PIVOTAL PATH
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The Inflation Effect on Hedge Funds

The following analysis is part two of a series in which PivotalPath parses hedge fund performance under macroeconomic regimes. Our suite of PivotalPath Hedge Fund Indices* are uniquely fit for this type of analysis.

Inflation has occupied the minds of the Federal Reserve and U.S. consumers since the term "transitory" admittedly became out of step almost 1.5 years ago as noted in this Reuters report. And rightfully so, as inflation directly affects everything from consumer purchasing power to company profit margins. Additionally, policy responses to persistent inflation, such as raising interest rates, can have knock-on effects on the economic conditions and risk premia, as discussed in the first part of our series.

Inflation effect on hedge fund performance

In this iteration we look at realized manager returns conditioned on low/high inflation regimes. For manager returns we use the PivotalPath Indices and the 12-month percentage change in the Core Consumer Price Index (CCPIY) as a proxy for inflation. Our data covers the period Jan 2000- Dec 2022. Results are below.

PIVOTAL PATH	Conditional Performance		
Inflation Regime	**Low Inflation (CCPIY<2.5%)**	**High Inflation (CCPIY>2.5%)**	**spread**
# Months	*223*	*53*	
MACRO VARIABLES			
Average Inflation	1.89%	3.71%	1.82%
S&P 500 Index	10.18%	-2.84%	-13.02%
HEDGE FUND PERFORMANCE			
PPATH Composite	9.67%	7.57%	-2.10%
PPATH Credit	9.28%	8.40%	-0.88%
PPATH Equity Diversified	10.20%	6.56%	-3.64%
PPATH Equity Sector	13.17%	10.05%	-3.12%
PPATH Event Driven	10.11%	6.24%	-3.87%
PPATH Global Macro	8.24%	8.64%	0.40%
PPATH Managed Futures	8.01%	11.10%	3.09%
PPATH Multi-Strategy	9.39%	8.28%	-1.11%
PPATH Volatility	8.92%	11.78%	2.86%

**CCPIY as proxy for inflation **All returns are annualized. ***History: Jan 2000-Dec 2022*

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As we can see, some effects are substantial and deserve closer inspection. The spread is economically meaningful for the S&P 500 Index though the differences are not statistically significant.

Since 2000, the level of CCPIY has coincided with large differences in performance – which historically favors many hedge fund strategies relative to the S&P 500 Index. Here are some core observations:

- The **PivotalPath Hedge Fund Composite Index** annualized performance was approximately 200bps lower in the higher inflation regime.
- However, while the majority of major Hedge Fund Indices generated lower performance during higher inflation periods, the differences are relatively small, especially in comparison to the stark drop in performance for the **S&P 500 Index**.
- Both the **PivotalPath Managed Futures** and **Volatility Indices** produced slightly better returns during elevated inflation, while differences in **Global Macro, Credit and Multi-Strategy Indices** were small.
- While interest rates tend to be correlated with CCPIY, when CCPIY was above 2.5, 3-month Treasury bill rate (**T3M**) averaged 2.8% and 1.2% when CCPIY was below 2.5. I.e., both inflation regimes coincide with T3M below the key level of 3%, which was analyzed in part one of our series.

What can we learn from this? While historical data is never completely indicative of future performance, it can be informative, especially when representing changes to structural inputs such as inflation.

As inflation remains elevated well above the Fed's comfort zone, representative Hedge Fund Indices and proper context should serve as a valuable guide to asset and strategy allocation.

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About PivotalPath

PivotalPath is a leading hedge fund research firm. Harnessing our research portal, Pivotalpath enables a diverse set of institutional investors with over $300 billion in combined hedge fund investments with valuable insights and necessary tools for informed investment decisions.

Through our dedicated research team, we have built significant trust and lasting partnerships with both allocators and hedge funds through transparency and by ensuring that allocators evaluate each manager in the right context. PivotalPath protects confidential manager information and only shares insights with its institutional investor clients.

Pivotalpath enables clients with the full cycle of due diligence: intelligence reports, analytics, and performance analysis tools.

**In building trust and partnerships with both hedge funds and institutional investors, PivotalPath has developed a comprehensive (>$2.5tn in hedge fund AUM) and representative set of hedge fund data, creating a unique window into evaluating strategy performance across various regimes.*