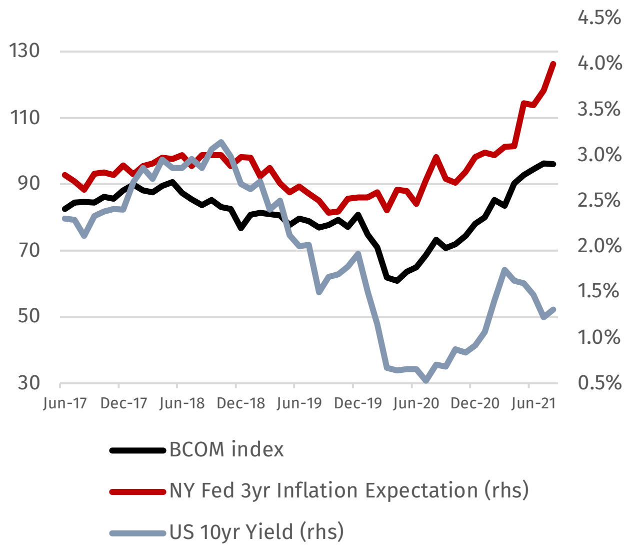
THE ALTERNATIVE CAUSERIE

1-TO-1 MEETINGS ARE BACK

September was an eventful month for ITERAM's research team as we participated in about 60 manager presentations across all hedge fund strategies. We attended the Morgan Stanley Global Hedge Fund Forum from the 13th to 15th and Goldman Sachs's European Emerging Managers Forum from the 22nd to 23rd, both in virtual format. Finally, we were glad to be on the road again as we completed our first business trip since Q1 2020, in London, during the last week of the month.

This fall's buzzword in the industry is undoubtedly "inflation". After years of anticipating a higher volatile market regime due to excessive leverage, loose monetary policy and unabated rally in risk assets, this new layer of concern could be the straw that breaks the camel's back. Therefore, most managers were very active positioning their portfolios to benefit from rising inflation across various asset classes. Global macro and cross-asset managers in particular share a strong bearish view on rates, both in Europe and the US, while stock pickers were looking for companies with pricing power. Also, it is worth mentioning the great revival of commodities as a core asset class since it tends to thrive during inflationary environments.

Inflation is roaring but rates are lagging behind



Source: Bloomberg as of August 31, 2021

Other key takeaways from the meetings are:

- Hedge fund allocators continue to lose appetite for systematic strategies after years of disappointing performance. Established systematic programs using arbitrage, multi-factor and alternative data signals are struggling to meet their expected return targets and retain assets while artificial intelligence/machine learning-driven models are still live testing their models amid uncommon market conditions with so far limited success.
- There is growing interest in private markets, both in credit and equities, as investors are attracted by unique opportunities delivering higher returns while exhibiting smoothed volatility due to the absence of mark-to-market valuations.
- Outperforming managers have all in common the ability to take concentrated bets in a handful of high conviction bets, an approach which has been particularly profitable during the post-Covid rally that started in April 2020 and extended into the first half of this year.

MARKET VOLATILITY: AN OPPORTUNITY FOR ALTERNATIVES TO SHINE

On September 20th, a panic selloff in equities was fueled by concerns around the global consequences of the ongoing liquidity issues surrounding the Chinese real estate developer China Evergrande Group which has been struggling with liabilities in excess of $300 billion. It is however important to mention that the property sector deleveraging is self-imposed by the Chinese government, as part of a wide initiative to fix the imbalances created by 40 years of relentless economic miracle. Few weeks earlier, online education companies and internet platforms were the target of the state's effort to tackle monopolies and data privacy issues. Our EM managers' view is that the central government is currently carrying out a broad cleaning on multiple fronts (energy transformation, social equality, less speculation, foster innovation) to build the path towards healthy growth over the next decades. That being said, these reforms combined with external headwinds (energy prices and supply chain bottlenecks) should limit the growth potential in China for the very next years.

Unsurprisingly, equity hedge funds have outperformed in 2021 as their long books benefited from another steady bull market until the end of September. Energy, financials and real estate in particular were buoyed by the inflation narrative and have been the best performing sectors year-to-date. Uncorrelated strategies are however barely positive for the year.

Index/Active portfolio performance as of September 2021

HFRX Flagship Funds Index	Q1-21	Q2-21	Q3-21	YtD-21
Global Hedge Fund	+1.29%	+2.41%	-0.14%	+3.58%
Equity Hedge	+2.65%	+5.07%	+1.28%	+9.24%
Equity Market Neutral	+2.52%	-0.05%	-1.11%	+1.33%
Event Driven	+1.71%	+1.67%	-1.04%	+2.34%
Macro/CTA	+0.52%	+1.03%	-1.49%	+0.04%
RV Multi-Strategy	-0.30%	+0.91%	-0.01%	+0.59%
EQUITY Index				
S&P 500 TR	+6.17%	+8.55%	+0.58%	+15.92%
MSCI World TR	+4.92%	+7.74%	-0.01%	+13.04%
ACTIVE Portfolio				
Absolute Return	+1.22%	+1.06%	+1.80%	+4.13%
Healthcare/Biotech	-5.80%	-3.95%	+0.70%	-8.89%
Macro Diversified	+1.55%	+0.93%	+1.00%	+3.52%
Alternative Income	+1.51%	+1.58%	+1.74%	+4.91%
Venture Capital	+7.16%	+3.48%	NA	+10.89%

Source : HFR and Bloomberg as of September 2021 and active portfolio are estimates

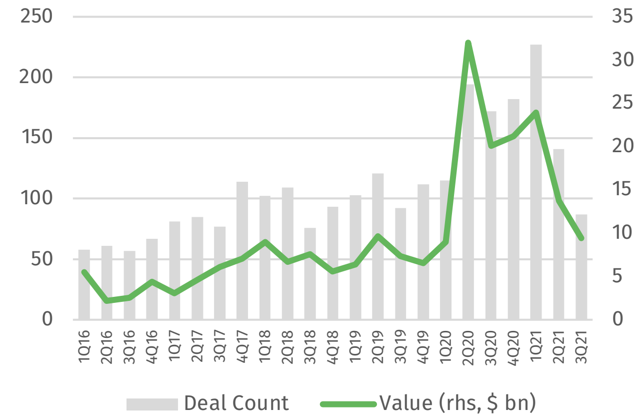
Having an allocation to an active portfolio of heterogeneous hedge funds with idiosyncratic risk-return profiles and diversified performance drivers can greatly help stabilize returns as shown in the table above. Portfolios of hedge funds and private markets could be seen as a good diversifier in times of high market volatility.

ATTRACTIVE ENTRY POINT IN HEALTHCARE - BIOTECH

In healthcare, accumulating headwinds (rising rates, taxes, expensive legislation, and of course drug pricing) continued to dampen the sector. The consequence is that many small cap biotech are now trading near their cash levels, offering attractive buying opportunities for big Pharma to expand their product range with new innovative drugs. While M&A in the sector has not gone back to pre-pandamic levels yet, especially with no mega-merger so far this year, the activity has picked up lately with the acquisitions of Translate Bio and Kadmon Holdings by Sanofi, Trillium Therapeutics by Pfizer and Kadmon as well as Acceleron by Merck in September, and two smaller deals in October (Adamas Phamaceuticals by Supernus Phamarceuticals and Flexion Therapeutics by Pacira BioSciences). Such deals were not really a surprise given that the S&P healthcare index is trading at 16 times estimated 2022 earnings compared to the S&P 500's 20 times. The "pickup in M&A" could potentially just be in its early innings. Especially when we know that healthcare companies typically offer superior growth to the general economy. As such, they generally deserve, and usually receive, an appealing premium to their bottom valuations.

After a strong post-Covid period, IPO and secondary volumes cooled off over the summer, bringing a certain relief to the sector. We have witnessed a meaningful surge in ECM activity within biotechnology between 2Q20 and 1Q21 vs. prior years. The low quality of some of these new issues combined with stretched valuations contributed to the underperformance of the sector.

Biotechnology - Quarterly Global ECM Activity



Source: Bloomberg as of September 30, 2021

One topic that was widely mentioned during our last calls with healthcare managers and seemed to be a hot topic was protein degradation. Proteins are fundamental to cellular function and play a significant role in the body and are necessary for the structure, function and regulation of tissues and organs. Protein degradation ensures unnecessary proteins are removed from the cellular environment when they are no longer needed or are damaged or faulty in some way. When a cell is unable to degrade abnormal and/or unnecessary proteins, these proteins can accumulate within the cellular environment. The accumulation of proteins within a cell is involved in the pathogenesis of many diseases, including several malignancies and neurodegenerative disorders. With many approaches to treating cancer focused on inhibiting specific pathways or proteins, scientists are exploring how to use protein degradation to approach cancer research in a new way, effectively leveraging the body's natural system to target and remove the pathogenic proteins and maintain homeostasis. While still several companies operating in the space remain private, there are a few listed companies that seem to attract our managers' attention.