Strategies
July 2008

25 August 2008

July was a difficult month for the alternative investment industry. There is some degree of comparison with what happened in March of this year with the bailout of Bear Stearns by the US financial authorities. This time it was the rescue plan for Fannie Mae and Freddie Mac that triggered, as in March, a rally in risky assets and very contrarian moves, not to say dislocations, in most markets. Nevertheless, pessimism about growth prospect in major developed countries is still shared by our fund managers. The recent pullback in commodities, especially oil, has confirmed that the commodity bubble is deflating. Some of our Macro fund managers foresee oil price to be valued at around $80 per barrel and start to believe that speculation explained most of the oil price volatility that we have observed over the past few months. Other commodities like wheat and copper are under pressure (38% and 16% off their high respectively). This decline in commodity prices has removed some pressure from central bankers and has curbed inflation. On the short-term, the economic environment remains pretty uncertain. We continue to run our portfolios in a defensive mood regarding the direction of the equity market, with a low net exposure, and focus on alpha generation. Our managers are seeing many opportunities on both sides of the balance sheet but they need some time, and also a market driven by fundamentals, to extract value. We did a lot of work to restructure our portfolios over the first part of the year and we are confident with the good quality of our managers.

Fixed Income and Relative Value Strategies

Fixed Income and Long/Short Fixed Income

Fixed Income and Foreign Exchange funds (Long/Short Fixed Income) generated a positive performance over July. For example, one of our managers benefited from the recovery of his position on Turkish bonds and British rates. Some gains were made in FX pair trades taking advantage of the recent appreciation of the USD. In Asia, the focus is shifting from fears of heightened inflation to slower growth as the reversal in commodities moderated price pressure. Our managers benefited from the interest rates rally in the region.

Long/Short Credit

The performances of the Long/Short Credit funds were almost flat over the month despite the fact that our managers have globally reduced their short financials to build short positions in other sectors in the high yield universe such as chemicals. In their long book, the high yield bonds they hold suffered over the month, offsetting their gains on the short side. Seeing the volatility on the commodity market and more precisely on the energy market, one of our managers took a small directional net short position through options in order to hedge his portfolio.

Fixed Income Arbitrage

Fixed Income Arbitrage funds were positive contributors. Relative swap spread positions, swap butterflies and basis swaps in the US and Europe generated some profit, while GBP positions recovered from their negative mark in June. Negative performance came from JPY volatility positions. Efforts to reduce less liquid positions are still underway.

Volatility Arbitrage

Behind the Fixed Income and Foreign Exchange funds, the Volatility Arbitrage strategy was the second best contributor, as all our managers in this bucket performed well. The positive performance is all the more noticeable because all the implied volatilities had to undergo a wide swing over the month.

Equity Strategies

Long/Short Equities

July was a negative month for our Long/Short Equity managers who suffered from the exceptional level of volatility and the rotation across sectors.

U.S.

The S&P 500 Index went down by 5.45% over the first two weeks of July before rallying back 5.71% between the 16th and the 30th of July. After being down 18.7% in June, the S&P Financial Index rallied 6.8% in July (and 24.7% from the middle of the month). At the same time, the S&P Energy Index sunk 14.0% in July after being up 2.2% in June. This sector rotation hurt badly some of our managers by turning the June profitable trades upside-down. Indeed, our more bottom-up fundamental long-term oriented managers got severely hurt because they are more inclined to keep their positions over the long-term. Nevertheless, our most flexible managers succeeded in taking profit from the intra-month volatility while mid-term investors minimized losses by trimming their net exposure down.

Asia

The MSCI AC Asia Pacific Index lost 3.22% in July despite a strong comeback from India (Nifty was up 7.24% thanks to mid-month election) and China (+5.01% for H shares). However, Asia also suffered from the massive "reverse trade" (short financial and long commodity). Stock picking skill does not bring alpha in such a market environment. Nevertheless, fundamental analysis is still the only way to protect capital. The books of our managers are now more concentrated than 6 months ago, they are keeping only big convictions on both sides (long and short). The feedbacks we get from them are pretty mixed. None of them is really bullish. However, only a few of them are really pessimistic (i.e. have net short bias). All of them are following inflation data. Once the peak of inflation is behind us, interest rates will start decreasing and growth resilience could surprise.

Europe

The market experienced relatively benign losses with a return of -2.0% for the MSCI Europe index. European equities continued their downward trend, posting approximately a -8.0% return at mid-month, before the sharp reversal in the price of crude oil which allowed the market to rebound. We had three funds which were strongly hit by the reversal and notably by their positions in the energy/materials sectors. Financials funds did not bring the protection we expected in the reversal of the short financials/long energy trade because the first move was too quick.

Low-Beta Long/Short Equities

The Low-Beta equity managers were impacted by the sharp reversal of the long energy/short financials position. As a consequence, they gave back part of the alpha generated up to now through this trade. However, they were positive contributors, playing their alpha generation role in a very volatile market driven by significant sector rotation.

Event Driven Equities

Event Driven managers were surprised by the overall widening of premiums and the fact that it is more and more difficult to find efficient hedging positions on their long or short bets, given the market volatility.

Macro and Trading Strategies

All but one of our Macro fund managers posted positive performance due to the variety of their themes. The only negative contributor over the month was a manager particularly affected by the recent burst of the commodities bubble and drop in oil prices. CTAs had their worst month in several quarters, as most of the trends created in the last 8 months suddenly stopped and reversed in the second half of the month.

