

Welcome to the July 2010 edition of *Hedge Fund Investor Spotlight*, the monthly newsletter from Preqin providing insights into institutional investors in hedge funds. This month *Hedge Fund Investor Spotlight* contains information from our industry-leading online product, *Hedge Investor Profiles*.

## Funds of Funds vs Direct Funds: The Investor Viewpoint

### Feature

page 2

#### Institutional Movement from Funds of Hedge Funds to Direct Investment

Results of a recent Preqin survey are used as part of an in-depth analysis of institutional investors' move from funds of funds to direct hedge fund investment

### Investors in Focus

page 6

#### US Investors in Emerging Markets

We take a look at the growing trend for US investors to commit to emerging market hedge funds.

### Strategy in Focus

page 7

#### CTA/Managed Futures

An in-depth look at CTA/managed futures using data from Preqin's *Hedge Investor Profiles* service.

### Conferences Spotlight

page 10

A look at the upcoming events in the hedge fund world.

### Investor News

page 11

A round up of the most important new developments in the institutional investor universe. Full profiles for all institutions featured in *Investor News* can be viewed on our online service, *Preqin Hedge Investor Profiles*.

Featured this month:

- Nationwide Building Society
- Delta Lloyd
- Nordea Life and Pensions

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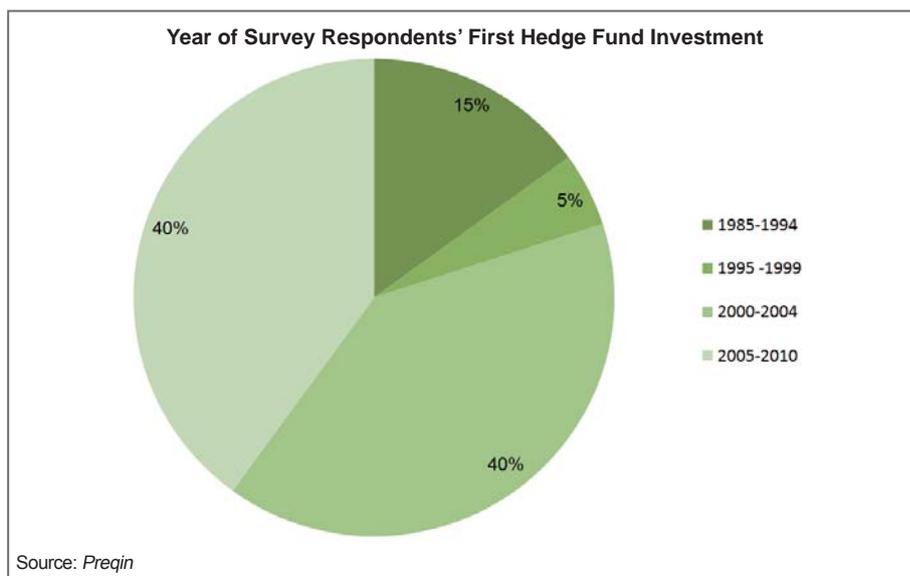
# Institutional Movement from Funds of Hedge Funds to Direct Investment

There have been significant changes in the hedge fund industry over the last two years. Institutional investors now constitute a significant proportion of the investors in hedge funds and their demands for transparency, liquidity and better fee terms are shaping the industry as it emerges from the financial crisis.

In June 2010, Preqin surveyed 50 global investors from a wide range of institutions including public and private sector pension funds, asset managers, insurance companies, banks, foundations, family offices and endowments, to gather information about their hedge fund portfolios and appetite for funds of hedge funds and single manager hedge funds.

This survey reveals that funds of funds came under scrutiny during the financial crisis for several reasons: their relatively poor performance compared to directly investing in the asset class, the gating of assets and their exposure to high profile fraudulent funds. This article will examine the extent to which institutional investors have moved away from funds of hedge funds and what the future holds for the asset class in terms of institutional mandates.

Fig. 1:



## Initial investment in hedge funds

Fig. 1 shows when investors made their first hedge fund investment. Many have been actively investing in hedge funds for a number of years and the average entry date for those surveyed is 2001. Fig. 2 shows 64% of investors gained initial exposure to the asset class through a multi-manager vehicle. As Fig. 3 shows, only 36% of respondents still

invest solely through funds of hedge funds, with 34% stating a preference for both types of investment. None of the surveyed investors began investing directly and then moved towards a funds of funds style of investment.

Many investors still enter the hedge funds industry through funds of funds. Institutional investors such as

Fig. 2:

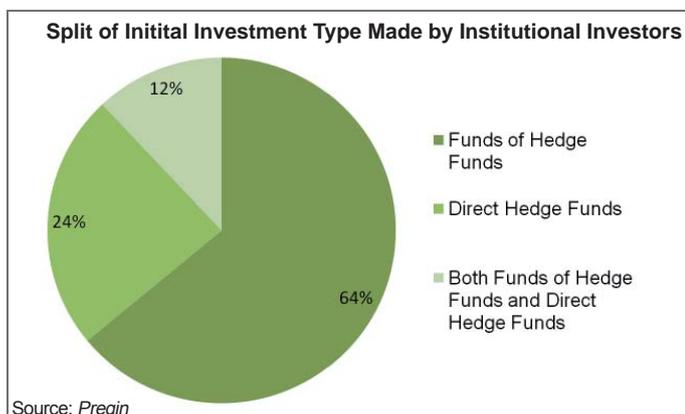
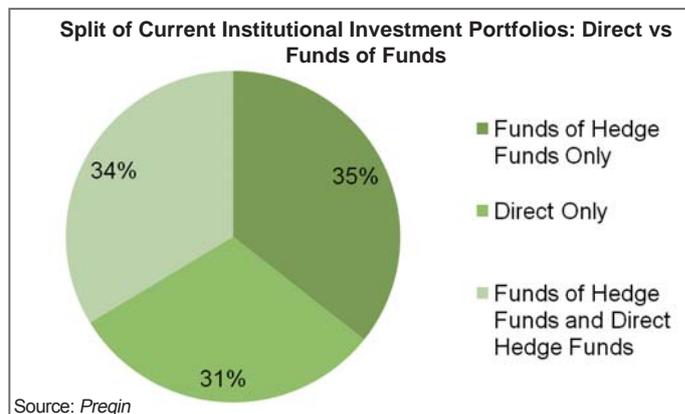


Fig. 3:



Metropolitan Government of Nashville & Davidson County Employee Benefit System, Illinois Student Assistance Commission and Powys County Council Pension Fund have all either released funds of funds mandates in the past six months or have made their first investments in the asset class through a fund of funds.

**Moving from funds of funds to direct investment**

Most investors that have moved away from funds of hedge funds did so during or after 2008 (Fig. 4). This is in line with the downturn in the financial markets and the Madoff scandal, both of which negatively affected the appeal of funds of hedge funds for a number of different reasons. Fig. 5 shows reduced fees to be the main reason why respondents decided to move away from funds of hedge funds and into direct investment. The higher fees and poor performance of funds of funds during and following the financial crisis left many investors questioning the value of such vehicles in their portfolio. In 2008 and 2009, many institutional investors liquidated portions of their hedge fund holdings and put further investment on ice until markets stabilized. When the time came to reinvest this available hedge fund capital, many institutions chose to invest directly in funds, avoiding the extra layer of fees they would be subject to if they invested in funds of funds.

Once investors have the in-house resources and knowledge to create their own portfolio of funds, many begin investing directly in order to avoid the extra layer of fees. Another popular reason for moving away from such funds was so investor could gain more control over their hedge fund portfolio. Through the typical commingled funds of hedge funds structure, investors do not choose the underlying investments that they are exposed to. By investing directly institutional investors have complete control of their portfolio, and are able to balance their holdings to match their objectives. Some large funds of funds were invested in the fraudulent

Madoff vehicles, so carrying out the due diligence for each fund in-house may give more peace of mind in regards to the funds they are exposed to.

Investors that entered the asset class nearly 10 years ago have a much better understanding of hedge funds than they did when they first began investing, giving them more confidence to move away from multi-manager vehicles and to build their portfolios directly. A proportion of the investors surveyed stated that increased in-house resources and ability to invest themselves was part of the reason they moved away from multi-manager vehicles. Many investors use funds of hedge funds to learn how to create a well diversified hedge fund portfolio and more experienced institutions are now using what they have learnt to build their own portfolio of direct hedge funds. (Fig. 6) As the hedge fund industry has evolved, so have investors. Those institutions that began investing

with a small in-house investment team may since have increased the size of their investment team and the resources devoted to hedge fund investment in order to get the most out of their portfolio.

**Why do investors stick with funds of funds?**

A significant number of investors have decided to maintain their funds of hedge funds investments for the foreseeable future. While many investors see the advantages of moving into direct investments, others are satisfied with their existing portfolios and plan to maintain their investment style. Diversification was the main factor

Fig. 4:

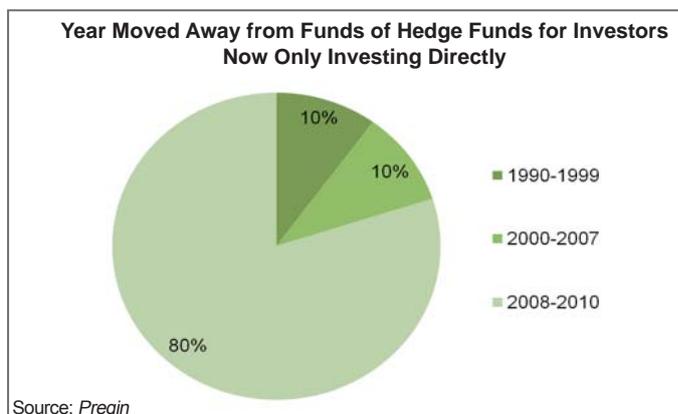
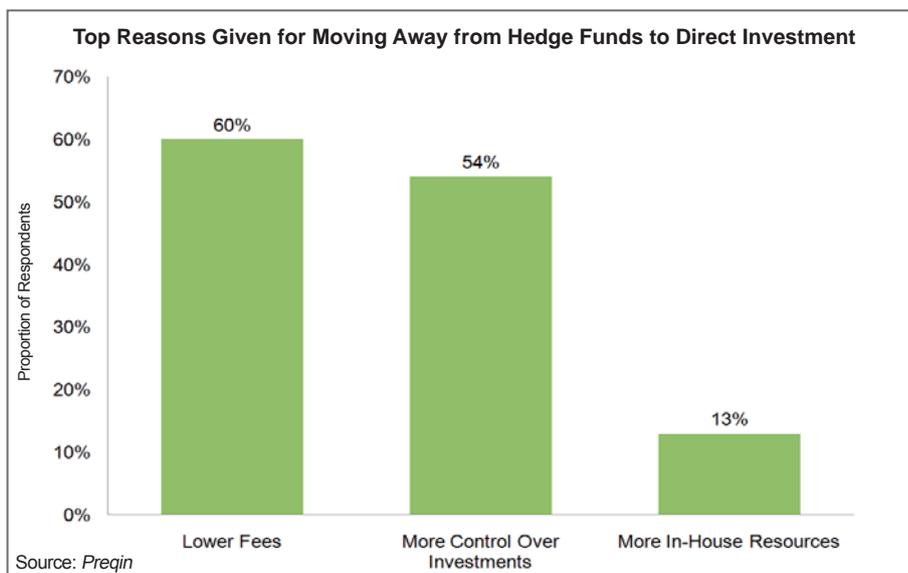


Fig. 5:



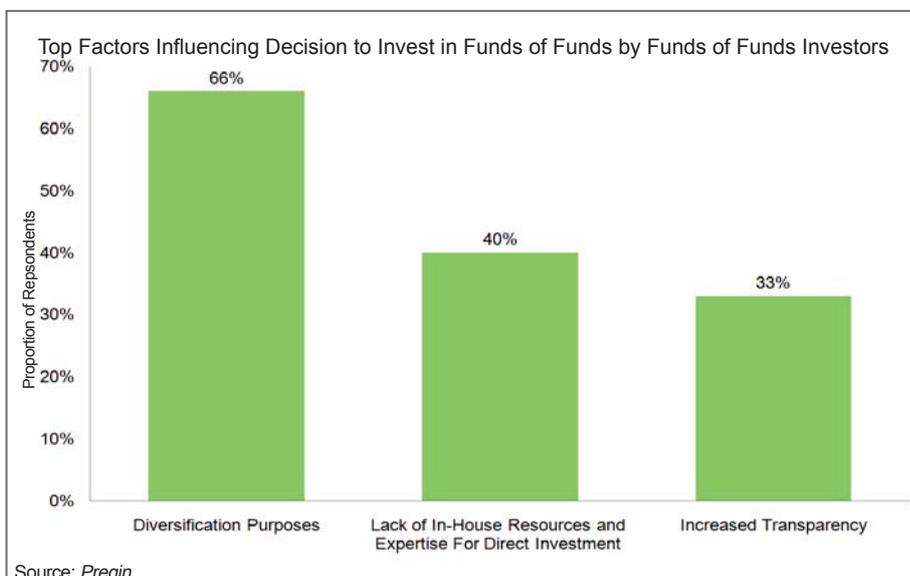
respondents stated for continuing to invest solely in funds of hedge funds. Despite the extra layer of fees, funds of hedge funds are beneficial for investors seeking to diversify their portfolios, and for those that have limited amounts of capital to invest in the asset class. A lack of in-house resources and expertise is another reason why some investors intend to stay with funds of hedge funds. Many investors have small investment teams and are therefore not equipped with the expertise to make their own diversified portfolio. It is more appropriate and less risky for such investors to commit to funds of hedge funds.

### Summary

Funds of funds are still viewed positively by institutional investors, with a significant proportion utilizing multi-manager vehicles as an educational tool to familiarize themselves with the asset class. Fund of hedge funds managers can expect a steady flow of mandates as new investors are constantly committing to the asset class. However, as the institutional market continues to mature, we can expect an increasing number to allocate capital to single manager funds. As a manager of funds of funds it is increasingly important to be aware of which investors are looking to take their first steps into the asset class in order to market your fund to the correct audience.

**Katy Johnson**

Fig. 6:



Preqin's Hedge Fund Investor Profiles has detailed information on over 2,500 institutional investors that have expressed an active interest in hedge funds. The database includes profiles for 223 institutional investors which are considering making their first investment in hedge funds over the next 12 months.

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- Listings and analysis for 116 third party marketers and 62 prime brokers
- Analysis of emerging manager investors
- Exclusive information gained through direct contact with institutional investors



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# Investors in Focus: US Investors in Emerging Markets

Fig. 1:

Key Facts: US Investors With A Preference for Emerging Markets	
% of US investors that have a preference for emerging market hedge funds	17%
Most favoured investment approach (fund of hedge funds, direct hedge funds, mixture of both)	Direct
Average overall allocation to hedge funds for US investors allocating to emerging markets	19%

Approximately 54% of all active hedge fund investors on Preqin's investor database are US-based. Due to the vast expertise and range of both managers and funds available, many such investors have a tendency to invest the majority of their hedge fund allocation domestically. However, following the global financial crisis in 2008, many investors began to look for alternative investment opportunities and as a result, emerging markets have been a growing area of interest for US investors. Today, approximately 17% of all US-based hedge fund investors have an active interest in emerging markets. Although emerging markets have traditionally been viewed as highly volatile investments, many institutions have invested in the region because of the potential for high returns. This is at the forefront of many investors' immediate

plans in the current economic climate due to the huge losses incurred during the market crash in 2008. The majority of US investors prefer to make direct investments, and approximately 50% of all US investments in emerging markets are in single manager hedge funds.

Long/short equity and macro strategies are the most popular strategies employed by US institutions investing in emerging markets. These are highly liquid strategies, which is of great importance to many investors in the current economic climate. Other strategies that are of interest to US investors include distressed securities, CTA and credit. Unsurprisingly, many funds of hedge funds managers are offering US investors exposure to emerging markets through their fund of funds vehicles. US endowment

plans, foundations and pension funds are also looking to diversify their portfolios and increase their activity in emerging markets. These institutions are more established hedge fund investors with more hedge fund investment experience and are often the larger allocators to the asset class, with the ability to reposition their exposure to different regions.

**Suganniya Kanaganayagam**

Preqin currently monitors 216 US institutional investors which are either already invested in emerging market hedge funds or are considering doing so in the next 12 months

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Fig. 2:

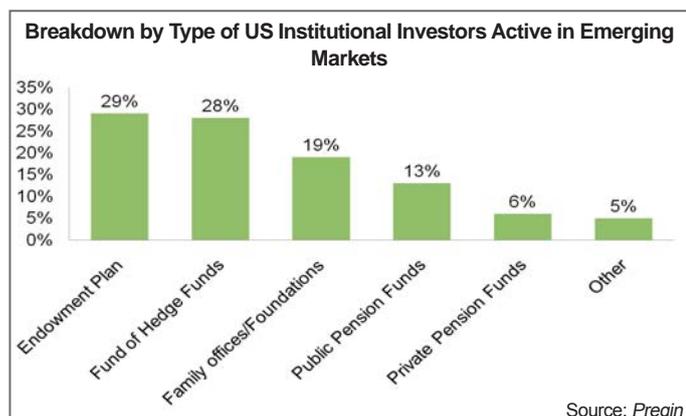
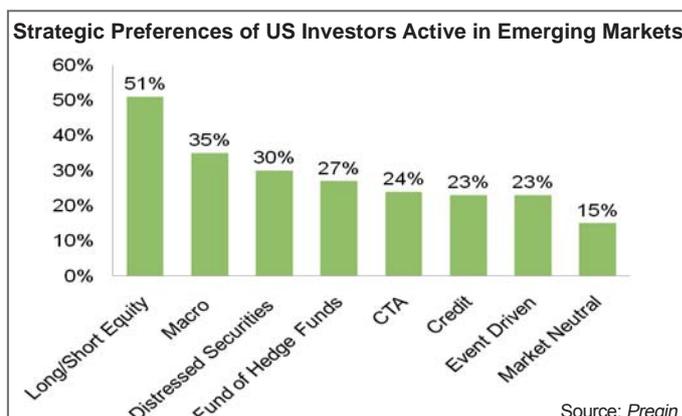


Fig. 3:



# Strategy in Focus: CTA/Managed Futures

Fig. 1:

Key Facts: Investors in Active CTA Funds	
% of institutional hedge fund investors that state CTA as a preference	16%
Median AUM of a CTA investor (\$bn)	1.1
Average allocation to hedge funds of a CTA investor	13.6%
Average returns sought from CTA investments	8.6%
Most favoured investment approach (funds of hedge funds, direct hedge funds, mixture of both)	Direct Hedge Funds

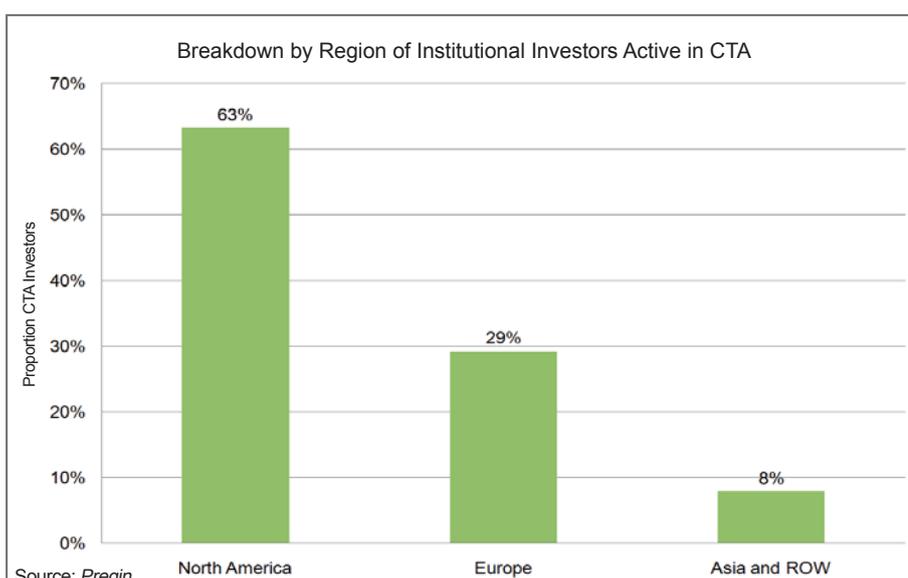
CTAs continue to be an attractive investment opportunity and the number of investors stating an active interest in the strategy has risen since last year. Prequin currently monitors over 400 institutional investors with an active interest in the sector, 16% of the total investor universe. Direct hedge funds are the most favoured investment approach for these investors. Many have chosen to invest in CTAs as a way to diversify their portfolios, lower portfolio risk and get exposure to non-equity and fixed income-related returns. Managed futures have benefitted investors by generating increased portfolio returns even in declining markets and have

reduced portfolio volatility. Globally, North American-based investors are the most active in the sector (representing 63% of all CTA investors). 29% are European and 8% are based in Asia and Rest of World.

Most of the capital in the CTA industry comes from the larger, more established investors. At present, funds of hedge funds are the biggest source of capital for CTA managers and as Fig. 3 shows, 28% of all such investors are active in managed futures. CTAs are also very popular amongst public sector pension funds, not least because they provide their portfolios with transparency and liquidity, two key issues in the institutional

market at the moment. 75% of the 20 largest investors in CTA in terms of assets are public pension funds. 21% of endowments and 13% of foundations also invest in managed futures. Interest in CTAs is expected to continue in the future, as more investors seek to diversify their portfolios while adding an additional layer of transparency and liquidity to their holdings. Managed futures have the benefit of potentially decreasing portfolio risk. Large institutional investors, such as funds of hedge funds and public sector pension funds, represent the most significant contributors in the managed futures sector. However, smaller institutional investors are increasing in

Fig. 2:



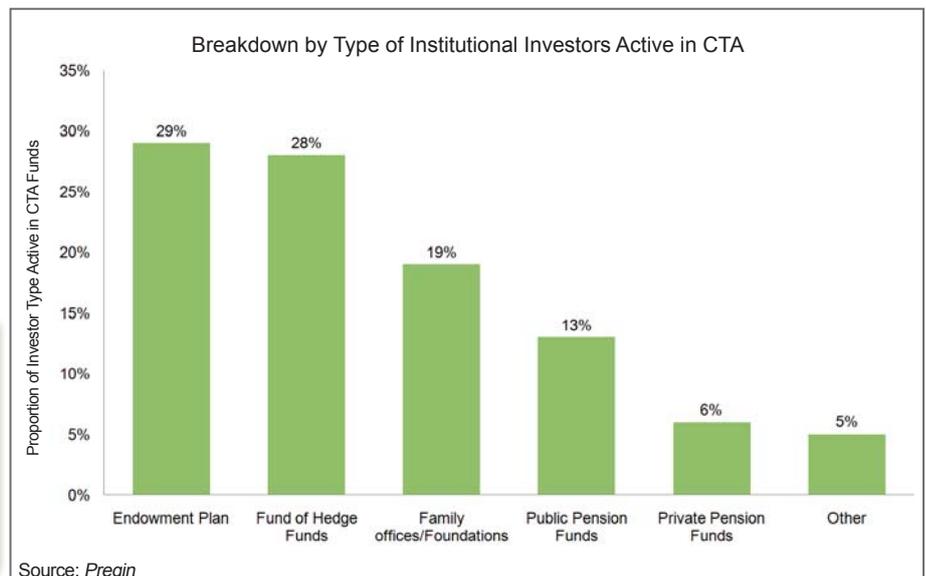
numbers. Therefore the diverse CTA universe, comprised of a variety of trading styles from currencies, interest rate products, stock indices, base metals, agriculture and energy, promises to attract new investors in 2010 and beyond.

**Nicole Rubbi-Clark**

Preqin monitors 409 institutional investors with an appetite for CTA funds. 253 are based in North America, 117 in Europe and 39 in Asia and Rest of World.

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Fig. 2:



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### SESSION HIGHLIGHTS

Changing Industry Dynamics: Profiling Best-of-Breed Investing ♦ Emerging Managers: What It Takes to Launch a New Firm or Fund Now ♦ Convergence: Opportunity, Threat or Obliteration? ♦ Intermediaries vs. Direct Investment: Can the FOF Model Survive? ♦ The Assets: Who Has Them, Where They Are, Where They're Going and When ♦ Regulatory Update ♦ The Takeover of Defined Contribution Plans: The Impact and the Consequences ♦ Manager Selection Criteria: New Definitions, No More Boxes, New Opportunity

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## 2010 Preqin Global Hedge Fund Investor Review

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# Conferences Spotlight: Forthcoming Events

## Conferences

Conference/Event	Dates	Location	Organizer
Hedge Fund and Funds of Funds Auditing, Accounting, Tax and Administration	19-21 July	New York	Financial Research Associates
Third Annual Alternative Investment Consultants Summit	21 July	Greenwich, CT	IMI
AIFM Directive	9-10 September	London	Infoline
Hedge Funds World Asia	13-15 September	Hong Kong	Terrapinn
High Frequency Trading World Asia	13 September	Hong Kong	Terrapinn
Hedge Fund Redomiciliation and Restructuring	21 September	London	IBC
InvestHedge Forum	21-22 September	London	Hedge Fund Intelligence
Alpha Hedge Institutional Investment	26-28 September	San Francisco	Institutional Investor Alpha Hedge
Hedge Funds World LatAm	5-7 October	Miami	Terrapinn
UCTIS Asia	5-6 October	Tokyo	Informa

### Third Annual Investment Consultants Summit

**Date:** 21 July 2010

**Location:** Hyatt Regency Greenwich

**Organiser:** Investment Management Institute

Hear from leading consultants, endowments, foundations, and pension funds on how to develop new business opportunities with institutional investors. Listen to institutional investors on where they expect to allocate funds to alternatives.

**Information:**

[www.investmentmanagementinstitute.com](http://www.investmentmanagementinstitute.com)

### Managing the Consequences of the AIFM Directive

**Date:** 9-10 September 2010

**Location:** London

**Organiser:** Infoline

This timely one day conference is unique in its coverage of both non-alternative and alternative funds. In just one day, it will explain the practical implications of the directive and provide a platform for debate on the opportunities and challenges it brings.

**Information:**

[www.informaglobalevents.com/KM6480PQSP](http://www.informaglobalevents.com/KM6480PQSP)



# Investor Spotlight: Investor News

## Local Government Superannuation Scheme (LGSS) re-enters hedge fund space.

The AUD 2.75 billion superannuation scheme has recently re-entered the hedge fund space via capital allocations to three hedge fund managers. It expects to add a fourth mandate in the next few weeks. It has awarded AUD 28 million mandates to Sydney-based managers Attunga Capital and H3 Global Advisors, and to London-based Winton Capital Management. In June 2009, LGSS withdrew from the hedge fund asset class, terminating its contracts with BlackRock, Warrakirri and FRM Investment Management. It is now looking to invest in defensive, liquid strategies that support significant short positions.

## Nationwide Building Society Pension Fund redeems its investment in a fund of hedge funds and will be moving into direct investments going forwards.

The GBP 2.2 billion private sector pension fund is in the midst of liquidating its holding in a fund of hedge funds vehicle. The process should be completed within the next 3-6 months. Going forward, Nationwide Building Society Pension Fund plans to gain exposure to the asset class through direct hedge fund investments. As a result of this move the pension fund is likely to increase its exposure to hedge funds to 4% of total assets. At this time, it was seeking 3-4 long/short equity managers. It expects to grant GBP 20-30 million mandates to each new manager.

## Carnegie Mellon University Endowment sets plans to reach its 15% allocation to hedge funds.

The endowment, which manages USD 1 billion for the Carnegie Mellon University, has announced plans to reach its target allocation of 15% by adding around five new managers to its portfolio. It is particularly interested in multi-strategy, macro and credit hedge funds. The typical bite size for its hedge fund investments ranges

between USD 3-10 million but it will commit further capital if an attractive investment opportunity arises. It currently has 13.9% of its assets invested in hedge funds.

## Shell Asset Management Company adds a new hedge fund investment and looks for more.

The private sector pension fund, which handles the assets of the pension schemes for Dutch and UK staff employed by Royal Dutch/Shell Group, has announced that it has made a new hedge fund investment and will continue to look for more. It plans to add around five more managers in 2010 and is focusing on global macro and CTA vehicles. The pension fund makes direct investments in hedge funds located worldwide, including emerging markets. When looking for new managers the pension fund looks for candidates with around EUR 115 million and a track record of three years.

## Chicago Public School Teachers Pension and Retirement Fund issues RFP for a fund of hedge funds.

The USD 9.2 billion public pension fund has issued an RFP for a fund of hedge fund vehicle to add to its portfolio. It is looking for a minority or female-owned vehicle and initially plans to invest USD 25 million. The pension fund invests globally including emerging markets and will invest with emerging managers. It seeks returns of 3-6% above T-bills from its hedge fund investments.

## Nordea Life & Pensions continues to add new managers.

The insurance company has announced plans to reach its target allocation of 2% to hedge funds over the next two to three years. It currently invests half this amount in the asset class and invests with eight managers. Nordea plans to add a wide range of managers to its portfolio and is particularly interested in long/short equity, event driven and macro managers. Its investments are normally split between

Europe and the US but it will invest in Asia and other emerging markets should the right opportunity present itself. Nordea has the capacity for both large and small investments. For single manager funds, it typically invests between EUR 5 and 50 million, while fund of funds usually see investments from EUR 50 million up as high as EUR 200 or 300 million.

## Delta Lloyd moves into direct investments.

The EUR 40 billion insurance company began investing in hedge funds in 2000 through a mixture of funds of hedge funds and direct vehicles. It has recently reviewed its hedge fund portfolio and decided to move away from funds of hedge funds in favour of direct investments. Its funds of hedge funds investments are currently in liquidation. Delta commits EUR 400 million to the asset class.

## Wischmeier moves from Indiana to North Carolina.

Shawn Wischmeier has been hired to take over the CIO position at North Carolina Department of State Treasurer. Wischmeier is moving to the pension fund from Indiana Public Employees' Retirement Fund. During his time at Indiana he implemented its maiden hedge fund portfolio and in recent months has doubled its allocation to hedge funds. North Carolina has been without a CIO since August 2009, when Patricia Gerrick departed following issues regarding state personnel policy.

**Amy Bensted**

This is just a selection of recent news on institutional investors in hedge funds. More news and updates are available online for Hedge Investor Profiles subscribers.

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