2013 Preqin Investor Network Global Alternatives Report

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Datapack for the 2013 Preqin Investor Network Global Alternatives Report

The data behind all of the charts featured in the Report is available for free in an easily accessible datapack. It also includes ready-made charts that can be used for presentations, marketing materials and company reports.

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CEO's Foreword

Finding the Best Opportunities in Alternative Assets

Welcome to Preqin Investor Network's 2013 Global Alternatives Report!

Alternative assets are now of core importance to most investors, yet the challenges of constructing and managing an effective alternatives program are magnified by five factors:

1. Growth: allocations to alternatives have grown significantly, and make a real impact on the entire portfolio's performance;
2. Dispersion: the variance in performance between the best and worst alternatives managers is huge, so picking the right funds and managers makes a big difference;
3. Illiquidity: with many alternatives strategies inherently illiquid, the consequences of investment decisions are long-lasting;
4. Segmentation: alternatives encompass a wider range of strategies than ever before – good news for investors seeking diversification, to be sure – but the challenges of selecting between a multitude of strategies, geographies and managers should not be underestimated; and
5. Opacity: alternatives are generally less transparent and reliable data is less readily available than in other asset classes.

Preqin Investor Network – PIN for short – is designed to help. By providing free access for investors to some of Preqin's core data – benchmark returns across the alternative assets universe; investment opportunities in 1,900 **private equity**, **real estate** and **infrastructure** funds and 9,500 **hedge funds** open for investment; and background information and track records for 5,200 alternatives fund managers seeking investor capital – PIN has broadened Preqin's reach to help over 6,000 institutional investors worldwide with the challenge of finding and selecting the best and most suitable investments for their portfolios.

If you are an investor and haven't yet tried it, please visit www.preqin.com/pin and register for free.

PIN is also highly relevant for alternatives fund managers, placement agents and third-party marketers. Finding the right investors for your funds and getting your offerings in front of them is an enormous challenge. More and more of these investors are using PIN as a vital part of their investment process. Make sure they can find you. Make sure they have access to information on your funds through PIN.

If you are a fund manager or advisor and haven't yet shared data with Preqin, please visit www.preqin.com/sharedata.

We hope that you find the 2013 Preqin Investor Network Global Alternatives Report to be a useful resource in your alternatives investing. The Report and the PIN service represent the culmination of ten years' of effort and investment from my colleagues at Preqin, and I am grateful to them.

Data is important for sure, but insight and experience are the vital ingredients to put data into context, and to help make the best investment decisions. We are incredibly grateful to our many external contributors – each and every one of them a leading expert in the world of alternative assets – for their support and for taking the time and effort to contribute the excellent and thought-provoking articles that you will find in the Report. We hope you enjoy them.

Thank you.

Mark O'Hare

The Importance of Alternative Investments

- Robert Howie, European Head of Mercer's Alternatives Research Boutique

The last decade has seen significant changes in asset allocation, particularly for pension funds. There has been a strong trend to diversify and move away from traditional public equities and bonds into alternatives. The key driver has been the desire to create portfolios with better risk/return profiles by exploiting the potential of alternative strategies.

Alternative asset classes and strategies can serve a number of different roles in growth portfolios to improve the risk/return profile. Some will be attractive as "return enhancers", some will help with diversification, and others may add value through their sensitivity to factors such as inflation.

Are There Any Wider Benefits?

The activities of alternative investment managers are generally considered positive for markets in most circumstances – their trading activities are seen to increase liquidity and improve efficiency by allowing asset prices to adjust to fair value more quickly. The economic benefit of alternatives investment is also clear; for instance, private equity firms can turn around companies that might otherwise have gone bankrupt, while infrastructure funds can play their part in projects that benefit society and the economy, such as building hospitals. More generally, alternatives take centre stage when it comes to the efficient allocation of capital.

The Rise of Institutional Quality Products

Alternative investments are not without their drawbacks. Those most commonly cited are high fees and costs, lower transparency and the highly illiquid nature of many strategies. Increased participation of institutions in asset selection and expanding regulation impacting on the alternatives arena has meant that the industry has evolved. The cumulative effect is continued improvement in a number of areas:

- Lower fees and improved alignment of interests – fee structures should reward skill rather than market return. This has led to an increased use of hurdle rates for performance-related fees. Fee structures are also starting to encourage managers to add value over the long term, rather than promote taking short term risks. Fee levels have declined, but not uniformly, and are still usually high compared to traditional strategies.

- Improved transparency on investment strategy, processes and organization – investors need sufficient information in order to choose the right fund manager for their needs and to monitor a live investment. Full position-level disclosure is not always helpful, but managers do need to provide their prospective and existing clients with a timely explanation of exposures.

- Functions such as administration (the settlement and recording of transactions), asset valuation, or fund governance are increasingly being managed independently from fund management. As such, fund managers are becoming more accountable to investors.

- Fairer liquidity terms – investors accept that where the underlying assets of a fund are less liquid, capital will need to be tied-up for longer. It is worth noting that there is a premium for accepting this illiquidity, for instance in private markets. However, in order to ensure fair play, liquidity terms should reflect the liquidity of the underlying assets. Different classes of investor should be treated equitably, such that, the interests of remaining investors is balanced against those redeeming.

Alternative Asset Allocation: Taking Stock

At the more liquid end of the spectrum of alternatives (which largely comprises hedge funds) there has been a relatively slow but steady increase in capital deployed by institutional investors. Strategies that offer more diversification benefit, for example, macro trading strategies (especially managed futures), have attracted more capital, as have some of the more niche strategies such as insurance-linked securities. Investors are increasingly building customized portfolios, rather than through off-the-shelf funds of funds, but are still tending to build hedge fund portfolios that are multi-strategy and diversified in nature.

On the illiquid and private market side, private debt has received much of the limelight, playing to the theme of constrained lending from banks. This has spanned corporate, real estate and infrastructure debt. Infrastructure more broadly, has attracted serious interest and new capital from investors on both the equity and debt side. Investors are also increasingly investing directly into private markets rather than through funds of funds, and in infrastructure, sizeable investors are willing to buy assets directly, rather than investing through funds.

Mercer

Mercer is a global leader in talent, health, retirement, and investments. Mercer helps clients around the world advance the health, wealth, and performance of their most vital asset – their people. Among other things, Mercer advises on the creation and administration of pension schemes, their investment strategies, company workforce and health issues and executive and workforce remuneration.

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Asset Allocation

What Should Investors Consider When Allocating to Alternative Assets?

Asset allocation is at the core of an investor's decision-making process. Before an investor commits capital it must consider its objectives, namely its required returns and the horizon for achieving them.

Subsequent considerations follow: appetite for risk; the offsetting of risk with diversification; necessary levels of liquidity. Crucially, the mix of investments that will help build a portfolio that will enable the investor to achieve all of its returns objectives. The considerations are complex; the solutions challenging.

How Can This Report Help With Asset Allocation?

This section addresses many of the key asset allocation questions investors must consider when assembling and maintaining an alternatives investment portfolio:

- Do alternatives **outperform** traditional investments?
- Can alternatives **deliver** in different economic climates?
- Do alternatives suitably **diversify** an investment portfolio?
- What alternative investment strategies and geographies deliver the **best** returns and which strategies offer **low volatility**?
- Is a slow exit environment showing signs of **recovery**, and will this free up capital for investors?
- Are there ways of identifying which managers are likely to provide the **best** returns?

The **2013 Preqin Investor Network Global Alternatives Report** explores all of these vital questions in depth. The Report is a useful complement to any investor's market intelligence resources for 2013, but Preqin Investor Network and other Preqin services can offer much more.

How Can Preqin Investor Network Help With Asset Allocation?

The PrEQIn Index, available for free on **Preqin Investor Network**, uses fund-level cash flow transactions and net asset values for over 4,000 private equity, private real estate and private infrastructure funds to provide investors with performance of private equity (and its component strategies) over time compared to traditional markets.

Additionally, **Preqin Investor Network** has fund-level returns and performance data for over 6,200 private equity, real estate and infrastructure funds and 5,400 hedge funds, giving investors market benchmark overviews of alternatives by asset class, strategies, geographies and year of inception, and the performance track record of each fund and manager making up those benchmarks.

Read on to learn more about the key asset allocation considerations for investors or contact us at pin.info@preqin.com to find out more about how Preqin's data can assist with your asset allocation study needs.

Key Industry Voices Discuss Asset Allocation:

- **David M. Rubenstein**, Co-Founder and Co-Chief Executive Officer, Carlyle Group
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Challenges and Opportunities for Private Equity

- David M. Rubenstein, Co-Founder and Co-Chief Executive Officer, Carlyle Group

All asset classes were hit hard by the global financial crisis, and private equity was no exception: investing, fundraising, and distribution volumes all dropped dramatically after 2008. There were concerns that major private equity firms might fail; that large limited partners might not be able to honour capital calls; that many of the most visible buyout deals would go bankrupt; and that governments would take steps which would significantly hamper the industry's future viability.

These concerns turned out to be, on the whole, unfounded. Six years after the global financial crisis began, private equity remains an asset class that is widely recognized for its unique capabilities and growing investor appeal.

Evolution of the Industry

The relative strength of the industry is due to a number of factors: improved general partner/limited partner alignment; the blossoming of transparency and ESG practices; the strengthening of investment and lending discipline; and greater development of value-added operational capabilities.

As the industry has evolved and become more "mainstream," rather than "alternative," and more global rather than focused on developed markets, there are several key challenges and opportunities which should be addressed if private equity is to reach its full potential.

Challenges (and Opportunities) Remain

First among these challenges is the need to improve the industry's image by de-mystifying how private equity actually works and how it adds value to society. Although measurable progress has been made in this area over the last few years, the industry's image took a hit during the recent US presidential election.

A second challenge is the need to ensure that governments and regulators around the world do not take actions that inhibit private equity firms from achieving superior returns for their investors, many of which are pension funds that represent blue collar and middle income workers.

Third among the challenges is making certain that returns for the industry's investors continue to outpace those that might be achieved in traditional asset classes and that this outperformance is clearly communicated. While, on an absolute basis, returns will likely come down from earlier peak levels, on a relative basis, returns will still almost certainly outpace those from most other asset classes. The industry needs to prepare investors for the decline in absolute returns by delivering both better means to measure private equity returns as well as better means to compare those returns with the returns of other asset classes.

The fourth challenge is ensuring attractive returns are in fact achieved in any investment environment. The industry needs to continue to expand its post-investment, value-add capabilities; failing to do so in a time of uncertain-to-modest underlying economic growth will threaten the industry's ability to achieve the same levels of performance in the future. In the future, returns will likely be generated from operational improvements, and developing that in-house skillset will be essential for every private equity firm.

And the fifth and final challenge is the need to "democratize" the private equity investor base by developing – with the approval of regulators – investment vehicles (with appropriate safeguards) which enable smaller individual investors to access the higher return levels that up until now have only been available to institutional investors and high-net-worth individuals. Arguably, it is the smaller individual investor which most needs these higher returns, and it is the smaller individual investor which can be the industry's new source of capital as it continues to expand throughout the world.

Outlook

To be clear, addressing these five challenges will not solve all of the industry's problems, or address all of the concerns expressed by the industry's critics. However, the industry's full potential can be much more readily achieved if the need for further change is recognized and steps along the lines described here are taken.

The Carlyle Group

The Carlyle Group (NASDAQ: CG) is a global alternative asset manager with $176 billion of assets under management across 114 funds and 76 fund of funds vehicles as of March 31, 2013. Carlyle's purpose is to invest wisely and create value on behalf of its investors, many of whom are public pensions. Carlyle invests across four segments – Corporate Private Equity, Real Assets, Global Market Strategies and Solutions – in Africa, Asia, Australia, Europe, the Middle East, North America and South America. The Carlyle Group employs more than 1,400 people in 34 offices across six continents. This article does not constitute an offer for any Carlyle fund.

www.carlyle.com

The Interdependence of Pension Security and Private Equity

- Bronwyn Bailey, Ph.D., Vice President, Research, Private Equity Growth Capital Council

In the wake of the financial crisis, American pensions face an unprecedented challenge. Pension funds are struggling to recover large losses suffered during the financial crisis due to declining stock prices. Throughout this period however, private equity remained a bright spot in pension portfolios. Now more than ever, pension funds have an interdependent relationship with the private equity industry. Private equity depends on pension plans for capital commitments, and pensions rely on private equity to provide superior returns to help meet their investment targets.[1]

Private Equity Funds Depend on Pensions for Capital

Pension funds are the largest investors in private equity. According to Preqin, public and private pension funds made up 43% of capital invested by private equity funds during 2001-2011. Public pensions alone make up 30% of the total capital invested. In contrast, foundations and endowments comprise only 19% of total capital invested during this period.

Moreover, pension plans continue to increase their allocations to private equity funds. Wilshire Consulting finds that the percentage of assets allocated to private equity by state pension plans more than doubled from 3.9% in 2001 to 8.2% in 2011.[2] Preqin estimates that public plans' current allocation (8.9%) to private equity is still below their target allocation (9.7%), based on average allocations of US-based pensions with $5bn or more in AUM. In the post-recession economy, public pensions are putting more capital in private equity funds at an increasing rate. Given these trends and the tough fundraising environment, private equity firms have become increasingly dependent on pension plans during fund raises.

Private Equity Provides Higher Returns Compared to Other Asset Classes

Pensions' rationale for increasing their commitment to private equity is superior returns. A study by the Private Equity Growth Capital Council found that the median US public pension portfolio received an annualized 8.8% return from private equity, compared to 3.7% from public equity and 6.6% from fixed income for the 10 years ending 2011. The median US pension fund portfolio returned an annualized 5.7% the same period. Generating 3.1 percentage points above total portfolio returns on an annual basis, private equity funds are boosting the retirement security of pension members.

Investment performance is important to public pensions because these returns are a major source of revenue. Portfolio returns comprise 61% of all revenues pensions receive. The other sources are contributions by employees, i.e. pension members who pay into the system, and by employers, i.e. state and local governments, which are funded by taxpayers.

Over the past decade, public pensions' total investment returns have fallen short of their target rate of return. Pension funds have an average target return of 8%. The 8% target return is considerably higher than the 5.7% return received by the median pension plan over the last decade. Consistent underperformance – driven by low equity returns – has reduced the funded status of public pension plans. Based on a study from the Center for Retirement Research at Boston College, the overall ratio of assets to liabilities by public plans fell to 75% in 2011, from 103% in 2000.[3]

Pensions are More Reliant on Private Equity for Investment Returns

Given the low performance of traditional assets during the first decade of the 21st century, pension funds are looking to alternative assets, such as private equity, for returns. Meeting the pre-set target return is essential for pensions. When pension plan returns do not meet or surpass the target, pensions' ability to fund retirement payments deceases. The gap between assets and promised retirement payments will be paid by pension employees or the taxpayers that support state and local governments.

Private Equity and Pension Funds Have an Interdependent Relationship

The private equity industry relies on pension funds to commit significant amounts of capital to their funds. Pensions, in turn, seek exposure to a high performing asset class to increase the likelihood that their portfolios will hit the assumed rate of return.

Now more than ever, there is interdependence between private equity and pension funds. A better understanding of these dynamics will aid the dialogue between investors and fund managers in their long-term commitment.

Private Equity Growth Capital Council (PEGCC)

The Private Equity Growth Capital Council, based in Washington, DC, is an advocacy, communications and research organization and resource centre established to develop, analyze and distribute information about the private equity and growth capital investment industry and its contributions to the national and global economy.

www.pegcc.org

[1] *This article is based on a larger study conducted by the Private Equity Growth Capital Council.*
[2] *Julia K. Bonafede, Steven J. Foresti and Russell J. Walker. "2012 Report on State Retirement Systems: Funding Levels and Asset Allocation", Wilshire Consulting, March 2, 2012, p. 14.*
[3] *Alicia H. Munnell, Jean-Pierre Aubry, Josh Hurwitz, Madeline Medenica and Laura Quinby. "The Funding of State and Local Pensions: 2011-2015", Center for Retirement Research at Boston College, Number 24, May 2012.*

The Prominence of Alternative Assets in an Investor's Portfolio

Alternative assets are increasingly prominent within the portfolios of institutional investors, with many becoming more reliant on alternatives to provide both returns and stability. This article explores the role of alternative assets in investors' portfolios, including investors' evolving allocations to different asset classes within alternatives and their plans for allocations going forward, as well as the types of investors committing to alternatives and their investment preferences.

Allocations Over Time

Fig. 2.1 shows that, year on year, many institutional investor types have been increasing their level of exposure to private equity. Family offices have the largest current allocations to the asset class, with the average investor of this type allocating 24.5% of total assets to private equity. Interestingly, the average allocation to private equity among family offices increased significantly from 18.1% in 2010 to 24.9% in 2011.

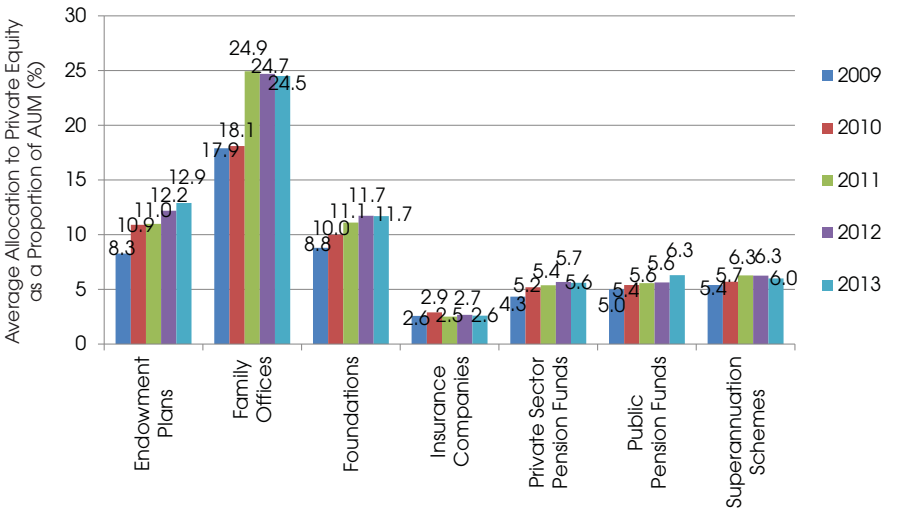
The early adoption of alternative assets by endowment plans, particularly US-based universities such as Yale, which pioneered the so-called "Yale Model", has paved the way for the rest of the endowment universe to invest in alternative assets in large numbers. Endowment plans have significant allocations to private equity, with the average investor of this type currently allocating 12.9% of total assets to the asset class; this is a significant increase from the average allocation of 8.3% of total assets to private equity among investors of this type in 2009.

Similar to private equity, investors in private real estate have generally increased allocations to the asset class in recent years. Superannuation schemes, for example, have the largest average allocation to private real estate of all investor types committing to the asset class, with the average superannuation scheme currently allocating 10.7% of total assets to private real estate (Fig. 2.2). This is a significant increase on the average of 8.2% of total assets investors of this type allocated to private real estate in 2011. Although private sector pension funds account for 37% of the private real estate investor universe, they have a lower average current allocation of 9.0% of total assets to private real estate compared to superannuation schemes. However, this is an increase from the average of 5.6% and 4.6% of total assets private sector pension funds allocated to private real estate in 2011 and 2012 respectively.

Unlike private equity and private real estate, the relative liquidity of hedge funds allows portfolios to be rebalanced regularly. The ability to shift capital from fund to fund as market conditions and portfolio needs dictate is an attractive proposition for investors interested in allocating to alternatives. However, a long-term consistent allocation to the more liquid asset class as a whole is needed in order to get the best out of the asset class, which has beaten wider equity indexes over five-year time-frames with lower volatility.

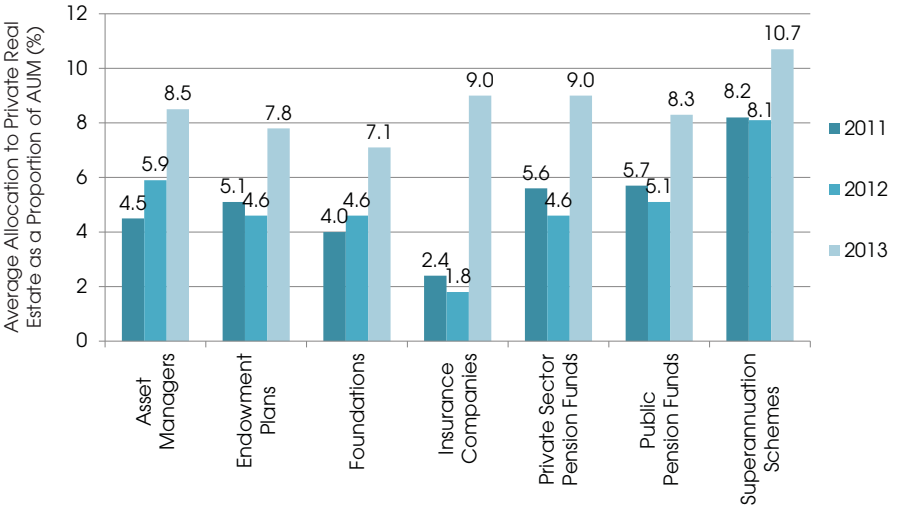
Longer established investors in hedge funds, such as family offices and

Fig. 2.1: Average Allocation to Private Equity by Investor Type, 2009 - 2013



Source: Preqin Investor Intelligence

Fig. 2.2: Average Allocation to Private Real Estate by Investor Type, 2011 - 2013



Source: Preqin Real Estate Online

endowment plans, have experienced greater fluctuations in their allocations to the asset class than newer investors, such as pension funds, as shown in Fig. 2.3. More experienced hedge fund investors are more likely to have an established target allocation to the asset class, and their current allocation then fluctuates around this based on market conditions year to year and the movement of an investor's capital.

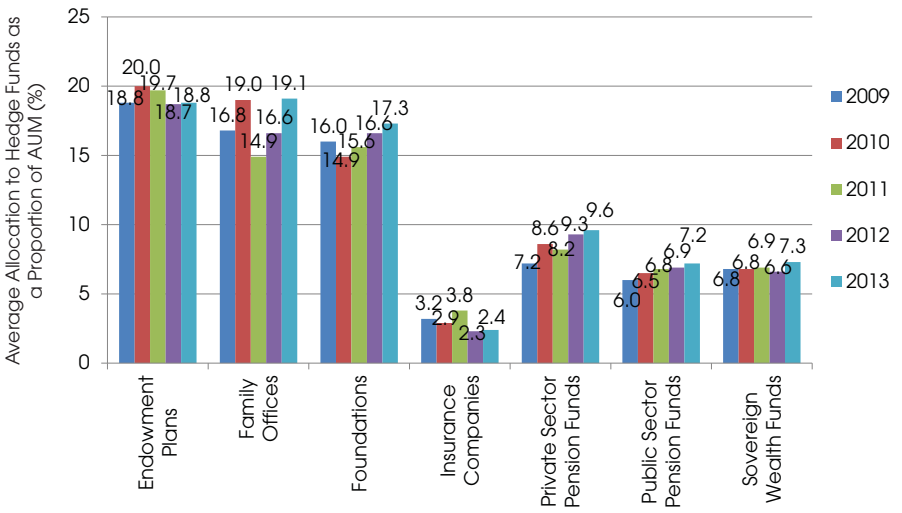
In comparison, less experienced investors in hedge funds, including private sector pension funds and public pension funds, investor types which both entered the hedge fund asset class on average around 2007, are still in the process of building their hedge fund portfolios; as a result their current allocations to the asset class are slowly increasing year on year, as shown in Fig. 2.3. Private sector pension funds, for instance, have increased their allocations to hedge funds from an average of 7.2% of total assets in 2009 to 9.6% in 2013. Similarly, public pension funds have been gradually increasing their average allocations to hedge funds, leading to a rise in the allocation of public pension funds to hedge funds from an average 6% of total assets in 2009 to 7.2% in 2013. Increasing allocations to hedge funds among private sector pension funds and public pension funds have been a significant contributor to the expansion of the hedge fund industry as a whole, which now has over $2.3tn in total assets under management.

Investors' Intentions for Their Allocations in the Future

Looking at investors' plans for their allocations to alternatives for the next 12 months and over the longer term gives further indication of the increasing importance of alternative assets to investors' portfolios, with many investors demonstrating an intention to continue increasing their allocations to private equity, real estate, infrastructure and hedge funds.

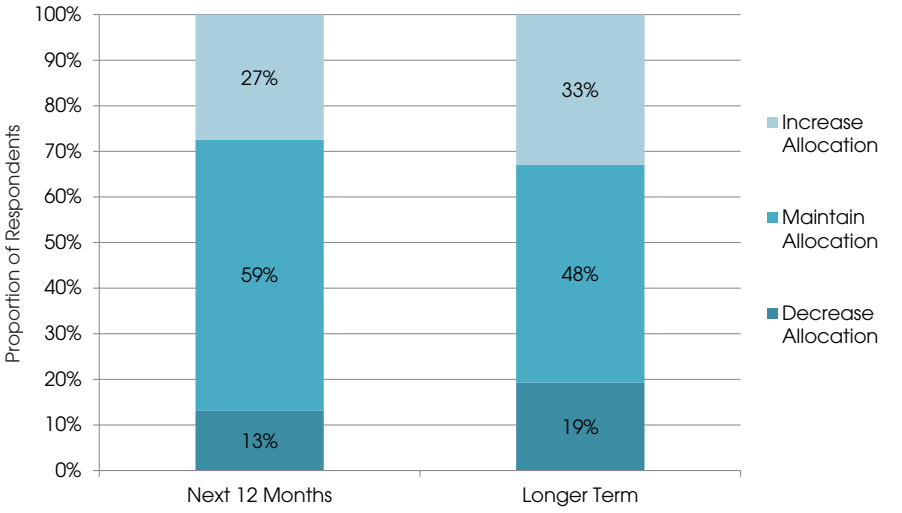
Preqin's interviews with private equity investors in December 2012 revealed that more than 80% of respondents are looking to increase or maintain their allocations to private equity in the following 12 months and the longer term, as shown in Fig. 2.4. A significant 27% and 33% of investors plan to increase their allocations to private equity in the next 12 months and longer term respectively. Additionally, 24% of investors interviewed indicated that they would commit more capital to private

Fig. 2.3: Average Allocation to Hedge Funds by Investor Type, 2009 - 2013



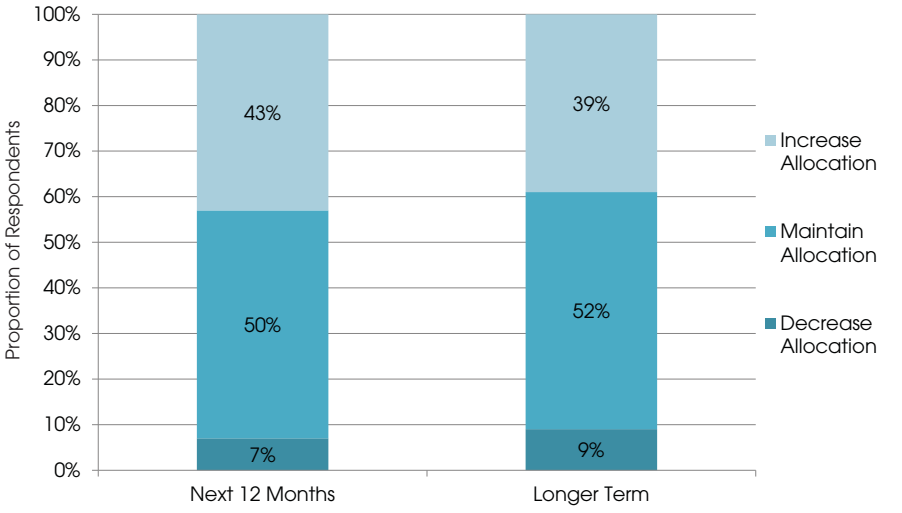
Source: Preqin Hedge Fund Investor Profiles

Fig. 2.4: Investors' Intentions for Their Private Equity Allocations in the Next 12 Months and Longer Term



Source: Preqin Private Equity Investor Interviews, December 2012

Fig. 2.5: Investors' Intentions for Their Private Real Estate Allocations in the Next 12 Months and Longer Term



Source: Preqin Real Estate Investor Interviews, December 2012

equity funds in 2013 than they did in 2012, with 10% of investors looking to return to the asset class this year having suspended activity in the last. Fifty-two percent of investors interviewed stated they would commit the same amount of capital in 2013 as in 2012, with only 14% planning to commit less capital in 2013 compared to 2012.

Similarly, a large proportion of real estate investors remain committed to investing in real estate in the future. Preqin's interviews with real estate investors in December 2012 revealed that 43% expect to increase their allocations to real estate in the following 12 months, with 50% maintaining their allocations to the asset class (Fig. 2.5); only 7% of real estate investors are aiming to decrease their exposure to the asset class in the 12 months following December 2012. In terms of longer term intentions, 91% of real estate investors plan to increase or maintain their allocations to the asset class.

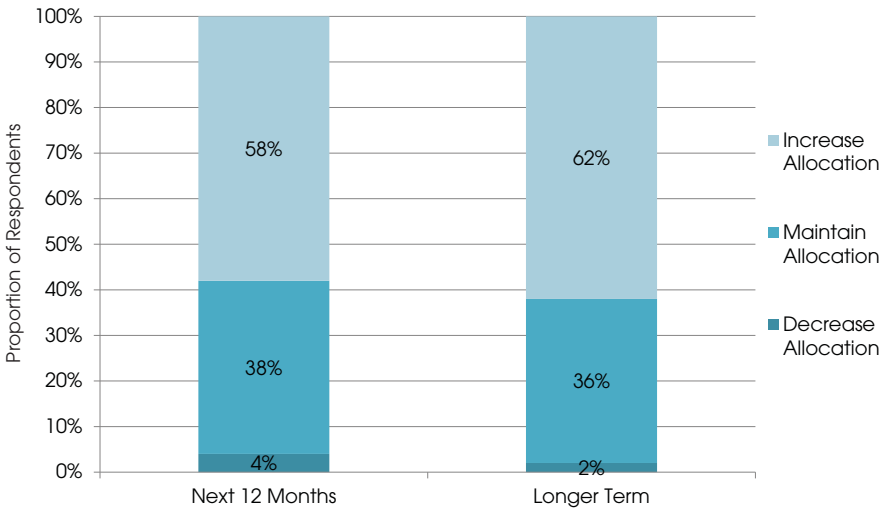
Infrastructure investors have shown considerable confidence in this comparatively younger asset class, with 58% of infrastructure investors interviewed by Preqin planning to increase their allocations to the asset class over the next 12 months; this increases to 62% of investors over the longer term. Only 4% of investors are looking to decrease their infrastructure exposure in the short term and only 2% in the longer term.

Hedge fund investors are also set to increase their allocations to the asset class in the future. Eighty percent of hedge fund investors are looking to either increase or maintain their allocations to hedge funds in the next 12 months, and only 20% are looking to decrease their allocations. Similar patterns emerged during Preqin's interviews with hedge fund investors in December 2012, with 53% of respondents planning to make a new investment in hedge funds in 2013. It is likely that even among the 20% of investors that plan to decrease their allocations to hedge funds in the next 12 months, many of those will still invest in further funds, redeeming from some and using the capital to allocate to others.

Breakdown of Investor Universe

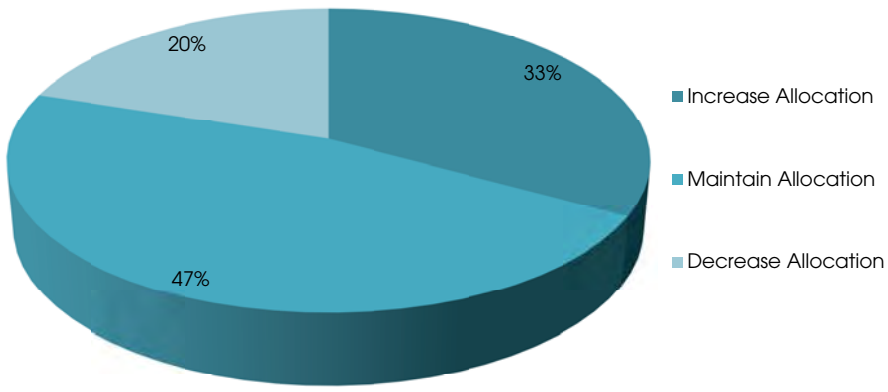
Although many large investors make commitments to alternative assets, the majority of investors in private equity, real estate, infrastructure and hedge funds are relatively smaller in size. Fig. 2.8 shows that investors with less than $1bn in assets under management

Fig. 2.6: Investors' Intentions for Their Infrastructure Allocations in the Next 12 Months and Longer Term



Source: Preqin Infrastructure Investor Interviews, H2 2012

Fig. 2.7: Investors' Intentions for Their Hedge Fund Allocations in the Next 12 Months



Source: Preqin Hedge Fund Investor Profiles

Fig. 2.8: Breakdown of Investors in Alternative Assets by Total Assets under Management

Source: Preqin

represent half of the alternative assets investor universe, with 13% holding less than $100mn in total assets. On the larger end of the scale, 18% of investors in alternatives have total assets under management of $10bn or more, including 4% that manage over $100bn, such as Abu Dhabi Investment Authority, MetLife Insurance Company and China Investment Corporation.

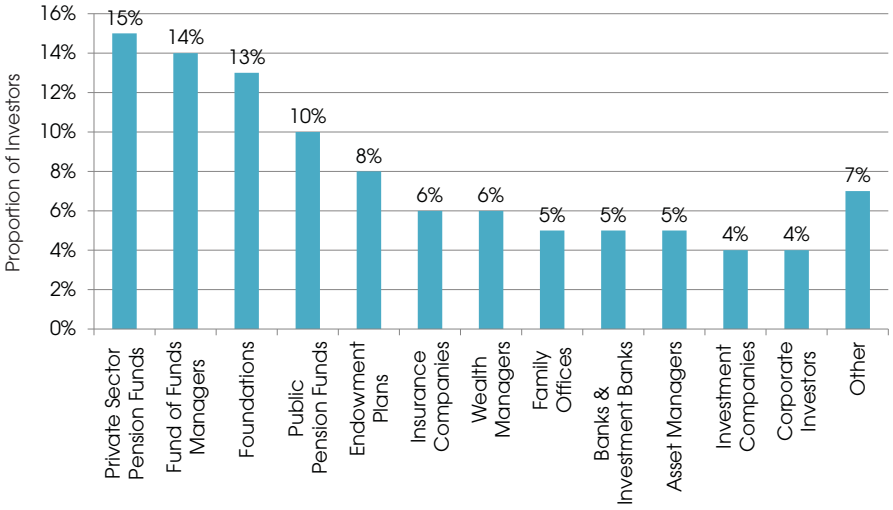
Our data demonstrates the different types of investors committing to alternative assets funds. As Fig. 2.9 shows, private sector pension funds account for the largest proportion of investors pursuing alternatives (15%), followed by fund of funds managers (14%), foundations (13%) and public pension funds (10%). A number of prominent investor types are likely to be soon affected by the industry's latest regulations. For instance, insurance companies, which represent 6% of investors in alternatives, will be affected by the Solvency II directive that will require them to restrict their allocation to illiquid assets. Likewise, the Volcker Rule is set to affect banks and investment banks' strategies and their alternative investment holdings. This investor type currently represents 5% of the alternative assets investor universe.

North America, a prominent hub for alternative assets investments, hosts the largest proportion (51%) of investors in alternatives (Fig. 2.10). A further 31% of investors in alternatives are based in Europe, another developed market for alternative assets. Investors based outside North America and Europe are becoming increasing visible in the alternative assets space. While many investors based in North America and Europe find themselves contending with increased financial regulation, emerging markets around the globe are opening up to private equity and hedge fund investment. As Fig. 2.10 shows, 18% of investors in alternatives are currently based outside North America and Europe, a figure which will likely increase in the coming years as investors based in these regions become more active in alternative assets.

Investment Strategy

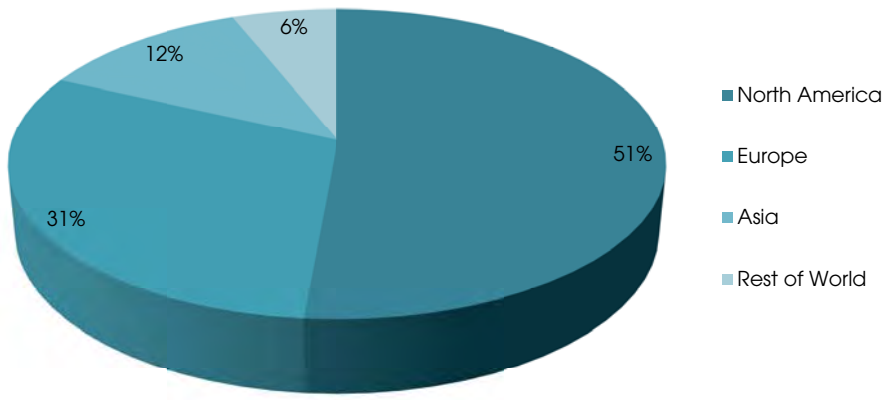
So with increasingly large pools of capital available within the investor community, how will investors allocate their capital to alternative assets in 2013? As Fig. 2.11 shows, a recent survey of private equity investors highlights that 51% are looking to invest in small to mid-market buyout funds over 2013, a similar proportion to the

Fig. 2.9: Breakdown of Investors in Alternative Assets by Type



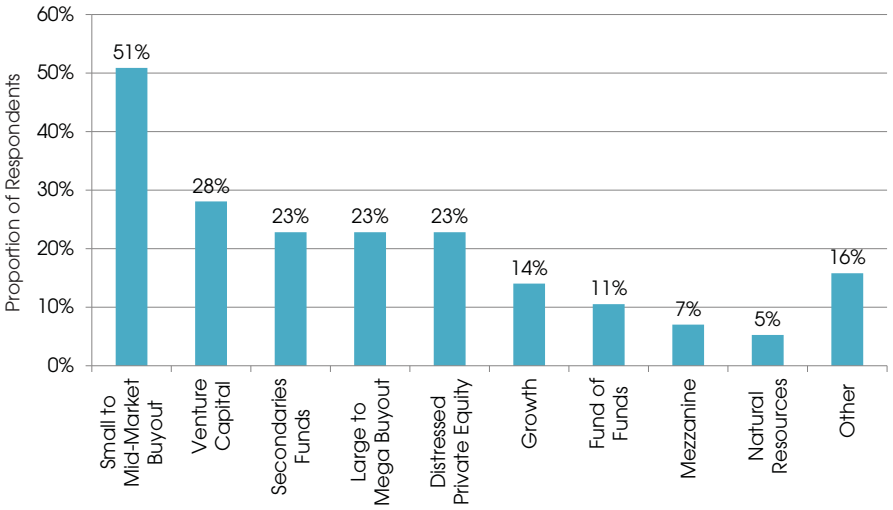
Source: Preqin

Fig. 2.10: Breakdown of Investors in Alternative Assets by Location



Source: Preqin

Fig. 2.11: Strategies Targeted by Private Equity Investors in 2013



Source: Preqin Private Equity Investor Interviews, December 2012

49% which were targeting this strategy in 2012. Venture capital is the next most sought after fund type in 2013, with 28% of investors looking to invest in private equity funds following this strategy; this is a significant increase compared to the 15% of investors that planned to invest in this strategy in 2012. Interestingly, there has been an increase in investor appetite for large and mega buyout funds from 16% of investors targeting the strategy in 2012 to 23% of investors planning to invest in the fund type in 2013.

Many private real estate investors appear to be moving up the risk/return profile spectrum in 2013, with a greater proportion targeting core-plus and value added funds in 2013. The proportion of investors looking to make value added investments has increased from 47% in 2012 to 55% in 2013 (Fig. 2.12), making value added the most sought after strategy this year. However, core is still a commonly sought strategy, with 45% of investors targeting the strategy in 2013.

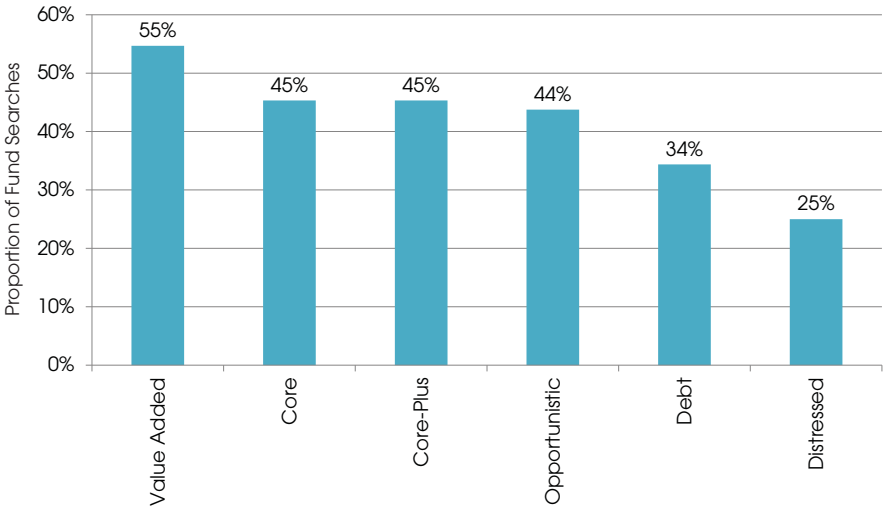
Notably, there has been a marked increase in the proportion of investors seeking distressed and debt vehicles. Eight percent of investors were seeking debt-focused vehicles in 2012 compared with 34% in 2013. There has also been a significant growth in the proportion of investors seeking distressed vehicles from 5% in 2012 to 25% in 2013.

Ninety-eight percent of infrastructure investors are planning to target primary infrastructure funds in the next 12 months, as Fig. 2.13 shows. Primary funds have traditionally been the main route to the infrastructure market for the majority of investors and Preqin's data indicates that this is set to continue over the coming year. Investor appetite for infrastructure debt/mezzanine funds is growing and 12% of infrastructure investors are targeting this strategy in 2013.

Despite 28% of investors interviewed by Preqin in December 2012 stating that long/short equity funds produced disappointing returns in 2012, the strong returns these funds have posted so far in 2013 has led to long/short equity strategies being the most commonly sought single strategy over 2013. Forty-five percent of investors are targeting long/short equity funds in 2013, with many looking to take advantage of rallying equity markets. In contrast, more illiquid CTA/managed futures funds, which have posted disappointing returns recently, are sought by just 18% of investors, a drop compared to the 25% of investors that expressed a preference for this fund type in 2012.

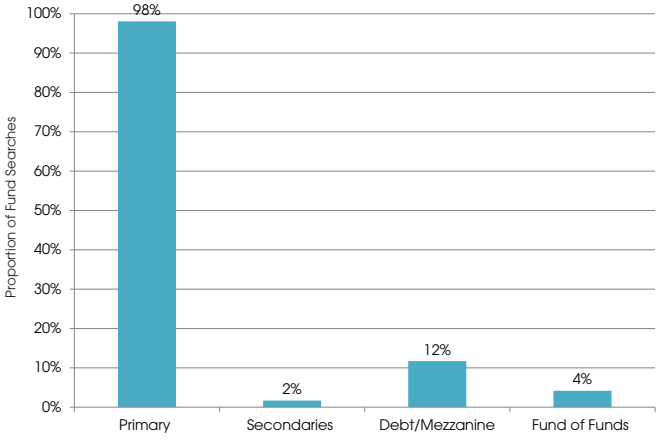
Although equity markets have been bullish over the past several months, investors are still seeking macro funds to hedge against possible future downturns as well as to tap into opportunities that are occurring across global markets. Over the next 12 months 31% of investors looking for new hedge funds are seeking out those with a macro focus. Some investors have taken on more illiquidity in the hope of achieving better returns by looking to invest in funds where their capital is locked-up for longer periods. For instance, event driven, long/short credit and distressed securities are being targeted by 20%, 19% and 13% of hedge fund investors respectively over the coming year, suggesting that longer-term and less liquid hedge fund strategies are still attractive to hedge fund investors.

Fig. 2.12: Strategies Targeted by Private Real Estate Investors in 2013



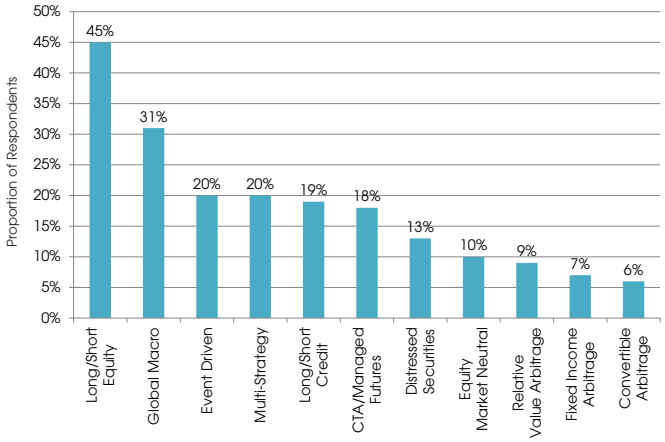
Source: Preqin Real Estate Online

Fig. 2.13: Strategies Targeted by Infrastructure Investors in 2013



Source: Preqin Infrastructure Online

Fig. 2.14: Strategies Targeted by Hedge Funds Investors in 2013



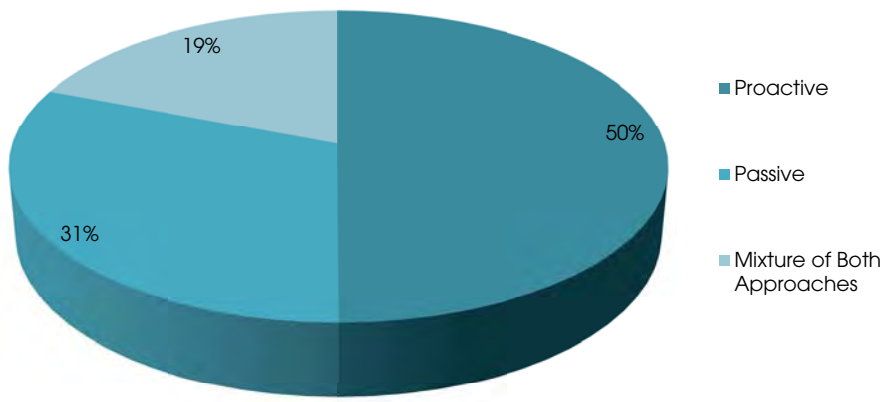
Source: Preqin Hedge Fund Investor Profiles

Investors' Approach to Alternative Investments: Proactive or Passive?

The alternative investor universe has grown considerably in the past decade, with many investors now seeing alternative assets as an integral part of their portfolios. As institutions become more active and experienced in alternative investment, many are gaining more confidence in navigating fund opportunities and are also more proactive with their approach.

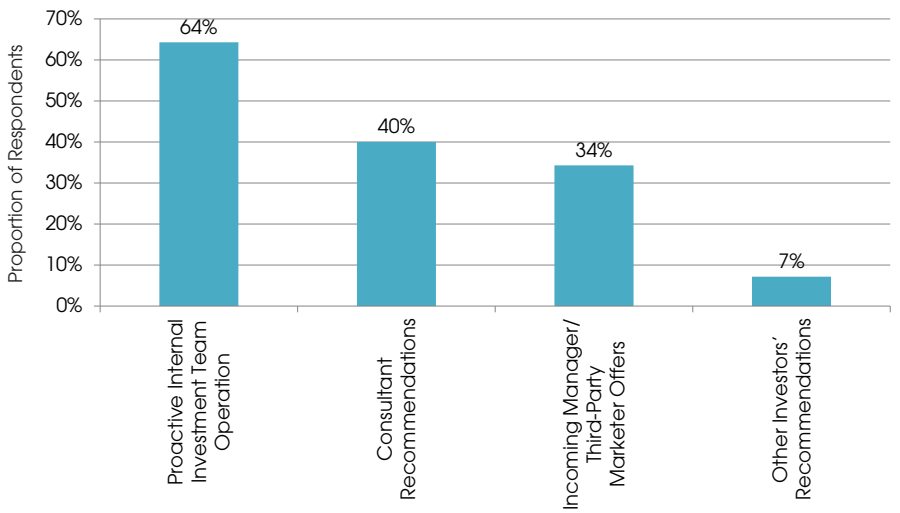
In light of the global economic downturn and greater pressure on investors to be prudent with capital and selective with where it is allocated, in April 2013 Preqin interviewed 70 institutional investors from around the globe to find out just how proactive and sophisticated they are in relation to committing to alternatives. Investors may need to consider managing a variety of areas: risk exposure, returns requirements, liquidity allowances, and capital and staff resources. This article explores what proportion of the alternative investment community considers itself proactive, how investors source investments and the resources they have to do so.

Fig. 2.15: Investors' Attitudes Towards Sourcing Alternative Asset Fund Investments



Source: Preqin Investor Interviews, April 2013

Fig. 2.16: Investors' Sources of Alternative Asset Fund Investments



Source: Preqin Investor Interviews, April 2013

Sourcing Alternative Investment Opportunities

As Fig. 2.15 shows, 50% of investors interviewed stated that they have a proactive approach to sourcing new alternative asset fund investments, meaning they actively review and source new investment opportunities. Thirty-one percent of investors interviewed declared a passive approach to sourcing new investment opportunities, relying exclusively on third parties to present viable fund opportunities. The remaining 19% stated that they employ a mixed approach to sourcing alternative asset fund investments.

With greater transparency on fund manager activity available than ever before, investors can be proactive in sourcing funds themselves, cross-referencing information given to them by third parties, and making fund suggestions for third parties to undertake due diligence on.

Investors in alternatives use various methods to source alternative assets fund opportunities, often concurrently. Fig. 2.16 shows that 40% of investors interviewed gain access to funds following recommendations from their consultant, while just over a third (34%) depend on incoming fund manager, placement agent and third-party contacts to commit to funds. Sixty-four percent of investors interviewed have an investment team tasked with finding appropriate opportunities and 7% find funds following recommendation from a fellow investor. One Europe-based government agency stated that it uses "mostly an internal team but sometimes uses an external consultant when [it] wants to examine profit and risk more closely". One Middle East-based bank interviewed typically "speaks to existing managers and finds out what competitors are doing".

Preqin's interviews with investors confirm that alternative investments have grown in importance for investors over the years, with almost half (49%) of investors interviewed stating that their investment teams have given

more attention to managing alternative assets in the last two years than in the past. Only 8% of investors said that they have given alternative investments less attention over the last two years, and 42% indicated that their level of attention to alternative investments has stayed the same.

Alternative Investment Staff Resources

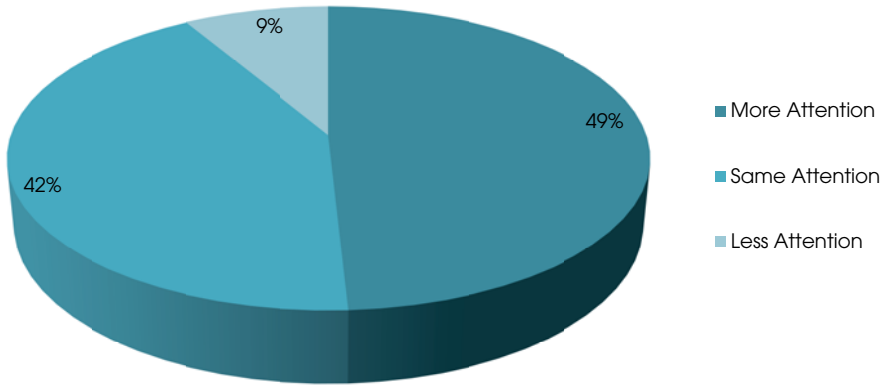
Many investors in the asset class have established an internal team with multiple employees specializing in alternatives. The majority of investors (67%) we spoke to employ more than two investment professionals to oversee alternatives, including 16% that have alternative investment teams of more than five people. In one case, a large Asia-based bank has 18 individuals on its alternative investments team. The largest proportion (51%) of investors we spoke to have teams of between two and five individuals. Despite the growing number of alternative investment teams across the globe, 15% of investors interviewed have their investment activities completely outsourced to investment consultants, asset managers or other third-party investment managers.

Outlook

Proactivity in sourcing and making alternative investment fund commitments is often dictated by an investor's circumstance; those investors with fewer resources may have to completely or almost completely outsource alternative investment decisions to a third party.

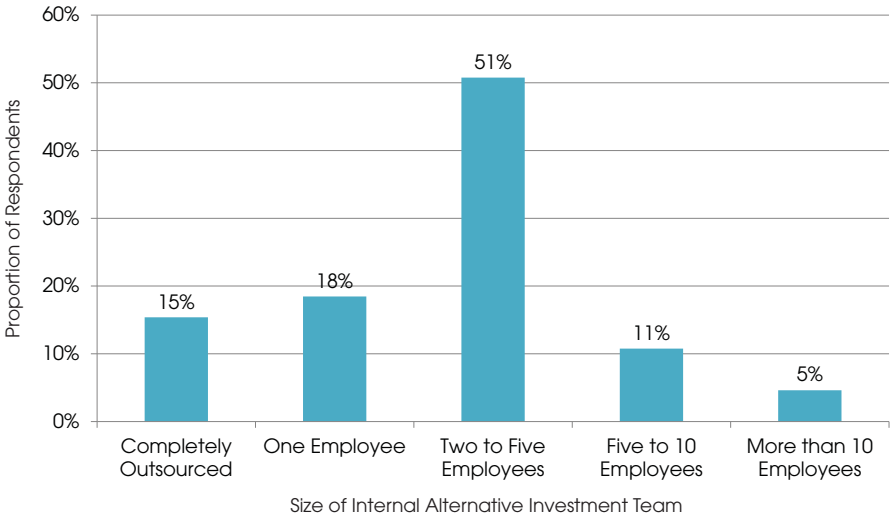
However, those with resources to actively source funds perhaps should consider the way their peers manage their alternative investment portfolios when looking after their own. With 69% taking either a proactive or somewhat proactive approach to sourcing funds, investors that take a passive stance out of preference may reflect on the difference greater internal focus could make on gaining access to better funds.

Fig. 2.17: Attention Given by Investors to Managing Alternative Investments Over the Last Two Years Compared to the Past



Source: Preqin Investor Interviews, April 2013

Fig. 2.18: Size of Investors' Internal Alternative Investment Teams



Source: Preqin Investor Interviews, April 2013

With the chasm between top quartile funds and the rest so acute, investors having insightful, objective fund manager information at their disposal and being proactive in using it, could prove crucial to building and maintaining a successful portfolio.

Private Equity Dry Powder and Assets under Management

Despite the impact of the global financial crisis, over the past five years the private equity industry's assets under management (AUM) have continued to grow. While total dry powder has declined slightly over this period, it has still remained at a high level, close to the $1tn mark, with unrealized value increasing steadily each year. This section analyzes the reasons behind increasing AUM and how this impacts investors, particularly the cash flows they have experienced within their private equity portfolios, and their ability to commit to new funds.

Growing Assets under Management

Fig. 2.19 shows the private equity industry's assets under management from December 2000 to September 2012. From 2000 onwards, assets under management grew steadily, producing average year-on-year growth rates of 7.8% between 2001 and 2004. However, the 2004-2007 period saw these year-on-year figures increase significantly due to high levels of deals and fundraising activity, resulting in increased dry powder and portfolio value.

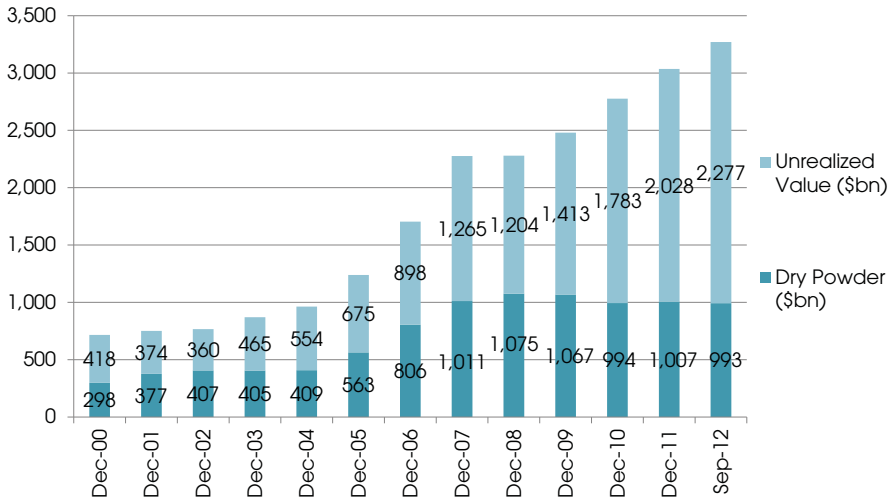
This boom period was followed by a flattening out in 2008 as the financial crisis hit. The crisis resulted in a sharp decline in exit activity; Fig. 2.20 shows that during this time the amount of capital distributed to investors was significantly lower than in previous years. However, the graph also shows that fund managers continued to call capital from investors for portfolio acquisitions. This, together with continued fundraising, resulted in further subsequent increases in industry AUM despite the markdown in portfolio valuations and lack of exits as a result of the financial crisis.

This slow exit environment in recent years has resulted in increasing levels of unrealized portfolio value each year. With lower exit levels, investors have less capital returned from their private equity portfolios to commit to new funds, leading to a far more competitive fundraising market. This increase in portfolio value drove industry AUM to surpass the $3tn mark for the first time in December 2011. It has remained above this level since.

Fig. 2.21 shows the assets under management in private equity as of September 2012 by vintage year. The graph indicates that the greatest proportion of industry AUM comes from vintage 2006-2008 funds, with almost 50% of total assets under management belonging to these vintage years. Only 35% of AUM comes from funds of the most recent vintages (2009-2012). This distribution highlights the significant levels of fundraising and investment seen as a result of the boom period, and the difficult exit environment since.

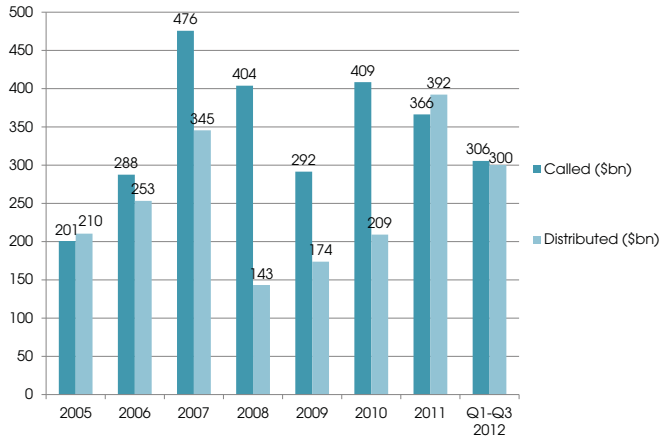
Private equity fund managers had $993bn in available dry powder as of

Fig. 2.19: Private Equity Assets under Management, 2000 - 2012



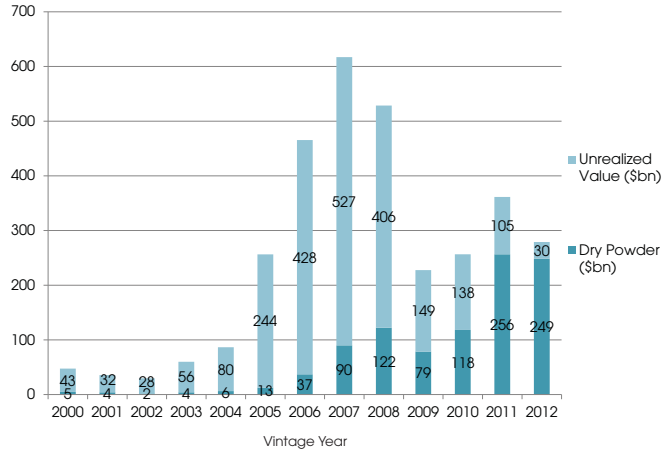
Source: Preqin Fund Manager Profiles and Performance Analyst

Fig. 2.20: Annual Amount Called and Distributed by Buyout Funds, 2005 - 2012



Source: Preqin Performance Analyst

Fig. 2.21: Private Equity Assets under Management by Vintage Year as of September 2012



Source: Preqin Fund Manager Profiles and Performance Analyst

September 2012, slightly lower than the $1tn available as of December 2011. Buyout funds hold the largest share of industry dry powder, with 39% of the total, followed by real estate and venture capital, with 14% and 12% respectively (Fig. 2.22). North America-focused funds account for the largest share of industry dry powder, at 55% in September 2012 (Fig. 2.23), followed by Europe and Asia, with 23% and 16% respectively. Asia has seen the most significant increase in its industry share over this period, from 3% in 1999 to 16% as of September 2012.

Impact on Investors

Preqin data shows that average holding periods for portfolio companies have increased, for example from 3.8 years for companies exited by buyout funds in 2008 to 4.9 years for companies exited in 2012. As a result of this increase in holding periods, unrealized investments held by private equity funds have accumulated, delaying the return of capital to investors. The slowdown in distributions has meant less liquidity for investors, impacting their ability to commit to new private equity funds.

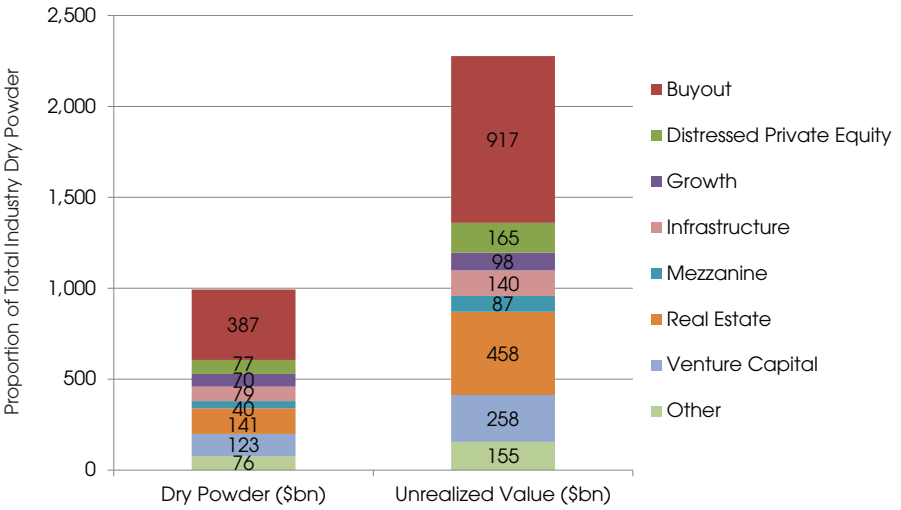
Recent returns data (see page 21) for vintage 2006-2008 funds indicate that these vehicles are recovering. However, with high proportions of capital still tied up in these vintage years, the level of capital which will be returned to investors by the end of these funds' lives remains to be seen.

Fig. 2.24 shows that, approximately six years into a 2007 vintage fund, the median level of distributions to investors was just 33% of paid-in capital, whereas, six years into a 2001 vintage fund, the median distributions stood at 95% – almost all of investors' paid-in capital. Although the figure for 2007 vintage funds has clearly been affected by the fall in portfolio company valuations caused by the economic downturn, the data shows that the slowdown still applies to other recent vintages. For example, the median DPI figure for 2009 vintage funds after four years is 8.9%, lower than any of the equivalent figures for vintages 2000-2005.

Positive Signs for Investors

With the aforementioned slow exit environment resulting in longer holding periods for portfolio companies and less liquidity for investors, there have been many areas of concern for investors in recent years. However, the annual amount of capital called-up and distributed by private equity funds demonstrates that distributions picked up significantly in 2011 (Fig. 2.20), exceeding contributions for the first time since 2005. The data currently available indicates that distributions for the whole of 2012 may exceed those of 2011, and these figures may help to explain why overall private equity fundraising in 2012 picked up to a total of $342bn in commitments, the highest figure since 2008. Given the rise in absolute distributions from 2011 onwards, we may see investors increasing their rate of new commitments to private equity funds in order to maintain their allocations to the asset class, helping to ensure that capital again cycles through the private equity industry as it recovers from the slowdown in recent years. Recent years have been tough for investors in private equity, but these signs of recovery in the asset class are positive for investors and fund managers alike.

Fig. 2.22: Private Equity Assets under Management by Fund Type as of September 2012



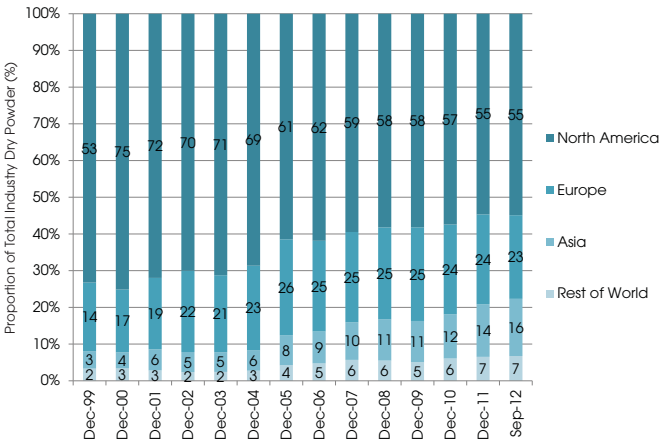
Source: Preqin Fund Manager Profiles and Performance Analyst

Data Source:

Preqin tracks detailed information on dry powder, distributions, and more.

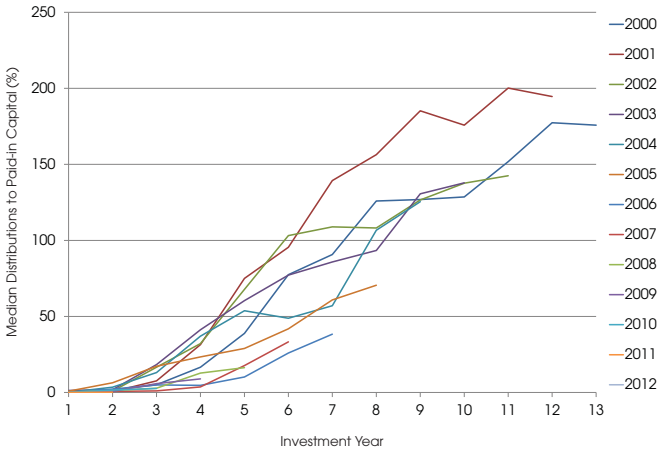
www.preqin.com/privateequity

Fig. 2.23: Breakdown of Private Equity Dry Powder by Region, 1999 - 2012



Source: Preqin Fund Manager Profiles and Performance Analyst

Fig. 2.24: Historical Buyout Fund Median Distributions to Paid-in by Vintage Year



Source: Preqin Performance Analyst

Overview of Private Equity Performance

As an investor, the challenge of constructing and maintaining an effective private equity program is great, and many considerations need to be taken into account to assess fund selection and asset allocations. In order to address these challenges, it is vital that the most relevant and comprehensive performance data be available to investors.

To provide insight into these important considerations, Preqin provides fund-level returns and performance data for around 6,200 individual named funds, and generates benchmark data by fund strategy, vintage year and geographic focus.

Asset Allocation and the PrEQIn Private Equity Quarterly Index

Typical private equity performance metrics such as net value multiple and net IRR are important and can help guide an investor in terms of fund selection and assessing fund manager track records. However, for investors to determine their optimum level of exposure to private equity, and to ensure that their asset allocations continue to meet their overall investment objectives, a different metric is required in order to assess the performance of the industry as a whole – and the performance of the various private equity strategies – compared to other asset classes over time.

The PrEQIn Index is a time-weighted index that uses fund-level cash flow transactions and net asset values for over 4,000 private equity funds. The PrEQIn Index gives an indication of the performance of each particular fund type from a given point in time and allows investors to compare the returns of private equity to other asset classes.

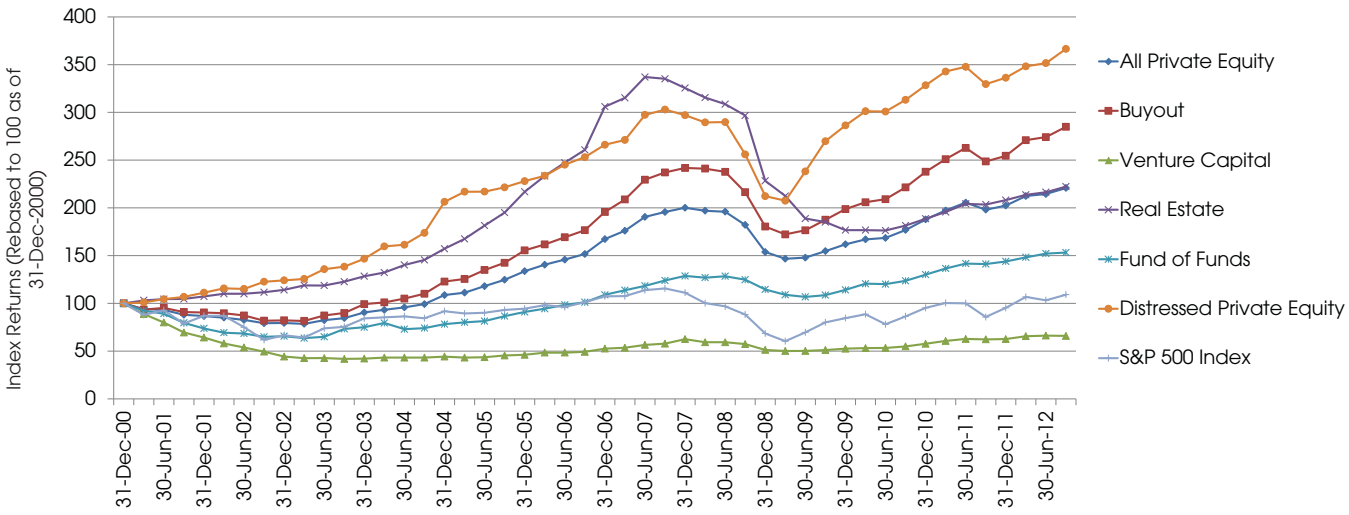
Fig. 2.25 shows the PrEQIn All Private Equity, Buyout, Venture Capital, Real Estate, Fund of Funds and Distressed Private Equity Indices, together with the S&P 500 Index, all rebased to 100 as of 31st December 2000. The PrEQIn All Private Equity Index showed steady quarterly increases until December 2007, followed by a period of decline due to the market instability of 2008 and 2009. Since reaching its lowest post-financial crisis level in Q1 2009, the PrEQIn All Private Equity Index has recovered to reach its highest level of 220.8 in Q3 2012. In comparison, the S&P 500 Index shows a similar rate of decline during the financial crisis of 2008 and 2009 compared to the PrEQIn All Private Equity Index. However, the S&P 500 Index has yet to recover to pre-crisis level.

The PrEQIn Buyout Index shows a similar trend to the PrEQIn All Private Equity Index due to the large proportion of capital held in buyout vehicles. The PrEQIn Distressed Private Equity Index consistently outperformed the other private equity indices, showing that this fund type has been one of the best performing strategies since 31st December 2000. Due to the relative abundance of distressed opportunities in the wake of the financial crisis, the recovery of this index was achieved at a faster rate than other fund types.

The PrEQIn Real Estate Index reached its highest point in Q2 2007, outperforming all other fund types at this time; however, due to the sub-prime mortgage crisis, this fund type suffered some of the largest quarterly declines during 2008 and 2009. The PrEQIn Real Estate Index reached its lowest point in the latter half of 2010, while all other fund type indices reached their lowest points in 2009. There has, however, been significant improvement for real estate over the last couple of years, and while it has not recovered to pre-crisis levels, like distressed private equity, signs are positive.

With the exception of the PrEQIn Venture Capital Index, all PrEQIn Indices are outperforming the S&P 500 Index as of Q3 2012 and show four successive quarterly increases since Q3 2011, demonstrating that, on the whole, private equity is able to produce superior returns compared to the listed markets. As seen in Fig. 2.25, private equity consistently outperforms listed

Fig. 2.25: PrEQIn Private Equity Quarterly Index: All Strategies



Source: Preqin Investor Network

markets across the years, providing better returns than public equity in both good and bad economic conditions.

PrEQIn is the first quarterly index for the whole private equity industry, enabling comparison of the performance of private equity funds against other classes, and is available for free on Preqin Investor Network.

The Resilience of Private Equity

The PrEQIn Index gives us an indication of the relative resilience of private equity since the financial crisis of 2008 and 2009 compared to listed equities. However, an examination of the median net IRRs over time by vintage provides insight into how the particular vintage years which were the most affected by the financial crisis have since recovered.

Fig. 2.26 shows private equity 'J-curves' by vintage year. J-curves show the trajectory of private equity returns over the life of a fund and are found by plotting the median net IRR for each vintage year at each quarter-end. Returns tend to be in the red during the early part of a fund's life and then transition into positive territory as the investment cycle progresses and fund managers add value to their investments and begin to distribute capital back to investors. The graph shows that for vintage years 2005 and 2006, the trajectories resemble 'w-curves' as the financial crisis caused large write-downs within these funds' portfolios. However, since this time, the median returns for these funds have returned to the black, further highlighting the resilience of the asset class over the long-term.

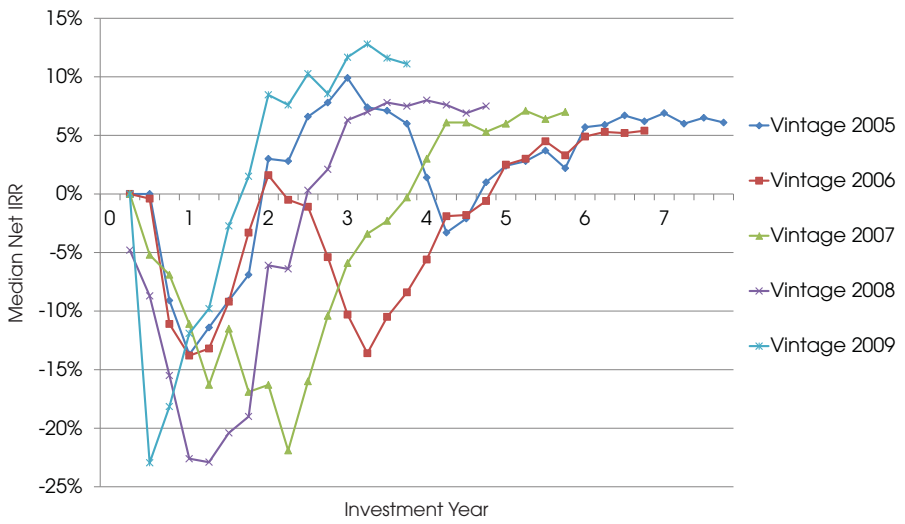
The Importance of Fund Selection

As well as determining the most appropriate asset allocation, the task of selecting the best fund managers in order to maximize returns from a private equity portfolio is a very important consideration for an investor. Fig. 2.27 highlights the wide difference between returns generated by top quartile funds and those falling below the bottom quartile boundary for each vintage year.

Does Top Quartile Performance Persist?

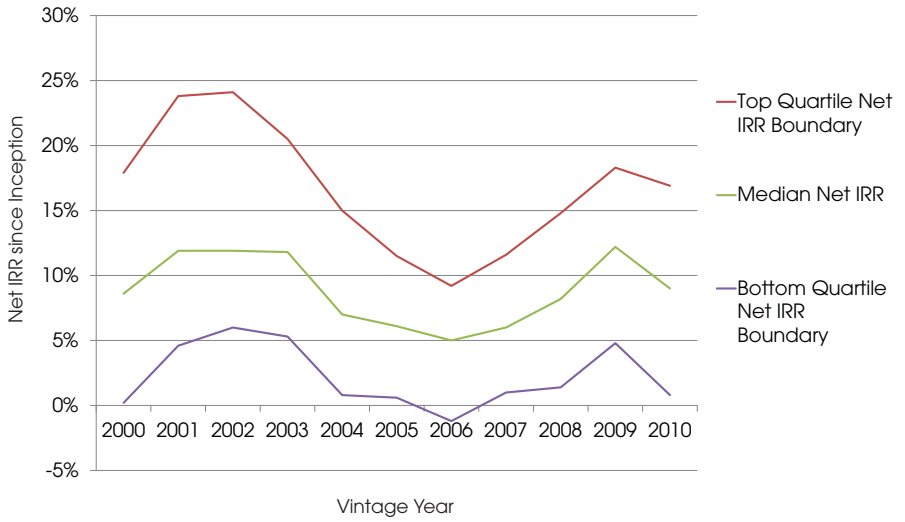
Fig. 2.27 demonstrates just how vital it is for investors to be able to distinguish between the many different investment opportunities presented to them and to select the funds most likely to perform best. Track record is an important part of the due diligence process for investors,

Fig. 2.26: All Private Equity - J-Curve: Median Net IRRs by Vintage



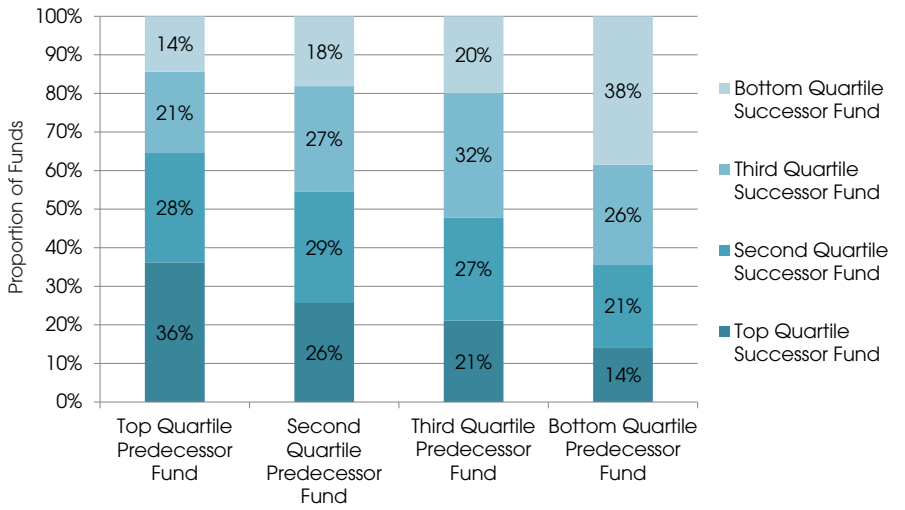
Source: Preqin Performance Analyst

Fig. 2.27: All Private Equity - Median Net IRRs and Quartile Boundaries by Vintage Year



Source: Preqin Investor Network

Fig. 2.28: All Private Equity - Relationship between Predecessor and Successor Fund Quartiles



Source: Preqin Performance Analyst

but how relevant is it? Can we determine whether past performance can provide an indication as to how a fund manager may perform in the future with their newest vehicles? Do top quartile managers remain in the top quartile with their next fund?

We have assessed the quartile ranking, which is based on both net IRR and net multiple, of each manager from fund to fund, and the relationship between predecessor and successor fund performance quartiles is shown in Fig. 2.28. This chart shows that 36% of fund managers with a top quartile fund go on to have their next fund also ranked in the top quartile, while overall 64% of top quartile fund managers go on to achieve above-median performance with their next fund. In comparison, just 14% of bottom quartile fund managers go on to achieve top quartile performance with their next fund. At the other end of the scale, 38% of managers with a bottom quartile fund go on to have their next fund also ranked in the bottom quartile, and overall 64% fail to surpass the median benchmark with their next fund.

These figures indicate the clear relationship between the performance quartile rankings of successive funds. While it is important to note that past performance is no guarantee of future returns, with data pointing towards repeat success, track record is a very important consideration for investors and should thus constitute a key part of their due diligence process.

Top Performing Fund Managers

Given that above-average performance persists from fund to fund in many cases, it is imperative that investors have access to information on which managers tend to perform well across successive fund vintages, in order that they can seek to build relationships with those managers that best match their investment requirements. Fig. 2.29 displays a small sample of managers across the various private equity strategies that have achieved consistent performance in terms of the quartile rankings of their funds. More detailed lists of consistent performing fund managers split out by strategy can be found on page 84. The section analyzes the most consistent performing private equity fund managers. It does not seek in any way to endorse the fund managers listed, but rather to illustrate those that have performed the most consistently in the past.

Preqin only assigns quartile rankings to funds with more mature performance data, so recent vintage funds (2011-2013) will not have been assigned rankings. Furthermore, the lists are restricted to active fund managers that have raised at least three funds of a similar strategy that Preqin has performance data on, and have either raised a fund in the past six years or are currently raising a fund of a similar strategy.

Top quartile funds are given a score of one; second quartile funds are given a score of two, and so on. An average quartile ranking is then calculated. All of the fund managers listed in Fig. 2.29 have achieved a score of 1.00 – the best score possible. EnCap Investments and Pittsford Ventures Management each manage six top quartile funds. EnCap Investments manages funds focused on natural resources, while Pittsford Ventures Management manages venture capital funds. Nine of the 13 firms appearing on the list are headquartered in the US.

Outlook

This article has outlined some of the various ways that Preqin presents the performance data it holds on around 6,200 private equity, private real estate and private infrastructure funds. These performance measures highlight the importance to investors of having information available to them. The correct data sources can enable comparison between asset classes and the relative performance of different private equity strategies, and show which managers provide their investors with consistent performance. With this information available to Preqin subscribers, investors can make better informed decisions about their investment choices when looking to invest in private equity, real estate or infrastructure funds.

Fig. 2.29: Consistent Performing Private Equity Fund Managers

Firm	Location	Type	Overall Number of Funds with Quartile Ranking	Number of Funds in Top Quartile	Number of Funds in Second Quartile	Average Quartile Rank
EnCap Investments	US	Natural Resources	6	6	0	1.00
Pittsford Ventures Management	US	Venture Capital	6	6	0	1.00
JBG Companies	US	Real Estate	5	5	0	1.00
Ampersand Capital Partners	US	Growth	4	4	0	1.00
Sequoia Capital	US	Venture Capital	4	4	0	1.00
ATP Private Equity Partners	Denmark	Fund of Funds	3	3	0	1.00
Bell Partners	US	Real Estate	3	3	0	1.00
Benchmark Capital	US	Venture Capital	3	3	0	1.00
Carmel Partners	US	Real Estate	3	3	0	1.00
Industry Ventures	US	Direct Secondaries	3	3	0	1.00
North Sea Capital	Denmark	Fund of Funds	3	3	0	1.00
Prosperitas Investimentos	Brazil	Real Estate	3	3	0	1.00
Sveafastigheter	Sweden	Real Estate	3	3	0	1.00

Source: Preqin Performance Analyst

Private Equity Horizon Returns

Private equity horizon returns provide a snapshot of the performance of the private equity industry over a set period of time, rather than looking at the performance of an individual fund over its lifetime. Horizon returns therefore facilitate the analysis of private equity performance in comparison to the performance of other asset classes in an investor's portfolio, which is important when configuring an optimum asset allocation. Horizon IRRs also provide a way to analyze private equity performance as a whole since a set point in time across all vintages, and by examining them it is possible to highlight overall trends and developments in the performance of the asset class.

Preqin holds quarterly cash flow data on more than 2,100 individual private equity funds, and using this data we are able to calculate horizon IRRs for various time horizons. The calculation uses the NAVs at both the beginning and the end of the period, and takes into account all cash flows during the period. The horizon returns are all annualized, dollar-weighted and net of management and carried interest fees.

Private Equity Performance vs. Public Indices

Private equity is an illiquid asset class where investors are committed over a long period of time, and comparing returns with short-term, liquid asset classes such as public equities should be treated in the correct context; a short-term analysis of the returns of private equity, such as over one year, does not provide the best evaluation of the returns of the asset class, particularly since information on private equity returns often lags listed equities by three to six months. Other factors aside, investors expect a premium on performance to compensate for the lack of liquidity. Fig. 2.30 shows the horizon returns over the one-, three-, five- and 10-year periods (where available) to September 2012 for private equity as a whole, buyout funds, venture capital funds, private real estate funds, the S&P 500, the MSCI Europe, and the MSCI Emerging Markets.

Over the one-year period, the S&P 500 has been the best performer, but over three years the buyout and the all private equity horizon IRRs have exceeded the S&P 500's returns by 3.2 and 1.2 percentage points respectively. Private real estate funds saw returns of 5.6% over one year and 1.3% over three years.

Since investing in a private equity fund is generally a long-term commitment, it is also important for investors to assess performance over longer time horizons, to see what they might expect over the entirety of a fund's life. Over the longer-term horizons of five and 10 years, private equity as a whole outperforms the S&P 500 by 3.4 and 11.1 percentage points respectively. Buyout funds have similar returns to all private equity over five years, but have exceeded the performance of the industry as a whole by 4.3 percentage points over 10 years. Both buyout funds and private equity as a whole outperform the MSCI Emerging Markets Index over this horizon. As well as over the five-year period, buyout fund performance also closely tracks the performance of private equity overall across the one- and three-year periods. This is due to a large proportion of the overall industry assets under management being accounted for by buyout funds.

Rolling One-Year Horizon IRRs

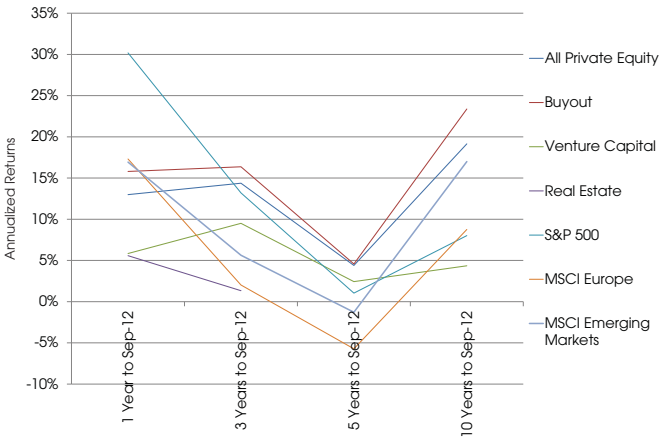
Assessing the horizon IRR figures as at each quarter-end provides insight into how private equity performance has progressed over time. Fig. 2.31 shows the rolling one-year horizon returns for all private equity, buyout and venture capital, and demonstrates that after reaching a peak of over 20% in the year to June 2011, returns for all three categories have since been lower. However, the one-year returns to September 2012 for all private equity and buyout are up significantly on the previous quarter, and stand at 13.0% and 15.8% respectively.

Data Source:

Looking for more information on horizon IRRs? **Preqin Investor Network** can help. Compare your buyout, venture capital, mezzanine, fund of funds and overall private equity portfolios to industry-wide horizon IRRs over the last one, three five and 10 years.

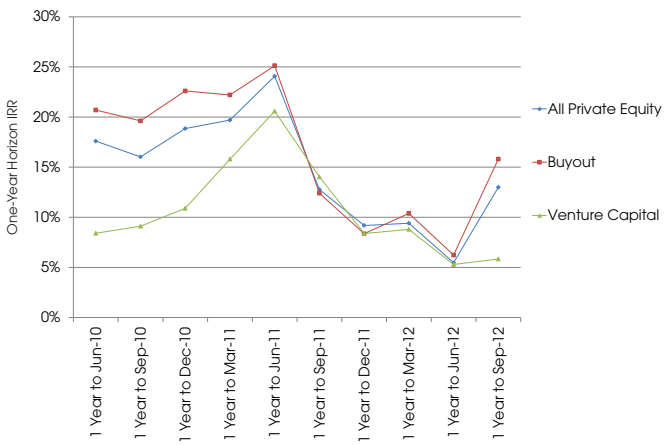
www.preqin.com/pin

Fig. 2.30: Private Equity Horizon IRRs vs. Public Indices (As at 30 September 2012)



Source: Preqin Investor Network

Fig. 2.31: Rolling One-Year Horizon IRRs, June 2010 - September 2012



Source: Preqin Investor Network

Performance Benchmarks

Fund Type: Buyout
Geographic Focus: All Regions
Benchmark Type: Median
As At: 30 September 2012

Vintage	No. Funds	Median Fund			Multiple Quartiles (X)			IRR Quartiles (%)			IRR Max/Min (%)	
		Called (%)	Dist (%) DPI	Value (%) RVPI	Q1	Median	Q3	Q1	Median	Q3	Max	Min
2012	38	8.4	0.0	86.0	1.00	0.87	0.57	n/m	n/m	n/m	n/m	n/m
2011	47	24.0	0.0	92.0	0.98	0.93	0.84	n/m	n/m	n/m	n/m	n/m
2010	41	43.8	0.7	92.8	1.15	1.03	0.88	n/m	n/m	n/m	n/m	n/m
2009	31	57.3	4.0	102.6	1.29	1.13	1.03	17.1	9.3	2.1	90.0	-21.2
2008	73	71.9	13.7	103.0	1.51	1.19	1.06	18.0	8.9	2.1	40.5	-31.1
2007	88	86.0	28.4	94.4	1.47	1.31	1.16	16.5	10.8	5.5	43.0	-23.3
2006	77	92.9	37.2	87.0	1.52	1.30	1.08	12.0	8.1	3.0	30.4	-25.2
2005	80	95.0	70.0	72.9	1.75	1.41	1.21	15.2	10.5	5.2	76.9	-7.5
2004	38	92.6	127.1	58.0	2.27	1.83	1.62	28.1	16.6	12.0	79.9	-7.0
2003	30	96.2	123.5	46.2	2.57	1.81	1.35	37.6	18.9	8.7	57.0	-86.2
2002	29	98.5	164.5	13.0	2.26	1.95	1.25	36.5	19.5	7.6	72.0	-4.7
2001	35	96.2	189.6	13.7	2.77	2.11	1.66	40.8	27.2	13.7	94.0	6.1
2000	64	97.2	168.6	6.7	2.32	1.83	1.53	27.3	19.6	11.1	57.5	-11.3
1999	36	98.7	150.1	0.6	2.03	1.63	1.13	18.4	10.6	6.0	35.7	-25.1
1998	56	99.6	148.9	0.0	2.05	1.49	1.10	19.6	9.3	0.5	31.9	-100.0
1997	47	100.0	150.4	0.0	2.12	1.54	1.06	17.0	9.3	1.0	84.0	-21.6
1996	23	99.6	179.9	0.0	2.43	1.80	0.78	24.9	14.3	-2.4	147.4	-19.6
1995	28	100.0	138.1	0.0	2.18	1.37	1.08	20.8	9.5	2.3	59.9	-15.5
1994	32	100.0	165.8	0.0	2.17	1.66	1.37	29.1	17.7	9.9	92.2	-22.6
1993	17	100.0	207.0	0.0	2.88	2.02	1.39	26.7	16.9	7.7	58.0	0.8
1992	19	100.0	207.4	0.0	3.22	2.08	1.49	41.0	21.2	10.3	60.6	-49.9
1991	9	100.0	297.0	0.0	3.65	2.97	2.04	49.0	25.9	24.8	54.7	-0.5
1990	19	100.0	222.6	0.0	3.46	2.23	1.38	31.1	18.9	8.0	72.0	2.4

Source: Preqin Investor Network

Fund Type: Buyout by Fund Size
Geographic Focus: All Regions
Benchmark Type: Median

Vintage	Mega Buyout				Large Buyout				Mid-Market Buyout				Small Buyout			
	Median Fund		Weighted Fund		Median Fund		Weighted Fund		Median Fund		Weighted Fund		Median Fund		Weighted Fund	
	Multiple (X)	IRR (%)	Multiple (X)	IRR (%)	Multiple (X)	IRR (%)	Multiple (X)	IRR (%)	Multiple (X)	IRR (%)	Multiple (X)	IRR (%)	Multiple (X)	IRR (%)	Multiple (X)	IRR (%)
2012	n/a	n/m	n/a	n/m	0.94	n/m	0.78	n/m	0.79	n/m	0.77	n/m	0.88	n/m	0.65	n/m
2011	1.01	n/m	1.03	n/m	0.94	n/m	0.92	n/m	0.93	n/m	0.93	n/m	0.85	n/m	0.79	n/m
2010	n/a	n/m	n/a	n/m	1.02	n/m	0.99	n/m	0.98	n/m	1.01	n/m	1.03	n/m	0.97	n/m
2009	1.15	9.1	1.17	8.8	1.12	7.2	1.14	7.1	1.15	10.4	1.20	8.6	1.24	13.0	1.22	15.2
2008	1.06	6.0	1.21	9.9	1.16	10.8	1.22	10.2	1.16	7.9	1.14	8.1	1.27	10.9	1.14	10.4
2007	1.19	6.6	1.16	4.8	1.32	10.4	1.23	8.7	1.30	10.6	1.32	10.8	1.30	11.0	1.31	9.8
2006	1.20	3.2	1.12	1.2	1.33	8.0	1.23	5.9	1.24	6.0	1.30	6.1	1.33	9.7	1.44	10.3
2005	1.63	11.6	1.72	11.5	1.28	6.4	1.35	9.7	1.35	8.1	1.47	11.4	1.54	12.3	1.83	21.4
2004	1.62	10.6	1.71	14.9	1.77	16.0	1.64	9.9	1.82	13.7	1.35	8.6	1.83	21.0	1.70	13.2
2003	1.84	20.7	2.03	23.7	1.99	19.0	2.13	21.4	1.57	14.5	1.72	17.6	1.57	18.1	1.72	16.8
2002	1.94	31.7	1.88	28.6	2.01	21.3	1.98	19.9	1.97	22.0	1.80	21.1	1.82	16.2	2.17	27.6
2001	2.37	28.8	2.46	32.7	1.93	24.3	2.07	25.4	1.97	24.8	2.15	25.9	2.11	24.7	1.75	17.2
2000	2.03	19.2	2.02	18.3	1.75	14.8	1.74	13.4	2.11	19.9	1.99	17.9	1.93	18.3	1.74	29.6
1999	1.72	11.5	1.60	8.0	1.54	9.7	1.40	5.6	1.83	10.3	1.90	12.7	1.65	14.3	1.21	4.6
1998	1.45	5.8	1.39	5.0	1.39	7.9	1.26	1.3	1.45	7.4	1.55	4.2	1.63	11.8	1.71	11.8
1997	1.70	10.0	1.52	5.8	1.71	11.8	1.77	19.0	1.09	1.9	1.14	2.5	1.56	10.9	1.41	8.3

Source: Preqin Investor Network

Definition used for Mega, Large, Mid-Market, Small Buyout:	Small	Mid-Market	Large	Mega
Vintage 1992-1996	≤ $200mn	$201-500mn	> $501mn	-
Vintage 1997-2004	≤ $300mn	$301-750mn	$751mn-$2bn	> $2bn
Vintage 2005-2012	≤ $500mn	$501mn-$1.5bn	$1.6-4.5bn	> $4.5bn

Fund Type: Venture Capital
Geographic Focus: All Regions

Benchmark Type: Median
As At: 30 September 2012

Vintage	No. Funds	Median Fund			Multiple Quartiles (X)			IRR Quartiles (%)			IRR Max/Min (%)	
		Called (%)	Dist (%) DPI	Value (%) RVPI	Q1	Median	Q3	Q1	Median	Q3	Max	Min
2012	15	8.8	0.0	83.0	0.94	0.83	0.32	n/m	n/m	n/m	n/m	n/m
2011	22	26.0	0.0	93.6	1.03	0.96	0.86	n/m	n/m	n/m	n/m	n/m
2010	18	42.1	0.0	98.1	1.24	1.05	0.93	n/m	n/m	n/m	n/m	n/m
2009	21	55.0	1.7	97.0	1.25	1.08	0.92	13.9	7.5	-2.7	39.4	-17.7
2008	53	66.7	7.1	91.7	1.26	1.10	0.96	11.1	4.0	-1.7	47.2	-23.5
2007	59	83.0	13.0	94.3	1.52	1.15	0.93	15.5	5.0	-1.9	64.1	-13.4
2006	52	90.1	18.3	80.7	1.36	1.01	0.81	8.3	0.5	-5.2	26.9	-25.1
2005	40	94.8	29.0	75.1	1.45	1.09	0.78	9.7	1.9	-5.8	104.9	-36.5
2004	35	99.0	34.4	68.0	1.47	1.03	0.78	5.1	0.5	-4.7	69.7	-93.7
2003	23	100.0	71.1	53.5	1.43	1.20	0.83	8.5	3.4	-4.2	35.1	-13.8
2002	37	100.0	56.5	31.6	1.44	1.10	0.76	8.4	0.6	-6.6	24.1	-47.2
2001	63	100.0	73.9	28.8	1.52	1.20	0.78	9.6	3.0	-4.9	30.7	-19.5
2000	97	100.0	64.8	22.4	1.25	0.94	0.61	5.1	0.3	-5.6	52.9	-40.0
1999	56	100.0	63.9	5.0	1.34	0.79	0.44	7.5	-2.8	-13.0	24.8	-43.4
1998	44	100.0	133.0	0.0	1.68	1.34	0.70	18.5	8.7	-3.1	1025.0	-34.4
1997	55	100.0	195.1	0.0	3.60	1.90	1.20	79.0	31.9	6.2	267.8	-30.0
1996	33	100.0	179.0	0.0	3.49	1.87	1.27	71.9	23.6	7.7	188.4	-33.3
1995	28	100.0	225.9	0.0	4.61	2.26	1.48	80.0	20.0	6.1	447.4	-22.0
1994	27	100.0	290.4	0.0	5.94	2.57	1.11	64.2	29.8	10.7	94.1	-19.4
1993	37	100.0	259.9	0.0	3.56	2.60	1.09	53.0	31.7	5.3	105.7	-14.8

Source: Preqin Investor Network

Fund Type: Real Estate
Geographic Focus: All Regions

Benchmark Type: Median
As At: 30 September 2012

Vintage	No. Funds	Median Fund			Multiple Quartiles (X)			IRR Quartiles (%)			IRR Max/Min (%)	
		Called (%)	Dist (%) DPI	Value (%) RVPI	Q1	Median	Q3	Q1	Median	Q3	Max	Min
2012	20	19.9	0.0	99.0	1.01	0.99	0.92	n/m	n/m	n/m	n/m	n/m
2011	42	34.6	2.2	99.8	1.11	1.02	0.98	n/m	n/m	n/m	n/m	n/m
2010	45	67.7	6.9	109.9	1.27	1.14	1.07	n/m	n/m	n/m	n/m	n/m
2009	26	81.7	15.4	104.9	1.30	1.23	1.12	16.7	15.2	8.2	38.7	-18.8
2008	46	92.6	16.1	94.6	1.32	1.11	0.97	14.9	5.9	-3.7	29.3	-20.3
2007	82	90.9	13.8	80.8	1.18	1.03	0.71	8.5	1.5	-7.2	15.3	-46.8
2006	69	96.4	17.4	67.6	1.25	0.96	0.54	5.6	-1.0	-11.6	18.3	-100.0
2005	56	100.0	22.4	49.4	1.17	0.90	0.58	5.7	-1.4	-9.0	20.4	-100.0
2004	32	100.0	81.9	8.1	1.48	1.04	0.89	23.2	6.4	-3.6	75.0	-32.2
2003	32	100.0	119.2	16.5	1.64	1.50	1.30	20.0	15.1	9.0	57.5	-19.8
2002	20	100.0	155.2	0.0	1.79	1.57	1.28	27.2	19.2	9.5	40.0	-1.0
2001	23	100.0	156.5	0.0	1.90	1.57	1.35	26.5	19.0	11.4	42.5	3.3
2000	17	100.0	148.0	0.0	1.90	1.51	1.36	19.6	17.8	12.8	32.1	-66.2
1999	26	100.0	166.4	0.0	2.00	1.70	1.41	17.9	12.8	8.0	29.0	-1.8
1998	24	100.0	156.4	0.0	1.94	1.59	1.42	15.4	11.1	7.7	28.0	-1.0
1997	21	100.0	148.5	0.0	1.67	1.51	1.38	14.8	9.6	5.4	24.1	-26.7
1996	20	100.0	170.0	0.0	2.08	1.85	1.41	17.6	13.2	9.6	29.0	5.0
1995	16	100.0	169.2	0.0	2.16	1.70	1.48	25.0	21.7	16.1	32.7	9.6

Source: Preqin Investor Network

Data Source:

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For more information, and to register for free, please visit:

www.preqin.com/pin

Fund Type: Mezzanine
Geographic Focus: All Regions
Benchmark Type: Median

Vintage	No. Funds	Median Fund			Multiple Quartiles (X)			IRR Quartiles (%)			IRR Max/Min (%)	
		Called (%)	Dist (%) DPI	Value (%) RVPI	Q1	Median	Q3	Q1	Median	Q3	Max	Min
2012	5	17.2	0.0	96.4	n/a	0.96	n/a	n/m	n/m	n/m	n/m	n/m
2011	12	22.7	0.6	100.8	1.16	1.04	0.73	n/m	n/m	n/m	n/m	n/m
2010	16	44.0	9.2	100.0	1.17	1.12	1.01	n/m	n/m	n/m	n/m	n/m
2009	6	64.4	32.7	87.4	n/a	1.16	n/a	n/a	9.3	n/a	15.0	-2.4
2008	17	79.6	32.0	87.2	1.29	1.16	1.11	13.9	10.9	7.3	27.0	5.0
2007	15	78.0	30.1	88.7	1.46	1.19	1.08	12.9	9.0	3.6	20.0	-0.5
2006	19	93.5	72.4	51.7	1.38	1.25	1.21	8.8	7.8	5.4	12.9	-5.5
2005	19	90.0	79.3	55.6	1.67	1.33	1.24	12.5	8.1	5.1	14.3	-4.3
2004	7	92.1	85.6	56.2	n/a	1.32	n/a	n/a	8.0	n/a	10.0	-4.1
2003	10	95.7	119.8	16.7	1.80	1.32	1.20	13.1	8.0	6.7	26.1	5.4
2002	5	98.8	128.2	5.3	n/a	1.34	n/a	n/a	11.5	n/a	16.5	8.4
2001	8	84.3	140.0	29.4	n/a	1.56	n/a	17.7	10.7	8.9	33.8	-0.3
2000	13	98.7	125.8	9.2	1.96	1.45	1.29	16.5	12.2	8.8	23.4	7.1
1999	13	91.6	147.2	1.3	1.57	1.48	1.34	13.6	11.9	9.7	18.6	-9.5
1998	12	98.5	132.3	1.1	1.40	1.35	1.23	10.0	6.3	3.4	13.5	-0.3

Source: Preqin Investor Network

Fund Type: Fund of Funds
Geographic Focus: All Regions
Benchmark Type: Median
As At: 30 September 2012

Vintage	No. Funds	Median Fund			Multiple Quartiles (X)			IRR Quartiles (%)			IRR Max/Min (%)	
		Called (%)	Dist (%) DPI	Value (%) RVPI	Q1	Median	Q3	Q1	Median	Q3	Max	Min
2012	19	7.9	0.0	92.0	0.99	0.92	0.84	n/m	n/m	n/m	n/m	n/m
2011	51	19.0	0.0	93.9	1.03	0.95	0.89	n/m	n/m	n/m	n/m	n/m
2010	18	28.0	0.0	98.9	1.10	1.02	0.96	n/m	n/m	n/m	n/m	n/m
2009	24	44.5	8.3	93.9	1.21	1.11	1.00	13.8	8.4	0.3	46.5	-9.7
2008	62	61.0	9.6	98.5	1.21	1.11	1.02	9.6	6.7	2.6	19.2	-5.9
2007	75	75.6	15.0	95.1	1.23	1.13	1.04	9.0	5.9	2.9	20.0	-9.7
2006	61	85.1	22.6	90.8	1.29	1.17	1.09	7.5	5.3	3.4	11.3	-5.9
2005	42	89.8	27.9	90.8	1.28	1.20	1.13	7.6	4.8	3.5	13.8	-1.8
2004	31	92.7	49.6	78.8	1.36	1.32	1.23	7.7	6.4	5.6	21.7	-6.0
2003	19	93.9	71.8	68.3	1.48	1.33	1.29	10.5	7.1	5.7	20.7	-2.4
2002	17	96.1	79.9	73.4	1.65	1.55	1.43	10.7	9.7	8.4	14.1	-0.1
2001	26	95.8	115.8	44.0	1.72	1.55	1.40	14.1	10.5	7.2	23.6	-7.5
2000	23	96.0	114.8	32.0	1.69	1.36	1.19	12.9	7.3	3.5	18.6	-8.9
1999	13	98.0	107.4	15.3	1.68	1.33	1.18	10.0	5.7	2.8	11.9	-2.6
1998	8	97.0	120.5	20.3	1.61	1.32	1.17	n/a	4.8	n/a	11.6	1.3

Source: Preqin Investor Network

Fund Type: Distressed Private Equity
Geographic Focus: All Regions
Benchmark Type: Median

Vintage	No. Funds	Median Fund			Multiple Quartiles (X)			IRR Quartiles (%)			IRR Max/Min (%)	
		Called (%)	Dist (%) DPI	Value (%) RVPI	Q1	Median	Q3	Q1	Median	Q3	Max	Min
2012	9	15.1	0.0	100.0	1.02	1.00	1.00	n/m	n/m	n/m	n/m	n/m
2011	17	40.0	0.2	97.1	1.08	1.04	0.96	n/m	n/m	n/m	n/m	n/m
2010	19	74.0	6.5	102.1	1.18	1.15	1.03	n/m	n/m	n/m	n/m	n/m
2009	14	74.5	20.0	104.8	1.44	1.26	1.17	20.9	15.6	11.0	36.7	6.0
2008	23	90.0	45.5	94.8	1.60	1.43	1.20	17.8	14.0	9.0	27.9	1.0
2007	22	95.4	43.1	88.3	1.44	1.28	1.15	13.2	8.0	4.8	32.0	-19.0
2006	22	100.0	52.0	71.1	1.41	1.31	1.12	9.9	5.4	2.5	23.4	-20.5
2005	12	100.0	70.1	62.8	1.61	1.39	1.22	10.1	8.5	4.6	18.1	-3.3
2004	8	100.0	123.4	12.3	n/a	1.57	n/a	n/a	10.6	n/a	31.4	7.8
2003	9	94.6	138.3	7.7	1.97	1.64	1.43	35.1	22.9	10.3	45.5	-30.5
2002	13	100.0	173.8	12.9	2.65	1.75	1.54	50.6	21.3	11.3	78.8	-4.0
2001	11	100.0	177.4	6.1	3.49	1.81	1.56	33.4	26.8	17.8	70.0	11.8
2000	12	100.0	160.1	0.0	2.68	1.61	1.40	22.9	18.8	9.4	27.8	-2.2
1999	6	100.0	157.2	3.7	n/a	1.58	n/a	n/a	13.3	n/a	18.4	-22.3
1998	7	100.0	154.5	0.0	n/a	1.55	n/a	n/a	10.1	n/a	18.0	-1.4
1997	8	100.0	155.8	0.0	3.02	1.56	1.45	n/a	12.6	n/a	35.2	-15.6
1996	6	100.0	154.3	0.0	n/a	1.55	n/a	n/a	13.0	n/a	19.9	3.5

Source: Preqin Investor Network

Fund Type: Growth
Geographic Focus: All Regions
Benchmark Type: Median

Vintage	No. Funds	Median Fund			Multiple Quartiles (X)			IRR Quartiles (%)			IRR Max/Min (%)	
		Called (%)	Dist (%) DPI	Value (%) RVPI	Q1	Median	Q3	Q1	Median	Q3	Max	Min
2012	8	9.5	0.0	95.8	1.04	0.97	0.44	n/m	n/m	n/m	n/m	n/m
2011	22	31.3	0.0	94.7	1.07	0.95	0.84	n/m	n/m	n/m	n/m	n/m
2010	12	52.5	0.0	96.8	1.19	1.00	0.94	n/m	n/m	n/m	n/m	n/m
2009	10	69.5	5.9	98.3	1.40	1.11	0.97	18.5	9.0	-2.1	22.4	-15.1
2008	31	76.1	8.6	90.3	1.32	1.08	0.89	11.3	4.0	-4.5	117.4	-30.4
2007	28	84.8	23.3	96.9	1.45	1.32	1.02	20.0	12.0	6.0	62.1	-7.0
2006	18	88.0	26.8	81.0	1.49	1.22	1.07	13.8	7.3	2.6	15.2	1.5
2005	18	98.0	92.0	66.3	2.18	1.71	1.08	40.5	16.8	6.6	105.5	-10.8

Source: Preqin Investor Network

Fund Type: Secondaries
Geographic Focus: All Regions
Benchmark Type: Median

Vintage	No. Funds	Median Fund			Multiple Quartiles (X)			IRR Quartiles (%)			IRR Max/Min (%)	
		Called (%)	Dist (%) DPI	Value (%) RVPI	Q1	Median	Q3	Q1	Median	Q3	Max	Min
2012	4	1.4	0.0	98.1	n/a	0.98	n/a	n/m	n/m	n/m	n/m	n/m
2011	9	26.2	4.0	129.9	1.58	1.36	1.20	n/m	n/m	n/m	n/m	n/m
2010	11	54.3	17.3	111.5	1.53	1.27	1.16	n/m	n/m	n/m	n/m	n/m
2009	10	69.0	23.0	104.0	1.59	1.37	1.22	39.2	19.3	14.0	47.8	10.0
2008	16	82.0	35.0	96.1	1.44	1.34	1.31	22.2	20.4	14.4	43.3	11.2
2007	9	83.0	45.4	84.4	1.32	1.28	1.23	14.6	11.2	7.1	27.5	5.4
2006	11	91.5	44.9	61.7	1.26	1.16	1.07	8.5	4.6	1.9	11.6	-3.0
2005	12	89.4	71.2	59.1	1.42	1.28	1.23	11.3	7.0	6.2	32.8	5.9
2004	7	94.6	127.9	35.0	n/a	1.58	n/a	n/a	12.0	n/a	45.5	7.1
2003	9	93.9	134.0	26.9	2.17	1.87	1.50	32.7	23.4	16.7	49.6	6.2
2002	7	95.8	130.4	25.2	n/a	1.52	n/a	n/a	17.1	n/a	24.1	12.9
2001	4	93.5	145.3	15.0	n/a	1.61	n/a	n/a	20.4	n/a	22.6	10.8
2000	6	99.1	144.1	10.4	n/a	1.62	n/a	n/a	14.4	n/a	20.2	4.2
1999	5	96.1	119.4	4.0	n/a	1.26	n/a	n/a	12.3	n/a	39.7	-3.1
1998	7	100.0	115.2	5.2	n/a	1.27	n/a	n/a	7.0	n/a	25.0	-7.0

Source: Preqin Investor Network

Fund Type: Infrastructure
Geographic Focus: All Regions
Benchmark Type: Median

Vintage	No. Funds	Median Fund			Multiple Quartiles (X)			IRR Quartiles (%)			IRR Max/Min (%)	
		Called (%)	Dist (%) DPI	Value (%) RVPI	Q1	Median	Q3	Q1	Median	Q3	Max	Min
2012	8	14.6	0.0	98.6	1.00	1.00	0.95	n/m	n/m	n/m	n/m	n/m
2011	12	21.9	1.7	95.0	1.09	0.97	0.85	n/m	n/m	n/m	n/m	n/m
2010	11	47.0	0.0	101.6	1.22	1.02	0.93	n/m	n/m	n/m	n/m	n/m
2009	13	72.7	4.6	89.2	1.28	1.11	0.78	34.0	17.2	8.9	452.0	-15.6
2008	20	79.2	16.8	97.6	1.29	1.16	1.02	9.5	6.4	0.7	10.3	-4.2
2007	15	93.5	11.9	92.9	1.55	1.22	0.97	20.4	6.4	0.8	31.5	-7.0
2006	13	94.4	30.6	98.8	1.59	1.16	1.03	12.7	5.5	0.3	19.9	-9.6
2005	5	94.2	31.5	97.8	n/a	1.24	n/a	n/a	n/a	n/a	11.0	5.0
2004	9	89.3	87.5	79.3	1.80	1.73	1.55	n/a	13.0	n/a	18.2	3.8

Source: Preqin Investor Network

Data Source:

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Real Estate: Renewed Interest in the World's Oldest Asset Class

- Greg MacKinnon, Director of Research, PREA

The lessons of the global financial crisis have caused many institutional investors to reevaluate their strategies and asset allocation practices. As part of this process, alternative asset classes have drawn renewed interest from investors and real estate in particular has increasingly come to be seen as a cornerstone asset class in many institutional portfolios.

Real estate as an asset class has a number of attractive qualities that draw investor capital. However, real estate, as with most asset classes, is not homogenous; there are a number of strategies within real estate that can be pursued, allowing investors to tailor their real estate strategy to portfolio needs. For instance, while some investors use real estate as an alpha generator, using opportunistic strategies with higher potential return (and higher risk), others prefer to invest in core properties to benefit from general exposure to the asset class. One of the attractions of real estate as an alternative asset class is this flexibility in implementing a real estate allocation so as to meet different needs at the overall portfolio level. Despite the variety of specific approaches possible, one can still outline the major characteristics of the asset class that make it so attractive.

With low volatility and healthy average returns, real estate performs well on a risk-adjusted basis relative to other asset classes. From Q1 1978 to Q4 2012 the NCREIF Property Index (NPI) had an average return between those on equities and fixed income, but the lowest volatility of the three. Looking at more recent numbers, the PREA | IPD U.S. Property Funds Index, measuring returns to open-end private equity real estate funds, showed a total return of 10.4% (net of fees) in 2012. Going forward, the most recent PREA Consensus Forecast Survey indicates that market participants expect an 8.6% return from (unleveraged) real estate in the U.S. in 2013, and 8.1% on average over the next five years. In today's low interest rate environment, these types of returns combined with low volatility make a compelling argument for real estate.

Of course, it is not just the investment characteristics of real estate alone that are important to investors, but also the role it plays within a portfolio. Low correlations with other asset classes make real estate a strong diversifier and, combined with the risk-return properties of the asset class itself, can help improve the performance of a portfolio.

Even beyond basic diversification a real estate allocation can play a beneficial role in portfolio risk management. Two trends in portfolio management that have arisen in recent years are the move to liability driven investing (LDI), especially among public pension funds, and the increasing concern about mitigating exposure to extreme events (or "tail risk"). While LDI's emphasis on fixed income to better reduce risk in funding ratios is a great attraction to pension funds, with yields at historically low levels this risk reduction comes at a cost. Recent research by PREA has shown that real estate can play an important role in a more cost-effective liability hedge. Other research conducted at PREA has shown that real estate has historically been a hedge against extreme market conditions in both the stock and bond markets. From a risk management perspective, then, real estate has additional benefits even beyond the traditional diversification argument.

Many investors look to a real estate allocation as a source of income. The Q4 2012 cash flow yield on the NPI was 3.2% on an annualized basis. Compared to a dividend yield on the S&P 500 of 2.14% and a yield on the Barclays US Aggregate Bond Index of 1.82% (both as of April 4, 2013), the attraction of real estate as a source of income relative to traditional asset classes is obvious. This is especially important for those institutions with current cash outflow needs.

In some institutional portfolios, real estate is integrated into the real asset or inflation hedging bucket. This reflects the commonly held view that real estate acts as a hedge against inflation, something of importance given current loose money policies at central banks globally. Whether real estate in general has better inflation hedging abilities than other asset classes is still a topic of debate, but properties chosen within growing but supply constrained markets should have pricing power in inflationary times; this allows rents to rise and protect the real return earned by investors.

Commercial real estate is a major component of the universe of potential investments faced by institutions. While difficult to measure exactly, one report estimated the size of the institutional-grade property market globally at over $26tn (Source: Prudential Real Estate Investors). As real estate comprises an important part of the global market portfolio, an investor with no allocation to real estate could be viewed as making an active bet that real estate will underperform. Given real estate's historical performance, that is a bet that many investors may not want to make.

Pension Real Estate Association

Pension Real Estate Association is the premier sponsor of research, educational programming and other forums for the exchange of market information and best practices in the institutional real estate community. On behalf of its membership of approximately 700 organizations representing $3tn in managed assets, PREA organizes meetings and conferences, publishes independent research, a quarterly magazine, and facilitates education and communication for and among its members, which include leading pension plans, endowments, foundations, asset management firms, and REITs operating globally.

www.prea.org

The Myth and Reality of Hedge Funds' Performance and Costs

- Pius Fritschi, Managing Partner, LGT Capital Partners

"Are Hedge Funds Underperforming and Costly?"

Let's get straight to the point: most hedge fund strategies were unable to match their long-term average returns in 2012 again. Many hedge fund critics see this as renewed affirmation of their view that hedge funds are too costly and do not deliver on performance.

Has the difficult market environment now finally exposed the purportedly overpriced and underperforming avaricious hedge fund managers?

Not at all! Over the past twelve months, institutional investors have invested heavily in hedge fund strategies and pushed the total assets managed by hedge funds to a new all-time high. In 2012, LGT Capital Partners, which specializes in alternative investment solutions for institutional investors, recorded the highest inflows into hedge fund portfolios in the company's history.

The sweeping statement at the beginning of this article therefore does not stand up to closer analysis: institutional investors are indeed positive in their assessment on hedge fund strategies.

Investment Strategies Instead of Asset Classes

Many investors now no longer view hedge funds as an asset class in their own right, and instead see them as offering a means of managing various asset classes in a different, more active approach – much like a pianist who can use all the keys on the piano, black and white, to allow their full talent to unfold.

In the interests of active risk management, hedge funds should thus be used in addition to traditional investment strategies to optimize the risk/return profile of an overall portfolio.

Simply put, modern risk management sees an investment portfolio as a bundle of individual risks that the investor is compensated for taking on. The aim of a modern portfolio construction is to "bring together" as many of these individual risks as possible (e.g. currency risk, interest rate risk, credit risk, or equity risk), in order to participate in many sources of earnings that are independent of each other.

If we look at hedge funds as an alternative approach to managing traditional asset classes, investors can use hedge funds to tap into specific sources of returns at more favourable terms, namely at a lower risk.

One concrete example of this is strategies that invest in equities by going long and short (known as equity long/short or equity hedge strategies). In the past 20 years such a portfolio, taken across a market cycle, has at least matched equity market returns, with exposure to only around half of the corresponding risk or equity market volatility. These strategies make it possible to participate in the performance of equity markets with a defensive positioning, and as such, it is clear to allocate them to the equity exposure of a portfolio rather than an "alternative" asset class.

In addition to such "substitutions", hedge funds can also be used to add new risks – i.e. previously unknown sources of earnings – to the portfolio. This lowers the risk of the portfolio as a whole; returns are more broadly diversified, making the portfolio more resilient and robust.

There are specific opportunities arising at present, for example, due to banks and insurance companies having to sell certain investments – i.e. risks – to third-party investors due to stricter capital adequacy requirements (Basel III, Solvency II). In most cases, these are very complicated investments which traditional investment strategies typically cannot invest in (e.g. insurance-linked securities, or complex credit strategies such as securitized commercial loans).

Another possibility for reducing the risk of an overall portfolio, or in other words diversifying, is offered by trend-following strategies. With their unusual return characteristics, these strategies can be used in a very focused way to diversify the risks of an equity allocation. In the economic crises over the past 15 years, trend-following strategies have proven impressive in their ability to quickly respond to new market trends and to generate very attractive risk-adjusted returns over the long term using this opportunistic approach. Such strategies stood out especially in 2008, when our portfolios, for example, were able to generate a return in excess of 20% while virtually all asset classes generated losses of up to half of their value.

Hedge Funds: If Not Now, Then When?

The hedge fund industry has matured in recent years. Costs have come down considerably and, thanks to managed accounts, there has also been a clear increase in transparency and liquidity. However, it remains fundamentally important not to view hedge fund strategies as an asset class, but instead to integrate them into an overall portfolio in a manner tailored to specific requirements. Constructing such robust portfolios requires many years of experience. The key here is to enter into a lasting partnership with clients, to understand their goals and to clarify what restrictions they are subject to.

Investors have by no means turned their backs on hedge funds, but they expect to be rewarded for the risks they are taking on. To achieve this, a portfolio has to be put together opportunistically, both in the case of traditional and alternative investment approaches. The track record of the Princely Portfolio, which is managed by LGT and ranks among the top performing endowment portfolios worldwide in long-term comparisons, reaffirms our belief in this approach while at the same time providing the motivation to continue pursuing it consistently in the future.

LGT Capital Partners

LGT Capital Partners is a leading alternative investment specialist with over $26bn in assets under management and more than 300 institutional clients. A large, international team is responsible for managing a wide range of investment programs focusing on private markets, liquid alternatives and multi-asset class solutions. Headquartered in Pfaeffikon (SZ), Switzerland, the firm has offices in North America, Europe and Asia.

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Overview of Hedge Fund Performance

The returns delivered by hedge funds in recent years have not matched the double-digit expectations some have of the industry. Hedge funds underperformed compared to prominent equity markets in 2012, and losses in 2011 have contributed to enhanced scrutiny of the asset class. However, too strong an emphasis on this recent underperformance ignores the important role that hedge funds continue to play as part of investors' diversified portfolios.

Investors face an array of complexities when making allocation decisions and must consider factors such as investment timeframes, liquidity requirements, tolerance of volatile returns and the profile of different strategies. Preqin tracks fund-level returns and performance data for over 5,400 individual hedge funds and generates benchmark data by fund structure, strategy and geographic focus in order to help investors accurately evaluate hedge fund investment opportunities.

Recent Returns

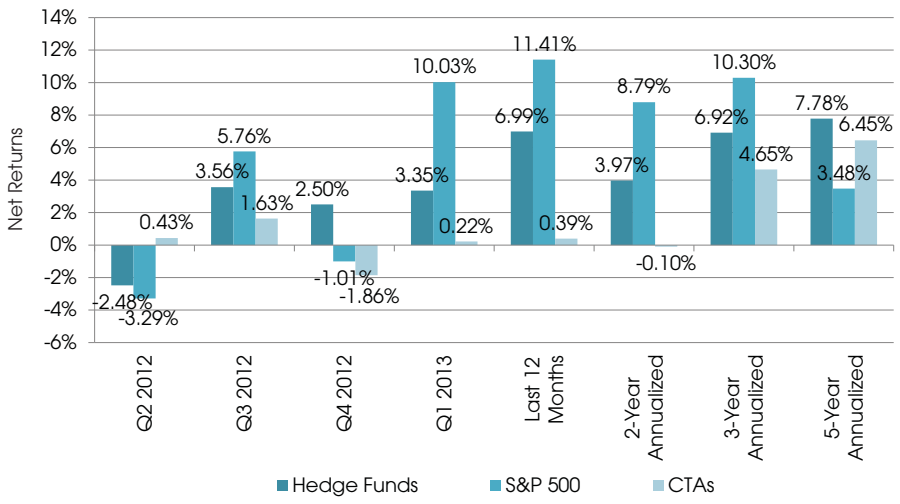
Preqin's benchmarks show that hedge funds started 2013 on a positive note after experiencing mixed fortunes during 2012. Preqin's data shows that hedge funds posted net returns of 3.35% in Q1 2013 as many funds built on a strong close to 2012. Several strategies generated returns exceeding 2% in January before neutral-to-positive performance in the next two months left 12-month gains at nearly 7% by the end of March. The solid Q1 performance of hedge funds did not match the surge seen in some stock markets, with the S&P 500 rising by 10% during the quarter to reach record levels and post a price return of 11.41% over the last 12 months (Fig. 2.32).

Risk Performance

Although hedge funds were unable to capture the same upside returns as public markets over the last 12 months, they did post a less severe drawdown for the year. The average hedge fund declined by 2.72% between March and the end of May 2012, while the S&P 500 fell by 6.97% in the same period. In contrast to hedge funds, which followed this 2012 drawdown with 10 consecutive months of gains, the equity index also ended last year in drawdown after failing to make up for a fall of almost 2% in October.

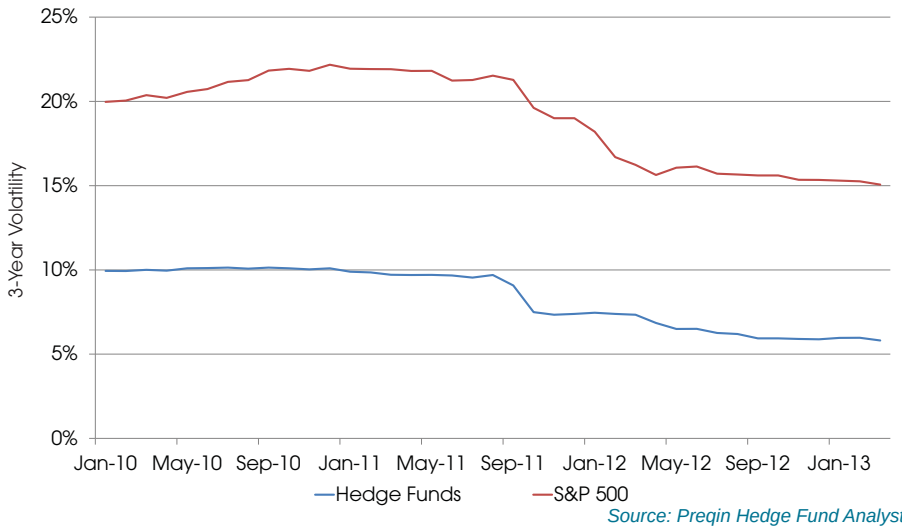
Risk profile is a key consideration for hedge fund investors and the industry has maintained its reputation for offering low volatility of returns. Hedge fund returns had a volatility (measured by annualized standard deviation) of 4.26% in the 12 months to March 2013, compared to the S&P 500's level of 10.45%. Investors with a longer investment horizon will see a similar pattern. Fig. 2.33 plots the three-year rolling volatility of hedge fund returns compared to the S&P 500 since January 2010. It shows that the generation of less volatile returns is a familiar occurrence over the long term. Volatility of hedge fund returns was in the range of 5-10%; the same measure of the S&P 500 did not drop below 15% and peaked at just over 22%.

Fig. 2.32: Performance of Hedge Funds, CTAs and S&P 500 (As at March 2013)*



Source: Preqin Investor Network

Fig. 2.33: Rolling Volatility of Hedge Funds vs. S&P 500, January 2010 - March 2013*



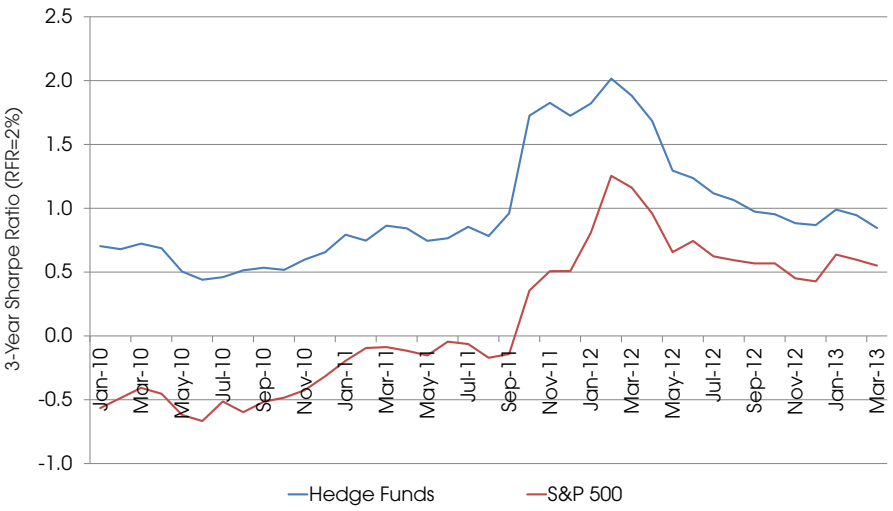
Source: Preqin Hedge Fund Analyst

** Please note, all performance information includes preliminary data for March 2013 based on net returns reported to Preqin in early April 2013. Although stated trends and comparisons are not expected to alter significantly, final benchmark values are subject to change.*

Low volatility coupled with reasonable returns has seen the risk-return profile of hedge funds remain attractive in recent years. The Sharpe ratio, measured with a risk-free rate of 2%, for hedge fund returns in 2012 stood at 1.53, indicating that the average hedge fund generated a return of 1.53% above the risk-free rate by taking on more risk and stretching the volatility of returns by 1%. The same measure for the S&P 500 during 2012 was 1.08.

Investors also see a consistently superior risk-adjusted return over the longer term. The three-year Sharpe ratio to March 2013 was 0.85 for hedge funds and 0.55 for the S&P 500. The equity index was slightly positive at 0.08 over the five-year period and the Sharpe ratio of the average hedge fund was 0.69. Fig. 2.34 charts the three-year Sharpe ratio since January 2010 and demonstrates that hedge funds have sustained an appealing risk-return profile over time, with the measure ranging from 0.44 to 2.02 during the last three years. In contrast, the movement of the S&P 500 has produced a negative Sharpe ratio for much of the three-year period and the statistic only rose above 1.00 twice, in February and March 2012. However, the gap between the risk-return profile of hedge funds and the S&P 500 closed last year, with hedge funds dipping below a ratio of 1.00, as the superior performance of 2009 was replaced by the subdued performance of 2012.

Fig. 2.34: Rolling Sharpe Ratio of Hedge Funds vs. S&P 500, January 2010 - March 2013*



Source: Preqin Hedge Fund Analyst

Fig. 2.35: Net Returns of Hedge Funds by Strategy (As at March 2013)*

Q4 2012	Q1 2013	Last 12 Months	3-Year Annualized	5-Year Annualized
Event Driven 4.71%	**Long/Short** 4.43%	**Event Driven** 9.45%	**Event Driven** 8.01%	**Event Driven** 8.95%
Long/Short 2.93%	**Event Driven** 3.82%	**Long/Short** 7.52%	**Relative Value** 7.44%	**Relative Value** 8.58%
Multi-Strategy 2.32%	**Multi-Strategy** 2.59%	**Relative Value** 6.70%	**Multi-Strategy** 6.60%	**Multi-Strategy** 7.77%
Relative Value 1.18%	**Relative Value** 2.55%	**Multi-Strategy** 5.96%	**Long/Short** 6.40%	**Macro** 7.45%
Macro 0.91%	**Macro** 1.16%	**Macro** 4.04%	**Macro** 6.29%	**Long/Short** 7.09%
CTAs -1.86%	**CTAs** 0.22%	**CTAs** 0.39%	**CTAs** 4.65%	**CTAs** 6.45%

Source: Preqin Hedge Fund Analyst

Performance of Hedge Funds Over the Long Term

In spite of posting lower returns than some equity markets recently, hedge funds continue to offer a compelling solution for investors seeking capital preservation and growth in the long term. Hedge funds recovered from the market shock and severe drawdown in 2008 to deliver net returns at an annualized rate of 7.78% over the last five years (see Fig. 2.32). In contrast, the S&P 500 only recently returned to the level it experienced at the start of 2008, having declined by almost 50% between December 2007 and March 2009, and has posted an annualized rise of 3.48% over the five years to March 2013. The long-term volatility of hedge fund returns is also favourable at 8.38% over the last five years, compared to the volatility of the S&P 500 index at 18.95%.

Hedge Fund Strategies

Preqin's hedge fund benchmarks provide not only an in-depth overview of the performance of the industry, but also a breakdown of the performance of hedge funds by strategy, helping investors evaluate hedge fund investment opportunities by sector. Fig. 2.35 shows that long/short funds were one of the key contributors to overall hedge fund performance in the last 12 months, with an average return of 7.52%. Buoyant stocks contributed to long trade gains for equity-focused funds operating in key markets, such as the US and Japan.

Event driven hedge funds posted gains of 3.82% in the first three months of 2013 to bring 12-month returns to 9.45%. Continued tough economic conditions in many developed markets provided opportunities in the distressed space, and there was solid merger and acquisition activity, particularly in Q4 2012, for event driven funds to exploit.

Relative value hedge funds posted positive returns in 11 of the last 12 months to bring returns for the year to 6.70%. Equity market neutral vehicles performed particularly well in Q1 2013, delivering gains of 3.12%. Fixed income arbitrage funds did not fare as well during the quarter (+2.18%) but have compounded a strong period in which the last lossmaking month was November 2011.

The recent underperformance of macro hedge funds compared to other strategies continued in Q1 2013. Opportunities for outsized returns offered by the depreciation of the yen against the dollar and the sustained rise of Japanese stocks have been countered by policy uncertainty elsewhere. A series of destabilizing issues hit Europe in the first quarter, including a delayed bailout of banks in Cyprus, an Italian election resulting in significant gains for anti-austerity parties, political corruption allegations in Spain, and a downgrade of the UK's credit rating. In the US, the Federal Reserve committed to continuing

its monthly $85bn stimulus program but questions were raised about how much longer this would continue after some officials indicated a preference for slowing or ceasing the asset purchase scheme.

Although macro funds posted lower returns than other hedge fund strategies over the last three years, investors in such vehicles were also exposed to lower levels of volatility. As Fig. 2.36 shows, the volatility of macro funds stood at 3.59%, while the level was notably higher for event driven (6.71%) and long/short (7.76%) funds. Relative value funds performed particularly well in this regard, with the lowest level of volatility (1.67%) and strong annualized returns (+7.44%). The returns and volatility posted by multi-strategy vehicles over the last three years was very close to that of hedge funds in general, demonstrating their appeal to investors aiming to temper greater returns with lower volatility through strategic diversification.

Over the longer term of five years, event driven and relative value funds have delivered superior returns compared to other strategies (Fig. 2.35). Relative value funds have performed particularly well, generating both greater returns and less volatility than most other hedge fund strategies, resulting in a consistently higher Sharpe ratio.

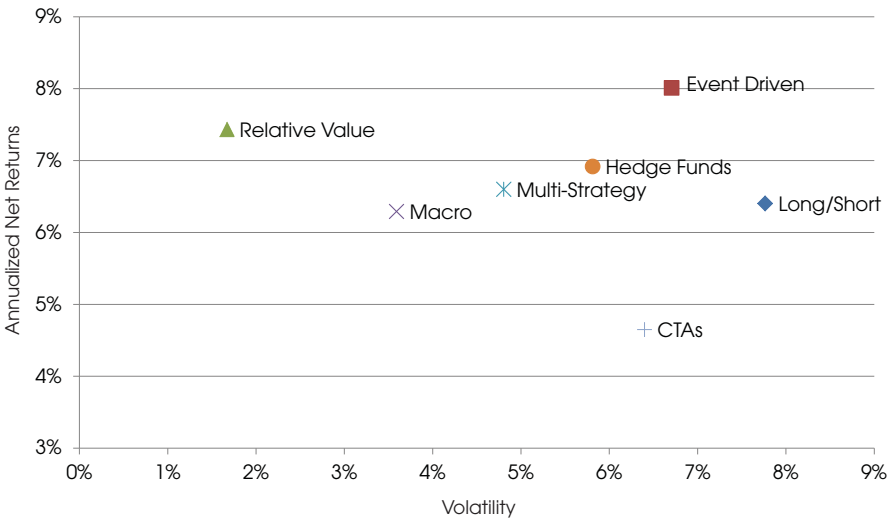
CTAs

The performance of CTAs and managed futures during Q1 2013 was affected by declining prices for an array of commodities, notably in the metals sector, and the US dollar strengthening against major currencies. This prolonged a difficult period of performance for CTAs, with the sector posting broadly neutral returns over the last year (+0.39%) and two years (-0.10% annualized; see Figs. 2.32 and 2.35).

Despite the low level of returns generated by CTAs recently, their lack of positive correlation to traditional equity markets means CTAs remain an important portfolio component for investors seeking to hedge against downside risk. In 2008, when the S&P 500 dropped by nearly 40%, CTAs made double-digit gains. Over the last five years the correlation coefficient of CTAs to the S&P 500 is 0.05 in up markets and -0.37 in down markets.

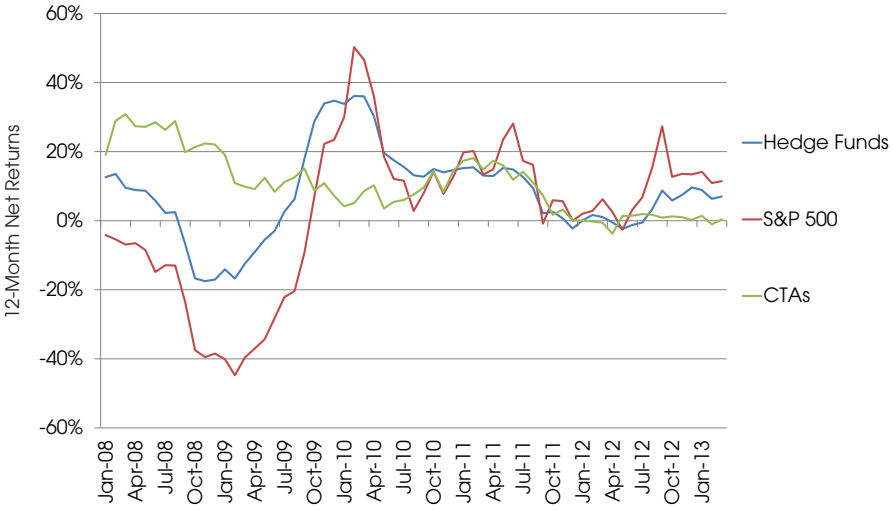
This lack of correlation is illustrated in Fig. 2.37, which charts the 12-month rolling returns since 2008 of CTAs compared to hedge funds and the S&P 500. It shows that in periods of particularly high volatility, such as 2008 and 2009, CTAs steered a steady path, avoiding the extreme losses and gains seen in equity markets. Volatility of returns over the last five years stands at 6.67% for CTAs, 8.38% for hedge funds and 18.95% for the S&P 500.

Fig. 2.36: Risk-Return Profile of Hedge Funds by Strategy, April 2010 - March 2013*



Source: Preqin Hedge Fund Analyst

Fig. 2.37: Rolling Returns of Hedge Funds, CTAs & S&P 500, January 2008 - March 2013*



Source: Preqin Hedge Fund Analyst

Liquidity of Strategies & Stability of Returns

The different levels of liquidity offered by hedge fund managers tend to reflect the nature of their underlying strategies. The issue of liquidity also plays a key role for investors in managing their own portfolios. Preqin's in-depth data on performance, lock-up periods and redemption frequencies can help investors evaluate the cost of liquidity: what are the benefits for accepting less liquid funds? Can funds with infrequent liquidity balance this with better returns or lower volatility?

Fig. 2.38 depicts the three-year volatility level and returns of different strategies and different redemption periods. Relative value funds offering monthly and quarterly liquidity terms posted attractive returns with low volatility. Moreover, these funds posted both higher returns and lower volatility than their daily redemption counterparts, suggesting that investors in relative value funds, which tend to employ comparatively high leverage, can access better performance if they are able to sacrifice daily liquidity for less frequent access to capital. The risk-return profiles of macro and long/short funds tell a similar story, with monthly redemption vehicles delivering less volatile and higher returns than daily or weekly redemption funds over the period.

In contrast, CTAs and managed futures funds, which are typically more liquid than other alternative investment strategies, saw daily redemption vehicles post better returns with lower volatility than less liquid counterparts. Event driven strategies tend to be comparatively illiquid, with longer investment horizons designed to capture the value of corporate restructuring. Quarterly redemption versions of event driven funds posted lower volatility at the expense of slightly inferior returns compared to more liquid, monthly redemption funds.

UCITS Hedge Funds

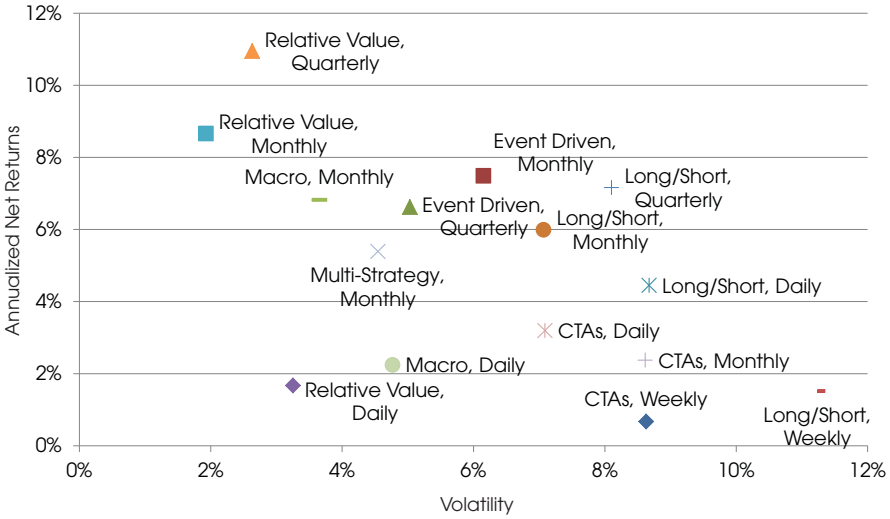
Hedge funds complying with Europe's UCITS Directive made an understated but positive start to 2013, with a Q1 return of 2.02% representing the sector's poorest quarter since Q2 2012. This brought 12-month performance to 3.81%, while the losses of 2011 have left two-year annualized returns at just 1.02% (see Fig. 2.39). Long/short UCITS funds have been the primary contributors to performance over the last three years as relative value and, in particular, macro vehicles, have trailed. However, these strategies have proven their worth over the longer term. Both relative value (+3.29% annualized) and macro (+2.76%) UCITS funds outperformed long/short vehicles (+2.07%) over the last five years.

Returns are often not the principal motivator for investors in UCITS hedge funds and the risk-reducing requirements (such as limited leverage and restrictions on financial instruments traded) placed on these vehicles in fact represent an incentive for many investors. The volatility of returns of UCITS hedge funds is typically lower than that of non-UCITS hedge funds. Over the last three and five years, UCITS fund volatility stood at 5.06% and 6.39% respectively, compared to 5.81% and 8.38% for non-UCITS vehicles.

Funds of Hedge Funds

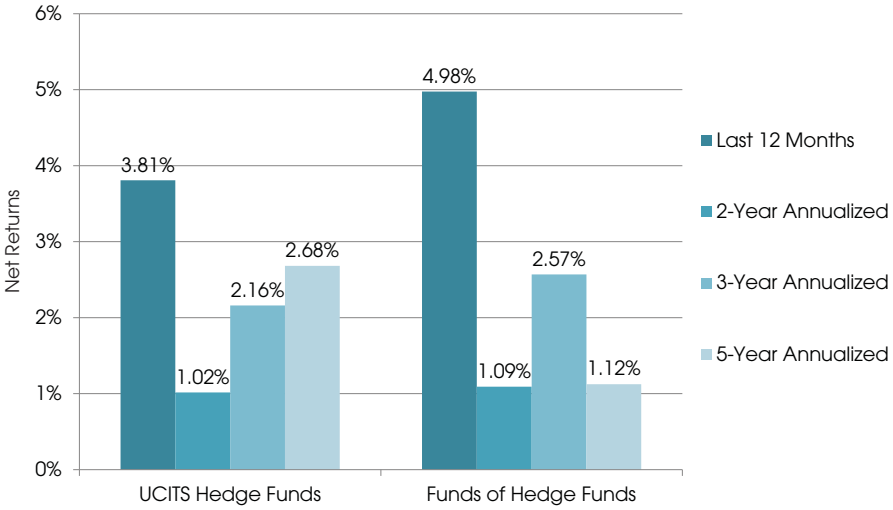
The 3.16% posted by funds of hedge funds in the first three months of 2013 represented the best quarterly return for these vehicles since Q1 2012 and made a significant contribution to a gain of 4.98% over the last year (see Fig. 2.39). Multi-strategy vehicles are chosen by investors looking to gain diversified exposure to the asset class, and these funds have led multi-manager performance in the last two (+1.15% annualized) and three (+2.54%) years.

Fig. 2.38: Comparison of Hedge Fund Risk-Return Profiles by Strategy & Redemption Frequency, April 2010 - March 2013*



Source: Preqin Hedge Fund Analyst

Fig. 2.39: Performance of UCITS Funds & Funds of Funds, as at March 2013*



Source: Preqin Hedge Fund Analyst

Other investors prefer to participate in single-strategy funds of hedge funds to gain access to and reduce the risk of investing in a portfolio of hedge funds employing similar strategies. Funds of long/short funds have posted annualized returns of 0.86% and 2.08% over the last two and three years, outperforming funds of macro funds, which delivered -1.32% and 1.79% in the same periods. However, macro-focused multi-manager funds have generated slightly superior returns over the longer term, posting an annualized gain of 1.22% over the last five years compared to 0.90% and 0.80% posted by multi-strategy and long/short vehicles respectively.

** Please note, all performance information includes preliminary data for March 2013 based on net returns reported to Preqin in early April 2013. Although stated trends and comparisons are not expected to alter significantly, final benchmark values are subject to change.*

Hedge Fund Performance Benchmarks

Fig. 2.40: Summary of Hedge Fund Performance Benchmarks, as at March 2013 (Net Returns, %)*

	Q1 2013	2012	2011	2-Year Annualized	3-Year Annualized	5-Year Annualized	2-Year Volatility	3-Year Volatility	5-Year Volatility
Hedge Funds (All Strategies and Regions)	**3.35**	**9.61**	**-2.27**	**3.97**	**6.91**	**7.78**	**5.86**	**5.81**	**8.38**
Long/Short	4.43	10.58	-5.77	3.23	6.40	7.09	7.89	7.76	10.83
Event Driven Strategies	3.82	11.91	-2.00	4.47	8.01	8.95	6.83	6.71	9.94
Relative Value	2.55	7.35	5.34	6.24	7.44	8.58	1.65	1.67	4.17
Macro Strategies	1.16	6.62	2.03	3.93	6.29	7.45	3.31	3.59	5.46
Multi-Strategy	2.59	8.39	0.07	4.46	6.60	7.77	4.91	4.81	6.19
North America	4.42	12.17	0.87	6.47	10.58	10.93	6.61	7.17	9.68
Europe	2.82	8.43	-4.18	2.59	4.98	6.47	5.39	5.24	6.96
Asia-Pacific	8.90	11.25	-4.38	6.67	8.51	9.00	8.09	7.77	10.13
Emerging Markets	2.33	13.06	-5.48	3.87	6.22	7.39	7.97	7.51	11.26
Developed Markets	2.90	9.84	1.05	5.70	6.51	9.03	3.93	3.70	5.89
USD	3.82	10.46	-2.72	4.15	7.49	8.04	6.88	6.75	9.59
EUR	2.58	5.32	-3.81	1.40	3.56	5.39	4.42	4.24	5.65
JPY	13.96	6.12	0.53	9.00	7.54	5.52	7.68	7.32	8.97
GBP	1.41	3.78	-1.45	1.45	2.39	3.88	2.27	2.46	4.23
BRL	1.33	14.94	6.81	10.24	10.97	13.58	2.93	2.98	5.81
AUD	4.93	12.56	-2.59	6.25	7.27	7.24	6.27	6.23	7.40
CAD	-0.30	0.31	-9.06	-5.90	1.20	3.51	7.08	7.50	9.85
ZAR	3.84	14.77	10.02	12.86	12.86	11.56	2.20	2.18	3.26
CTAs (All Strategies and Regions)	**0.22**	**0.23**	**0.08**	**-0.10**	**4.65**	**6.45**	**6.04**	**6.40**	**6.67**
Funds of Hedge Funds (All Strategies and Regions)	**3.16**	**4.99**	**-4.60**	**1.09**	**2.56**	**1.12**	**4.16**	**4.23**	**5.84**
Long/Short	3.84	5.97	-6.95	0.86	2.08	0.80	5.71	5.60	7.12
Macro Strategies	0.85	0.82	-3.72	-1.32	1.79	1.22	3.75	4.31	5.06
Multi-Strategy	3.18	4.58	-4.11	1.15	2.54	0.90	3.66	3.79	5.52
North America	4.61	7.33	-3.04	3.31	4.77	2.67	4.72	4.71	6.47
Europe	3.65	1.87	-5.41	-0.10	0.54	-0.27	3.65	3.75	4.68
Emerging Markets	2.89	9.24	-7.21	2.19	4.12	1.62	6.57	6.40	9.22
USD	3.07	5.34	-4.90	1.20	2.70	1.09	4.52	4.59	6.17
EUR	1.90	2.73	-6.84	-0.97	0.32	-0.99	4.31	4.52	6.08
UCITS Hedge Funds (All Strategies and Regions)	**2.02**	**6.07**	**-5.06**	**1.02**	**2.16**	**2.68**	**5.37**	**5.06**	**6.39**
Long/Short	3.87	8.18	-6.76	1.82	2.90	2.07	7.27	6.92	10.66
Relative Value	2.01	3.34	-2.71	1.14	1.69	3.29	2.67	2.36	3.20
Macro Strategies	-0.96	4.85	-3.56	0.03	1.50	2.76	4.50	4.36	4.14
USD	2.44	7.12	-6.94	0.92	2.05	n/a	7.11	6.94	11.58
EUR	2.32	4.37	-4.65	0.73	1.75	2.27	4.42	4.02	5.50

Source: Preqin Investor Network

** Please note, all performance information includes preliminary data for March 2013 based on net returns reported to Preqin in early April 2013. Although stated trends and comparisons are not expected to alter significantly, final benchmark values are subject to change.*

The Changing Fund of Hedge Funds Landscape

- Francois Buclez, CEO and CIO, Cube Capital

The fund of hedge funds industry has had some bad press of late, accused of high fees and low performance. This has put investors which might previously have invested in a fund of funds into a bit of a quandary. Should they move forward with fund of hedge funds allocations? Even if they can't themselves invest directly (e.g. not enough internal resources), investors struggle to justify allocations to funds of hedge funds. None of this is particularly promising, suggesting a homogenized, outdated product which has failed to deliver value to its investors.

This view is simplistic. Rather, underneath the generic "fund of funds" label, a range of product offerings have evolved. If investors are willing to look, there are a multitude of options perfectly suited to a variety of business requirements.

In questioning the value-add of this new breed of fund of hedge funds for the fees paid it is useful to compare them to either "managers" or "consultants" and what service elements of each of these they are delivering. Are they performing an asset allocation exercise and "outsourcing" the on-going risk exposures to the selected underlying managers? Or are they exercising their investment acumen to take and manage risks according to their own views?

The most recognized path, increasingly adopted by larger fund of hedge funds, is the consultancy or advisory role. This involves creating bespoke portfolios of hedge funds with lower fees and less discretion. Many of these mandates are now being explicitly described as emphasizing knowledge sharing.

Another successful fund of funds strategy appears to be in offering specialized exposures focused on a region or strategy. This can be very useful in filling gaps in an investment portfolio created by large allocations to a core manager, or even as a result of adopting hedge fund exposures. For instance, some investors have allocated to long/short fund of funds managers within their equity allocation instead of as a distinct absolute return exposure. Others may seek specified hedge fund exposures given policy requirements that limit their scope.

For those seeking an allocation to small, nimble strategies, there is a great deal of value added to be found in funds of hedge funds that focus on emerging managers, seed managers or small high conviction efforts. Such an approach applies elements of private equity skills to the fund of funds space, providing an opportunity to gain access to success-hungry firms developing innovative strategies.

Yet another route is the hybrid approach, where funds of hedge funds include direct trades or an overlay in addition to investment in underlying managers. This enables managers to practice their market insight beyond fund allocation, limiting the downside of funds of funds, and provides a more efficient portfolio. For instance, if an opportunity is identified, but the portfolio is fully invested, it could take months to redeem and reallocate a sizeable allocation.

Similarly, the overlay function of hybrid models, while primarily used as a hedging function, can also act to reshape portfolio positioning. In this context, they may use the overlay as a dynamic beta tool, offering the flexibility to enhance or reduce exposures, or to modify overall risk levels. In a rapidly changing and volatile market environment, this ability is highly advantageous.

Less common in a fund of hedge funds format is the combination of security selection with manager selection. The primary difference between running an overlay and direct security selection is the linkage with the overall portfolio and the nature of the instruments traded. While both are for enhancement of risk and return, the overlay can be considered more of a modification of existing portfolio exposures and direct securities would be considered additive. Direct exposures can be a pragmatic solution to enhancing returns by taking advantage of inefficiencies that are ad-hoc, or not easily categorized, and thus not considered by a large group of investors.

In addition to these benefits, the hybrid model also offers lower fees than other forms of funds of hedge funds. Given that there is only one manager involved in the direct exposures of a hybrid fund, these exposures would only be subject to a single layer of fees, thus reducing fees by the amount of overall internally managed exposures.

The downside, of course, is that hybrid models require an additional level of research, skill and market acumen, rather than fund manager selection alone.

In summary, the fund of hedge funds industry has evolved. A new breed of differentiated strategies have emerged that offer value to a whole range of needs. As investors consider the merits of a variety of fund of hedge funds models, they will better see their strategic role in portfolio construction.

Cube Capital

Cube Capital is a global alternatives boutique that manages approximately $1.3bn. The company has offices in London and Hong Kong with efforts focused on institutional hedge funds and real estate related activities.

www.cubecap.com

Private Equity, Real Estate and Hedge Fund Returns for Public Pension Funds

With significant capital reserves, large public pension funds are important investors in private equity funds, private real estate funds and hedge funds, and are key targets for fund managers when raising capital.

Preqin has reviewed over 150 pension funds spread across North America, the UK and Europe. In order to compare the performance of various asset classes, Preqin has generated a median figure for returns across the one-, three-, five- and 10-year horizons for each of the most common asset classes, for pension funds that have reported horizon returns as of September 2012. It should be noted that the performance figures calculated for private equity lag by one quarter as pension funds calculate these returns using cash flow figures from the current quarter and net asset values reported to them by fund managers from the previous quarter.

The median pension fund returns across the one-, three-, five- and 10-year periods for listed equity, fixed income, hedge funds, private equity and real estate, as well as the overall portfolio, are given in Fig. 2.41. Over the one-year period, listed equity is the best performing asset class with a median return of 21.4%, and all asset classes shown experience positive median returns over this time period.

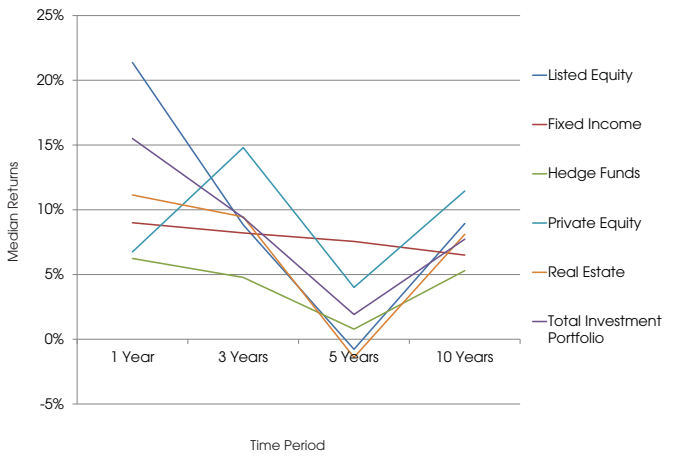
Private equity is the best performing asset class over three years, with a median return of 14.8%, while hedge funds have the lowest median return over this period at 4.8%. Real estate, fixed income and listed equities show similar returns across this time period, ranging from 8.2% to 9.4%.

Over the longer time periods of five and 10 years, private equity is again one of the best performing asset classes, with median returns of 4.0% over five years and 11.5% over 10 years. Only fixed income shows a greater median return over five years with 7.6%, whereas over 10 years, private equity is the best performing asset class. Real estate and listed equity are the only asset classes showing negative returns over five years, while all asset classes are in positive territory over 10 years. Hedge funds have the lowest median returns across 10 years compared to the other asset classes shown, with an annualized figure of 5.3%. However, these funds must be analyzed by volatility as well as returns to get a clear understanding of their value.

Fig. 2.42 shows the rolling one-year median returns in each quarter from Q1 2011 to Q3 2012 for listed equity, private equity and the overall portfolio. As would be expected, there is significant correlation between listed equity and the overall portfolio, as the public pension funds under consideration generally have a higher allocation to public equities than to the other asset classes.

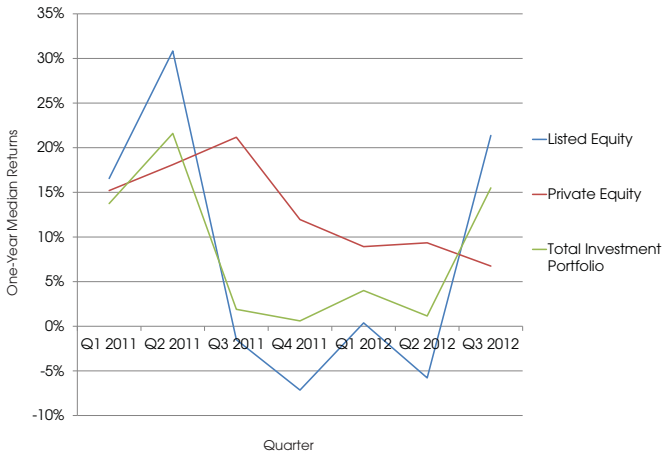
One-year listed equity returns exceeded both private equity and the overall portfolio in Q3 2012, showing a median return of 21.4%, with private equity showing a figure of 6.7% and the total portfolio 15.5%. Private equity one-year returns outperformed listed equity and the overall portfolio from Q1 2011 to Q2 2012. However, due to the one-quarter lag in reporting schedules for private equity, Q4 2012 could see an increase in one-year private equity returns that corresponds with the rise in listed equity returns seen in Q3 2012.

Fig. 2.41: Median Returns of Public Pension Funds by Asset Class (As at 30 September 2012)



Source: Preqin

Fig. 2.42: Rolling One-Year Median Public Pension Fund Returns - Private Equity vs. Total Investment Portfolio and Listed Equity



Source: Preqin

Fund Selection

Investors today benefit hugely from an alternative asset fund universe that is both mature and expansive in outlook. Fund opportunities are abundant, with more vehicles in private equity, real estate, infrastructure and hedge fund markets than ever before. There is not only a large volume of opportunities, but also a large variety, with a myriad of funds to choose from in terms of strategy, geography, manager location, size, domicile, levels of liquidity, manager experience and so on.

How Can This Report Help With Fund Selection?

Choice for investors is in equal parts a blessing and a burden; it is vital for finding the right funds to match an investor's risk/return profile, but cost heavy and time consuming to navigate through all the different options available in the current marketplace. This section explores the options available for investors in today's alternative assets market, looking at key breakdowns of funds and managers across private equity, real estate, infrastructure and hedge funds:

- How do the different asset classes break down by geographies, manager experience and strategies?
  - **Private equity:** buyout, venture capital, distressed private equity, growth, mezzanine and more.
  - **Real estate:** core, core-plus, value added, opportunistic, distressed and debt.
  - **Infrastructure:** primary, debt/mezzanine, fund of funds and secondaries.
  - **Hedge funds:** single-manager funds, fund of hedge funds, UCITS, CTAs, and long/short, event driven, relative value, macro and more.
- How do investors get access to the **best** fund managers?
- What are the **largest** funds in market for each asset class?
- What strategies and geographies are **funds of funds** in each asset class targeting?
- How can investors utilize the **secondary market** to rebalance their portfolio?

How Can Preqin Investor Network Help With Fund Selection?

The 2013 Preqin Investor Network Global Alternatives Report gives a great insight into the different funds available for investors in the alternatives asset marketplace and their managers. Our flagship investor product, **Preqin Investor Network**, goes into even more detail.

View all the underlying fund data that contributed to the overview information you are able to see in the Fund Selection section of the Report. Sign up to Preqin Investor Network to view strategies, geographies, manager profiles and performance track records for **all** 1,900 private equity, real estate and infrastructure funds in market and **all** 9,500 hedge funds open for investment. Read on to learn more about the funds available to investors or contact us at pin.info@preqin.com to find out more about how Preqin can assist investors with their fund selection needs.

Key Industry Voices Discuss Fund Selection:

- **Chris Meads**, Global Head of Investment, Pantheon *Page 40*
- **Josh Lerner**, Harvard Business School and Private Capital Research Institute *Page 41*
- **Christophe Evain**, Chief Executive Officer, ICG *Page 47*
- **Jeremy Coller**, CIO, Coller Capital *Page 50*
- **Ed Casal**, Global Managing Director Real Estate Multi Manager, Aviva Investors *Page 54*
- **James Wardlaw**, Partner, Campbell Lutyens *Page 60*
- **Moose Guen**, CEO, MVision *Page 65*
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Compelling Private Equity Strategies in the Current Environment

- Chris Meads, Global Head of Investment, Pantheon

The global economy has entered a phase of slower growth, but hopefully relative stability. In Europe, and especially the US, we expect to gradually move out of crisis and perhaps into recovery, but growth will not be buoyant for a long time. In emerging markets where private equity is most well established, such as China, India and Brazil, growth has moved down to a lower plane.

A subdued but more stable global economy continues to favour GPs and investors who play the long game; that is, active management, discipline in pricing, diversification, and thematic investment based on long-term trends, particularly demographic ones. Successful investors will need to balance between consistency and adaptation – tilting away from "fashionable" sectors before they become overpriced in the short term. Longer term, the key is to tilt towards those parts of the market which are benefiting from trends such as lower energy costs and more competitive manufacturing.

Signs of Stability Returning to the US

The sense of a new pattern emerging is present in private equity, as it is in the economy more broadly. On several measures, the industry in the US seems to have put the lows of 2008 and 2009 behind it, as well as the highs of 2007, and attained something like a new interim steady state. Private equity investment increased in the US in 2012 and we are starting to see signs of a pick-up in general M&A activity. Valuation multiples for private equity transactions are back to 2005 levels, at around 8.5x. When it comes to the exit environment, IPOs are recovering in number and value. The outlook for trade sales also looks positive, given the trillions of dollars sitting on the balance sheets of US companies needing to be deployed in productive investments.

The Proliferation of Managers in China – and their Dearth Elsewhere

Meanwhile in China, although GDP has stabilized at a lower level, the number of GPs has rocketed, creating difficulties for investors. In 1990, when Pantheon first began investing in China, there were 10 GPs in the whole country. There are now around 4,500 private capital deal makers. This huge growth in numbers exacerbates other problems, such as a lack of transparency, corporate governance and alignment. In this environment, selecting the right managers demands great resources, relationships, experience and patience. In markets such as these, where growth is good, despite the slowdown, it makes sense to concentrate on the fundamentals, including solid execution of deals, good attention to detail, not investing too much just because the local market is hot, and diversification.

Outside China, some emerging markets in Asia have been attracting attention for the right reasons: Southeast Asia, Indonesia and the Philippines have large populations, rapid economic growth, a consumer focus, and they sailed through the global financial crisis fairly unscathed. The Latin American markets with particular potential, in our view, are currently Mexico, Peru, Chile and Colombia. Colombia in particular is attracting a lot of attention from private equity at the moment because of its strong economic growth, expanding middle class and good business climate. By contrast, Africa is a less mature private equity market, which is one of the reasons why it is worth monitoring developments there. Obvious targets are South Africa (as the most developed GP market), Nigeria (based on size of market), Ghana and Kenya.

Fragmentation in Europe

There are also signs of increasing stability in the European private equity market. The focus in Europe should be on adding value operationally, capitalizing on social and economic change, and concentrating on areas where banks have solid balance sheets. The time is not yet right in our view for going back into Spain and Italy in a big way – though of course there will always be isolated worthwhile opportunities. These large southern European economies are not likely to become attractive again until local banks recognise that the assets on their balance sheets are overpriced, and mark them down.

Northern European countries clearly provide the most stability. The more robust economies of this region are well positioned to benefit from export-led growth and are less pressured by the weight of sovereign debt and weak consumer spending. Germany is very well positioned, being Europe's largest exporter and an important trade partner with China. The Nordic region and the Netherlands are also well positioned, with exports making up a healthy proportion of GDP.

Secondaries and Co-investments for Enhanced Returns

The secondaries market has seen a surge in activity as more institutional investors look to sell-down assets. The market continues to be driven by regulatory developments pushing financial institutions to divest their private equity holdings and LPs taking a more active approach to portfolio management. As the market broadens there is increasing scope for investors to complete more complex transactions. We anticipate there will be some very attractive opportunities to buy quality assets at a significant discount to fair market value over the course of the coming year. Co-investment activity also continues to increase given the higher equity participation required and the challenging fundraising environment. Co-investment provides incremental exposure with advantageous economics (typically low or no fees being paid to the underlying fund manager), and thus offers the potential to invest in known assets and enhance returns.

Overall, we believe the current climate can provide opportunities to invest in businesses at attractive valuations, as well as the ability to capitalize on certain pockets of higher growth and exploit market dislocations.

Pantheon

Pantheon is a leading international private equity fund investor and currently manages $24.2bn for over 400 clients. Pantheon has developed a strong reputation and track record in primaries, secondaries and co-investments across all stages and geographies. Pantheon has employees located across offices in London, San Francisco, New York and Hong Kong.

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Growth and Success in Private Equity

- Josh Lerner, Harvard Business School and Private Capital Research Institute

It is well understood among limited partners that established groups with excellent historical track records are likely to perform well: this is one of the reasons why first-time funds find it so difficult to raise capital. But there is an important limitation: sponsors that have been successful in the past frequently expand their capital under management rapidly, and a rapid growth in fund size can result in a significant deterioration of investment returns. This is dramatically illustrated by the impact of changes in fund size on returns, controlling for the features and skills of each firm and the year and focus of the fund. We find that growth has a substantial negative effect on returns: a doubling of fund size, all else being equal, leads to a drop in IRR of -5.3%. This analysis suggests that a group with a 25% IRR in its $1bn third fund could expect a return of less than 20% if it raised a $2bn fund next.

While interpretation of this effect's magnitude must be cautious, the implications about the impact of growth seem clear. While large funds do not necessarily perform dramatically worse than small funds, the process of getting larger seems to be associated with a deterioration of returns. Because many of the firms that have grown rapidly have been successful in the past, this pattern limits the tendency for established successful groups to outperform.

It is natural to ask why this pattern comes about. Normally, we are used to thinking of growing businesses as a good thing: growth allows us to exploit economies of scale by spreading our fixed costs over a larger base of activity. Why is private equity different? While we cannot answer this question definitively, we can provide two clues about what might be behind this relationship, both of which relate to the human dimension of private equity.

The first of these relates to the investment professionals at the private equity firm. Private equity is very much a "people business," where the connections and experience of the managing partners drive a group's success. In this industry, growth frequently entails more and more money being managed by a slowly growing number of partners. However, a growth in fund size without a proportional growth in the number of senior professionals at a firm can have a negative impact on returns. As we move from the senior professional-to-capital ratio of the average fund (0.09) to a ratio that is 25% higher (0.11), the expected performance climbs by 1%. Similarly as the ratio of partners to fund size falls, performance deteriorates.

A second reason why growth may be associated with decreased returns is a loss of focus at private equity groups. Even for very seasoned private equity professionals and groups, transferring the skills that made them successful in one area to another arena may be challenging.

Paul Gompers, Anna Kovner, and I examined how the specialization of firms and performance affects the performance of venture capital funds. These analyses focused on the performance of individual transactions, rather than the returns of funds as a whole. Using a database of 11,000 investments made up to 2003 by more than 800 venture capital organizations, we determined the degree of specialization or generalization of each by examining the diversity of deals across nine broad industry categories. We found that generalist firms tend to underperform relative to specialist firms. Generalist firms appear to fail on two fronts: they do not appear to allocate capital well across industries (e.g., picking "hot" sectors to invest in) and they also underperform in their investments within an industry. Importantly, however, this underperformance is far less if the individual venture capitalists in generalist firms are industry specialists. Thus, if 50% of the transactions of a generalist firm with generalist people were acquired or went public, the success rate of an equivalent firm with more specialized people would be predicted to be 52.7%. Meanwhile, a specialized firm with specialized people would have the most exits, with a success rate of 54.2%.

Despite this pattern, venture capital groups tend to become less specialized over time, as do the individual partners. On a scale of zero (least specialized) to one, the typical fund under two years old has a specialization index of 0.77; the same group when ten years or older has a specialization index of 0.40. That is, if the partner focused solely on companies in a single industry, the index would be 1.0; if the partner split his investments equally between three industries, the index would be 0.33. We see the same pattern when we look at investments over the past five years and at the specialization of individual partners. This pattern likely reflects the consequences of growth - as groups struggle to deploy more capital, the partners move into sectors, deal types, or transaction sizes further from their original expertise.

Despite large variations in fund performance, more mature funds tend to do better; in particular, seasoned funds that have done well in the past. But this tendency is limited by the effects of growth: in a sort of Faustian bargain, if firms take advantage of their success to raise dramatically larger funds, their performance is likely to decline. The data suggest that this decline is associated with an increase of dollars managed per partner, as well as a loss of focus. However, statistical evidence can only give us broad patterns, and groups manage growth, and the trade-offs associated with scaling and institutionalization, differently.

Josh Lerner is the Jacob H. Schiff Professor of Investment Banking at Harvard Business School and the founder of the Private Capital Research Institute. He is the co-author of Venture Capital, Private Equity, and the Financing of Entrepreneurship, from which this essay is excepted.

[1]*Paul Gompers, Anna Kovner, and Josh Lerner, "Specialization and Success: Evidence from Venture Capital," Journal of Economics and Management Strategy, 18 (2009), 817-844.*

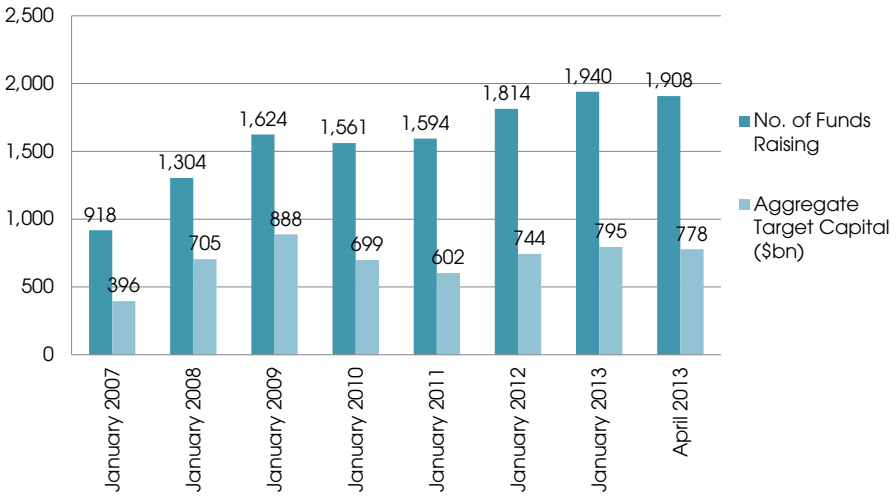
[2]*These indexes are again the sum of the squared industry shares (more technically, Herfindahl indices) described above. This pattern holds whether one looks at all investments by the funds, or just the ones they have made recently.*

Investment Opportunities in Private Equity: Funds in Market

As a global asset class, private equity provides investors with the opportunity to commit to a variety of fund strategies targeting investment opportunities around the world, from the traditional private equity hubs of North America and Europe to the developing regions of Asia and Latin America.

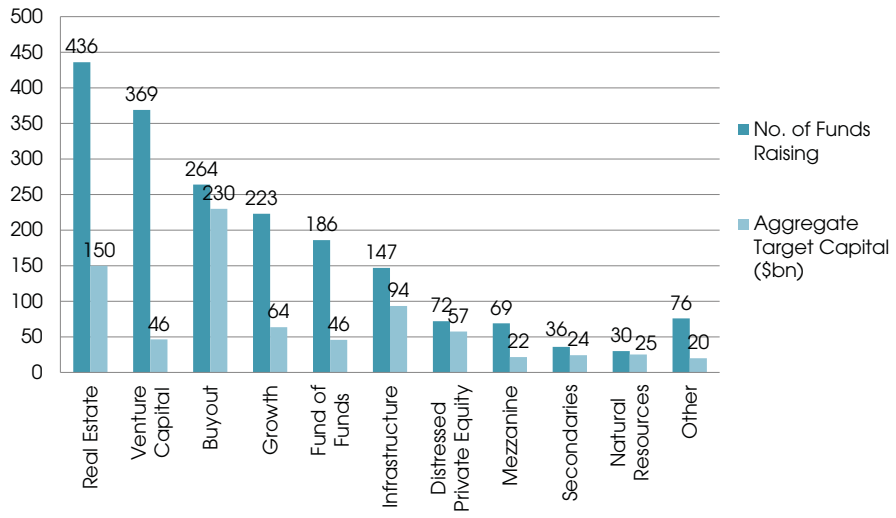
The number of private equity funds currently in market is near record levels, with 1,908 private equity vehicles, including real estate and infrastructure, vying for an aggregate $778bn in investor commitments. Both the number of funds and aggregate capital sought have increased in comparison to the previous year. With a large variety of funds seeking capital offering both traditional and new strategies, investors are faced with the challenge of filtering through and identifying the most appropriate investment opportunities that suit their current investment objectives.

Fig. 3.1: Private Equity Funds in Market Over Time, 2007 - 2013



Source: Preqin Investor Network

Fig. 3.2: Composition of Current Funds in Market by Fund Type



Source: Preqin Investor Network

Fund Type Breakdown

Fig. 3.2 shows the variety of private equity funds in market seeking investor commitments by fund type. Buyout funds continue to seek the largest amount of capital, with 264 buyout vehicles on the road looking to raise $230bn. In particular, many investors view small to mid-market buyout funds as presenting the best investment opportunities, which is helping to drive interest in buyout investments. Private real estate funds are the most numerous fund type in market and collectively these vehicles are seeking the second largest amount of capital, with 436 funds looking to raise a total of $150bn. Venture capital funds are the second most numerous in market, with 369 seeking capital.

Regional Focus

North America represents the largest private equity market in the world and is home to large numbers of institutional investors and fund managers alike. Investors looking to allocate capital to North America-focused private equity funds have a wealth of opportunities to assess. Fig. 3.3 shows that there are currently 871 North America-focused vehicles targeting $401bn in aggregate capital, accounting for almost 46% of private equity funds in market and 52% of aggregate capital sought.

Investors not only have various strategies to consider if looking to access North American markets, but they must also decide upon the best route into the market: North America-focused private equity is a global industry, with managers targeting the region for investment located around the world. Four percent of North America-focused funds seeking capital are managed by firms headquartered outside of the region. Excluding real estate and infrastructure funds, 23% of North America-focused private equity funds are targeting buyout opportunities; these funds represent 43% of the aggregate capital sought by private equity funds targeting the region. A further 30% of North America-focused funds are targeting venture capital investments, representing 9% of aggregate capital sought by North America-focused private equity funds.

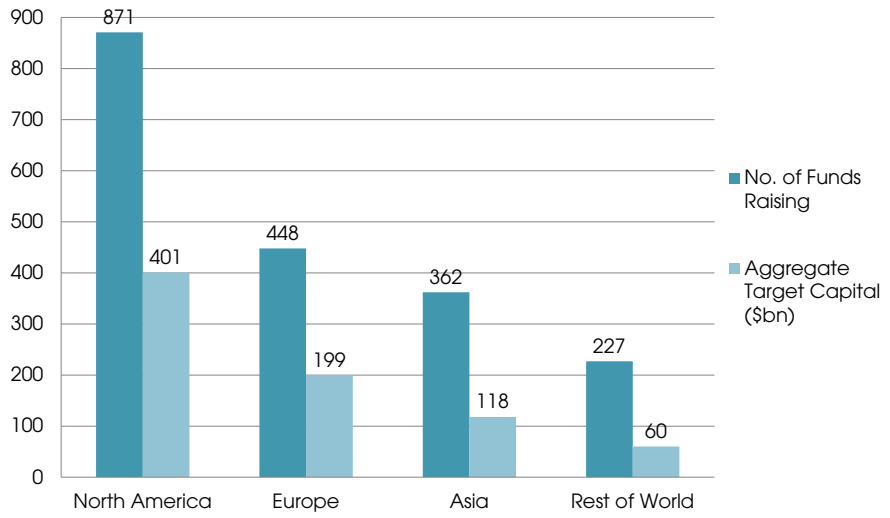
As of April 2013, there are 448 Europe-focused funds on the road seeking an aggregate $199bn in investor capital. Investor appetite for distressed private equity investments has grown in recent

years and the number of opportunities for investment in distressed private companies in Europe has increased in the current financial climate. There are 18 Europe-focused distressed private equity vehicles in market seeking $11bn in investor commitments, three of which are managed by firms based in North America. Excluding real estate and infrastructure funds, 24% of Europe-focused vehicles target buyout markets and account for 60% of the aggregate capital sought by private equity funds targeting the region, and 28% of Europe-focused funds target venture capital markets but are seeking a comparatively smaller 7% of the aggregate capital targeted by Europe-focused vehicles.

In stark contrast to North America and Europe, where growth funds only account for a small proportion of funds in market and capital targeted, in Asia growth funds account for 42% of funds in market targeting the region and 41% of the capital being sought. This is representative of the opportunities in Asia; many investors committing to private equity funds targeting the region will do so to take advantage of emerging economies ripe with stable, maturing companies not yet ready or willing for buyout.

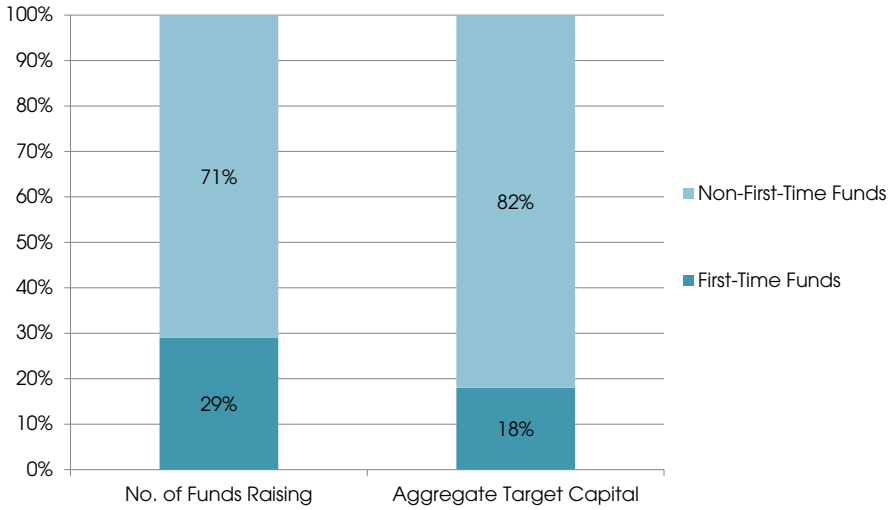
There are 227 funds currently seeking an aggregate $60bn for investment in in economies outside of North America, Europe and Asia. Of these funds, 74 are focused on investing in Latin America, targeting an aggregate $20bn. Thirty of these private equity vehicles focus solely on investment in Brazil, representing 45% of the capital sought for private equity investment in Latin America.

Fig. 3.3: Composition of Current Funds in Market by Fund Focus



Source: Preqin Investor Network

Fig. 3.4: Proportion of Funds Raising/Capital Sought by First-Time vs. Non-First-Time Funds



Source: Preqin Investor Network

First-Time vs. Established Funds

Currently, there are 556 private equity funds seeking capital managed by first-time fund managers, accounting for 29% of all funds on the road (Fig. 3.4). In general, first-time managers tend to target smaller amounts of capital from investors than their established counterparts. Collectively, first-time funds are seeking $138bn in capital commitments, accounting for 18% of the aggregate capital being sought by all private equity funds in market.

For investors, there is a higher degree of risk associated with allocating to a first-time manager as opposed to a more established fund manager. However, first-time managers are often run by experienced private equity players, which can encourage investors to contribute capital to the fund. Nonetheless, a first-time fund manager will often have to provide a sizeable contribution towards the total target of the fund and perhaps offer more favourable management and performance fees than a more established market player would, especially to first-close investors.

Outlook

Overall, competition in the fundraising market looks set to remain intense. Nevertheless, 47% of the 1,908 funds seeking capital have already held at least one interim close, having collectively secured $173bn in capital commitments towards their final targets. The crowded private equity market provides a variety of fund offerings, making the task of selecting new investment opportunities even more challenging for investors. A thorough understanding of the current private equity market is even more important as investors decide where to focus their attention when looking to make new investments.

Data Source:

Where are the best fund investment opportunities for you? Access details for every private equity, hedge fund, real estate and infrastructure fund seeking capital on **Preqin Investor Network**.

For more information, please visit

www.preqin.com/pin

Private Equity Funds Open for Investment - League Tables

Fig. 3.5: 10 Largest Private Equity Open for Investment, May 2013

Fund	Manager	Type	Target Size (mn)	Main Fund Focus	Manager Country
CVC European Equity Partners VI	CVC Capital Partners	Buyout	10,000 EUR	Europe	UK
Apollo Investment Fund VIII	Apollo Global Management	Buyout	12,000 USD	US	US
Apax VIII	Apax Partners	Buyout	9,000 EUR	Europe	UK
Carlyle Partners VI	Carlyle Group	Buyout	10,000 USD	US	US
KKR North American XI Fund	Kohlberg Kravis Roberts	Buyout	10,000 USD	US	US
Permira V	Permira	Buyout	6,500 EUR	Europe	UK
Bain Capital Fund XI	Bain Capital	Buyout	6,000 USD	US	US
KKR Asia Fund II	Kohlberg Kravis Roberts	Buyout	6,000 USD	Asia	US
Riverstone Global Energy and Power Fund V	Riverstone Holdings	Natural Resources	6,000 USD	US	US
Brookfield Infrastructure Fund II	Brookfield Asset Management	Infrastructure	5,000 USD	US	Canada

Source: Preqin Investor Network

Fig. 3.6: 10 Largest First-Time Funds Open for Investment, May 2013

Fund	Manager	Type	Target Size (mn)	Main Fund Focus	Manager Country
Russia-China Investment Fund	Russian Direct Investment Fund	Buyout	4,000 USD	Europe	Russia
Terra Firma Infrastructure Fund for Global Renewable Energy	Terra Firma Capital Partners	Infrastructure	3,000 USD	Europe	UK
CITIC Buyout Fund	Goldstone Investment	Buyout	10,000 CNY	Asia	China
Urban Infrastructure Construction Industrial Investment Fund	All-China Federation Industrial Funds Management	Infrastructure	10,000 CNY	Asia	China
AVG CIS Agricultural Opportunities Fund	AVG Capital Partners	Buyout	1,500 USD	Europe	Russia
CVC European Infrastructure Fund	CVC Infrastructure	Infrastructure	1,000 EUR	Europe	UK
Allianz Infrastructure Debt Fund	Allianz Global Investors	Infrastructure	1,000 EUR	Europe	Germany
Seqimco Infrastructure Debt Fund	Sequoia Investment Management Company	Infrastructure	1,000 EUR	Europe	UK
InfraMed Infrastructure	InfraMed Management	Infrastructure	1,000 EUR	Europe	France
India Inclusive Innovation Fund	National Innovation Council	Venture Capital	55,000 INR	Asia	India

Source: Preqin Investor Network

Fig. 3.7: Funds Open for Investment Targeting More than $500mn that Raised the Largest Proportion of Target at First Close, May 2013

Fund	Manager	Type	Target Size (mn)	First Close (mn)	Main Fund Focus	Manager Country
Kayne Anderson Real Estate Partners III	Kayne Anderson Capital Advisors	Real Estate	700 USD	675 USD	US	US
JOG VI	JOG Capital	Natural Resources	600 CAD	510 CAD	US	Canada
Resource Capital Fund VI	Resource Capital Funds	Natural Resources	1,750 USD	1,500 USD	US	US
Crow Holdings Realty Partners VI	Crow Holdings Capital Partners	Real Estate	750 USD	604 USD	US	US
Harrison Street Real Estate Partners IV	Harrison Street Real Estate Capital	Real Estate	600 USD	465 USD	US	US
Macquarie Everbright Greater China Infrastructure Fund	Macquarie Infrastructure and Real Assets (MIRA)	Infrastructure	1,000 USD	729 USD	Asia	UK
W Capital Partners III	W Capital Partners	Direct Secondaries	750 USD	519 USD	US	US
CITIC Capital (Tianjin) Equity Investment Partnership	CITIC Capital	Buyout	4,500 CNY	3,000 CNY	Asia	Hong Kong
Blackstone Real Estate Debt Strategies II	Blackstone Group	Real Estate	3,000 USD	2,000 USD	US	US
Phoenix Asia Real Estate Investments V	Phoenix Property Investors	Real Estate	600 USD	400 USD	Asia	Hong Kong

Source: Preqin Investor Network

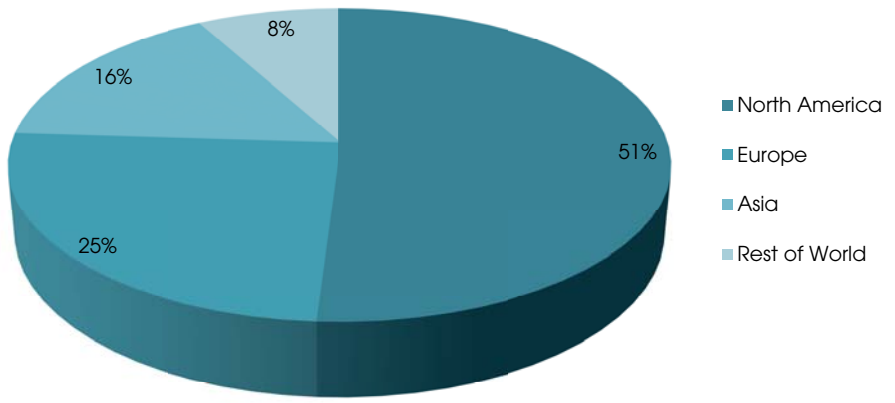
Private Equity Fund Managers in Market

Preqin tracks more than 4,770 active private equity fund managers globally and, as of April 2013, 1,678 of these firms were in market raising one or more private equity funds.

The majority (51%) of active private equity fund managers are based in North America (Fig. 3.8). Increasing interest in investing in less developed private equity markets has driven growth in the number of private equity firms based outside North America and Europe; 16% of firms currently seeking investor capital are based in Asia and 8% are based outside these regions.

Thirty-four percent of private equity firms with a closed-end fund in market are based in the 10 metropolitan areas shown in Fig. 3.9. Five out of the top 10 metropolitan areas for firms actively fundraising are located in the US. New York is the most significant, with 179 private equity fund managers in market based in the city targeting an aggregate $181bn. London follows, with 114 actively fundraising private equity fund managers based in the metropolitan area. Three of the top 10 metropolitan areas for private equity firms currently seeking investor capital are located in Asia: Beijing, Mumbai, and Singapore.

Fig. 3.8: Breakdown of Private Equity Firms Managing Closed-End Funds in Market by Location of Headquarters



Source: Preqin Investor Network

First-Time Fund Managers

Although first-time fund managers have no performance track record as a firm, they still have the potential to provide strong returns for investors. Interestingly, these first-time fund managers represent a significant 38% of private equity firms with a closed-end fund in market (Fig. 3.10). This suggests that emerging managers still see good opportunities to raise capital, despite challenging private equity fundraising conditions. Forty-four percent of these are based in North America, 26% in Europe and 19% in Asia.

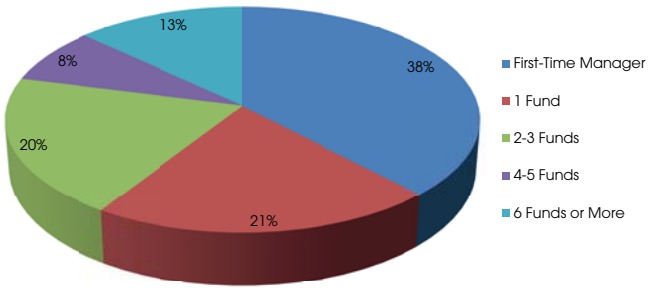
However, a significant proportion of private equity firms with a fund in market are relatively well experienced, with 41% already managing two or more funds. Thirteen percent of fund managers seeking investor capital are long established, having raised six or more vehicles in the past. With more lengthy track records, these fund managers are able to provide investors with a history of their past performance, which may help investors gauge the potential future performance of a manager's fund in market. The majority (65%) of firms in market that have raised six or more funds are based in North America, and a further 24% are based in Europe.

Fig. 3.9: Top 10 Metropolitan Areas for Private Equity Firms Managing Closed-End Funds in Market (Based on Headquarters)

Metropolitan Area	No. of Firms	Aggregate Target Size ($bn)
New York	179	181
London	114	80
Boston	45	30
Paris	43	22
San Francisco	38	13
Mumbai	37	10
Chicago	35	12
Beijing	28	16
Singapore	28	9
Los Angeles	27	23

Source: Preqin Investor Network

Fig. 3.10: Breakdown of Private Equity Firms Managing Closed-End Funds in Market by Number of Funds Raised Previously



Source: Preqin Funds in Market

European Direct Lending – an Attractive Risk/Return Opportunity for Investors?

- Christophe Evain, Chief Executive Officer, ICG

Changing Face of the European Direct Lending Market

European mid-sized corporates have historically relied on the European clearing banks for almost all of their debt funding requirements. Prior to the recent financial crisis, the banks were always willing and able to finance the long-term funding requirements of mid-sized corporates and aggressively used their balance sheets to fund large portfolios of term loans. Competition within the fragmented European bank industry kept spreads on these loans tight and alternative, and non-bank sources of liquidity never developed for mid-sized corporates. Unfortunately, the well-publicized need for the European banks to repair their own balance sheets, as well as the introduction of a raft of new regulations, has meant that the banks are constrained in new lending. Their ability to provide long-term liquidity to mid-sized corporates seems to be particularly impacted given the regulatory capital required to be held against such loans.

The Rise of Direct Lending Funds in Europe

The retrenchment of the banks has resulted in a supply-side dislocation in the European market. The resulting market opportunity is attracting specialized fund managers, which have the networks and skills to successfully implement a direct lending model. These managers are raising larger pools of capital, using structures that are suitable for mainstream institutional investors and replicating what is already prevalent in the US market.

These direct lending funds are essentially filling the gap left by the retrenchment of the banks. The successful direct lending funds will be those that have broad origination capabilities, many years of experience of lending in the sub-investment credit market, and the ability to use their market knowledge and structuring expertise to be an effective and trusted lender to borrowers.

European Direct Lending: an Attractive Risk/Return Opportunity for Investors?

There is increasing interest in European direct lending funds from institutional investors. Pension funds and life insurance companies in particular are looking for ways to generate sufficient returns to meet their income needs and long-term liabilities in the current capital market environment. While the total volume of capital raised for these strategies to date in Europe is relatively low, we are seeing a huge increase in investor interest and the number of funds becoming available for investment. Modelled returns for investors of 8-10% based on current deals are perceived to be sufficiently attractive to compensate for reduced liquidity of the asset class (loans to mid-sized corporates have low liquidity).

In our experience the key features of the strategy that appeal to investors are:

- The market dislocation means that European mid-sized borrowers now have to pay a significant premium over historic rates to attract new funding. This means that returns available from investment in European direct lending are currently significantly higher than both the long-term historic average and the equivalent returns in the US.

- Direct lending is targeted at performing, consistently structured, 'mainstream' loans. Portfolios will be heavily weighted towards senior secured loans, an asset class that has strong capital preservation mechanics and the highest recovery rate of any class of investment within the sub-investment grade space.

- Fund managers can actively manage credit loss risk and generate excess returns in their portfolio. Managers can undertake very detailed due diligence on each borrower prior to making a loan, mitigating risks through a comprehensive package of legal rights and managing risk through the close monitoring of each loan post investment. Therefore, when investing in direct lending it is essential to work with a specialist manager that has the infrastructure, depth of experience and track record in raising and managing funds long term.

- Another result of the market dislocation is that new loans in Europe are more conservatively structured as lenders are able to drive better terms. A key metric of risk is leverage – we are seeing leverage levels on new transactions in Europe that are lower than at any time since 2005 and are more than 20% below the peak leverage levels seen in 2007. This should result in lower than historic default rates on the current vintage of loans. In contrast, the US leverage levels are now at historically high levels and, since 2011, are higher than those seen in Europe.

Other attractive features of European direct lending are high cash yield (most of the targeted returns will be cash yield, paid quarterly), lower volatility of returns, a low correlation to other mainstream financial markets, and low inflation risk.

Outlook: Will the Opportunity Last?

ICG believes the factors that have led to the decline in bank lending volumes are structural and will remain for the medium to long term. We do not believe that the new private debt funds being raised will be able to meet the need for credit, which is driven by a number of factors including new deals, growth capital and the refinancing of existing loans as they come to maturity. Existing non-bank sources of liquidity have not yet been accessible to mid-sized borrowers and we do not expect this to change given the liquidity requirements of investors in these markets. Consequently, the credit supply and demand dislocation will remain, providing the opportunity for well positioned direct lending funds.

ICG

Intermediate Capital Group is a specialist investment firm and asset manager providing mezzanine finance, leveraged credit and minority equity, with AUM of €13bn. Founded in 1989, ICG's head office is in London with a strong local network of offices in Paris, Madrid, Stockholm, Frankfurt, Amsterdam, Hong Kong, Singapore, Sydney and New York. Its stock (ticker symbol: ICP) is listed on the London Stock Exchange.

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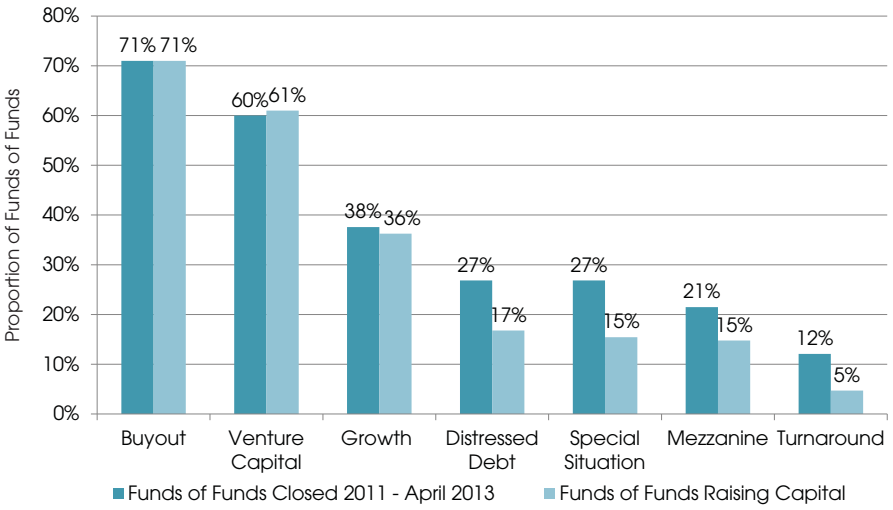
Spreading the Risk: Private Equity Funds of Funds

Private equity fund of funds managers play a unique role in the private equity industry, providing an important link between institutional investors and fund managers. By means of diversification, fund of funds managers aim to lower the risk of a portfolio and can offer exposure to a range of strategies, geographies and industries. Private equity funds of funds typically include a pre-set allocation to various fund types and geographies, as well as to the strategy through which they access the asset class. This is usually adjusted over time to reflect current market conditions. By looking at fund of funds activity and preferences, investors can see the multi-manager opportunities available to them and also gain insight into the fund types and geographies these managers believe present good opportunities in today's market.

Fig. 3.11: Proportion of Private Equity Funds of Funds in Market Targeting Various Fund Types



Source: Preqin Funds in Market

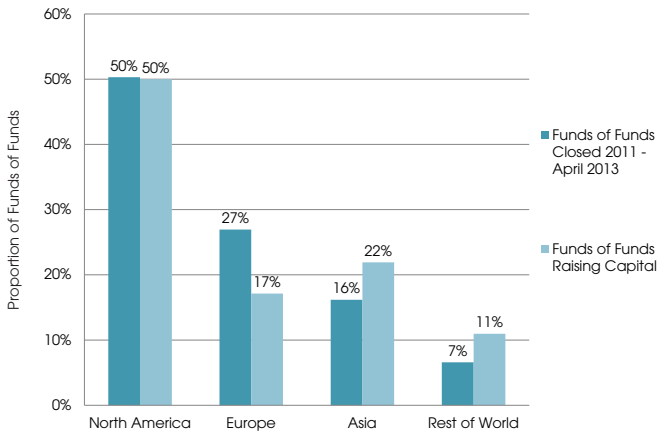
Strategies Utilized by Private Equity Fund of Funds Managers

Fig. 3.11 looks at the fund types targeted by vehicles currently in market compared with vehicles closed in the period 2011-April 2013, illustrating the proportion of total funds in each category that have included an allocation to the various fund types. The most prominent fund types are buyout and venture capital funds, with the majority of funds of funds including an allocation for these strategies. Typically, buyout funds will receive the majority of capital raised by a private equity fund of funds vehicle with a multi-strategy remit. For funds of funds closed in 2011-April 2013, the average allocation for buyout funds is 60%. For venture capital vehicles, the average allocation is much less, at 22% of a funds of funds' total capitalization.

The chart also displays the other fund types being pursued by fund of funds vehicles. The most common fund type outside of buyout and venture capital funds is growth capital. Fund types such as distressed private equity and mezzanine are less common among funds of funds in market than in funds of funds recently closed, with a lower proportion of funds raising including an allocation for these vehicles, compared to funds of funds that have concluded fundraising since 2011.

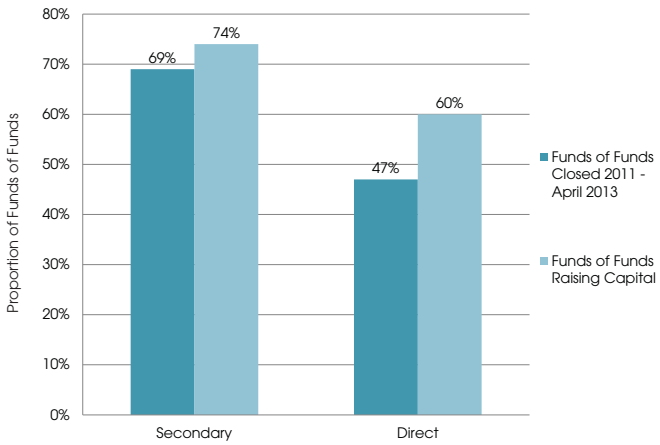
Identifying the main geographic preference of each fund of funds vehicle can help to reveal the broad level of interest shown by funds of funds across the main geographic regions. North America is the leading region for commingled vehicles to target. Half of all funds of funds, both currently seeking capital and those closed since 2011, have

Fig. 3.12: Breakdown of Private Equity Funds of Funds in Market by Main Geographic Focus



Source: Preqin Funds in Market

Fig. 3.13: Proportion of Private Equity Funds of Funds in Market Targeting Various Strategies



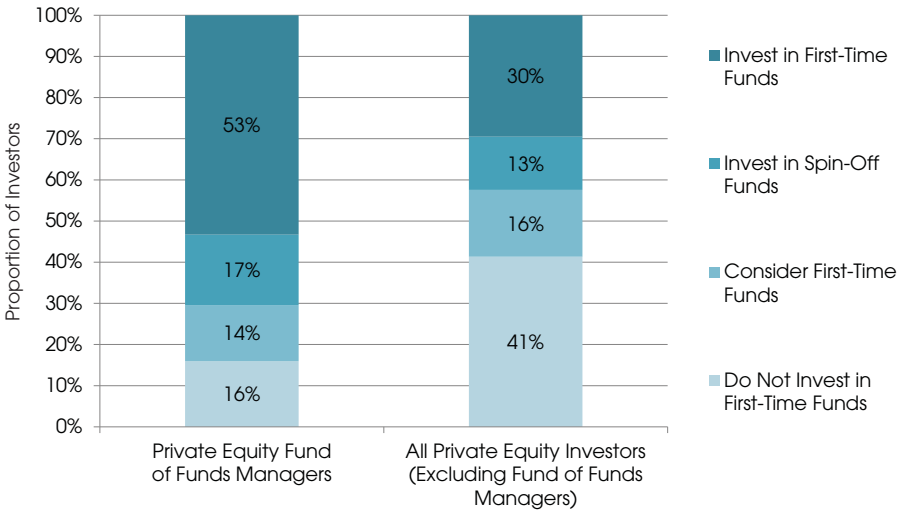
Source: Preqin Funds in Market

a main focus on North America-focused funds. The data for the other regions have some differentiations between those funds that are raising and those that are closed. The statistics for funds currently raising indicate that fewer vehicles are interested in European opportunities, and more are seeking investment in Asia and other economies outside of North America and Europe.

Fund of funds vehicles access private equity investments, not only through primary commitments to managers, but also increasingly through secondary market acquisitions of interests and direct co-investments alongside fund managers. Fig. 3.13 shows the proportion of funds that include an allocation to secondary investments and direct co-investments. Most funds of funds that closed recently included an allocation to secondary investments (69%), with an even greater proportion of fund of funds vehicles raising capital (74%) doing so. Direct co-investments are also becoming a more commonly utilized strategy for funds in market.

Preqin's Investor Intelligence online service tracks investors' appetite for first-time funds, and Fig. 3.14 compares the responses of private equity fund of funds managers to those of all other investor types, including insurance companies, pension funds, and endowments. There is a clear difference between the groups; the chart shows that fund of funds managers are much more open to investing in first-time funds in comparison to other investor types. The majority of private equity fund of funds managers (53%) indicate that they will invest in first-time funds, but the most common stance to first-time funds from all other investors is that they will not commit to these funds, with 41% not willing to invest. This points to the relatively higher risk a fund of funds can absorb compared to some investors which are not able to sufficiently diversify their portfolio. Investors too risk-adverse to commit directly to first-time funds can get access to these managers via the fund of funds structure.

Fig. 3.14: Appetite for First-Time Funds, Private Equity Fund of Funds Managers vs. All Private Equity Investors



Source: Preqin Investor Intelligence

Looking Forward

Over the next 12 months, the majority of fund of funds managers' foci will include some allocation to North America and Europe. Preqin's data shows that 63% of private equity fund of funds are seeking opportunities in North America-focused funds. While only 22% of funds of funds in market have a predominant focus on Asia (Fig. 3.12), almost half of fund of funds managers (48%) include Asia within their immediate investment remit.

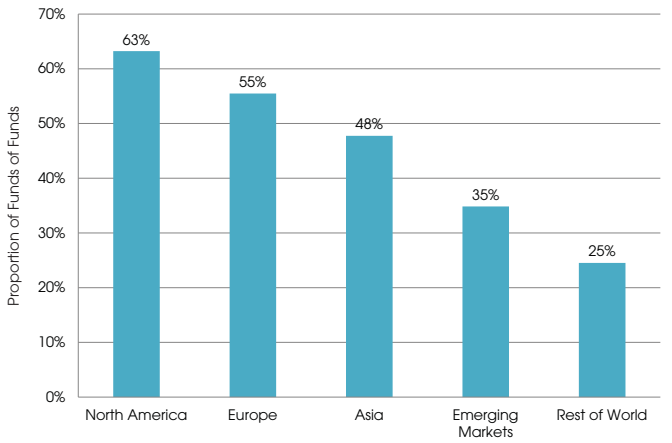
Buyout and venture capital funds are the most sought by commingled vehicles looking to invest over the next year. Growth vehicles are the third most favoured fund type (Fig. 3.16); this correlates with the large number of funds of funds which include Asia in their investment focus, where growth stage companies are frequently targeted by private equity firms.

Data Source:

View detailed information on all 160 private equity funds of funds open for investment, including key contact details, strategies targeted, and more, for free on **Preqin Investor Network**.

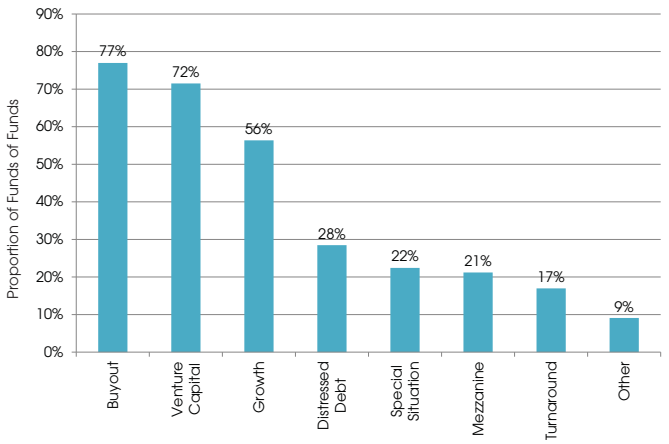
www.preqin.com/pin

Fig. 3.15: Regions Targeted by Private Equity Fund of Funds Managers Over the Next 12 Months



Source: Preqin Investor Intelligence

Fig. 3.16: Fund Types Targeted by Private Equity Fund of Funds Managers Over the Next 12 Months



Source: Preqin Investor Intelligence

The Secondary Market: An Indispensable Tool for the Private Equity Investor

- Jeremy Coller, CIO, Coller Capital

Institutional investors' engagement with the private equity secondary market has grown hugely over the last decade. I explore their motivations for using the market, both as investors and sellers.

Why Investors Commit to Secondary Funds

In making capital commitments to secondaries funds, LPs are seeking a number of benefits: attractive risk-weighted returns, a smoothing of the J-curve effect on cashflows, portfolio diversification, and insight into individual GPs.

Attractive Risk-Weighted Returns

The secondary market is characterized by price and information inefficiencies, which enable good secondaries funds to generate strong returns. Because they can invest in mature, substantially invested portfolios, secondaries funds should be able to generate attractive returns with a substantially reduced risk. Preqin analysis of competing private equity-related strategies over the last decade confirms this, showing an attractive risk-return profile for secondaries funds compared with other private equity-related investment opportunities.

Smoothing the J-curve Effect

Secondaries funds are able to offer institutional investors mitigation of the 'J-curve effect' by acquiring positions in mature (typically over five years old) primary funds in which the underlying portfolio companies are relatively close to exit. And since secondaries funds typically return cash faster than buyout funds or funds of funds, investors have significantly reduced capital-at-risk.

Diversification

Secondaries funds offer institutional investors substantial diversification. Like a broad-based fund of funds, secondaries funds provide investors with diversification by investment strategy, geography, industry sector, and fund manager. However, secondaries offer the additional advantage of diversification by vintage year. This ability to back-fill a portfolio with a range of historic vintages is particularly attractive to investors new to the private equity asset class.

Insight into Individual GPs

Secondaries funds can provide investors with insight into GPs that they are considering establishing a relationship without the risk of making a commitment 'sight unseen'. The extensive diversification of secondaries players' funds gives them valuable information into the strengths and weaknesses of primary market GPs, and they often play the part of an unofficial advisor to their investors as the latter construct their private equity portfolios.

Why Investors Sell in the Secondary Market

The secondary market has experienced unprecedented growth in recent years: the volume of transactions reached $25bn in 2012, double the level seen in 2009. In many ways, this growth is just a natural consequence of the immense volume of private equity commitments made in the last eight to nine years. Private equity is an inherently illiquid asset class; private equity funds typically have 10-year lives (and these have often stretched beyond this point since the onset of the global financial crisis). When LPs' priorities and strategies change, as they inevitably do over time, the secondary market is the only way for them to gain an early exit from their private equity commitments.

However, the evolution of the market has been accelerated in the years since the crash by a range of additional challenges, both strategic and tactical, which LPs have encountered. Investors facing strategic challenges are mainly banks and insurance companies, which have had to modify their business or investment strategies in response to both regulatory and capital pressures. Banks everywhere are having to deal with Basel III; US banks with the Volcker Rule; and European insurance companies with Solvency II – regulatory frameworks created to address international concerns over capital adequacy and investment risk.

Some of these rules actually require institutions to make disposals of private equity interests; others do not require them in principle, but make them more likely in practice. Banks, especially in Europe, have been told to strengthen their balance sheets at a time when this is particularly hard to do, and their significant write-downs of sovereign debt and other assets have made this even more difficult. In addition, publicly-owned banks in certain countries have had to accept obligatory asset sales as a condition of emergency government assistance.

Since the global financial crisis, many other types of private equity investor (pension funds, endowments/foundations, and various types of asset manager, for example) have found themselves with private equity portfolios created for a pre-crisis world. These LPs are not obligated to sell, but they have nonetheless been highly visible in the marketplace. These tactical sellers have taken advantage of attractive secondaries pricing to re-balance their private equity portfolios by vintage year, general partner, investment stage, investment type, or geography. Many large investors have also used the market to concentrate their resources in a smaller core of high-quality managers.

I expect secondaries sales to remain buoyant for a number of years, since neither the strategic nor the tactical challenges have yet been fully addressed. Banks have in excess of $100bn of private equity assets still on their books according to industry analysts, who say they could dispose of close to $30bn of this in the secondary market. For their part, a number of insurance companies, though not all, will quit the asset class, since private equity will become more expensive to hold under Solvency II. And, having become familiar with it, the larger pension plans and asset managers will continue to use the secondary market to remodel their private equity portfolios.

Coller Capital

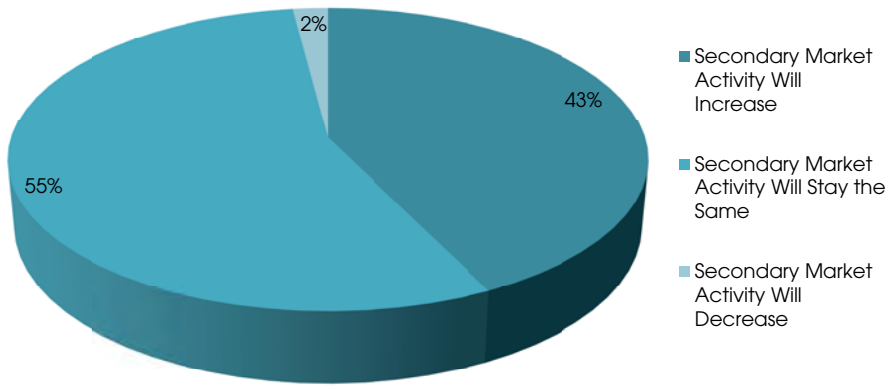
Coller Capital is the leading global investor in private equity secondaries. The firm provides liquidity to investors wishing to exit early from their private equity investments – which may be either limited partner positions in private equity funds or portfolios of direct investments in private companies (typically owned by financial institutions or corporations).

www.collercapital.com

Private Equity Secondary Market for Investors

The private equity secondary market, which includes real estate and infrastructure, has experienced significant growth, with transaction activity widely believed to be at its highest level ever. For 2013, this level of activity will likely continue, as the factors responsible are anticipated to remain in place. The vast majority (98%) of investors interviewed by Preqin in March 2013 expect that secondary market activity levels will increase or stay the same over the next 12 months, demonstrating the potential for continued growth.

Fig. 3.17: Investors' Expectations for Private Equity Secondary Market Activity Over the Next 12 Months



Source: Preqin Investor Interviews, March 2013

Supply of Interests is Fuelling the Market

The changing regulatory landscape for financial institutions, particularly banks, investment banks, and insurance companies, has motivated many to sell fund interests on the secondary market. The secondary market has provided an avenue for these investors to free up capital to conform to more stringent capital requirements.

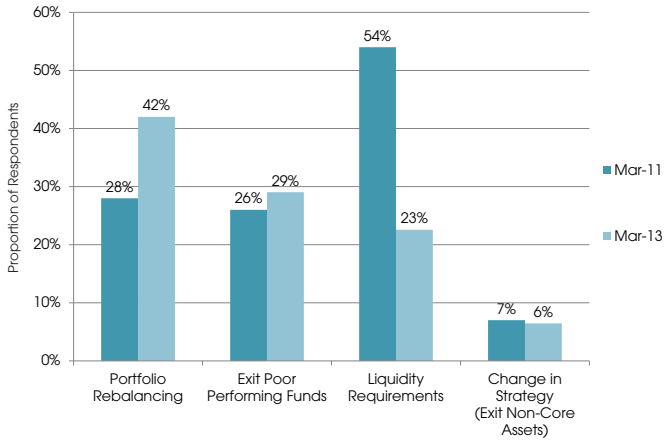
The supply of interests to the secondary market comes not only from investors with a need to sell interests, such as financial institutions, but also from non-distressed sellers that are selling fund interests to rebalance their portfolios. Fig. 3.18 shows that, among institutional investors surveyed by Preqin in March 2013, 42% cited portfolio rebalancing as a motivation for selling fund interests on the secondary market, compared to 28% of investors interviewed for a similar study conducted in March 2011. A number of investors are planning to reduce the number of fund managers in their portfolio, and re-direct capital, often to focus on top performing fund managers.

Other cited benefits of selling on the secondary market include the opportunity to exit poor performing funds (29%), liquidity requirements (23%) and a desire to exit non-core assets (6%).

Preqin's Secondary Market Monitor tracks potential sellers of fund interests on the secondary market over the next 12-24 months. Banks and insurance companies, which are facing a number of regulatory pressures, represent over a fifth (21%) of potential secondary market sellers, as shown in Fig. 3.19. Interestingly, public and private sector pension funds account for a quarter of potential secondary market sellers.

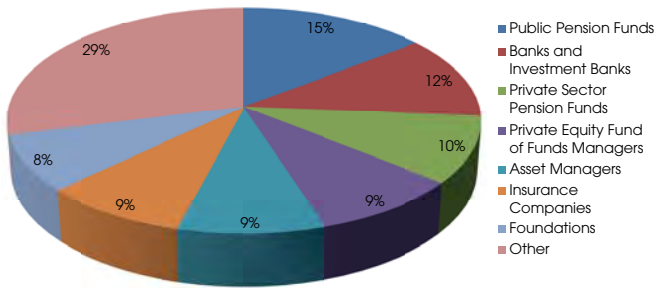
Buyout funds are the most common fund type that will be available on the

Fig. 3.18: Investors' Motivations for Selling Fund Interests on the Private Equity Secondary Market



Source: Preqin Investor Interviews, March 2011 - March 2013

Fig. 3.19: Breakdown of Potential Private Equity Secondary Market Sellers by Type



Source: Preqin Secondary Market Monitor

secondary market, with 66% of investors interviewed looking to sell interests in this fund type in the future (Fig. 3.20). Twenty-nine percent of investors are looking to divest their venture capital funds, while 17% and 14% are looking to sell interests in funds of funds and growth vehicles respectively.

Pricing: An Important Factor

Pricing plays an important part in investors' decisions to sell existing assets, particularly for non-distressed sellers that are not under pressure to sell but are instead looking to rebalance their portfolios; these investors are more willing to sell fund interests at prices closer to the net asset value (NAV) of the funds they hold. Preqin's data shows that in recent years the steady reduction in discounts to NAV observed has coincided with increased levels of secondary market activity and investor interest, and increases in discounts to NAV have corresponded with decreased levels of secondary market activity. Preqin tracks listed private equity prices and discounts/premiums to NAV which can be used as a proxy for secondary market prices and discounts; purchasing a share in a listed private equity vehicle is conceptually similar to buying a secondary interest in a limited partnership. Fig. 3.21 shows that the discount observed for secondary market interests rose steeply in Q1 2009, which corresponded closely with a decrease in activity at the same time. Increases in secondary market activity in recent years have paralleled decreases in the discount to NAV for secondary market interests.

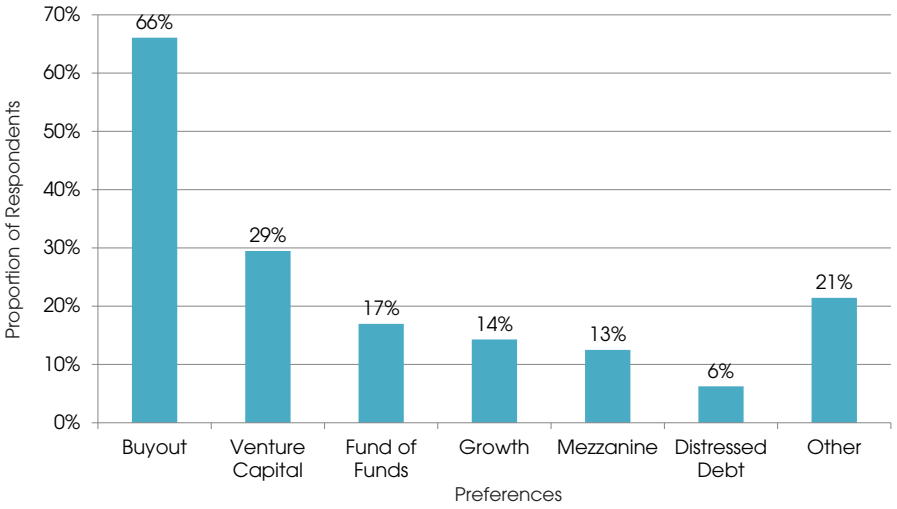
Secondaries Funds

Secondaries funds that closed in 2012 secured an aggregate $21bn in capital commitments, almost double the amount of capital raised by funds that closed in 2011 and the highest amount of capital seen since the peak in 2009.

However, a key feature of the fundraising market in 2012 was the concentration of investor capital among larger vehicles raised by a few managers. These sizeable fund closes include AXA Secondary Fund V, managed by AXA Private Equity, which became the largest secondaries fund ever raised when it held a final close in June 2012. The fund secured $7.1bn, with an additional side car of $900mn, and far exceeded its original target of $3.1bn. The largest secondaries funds are better placed to take advantage of the large portfolios likely to be disposed of by financial institutions and large pension funds on the secondary market. A number of large secondaries funds are also in market, as shown in Fig. 3.22, which displays the largest secondaries funds currently on the road.

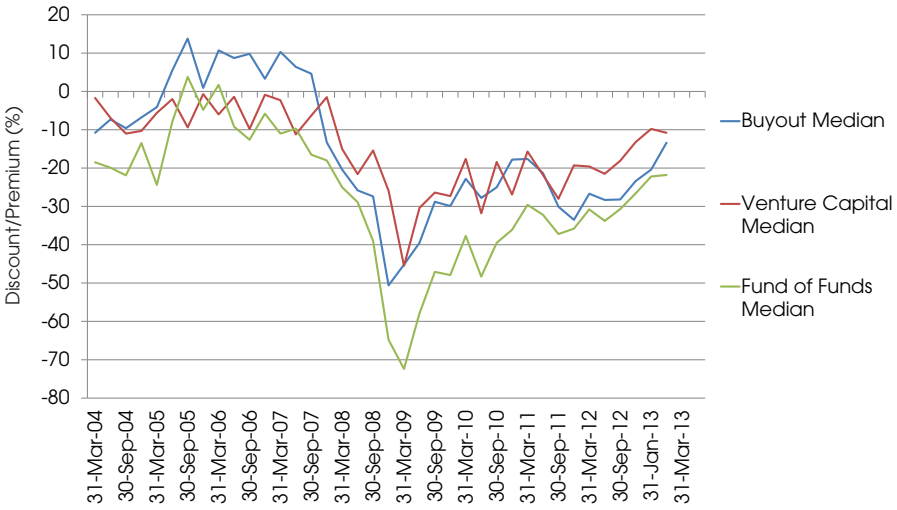
However, there are still funds which seek smaller amounts of capital from investors. For example, the recently closed StepStone Secondary Opportunities Fund II raised a total of $450mn from investors.

Fig. 3.20: Investors' Selling Preferences by Fund Type



Source: Preqin Investor Interviews, March 2013

Fig. 3.21: Discount/Premium to NAV by Fund Type, 2004 - 2013 YTD (As at 5 April 2013)



Source: Preqin Secondary Market Monitor

Fig. 3.22: Top Five Private Equity Secondaries Funds in Market by Target Size, May 2013

Fund	Manager	Target Size ($bn)
Dover Street VIII	HarbourVest Partners	3.0
Vintage Fund VI	Goldman Sachs Private Equity Group	3.0
Landmark Equity Partners XV	Landmark Partners	2.5
Paul Capital Partners X	Paul Capital	2.0
NB Secondary Opportunities Fund III	Neuberger Berman	1.6

Source: Preqin Secondary Market Monitor

Although secondaries funds bring the benefit of portfolio diversification and experience in the management of secondary market investments, investors can also choose to buy fund interests on the secondary market directly. Preqin tracks 439 vanilla investors which have an interest in purchasing fund interests directly on the secondary market. Fig. 3.23 shows that 67% of investors cited the potential to purchase a fund interest at a discount to NAV as the most important benefit of buying fund interests on the secondary market.

Intermediaries: Adding Efficiency to the Market

A lack of clarity surrounding pricing and potential sellers and buyers can make the secondary market challenging to navigate. Intermediaries seek to increase efficiency by assisting buyers and sellers in finding counterparties for their secondary transactions, as well as helping investors to identify which funds or group of funds would be most beneficial to sell in their portfolio.

Preqin tracks 70 active intermediary firms providing secondary market services, the majority of which are placement agents (68%), which offer this service as an extension of their role in advising institutional investors (Fig. 3.24). Twenty-two percent are dedicated secondary market intermediaries, which focus solely on providing secondary market advisory services.

Of the intermediaries tracked by Preqin, 51% are headquartered in Europe as shown in Fig. 3.25, 46% in North America and 3% in Asia. The majority (81%) can cater to clients outside North America and Europe. By total value of transactions represented, the three largest intermediaries are Cogent Partners, UBS Investment Bank Private Funds Group and Campbell Lutyens.

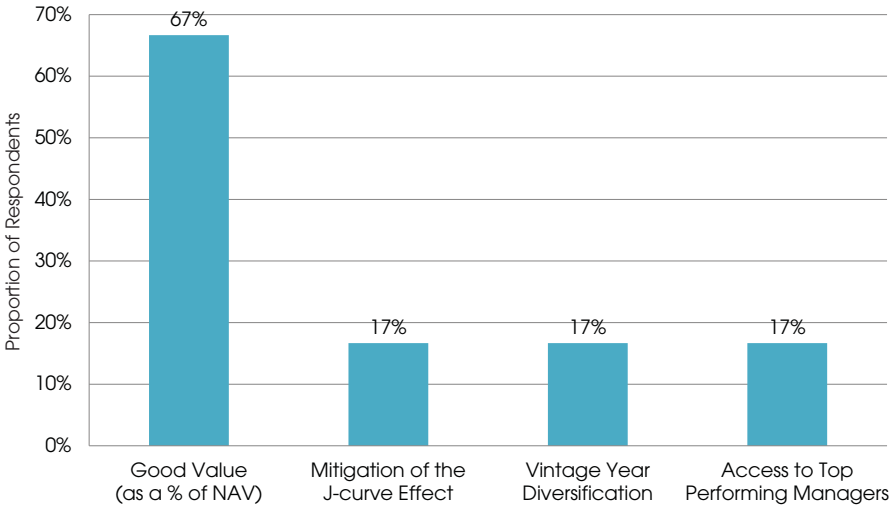
Data Source:

Preqin tracks activity across the secondary market, including information on investors buying and selling private equity, real estate and infrastructure fund interests, details of secondaries funds in market and closed historically, secondaries transactions, and much more.

For more information, please visit:

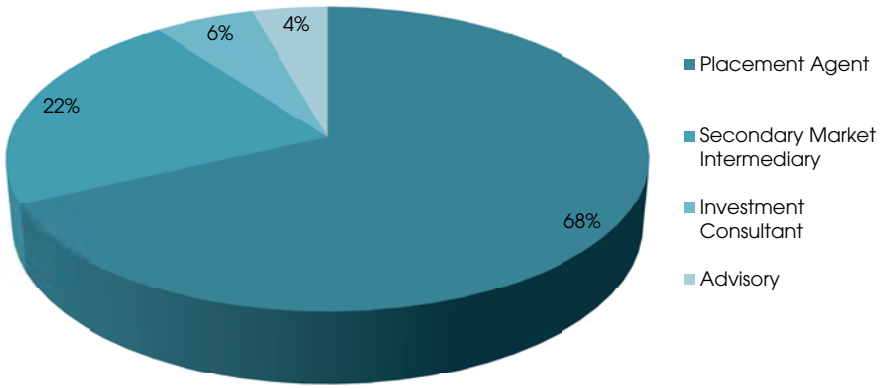
www.preqin.com/smm

Fig. 3.23: Investor Buyers' Views on the Most Important Benefits of Buying Fund Interests on the Private Equity Secondary Market



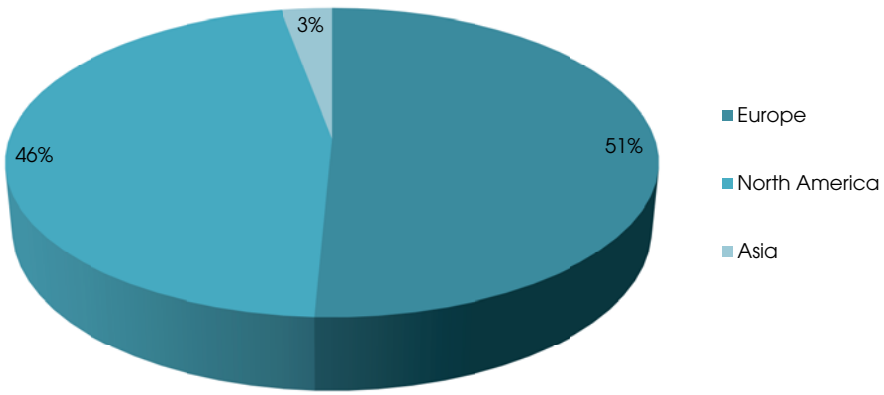
Source: Preqin Investor Interviews, March 2013

Fig. 3.24: Breakdown of Intermediary Firms Providing Private Equity Secondary Market Services by Type



Source: Preqin Secondary Market Monitor

Fig. 3.25: Breakdown of Intermediary Firms Providing Private Equity Secondary Market Services by Type



Source: Preqin Secondary Market Monitor

Most Compelling Strategies and Geographies in Real Estate

- Ed Casal, Global Managing Director
Real Estate Multi Manager, Aviva Investors

Recent months have seen markets display growing conviction in central banks' commitment to extremely loose monetary policy, and risk assets such as equities and high yield debt have rallied strongly. In many markets, this has made good quality real estate look relatively cheap. We believe that continued low interest rates across the developed world will be good for real estate from a capital market standpoint over the medium term, and any signs of job growth and/or household formation will be seen as evidence that the real estate asset class has recovered.

Outside of continental Europe, we believe that the better balance of risks means investors should be positioning for both upside opportunity and downside risk, taking on a less defensive posture from our view during the global financial crisis. Nevertheless, we believe investors should be selective to acquire only high-quality assets in markets with demographic support as a way to "future-proof" their investment portfolios.

The US Leads the Developed World

Over the medium term, we expect the US to be the strongest economy in the developed world, with policies and finances that are relatively positive for real estate. We are already seeing a number of positive signs in the auto and housing sectors; the financial sector is largely recapitalized; the equity markets are at all-time high levels; the corporate sector is financially very strong; and most importantly, employment trends are positive (weak, but positive). In some places capital flows are actually pushing valuations well ahead of fundamentals.

Europe: France, the Wild Card

We expect continental Europe will continue to experience difficulties for the foreseeable future. There has been no improvement in real estate credit conditions in continental Europe where banks are de-risking and building up capital in order to meet regulatory requirements. As debt conditions and economic fundamentals continue to deteriorate, our continental European focus remains on income-secure, defensive assets in the northern-tier countries.

Looking past the well-publicized difficulties of the southern European countries, we are increasingly focused on the health of the central core countries. With Greece, Italy, Portugal, Cyprus, Slovakia, Slovenia and Spain already in recession, the malaise may be spreading to healthier economies. Germany, which accounts for about 27% of the eurozone's output, saw slower growth in each of the past four quarters from the year-earlier period as orders at exporters fell.

France in particular appears problematic in the medium term – and not specifically because of a shift in federal government to a socialist model. Most would consider France the junior, but still very strong, partner in the German/France alliance working to maintain stability for the eurozone. We believe there are serious questions to be asked about France's own long-term economic stability as the fundamentals in France are similar to those of the periphery, and the oversized banking sector remains over-leveraged.

Asia: the Japanese End-game

Overall, we expect returns in Asia-Pacific to improve in 2013, driven by improving occupier demand and growing investor interest. We believe Australia remains attractive over the long term, with its relatively stable and high yields. However, it is important to consider China's economy when evaluating Australia's due to the many export linkages.

Japan has benefited from reconstruction efforts, a surprisingly resilient consumer, and now the world's most aggressive monetary policy. Nevertheless, longer-term structural issues are so profound that short investment duration should be maintained. To be clear, Japan compensates for its large fiscal deficit with a current account surplus and high domestic savings rate, both of which are in decline. The trade account has shifted to deficit and will likely tip the current account into the red as well. Further, Japan's aging population is beginning to dis-save, selling assets to fund retirement.

We believe this will ultimately cause Japan to borrow from abroad, likely at higher rates than the domestic market has been willing to accept. The alternative is to pursue punishing austerity and large tax hikes. These factors very well could lead to a crisis of confidence and a re-pricing of Japanese debt and currency. Higher interest rates will have a cyclically negative reinforcing effect on the country's debt dynamics. Accordingly, we believe that investment opportunities in Japan should be kept very short term, and fully hedged for currency risk. Japanese investors should be considering global diversification to take advantage of current global capital market dynamics.

We believe sizeable investors should consider investing their real estate portfolios globally. In doing so, it is imperative to take a wide, and long-term view, considering fundamental drivers to economic growth, demographic trends, geopolitical influences and global capital flows. Matching investor risk tolerance to a global opportunity set has the potential to improve the risk/return equation and meet long-term investing objectives.

Aviva Investors

Aviva Investors is a global asset manager operating across 15 countries, with assets under management of £274bn. Aviva Investors Real Estate Multi Manager provides indirect real estate solutions to investors, with assets under management of over £5bn, and on the ground presence in the Americas, Europe and Asia.

www.avivainvestors.com

Investment Opportunities in Private Real Estate: Funds in Market

As of April 2013, there are 436 closed-end private real estate funds in market seeking $150bn in aggregate capital commitments. With so many funds in market utilizing a range of strategies and targeting various property markets and regions globally, it is important for investors to identify the best opportunities and most suitable funds when deploying capital to meet their real estate allocations.

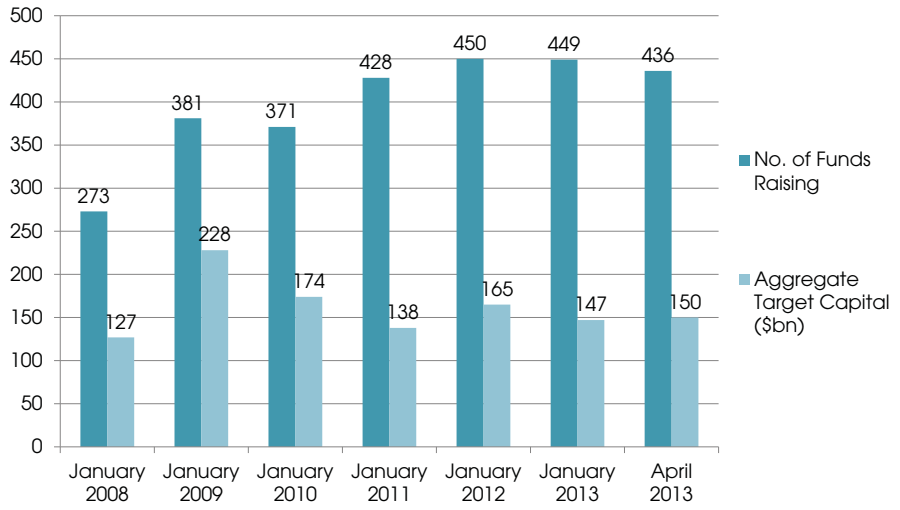
Strategy Breakdown

Fig. 3.27 shows a breakdown of closed-end private real estate opportunities currently open for investment by strategy. The majority are multi-strategy funds, with 182 multi-strategy vehicles targeting an aggregate $59.7bn in capital commitments. Proportionally, this accounts for 42% of private real estate funds currently in market, and 40% of the aggregate capital targeted. In addition, 58% of private real estate funds in market are multi-sector funds, investing in more than one property type. With so many vehicles providing exposure to varying levels of risk and diversified property portfolios, fund selection is a complex process where due diligence centres around manager capability and track record for a range of property types and strategies.

Some managers are more specialist in their investment approach. For example, there are 30 private real estate funds currently in market with a primary focus on office properties, 78 vehicles with a primary focus on residential and 20 funds with a primary focus on retail assets.

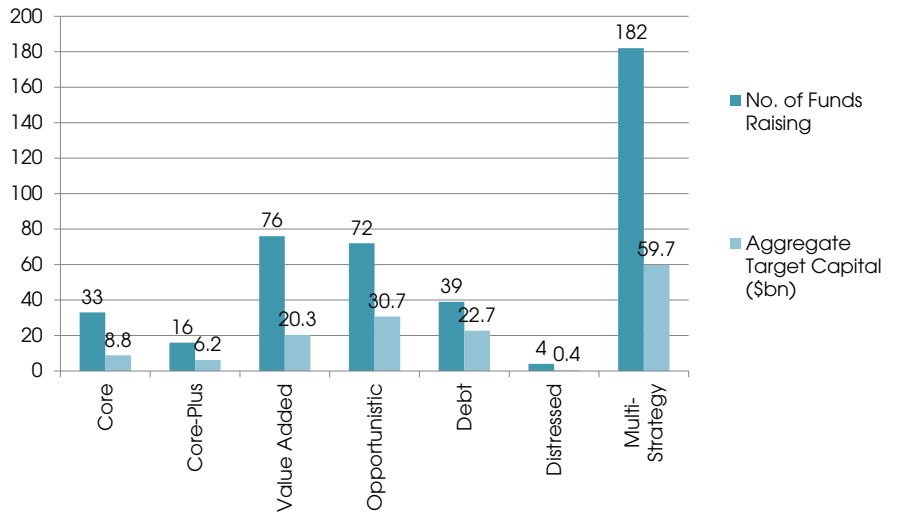
Funds following solely opportunistic strategies account for the largest volume of capital being targeted in market beyond multi-strategy vehicles, with 72 vehicles targeting $30.7bn. Funds with an opportunistic strategy represent 17% of private real estate funds currently in market and 21% of aggregate capital targeted. Thirty-nine private real estate funds in market targeting debt investments are looking to raise a significant $22.7bn, accounting for 15% of the total capital targeted by private real estate funds in market but only 9% of the number. Value added funds are the most numerous single-strategy funds in market, with 76 vehicles targeting $20.3bn in capital.

Fig. 3.26: Closed-End Private Real Estate Funds in Market Over Time, 2008 - 2013



Source: Preqin Investor Network

Fig. 3.27: Composition of Closed-End Private Real Estate Funds in Market by Fund Strategy



Source: Preqin Investor Network

The strategy with the largest proportional disparity between number of funds and aggregate target capital is debt; a difference of six percentage points in favour of aggregate target capital. Private real estate funds following a debt strategy have a large average target size of $630mn due to ample investment opportunities, but a smaller number of fund managers are specializing in debt because of the strategy's relatively new prominence within private real estate funds. With finance difficult to obtain in the wake of the financial crisis in 2008, private real estate managers have stepped in to fill the void. In April 2011, 21 funds on the road focused solely on debt, targeting an aggregate $7.8bn. Two years on, there are 39 funds exclusively focus on debt, targeting a significant larger $22.7bn.

Regional Focus

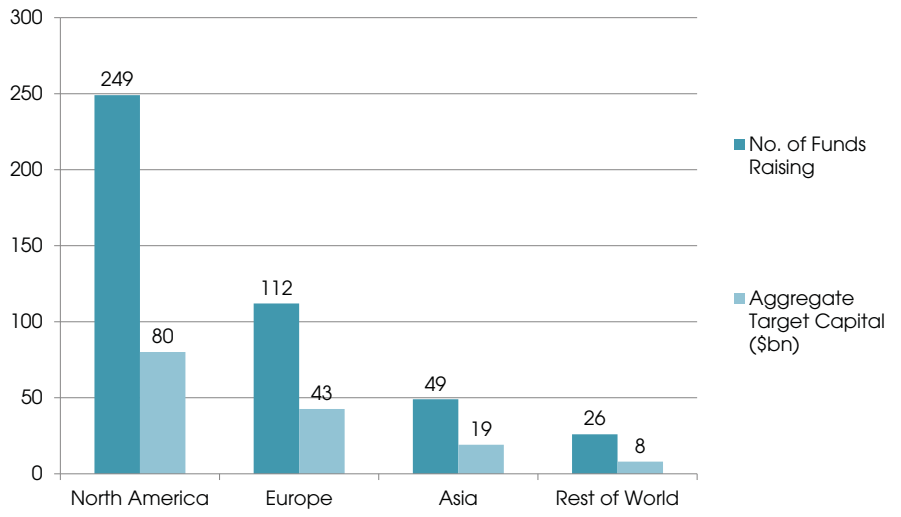
As expected, of the private real estate funds currently raising capital, North America is the most targeted geographic region, both by number of funds in market and aggregate capital targeted. Fig. 3.28 shows that 249 private real estate funds in market are focusing primarily on North America, targeting an aggregate $80bn. There are 112 primarily Europe-focused funds looking to raise $43bn. Asia-focused funds follow, with 49 funds targeting an aggregate $19bn; 26 funds are targeting an aggregate $8bn to invest in economies outside of North America, Europe and Asia.

Interim Closes and Time Spent in Market

Of the 436 closed-end private real estate funds in market, 210, or almost half, have held at least one interim close. Together these interim closes have raised an aggregate $31.8bn towards the overall fundraising targets of vehicles currently in market. Of the funds that have held at least one interim close, 139 have held only a first close, raising an aggregate $18bn in capital commitments. Fifty funds have held two interim closes, securing an aggregate $8.6bn. Aggregate commitments of $2.2bn have been raised by the 12 funds to have held three interim closes, with $3bn raised by the nine funds that have held four interim closes or more.

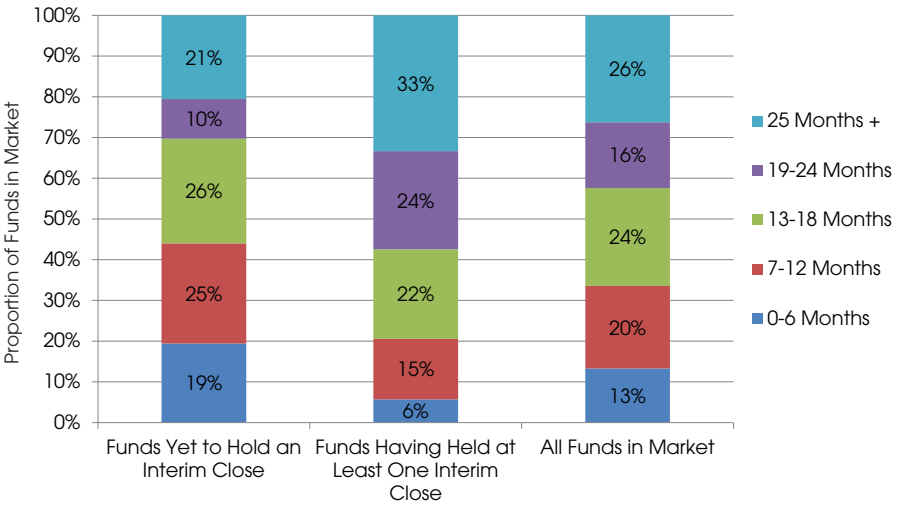
This suggests that there is momentum in the fundraising market, with managers able to secure enough capital to hold an interim close and begin investing. However, of the funds in market that are yet to hold an interim close, 57% have been fundraising for more than a year (Fig. 3.29). Fundraising for these firms is likely to be particularly challenging given that the majority of firms to close funds in recent years did so having held a first close within 12 months. Of all funds in market, a significant 42% have been fundraising for more than 18 months.

Fig. 3.28: Composition of Current Closed-End Private Real Estate Funds in Market by Fund Focus



Source: Preqin Investor Network

Fig. 3.29: Time Spent on the Road by Closed-End Private Real Estate Funds Currently in Market



Source: Preqin Real Estate Online

Private Real Estate Funds Open for Investment - League Tables

Fig. 3.30: 10 Largest Closed-End Private Real Estate Funds Open for Investment, May 2013

Fund	Manager	Strategy	Target Size (mn)	Main Fund Focus	Manager Country
Blackstone Real Estate Partners Asia	Blackstone Group	Opportunistic	4,000 USD	Asia	US
Brookfield Strategic Real Estate Partners	Brookfield Asset Management	Opportunistic	3,500 USD	US	Canada
Blackstone Real Estate Debt Strategies II	Blackstone Group	Debt	3,000 USD	US	US
Goldman Sachs Real Estate Mezzanine Partners II	Goldman Sachs Merchant Banking Division	Debt	3,000 USD	US	US
Aalto Commercial Real Estate Loan Programme	Aalto Invest	Debt	1,500 GBP	Europe	UK
Walton Street Real Estate Fund VII	Walton Street Capital	Opportunistic and Value Added	2,000 USD	US	US
CIM Fund VIII	CIM Group	Opportunistic	2,000 USD	US	US
Orion European Real Estate Fund IV	Orion Capital Managers	Opportunistic	1,300 EUR	Europe	UK
Oaktree Real Estate Opportunities Fund VI	Oaktree Capital Management	CMBS, Debt, Distressed and Opportunistic	1,500 USD	US	US
Perella Weinberg Real Estate Fund II	Perella Weinberg Partners	Opportunistic	1,200 EUR	Europe	US

Source: Preqin Investor Network

Fig. 3.31: 10 Largest Emerging Markets-Focused Closed-End Private Real Estate Funds Open for Investment, May 2013

Fund	Manager	Strategy	Target Size (mn)	Main Fund Focus	Manager Country
Blackstone Real Estate Partners Asia	Blackstone Group	Opportunistic	4,000 USD	Asia	US
Alpha Asia Macro Trends Fund II	Alpha Investment Partners	Core-Plus and Value Added	1,000 USD	Asia	Singapore
Aetos Capital Asia V	Aetos Capital Asia	Debt, Distressed, Opportunistic and Value Added	1,000 USD	Asia	US
Gateway Real Estate Fund IV	Gaw Capital	Opportunistic and Value Added	800 USD	Asia	Hong Kong
Invesco Asia Real Estate Partners III	Invesco Real Estate	Opportunistic	800 USD	Asia	US
SEB Asian Property Fund II	SEB Asset Management	Core, Core-Plus and Value Added	600 EUR	Asia	Germany
LaSalle Asia Opportunity Fund IV	LaSalle Investment Management	Opportunistic	750 USD	Asia	US
Vinci Real Estate Fund	Vinci Partners	Opportunistic	650 USD	Latin America	Brazil
Tokyo Office Property Fund	AXA Real Estate	Core and Core-Plus	50,000 JPY	Asia	France
CITIC Capital China Retail Properties Investment Fund	CITIC Capital	Value Added	600 USD	Asia	Hong Kong

Source: Preqin Investor Network

Fig. 3.32: 10 Largest Opportunistic Private Real Estate Funds Open for Investment, May 2013

Fund	Manager	Strategy	Target Size (mn)	Main Fund Focus	Manager Country
Blackstone Real Estate Partners Asia	Blackstone Group	Opportunistic	4,000 USD	Asia	US
Brookfield Strategic Real Estate Partners	Brookfield Asset Management	Opportunistic	3,500 USD	US	Canada
CIM Fund VIII	CIM Group	Opportunistic	2,000 USD	US	US
Orion European Real Estate Fund IV	Orion Capital Managers	Opportunistic	1,300 EUR	Europe	UK
Perella Weinberg Real Estate Fund II	Perella Weinberg Partners	Opportunistic	1,200 EUR	Europe	US
AREA European Real Estate Fund IV	AREA Property Partners	Opportunistic	750 EUR	Europe	US
Invesco Asia Real Estate Partners III	Invesco Real Estate	Opportunistic	800 USD	Asia	US
DLJ Real Estate Capital Partners V	DLJ Real Estate Capital Partners	Opportunistic	750 USD	US	US
LaSalle Asia Opportunity Fund IV	LaSalle Investment Management	Opportunistic	750 USD	Asia	US
Carlyle Asia Real Estate Fund III	Carlyle Group	Opportunistic	750 USD	Asia	US

Source: Preqin Investor Network

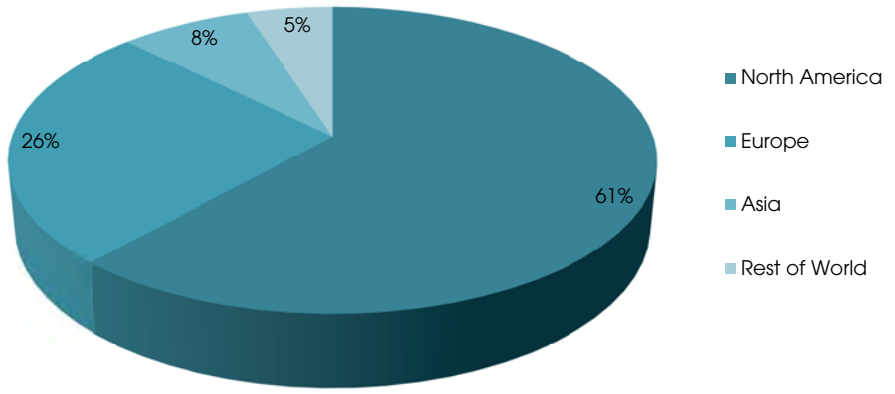
Private Real Estate Fund Managers in Market

There has been considerable growth in the number of active private real estate fund managers in recent years, despite the tough fundraising environment. Preqin has identified more than 1,700 private real estate firms globally, including managers of both closed- and open-ended funds. As of April 2013, there are 386 fund managers managing closed-end vehicles currently in market. This figure includes both experienced managers and those raising their first fund.

In terms of managers of closed-end private real estate funds that are currently in market, North America is the base for the majority (61%), as shown in Fig. 3.33. Europe is the second most significant region for managers in market, with 26% headquartered in the region. Of the remaining firms raising capital, 8% are based in Asia and 5% in economies outside North America, Europe and Asia.

New York and London are the two most significant metropolitan areas for private real estate fund managers in market with 62 and 44 managers headquartered in these cities respectively (Fig. 3.34). US cities account for seven of the top 10 locations for headquarters of private real estate firms managing closed-end funds in market, with London, Toronto and Paris making up the remainder. Interestingly, the top 10 metropolitan areas account for 61% of total capital sought by fund managers marketing private real estate funds to investors.

Fig. 3.33: Breakdown of Private Real Estate Firms Managing Closed-End Funds in Market by Location of Headquarters



Source: Preqin Investor Network

Fig. 3.35 demonstrates that the majority (61%) of private real estate firms managing closed-end funds currently in market have managed one fund or more previously. Thirteen percent of active private real estate fund managers have raised six funds or more previously, demonstrating an established track record. While some investors might prefer to invest in funds operated by more experienced fund managers with a more extensive track record available to review, other investors look to tap into the more favourable fund terms they are likely to obtain when committing to less experienced managers. Thirty-nine percent of private real estate firms managing closed-end funds in market are currently raising their first fund.

Data Source:

Access key data on 386 real estate firms with a fund open for investment for free on **Preqin Investor Network**.

For more information, please visit:

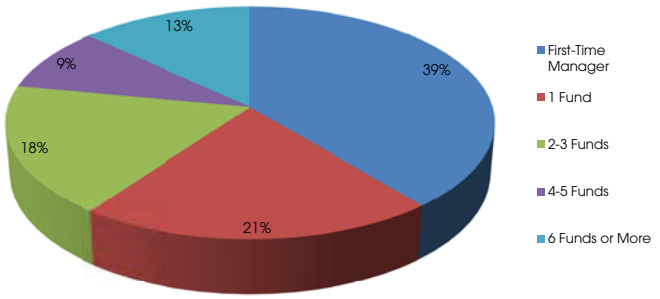
www.preqin.com/pin

Fig. 3.34: Top 10 Metropolitan Areas for Private Real Estate Firms Managing Closed-End Funds in Market (Based on Headquarters)

Metropolitan Area	No. of Firms
New York	62
London	44
Boston	19
Los Angeles	18
Chicago	13
Dallas	11
Atlanta	7
Austin	7
Toronto	7
Paris	6

Source: Preqin Investor Network

Fig. 3.35: Breakdown of Private Real Estate Firms Managing Closed-End Funds in Market by Number of Funds Raised Previously



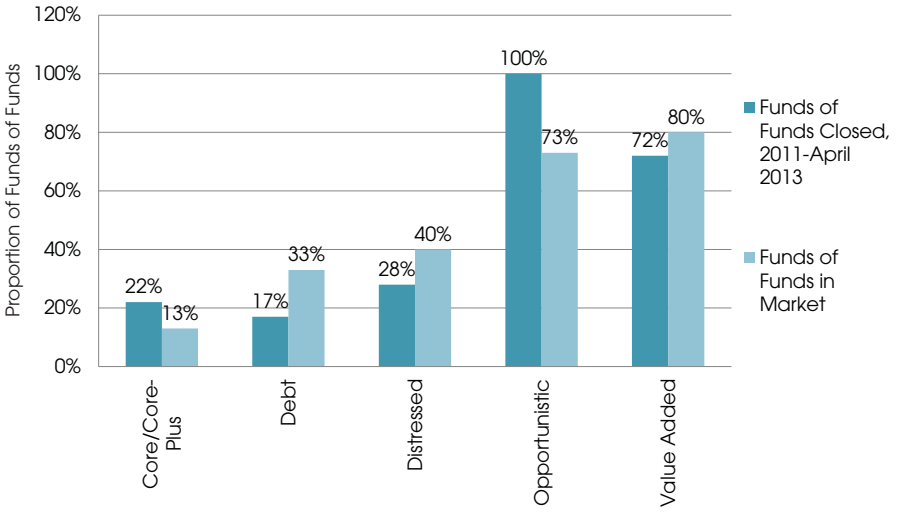
Source: Preqin Real Estate Online

Spreading the Risk: Real Estate Funds of Funds

Real estate fund of funds managers are influential investors in the private real estate market. The significant resources of these firms are required for implementing the necessary research and due diligence on potential investments, meaning that they are a particularly sophisticated and specialized group of investors. Analyzing the investment preferences of these managers can provide investors with a good indication of where the best opportunities reside in the market.

All real estate funds of funds that closed between 2011 and April 2013 targeted funds with an opportunistic strategy. However, this fund type is being targeted by less than three-quarters (73%) of real estate funds of funds that are currently in market (Fig. 3.36). A higher proportion of funds of funds in market are favouring value added, debt and distressed strategies than those funds of funds that closed in the period 2011 to April 2013, with value added the most sought after strategy for the real estate funds of funds in market. Underlying debt funds are more prominent as decreasing availability of bank financing has offered real estate firms the opportunity to address the demand for funding. Real estate fund of funds managers are often able to adapt to market changes promptly, shifting strategy to capitalize on market movements. Accessing funds of funds gives investors the opportunity to tap into the relative flexibility funds of funds can enjoy.

Fig. 3.36: Proportion of Closed-End Private Real Estate Funds of Funds Targeting Various Fund Types

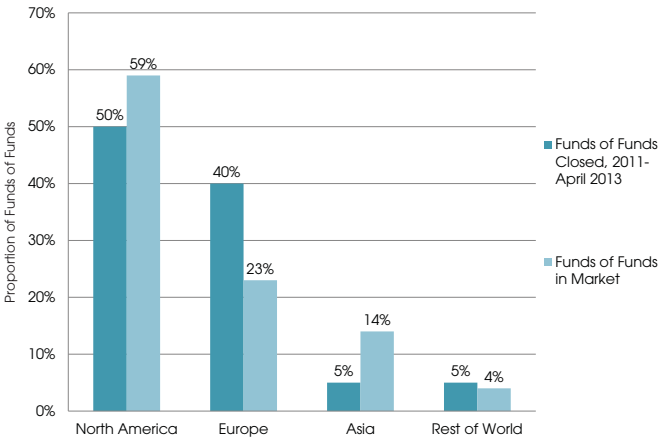


Source: Preqin

As seen in Fig. 3.37, real estate funds of funds in market are more likely to invest in North America and Asia compared to vehicles that closed in 2011-April 2013. Appetite for Europe-focused funds has decreased among real estate funds of funds in market, with only 23% of funds of funds on the road targeting Europe in comparison to 40% of funds of funds that closed between 2011 and April 2013. Again, this is partly a result of these multi-managers altering their investment focus to target the regions they believe are presenting the best investment opportunities.

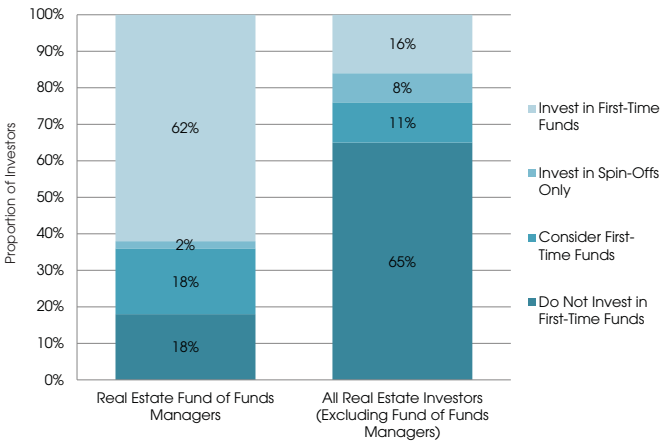
Fig. 3.38 shows that 62% of real estate fund of funds managers are willing to commit to first-time funds, 18% will consider these vehicles, and a further 2% will invest with spin-off teams only. In contrast, only 16% of institutional investors will commit to first-time funds, and a significant 65% are not willing to commit to first-time funds at all. Funds of funds as multi-managers can afford the associated greater risk of investing in fund managers raising their first private real estate vehicle, and can take advantage of more favourable fund terms. Investors not willing or able to take such risk can capitalize on first-time funds via fund of funds managers.

Fig. 3.37: Breakdown of Closed-End Private Real Estate Funds of Funds by Main Geographic Focus



Source: Preqin Investor Network

Fig. 3.38: Appetite for First-Time Funds, Real Estate Funds of Funds Managers vs. All Other Real Estate Investors



Source: Preqin Investor Network

Investing in Infrastructure: Compelling Opportunities

- James Wardlaw, Partner, Campbell Lutyens

A recurring theme in infrastructure in Europe at present is that core infrastructure is showing many signs of a bubble in being "priced to perfection" or beyond, reflecting very strong demand and insufficient supply of assets in which to invest. At the same time, regulatory risk across the core infrastructure sector is perceived to be rising, not falling.

But how does one explain the apparent contradiction between rising asset prices and falling IRRs and yields at the same time as perceptions of rising regulatory risk? There are three possible explanations, each of which might be partially true: the appropriate return on an infrastructure asset at the time of purchase is not an absolute judgment, but relative to long bond yields which are at historic lows; the "investable" universe is shrinking, particularly in Europe, and regulated assets provide a contractual linkage to inflation, which is rising in the medium term.

Another apparent contradiction is at play too: although there are vast flows of capital from institutional investors into infrastructure, the commingled fundraising environment is very challenging. But there have been a number of final closes in the first quarter of 2013 and, apart from a few notable exceptions, the forward pipeline of funds is light.

Reviewing Infrastructure Fund Investment Opportunities

Focus on sourcing capabilities outside auction processes

LPs can, and do, participate in auctions for assets directly. One of the key areas in which GPs can add value to LPs is in sourcing deals to which LPs would not otherwise have access. Therefore, LPs should further focus on the sourcing capabilities of any GP in their due diligence.

Focus on unlevered returns on underlying assets

Relative risk and return in infrastructure is still calibrated on a levered basis. i.e. we compare the equity return on a PPP project with 85/90% senior debt leverage to an airport, with say, 50% leverage. The comparison should really be done on an unlevered asset basis. In addition, a shift to direct investment by institutional investors is likely to lead to reduced leverage over time. We certainly see increasing focus on analyzing unlevered returns among the most sophisticated institutions and a desire to see less levered structures which enable greater volumes of institutional capital to be committed. Institutions, in relation to the supply of long-term debt, are the new banks.

Focus on net returns to investors after fees and taxes and cash yield

Many institutional investors think that they should be investing directly in core infrastructure and not through funds. If target returns on core infrastructure are 8-10% and there is typically, on old private equity style fund structures, an 8% hurdle for carry to kick in for the fund manager, there is little prospect of the fund manager making any carry and so the incentivization doesn't really work. For several years, Campbell Lutyens has pioneered new types of fund structures specific to infrastructure. Today, fee structures for infrastructure funds are generally becoming more aligned with the interests of investors. Investors are rightly increasingly focused on a fund's gross to net erosion by fees and taxes as a percentage of the target return and not just on the absolute level of fees.

Focus on risk-adjusted returns

This is easier said than done. We would suggest focusing on those managers that can really quantify risk-adjusted returns across geographies and sectors because one cannot manage what one cannot measure. There is a need for considerably greater research on true infrastructure returns. The Meridiam Infrastructure/ Campbell Lutyens recently endowed Chair at the EDHEC Risk Institute seeks to address this.

Most Compelling Strategies and Geographies in Infrastructure

Focus on greenfield with construction risk managed by competent parties

The weight of money chasing core regulated assets in northern Europe is focused on brownfield assets because there is a fear of construction risk. Managed by competent managers laying off risks to those best placed to manage them, we firmly believe that the incremental returns available for well managed greenfield assets outweighs the risk of construction cost overruns and timing delays.

Focus on assets offering contractual links to inflation

Many investment strategies involving commodities and real assets are based on some vague correlation between asset returns and inflation. By contrast, infrastructure can provide contractual linkage of revenues to inflation. But it is not enough to simply focus on the revenue linkage to inflation; one must also analyze the inflation sensitivity of the cash flows to equity after costs and debt service. Notwithstanding real bond yields, which are generally negative, the real yields available on infrastructure are attractive, I would argue, in the context of rising inflation expectations in the medium term.

Focus on the US and growth markets

Having established that core infrastructure in Northern Europe is expensive with lots of money chasing too few brownfield assets, relative value can be found in the US and in the so called "growth markets" around the world (as that term is used by Jim O'Neill formerly of Goldman Sachs), where an increase in infrastructure investment is an economic necessity. Sophisticated investors are realizing that the North American "shale (gas) gale" will impact European and Asian infrastructure investment opportunities even if there is little or no upstream gas exploration and production in these two regions over the next decade.

Campbell Lutyens

Campbell Lutyens is an independent advisory firm founded in 1988 focused on private equity and infrastructure fund placements and provides specialist advice on the sale or restructuring of portfolios of private equity fund or direct investments. The firm has offices in London, New York and Hong Kong.

www.campbell-lutyens.com

Investment Opportunities in Private Infrastructure: Funds in Market

Growing investor demand for exposure to infrastructure has led to a general increase in the number of unlisted infrastructure funds launched in recent years. Infrastructure investments are particularly attractive to investors with long-term liabilities, such as pension funds, which are looking for investment opportunities that will provide consistent returns over longer periods of time. The current infrastructure fund market features a wide range of available opportunities, more than ever before, spanning various different strategies, geographies and industries. It is important for investors to recognize these nuances in order to source the most appropriate and profitable opportunities for their portfolio.

As of April 2013, there are 147 unlisted infrastructure funds on the road competing for investor capital, targeting an aggregate $94bn. As shown in Fig. 3.39, this represents a record number of available fund opportunities, with the aggregate target capital also slightly higher than the $93bn sought 12-18 months ago. The average infrastructure fund target size currently stands at $660mn, although in reality the majority of funds seek to raise less than $500mn. Fifty-four percent of all infrastructure funds currently seeking capital have a target of less than $500mn, although 26% have a target of $1bn or more. The largest unlisted infrastructure fund on the road is Brookfield Infrastructure Fund II, which is seeking to raise $5bn.

In terms of strategy, primary equity infrastructure funds remain the most common route to the infrastructure market. A significant 88% of infrastructure funds available for investment are primary funds looking to make equity investments in infrastructure assets. The infrastructure debt/mezzanine fund market is a fast growing sector; there are currently 18 such funds on the road, seeking to raise $11bn, only 33% of which are pure debt funds. There are just seven infrastructure fund of funds vehicles in market seeking capital.

As of April 2013, there are 57 funds available in the market with a main focus on Europe, targeting an aggregate $34bn. The largest Europe-focused infrastructure fund currently seeking investor capital is Terra Firma Infrastructure Fund for Global Renewable Energy, seeking $3bn in investor commitments. As shown in Fig. 3.40, North American opportunities are less in number but higher in terms of aggregate capital targeted, with 35 funds looking to raise $35bn. Seven of these vehicles are targeting $2bn or more. Interest in Asia and other parts of the world is also growing, with 23 Asia-focused funds seeking investor capital and 32 funds targeting opportunities outside of Europe, North America and Asia, seeking $11bn and $14bn respectively. Infrastructure remains very much a global asset class, with a range of fund opportunities available, providing diverse geographic exposure.

A notable 53% of infrastructure funds seeking investor capital have already held an interim close, securing $20bn in capital so far. For investors more comfortable committing to funds that have already held an interim close, there are consequently a significant number of these vehicles to choose from. In terms of project stage focus, 73% of infrastructure funds currently seeking investor capital consider investments in greenfield assets, while 78% invest in brownfield projects and 57% invest in established secondary stage opportunities. This is important to recognize in order to efficiently manage the risk profile of an infrastructure investment portfolio when making new commitments.

Data Source:

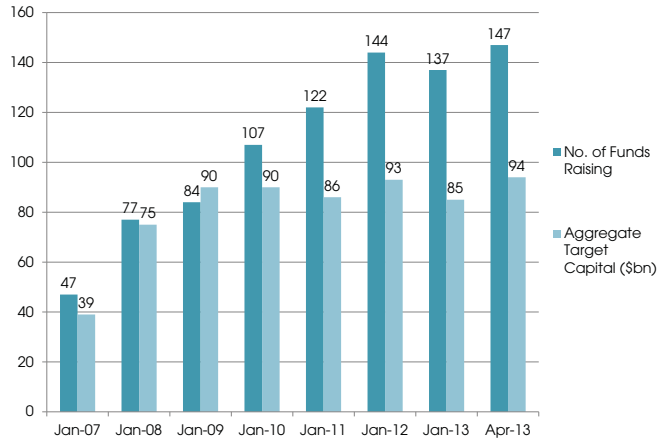
Looking for more information on the infrastructure opportunities currently available to investors?

Access data on all infrastructure funds seeking capital on **Preqin Investor Network** for free, including key contact information, strategies employed, fundraising data, and more.

For more information, or to register for a demonstration, please visit:

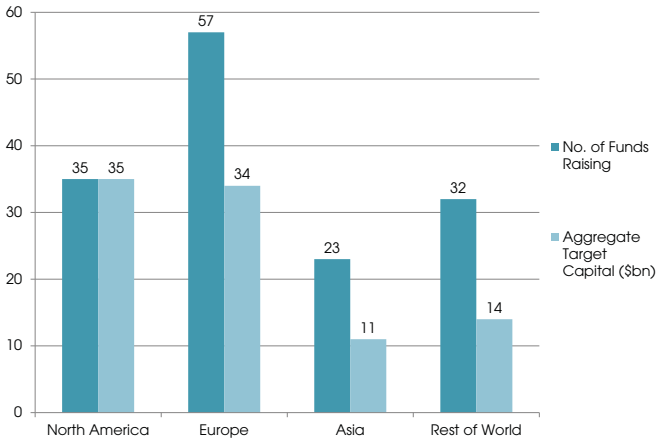
www.preqin.com/pin

Fig. 3.39: Unlisted Infrastructure Funds in Market Over Time, 2007 - 2013



Source: Preqin Investor Network

Fig. 3.40: Composition of Current Unlisted Infrastructure Funds in Market by Fund Focus



Source: Preqin Investor Network

Infrastructure Funds Open for Investment - League Tables

Fig. 3.41: 10 Largest Unlisted Infrastructure Funds Open for Investment with a Primary Focus on Europe, May 2013

Fund	Manager	Target Size (mn)	Manager Location
Terra Firma Infrastructure Fund for Global Renewable Energy	Terra Firma Capital Partners	3,000 USD	UK
First State European Diversified Infrastructure Fund	Colonial First State Global Asset Management/ First State Investments	1,500 EUR	Australia
Aviva Investors REaLM Infrastructure Fund	Aviva Investors	1,000 GBP	UK
Aviva Investors Hadrian Capital Fund I	Aviva Investors	1,000 GBP	UK
Fondi Italiani Per Le Infrastrutture II	F2i SGR	1,200 EUR	Italy
CVC European Infrastructure Fund	CVC Infrastructure	1,000 EUR	UK
EISER Infrastructure Fund II	EISER Infrastructure Partners	1,000 EUR	UK
Infracapital Partners II	Infracapital	900 GBP	UK
Allianz Infrastructure Debt Fund	Allianz Global Investors	1,000 EUR	Germany
InfraMed Infrastructure	InfraMed Management	1,000 EUR	France

Source: Preqin Investor Network

Fig. 3.42: 10 Largest Unlisted Infrastructure Funds Open for Investment with a Primary Focus on North America, May 2013

Fund	Manager	Target Size (mn)	Manager Location
Brookfield Infrastructure Fund II	Brookfield Asset Management	5,000 USD	Canada
EIG Energy Fund XVI	EIG Global Energy Partners	4,250 USD	US
Alinda Global Core Infrastructure Fund	Alinda Capital Partners	3,000 USD	US
Energy & Minerals Group Fund II	Energy & Minerals Group	3,000 USD	US
Morgan Stanley Infrastructure Partners II	Morgan Stanley Infrastructure	2,500 USD	US
Macquarie Infrastructure Partners III	Macquarie Infrastructure and Real Assets (MIRA)	2,000 USD	Australia
UBS International Infrastructure Fund II	UBS Infrastructure Asset Management	2,000 USD	UK
SteelRiver Infrastructure Fund North America II	SteelRiver Infrastructure Partners	1,250 USD	US
First Reserve Energy Infrastructure Fund II	First Reserve Corporation	1,250 USD	US
BlackRock NTR Renewable Power Fund	BlackRock	1,000 USD	US

Source: Preqin Investor Network

Fig. 3.43: 10 Largest Unlisted Infrastructure Funds Open for Investment with a Primary Focus on Asia and Rest of World, May 2013

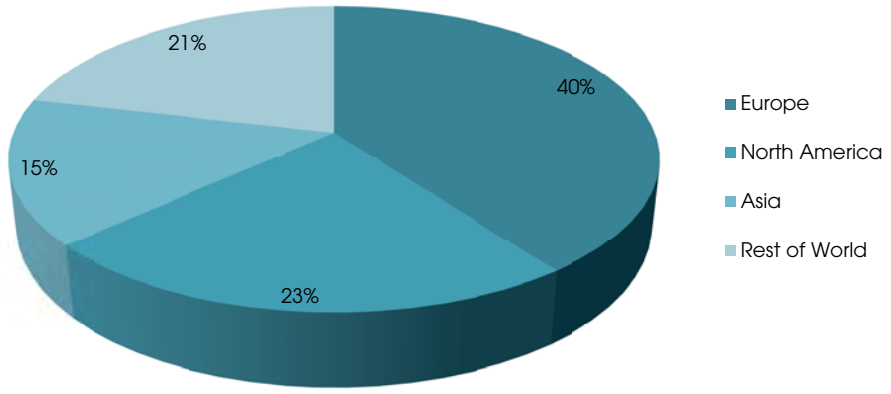
Fund	Manager	Target Size (mn)	Main Fund Focus	Manager Location
Urban Infrastructure Construction Industrial Investment Fund	All-China Federation Industrial Funds Management	10,000 CNY	Asia	China
BTG Pactual Brazil Infrastructure Fund II	BTG Pactual	1,500 USD	Latin America	Brazil
Pan African Infrastructure Development Fund II	Harith	1,200 USD	Africa	South Africa
Arab Financing Facility for Infrastructure	IFC Asset Management Company	1,000 USD	MENA	US
BTG Pactual Africa Fund	BTG Pactual	1,000 USD	Africa	Brazil
Cordiant Emerging Loan Fund IV (CELF IV)	Cordiant Capital	1,000 USD	Emerging Markets	Canada
IFC Global Infrastructure Fund	IFC Asset Management Company	1,000 USD	Emerging Markets	US
JPMorgan Asian Infrastructure & Related Resources Opportunity Fund II	JPMorgan - Infrastructure Investments Group	1,000 USD	Asia	US
LAC-China Infrastructure Fund	Macquarie Infrastructure and Real Assets (MIRA)	1,000 USD	Latin America	Australia
Macquarie Everbright Greater China Infrastructure Fund	Macquarie Infrastructure and Real Assets (MIRA)	1,000 USD	Asia	Australia

Source: Preqin Investor Network

Private Infrastructure Fund Managers in Market

The growth of the private infrastructure market over recent years has been fuelled by a surge in investor demand for exposure to infrastructure assets and a significant number of private fund managers launching new funds. Preqin is currently tracking over 320 active unlisted infrastructure fund managers, which have together launched almost 600 private infrastructure funds. These fund managers are based in many different countries around the world and have varying levels of fundraising experience and track record. The market also features a host of different risk/return opportunities dependent on the strategy pursued by the fund manager. As a result, an investor's ability to accurately identify and select the best and most appropriate infrastructure fund managers is vital when looking to build a successful portfolio.

Fig. 3.44: Breakdown of Unlisted Infrastructure Fund Managers with a Fund in Market by Location of Headquarters



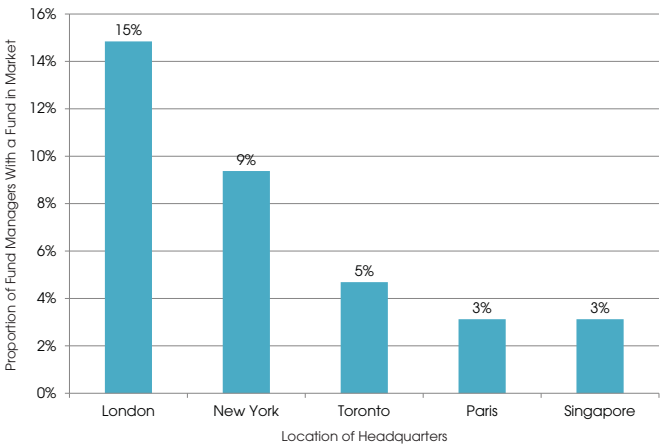
Source: Preqin Investor Network

As of April 2013, there are 132 unlisted infrastructure fund managers actively marketing 147 infrastructure funds. As shown in Fig. 3.44, a significant 40% of these firms are based in Europe, while 23% are based in North America. Fifteen percent of infrastructure fund managers actively raising a fund are based in Asia, while 21% are based outside these core markets in regions such as South America, Australasia, Africa and the Middle East.

Fig. 3.45 illustrates the top five cities acting as a base for the 132 unlisted infrastructure fund managers actively raising capital. London is the most prominent city, with 15% of infrastructure fund managers with a fund in market based there. Nine percent of active infrastructure fund managers are based in New York, while a further 5% are based in Toronto. Both Paris and Singapore provide the base for 3% of active infrastructure fund managers.

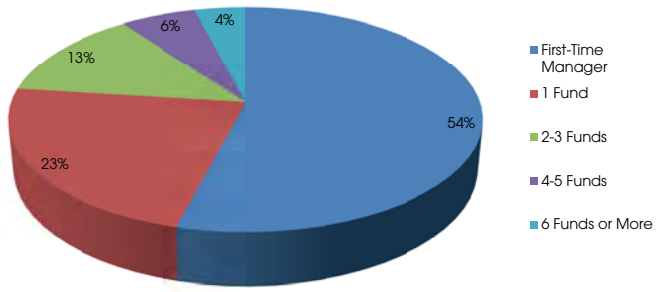
Fund manager experience, past performance and track record is of primary importance as investors look to select a fund manager. Of the infrastructure funds to reach a final close in the past 12 months, 46% were launched by firms with previous fundraising experience (those managing at least one other infrastructure fund). In contrast, 54% of fund managers currently in market are raising their first fund as shown in Fig. 3.46, and only 10% have previously raised four or more vehicles. Consequently, there are only a limited number of fund managers in the market with previous fundraising experience. This will result in increased competition to gain access to the most desirable vehicles managed by the most experienced firms, but will also provide room to negotiate on the terms linked to funds managed by less experienced managers.

Fig. 3.45: Top Five Metropolitan Areas for Unlisted Infrastructure Fund Managers with a Fund in Market (Based on Headquarters)



Source: Preqin Investor Network

Fig. 3.46: Breakdown of Unlisted Infrastructure Fund Managers with a Fund in Market by Number of Funds Raised Previously



Source: Preqin Infrastructure Online

Fundraising Momentum in Private Equity

The first close of a private equity fund can play a pivotal role in helping investors decide whether to commit capital to a particular fund. Preqin Investor Outlook: Private Equity H1 2013, which drew on the results of detailed interviews with over 100 institutional investors, shows that 35% of investors will not commit to a fund until it has reached a first close. For many of these investors, before they consider committing to a fund, it is important to see which managers are able to secure capital and whether they will be able to put this capital to work. Some investors may wish to see if returning managers can attract capital from the same investors they garnered commitments from for a predecessor fund, whereas with first-time managers many investors prefer to wait until the fund can demonstrate momentum with a first close.

Preqin Investor Network tracks the fundraising progress of funds so that investors can determine how quickly a vehicle held a first close, how much capital it was able to raise and what percentage of the fund's overall target the first close achieved. Through this, investors can evaluate which funds have gained momentum in the market and therefore decide which fund managers to invest with.

Time Taken to Reach First Close

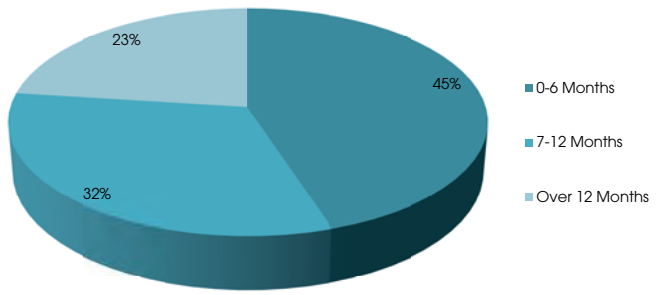
Preqin data shows that funds closed in 2012 took, on average, eight months to hold a first close, with the figure at seven months for funds closed so far in 2013. For funds still open to investors, those that have held a first close have, on average, taken nine months to do so. A closer look at the time taken for funds in market to reach a first close (Fig. 3.47), indicates that 45% of funds that have held an initial close took up to six months to do so. Thirty-two percent of funds took from seven months to a year to hold a first close and 23% took over a year.

Proportion of Fundraising Target Reached by First Close

A look at what proportion of the overall fundraising target has been achieved by a first close for funds closed in 2012 and 2013 so far shows that funds raised, on average, 44% of their total fundraising target by the time a first close was held. In comparison, funds in market that have held a first close have, on average, raised 38% of their target allocation. This reveals that fund managers are finding it increasingly challenging to attract investor capital before an initial close. As shown in Fig. 3.48, the majority of funds (61%) achieved a first close raise of less than 40% of their overall target. However, a significant 39% of funds in market that have reached a first close have raised over 40% of their overall fundraising target.

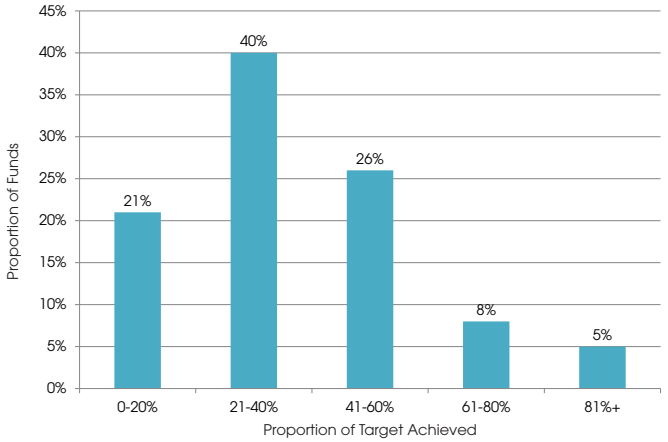
Alongside overview statistics, Preqin Investor Network also provides underlying data to show which managers have gained momentum in the fundraising market. Fig. 3.49 shows a sample of funds with significant final target sizes that have reached a first close. Each fund achieved a first close within six months and secured more than 40% of its target capital. KKR Asia Fund II managed to raise 50% of its $6bn fundraising target in approximately six months. Launched in January 2012, the fund was set to conclude fundraising in June 2013.

Fig. 3.47: Time Taken for Funds in Market to Reach a First Close



Source: Preqin Investor Network

Fig. 3.48: Proportion of Fundraising Target Achieved at First Close, Funds Currently in Market



Source: Preqin Investor Network

Fig. 3.49: Sample of Large Funds in Market that Have Achieved A Significant First Close

Fund Name	Manager	Type	Target Size ($bn)	First Close Size ($bn)	Proportion of Target Size Raised at First Close	Months taken to Reach First Close
KKR Asia Fund II	Kohlberg Kravis Roberts	Buyout	6.0	3.0	50	6
Affinity Asia Pacific Fund IV	Affinity Equity Partners	Buyout	3.5	1.5	43	5
MBK Partners III	MBK Partners	Buyout	2.3	1.3	56	2
CVI Credit Value Fund II	CarVal Investors	Distressed Debt	2.0	1.1	55	6
CDH China Fund V	CDH Investments	Growth	2.0	1.0	50	5

Source: Preqin Investor Network

Committing to Successful Private Equity Fund Managers

- Moose Guen, CEO, MVision

In such a crowded fundraising market, it can be difficult to identify funds that are likely to be the strongest performers. What advice would you give to investors in identifying a potentially successful fund manager?

The answer to the question really depends on which market you invest in, because for markets that are newer in terms of their cycles to private equity, the length of history isn't there. But now we have, for example in the US and in Europe, GPs that are 25-30 years old, and with these firms one is able to look and create a comparison of best practice and best potential performance. As a rough guideline, investors are looking for the potential of a portfolio to generate a 2.5x gross return, have less than 10% write-off and capital loss, outperform a local public market index by over 5%, and, looking at the 2012 valuations, they want to see an uplift of 30-40%. Within the deals team, they would love to see evidence of a well-managed business and understand the mechanisms; what is most crucial to them is that the team has the right skill sets and experience.

How can investors identify the best opportunities with first-time fund managers, that do not have an established track record?

The dynamic of success of a first-time fund all hinges on the quality of the individuals coupled with the fund's access to deal flow. I still think it is simpler to market a first-time fund than to market an established fund. With established funds, everything is examined to minutia. But with a first-time fund, the simpler the story, the more the story stands out. Then, if an investor gives a first-time fund support, the fund can and will move into a closing pattern as it makes investments. Working with an established fund is actually more complex.

What significance do you place on the re-up rate of a fund?

When we launch a fund today, our average assumption is that the re-up rate on a dollar-for-dollar or currency-for-currency basis is 50%. So if the fund in question has more than 50% of the money back from the current pool of investors, that fund can be oversubscribed. If the fund has less than 50% that fund will not reach its target. As an example for large funds, for every $300mn commitment that is not coming back, you might need 10 investors to fill that gap. But in oversubscribed and popular funds, existing investors normally present themselves early in the process and express their interest, and new investors are also more proactive than they have been in the past. Then it is a question of navigating through and understanding which investors to prioritize, and how to process them efficiently knowing that sometimes a premature marketing can be more damaging than people realize.

The question becomes do I just close the fund on a date, or do I remain in the marketplace and try to pick up a higher quality mix of investors for the future? This is a difficult business decision because it means that you are in the market longer than you would like to be, and many people, particularly after 2008, want to get out as quickly as possible. The advice that they are getting from investors is for the GPs to go out later rather than sooner and investors are using money drawn as a rough guideline. They would like the GPs to be using the full capital and generating as robust a portfolio as they can.

How can new investors which are not in a position to re-up with large successful managers that are possibly going to be oversubscribed position themselves to gain access to these vehicles?

Well it all depends – does the new investor have a gatekeeper or a fund of funds or a relationship whom they can use to assist them? When an investor comes into a new market, normally the pattern for opening a program begins with a more passive position, and then you build core holdings, and move into a more active portfolio. With the traditional first round of commitments you will have a fund of funds or potentially advisors or gatekeepers, but these groups normally know all the GPs and they do scans of the market. The other thing that investors are doing today, from small to large, is proactively forward marking their calendar. They are calling around and looking at services such as Preqin's to look at and gauge the market. They are assuming a three to four year investment period, so if they see anything that is three to four years out they are then looking to see if they can get the capital needed, and then they can position themselves in getting to know those GPs.

In your recent interactions with institutional investors, what sort of strategies and geographies are attracting a lot of attention at present?

The main focus of today's investors is back into the US and in developed countries. There is a lot of travel into Japan, and there is a huge amount of activity in the US, and I think that Europe will end up benefiting from this. We are seeing it in the larger European funds that have recently closed, and there is life that is going into that end of the marketplace, so the mid-to-large end will really benefit from the current cycle. It is generally felt by the larger GPs that financing is back, and that should lead to some very attractive distributions for the next year, which will then focus investors to commit more to funds targeting developed countries in the near term. Exposure to emerging markets was very much driven by the BRIC countries, but now most of these countries are not an area of focus for investors. Many investors are now considering Columbia, Peru, Mexico, South East Asia and Sub-Saharan Africa.

MVision

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MVision executes as one team – an industry-leading group of 55 professionals operating out of offices in London, New York, Hong Kong and Sydney.

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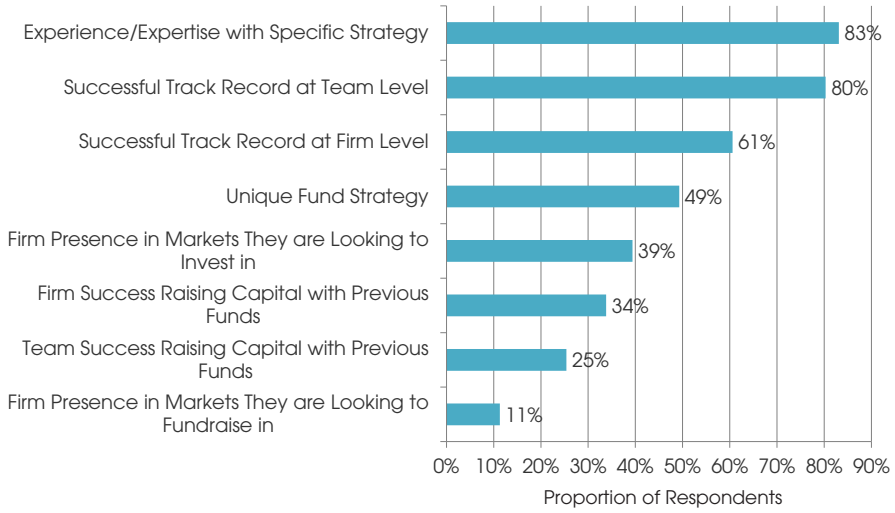
Placement Agent Survey: Signs of Success and Accessing the Top-Tier

Placement agents play a key role in the alternative assets industry. Fund managers hire placements agents to garner commitments from investors, relying on their fundraising expertise, experience and networking capabilities to reach investors that they may not otherwise be able to secure capital from. Placement agents are also important to investors, presenting them with opportunities they might not usually have access to.

Preqin recently surveyed 72 placement agents from around the world, in order to better inform the investor community about fundraising. This article seeks to reveal what placement agents look out for when deciding whether to represent a fund manager, and what top-tier fund managers look for when deciding which investors to take commitments from in a potentially oversubscribed vehicle.

Fig. 3.50: Placement Agents' Views on the Most Important Traits Fund Managers Need to Exhibit for Placement Agents to Fundraise on Their Behalf



Source: Preqin Placement Agent Interviews, April 2013

Indications that a Manager Will Be Successful in Fundraising

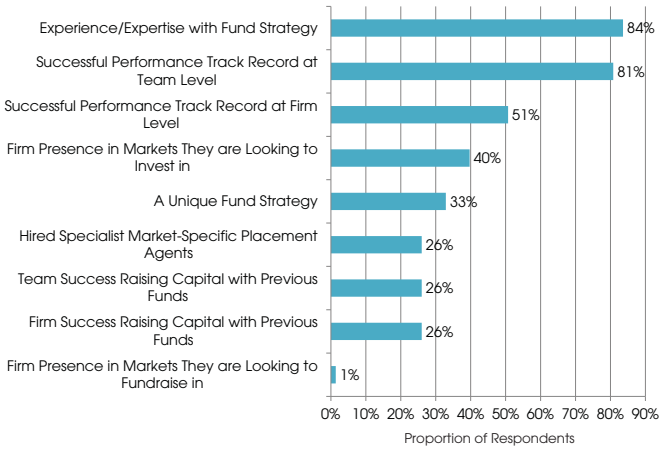
When placement agents were asked which traits are the most important when selecting a fund manager to work with, a large majority (83%) of respondents cited experience/expertise with a specific strategy as being important if they are to represent the fund. This is a clear indication of the importance placement agents place on specialist knowledge within a given private equity field. Regarding a successful performance track record, it is interesting to note that a significant 80% of placement agents interviewed require managers to have been successful on a team level, compared to 61% which require a good track record on a firm level.

Additionally, several survey participants mentioned characteristics such as low team turnover and stability, with one placement agent valuing "team cohesion and returning base of investors".

We also asked placement agents which attributes a fund manager needs in order to successfully fundraise. Experience and expertise with fund strategy were again suggested by the highest proportion of respondents (84%). Track record was stated as the next most important factor, with 81% stating that a successful performance track record at team level was a good indication of the manager being able to meet its fundraising target; additionally, 51% of placement agents stated that a successful track record at firm level is an important attribute in fund managers.

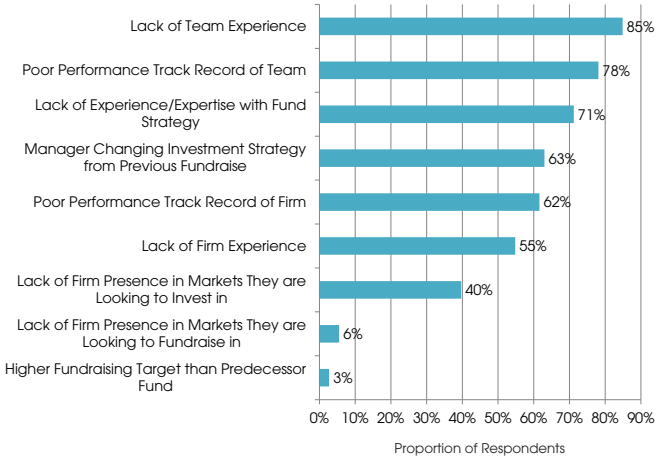
One placement agent stated "a manager's willingness to be flexible on terms and conditions" as important when fundraising, while another highlighted that the "first closing is crucial, as are

Fig. 3.51: Placement Agents' Views on the Most Important Traits a Fund Manager Needs to Possess in Order to Meet its Fundraising Target



Source: Preqin Placement Agent Interviews, April 2013

Fig. 3.52: Warning Signs Placement Agents Look for that Suggest a Manager Will be Unsuccessful with Fundraising

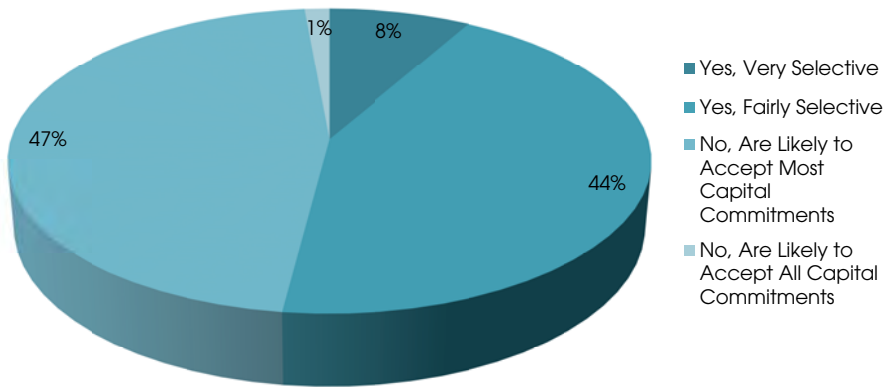


Source: Preqin Placement Agent Interviews, April 2013

investments, particularly involving commitments from existing investors".

Conversely, placement agents also look for warning signs that might suggest a manager will be unsuccessful with fundraising, which is certainly something for investors to consider when deciding whether to commit to a fund. Lack of team experience was mentioned by the highest proportion of respondents (85%). Again, poor performance track record of team (78%) and firm (62%) were other major concerns, as was lack of experience/expertise with the fund strategy they are in market with (71%).

Fig. 3.53: Placement Agents' Views on Whether Top-Tier Fund Managers Are Selective About Which Investors Commit to Their Funds



Source: Preqin Placement Agent Interviews, April 2013

Accessing Top-Tier Fund Managers

While new managers or those with a less established performance track record may find it challenging to attract investor capital, managers with a proven performance track record may be oversubscribed. Placement agents are divided about how selective top-tier fund managers are when choosing which investors commit to their funds. Forty-eight percent stated that managers are not selective about which institutions they take capital from; however, 52% state that managers are selective about which investors can commit to their funds.

When asked what investors need to do to access top-tier funds, 75% of placement agents cited willingness to make a sizeable commitment to the fund. Some investors not long established in alternatives may have difficulty investing with top-tier managers, with 52% of placement agents stating that having a widely recognized name within alternatives is key to being accepted by a top-tier manager.

Some placement agents cited that top-tier managers seek out long-term compatibility with an investor, seeking potential re-ups in successor funds. One respondent labelled this requirement as the need to find "sticky capital".

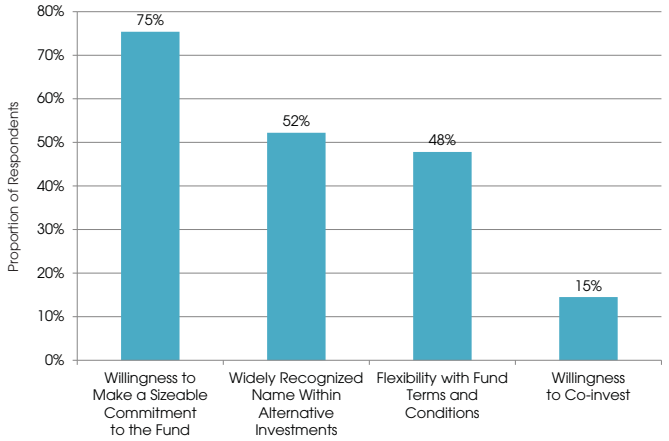
We also asked placement agents about the potential obstacles investors had to be aware of when trying to gain access to top-tier fund managers. The overwhelming majority (96%) of placement agents told us that top-tier fund managers decline investors if they are too demanding with fund terms and conditions. With investor-fund manager alignment of interest a much discussed subject in the current climate, investors should be aware of pushing fund managers too far when negotiating on fund terms and conditions.

Outlook

Positioned between investors and fund managers, placement agents, and their views on the alternative assets industry, can provide an insight for investors into key areas that impact the investment process.

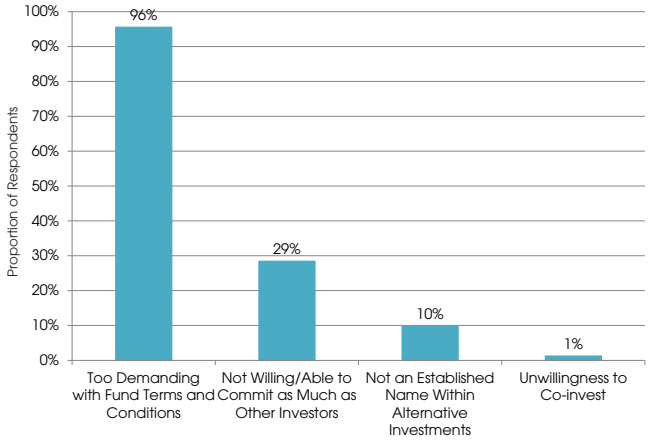
Preqin's interviews with placement agents demonstrate that experience and track record are of clear importance to both investors and fund managers. Placement agents are often wary of backing a fund manager without a sufficient track record. Many believe that top-tier fund managers may be unwilling to take commitments from investors that are not established investors in alternatives. Other key factors for investors to take into account with top-tier managers are the importance placed on making a sizeable commitment to a fund, as well as the possibility of pushing fund managers too far in attempting to negotiate over fund terms and conditions, a current point of much contention in the industry.

Fig. 3.54: Placement Agent's Views on Attributes Top-Tier Managers Look for from Investors



Source: Preqin Placement Agent Interviews, April 2013

Fig. 3.55: Placement Agent's Views on Factors that Lead Top-Tier Managers to Decline Investors



Source: Preqin Placement Agent Interviews, April 2013

The Value of Investing in Hedge Funds

- Luke Ellis, President of Man

What value can hedge funds add as part of an investor's broadly diversified portfolio?

Hedge funds are potentially an extremely important part of an investor's broadly diversified portfolio, as they can generate a real rate of return for investors. Hedge funds are about delivering absolute returns, so if an investor's target is to make, for example, 3% over inflation, that coincides exactly with what hedge funds do for a living. Additionally, in an overall portfolio investors are trying to combine a mixture of sources of return and active management, which is what hedge funds are all about. To me, this makes hedge funds ideal for investors to have a significant allocation to.

We have observed an influx of capital from the institutional investor market into hedge funds in recent years. Do you think all institutional investors should be investing in hedge funds?

For almost all institutional investors or investors generally, it makes absolute sense for them to commit to hedge funds, as long as they can get sufficient information or advice to understand what they are doing. Institutional investors' long-term goals often do not have anything to do with equity markets; they are focused on a return target they have promised. A well-managed hedge fund, and in particular, a well-managed portfolio of hedge funds, is really designed to give institutional investors exactly the return profile that they are looking for. If they can achieve this within an investor's target risk tolerance, it makes sense for investors to have a lot of them in their portfolios.

Despite improvement in the returns generated by hedge funds in 2012, their overall performance lagged wider equity markets in the year. Should investors be concerned? Or do you think the risk mitigation provided by hedge funds outweighs performance concerns?

Firstly, it is extremely difficult to predict markets over the short term, and trying to judge returns over a fixed or a 12-month period sometimes does not provide the best perspective. If you look over the longer term, for example by five or 10 years, which is the time frame most investors real return goals are centred around, then hedge funds have actually pretty consistently delivered what investors are looking for with a very tolerable level of risk.

Have you seen any growth in investor appetite for alternative structures to provide liquidity, such as managed accounts or UCITS funds?

The market environment in Europe has contributed to a growth in appetite for UCITS funds among investors based in the region. However, investors have not been rushing to put their capital to work in Europe, so the growth in interest in UCITS funds has been relatively constrained. If Europe feels more secure in the future, I think we will see a significant flow of investor capital into UCITS funds.

Managed accounts are a very big and growing area for our business; however, this is not being driven by liquidity needs but more by a need for transparency, control of the fund, and a tailored strategy.

Which areas of the hedge fund market do you think are currently presenting the best opportunities for investors?

What we look for are mismatches in supply and demand, because that creates opportunity. The big opportunity today is that ever since 2008 the banks have been pulling further and further away from providing market-making capital and liquidity to markets, and this creates a significant opportunity for hedge funds to provide that capital into the market. In a lot of cases, the strategies that we think are most exciting for hedge funds to provide capital to right now have been around for years, but are providing better returns today than they have done for 10 years or more because the banks are no longer competing in the same space.

Are there any particular regions you're seeing opportunities in over the next year or so?

I think that mostly hedge fund management done at its best is not particularly geographically focused, because it should be about absolute returns and that tends to be more diversified than geographically focused. However, I would say that it is always easiest to make money in markets where there is a significant flow of capital; when people feel good about life, people tend to be less exact about what they're doing, and that creates mispricing which creates opportunity for hedge funds.

I think that what's going on in Japan has clearly changed the rules – Japan has been the hardest place to run a hedge fund for as long as I can remember until the last six months when it's become in some ways the easiest. Although historically Japan has never been an interesting opportunity for hedge funds, suddenly valuations matter and capital is flowing, and suddenly there's lots of alpha to be made.

Do you have any final comments?

For any investor's hedge fund portfolio, I think it makes rational sense to diversify your sources of return. Manager skill is one of those possible sources of return, which shouldn't need to depend on equity market beta, or bond market beta. I'm a passionate believer that people should include a significant allocation to skill within their portfolio; even though you have to pay for that, it's worth it. But you shouldn't pay 2 and 20 for equity market beta. In hedge funds, when we deliver absolute returns to investors, we deliver real value to our clients, and that's what certainly we as a group are focused on.

Thank you for your time.

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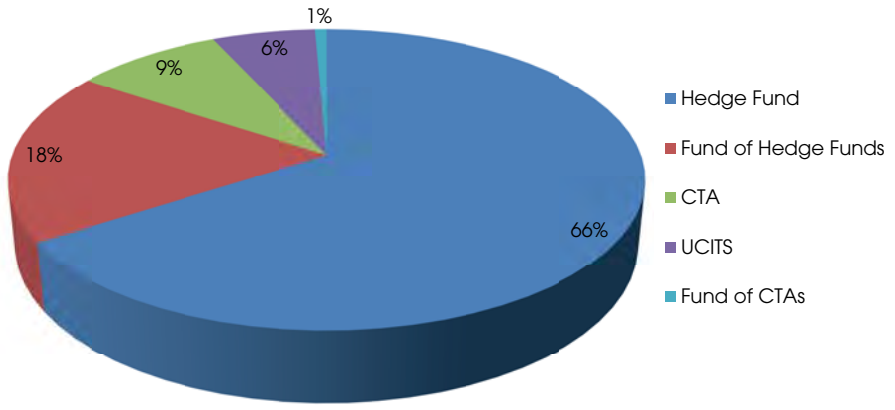
Investment Opportunities in Hedge Funds: Funds in Market

Evaluating the large number of hedge fund opportunities currently open for investment is a challenging task for investors looking to commit to the asset class. Preqin tracks detailed information on over 9,500 hedge funds, UCITS, CTAs, funds of hedge funds and funds of CTAs which are open to new investment – in this section we explore these opportunities in order to provide insight into the current market.

Fig. 3.56 shows that two-thirds of these funds are single-manager hedge funds, with almost a fifth being funds of hedge funds. CTAs, which are viewed as an all-weather investment that can add diversity to a hedge fund portfolio due to their lack of correlation with equity markets, account for 9% of all hedge funds open to investment. The UCITS wrapper for funds, which represents 6% of funds, also appeals to investors seeking to participate in the positive returns of hedge funds while being able to have greater control over liquidity than when investing in regular hedge funds.

Fig. 3.56: Breakdown of Active Hedge Fund Universe by Type



Source: Preqin Investor Network

Number of Funds and Industry Capital

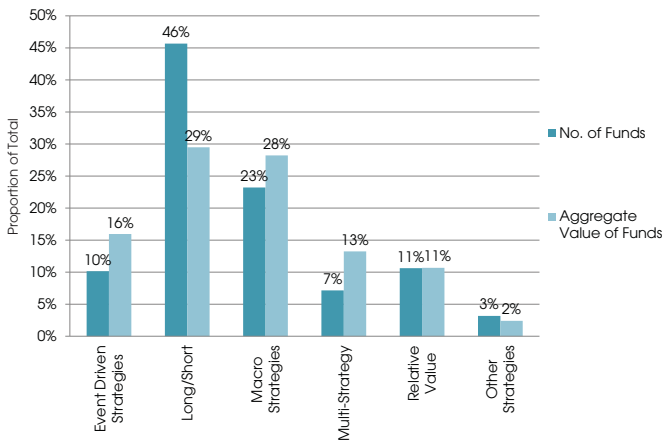
An analysis of the most commonly utilized hedge fund strategies and the value of all industry capital they represent can reveal to investors where their peers are choosing to place capital, and which hedge fund strategies currently dominate the market. According to Fig. 3.57, long/short funds, with 3,517 vehicles open for investment, represent the largest proportion of single-manager hedge funds, at 46%. However, long/short strategy funds make up less than a third (29%) of the aggregate value of direct hedge funds that are open to investment. This is almost equal to the 28% of aggregate value represented by macro strategies which have half the number of active funds (23%) compared to those in the long/short space.

Event driven strategies comprise a relatively small proportion (10%) of single-manager hedge funds, with 782 funds employing this strategy open for investment, but these vehicles account for 16% of the total capital managed by hedge funds. By way of contrast, although relative value funds represent a similar proportion (11%) of single-manager hedge funds to event driven, they account for only 11% of the aggregate value of single-manager hedge funds. Multi-strategy hedge funds make up 7% of funds by number, but the total value of hedge fund industry capital they represent is almost double this at 13%.

Fund Launches by Strategy

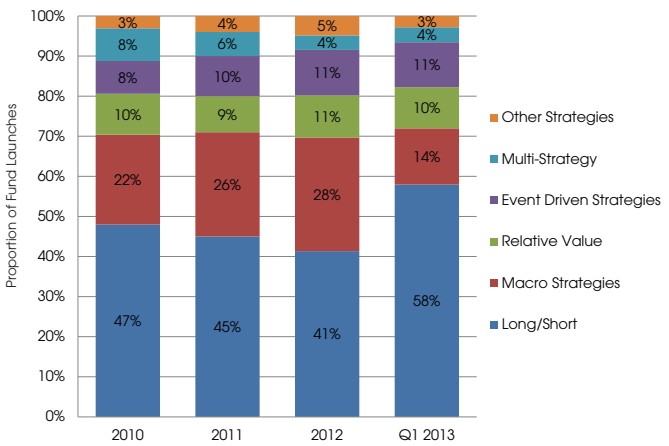
The wide variety of strategies in the hedge fund universe may mean that deciding which to incorporate into an investment

Fig. 3.57: Proportion of Number and Aggregate Value of Active Single-Manager Hedge Funds by Hedge Fund Strategy



Source: Preqin Investor Network

Fig. 3.58: Breakdown of Hedge Fund Launches by Strategy, 2010 - Q1 2013



Source: Preqin Hedge Fund Analyst

portfolio requires a significant amount of time and resources. Focusing on the most common strategies launched in the last few years by hedge fund managers can help investors to see the strategies that fund managers feel will yield the greatest opportunities in current and future market conditions. Long/short funds have historically accounted for the largest proportion of hedge fund launches each year, with 47% of single-manager hedge funds launched in 2010 being long/short, decreasing slightly to 45% in 2011 and reducing further in 2012 to 41%. With US equity markets rallying in Q1 2013, it is no surprise to see that 58% of recent fund launches have a long/short focus.

Macro strategies are the second most favoured strategy, with an average of 25% of active funds launched between 2010 and 2012 using this strategy, although the proportion of total hedge fund launches represented by macro strategy funds has decreased to only 14% in Q1 2013. Relative value, event driven and multi-strategy funds are represented by an average proportion of 10%, 10% and 6% respectively of hedge funds launched each year between 2010 and 2012.

Preqin also tracks detailed performance on over 5,300 active hedge funds; more detail about the performance of hedge funds by strategy and geographic focus, information available to investors for free on Preqin Investor Network, can be found on page 31.

UCITS

The use of the European-regulated Undertakings for Collective Investment in Transferable Securities (UCITS) as a wrapper for hedge fund strategies increased following the financial crisis of 2008, with investors seeking more regulation and greater transparency within the hedge fund industry. UCITS funds have to offer their investors at least fortnightly liquidity and monthly transparency documentation outlining the strategy and investments of the fund. UCITS funds have restrictions on the underlying investments they are allowed to make, as well as a cap on the level of leverage they are allowed to employ.

Fig. 3.59 shows that the alternative UCITS market is cornered by three top strategies; long/short, macro, and relative value. These strategies combined account for 91% of UCITS hedge funds. Unsurprisingly, long/short is the most commonly utilized strategy, as it is used by 46% of all alternative UCITS funds. Macro and relative value funds account for 26% and 19% of funds in the space respectively. These strategies are favoured by UCITS fund managers due to their ability to meet UCITS liquidity requirements and the investment restrictions within the directive. The illiquid characteristics and long-term investment horizon of event driven strategies and funds grouped here under other strategies, such as asset-backed lending, do not fit in easily with the fortnightly liquidity requirements of the UCITS regulatory framework.

CTAs

Although the majority of CTAs (61%) favour a traditional commingled structure, a third of CTAs are structured as managed accounts (Fig. 3.60). This is significantly higher than the overall single-manager hedge fund industry, where only 5% of funds are offered to individual investors in a managed account structure. Managed accounts are tailored to the needs of the individual investor, and offer investors greater control of their investments, greater transparency and lower counterparty risk due to the investor being able to use their own nominated service providers.

Preqin tracks the different strategies used by CTAs, namely trend following, macro, pattern recognition, counter trend, option writing and arbitrage. Often CTAs use a combination of these strategies. Trend following, which is based on the technical analysis of market prices to identify long- or short-term directional trends in financial markets, is the most favoured strategy, utilized by 67% of actively investing CTAs.

CTAs provide a trade-off for investors in the sense that they charge higher than average management and performance fees but provide a greater degree of liquidity. Preqin data shows that the mean management fee for single-manager hedge funds is 1.62%, with a mean performance fee of 19.17%. By contrast, CTAs charge on average a 1.78% management fee coupled with a 20.28% incentive fee. However, investors in a CTA benefit from favourable liquidity terms as they can access their capital on average every 21 days with 14 days' notice. This compares favourably with the hedge fund industry as a whole, with investors only able to redeem their capital on average once every 1.4 months with 35 days' notice.

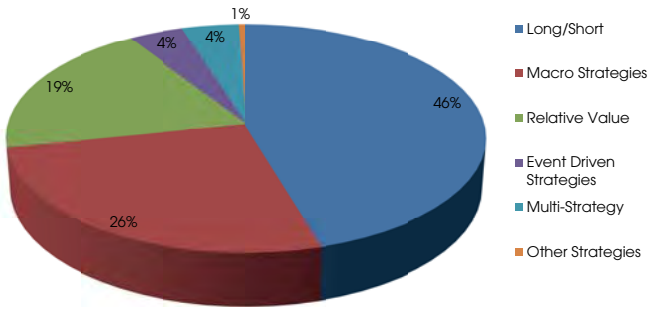
Data Source:

Preqin Investor Network provides investors with free access to detailed data on the 9,500 hedge funds currently seeking capital, including fund manager key contact details, strategies followed, fundraising data, and more.

For more information, please visit:

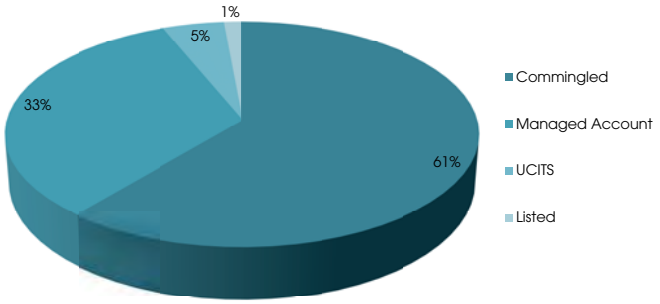
www.preqin.com/pin

Fig. 3.59: Breakdown of UCITS Funds by Strategy



Source: Preqin Investor Network

Fig. 3.60: Breakdown of CTAs by Fund Structure



Source: Preqin Investor Network

Hedge Funds Open for Investment - League Tables

Fig. 3.61: 10 Largest Hedge Funds Open for Investment, May 2013

Fund	Firm	Core Strategy	Fund/Share Class Assets under Management
Bridgewater All Weather Strategy 12%	Bridgewater Associates	Macro	$70.7bn as at 31 March 2013
OZ Master Fund	Och-Ziff Capital Management	Multi Strategy	$21.8bn as at 31 December 2012
Viking Global Equities	Viking Global Investors	Long/Short Equity	$16.0bn as at 31 December 2012
BlueCrest Capital International	BlueCrest Capital	Macro	$13.7bn as at 30 November 2012
Millennium International	Millennium Management	Multi Strategy	$10.9bn as at 31 March 2013
King Street Capital, Ltd.	King Street Capital Management	Event Driven	$10.5bn as at 30 November 2012
Winton Futures Fund Ltd	Winton Capital Management	Multi Strategy	$9.7bn as at 28 February 2013
Canyon Value Realization Master Fund, L.P.	Canyon Partners	Event Driven	$8.0bn as at 30 November 2012
Renaissance Institutional Equities Fund	Renaissance Technologies	Long Bias	$7.3bn as at 31 March 2013
BlueMountain Credit Alternatives Fund	BlueMountain Capital	Equity Market Neutral	$6.0 as at 31 March 2012

Source: Preqin Investor Network

Fig. 3.62: 10 Largest UCITS Funds Open for Investment, May 2013

Fund	Firm	Core Strategy	Fund/Share Class Assets under Management
Standard Life Global Absolute Return Strategies Fund	Standard Life Investments	Multi Strategy	$23.9bn as at 28 February 2013
JPMIF Income Opportunity Fund	JP Morgan Asset Management	Fixed Income	$7.7bn as at 31 March 2013
Amundi Funds Absolute Volatility Euro Equities	Amundi Alternative Investments	Statistical Arbitrage	$3.1bn as at 31 March 2013
Amundi Funds Absolute Volatility World Equities	Amundi Alternative Investments	Statistical Arbitrage	$2.6bn as at 31 March 2013
Dexia Index Arbitrage	Dexia Asset Management	Relative Value Arbitrage	$1.9bn as at 31 July 2012
Schroder GAIA Egerton Equity	Egerton Capital	Long/Short Equity	$1.5bn as at 28 February 2013
GAM Star Global Rates	GAM	Managed Futures/CTA	$1.5bn as at 31 March 2013
AC - Risk Parity 7 Fund	Aquila Capital	Macro	$1.0bn as at 28 February 2013
Henderson Horizon Euro Corporate Bond Fund	Henderson Global Investors	Fixed Income	$1.0bn as at 28 September 2012
ZEST Global Strategy Fund	Zest Asset Management	Macro	$0.9bn as at 31 March 2013

Source: Preqin Investor Network

Fig. 3.63: 10 Largest CTAs Funds Open for Investment, May 2013

Fund	Firm	Core Strategy	Fund/Share Class Assets under Management
BlueTrend Master Fund	BlueCrest Capital	Managed Futures/CTA	$10.6bn as at 30 November 2012
Diversified Trend Program - Enhanced Risk	Transtrend	Managed Futures/CTA	$6.6bn as at 31 March 2013
Renaissance Institutional Diversified Alpha Fund	Renaissance Technologies	Managed Futures/CTA	$5.6bn as at 31 March 2013
Discus Feeder Ltd	Capital Fund Management	Managed Futures/CTA	$3.1bn as at 31 January 2013
FDO Partners (Emerging Quant Currency)	FDO Partners	Managed Futures/CTA	$2.7bn as at 28 February 2013
FDO Partners (GL Quant Currency)	FDO Partners	Managed Futures/CTA	$2.2bn as at 28 February 2013
Lynx (Bermuda)	Brummer & Partners	Managed Futures/CTA	$1.6bn as at 31 March 2013
Man AHL Diversified plc	Man Investments (AHL)	Managed Futures/CTA	$1.6bn as at 31 December 2012
Aspect Diversified Fund	Aspect Capital	Managed Futures/CTA	$1.5bn as at 31 March 2013
Dreiss Research Global Diversified Program	Dreiss Research	Managed Futures/CTA	$1.3bn as at 28 February 2013

Source: Preqin Investor Network

Hedge Fund Managers in Market

Preqin currently tracks over 3,900 active hedge fund managers (excluding funds of funds), 3,500 of which are managing hedge funds open for investment to the institutional investor market.

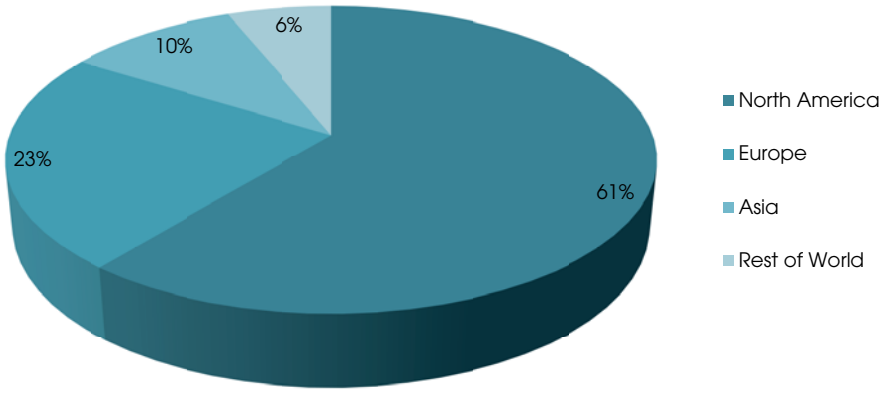
North America has long been the most established hedge fund market, with 61% of all managers in the hedge fund market based in the region. In Europe, UK managers account for over half of the 23% of all hedge fund managers based in the region.

Hedge fund managers tracked by Preqin manage a combined $2.2tn globally. The bulk of this capital comes from North America-based hedge fund managers, which manage an aggregate $1.6tn, or 72% of total industry capital. Of this, US-based managers are by far the largest contributor, managing $1.5tn of the region's assets under management. Of the $512bn managed by Europe-based funds, $402bn, or 79%, is invested with UK managers.

Prominent economies outside of the more established hedge fund markets of North America and Europe include Hong Kong, Australia, Brazil and Singapore. Fig. 3.65 shows that these four locations rank in the top 10 globally for funds under management. With 193 active managers, Hong Kong ranks as the country with the third highest number of hedge fund managers, while Australia, Brazil and Singapore are home to 81, 66 and 105 active fund managers respectively.

As the most established regions for hedge funds, North America and Europe offer the greatest spread in available strategies. Of all available hedge funds based in Asia and other countries outside of these three core regions, just 26% and 23% respectively lie outside of the two most favoured strategies, long/short and macro. Within North America and Europe however, 35% and 28% of funds offer investors these alternate strategies.

Fig. 3.64: Breakdown of Hedge Fund Managers Managing Funds in the Marketplace by Location of Headquarters



Source: Preqin Investor Network

Data Source:

Investors can access key contact details, performance data, and more on all hedge fund managers with a fund open for investment using **Preqin Investor Network**.

For more information, or to register for a demonstration, please visit:

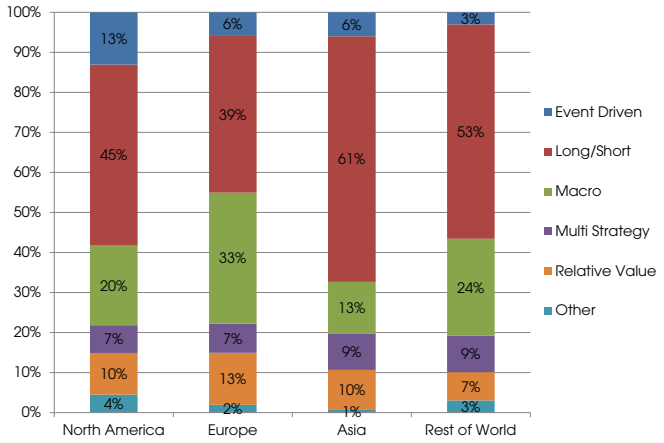
www.preqin.com/pin

Fig. 3.65: Top 10 Countries for Hedge Fund Managers Managing Funds in the Marketplace by AUM (Based on Headquarters)

Country	No. of Firms	AUM ($bn)
US	2,010	1,516
UK	414	402
Canada	74	89
Hong Kong	193	34
Sweden	39	33
Australia	81	29
France	51	25
Brazil	66	23
Switzerland	106	23
Singapore	105	17

Source: Preqin Investor Network

Fig. 3.66: Breakdown of Hedge Funds Managed in Each Region by Top Level Strategy

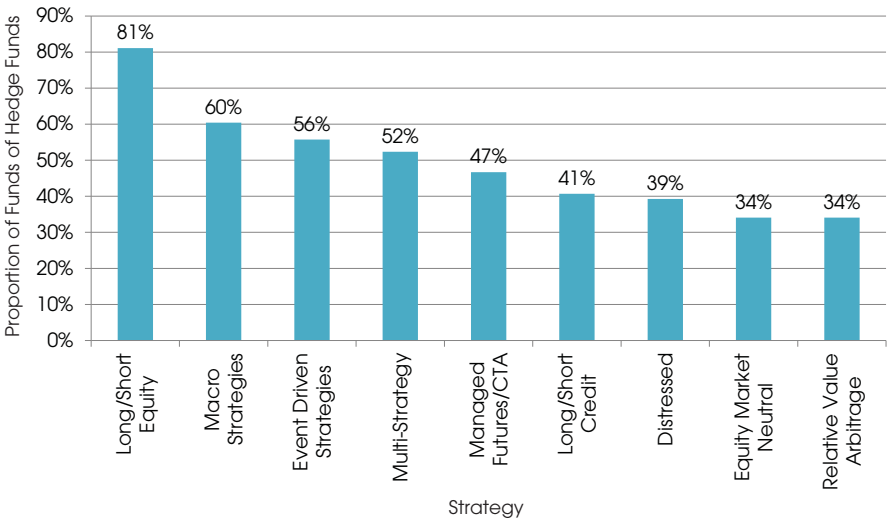


Source: Preqin Investor Network

Spreading the Risk: Funds of Hedge Funds

Despite the double layer of management fees, investors continue to invest in fund of hedge funds managers, as they can be a useful way to provide portfolio diversification and tap into experienced hedge fund manager selection skills. Funds of hedge funds can be used to provide access to a diverse range of hedge funds through a single investment with a lower level of risk and volatility when compared to direct investments in single-manager hedge funds. By looking at their investment preferences, past and current commitments and future investment plans, investors can gain insight into where industry experts see the best opportunities in today's hedge fund market.

Fig. 3.67: Strategies Utilized by Fund of Hedge Funds Managers



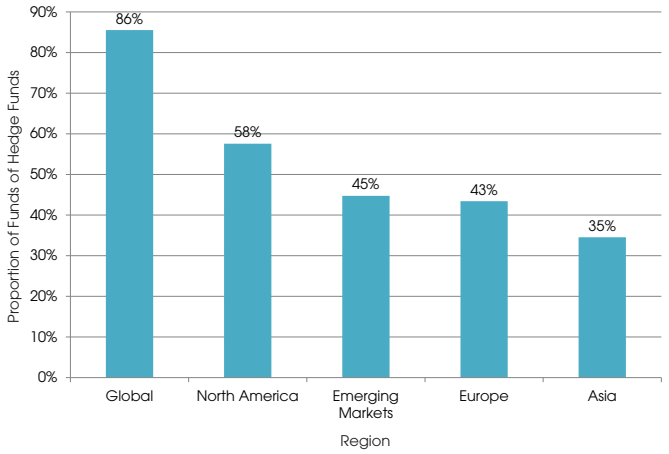
Source: Preqin Hedge Fund Investor Profiles

Strategies Utilized by Fund of Hedge Funds Managers

Fig. 3.67 shows the strategies most commonly utilized by fund of hedge funds managers. The top three hedge fund strategies currently used by fund of hedge funds managers are long/short equity (81% of managers invest in this strategy), macro (60%) and event driven (56%). Other commonly utilized strategies include managed futures/CTA, long/short credit, distressed, equity market neutral and relative value arbitrage. Funds of hedge funds also provide an opportunity to gain exposure to more niche hedge fund strategies, allowing investors to tap into markets where expertise in the underlying investments is difficult to attain. For instance, 8% of fund of hedge funds managers invest in mortgage-backed strategies, compared to 3% of all other investors.

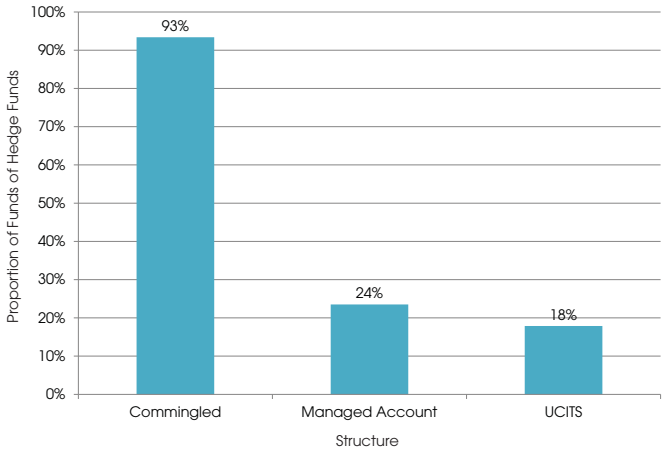
Investments in funds of hedge funds can also help investors to gain global exposure, as many funds of funds have offices globally. Fig. 3.68 shows that 86% of fund of hedge funds managers have a global investment mandate, providing investors not only with a diversified portfolio, but also often giving access to markets perhaps beyond their investment means if allocating directly. Forty-five percent of fund of hedge funds managers have a mandate for investments in emerging markets; some investors choose to gain exposure to emerging markets through funds of funds due to the higher level of risk associated with investing directly in these regions. Some managers may offer a fund of hedge funds focused on a particular region, allowing an investor to gain exposure to a diverse range of funds in a specific area of interest.

Fig. 3.68: Geographic Preferences of Fund of Hedge Funds Managers



Source: Preqin Investor Network

Fig. 3.69: Structural Preferences of Fund of Hedge Funds Managers



Source: Preqin Investor Network

The vast majority of fund of hedge funds managers invest through commingled hedge funds, with 93% including an allocation to this standard hedge fund structure (Fig. 3.69). Twenty-four percent of managers invest via separately managed accounts and investing with the larger fund of hedge funds managers can be an opportunity to gain exposure to separate account mandates. UCITS-compliant hedge funds are becoming more prominent in Europe and 18% of fund of hedge funds managers currently include an allocation to this regulated fund structure. Some managers offer funds of UCITS funds which invest entirely in UCITS-compliant alternative strategies. Investing in such funds allow investors to gain exposure to hedge fund strategies in a more liquid and transparent format.

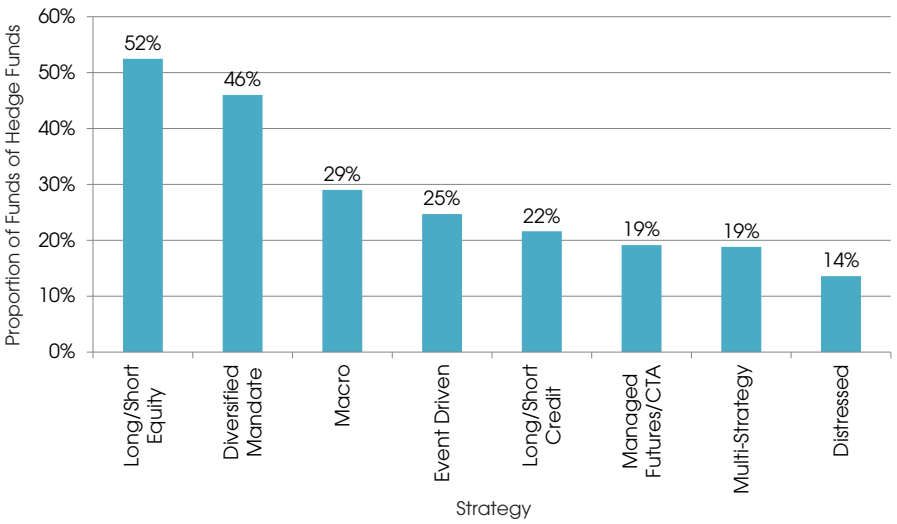
Looking Forward

So what specifically are fund of hedge funds managers looking to invest in over the coming year? This insight should prove useful both in determining investment opportunities within the fund of hedge funds universe itself, and also in identifying where value resides for investors looking to commit to single hedge fund managers.

Fig. 3.70 shows the strategies that fund of hedge funds managers are targeting over the coming 12 months. Similar to the strategies most commonly utilized by fund of hedge fund managers, long/short equity is the most commonly targeted strategy over the next year, and these funds have had an encouraging start to 2013 in terms of performance. Extended periods of low intra-stock correlations can benefit managers that utilize a fundamental long/short approach, leading to higher returns. Forty-six percent of fund of hedge funds managers have a diversified mandate for the coming 12 months, committing to various strategies on a case-by-case basis depending on the best available opportunities. Many fund of hedge funds managers regularly re-adjust their strategy allocations, highlighting the challenges investors face in staying nimble and aware of fast moving market changes to determine which hedge fund strategy they should target going forward.

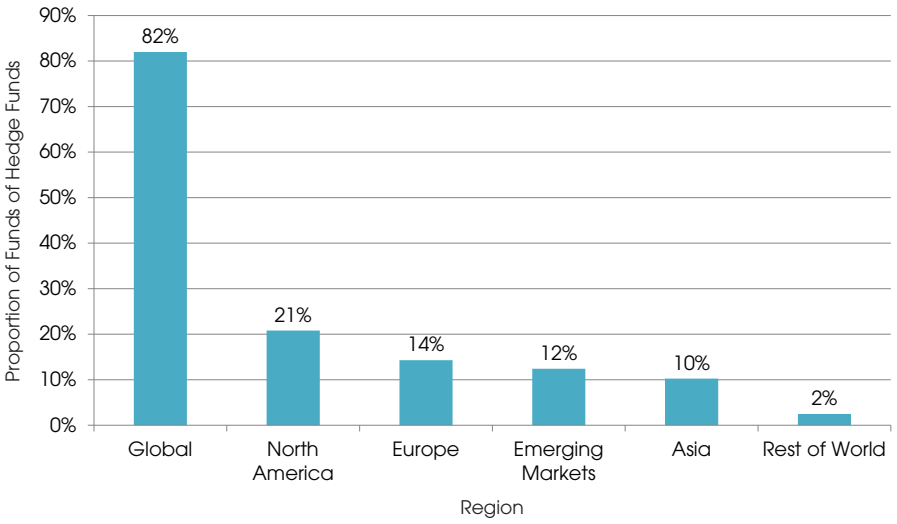
The majority of fund of hedge funds managers have a global outlook over the next 12 months, with 82% of managers targeting global investments (Fig. 3.71). This again indicates some of the challenges investors have to overcome to build a portfolio of single-manager hedge funds. For investors looking to add single-manager hedge funds over the coming year, vehicles with a global investment mandate may prove an important component of a hedge fund portfolio. In terms of specific regions, North America is the most common in future searches over the next year, with 21% of fund of hedge funds managers targeting investments in this region. Fourteen percent of managers are targeting investments in Europe, 12% are focusing on emerging markets and 10% are looking for Asia-based investments.

Fig. 3.70: Strategies Targeted by Fund of Hedge Funds Managers over the Next 12 Months



Source: Preqin Hedge Fund Investor Profiles

Fig. 3.71: Locations Targeted by Fund of Hedge Funds Managers over the Next 12 Months



Source: Preqin Hedge Fund Investor Profiles

Data Source:

Preqin tracks comprehensive, exclusive data on all fund of hedge funds managers active in the asset class, including performance, known investors, key contact details, and more.

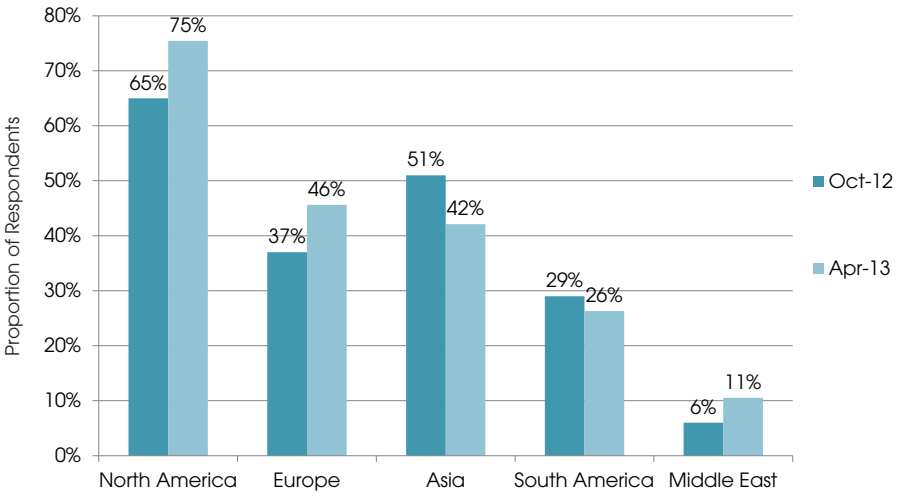
For more information on how Preqin's services can help you, please visit:

www.preqin.com/hedge

Latest Advice from Consultants: Areas of Opportunity for Investors in Alternatives

In April 2013, Preqin surveyed 115 alternatives investment consultants around the world in order to find out their attitudes towards alternative investments. For investors utilizing consultants or considering doing so, it is useful to gain an overview of what the consultant industry considers to be good opportunities for investors in the current market across the different asset classes. With investment consultants often playing a pivotal role in the selection of portfolio investments, such information is vital for investors seeking guidance on their alternative investments. The sample of consultants interviewed was selected from Preqin's alternatives investment consultant modules, the most comprehensive and accurate sources of information on investment consultants and the clients they advise on private equity, private real estate, infrastructure and hedge fund investments.

Fig. 3.72: Regions Viewed by Alternatives Investment Consultants as Presenting the Best Opportunities in Private Equity Over the Following 12 Months, 2012 - 2013



Source: Preqin Alternatives Investment Consultant Survey, April 2013

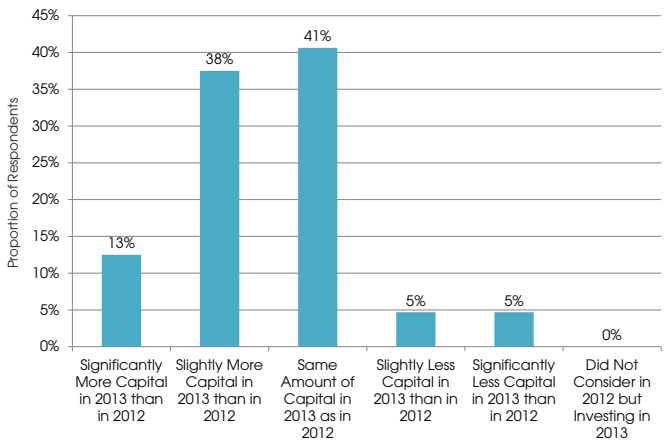
Private Equity

The majority (75%) of consultants view North America as the region presenting the best opportunities in private equity at present (as shown in Fig. 3.72), compared to 65% of consultants of the same opinion in Preqin's last investment consultant survey in October 2012. Compared to last year, when 37% of consultants viewed Europe as one of the regions presenting the best opportunities in private equity, this year almost half (46%) named the region. Asia is now viewed as one of the regions presenting the best opportunities in private equity by 42% of consultants, a drop from 51% in 2012's survey and a more significant drop from 65% in Preqin's investment consultant survey in 2011.

South America and the Middle East were selected by 26% and 11% of investment consultants respectively as presenting the best opportunities in private equity. This is a small decline in favour for South America (a three percentage point decrease since 2012), and a five percentage point increase since 2012 in the proportion of consultants naming the Middle East as a favourable region to invest in.

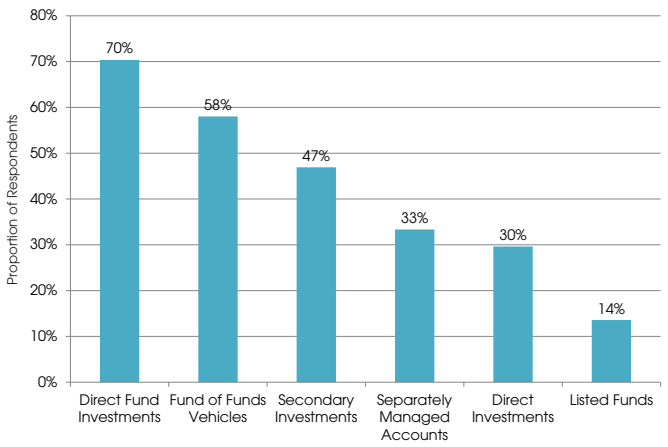
Fifty-one percent of investment consultants stated that they and their clients intend to commit slightly more or significantly more capital to private equity over the course of 2013 than in the previous year, with just 10% stating that they plan to commit slightly less or significantly less (Fig. 3.73.). Forty-one percent of consultants intend to commit an equal amount of capital to private equity as they did last year. This illustrates a slight positive change in attitudes towards the asset class, with a smaller proportion of consultants intent upon committing less to the asset class in comparison to 2012, when 48% of

Fig. 3.73: Amount of Capital Alternatives Investment Consultants/Clients Plan on Committing to Private Equity in 2013 Compared to 2012



Source: Preqin Alternatives Investment Consultant Survey, April 2013

Fig 3.74: Alternative Investment Consultants' Preferred Route to Market for Private Equity Investment



Source: Preqin Alternatives Investment Consultant Survey, April 2013

consultants planned to commit slightly or significantly more to private equity and 21% planned to commit slightly or significantly less.

In the private equity asset class, the most common route for consultants to invest is via direct fund investments, with 70% of consultants using this route to market. Fifty-eight percent invest via funds of funds and 47% via secondary investments. Direct investments in private equity are targeted by 30% of survey respondents, which is similar to those that prefer direct investments in real estate (33%) and infrastructure (30%).

Real Estate

Investor appetite for private real estate investments has increased in the last year, with more investors looking to make new commitments to the asset class and the majority looking to invest more than this time last year, according to Preqin Investor Outlook: Real Estate, H1 2013. Furthermore, many investors are now increasingly interested in strategies higher up the risk/return spectrum, with confidence in the real estate asset class growing.

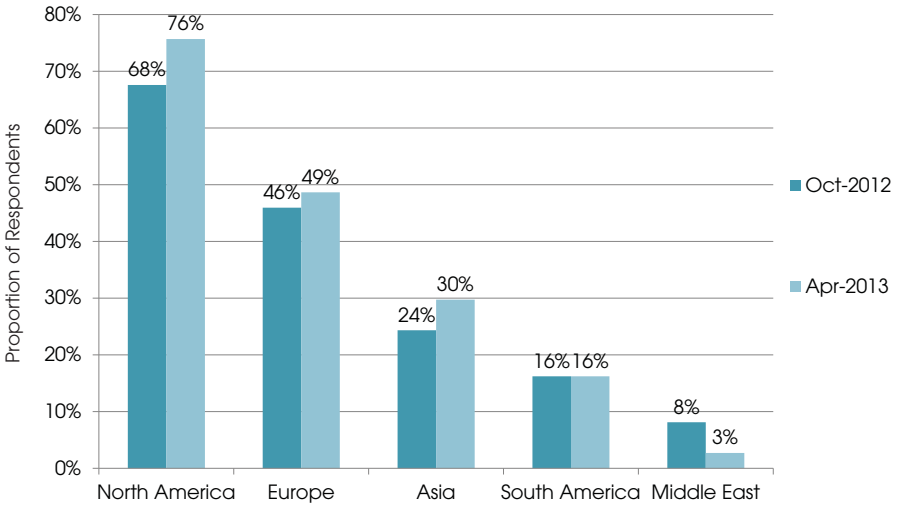
Private real estate investment consultants interviewed by Preqin regarded North America as presenting the best opportunities in the asset class, with more than three-quarters (76%) naming the region. Europe was regarded as an attractive area for real estate investment by almost half (49%) of consultants, with Asia cited by 30% of investment consultants.

Each of these regions is regarded by a greater proportion of consultants as presenting the best opportunities in the asset class compared to 2012. North America has seen an increase of eight percentage points, with Europe and Asia witnessing increases of three and six percentage points respectively compared to 2012. This shows a generally more positive outlook towards the asset class from consultants. However, the proportion of consultants favouring Asia for alternative investments is still far below the level seen in 2011, when 51% of consultants viewed it as presenting the best opportunities.

Forty-five percent of private real estate consultants intend to commit the same amount of capital to private real estate in 2013 as in 2012. Forty-five percent are looking to increase their capital commitments to real estate either significantly or slightly, with a further 2% investing in the asset class in 2013 after not doing so in 2012. Only 8% are looking to commit slightly less and no consultants are looking to commit significantly less. This is another positive indicator for the real estate asset class and those considering becoming active investors in this space.

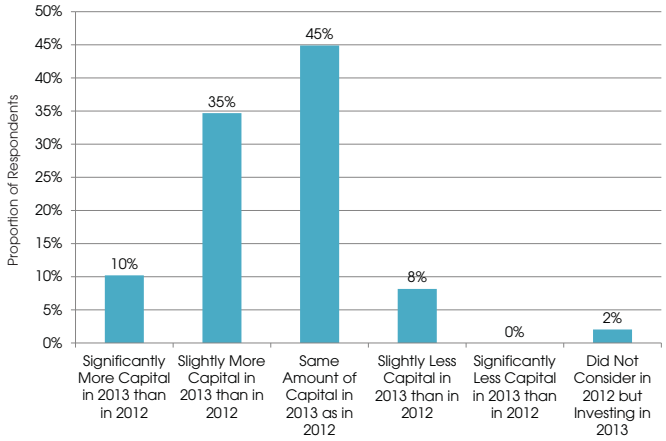
Direct fund investments are the most favoured method for investment into the real estate asset class (81%), with funds of funds the second most commonly utilized strategy (37%), although this is significantly less than for private equity (58%). For the remaining three investment structures, the same proportion of survey respondents utilize direct investments and separately managed accounts (33%), while just a

Fig. 3.75: Regions Viewed by Alternatives Investment Consultants as Presenting the Best Opportunities in Private Real Estate Over the Following 12 Months, 2012 - 2013



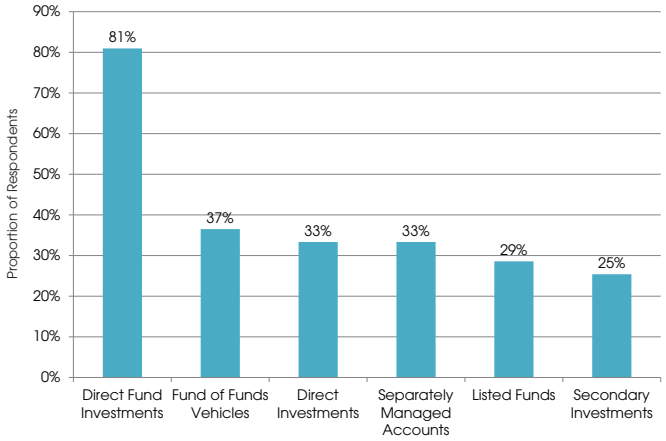
Source: Preqin Alternatives Investment Consultant Survey, April 2013

Fig. 3.76: Amount of Capital Alternatives Investment Consultants/Clients Plan on Committing to Private Real Estate in 2013 Compared to 2012



Source: Preqin Alternatives Investment Consultant Survey, April 2013

Fig. 3.77: Alternatives Investment Consultants' Preferred Route to Market for Private Real Estate Investment



Source: Preqin Alternatives Investment Consultant Survey, April 2013

quarter of respondents target investment opportunities on the relatively small real estate secondary market.

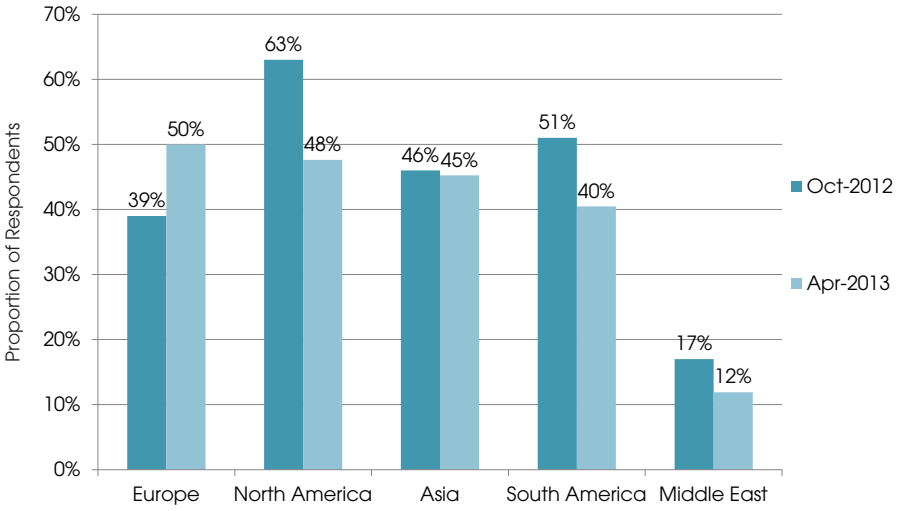
Infrastructure

With government budgets squeezed and liquidity requirements having increased at banks, institutional and private investors are increasingly important alternative sources of capital to the growth of the infrastructure asset class. A number of such investors utilize the services of an investment consultant in their search for viable opportunities in the asset class; therefore, an analysis of consultants' views on infrastructure can provide a valuable insight for investors.

Europe is viewed by half of the investment consultants surveyed as presenting the best opportunities in infrastructure at present, closely followed by North America (48%). Emerging markets are also viewed favourably, with 45% of investment consultants viewing Asia and 40% regarding South America as presenting the best opportunities in infrastructure. The Middle East was viewed favourably for infrastructure opportunities by 12% of investment consultants.

In comparison to 2012, the proportion of investment consultants stating that North America and South America present the best infrastructure investment opportunities has decreased, by fifteen and eleven percentage points respectively. The proportion of consultants naming Europe has increased by eleven percentage points, while the proportion of consultants favouring infrastructure investments in Asia and the Middle East has remained relatively constant since 2012, with a one percentage point and a five percentage point decrease respectively.

Fig. 3.78: Regions Viewed by Alternatives Investment Consultants as Presenting the Best Opportunities in Infrastructure Over the Following 12 Months, 2012 - 2013



Source: Preqin Alternatives Investment Consultant Survey, April 2013

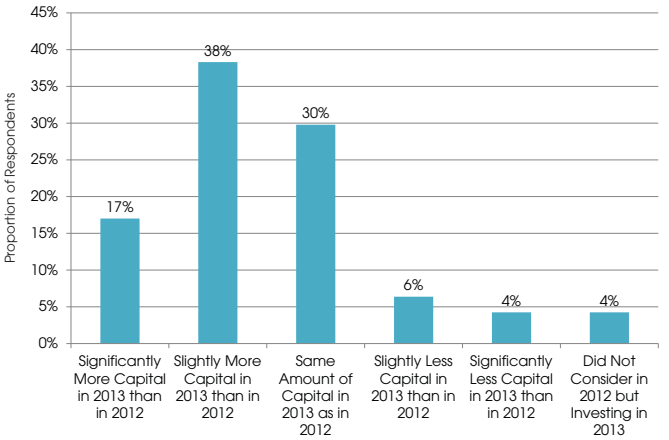
In terms of commitments in 2013 compared to 2012, the majority of consultants are looking to maintain their infrastructure allocation or to increase it. Thirty-eight percent intend to increase their commitments slightly, 17% look to increase them significantly and 30% plan to commit the same amount of capital over the next 12 months. Only 10% of infrastructure consultants intend to decrease their commitments to the infrastructure asset class over the course of 2013, eight percentage points less than the proportion looking to decrease their commitments when surveyed in 2012.

Concerning the route taken to market, infrastructure investment consultants have similar views to real estate consultants, as shown in Fig. 3.80. Direct fund investments are the most commonly targeted investment type, with 78% of survey respondents recommending them to clients. Fund of funds vehicles are the next most favoured strategy (35%), although they are recommended by a significantly lower proportion of consultants when compared with private equity.

Hedge Funds

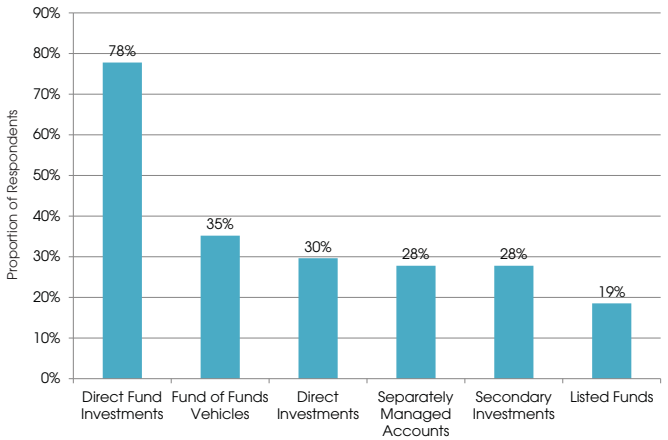
Despite 2012 having been disappointing for some hedge fund investors with regard to returns, a large proportion still view the asset class positively. Fund managers have some concerns about

Fig. 3.79: Amount of Capital Alternatives Investment Consultants/ Clients Plan on Committing to Infrastructure in 2013 Compared to 2012



Source: Preqin Alternatives Investment Consultant Survey, April 2013

Fig. 3.80: Alternatives Investment Consultants' Preferred Route to Market for Infrastructure Investment



Source: Preqin Alternatives Investment Consultant Survey, April 2013

the impact of changing regulation in 2013, including the European AIFMD (Alternative Investment Fund Managers Directive) due in July, with supervision, registration and compliance likely to increase. However, for many investors this regulation is viewed as a positive step to improve investor protection for an increasingly institutionalized industry.

The regions viewed by alternatives investment consultants as providing the greatest opportunities in hedge funds have shown some notable changes since 2012. The region viewed by the largest proportion of consultants as presenting the best opportunities is North America, with 83% of consultants citing this region; this is a significant increase from the 68% of consultants which stated this in 2012. In contrast, Europe is now viewed by 39% of consultants as the region presenting the best opportunities for hedge fund investment, while this figure stood at a much higher 68% in 2012. Asia is regarded as presenting the best opportunities in the hedge fund space by 41% of consultants, a small decrease from last year's proportion of 45%.

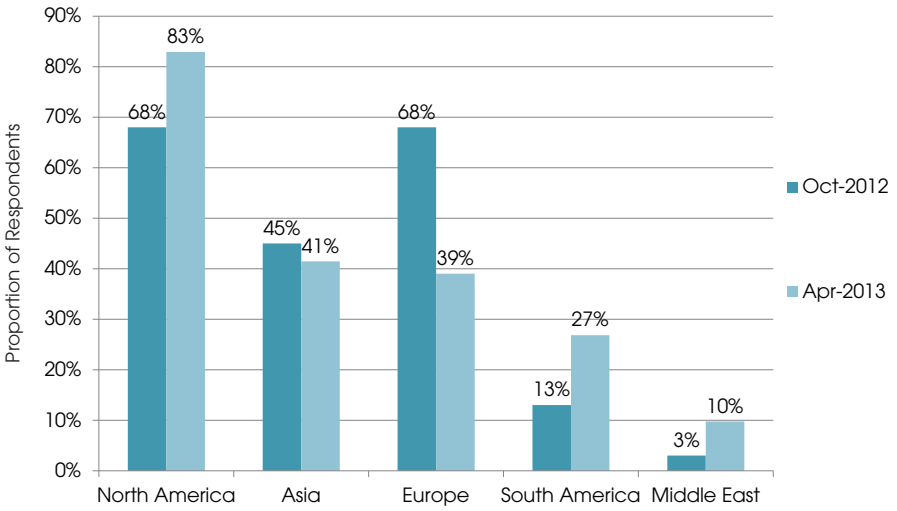
Although South America and the Middle East are regarded by smaller proportions of consultants as presenting the best opportunities in hedge funds, investor appetite for these regions has increased over the past year. At present, 27% of consultants view South America as presenting strong investment opportunities, which is more than double the proportion in 2012. In 2012, only 3% of consultants selected the Middle East as one of the regions presenting the best opportunities in hedge funds; this has risen to 10% in 2013.

The majority of consultants are recommending investing more capital in hedge funds in 2013 compared to 2012, with 38% expressing that they plan to commit slightly more capital to the hedge fund space and 17% significantly more. This is a notably higher proportion than in 2012, when 28% planned to commit slightly more and 10% significantly more.

Only 10% of consultants plan to invest less capital in the hedge fund space on behalf of their clients in 2013 than in 2012, which is significantly lower than the 34% of consultants which stated that they would invest less capital in 2012 than they did in 2012. This indicates that consultants are feeling positive about hedge funds, and the position they may have in their clients' portfolios in the future.

As shown in Fig. 3.83, direct fund investments are the most commonly recommended investment type (74%), with fund of funds vehicles also being recommended by a relatively high number of survey respondents (58%). Alternatives to the traditional offshore commingled model are also recommended by consultants, such as separately managed accounts (33%), listed funds (23%) and UCITS vehicles (22%).

Fig. 3.81: Regions Viewed by Alternatives Investment Consultants as Presenting the Best Opportunities in Hedge Funds Over the Following 12 Months, 2012 - 2013



Source: Preqin Alternatives Investment Consultant Survey, April 2013

Data Source:

Preqin tracks detailed information on over 370 active alternatives investment consultants, including key contact details, known clients, assets under advisement, and more.

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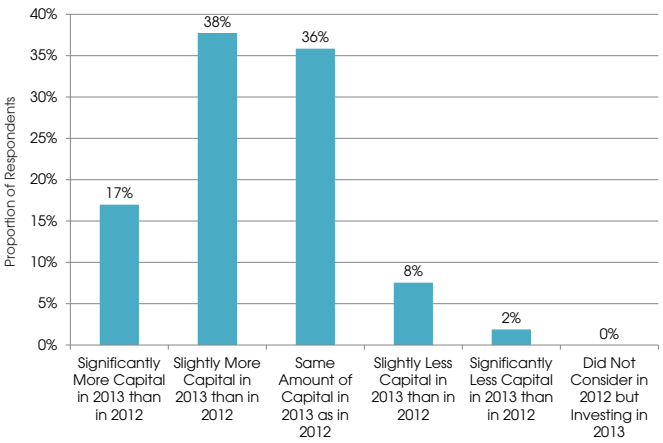
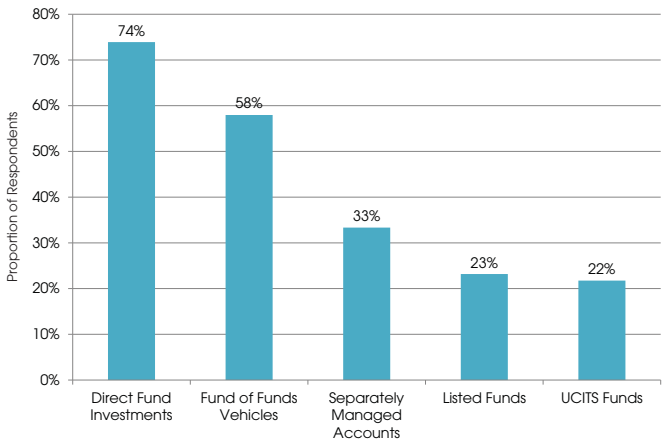
Fig. 3.82: Amount of Capital Alternatives Investment Consultants/Clients Plan on Committing to Hedge Funds in 2013 Compared to 2012



Source: Preqin Alternatives Investment Consultant Survey, April 2013

Fig. 3.83: Alternatives Investment Consultants' Preferred Route to Market for Hedge Fund Investment



Source: Preqin Alternatives Investment Consultant Survey, April 2013

Due Diligence

What Should Investors Consider When Conducting Due Diligence?

Selecting a group of funds that match an investment portfolio's risk/return profile is a big undertaking for investors; deciding which funds to actually commit capital to is an even bigger task. However, conducting due diligence to ensure a portfolio has the best funds within a given group of options can be considerably more challenging and can have a significant impact on returns.

Investors need to be sure that the manager they are preparing to allocate to has not only the right strategy, but also a performance track record the investor is comfortable with. Furthermore, and indeed directly tied to the track record a manager is able to demonstrate, investors need to know they are getting competitive fund terms and conditions – paying management and performance fees that are fair, that the manager can justify, and that will align interests so that investors are duly rewarded and managers duly incentivized.

How Can This Report Help With Due Diligence?

This Due Diligence section covers these vital areas investors have to consider when constructing their portfolios. Key questions asked and answered include:

- Who are the most **consistent** performing private equity, real estate and infrastructure fund managers?
- Which are the **best** performing hedge funds in the marketplace?
- What are the industry-standard benchmarks for **management** and **performance fees** per asset class?
- What **lock-in periods** and levels of **liquidity** are commonplace when investing in different hedge fund strategies?
- Where do investors see room for **improvement** with fund terms and what **changes** are investors pushing for?

The **2013 Preqin Investor Network Global Alternatives Report** covers all this and more with detailed breakdowns of consistent performing managers, best performing funds and fund terms and conditions market benchmarks.

How Can Preqin Investor Network Help With Due Diligence?

Preqin Investor Network takes this further, with regularly updated performance and fund terms data. Access fund terms benchmarks for private equity, real estate and infrastructure funds, including management fees, performance fees, manager commitment levels, fund formation costs, and the fee rebates to investors, and see the impact these terms have on an investor's potential returns. Benchmark hedge fund management and performance fees and lock-up periods per strategy, geography and fund size are also accessible. Access our Performance Analyst and Hedge Fund Analyst online services to see live league tables for the best performing managers and funds.

Continue reading for Preqin analysis and insights from industry experts on due diligence and investor considerations, and contact us at pin.info@preqin.com to find out more about how Preqin can assist investors with their due diligence needs.

Key Industry Voices Discuss Due Diligence:

- **Dörte Höppner**, Secretary-General, EVCA
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- **Stephen Cravens**, Head of Fund Analytics, Cogent Partners
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- **Jonathan Blake**, Head of International Funds Department, SJ Berwin
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The Need for Greater Communication and Transparency

- Dörte Höppner, Secretary-General, EVCA

The attitude towards transparency in European private equity has certainly evolved over the last 10 years, moving towards more frequent and open communication about the industry and its actions. This was driven by a number of factors, all of which contributed to the realization that no institution, no industry, no company can allow itself not to communicate.

The locust debate that hit German private equity in 2005 was a turning point for the European industry. Until then, most private equity firms had underestimated the importance of a regular communication with all their stakeholders – including the broader public. However, private equity was rightly proud of being extremely transparent towards one important audience, namely their investors.

Twenty years ago, the EVCA developed its Professional Standards. Those guidelines made an effective contribution to self-regulation, setting out how general partners should report to their limited partners. Every GP that aimed to be successful in fundraising needed to demonstrate to LPs that they adhered to this industry gold-standard. But because the industry had not explained itself properly to a wider audience, the locust image stuck. When the financial crisis triggered a raft of new regulation, the industry felt the consequences of poor communication; private equity found itself caught in a regulatory process that was mainly targeted at short-term investors, such as hedge funds.

By then, the industry had already taken action to address the damaging misconceptions about its practices and business model by increasing its communication efforts. But it takes a long time to adjust the public image of an industry, particularly during a financial crisis. It is not sufficient to simply act as a responsible investor. It is of equal importance to communicate as a responsible investor. Investors have welcomed this move towards enhanced communication. They are operating under the public eye. They need to report to their boards of trustees. Investors are expected to communicate and justify their decisions to their stakeholders like never before.

Good communication and transparency between GPs and LPs is the bedrock of the private equity business model. GPs regularly report to their investors and trust between the parties is vital, but can only be earned with honesty and plain-speaking. The EVCA Handbook of Professional Standards contains clear and concise rules of reporting, guidelines for valuation and for risk management as well as the EVCA Code of Conduct. This code is mandatory for all EVCA members and ensures that the industry adheres to the highest ethical standards by conducting their business. It is the first time that both GPs and LPs have agreed to the same set of values for the whole industry, replacing the separate codes of conduct that existed beforehand. Institutional investors need to be able to justify their investment choices on an ethical as well as financial basis. Many have ESG policies in place, which can only be fulfilled if there is clear GP communication about its portfolio and investment strategy.

Over the past two years, the EVCA has pursued a strategy of proactive communication work designed to explain to a broader audience, in an accessible fashion, what private equity is and how it works. We, the industry, must undertake to explain who we are; we cannot expect anyone else to do it for us. Making sure the industry is correctly understood will help us to make sure that the regulation of the industry is neither inappropriate nor disproportionate. Private equity has a very sophisticated group of clients and the model is ideally suited to long-term institutional investors such as pension funds and insurance funds, helping them to meet their future liabilities.

Our key message is that private equity investment has a positive effect on the local and European economies, while delivering excellent returns for these long-term investors. It is only through continued commitment to outreach that politicians – and the public that elects them – will come to understand the many positive outcomes that are caused through the partnership of private equity manager and investor.

The AIFM Directive (AIFMD), which comes into force in July 2013, marks private equity out as a mature, regulated and established asset class, with a widely recognized corporate governance model that ensures the interests of investors, fund manager and companies are aligned. This quality label will also be helpful for our communication efforts. Policymakers learnt a great deal about private equity during the legislative process and they often listened to our concerns.

We are optimistic and confident that our policy work in investor regulation, such as Solvency II, will also have positive results. We continue to be strident in our opposition to capital adequacy regulation that could discourage investors from choosing long-term investments like private equity. By working in partnership with our LP members and having open dialogue with lawmakers, we can get real results. Good communication is the key to a stable future for our industry.

European Private Equity & Venture Capital Association

The EVCA is the voice of European private equity. Our membership covers the full range of private equity activity, from early-stage venture capital to the largest private equity firms, investors such as pension funds, insurance companies, fund of funds and family offices and associate members from related professions. We represent 650 member firms and 500 associate members.

www.evca.eu

Services Available to Investors from Alternatives Investment Consultants

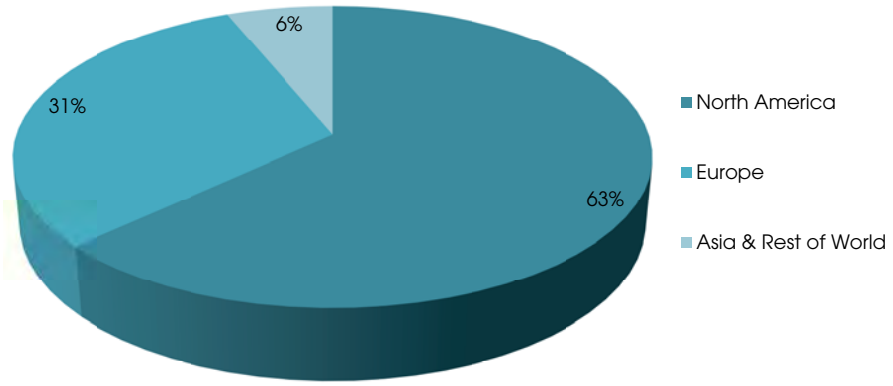
Preqin tracks detailed information on 371 active alternatives investment consultants, helping investors to see what services are available from consultants and how they can help during the asset allocation process.

The majority (63%) of these consultants are headquartered in North America, and 98% of these North America-based consultants are located in the US. Europe is home to 31% of investment consultants, with the UK, Switzerland and Germany representing the most prominent locations in the region. Significantly fewer investment consultants are based outside of North America and Europe, with only 6% of consultants based in these regions. A number of larger, more established alternatives investment consultants operate in Asia and other regions outside North America and Europe through smaller outfits, which they use to gain local knowledge and form relationships, but are headquartered in North America or Europe.

Investment consultants are able to serve clients on a discretionary or non-discretionary basis, or provide both discretionary and non-discretionary services. Providing both types of services has been the trend among investment consultants in recent years, with firms adopting the ability to offer clients either service based on their needs in order to meet investors' varying requirements. Fifty-nine percent of alternatives investment consultants tracked by Preqin provide clients with both discretionary and non-discretionary services, 32% provide non-discretionary only services and 9% provide discretionary only services.

Most alternatives investment consultants provide clients with services in a variety of alternative investments, as shown in Fig. 4.3. More than a third of investment consultants (34%) have services which cover private equity, hedge funds, real estate and infrastructure simultaneously. Only 16% focus upon a single asset class and, within this, 7% focus solely on hedge funds and 6% cover only private equity, and do not provide consulting services on any other asset types.

Fig. 4.1: Breakdown of Alternatives Investment Consultants by Location of Headquarters



Source: Preqin

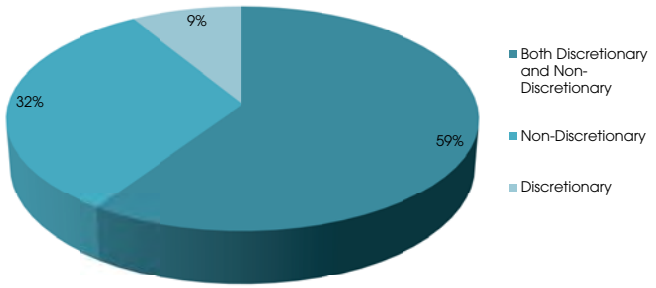
Data Source:

Use Preqin's online services to track recent investment consultant news and filter in-depth data on investment consultants by services provided, total assets under advisement, known clients, and more.

For more information, please visit:

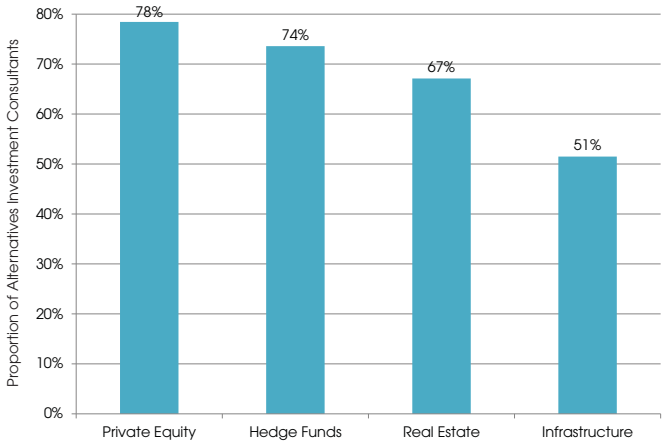
www.preqin.com

Fig. 4.2: Breakdown of Alternatives Investment Consultants by Nature of Service Provided



Source: Preqin

Fig. 4.3: Proportion of Alternatives Investment Consultants Offering Services by Asset Class



Source: Preqin

Due Diligence: What Do Investors Need to Know When Assessing Potential Private Equity Investment Opportunities?

- Stephen Cravens, Head of Fund Analytics, Cogent Partners

Investors are taking a fresh approach to underwriting private equity commitments to both new and legacy relationships. Driven by the collective learning in the aftermath of the financial crisis, as well as the natural progression away from funds of funds and discretionary mandates, more LPs are deciding to do the work themselves.

Investors are taking on this directive in order to avoid mistakes and achieve higher returns with the belief that only top managers can materially outperform a more liquid investment program over time.

Discerning LPs set out to gain confidence in a manager's investment process, understand its team dynamics and business practices, verify its operational procedures, and check references. Focusing on these issues is especially critical since you are locking up your money for many years. One must do the homework to cross-examine the selling points represented in the marketing materials and understand what differentiates managers from their peer group.

While past performance is an indicator of quality, understanding how managers achieved their results is more relevant to answering the main question: is it likely that they will repeat past success? And further, will the investor's take be meaningful enough to justify bearing the intrinsic risks?

Potential investors need to understand the track record in detail, not just the headline IRR numbers. What types of companies have been bought and sold, and at what multiples? Which investments have not been realized and why? What happened to the underlying companies' fundamentals (revenue, EBITDA, and net debt)? Is performance built on a home run that might be luck, or rather a consistent track of meaningful realizations? Was there a process for generating the ideas that led to their investments or was it more reactionary? Be bold in asking what the market inefficiencies are that produced prior success and further, to be convinced that those inefficiencies will remain.

LPs must also understand whether the manager generated returns by actively improving the companies or through fortuitous timing. If a previous fund's returns were dominated by a single sector or geography, potential investors need to be able to identify that in short order. LPs are wise to ground in truth a manager's claim of proprietary deal flow. The longer (and more realized) the track record, the more predictive value there is in historical results. With so many funds in the market vying for your attention, it's crucial to identify these key points of differentiation early on in the process.

Once you have assimilated the information in the data room and conducted a first meeting, it's perfectly reasonable to ask for additional materials. Ask for investment memos. Ask which firms they believe to be their closest competitors. Ask how many of their existing LPs they expect to re-up. Are there any side-letters that put other investors on more attractive footing? LPs should include in the course of due diligence interviews with portfolio company executives, intermediaries of past transactions, as well as current or former LPs (ideally those on the advisory board).

While this is often difficult to verify, the general partners' capital commitment should represent a meaningful portion of their personal net worth. Team cohesion is also hugely important, and you should ask yourself if this is a team that you can see staying intact for a decade or more. Due diligence should uncover whether there has been any irregular turnover or whether the partners responsible for past success are still with the firm. Is succession being managed with steps in place to transfer ownership of the firm from senior partners to the next generation? Seeing carry pushed down far into the organization gives comfort that the broader team is properly incentivized. If the new fund is much larger, is it reasonable to think that this team can be successful either hiring rapidly or competing for significantly larger transactions?

Thanks in large part to initiatives pushed by the ILPA, terms are moving in the investor's direction, characterized by better alignment of interests. The balance between management and performance fees should provide ample motivation to generate strong returns. Preferred hurdles and back-end weighted carry protect economics for limited partners, and a strong key man clause provides a layer of protection against an unstable organization.

The difference in performance between top and average players is enormous in private equity and therefore manager selection is crucial. Building an efficient system to work through and decode the provided materials will allow for important synthesis to take place, resulting in productive in-person meetings and stronger GP relationships. These relationships are key because top managers are generally less accessible, requiring more effort on the part of new relationships.

The legal structure and lock-up timeline of private equity partnerships provide limited partners very little control over the outcome (apart from a secondary transaction). Rigorous due diligence is the primary line of defense and will best position your portfolio to outperform.

Finding the Winners: Consistent Performing Fund Managers

Consistent performance across multiple funds in a series is a very important trait sought by long-term investors in private equity funds from the fund managers they have relationships with. Analysis of a fund manager's track record is a key component of any investor's due diligence process, and while previous successful performance does not guarantee similar performance in the future, Preqin's analysis has shown that managers with top-quartile performing funds are more likely to produce returns that beat the median benchmark with the next fund in their series (see page 21).

This section analyzes the most consistent performing private equity fund managers for buyout funds, venture capital funds, real estate funds and funds of funds, and also examines the various other private equity strategies such as distressed private equity, and natural resources. It does not seek in any way to endorse the fund managers listed, but rather to illustrate those that have performed the most consistently in the past.

Listed in the following tables are the private equity fund managers on which Preqin holds fund performance data and has assigned quartile rankings. Preqin only assigns quartile rankings to funds with more mature performance data, so funds of more recent vintages (2011-2013) will not have been assigned quartile rankings. Furthermore, the lists are restricted to active fund managers that have raised at least three funds of a similar strategy that Preqin has performance data on, and have either raised a fund in the past six years or are currently raising a fund of a similar strategy.

Top quartile funds are given a score of one, second quartile funds are given a score of two, and so on. An average quartile ranking is then calculated. All the managers listed in the following tables have achieved a score of 1.50 or better. Investors using Preqin's Performance Analyst online service can access more complete lists, with filtering by fund strategy and geographic focus, a vital tool during the due diligence process. Performance Analyst is the industry's most extensive source of net-to-LP private equity fund performance, with full metrics for over 6,200 named vehicles.

Among buyout fund managers (Fig. 4.4), the best average score is 1.25, achieved by FIMI, an Israel-based manager, and Waterland, based in Netherlands. There are 15 managers listed in this table; eight are headquartered in the US and four are from Europe – Waterland, Altor, Harwood Private Equity and Inflexion. The table also includes Argentina-based Southern Cross Group, which scores 1.33, and Australia-based Pacific Equity Partners, with a score of 1.40. The buyout firms listed in the table come from a sample universe of 162 firms and 753 buyout funds fulfilling the selection criteria described previously.

In the venture capital fund manager list, there are three firms which achieve the best possible score of 1.00: Benchmark Capital, Pittsford Venture Management and Sequoia Capital, all of which are headquartered in the US (Fig. 4.5). The majority of the fund managers listed in this table are based in the US, while those located elsewhere include Israel-based Jerusalem Venture Partners and South Korea-based AJU IB Investment, which have achieved scores of 1.25 and 1.40 respectively. There are 15 venture

Fig. 4.4: Consistent Performing Buyout Fund Managers

Firm	Location	Overall Number of Funds with Quartile Ranking	Number of Funds in Top Quartile	Number of Funds in Second Quartile	Average Quartile Rank
FIMI	Israel	4	3	1	1.25
Waterland	Netherlands	4	3	1	1.25
Altor	Sweden	3	2	1	1.33
American Securities	US	3	2	1	1.33
Harwood Private Equity	UK	3	2	1	1.33
Industrial Growth Partners	US	3	2	1	1.33
Inflexion	UK	3	2	1	1.33
Metalmark Capital	US	3	2	1	1.33
Southern Cross Group	Argentina	3	2	1	1.33
Veritas Capital	US	3	2	1	1.33
Vista Equity Partners	US	3	2	1	1.33
Leonard Green & Partners	US	5	3	2	1.40
Pacific Equity Partners	Australia	5	4	0	1.40
Berkshire Partners	US	7	5	1	1.43
Olympus Partners	US	4	3	0	1.50

Based on a universe of 162 firms and 753 funds fulfilling the selection criteria

Source: Preqin Performance Analyst

firms listed in the table, from a sample universe of 141 firms and 703 venture funds that match the selection criteria.

Within the fund of funds universe, two GPs yield the best average score of 1.00, and they are both headquartered in Denmark – ATP Private Equity Partners and North Sea Capital (Fig. 4.6). The remaining firms listed in the table are Hong Kong-based Asia Alternatives Management, with a score of 1.33, and three US-based firms, two of which achieve a score of 1.33 and one a score of 1.40.

In the real estate table (Fig. 4.7) there are 13 real estate firms listed from a sample universe of 116 firms and 649 funds fulfilling the selection criteria. In the list there are five firms which achieve the best possible score of 1.00; three are US-based: Bell Partners, Carmel Partners and JBG Companies, and the remaining two are Brazil-based Prosperitas Investimentos and Sweden-based Sveafastigheter.

Finally, looking at the table which is made up of all the other private equity investment strategies (Fig. 4.8), there are three firms which achieve the best possible score of 1.00, all of which are headquartered in the US, but focus on different private equity investment strategies. Ampersand Capital Partners manages growth funds, EnCap Investments manages funds with a focus on natural resources and Industry Ventures manages direct secondaries funds.

Data Source:

Use Preqin's online services to identify consistently top performing private equity, real estate and infrastructure fund managers, and split by fund geographic focus and strategy.

www.preqin.com/privateequity

Fig. 4.5: Consistent Performing Venture Capital Fund Managers

Firm	Location	Overall Number of Funds with Quartile Ranking	Number of Funds in Top Quartile	Number of Funds in Second Quartile	Average Quartile Rank
Benchmark Capital	US	3	3	0	1.00
Pittsford Ventures Management	US	6	6	0	1.00
Sequoia Capital	US	4	4	0	1.00
Bain Capital Europe	US	4	3	1	1.25
Jerusalem Venture Partners	Israel	4	3	1	1.25
BlueRun Ventures	US	3	2	1	1.33
Matrix Partners	US	6	4	2	1.33
Merlin Nexus	US	3	2	1	1.33
RRE Ventures	US	3	2	1	1.33
Storm Ventures	US	3	2	1	1.33
Battery Ventures	US	8	5	3	1.38
AJU IB Investment	South Korea	5	3	2	1.40
Insight Venture Partners	US	5	3	2	1.40
Summit Partners	US	9	5	4	1.44
Avalon Ventures	US	8	5	2	1.50

Based on a universe of 141 firms and 703 funds fulfilling the selection criteria

Source: Preqin Performance Analyst

Fig. 4.6: Consistent Performing Private Equity Fund of Funds Managers

Firm	Location	Overall Number of Funds with Quartile Ranking	Number of Funds in Top Quartile	Number of Funds in Second Quartile	Average Quartile Rank
ATP Private Equity Partners	Denmark	3	3	0	1.00
North Sea Capital	Denmark	3	3	0	1.00
Asia Alternatives Management	Hong Kong	3	2	1	1.33
Franklin Park	US	3	2	1	1.33
Siguler Guff	US	6	4	2	1.33
Morgan Stanley Alternative Investment Partners	US	5	3	2	1.40

Based on a universe of 73 firms and 622 funds fulfilling the selection criteria

Source: Preqin Performance Analyst

Fig. 4.7: Consistent Performing Real Estate Fund Managers

Firm	Location	Overall Number of Funds with Quartile Ranking	Number of Funds in Top Quartile	Number of Funds in Second Quartile	Average Quartile Rank
Bell Partners	US	3	3	0	1.00
Carmel Partners	US	3	3	0	1.00
JBG Companies	US	5	5	0	1.00
Prosperitas Investimentos	Brazil	3	3	0	1.00
Sveafastigheter	Sweden	3	3	0	1.00
Brookfield Asset Management	Canada	8	6	2	1.25
Calare Properties	US	3	2	1	1.33
Embarcadero Capital Partners	US	3	2	1	1.33
HDFC Property Ventures	India	3	2	1	1.33
John Buck Company	US	3	2	1	1.33
Pacific Star Financial	Singapore	3	2	1	1.33
Harbert Management Corporation	US	8	5	2	1.50
RockBridge Capital	US	4	2	2	1.50

Based on a universe of 116 firms and 649 funds fulfilling the selection criteria

Source: Preqin Real Estate Online

Fig. 4.8: Consistent Performing Managers of Other Fund Types

Firm	Location	Type	Overall Number of Funds with Quartile Ranking	Number of Funds in Top Quartile	Number of Funds in Second Quartile	Average Quartile Rank
Ampersand Capital Partners	US	Growth	4	4	0	1.00
EnCap Investments	US	Natural Resources	6	6	0	1.00
Industry Ventures	US	Direct Secondaries	3	3	0	1.00
CapX Partners	US	Mezzanine	3	2	1	1.33
Catalyst Capital Group	Canada	Distressed Private Equity	3	2	1	1.33
Catalyst Investors	US	Growth	3	2	1	1.33
Enfoca Inversiones	Peru	Growth	3	2	1	1.33
Excelsior Capital Asia	Hong Kong	Growth	3	2	1	1.33
Falcon Investment Advisors	US	Mezzanine	3	2	1	1.33
Energy Spectrum Capital	US	Infrastructure	5	3	2	1.40
Resource Capital Funds	US	Natural Resources	5	4	0	1.40
Merit Energy Partners	US	Natural Resources	7	5	1	1.43
SCF Partners	US	Natural Resources	7	5	1	1.43
Intermediate Capital Group	UK	Mezzanine	6	4	1	1.50
Sun Capital Partners	US	Distressed Private Equity	4	2	2	1.50

Based on a universe of 142 firms and 692 funds fulfilling the selection criteria

Source: Preqin Performance Analyst

Finding the Winners: Top Performing Hedge Funds

Fig. 4.9: Net Returns of Top Performing Hedge Funds in the Last 12 Months*

Fund	Manager	Core Strategy	Net Return in the Last 12 Months (%)
Trophy Fund	Winnington Capital	Long Bias	110.24
Northwest Warrant Fund - USD	Northwest Investment Management	Long Bias	81.85
ISP Helium Special Situations Fund - GBP	Investment Solutions Partners	Event Driven, Special Situations	53.91
AccessTurkey Fund	AccessTurkey	Long/Short Equity	50.50
Horizon Growth Fund N.V.	Horizon Capital Management	Long Bias	49.22
Hildene Opportunities Fund, LP	Hildene Capital Management	Distressed	48.97
Ginga Golden Egg Fund	Stats Investment Management	Long Bias	40.63
Blackhorse Emerging Enterprises Fund	Blackhorse Asset Management	Long Bias	39.83
Gator Financial Partners	Gator Capital Management	Long/Short Equity	38.31
Quam China Focus Fund - Class A	QUAM Asset Management	Multi Strategy	38.22
Greyhound Asia Fund	Quest Management	Long/Short Equity	35.20
Naos Long Short Equity Fund	Naos Asset Management	130/30	34.70
Vertex Managed Value Portfolio - Class A	Vertex One Asset Management	Value-Oriented	34.21
Ginga Explorer Fund - JPY	Stats Investment Management	Long/Short Equity	34.11
Rabin Capital I	Rabin Capital	Multi Strategy	33.54
Barnegat Fund - Series B	Barnegat Fund Management	Fixed Income Arbitrage	33.21
Chenavari - Toro Capital I A - Class A - €	Chenavari Investment Managers	Asset-Backed Lending Strategies, Mortgage-Backed Strategies	32.97
Metacapital Mortgage Opportunities Fund	Metacapital Management	Mortgage-Backed Strategies	31.31
400 Capital Credit Opportunities Fund LP	400 Capital Management	Fixed Income	31.23
Grandmaster Capital Fund Ltd - Class B	Grandmaster Capital Management	Long/Short Equity	31.21

Source: Preqin Hedge Fund Analyst

Fig. 4.10: Net Returns of Top Performing Long/Short Funds in the Last 12 Months*

Fund	Manager	Core Strategy	Net Return in the Last 12 Months (%)
Trophy Fund	Winnington Capital	Long Bias	110.24
Northwest Warrant Fund - USD	Northwest Investment Management	Long Bias	81.85
AccessTurkey Fund	AccessTurkey	Long/Short Equity	50.50
Horizon Growth Fund N.V.	Horizon Capital Management	Long Bias	49.22
Ginga Golden Egg Fund	Stats Investment Management	Long Bias	40.63
Blackhorse Emerging Enterprises Fund	Blackhorse Asset Management	Long Bias	39.83
Gator Financial Partners	Gator Capital Management	Long/Short Equity	38.31
Greyhound Asia Fund	Quest Management	Long/Short Equity	35.20
Naos Long Short Equity Fund	Naos Asset Management	130/30	34.70
Vertex Managed Value Portfolio - Class A	Vertex One Asset Management	Value-Oriented	34.21

Source: Preqin Hedge Fund Analyst

Data Source:

Preqin tracks over 9,500 active hedge funds open for investment, including detailed information on their performance. Investors can access key details of all hedge funds looking for investor capital for free on **Preqin Investor Network**, including their strategies, geographic foci and the key people to contact.

For more information, or to register for a demonstration, please visit:

www.preqin.com/pin

** Please note, all performance information includes preliminary data for March 2013 based on net returns reported to Preqin in early April 2013. Although stated returns are not expected to alter significantly, final figures are subject to change.*

Fig. 4.11: Net Returns of Top Performing Event Driven Funds in the Last 12 Months*

Fund	Manager	Core Strategy	Net Return in the Last 12 Months (%)
ISP Helium Special Situations Fund - GBP	Investment Solutions Partners	Event Driven, Special Situations	53.91
Hildene Opportunities Fund, LP	Hildene Capital Management	Distressed	48.97
Third Point Offshore Fund	Third Point Management	Event Driven	24.46
Greylock Global Opportunity Master Fund	Greylock Capital Management	Distressed	22.23
Argo Distressed Credit Fund - USD A	Argo Capital Management	Distressed	21.52
Hildene Opportunities Fund II, LP	Hildene Capital Management	Distressed	21.41
Litespeed Partners - Series AU	Litespeed Management	Event Driven	18.40
Carl Marks Strategic Opportunities Fund	Carl Marks	Distressed	16.89
Ross Smith Opportunities Fund	Ross Smith Asset Management	Event Driven	16.52
FrontFour Capital Partners	FrontFour Capital	Event Driven	16.27

Source: Preqin Hedge Fund Analyst

Fig. 4.12: Net Returns of Top Performing Relative Value Funds in the Last 12 Months*

Fund	Manager	Core Strategy	Net Return in the Last 12 Months (%)
Barnegat Fund - Series B	Barnegat Fund Management	Fixed Income Arbitrage	33.21
Pine River Fixed Income Master Fund	Pine River Capital Management	Fixed Income Arbitrage	29.65
LFP JKC China Value Fund	JK Capital Management	Relative Value Arbitrage	28.01
Fixed Income Strategies Fund - S	Danske Invest	Fixed Income Arbitrage	25.06
Frontaura Global Frontier Fund	Frontaura Capital	Relative Value Arbitrage	23.00
Pine River Fund - Class B Series 1 Shares	Pine River Capital Management	Relative Value Arbitrage	22.55
Midway Market Neutral Domestic Fund	Midway Group	Fixed Income Arbitrage	20.16
Credence Global - Class C	Splendor Capital Management	Relative Value Arbitrage	19.63
III Fund L.P. - Series 1	III Offshore Advisors	Fixed Income Arbitrage	18.28
Wada Capital Japan Trust	Wada Capital Management	Equity Market Neutral	18.22

Source: Preqin Hedge Fund Analyst

Fig. 4.13: Net Returns of Top Performing Macro Funds in the Last 12 Months*

Fund	Manager	Core Strategy	Net Return in the Last 12 Months (%)
400 Capital Credit Opportunities Fund LP	400 Capital Management	Fixed Income	31.23
Brasil Capital FIC FIA	Brasil Capital	Fixed Income, Macro	30.16
Brasil Capital II FIC FIA	Brasil Capital	Fixed Income, Macro	29.58
Cairn Subordinated Financials Fund	Cairn Capital	Fixed Income	27.18
Paineiras Hedge FIM	Paineiras Investimentos	Macro	26.28
Quantedge Global Fund	Quantedge Capital	Macro	25.88
Sparta Global Funds SPC - Class B	Sparta Administradora de Recursos	Macro	25.03
Polo Macro FIM	Polo Capital Management	Macro	17.81
CSHG Verde	Credit Suisse Hedging-Griffo	Macro	16.36
CSHG Agar Fund	Credit Suisse Hedging-Griffo	Macro	15.88

Source: Preqin Hedge Fund Analyst

Fig. 4.14: Net Returns of Top Performing Multi-Strategy Funds in the Last 12 Months*

Fund	Manager	Core Strategy	Net Return in the Last 12 Months (%)
Quam China Focus Fund - Class A	QUAM Asset Management	Multi-Strategy	38.22
Rabin Capital I	Rabin Capital	Multi-Strategy	33.54
Nubuke Africa Multi Strategy Fund - Class A2	Nubuke Investments	Multi-Strategy	22.13
CAP Funds	BBT Capital Management	Multi-Strategy	21.62
Strategic Equity Fund	BlueAlpha Investment Management	Multi-Strategy	19.80
Visium Global Fund, L.P.	Visium Asset Management	Multi-Strategy	19.18
Enko Opportunity Growth Fund	Enko Capital Management	Multi-Strategy	18.87
Phalanx Japan AustralAsia Multi-Strategy Fund - Share Class USD	Phalanx Capital Management	Multi-Strategy	16.04
CSHG All Ibiuna Hedge	Credit Suisse Hedging-Griffo	Multi-Strategy	15.69
Insparo Africa & Middle East Fund - USD Class	Insparo Asset Management	Multi-Strategy	13.99

Source: Preqin Hedge Fund Analyst

** Please note, all performance information includes preliminary data for March 2013 based on net returns reported to Preqin in early April 2013. Although stated returns are not expected to alter significantly, final figures are subject to change.*

Fig. 4.15: Net Returns of Top Performing Funds of Hedge Funds in the Last 12 Months*

Fund	Manager	Core Strategy	Net Return in the Last 12 Months (%)
Long Short Equity Fund of Hedge Funds	Symmetry Multi-Manager	Long/Short Equity	22.23
Gapstow Community Financials Fund	Gapstow Capital Partners	Long/Short Equity, Special Situations	20.58
SkyBridge Multi-Adviser Hedge Fund Portfolios - Series G	SkyBridge Capital II	Diversified	19.53
Legion Strategies	SkyBridge Capital II	Diversified	18.45
Ceres Agriculture II - Class B (2x)	FourWinds Capital Management	Commodities	16.48
Multi-Strategy Balanced Fund of Hedge Funds	Symmetry Multi-Manager	Diversified	16.07
Acantias Offshore Fund - USD	Ayaltis	Distressed	15.44
Castle Alternative Invest AG - CHF	Castle Alternative Invest	Macro	15.10
Multi-Strategy Conservative Fund of Hedge Funds	Symmetry Multi-Manager	Diversified	14.83
Galileo Pacific Fund	GL Funds	Long/Short Equity	14.43

Source: Preqin Hedge Fund Analyst

Fig. 4.16: Net Returns of Top Performing UCITS Hedge Funds in the Last 12 Months*

Fund	Manager	Core Strategy	Net Return in the Last 12 Months (%)
Vitruvius Greater China Equity Portfolio - B (USD)	Belgrave Capital Management	Long Bias	29.02
LFP JKC China Value Fund	JK Capital Management	Relative Value Arbitrage	28.01
Vitruvius Japanese Equity Portfolio - B (EUR)	Belgrave Capital Management	Long Bias	22.48
Tiburon Taiko Fund - Class A (JPY)	Tiburon Partners	Long Bias	21.90
Veritas China Fund - Class A - Institutional Investors (USD)	Veritas Asset Management	Long Bias	19.23
LFP JKC Asia Value	JK Capital Management	Relative Value Arbitrage	16.97
Arcus Japan Long/Short Fund - Retail Class	Arcus Investment	Long/Short Equity	16.41
Ennismore European Smaller Companies Fund (UCITS) - GBP A £	Ennismore Fund Management	Long/Short Equity	16.39
European Absolute Alpha - Ordinary Class - GBP	Martin Currie	Long/Short Equity	16.15
Vitruvius Asian Equity Portfolio - B (USD)	Belgrave Capital Management	Long Bias	15.97

Source: Preqin Hedge Fund Analyst

Fig. 4.17: Net Returns of Top Performing CTAs in the Last 12 Months*

Program	Manager	Location	Net Return in the Last 12 Months (%)
eFED Commodity Futures Fund	Ebullio Capital Management	Cayman Islands	53.94
White Indian STAIRS Futures Program - STAIRS Client	White Indian Trading Company	US	38.79
FX Concepts Global Financial Markets Fund	FX Concepts	US	38.45
LJM Aggressive Strategy	LJM Partners	US	33.84
Ditsch Trading	Ditsch Trading	US	32.30
Clarke Worldwide Program	Clarke Capital Management	US	31.53
Cardwell Investment Technologies Global 3X Fund	Cardwell Investment Technologies	UK	27.55
Crabel Multi-Product (Offshore) - Class A 2 & 30	Crabel Capital Management	US	25.54
LJM Moderately Aggressive Strategy	LJM Partners	US	24.78
Brandywine Symphony Preferred Fund	Brandywine Asset Management	US	23.14

Source: Preqin Hedge Fund Analyst

** Please note, all performance information includes preliminary data for March 2013 based on net returns reported to Preqin in early April 2013. Although stated returns are not expected to alter significantly, final figures are subject to change.*

Paying for Alpha?: Private Equity Fund Terms and Conditions

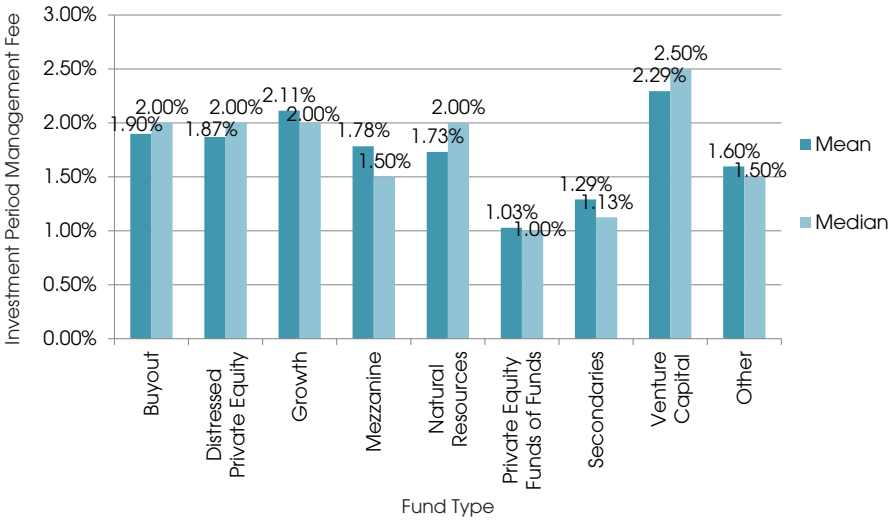
Private equity fund terms and conditions have been a topic of debate in the industry over recent years. In an increasingly competitive fundraising market, deciding which funds to commit to is a difficult task for investors. Fund terms and conditions should be designed to provide an alignment of interests between fund managers and investors and should benefit both parties. While investors want fund terms and conditions that will allow for the best returns, fund managers also need to be incentivized to put capital to work in the best possible way.

The 2/20 fee model associated with the private equity industry has largely remained over recent years, particularly with top-tier fund managers, which can generally command higher fees as a premium for an impressive track record. Certain fund terms and conditions have changed recently but variations still remain at present between different fund types. However, with fund managers still finding it a challenge to attract investor capital, investors are in a prime position to negotiate fund terms and conditions to get the best deal.

Management Fees During Investment Period

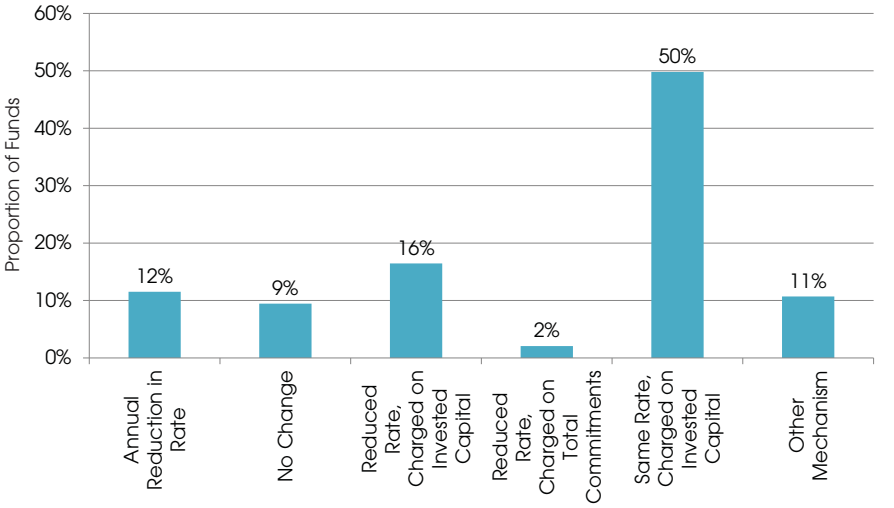
The management fees offered by fund managers have frequently been an issue of contention among investors and can vary significantly by fund type. As shown in Fig. 4.18, of funds currently raising capital and those closed with vintages 2011-2013, venture capital funds command the highest management fees, with a mean of 2.29% and a median of 2.50%. This has increased from a mean of 2.20% and a median of 2.00% for closed vintage 2009-2010 venture capital funds and funds still raising capital as of Q2 2010.

Fig. 4.18: Average Management Fee During Investment Period by Fund Type (Funds Raising & Vintage 2011-2013 Funds Closed)



Source: Preqin Investor Network

Fig. 4.19: Mechanisms for Reducing Management Fees After Investment Period (Funds Raising & Vintage 2011-2013 Funds Closed)



Source: Preqin

Buyout funds currently in market and closed with vintage years 2011-2013 charge on average a mean management fee of 1.90%, closest to the industry norm of 2.00%, which has decreased slightly from buyout funds closed with vintage years 2009-2010 and those still in market as of Q2 2012, when the mean was 1.93%. Natural resources funds in market and of vintage years 2011-2013 have lower mean management fees at 1.73%, which has recently decreased from a mean management fee of 2.00% for funds of vintage years 2009-2010 and funds raising capital as of Q2 2010. The median fee has remained constant at 2.00%.

Private equity funds of funds and secondaries funds have the lowest management fees, which is unsurprising given the double layer of fees investors have to pay when investing in such funds. Mezzanine funds in market and of vintages 2011-2013 have notably low management fees, with a mean of 1.78% and a median of 1.50%.

Management Fees Post-Investment Period

The investment period is generally the most costly time for fund managers due the time spent sourcing and managing investments; therefore many funds offer management fee discounts after this period and there are a number of ways in which this can be achieved. As Fig. 4.19 displays, half of funds in market and vintage 2011-2013 funds closed offer the same management fee post-investment period but only for invested capital, instead of committed capital as during the investment period.

Sixteen percent of funds raising and closed with vintage years 2011-2013 offer a reduced management fee on invested capital, while 2% offer a reduced rate on committed capital. Twelve percent of funds choose to offer an annual reduction in the management fee.

Performance Fees

The 8% hurdle rate remains the most preferred common return, with just over three-quarters (76%) of funds in market or closed with vintage years 2011-2013 having a hurdle rate of 8%, as shown in Fig. 4.20.

Carried interest rates have changed little in recent years, with a significant 88% of funds in market and closed with vintage years 2011-2013 having a carry rate of 20%, demonstrating that the industry norm is likely to remain in the foreseeable future.

Transaction Fees

While management and performance fees have typically remained at the industry standard 2/20 model, there have been changes in the amount of transaction fees that are rebated to investors through management fee reductions. The majority (62%) of funds currently raising or closed with vintage years 2011-2013 rebate all transaction fees to investors, as shown in Fig. 4.21, compared to only 39% of funds closed with vintage years 2009-2010 and funds in market as of Q2 2010. This demonstrates that certain fund terms and conditions have moved more in favour of investors in recent years, highlighting the struggle by fund managers to attract investor capital.

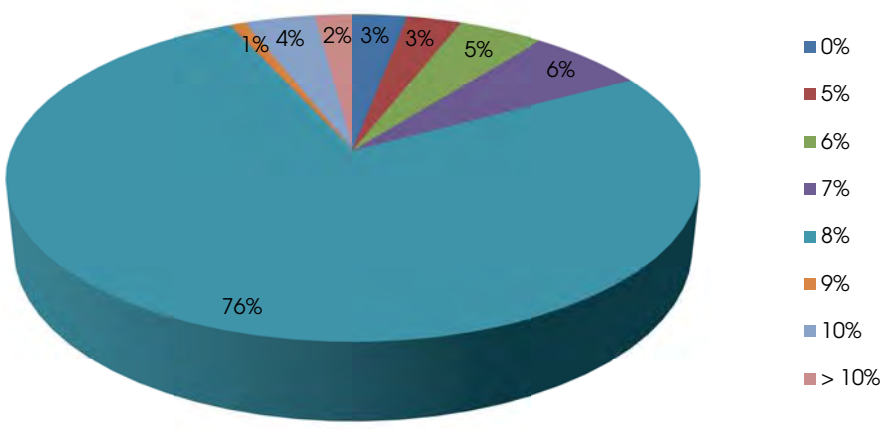
Fund Manager Commitments

The amount of capital a fund manager commits to its fund can go a long way to improve the alignment of interests between investors and the fund manager. While historically fund managers have typically committed 1.00% of the total fund size, there is now a definite trend of many fund managers committing larger amounts of capital to their own funds as a means of demonstrating commitment to the fund and fostering a closer alignment between fund managers and investors.

Sixty-four percent of funds currently in market and closed with vintage years 2011-2013 have fund manager commitments of 2.00% or more, whereas for funds closed with vintage years 2009-2010 and funds in market as of Q2 2010, a slightly smaller 59% of funds have a fund manager commitment of 2.00% or more.

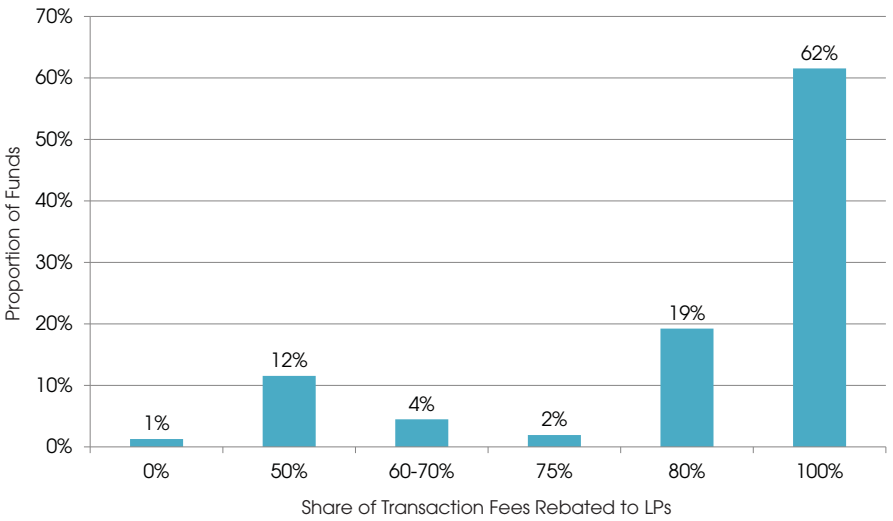
The amount of capital committed by a fund manager varies by fund type. As displayed in Fig. 4.22, for funds currently in market and those of vintage years 2011-2013, venture capital funds have the highest mean fund manager commitment at 4.00%, with a median of 2.20%. Growth funds also have a high mean fund manager commitment at 3.90%, but with a lower median of 1.50%. Buyout funds have a mean fund manager commitment of 3.80% and a median of 2.40%.

Fig. 4.20: Hurdle Rate Used by Direct Private Equity Funds (Funds Raising & Vintage 2011-2013 Funds Closed)



Source: Preqin

Fig. 4.21: Share of Transaction Fees Rebated to LPs (Funds Raising & Vintage 2011 - 2013 Funds Closed)

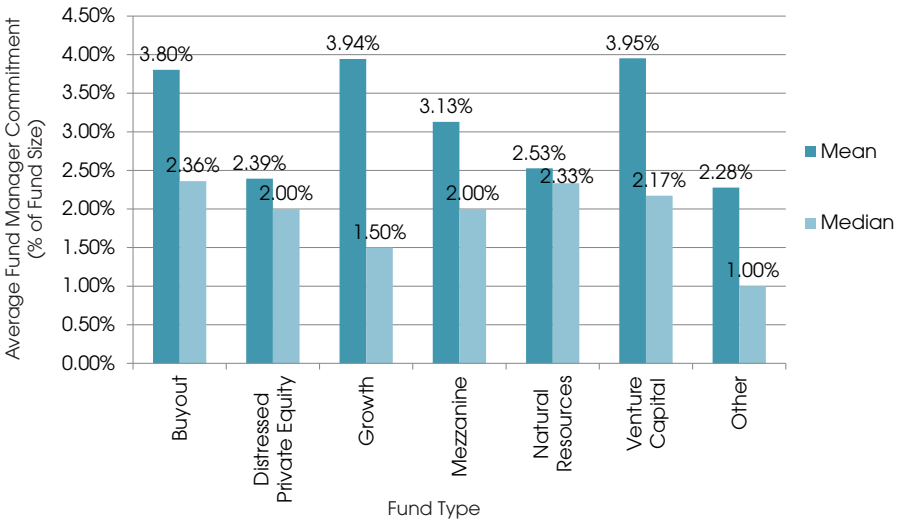


Source: Preqin

Outlook

It is evident that the 2/20 fee model remains prevalent in the private equity industry and that this is likely to continue in the future. However, it is important to recognize that given the difficult fundraising environment over the past few years, many fund managers have altered their fund terms and conditions to meet investor demands. The majority of managers now offer fee reductions post-investment period and a high proportion now rebate all transaction fees to the investors. Furthermore, the average fund manager commitment to a fund has increased in an effort to attract additional investor capital and further align fund manager and investor interests. With the fundraising market remaining crowded and managers having to work harder to secure capital, it is likely that certain fund terms and conditions will continue to move in investors' favour.

Fig. 4.22: Average Fund Manager Commitment as a Percentage of Fund Size by Fund Type (Funds Raising & Vintage 2011 - 2013 Funds Closed)



Source: Preqin

Towards Ever Closer Alignment of Interests - Jonathan Blake, Head of International Funds Department, SJ Berwin

Alignment of interests has always been a fundamental tenet of venture capital and private equity, and it is a principle that goes right through the value chain: from the managers of portfolio companies, all the way to the ultimate investors in the fund. Regarding the fund terms and structure itself – a model now widely adopted across the private funds landscape, with infrastructure and debt funds among those using it – one of its strengths, and one reason it has been widely used, is that the economic incentives of the actors can be aligned so that those with an ability to make a difference to the outcome have a similar interest in achieving it.

At one level there has been very little change to the traditional GP and LP limited partnership structure: it retains its commitment-based management charge and 20% carried interest, and many of the other terms have remained remarkably intact over the years. However, there have been significant changes of detail, both in terms of the overall structure of the relationship, and the terms and conditions. Some of these have been driven by investors – and the Institutional Limited Partners Association has helped to spread some of the best practices that larger investors had been demanding – while others have evolved from changing practices of the managers themselves as the industry has matured. We have also seen quite a striking difference in the terms negotiated in recent years between those managers with strong demand and those which are struggling to raise capital.

The starting point, of course, is the basic alignment created by a combination of carried interest and co-investment, and this has strongly withstood the test of time. The 20% share of profits (once a hurdle is reached) creates a strong link between the rewards of the manager and the investors in the case of strong performance, and a significant investment by the general partner provides downside alignment. This realization-based approach contrasts favourably with the model used in some other asset classes.

As one might expect, recent developments in terms and conditions have focused on enhancing this alignment further. Investors are attracted by managers which are willing to make a greater co-investment in the fund, and want this to be a meaningful amount in the context of the particular team, and on average we have seen co-investments increase. Investors have also been looking hard at carried interest waterfalls and arrangements put in place to ensure that there cannot be over-payment of carry and that, if realizations early in the life of the fund do give rise to carry distributions to managers which are offset by later losses, there are reliable mechanisms, such as escrow and clawbacks, that allow the investors to recover the overpayment. Investors also do not like managers earning other income from sources which are not, in their view, focusing them on the performance of the funds they manage for them. This means that transaction fees are now almost always given to the fund, rather than kept by managers, and investors are focused on the trigger point that allows a general partner to start raising another fund (which they do not want to be too early).

However, investors are also aware that managers need to be able to retain and recruit investment professionals in their team, and recognize that it is in their interests that managers maintain a strong and stable team during the harvesting as well as the investing stage of the fund. These factors may mean that some early payment of carried interest, and other income sources, are desirable, so long as they are reasonable and subject to safeguards.

Investors have also paid more attention to the detail of governance terms and the way that they operate in practice, including no fault divorce and key man provisions (although some investors are seeing that pre-determined outcomes hard-wired into these clauses are not necessarily in their interests, and a vote may be more appropriate).

Investors and managers have been looking at alternative structures in recent years, and there is now more variety than there has been for some time. Without question, the fully committed 10-year fund still dominates, and will continue to do so, but general partners have also sometimes used deal-by-deal financings. However, these structures can be problematic, especially if the manager is looking to purchase an asset in circumstances where speed is essential, or through an auction where the seller wants to see that the bidder has fully committed funds from the outset.

On the other hand, investors making larger commitments have been using some of their greater power to seek better terms from managers, and this has ranged from lower management fees, priority co-investment, through to separately managed accounts, where the investor may have better terms and more individual power in the arrangement.

These developments in terms and structures are natural progressions of a model which continues to have alignment of interests at its core, and allows for bespoke negotiation between investors and fund managers. They are, on the whole, developments that will benefit all of the industry's stakeholders.

Investor Attitudes towards Private Equity Fund Terms and Conditions

Fund terms and conditions and the impact they have on the returns investors actually see means that they can often be a significant influencing factor in investors' decision-making processes. In the current fundraising climate, fund managers are often carefully considering the terms that they present to prospective investors to improve the chances of securing capital commitments. But has this translated into any changes to fund terms and conditions in recent years? Are fund manager and investor interests properly aligned, or do investors still feel there are areas that could be improved?

In order to assess the attitudes of investors towards the fund terms and conditions they are offered and to find out whether fund manager and investor interests are currently aligned, Preqin interviewed over 100 investors of different types around the world in December 2012.

Alignment of Interests

Sixty-seven percent of the respondents that were asked whether fund manager and investor interests were properly aligned stated they were satisfied at present, as illustrated in Fig. 4.23. This shows an improvement on investor attitudes seen in December 2011 and December 2010, when 47% and 44% of respondents respectively stated that they were satisfied with the arrangements. Despite this improvement, it is interesting to note that in April 2008, before the onset of the global financial crisis, a much more significant 82% of investors believed there was a proper alignment of interests between fund managers and investors, indicating that investors are now scrutinizing their portfolios more closely and are questioning the fund terms and conditions offered by fund managers.

Thirty-three percent of investors disagree that fund manager and investor interests are properly aligned. This figure has fallen by 20 percentage points over the past year, as 53% of the investors interviewed in December 2011 voiced dissatisfaction; however, it still remains distinctly higher than the pre-financial crisis figure in April 2008, when just 18% of investors believed fund manager and investor interests were not properly aligned.

When Preqin asked what could be done to improve the alignment of fund manager and investor interests, the largest proportion (47%) of respondents quoted management fees as being a key issue, as displayed in Fig. 4.24. Although this is a reduction on the proportion of investors with the same opinion in December 2011 (77%), a number of investors still view this as a significant problem, with one UK-based endowment plan telling us: "Profit should not be made from management fees."

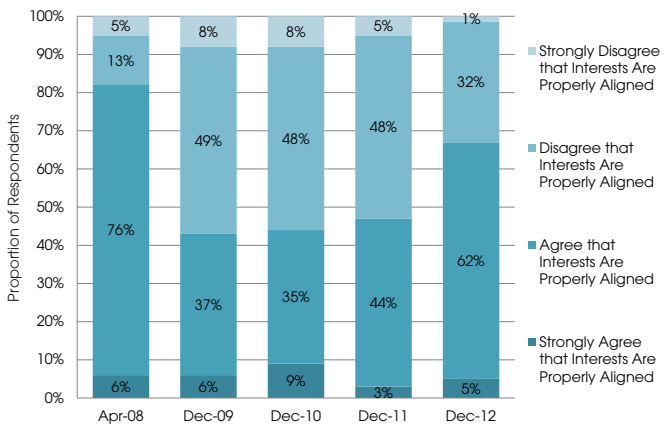
A significant proportion (42%) of the respondents named the carry structure as an area of dissatisfaction. This is a significant increase on the responses Preqin received last year, when just less than a fifth (19%) of respondents gave this as an area to be improved.

It is clear that investors feel that terms involving financial agreements are the areas in greatest need of improvement. Nevertheless, 6% of respondents named non-financial clauses as an area that needs attention. These include the no-fault divorce clause and the key man clause. Another 19% quoted other areas such as the level of reporting from fund managers to investors, suggesting that investors are now looking further into the fund terms and conditions offered by fund managers and are expecting more from them rather than just changes to the level of fees paid or the carry structure.

Development in the Prevailing Terms

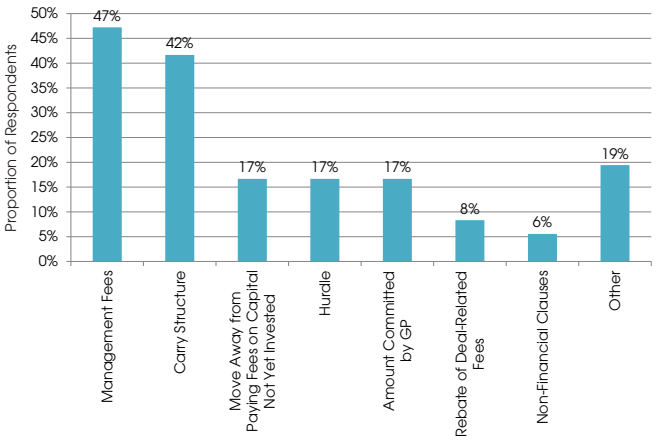
In the present financial climate, many fund managers are struggling to secure commitments from investors and therefore investors are able to negotiate terms and conditions in their favour. However, one German bank told us: "Investors have to be careful right now. It's likely that a number of fund managers will begin to disappear, and the alignment of interests between fund managers and investors will weaken

Fig. 4.23: Investor Opinion on the Alignment of Interests between Investors and Managers



Source: Preqin Investor Interviews, April 2008 - December 2012

Fig. 4.24: Investors' Views on Areas of Fund Terms and Conditions Where Alignment of Interests Can Be Improved



Source: Preqin Investor Interviews, December 2012

further, as fund managers struggle to meet the terms and conditions agreed."

The number of investors that have seen changes in fund terms and conditions over the past six months in their favour is lower than was seen at the same time last year. In December 2011, 57% of investors noted a positive change had occurred in fund terms and conditions in favour of the investor in the previous six months, as shown in Fig. 4.25. This compares with 36% of respondents noting the same in December 2012. One German asset manager told us that: "There have been changes over the last couple of years, with reduced fees, but now it looks like these changes are reversing." However, 6% of investors interviewed did state that the changes they had witnessed in favour of the investor had been significant. Only 4% of the investors interviewed in both December 2011 and December 2012 noted that they had seen a slight change in favour of fund managers.

Although fewer investors have seen changes in fund terms and conditions in the past six months, there are still a number of areas where changes have been made, with management fees being the most frequently cited by those interviewed by Preqin. Fig. 4.26 shows that 81% of investors that answered this question have seen a change in the structure of management fees over the last six months. One UK-based pension fund told us: "There has been a big push from many investors to have fund managers lower their management fees, and now they have to justify fee levels".

As well as the change seen in management fees, the second most quoted change seen in the prevailing terms and conditions was in the carry structure. Just over a quarter (26%) of the investors that were asked this question by Preqin have seen a change in this area over the past six months, which is significantly more than the 9% that saw a change during the six months prior to December 2011.

Seven percent of investors told us they had seen adjustments in the amount of capital committed by fund managers to their funds in the past six months. An Israeli insurance company told us: "The alignment of interests has been improved further by fund managers providing more capital." Many investors are of the opinion that if fund managers place more of their own capital into funds then it shows they are committed to that fund and will make investments based on what is in the best interests of both the parties, although there are also concerns among some investors that fund managers that commit too much to their vehicles, where a significant loss could be catastrophic for the individual partners, may be hampered in their deal-making activities by personal concerns.

Multiple investors that were interviewed by Preqin said that they would like to be kept better informed about their funds' investments; as one Saudi Arabian insurance company said: "The fund manager needs to hold meetings to showcase what is happening at the fund level, and increase transparency for the investor." However, some investors do not believe that the relationship between the fund manager and investor will ever be completely satisfactory, with one US pension fund saying that: "There are always areas of the relationship that will be disjointed."

Outlook

Although investors have become increasingly satisfied with the alignment of interests over the past two years, the proportion of investors that believe fund manager and investor interests are properly aligned still remains below the proportion prior to the global financial crisis. While the level of changes to the prevailing terms and conditions have decreased over the past year, it is clear that there are still alterations being made by fund managers in an effort to secure capital commitments from investors. Management fees were most frequently cited as being an area of dissatisfaction for investors, which is supported by the fact that it is the area where the most changes have been seen over the past six months. With such a crowded fundraising market and many fund managers facing challenges with regards to securing capital commitments, investors may be more able to negotiate better fund terms and conditions moving forward.

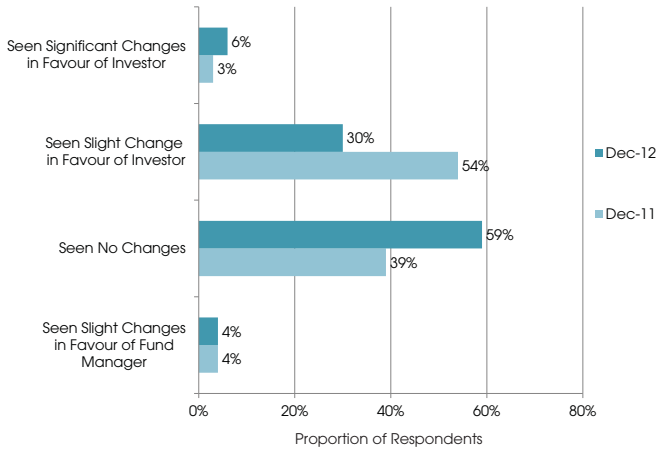
Data Source:

Interested in private equity fund terms and conditions? Compare average benchmark terms for different types and locations of private equity funds free of charge on **Preqin Investor Network.**

For more information, or to register for a demonstration, please visit:

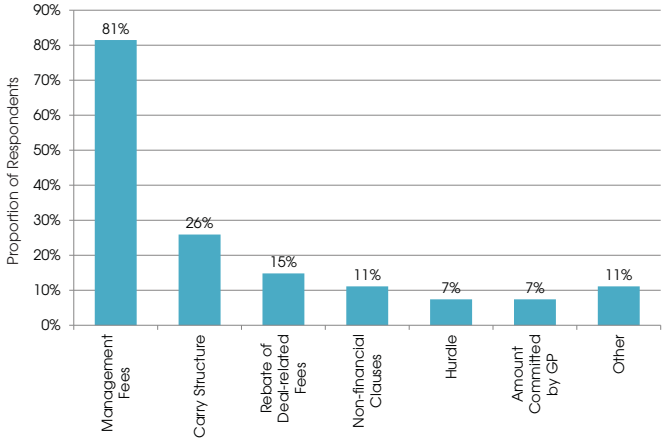
www.preqin.com/pin

Fig. 4.25: Proportion of Investors That Have Seen a Change in Prevailing Terms Over the Last Six Months



Source: Preqin Investor Interviews, December 2011 - December 2012

Fig. 4.26: Areas in Which Investors Have Seen a Change to Prevailing Terms Over the Last Six Months



Source: Preqin Investor Interviews, December 2012

Paying for Alpha?: Private Real Estate Fund Terms and Conditions

One of the key considerations for investors in private real estate funds is the level of management and performance fees they charge. Many investors, and their consultants, give high priority to understanding the varying nature of the fees charged by private real estate funds. It is important to get access to the right funds, but also to ensure you are being offered appropriate fee structures.

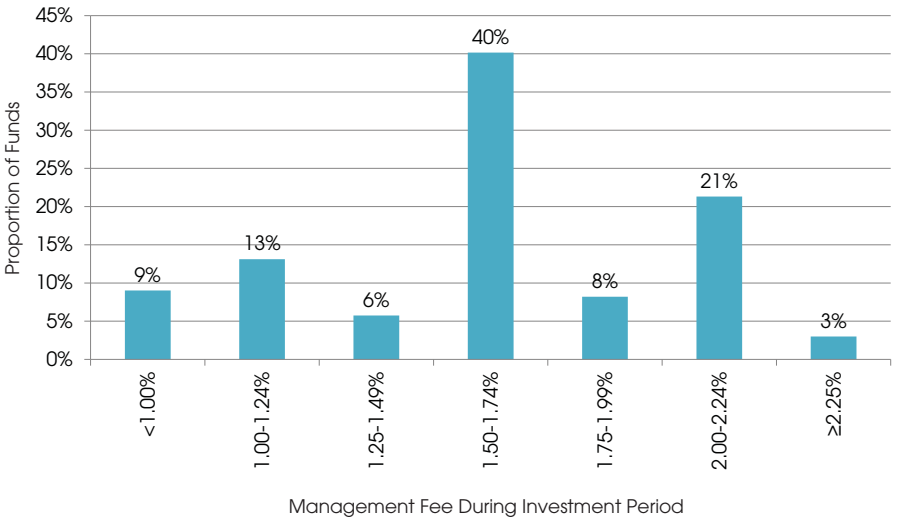
Management Fees

Fig. 4.27 demonstrates the breakdown of management fees during the investment period by closed-end private real estate funds currently raising capital and closed funds of vintages 2011-2013. Forty percent of private real estate funds charge a 1.5-1.74% management fee. This range is fairly typical of real estate funds and an indication that, while many investors feel manager terms are not quite aligned with their interest, management fees have not shifted dramatically in their favour. Management fees of 1.75% and above are not uncommon either, and 24% of funds charge management fees of over 2.00%. There are funds that offer lower management fees, with about 28% of vehicles having management fees of 1.50% or below.

With the post-investment period resulting in fewer costs for fund managers, management fees charged to investors are often lowered. Nonetheless, 15% of funds do not alter the management fee structure as highlighted in Fig. 4.28.

The majority of funds offer a reduction in fees by way of charging the same management fee but only on invested capital, with 55% of funds offering this method of fee reduction. A further 9% of funds provide a reduced rate charged on invested capital. Investors should factor in appropriate fee structure both upon commitment and after the investment period.

Fig. 4.27: Management Fee During Investment Period* (Funds Raising & Vintage 2011-2013 Funds Closed)

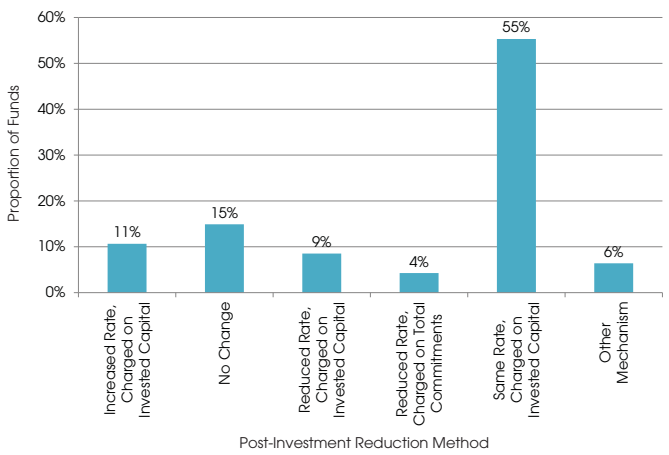


Source: Preqin Investor Network

Performance Fees

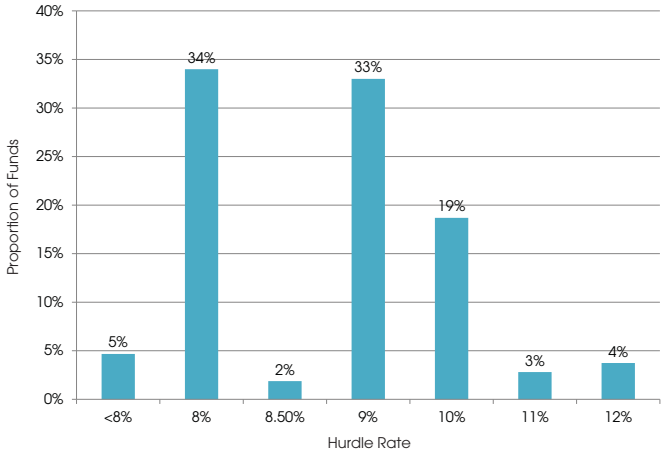
As shown in Fig. 4.29, hurdle rates are similar to the levels seen in private equity and infrastructure, with 88% of funds maintaining a hurdle rate of 8-10%. It is worth noting that 86% of real estate funds charge a carried interest rate of 20%, similar to private equity and infrastructure. Investors should seek funds that are not only competitive on management fees, but also on performance fees.

Fig. 4.28: Mechanism for Reducing Management Fee after Investment Period* (Funds Raising and Vintage 2011-2013 Funds Closed)



Source: 2012 Preqin Private Equity Fund Terms Advisor

Fig. 4.29: Hurdle Rate Used by Closed-End Real Estate Funds** (Funds Raising & Vintage 2011-2013 Funds Closed)



Source: 2012 Preqin Private Equity Fund Terms Advisor

** Including funds of funds and secondaries; ** Excluding funds of funds and secondaries*

Paying for Alpha?: Infrastructure Fund Terms and Conditions

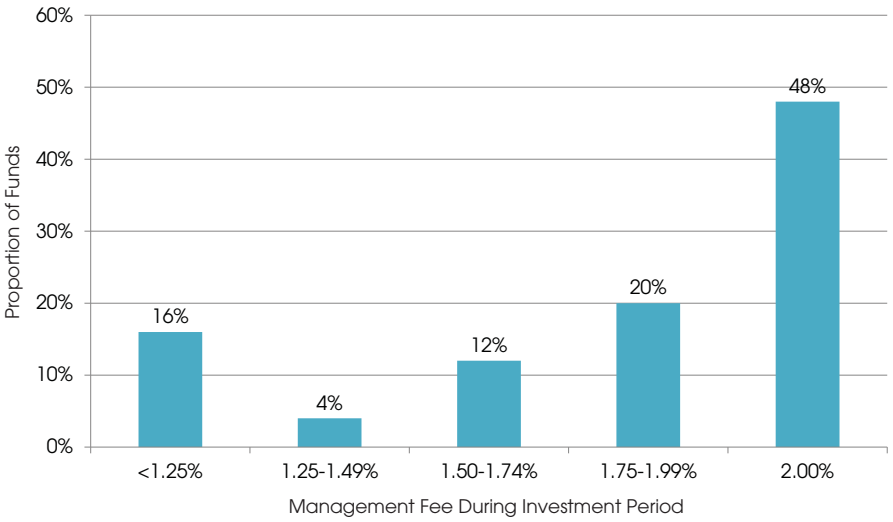
The use of the traditional 2/20 private equity fee model remains a contentious issue within the private infrastructure industry. With investors turning to infrastructure as a source of lower but stable yield over the long term, the application of such a high fee structure to funds generally forecasted to produce lower returns is likely to affect investor appetite. Although fund managers are beginning to make greater concessions to satisfy investor demands, Preqin data shows that nearly half of infrastructure managers still maintain a strict 2/20 structure.

Fig. 4.30 shows a breakdown of the management fees charged during the investment period by infrastructure funds currently raising capital and closed vehicles of vintages 2011-2013. Despite calls for lower fees, investors can still realistically expect to pay a 1.75-2% management fee when investing in many infrastructure funds, with a significant 48% of vehicles still charging a 2% fee. Carried interest and hurdle rates also continue to emulate the private equity industry, with 73% of infrastructure funds maintaining a 20% carry and 71% holding an 8% hurdle rate.

Despite this, the mean management fee for infrastructure funds currently raising capital and closed funds of a 2011-2013 vintage is 1.70%. Therefore, there are still plenty of fund managers willing to make concessions on fees in order to secure commitments. Over half of unlisted infrastructure fund managers now charge a fee of less than 2%, with 32% of funds charging a management fee of under 1.75%. Investors are in a strong position to negotiate on fees in the current market, as a large number of fund managers are in competition for limited available capital.

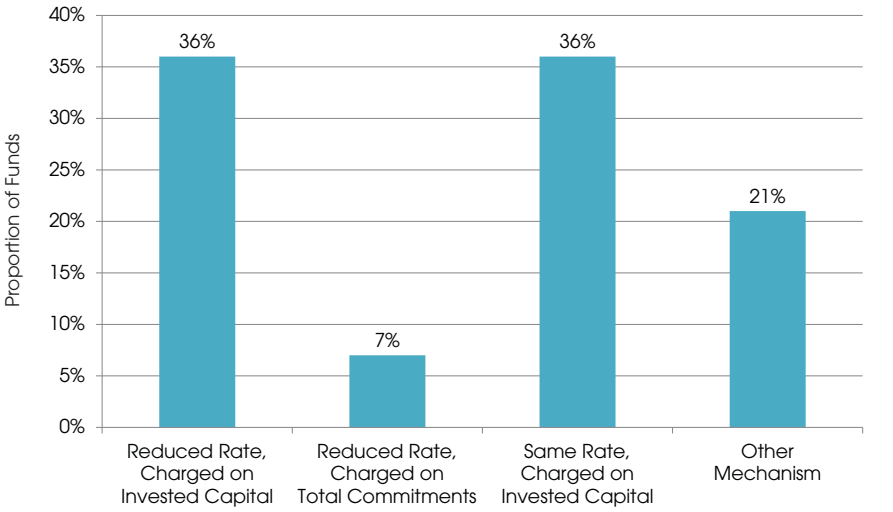
It is also realistic to expect a reduction in the level of fee charged once the fund's investment period is complete. The investment period is a costly time for fund managers due to the need to source and execute deals; however, many fund managers employ a mechanism to reduce the management fee level later on. As shown in Fig. 4.31, the two most common methods used by fund managers to reduce the fee charged is to charge a lower rate or the same rate but apply this to the amount of capital actually invested by the fund as opposed to an investor's commitment to the vehicle. A combined 72% of funds currently raising capital or those vehicles closed of a 2011-2013 vintage employ one of these two mechanisms. In order to reduce fee burden, investors should ensure that a method of fee reduction is included in the fund terms and conditions.

Fig. 4.30: Management Fee Charged by Infrastructure Funds during the Investment Period (Funds Raising and Vintage 2011-2013 Funds Closed)



Source: Preqin Investor Network

Fig. 4.31: Infrastructure Funds - Mechanisms for Reducing Management Fee after Investment Period (Funds Raising and Vintage 2011-2013 Funds Closed)



Source: 2012 Preqin Private Equity Fund Terms Advisor

Data Source:

Looking to track typical infrastructure fund terms? **Preqin Investor Network** can help.

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Paying for Alpha?: Hedge Fund Terms and Conditions

Since its inception, the hedge fund industry has been synonymous with a 2/20 fee structure. The fees charged by hedge fund managers have come under scrutiny in recent years, with investors now rallying for change within the industry. Preqin data shows that the mean fees for the industry are a 1.62% management fee with a 19.17% performance fee. With just 37% of hedge fund managers still employing the flat 2/20 fee structure, it is clear this fee schedule is no longer quite the norm. With the fee landscape constantly evolving, what fees should investors expect to pay?

Fees by Strategy

The average fees charged by fund managers based on the core investment strategy of the fund are shown in Fig. 4.32. As the chart demonstrates, investors that are looking to add macro strategy funds to their portfolio should expect to pay above average fees, with macro strategy fund managers charging the highest mean fees of any hedge fund strategy. The mean management fee of a macro fund stands at 1.72% and the mean performance fee at 19.52%. These fees reflect the higher operational and trading costs of running this type of actively managed fund. The competitive long/short sector charges comparatively lower fees. Relative value funds charge the lowest management fees of any hedge fund strategy of 1.50%, although investors in these funds have to pay one of the highest performance fees of any strategy at 19.44%.

Fees by Fund Manager Location

Investors in North America-based funds can expect to pay the highest performance fee of any region, with an average of 19.70% (Fig. 4.33). With North America home to some of the largest and most successful funds in the hedge fund market place, investors often have to pay larger fees in order to tap into the most competitive funds. While Europe also has a strong presence in the hedge fund industry, it has lower management and performance fees, resulting from a variety of factors, including the high proportion of UCITS funds in Europe, and tougher fundraising conditions.

Fig. 4.32: Mean Hedge Fund Fees by Fund Strategy

Fund Strategy	Mean Management Fee (%)	Mean Performance Fee (%)
All Single Manager Hedge Funds	1.62	19.17
Event Driven	1.60	19.48
Long/Short	1.58	18.81
Macro	1.72	19.52
Multi-Strategy	1.63	18.93
Other	1.56	18.63
Relative Value	1.50	19.44

Source: Preqin Investor Network

Fig. 4.33: Mean Hedge Fund Fees by Fund Manager Location

Region	Mean Management Fee (%)	Mean Performance Fee (%)
Asia-Pacific	1.63	18.45
Europe	1.61	18.55
North America	1.62	19.70
Rest of World	1.64	18.95

Source: Preqin Investor Network

Asia-Pacific-based hedge fund managers offer the lowest performance fees, with an average performance fee of 18.45%; this is lower than those charged on average by any single hedge fund strategy. The hedge fund industry in the region is still developing and fund managers are more flexible on fee structure in order to attract investment.

Hedge Fund Liquidity

Fig. 4.34 shows the liquidity spectrum of the main groupings of hedge fund strategies. Macro strategies provide investors with the greatest amount of liquidity, allowing investors access to their capital, on average, more than once per month, with the shortest notice period of all hedge fund strategies (23 days on average, for all macro strategies). As we have already seen, investors in macro strategy funds are likely to have to pay higher fees but they will be allowed greater access to capital once it is invested in the fund, an important consideration if liquidity is a key concern. In cases where a lock-up is in place, these also tend to be quite short, at approximately 2.8 months on average. Macro funds tend to be more liquid than some of their counterparts in the wider hedge fund industry. Some macro strategies, such as those that trade foreign exchange markets, may have daily or intra-daily trading.

At the other end of the spectrum, investors in event driven funds have the lowest levels of liquidity of any hedge fund strategy, with the majority of funds only offering quarterly redemptions. On average, investors can only access their capital every 2.7 months with a two-month notice period. Event driven strategy hedge funds can also have significant lock-up periods; for event driven funds which initially lock up capital, the average period amounts to over 10 months. Event driven hedge funds look for inefficiencies caused by corporate events; in order to create value from these positions, investments are often held for significant periods of time. Investors in event driven funds therefore need to expect liquidity restrictions in order for the fund to fulfil its investment period and ensure that they do not need to exit an investment prematurely before value is created. Distressed hedge

Fig. 4.34: Single-Manager Hedge Funds - Mean Liquidity Terms Offered by Hedge Fund Strategies

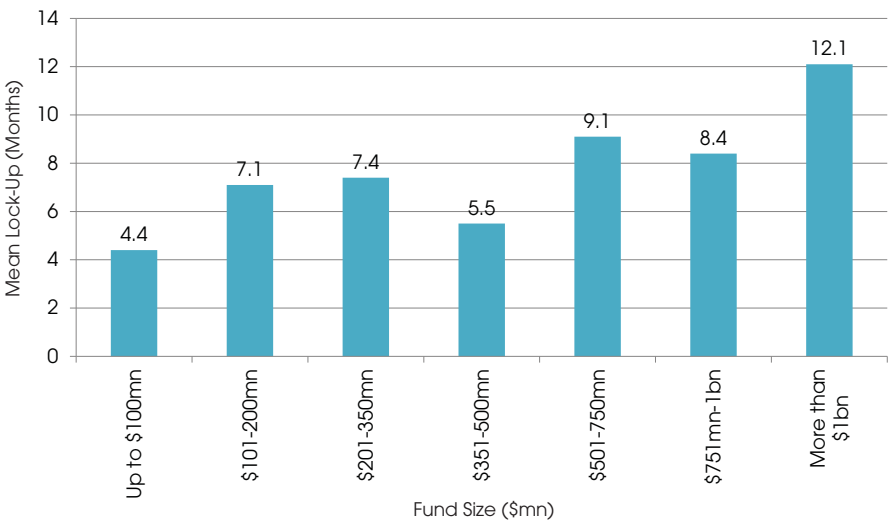
Core Strategy	Mean Redemption Frequency (Months)	Mean Redemption Notice (Days)	Mean Lock-Up (Months)
Macro Strategies	0.9	23	2.8
Relative Value	1.5	38	4.8
Long/Short	1.7	38	5.7
All Single-Manager Hedge Funds	1.6	39	5.9
Multi-Strategy	1.8	47	6.5
Other	2.3	70	8.9
Event Driven	2.7	65	10.3

Source: Preqin Investor Network

funds are one of the most illiquid hedge fund strategies; on average they offer their investors access to their capital every 3.7 months with 106 days notice.

There are a few niche "other" hedge fund strategies which tend to exhibit very illiquid characteristics. These include asset- and mortgage-backed lending funds and insurance-linked strategies. For instance, the average mortgage-backed lending fund has a mean redemption frequency of 2.3 months with a notice period of at least 70 days. The liquidity restrictions on the underlying assets can be significant for fund types which provide credit in illiquid markets; therefore, investors in these funds will need to tolerate less access to their capital than those strategies which may only have daily holding periods. However this restriction on capital access can often be coupled with an illiquidity premium in terms of the returns generated by these direct lending funds.

Fig. 4.35: Mean Hedge Fund Lock-Up Period by Fund Size ($mn)



Source: Preqin Investor Network

Fund Size and Liquidity

If investors are looking to allocate capital to larger hedge funds, then it is likely that they will need to compromise on the liquidity of that fund. Fig. 4.35 demonstrates that larger hedge funds have, on average, longer initial lock-up periods than smaller funds. Larger funds have been more successful in gathering investor assets than their smaller peers and are in a stronger competitive position. In addition, the relative size of some of their positions means that they will need to lock capital into funds to preserve it for the lifecycle of an investment. However, if liquidity is of paramount importance to an investor, smaller funds may offer some good opportunities, particularly for those investors that will not tolerate lock-ups over six months in length.

Outlook

The hedge fund industry offers investors a wide range of fee structures and liquidity options to suit each investor's needs. Due to investor pressure for fund managers to lower their fees, the industry has moved away from the traditional 2/20 fee structure. This trade-off between investors and fund managers looks set to continue into 2013; Preqin's recent hedge fund manager survey showed that 48% of fund managers see fundraising as a key challenge in 2013. This means that now is a better time than ever for investors to negotiate the fees that they are paying, due to the challenges facing fund managers when it comes to raising new capital.

Data Source:

Preqin tracks fund-by-fund and industry level fund terms and conditions data for over 5,500 hedge funds. View management and performance fees as well as any associated hurdle rates or high watermarks via **Preqin Investor Network** and view the liquidity and redemption terms, such as lock-up periods, notice periods and redemption fees via **Hedge Fund Analyst**.

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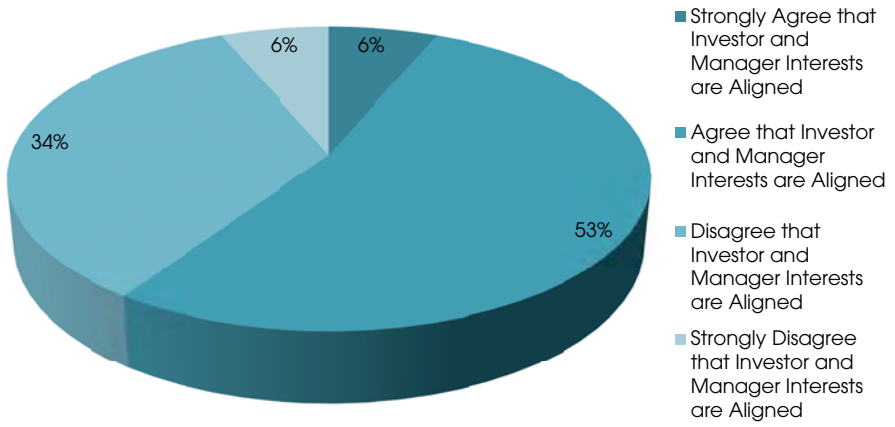
Investors' Attitudes Towards Hedge Fund Terms and Conditions

The economic crisis in 2008 and the ongoing financial uncertainty following these events, as well as underwhelming performance of the hedge fund industry over recent years has catalyzed change in how investors look at the asset class. One of the key areas that has come under investor scrutiny has been the terms and conditions of hedge funds, as investors question both the traditional 2/20 fee structure and the liquidity and transparency of these alternative assets. Preqin has conducted studies of investor attitudes towards fund terms and conditions since 2009. Here we present the results of our latest study following our in-depth interviews with over 80 hedge fund investors. How do investors view the terms and conditions of funds and what more can be done by these allocators to lead to further improvements in the structures of hedge funds?

Fig. 4.36: Investor Opinion on the Alignment of Interests between Investors and Managers



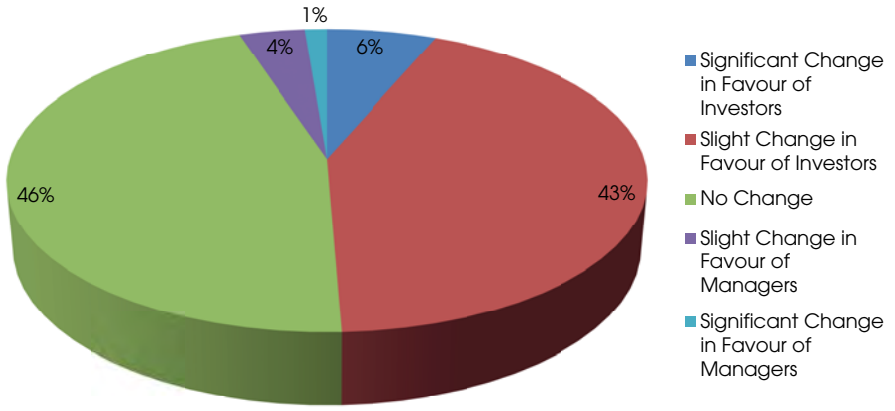
Source: Preqin Investor Interviews, April 2013

Alignment of Interests Still a Concern For Investors

Fewer investors in 2013 feel that manager and investor interests are aligned than in the previous year. In 2013, 59% of investors either agreed or strongly agreed that manager and investor interests are properly aligned, compared to 74% in 2012. There was a noted increase in investor dissatisfaction with hedge fund performance over 2012 from previous years, with some funds generating returns below traditional benchmarks. These questions over the performance of hedge funds, coupled with high fees, have led to a rise in dissatisfaction with alignments of investor and fund manager interests.

However, a significant proportion (49%) of all investors interviewed believe that there has been a shift in favour of the investor regarding changing terms and conditions, compared to just 5% that feel that there has been a change in favour of fund managers (Fig. 4.37). Despite this, with 46% of respondents indicating that they had seen no change in fund terms over the past year, investors still have a way to go in reaching an optimum equilibrium of incentivizing hedge fund managers to manage capital in the best possible way while representing good value for the investor.

Fig. 4.37: Investor Opinion on Changes in the Alignment of Interests between Investors and Managers over the Past 12 Months



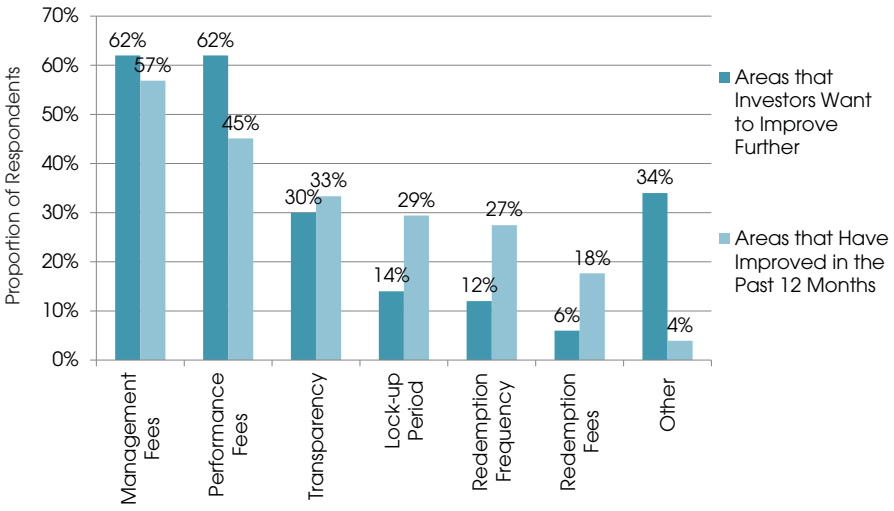
Source: Preqin Investor Interviews, April 2013

Fees Still Under Pressure

The traditional 2/20 fee structure has come under increasing pressure over recent years, with many investors seeking reduced fees. Fig. 4.38 indicates that managers have responded to this, with 57% of investors seeing an improvement in management fees over the past 12 months and 45% believing the same for performance fees. Despite these concessions, there is still room for improvement, with 62% of investors interviewed still seeking further reductions in both management and performance fees. This is higher than in 2012, when 58% and 55% of investors sought reductions for management and performance fees respectively, indicating that concerns regarding the alignment of interests centre on the issue of fees. With the ongoing uncertainty surrounding the global economic system, performance concerns are unlikely to disappear in the short term, which may have a long-term impact on fund term dissatisfaction.

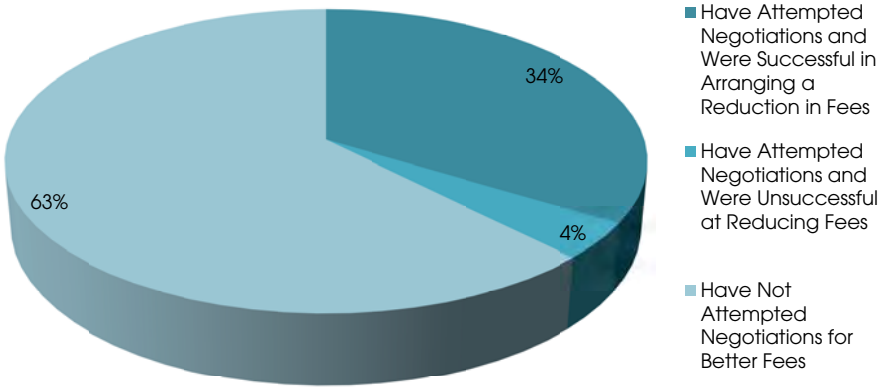
With many investors looking to avoid the traditional 2/20 fee structure, investors are looking to enter negotiations over terms in the pre-investment stages. Over the past 12 months, 38% of investors have attempted to negotiate lower fees, as shown in Fig. 4.39. Of those that entered into negotiations with their managers, 94% of investors were successful in securing more favourable terms. This represents an increase from 89% of investors that were successful in 2012. However, there has been a decrease in number of investors entering into negotiations, from 46% in 2012 to 38% in 2013. With dissatisfaction with fees increasing over the past year, investors need to continue attempting to enter into negotiations with fund managers; the proportion of investors that were successful following entering into negotiations indicates that this is likely to lead to a positive outcome for the investor.

Fig. 4.38: Areas of Fund Terms Investors Feel Have Shown the Most Improvement over the Past 12 Months and that Need to Improve Further in 2013



Source: Preqin Investor Interviews, April 2013

Fig. 4.39: Investors' Fund Terms Negotiation Experiences in the Past 12 Months



Source: Preqin Investor Interviews, April 2013

Significant Improvements in Liquidity and Transparency Terms over the Past Year

There have been significant improvements in how investors view the liquidity and transparency terms of hedge funds over the past year. In 2012, 39% of investors were looking for increased transparency from their hedge fund managers, whereas in 2013 this has fallen to 30%. The liquidity terms are the areas that most investors are becoming satisfied with; in 2012 37% of investors wanted to see improvements on the lock-up terms of a fund, whereas in 2013 this has fallen to 14%. Similarly, in 2012 34% of investors wanted to see more appropriate redemption frequencies; this has decreased to 12% of investors in 2013. With managers responding to investors' requests for increased disclosure and better liquidity terms, hedge funds have shown considerable improvements from the days when they were viewed as "black box" trading strategies.

Outlook

The lessons learnt by investors and managers from the events in 2008 are shaping the post-crisis hedge fund landscape. Managers are paying increasing attention to investor demands for changes in the structures and terms of their funds, and hedge fund fees have dropped over the past few years. Liquidity and lack of transparency were key issues for investors in the immediate aftermath of 2008, in a period when many fund managers looked to exit illiquid assets to fulfil redemption requests, with investors often finding themselves locked into funds. Greater scrutiny from investors on the holdings of funds, as well as calls for full disclosure of illiquid assets and side-pockets has led to a strong response from the hedge fund management community, with most investors reporting positive change in these respects. As a result, the hedge fund industry is finally reaching a point where many investors feel that the levels of disclosure and liquidity of funds is at an appropriate level.

However, the issues concerning fees are certainly far from resolved. Sixty-two percent of investors feel that further improvements are needed on both management and performance fees. With an increasing number of investors feeling that interests between managers and investors are not aligned and fewer investors entering negotiations with their managers over fees than in 2012, the onus to improve these terms and conditions is on the shoulders of the investor. In general, managers have been responsive to investors' direct requests for better terms and conditions in the pre-investment period, with 94% of investors finding that their term negotiations have been successful in the past 12 months.

Data Source:

View hedge fund management and performance fee benchmarks and average lock-in periods on a strategy-by-strategy basis for free on **Preqin Investor Network**.

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