Editor's View – Industry News

Amy Bensted provides her view on the news affecting the hedge fund industry at present, including investor attitudes towards hedge fund terms and conditions and the fees charged by hedge funds.

This month's feature article was taken from the newly released Preqin Investor Outlook: Alternative Assets, H2 2013, a definitive and extensive guide to investors in alternatives based on interviews with 450 institutional investors. As the feature article shows, many investors have witnessed improvements in the levels of fees being charged by managers, and the majority of participants believe that interests between managers and investors are suitably aligned. However, further improvements in fees are still being sought by 55% of investors and many are continuing to enter into negotiations to reduce fees.

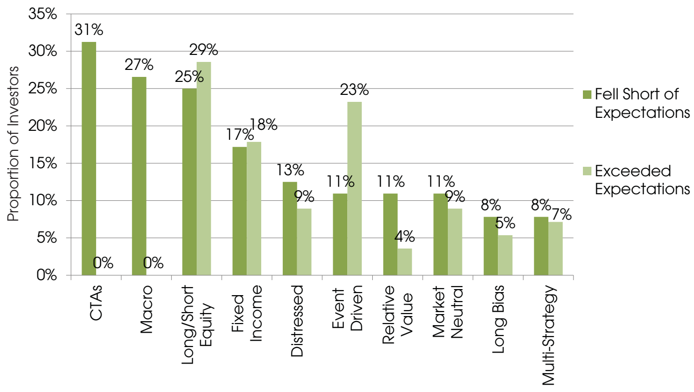
For some institutions fees have been cited as among the reasons they have abandoned investing in hedge funds. Pensionskassen for Borne og Ungdomspaedagoger (PBU), Rahn & Bodmer Banquiers and Pohjola Insurance, all Europe based, have either exited hedge funds over the past year or are in the process of redeeming, with the high fees involved in hedge fund investment cited as one of the deciding factors to leave the asset class. However, as our article *Can Hedge Fund Managers Justify High Performance Fees* on page 5 shows, funds that charge the highest fees, those with performance incentives over 20%, can produce the strongest returns. Therefore investors seeking long-term sources of absolute returns should not discount funds that charge the highest fees.

Funds with the highest fees more commonly have performance hurdles (see *The Facts: Fees and Hurdles in Focus* on page 12) which must be met before the incentives are charged. This provides some guarantees to investors that they will not be charged if the fund is not performing well. One of the top 20 best performing funds over the last 12 months, Pabrai Investment Fund 3, which has returned 58.37% over the past 12 months, uses a 0-6-25 fee structure. This is where there is no management fee and a performance fee is charged once the fund clears a 6% hurdle rate.

Over the past 12 months, hedge funds have posted cumulative returns of 10.83%. Another finding from Preqin Investor Outlook: Alternative Assets, H2 2013 shows that 74% of hedge fund investors have stated that returns have either met or exceeded their expectations in the past 12 months, the highest level since we started gathering this intelligence back in 2008. July's benchmark returns of 1.53% go some way to recovering the disappointing negative returns in June, with long/short funds leading the way posting 2.04% in July. The CTA strategy was chosen by the largest number of investors as a strategy that has fallen short of expectations, as our Chart of the Month shows. Although returns across CTAs continue to disappoint, two managed futures funds, both with a gold theme, feature in the top five best performing vehicles in July: AIS Gold and FortyEighters II Gold Program.

The strong performance of long/short funds in 2013 has not gone unnoticed by investors. Twenty-nine percent of investors interviewed by Preqin stated that these funds have exceeded returns expectations, the top rated strategy among institutional investors, and 51% of investor mandates issued in July were for a long/short equity fund. Among these investors is Pitcairn Financial Group, which is looking for European long/short equity and convertible arbitrage managers. Pitcairn Financial Group looks for funds that are smaller, growing and entrepreneurial in nature.

Chart of the Month: Hedge Fund Portfolio Performance Relative to Investor Expectations by Strategy



Source: Preqin Investor Interviews, July 2013

CTAs were named by the highest proportion of investors (31%) as having fallen short of expectations, followed by macro strategy funds (27%). In comparison, long/short equity funds were named by 29% of investors as having exceeded expectations and event driven hedge funds were named by 23% of investors.

In other news:

As our spotlight on California on page 11 shows, the state plays a prominent role in the hedge fund industry and there has been some significant activity there over recent months:

Intel Corporation Pension Fund is looking at long/short equity and macro funds to tap into opportunities in the ASEAN region and Japan.

Los Angeles-based Shinnecock Partners has launched a new fund of hedge funds, Shinnecock Niche Opportunity Fund, which is looking to tap into niche strategies on a global basis.

Another California-based fund of hedge funds, T2AM, is currently considering new fund opportunities in liquid strategies. This follows its latest fund of CTA launch, AT-Research Managed Futures Fund, on 1st August.

Do you have any news you would like to share with the readers of Spotlight? Perhaps you're about to launch a new fund, have implemented a new investment strategy, or are considering investments beyond your usual geographic focus?

Send your updates to spotlight@preqin.com and we will endeavour to publish them in the next issue.