PARTNERS CAPITAL

Insights 2023

Asset Class Investment Strategies

Absolute Return

Major Trends

Higher Policy Rates Increase Total Return Potential: Hedge funds across absolute return strategies have historically demonstrated resilience to rising rates, as increased leverage costs are offset by a corresponding increase in short rebates. Higher base interest rates are therefore expected to increase total returns by the amount of the base rate increase. Absolute return strategies target a cash plus spread return profile and empirical analysis supports the notion that gross alpha over the cash rate does not diminish as rates rise.

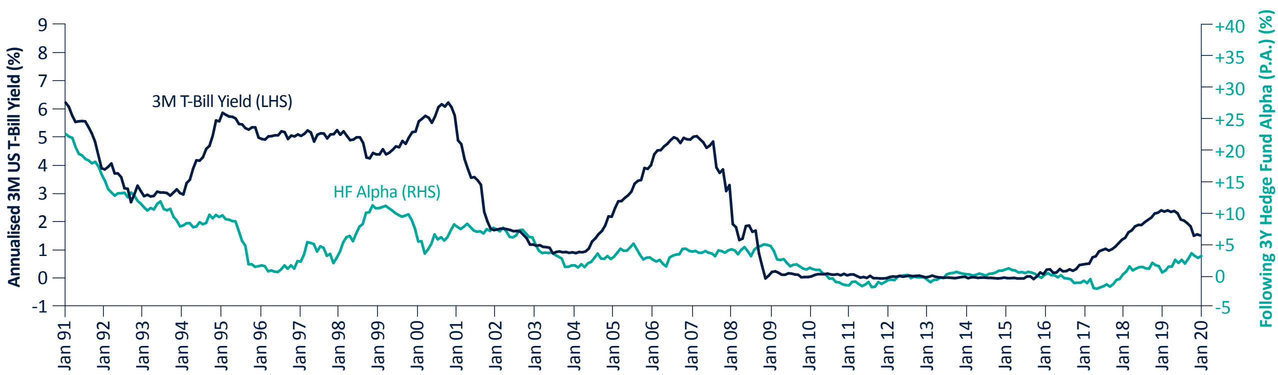
Market Volatility Likely to Persist: We expect the elevated levels of market volatility that pervaded 2022 to persist in the new year due to an overhang of global policy uncertainty (fiscal and monetary), ongoing geopolitical conflicts and deteriorating corporate fundamentals. Elevated market volatility can increase the risk of a financial crisis, which can stress bank balance sheets and reduce leverage availability for hedge funds. However, elevated market volatility may also improve unlevered alpha potential, as it can lead to greater dislocations and mispricings that can be monetised by skillful managers. Allocating across a diversified array of risk-controlled managers and strategies is key to maximising opportunity and mitigating risk.

Golden Rules

- Diversification across strategy, manager, geography and asset class is essential to deliver sustainable risk-adjusted absolute returns across market environments.
- Managers who have a proven track record of alpha generation from a discernible and sustainable edge should be core partnerships in the portfolio.
- Emerging managers led by experienced portfolio managers can improve portfolio risk/return characteristics via mandate customisation, enhanced transparency and control, fee discounts and a focus on more capacity-constrained opportunities.
- Investment strategies focused on niche, inefficient markets often provide the greatest potential for generating attractive, uncorrelated returns.
- Accessing strategies through capital-efficient structures can significantly enhance the risk-return characteristics of the portfolio.

Exhibit 1

Rising rates have correlated with higher alpha, but we have limited rate regimes to analyse



Source: *Bloomberg, HFRI*

Notes: *Hedge fund returns proxied by the HFRI Fund-Weighted Composite Index. Alpha calculated on a beta-adjusted basis vs. Global Equities, as measured by the MSCI All Country World Index Net Return with Developed Market FX Hedged to USD (Local Currency before August 2010). Calculations include a cash component, as measured by the total return of 3-Month US Treasury Bills over the applicable period.*

Sub-Strategy Attractiveness

Fundamental Equity Long/Short: Positive view. Elevated stock volatility and dispersion may create opportunities for well risk-managed strategies (i.e., those seeking to constrain market, industry, and style factor risk in their portfolio construction process).

Fixed Income Relative Value: Positive view. Uncertainty of monetary policy creates symmetrical risk in bond markets, and the volatility of data-driven movements can create trading opportunities. However, we still target modest exposure to this strategy due to the high leverage employed, which can exacerbate drawdown potential.

Statistical Arbitrage: Positive view. High expected dispersion and volatility in equity markets in 2023 should advantage arbitrage strategies. Within the quantitative equity space we tend to favour shorter-horizon strategies that we believe can capitalise most effectively on short-term volatility and mispricings. We target modest exposure given deleveraging risk that can accompany the strategy.

Long-Term Expected Return

Exhibit 3

Based on our 10 year forecasts, we target the following long-term expected returns for Absolute Return

	Absolute Return
Risk-free Rate	3.5%
Risk Premium	0.5%
Illiquidity Premium	—
Manager Alpha	3.0%
Total Return	**7.0%**

Beta return of 4.0% for Absolute Return derived from 0.9x Cash + 0.1x Long Equities exposure, with manager alpha of 3.0% modestly below our realised pooled vehicle results over the past 5 years.

Hypothetical return expectations do not represent actual trading and are based on simulations with forward looking assumptions, which have inherent limitations. No representation is being made that any investor will or is likely to achieve returns similar to those shown. Such forecasts are not a reliable indicator of future performance.

Your capital is at risk and you may not get back the full amount invested.

Absolute Return
continued

Event Driven: Neutral view. While average M&A spreads remain elevated vs. long-term averages, deal volumes are depressed from post-Covid highs. We prefer active over systematic implementation due to an expectation for increased volatility throughout the life cycle of a merger deal, and susceptibility of the overall deal universe to market-driven, mark-to-market drawdowns, presenting trading opportunities for experienced managers. Similarly, while SPACs can readily be acquired at favourable discounts, the universe is shrinking as more SPACs are reaching deal expiration, sharply reducing the likelihood of right-tail outcomes.

Macro: Neutral view. Macro strategies have recently experienced an exceptional run of performance not seen since mid-2004. Three-year excess return over cash for the peer group touched +13% p.a. in September of 2022.[1] While conditions that enabled the recent rally, such as trending markets and global central bank policy, may persist in 2023, it is also possible that trends face sharp reversals and create a more challenging landscape to navigate. A sustainable edge is hard to maintain in liquid futures markets, and we do not expect the exceptional recent performance to be maintained over the longer term. We selectively favour managers with diversified approaches over those taking concentrated positions in a small number of themes each year.

Convertible Arbitrage: Neutral view. While volatility in equity markets and high current spreads in more credit-sensitive portions of the convertible bond market offer opportunities for relative value hedge fund strategies, we expect issuance to increase significantly in 2023, putting downward pressure on pricing. In addition, given that most of the secondary market is trading well below par after last year's sell-off, leverage availability, and with it, buying power, will be reduced.

1 Macro peer group as measured by the HFRI Macro Index

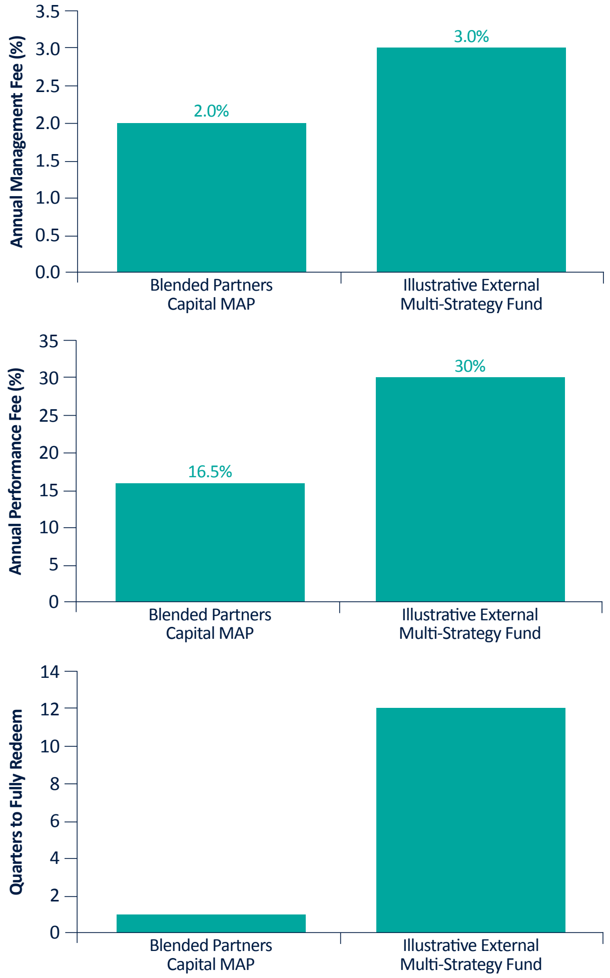
2023 Strategic Priorities

- **Maintain risk-balanced portfolio allocations:** While we form tactical views on each strategy based on our perception of the opportunity set, these views do not dominate our portfolio construction decisions. Rather, after evaluating each strategy based on its opportunity set and other characteristics – such as long-term risk-adjusted return potential, left-tail risk and liquidity – our sizing decisions aim to maintain balanced contributions to risk at the manager and strategy level. Our current portfolios tilt modestly towards market neutral equity strategies (both systematic and fundamental approaches), though we also allocate in meaningful size to five or more other strategy categories, such as macro and arbitrage, which remain important diversifiers of risk and opportunity.
- **Continue to scale our internal managed account platform ("MAP"):** Multi-strategy platform hedge funds have outperformed in recent years due to their tight risk controls, high diversification, and ability to monetise superior cash efficiency. However, as these platforms have enjoyed success, capacity has become scarce and terms have worsened. In this context we believe our internal MAP program, which accesses the same structural advantages enjoyed by external multi-strategy managers, is a critical building component of our absolute return allocation. We added eight sub-strategies to our MAP program in 2022 and aim to opportunistically add more sub-strategies in 2023.
- **Explore burgeoning strategies and asset classes:** We constantly seek to add new, uncorrelated sources of alpha to the portfolio. Areas we plan to explore in 2023 include the electricity market and alternative trend strategies.

Benefits of Internal MAP Program

Exhibit 3

We can drive terms more effectively in our MAP program vs. established external multi-strategy funds



Source: Partners Capital analysis

Notes: Figures for illustrative multi-strategy funds based on Partners Capital estimates and analysis of a representative pool of multi-portfolio manager “platform” funds with > $10B of assets under management. Such funds typically pass-through fees/expenses to LPs (e.g., salaries, overhead and portfolio manager variable compensation) in lieu of a management fee, before charging an incentive fee at the fund-level. Partners Capital has developed a model that aims to translate this variable fee structure into a “fixed” management/performance fee construct, to allow for comparisons vs. non-platform managers that generally use this "fixed" construct. Partners Capital believes that this translation results in “effective” fees of at least 3% management / 30% performance fees for platform funds, though analysis of available information suggests that the true expense layer has historically been higher. Partners Capital therefore believes the 3%/30% figures presented herein are conservative.

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