Preqin Investor Outlook: Alternative Assets H2 2014

Private Equity | Hedge Funds | Real Estate | Infrastructure

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Contents

Datapack for Preqin Investor Outlook: Alternative Assets, H2 2014

The data behind all of the charts featured in the report is available for free in an easily accessible datapack. It also includes ready-made charts that can be used for presentations, marketing materials and company reports.

To download the datapack from Preqin's **Research Center Premium**, please visit:

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Foreword

Welcome to Preqin Investor Outlook: Alternative Assets, H2 2014, a unique and in-depth look at the appetite, plans, expectations and concerns of institutional investors in private equity, hedge funds, real estate and infrastructure. This report draws on in-depth conversations between Preqin's dedicated research analysts and key investment decision makers at over 380 institutional investors from across the globe. This representative sample of investors was drawn from Preqin's industry-leading online products which feature detailed profiles for more than 8,400 active institutional investors with allocations to one or more alternative asset classes.

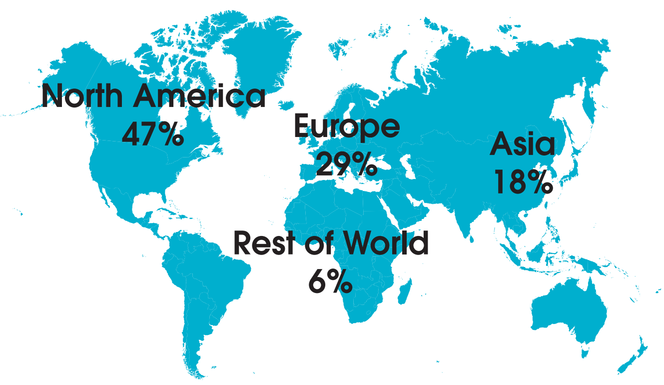
In this report, we explore investors' changing appetite and plans for their alternative investments in the coming year, as well as how they see their allocations evolving in the longer term and what impact this will have on the size of their investment teams. We also look at the key issues facing institutional investors today, including their views on regulatory changes. It is clear that the longer term outlook for alternative assets is one of further growth, with many investors below their target allocations to these asset classes and a large proportion expecting to up their targeted portfolio weightings to alternatives in the coming years. We are also seeing a more proactive investor community, demanding more information from fund managers they invest with, seeking greater control of their portfolios through managed accounts or direct investments, and increasingly looking to seek out the best performing managers rather than waiting to be presented with attractive opportunities.

For managers looking to raise capital in the coming year, while there certainly is appetite from institutional investors, competition remains intense and getting in front of the right investors is crucial. Every institutional investor has its own unique set of circumstances, preferences, return objectives and risk tolerance, and identifying the most relevant investors for a private equity, real estate, infrastructure or hedge fund is a challenging prospect. Preqin's leading online services are indispensable fundraising and investor relations tools for all fund managers, from niche boutiques to global players, allowing firms to identify new investors, track competing firms, benchmark performance and much more.

We hope you find this report informative and valuable, and would welcome any suggestions for future editions. To find out how Preqin's services can help your business in the coming months, please do not hesitate to contact at us at info@preqin.com or at our New York, London, Singapore or San Francisco offices.

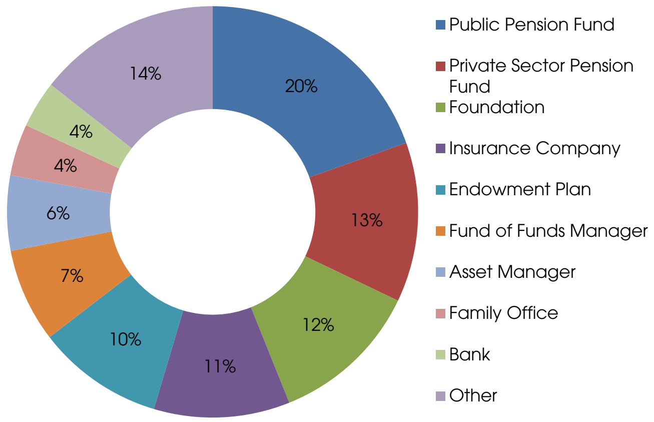
Breakdown of Respondents

Breakdown of Respondents by Investor Location



Source: Preqin

Breakdown of Respondents by Investor Type



Source: Preqin

Are You an Investor?

Join **Preqin Investor Network** for free to gain access to details of all alternative assets funds in market, key contact information and fund manager performance track records.

www.preqin.com/pin

Looking to Connect with Investors?

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Industry Perceptions and Satisfaction with Returns

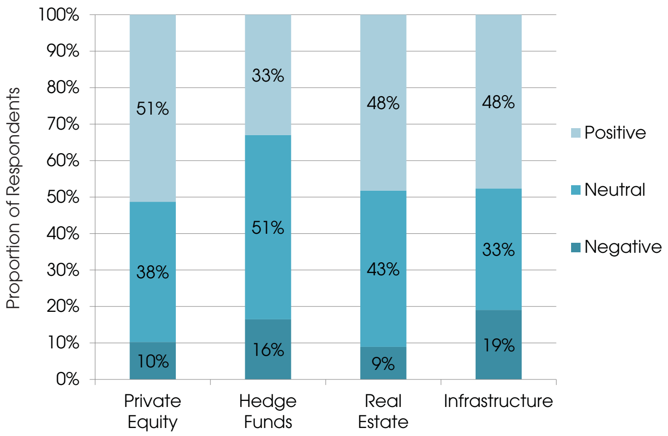
Investors remain largely satisfied with recent returns from their alternatives portfolios, and the majority remain positive about the ability of these asset classes to continue to benefit their overall portfolios.

Investments in alternatives are an essential part of many investors' portfolios, with many relying on the return potential of these asset classes to help meet their liabilities, or the reduction in volatility that can be achieved with a portfolio diversified across a range of asset classes. Institutional investors remain largely positive about alternatives, with around half of all investors in private equity, real estate and infrastructure having a positive view of these asset classes (Fig. 1.1). Fewer investors view hedge funds positively, with most having a more neutral outlook, but only 16% view the asset class in a negative light.

For each alternative asset class, a sizeable proportion of investors feel that returns in the past year met or exceeded their expectations (Fig. 1.2). There has, however, been a fall in satisfaction among investors in hedge funds, with 27% stating returns had fallen short of their expectations compared to 16% in December 2013. This is a reflection of the volatile start to the year, which saw the Preqin All Hedge Fund Benchmark suffer a loss in three of the first four months of 2014. The result of the strong performance of many real estate markets in recent quarters is that one-third of investors felt performance of the asset class had exceeded their expectations in the past year, while just 15% felt it had fallen short .

Institutional investors remain assured of the ability of alternative assets to fulfil portfolio objectives, with investors' confidence in real estate and private equity most likely to have increased. Despite a disappointing start to 2014, just 14% of investors stated their confidence in hedge funds had declined, while 10% felt it had increased (Fig. 1.3). Nineteen percent of investors in infrastructure stated their confidence had fallen, which is likely to be a reflection of concerns over the pricing of infrastructure assets and the impact this may have on future returns.

Fig. 1.1: Investors' Perceptions of Each Alternative Asset Class at Present



Source: Preqin Investor Interviews, June 2014 - August 2014

Research Center Premium

Preqin's **Research Center Premium** provides access to **free** alternative assets data and tools taken from Preqin's online products, as well as a wide range of free research reports and newsletters.

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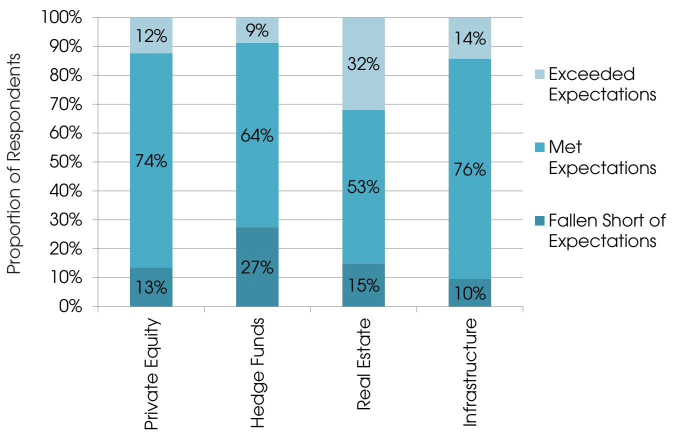
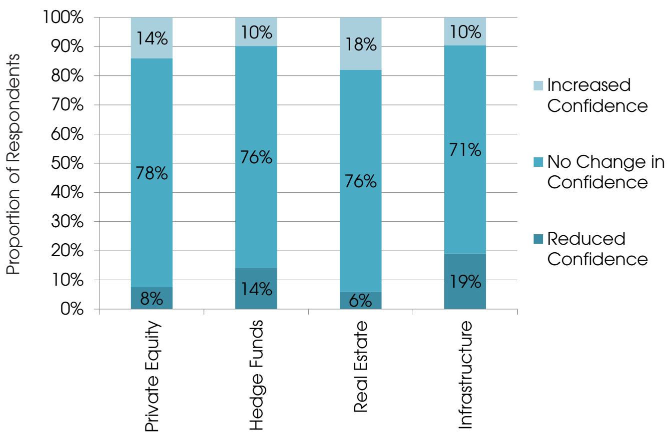
Fig. 1.2: Investors' Views on Whether Alternative Asset Class Investments Have Lived up to Expectations in the Past 12 Months



Source: Preqin Investor Interviews, June 2014 - August 2014

Fig. 1.3: Investors' Views on Whether Their Confidence in Alternative Assets to Perform Portfolio Objectives Has Changed over the Past 12 Months



Source: Preqin Investor Interviews, June 2014 - August 2014

Investor Appetite for Alternatives and Key Issues in the Next 12 Months

Fundraising for alternative assets funds looks set to see further growth in the coming year, with many investors planning to step up the pace of commitments to private equity, hedge funds, real estate and infrastructure. The outlook for the longer term is also positive, with many institutions intending to increase their allocations to these asset classes.

Institutional investor appetite for alternative assets has increased over the past year, with the amount of capital raised by fund managers increasing as a consequence. Fig. 1.4 suggests that fundraising may see further growth in the next 12 months, with many investors expecting to increase their capital outlay in the coming year. This is most notable for infrastructure, with 57% of respondents expecting to invest more in the coming year than in the past 12 months, but in all asset classes the proportion expecting to put more capital to work is significantly larger than the proportion planning to commit less capital.

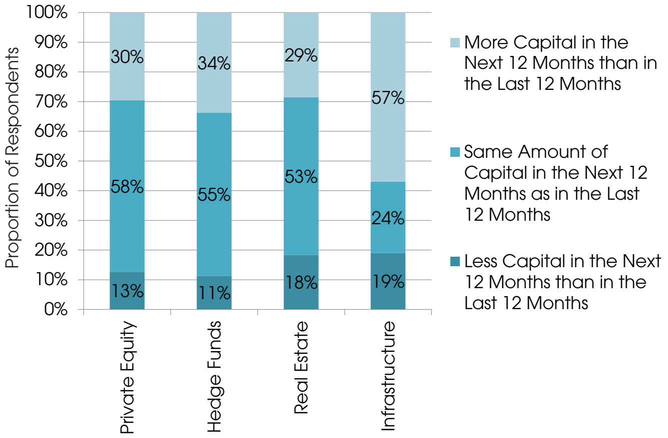
Fig. 1.5 illustrates the extent to which alternative assets make up a sizeable and important part of many institutional investors' portfolios. Hedge fund allocations in particular frequently make up a large part of institutional investors' total portfolios, with over 50% of institutions investing in hedge funds placing 10% or more of their total assets in the asset class. In contrast, as the newest and smallest alternative asset class, infrastructure allocations are typically lower, with the vast majority of investors having less than 5% of their overall portfolios directed towards infrastructure investments. This looks set to change, however, with more than 40% of investors planning to increase their infrastructure exposure over the longer term, while just 13% expect it to decrease (Fig. 1.6). A similar picture is also seen across other alternative asset classes, with far more investors expecting to increase their allocations to private equity, real estate and hedge funds than are expecting to decrease.

Key Issues for Investors

While some common themes are visible, there are also notable differences between the issues that most concern investors in different alternative asset classes (Fig. 1.7). The wider economic environment and the availability of attractive investment opportunities are both concerns when investing in real estate and infrastructure, while regulation, which is an issue that investors feel will impact the private equity and hedge funds markets, appears to be less of a concern. Fees are frequently an area of contention between investors and fund managers, which respondents are often concerned about when investing in private equity, infrastructure and hedge funds.

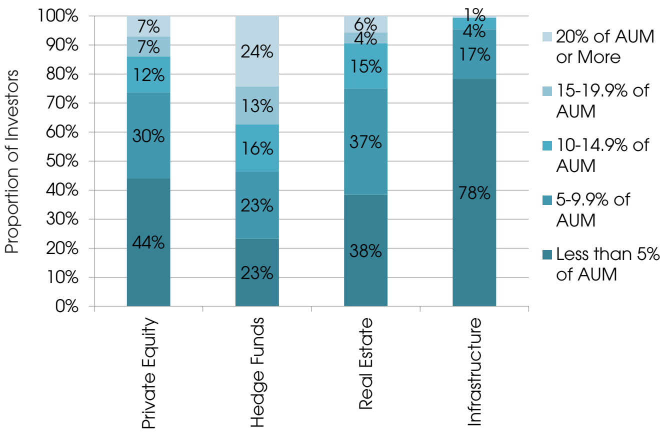
Examining regulation in more detail, we see that a significant proportion of the investor community are positive about the impact

Fig. 1.4: Investors' Expected Capital Commitment to Alternative Assets Funds in the Next 12 Months Compared to the Past 12 Months



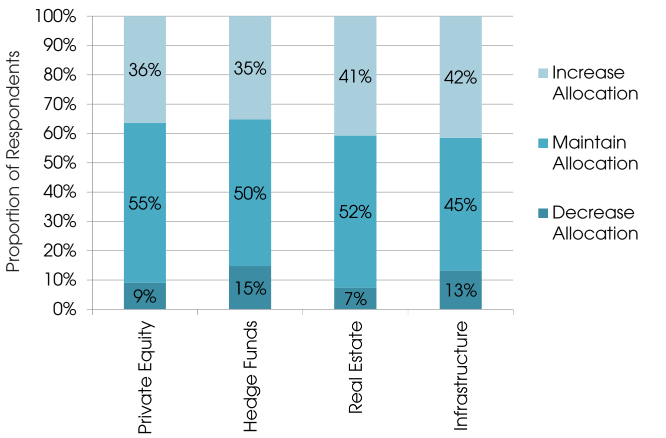
Source: Preqin Investor Interviews, June 2014 - August 2014

Fig. 1.5: Breakdown of Alternative Assets Investors' Current Allocations to Each Asset Class (Investors with an Active Allocation to the Asset Class)



Source: Preqin Online Products

Fig. 1.6: Investors' Intentions for Their Alternative Assets Allocations in the Longer Term



Source: Preqin Investor Interviews, June 2014 - August 2014 of new regulation, in contrast to many fund managers that have concerns over the impact of new regulation. Investors are most positive about the effect regulation will have on hedge funds, but are more negative about the impact on private equity, with 28% believing recent regulatory changes have had a negative influence (Fig. 1.8). Most are unsure of the implications for their real estate and infrastructure investments.

Manager Selection

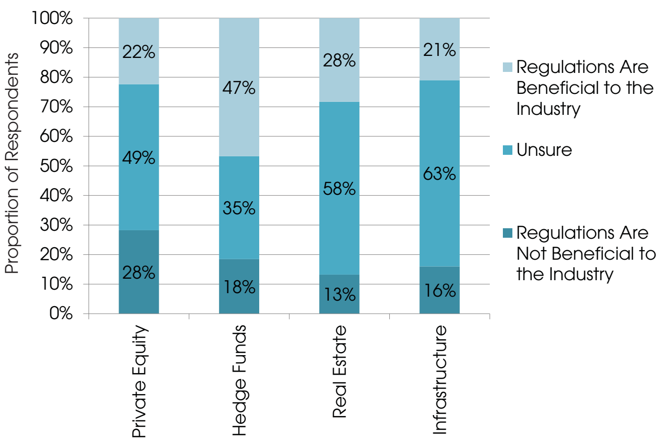
Fig. 1.9 illustrates the most important factor investors look at when selecting fund managers. The firm's investment strategy is often a critical factor, but almost as frequently named as the key factor is past performance. More than ever before investors are looking for firms that can demonstrate that they have been able to generate strong returns through a consistent investment strategy, and that they have performed well in more difficult markets. A long track record is important for many, particularly when investing in private equity, with investors wanting to see that strong returns are repeatable across multiple funds. Also essential for many investors is that a fund manager's interests are appropriately aligned with their own, with this of particular importance in selecting infrastructure fund managers. While there have been changes in infrastructure fund terms in recent years, with investors often reluctant to pay private equity-style fees when investing in infrastructure given the lower returns typically expected from the asset class, it appears investors still see fund terms as a major concern.

Fig. 1.7: Top Three Key Issues for Investors in Alternatives in the Next 12 Months by Asset Class (Proportion of Respondents Stated in Parentheses)

	Private Equity	Hedge Funds	Real Estate	Infrastructure
1	Regulation (30%)	Performance (35%)	Economic Environment (29%)	Investment Opportunities (38%)
2	Fees (26%)	Regulation (30%)	Performance (20%)	Economic Environment (14%)
3	Transparency (26%)	Fees (30%)	Investment Opportunities (15%)	Fees (14%)

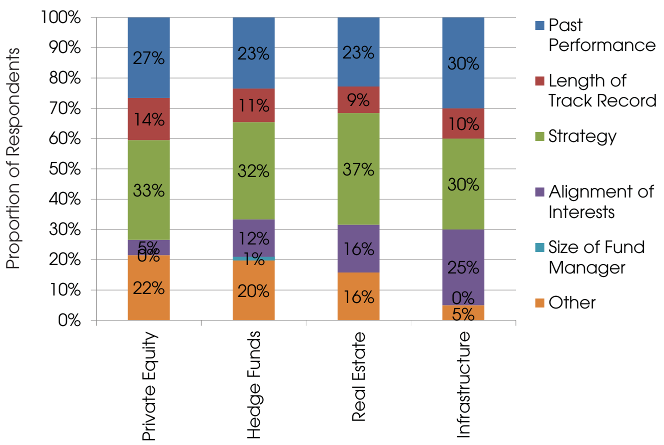
Source: Preqin Investor Interviews, June 2014 - August 2014

Fig. 1.8: Investors' Views on Whether the Regulations Introduced in 2012, 2013 and 2014 Are Beneficial to the Alternatives Assets Industry by Asset Class



Source: Preqin Investor Interviews, June 2014 - August 2014

Fig. 1.9: The Key Factor Investors Assess When Looking for an Alternatives Fund Manager by Asset Class



Source: Preqin Investor Interviews, June 2014 - August 2014

Preqin's Online Services

Preqin provides a range of online services covering all aspects of the private equity, real estate, infrastructure and hedge fund industries, including fund managers, funds, investors, performance, deals, fund terms and more.

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Alternative Fund Sourcing

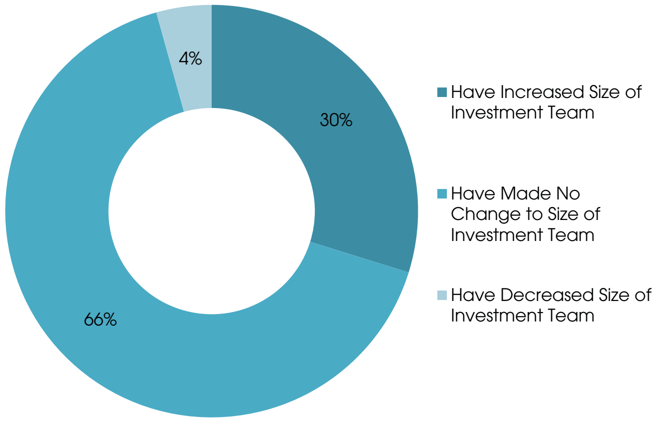
Alternative investments have become an increasingly important part of investors' portfolios, with many institutions looking to increase the size of their investment teams in the next two years. Investors source fund opportunities via a range of different methods, although many act proactively and rely on their internal teams to source new fund managers.

Investing in alternatives has played an increasingly important role within investors' portfolios in recent years, as many institutions seek the diversification and often superior returns offered through investing in alternatives. Many investors have increased their allocations across various asset classes, and as a result, have been required to build up their investment teams in order to undertake the necessary due diligence and research required for manager and fund selection, and the ongoing monitoring of these investments. Fig. 1.10 reveals that 30% of investors have increased their alternative investment teams over the last two years.

Looking ahead, this trend looks set to continue, with Fig. 1.11 showing that 28% of investors plan to increase the size of their alternatives teams in the next two years, and no respondents stating that they plan to decrease the size of their teams.

The methods investors utilize to source fund opportunities vary across asset classes, although a growing proportion source investments proactively, either through their internal investment teams or via networking and peer recommendations. As shown in Fig. 1.12, a considerable 41% of private equity investors source fund opportunities through their internal team, with 27%, 25% and 14% of hedge fund, real estate and infrastructure investors doing so respectively. Among infrastructure investors, the largest proportion (38%) source opportunities after being approached by a fund manager, perhaps a reflection of many institutions being relatively new to investing in the asset class and therefore lacking specific experience and relationships in the space required for sourcing investments more proactively.

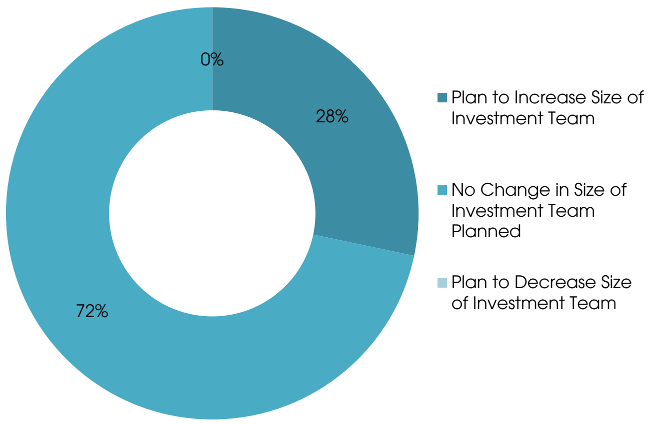
Fig. 1.10: Investors' Change in the Size of Their Alternatives Investment Team in the Last Two Years



Source: Preqin Investor Interviews, June 2014 - August 2014

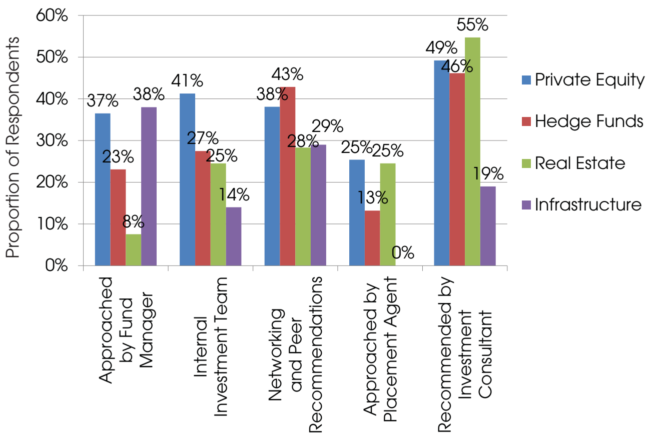
A large proportion of real estate investors source fund opportunities via their investment consultant, with 55% doing so. A considerable 49% and 46% of private equity and hedge fund investors source opportunities via these third parties respectively. Placement agents also play an important role, with 25%, 13% and 25% of private equity, hedge fund and real estate investors sourcing funds through third-party fundraisers respectively.

Fig. 1.11: Investors' Expected Change in the Size of Their Alternatives Investment Team in Next Two Years



Source: Preqin Investor Interviews, June 2014 - August 2014

Fig. 1.12: Main Methods Utilized by Investors to Source New Alternative Fund Investment Opportunities by Asset Class

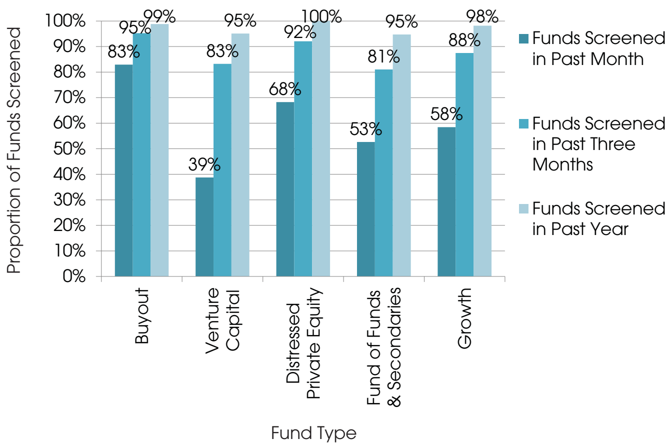


Source: Preqin Investor Interviews, June 2014- August 2014

Investor Proactivity on Preqin Investor Network

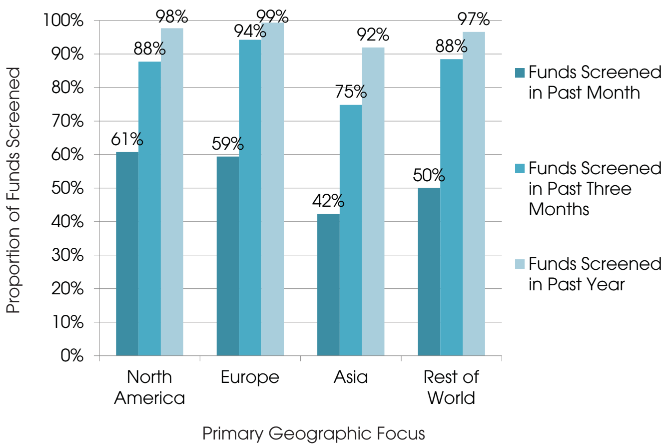
Preqin Investor Network provides accredited investors with free access to key information on all 2,200 private equity, private real estate and private infrastructure funds and 12,000 hedge funds currently open to investment. This section takes a look at the types of funds in market that investors have paid particular attention to over the past year.

Fig. 1.13: Proportion of Private Equity Funds Screened by Investors on Preqin Investor Network by Fund Type



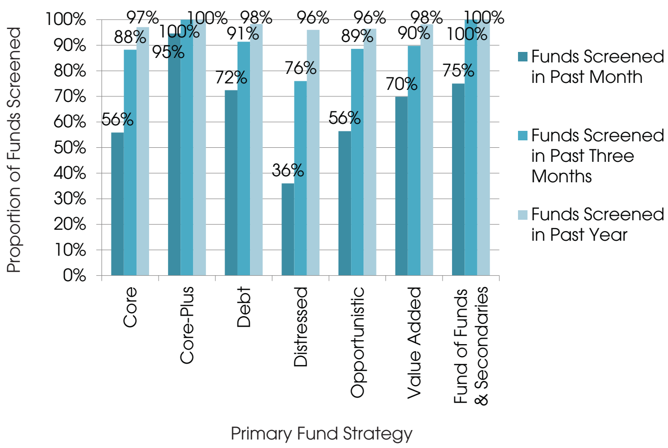
Source: Preqin Investor Network

Fig. 1.14: Proportion of Private Equity Funds Screened by Investors on Preqin Investor Network by Primary Geographic Focus



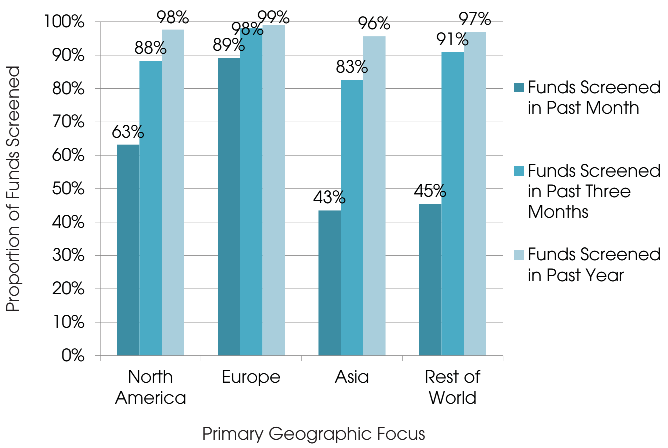
Source: Preqin Investor Network

Fig. 1.15: Proportion of Real Estate Funds Screened by Investors on Preqin Investor Network by Primary Fund Strategy



Source: Preqin Investor Network

Fig. 1.16: Proportion of Real Estate Funds Screened by Investors on Preqin Investor Network by Primary Geographic Focus



Source: Preqin Investor Network

Preqin Investor Network

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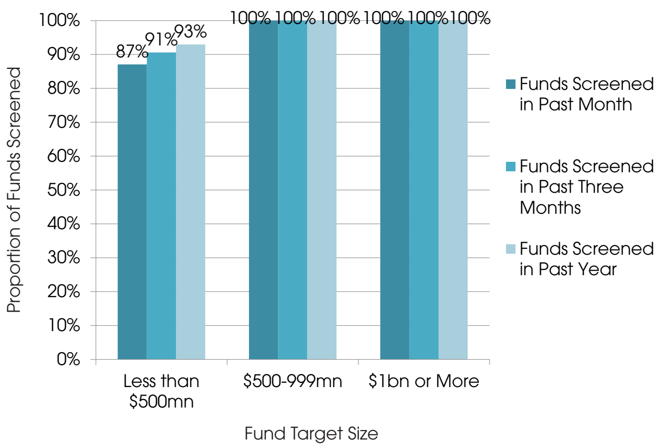
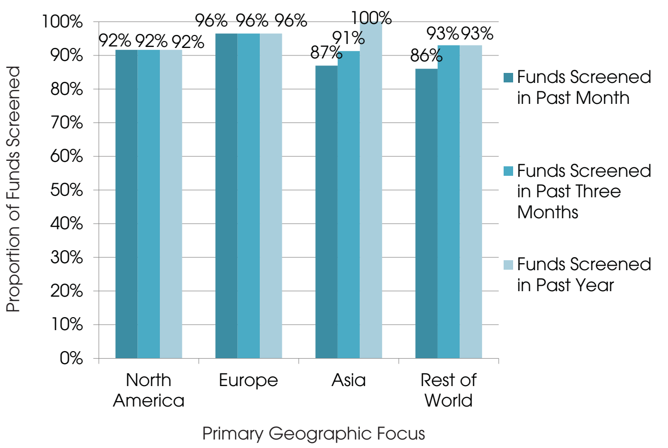
Fig. 1.17: Proportion of Infrastructure Funds Screened by Investors on Preqin Investor Network by Target Size



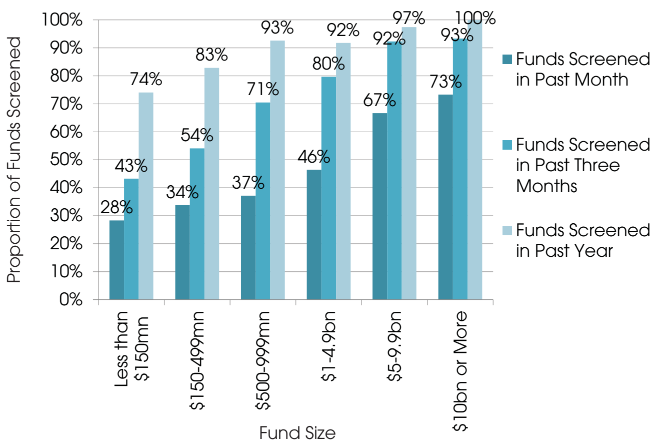
Source: Preqin Investor Network

Fig. 1.18: Proportion of Infrastructure Funds Screened by Investors on Preqin Investor Network by Primary Geographic Focus



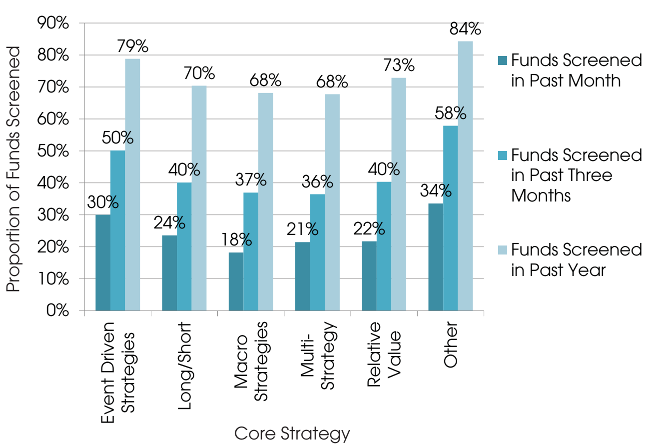
Source: Preqin Investor Network

Fig. 1.19: Proportion of Hedge Funds Screened by Investors on Preqin Investor Network by Fund Size



Source: Preqin Investor Network

Fig. 1.20: Proportion of Hedge Funds Screened by Investors on Preqin Investor Network by Core Strategy



Source: Preqin Investor Network

Private Equity

Confidence in Private Equity Continues to Grow

While fundraising levels appear healthy, competition remains fierce among fund managers; as of August 2014, there were 2,224 private equity funds on the road targeting aggregate capital commitments of $773bn. Therefore, understanding the needs of investors and where they are looking to place their capital is more crucial than ever. Preqin's latest survey of 100 institutional investors across the globe captured a wealth of valuable information on investors' current attitudes towards a range of hot topics within the market, from challenges investors face while trying to operate an effective portfolio (page 14) to investors' intentions for their private equity allocations (page 12).

Preqin's recent survey shows continued positive sentiment towards the private equity asset class, with an encouraging 86% of respondents feeling that their private equity fund commitments have met or exceeded their expectations in the past 12 months. This is supported by the fact that only 9% of investors plan to reduce their allocations to the asset class in the longer term, with external factors such as regulation likely to be the root cause for a number of these planned reductions. With industry deadlines either passing or looming ever closer, regulation would be expected to be at the forefront of many investors' minds; however, Preqin's results show that 89% of LPs have not made any changes to their private equity allocations due to regulation.

Furthermore, despite record levels of dry powder and relatively sluggish deal flow, investors on the whole remain optimistic towards private equity and are actively seeking new opportunities within the asset class. In fact, 39% are looking to form new GP relationships over the next two years, which is encouraging news for fund managers seeking fresh capital commitments from new investors. Preqin's latest survey results should also be reassuring to managers based in the more established markets of North America and Europe, as many investors are regaining confidence in these regions.

It is apparent that as the market evolves, investors are maturing and are focusing more resources on operating successful private equity portfolios; 42% of investors have increased their alternatives team in the past two years and 31% of respondents plan to do so over the next two years. Moreover, the past few years have also seen a gradual increase in the number of investors seeking alternative ways to approach the asset class outside of the traditional primary fund commitment route, and consequently a growth in the utilization of separate account mandates and the private equity secondary market (page 16).

Key Facts

62% of investors made a commitment to a private equity fund during the first half of 2014.

67% of investors plan to make their next commitment by the end of 2015.

91% of investors plan to increase or maintain their private equity allocation in the longer term.

30% of investors feel that regulation remains a big concern. However, only 7% of LPs have reduced their private equity allocations due to regulation.

86% of investors feel the returns from their private equity portfolios have met or exceeded their expectations.

58% of investors stated Europe as presenting the best opportunities in the current climate, signalling continued appetite for the region.

Satisfaction with Returns

Preqin's recent interviews with private equity investors reveal that the vast majority of LPs interviewed had their returns expectations for their private equity portfolios met or exceeded in the last 12 months.

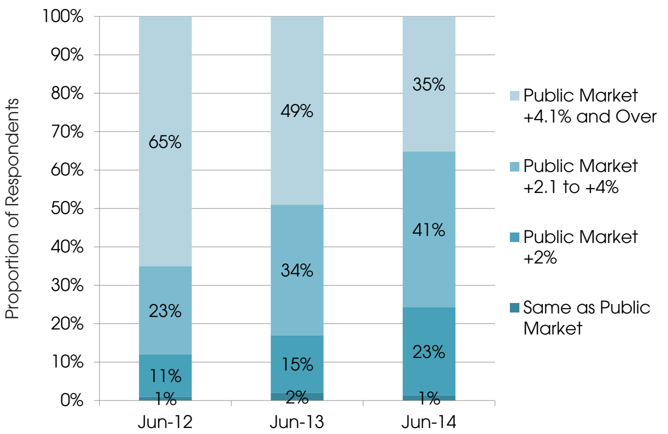
The inherently high risk and illiquid nature of the private equity asset class should be compensated by its superior returns compared to public markets over the longer term. Preqin has aimed to gauge what returns investors expect compared to public markets, and how they feel their investments have fared in the last year. While the asset class has traditionally been expected to provide higher returns in the longer term, the margin by which investors expect their private equity portfolios to outperform public markets has, in fact, reduced in recent years, as performance in public markets improves.

Fig. 2.1 shows the extent to which investors expect the returns from their private equity portfolios to be greater than those in public markets. From 2012 to 2014, the proportion of investors surveyed that expect their private equity portfolios to outperform public markets by over 4% fell from 65% to 35%. The proportion of LPs that expect returns between 2.1% and 4% above public markets has been rising steadily since 2012, with 41% of investors stating this in June 2014, compared with 34% in June 2013 and 23% in June 2012.

While overall investor satisfaction with returns from the asset class over the last 12 months has not seen substantial changes, it is reassuring to observe that the proportion of investors that said their private equity fund investments had fallen short of expectations remains firmly in the minority. Only 14% of investors reported investments in the asset class had failed to meet their expectations in the 12 months up to June 2014, compared to 21% in 2012 (Fig. 2.2).

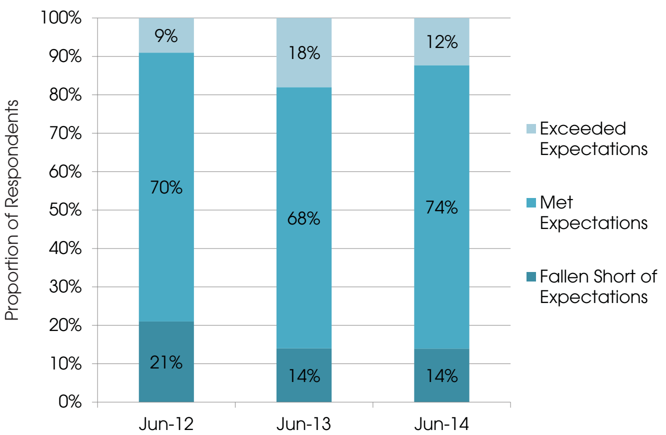
It is apparent, however, that there is a difference of opinion among investors based in different geographic regions; 38% of LPs based in Asia stated their private equity fund commitments had fallen short of their expectations, compared with just 10% in North America, 14% in Europe and none in economies based outside of these regions (Fig. 2.3).

Fig. 2.1: Investors' Returns Expectations for Their Private Equity Portfolios, June 2012 - June 2014



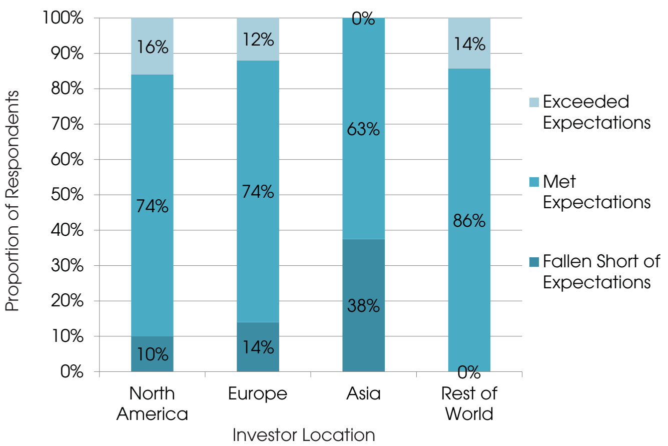
Source: Preqin Investor Interviews, June 2012 - June 2014

Fig. 2.2: Proportion of Investors that Feel Their Private Equity Fund Investments Have Lived up to Expectations, June 2012 - June 2014



Source: Preqin Investor Interviews, June 2012 - June 2014

Fig. 2.3: Proportion of Investors that Feel Their Private Equity Fund Investments Have Lived up to Expectations by Investor Location



Source: Preqin Investor Interviews, June 2014

Investor Activity in H1 2014

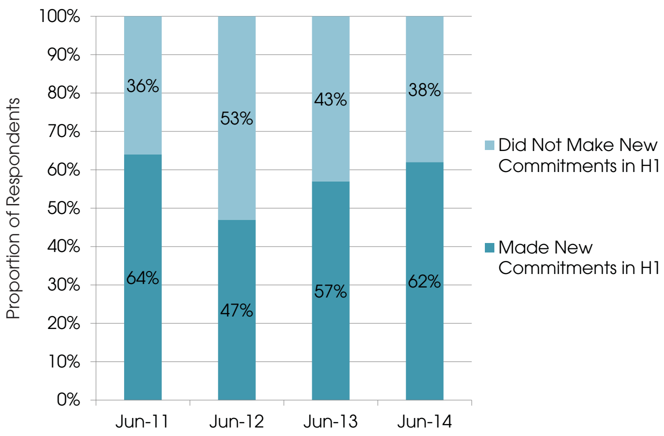
As the amount of capital raised by fund managers and the level of private equity dry powder has grown, what has 2014 seen so far in terms of investor activity?

As the private equity asset class enjoys a favourable fundraising climate, Preqin's recent survey reveals an uptick in investor activity at the half-year mark. A considerable 62% of respondents made a commitment to a private equity fund during the first half of the year, a notable increase from 47% of LPs interviewed in June 2012 and 57% interviewed in June 2013 (Fig. 2.4). The rise in the proportion of investors making new commitments signals renewed confidence in the asset class, as it rides on the back of an acceleration in global economic growth.

The majority of investors across all regions made new commitments in H1 2014. Asia leads the pack as the most active region for investors, with a significant three-quarters of the Asia-based LPs we interviewed having already committed to a private equity fund in H1 2014 (Fig. 2.5). North America follows closely behind, with 65% of LPs based in the region having made new investments over the same time period. European investors have adopted a seemingly more cautious approach when making new commitments, with 56% of LPs from the region having made new commitments over the same time period, which could be attributed to EU-specific regulatory changes such as Solvency II. While a lower proportion of respondents based in Europe and Rest of World made new commitments than was seen among LPs in North America and Asia, the respective figures of 56% and 57% still reflect the overarching trend of robust private equity investor activity and positive sentiment in H1 2014.

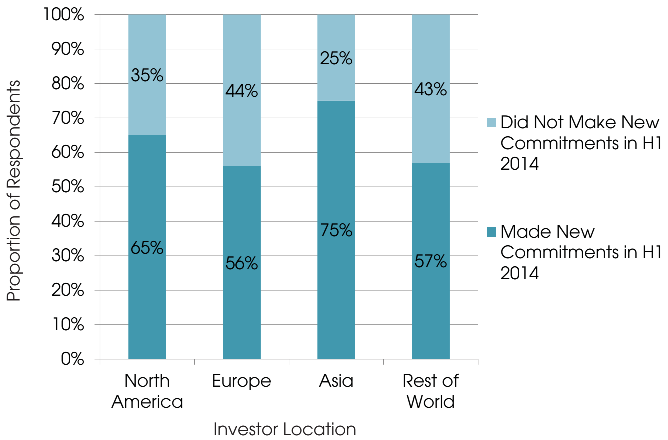
Fig. 2.6 indicates that 44% of institutional investors interviewed are currently below their target allocation to private equity, while 49% are at their target and 7% are above their desired allocation. Encouragingly, this suggests that 93% of investors are likely to continue to make new commitments to private equity funds in the near future in order to maintain or build towards their target allocations to the asset class.

Fig. 2.4: Proportion of Investors that Made New Private Equity Fund Commitments in H1, June 2011 - June 2014



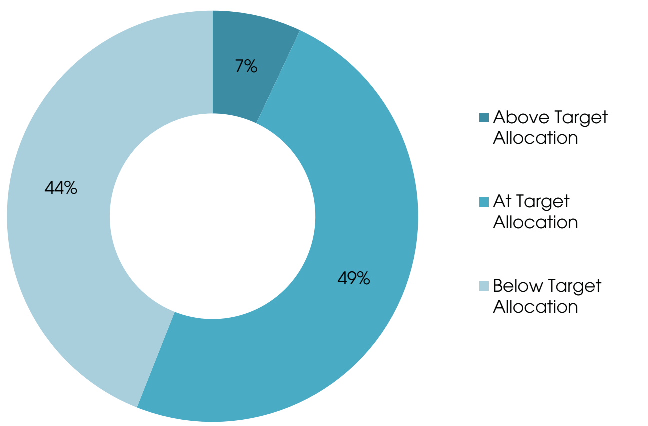
Source: Preqin Investor Interviews, June 2011 - June 2014

Fig. 2.5: Proportion of Investors that Made New Private Equity Fund Commitments in H1 2014 by Investor Location



Source: Preqin Investor Interviews, June 2014

Fig. 2.6: Proportion of Investors At, Above, or Below Their Target Allocations to Private Equity



Source: Preqin Investor Interviews, June 2014

Investor Activity in the Coming Year and the Longer Term

Recent regulatory changes and unrest in certain parts of the world could have short- and long-term effects on the global financial market. Preqin's recent investor survey revealed private equity LPs' investment plans for the next 12 months and into the longer term.

Largely, investors are showing increased interest in the private equity asset class, despite the restrictions placed on certain investors as stipulated by recent regulatory changes from the Volcker Rule, and economic uncertainty in the world's financial markets following unrest in parts of the world such as Eastern Europe and the Middle East. The survey conducted by Preqin in June 2014 indicates that 67% of investors are either actively seeking to make new commitments to the private equity asset class in H2 2014 or sometime in 2015 (Fig. 2.7). Only 7% of investors interviewed do not anticipate making any investments before at least 2016. Fund managers seeking capital should see these results as a clear indication that despite economic uncertainties, investors are still actively looking to make commitments to private equity.

New GP Relationships

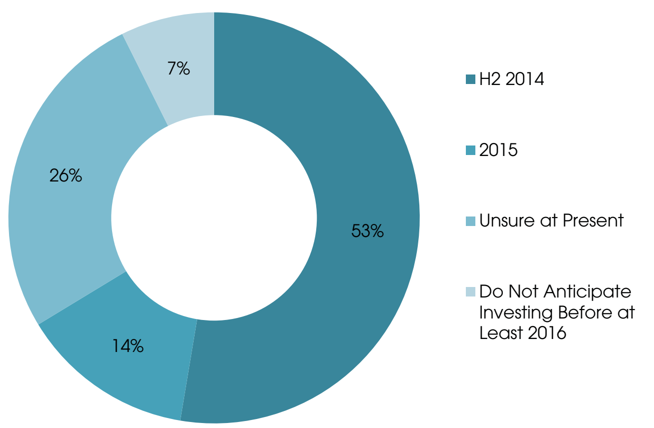
Preqin's direct conversations with investors around the world demonstrate that LPs generally seem content with their existing fund managers, with 97% looking to re-up with existing managers in varying proportions in the next 12 months. While a large proportion of investors feel secure with their existing fund managers, 83% will also consider forging relationships with new GPs. Past performance and strategy seem to be the most important factors when considering which managers to commit capital to, each stated by 32% of respondents.

Allocations in the Next 12 Months and Longer Term

Interviews with investors also revealed that the majority plan to either maintain or increase their current allocation to private equity in the next 12 months, as cited by 87% of respondents (Fig. 2.8). Results were even more positive for the asset class in the longer term, with nearly 91% of respondents stating that they anticipate either increasing or maintaining their current allocation to private equity. Only 13% and 9% of investors expect to allocate less capital to private equity in the next 12 months and longer term respectively.

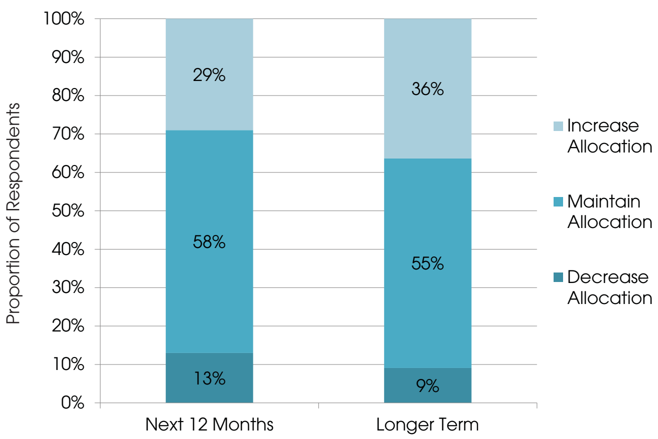
Despite the external factors affecting financial markets, as mentioned previously, investors' plans in relation to increasing and maintaining private equity allocations appear to have remained constant. In June last year, 92% of investors planned to increase or maintain their private equity allocations over the following 12 months, while 85% expected to do so over the longer term. This positive trend of growing investor appetite shows little sign of stopping, and such continuation will be encouraging for any private equity fund manager coming to market with a new offering this year and beyond.

Fig. 2.7: Investors' Timeframe for Their Next Commitments to Private Equity Funds



Source: Preqin Investor Interviews, June 2014

Fig. 2.8: Investors' Intentions for Their Private Equity Allocations



Source: Preqin Investor Interviews, June 2014

Strategies and Geographies Targeted

Investor appetite for small to mid-market buyout funds remains strong, while appetite for secondaries vehicles is at an all-time high. Preference for established markets, coupled with the trend of many LPs gravitating towards investing in their domestic regions, continue to create a shortfall for emerging markets.

Fund Type Preferences

Small to mid-market buyout funds continue to be perceived as presenting the best opportunities in the current financial climate. The majority (59%) of investors interviewed are actively seeking to invest in these types of vehicles over the coming year (Fig. 2.9). Large to mega buyout funds and secondaries vehicles were the next most favoured fund types, with almost a third of investors looking to invest in these types of vehicles in the next 12 months. This is the highest level of investor appetite for secondaries vehicles seen from Preqin's investor surveys to date, in line with the ever-increasing deal volume seen in the secondary market.

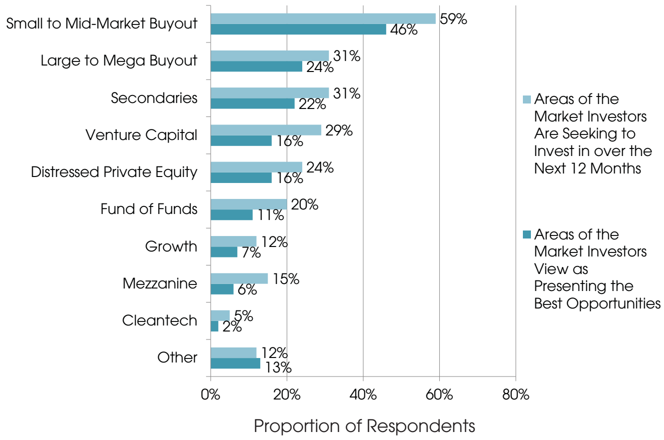
Appetite for First-Time Funds

First-time funds can be a risky choice for investors given the GP's lack of prior investment experience and proven track record, so it is unsurprising that a significant proportion (43%) of investors interviewed choose to not invest in first-time funds, and 13% would only consider a spin-off vehicle. It should be noted, however, that a greater proportion of investors are willing to commit to first-time funds in 2014 compared to 2013. Last year, 37% of investors stated they would consider investing in a first-time fund, compared with 44% this year.

Geographic Preferences

Preqin's interviews revealed which regions are currently most attractive for private equity investors and shows that North America-based (48%) and Europe-based (82%) LPs show a strong preference for their respective domestic regions (Fig. 2.10). Fig. 2.10 further illustrates how these two markets are also highly favoured by investors in other parts of the world.

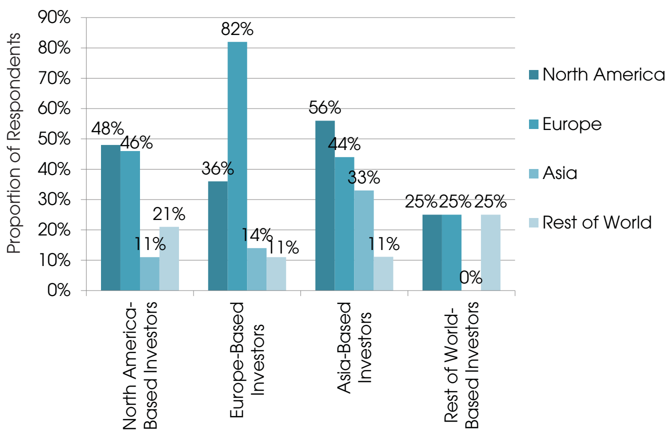
Fig. 2.9: Investor Attitudes towards Different Fund Types at Present*



Source: Preqin Investor Interviews, June 2014

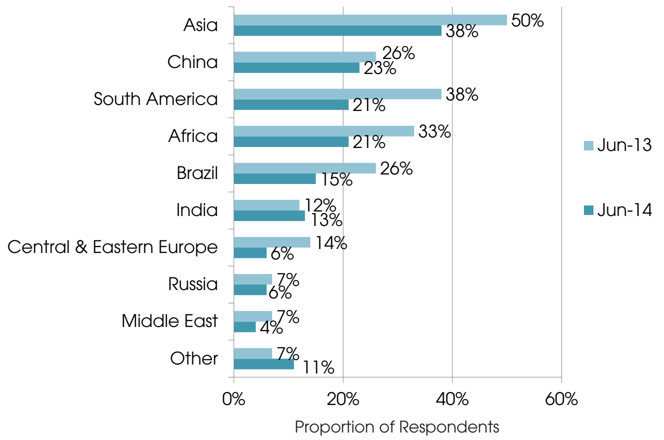
Fig. 2.11 compares investors' views regarding countries and regions within emerging markets thought to be presenting the best opportunities in June 2013 and June 2014. Shifts in opinions are apparent; though Asia continues to take the lead as in previous years, there has been a significant decrease in the proportion of investors that consider the region to be presenting the best investment opportunities, from 50% to 38%. Other than India, which saw a single percentage point increase, all emerging market regions and countries have experienced a decline in investor interest in the past year. This is likely a result of rejuvenated appetite for established markets, as those economies regain strength following the financial crisis.

Fig. 2.10: Regions Found Attractive by Private Equity Investors by Investor Location



Source: Preqin Investor Interviews, June 2014

Fig. 2.11: Countries and Regions within Emerging Markets that Investors View as Presenting the Best Opportunities*



Source: Preqin Investor Interviews, June 2013 - June 2014

**Respondents were not prompted to give their opinions on each region/fund type individually but to name those they felt best fit these categories; therefore, the results display the regions/fund types at the forefront of investors' minds at the time of the survey.*

Key Issues and Regulation

Preqin's recent survey exposed regulation, fees and transparency as some of the most prevalent issues investors face while seeking to operate an effective private equity portfolio at present. This year, other issues such as too much dry powder and surplus of capacity were cited by a notable number of LPs.

Regulation

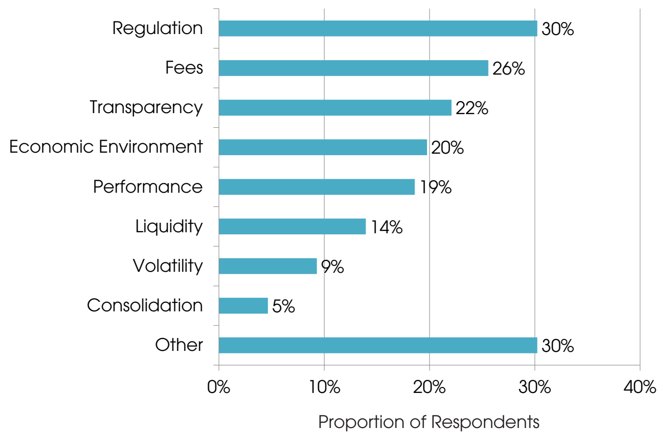
With the passage of the Alternative Investment Fund Managers Directive (AIFMD) deadline, and regulations such as Solvency II, Basel III and the Volcker Rule coming into force, regulatory changes have the potential to considerably impact investors' private equity portfolios. A Finland-based insurance company told us: "Regulation is a source of confusion and it causes the market to fluctuate." Forty-nine percent of LPs surveyed by Preqin stated they were unsure whether the recently announced regulations are good for the private equity industry.

Theoretically, the four aforementioned directives will predominantly affect investor activity in the world's more established markets of North America and Europe. However, in reality, Preqin's survey results show that a relatively small proportion of private equity investors have been affected by the regulations, with only 7% of institutional investors having already reduced their allocation to private equity as a result, and just 4% considering reducing their allocation in the future (Fig. 2.12).

Key Issues

Fig. 2.13 shows that almost a third (30%) of LPs have concerns other than the more common issues of regulation, transparency and fees within private equity, with one US endowment stating: "There is too much dry powder; fund managers are unable to deploy capital raised without a negative impact on returns". This was a view held by several survey respondents. Political issues were also mentioned as another cause for concern. In comparison to June 2013, when 30% of investors surveyed believed the economic environment to be a key issue in private equity, only 20% of institutional investors now believe this is still an issue, a signal of the market's progressive recovery from economic recession.

Fig. 2.13: Biggest Challenges Facing Investors Seeking to Operate an Effective Private Equity Program at Present



Source: Preqin Investor Interviews, June 2014

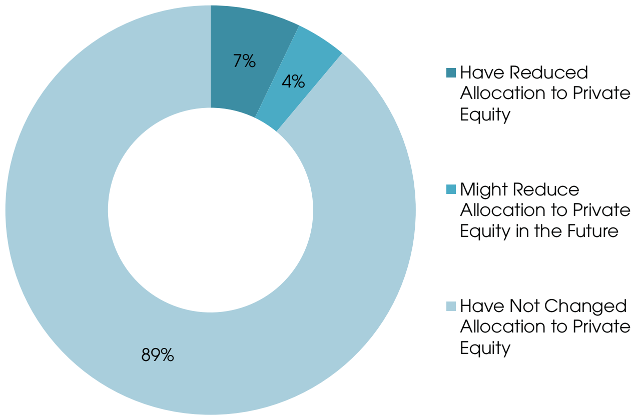
Despite regulation and a number of other factors being key areas of concern for many private equity investors, over half (51%) of LPs surveyed have a positive opinion of private equity and only 10% perceive the industry negatively (Fig. 2.14).

Interested in Accessing Free Data and Research Tools?

Preqin's **Research Center Premium** is a free online service providing access to up-to-date charts and league tables, research reports and newsletters, fund performance benchmarking tools and slide decks from recent Preqin presentations at conferences.

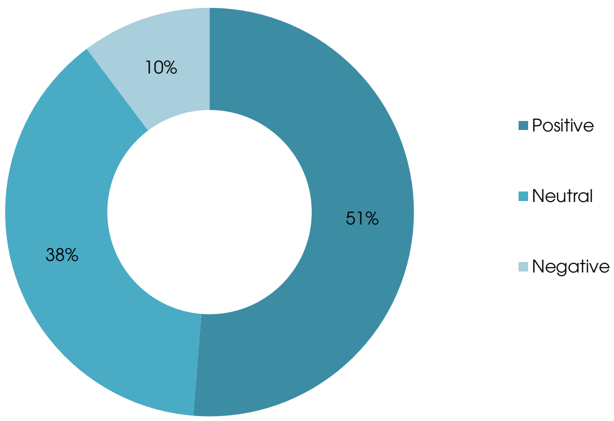
For more information, please visit: www.preqin.com/rcp

Fig. 2.12: Impact of Regulatory Changes and Proposals on Investors' Private Equity Allocations



Source: Preqin Investor Interviews, June 2014

Fig. 2.14: Investors' General Perception of the Current Private Equity Industry



Source: Preqin Investor Interviews, June 2014

Fees and Alignment of Interests

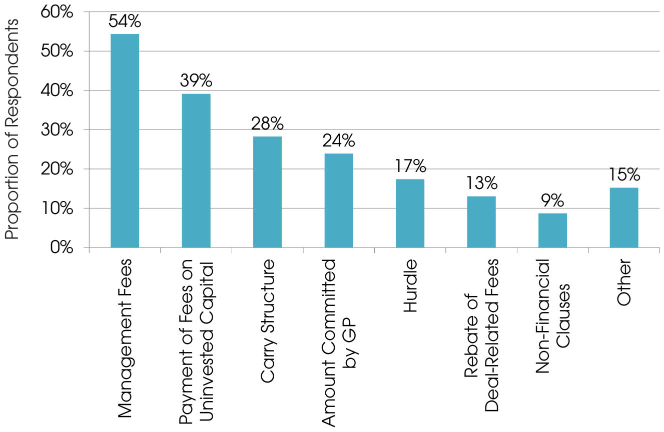
There has been a notable rise in the proportion of private equity investors that are dissatisfied with GP-LP relations. In light of this, we highlight key fund terms and conditions that LPs believe need to be amended, and investigate LP intentions for the number of fund managers they will seek to work with in the future.

As with last year's result, the latest investor interviews carried out by Preqin reveal that the majority of investors in private equity still believe that LP and GP interests are appropriately aligned, with 63% stating they either agree or strongly agree (Fig. 2.15). However, for the remaining 37%, there is lack of confidence in the alignment between fund manager and investor. In Preqin's last survey conducted in December 2013, only 23% of investors showed dissatisfaction with GP-LP relations. Given this significant 14 percentage point increase in the proportion of investors that disagree that there is alignment, attention should be given to improve the GP-LP relationship.

Fig. 2.16 illustrates the fund terms in which investors believe LP and GP relations could be improved. Management fees continue to be named by the largest proportion of investors (54%) as an area of fund terms that needs improving. Interestingly, the payment of fees on uninvested capital has become far more prevalent among investors over the last 12 months; 39% stated this as an important area for improvement in June 2014, compared to just 6% in June 2013. The amount of capital committed by GPs remains an area of concern, with almost a quarter of investors (24%) citing this as an area that needs adjustment in order to better align LP and GP interests. This proportion has, however, fallen by 11 percentage points since this time last year, suggesting a marked improvement over the course of the last 12 months.

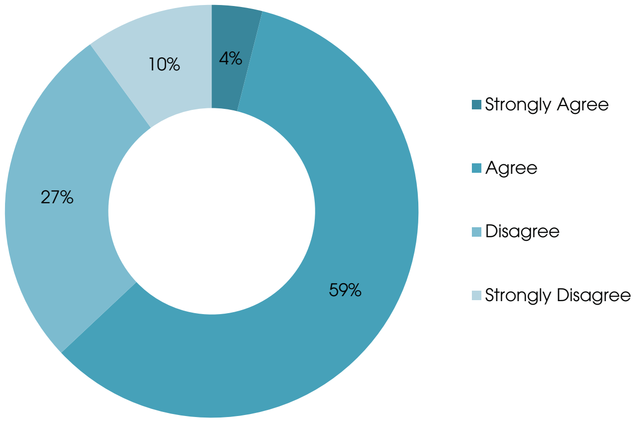
Fifteen percent of investors interviewed in June 2014 stated they would be looking to reduce manager relationships over the next two years, but a more sizeable 39% indicated that they would look to increase the number of GP relationships in their portfolios (Fig. 2.17). This increase is likely to have been driven by a desire from investors to diversify their portfolio and gain exposure to strategies and geographies that they otherwise would not have achieved with their existing fund managers.

Fig. 2.16: LPs' Views on Areas of Fund Terms and Conditions Where Alignment of Interests Can Be Improved



Source: Preqin Investor Interviews, June 2014

Fig. 2.15: Proportion of LPs that Believe LP and GP Interests Are Properly Aligned



Source: Preqin Investor Interviews, June 2014

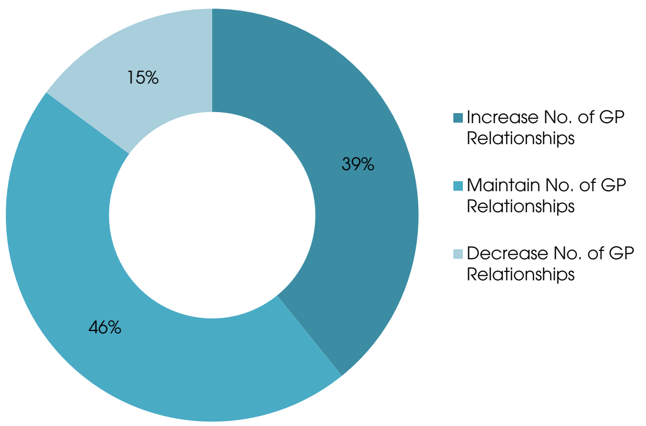
In-Depth Private Equity Fund Manager Data

Preqin's **Fund Manager Profiles** contains detailed information for over 7,800 private equity fund managers. Access league tables of the most prominent fund managers, performance track records, investment preferences, known investors, key contact details, and much more.

For more information, please visit:

www.preqin.com/fmp

Fig. 2.17: Investors' Intentions for GP Relationships over the Next Two Years



Source: Preqin Investor Interviews, June 2014

Alternative Methods of Accessing the Asset Class

With the continued growth and maturity of the private equity industry, investors are increasingly exploring new ways to access the asset class, prompting increased interest in separate account mandates, direct investments, and the secondary market.

Separate Accounts

Separate accounts are becoming increasingly important within the private equity space. A significant number of institutional investors are recognizing the benefits of investing via separate accounts and are utilizing the vehicles in asset allocation and diversification strategies, consequently allowing them to attempt to reduce risk and add value to their portfolios. Twenty-two percent of the LPs Preqin interviewed in June 2014 were investing in separate account vehicles, an increase on the 19% of institutional investors from the same time last year. Signalling a healthy long-term trend, over two-thirds of investors from the latest survey (68%) that currently use separate accounts stated that these commitments will become a permanent part of their investment strategy (Fig. 2.18). Furthermore, of those investors that do not currently invest through separate accounts, 27% will be looking to add these vehicles into their private equity portfolios, or will consider doing so.

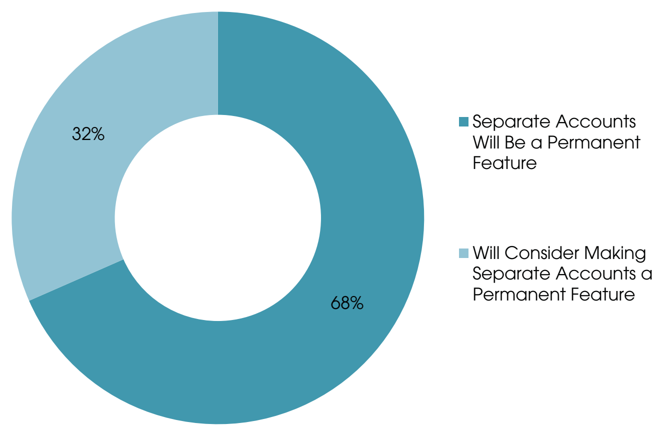
Direct Investments

Institutional investors are increasingly recognizing the benefits associated with direct investments and co-investments. In the year ahead, many LPs plan to continue investing via these methods, complementing their existing private equity portfolios and often gaining from the advantages associated with investing alongside their fund managers. Of the LPs interviewed, 25% invest directly in portfolio companies on a proprietary basis, which is a notable decrease from 40% this time last year. However, over half (52%) of LPs interviewed that already invest directly intend to increase their direct investment activity in the next 12 months. Thirty-six percent of the investors surveyed currently co-invest alongside GPs in their portfolio companies, which is a small growth from the corresponding 34% stating the same this time last year. The increase in appetite for direct and co-investments, particularly among those LPs that already invest directly, suggests a more sophisticated LP community, with greater capabilities to capitalize on the benefits direct investments and co-investments can offer an investor.

Secondary Market

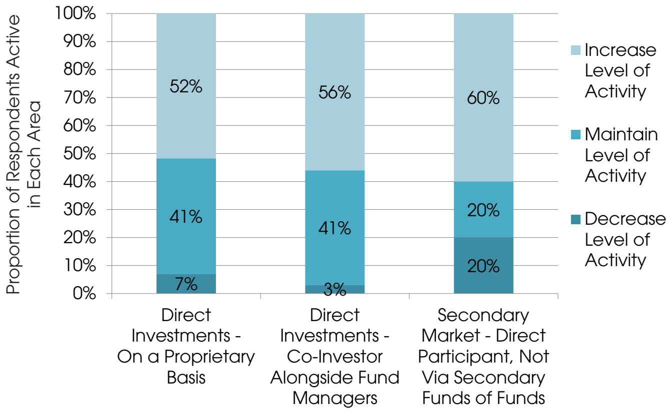
Many institutional investors see the secondary market as an appealing way to access the asset class, with activity in buying and selling fund interests continuing to rise. Such investments can offer several advantages to LPs, including the opportunity to purchase interests at a discount to NAV and mitigate the J-curve effect. Fig. 2.19 shows that 20% of investors active on the secondary market stated they would maintain their level of activity, and a further 60% plan to increase their activity on the secondary market. The latter is notably higher than the 40% of secondaries investors that stated the same this time last year. These statistics give a clear indication that investor confidence in this method has grown, and suggest an imminent rise in LP activity on the secondary market, a continuation of the upward trend seen in recent years in the private equity industry.

Fig. 2.18: LPs Investing in Separate Accounts: Proportion that Expect Separate Accounts to Be a Permanent Feature of Their Private Equity Portfolios



Source: Preqin Investor Interviews, June 2014

Fig. 2.19: Investors' Expectations of Their Direct Investment and Secondary Market Activity in the Next 12 Months



Source: Preqin Investor Interviews, June 2014

Hedge Funds

A More Volatile Start to 2014 but Investors Remain Positive

In the previous Preqin investor study in December 2013, investor satisfaction with hedge fund performance was at record levels. An inconsistent start to 2014, with the Preqin All Hedge Fund Benchmark up three months and down three months, has reduced satisfaction; however, with 72% of investors believing hedge fund returns to have at least met expectations, the majority of investors appear confident that hedge funds are meeting portfolio objectives. Investors have specified that their main objectives from their hedge fund investments are uncorrelated returns, absolute returns in all markets and robust risk-adjusted returns; generally hedge funds have been successful at meeting these objectives and the vast majority of investors retain confidence in the asset class.

Performance does however remain the most commonly cited key issue by investors when considering the outlook for the industry; there has been an increase in the number of investors concerned about fees, which tends to be the case in spells of more muted performance. Other key issues are transparency and regulation; with the AIFMD being formally introduced on 22 July 2014 and other regulations developing, investors seem to have a greater demand for regulated products. This is driving growth in appetite for liquid alternatives, with more than half of surveyed investors currently allocating or considering allocating to alternative mutual funds or UCITS hedge funds in the future. Managed accounts are also becoming more prominent due to their ability to offer investors greater transparency and more control.

Despite the concerns highlighted above, the vast majority of investors plan to maintain or increase their hedge fund allocation over both the next 12 months and the longer term. This is positive for the industry and suggests that there should be a net increase in hedge fund allocations over the coming year. A range of strategies, structures and geographies will be targeted as investors continue to seek increased diversification; however, it is long/short equity, macro and event driven funds which seem to be most in favour with investors. Several different groups of investors will contribute to these allocations but it is public pension funds and private wealth firms that are currently the most significant allocators to hedge funds.

Preqin conducted detailed interviews with around 100 institutional investors in July 2014 in order to assess their current attitudes towards hedge funds and their outlook for the industry. This included asking their opinion on issues such as performance, regulation, fund selection, asset allocation and fund structures, and here we present a detailed analysis of the key topics affecting hedge fund investors in H2 2014 and beyond.

Key Facts

72% of investors believe that hedge fund returns met or exceeded expectations over the previous 12 months.

89% of investors plan to maintain or increase their hedge fund allocation over the next 12 months.

47% of investors believe that additional regulations are positive for the hedge fund industry.

41% of investors believe that North America is currently presenting good hedge fund investment opportunities.

29% of investors stated that strategy is the most important factor when selecting a hedge fund manager.

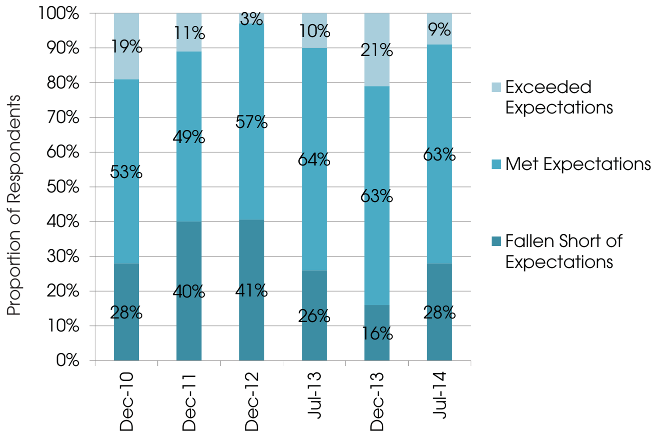
53% of investors in liquid alternatives stated additional liquidity as a key reason for investing in these funds.

Satisfaction with Returns

In December 2013, investor satisfaction with the performance of hedge funds was at its highest level since Preqin began conducting this study in 2008. However, volatile performance in the first half of 2014 has led to reduced investor satisfaction, with managers under renewed pressure to meet investor objectives.

2014 got off to a disappointing start in terms of hedge fund performance, and this led to a decrease in investor satisfaction with returns between December 2013 and July 2014. Investors were asked if they felt hedge fund performance had met their expectations over the previous 12 months, and 28% of respondents indicated that returns had fallen short of their expectations, a 12 percentage point increase from December 2013 (Fig. 3.1). The majority of investors are looking for hedge funds to deliver attractive risk-adjusted returns over the longer term, and as a result, their faith in these investments is not affected by short-term fluctuations in performance. However, the reduction in investor satisfaction highlights the fact that some investors are concerned by the volatile start to the year, which saw the Preqin All Hedge Fund Benchmark suffer a loss in three of the first four months of 2014. The level of investor satisfaction at this point is more positive than it was in both December 2011 and December 2012, and managers will be looking to post more consistent returns in the second half of 2014 in order to meet the portfolio objectives of investors.

Fig. 3.1: Hedge Fund Portfolio Performance Relative to Expectations of Institutional Investors, 2010 - 2014



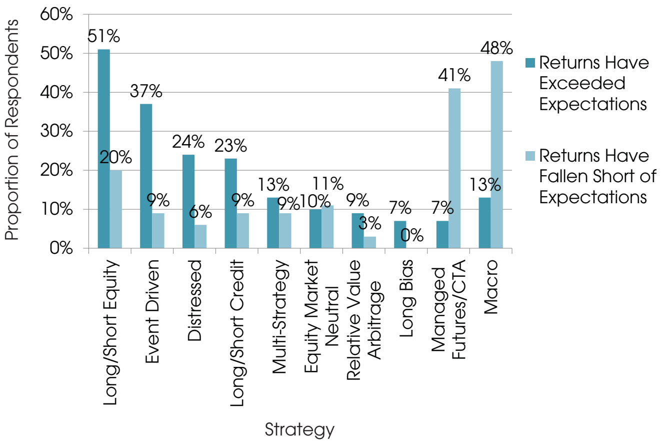
Source: Preqin Investor Interviews, December 2010 - July 2014

Fig. 3.2 shows the specific investment strategies that investors believe exceeded or fell short of expectations over the past 12 months. Long/short equity was the most cited as having outperformed compared to investor expectations, mentioned by 51% of respondents. However, 20% of investors felt that the returns of long/short equity funds had not met expectations, highlighting the diversity of the long/short equity universe, which includes funds focused on different regions, markets and sectors. Event driven strategies have formed the best performing strategy category over the previous 12 months, and event driven and distressed were the next most positively viewed by investors, cited by 37% and 24% of investors respectively as having outperformed.

Macro strategies funds and CTAs have continued to struggle to meet the expectations of institutional investors, with 48% and 41% of investors respectively stating that these strategies had fallen short of expectations. These strategies have underperformed other hedge fund approaches such as long/short and event driven strategies over the previous 12 months and, although investors are attracted to these strategies due to their potential to provide uncorrelated returns, some investors clearly feel that they are not meeting portfolio objectives.

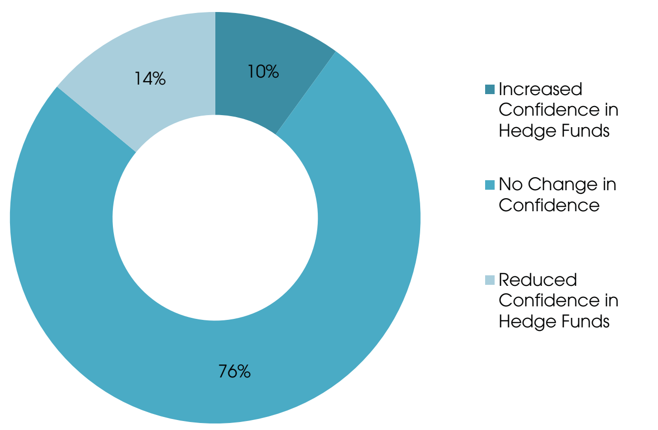
Despite this reduction in investor satisfaction with performance, overall confidence in hedge funds has remained relatively unchanged over the past 12 months; 76% of respondents said there has been no change in their confidence in hedge funds to meet portfolio objectives (Fig. 3.3). Of those investors that did report a change in confidence, there were slightly more reporting a decrease in confidence in hedge funds (14%) than an increase (10%).

Fig. 3.2: Hedge Fund Portfolio Performance Relative to Expectations over the Last 12 Months by Strategy



Source: Preqin Investor Interviews, July 2014

Fig. 3.3: Change in Investor Confidence in Hedge Funds over the Last 12 Months



Source: Preqin Investor Interviews, July 2014

Key Issues and Regulation

Regulation has come back into the limelight in the second half of 2014 as the 22 July registration deadline for the AIFMD has now passed. However, this is not the only issue affecting institutions today; the first half of 2014 has been a bumpy one for hedge funds and their investors with as many months in the red as in the black. We look at what investors see as the key issues for the industry in the second half of the year, and how they view the recent regulations that have been passed into global law.

Key Issues Facing the Industry in H2 2014

Consistent with our findings in similar previous studies of hedge fund investors, performance was ranked the leading key issue in the hedge fund industry today by the investors that participated in this study (Fig. 3.4). In light of a start to the year which has seen the monthly hedge fund benchmark in negative territory as many times as it was in positive territory, this concern around performance is somewhat understandable. However, as our report "Investing in Hedge Funds: All About Returns?" shows, institutional investors are committed to investing in hedge funds for the long term, and short term bumps in performance numbers can be tolerated if longer term performance objectives, on a risk-adjusted basis, can be met.

In addition, fees and transparency are other key issues which investors face in the industry today. In light of recent volatile performance, investors will be looking for managers to continue to communicate transparently regarding what is driving any short-term performance issues of their strategy. Alongside this, investors will be keeping a close eye on the industry over the second half of the year in the hope that a longer stretch of positive performance returns to the asset class in order to allay any concerns surrounding first half performance.

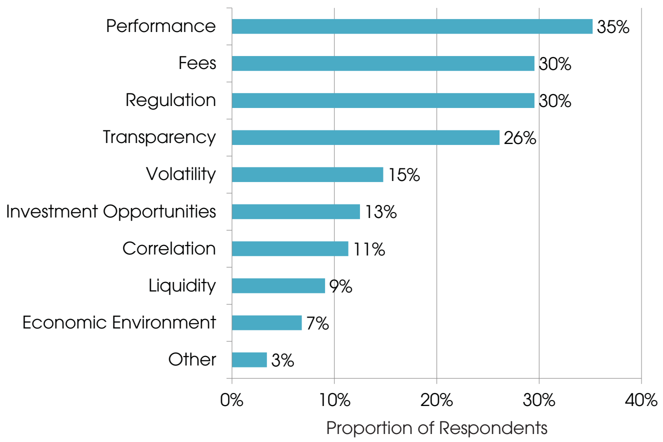
Investors have been calling for fee structures in the industry to change for many years; however, in times of relatively poor performance, the calls for fees to be aligned more closely with investor interests become more vocal. In general, investor satisfaction with the returns of hedge funds has dipped from a high we saw at the end of 2013, and it is likely that investors will be paying close attention to the management and performance incentives on funds as long as these concerns persist.

Impact of Regulations on Hedge Fund Investors

The wave of regulation that has swept through the alternative assets industry over recent years is clearly something which investors are seeing as a key issue in the sector: 30% of the investors which participated in this study noted it as a key issue facing the industry today (Fig. 3.4), an increase from 24% which stated the same thing in December 2013. Nearly half (47%) of all investors interviewed by Preqin view the new era of regulation within the alternative assets sector as a positive improvement (Fig. 3.5). For these investors, benefits such as a new regulated standard for hedge funds, along with consistency in transparency of reporting, could help them in assessing quality managers and also provide a sense of security for their investments.

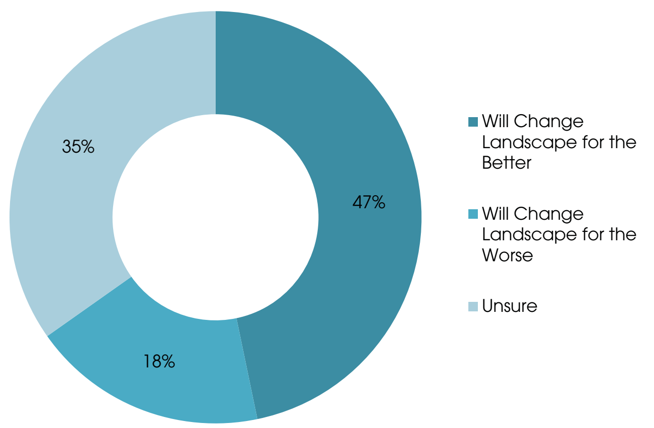
A large proportion of investors (35%) are unsure of the effect of regulation on the industry. Although some of the uncertainty around the final versions of these regulations has been resolved in the last 12 months, many fund managers are choosing to delay complying, especially in regards to the European Union's Alternative Investment Fund Managers Directive (AIFMD). As a result, many investors may be unsure of the final effect these regulations will have until the impact it has on their choice of fund managers becomes a clearer issue in the longer term. In addition, the regulatory landscape is much more complex than it was five years ago; investors are in the process of familiarizing themselves with the dozens of regulations which are affecting the industry across the globe. Institutions may not fully understand each of the regulations that will impact their portfolios and are therefore waiting for the full effects to play out before they decide whether these are positive or detrimental to the hedge fund sector.

Fig. 3.4: Key Issues Facing the Hedge Fund Industry According to Institutional Investors



Source: Preqin Investor Interviews, July 2014

Fig. 3.5: Investor Perception of the Effect of Regulation on the Hedge Fund Industry



Source: Preqin Investor Interviews, July 2014

Investor Activity in the Next 12 Months

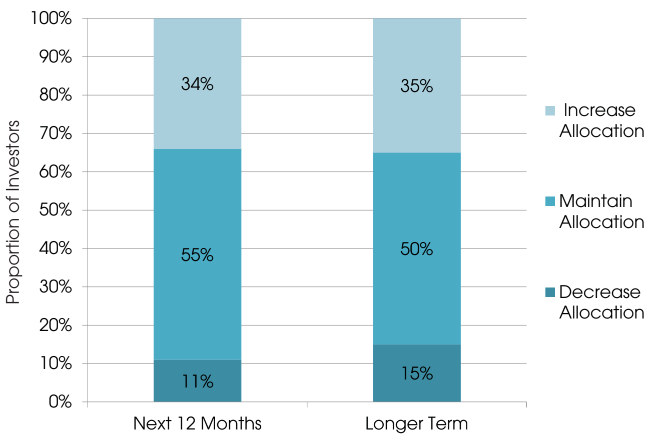
Despite a slight increase in dissatisfaction with hedge fund performance in the first six months of 2014, the majority of investors continue to value the benefits that hedge funds bring to their portfolios. Capital should continue to flow into the industry from the institutional community over the next 12 months, with the majority of investors planning to increase or maintain their hedge fund allocation.

The continued demand for hedge funds is highlighted by the fact that the vast majority (89%) of investors interviewed by Preqin plan to increase or maintain their allocation to hedge funds over the coming 12 months (Fig. 3.6). This shows that investors are generally satisfied with the role that hedge funds fulfil in their portfolios, and is likely to mean that many of these investors will be making new hedge fund investments during the rest of 2014 and beyond. Just 11% of respondents plan to decrease their allocation to hedge funds over the next 12 months. A similar pattern emerges when considering investor plans for hedge fund allocations in the longer term, with 35% expecting their hedge fund allocation to increase and 15% expecting it to decrease. Investors look set to keep faith with hedge funds over the next few years, providing a positive outlook for the industry which should result in a net increase in allocations to the asset class.

Fig. 3.7 illustrates the breakdown of the amount of capital institutional investors will be looking to commit to new hedge fund investments over the next 12 months. The majority (59%) of investors expect to allocate less than $50mn to new hedge fund investments, an increase of 10 percentage points from December 2013, which suggests that some investors are making smaller allocations to hedge funds than previously. However, 9% of investors will look to allocate more than $500mn over the next 12 months and it is these large investors that tend to be significant in driving inflows to the industry. For instance, one notable sovereign wealth fund revealed to Preqin that it plans to allocate around $1bn to new hedge fund investments over the next year.

Investors will be continuing to source new hedge fund investments, with activity varying from small investors making one new commitment to the largest investors allocating to more than 20 new funds over the course of the year. The majority of investors that are actively seeking new hedge fund investments will allocate to more than one fund, with 62% of investors planning to invest in at least three new funds over the next 12 months (Fig. 3.8). This highlights the fact that investors are looking to increase diversification and reduce risk across their portfolios.

Fig. 3.6: Investors' Intentions for Their Hedge Fund Allocations in the Next 12 Months and Longer Term



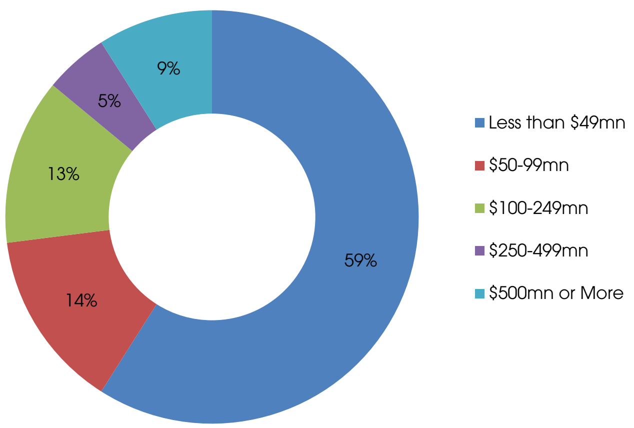
Source: Preqin Investor Interviews, July 2014

Looking to Source New Hedge Fund Investors?

Preqin's **Hedge Fund Investor Profiles** tracks over 4,500 active investors in hedge funds, including current and target allocations to hedge funds, strategy and geographic preferences, future investment plans and much more.

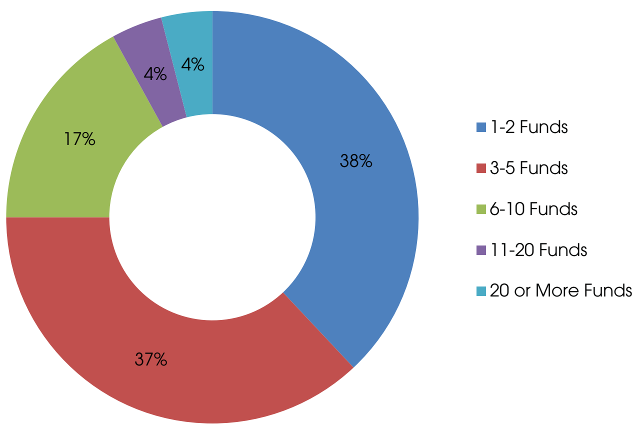
For more information, please visit: www.preqin.com/hfip

Fig. 3.7: Amount of Fresh Capital Institutional Investors Expect to Invest in Hedge Funds over the Next 12 Months (Investors that Plan to Be Active)



Source: Preqin Hedge Fund Investor Profiles

Fig. 3.8: Number of Hedge Funds Institutional Investors Expect to Add to Their Portfolios over the Next 12 Months (Investors that Plan to Be Active)



Source: Preqin Hedge Fund Investor Profiles

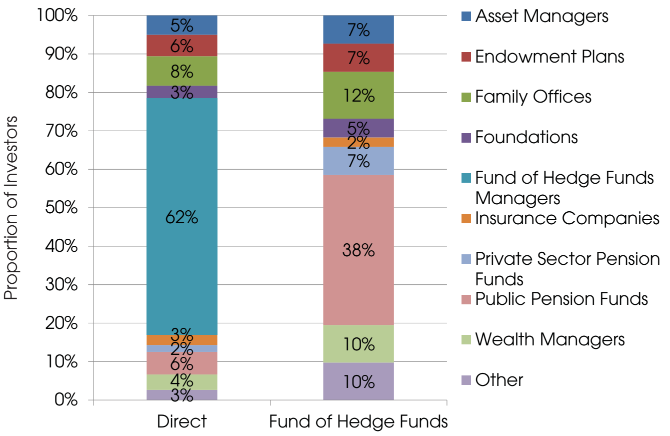
Strategies and Geographies Targeted

As indicated in the previous section, hedge funds are likely to continue to see a significant number of new commitments from institutional investors over the coming year. In this section, we assess which fund strategies, structures and geographies investors feel are presenting the best opportunities for new investment.

Investors include hedge funds in many different segments of their portfolios, and as a result, they tend to allocate to a diverse range of strategies. Using data from Preqin's Hedge Fund Investor Profiles, Fig. 3.9 shows the investment strategies which are being most targeted by investors over the next 12 months. Long/short equity continues to be the most sought after strategy, with 53% of investors looking to make new allocations to long/short funds over the coming year. Macro funds have underperformed over the previous year resulting in many investors being unsatisfied with the performance of these funds (See Satisfaction with Returns on page 18); however investors value the benefits macro funds can provide in terms of uncorrelated returns and 26% of current mandates include a macro component. Event driven strategies has been the best performing Preqin strategy category over the past few years and these funds have found favour with a number of investors; 19% of investor searches include event driven funds.

The majority of investors seeking new investments in hedge funds will be looking to allocate directly to single-manager hedge funds, with fund of hedge funds managers representing 62% of all current searches for direct hedge fund investments (Fig. 3.10). However, 27% of all searches (excluding those made by fund of hedge funds managers) include a search for funds of hedge funds, showing that there remains significant demand for the multi-manager structure. After a resurgence in 2013, private wealth firms (wealth managers and family offices) are continuing to allocate significant capital to hedge funds (representing 12% of all single-manager searches and 22% of all multi-manager searches). Public pension funds continue to drive inflows to the asset class; these firms represent 6% of single-manager searches and are the most receptive to fund of hedge funds structures, representing 31% of all multi-manager searches.

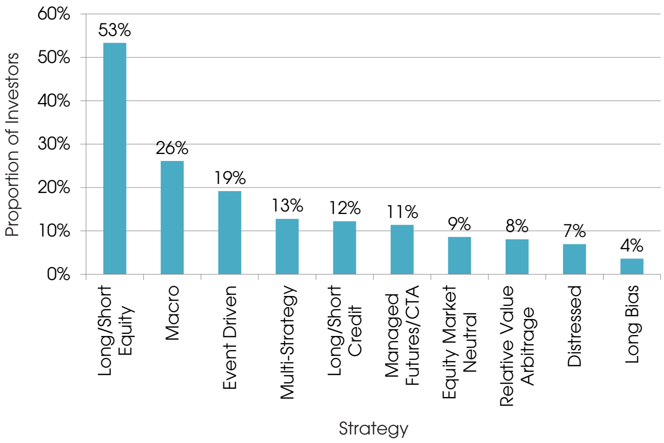
Fig. 3.10: Breakdown of Investors Searching for Direct Investments vs. Funds of Hedge Funds by Investor Type



Source: Preqin Hedge Fund Investor Profiles

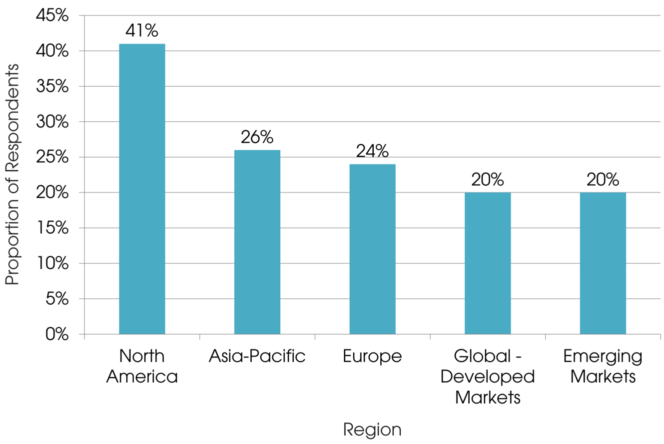
During the July interviews, Preqin asked investors about which regions they feel are presenting the best opportunities for hedge fund investment over the next 12 months. North America is the most established hedge fund region and it was also the leading regional hedge fund benchmark for the first six months of 2014. This is reflected in the highest proportion of investors (41%) believing North America to be presenting attractive investment opportunities for hedge fund investment (Fig. 3.11). Asia-Pacific was the leading regional benchmark in 2013 as a result of buoyant equity markets; however, performance in the first half of 2014 was more muted. Despite these relative performance struggles, Asia-Pacific was cited by 26% of respondents, making it the second most specified region.

Fig. 3.9: Hedge Fund Strategies Sought by Investors over the Next 12 Months



Source: Preqin Hedge Fund Investor Profiles

Fig. 3.11: Regions Investors Feel Are Presenting the Best Opportunities for Hedge Fund Investment over the Next 12 Months



Source: Preqin Investor Interviews, July 2014

Attracting Investor Capital

Investors take a number of factors into account when selecting hedge fund investments in order to ensure they are investing with the managers that are best suited to their objectives. Here we assess the key factors in manager selection, along with the return objectives of investors and key methods used when sourcing new hedge fund investments.

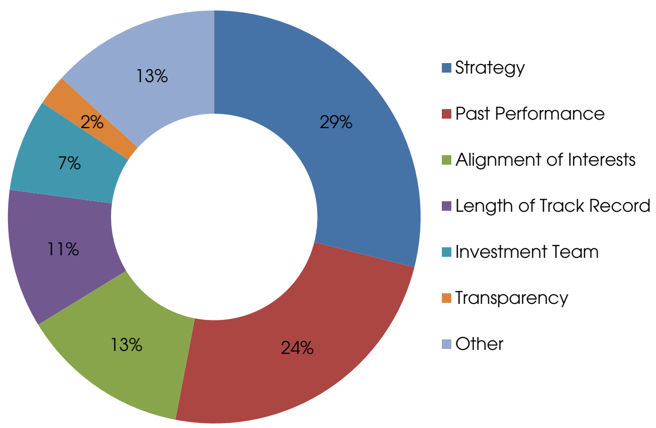
Key Factors in Manager Selection

Investors surveyed by Preqin were asked what they consider to be the single most important factor when selecting a hedge fund manager, with the results presented in Fig. 3.12. The largest proportion of investors (29%) stated that the strategy employed by a manager was the most important factor in fund selection, ahead of past performance (24%). This shows that investors want to see that managers have a viable and repeatable investment strategy and are placing greater importance on this than short term performance figures. Other important factors in the selection process are alignment of interests between investor and manager (cited by 13% of respondents as the key factor) and length of track record (11%), with investors looking for assurances that they are able to trust a manager with their capital before investing.

Return Objectives of Investors

Investors are looking for their hedge fund investments to perform a variety of functions, from producing uncorrelated returns through to risk mitigation (Fig. 3.13). The most frequent objectives stated by investors were returns that are uncorrelated to equity markets (cited by 59% of respondents), absolute returns in all markets (54%) and robust risk-adjusted returns (53%). However, producing high returns, a perception many outside of the industry believe is the domain of the hedge fund, is a priority for just a small proportion (7%) of the investors that participated in the Preqin survey. When investors were questioned further about what their single reason for recommending hedge funds would be, three key benefits came out time and time again – to reduce volatility, diversify risk premia and produce absolute returns.

Fig. 3.12: Key Factors Used by Institutional Investors to Evaluate Hedge Fund Managers

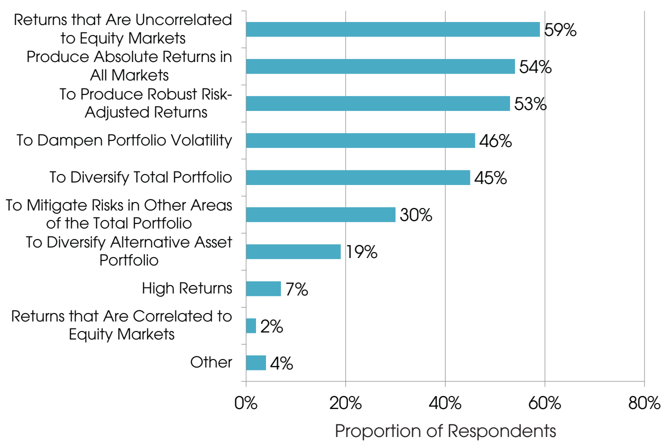


Source: Preqin Investor Interviews, July 2014

Methods of Sourcing Hedge Funds

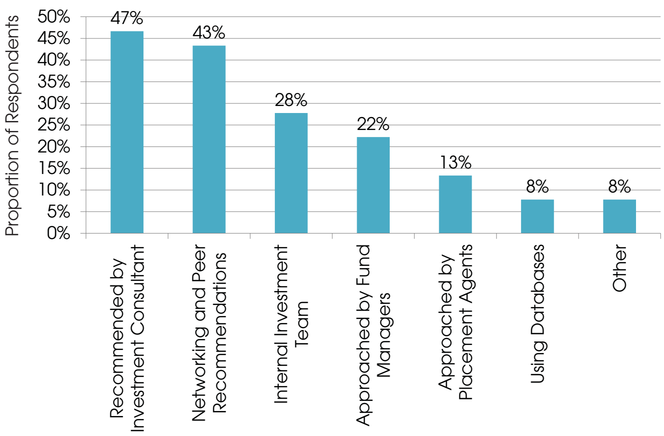
Institutional investors utilize a number of methods to source new hedge fund investment opportunities. Recommendation from investment consultants was the most mentioned method, with 47% of respondents stating that they use an outside advisor to identify hedge fund investments (Fig. 3.14). Smaller and less established investors, in particular, are likely to rely on the use of consultants as they may not have the knowledge or resources to manage a hedge fund portfolio internally. On the other hand, more established investors are likely to be able to conduct their own due diligence on managers and 28% of respondents stated that they rely on their own internal investment team. Industry events and conversations with fellow investors also play a big part in finding out about new managers.

Fig. 3.13: Key Objectives of Institutional Investors from Their Hedge Fund Portfolios



Source: Preqin Investor Interviews, July 2014

Fig. 3.14: Main Methods Used by Investors to Source New Hedge Fund Investment Opportunities



Source: Preqin Investor Interviews, July 2014

Alternative Fund Structures

As investors look for new ways to diversify their portfolios and gain maximum benefit from their alternatives allocation, we have witnessed a growth in investor appetite for liquid alternatives and managed account structures in recent years. In this section, we assess investor appetite for these funds and examine the reasons why investors are turning to these specialized structures.

In recent years, demand for greater liquidity and transparency among institutional investors has led to growing appetite for liquid alternatives and managed account structures. These fund structures offer investors an alternative to pooled hedge fund investments and help to make hedge fund strategies accessible to different investor groups that may have previously been unable to invest in the asset class. This special feature looks at investor attitudes towards these two approaches and assesses whether or not demand for these structures is likely to grow further in the future.

Liquid Alternatives

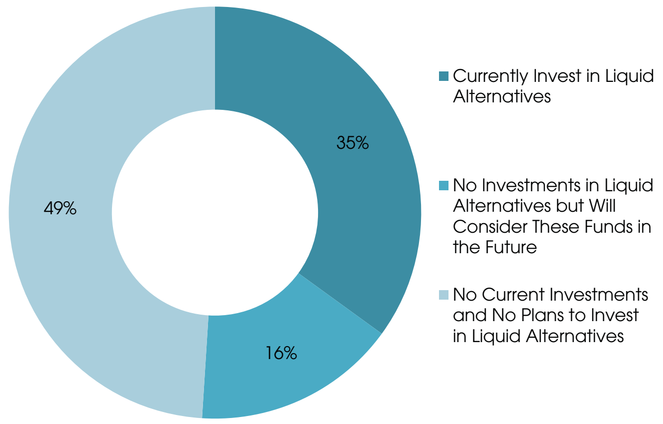
As shown in the Key Issues and Regulation section on page 19, regulation remains a key issue in the hedge fund industry and demand for increased regulation from investors is leading to a growth in appetite for liquid alternatives. Within Europe, UCITS-compliant funds have been a viable hedge fund investment approach for a number of years, with investors attracted to the increased liquidity, transparency and regulation that these funds can provide. A similar structure in the US, registered '40 Act' alternative mutual funds, has been growing in prominence in recent years, with these funds providing retail investors with the ability to gain exposure to hedge fund strategies in a mutual fund format. Of the investors surveyed by Preqin in July, 35% stated that they currently have an allocation to liquid alternatives (alternative mutual funds and/or UCITS-compliant hedge funds), while a further 16% of respondents stated that they were likely to consider these funds in the future (Fig. 3.15). With approximately half of all respondents either investing in liquid alternatives or willing to consider doing so in the future, there appears to be significant demand among investors for these regulated products.

Those investors that are interested in liquid alternatives were asked about their main reasons for allocating to these funds. The increased liquidity of these structures was cited as a key factor by more than half (53%) of those investors that invest in liquid alternatives (Fig. 3.16), as the liquidity terms of these funds are attractive to those investors that require access to capital on a regular basis; alternative mutual funds offer investors access to capital on a daily basis, whereas UCITS funds offer at least fortnightly liquidity. Increased transparency (cited by 31% of respondents) and increased regulation of these fund structures (28%) are also attractive characteristics for investors that are looking for assurances in terms of how their funds are investing. Nineteen percent of respondents mentioned lower cost as a factor, with alternative mutual funds and UCITS funds typically offering lower fee structures than hedge funds.

Managed Accounts

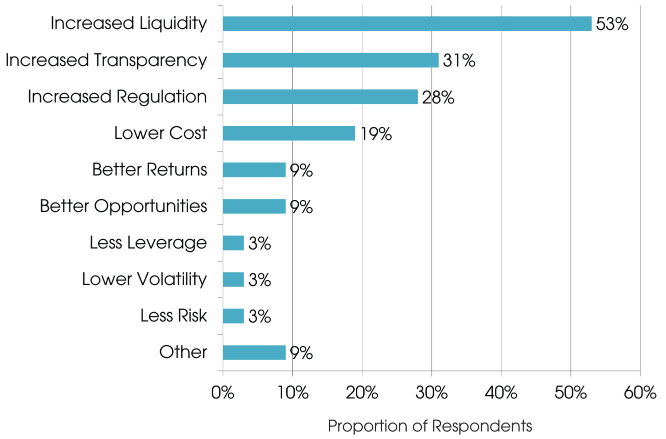
Investing via managed accounts is another method used by investors that are looking for more transparency and control over how their hedge fund capital is invested. Twenty-nine percent of surveyed investors stated that they include an allocation to hedge fund managed accounts, with the proportion of their hedge fund portfolios that are invested via managed accounts ranging from 5% to 100%. While the majority of investors reported that they had not changed their allocation to managed accounts in the previous 12 months (90%) and had no plans to change this allocation in the next 12 months (88%), there were more investors increasing the proportion they allocate to managed accounts than decreasing (Fig. 3.17). Seven percent of investors reported that they had increased their managed account allocation over the past year and 11% stated they planned to increase their allocation over the

Fig. 3.15: Hedge Fund Investor Allocations to Liquid Alternatives (Alternative Mutual Funds and UCITS Hedge Funds)



Source: Preqin Investor Interviews, July 2014

Fig. 3.16: Investors' Reasons for Investing in Liquid Alternatives

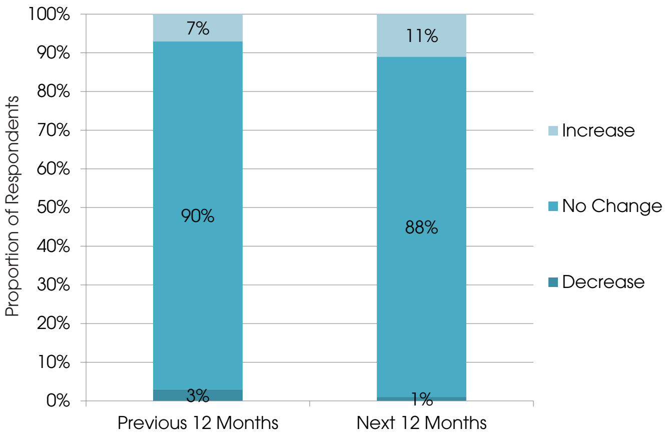


Source: Preqin Investor Interviews, July 2014

next year, compared to 3% and 1% that stated a decrease respectively. This shows that, while managed accounts remain a fairly niche aspect of hedge fund investing, they are becoming more prominent as investors look for more control over their investments.

Those investors that allocate to hedge funds via managed accounts were asked about their main reasons for investing through these structures, with the results presented in Fig. 3.18. Improved transparency was the most commonly stated factor, mentioned by 52% of respondents, as managed accounts provide investors with more information about where their capital is being invested. Improved liquidity (cited by 39% of respondents) is also a significant factor as managed accounts tend to allow investors more frequent access to capital than commingled fund structures. Some investors have a preference for investing through managed accounts due to the ability to create customized solutions, and the ability to impose guidelines and restrictions on managers was considered a key benefit of managed accounts by 26% of respondents.

Fig. 3.17: Investors' Changes to Managed Account Allocations over Previous 12 Months and Expected Change in Next 12 Months



Source: Preqin Investor Interviews, July 2014

Within the managed account category, investors can invest via a variety of different structures; a separately managed account gives an investor control over how the assets are invested, whereas a fund of one structure is a separate fund where the hedge fund manager retains control of the assets. Separately managed accounts were the more utilized of these two structures among respondents that have a managed account allocation, with 52% investing via this structure compared to 28% that invest via fund of one structures (Fig. 3.19). Another method of gaining access to managed accounts is to invest via a managed account platform; in this case, the platform negotiates terms with hedge fund managers to create a managed account product which is then offered to investors. This method is used by 44% of surveyed managed account investors, and managed account platforms can be attractive to investors that do not have sufficient resources to negotiate terms of managed accounts with individual managers.

Outlook

The Preqin investor survey highlights the growing prominence of liquid alternatives and managed account structures, with investors likely to increase their exposure to both of these structures over the coming year and beyond. Both of these methods of investing remain fairly niche in the overall context of hedge funds, but there is clearly the potential for both of these industries to significantly increase assets in the future. With these alternative fund structures typically offering increased transparency, liquidity, control and regulation, it will be interesting to see if appetite for traditional pooled hedge fund investing is affected by the corresponding growth in demand for these products.

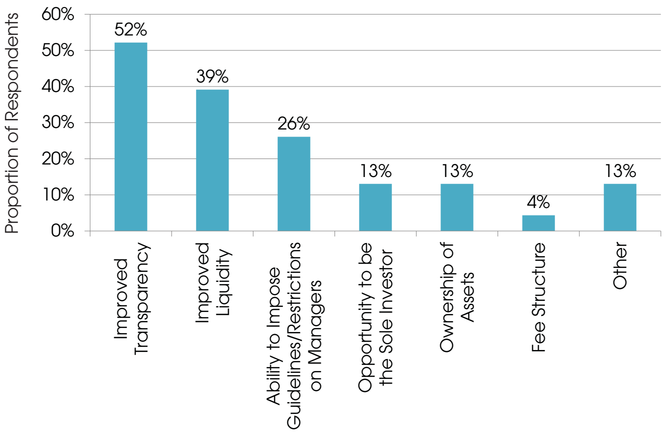
In-Depth Data: Liquid Alternative Funds

Preqin's **Hedge Fund Analyst** contains comprehensive information for 1,204 liquid alternative funds.

Detailed profiles include strategy and geographic preferences, investment methods employed, fund manager overview, terms and conditions, direct contact information and much more.

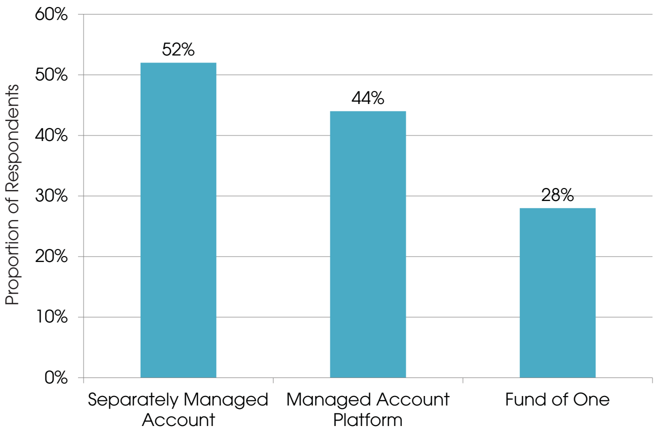
For more information, or to register for a demonstration, please visit: www.preqin.com/hfa

Fig. 3.18: Investors' Reasons for Investing in Hedge Funds via Managed Accounts



Source: Preqin Investor Interviews, July 2014

Fig. 3.19: Managed Account Structures Invested in by Institutional Investors



Source: Preqin Investor Interviews, July 2014

Real Estate

Investor Confidence Returning

Investor activity in private real estate picked up over the last 12 months, with 52% of institutions surveyed making commitments. However, activity continues to vary by institution size, with investors with greater assets under management considerably more likely to make commitments. Over the next year, larger investors are likely to continue dominating new allocations, with many small- to mid-size investors remaining wary of making new commitments.

In terms of capital, 29% of investors are intending to put more capital to work in the next 12 months than they did in the previous year, compared to just 18% which stated so six months ago; further positivity can be revealed through the fact that 63% of investors intend to invest in three or more funds, with 55% planning to commit $100mn or more.

Regionally, many investors continue to favour investing domestically, with Asia-based investors seeking the most geographic diversity. In terms of strategy, funds across the risk spectrum are sought by investors, with appetite both for core and value added funds particularly high.

Investors are now generally positive towards the asset class, with just under a third stating that returns had exceeded expectations in the last year, and many investors are looking to increase their allocation to the asset class.

However, while some investors plan to put sizeable amounts of capital to work, others remain cautious of making commitments to private real estate funds, with the economic environment highlighted by a large proportion of investors as a key issue in the current market, while others stated performance, availability of investment opportunities and liquidity as current problems.

Investors are also becoming more proactive in sourcing new opportunities, with many investment teams actively searching for attractive funds rather than waiting for fund managers to come to them, often through networking and peer recommendations, as well as through their investment consultants.

Key Facts:

52% of investors made commitments in the last 12 months to private real estate funds.

55% of active investors will commit $100mn or more to private real estate funds in the next 12 months.

29% of investors will commit more capital in the next 12 months than they did over the previous year.

32% of investors believe their real estate investments exceeded expectations in the last 12 months.

63% of active investors will commit to three or more funds in the year ahead.

41% of investors will increase their allocation to real estate in the longer term.

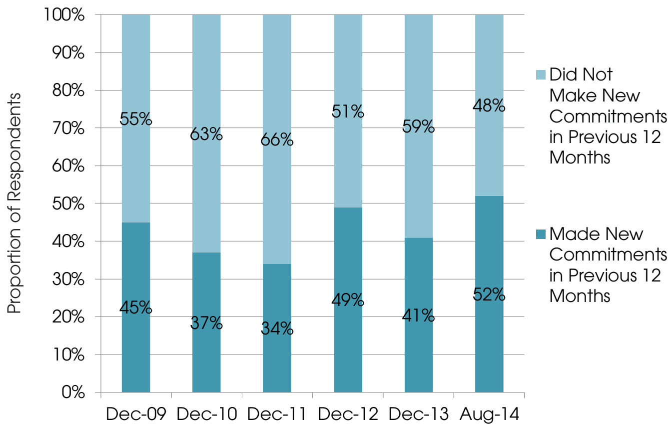
Investor Activity in the Last 12 Months

Investor activity picked up over the last year, with over half of institutions making commitments to private real estate funds, reflected in improving fundraising numbers. Although larger institutions were considerably more likely to have placed capital in the asset class, many investors committed to multiple funds.

Encouragingly, investor activity in private real estate funds has increased in the last 12 months, with Fig. 4.1 showing that 52% of institutions interviewed in August 2014 had committed to funds in the past year, representing an upward trend from the low of 2011, when just 34% of investors were active in the year. Increasing institutional appetite for real estate investment is reflected in improving fundraising data, with increasing amounts of capital raised. In H1 2014, a total of $43bn was raised by 80 funds reaching a final close, compared to $33bn raised by 112 funds in H1 2013.

However, there continues to be a clear distinction between larger and smaller institutions regarding their commitments to private real estate in the last 12 months. Seventy-six percent of investors with more than $10bn in total assets made fund investments within the last year, compared to 40% of those with less than $10bn under management (Fig. 4.2). A notable 71% of those that were active made one or two fund commitments in the last 12 months, while 29% added three or more funds to their portfolio (Fig. 4.3).

Fig. 4.1: Proportion of Investors that Committed to Private Real Estate Funds in the Previous 12 Months, December 2009 - August 2014



Preqin Investor Interviews, December 2009 - August 2014

Source Investors for Your Fund on Real Estate Online

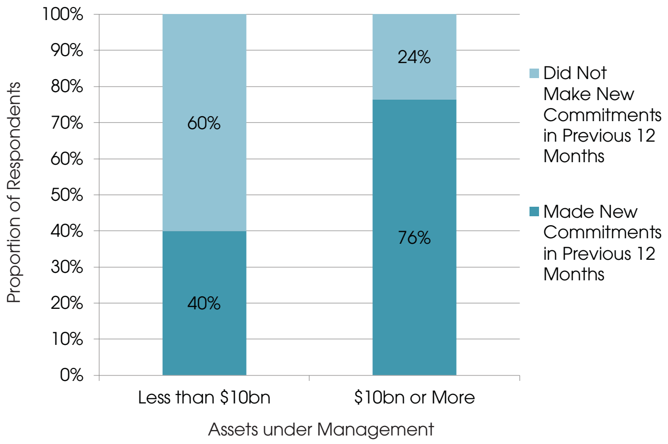
Preqin's **Real Estate Online** service features comprehensive information on over 4,400 active investors in real estate.

Detailed profiles include known past investments, fund managers invested with, allocations to the asset class, future investment plans, contact information for key decision makers and much more.

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

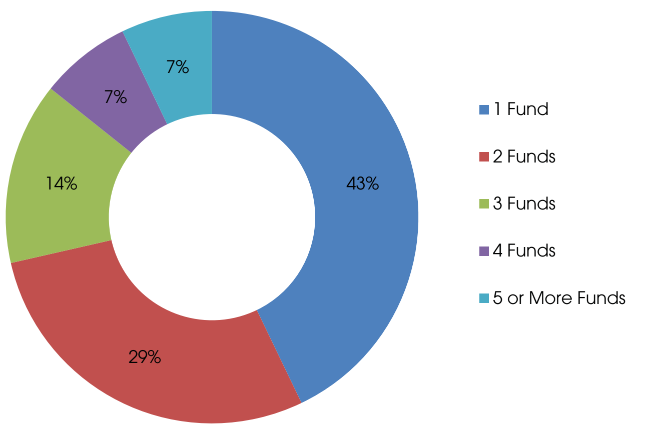
www.preqin.com/reo

Fig. 4.2: Proportion of Investors that Committed to Private Real Estate Funds in the Previous 12 Months by Assets under Management



Preqin Investor Interviews, August 2014

Fig. 4.3: Breakdown of Investors that Committed to Private Real Estate Funds in the Previous 12 Months by Number of New Fund Commitments



Preqin Investor Interviews, August 2014

Investor Activity in the Next 12 Months

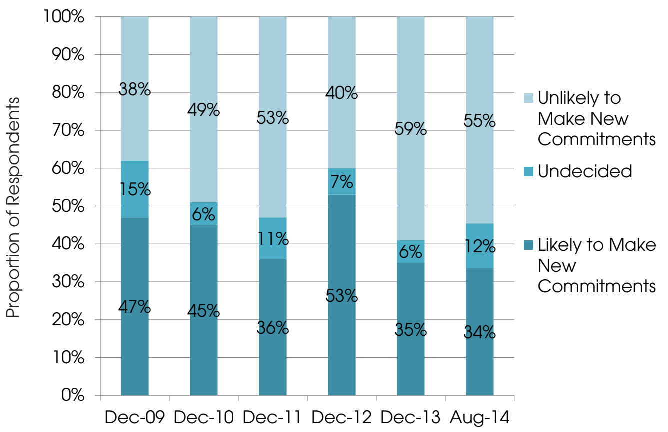
Many investors remain cautious regarding investing in private real estate in the year ahead, with just over a third intending to make new fund commitments. However, activity continues to vary according to institution size, with larger investors considerably more likely to invest capital in the next 12 months. Regionally, there are small variations, with European investors slightly more likely to make new fund commitments.

Many investors appear to remain cautious regarding making new private real estate commitments in the next 12 months, with just 34% of institutions likely to make new commitments in the year ahead, similar to the 35% of institutions that stated so in December 2013 (Fig. 4.4). However, the proportion of investors that are undecided or are considering making new commitments has doubled from 6% to 12% in the six-month period, indicating that more investors are open to committing more capital to the asset class.

However, investor activity continues to vary significantly according to assets under management, with larger institutions more likely to make new commitments in the year ahead. Fig. 4.5 reveals that a considerable 58% of investors with $10bn or more in assets under management plan to invest in the next 12 months, compared to just 25% of investors with less than $10bn in AUM.

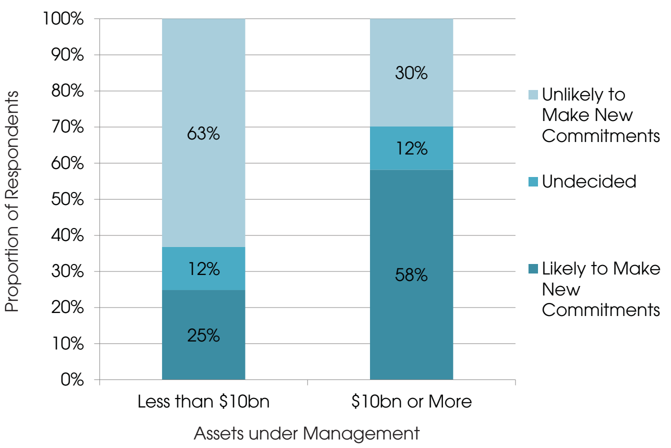
Regionally, Europe-based investors are marginally more likely to invest in the next 12 months than investors based in North America and Asia, with 38% planning to make new commitments, compared to 32% and 37% respectively (Fig. 4.6). A larger proportion of Europe-based investors are also considering making new commitments than institutions based in other regions, with 15% undecided, compared to 12% of North America-based investors and 10% of Asia-based institutions. However, with the majority of North America- and Asia-based investors unlikely to invest in the next 12 months, and 47% of Europe-based investors not planning to do so, managers marketing funds need to ensure that they are getting their funds in front of the right investors as this is potentially the decisive factor in successful fundraising.

Fig. 4.4: Investor Intentions for Private Real Estate Investments in the Following 12 Months, December 2009 - August 2014



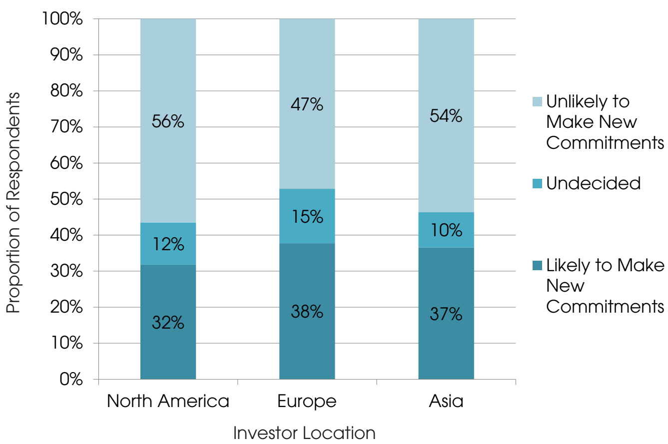
Preqin Investor Interviews, December 2009 - August 2014

Fig. 4.5: Investor Intentions for Private Real Estate Investments in the Following 12 Months by Assets under Management



Preqin Investor Interviews, August 2014

Fig. 4.6: Investor Intentions for Private Real Estate Investments in the Following 12 Months by Investor Location



Preqin Investor Interviews, August 2014

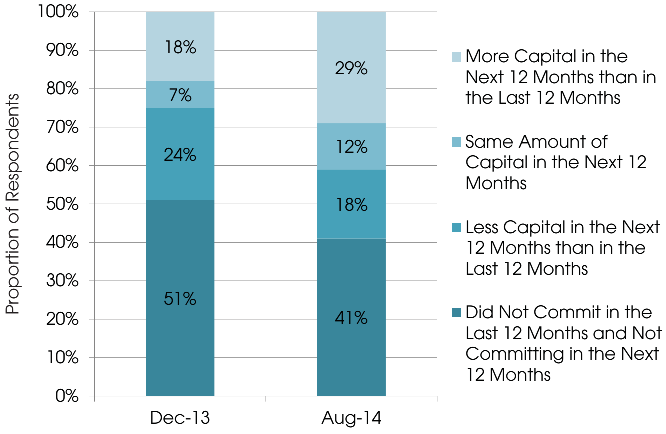
Investor Activity in the Next 12 Months - Capital Outlay

Nearly half of active investors are planning to commit more capital to private real estate funds in the next 12 months compared to the last 12 months. Active institutions are likely to place capital in multiple funds, with the majority of investors intending to commit $100mn or more in the year ahead.

Investor confidence in private real estate appears to have increased over the last six months, with 29% of investors planning to commit more capital to the asset class in the year ahead than they did over the previous 12 months, compared to 18% which stated so in December 2013 (Fig. 4.7). Correspondingly, the proportion of institutions that intend to commit less capital to real estate has declined from 24% to 18% over the same time period. Forty-one percent of investors do not plan to commit capital in the year ahead having not done so in the previous 12 months.

Encouragingly, those investors that will be active are likely to commit to several funds, with the proportion of investors looking to commit to multiple funds increasing over the last 12 months. Fig. 4.8 reveals that 50% of active investors stated that they plan to invest in four or more private real estate funds in the next year, compared to just 16% of investors which stated so in August 2013. Forty percent of investors intend to commit to two to three real estate vehicles, while only 10% stated they plan to invest in one vehicle. In comparison, in August 2013, 41% of investors stated they would commit to just one vehicle.

Fig. 4.7: Investors' Expected Capital Commitment to Private Real Estate Funds in 2014 Compared to 2013



Source: Preqin Investor Surveys, December 2013 - August 2014

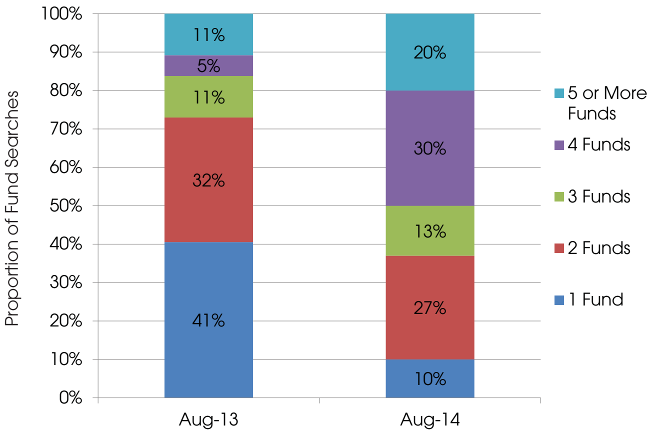
This trend is further highlighted in Fig. 4.9, with over half of investors planning to commit more than $100mn to private real estate in the next 12 months, compared to 40% which stated so in August 2013. A considerable 20% of investors are planning to invest more than $300mn, with 11% targeting investments of $600mn or more.

In-Depth Data on All Private Real Estate Funds in Market

Preqin's **Real Estate Online** features extensive information on all 455 closed-end private real estate funds currently seeking capital. Access details on a fund's strategy, geographic focus, target size, key contact details and much more.

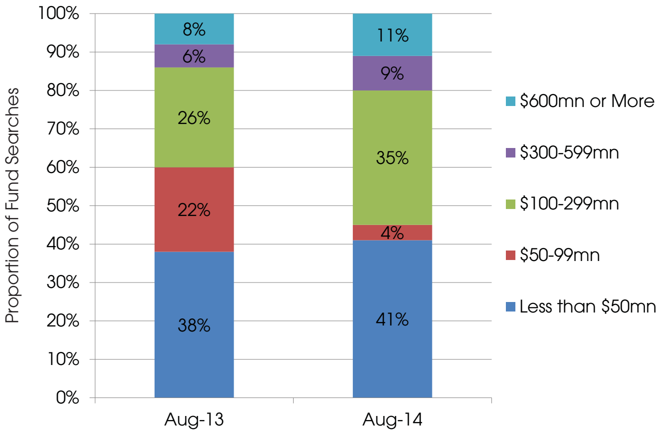
For more information, please visit: www.preqin.com/reo

Fig. 4.8: Investors' Expected Number of Private Real Estate Fund Commitments in the Next 12 Months, August 2013 - August 2014 (Investors that Plan to Be Active)



Source: Preqin Real Estate Online

Fig. 4.9: Amount of Fresh Capital Investors Plan to Invest in Private Real Estate over the Next 12 Months, August 2013 - August 2014 (Investors that Plan to Be Active)



Source: Preqin Real Estate Online

Strategies and Geographies Targeted and Appetite for First-Time Funds

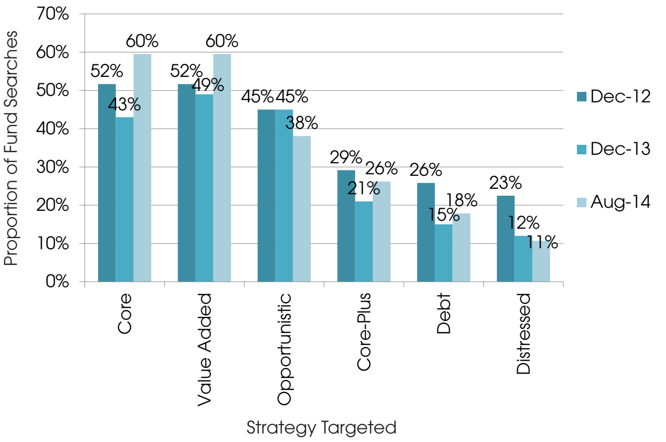
Strategies across the risk spectrum are sought by investors in the next 12 months, with appetite for core funds seeing a sizeable increase. Institutions continue to favour domestic investment, while appetite for first-time funds remains low.

Private real estate investor appetite for core investments has seen a surge in the last six months, increasing from 43% of institutions targeting the strategy in December 2013 to 60% in August 2014, as shown in Fig. 4.10. Appetite for value added funds has also increased over this time period, from 49% to 60% respectively, demonstrating that investors are targeting a wide range of strategies across the risk spectrum. Appetite for core-plus and debt funds has also increased in the last six months, standing at 26% and 18% respectively as of August 2014, although appetite for opportunistic funds has declined from 45% in December 2013 to 38% in August 2014.

When looking at the regional investment preferences of investors, the vast majority continue to target domestic real estate opportunities. Eighty-seven percent of Europe-based investors, 79% of North America-based investors and 72% of Asia-based investors target domestic real estate investments (Fig. 4.11). Asia-based investors appear to favour greater geographic diversification in their portfolios, with 44% and 39% including North American and European real estate investments in their preferences respectively, and 33% targeting globally diversified funds.

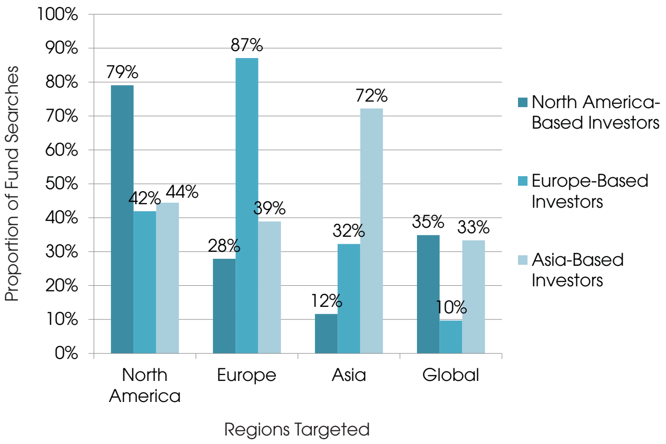
Institutions are increasingly favouring fund managers with a strong track record, leading to declining appetite for investing with first-time managers. Fig. 4.12 reveals that the proportion of investors that will invest in first-time funds has declined from 41% in December 2009 to 18% in August 2013. Correspondingly, the proportion that will not invest in first-time funds has increased from 28% of institutions to 63% over the same time period.

Fig. 4.10: Strategies Targeted in the Next 12 Months by Private Real Estate Investors, December 2012 - August 2014



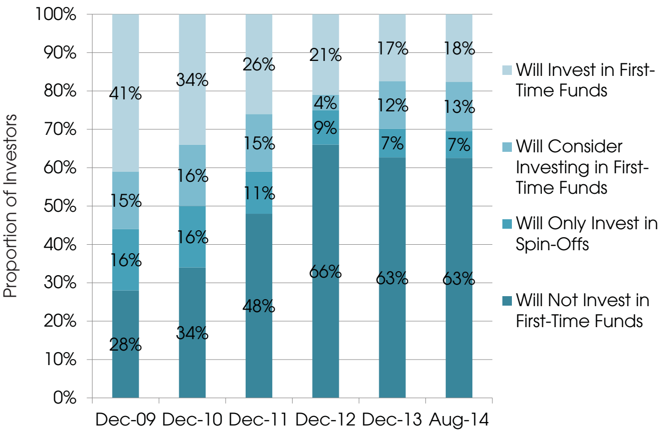
Source: Preqin Real Estate Online

Fig. 4.11: Breakdown of Regions Targeted in the Next 12 Months by Private Real Estate Investor Location



Source: Preqin Real Estate Online

Fig. 4.12: Changing Investor Appetite for First-Time Private Real Estate Funds, December 2009 - August 2014



Source: Preqin Real Estate Online

Allocations and Confidence in the Asset Class

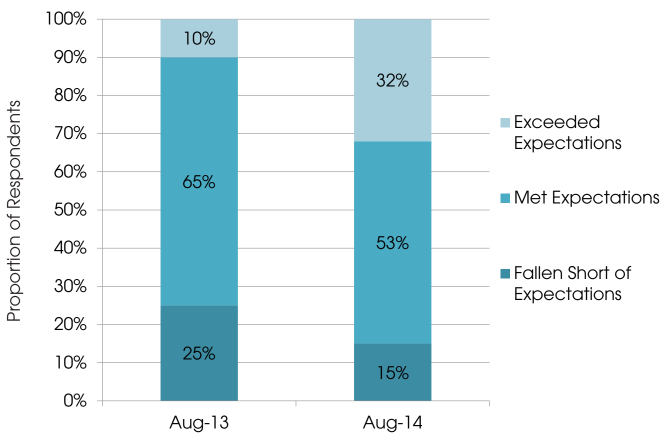
Investor confidence in private real estate is strong, with the proportion of investors believing that returns have exceeded expectations increasing over the last year. As a result, many investors plan to increase their allocations to the asset class over the longer term.

Investors continue to view private real estate as an important component of their portfolios, with many institutions having a positive outlook towards the asset class. Thirty-two percent of investors stated that their investments have exceeded expectations over the last 12 months, a considerable increase from 10% in August 2013 (Fig. 4.13). Additionally, the proportion of investors which stated that returns have fallen short of expectations has declined from 25% to 15% in the last year. Consequently, 41% of investors are planning to increase their allocation to private real estate in the longer term (Fig. 4.14).

Investor confidence in private real estate to achieve portfolio objectives has remained broadly constant, with 76% of investors polled indicating no change in confidence (Fig. 4.15). Eighteen percent had increased confidence in real estate, while only 6% felt less confidence in the ability of their real estate investments to fulfil portfolio objectives.

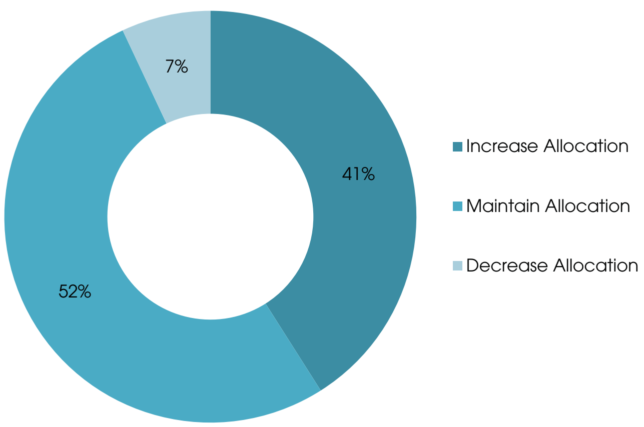
The general perception of the real estate fund industry varies greatly by investor location, with North American and Asia-Pacific investors being more positive about the market compared to those based in Europe (Fig. 4.16). The slower pace of economic recovery in Europe and its corresponding impact on real estate markets may mean that some investors based in the region have a less positive outlook.

Fig. 4.13: Proportion of Investors that Feel Their Private Real Estate Investments Have Lived up to Expectations over the Past 12 Months, August 2013 - August 2014



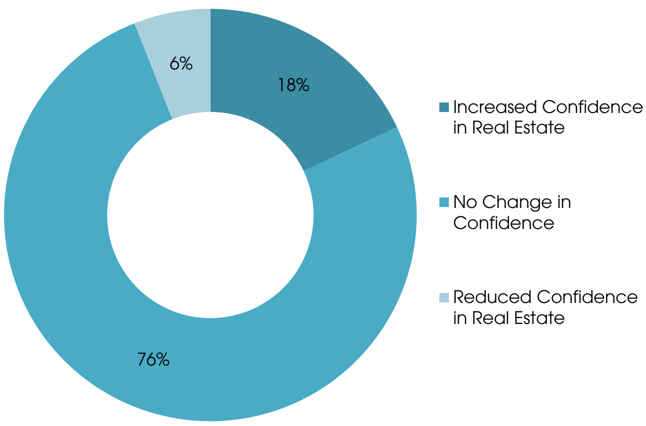
Source: Preqin Investor Interviews, August 2013 - August 2014

Fig. 4.14: Investors' Intentions for Their Private Real Estate Allocations in the Longer Term



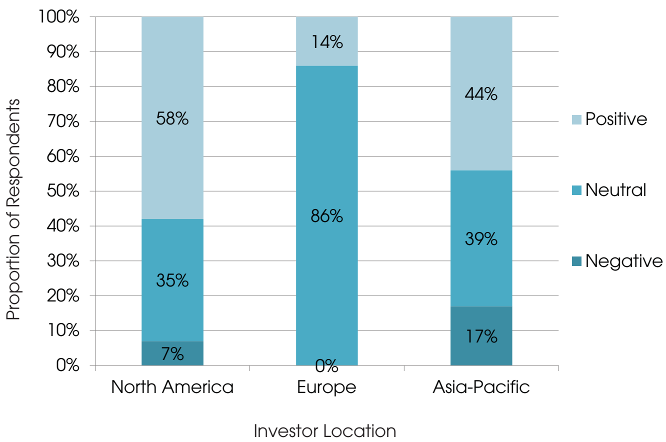
Source: Preqin Investor Interviews, August 2014

Fig. 4.15: Investors' Change in Confidence in Private Real Estate to Achieve Portfolio Objectives in the Past 12 Months



Source: Preqin Investor Interviews, August 2014

Fig. 4.16: Investors' General Perception of the Current Real Estate Industry by Investor Location



Source: Preqin Investor Interviews, August 2014

Key Issues and Manager Selection

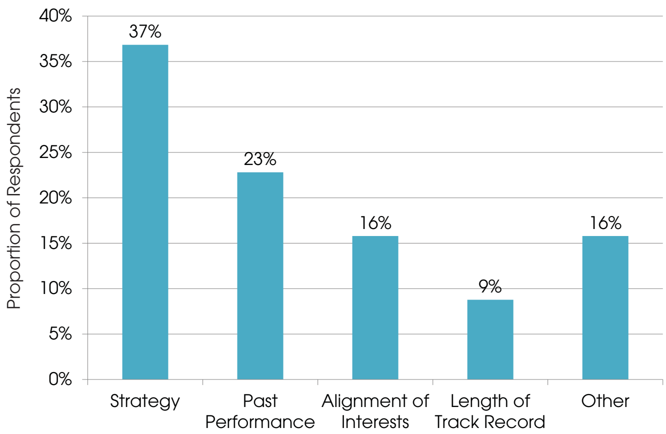
When selecting managers to work with, the investment strategy of a private real estate fund manager ranks as the top consideration for investors, above past performance. Investment consultants remain extremely influential as intermediaries, with the majority of investors sourcing fund opportunities through their consultants, and the economic environment remains the key issue for investors in the current market.

When asked what they viewed as the most important factor when selecting a private real estate fund manager, the largest proportion of investors (37%) stated that the fund investment strategy was the key issue (Fig. 4.17). Twenty-three percent stated past performance, which is often a decisive factor when choosing between more and less experienced managers, as investors frequently look to invest with managers with a track record of performing well in different market conditions. Sixteen percent of respondents stated the alignment of interests between managers and investors as the key deciding factor.

The majority of investors source real estate fund opportunities via recommendations from their investment consultant, with 55% of respondents doing so, demonstrating the vital role that consultants play as gatekeepers of institutional capital (Fig. 4.18). Twenty-eight percent source opportunities via networking and peer recommendations, while a quarter are approached by fund managers. Interestingly, a quarter also source fund investments through their internal investment team, indicating that many investors are proactive in sourcing opportunities.

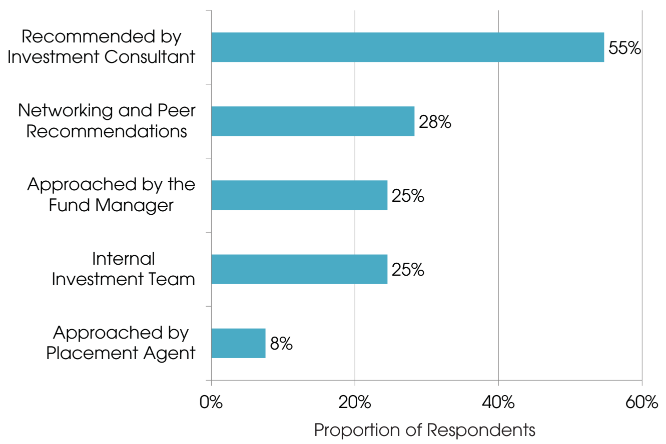
The economic environment was viewed by the largest proportion of respondents (29%) as one of the key issues in the market, with 20% stating performance, as shown in Fig. 4.19. Fig. 4.20 reveals that the majority of investors are unsure of the impact of regulations on the real estate industry, although 28% do believe the impact to be positive.

Fig. 4.17: Investors' Views on the Most Important Factor to Consider When Searching for a Private Real Estate Fund Manager



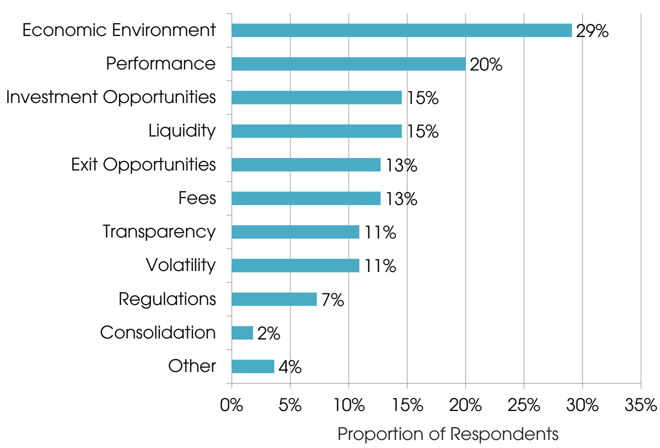
Source: Preqin Investor Interviews, August 2014

Fig. 4.18: Main Methods Used by Investors to Source New Private Real Estate Fund Investment Opportunities



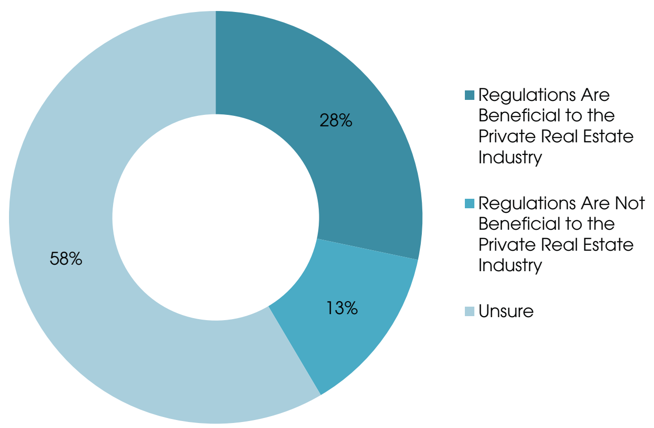
Source: Preqin Investor Interviews, August 2014

Fig. 4.19: Investors' Views on the Key Issue for the Private Real Estate Market in 2014



Source: Preqin Investor Interviews, August 2014

Fig. 4.20: Investors' Views on Whether Regulations Introduced in 2011, 2012 and 2013 Are Beneficial for the Private Real Estate Industry



Source: Preqin Investor Interviews, August 2014

Appetite for Co-Investments, Joint Ventures and Separate Accounts

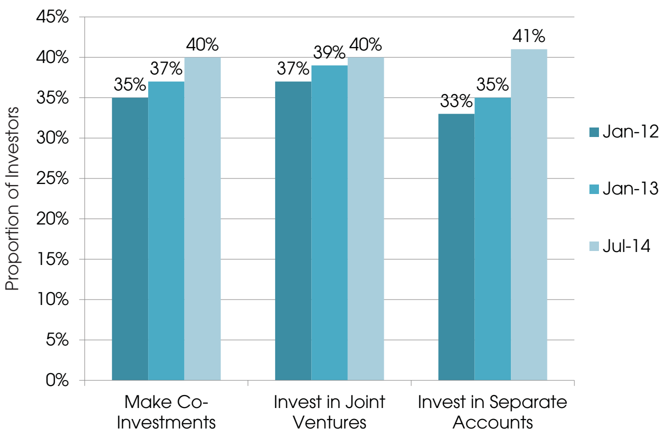
Use of alternative routes to market among investors continues to grow, although these methods are mainly utilized by larger investors with the internal resources to undertake the necessary monitoring and due diligence.

Alternative methods of investing in real estate are increasingly sought by institutional investors, with investors utilizing specialized structures such as joint ventures, co-investments and separate accounts to gain exposure to the market, rather than focusing on commitments to multi-investor funds. These methods of investing have many advantages for investors over the closed-end private real estate fund model, including increased control over underlying acquisitions and the potential to negotiate more favourable fees. Fig. 4.21 reveals that there has been an increase in all three alternative routes to market since January 2012. Forty percent of investors co-invest, or consider doing so alongside a fund manager, another 40% invest through joint ventures, and 41% invest via separate accounts.

The use of these vehicles does however strongly correlate to the size of the investor, as shown in Fig. 4.22, as making and monitoring these types of investments often requires a fairly large and experienced investment team. Seventy percent of investors with over $10bn in assets under management invest in joint ventures, with 68% investing through separate accounts and 59% utilizing co-investments. For investors with $1-9.9bn in assets under management, 35%, 31% and 38% respectively invest via co-investments, joint ventures and separate accounts. Investors with less than $1bn in assets are less likely to invest in these structures due to the high barrier to entry for these specialized vehicles, which are often out of reach for smaller investors.

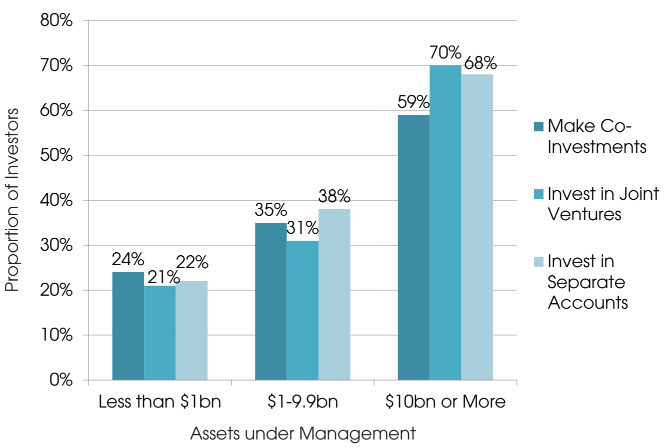
Fig. 4.23 shows different investor types' varying appetite for separate accounts. Asset managers continue to be prolific in this space, with 42% actively investing through these structures, and a further 21% considering doing so; asset managers often have specialized and sophisticated investment teams and are therefore able to take advantage of investing via separate accounts. Public and private pension funds generally have significant capital bases, and are likely to have internal teams capable of undertaking the necessary ongoing monitoring and due diligence to utilize separate accounts; as a result, 35% and 30% of public and private sector pension funds will invest in separate accounts respectively.

Fig. 4.21: Investor Appetite for Co-Investments, Joint Ventures and Separate Accounts, January 2012 - July 2014



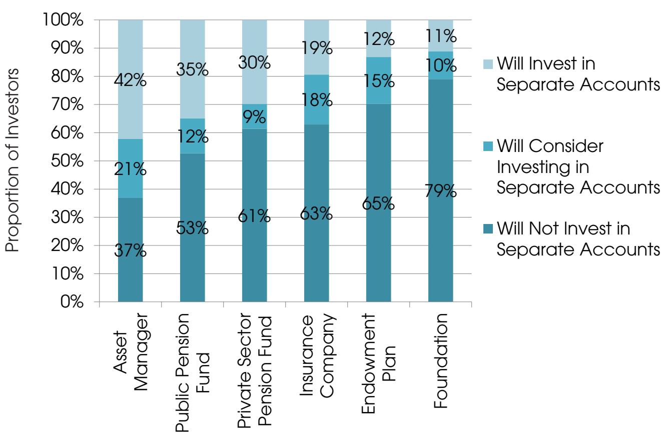
Source: Preqin Real Estate Online

Fig. 4.22: Institutional Investor Appetite for Co-Investments, Joint Ventures and Separate Accounts by Assets under Management



Source: Preqin Real Estate Online

Fig. 4.23: Investor Appetite for Real Estate Separate Accounts by Investor Type



Source: Preqin Real Estate Online

Infrastructure

Continued Demand Will Lead to Growth

Institutional investor appetite for infrastructure remains strong, with over half of investors surveyed planning to commit more capital to infrastructure in the next 12 months than they did in the previous year. As it becomes ever more established as an asset class, many institutions expect to increase their targeted allocations to infrastructure.

Most institutional investors are satisfied with the recent performance of their portfolios, with 90% stating that returns in the last year have either met or exceeded expectations, while just 19% perceive the industry negatively. Many will be making sizeable commitments in the coming year, with 55% of investors that are planning to be active expecting to allocate $100mn or more to the asset class. The main route to market remains unlisted infrastructure funds, despite the proportion of investors that access the asset class directly increasing over the last year.

However, many investors still have concerns surrounding their investments in infrastructure, with 38% stating that the availability of attractive investment opportunities was a key concern in the current market, with many concerned over asset pricing. As infrastructure matures as an asset class, investors can be increasingly discerning in the attributes they look for in a fund manager, with 30% citing past performance as the key factor to consider when searching for managers. There are more than 150 infrastructure funds being marketed and investors are also becoming more proactive in sourcing the most attractive fund opportunities, with a combined 43% doing so through networking and peer recommendations or via their internal investment team.

Key Facts

57% of investors will commit more capital to infrastructure in the next 12 months than in the previous year.

55% of active investors will invest $100mn or more in infrastructure over the next 12 months.

55% of investors plan to increase their direct investments in infrastructure in the next year.

90% of investors feel their returns from infrastructure investments have met or exceeded expectations over the past 12 months.

37% of investors will increase the size of their investment team in the next two years.

30% of investors cite past performance as the most important factor to consider when looking for a fund manager.

Satisfaction with Returns and Confidence in the Asset Class

Investor perception of the infrastructure industry appears largely positive, with the majority of institutions satisfied with the returns from their investments and remaining confident in the prospects of the asset class.

The vast majority of infrastructure investors appear satisfied with the returns from their infrastructure investments, although there are disparities between performance in the last 12 months and that over the last five years. As shown in Fig. 5.1, 90% of investors surveyed believe that their fund investments have met or exceeded expectations over the past 12 months, with 65% stating this for investments made over the last five years. Fourteen percent of investors believe that their investments have exceeded expectations over the last year, with 18% believing so over the last five years. As a consequence, it is possible to see that infrastructure investments have largely performed positively over the time periods shown. However, a considerable 35% of investors believe that investments over the last five years have fallen short of their expectations, compared to just 10% over the 12 month period. Although infrastructure is often capable of producing stable long-term yields, these may have been lower than investors had expected, perhaps resulting in some level of disappointment among investors when considering their returns over a five-year period.

The lower long-term yields and lower risk associated with investing in infrastructure funds helps investors to achieve a range of portfolio objectives, such as providing diversification, acting as an inflation hedge or providing a reliable income stream. When asked whether their confidence in infrastructure to achieve those objectives had changed in the last 12 months, the vast majority (71%) of investors stated that it had not, although 19% stated a reduction in confidence, possibly a reflection of concerns over pricing (Fig. 5.2).

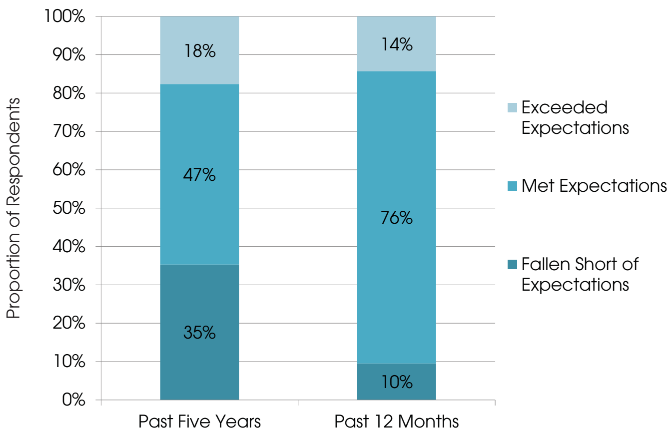
When asked about their general perception of the infrastructure industry at present, infrastructure investors overall appear more positive than six months ago, with the proportion viewing the industry positively increasing from 34% in December 2013 to 48% in August 2014 (Fig. 5.3). However, there has also been a slight increase in the proportion of institutions viewing the industry negatively, from 14% to 19% over the same time period, while 33% currently view the industry neutrally.

In-Depth Infrastructure Performance Data

Preqin's **Infrastructure Online** features individual fund returns for over 140 separate named infrastructure funds, including percentage called and distributed, net IRR and much more.

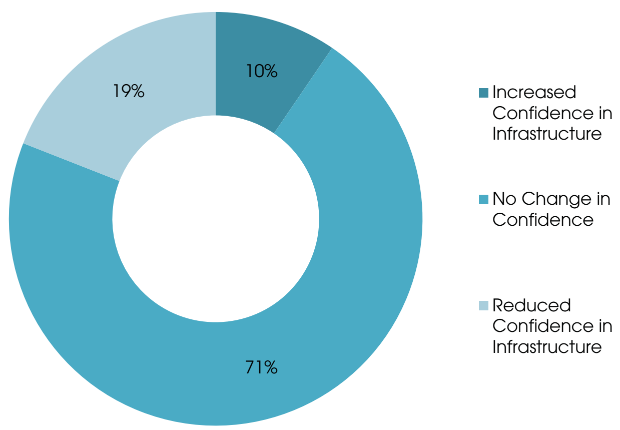
www.preqin.com/infrastructure

Fig. 5.1: Proportion of Investors that Feel Their Infrastructure Fund Investments Have Lived up to Expectations: Past Five Years vs. Past 12 Months



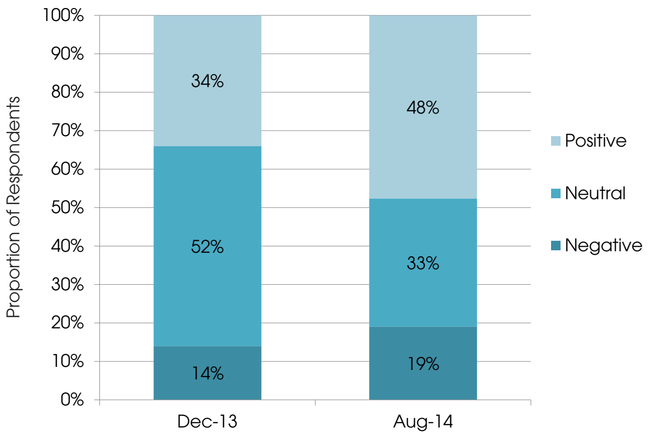
Source: Preqin Investor Interviews, August 2014

Fig. 5.2: Investors' Confidence in Infrastructure to Achieve Portfolio Objectives in the Past 12 Months



Source: Preqin Investor Interviews, August 2014

Fig. 5.3: Investors' General Perception of the Infrastructure Industry, December 2013 - August 2014



Source: Preqin Investor Interviews, December 2013 - August 2014

Investor Activity in the Next 12 Months

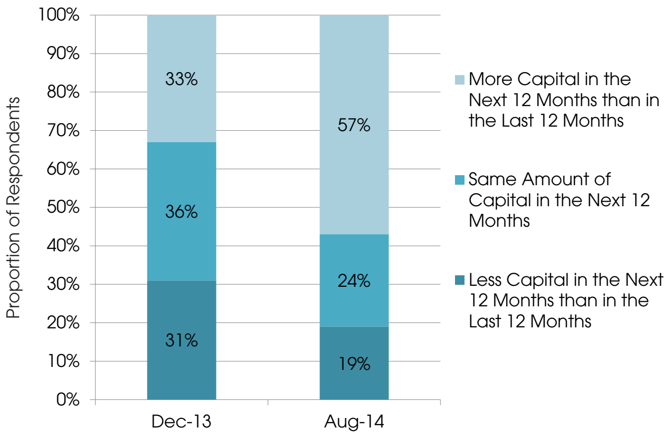
Infrastructure investors are likely to remain active in the asset class in the year ahead, with many looking to commit more capital and increase their allocations. Investors are increasingly looking at investing in infrastructure directly, and many are looking to grow their internal investment teams as their exposure to the asset class grows.

Infrastructure remains a growing area of interest for institutional investors. As shown in Fig. 5.4, a significant 57% of surveyed investors expect to invest more capital in the infrastructure asset class over the coming 12 months compared to the previous year, compared to 33% of investors that stated so in December 2013. A further 24% expect to invest the same amount of capital in 2014/15. Just 19% of survey respondents plan to invest less capital in the coming year when compared to the previous 12 months.

Fig. 5.5 also illustrates this growing investor appetite for infrastructure, with 95% of surveyed investors planning to either increase or maintain their current infrastructure allocation over the next 12 months. Over the longer term, a considerable 42% of investors plan to increase their allocation to infrastructure, suggesting that the amount of capital set to enter the infrastructure asset class is likely to increase, both in the year ahead and over the longer term.

In terms of route to market, a range of different methods of accessing infrastructure will continue to be utilized by institutional investors in 2014-2015. However, particularly notable is investors' growing interest in direct exposure to the asset class, with 55% of surveyed investors expecting direct investments to account for a larger proportion of their portfolio in the year ahead, a greater proportion than in any other strategy (Fig. 5.6). No investors are planning to decrease their exposure to infrastructure via direct investments. Although investors are increasingly looking towards direct infrastructure investment, in many cases, this remains feasible only for the largest and most experienced institutions, which are able to create an investment team capable of making and managing investments in infrastructure assets. Investors are seeking to create separate accounts with fund managers to invest directly on their behalf; 28% of surveyed investors expect this route to constitute a higher proportion of their infrastructure investment portfolio in the year ahead.

Fig. 5.4: Investors' Expected Capital Commitment to Unlisted Infrastructure Funds in the Next 12 Months Compared to the Previous 12 Months, December 2013 - August 2014

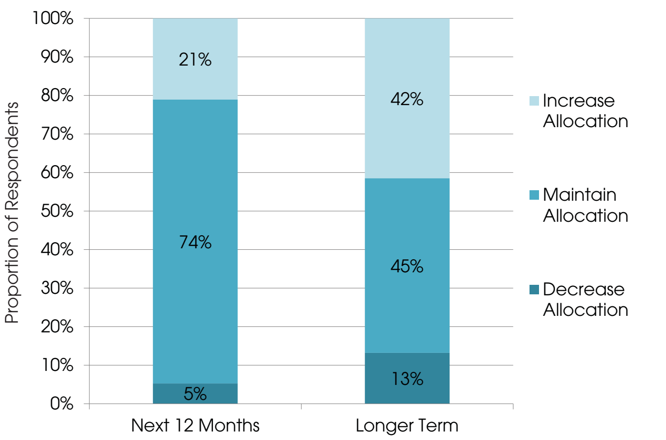


Source: Preqin Investor Interviews, December 2013 - August 2014

However, unlisted infrastructure fund commitments remain the primary route to market for most investors, which is likely to continue to be the case in the year ahead. A considerable 40% of surveyed investors expect unlisted funds to account for a larger proportion of their infrastructure portfolio in the next 12 months, while listed infrastructure funds continue to be targeted by only a limited number of infrastructure investors. Just 18% of respondents expect to increase their exposure to listed infrastructure vehicles in the coming year.

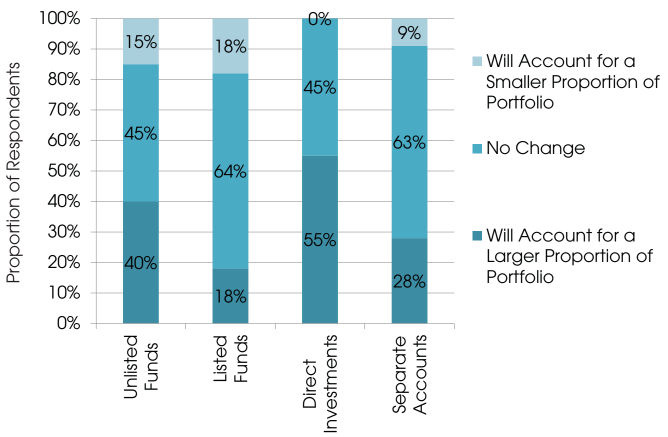
As many investors have relatively small allocations to infrastructure, with the average current allocation standing at 4.5% of assets under management, it is unsurprising that most

Fig. 5.5: Investors' Intentions for their Infrastructure Allocations in the Next 12 Months and the Longer Term



Source: Preqin Investor Interviews, August 2014

Fig. 5.6: Investors' Intentions for the Weighting of Their Infrastructure Portfolio in the Next 12 Months

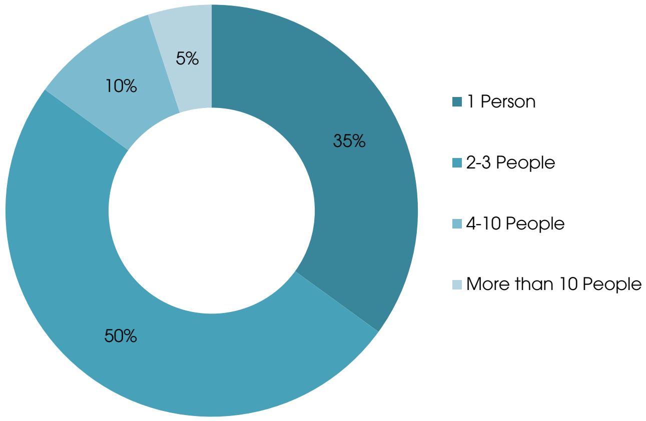


Source: Preqin Investor Interviews, August 2014

maintain a small infrastructure investment team often consisting of just one individual. Fig. 5.7 shows that 85% of investors maintain an infrastructure investment team of three people or less, with 35% operating with a single investment professional. Just 15% of respondents have an infrastructure investment team consisting of four or more people, including just 5% with a team of over 10 people.

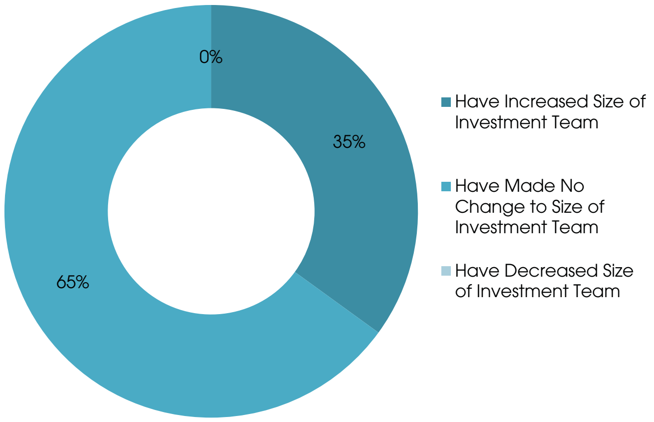
However, Fig. 5.8 shows that 35% of these institutions have increased the size of their infrastructure investment teams in the past two years, while Fig. 5.9 suggests that an additional 37% of surveyed investors expect to increase the size of their infrastructure teams in the coming 24 months. This again suggests that many investors will be placing a greater emphasis on their infrastructure portfolios in the coming years, and with a large proportion of investors looking to increase their allocation to the asset class, many institutions will need to grow their dedicated infrastructure investment teams.

Fig. 5.7: Breakdown of Infrastructure Investors by Size of Infrastructure Investment Team



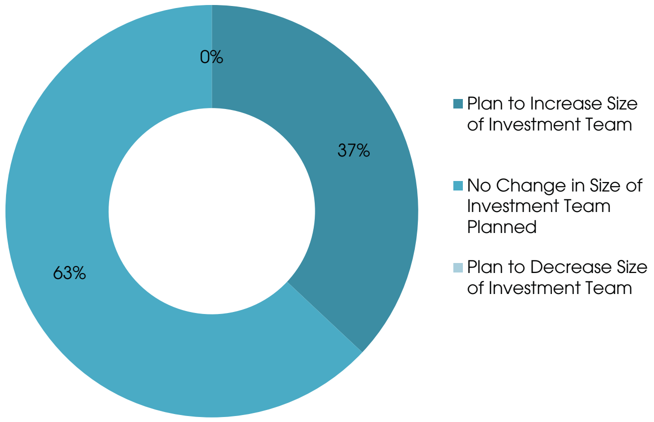
Source: Preqin Investor Interviews, August 2014

Fig. 5.8: Infrastructure Investors' Change in the Size of Their Infrastructure Investment Team in the Last Two Years



Source: Preqin Investor Interviews, August 2014

Fig. 5.9: Infrastructure Investors' Expected Change in the Size of Their Infrastructure Investment Team in the Next Two Years



Source: Preqin Investor Interviews, August 2014

Fund Searches and Capital Outlay

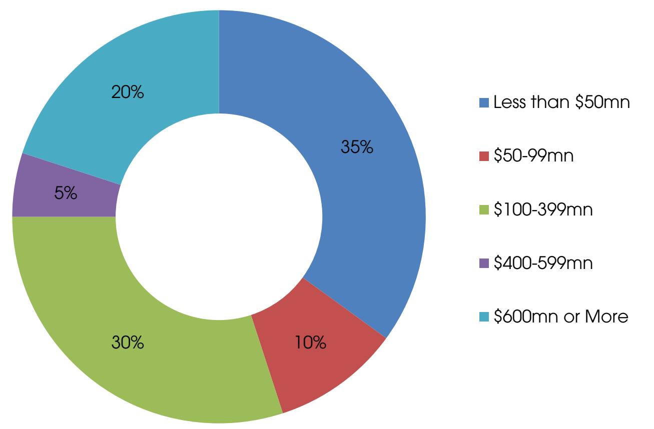
Many investors are looking to invest considerable amounts of capital in infrastructure in the next 12 months, with over half intending to invest $100mn or more; however, despite the majority continuing to favour investment via unlisted funds, institutional interest in direct investment has increased. Regionally, investors largely seek global or diversified funds, and although separate account mandates and co-investments offer many advantages to investors, these routes to market remain mostly utilized by larger investors.

Through frequent contact with over 2,300 institutional investors active in infrastructure, we are able to build a clear picture of their investment strategies and plans over the next 12 months. Fig. 5.10 reveals that many infrastructure investors intend to commit considerable amounts of capital to the asset class in the next 12 months, with 55% of institutions intending to invest $100mn or more, and 20% of investors looking to invest $600mn or more.

Although the vast majority of institutions looking to invest in infrastructure in the year ahead plan to do so through unlisted infrastructure funds, with 77% stating that they would invest via this route (Fig. 5.11), this has declined since August 2013, when 91% of investors stated that they favoured accessing the asset class via this route. In comparison, the proportion of investors targeting direct infrastructure investment has increased from 35% to 44%. Typically, investors looking to access the asset class directly are larger, more experienced firms with the resources and expertise to invest via this method.

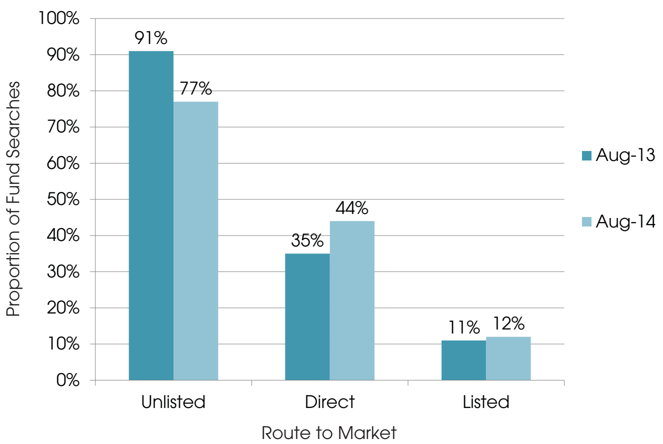
The majority of investors favour investing in infrastructure via the primary unlisted infrastructure fund method, with 92% of institutions seeking to invest through this strategy (Fig. 5.12). However, a sizeable proportion of investors are seeking investments in debt/mezzanine funds, with 27% looking to invest in such funds. Investment in infrastructure via funds of funds or secondaries is sought by 9% and 7% of investors respectively.

Fig. 5.10: Amount of Fresh Capital Investors Plan to Invest in Infrastructure over the Next 12 Months (Investors that Expect to Be Active)



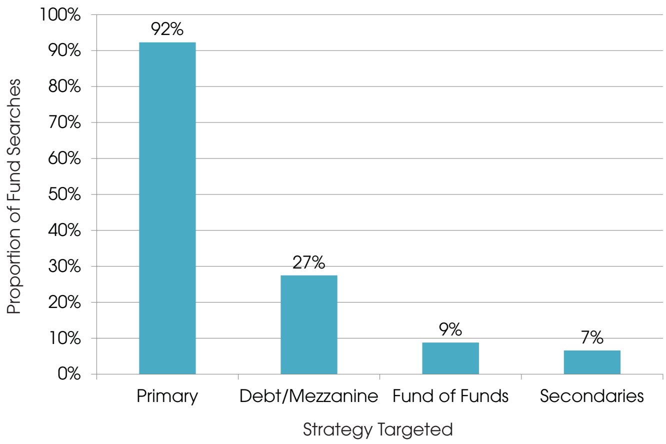
Source: Preqin Infrastructure Online

Fig. 5.11: Preferred Route to Market of Infrastructure Investors in the Next 12 Months, August 2013 - August 2014



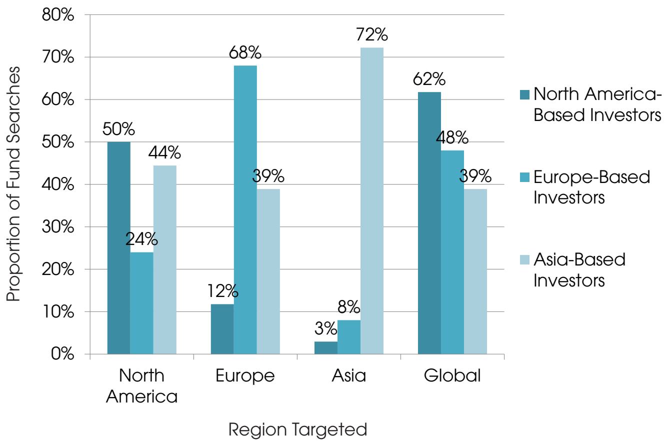
Source: Preqin Infrastructure Online

Fig. 5.12: Strategies Targeted by Infrastructure Investors in the Next 12 Months



Source: Preqin Infrastructure Online

Fig. 5.13: Breakdown of Regions Targeted by Infrastructure Investors in the Next 12 Months by Investor Location

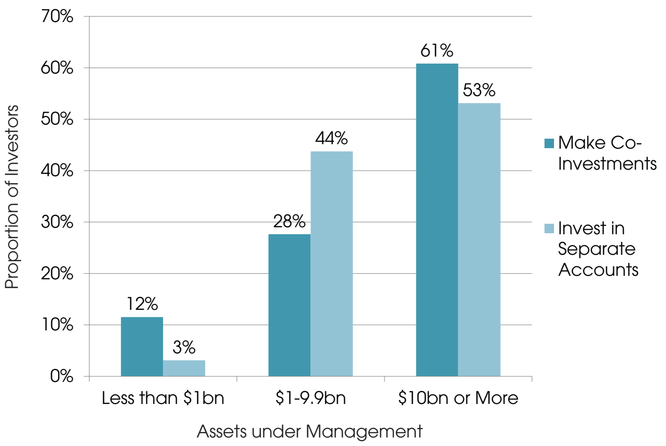


Source: Preqin Infrastructure Online

Regionally, many investors favour domestic investment, as shown in Fig. 5.13. Half of North America-based investors, 68% of Europe-based investors and 72% of Asia-based investors plan to invest in domestic infrastructure in the next 12 months. Overall, North America-based investors appear more globally diversified in their investment focus, with 62% seeking infrastructure funds with a global investment mandate; comparatively, just 39% of Asia-based investors seek global funds, favouring infrastructure investments closer to home.

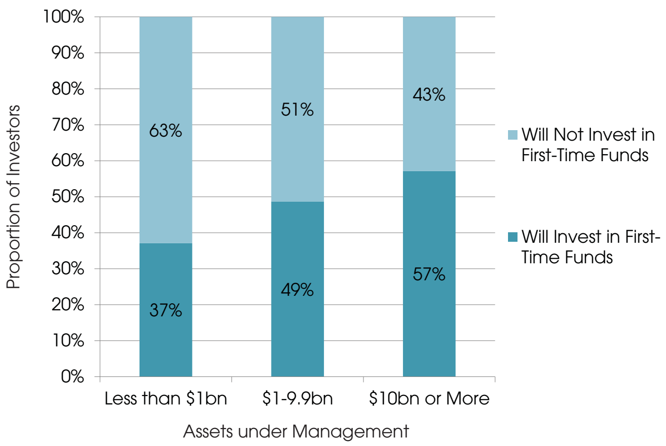
As the infrastructure asset class continues to mature and investors become more knowledgeable and experienced in the space, other routes to market are growing in prominence, such as making co-investments with portfolio managers and utilizing externally managed separate accounts. However, investor appetite for co-investments and separate accounts varies by assets under management, with investors possessing $10bn or more in AUM considerably more likely to make co-investments or invest via separate accounts, with 61% and 53% doing so respectively (Fig. 5.14). The same is true of investing in first-time funds, with larger investors more able to able to conduct the necessary due diligence on these managers. Fifty-seven percent of investors with $10bn or more in AUM will invest in first-time funds, compared to just 37% of investors with less than $1bn in AUM (Fig. 5.15).

Fig. 5.14: Infrastructure Investor Appetite for Co-Investments and Separate Accounts by Assets under Management



Source: Preqin Infrastructure Online

Fig. 5.15: Infrastructure Investor Appetite for First-Time Funds by Assets under Management



Source: Preqin Infrastructure Online

Key Issues and Manager Selection

Institutional investors are now more selective than ever when sourcing new investment opportunities. Manager experience and past performance remain key considerations when seeking to establish new fund manager relationships, while the availability of attractive investment opportunities is a growing concern.

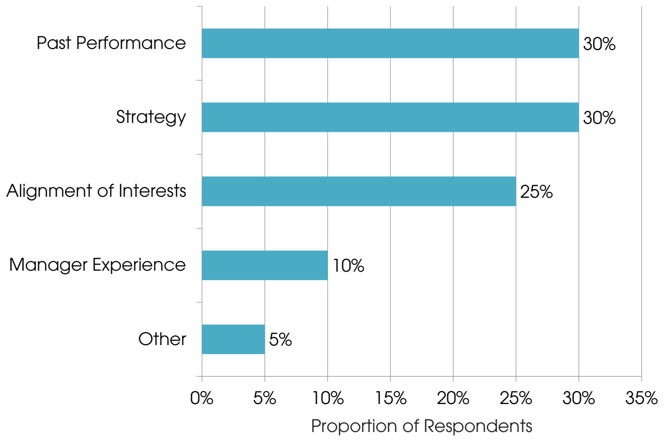
Although there are relatively few experienced managers in the infrastructure space, those that can point to a long track record may be best placed to secure investor commitments. A combined 40% of surveyed investors highlighted manager experience and past performance as the most important factor they consider when selecting an infrastructure fund manager (Fig. 5.16). Other key factors highlighted include fund manager strategy (30%) and alignment of interests (25%).

Although a significant proportion of surveyed investors (38%) prefer to be approached by a fund manager in order to source new investment opportunities, a relatively large proportion favour a more proactive approach through seeking out their own investment opportunities. Twenty-nine percent of respondents prefer networking or fund manager recommendations from peers, and 14% of surveyed investors source investment opportunities via their own internal investment team (Fig. 5.17)

With greater amounts of capital entering the asset class, a growing concern among investors is asset prices being driven up and diluting the return potential for investors. As a result, a considerable 38% of surveyed investors named the availability of investment opportunities as the key issue for the infrastructure market in 2014 (Fig. 5.18). Other key issues highlighted include the economic environment, fees and regulation.

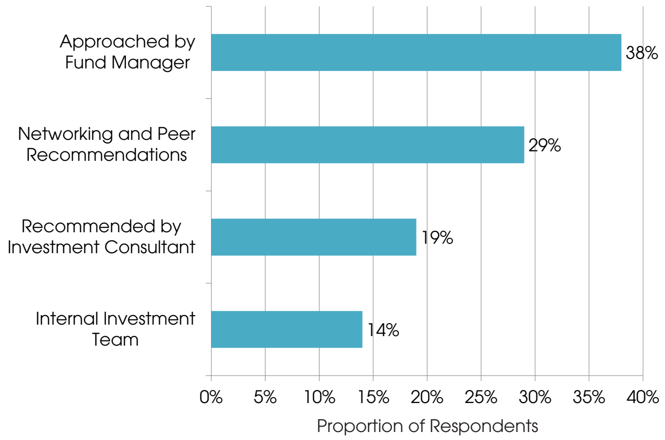
In terms of recently introduced regulations such as Basel III, Solvency II, and the AIFMD, the majority of surveyed investors (64%) are unsure about whether this will be beneficial for the industry (Fig. 5.19).

Fig. 5.16: Investors' Views on the Most Important Factor to Consider When Searching for an Infrastructure Fund Manager



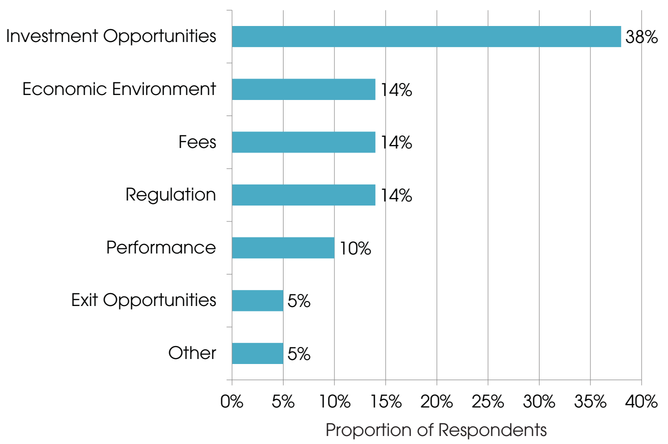
Source: Preqin Investor Interviews, August 2014

Fig. 5.17: Main Methods Used by Investors to Source New Infrastructure Fund Investment Opportunities



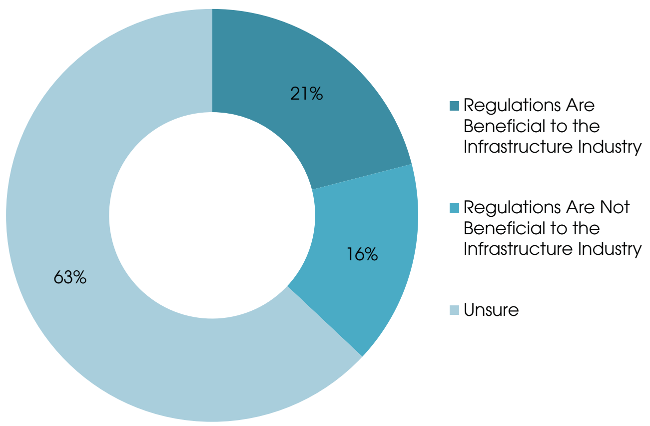
Source: Preqin Investor Interviews, August 2014

Fig. 5.18: Investors' Views on the Key Issue for the Infrastructure Market in 2014



Source: Preqin Investor Interviews, August 2014

Fig. 5.19: Investors' Views on Whether Regulations Introduced in 2011, 2012 and 2013 Are Beneficial for the Infrastructure Industry



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London:

Equitable House
47 King William Street
London
EC4R 9AF

Tel: +44 (0)20 7645 8888
Fax: +44 (0)87 0330 5892

Singapore:

One Finlayson Green, #11-02
Singapore 049246

Tel: +65 6305 2200
Fax: +65 6491 5365

San Francisco:

1700 Montgomery Street
Suite 134, San Francisco
CA 94111

Tel: +1 415 835 9455
Fax: +1 440 445 9595

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