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HEDGE FUND CAPITAL, FLOWS MIXED AS EQUITIES ECLIPSE RECORD, US RATES RISE

Second consecutive quarterly outflow concentrated in Macro funds;
HFRI performance gains drive industry capital to record;
Forward risks focused on European bonds, US rates

CHICAGO, (October 18, 2018) – Hedge fund capital began 4Q18 at a new record level for the ninth consecutive quarter as investors continued the 2Q redemption trends from Macro, Event-Driven, and Relative Value strategies, while Equity Hedge strategies also experienced small outflows in 3Q18. Despite investor outflows, hedge fund performance drove total industry capital to a net increase of $8.4 billion, ending the quarter at a record $3.24 trillion, 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.

Following the $3.1 billion net outflow in 2Q18, investors redeemed an estimated $9.1 billion in 3Q18, the second consecutive quarter of net outflows. For the year, investors have redeemed an estimated $11.1 billion (0.34 percent) of hedge fund industry capital, though total hedge fund assets have increased by $34.4 billion (1.0 percent).

The HFRI Fund Weighted Composite Index® (FWC) gained +0.55 percent in 3Q18, with strong performance from Technology and Event-Driven strategies partially offset by volatility associated with expectations for higher US rates, as well as trade and tariff volatility in late 3Q. The HFRI FWC has gained +1.4 percent YTD through September while the HFRI Asset

Weighted Composite Index has advanced +1.7 percent, topping most European and Asian equities, though trailing the S&P 500.

Continuing the trend of the prior quarter, Macro hedge funds led strategy outflows in 3Q18 with an estimated net outflow of $3.8 billion, as investors rotated out of quantitative, trend-following CTA and Discretionary Thematic strategies. The HFRI Macro (Total) Index posted a narrow decline of -0.03 percent in 3Q, bringing the YTD performance through September to a decline of -1.8 percent. The muted quarterly performance and net outflows reduced total Macro capital to $589.2 billion.

Reversing a trend from the prior quarter, Equity Hedge (EH) strategies experienced a small outflow for 3Q18 despite leading hedge fund industry performance in the quarter, with strong returns concentrated in specialized Technology and Healthcare funds. Although investors redeemed an estimated $2.0 billion from EH strategies in the third quarter, performance drove total EH capital to $955.0 billion, the industry's largest strategy capital area. Quantitative Directional funds led EH sub-strategies with a net inflow of $1.1 billion, although this was offset by an outflow of $1.8 billion in Fundamental Growth strategies. The HFRI Equity Hedge (Total) Index gained +0.5 percent in 3Q18 and +1.7 percent YTD through September, while the HFRI Equity Hedge (Asset Weighted) Index posted a higher return of +2.54 percent YTD. EH sub-strategy performance for the year has been led by the HFRI EH: Healthcare Index, which has surged +14.9 percent, leading all sub-strategy indices and topping the Russell 2000, S&P 500 and DJIA Indices, while the HFRI EH: Technology Index has jumped +11.5 percent YTD.

Despite investor outflows in both Event-Driven (ED) and Relative Value Arbitrage (RVA) funds, total capital in each strategy increased on 3Q performance. ED capital rose by $2.4 billion in 3Q to $847.1 billion, as the +0.8 percent return of the HFRI Event-Driven (Total) Index offset net redemptions of $2.4 billion. For the year, the HFRI ED Index has gained +2.8 percent, trailing only the HFRI Relative Value (Total) Index YTD return of +3.0 percent in main strategy performance. Also mirroring trends industry-wide, larger ED funds have outperformed smaller funds on a relative basis for the year, as the HFRI Event-Driven (Asset Weighted) Index has advanced +4.1 percent YTD. Similarly, capital invested in RVA strategies increased by $4.8 billion to $853.0 billion in 3Q despite a small quarterly outflow of approximately $880 million. The HFRI Relative Value (Total) Index added +1.3 percent in 3Q18, increasing its YTD performance to +3.0 percent, while the HFRI Relative Value (Asset Weighted) Index returned +1.5 percent in the quarter and +3.6 percent YTD.

Net asset flows by firm size were dispersed across firms within each AUM tier in 3Q18, as firms with greater than $5 billion AUM experienced outflows of $5.2 billion, while mid-sized firms ($1-5 billion AUM) saw outflows of $2.5 billion. Investors redeemed an estimated $1.2 billion from firms managing less than $1 billion. For the year, the largest firms have experienced an estimated net outflow of $9.3 billion, mid-sized firms have seen outflows of $2.3 billion, while firms managing less than $1 billion have recorded a small net inflow of $600 million.

"Total hedge fund capital increased to a record despite a modest investor outflow as US financial markets began 4Q18 near an inflection point in interest rates, economic growth and equity market valuation," stated Kenneth J. Heinz, President of HFR. "Critical drivers of investor allocation trends have expanded from performance and asset under management to also include an intense focus on fees, liquidity, firm management, European credit risk, social responsibility, and interest rate risk factor sensitivities. Funds which are able to position for and navigate this shifting transitional inflection point in financial markets are likely to lead industry performance and growth into 2019."

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