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Performance

Managers report that Brexit has had a significant impact on the performance of hedge funds in 2016.

Location of Firms

UK-headquartered hedge fund managers look set to stay in the UK.

Institutional Investors

Institutional sentiment towards investment in the UK improves five months after Brexit decision.

Outlook

While uncertainty remains, fund managers are increasingly optimistic.

Preqin Special Report: Impact of Brexit on Hedge Funds

Investors and Managers Respond: Year-End 2016 Update

December 2016





Foreword

2016 has been a challenging year for hedge fund managers: investor concerns surrounding the performance of the asset class have led to many difficulties in both retaining capital and raising fresh assets. Despite signs of improvement in performance in recent quarters, the industry has not done enough to stem outflows of assets from the industry: almost \$70bn in capital has exited hedge funds over the first nine months of the year. Compounding outflows and performance concerns, a number of macroeconomic events have made for a challenging environment in which to generate alpha for investors. Among these events was the referendum on the UK's membership of the EU, held on 23 June 2016, which saw a largely unexpected majority vote in favour of leaving the Union, resulting in volatility and uncertainty both politically and in global financial markets.

Five months on and uncertainty still prevails regarding the timing and terms of the UK's secession from the EU. However, with nearly half a year to reflect on how the hedge fund industry could adapt to the changing landscape, Preqin surveyed 276 hedge fund managers and 108 hedge fund investors, as well as utilized data from Preqin's **Hedge Fund Online**, to analyze the changing sentiment of the hedge fund industry surrounding the 'Brexit' vote and how the performance of hedge funds has been affected by this event.

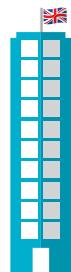
We hope you find this report useful, and welcome any feedback you may have. For more information about Preqin and our **Hedge Fund Online** database, please visit www.preqin.com or contact info@preqin.com.

Key Facts

Size of the Hedge Fund Industry (As of 30 September 2016)



590
of the 944 EU-based hedge fund managers are UK based.



UK **\$478bn**



EU*

\$125bn



408
of the 757 EU-based institutional investors in hedge funds are UK headquartered.

*Excluding UK.

Pre-Vote: Hedge Fund Manager Views on Whether Britain Will Vote to Leave or Remain in the EU



11%
Leave



18%
Unsure



71%
Remain

Referendum Result:



52%
Leave



48%
Remain

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The Impact of Brexit on Hedge Funds: Year-End 2016 Update

UK- and EU-Focused Hedge Funds Suffer in Immediate Aftermath of Brexit, but Both Show Rapid Recovery

The latest performance data taken from the 1,922 UK- and Europe-focused hedge funds profiled on Preqin's **Hedge Fund Online** illustrates the effect of the Brexit vote on both markets over the course of 2016.

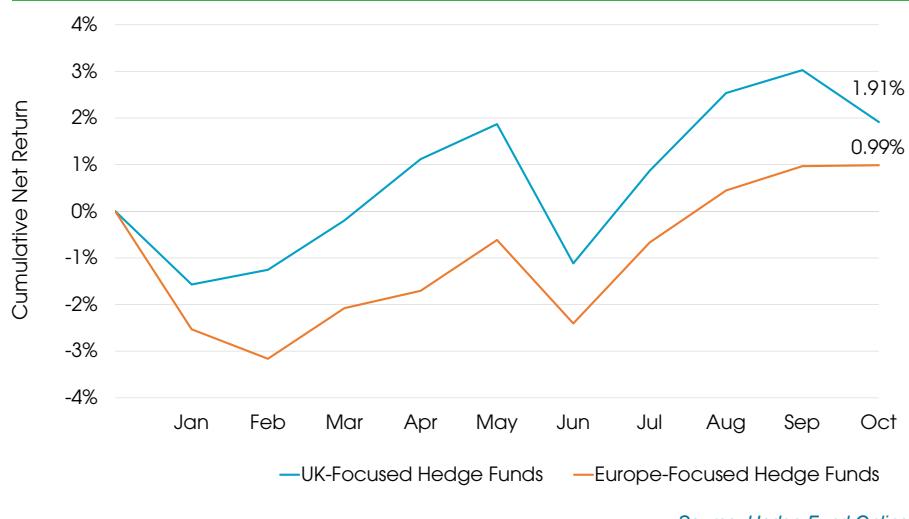
Both benchmarks have been broadly in line with each other since the beginning of the year (Fig. 1). Prior to the referendum, both sets of funds recouped early 2016 losses, with the UK industry reaching positive returns for 2016 in April at 1.12%; however, Europe-focused funds were still in negative territory (-1.71%). The immediate aftermath of the EU referendum had a negative impact on both UK- and Europe-focused funds, with UK-focused vehicles losing the most. However, both UK- and Europe-focused funds have managed to capture the upside of the volatility created in European markets post Brexit, and despite a small loss in September for UK-focused funds, both benchmarks are in positive territory.

Managers Report Brexit Has Had Significant Impact on Performance of Hedge Funds in 2016

In a June survey of 270 fund managers – conducted prior to the EU referendum – just 26% of fund managers noted an impact of the forthcoming poll on the performance of their hedge funds at that time, with nearly two-thirds of these managers stating any impact was negative (Fig. 2).

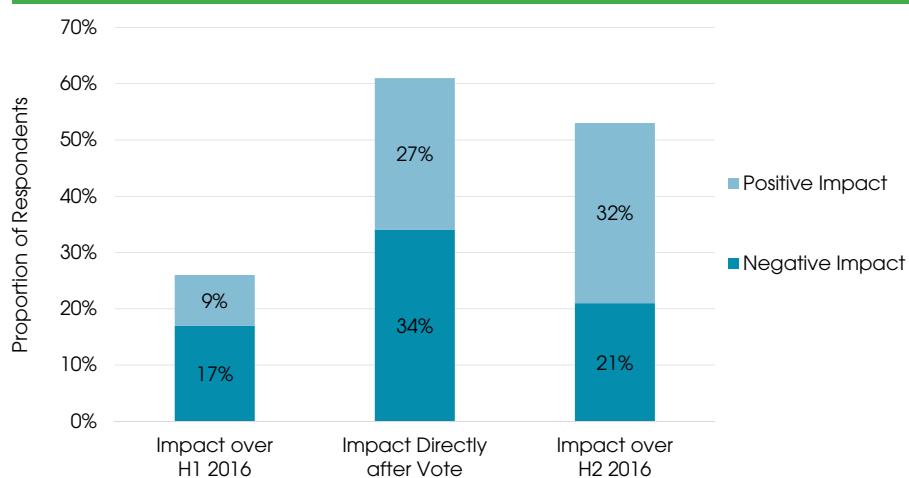
In the immediate aftermath of the Brexit decision, the effects were widely felt across the hedge fund management industry: 61% of fund managers reported to Preqin in July that the EU referendum had impacted their fund's performance. More than half (55%) of these fund managers reported this impact was negative, in line with the data

Fig. 1: Cumulative Performance of UK- and Europe-Focused Hedge Funds in 2016 (As at November 2016)



Source: Hedge Fund Online

Fig. 2: Hedge Fund Manager Views on the Impact of Brexit on Their Performance



Source: Hedge Fund Manager Surveys, June, July & November 2016

in Fig. 1, which shows the sharp fall in the performance of UK- and EU-focused funds in June 2016.

However, despite managers in the weeks after the Brexit decision facing performance difficulties as a direct result, hedge funds at this time were also largely positive about the effect of the referendum on their portfolio for the year ahead: 31% predicted that Brexit

would positively impact their portfolio in the forthcoming 12 months compared with 13% that believed the effect would be negative (Fig. 3).

Five months on, and the effects of Brexit continue to be felt among the majority of hedge fund managers: 53% of managers surveyed reported to Preqin in November 2016 that the outcome of the EU referendum had impacted the



performance of their funds in H2 2016 (Fig. 2). However, those fund managers that believed that Brexit would have a positive impact on their portfolios were proved correct – hedge funds were able to rapidly bounce back from the post-referendum market volatility. Sixty percent of the hedge fund managers whose performance had been impacted by Brexit reported that in H2 this impact was positive (Fig. 2).

When looking forward at the effect of Brexit on hedge funds in 2017 and beyond, there are significant levels of uncertainty: a third of fund managers reported that they are uncertain as to the impact of the referendum on their portfolios in the next 12 months, and a greater proportion (36%) are uncertain regarding the longer term impact (Fig. 3).

However, any effects felt by the hedge fund community are mostly predicted to be positive: a quarter of hedge fund managers surveyed in November 2016 believe Brexit will have a positive impact on their portfolio in the next 12 months and in the longer term, in comparison to 7% and 5% respectively that predict the effect will be negative.

UK-Headquartered Hedge Fund Managers Look Set to Stay in the UK

Our survey of fund managers after the vote in July indicated that it was unlikely there would be a mass exodus of UK-based hedge fund managers immediately following the Brexit result: 80% of UK-based managers did not anticipate changing their location (Fig. 4). Fast-forward five months, and with the implications of Brexit still very uncertain, a greater proportion of surveyed managers in November are uncertain of their position (24% vs. 17% in July 2016), or are considering moving operations away from the UK (6% vs. 3% in July 2017). However, notably, no hedge fund managers surveyed directly after the vote or in November stated definitively that they would move their business out of the UK.

Investor Sentiment towards UK Improves Five Months after Vote

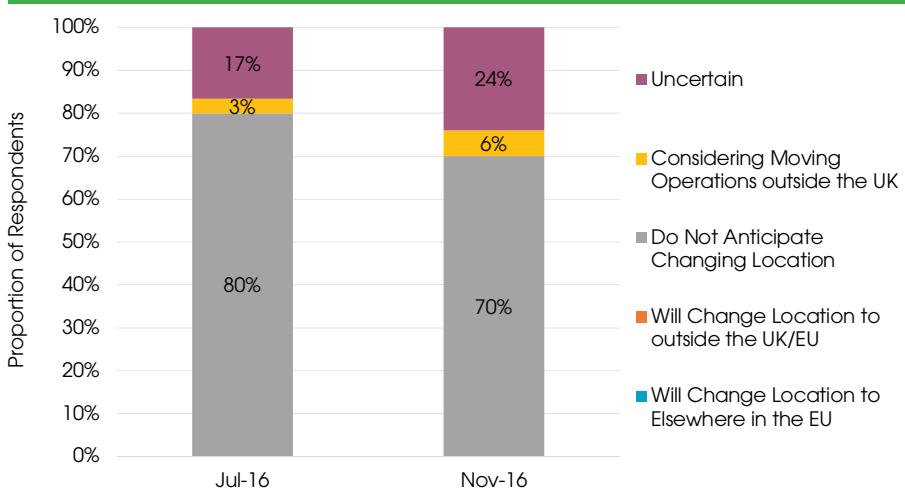
Preqin also surveyed 50 institutional hedge fund investors globally in July, and a further 108 investors in November

Fig. 3: Hedge Fund Manager Views on the Future Impact of Brexit on Their Portfolios



Source: Hedge Fund Manager Surveys, July and November 2016

Fig. 4: UK-Based Hedge Fund Manager Views on Whether Brexit Will Lead to a Change in Location of Their Business Operations



Source: Hedge Fund Manager Surveys, July and November 2016

2016, to discover the potential impact of the UK's decision to exit the EU on their portfolios, and to see if there have been any changes as year progressed.

In July's survey, the majority of investors thought there would be no change to their UK hedge fund investments as a direct result of Brexit over both the next 12 months and the longer term (Fig. 5). Five months later and this looks largely to still be the case. Although a greater proportion (21%) of investors indicated to Preqin in November that they plan to invest less in the UK in the next 12 months than those that plan to invest more (13%), the proportion of investors looking to take capital out of UK hedge fund investments has decreased and

those looking to increase their UK investments has grown since our July 2016 survey.

A similar trend was reported over the longer term, suggesting the concerns of some investors immediately after the EU referendum have been assuaged in the intervening five months, even though there remains a relatively significant proportion of investors – about one-fifth – that may reduce their exposure to UK hedge funds as a direct result of Brexit.

In contrast to the UK, investor sentiment towards the rest of the EU has become more bearish since our survey in June. While the majority of respondents to both surveys stated there would be no

change to their activity, when asked what their plans were for the year ahead, only 4% of surveyed investors in November stated they will invest more in the EU, compared with 12% directly after the vote (Fig. 6). Over the longer term, a smaller proportion (4%) of respondents in November plan to invest more in the rest of the EU than when surveyed in June (9%), and a larger proportion will actively look to invest less (15% vs. 12%).

Outlook

The UK Government is yet to trigger Article 50, which would formally notify its intention to withdraw from the EU. Given no state has ever left the EU before, the political and economic consequences of the Brexit decision, both locally and globally, are still far from clear.

The results of a series of surveys conducted by Preqin throughout 2016 reveal that uncertainty about the full ramifications of this unprecedented decision also pervades. In the immediate aftermath of the referendum, funds focused on the UK and EU suffered performance difficulties as a result of a decision that shocked many, including the 71% of hedge funds that reported to Preqin in June that they expected UK voters to choose to stay as part of the EU.

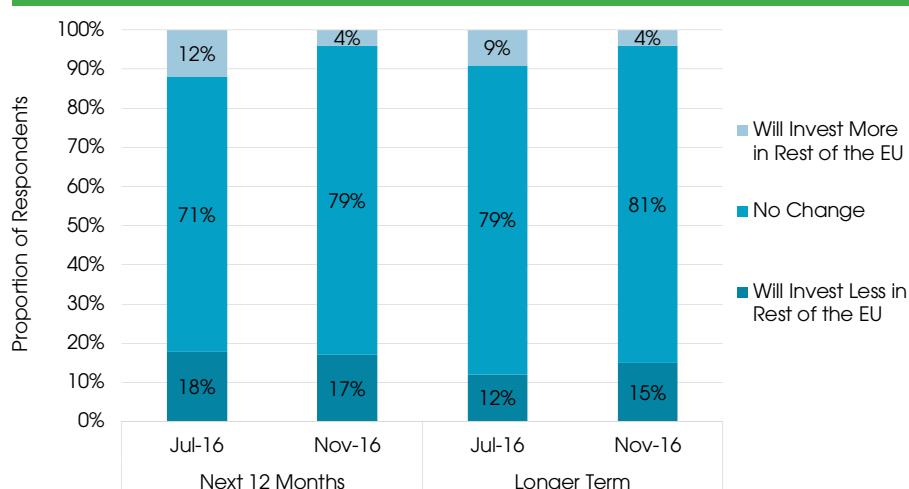
However, as the year progressed, many fund managers globally, as well as in the UK and EU, found that although Brexit was impacting their portfolios, this effect was positive, as they were able to generate strong returns on the back of the resulting volatility within the market. Looking ahead to 2017 and beyond, although a large proportion of fund managers are unsure of the impact of Brexit on their portfolios, most believe any impact would be positive rather than negative.

There has been growing uncertainty among UK hedge funds throughout 2016 regarding where they choose to be located as a result of the EU referendum. Although the largest proportion of UK-based fund managers surveyed have no plans to leave its shores in the immediate future, many will be paying close attention to the negotiations between UK and the EU nations if and when Article 50 is triggered.

Fig. 5: Investor Views on the Impact of Brexit on Their Hedge Fund Investments in the UK



Fig. 6: Investor Views on the Impact of Brexit on Their Hedge Fund Investments in the Rest of the EU



Preqin Hedge Fund Online: The Leading Source of Intelligence on the Hedge Fund Industry

Hedge Fund Online is Preqin's award-winning hedge fund information resource, incorporating all of our hedge fund data, intelligence and functionality, providing you with the most comprehensive coverage of the asset class available.

Hedge Fund Online is updated on a daily basis by teams of skilled research analysts based around the globe, making it a vital source of data and information for fund managers, investors, service providers and other professionals seeking to keep up-to-date with the latest developments in the industry.

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December 2016

Preqin: Global Data and Intelligence

With global coverage and detailed information on all aspects of the hedge fund asset class, Preqin's industry-leading **Hedge Fund Online** service keeps you up-to-date on all the latest developments across the hedge fund universe.

Source new investors for funds

Find the most relevant investors, with access to detailed profiles for over 5,000 institutional investors actively investing in hedge funds, including insurance companies, pension funds, family offices, foundations, wealth managers, endowment plans, banks, fund of hedge funds managers and more.

Identify potential investment opportunities

View in-depth profiles for hedge funds seeking capital, including information on investment strategy, geographic focus, structure, service providers used, sample investors, direct contact information and more.

Find active fund managers of hedge funds

Search for firms operating hedge funds. View information on key contacts, assets under management, performance history, key investment preferences, known investors and more.

Benchmark performance

Identify which fund managers have the best track records with fully customizable performance benchmarks, and view performance details on individual named funds and share classes.

Examine fund terms and conditions

Access fund-by-fund and industry level fund terms and conditions data for individual hedge funds, which provide a market overview, enabling you to see the current trends for specific strategies, structures, sizes and more.

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Search for active administrators, custodians, prime brokers, auditors and law firms by type and location of funds and managers serviced. Customize league tables of service providers by type, location of headquarters, and total known number of funds serviced.

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