

# Albourne Annual Hedge Fund Update

Employees Retirement System of Texas

11 May 2022

# Albourne Outlook\*

In order to capture the multiple dimensions of the outlook over the next 12-months, we set out three distinct cases, or scenarios, in each Quarterly Strategy Forecast. In the current 2Q 2022 QSF, we have increased the probability of the Negative Case once more, raising it to 40%, and reducing the Central Case to 35%. The base case for these probabilities is 1/3-1/3-1/3, hence these probabilities suggest there is a somewhat higher probability of the Negative Case relative to history, and a slightly lower probability of the Positive Case. The Central Case is broadly in line with history.

## Negative Case

(40% Probability)

- The Negative Case is one in which the economy weakens more than expected, leading to a pull back in long-term interest rates from their current levels, US dollar weakness and a widening of the credit spread. But this is only one potential Negative path.
- Clearly how the Fed walks this tightrope will have a profound impact on the path of long-term interest rates.

## Central Case

(35% Probability)

- Our assumption is that in the Central Case the outcome is in line with market expectations, i.e. no surprises.
- With 8 meetings a year, this implies at least one 50bp rate hike over the coming year.
- Equity returns should be in line with more long term averages; bond yields will sell off modestly having priced in much of the hiking cycle, and the US dollar weakens as the rate hiking cycle internationally catches up with the US.

## Positive Case

(25% Probability)

- The recovery in investment spending is expected to continue as firms look to overcome supply-chain issues both in the short term, and on a more long-term basis.
- Monetary authorities may well countenance higher inflation for a while both as a short-term consequence of the post-Covid rebound and as a price worth paying for reducing the West's reliance on Russian energy and other commodities.
- Long term inflation expectations remain anchored by the multi-decade decline in inflation.

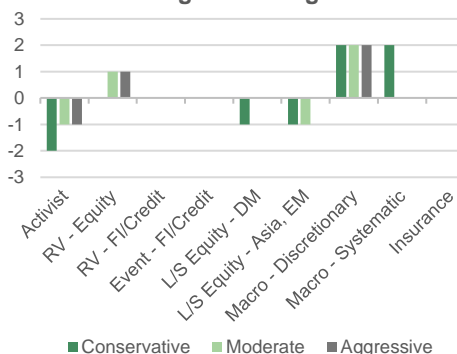
# Albourne Outlook\*

## Key Points:

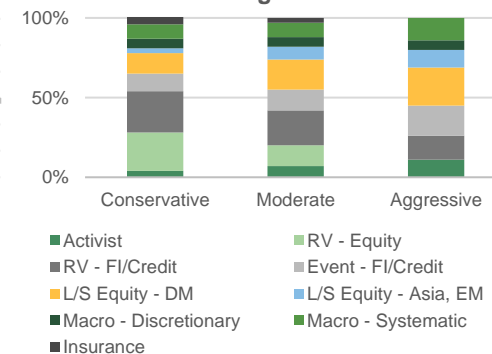
- 1Q 2022 saw the first quarterly decline in both US equities and bonds since the Global Financial Crisis. This breakdown in the diversification benefit of bonds has long been feared if inflation becomes a true concern for the markets. Such an environment is exactly the reason investors build diversified portfolios of alpha-based, low-beta, strategies through hedge funds. Overall, these strategies came through for investors since the start of the year.
- Inflationary pressures were clearly evident coming into 2022, but the war in the Ukraine has significantly reinforced these through price rises across commodity markets. So far both markets and households appear to believe this will be temporary, with a rise in inflationary expectations concentrated in the next 5-years. However, it would not be unreasonable to expect markets to, at very least, build in a greater medium term risk premia around inflation.
- Global Macro, CTA and GAA strategies have thrived in the current environment having seen their tilts coming into 2022 benefiting from recent events. We continue to see these strategies well placed in the current environment.
- Strong crosswinds make for a more difficult environment for other strategies. While it is more positive for Fixed Income Arbitrage managers, it more challenging for FEMN and QEMN. A relatively robust global economy should be good for Event Driven managers, with Distressed managers benefiting if default rates increase. Greater sector and company dispersion should benefit Long/Short Equity managers, albeit with greater volatility.

Quantile	Rank	Strategy	Super Strategy	Sub-Strategy	Expected Return			
					Weighted Average	Negative	Central	Positive
1	1	Global Macro	Directional	Macro – Discretionary	6.9%	7.2%	5.4%	8.6%
	2	CTA	Directional	Macro – Systematic	6.7%	8.5%	3.8%	8.0%
	3	Fixed Income Arbitrage	Relative Value	RV FI/Credit	6.5%	5.1%	6.6%	8.6%
	4	Risk Arbitrage	Event	Event	5.5%	1.5%	7.6%	9.0%
	5	Insurance*	Directional	Insurance	5.0%		5.0%	
2	6	Global Asset Allocation	Directional	Macro – Systematic	4.0%	3.5%	4.3%	4.3%
	7	CB Arbitrage	Relative Value	RV FI/Credit	3.9%	-2.1%	6.5%	10.0%
	8	Japan Long / Short	Equity Long Short	L/S Equity DM	3.8%	-2.6%	5.5%	11.7%
	9	Statistical Arbitrage	Relative Value	RV Equity	3.7%	1.0%	6.0%	4.5%
	10	Quantitative Equity MN	Relative Value	RV Equity	3.6%	1.0%	4.5%	6.5%
3	11	Activist	Event	Activist	3.2%	-11.1%	7.2%	20.6%
	12	Asia Pacific Long / Short	Equity Long Short	L/S Equity EM/Asia	3.1%	-8.6%	7.0%	16.3%
	13	Emerging Markets Long / Short	Equity Long Short	L/S Equity EM/Asia	3.0%	-5.7%	5.6%	13.0%
	14	Fundamental Equity MN	Relative Value	RV Equity	2.8%	-1.5%	4.5%	7.5%
	15	Distressed / Restructuring	Event	Event	2.7%	-8.5%	7.5%	13.9%
4	16	Emerging Market Fixed Income	Event	Event	2.4%	-5.3%	5.7%	10.2%
	17	European Long / Short	Equity Long Short	L/S Equity DM	2.3%	-6.9%	5.9%	12.1%
	18	US Long / Short	Equity Long Short	L/S Equity DM	2.2%	-9.0%	5.2%	16.0%
	19	Relative Value Credit	Relative Value	RV FI/Credit	1.9%	-4.6%	5.0%	7.8%
	20	Structured Credit - Relative Value	Relative Value	RV FI/Credit	1.6%	-11.0%	9.0%	11.5%

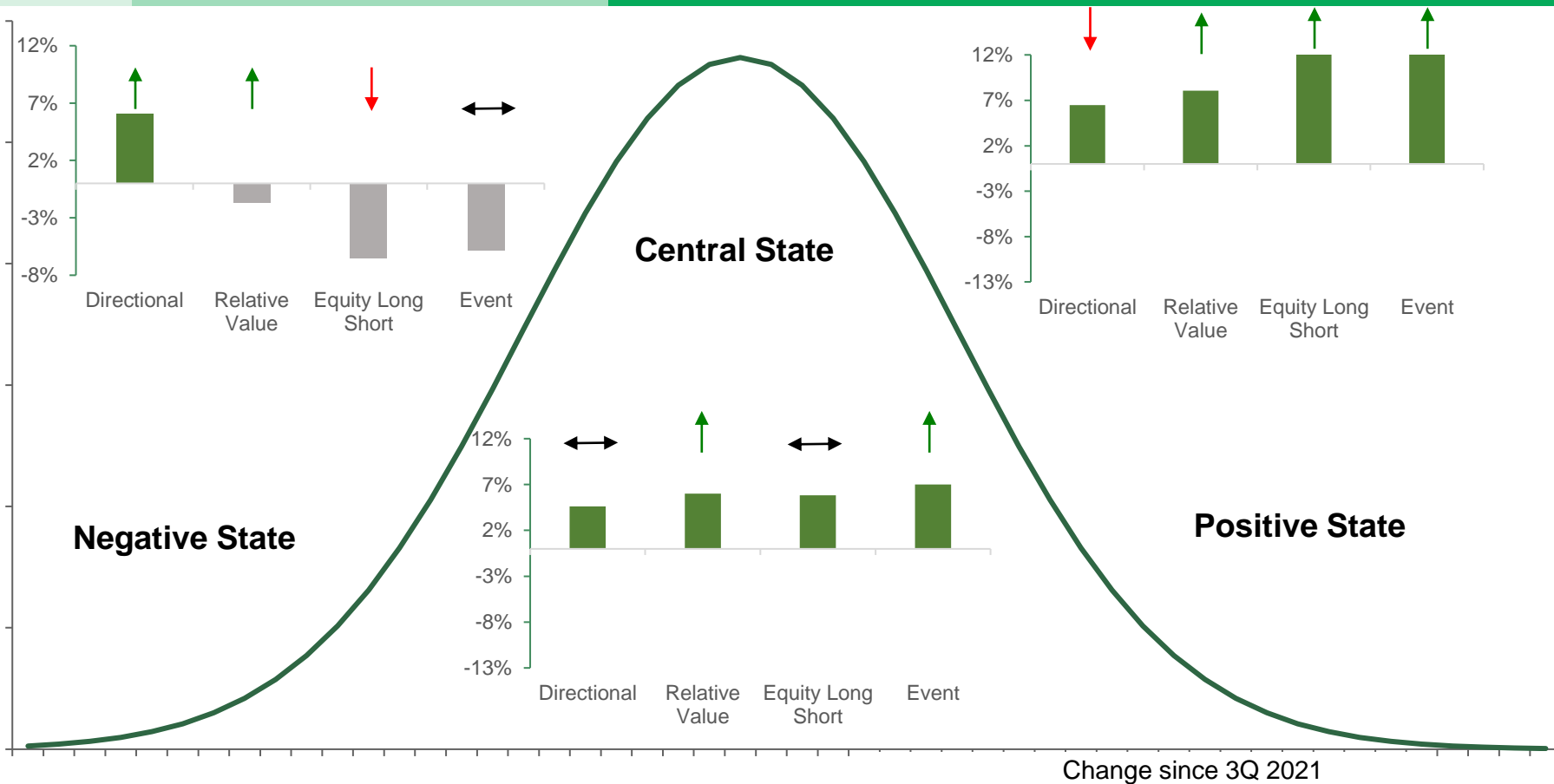
Model Portfolio Tilts relative to Long-Term weights



Model Portfolio Long-Term weights



# Strategy Outlook\*



Rank	Super-Strategy
1	Directional
2	Event
3	Relative Value
4	Equity Long Short

Directional  
Relative Value  
Equity Long Short  
Event

	Negative	Central	Positive
Directional	1%	0%	-1%
Relative Value	1%	1%	1%
Equity Long Short	-2%	0%	2%
Event	0%	1%	1%

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