

Preqin Special Report:

Tapping Into Institutional Sources of Capital
June 2010



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After the fundraising difficulties of the last two years, 2010 has seen increased interest in hedge funds from the institutional market, with new investments being made and sought.

With a healthier environment for capital raising, hedge fund marketers are increasingly seeking institutional support. In May 2010, Preqin surveyed 50 global investors from an array of institutions (including family offices, foundations, endowments, pension funds and funds of funds) to find out more about how they wish to be marketed to and what processes they use when selecting new hedge fund managers.

Number of Institutional Investor Fund Investments Made Per Year

Fig.1 shows the breakdown of the surveyed investors in terms of the number of new investments in hedge funds they make each year. Nearly a quarter of the respondents stated that the number of investments they make varies from year to year. In some years they may not make any investments but in others they may make one or more depending upon the performance of their current portfolio, opportunities in the market and available capital from their hedge fund allocation. 56% of the surveyed investors make 10 or fewer investments each year with the remaining 20% making over 10 new fund investments on an annual basis. The number of fund investments that can be made by an institutional investor depends upon the amount of capital they have available as well as their investment horizons. Funds of funds tend to be the most prolific investors in new funds on an annual basis. Conservative, long-term investors, such as public pension funds, generally make fewer new investments on an annual basis.

Number of Fund Proposals Received Monthly by Institutional Investors

The largest proportion of respondents (38%) stated that they receive between 15 to 29 fund proposals each month with this number varying depending upon how well known that investor is, the size of the institution and its current status in terms of hedge

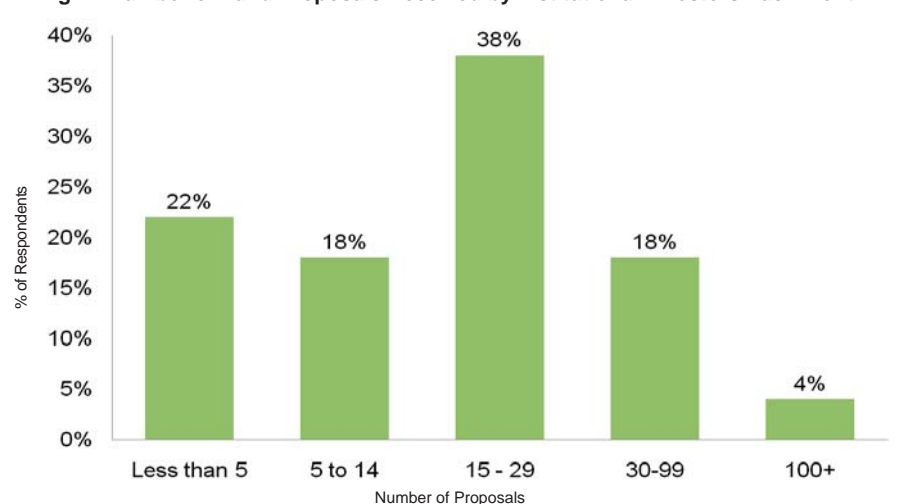
Fig. 1: Number of New Fund Investments Made Each Year by Institutional Investors



fund investments (Fig. 2). With institutional investors receiving dozens of fund proposals for every fund investment they actually make, it is vital that fund managers market their funds in the correct way in order to be attractive to this market.

The number of funds an institutional investor will monitor as a potential investment over the medium to long-term time frame will vary depending upon the size of the investor; both in terms of its hedge fund portfolio and its internal investment resource. Institutional investors will monitor funds on an ongoing basis for

Fig. 2: Number of Fund Proposals Received by Institutional Investors Each Month





both performance and fund volatility and it is important to maintain relationships with the institutional market even if the fund was previously rejected by an investor. Of the surveyed institutions, 72% informed Preqin that if they reject a fund the first time round they would reconsider the same vehicle at a later date as both the market and the investor's portfolio objectives change with time.

Time Frame for the Decision Making and Due Diligence Process

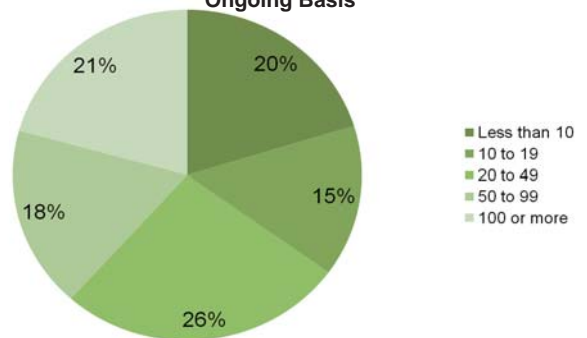
The median minimum time from receiving a fund proposal to actually investing in a fund for an institutional investor is three months with the median maximum period of six months. As Fig. 4 shows, the decision making process varies greatly between institutional investors. Those that are accountable to boards or other monitoring authorities such as pension funds or foundations will take the longest to carry out the due diligence on funds. Less restricted investors such as family offices and funds of funds will carry out all due diligence a lot quicker.

How do Institutional Investors Source New Managers?

It is clear that the institutional market is a vital source of capital for all hedge fund managers. Preqin's latest estimate for the percentage of the total hedge fund capital coming from institutional investors and funds of funds is 72%. With such investors receiving significantly more proposals per fund that they actually invest in, marketers should ensure that they approach institutional investors in the right way to get their attention and to be added to the institution's list of funds for ongoing monitoring.

Just under half of all institutional investors use one source to find new hedge fund managers. These are predominantly investors that make all of their hedge fund investments via their consultants. Consultants and advisors are often crucial to fundraising in the institutional market. Many investors do not have the resources or experience to examine potential fund managers themselves and to monitor hedge funds on an ongoing basis. Of the institutional investors surveyed, 52%

Fig. 3: Number of Funds Institutional Investors Monitor on an Ongoing Basis

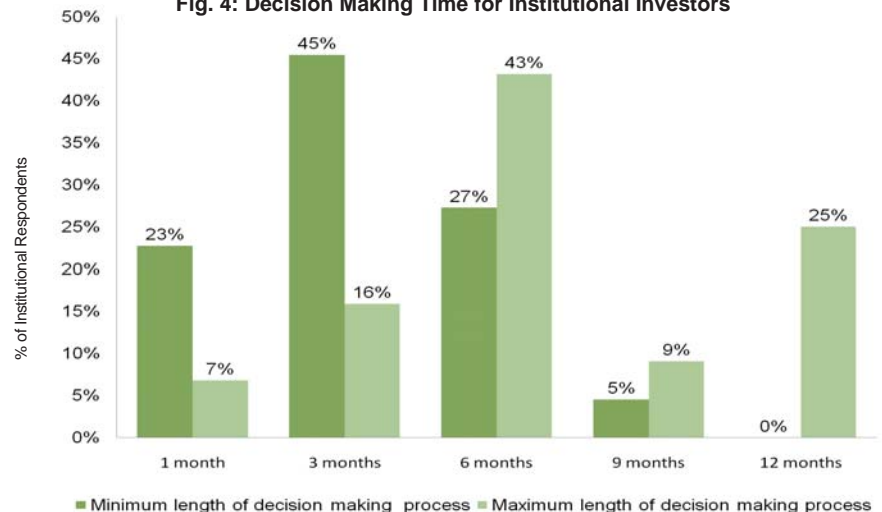


Source: Preqin

use consultants to source new hedge fund managers. It is crucial that hedge fund marketers know the key players in the advisory market. By connecting with the right consultants and advisors, hedge fund marketers can in turn increase the number of institutions they are able to connect to. Preqin monitors 200 consultancy firms and over 1,000 relationships between investors and consultants.

52% of institutional investors surveyed use two or more sources to find new hedge funds – with most investors utilizing two or three potential sources of new funds. (Fig.

Fig. 4: Decision Making Time for Institutional Investors



Source: Preqin



6). Second to consultants sourcing funds directly from fund marketing teams and through networking/conferences, other recommendations are commonly used by investors to source new investments. A fifth of the surveyed investors will invest in funds introduced to them by third party marketers or via capital introduction teams at prime brokers, and the same percentage use databases of funds to source new investments.

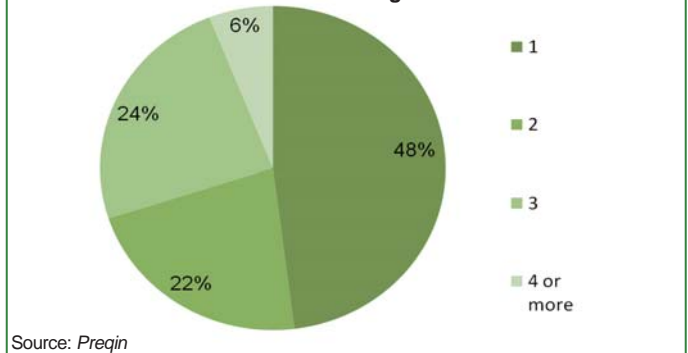
Different groups of institutional investors are using different sources when searching for new investments. Funds of funds typically use the widest range of methods in order to obtain information on the largest number of funds possible. Endowments, public pension funds, foundations and asset managers rely heavily on consultants to provide them with information and potential funds to invest in. Family offices with their own in-house investment teams tend to source new funds directly from hedge fund sales teams or through personal networks, recommendations or via conferences. Sourcing directly through hedge fund sales teams is a common approach for all groups of institutional investor – for instance private sector pension funds use direct marketing sources to the same extent as they use funds sourced through their consultants.

US investors rely much more heavily on consultants to source new hedge fund investments than their European and Asian counterparts; whereas European investors are far more likely to prefer to be directly marketed to – either by email or phone calls from hedge fund sales teams or through the general network and conference scene. Asian investors tend to source potential funds in a different way to US and European institutions –with many such investors preferring introductions via third party marketers or cap-intro teams.

How should a hedge fund sales team approach an institutional investor?

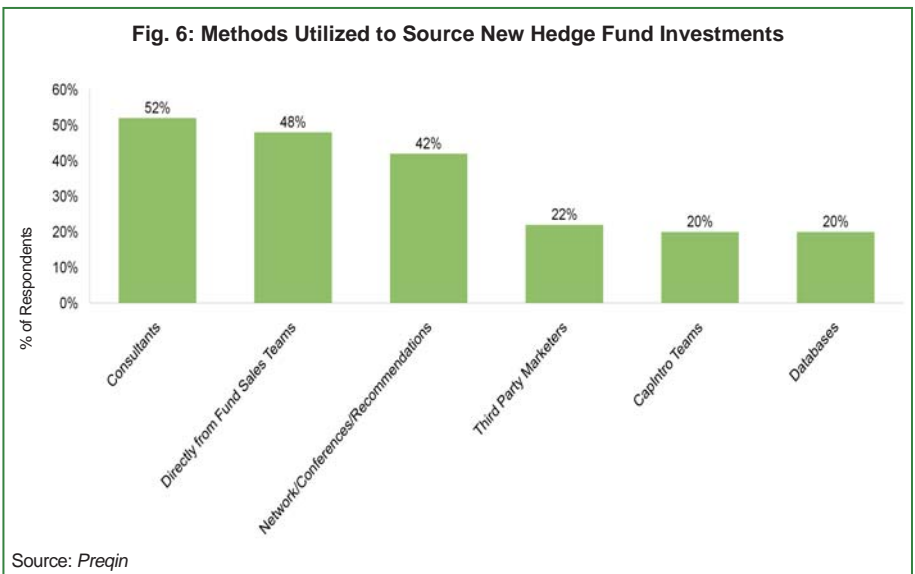
As Fig. 7 shows, most of the investors surveyed preferred an email with the fund proposal as the first point of contact. Just

Fig. 5: Number of Methods Utilized by Institutional Investors to Source New Hedge Funds



over half of all the investors that preferred email as the initial marketing approach would not want to be followed up with a marketing phone call or meeting unless an interest in the fund is expressed. However, a lack of response should not indicate a lack of interest, with many investors keen to monitor funds over time before making an investment. To a lesser extent institutional investors are willing to be marketed to via a phone call or through face to face meetings. Only 5% of institutional investors do not wish to be contacted at all by fund marketers.

Fig. 6: Methods Utilized to Source New Hedge Fund Investments

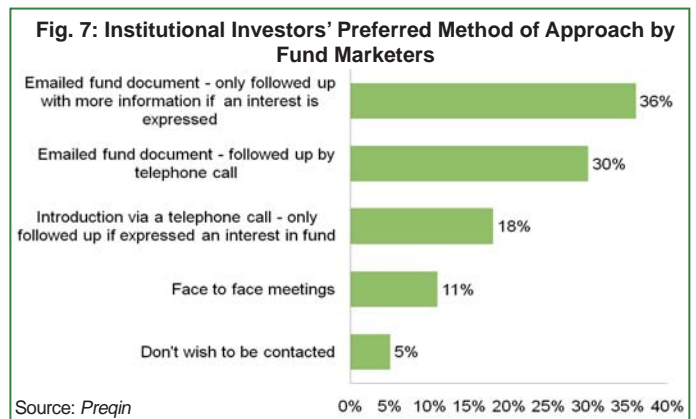




Summary

Institutional investors have begun to invest in hedge funds over the tail end of 2009 and into 2010. The institutional sector of the hedge fund market has become more important in the wake of the market tumult, as such investors have stuck to the asset class in much greater numbers than the high-net-worth sector. Marketing to these investors can be difficult and a knowledge of where they source funds and what funds they are investing in is essential, as is getting in touch with the right people at the institution with the right proposal.

Consultants are important to many institutional investors – by forming relationships with consultants or other advisory groups a hedge fund manager can be promoted to a variety of institutions. Direct marketing of funds is also welcomed by institutional investors, with most preferring to be emailed a pitch book or other promotional materials as the first point of contact. Institutional decision making tends to take between three and six months, therefore if marketers can form longer- term relationships with investors then a fund could be reconsidered further down the line even if it was initially rejected.



About Preqin

Preqin provides hedge fund managers, marketers and others with a database of over 2,500 institutional investors in hedge funds.

Our customers can access this market intelligence in four different ways:

- Hard copy publications
- Online database services
- Consulting and research support
- Tailored data downloads

Preqin's Hedge Investor Profiles Online is a vital resource for all hedge fund managers and marketing professionals seeking backing from institutional investors. Preqin's team of dedicated analysts is constantly contacting institutional investors from around the world in order to ensure that the data we hold is up to date, reliable and complete. To register for a demo, please visit: www.preqin.com/demo

Preqin regularly releases research and information on fundraising and all other aspects of the hedge fund industry as both research reports, and as part of our monthly Spotlight newsletter. To register to receive more research and analysis, please visit www.preqin.com/spotlight

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