Hedge Fund Performance Feb 2009

February was another difficult month for hedge funds. If anyone thought 2009 would be an easier year for hedge funds, think again. Hedge funds lost 0.51% in February, compounding January's 0.09% loss for a year to date loss of 0.60%, according to the HFRI Index. Fund of funds managed a smaller loss of 0.31% which together with January's gain of 0.67% resulted in a +0.36% return for the year.

Broad indices, however, hide interesting detail.

Equity hedge funds lost 1.38% in February for a YTD loss of 2.22%, market neutral funds lost 0.77% for a YTD loss of 0.60%, EM Asia lost 1.46% for a YTD loss of 2.89%, this compared with the MSCI World which lost 8.6% in January and 10.17% in February.

Fixed income arbitrage, however, continued January's profits with a **1.35% return in February** for a YTD return of 3.60%. Dislocations in sovereign fixed income markets has opened up some interesting opportunities for that strategy.

Merger arbitrage has continued to outperform. The strategy lost 5% last year, the second best performing strategy behind global macro in 2008. This year, it has made 0.31% in January and 0.63% in February for a YTD gain of 0.94%. Consolidation in distress, high dispersion of valuations, Emerging Market strategic acquirers, all continue to make the strategy highly interesting, even with the LBO market in stasis.

Global macro lost 0.08% in January, then made 0.05% in February for a YTD return of -0.03%. Global macro is dominated by a few outstanding managers, and a whole lot of mediocre ones generating fairly random results.

Event driven and Distressed strategies made moderate returns in January (+0.36% and +1.00% respectively,) followed by **moderate losses in February -0.92% and -0.87% respectively**, for YTD returns of -0.56% and +0.12% respectively. While investors have as expected begun to look at distressed debt, default rates in corporate credit have yet to accelerate. Managers wandering into high yield have been fully exposed to spread volatility.

Convertible arbitrage has been the best performer this year, **+4.87% in January and +3.26% in February** for a YTD of 8.39%. Convertibles of course performed particularly horribly in 2008 (down 33.65% for the year) and there has been a relief rally in the asset class. In addition to this, valuation issues contributed to an exaggerated drawdown in 2008 where wide bid offers led to exaggerated cheapness in 2008, from which the market is now rebounding. Nevertheless, convertibles remain extremely cheap and the strategy may see further tailwinds.

While there are no benchmarks for **capital structure and credit strategies** the same dynamic is driving performance this year. These strategies were highly distressed last year from market dislocation as well as from poor liquidity driving valuations artificially low. These strategies are repricing and are recovering to a great extent from a return to normal liquidity and bid offers.

Hedge funds are still dealing with, **1)** a difficult market environment of high volatility and falling equity markets, **2)** continued selling pressure from deleveraging hedge fund peers and bank prop desks, **3)** redemptions by investors trying to cash out, **4)** possible industry intervention by regulators seeking to regulate hedge funds, possible market intervention by regulators in bailing out areas of the economy. As the nature, if not the extent, of the volatility begins to return to normalcy, hedge funds will find it easier to cope with the falling markets. As long as the volatility is irregular and very high in the short term, hedge funds will continue to struggle. Intra day volatility explained by fear and deleveraging rather than by rational pricing continues to plague the markets, albeit in much calmer fashion than was seen in 4Q 2008. Regulation remains a high risk. Arbitrary, unilateral intervention in markets will continue to overhang hedge fund strategies.