

## Update: Hedge Fund Performance and Short Selling Bans in Times of the COVID-19 Pandemic

### Q1 Update: Hedge Fund Performance

The outbreak of the COVID-19 pandemic had a significant impact on global markets in the first months of 2020. Hedge fund managers were confronted with volatile prices in equity, debt and commodity markets. The MSCI World Index fell by 21.4% in the first quarter of 2020. Unfortunately, investors were not able to fully escape the price losses, even through hedge fund investments. Those strategies strongly correlated to public equity markets were affected substantially. Equity strategies (-14.6%) and event driven strategies (-16.1%) recorded significant losses in Q1 2020. Against the backdrop of the economic uncertainty and the market dislocations caused by the COVID-19 pandemic on the other hand, macro strategies (-3.0%) and relative value strategies (-3.8%) in particular diversified the losses of traditional equity investments in Q1 2020 (see Figure 1).

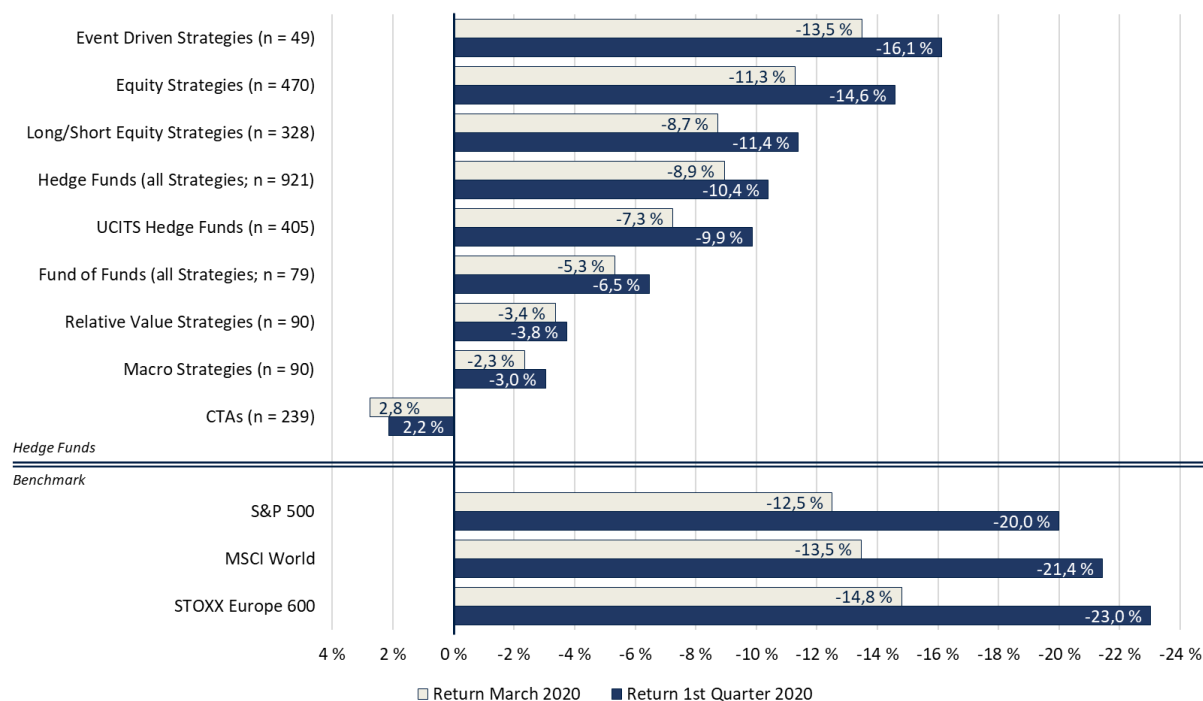


Figure 1: Hedge fund strategy index performance vs. popular stock market index performance Q1/March 2020 (n = number of included hedge funds), own illustration, hedge fund index data: PreqinPro, as of 20.04.2020.

Put simply, Figure 1 shows, generating returns was a particular challenge in the first quarter of 2020. That said, the capital market recovery in the last week of March benefited hedge fund managers as well, saving some hedge funds from setting of NAV triggers<sup>1</sup>. In order to put the previous hedge fund performance during the Corona crisis into perspective, it is useful to compare it to the last major crisis with strong market distortions. The index losses recorded in March 2020 (-8.9%) are greater than those at the height of the financial crisis in September (-6.7%) and October (-8.1%) 2008. Concrete effects of the corona crisis on hedge fund

<sup>1</sup> The maximum amount of the decline in the net asset value as defined in the business agreements between hedge funds and counterparties. If the net asset value falls by a certain percentage within a specified period, the counterparty may terminate the trading relationship at the expense of the hedge fund.

managers can already be quantified. With 87 new hedge fund launches worldwide in Q1 2020, the number has fallen sharply compared with the previous year (Q1 2019: 235).<sup>2</sup> Hedge fund managers are thus anticipating the conservative hedge fund investments expected by investors in the coming months.

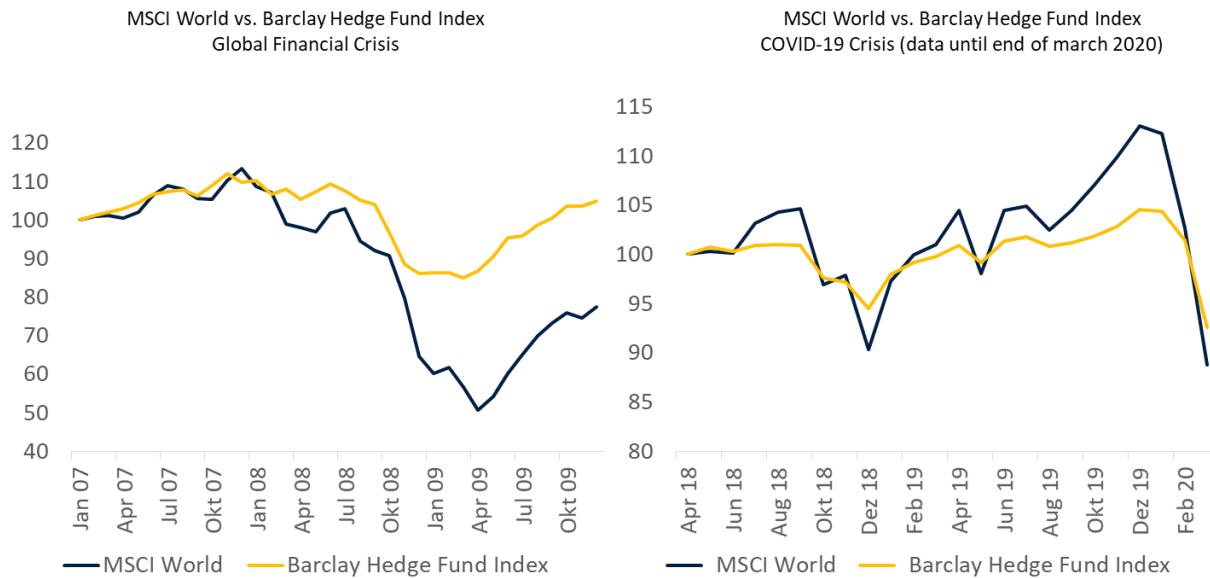


Figure 2: Barclay Hedge Fund Index vs. MSCI World Performance (end of month), own indexed illustration, source of hedge fund index data: Barclayhedge.

### **April Update: Short Selling Bans**

The bans on short selling in France, Spain, Austria, Belgium and Greece have been extended until May 18, 11:59 PM, with the possibility of a further renewal. The measures enter into force on 16 April 2020 for FMA, 17 April 2020 for AMF and FSMA, 18 April 2020 for CNMV, 25 April 2020 for HCMC (see *Table 1*). The bans in Italy remain in place as planned. Possible negative effects on liquidity, volatility and spreads are expected to persist accordingly. To be welcomed is therefore the fact that Germany has refrained from taking such a step and is allowing the markets to operate without restrictions on short selling. Germany's position will have a major barring on what other authorities in Europe could potentially do. If Germany shifts positions in favor of a short selling ban, it could potentially shift the balance in Europe in terms of having a Europe-wide restriction. Short selling bans should, in principle, be the last resort of national supervisors. Regarding the pros and cons of short selling bans, please also refer to the literature below.<sup>3</sup>

<sup>2</sup> See Preqin Ltd. (2020): Preqin Quarterly Update: Hedge Funds Q1 2020.

<sup>3</sup> On the question of the regulation of short selling, see for example Zetzsche/Lehmann in: Schwark/Zimmer, Kapitalmarktrechts-Kommentar, 5. Aufl. 2020, § 53 WpHG Rn. 4 ff.; zum Aufsichtsrecht der Leerverkäufe vgl. F. Schäfer in: Assmann/Schütze/Buck-Heeb, Handbuch des Kapitalanlagerechts, 5. Aufl. 2019, § 21 Rn. 9 ff., with further evidence in each case; for the effects of short-selling bans, see for example): [ESRB \(2018\)](#): Short-selling bans and bank stability, Working Paper Series No 64 / January 2018; [CFS \(2013\)](#): The 2011 European Short Sale Ban on Financial Stocks: A Cure or a Curse?, CFS Working Paper No. 2013/17; [Beber/Pagano \(2013\)](#): Short-Selling Bans Around the World: Evidence from the 2007–09 Crisis, in: Journal of Finance, VOL. LXVIII, NO. 1.

<b>Country &amp; Duration</b>	<b>Measure</b>	<b>Updates &amp; Exemptions</b>
<b>Spain (CNMV)</b> Measures extended until 18.05.2020	The measures apply to shares admitted to trading on Spanish stock exchanges and to all related instruments relevant to the calculation of the net short position.	Exemptions for market making activities & transactions in indices/ETFs etc. baskets where banned shares represent less than 50% + subscription rights/convertible bonds.
<b>Italy (CONSOB)</b> Measures apply until 18.06.2020	The measures apply both to transactions in selected shares and to all related instruments relevant for the calculation of the net short position.	Exemptions for market making activities & transactions in indices/ETFs etc. baskets where banned shares represent less than 20% + subscription rights/convertible bonds.
<b>France (AMF)</b> Measures extended until 18.05.2020	The measures apply to shares admitted to trading on French stock exchanges and to all related instruments relevant for the calculation of the net short position.	Exemptions for market making activities & transactions in indices/ETFs etc. baskets where banned shares represent less than 50% + subscription rights/convertible bonds.
<b>Belgium (FSMA)</b> Measures extended until 18.05.2020	The measures apply to shares listed on Euronext Brussels and Euronext Growth.	Exemptions for market making activities & transactions in indices where banned shares represent 50% or less (increased from 20%); carve-outs for subscription rights/convertible bonds
<b>Greece (HCMC)</b> Measures extended until 18.05.2020	The measures apply to shares admitted to trading on the Athens Stock Exchange and to all related instruments relevant for the calculation of the net short position.	Exemptions for market making activities & transactions in indices where banned shares represent 50% or less (increased from 20%)
<b>Austria (FMA)</b> Measures extended until 18.05.2020	The measures apply to all shares admitted to official trading on the Vienna Stock Exchange.	Exemptions for market making activities & transactions in indices/ETFs etc. baskets where banned shares represent less than 50%. Ban now applies to net short positions rather than any short sales; carve-outs for subscription rights/convertible bonds

Table 1: Summary of current short selling ban measures in EU Member States entering into new/increasing existing net short positions, in-house illustration.<sup>4</sup>

<sup>4</sup> Recent changes source: AIMA Webinar "Short Selling Bans Review". BaFin notice dated 23.03.2020: Instruments based on the Euro STOXX 50®, STOXX® Europe 600, MSCI Europe, MSCI EMU indices are exempted from the short selling prohibitions, i.e. trading in the instruments is possible and not covered by the prohibitions. Instruments based on the Euro STOXX® Banks index are partially excluded (see link). The restrictive measures only apply to index-related instruments if the shares covered by the prohibitions represent more than a defined threshold value of the index weighting in each case. This is not the case for instruments based on the Euro STOXX 50®, STOXX® Europe 600, MSCI Europe, MSCI EMU.

As a reminder, on the basis of Art. 28 (1) (a) of Regulation (EU) No. 236/2012 of the European Parliament and of the Council of 14 March 2012 ("EU Short Selling Regulation"), ESMA, the European Securities and Markets Authority, has introduced a reporting obligation for holders of net short positions of 0.2% to 0.1% of the issued nominal value. The publication threshold of 0.5% remains unchanged. Provisions of the EU Short Sale Regulation also apply outside the EU and to natural or legal persons from third countries. The positions must be reported to the national supervisory authority responsible for the market. The ESMA measure entered into force on 16 March 2020 and will apply for three months (market-making activities are excluded). The previous notification and publication thresholds pursuant to Articles 5 and 6 of the EU Short Selling Regulation continue to apply without change.

Bonn, 23.04.2020

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