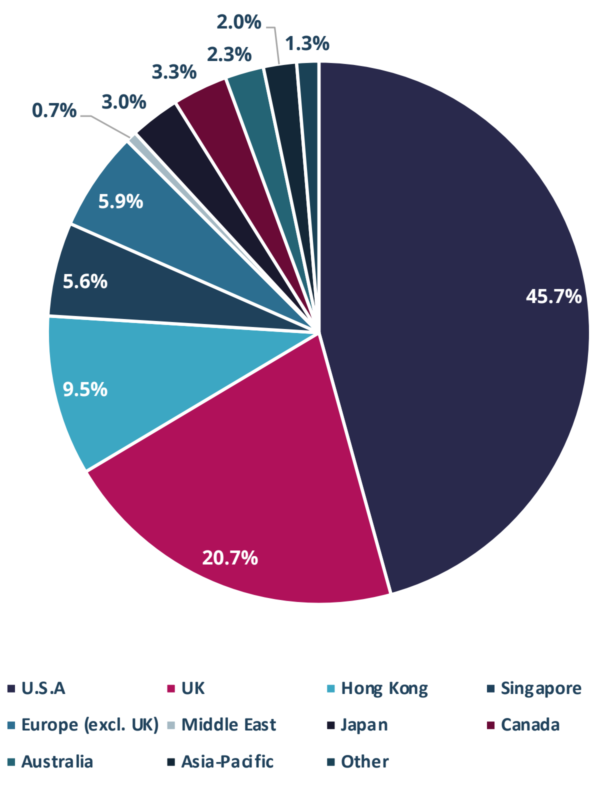
Hedge Fund Confidence Index

The AIMA Hedge Fund Confidence Index (HFCI) is a new global index which measures the level of confidence that hedge funds have in the economic prospects of their business over the next 12 months. A product of AIMA, Simmons & Simmons and Seward & Kissel, the HFCI is calculated at a specified point in time with the index published at the start of each quarter.

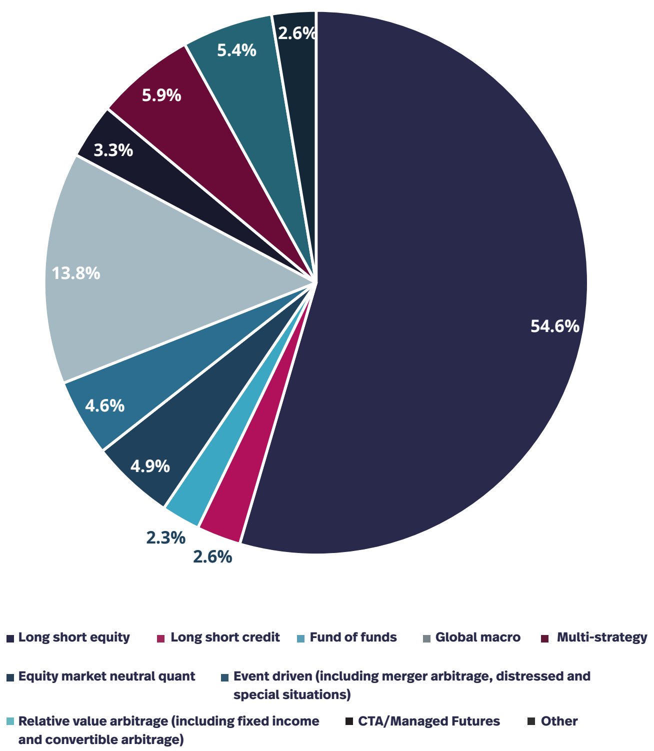
Selecting the appropriate level of confidence, respondents are asked to choose from a range of -50 to +50, where +50 indicates the highest possible level of economic confidence for the firm over the next 12 month period and -50 indicates the lowest level of economic confidence for the firm over the same period. An index level of zero (0) indicates a neutral level of confidence.

When considering how best to measure 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).

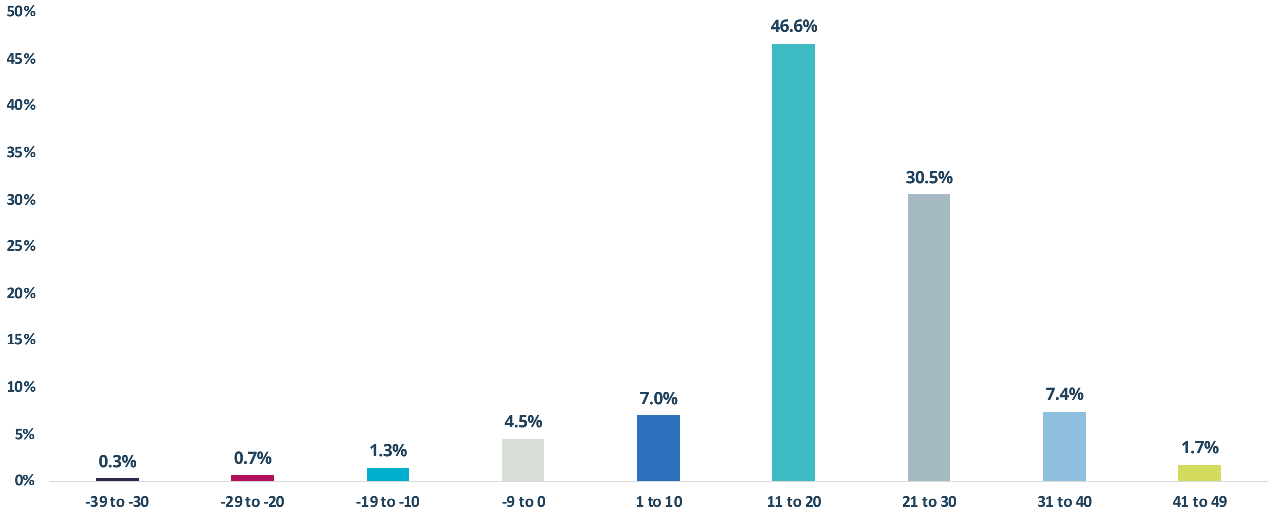
Location breakdown of respondents:



Breakdown of respondents by strategy:



Q1 2021 results:

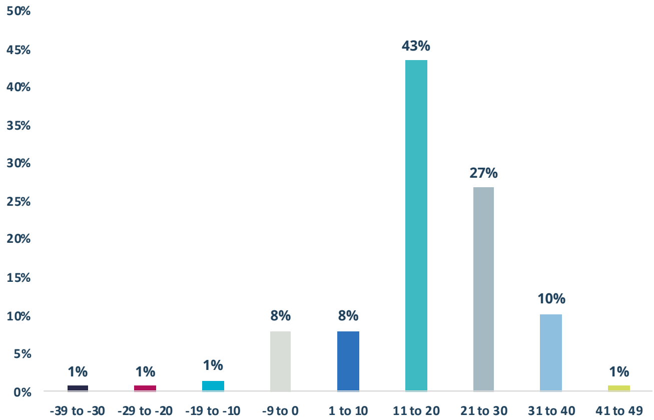


Average confidence score: +18.4

Based on a sample of over 300 hedge funds (accounting for approx. $1 trillion in assets) that participated in the index, the average measure of confidence (in the economic prospects of their business over the coming 12 months) is +18. This is a near 40% increase on the confidence level reported by hedge funds last quarter. (Read the HFCI December 2020 here) Over 90% of the total number of funds that reported to the Q1 index cited a positive confidence measure.

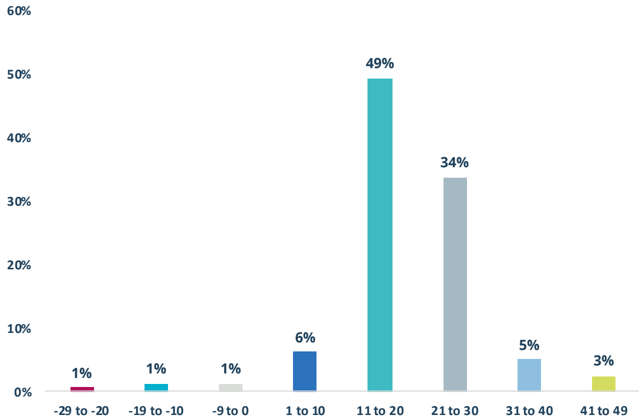
In comparison to the Q4 2020 index where there was a wide dispersion in confidence scores, hedge funds regionally are expressing near similar confidence levels. Once again North America based hedge funds are expressing the highest level of confidence with an average confidence rating of +20 with EMEA and APAC based funds scoring +17 on average (up 70% and 58% respectively from Q4 2020). Hedge funds in the UK also express markedly higher confidence levels of +16 (up 60% on Q4 2020).

Less than $1Bn



Confidence score: +17.2

Above $1Bn



Confidence score: +19.4

Observing the funds confidence level based on their size, we split the population of responses into larger funds (for those that manage greater than $1billion in assets) accounting for 54% of the total number of responses and smaller funds (for those that manage $1billion or less) accounting for 46%. Both large and small hedge funds express high levels of confidence with larger firms being the most confident with a rating of +19 versus their smaller counterparts scoring a confidence rating of +17.

Overview:

Despite increased industry headline risk, confidence levels among hedge funds continue to increase. Both the Gamestop and Archegos incidents being relatively short-lived with global markets ending the first quarter on a positive note. With multiple COVID-19 vaccines being made more widely available and pandemic restrictions being slowly lifted, a cautious optimism exists that the worst of the pandemic is behind us.

Industry confidence is rising amidst strong quarterly performance and net inflows:

Prospects for the hedge fund industry are as strong as they have been in several years with the industry returning another solid set of results in the first three months of this year. As of the end of March, hedge funds on average returned 6% net of fees[1] for the year. Performance dispersion remains prominent with some hedge funds continuing to deliver exceptionally strong returns.

Among the funds that reported to the HFCI this quarter, long/short equity funds, event driven funds, CTAs and Managed Futures score the highest on confidence.

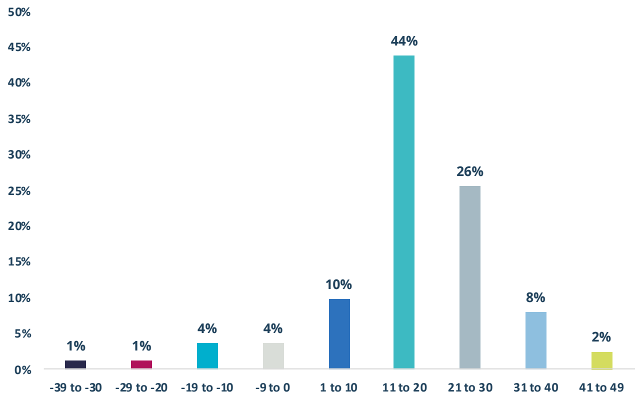
Long/short equity funds remain among the best performing investment strategies having been able to take advantage of the market dislocation. Sector specialist strategies have also enjoyed a good period of returns. Funds investing in biotech, healthcare and technology have all seen good returns over the past 12 months. Event driven funds, particularly merger arbitrage and special situations enjoyed a good period of performance benefiting from more activity in the marketplace and a rise in merger and acquisition activity. Some have also benefit from the increase in popularity for SPACS. Trend following hedge funds (CTA, Managed Futures) and risk premia strategies have also reported a solid period of performance with indications that they are now back in vogue among investors.

The continued strong performance by the industry has not gone unnoticed by investors. The strong investor sentiment highlighted in the Q4 2020 confidence index has translated to the industry reporting an estimated $24bn in net inflows in the first two months of this year making it the best two months start since 2014[2]. Increasingly investors are looking to the qualities of hedge funds to best manage any downside risk from market volatility and deliver on performance better than most asset classes. In a further boon to industry prospects, with yields for some fixed income strategies becoming more challenging, investors are turning to hedge funds as a replacement, given their ability to deliver higher returns.

[1] Source: HFM Pageant Media (March and Q1 figures are estimates and subject to change as more hedge funds report).
[2] Source: Evestment (https://www.evestment.com/news/assets-continued-to-flow-into-hedge-funds-in-february/)

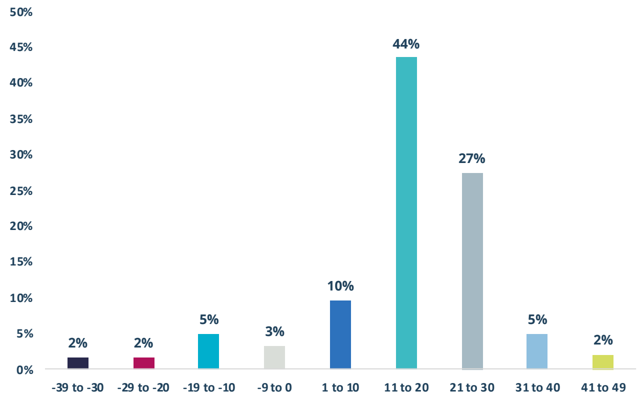
Breakdown by hedge fund location

EMEA



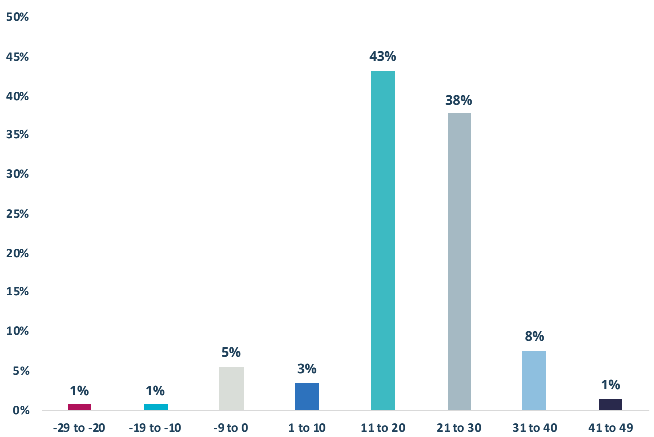
Confidence score: +17.3

UK



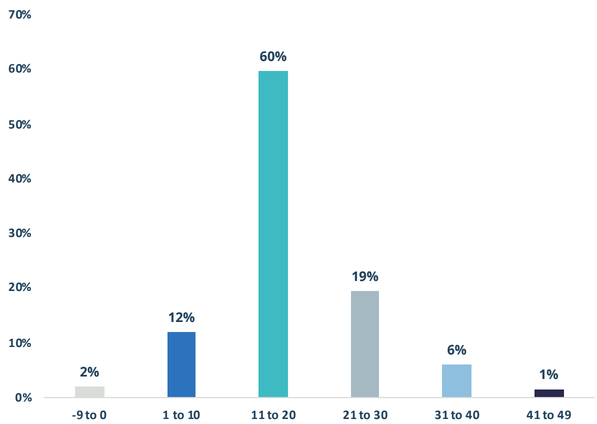
Confidence score: +16.4

North America



Confidence score: +19.6

APAC



Confidence score: +17.2

All regions enjoy a healthy level of confidence with the promise of greater times ahead.

Comparing the confidence scores of the four regions, North America based funds continue to report the highest level of confidence although the delta has narrowed versus its peers with all four scoring in a narrow range of 16.4 to 19.6. Notably the high confidence scores cited by North America, EMEA and APAC based funds are from larger funds pursuing long/short equity, global macro as well as from fund of funds.

Observations from the market

The positivity in the market is reflected in the interviews conducted post survey with a number of managers and industry stakeholders.

The industry appears to be tiptoeing back to normal amidst vaccination rollouts increasing in scale and lockdown restrictions being lifted. In APAC and certain parts of the US major business districts are seeing an increase in numbers returning to the office. Fund managers with larger workforces appear to be returning to the office at a slower rate than those with smaller teams. We are also seeing pockets in the market where certain teams or personnel that need to collaborate are going back to work in-person or are already back in the office.

The launch environment is exceptionally strong especially among hedge fund firms that have a pre-existing relationship with investors. Among the more popular launches include specialist sector equity strategies, macro funds, SPVS, closed-end products to more opportunistic products like SPACS. With respect to emerging managers, the fund raising market is still challenging, with any efforts concentrated among managers that have pre-existing investor relationships and/or a strong track record. While travel and in-person meetings are a prerequisite; allocators have been able to adapt their due diligence practices to the virtual environment with a greater level of confidence now being show in the virtual outreach. There have been some examples of new business successfully onboarded via solely virtual means.

On a regional basis, APAC is leading the global effort in unlocking COVID-19 restrictions with thoughts even turning to a resumption of international travel. Not surprisingly, activity levels have subsequently multiplied – underpinned by higher levels of confidence expressed by local funds and international investors.

APAC based funds are predicting a raft of new capital investment amidst investors preference for China and emerging markets this year. Regulatory changes facilitating hedge funds investment in China are also boosting demand from investors. In addition to China, investment opportunities are emerging following a series of corporate governance improvements in Japan and South Korea.

Reasons to be cheerful

Hedge funds appear to be riding a wave of optimism sweeping the globe as it moves closer to exiting the pandemic. Further reasons for the industry to be cheerful include appetite among investors being among the strongest witnessed in several years with both increased allocation from existing investors, while the pipeline for new fund launches remains resilient admist a strong tailwind of performance.

Notes

- On behalf of AIMA, Simmons & Simmons, and Seward & Kissel, we would like to thank everyone who took the time to participate in the survey and share their insights. These views have been pivotal in helping us form this valuable report.
- The average confidence numbers and charts which follow are based on results between -49 and 49, this has been done to remove outliers which would skew results.