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HEDGE FUND INDUSTRY CAPITAL FALLS FROM RECORD ON INVESTOR OUTFLOWS

Investors redeem $22 billion in 4Q, highest quarterly outflow since 3Q 2016; Equity Hedge leads strategy outflows, while Event Driven strategies see inflows

CHICAGO, (January 18, 2019) – Total hedge fund industry capital declined from the prior quarter record as investors redeemed capital, equity markets posted record losses, and financial market volatility surged. Investors redeemed an estimated $22.5 billion (0.7 percent of industry capital) from hedge funds in 4Q18, the largest quarterly outflow since 3Q 2016, according to the latest *HFR Global Hedge Fund Industry Report*, released today by HFR®, the established global leader in the indexation, analysis and research of the global hedge fund industry.

The 4Q18 net asset outflow brings the full-year 2018 (FY18) capital outflow to $34 billion (approximately 1 percent of industry capital) and decreases total hedge fund capital to $3.11 trillion, down from the prior quarter record of $3.24 trillion.

The HFRI Fund Weighted Composite Index® (FWC) declined -5.76 percent in 4Q18, while the HFRI Asset Weighted Composite Index (AWC) fell -2.73 percent, with performance losses reducing industry capital by $115 billion from the prior quarter.

Despite performance weakness, hedge funds topped the steep declines of many equity markets in both December and for FY 2018, as the HFRI AWC Index declined -0.8 percent in December and -1.0 percent for 2018, while the HFRI FWC Index fell -2.4 and -4.5 percent, respectively, over the same periods.

Large fund outflows were concentrated in several firms which closed and returned capital to investors, with approximately two dozen firms experiencing net asset outflows of greater than $500 million for the quarter. Despite the overall negative trends on flows and performance, but reflecting the trend of larger hedge fund relative outperformance, approximately one dozen firms received net asset inflows of greater than $500 million for the quarter. Flows by firm size also showed net outflows across all firm sizes, with firms managing greater than $5 billion experiencing outflows of $15.6 billion. Mid-sized firms managing between $1 and 5 billion saw outflows of $2.8 billion for the quarter, while firms managing less than $1 billion saw outflows of $4.1 billion.

Equity Hedge (EH) funds, the largest strategy of industry capital, led both outflows and performance-based declines in 4Q18, as investors redeemed an estimated net $16.8 billion, reducing total EH capital to $871.8 billion. The HFRI Equity Hedge (Total) Index fell -8.3 percent in 4Q, bringing 2018 performance to a decline of -6.9 percent; the HFRI Equity Hedge Index (Asset Weighted) fell -5.9 percent in 4Q and -5.9 percent for the year. EH sub-strategy outflows were driven by Fundamental Value funds, which experienced outflows of $6.7 billion in 4Q, decreasing sub-strategy AUM to $461.2 billion. Partially offsetting these, Technology/Healthcare and Quantitative Directional sub-strategies experienced small inflows in the quarter.

Macro hedge funds led industry performance in December, with the HFRI Macro (Total) Index gaining +0.5 percent for the month and the HFRI Macro (Asset Weighted) Index surging +1.8 percent, as US equities fell more than -9.2 percent for the month. The December gain drove the HFRI Macro (Asset Weighted) Index to a FY 2018 return of +1.6 percent. Macro sub-strategy gains in December were led by quantitative, trend-following CTA strategies, as the HFRI Macro: Systematic Diversified/CTA Index advanced +1.7 percent. Despite these, Macro strategies experienced an estimated net outflow of $6.6 billion for 4Q, decreasing Macro capital to $581 billion. CTA strategies experienced only a modest outflow of $1.1 billion for the quarter.

Partially offsetting the outflow trend, Event-Driven (ED) strategies received an estimated net asset inflow of $6.4 billion for 4Q, although performance weakness decreased total ED capital to $819 billion from the prior quarter. ED sub-strategy flows were driven by Distressed/Restructuring and Special Situations funds, which experienced inflows of $6.5 billion and $1.4 billion, respectively. For the year, the HFRI Event-Driven Index (Total) declined -2.35 percent, while the HFRI Event-Driven Index (Asset Weighed) fell only -0.6 percent.

Fixed income-based Relative Value Arbitrage (RVA) strategies led industry performance in 2018, as the HFRI Relative Value Index (Asset Weighted) added +0.5 percent for the year, while the HFRI Relative Value (Total) Index posted a narrow decline of -0.2 percent for 2018. In 4Q18, RVA strategies experienced outflows of $5.4 billion, decreasing total RVA capital to $835 billion from the prior quarter. RVA sub-strategy outflows were led by an estimated $4.0 billion of net outflows from RV: Multi-Strategy funds in 4Q18, as these were only partially offset by minor inflows into FI Asset-Backed and FI Sovereign sub-strategies.

"Hedge fund outflows in 4Q were driven by several factors, most notably investor reaction to steep losses in traditional asset investments and the sharp spike in equity market volatility leading to redemptions. However, outflows also included several large fund closures from early 4Q (pre-equity market declines in Oct & Dec), including instances of family office conversions and orderly, manager-initiated returns of investor capital, with all of these representing a stark contrast from the panic-driven redemption from the 2008 Financial Crisis," stated Kenneth J. Heinz, President of HFR. "Trends in Macro, CTA, and RVA/Credit Multi-Strategies, and stronger relative outperformance of larger funds were all favorable throughout the intense market dislocations of December and 4Q. While the overall investor flows and performance trends were negative, it is likely that discriminating institutional investors which experienced or observed areas of strong performance through the most difficult equity and commodity trading environment in a decade will factor these positive dynamics into portfolio allocations for 2019."

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