A Brodie Consulting publication in conjunction with RQC Group

September 2021

The Hedge

Looking back at the past month's news and views

Hedge funds back in positive territory

Together with global equities, hedge funds were back in positive territory in August, having fallen 0.60% in July, as the **HFRI Fund Weighted Composite Index** advanced 0.81%.

Equity focused funds were the best performing in August, with the **HFRI Equity Hedge (Total) Index** up 1.18%, taking the year-to-date figure to 11.94%, with **Healthcare** and **Technology** strategies the strongest performers during the month (up 3.26% and 3.02% respectively).

The HFRI Macro (Total) Index rose 0.23% for the month, with the **Commodity** managers the best performers, up 2.16%, and **Currency** focused managers the worst, down 0.47%. All event driven strategies were up for the month, with the **HFRI Event Driven (Total) Index** up 0.96%. Fund of funds also had a decent month, with the **HFRI Fund of Funds Composite Index** up 1.14%, which was partly driven by the **Strategic Index**, which was up 2.41%.

The top performing region was Japan, with the **HFRI Japan Index** up 6.58%. This was followed by the **HFRI Emerging Markets: Russia/Eastern Europe Index**, which was up 4.98%. At the other end of the scale was China, with the **HFRI Emerging Markets: China** Index down 1.65%, partly the result of rising concern about regulation in the region.

Upcoming events

13-15 September 2021
SALT, NYC
20-24 September 2021
Women in Finance
21 September 2021
MFA Digital Assets 2021
21-22 September 2021
Global Distribution Conference, ALFI.
27-29 September 2021
GAIM ops – NY Edition

Click here to see further events in 2021

$2.01 trillion

Total value of the global crypto market to 8 September 2021

Source: Coinmarketcap

$9.30 trillion

Total value of gold in the world – based on a spot price of $1,802

Source: GoldenEagle Coins

Goldman expands in Europe to bolster its green credentials

In a move that further enhances its European asset management business, **Goldman Sachs** is set to acquire **NN Investments**, the money management arm of Dutch insurer NN Group.

NN had been under pressure from **Elliott Management** to sell assets to improve returns and streamline the business. In the end, Goldman won against DWS, paying $1.9 billion.

The additional $355 billion of AUM that this brings to Goldman *"strengthens [its] position in Europe"* and adds *"scale"*, according to ***David Solomon***, Goldman CEO. Not that Goldman Sachs Asset Management needs scale, given it has $2.3 trillion in assets under supervision. But it does add to Goldman's ESG business, with NN noted - in particular - for its green bonds, impact equity and sustainable equity investments.

From SPACs to SPARCs

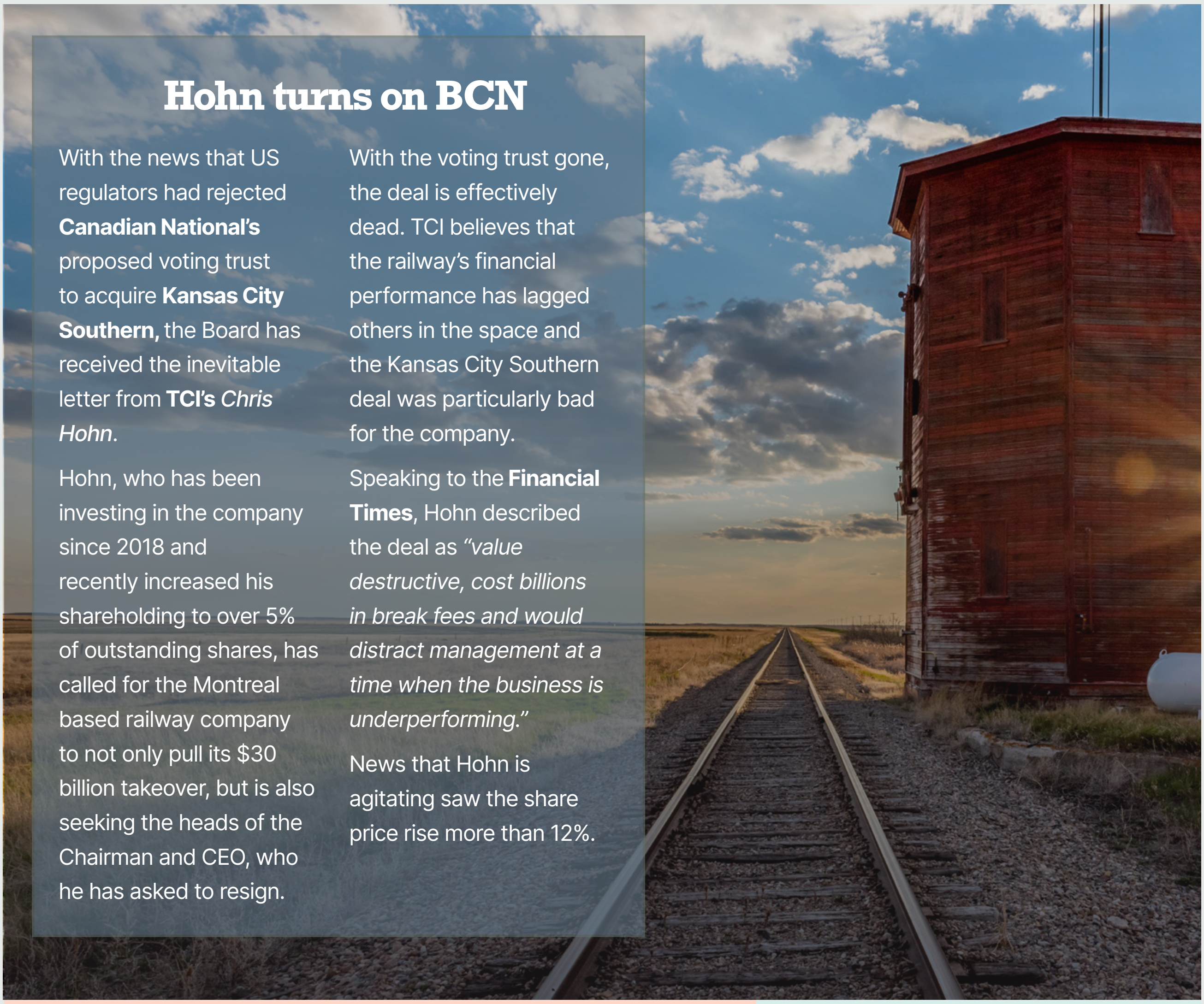
Rarely is **Pershing Square's** ***Bill Ackman*** knocked down and out. News that he plans to wind up his SPAC - after objections from the **SEC** over use of the vehicle to buy shares in **Universal Media Group**, alongside a lawsuit that the SPAC was being treated as an *'investment company'* - would have floored lesser individuals.

Instead, Ackman has swiftly followed up with plans to launch a SPARC, which he filed with regulators in June. This is a special-purpose acquisition rights company – similar to a SPAC, just without the funds, that instead offers an option to buy shares once a deal is struck.

The **Wall Street Journal** describes the new vehicle as *'novel',* while **The Economist** believes it could be more efficient than a SPAC, as it *'eliminates the opportunity cost of locking up investors' funds for two years.'*

The SPARC has to yet to be approved by the **SEC** or **NYSE**.

News (cont.)



Hohn turns on BCN

With the news that US regulators had rejected **Canadian National's** proposed voting trust to acquire **Kansas City Southern,** the Board has received the inevitable letter from **TCI's** *Chris Hohn*.

Hohn, who has been investing in the company since 2018 and recently increased his shareholding to over 5% of outstanding shares, has called for the Montreal based railway company to not only pull its $30 billion takeover, but is also seeking the heads of the Chairman and CEO, who he has asked to resign.

With the voting trust gone, the deal is effectively dead. TCI believes that the railway's financial performance has lagged others in the space and the Kansas City Southern deal was particularly bad for the company.

Speaking to the **Financial Times**, Hohn described the deal as *"value destructive, cost billions in break fees and would distract management at a time when the business is underperforming."*

News that Hohn is agitating saw the share price rise more than 12%.

Petershill seeks LSE Listing

Following in the footsteps of **Bridgepoint Group Plc's** successful IPO in July – and with what appears to be a fair wind behind them - **Goldman Sachs' Petershill Group** is considering a main market listing on the LSE, which could value Petershill at more than $5 billion.

Petershill, which according to the filing has minority investments in 19 alternative asset managers with AUM of $187 billion, is working with advisors on the London listing. This follows reports in August that Petershill is planning to launch a permanent capital vehicle.

Naguib Kheraj, Non-executive Chair of Petershill Partners, said that this listing will give investors *"stakes in a number of leading privately owned alternative asset managers."*

The listed vehicle will continue to be managed by Goldman Sachs Asset Management.

Citadel redeems

Citadel is redeeming around $500 million from **Melvin Capital Management** at the end of September, the **New York Times** reports. This follows the injection of $2.75 billion from Citadel and *Steve Cohen's* **Point72 Asset Management** at the start of this year, which shored up Melvin when its short position against **GameStop** went badly wrong following a short squeeze attack by retail traders, orchestrated through social media.

Guest Article

Building diversity in alternatives

The proportion of women in senior hedge fund roles remains stubbornly low, ***Tanya Lutyens*** writes. Although more women are working in the alternatives industry now than five years ago, the pace of change is slow and the number of women reaching hedge funds' senior ranks is lower than most other alternative asset classes like venture and private equity.

This is despite investors increasingly badgering hedge funds for more diversity in their investment teams to ensure better outcomes and for the sector's own long-term success. Celebrated alternatives investor ***David Swensen***, **Yale's** late CIO, captured the frustration when he wrote to the fund's external investment managers last year requesting *"a level of diversity in investment management firms that reflects the diversity in the world in which we live."*

Tanya Lutyens
Lutyens Advisory

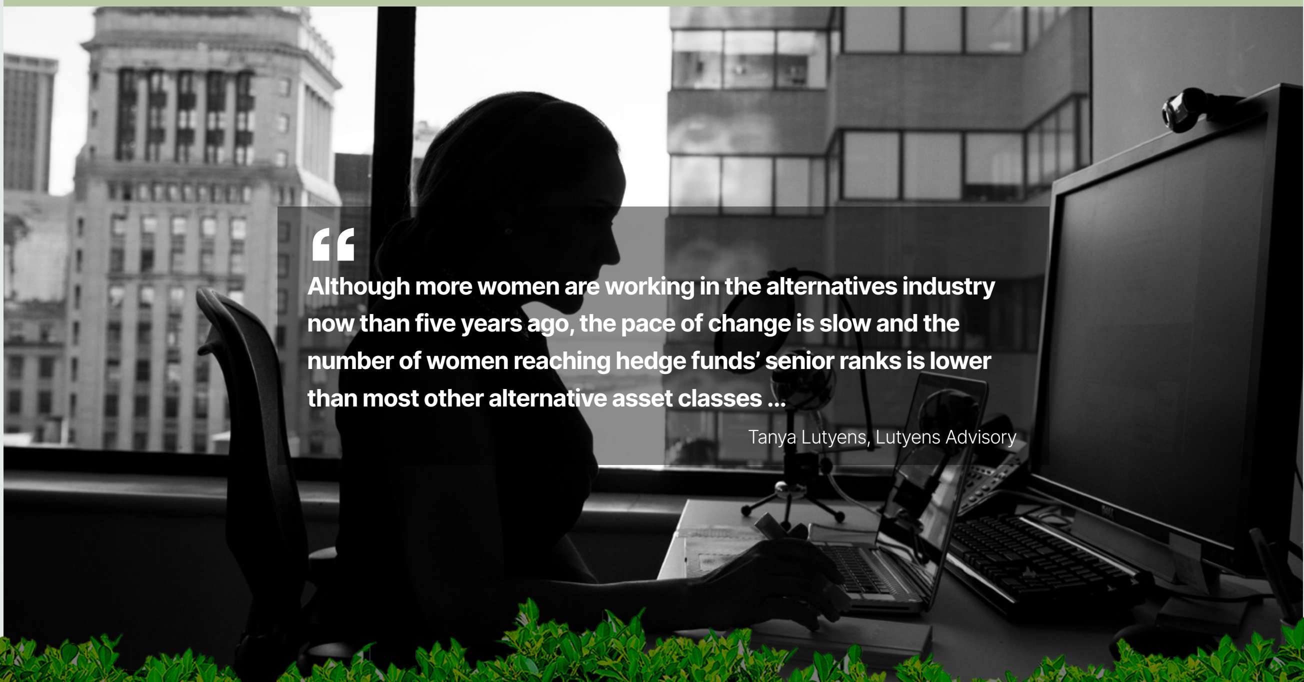
For sure there are some signs of change. Like the wave of female-led hedge funds launched in the last year, plus women-run funds' robust performance.

Yet we don't believe things can really start to change until the industry changes the way it recruits. In what is a first step, some hedge funds are finally beginning to gather data around the gender split of their internal staff, retention rates, internal promotions and pay scales. With this data to hand they can put in place the recruitment processes that move the dial with the help of head-hunters, shortlists and targets all the while safeguarding against tokenism or jeopardising finding candidates with the best cultural and technical fit.

Elsewhere, hedge funds can improve diversity by offering more flexible working, ensure their recruitment panels are diverse and by opening investment positions to returners and those who haven't had linear careers to widen the applicant pool.

Finally, nothing will change until more women choose a career in the sector in the first place. Some voluntary initiatives like **Girls are INvestors (GAIN)** or **Maths4Girls**, a pilot programme of **100 Women in Finance** and **Founders4Schools** are pushing. Now it's time for the industry to step up, actively targeting women at entry level by going into schools and universities. Only this way will the number of individuals looking to work within the hedge fund industry increase to include the essential next generation of gender, ethnic, cognitive and socio-economic diverse candidates.

Tanya Lutyens is the co-founding partner at Lutyens Advisory, a leading consultancy that advises boards and executive teams on all human capital related matters.



"Although more women are working in the alternatives industry now than five years ago, the pace of change is slow and the number of women reaching hedge funds' senior ranks is lower than most other alternative asset classes ...

Tanya Lutyens, Lutyens Advisory

GAIN
Girls Are INvestors

GAIN seeks to change the staggering lack of gender diversity in today's investment management. Our purpose is to inform and inspire young women.

- Women represent just 8% of decision makers in UK investment management.
- Only 20% of applicants to the investment management industry are women.

RQC Group is a proud supporter of GAIN and was part of the 2021 Empower - Investment Internship Programme. For further information visit www.gainuk.org.

ESG

Vantage point

The accelerated interest in funds offering and developing new ESG strategies is mind-blowing, *Alastair Crabbe* writes. This has seen stratospheric growth over the past few years as investors – institutional as well as retail – have been increasingly vocal, as they look for cleaner, greener and kinder investments. Unsurprisingly, funds are chasing the money and re-gearing their businesses with new hires and even building new arms to focus on this space.

In this edition of The Hedge there are stories of funds that have launched, or are in the process of launching, ESG funds, yet there are real questions now being asked as to what the reality is behind such claims. We have seen this in the **DWS** whistleblowing scandal, which may turn out to be nothing more than a disgruntled former employee, or perhaps there is more to it.

If you offer ESG funds, with an ESG overlay, or have an ESG base case, you must do what you say on the tin. This is far more than just a label – it is why investors are buying these funds – anything less and it becomes misrepresentation. There is a requirement for uniform standards to ensure it is a level playing field. If there is anything behind these accusations of greenwashing, then there is the very real potential for a massive mis-selling scandal down the line.

Fact or fiction?

According to a **Bloomberg** study out earlier this year, global ESG assets are set to exceed $53 trillion by 2025, which will be a third of the $140.5 trillion projected total AUM.

With such extraordinary appetite for sustainable assets, there are always going to be questions raised about how much ESG is actually in an ESG fund. Certainly, the difficulties of what is fact or fiction have been laid bare - very publicly - in recent weeks at **DWS, Deutsche Bank's** asset management arm.

This follows allegations from ***Desiree Fixler***, its former global head of sustainability, that more than half the $900 billion in assets that used ESG criteria was misleading. Fixler claims the ESG risk management systems were flawed and *'only a fraction'* of the investments used the sustainable investing criteria.

For DWS these are difficult accusations to swallow, with sustainable investing at the very heart of their marketing proposition. A glance at DWS's 2020 annual report shows 712 mentions of ESG (compared with 65 in 2019 and 15 in 2018), while ESG-dedicated funds account for 30% of total annual net inflows during that year.

Following Fixler's claims **BaFin** and **SEC** have launched investigations. In response, DWS has said that it *"stands by its annual report disclosures"* and firmly *"rejected the allegations."*

This also comes as the European asset management industry has had to swallow the **Sustainable Finance Disclosure Regulation** that came into force earlier this year, requiring managers to document claims of sustainability in portfolios.

ESG (cont.)

Bridgewater builds ESG focus

Together with **Lyxor, Bridgewater Associates** has launched the Lyxor/ Bridgewater **All Weather Sustainability Fund** with $2 billion of committed capital, writes **Institutional Investor.** Managed by Lyxor and sub-advised by Bridgewater, this UCITS compliant strategy trades equities, bonds and commodities and meets the **United Nations' Sustainable Development Goals.**

This is just the latest in a series of sustainability initiatives at Bridgewater, which are being actively promoted by *Karen Karniol-Tambour* and *Carsten Stendevad*, who were both named co-chief investment officers for sustainability at Bridgewater earlier this year, according to **Pensions & Investments**. This aligns with what ***David McCormick***, Bridgewater CEO, has been saying that *"sustainable investing is a strategic priority for Bridgewater and [its] clients."*

Bain to launch low carbon fund

Bloomberg reports on **Bain Capital's** plans to launch a low carbon long-short fund. This portfolio will focus on green investing and, according to the report, is set for launch in October.

The focus is *'consumer, financial, technology and healthcare stocks,'* and is based on a sustainable investing criteria. Bain may be far better known as a private equity business, but it also has a $3 billion public equities investment arm, with a heavy focus on ESG that includes Global Equity Long/Short, Global Long Equity and Co-investments.

What are the United Nations Sustainable Development Goals?

At the heart of the United Nations' 2030 Agenda for Sustainable Development is a plan of action for the 'people, planet and prosperity.' This was adopted by all United Nations Member States in 2015, with the following 17 interlinked global goals.

ESG (cont.)

Green shorting

There is an interesting article in the **Sydney Morning Herald** on the merits of *'green shorting.'* This strategy, which focuses on short selling carbon-heavy stocks, has been *'widely discussed within the impact investment community.'* **Stuart Palmer,** Head of Research at Australia's largest ethical fund, **Australian Ethical,** said that the more traditional short investors are looking for a catalyst over a relatively small time-period, whereas in the *"climate space... there are so many catalysts."*

In a separate piece, again in The Sydney Morning Herald, **AQR** is reported as having told the **Australian Prudential Regulation Authority** that some of its Australian clients are looking for new ways to reduce their carbon emissions, with short selling carbon heavy stocks as one such strategy.

Crypto

Shorting Cathie Wood

Crypto funds are now firmly in the crosshairs of the short-sellers.

One of the most prominent and successful investment stories in crypto over the past few years has been *Cathie Woods'* **Ark Innovation ETF**. But now, Woods' fund has become the target.

S3 Partners, the data company, has said that short interest amounts to 13.4% of the ETF, with one of the largest shorts being held by **Laurion Capital Managemen**t and another by **Scion Asset Management.**

With Woods held in high regard by the **Reddit** crowd, who see her as some sort of *'meme warrior,'* there are very real dangers to holding such short positions should the crowd decide to turn on the short investors.

Is crypto a commodity?

According to an **SEC** filing, **Neuberger Berman's** $164 million commodities fund can now invest indirectly 5% in cryptocurrency futures, notably bitcoin. An earlier filing had included ether, but this was later replaced by a *'bitcoin-only filing,'* according to **Coindesk**.

The Neuberger Berman portfolio managers believe that this exposure increases the fund's diversification and provides a hedge against inflation.

Digital gold...

Legendary asset manager ***Bill Miller*** believes that bitcoin's upward potential is huge. Miller, who runs the **Miller Opportunity Trust,** said he would increase his exposure to bitcoin over the coming years. Speaking to **FX Empire**, he said that ***"no asset in the world... combines bitcoin's liquidity with its upside potential."*** He goes on to say that the cryptocurrency remains at an early stage in the adoption curve and while it is likely to be volatile, its risk-reward is attractive.

Crypto (cont.)

Global bitcoin day...

Reddit and **Twitter** users called for 7 September to be **Global Bitcoin Day**, as **El Salvador** adopted bitcoin as legal tender.

According to the country's President, ***Nayib Bukele***, the move will increase financial inclusion and innovation, as well as economic development. The **Financial Times** had another view, describing the move as a *'dangerous gamble'* that *'risks economic stability and personal finances'* and it is *'hard to see the experiment ending well.'*

El Salvador opinion polls showed a high degree of scepticism about this development. The excitement appears to have driven bitcoin's price up almost 10% in the run-up, which was promptly burst on 7 September, when it fell by 11%.

Bitcoin futures

According to a regulatory filing, **Citigroup** is waiting on approval to start trading bitcoin futures contracts on the **Chicago Mercantile Exchange** (CME), writes **Coindesk**.

The same piece also added that sources have said '*Citi is actively recruiting people to join a crypto-focused team in London.*' In June, Citi launched a crypto business unit under its wealth management division.

Meme stocks

The Cassava ride

The buckle-up ride for the meme stock investor has been well and truly illustrated by **Cassava Sciences Inc.**, a popular meme pick, in recent months.

This clinical stage pharma was driven up by the meme crowd who pushed the stock price up over 1,700 per cent in only a year. However, in August, the wheels largely came off this ride as questions were raised about its main Alzheimer drug, writes **Market Insider**, with one analyst describing it as a *"diligence challenge."* This news has, in turn, made short sellers over $100 million in August, according to **S3 Partners**, as the stock traded heavily down.

Yet having lost 55% in the last four trading days in August – and illustrating the dangers and difficulties of shorting such stocks – Cassava remains the second best performer in the Russell 2000 this year (to end August), according to **Bloomberg.**

Marketing

Presented by brodie consulting group

The importance of a smart monthly commentary

Do you or do you not provide a monthly commentary on fund performance? The answer to this largely depends on who you speak to.

For those funds focused on long-term locked up institutional investment, there tends to be a far higher degree of reticence to write such 'short-termist' reports. Surely the goal is long-term risk adjusted positive returns, so why should they explain the past month's performance?

The rationale for this makes plenty of sense, but managers are still beholden to investors, or should be, and this is their capital at risk. Furthermore, investors inherently want to know how things stand when it comes to investment and money. This is an inherent trait in human nature when it comes to money - although, the other side of the coin is Cassandra's Regret, which is the psychology of not wanting to know.

Generally speaking, if a fund is making money, investors are interested in where this was generated - was this a market return, or was it alpha. If a fund loses money, this is fine if explained intelligently and there are no surprises. By knowing, or being reminded of, the rationale behind the fund positioning and where the investment thesis perhaps fell short for that month, investors tend to sleep rather more easily.

Where it becomes more difficult to explain, is when that same case continues to not work month after month. This was the situation macro managers found themselves in post 2008, when managers assumed Fed policy would ultimately come short or unravel. For months and even years on end, managers rolled out the same lines. I should know, I was writing much of this.

When it comes to comment, in our view - and it is important to make this clear that it is only a view - is to keep it simple and easy to understand. Some managers prefer writing long commentaries, but our preference is short and to the point. Today, all of our inboxes are filled with junk, as well as research reports, papers and so much more that we want to read, but just don't have the time. Concise comments that reflect the fund, the manager's thinking and comes across in a way that is not dry, but reflects their personality, works well.

Ultimately, there is no right or wrong way to write a monthly commentary, unless it is poorly written. Instead, it comes down to personal preference. But there are always certain areas that should be covered: the manager's macro-overview; what worked; what didn't work; why the above happened (transparency is key); what has changed in the portfolio; and the thinking behind the changes in the portfolio.

Alastair Crabbe is a director at Brodie Consulting Group and has provided marketing and communications advice to managers for over 20 years.

Regulatory

Presented by RQC GROUP

FCA – a quiet month, but IFPR is on the horizon!

August is typically a quiet month for the **FCA**. Last month, the FCA published only 12 news items, across all sectors. Most of these do not directly impact upon hedge funds. One exception relates to a reminder for firms regarding potential financial crime risks linked to Afghanistan, no doubt prompted by recent developments in the region. These risks include money laundering and terrorist financing risks, and the requirement for firms to apply 'enhanced due diligence' measures where 'country risk' is high.

The FCA also published its third (and final) consultation on the **Investment Firms Prudential Regime ('IFPR')**, which will affect most FCA regulated investment managers. IFPR, which takes effect on 1 January 2022, is a comprehensive overhaul of the prudential regime. It aims to

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consolidate the framework for firms whilst making it more aligned with the risk profile of the sector.

A key focus of IFPR is the **'ICARA' (Internal Capital Adequacy and Risk Assessment)**. This aims to ensure that firms have sufficient resources and plans of action to address 'harms' – to the firm, to its clients and/or to the financial markets. This process involves a firm:

- Conducting business model planning, forecasting and stress testing;
- Identifying and monitoring risks of harm;
- Assessing the degree to which the firm's systems and controls mitigates these risks;
- Determining if additional regulatory capital and/or liquidity is required to mitigate the residual risk;
- Setting out appropriate recovery actions to restore resources; and
- Drafting a wind-down plan that is linked to resources and recovery actions.

The ICARA is likely to be more complex than its predecessor, the **ICAAP**, and the FCA considers that the ICARA will be a key component of a firm's risk management processes.

The FCA is also introducing various events that trigger a mandatory notification to the regulator, including where a firm is approaching its regulatory capital threshold, when it breaches a regulatory capital or liquid assets threshold and where regulatory capital or liquid assets has reached a level where it is presumed that the firm will commence its wind-down plan.

Factoring in other aspects of IFPR, such as new formulae and definitions when calculating 'base' (i.e. pre-ICARA analysis) regulatory capital and liquid assets, updated 'consolidation' requirements for certain firms that are part of a wider group, and new remuneration, FCA disclosure and public disclosure requirements, for many firms IFPR implementation is a significant task. Tackling harms is a FCA priority, and it may be the case that the FCA will pay closer attention to a firm's prudential matters in the coming years.

SEC – enforcement action

The **SEC** has sanctioned eight firms in three actions for failures in their cybersecurity policies and procedures that resulted in email account takeovers exposing the personal information of thousands of customers and clients at each firm. All were SEC-registered as broker dealers, investment advisory firms, or both.

The SEC found that – collectively – the firms:

- Failed to protect accounts in a manner consistent with the firm's policies;
- Sent breach notifications to clients that included misleading language suggesting that the notifications were issued much sooner than they actually were after discovery of the incidents;

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- Failed to adopt and implement firm-wide enhanced security measures for cloud-based email accounts of its representatives until 2021, even though the first email account takeover occurred in January 2018; and
- Failed to adopt and fully implement written policies and procedures until 8 months after the end of the period in which the breaches occurred.

Without admitting or denying the SEC's findings, each firm agreed to cease and desist from future violations of the charged provisions, to be censured and to pay penalties ranging from $200,000 to $300,000.

In a separate matter, the SEC filed an emergency action to stop a fraudulent Ponzi scheme allegedly perpetrated by registered investment adviser **Livingston Group Asset Management Company**, doing business as **Southport Capital** ('Southport'), investment fund **Horizon Private Equity, III LLC ('Horizon')** and their principal, ***John Woods.***

According to the complaint, the defendants raised more than $110 million from more than 400 investors in 20 states by offering and selling interests in Horizon. Woods, Southport, and other Southport representatives allegedly told investors that their Horizon investments were safe, would be used for different investment activities, would pay a fixed rate of return, and that investors could redeem their principal without penalty after a short waiting period.

According to the complaint, however, these statements were false and misleading as Horizon did not earn any significant profits from legitimate investments, and a significant percentage of purported "returns" to earlier investors were paid from new investor money.

The SEC's complaint also alleges that Woods repeatedly lied to the SEC during regulatory examinations and charges the defendants with violating the antifraud provisions of federal securities laws.

RQC Group is a proud member of AIMA

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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