

# FRM Early View - September 2015

Stockholm (HedgeNordic) - The HFRX Global Hedge Fund Index fell -2.07% in September, pushing the index further into negative territory at -3.05% for the year-to-date 2015. After a fall of -0.13% recorded in the first half of the month (September 16), hedge funds' negative performance accelerated into the month-end. All four main strategy buckets posted negative performance during the month amid further weakness in global equities markets and commodities prices, while the VIX remained elevated from the subdued levels observed in the first-half of 2015.

Event Driven strategies endured the biggest losses with the HFRX Event Driven Index recording negative performance of -3.24% for the month. Equity Long-Short strategies were the next biggest detractor. Small gains ahead of the FOMC meeting at mid-month reversed into negative performance after the Fed delayed raising rates. Discretionary Macro strategies were more mixed, with long USD positions against G3 currencies a negative, while those with more concentration in Asia currencies ended the month with gains. For more systematic strategies September provided gains in Commodities and Fixed Income.

A key event in September for Discretionary Macro strategies was the collapse in swap spreads with the 10-year spread dipping below zero late in the month for the first time in three years. Other durations, both shorter and longer, also traded at negative spreads during the month. Macro managers that were long swap spreads as a hedge or proxy for long volatility lost performance on the move. The fact that a risk asset trades at a negative yield to risk-free US treasuries reflects both post credit crunch regulatory change, but also large-scale selling of Treasuries and surging corporate bond issuance.

Managed Futures offered a welcome respite from losses in most other sub-strategies, exploiting trends in Fixed Income and Commodities. In Fixed Income, gains came from long positions both at the front and the back end of the curve across developed markets. Within Commodities, the main driver continued to be shorts in energy, with shorts in livestock and softs also contributing. Precious metals, however, were net detractors. With long exposure being cut (and in some cases becoming net short) after the strong market reversal in August, the performance in equity futures was broadly flat. The outcome in FX was similar with no major winners or losers.

Among Emerging Markets, the outstanding feature of the month was the deterioration of Brazil across FX, credit and equities. The USD broke through 4 BRL late in the month, while the Bovespa and key credit benchmarks continued to chart lower. The currency move was generally positive for macro managers who were largely bearish already. However, for Emerging Market equity players, which generally operate with a long bias in the region, the continued equity market slide hurt performance. In China, the settling of the SHComp above 3,000 brought a welcome pause to the market volatility, although that is likely to have given only a partial recovery to the many managers that lost performance in the summer downturn.

US Equity Long-Short managers were buffeted by uncertainty around the Fed's deliberations leading into the September 17 FOMC meeting. Hedging by managers helped to reduce much of the negative fallout that swept through both US and global equity markets following the decision not to raise rates. Managers that were net long in biotech and healthcare suffered negative performance after price control proposals were aired. This led to negative performance for a number of prominent hedge funds. Breaks in a couple of major M&A deals (in addition to hurting Event managers) fed broader de-gearing across equities, and thus had a negative impact across the Equity Long Short space. A few managers were sufficiently nimble to generate performance out of a short period in late

September when value stocks briefly outperformed growth.

In Event Driven, managers trading on softer catalysts generated substantial negative performance, particularly those with exposure to biotech and healthcare – a key theme for a good number. Strategies focused on short term hard catalysts outperformed as spreads on several large deals tightened. Portfolio hedges were again among the top performance drivers. Despite the difficulty many managers face in generating performance, M&A remains vibrant with activity volume for September hitting \$300bn, not including the proposed \$100bn-plus bid by Anheuser-Busch for SABMiller.

In Europe, Equity Long-Short managers once again generated solid alpha with many reporting positive returns. This came as European equity markets fell about 5% during September as sentiment softened on the growth outlook for China and negative reaction to the dovish outcome of the FOMC meeting. Losses from large cap stocks specifically in a German automotive manufacturer and a multinational commodity and mining company hurt performance. In general, however, the thematic behavior of markets continued from August with materials, luxury goods and industrials exposed to China underperforming, while defensives and domestic/developed market growth stocks outperformed. As a result, European equities markets continue to exhibit strong stock and sector-level momentum, which tends to bode well for hedge fund strategies. Data supports managers' bullish outlook for European stocks, although the most favored plays haven't fallen as much as the market.

Turning to Statistical Arbitrage, initial indications show that September appears to have been a reasonable month. We await details on technical strategies, but there do not appear to be big profit and loss swings, whereas early indications suggest that factor-driven strategies have done well. Overall, the US looks set to be the strongest region, followed by Europe which was very volatile and, lastly, Asia which was a net detractor. In general, outside Asia, momentum themes did well and valuation themes fared poorly. However, the reverse was true in Asia and Japan.

In common with most risk assets, September was generally a negative month for credit amid negative sentiment about growth prospects in the wake of the Fed staying its hand. Emerging market credit was weak, too, as the S&P downgraded Brazil to junk. In US corporate credit, widening high yield spreads extended beyond energy and the metals/mining sectors to include broadcasting, cable and satellite operators, chemicals and telecom providers. But unlike in July and August, the performance of corporate credit markets in Europe was worse than in the US. The investment grade and leveraged loan markets in both the US and Europe outperformed high yield, benefitting from the rally in rates. Corporate credit focused managers (in Credit Long-Short and Credit Value/Distressed) were resilient in September, but, overall, returns were mixed. Some managers lost performance on long exposure to commodity-related sectors as well as solar, cable and media in the US. Small positive drivers included hedged commodity company trades (long senior debt; short equity) and positive news on Puerto Rico's debt restructuring. Meanwhile, structured credit managers generated positive returns as mark-to-market losses were offset by carry and gains from hedges.

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