Jefferies Prime Services Monthly

MARCH 2018

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Jefferies

These Are Consequential Times: March's Ongoing Madness

Markets continue their upward march to all time highs. Recent job numbers indicate the US economy keeps strengthening and global growth accelerated in most major economies in 2017.

At the same time, we have an extremely *eventful* Administration in Washington, the U.K. has entered an (as of now) minor diplomatic skirmish with Russia, and we lost one of our most brilliant thinkers with the passing of Stephen Hawking.

It seems, as Stephen Colbert says, these are consequential times. Here's some other things of consequence we've been focused on recently:

1. **The New ODD: Operational & Data Diligence**. The due diligence process has contributed to the institutionalization of the alternatives industry. The newest dimension includes ensuring any new data sources are vetted and onboarded with the same compliance focus as other information sources. Allocators and managers want to understand and feel comfortable with all stages of their information supply chains. We will release a two pager on this topic next week.
2. **Keeping an Eye on Crypto**. It's been an eventful month for cryptocurrencies as well. Google joined Facebook in banning cryptocurrency related advertising. The SEC released a statement indicating it may look to apply securities laws to everything from crypto exchanges to digital asset storage companies. Japan is cracking down on cryptocurrency exchanges after a material hack.
3. **Man-Made Data Lakes**. A growing number of funds report working on building their own data lakes to centrally store data (see right). Typically these firms look to leverage third party experts in helping build these, and they came up as a common topic at Battlefin Miami.

Q1 is winding down on an already eventful year. Volatility returned, but we think net inflows have, too – as anecdotal reports of new capital continue to roll in. We'll continue to keep an eye on the potential head and tailwinds that could make 2018 one of the strongest, and perhaps most interesting years in recent memory.

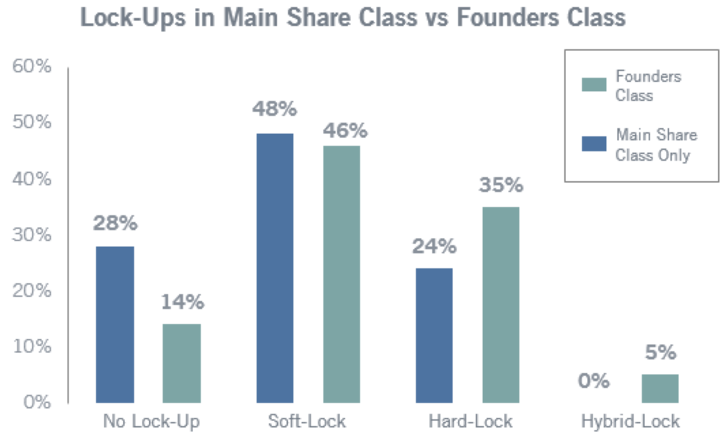
To help stay on top of it all, we are hosting **Finger on the Pulse**, with **experts from Ernst & Young** on Thursday April 22nd. Please email eshea@Jefferies if you would like to attend.

2018 Hedge Fund Performance Review | HFRI

Strategy	Feb-2018	YTD
HFRI Event Driven	-0.60%	0.69%
HFRI Macro	-3.93%	-1.27%
HFRI Relative Value	-0.63%	0.51%
HFRI Equity Hedge	-1.51%	1.39%
HFRI Fund Weighted Composite Index	**-1.84%**	**0.50%**

Source: HFRI

The Longer the Lock Up…



Last month we dug into Founders Share terms and fees. This month the spotlight is on locking up early stage capital.

Nearly half of all managers have a soft lock, in both Founders' and main share classes, but it is increasingly common for allocators to lock their capital up (in some cases, for up to 2-3 years), in exchange for lower incentive fees or more attractive.

When a hard lock is involved, incentive fees drop anywhere (on average) from 17.5% to 12.5%. In some cases, allocators are seeking crystallization of performance to be more in line with duration of capital.

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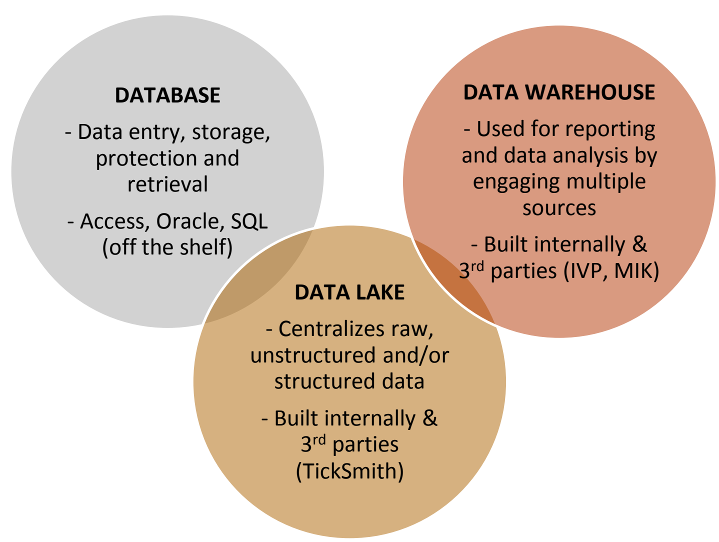
From Database to Data Warehouse to Data Lake

A growing number of firms are looking to build their own data lakes – central repositories of raw, structured and unstructured data from multiple sources. Data lakes emphasize the flexibility and availability of data – and organizations are looking to build these now in order to marshal current and historic data that may be used down the road.

Here's a quick primer on the shift from database to data lake.



Jefferies Capital Intelligence Corner

As we head into tax season, many firms are focused on nailing the minutiae of the new regulations. But what else *besides* tax is keeping clients busy?

1. **Expenses, expenses, expenses.** While much focus has been turned to revisiting various fee paradigms, we're hearing that a number of allocators have put expenses (particularly fund expenses) back in view for 2018. They're specifically working to ensure that any "concessions" or "compression" that happened on the management or incentive fee sides haven't merely made their way to a fund expense buckets. These conversations are ongoing, but obviously most productive when both managers and allocators have a clear, concise and appropriate view on what is charged where.
2. **We're almost 3 months into the year – what does 2018's launch pipeline look like?** Robust – but also somewhat different from past years. The back end of 2017 had a much stronger flow of individuals raising an eye to a likely 2018 launch… which is notable given hedge funds' outperformance (and in some cases, considerable outperformance) last year. A high number of these mentioned they believe the forward opportunity set is as constructive as they've seen in a decade – across most asset classes – and they want to get involved. But that doesn't mean all asset classes are seeing the same number of potential launches. We continue to see "generalist exhaustion," with more sector focused funds and Event Driven shops coming to market in 2018 than their generalist Equity Long/Short brethren.
3. **Finger on the Pulse:** Much has happened in the tax and regulatory space in recent months. To help clients understand this continually moving landscape, we are cohosting an event on March 22nd with Partners from Ernst & Young to review their 2017 Global Hedge Fund and Investor Survey and see what has changed through Q1 this year. To RSVP to this session, "*Finger on the Pulse*," please email eshea@Jefferies.com.
4. **Clients Are Asking:** We launched a new video series *Clients Are Asking*, to do a deeper dive into the interesting, unique or frequent questions we're getting from clients. Click here to view the video, and please let us know if you have any questions you'd like addressed.

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Postcards from Chicago

We spent time in the Chicago area recently, meeting with allocators throughout Chicago, Evanston, Highland Park and Lake Forest, among others. Topics discussed and firms visited were highly diverse.

Of particular note:

- **The Chicago landscape** - continues to evolve – in some ways, among the most rapidly changing we cover. Given ongoing consolidation in the FoHF space there – there are simply fewer of those organizations that are particularly active in the new launch space.
- Most allocators have **mature and built out portfolios**; as such, when adding new managers to their portfolios, the focus is on differentiation to the broader portfolio and what additional alpha that manager adds absolutely and relative to the rest of the book.
- The allocating community is much more heterogenous, and should be viewed as such when considering where a fund's value proposition may fit in a broader portfolio
- Single and multi-family offices continue to be active, typically focusing on managers with at least $500 mm in AuM and 3 year track records. While some are willing to come down the AuM spectrum, most family offices remain less willing to take on business risk of new launches unless there is a prior relationship with the manager (of at least 1 – 3 years).
- **Portfolio Trends**: appetite for internationally focused managers, particularly Europe and Emerging Markets. While this has been largely in the Long Only bucket – it also holds true for alternatives and fixed income exposure as well, as investors seek lower valuations and opportunities in less efficient markets.
- Uncorrelated and niche searches remain high – but while demand is there, there are less actionable allocations being made to this space, in part due to the longer diligence process.
- **Current appetite:** 1) Generalist equity long short managers with a variable net bias and 2) Concentrated (15 to 25 positions) long only and/or long biased equity managers.
  - Some of this capital will be coming from reallocations of other underperforming managers; others are looking to come down the AuM spectrum.
- **Keeping an eye on:** What lies ahead in the wake of Lighthouse's Mesirow acquisition.

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MENDING YOUR FENCES: 2018 REFRESH ON CYBER

Maybe it's just the headlines, but we've had a material uptick in requests for and questions about our cybersecurity materials. It's always a good time to ensure your firm is staying on top of current best practices. Clients have been spending time on the below to ensure they're keeping themselves protected in light of ever growing and persistent threats.

- **Conducting table top cyber breach scenarios**. Often with the assistance of 3rd party experts. Have personnel changed since your last cyber simulation? Firms report conducting these acute event walk throughs every 12 – 18 months.
- **Vendor due diligence**. Particularly in light of the looming GDPR laws in Europe, firms are revisiting any external organization that touches their firm's data to ensure their practices and standards remain as high as the manager's.
- **Passphrase policies**. We've moved on from pass*words*. Firms continue to explore multi-factor authentication as potential ways to add additional security to their data perimeters.
- **Revisiting training**. Q2 is often a popular time to conduct thorough cybersecurity training. Post-tax season and before the summer slumber, Q2 offers a good opportunity to remind employees of best practices for protecting both professional and personal data.

For further information: please contact Erin Shea – eshea@Jefferies.com

Top Jefferies Research Reads in recent weeks

Leaders of the Pack:

- Active v. Passive Debate 2.0 – the Kettle is Moving from Simmer to Boil
- Two Weeks in Two Minutes: Late cycle, Small Caps and Shale
- Reading the Yee Leaves: Bull-Bear on Big-Caps and Catalyst Calendar for Top Events
- Notable Takeaways from FB's 10K
- NKTR: Report of NKTR Exploring Strategic Options a Logical Development

Other Notable Reads

- A Trip Around the Block: Online Real Estate Deep Dive
- Finding Fresh Arms in the Bottom of the 12th: Stocks That Can Still Work

Jefferies Equity Strategy: US – Passive Aggressive

- Over the past month meetings with US equity investors hint that they are evenly split between buying growth or buying income plays (reach for yield proxies). While the 'yield seekers' may point to a peaking in economic data and the fact that the real US 10 yield is above zero versus its peer group, we would counter that the S&P 500 earnings and sales revisions are still climbing alongside resilient corporate pricing power and a weak dollar.
- The US yield curve was undecided whether to flatten or steepen on the impressive February employment data (313k, unchanged unemployment rate 4.1%) and the fact that 97% of the people who joined the labor force got a job! The deceleration in AHE for all private sector workers to 2.6% from 2.8% seems to have provided a 'goldilocks' cushion for asset markets.
- US equity investors continue to remain skittish. The return of interest in US equities previously was short-lived. Investors returned to sell with a US$9.5bn liquidation. Large caps, information technology, industrials and the healthcare sectors suffered substantial withdrawals last week. Year-to-date, Energy is the only sector that recorded net injections.
- Full note: US Strategy: Passive Aggressive available here

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Spring Awakening: Fitness Wars – The Pumped Up Primer 2.0

The days are getting longer – and in most places outside of New England – somewhat warmer. Randy Konik and team just released an update of their inaugural fitness deep dive from May 2017.

They refreshed perspectives with new data sets and channel checks. Analysis of industry dynamics, emerging themes, key players, valuation trends, and M&A reveals disruptors at the High-Value Low-Price (HVLP) end of the spectrum, pressure at mid-market gyms, and more innovation in equipment. We remain Hold-rated on PLNT primarily due to valuation, as well as increasing competition in HVLP.

HVLP Is Our Focus For '18. HVLP Disrupting Legacy Pricing & Biz Models. What started as cardio and strength equipment in a box for $9 – $19/mo has evolved into premium amenities that mimic offerings of legacy gyms at still discounted prices. Our proprietary LT industry growth model underscores the substantial backlog in unit growth, pointing to a 20% 3-year CAGR through '20. This outsized growth (~2x of PLNT's unit CAGR) along with high-margin biz models (e.g., personal training) could moderate PLNT's growth LT.

What HAS Changed Since Fitness Wars Vol. 1:
(1) Industry datapoints have strengthened. Physical inactivity has decreased in most states, but 45% of adults are not sufficiently active to achieve health benefits, leading to $117B in annual healthcare costs, which we believe will be a catalyst for more federal government funding and corporate wellness programs to spur gym memberships.
(2) PLNT's growth has accelerated. Planet Fitness reached 1,500 locations at the end of '17, and robust domestic growth is now being complemented by new int'l locations.
(3) At-home fitness has picked up steam. Peloton remains the pioneer with a war chest of ~$440M in VC funding to innovate. FlyWheel is the most recent entrant, and we expect more in the coming years.
(4) Equipment providers are prioritizing technology more. Vendors are responding to the push from clubs for more tech-enabled equipment to satisfy user demands and up-sell higher-margin memberships. Our review of product innovations lead us to believe monitoring of vitals, programmatic feedback, and VR will be aspects of new-age equipment for years to come.
(5) Valuations have expanded. As PLNT reached 35x P/E and 19x EBITDA, we moved to the sidelines believing valuation was fair and upward EPS revisions were unlikely.

To read what HASN'T changed since Fitness Wars Vol. 1, and to read the full note – please click here.

Original Fitness Deep Dive (May 2017) available here

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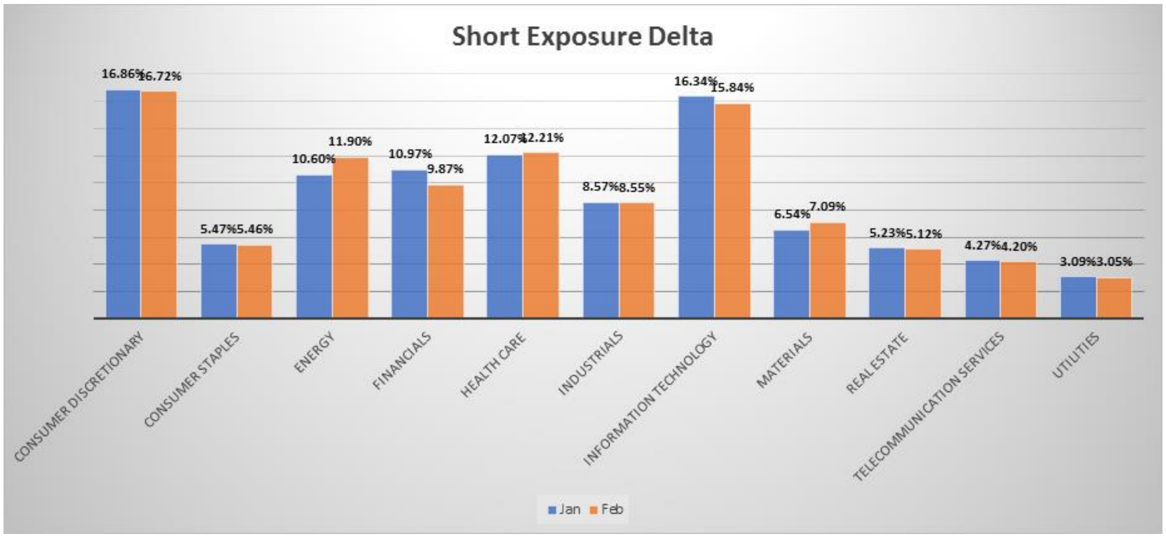
Jefferies Stock Loan Corner

U.S.: Overall short exposure remained steady over the past 30 days on the US book. We've continued to see portfolios rotate into different sectors, with the below indicating that shorts have increased exposure to the Energy and Materials sectors. The increase in the Energy sector has been driven by an increase to Integrated Oil and Gas companies. There has also been a reduction to short exposure in Financials, Diversified and Money Center Banks, as well as in Technology. ETFs have become a larger percentage of the book - increasing roughly 10% over the last 30 days.



Europe: We saw a relatively busy month in Europe with opportunistic buying from an increase in volatility and short side positioning combined with a significant increase in activity in the European M&A space with particularly strong trading in Smurfit Kappa group (SKG LN), GKN/Melrose (MRO LN) and SKY Plc (SKY LN), we also saw the Tesco/Booker deal come to a close.

Strong European M&A Pipeline includes:

GVC/LCL – Continued interest as the triennial review looks like it may drag on and the potential upside looks less attractive under a longer time horizon.

MRO/GKN – Melrose's hostile takeover continues to rumble on with a new 'sweetened' bid by Melrose this week. The proposal has been rejected by GKN and pension schemes are still being negotiated.

UBM/IFN – Informa have launched a bid for UBM. Deal is cash and stock which could result in a mix and Match offer.

SKY/FOX - completion does seem to be edging closer with the companies are looking to remedy the CMA findings. Sky is now trading through the terms.

ABE/HOT – New speculation that there will be a joint bid by ACS/HOT and Atlantia for Abertis, announcement expected in the next 2 weeks.

SKG/IP – SKG rejected a EUR 36 bid from IP, talk of a new bid around EUR 40 possibly in the pipeline.

Asia: Overall the broader HF universe quieted down significantly heading into the Chinese New Year as most flows shifted to Japan, with most markets shut or greatly down on liquidity. Post the CNY, activity has returned, with some clients searching for new shorts and some traditional names that have been popular, have been rallying hard creating caution (Prada spiked up on their positive growth forecasts, LGE is approaching new highs). It's about timing as much as the stock. There seems to be reasonable liquidity waiting to be deployed on shorts. Anecdotally the battleground in Asia has continued to be in the quant space, as long /short funds have not been as active in traditional shorts and there has been limited notable events to play.

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Most Active Hard to Borrow U.S. Stocks

Security	Utilization	Quantity on Loan	SI Delta Since 1/31/18	Indicative Fee
HIMX	97.46%	25,354,888	3,717,260	-2.6936
QD	89.84%	10,551,983	2,085,181	-13.734
FTR	84.66%	32,140,004	2,079,642	-30.4178
RCII	81.76%	23,607,216	1,844,420	-1.8331
DO	83.61%	24,282,866	1,814,278	-2.4788
TK	89.56%	12,781,552	1,724,068	-2.3227
TXMD	80.70%	56,015,800	1,693,932	-1.1577
BT	90.62%	1,587,199	1,558,579	0.4371
UBNT	91.92%	8,545,053	1,539,160	-14.7971
ROKU	96.84%	7,102,411	1,523,024	-110.7895

Source: Markit/Jefferies

JEFFERIES UPCOMING EVENTS

Learn 2 Quant Scheduled for Nearly 10 Cities in 2018

On the back of three successful Learn 2 Quant conferences last year in New York, Hong Kong and London, Jefferies is cosponsoring an additional 8 summits this year across **Zurich, Frankfurt, Toronto, Boston, San Francisco, New York, Hong Kong & London**. Learn 2 Quant Frankfurt and Zurich were in early March, with more than 100 discretionary institutional PMs, analysts, traders, data scientists, CROs, COOs and CTOs convening to discuss:

- How to collaborate with your team's 'quant' on building an actionable (and understandable) quantitative process.
- How to find, vet and incorporate new tools and data sets into your decision making process.
- How to gain further education on the world of quantitative investing.

For full schedule or further information, please contact your Jefferies sales person.

Upcoming Conferences & Events		
April 3	NEW YORK	Jefferies Healthcare REIT Summit
April 9-10	LAS VEGAS	Jefferies 3rd Annual Broadcast Roundtable at the NAB Show
April 24	NEW YORK	Jefferies Flagship Capital Introductions and Best Ideas Symposium
May 9-10	BEVERLY HILLS	Jefferies 2018 Global Technology Conference
June 3-6	ISRAEL	Jefferies Israel Tech Trek
June 7	ISRAEL	Israeli Hedge Fund Association Conference
June 5-8	NEW YORK	Jefferies 2018 Global Healthcare Conference
June 12	TORONTO	Learn 2Quant Toronto
June 14	BOSTON	Learn 2Quant Boston
June 19-20	NANTUCKET	Jefferies 2018 Global Consumer Conference