



# Hedge Fund Industry Forecast for 2016

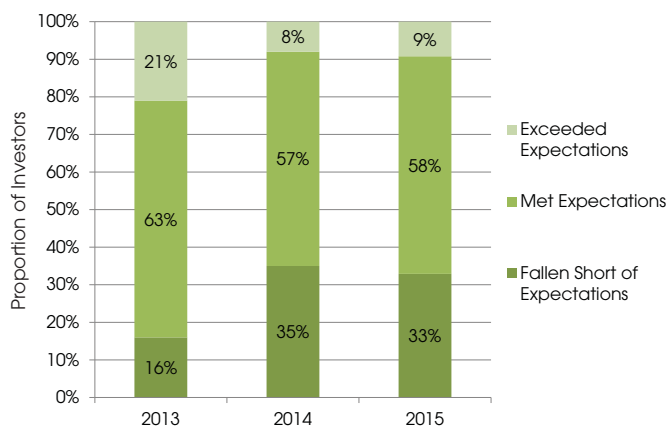
In November 2015, Preqin conducted surveys with over 500 hedge fund managers and institutional investors from across the globe to ascertain their views on the hedge fund industry and their outlook for the year ahead. In this article, we take a closer look at some of the key trends that emerged from the survey results as we make our predictions for the year ahead.

## Hedge Fund Performance Will Be under the Microscope

The performance of the hedge fund sector is likely to come under even more scrutiny in 2016. Investor satisfaction with the performance of their hedge fund portfolios declined from the end of 2013 to the end of 2014, and at the start of 2015 Preqin noted that it would be a year for hedge funds to show what they are worth. For many investors, this was not achieved: 33% of investors reported that their hedge funds had not met expectations in 2015, compared to 35% that reported the same in 2014 (Fig. 1). In addition, 40% of fund managers believed their return objectives had not been met in 2015 (Fig. 2). However, despite the Preqin All-Strategies Hedge Fund benchmark adding just 2.02% in 2015, its

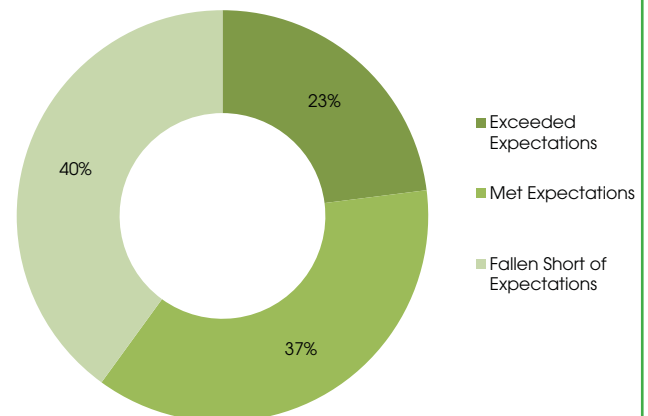
lowest level since 2011, the value of hedge fund investment is becoming more evident, in many ways, in light of recent events in traditional equity and fixed income markets. Hedge funds outperformed many global indices such as the S&P 500 Index, MSCI World Index and Barclays Capital Global Aggregate Bond Index in 2015, and the turbulence in leading markets has continued into 2016. In the current environment, if hedge funds can prove their value as a product that can help preserve assets, reduce portfolio volatility and provide a risk-adjusted return stream, then those investors that are currently taking a cautious approach to the asset class may indeed reconsider their outlook.

**Fig. 1:** Hedge Fund Portfolio Performance Relative to Expectations of Institutional Investors, 2013 - 2015



Source: Preqin Investor Interviews, November 2015

**Fig. 2:** Fund Manager Return Goals in 2015 Relative to Expectations

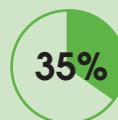


Source: Preqin Fund Manager Survey, November 2015

### Other Key Findings:



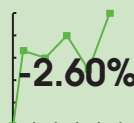
53% of investors rated a hedge fund's returns as a key factor they take into account when evaluating new opportunities.



35% of investors believe performance is the biggest issue in the hedge fund industry, the leading factor ranked.



69% of fund managers believe the 2016 Preqin All-Strategies Hedge Fund benchmark will surpass the 2015 return.



The return of the Preqin All-Strategies Hedge Fund benchmark for January 2016.



## Fundraising to Become More Challenging in 2016

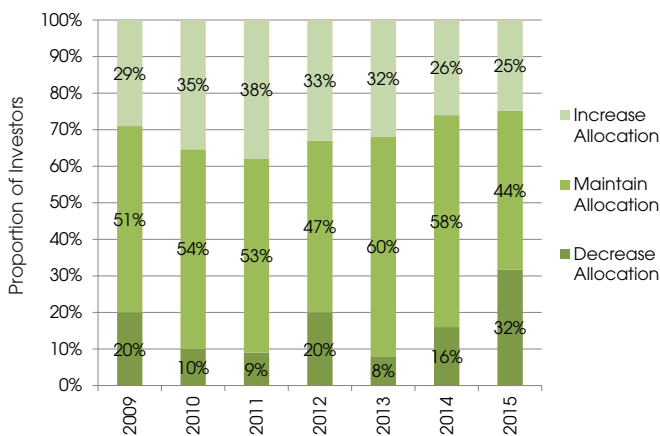
Hedge funds have had a second year in which performance has disappointed a large number of investors (see Fig. 1). These concerns have led to signs that fundraising could become extremely challenging in 2016; more investors have indicated that they intend to invest less capital in 2016 than in 2015 (Fig. 3) – an early sign there may be net outflows over the year. Although investors recognize the long-term benefits of hedge funds within their portfolios, if fund search activity declines in the short term, finding and gaining the attention of those investors looking to make new investments will be vital if fund managers are to accumulate fresh assets over 2016.

Coupled with an increasing number of investors indicating that they will reduce the size of their hedge fund portfolios in 2016, investors that have fresh investments planned have indicated that they will invest smaller sums in fewer funds

than in previous years. Sixty-five percent of investors will be investing less than \$50mn of fresh capital in hedge funds in 2016, an increase from the previous year (54%). In addition, the proportion of investors investing \$250mn or more has decreased from 15% in 2015 to 8% in 2016. In contrast, 42% of fund searches planned for 2016 are for one or two funds – an increase from 32% on the previous year. Again, this highlights that 2016 could potentially be challenging for fund managers looking to grow, as institutional investors have indicated that they will placing smaller sums of capital in the hands of a smaller number of hedge fund managers

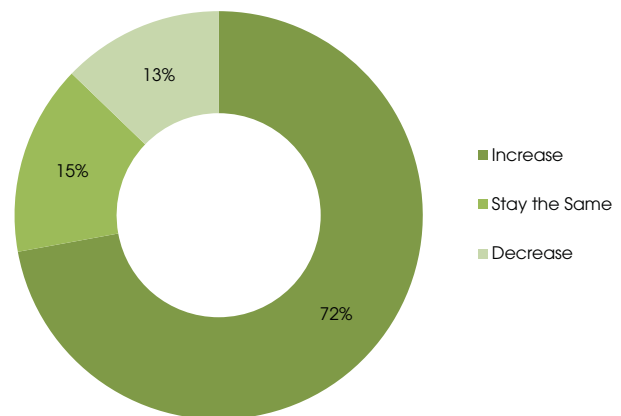
Despite a challenging outlook on fundraising in 2016, fund managers are largely optimistic that the industry will grow in 2016: 72% of fund managers believe that industry assets will increase next year (Fig. 4).

**Fig. 3: Investors' Intentions for Their Hedge Fund Allocations in the Next 12 Months, 2009 - 2015**



Source: Preqin Investor Interviews, November 2015

**Fig. 4: Fund Manager Outlook for Hedge Fund Industry Assets under Management in 2016**



Source: Preqin Fund Manager Survey, November 2015

### Other Key Findings:



65% of investors searching for new funds in 2016 plan to invest less than \$50mn.



42% of investors searching for new funds in 2016 plan to invest in one or two new funds only.



Funds of hedge funds make up 45% of investors searching for new funds in 2016.



95% of searches planned for 2016 include a direct investment. 22% include a funds of hedge funds.

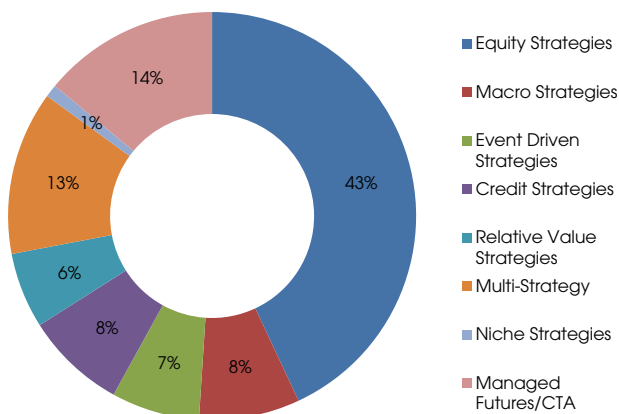


## CTAs, Macro Strategies and Equity Strategies May Have a Successful 2016...

Although fundraising looks set to be challenging in 2016, there are some fund types and strategies that may have a more successful year than others, in terms of capital inflows from investors. Fig. 5 shows the breakdown of investors' plans for their portfolios by strategy in 2016. The chart shows whether investors plan to add or increase their exposure to strategies in 2016, or reduce or cut their exposure, as well as whether investors have no exposure to the strategy. The more liquid strategies are the most attractive to investors in 2016 – equity strategies, macro strategies and managed futures/CTAs all look set to see the largest inflows in 2016 (Fig. 5).

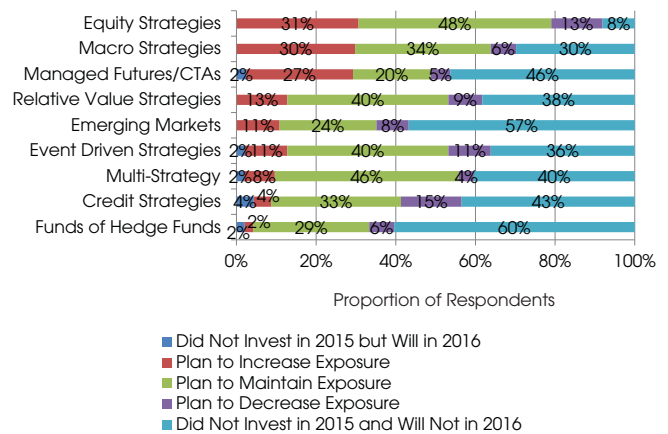
Equity strategies funds are planned by a significant proportion of fund managers: 43% of respondents with a new fund planned are looking to launch an equity-focused fund in 2016 (Fig. 6). Correspondingly, equity strategies funds are expected to be the best performing in 2016; 26% of fund managers believe it will perform the best in 2016, ahead of the next largest proportion (17%) of fund managers that believe macro strategies will perform the best in 2016 (Fig. 7). In contrast, however, fund managers have a mixed outlook on the success of CTAs in 2016: approximately equal proportions believe it will be the best and worst performing strategy over this year.

**Fig. 6:** Strategies that Fund Managers Are Planning to Launch in 2016



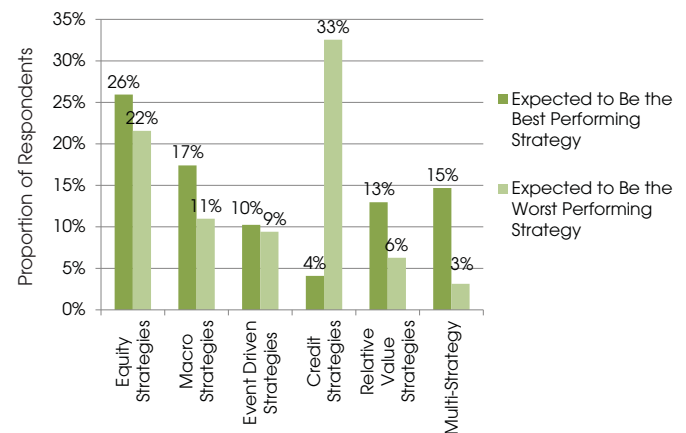
Source: Preqin Fund Manager Survey, November 2015

**Fig. 5:** Breakdown of Investors' Allocation Plans for 2016 by Strategy



Source: Preqin Investor Interviews, November 2015

**Fig. 7:** Fund Manager Expectations for the Best and Worst Performing Strategies in 2016



Source: Preqin Fund Manager Survey, November 2015

## ...However Credit Strategies May Struggle in 2016

At the other end of the spectrum, a larger proportion (15%) of all investors in credit strategies plan to reduce their exposure rather than increase or add these funds (4%) to their portfolios over 2016 (Fig. 5). This indicates that we could see outflows from these strategies in 2016.

The fund managers that Preqin interviewed at the end of 2015 also expect credit strategies to struggle in 2016 – one-third of managers are tipping these funds to be the worst

performers over the course of the year (Fig. 7). A similar proportion (30%) made the same forecast at the end of 2014 and yet credit funds outperformed some other strategies for much of 2015, ending the year with a 12-month return of 2.46%.

It will be interesting to see if fund managers are proved correct in 2016, with the planned tightening of monetary policy by the US Federal Reserve and its consequences uncertain.



## Fees Are Likely to Remain Contentious in 2016

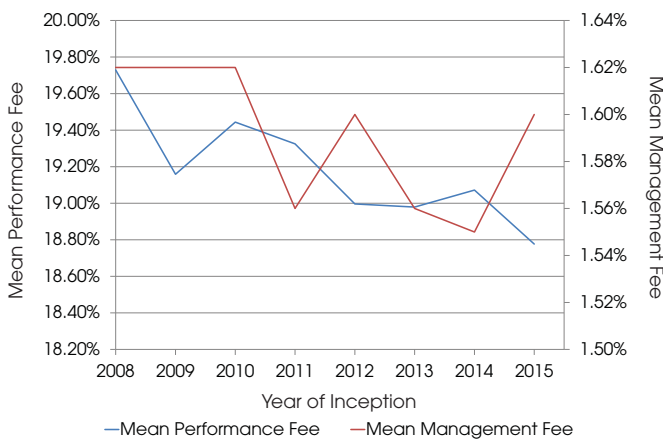
With performance proving challenging in 2015, and investor satisfaction with hedge fund returns failing to improve over the year, our survey indicates that institutional investors will continue to press for further reduction in both management and performance fees in 2016. Approximately 14% of investors regard fees as the key issue facing the hedge fund industry going into 2016, making it the third most important issue behind performance and transparency. Many of the more high-profile exits of institutional investors from the hedge fund industry in recent years, most notably CalPERS in 2014 and Railpen in 2015, cited costs and fees incurred by investing in the asset class among the reasons for their redemptions, and therefore the perceived lack of value provided by hedge funds.

In recent years, the 2/20 fee structure, once synonymous with the asset class, has gradually given way to a wide range of terms of remuneration, reflecting the variety of fund types now available to investors in hedge funds and the high level of competition in the hedge fund market. As shown in Fig. 8, we have seen a general downward movement of

management and performance fees by year of inception. However, we did note an increase in mean management fees for funds launched in 2015 to levels that have not been seen since 2012.

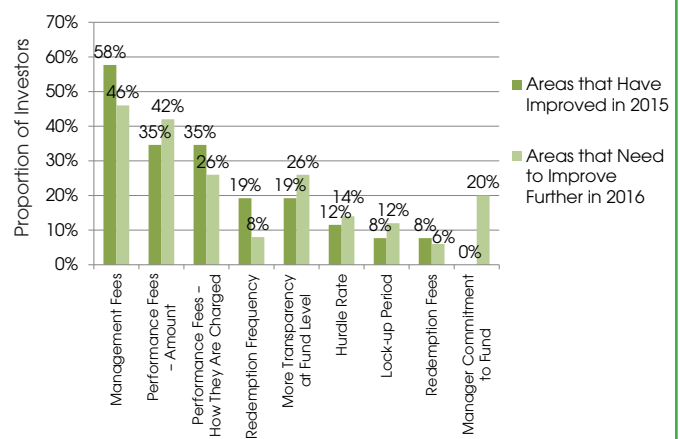
Many investors still see room for improvement in terms of fees. When asked which areas of fund terms had improved the most over 2015, management fees were most commonly cited (58% of investors, Fig. 9). However, management fees was also the most common answer when investors were asked which area of fund terms and conditions they want to improve further in 2016, as cited by 46% of investors. Similarly, although 35% of investors reported improvements in the level of performance fees, 42% would like to see performance fees reduced further over the coming year. This indicates that while there has been continued movement in the right direction regarding the level of management and performance fees, there remains clear demand for further improvements over 2016.

**Fig. 8:** Mean Performance Fee Charged by Single-Manager Hedge Funds by Year of Inception, 2008 - 2015



Source: Preqin Hedge Fund Online

**Fig. 9:** Areas of Fund Terms Investors Feel Have Shown the Most Improvement over the Past 12 Months and that Need to Improve Further in 2016



Source: Preqin Investor Interviews, November 2015

### Other Key Findings:



51% of investors entered into negotiations over fund terms and conditions in 2015.



1.58% and 19.40% are the mean management and performance fees across all single-manager hedge funds.



Proportion of investors that were successful when negotiating terms and conditions with fund managers.



Proportion of institutions that believe investor and fund manager interests are aligned.

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