epsilon
Asset Management
The Intersection of Active and Passive®

Best Ideas **Addendum**

January 2022

Research History

In April 2020, Epsilon released an academic paper, an online research portal, and industry white paper.
The paper **analyzed hedge fund stockpicking** and **best ideas** from 1999 - 2018.
In December 2020, the paper was accepted for publication by the **Journal of Portfolio Management**.



1 **Industry White Paper**

Covered by **Bloomberg** and **Barrons**

Downloaded over 1,000 times

2 **Academic Paper**

Accepted for Publication by **Journal of Portfolio Management (Feb 2022)**

Nearly 3,000 abstract views on **SSRN**

3 **Free Code Repository**

Code underlying our research available on our **GitHub**

Our commitment to transparency

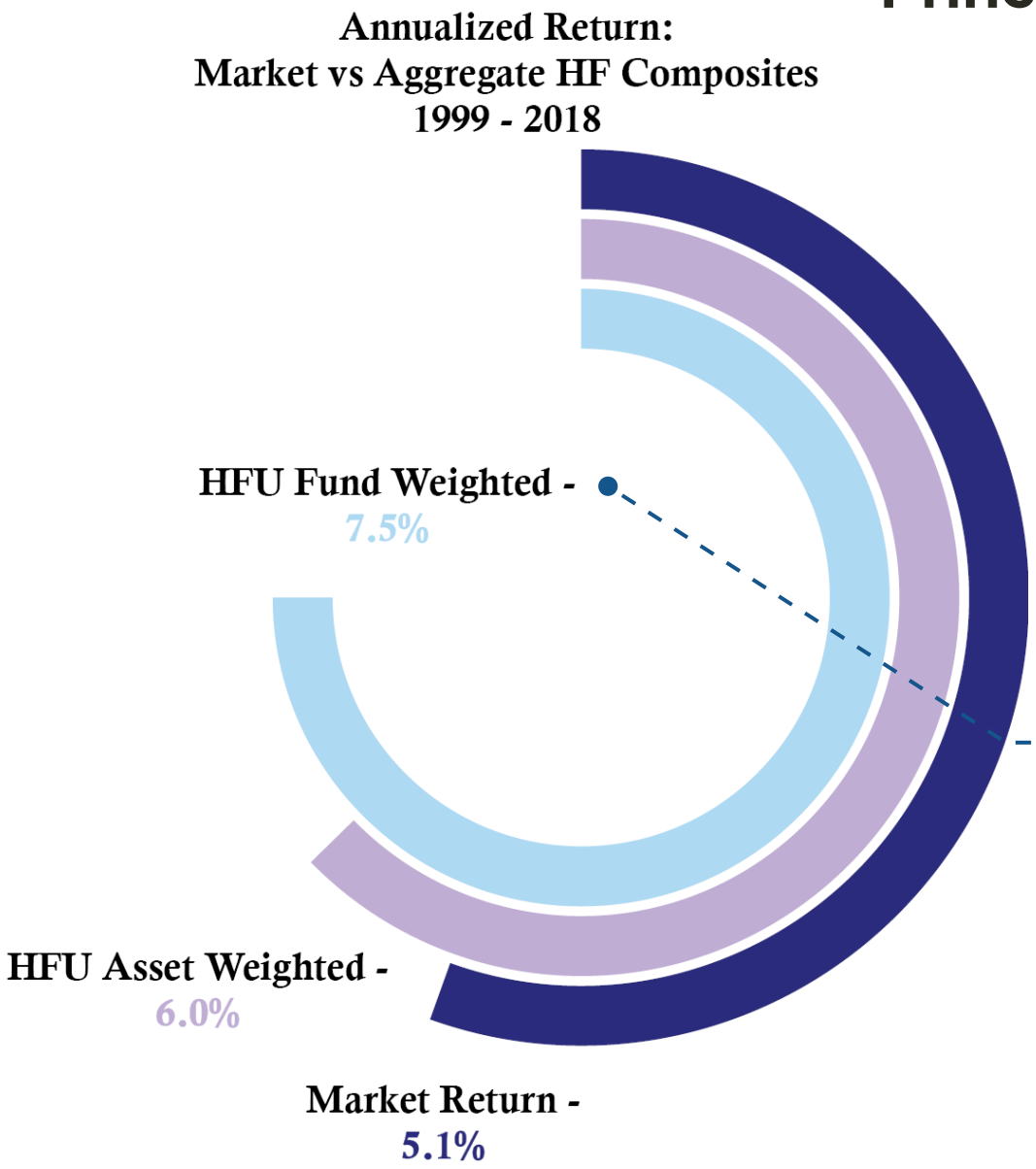
SSRN Tomorrow's Research Today

the journal of PORTFOLIO management

GitHub

©2022 Portfolio Management Research. All rights reserved.

Principal Inquiry



The paper was focused on studying hedge fund **stock selection skill**

Areas of deeper inquiry:

1. Does stockpicking skill exist across hedge funds?

2. Has stockpicking skill deteriorated over time?

3. Has asset growth led to lower alpha?

4. Do hedge fund Best Ideas outperform the rest of their stockpicks?

HFU denotes Epsilon hedge fund universe of long domestic equity positions

Original Paper (1999 - 2018)

Key Findings



Hedge Funds generate statistically significant stock selection alpha over 20 years



That alpha has deteriorated after the financial crisis, in conjunction with growth of assets



Hedge Fund Best Ideas do not outperform the rest of their portfolio positions

Addendum (2019 - 2021)

New Period Findings

Hedge Fund stock selection alpha was **negative** from 2019-2021

2021 was one of the **worst** years for long stock selection in the past 20

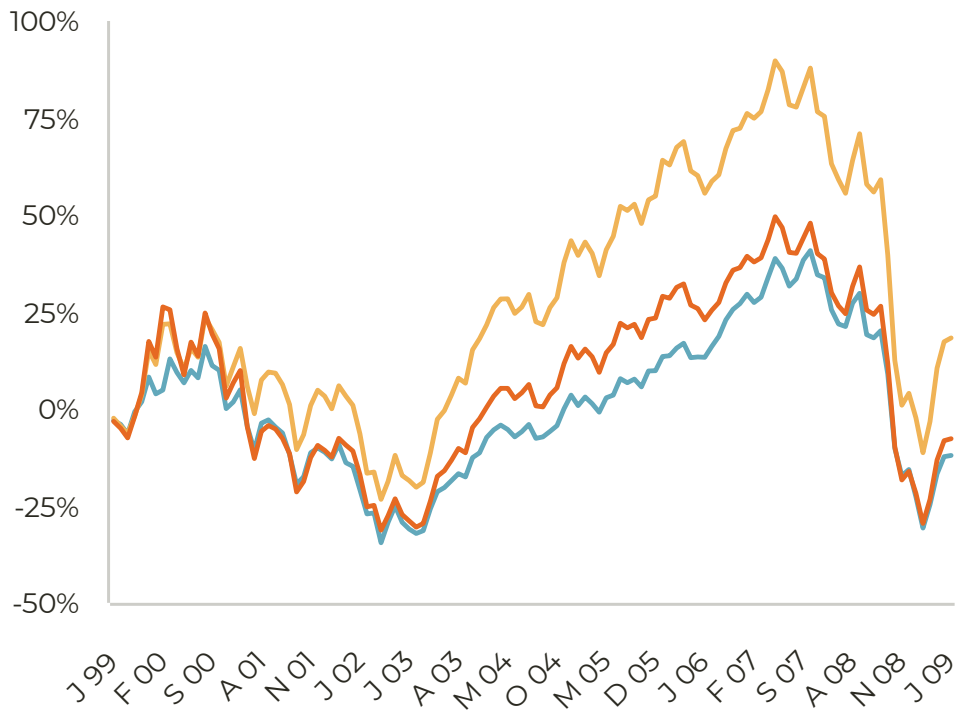
Best Ideas outperformed the rest of hedge fund stocks

Pre / Post Financial Crisis

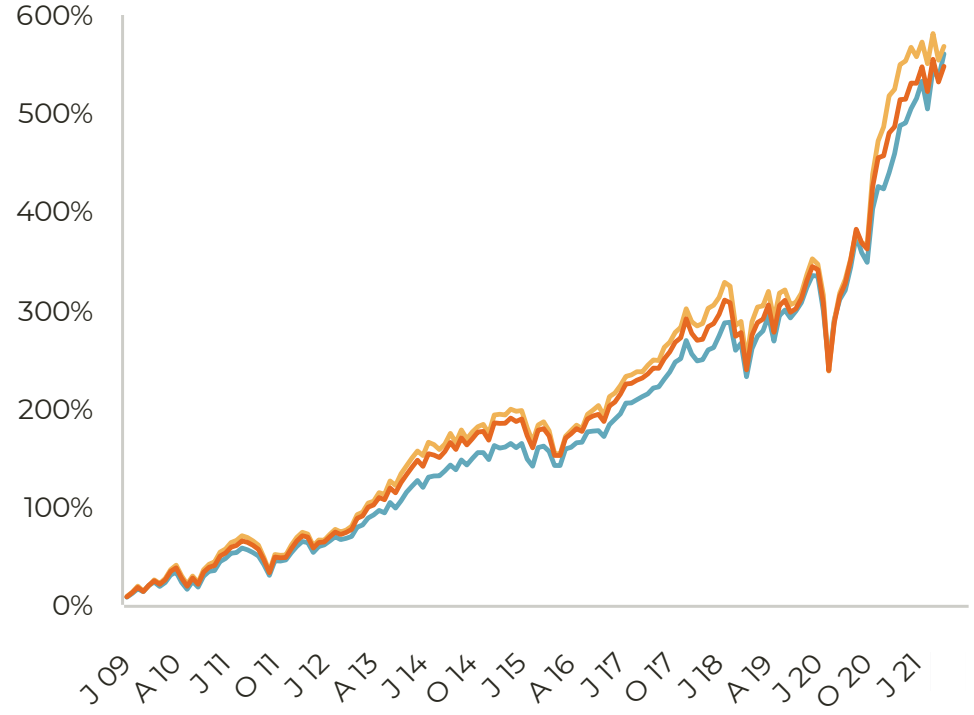
One of the central assertions of the paper was the decline in stock selection alpha by hedge funds after the Global Financial Crisis

The 2019-2021 data adds more weight to this trend

Pre Financial Crisis: Statistically Significant Alpha



Post Financial Crisis: Statistically *Insignificant* Alpha



R3K HFU_{FW} HFU_{AW}

Source: Epsilon, FTSE Russell. This analysis is subject to certain limitations and does not represent portfolios that Epsilon manages. Please see the last page for more detail on data and assumptions.

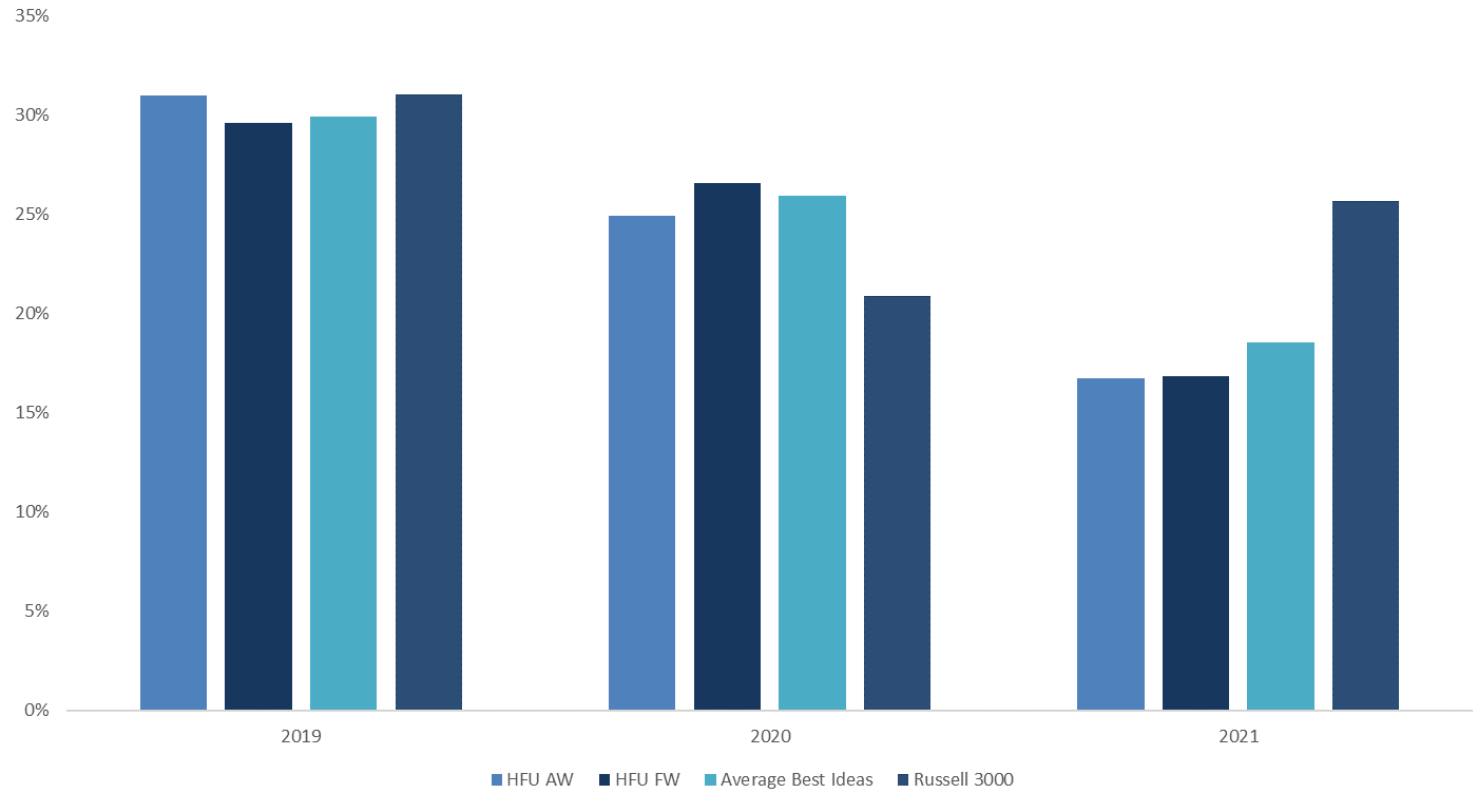
2019 - 2021 Summary Performance

Two aggregate composites of all hedge fund public ownership filers: HFU Asset Weighted, HFU Fund Weighted

One composite of hedge fund best ideas (4 methodologies)

Statistically significant **negative alpha**

600 - 800bps of cumulative underperformance vs index (driven by 2021)

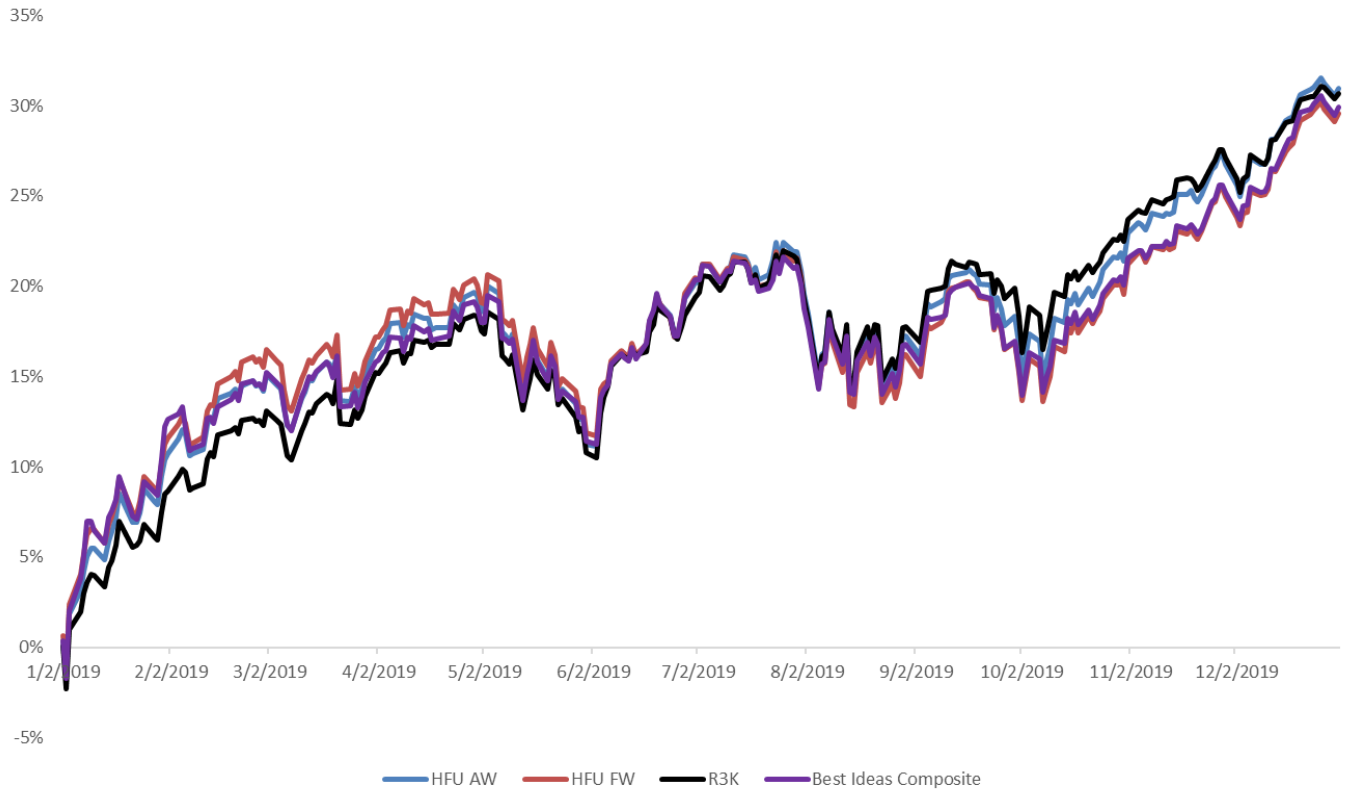


Source: Epsilon, FTSE Russell. This analysis is subject to certain limitations and does not represent portfolios that Epsilon manages. Please see the last page for more detail on data and assumptions.

2019

HFU_{FW} +29.6%, HFU_{AW} +31.0%, Best Ideas Composite +29.9%, Russell 3000 +31.0%

56% of modeled funds generating stock selection alpha



	Fund Weighted Alpha Drivers	Fund Weighted Alpha Detractors
1	Microsoft	PG&E Corp
2	Apple Inc	Alpha Metalurgical
3	Meta Platforms (fka Facebook)	Uber Technologies
4	Alibaba	Intelsat
5	Mastercard	Peabody Energy

Source: Epsilon, FTSE Russell. This analysis is subject to certain limitations and does not represent portfolios that Epsilon manages. Please see the last page for more detail on data and assumptions.

2020

HFU_{FW} +26.5%, HFU_{AW} +24.9%, Best Ideas Composite +25.9%, Russell 3000 +20.9%

56% of modeled funds generating stock selection alpha



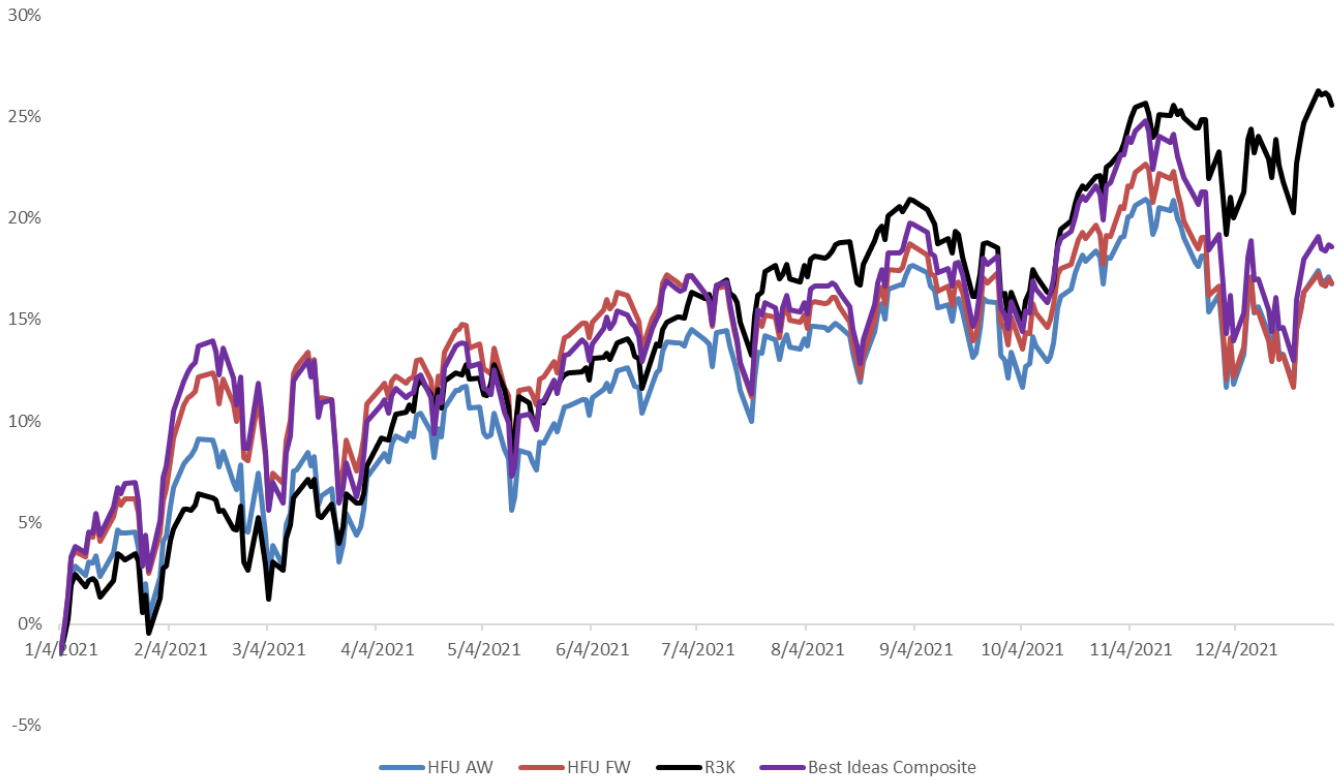
	Fund Weighted Alpha Drivers	Fund Weighted Alpha Detractors
1	Amazon	Delta Airlines
2	Microsoft	United Airlines
3	Apple	Citigroup
4	Tesla	Amarin
5	Paypal	Boeing

Source: Epsilon, FTSE Russell. This analysis is subject to certain limitations and does not represent portfolios that Epsilon manages. Please see the last page for more detail on data and assumptions.

2021

HFU_{FW} +16.8%, HFU_{AW} +16.8%, Best Ideas Composite +18.6%, Russell 3000 +25.7%

32% of modeled funds generating stock selection alpha (*lowest since 2015*)



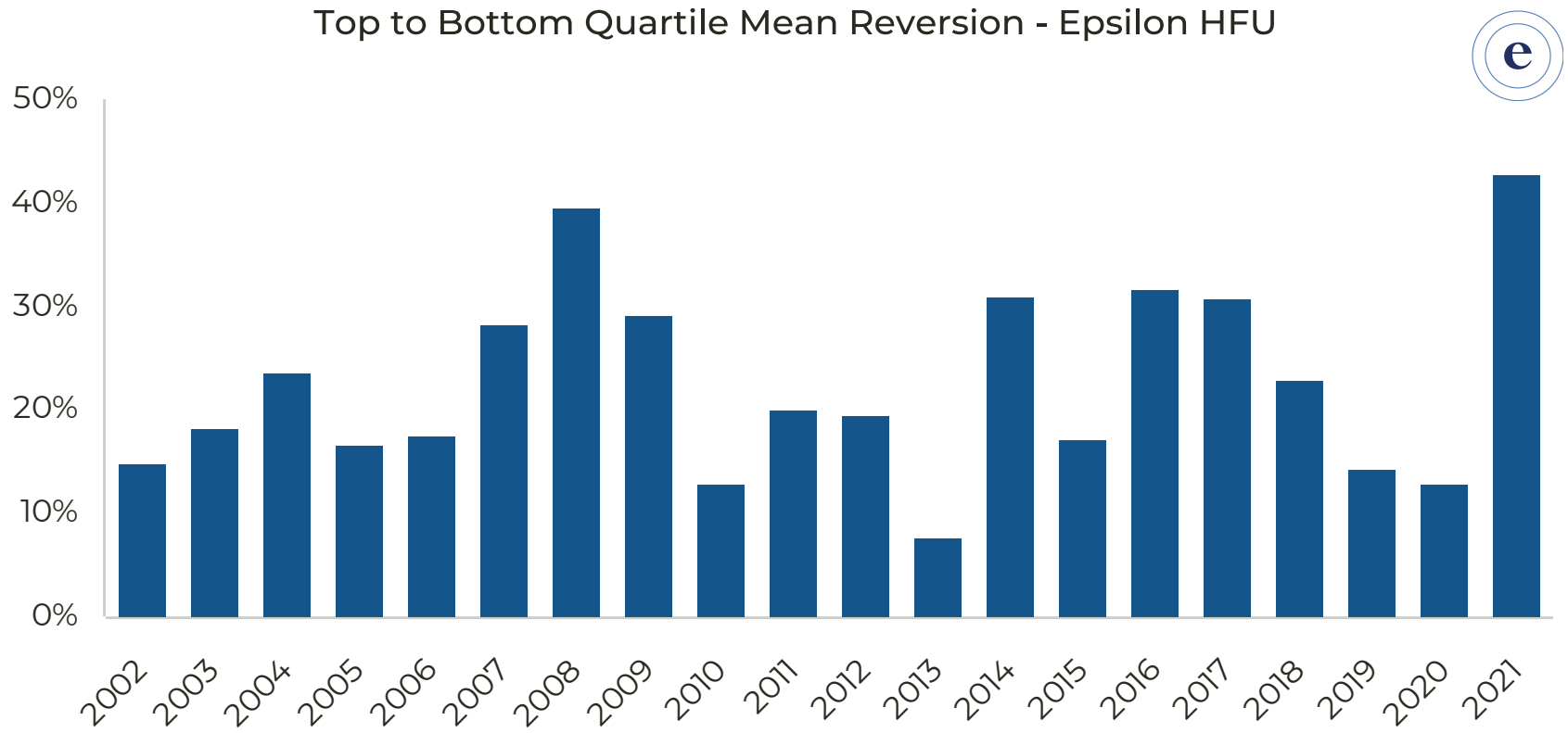
	Fund Weighted Alpha Drivers	Fund Weighted Alpha Detractors
1	Microsoft	Alibaba
2	Alphabet	Peloton
3	Gamestop	Pinduouo
4	NVIDIA	StoneCo
5	Apple	QuantumScape

Source: Epsilon, FTSE Russell. This analysis is subject to certain limitations and does not represent portfolios that Epsilon manages. Please see the last page for more detail on data and assumptions.

2021 Mean Reversion

2021 could be characterized as a year of mean reversion

Across the universe of modeled funds, it was the **highest year of top to bottom quartile performance reversion**



Source: Epsilon, This analysis is subject to certain limitations and does not represent portfolios that Epsilon manages. Please see the last page for more detail on data and assumptions.

Takeaways

2019 was a decent year for hedge fund long stock selection, **2020** was excellent, but **2021** was highly disappointing, wiping away the cumulative outperformance of the prior two

This three year period extends the marginal stock selection alpha generated by hedge funds **after the financial crisis**

Legal Disclaimers

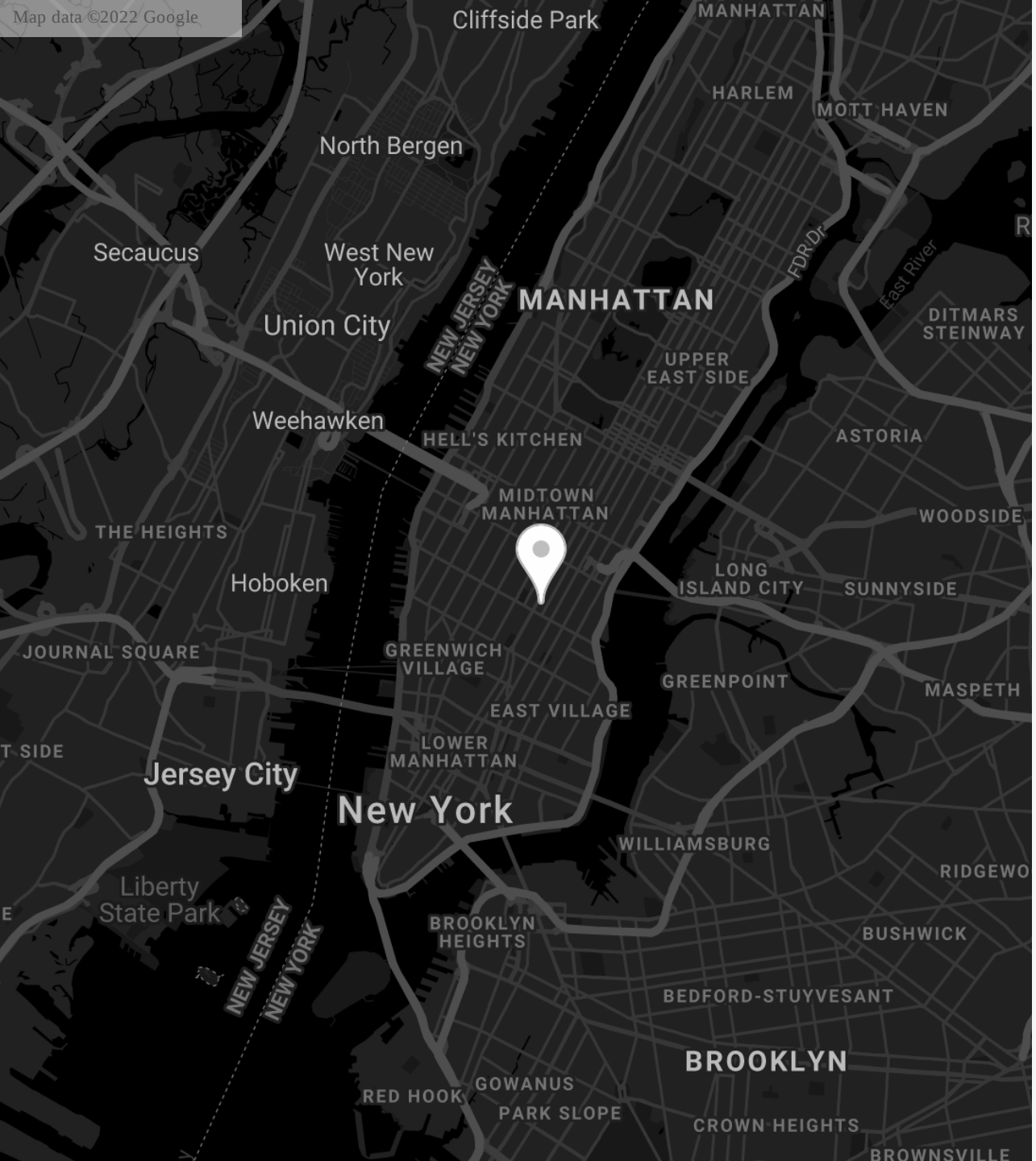
This document does not constitute an offer to sell or a solicitation to buy any security. This document may not be reproduced or distributed without written authorization from an authorized person at Epsilon Asset Management, LLC. By accepting this document, you acknowledge and agree that the information contained in it will be kept strictly confidential. Neither the information nor any opinion contained on this site constitutes an offer, or a solicitation of an offer, to buy or sell any securities or other financial instruments, including any securities mentioned in any report. Such a solicitation may only be made at the time a qualified offeree receives a confidential investment management agreement, containing information including account policies, risks, and expenses.

The information contained herein was obtained from various sources that Epsilon believes to be reliable, but Epsilon does not guarantee its accuracy or completeness. Opinions are subject to change without notice. Investors are cautioned that statements regarding future prospects may not be realized and that past performance is not necessarily indicative of future performance. Projections, perspectives, or assumptions should not be interpreted to be indicative of future events. Investing involves risk, including the potential loss of principal, and returns may be adversely impacted by unforeseen changes in market and/or economic conditions.

While the performances of non-investable composites are compared here with the performance of various indices, the indices have not been selected to represent an appropriate measure of risk and return, as portfolio holdings may differ significantly in composition and relative weighting from the securities that comprise the index. Logos or representations of other firms are provided for illustrative purposes only and do not depict a relationship or involvement with these separate entities.

Certain charts included sourced information from the London Stock Exchange Group plc and its group undertakings (collectively, the “LSE Group”). © LSE Group 2022. FTSE Russell is a trading name of certain of the LSE Group companies. Russell® is a trademark(s) of the relevant LSE Group companies and is/are used by any other LSE Group company under license. All rights in the FTSE Russell indexes or data vest in the relevant LSE Group company which owns the index or the data. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. No further distribution of data from the LSE Group is permitted without the relevant LSE Group company’s express written consent. The LSE Group does not promote, sponsor or endorse the content of this communication.Live Performance for the strategies represent during live implementation an asset-weighted composite of pari-passu client accounts.

Epsilon is a registered investment adviser with the U.S. Securities and Exchange Commission. For a copy of the firm’s Form ADV2, please visit the SEC’s Investment Advisor Public Disclosure Portal.



epsilon
Asset Management

Learn More

110 E 25th Street, New York, NY 10010

@ ir@epsilonmgmt.com

www.epsilonmgmt.com

@epsilonmgmt