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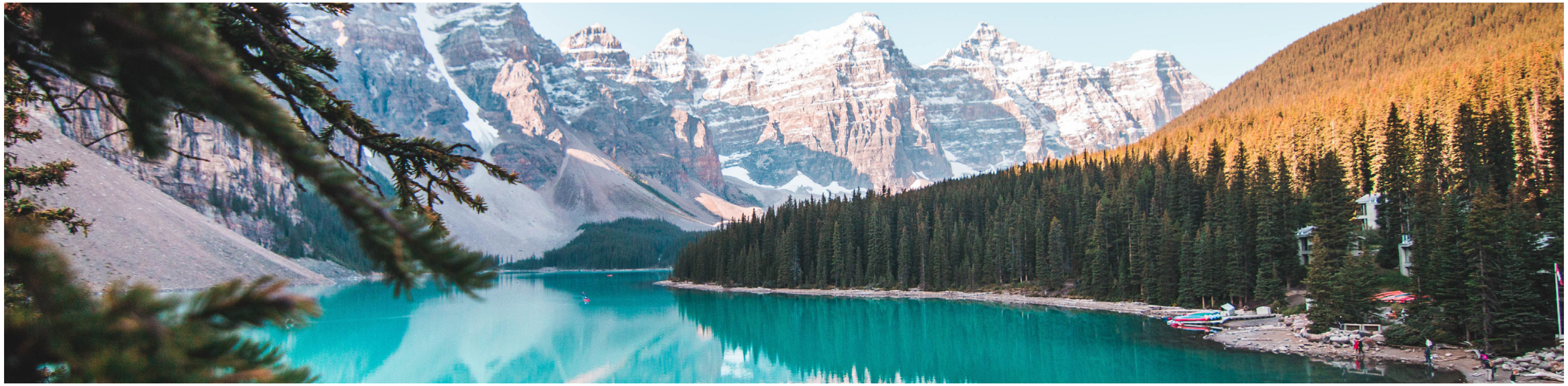
GLOBAL OUTLOOK 2023

HEDGE FUND MANAGERS PREVIEW THE YEAR'S KEY TRENDS



Welcome to Hedgeweek's preview of the year, Global Outlook 2023.

Like last year, the report features insights and forecasts from some of the hedge fund industry's leading investment professionals – chief investment officers, portfolio managers, economists, and more from a range of established fund managers and investors. Unlike last year, our contributors are reacting to a bruising previous 12 months; not one defined by wider success.

In 2021, hedge funds produced a double-digit gain. In 2022, most finished the year in the red, the industry average dragged by steep losses for some long/short equity funds and other strategies, albeit with wide dispersion between the wider industry's 'winners' and 'losers'.

Looking ahead, many of our commentators divide 2023 in two. Writing in the report's opening section, Savvas Savouri, chief economist at Toscafund, expects market volatility in Western economies to continue until May when central banks pause their cycle of hiking rates, followed by a "substantial fall in inflation in 2H".

However, BlueBay's Russel Matthews, portfolio manager of the firm's global macro fund, highlights "concerningly tight" labour markets in key economies as a sign that "slaying the inflation dragon might take longer and require more drastic action from monetary policy than is currently priced."

So, what does it mean for hedge funds? K2 Advisors, one of the industry's leading fund of hedge funds providers, favours "macro-savvy, high alpha managers within certain hedge fund strategies". Writing in the report's investor outlook section, K2 co-CIO Brooks Ritchey highlights equity market neutral, macro/CTA, and alternative risk premia as among H1's likely winners. By H2, he adds, conditions will have shifted enough to favour long/short equity, event-driven, commodities, and credit.

Elsewhere, global macro, systematic/quant, and relative value strategies are tipped to take their strong performance from 2022 into 2023 by Patrick Ghali, managing partner at global investment consultant Sussex Partners. Likely bouts of market volatility mean systematic strategies are best implemented through a basket rather than individual managers, Ghali adds.

MSCI's Mark Carver agrees, saying that significant market uncertainty may favour a diversified, rather than a concentrated, portfolio. "It could be another year where quantitative strategies – to the extent they favour breadth– may perform strongly," he writes.

To our contributors, thank you for your insights and for being bold in your forecasts ahead of (another) unpredictable year. To our readers, we hope 2023 brings you happiness and success despite – or maybe because of – the ongoing volatility.

Tony Griffiths
Head of content

HEDGEWEEK

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MACRO OUTLOOK

Macro specialists from Toscafund, BlueBay, and Quest Partners provide their insight into the macroeconomic forces at play in 2023

> We expect a substantial fall in inflation in 2H 2023

SAVVAS SAVOURI
PARTNER AND CHIEF ECONOMIST
TOSCAFUND ASSET MANAGEMENT

The last was a chaotic year for markets and economies, with the macro clouds seemingly darkening throughout. Then again, for nations blessed with natural resources, there was profit in the chaos. So, is high volatility set to continue this year, and how will the macro picture shift?

Starting with 'the West', it is clear the Fed, ECB, and BoE are far from finished in their respective hiking cycles. We expect these central banks to pause around May, with market volatility to continue until then. We expect a substantial fall in inflation in 2H 2023. At the time these central banks peak, the West's concerns over inflation will have been displaced by concerns over recession.

For the US, we believe a so called 'hard landing' is unavoidable – although coming later than many expect. We anticipate a significant sell off in the dollar this year, for numerous reasons. Despite the decline in 2022 for US equity markets, we still see further downside ahead. US 'Big Tech' valuations remain too high despite a rerating in 2022; the crypto market still has a capitalisation of over $800bn despite last year's crash. Wild leveraged speculation – induced by ultra-lax Fed policy through 2021 – is still prevalent across US markets. Until the insanity ends, the bear market of 2022 will continue. Expect regulators to up their game in 2023, both in terms of clamping down on cryptos, and indeed the wider "gamification" of financial markets, with the aim of protecting inexperienced speculators. Foreign holders of US Treasuries will continue to offload. The recession that Europe is now in, will prove longer and deeper than many expect. The degree of monetary tightening that has and will continue to be conducted by the ECB means a significant, prolonged recessionary period lies ahead.

However, the picture is very different for the UK; the recession the BoE have done their best to talk up will prove to be no such dramatic downturn, thanks in part to the UK's extraordinary labour market strength. UK equity markets, particularly lower down in the size scale, have once again become a 'no-brainer' post 2022's decline.

As for 'the Eastern and Southern worlds', we anticipate Chinese economic strength, powerfully beating lowly forecasts, aided by a full COVID reopening and an easing PBOC. The RMB will prove strong this year, and we expect generous returns in both Chinese debt and equity markets. The major story of 2023 however, we believe, will be one of 'de-dollarisation'. Expect the ever more buying of Gold by Eastern central banks and ever more transactions – in commodities for example – being conducted in the RMB, not the USD. Central Bank digital currencies will continue to be rolled out, and their introduction should be welcomed by all. In forecasting the macro picture for the rest of 'the Eastern world', we just say this; if their interests are aligned with China, expect strength.

About Toscafund Asset Management: Founded in 2000, Toscafund is a specialist investment manager with approximately $5bn of assets under management across hedge fund, private equity, and long-only strategies.

> *"There are worrying signs that slaying the inflation dragon might take longer"*

RUSSEL MATTHEWS
SENIOR PORTFOLIO MANAGER
BLUEBAY ASSET MANAGEMENT

2023 kicked off with macro markets bang in the middle of a difficult transition phase. The market is hoping that central banks have done the heavy lifting in terms of monetary tightening, and positive price action in fixed income markets and stocks in October and November can be interpreted as the market front running a more benign outlook for macro data and central bank policy. After the final round of major central bank meetings in December, our fear is that the Federal Reserve (Fed) and the ECB have other ideas and are not yet ready to sanction any kind of pivot. When we look at the macro data points that came out towards the end of last year, there are nascent signs that inflation is moderating in many parts of the global economy and the latest CPI data out of the US was most encouraging.

However, in one significant area, there are worrying signs that slaying the inflation dragon might take longer and require more drastic action from monetary policy than is currently priced. Labour markets in many key economies remain concerningly tight. There is no doubt unemployment is a lagging indicator, but there are structural factors at work that potentially point to labour markets remaining tight for longer. These factors include labour hoarding, skills shortages, reduced mobility and declining immigration. The burden of proof has shifted heavily to macro data points in the first quarter to justify the more positive tone, and the benign path for monetary policy that has emerged in recent months.

If inflation and economic activity indicators continue to weaken, and, in particular, if labour markets soften materially (US payrolls declining towards flat, job openings falling rapidly and the Claimant report showing meaningful increase) then a meaningful pivot from the Fed becomes more realistic and financial assets can continue to rally.

That said, the counterfactual also applies. If the labour market does not soften, then the Fed will continue to hike the US base rate well above 5% and will not be cutting rates towards the end of the year. Currently, the market is dismissing the concerns of the Fed, and pricing a fairly benign path for interest rates over the next 12-18 months. The Terminal rate below 5% in Q1 and then at least two cuts of 0.25% before year end. With uncertainty high, and crosscurrents buffeting the global economy we are reluctant to take big-macro directional bets, but on balance are more disposed to back the Fed. In our global macro strategy, this makes us negative on the outcome for core rates and we are short US duration in the 10yr part of the curve.

We are also cautious on risk in general and running credit and FX exposure close to neutral. At the current juncture, picking 'winners' and 'losers' at an idiosyncratic, bottom-up level makes more sense.

About BlueBay Asset Management: BlueBay is an active fixed income specialist. Headquartered in London, the firm manages over $92bn in assets across alternative and long-only investment strategies.

> For the US, we believe a so called ‘hard landing’ is unavoidable – although coming later than many expect.

Savvas Savouri, Partner and Chief Economist
Toscafund Asset Management

MIKE HARRIS
PRESIDENT
QUEST PARTNERS

"The major market risk will be the transition from inflation to a recession"

MACRO OUTLOOK – QUANT SPECIALIST FIRM

In 2023, the major market risk will be the transition from inflation to a recession, ushered in by three key factors that will more directly impact markets this year:

1) The effects of tightening will begin to reverberate through the economy

2) Unemployment will rise as layoffs transcend the technology sector

3) Geopolitical risks will persist, leading to more episodic bouts of volatility

For much of the past two years, the predominant risk for financial markets has been surging inflation. To counter the impact of the pandemic, central banks and governments conducted the largest monetary and fiscal stimulus in modern history, flooding markets with liquidity and massively boosting demand for goods and services when supply chains were acutely constrained. These actions led to the highest level of inflation in developed economies in over 40 years.

Having realized their error of overstimulating economies, central banks reversed course in 2022, embarking on the most aggressive tightening of monetary policy since the early 1980s. The U.S. Federal Reserve hiked rates by 425 bps and began quantitative tightening by withdrawing $100bn of liquidity from the financial system each month. These actions are already impacting inflation. While official data remains elevated, leading indicators are dropping markedly and pointing to declining inflation in 2023.

The good news on inflation unfortunately comes at a cost to the economy, however; high interest rates are not only slowing inflation but also growth, and the risk of a recession is mounting. With U.S. interest rates expected to peak close to 5% and the Federal Reserve indicating they are likely to remain elevated for an extended period until inflation comes close to their 2% target level, fears are growing that high interest rates will choke off growth. The yield curve has taken notice, with the 2-Year/10-Year Treasury Spread inverting the most since 1981, when the Federal Reserve hiked rates to 20% and engineered the recession of 1982 to quell inflation.

The prospect of a recession is also showing up in labor markets with employers announcing layoffs at the fastest pace since the height of the COVID-19 pandemic. Although current economic growth is still robust, concern about the future is increasing the pace of layoffs and thereby causing a deeper, more widespread impact across the economy.

This environment is even more precarious than typical recessionary periods as it remains fraught with geopolitical risks: Russia's unexpectedly long-lasting war against Ukraine, OPEC's consideration of even further supply cuts, and Chinese posturing around Taiwan forcing many corporations to reconsider using the country as their primary manufacturing base.

All these risks are likely to be more palpable in 2023, resulting in a recessionary environment with more episodic bouts of volatility as markets become increasingly sensitive to news headlines and economic data prints. Such environments have historically been auspicious for discretionary and systematic macro strategies and this year seems poised to once again demonstrate the value of including such strategies within one's portfolio.

About Quest Partners: Based in New York, Quest Partners is a quantitative investment specialist with an emphasis on tail risk. The firm manages $2.6bn in assets and employs 37 people as of December 2022.

PERFORMANCE OUTLOOK

The prospects for key hedge fund investment strategies in the coming months and the important role played by risk management

JAMES JAMPEL
FOUNDER, CO-CIO
HITE HEDGE ASSET MANAGEMENT

"The question for 2023 is: Why be long when you don't have to be?"

In 2021, popular culture charged into finance and subsumed many of the old rules. Memes, star power, and the 31% return of the S&P crushed many hedge fund shorts.

In 2022 a partial dose of reality set in, and the year could not have been more different, with short books saving the day for some, but not all fund managers. 2022 was supposed to bring hedge fund outperformance, but unfortunately some famous and not-so-famous names were revealed to be levered long after all. Some macro managers who were smart or lucky enough to call the turn prospered, along with some managing teams in the multi-strategy format.

The outlook for hedge fund managers that truly hedge continues to be bright compared to those whose business models rely on repackaged or exotic beta. Convincing allocators to take on beta when they don't have to could be difficult given the unprecedented changes we saw in 2022:

1. Real interest rates went from strongly negative to strongly positive, as the yield on a 10-year inflation-protected Treasury shot up from -1% to +1.3% (the highest since 2008). The presence of fixed income as a real alternative has profoundly impacted equity valuations, suggesting that the outlook for future returns outside of fixed income has worsened.

2. Geopolitical risks have risen to levels not seen since the Cuban missile crisis in 1962. Putin detonating a nuclear device or Xi making a grab for Taiwan are no longer unthinkable, and now need to be in every investor's model, even though they can't really be modelled. Moreover, investors cannot rule out political upheaval in the United States (e.g. the debt ceiling) and other significant western economies.

3. Industrial policy and onshoring will necessarily accelerate, which will be positive for labour and national security, but potentially negative for corporate profits.

4. Climate change, not inflation, is now clearly the "runaway" threat. Global productivity could stall or even reverse as droughts and heat continue to stress agriculture, disrupt waterborne trade, increase fire danger, and dry up sources of hydropower. Scientists tell us we should expect more intense storms when the rain does fall. Over time, climate change will require massive government spending on projects like seawalls and relocations just to maintain productivity, rather than enhance it.

On the alpha side, large multi-manager market neutral firms will likely continue to increase fees and lengthen lockups, so long as allocators bear it and choose to discount the risks of increasing gross exposures and the leverage required to support it. Should we continue to dodge the geopolitical crossfire and avoid the associated chaos, select multi-manager firms might continue to offer strong, uncorrelated returns. On the other hand, long lockups could result in a very painful series of years should there be cascading unwinding that impacts many, or if a particular firm loses its mojo.

For all but the very largest allocators, the question for 2023 is: Why be long when you don't have to be?

About HITE Hedge Asset Management: HITE has an 18-year track record of managing market neutral strategies to attempt to capture alpha. The firm uses energy-related securities as its tools for generating uncorrelated returns.

DEEPAK GURNANI
FOUNDER AND MANAGING PARTNER
VERSOR INVESTMENTS

"Wide spreads on existing and new mergers now offer an attractive entry point."

Currently, many investors have a surprisingly negative outlook for merger arbitrage.

Some express concern about increased regulatory scrutiny of mergers and what this might do to deal flow and deal success. Although merger flow is below the record-breaking pace of 2021, it remains strong by historical standards. While the Justice Department has tried to block several large mergers, merging firms willing to fight in court generally won in 2022.

Some investors express concern about economic uncertainty and its effects on merger returns. Although merger arbitrage invests in equities, it does so in a market-neutral fashion and often succeeds even when equity markets fall. While merger arbitrage conceptually is related to short-term bonds, it fares well in inflationary environments because deal durations are short.

We think the current merger arbitrage environment is positive. This is especially true for sophisticated implementations of the strategy and by comparison to the continued uncertainty in equity and bond markets.

Presumably the DOJ/FTC will continue to have extended reviews of mergers and even litigate to block some deals. Since antitrust laws themselves have not changed, however, many firms are willing to defend their mergers in court and we expect many of them to prevail. Recently, three blocked deals closed after winning in litigation against the DOJ.

Versor expects merger volumes to settle at a normal level. Long-term drivers of M&A remain in place, even as we work through economic and regulatory uncertainty. Importantly, sophisticated merger arbitrage doesn't require exceptional deal flow or extremely large deals to generate attractive returns.

Average merger spreads in excess of the risk-free rate are currently in the top 20% of excess spreads since 2000. The riskiest deals are now trading at a 50% implied probability of closing. Investors are generously compensated for potentially higher risk. At the same time, deal cancellations remain well below historical norms. U.S. termination rates are currently near 4%, far below the historic median of approximately 7%.

Given the various uncertainties, capitalizing on this merger environment requires a robust investment process – specifically in terms of risk management. A sophisticated approach that invests in a large cross-section of mergers geographically and across the risk and size spectrum provides meaningful portfolio diversification, even at moderate merger volumes. A key is discipline in initial position sizing and deal exits, which reduce exposures to deals in case the risk of termination or loss rises. With this focus, a merger portfolio can offset losses from occasional deal terminations with gains from improved offers, which remain more frequent than terminations.

Over much of 2022, negative sentiment widened overall merger spreads. The associated mark-to-market effects temporarily offset many of the gains from mergers that closed during the year. Some investors may conclude that their negative sentiment toward merger arbitrage was justified. However, wide spreads on existing and new mergers now offer an attractive entry point. As deals close, the wide spreads can produce strong returns on existing and new positions going forward.

About Versor Investments:
Headquartered in New York, Versor is a quantitative investment boutique for institutional investors. The firm has two business lines: hedge funds and risk premia.

> *The significant uncertainty in the markets may favour a diversified portfolio.*

MARK CARVER

GLOBAL HEAD OF EQUITY FACTORS AND EQUITY PORTFOLIO MANAGEMENT

MSCI

This time last year, professional investors were in positive mood. Developed equity markets had gained over 20% in 2021 and the key themes for the year ahead – inflation, interest rates, and the rotation from growth to value – were piquing curiosity rather than fear. Was growth going to rebound or is value here to stay? Today, the mood among investors is more uncertain. Resilient inflation and Russia's invasion of Ukraine has altered regional outlooks and spurred deglobalisation.

Which hedge fund managers will fare well in this environment? It's hard to say, of course. But the significant uncertainty in the markets may favour a diversified portfolio rather than large, concentrated positions. As a result, it could be another year where quantitative strategies – to the extent they favour breadth– may perform strongly.

Factor investors, those who deliberately manage portfolio exposure, may fare well as they may navigate the market rotation more effectively. This is a change from two years ago, when people were telling us factors didn't matter anymore. No-one is saying that in 2023 as investors have turned back toward factors to better understand their portfolio characteristics and market opportunities. It's clear that the first principles of investing – know your exposure and manage them deliberately – have played out.

Not all hedge funds were prepared for the level of market volatility we saw last year, nor the strong rotation across industries and factors, which influenced some of the winners and losers. All investors need to better understand the characteristics of the names they own. At MSCI, we've seen more hedge funds using our equity risk and crowding models to check that the stock they've bought, which they think they know so well, is moving as they expect. Why? Because the stocks factor characteristics will drive its behaviour, and these characteristics are moving quickly.

Understanding these factors will be a vital part of risk and performance management in 2023. Over the past two years, the nature of risk shifted substantially. During the pandemic, global equities fell sharply and swiftly, but this was followed by an unprecedented rally in risky assets. Investors who over forecast risk coming out of the drawdown may have been less capital efficient during the rebound. At MSCI we've introduced into our models new ways to help investors forecast risk during volatility shifts, hoping to enable investors to deploy capital most efficiently to pick up additional return or protect in drawdowns

But underlying all last year's big themes – factor rotation, market rotation, the bursting of big tech – there was, and still is, the debate about whether value will continue to lead or if growth will be resurgent. That is going to be a central question we all try to answer throughout 2023.

About MSCI: Headquartered in New York, MSCI is a leading provider of investment decision support tools and services. Its clients include hedge fund managers, other fund and asset managers, and asset owners.

> The outlook for managers that truly hedge continues to be bright compared to those whose business models rely on repackaged or exotic beta.

James Jampel, Founder and Co-CIO
HITE Hedge Asset Management

JONATHAN BOWERS
CIO
ACER TREE INVESTMENT MANAGEMENT

ASKIN AZIZ
PORTFOLIO MANAGER
ACER TREE INVESTMENT MANAGEMENT

What is in store for 2023? Before we get to that, let's recap what 2022 looked like from a long/short credit lens. We entered 2022 with concern around the tightness of credit spreads, increasingly evident inflationary pressures, and central banks stubbornly reiterating transitory inflation views.

From the get-go spreads began to widen and, as Russia/Ukraine tensions escalated, spreads trended wider. In late February the invasion commenced and the implications for Europe and the broader global economy were immediate. Rates sold off hard as central banks moved from dovish to hawkish, and credit spreads indiscriminately moved wider coupled with fund outflows across investment grade (IG) and high yield (HY), most notably at the end of June. The short-lived illiquid bounce in spreads in August saw a further sell-off off post summer. More recently, risk has been rallying, positioning across markets has trended longer and markets have calmed – or have they?
As markets have moved on from rates/inflationary concerns, we are beginning to see some dispersion amongst credits as markets focus on identifying the 'winners' and 'losers' – in what is a weakening economic backdrop. Businesses are under enormous pressure, still reeling from 'post-covid-disorder', cost/energy inflation has been and continues to be rampant, and customers squeezed. One would expect this to create meaningful dispersion in credit spreads amongst 'winners' and 'losers'. Thus far, dispersion has been somewhat limited, but there is mounting evidence of recessionary indicators from 3Q earnings and outlook commentary, which we expect to accelerate in 2023.

Decompression between IG and HY is another trend that is manifesting itself in spreads as focus shifts from rates to economic and single name credit fundamentals. Higher rates mean higher refinancing costs for bond issues as well as floating rate issuers which have clearly been woefully underhedged. A combination of these factors will inevitably weed out 'zombie' and over-levered credits, unable to support high debt loads. Default levels will trend higher, creating opportunities in the distressed area. In summary, 2023 will prove a rich environment for fundamental credit picking across the credit spectrum.

More broadly looking at asset allocation, the 'great migration' towards fixed income credit has started. Real money and in particular pension funds and insurance companies can now invest in credit products at yields that are finally attractive from a risk reward perspective after a near decade of QE. HY and leveraged loan portfolios are now more attractive than private equity as they allow more diversification, less risk and additional capital seniority coupled with returns that may be similar but more certain. We expect to continue to see demand for strategies led by experienced fundamental long/short teams in being able to monetize dislocations in volatile markets.

About Acer Tree Investment Management: Based in London, Acer Tree is a Europe-focused corporate credit specialist. Founded in early 2020, the firm manages assets across a long/short credit hedge fund and a CLO business.

PERFORMANCE OUTLOOK – TREND-FOLLOWING

LAURENT LE SAINT
MANAGING PARTNER, COO, AND CRO
METORI CAPITAL MANAGEMENT

> *Macroeconomic themes generated significant directional price trends.*

2022 was a challenging year for asset allocators, with market volatility fueled by the war in Ukraine, inflationary pressures, interest rate hikes, and energy price shocks. Virtually all asset classes ended the year with negative returns, including bonds which were traditionally perceived as a safe haven.

However, these macroeconomic themes generated significant directional price trends, creating opportunities for trend-following strategies that can take both short and long positions.

Like many of our quantitative CTA peers Metori, had a successful 2022, increasing our total assets under management. Our flagship Lyxor Epsilon Global Trend Fund (I-USD) returned +17.6% (net of all fees) with a volatility of 10.0%, and our Epsilon Managed Futures Program (which also includes commodities) returned +25.2% with a volatility of 14.4%.
The events of 2022 have reinforced the importance of diversification in portfolio allocation. Managing correlations between asset classes will be crucial in the coming year. In this context, trend-following strategies offer a compelling solution for investors. These strategies have the potential to deliver long-term returns while also offering attractive properties such as ample liquidity, low correlation to traditional assets, and controlled volatility.

As 60/40 portfolios are called into question, CTAs bring an alternative source of diversification while providing a level of adaptability to different macroeconomic environments.

As the new year begins, Metori is building on last year by setting an ambitious agenda of projects. We plan to continue promoting our Global Trend fund, one of the largest managed futures UCITS in Europe, and address demand for offshore versions of our strategy by launching new fund vehicles. Additionally, Metori will expand its range of programs by launching a new fund which will include QFII eligible Chinese Futures in a global trade universe. This will allow foreign investors access to unique contracts only traded in China, one of the world's most liquid futures markets.

Markets do not move in isolation. They are interconnected. They follow macro-drivers, which emerge and unfold, influenced by economic, monetary, and geopolitical environments. Therefore, rather than chasing patterns on single instruments our investment model aims to identify the principal components that drive market moves. To this extent, we believe being at the crossroads of trend-following and global macro will deliver success in 2023.

About Metori: Metori Capital Management is a quantitative fund manager, headquartered in Paris, whose funds follow a trend-following strategy and currently manage in excess of $800m.

SAMED BOUAYNAYA
PORTFOLIO MANAGER
ALTANA WEALTH'S DIGITAL ASSETS FUND

"2022 will go down as very productive for the future of digital assets."

While 2022 was the Year of the Bear for traditional risk assets, digital assets did not escape the macro bloodbath. A series of idiosyncratic events – from failed experiments to Ponzi fraudsters – destroyed the crazy valuations built during the 20/21 FOMO years. The space endured decades of Trad-Fi lessons inside a few months. Those lessons have been taken on board.

Many investors will tell you that it is a year to forget. We believe the opposite and that 2022 will go down as very productive for the future of digital assets. Speculative bubble implosions pave the way for creation, progress, and maturity. Had we not invested in the DotCom bubble and suffered its subsequent implosion, we wouldn't have unleashed the power of today's internet.

The irony of the failure of FTX and other centralised entities is that it highlights the importance of Defi and crypto's major tenets:

• trustlessness via smart contract execution vs biased human decision making,
• true ownership via self custody
• transparency via blockchain public ledger traceability.

So, we start 2023 with fewer but stronger players driving an organic growth of blockchain solutions and use cases. The large amount of dry powder kept aside by VC investors in 2022 combined with the need to digitise real world assets and on-board users of Web2 companies could usher a new wave of investments.

NFTs and tokens are revolutionising direct consumer engagement and payment solutions linked to rewards and loyalty programs for retail, media, and travel industries. These unique forms of identification and ownership are recorded on an immutable blockchain and can then be transacted in a token-based economy without the need for giant technology platforms.

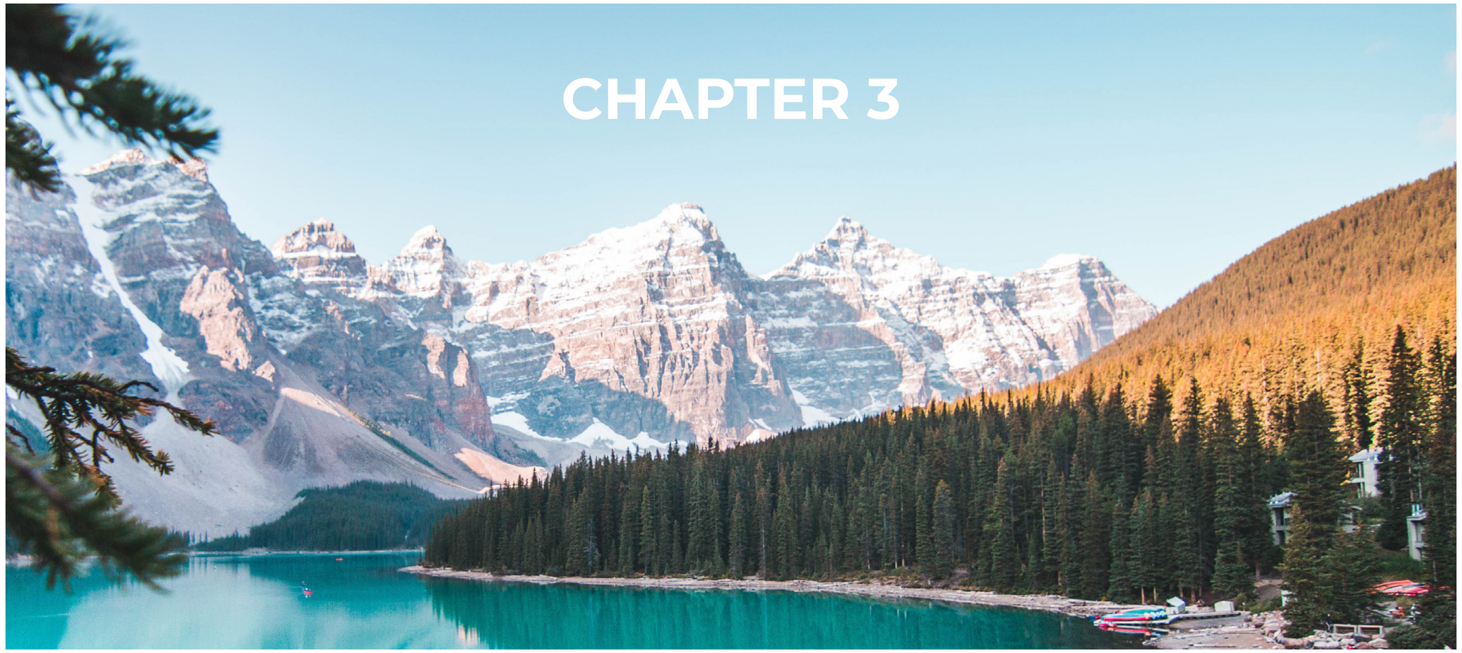
These NFT driven web3 projects as well as the continuing rise of Defi market share vs Cefi will mostly occur on Ethereum and its supporting scaling solutions. After massively reducing its energy consumption by merging to proof of stake technology, the Ethereum network is pushing ahead with Shanghai hard fork, a key software update that will enable staked ETH token withdrawals in March.

The Shanghai update has already increased demand for liquid staking services sending LIDO 60% higher in the first week of 2023, proving that even in the midst of a bear market crypto narratives can be hugely rewarding.

Indeed, the intrinsic value of most digital assets is still driven by the 'narrative' behind the tokens they trade as they lack TradFi valuation metrics like earnings. One needs to keep a close look at all narratives surrounding Ethereum or other chains/layer 2's and be nimble to update one's investment thesis once new information comes along.

At Altana, we remain bullish on the future of digital assets. There are still unique opportunities to find fundamental value in this emerging asset class at distressed prices. When volatility dries down, investors are disheartened and the market is boring, that is the signal to start scooping up deals.

About Altana Wealth: Founded in 2011, Altana Wealth focuses on specialist, under-explored areas that can generate alpha. Altana currently manages $500m in crypto and digital assets, distressed, fixed income, sovereign debt, and carbon trading funds.



INVESTOR OUTLOOK

Insights into allocator sentiment heading into the new year, from hedge fund strategies of interest and the role of alpha, to ESG in China

> We expect asset allocation decisions to remain a key performance driver in 2023.

BROOKS RITCHEY
SENIOR MANAGING DIRECTOR, CO-CIO, AND PORTFOLIO MANAGER
K2 ADVISORS

David Swensen, the revered former CIO of Yale University, once wrote that "establishing a coherent investment program begins with understanding the relative importance of asset allocation, market timing, and security selection."

That certainly rang true in 2022, and we expect asset allocation decisions to remain a key performance driver in 2023.

Fund of hedge funds allocators and manager research teams will have to contend with a different macro environment to that seen one year ago. Interest rates are not 'lower for longer'. Inflation has now returned from a 40-year dormant period. Major nations are fighting (or threatening to fight), and global growth is below trend. In addition, the term 'Stagflation' has returned to many forward-looking conversations.

While the outlook for security selection 'alpha' has improved for 2023, the impact of various market 'betas' will continue to either help or hurt total individual manager performance, and therefore nimble managers who can avoid equity, bond, currency, and commodity downside volatility should be rewarded.

That said, certain hedge fund sub-strategies may see a bit of a performance tailwind, if our 2023 base case market and economic scenario below proves to be accurate:

- Central bank interest rates move slightly higher and remain there (i.e., no rate cut pivot until 2024).
- The U.S. Dollar resumes it uptrend in the first quarter of 2023 but stalls in Q2 and declines in the second half.
- Inflation has peaked but declines at a slower pace than central bankers would like.
- Prospects improve for an end to the Russia/Ukraine conflict. The European energy crisis ends by Summer 2023.
- China's economic re-opening is delayed until Q2 of 2023 at the earliest.

Within this environment, we would favour macro-savvy, high-alpha managers within certain hedge fund sub-strategies during 2023. Those strategies well placed in the first half of the year include: equity market neutral, macro/CTA, alternative risk premia, volatility arbitrage, insurance linked, and – for the first quarter – fixed income long/short. But by the second half of the year, conditions will have shifted enough to favour: equity long/short, event-driven, commodity long/short, and credit.

Ultimately, though, individual hedge fund managers with a healthy respect for the macro influences impacting their portfolios will have a smoother ride in 2023 than those primarily focusing on 'bottom-up' security selection.

About K2 Advisors: Established in 1994, K2 Advisors is one of the hedge fund industry's largest fund of funds managers, overseeing more than $10bn in AuM. It is an affiliate of Franklin Templeton.

INVESTOR OUTLOOK – INVESTMENT CONSULTANT

PATRICK GHALI
MANAGING PARTNER
SUSSEX PARTNERS

> *An uncertain environment favours diversifying and pure alpha strategies.*

The focus over the last year has been on diversifying strategies and an avoidance of traditional (spread based) fixed income or higher net equity exposures. Markets have been challenging in 2022 and we expect that to continue well into 2023. As yet, the full effect of global rate increases doesn't seem to have been fully digested by markets or by consumers and, in addition to geopolitical and other headwinds, we anticipate that companies will face an earnings recession. This is on top of geopolitical and other headwinds. The expectation is for more muted rates volatility, a tradeable range for FX volatility, and that equity (especially single stock) volatility has more extremes to come as the market digests a change in earnings.

Strategy selection will remain a key driver of returns and a mitigator of risk, as evidenced by the performance dispersion amongst strategies in 2022. While manager selection always makes a big difference, getting the strategy call right will continue to be of paramount importance.

An uncertain environment favours diversifying and pure alpha strategies – global macro, systematic/quant based, and relative value. These strategies have done well in 2022 and will continue to do so. But systematic strategies are best implemented through a basket (short term, medium term, machine learning/AI, etc.), rather than through individual managers, as it is not easy to predict exactly how strategies will perform under difference conditions, and we expect markets to face continued bouts of sudden volatility. Evidence shows that through baskets, the constituents of which are also uncorrelated, investors tend to get more predictable and stable returns.

High net exposure equity managers should be avoided. Indeed, until such time as fundamentals are once again rewarded by markets, we think that any strategy that hinges on equities will continue to struggle, including equity market neutral. We will also avoid any strategies that are subject to gap risk such as illiquid or semi-liquid credit. A revaluation of private equity, private credit, and real estate funds in 2023 is a near certainty and also a concern.

Geographically, Asia continues to be of interest, mainly due to the higher alpha potential stemming from greater market inefficiencies, but allocators to the region must be careful to avoid beta risk, especially given the political backdrop in several Asian countries. Here, again, low net managers and stock pickers are preferred, as are manages that can take advantage of region-specific arbitrage opportunities stemming from idiosyncratic local market dynamics and investor make up.

Finally, we expect 2023 to be another year in which active management has an advantage over passive strategies. Within the range of active management strategies, those without reliance on sustained directionality and which are thus uncorrelated to major markets, should at least form part of an investor's portfolio

About Sussex Partners: Founded in 2003, Sussex Partners is an independent, global investment advisor dedicated to alternative investments. The firm focuses on single manager and funds of hedge funds, and the creation of bespoke portfolios.

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Managers with a healthy respect for macro influences will have a smoother ride in 2023 than those focusing on ‘bottom-up’ security selection.

Brooks Ritchey, Co-CIO and portfolio manager
K2 Advisors

FRANK TSUI
SENIOR FUND MANAGER
HEAD OF ESG INVESTMENT OF VALUE PARTNERS

"A proprietary ESG assessment will be essential when covering the China markets."

Environmental, social, and corporate governance (ESG) factors have become critical drivers for business sustainability. We believe a proprietary ESG assessment will be essential when covering the China markets in 2023 due to the challenges of data inefficiency.

The region's disclosure awareness continues to diverge among companies, and disclosure quality varies, given the different regulatory regimes across jurisdictions. Adopting a proprietary approach to assessing ESG factors makes a considerable difference when researching companies, especially in identifying risks and opportunities. It enables more effective engagement, as it provides analysts and portfolio managers with structured, proprietary insights when meeting with the investees' management.

For example, one of the companies under our coverage is an onshore-listed slewing bearing company that supplies products for wind energy turbines and various cranes, which could arguably be deemed ESG-friendly as it supports the transition to new energy solutions. However, the company's ESG data was not easily obtainable, making it difficult to gauge how the company is performing from an ESG perspective. Thus, the company resulted in a low ESG score from many industry practitioners.

However, as we were undertaking our proprietary ESG assessment of the company, we discovered data from the company's Chinese website that detailed ESG-related metrics and initiatives, including data relating to the amount of waste reduction and carbon emissions. The data thus enable us to develop a much better and more holistic picture. This example largely reflects that the company is making progress, but it did not know how best to showcase this information to the public. We believe additional resources are needed to unearth, translate, and interpret ESG information from Chinese companies.

Engagement is a crucial step in conducting ESG assessments in our process. Our proprietary assessment provides our analysts and portfolio managers with a more focused and structured ESG framework.

In the case of the slewing bearing company, while the engagement allowed us to scrutinise its sustainability practices based on local standards, we were also able to suggest how it could articulate its ESG disclosures in a manner more aligned with the Sustainable Finance Disclosure Regulation (SFDR) requirements. This constructive engagement should ultimately help the company to receive more appropriate recognition for its ESG practices.

Our proprietary ESG assessment now covers 100% of the companies we invest in on behalf of our clients. We will continue refining our proprietary ESG assessment to constantly improve our engagement with our investees and firmly believe that it is pivotal for us to proactively engage in structured discussions with investees on ESG-related practices. In our opinion, this should ultimately lead to sustainable value creation and long-term resilience.

About Value Partners: Based in Hong Kong, Value Partners manages various investment strategies, including equities, fixed income, multi-asset, and alternatives. At the end of June 2022, the firm's assets total $7.5bn.

HEDGEWEEK

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