Absolute Return

Major Trends

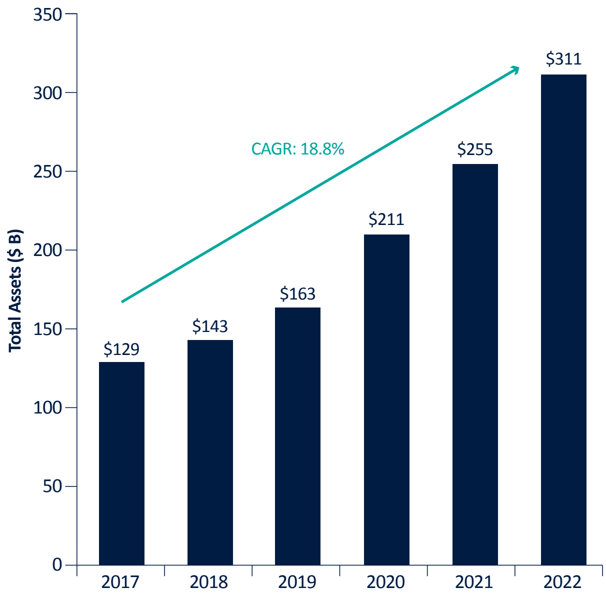
Expect higher cash rates to flow through to hedge funds, maintaining alpha via increased total return: Absolute return managers have historically benefitted from higher interest rates, via 1) higher income on unencumbered cash balances and 2) increased rebate on short positions offsetting higher leverage costs on long positions. While some of this benefit may be partially offset by non-hurdle performance fee structures (detracting 0-100bps from annual returns), we believe this is mitigated by our manager fee hurdles (currently on over one-third of our lineup) and the increased total return potential from higher volatility. We remain confident that Absolute Return managers can continue to provide a "cash-plus" return stream.

Weaker 2023 alpha viewed as cyclical, not structural, outcome: While Absolute Return managers benefitted from cash rates in 2023, the trading alpha in the industry proved challenging. Trading alpha can vary from year-to-year, and various themes and events in 2023, such as the narrow equity market rally, challenging regulatory environment for M&A transactions and regional bank crisis in March, proved to be headwinds to alpha generation.

Multi-PM platform managers dominate the landscape: Platforms have seen significant asset growth following a decade-plus run of strong performance (Exhibit 1). Their growth has led to greater competition for talent, increased crowding and deleveraging risks, and worse terms for investors. Effective fees for some platforms can exceed 3% management / 30% performance[1], and it may take up to three years to fully redeem capital. As an alternative, we believe our own managed account platforms (MAP) can offer the benefits of the platform model (e.g., diversification, cash efficiency, real-time risk control), with the potential for more alignment on terms.

Exhibit 1

Platform assets grew +19% p.a. from 2017-22



Notes: *Data sourced from "The Multiplier Effect" (December 2022), Goldman Sachs Global Markets Division and "Global Hedge Fund Industry Monthly Update" (August 2023), Bank of America Securities. Platforms defined by central capital allocation across at least 10 autonomous portfolio managers*

Source: *Partners Capital Analysis based on data from Goldman Sachs and BAML*

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 investors can improve portfolio risk/return characteristics via mandate customisation, enhanced transparency and control, fee discounts and a focus on more capacity-constrained opportunities.

1 Based on Partners Capital estimates and analysis.

- Investment strategies focused on niche, inefficient markets often provide the greatest potential for generating attractive, uncorrelated returns.
- Accessing strategies through capital-efficient structures can enhance the risk- return characteristics of the portfolio.

Sub-Strategy Attractiveness

- **Statistical Arbitrage:** Positive view. Elevated stock dispersion may provide a tailwind to quantitative strategies. Within this space, we generally favour shorter-horizon, capacity-constrained strategies that we believe can capitalise most effectively on temporary mispricing. Despite these characteristics, we moderate our exposure to the strategy given the potential for deleveraging risk.
- **Event Driven:** Positive view (Merger) / Neutral view (SPAC Arbitrage). M&A spreads remain elevated and volatile vs. long-term averages, driven by increased regulatory risk. We favour managers that we believe can 1) negotiate a challenging regulatory environment and 2) capitalise on opportunities driven by mark-to-market spread volatility throughout a deal lifecycle. Within SPACs, while discounts remain prevalent, the investible universe has meaningfully shrunk from its 2021 peak, as new issuance has ground to a halt and seasoned SPACs continue to expire.
- **Fixed Income Relative Value:** Marginally positive view. High rates and moderate volatility can create trading opportunities for skilled managers. However, we still target modest exposure to this strategy due to the high leverage employed, which can exacerbate drawdowns.

- **Fundamental Equity Long/Short:** Neutral view. While only a handful of mega cap stocks drove 2023 market returns, stock dispersion remains elevated relative to history. We continue to favor risk-managed strategies that constrain market, industry, and style factor exposures, which may mitigate the impact of sharp positioning rotations.
- **Macro:** Neutral view. Following exceptional performance in 2020-22, macro strategies struggled with various market reversals in 2023. In particular, the sharp interest rate rallies around the Silicon Valley Bank collapse (March) and investor expectations of Federal Reserve rate cuts (November/ December) proved challenging. The complex market landscape in 2024 may provide a richer opportunity set. However, geopolitical, economic and policy risks may be difficult to successfully navigate. Within this strategy, we prefer managers with diversified approaches over those taking concentrated positions in a small number of themes each year.
- **Convertible Arbitrage:** Neutral view. Higher rates and upcoming maturity walls have driven a significant increase in issuance, as companies struggle to manage their interest costs. While this issuance increases the investible universe favorably, it may also put downward pressure on pricing. We express our exposure via broad-based managers who are not beholden to the opportunity set in a specific segment of the market.

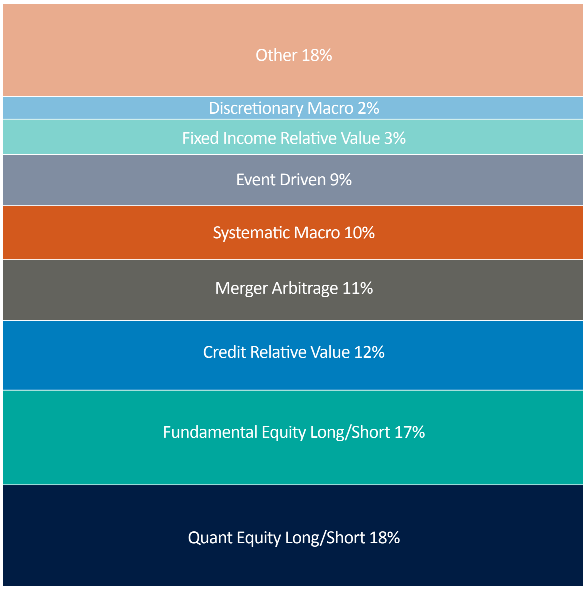
Absolute Return
continued

2024 Strategic Priorities

- **Maintain risk-balanced portfolio allocations:** We recommend diversifying across strategies and managers, with the goal of creating an "all weather" return profile at the portfolio level (Exhibit 2). Our tactical views influence positioning, but they do not dominate portfolio construction decisions. We also consider characteristics such as long-term risk-adjusted return potential, left-tail/stress risk and liquidity. Our current portfolios tilt modestly towards market neutral equity strategies, though we also allocate meaningfully to over five other strategy categories (e.g., macro and arbitrage), which remain important diversifiers of risk and opportunity.
- **Cautiously expand portfolio volatility to increase total returns:** Our Absolute Return strategy has historically generated strong risk-adjusted returns. Based on that foundation, we seek to modestly expand the volatility of the program, while still managing left-tail/stress risk, to enhance total returns and alpha for our clients. Example initiatives include adding more cash-efficient structures to the lineup (e.g., managed accounts) and exploring higher-volatility, niche strategy allocations (e.g., commodity relative value).
- **Leverage the scale of our multi-manager managed account platform (MAP) funds:** Our multi-manager MAP approach employs the same structural advantages of external multi-manager platform funds but with more alignment and better terms to investors. For example, unlike external platforms, our MAP approach 1) only charges performance fees over the cash rate (most platforms do not carry such a "hurdle") and 2) allows investors to fully redeem within one quarter (vs. at least two years for most platforms). After a multi-year buildout, we believe that this program is at sufficient scale to drive even greater benefits going forward (Exhibit 3). Initiatives include adding niche strategies, driving further fee discounts and optimising risk utilisation, all with the goal of increasing potential returns.

Current Allocations

Exhibit 2
Risk in our flagship absolute return vehicle remains well-diversified across over seven strategy groups

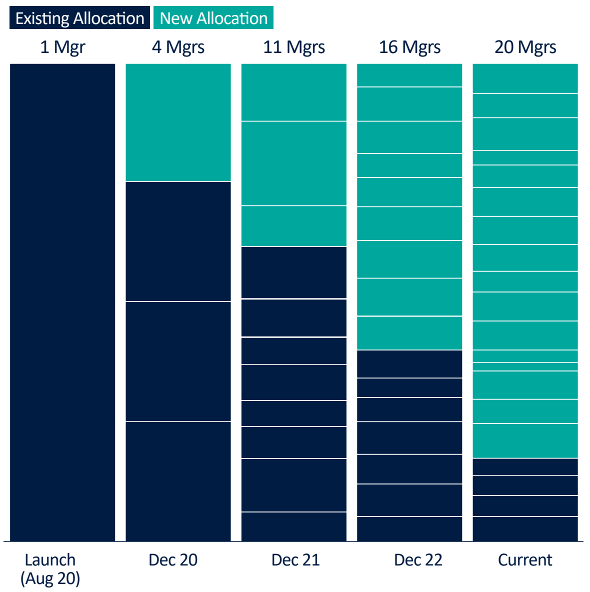


Source: *Partners Capital Analysis*

MAP Program Evolution

Exhibit 3

Our Absolute Return Strategy MAP program has broadened considerably since launch



Notes: *Allocations use 31 December 2023 NAVs, excluding cash and sidepockets, adjusted for subsequent actions. Allocations less than 3% of estimated risk are not shown.Any forward-looking comments are hypothetical. Actual results may vary materially and there is no guarantee that Partners Capital will achieve its objectives within the asset class.*

Strategy look-through allocations shown based on estimated contribution to risk, as proxied by volatility. Underlying estimates are hypothetical based on Partners Capital analysis. Actual risk may differ from these figures. Other strategies include Trend, Volatility, Risk Premia and other strategies not captured elsewhere. "Current" manager lineup as of 31 December 2023.

Source: *Partners Capital Analysis*

Long-Term Expected Return

Exhibit 4

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

	Absolute Return
Risk-free Rate	4.0%
Risk Premium	0.3%
Illiquidity Premium	—
Manager Alpha	3.0%
Total Return	**7.3%**

Beta return of 4.3% for Absolute Return derived from 0.9x Cash + 0.1x Long Equities exposure, with manager alpha of 3.0% modestly below our realised strategies results over the past 5 years.

Hypothetical return expectations are based on simulations with forward looking assumptions, which have inherent limitations. Such forecasts are not a reliable indicator of future performance.