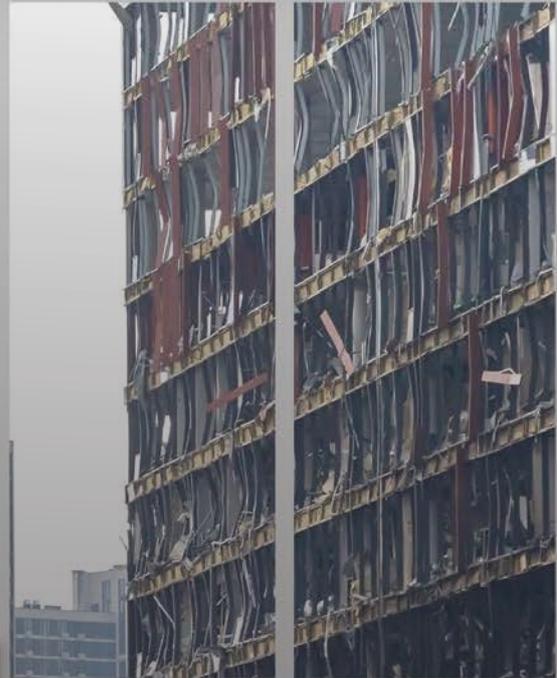
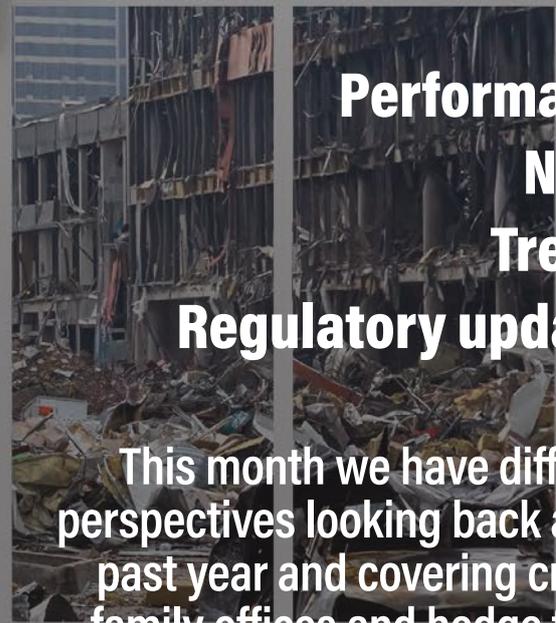


The Hedge



War, inflation, volatility and a long crypto winter, a look back at 2022.



**Performance
News
Trends
Regulatory updates**

This month we have different perspectives looking back at the past year and covering crypto, family offices and hedge funds and private equity, featuring PwC, AIMA, Bitwise, Lutyens Advisory and RQC Group.



A Brodie Consulting publication in conjunction with Capricorn Fund Managers and RQC Group.

2022 CLOSES WITH A WHIMPER NOT A BANG

The **HFRI Fund Weighted Composite** was down -0.4% in December, taking the year-to-date number to -4.3%. For the 12 months this was a good result compared to many global indices, but masks wide disparities across investment strategies.

After crypto, equities closed the year as the worst-performing strategy, with the **HFRI Equity Hedge (Total) Index** down -10.4%. At the bottom of the pile was **Technology** -16.4%, then **Healthcare** -14.7%. At the top were **Energy/ Basic Materials** +6.6%, and **Equity Market Neutral** +1.6%. In December, most equity strategies were in the red, although **Healthcare** and **Equity Market Neutral** bucked the trend to eek out small gains.

Event driven was more subdued for much of the year, yet the **HFRI Event-Driven (Total) Index** was still down -5.0% and -0.5% in December. **Activist** managers, in particular, found it difficult ground, dropping -4.4% in December and -17.2% through the year. **Event Driven Multi-Strategy** also had a hard time, down -8.9%. **Merger Arbitrage**, however, fared well, +2.5% in 2022 and +0.7% in December.

Macro closed the year with a flourish, with the **HFRI Macro (Total) Index** seeing uncorrelated gains of +0.5% in December and +9.3% in 2022, outperforming the **Equity** index by almost 14%. The best-performing sub-strategy was commodities, with the **Commodity** index up +14.6% in 2022, followed by **Systematic Directional** +12.52%. December was more mixed, with **Multi-Strategy** up +1.6% and **Discretionary Directional** managers up 1.5%, while **Active Trading** was down -2.0% and **Systematic** down -0.5%.

Relative Value held up reasonably well in 2022 with the **HFRI Relative Value (Total) Index** seeing a small decline of -0.9% and was virtually flat in December. The best-performing RV sub-strategy for the year was **Yield Alternative**, up +6.3%, followed by **Volatility** up +4.2% and the worst-performing **Fixed Income Corporate** down -4.5%.

Crypto funds had a year to forget as managers got caught up in the wake of FTX, with the **HFR Cryptocurrency Index** down -55.1% and -5.7% in December.

The **Fund of Funds Composite Index** was down -4.7% for the year after gaining 0.9% in December. The **Defensive** index was the best performing in 2022, up +5.9% and **Strategic** the worst performing, down -10.0%.

Upcoming Industry Events

18 January

How do you value Digital Assets (webinar)

23-24 January

Pension Bridge: Private Markets Europe 2023 (UK)

30 January - 2 February

Global Alts 2023 (Miami)

Click [here](#) to see all the listings

\$44bn

Amount of dry powder Blackstone is sitting on ready to invest

Source: Preqin

193%

2022 return of Haidar Jupiter Fund that at one point was up 274%

Source: Bloomberg

RETURN OF THE MAC

For the largest and best-known macro managers, 2022 was their big return. This follows 15-years of disappointment and multiple false dawns.

It turns out that what macro managers needed was the end of central bank largesse and a return to more hawkish policies, mixed with geopolitical turmoil.

In 2022 many of the best-known macro managers had record years, with reports of triple digit returns from **Said Haidar**, **Crispin Odey** and **Michael Platt**, and others registering exceptionally healthy double-digit returns, with **Caxton** up over 30% and **Brevan Howard** not far behind.

Quant managers also latched onto these macro trends and market volatility, the magic ingredients for any quant. Within this space, the outperformers were the macro quants and managed futures, with some of the largest CTAs up more than 20%. We are now in a completely new

economic cycle in which quants are ideally positioned. To quote **Leda Braga**, the legendary founder of **Systematica Investments**, speaking to **Bloomberg**: *"There were some overarching macro themes that are alive and kicking at the moment... The next ten years are going to be very different from the last 20"*

In addition, managers believe that this macro environment will continue into 2023, with many of the same themes still in play, plus a few more: 1) Interest rates will continue to rise and are unlikely to fall until 2024 at the earliest. 2) Global recession is imminent, with many believing the UK is already in one. 3) There has been little to no resolution to the 2022 geopolitical turmoil. 4) China is opening up, but Covid remains a real issue, impacting the speed and confidence of recovery. 5) Managers expect to see further volatility in the commodity markets.

LONG HARD SLOG FOR EQUITIES

With equity long-short managers correlated to US equity markets, there was little surprise that managers had such an uphill battle throughout 2022, as the **S&P 500** and **Nasdaq** closed 2022 down 16% and 30%.

Only a handful of equity-focused managers escaped unscathed. By year-end, the vast majority carried the scars, battle weary and reticent about taking on additional risk. Some of the biggest brands lauded in recent years, particularly in tech, including **Light Street**, **Perceptive** and **Tiger Global**, took baths as tech stocks got hammered.

This was not helped by the top

hedge fund equity holdings all being tech. According to the **Goldman Sachs Hedge Fund Trend Monitor** list, the top five were **Alibaba**, **Alphabet**, **Amazon**, **Meta** and **Microsoft**, down 25%, 39%, 50%, 64% and 28% for the year.

This did, however, create an attractive shorting environment, although still not ideal for long-short funds that tend to run with a net long bias. According to **S3 Partners data**, investors made over \$300 billion in gains from their shorts, both realized and unrealized.

UPDATES (cont.)

BRIEF COMMENT

2022 was a polarising year for alternative funds, with heroes and zeroes.

The heroes were the quants and macro funds, which reported some exceptional returns. While some of the heroes of yesteryear, particularly the more tech-focused equity funds, were the zeroes. There were also villains, led by FTX's *Sam Bankman-Fried*.

On a net basis, the hedge fund world saw significant outflows and remarkably few fund launches. This was the case even in macro, although there were signs towards year-end that this was, perhaps, starting to change.

To see change in 2023, we need equity long-short managers to perform once more. As the largest hedge strategy, there is a clear correlation between new launches and sector confidence.

While deal-making was down for the year in private equity, many of the big brand funds still managed to attract record assets.

From an investor's perspective it is about gaining diversification and seeing significant real returns from their alternative investments over the next year.

SEESAWING FLOWS

November was a virtual outlier in 2022 as one of only a handful of months to see net inflows to hedge funds. This data comes from **Citco's** hedge fund report that shows US net inflows of \$1.9 billion and Europe \$1.6 billion, while Asia saw small outflows. This does not change the pattern for the year, with Citco expecting to see outflows for the whole of the fourth quarter, which is undoubtedly the picture for 2022, with most months in the red. **EVestment** data

further backs this up, showing net outflows of \$14 billion in October alone, the highest reading since 2016 and the fifth consecutive month of outflows.

One could be forgiven for thinking that macro should be back in favour, given its performance this year, yet it is one of the sectors to see the highest outflows, alongside long/ short equity and credit strategies.

FUNDS SHORT LUXURY GOODS

On the subject of shorts, given the economic climate, hedge fund managers have been upping their short exposures to consumer discretionary stocks, believing consumers will be pulling back from non-essential goods and services. According to **S&P Global**, consumer discretionary was the most popular shorted sector in the

US to the end of November, with average short interest standing at 4.9%. This was followed by healthcare (3.8%), with **Novavax Inc.** the most shorted healthcare stock, energy (3.6%) and consumer staples (3.1%).

LAUNCHES HIT PAUSE BUTTON

Given today's economic headwinds, there can be little surprise that there were so few new fund launches during the year. We saw this first-hand, with launches put on hold until 2023 and possibly even 2024 and others pulled. Taking **Preqin** data, the number of new launches in 2022 stood at 915 funds, which is the lowest for ten years. There were the occasional big launches, such as the \$1.8 billion raised by *Malo Gaonkar* for **SurgoCap Partners**, but these were few and far between. Even the most popular strategies were proving difficult to get off the ground, with equity launches down 70% year-on-year, with 232 launched in 2022, compared with 788 in 2021 and 782 in 2020.

UPDATES (cont.)

NICKEL FOR YOUR THOUGHTS

Nickel was a stand-out dislocation trade in early 2022. In February and early March, the price of nickel blew sky-high but proved a more problematic trade to close for several hedge funds, with various legal actions taken against the **London Metal Exchange (LME)** after it suspended nickel sales. One of the most prominent cases was that of **AQR, DRW Commodities, Flow Traders, Capstone** and **Winton**, who

lost \$95 million on the metal, but has since been dismissed. Unfortunately for these managers, the judge, Justice **Adrian Beltrami**, described "the merits of the case as weak". AQR's **Cliff Asness** responded in a typically robust fashion, tweeting "what the LME did here was wrong" and "I don't back off one iota from any of my prior assertions".

NO MEME FEAT

Touted by the meme crowd, **GameStop Corp** was the stock that without any decent fundamentals burnt at the stake a number of hedge funds in 2021. **Melvin Capital** was the most famous fund to close because of this trade.

Revisiting many of these same stocks in 2022 and it is clear that without the backing of this retail crowd, they showed their true colours. Gamestop was one of the better performers, closing the year down 50%, while others, including **Digital Brands Group, Mullen Automotive** and **Bed Bath & Beyond**, were down 98%, 95% and 83% respectively.

This does not mean that the **Reddit** crowd will not give them a boost again, but the game is less fun than it was when they all jumped on the bandwagon.

WOOD'S UNDER FIRE

Third Point's Dan Loeb has fired a vicious broadside at underperforming **Cathie Wood**. This follows Wood's worst-ever year, with her flagship fund **ARK Innovation ETF** down 68% in 2022, dropping from \$16.5 billion in January to close the year at \$6 billion. In a tweet, Loeb accused Wood of being a "stonk hodler" - a term we had to look up - it is someone that holds on for dear life (or HODL); in Wood's case, this is to her falling investments.

BLACKROCK TARGETED

The David v Goliath activist award from the past month goes to **Bluebell Capital** for its **BlackRock** campaign.

Bluebell, a \$250 million activist manager that is best known for toppling **Danone** CEO, **Emmanuel Faber**, is looking to shake up the **BlackRock** establishment. With a 0.01% stake in the global asset manager, Bluebell wants to remove **Larry Fink**, change the board and review its ESG policies that it describes as "politicized and a distraction."

Bluebell certainly got the headlines, although it remains to be seen if they will get much more.

ROKOS SEEKS \$3 BILLION

Macro manager **Chris Rokos** is looking to make hay while the sun shines over **Rokos Capital Management**. He has just closed an exceptional 12 months that saw gains of over 50% for the year, following a more fallow period that saw him lose 26% in 2021, according to **HedgeWeek**. Rokos is now raising \$3 billion of additional funding to top up the firm's \$15.5 billion AUM.

FUNDS ADJUST TERMS

Not every manager that struck out in 2022 is looking to raise fresh capital, with various funds viewing this as an opportunity to return funds or adjust investor terms. One such manager is **Citadel**, which is returning \$7 billion to investors after making gains of over 32% in its flagship **Wellington** fund. According to reports, other firms taking similar actions include **Brevan Howard, Two Sigma** and **D.E. Shaw**. **Caxton**, on the other hand, is raising performance fees on specific share classes.

TESLA'S YEAR FOR SHORTS

With **Elon Musk's** well publicised focus on **Twitter**, there are genuine concerns among commentators and investors that his eye is off the ball at **Tesla**. Its share price took an absolute shellacking in 2022 - down 69% for the year and down 47% in the second half.

There are funds on both sides of Tesla's book, with plenty of hedge funds long the car manufacturer looking to ride out the current share price drop. Short investors may only account for 2.9% of the free float but these investor have made out like bandits - *nb this number used to be far bigger, until funds got badly burnt*. **S3 data** shows short investors in 2022 made \$17 billion, with December proving particularly profitable as the Tesla share price fell 37%.





Money Maze Podcast

Est. 2020

2023



Global Rank
Top 1%

According to Listen Notes



After a four part venture capital miniseries, the **Money Maze Podcast** wrapped up 2022 with an insightful festive interview with **Simon Sebag Montefiore**, the bestselling author of works such as '**Stalin: The Court of the Red Tsar**', '**Jerusalem: The Biography**' and '**The Romanovs**'.

In this episode, Simon discusses some key ideas from his new book, '**The World: A Family History**', which tells the story of humanity, from prehistory to the present day, through the lens of the one thing all humans have in common: family. With a focus on well-known names, from the **Caesars** to the **Obamas**, and lesser known ones, it captures the story of humankind in all its joy, sorrow, romance, ingenuity and cruelty.

Simon starts the interview by describing **Putin's** fascination with Ukraine and the **Potemkin** era, and continues with the access granted to him to explore the Russian archives to write about **Stalin**. He then describes the powerful impact of human migration, and influence of powerful families; from the **Medicis** and **Mughals**, to the **Kennedys**, **Pahlavis**, **Kenyattas**, **Kims** and **Assads**, before describing how family dynasties are making a comeback in some parts of the world.

In 2023, the Money Maze Podcast has a number of fascinating new episodes in the works, featuring some of the biggest names in finance and business from across the world.

In our next episode, the show is featuring **Michael Birshan**, Senior Partner at **McKinsey**. Here he discusses how the management consulting industry is changing, and how they're adapting to this year's challenges and opportunities. Notably, Michael highlights the immense financial implications of the transition to net zero, and the new markets that are emerging from this.

Established in 2020 by two finance industry veterans, **Simon Brewer** and **Will Champion**, the Money Maze Podcast features some of the biggest names in investment management, finance & business. Through direct, entertaining and insightful interviews with masters of the real life money maze, it aims to help listeners learn about the different approaches to allocating capital and better navigate the pitfalls that line the path to prosperity. Whether you're a current or aspiring investor, entrepreneur, professional or student exploring career options, we hope you gain some helpful insights and enjoy the show.

To listen, search '**Money Maze Podcast**' on any major podcast app or **YouTube**. You can also find out more via www.moneymazepodcast.com.



www.moneymazepodcast.com

UPDATES (cont.)

BIG BRANDS SEE BIG FLOWS

Despite economic headwinds, many of the largest private equity houses continued to attract significant assets in 2022.

According to **Private Equity International's** Q3 data, the top ten houses by size raked in an impressive \$160 billion, with total industry inflows of \$517 billion to the end of that quarter. We do not yet have the data for Q4 but it is doubtful that the industry attracted a further \$216 billion to match the \$733 billion raised for the whole of 2021, which was an exceptional year driven by pent-up demand post-Covid.

2022 saw big fund raises from the likes of **Thoma Bravo** that pulled in a record \$32.4 billion in new assets. Even under-fire **Tiger Global Management** raised \$12.6 billion for **Tiger Global Private Investment Partners XV**.

CASH RICH, IDEAS POOR

Although assets have continued to flow to private equity, firms still need to invest the cash, yet activities were increasingly subdued as the year progressed.

Taking **Refinitiv** data, M&A activities for the second half totalled \$1.4 trillion, compared with \$2.2 trillion in the first half, a fall of 36%. Compared with 2021 and M&A in 2022 is down 38%.

There is certainly no lack of dry powder, with almost \$2 trillion sitting untapped on the sidelines. This is up from \$1.6 trillion the previous year. Dig deeper, using **Preqin** data, and around a quarter of this powder sits with just 25 firms. The largest of which is **Blackstone** with \$44 billion, followed by **Thoma Bravo** with \$34 billion, and then **Advent International** with \$32 billion.

BLACKSTONE COMES OUT FIGHTING

Having written last month about the liquidity problems faced by **Blackstone's** real estate fund, **Blackstone Real Estate Income Trust**, the private equity giant has taken significant steps to take ownership of the narrative and shore up the fund.

The **Financial Times** reports on the **University of California** endowment making a not insignificant \$4 billion investment in the Trust. This investment is locked in until 2028 and should allow **Steve Schwarzman** to sleep better at night. In return, the endowment has been guaranteed a minimum return of 11.25% p.a. for six years.

CARLYLE UNDER THE COSH

The difficulties at **Carlyle** were fully laid bare in December. This was the result of a **Financial Times** story, with the paper highlighting the troubles at the Executive level, losing its CEO back in August and a return to its founders' ways. There were also difficulties the firm had in 2022 raising assets when other industry giants were achieving record fund raises.

With Carlyle's long track record, this should be a temporary blip, but they need a new CEO sharpish and a more precise strategic direction to take to investors.

MARKETS HAMMER PE FIRMS

While most of the largest private equity houses were successfully raising money, this was not reflected in 2022 share prices, with material share price drawdowns during the year.

Blackstone's 2022 share price declined by -40%, **KKR's** -36% and **Carlyle Group's** -45%. Among the more resilient were **CVC** -14% and **Apollo Global Management** -10%.

CRYPTO FUNDS FLOW

Crypto may have had a torrid year in 2022, yet funds continued to flow to the sector. According to **Galaxy Research**, around \$30 billion was invested in crypto start-ups and venture investments, which is fractionally lower than during the 2021 crypto bull market. More than 40% of these start-ups were US based. In the same report, Galaxy writes that the fundraising environment for 2023 will be significantly harder, given the higher demands from investors, lower valuations and the question of when and what form industry regulation will take.



MARKETS

LOOKING BACK AT DECEMBER

Having survived Covid, this was supposed to be the year of opening up and a return to normality. Instead, 2022 will go down in history as a year to remember, just not for the right reasons. We had a brutal war, geopolitical tensions, accelerating inflation and fast-rising interest rates.

Luckily, December was less dramatic than many other months, although investors may well disagree. There were signs that inflation had peaked, yet markets were still on edge, with the VIX sitting above the average (21 vs 17) but still far below recent highs.

Market participants entered December relatively bullish and risk-on, believing central bank policy was becoming more dovish. Central banks, however, soon showed that this was jumping the gun and maintained a hawkish, albeit toned-down, approach and sought to slow down the pace of interest rate increases.

US inflation stood at 7.1% over the 12 months to the end of November, dropping from 7.7% in October. While in the UK, the latest inflation figure was 10.7%, down from 11.1% in November. The Euro region likewise dropped to 10% in November from 10.6%.

On 14 December, the Fed hiked interest rates by 0.5% to a targeted range of 4.25% and 4.5%, the highest in 15 years. Officials expected to keep rates higher in 2023, with no reductions likely until 2024. Similarly, the Bank of England raised rates to a 14-year high of 3.5%, warning that further rate rises are on the cards.

According to the Centre of Economics and Business Research, global recession remains on the cards for 2023. The Centre puts this down to ongoing inflation, with *'the battle ... not won yet [and] central bankers [sticking] to their guns in 2023.'*

The UK economy continues to be in no man's land, with the ONS revising down growth figures in the third quarter, which saw a contraction of -0.3%, against estimates of -0.2%. The expectation is that the UK fell into recession in the fourth quarter.

It has now been almost ten months since Russia invaded Ukraine. This war has been a disaster on so many different levels, setting off a chain of events that has adversely hurt what was already a fragile global economy. Russia's 'Armageddon' rhetoric may have calmed down in recent months, but there is still little indication that it will pull back or seek peace. There remains a worrying stalemate during the winter, with neither side making significant gains.

A positive sign was China reopening, as it cancelled the zero covid policy. Markets have yet to be convinced that they will go through with this fully as Covid cases skyrocket. China's colours however remain firmly attached to Russia as what they view as a Western axis against totalitarianism, with Putin inviting Xi Jinping to make a state visit in the new year.

For much of the month, markets were more risk on than off, yet still closed the month in negative territory. This was a particularly unsettling year and investors by year-end were looking for closure as they became increasingly gun-shy, worried about taking on too much risk.

The Nasdaq, in particular, was hard hit, falling -8.7%, followed by the S&P 500, which was down -5.9%, taking the year-to-date figures to -30% and -16.1%, respectively.

Looking beyond the US, most indices were heavily down, with the Dax -3.3% and Nikkei 225 -6.7%, taking their year-to-date figures to -13.1% and -10.9% respectively. The best performing index during the year, due to its heavy oil and gas weighting, and despite the British political shenanigans, was the FTSE 100, which still closed the year down but only -0.7%, having fallen -1.6% in December.

Even with the price cap to curb Russian oil, there was little movement in oil markets.

Brent rose 0.6% and WTI fell 0.5%. At the OPEC meeting, there was no change to the status quo. More broadly in commodities, there were reasonable moves in precious metals, with silver and gold rising 7.5% and 3.3%, boosted by the weaker USD, expectation of a Fed pivot and higher demand, particularly for gold.

In this topsy-turvy environment, the USD weakened, particularly against the EUR. This was also the case against GBP until mid-month when the release of the UK GDP figures saw sentiment fall, and by the end of the month, USD/GBP closed virtually unchanged.

Crypto continued to suffer from the after-effects of FTX. Confidence is undoubtedly lacking in this space with few prepared to carry the risk. Bitcoin broke below \$17,000 to close the month at \$16,547, down -2.7% in December and by close was down a staggering -65% for the year.

...December was less dramatic than many other months, although investors may well disagree. There were signs that inflation had peaked, yet markets were still on edge...

Creating a memorable brand is essential in asset management. It is the same across traditional and alternatives. A strong brand invokes trust and develops knowledge, helping to raise funds and ride the storms.

Branding

Building and strengthening a firm's identity to tell a clearer story.



Marketing

Developing and updating collateral to enhance a firm's offering.



Writing

Editing and/or writing materials, commentaries, thought pieces.



Design

Designing PPTs, documents, infographics, adverts.



Website

Scoping, design, development and SEO for websites.



Comms

Reactive and proactive, external and internal communications.



For further information contact the team at TheHedge@brodiecg.com

VIEWS

2022 YEAR IN REVIEW

✪ JACK INGLIS, CEO AIMA ✪

2022 was demonstrably a good year for alternative investments when average performance is set against the backdrop of double-digit downturns across equities and bond markets. Notwithstanding a wider-than-usual disparity in performance among hedge fund strategies, the overall industry once again underscored its utility as a protector of wealth and provider of uncorrelated returns for investors during a year when leading equities indices recorded declines of around 20%. In sharp contrast, hedge fund indices posted small gains on the year while the top decile of funds were up more than 40%¹, including CTA/managed futures and global macro funds that performed admirably for much of the year.

The drivers of volatility last year are well documented: war in Ukraine, upended energy markets, spiralling inflation, spiking interest rates, global economic slowdown, political upheaval, and severe shocks to digital assets markets. Many, if not all, of these trends, are expected to remain prominent for the year ahead, if not longer.

Moreover, for the alternative investment industry, 2022 presented a bevy of additional challenges. Chief among these factors is undoubtedly the storm of new regulatory proposals from the SEC that could negatively impact the businesses of fund managers, including those outside of the US, and overall market stability. The SEC is proposing major changes to the Private Funds Advisor rule, Form PF and Short Selling reporting frameworks, among many others, all of which AIMA is addressing through proactive dialogue with regulators and senior policymakers to ensure our members' concerns are heard.

Elsewhere, regulations in the UK and the EU also required intense scrutiny to ensure they were fit for purpose. During the past year, AIMA contributed to achieving positive results around the finalisation of the ELTIF rules. Similarly, we expect that the final reforms to AIFMD will be positive for our members and the wider industry.

Going into 2023, the EU still leads in the introduction of new ESG rules, although widespread uncertainty over how best to apply certain aspects of responsible investing, alongside a fear of being accused of greenwashing, is hampering more rapid adoption of these principles in other markets.

In APAC, Singapore continued to thrive and capture an increased market share of the region's financial sector, including alternative investment funds, while Hong Kong grappled with balancing lingering COVID restrictions and

the need to open for international business. Following intervention by industry representatives – including the publication of AIMA's "Alternatives in Hong Kong" paper – and fruitful discussions with regulators and policymakers I'm now confident the city will flourish again in the coming year if it stays on its current trajectory.

Elsewhere, AIMA's research indicates that private credit fund managers expanded

their lending activity in 2022. Private credit funds responding to a survey by AIMA's Alternative Credit Council reported a 20% increase in their lending volumes in 2021, with further growth in 2022. The sector retains a positive outlook towards deployment opportunities in 2023.

Despite the ongoing macroeconomic headwinds, there are some breaks in the clouds forecast. Much of the proposed regulatory changes in the US will be finalised this year and, for good or ill, that will bring clarity to the global industry. Inflation is also expected to peak this year which will also provide some relief for those investment strategies most impacted in 2022. In the meantime, those strategies that thrived during the recent volatility may well continue to do so. Overall, the year ahead will no doubt be demanding but there are many reasons for cautious optimism too and I am confident our industry has the skill set to prove its mettle once again in navigating difficult times successfully.

“Much of the proposed regulatory changes in the US will be finalised this year and, for good or ill, that will bring clarity to the global industry.”

Jack Inglis, AIMA



Jack Inglis, AIMA

¹ Industry data as of November 2022.



The Long-Short Podcast

Your window to the alternative investment universe

Latest guests include:



Sebastian Mallaby
Paul A. Volcker Senior Fellow in International Economics, Council on Foreign Relations
Author of *The Power Law* and *More Money than God*



Nadia Humphreys
Co-Rapporteur Platform for Sustainable Finance
European Commission



Dan McCrum
Investigative reporter at the Financial Times
Author of *Money Men*



Bill Kelly,
President and CEO of CAIA Association



For more information visit aima.org/media/the-long-short.html

VIEWS (cont.)

THE RISE OF FAMILY OFFICE INVESTMENT FUNDS – AN EMERGING TREND

✪ SEEMA CHANDARIA AND DAVID W. SELDEN, PRICEWATERHOUSECOOPERS UK ✪

The number of family offices across the globe has risen steadily over the past decade, and family offices are playing an increasingly important role in the private markets. In Europe alone, both the volume and value of family office deals – whether as the target location or origin of a transaction elsewhere – are running at record levels.

A less conspicuous trend that has been gaining pace among private clients and family offices for several years and that really took off in 2022 is the establishment of family office investment funds. While these vehicles are established for a variety of purposes and with a variety of structures, the common theme has been the utilisation of structures more common to the investment funds space in lieu of (or in addition to) more traditional estate planning and wealth management vehicles.

DRIVERS AND BENEFITS

The emergence of this trend is driven by a number of factors. Fund-like structures are inherently flexible and may be used (among other reasons) in order to:



Seema Chandaria, PwC

- pool a dispersed array of investments into a single, actively managed structure;
- provide a means of allowing multiple family members and estate planning vehicles to participate;
- concentrate investment capital into a vehicle that can make investments with larger impact (ESG or otherwise);
- allow family members to elect which investments or asset classes they would like to participate in;
- enable participants to invest confidentially, protecting their identity and minimising reputational risk;
- centralise decision making and administration, which may in turn yield cost savings and consistent application of best practices;
- create a consistent and “market” approach to incentivising investment professionals;
- establish an avenue for managing third party capital.



“Each family brings to the design process its own purpose, pre-existing investment structures, tax considerations, estate planning vehicles, jurisdictional footprint and vision for the future.”

VIEWS (cont.)

COMMON ISSUES

Just as no two families are the same, the ideal fund structure will vary from family office to family office. Each family brings to the design process its own purpose, pre-existing investment structures, tax considerations, estate planning vehicles, jurisdictional footprint and vision for the future. Having said that, there are some questions that will typically require consideration with the appropriate advisers:

- Which jurisdiction should the fund vehicle be established in, and from which jurisdiction will it be managed?
- What is the investment profile of the fund? For example, is the family targeting liquid or illiquid assets, or both?
- What structures will work best from a tax perspective?
- Will the fund or its manager require regulatory authorisations?
- How will investment professionals be compensated and incentivised?
- What service providers will be required?
- What sort of governance and reporting structure is appropriate?
- What commercial terms are appropriate? For

example, what rights will participants have to withdraw capital?

- How will the family's values be expressed through the vehicle (e.g., through social impact investing or sustainability considerations)?

CONCLUSION

Undoubtedly, many of the key trends in 2022, including strategic asset allocation, growth in sustainable investment/ESG and investment into tech/digital assets as well as succession planning and managing reputational risk, will continue to influence how family offices think, invest, and operate. Private clients and family offices remain agile, exploring new avenues to manage and grow their wealth – investment fund structures have proven to be an important addition to the family office tool kit and we expect this emerging trend to continue into 2023 and beyond.



David Selden, PwC

David Selden joined PwC UK in 2020 from US law firm Fried Frank and Seema Chandaria joined in 2021 from international law firm, Osborne Clarke.

Together, they bring together the experience and credentials to support the firm in delivering a new integrated tax, legal and regulatory service to global fund clients as part of PwC's market leading Financial Services Tax team.

“Private clients and family offices remain agile, exploring new avenues to manage and grow their wealth - investment funds have proven to be an important addition to the family office tool kit...”

TRENDS WHICH GOVERNED THE FAMILY OFFICE SPACE IN 2022

CHARLIE HARRIS, LUTYENS ADVISORY

Unusual and disruptive macroeconomic events dominated the financial headlines of 2022. However, whilst attention was so often fixated on the behaviour of governments and central banks, it is worth addressing how a year of political and economic uncertainty was met by investors and, more specifically, those working in the family office space. Irregular market conditions elicited the acceleration of multiple emerging trends within the space, granting a glimpse into what its future may hold.

Amongst these trends included the growing pressure for institutionalisation. Long gone are the days when employees were assembled from a pool of distant relations and friends. A new wave of first-generation Principals are now demanding offices which reflect the rigorous business practises from which they built their wealth.

With this comes a new approach to recruitment, with the investment in executive search firms now seen as a necessary expenditure to ensure an inflow of high-quality human capital. This has resulted in a widening of the available candidate pools alongside a concurrent increase

in employee compensation expectations, as those moving out of institutional investment managers bring their skills and experience at a premium.

However Joel Press, as quoted by James Williams in a recent FamCap article, notes that this is no bad thing. If Principals want their wealth managed securely then they need to approach their family office as though it were a "commercial firm". This includes treating, and remunerating, employees in a way which reflects what they bring to the organisation. Doing so ensures a Principal builds not only a technically proficient team, but also a culture which reflects the aims of the Principal themselves.

REASSESSING LOCATION

Institutionalising the family office has also required a reassessment of its location.

Whilst competitive tax rates mean that Singapore and Monaco have remained popular there has been a noticeable increase in UHNWI relocations to other destinations. The Henley Global Citizens Report



Charlie Harris, Lutyens Advisory



VIEWS (cont.)



...the personal nature of family offices means Principals must be aware not only of the financial risk of greenwashing associations but also its potential for reputational damage.

Charlie Harris, Lutyens Advisory

2022 recorded a record number of investment migration applications in a single quarter, with this only offering a proportional reflection of the HNWI movement which occurred during the year.

Noticeably the UK has seen a sharp increase in American interest. The sterling's relative weakness has offset the UK's historically unattractive tax rates, with a large number of tech entrepreneurs looking to relocate out of Silicon Valley. Moreover, the UK's internationally 'safe' reputation means Principals, considering familial welfare alongside their commercial interests, have begun to realise, and act upon, London's offerings in both areas.

ESG

Finally, any article reflecting on the past year would be incomplete without a brief mention of ESG; no longer a future concern, the acronym has become a dominant force in guiding future business planning. The family office's attention to wealth preservation means that incorporating Article 8 into investments is now viewed as vital in 'fireproofing' any organisation. Moreover, in light of concerns about generational transition, Principals are increasingly conscious that their investment practises

embody the interests of those who will inherit their wealth.

This necessitates going beyond a tokenistic acknowledgement of ESG; the personal nature of family offices means Principals must be aware not only of the financial risk of greenwashing associations but also its potential for reputational damage. Recent research by KPMG showed that one in five corporate risk incidents linked to ESG were the result of greenwashing. As such, whilst the past year showed sustainability-focused investments hold great promise for family offices, it is an area which must continue to be approached with care and due diligence.

THE FUTURE

Looking ahead to 2023, the family office space remains an exciting one to observe. The trends of the past year have shown its structures to be more malleable than its traditional connotations imply, promising another 12 months of challenges and changes to how the space operates and is perceived.

— VIEWS (cont.) —

BACK TO THE FUTURE... FOR CRYPTO

✎ VINCENT MOLINO , HEAD OF OPERATIONAL DUE DILIGENCE, BITWISE ASSET MANAGEMENT ✎

For those who remember the popular film Back to the Future (1985, Universal Pictures), the central character, Marty McFly, accidentally travels back in time to the 1950s, and in doing so alters his family's future by changing the past. Marty, aided by his friend and time machine inventor Dr. Emmett Brown, must fix what had been disturbed in the past in order to restore the future world from where he came. However, after Marty fixes what he believes to be the right order of the past, what results upon returning to his time (spoiler alert!) is a different and better future for him and his family, due to Marty's leaving a bestselling sci-fi book idea with his younger father, which his father successfully authors in the new future.

As we look back on 2022, many may be wishing for crypto to have a Back to the Future moment, as there are a number of operational failures that the industry would hope for a chance to correct. Fortunately, while time travel is still the stuff of fiction, an opportunity exists to create a better crypto future in 2023 and beyond.

Counterparty selection and risk management is likely the most significant issue which many would hope to go back in

time to fix. Specifically, the failures of centralized exchanges and other crypto intermediaries have caused industry participants to question the safety of centralization, which in turn has led many down the path to directly transacting or self-custodying crypto assets.

Yet in this case the rearview mirror may be a poor guide to the future. As we look forward, there are several ongoing factors which favor staying the course with centralized third parties. First, an increasing number of crypto brokers and custodians are voluntarily submitting to regulation, and in doing so are subjecting their operations to regulatory oversight and reporting. Second, many of the same counterparties are also voluntarily, or as mandated by regulation, producing company financial statements and initiating independent audits, which should always be available for clients to review.

Third, as the crypto counterparty space evolves, an increasing number of these businesses are purpose-built for their respective functions, be it as a trading counterparty or as a custodian, and as such can provide product controls

“As we look back on 2022, many may be wishing for crypto to have a Back to the Future moment, as there are a number of operational failures that the industry would hope for a chance to correct.”

Vincent Molino, Bitwise Asset Management



VIEWS (cont.)

and services that address the specific needs of their clients. Examples of such controls are multi-party transaction authorizations, hardware security features, and in some instances physical security services.

Legal structures and agreements were another source of pain in 2022. Many crypto industry participants have learned the hard way that properly documenting bilateral terms and related recourse, giving careful consideration to contracts, and ensuring legal rights are recorded and understood must no longer be ignored in the name of getting business done. Future best practices for legal agreement processes should include seeking tri-party agreements, which can for example separate the risks of facing an exchange and an affiliated custodian. Another best practice, specific to investing in legal entities such as venture capital or hedge funds, is negotiating a side letter that can afford an investor specific desirable provisions like increased transparency; notification of organizational, legal, or regulatory events; and receiving reasonable financial documentation.

A glaringly obvious 2022 issue, which encapsulates both of the above subjects, is the poor or severely lacking due diligence, which surprisingly has caught up many, including institutional investors. As has been publicly reported, and often relayed to investors in an apologetic manner, many industry leaders have admitted to doing little to no research on businesses which had been entrusted with client assets. Here, the simple solution to ensuring a better and risk-reduced crypto industry is conducting a thorough amount of due diligence, which should include the practices of understanding the organization one is scrutinizing, the people running the business, the operational processes and controls in place to reduce business risks, and the tools at your disposal to effectuate such due diligence, inclusive of requesting and analyzing documentation (audits, financial documentation, policies, etc.), conducting interviews, and assessing the risks that are identified.

As the above remedies make clear, the reality is that much of what caused the volatility in the crypto industry throughout 2022 is not issues related to the fundamental capabilities of crypto, blockchains, and related technologies, but rather an unfortunate choice of lax standards. This raises important questions: Does crypto have something

better to offer? Is the industry able to turn a corner and put many of these traditional business issues behind it? In addition, what should be considered for crypto operations in 2023 and beyond?

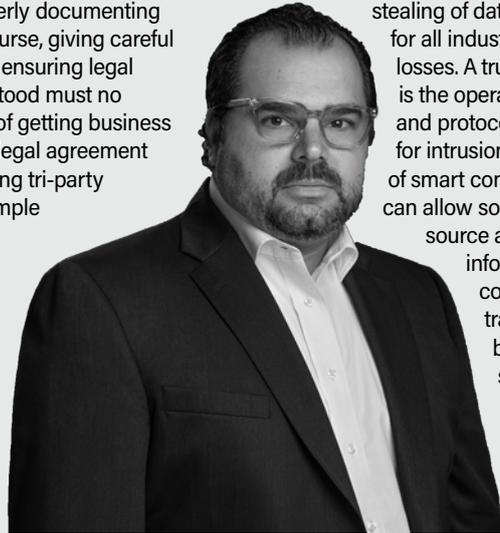
One problem that will persist in the near future and beyond is cyber attacks. Attacks, breaches, and the subsequent stealing of data or assets remain a large problem for all industries, resulting in billions of dollars of losses. A truly crypto solution to such cyber risks is the operational capabilities of DeFi technology and protocols. DeFi removes much of the ability for intrusion to occur through the implementation of smart contracts. While traditional technology can allow someone to breach a central data source and be able to track or transmit information while undetectable, smart contracts can access data feeds, APIs, transactions, and accounts without blindly trusting a single, centralized source.

DeFi, by its very definition, is built to provide access to financial services for participants outside of the centralized crypto venues and products mentioned above. Yet this begs the question: How are participants going to access DeFi?

Ironically, the most likely way access to DeFi will be provided in the future is through some of the centralized players that exist today. In addition to crypto wallet providers and crypto exchanges, traditional market participants such as banks and brokers will likely be a common path for many individuals and most institutions to

access DeFi. The simple reason is that these players have the resources (and potential motivation) to develop their own DeFi infrastructure and applications, in addition to existing services and policies such as client onboarding, AML checks, and other safeguards desired by most market participants.

Just as Marty McFly had to deal with the tribulations of his family's past in order to secure his future, crypto is having its moment of needing to fix years of missed operational readiness and insufficient risk management. Although there is no time machine to avoid the failures and volatility of 2022, there is nevertheless an opportunity to mature, create longevity, and ensure a better future for the crypto industry, its participants, and investors.



Future best practices for legal agreement processes should include seeking tri-party agreements, which can for example separate the risks of facing an exchange and an affiliated custodian.

Vincent Molino, Bitwise Asset Management

UK COMPLIANCE REVIEW OF THE YEAR

✪ MATT RAVER, RQC GROUP ✪

When the economy wobbles, it would appear that there are two somewhat distinct politically-driven regulatory responses.

The first was seen in the aftermath of the 2008 financial crisis which saw a dramatic increase in regulatory requirements.

Arguably and in retrospect, not all of this was required. For instance:

- AIFMD was in part borne out of an aspiration to obtain greater transparency on highly leveraged portfolios, or portfolios containing certain asset classes such as securitised assets. However, AIFMD applies to all non-retail funds regardless of investment strategy and other characteristics.
- For many firms, in particular, those in the non-retail sector, the product governance regime (eventually) introduced as part of MiFID II in 2018 is a papering exercise that doesn't add any tangible incremental regulatory protection to investors.

The second is where there is a political imperative to

adjust the regulatory environment to afford a country a more competitive edge. After several decades of adopting regulation in tandem with the rest of the EU, the UK is now able to follow a different path. 2021 – the first year following the end of the Brexit transitional period – was something of a 'phoney war' – there was not much activity in terms of financial services reform and the regulatory framework that had been adopted from the EU looked broadly the same. 'Evolution, not revolution' was an oft-used phrase. However, 2022 has re-set the dial on such matters, an initiative effectively put in motion by the UK's first Chancellor of the Exchequer (now, Prime Minister) of 2022 with the year's fourth Chancellor applying the coup de grace.

The Financial Services and Markets Bill was introduced to Parliament in July. The Bill, which is expected to become law in 2023, aims to tailor financial services regulation to UK markets to bolster the competitiveness of the UK as a global financial centre. Politically it was announced that hundreds of pieces of retained EU law will be repealed. A closer examination reveals that this does not include onshored EU primary legislation such as MIFID, MiFID II and UCITS.



Matt Raver, RQC Group



“What might be more relevant is affording financial services certain powers so that the UK can act more nimbly to implement regulatory change.”

Matt Raver, RQC Group

What might be more relevant is affording financial services certain powers so that the UK can act more nimbly to implement regulatory change. Over time, this might accelerate the divergence from the EU rulebook and in a way that directly affects investment firms and asset managers.

Then in early December, Chancellor Hunt announced the 'Edinburgh Reforms' – a 'bold collection of reforms' to propel the government's ambition in creating a financial services sector that is open, sustainable, technologically advances, and globally competitive. Revising the ring-

regulatory hot topics to the agenda. The invasion pushed international sanctions regimes to the fore like never before, and there was also associated regulatory commentary on the impact of the invasion on anti-money laundering and market abuse.

Most investment firms and asset managers became subject to a new prudential regime – the Investment Firms Prudential Regime ('IFPR'). This includes putting in place a new 'harms assessment' document, the ICARA, and has also prompted a further regulatory interest in the resilience of firms during periods of stress or a wind-down



fencing requirements for banks that were put in place post-2008 financial crisis is one of the more high-profile aspects of these reforms. However, there are other aspects affecting investment firms and asset managers covering topics such as the senior managers and certification regime, short selling, securitisation, crypto, research, sustainable finance and the UK fund regime.

The reforms are in fact a series of initiatives that will be implemented over time, and we are very much at the start of the process. Whilst there will be no 'big bang' it appears to be the case that the pace of regulatory evolution will increase in the coming years.

Away from holistic regulatory change, there were a number of regulatory themes that were brought to the fore within 2022 or were carried forward from previous years.

At the start of 2022, the most meaningful impacts of Covid were in the past. However, regulatory hot topics from the pandemic remained in situ. In particular, the operational and financial resilience of firms, including business continuity and cyber security.

The invasion of Ukraine added some hitherto unplanned

of business operations.

As the year progressed, the FCA promoted a more 'hard-line' stance on matters such as regulatory permissions and the FCA application process. Regarding the former, the FCA announced that it would 'act faster' against firms that fail to meet its Threshold Conditions. This would lead to an increase in the number of cancellations and withdrawals over the next three years. The FCA can amend or cancel a regulated firm's permissions, for example if a permission is not being utilised.

As summer arrived, there were some important developments on a key regulatory initiative – consumer protection. This included the publishing of the final rules on the Consumer Duty – which takes effect in July 2023 – and an initiative to further monitor so-called 'high-risk investments'.

Whilst these have a retail slant, they are of potential relevance to firms in the 'alternatives' sector, a point made by the FCA in their 'Dear CEO letter' to such firms. Other main risks of harm articulated in the letter included the importance of conflicts of interest, risk controls including

REGULATION (cont.)

Presented by  RQC GROUP

market abuse risk controls, conduct and culture (including the influence of senior managers, diversity and inclusion and staff remuneration) and ESG.

In October, the FCA took a significant step forward with its ESG regulatory requirements for the investment sector with proposed new requirements related to sustainability disclosures and investment labels. A new anti-greenwashing requirement is also proposed. These requirements are in addition to already introduced climate change disclosure requirements affecting various industry participants. Firms operating internationally are increasingly finding challenges in adopting multiple regulatory standards concerning ESG.

In early December the regulatory requirements on Appointed Representatives were updated, with additional operational and disclosure requirements imposed on Principal firms. Whilst – again – this has a consumer focus, it also affects the non-consumer investment firm sector, where a number of Principal firms are in operation.

Crypto continues to set challenges for regulators including the FCA. In the UK, crypto assets such as Bitcoin are regulated for money laundering purposes only, and they are not considered to be financial instrument types which means, for example, providing investment advice on crypto assets is not a 'regulated activity'. The Financial

Services and Markets Bill would give additional authority and powers over crypto assets to the FCA and the Bank of England. November's collapse of FTX Trading further spooked the authorities. So do not be surprised to see significant regulatory shifts in this sector in 2023.

There was a marked increase in the number of publicly announced FCA enforcement actions as the year drew to a close. These served as a reminder that the FCA will sanction firms for systems and controls failings, even if there is no demonstrable harm as a result of this, and individuals – in particular senior managers – can also be sanctioned for their role in such failings.

Finally, for individuals such as senior managers or certification function holders, [attacking a nightclub bouncer with a machete is not a wise move](#). As the FCA noted, they 'will continue to uphold high standards of character and conduct for those working in financial services.'

Matt Raver has been a Managing Director of the RQC group since 2013, where he supervises the teams dealing with technical regulation, regulatory change, regulatory submissions, and technology. He started at Morgan Grenfell and Nomura.

Capricorn Fund Managers and RQC Group are proud members of 

Click [here](#) to subscribe to The Hedge; or if you have a question about the publication or suggestion for a guest article send an email to the editorial team at thehedge@brodiecg.com

This document has been produced by Brodie Consulting Group in conjunction with RQC Group and Capricorn Fund Managers.



Brodie Consulting Group is an international marketing and communications consultancy, focused largely on the financial services sector. Launched in 2019 by Alastair Crabbe, the former head of marketing and communications at Permal, the Brodie team has extensive experience advising funds on all aspects of their brand, marketing and communications.

Alastair Crabbe
Director
Brodie Consulting Group
[+44 \(0\) 778 526 8282](tel:+44207785268282)
acrabbe@brodiecg.com
www.brodiecg.com



Capricorn Fund Managers Limited is an investment management and regulatory hosting business that provides regulatory infrastructure and institutional quality operational, compliance and risk oversight. CFM is part of the Capricorn Group, an international family office, which has been involved in alternative assets since 1995.

Jonty Campion
Director
Capricorn Fund Managers
[+44 \(0\) 207 958 9127](tel:+442079589127)
jcampion@capricornfundmanagers.com
www.capricornfundmanagers.com



Founded in London in 2007 and with a dedicated office in New York, **RQC Group** is an industry-leading cross-border compliance consultancy specializing in FCA, SEC and CFTC/NFA Compliance and Regulatory Hosting services, servicing clients with AUM in excess of \$295 billion.

United Kingdom:
[+44 \(0\) 207 958 9127](tel:+442079589127)
contact-uk@rqcgroup.com
United States:
[+1 \(646\) 751 8726](tel:+16467518726)
contact-us@rqcgroup.com
www.rqcgroup.com

A Brodie Consulting publication in conjunction with Capricorn Fund Managers and RQC Group.
Click [here](#) to subscribe to all future copies.

