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Surging Deal Volume for Event-Driven Hedge Funds Sparks Inflows

By Lydia Tomkiw July 7, 2021

Event-driven hedge funds started off the first half on strong footing, nearly surpassing full-year 2020 inflows and posting solid performance amid surging deal flows following last year's pandemic-induced turbulence.

Investors added $3.9 billion to event-driven funds through May, nearly topping the $3.94 billion added during all of last year, according to eVestment, and putting 2021 on course to be the third year in a row of positive inflows.

The wide array of strategies under the event-driven banner has posted strong performance numbers, with HFRI's event-driven index returning 11.5% through May. Event-driven strategies also had strong performance under bfinance's composite, which returned 7.3% during the first quarter, making it the strongest first quarter since 1993.

The event-driven category includes mergers and acquisitions, restructurings, bankruptcies, spinoffs and recapitalizations, credit and distressed opportunities, merger arbitrage, special situations, event-driven equity, activists and multi-strategy funds.

A big contributor to the segment's activity is in merger deals. Amid vaccine rollouts, an economic recovery and large amounts of dry powder, global mergers and acquisition activity has soared since the start of the year, with pending and completed deals through May hitting a record $2.4 trillion, according to data from Refinitiv.

The interest in event-driven funds comes amid broader interest in hedge funds as a whole, as investors look for return sources not principally correlated to equities, says Toby Goodworth, head of liquid markets at bfinance, who recently authored a report on the space. M&A activity is likely to remain strong even as certain areas such as special-purpose acquisition companies (SPACs) have cooled in recent months, he adds.

"There has been a glut of deal activity and that deal activity is playing a bit of catch up on what was missed," he says.

Performance this year has been "excellent across the space," says Sam Diedrich, managing director and head of absolute return and credit at Partners Capital, pointing to returns for merger arbitrage, distressed credit and SPACs, especially at the start of the year.

"The event-driven strategy can have a little bit of a higher beta to markets than many other strategies in hedge funds, so certainly some of the numbers we've seen this year is because the market rally is so fierce and has helped the long side of these portfolios do well," he says.

Event-driven returns have been in the black, with only one fund in Societe Generale's prime service performance survey reporting it was down slightly this year, while some posted returns topping 30%, according to a late June report seen by *FundFire Alts*.

The environment for merger arbitrage is especially strong now after recovering from a tumultuous environment with the onset of the pandemic in March 2020, says Deepak Gurnani, founder and managing partner at Versor Investments, a New York-based hedge fund with over $1.8 billion in assets under management, including over $900 million in a merger arbitrage strategy.

Deal flow picked back up in the second half of 2020, with 100 deals announced in the second half of the year, and 150 deals already on the charts in the first five months of 2021, Gurnani says, citing the firm's own analysis of select deals. And the deal flow has been broad based across sectors as well as globally, he adds.

"It makes for a very compelling argument for merger arbitrage," he says, pointing to elevated deal flow, a lower deal failure rate, spreads adjusted for a risk-free rate, improved offers and competing bids. "It's a near Goldilocks environment for merger arbitrage."

Gurnani also points to the high level of dry power as "a positive," with situations where strategic buyers and private equity firms will compete for the same companies.

Versor, which is focused on deals that will successfully complete and underweight deals that will terminate, combines a fundamental investment style with a systematic process that uses machine learning to process a vast amount of data on deals since 2000. Gurnani says the first half of 2021 has been the strongest for the merger arbitrage strategy in a long time. "It's an unusually positive environment for the strategy," he says.

Versor's Systematic Alpha Merger Arbitrage fund was up 10.75% through the end of May, according to the Societe Generale report seen by FundFire. Versor declined to comment on its performance.

One of the big challenges to selecting event-driven managers is "an abundance of choice," with the bfinance report counting over 380 managers.

With so many factors at play, including questions over when interest rates will rise, the potential for tax code changes and an active deal-making year, it's key to invest with managers that have lived through multiple cycles up and down, says Adam Blitz, CEO and CIO at Evanston Capital Management, where a larger portion of exposure to the event-driven space is on the credit side.

"A lot of experience – you just can't put a price on that," he says. "Investing with folks who have experience in multiple cycles, who won't stretch for the last drop of yield, who have experience in restructuring companies."

Event-driven strategies make up a large part of hedge fund holdings in most investor portfolios, according to the bfinance report, second only to equity long/short funds.

"We feel the return set for event-driven will be positive," Goodworth says. "The wide opportunity set that many event-driven managers have means they aren't reliant on one source of returns."