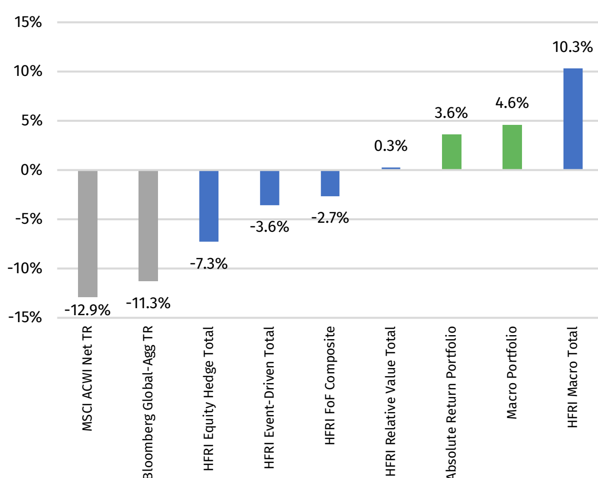
ITERAM

THE ALTERNATIVE CAUSERIE

HOW TO THRIVE IN TURBULENT MARKETS?

There is no doubt that traditional investors must be scratching their heads to find the optimal formula to navigate the current markets as both equities and fixed income assets have been delivering abysmal losses since the beginning of the year on the back of numerous headwinds: global growth slowdown, surging inflation, higher interest rates, war in Ukraine and supply chain bottlenecks among other factors. While hedge funds have been shrugged during the past decade as they lagged equity markets' stratospheric returns, we now feel that it is time for investors to review their thesis on the benefits of alternatives and particularly hedge funds within portfolio allocations. Even within hedge funds, strategy allocation and manager selection remain key as mainstream long/short equity managers have also been driven down by their embedded market beta.

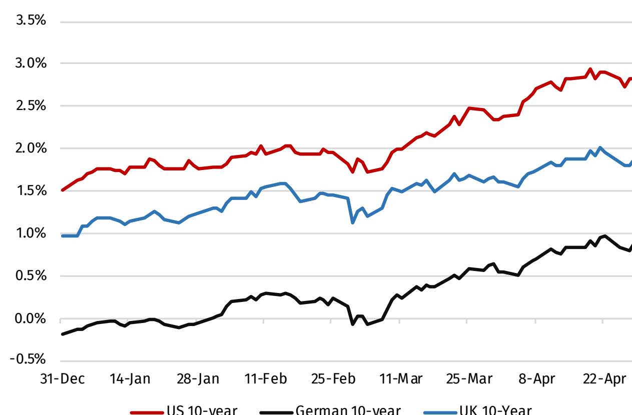
Hedge Fund Indices – YTD Performance



Source: Bloomberg, as of April 30, 2022

We have been vocal supporters of commodity strategies for the past 18 months as we felt that the post-COVID disruptions have set the stage for ideal market conditions for commodity managers. Sadly, our investment thesis has been strengthened by the Russian invasion of Ukraine which has jeopardized the supply of various critical commodities given the sheer importance of both countries in global production of energy, grains and metals. As of March 31st 2022, the SG Commodity Trading Index was up +4.26% while the HFRX Global Hedge Fund Index (which is heavily skewed toward equity strategies) lost -1.35%.

Global interest rates have been rising steadily this year



Source: Bloomberg

As major central banks embark on one of their largest normalization processes, there are finally compelling alpha opportunities to be captured within fixed income and foreign exchange. The US 2-year yield increased by +160bps during the first quarter of 2022 as investors anticipate the upcoming Fed's rate hikes, which was the largest quarterly upward move since Q2 1984. As a result of the strong moves in rates, the Dollar index rose by +4.73% in April 2022, its best monthly performance since January 2015. Global macro managers are on the front line to be the main beneficiaries of these policy shifts and we have been focused on building a solid allocation to this space over the past year. Furthermore, we are also witnessing the revival of CTAs which have greatly benefitted in this market environment. While these strategies thrived in 2008 thanks to their core trend-following components, these strategies have been evolving to include a myriad of new sophisticated quantitative models and data to identify additional sources of alpha.

Equities will remain a tough space right now but there is still value in sourcing low-net tactical managers which can extract alpha from short-term relative value trades to take advantage of higher volatility and price dispersion. Long-biased growth-focused managers should continue to be challenged for the rest of the year, the NASDAQ Composite index and the SPDR S&P Biotech ETF having already shed -21.16% and -34.06%

year-to-date respectively (as at end of April). Tiger Global's flagship fund, one of the hedge funds industry leading performers of the past decade, has lost -44% during the first 4 months of the year according to Bloomberg which somehow feels like the end of an era of overcrowded investments in cash-burning high-growth technology stocks. It is probably time to reward skilled short pickers and we believe that multi-manager platforms have the ability to outperform thanks to a selection of market-neutral capacity-constrained strategies with a disciplined risk management approach to minimize drawdowns.

RESILIENCY OF PRIVATE DEBT: A SOLUTION AGAINST HIGHER RATES AND INFLATION

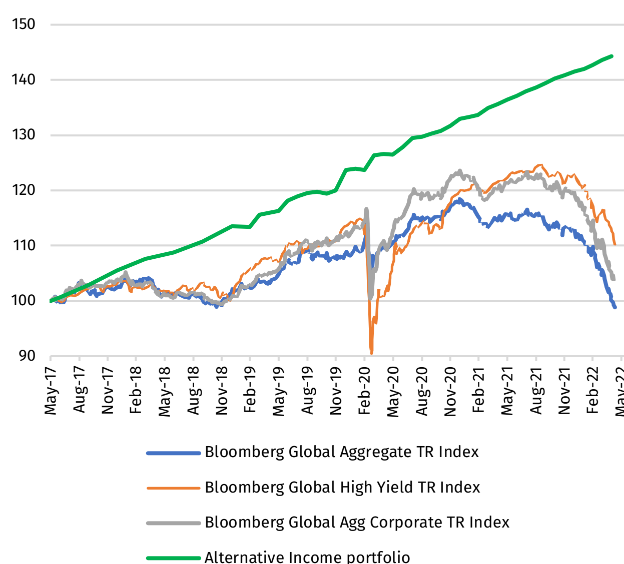
The market environment for fixed income investors is probably in the midst of a major turnaround after being propelled by low and negative interest rates during the last decade. Investors have pushed bond prices and negative yielding debt stockpile to more than $18 trillion back in 2020. Today this same stockpile is only worth $2 trillion wiping out most of investor's returns as they have been investing in longer duration assets in order to capture higher yields. These assets are also more sensitive to rate hikes as current yields can't compensate for the unprecedented move. This has been the worst start to a year since the 1980's for bond investors.

Bloomberg Global Agg Negative Yielding Debt Market Value (USD)

Source: Bloomberg as of May 10th 2022

Fixed income investors are now faced with two major headwinds: central banks tightening monetary policies and surging inflation. Europe, the UK and the US are on path or have already started to taper their quantitative easing programs which is a fundamental shift away from their ultra-accommodative stance. This means that investors can't no longer rely on governments to support risky assets, what is more, in an inflationary environment. To that end, Private Debt can be seen as a good inflation protector as higher yields can compensate for the increase in rates and inflation. We therefore have a preference owning and financing real assets, real estate and infrastructure assets that can weather inflation as prices readjust.

Performance of major global bond indices last 5 years



Source: Bloomberg as of May 10th 2022, Alternative income portfolio as of April 2022

Against this challenging backdrop, we are able to structure financings that charge higher interest rates than typical public investment grade or high yield corporate bonds, with a shorter-duration framework and with enhanced and secured collateralization. These in-built protections limit and cushion the sensitivity to raising interest rates. Moreover, the shorter duration characteristics enable us to profit from this market environment and redeploy capital at higher rates going forward.

Historically during high market volatility and uncertainties, private debt, has been quite resilient and provided diversified and uncorrelated returns to investors with downside-risk protection.

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