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.
- **28** fund launches in 2015.
- **$68bn** AUM of Blackstone Alternative Asset Management, the largest fund of hedge funds manager globally, which is based in the US.

### Europe

- **$14bn** assets lost by Europe-based funds of hedge funds in 2015.
- **51** fund liquidations in 2015.
- **$27bn** AUM of HSBC Alternative Investments, the largest fund of hedge funds manager in Europe.

### Rest of World

- **$0bn** no change in assets of Rest of World-based funds of hedge funds in 2015.
- **5** fund liquidations in 2015.
- **$0.6bn** AUM of BSP Funds, the largest fund of hedge funds manager in Rest of World.

### Asia-Pacific

- **$7bn** assets lost by Asia-Pacific-based funds of hedge funds in 2015.
- **13** fund liquidations in 2015.
- **$5bn** AUM of MCP Asset Management, the largest fund of hedge funds manager in Asia-Pacific.
Overview of Funds of Hedge Funds

Funds of hedge funds were unable to sustain the growth witnessed in 2014 over the course of 2015. The industry’s assets under management (AUM) declined by $12bn over the year, wiping out over a third of the $33bn added in 2014. As of 31 December 2015 the fund of hedge funds sector managed $807bn in capital (Fig. 1). The sector experienced a wide range of activity over the year, from closures to mergers, acquisitions and spin-outs, as fund of hedge funds managers continued to search for solutions that meet the evolving needs and performance demands of institutional investors.

The Evolution of Industry Assets

The steady decline in fund of hedge funds assets, which began in 2008, was reversed in 2014. However, the sector once again saw outflows in 2015, with $12bn in capital lost over the course of the year. North America was the only region in which funds of hedge funds showed growth over the year, adding $8bn in new assets. In fact, North America-based fund of hedge funds managers have experienced year-on-year growth since 2011.

In contrast to their North America-based counterparts, Europe-based fund of hedge funds managers experienced a tough year in 2015 as they recorded a further decline in assets, dropping $14bn to $183bn by December 2015. Europe-based managers have faced financial uncertainty surrounding the eurozone and regulatory challenges in the shape of the AIFMD. Managers in the region have dropped from a 44% share of multi-manager assets in 2007 to just 23%. The difficulties faced by funds of hedge funds in the region in 2015 translated into a notable number of fund closures: 53% of the fund of hedge funds liquidations in 2015 were Europe-based vehicles (Fig. 2).

Fund of hedge funds managers based in Asia-Pacific saw the 2014 asset gains of $5bn completely reversed, ending 2015 with $18bn in AUM. Despite this, there is some cause for optimism in the region. Vehicles targeting Asia-Pacific opportunities outperformed their North America- and Europe-focused counterparts in 2015, and recent regulatory changes, particularly in China, have focused on reducing barriers to entry for overseas investors. Fund of hedge funds managers outside North America, Europe and Asia-Pacific are predominantly based in Brazil and South Africa. The combined fund of hedge funds AUM in these two countries accounts for 78% of Rest of World capital.

Despite the fund of hedge funds sector showing a drop in AUM over 2015, marginally more fund managers reported

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Fig. 1: Fund of Hedge Funds Managers’ Assets under Management by Region, December 2007 - December 2015

Source: Preqin Hedge Fund Analyst

Fig. 2: Fund of Hedge Funds Liquidations by Fund Manager Location, 2011 - 2015

Source: Preqin Hedge Fund Analyst

Fig. 3: Proportional Change in Fund of Hedge Funds Managers’ Assets under Management, 2007 - 2015

Source: Preqin Hedge Fund Analyst
that AUM increased in 2015 than decreased (33% and 31% respectively). The largest proportion (36%) witnessed no change in AUM (Fig. 3). Further growth in 2016 may be driven largely by performance; 78% of current investors in funds of hedge funds told Preqin they planned to maintain their fund of funds exposure during the year.

Thirty-nine percent of firms managing at least $1bn reported that their assets grew in 2015 compared with 26% of sub-$100mn managers (Fig. 4); this shows that it is predominantly the largest players that are getting much of the inflows in 2015. In fact, the largest proportion of fund managers reporting growth in AUM in 2015 were in the $500-999mn group, where 41% added new capital in 2015.

**Fund of Hedge Funds Launches in 2015**

With the level of capital invested in funds of hedge funds falling slightly, fund managers saw little scope for new products to enter the market in 2015. As a result, just 28 new funds were inceptioned in 2015 (Fig. 5). Although the number of launches recorded for 2015 is likely to increase in the first half of 2016 as more data becomes available, it remains unlikely that this figure will surpass the number (86) of launches in 2014 or will outstrip the number of liquidations in 2015, which stands at 97 and is also expected to grow.

The fact that there were more than three times as many fund closures as launches in 2015 confirms that the fund of hedge funds industry remains in a period of consolidation. There were a number of mergers, acquisitions and spin-outs in 2015, including Aberdeen Asset Management announcing the purchase of Arden Asset Management in Q3 2015, which was completed in January 2016, and Investcorp acquiring SSARIS Advisors in Q4 2015. A long period of growth prior to 2008 saw the fund of funds sector mature and institutional investors become more comfortable with hedge fund investments. The environment in recent years has become more competitive, as investors increasingly move towards single-manager portfolios, and many established players in the industry now seek to facilitate innovation by acquiring profitable fund of hedge funds businesses. By marketing new products and investment solutions, managers aim to diversify their offering and attract a wider group of investors. A multi-strategy approach is sought by many fund of hedge funds investors; the majority (57%) of new funds that came to market in 2015 aim to provide strategy diversification (Fig. 6). One-quarter of fund of hedge funds launches focus on equity strategy hedge funds and 7% primarily provide exposure to macro strategies. Perhaps encouraged by solid performance in recent years and possible opportunities in fixed income markets in 2016, managers launched a notably larger proportion (4%) of credit-focused vehicles in 2015 than in 2014 (1%).

**Performance in 2015**

Funds of hedge funds enjoyed mixed fortunes in 2015 as returns fluctuated throughout the year (Fig. 7). Although second-quarter performance was essentially flat, gains of 3.02% were posted in Q1 and a year-to-date net return of +3.15% as of June represented the second-best H1 return since 2009. However, a number of hedge funds struggled to navigate the volatile macroeconomic and market conditions...
later in the year, and the All-Strategies Fund of Hedge Funds benchmark lost 2.68% in Q3. A slight recovery in Q4 led to funds of hedge funds ending 2015 with a return of +1.13%, over two percentage points below the 3.86% gain of 2014. Fund of hedge funds returns have been fairly healthy over the last three years (+4.46% annualized) but losses in 2011 have hit returns over the five-year time horizon (+2.91% annualized).

Equity-focused vehicles were the main drivers of fund of hedge funds performance in 2015, gaining 1.64% (Fig. 8). Multi-strategy funds returned +1.21%, the diversification granted by their varied investments going some way to counterbalancing the volatility seen in equity markets. Funds of CTAs suffered from poor performance in the managed futures sector and ended the year reporting a loss of 6.77%, while funds of macro funds also struggled (-1.66%).

Fig. 9 highlights the difference in performance between the first and second halves of the year. Despite the threat of a slowing Chinese growth rate contributing to four consecutive months of losses (June-September), funds of hedge funds focused on the Asia-Pacific region ended the year in a strong position, posting gains of 5.90%. Emerging markets funds also fared well during 2015, ending the year up 5.09%. This compares favourably to the performance of single-manager emerging markets funds (+1.15%) and suggests that a number of funds of hedge funds have been successful at selecting managers specializing in these areas.

Europe-focused funds of hedge funds outperformed North America-focused vehicles in 2015 for the first time since 2008. Despite managers based in the region witnessing declining assets and a number of fund closures, vehicles targeting European strategies suffered a smaller dip than North America-focused funds of hedge funds in August and September when equity markets tumbled.

Compared with 2014, when 84% of funds of hedge funds posted a positive return by year-end, 2015 was somewhat disappointing as only 60% of funds ended the year in the black (Fig. 10). The proportion of funds of hedge funds that achieved positive returns also slightly lags the wider single-manager sector, where 62% were above water. A small proportion of managers were able to generate double-digit returns in 2015: 6% of funds of hedge funds returned 10% or more over the course of the year, compared with 10% of vehicles that achieved the feat in 2014.

The Risk Profile of Funds of Hedge Funds

Due to the benefits of geographic, strategic and industry diversification, the returns of a fund of hedge funds vehicle will typically exhibit lower volatility than the average single-manager fund. While this may also be accompanied by slightly lower returns, many fund of hedge funds investors value the risk mitigation and downside protection offered by the multi-manager approach. Volatility has been falling since the start of 2013 for both funds of hedge funds and single-manager hedge funds (Fig. 11). At the start of 2013, the volatility of returns stood at 6.1% for hedge funds and 4.0% for funds of hedge funds (Fig. 11). At the start of 2013, the volatility of returns stood at 6.1% for hedge funds and 4.0% for funds of hedge funds.
of hedge funds. This trend persisted until Q3 2014, but there has been a degree of convergence since and there is much less disparity than in the past. Equity market corrections in the second half of 2015 caused a general spike in volatility and the three-year measure for hedge funds at the end of 2015 stood at 3.8% for hedge funds and 3.1% for funds of hedge funds.

Alongside returns, the risk profile of a fund is a key factor for investors when evaluating potential managers and this can vary considerably according to the strategy employed. Fig. 12 depicts the relationship between these risks and returns for funds of hedge funds and some of the most commonly used multi-manager strategies. Funds of funds targeting equity strategies hedge funds have delivered superior returns over the last three years, albeit at a slightly higher volatility level (4.3%) than the overall sector (3.1%). Conversely, funds of macro funds offer a lower level of volatility (3.2%) but have posted annualized gains of less than 1% over the last three years. Multi-strategy vehicles have offered a more balanced profile over the period 2013-2015, with low volatility (2.9%) and mid-single-digit gains (annualized +4.48%).

Outlook

Funds of hedge funds experienced varying degrees of success in 2015 – a year in which many hedge fund managers struggled to navigate tricky macroeconomic environments. The industry saw a significant amount of consolidation, with overall assets declining slightly amid numerous fund closures, particularly in Europe. North America-based managers enhanced their market share and now control almost three-quarters of global fund of hedge funds assets. Despite this, Europe-focused funds outperformed those targeting North American opportunities for the first time since 2008. It will be interesting to see if this helps the European industry to stabilize in 2016 or whether the trend of fewer funds controlling smaller AUM will continue.