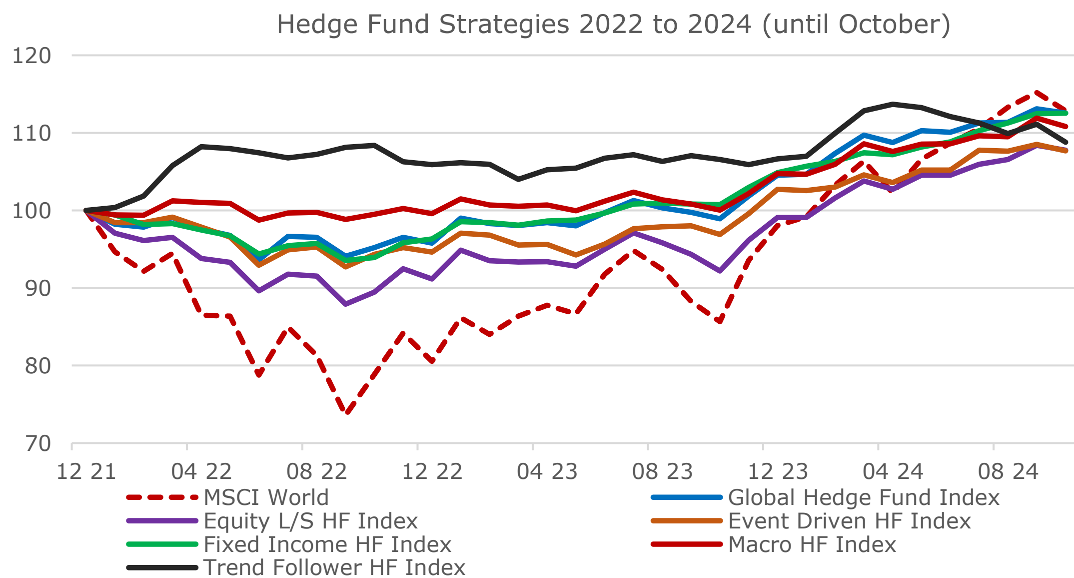
Hedge Funds Review & Outlook

1 Hedge Funds Review 2024

By October 2024, the broad hedge fund index had risen by +7.7% (Eurekahedge Hedge Fund Index), while traditional asset classes such as equities were up +17.0% (MSCI World), investment grade bonds by +0.1% (Bloomberg Global-Aggregate TR Index Value Unhedged) and high yield bonds by +7.8% (ICE BofA Global High Yield). All main strategies benefited from the generally positive market environment. Even in the months with negative equity markets, the hedge funds held their ground with a low market beta (~24), while over the year as a whole the hedge funds participated in the upward trend with around ~45%.

Chart I - Hedge Fund Strategies (Data until October 2024)



Source: Alpinum IM, Eurekahedge

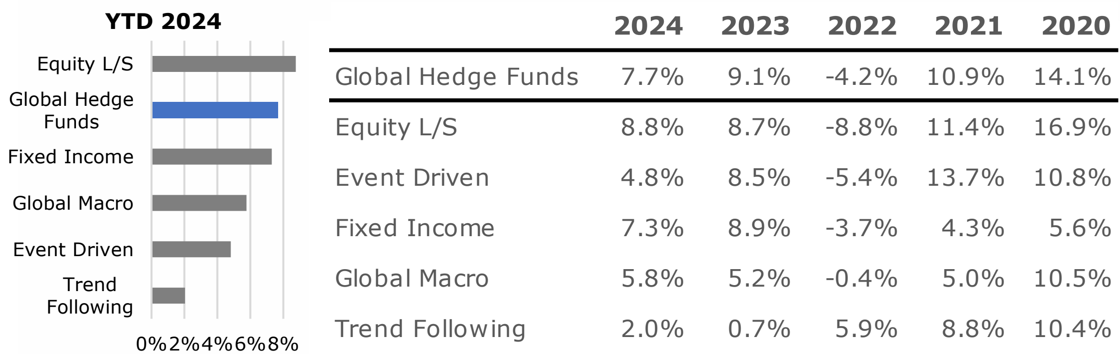
On the strategy side, a clear picture emerged in 2024, with equity long-short managers (+8.8%) and credit managers (+7.3%) showing the strongest performance of the main strategies. Equity long-short managers benefited on the one hand from

the positive market environment and the average net 'long' exposure (~45%), and on the other hand from a slight normalisation of the lack of market depth that prevailed in 2023 (centred performance of the 'Magnificent Seven' stocks).

Event-driven managers were unable to replicate the excellent performance of the previous year. At +4.8%, they lagged behind the other strategies. The realised merger and acquisition activity remained below expectations, well-known deals ran into turbulence (e.g. US Steel, Capri) - the regulatory hurdles proved to be high, and the unknown outcome of the presidential election in the USA also created uncertainty.

Trend-following models made a strong start to the year (+5.1% in H1), but only reached the +2.0% mark at the end of October. Sharp trend reversals cost performance. From August onwards, strong movements in the currencies (Japanese yen in August, USD strength from September), erratic movements on the commodity markets and increased volatility ahead of the US elections took their toll.

Chart II - Performance Main Strategies (until October 2024)



	2024	2023	2022	2021	2020
Global Hedge Funds	7.7%	9.1%	-4.2%	10.9%	14.1%
Equity L/S	8.8%	8.7%	-8.8%	11.4%	16.9%
Event Driven	4.8%	8.5%	-5.4%	13.7%	10.8%
Fixed Income	7.3%	8.9%	-3.7%	4.3%	5.6%
Global Macro	5.8%	5.2%	-0.4%	5.0%	10.5%
Trend Following	2.0%	0.7%	5.9%	8.8%	10.4%

Source: Alpinum IM, Eurekahedge

Characterisation of the Hedge Funds Year 2024

Based on the numbers available (up to October), we can already say that 2024 will be a successful year for hedge funds. They benefited from confident investor sentiment, with all main strategies making gains. The most popular strategy, equity long-short, has a share of around 30% in the index. Fundamental equity long-short managers have had one of their best years in two decades.

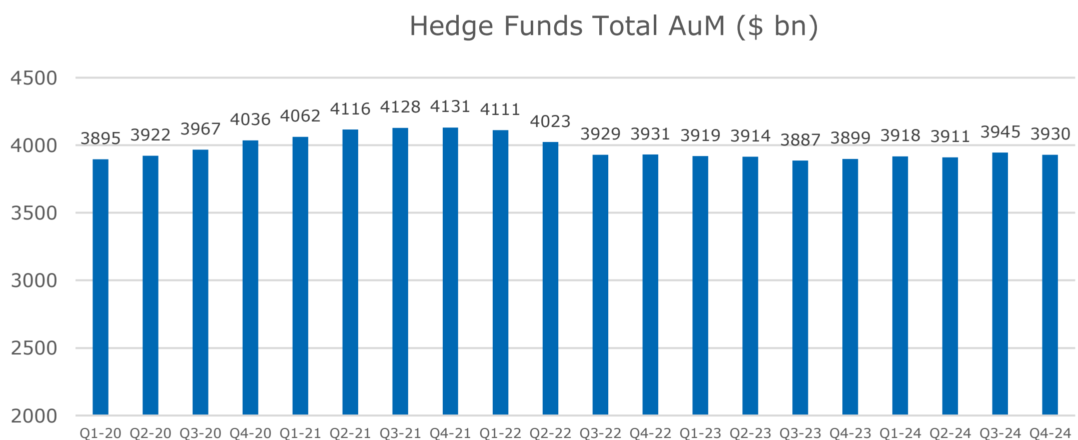
The promise of high risk-adjusted performance was apparently only tested twice during the year. Hedge funds proved their resilience in April (MSCI -3.7%, hedge

funds -0.8%) and in October (MSCI -2.0%, hedge funds -0.5%). August was interesting, however, as it is recorded as a positive month in the monthly data: The abrupt unwinding of the 'yen carry trade' sent shockwaves through the system. The Nikkei Index plunged 20% over 3 days, the S&P 500 lost -6% and the VIX volatility index climbed to over 65 intraday - a level not seen since the coronavirus crisis. Just 8 days later, however, the western indices reached new highs again. The hedge funds mastered this complex situation well and closed the month on a positive note.

2 Hedge Funds Industry 2024

The hedge fund industry grew by 1% for the first time after two negative years (data to October 2024) and managed around USD 4 trillion. Although there were net outflows totalling USD 34 billion, positive performance caused assets under management to grow slightly.

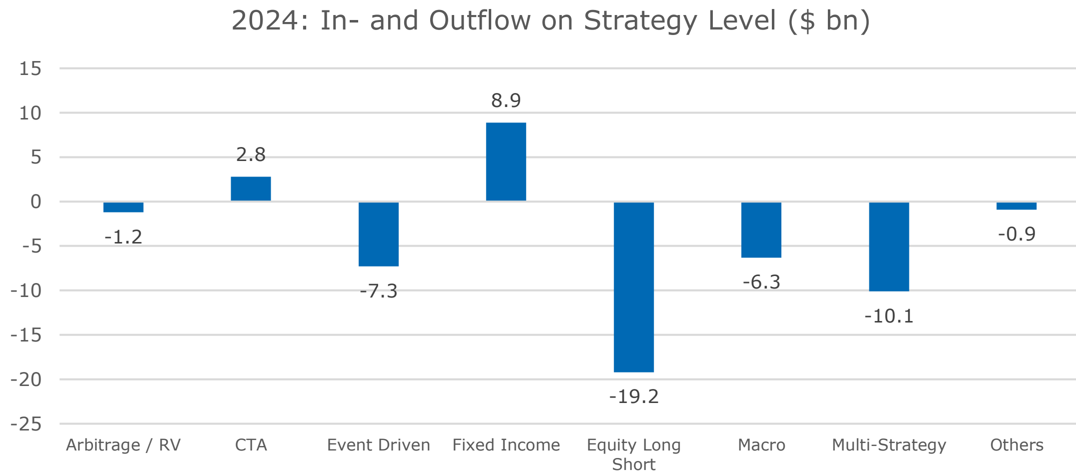
Chart III - Hedge Funds Assets



Source: Alpinum IM, Eurekahedge

At strategy level, the picture is mixed. Equity long-short managers (USD -19.2 billion) and multi-strategy managers (USD -10.1 billion) experienced the highest outflows. Fixed income managers (USD +8.9 billion) and CTA managers (USD +2.8 billion) recorded net inflows.

Chart IV – In- and Outflow on Strategy Level



Source: Alpinum IM, Eurekahedge

The attractiveness of fixed income managers has been evident since the paradigm shift in interest rates, and this strategy has also benefited from this. The continuing outflows in the equity long-short segment this year can also be explained by the fact that quite a few investors favoured a more directional equity exposure in a strongly rising market and reduced their 'hedged' component.

We have been observing a concentration of hedge fund investments in ever larger managers for some time now. An analysis by Bank of America showed that managers with AuM > USD 5 billion held a 65% share of all funds in 2018, which has now risen to 73%. It is worth noting, however, that the lost share of the cake was not at the expense of smaller managers with AuM < USD 1 billion, but at the expense of mid-sized houses with AuM between USD 1 and 5 billion - their share fell from 25% in 2018 to 19% in 2024. This shows the ongoing consolidation in the mid-sized segment towards large multi-strategy funds.

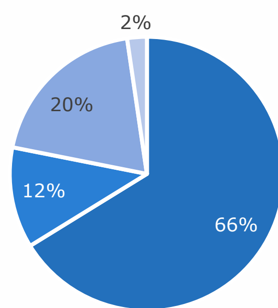
3 Hedge Funds Focus Topic: Opportunities in the Asian Region

We would like to focus not on one hedge fund strategy, but on one region, Asia. The region is a little out of the spotlight, but in our opinion it offers considerable opportunities at the moment. As this region is characterised by structurally higher volatility and dispersion, hedge funds in particular are predestined to generate attractive risk-adjusted performance.

At a regional level, around USD 468 billion of hedge funds assets are managed in Asia, which corresponds to around 12% worldwide (data as at the end of 2023, Eurekahedge). With a share of 66%, the USA is the dominant hedge fund manager, while Europe got around 20% of all assets.

Chart V – Hedge Fund Industry in Asia

Global Distribution Hedge Fund Industry AuM



Location	# of funds	2023 $ bn
Hong Kong	588	172
Singapore	238	79
Australia	199	50
USA	96	37
China	64	31
UK	61	30
Japan	57	5
Other	155	26
Total	**1458**	**430**

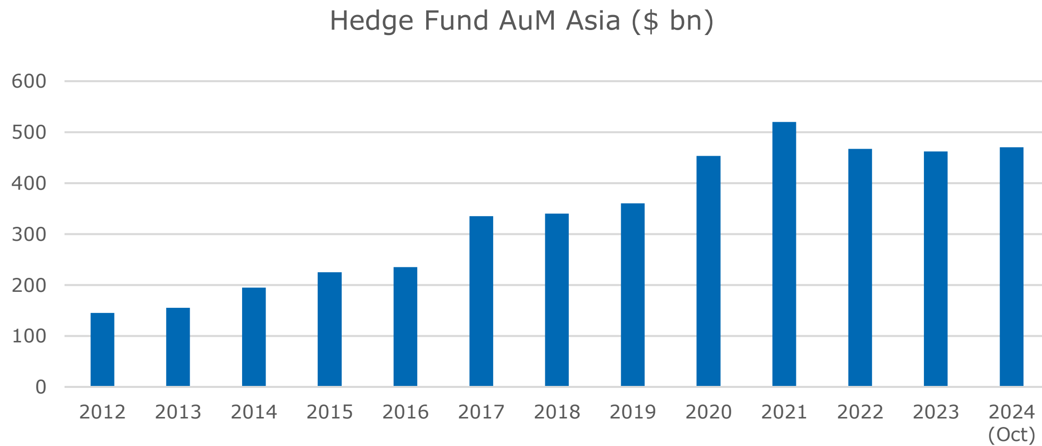
Source: Alpinum IM, Eurekahedge

Asian hedge funds had their 'peak assets' at the end of 2021, when they managed around USD 520 billion in assets; since then, assets have shrunk by 18%. After a decade of 15% annualised growth, Asian managers recorded real losses in 2022, but outflows have not stopped ever since.

Hong Kong and Singapore are clearly the leading hedge fund hubs, holding 40% and 19% of the Asian market respectively. It can be observed that Singapore is becoming increasingly important, which also has to do with the regulatory uncertainty in Hong Kong. Historically, Hong Kong has tended to be home to equity long-short managers, especially those focussing on the Chinese market; Singapore, on the other hand, is home to a comparatively large number of global macro managers. Two thirds of all hedge fund assets in Asia are invested in equity long- short strategies - these in turn have suffered the largest outflows since 2021, around -

25%. Persistent outflows and performance losses, particularly in China-focused funds, have taken their toll.

Chart VI – Hedge Funds Assets in Asia



Source: Alpinum IM, Eurekahedge

Despite the negative news, we believe that a large window of opportunity is opening in Asia. We are observing a recovery in performance and must realise that we should not judge all Asian countries by the same yardstick. There are big regional differences, each country has its own specific characteristics, is in its own cycle and is differently dependent on China or exports to the western world, risks and opportunities on the investment side are therefore very nuanced.

Opportunities in Asia & China

- High dispersion, winners and losers among companies are due to country-specific growth differences (Vietnam, India, Indonesia), geopolitical forces and trends.
- Strong sector/industry trends resulting from e.g. EV, AI or alternative energies; dominant part of the value chain is in the Asian region.
- Possible revaluation of Chinese equities and the entire 'China investment case' following the Chinese government's commitment to rigorous support measures.
- Money flows: The investment community is investing too little in China. The country has become uninteresting in their eyes. However, if the direction and speed of money flows reverse, the market can quickly turn positive, as it has done in the past.

- Valuations in China are comparatively favourable. Often rightly so, but some sectors and companies are growing healthily and deserve higher prices.
- The high level of dispersion in the equity universe has increased significantly, which is extremely attractive for trading-oriented equity long-short managers.

Asian Countries and their specific Opportunities

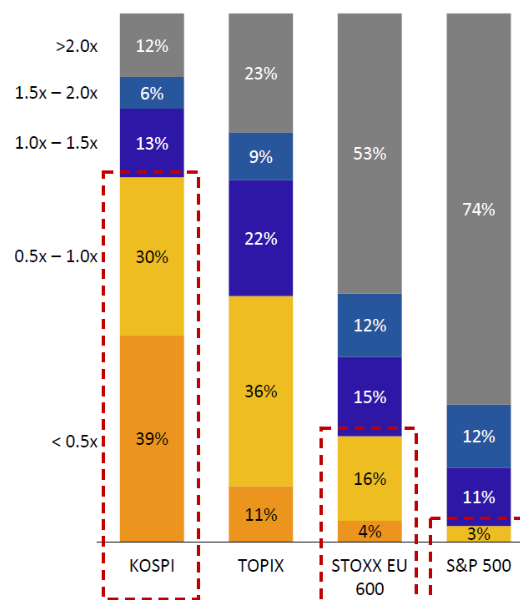
China-focussed managers struggled to generate alpha as the aftermath of China's zero-Covid policy and strict regulation in areas such as the technology sector created a difficult environment. Some sectors, especially state-owned entities, are so unpopular that valuations are hard to justify. The Chinese government's commitment to supporting the economy with far-reaching measures and thus stabilising not only the economy but also sentiment has now completely changed the starting position. Active and agile hedge fund managers have reacted quickly and we have been observing extremely good performance for some time now - new opportunities are opening up in equity long-short strategies, convertible bond arbitrage specialists, relative value on-shore/off-shore traders or explicit experts in the stressed credit area.

At a regional level, Indian equity long-short managers have performed best over the last three years (8.6% annualised), with the market functioning independently of Chinese or Japanese influences. Managers benefit from the peculiarities of this country and its potential to catch up with its big rival China. Away from the now expensively valued market, there are opportunities for event-driven managers (lively IPO market), fixed income and relative value managers. In addition - and you wouldn't expect it - options trading is unique, being the second largest market in the world after the USA.

In Japan, the potential is primarily to be found in niches such as the event-driven strategy. Under pressure from the government, many conglomerates are being split up with the aim of increasing corporate governance and ultimately shareholder value. This has brought considerable success in recent years, but there is still a long way to go - see chart VII. For equity long-short managers, there are opportunities in the mid/small cap segment: inflation has arrived in Japan, and smaller Japanese companies will be able to benefit more from this as they are focussed exclusively on the domestic market.

Korean politicians want to follow the Japanese example and reduce the 'Korea discount' in shares, which has existed for years, with similar measures. The 'Korea discount' is due to weak corporate governance, which for the most part only benefited the majority shareholders - it is about control, not shareholder value. Returns on invested capital are low due to inefficient allocation. Over 70% of Korean companies trade below 1x book value, compared to 20% in the West - see chart VII. KOSPI Index companies have a return on equity of 8%, compared to 23% in the S&P 500. The Korean government is making a new attempt to implement the 'Corporate Value-Up' programme. The aim is to support valuations and better protect minority shareholders. This opens up various opportunities for relative value, event-driven and active equity long-short managers.

Chart VII – Market Value/Fair Value Comparison Korea, Japan, Europe, USA



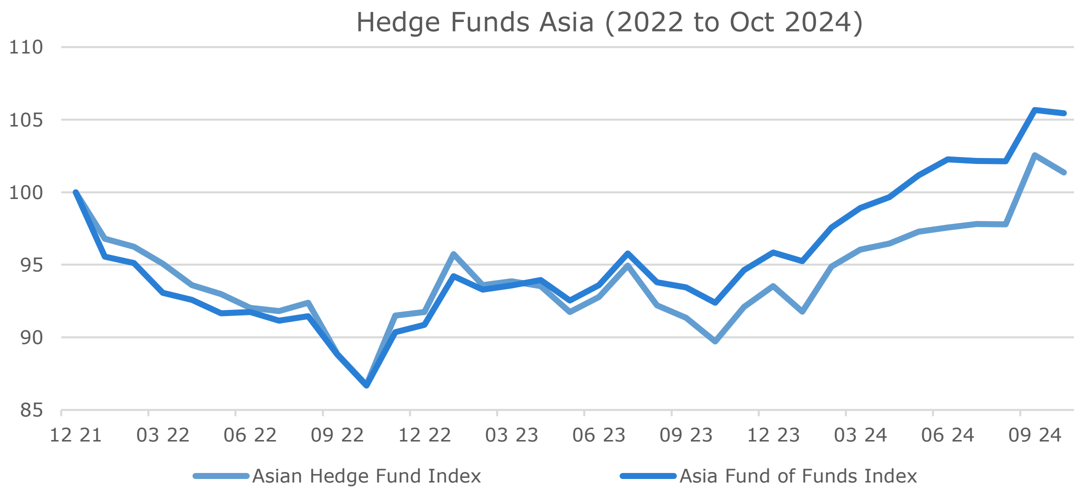
Source: Alpinum IM, Goldman Sachs

These examples show: Asia is extremely diverse, Asia is not just China. We see great opportunities in the countries, but also as a whole. The regional dispersion is very large for good reason, and the volatilities are historically rather high. With the geopolitical tensions and an expectedly unstable policy from the White House in America, the entire region is facing a challenging time. Active and agile managers will therefore find very attractive opportunities in the current environment.

In Asia, a very cautious selection of hedge fund managers is even more important. The risks should not be underestimated, and local expertise is key to making the most of dispersion. Alpinum Investment Management has already been on two due diligence trips to Asia this year to put dozens of managers through their paces.

Figure VIII shows how active manager selection can make the difference, especially in Asia. Asian fund of hedge funds have outperformed the Asian Hedge Fund Index on average in recent years.

Chart VIII – Fund of Hedge Funds in Asia



Source: Alpinum IM, Bloomberg

4 Outlook: Hedge Funds Strategies

	Underweight		Neutral	Overweight	
	heavily	slightly		slightly	heavily
HFRI Global Hedge Funds					
HFRI Equity Long-Short					
HFRI Event Driven					
HFRI Credit Fixed Income					
HFRI Global Macro					
HFRI Trend Following					

We are working with the scenario of further normalisation, i.e. minimal GDP growth in the US, stagnation in the EU and China reaching its 4%+ GDP growth.

Higher but normalised capital costs, normalised but positive private consumption lead to a weaker cyclical economic outlook, which remains positive overall. The manufacturing sector in the US is in recession, while the service sector is resilient and continues to grow. Although government agencies are still signalling their support, the high budget deficits are limiting their impact on growth. Inflation is moving towards 2.5-3%. This leads us to a generally positive risk assessment for the credit sector and equities, although we are well aware of the risks of narrow credit spreads or high equity valuations. Market sentiment is currently dominated by speculation about three important uncertainties: 1) the next steps of the new Trump administration, 2) China's possible reactions and 3) the possible timing and conditions for a solution to the Russia-Ukraine conflict.

Given the fragile state of the global economy and the prevailing geopolitical tensions, it seems particularly risky to make large bets. Diverging forces and a new administration in the US could lead to slightly increased volatility, creating a good environment for active hedge fund managers. We still have the greatest 'Visibility & Conviction' over the next 12 months among hedge fund managers in the Fixed Income Credit strategy. However, equity long-short managers are also likely to encounter a wealth of profitable situations - even if, or precisely because, the path will not be straightforward.

As described in the Focus section, we consider the Asian region to be attractive for risk-controlled hedge fund managers. Regionally, however, an opportunity could also open up for Europe towards the second half of the year. We may be going out on a limb with this opinion, but if the conflict in Eastern Europe comes to an end,

this could have a positive impact on many levels in the short term (commodities, currency, sentiment).

One risk for hedge funds in 2025 could be that the market assumes far too much volatility. Trump may prove to be less erratic than predicted. Many of the market participants' assumptions could also already be reflected in prices - in which case the price reaction would be meagre if the predictions materialise.

Nevertheless, we recommend that investors in hedge funds focus on broad diversification, especially in this challenging environment. However, active management and maximum proximity to the manager are important. Thanks to access to non-traditional sources of return with a low correlation to equity and bond markets, alternative investments will continue to serve as a valuable stabiliser in a portfolio for the rest of 2025.

Notes on the Assessment at Strategy Level

Equity Long-Short: positive environment

The strategy could perform well again in 2025 for the following reasons: 1) The euphoria on the US stock market following Trump's election in November has subsided slightly. The reality check of the high expectations has yet to materialise. This could be interesting for equity long-short managers, as erratic sector and style rotations may provide trading activity and opportunities. 2) It is possible that interest rates will not correct downwards as quickly as predicted. This could mean that some companies will face refinancing problems, as not all companies in the index are financed in an exemplary manner, which might lead to increased dispersion. 3) 70% of the MSCI World Equity Index is represented by the USA. Other regions such as Europe, Asia or Latin America have considerable catch-up potential - see also the Focus topic Asia. 4) Back to the USA: although the S&P 500 is relatively highly valued, with an expected P/E of 24.8 at the end of November, discretionary, fundamental bottom-up equity long-short managers can exploit the opportunities on both sides - but agility is very important; overly dogmatic characters can also get in their own way in this market environment. The outlook for the strategy remains positive thanks to the many opportunities.

'Long biased' long-short strategies are clearly heavily dependent on the performance of the equity markets. In general, the managers' market beta has increased over the course of the year, which has brought them fantastic performance. If market sentiment remains favourable, these directional strategies will continue to benefit - although they are naturally subject to major fluctuations.

Equity Market Neutral: neutral outlook

We have observed a steady improvement in the performance of equity market neutral managers in recent months. The market is once again increasingly rewarding fundamental-oriented managers who evaluate companies with forensic analyses. Strong exaggerations on the long and short side are not discernible in the current environment (e.g. Magnificient 7 on the long side; short squeezes on the shorts). The outlook remains (positive) neutral.

Event Driven (Merger Arbitrage): slightly underweighted

We did well to downgrade the Event Driven Managers. The managers' problems manifested themselves in 2024. Although it is predicted that merger and acquisition activity will increase, deals have yet to materialise. Merger spreads have widened as notable deals have failed to materialise, while regulatory and cross-border risks have not yet been reduced. The new administration in the USA is contributing to the ongoing uncertainty. Although the replacement of Lisa Kahn (head of the Federal Trade Commission) is expected, it remains to be seen to what extent Trump will really bring calm to the market. If the dust settles in the second half of the year, the strategy could benefit. Operating conditions for companies are difficult as they face slowing sales growth while costs continue to rise. Mergers and acquisitions, which enable synergies and margin expansion such as vertical integration, remain one of the few 'easy' levers to achieve profit growth in a difficult environment.

Credit Fixed Income: very positive environment

We continue to observe a very attractive environment for credit fixed income managers. Credit spreads have tightened further in 2024, but opportunities still exist - also in view of the scenario that interest rates may not fall as much as many market participants are predicting. On the long side, high-quality loans at attractive levels are tempting, and the coupon will probably continue to pay high percentages for some time to come. On the short side, companies are coming under increasing pressure, with many having to refinance in the next two years. This creates a large dispersion in the market, which can be exploited by active hedge funds. We are aware of the good performance of credit fixed income managers over the last two years; there is no longer a 'free lunch'. However, very active and specialised managers should continue to generate good returns next year - even if volatility increases slightly.

Global Macro: neutral outlook

There is often talk of macro-driven markets. This may apply to the sentiment of market participants, but this does not mean that the Global Macro Strategy will necessarily benefit from this. Many fundamentally oriented managers were also positioned too conservatively in 2024, they sometimes misjudged inflation expectations and the resulting interest rate movements, and they were also unable to

monetise the sharp movements on the interest rate, FX and commodity side in the second half of the year. Consistent macro trends are difficult to forecast in the first year of the Trump administration. A new equilibrium has yet to be found. We are therefore sticking to the neutral positioning of the Global Macro Managers. We continue to favour discretionary managers over systematic Global Macro models.

Trend Following: slightly underweighted

As predicted, 2024 has been a difficult year for Trend Following so far. The gains made in the first half of the year were wiped out in the second. As with the Global Macro Managers, the models were unable to capitalise profitably on the strong movements in asset classes in the second half of the year. Compared to the previous year, the entire volatility complex fell again (average level VIX Index 2022: 25.6 / 2023: 16.9 / 2024: 15.5 (until 28 October)). Although we can certainly imagine a slight increase in volatility, we believe that the markets will certainly be ‘news-driven’ by Washington, which will make profitable positioning more difficult for trend followers, as constant repositioning will be required. We maintain our underweight position in the strategy. We continue to favour discretionary managers over systematic Global Macro models.

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