Hedge Fund Investor Spotlight

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Welcome to the April 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, The 2010 Preqin Sovereign Wealth Fund Review and The 2010 Preqin Global Hedge Fund Investor Review.

The Fee Debate: An End to “2 & 20”?

The Fee Debate: An End to “2 & 20”?

This month’s Feature Article investigates the results of our survey of hedge fund managers and fund of hedge funds managers, conducted to assess how the shift of power from managers to investors has affected terms and conditions.

Sovereign Wealth Funds

This month’s Investors in Focus looks at sovereign wealth funds investing in hedge funds, examining their strategic hedge fund preferences.

Global Macro

Each month, Strategy in Focus examines a particular hedge fund strategy, using data from Preqin’s Hedge Investor Profiles service. This month we look at global macro.

What would you like to see in Hedge Fund Spotlight?

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A look at the upcoming events in the hedge fund world.

This month’s Investor News identifies some 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:

- New Mexico Public Employees’ Retirement Association
- Bahrain Mumtalakat Holding Company
- London Borough of Camden Pension Fund

Feature Article

The Hedge Fund Fee Debate: An End to "2 & 20"?

2009 was a turbulent year for the hedge fund industry. The beginning of the year was the most testing time for the asset class as it witnessed the collapse of many funds following the financial crisis that took hold of the markets in 2008. However, in the latter part of 2009, the market started its recovery and the proposals for increased regulation and transparency in the industry, coupled with fund managers' willingness to be more flexible in order to attract investors, helped improve investor confidence.

Preqin carried out a survey of hedge fund managers and fund of hedge funds managers in Q2 2009 and again at the end of Q4 2009. The aim of the initial survey was to assess how the market crisis had resulted in a shift of power from managers to investors and how this in turn affected the terms and conditions of hedge funds and funds of hedge funds. Preqin's survey in December 2009 examined this further. The survey covered both single hedge fund managers and fund of hedge funds managers across a wide range of strategies and regions. The survey covered data on 900 hedge funds.

Fig. 1:

Key Statistics: Mean and Median Management Fees				
	HF		FOHF	
	Mean	Median	Mean	Median
Management Fee	1.65%	1.50%	1.44%	1.50%
Performance Fee	18.89%	20.00%	11.54%	10.00%

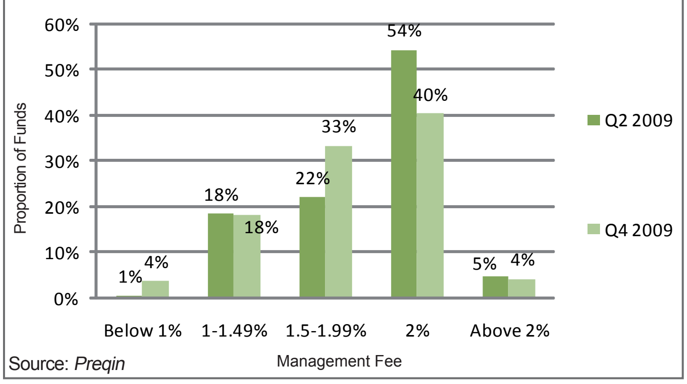
Source: *Preqin*

Management fees for single manager funds are, on average, considerably lower than the perceived industry standard of 2%. The mean management fee is 1.65%, with the median at 1.5%. This suggests that an increasing number of funds are charging below the standard 2% management fee. Many managers have lowered their management fees in order to attract investors following the market crisis. The mean management fee for funds of hedge funds is 1.44% and the average performance fee is 11.54%.

The market crisis changed the fundraising environment and as a result, the traditional "2 & 20" fee structure has become less common. Today just 38% of single manager hedge funds charge "2 & 20". Hedge fund managers are becoming more flexible with their fee structures by either charging lower management or performance fees or reducing both in an attempt to attract investors and retain a competitive advantage.

Fig. 2:

Management Fee Distribution for Single Manager Hedge Funds



Source: *Preqin*

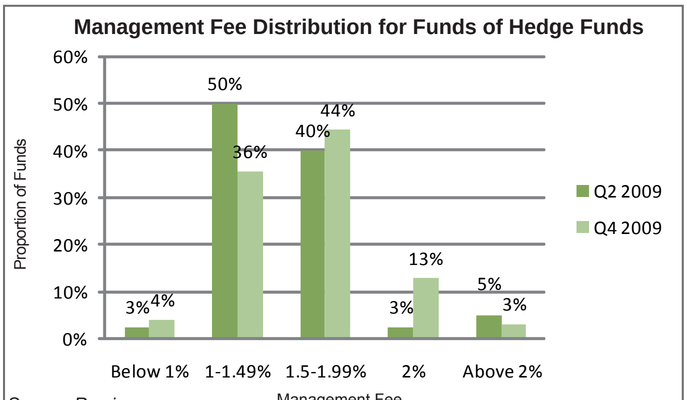
Fees

From Fig. 2 we can see that across the sample of funds in the Q2 versus Q4 2009 surveys there was a significant decrease in the proportion of single manager funds charging a management fee of 2% and an increase in the proportion charging 1.5-1.99%. The distribution of hedge fund management fees is shifting towards the lower end of the scale. The highest management fee charged by any survey respondent was 4% and the lowest was 0%.

Funds of funds typically charge a management fee of 1-1.99%. At the beginning of last year, funds of hedge funds were going through what was arguably the worst period in their history. Investor dissatisfaction was at an all-time high following the poor performance of many such vehicles (compared to direct investments) and the gating of assets, which was occurring as a result of liquidity restrictions in underlying funds. However, there was a recovery in the sector towards the end of the year and there was an improvement in the performance of many funds of hedge funds. As a result, some funds that were launched towards the end of last year were coming to market with management fees that were higher than funds launched in the midst of the market crisis. The average management fee for funds of hedge funds is 1.44%

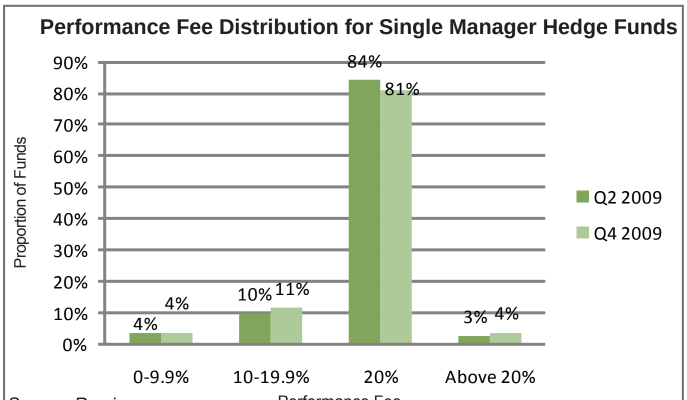
In Q2 and Q4 2009, it is clear that performance fees showed less variation than management fees. The mean performance fee charged by single

Fig. 3:



Source: *Preqin*

Fig. 4:



Source: *Preqin*

manager hedge funds as of Q4 2009 was 18.89% compared to 18.88% in Q2 2009. This indicates that investors are still prepared to reward good performance despite the market turbulence, and there has been much less pressure for managers to reduce performance incentives. The predominant pressure from investors has been towards a reduction in management fees. Investors believe that such fees should cover “operational, back office and other overhead costs” and should not be used as a profit incentive like performance fees.

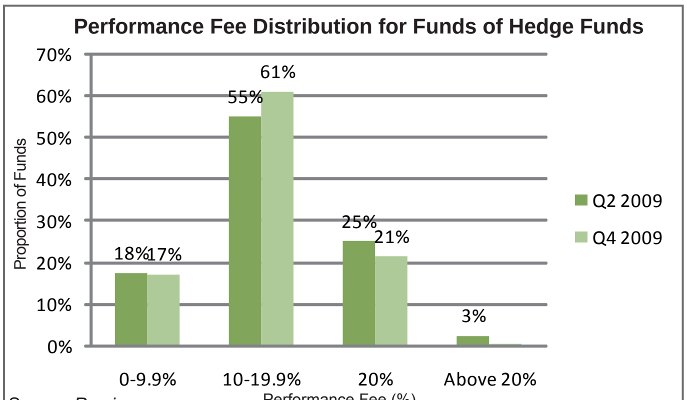
There are greater differences in the mean performance fee charged by fund of hedge funds than single manager funds, but the shifts have not been significant. The average performance fee for a fund of funds is 11.58%. Due to the poor performance of hedge funds during the financial crisis, many investors redeemed investments from funds of hedge funds in favour of direct investment, and movement back into funds of hedge funds has been relatively slow in comparison to single manager hedge funds. The performance fees of funds of funds are under more scrutiny from investors with some investors debating whether this type of investment adds value to a portfolio. However, as with single manager funds, if performance objectives are met, investors are satisfied to award managers performance fees.

Some investors have called for the implementation of ‘clawback’ procedures in relation to performance fees because of poor performances. This would enable the investor to clawback performance fees charged by the manager in previous years if performance was not sustained. However, many investors feel that performance fees are justified if performance benchmarks are met and as a result “clawbacks” have not become common in the hedge fund industry. Only a limited number of managers have chosen to reduce their performance fees and many of these managers have negotiated other terms alongside such a reduction, such as being able to lock investor capital up for longer periods of time.

Manager and Investor Alignment of Interests

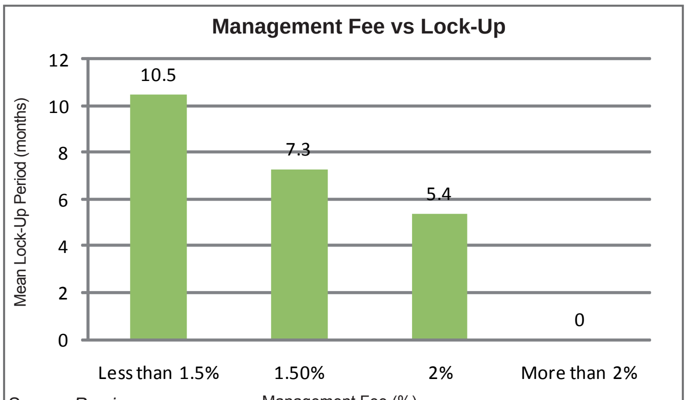
An important topic over the past 12 months has been the notion of a

Fig. 5:



Source: *Preqin*

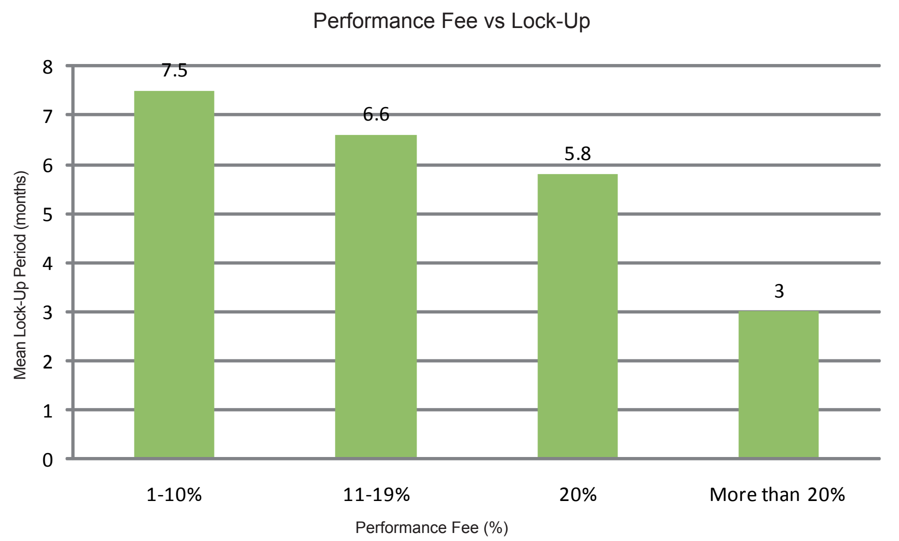
Fig. 6:



Source: *Preqin*

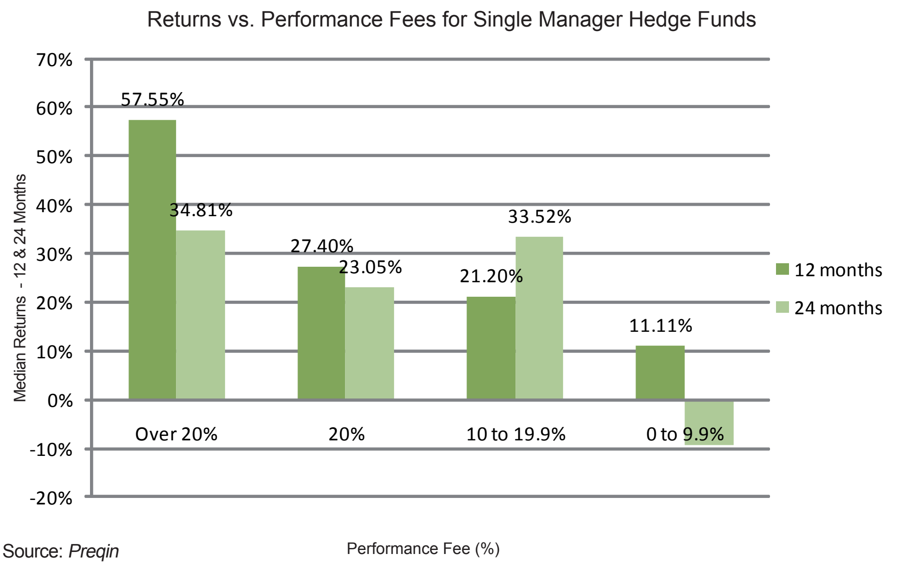
greater alignment of interests between managers and the investors in their funds. As discussed, there has been pressure from institutional investors to reduce management fees, as many investors feel that the current fee structure is not justified. Many managers have answered these calls by launching new funds with lower fees than the "2 & 20" standard or by launching new share classes of existing funds with lower management or performance fees. However, in return, managers have added terms that favour their fund's structures and can protect against the mass redemption requests that led to many problems at the end of 2008. As a result, many new funds, new share classes or individual negotiations on reduced fees have been coupled with an increased initial lock-up on the fund. This trend is clear in Fig. 6: the funds that charge lower management fees lock-up investor capital for longer periods than funds that charge higher management fees. This trend is also evident in performance fees (Fig. 7). Although there has been a power shift in favour of investors over the past two years, investors are also being flexible in the terms they are willing to compromise on with fund managers.

Fig. 7:



Source: *Preqin*

Fig. 8:



Source: *Preqin*

Performance

As part of our survey we collected data for each fund on cumulative 12- and 24-month performance (as of November 30th 2009). We used this data to analyze fund returns through the market crisis and compared this to performance fees.

Fig. 8 shows that there was a strong correlation between performance fees and the returns of single manager hedge funds over the period shown. It can be seen that single manager hedge funds that charged a higher performance fee, produced higher returns for their investors. This confirms that investors are prepared to pay higher fees if they are rewarded with good performance. Conversely the funds that charged the lowest performance fees generated the lowest returns for their investors. It is likely that many of these funds were forced to cut performance incentives following poor performance during the downturn in the markets. Although investors in funds charging a performance fee of 0-9.9% will save money on manager performance incentives, they will in turn have to compromise on the returns their hedge funds are generating for them.

Similarly, there is a clear correlation between the returns generated and the performance fees charged by fund of hedge funds managers. In general, the greater the performance fee, the higher the returns of a fund. For 24-month returns, only the funds of funds charging performance fees of 20% generated positive returns for their investors. These funds were able to keep their performance fees at a high level as they proved they could continue to generate positive returns to their investors even through the downturn.

Conclusions

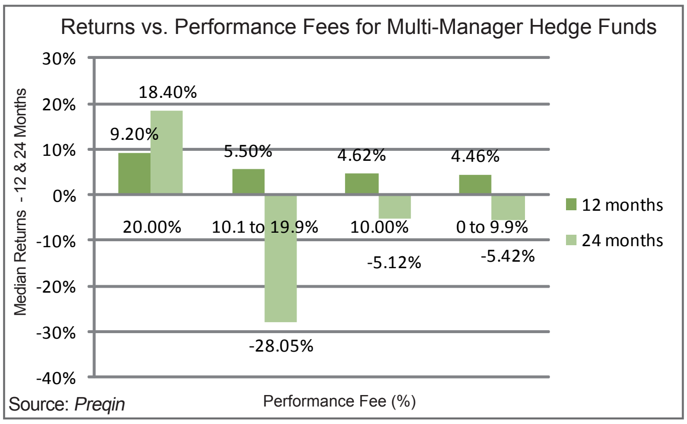
Hedge fund fees are significantly below the "2 & 20" standard. The mean management fee of single manager hedge funds is 1.65% and the mean performance fee is 18.89%. When setting up new funds, fund managers have deviated from the typical fee structure in order to attract institutional investors back to the asset class following a difficult period of disappointing returns and low investor confidence. Over 2009 an increasing number of investors demanded a greater alignment of interests between themselves and their managers. Many managers answered these calls by changing the terms of their funds and in many cases lowering the fees they charge. In 2009, institutional investors found themselves with much stronger bargaining power than when the hedge fund industry was booming. Prior to the market crisis fee structures were not questioned and investors were willing to pay more in order to access top-tier funds. However, in the current climate it is vital that managers are flexible with their fees in order to attract more sceptical and increasingly demanding investors.

In order to meet such investor demands, hedge fund managers are introducing new share classes of their funds with lower fees and longer lock-up periods. By limiting the liquidity of the fund, the managers are guaranteed a stable source of capital and in return investors pay lower fees. So if investors are prepared to be flexible with their requirements, many managers will reciprocate with lower fees.

The results of our returns versus performance comparison demonstrated that the funds that were earning the highest performance incentives generated the largest and most consistent returns for their investors. Performance fees have not declined as much from the standard management fee, which demonstrates that investors are not willing to compromise returns in favour of cost.

Suganniya Kanaganayagam

Fig. 9:



Source: *Preqin*

For the full findings of the hedge funds terms and conditions survey, please see our research report, available at:

www.preqin.com/hfterms

2010 Preqin Global Hedge Fund Investor Review:
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This year's Global Hedge Fund Investor Review includes profiles and analysis for the most important 1,000 investors from around the world, all split into separate regions and countries for ease of use. The Review also includes analysis and listings of investors with a preference for the 10 most important fund strategies.

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- Analysis for investors in each of the ten most important hedge fund strategies with listings for active investors
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Investors in Focus:
Sovereign Wealth Funds

Sovereign wealth funds are becoming increasingly important sources of capital for hedge fund managers and currently nearly 40% of all sovereign wealth funds invest in the asset class. Around half of all known sovereign wealth fund hedge fund investors made their maiden allocation in the last five years and 26% made their first commitments to hedge funds since the beginning of 2007.

Fig. 1:

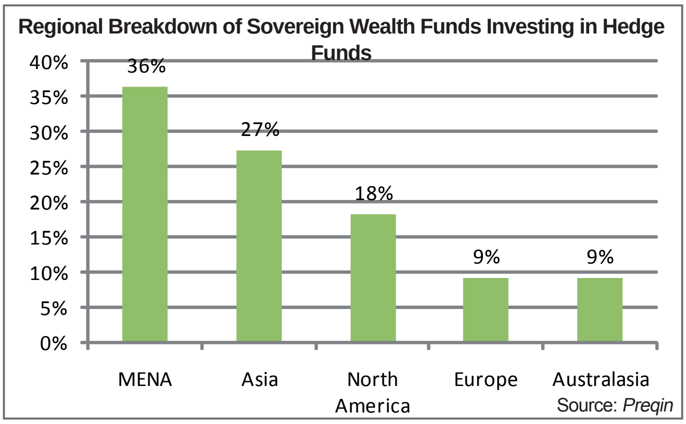
Overview of Sovereign Wealth Fund Hedge Fund Investors	
% of SWFs investing in hedge funds	39%
Average allocation to hedge funds	8.2%
Average target allocation to hedge funds	7.70%
Average AUM of a SWF hedge fund investor	USD 60 billion

Source: *Preqin*

The highest proportion of sovereign wealth funds investing in hedge funds are located in the MENA region. This region contains some of the most established sovereign wealth funds in the world, most of which have vast investment portfolios and significant investment experience. Sovereign wealth funds located in Asia make up nearly a third of all sovereign wealth funds globally, but only a third of these institutions invest in hedge funds. The Asian hedge fund market is likely to continue to evolve over the next few years as we are seeing an increasing number of hedge funds launched in this region and, although the industry there is currently relatively immature, it will develop with time and will be able to offer a range of investment options for investors. It is a positive sign that the proportion of Asia-based sovereign wealth funds investing in hedge funds has grown over the past year and we can expect this figure to keep increasing. North America represents 18% of all sovereign wealth funds investing in hedge funds; it is notable that four out of the five North America-based sovereign wealth funds invest in the asset class, as shown in Fig. 3. This is due to their familiarity with the industry and the investment options available domestically. Two out of the three institutions in Australasia invest in hedge funds, allocating a considerable amount to the asset class. The proportion of European sovereign wealth funds with a preference for hedge funds is relatively low given the large number of opportunities available in the region. Most European sovereign wealth funds are conservative in their investment approach and are unlikely to consider hedge funds in the near future. No sovereign wealth funds based in Africa (excluding MENA) or Latin America & Caribbean invest in hedge funds at present.

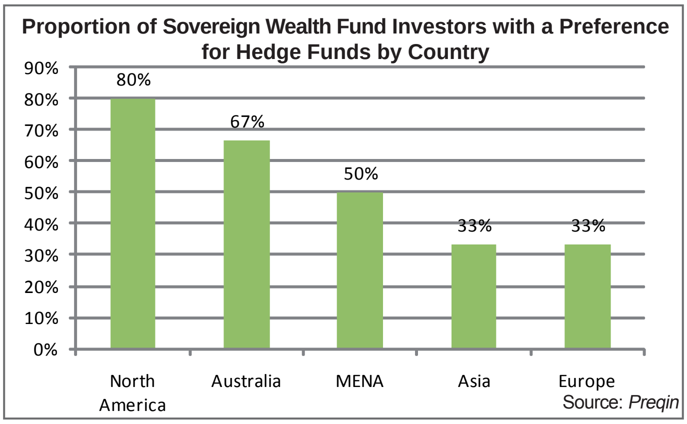
A high proportion of sovereign wealth funds have a global mandate for their hedge fund investments. North America attracts over three-quarters of all sovereign wealth funds investing in hedge funds. Some of the most experienced and best performing hedge funds in the world are based in this region. Furthermore, given the relative maturity of the hedge fund industry in North America, investors can benefit from the large number of fund managers and brand names located in the region. Taking into account that 36% of sovereign wealth funds that invest in hedge funds are based in MENA, it is interesting to see that only 29% of sovereign wealth funds state this region as a preference when investing in hedge funds. This

Fig. 2:



Source: *Preqin*

Fig. 3:



Source: *Preqin*

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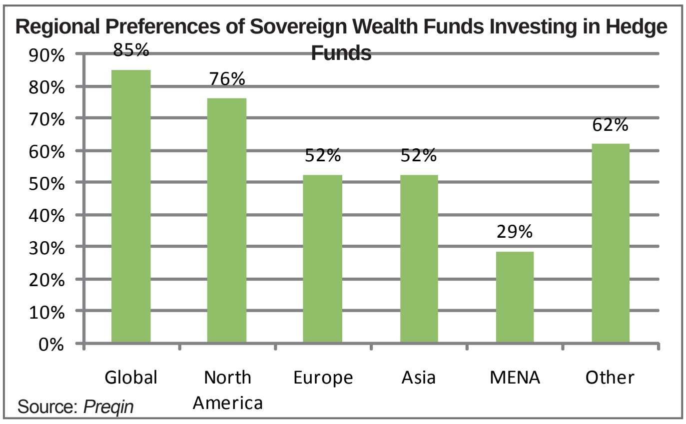
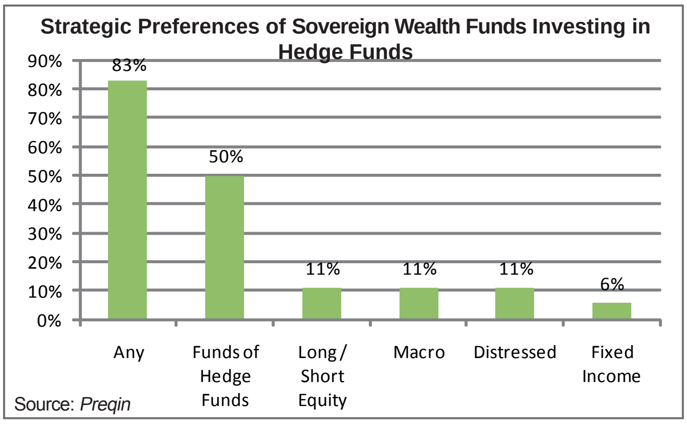


Fig. 5:



highlights that, although there are benefits of investing domestically, some MENA-based sovereign wealth funds feel that the best opportunities are found further afield.

There are no clear strategic preferences amongst the sovereign wealth funds investing in hedge funds and most (83%) look to create a diversified portfolio of funds by considering all hedge fund opportunities. Funds of hedge funds are a popular choice for many sovereign wealth funds investing in the asset class, with half of such investors stating a preference for multi-fund vehicles. Funds of hedge funds allow the investors to gain access to a number of hedge funds through one investment, adding diversification to their investment portfolios.

Conclusion

We can expect more sovereign wealth funds to begin investing in hedge funds in the near future. As Asia becomes a more established base for hedge fund managers, investors in this region will have an increased opportunity to invest domestically, which may increase their confidence in the asset class. Established sovereign wealth funds already investing in hedge funds are likely to remain active in the asset class for the foreseeable future. These investors are already investing large sums of capital in the asset class and, although their total exposure is set to remain relatively stable over the next 12-18 months, they will continue to be important sources of capital to managers as they use their growing experience of the asset class to access the best strategies in 2010 and beyond.

Katy Johnson

Strategy in Focus:
Global Macro

The global macro strategy maintains a strong appeal amongst institutional investors in 2010, with 20% of the investor universe, or 503 institutional investors, stating an active preference for such vehicles. Macro represents the third most popular single strategy on the Preqin database. Following the market downturn, there was a surge in opportunities for macro strategies and 2009 closed with strong returns for macro. Fig. 2 shows the proportions of the different hedge fund institutional investor types that have a preference for macro hedge funds. More than one-third of both funds of hedge funds and public pension funds have a preference for macro hedge funds, and a quarter of endowment plans also show a preference for this type of fund. Other hedge fund investor types with significant proportions interested in macro hedge funds include government agencies, foundations and banks.

Macro strategies are popular worldwide and Preqin monitors institutional investors from 34 countries across the globe that state a preference for global macro funds. The largest proportion of global macro investors are based in the US, with this region accounting for 291 investors in the strategy or nearly 60% of the investor universe. Europe is also an important source of capital, particularly the large funds of hedge funds, many of which are managed in the UK and Switzerland, as well as private sector pension funds such as London-based Trafalgar House Pension Trust.

Institutional global macro investors tend to access the strategy by investing in single manager hedge fund vehicles rather than multi-managers in order to capture the potential for high returns directly. The lock-up period for macro funds is short, on average two months, which is appealing for institutional investors in this time of increased demand for liquidity.

Nicole Rubbi-Clarke

Fig. 1:

Key Facts - Investors Active in Macro	
% of institutional investors that state macro as an active preference	20%
Median AUM of macro investor ($bn)	1.3
Average allocation to hedge funds of a macro investor	20.5%
Average returns sought from a macro investment	8.3%
Most favoured investment approach (funds of hedge funds, direct hedge funds, mixture of both)	Direct hedge funds
Average lock-up period of a macro fund (months)	2

Source: *Preqin*

Preqin curently tracks 503 investors with a preference for global macro funds. 362 are US-based, 166 are European and 35 are based in Asia and RoW.

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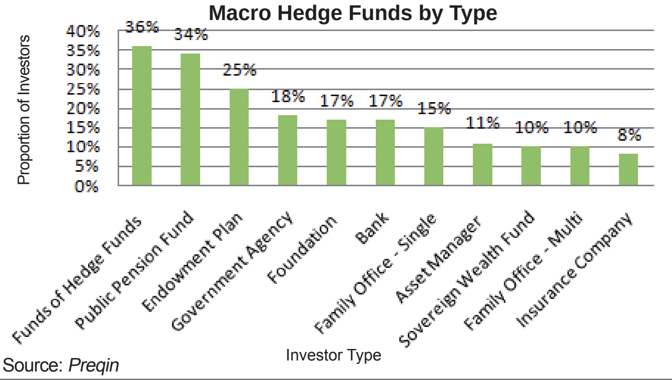
Fig. 2:

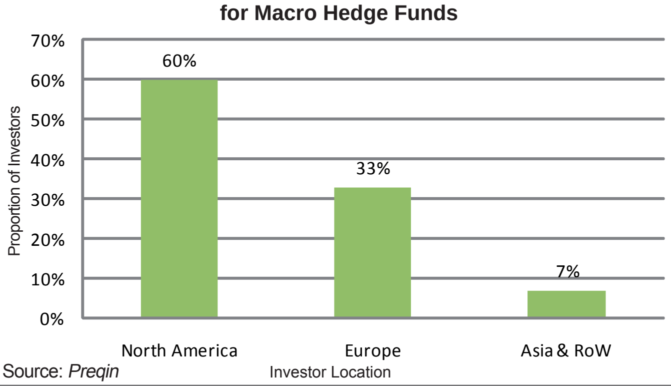
Proportion of Institutional Investors with a Preference for Macro Hedge Funds by Type



Source: *Preqin*

Fig. 3:

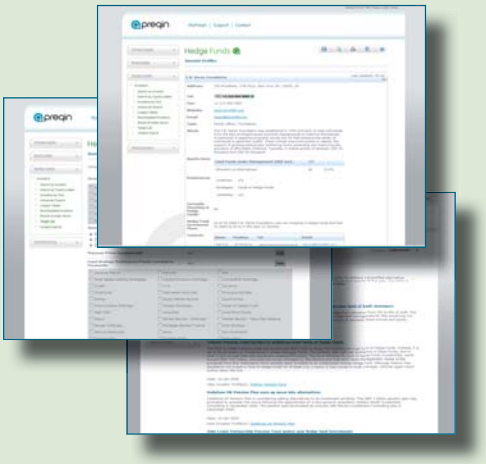
Regional Breakdown of Institutional Investors with a Preference for Macro Hedge Funds



Source: *Preqin*

Preqin: Hedge Fund Services

Preqin maintains a range of products for professionals involved with sourcing institutional investors for hedge fund vehicles, all based on our detailed database of over 2,500 institutions. With online services, data downloads and publications all available, Preqin can help you to identify and contact future investors.



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See detailed profiles for over 2,500 investors of all types globally - pension funds, insurance companies, banks, foundations, endowments, family offices, fund of hedge funds and others. Profiles include background, contact details, investment plans, preferences, assets under management, firms previously invested with and more.

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Fund of Hedge Funds Download

With over 550 fund of hedge funds listed and contact details, including phone number and email address, for more than 1,750 individuals at these firms, the Fund of Hedge Funds download is a vital tool for all hedge funds looking to promote their fund to the multi-manager market. The fund of funds on this download are distributed across the globe, with interest in a wide range of strategies and fund types.

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Conferences Spotlight: Forthcoming Events

Other Conferences

Conference/Event	Dates	Location	Organizer
Fund Forum Asia 2010	19 - 23 April 2010	Hong Kong	ICBI
EuroHedge Summit 2010	21 - 22 April 2010	Paris	HedgeFund Intelligence
Hedge Fund Managed Accounts	26 - 29 April 2010	London	IIR
Global Hedge Fund Summit	2 - 4 May 2010	Bermuda	Institutional Investor
Emerging Managers Summit	19 - 21 May 2010	Chicago	Opal
2010 SALT Conference	19 - 21 May 2010	Las Vegas	Skybridge Capital
The Spring Hedgeworld Fund Services Conference	20 May 2010	New York	HedgeWorld
GAIM 2010	14 - 17 June 2010	Monaco	ICBI
Hedge Funds World Asia 2010	13 - 15 September 2010	Hong Kong	Terrapinn

Hedge Fund Managed Accounts 2010

Date: 27th April 2010
Location: The Hatton, London
Sponsor: IIR

Key Themes to be discussed at Hedge Fund Managed Accounts 2010:

- Aligning investor expectations with platform services
- Effectively maintaining investor control of investments
- Transparency - how much Information are Managed Accounts Expected to Divulge?
- Determining the true extent of platform liquidity and pricing
- Accurately assessing the tracking error; when not to be concerned, and how to mitigate it
- Back end reporting: the most effective solutions
- Clarifying the roles for investor and platform due diligence
- The future for fund of funds: What is the emerging standard?

Information:
www.iir-events.com/IIR-Conf/page.aspx?id=25047

SALT Conference 2010

Date: 19-21 May 2010
Location: Bellagio, Las Vegas
Sponsor: SkyBridge Capital

The second annual SkyBridge Alternatives (SALT) Conference provides an unmatched opportunity to connect with global leaders and network with industry peers. Over three days, speakers and attendees from around the world will discuss prevailing issues as well as investment ideas and strategies within the context of a changing economic environment. President Bill Clinton will deliver the keynote address. As SALT 2010 attendance is projected to exceed 750 guests, capacity will be extremely limited.

Information:
www.saltconference.com

Investor Spotlight: Investor News

Hermes BPK Partners launches its third fund of funds.

Hermes BPK was formed last year after the UK fund manager, Hermes, decided to bring in an external team to manage its funds of hedge funds in order to reduce the amount of resource it was devoting to alternatives. It was launched with USD 800 million in seed capital from the BT Pension Scheme. It runs two existing funds: its flagship product, Hermes BPK Fund, a multi-strategy low volatility vehicle; and the Hermes BPK Restructuring Fund, its USD 363 million credit strategy specialist. Its new fund of funds, Hermes BPK Trading Fund, will invest in CTAs in conjunction with other selected trading-oriented strategies in order to generate absolute returns over 10%. The fund was seeded by USD 100 million of institutional capital.

New Mexico Public Employees' Retirement Association adds more managers to its roster and puts two funds on its watch list.

New Mexico has been steadily adding new hedge funds to its holdings since 2009, having funded six new funds last year and three already in 2010. This number has been bolstered to four following its USD 20 million investments in LIM Asia Multi-Strategy Fund. The pension fund has put State Street Global Advisors and Artio Global Investors on its watch list following performance concerns. These firms manage a combined USD 585 million on behalf of the pension fund.

Legacy Trust Company looks for new managers.

The USD 1.8 billion multi-family office is looking to invest in 5-10 hedge fund managers in the next 12 months. It plans to focus on long/short equity and CTA managers on a global scale and will consider both funds of hedge funds and direct hedge fund managers. It will invest USD 5 million per fund and will consider emerging managers and spin-off teams. This is not the firm's first foray into hedge funds, although it currently has no exposure to the asset class as it decided to change its investment strategy in 2009 and redeemed all of its hedge fund investments.

Chicago Public School Teachers' Pension and Retirement Fund has begun the search for new investment staff.

CTPF is looking for a new manager of investments and a manager of private equity and hedge funds. The manager of investments will oversee the entire investment portfolio in all asset classes and a staff of four, as well as help to develop and implement investment strategy. Required qualifications include having at least five years of experience in pension fund investment management and administration at a management level. The portfolio manager for private equity and hedge funds will oversee those investments, reporting to the manager of investments. Applicants should either have a bachelor's degree in accounting or a finance-related field or more than five years of investment experience. Currently the CTPF invests 2% of its total assets in hedge funds, all of which is in two funds of funds vehicles managed by Mesirow and K2. The new appointments are expected to be made by the end of June 2010.

Cathay Life Insurance may add new managers in 2010.

The insurance company currently allocates 1% of its USD 76 billion in assets to hedge fund vehicles and is considering adding more funds of hedge funds to its portfolio over 2010. It is particularly interested in credit and event driven managers in 2010. Cathay invests on a global scale including emerging markets.

Bahrain Mumtalakat Holding Company considers first hedge fund investments.

The USD 14 billion sovereign wealth fund, which is the main investment arm of the government of Bahrain, is considering making a move into hedge funds. If a decision is made in favour of hedge funds it intends to fund its first managers in 2011. Bahrain Mumtalakat Holding Company is looking to invest in alternatives in order to diversify its holdings. It has yet to set specifics on how much it will invest in the asset class and other preferences.

London Borough of Camden Pension Fund expected to make first investments in alternatives after the UK general election.

The pension fund has been considering all types of alternative assets, including hedge funds, since mid-2008 but has put its initial investments on ice until after the council's officials and councillors are selected in the UK elections in May 2010. Once this has been decided, the pension fund will be making a final decision on what asset classes will be included in its potential 10% allocation to alternatives and which managers to select.

Centrum Bank may redeem and replace managers throughout 2010.

The Liechtenstein-based private bank is considering redeeming some of its seven fund of hedge funds investments throughout the year and replacing them with other funds of hedge funds. It plans to keep the same amount invested in hedge funds but will look for opportunities in a range of strategies including long/short equity, event driven, volatility arbitrage, macro and CTA. It employs a global mandate for its hedge fund investments and allocates a small portion of its portfolio to emerging markets.

Amy Bensted

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