THE ALTERNATIVE CAUSERIE

HEDGE FUNDS CONTINUE TO PERFORM POSITIVELY

The third quarter was an eventful period that saw volatility coming back to the forefront. Most hedge fund managers were able to grind higher albeit with some volatility during the quarter. Directional managers profited from the increase in risk assets and equity prices as major central banks around the world cut interest rates. Hedge funds continued to deliver strong performance in Q3 and according to HFR, Q3 performance resembled the second quarter where almost all hedge fund strategies were positive apart from equity market neutral that sustained minor losses. During the quarter, Macro/CTA strategies led the way with a solid rebound (+2.4%) followed by equity hedge (+1.8%) and event driven (+1.7%). Having an allocation to an active portfolio of heterogeneous hedge funds with distinctive risk-return profiles and performance drivers can greatly help stabilize returns as shown in the table below. Portfolios of hedge funds could be seen as a good diversifier in times of high equity and bond market valuations.

HFRX Index	**Q3-19**	**2019**	**2018**
Global Hedge Fund Index	+1.6%	+5.9%	-6.7%
Equity Hedge	+1.8%	+7.9%	-9.4%
Equity Market Neutral	-0.2%	-1.3%	-3.2%
Event Driven	+1.7%	+4.3%	-11.7%
Macro/CTA	+2.4%	+5.1%	-3.3%
RV Multi-Strategy	+0.6%	+4.6%	-1.2%
Fixed Income Credit	+0.7%	+3.6%	-2.6%
ACTIVE FoHF Portfolio			
Absolute Return Strategy	+1.0%	+7.4%	+1.0%
Healthcare/Biotech Strategy	-8.5%	+7.7%	+2.2%
Macro/CTA Strategy	-0.4%	+2.2%	+0.1%

Source : HFR and Bloomberg

Dispersion across hedge fund managers was elevated as several events during the quarter had a meaningful impact on portfolios. Some Macro managers where caught in the Argentinian sell-off during the month of August with bonds and FX declining substantially. On the equity front, most managers were able to withstand the equity correction in August but suffered from the factor/sector rotation in September with growth and momentum underperforming while value and quality outperformed.

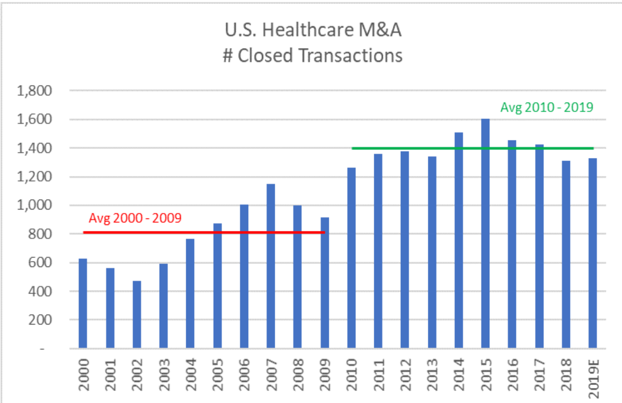
Performance of various HF managers in Q3 2019*:

- **Event Driven:** ED1 +2.2%; ED2 -0.3%; ED3 -0.7%
- **Long/Short Equity:** LS1 +0.1%; LS2 +0.2%; LS3 -10.2%
- **Healthcare L/S:** ALS: -15.1%; RTW -14.9%; BOV -7.4%; EGH -0.3%
- **Global Macro:** GM1 -3.4%; GM2 +3.7%; GM3 +18.9%; GM4 +6.2%; GM6 -0.8%; GM7 -0.4%
- **CTA/Managed Futures:** CTA1 +12.6%; CTA2 -3.8%; CTA3 -1.5%; CTA4 -1.4%; CTA5 +3.5%; CTA6 -0.7%; CTA7 +1.6%
- **Low Net/Market Neutral:** LMN1 +0.6%; LMN2 +7.0%; LMN3 -0.9%; LMN4 +3.6%; LMN5 +0.7%; LMN6 +1.7%; LMN7 -1.2%; LMN8 +1.1%
- **RV Arbitrage / Multi-Strategy:** MS1 +1.6%; MS2 +0.9%; MS3 +0.7%; MS4 -1.6%

**Estimated performance based on latest available data or found in the public domain*

HEALTHCARE/BIOTECH IN FOCUS

The third quarter was characterized by volatility and de-risking in the sector. US Healthcare policy was in the spotlight, similarly to the last election cycle, putting pressure on stocks. Despite this, the sector remains at a very compelling cross road between strong innovation and high demographic and geographic demand. Temporary volatility will certainly create enticing investment opportunities for specialised long-term investors. Shorter term, M&A should continue in the sector as cash rich pharma and biotech large caps seek pipeline opportunities. This is reflected by two recent acquisitions at attractive premiums (RA pharmaceuticals and Achillion pharmaceuticals, acquired for a +112% and +73% premiums to previous closing prices, respectively).



Source: S&P CapIQ

In the last few months the Senate Finance Committee released its drug-pricing bill, announcing its plan to push for drug re-importation. Even though the title is dramatic (and was amplified by media comments from Trump and Co.) the reality is that the plan would mainly allow re-importation of specific molecules from Canada and excludes, biologics, intravenously administered drugs and inhaled products. However, the bill does include other more relevant aspects, in particular the capping of out of pocket expenses in Medicare part D. Currently chronically ill patients covered by Medicare have to co-pay 5% without limit, a fact that can be devastating for patients who are on expensive anti-cancer drugs or other expensive drugs of the like, in some cases leading to personal bankruptcy. This is a very sensitive political issue on which both sides of the political isle agree as being a major concern for voters. The new bill would cap out of pocket expenses at $3'100 annually for Medicare patients. The estimated impact on biopharmaceutical companies would be a 3-10% loss of revenue from Medicare Beneficiaries, which would be manageable by the industry and alleviate a major issue in the US healthcare system. What is important to note is the reality of the claims made. Certain politicians are claiming a universal healthcare system in the US, which is very unlikely, simply due to the strong business and employment implications as well as the big unknown on how it would be financed.

Fundamentally, healthcare sector continues to have a number of attractive facets, the high unmet medical need as expressed by the multiple number of diseases for which we still need to find adequate care solutions and the growing ageing population. Successful drugs (among them personalised medicines) and technologies (digital health) will improve the quality of life, while reducing cost of care. The pricing pressure on drugs will certainly continue, but it will also push the healthcare system (particularly the US) to a value based system, which will open up a plethora of other opportunities, particularly in personalised medicine, with innovative business models. It is important to keep a long-term view in healthcare.

There will be news flow in the coming months concerning this issue, giving more clarity on how this will pan out. Nevertheless there remain very interesting opportunities on the long and short side. It is also important to note that generalist investors' exposure to healthcare equity stocks (particularly small and mid cap) is currently low, making the price sensitivity to healthcare regulatory macro event less impactful than could be suspected.
This is an attractive environment for acquisitions. Larger pharma and biotech companies with a high cash pile are long-term investors; they therefore thrive in environment such as this.

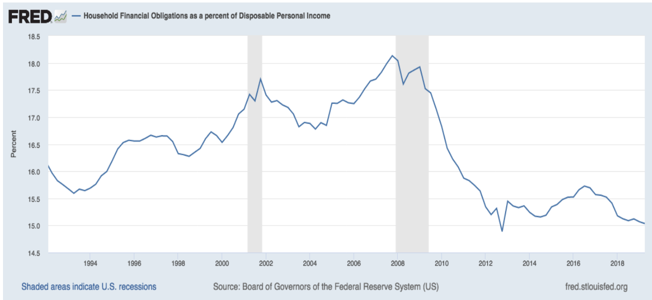
PRIVATE MARKETS
US CONSUMER LOANS

The US consumer debt is an important market that can't be ignored as it represents more than $15.6 trillion of debt of which the majority is in home mortgage loans for about $11tr and $4tr is in outstanding consumer credit.
One sub-category of this market is represented by personal loans that have been present since the existence of traditional banking.

PROSPER LendingClub

These loans are mainly used to refinance existing credit card debt, to consolidate debt or to make home improvements. With the emergence of alternative lending solutions this market has grown tremendously in the last decade and has attracted more borrowers. Online lending platforms like LendingClub and Prosper have been the engines of this growth.

Since the financial crisis, the US consumer has been able to take advantage of the low interest rate environment and refinanced its mortgage debt at a lower level. Their financial obligations versus disposable income has been also trending lower since 2008, which reinforces the consumer ability to meet future obligations. Moreover, unemployment rate in the US is at historical lows, which benefits this market.



There are different ways to access this sector and one of them is through primary sourcing deals coming from online platforms. These companies have revolutionized the lending landscape by competing directly with traditional banks, offering lower rates and faster execution. Investors/Lenders profit from the self-amortizing nature of the loans as borrowers pays back interest plus amortized principal every month, which mechanically shortens the investment horizon. Furthermore, the diversification of a pool of loans is easily achievable as the size of each loan is very small, on average $15k. The average interest rate paid is between 14-16% with average duration around 18 months and loan maturities vary from 36 to 60 months. In case of a deterioration in the macroeconomic environment (increase in unemployment, late credit card payments, …), the strategy is quite flexible as it will be able to stop the reinvestment of principal/interest received or it could target borrowers that are employed in less sensitive sectors to economic changes (ie. healthcare employees are less vulnerable than those in construction) and having higher FICO scores. Finally, the major risk is that borrowers default on the loan and generally it is expected that one third of the interest rate paid is charged off. However, during an economic downturn the default rate will be much larger. The ability to screen all borrowers data, platform performance and pricing using advanced technologies (AI/Machine Learning) will be the key to maximise returns and mitigate risks.