Strategies

December 2008

23 January 2009

After 3 months that will remain in the history of financial markets, the month of December was relatively calmer on equity markets, which were almost flat over the month. However, investors are still worried. This month, Flight to Quality was the favourite theme, as it actually was all year long. The economic crisis is severe and is taking place simultaneously across the world. Major central banks still pursue their measures of easing monetary conditions in a macro economic environment which is getting worse, as shown in the number of job losses in the U.S. (584,000). 2008 will actually remain as the worst year for US employment since 1945. Nevertheless, the exceptional measures announced by the Obama administration are a true ray of hope. The drop in short-term rates (the Euribor 3-month rate indeed decreased from 5% in October to 2.8% in December) is also a very positive thing. But the most stunning news for the asset management industry was the revelation of the gigantic Madoff fraud. Although it has no impact on markets and on the performances of investment funds in general, it nourishes the crisis of confidence that has been affecting the financial markets for several quarters now. At HDF, where none of our FoHFs were directly nor indirectly invested with Madoff, we are more than ever focusing our efforts on having the best transparency from our underlying fund managers, understanding well how money is achieved, cross-checking our information with various sources and making no exceptions to our full due diligence process. We also intend to keep a conservative approach in the way we put capital at work as long as macro events and government interventions drive the markets.

Fixed Income and Relative Value Strategies

Fixed Income and Long/Short Fixed Income

The extreme volatility experienced by the Fixed Income markets following the Fed meeting in mid-month benefited most players, via directional and curve trades. Market movements ahead of a deluge of government paper issuance in January were correctly read by our managers. Only one of our managers was negatively impacted by long positions in some emerging markets bonds. In FX, the US dollar currency appreciation movement came to a halt and reversed, and options players took advantage of the uptick in volatility.

Fixed Income Arbitrage

Four out of our five managers were positive contributors. They profited from core relative value strategies associated with macro overlays. Curve steepeners generated performance in December and should continue to do so. Aggressive fiscal measures and continued monetary stimulus should continue to benefit the strategy. Our sole manager in MBS Arbitrage recorded a loss.

Long/Short Credit

Our two investments in this space contributed negatively to the performance of our funds of funds. Despite being only involved in Investment Grade and High Yield bonds, the continued sell-off in less liquid loans and distressed bonds is still driving negative performance. However, as a result of the auto bailout and the multi-million investments of the U.S. government in the big Three, our managers see some relief coming with the New Year.

Capital Structure Relative Value

This strategy had a small negative contribution to our portfolios over the course of December. Even if liquidity continues to be scarce, marginal buying occurred in the credit and convertible space, allowing our managers to turn a profit this month. On the back of the ocean of liquidity offered by the major central banks, the negative bonds vs. CDS basis diminished somewhat as funding was cheaper. Most managers kept exposure below average ahead of the New Year.

Equity Strategies

Long/Short Equities

Overall, there was little dispersion among equity managers' performances, which were for the most part comprised between -1% and +1%. There was little liquidity, as usual during the month of December. However the market seems to be gradually coming back to more rationality.

U.S.

From the 2nd to the 31st, the S&P posted a 10.66% performance which more than compensated the 1st of December -8.93% performance. Our underlying managers stabilized their gross and net exposures in the low band of their range. Nonetheless, we anticipate a rise in the exposures during the following quarters. 8 of our underlying funds were down this month, of which 2 by more than 5%. Our worst performer lost money as bad names and small caps bounced back more than good businesses and large caps, resulting in a faint performance on long positions and a poor performance on the short positions. We redeemed 2 of our positions at the end of the month of December.

Asia

Markets rebounded strongly across Asia. The MSCI AC Asia Pacific was up 8.36% but closed the year down 43%. The situation was even worse in the small cap space (-62% for the Nomura Asian Small Cap). We plan to keep our level of exposure going forward and to probably be close to market neutral situation. First signs of improvement are not there yet and none of our managers is keen to be aggressive on the long side. As we mentioned last month, alpha destruction seems to be over. We have several positions which performed very well this month including one with a net short bias.

Europe

The MSCI Europe finished the month at around -4%, part of this negative figure coming from the drop of the sterling pound against the euro. Generally, our underlying managers have increased their exposure to defensive sectors at the expense of cyclical sectors. However, sector exposure is well diversified among managers and there are no real sector biases at our funds of funds level. They nevertheless tend to be long companies with good cash-flows and a strong balance sheet, and short leveraged companies with potential issues to refinance their debt.

Low-Beta Long/Short Equities

Our Low-Beta Long/Short Equities funds resisted well and had a positive return as rationality increased in the market, therefore rewarding the companies with good fundamental businesses in which our managers are generally invested, while punishing the companies with flawed business models and refinancing issues.

Event Driven Equities

Event Driven funds had a negative contribution to the performance of our funds of funds. Although there were deal closures during the month, there should be less M&A operations this year as financing remains difficult to obtain. Some of our managers are starting to look at distressed opportunities in which they should start to invest in 2009.

Macro and Trading Strategies

Global Macro

This strategy still continues to generate positive performance with managers having the right macro calls such as directional US and European Fixed Income positions; short USD or long JPY positions; and curve shape trades in the US and UK. They are currently less involved in commodities.

CTA

Our managers registered another good month as most asset-classes continued to move in line with their mid- to long-term trend. Here again, they were involved in the Fixed Income rally, where US 10-year futures were up 10% in December. Equities remained under pressure. Currency markets were more erratic, with certain pairs reversing recent trends at least in the short term. Short positions in the Energy complex contributed nicely to their performance.