bfinance

Quarterly Analysis

Manager Intelligence and Market Trends

August 2018

Contents

bfinance is an award-winning specialist consultant that provides investment implementation advice to pension funds and other institutional investors around the globe. Founded in 1999, the London-headquartered firm has conducted engagements for more than 300 clients in 33 countries and now has eight offices in seven countries. Services include manager search and selection, fee analysis, performance monitoring, risk analytics and other portfolio solutions. With customised processes tailored to each individual client, the firm seeks to empower investors with the resources and information to take key decisions. The team is drawn from portfolio management, research, consultancy and academia, combining deep sector-specific expertise with global perspective.

This commentary is for institutional investors classified as Professional Clients as per FCA handbook rules COBS 3.5R. It does not constitute investment research, a financial promotion or a recommendation of any instrument, strategy or provider.

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At a glance...

An end to bullishness.

After five increasingly confident quarters up to December 2017, the first quarter saw a significant decline in risk appetite, indicated by the bfinance Risk Aversion index. Wariness has persisted through the second quarter, although multi-asset managers appear to be remaining overweight growth assets.

Manager searches surge.

The volume of new mandates from bfinance clients was 39% higher for the twelve months to June 30th 2018 than the prior year. Emerging markets (equity and debt), private debt, real assets and hedge funds are currently among the most popular destinations for capital.

A difficult quarter for active management.

Managers across various sub-sectors have struggled to outperform benchmarks in 2018, although the medians mask considerable dispersion. The average active global equity manager has underperformed the MSCI Global by nearly 1% over the quarter to June 30th and 0.7% year to date.

Emerging markets give investors a rough ride.

In an immensely challenging period for emerging market stocks and currencies, active equity and bond managers have suffered along with the markets.

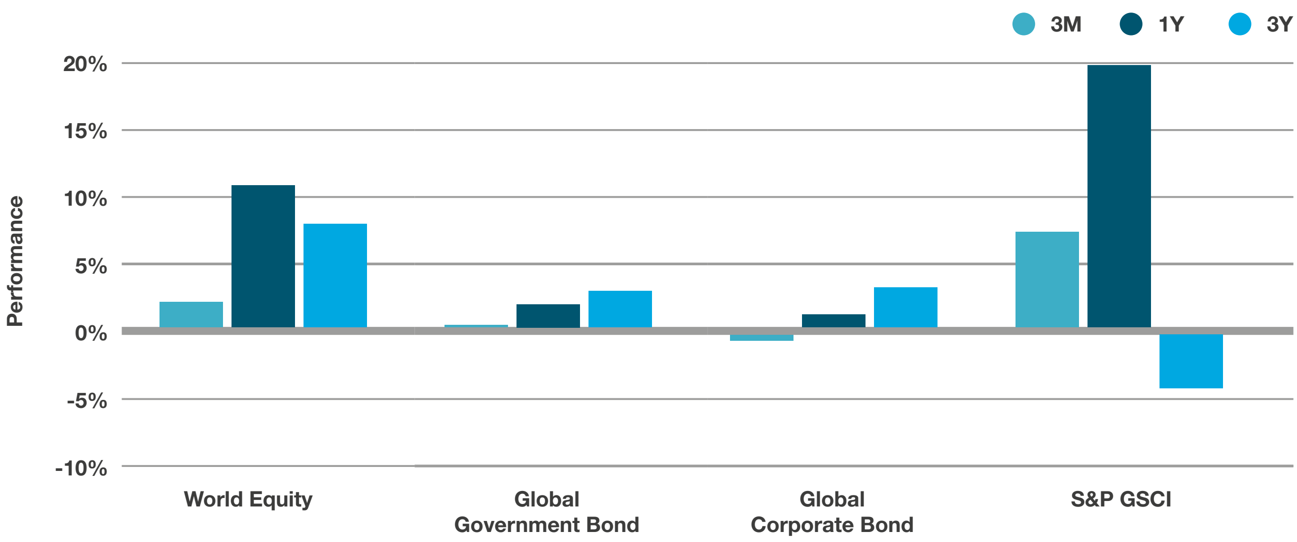
Risk mitigation in focus.

A growing trend in 2018 sees bfinance clients looking to mitigate equity, currency and liability risks at portfolio level through the use of overlays.

New appetite.

Recent bfinance client activity reveals a notable increase in demand for fund-of-hedge funds, real asset debt, small cap equity, listed real assets and high yield debt.

PERFORMANCE OF PUBLIC MARKETS TO END OF JUNE 2018

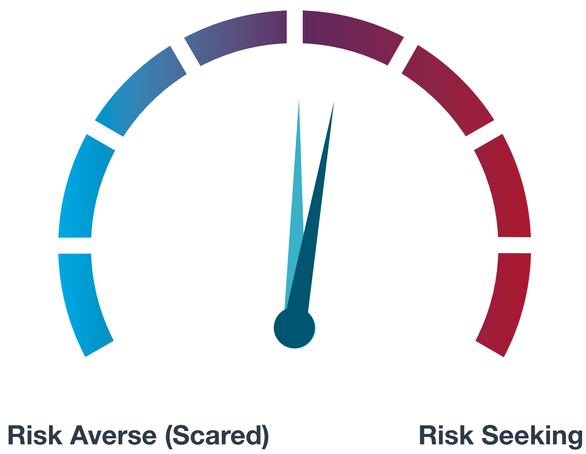


Source: bfinance/Bloomberg

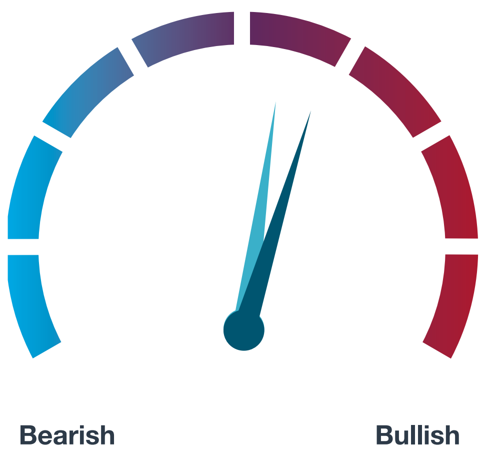
Risk appetite

Manager confidence remains subdued after rocky first half.

Risk appetite barometer, Q2 vs Q1



Manager positioning barometer, Q2 vs Q1



Q2 Q1

Source: bfinance (see page 5)

Risk appetite continued

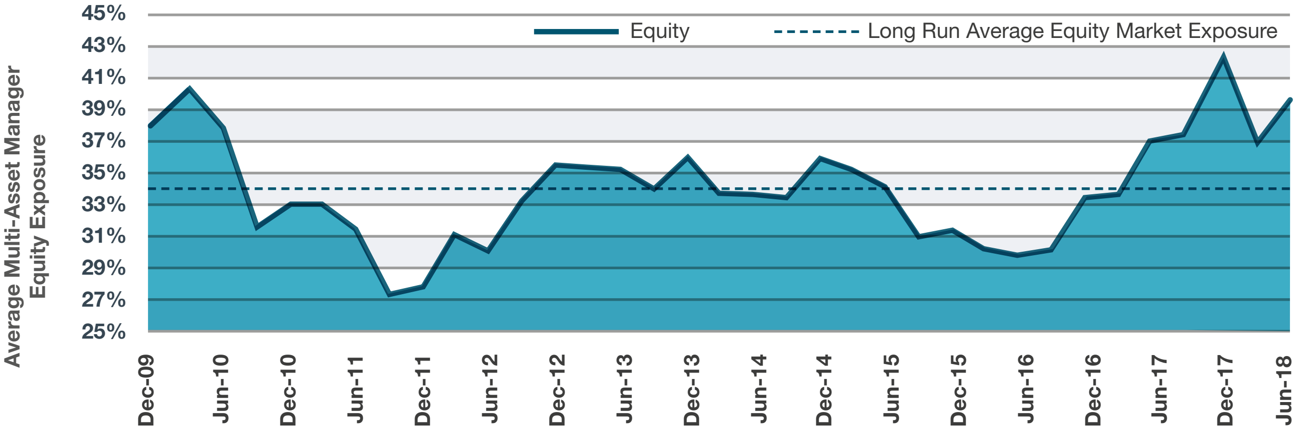
It has been a year of two halves from a risk appetite perspective.

2017 H2 saw market participants in a bullish mood, with risk aversion well under its ten-year average. Indeed, the five quarters to December 30th 2017 were each marked by successive declines in the bfinance Risk Aversion Index - a robust indicator of investor skittishness through recent years.

2018 H1, on the other hand, has brought a significant shift in sentiment. The heightened wariness has rolled on through the second quarter, although – unlike in Q1 – Risk Aversion was slightly under the ten-year average.

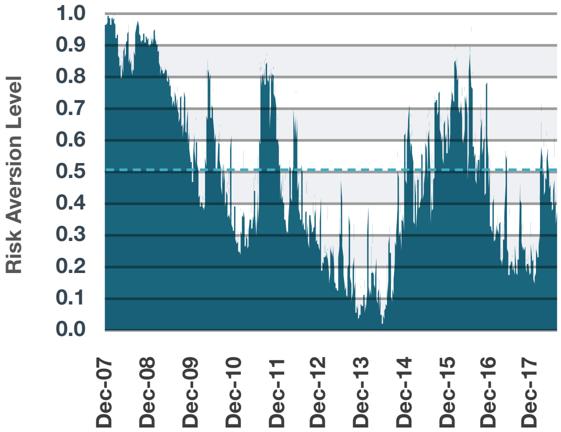
Amid this change in investment climate, it is interesting to note that multi-asset funds are remaining overweight equity. Indeed, the reduction in risk asset exposure in Q1 has been partly reversed in Q2.

MARKET POSITIONING OF MULTI-ASSET FUNDS



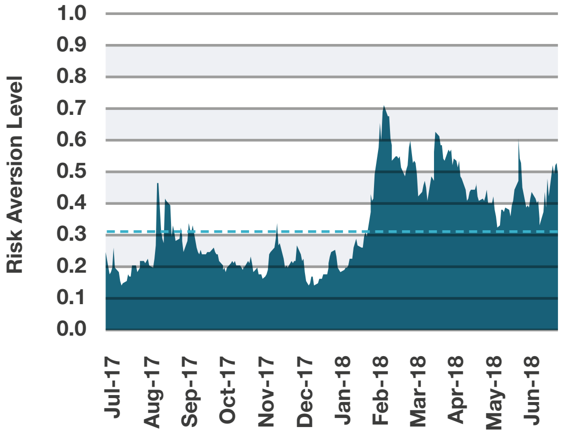
Source: bfinance. This graph shows the current and average exposure to equities held by a range of multi-asset managers. This is based on proprietary analysis performed by bfinance. The managers analysed vary in strategy from macro and GTAA through to bottom-up allocation strategies.

THE BFINANCE RISK AVERSION INDEX: 10-YEAR VIEW



Source: bfinance/Bloomberg

THE BFINANCE RISK AVERSION INDEX: 1 YEAR VIEW



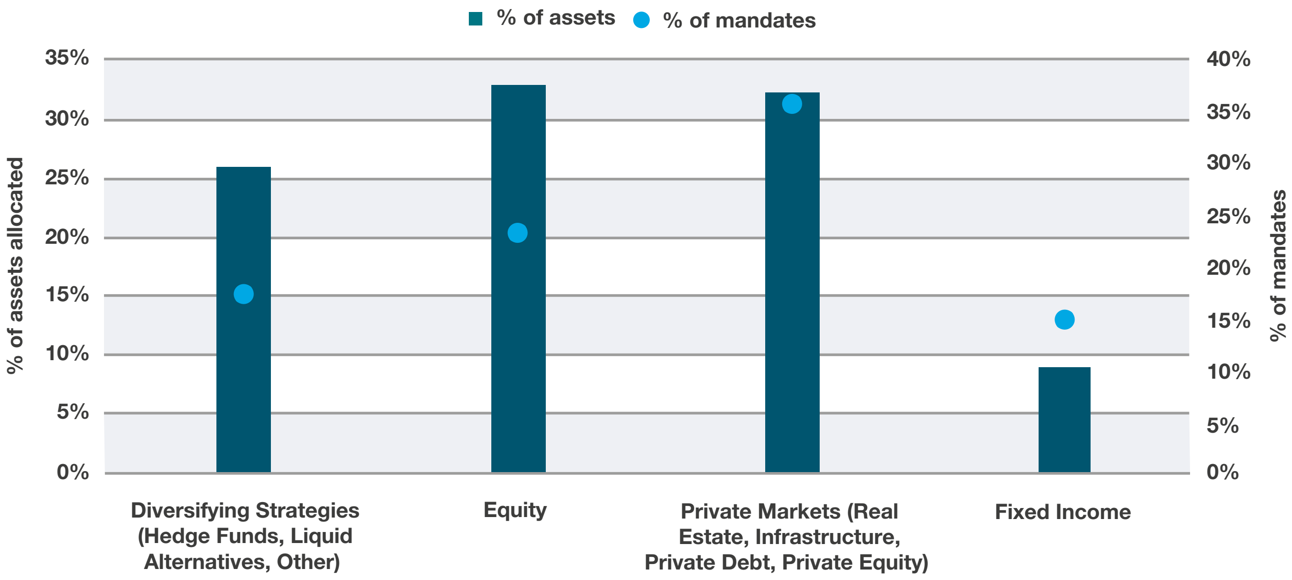
Source: bfinance/Bloomberg

The bfinance risk aversion index is a proprietary measure we use to calculate how risk seeking (nearer zero) or risk averse (nearer 1) the market consensus is. It ranges between 0 and 1. The internal algorithms used incorporate indicators of market expectations of future volatility (e.g. implied volatilities in equities and FX), the level of classic safe haven investments (gold) and market expectations of corporate default (e.g. CDX).

New manager searches

Mandate volume from bfinance clients increases by 39% year-on-year.

NEW MANAGER SEARCHES, YEAR TO JUNE 30 2018 (BY ASSET CLASS)



Note: these figures only represent projects initiated after July 1st 2017 and do not include pre-existing client engagements that continued during the year.

New manager searches continued

The first half of 2018 has seen a surge in mandates from bfinance clients around the globe. For the twelve months to June 30th, the volume of new manager searches was 39% higher than the previous year.

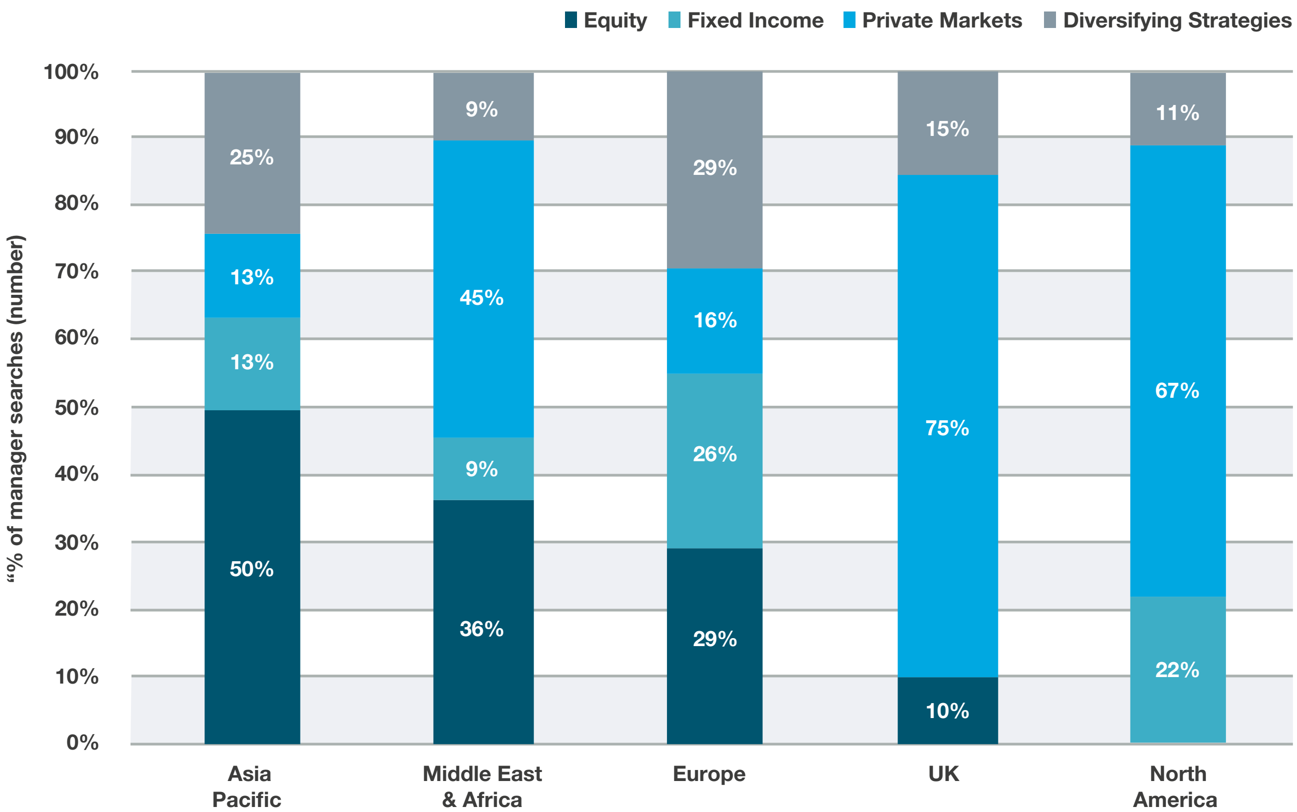
The number and volume of new mandates in private markets reached an all-time high for the firm, in contrast to the industry-wide trend which has shown a softening of overall fundraising for Q1 and Q2. While private debt proved to be the most attractive sub-sector in this category, real assets as a group – including real estate, infrastructure and niches such as agriculture – have been even more popular.

Investor appetite for emerging markets remains strong in both debt and equity, although it remains to be seen how this will be affected by the significant declines in both stock markets and currencies witnessed in Q2. EM allocations have historically been vulnerable to a risk-on/risk-off approach from developed market investors.

Also continuing is the ever-increasing focus on ESG, particularly in asset classes where sustainable investing is less embedded and commercialised, leading asset owners to seek innovative approaches.

There are a number of interesting new trends in investor activity, discussed in the relevant sections of this report. They include a significant increase in appetite for **Fund-of-Hedge Funds**, **listed real assets** (after very weak demand in the previous three years, **real asset debt, small cap equity** and **high yield debt.**

NEW MANAGER SEARCHES, YEAR TO JUNE 30 2018 (BY INVESTOR LOCATION AND ASSET VOLUME)

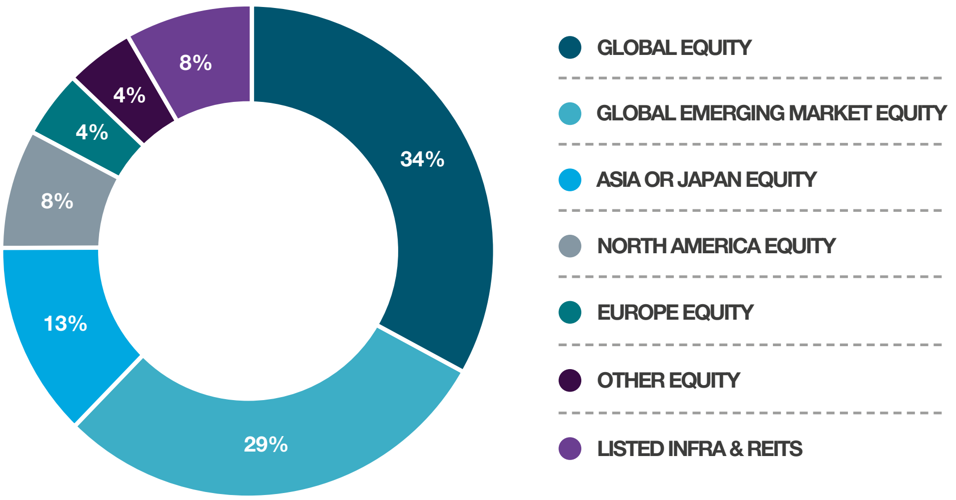


Note: these figures only represent projects initiated after July 1st 2017 and do not include pre-existing client engagements that continued during the year.

Equity

> Investors diversify into small cap, value strategies and listed real assets.

NEW EQUITY MANDATES, YEAR TO JUNE 30 2018 (BY GEOGRAPHY)



Note: these figures only represent projects initiated after July 1st 2017 and do not include pre-existing client engagements that continued during the year.

Equity continued

Investor trends

With some concern around market valuations, bfinance clients have been looking holistically at their equity allocations to ensure sufficient diversification in case of a correction.

The clear trend of clients in 2017 involved new allocations and mandates for **Asian** and **Emerging Market** equity managers, and this has continued through the first half of 2018. Over the twelve months to June 30th, 29% of new manager searches have been for Global Emerging Market equity and a further 13% have targeted Asian equity, with the latter portion split between Japanese and non-Japanese searches.

An increasing number of recent searches have had an element of style attached to them, with **'value'** strategies now evidently preferred among clients. In part, this is related to the diversification theme noted above. Yet the relative underperformance of 'value' strategies versus their 'growth' peers has resulted in some investors looking to ensure that they are exposed to this part of the market should any correction result in a sustained period of outperformance for 'value'.

Continuing the diversification agenda, bfinance is seeing signs of greater interest in **small cap** equities, either at the regional or global level. Clients concerned over the narrowing of the market with just a few mega-cap stocks driving performance have started to assess their portfolios and add exposure throughout the market capitalisation spectrum.

From a geographical standpoint, global equity has been the most popular sub-sector for new manager searches. Many of these searches have been focused on identifying superior active managers, and there has been some support for smart beta although appetite for the latter is down from the heights of 2014-15. Meanwhile, ESG considerations remain at the forefront for both **global** and **emerging market** equity. In comparison with global equity mandates, European and US manager search volume has been very modest.

An interesting trend in 2018 has been the increase in interest for listed real assets, including REITS and infrastructure-themed equities – two sectors that were somewhat out of favour among bfinance clients in 2016-17. At bfinance, the equity and private markets team work closely together on projects involving these asset classes.

Equity continued

Market snapshot

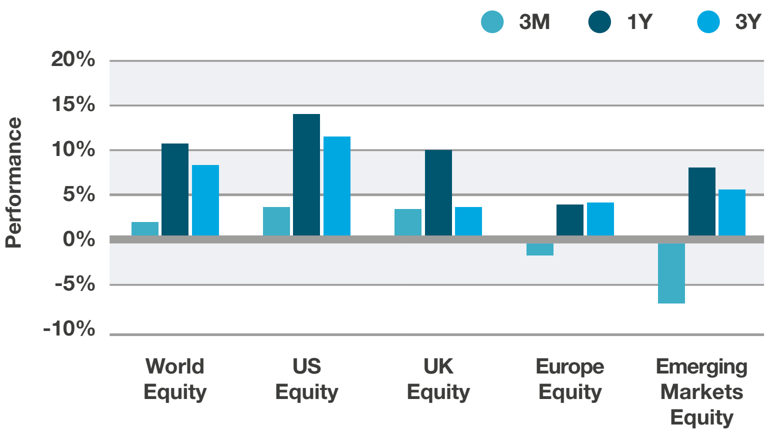
After a first quarter marked by volatility and geopolitical uncertainty, the second quarter was characterised by substantial divergence between US markets and the rest of the world. Modest positive returns for the MSCI World (up 1.7% in USD) masked major differences in regional fortunes.

US equities continued on an upward trend despite the political noise, most notably the trade war with China. This surge was driven by extraordinary earnings momentum, corporate tax cuts and fiscal stimulus. As a result, the S&P 500 delivered 3.4% over the quarter. The US dollar strengthened against most currencies, while energy stocks rallied sharply, supported by rising oil prices in the face of speculations around shortages.

In Europe and Japan, signs of slowing economic growth, deteriorating trade relations and rising US rates dampened the mood. Although the quarter saw positive equity returns in local currency, a sharp decline for the euro impacted returns for many investors. This fall was primarily driven by the change in monetary policy at the ECB, which announced in mid-June that it will slow down its bond buying programme from September. In total, the MSCI Europe gained 4% in local currency but declined by 1% in USD. Europe was also affected by a new populist coalition in Italy, which may – once again – threaten the solidity of the European Union.

Emerging markets experienced a very heavy correction during the quarter, with the MSCI Emerging Markets falling by 8% in USD. Major events include the ripple effects of a strengthening dollar, trade tensions and uncertainty in Latam politics. Banks and financials were the most severely affected stocks across emerging markets, most notably in Latin America.

EQUITY MARKET PERFORMANCE (TO JUNE 2018)



	YTD USD	YTD LOCAL
World Equity	0.4%	1.3%
US Equity	2.6%	2.6%
UK Equity	-0.8%	1.7%
Europe Equity	-3.8%	-1.0%
Emerging Markets Equity	-6.7%	-2.8%

Indices Used
World Equity: MSCI World Index in USD and in Local Currency
US Equity: S&P 500
UK Equity: FTSE 100
Europe Equity: Euro Stoxx 50
Emerging Markets Equity: MSCI Emerging Markets Index in USD and in Local Currency

Equity continued

MANAGER PERFORMANCE (TO JUNE 2018)

	3m	YTD	1Y	3Y (p.a)
Global Equity Composite*	**0.8%**	**-0.3%**	**11.1%**	**8.2%**
MSCI World	1.7%	0.4%	11.1%	8.5%
MSCI ACWI	0.5%	-0.4%	10.7%	8.2%
Outperformance VS MSCI World	**-1.0%**	**-0.7%**	**0.0%**	**-0.3%**
Outperformance VS MSCI ACWI	**0.2%**	**0.1%**	**0.3%**	**0.0%**
Global EM Composite*	**-8.3%**	**-7.1%**	**7.6%**	**7.0%**
MSCI EM Index	-8.0%	-6.7%	8.2%	5.6%
Outperformance	**-0.3%**	**-0.5%**	**-0.6%**	**1.4%**

Source: bfinance/Bloomberg

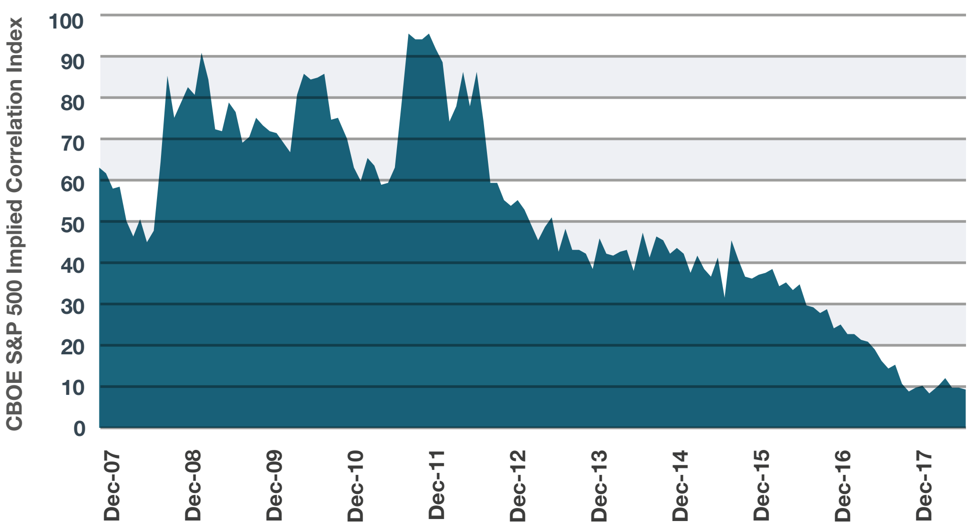
The Global Equity Manager and Global EM Manager composites show the performance of a sensible and representative sample of managers that invest in global equities and global emerging markets equities respectively. We use these composites as a proxy for how managers in the space are performing relative to their benchmarks. They do not represent manager recommendations.

After a challenging start to the year, active managers struggled to outperform through volatile markets in Q2. Active global equity managers tracked by bfinance have, on average, underperformed their benchmarks by nearly 1% over the quarter before fees and 0.7% year to date. (Readers should note that these composites do not represent manager recommendations but a sensible and representative sample of active managers in the sector).

There is also is substantial dispersion between the higher and lower quartiles. Looking at the managers more closely, it is evident that value-driven strategies are still, in general, finding market conditions tough. Growth managers, particularly those with an element of momentum in their strategies, continue to benefit from a tailwind.

Emerging market equity presented a gloomier picture in Q2 than developed market equity. Manager performance also fell short, with the average emerging market equity manager tracked by bfinance underperforming the benchmark by 0.3% before fees. Growth strategies were again better rewarded than value.

CORRELATIONS BETWEEN STOCKS



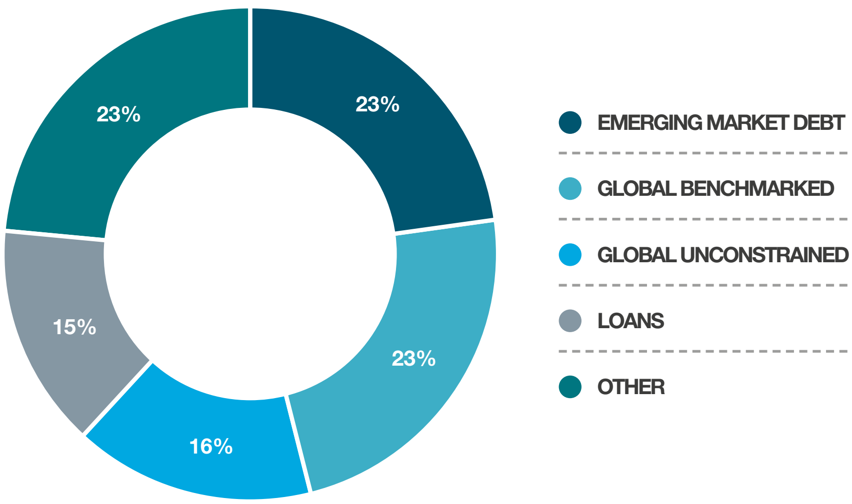
News from the equity manager world

- Diego Franzin, Head of Equities at **Amundi Pioneer,** leaves the firm in August, having held the role since February 2018 after the departure of Romain Boscher. This announcement follows the departure of Mauro Ratto, Head of Emerging Markets.
- **Aviva Investors** hires a team of eight equity portfolio managers from **Standard Life Aberdeen** including SLI's Head of Global Equities Mikhail Zverev and Head of Global Emerging Market Equities Alistair Way.
- Mark Mobius hires former **Franklin Templeton** portfolio managers Carlos Hardenberg and Greg Konieczny at his new firm **Mobius Capital Partners.**
- Matthew Vaight, manager of **M&G's** Global Emerging Markets strategy, will leave the firm after 22 years to pursue interests outside of the asset management industry.
- Alice Gaskell leaves **BlackRock,** where she was a portfolio manager and member of the group's European Equity team.
- **Polar Capital** expands its capability in Emerging Markets Equity, hiring of a team of four led by Jorry Rask Nøddekær from **Nordea Asset Management**.
- Knut Harald Nilsson leaves **Skagen,** where he was an Emerging Markets Equity portfolio manager.
- **Natixis Investment Managers** agrees to acquire a 24.9% stake in US-based Growth Equity manager **WCM Investment Management** and become its exclusive third-party distributor.
- **Federated Investors** completes the acquisition of a 60% interest in **Hermes Investment Management** from BT Pension Scheme.

Fixed income

Strong appetite for emerging market debt persists despite turbulence.

NEW FIXED INCOME ENGAGEMENTS, YEAR TO JUNE 30 2018 (BY TYPE)



Note: these figures only represent projects initiated after July 1st 2017 and do not include pre-existing client engagements that continued during the year.

Fixed income continued

Investor trends

The most prominent fixed income manager selection theme of the first half of 2018 has been the continuation of strong appetite for **emerging market debt.** This sector represents 23% of all new manager selection engagements by bfinance clients in the twelve months to June 30th.

Demand for EMD continues to outstrip searches for high yield bonds, although interest in the latter has somewhat revived on the back of spread widening in the first half of the year and the still-low rate environment for safer debt instruments, particularly in Europe. Looking more closely, the most popular EMD search types include hard currency strategies and, increasingly, blended or unconstrained strategies that incorporate local currency debt.

Appetite for unconstrained fixed income strategies (including absolute return fixed income and multi-asset credit) also continues to be robust, although the volume of new mandates for these sectors has declined since 2015-16

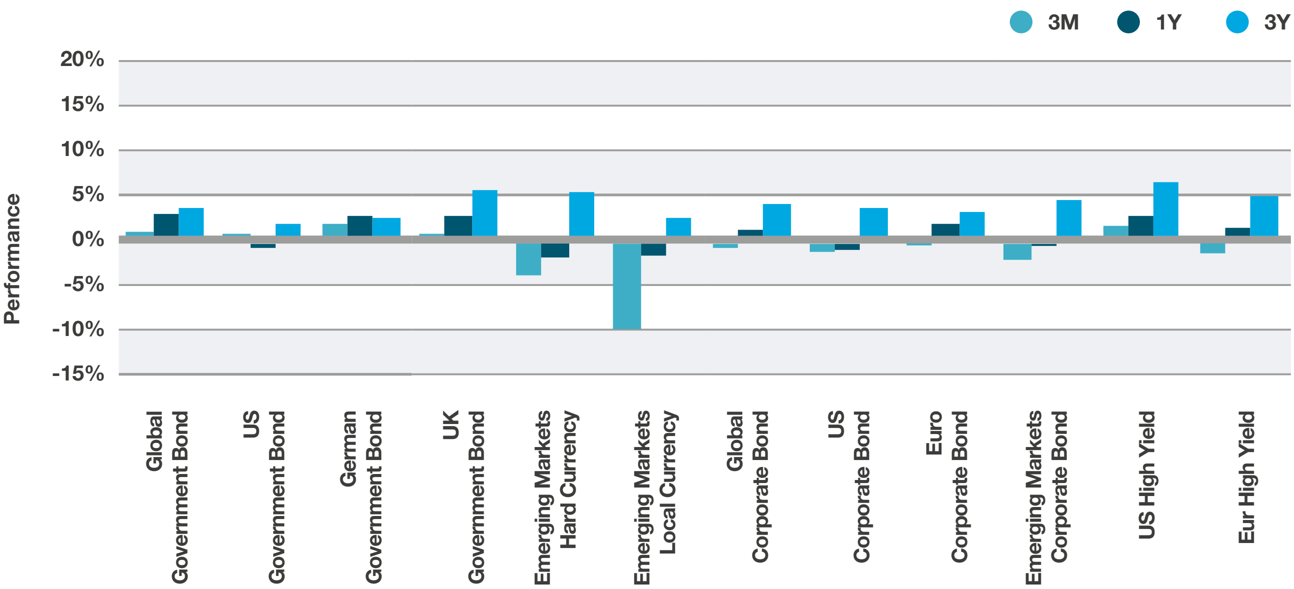
Although less significant, there is some renewed interest in previously lower-yielding areas of the market such as **investment-grade corporate bonds** and **global sovereigns,** and in less mainstream asset classes such as **global convertible bonds.**

Market snapshot

US investment grade credit fell by 0.94% in Q2, primarily due by the rise in UST yields with the curve shifting up by at least 20bps in April. The BBB segment was the hardest hit (-1.20%). **European investment grade** fell by -0.22% and, unlike in the US, the market was strongly influenced by spread moves. Here too BBB-rated debt was the worst performer (-0.67%) while more rate-sensitive segments (AAA, AA) fared better (0.43% and 0.56% respectively) as they benefited from a fall in bund yields.

US high yield was up by around 1%, with solid returns in the B-rated tier (+1.5%) while BB-rated debt delivered -0.12% and CCC 2.87%. The CCC tier was supported by spread compression of 60bps; compression was muted in the BB-B complex. Over the quarter, Telecommunications (+3.08%) and Energy (+2.37%) delivered the strongest returns while Autos (-3.44%) and Banking (-1.51%) struggled. Defaults fell to their lowest level since Q4 2013 at around $1.5bn (HY bonds and leveraged loans).

PERFORMANCE OF BOND MARKETS TO END OF JUNE 2018



Source: Bloomberg, JP Morgan. All data in USD, hedged or unhedged. Contact bfinance for index queries

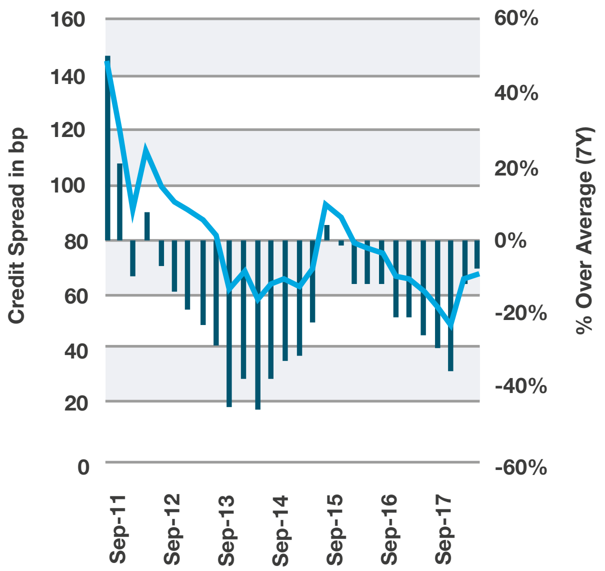
Fixed income continued

Market snapshot continued

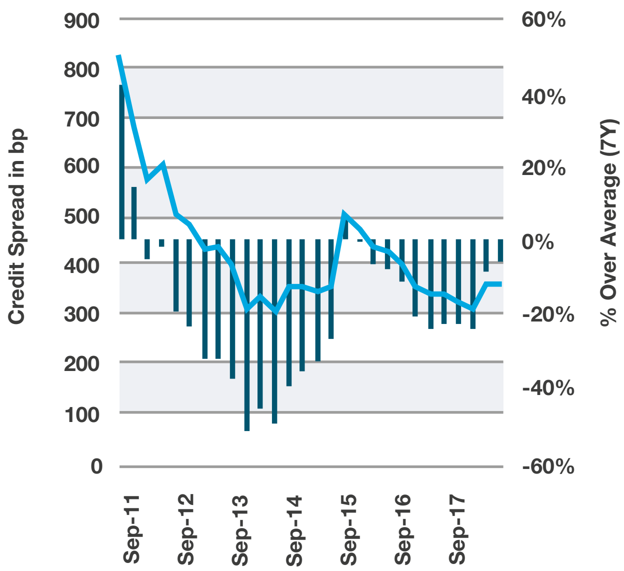
For **European HY**, the fall of 1.21% during the quarter was broadly driven by spread widening (+73 bps); this widening was most strongly evident in the CCC segment (110bps). From a sector perspective, Financial Services was the only sector that saw some spread compression, but still generated negative returns (-0.71%). On that note, the worst performing sectors were Insurance (-4.71%), Transportation (-3.10%), and Banking (-2.52%).

In **emerging markets,** hard-currency sovereign debt delivered negative returns (-3.54%) mainly driven by the more spread-sensitive high yield tier (-5.83%). In a similar fashion, EM local markets fell by a whopping 10.40% (in USD) driven to a large extent by EMFX depreciation, particularly in Brazil, South Africa, Turkey and Hungary. EM Corporate debt generated -1.77% and, similar to hard currency sovereigns, this was driven by the high-yield segment of the market (-2.99%). The worst performing sectors were Real Estate (-3.35%), Metals & Mining (-3.27%), and Oil & Gas (-2.66%).

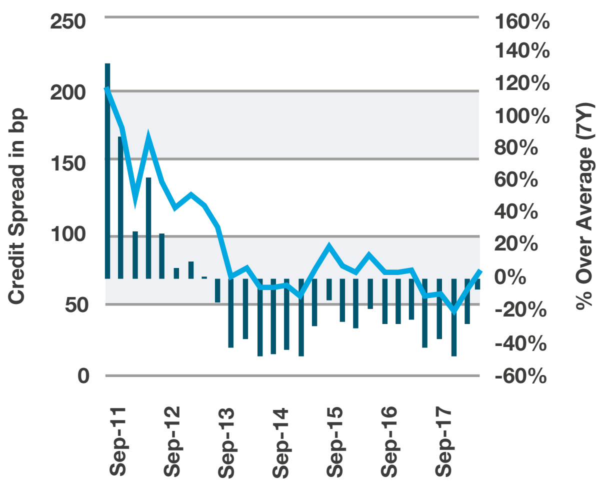
US IG CREDIT SPREAD CURRENT VS AVERAGE



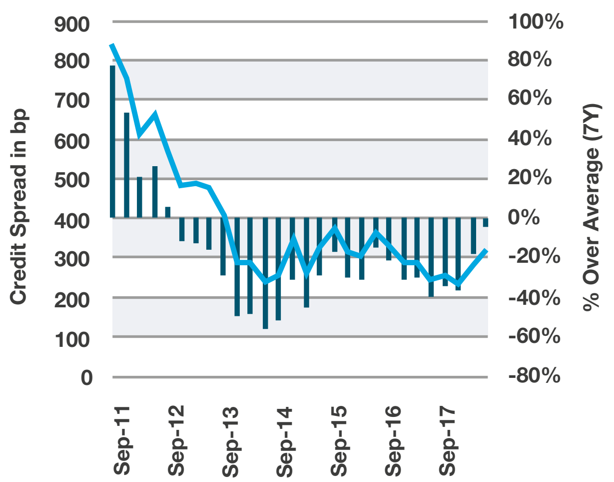
US HY CREDIT SPREAD CURRENT VS AVERAGE



EUROPEAN IG CREDIT SPREAD CURRENT VS AVERAGE



EUROPEAN HY CREDIT SPREAD CURRENT VS AVERAGE



Source: bfinance, Bloomberg.

Fixed income continued

MANAGER PERFORMANCE (TO END JUNE 2018)

	3m	YTD	1Y	3Y (p.a)
US Investment Grade*	**-0.86%**	**-2.85%**	**-0.26%**	**3.50%**
Barclays US Corporate IG	-0.98%	-3.27%	-0.83%	3.07%
Outperformance	0.12%	0.42%	0.56%	0.44%
Euro Investment Grade*	**-0.43%**	**-0.85%**	**1.14%**	**2.81%**
Barclays Euro Corporate	-0.25%	-0.64%	1.12%	2.49%
Outperformance	-0.18%	-0.21%	0.01%	0.32%
US High Yield*	**0.77%**	**0.09%**	**2.87%**	**5.14%**
BofA ML US High Yield Master II	1.00%	0.08%	2.53%	5.55%
Outperformance	-0.23%	0.01%	0.34%	-0.40%
EUR High Yield*	**-0.96%**	**-1.53%**	**0.86%**	**4.55%**
ML European Curr HY Constr. EUR Hedged	-1.21%	-1.68%	0.83%	4.24%
Outperformance	0.25%	0.16%	0.03%	0.30%
EMD – Hard Currency*	**-4.52%**	**-5.62%**	**-1.36%**	**5.19%**
JPM EMBI Global Diversified	-3.54%	-5.23%	-1.60%	4.63%
Outperformance	-0.98%	-0.39%	0.24%	0.55%
EMD – Local Currency*	**-11.11%**	**-6.88%**	**-2.68%**	**2.30%**
JPM GBI-EM Global Diversified	-10.40%	-6.44%	-2.33%	1.96%
Outperformance	-0.71%	-0.44%	-0.35%	0.34%
EMD – Corporates*	**-3.17%**	**-4.07%**	**0.29%**	**4.68%**
JPM CEMBI Broad Diversified	-1.77%	-2.87%	-0.14%	3.94%
Outperformance	-1.40%	-1.20%	0.43%	0.74%

Source: bfinance/eVestment

The Fixed Income Manager peer groups show the average performance of a sensible and representative sample of managers. We use these peer groups as a proxy for how managers in the space are performing relative to their benchmarks. They do not represent manager recommendations.

In US investment grade credit, 61% of active managers beat their benchmarks in the second quarter. Stronger performers tended to have underweight duration positions, since rising UST yields punished those with higher duration on their books.. On the flip side, the median European investment grade manager underperformed by -0.18% (36% beat the benchmark) with those overweight credit risk suffering more due to spread widening.

At this stage in the credit cycle, it is no surprise to see managers positioned more defensively. As such, many high yield managers have missed some of the market's short-term upswings. In a quarter where the US high yield market generated 1%, the median manager lagged by 25bps. Overall, only 27% of active managers outperformed their benchmark in the US. In Europe, a negative performing market this quarter, 80% of managers beat the index.

Fixed income continued

In a difficult quarter for the emerging markets complex, most managers struggled to stay above their respective benchmarks. In the hard-currency sovereign space, only 26% of managers outperformed the broad market index, with the median relative return being -0.86%. A bias to higher yielding countries there would have been a key detractor from performance. Similarly, the high yield complex was the hardest hit within the EM corporate bond space and only 3% of managers were ahead of the index in that market. Lastly, only 27% of managers beat their benchmarks in the EM local-currency space. This is consistent with the expectation that managers would have been caught with long EMFX positions in an environment that has seen the USD appreciate.

Fixed income continued

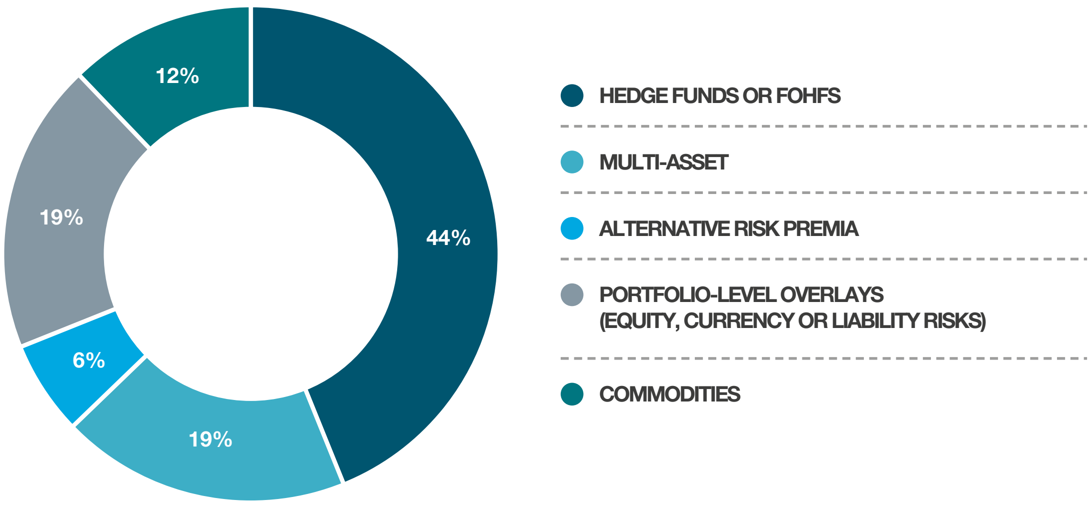
News from the fixed income manager world

- Simon Lue-Fong leaves Pictet Asset Management, where he was Head of Emerging Market Debt. His long-time colleague Mary-Therese Barton takes on the role.
- Jon Mawby leaves Man GLG, where he was co-manager of the Strategic Bond and Corporate Bond fund. His future destination is not yet known.
- Yvette Babb moves to NN Investment Partners as an Emerging Market Debt Fund Manager. She was formerly at JP Morgan as Chief Economist and Strategist covering Sub-Saharan Africa.
- David Forgash joins PIMCO as Head of European High Yield Portfolio Management. He was formerly at Millennium Capital Partners, where he focused on European Credit.
- Thomas Sartain goes to Invesco Asset Management as a Senior Portfolio Manager within the London based Fixed Income Team. Sartain, formerly a Fixed Income PM at Schroders, will be responsible for the Global Multi-Sector offering, including Global Aggregate strategies.
- MFS Investment Management veteran portfolio manager Richard Hawkins retires, leaving his roles on the MFS Meridian Funds (US Corporate Bonds and Global Opportunistic).
- Richard House joins Allianz Global Investors as Chief Investment Officer for EMD replacing Greg Saichin, who has decided to take a career break after five years with AllianzGI. He was formerly at Standard Life Investments as Head of Emerging Market Debt.
- Roman Gaiser moves to Columbia Threadneedle Investments as Head of High Yield Portfolio Management for EMEA. He replaces Michael Poole, who has resigned to relocate to the US. Gaiser will manage a number of European High Yield portfolios, including the Threadneedle European High Yield Bond Fund. He was formerly Head of High Yield at Pictet Asset Management.
- Following the recent restructuring of the Multi-Asset team at Aviva Investors, former Global Head of Fixed Income Daniel James leaves the firm. The restructuring will integrate the firm's Global Rates and Emerging Market Debt teams alongside other asset class specialists under the banner of Multi-Asset and Macro.
- Sid Chhabra heads to BlueBay Asset Management as Head of Structured Credit and CLOs. He will lead the initiative to establish a new range of BlueBay Global Structured Credit and ABS strategies. He was formerly at Anchorage Capital Europe.
- Fabrizio Pagani joins Muzinich & Co as Global Head of Economics and Capital Market Strategy. He had formerly held a number of roles in the public sector, including most recently Head of the Office of Italy's Minister of Finance.
- Markus Heider moves to GAM Investment Management as an Emerging Market Fixed Income Fund Manager.

Diversifying strategies

Clients look to mitigate equity, currency and liability risk at portfolio level.

NEW DIVERSIFYING STRATEGY MANDATES, YEAR TO JUNE 30 2018



Note: these figures only represent projects initiated after July 1st 2017 and do not include pre-existing client engagements that continued during the. year

Diversifying strategies continued

Investor trends

In the trailing 12 months to end Q2 2018, 15% of new manager searches by bfinance clients were for Diversifying Strategies including hedge funds, FoHFs, multi-asset, alternative risk premia (ARP), currency and commodities. However, the larger average mandate size – particularly in multi-asset and ARP – meant that this segment accounts for more than 25% of assets allocated.

Hedge funds remained the most populous category, with single manager and multi-manager allocations together representing 44% of Diversifying Strategy searches. Within the single manager hedge fund space we continue to note a preference for Equity L/S searches with a bias to market neutral approaches, as well as systematic multi-asset strategies such as CTA and Systematic Macro.

An interesting trend has been the resurgence in interest in the fund-of-hedge-fund space, which has accounted for nearly half of total hedge fund searches. All such projects have involved customised solutions, with clients looking for managers / advisors that place a clear focus on diversifying their existing portfolio exposures.

Outside of the hedge fund space, the team has been increasingly active in working on 'portfolio level' solutions for clients who are looking for **overlays** to explicitly hedge (or actively manage) equity, currency or liability risks. These projects now account for 19% of Diversifying Strategies activity.

Multi-asset projects have also remained popular, comprising 19% of searches. Clients' attention has primarily been directed toward customised multi-asset portfolios and absolute return, although investors should note that the "multi-asset" label covers an increasingly wide variety of strategy types. A framework for categorising these strategies can be found in a recent article by Chris Stevens (Director – Diversifying Strategies): *Seven Shades of Multi-Asset*.

While 2016-2017 saw a strong wave of activity in **Alternative Risk Premia**, appetite for this sector has now settled down to a more gentle pace; this category comprises 6% of new mandates. The balance of activity has focused on commodity investment (12% of engagements). That activity has been primarily focused on "enhanced commodities" (modest outperformance versus a passive index) rather than active hedge fund-type strategies.

Looking forward, we expect the above trends to continue with investors focused on making allocations to liquid diversifying strategies (principally ARP & hedge funds) or taking portfolio-level action to mitigate the risks their portfolios face in the current market environment.

Diversifying strategies continued

MANAGER PERFORMANCE (TO END JUNE 2018)

	3m	YTD	1Y	3Y(p.a)
bfinance Equity Long/Short Composite	-0.03%	1.04%	5.64%	6.90%
bfinance Event Driven Composite	2.16%	2.04%	7.50%	4.97%
bfinance Credit Long/Short Composite	-0.07%	0.30%	3.81%	1.36%
bfinance Macro & Trading Composite	-0.44%	-0.15%	6.45%	1.56%
bfinance Alternative Risk Premia Composite	-1.53%	-2.93%	1.33%	3.77%

The Hedge Fund Manager composites show the performance of a sensible and representative sample of each of the main hedge fund strategies. This is restricted to managers that genuinely pursue the relevant strategy rather than generating the majority of their returns from exposure to market direction alone. We use these composites as a proxy for how managers in the space are performing. They do not represent manager recommendations.

Q2 2018, as measured by bfinance's suite of composites, was broadly flat-to-negative for the majority of liquid alternative strategies. The only exception was the Event Driven group of managers, who posted a strong positive quarter to become the leading composite on both a YTD and trailing 12m basis.

The **Equity L/S** composite ended the quarter essentially flat at -0.03%, after positive returns in April and May were entirely offset by losses in June. This left the group up just over 1% YTD. Performance dispersion was considerable within this group, with a majority of modestly positive Q2 figures being offset by a few larger losses for the quarter (mainly resulting from the June trends). There was no clear differentiation in aggregate performance between lower net exposure strategies and more directional approaches for the quarter overall.

The **Event Driven** composite saw positive returns in all three months of Q2, with stronger performance generated earlier in the quarter. Broadly, returns followed risk levels, with stronger performance seen from the more aggressive / volatile strategies. The exception to this rule was the group of managers using merger arbitrage strategies, which also performed well over the quarter.

The **Credit L/S** composite continued to have a very muted 2018, with an aggregate return of -0.07% for Q2 leaving it up just 0.3% YTD. Positive performance in April was entirely offset by negative returns for the rest of the quarter and May in particular, when the majority of constituents reported negative attribution.

The **Macro & Trading** composite posted a Q2 return of -0.44%, pushing YTD performance into negative territory. At an aggregate level, positive returns generated in April were fully offset by negative attribution in May, with June closing out Q2 with modestly negative performance. CTAs and other trend-heavy strategies were the main driver of negative attribution in May, largely as a result of poor results from long (Italian) bond exposures, but otherwise generally performed positively through April and June. Although Discretionary Macro and Systematic Macro strategies were less impacted by May, we noted weaker performance through the rest of Q2, resulting in full-quarter returns not materially different from those of CTA-type strategies.

Finally, the **Alternative Risk Premia** composite saw broadly similar aggregate attribution to the Macro & Trading composite, although a more muted positive April, and a weaker June saw the ARP composite post a Q2 return of -1.53%, leaving YTD performance down -2.93%. In general, more significant negative attribution was seen from the constituents with a greater focus on trend-following and/or equity value signals; both of which suffered through the quarter.

Diversifying strategies continued

News from the alternative manager world

- Lansdowne Partners' chairman and senior partner, Stuart Roden, announces his upcoming departure after 17 years at the firm. Current COO Suzi Nutton will become CEO.

- BAML announces the sale of its UCITS hedge fund platform, Merrill Lynch Investment Solutions (MLIS), to the Italian group Generali Investments.

- Systematic asset manager Winton spins out its data analytics division, Hivemind. Winton's head of data science Daniel Mitchell becomes Hivemind's CEO.

- Old Mutual Global Investors' single strategy division rebrands as Merian Global following its joint PE and senior employee buy-out.

- Swedish pension fund AP1's head of alternatives, Martin Källström, joins Swedish systematic manager Lynx Asset Management as a partner.

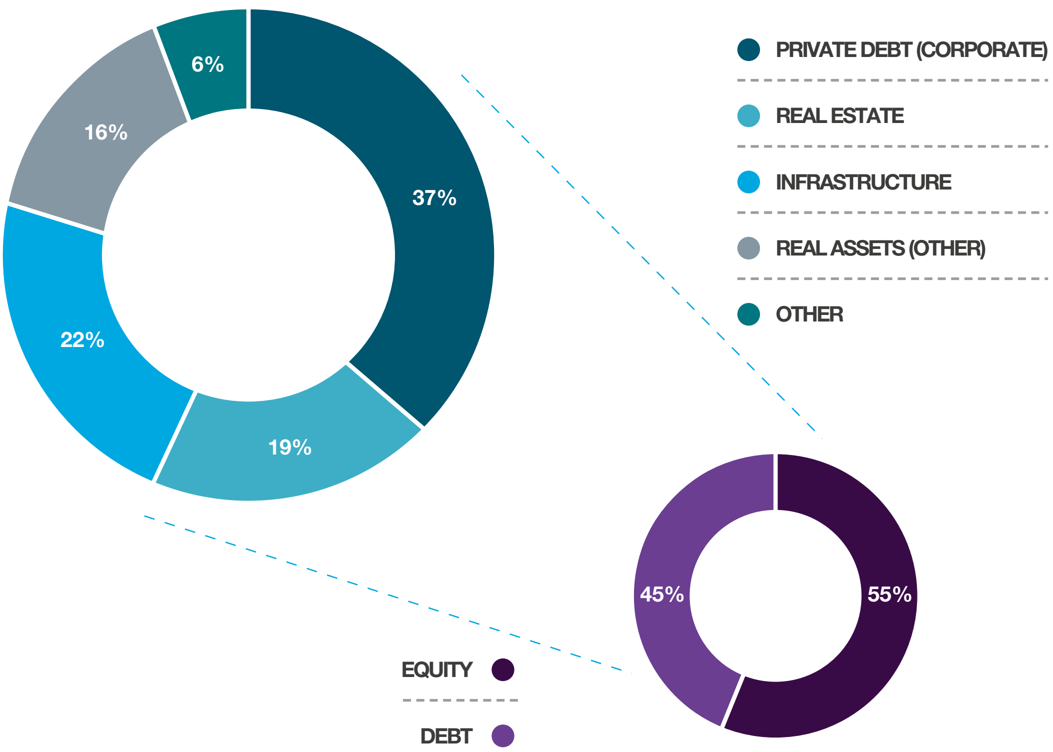
- HSBC Alternative Investment Group's head of hedge fund research, Heath Davis, leaves the firm.

- Leon Cooperman announces that his hedge fund Omega Advisors will convert to a family office.

Private markets

Real assets and private debt continue to dominate new allocations.

NEW PRIVATE MARKET ENGAGEMENTS, YEAR TO JUNE 30 2018



Note: these figures only represent projects initiated after July 1st 2017 and do not include pre-existing client engagements that continued during the year.

Private markets continued

Investor trends

Although industry-wide fundraising for private markets has softened in the first half of 2018, as discussed on page 25, bfinance has seen an opposing trend with an increase in manager search activity. Indeed, as shown on page six, bfinance clients have conducted more new manager searches in private markets over the past year than in equity, fixed income or diversifying strategies. Meanwhile, the average size of those mandates has increased by more than 25% since the prior year.

The two most popular sub-sectors among bfinance clients for the year to June 30th 2018 have been corporate private debt (37%) and infrastructure (22%) although, taken as a group, real assets (infrastructure, real estate and niche) make up more than half of manager searches.

Within infrastructure and real estate, appetite is oriented towards the value-added part of the market, but there is also strong demand for strategies that protect on the downside, including debt.

Indeed, the resurgence of appetite for "real asset debt" (infrastructure debt and real estate debt) has been one of the most interesting trends of the first half of 2018. In the chart on page 23, these are incorporated within the real estate and infrastructure segments. Overall, 45% of new manager searches in private markets have been on the debt side as opposed to equity.

CAPITAL RAISING MOMENTUM ACROSS PRIVATE ASSET CLASSES, 2018 Q1

Asset Class	Q2 2018 No. & Vol., and % change in share		Strategy & Geography Focus	Largest Fund Raises During Q2 2018
	No. Funds	Volume		
Real Estate	47 -27%	$22bn -40%	Sharp reduction in the number of large funds being closed. Value Added and Opportunistic continued to account for around two thirds of capital raised, with U.S. dominating.	• Landmark Real Estate Fund VIII, Secondaries Global, $3.3bn • Kayne Anderson RE Partners V, Opportunistic U.S., $2.9bn • GreenOak US III, Value Added U.S., $1.6bn
Infrastructure	17 116%	$25bn 93%	Surge of fund closings compared with prior quarter. U.S. (49%) and Europe (36%) dominated capital raising. Core and Core-Plus strategies accounted for the majority of larger fund capital raising.	• ISQ Global Infrastructure Fund II, Core-Plus Global, $6.5bn • Macquarie Asia Infrastructure Fund II, Core Asia, $3.3bn • Infracapital Partners III, Core-Plus Europ, £1.9bn
Private Equity	230 +7%	$85bn -3%	Although Buyout represented close to 50% of total capital, this was lower than in previous quarters, with an increase in VC (26% of total). The U.S. represented 43% with the remainder evenly split Asia & Europe.	• Carlyle Asia Partners V, Buyout Asia, $6.6bn • Bain Capital Europe V, Buyout Europe, $4.4bn • Nordic Capital Fund IX, Buyout Europe, $4.3bn • TowerBrook Investors V, Buyout U.S., $4.3bn
Private Debt	22 -23%	$25bn 29%	North America dominated capital raising at $16bn in 11 funds. There was a surge of Distressed Debt fund closing with these strategies accounting for close to 60% of capital raised this quarter.	• GSO Capital Solutions Fund III, Distressed U.S., $7.4bn • CVI Credit Value Fund IV, Distressed U.S., $3bn • Strategic Value Special Situations Fund IV, Distressed Europe/U.S., $2.9bn

Source: bfinance, Preqin. Note: Based on capital raised for closed ended commingled funds. Given the tendency for most recent quarter to be revised, the % change shows the change in the share of each asset class out of total private markets. For instance, in Q1, Infrastructure accounted for 8% of capital raised and in Q2 it accounted for 15.8%, an increase of 93%.

Market snapshot

The extended period of strong performance across private markets continues to support concerns around valuations in the various asset classes, although there are considerable variations by geography and strategy. Even those that are attractively priced in relative terms are fairly expensive in absolute terms. This challenge, and the need to identify more attractive or well-insulated opportunities, continues to be the primary concern for institutional investors working with bfinance.

Manager watch

The trend for consolidation and expansion across private markets has continued during the course of the year. Beyond the acquisition of smaller, boutique-type, managers by larger platforms there has been a refocusing of the strategies of some of the larger managers. A good example of this was the decision by Aviva Investors to create a real assets platform (encompassing real estate, infrastructure and private debt activities, led by Mark Versey), and the sale of its Real Estate Multi-Manager business and its share of the pan-European core fund (Encore+) to LaSalle.

The consolidation of the REIT market also continues, with more companies being taken private. This was particularly apparent in the logistics market, with the Prologis' $8.4bn acquisition of DCT Industrial Trust and Blackstone's planned acquisition of Gramercy Property Trust for $7.6bn. Readers should note that the bfinance Private Markets and Equity teams work together on projects relating to REITS and Listed Infrastructure; manager searches for these two sub-sectors are shown in the Equity section of this report.

Spotlight on: fundraising

Following on from the trend discussed in the previous quarterly report, there appears to be a continuing slowdown of capital raising. Q2 figures are considerably down on Q2 2017, when a record $223bn was raised in 535 funds. The results for Q2 2018 were $156bn in 316 funds, nearly 30% below the previous level. This slowdown is a consequence of a range of factors including the high levels of dry powder and the challenges of deploying capital across most private asset classes, as well as increasing concerns over asset class pricing. That being said, it is difficult to draw concrete conclusions from the Preqin quarterly datasets as the results tend to be revised upwards in subsequent quarters.

Although **Private Equity** continues to generate the majority of capital raising at $85bn in Q2, there has been a significant slowdown here in absolute and relative terms. For much of 2016 and 2017, capital raising was well above $100bn per quarter (averaging $125bn), and this has fallen to an average of less than $90bn across Q1 and Q2 2018. There has also been a decline in Private Equity's share of overall private market fundraising: the sector accounted for close to 70% of the total in the first half of 2017, but closer to 50% in the first half of 2018 (54% in Q2). This is driven, in part, by high levels of dry powder and the challenges of deploying capital.

Although **Infrastructure** also faces the challenge of high levels of dry powder and aggressive pricing of assets, there has been a surge of capital raising. The $25bn raised in Q2 represents the highest level since Q1 2017. This surge means that the asset class accounted for 16% of total Private Markets capital raised, up from around 6% for much of 2017.

The spike of **Real Estate** capital raising in Q1 was sharply reversed in Q2, with just $22bn in the quarter. This was not a surprise as the Q1 numbers were driven by the closing of two large funds (half the capital raised in the quarter), and continues the recent downward trend following the peak levels reached back in 2015. As a consequence, Real Estate accounts for just 14% of all private markets capital raised, when it has traditionally been closer to 20%.

As in previous quarters, the appetite for **Private Debt** remains strong. Yet, even for this asset class, levels of capital raising were slightly down on prior quarters. During 2016-17 quarterly capital raising was close to $30bn, but this has fallen to $22bn in the first two quarters of 2018. Appetite remains strong, with a record number of funds in the market: Preqin reporting 389 funds seeking to raise an overall $180bn.

Private markets continued

News from the private market manager world

- At Savills Investment Management, Nick Cooper and Kiran Patel take on the roles of chairman and global CEO, respectively, from Justin O'Connor.
- Serkan Bahceci joins Arjun Infrastructure Partners, having led infrastructure research at JP Morgan Asset Management.
- Columbia Threadneedle Investments hires Heiko Schupp to lead their new initiatives in Infrastructure.
- A number of managers are bringing in hires with strong "tech" background, reflecting the increasing significance of technology in private markets, particularly real assets. A few of the most significant appointments are listed below.
- Nuveen appoints Jack Sibley as Innovation and Technology Strategist.
- Macquarie Infrastructure and Real Assets hires Peter Durante as managing director to co-ordinate MIRA's application of new technologies across EMEA.
- JLL brings in Vinay Goel from Google as chief digital product officer.

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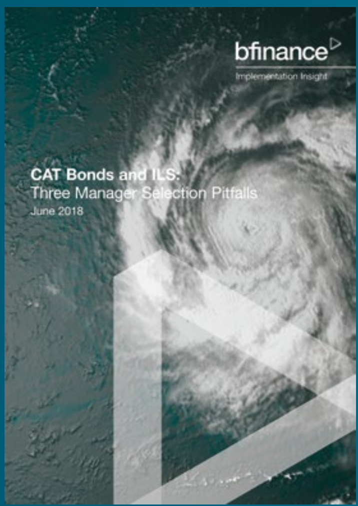
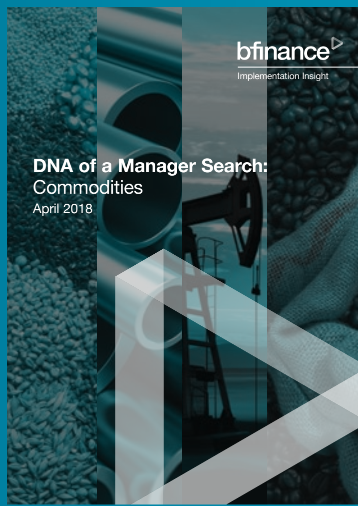


CAT Bonds and ILS: Three Manager Selection Pitfalls
(June 2018)

Sector in Brief: Private Market Secondaries
(May 2018)



DNA of a Manager Search: Commodities
(April 2018)

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