

Content Includes:

Preqin Special Report: Hedge Fund Manager Outlook

July 2016

Review of H1 2016

Half of fund managers have failed to meet their return goals in the first half of the year.

Drivers of Change

What do fund managers perceive to be the key challenges for the rest of the year?

Outlook for H2 2016

Almost half of fund managers expect industry AUM to decrease in H2.

Overcoming Investor Concerns

How do fund managers plan to overcome investors' concerns about the asset class?





Foreword

H1 2016 presented multiple challenges for hedge fund managers; high volatility at the beginning of the year, linked to concerns over oil prices and the health of the global economy, created opportunities for some managers but disadvantaged others. Meanwhile, investor concern over fund performance has further increased pressure on fees, and led some investors, such as New York City Employees' Retirement System (NYCERS), to reduce or eliminate their allocation to the asset class.

With these issues in mind, Preqin surveyed over 270 hedge fund industry professionals in June 2016 to find out their opinions on industry developments in the first half of the year and their forecasts for H2.

Fund managers presented an image of an industry that is attempting to adapt to the dual pressures caused by investors seeking to reduce fees while business costs are rising due to increased regulation. Fund managers acknowledged that the performance of the industry as a whole affects the way that many investors approach the asset class: 44% of fund managers identified performance as a key driver of change for the industry in the second half of the year.

Communication with investors will prove crucial as fund managers seek to negotiate these challenges in H2, with managers recognizing that in order to retain investors and continue to receive new capital, they will need to overcome significant investor concerns about the asset class; 52% of fund managers reported that investors are more negative about hedge funds than they were last year, and 39% reported that fundraising has been more difficult than in 2015. In order to address these concerns, fund managers are concentrating primarily on improving the transparency of their funds and their businesses, strengthening their middle- and back-office infrastructure and educating investors about their funds and the industry.

We hope you find this report useful and welcome any feedback you may have. For more information about Preqin and our **Hedge Fund Online** database, please visit www.preqin.com or contact info@peqin.com.

Key Facts



48%

Proportion of fund managers that expect hedge fund industry assets under management to decrease in H2 2016.



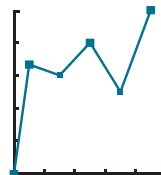
50%

Proportion of fund managers that did not meet their return goals in H1 2016.



52%

Proportion of fund managers that believe investors have become more negative towards hedge funds in the past 12 months.



3%

Median fund manager prediction of hedge fund industry returns for the full-year 2016.

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Hedge Fund Asset Flows in H1 2016

From the end of 2015 to the end of May 2016, the hedge fund industry experienced net outflows of \$8.4bn (Fig. 1). The greatest outflows were from credit hedge funds (-\$16.4bn), while multi-strategy funds and CTAs both went against the trend by recording inflows of \$16.0bn and \$12.4bn respectively.

In H1 2016 TD, a greater proportion of funds experienced outflows than inflows across all top-level strategies except relative value strategies and niche strategies (Fig. 2). Furthermore, only the Asia-Pacific region recorded more inflows than outflows, as funds in all other regions experienced more outflows than inflows (Fig. 3).

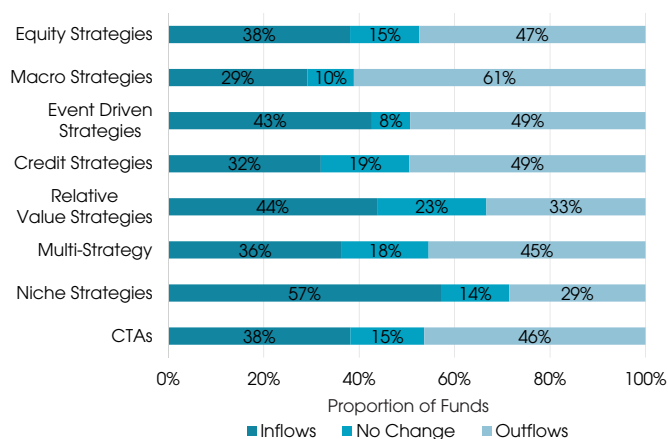
Fifty-three percent of fund managers surveyed by Preqin reported an increase in allocations from high-net-worth individuals and 46% from family offices in H1 2016. Forty-seven percent saw an increase from investors based in the US, 39% from Europe and 37% from Asia-Pacific.

Fig. 1: Quarterly Asset Flows by Strategy, Q2 2015 - Q2 2016 TD (As at 31 May 2016)

	Q2 2015 Asset Flows (\$bn)	Q3 2015 Asset Flows (\$bn)	Q4 2015 Asset Flows (\$bn)	Q1 2016 Asset Flows (\$bn)	Q2 2016 TD Asset Flows (\$bn)	Q2 2016 TD AUM (\$bn)	Percentage Change in AUM over H1 2016
Equity Strategies	28.8	-1.7	3.6	-9.7	2.3	812	0.6%
Macro Strategies	-14.0	-11.2	2.8	-6.4	-3.4	923	0.4%
Event Driven Strategies	12.3	-1.8	-10.7	-2.8	1.5	167	0.8%
Credit Strategies	15.1	-2.0	-5.1	-11.9	-4.5	231	-4.4%
Relative Value Strategies	5.6	-5.3	-3.8	-8.7	8.0	349	1.4%
Multi-Strategy	5.2	7.8	2.4	12.8	3.2	448	4.1%
CTAs	-4.8	16.7	1.4	13.7	-1.3	237	6.3%
Niche Strategies	-0.6	1.4	0.6	-1.5	0.1	13	-7.7%
Total Industry	47.5	3.9	-8.9	-14.3	5.9	3,136	-0.3%

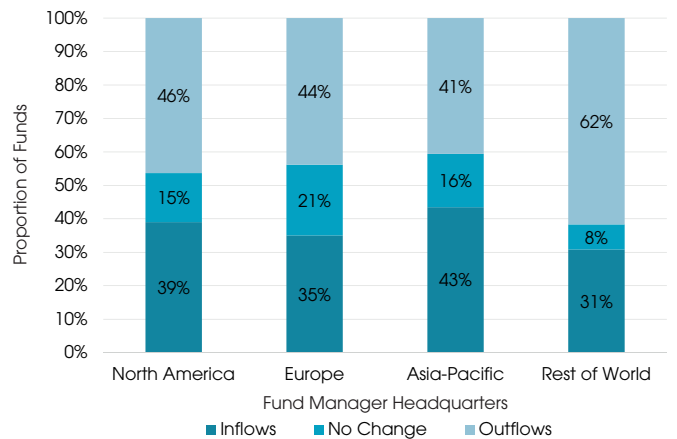
Source: Preqin Hedge Fund Online

Fig. 2: Asset Flows over H1 2016 TD by Core Strategy (As at 31 May 2016)



Source: Preqin Hedge Fund Online

Fig. 3: Asset Flows over H1 2016 TD by Fund Manager Headquarters (As at 31 May 2016)



Source: Preqin Hedge Fund Online

Preqin Hedge Fund Online: The Leading Source of Intelligence on the Hedge Fund Industry

Hedge Fund Online is Preqin's award-winning hedge fund information resource, incorporating all of our hedge fund data, intelligence and functionality, providing you with the most comprehensive coverage of the asset class available.

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www.preqin.com/demo



Review of H1 2016

Following a challenging 2015 in terms of performance, during which the Preqin All-Strategies Hedge Fund benchmark returned 1.94% for the year, hedge funds have had a similarly slow start to 2016. Early losses during the financial market turbulence in January were recovered slowly over the following months, and the benchmark was up just 1.32% through to the end of May (Fig. 4). Approximately half of fund managers surveyed reported that their funds had not met their return goals in the first half of the year, compared with only 15% whose funds had exceeded their targets.

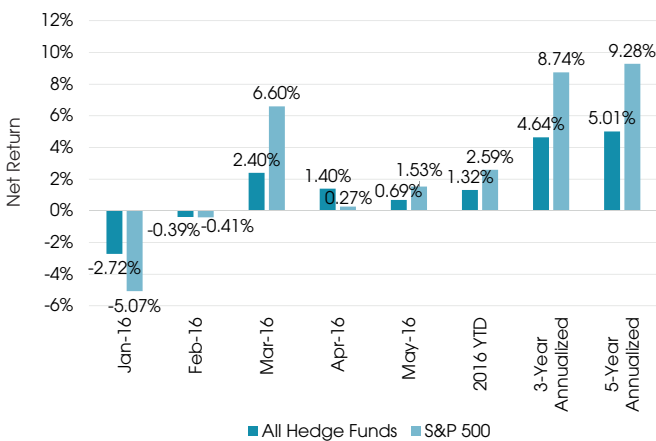
Oil and commodity price volatility were among the largest influences on performance in H1 2016, as cited by 72% and 66% of managers respectively (Fig. 5). Fund managers based in North America and Europe were more likely to see these developments as positive contributors to performance, but managers in Asia & Rest of World tended to regard them as negative (Fig. 6).

The US Federal Reserve's cautious policy towards interest rate rises and zero and negative interest rate policies in Europe and Japan were both seen as significant influences on hedge fund performance in H1.

Continued uncertainty about the Chinese economy was identified as a significant negative influence on performance, particularly by fund managers based in Asia & Rest of World, as cited by 71% of respondents from this region.

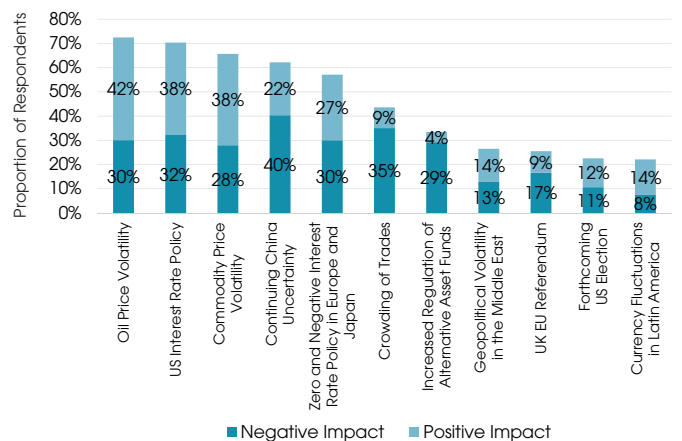
Interestingly, the EU referendum was not considered to be a major factor driving returns for hedge fund managers. However, the survey was conducted before the Brexit decision, perhaps in itself an illustration of how unexpected the result was. (Please see **Preqin Special Report: Impact of Brexit on Alternative Assets** for Preqin's post-referendum survey results.)

Fig. 4: Performance of All Hedge Funds vs. S&P 500 Index (As at May 2016)



Source: Preqin Hedge Fund Online

Fig. 5: Fund Manager Views on the Impact of Major Events on Fund Performance in H1 2016



Source: Preqin Hedge Fund Manager Survey, June 2016

Fig. 6: Fund Manager Views* on the Most Significant Positive and Negative Events for Hedge Fund Performance by Fund Manager Location

	Rank	North America	Europe	Asia & Rest of World
↑	1	Oil Price Volatility 43%	Oil Price Volatility 48%	Zero and Negative Interest Rate Policy in Europe and Japan 53%
	2	Commodity Price Volatility 37%	Commodity Price Volatility 43%	US Interest Rate Policy 52%
	3	US Interest Rate Policy 36%	US Interest Rate Policy 35%	Commodity Price Volatility 32%
↓	1	US Interest Rate Policy 31%	Zero and Negative Interest Rate Policy in Europe and Japan 34%	Commodity Price Volatility 38%
	2	Continuing China Uncertainty 35%	Continuing China Uncertainty 37%	Oil Price Volatility 46%
	3	Crowding of Trades 41%	US Interest Rate Policy 37%	Continuing China Uncertainty 71%

Source: Preqin Hedge Fund Manager Survey, June 2016

*Percentages refer to proportion of total number of respondents from each region that consider the event to have affected performance positively or negatively.



Drivers of Change in the Hedge Fund Industry

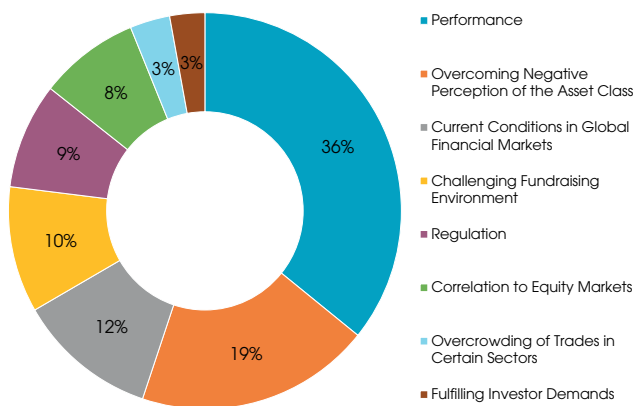
With half of surveyed fund managers reporting that their funds did not meet their return goals in H1 2016, fund managers recognize that recent industry performance is shaping investors' perceptions of the asset class and consequently managers' ability to attract further capital in the future. Forty-four percent of fund managers identified performance as a key driver of change in the hedge fund industry in the second half of 2016, up from 33% in November 2015 (Fig. 8).

Consecutive years of poor industry performance have also intensified investors' focus on the fee structures of their hedge fund investments and increased the pressure on fund managers to reduce the fees they charge. Forty-three percent of respondents identified this as one of the key drivers of change in the hedge fund industry, up from 28% towards the end of 2015.

Fund managers are experiencing pressures on both sides as investors are calling for reduced fees at a time when

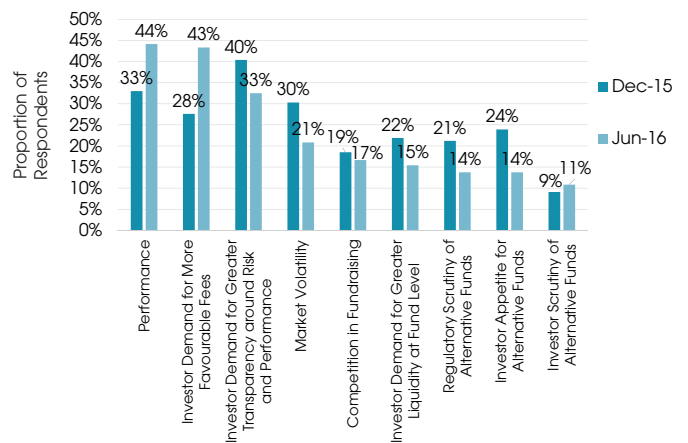
managers are also facing increased costs from regulation; 86% of fund managers surveyed reported that recent regulations are increasing the costs of their business (Fig. 9). This may be a contributing factor in the rising levels of negative sentiment towards regulation among industry participants: 59% of fund managers surveyed in June 2016 expressed the view that recent regulations will change the industry for the worse, up from 42% in December 2012 (Fig. 10).

Fig. 7: Fund Manager Views on the Key Challenges in the Hedge Fund Industry Today



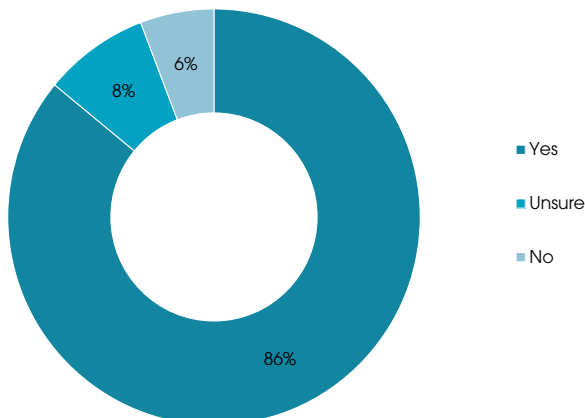
Source: Preqin Hedge Fund Manager Survey, June 2016

Fig. 8: Fund Manager Views on the Key Drivers of Change in the Hedge Fund Industry, December 2015 vs. June 2016



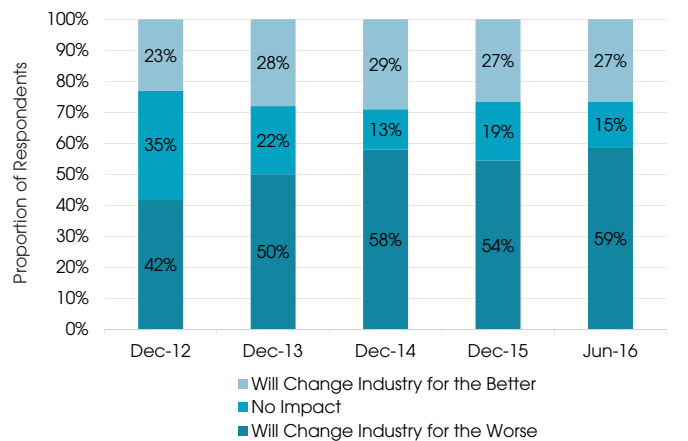
Source: Preqin Hedge Fund Manager Surveys, December 2015 and June 2016

Fig. 9: Fund Manager Views on whether Regulation Is Increasing the Costs of Their Business



Source: Preqin Hedge Fund Manager Survey, June 2016

Fig. 10: Fund Manager Views on the Impact of Regulation on the Hedge Fund Industry, December 2012 - June 2016



Source: Preqin Hedge Fund Manager Surveys, December 2012 - June 2016



Outlook for H2 2016

Hedge fund managers are divided on the prospects for the asset class in the second half of 2016: an equal proportion (35%) of fund managers feel that the outlook for the hedge fund industry is positive as negative, with 30% maintaining a neutral outlook at this stage (Fig. 11).

Performance

Unsurprisingly given the recent low returns of the industry and continued uncertainty regarding the potential impact of macroeconomic events, the majority of hedge fund managers forecast low, single-digit full-year returns for the hedge

fund industry (Fig. 12). The median predicted return for 2016 was 3%; only 6% of managers predicted returns of 6% or more and one in 10 respondents forecasted negative returns for the year.

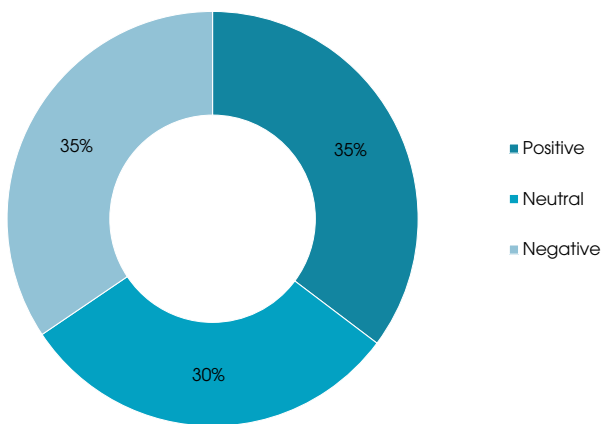
Assets under Management

Following outflows from the industry in the early part of 2016, almost half (48%) of fund managers surveyed believe that hedge fund assets under management (AUM) will decline in the second half of the year, compared with only 23% that believe AUM will increase (Fig. 13).

Top Performing Strategies

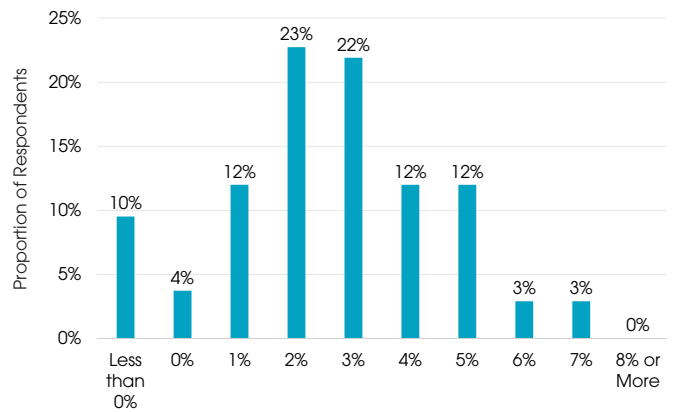
The largest proportion (21%) of fund managers believe that managed futures/CTAs will be the best performing hedge fund vehicles this year (Fig. 14). CTAs are currently the weakest performing top-level strategy in 2016 YTD (+0.49%); however, the strategy typically has a low correlation with other hedge fund strategies and performed well in the first two months of the year, when most other strategies recorded negative performance (see Preqin Special Report: CTAs). Meanwhile, the greatest proportion (30%) of hedge fund

Fig. 11: Fund Manager Outlook for the Hedge Fund Industry in H2 2016



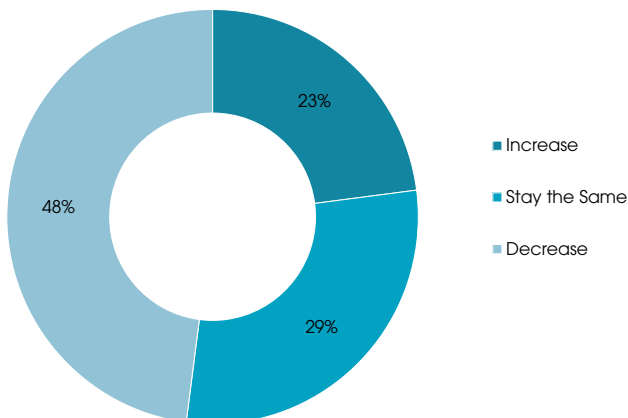
Source: Preqin Hedge Fund Manager Survey, June 2016

Fig. 12: Fund Manager Expectations of Full-Year 2016 Hedge Fund Industry Performance



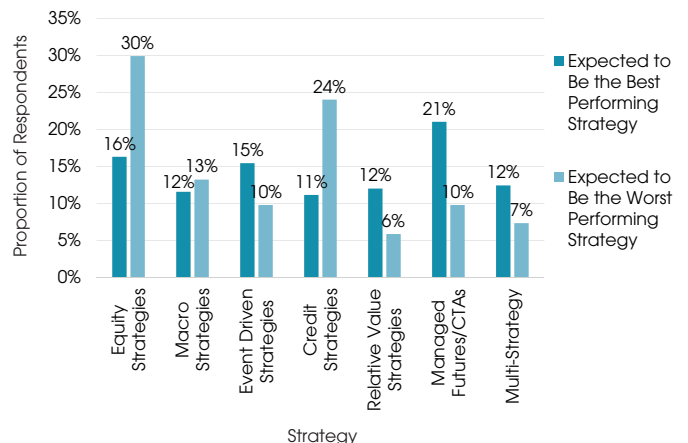
Source: Preqin Hedge Fund Manager Survey, June 2016

Fig. 13: Fund Manager Expectations for Hedge Fund Industry Assets under Management in H2 2016



Source: Preqin Hedge Fund Manager Survey, June 2016

Fig. 14: Fund Manager Expectations for the Best and Worst Performing Strategies in 2016



Source: Preqin Hedge Fund Manager Surveys, June 2016



managers expect equity strategies to be the worst performing strategy this year, compared with only 16% that expect them to be the best performing.

Fundraising

With investors' attention firmly focused on the issues of hedge fund performance and fees, over half (52%) of surveyed fund managers feel that investors are more negative towards hedge funds than they were 12 months ago (Fig. 15). Nevertheless, hedge fund managers' outlook on fundraising is mixed: although 39% stated that fundraising was more difficult in H1 2016 than in 2015, 29% found it easier and 32% reported no change (Fig. 16).

Overcoming Investor Concerns

Fund managers will seek to overcome investor concerns about the industry and encourage investment in their funds by making use of a range of strategies (Fig. 17). Most frequently, fund managers aim to reassure investors by improving the transparency of their strategy (69%), the risks (63%) and their business through opening their offices to client visits (58%). For many, this will also involve investing in their middle- and back-office infrastructure in order to ensure that they are able to fully meet investors' needs (42%).

A smaller but significant proportion recognize that outward engagement and educating investors about the industry and its benefits may also improve investor sentiment towards the asset class and encourage investors to engage with fund managers. While some fund managers focus on educating investors on their firm strategy, through providing education to investment teams (33%) or presenting at conferences and industry events (31%), others also seek to improve perceptions of the wider industry through membership of industry associations (16%) or educating investors' investment teams on hedge funds (11%).

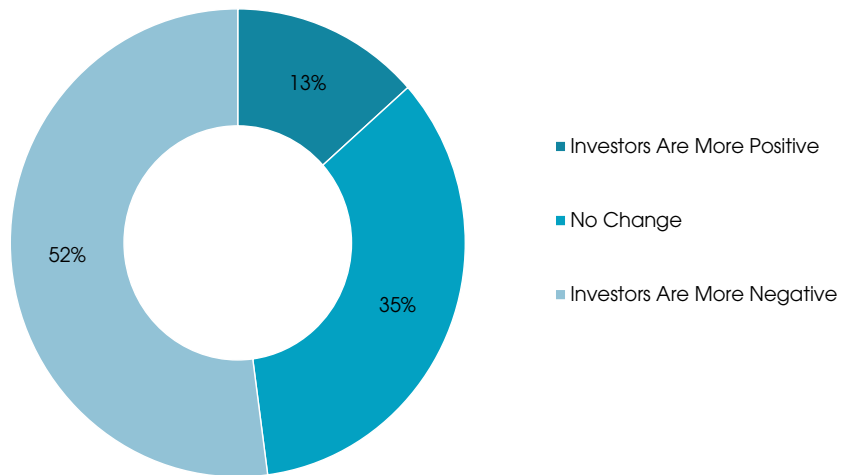
Source New Investors for Funds

Preqin's **Hedge Fund Online** contains detailed profiles for over 5,000 institutional investors actively investing in hedge funds.

For more information, please visit:

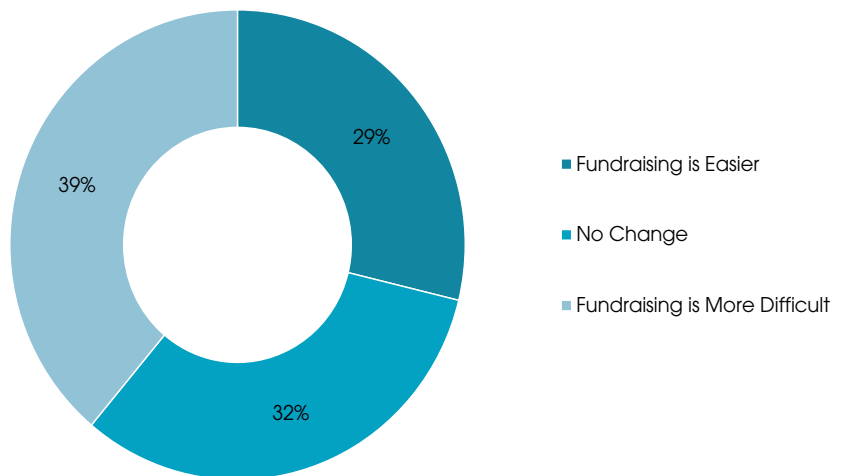
www.preqin.com/hedge

Fig. 15: Fund Manager Views on Investors' Changing Attitudes towards Hedge Funds in the Past 12 Months



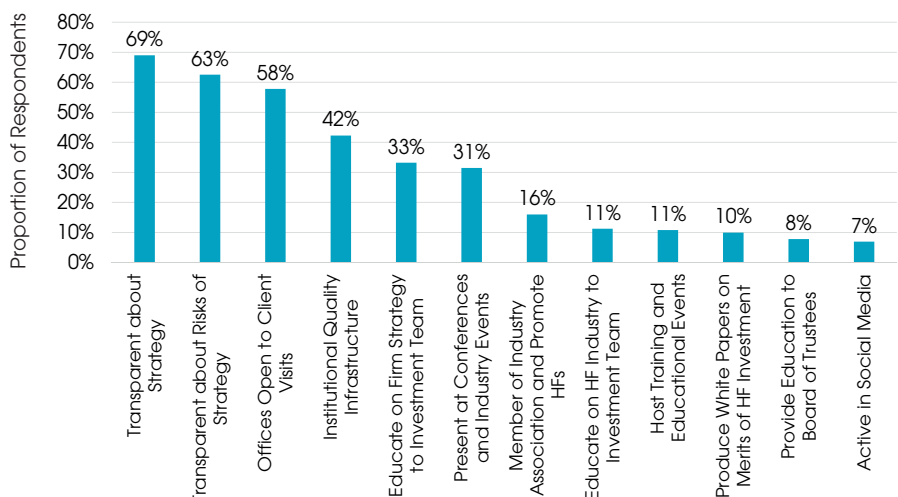
Source: Preqin Hedge Fund Manager Survey, 2016

Fig. 16: Fund Manager Views on the Change in Fundraising Environment in H1 2016 Compared to 2015



Source: Preqin Hedge Fund Manager Survey, 2016

Fig. 17: Fund Manager Strategies to Overcome Investors' Concerns about Hedge Funds



Source: Preqin Hedge Fund Manager Survey, 2016



Preqin Special Report: Hedge Fund Manager Outlook

July 2016

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