

2016 Preqin Global Hedge Fund Report



Highlights



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After a Difficult 2015, Hedge Funds Need to Rise to the Challenges of 2016

- Amy Bensted, Preqin

2015 proved a challenging year for the hedge fund industry. Although the year started well, with hedge funds making gains in each of the first five months of 2015, a series of events across the globe hit many of the markets traded by hedge funds. This resulted in four months of losses from June to September, the longest losing streak for hedge funds since 2008. By the end of 2015, hedge funds had returned just 2.02%, representing the Preqin All-Strategies Hedge Fund benchmark's worst performance since 2011. Although the benchmark outperformed the S&P 500 over the year, this poor performance did not go unnoticed by investors: approximately a third of institutional investors reported to Preqin that hedge funds had failed to meet expectations in 2015. Many fund managers themselves were disappointed with performance in 2015: 44% of fund managers reported that their funds had failed to meet return objectives in 2015. However, amid the performance difficulties of 2015 there were some bright spots; in particular, the industry recorded net capital inflows of \$71.5bn, taking the size of the hedge fund industry to nearly \$3.2tn.

More Challenges Ahead in 2016

With 2015 behind us, what does 2016 hold for the hedge fund industry? In our end-of-year survey of 150 institutions, more investors indicated that they will invest less capital in hedge funds in 2016 than in 2015, which could mean that raising new capital, as well as retaining capital, could become increasingly difficult over the course of this year. Although we have seen similar levels of disappointment in hedge fund performance to 2015, in 2011 and 2014 for instance, this is the first time (since Preqin began tracking institutional investor activity in hedge funds in 2007) that we have seen a net change in appetite in favour of investors taking capital out of their hedge fund portfolios.

Fund managers and investors agree that performance will be the leading challenge for the hedge fund industry in 2016, so perhaps performance will be the key to the success of the industry over the year. If hedge funds can navigate the changeable economic environment and continue to show better

performance in times when traditional markets are struggling, then maybe the value of hedge funds can be proved to those investors that are currently taking a cautious approach to the asset class.

During periods when many investors believe performance is poor, the fees associated with hedge funds are often increasingly scrutinized. Although management and performance fees – as shown in 'Management and Performance Fees' (see the full Global Hedge Fund Report for more details) – have been on a general downward trend over recent years, high levels of investors still want to see further reductions in these terms over the course of 2016. The need to change fee structures could add additional pressures on hedge fund managers. The cost of running a successful hedge fund has increased over recent years as fund managers have invested in improving their business infrastructure to cope with an increasingly sophisticated client base and to adapt to new regulations. The calls to cut fees further could make it more difficult to run a profitable business in 2016 – in particular for smaller managers.

How to Successfully Navigate 2016

Although further investment in their business operations is difficult in light of calls for reduced fees, it could be vital to the success of a hedge fund in 2016. Investors are seeking improvements in performance; therefore the 41% of fund managers looking to beef up their portfolio management capabilities may be better placed to navigate the volatile environment in 2016 and win back investor favour. Transparency is another issue at the forefront of investors' minds. Investors increasingly want to better understand the source of their hedge fund performance, for better or worse, and those fund managers that are able to provide the much demanded transparency, as well as educate investment officers and trustees on the benefits of investment in hedge funds, may be well placed to retain existing clients as well as gain fresh assets.

Originally a product used exclusively by wealthy individuals and families, institutional investors began to increasingly use hedge funds in the early

2000s. Today, Preqin tracks over 5,000 institutions that invest in hedge funds, with this number growing on a daily basis. Despite some notable investors cutting hedge funds from their portfolios over the past few years – CalPERS, PFZW and Railpen to name a few – the majority of institutional investors look set to remain active in hedge funds over the longer term. However, hedge fund managers have also reported that sources of private wealth – family offices and wealth managers – are once again increasing their allocations to their funds. With changes to regulations allowing the proliferation of alternative structures in hedge funds, such as UCITS in Europe and alternative mutual funds in the US, fund managers have also reported growth in assets from retail clients. As the universe of investors active in hedge funds becomes increasingly diverse, the hedge fund managers with products that can appeal to a variety of investors may be rewarded with a growing asset base.

For many investors, 2016 may be a time to re-evaluate their hedge fund portfolio. The performance of the industry as a whole has been somewhat disappointing, with two back-to-back years of returns below the level expected by many investors. However, there are some bright spots, with some strategies and regional funds showing strong performance in 2015, and many individual funds showing significant success. Investors may want to rebalance their portfolios to ensure they are well diversified in order to navigate a potentially changeable economic environment, and tools such as our 'Most Consistent Top Performing Hedge Funds' league tables (see the full Global Hedge Fund Report for more details) may help in assessing the long-term success of a manager. With traditional markets showing signs of problems at the start of 2016 – for instance, the Dow Jones Industrial Average and the S&P 500 showed their worst ever results during the first trading sessions of the year and the FTSE 100 crashed into a bear market in the third week of 2016 – the need to diversify into all-weather or non-correlated assets may become more pressing and investors may need to rethink their plans to cut back on hedge funds over the year.

Hedge Funds in Numbers

Growth in Assets, Number of Investors and Number of Funds in 2015



\$3.197tn

Hedge fund industry assets under management reach nearly \$3.2tn as of November 2015.



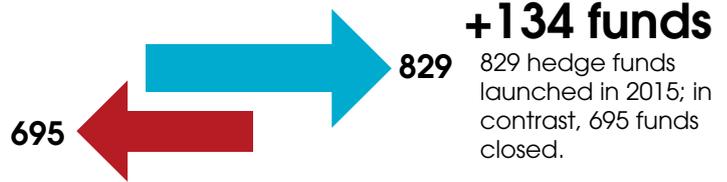
\$71.5bn

The hedge fund industry added \$71.5bn in new capital inflows in 2015.



5,000+

More than 5,000 institutional investors allocate to hedge funds.



Performance in 2015



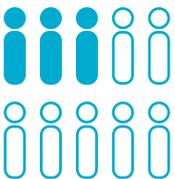
+2.02%

The Prequin All-Strategies Hedge Fund benchmark returned 2.02% in 2015.



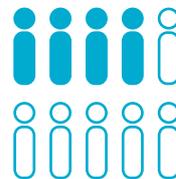
62%

of hedge funds posted positive returns.



33%

of investors believe performance expectations were not met in 2015.

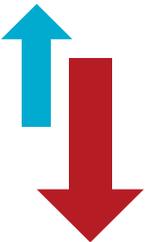


40%

of fund managers believe their performance objectives were not met in 2015.

Fundraising Could Become Challenging

25%



32%

Fundraising could become challenging in 2016 as more investors (32%) plan to cut back on hedge funds than plan to increase exposure (25%).

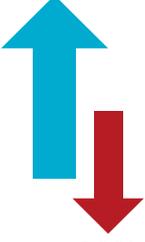
Better Performance and New Launches Expected in 2015



69%

Fund managers are confident of better performance: 69% believe the Prequin All-Strategies Hedge Fund benchmark will be higher in 2016 than in 2015.

72%



13%

However, fund managers remain optimistic: 72% believe industry AUM will increase in 2016 compared with 13% that believe industry assets will decline.



of fund managers have plans for a new launch in 2016.

Overview of the Hedge Fund Management Industry

Over the course of 2015 the hedge fund industry continued to grow, adding assets of more than \$71bn, leading the total assets of all hedge funds globally to reach almost \$3.2tn. Although North America-based funds saw the largest inflows in dollar terms, the growth in size

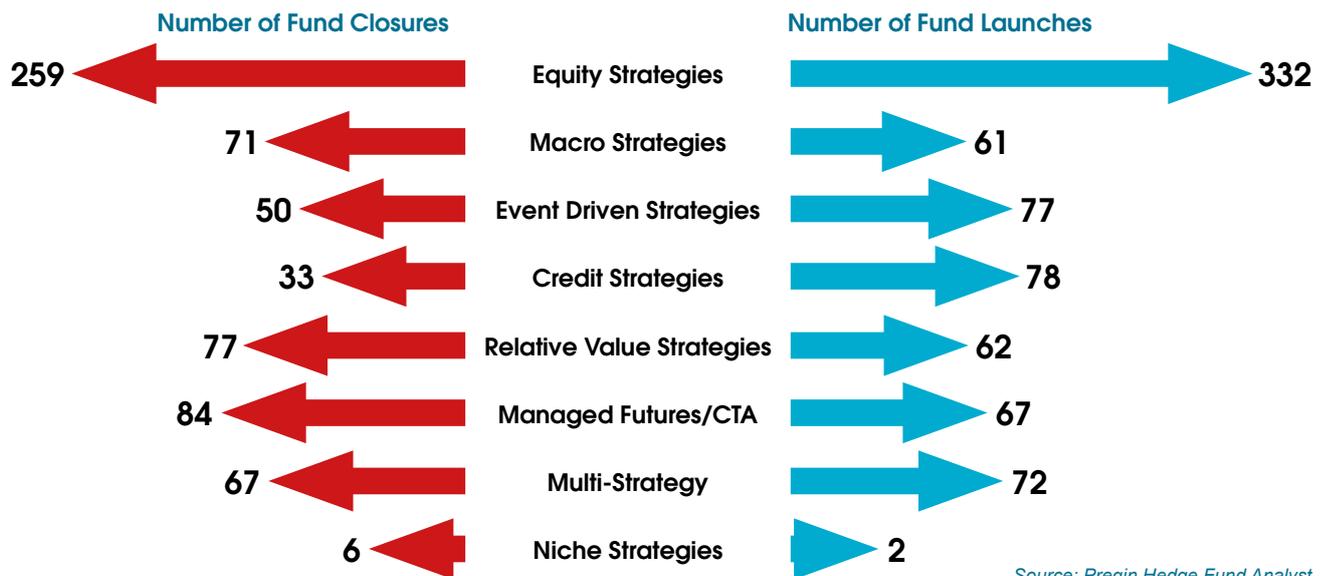
of the European fund sector was the largest in terms of percentage increase. Despite a difficult returns environment, fund managers continued to see new opportunities in 2015 with the number of launches eclipsing the number of funds closing. Some strategies and sectors

have had a more successful 2015 than others. In this extract from the 2016 Preqin Global Hedge Fund Report, we take a closer look at the make-up of the hedge fund industry today, fund launches and closures in 2015, and assets by region.

Key Facts about Hedge Funds



Source: Preqin Hedge Fund Analyst



Source: Preqin Hedge Fund Analyst

Breakdown of Hedge Fund Assets by Region



Source: Preqin Hedge Fund Analyst

Asset Flows in 2015

The hedge fund industry saw a net inflow of \$71.5bn during 2015, as of 30 November 2015 (Fig. 1), with the majority of this figure coming in the first half of the year. More than half of the inflows were secured by equity strategies despite net outflows during the third quarter of the year. Many investors pulled their capital out of the strategy following the global volatility in public markets during this time. Despite the volatile performance of CTAs during 2015, investors continued to allocate capital to the strategy with \$25.4bn of new capital inflows during the year.

Regionally, North America-based funds have seen the largest inflows throughout the year, with \$79.6bn of inflows

outstripping the \$31.7bn of new capital received by European funds. Following strong inflows during the first half of the year, Asia-Pacific-based hedge funds had a difficult H2 and ended the year having suffered an overall net outflow of \$1.3bn.

Preqin's analysis shows that a greater proportion of larger funds received net inflows compared to smaller funds (Fig. 2). More than half of funds over \$500mn in size received inflows during 2015. In contrast, 53% of funds managing less than \$100mn experienced net redemptions during the year.

There were varying fortunes across different strategies in 2015. More than half of CTAs secured net inflows during

the year, with 52% of funds receiving new capital, whereas 58% of macro strategies hedge funds saw net redemptions (Fig. 3).

Preqin estimates industry asset flows from performance and asset growth information for over 12,200 hedge fund track records, as showcased on Preqin's **Hedge Fund Analyst**. Flows are estimated based on a sample of funds with available size and performance data and scaled up based on the proportion of represented capital by strategy, headquarters location and fund classification.

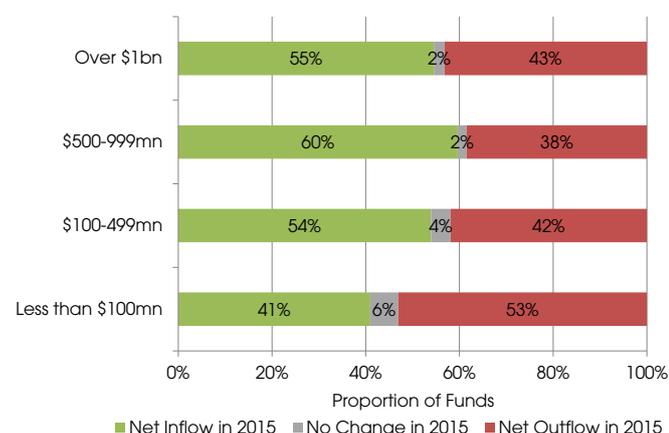
Fig. 1: Quarterly Asset Flows by Strategy

Strategy	Q1 2015 Asset Flows (\$bn)	Q2 2015 Asset Flows (\$bn)	Q3 2015 Asset Flows (\$bn)	Q4 2015 Asset Flows (\$bn)*	2015 Total (\$bn)
Equity Strategies	29.6	28.8	-1.7	0.4	57.1
Multi-Strategy	12.2	5.2	7.8	1.3	26.5
CTAs	11.3	-4.8	16.7	2.2	25.4
Credit Strategies	-3.7	15.1	-2.0	-5.7	3.6
Event Driven Strategies	-1.6	12.3	-1.8	-7.3	1.7
Niche Strategies	-0.1	-0.6	1.4	0.5	1.1
Relative Value Strategies	-15.3	5.6	-5.3	-3.2	-18.3
Macro Strategies	-3.4	-14.0	-11.2	3.1	-25.6
All Hedge Funds	28.8	47.5	3.9	-8.7	71.5

Source: Preqin Hedge Fund Analyst

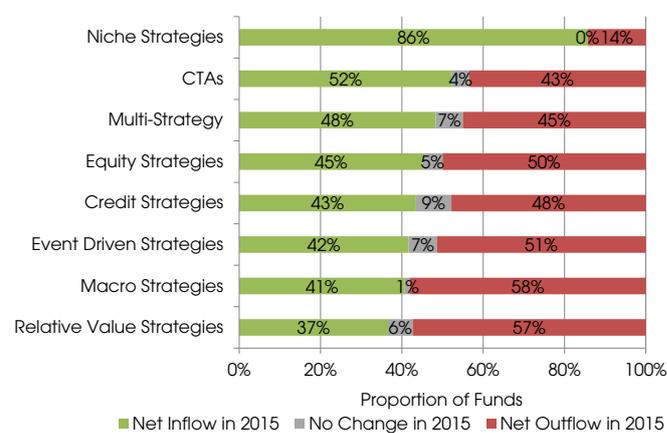
*Q4 2015 asset flows estimated to 30 November 2015.

Fig. 2: Asset Flows over 2015 by Fund Size



Source: Preqin Hedge Fund Analyst

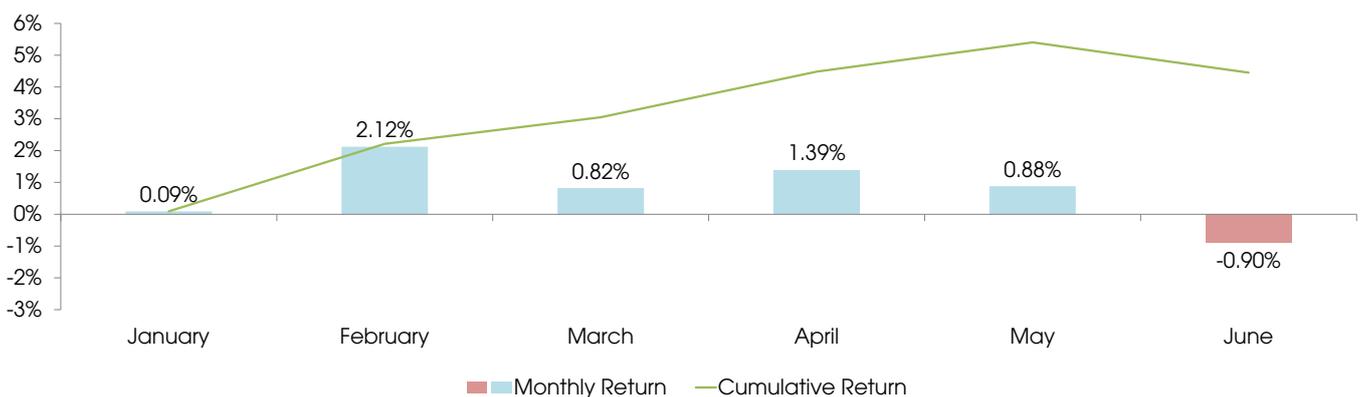
Fig. 3: Asset Flows over 2015 by Strategy

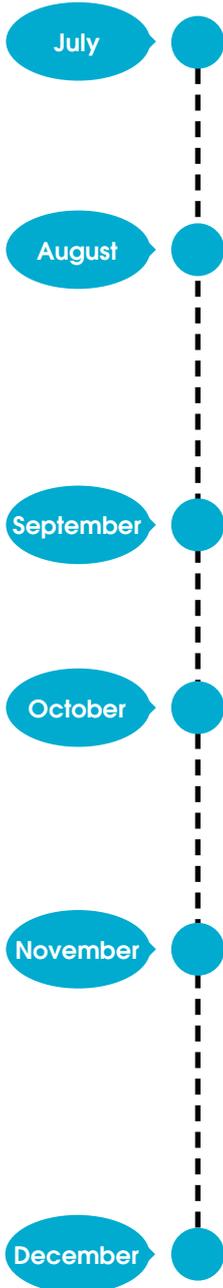


Source: Preqin Hedge Fund Analyst

Timeline of Key Events in the Hedge Fund Industry in 2015

<p>January</p>	<p>January Swiss De-Peg Results in Winners and Losers</p> <p>The Swiss National Bank's decision in January 2015 to remove the cap on the value of the Swiss franc against the euro led to swings in currency markets. The Swiss franc lost 17% against the euro, the USD-CHF rate dropped approximately 30% and Swiss stocks fell 13%, all in one day. Due to this volatility, there were some major wins and losses for hedge funds. Notably, the \$830mn Everest Capital Global Fund closed in February, and the currency movement was cited as a main factor in the closure of six out of seven of Everest's funds in March. In comparison, Switzerland-based Quaesta Capital generated +14.36% in January through its v-Pro Dynamic fund (GBP – P share class).</p>	
<p>February</p>	<p>February More Acquisitions for Man Group</p> <p>Man Group announced that it was to acquire the asset management business of NewSmith. The acquisition, the latest in a long line by the group, led to Man gaining a Japanese hedge fund, a new Tokyo office and an expanded team in London. Other recent acquisitions by Man Group include Numeric Investments and Pine Grove in 2014.</p>	
<p>March</p>	<p>Q1 Best Quarterly Performance of 2015</p> <p>Hedge funds had a good start to the year, adding 3.05% in Q1 2015 – the best quarter since Q4 2013, and ultimately the best quarter of 2015.</p>	
<p>April</p>	<p>April - June Trend Reversals in Oil Markets Foil CTAs</p> <p>In April, following a report that US oil and natural gas drilling activity fell to a six-year low and supply concerns grew as a result of tension in the Middle East in turn, oil prices began to rally, reversing trends of falling prices in Q1. However, OPEC's June announcement that they will not cut oil production caused fears of over production and led to declining oil prices and further trend reversal. With many CTAs trading instruments derived from oil prices, CTAs were unable to follow the sharp trend reversals and the benchmark posted a loss of 3.73% in Q2, almost wiping out the +4.29% Q1 return.</p>	
<p>May</p>	<p>June - July Greek Debt Crisis Hits European Hedge Funds</p> <p>Concerns over a potential "Grexit" had been growing since June when newly elected Prime Minister Alexis Tsipras announced a surprise referendum on whether Greece should accept bailout conditions, Greek banks closed and Greece missed a payment to the IMF. The uncertainty in Greece sent shockwaves throughout European markets. On 13 July 2015 Greece and Europe agreed a deal for an €86bn bailout over the course of three years. Hedge funds in the region were not immune to the volatility caused by these events, and Europe-focused funds lost 1.05% in June. However, following the bailout in July they were able to post gains of 0.94%. In fact, over the course of 2015, Europe-focused funds were able to outperform the wider All-Strategies Hedge Fund benchmark, with each making gains of 5.60% and 2.02% respectively.</p>	





June - August
China's "Black Monday" Sends Shockwaves across Hedge Funds Globally



The financial crisis in China, which had been unfolding over June and July, reached a head in August, as China devalued the Yuan on 11 August in response to economic slowdown. Markets worldwide began to see losses, and on 24 August, the Shanghai Composite Index fell 8.5%, its biggest one-day loss in eight years. Following renewed government market-rescue measures, the Shanghai Composite Index gained 4.8% on 28 August. The crisis in China had a wide-reaching impact on the hedge fund sector: all major hedge fund benchmarks made losses over the month and the Preqin All-Strategies Hedge Fund benchmark posted a loss of 2.21% over the month. The losses as a result of the China crisis also led to several major fund closures in 2015, notably Fortress Macro Fund, Absolute Return Capital's Absolute Return Cayman and Blackrock's Global Ascent Fund.



Q4
Losses Compound Worst Quarter of 2015

The Preqin All-Strategies Hedge Fund benchmark was below water in every month of the third quarter of 2015, eventually making losses of 3.90%, the benchmark's worst quarterly performance since Q3 2011.

November
More Europe-Based Private Pension Funds Cut Hedge Funds

Railways Pension Trustee Company (Railpen) announced that it was cutting its exposure to hedge funds; however, it may reinvest again in the future. In fact, the £20bn pension scheme had been unwinding its holdings throughout 2015 in an attempt to cut costs across its portfolio. Railpen had been investing in hedge funds since 2005, and at its peak, invested 10% of total assets in the space.

The exit of Railpen from hedge funds is part of a wider trend across Europe among private sector pension funds. Since 2013, the number of Europe-based private sector pension funds investing in hedge funds has declined from 205 to 189.

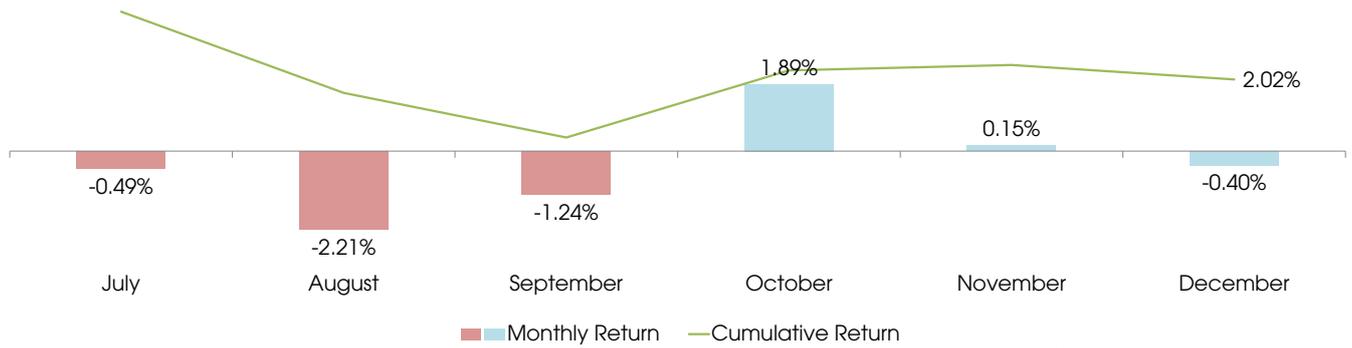
December
BlueCrest Announces It Will Return All Capital to Investors

The \$8bn hedge fund manager announced on 1 December that it would be returning all investor capital and as a result would become a family office. Preqin's **Hedge Fund Online** tracks over 160 institutional clients of BlueCrest, all of whom will soon be receiving their capital and looking for new funds in 2016.



16 December
US Fed Raises Interest Rates by 25 Basis Points

The Federal Reserve announced in December that it would increase interest rates – its first increase since 2006. The decision puts US policy at odds with that of Europe, where new policies to further ease borrowing terms have been approved. Hedge funds have been anticipating the Fed's rate hike for some time and the move at the end of 2015 is likely to have far-reaching consequences for hedge funds in 2016.



Source: Preqin Hedge Fund Analyst

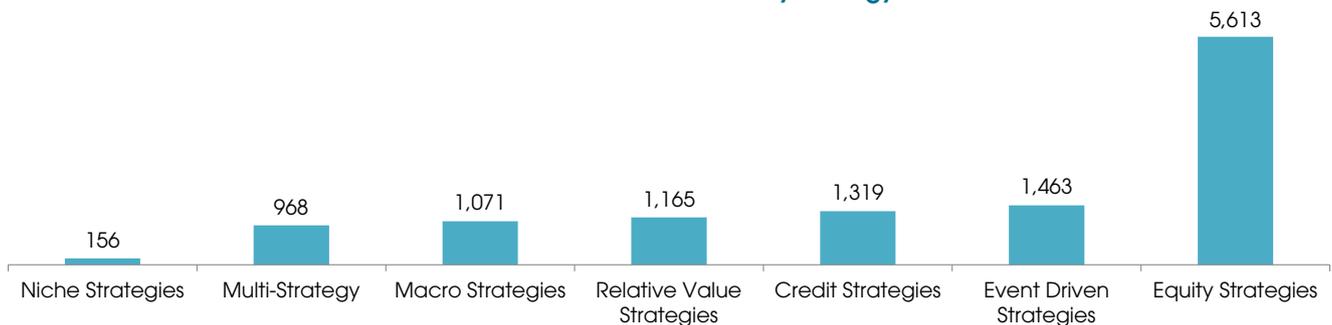
Overview of the Hedge Fund Industry by Strategy

The hedge fund sector covers a broad range of funds that operate in a vast array of trading styles and markets and use a variety of different instruments. Every fund is unique; however, most funds share characteristics with other vehicles, which allows us to categorize these

funds into broad groups – a vital task for benchmarking fund performance, seeing asset flows and assessing investor appetite. In this section, we examine the seven top-level hedge fund strategies tracked by Preqin: equity strategies, macro strategies, event driven strategies,

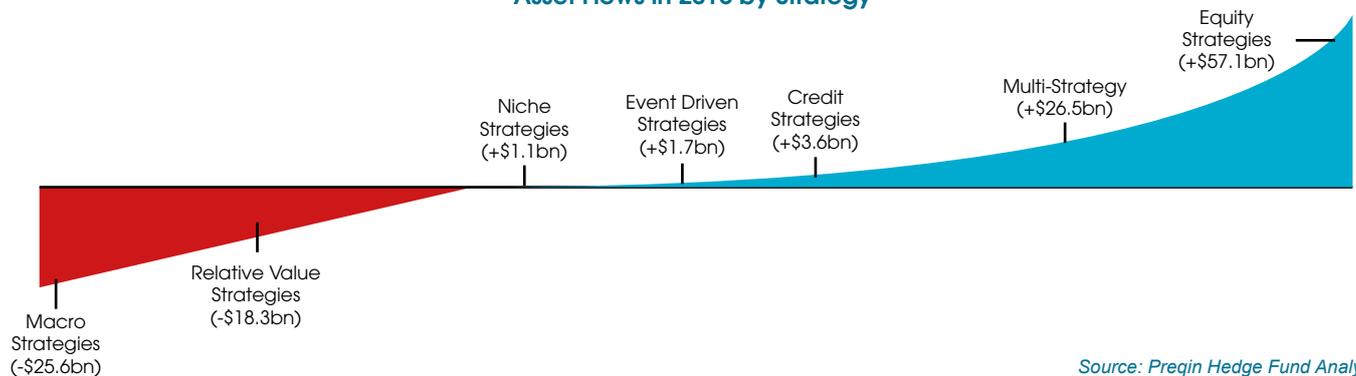
credit strategies, relative value strategies, multi-strategy and niche strategies. In addition, we take a closer look at funds based on their core trading approach: activists, volatility trading funds, discretionary funds and systematic funds.

Number of Funds in Market by Strategy



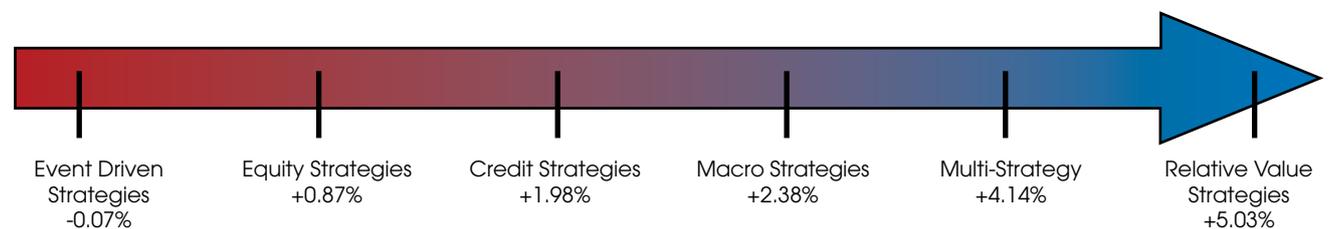
Source: Preqin Hedge Fund Analyst

Asset Flows in 2015 by Strategy



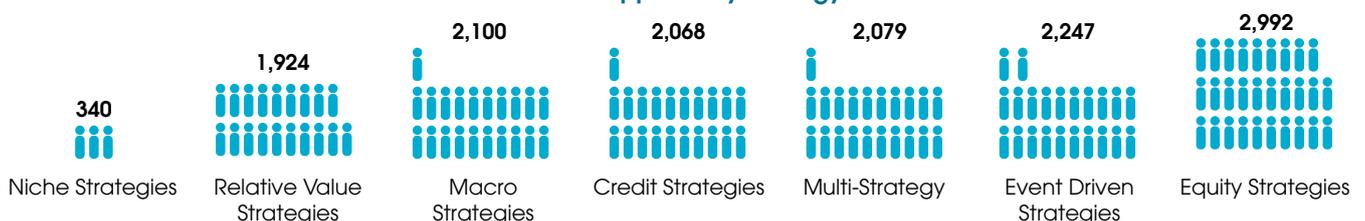
Source: Preqin Hedge Fund Analyst

Performance in 2015 by Strategy (Cumulative Performance as of 31 December 2015)



Source: Preqin Hedge Fund Analyst

Investor Appetite by Strategy*



Source: Preqin Hedge Fund Investor Profiles

*Number of investors allocating or considering hedge funds.

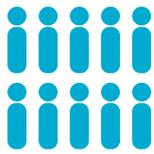
Investors in Hedge Funds

Preqin tracks over 5,000 institutional investors with current portfolios of hedge funds. These investors span pension funds – both public and private – endowment plans and foundations, family offices, funds of hedge funds and sovereign wealth funds among many others. Our investor survey (see

the full Global Hedge Fund Report for more details) reveals that performance continues to be a concern for many investors, and that a large number of investors are taking a cautious approach to investment in the asset class in 2016. It is therefore more important than ever to understand the needs of these institutional

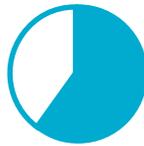
investors in order to successfully raise capital in 2016. Each investor is unique, with their own requirements from their hedge fund portfolio; however, these groups of institutions often have similar characteristics in terms of fund preferences which can help to understand their allocation preferences.

Key Facts about Investors in Hedge Funds



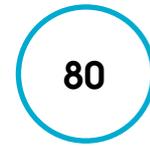
5,073

Number of institutional investors active in hedge funds.



60%

Proportion of hedge fund capital that is invested by institutional investors.

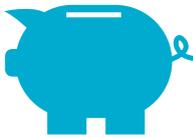


80

Number of institutional investors that made their first allocation in 2015.

Source: Preqin Hedge Fund Investor Profiles

Leading Sources of Hedge Fund Capital*



23%

Public Pension Fund



19%

Private Sector Pension Fund



11%

Endowment Plan



11%

Sovereign Wealth Fund



9%

Foundation

* Proportion of institutional capital invested by each group.

Source: Preqin Hedge Fund Investor Profiles

Proportion of Institutional Capital Invested in Hedge Funds by Region



Source: Preqin Hedge Fund Investor Profiles

Institutional Investor Plans for 2016

Investors Plan to Increase Allocations to:



Equity Strategies



Macro Strategies



CTAs

Investors Plan to Reduce Allocations to:



Credit Strategies



Funds of Hedge Funds

Source: Preqin Hedge Fund Investor Interviews, November 2015

CTAs in Focus

CTAs underwent a revival in 2014, making gains of 9.96% and exceeding the Preqin All-Strategies Hedge Fund benchmark for the first time since 2011. Although 2015 started well, with the All-Strategies CTA benchmark adding gains

of 4.28% in Q1 2015, commodity market conditions made the returns environment a difficult one for many CTAs over much of the rest of the year, and by the end of 2015 the benchmark was underwater.

Despite the difficulties faced in 2015, investors look set to remain committed to CTAs in 2016; more than half of all investors in the strategy plan to increase their exposure as they seek an asset non-correlated to equity markets.

Key Facts



Number of active CTA programs.



1,067

Number of institutional investors that invest in CTAs.



52%

Proportion of CTA investors that plan to increase their exposure to the strategy in 2016.



67

Number of new CTAs launched in 2015.



84

Number of CTAs that liquidated in 2015.



69%

Proportion of CTA investors that stated return expectations had been met in 2015.

Source: Preqin Hedge Fund Investor Profiles and Hedge Fund Analyst

Performance in 2015



+0.95%

Discretionary CTA benchmark return in 2015.



-1.44%

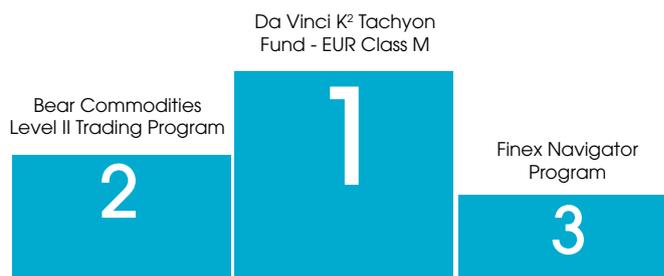
Systematic CTA benchmark return in 2015.



July 2008

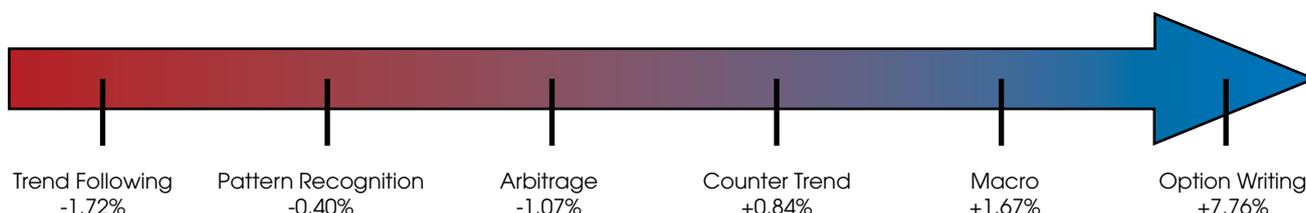
June's loss of 2.35% was the worst monthly return for the All-Strategies CTA benchmark since July 2008 (-2.85%).

Top Three Performing CTAs in 2015



Source: Preqin Hedge Fund Analyst

Best and Worst Performing CTA Strategies in 2015 (Cumulative Performance as of 31 December 2015)



Source: Preqin Hedge Fund Analyst

Funds of Hedge Funds in Focus

In 2014, the fund of hedge funds sector experienced its first year of net growth, in terms of AUM, since 2011. Funds of hedge funds were unable to sustain this growth, however, in 2015. The fund of hedge funds industry lost \$12bn in capital over 2015, with only North America-

based funds of hedge funds witnessing any growth over the year. In comparison, funds of hedge funds in all other regions either saw outflows or no net growth.

The fund of hedge funds sector as a whole saw much activity in 2015, including a

number of fund closures and mergers and acquisitions, and as a result, there are fewer funds of hedge funds in market in 2016 than there were in 2015. In this section, we take a closer look at fund launches and closures in 2015 and asset flows over the year.

North America



\$9bn

Assets added by North America-based funds of hedge funds in 2015.



AUM of **Blackstone Alternative Asset Management**, the largest fund of hedge funds manager globally, which is based in the US.

Source: Preqin Hedge Fund Analyst

Europe



\$14bn

Assets lost by Europe-based funds of hedge funds in 2015.



AUM of **HSBC Alternative Investments**, the largest fund of hedge funds manager in Europe.

Source: Preqin Hedge Fund Analyst

Fund of Hedge Funds Assets under Management



Source: Preqin Hedge Fund Analyst

Rest of World



\$0bn

No change in assets of Rest of World-based funds of hedge funds in 2015.



AUM of **BSP Funds**, the largest fund of hedge funds manager in Rest of World.

Source: Preqin Hedge Fund Analyst

Asia-Pacific



\$7bn

Assets lost by Asia-Pacific-based funds of hedge funds in 2015.



AUM of **MCP Asset Management**, the largest fund of hedge funds manager in Asia-Pacific.

Source: Preqin Hedge Fund Analyst



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- > Fund Profiles
- > Fund Performance
- > Fund Manager Profiles
- > Fund Terms