What Are Investors Looking For? Size and Track Record Requirements

Extra-large hedge funds have been the biggest winners in recent years as investors look for the perceived security associated with investing in established firms. Drawing on research featured in Preqin Investor Outlook: Alternative Assets, H1 2014, we assess which funds are being targeted by investors in 2014.

Sizes of Managers Being Targeted in 2014

Much of the capital inflow over the past few years has been to just the largest hedge funds in the industry, meaning it has been difficult for smaller funds to gain traction from the institutional market. With this in mind investors were asked about what sizes of hedge fund managers they were likely to consider for investment in 2014, with the results presented in Fig. 1. Track record and management experience are attractive characteristics for many hedge fund investors, and the largest proportion of investors (57%) stated that they expect to invest with managers with assets under management of $1-5bn in 2014. However, the size category with the lowest proportion of investor interest was for managers with more than $5bn in assets, suggesting that investors are beginning to look towards the mid-to-large funds, away from the behemoths of the industry. A number of investors are open to investing with smaller managers in 2014, with 52% of investors set to target managers of between $100 and 499mn and 42% open to investing in managers with less than $100mn in assets. This indicates that investors are at least in principle willing to work with smaller managers, although the track record and other characteristics of larger funds remain appealing.

The Case for Smaller Managers

Smaller managers have a number of characteristics which can be attractive to investors (Fig. 2). These managers are often better placed to take advantage of a wider opportunity set due to their smaller position sizes, and more than half (52%) of investors targeting smaller managers cited their nimbleness as a key characteristic. One UK-based investment company stated “smaller managers on the whole tend to be more nimble and less concerned with accumulating management fees than the larger managers”, and overall, 19% of investors said they prefer investing with smaller managers due to these firms offering more attractive fund terms. With investors also seeking unique and individual investment strategies, the more focused edge of smaller fund managers can be appealing, with a quarter of investors naming a more specialized investment approach as a key characteristic of these managers.

The Case for Larger Managers

A strong previous track record continues to be a vitally important factor for a number of hedge fund investors and 59% of respondents stated this as a key reason for targeting investments with larger managers (Fig. 3). The level of experience within these teams was also named as a preferential characteristic of these managers,

Fig. 1: Hedge Fund Manager Sizes Targeted by Investors in 2014

<table>
<thead>
<tr>
<th>Hedge Fund Manager Assets under Management</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proportion of Respondents</td>
</tr>
<tr>
<td>Less than $100mn</td>
</tr>
<tr>
<td>$100-499mn</td>
</tr>
<tr>
<td>$500-999mn</td>
</tr>
<tr>
<td>$1-4.9bn</td>
</tr>
<tr>
<td>$5bn or More</td>
</tr>
</tbody>
</table>

Source: Preqin Investor Outlook: Alternative Assets, H1 2014

Fig. 2: Reasons for Investors Preferring Managers With Less than $1bn in Assets under Management

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Proportion of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>More Nimble</td>
<td>25%</td>
</tr>
<tr>
<td>More Focused/Specialized</td>
<td>21%</td>
</tr>
<tr>
<td>Better Returns</td>
<td>19%</td>
</tr>
<tr>
<td>Better Terms</td>
<td>8%</td>
</tr>
<tr>
<td>More Skilled Fund Managers</td>
<td>6%</td>
</tr>
<tr>
<td>Larger Funds Closed to New Investment/Harder to Access</td>
<td>6%</td>
</tr>
<tr>
<td>Other</td>
<td>10%</td>
</tr>
</tbody>
</table>

Source: Preqin Investor Outlook: Alternative Assets, H1 2014

Fig. 3: Reasons for Investors Preferring Managers With More than $1bn in Assets under Management

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Proportion of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proven Track Record</td>
<td>55%</td>
</tr>
<tr>
<td>Experienced Team</td>
<td>39%</td>
</tr>
<tr>
<td>Institutional Quality Funds</td>
<td>27%</td>
</tr>
<tr>
<td>Less Risky</td>
<td>4%</td>
</tr>
<tr>
<td>Bite Size Too Large for Smaller Funds</td>
<td>4%</td>
</tr>
<tr>
<td>Other</td>
<td>10%</td>
</tr>
</tbody>
</table>

Source: Preqin Investor Outlook: Alternative Assets, H1 2014
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March 2014

Institutional Investors in Hedge Funds

mentioned by 39% of respondents, as investors look to tap into the specialized knowledge of these larger firms, where the principals may have decades of specific sector knowledge. Twenty-seven percent of investors cited institutional quality funds as a reason for targeting larger managers, as smaller funds are often less well developed in terms of infrastructure and back office operations, and may be less equipped to deal with the sizeable assets invested by institutional investors.

Emerging Manager Preferences

With investors showing a willingness to at least consider smaller managers in 2014, Preqin conducted a more in-depth study into investor attitudes towards emerging funds. There has been an overall reduction in appetite for emerging managers among institutional hedge fund investors since Preqin last conducted this study in October 2012. Thirty-seven percent of investors will invest in first-time funds (Fig. 4), compared to 42% in 2012. This continues a trend of decline from 54% in 2010 and 48% in 2011, suggesting that investors have moved towards investing with more established fund managers as they often perceive such investments to be less risky.

Interest in investing with spin-off teams has also dropped over the past year, with 35% of investors currently targeting such investments compared to 38% in 2012. Spin-off funds provide access to experienced industry professionals but they do not always offer exposure to the value-added niche strategies that investors typically look for in an emerging manager allocation. Seeding new hedge funds is a more niche aspect of the hedge fund industry, with such opportunities typically taken up by fund of hedge funds managers or investors with a large capital base. The proportion of investors interested in seeding opportunities has declined from 19% in 2012 to 15%, with this market dominated by specialist seeding firms.

Minimum Track Record Requirements

In line with a reduction in appetite for emerging managers, the average minimum track record required by hedge fund investors before committing to a manager has increased. In 2012, 16% of investors were willing to invest with a manager with less than a year’s track record, but this has decreased to 10%, as shown in Fig. 5.

Investor Screening of the Market

The investors interviewed by Preqin in December 2013 indicated that they are searching for funds across all size ranges; however, how is this translating into actual fund searches? Looking at investor activity data on Preqin Investor Network, we can see just how proactive investors are in discovering and researching potential investment opportunities across various fund sizes. Over 5,600 accredited investors across 3,200 institutional firms use the Network to obtain overview and contact information for all hedge funds open to investment. More than 140,000 pages of alternatives fund, firm, performance, market overview and benchmark data are reviewed by investors on the Network every month.

5. Investors are becoming more demanding when selecting hedge fund managers and, as a result, they want to see a significant track record before investing. There has been an increase in the proportion of investors requiring four or more years’ track record over the past year from 22% to 26%. The most common minimum track record requirement is three years, with 45% of investors having this policy.

Fig. 4: Institutional Hedge Fund Investor Attitudes Towards Emerging Manager Fund Types

Source: Preqin Investor Outlook: Alternative Assets, H1 2014

Fig. 5: Minimum Fund Manager Track Record Required by Institutional Investors in Hedge Funds

Source: Preqin Investor Outlook: Alternative Assets, H1 2014

Fig. 6: Proportion of Funds in Each Size Group that Have Been Screened by Investors on Preqin Investor Network, over One, Three and 12-Month Periods

Source: Preqin Investor Network
As Fig. 6 clearly shows, every month all of the largest funds on the platform are reviewed by investors. It is unsurprising that the largest hedge fund in the world today, Bridgewater All Weather Strategy, is the most viewed hedge fund on the Network; however, more surprisingly, among the top 20 most viewed funds on the Network over the past 12 months, there are four funds with less than $100mn in assets under management. As Fig. 6 also shows, investors are casting a broad net when screening funds on the Network, with at least two-thirds of funds in all size ranges having been considered by investors on the Network over the last year. The wide fund size scope that the surveyed fund investors indicated they are searching across in Fig. 1 is translating into fund screening on Preqin Investor Network.

Fig. 7 shows the proportion of funds incepted in each year since 2000 that have been reviewed on Preqin Investor Network over the past 12 months. 2013 is excluded as this does not represent a full year of page views on the Investor Network. The reduced appetite for funds with less than a three-year track record, as highlighted in Fig. 5, is apparent as fund views drop off for funds incepted since 2010. However, with over 60% of funds with less than a three-year track record being reviewed by the investors on the Network over the past year, managers of newer funds can take confidence that many investors are regularly looking at funds with a shorter track-record, possibly not for immediate investment but more as potential future investments when a longer history of fund returns has been built.

Outlook

Investors are looking at a wide range of hedge fund managers for investment in 2014, with a number of different criteria to be considered in the manager selection process. Track record is the most common reason for investors preferring funds with more than $1bn in assets and investors value the investment experience typically associated with these managers. As a result there has been an overall reduction in the proportion of investors targeting newer managers over the past year as investors focus on investing with established firms.

However, the majority of investors are willing to consider smaller managers with less than $500mn in assets, with the nimbleness of these firms a particularly attractive characteristic. In addition, a number of the largest hedge funds are becoming closed to new investment and this is another factor which could lead to investors looking at smaller managers. As a result, there are opportunities for these managers, although funds will need to build an impressive track record in order to be successful. There will be opportunities for both smaller and larger managers to secure institutional capital in 2014 and those managers that can differentiate themselves from their competitors in terms of both strategy and performance are likely to be most successful.

Data Source

Preqin’s Hedge Fund Investor Profiles tracks over 4,500 institutional investors in hedge funds worldwide. Extensive profiles include track record requirements, typical investment size, appetite for first-time funds, assets under management, current and target allocations to hedge funds, future investment plans and more.

For more information, or to arrange a demonstration, please visit:

www.preqin.com/hfip

Preqin Investor Outlook: Alternative Assets, H1 2014

With more than 13,000 private equity, hedge fund, real estate and infrastructure vehicles currently open for investment, competition for investor capital is extremely high, and understanding investors and what they are looking for is more important than ever.

Based on the results of extensive interviews with 430 institutional investors in alternative assets, Preqin Investor Outlook: Alternative Assets, H1 2014 explores investor appetite in the coming year, strategies and geographies targeted, key issues and satisfaction with returns, and more.

To download your complimentary copy, please visit:

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**Preqin Global Data Coverage**

As of 1 March 2014

### Fund Coverage: 35,210 Funds

- **15,090 Private Equity** Funds
- **14,797 Hedge Funds**
- **4,558 PE Real Estate Funds**
- **765 Infrastructure Funds**

### Firm Coverage: 16,628 Firms

- **7,687 PE Firms**
- **6,559 Hedge Fund Firms**
- **1,941 PERE Firms**
- **441 Infra. Firms**

### Performance Coverage: 15,450 Funds

(IRR Data for 5,382 Funds and Cash Flow Data for 2,489 Funds)

- **5,453 PE Funds**
- **8,696 Hedge Funds**
- **1,152 PERE Funds**
- **149 Infra. Funds**

### Fundraising Coverage: 14,633 Funds Open for Investment/Launching Soon

Including 2,115 Closed-Ended Funds in Market and 382 Announced or Expected Funds

- **1,773 PE Funds**
- **11,643 Hedge Funds**
- **973 PERE Funds**
- **254 Infra. Funds**

### Deals Coverage: 97,402 Deals Covered: All New Deals Tracked

- **34,008 Buyout Deals**
- **56,461 Venture Capital Deals**
- **6,933 Infra. Deals**
- **6,933 Infra. Deals**

### Investor Coverage: 11,651 Institutional Investors Monitored,
Including 8,225 Verified Active in Alternatives and 87,672 LP Commitments to Partnerships

- **5,253 Active PE LPs**
- **4,502 Active Hedge Fund Investors**
- **4,232 Active RE LPs**
- **2,201 Active Infra. LPs**

### Alternatives Investment Consultant Coverage: 460 Consultants Tracked

### Fund Terms Coverage: Analysis Based on Data for Around 8,800 Funds

### Performance Coverage: Funds (IRR Data for 5,382 Funds and Cash Flow Data for 2,489 Funds)

- **5,453 PE Funds**
- **8,696 Hedge Funds**
- **1,152 PERE Funds**
- **149 Infra. Funds**

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  - Fund Administrators
  - Law Firms
  - Debt Providers
  - Dry Powder
  - Compensation
  - Plus much more...

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- Depth and quality of data from direct contact methods
- Unlimited data downloads
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***Venture capital deals: Preqin tracks cash-for-equity investments by professional venture capital firms in companies globally across all venture capital stages, from seed to expansion phase. The deals figures provided by Preqin are based on announced venture capital rounds when the capital is committed to a company.
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