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HEDGE FUND LAUNCHES SURGE THROUGH MID-YEAR, DOMINATED BY MULTI STRATEGY INFLATION TRADING

Industry growth accelerates as launches exceed liquidations; Fees steady, increase on capacity, demand as volatility, inflation drive expansion

CHICAGO, (October 4, 2023) – New hedge fund launches surged through mid-2023 as managers shifted the strategic growth focus to aggressive expansion of inflation trading teams in multi-strategy funds designed for and positioned to trade volatility driven by rising rates and generational inflation. The estimated number of new hedge fund launches surged to 133 in 2Q23, bringing the 1H23 launch total to 226, according to the latest *HFR Market Microstructure Report*, released today by HFR®, the established global leader in the indexation, analysis and research of the global hedge fund industry.

New hedge fund launches were dominated by a large increase in fixed income based Relative Value Arbitrage, which includes large credit multi-strategy funds, with the 2Q launch total rising to an estimated 51 from the prior quarter total of only 13. Launches were driven by new RVA multi-strategy funds specifically positioned to navigate the volatile interest rate and inflation market cycles which have dominated financial markets as inflation has risen to generational records and the US Federal Reserve has increased interest rates over 500 basis points. New hedge fund launches exceeded liquidations for the first time since 1Q22.

The number of hedge fund liquidations was steady through mid-year as an estimated 109 funds closed in 2Q23, rising slightly from the prior quarter total of 102. In the trailing twelve-month period ending 2Q23, an estimated 393 funds launched, while an estimated 500 funds liquidated.

The HFRI Fund Weighted Composite Index® (FWC) advanced +4.5 percent YTD through August, led by Equity Hedge and Event Driven strategies; gains were complemented by steady, recent gains in Relative Value Arbitrage. Strategy gains were led by the HFRI Equity Hedge (Total) Index which has advanced +6.6 percent YTD through August, while the HFRI Event Driven (Total Index complemented these gains in recent month, bringing YTD performance to +5.2 percent through August.

The performance dispersion of the HFRI Fund Weighted Composite Index® (FWC) decreased slightly from the prior quarter, as the top decile of index constituents returned an average of +14.6 percent in 2Q23, while the bottom decile declined by an average of -8.2 percent, representing a top/bottom decile dispersion of 22.8 percent, compared to a top/bottom dispersion of 2369 percent in 1Q23. In the trailing twelve-month period ending 2Q23, the top decile of FWC constituents returned an average of +32.2 percent, while the bottom decile declined by an average of -16.6 percent, representing a top/bottom decile dispersion of 48.8 percent.

Hedge fund fees increased through mid- 2023, driven not only by strong performance and capital inflows, but on capacity limitations at many large well-established firms, as well as increased operating costs associated with expanding inflation portfolio teams. The average industry-wide management fee was unchanged from the prior quarter at 1.36 percent, while the average incentive fee increased by 2 bps to 16.19 percent. For funds launched in 2Q23, average management fees increased by 8 bps from the prior quarter to an estimated 1.29 percent.

"Hedge fund performance, dispersion, fee, and launch trends in recent months continue to be driven by market cycles of inflation and interest rates – a trend which is likely to accelerate into 2024. Through mid-year the focus of new launches and expansion of established funds was driven by demand to enhance and add inflation trading teams and exposures, with increased competition for these highly specialized teams driven by interest from multi-strategy funds looking to increase exposures and offerings in this area," stated Kenneth J. Heinz, President of HFR. "Through mid-year the performance trend has shifted from the tailwind of AI technology beta and recovery from regional bank volatility to be intensely focused on inflation and interest rates as the primary driver. Fee increases have also been accompanied by limited capacity, increased required commitment periods, and increased rate of closing of the most desirable, highest performing strategies to new capital. Institutions seeking exposure to trends in specialized inflation and interest rate trading are likely to continue expanding their exposures to hedge funds, focusing new commitments to funds which have both demonstrated their robustness and increased their portfolio focus on these areas in recent months."

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