NOVEMBER 2021

The Hedge

A look back at the month's news, views and a little more

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AND MORE...

A Brodie Consulting publication in conjunction with RQC Group

HEDGE FUND ASSETS SURPASS $4TN

Even with the overhang of inflation, virus concerns and imminent Fed tapering, October was a particularly strong month for equity markets. The **MSCI World index** rose 5.7% and the S&P 500 7.0%. In such an environment, perhaps unsurprisingly, looking at **HFR** data, equity hedge funds outperformed all other HFR strategies.

In October, the hedge fund sector also hit an significant milestone as total assets surpassed $4 trillion, *"driven by strong performance which extends widely across strategies – including high and low beta, equity, fixed income, commodity and currency strategies, and emerging and established managers,"* according to ***Kenneth Heinz***, President of HFR. Back in April 2020 the industry had fallen below $3 trillion.

For the month, the **HFRI Equity Hedge (Total)** index rose 2.1%, with **Quantitative Directional** the best performing sub-strategy, up 9.2%. This was followed by **Energy/ Basic Materials**, which was up 3.6% as managers profited from sharp rises in crude, heating oil and gas oil. At the other end was **Equity Market Neutral**, with the index down 0.2%.

Macro and **Event Driven** indices were both up 1.3% for the month. **Systematic Diversified** was up 2.5% and **Active Trading** 1.6%. However, FX focused managers struggled, with the sub-index down 4.4%, and **Discretionary Thematic** was down 2.1% as managers found themselves on the wrong-side of the bond market as yield curves flattened. In **Event Driven**, the strongest sub-strategy was **Activist,** with the index up 3.3%, while **Distressed/ Restructuring** was down -0.6%.

Relative Value was more subdued, with the **HFRI Relative Value (Total)** index up 0.7%. **Yield Alternatives** had the strongest month, up 4.1%, followed by **Convertible Arbitrage** up 2.1%.

UPCOMING EVENTS

11 November 2021
HFM Asia Performance Awards 2021

17 November 2021
HFM European Quant Summit 2021

18 November 2021
Impact Investment ESG Banking Conference

1 December
Conversation with Rajeev Misra, SoftBank (LSE)

Click here to see other events in 2021 and 2022

$1.1 trillion

Value of bitcoins in circulation

Source: Blockchain.com

13,015

Total number of crypto currencies

Source: CoinMarket Cap

TESLA SHORTS AT RECORD LOWS

Tesla's path to becoming the first junk rated company to be valued at $1 trillion has proved one of the most painful hedge fund short experiences of all time. Even anti-Tesla stalwarts such as 'Big Short' investor ***Michael Burry*** have closed their short positions.

Tesla's stock is currently trading at around 120 times next year's estimates, yet short interest sits at an all-time low, having once been the most shorted stock on **NASDAQ**.

However, there are a few shorts remaining in place, including legendary short seller ***Jim Chanos*** who told **CNBC** that he maintains his 1% short, believing that Tesla's valuation, which is *"more than the entire rest of the of the global automobile industry combined… just highlights the risk."*

CREDIT SUISSE EXITING PRIME SERVICES

He may only be six months into the top job but **Credit Suisse** CEO ***Antonio Horte-Osario*** is already closing most of its prime broking activities. This follows the bank's multi-billion dollar losses from its exposure to Archegos and is part of a broader restructuring that includes consolidation of the wealth management division.

From the outside many of the changes look far-reaching, but some analysts were underwhelmed, with **Citigroup's** ***Andrew Coombs*** expecting the update to be *"met with mixed reviews."*

NEWS (CONT.)

Bloomberg reports on **Goldman Sachs** data that shows hedge fund exposure to FAANG stocks (or is it ***MAANG*** as **Facebook** becomes **Meta**) is at a two-year low. Perhaps the lustre of such growth stocks over the past few years has started to wane, but there are definite concerns about supply chain disruption. **Business Insider** writes that hedge funds see the supply chain shocks as opportunities to invest both on the long and short side; unsurprisingly managers are closely monitoring *'computer chips to ocean freight'* and other datasets to get their edge on their investments.

ENDOWMENTS PE INVESTMENTS STRIKE GOLD

Yale's $42.3 billion endowment posted staggering returns of 40.2%, net of fees, for their 30 June year end. This compares against an average return of 12.4% over the previous ten years. Similarly, **Dartmouth's** endowment posted returns of around 47%, while **Harvard's** somewhat lagged its peers, albeit with an impressive 34%. According to the **New York Times**, a large part of the endowment performances over the past year has been the result of their private equity investments, with a third of Harvard's portfolio in such investments, which returned 77% in its latest fiscal year. The past year has seen the best returns for endowments since the mid 1980s.

FUNDS PROFIT FROM TRUMP MEDIA & TECH GROUP

US regulatory filings reveal hedge funds that invested in the **Digital World Acquisition Corp (DWAC)** SPAC, including **DE Shaw** and **Highbridge**, have made up to five times their initial investment. This followed news that DWAC is merging with **Trump Media and Technology Group**, a media and technology company that is long on plans for Trump's social media platform and, as things stand, short on substance. Since then, according to **CNBC**, funds including **Saba Capital** and **Lighthouse Investment Partners** have sold their stakes in the SPAC.

In its fourth quarter Strategy Outlook, **Man Group** writes that it currently favours Convertible Arbitrage, believing the 'strategy would be well-placed to perform… [in] an environment of higher market volatility.' They are however more cautious towards structured credit. Man also likes Macro, both Discretionary and Systematic, particularly Commodity strategies with 'some exceptional opportunities in European gas and power in Q4.' They are neutral Equity Long/ Short, believing there are a 'limited number of alpha generation opportunities,' maintain a neutral stance on Credit Long/ Short and has a negative outlook on Distressed.

According to **HFM** news and data, the European hedge fund industry is flourishing. At the end of the first half of this year, regional offshore assets under management stood at $600 billion. This is an increase of 5% for the year and is a record, which is a mix of good performance and investment inflows. The largest strategy in the region continues to be Global Equity, with assets of $117 billion, followed by Macro, with $85 billion. **Man Group** remains the largest manager of offshore assets in Europe, followed in order by **TCI, Marshall Wace, Capula Investment Management** and **Cevian Capital.**

NEWS (CONT.)

TIGER GLOBAL RAISES $9BN

Tiger Global continues to break new records as it soft closed $8.8 billion for its biggest venture fund to date, with employees adding $1.5 billion. According to **Bloomberg**, the manager is targeting a $10 billion close for Tiger's 15th fund, with a second and final close planned for March. Given the firm's reputation for moving fast, inevitably a third of the cash has already been called and invested. The previous fund raised $6.7 billion, which it closed earlier this year.

A16Z SEEKS $6.5 BILLION

Evidence that there is a wall of money sitting on the side-lines, another manager seeking multi-billion dollars is *Andreessen Horowitz's* **a16z**, which is looking to raise $6.5 billion. According to a report in the **Wall Street Journal**, the Silicon Valley venture capital firm is aiming to raise two funds, one for early-stage start-ups and the other in growth companies. This follows the launch of a $2.2 billion crypto fund - their third - in June.

SHELL SHOCK

Royal Dutch Shell has come under attack from **Third Point's** ***Dan Loeb's.***

The activist manager has built a $750 million stake in the firm and is calling for the company to split into two companies, one focused on dirty legacy carbon assets and the other on LNG and transition gas.

Loeb makes the case that Shell's assets are ill-fitting and investors have diverging goals, with *'some shareholders wanting Shell to invest aggressively in renewable energy,'* while *'others want it to prioritise return of capital and enjoy the exposure to legacy oil and gas.'* The letter was sent to Shell's Board just one day before the oil major announced disappointing third quarter results and in the run up to COP26, timing that the **Sunday Times** described as an 'ambush.'

Shell swiftly responded that it had been in preliminary conversations with Third Point and the company will engage with them, adding that they *'welcome open dialogue with all shareholders including Third Point.'*

The CEO, ***Ben van Beurden***, went further when speaking to reporters about the financial results: *"Replacing long-term thoughtful investors for say, hedge funds, is not necessarily a good thing for the energy transition."* He added that Shell has a coherent strategy *"that is very hard to replicate if you split into a number of different companies."*

PROFILE

THE MOUSE THAT ROARS

Describing itself as an impact investing group, **Engine No. 1** has made its mark as an out-and-out US activist. This is what the firm calls *'active ownership.'* The San Francisco business is a new type of hedge manager that is out *'to create long-term value by harnessing the power of capitalism.'*

It is also a firm that revels in its status as an *'underdog.'*

Taking its name from one of the oldest fire stations in San Francisco, Engine No. 1 is certainly not shy and has big plans. They are very adept at using the media to their advantage. In less than a year, Engine No. 1 has come out of nowhere to become one of the best-known names in the sector – in the US not Europe – an impressive achievement with a relatively small amount of assets.

Its most notable action, and what made its name this year, was the campaign for **Exxon Mobil Corporation** to reduce its carbon footprint. With a holding of just $12.5 million in a firm worth around $270 billion, but with the backing of some of the largest institutional investors, it successfully added three of its chosen directors to the oil and gas major's board. Engine No. 1 really has shown that it is the mouse that roared.

Its public facing activities stretch beyond Exxon, when in early October the firm announced that it had taken a stake in **General Motors** (GM). With this news Engine No. 1 revealed that they were backing the car manufacturer's transition to electric vehicles. This sent GM's shares up over 3%.

According to recent filings, the firm has 144 current positions with a

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PROFILE (CONT.)

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valuation of $363 million. It also has the Engine No. 1 Transform 500 ETF, with net assets of $234 million, which invests in 500 of the largest US public stocks. Aligning with its mantra of active ownership, the aim of this ETF is to *'instigate positive change for employees, customers, communities and the environment.'*

Behind Engine No. 1 is Founder and Executive Chairman, **Christopher James**, who is a long-term hedge funder He was the founder of **Partner Fund Manager** and prior to that co-founded **Andor Capital Management**. He is also one of the founders of **Tipping Point Community**, a non-profit organisation fighting poverty in San Francisco. Speaking to **Institutional Investor**, James said he '*wants to take ESG investing to the next level by showing that adhering to its principles is actually good for business – in the long run.'*

The CEO is **Jennifer Grancio**, one of the few women CEOs in this space. Ms. Grancio brings very different experience, having trained as an accountant as PwC and as a founding member of **BlackRock iShares**, where she led European, US and global distribution. Behind the activist side is **Charlie Penner**, who is Head of Active Engagement, who joined from **Jana Partners** where he had a good track record on shareholder activism, and like many of the hardest hitting activists was previously an attorney at **Schulte Roth & Zabel.**

CRYPTO

GREEN LIGHT FOR BITCOIN FUTURES

The biggest story of the past month in crypto was the US launch of a bitcoin futures ETF. This was seen as a milestone in the crypto-currency world, particularly as the **SEC** had sat on dozens of applications and ***Gary Gensler***, SEC chair, talked down such applications. Ultimately, the SEC resisted approving a spot bitcoin ETF and instead favoured the futures fund.

The **ProShares Bitcoin Strategy ETF** started trading on the NYSE on 19 October and became the fastest ETF to attract $1 billion in assets - on the first day alone it stood at $550 million. This now stands at around $1.2 billion.

News of the listing drove the price of bitcoin upwards as it surged through $67,000 for the first time before falling back. Since then, the SEC has made it clear that it is restricting bitcoin related investments to unleveraged exposures only.

The second fund to gain approval was the **Valkyrie Bitcoin Strategy ETF**, which had a more subdued start. There are still plenty of other funds sitting on the side-lines awaiting approval, including **Cathie Wood's ARK 21 Shares Bitcoin Futures Strategy**, **Van Eck** and a dozen others

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CRYPTO CONT.)

VIEWPOINT

With so many big names in alternatives and now large institutional investors investing in digital assets means that the asset class has a place in The Hedge. No longer is crypto the preserve of hipsters, geeky intellectuals and speculators.

Yes, there are red flags from regulators, but there is zero evidence that it is disappearing. China may be able to catch US intelligence unawares with hypersonic missiles but is unable to make a dent on the crypto juggernaut shows that it has staying power. The SEC has said on numerous occasions that it is concerned by the lack of regulation in this space and yet it has given its blessing to bitcoin futures.

Many questions remain unanswered. One of which is volatility of such an asset class. Crypto movements are more akin to exotic currencies that are rarely traded due to their unpredictability. Only last month we were writing about bitcoin surging through $50,000, yet over the past month it has broken $67,000. Can this continue?

How will it stand up to the looming inflationary problem? So far crypto is untested in such a world, with limited data from what has been a low inflationary environment.

Crypto's environmental credentials are still questionable. China may have stopped mining for bitcoins, yet Texas and Kazakhstan have picked up the slack. This is highly relevant today with COP26 still fresh in our memory. How can crypto mining become sustainable?

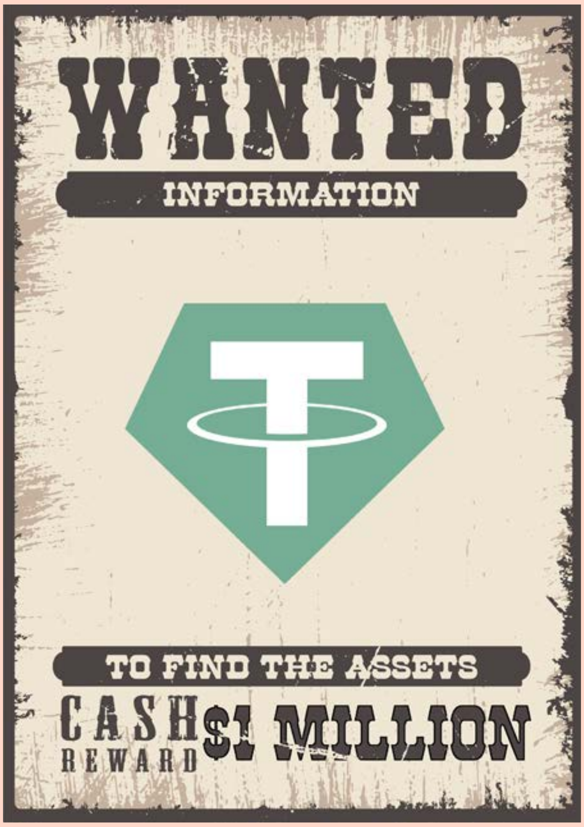
There is always the possibility of a global hack. There are certainly plenty of countries, organisations and individuals trying. We have already seen this around the fringes and individuals disappearing into the ether, supposedly hugely enriched... How secure is crypto?

And finally, how can such a disruptive technology/ asset go about winning over international financial regulators? Nobody owns it, nobody provides guidelines...

Ultimately, whichever direction we take, crypto is at a fascinating point in its evolutionary path.

FLYING HIGH

A manager that has seen its assets soar is **Nickel Digital Asset Management.** This crypto focused fund claims to be *'Europe's leading digital asset manager'* and is run by former **Goldman** investment manager ***Anatoly Crachilov.*** According to **HedgeWeek,** the firm has seen its assets increase by around 260% this year alone to more than $250 million.



TETHER BOUNTY

Hindenburg Research is offering a $1 million bounty for any information related to the **Tether** stablecoin. Describing this as the Hindenburg Tether Bounty Program, the short seller, which has recently been targeting **Nikola** and betting company **DraftKings**, is looking for the reserves that are behind Tether.

In a statement, the manager who has no exposure to Tether, said *'we have doubts about the legitimacy of Tether,'* in particular the nature of the *'unspecified commercial paper'* backing it. Tether responded by calling the move *'cynical'* and a *'pathetic bid for attention.'*

On the subject of Tether, if you have a spare ten minutes, there is a fascinating story by **Bloomberg's *Zeke Faux***, asking if *'anyone [has] seen Tether's Billions?'*

CRYPTO CONT.)

Two of **HFR's** more interesting indices are the **HFR Blockchain Composite Index** and the **HFR Cryptocurrency Index.**

Both have had extraordinary performances and unsurprisingly, given their markets have been particularly volatile, with the former made up of funds that are classified as either blockchain digital currency and/ or distributed ledger technologies, and the latter as the name suggests solely focused on cryptocurrency funds.

Year-to-date the Blockchain Index is up 197% (through end of September) and is up 534% over the previous 12 months. The Cryptocurrency Index's performance has followed a similar path, up 213% year-to-date and 562% over the 12 months.

INSTITUTIONAL HESITANCY

A *survey* recently released by **Vidrio,** the software and data provider, asked institutional investors with total alternative assets of more than $100 billion about their appetite for cryptocurrencies. The results showed investors continue to be hesitant to commit to the asset class, with 50% claiming zero exposure, 17% had between 6% and 10% exposure in their portfolios. Although 33% had no exposure, this group of investors said they were looking at it as a potential investment option.

US PENSION WATERSHED

The **Houston Firefighters Relief and Retirement Fund** (HFRRF) has broken new ground in US public pensions, with a $25 million investment of its $5.5 billion of assets into bitcoin and ether. This was executed through **NYDIG** and was the first public pension fund to take such a step, which has been described as a watershed moment in the US institutional space. According to HFRRF's Chief Investment Officer, ***Ajit Singh***, this *'expresses our belief in the disruptive potential of distributed ledger technology for the development and democratisation of value accumulation through disintermediation.'*

FALLING VOLUMES

In its recently released third quarter earnings, **Robinhood** revealed a particularly sharp decline in crypto activities by its clients. In the previous quarter, crypto revenues were responsible for a record $233 million, but only $51 million in the third, a drop of 78%. Robinhood was also impacted by a fall in meme stock volumes. Total revenue was $365 million, down from $565 million the previous quarter. This drop was described by **Forbes** as a *'huge earnings miss'* that saw the shares falling below the IPO price.

MINING TURNS TO US

While not wholly relevant to our alternative world, although I think interesting, is a crypto index I came across. This is the **Cambridge Bitcoin Electricity Consumption Index** (CBECI), which is a product from the **Digital Assets Programme** (DAP) team at the **Cambridge Central for Alternative Finance.** In a nutshell it is a unique index of global crypto mining activities.

By aggregating IP addresses of global bitcoin mining facility operators, the team have built a global bitcoin index. This show that China, from having been the dominant bitcoin miner, is now conducting no mining. Perhaps not fool-proof, given the assumption that IP addresses are accurate geographical indicators – apparently, I am based in Slough – it does show that China's crackdown on mining operations has been working.

Looking at the most recent data, which can be seen *here*, the bulk of mining activities are now conducted in the US and Kazakhstan. The ***Sunday Times*** also picked this up and narrowed down activities to Texas, where energy is cheap, writing that the *'state has been flooded with Chinese bitcoin miners and a flurry of new investments in new mines.'*

GUEST ARTICLES

THE BUZZWORD IS CRYPTO

Nilesh Jethwa, Chief Executive Officer, Marex Solutions

The really big change of 2021 has been the accelerated interest from institutional clients in crypto investments and decentralised finance (DeFi). These have become the buzzwords throughout the investor community.

Investors, from hedge funds to pension funds, are looking for crypto exposure, but are coming up against a new set of hoops to jump through. There are far more complexities involved in this asset class, compared to more traditional assets.

Our role is to make it easier for investors to invest in crypto. We like to see ourselves as being at the head of the curve on this – in 2018, we traded the first structured product transacted and custodied using blockchain and this year we traded the first bitcoin auto callable.

> “Investors, from hedge funds to pension funds, are looking for crypto exposure, but are coming up against a new set of hoops to jump through.
>
> *Nilesh Jethwa, CEO, Marex Solutions*

Crypto is a completely new asset class but in only a few years has become a mainstream asset class. However, what investors are finding is that the toolbox is rather bare, with few tools to use. At Marex Solutions, our expertise is focused on structuring investments, which is knowledge that we put to good use in the world of crypto.

We make it easier to express a view, be it in equities, foreign exchange, commodities and now crypto currencies. Our role is to create customised derivative solutions that suit the particular needs of an investor.

If you are a pension fund or a family office that is looking to participate in crypto, the chances are you do not have the specialist knowledge. From where we sit, we bridge the traditional with the new.

In traditional asset classes, when things go wrong there are traditional remedies and big brand counterparties. But in the crypto universe, there are heightened concerns, quite rightly about type of investment, custody, etc.

Our job is to deliver an effective solution that works for the investor, wrap it in an ISIN and custody through an institutional custodian.

Through our proprietary technology we are monitoring all price derivatives. What is clear from what we are seeing is that crypto underlyings have accelerated in popularity faster than any other investment. The interest has gone through the roof. Investors see this as the most effective way to diversify their portfolio exposure.

Every single meeting that we have, from Europe to North America, the conversation always turns to inflationary or stagflationary concerns. How to get yield and how to protect a portfolio. This is where crypto sits, for it is viewed as an alternative to gold as a store of value.

As things stand, there are two stories. The first are those investors who want to allocate assets to crypto, most likely bitcoin. This is seen as an alternative investment that will help avoid inflationary pressures. The second is DeFi, which is viewed by many as the next big thing. Some investors believe that this will have the same impact as the Internet when it arrived in the ‘90s and undoubtedly it will change global finance. But it is a competitive world and there will be a number of potential winners and losers. Given this question we are creating a product that tracks a selection of decentralised assets.

To borrow a line from **Tyler Winklevoss** that bitcoin is digital gold and ether is oil is a view I firmly believe in. Bitcoin like gold is limited in supply - to 21 million coins - and Ethereum fuels the digital protocol. They both have reasons for being and investors understand this. In a world of inflationary concerns, these are strong arguments for continued investment.

As I see it, the trend for the next year is likely to be more requirements from the investor community for yield enhancement products, increasingly with crypto underlyings. These are interesting times.

GUEST ARTICLES (CONT.)

BITCOIN FUTURES ETF'S A (MODEST) STEP FORWARD

Louis LaValle, Managing Director, Co-Head of Distribution, 3iQ Digital Assets (US)

Exchange Traded Funds (ETFs) have proved themselves to be great investment wrappers. These vehicles have made it easy for investors to buy and sell all types of assets – they trade on public exchanges, are offered on many of the brokerage platforms and provide buyers and sellers intraday liquidity. Why go through the process of owning and rebalancing every stock in the S&P 500 when you can own the ETF that tracks in real time?

Bitcoin is classified as a commodity in the US under the Commodity Exchange Act. Even though it's a digital asset with little resemblance to traditional commodities (gold, silver, oil, sugar, etc.) there is a still a process to owning physical bitcoin. It involves making a direct purchase from a crypto exchange (eg, Coinbase, Gemini, Binance, etc.) and then storing bitcoin in a wallet either on the exchange (hot) or offline (cold). Security is important. Special attention must be paid to storing of private keys and seed phrases. Two-factor authentication setup is a must. So yes, there is operational friction, however, it is much easier buying and storing bitcoin versus other commodities like bricks of gold or barrels of oil. That said, certain investors believe an ETF wrapper is a superior way to access bitcoin.

Louis LaValle, Managing Director, Co-Head Distribution, 3iQ Digital Assets (US)

Physical bitcoin exchange listed products are not a new phenomenon in markets like Europe and Canada; however, it has been an eight-year battle getting an exchange listed bitcoin product approved in the United States. On 19 October the US debuted the first futures-based bitcoin ETF. This was a big step forward for US investors. But there are key differences in purchasing bitcoin in the spot markets (eg, Coinbase, Gemini, Binance, etc.) versus owning an ETF holding bitcoin futures contracts.

One key difference is that bitcoin futures are derivatives of bitcoin and do not always track the price of spot bitcoin consistently. The basis for bitcoin, or the difference between the spot price and the futures contract price, is unique to the derivatives market given the term structure of futures contracts. The bitcoin futures basis typically (but not always) trades at a premium, or in 'contango' – meaning future prices are higher than the current spot price. To maintain exposure each month, as front month contracts expire, bitcoin futures ETFs 'roll' into new futures contracts at a higher price than spot bitcoin. Each time this happens buy-and-hold investors lose a small amount of money. In the short term, the effects are mild. But if futures remain in a state of contango for extended periods of time the additional 'roll cost' can add up and have a meaningful impact on returns. For example, the Horizons Bitcoin Front Month Rolling Futures Index trailed spot bitcoin by ~36% over the last 12-months and ~92% over the last 24-months (as of 9/30/2021). That's a meaningful price discrepancy that is hard to ignore.

This anomaly does present potential unique trading opportunities for hedge funds and institutional investors, though. One example is 'cash and carry.' With physical bitcoin ETFs available in Canada and futures-based bitcoin ETFs available in the US, traders and market neutral hedge funds can execute cash and carry arbitrage by going long spot bitcoin ETFs while simultaneously shorting bitcoin futures ETFs to lock in the basis.

Bitcoin futures ETFs also provide traders with new ways to speculate on bitcoin volatility – option trading is available making it easier to lever up a bitcoin position, which until now was available only through crypto trading platforms or the CME. Both venues have restrictions around suitability and minimum margin requirements making access to leverage difficult.

It's still unclear whether a futures-based bitcoin ETF will be a watershed moment for the digital asset space. The new bitcoin futures ETFs do, however, potentially represent more trade opportunities for hedge funds and institutional investors. And more importantly, a positive (but modest) move toward broader adoption.

GUEST ARTICLES (CONT.)

ANCHORING CRYPTO INVESTMENT STRATEGIES WITH CAPABLE PARTNERS

Vincent Molino, Head of Risk Management Solutions, Northern Trust Front Office Solutions

Crypto assets have made their way into the mainstream, and the institutional investing space has noticed. Crypto hedge funds are seeing increased interest from investors and growing AUM as a result. According to PwC, the average crypto hedge fund grew AUM from US$12.8 million in 2019 to US$42.8 million in 2020,* with 2021 likely surpassing those numbers by a significant amount.

Now, the industry's embrace has gone beyond crypto currency funds. Some institutional investors are not just investing in token or coin funds, but investing in new financial instruments, such as ETFs and futures, and seeding new strategies in anticipation of growth and returns. With emerging examples of blockchain enabled assets recently entering the space, like non-fungible tokens (NFTs), new funds are cropping up which also invest in digital collectibles.

Crypto asset acceptance may be growing, but in many ways the space is still uncharted territory. For investment managers and institutional investors who are ready to participate in a risk-managed way, they should consider a few operational factors:

- **Custody** – Institutional crypto market participants will need an option for holding these non-traditional assets in custody. Investment managers should seek a reputable third-party custodian with the necessary infrastructure and expertise to handle this need. As crypto strategies continue to gain interest, investors will likely seek to hold digital assets with a capable custodian rather than maintain self-custody, both from a record keeping and security perspective.
- **Reporting** – Those managers and investors who are new to the crypto investment space will likely need detailed and transparent views into performance, risk and liquidity. Working with a partner to assist in custom reporting can help build a solid foundation for portfolio management through capable technology.
- **Regulation** – As crypto strategies continue to grow in prominence, new regulatory frameworks are sure to arise across the globe. Managers and institutional investors planning to adopt crypto strategies for their portfolios should pursue a relationship with a partner who tracks emerging regulation and provides tools to better position an organization for such investment.

Developments in the crypto space are presenting significant innovation and change. However, for institutional-grade investing through hedge funds or interest in direct participation, the right operational components should be in place before and after a decision is made to invest.

*PwC, 3rd Annual Global Crypto Hedge Fund Report 2021, May 2021

Vincent Molino, Head of Risk Management Solutions, Northern Trust Front Office Solutions

> "Some institutional investors are not just investing in token or coin funds, but investing in new financial instruments, such as ETFs and futures, and seeding new strategies in anticipation of growth and returns.

MARKETING — Presented by brodie consulting group

RESPONDING TO AN ACTIVIST CAMPAIGN

It is always interesting to see how a company reacts to aggressive activist investor approaches, ***Alastair Crabbe*** writes.

The immediate *'gut'* reaction from the executive team is to call an activist *"opportunistic"* and *"short-termist,"* without offering anything of substance. That invariably means round one goes to the activist.

Activists spend months and sometimes years poring through every element of a company's balance sheet and annual reports, working and developing through multiple scenario analysis. This is all they do - they cannot afford a misplaced assumption, or an incorrect zero, so they make absolutely certain that the numbers stack-up when they go public.

Activists also get to choose their timings for going public – **Third Point** chose the day before **Royal Dutch Shell** announced disappointing Q3 numbers, not the quietest day in the investor calendar, particularly when the numbers fell short.

The demands the activist sets out will make sense, or certainly should, on paper - generally disappointing performance and underwhelming, incoherent or incorrect strategy - but whether the route they put forward is right for the company is an important question that at this stage is unanswered.

Unfortunately for any company under fire from activists, journalists love these types of campaigns. They also tend to be long and often dirty.

Consequently, a journalist will rarely turn away a call from an activist or their representative. Activist campaigns are an open door to write easy stories. You saw this with **GSK**, firstly with **Elliott's** letter and then the far smaller activist **Bluebell**, all of which generated huge quantities of coverage.

In the face of such public onslaught, a company is damned if they complain about the approach and they are damned if they stand back and ignore it.

To take an aggressive and personal approach, such as calling activists *"locusts"* makes it personal, which looks bitter and adds nothing. This is one of the main reasons that the **Deutsche Börse** CEO ***Werner Seifert*** was successfully removed by ***TCI*** in 2005 – he even wrote a book called *'Invasion of the Locusts.'* I remember it well, DB was one of my clients.

Ultimately a company has a duty to respond. You must be seen to be actively engaging with an investor, rather than shying away. This is the right course of action. The target company will naturally not agree with what it is laid out, or at least most of what is set out, but that is understandable.

Shell's immediate response to Third Point was sensible to say that they welcome *'open dialogue'* with investors and there have already been discussions.

Further down the line, there does need to be a more measured and substantive response, relating to the firm's strategy. This should set out why the proposal doesn't work and where potentially there is agreement. It is about getting in front of the activist's strategy and to be simple to understand and robust enough to stand up to scrutiny, as well as make sense of the existing strategy and position of the company.

However, to offer a line-by-line rebuttal is a route to self destruction, for it just adds paragraphs, not always complimentary, to the press coverage.

A public company has a responsibility to be prepared for such a campaign. The IR team should, as a matter of course, be closely monitoring the shareholder register - Third Point's Shell holding is, according to reports, $750 million, so you would certainly hope there was no surprise. Public campaigns also rarely come completely out of left field, with most activists seeking some level of backdoor engagement beforehand.

For a company to sit back and offer nothing is raising the white flag in the eyes of the investor. The CEO's heart may sink when they receive the letter, but they must acknowledge the approach, respond and build the rebuttal.

REGULATION

Presented by RQC GROUP

OVERVIEW

In advance of the **'COP26'** climate summit, and in the month during which **The Guardian** newspaper named ***Jamie Dimon*** of **JP Morgan** and ***Larry Fink*** of **BlackRock** among *'America's top climate villains'*, and **KPMG** posed the question *'Can capital markets save the planet?'*, there were a few ESG-related updates from the UK and US regulators.

CLIMATE FINANCIAL RISK FORUM GUIDES

The **Climate Financial Risk Forum** (the 'Forum'), which is chaired jointly by UK regulators the **Prudential Regulation Authority** and the **Financial Conduct Authority**, has published the *second round of its industry guides*. These guides aim to assist financial services firms to manage their climate-related financial risks. There is a specific focus on risk management, scenario analysis, disclosure, innovation and climate data/ metrics.

SEC AND CLIMATE DISCLOSURE REGULATION

In the US, the *'tone from the top'* on climate change has shifted markedly in 2021, at least in terms of rhetoric from the President. The **SEC** also appears to be actively engaged on this topic. Most recently ***Allison Herren Lee***, a Commissioner at the SEC, has advocated a consistent approach to climate-related disclosure.

The remarks were made on a webcast hosted by Principles for Responsible Investment and the London Stock Exchange Group.

A number of ESG or climate-specific disclosure regimes have been, or are in the process of being, implemented. These include the **EU Sustainable Finance Disclosure Regime**, which took effect in March 2021, and the UK's upcoming climate disclosure framework for market participants.

It is expected that the SEC will propose its climate-related disclosure requirements in late-2021 or early-2022.

There remains the risk that a plethora of disclosure requirements will be overly burdensome on global market participants, including asset managers that might be required to make disclosures in – for instance - fund offering documentation, legal contracts, websites and/or client/investor reports.

CLIMATE CHANGE ADAPTION REPORTS

The UK financial services regulators, and the **Financial Reporting Council**, have issued a *joint statement* on the publication of **Climate Change Adaption Reports.**

These reports are published by the **Financial Conduct Authority, the Prudential Regulation Authority** and **The Pensions Regulator.**

The FCA's report sets out its strategic approach to climate change, and how the financial services industry and listed companies are tackling this issuing effective price formation in the markets and the efficient allocation of capital.

Among other initiatives, the report reiterates the UK's intention to introduce a climate-related disclosure framework for market participants that are aligned to the recommendations of the **Task Force on Climate-Related Financial Disclosures** ('TCFD'). The UK government claims that on 6 April 2022, the UK will become the first G20 country to introduce mandatory legal requirements for the largest companies, banks and insurers (over 1,300 companies in total). Disclosure requirements for other financial institutions, including assets managers, will follow.

REGULATION (CONT.)

FCA FINALISES RULES FOR A NEW TYPE OF FUND DESIGNED TO INVEST EFFICIENTLY IN LONG-TERM ASSETS

The **FCA** has *confirmed* that it will be taking forward proposals to create a new type of open-ended authorised investment fund which will help support investment in assets like infrastructure and private equity. Investment in these assets has the potential to generate better returns for investors, including those saving for retirement in defined contribution (DC) pension schemes, can also benefit the wider economy by supporting the economic recovery from Covid-19 and supporting financial stability.

Currently, some investors are unable, or unwilling, to invest in long-term assets, even though these assets could meet their investment goals.

The new rules create a **Long-Term Asset Fund** (LTAF) regime, a new FCA regulated fund that is designed specifically to help investment in assets including venture capital, private equity, private debt, real estate and infrastructure.

As investments in this type of fund may take longer to sell, the FCA has put in place rules to ensure there is a consistency between how long it will take to sell assets and how often and quickly an investor will be able to sell out of the fund.

The LTAF is aimed at DC pension schemes which may be interested in investing, in line with their investment horizons and risk appetite. It also offers long-term investment opportunities to sophisticated investors and some high-net-worth individuals.

The FCA will be consulting next year on the potential for widening the distribution of the LTAF to certain retail investors.

IFPR – FINAL RULES PUBLISHED

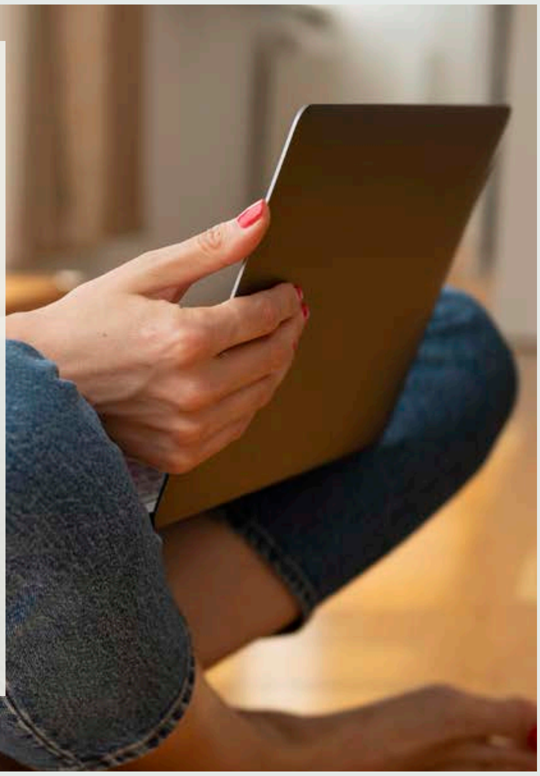
The **FCA** has *published a majority of the final rules* with respect to the **Investment Firms Prudential Regime** which takes effect in the UK on 1 January 2022.

These final rules cover a variety of topics including: own funds and the own funds requirement; the liquid assets requirement; consolidation and the group capital test; governance arrangements and the **ICARA**; concentration risk; FCA reporting; and remuneration.

The final rules regarding public disclosure requirements have yet to be published. The FCA advises that these will be published before the end of 2021.

Affected firms include **MiFID** investment firms and full-scope **AIFM**s with 'top-up' permissions (**CPMI** firms).

REGULATION (CONT.)



REMOTE OR HYBRID WORKING EXPECTATIONS

The **FCA** has *set out its expectations* for firms that are planning to work remotely over the longer-term.

Among other things, the FCA advises that remote working should not affect the firm's location in the UK, prevent the FCA from receiving information about a firm, impact the ability of a firm to oversee its functions or increase the risk of financial crime.

Firms are also advised of the requirement to inform the FCA of any material changes to working arrangements.

Finally, firms should consider the location of their principal place of business, which might be a residential address. In this regard, the FCA asserts that it has powers to visit any location where work ais performed, business is carried out and employees are based (including residential addresses) for any regulatory purposes and that employees should fully understand this.

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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 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.

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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