

Preqin Survey Results: Have Hedge Fund Investors Recovered from the Crash? (1)

At the end of September 2009 Preqin's analysts surveyed more than 50 institutional investors with known activity in hedge funds to garner their thoughts on various issues key to the industry today. Preqin carried out a similar survey in October 2008 – just as the global financial markets crashed. In this article we look at how the results of this year's survey compare to 2008's and examine investor confidence on the cusp of a new decade. We surveyed a variety of institutional investors including private and public sector pension funds, endowment plans, family offices, foundations and insurance companies. The survey also encompassed a large cross section geographically, with investors based in Europe, North America, Asia and Rest of World.

Investor satisfaction and confidence

Institutional investors are, on the whole, more satisfied with the returns of their hedge fund portfolios today, compared to a year ago. In 2008, just under 40% of all surveyed investors were dissatisfied with their hedge fund investments following returns which had not met expectations – today this figure stands at around 27%. As shown in Fig. 1, 62% of investors surveyed in 2009 stated that return expectations have been met, and a further 11% stated hedge fund returns have exceeded their expectations.

Although the industry as a whole was successful in outperforming public markets following the crash, a significant proportion of investors remained dissatisfied with their investments in hedge funds in 2008. In addition, the fact that hedge funds are a relatively liquid investment meant that investors that were satisfied and dissatisfied alike were seeking redemptions from existing investments in order to rebalance other distressed areas within their portfolios. In some cases investors in the more successful strategies have found themselves over-exposed to the asset class, and as a result have been making redemptions in order to rebalance.

As a result, many hedge funds disappeared altogether and the industry shrank considerably, from \$1.93 trillion at its peak to approximately \$1.3 trillion today (source: Hedge Fund Research). Today returns are back in positive territory and some strategies have been producing their best performances for five years or more. This bounce back has helped to restore some of the investor confidence that was lost in 2008; with 73% of investors stating that they are satisfied with hedge funds returns in 2009 up from 62% in 2008. In addition institutions are once again investing in the asset class following their temporary suspension of activity at the end of 2008 and we have

recently witnessed new investments being made by institutions such as Alaska Retirement Management Board and New Zealand Assets Management.

Fig. 2 shows that 66% of institutional investors are either confident or very confident that their hedge fund investments meet their investment objectives. There still remains a degree of apprehension about the asset class following the disappointing returns, high-profile scandals and gating of capital which characterised the end of last year. However, if returns remain strong and managers have learnt from the lessons of the crash, then investor confidence in the asset class should be restored to pre-2008 levels.

As a result of this increased investor satisfaction, there is once again a net positive balance of investors planning to increase their allocation to the asset class: 29% of the investors surveyed plan to increase their investments, compared to only 20% planning to decrease them (and the balance of 51% plan to maintain their investment at current levels.) Among the institutions planning to reduce their investments in hedge funds, it was interesting to note that in some cases this was due to short-term liquidity reasons. One European foundation told Preqin that it was cutting some hedge funds from its portfolio "unwillingly; ...because of their outperformance, hedge funds' relative proportion of the total portfolio now exceeds the maximum allowable by the board so I am forced to redeem to bring the proportion into line with the strategic allocation."

What are investors looking for in hedge fund managers?

Fund transparency has replaced fund performance as the greatest consideration for investors when selecting new hedge fund managers. Risk management and firm reputation have also grown in importance to hedge fund investors following the high-profile hedge fund scandals which have dogged the industry in the past 12 months. Last year the performance record of a fund was the most important criteria used by institutional investors to assess new hedge fund opportunities; however investors now are more conservative in their reasons for investing in hedge funds. As Fig. 5 shows, most investors choose hedge funds for portfolio diversification and to improve the risk/return profile of their portfolio rather than to produce outsized returns.

Just under half of all investors surveyed stated that they have not altered what they look for in hedge fund managers since the market crisis at the end of 2008. Of the investors which have altered their search criteria, 52% are now looking

Fig. 1:
Institutional Satisfaction with Hedge Fund Performance: 2008 vs. 2009

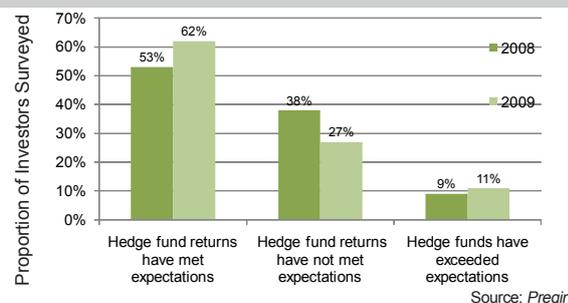


Fig. 2:
Institutional Investor Confidence in Hedge Funds

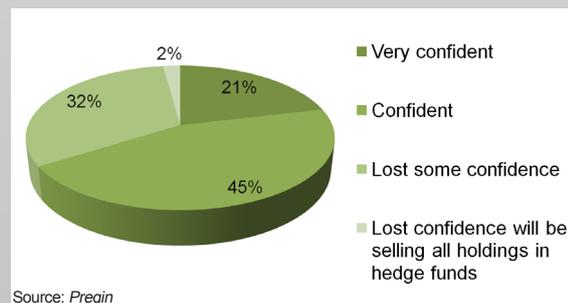
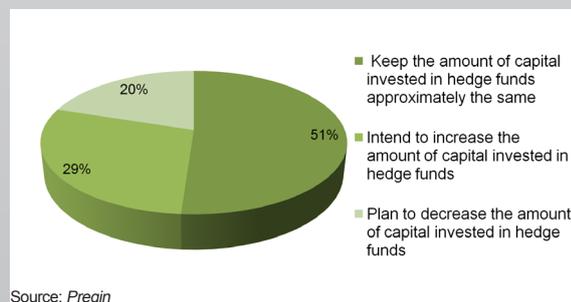


Fig. 3:
Investor Plans for Next 12 Months



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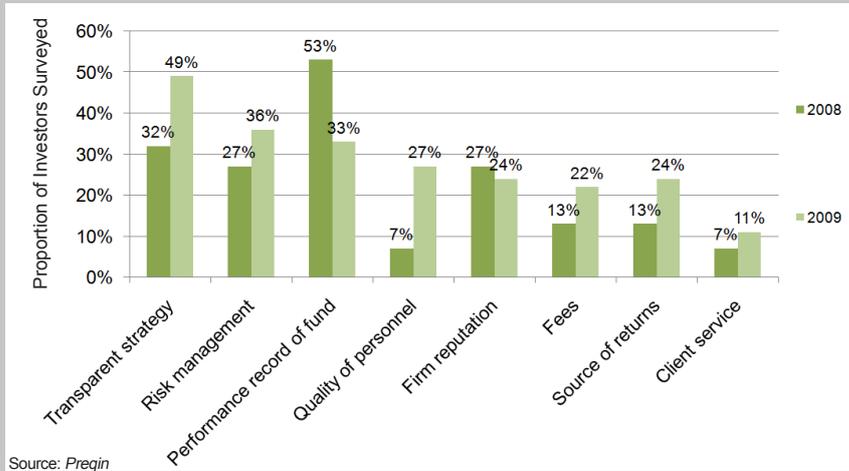
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Fig. 4:
Institutional Investors' Key Considerations
When Choosing Hedge Fund Managers



for increased liquidity, and a third look for more transparency at fund level. While fees are a key issue for institutional investors, they do not specifically set out to invest in funds that charge lower fees, preferring instead to negotiate fees with funds that exhibit characteristics which are more important to them, such as greater liquidity and transparency.

Conclusions

Institutional confidence in hedge funds is returning after the global crisis in 2008. A significant degree of investor confidence was lost last year following disappointing returns and several high-profile fund collapses and scandals. However these investors are beginning to make new investments and have been more satisfied with their hedge fund performance over 2009, than in 2008. The hedge fund industry has changed: with less in assets under management and fewer funds. Institutional investors are now the key source of capital to hedge fund managers – providing over 70% of the total assets in the industry – therefore it is vital for managers to understand the needs and demands of these investors if they are to be successful in their search for institutional support.

Liquidity and transparency are key issues for the institutional investor. Funds that can provide this will be very attractive to the institutional investor over the next 12 months. Also those hedge fund managers that are flexible in the terms and conditions associated with their funds will be more successful at gaining institutional support. The issue of fees has been at the forefront of the hedge fund industry in 2009, and institutional investors are becoming increasingly dissatisfied with the “2&20” structure that has been implemented traditionally.

Future Preqin Surveys

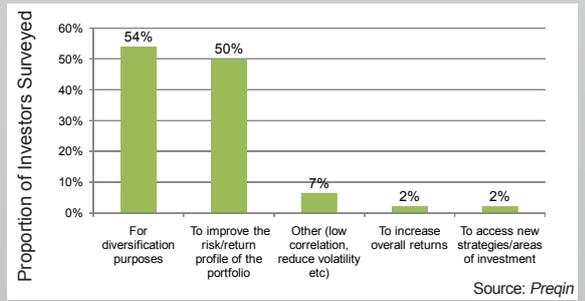
In the coming weeks Preqin will be releasing a report examining investors' attitudes towards fees. This detailed report will include the results from the second Preqin hedge fund investor survey.

Preqin's Hedge Investor Profiles is an online database which contains information about institutional investors in hedge funds.

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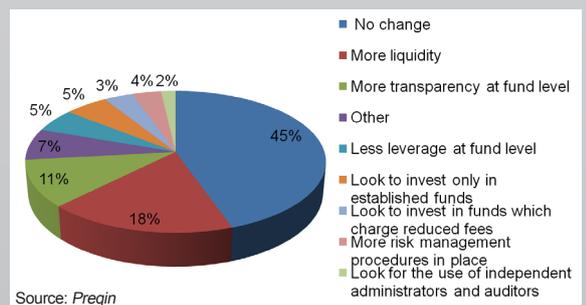
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Fig. 5:
Main Reason(s) Stated for Institutional Use
of Hedge Funds



“
...some strategies have
been producing their best
performances for five years
or more...
”

Fig. 6:
How Institutional Investors Have Changed What
They Look for in Hedge Fund Managers Since the
Market Crisis



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