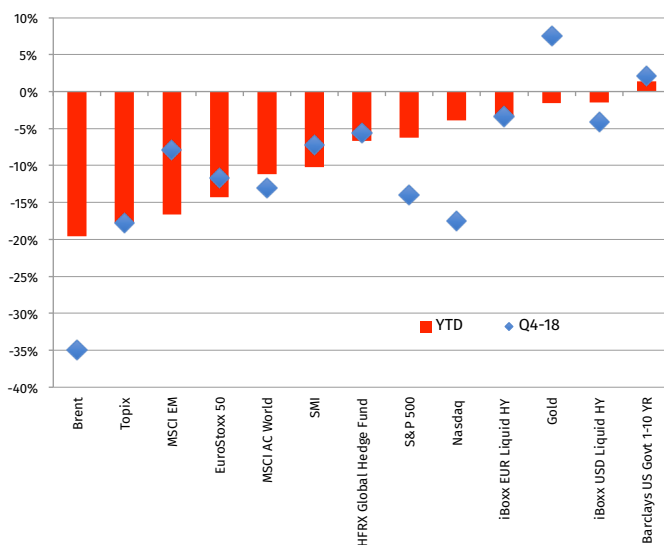


THE ALTERNATIVE CAUSERIE

2018 MARKET REVIEW

2018 turned out to be a very difficult trading environment with almost all asset classes ending the year in negative territory. Up until September markets were trading positively albeit with some volatility. However, the last quarter was very painful for equity markets with global indices posting their worst returns since 2008 and the Dow index had the worst record for the month of December since the great depression (1931). The sell-off was buoyed by a combination of fears of slowing global growth centred on China and rising inflationary pressures in the U.S., U.S. trade policy, Italian budget challenge, and tough Brexit negotiations. Moreover, economic conditions were showing some sign of slowdown and corporate results didn't keep up the double-digit earnings growth pace seen at the start of the year. The "Santa rally" never came and left financial markets in a perfect storm with few places to hide.

Performance of main global indices in Q4 2018 and full-year 2018



Source: Bloomberg

Hedge Funds performance didn't live up to expectations if looked through the HFRX indices. End-year results were lacklustre depending on the underlying hedge fund strategy.

In relation to the long bias strategies, Equity Hedge and Event Driven managers were the most disappointing, as the majority of them were unable to protect capital in the downturn and generate alpha. Even if the selloff was quite brutal and swift, managers were caught off-guard underestimating the economic downturn and readjusting not

HFRX Index	Q4-18	YTD
Global Hedge Fund	-5.6%	-6.7%
Equity Hedge Index	-8.6%	-9.4%
Equity Market Neutral	-2.7%	-3.2%
Event Driven	-6.5%	-11.7%
Macro/CTA	-2.1%	-3.3%
RV Multi-Strategy	-3.9%	-1.2%
Fixed Income Credit	-3.0%	-2.6%

Source : HFR and Bloomberg

fast enough their exposures, as they were blinded by strong company fundamentals and companies long-term growth prospects. The HFRX Global Hedge Fund index ended the year with a -6.7% loss, its worst performance since 2011. Event Driven Managers (HFRX Event Driven) led the way with a -11.7% return for the year, followed by Equity hedge managers (HFRX Equity Hedge) returning -9.4%. Other hedge fund strategies fared better but were still negative for the year such as Global Macro Managers (HFRX Macro/CTA) down -3.3% and Equity Market Neutral managers losing -3.2%.

Actively managed FoHF portfolios have posted stronger results than HFRX Hedge Fund indices, which supports the importance of having an actively managed portfolio of hedge funds that will move around allocations through strategies and manager selection depending on the market environment. There are more than 15'000 hedge funds across numerous strategies representing more than \$3 trillion in assets, which make the due diligence, screening, sourcing and monitoring an important part of investing in hedge funds.

HEDGE FUNDS: OUTLOOK FOR 2019

The weak performance of some strategies and hedge fund managers will again put more pressure on the industry where shutdowns and wind downs should continue in 2019. Moreover, the amplitude of the market volatility in 2018 will increase the divergence of returns between managers in similar strategies and underperformers will have a tough time to keep their assets while getting back to their high-water mark. It will not be surprising to see other high-profile hedge funds turning their business into a family office due to high investor redemptions or more sadly closing down. However, we think that having a hedge fund allocation in a global portfolio is important as it has the potential to generate strong risk-adjusted returns, add diversification and reduce portfolio volatility overall.

STRATEGY	FORECAST
Multi-Strategy	
Global Macro	
CTA/Managed Futures	
L/S Equity	
Event Driven	
Fixed Income & Credit	

We expect to see further consolidation in the industry with a shift towards less directional strategies (less beta and uncorrelated strategies). Equity hedge fund managers will need markets to trade more on fundamentals in order to prove their skills and post better returns, which should normally be the case as we move from quantitative easing to quantitative tightening, slower corporate growth earnings and higher interest rates. Event driven managers with a tilt towards merger arbitrage should continue to do well as M&A is still on the forefront in healthcare and technology sectors. Distressed managers should soon be able to find interesting opportunities as companies' financials may start to deteriorate and default rates should creep higher. Macro managers should benefit from fluctuations around interest rates and currencies in a state of market disequilibrium. CTA/Managed futures strategies should continue to perform as they are constantly looking at new set of broader data (big data) to extract alpha and incorporating machine-learning techniques in their models. Credit managers will need to be nimble in finding relative value opportunities in a changing environment where companies have re-leveraged and will need to refinance at higher rates.

The hedge fund industry should benefit from the change and normalization of monetary policies with central banks being less supportive of all assets and having more guidance around the path of future interest rates. This should lead to the differentiation across assets as investors are starting to

focus more on fundamental investing. The uptrend in interest rates, currency fluctuations and greater price dispersion across securities should be a fertile playground for hedge fund managers in the coming years.

RISKS

2019 will see a continuation of the market volatility as investors are repositioning their portfolios in sight of a global economic slowdown coupled with monetary tightening by several central banks and commercial trade war. The economic growth will be less homogeneous between countries and the country-specific political risk will continue with growing populist and protest movements. A hard landing in China and uncertainties around Brexit carry a meaningful risk as well as geopolitical risks continuation, notably in Ukraine, Iran, Mexico and Middle East. Corporate results could entail some sort of softening and downward adjustments, but should still grow positively.

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