A Brodie Consulting publication in conjunction with RQC Group

July 2021

The Hedge

Looking back at the past month's news and views

Equity funds lead the June charge

Hedge funds continued their winning streak into June as they closed the month with their ninth consecutive month of positive performance.

In June, the **HFRI Fund Weighted Composite Index** was up 0.43%, taking the year-to-date figure to 10.03%. This completes, writes **HFRI**, the *'best first half of a calendar year since 1999.'*

Equity managers led the field, with the **HFRI Equity Hedge (Total) Index** up 1.32% and now up 12.72% for the half; in comparison, the **MSCI World Index (USD)** was up 1.49% and 13.05% for the year. The best performing equity managers were the quants, with the **HFRI Quantitative Directional** index up 3.73%, followed by tech, with the **HFRI Technology Index** up 3.48%.

Event driven managers were up 0.38% for the month, taking the year's return to 11.52% (**HFRI Event-Driven (Total) Index**), within which the **HFRI ED Activist Index** was down 0.25%, but remains up 12.95% for 2021.

Macro was the only HFRI strategy to fall in June, with the **HFRI Macro (Total) Index** down 0.96%. as both discretionary and systematic managers failed to make ground during the month.

£100 billion

Elliott's target valuation for pharma giant GSK

+10.03%

HFRI Fund Weighted Composite Index H1 performance

Survey finds 'satisfied' investors

There were a number of interesting findings in a recent joint **HFM / AIMA** report on investor views on the first half of the year and intentions for the second half.

Based on surveys and interviews with 108 investors in alternatives and 128 senior hedge fund IR and marketing professionals, the report found 82% of investors to be satisfied with hedge fund performance in the first half of the year and 34% planned to increase their allocations in the second. The most popular strategy for the second half is global macro, followed by long/ short equity and multi-strategy funds. While the top targets for fund investment are single and multi-family offices.

Wellcome targets carbon neutral

Wellcome, the £29 billion foundation, pledged to be carbon neutral by 2050. This is a reminder to managers of how important the environment is to large investors.

In its strategy paper (link) released this month, the foundation said that it would take *'a staggered approach to measuring the portfolio's carbon footprint.'*

To hit the target, the foundation is encouraging managers and underlying assets to follow **TCFD** recommendations, the global standards for climate-related disclosure. Having said that, they view the return-on-effort pay-off for measuring emission of hedge funds as 'low' - at this stage - with no consensus on *'how to measure the footprint of short and derivative positions.'* They will continue to engage with managers on this point.

This news comes as **Amundi, Franklin Templeton, Sumitomo Mitsui Trust** and **HSBC**, alongside 124 other managers, have signed-up to the **Net Zero Asset Managers Initiative** (link), which supports the goal of net zero greenhouse gas emissions by 2050. These signatories account for $43 trillion in assets.

Upcoming Events

3-6 August 2021
Pension Bridge - *Altinvestor APAC 2021*

11-13 August 2021
The Indian Alternative Investment Meeting *(AIMA)*

15 September 2021
Australia Annual Forum 2021 *(AIMA)*

21 September
MFA Digital Assets 2021

Click here to see further events in 2021

News

Value, growth or ESG?

Analysis of US **Google** search terms by research firm **DataTrek** has found 'ESG' to be a more popular than *'value stock'* or *'growth stock.'*

In a blog, DataTrek has written that the old 'growth/ value paradigm' has shifted, adding that 'if your livelihood involves convincing other people to allocate capital for you to manage, then ESG has to be part of your pitch.'

No more dirty finance

Speaking at **Incisive Media's Sustainable Investment Festival** on 23 June, **TCI's *Sir Chris Hohn*** talked about climate change saying that hitting the net zero target by 2050 is a joke.

According to **Professional Pensions**, Hohn said that this date is too late and asset managers should be actively looking to end *"dirty finance",* whilst pensions funds should be removing those managers that do not take sufficient action on climate change.

Tudor Jones' macro call

Unsurprisingly, for a macro manager of his stature, there were some big market calls from ***Paul Tudor Jones***, when he spoke to ***Andrew Ross Sorkin*** on **CNBC's Squawk Box.**

Tudor Jones said that the stock market valuation was making him "uneasy" and he would go "all in on the inflation trades" should the Fed continue to be indifferent to rising consumer prices.

Perhaps, most striking, were Tudor Jones' comments on bitcoin as a portfolio diversifier, having previously described the token as the "great speculation". He said that he would be comfortable with a 5% portfolio allocation to bitcoin, 5% gold, 5% cash and 5% commodities.

Meme stocks hurt shorts

Meme stocks continue to add to the pain felt at **Melvin**, writes **Bloomberg**. Having weathered further losses in May and June, Melvin was down around 46% for the year, according to the wire.

Another fund to have been hit by losses from shorting **Gamestop** is London-based **White Square Capital.** The **Financial Times** reported that the fund, run by former **Paulson** trader ***Florian Kronawitter,*** closed its doors after double digit losses and is now returning capital to investors.

According to data from **Ortex Analytics**, the overall hedge fund losses on **GameStop, Bed Bath & Beyond, AMC Entertainment, BlackBerry** and **Clover Health** – the five most popular meme stocks – was around $6 billion in May alone.

Furthermore, this continued into June, with AMC short sellers losing $512 million in the stock on 14 June after a rally sent the shares rising 15%.

Funds may well have reduced their shorts in meme stocks, but short interest continues to be at 'high levels', writes the **Financial Times**.

News (cont.)

Shorting SPACS

Arguably the best-known short seller in the market, ***Jim Chanos***, founder of **Kynikos Associates**, has spoken out against the SPAC boom.

Speaking to the **Financial Times** he said that valuations are too high and SPACS have over-promised and under-delivered as they try to attract retail investors. He concluded by saying that this boom will ultimately hand investors *"a pretty expensive lesson".*

Chanos may well be right, particularly as SPACS have struggled this year, it is however a tough game being a short seller in today's bullish markets, with Kynikos' assets dropping from $7bn to below $1 billion.

Morrison's pain

Unsurprisingly, news that Morrison's, the UK's fourth largest supermarket, was on the receiving end of various private equity bids has proved to be highly profitable for those managers who were long this trade and other supermarkets. But it has been a disaster for the short sellers, with Morrison's not long ago a top five UK equity short.

MFA seeking to raise awareness

The **Managed Funds Association** (MFA) has launched an ambitious campaign, Investing in Opportunity, to raise awareness of hedge funds and their importance on everyday US lives.

To make their case, the MFA is citing some impressive numbers, with nearly 26 million American investing in hedge funds through their pension plans ($789 billion); more than 300 colleges and universities across the US investing $145 billion in hedge funds through endowments; and non-profits and charitable foundations investing $438 billion in hedge funds.

Funds

Europe's largest launch

Showing the power of a big brand fund raising, former **Citadel** managers *Niall O'Keeffe* and *Tio Charbaghi* have successfully raised $1.25 billion for **FIFTHDELTA**, a global technology and industrial stock fund.

This becomes the largest European fund launch of the year and, according to **Bloomberg**, has already closed to new investors until next year, a rare move and only the second known European fund to have done so in recent years

Hybrid launch

Reuters has reported on a new $2 billion hybrid hedge fund and private equity fund to be launched by **Blackstone**.

Timings for this launch and further details remain unclear, but the Fund will be managed by New York-based ***Scott Bommer,*** who founded **SAB Capital** Management in 1999. He joined **BAAM** in March of this year as CIO of the new **Blackstone Horizon** platform.

Funds (cont.)

Elliott breaks cover

It has taken a couple of months, but finally in a 17-page letter to **GlaxoSmithKline (GSK)** chairman, *Jonathan Symonds*, **Elliott Advisors** has broken cover on its position, questioning GSK's value, corporate strategy and management, stating that *'GSK has lost its way.'*

This follows GSK's much trumpeted 23 June capital markets day.

Elliott believes that the pharma group is worth more than £100 billion, when its currently market cap is £71 billion.

The activist says that it wants GSK to halt its plans to list the consumer business and instead consider the option of selling the business to a private equity consortium, which Elliott believes it can lead. They also called for a boardroom overhaul to bring in directors that have more relevant experience.

In response, GSK has said that these *'issues... are not new... The Transformation programme has been designed to address all of these legacy issues, and more... [and] will respond to Elliott's letter more fully in due course.'*

Crypto

Crypto finely poised...

Although a hedge fund focused newsletter, crypto has a definite place in this newsletter as funds increasingly look to it as an idiosyncratic investment. Various funds have made sizeable returns in this asset class, while others have undoubtedly been roiled over the past few months as the sector struggles to recapture the momentum seen earlier in the year.

Crypto is also at an interesting point in its development. On one side, the advocates remain as staunch as ever – it's a universal currency, non-fiat/ non-government, increasingly established, etc. – while the detractors, including most mainstream (if not all) regulators, are proving harder to turn given their inability to police the asset class and have become increasingly vocal about their views.

The pro case has not been helped by multiple scandals, the cost to the environment of mining and recent volatility. As things stand, crypto sits on a knife edge, but there continues to be tangible interest from the hedge space. One such manager, **Marshall Wace**, writes the **Financial Times**, is *'plotting investments in the digital asset sector,'* with a particular focus on blockchain technology, payments systems and stablecoins.

Crypto (cont.)

Funds looks to crypto

A recent **Intertrust** survey of 100 hedge fund CFOs found growing appetite for crypto assets, with manager allocations expected to hit 7.2% in five years' time. The survey, which was first reported in the **Financial Times**, found the biggest advocates to be North American funds, which expect - in five years - to be allocating 10.6% on average, while the figure for Europe and the UK is lower at 6.8%.

There have been various surveys out over the last few months showing a range of views. One of these, a **Goldman Sachs** survey of 25 hedge fund CIOs, was less than enthusiastic, with value, growth and commodities seen as the most favoured investment styles, and bitcoin the least favourite.

Goldman moves into crypto trading

As investor interest in crypto increases, **Goldman Sachs** has become the latest bank to develop this side to their business, with the news that it will offer options and futures on ether, the Ethereum network's currency.

In an interview with **Bloomberg**, ***Mathew McDermott***, head of digital assets at Goldman, said the bank will also enable trading via bitcoin exchange traded notes. This follows Goldman's move to restart its crypto trading desk.

Timing is also seen as good by McDermott, who believes there is less *"excess"* in the system following the recent crypto sell-off.

Elwood ETF sold

Europe's largest crypto asset manager **CoinShares** has acquired **Elwood Technologies**' ETF index business. Owned by ***Alan Howard***, Elwood was founded in 2018 and today has over $1 billion in AUM. As part of the deal, Elwood's digital asset focused equity research team will join CoinShares. According to **Coin Telegraph,** Howard is also a major investor in CoinShares.

4.4% of UK adults own crypto

In our minds a surprising statistic released by the **FCA** is the number of UK adults that own crypto, which they estimate to be 2.3 million, or 4.4% of UK adults. According to the FCA's research, UK holders of crypto are largely male, over 35 and AB social grade. Furthermore, these same investors today see crypto as less of a gamble and more as an alternative to mainstream investments.

Crypto (cont.)

SEC kicks crypto ETFs down the road

As we wrote last month, the US crypto ETF industry had its fingers crossed that the **SEC** would approve the **Van Eck's** bitcoin ETF, which they hoped would open up this market with around a dozen in the pipeline. Unfortunately, the SEC once more postponed their decision.

Yet other crypto-related funds, which invest in related mining and technology companies, are being approved, including the **Bitwise Crypto Industry Innovates ETF** that was launched in May.

Nuts & Bolts

Funds choose the hybrid office route

A **Managed Funds Association** survey found most US hedge funds are moving to a hybrid working model from September as front and back-offices head back into the office. Various funds are moving to one day in the office, but the majority have opted for three days, with remote working on Monday's and Friday's.

Bloomberg has reported on almost all **Citadel's** 2,000 plus employees being back in the office, while **Millennium Management** will be moving to three days in the office from September, and **Bridgewater Associates** and **Two Sigma** to two days.

Beyond hedge funds, it is clear there is no single direction being taken by the financial services industry. While some banks decried the working from home trend as being an *"aberration"*, most it appears have opted for the more balanced *'hybrid'* approach, where they talk about the value of being *'flexible'* and *'agile'*, with core staff, such as traders working on site and the majority working from home and office.

Opponents of hybrid working practices include **JPMorgan, Goldman Sachs** and **Morgan Stanley**, with *James Gorman,* Morgan Stanley's CEO, notably saying: *"If you can go into a restaurant in New York, you can come into the office".* On the other side, supporting greater flexibility are **BNP Paribas, Deutsche Bank, HSBC, Standard Chartered, Citigroup** and **UBS**. HSBC's CEO ***Noel Quinn*** has even publicly said that he is no longer going to come into the office five days a week and has scrapped the executive floor of their Canary Wharf HQ.

Looking beyond the banks, **Deloitte** has told staff that they can choose when, where and how they work. This comes after an internal survey found 96% of employees wanted flexibility to choose where they could work, with more than four in five saying they expected to work in the office up to two days a week. **KPMG** is also moving to a hybrid approach, as is **PwC**, although it is encouraging workers back to the office for '*human contact*', writes **Consultancy Magazine.**

Marketing

Presented by brodie consulting group

A simple story is a far more powerful proposition

Too often asset managers are guilty of over-complicating their story, be it the mandate, investment process, even the manager's experience. A complicated story may well add to the air of mystery, particularly when it comes to a black box strategy. This sounds interesting in practice and perhaps worked a decade or so ago, but it is largely unhelpful in today's world.

Ultimately, you want your sales and third parties to be able to tell your story simply. Investors are inundated with offerings and are actively hunting for red flags. If they fail to understand the strategy, or even just a part of a fund, it is often easier to look elsewhere.

Keep the story simple should be the mantra. Break it down to the nuts and bolts of the offering. Differentiate your story from others in your space. And where required use infographics to help explain the more convoluted areas of the business or processes. Ensure that this resonates across all materials, particularly the website as this remains the first port of call for any due diligence.

There is plenty of noise in the alternative space but by keeping it simple you can make your brand less intimidating and significantly more approachable.

REGULATORY

Presented by RQC GROUP

HM Treasury Wholesale Markets Review

In early July, **HM Treasury** published their 'Wholesale Markets Review' consultation document. This discusses potential changes to the UK's wholesale markets environment following the end of the Brexit transitional period and in particular whether certain aspects of the second **Markets in Financial Instruments Directive** ('MiFID II') should be revised.

It is recognised that the review is not about revolutionising the rulebook but about making it nimble and fit for purpose. However due to the extent and complexity of new regulation introduced by MiFID II in 2018, some rules have not delivered their intended benefits, have led to duplication and excessive burdens for firms, or have stifled innovation.

The proposals relate to execution venues, markets (equity, fixed income, derivatives and commodities), market data, reporting and cross cutting issues.

Continued over page

RQC GROUP (cont.)

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Specific proposals include the removal of the limits on the amount of trading in "dark pools" (the so-called Double Volume Cap), the removal of limits on where shares can be traded (the Share Trading Obligation), changes to the Derivatives Trading Obligation, narrowing the scope of the 'commodity derivatives' regime and reviewing potential overlaps between transparency reporting regimes such as **MiFIR** reporting, **EMIR** reporting and **SFT** reporting.

FCA announces climate-related disclosures for asset managers

On 22 June 2021, the **FCA** published a Consultation Paper that sets out the proposed climate-related disclosure framework for asset managers.

This is part of a UK Government initiative towards mandatory climate-related disclosures across the UK economy by 2025.

Under the proposal, all UK asset managers (and some investment advisers) with assets under management of £5 billion or above are required to make disclosures at two levels:

Entity-level: A requirement to publish an annual entity-level report on how the firm takes climate-related risks and opportunities into account when managing investments.

Product or portfolio-level: A requirement to produce, annually, a baseline set of consistent, comparable disclosures in respect of the firm's products and portfolios, including a core set of metrics

The disclosures will be based upon the recommended disclosures of The **Task Force on Climate-related Financial Disclosures ('TCFD')**, which is a global body aiming to develop more effective climate-related disclosures that could promote more informed investment decisions and enable stakeholders to better understand climate-related risks and opportunities. The disclosures fall into four overarching categories: Governance; Strategy, Risk management; and Metrics and targets.

The requirements would take effect on 1 January 2022 for firms with assets under management of £50 billion or above and on 1 January 2023 for firms with assets under management of between £5 billion and £50 billion.

The FCA acknowledges certain similarities between this regime and the European Union's Sustainable Finance Disclosure Regulation ('SFDR') which took effect in March 2021, recognising that by focussing on climate-related issues the UK regime has a narrower remit. In part, this will minimise the impact of duplicative effort between the respective regimes.

The FCA is seeking comments on the publication by 10 September 2021.

Separately, the FCA is also proposing to extend the application of its TCFD-aligned Listing Rule for premium-listed commercial companies to issuers of standard listed equity shares.

RQC GROUP (cont.)

Review of host Authorised Fund Management Firms

The FCA has published the results of its review of **Authorised Fund Managers ('AFMs')** that delegate investment management to third-parties outside of its corporate group.

The review took place in 2019 and 2020 and involved visiting a sample of AFMs to review the effectiveness of their governance, controls and monitoring.

Aside from AFMs, these findings may be of interest to firms that outsource or delegate a key function, such as investment management, to a third-party.

The key findings are grouped into four categories:

1. **Due diligence over third-party investment managers and funds**

   The FCA found that overall, firms performed poorly. Some firms relied on informal conversations to assess and understand proposals, as opposed to following a set process. There was evidence of not adequately addressing identified risks or inconsistencies and a lack of effective challenge to proposals and information from third-parties.

   Furthermore, the FCA found AFMs to have a lack of knowledge when submitting fund applications to the FCA.

2. **Oversight over third-party investment managers and funds**

   The FCA found that there was often a skills gap at an AFM, with staff not properly understanding the strategies and financial instruments employed. A number of firms also displayed poor oversight of the third-party managers.

3. **Governance and oversight**

   A number of AFMs were unable to provide evidence of robust governance procedures, including ineffective challenge by non-executive directors, key decisions being taken outside of formal board meetings.

4. **Financial resources**

   There were identified shortcomings with respect to an appropriate investment in systems, controls and people, the risk framework, reliance on professional indemnity insurance and/or parent support and stress-testing/wind-down planning.

Consumer warning on Binance Markets Limited and the Binance Group

On 26 June 2021, the **FCA** advised that **Binance Markets Limited**, part of the Binance Group, a global crypto-asset exchange, is not permitted to undertake any regulated activity in the UK.

The FCA is also warning consumers of the dangers of investing in cryptoassets generally, noting that most firms offering cryptoassets products and services are not regulated by the FCA, and therefore consumers do not have recourse to the Financial Ombudsman Service or the Financial Services Compensation Scheme.

Consequently, Binance Group, which has an exchange in the Cayman Islands, can – in theory - continue to offer cryptoasset exchange services to UK investors, where the asset is unregulated (e.g. cryptocurrencies such as Bitcoin, as opposed to financial derivatives where a cryptoasset is an underlying asset). However on 5 July Barclays stopped UK customers from making debit and credit payments to Binance.

Regulators in other countries, such as Japan and Canada, have communicated similar warnings in recent weeks.

RQC GROUP (cont.)

SEC approves adjustment for inflation of "qualified client" thresholds

Section 205 of the Investment Advisers Act of 1940 (the 'Advisers Act') generally prohibits a registered investment adviser from entering into any investment advisory contract with a client that provides for compensation to the adviser be based on a share of capital appreciation of the client account (a 'performance fee'). Rule 205-3 provides an exemption from the general performance-based fee prohibition for advisers to private funds whose investors are "qualified clients" meeting certain financial thresholds.

On 17 June 2021, the SEC issued an order adjusting the dollar amount thresholds for clients of registered advisers to be "qualified clients" under rule 205-3 of the Advisers Act. The SEC's order amends the rule to increase the assets-under-management test from $1,000,000 to $1,100,000, and the dollar amount of the net worth test from $2,100,000 to $2,200,000.

The Order will be effective on 16 August 2021.

The restriction on performance fees applies to registered advisers only, and excludes exempt reporting advisers, foreign private advisers, family offices, etc. To the extent that contractual relationships are entered into prior to the order's effective date, the dollar amount test adjustments in the order would not generally apply retroactively.

Click here for RQC Group's recently published 2021 Q2 Newsletter containing further detail on these topics and a broader overview of other key regulatory issues affecting the UK/EU and the USA, to help you connect the dots.

If you have any questions about **The Hedge**, or would like to have a colleague 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 sector. 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.

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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