Liquid Alternatives —

Investment Insights

February 2025

Hedge Funds on a Winning Streak, What's Next for 2025?

The second half of 2024 saw a number of big events and significant market moves. In August, Japan's Nikkei plunged over 12%, triggering global market volatility as traders unwound FX carry trades. The S&P 500 dropped and VIX spiked to 65. In response, the Fed cut rates by 50bp in September and a further 25bp in November and December. Trump's election win and a Republican sweep led to market optimism, pushing the S&P 500 past 6,000 amid expectations of tax cuts and deregulation. Concerns persist over China's weak growth and potential Taiwan tensions. In the US, despite valuation worries, strong economic growth and pro-business policies suggest a favorable market setup heading into 2025.

Hedge funds performed well in 2024 across all strategies, with indices showing returns ranging from 6-10%. Equity Long Short funds achieved double-digit returns but had high dispersion, with Directional managers seeing the widest range. Multi-Strategy funds also ended in double digits with moderate dispersion. Relative Value strategies made steady gains with strong issuance driving CB arbitrage and dispersion supporting market neutral traders. Crypto arbitrage strategies also delivered a strong year with double digit gains with momentum picking up in the second half of 2024. Systematic Macro and Discretionary Macro managers posted positive returns, though the latter saw varied end-of-year performance. CTA managers finished slightly positive after a volatile year. Event Driven funds dipped in December but closed the year with double-digit gains.

Our own hedge fund portfolios ended the year very strong with our uncorrelated strategy continuing to post positive returns in every down month for bonds and equities and closing out 2024 outperforming its peers and benchmarks, marking its best year since 2009. Our uncorrelated crypto strategy also posted high teens returns for its first full calendar year, a significant milestone.

At the end of this letter, we will focus on a thematic that has seen increasing attention in the wake to the Trump election with a push for deregulation and a supportive stance towards consolidation and mergers.

Highlights

- Strong second half in 2024 to close a remarkable year for Hedge Funds
- Equity Hedge managers have thrived thanks to healthy sector dispersion. No signs of slowdown ahead
- While Merger Arbitrage faced regulatory issues Event-Driven overall benefitted from market strength
- Discretionary macro capitalized on divergent policies and global shifts, while Systematic strategies lagged
- Relative Value managers sailed through a flawless year with tailwinds still in their favor
- Digital asset strategies have outpaced the broader hedge fund industry while shielding investors from crypto volatility
- Improving landscape for Merger-Arbitrage as a new administration takes office

Equity Hedge

Equity Hedge strategies posted solid gains in the second half of 2024, fueled by sector dispersion, shifting macro trends, and effective stock selection. Amid volatility, managers capitalized on divergent regional dispersion.

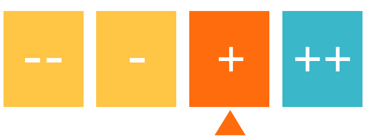
In the U.S., consumer discretionary and industrial managers led performance, driven by resilient consumer spending and infrastructure-related investments. Tech focus managers delivered mid-double-digit gains, capitalizing on AI-driven innovation. However, biotech managers underperformed, hindered by pricing headwinds, regulatory challenges, and muted earnings growth.

European equity hedge fund managers underperformed U.S. peers, weighed down by slowing activity in financials and industrials. Profitable shorts in vulnerable bank stocks and alpha generation in energy through company-specific fundamentals helped offset challenges.

EM manager struggled with weaker Chinese growth, political uncertainty, and fallout from the U.S. election, strengthening the dollar and driving outflows to developed markets. Asia ex-China and Latin America were hit hardest, grappling with tighter monetary conditions and trade policy risks.

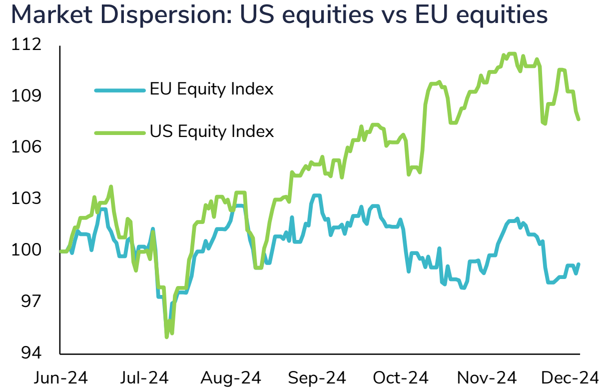
Managers tactically adjusted gross and net exposures to preserve capital as volatility persisted, and caution heightened in Q4 to mitigate drawdowns. Ultimately, equity strategies ended 2024 on a robust footing, demonstrating adaptability in complex markets.

Strategy outlook



Equity Hedge strategies will navigate continuing volatility in 2025, emphasizing sector and regional differentiation. In the U.S., technology and small caps may stay resilient, though caution is advised in cyclicals facing economic headwinds. Europe is likely to face structural challenges, prompting a defensive stance with selective shorts in financials and industrials, while seeking undervalued opportunities in energy and utilities. In China, supportive government policies have lifted sentiment, yet geopolitical risks and hawkish U.S. signals require caution. Short positions in export-heavy industries may reduce volatility. Managers will prioritize risk management amid higher interest rates, earnings uncertainty, and geopolitical instability, leveraging dynamic exposures to capture alpha.

Market Dispersion: US equities vs EU equities



Source: Bloomberg (SPX Index, SXXP Index)
Data as of 27.01.2025

Event Driven

Activist managers posted double digit returns in 2024, benefiting from overall market strength and higher interest rates, which made companies more receptive to activist influence. With M&A activity expected to increase, we should see this carry over in 2025 as companies become more open to shareholder-driven changes.

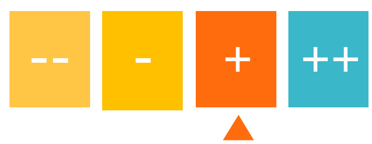
The Merger Arbitrage space returned a little more than cash, underperforming due to losses from individual arbitrage situations such as Tapestry-Capri and US Steel, though optimism remains that a Trump administration will spur M&A growth and reduce regulatory scrutiny.

Distressed managers also had a strong year, often returning above 10%, driven by exposure to high-yield bonds, though some funds did not fully participate in the broader market rally. While default rates have remained stubbornly low, there are pockets of opportunity across sectors, it is probably too early for returns to really accelerate.

Multi-Strategy Event managers were also up double digits, with larger funds outperforming smaller ones. While Merger Arbitrage performance was disappointing, managers benefited from structured credit pricing in higher risk-free rates.

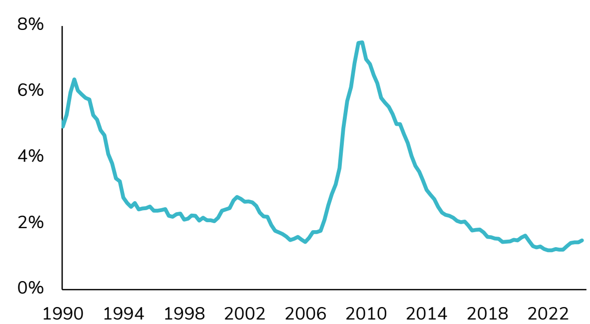
Overall, Event Driven strategies delivered strong absolute returns in 2024, though outlooks for 2025 vary, depending on macroeconomic conditions and policy changes, specially at a regional level.

Strategy outlook



We anticipate a generally favorable environment for Event Driven investing, though periodic market dislocations are to be contended with due to new US administration's unconventional policy communication and implementation methods. In this landscape, maintaining a disciplined and objective approach will be essential for sound investment decisions. We increase our conviction overall as we feel the policies will be mostly constructive with select sectors poised to benefit from specific measures, as well as the expected uptick in M&A and corporate actions, which should create compelling opportunities within the Event Driven strategies.

Delinquency Rate on All Loans, All Commercial Banks



Source: Federal Reserve Bank of St Louis
Data as of 31.12.2024

Macro

Macro strategies delivered robust gains in H2 2024, buoyed by divergent central bank policies, geopolitical risks, and energy dislocations. Rate differentials fueled FX opportunities: the BOJ's easing stance drove the yen to multi-year lows, prompting profitable long USD/JPY trades. Managers found value in EM currencies, capitalizing on shifting monetary expectations. The Fed's unexpected rate adjustment added volatility to markets, creating opportunities in rates, FX, and cross-asset trades.
Energy was a key catalyst, as natural gas prices spiked on colder-than-anticipated European weather, while oil enjoyed a brief rally before moderating in December. Macro managers who anticipated weaker global growth scored gains by shorting industrial metals, benefiting from softening demand signals. Meanwhile, CTAs encountered headwinds, with the Macro/CTA index dipping during the period. Though systematic models profited from trends in FX and natural gas, choppy equity markets eroded returns, especially during late-year reversals. Fixed income offered fertile ground for discretionary traders as the U.S. yield curve steepened on renewed fiscal deficit concerns. Relative value plays along the curve, coupled with selective equity index shorts (particularly in weakening European markets) helped offset broader volatility. By year-end, prudent risk management and targeted thematic positioning underpinned the macro strategy's strong finish to 2024. Precious metals also saw inflows, particularly gold, providing a safe-haven hedge amid persistent geopolitical tension.

Strategy outlook

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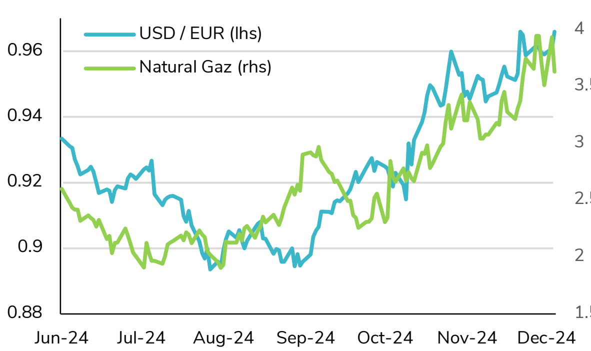
Macro strategies enter 2025 on solid footing, supported by global economic and geopolitical themes. Divergent monetary paths, led by the European Central Bank's hawkish stance versus a more neutral Federal Reserve, should heighten FX and rates arbitrage opportunities. Discretionary managers are back to full risk, ready to capitalize on these shifts. CTAs may gain from prolonged trends in currencies and commodities, with energy remaining a focal point amid ongoing supply risks.
A new U.S. administration could increase equity volatility, particularly in policy-sensitive sectors like healthcare and technology. Both discretionary and systematic managers will emphasize rigorous risk control and careful positioning to capture alpha in an evolving macro environment.

USD / EUR and Natural Gaz Trend



Source: Bloomberg (USDEUR BGN Curncy, NG1 COMB Comdty)
Data as of 27.01.2025

Relative Value

Building on strong momentum, Relative Value delivered positive return each month in H2 to complete a perfect year, a milestone not achieved since 2009. The index gained nearly +5% over the period, closing a robust 2024 around +9%, with larger funds slightly outperforming. Although returns initially slowed in Q3 for Quant Equity Market-Neutral, they picked up post-election as stock selection opportunities improved, marking another remarkable year for the sub-strategy. H2 was also a walk in the park for Convertible Arb, one of our strongest convictions from previous letters. Outside Europe, refinancing and new issues were generally healthy, with ~$120bn of new paper in 2024. Discounted volatility on crypto-related issuers offset an otherwise weak opportunity set in that area, leaving pure-play Vol Arb managers significantly lagging. Despite decent returns, Fixed Income Arb was underwhelming given the strong cash tailwind. As regional diversification and opportunities moderated in the second half of the year, gains concentrated in US cash-futures basis trades, driven by heavy issuance and weak demand for US bonds. Multi-PM platforms didn't take their foot off the gas in H2, finishing 2024 in the mid-teens. As a representation of the broader hedge fund universe, they unsurprisingly saw gains across all strategies, notably systematic and fundamental equities, which attracted capital allocations at the expense of commodities or event-driven, where alpha normalized. Despite below average dispersion hampered by tightening spreads, RV Credit managers generated long alpha on top of beta gains.

Strategy outlook

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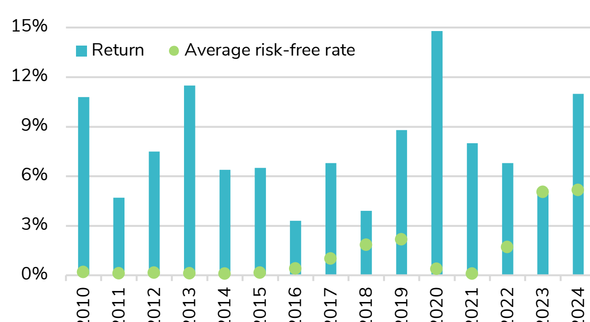
We remain overweight Relative Value, as key drivers, particularly high interest rates, will persist in 2024. Convertibles Bonds face a looming maturity wall, with one-third of total bonds outstanding maturing in 2025/26. With most out of the money and already high stock prices, conversions seem unlikely. Recognizing the compelling opportunity, funds are increasing leverage. Moreover, volatility shouldn't be confined to crypto, with Trump's policies spilling into other sectors which should finally benefit Vol Arb while continuing to drive dispersion for Quant/Stat Arb. Multi-PM platforms should remain unstoppable, with top firms at capacity and compressing dispersion in 2024, Tier-2 funds and new launches should compete for healthy inflows.

Multi-Manager Performance and Risk-Free Rate

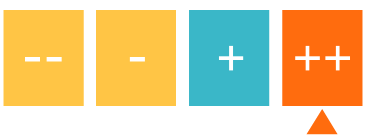


Source: Goldman, Sachs, Federal Reserve Bank of St Louis
Data as of 31.12.2024

Digital Assets

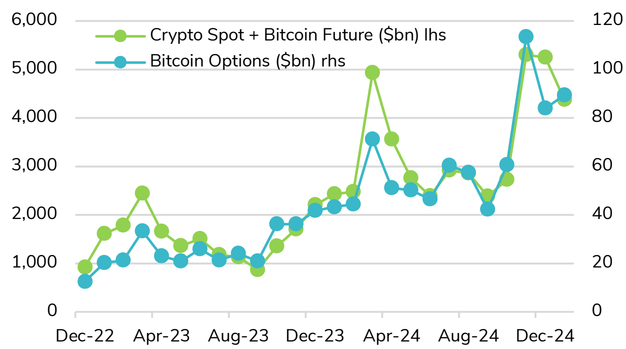
In line with H1, market-neutral digital strategies emerged as the top-performing hedge fund subset in the second half of the year, laying the foundation for a transformative era in the crypto space. Managers closed 2024 with returns over +20%, alongside Bitcoin's staggering +120% performance. The groundbreaking ETF approval for Bitcoin in January, followed by the much-anticipated halving, propelled the ecosystem to unprecedented heights. Market-neutral strategies thrived in Q1's frenzy but encountered a weak Q2 as activity waned with participants awaiting new catalysts. H2 began sluggishly with sideways price action until markets started pricing in a Trump win and an embraced pro-crypto stance. Renewed industry interest drove rising volumes, benefiting market makers, while bullish sentiment leading to a consolidation in perpetual swap funding rates began to profit arbitrageurs. November marked the culmination of this momentum with the confirmation of a crypto-friendly administration, igniting crypto markets as Bitcoin later surpassed $100k. Trading volumes soared to levels unseen since 2021, while perpetual and term futures rates turned sharply positive, prompting managers to increase leverage to capture the vast web of market dislocations. Options strategies excelled navigating shifts in implied volatility. Statistical Arbitrage stood out, bolstered by heightened altcoin volatility, as cross-sectional and trend signals delivered exceptional profitability. Due to its specificities, DeFi remained the only strategy immune to market fluctuations, offering stable yield arbitrage throughout the period.

Strategy outlook



The environment remains highly favorable for crypto strategies, with activity expected to stay robust, benefiting volume-hungry market-neutral managers. Consequently, we hold a very positive outlook on Arbitrage & Market Making, well-positioned to capitalize on dislocations across exchanges. Similarly, we see significant opportunities in Vol Arb. The recent approval of new instruments, like options on IBIT, Blackrock's Bitcoin ETF, will add market depth and open up broader derivative trading strategies, supporting alpha expansion. Additionally, we're increasingly optimistic about Stat Arb. Greater regulatory clarity should foster the emergence of new projects, each with distinct dynamics. This growing dispersion will expand the toolkit for managers, creating fresh opportunities across the ecosystem.

Monthly Crypto Volumes on Exchanges



Source: The Block
Data as of 31.01.2025

Spotlight on Merger Arbitrage

Merger Arbitrage strategies, which involve capitalizing on discrepancies between the market price of a target company and the agreed-upon acquisition price, are expected to play a pivotal role in 2025. After a slower period in 2023 and 2024, a more favorable economic and regulatory environment has created an opportunity for increased M&A activity, making this strategy highly relevant for hedge funds and institutional investors.

Key Trends Driving the 2025 Merger Arb Market:

- Regulatory Environment: The regulatory landscape for M&A is shifting, with expected easing of antitrust scrutiny in major markets, particularly in the U.S. and Europe. This will facilitate the completion of larger deals that had previously faced delays or rejections. While regulatory hurdles remain, especially in sectors like big technologies, these changes open up new opportunities for Merger Arb strategies.

- Economic Outlook: With lower interest rates and a recovering economic environment, M&A activity is set to rebound. The market, having been suppressed by high borrowing costs in recent years, is poised for growth in 2025. Companies are now more inclined to engage in strategic mergers and acquisitions, which create arbitrage opportunities as market prices fluctuate during the acquisition process.

- Sector-Specific Insights: Several sectors are expected to see robust deal-making activity. The healthcare, biotechnology, energy, and technology sectors—especially those focused on AI and green tech—are expected to be at the forefront. These sectors provide a rich landscape for consolidation, where market inefficiencies and deal structures create favorable conditions for arbitrageurs.

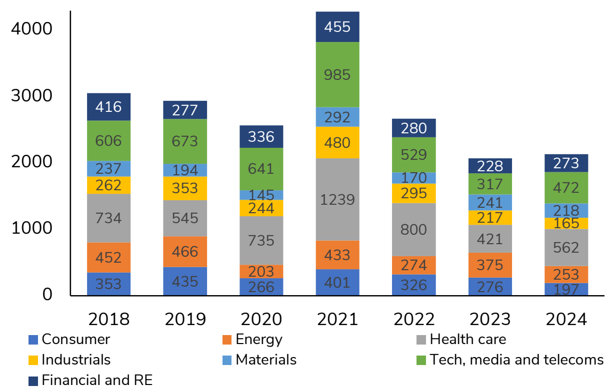
Merger Arbitrage Opportunities:

- Take-Privates and Strategic Transactions: The anticipated rise in take-private transactions, driven by private equity firms and strategic buyers, will provide a wealth of arbitrage opportunities. These deals are particularly attractive for Merger Arb investors due to the price discrepancies between the market and the acquisition price.

- Cross-Border Deals: With easing regulatory barriers, cross-border transactions are expected to increase, further expanding the arbitrage opportunities. However, these deals come with additional complexities, such as geopolitical risk and varying market conditions across regions, which may influence deal timelines and success rates.

- AI and Tech M&A: The technology sector, especially in areas like AI and semiconductor manufacturing, is ripe for consolidation. These sectors present unique opportunities for Merger Arb strategies as valuations are volatile, and mergers often face lengthy regulatory reviews, creating favorable conditions for short-term arbitrage.

M&A value by acquisition target's sector (in $billions)



Source: BCG - M&A Outlook 2025: Expectations Are High
Data as of 27.01.2025

Challenges and Risks to Consider:

- Market Volatility: Despite the optimistic outlook, market volatility remains a risk. Geopolitical tensions, trade policy uncertainties, and the potential for economic downturns can all impact deal closures and the overall success of M&A transactions.

- Antitrust Scrutiny: Antitrust concerns, particularly in the high-value tech space, and regulatory scrutiny, for deals representing strategic national interests, remain key factors to consider. Investors in Merger Arb need to closely monitor the progress of antitrust reviews and adjust their strategies accordingly.

Merger Arbitrage in 2025 offers an attractive opportunity for hedge funds. With increased M&A activity, a more favorable regulatory environment, and a recovering global economy, Merger Arb strategies are poised to thrive. Investors can benefit from significant arbitrage opportunities in this dynamic and evolving market.

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About Syz Capital

Syz Capital is an independent asset manager and centre of excellence for alternative investments. Part of the Syz Group, we offer clients the opportunity to invest alongside us in niche opportunities throughout uncorrelated strategies, hedge funds, direct private equity and special situations. Many of these are hard to access for private clients - our mission is to democratise alternative investing.

When we invest it's our goal to grow your wealth for the future by identifying investment strategies across the entire investment universe, some of which often overlooked by investors because of their size or complexity and seek the best risk-adjusted returns for our clients.

Investing in alternatives has always been part of our DNA - the Syz family has been investing in hedge funds since 1980 and in private companies for over 200 years. Through Syz Capital we offer clients complete alignment of interest with us and the opportunity to be actively involved in every transaction we undertake on your behalf.

Key facts and figures

Audited figures as at 31.12.23

23.8%
Syz Group's CET1 solvency ratio

+25yrs
Award-winning investment experience in alternatives investments

23.1bn
Assets under management (CHF)

8
Locations (Europe, Asia, South America and Africa)

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To tell us about the future you're looking forward, please email us at investor@syzcapital.com and we'll be in touch.