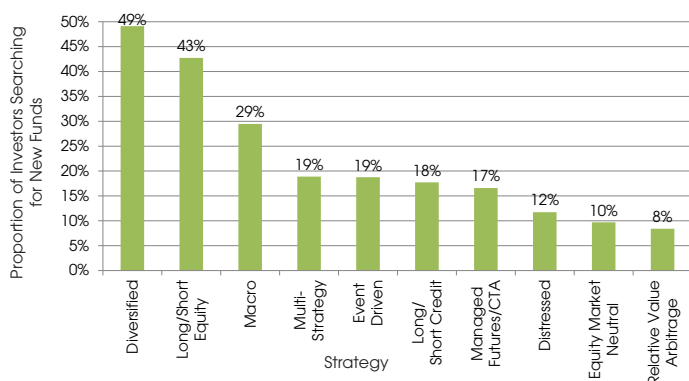




Institutional Investor Hedge Fund Searches: Q1 2013 Roundup

What hedge fund strategies are investors targeting? Which regions are they seeking exposure to? Amy Bensted looks at the fund searches and mandates issued by institutional investors in Q1 2013.

Fig. 1: Strategies Sought by Investors over the Next 12 Months



Source: Preqin Hedge Fund Investor Profiles

An understanding of investors' preferences towards hedge fund investment is vital for fund managers seeking new investors. Using Preqin's Fund Searches and Mandates feature on Hedge Fund Investor Profiles, we examine the current appetite for new hedge funds among institutional investors.

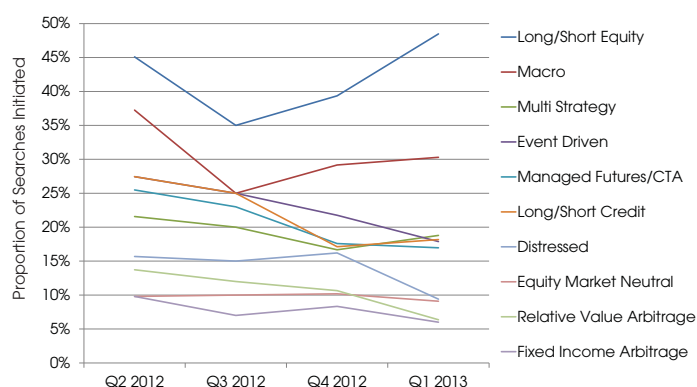
Strategies Sought by Investors

Investors seeking hedge funds across the spectrum of fund strategies still lead in terms of investor searches over the next 12 months, with a diversified mandate sought by nearly half of all institutions currently in the market for new hedge fund investments (Fig. 1).

Long/short equity vehicles are currently being sought by 43% of institutional investors planning on making new allocations to hedge funds. Fig. 2 shows the changing appetite for various hedge fund strategies from Q2 2012 to Q1 2013, as measured by the proportion of all investor searches for that strategy over that period. Investor appetite for long/short equity funds is at its highest level over the past four quarters, with 48% of mandates issued in Q1 2013 including a long/short equity component, an increase from 39% in Q4 2012 and 35% in Q3 2012.

Conversely, fixed income arbitrage strategies, which make investments in bonds and other fixed income products, have shown a general decline in investor appetite over the past four quarters; from 10% of mandates issued in Q2 2012 down to 6% of searches initiated in the first quarter of this year. Similarly, Fig. 2 reveals that two other relatively illiquid strategies, event driven and long/short credit, have also shown a general decline in appetite among institutional investors over the past year. Both strategies are sought by 18% of investors which initiated a new mandate in Q1 2013, significantly lower than the 27% of investors which indicated an interest in each strategy in Q2

Fig. 2: Investor Appetite for Top 10 Strategies Sought by Proportion of Searches Initiated, Q2 2012 - Q1 2013



Source: Preqin Hedge Fund Investor Profiles

2012. Despite the above average returns of these illiquid strategies, many investors are still unwilling to take on the liquidity risk of investing in strategies where capital could be locked in for up to two years.

Twenty-nine percent of investors have indicated to Preqin analysts that they are searching for macro strategies. This is an increase from the marked dip witnessed in Q3 2012, when the proportion of investor mandates including macro funds fell from 37% of all investors which initiated a search in Q2 2012 to 25% in Q3 2012. However, although investor appetite for this strategy has not yet returned to the Q2 2012 level, this trend shows investor sentiment towards the strategy is improving.

Following the poor performance of CTAs in 2011 and 2012, and a slow start to 2013 in terms of returns generated, investor appetite for CTAs is showing signs of decreasing. Investor searches initiated for the strategy fell again to 17% of all searches gathered by Preqin analysts in Q1 2013, down from 18% in Q4 2012 and 25% in Q2 2012.

Fund Structure Preferences

Commingled direct funds are being sought by the greatest number of investors, with 85% of all open investor searches over the next 12 months including at least one single-manager vehicle. Much of this appetite is driven by the large number of funds of hedge funds looking for new investments in the next 12 months, as well as other established institutional investors in direct funds, notably endowments, family offices and foundations, seeking new opportunities in the year ahead. Other groups of investors, in particular public pension funds, are also seeking to direct more capital to single-manager funds to avoid the additional layer of management fees involved in funds of hedge funds. However, in general, public pension funds and their private sector counterparts are still large supporters of funds of hedge



funds and are driving much of the appetite for multi-manager vehicles over the next 12 months.

Although relatively niche, there is also investor interest in managed account versions of single-manager funds, with 17% of investors looking to invest in these more liquid and transparent structures over the next year. The European-regulated UCITS wrapper for hedge funds has also continued to gain traction among institutional investors, with 14% of investor mandates including a UCITS-compliant hedge fund component. This is double the 7% of investor searches which included UCITS funds in 2012, further demonstrating the increased appetite for these liquid alternatives to the offshore model.

Investors by Type and Region

Fund of hedge funds managers are seeking new funds in the greatest number, with 39% of all searches issued in the first quarter of 2013 coming from this group of investor. Public pension funds show a revived appetite for hedge funds following a quiet end to 2012, a period where many public pension funds were reviewing their current portfolios before making any decisions on new investments for the year ahead. Thirteen percent of all hedge fund searches gathered by Preqin analysts in Q1 2013 were from public pension funds. This is positive news for the industry as the average public pension fund with an open mandate is looking to deploy \$100mn in new hedge funds in the next 12 months.

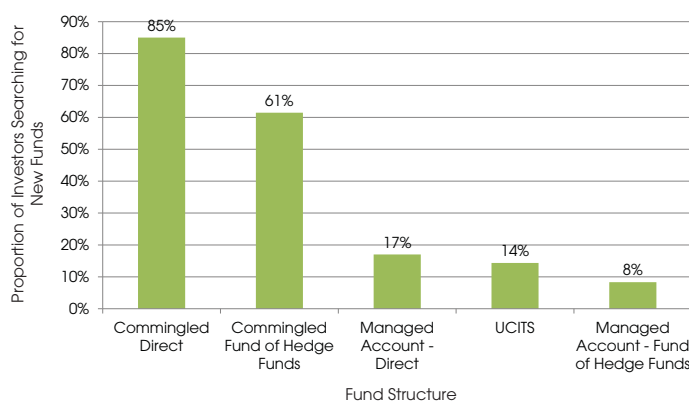
The established centres for hedge fund investment, North America and Europe, form a combined 90% of all investors searching for funds over the next 12 months. The emerging centre for hedge fund investments, Asia-Pacific, accounts for the majority of the remaining 10% of investors searching for new fund investments. As these investors become more accustomed to the asset class, and changing regulation in the region opens up new areas of investment in hedge funds, we can expect to see more searches for hedge funds coming from the Asia-Pacific region.

Outlook

Liquid strategies trading on equities, notably long/short equity, are increasingly being sought by institutional investors looking to take advantage of the current market rally. As Preqin's fund launch data demonstrates, there has been a marked increase in the number of long/short launches since the turn of the year; therefore investors targeting this strategy will have a wide choice of funds, both established and emerging, to fill these open mandates.

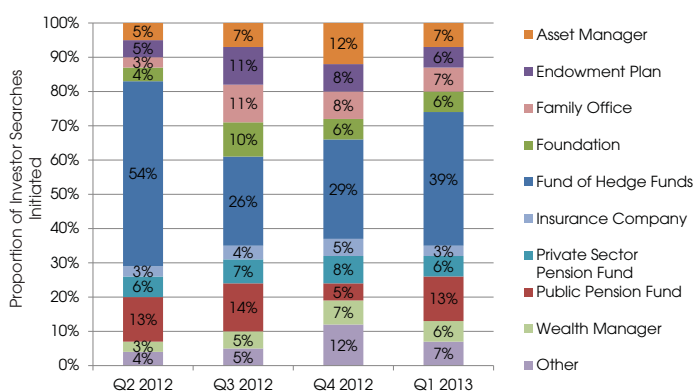
However, the more illiquid strategies have shown a decrease in appetite from institutional investors, alongside CTAs, which, although extremely liquid, have had a difficult two years in terms of performance. Single-manager funds and funds of hedge funds are the most commonly sought structures by institutional investors over the year ahead. However, alternative structures such as managed accounts and UCITS funds are increasingly sought by investors, as they look for alternatives to the traditional offshore model to fill their liquidity and transparency needs.

Fig. 3: Proportion of Investors Searching for New Funds by Fund Structure



Source: Preqin Hedge Fund Investor Profiles

Fig. 4: Breakdown of Investor Searches Initiated in Q2 2012 - Q1 2013 by Investor Type



Source: Preqin Hedge Fund Investor Profiles

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