

# Implications for Hedge Funds After the Fed Lift-Off

For the first time in almost a decade, the Fed has finally hiked rates as the FOMC decided that the US growth/ inflation mix was robust enough to absorb monetary tightening. Over the next twelve months, three to four additional rate hikes of 25 bps are on the cards (p. 2).

As we head into 2016, investors are left wondering what will be the wider market implications of these moves. While the new monetary stance is backed by strong US economic data, investors will need to keep in mind that liquidity tightening is a headwind for risk assets such as US equities and High Yield credit. We believe that the market sentiment in 2016 is likely to rotate between exuberance and depression swiftly. Over the last six months the investment horizon has shortened considerably and this is likely to continue. In a nutshell: be tactical.

Long term investors are likely to struggle in such an environment and the value proposal of hedge funds makes greater sense in this context. In a recent publication (A New Era for Hedge Funds) we highlighted that monetary policy tightening in the US should translate into an outperformance of hedge funds versus traditional assets. With little market beta to capture from now on across the asset classes, alpha generation will be key. Selecting the right strategy and the best manager within each strategy is likely to ensure attractive risk adjusted returns amidst volatile conditions.

In terms of hedge fund strategies following the Fed lift-off we favor Global Macro, and to a lesser extent CTAs, for their diversification properties. Both tend to outperform when the volatility regime is higher. In the L/S Equity space, we suggest managers who have limited directionality. We err on the side of caution with Event-Driven managers who are active in the distressed and high yield space (i.e. preference is with Merger Arbitrage over Special Situations). It is likely that the sharp widening in HY spreads over recent weeks is an indication of how market conditions will prevail in this segment during 2016. Finally, we prefer Fixed Income Arb. to L/S Credit. We are however more concerned about US L/S Credit than European L/S Credit.

For Lyxors entire report, please follow this link: [Implications for Hedge Funds After the Fed Lift-Off](#)

*Picture: (c) olegator—shutterstock.com*