4TH QUARTER ▪ 2021

HEDGE FUND UPDATE

Eric Costa
Global Head of
Hedge Funds

Global capital markets remained volatile during fourth quarter 2021 but ended in strong positive territory for the quarter and year. Positive equity markets index performance during the fourth quarter masked the underlying carnage that occurred in high-growth sub-sectors. These sectors continue to respond negatively to anticipated central bank tightening. Core hedge fund strategies were mostly positive during the quarter; however, hedge fund alpha generation was poor. HFRI Equity Hedge (Total) produced 0.8%, HFRI Event Driven (Total) increased 1.5%, HFRI Macro returned -0.5%, and HFRI Relative Value gained 0.1%.

FIGURE 1 INDEX PERFORMANCE
As of December 31, 2021 • US Dollar

Index	QTD	1 Yr	3 Yr
S&P 500	11.0	28.7	26.1
Euro Stoxx	3.8	14.0	15.6
MSCI EM	-1.3	-2.5	10.9
JPM Global HY	0.3	4.9	8.2
HFR Equity Hedge	0.8	11.8	14.4
HFR Event Driven	1.5	12.9	9.9
HFR Macro	-0.5	7.6	6.5
HFR Relative Val	0.1	7.5	6.1
HFR Credit	0.0	8.0	6.9

Sources: Hedge Fund Research, Inc. J.P. Morgan Securities, Inc., MSCI Inc., Standard & Poor's, Stoxx®, and Thomson Reuters Datastream. MSCI data provided "as is" without any express or implied warranties.

Notes: Hedge Fund Research index data are preliminary for the proceeding five months. Returns are represented by total returns, except for three-year, which is represented by average annual compound returns. MSCI indexes return data are net of dividend taxes.

While hedge funds generally produced positive absolute performance, many growth-oriented long/short equity managers experienced significant drawdowns during the quarter. High-growth, cash flow–negative companies in software and internet suffered a significant correction during the quarter. Widely held hedge fund names, such as Coupa Software, Twilio, Snowflake, Unity Software, and Roblox, corrected 15%–60% from the highs set earlier in the year. Broken growth stories like Peloton and Zillow are down 70% to 80% from their peak. The disparity of results between these equities and mega-cap technology companies, such as Microsoft and Apple, is stark. The fourth quarter and year-to-date returns of the major indexes were once again driven by a small number of large technology names (Figure 2).

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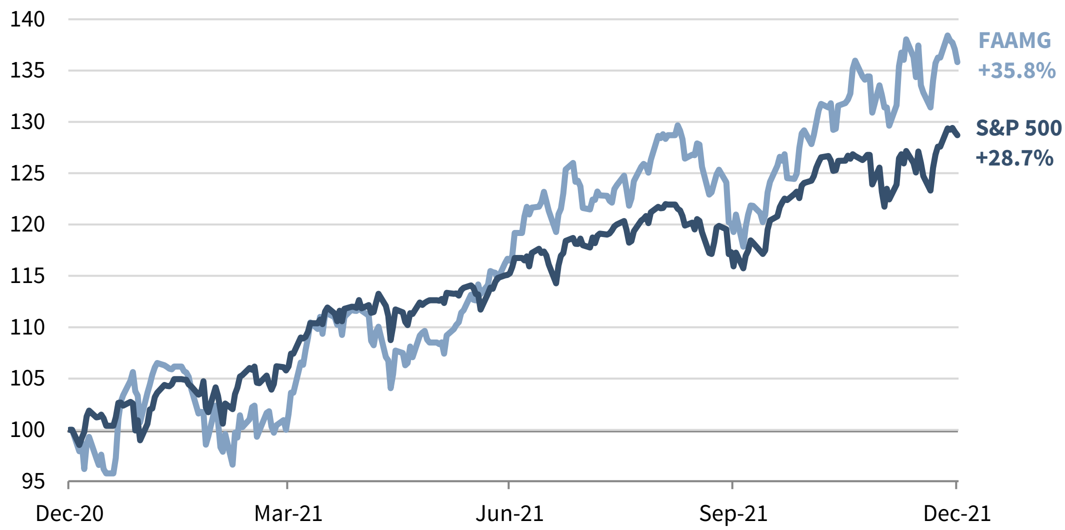
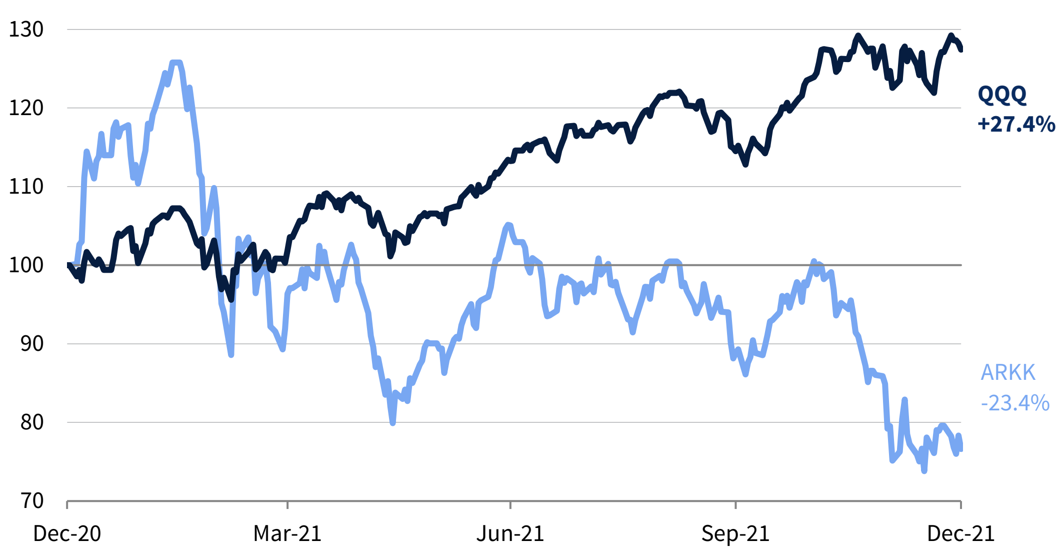
FIGURE 2 FAAMG AND S&P 500 YTD PERFORMANCE
December 31, 2020 – December 31, 2021 • December 31, 2020 = 100 • US Dollar



Sources: FactSet Research Systems, Standard & Poor's, and Thomson Reuters Datastream.
Notes: FAAMG represents Meta Platforms (formerly known as Facebook), Amazon, Apple, Microsoft, and Alphabet (formerly known as Google). Total returns data are daily and gross of dividend taxes.

The selling of growth company equities appears to be driven by hedge funds and innovation-focused, long-only investors like Cathie Wood's ARK Funds (Figure 3). In December, Goldman Sachs reported net hedge fund buying in "TMT," but this was the first reported monthly inflow over the last eight months. As a result of the large sell-off, many technology-focused long/short managers experienced significant draw-downs during the quarter. We observed a wide range of outcomes for these managers ranging from -20% to 5%.

FIGURE 3 ARK INNOVATION AND INVESCO QQQ YTD PERFORMANCE
December 31, 2020 – December 31, 2021 • December 31, 2020 = 100 • US Dollar



Source: Thomson Reuters Datastream.
Note: Total returns data are daily and gross of dividend taxes.

The current environment provides technology-focused long/short equity managers with an incredible opportunity to purchase compelling growth companies at a large discount to recent valuation multiples. The sector has been ripe for alpha generation for many years and should continue to because of the continued disruption created by innovation. This market appears to be giving investors an attractive entry point for those able to accept the associated volatility. ■

Kristin Roesch also contributed to this publication.