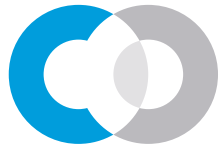


Canterbury Consulting

Quarterly Asset Class Report

Hedge Funds

Canterbury Consulting ("CCI") is an SEC registered Investment Adviser. Information pertaining to CCI's advisory operations, services, and fees is set forth in CCI's current Form ADV Part 2 (Brochure), a copy of which is available upon request and at www.adviserinfo.sec.gov. Information provided through CCI's Quarterly Outlook related to market or asset class performance figures is believed to be derived from reliable sources. However, CCI assumes no responsibility for their content or the manner in which the viewer utilizes such information. The performance information presented in certain charts or tables is for informational purpose only and represents historical performance based on available market data results for the quarterly period shown above and does not reflect any performance related to trading in actual accounts. Any recommendations or statement made in the Quarterly Outlook is not to be construed as specific investment advice. The viewer should be aware of the inherent limitations of data derived from the retroactive application of historical data developed with the benefit of hindsight and that actual results may differ. Actual performance with client accounts would be materially less than the stated performance results for the same period when including the deduction of advisory fees, brokerage or other commissions, and any other expenses that a client would have paid.

canterburyconsulting.com

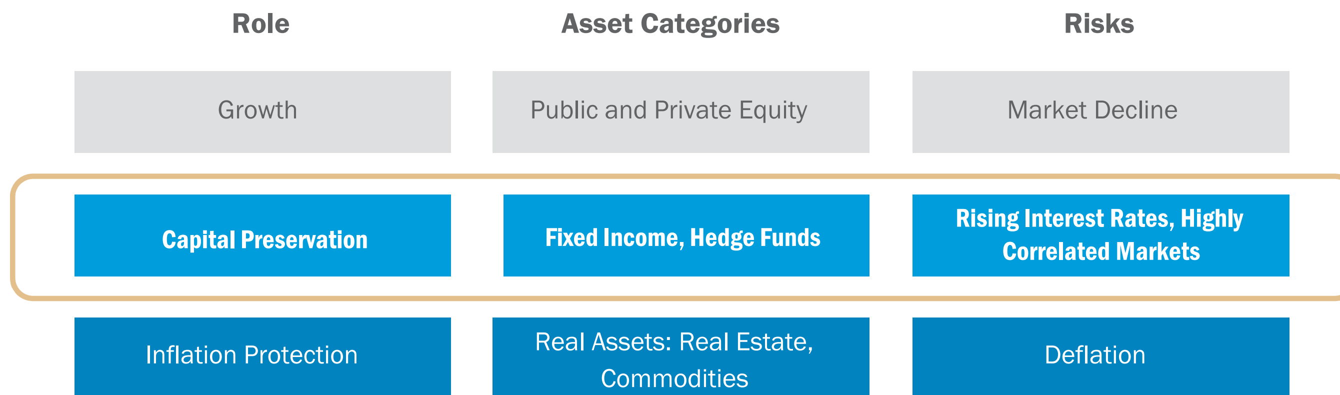
December 31, 2016

Canterbury Consulting recommends and communicates asset-class strategy with the objective of constructing a diversified portfolio of long/short strategies designed to (in aggregate):

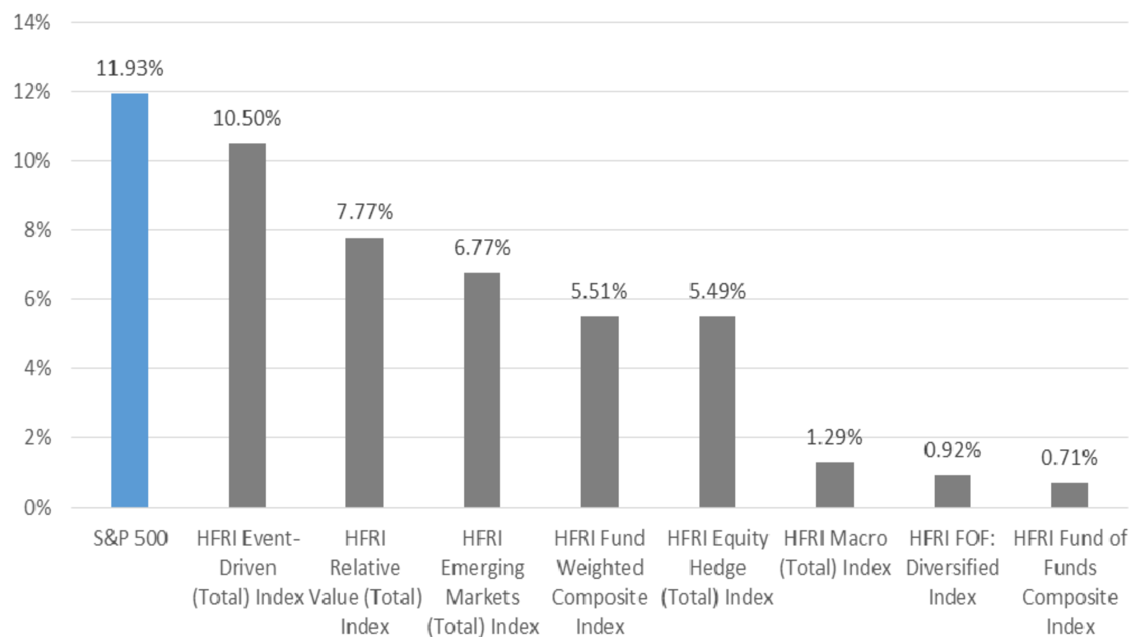
(i) Preserve capital and mitigate volatility

(ii) Maintain exposure to a diversified set of securities in global markets

(iii) Exhibit less-correlated investment returns



- Canterbury Consulting recommends a diversified mix of long/short equity, long/short credit and multi-strategy managers for client portfolios. We seek managers with strategies that rely upon superior security selection and portfolio management, not leverage or quantitative models, to generate performance
- Short term returns from Canterbury hedge funds may act differently than broad market indices, but they should generally protect from losses in negative markets and participate with the gains of positive markets
- Over a full market cycle, Canterbury hedge fund portfolios are expected to produce market-like returns with a significantly lower volatility profile



Source: HFRI

- During the fourth quarter 2016, the S&P 500 Index generated 3.8%, higher than any of the HFRI indices
- Among the major HFRI indices, the HFRI Event-Driven (Total) Index generated the largest return of 3.5%, driven by underlying activist and distressed/credit funds
  - Distressed/credit funds benefitted from idiosyncratic events; notably, many of their underlying investments in distressed energy companies experienced positive catalysts and emerged from bankruptcy
- The HFRI Equity Hedge (Total) Index generated 1.3% during the quarter. Post-election, the market observed sector rotation, mainly from information technology to financials, and factor shifts from growth to value
  - The HFRI EH: Fundamental Value Index generated 3.6%, while the HFRI EH: Fundamental Growth Index generated -0.7%

The U.S. presidential election and large shifts in equity markets

- The U.S. presidential election result was a surprise to most long/short equity managers
- Large factor shifts from growth to value
  - Within the long/short equity space, managers with significant exposure to companies with higher multiples underperformed the S&P 500 Index
  - The general strength in the equity market did not benefit managers with a large short book
- Sector rotation from information technology to financials
  - There was a large momentum reversal and sector rotation; post-election, the market priced in further interest rate rises and the financials sector began to outperform the information technology sector (+21% vs. +1%, respectively)
- Although short exposure generally detracted from performance, managers with value orientation and larger long exposure to financials generated the highest returns

Idiosyncratic events drove returns for credit funds

- Distressed/credit funds generated alpha in underlying investments experiencing positive catalysts and in other cases companies emerging from bankruptcy
  - Although funds invested in distressed energy credit experienced a large drawdown in the first quarter, those who took advantage of volatility and added to their book generated higher returns since the trough
- Credit/multi-strategy funds focused on hard-catalyst names or heavily hedged equities were able to insulate their exposure from broader equity market volatility
- Managers with a strong skillset in identifying mispriced opportunities in the structured credit market, particularly in the CMBS market, generated strong idiosyncratic returns

Canterbury Consulting recommends a diversified mix of long/short equity, long/short credit, and multi-strategy managers. We expect positive absolute and relative returns from hedge fund strategies as the market headwinds that have accompanied this prolonged rally dissipate

- Hedge fund managers and Canterbury Consulting expect markets to experience volatility with greater frequency in 2017. This should create long and short opportunities across equity and credit securities
- Historically, rising rate environments have favored actively managed investment strategies. Falling rates has supported positive market returns, but with interest rate hikes in our future, Canterbury is focused on recommending exposure to a diversified line-up of managers that can generate alpha through portfolio management and superior security selection
- A market environment with a heightened level of volatility and a higher dispersion of return would provide more opportunities for managers to outperform through active security selection and management of overall exposures
- Canterbury recommends that clients keep their hedge fund allocations at target weights with an even split between long/short equity and multi-strategy/credit hedge funds