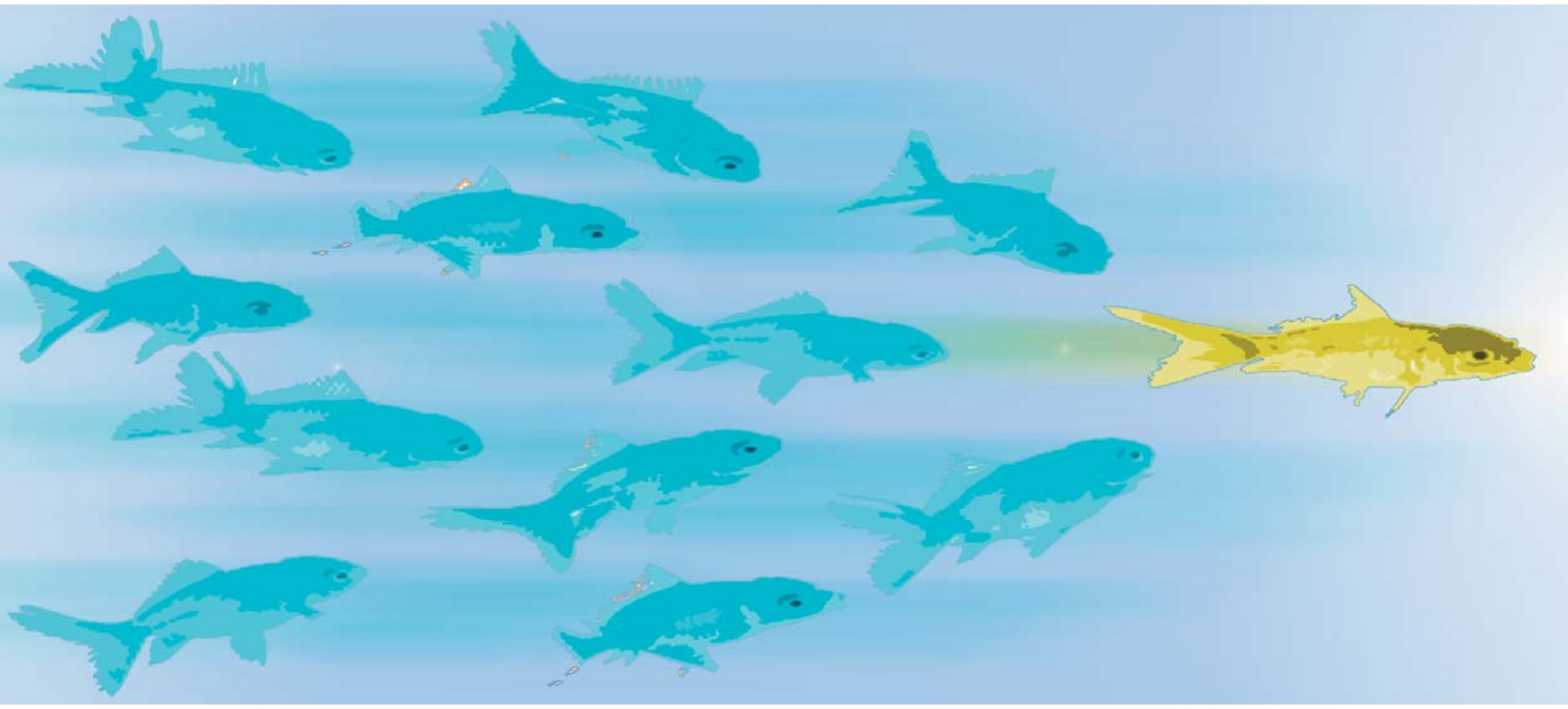
Investment Advisor Special Report

November 2008



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Investment Advisor Special Report

Fundraising Conditions Getting Tougher
The Importance of Advisors

Fundraising Conditions Getting Tougher

The events of mid-September have changed the financial climate dramatically, with repercussions being felt strongly in the alternative assets fundraising markets. New commitments to private equity funds fell to a three year low in Q3 2008, and Q4 figures look unlikely to improve upon this.

The problems facing the market are twofold. Firstly, investors are much more cautious before making new investments. Many have reduced cashflows, and are facing significant volatility in their overall investment portfolios. Making new commitments in the current climate is therefore very difficult, and is not an appropriate action for some. Secondly is the fact that so many managers are on the road seeking capital. The majority of the record number of fund managers currently on the road launched their vehicles before the current financial climate came to fruition, and could not have predicted the dramatic shift in the market. With so many managers all seeking capital from a cautious and restricted investor universe, it is clear that not all managers are going to be successful in raising capital.

However, the outlook is not all doom and gloom. Investors are still positive towards alternatives, and a significant number are still making new investments. Various sectors within alternatives have been stellar performers, and fund managers that can demonstrate a good plan for how to use the current financial situation to their advantage will find that knowledgeable investors will still be keen to gain access to their new vehicles. The drop in recent fundraising has a lot to do with investors having reduced cashflows, and many are waiting for the financial climate to become more stable before making new investments. We have not seen many investors looking to pull out of alternatives as a result of recent developments.

The Importance of Advisors

With the market for alternatives fundraising currently more competitive than at any other point in the history of the industry, increasing numbers of institutional investors are utilising the services of advisors in order to assist them with fund selection, advice and due diligence. If a fund manager is able to communicate its strategy to an advisor in an effective manner, then it can lead to them potentially gaining a number of commitments from the advisor’s clients.

This research report, which is based upon data taken from the 2009 Preqin Alternative Investment Advisor Review, shows the scope of the market, and reveals what the most important factors are for investors when reviewing their advisors. A good understanding of this market and the relationship between investor and advisor will ensure that you are able to approach advisors in the right way in order to form lasting and fruitful relationships, enabling you to gain commitments for both current and future fundraisings.

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Proportion of Institutional Investors Using Advisors
Advisor Usage by Investor Location

Proportion of Institutional Investors Using Advisors

Looking at the breakdown of investors that employ the services of an advisor for their alternative investments versus those that make their alternative investment decisions in-house reveals that just over 57% of investors consult an external advisor when making alternative investment decisions, as shown in Fig. 1. This includes those receiving alternative investment advice from their general consultants as well as those employing specialist alternative investment advisors for one or more specific asset classes. Just under 43% of investors make their investment decisions internally.

Preqin recently carried out a survey on behalf of a large US buyout house, interviewing 100 institutional investors in private equity funds in order to ascertain their views on a series of topical questions relating to continued investment in, and expectations from, the asset class in the current climate. One of the findings of this survey was that investors with smaller private equity programs were more likely to use an advisor than those with larger private equity programs. As shown by Fig. 2, 67% of institutional investors surveyed with private equity allocations of less than $100 million employed the services of an external advisor, either relying on them as the primary source of their investment decisions or to assist in investment decisions alongside the in-house investment team. This figure dropped to just 32% for institutional investors with private equity allocations of size greater than $1 billion. Approximately 41% of investors surveyed with between $100 million and $1 billion committed to private equity used the services of an advisor for their private equity investments. Investors with a higher level of assets under management have a greater ability to commit resources to in-house investment teams, whereas for smaller investors it makes more financial sense to outsource the decision making process to an external specialist.

Breakdown by Geographical Location of Institutional Investors

In terms of location, 68% of institutional investors based in North America employ the services of an advisor for their alternative investment activities, as shown in Fig. 3. For

Fig. 1: Proportion of Investors Using Advisors

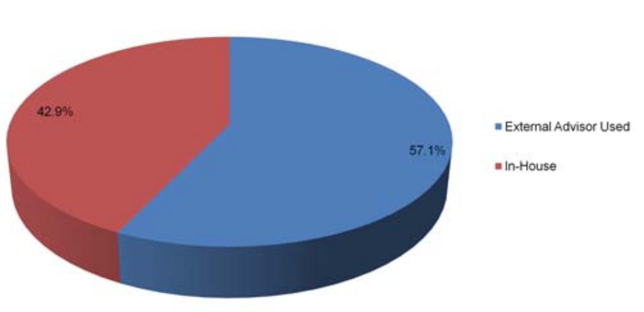
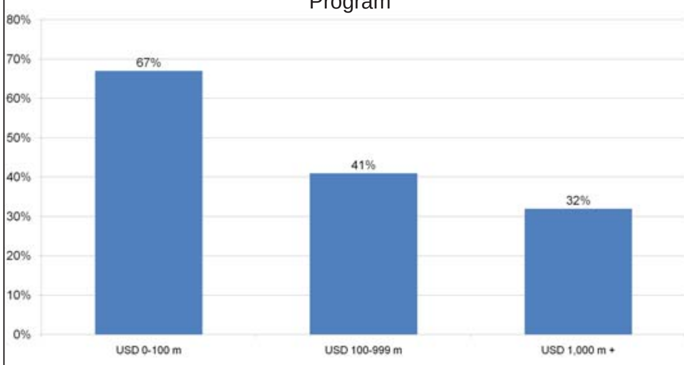


Fig. 2: Proportion of LPs Using Advisors by Size of Private Equity Program



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Advisor Usage by Investor Type

institutional investors based in Europe, the proportion using advisors is approximately 50%. 65% of investors based in Asia and Rest of World seek external advice. The relatively high figure for investors in this region may be down to the large number of institutions investigating and entering alternative asset classes for the first time, seeking to tap the knowledge of experienced advisory firms, especially regarding the developed alternatives markets of the US and Europe, given that the vast majority of advisory firms are primarily based in these two regions. As such, advisory firms may also be able to provide investors from the rest of the world with access to funds in these regions.

Breakdown by Types of Institutional Investor

Unsurprisingly, public and private sector pension funds, family offices / foundations and endowments are the types of institution most likely to employ the services of advisory firms, as shown in Fig. 4. Financial institutions with greater resources at their disposal, such as banks and insurance companies, are the least likely to employ external advice.

More than 80% of public pension funds use advisors to assist with their alternative investments, with over 67% of private sector pension funds also doing so. Pension plans carry a fiduciary responsibility to their contributing members, managing assets on their behalf, and as such many will rely on the use of specialist advisors to ensure that this responsibility to fulfil the requirements of contributors is met to the highest possible standards. Both public and private sector pension funds often have certain legal requirements to abide by as fiduciaries when making investments, which is also something that consultancy firms can assist them to adhere to. In many jurisdictions, public pension funds are also legally required to employ the services of an external investment consultant and to review the incumbent periodically.

More than 85% of endowments are utilising the services of an advisor, making them the institutional investor type with the highest proportion of advisor usage. Many of these types of institution, such as small to medium sized college and university endowments, do not have particularly large investment teams and do not have the resources to analyse all types of different

Fig. 3: Proportion of Investors Using Advisor by Region

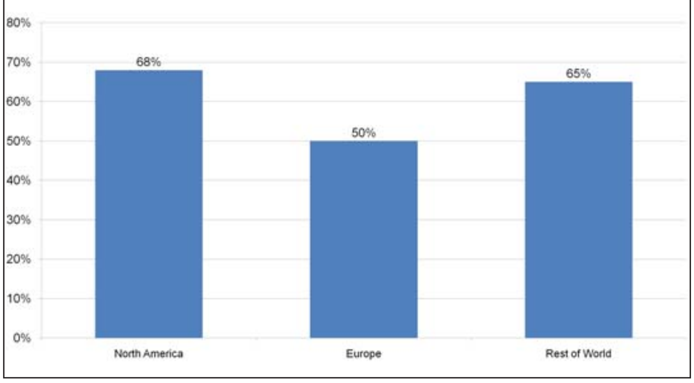
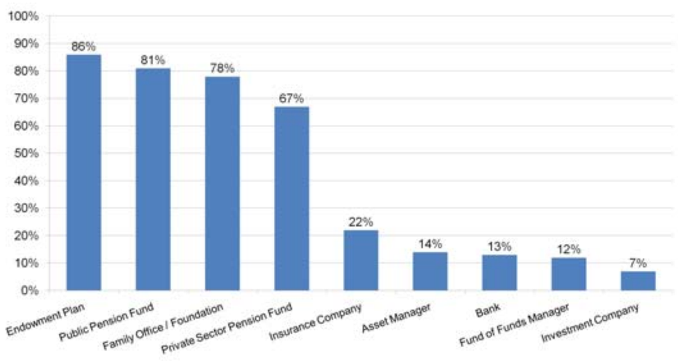


Fig. 4: Proportion of Investors Using Advisors by Firm Type

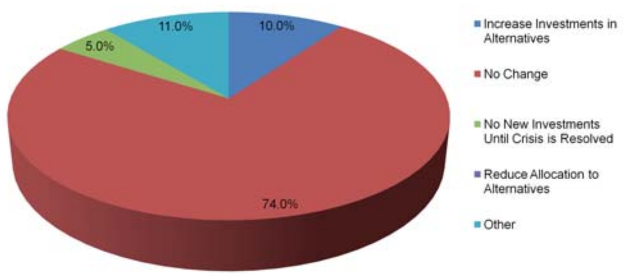


investments, and so outsource to advisors. Additionally, for many endowment plans, investment returns are the primary source of funding for the various activities they support, and so they rely on external advisors to maximise the profitability of their investments through sound asset allocation and fund selection.

Banks and investment companies are amongst the types of institution with the lowest proportions using external advisory firms, with 13% and 7% of firms doing so in each category respectively. Financial institutions such as these often have a greater knowledge of alternative investments and frequently have more resources available to them to support specialist in-house investment teams. They also have fewer legal restrictions and regulations on how they approach their investment activities.

Interestingly, there are a small but significant minority of fund of funds managers that employ the services of advisors in one form or another – approximately 12% of such firms do so. The relationship may take the form of a partnership with a firm based in a different region of the world, such as Gutmann Group, which works with Hamilton Lane for US opportunities. Alternatively, fund of funds managers may use an advisor to help with investments outside of their field of knowledge or to perform specific tasks, such as Centinela Capital Partners and Asia Alternatives Management, which have both utilised the services of Gateway Private Capital to perform due diligence on their behalf.

Fig. 5: Advice Clients Have Been Given With Regards To Alternatives as a Result of The Credit Crunch



What Advice Have Advisors Provided with Regards to Alternatives as a Result of the Ongoing Troubles in the Financial Markets?

The turmoil in the financial markets towards the latter half of 2008 has led to a great deal of uncertainty and reluctance to make new commitments in the alternatives sphere. We have seen fundraising for a number of different alternative assets falling, and it is at times like this when the services of advisors are more in demand than ever. What advice have they been giving towards alternatives in the wake of the credit crunch?

A significant majority of 75% of investors surveyed indicated to us that they had actually been advised not to make any changes in their alternatives investment strategy. The most common reasoning for this was that due to the long term nature of alternative investments such as private equity, there was no immediate need to alter their strategy. Fig. 5 shows that 10% of investors have been advised to increase their allocation to alternatives as a direct result of the current turmoil in the financial markets, with one investor stating that they would be increasing their allocation to alternatives and then joking: “it’s not exactly rocket science is it?”.

None of the investors we surveyed had been advised to reduce their allocation to alternatives and only 5% had been advised to terminate investments in alternative assets until a solution to the financial crisis had been found. Of the investors surveyed, 10% of respondents answered ‘other’ to this question and one of the reasons for this was that their advisor was either in the process of reviewing their alternatives investment strategy or the investor was to meet with their advisor in the near future to discuss their options. Another common reason for answering ‘other’ was that investors had been told to increase their allocation to private equity and reduce their exposure to other alternatives strategies such as hedge funds.

A prominent UK endowment plan explained to us that in terms of private equity, they had been advised to avoid over-leveraged funds, especially in larger vehicles. Their advisors had also told them that they do not foresee any issues in investing in traditional private equity such as buyout and venture funds.

Conclusions

The findings of this report have some important ramifications for those involved with the management and especially marketing of alternative investment vehicles. The results show that many institutions using advisors are still actively investing in alternatives, and will be relying heavily on their advisors to select appropriate new investments. With the market for alternatives fundraising currently more competitive than at any other point in the history of the industry, increasing numbers of institutional investors are utilising the services of advisors in order to assist them with fund selection, advice and due diligence. If a fund manager is able to communicate its strategy to an advisor in an effective manner, then it can lead to them potentially gaining a number of commitments from the advisor’s clients.

With the fundraising market currently in a crowded state, it is important that fund managers are maintaining effective communications with advisors both during a fundraising process, and also during a fund investment period when new capital is not being sought. A consistent approach to providing advisors with information on performance and strategy is vital in fostering a relationship that can lead to mutually beneficial new commitments being made in future fundraising drives. In order for this to be effective, a good understanding of the key factors that advisors are considering, along with a detailed knowledge of the services they offer and make up of their client base is of the highest importance.

2009 Preqin Alternative Investment Advisor Review

A Guide to the Advisors of Institutional Investors in Alternative Assets

The 2009 Preqin Alternative Investment Advisor Review contains the vital information necessary for managers and fund marketers to ensure that they are approaching the best advisors with the most appropriate clients in order to build the most effective and fruitful relationships possible. The Review is also an excellent resource for investors seeking detailed profiles on all advisors active in this space along with analysis for the latest factors affecting the market. The Review provides advisors themselves with comprehensive intelligence on other firms active in this space, and also the latest trends and breakdown of all areas of the alternative investment advisor universe.

Key features of this comprehensive publication include:

- Vital analysis on all aspects of the alternative investment advisor universe, including key trends and information on the make-up of the market.
- Comprehensive profiles for over 100 advisors, including key individual contact information, areas of speciality, plans for 2009 and beyond, financial information, service coverage etc.
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- Articles from leading industry figures on the latest factors affecting the market, including Watson Wyatt and Cambridge Associates
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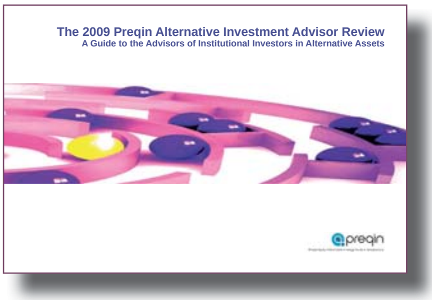
As the alternative investments market has evolved and become more complex in recent years, the importance and stature of advisors in the industry has also been growing. The 2009 Preqin Alternative Investment Advisor Review provides a comprehensive overview of this significant sector of the market, working as an effective tool in facilitating and furthering relationships between investors, advisors and fund managers.



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- Fundraising
- Investor profiles
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Our services and products are used daily by thousands of professionals from around the world. If you are in need of information on the alternative assets industry then we can help.

Our information is drawn from as many sources as possible, with our large teams of dedicated analysts working to ensure that our research is far reaching, detailed and up to date.

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