1Q17

Hedge Funds Snapshot

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1. Overview

The first quarter of 2017 has seen a strengthening of the dominant trend of 2016: quantitative investing. Quant strategies are enjoying growth in absolute and relative terms, as well as outperforming traditional, fundamental strategies. As a result, hedge funds are heavily investing in quantitative talent and technology to boost risk management, portfolio construction, and data science operations. Candidates in the quantitative space at all levels are seeing an increase in opportunity at hedge funds and ancillary businesses. Hedge funds are growing in-house teams or engaging with boutique subscription services to develop quant strategies and capabilities.

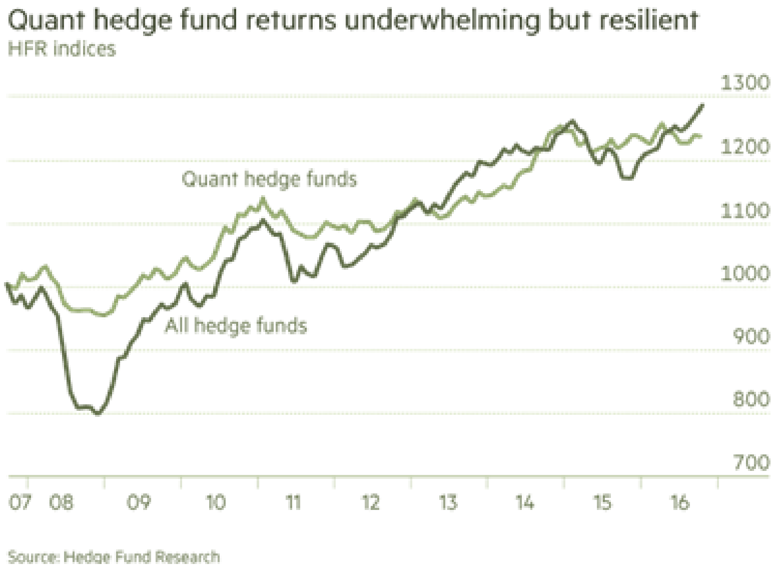
While many hedge funds running fundamental strategies have been playing catch-up with their quantitative peers, there have been bright spots for some strategies. One macro systematic fund was up almost 25% on the year through November. Distressed credit or global credit long/short also have performed well. Portfolio managers are returning to merger arbitrage and event-driven investing with notable success. A number of issues are generating headwinds for hedge funds.

Regulatory and compliance issues are adding costs and creating hurdles for fundraising. Trade crowding is a growing problem that ironically has been intensified by the growing reliance on quant strategies and low-latency trading. Cybersecurity constitutes yet another issue facing hedge funds, forcing them into unending races against the ever-evolving cyber-threats plaguing the financial community at large.

The single greatest challenge facing hedge funds, however, is the political environment. The Brexit vote and Trump's win in the American presidential elections are bellwethers of populist sentiment growing in both the United States and Europe; feelings are running strongly against open markets and financial powerhouses. The Trump administration has presented an array of different and sometimes contradictory initiatives. While the Cabinet is full of Wall Street bankers, primarily Goldman Sachs alumni, the administration's withdrawal from the Trans-Pacific Partnership agreement and its expressed desire to rewrite NAFTA are hardly friendly to financial markets in general and to hedge funds in particular.

Another pressing issue, particularly given the importance of quant talent for hedge funds, is immigration policy. In April, President Trump signed an order directing American agencies to propose new rules and protocols for the H-1B visa program. The President's goal is to ensure that the current lottery system is replaced by one that favors the most highly skilled or most highly paid applicants; and further, the President is adamant that anyone receiving such a visa must not be displacing an American worker. While it is more likely that technology outplacement workers will be more affected than financial specialists, the lack of clarity about immigration rules is another obstacle that hedge funds navigate.

It is ironic, then, that the current uncertainty has favored the largest funds even though a number of them have had disappointing performance. These funds have both the resources to withstand weak performance and redemptions; and they are widely seen as safe havens. On the other hand, smaller funds have suffered badly, not only because of difficult market conditions but for a number of other reasons as well. For example, banks, under pressure to allocate



capital conservatively, have turned away all but the most profitable hedge fund clients from their prime brokerage businesses. The figures on launches and closures tells the story; in 2016, 566 hedge funds closed while only 518 launched.

New funds are also facing pressure to lower their fees from the traditional 2/20 model. A survey late last year by Prequin found that new funds were charging 1.5% management fees and 19% performance fees. A survey released in February by HFM and Citco Fund Services found that 72% of polled managers were introducing new fee structures to attract investors. In the United States, the figure was even higher, at 78%. Even established funds have cut fees, including Moore Capital Management, Tricadia Capital, and Valinor Management.

Going into the second quarter, we anticipate that the appetite for quantitative talent will only grow. However, we also believe that there will be hiring for select fundamental strategies. The June election in the United Kingdom, the possibility of currency and trade wars, American immigration rules and tax reform, the refinancing of Greece's debt, Russia's increasing belligerence toward both Europe and the United States, tensions with North Korea: these and other factors will also deeply influence hedge fund performance in the coming quarter.

2. OG Recruiter Interview

Three of Options Group's top hedge fund recruiters sat down to discuss international talent movement, the impact of perception, and our unique positioning in the hedge fund recruiting space.

Graham Smith is a Partner based in London, and looks after our European and Asian hedge fund practice. He works across all hedge fund strategies including Equity Long/Short, Equity Event Driven, Fixed Income Macro, Relative Value, Global Macro, Systematic and Stat Arbitrage, Credit, Distressed and Special Situations. He has successfully placed individuals across Asia, Europe and the US.

Brian Palabrica is a Director based in New York, where he focuses on recruiting for our alternative investment clients. He focuses mainly on hedge funds, with an asset class specialty within Equities and Equity Derivatives. He has placed professionals across Trading, Research, Portfolio Management, Risk Management as well as quantitative investment and research.

Amit Kapoor is a Director based in New York. His expertise is with senior management and senior investment professionals within Equities across Long-Short, Value Based Investing, Market Neutral, Event Driven, and Family Offices. He also has a strong knowledge base across Macro, Credit, Quantitative, and Commodity strategies.

Q: How is OG positioned to address cross-border talent movement?

Brian: The political climate has made it desirable to work with firms that can easily relocate people. That favors a firm like ours. We have offices all over the world and an information-sharing culture. If there's an appetite for it, we can move 1,000 people from the US to Asia.

Graham: Yes. For example, we have a hedge fund client in Asia looking to hire a US rates trader to move to either London or Asia. We've got some candidates in London, and we'll have someone in New York, like Amit, working on finding candidates from there. There isn't another search firm that can do that as well as we can. We know the market; we have offices all over the world, we can execute on this swiftly and efficiently.

Brian: Cross-border talent movement is Options Group's strong suit. A US-only recruiting firm won't be able to respond to a situation where you need to move talent. It's easy for us with our experience and worldwide reach. When macro forces are affecting how and where people are being hired, we're best positioned to help.

Q: Speaking of macro forces, how does the changing regulatory environment in Europe and the US affect the hedge fund industry?

Amit: Well, regulatory compliance is obviously a point of concern for the hedge fund industry.

Graham: Right, in terms of European regulatory issues, the Markets in Financial Instruments Directive (MiFID II) will change the relationship between hedge funds and research. It basically has to do with how banks are separating their research arms. Banks can no longer provide free research. Hedge funds will have to pay for research from the banks. I think good research will be paid for, but the vast majority of research will not be bought. This is still an ongoing process, so we'll see what happens.

Amit: I'm sure there will be an impact on how US-based hedge funds use research.

Graham: It could be positive. Hedge fund managers are looking for good research and indicators of good research. This might make it easier to determine what's worthwhile.

Amit: We also have to keep an eye on the current US administration and regulatory changes. For example, the possibility of rolling back Dodd-Frank – to what degree could that happen? Consumers like the protection, so we'll have to see if there's any movement there and if there'll be an impact on hedge funds.

Brian: The more interesting regulatory and compliance issue are those associated with retail strategies and long-only offerings. For example, there's a hedge fund building out its long-only fund, which requires building out a whole class of people that know about that kind of thing, whether it's individuals that know how to market that kind of structure or build that business. Hedge funds are blurring the line between what was previously only available to secretive, high net worth investors. Now, the door is opening to more people, like mom-and-pop investors. This creates new concerns and new hiring appetite. One fund I work with is looking to build an ETF and needs a marketer to push the process. The demand is there, but hedge funds now need to deal with regulatory and compliance concerns.

Q: What about the potential impacts if the H1B program were changed?

Graham: In Europe and Asia, there are candidates who wanted to move to the US, but now they're thinking, "Oh, I won't go, I'm not sure I'll get a visa." But I'm not sure this is affecting the hedge fund industry, yet. There's a lot of talent moving around, so there are many people that we're still able to place.

Amit: It could hurt the group that's looking to access the expedited process. The impact will be on younger people, and students, looking to enter the industry. It'll also complicate the process by adding time. It wouldn't have a positive impact on the industry.

Brian: There's no arguing against the fact that there is not enough US-based or US-born talent to support hedge fund demand. A reduction in foreign-born talent would be damaging. Broadly speaking, political bans that potentially demonstrate a negative posture towards the world may impact if and how people decide to move.

Graham: And in the UK, Brexit has led to a similar perception. If the UK is perceived as unwelcoming to foreign individuals, it can be really harmful, regardless of whether it's true or not.

Brian: For hedge funds, Asian and Russian talent is essential; they make up a majority of the quant talent pool. So if the majority of hedge fund hiring is going to be in the quant space, then this would have an impact.

Q: Can you speak to quant hiring as a point of focus for hedge funds?

Graham: The quant side is very busy. Their funds are generally cheaper and performing well. Of course, if they perform poorly, people will question the strategy.

Amit: What we're starting to see is that there is a lot of trade counting especially with momentum-based trading. People are saying, "Okay, where's the alpha in the market?" "Quantamental" analysts and data scientists are starting to see this as the next wave. The momentum environment is overcrowded, and people are saying, "I don't know where to find my alpha."

Graham: There's also this concept of finite talent. Essentially, the top quants are already at the top hedge funds. So the next tier, which aren't as good, are being hired across the hedge fund landscape. The idea goes, one of these lower-performing individuals will eventually write a code that goes awry, and the media will pounce on the blow-up that follows. People will see it in the news and decide it's time to go back to human-run value strategies. I'm not sure I share that opinion, but that's a theory that's being shared by people in the industry.

Brian: But that doesn't account for the new talent that's entering the market. New top performers graduate each year.

Graham: There was an interesting article in OGAxess, our news platform, about Quantopian. They've had 100,000 models submitted to them, and there are 25 that they are actually running. They said that the vast majority are useless. However, it's an interesting concept.

Brian: Quant hires will continue to be a point of focus for hedge funds unless there's another flash crash-type event. The interesting concept here is that data science is just more information, but everyone is chasing the same information. Basically, there's this class of people who are just traveling the world to secure specific data agreements with data providers, ideally on an exclusive basis so competitors don't have access. Ultimately, the people with the best data sets will win. This is basically the way it was before, except that it was based on human-driven interpretation and data gathering. Algorithmic trading is great and it's additive, but it's not altogether different from how money was made in the past. The human element will always be a part of it.

Graham: I saw a client two weeks ago that buys data from the New York Stock Exchange. As a quant fund, they use the data to build a model. The current legal agreement when you buy data like that is any future model you build using that data is proprietary. So if you stop paying a monthly fee to the NYSE, you have to stop using that model. Now this fund is trying to fight that because it's sort of nonsensical. But the NYSE is resistant, because you can imagine if the fund makes $10 million off the algorithm, the NYSE wants a piece of that. They realize they can make a few millions by selling data and keeping the proprietary rights.

Brian: The quant space will keep growing. It's an arms race. People know or feel that they have to be involved in this space; they feel that they have to be involved with data science. Of course, a major event would slow this growth. Or there could be a gradual slowing. Small funds might realize they can't afford the necessary research and that they're not making returns, so they'll leave the space. Otherwise, I can't envision a slow-down.

Amit: Right, but for now a lot of third-party research groups are popping-up as a result of this. So instead of internal spending on research, funds are heading to third-party providers.

This interview has been edited for clarity and length. The information presented here is speculative, and is based on our recruiters' experiences and opinions. If you're interested in reaching out to our recruiters, you may contact them at:

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3. OG CLIENT COMMENTARY

Earlier this year, Options Group hosted People Science, an informative conference on the use of data analytics and people science in hiring practices. Richard Stein, OG's Chief Growth Officer and Head of OGiQ at Options Group, led the conversation between Evan Anger, Senior Vice President in Recruiting at Two Sigma Investments; Russell Farhang, Head of Talent and Culture at PDT Partners; and Glen Vilim, President of GV Trusted Partners.

The panel focused on talent attraction and selection, engagement, and measurement. They discussed fit-to-role, fit-to-culture, and fit-to-lifestyle, along with other factors that are shaping the talent market. The panelists shared their insight on identification and retention processes that are changing the way hedge funds hire.

The key themes from January's discussion included data imperfection, data collection, unquantifiable characteristics, creative incentives, culture-building, and blind spots in data analytics. Evan, Russell, and Glen suggested approaches to current challenges, and potential problems that may arise as the talent market continues to change. Through a lively discussion, they agree that data analytics and people science are becoming critical tools in building the right team and predicting business performance.

4. PEOPLE MOVES

Person	*Title*	Current Firm	Previous Firm
Akiyama, Yuki	*Portfolio Manager*	Millennium Management	Nezu Asia Capital
Allende, Andres	*Portfolio Manager*	Cobas Asset Management	Standard Life Investments
Ashoka, Vikram	*Associate, Healthcare*	Aptigon Capital	Morgan Stanley
Barden, John	*Portfolio Manager*	Cobas Asset Management	Matrix Alternative Asset Management
Berkley, Michael	*Portfolio Manager*	Aptigon Capital	Tiger Consumer Management
Berman, Andrew (Andy)	*Head, Credit*	Graticule Asset Management	Fortress Investment Group
Cipollini, Alessandro	*Portfolio Manager*	Hutchin Hill	Markham Rae
Fitzpatrick, Dawn	*CIO*	Soros Fund Management	UBS O'Connor
Galam, Elie	*CIO*	Eastmore Group	BlueCrest Capital
Giardina, Scott	*Head, Event Driven Trading*	DW Partners	Magnetar Capital
Goekjian, Christopher	*Portfolio Manager*	Blue Glen Investment Partners	Cheyne Capital
Goldthorpe, Ted J.	*Managing Partner*	BC Partners	Apollo Management
Hamontree, Bryan	*Credit Analyst*	HBK Investments	Taconic Capital Advisors
Irion, Eric	*Head of Distressed Trading*	Anchorage Capital Group	Arrowgrass Capital
Lewinsohn, Jonathan	*Founder*	Diameter Capital Partners	Centerbridge Partners
Maldutis, Alexander (Lex)	*Portfolio Manager*	Napier Park Global Capital	Bank of America Merrill Lynch
Molinari, Gioel	*President*	Butterfly Network	Bridgewater Associates
Murti, Vedula	*Portfolio Manager*	BlueCrest Capital Management	Caisse Des Dépots Securities
Ning, Michael Zhu	*CIO*	PhaseCapital	First Eagle Funds
Parekh, Neel	*Portfolio Manager*	Aptigon Capital	Tiger Consumer Management
Rahemtulla, Nav	*Co-Founder*	LightBay Capital	Ares Management
Santoro, Peter	*Global Head of Equities*	Millennium Management	Morgan Stanley
Schwarting, Carsten	*Portfolio Manager*	BlueCrest Capital Management	Goldman Sachs
Senhaji, Amine	*Metals Trader*	Millennium Management	BNP Paribas
Taylor, George	*Founder*	Madava Asset Management	Taylor Wood Capital
Troup, Anna	*Head of UK*	Legal & General Investment Management	BlueBay Asset Management
Tse, Anthony W.	*Head of Global Equities*	CrimsoNox Capital	Visium Asset Management
Valerio, Chad	*Portfolio Manager*	Oak Hill Advisors	BlueMountain Capital
Vyas, Amit	*Research Analyst*	Diameter Capital	Anandar Capital
Williamson, Jim	*Associate - Credit*	HBK Investments	Davidson Kempner Partners
Yip, Dominic	*Portfolio Manager*	Dymon Asia Capital	Credit Suisse

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