Quarterly Analysis

# Manager Intelligence and Market Trends

**August 2020**

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bfinance is an award-winning specialist consultant that provides investment implementation advice to pension funds and other institutional investors around the globe. Founded in 1999, the London-headquartered firm has conducted engagements for more than 370 clients in 38 countries and now has eight offices in seven countries. Services include manager search and selection, fee analysis, performance monitoring, risk analytics and other portfolio solutions. With customised processes tailored to each individual client, the firm seeks to empower investors with the resources and information to take key decisions. The team is drawn from portfolio management, research, consultancy and academia, combining deep sector-specific expertise with global perspective.

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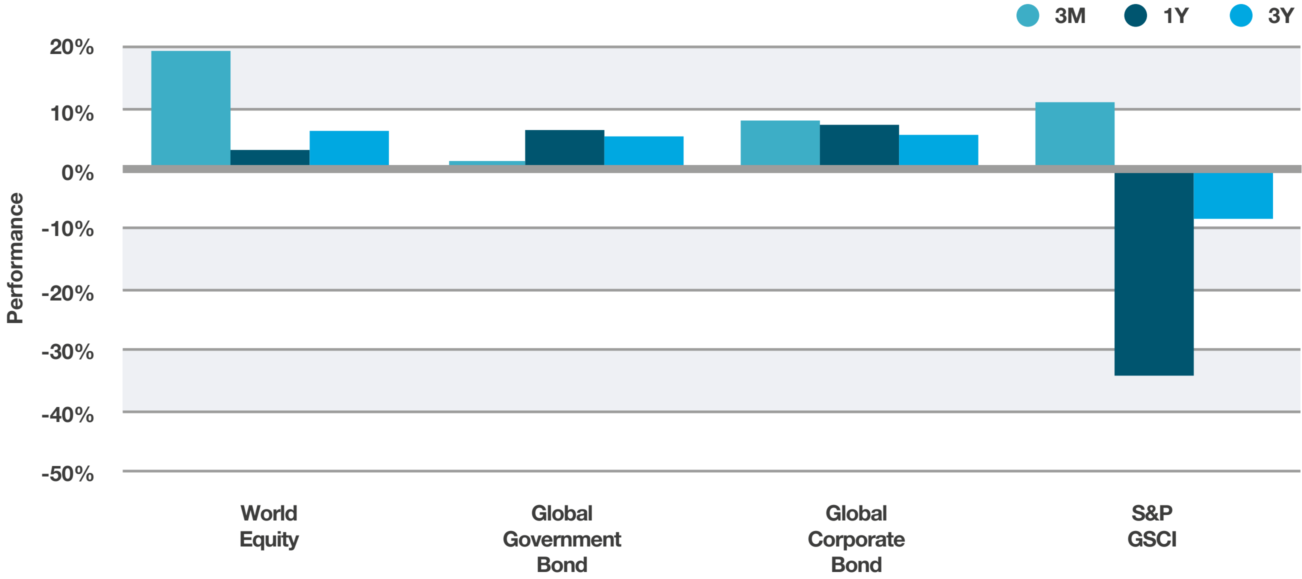
# At a glance...

- Although managers boosted equity exposure in Q2, the Q1 spike in the bfinance Risk Aversion Index has not substantially softened in Q2, with a range of indicators illustrating the ongoing uncertainty (implied volatilities, gold prices, CDX etc).
- On the back of a tumultuous first half, investors have been seeking to dissect their performance – and that of their external asset managers – through the crisis. One key issue in focus: how does portfolio diversification hold up when risk exposures such as factor intensity suddenly increase?
- Strategically, many investors are in “wait and see” mode. Yet the first half of 2020 has proven to be a remarkably active period for new manager selection activity: 55% of all manager searches launched by bfinance clients during the last twelve months have been initiated in the first half of this year.
- For equity manager performance, growth is virtually the only game in town. Equity growth managers outperformed the MSCI World index by more than 10% in Q2 - extending their outperformance to more than 20% for the year to date. Quality managers underperformed by nearly 3% in Q2, while more significant underperformance was felt among strategies with a focus on low volatility (-10%), income (-7%) and value (-4%).
- The second quarter proved to be a more favourable climate for active Investment Grade Credit managers: 75% of those in the US outperformed the market, as did 77% in Europe. Yet High Yield managers struggled to beat their benchmarks.
- The second quarter saw positive performance across liquid alternative strategies, with the notable exception of Alternative Risk Premia where average returns are at around -11% year-to-date. Some strategy and fund closures have already been seen in this space, with more expected.
- bfinance client activity in private markets continues to increase but industry-wide data indicates a slowdown of fundraising in Q2, although distressed debt strategies are attracting strong flows.

**PERFORMANCE OF PUBLIC MARKETS TO END OF JUNE 2020**




Source: bfinance/Bloomberg

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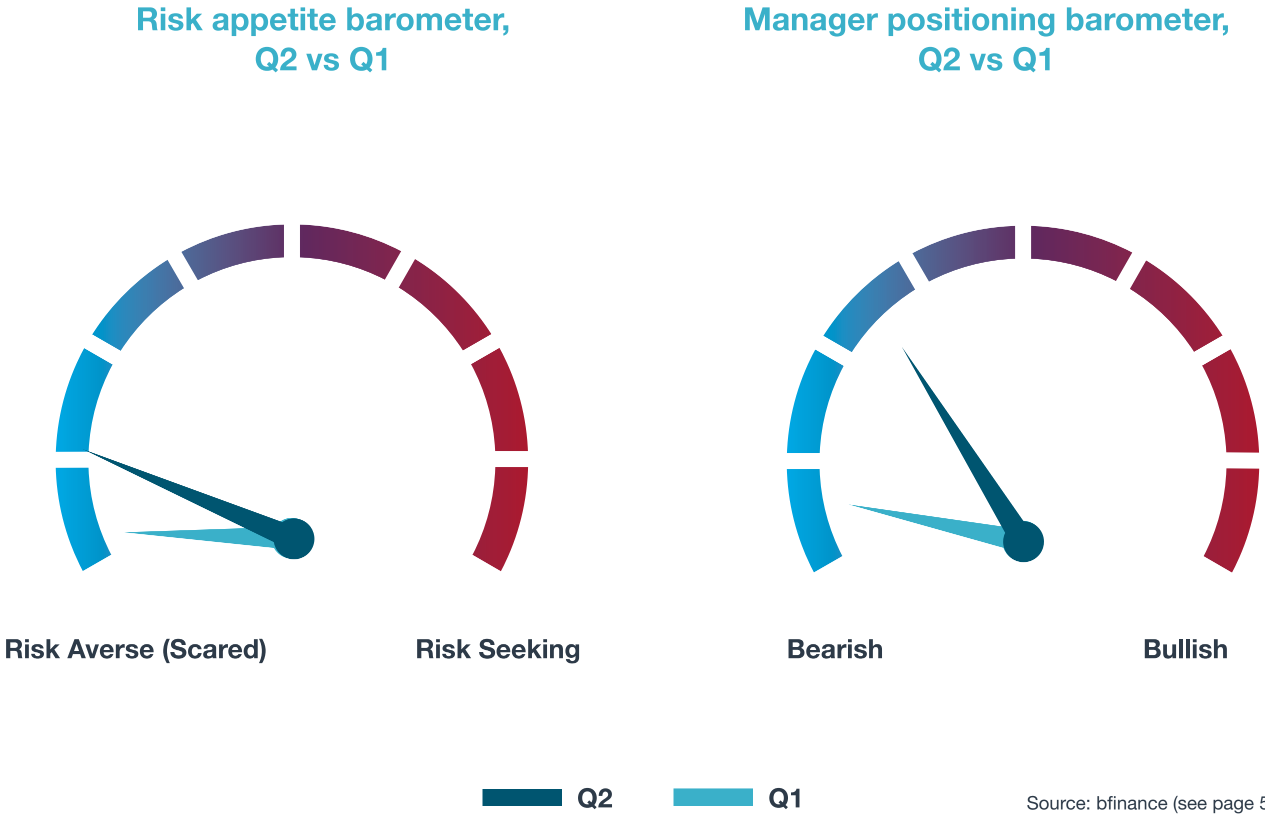
# Risk snapshots




Source: bfinance (see page 5)

# Risk snapshots continued

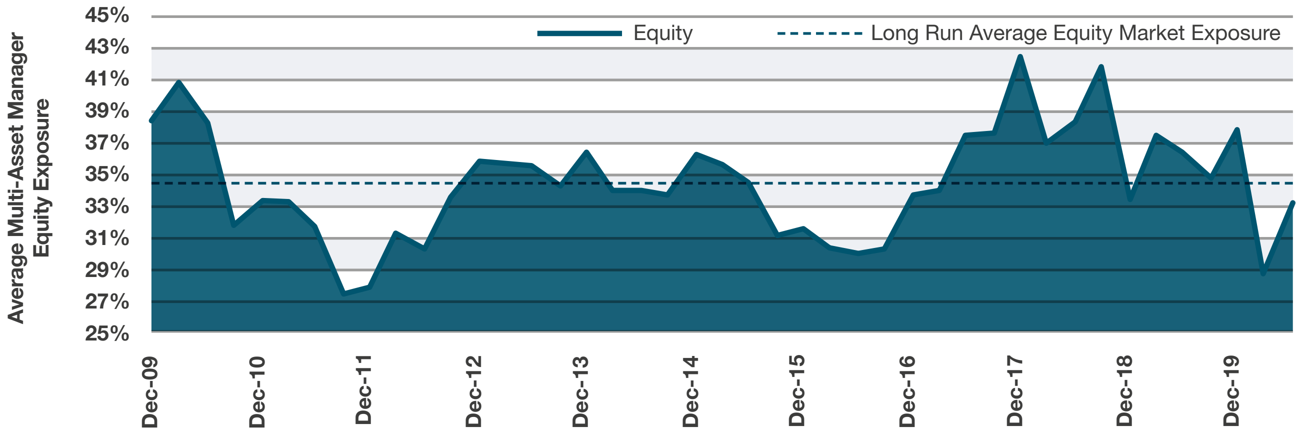
### Risk aversion

Multi asset managers modestly increased risk asset exposure in Q2, although average allocations to equities remained lower than the long-run average of around 34.5%.

Incidentally, the speed at which funds cut exposure during the early part of the downturn proved to be a key differentiator in the performance of multi asset managers, with more reactive strategies – or those with shorter lookback windows – generally doing better. (Source: *Are Multi Asset Managers Delivering for Investors? April 2020*.)

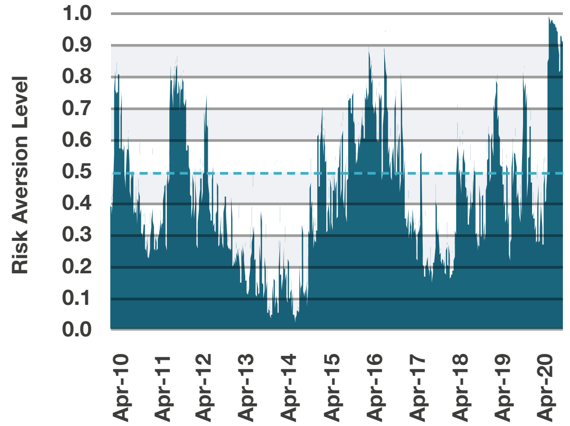
The Q1 spike in the bfinance Risk Aversion Index has not substantially softened in Q2, with a range of indicators illustrating the ongoing uncertainty (implied volatilities, gold prices, CDX etc).

**MARKET POSITIONING OF MULTI-ASSET FUNDS**



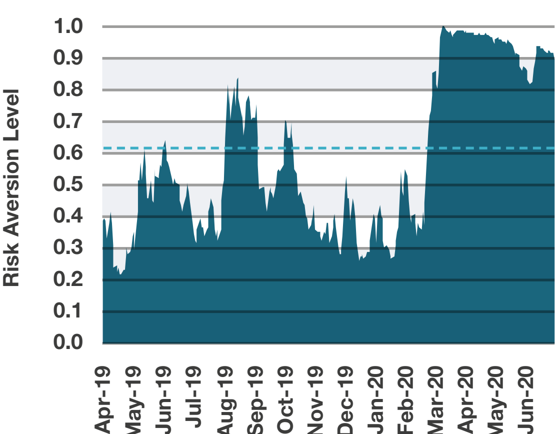

Source: bfinance. This graph shows the current and average exposure to equities held by a range of multi-asset managers. This is based on proprietary analysis performed by bfinance. The managers analysed vary in strategy from macro and GTAA through to bottom-up allocation strategies.

**THE BFINANCE RISK AVERSION INDEX: 10-YEAR VIEW**




Source: bfinance/Bloomberg

**THE BFINANCE RISK AVERSION INDEX: 1 YEAR VIEW**




Source: bfinance/Bloomberg

The bfinance risk aversion index is a proprietary measure we use to calculate how risk seeking (nearer zero) or risk averse (nearer 1) the market consensus is. It ranges between 0 and 1. The internal algorithms used incorporate indicators of market expectations of future volatility (e.g. implied volatilities in equities and FX), the level of classic safe haven investments (gold) and market expectations of corporate default (e.g. CDX).

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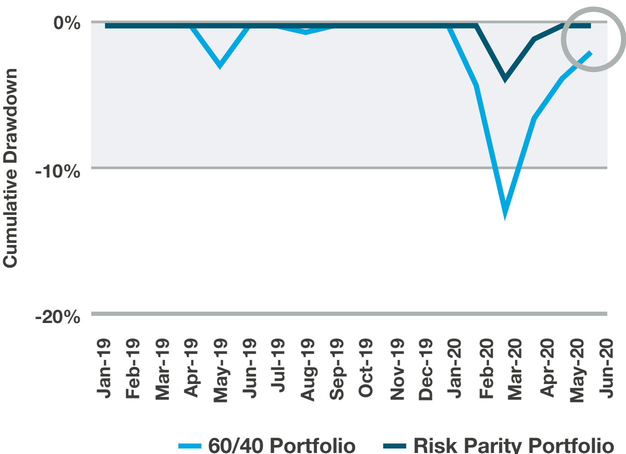
# Risk snapshots continued

### What have we learned this quarter?

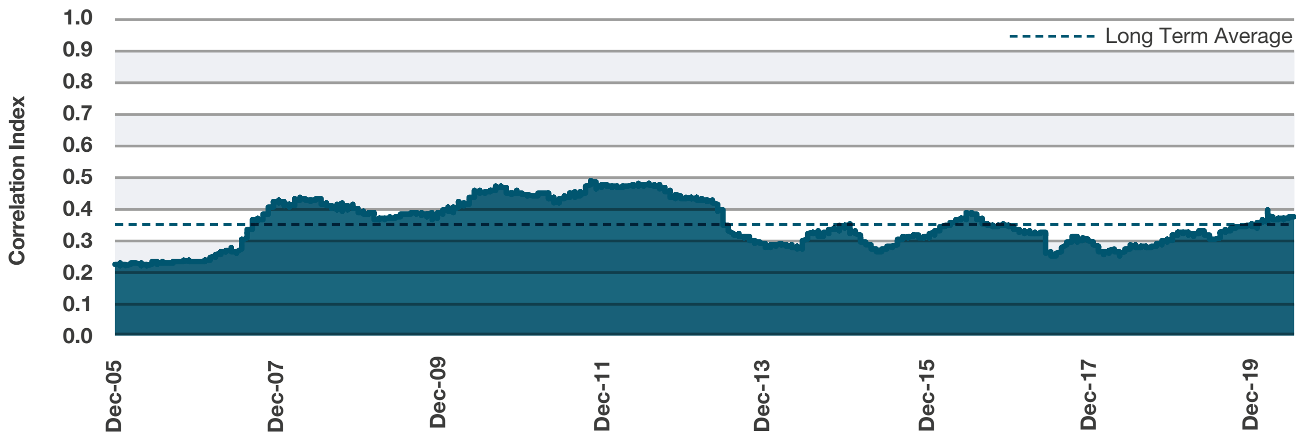
The second quarter of this year was extremely positive for risk assets, largely reversing Q1 losses for both a simple 60/40 (global equities/government bonds) portfolio and a risk parity portfolio. Indeed, the model risk parity portfolio shown on here would be in positive territory again.

From a risk perspective, our clients have been focusing on areas such as improved liquidity management and more clarity on risk exposures. One key issue that investors are trying to reassess is the adjustment in inflation expectations as a result of measures taken to address the COVID-19 pandemic. While reduced demand for goods in the short-to-medium term will dampen inflation, there are fears of an inflationary scenario in which central banks are unable to hike interest rates due to the unprecedented amount of outstanding debt in the economy. Risk managers are seeking robust portfolios that are more attuned to – and better able to navigate – these dynamics.

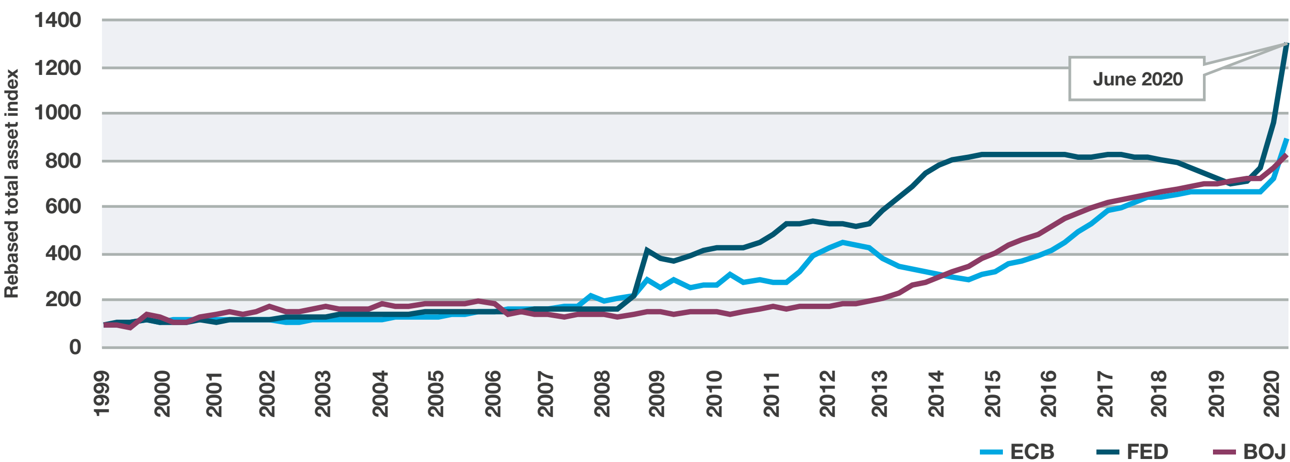
### REALISED CUMULATIVE DRAWDOWN




### CORRELATIONS BETWEEN MAJOR ASSET CLASSES




### CENTRAL BANK TOTAL ASSETS INDEX (MAR-99 = 100)



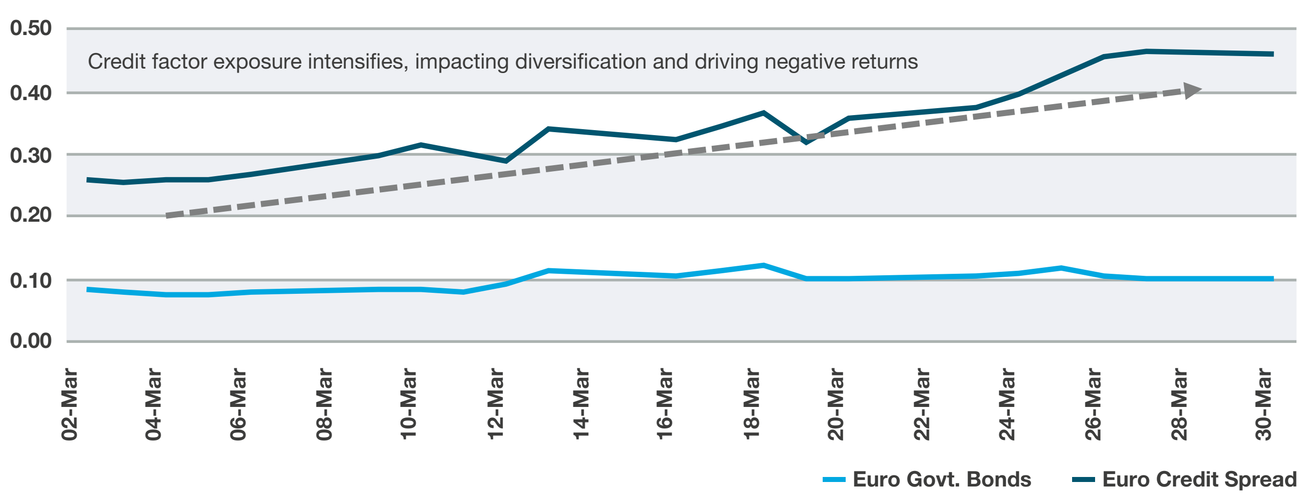

Source: bfinance. Portfolios based on MSCI ACWI and Bloomberg Barclays Global Aggregated USD Hedged. Risk exposures calculated using proprietary bfinance models.

# Risk snapshots continued

### What have we learned this quarter? *continued*

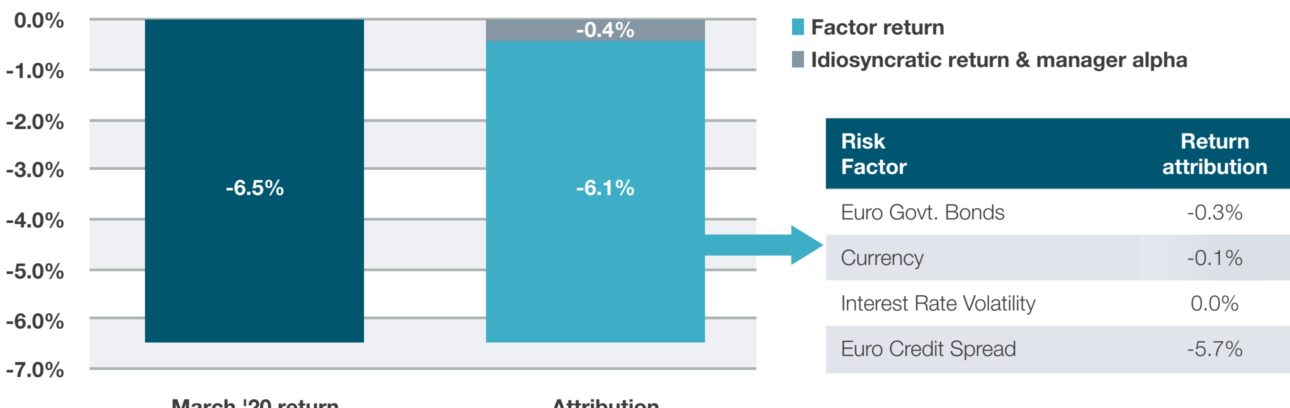
On the back of a tumultuous first half, investors have been seeking to dissect their performance – and that of their external asset managers – through the crisis. One key question has been highlighted by recent events: how does portfolio diversification hold up when risk exposures such as factor intensity suddenly increase? How would the portfolio behave if is such exposures continue for a prolonged period? One interesting example, highlighted below, has been the rising credit risk exposure for many Euro Short Duration strategies.

**CRISIS FACTOR EXPOSURES EURO SHORT DURATION STRATEGY**




For this particular Euro Short Duration credit strategy, we would have estimated March ‘20 returns to be at circa -2% if the strategy had maintained its pre-crisis risk factor profile. Instead, the strategy returned -6.5% of which -5.7% is attributable to increased credit risk exposure. Scenario analysis using unprecedented adverse market environments is a highly valuable source of insights to every institutional investor.

**MARCH ‘20 RETURN ATTRIBUTION**




| Risk Factor | Return attribution |
|---|---|
| Euro Govt. Bonds | -0.3% |
| Currency | -0.1% |
| Interest Rate Volatility | 0.0% |
| Euro Credit Spread | -5.7% |

The crisis has also served as a stark reminder that static diversification across asset classes pays off in times of crisis. Recent research indicates that over 50% of asset owners were not taking a tactical view on risk assets at end-Q2 (bfinance Asset Owner Survey 2020) and only a quarter are changing their Strategic Asset Allocation in 2020, indicating broad faith in existing diversification.

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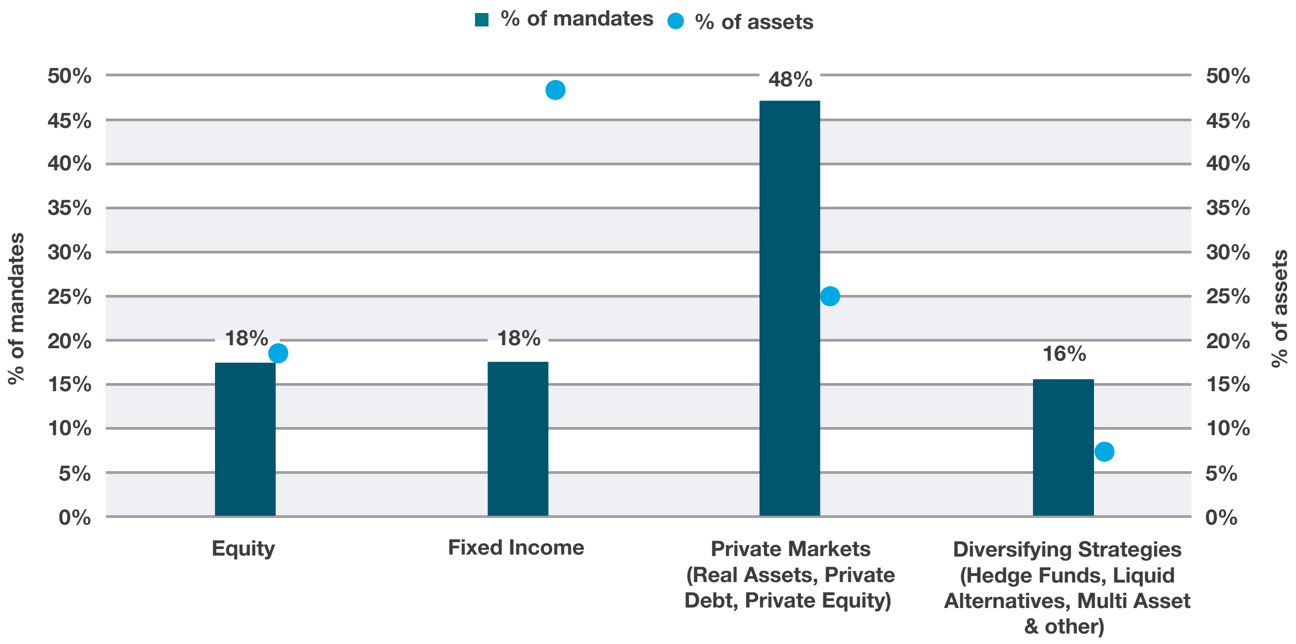
# Investor activity

NEW MANAGER SEARCHES, 12 MONTHS TO JUNE 30TH 2020 (BY ASSET CLASS)




Note: these figures only represent projects initiated **after** July 1st 2019 and do not include pre-existing client engagements that continued during the year.

# Investor activity continued

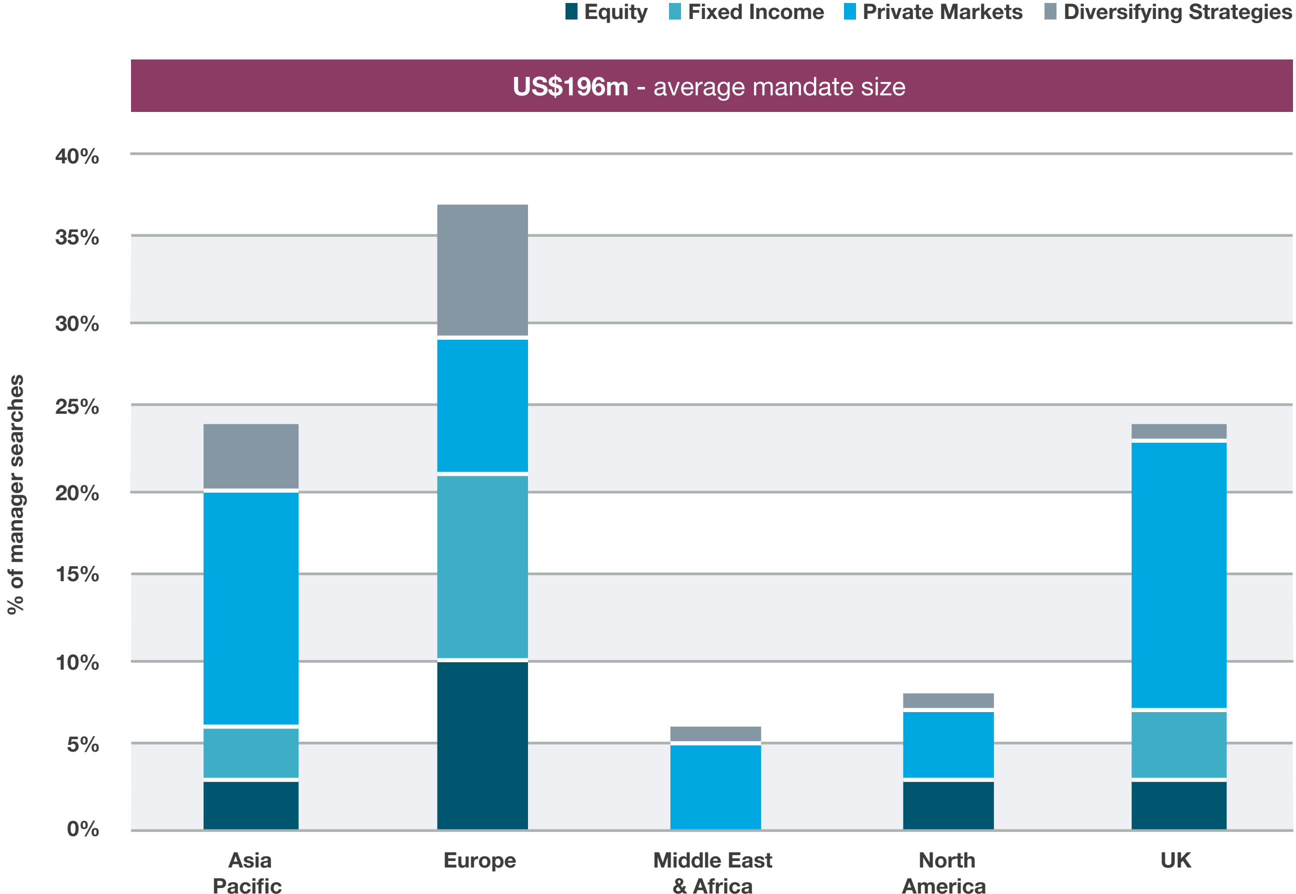
### Manager searches

The implications of the COVID-19 crisis for markets and economies are yet to be fully understood. Most investors are currently satisfied with performance YTD, according to new research (see pages 10-11), and remain in "wait and see" mode in terms of broader strategy. However, the first half of 2020 has proven to be a remarkably active period for new manager selection activity: 55% of all manager searches launched by bfinance clients during the last twelve months have been initiated in the first half of this year.

These searches have not generally been driven by investors terminating asset managers due to pandemic performance. Instead they represent both a continuation of pre-existing plans and proactive strategic or tactical responses to COVID-19 conditions. That being said, the bfinance Asset Owner Survey indicates that a wave of reviews and replacements are on the cards, with 54% of asset owners either terminating or likely to terminate based primarily on poor performance in 2020 YTD.

Illiquid asset classes continue to become increasingly dominant as a proportion of new investor mandates, with demand spanning real estate, infrastructure, private debt and private equity: private markets strategies represent 48% of searches initiated during the last 12 months and 50% of those initiated in H1, with demand continuing to be strong in Q3 so far. Private markets strategies are a logical beneficiary of current conditions, given the historically outstanding results of post-crisis vintages and lower sensitivity to timing: it can take months or years for money to be deployed following commitment.

### NEW MANAGER SEARCHES (BY INVESTOR LOCATION)




Note: these figures only represent projects initiated **after** June 1st 2019 and do not include pre-existing client engagements that continued during the year.

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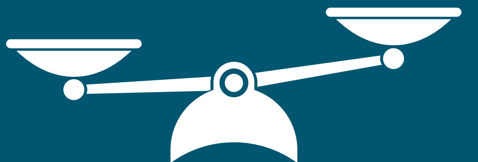
# Investor activity continued

Highlights from the Asset Owner Survey conducted in June 2020 (published July 2020)

**$11trn** managed by 368 investor participants, including pension funds (52%), insurers, endowments, family offices and others.

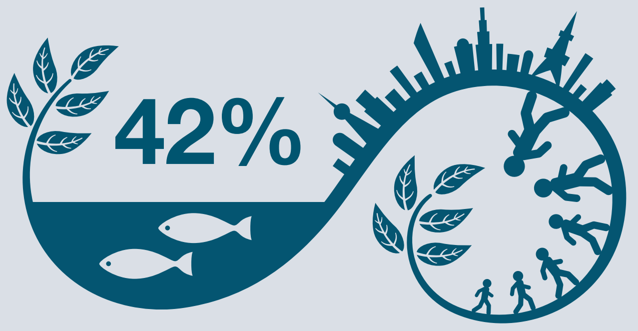
**24%** are changing their Strategic Asset Allocation in 2020, including 39% of those in the Asia-Pacific region.

**29%** of investors are currently underweight risk assets versus 19% who are overweight. North American investors appear more confident than global peers.



**48%** say actual exposure to private markets will increase in 2020, continuing a multi-year trend (54% increased exposure in 2017-19).

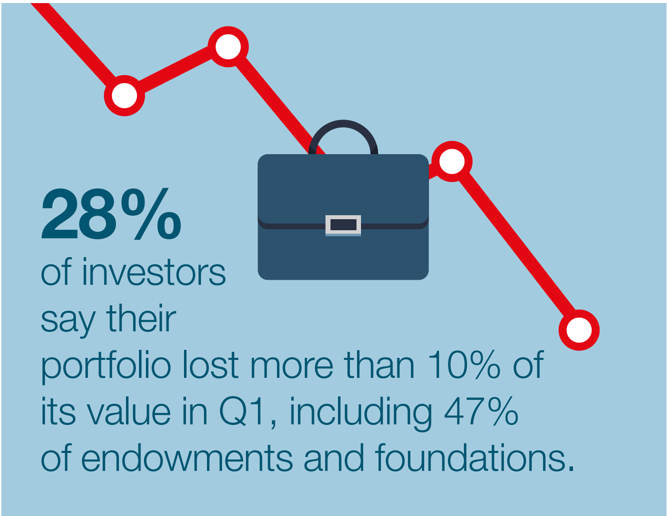
**35%** are making changes to risk management, including 46% of insurers.



**42%** of investors say ESG issues will become more important as a result of C-19, and zero say they'll become less important.

## Investor activity continued

**82%** are satisfied with how their portfolios have performed in 2020 so far. Active management received positive feedback across most asset classes, but not all…



**28%** of investors say their portfolio lost more than 10% of its value in Q1, including 47% of endowments and foundations.

**54%** of investors are terminating or likely to terminate managers based primarily on their 2020 performance, including 82% of family offices.

**53%** of investors using active Emerging Market Debt strategies are dissatisfied with their performance; so are 48% of Hedge Fund investors and 64% of Alternative Risk Premia investors.

**31%** say the inability to travel and do face-to-face meetings is not an obstacle to selecting new asset managers and investments, 13% say it's a "major obstacle".

**33%** are investing in distressed or opportunistic strategies that explicitly target COVID-19 fallout, with more to follow. European investors are less involved than global peers.

To download the full Asset Owner Survey report, click here.

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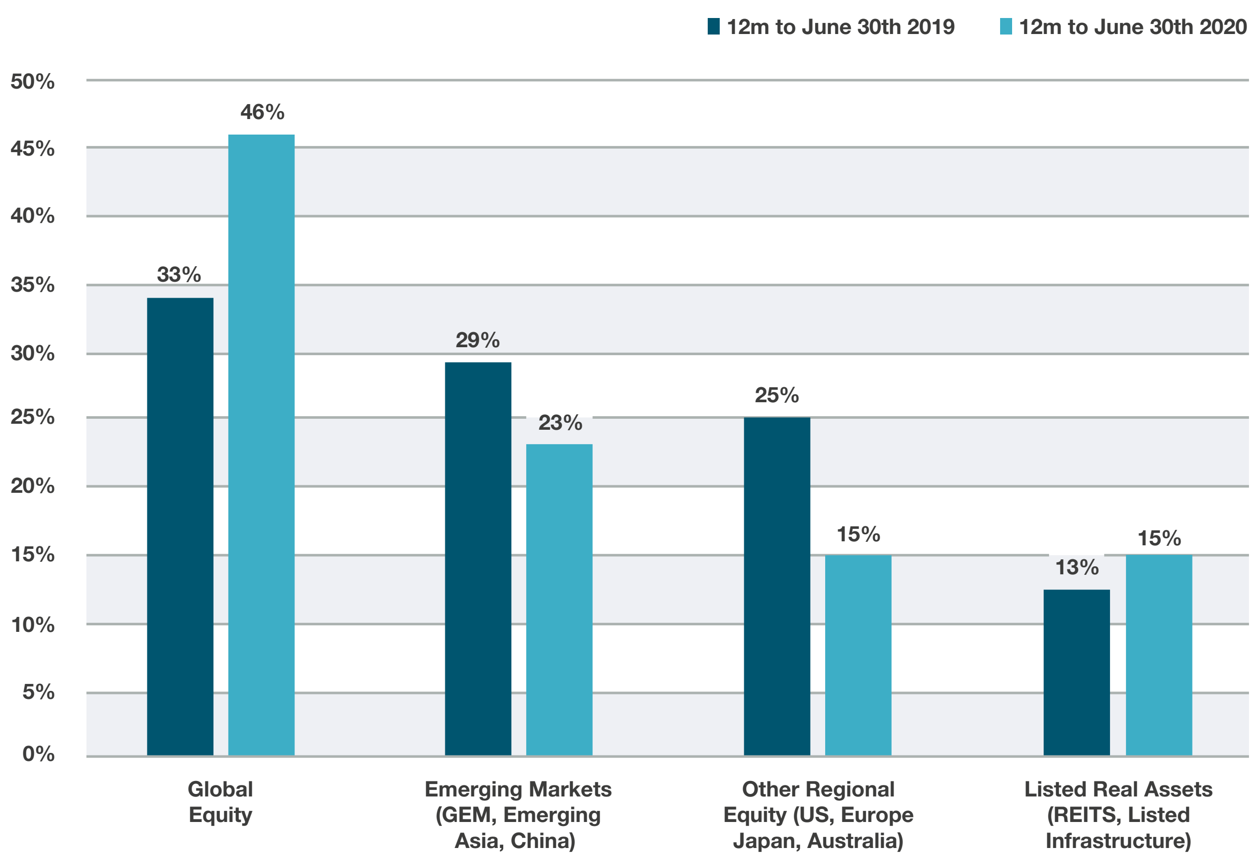
# Equity

## Growth is the only game in town as Q2 rebound brings a testing first half for key styles

**NEW EQUITY MANAGER SEARCHES, YEAR ON YEAR**




Note: these figures only represent projects initiated in the relevant 12m period and do not include pre-existing client engagements that continued during the year.

### Investor trends

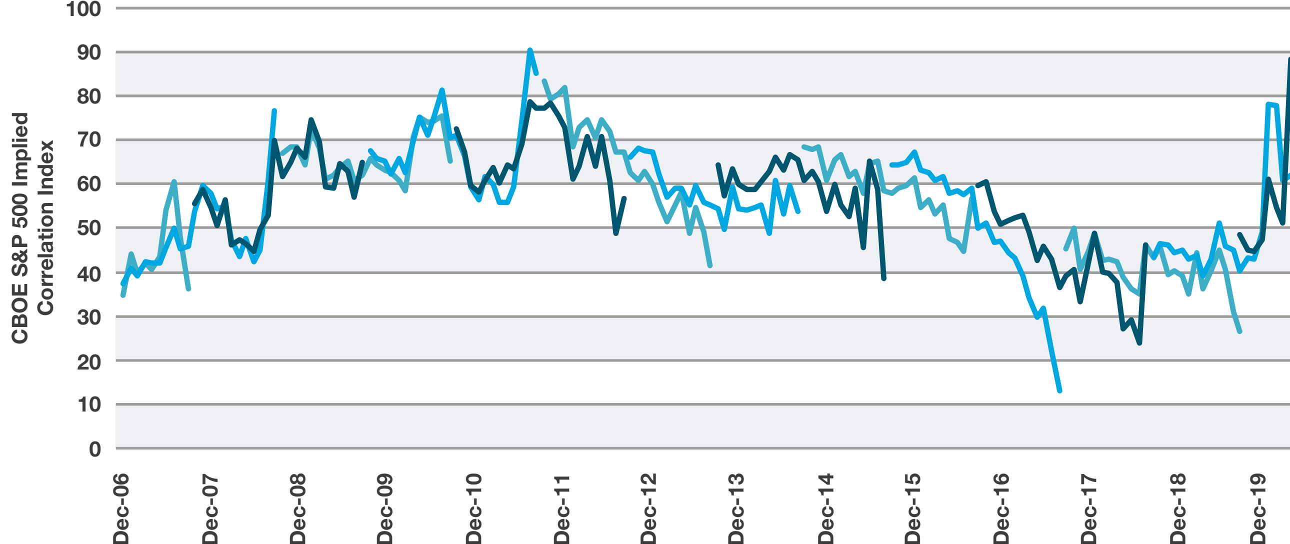
Most equity manager searches for clients through this twelve-month period had a core or defensive undertone, whether that takes the shape of a quality focus, low volatility, low tracking error/active risk, or ESG (which is strongly associated with the quality factor). There has been no demand whatsoever for value equity strategies within any region, with few investors apparently willing to bet on a sustained recovery from the style.

Overall demand for emerging market equity manager searches has declined only a little versus the previous twelve months, thanks in part to heightened interest in China-specific equity managers (discussed in recent white paper *Rethinking China's Role in Emerging Market Equity Portfolios*).

Relatively little of the activity through this period constituted 'new money' into the asset class: most of these searches have been manager replacements or portfolio restructuring to adjust geographical, style or strategy composition.

We have also seen a continuing rise in searches for listed infrastructure and REITs, reflecting investors building diversified exposure to real assets using public as well as private markets.

### CORRELATIONS BETWEEN STOCKS




CBOE Indicies measures the implied correlation between stocks that make up the S&P500. The series measures the expected average correlation of price returns of S&P 500 Index components, implied through SPX option prices and prices of single-stock options on the 50 largest components of the SPX for different maturities.

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# Equity continued

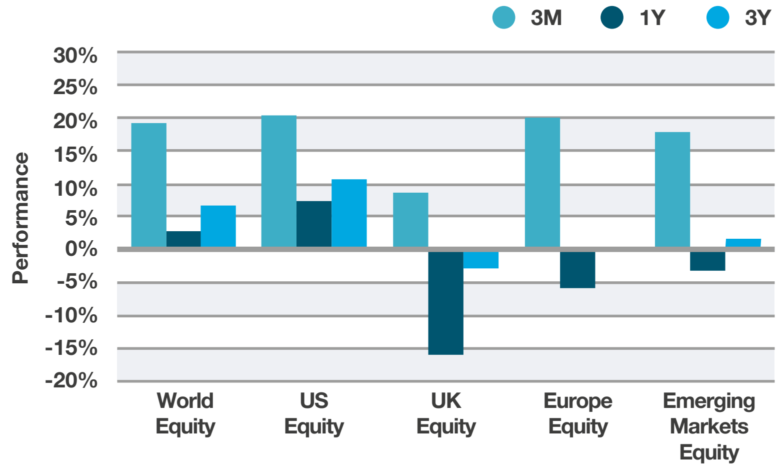
### Market snapshot

Equity markets rebounded strongly in Q2, recouping much of their Q1 decline, with the MSCI World index rising 19.4% (in USD terms). While data early in Q2 highlighted the severe economic impact of measures to combat the spread of COVID, markets were buoyed by the widespread loosening of monetary policy and gradual easing of lockdown measures.

The surge was spearheaded by US equities, which posted their best quarterly returns in more than 20 years. The gains chiefly came in April and May, with investor optimism tempered in June amid a rise in COVID cases that prompted some states to re-introduce lockdown measures. Consumer discretionary stocks generally fared well amid a rebound in retail spending, while IT-related stocks – which were among the winners in Q1 – had another strong quarter. Stocks in the energy and materials sectors also made strong gains, aided by a sharp recovery in oil prices. More defensive areas of the market, such as utilities and consumer staples, lagged the wider market. European equities (up 13% in EUR terms) followed a similar path, with all sectors posting positive returns for the quarter, led by IT, industrials, consumer discretionary and materials.

Emerging market equities rallied 18%, recording their strongest quarterly return in over a decade, with US dollar weakness amplifying returns. This was despite a significant divergence in the pattern of the coronavirus pandemic. China underperformed the wider EM index, having outperformed by a wide margin in Q1. Within Asia, export-oriented markets such as Indonesia, Thailand and Taiwan outperformed on hopes of a recovery in global demand, while India and South Korea also fared well.

### EQUITY MARKET PERFORMANCE (TO MARCH 2020)




| | YTD USD | YTD LOCAL |
|---|---|---|
| World Equity | -5.8% | -5.3% |
| US Equity | -3.1% | -3.1% |
| UK Equity | -22.4% | -16.9% |
| Europe Equity | -12.3% | -12.4% |
| Emerging Markets Equity | -9.8% | -5.5% |

**Indices Used**
World Equity: MSCI World Index in USD and in Local Currency
US Equity: S&P 500
UK Equity: FTSE 100
Europe Equity: Euro Stoxx 50
Emerging Markets Equity: MSCI Emerging Markets Index in USD and in Local Currency

### Manager watch

Within global developed equities, investors rewarded those companies with strong growth characteristics, low levels of debt and positive momentum. As with Q1, value stocks were heavily out of favour, as were high dividend yielding companies with investors concerned about the sustainability of dividend streams. Most measures of quality were detractors in Q2 (after a strong Q1), though investors paid close attention to balance sheet strength above all else. Lower volatility stocks trailed significantly, as they often do in sharp rallies.

Active manager returns followed these trends, with growth managers outperforming the MSCI World index by more than 10% in Q2 - extending their outperformance to more than 20% for the year to date. Quality managers underperformed by nearly 3% in Q2, but the more significant underperformance was felt among those strategies with a focus on low volatility (-10%), income (-7%) and value (-4%).

Trends within emerging markets were not dissimilar, but they were less pronounced. Style rotation within the three-month period left value stocks trailing overall. As with developed markets, there was less demand for companies with high-dividend, quality or low volatility traits, with growth, momentum and high volatility the winning trades. When we look at active manager returns, the trends were broadly similar to developed markets. Growth managers outperformed the MSCI EM index to varying degrees (range of 5-15%), while quality managers trailed the benchmark by 1% on average. Managers in the low volatility (-4%), income (-5%) and value (-4%) categories once again broadly underperformed.

To access a recording of bfinance's July 2020 webinar with further discussion on equity and fixed income manager performance, *Click Here*.

### MANAGER PERFORMANCE (TO JUNE 2020)

| | 3m | YTD | 1Y | 3Y (p.a) | 5Y (p.a) |
|---|---|---|---|---|---|
| **Global Equity Composite*** | **20.3%** | **-3.6%** | **4.5%** | **8.4%** | **8.8%** |
| MSCI World | 19.4% | -5.8% | 2.8% | 6.7% | 6.9% |
| MSCI ACWI | 19.2% | -6.3% | 2.1% | 6.1% | 6.5% |
| **Outperformance VS MSCI World** | **1.0%** | **2.2%** | **1.7%** | **1.7%** | **1.9%** |
| **Outperformance VS MSCI ACWI** | **1.1%** | **2.6%** | **2.4%** | **2.3%** | **2.3%** |
| **Global EM Composite*** | **19.3%** | **-9.8%** | **-3.1%** | **3.1%** | **4.4%** |
| MSCI EM Index | 18.1% | -9.8% | -3.4% | 1.9% | 2.9% |
| **Outperformance** | **1.2%** | **0.0%** | **0.3%** | **1.2%** | **1.5%** |

Source: bfinance/Bloomberg

The Global Equity Manager and Global EM Manager composites show the performance of a sensible and representative sample of managers that invest in global equities and global emerging markets equities respectively. We use these composites as a proxy for how managers in the space are performing relative to their benchmarks. They **do not** represent manager recommendations.

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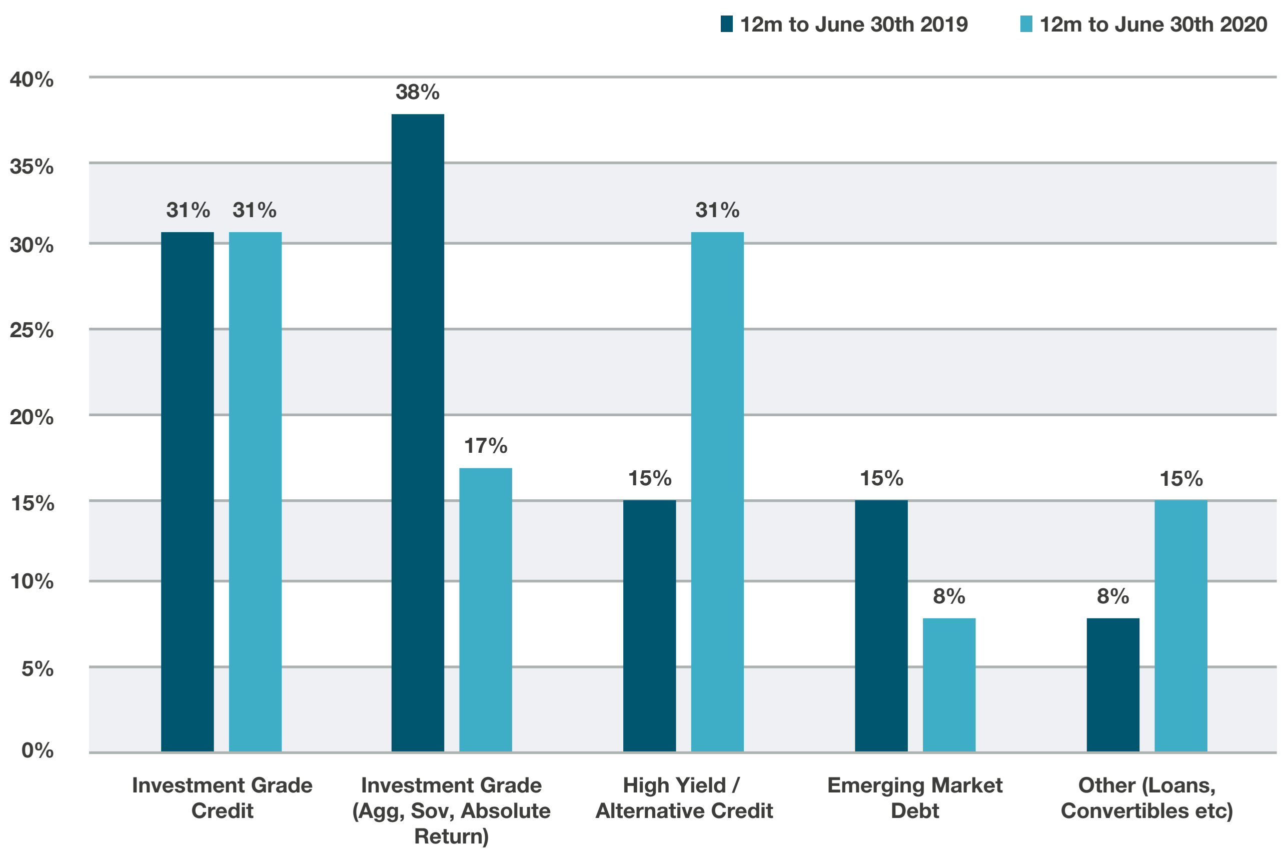
## News from the equity manager world

- Alan Rowsell, lead manager for **Aberdeen Standard**'s Global Smaller Companies strategy, leaves the firm to join **Premier Miton**.
- Lucy Macdonald, ex CIO of Global Equities at **Allianz Global Investors**, leaves the firm following a team restructuring.
- **Artemis** hires **Kames Capital**'s Sustainable Global Equity team.
- Mark Barnett leaves **Invesco**, where he was Head of UK Equities. Jeff Taylor, Head of European Equities at Invesco, also announces his retirement.
- Emerging Markets equity portfolio manager Naomi Waistell departs **Newton** to join **Polar Capital**.
- Peter Ferket departs Robeco, where he was Head of Investments.
- **T. Rowe Price**'s European equity portfolio manager Dean Tenerelli announces he will retire later this year.

# Fixed income

NEW FIXED INCOME SEARCHES, YEAR ON YEAR




Note: these figures only represent projects initiated in the relevant 12m period and do not include pre-existing client engagements that continued during the year.

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# Fixed income continued

### Investor trends

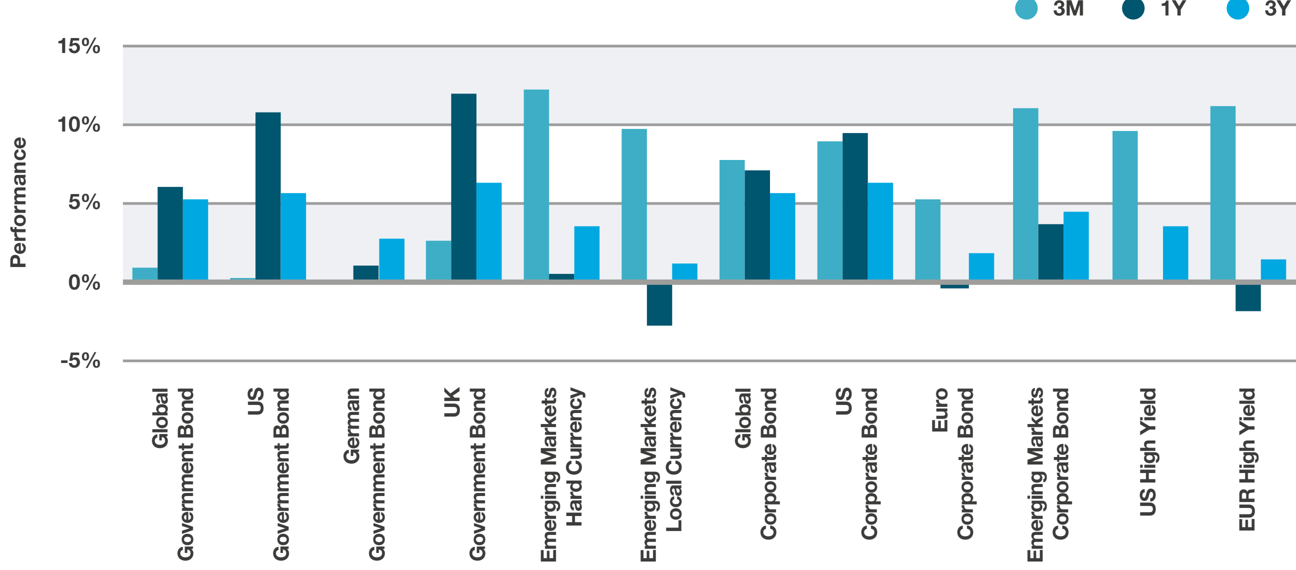
Recent months have brought a renewal of interest in allocating towards high yield strategies and a decline in sovereign debt investment activity. Meanwhile, investor appetite for Absolute Return strategies has dropped off markedly and remains weak. At present, we are working with various clients to help them identify strategies that are better-suited to the current climate, with particularly strong interest in High Yield, Leveraged Loans and Structured Credit.

### Market snapshot

**US investment grade bonds** rebounded in Q2, with a 9.3% return bringing the YTD figure to 4.8%. Risk sentiment improved as C-19 infection rates declined, while monetary and fiscal easing provided additional fuel to markets. The strongest effect in the IG space was seen in BBB-rated debt (+11.4%) though higher quality bonds also contributed (AAA +4.7%). Spreads tightened across the curve with US IG spreads shrinking 134bps to 169bps over Treasuries. **European investment grade** followed suit, returning 5.1% in Q2, bringing YTD returns to -1.3%. Aggregate spreads tightened 81bps to 117bps. US Treasury yields fell over the period, particularly at the short end of the curve, while Bund yields remained broadly flat. Ratings agencies downgrades of investment grade issuers also slowed with 8 US IG and 12 Euro IG corporates downgraded into high yield over Q2 (relative to 19 and 6 respectively in Q1).

**US high yield bonds** performed well, with a 9.6% return making up much (but not all) of Q1 losses. Lower-rated credits lagged over the quarter, in contrast to the IG space, leaving YTD returns in negative territory for bonds rated B and below. Although sentiment improved through May and June on the back of better macro data, investors remained cautious over the risks faced by stressed/distressed issuers in the US. **European high yield bonds** returned 11.3% in Q2, with strong returns from lower quality debt (bonds rated CCC and below returned 24%). At 642bps, US high yield spreads remains higher than their European counterparts (489bps). All industries performed well, with notable rebounds from Gaming, Leisure and Autos in Europe while Energy, Banking and Industrials led returns in the US. Weaker performance came from Airlines and Transportation in the US while REITs, Utilities and Healthcare sectors lagged in Europe.

PERFORMANCE OF BOND MARKETS TO END OF JUNE 2020



# Fixed income continued

### Market snapshot *continued*

**Hard Currency EM Debt** was the strongest performer over the quarter, gaining 123% (in USD terms), aided strongly by commodity exporting countries in Africa which were buoyed by an improving oil price. **EM Corporate debt** also revived, returning 11.2%, mostly driven by sectors such as Industrials, Metals & Mining, Oil & Gas. High yield corporates outpaced investment grade issuers (15% vs 9% total return in USD terms).

**Local Currency EM Debt** also gained 9.8% in Q2, which was not enough to offset Q1 losses; EM currencies contributed more modestly than usual to overall returns, which were mainly driven by local rates thanks to (in some cases historic) rate cuts from central banks of certain countries such as Uruguay (16% total return), Chile and South Africa. China was an oasis of calm in this segment, as were countries in Eastern Europe and South-East Asia.

**US IG CREDIT SPREAD CURRENT VS AVERAGE**

**US HY CREDIT SPREAD CURRENT VS AVERAGE**

**EUROPEAN IG CREDIT SPREAD CURRENT VS AVERAGE**

**EUROPEAN HY CREDIT SPREAD CURRENT VS AVERAGE**

Source: bfinance, Bloomberg.

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# Fixed income continued

### Manager watch

The second quarter proved to be a more favourable climate for active Investment Grade Credit managers: 75% of those in the US outperformed the market, as did 77% in Europe. The median manager beat the market by 24bps before fees: the typical “long credit / short duration” positioning worked well with BBB credits outperforming higher-rated debt and the US yield curve moving downwards.

High yield bond managers, on the other hand, struggled to beat their indices in Q2: the average relatively cautious stance paid off in Q1 but created a drag in Q2. Only 49% of active managers outperformed their benchmarks in the US, as did 43% of those in Europe. Despite the recovery, US HY managers have not found themselves in a classic risk-on market where CCC outperform higher rated credits, so o a simple “long credit risk” positioning did not pay out either. The key to outperformance was sector selection (e.g. higher exposure to Energy, Auto and Gaming).

### MANAGER PERFORMANCE (TO END JUNE 2020)

| | 3m | YTD | 1Y | 3Y (p.a) |
|---|---|---|---|---|
| **US Investment Grade*** | **9.82%** | **5.13%** | **9.65%** | **6.51%** |
| Barclays US Corporate IG | 8.98% | 5.02% | 9.50% | 6.34% |
| Outperformance | 0.84% | 0.11% | 0.15% | 0.18% |
| **Euro Investment Grade*** | **5.95%** | **-1.10%** | **0.24%** | **2.25%** |
| Barclays Euro Corporate | 5.28% | -1.19% | -0.42% | 1.80% |
| Outperformance | 0.67% | 0.09% | 0.66% | 0.45% |
| **US High Yield*** | **9.49%** | **-4.09%** | **-0.13%** | **3.35%** |
| BofA ML US High Yield Master II | 9.61% | -4.78% | -1.10% | 2.94% |
| Outperformance | -0.11% | 0.69% | 0.97% | 0.41% |
| **EUR High Yield*** | **10.94%** | **-4.64%** | **-1.20%** | **1.87%** |
| ML European Curr HY Constr. EUR Hedged | 11.25% | -5.03% | -1.89% | 1.47% |
| Outperformance | -0.30% | 0.39% | 0.70% | 0.41% |
| **EMD – Hard Currency*** | **14.01%** | **-3.53%** | **-0.47%** | **3.12%** |
| JPM EMBI Global Diversified | 12.26% | -2.76% | 0.49% | 3.60% |
| Outperformance | 1.75% | -0.77% | -0.96% | -0.47% |
| **EMD – Local Currency*** | **10.70%** | **-7.28%** | **-3.63%** | **0.68%** |
| JPM GBI-EM Global Diversified | 9.82% | -6.89% | -2.82% | 1.14% |
| Outperformance | 0.88% | -0.39% | -0.81% | -0.46% |
| **EMD – Corporates*** | **14.16%** | **-1.51%** | **2.38%** | **4.40%** |
| JPM CEMBI Broad Diversified | 11.15% | -0.16% | 3.74% | 4.52% |
| Outperformance | 3.02% | -1.35% | -1.37% | -0.11% |

Source: bfinance/eVestment

The Fixed Income Manager peer groups show the average performance of a sensible and representative sample of managers. We use these peer groups as a proxy for how managers in the space are performing relative to their benchmarks. They do not represent manager recommendations.

# Fixed income continued

**Manager watch** *continued*

Emerging market debt managers delivered significant outperformance versus their benchmarks in the second quarter, although it was not enough to offset Q1 losses. Over 80% of active managers beat their respective benchmarks in Hard Currency, Local Currency and EM Corporate Bonds. Managers did well by keeping currency exposure low and selective in Q2. The winning trade in Q2 was to be long on local yield curves, particularly those where central banks intervened vigorously to fight off an economic slowdown.

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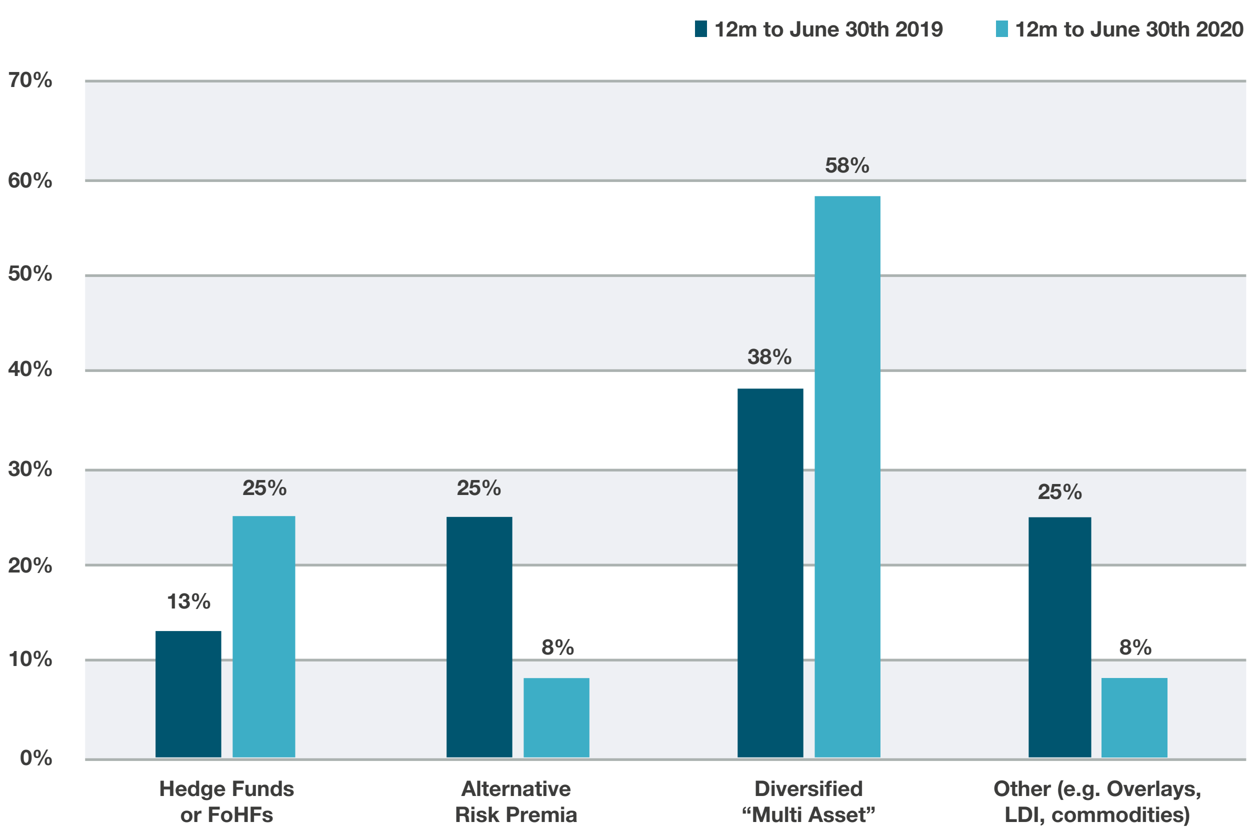
## News from the fixed income manager world

- At **DNCA**, Portfolio Manager Igor de Maack steps back from all fund management responsibilities although he remains at the firm.
- Martin Dreier, Head of Fixed Income at **Ethenea** since January 2020, leaves the firm for family reasons. He joined the firm in June 2019.
- Paul Griffiths steps down from his position as CIO of Fixed Income and Multi-Asset Solutions at **First State**, following a decision by new CEO Mark Steinberg to create one overall CIO based in Sydney. There had previously been three CIOs: Griffiths in Fixed Income and Multi-Asset; David Dixon in Equities and Perry Clausen in Infrastructure debt.
- Navindu Katugampola becomes Head of Sustainability for Fixed Income at **Morgan Stanley**, based in London. He has been at the firm since 2004.
- Marcin Adamczyk moves to to **NN Investment Partners** as Head of Emerging Market Debt based in The Hague. Adamczyk was formerly at **PZU Group**, where he was CEO of the asset management unit.
- Florent Rouget de Conigliano leaves **Ostrum Asset Management**, where he was a High Yield Fund Manager; Erwan Guilloux takes over as lead manager.
- Dilawer Farazi moves to **Royal London Asset Management** as a Fund Manager within the Global Credit team. He was formerly an Emerging Markets Specialist at **Loomis Sayles**.
- **Schroders** hires Hugo Squire – formerly of **Muzinich & Co** – as a Credit Fund Manager.
- **Swisscanto Invest** hires Sebastien Zoller as Head of Fixed Income. He replaces Benno Weber and will report directly to Head of Asset Management.
- Raphael Thuin leaves **Tobam**, where he was Head of Fixed Income, to work on another project outside the firm.

NEW 'DIVERSIFYING STRATEGIES' MANAGER SEARCHES, YEAR ON YEAR




Note: these figures only represent projects initiated in the relevant 12m period and do not include pre-existing client engagements that continued during the year.

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# Diversifying strategies continued

### Investor trends

Prior to the crisis, appetite in this space primarily involved investors seeking to build out liquid diversification, either via Multi-Asset strategies or via allocations to hedge funds (either directly or via a multi-manager solution). Demand for Alternative Risk Premia (ARP) strategies, which were relatively popular in the 2016-18 period, continues to be weak following a protracted period of subdued performance and now, in 2020, some disappointing YTD results.

As the pandemic has progressed, alternative investment search activity has been relatively muted. We see ongoing demand for traditional Multi-Asset strategies, with investors also seeking to access the asset allocation insights and macro views of such managers. In addition, we note greater apparent interest for Equity Long/Short and Systematic Macro hedge funds, stemming from a belief that today's environment is more conducive for some of these strategies as well as the broader goal of portfolio diversification, and anticipate that to be reflected in mandates during H2. Meanwhile, we expect that appetite for Multi-Asset Absolute Return strategies will remain relatively strong.

### Manager watch

Q2 2020 saw positive performance across the liquid alternative universe: almost all Diversifying Strategy manager composites (page 25) posted positive returns in Q2 and particularly in April. The strongest recoveries included strategies which suffered the most in March, such as Event Driven and Credit Long/Short. Alternative Risk Premia was the only group which delivered negative average returns; some strategy and fund closures have already been seen in this space, with more expected.

The **Event Drive**n space saw the largest rebound (+6.8%, including +4.3% for April), having been battered in the first quarter. Q2 brought a reversal of much of the indiscriminate deal spread widening seen in March.  Equity-biased strategies posted the strongest returns. Deal activity was subdued as companies focused on shoring up their balance sheets but market participants appeared happy to wait on the side-lines for re-entry points. Multi-Strategy Event Driven strategies also enjoyed a strong quarter (+9.9% on average). Dividend futures arbitrage was another bright spot (read *Sector in Brief: Event Driven*).

The **Equity Long/Short** composite posted a gain of +5.8% for Q2. Long-biased strategies, as one might expect, led performance with aggregate returns of +12.7% compared to +2.8% for Market Neutral / Low Net strategies (read *Sector in Brief: Equity Long/Short* for a review of strategy types). Discretionary approaches outperformed systematic, even after adjusting for the fact that systematic strategies tend to have less of a long bias, while value-focused managers continued to underperform.

The **Credit Long/Short** composite gained +6.2% in Q2. We note high dispersion in April, with some managers having cut net exposure during March and recovering less strongly than more directionally-exposed peers. For these managers, returns of 4% in April were not uncommon. In aggregate, long-biased strategies delivered +6.9%. The more market neutral arbitrage strategies, having held up well in March, were able to find opportunities as markets normalised with the Market Neutral sub-strategy composite generating a strong +4.9% return.

# Diversifying strategies continued

## MANAGER PERFORMANCE (TO END JUNE 2020)

| | 3m | YTD | 1Y | 3Y (p.a) |
|---|---|---|---|---|
| **bfinance Equity Long/Short Composite** | 5.79% | -5.10% | -0.58% | 1.08% |
| **bfinance Event Driven Composite** | 6.82% | -6.72% | -4.31% | 2.14% |
| **bfinance Credit Long/Short Composite** | 6.11% | -2.96% | -1.63% | 1.59% |
| **bfinance Macro & Trading Composite** | 0.00% | -5.24% | -2.65% | 1.71% |
| **bfinance Alternative Risk Premia Composite** | -2.24% | -11.35% | -11.78% | -4.14% |
| **bfinance Multi-Asset Composite** | 5.01% | -3.21% | 0.47% | 3.30% |
| **bfinance Multi-Strategy Composite** | 2.08% | -4.51% | -3.14% | 1.58% |

The Hedge Fund Manager composites show the performance of a sensible and representative sample of each of the main hedge fund strategies. This is restricted to managers that genuinely pursue the relevant strategy rather than generating the majority of their returns from exposure to market direction alone. We use these composites as a proxy for how managers in the space are performing. They do not represent manager recommendations.

Source: bfinance

### Manager watch *continued*

bfinance's **Macro & Trading** composite was flat in Q2. **Core Trend-Following** was notably weak (-3.1%), following a strong period in March, due in large part to trend reversals in commodity and currency markets. **Diversified CTAs** were modestly positive (+0.81%), thanks in part to diversification away from trend via shorter-term and mean reversion models. **Systematic Macro** ended the quarter at -0.64%; many strategies have relatively low conviction and thus low overall exposure. Our **Discretionary Macro** composite gave +2.9%; high dispersion here saw double-digit losses for bearish strategies while some (typically fixed income focused) managers saw gains of similar magnitude.

**ARP** continued to struggle in Q2 (-2.2%). bfinance segments ARP into two families: Academic and Practitioner premia. Both saw drawdowns in Q1 but the more complex strategies featuring Practitioner premia fared better (c.-1%)  than their Academic premia-focused counterparts (-2.9%). Equity value saw brief recoveries but ended in negative territory, as did quality factors. Short vol exposures recovered a little but remained substantially drawn down for the year to date.

The **Multi-Asset** composite saw a gain of +5.0%. The strongest performance unsurprisingly came from the more long-biased and beta-heavy **Unconstrained Balanced** segment (+7.6%), with **Diversified Growth** funds also benefiting (+5.9%). **Risk Parity** approaches averaged 5.1%, with a more muted April (2.1%) but further gains in May and June including strong contribution from commodity exposures. The **Multi-Asset Absolute Return** sector saw minor gains (+0.44%); this is not surprising of a sector that eschews large directional bets, but one might have expected Q2 to provide more fertile ground for relative value trading styles.

Finally, the **Multi-Strategy Hedge Fund** composite realised gains of 2.2%; Discretionary Multi-Strategy and Multi-Manager products were positive outliers (4.3% and 4.9% respectively). Convertible Arbitrage and Quantitative Equity strategies were common positives for the multi-strategy products while Trend Following was a laggard.

For further discussion of manager performance, watch the *bfinance Mid-year review*.

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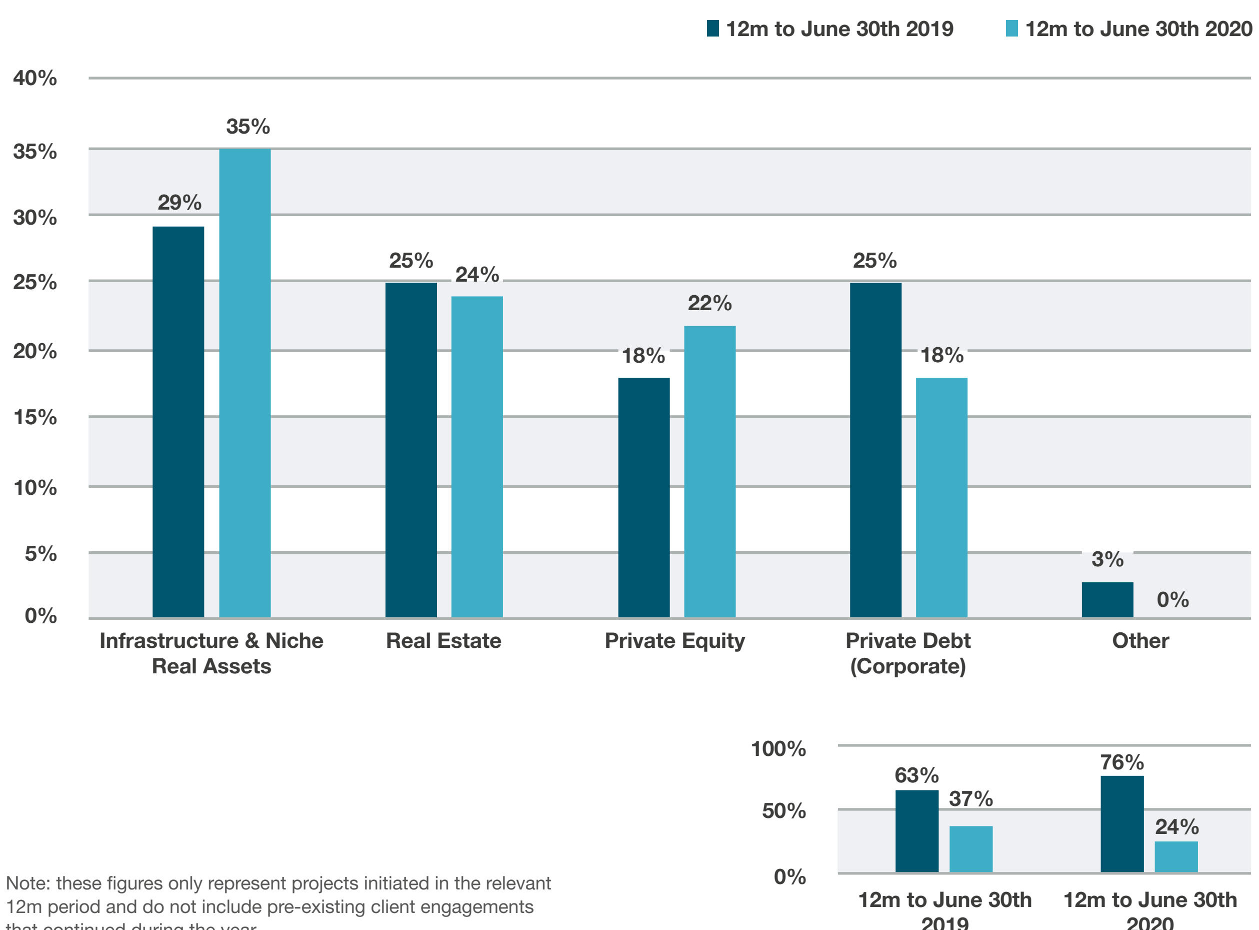
# Diversifying strategies continued

## News from the alternative manager world

- Ex-**ADG** CIO Igor Yelnik is reportedly planning to launch a new systematic macro fund in Q4. He left ADG in 2019 having joined from IPM seven years prior.
- **Aspect Capital** plan to open their multi-strategy to outside investors, offering a combination of their trend-following, systematic macro and other diversified models in a single vehicle.
- **Candriam** acquires the multimanager hedge fund team and assets of **Rothchild & Co AM Europe**, combining it with their own. The combined team will manage c.€700m.
- **Capital Fund Management** (CFM) plans the launch of an 'equity capped' trend-following strategy in UCITS form. Other CTA firms such as Campbell & Co and Graham Capital have also offered CTA programs with limited long-exposure to equity markets in recent years.
- **Investcorp** and **Tages Group** merge their respective absolute return businesses to create a 50-50 joint venture. Investcorp-Tages will manage over $6bn.
- **Janus Henderson** launches a UCITS version of their Global Multi-Strategy hedge fund under the management of Head of Diversified Alternatives David Elms. **Campbell & Co** also launch their Absolute Return program in UCITS form on the UBP Platform.
- **Lansdowne Partners** will close its flagship equity long/short fund after 19 years, focusing instead on its long-only products.
- **Marshall Wace** moves their UCITS funds to the Lumyna platform, which already hosted the successful $1.9bn TOPS Market Neutral fund. The platform currently has $12.5bn across 19 funds, with the AuM from Marshall Wace expected to total $4.4bn.
- Macro hedge fund **Rubicon** closes after 20 years having seen AUM decline in recent years and noting that the current environment would not be conducive to raising capital.
- GAIA Helix, **Schroders'** internal multi-manager hedge fund, adds a new Event Driven strategy to its line-up to be managed by recent hire Lin Yang.
- After 25 years in the business, **Sloane Robinson** is winding down operations by end-2020.
- It was reported that **Winton** planned to launch a multi-PM hedge fund platform in a further step to diversify away from their historical focus on trend-following programs.

# Strong client activity, but industry fundraising data confirms C-19 slowdown

NEW PRIVATE MARKETS MANAGER SEARCHES, YEAR ON YEAR




Note: these figures only represent projects initiated in the relevant 12m period and do not include pre-existing client engagements that continued during the year.

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bfinance

# Private markets continued

### Investor trends

As noted on page 9, new mandates for private markets managers are increasingly dominant as a proportion of new manager searches by bfinance clients. Appetite spans the 'four pillars' of private markets (Private Equity, Private

Debt, Infrastructure and Real Estate). The recent bfinance Asset Owner Survey supports expectations for 2020, with more than half of investors expecting their exposure to illiquid strategies to increase between January 1st this year and January 1st next year – particularly in Private Debt.

2020 has brought a reduction in searches from European and North American investors, but this has been offset by investors from Asia Pacific, the Middle East and Africa. Much of this represents structural demand rather than a drive to exploit dislocations. The post-March period has seen particularly strong activity targeting Private Debt (after a softer twelve months in that space) and Infrastructure. There is greater interest in niche sectors such as long-term private equity, fund of funds/secondaries, renewables, impact, and alternative credit such as equipment leasing, trade finance and long lease.

One particularly interesting trend is the rising popularity of "Multi Asset" type searches in Private Markets, with investors ideally seeking strategies that can deliver exposure to a range of illiquid asset classes. **(e.g. "Infrastructure + Private Equity" or "Private Debt + Private Equity"). We also see a theme around investors seeking hybrid public and private market strategies, particularly for real assets.**

### CAPITAL RAISING MOMENTUM ACROSS PRIVATE ASSET CLASSES, 2020 Q2

| Asset Class | Q2 2020 No. & Vol., and % change in share | | Share of Private Market Capital Raised and Strategic Focus | Largest Fund Raises During Q2 2020 |
|---|---|---|---|---|
| | No. Funds | Volume | | |
| **Real Estate** | 53<br>-7% | $39bn<br>+63% | Real Estate significantly increased its share of total capital raising, skewed by the closure of BREP VI that represented 30% of the total. Increasing appetite for Value Add/Opportunistic strategies. | • Blackstone BREP VI, Opportunistic, Europe, $10.6bn<br>• Rockpoint Real Estate Fund VI, Opportunistic, US, $3,8bn<br>• PAG's SCREP VII, Opportunistic, APAC, $2.8bn<br>• Sculptor Fund IV, Opportunistic, US, $2.6bn |
| **Infrastructure** | 15<br>-21% | $12bn<br>-65% | Significant decline in the share of private market capital raised, to just 6%. Increase in capital raised by US strategies, at over 60% of the total. Continued emphasis on larger funds, with Blackrock's fund representing over 40% of the total. | • Blackrock Global Energy & Power Infrastructure Fund III, Core+, Global, $5.1bn<br>• HPS' European Asset Value Fund (USD) II,Core+, Europe/North America, $1.5bn<br>• Arcus European Infrastructure Fund II, Value Add, Europe, $1.3bn<br>• InstarAGF Essential Infrastructure Fund II, Core, North America, $1.2bn |
| **Private Equity** | 225<br>-6% | $116bn<br>-6% | Private equity represented 58% of total capital raising, down from the 64% of recent quarters. Continued concentration on a small number of larger funds with 39% of capital raised by the largest 10 funds. | • Ardian ASF VIII, Secondaries, Global, $19bn<br>• Insight Partners XI, Growth, Global, $9.5bn<br>• Francisco Partners VI, Buyout, US, $7.5bn<br>• Clearlake Capital Partners VI, Special Situations, U,S $7bn. |
| **Private Debt** | 49<br>+86% | $34bn<br>+78% | Surge of capital raising by Private Debt funds to close to 20% of all private markets, close to the heydays of late 2017/2018. Significant increase in 'distressed' and 'special situation' strategies | • Clearlake Capital Partners VI, Special Situations, US, $7bn<br>• Ares Special Opportunities Fund, Special Situations, Global, $3.5bn<br>• Bain Capital Distressed & Special Situations, Distressed Debt, Global, $3.2bn<br>• KKR Dislocation Fund, Distress, Global, $2.8bn |

Source: bfinance, Preqin. Note: Based on capital raised for closed ended commingled funds. Given the tendency for most recent quarter to be revised, the % change shows the change in the share of each asset class out of total private markets. For instance, in Q2 2020, Private Debt accounted for 9.4% of capital raised and in Q1 2020 it accounted for 16.7%, an increase of 78%.

# Private markets continued

### Market snapshot

While it is too early to gauge the impact of COVID on private market performance, it seems that Private Market asset classes are holding up relatively well. Valuations underwent modest and highly variable writedowns after the first quarter of 2020, with substantial differentiation even in troubled sub-sectors such as transport (read *Testing Times for Infrastructure Investment Resilience*). Further insight is expected as Q2 valuations emerge, although the true impact of the developing pandemic on the real economy is still highly uncertain.

### Manager watch

The 2017, 2018 and 2019 vintages for certain private market strategies and sub-sectors are expected to be weaker by historical standards, as they were for 2004-07. We anticipate (and already note) very significant dispersion between managers – even where strategies are nominally similar. Exposure to COVID-sensitive sectors and geographies will be a key driver, but more broadly investors should expect outperformance from disciplined teams that have been prudent in the deployment of capital during the last two years, focused on high quality assets, maintained low levels of leverage on favourable terms, hedged effectively and maintained good levels of liquidity. For further discussion on manager positioning and activity, *watch the bfinance Mid-year Review.*

### Spotlight on fundraising

By the end of Q1 2020 it had become clear that private market capital raising would slow, and this has been proven by the numbers for Q2: Preqin confirms that just 340 funds closed ($200bn) - just over half the average of previous quarters. Investors have been focused on managing existing exposures, preserving liquidity and cautiously approaching the new environment. As discussed on the following page, the sharpest falls in Q2 recorded by Preqin were in Infrastructure and Private Equity; Real Estate figures were strong, but this was skewed by the $10.5bn close of Blackstone's European Value Add fund. Private Debt experienced a sharp increase in fundraising to over $30bn, driven by the increased flow of capital to Distressed funds.

**Private Equity** fundraising fell by 20% in Q2, from $143bn to $116bn – a notable decline, particularly given that Q1 tends to be the weakest quarter of the year and the quarterly average over the prior four years has been $160bn. At 225, the number of funds closed was the lowest level since Q3 2012. Although Private Equity continues to be the largest share of all private market activity, it fell to 58%, well below the average of 64% over since 2016. We also note funds taking longer to reach their targets: just 30% of the funds that closed in H1 2020 did so within 12 months, compared with over 50% in 2012. US and Buyout funds continue to dominate capital raising, but there seems to be an increase in appetite for Secondaries strategies, as well as interest in Asia Pacific private equity.

Only 53 **Real Estate** funds closed during the quarter – the lowest level for nine years. This reflects concerns over the outlook for real estate, particularly in the COVID-19 affected sectors of Retail and Hospitality as well as Offices. These concerns follow several quarters during which capital raising had slowed based on concerns over yield compression and the challenge of deploying capital. Actual capital raising was at its highest level since 2017, but this was skewed by the closure of Blackstone's $10.6bn European opportunistic fund (Blackstone Real Estate Partners Europe VI) which represented over 30% of capital raised.

The strong interest in 'distressed credit strategies' identified in the previous quarterly report continued during the second quarter. There was a significant increase in the amount of capital raised at $34bn, up from $22bn in Q1; over 60% of this capital was for 'Special Situations' or 'Distressed' strategies. This strong increase meant that **Private Debt** accounted for close to 20% of all Private Markets capital raising activity in Q2, up from 9% in Q1 – the highest quarterly share since the heydays for Private Debt of late 2017 and early 2018. It seems that this strong investor appetite will continue for a while, with the number of Private Debt funds in the market reaching another record: 486 targeting a record $239bn. Dry powder remains high, but is slightly down on the previous quarter.

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# Private markets continued

### Manager watch *continued*

A small number of large **Infrastructure** funds continue to have a strong influence on quarterly capital raising. After the very strong Q4 2019 and Q1 2020 when capital raising achieved over $40bn (skewed by the likes of the $20bn in Brookfield Fund IV), Q2 capital raising fell to just $12 bn or 6% of total private market capital raising with a shortage of 'mega fund' closures. Infrastructure transaction activity slowed sharply during the second quarter and there were widespread concerns over the prospects for GDP-linked infrastructure, particularly the transport and energy sectors. These concerns contributed to the plateauing of the number of funds in the market and the capital they were seeking to raise. Despite the challenging business environment, there were some notable fundraising developments during the quarter including Stonepeak holding a first close of over $6bn for Stonepeak Infrastructure Fund IV, targeting $10bn. There were also some marked shifts in investor appetite, with Preqin reporting a surge of interest in Infrastructure Debt, with 34% of investors they surveyed targeting these strategies compared with 15% in Q2 2019.

## News from the private market manager world

- **Aberdeen Standard** announces plans to sell its Nordic Real Estate business
- Boe Pahari is promoted from Global Head of Infrastructure Equity to Group CEO at **AMP Capital**.
- Apollo develops new direct lending platform with UAE-based **Mubadala**.
- Chad Pike, Head of **Blackstone**'s Asia business, leaves the firm.
- **BNP Paribas Asset Management**'s head of real estate debt, Philippe Deloffre, leaves the firm and is replaced by his deputy head Christophe Montcerisier.
- Paul Mouchakkaa, former head of **CalPERS** Real Assets, moves to become managing partner for **Bentall Kennedy Greenoak**.
- Global Head of **DWS Real Assets**, Pierre Cherki, leaves.
- After **EQT** announced plans in Q1 to spin off their Credit business, it was revealed in Q2 that the business was being acquired by **Bridgepoint Capital**.
- **Greystar** acquires **Alliance Residential**'s property management arm.
- Head of **LaSalle**'s European business, Karen Brennan, leaves to become CFO at LaSalle's parent, **JLL**.
- **LGIM Real Assets** creates a new private credit leadership team and appoints James Spencer-Jones to head real estate debt in Europe.
- Paul Taylor and John Page leave **M&G**'s credit business. Paul was head of the Debt Opportunities strategy and John was responsible for the business and administration functions of the team.
- **Novo Holdings** acquires a minority stake in NREP, the Nordics' real estate manager with €5B AUM.
- **Schroders** agrees to acquire a majority stake in Pamfleet, a value-add Asian real estate investment manager with around $1bn AUM across four funds.
- **Schroder Adveq** hires Christian Van der Kam, previous co-head of secondaries at **Unigestion**, as Head of Secondaries.
- **Stafford Capital Partners** acquires **Robeco's** European PE business, adding $1.5bn to the existing $5bn in AuM.
- **USAA** sells a controlling interest in USAA Real Estate to the management team and some external investors.

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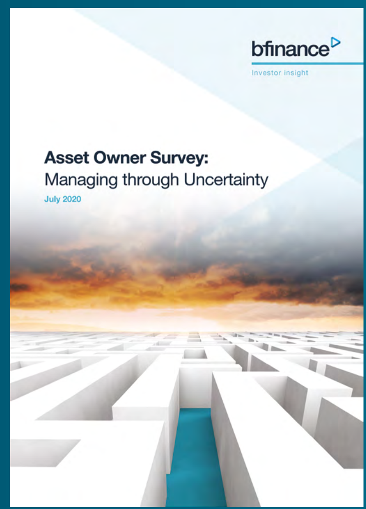
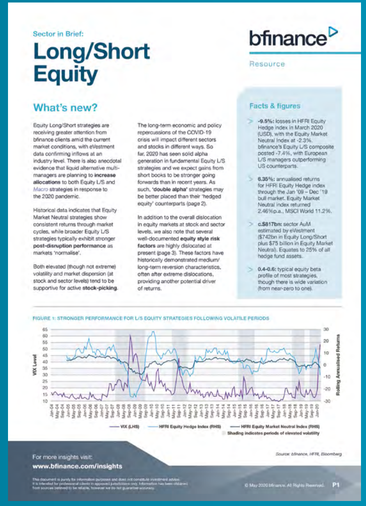



**Asset Owner Survey:**
**Managing Through Uncertainty**
(July 2020)

**Rethinking China's Role in**
**Emerging Market Equity Portfolios**
(June 2020)




**Sector in Brief:**
**Long/Short Equity**
(May 2020)

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