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2018: The Year of Hedge Funds and Alternative Equity

The Hedge Fund industry is doing better than investors typically think, either due to performances or net inflows. The Alternative Equity strategy in particular is getting plenty of attention.



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Many investors are surprised that the Hedge Fund industry's assets under management are at an all-time high of \$3.2 Trn. Despite many critics, the industry has grown continuously since 2008. In 2017, Hedge Funds gained 8.6 percent according to Hedge Fund Research. The best performing strategy was Long/Short Equity, which was helped by the equity market rally, low stock correlation and alpha being produced on both the Long and Short sides. The best Funds-of-Hedge-Funds in Long/Short Equity were up more than 11 percent last year. It is thus not surprising that Hedge Fund allocations are, on average, on the rise, at the expense of Long-only Equity and Fixed Income. Typically, recommendations range between a few percent to over 20 percent for Family Offices, Endowments and Independent Asset Managers. Interestingly, about half of these allocations are to Long/Short Equity.

Alternative Equity

With Long/Short Equity as the most sought-after strategy, many allocations are to managers that have a sector focus

such as Healthcare, TMT or Consumer. These are typically fundamental managers with a bottom-up approach to stock selection and portfolio construction: in other words, they are stock pickers rather than traders, with a time horizon of 12 to 18 months. While this investment approach may seem simple, it is not easy to master. Careful talent selection allows you to find managers who can consistently capture equity-market upside while limiting the downside (an asymmetric return profile), such as during the recent market pull-back in the second week of February or the more significant drawdowns in 2008 or in 2002. However, only disciplined manager selection enables you to have a return stream that is primarily alpha-driven, as opposed to returns coming from beta and/or leverage. The very best managers posted returns greater than 15 percent last year and compounded about 15 percent for the last decade but with only half of the market risk!

A Great Environment for Stock Picking

Fundamentals and flows have rarely been so positive at the same time for the Long/Short Equity strategy. Given last year's strong performances, we can expect continued flows into the strategy. In addition, the Goldilocks scenario (with good growth and sentiment, and inflation being contained) seems to be prevailing in developed markets. Specific opportunities abound in major sectors such as TMT: e-commerce growth, online advertising spending, electric vehicle, new markets being driven by home assistants, and artificial intelligence, to name a few. On the other hand, while federal

funds rate increases in the US are a market positive for now, that will change at some point. Until then, managers are still able to find plenty of Short opportunities, either with company specific problems (e.g. Steinhoff which lost -68 percent in December 2017 due to accounting issues) or with secular themes such as retail disruption due to e-commerce (e.g. Vitamin Shoppe fell -81 percent in 2017).

So, what's your «Alternative Equity» allocation for 2018?



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