TITAN ADVISORS

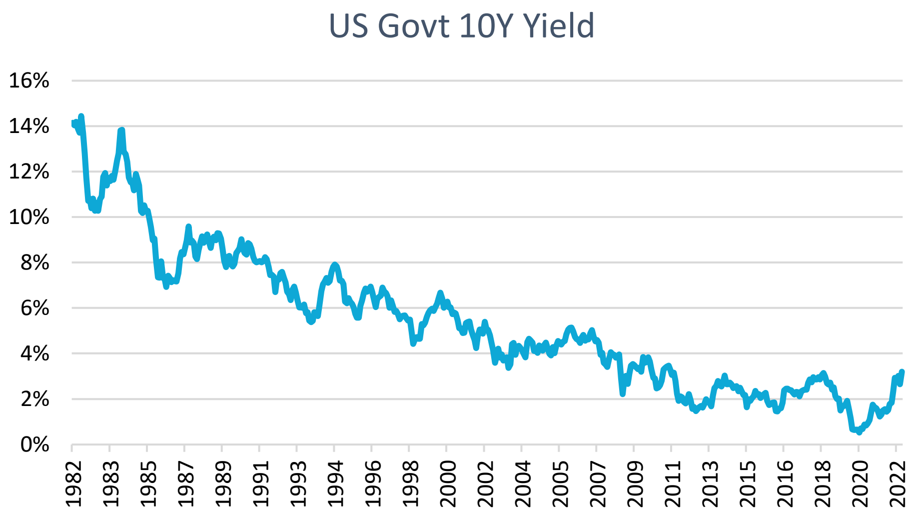
Higher Interest Rates and the Hedge Fund Opportunity

750 Washington Blvd. 10th Floor, Stamford, CT 06901 Phone: (203) 327-8600 Fax: (203) 327-8599
TITANADVISORS.COM

Higher Interest Rates and the Hedge Fund Opportunity

Investment portfolios are typically constructed by using historical data to build an efficient portfolio for clients in line with their desired risk/return objectives. Portfolios centered around some combination of stocks and bonds have delivered acceptable risk-adjusted results for decades. The current generation of investors has witnessed a 40-year bull market in bonds, as interest rates made a series of lower highs and lower lows with each cycle since 1982. Persistently falling interest rates have provided a tailwind to the total return of bonds while also creating an environment for earnings growth and price-to-earnings multiple expansion in equity markets. This dynamic changed materially in 2022, as the Covid-related stimulus, years of underinvestment in supply chains and materials, and deglobalization trends catalyzed a surge in inflation.

The Federal Reserve is in the midst of an aggressive interest rate hiking cycle, leading to poor returns in 2022 for portfolios allocated to only equities, bonds, or a blend thereof. Through September 30, the S&P 500 is -23.5% and the Barclays Aggregate is -15.4%.



Government bond securities have moved from offering investors a source of income that acted like a volatility dampener within portfolios, to becoming positively correlated with equities on the downside. This dynamic presents portfolio construction dilemmas to traditional portfolios.

While increasing interest rates will likely cool demand and inflation in the immediate term, we believe there are some structural issues that will create an environment where inflation and interest rates remain elevated relative to the levels of the past several decades. In many ways, the variables that were tailwinds for equity and bond returns for the last 40 years are likely to be headwinds for the foreseeable future. We think investors should turn to other alternatives to navigate this new regime.

750 Washington Blvd. 10th Floor, Stamford, CT 06901 Phone: (203) 327-8600 Fax: (203) 327-8599
TITANADVISORS.COM

We believe hedge fund exposure is particularly attractive to portfolios as a diversifier in today's markets. We think certain strategies, such as global macro, relative value, and low net exposure long/short equity, are well suited to today's environment for a variety of reasons. Hedge funds generally, as defined by the HFRI index, have exhibited a much lower sensitivity (duration) to interest rates over time.

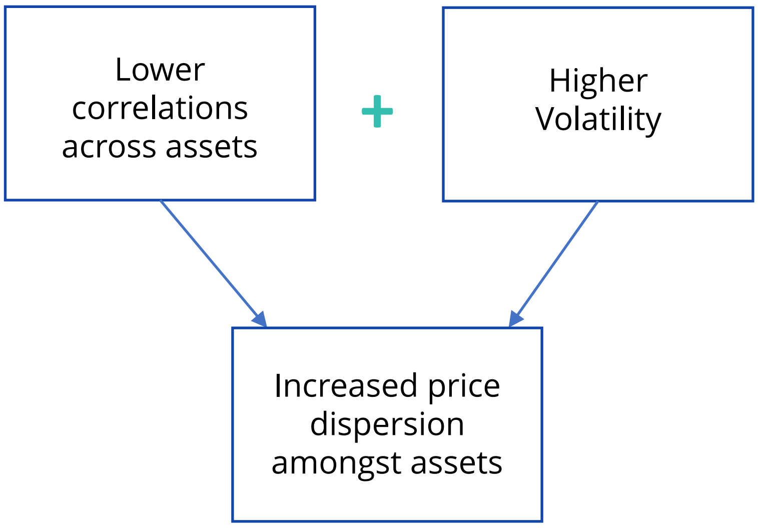
	Fall in Discount Rate since 2009-10	Effective Duration
S&P 500	-1.8%	21
MSCI EAFE	-1.0%	19
MSCI Emerging	0.7%	19
30-Year US Treasury	-1.1%	21
30-Year Bund	-2.6%	27
30-Year JGB	-1.3%	29
30-Year Gilt	-2.6%	22
MSCI US REIT	-1.4%	19
Cambridge Associates Private Real Estate	-2.8%	17
Cambridge Associates Private Equity	-1.5%	31
Cambridge Associates Venture Capital	-1.5%	23
Cash	-2.8%	0
HFRI Index ("Alts")	-1.5%	2
S&P/GSCI Reduced Energy Index	-1.5%	1

Source: GMO, Cambridge Associates, Datastream, MSCI, S&P, HFRI

Low interest rate sensitivity is certainly not the only reason hedge fund strategies can be a benefit to investors' portfolios in today's macro backdrop. Below we highlight three main reasons we believe the opportunity set is rich for hedge fund strategies.

Increased Asset Price Volatility

Increasing volatility in equity and bond markets usually means challenging times for passive investing. The long/short nature of hedge fund strategies and active trading acumen benefit from large swings in prices. For active traders, larger moves provide a more fruitful opportunity set on both the long and short side of portfolios. The withdrawal of liquidity and tightening of monetary policy will create winners and losers in both equity and credit markets. We see this environment as more favorable for long/short strategies than one of low, stable growth and subdued interest rate volatility.



750 Washington Blvd. 10th Floor, Stamford, CT 06901 Phone: (203) 327-8600 Fax: (203) 327-8599
TITANADVISORS.COM

Increased Dispersion of Global Policy

Increasing globalization and coordinated monetary policy have been a core staple of the global economy in the 21st century. The pandemic and conflict in Ukraine have caused many countries to reconsider their policy decisions. Nations have realized the importance of being self-sufficient with respect to their supply of food, energy, and basic materials, which has a significant impact on fiscal policy decisions. In addition, countries acknowledge they should be self-reliant in their currency and bond market funding needs. Heterogeneous global monetary and fiscal policy across nations is a large change from the last 15 years and will likely create a rich opportunity set for macro investors who trade global interest rates, currencies, and commodities.

Short Rebate Rates and Cash Yield

Most hedge fund strategies fall under two broad categories: a long/short approach that leaves a significant cash balance earning the risk-free rate or a strategy that trades various derivatives that do not utilize a lot of cash in the portfolio. In both cases, cash rates are an important building block of hedge fund total returns. It is no secret that that this aspect of hedge fund returns has been largely non-existent for the past 15 years. However, that factor has finally begun to shift and become a positive contributor to returns. Because hedge funds have no mandated directional bias, we believe they should be best thought of as "cash plus" strategies, much like floating rate loans (bank loans). The incremental return, however, stems from skill (alpha) and is less dependent on global economic conditions.

Summary

This paper is intended to highlight the opportunity set for hedge funds in a higher or rising interest rate environment. Many forms of investing are challenged from higher interest rates however, in our opinion a fully diversified portfolio, will have additional tools to weather the storm. The benefit of the hedge fund approach is that it is asset class agnostic, and there are strategies to navigate all types of environments. We believe in active rotation across various strategies implemented with quality managers.

750 Washington Blvd. 10th Floor, Stamford, CT 06901 Phone: (203) 327-8600 Fax: (203) 327-8599
TITANADVISORS.COM

Disclaimer

The views expressed in this commentary are solely those of Titan Advisors, LLC (together with its affiliates, "Titan") as of the date of this commentary. The views expressed in this commentary are subject to change without notice and may not reflect the criteria employed by Titan to evaluate investments or investment strategies. This commentary is provided to you for informational purposes only. This commentary does not, and is not intended to, constitute investment advice, nor does it constitute an offer to sell or a solicitation of an offer to buy any security, investment product, or service. The statistics and other factual information in this commentary were gathered from third party sources and have not necessarily been confirmed with any independent source. To the fullest extent permitted by law, Titan shall not be liable for any errors in the information, beliefs, and/or opinions included in this commentary, or for the consequences of relaying on such information, beliefs, and/or opinions. The information contained in this commentary may not be current and Titan has no obligation to provide any updates or changes. This commentary does not take into account any particular investor's investment objectives or tolerance for risk. This commentary is not an advertisement. The circulation or disclosure of this commentary without the express consent of Titan is prohibited.

750 Washington Blvd. 10th Floor, Stamford, CT 06901 Phone: (203) 327-8600 Fax: (203) 327-8599
TITANADVISORS.COM