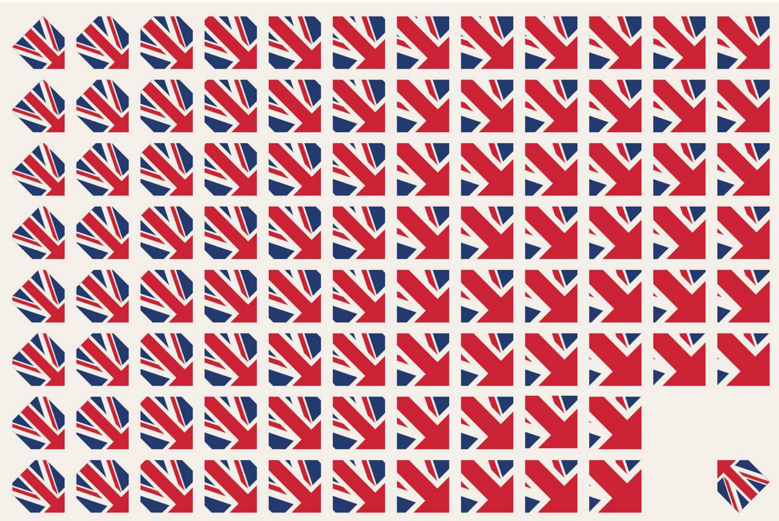
HEDGE FUNDS

Dozens of hedge funds puncture the industry's pro-Brexit myth

Some Brexiteers welcome 'The Hunger Games in Mayfair', but many alternatives investors are bearish on the benefits of leaving the EU



— FN Staff

By Tom Teodorczuk

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George Soros is the world's richest hedge fund manager, and its most prominent opponent of Brexit. He has donated substantially to campaign groups lobbying for a second referendum over Britain's membership of the European Union.

Yet some industry experts reckon without Soros heavily shorting the pound in September 1992 – a day dubbed Black Wednesday, which led to Britain's exit from the Exchange Rate Mechanism and which reportedly made Soros £1bn – Brexit might never have happened.

"From that point, Britain was not going to be in the euro. It was on the outside looking in, with a vital EU institution," said Simon Lack, managing partner at SL Advisors, the energy asset management specialist. "His [Soros's] hedge fund started the whole march towards Brexit."

The notion of Soros bearing indirect responsibility for Brexit typifies the torturously ironic debate that exists in the hedge fund industry over Britain's attempt to extricate itself from the EU.

Contrary to public opinion, the majority of the more than 40 hedge fund managers *Financial*

News spoke to about Brexit do not support it.

"There were big-name money sponsors from the community," said one hedge funder speaking on condition of anonymity, "but that's a handful of high-profile people versus tens of thousands that are less politically motivated and who prefer a degree of certainty".

The present political instability, they add, is not particularly conducive to making money.

Politicians opposed to Britain leaving the European Union and media pundits, not to mention a vociferous chorus on Twitter, believe hedge funds are profiting from the political pandemonium.

Guy Verhofstadt, the European Parliament's Brexit coordinator, wrote in *The Guardian* in July: "The few who may prosper [from Brexit] are the wealthy bankers and hedge fund managers who have already bet on chaos." In May, ITV newsreader Tom Bradby tweeted: "No-deal would mean very radical change to a low-tax, low-regulation economy, but with a very different welfare system and possibly health service. This is why it is so popular with the hedge funders."

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This perception was fuelled by high-profile hedge fund managers' donations to the Vote Leave campaign during the referendum, among them Crispin Odey, founder of Odey Asset Management, Sir Paul Marshall, co-founder of Marshall Wace, and Jeremy Hosking, co-founder of Marathon Asset Management.

Have hedge funds really been fiscally feasting at the Brexit table for the past three years? If only.

"The perception that hedge funds have done well out of Brexit is wide of the mark," said Oliver Fochler, chief executive of Stone Mountain Capital, the alternative investment adviser. "Unless you shorted the pound a few years ago and took a specific view and successfully implemented the trade, Brexit didn't make hedge funds money. And many of those trades got delayed or ended up not happening."

Take Crispin Odey. According to *Bloomberg*, the Brexiteer made an estimated £220m after sterling collapsed following the 2016 referendum result. But his gains were quickly erased when sterling rallied in the weeks following the referendum.

"I haven't been interested in sterling for a while," Odey told *FN*. "I turned round on sterling in February."

The pound fell to a two-and-a-half year low after prime minister Boris Johnson's new government signalled it was willing for Britain to leave the EU without a deal on October 31. Global hedge funds have raised their short positions on the pound to $7.8bn in currency futures, according to the US Commodity Futures Trading Commission.

But a hedge fund manager, speaking on condition of anonymity, said while more managers are selling the pound, it is not an especially crowded trade. “Not many hedge fund managers are taking big positions in sterling,” he said. “They don’t feel they have an edge where it’s going to be. It’s not a great binary option either side.”

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“The market has started to price in a higher no-deal probability and may even start to panic towards the end date,” said Graham Neilson, investment director at Fulcrum Asset Management, “but any panic will not be as big as after the initial Brexit vote.”

“Who, apart from those that shorted sterling, has made a killing out of Brexit?” asked Stuart MacDonald, managing partner at Bride Valley Partners, which raises money for hedge funds. “If that’s the case [that people have made a killing], why aren’t most macro or currency funds going through the roof?”

Rather than eyeing short-term profit opportunities, the majority of hedge fund managers spoken to by *FN* are panicking about Brexit’s potential impact on the industry’s ability to operate in Europe once the UK leaves the EU.

“More people who work in hedge funds would like to stay in the European Union than leave,” said one hedge funder speaking on condition of anonymity.

“It is absolutely undeniable that London’s role as one of the greatest clearing houses for investment flows has been impaired since the vote,” MacDonald said.

The EU insists that, after Brexit, British hedge funds will lose the “passport” that gives them the right to smoothly sell to clients in the single market.

The hedge funds theoretically most affected by Brexit are those managed from the UK but which have their fund vehicles domiciled in the EU, such as leading quantitative investment group Winton, whose fund strategies are domiciled in Luxembourg and Dublin.

A Winton source said they have made contingency plans and even in the event of a no-deal, the firm would not be affected at all by any Brexit scenario.

Man Group, the $114.4bn asset manager, has also taken decisive action in anticipation of a hard Brexit. In an investor letter obtained by *FN*, Man AHL, its core systematic investment engine, has moved its alternative investment fund manager licence from the UK to the Cayman Islands, citing Brexit.

"The ongoing lack of certainty at a political level in relation to the final framework which might emerge post Brexit… has led AHL to review the structure of the Company," the letter declared. A source at Man Group said the move was primarily driven by the need to bring AHL's AIFM licence in line with its other group structures.

Matthew Hudson, founder of MJ Hudson, the legal asset management advisory firm, said he set up a Luxembourg office the day after the Brexit vote and subsequently added operations in Milan and Zurich. "If you want to raise money in the EU, which is what Brexit comes down to, you need to have something in the EU."

For all the uncertainty over Brexit, many think there is too much at stake for the situation not to be resolved satisfactorily.

"I don't think hedge funds in general are scared of Brexit from a regulatory perspective," said Leonard Ng, partner at Sidley Austin, the law firm. "There will be some restrictions on what they want to do - managed accounts, marketing, delegation issues [whereby funds can be domiciled and regulated in another EU country] - but for typical hedge funds with offshore structures (which is most of them), the impact is less significant than [for] banking or insurance firms providing services to EU27 clients."

Yet Stone Mountain's Fochler said he discovered the hard way that dealmaking had already been shifted by Brexit. "Last January, we were doing a new client agreement," he recalled. "Financial agreements are typically written in UK law or New York state law, but a Luxembourg-based manager insisted the contract to be written in Luxembourg law, which is non-standard, citing the legal uncertainty over Brexit. I found it shocking and declined."

Others worry about a Brexit "brain drain", given that many of London's hedge fund personnel are non-UK Europeans.

Then there is the opportunity cost of exhaustive Brexit preparation.

"Unsurprisingly, it's taken up a lot of hours internally and externally," said Fulcrum's Neilson. "It has affected productivity in a variety of ways, added to the cost of doing business and acted to delay investor decisions."

If the downsides to Brexit are driven by uncertainty, the hedge fund bosses who favour Brexit are certain it will accrue positive gains for hedge funds in the long run. Bride Valley 's MacDonald said: "There are people who believe post-Brexit, once we're out on whatever terms, that the UK will become Singapore on crystal meth."

MacDonald added that he did not see any evidence for such claims, but pro-Brexit managers are quick to enumerate the potential benefits. "If you stop sovereignty from being sacrificed, that can only be good for the industry," said Odey. "We can ignore Brussels, because they're not going to be there in the long term."

One Brexiteer-supporting hedge fund manager was suitably Darwinian about the industry's future outside the EU. "If done properly, Brexit will kick-start the London hedge fund industry. Being apart from the unsustainable and undemocratic basket case that is the EU will result in more dynamism, competition and risk," he said. "The only UK hedge funds that will lose out from EU membership will be those that shouldn't be there in the first place. Firms will have to show what they're made of. It will be *The Hunger Games* in Mayfair!"

Another hedge fund Brexiteer highlighted the recent entry into London of prominent US financiers including Steve Cohen and Nelson Peltz as "proof the London hedge fund space will grow once we leave the EU".

Suella Braverman, the former parliamentary under-secretary of state for exiting the EU who resigned over the proposed Northern Ireland backstop last autumn, stressed Brexit will deliver certainty amid the current confusion. "The City of London Corporation has made it clear [that], in a no-deal scenario, there's a lot of confidence amongst their representatives, and that includes the hedge fund and alternatives community."

READ Odey rubbishes Channel 4's 'Brexit Millionaires' investigation

A City of London Corporation spokesperson said: "The risk of a no-deal Brexit is drawing dangerously close and businesses need to prepare for that… Politicians on all sides must now come together to agree a pragmatic solution to Brexit and make avoiding a no-deal scenario the absolute priority."

As for which hedge funds will benefit from Brexit, one hedge fund manager said London's bustling activist hedge fund scene, which includes Elliott Management, Gatemore Capital Management and Cevian Capital, are "licking their lips at a hard Brexit resulting in greater corporate turmoil and indecision" among UK companies.

Top global macro hedge funds are also not blind to Brexit's potential benefits. Asked about Brexit, a senior employee at Brevan Howard, speaking on conditions of anonymity, said: "It's very simple: it's a trading opportunity."

Brevan Howard co-founder Chris Rokos, who now runs Rokos Capital Management, is ambivalent about Brexit's effects, according to a partner speaking on condition of anonymity.

"Chris thinks Brexit will be a disaster and he has 25 economists working at the firm who are reinforcing to him that it will be," the partner said. "But there will be companies who will spectacularly benefit from making money from Brexit. One of them might as well be us."

Additional reporting by Helena Irvine

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