

WILL HEDGE FUNDS EVER TRULY EMBRACE ESG PRINCIPLES?

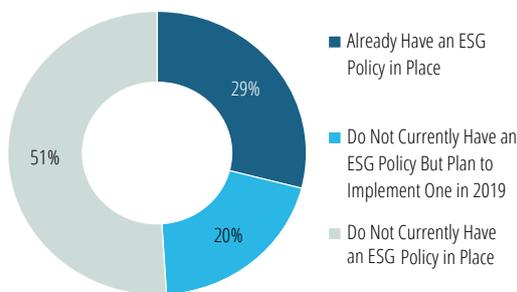
ESG is a hot topic in the private capital sector – you cannot pick up an alternative assets journal without finding a think piece on how ESG considerations are reshaping the illiquid alternatives space. In the world of hedge funds – an industry as multi-faceted and open to interpretation as ESG itself – the topic is far from clear cut, and managers are divided on whether ESG has a place in a sector designed around unconstrained investments.

For some, considering ESG within the context of hedge funds may appear contradictory. Hedge funds exist to generate an absolute return across a range of markets and asset classes, using a variety of instruments to achieve a differentiated return stream. Therefore, constraining portfolios based on ESG considerations may be an anathema for some hedge fund managers. However, many investors (29%) already have ESG policies in place specifically for their hedge fund investments, and a large portion (20%) are planning to do so in 2019 (Fig. 1). There is a clear appetite for hedge funds to invest responsibly – and ignoring this may prove foolhardy in a fundraising market that is already incredibly challenging.

Responding to this investor appetite is the 20% of hedge fund managers surveyed by Preqin that have an ESG policy in place, and the further 15% that plan to implement a policy imminently (Fig. 2). Although a significant proportion (65%) of hedge fund managers intend to have an ESG policy by the end of 2019, this pales in comparison to private equity, where 53% of managers already have ESG policies in place and a further 15% expect to by the end of the year. Hedge funds clearly have some way to go to match other alternative assets when it comes to embracing and adopting ESG.

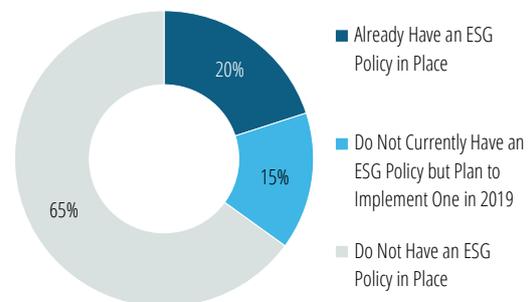
This begs the question: should more hedge funds be thinking about ESG factors? Looking beyond the clear appetite that already exists among institutional investors, ESG looks set to grow in importance in the future – we believe more hedge fund managers should be thinking about ESG policies today to have a successful tomorrow. Why do we believe this? In Preqin’s **Future of Alternatives** report, we looked five years ahead to examine what the alternative assets industry will look like in 2023. Our study found that the industry is likely to be much greater in size: we expect to see larger amounts of AUM (predicted \$14tn) with participants offering a more complex range of products.

Fig. 1: Investors with an ESG Policy in Place for Their Hedge Fund Portfolio



Source: Preqin Investor Interviews, November 2018

Fig. 2: Hedge Fund Managers with an ESG Policy in Place

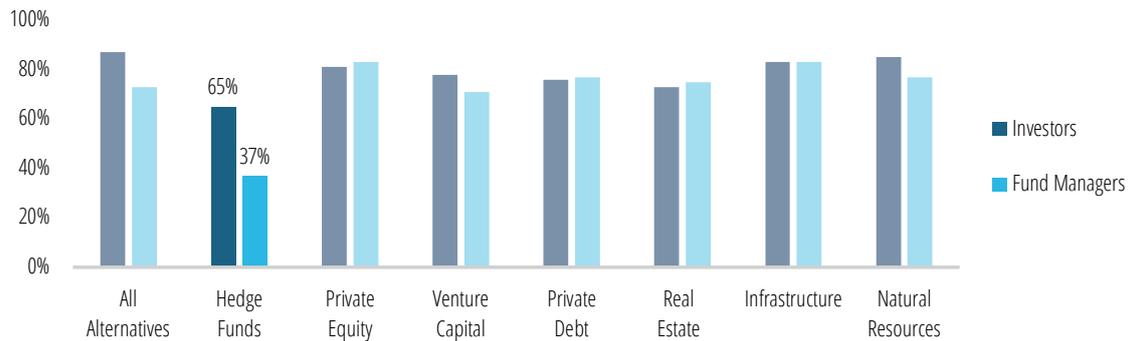


Source: Preqin Fund Manager Survey, November 2018

The uptake in ESG investing within alternatives assets is expected to be a key driver of some of this growth. LPs and GPs in the private capital industry share the belief that considering ESG factors when making investments leads to more sustainable returns and reduces risks when investing in private assets. In the hedge fund universe, however, managers of hedge funds and their investors largely disagree as to the importance of ESG factors moving forwards. Sixty-five percent of surveyed investors believe ESG factors will be more important to their

hedge fund portfolio in 2023 – by comparison, just 37% of hedge fund managers feel the same (Fig. 3). With the gap between investors and fund managers on the subject set to widen, it is likely that those hedge funds that embrace ESG considerations within their organizations may be the ones that are better able to tap into the expected growth in alternative assets.

Fig. 3: Investors and Fund Managers that Believe ESG Will Become More Important over the Next Five Years



Source: Preqin Investor and Fund Manager Interviews, November 2018

COMING SOON...

Preqin Pro will soon feature information on fund managers' and investors' ESG investments. Uncover investor preferences and mandates for ESG-compliant vehicles and know which fund managers have investment criteria that incorporates ESG.

To be the first to be notified when this new feature is available, please get in touch: marketing@preqin.com