THE ALTERNATIVE WEEKLY BRIEF

4 JANUARY 2023

By AMUNDI INSTITUTE

THE COMPLEMENTARY BENEFITS OF OFFSHORE & LIQUID/UCITS HEDGE FUNDS

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The Offshore vs. UCITS risk/reward is overall balanced, but changing over time. We seek to understand what drives relative returns between offshore and liquid hedge funds (“UCITS”). We find that UCITS tend to outperform during weak macro phases while offshore funds tend to take the lead otherwise. In particular, UCITS outperformed during the financial and euro crisis, the 2015 downturn, the trade-war and Brexit shocks, and to some extent in 2022. Likewise, while their relative volatility and risk/reward are overall comparable, they show large shifts down the road. UCITS display a higher Sharpe ratio during adverse episodes. In more constructive backdrops, the profile of offshore funds looks more attractive.

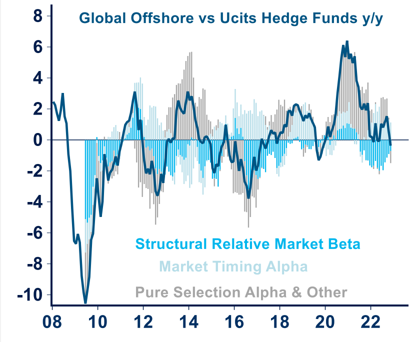
We use the HFRI FoHF index to track offshore fund returns and a combination of HFR and Eurekahedge indices for UCITS.

What is driving the performance gap? To understand the relative return drivers, we break down both vehicles’ performance, distinguishing structural from tactical market exposures, as well as their alpha from securities selection. The relative contribution from structural market exposures would typically capture offshore and UCITS uneven regulatory constraints. In particular, UCITS have tighter liquidity requirements due to their higher redemption frequency and lower allocation to illiquid assets. UCITS also have reduced access to some asset classes (such as commodities or exotic credit), or to some instruments and counterparties (higher cost of shorts). Risk management rules are also heavier for UCITS, regarding leverage, diversification, and daily VAR monitoring. Additionally, the contribution from structural exposures reflects an uneven spectrum of sub-strategies. Offshore funds encompass broader sets of arbitrage that cannot be easily replicated in UCITS. We note that UCITS are increasingly replicating strategies of larger managers who can afford the extra costs.

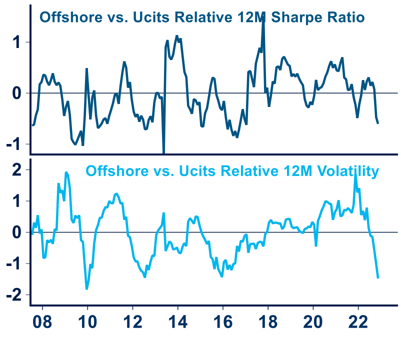
Other contributions come from alpha, both from their market timing and pure securities selection, as well as from other factors (such as their uneven fee structure: UCITS usually apply lower management fees).

Tighter UCITS’ risk management largely explains relative returns, but alpha matters too. Aggregate indices are too broad to reliably spot out key return contributions, requiring more granularity. Focusing on the four main underlying strategies, we find that the bulk of L/S Equity and Event Driven relative returns is explained by their uneven structural exposures. However, variations in alpha matter, emphasizing the importance of fund selection. In 2022, L/S Equity UCITS appear to have had milder value and growth factor biases, but more quality. Event Driven UCITS continued to display higher exposure to merger arbitrage than to other special situations or distressed strategies. Fixed Income Arbitrage relative returns can be explained both by structural and tactical positioning. UCITS are structurally more exposed to IG *[continued p2]*

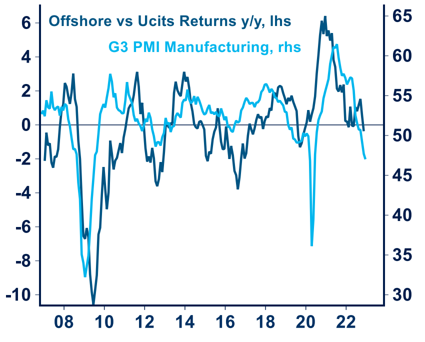
Shifting global offshore/UCITS relative returns



Similar overall risk/reward, with ups & downs

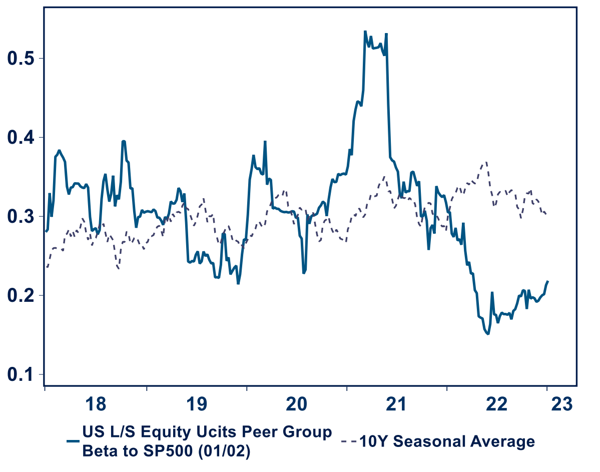


UCITS tend to lead in weak macro backdrops



Sources: HFR, Eurekahedge, Bloomberg, Macrobond, Amundi Institute

Positioning: Uneven L/S Equity managers' enthusiasm beginning of 2023



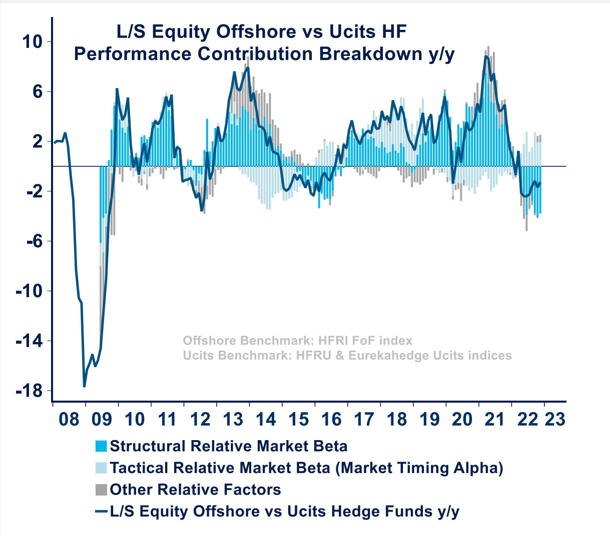
As we start 2023, we assess how L/S Equity hedge funds are positioning. While US and Global L/S Equity managers are marginally boosting their overall net exposures, they are adding more risk through factor and sector allocations (they reweighted value and cyclical stocks, including financials, in sympathy with a steepening yield curve).

Positioning in EU seems more cautious after the strong rally. Managers modestly added value stocks but sold cyclical stocks. UK managers remain substantially exposed but increased defensive and quality stocks, while selling momentum. Managers in Japan brought down their overall exposures to neutral, following the BoJ's tweaks.

Chinese L/S managers have fully rebuilt their exposures over the last couple of months, focusing on industrial, real estate, and domestic shares. The ongoing economic reopening and stimulus were the obvious catalysts.

The Complementary Benefits of Offshore & UCITS Hedge Funds *[continued from p1]*

L/S Equity offshore/UCITS relative return estimated contributions

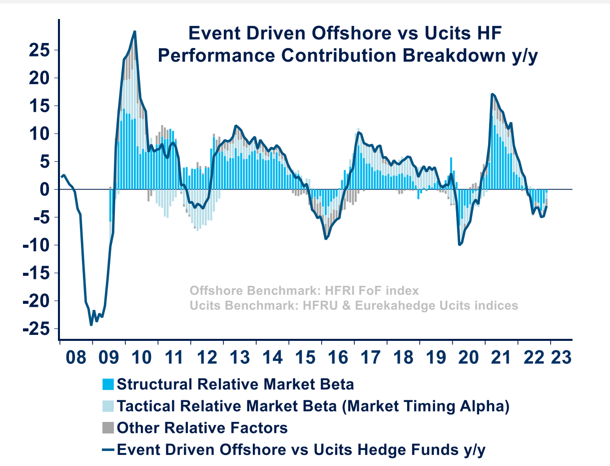


Source: HFR, Eurekahedge, Bloomberg, Macrobond, Amundi

and EM, while offshore funds allocate more to HY and structured credit. In 2022, UCITS kept on underperforming due to their low leveraged bond shorts. The greater number of UCITS focusing on EM bonds also detracted. The reliability of Global Macro offshore/UCITS relative returns analysis looks poor. The limited representativeness of global macro offshore/ UCITS indices and the heterogeneous available styles puts the emphasis on fund selection. Yet, UCITS' outperformance during adverse backdrop and vice versa, remains a common pattern.

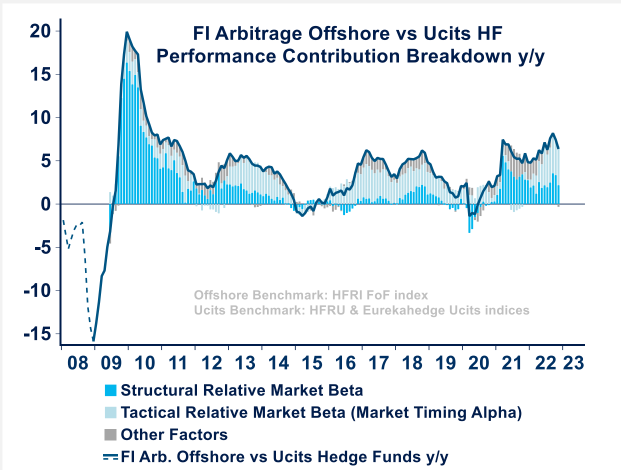
In summary, the analysis confirms that UCITS' constraints explain a large part of the gap with offshore funds, especially for L/S Equity, Event Driven, to some extent FI Arbitrage. Tight UCITS' risk management plays favorably during adverse macro episodes and vice versa. The cost of such protection approximates 1% per year. Yet, alpha also matters greatly, stressing the importance of fund selection. Combining offshore funds (to gain exposure to sophisticated arbitrage) with defensive/liquid UCITS makes sense. The shorter the investment horizon, the more UCITS would seem appropriate and vice versa.

Event Driven offshore/UCITS relative return contributions



Source: HFR, Eurekahedge, Bloomberg, Macrobond, Amundi

FI Arbitrage offshore/UCITS relative return contributions



Source: HFR, Eurekahedge, Bloomberg, Macrobond, Amundi

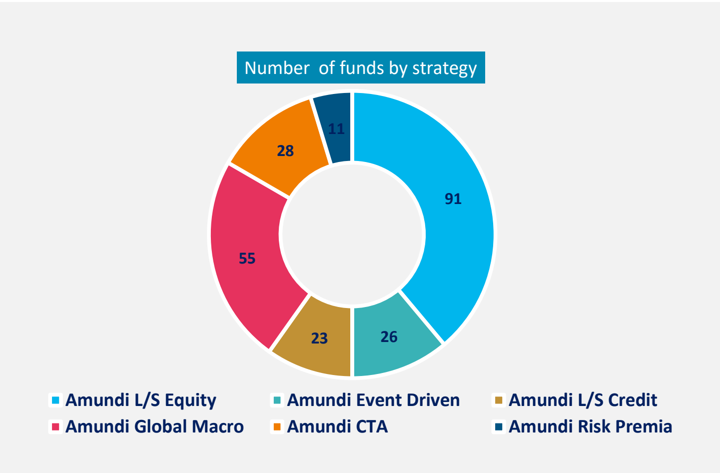
METHODOLOGICAL APPENDIX

The information contained in this report on the performance of hedge funds is based on publicly available information. The universe of underlying funds is relatively stable but varies depending on the criteria of inclusion presented below. It is based on an unbiased selection from our hedge fund analyst team.

Performance is calculated on a weekly basis, as of end-of-week, using an arithmetic average (equally weighted average).

Regarding share classes used in these peer groups, we selected the primary share class as referenced in Bloomberg. Non-USD share classes are hedged in USD based on hedging costs available on Bloomberg.

Amundi Hedge Fund Peer Groups: number of funds by strategy



- 234 strategies across the main categories in the industry
- USD 154 billion of assets under management
- As of January 2022

Criteria of inclusion

The criteria of inclusion are fourfold:

- Only UCITS strategies are included
- Assessment by Amundi's Hedge Fund selection team based on funds' materials or manager interaction
- Strategies included must have assets under management of at least USD 50 million
- Strategies included must display at least a one-year track record

PUBLICATION FREQUENCY

This report will be published every two weeks.

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Date of first use: 3 June 2022.

Document issued by Amundi Asset Management, “société par actions simplifiée”- SAS with a capital of €1,143,615,555 - Portfolio manager regulated by the AMF under number GP04000036 – Head office: 91-93 boulevard Pasteur – 75015 Paris – France – 437 574 452 RCS Paris – www.amundi.com.