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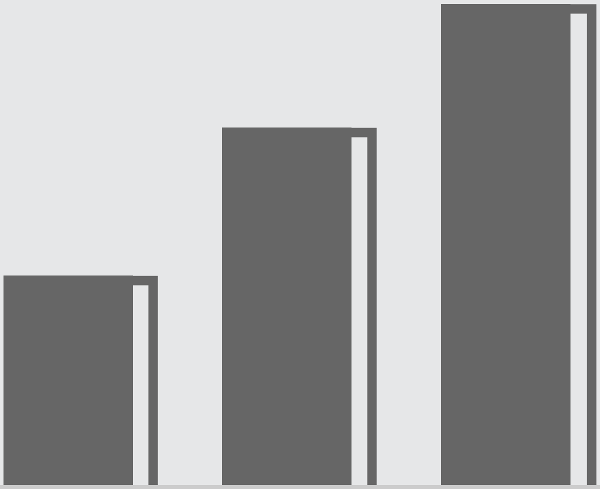
# Hedge Fund Industry Performance Report

## December/Q4/Year End 2016



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## Summary

The $3 trillion hedge fund industry entered 2016 on the back of one of its few negative years on record. Flows for most of 2016 highlighted elevated dissatisfaction with the industry's sub-standard 2015 returns. Despite some high profile declines, fund closures, and a general sense of gloom towards the industry's future, the average hedge fund outperformed an equal weighted equity/fixed income benchmark for the second consecutive year.

While the industry's distribution of performance has not necessarily been confidence inspiring for allocators, several strategy universes produced gains which might just come to show that 2015 was an anomaly for the industry.


## Highlights

- Hedge funds returned an average of 1.07% in December, 0.78% in Q4 and +5.34% for the full year 2016.
- Distressed funds ended the year as industry leaders, capitalizing on opportunities in the energy sector.
- After gaining new assets and producing elevated performance losses, managed futures will likely be considered the biggest disappointment in the hedge fund industry in 2016.

# 2016 Ends as Best Year for Hedge Funds Since 2013

Hedge funds returned an average of 1.07% in December. The industry average was +5.34% for the full year 2016.

The $3 trillion hedge fund industry entered 2016 on the back of one of its few negative years on record. Flows for most of the year, through November, highlighted elevated dissatisfaction with the industry's sub-standard 2015 returns. However, despite some high profile declines, the average hedge fund outperformed an equal weighted equity/fixed income benchmark for the second consecutive year and several segments showed that 2015 may have been an anomaly for the industry.

## Industry Return

| ***Industry Benchmarks*** | **Dec** | **Q4 2016** | **YTD 2016** | **2015** |
|---|---|---|---|---|
| Hedge Fund Aggregate | 1.07% | 0.78% | 5.34% | -0.72% |
| 50% MSCI World/50% Citi WGBI | 0.86% | -3.42% | 4.74% | -1.98% |
| S&P 500 | 1.98% | 3.82% | 11.96% | 1.38% |

## Return by Primary Market and Strategy

| ***Primary Markets*** | **Dec** | **Q4 2016** | **YTD 2016** | **2015** |
|---|---|---|---|---|
| Broad Capital Structure | 1.39% | 2.48% | 9.43% | -1.40% |
| Broad Multi-Market | 1.36% | 0.26% | 2.85% | -1.56% |
| Commodities | 1.16% | 0.51% | 6.14% | -9.45% |
| Equity | 1.15% | 0.98% | 5.44% | -0.17% |
| Fixed Income/Credit | 0.92% | 1.05% | 7.14% | -0.57% |
| Broad Financial Derivatives | 0.82% | -1.81% | 0.61% | -0.61% |
| Volatility/Options Strategies | 0.49% | 0.64% | 5.54% | 5.94% |
| FX/Currency | -0.14% | 2.52% | 2.71% | 2.90% |
| ***Primary Strategy*** | **Dec** | **Q4 2016** | **YTD 2016** | **2015** |
| Event Driven - Activist | 2.31% | 3.78% | 10.43% | 4.37% |
| Distressed | 1.55% | 3.51% | 11.50% | -7.82% |
| Event Driven | 1.52% | 2.17% | 8.91% | -2.76% |
| Long/Short Equity | 1.33% | 1.68% | 5.79% | -0.08% |
| Directional Credit | 1.19% | 1.46% | 7.32% | 0.37% |
| Multi-Strategy Equity | 1.01% | 0.76% | 3.75% | 1.72% |
| Origination & Financing | 0.99% | 1.05% | 4.31% | 6.39% |
| Market Neutral Equity | 0.91% | 1.30% | 1.72% | 3.76% |
| Macro | 0.89% | 0.38% | 2.12% | -1.07% |
| Multi-Strategy Credit | 0.85% | 0.69% | 5.33% | -1.66% |
| Managed Futures | 0.77% | -1.30% | 0.81% | -1.62% |
| Broad Multi-Strategy | 0.70% | -0.90% | 2.02% | 0.58% |
| Relative Value Credit | 0.66% | 0.61% | 6.44% | -0.57% |
| Convertible Arbitrage | 0.38% | 0.39% | 5.14% | 0.96% |
| ***Approach*** | **Dec** | **Q4 2016** | **YTD 2016** | **2015** |
| Discretionary | 1.14% | 1.16% | 6.31% | -0.63% |
| Systematic | 0.95% | -0.70% | 1.54% | -1.01% |

## Return by Fund Size

| ***Size and Primary Strategy*** | **Dec** | **Q4 2016** | **YTD 2016** | **2015** |
|---|---|---|---|---|
| Large Funds (>$1b) | 1.07% | 1.22% | 3.60% | -0.81% |
| Mid-size Funds (<$1b, >$250m) | 0.71% | 0.45% | 3.42% | 0.71% |
| Small Funds (<$250m) | 1.14% | 0.81% | 6.08% | -0.96% |
| Broad Multi-Strategy - Large | 0.94% | 0.36% | 3.03% | 0.92% |
| Broad Multi-Strategy - Smaller | 0.61% | -0.95% | 2.34% | 0.90% |
| Event Driven - Large | 1.97% | 3.14% | 3.06% | -5.35% |
| Event Driven - Smaller | 1.45% | 2.23% | 9.72% | -2.29% |
| Fixed Income/Credit - Large | 0.83% | 1.78% | 5.81% | -1.05% |
| Fixed Income/Credit - Smaller | 0.92% | 1.01% | 7.53% | -0.60% |
| Long/Short Equity - Large | 1.16% | 1.17% | 2.10% | -0.14% |
| Long/Short Equity - Smaller | 1.28% | 1.58% | 5.83% | -0.15% |
| Macro - Large | 1.36% | 2.53% | 4.34% | -0.15% |
| Macro - Smaller | 0.89% | 0.01% | 1.79% | -1.57% |
| Managed Futures - Large | 0.62% | -3.12% | -3.63% | 1.93% |
| Managed Futures - Smaller | 0.81% | -1.09% | 1.18% | -1.77% |

# Performance Overview

- Corporate capital markets provided the best environment for hedge funds to produce consistent gains in 2016. **Activists** finished the year with the best Q4 performance of any primary strategy and ended just behind distressed as the best hedge fund strategy in 2016.

- After lagging most of the industry in 2015 **distressed** funds capitalized on opportunities in the energy sector in 2016 to emerge as the year's best primary strategy. It was entering that same exposure which hurt the universe last year. It will be interesting to see whether gains remain in those trades for 2017, or if new opportunities emerge for the group.

- Despite lagging returns in 2013 and 2014, and even worse performance in 2015, investors returned to **commodity** strategies in mid-2015. The contrarian allocation theme proved successful in 2016 as commodity managers' returns were their highest since 2010.

- **Managed futures** will likely be considered the biggest disappointment in the hedge fund industry in 2016. After an outstanding year in 2014 and a good start to 2015, investors began to allocate heavily to larger funds within the universe. While the segment has been the only primary strategy with positive aggregate flows in 2016, performance has lagged, and it has been worst within the larger funds. Large managed futures funds ended 2016 as the only group within a primary strategy to produce negative returns in 2016.

- After a difficult stretch spanning June 2015 to June 2016, **multi-strategy** hedge funds produced reasonable results in the second half of this year to salvage what would otherwise be one to forget. After several years of positive investor sentiment, the universe endured high profile closures, litigation and some elevated losses in 2016. When year-end flows are released, the universe will likely end the year with its first annual redemptions since 2012.

- **Credit** hedge funds had their second worst year on record in 2015, but generally rebounded well in 2016. The universe, which had gained over $200 billion in new assets between 2010-2014, had been plagued by redemption pressures in 2015 and 2016. From the fallout of the financial crisis, to the enduring issues in Europe from sovereign then banking institutions, to the energy sector, and various regional special situations, credit hedge funds have experienced, and capitalized upon, a relatively generous opportunity set over the years.

# Emerging Markets Beat Developed Market in 2016

Despite the setback from a surprise Trump election win in November, emerging market hedge funds outperformed their developed market-focused peers in 2016 for the second consecutive year. A high amount variability across regions and countries provided opportunities for those able to foresee the influence of currency themes emerge, or those able to be a step ahead of the regional equity performance rotations, or to take advantage of special situations as they emerged.

## Return by Primary Regional Exposure

| ***Regional Exposure*** | **Dec** | **Q4 2016** | **YTD 2016** | **2015** |
|---|---|---|---|---|
| Developed Markets | 1.22% | 1.47% | 5.78% | 0.29% |
| Emerging Markets | 0.55% | -1.18% | 7.47% | -3.32% |
| North America | 1.57% | 2.86% | 9.46% | -1.20% |
| Developed Europe | 1.23% | -1.32% | -1.74% | 2.78% |
| Asia | -0.92% | -2.32% | 0.93% | 4.49% |
| Africa/Middle East | 2.07% | 1.03% | -4.59% | -11.77% |
| Russia | 5.00% | 5.47% | 28.57% | 4.27% |
| Brazil | 2.00% | -0.81% | 33.29% | -31.23% |
| Japan | 0.44% | 2.18% | 1.58% | 6.15% |
| Asia ex-Japan | -0.66% | -3.11% | 3.14% | -2.93% |
| India | -1.10% | -5.55% | 5.01% | 3.77% |
| China | -3.05% | -4.81% | -5.82% | 9.73% |

## Returns by Firm Domicile

| ***Firm Domicile*** | **Dec** | **Q4 2016** | **YTD 2016** | **2015** |
|---|---|---|---|---|
| Asia | -0.74% | -2.41% | 1.34% | 5.13% |
| Continental Europe | 0.90% | -1.87% | 1.44% | -2.03% |
| United Kingdom | 0.98% | -0.16% | 0.75% | 0.49% |
| United States | 1.23% | 1.99% | 6.47% | -0.43% |
| Singapore | 0.20% | -0.69% | 2.25% | 5.03% |
| China | -0.65% | -1.45% | 0.77% | 5.74% |
| Asia ex-Japan | -0.67% | -1.84% | 1.33% | 5.12% |
| Hong Kong | -0.88% | -2.01% | -1.65% | 6.49% |
| Japan | -1.42% | -7.32% | 2.08% | 4.89% |
| Middle East | 2.26% | 3.41% | 8.97% | -5.62% |
| Latin America | 1.80% | 0.27% | 23.22% | -18.87% |
| Offshores | 0.77% | -1.44% | 10.53% | -1.50% |
| Oceania | 0.06% | -2.27% | 3.75% | 0.97% |

## Regional Performance Overview

- From 2002 – 2012, major **emerging markets** moved in tandem. In each of those eleven years, Brazil, Russia, India and China-focused hedge funds produced returns directionally the same, and for many of the years, of similar magnitudes. In 2013, the similarities ended, and the fate of the major EM countries has since been influenced by currency and commodity shifts, often due to non-market forces.

- After an uncharacteristic single-digit directional move in 2015, **Russia**-focused funds surged near 30% in 2016 punctuated by their second largest gains of the year in December.

- **Brazil**-focused funds were the single best performing segment of the hedge fund industry in 2016, but the 33% gains for the year are not nearly enough to offset losses from the prior three years. As the USD strengthened and commodity prices dropped, funds focused on Brazil lost an average of 48% from 2012 – 2015.

- **China**-focused funds ended 2016 down meaningfully after large losses in December, their third consecutive monthly decline, wiped away the remaining gains. Despite the aggregate losses, just over 25% of China-focused funds were able to produce gains during the year. While this does not support a broad allocation to the universe, it is evidence of skilled managers for those willing to accept the country-specific risks.

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