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Other Voices: 2021: An eventful year for hedge funds

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Given the events of 2020, many people could have been forgiven at the start of the year for thinking that 2021 would not be as eventful, however, for those in the hedge fund industry, this has certainly not been the case. Following large market dislocations and equity market selloffs, the spotlight always falls on hedge funds, given it is precisely these moments when hedge funds' potential for diversification, lack of correlation and alpha generation are needed, and managers truly earn their fees. Overall, the industry performed well in 2020, with the result being increased levels of demand for hedge funds from investors across the board, from institutional investors to RIAs. With hedge funds once again showing why they are a necessary part of the asset allocation mix, we have outlined the trends we have observed this year from our interactions with hundreds of managers and investors.

Firstly, increased investor interest has come hand in hand with increased scrutiny during manager selection and due diligence. Investors continue to not only get more sophisticated in the ways they conduct operational and investment due diligence, but a core part of due diligence is now focused specifically on environmental, social and governance factors, as well as how diverse and inclusive a manager is Once the domain of ESG-specific investment strategies, ESG is now something that nearly every manager is thinking about, and the concept of operational ESG, and how a business is run and treats is employees, is now a something against which allocators judge managers.

The second notable trend has been a continuation of the blurring of lines between hedge funds and private equity. Many sizeable managers, traditionally known for their hedge fund strategies, have branched out into private markets investing and launched hybrid structures (notably closed-end funds) to match the liquidity profile of the underlying assets. The use of side pockets and hedge fund co-investments has increased in line with the trend of companies staying private for longer. Hedge funds have taken note of investors' desire for pre-IPO growth companies and resurrected these structures to hold these investments separate from their core liquid strategies. Lastly, the start of the year was marked by a boom of SPAC

(Special Purpose Acquisition Company) issuance, mostly by private equity managers, but with some notable hedge funds names involved as well. As a result, SPAC trading is something that event-driven managers have focused on more.

Whereas in 2020 the shift to remote work was seen as a novelty, in 2021 hybrid work has been cemented as the new operational model for hedge funds of all sizes. Powering the hybrid operating model is an increased focus on technology, notably the cloud and its ability to power data management and analytics, as well as more reliance on outsourcing operations to service providers to ensure resiliency and improve efficiency. Also of note cyber security which has become a crucial component of every manager's ongoing strategy given the rise in threats over the pandemic and both investors' and regulators' resultant attention.

Lastly, we have observed three interesting trends as it relates to the evolution of different hedge fund strategies. The first is the decline in short-bias funds. The rise of meme stocks, and subsequent resurgence of the debate around shorting, has added additional pressure on short-bias strategies to the point where it is extremely difficult to execute these strategies effectively. Managers are aware of the risks they face if their high conviction concentrated shorts make their way onto forums such as Reddit, and as such, short bias strategies face an existential threat. The second trend is that hedge funds which have traditional focused on municipal bonds are branching out into two adjacent areas: private infrastructure credit and public-private partnerships (PPPs). Private infrastructure credit involves managers providing non-bank financing for US infrastructure projects, whereas PPPs are a collaboration between a government agency and the private sector to finance, build and operate infrastructure projects. Both have seen a surge in interest fueled by this administration's $1 trillion infrastructure bill.

The third trend, which has yet to receive much attention, is the growth in interest in multi-strategy platforms, inclusive of both multi-manager hedge funds and fund-of-SMAs. With allocators unable to meet with as many managers due to travel restrictions, multi-strategy platforms have proven their worth and started to win larger mandates. Allocators essentially are outsourcing the strategy reallocation decision-making process to the manager as an easier way to operate in the current environment. This rise in popularity of multi-strategy platforms and the convergence of the multi-manager hedge fund and fund-of-SMA spaces has meant increased competition between the platforms for both new talent and investor allocations.

There is no need to break out the crystal ball to understand that these trends will likely continue into the first half of 2022. However, with the concept of a post-pandemic world still some way off and diverging views on inflation, it remains to be seen what new trends and developments might appear as the industry continues to both grow and evolve.