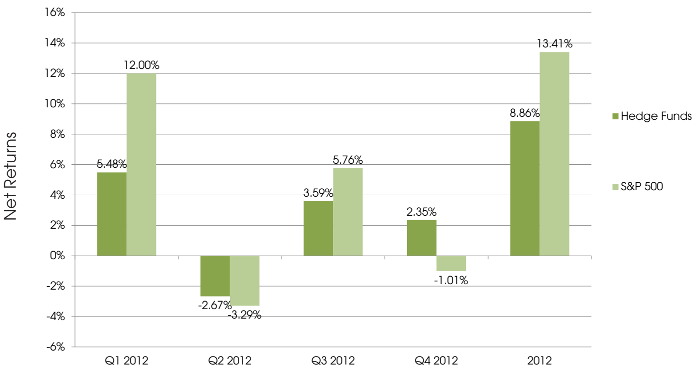
Hedge Fund Performance in 2012

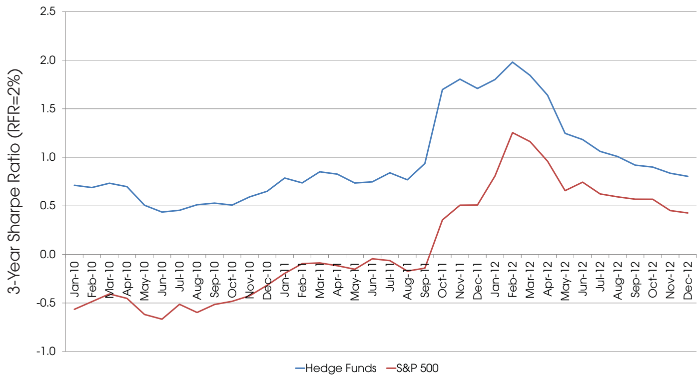
Joe Childs provides a breakdown of the key hedge fund performance statistics from 2012 using data from the **2013 Preqin Global Hedge Fund Report**.

Fig. 1: Performance of Hedge Funds (As at December 2012)



Source: 2013 Preqin Global Hedge Fund Report

Fig. 2: Rolling Sharpe Ratio of Hedge Funds, January 2010 - December 2012



Source: 2013 Preqin Global Hedge Fund Report

Hedge Fund Performance

Preqin's benchmarks show that hedge funds returned to positive territory in 2012 after delivering negative returns in 2011. Based on preliminary benchmarks for December, Preqin data indicates that hedge funds posted net returns exceeding 8% in 2012 to recover from a decline of 2.46% over the course of the previous year. While investors will have been satisfied to see hedge fund managers respond to the losses experienced in 2011, the positive performance in many bond markets and the double-digit growth of a number of prominent equity markets around the world will likely ensure continued scrutiny of hedge fund performance.

As Fig. 1 shows, hedge funds made a solid start to 2012 but did not experience the same surge seen in stock markets, with the S&P 500 rising by 12% in the first three months compared to an average return of 5.48% across hedge funds. Losses in April and May were recovered in the third quarter and hedge funds posted 2.35% in the final three months of 2012 to end the year up 8.86%.

Although hedge funds were unable to capture the same upside returns as public markets in 2012, they did post a less severe drawdown for the year. The average hedge fund declined by 2.87% between March and the end of May, while the S&P 500 fell by 6.97% in the same period and ended the year in drawdown after a near 2% fall in October.

The risk profile is a key consideration for hedge fund investors and in 2012 the industry maintained its reputation for offering low volatility of returns. The volatility of hedge fund returns was 4.91% in 2012, compared to the S&P 500's level of 10.56%. Low volatility coupled with reasonable returns has seen the risk-return profile of hedge funds remain attractive in recent years. The Sharpe ratio for hedge fund returns in 2012 stood at 1.40 while the same measure for the S&P 500 was 1.08.

Investors with a longer investment horizon see a similar pattern. Fig. 2 charts the 3-year Sharpe ratio since January 2010 and demonstrates that hedge funds have sustained an appealing risk-return profile over time, with the measure in the range 0.4-2.0 during the last three years. In contrast, the movement of the S&P 500 produced a negative Sharpe ratio for much of the three-year period.

Hedge Fund Strategies

Fig. 3 compares the performance of different hedge fund strategies to the end of 2012. Long/short funds ended 2012 as a key contributor to overall hedge fund performance, posting an average return of 9.67%. A positive start to the year was tempered by a loss of 3.60% in May, before positive monthly returns in the second half of 2012 were achieved.

Event driven funds improved on gains of 2.20% in the first half of 2012 to post an 11.43% return for the year. Tough economic conditions in many developed markets provided opportunities in the distressed space while there was also solid merger and acquisition activity for event driven funds to exploit.

Relative value funds posted positive returns in 10 months during 2012 to bring returns for the year to 7.05%. Relative value arbitrage and fixed income arbitrage strategies were most successful within this category, while equity market neutral vehicles were among the poorer performers, posting 3.40%.

In a year that saw equity markets provide strong returns, macro hedge funds delivered lower returns than other strategies. A return of 5.89% was achieved amid prolonged uncertainty surrounding the European sovereign debt crisis and the US fiscal cliff.

Although macro and relative value funds posted lower returns than

Fig. 3: Net Returns of Hedge Funds by Strategy

H1 2012	H2 2012	Cumulative 2012	3-Year Annualized	5-Year Annualized
Relative Value 3.60%	Event Driven 9.03%	Event Driven 11.43%	Event Driven 8.82%	Relative Value 8.17%
Long/Short 2.65%	Long/Short 6.85%	Long/Short 9.67%	Relative Value 7.28%	Event Driven 7.32%
Multi-Strategy 2.24%	Multi-Strategy 5.94%	Multi-Strategy 8.31%	Multi-Strategy 6.69%	Multi-Strategy 7.28%
Event Driven 2.20%	Macro Strategies 4.23%	Relative Value 7.05%	Long/Short 6.09%	Macro Strategies 7.27%
Macro Strategies 1.59%	Relative Value 3.32%	Macro Strategies 5.89%	Macro Strategies 5.86%	Long/Short 5.26%

Source: 2013 Preqin Global Hedge Fund Report

other strategies, investors in such vehicles were also exposed to lower volatility. Relative value funds performed well in this sense, with volatility of returns for the year at 1.46%. The volatility of macro funds stood at 3.75%, while the level for event driven and long/short funds was at 5.66% and 6.43% respectively. The returns and volatility posted by multi-strategy vehicles in 2012 was very close to that of hedge funds in general, demonstrating their appeal to investors aiming to temper greater returns with lower volatility through strategic diversification.

CTAs

CTAs and managed futures funds returned -0.48% in 2012. The modest return of 1.33% prior to the fourth quarter of the year was undone with losses in October. Despite posting a return of 14.62% in 2010, the near-neutral performance in 2011 (0.14%) means that CTAs also lag hedge funds and the S&P 500 over the trailing two- and three-year timeframes.

CTAs typically lack correlation to equity markets and offer investors low volatility. The recent trade-off between risk and returns is illustrated in Fig. 4, which compares 12-month rolling volatility and returns in 2012. The returns of CTAs demonstrated low and stable volatility of 5.3-6.3% during the period. In contrast, volatility of the S&P 500 was notably higher, ranging from 10.6% to 18.2%.

UCITS Hedge Funds

UCITS funds gained 5.70% in 2012 following a decline of 4.28% in 2011. UCITS hedge funds generated slightly superior returns during

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Q2 but their performance lagged the hedge fund industry as a whole in 2012.

One effect of the constraints placed on UCITS funds, such as limited leverage and restrictions on financial instruments traded, is that the volatility of returns of UCITS funds is typically slightly lower than that of non-UCITS hedge funds. During 2012, the 12-month volatility was in the range 4.5-6.7% for UCITS vehicles and 5.0-7.6% for general hedge funds. The volatility of UCITS fund returns is also lower over the longer term: 4.7% and 6.1% over the last three and five years respectively compared to hedge fund volatility of 6.0% and 8.7%.

Funds of Hedge Funds

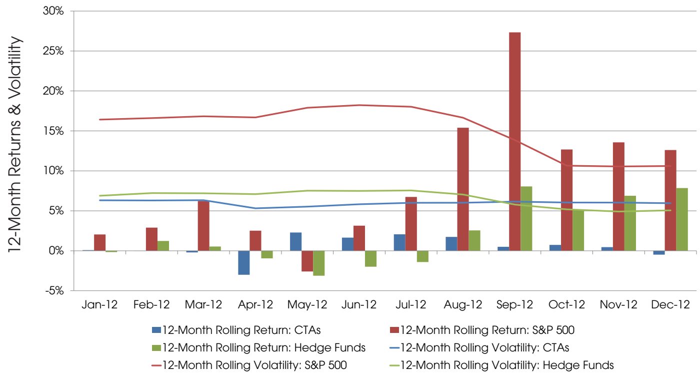
Multi-manager funds started 2012 positively after posting negative returns in November and December 2011. A return of 3.08% in Q1 2012 preceded a decline in Q2 (-2.13%), with returns in May the lowest for eight months. Funds of hedge funds recovered to generate 2.31% in Q3 and 0.28% in Q4. This contributed to a 3.50% gain for the year.

Funds of long/short hedge funds ended the year up 3.91% after recovering from a 3% drawdown between March and June (Fig. 5). Multi-strategy vehicles suffered a less severe drawdown during the same period and these were up 3.51% in 2012. Funds of macro funds fared less well, posting 0.37% for the year as the unpredictability of policy makers and the value of the euro challenged macro hedge fund managers.

Outlook

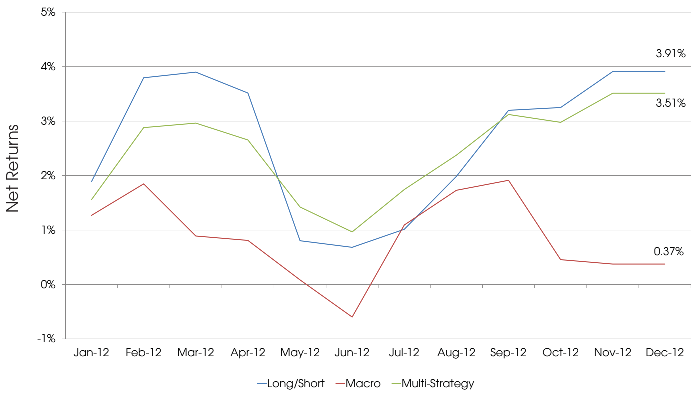
Despite posting relatively low returns recently, hedge funds continue to offer a compelling solution for investors seeking capital preservation and long-term growth. Recovery from the market shock and severe drawdown in 2008 delivered net returns at an annualized rate of 6.34% over the last five years, while other benchmarks, such as the S&P 500, are yet to return to the levels experienced at the start of 2008.

Fig. 4: Rolling Returns & Volatility of CTAs, January - December 2012



Source: 2013 Preqin Global Hedge Fund Report

Fig. 5: Cumulative Performance of Funds of Hedge Funds in 2012: Long/Short, Macro and Multi-Strategy



Source: 2013 Preqin Global Hedge Fund Report

Data Source:

Preqin's Hedge Fund Analyst database contains performance data for over 4,000 hedge funds. View performance statistics over a variety of time periods, strategies, and geographies, as well as benchmarks, cumulative returns and volatility.

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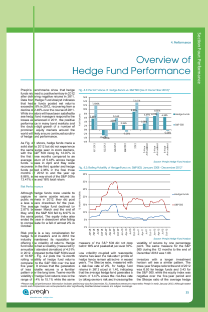
2013 Preqin Global Hedge Fund Report:

This article features analysis and data from the 2013 Preqin Global Hedge Fund Report.

The report provides detailed insight into hedge fund performance, including:

- Rolling volatility of hedge funds
- Risk/return profile by hedge fund strategy
- Cumulative performance by geographic focus
- Top performing hedge funds



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