INSIGHTS

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DECEMBER 2023

HEDGEWEEK

INVESTOR INTEREST 2024

ALLOCATORS' PLANS FOR HEDGE FUNDS AND BEYOND

EXECUTIVE SUMMARY

The transition from the post-crisis era of zero rates to the higher-for-longer environment now priced in by markets has upended the outlook for allocators to alternatives.

Hedgeweek's Investor Interest Report reveals a positive outlook towards hedge funds, with allocations increasing. Sentiment is most positive towards the relative value/arb and distressed credit strategies expected to benefit from higher rates. But there is also more churn as LPs regear their portfolios towards the new environment.

There are challenges – after years in which the risk-free rate was hardly relevant, allocators can now get 5% or more from cash, increasing their return expectation from hedge funds and other alternatives.

All of this and more will be explored in this report, focused on hedge funds in section one before broadening to alternatives focused on private markets in section two. The second section reveals a softening in interest in private equity but continued high interest in private credit – while real estate has dropped sharply down the priority list in the post-pandemic era of increased home-working and higher rates, hitting the commercial sector.

The third section focuses on ten key trends which are dominating hedge fund LP perspectives going into 2024: from strategies of note to viewpoints on AI and ESG, as well as fees and macro risks.

WILL WAINEWRIGHT
HEAD OF HEDGE FUND RESEARCH

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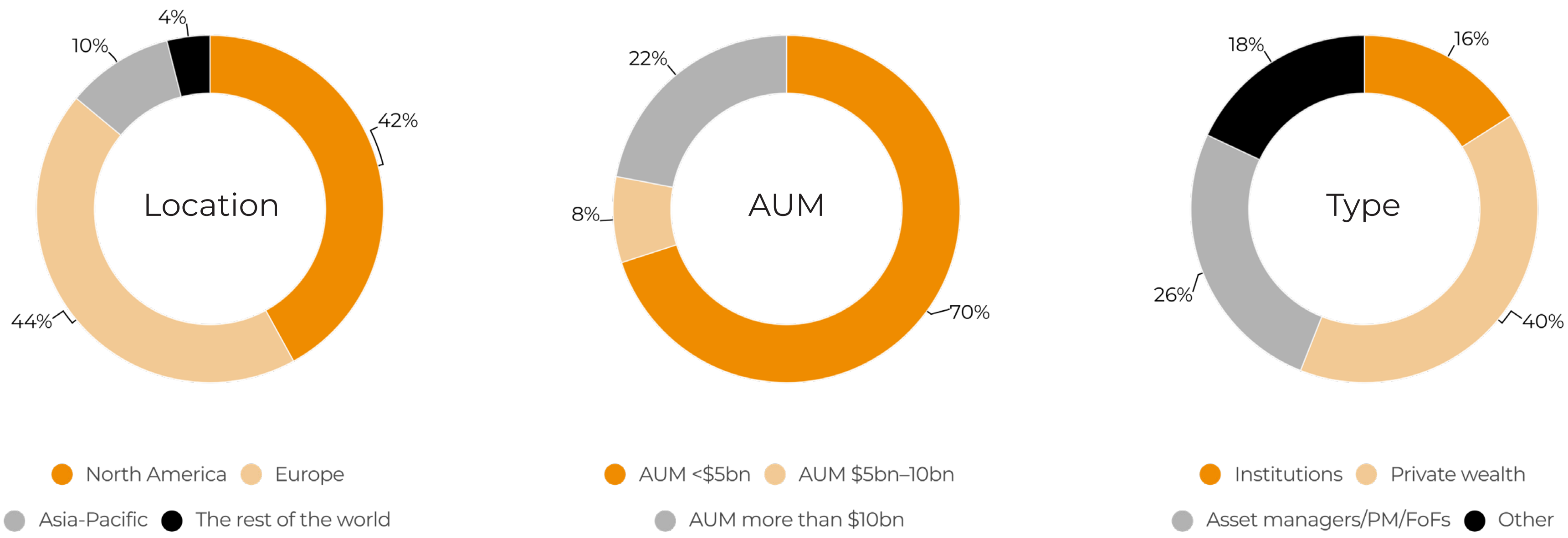
Breakdown of respondents to Hedgeweek's 2024 Investor Survey by firm location, size, and type



METHODOLOGY

The primary source of data in this report is Hedgeweek's 2024 Investor Survey, conducted in collaboration with sister title Private Equity Wire in November 2023. Of the 50 alternative investment allocators that participated in the survey, the vast majority were based in North America or Europe. By investor type, 'private wealth' was most common. Further insights in this report were gathered during interviews in November and December with named and unnamed hedge fund sources, and additional third-party research and intel.

KEY FINDINGS

1

RV/arb tops hedge wishlist

Relative value/arbitrage strategies are by far of most interest among hedge fund allocators next year, with 33% of LPs planning an increase. This preference reflects the greater volatility expected and potential for managers to eke out alpha from price differentials between securities in various asset classes. Hedgeweek interviewees focused on macro and distressed credit, which are also expected to flourish amid higher rates.

2

Long/short equity declines

Though long/short equity performance has improved this year, part of the increase has been driven by beta from the market rebound, while gains have been concentrated in large US tech stocks. Outflows have continued from the space, which has seen the least interest from LPs according to our survey. Interviewees told Hedgeweek managers could still succeed in the space by differentiating themselves and delivering true alpha.

3

AI tops agenda

More LPs are interested in asking GPs about their use of AI. According to Man Group CEO, Robyn Grew, not a client discussion has gone by this year without the subject of AI coming up. Investors are interested in how the new technology can be used to boost investment and operational performance. Our research suggests that, by contrast, DE&I and ESG have become less central concerns in the new market era.

4

Private credit booms

In private markets, credit continues to dominate LP plans – half of those surveyed plan to increase their holdings in the asset class. The talk of Wall Street this year, interest is highest in distressed (44% plan to increase) and direct lending (41%), followed by special situations and infrastructure debt (both 38%). Those intentions suggest the flows into private credit will not cease soon.

HEDGE FUND PLANS

Allocators plan to increase hedge fund holdings but are also shaking them up, with a distinct preference for certain strategies.

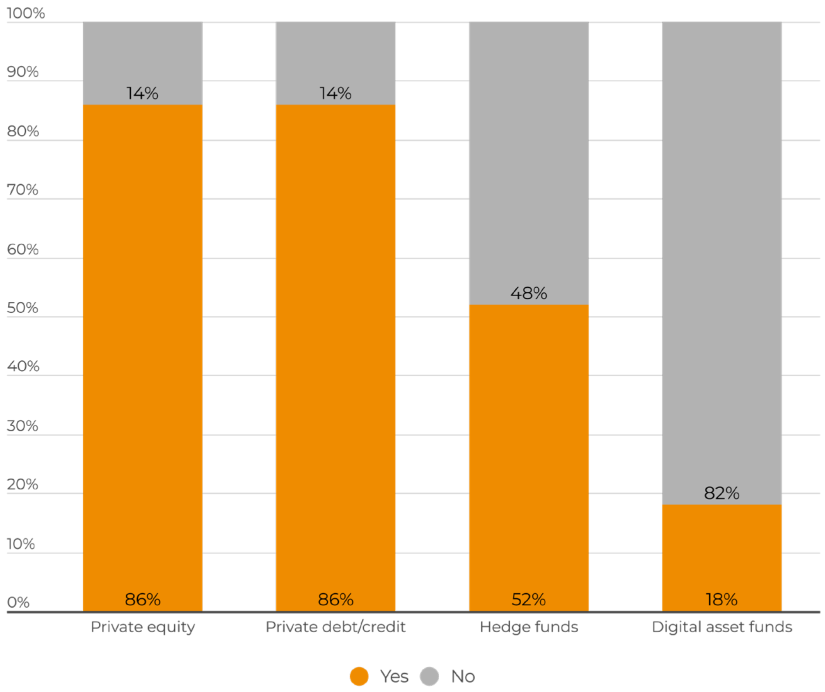
Recent themes in asset allocation were reflected in the make-up of respondents to Hedgeweek's survey, with a higher proportion allocated to private markets than hedge funds and only a minority (18%) to digital assets (see Figure 1.1).

The era of low interest rates after the financial crisis saw a huge increase in the size of private market investments, particularly private equity, as allocators hunted strong returns in a sector benefiting from low debt refinancing costs. More than four-fifths (86%) of respondents are allocated to private equity.

That era came to an end in 2022, which saw a sell-off equity and bond markets as an inflation spike triggered rapid monetary tightening. The new era of higher rates has boosted interest in private credit investments, in which the same proportion (86%) are also now invested.

Hedge funds, in contrast to private markets, did not enjoy strong inflows during the post-crisis years, as low volatility stifled returns and long/short equity performance was criticised in comparison to stock market indices. Industry outflows in recent years have been led by long/

Fig. 1.1 Proportion of alternatives allocators surveyed that invest in hedge funds and other select asset classes



Analyst note: *Survey respondents were asked in November, Does your organisation make the following alternative investments?*

Source: Hedgeweek-Private Equity Wire 2024 Investor Survey

short equity, traditionally the main hedge fund strategy (see box out). That may explain why the 51% of respondents invested in hedge funds lags the holdings in private markets.

Sentiment towards hedge funds has grown more positive according to Hedgeweek's survey, with the proportion of respondents having made a hedge fund allocation in Q3 rising to 44% from 24% in Q2 (see Figure 1.2). But there was also more redemptions activity, with the proportion withdrawing from a fund rising to 36% from 19%. This suggests that wholesale changes are being made to hedge fund portfolios as allocators bed in to a period of sustained higher rates.

As for digital assets, despite a big increase in cryptocurrency interest, particularly during the pandemic era, the market events and controversies within the sector in 2022 have been hard to shake off. An increase in the bitcoin price this year has not – so far – persuaded more allocators to invest.

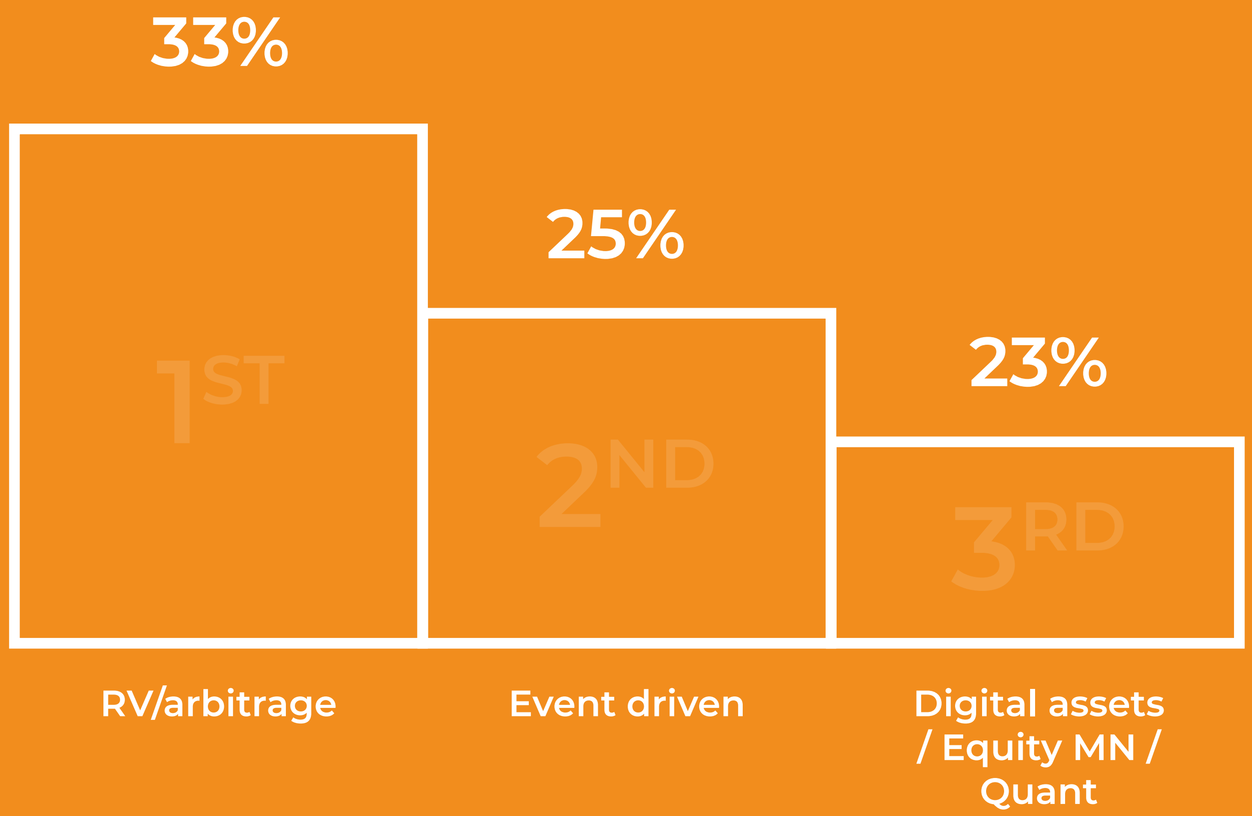
HEDGE FUNDS IN FOCUS

The first section of this report focuses exclusively on hedge funds before broadening to alternatives in general in the next part. The $4trn industry posted strong returns in the market selloffs of last year, concentrated within macro, multi-strategy and managed futures. This year, returns in those strategies have been lower but the sector as a whole is up 4.4% for the first 11 months, boosted by equity strategy gains, according to the HFRI Fund Weighted Composite Index.

KEY FINDING

RV/arbitrage allocations are being lined up by a third of hedge fund investors

Top three hedge fund strategies ranked by the highest proportion of hedge fund investors surveyed planning to increase exposure in the next 12 months.



INSIGHTS

Sentiment for the coming year in hedge funds is positive, with more than twice as many respondents currently allocated to the sector planning an increase (27%) as not (12%, see Figure 1.3). For the remaining 62% majority, no increase is planned (those inactive in the space have been removed). The proportion of LPs planning an increase is slightly down on the 32% last year, but the 18% planning a decrease has fallen even more sharply, by a third to 12%.

Relative value/arbitrage strategies are by far of most interest among allocators next year, with 33% of LPs planning an increase (see Figure 1.4a). This preference reflects the greater volatility expected within the higher-for-longer environment and potential for managers to eke out alpha from price differentials between various securities within and between multiple asset classes.

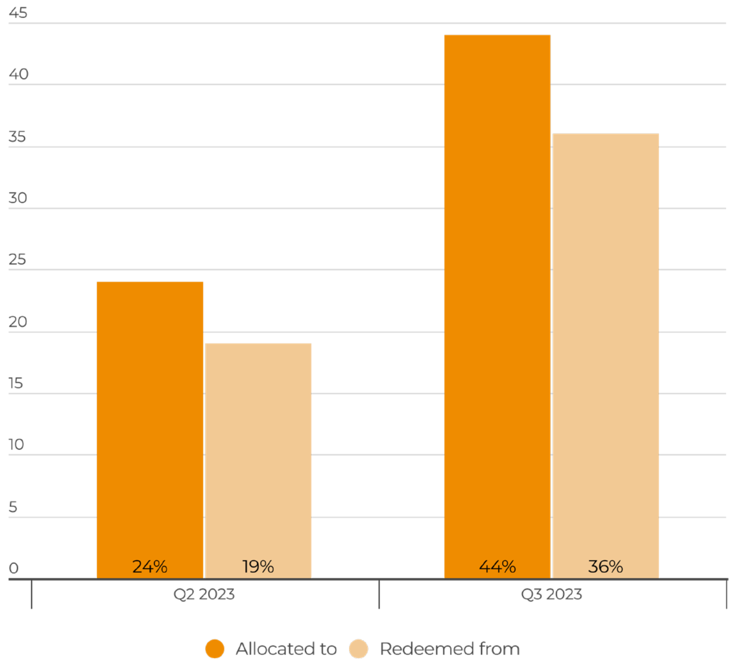
RELATIVE VALUE OPPORTUNITIES

“Hedge funds should perform well in this environment,” said Jack Seibald, global co-head of prime brokerage services and outsourced trading, Marex. “It is telling that relative value/ arbitrage was most popular with 15% planning an increase.

“When you have an economy that’s in a transition phase, whether up or down – and we are in a down phase for the foreseeable future – you will see assets being valued differently, creating macro/RV opportunities.”

A greater interest in event-driven, which has under-performed this year, was also detected.

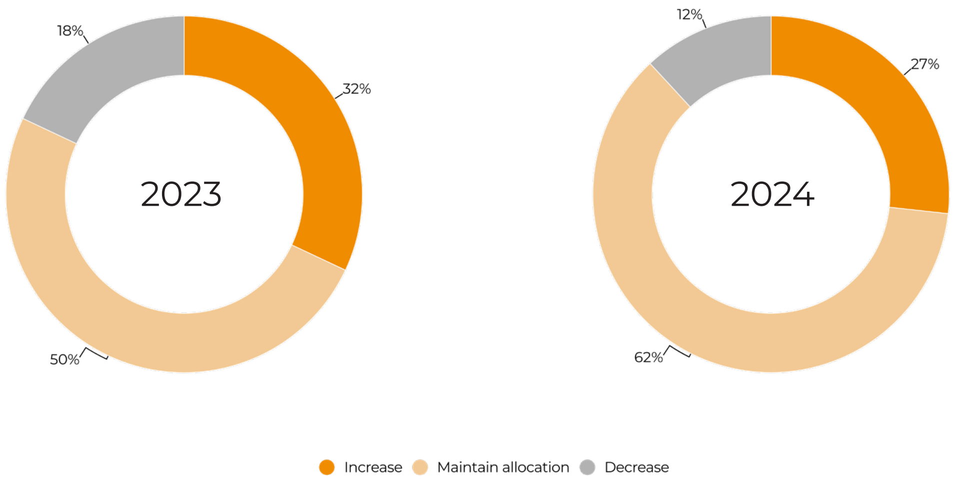
Fig. 1.2 Proportion of alternatives allocators surveyed allocated to or redeemed from a hedge fund in Q3 and Q2 2023



Analyst note: *Survey respondents were asked in November 2023, During the previous calendar quarter, did your organisation allocate to or redeem from a hedge fund manager?*

Source: Hedgeweek-Private Equity Wire 2024 Investor Survey

Fig. 1.3 Hedge fund investors' plans for their hedge fund allocations in 2024 versus 12 months ago



Analyst note: *Survey respondents were asked in November 2023, How do you expect to change your exposure to the following asset classes over the next 12 months? Data for 2023 relates to the same questions asked of a different survey sample in Q4 2022. Totals may not add up to 100% due to rounding.*

Source: Hedgeweek-Private Equity Wire 2024 Investor Survey

A quarter (25%) said they would increase holdings, with greater merger arb opportunities in 2024 possibly the reason.

Quant/systematic and equity-market neutral (both have 23% of active hedge fund investors planning an increase) remains popular, the latter seen as a way of profiting from stock investments against the backdrop of greater market turbulence.

Long/short equity is most out of favour, with the lowest proportion of investors planning an increase in exposure (15%), a theme to be explored in section three.

"MORE POSITIVE"

"We believe that there are good reasons to be more positive about the returns to hedge funds and other active strategies over the next few years than for much of our careers," said Adam Singleton, CIO of Man Group's investing unit, FRM.

"This comes down to three key interconnected beliefs; firstly, that inflation will be structurally higher, secondly, that this will keep asset volatilities higher on average, and thirdly that policy makers will respond with interest rate levels which are higher and less certain than for much of the last 20 years.

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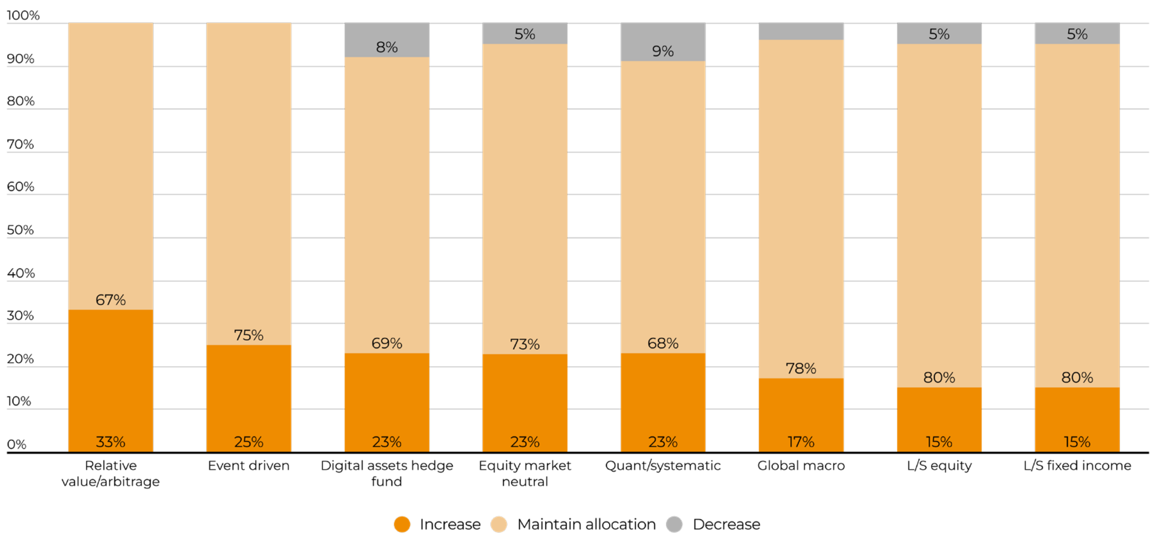
There are good reasons to be more positive about the returns to hedge funds and other active strategies over the next few years

Adam Singleton
CIO, Man FRM

Fig. 1.4a Hedge fund investors' plans for their hedge fund allocations in 2024 – by hedge fund strategy



Analyst note: *Survey respondents were asked in November 2023, How do you expect to change your exposure to the following hedge fund strategies over the next 12 months? Totals may not add up to 100% due to rounding.*

Source: Hedgeweek-Private Equity Wire 2024 Investor Survey

"We believe that structurally higher inflation will lead to more episodes of higher market volatility as markets digest inflation surprises, such as those seen in 2021 and 2022. Those years were coincident with high levels of hedge fund alpha. Indeed, it is telling that the drop off in equity market volatility during 2023 has coincided with lower levels of hedge fund alpha."

Sentiment towards relative value/arb and event-driven is roughly level with a year ago (see Figure 1.4b). Though LPs are still bullish on macro, there was a notable drop-off in net appetite, perhaps because they delivered such strong returns in 2022 but have been muted this year. But over the long-term, amid the higher-for-longer rates environment which most investors expect to persist, macro is seen as a strong long-term bet.

Macro and distressed credit will be the two hedge fund strategies explored in section three, as attracting the most interest among LPs interviewed by Hedgeweek. Both benefit from higher rates, showing how dominant monetary tightening is in affecting investor thinking. The key trends in alternatives in general, including private markets strategies, will be explored in the next section. ■

FLOWS WATCH

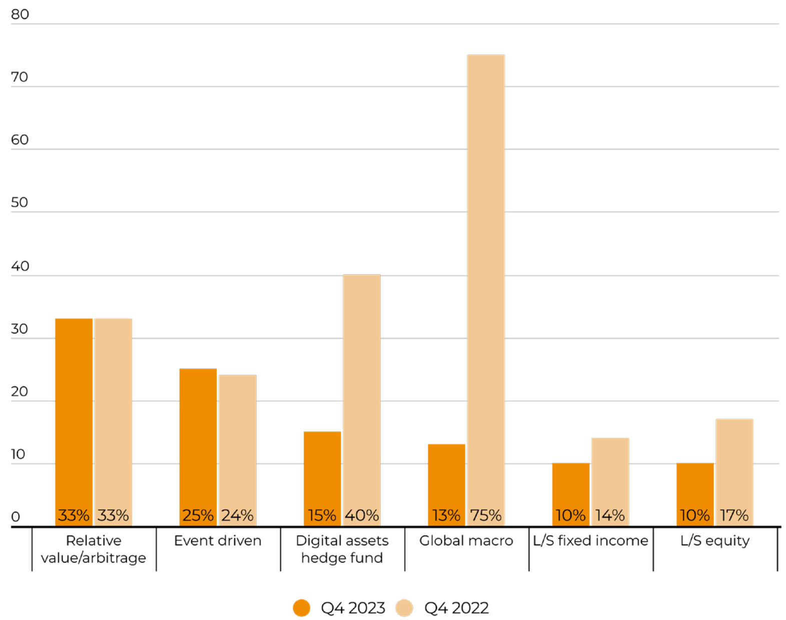
Hedge fund redemptions in the year to October have exceeded inflows by $74.9bn, according to eVestment data, putting the sector on track for a second consecutive year of net outflows.

That follows a net outflow of $112.2bn in 2022 and net inflow of $13.9bn in 2021. A preference for debt-related strategies has emerged, with fixed income/credit attracting the lightest outflows so far this year, while the only sub-strategy with a net inflow of above $3bn is relative value credit ($3.4bn). The latter saw inflows in October for the fifth month in six, leading eVestment to observe: “The data is clear that the current environment is making credit hedge fund strategies more attractive than they have been in years.”

At the other end of the interest scale, long/short equity has seen a $5bn net outflow October alone, extending year-to-date outflows to $28bn after two years of heavy redemptions. AuM in the strategy has now fallen level with multi-strategy.

Multi-strategy hedge funds boomed during the pandemic years, delivering strong returns with low volatility, and inflows as a result in 2021 and 2022. But there have been net outflows to the tune of $4.2bn in the year to October. Managed futures funds have seen consistent net inflows for three consecutive years, the only sub-strategy to do so, according to eVestment.

Fig. 1.4b Hedge fund investors’ net plans for their hedge fund strategies in Q4 2023 versus Q4 2022



Analyst note: *Where net equals ‘increase’ minus ‘ decrease’. Survey respondents were asked in November 2023, How do you expect to change your exposure to the following hedge fund strategies over the next 12 months? Data for 2023 relates to the same questions asked of a different survey sample in Q4 2022.*

Source: Hedgeweek-Private Equity Wire 2024 Investor Survey

BEYOND HEDGE FUNDS

Private credit has dominated headlines on Wall Street all year, and allocators are still putting in new money. Real estate, on the other hand, has fallen firmly out of favour with LPs.

Comparing asset allocation plans across alternative investments reveals a continued high interest in private markets strategies despite the higher-rate environment.

Private credit/debt, which can serve as a hedge against rising interest rates, is the clear preferred asset class, with 50% of allocators planning to increase their investment (see Figure 2.1). Just 5% plan a decrease, with the rest holding steady.

Infrastructure is the second most popular alternative asset class, with 30% planning an increase in the space, which will benefit from interest rates being higher as LPs seek a guaranteed long-term return.

Next was private equity, with 20% planning an increase and 18% a decrease, followed by hedge funds (16% and 7%, respectively). But if you strip out the investors not currently active in the respective strategies, sentiment on hedge is more positive than private equity.

For hedge funds, 26% of LPs are planning to increase their investment and just 11% to decrease. For the reasons covered in section one, they are seen as more attractive for their active trading qualities and liquidity in an era where cash access, given its improved return potential and an unstable macroeconomic environment, is more important than ever. The long lock-ups associated with private markets have become relatively less appealing.

Strip out investors not currently invested, and 23% of private equity investors plan an increase and a fifth a decrease, double the rate of hedge funds.

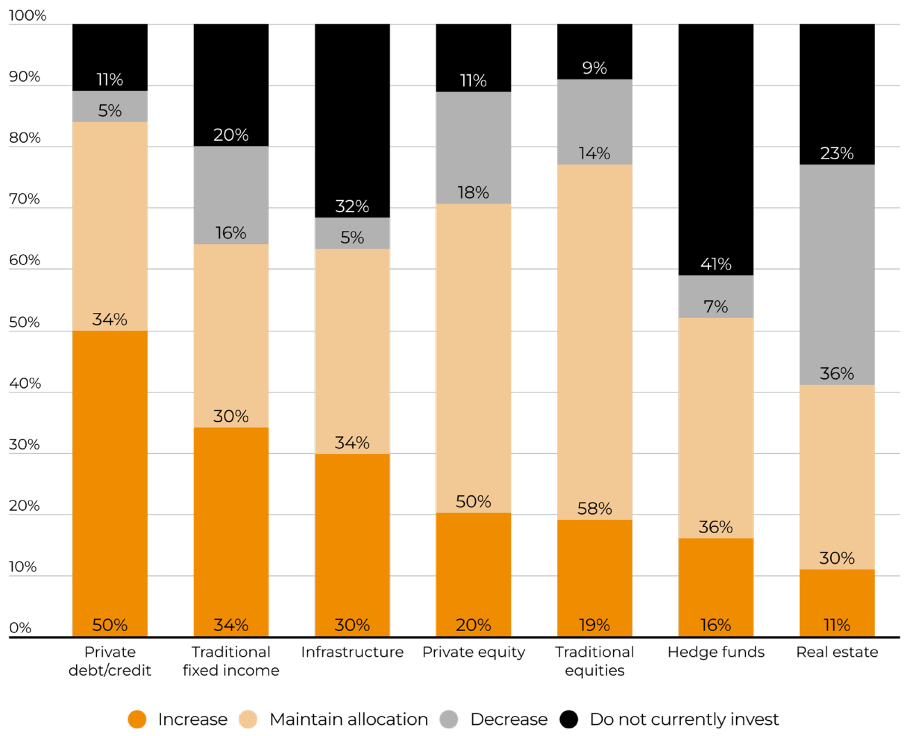
Lagging all other alternative asset classes is real estate, with just 11% planning an increase and 36% a decrease. Fourteen percent of real estate investors plan to increase exposure in a difficult post-pandemic market for office rents and the all-consuming backdrop of tightening rates.

For traditional asset classes, 34% plan to increase equity exposure against 19% planning to decrease, with bonds offering attractive returns and stock markets volatile. Among current investors only, twice as many LPs plan to increase their fixed-income allocations as equity.

PRIVATE EQUITY IN FOCUS

There are two clear preferences within private equity: distressed private equity and secondaries, with 48% and 45%, respectively, of respondents planning an increase (see Figure 2.2). Valuations within the space have slumped amid higher rates and the IPO exit route is far reduced this year.

Fig. 2.1 Alternative allocators' plans by asset classes over the next 12 months



Analyst note: *Survey respondents were asked in November 2023, How do you expect to change your exposure to the following asset classes over the next 12 months? Totals may not add up to 100% due to rounding.*

Source: Hedgeweek-Private Equity Wire 2024 Investor Survey

KEY FINDING

Investors are confident in hedge funds' prospects – but more so in PE

Confidence of the alternatives investors surveyed in the 12-month growth prospects of the hedge fund and private equity sectors:

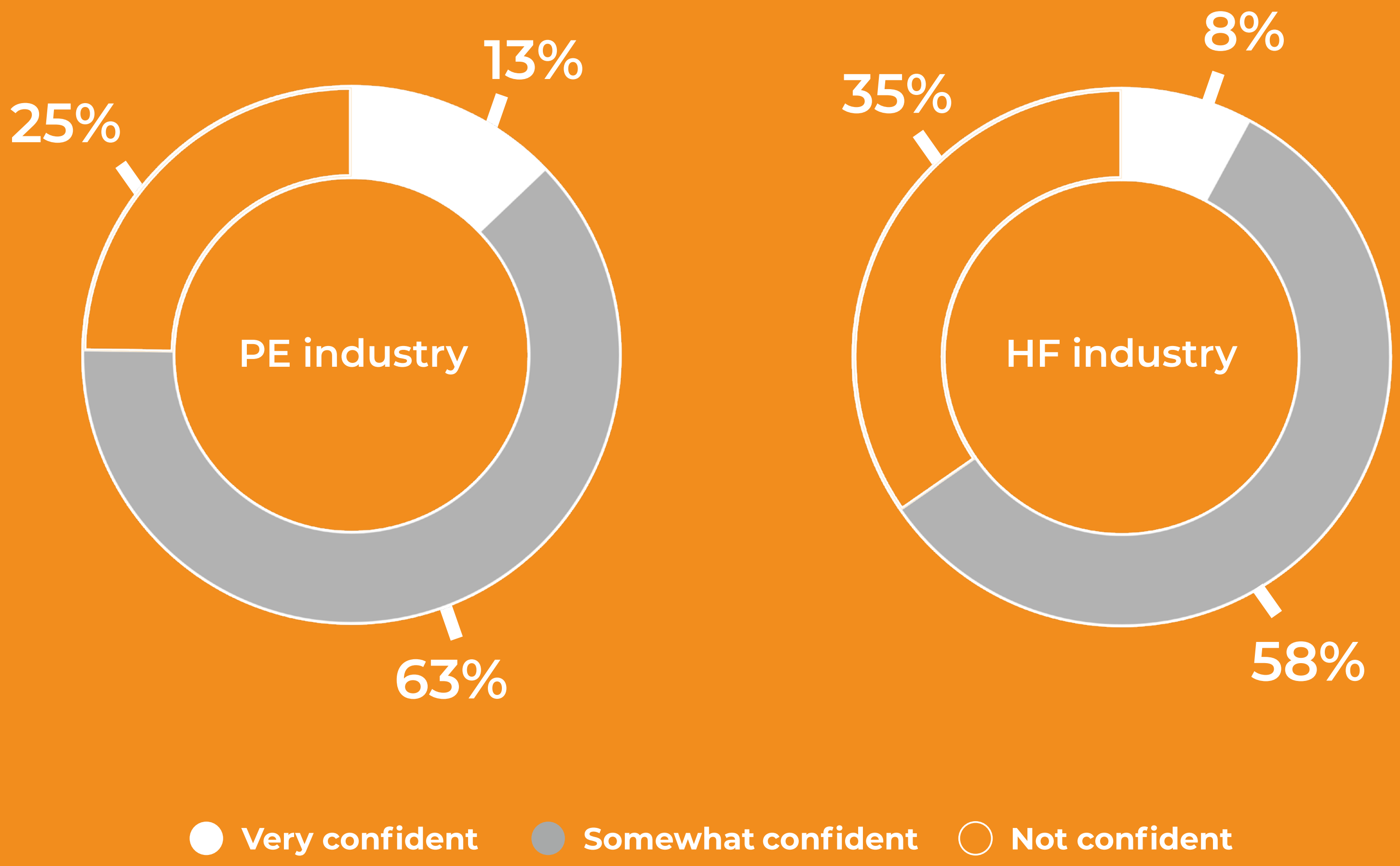
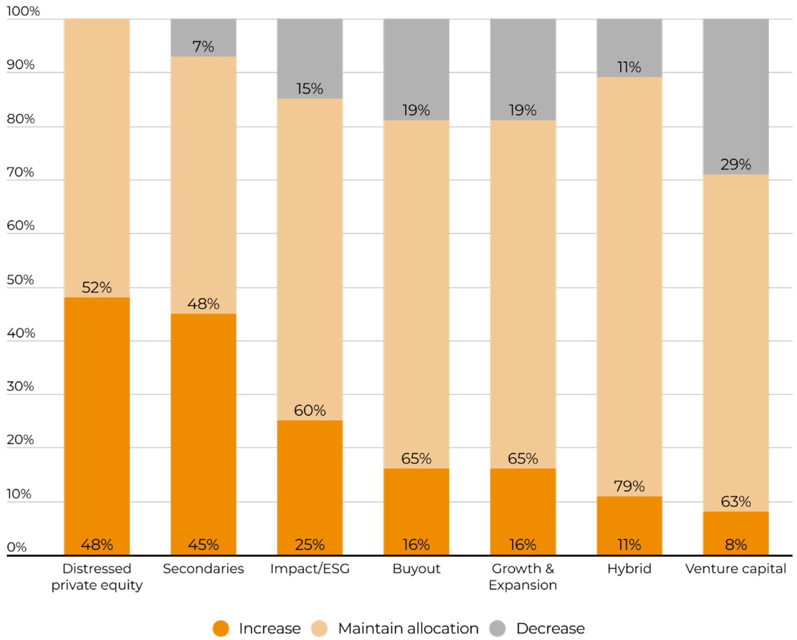


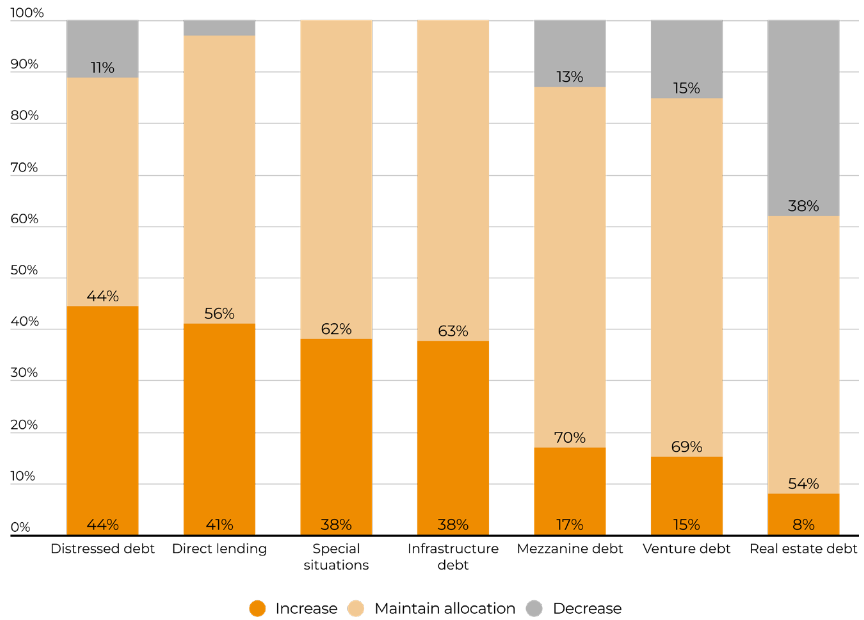
Fig. 2.2 Private equity investors' plans for their allocations in 2024 – by private equity strategy



Analyst note: Survey respondents were asked in November 2023, How do you expect to change your exposure to the following private equity strategies over the next 12 months? Totals may not add up to 100% due to rounding.

Source: Hedgeweek-Private Equity Wire 2024 Investor Survey

Fig. 2.3 Private credit investors' plans for their private credit allocations in 2024 – by private credit strategy



Analyst note: *Survey respondents were asked in November 2023, How do you expect to change your exposure to the following private credit strategies over the next 12 months? Totals may not add up to 100% due to rounding.*

Source: Hedgeweek-Private Equity Wire 2024 Investor Survey

“

Unique circumstances have led to a massive re-pricing of labour. Investors expect hedge funds to take advantage of this flux

Jack Seibald
Global co-head of Prime Brokerage Services and Outsourced Trading, Marex

That has all led to an increase in distressed private equity transactions and better opportunities in this area, as well as a boom in the secondaries market as firms with multiple transact with private equity peers in preference to more traditional exit routes.

The private equity findings suggest diversification is a key theme, with active investors keen to allocate across non-traditional areas. Just 16% plan an increase in traditional buyout-focused private equity, with a higher proportion (19%) planning a decrease and the remainder maintaining their allocation. Slightly more plan a decrease in growth & expansion (19%) than increase (16%).

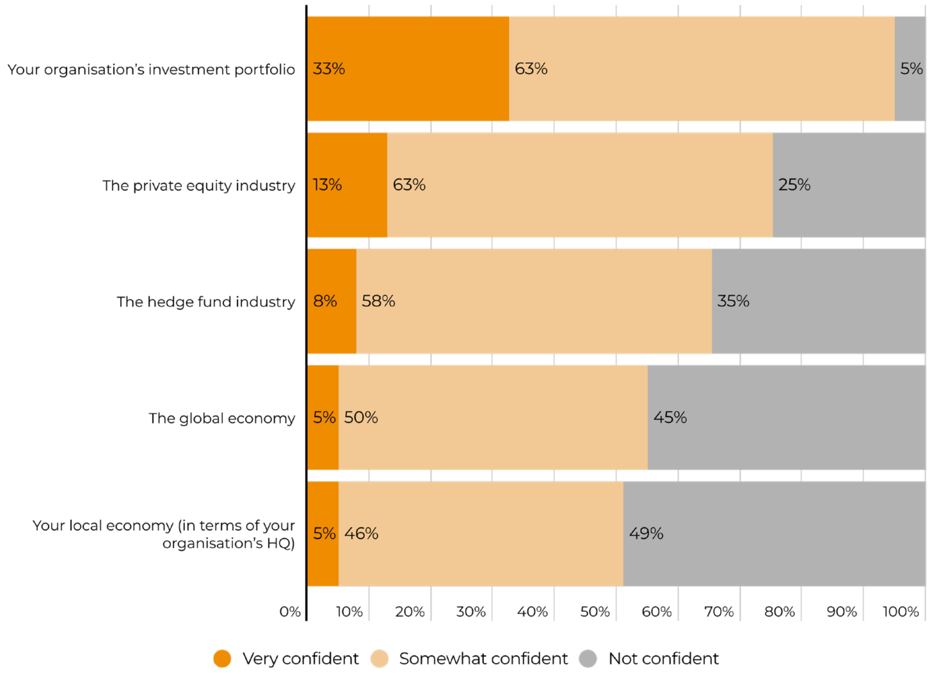
But there was a significant gulf when it comes to venture capital, which benefited massively in the low-rate environment, which led to a boom in valuations and has declined markedly since the end of the easy-money environment. Less than a tenth of respondents (8%) plan to increase compared to 29% which plan an increase.

PRIVATE CREDIT IN FOCUS

If private equity appetite has become more muted, the opposite has happened in private debt/credit. James Medeiros, president at Investcorp-Tages, says liquid strategies have become more attractive on a relative basis compared to private assets, but private credit could be the exception and "is seeing a lot of interest".

The boom in private credit strategies has been the talk of Wall Street this year. Interest in this

Fig. 2.4 Alternative allocators' confidence in the prospects of their portfolios, alternatives markets, and the global economy



Analyst note: *Survey respondents were asked in November 2023, How confident are you in the 12-month growth prospects of the following Totals may not add up to 100% due to rounding.*

Source: Hedgeweek-Private Equity Wire 2024 Investor Survey

> "The investment opportunity in high-yield and distressed for the next 12-24 months ought to be meaningful

area of alternatives is highest in distressed (44%) and direct lending (41%), followed by special situations and infrastructure debt (both 38%, see Figure 2.3). The fact that each of those four private credit segments are all expected to see an increased allocation from more than a third of LPs suggests the flows into private credit will not cease soon.

Though private credit is now outshining private equity in the eyes of investors, the PE should be heartened by the fact that LPs are more optimistic about the latter in comparison to the hedge fund industry over the next 12-months in terms of growth prospects (see Figure 2.4).

The global recession risk, a key concern which will be covered in section three, emerges as a top worry. Just 5% are very confident about the global economy in the year ahead, and 45% not confident. A similar proportion feel the same about their local economies. ■

JACK SEIBALD

Global Co-Head of Prime Brokerage Services and Outsourced Trading, Marex

Very few LPs with hedge fund investments plan a decrease next year. What explains this appetite?

Hedge funds should perform well in this environment. It is telling that relative value/arbitrage was most popular with 15% planning an increase. When you have an economy that's in a transition phase, whether up or down – and we are in a down phase for the foreseeable future – you will see assets being valued differently, creating macro RV opportunities.

On top of that, the concentration of gains in a small handful of tech names means equity returns have been incredibly lopsided. It means valuations are stretched in one place and contracted in another. Unique circumstances, from the pandemic to the inflation surge which followed, have led to a massive re-pricing of labour. Investors expect hedge funds to take advantage of this flux.

In private market strategies, why is private debt/credit the most popular?

Given the current stage in the economic cycle, I am not surprised that private debt/credit holdings are attracting so much interest going forward. The dramatic rise in rates and economic slowdown have had a big impact on many companies, creating opportunities for investors to buy debt at huge discounts or fund these companies through new paper with materially higher yields than was the case just a year ago. The investment opportunity in high-yield and distressed for the next 12-24 months ought to be meaningful.

Why is private equity and real estate interest so much lower?

Private equity has had a more difficult time this year, with recent attempts at public offerings by privately held companies not performing well. That would give any private equity investor pause when thinking about exit strategies. As a result, opportunities in distressed and secondaries stand out in this space.

As for real estate, I am surprised it is not less than 11%. Commercial buildings in major metropolitan centres are in distress. Higher rates mean a lot of owners of such properties now face problems as they have to re-finance at higher rates, or can't keep up with debt servicing.

DRIVING FORCES IN 2024

What are the top trends that will impact hedge fund capital raising in 2024? This section picks out nine key investor talking points.

1 | GREAT EXPECTATIONS

After the post-crisis era of zero rates, the higher risk-free-rate is now a material concern for allocators – if cash can offer a guaranteed return of 5% or more, hedge funds need to offer significantly more in justification for their fees and terms.

This is reflected in the survey findings. Against the backdrop of the higher-for-longer environment, allocating to managers which offer a strong return above the risk-free rate was the priority for 38% (see Figure 3.1).

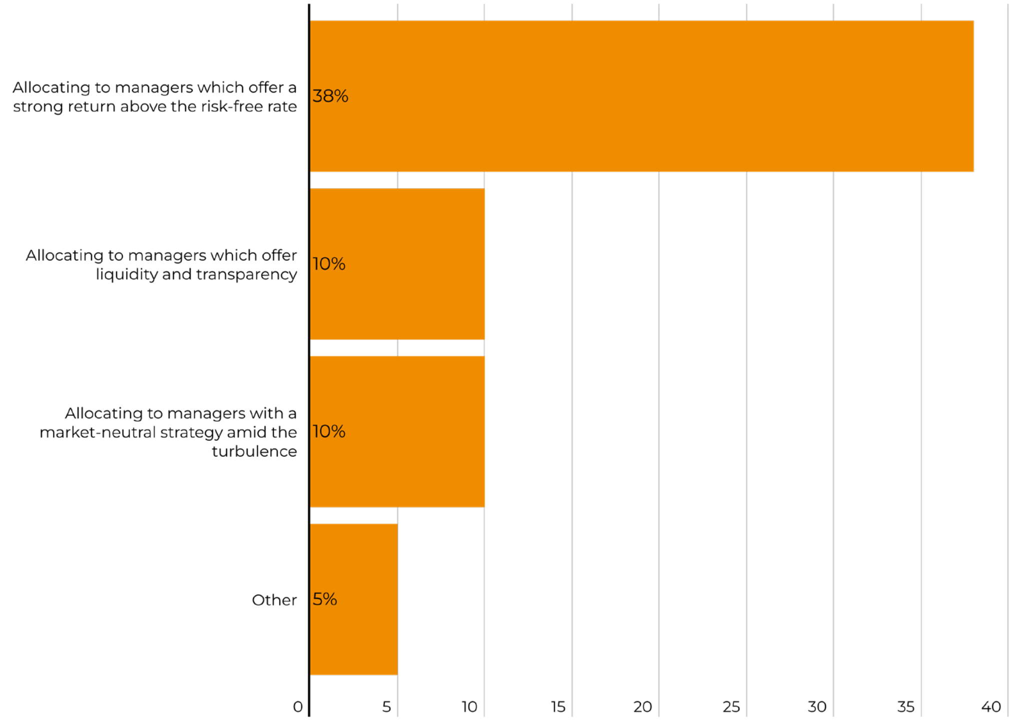
"Cash returns have gone from near-zero to 5% in no-time," says Michael Weinberg, a special advisor to the Tokyo University of Science Endowment who also serves as adjunct professor of finance and economics, Columbia Business School in New York.

"Investors should be getting at least mid-teens returns from hedge funds to justify the investment. Otherwise, if they can invest in senior secured credit, high in the capital structure with similar equity-like returns, but with bond-like risk why take the risk in hedge funds?"

James Medeiros, president at Investcorp-Tages, does not see the return requirement as quite so high but agrees "investor expectations have definitely shifted" now rates are higher.

"It's the new bogey, the elephant in the room. If you're a hedge fund which for the last 10 years

Fig. 3.1 Hedge fund investors' priority in the 'higher-for-longer' environment



Analyst note: *Survey respondents were asked in November 2023, What is your top hedge fund investment priority in the higher-for-longer environment?*

Source: Hedgeweek-Private Equity Wire 2024 Investor Survey

compounded at 6%, 7%, 8%, that looked OK. Now allocators want high single to double-digit type returns."

2 | LPS CONSIDER NEW TERMS

The new environment has led to more talk in allocators circles about whether the cash rate should be built into the fee structure, especially as some strategies – like managed futures – have it baked into the returns.

"Investors talk about a term premium in long-term Treasuries. We would argue there should similarly be one in hedge funds. In our view, with rates at 5%, investors should even be considering cash hurdles for hedge funds," says Weinberg.

Medeiros adds that: "A lot of investors are talking about carving out performance fees on cash or having a cash hurdle in terms of performance fees. There's a major push on that within the LP community."

3 | RECESSION RISK

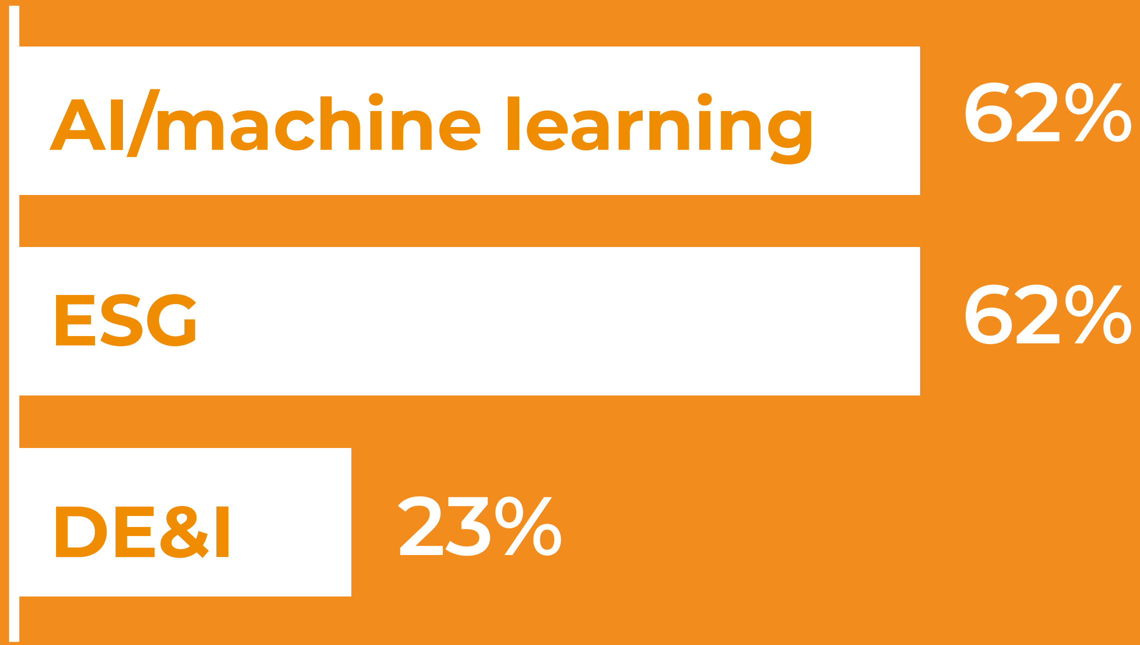
Inflation has regularly topped LP concerns in the past year, but after the recent steep fall, it has been displaced. Global recession was the key macroeconomic recession when it comes to portfolio positioning, picked by more than three-quarters of respondents (78%, see Figure 3.2), followed by rising rates (68%) and inflation (65%).

According to Courtney Birnbaum, with Corbin Capital Partners, a New York-based fund of

KEY FINDING

Investor DDQs in 2024 are just as likely to feature AI as ESG

Proportion of alternatives investors surveyed that ask fund managers about their use of AI, ESG, and DE&I:



hedge fund, this should be good news for hedge funds. "A higher interest rate environment, shifting global macro trends around commodities and other securities, and the uncertainty caused by geopolitical events, including elections in the US and, almost certainly, in the UK in 2024, should all play to hedge fund managers' strengths."

4 | DISTRESSED CREDIT IN VOGUE

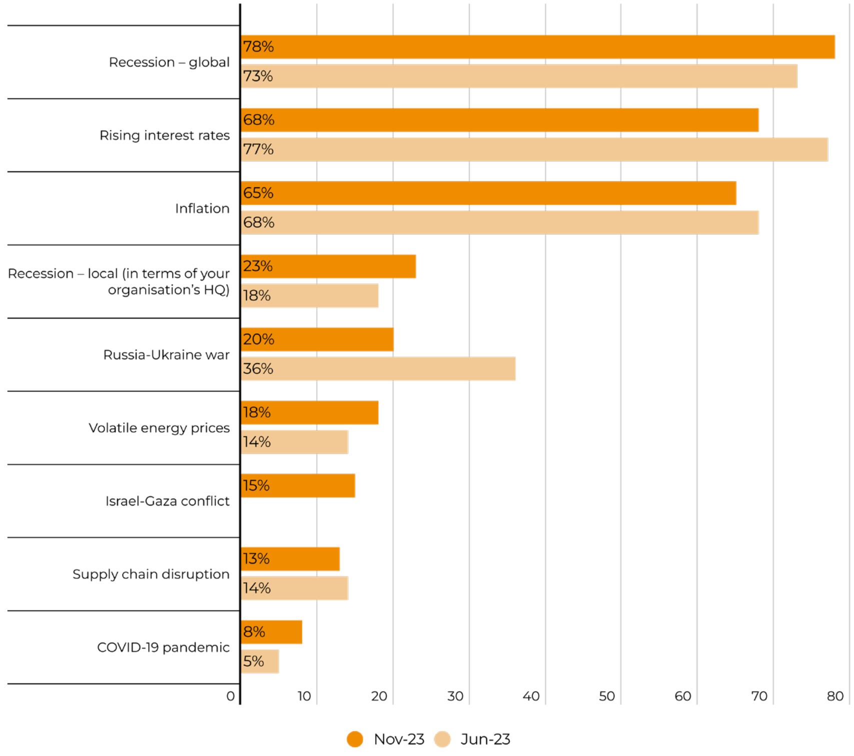
Distressed credit is the key strategy of interest highlighted by Kier Boley, co-head of Alternative Investment Solutions.

"In 2024 we could see spreads at index level remain the same, with positive technicals pushing spreads tighter, but deteriorating fundamentals pushing spreads wider, as not all companies and sectors will be impacted in the same way. As a result, dispersion between good and bad companies and sectors should increase in the months to come. This environment should generate plenty of opportunities for credit long/short strategies.

"For the top tier of credit long/short managers our expected return over the next 18 months is net 9 to 11% per annum, driven by a combination of positive net interest carry, capital gains through active trading and idiosyncratic manager alpha."

Weinberg adds: "Within the hedge fund world, one of the best opportunity sets is likely to be in stressed/distressed credit. This will be driven by the astronomical rise in rates, with SOFR having

Fig. 3.2 Alternative allocators' top macroeconomic concerns



Analyst note: *Survey respondents were asked in November 2023, In terms of the way your firm positions its portfolio, what are your three biggest macroeconomic concerns? (Please select three only). June 2023 data taken from the Hedgeweek-Private Equity Wire Mid-year 2023 Investor Survey*

Source: Hedgeweek-Private Equity Wire 2024 Investor Survey

Macro's moment?

This backdrop has increased the buzz around macro strategies, which outperformed in the volatility of 2022, but has been muted this year as equity markets rebounded.

Weinberg observes: "This very well could be one of those times where geopolitics, onshoring, divergent inflation, monetary and fiscal policy could provide outsized opportunities for macro funds."

The post-pandemic return of volatility has seen every market move, adds Medeiros. "Stocks, bonds, currencies and commodities, and others, are displaying volatility again. It should be a very good environment for active trading strategies. It doesn't mean everyone's going to get it right, but big picture, it should be a very good environment for macro."

He highlights its two "prized attributes" as its ability to make absolute returns, and do so in an idiosyncratic or non-correlated manner. "Diversification plus returns is the order of the day for allocators at the moment," he says.

Kier Boley, co-head of alternative investments at Swiss investor UBP, agrees. He breaks down the ongoing rates opportunity, which works both ways.

"If interest rates remain higher than the market is currently pricing, profitable trades will be longer-term broadly positioned short rates and long USD – even with the recent market pull back. Conversely, if the Fed has to cut rates aggressively then typically trades that are positioned long the front end and carry based strategies that take advantage of yields compressing are popular."

FX and emerging markets positions should also benefit the strategy, he adds. "Our expected return for the top tier macro managers over the next 18 months is net 10 to 14% per annum, driven by a combination of high returns on unencumbered cash, high carry, potential rate compression and idiosyncratic manager alpha."

"

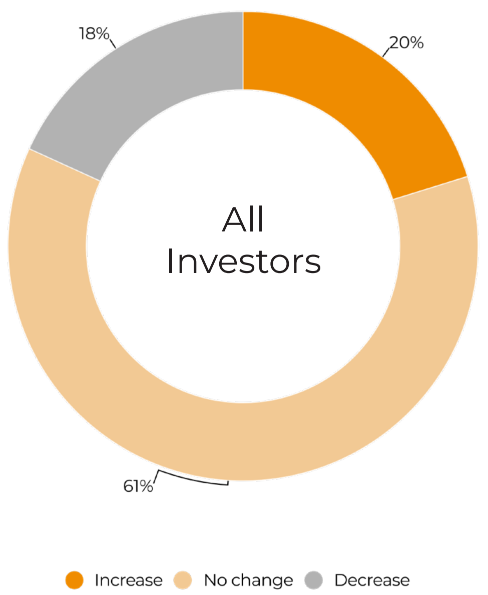
This very well could be one of those times where geopolitics, onshoring, divergent inflation, monetary and fiscal policy could provide outsized opportunities for macro funds

“

Investors talk about a term premium in long-term Treasuries. We would argue there should similarly be one in hedge funds

Michael Weinberg
A special advisor to the Tokyo University of Science Endowment

Fig. 3.3 Alternative allocators' risk appetite compared now to six months ago



Analyst note: *Survey respondents were asked in November 2023, How would you say your organisation's risk appetite will evolve going into H1 2024 compared to going into H2 2023?*

Source: Hedgeweek-Private Equity Wire 2024 Investor Survey

gone from close to zero to 5% within just over a year and banks diminished ability to lend. There will be a slew of good companies, with bad capital structures, i.e. that can no longer afford their debt coverage."

5 | HIGHER RISK IN HEDGE

Though Adam Singleton, CIO of Man FRM, describes the environment for hedge funds as being as positive as at any point in his career (see section one), he adds a note of caution.

"We also think that this environment could increase the risk within hedge fund strategies, so our central case is now that both the expected return and the expected risk from hedge funds should increase over the next few years. However, given that most well-constructed hedge fund portfolios typically undershoot on their realised volatility, this is likely to be a tolerable development.

6 | LONG/SHORT EQUITY DECLINES

Though long/short equity performance has improved this year, part of the increase has been driven by beta from the market pullback, while gains have been concentrated in large US tech stocks. Outflows have continued (see box out, section one).

"It has been challenging for long/short equity, which constantly gets compared – rightly or wrongly – to equity indices," says James Medeiros, president at Investcorp-Tages. "I don't think that's a fair comparison, but that's just the reality.

"It is a crowded market and a tougher market, but managers can succeed if they differentiate themselves – whether through sustained absolute returns, true alpha such as from a short book, or as a regional or sectoral specialist which will be important as divergence emerges across economies."

7 | RISK REMAINS

Against this volatile backdrop, the majority (61%) said they did not expect their risk appetite to change in 2024 (see Figure 3.3), with a similar amount saying it would increase as go down.

8 | AI TOPS AGENDA

More LPs are interested in asking GPs about their use of AI compared to DE&I and ESG, which have become less central concerns after the increase in volatility and monetary tightening (see Figure 3.4).

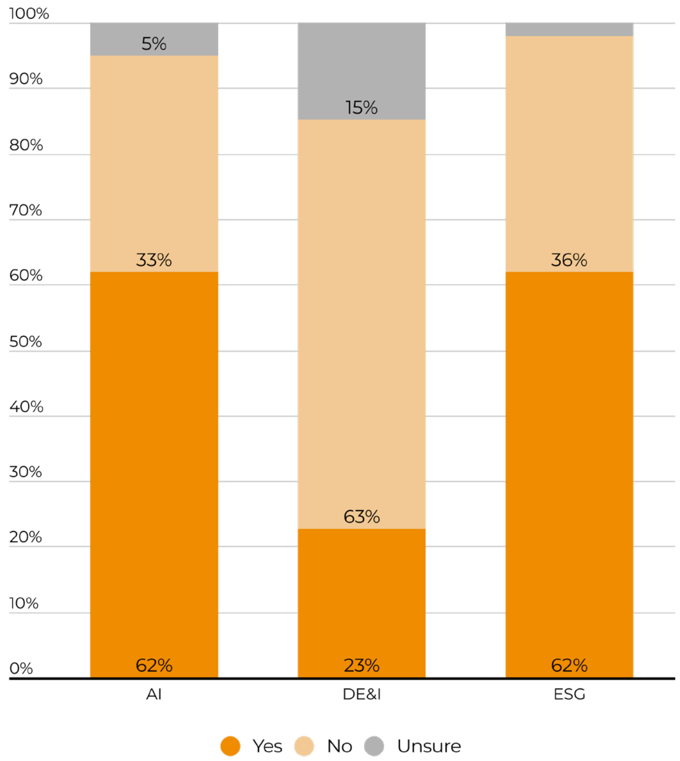
According to Man Group CEO, Robyn Grew, not a client discussion has gone by this year without the subject of AI coming up. Man Group has been doing sentiment analysis for years, but can now do it incredibly quickly, said CTO Gary Collier. It has been "additive across every part of the organisation".

9 | ESG DECLINES AS PRIORITY

Some LPs are putting less significance on ESG – environmental, social and governance – investing. "The underlying trends that ESG is seeking to capture, however imperfectly under the acronym of E, S and G, will continue to be important, and investors ignore them at their own risk," says Courtney Birnbaum of Corbin Capital Partners.

"There is no doubt, for example, that climate change is having an impact on insurance or that wildfires are a real risk for utility companies. With their diverse toolkit, nimble investment approach, and ability to identify and exploit information edges, hedge funds are actually extremely well-positioned to efficiently and effectively integrate material ESG factors, as well as support positive environmental and/or social outcomes, even if they don't always use the term ESG or sustainability." ■

Fig. 3.4 Proportion of alternative allocators that ask fund managers about AI, DE&I and ESG



Analyst note: *Survey respondents were asked in November 2023, Do you ask fund managers – whether current or prospective – about their approach to: ESG, DE&I, and AI?*

Source: Hedgeweek-Private Equity Wire 2024 Investor Survey

CONCLUSION

Investors are backing hedge funds to deliver in the new macro environment but remain cautious – and demand a higher return in a higher rate environment. Those are the key messages from Hedgeweek's investor intentions report looking into 2024, expected to be a key year for the industry.

Hedge fund strategies like RV/arb and distressed credit are being backed to succeed, while long/short equity remains out of fashion. In sum, there is a significantly high level of change being made within portfolios as LPs prepare for the new higher-rate environment to persist.

Cash is a key factor in asset allocation decision for the first time since before 2008, and the liquid nature of many hedge fund strategies should help from an LP perspective. The longer lock-ups of private assets are looking relatively less attractive, while higher refinancing costs have hit private equity, sparking a fall in valuations, and real estate in particular.

The opposite is true in private credit, now seen as the key opportunity area in private markets. Now is the time to take advantage. Hedge funds and other alternative strategies able to capitalise on the new era of macro volatility, geopolitical and market turbulence will be prized by LPs in the years to come.

HEDGEWEEK

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