

Hedge Funds With Highest Performance Fees Deliver Best Net Returns

Hedge funds that charge performance fees of more than 20% have produced the highest net returns in four out of the past six years

Preqin's data shows hedge funds with at least a three-year track record that have posted positive returns each month since inception charge an average performance fee of 19.50%. Funds with positive performance in less than a quarter of the months studied charge an average performance fee of 16.67%.

Other Key Facts:

Funds which deliver the best long-term net absolute returns for their investors charge the highest performance fees

- Hedge funds which have produced the highest net returns for investors on a three- and five-year annualized basis charge performance fees over 20%.
- Funds with fees over 20% have also produced the strongest risk adjusted net returns – with a Sharpe-ratio (2%) of 2.11 over a three-year period (compared to 1.18 of funds with a performance fee of 20%).

Despite this investors are still seeking further alignment of interests and are continuing to negotiate fees

- The proportion of investors that believe fund manager and investor interests are properly aligned at present has fallen to 64%, compared to 74% in 2012.
- Management and performance fees are most commonly cited by investors as the area of fund terms where further improvements are necessary: 55% of investors are seeking reductions in both.
- Despite this, 68% and 58% of investors have seen improvements in the levels of management fees and performance fees being charged respectively over the past 12 months.
- 57% of investors are now looking to negotiate fund terms and conditions, an increase from 46% in 2012. Of those investors that entered into negotiations, 81% were successful.

Funds with the highest fees are more likely to apply hurdle rates which must be reached before performance incentives are charged

- 49% of investors are seeking managers to change how performance fees are charged, for instance to make the use of hurdle rates* or clawbacks more widespread across the industry.
- 68% of funds that charge fees in excess of 20% use hurdle rates, compared to 39% of funds that charge performance fees of 20%, and 51% of funds that charge less than 20%.

For more information and analysis, please see

http://www.preqin.com/docs/newsletters/HF/Preqin_Hedge_Fund_Spotlight_August_2013.pdf

Comment:

“Hedge fund fees have been a topic of much discussion over the past five years as investors have called for more favorable terms. In a competitive fundraising climate, 58% of investors have seen reductions in performance fees over the past year.

Despite this trend, some funds are charging performance fees above the industry standard of 20% and have been successful at gaining institutional investment. Indeed, the funds with the highest performance fees have been the best at producing consistent long-term absolute net returns for their investors. This suggests investors are satisfied to pay higher compensations to those managers that have produced strong performance. The funds with the highest fees have also shown to offer other concessions to investor demands, for instance by showing greater use of hurdle rates which must be met before performance incentives are charged.

For investors seeking consistent, strong, risk-adjusted returns, funds which charge the higher performance fees should not be discounted, as they have demonstrated their ability to meet these goals over the long-

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term. However all managers should be mindful that regardless of what fee they charge, if they do not live up to expectations, investors will not hesitate to appeal against performance-based bonuses incongruent to returns, or even exit the fund completely.”

Amy Bensted, Head of Hedge Funds Products - Preqin

Note to Editors:

- Preqin is spelled without the letter ‘U’ after the ‘Q’, the company name being an amalgamation of the former name, Private Equity Intelligence.
- * When a hurdle rate is enforced the performance fee is only paid on the fund's performance in excess of a benchmark rate (e.g. LIBOR) or a fixed percentage.

About Preqin:

Preqin is the leading source of information for the alternative assets industry, providing data and analysis via online databases, publications and bespoke data requests.

Preqin has built a reputation in the alternative assets industry for providing the most comprehensive and extensive information possible. Leading alternative assets professionals from around the world rely on Preqin’s services daily, and its data and statistics are regularly quoted by the financial press. For more information, please visit: www.preqin.com

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