Jefferies Prime Services Quarterly

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CONTACTS

John Laub
Global Head of Prime Services
+1 212.284.1726
jlaub@Jefferies.com

Barsam Lakani
Head of Prime Services Sales
+1 212.284.1783
blakani@Jefferies.com

Leor Shapiro
Global Head of Prime Services
Capital Intelligence
+1 212.336.6267
lshapiro@Jefferies.com

Shannon Murphy
Head of Strategic Content
+1 212.336.1139
shannon.murphy@Jefferies.com

Lily Calcagnini
Strategic Content
+1 212.323.7596
lcalcagnini@Jefferies.com

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The Rise of Consultants

Numerous factors are converging **to create a huge opportunity for alternatives consultants in the coming years.** Global health recommendations have limited allocators' appetite for travel, limiting everything from introductory meetings to on site ODD. Anecdotally, many report "pressing pause" on new allocations, while remaining open to topping up managers already on platforms.

But, this pause is complicated by two other factors:

1. **The length of this "pause"** – there is no clarity on when travel, in person meetings or industry conferences will get a green light.
2. **Unprecedented portfolio and liquidity uncertainty** – allocators of all stripes are faced with novel issues:
    a. Will tuition paying students return in September? (Endowments)
    b. Will elective surgeries return in the same numbers expected pre-Covid? (Hospital systems)
    c. Will consistently low interest rates challenge retirement portfolios? (Pensions)
    d. Has the family's wealth experienced a 'jolt' due to broader Covid or commodity challenges? (Family offices)

While a temporary pause due to uncertainty and travel restrictions makes sense, a growing number of allocators are revisiting their Consultant relationships (either ongoing or new), to navigate some of these issues.

Tailwinds for the Consultant model for the coming years:

- **Vast, deep research on the global alternatives industry**. Consultants' businesses are typically grounded in two components: a) Advisory and b) Proprietary. **By definition**, they have a robust library of multiple dimensions of hundreds (if not thousands) of hedge funds.
- **Broad view across allocator landscape** – with nuanced understanding of operating models, payout schedules and sophisticated knowledge of balance sheets.
- **Allocators can leverage Consultants' libraries and research to avoid portfolios becoming stale or missing market opportunities.**

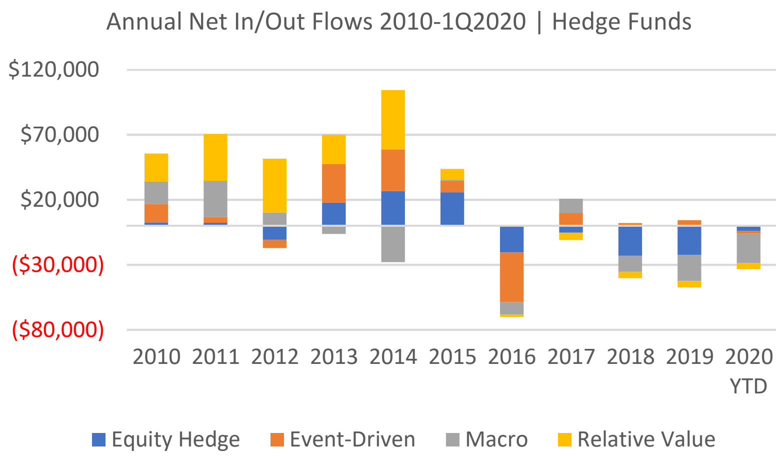
There has been considerable consolidation in the Consultant space over the last decade as firms looked to lock in economies of scale and broaden their portfolio of specialties.

As many of these firms built considerable Advisory businesses, they are now well positioned to expand client footprints, expanding to allocators who may be unable or unwilling to conduct in person meetings with a large number of potential managers – but who are also **squarely focused on not missing an opportunity or allow their portfolio to grow stale in what is a rapidly and non-linearly moving environment.**

This is also causing managers to reexamine their engagement with Consultants – in some cases, connecting earlier in their lifecycle than they otherwise would.

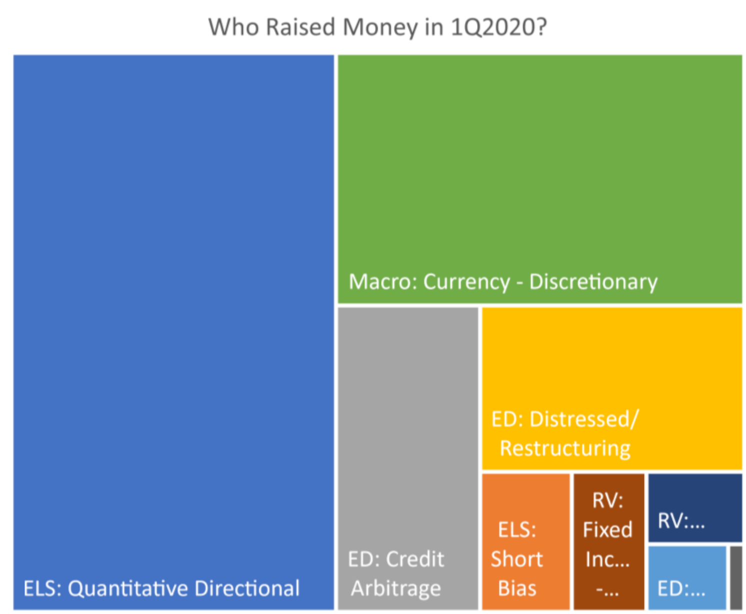
This is a place we are spending considerable time – to understand how Consultants view their value propositions in the current market, to meet new and emerging needs from the allocator community.

Capital Raising: So Far, So…OK?



Source: HFR

All Eyes on an ATM Effect With a violent downward move in March, the most precipitous since the Global Financial Crisis, many managers were waiting to see if allocators would be engaging in an 'ATM' effect – redeeming from funds indiscriminately to raise cash and shore up liquidity. At least for Q1, there is no evidence to support that broadly. Redemptions in Q1 were **highly concentrated**, and for some substrategies, capital flows were some of the best in recent quarters.



Source: HFR

It Wasn't All Bad News. At least ten substrategies welcomed net inflows in 1Q2020, from Equity Long/Short Quant Directional, to Macro: Commodity funds. NB: For scale, the boxes in the lower right hand side are: RV: Fixed Income Asset Backed, RV: Fixed Income Sovereign, Event Driven: Merger Arb and Macro: Commodity funds.

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WORD ON THE STREET I
WHEN OUTSOURCING BECOMES A MUST HAVE...INSTEAD OF A NICE TO HAVE

Covid-19 has been called an accelerant – accelerating trends or the demise of traditions – that predated the pandemic.

One of the most stark has been in the exploration and embrace of outsourced solutions.

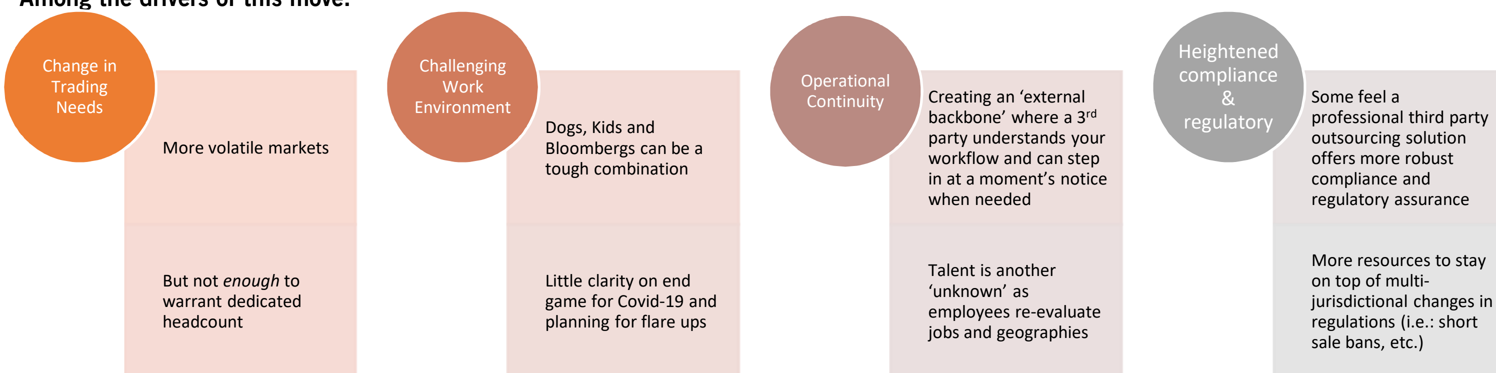
Not only have some allocators identified outsourced trading and outsourced operational/finance solutions as *stronger options* for some funds than keeping those responsibilities in house, but a growing number of mature institutions are exploring outsourcing as an efficient and effective way to evolve their operating footprints.

Among the drivers of this move:

Outsourcing has been accelerating as an acceptable solution for the last few years. Covid-19 is broadening the reach of these potential resources to a larger group of organizations, as firms look to build **more agile and resilient operating footprints.**

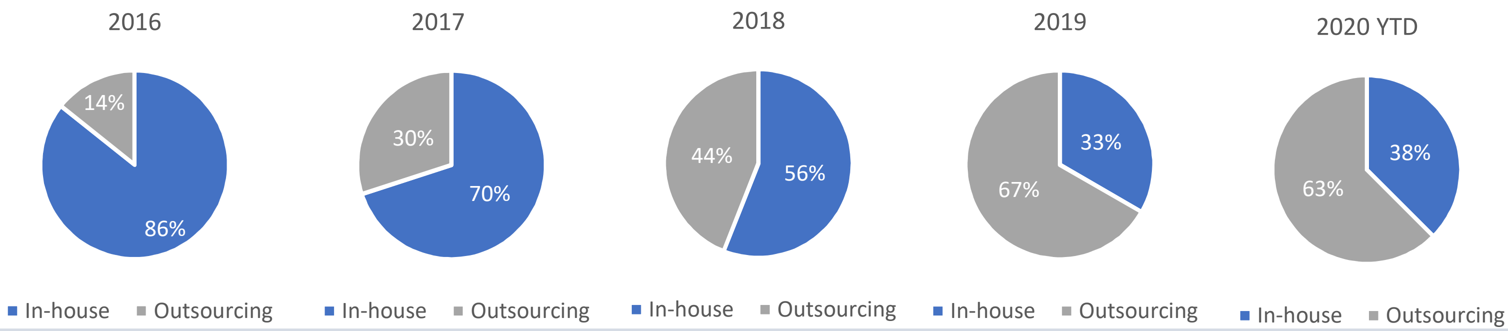
In some cases, it has almost become the norm, with **more than 60% of emerging managers now considering launching with an outsourced trader or operations professional on day 1.**

Many of the hesitations about leveraging third party providers had started to recede before Covid-19. Now, in the thick of a global pandemic, managers and allocators alike are finding comfort in additional institutional support for their businesses.



Source: Jefferies Prime Services

Percentage of New Launches Leveraging Outsourced Trading



ODD REASSERTS ITS RELEVANCE, PLANS FOR THE DECADE AHEAD

As we noted in our **Virtual Reality series**, Operational Due Diligence teams are hard at work defining the path forward for a Covid-19 world. **We don't say "post Covid,"** as there is little clarity as to when "post" Covid will begin.

Although some allocators say that as of today, they couldn't see themselves writing a ticket until onsite due diligence has been conducted, capital allocation is the lifeblood of our industry. If travel and social restrictions linger for an extended period of time, the industry will have to establish new and acceptable norms around conducting manager due diligence.

A recent Jefferies survey put "conducting **new** diligence on new emerging managers" at the bottom of allocators' current to do lists. But a growing number are grappling with our current and likely future reality that old norms will be curbed – and organic capital allocations and redemptions need to continue.

Some potential ways forward for onsite ODD:

1. **"Are you free?"** No one likes to be caught off guard – and PMs and analysts may require more lead time, **but virtual meetings lend themselves** to more informal and organic catch ups, **for a greater number of ODD team members**. More people, meeting more people – across different days and times could give better visibility into a firm. Even virtually.
2. **Stronger leveraging and reliance on third party networks and references**. This took off considerably post-Madoff, but given the growth of outsourcing solutions and the distributed nature of counterparty and service provider networks, **there are now more touch points for ODD teams to reference check. With the average fund maintaining more than a dozen external touchpoints,** ODD teams have a more fertile landscape to harvest for information.
3. **More**. Yes – simply, *more*. More transparency, more engagement, more data sharing, more NDAs (probably), more conversations and more time. **Managers *and* allocators will need more from each other to keep capital flowing and keep each other apprised.**

2020 AND BEYOND:
ASSET ALLOCATION IN THE AGE OF COVID-19

In 2019, **Jefferies Capital Consulting team conducted a deep dive on portfolio positioning for the days ahead,** reporting that dozens of leading alternatives allocators had already started strategically rethinking their portfolio construction.

Now, with rock bottom rates globally, ongoing employment and consumer uncertainty, and lingering questions about what any 'return to normal' means, an even greater number of allocators are going back to basics, revisiting assumptions and considering how to best align their portfolios with what they may need in the coming months and years.

When IR *is Marketing*

The landscape has shifted, and while there remains a huge amount of uncertainty – what we **do know** now is that we have slid into somewhat of a normal paradigm – at least for the medium term.

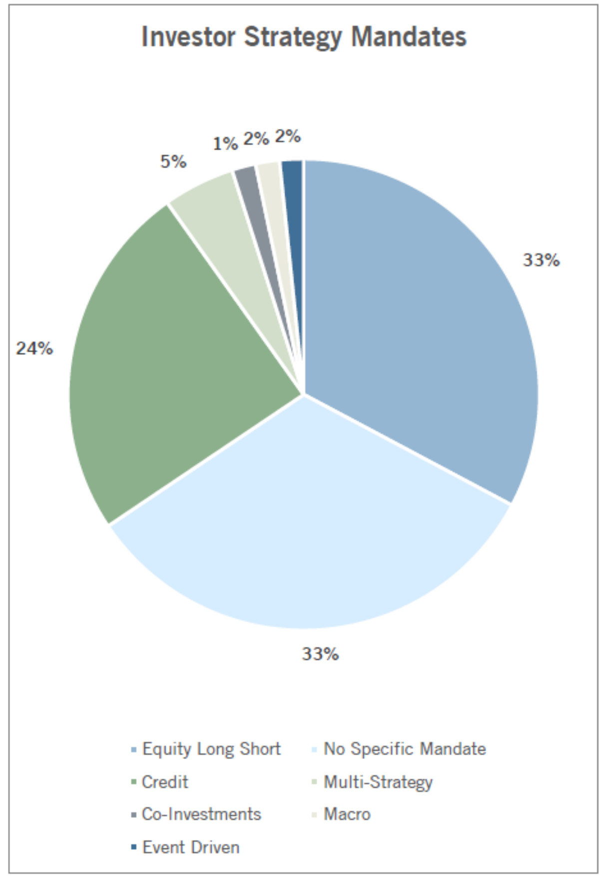
In this environment, when immediate incremental dollars **come from pre-existing partners**, investor relations professionals **are serving a marketing function: positioning the firm in the current landscape, and delivering a go-forward value proposition**. There has been considerable revisiting and breaking down of performance into a very granular level, both in the current environment and across previous periods of acute stress, to more succinctly tell the story of the fund's performance.

And *Yes, Marketing IS Happening…Just Not Like It Used To…*

Education as Marketing. There has never been the globally captive audience in the same way that exists right now. And a growing number of CIOs, PMs and Analysts are using new media (whether audio or video) to reach new audiences, and prospective future partners down the road.

Although there isn't the same "going door-to-door" nature as going to an industry conference – we **are seeing some funds think across the long term, building engagement strategies** to build a "different *kind* of pipeline" by educating larger audiences about a sector, a macro trend or other core competency.

Be concise. Be engaging. Be accessible. Use visuals.



Source: Jefferies Capital Intelligence

We continue to see appetite for both Equity and Credit managers – on the Equity side, there continues to be a skew towards sector specialists.

A number of allocators indicated this is due to the broader uncertainty – and the belief that sector and industry specialists know their space better than anyone, which is particularly critical in times like this.

The Death of the 'Midtown Uniform?' Organizations Grapple with "The Return to the Office" and Other Cultural Questions

We have gotten a lot of questions from clients, allocators and partners around return to office planning, and thoughts on operating footprints for the coming decade.

The **first and predominant concern of *all organizations* is the safety of their employees.** That said, organizations of all shapes and sizes are revisiting basic assumptions about where, when and how teams work.

It **is also clear to us that there are a range of views** on what's best for each firm. **Despite many organizations reporting extremely strong quarters or outperformance of portfolios**, some remain beholden to the idea "we are better when we're together." Others are **squarely focused on using this time and lessons learned** to revisit basic assumptions, and rethink whether decentralized work spaces will result in a **more productive, more *diverse* workforce**. Will the idea of a "Midtown Uniform" endure if a substantial number of organizations think **combining the old with the new** will optimize their performance and allow them to attract and retain better talent?

These are important questions for the culture of an organization. There will undoubtedly be those who are most comfortable returning to a 5 day, office based workweek. But we increasingly hear that the idea of returning to "the way it was in February" is akin to keeping a suit and tie as your daily "uniform." Even that was replaced (or at least balanced) by a more relaxed approach in recent years, for many firms.

We are only in the **earliest stages** of understanding the possibilities of the future – but what is clear is that the strongest firms will emerge with an "***AND*** **mentality" not an "OR" one** – taking the best of *then AND now…..*

2020: USING COVID TO CATCH UP ON CONTENT?

AUDIO

Jefferies Franchise-Wide Podcast: *Invisible Forces*

Jefferies' first podcast series explored the surprising currents moving markets, driving innovation and disrupting entire business models.

Episodes:

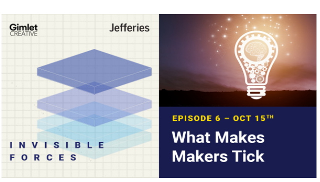
Episode 1:
The $10 Trillion Question

Episode 2:
From Bench to Bedside

Episode 3:
Value, Authenticity and What Makes Something 'Really' Real

Episode 4:
Building a Boom: Brand Lessons for Creating Explosive Value

Episode 5:
A Tech Revolution for Financial Services



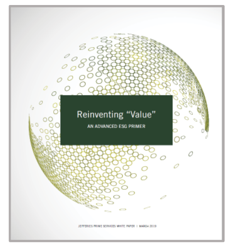
Episode 6
What Makes Makers Tick?

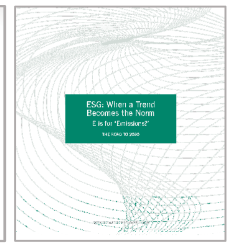
MARKET STRUCTURE MINUTES

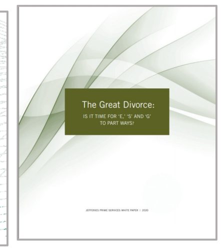
- Up and to the Right…*Right?*
- *The Icarus Rally*
- Taking the Long View on Recovery

THEMATIC WHITE PAPERS

ESG Trilogy: *Reinventing 'Value,' E is for 'Emissions'?, The Great Divorce*

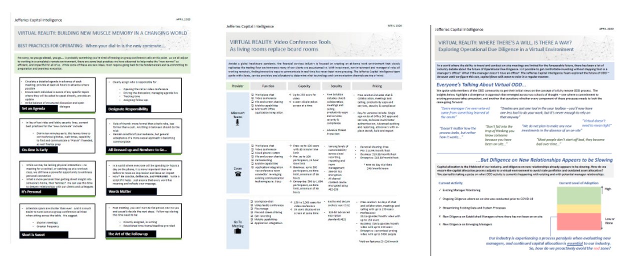




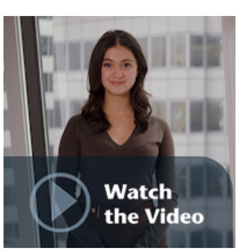


Market Structure Series: *When the Market Moves the Market* Equities & Fixed Income Editions

Virtual Reality Series: Living in a Covid-19 World



VIDEOS



Demographic-Cultural Series: Data Privacy and Monetization, Commercializing Existence, and Millennial Content Consumption

Current Hiring Trends

Current Hiring Trends: 2020 and Beyond

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