



## Smaller is better as Canadian hedge funds outperform global rivals

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Minuscule though they may be, Canadian hedge funds are dwarfing the returns of their bulky global peers.

Canadian hedge funds, with about \$35-billion under management, returned almost nine times as much as the nearly \$3-trillion global industry in the year through September, extending their outperformance from 2015.

Being small and nimble has given Canadian funds an edge, even as the industry has faced criticism for high fees and middling performance. Investors withdrew \$51.5-billion from funds in the first nine months of the year, the most since the aftermath of the global financial crisis, according to Hedge Fund Research Inc. Managers have blamed big index funds for warping markets, near zero interest-rate policies and government regulation for their poor performance.

Canadian hedge funds, with a median \$93-million under management, had returned 6 per cent in the year through the end of September, according to the asset-weighted Scotiabank Canadian Hedge Fund Index. That compares with a 0.7-per-cent return from global hedge funds, as measured by the Hedge Fund Research HFRI Asset Weighted Composite Index. In 2015, Canadian hedge funds posted a 6.2-per-cent return, while global funds suffered a loss.

For John Zechner, founder and chairman of asset manager J. Zechner Associates Inc., exploiting the distortions caused by exchange-traded funds has been a way to make money. The firm's Global Hedged Growth Fund, which has \$10-million of assets, returned 33 per cent in the 12 months ended in June, making it the best-performing global multi-strategy fund at the Canadian Hedge Fund Awards in October.

"We're that little fish that goes behind the shark," Mr. Zechner said in an interview at his Toronto office. "The shark is the big index funds that are moving through and they're going to throw off a lot of very edible stuff that we can feast on all day long."

## **Younger Industry**

Mr. Zechner trades actively, shifting 5 per cent to 10 per cent of his portfolio daily, playing different indexes, commodities and spreads. One of the trades that made him money this year was shorting a gold-stock ETF while buying a bullion ETF when stocks were up 100 per cent on the year and gold had only risen 10 percent. Gold stocks then corrected and he pulled out of the trade with a profit.

A big reason why Canadian hedge funds have outperformed their U.S. counterparts is because the relative size and youth of the industry, said Peter Klein, chief investment officer at Bull Wealth Management Group Inc. and a professor of finance at Simon Fraser University.

"You've got less capital chasing a greater number of opportunities on a relative basis in Canada as compared to the U.S.," Klein said. The industry only really began to take off after 2008 as former bank traders began opening their own funds.

## **Pulling Back**

Algonquin Capital Corp., manager of the Canadian credit-focused fund with the best one-year return at the industry awards, has outperformed by pulling back on risk ahead of big global events. The team bought five-year Canadian government debt which gained in the wake of the surprise Brexit vote, cashed that in shortly after, and bought corporate paper, which was then cheaper. Purchases included BBB names such as Molson Coors Brewing Co. and Fairfax Financial Holdings Ltd.

"We approach every day as a day when we can make money, and some days that becomes maybe let's not lose money," Brian D'Costa, a partner at Algonquin and former head of fixed income and rates at Canadian Imperial Bank of Commerce, said in an interview at his Toronto office. Algonquin's debt fund returned 19 per cent for the year ended June, beyond the 6 per cent to 9 per cent it targets.

Algonquin also gained with sector calls this year, such as buying oil and gas bonds and Canadian bank subordinated debt, said Greg Jeffs, Algonquin's partner in charge of the corporate-bond portfolio and a former executive director at CIBC.

## Solving Riddles

Stornoway Portfolio Management Inc., which manages the Stornoway Recovery Fund LP, focuses on solving the "riddle" of insolvent companies. The company, with about \$45-million under management, buys distressed debt, typically from high-yield investors looking to get out. They look for three to four investments a year, targeting companies valued at about \$100-million to \$300-million.

"We read covenants. We read trust indentures. We actually enjoy it," Scott Reid, Stornoway founder, said at the fund's office in Toronto. The fund has had the best five-year returns for three years running at the Canadian Hedge Fund Awards, chalking up a 13-per-cent gain for this year's results.

Stornoway, named after the official residence of the opposition leader in the Canadian Parliament, has been recently involved in the restructuring of GuestLogix Inc., a Toronto-based tech company, and meat producer and distributor Specialty Foods Group Inc.

In a low-yielding world with shrinking bank desks, competition in Canada's hedge fund industry will likely rise. So what is a Canadian hedge-fund manager left to do?

"Put your head down and get back to work," said Raj Tandon, co-founder at Algonquin and former structured-credit trader at Toronto-Dominion Bank in London.

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