital assets.

With concern about regulation from the US, China and more recently Japan, questions are being asked about their environmental impact and several traditional supporters, such as **Elon Musk**, dialling back their support, the sector must feel it is under sustained attack.

Fortune Magazine quoted *Chris Weston*, head of research at **Pepperstone Financial Pty**, as saying "crypto is a tough gig right now… bitcoin could easily break hard one way or the other."

Crypto allocation

The convergence story is backed by findings in the **AIMA, PwC** and **Elwood** annual **Crypto Hedge Fund Report**, which reveals that funds are increasingly upping their exposure to crypto assets.

The report found that half of traditional hedge funds are considering investing in digital assets, with 47% of those surveyed (accounting for $180 billion assets) saying that they are either already investing or are considering investing in this space.

This was confirmed by ***Drew Robinson***, Head of Hedge Fund Sales at **Coinbase,** who said, "interest from pension funds and hedge funds has sky-rocketed."

At the end of 2020 pure crypto hedge funds were managing almost $3.8 billion, up from $2 billion 2019, with 43% based in the US and 19% in the UK.

LEGACY

Swenson leaves behind lasting legacy

The death of Yale's ***David Swenson***, the legendary pioneer of the endowment investment model, was a sad day for institutional investment.

Swenson had been the Chief Investment Officer at **Yale University** for 36 years, from 1985 through to his death in May.

Over the years, most of us have had to study his innovative investment model and today we appreciate the value and importance of capital allocation.

It is fitting that we quote ***Peter Salovey***, Yale president, who said that "with [Swenson's] guidance, Yale's endowment yielded returns that established him as a legend among institutional investors... His approach, which has become known as the 'Yale model,' is now the standard for many university and foundation endowments."

MARKETING

FT's European coverage

While the **Financial Times (and FT.com)** has a reputation for giving hedge funds and the sector a tough time, its dedicated, highly knowledgeable, team of reporters covering these markets - and given its demographic - means that this is still the most important medium in the market to bring on side.

In Europe, the main journalists covering the space at the FT are **Harriet Agnew, Laurence Fletcher,** and **Robin Wigglesworth.**

Harriet is the paper's Asset Management editor. Based in London, Harriet was previously Financial Services editor and prior to that the Paris editor, where she covered luxury and consumer. She is hugely experienced, having interviewed many of the biggest names in business, as well as in the hedge fund space. Before the FT, she was at **Financial News** covering funds and prior to that was Editor of **Alternative Investment News**.

Laurence is also London based and has been covering hedge funds for many years, with many scoops to his name, as well as having a deep book of contacts. As Capital Markets correspondent, his role covers markets and hedge funds. Prior to the FT, he covered hedge funds at the **Wall Street Journal** and before that at **Reuters**.

Robin is the paper's Finance correspondent, based in Oslo, Norway. He is more focused on the bigger trends shaping markets, investing and finance. He writes features, profiles and columns.

REGULATORY

Presented by RQC GROUP

MiFID II research requirements pared back

The **FCA** is proposing some changes related to the **UK's MiFID II** research requirements.

Since 2018, subject to certain exemptions, research services are either paid for by the firm itself or by agreeing a separate research charge with its clients. 'Bundling' of research and execution services - which was hitherto conventional for certain asset classes - is not permitted.

Under the proposal, this requirement will be removed (i) with respect to companies with a market capitalisation of less than £200 million (ii) where the research relates to fixed income, currencies and commodities (iii) where the research is provided by an independent provider that does not also provide execution services and (iv) where the research is openly available.

If adopted, the changes will take effect during the second half of 2021.

FCA consultation on a new authorised fund regime for investing in long term assets

The **UK government** and the **FCA** are looking into the UK fund regime from a taxation and regulatory perspective. The objective is to identify options which will make the UK a more attractive location to set up, manage and administer funds, that will support a wider range of more efficient investments better suited to investors' needs. Among other considerations, it is perhaps hoped that this would 'break the inertia' of the onshore fund manager / offshore fund model.

Most recently, the FCA has published Consultation Paper CP21/12 on a new category of authorised open-ended fund, the **long-term asset fund ("LTAF").** This new fund type would be designed to enable authorised funds to be set up to invest efficiently in long-term, illiquid assets, such as real estate, private equity and infrastructure.

The LTAF would initially be restricted to professional clients and 'sophisticated retail investors'.

The FCA contends that LTAF's would provide useful alternative investment opportunities for certain investors, able to bear the risks, in assets that are less liquid and potentially higher risk.

RQC GROUP (cont.)

FCA fines Sapien Capital Ltd £219,000 for serious financial crime control failings in relation to cum/ex trading

This is the first **FCA** case in relation to cum/ex trading, dividend arbitrage and withholding tax reclaim schemes. Between 10 February 2015 and 10 November 2015, **Sapien** failed to have in place adequate systems and controls to identify and mitigate the risk of being used to facilitate fraudulent trading and money laundering.

The trading was characterised by a circular pattern of extremely high value trades undertaken to avoid the normal need for payments and delivery of securities in the settlement process. The trading pattern involved the use of Over-the-Counter equity trading, securities lending and forward transactions, involving EU equities, on or around the last day securities were cum dividend.

The FCA investigation found no evidence of change of ownership of the shares traded, or custody of the shares and settlement of the trades, which appear to have been undertaken to create an audit trail to support withholding tax reclaims in Denmark and Belgium.

Financial crime continues to be a regulatory hot topic, and there has been a recent increase in enforcement activity, covering market abuse and anti-money laundering.

Woodford Equity Income Fund investigation

Nikhil Rathi, Chief Executive of the **FCA** wrote to the *Rt Hon. Mel Stride MP*, Chair of the Treasury Select Committee updating on the progress of the investigation into the **Woodford Equity Income Fund ("WEIF").**

WEIF collapsed in June 2019, mainly due to investments in unlisted and less liquid companies. To date, £2.5 billion out of £3.7 billion of assets has been returned to investors.

Stating that the investigation has made 'substantial progress', the letter sets out that the FCA has interviewed 14 witnesses and has gathered 20,000 items of relevant material. If there is a case to answer, the FCA will instigate disciplinary proceedings.

RQC GROUP (cont.)

US and UK regulatory co-operation

The **US Treasury Department** recently issued a joint statement summarizing discussions at the latest meeting of the **US-UK Financial Regulatory Working Group**. Participants were senior staff from the **US Department of the Treasury** and **HM Treasury**, as well as US and UK regulatory agencies including the **SEC, CFTC** and **FCA**. Focus areas included international and bilateral cooperation, cross-border regimes, and management of climate-related financial risks and other sustainable finance issues.

US regulators have recently begun focusing on the climate-change and ESG arena which is significant if one considers that other regulatory jurisdictions have already taken steps to codify ESG-related rules.

The SEC's Division of Examinations recently announced the creation of a Climate and ESG Task Force, and also published ESG-related observations from recent examinations which further emphasize the importance of the new initiative.

Another area where we may see enhanced cooperation is cybersecurity crime. The increased threat of cyber risk has been a consistent hot topic in the financial services industry for many years, and seemingly has never been more important than in the last year due to the ongoing need for remote working arrangements. Ongoing phishing campaigns involving fraudulent emails purporting to be from regulators are becoming increasingly sophisticated and global cooperation amongst regulators in combating such activity should benefit the industry as a whole.

If you have any questions about **The Hedge**, or would like to be added to our distribution, do please contact the team at **thehedge@brodiecg.com**

This document has been produced by Brodie Consulting Group in conjunction with RQC Group.

brodie consulting group

Brodie Consulting Group is an international marketing and communications consultancy, focused largely on the financial services space. Established in 2019 by Alastair Crabbe, the former head of marketing and communications at Permal, the Brodie team has extensive experience advising funds on all aspects of their brand, marketing and communications.

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RQC GROUP

Founded in London in 2007 and with a dedicated office in New York, RQC Group is an industry-leading cross-border compliance consultancy specializing in FCA, SEC and CFTC/NFA Compliance and Regulatory Hosting services, servicing clients with AUM in excess of $580 billion.

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