Hedge Fund Confidence Index

North American hedge funds top sentiment going into 2024

AIMA, in partnership with Simmons & Simmons and Seward and Kissel, are proud to present the 13th quarterly Hedge Fund Confidence Index (HFCI), which provides a snapshot of fund managers' confidence in their economic prospects for the coming 12 months. A full time series of confidence levels since Q4 2020 can be found on the second to last page of this report.

Selecting the appropriate level of confidence, respondents are asked to choose from a range of -50 to +50, where +50 indicates the highest possible level of economic confidence for the firm over the next 12 months. When measuring their level of economic confidence, hedge fund respondents are asked to consider the following factors: their firm's ability to raise capital, their firm's ability to generate revenue and manage costs, and the overall performance of their fund(s).

Q4 2023 results

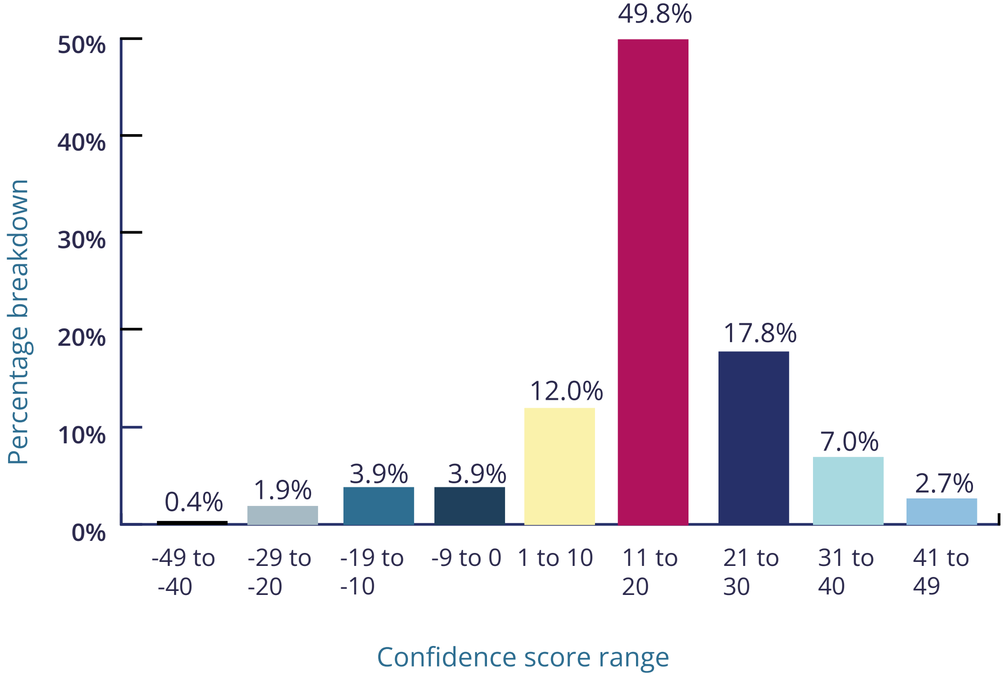
The Q4 2023 edition of the Hedge Fund Confidence Index (HFCI) surveyed 235 hedge fund firms worldwide, collectively managing approximately US$2 trillion in assets, over the week commencing the 11th December. The results show an average confidence level of +15.6, a decrease of six points from Q3, and just below the average score of +17.7 (see *HFCI over time* table on page 9).

In the third quarter, the confidence score was boosted by higher numbers from hedged equity and global macro managers. However, in Q4, these same strategies reported some of the lowest confidence scores of the year, contributing to the overall decline. Despite nearly all regions and strategies reporting a decline in confidence scores this quarter, almost 90% of those that polled recorded a positive confidence score.

Q4 overall confidence score: +15.6

Figure 1, Q4 overall confidence score

Overall, how would you score your confidence in the economic prospects of your business over the next 12 months, compared to the previous 12 months, on a scale of +50 to -50? (Hedge fund managers).



Trend analysis - Q4 downturn pattern asserts itself

Our ongoing data collection through the Hedge Fund Confidence Index (HFCI) is forming an increasingly valuable time series, offering fresh perspectives on industry confidence trends. This expanding dataset has revealed a distinct pattern in confidence levels.

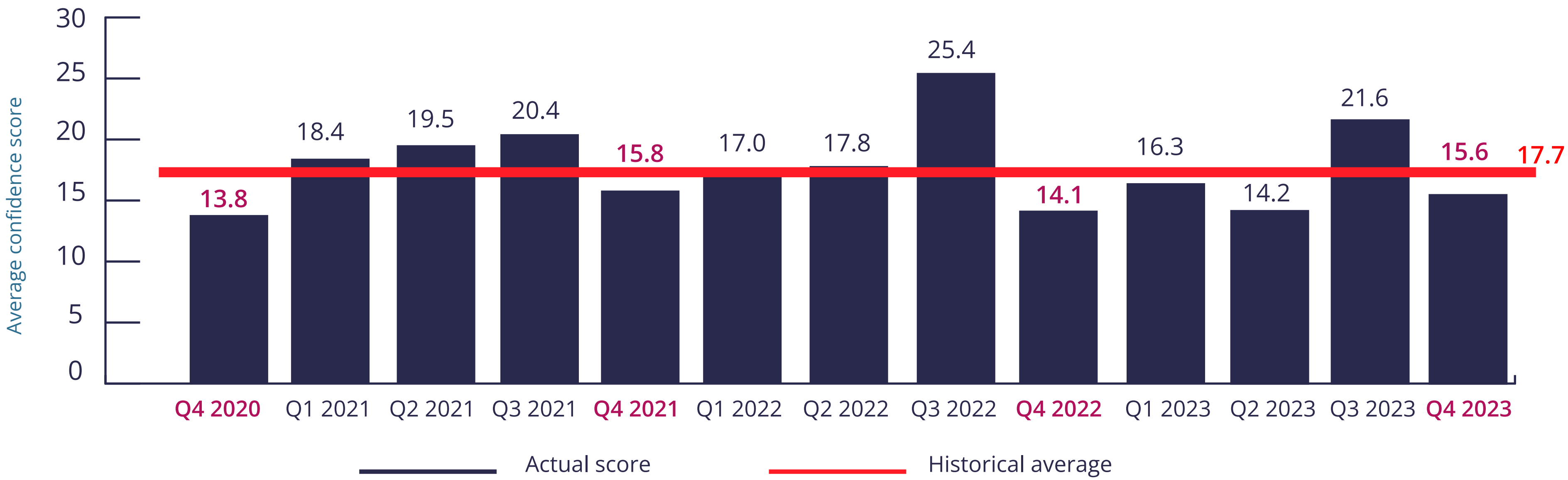
One such observation is the annual peak in confidence levels reported by hedge funds in the third quarter of each year only to be followed by a marked decrease in confidence in the fourth quarter.

Notably, the confidence score reported for this quarter is greater than the historical average for Q4, despite the sharp decline from Q3, see figure 2.

Digging deeper into the data shows a rebound in confidence levels during the first and second quarters of the following year. This recurring pattern of recovery post-Q4 confidence lows suggests a dynamic and resilient confidence landscape in the hedge fund sector, signalling adaptability and optimism among industry participants.

This quarter's results are notable for the wider-than-usual confidence score dispersion. Historically, the vast majority of confidence scores are clustered between +1 and +30, with an average of 87% of respondents scoring themselves in this range, see figure 12. This quarter, less than 80% of respondents fit in this range, with the remaining distributed on both tails. The other dominant observable trend is the greater-than-average representation of long-short equity funds, which historically reported lower confidence scores in Q4, compared to other strategies. This strategy accounts for 60% of respondents in this index, up from the quarterly average of 50%.

Figure 2, HFCI scores over time



New insights: What's driving confidence among hedge funds?

In a new development for the HFCI, we get under the hood to determine the dominant factor driving confidence among hedge funds this quarter.

The breakdown of these responses can be found below.

Figure 3, Ability to raise capital

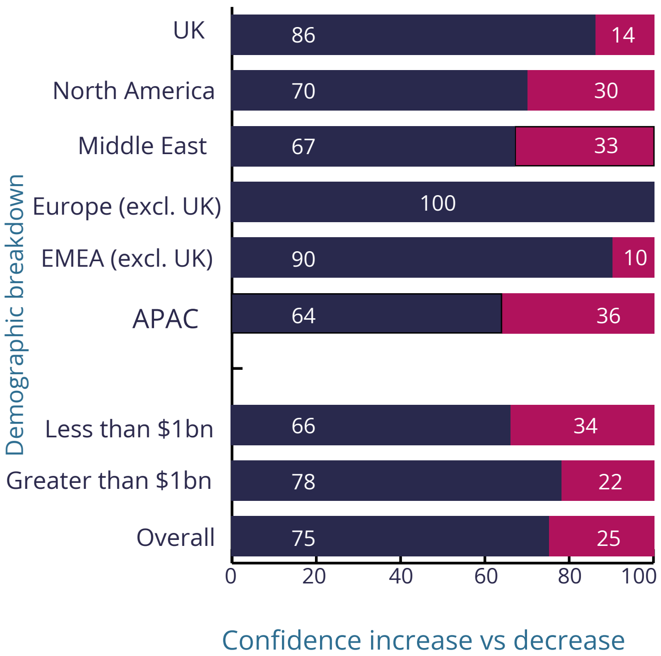


Figure 4, Ability to generate revenue and manage costs

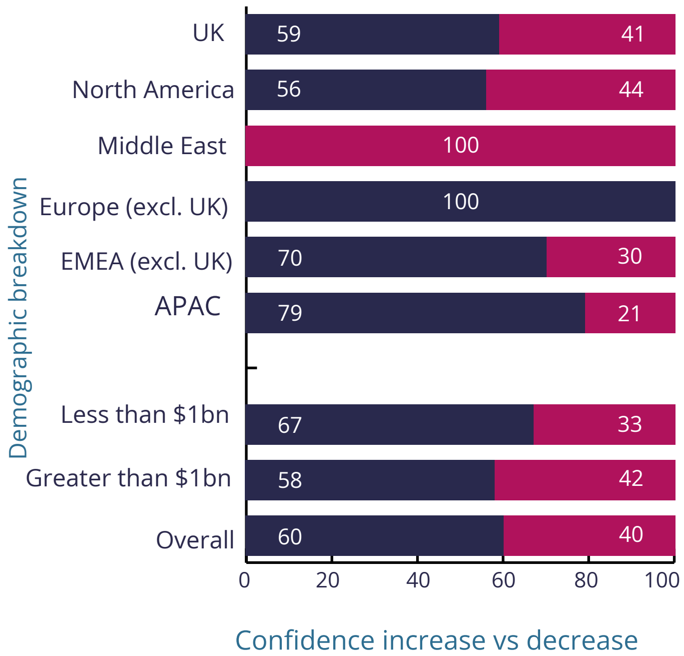
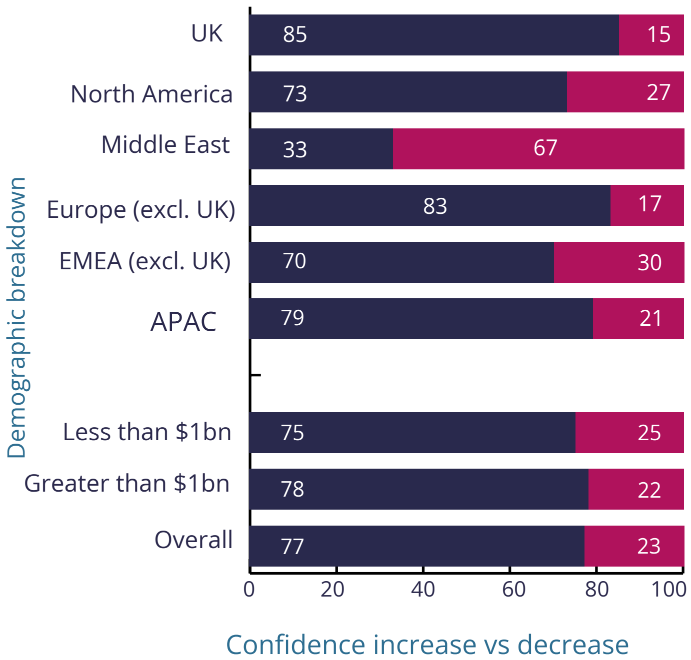


Figure 5, Overall performance of the fund(s)



Increases my confidence   Decreases my confidence

Breakdown by hedge fund location

The latest HFCI indicates a return to the mean for confidence across all regions both in terms of their 2023 confidence levels before Q3's breakout scores and their Q4 average score since records began, in Q4 2020.

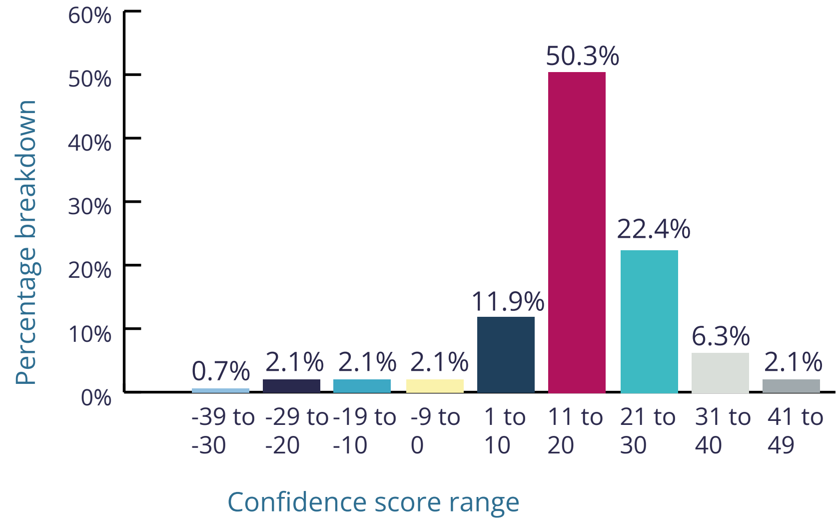
It must be noted upfront that this quarter's HFCI analysis should be framed in the context of being significantly overweight in North American and UK respondents, and underweight APAC and EMEA (excl. UK) respondents, which will influence average confidence scores this time around.

UK hedge funds once again relinquished their lead over North America this quarter, with an almost 10-point drop off in confidence since Q3 to +12.7. This decline positions UK hedge funds below their Q4 average of +13.8. North American hedge funds, meanwhile, experienced a relatively mild decline, from +19.5 to +16.6, which remains above their Q4 average of +15.7.

Beyond the macro environment undoubtedly influencing sentiment on either side of the Atlantic, this reversal is partly due to, the UK's dataset including 70% of respondents representing long-short equity managers (63% in North America). Digging deeper, North American respondents average a significantly higher AUM at US$11.2 billion, compared to the UK's US$9.3 billion. This disparity might contribute to the relatively smaller decrease in confidence observed in North America, as larger fund managers typically report higher confidence levels than their smaller counterparts.

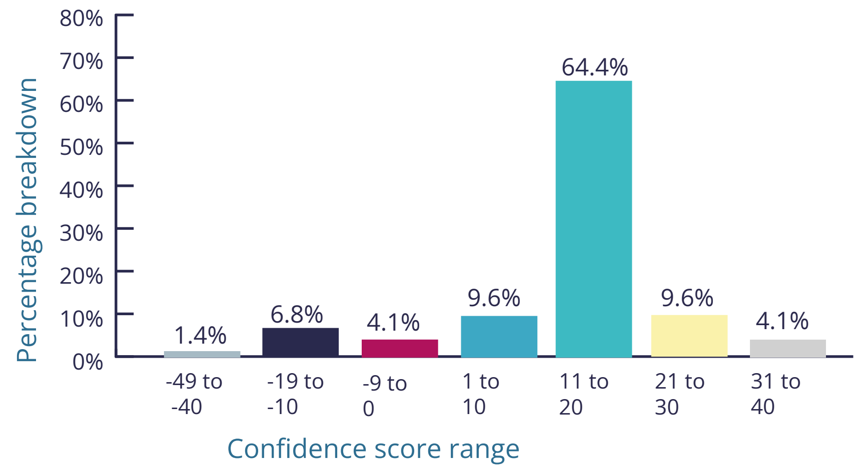
Despite these trends, UK hedge funds show slightly greater optimism than North America in several key areas: raising capital, generating revenue, managing costs, and overall fund performance. The greatest divergence between the UK and North America comes when considering their ability to raise capital. 86% of UK respondents said capital raising increases their confidence compared to 70% in the US, see figure 3.

Figure 6, North America



Confidence score: +16.7

Figure 7, UK

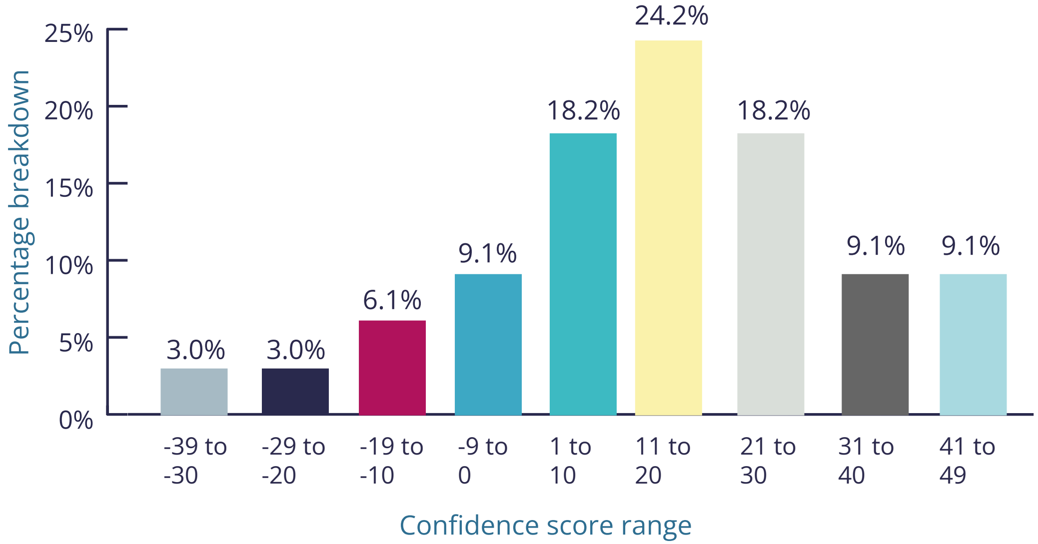


Confidence score: +12.6

Turning to APAC, the region's average confidence score has, on the whole, remained resilient. The APAC dataset includes a much more diverse range of investment strategies including a small pocket of very confident digital assets, global macro, and multi-strategy fund managers that lifted the regional score.

APAC respondents reported the greatest confidence of any region in their ability to generate revenue and manage costs but interestingly were the least confident in their ability to raise capital. Going further, the data reveals that Hong Kong-based respondents are much less confident than their regional peers in their ability to raise capital and deliver for investors over the next 12 months, demonstrating the divergence currently taking place across APAC and compared to the relatively bullish mood in Singapore.

Figure 8, APAC



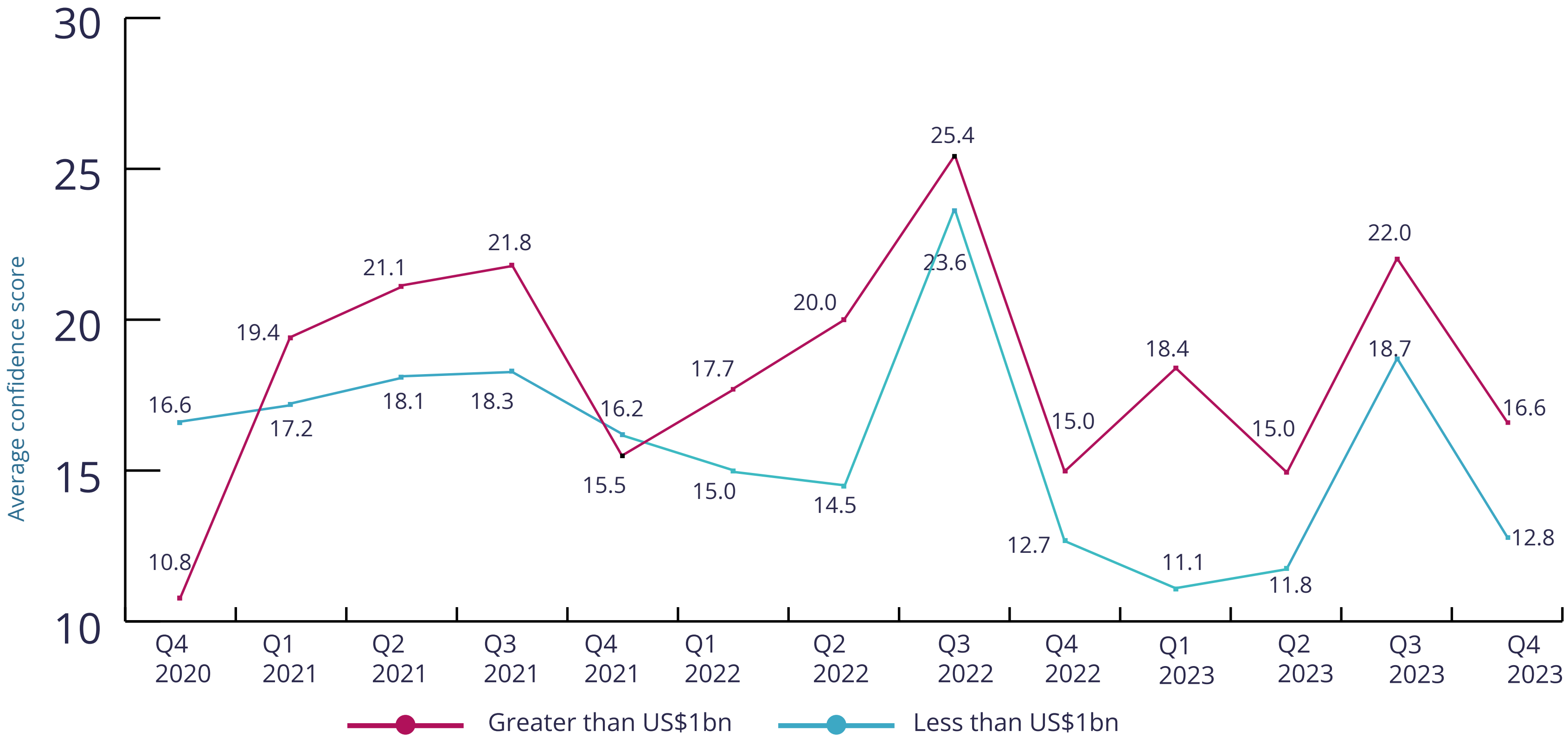
Confidence score: +15.7

Breakdown by hedge fund AUM

Larger managers continue to show greater resiliency than their smaller peers resulting in their confidence gap widening slightly. The pool of smaller managers includes a wide variety of strategies with a greater range of confidence levels, including those at extremes of the spectrum. Almost all larger managers, dominated by long-short equity, and to a lesser extent global macro and multi-strategy fund managers are closely clustered in the cautiously optimistic bracket of +11 to +20 or thereabouts.

In the analysis of factors influencing the confidence scores of fund managers, smaller managers now exhibit a higher level of confidence in their ability to generate revenue and manage costs than larger managers, while larger managers are more comfortable with raising capital.

Figure 9, AUM comparison over time



Commentary: Hedge funds take pragmatic view of challenges going into 2024, amid ongoing uncertainty

One of the defining factors of the 2023 trading environment was uncertainty, as the highly fluid macroeconomic environment endlessly shifted beneath the feet of hedge fund managers. As the rate cycle shifts into the next phase, 2024 is likely to follow suit, with further question marks arising around the changing regulatory and political outlook in major markets, most notably the US and the UK, which are heading into election years.

The overall average global hedge fund confidence score suggests an understandably cautious outlook compared to the previous quarter across most regions and strategies. Smaller hedge funds are showing a more significant decrease in confidence than their larger counterparts, as a result of particularly acute challenges in areas such as fundraising. Regional trends also indicate varying levels of confidence, with some of the US hedge funds showing the greatest resilience in their sentiment, supported by a late rally in the S&P 500 and dovish signals from the Fed that interest rates have at worst peaked and will likely be cut soon. By contrast, the UK appears to be slower to summit the current rate cycle, although the mood in London appears sanguine that the current move to streamline regulations post-Brexit will not be disrupted by whichever party wins the election. That said, with rates predicted to fall and other headwinds expected to also lessen compared to recent years, the capital raising environment may well prove more fertile for hedge funds in 2024.

It is unsurprising then that Q4's confidence scores present one of the most diverse ranges of sentiment scores of any HFCI to date, underscoring the lack of consensus among managers pursuing different investment strategies with some global macro and multi-strategy firms thriving, while hedged equity-focused strategies strike a more modest tone. Meanwhile, the ever-present risk of further unexpected volatility in both equities and fixed income means the proposition of allocating to alternatives for diversification and downside risk protection remains strong. This may explain why, despite the mixed signals from regulators, politicians and central banks, 90% of hedge fund respondents reported a positive confidence score and the majority are confident in their ability to deliver for investors over the coming 12 months.

Breakdown of respondents

Estimated assets under management for hedge fund respondents: US$2.2 trillion

Figure 10, Regional breakdown

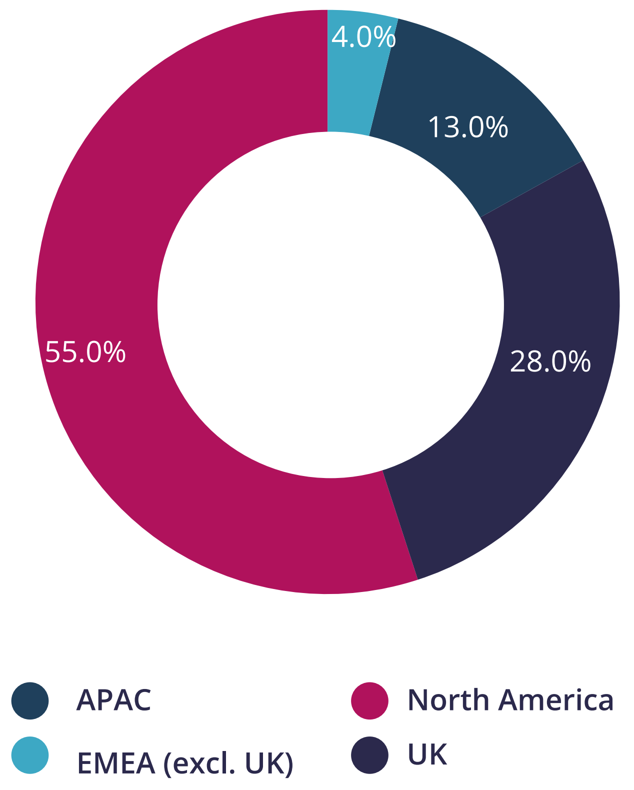
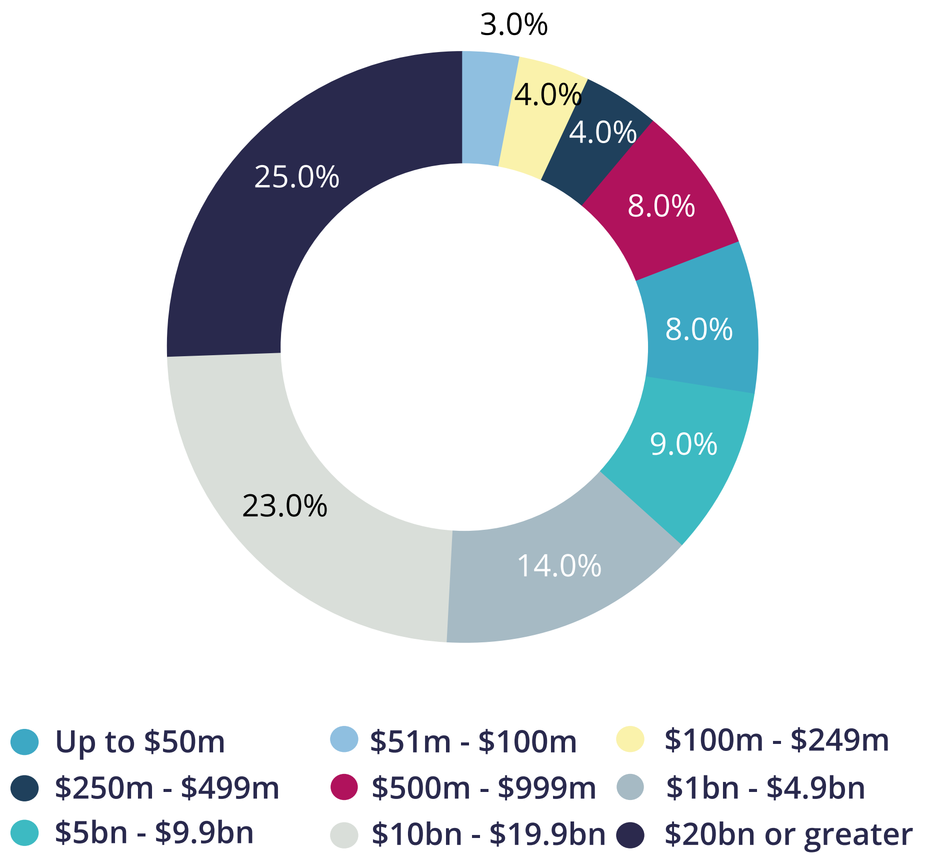


Figure 11, AUM (US$) breakdown



HFCI over time

Figure 12

Category	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023	Average
Overall	13.8	18.4	19.5	20.4	15.8	17.0	17.8	25.4	14.1	16.3	14.2	21.6	15.6	17.7
Greater than US$1bn	10.8	19.4	21.1	21.8	15.5	17.7	20.0	25.4	15.0	18.4	15.0	22.0	16.6	18.4
Less than US$1bn	16.6	17.2	18.1	18.3	16.2	15.0	14.5	23.6	12.7	11.1	11.8	18.7	12.8	15.9
APAC	11.1	17.2	18.2	19.5	16.0	14.8	15.6	23.3	13.8	10.6	9.4	19.3	15.7	15.7
North America	19.7	19.6	22.5	20.4	13.9	13.0	16.4	23.2	13.5	16.4	16.7	19.5	16.7	17.8
UK	9.7	16.4	17.0	21.3	18.2	20.7	21.0	25.6	15.1	18.0	14.5	21.3	12.6	17.8

Tom Kehoe, Global Head of Research and Communications at AIMA, said: *"It is understandable why average confidence scores across all regions are more tempered going into 2024 given the underlying uncertainty and risk of radical change in the regulatory and economic environments hedge funds operate in. Early indications from data providers show that, on average, hedge funds are likely to report better returns in 2023 than in 2022, reinforcing their value to investors as protectors of wealth. Overall, almost all of the hedge funds gave a positive confidence score for their economic prospects for the coming 12 months."*

Devarshi Saksena, Partner at Simmons & Simmons, said: *"It is reassuring to see fund manager confidence remaining consistent for this quarter, albeit with a modest decline from Q3. UK fund managers are having to navigate a different rhythm in the anticipated rate cuts - yet the prevailing sentiment suggests a sustained City-friendly environment as the country approaches an election year. The current market environment continues to pose significant challenges, especially for smaller managers grappling with capital raising and cost management. This quarter's wide dispersion in confidence scores reflects the divergent fortunes of managers in a high-volatility climate, with larger entities capturing the lion's share of capital raising success."*

Nicholas Miller, Partner at Seward & Kissel, said: "*In the US, while there is significant uncertainty caused by the SEC's new private fund adviser rules that has a dampening effect on confidence, we have seen a marked uptick in large allocations, especially into equities strategies. The primary recipients of these large allocations have been our larger clients, although we have seen an increase for more modestly-sized managers as well. Over time, we expect to see higher confidence scores as a result."*