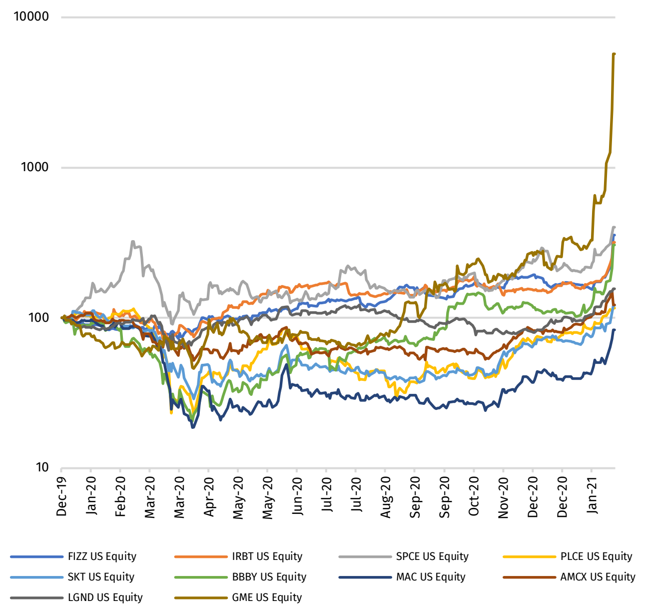
ALTERNATIVE FLASH UPDATE

SOME HEDGE FUNDS CAUGHT OFF GUARD

After posting one of the best years since 2009, a handful of hedge funds made the headlines in January as they faced synchronized attacks on their most shorted stocks. In fact, the top 10 most shorted companies have seen an influx of capital from retailers which have forced managers to pair back their bets and buy back stocks at a much higher level. One of the targeted companies was GameStop Corp. which saw its share price moving from $20 to $483 in a very short period and caused steep losses to some hedge fund managers. The combination of more people staying at home due to the sanitary crisis and opening new trading accounts in order to participate in the equity rally, should not be sustainable over the long run. However, retail investors' trading market share has increased considerably and it's a new risk parameter investment managers can't ignore anymore.

Performance of the 10 most shorted stocks

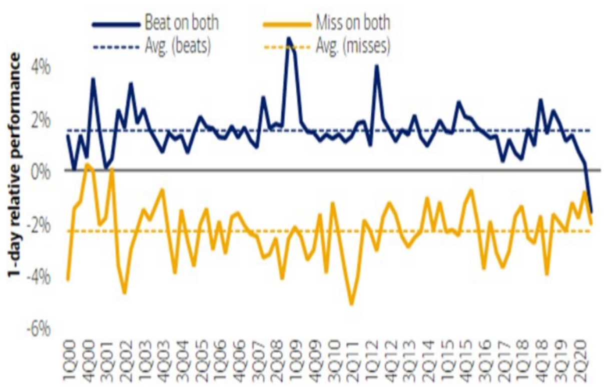


Source: Bloomberg – log graph

This "short-squeeze" forced some hedge fund managers to de-lever portfolios already during the second week of the month. According to Goldman Sachs, it was the largest short covering in years in 8 out of 11 sectors. However, 70% of the overall activity was concentrated mainly on technology and consumer discretionary sectors. It also saw the largest risk-off flows since March 2020 driven by short covers and long sales. A good proxy to follow is the Goldman Sachs Hedge Industry VIP ETF (GVIP US) of the most owned companies by hedge fund managers which lost around -4.9% on January 27th 2021 versus the broader market (MSCI World TR $) being down -2.2%.

The result of this mini-selloff was that high quality companies that were part of this de-leveraging also suffered. This explains the other side of the equation why some hedge funds suffered due to the underperformance of some of their longs. As illustrated on the below chart, the last week of January saw the one-day relative performance of companies that beat both revenues and earnings recording their worst performance. This reflected a clear temporary disassociation between fundamentals and price actions which over the long run is normally unsustainable.

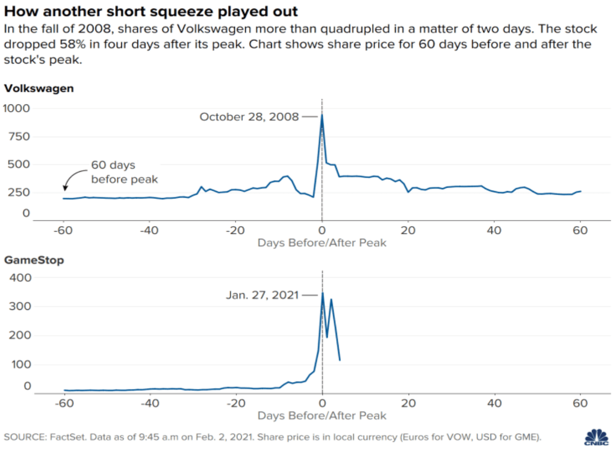
One-day relative performance of companies that beat both revenue and earnings



Source: Merrill Lynch

HF MANAGERS TAKEAWAYS

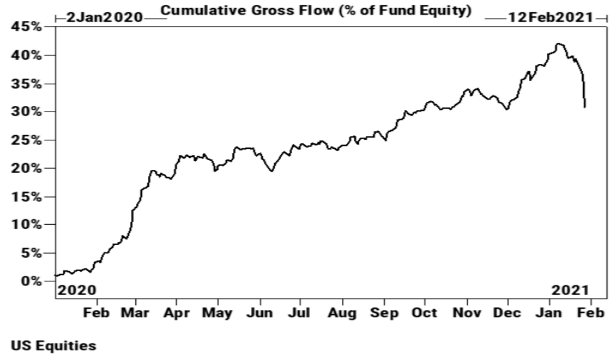
For the time being, managers are not too worried as this phenomenon is happening in a bull market due to some high market exuberance. Most of them think that there is still some leg to go, however, that it will not last. It is not the first time that we witness a short squeeze (ie. Volkswagen, Herbalife, Tesla ...) but this time, it was quicker and more pronounced (graph in the next page).



We see the recent events more as an idiosyncratic event linked to few hedge fund managers than a global problem that could spread around. It also seems to be specifically related to heavily shorted US companies despite some small collateral effects in Europe and Asia.

This market event impacted primarily long/short equity strategies. According to Morgan Stanley, US L/S managers are down -2.3% in January, vs -1.2% for European managers and +1% for Asian managers. In terms of L/S managers, it was primarily long biased and concentrated managers that were mostly impacted. L/S equity managers with sectoral bias (consumer, IT, ...) suffered more than global managers and second order instruments saw big price moves (volatility, options). Other strategies which traded volatility instruments have also been impacted due to the spike in the VIX on January 27th from 23 to 37, a 62% increase. This was the third largest percentage spike since VIX data began in 1990 and interestingly the SP&500 only dropped -2.9%. Collateral damages have also been seen across the industry as a big wave of de-grossing occurred (the largest since 2008). CTAs could have put additional price pressure as they might had to reduce their equity exposure due to the increased volatility.

Most managers were not caught in these names as they carefully monitor all risk parameters (such as the short interest coverage, volume traded, ownership split, market cap) and have a strict risk management framework. However, these managers had to comply with their internal risk budgets and had to reduce net and gross exposures. Entering in a new fiscal period and as first month of the year, a January effect is also not excluded, as managers had no performance cushion to rely on, and as a consequence, executed the limit breaches in a tighter way than they would usually do further down the year.



Source: Goldman Sachs

Prime Brokers don't think either that this could lead to an extensive sell-off. De-grossing could continue until the third week of February when options for the month are due.

Some managers also expect to see more regulation on cleared options further down the road with more margin requirements for the options' makers. Other types of regulation on retail investors vs Wall Street could also be plausible but probably somehow difficult to implement.

Fund MtD performance as of January 29th 2021

STRATEGY	PERFORMANCE	RANGE
Event Driven	⚪ ⚪ 🟢	-5.0% to +9.5%
Merger Arbitrage	⚪ ⚪ 🟢	-0.5% to +8.0%
Fixed Income RV	⚪ ⚪ 🟢	-0.4% to +2.5%
Long/Short Equity	🔴 ⚪ ⚪	-25% to +3.8%
Multi-Strategy RV	⚪ ⚪ 🟢	+0.5% to +3.5%
Equity Market Neutral	🔴 ⚪ ⚪	-6.7% to +3.8%
CTA/Managed Futures	⚪ 🟡 ⚪	-3.5% to +2.5%
Global Macro	⚪ 🟡 ⚪	-3.1% to +4.2%
Volatility RV	🔴 ⚪ ⚪	-3.9% to 0.0%

Based on ITERAM's followed list of managers
Red: on average negative performance
Yellow: high dispersion and on average flattish performance
Green: on average positive performance.

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