Hedge Fund Spotlight

December 2010

Welcome to the latest edition of Hedge Fund Spotlight, the monthly newsletter from Preqin providing insights into hedge fund performance, investors and fundraising. Hedge Fund Spotlight uses information from our online product Hedge Fund Online.

December 2010
Volume 2 - Issue 12

FEATURED PUBLICATION:

The 2011 Preqin Global Hedge Fund Investor Review
More information available at: www.preqin.com/hedge

London:
Equitable House,
47 King William Street,
London, EC4R 9AF
+44 (0)20 7645 8888

New York:
230 Park Avenue,
10th Floor, New York,
NY 10169
+1 212 808 3008

Singapore:
Samsung Hub
3 Church Street, Level 8
Singapore, 049483
+65 6408 0122

www.preqin.com
e: info@preqin.com

Twitter: www.twitter.com/preqin
LinkedIn: www.linkedin.com
Search for Preqin

Feature

Regulars

Data

You can download all the data in this month's Spotlight in Excel.
Wherever you see this symbol, the data is available for free download on Excel. Just click on the symbol and your download will begin automatically. Feel free to use the data in any presentations, but please remember to cite Preqin as your source.

alternative assets. intelligent data.

The Allure of Emerging Managers

Katy Johnson takes a look at emerging manager hedge funds, establishing the type of investor that is keen to invest with these managers and where they are based.

Emerging manager hedge funds can present a compelling investment for institutional investors that are looking to tap into new opportunities in the hedge fund arena. Although investment in a fund with less of a proven track record can be seen as riskier than investment with established managers, first-time funds have the potential for stronger returns and access to new strategies. Over the recent past, investors have increasingly been adding emerging managers to their hedge fund portfolios in order to gain access to the next generation of manager. However, the events of the past two years have begun to be felt by the newer fund managers, and it has become more difficult for emerging managers to pick up capital from the institutional market. An era of heightened caution brought on by hedge fund failures and high profile blow-ups has led to a decrease in the uptake of emerging managers by investors over the past 12 months.

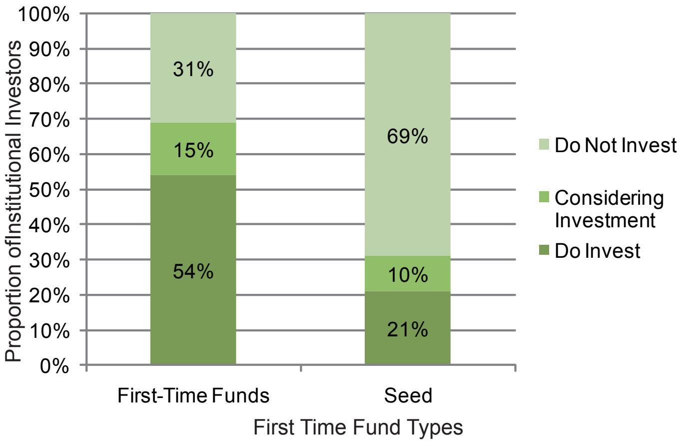
First-time funds are the most utilized type of emerging manager fund by the institutional investor community. 54% of institutional investors on Preqin's hedge fund investor database have stated a preference for first-time hedge funds. There has been a noticeable decline in the number of investors that allocate to these emerging managers from 2009, when 59% of institutional investors were investing in such funds. However, although the current fundraising environment is more difficult for an emerging manager, the outlook for the future looks more positive – 15% of institutional investors are considering adding emerging manager funds to their holdings in the near future, which could see a resurgence in the use of first-time funds back to pre-crisis levels.

There has been a surge in the provision of seed capital to hedge funds over the past year. Since 2008 investors had mainly been shying away from seed deals as they waited for more stability to return to the asset class and the wider financial markets in general. In 2009, just 11% of investors would provide seed capital to a fund; today this has nearly doubled to 21% of the institutional market. Many investors feel that there are numerous opportunities in the current environment for investment of this kind, and the benefits of fund ownership, fee negotiations and early access to the next generation of hedge funds outweigh the potential risk of such an investment. Seed arrangements are also beginning to evolve in this post-crisis era, with many investors not just providing seed capital to the youngest funds but also awarding seed capital to the more established vehicles, with years of track record under their belt, but which may have either stalled in their fundraising, and need a capital injection to reach institutional size, or have lost assets through the crisis. Before the crisis, many fund managers were wary of entering seed arrangements that could see a loss of earnings through fee-sharing arrangements with the investor, but in a more difficult fundraising climate many more funds are now seeking these kinds of capital injections. As a result the opportunities in the seeding market have rapidly grown in the past 12 months.

Emerging Manager Appetite by Investor Type

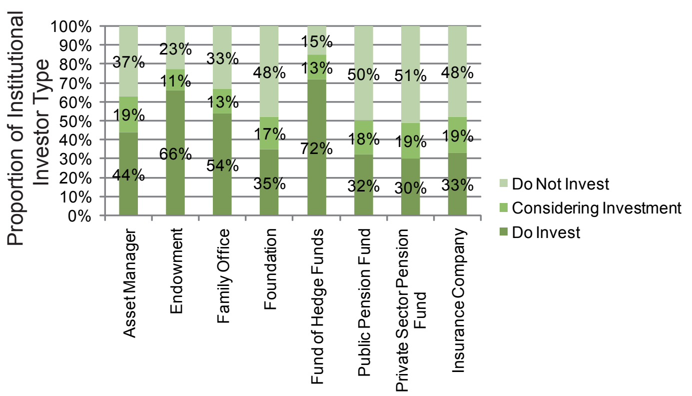
Emerging manager investors are most commonly those that have large resources behind them or extended experience within the hedge fund industry. Funds of hedge funds have the highest preference for first time funds; 72% of funds of hedge funds on the Preqin database reveal that they

Fig. 1: Investor Attitude to Emerging Markets



Source: Preqin

Fig. 2: Emerging Managers Appetite Split by Investor Type



Source: Preqin

"...over a third of emerging manager investors are based in Europe..."

would invest in an emerging manager and 13% would consider this type of investment. Funds of hedge funds are undoubtedly at the forefront of hedge fund investing and are more willing to take the risks involved in investing with a much less established manager. KCPS, an Israel-based fund of hedge funds, has recently announced plans to invest with up to 10 emerging managers over the next 12 months.

Endowments have changed very little in their attitude towards emerging manager funds in the past 12 months, which considering their long-term outlook on the asset class is unsurprising. 66% of endowments will invest in emerging manager funds (in 2009 this figure was 65%). As experienced investors often with dedicated investment teams they are able to select funds based on the fit of the strategy in their portfolio rather than the experience of the manager. Family offices, one of the traditional backers of emerging managers and younger fund groups, remain one of the leading groups active in first time funds going into 2011. For instance, Legacy Trust, a $1.8 billion multi-family office, announced that it would look for 5-10 hedge fund managers over 2011 and would include emerging managers in its search. However, there has been a decline in the use of emerging managers over the past 12 months within this group – from 63% of family offices in 2009 to 54% today.

Pension funds and insurance companies – some of the largest groups of allocators to hedge funds in dollar terms – have decreased markedly in their use of emerging manager teams over the past 12 months, cutting their exposure to these kinds of fund groups in favour of established "brand name" fund management teams. For instance, in 2009 44% of public pension funds invested in emerging manager funds. Today this figure is 32%. Despite these broad cuts across the group, some large public pension funds continue to actively invest in emerging manager hedge funds; for instance New York State Common Retirement Fund put its maiden emerging manager program in place in 2010.

Geographic Breakdown of Emerging Manager Investors

North America represents both the greatest number of emerging manager investors (57% of the total number) and the greatest proportional preference for such managers (60% of North American hedge fund investors will invest in emerging manager funds). Investors in this region are investing in significantly larger numbers than their counterparts from around the globe. The sheer number of opportunities within North America in terms of new fund launches, as well as being more experienced in hedge fund investment in general, enables institutions within this region to consider the emerging manager market more.

Over a third of emerging manager investors are based in Europe. However, European investors are in general much more cautious when it comes to investment in emerging manager hedge funds and are proportionally investing the least in these types of fund managers.

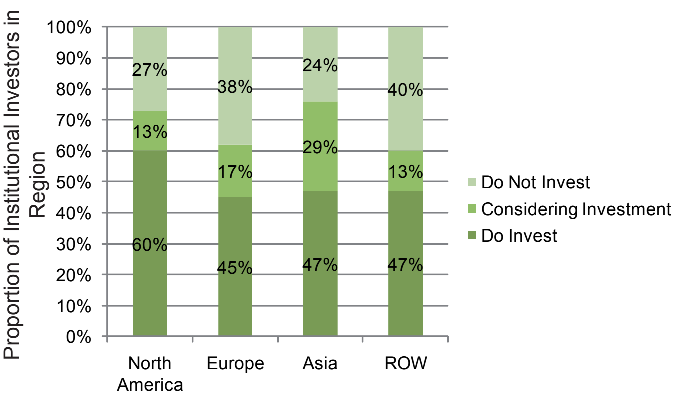
Although in comparison to North America investors in Asia are investing less in emerging managers this region offers many opportunities for the marketing of first time funds in the next 12 months. The hedge fund industry is starting to develop within Asia and almost 30% of all investors in this region would actively consider adding an emerging manager fund to their portfolio over the course of 2011.

Barriers to Entry

The new era of caution in terms of emerging manager investment can be seen in changes to track record and assets under management requirements of the investors on Preqin's database of institutional investors. In 2009, more than 50% of institutional investors would consider investment in a fund with a track record of two years of less. However, this figure has now fallen to 38%, as investors set higher barriers to entry for their fund managers. A larger proportion of investors now look for a track record of around three to four years. Hedge funds that have been around for this length of time, since before the financial crisis, have demonstrated their abilities in a tough financial climate, which has made them more appealing to investors.

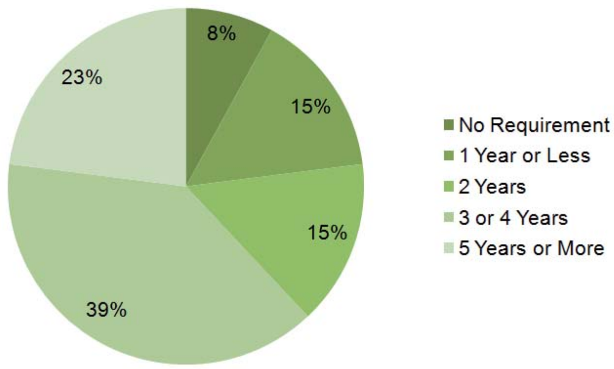
Over the course of 2010, in a trend contrary to the track record requirements, institutions have shifted to accept

Fig. 3: Emerging Manager Appetite Split by Investment Location



Source: Preqin

Fig. 4: Fund Manager Track Record Required by Institutional Investors



Source: Preqin

investment in smaller funds. In 2009, a quarter of all investors would only look at funds with at least $500 million in assets under management, but this year the figure has fallen to 19%. Following the market crisis the industry contracted in size and most funds lost assets. Institutional investors have recognized that funds have become smaller and correspondingly have reduced their minimum track record requirement. Managers of smaller funds are now able to attract the attention of institutional investors and as a result will be able to reach institutional size more quickly than in previous years.

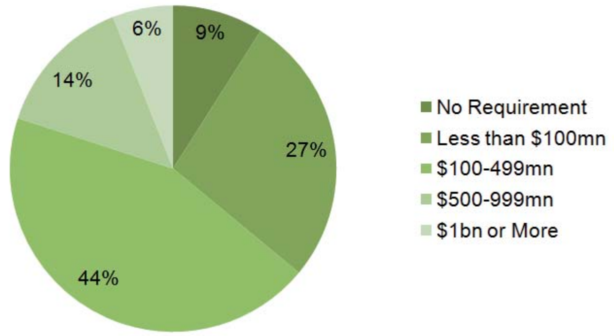
What Emerging Managers Can Expect over the Next 12 Months

There is no doubt that the fundraising environment for newer and smaller funds has become more difficult since the market crisis. Over the course of 2010, many investors have shifted assets away from emerging fund teams towards the perceived safe haven of established and large hedge fund groups. However the prospects for the next 12 months look more promising. With many investors beginning to consider investment in emerging manager teams, particularly investors from emerging regions for hedge fund investment such as Asia, the first-time fund managers that market their funds to the right audience will be able to pick up institutional capital in 2011.

Although investors are more wary of investment in funds in their very early stages, those fund managers that are able to build up a track record through investment of their own capital (or of a small fund) will be attractive to the institutional market, which is now looking at smaller funds, but also those with a demonstrable performance of at least three years.

Greater alpha production, stronger returns, lower fees and new strategies are all attractive features to the institutional market. Investor confidence is continuing to grow and the benefits of investment in emerging manager teams will outweigh caution within the industry. In 2011 we can expect investors to once again start to look at smaller and emerging fund managers and for more capital to flow into the sector.

Fig. 5: Fund Managers Assets Under Management Required by Institutional Investors



Source: Preqin

Download Data

Data Source:

The 2011 Preqin Hedge Fund Investor Review

This month’s feature article is an excerpt from The 2011 Preqin Hedge Fund Investor Review. This publication provides profiles of institutional hedge fund investors from around the globe and in-depth analysis of industry trends, hedge fund investment strategies and investor preferences.

For more information and to order your copy, please visit

www.preqin.com/hfir

2011 Preqin Global Hedge Fund Investor Review

preqin
alternative assets. intelligent data.

The 2011 Preqin Global Hedge Fund Investor Review provides profiles and analysis for the most important institutional investors in hedge funds from around the world.

- Profiles for 1,000 key institutional investors arranged into 23 key regions from around the world
- Profiles include fund preferences by strategy and geography, key financial information, direct contact details for key personnel, sample investments
- Analysis and league tables for investors from each region
- Analysis for investors in each of the ten most important hedge fund strategies with listings for active investors
- Analysis and listings for investors looking to allocate to UCITS or managed account vehicles
- Exclusive results of Preqin investor surveys
- Listings and analysis for 167 third party marketers and 103 prime brokers
- Analysis of emerging manager investors
- Exclusive information gained through direct contact with institutional investors

www.preqin.com/hfir

I would like to purchase the 2011 Preqin Global Hedge Fund Investor Review:

Single Copy:

- ☐ £465 + £10 Shipping
- ☐ $795 + $40 Shipping
- ☐ €520 + €25 Shipping

Additional Copies:

- ☐ £110 + £5 Shipping
- ☐ $180 + $20 Shipping
- ☐ €115 + €12 Shipping

Shipping costs will not exceed a maximum of £15 / $60 / €37 per order when all shipped to same address. If shipped to multiple addresses then full postage rates apply for additional copies.

Data Pack:

- ☐ $300 / £175 / €185

Data Pack contains all underlying data for charts and graphs contained in the publication. Only available alongside purchase of the publication.

Completed Order Forms:

Post (to Preqin):
Equitable House,
47 King William Street,
London, EC4R 9AF

230 Park Avenue
10th Floor,
New York, NY 10169

Samsung Hub
3 Church Street
Level 8
Singapore 049483

Fax:
+44 (0)87 0330 5892
+1 440 445 9595
+65 6408 0101

Email:
info@preqin.com

Telephone:
+44 (0)20 7645 8888
+1 212 808 3008
+65 6408 0122

Payment Details:

- ☐ Cheque enclosed (please make cheque payable to 'Preqin')
- ☐ Credit Card ☐ Amex ☐ Mastercard
- ☐ Visa ☐ Please invoice me

Card Number: ______________________

Name on Card: ______________________

Expiration Date: ______________________

Security Code: ______________________

American Express, four digit code printed on the front of the card.

Visa and Mastercard, last three digits printed on the signature strip.

Shipping Details:

Name: ______________________

Firm: ______________________

Job Title: ______________________

Address: ______________________

____

____

City: ______________________

Post/Zip: ______________________

Country: ______________________

Telephone: ______________________

Email: ______________________

Long/Short Equity

Sarah Corran takes a look at the investors pursuing opportunities to invest in long/short equity hedge funds

Fig. 1: Key Facts: Long/Short Equity Investors

% of institutional HF investors that state long/short equity as a preference	40.1%
Median AUM of a long/short equity investor (USD bn)	1.2
Average allocation to hedge funds of a long/short equity investor (% / USD mn)	15.1% / 181
Average returns sought from a long/short equity investment	8.7%
Most favoured investment approach (direct hedge funds, funds of hedge funds, mixture of both)	Direct
Average lock-up of a long/short equity fund (months)	5.6
Maximum lock-up accepted by a long/short equity investor (months)	22.1

Source: Preqin

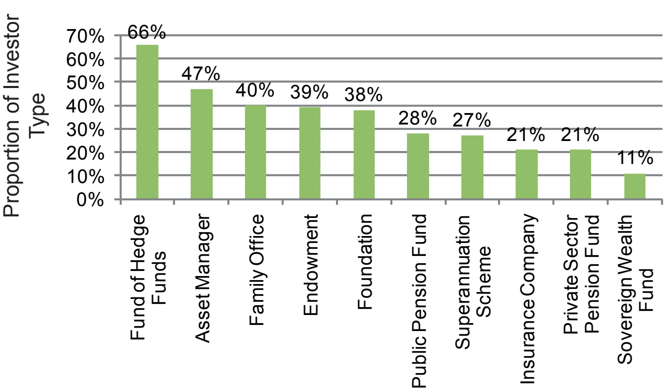
Long/short equity funds have continued to attract a significant amount of interest amongst institutional investors during 2010, with 766 investors on the Preqin database expressing an active interest in this type of vehicle. This represents an increase of 13% from 2009 and consequently long/short equity remains ranked as the most popular single strategy on the database. Long/short equity funds provide a liquid source of alpha to an investor's portfolio, which assists investors to hedge out market risk as well as to diversify their equity holdings. The ability to short the market through equity holdings in such vehicles continues to be attractive to institutional investors and there has been an increase in investors adding long/short managers to their portfolios from buckets other than their alternatives holdings over 2010. For instance, Mount Sinai School of Medicine Endowment has increased its hedge fund allocation to 75% of AUM over the past 12 months by adding long/short holdings to its traditional equity portfolio in order to capitalize on opportunities arising from market volatility.

The use of long/short equity funds is widespread across most major groups of investors. 66% of all funds of hedge funds monitored on the Preqin database have some exposure. A large proportion of asset managers, family offices and endowments also allocate capital to the sector, all of which predominantly invest in long/short equity funds directly. Long/short equity funds also require investor capital to be locked up for relatively short periods of time, 5.6 months on average, another attractive feature for institutional investors seeking greater liquidity in the current climate.

Investment in long/short equity funds is popular across the globe, with 40.1% of institutional investors globally both currently investing in long/short equity funds and actively searching for funds over the next 12 months. North America and Europe serve as large sources of capital for these funds in terms of sheer volume of investors within these two regions. Combined, 89% of all investors in long/short equity are based within North America and Europe. However, proportionally investors in Rest of World show the greatest preference for such funds, with 52% of investors having a current preference for long/short equity funds.

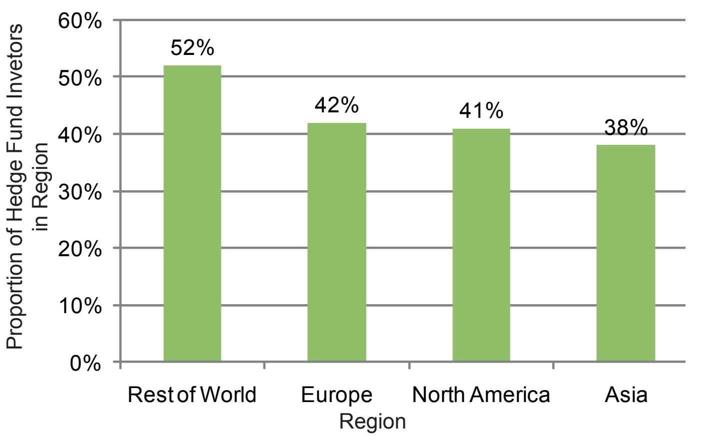
Download Data

Fig. 2: Proportion of Each Type of Institutional Hedge Fund Investor That Invests in Long/Short Equity



Source: Preqin

Fig. 3: Proportion of Institutional Hedge Fund Investors in Each Region That Invest in Long/Short Equity



Source: Preqin

Rest of World Funds of Funds

Amy Bensted takes an in-depth look at Rest of World-based funds of funds seeking to invest in hedge funds, considering their investment preferences and favoured investment approach.

Fig. 1: Key Characteristics of Rest of World - Based Fund of Hedge Funds

Median AUM of a Rest of World-based fund of funds ($mn)	203
Year of first investment (mean)	2002
Typical size of portfolio (# of funds)	18
Average returns sought from hedge fund investments	9%

Source: Preqin

In this month's Investor in Focus we examine funds of hedge funds based in regions from outside of the more established centres of hedge fund activity – Europe, North America and Asia. The term "Rest of World" (ROW) covers areas such as the Middle East, Latin America, Africa and the Caribbean (Fig. 2). The hedge fund industry in these regions is relatively new and as a result these funds of hedge funds have shorter track records than their counterparts from other regions across the globe. The mean year of establishment for funds of funds in both Europe and North America is 1998, compared to 2002 for funds of funds in Rest of World. Although many investors in funds of funds will predominantly allocate to the larger European and North American firms, they may also allocate smaller sums to managers from less established hedge fund regions in order to access opportunities in these emerging markets. As a result these funds are comparatively small, with median assets under management of $203 million and with a mean portfolio size of 18 hedge funds. Globally, funds of funds have portfolios that consist of 55 funds, on average.

Typically, funds of funds based in Rest of World will consider opportunities on a global scale, but will in addition place a particular emphasis on funds within their own region. For instance, funds of funds based in Brazil are likely to look at opportunities in South America. Proximity to funds within the managers' domestic regions provides a competitive edge in attracting overseas investors that are looking to gain exposure to emerging centres of hedge fund activity. Additionally, new legislation and the development of local economies are leading to new institutional investors entering the market from within these ROW regions. Many of these investors may be limited to investment within their countries because of local regulations or may wish to invest in opportunities closer to home. Meanwhile, just over a quarter of Rest of World-based funds of funds have some exposure to the established homes of the hedge fund industry in North America and Europe.

Two-thirds of Rest of World-based funds of funds use long/short equity strategies within their hedge fund portfolios. Global macro and event driven funds, which take advantage of changes in the global economic environment, are also popular, with 59% and 48% of Rest of World-based funds of funds using these types of vehicle within their portfolios respectively.

Rest of World-based funds of funds typically invest in smaller and younger hedge funds than funds of funds in more developed hedge fund regions. For example, the average Rest of World-based fund of funds manager requires that managers it is considering investing with have at least $50 million in assets under management, compared to the global average of $212 million. This is predominantly due to the nature of the industry within these ROW regions, which is typically newer and smaller than the hedge fund industry in Europe and North America. As a result the underlying hedge funds in these regions have a shorter track record and fewer assets under management. For instance KCPS, an Israel-based fund of hedge funds plans to make up to 10 new hedge fund investments over the course of 2011 and will be particularly looking at emerging managers for these commitments.

Download Data

Data Source:

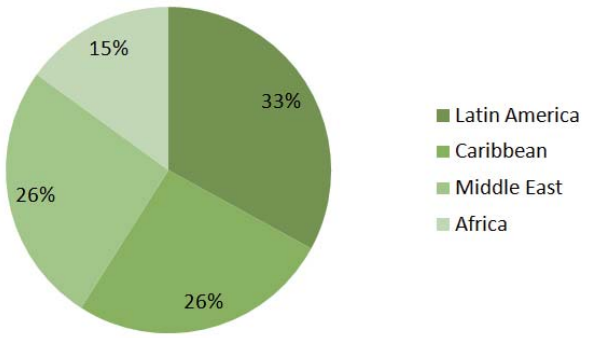
Preqin Hedge Investor Profiles

Data from Strategy in Focus and Investors in Focus was taken from Preqin's Hedge Investor Profiles service.

For more information or to arrange a demo please visit:

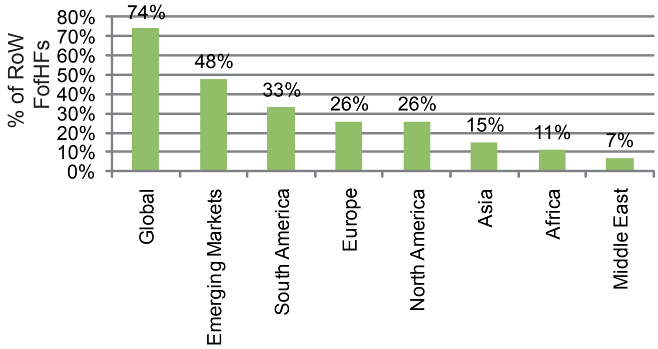
www.preqin.com/hedge

Fig. 2: Regional Distribution of Rest of World-Based Funds of Hedge Funds



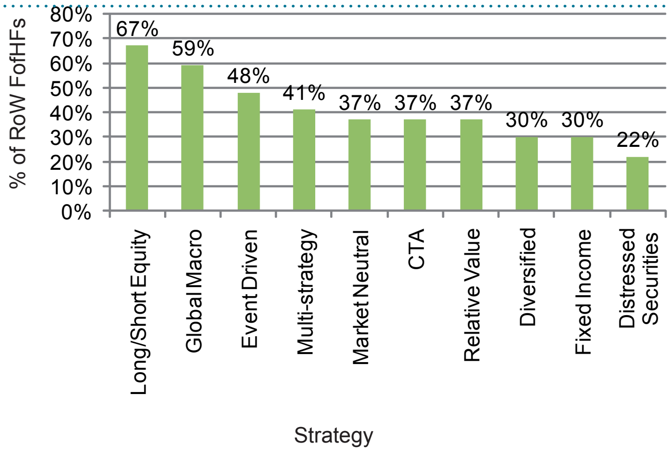
Source: Preqin

Fig. 3: Regional Preferences of Rest of World-Based Funds of Hedge Funds



Source: Preqin

Fig. 4: Strategic Preferences of Rest of World-Based Funds of Hedge Funds



Source: Preqin

Conferences Spotlight: Forthcoming Events

Conference	Dates	Location	Organizer
Hedge Funds World Australia 2010	7 - 8 December 2010	Sydney	Terrapinn
Hedge Funds World Zurich 2010	7 - 9 December 2010	Zurich	Terrapinn
Hedge Funds World Middle East	7 - 10 March 2010	Dubai	Terrapinn

Institutional Investor News

Peddie School has USD 10 million to invest in hedge funds.

The New Jersey based school's USD 260 million endowment has revealed that it is still to allocate around USD 10 million of its hedge fund budget. Peddie School has around 16% of its assets invested in hedge funds, and expects to reach its target allocation of 20% next year. The school is looking in particular for long/short equity managers, and in the non-directional space it is seeking market neutral multi-strategy managers. It is prepared to invest globally, including in emerging markets, but will not consider funds of hedge funds. Peddie School makes its hedge fund investment decisions on a case-by-case basis, and has not ruled out investing in emerging managers.

Jaidah Motors and Trading Company liquidates hedge fund investments due to cash demand.

The USD 250 million corporate investor has revealed that it began liquidating its hedge fund investments earlier this year. The decision was mostly attributed to the fact that it had relatively higher cash demands as of that time, even though it had a generally optimistic view of the hedge fund asset class. Due to this, it has not ruled out the possibility of re-entering the space in 2012 should an attractive opportunity be presented that fits in with its strategic investment plans. In the past, the Doha based group has had an allocation of approximately 20% of total assets under management committed to managers in the hedge fund asset class.

New Providence Asset Management to add long/short equity managers to its portfolio in following 12 months.

The New York-based funds of hedge funds manager, which currently has USD 2.5 billion in assets under management, is planning on adding new long/short equity managers to its portfolio over the course of the next 12 months. New Providence is currently invested in 25 managers, all in the long/short equity space, and will hire new managers from a list of around 50 hedge funds that it has been monitoring. The firm will only commit to managers with at least three years' track record and a minimum of USD 100 million in assets under management. It does not invest in funds that have lock-up periods. Typically, New Providence will invest up to USD 100 million per fund and prefers to invest via managed accounts.

Steenman Asset Management looks for 3-10 additional managers.

The funds of hedge funds manager which currently manages one multi-manager vehicle and has USD 200 million in assets under management has announced plans to add new managers over the next 12 months. It will look for up to ten new managers and plans to focus on global macro investments. Typically Steenman commits between USD 3-5 million per hedge fund vehicle and targets returns of 8% against absolute return.

University of Bristol Pension and Assurance Scheme is searching for an investment consultant and actuary.

The Bristol-based pension fund is searching for a consultant to provide investment consulting and actuarial services to its board of trustees and investment staff. University of Bristol Pension and Assurance Scheme is an active investor in hedge funds and all of its current exposure to the asset class is through funds of hedge funds. The fund's previous consultant and actuary was Xafinity Consulting, which was previously the investment consulting unit of PriceWaterHouseCoopers up until its purchase by Xafinity Group in August 2009. The contract is expected to commence in late February and will be for a three-year period with the option to extend for a further year.

Northamptonshire County Council Superannuation Fund considers increasing hedge fund allocation.

The GBP 1.1 billion public pension fund will be increasing its overall hedge fund allocation from 3% up to 5% in the near future. The county council is pleased with its performance in the asset class and will take this into consideration during its forthcoming asset allocation review. Should the increase be authorized, the pension fund will invest any additional capital into its sole hedge fund investment – a fund of hedge funds vehicle managed by Fauchier Partners.

Merseyside Pension Fund consolidates fund of hedge funds investment with Pacific Alternative Asset Management Company (PAAMCO).

The GBP 4.5 billion public pension fund will be consolidating its funds of hedge funds investments currently held by three external managers, to a single portfolio managed by Pacific Alternative Asset Management Company (PAAMCO). The pension has revealed that PAAMCO offered the best performance and stability over the past five years and therefore it has decided to triple its allocation to the manager. In addition to this increased allocation of capital, Merseyside Pension Fund has given PAAMCO advisory responsibility over its direct single manager hedge fund investment portfolio, which was previously managed in-house.

University of Sydney Endowment to make first foray into hedge funds.

The AUD 829 million endowment has revealed that it is in the final stages of beginning its maiden hedge fund investments. The endowment has committed 3% of its total AUM to the asset class and has recently finished selecting its manager line up, which is made up of single manager hedge funds specializing in multi-strategy investments.

Data Source:

Preqin Hedge Investor Profiles

Each month Spotlight provides a selection of the recent news on institutional investors in hedge funds

For more information please visit

www.preqin.com/hedge