Hedge Fund Investor Spotlight

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Welcome to the second edition of Hedge Fund Investor Spotlight, the monthly newsletter from Preqin, providing insights into institutional investors in hedge funds. Hedge Fund Investor Spotlight contains information from our industry-leading online product: Preqin Investor Profiles Online. This month's issue also contains details from our latest publication, The 2009 Preqin Global Hedge Fund Investor Review.

2009 Investor Outlook - Survey Results

Feature Article

page 3

Institutional Investor Outlook for 2009

In light of the fraudulent Madoff funds that were exposed in December 2008 and the downturn in the global economy, Preqin conducted interviews with over 50 institutional hedge fund investors to gauge their sentiment and attitude towards the hedge fund industry.

Please see page 3 for more information

Investors in Focus

page 7

US Endowment Plans
Each month Investors in Focus examines a particular group of investors using data from Preqin's Investor Profiles Online service. This month we examine US endowment plans, looking at their strategic and regional preferences, levels of exposure, and identify some of the most important players.

Please see page 7 for more information

Investor News

page 10

This month's Investor News section identifies some 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.

Included this month:

- Kentucky Retirement System sets maiden allocation to hedge funds.
- Drexel University Endowment plans to increase its portfolio tenfold.
- Investec remains confident in hedge funds despite the economic downturn and controversy within the industry.

Please see page 10 for more information

Products and Services

page 9

Preqin is the industry's leading source of information on institutional investors in hedge funds. Our information is available in three principal ways:

- Online Profiles
- Publications
- Data Downloads

We take an in-depth look at our products, and how they can help you to identify and approach potential investors. Includes information on ordering and registering for your free trial.

Please see page 9 for more information

If you would like to receive Hedge Fund Spotlight each month please email spotlight@preqin.com.

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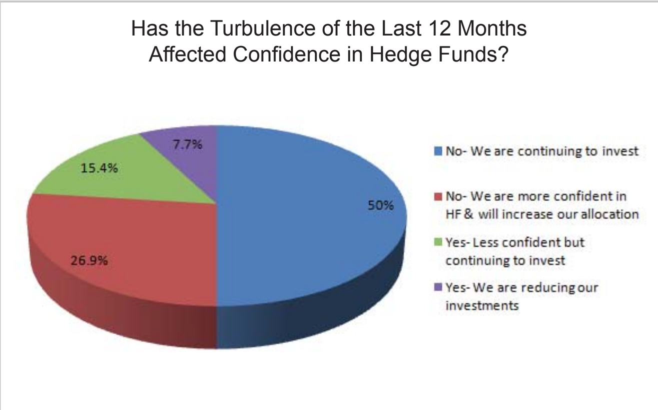
Feature Article:
The Institutional Investor Outlook for 2009

In light of the fraudulent Madoff funds exposed in December 2008, and with the global economic outlook becoming increasingly uncertain, Preqin conducted interviews with over 50 institutional hedge fund investors to gauge their sentiment and attitude towards the hedge fund industry in these challenging times.

We conducted the survey in late January 2009 across a wide range of institutional investors including pension funds, banks, endowments and insurance companies located across the globe. Investors we surveyed had assets under management ranging from USD 100 million to USD 35 billion.

Institutional investors have increasingly been a driving force behind the growth of the hedge fund industry over the last two decades, with investors looking to them as a means of diversification and for absolute returns. However with the onset of the global financial crisis and with hedge funds performing poorly in recent months, we asked institutional investors if this had changed their investment criteria and how they will invest in hedge funds in the future.

Fig. 1:



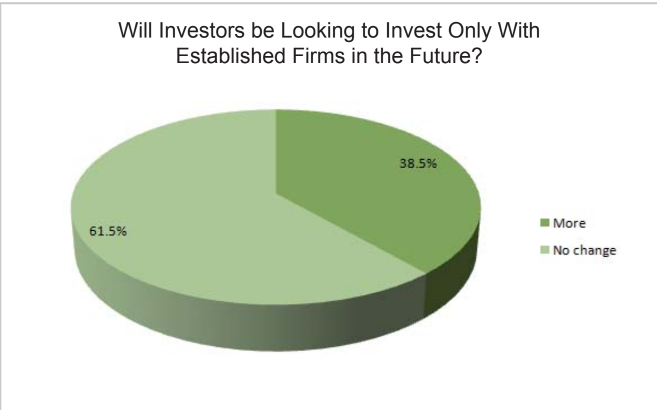
General Outlook

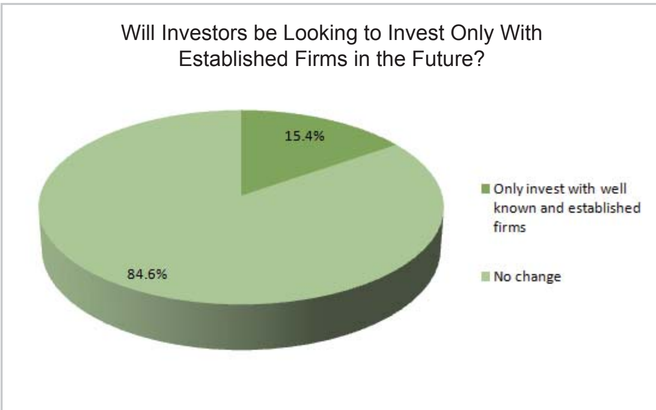
Our findings revealed a significant level of optimism towards the market with a combined 76.9% of investors stating that the turbulence of the last 12 months had not affected their confidence in the asset class and that they would continue to invest or even increase their allocation. Approximately one quarter of all investors we polled stated that they would be increasing their allocations over the next 12 months and believed that there were some exciting investment opportunities opening up on the market. Our interviews with investors show that many remain committed to the asset class and are set to weather the storm and capitalise on a market upturn whenever this may occur. At the other end of the spectrum 7% of investors we polled stated that they would be decreasing their allocations citing poor returns and a lack of transparency as the key factors in this decision.

Reactions to Madoff Scandal

The fallout from the Madoff affair

Fig. 2 & 3:





does not appear to have drastically altered what investors look for in fund managers, which is perhaps a reflection of the unprecedented nature of the scandal. A total of 15.4% reported that from now on they would be changing their strategies to only invest with well known or established managers with a proven investment strategy. Around 85% will still use the same criteria to search for new managers, and as a result Preqin expects trends witnessed over the past two years, such as emerging managers being increasingly used within investor's portfolios, to continue.

Investors Becoming more Stringent

Although the Madoff scandal has not seriously affected the types of funds that are being considered, it is having some notable effects on institutional investors with 38.5% of investors stating that going forward they would be carrying out more vigorous due diligence checks.

Whilst our findings revealed that there is no planned mass exodus from hedge funds, with some investors even increasing their allocations, for the majority of institutional investors the events of the last 12 months have changed their demands from hedge funds. Increased liquidity, lower fees, and transparency were common demands being made by investors we spoke with. A key finding of our survey was the number of investors that stated that increased liquidity and the ability for quick withdrawal from funds especially in bad times is essential in the future.

Quality of Fund Reporting

Calls for hedge funds to be less opaque was a common request amongst investors we surveyed, with 43% of investors raising this as a fundamental issue that needs to be improved. One prominent US endowment with a large allocation to hedge funds commented that often fund managers "provide lots of verbiage and no detail". In the aftermath of the Madoff scandal investors want to know what managers are doing on a more frequent basis and to have a better understanding of how their returns are being generated.

In addition to the dissatisfaction shown over the level of information they receive over strategy, over a third of investors were not completely satisfied with the quality of information on liquidity and fund reporting generally. Investors noted that the levels of communication between them and the fund manager can on occasion be rather poor and the amount of information they received is an area that needs to be improved. Some managers have been quick to respond to these concerns, with one example being US hedge fund manager Tuckerbrook Alternative Investment, which is offering its hedge fund investors daily asset statements, which will be prepared and delivered by the fund's independent administrator.

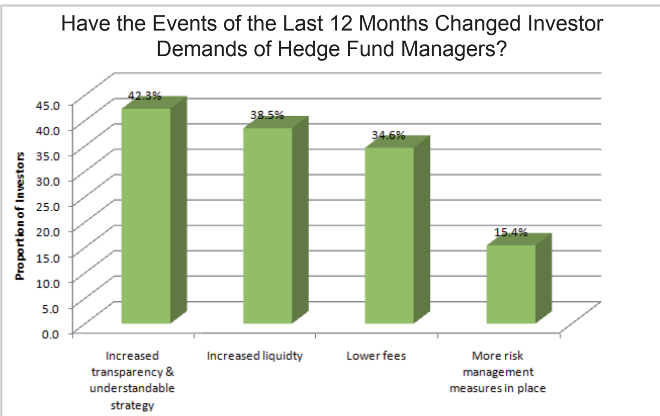
Independent Administration Essential

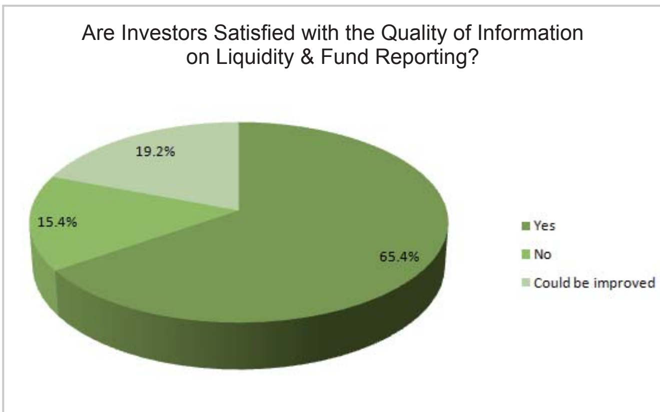
After the Madoff scandal hit the headlines in December, investors have been more stringent when it comes to the use of independent administrators and custodians. The absence of full time independent administrators and custodians at some large US hedge funds has caused some big name investors notably Union Bancaire Privee (who acknowledged a USD 700 million exposure to fraudulent Madoff funds) to publicly threaten to pull capital out of funds that do not employ independent administrators.

New Areas of Interest

Several investors stated that whilst they will continue to invest in hedge funds they have refocused their investment strategy and will be looking to invest with managers that employ a clear and understandable strategy. Investment strategies that investors expressed a keen interest in were

Fig. 4 & 5:





global macro, credit and event driven strategies whilst convertible arbitrage and emerging markets were less popular with investors.

Power Shifts to Investors

One of the most interesting findings of our survey was the proportion of investors that suggested the downturn in the market had reinforced their bargaining power when negotiating fees with managers. Approximately 35% of investors felt more confident to negotiate on fees. One UK bank noted that in the last 6 months they had noticeably more leverage and leeway when dealing with hedge fund managers, plus more opportunities with previously inaccessible managers. Another pension fund noted that they had been able to half fees with one of its fund of funds managers. On the other hand some investors reported that they would no longer be investing in fund of funds vehicles as they did not believe they were “value for money” because of the double layer of fees. In addition investors are also demanding that the structure of fees needs to be changed, with changes in performance fees if successful years are followed by losses and information about who other investors in the fund are. In order to hang onto investor capital some fund managers have actively responded to these demands by lowering management fees to meet with investor demands.

Conclusions

The key findings of our survey reveal that while investors on the whole remain committed to investing in hedge funds, they are re-evaluating their investment criteria and objectives. Although over 92% of investors we surveyed are continuing to invest in hedge funds, calls for increased transparency, lower fees and liquidity are key concerns amongst investors. In 2009 stricter demands will be placed upon fund managers and they will need to work hard to meet these demands if they are to secure investor capital. Transparency is a crucial concern amongst investors and there is a need for fund managers to communicate with investors on a more frequent and unambiguous basis. Institutional investors will be scrutinizing funds more closely. In particular investors will be looking at the investment processes fund managers undertake and will only invest in funds that employ independent administrators and custodians.

The turbulence of the financial markets over the last 12 months has shifted the balance of power towards institutional investors. In terms of fees, more investors are demanding reductions in the fees being charged and are also becoming increasingly vocal about the fee structures in place.

Angela FitzGerald

2009 Preqin Global Hedge Fund Investor Review:
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The newly released 2009 Preqin Global Hedge Fund Investor Review is the ultimate guide to institutional investors in hedge funds, featuring both profiles for 400 leading investors, plus comprehensive analysis on this increasingly important sector of the market.

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- Interviews and contributions from leading names in the industry

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Investor in Focus: US Endowment Plans

US endowment plans were amongst the first institutional investors in hedge funds. Many were pioneers in the asset class, and some have been investing in hedge funds for more than 20 years. This experience and confidence is reflected in the high average allocations they have to hedge funds. Some endowments entrust over half of their assets to hedge funds, with University of North Carolina at Chapel Hill endowment, for example, allocating 55% of assets to the asset class.

Target allocations remain robust, despite falling total assets and continued economic turbulence. Investors must remain vigilant, however, and it is likely that many endowments will alter the composition of their hedge portfolio. Although endowments do utilise fairly traditional strategies, with long/short equity, macro and multi-strategy predominant, they are knowledgeable and agile investors and an increasing proportion have been committing to distressed and credit strategies, seeking to take advantage of opportunities created by the economic downturn. This trend will probably continue, as many seek to recover losses made in their portfolios in 2008. Harvard Management Company, for example, lost approximately USD 8 billion in total assets in the second half of the year. Investors like Harvard will likely utilise the liquidity offered by hedge funds to seek new managers in strategies that better reflect the current economic climate. Any new commitments are likely to be geographically diverse, as endowments cast their net wide, with more than two-thirds investing globally, and 18% looking to take advantage of opportunities in emerging markets.

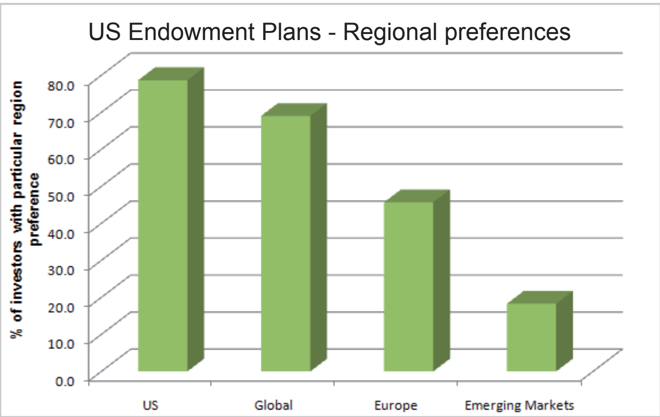
Fig. 1:

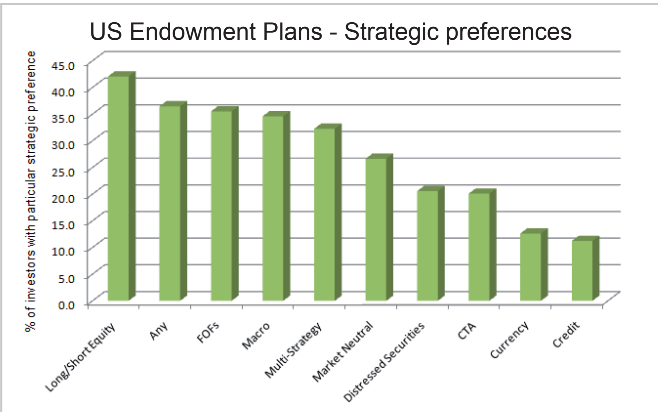
Key facts - US Endowments Plans	
% of US Endowment Plans investing in hedge funds	80.3%
Average allocation to hedge funds	19.8%/USD 274mn
Average target allocation to hedge funds	19.5%/USD 270 mn
Most favoured investment approach	Direct
% investing in or considering investment in emerging manager hedge funds	49.0%
Average # of hedge funds in a US Endowment Plan's portfolio	12.7
Typically been investing in hedge funds for…	10-12 years

Fig. 2:

Top 10 US Endowment Plans in Hedge Funds	Allocation to Hedge Funds ($mn)
Harvard Management Company	6,642
Yale University Endowment	5,242
DUMAC	4,960
University of Texas Investment Management Company	4,669
Stanford Management Company	3,240
Princeton University Investment Company (Princo)	3,160
Columbia University Endowment	2,700
University of Chicago Endowment	1,735
Atlantic Philanthropies Endowment	1,614
University of Virginia Investment Management Company	1,530

Fig. 3 & 4:





Richard Wells

Conferences Spotlight: Forthcoming Events:

CONFERENCE/EVENT	DATES	LOCATION	ORGANISER
Hedge Funds Masterclass 2009	17 - 20 February 2009	Hong Kong	Terrapinn Financial
Asset Allocation Summit	23 - 26 February 2009	Sydney	Terrapinn
14th Annual European Hedge Fund Conference	23 - 25 February 2009	Geneva	Institutional Investor
3rd Annual Marketing and Client Servicing for Hedge Funds	24 - 25 February 2009	New York	Financial Research Associates
Family Alternative Investment Conference	24 - 25 February 2009	Monte Carlo	Campden Media
P&I and AIMSE Hedge Fund Conference	26 February 2009	New York	Pensions & Investments
Fund Forum Emerging Markets 2009	2 - 5 March 2009	London	ICBI
Hedge Funds World Middle East 2009	10 - 12 March 2009	Dubai	Terrapinn
Hedge Funds World Espana 2009	24 - 26 March 2009	Madrid	Terrapinn
GAIM Asia 2009	21 - 23 April 2009	Hong Kong	ICBI
Hedge Fund Institutional Investment Conference	26 - 28 April 2009	San Francisco	Institutional Investor
GAIM Cayman 2009	26 - 29 April 2009	Cayman Islands	IIR
2009 Emerging Managers Conference	26 - 28 April 2009	Miami	Financial Research Associates
Hedge Fund Operations	27 - 29 April 2009	London	IIR Conferences
Emerging Managers Summit	6 - 8 May 2009	Chicago	Opal Financial Group
Hedge Fund Leadership Forum	19 May 2009	New York	Argyle Executive Forum
15th Annual GAIM International	16 - 18 June 2009	Monaco	ICBI

Preqin: Hedge Fund Services

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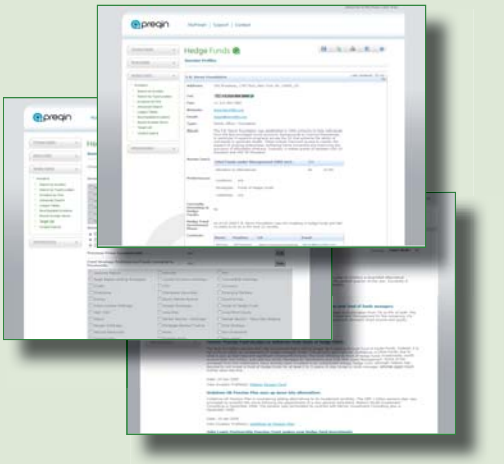

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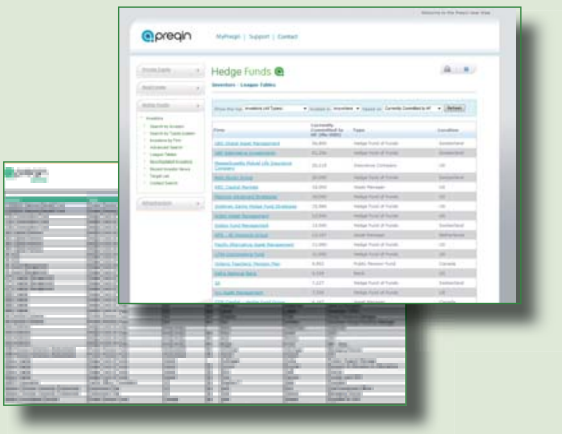

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Investor Spotlight: Investor News

Investec remains confident towards hedge funds despite the economic downturn and controversy within the industry.
The GBP 34 billion bank remains confident towards the asset class, and does not see the Madoff Securities scandal as having any significant impact on its investment approach. Both its strategy and approach to due diligence remain unchanged. It has, however, noticed a change in the attitude of fund managers in the wake of the current economic turbulence. It is finding itself with greater leverage when investing, with previously unavailable managers becoming available as many investors tighten their belts in response to falling assets. It was largely satisfied with the reporting it received from fund managers, but did see independent administrators as essential to any fund that it would invest in.

Ann Arundel County Retirement System makes commitment to new fund of hedge funds.
The retirement system has made an undisclosed commitment to a new fund of hedge funds at the beginning of January 2009. To date the retirement system has committed approximately USD 100 million to 3 multi-strategy fund of hedge funds. When considering new investments the retirement system typically looks for established managers with a solid track record but will on occasion review emerging managers. In 2009 the retirement system will be looking for increased liquidity and will be undertaking more stringent due diligence with the aid of its consultant New England Pension Consultants.

Kentucky Retirement Systems sets maiden allocation to hedge funds.
The USD 12 billion pension plan has decided to invest 5% of its assets under management in hedge funds. This move follows months of educational presentations carried out at the end of 2008. Kentucky initially plans to invest this capital in fund of hedge funds, but CIO Adam Tosh intends to eventually invest directly in hedge funds. The move was designed to minimize and diversify the fund's risk exposure and to enhance returns. The fund is advised by R.V. Kuhns & Associates who will assist with manager selection and due diligence.

New York pension schemes poised to invest in hedge funds to counter poor investment performance.
The New York City Fire Department Pension Fund and the New York City Police Pension Fund have each implemented a 7% opportunistic allocation within their portfolios through which they are likely to invest in fund of hedge funds. If their initial allocations to hedge funds prove successful, they will set formal allocations to the asset class.

Icelandic pension fund Stapi Lifeyrissjodur adds to hedge fund portfolio.
The pension fund has allocated capital to an undisclosed hedge fund manager. Stapi Lifeyrissjodur invests predominately through fund of hedge funds. The pension fund uses this strategy to gain exposure to top quartile funds, to help diversify its investment portfolio and to complement its investments in other asset classes. It has no typical commitment size and will analyse funds on an individual basis before deciding how much to commit.

University of South Florida Foundation considers hedge fund investments.
The USD 354 million foundation has announced that it will look at hedge funds performance in the coming months and make a decision on whether to invest based on the stability of the asset class. This will be the foundation's first foray into the asset class and a final decision will be made by the end of the year.

New Jersey State Investment Council to slow the growth of its hedge fund portfolio.
The USD 60 billion pension fund for New Jersey public employees has been steadily growing its hedge fund holdings since it began investing in the asset class three years ago. However, as a result of the market crisis it plans to allocate more of its assets to low volatility fixed income investments at the expense of its equities and alternatives holdings. However the retirement system may buy some hedge fund interests on the secondary market as it feels this offers an excellent opportunity to tap into top performing funds at a bargain price.

New Hampshire Retirement System to seek single manager hedge funds.
Following the advice of its consultants New England Pension Consultants at the end of 2008, the pension fund set a formal 4% allocation to hedge funds. It now plans to fill this new allocation by making two or three new direct investments in order to avoid the extra layer of fees associated with fund of hedge funds.

Drexel University Endowment plans to increase its portfolio tenfold.
The USD 490 million endowment of Drexel University Endowment made its first investment in July last year when it invested in two multi-strategy funds. It now plans to grow its portfolio to 20 hedge funds by investing in niche, strategy focused, vehicles. The endowment is actively seeking distressed debt managers as it feels that the credit crisis has resulted in excellent opportunities in this area. Drexel will not be issuing RFPs – instead it will seek to find new managers by networking, attending conferences, searching databases and responding to cold calls.

Angela FitzGerald

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