

Welcome to the August 2010 edition of *Hedge Fund Investor Spotlight*, the monthly newsletter from Preqin providing insights into institutional investors in hedge funds. This month *Hedge Fund Investor Spotlight* contains information from our industry-leading online product, *Hedge Investor Profiles*.

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**The Next 12 Months: Institutional Appetite for Hedge Funds.**

As the hedge fund industry continues to recover from the financial crisis, we look at how the difficulties have affected investor confidence and investment plans for the next 12 months.

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### Investor News

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A round-up of the most important new developments in the institutional investor universe. Full profiles for all institutions featured in *Investor News* can be viewed on our online service, *Preqin Hedge Investor Profiles*.

Featured this month:

- Old Dominion University
- EXTOREL
- Credit Suisse Alternative Capital

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# The Next 12 Months: Institutional Appetite for Hedge Funds

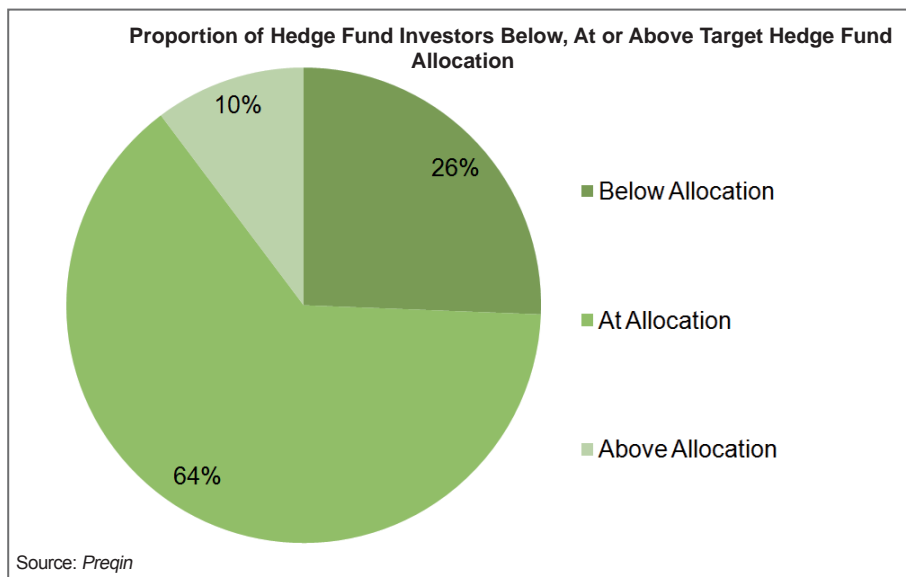
The hedge fund industry has experienced challenging conditions over the past two years following the onset of the financial crisis, with the asset class emerging from the downturn having undergone a number of significant changes.

Perhaps the most notable shift has been the move towards a more institutional investor base and the consequent evolution in fund management that this shift demanded, such as more transparent and detailed reporting standards. Although initially dictated by a reduction in high net worth capital available to the industry, the advantages of more stable long term capital in the form of institutional support have become increasingly appealing to hedge fund managers, with many firms previously only utilising high net worth capital now seeking to garner institutional commitments for the first time.

## Allocation to Hedge Funds

With the institutional sector being increasingly important to the industry, and with increasing numbers of fund managers seeking to position themselves effectively to attract institutional support,

Fig. 1:



Preqin undertook a survey of 50 leading institutional investors from around the world in July 2010 in order to ascertain their hedge fund investment plans for the coming 12 months. This month's feature article examines the findings of this survey.

Just over a quarter, 26%, of institutional investors are below their target allocation

to hedge funds and will therefore continue to look for new investment opportunities over the next 12 months. This suggests a positive shift in asset flow into the sector, which is encouraging news for hedge fund managers that are seeking institutional support.

Fig. 2:

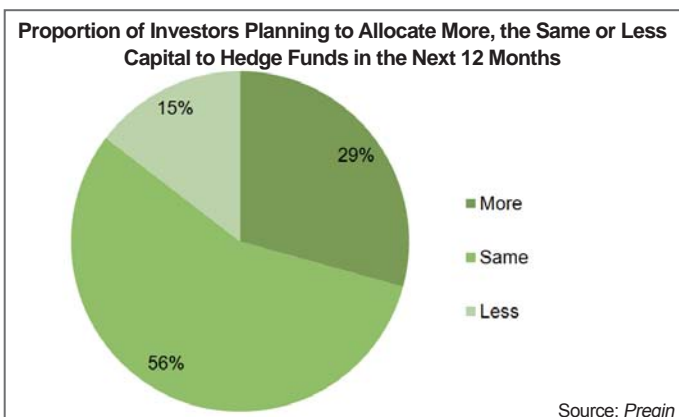
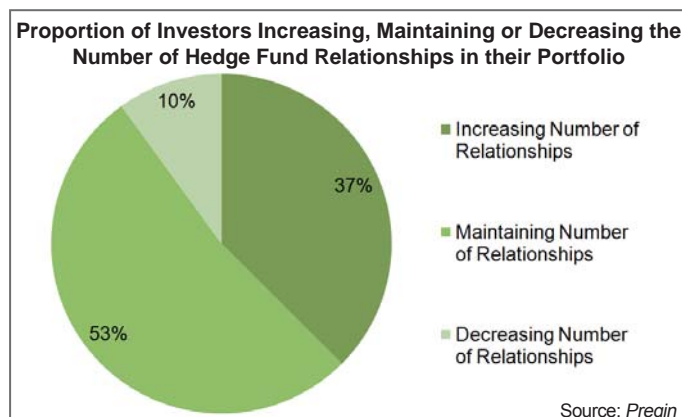


Fig. 3:



## Plans for the Next 12 Months

Investors were asked if they would be allocating more, less or the same level of capital to hedge funds as they had done in the previous 12 months. Fig. 2 shows that the results were again encouraging, with only 15% of respondents saying that they would be investing less capital. 56% plan to allocate the same amount of capital to the asset class, and 29% will invest more capital in hedge funds than they have in the previous 12 months. This suggests that investor confidence is returning and that institutional investors will be actively pursuing new opportunities in the coming year.

As shown in Fig. 3, the majority (53%) of investors plan to maintain the number of hedge fund manager relationships in their portfolios over the next 12 months, and more than a third, 37%, will be seeking to increase the number of relationships they have. Although 10% of investors plan to reduce the number of hedge fund relationships they currently maintain, investors are generally positive and are seeking new opportunities and looking to form new relationships with managers.

### Investor Appetite for Existing Managers vs. New Managers

It is likely that there will be an increasing amount of capital invested in hedge funds in the short to medium term and investors were asked whether they plan to invest this capital with new or existing managers.

Fig. 4:

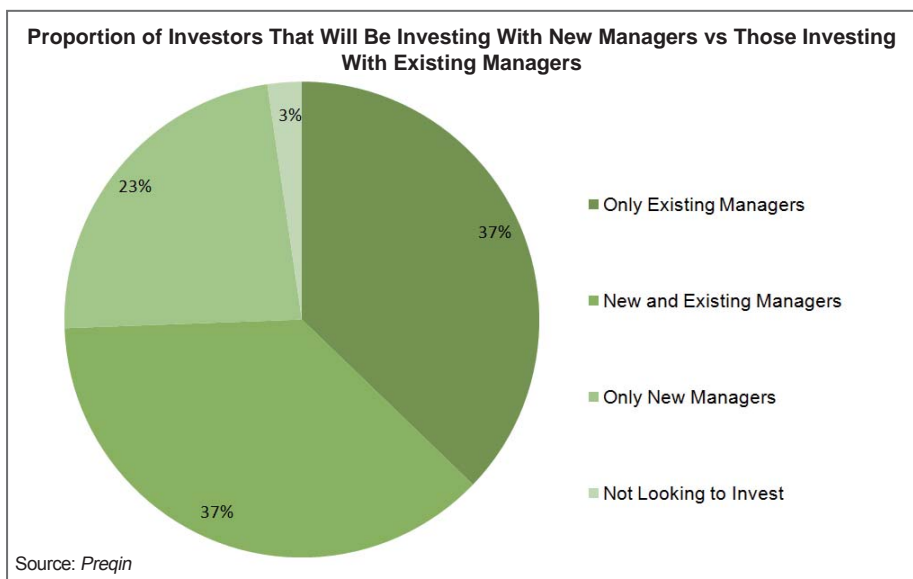


Fig. 4 shows that 37% will maintain relationships with their current managers and will not be seeking new managers for their investment portfolios. A further 37% will be investing in a mixture of both existing and new managers and 23% will be adding funds with new managers only. Although investors are satisfied with the relationships they already have, a significant proportion will be looking to invest only with new managers. This is likely to be due to a combination of factors such as investors seeking new fund strategies and dissatisfaction with fee structure and fund terms.

### Longer Term Plans

Fig. 5 shows that 46% of investors plan to increase their hedge fund allocation in the next three to five years, a higher proportion than are planning to do so in the next 12 months. Only a small proportion (10%) intend to reduce their exposure to hedge funds and 44% foresee their hedge fund allocation staying the same.

### Hedge Fund Performance

Fig. 6 shows that investors are generally satisfied with the performance of their hedge fund investments over the last 12 months, with 69% of respondents stating that their investments met or exceeded

Fig. 5:

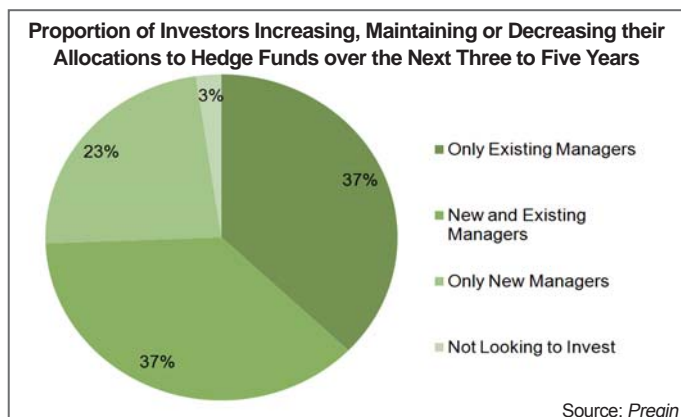
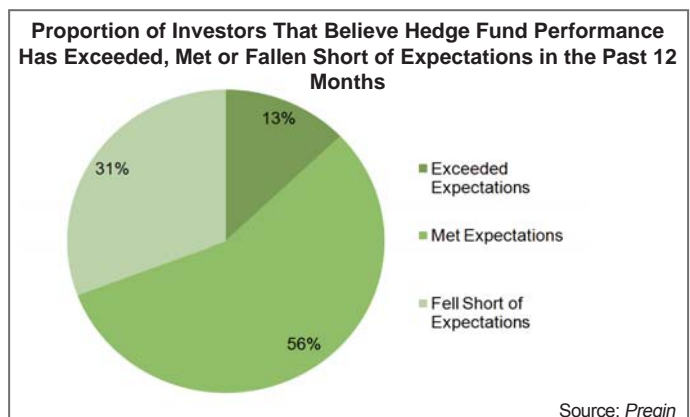


Fig. 6:



their expectations. However, just under a third of investors surveyed felt that the performance of their hedge fund portfolios had fallen short of expectations.

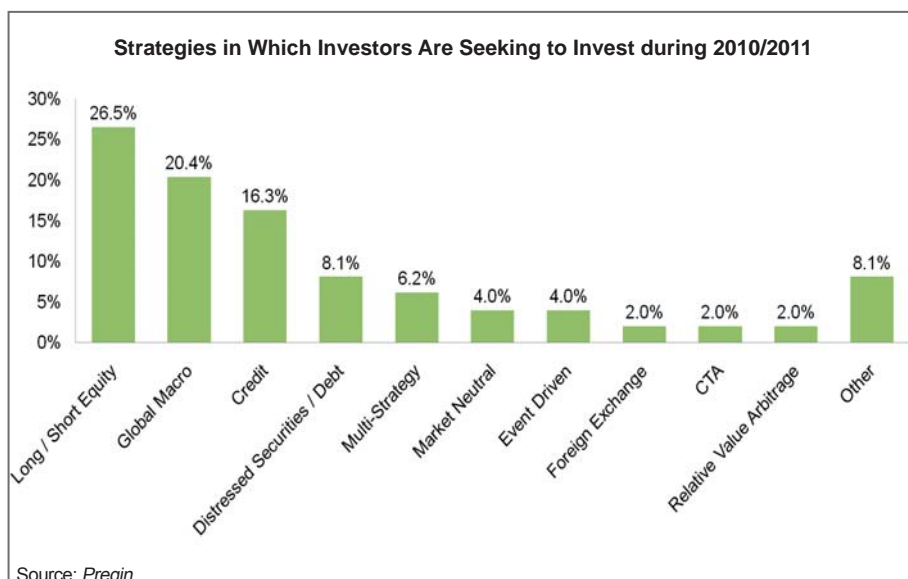
### Strategic Preferences

Long/short equity and global macro are amongst the most favoured hedge fund strategies, and in the current economic climate it is not surprising to see that institutional investors are seeking to invest in more liquid hedge fund strategies. While credit and distressed securities/debt are still popular strategies, none of the surveyed investors favour funds of hedge funds, as shown in Fig. 7. Those that have been investing in hedge funds for a while tend to move away from this type of fund as they become more familiar with the asset class, preferring to invest directly instead. There are a number of reasons for this, such as the additional layer of fees associated with multi-manager funds and the desire for a greater control over investments. Foreign exchange and relative value arbitrage are amongst the least targeted strategies and this is again a result of the change in the wider economic climate.

### Summary

The results of the survey indicate that institutional support for hedge funds is set to increase modestly in the coming year, with longer term plans pointing to a more significant increase in commitment levels. With new investors also continuing to enter the asset class all the time, the institutional investor base continues to grow in significance, and it will become increasingly vital for fund managers to adopt fund management practices that are suited to institutional capital if they are to attract such support.

Fig. 7:



One of the most significant findings of the survey is the relatively high proportion of institutions that will be considering exposure with new managers rather than simply increasing or maintaining allocations to existing managers. During this period of transition we are seeing investors paying close attention to existing investments and becoming especially active in ensuring that they are assembling an effective portfolio aligned to their appetite for risk and general strategy through reviewing potential new investments.

As a result there are many opportunities to gain institutional support for hedge funds in the current market, and it is especially important that managers seeking to raise capital are able to identify those investors exhibiting a preference for their fund types in order to be efficient and successful in the fundraising market.

**Suganniya Kanaganayagam**

Preqin's Hedge Investor Profiles has detailed information on over 2,500 institutional investors that have expressed an active interest in hedge funds. The database includes profiles for 223 institutional investors that are considering making their first investment in hedge funds over the next 12 months.

In addition Preqin monitors over 200 consultants active in alternative assets advisory.

For a demo of our service please visit:  
[www.preqin.com/hedge](http://www.preqin.com/hedge)



# Investors in Focus: European Banks

Fig. 1:

Key Facts: European Banks Investing in Hedge Funds	
Average allocation to hedge funds (of a European bank)	7.4%
Average # of hedge funds within a European bank's portfolio	15+
Typically been investing in hedge funds for...	10 years and over

The European banking industry has been under much scrutiny over the last two years and as regulation, stress testing and other ongoing continent and EU-wide issues remain the focus of much attention, the pressure on this market sector is likely to continue well into the future. European banks have traditionally been large supporters of the hedge fund industry and since the financial crisis, they have had to adapt to the changes within the industry, both in terms of client demands and what they look for in the hedge funds they invest in.

Banks are an important source of funds of funds based in Europe, with 15% of all European funds of funds being subsidiaries of units of European banks. The country with the highest proportion of its banks investing in hedge funds is Switzerland, which is also home to over a third of all funds of funds that are subsidiaries of European banks. Many European banks from other countries choose to head their fund of funds units from Switzerland. This could be because of tax and regulation breaks, proximity to clients or proximity to the funds they invest

in. Countries in Southern Europe, such as Spain and Italy, are also important centres for both banks that invest in hedge funds on behalf of their clients and for their subsidiary funds of funds.

European banks invest in a variety of hedge fund strategies, both to diversify portfolio risk and to access the best performing vehicles. "Traditional" liquid strategies such as long/short equity, macro and CTA funds are currently very popular as they enable investors to tap into liquid sources of alpha in a period where liquidity is paramount. About 40% of all banks invest in funds of funds to some extent; this might include exposure to their own funds of funds, or other multi-manager vehicles. Over the course of 2010 there has been an increase in the number of firms offering UCITS-style hedge funds to their clients, both to attract cautious and liquidity-minded investors, and to pre-empt regulation within the industry.

European banks are truly global investors, with nearly 70% stating that they look for hedge fund investments on a global

basis. As long-term investors in the asset class, often with links and offices in many regions across the globe, European banks are able to assess hedge funds based both within Europe and elsewhere in the world. This ability to search for and carry out due diligence on funds regardless of location has enabled these investors to source funds in regions which may be untapped by other European investors.

European banks are an important source of capital for hedge funds throughout the world. Through their investment banking activity, fund of funds units and retail offerings, European banks are one of the most prolific groups of investors in hedge funds in Europe. This sector of the market has come under much scrutiny following the market crisis, but it has started to recover and adapt to changes within the industry. Liquidity is one of the key concerns for these investors, and the uptake and distribution of UCITS-style funds is one of the ways in which we are seeing the banking sector adapt to the changing environment.

**Amy Bensted**

Fig. 2:

Top Five European Countries in Terms of Proportion of Banks Investing in Hedge Funds	
Country	Proportion of Country's Banks That Invest in Hedge Funds
Switzerland	25.0%
Italy	13.9%
UK	11.1%
France	11.1%
Spain	8.3%



Fig. 3:

Top Five Countries in Terms of the Funds of Hedge Funds Units Associated with European Banks	
Country	Top Locations of European Bank's Funds of Funds Arms
Switzerland	34.3%
UK	14.3%
Italy	11.4%
Spain	8.6%
Sweden	8.6%

Fig. 4:

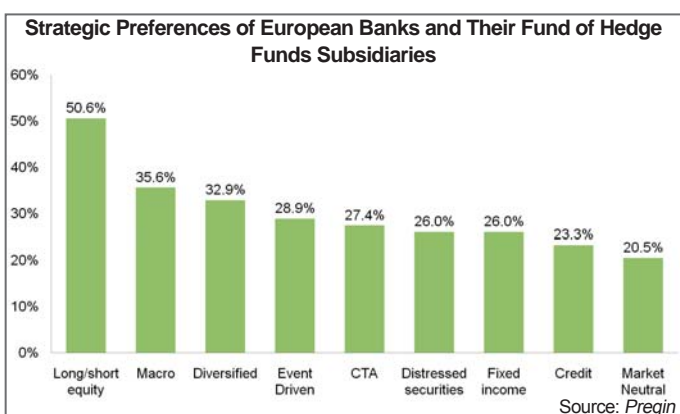
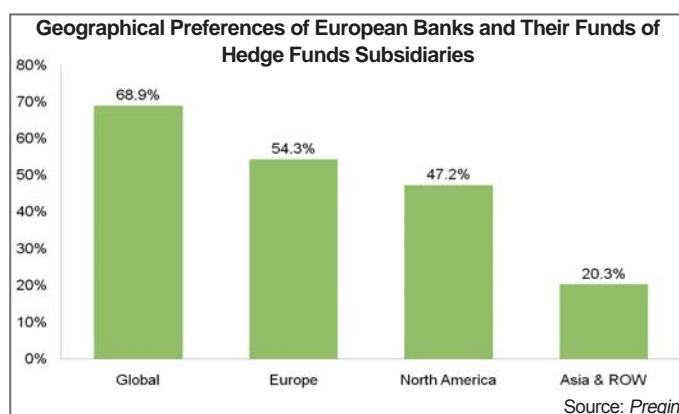


Fig. 5:



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# Strategy in Focus: Currency/FX Hedge Funds

Fig. 1:

Key Facts: Investors in Active Currency/FX Funds	
% of institutional hedge fund investors that state FX and currency as a preference	8.5%
Median AUM of an FX and currency investor	USD 4.5 billion
Average allocation to hedge funds of an FX and currency investor	18.0%
Average returns sought from FX and currency investments	9.0%
Most favoured investment approach (funds of hedge funds, direct hedge funds, mixture of both)	Direct

Although not traditionally a common strategy used by institutional investors, foreign exchange and currency hedge funds have become increasingly attractive as investors expand their hedge fund knowledge and place greater emphasis on portfolio liquidity. 8.5% of investors on the Preqin Hedge Investor Profiles database state a preference for this type of investment. The majority of investors commit to these funds directly rather than through funds of funds.

Most of the capital for these funds comes from North America, a region that includes some of the most experienced hedge fund investors, which are more likely to diversify their portfolios and invest in niche strategies. A considerable 25% of investors in these funds are based in Europe and if demand for increased hedge fund liquidity continues, it is likely that the strategy will gain a more global appeal.

Foreign exchange and currency hedge funds obtain most of their capital from endowment plans and fund of hedge funds managers.

**Katy Johnson**

Preqin monitors 216 institutional investors with an appetite for foreign exchange and currency funds. 157 are based in North America, 53 in Europe and 6 in Asia and Rest of World.

For more information visit: [www.preqin.com/hedge](http://www.preqin.com/hedge)

Fig. 2:

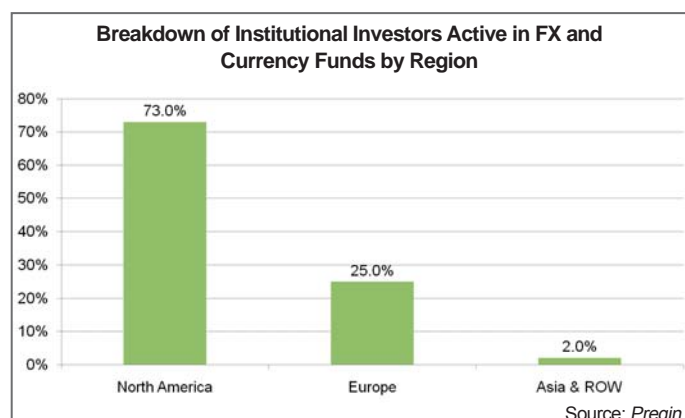
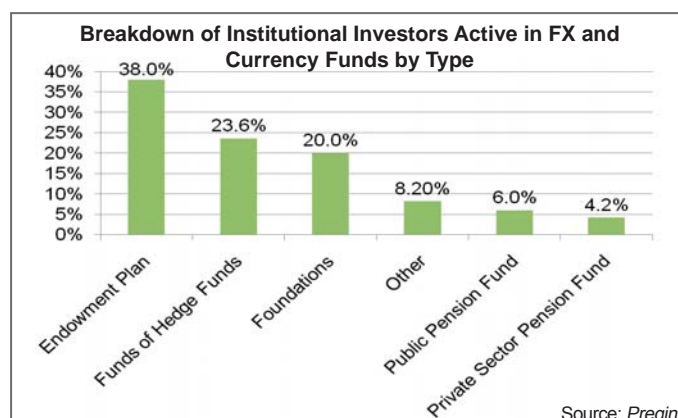


Fig. 3:



# Investor Spotlight: Investor News

## Denver Employees' Retirement Plan makes maiden investment in hedge funds.

The USD 1.7 billion Denver Employees' Retirement Plan (DERP) has made its first hedge fund investment, committing USD 80 million in July 2010. It awarded the mandate to New York-based Prisma Capital Partners, following cuts to some of its core fixed income managers.

## Credit Suisse Alternative Capital unveils new UCITS-focused fund.

The fund of hedge funds manager has unveiled its latest offering, a UCITS III-compliant multi-strategy fund. The CS Prima multi-strategy fund will invest in 15-35 underlying managers and will allocate to a range of strategies including equity, event driven, convertibles, macro, credit, managed futures, fixed income and emerging market equity. It has a target volatility of 5% and is hoping to start operations with initial subscriptions of more than EUR 100 million.

## EXTOREL ups its target allocation to hedge funds.

The family office has announced plans to increase its hedge fund allocation from 6% to 15% in the next 12-15 months. It currently invests in nine direct hedge fund vehicles, which it hopes to increase to around 15-20. It is particularly interested in foreign exchange, distressed, long/short equity and global macro hedge funds. EXTOREL has a far-reaching geographical mandate and will consider investments worldwide including in Asia and emerging markets. It will not invest in funds with lock-up periods and prefers to retain a certain amount of flexibility with all its investments. It has a preference for UCITS III hedge funds.

## Old Dominion University plans to add a new manager to its portfolio.

The endowment, which manages USD 150 million, has announced plans to add another hedge fund manager to its investment portfolio in the next six months.

It will not invest with any of its existing managers but instead plans to focus on finding a new manager. It believes that multi-strategy hedge funds are offering the best opportunities for investors at present but will consider other strategies.

## SEB Asset Management looking at seeding start-ups in 2011.

The USD 2 billion SEB Asset Management is planning to seed several hedge funds over the course of 2011. It will be seeking new hedge funds to invest in for a new fund of funds it will be launching. The firm intends to allocate capital to a range of liquid strategies including global macro, foreign exchange, fixed income, long/short equity, credit and event-driven strategies. The firm has previously incubated an early stage hedge fund, providing USD 15 million to Swedish start-up hedge fund firm, Vikström & Andersson Asset Management in 2009.

## GCI Asset Management on the lookout for Asian-based funds.

The asset manager is searching for new investment candidates and is specifically looking to target Asian-based funds with a wide range of strategies. It is likely to award USD 1-2 million mandates to each hedge fund manager. The Tokyo-based firm has been managing funds of hedge funds for nearly a decade and its investments are predominantly focused on funds located in Asia.

## NLI International seeking several new hedge fund managers.

NLI International expects to make 5-10 new hedge fund investments in the next 6-12 months. The firm is a wholly owned subsidiary of Nippon Life Insurance, one of Japan's biggest insurance companies. With over USD 1 billion invested in hedge funds, it is one of the largest investors in the asset class. NLI International invests opportunistically, currently focusing on long/short equity, global macro, emerging markets and event-driven strategies.

## Rabobank Corporate Pension redeems hedge fund investments.

The EUR 11.8 billion private sector pension fund has announced that it will no longer be investing in the asset class after terminating its investments with its fund of hedge funds managers. It decided to redeem more than EUR 383 million from the asset class and cited transparency issues as one of the main reasons for terminating its holdings in the asset class.

## New York State Common Retirement Fund finalizes its emerging manager program.

The USD 129 billion pension fund has chosen Rock Creek Group to run a USD 200 million mandate to focus on emerging managers. This program will target experienced managers which have yet to gain traction in terms of investor capital, female-owned or minority-led funds. New York State is also planning to deploy up to USD 300 million in a seed capital program.

This is just a selection of recent news on institutional investors in hedge funds. More news and updates are available online for Hedge Investor Profiles subscribers.

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