This report uses extracts from Preqin's April 2013 edition of Hedge Fund Spotlight.

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Content Includes:

Round-up of Hedge Fund Performance in Q1 2013

How have hedge funds performed so far in 2013? Which regions and strategies have seen the best performing funds?

Hedge Fund Launches in Q1 2013

Which hedge fund strategy was the most prominent in the first quarter? What proportion of funds launched were by first-time fund managers?

Institutional Investor Fund Searches: Q1 2013 Round-up

Which regions and strategies are investors targeting over the next 12 months? What are their fund structure preferences?

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March 2013 Preliminary Performance Benchmarks

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Q1 2013 Hedge Fund Industry Round-up

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Round-up of Hedge Fund Performance in Q1 2013

The hedge fund industry saw a broad base of positive returns posted during the first quarter of 2013. Many funds picked up from the strong close to 2012 as several strategies generated returns exceeding 2% in January, before neutral-to-positive performance in February and March continued the encouraging start to 2013. Robust equity markets contributed to the standout performance of Asia-Pacific funds and to the superior returns of the long/short sector over other strategies.

Funds of Funds Rally, UCITS Stall

Preqin's preliminary benchmarks for March show that funds of hedge funds experienced a particularly promising start to the year. The 3.16% posted by multi-manager funds in the first three months of 2013 represents the best quarterly return for these vehicles since Q1 2012 and was only slightly short of the returns of single-manager funds (see Fig. 1). Long/short (+3.84%) and multi-strategy (+3.18%) funds of funds were key contributors during the quarter, while funds of macro funds detracted slightly from average performance.

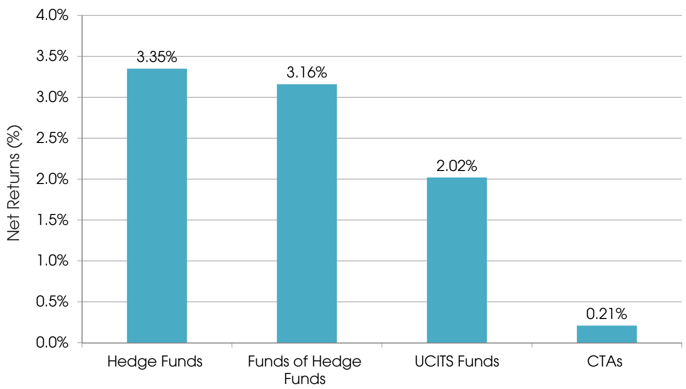
Hedge funds complying with Europe's UCITS directive did not fare as well, with the sector experiencing its poorest performing quarter since the low experienced in Q2 2012. A return of 2.02% in the year to date is largely due to January returns of 1.85% as near-neutral performance was posted in February (+0.18%) and March (-0.01%). Long/short (+3.87%) and relative value (+2.01%) UCITS funds were the key drivers of performance, with vehicles pursuing macro strategies suffering two consecutive months of decline to end Q1 down (-0.96%).

Long/Short Funds Top Other Strategies

The average hedge fund closed the first quarter of the year up 3.35% after long/short and event driven strategies enjoyed particularly promising periods. Buoyant stocks contributed to long trade gains for equity-focused funds operating in key markets. The S&P 500 reached record levels, rising by 10% during the quarter, as the US Federal Reserve reported that it would maintain its low interest rate policy and asset purchase program in its continued aim to stabilize prices and stimulate employment. Long bias hedge funds capitalized on bull markets to post first quarter returns of 7.99% and make a significant contribution to the 4.43% return of the long/short sector. Long/short credit funds posted 3.52% for the quarter and equity-only vehicles overcame marginally negative returns in February to gain 3.52% year to date.

Event driven hedge funds were among the top performers in March (+1.36%), second only to long/short funds in the first quarter (see Fig. 2). A strong start to the year by activist funds also contributed to event driven funds posting a Q1 net increase of 3.81%, which means the strategy leads all others over the last 12 months, with returns exceeding 9%.

Fig. 1: Net Returns of Hedge Funds by Structure, Q1 2013



Source: Preqin Hedge Fund Analyst

Fig. 2: Net Returns of Single-Manager Hedge Funds by Strategy

January 2013	February 2013	March 2013	Q1 2013	Last 12 Months
Long/Short 3.12%	**Relative Value** 0.51%	**Event Driven** 1.36%	**Long/Short** 4.43%	**Event Driven** 9.44%
Multi-Strategy 2.37%	**Event Driven** 0.12%	**Long/Short** 1.19%	**Event Driven** 3.81%	**Long/Short** 7.53%
Event Driven 2.30%	**Long/Short** 0.08%	**Relative Value** 0.74%	**Multi-Strategy** 2.58%	**Relative Value** 6.69%
CTAs 1.40%	**Multi-Strategy** 0.07%	**Macro Strategies** 0.47%	**Relative Value** 2.56%	**Multi-Strategy** 5.94%
Relative Value 1.28%	**Macro Strategies** -0.06%	**Multi-Strategy** 0.14%	**Macro Strategies** 1.17%	**Macro Strategies** 4.05%
Macro Strategies 0.75%	**CTAs** -1.38%	**CTAs** 0.22%	**CTAs** 0.21%	**CTAs** 0.39%

Source: Preqin Hedge Fund Analyst

Relative value hedge funds gained 2.56% to post their best quarter since the same period last year. Equity market neutral vehicles performed particularly well, building on a 1.41% return in January with solid gains in February (+0.71%) and March (+0.97%) to post 3.12% in the year to date. Fixed income arbitrage funds did not fare as well, generating 2.18% during the quarter, but have reinforced a strong period in which the last loss-making month was November 2011.

Multi-strategy and emerging markets hedge funds also started 2013 well, posting January returns of 2.37% and 2.76%, respectively. Multi-strategy vehicles went on to add marginal gains in the following two months to gain 2.58% so far this year. Funds targeting emerging markets declined on the back of a strong first month and ultimately gained 2.33% in the first quarter.

Macro Funds and CTAs Continue Poor Run

The underperformance of macro hedge funds and CTAs in 2012 compared to other strategies continued in the first quarter of 2013. Macro represented the only strategy to post a gain of less than 1% in January. This was followed by a marginal decline the following month (-0.06%) before slightly positive performance in March (+0.47%) to deliver 1.17% overall for the quarter.

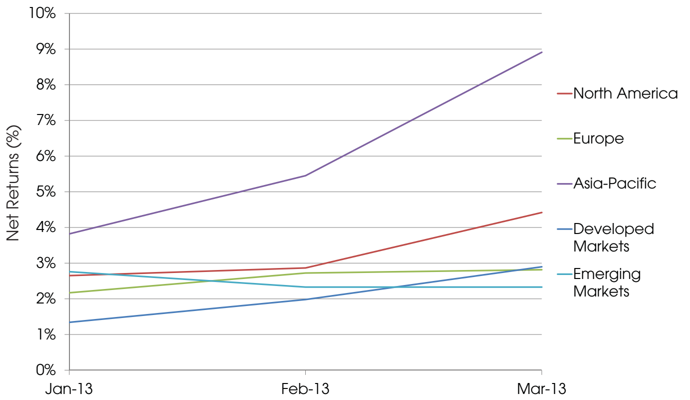
Opportunities for outsized returns in the macro sector offered by the continued depreciation of the yen against the dollar and the sustained rise of Japanese stocks (known as the “Abe trade” after Japan’s prime minister, Shinzo Abe) have been countered by policy uncertainty in other developed markets. A series of destabilizing issues hit Europe in the first quarter, including a delayed bailout of banks in Cyprus, an Italian election resulting in an unclear outcome and significant gains for anti-austerity parties, allegations of political corruption 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.

The performance of CTAs and managed futures managers was marginally positive in the first quarter. An array of commodities’ prices, notably in the metals sector, declined during the first three months of 2013 and major currencies weakened against the US dollar. A gain of 1.40%, the highest for six months, in January was all but given away the following month and CTAs ended Q1 up 0.21%.

Asia-Pacific Leads the Way

Hedge funds with a focus on the Asia-Pacific region were the leading performers in Q1 2013, posting larger returns than vehicles targeting other regions in each of the three months. The year to date return of 8.90% was influenced by the robust performance of equity funds, with stock markets in Japan, Australia and Singapore rising. The Nikkei 225, in particular, experienced an upswing of more than 19% as Japan’s government embarked on a bold monetary stimulus plan.

Fig. 3: Cumulative Net Returns of Hedge Funds by Geographic Focus, Q1 2013



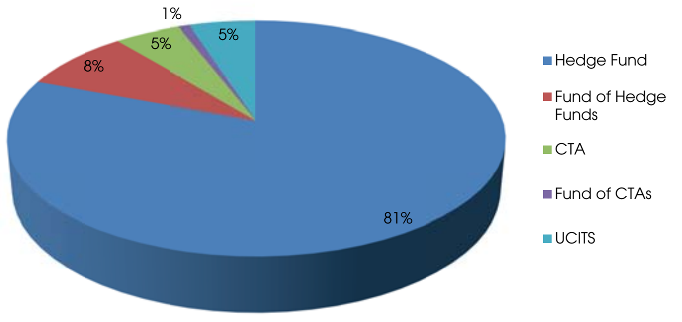
Source: Preqin Hedge Fund Analyst

Funds with a primary focus on North America did not hit the heights of Asia-Pacific funds in the first quarter but succeeded in outperforming other regions during the period, gaining 4.42% (see Fig. 3). A promising start to 2013 saw these hedge funds post their best month since January 2012 before consolidating to extend the current run of consecutive positive returns to 10 months.

First quarter benchmarks for hedge funds focusing on Europe, emerging markets and developed markets all indicate a solid period of performance for these vehicles. In each case, the bulk of the gains were achieved in January to be followed by near-neutral returns in February and March. Europe-focused funds posted 2.82% for the quarter and developed markets vehicles rose by 2.90%. Emerging markets funds are up 2.33% for the year to date having given away part of the January gain (+2.76%) in February (-0.42%) and remaining static in March.

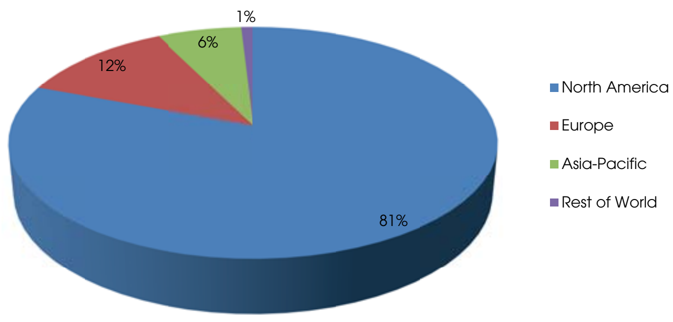
Hedge Fund Launches in Q1 2013

Fig. 4: Breakdown of Hedge Fund Launches in Q1 2013 by Structure



Source: Preqin Hedge Fund Analyst

Fig. 5: Breakdown of Hedge Fund Launches in Q1 2013 by Geographic Location



Source: Preqin Hedge Fund Analyst

Single-manager hedge funds were the dominant structure launched in Q1 2013, representing 81% of all new fund launches (Fig. 4). CTAs represent just 5% of all hedge fund launches in Q1 2013 compared to 10% and 9% in the same period in 2012 and 2011 respectively. This follows two years of disappointing performance in 2011 and 2012 (annual returns of -0.05% & 0.23% respectively). CTA launches in 2012 were at their lowest since 2006, and from the slow start in 2013 it appears it could be another year where CTA launches are overshadowed by hedge funds pursuing other strategies.

The rate of fund of hedge funds launches, in terms of numbers, has been steadily decreasing in recent years following some difficult years in terms of performance, investor appetite and decreasing assets under management. In 2011, the number of funds of hedge funds launched was approximately half that of 2010; 87 funds of funds were launched in 2011 compared to 154 in 2010. In 2012, fewer funds of funds still were launched; just 70 vehicles. In Q1 2013 there were just 13 funds of hedge funds launched. If this low rate of launches continues for the rest of the year it will represent the smallest number of funds of hedge funds launched in any single year since 2000.

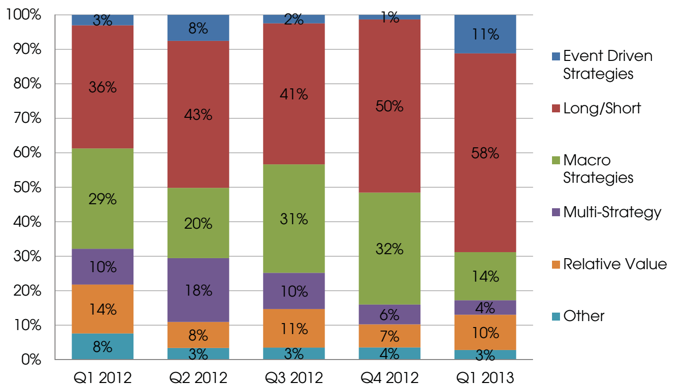
Geographical Location of Hedge Funds in Q1 2013

Fig. 5 shows the geographic location of hedge fund managers that have launched a new vehicle in Q1 2013. Eighty-one percent of new fund launches are managed by North America-based firms, indicating that the most established region for hedge fund management remains the most common region for hedge fund launches. In contrast, the number of launches by Europe-based managers has been relatively low, with just 12% of all funds launched coming from this region, considered to be the other main centre for hedge fund management, with 23% of fund management groups based in Europe. Within Europe, the impending AIFMD (Alternative Investment Fund Manager Directive) has led to many hedge fund managers delaying new launches in order to ensure that existing funds meet the new regulations in advance of the mid-2013 deadline. Therefore, we could see more funds raised by Europe-based managers coming into market in the second half of the year following the 22nd July AIFMD compliance deadline.

Core Strategies

Fig. 6 shows the core strategy breakdown of new hedge funds launched in Q1 2013 and over the past five quarters. Long/short strategies represent well over half of known hedge fund launches in the first quarter of 2013; this is the highest proportional representation of this fund type over the last five quarters. Long/short strategies, and in particular those that are equity focused, such as long/short equity and long-bias, have been increasing in terms of launches in order to take advantage of the rallying equity markets. As Fig. 7 demonstrates, of all funds launched in Q1 2013, 83% are equity focused. Investor demand for long/short strategies has also been strong over the quarter, with over 50% of fund searches initiated in Q1 including a long/short component.

Fig. 6: Breakdown of Hedge Fund Launches by Core Strategy, Q1 2012 - Q1 2013



Source: Preqin Hedge Fund Analyst

Macro strategies hedge funds account for 14% of launches in Q1 2013, a significant dip from the previous quarter, when macro strategies funds represented 32% of all funds. In the second half of 2012, fund launches in the macro sector represented over 30% of all funds launched, substantially higher than its usual 20-25% level. This dip at the beginning of 2013 could have resulted from a large number of managers opening funds at the end of the previous year. Performance of macro strategies funds continues to disappoint, but investors still show a strong appetite for these funds. Therefore, Q2 2013 will be an interesting period for the strategy, as we wait to see if fund managers will launch more new funds in order to tap into investor appetite rather than waiting for a better returns environment.

Event driven strategies hedge funds, which seek to take advantage of corporate events, represent 11% of newly launched hedge funds in Q1 2013. In 2012, the number of event driven strategies launches was relatively low; 5% of funds launches in 2012 pursued the strategy as compared to 10% in 2011 and 8% in both 2010 and 2009. Event driven strategies hedge funds posted the highest rate of cumulative returns at 9.44% over the last 12 months (as of 31st March 2013) of any single strategy. This is also true over annualized three- and five-year periods (8.01% and 8.94% respectively). The strong returns of this more illiquid strategy over the short and longer terms, has led to some investors taking on some illiquidity risk in their portfolios and seeking out event driven strategies for new investment. However appetite for certain event driven strategies such as distressed and pure event driven has fallen over the past year. Despite this, the growing opportunities for event driven funds in both recovering and distressed economies, has resulted in renewed enthusiasm by fund managers to launch funds which pursue the strategy.

First-Time Fund Managers

As Fig. 8 demonstrates, a number of new managers entered the hedge fund market with their first vehicle in the first quarter of 2013. There continues to be a number of proprietary desk spin-offs from investment banks launching hedge funds following the Volcker Rule, as well as some significant fund launches created by spin-outs from existing hedge funds. For example, Continuum Investment Management, formed by a group of Citadel executives, has launched its first fund, a fixed income vehicle, seeded by Grosvenor Capital Management in January 2013.

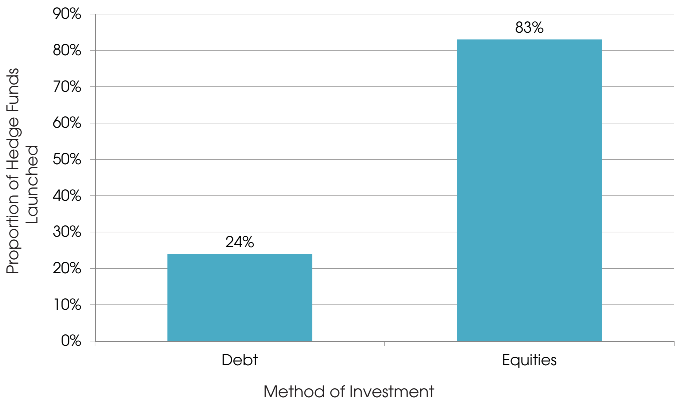
However, established managers have also been launching funds in significant numbers; a quarter of all funds launched in Q1 2013 have been by managers with at least five previous vehicles under management. For example, the $2.8bn, Odey Asset Management has launched both Odey Swan Fund, a UCITS IV version of Odey's flagship long/short fund, and Odey Orion Fund in the first quarter of the year.

Summary

Single-manager hedge fund launches dominate the landscape for new funds coming to market in 2013, with both CTAs and funds of hedge funds showing a significant decline in the number of new funds launched compared to previous years. North America-based fund managers are launching new funds in 2013 in the greatest numbers, as many Europe-based managers wait until after the AIFMD implementation deadline of 22 July 2013 before launching any new vehicles.

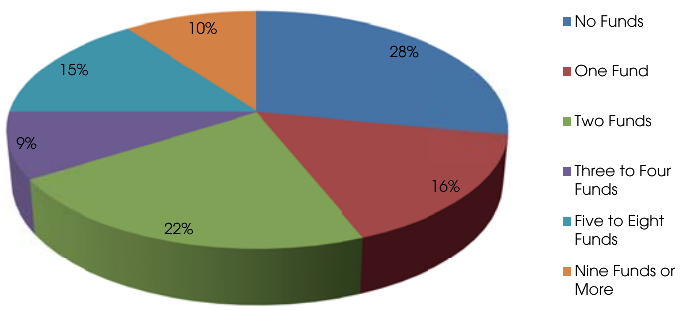
Hedge funds which seek to capitalize on the strong equity markets represent the largest number of launches over the first quarter of 2013, although event driven strategies have seen a resurgence following an extended period of strong returns and growing opportunities in the sector.

Fig. 7: Breakdown of Hedge Funds Launched in Q1 2013 by Method of Investment Used



Source: Preqin Hedge Fund Analyst

Fig. 8: Number of Existing Hedge Funds Managed by Firm Prior to Q1 2013



Source: Preqin Hedge Fund Analyst

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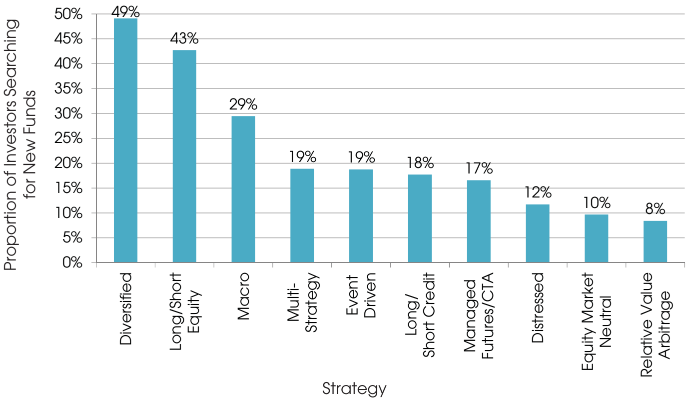
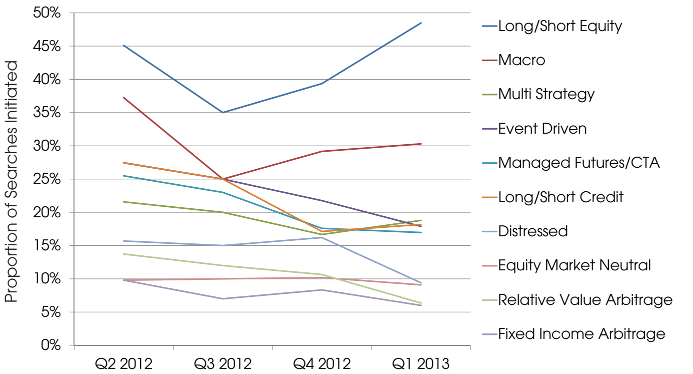
Institutional Investor Hedge Fund Searches: Q1 2013 Round-up

Fig. 9: Strategies Sought by Investors over the Next 12 Months



Source: Preqin Hedge Fund Investor Profiles

Fig. 10: Investor Appetite for Top 10 Strategies Sought by Proportion of Searches Initiated, Q2 2012 - Q1 2013



Source: Preqin Hedge Fund Investor Profiles

An understanding of investors' preferences towards hedge fund investment is vital for fund managers seeking new investors. Using Preqin's Fund Searches and Mandates feature on Hedge Fund Investor Profiles, we examine the current appetite for new hedge funds among institutional investors.

Strategies Sought by Investors

Investors seeking hedge funds across the spectrum of fund strategies still lead in terms of investor searches over the next 12 months, with a diversified mandate sought by nearly half of all institutions currently in the market for new hedge fund investments (Fig. 9).

Long/short equity vehicles are currently being sought by 43% of institutional investors planning on making new allocations to hedge funds. Fig. 10 shows the changing appetite for various hedge fund strategies from Q2 2012 to Q1 2013, as measured by the proportion of all investor searches for that strategy over that period. Investor appetite for long/short equity funds is at its highest level over the past four quarters, with 48% of mandates issued in Q1 2013 including a long/short equity component, an increase from 39% in Q4 2012 and 35% in Q3 2012.

Conversely, fixed income arbitrage strategies, which make investments in bonds and other fixed income products, have shown a general decline in investor appetite over the past four quarters, from 10% of mandates issued in Q2 2012 down to 6% of searches initiated in the first quarter of this year. Similarly, Fig. 10 reveals that two other relatively illiquid strategies, event driven and long/short credit, have also shown a general decline in appetite among institutional investors over the past year. Both strategies are sought by 18% of investors which initiated a new mandate in Q1 2013, significantly lower than the 27% of investors that indicated an interest in each strategy in Q2 2012. Despite the above average returns of these illiquid strategies, many investors are still unwilling to take on the liquidity risk of investing in strategies where capital could be locked in for up to two years.

Twenty-nine percent of investors have indicated to Preqin analysts that they are searching for macro strategies. This is an increase from the marked dip witnessed in Q3 2012, when the proportion of investor mandates including macro funds fell from 37% of all investors that initiated a search in Q2 2012 to 25% in Q3 2012. However, although investor appetite for this strategy has not yet returned to the Q2 2012 level, this trend shows investor sentiment towards the strategy is improving.

Following the poor performance of CTAs in 2011 and 2012, and a slow start to 2013 in terms of returns generated, investor appetite for CTAs is showing signs of decreasing. Investor searches initiated for the strategy fell again to 17% of all searches gathered by Preqin analysts in Q1 2013, down from 18% in Q4 2012 and 25% in Q2 2012.

Fund Structure Preferences

Commingled direct funds are being sought by the greatest number of investors, with 85% of all open investor searches over the next 12 months including at least one single-manager vehicle. Much of this appetite is driven by the large number of funds of hedge funds looking for new investments in the next 12 months, as well as other established institutional investors in direct funds, notably endowments, family offices and foundations, seeking new opportunities in the year ahead. Other groups of investors, in particular public pension funds, are also seeking to direct more capital to single-manager funds to avoid the additional layer of management fees involved in funds of hedge funds. However, in general, public pension funds and their private sector counterparts are still large supporters of funds of hedge funds and are driving much of the appetite for multi-manager vehicles over the next 12 months.

Although relatively niche, there is also investor interest in managed account versions of single-manager funds, with 17% of investors looking to invest in these more liquid and transparent structures over the next year. The European-regulated UCITS wrapper for hedge funds has also continued to gain traction among institutional investors, with 14% of investor mandates including a UCITS-compliant hedge fund component. This is double the 7% of investor searches which included UCITS funds in 2012, further demonstrating the increased appetite for these liquid alternatives to the offshore model.

Investors by Type and Region

Fund of hedge funds managers are seeking new funds in the greatest number, with 39% of all searches issued in the first quarter of 2013 coming from this group of investor. Public pension funds show a revived appetite for hedge funds following a quiet end to 2012, a period when many public pension funds were reviewing their current portfolios before making any decisions on new investments for the year ahead. Thirteen percent of all hedge fund searches gathered by Preqin analysts in Q1 2013 were from public pension funds. This is positive news for the industry as the average public pension fund with an open mandate is looking to deploy $100mn in new hedge funds in the next 12 months.

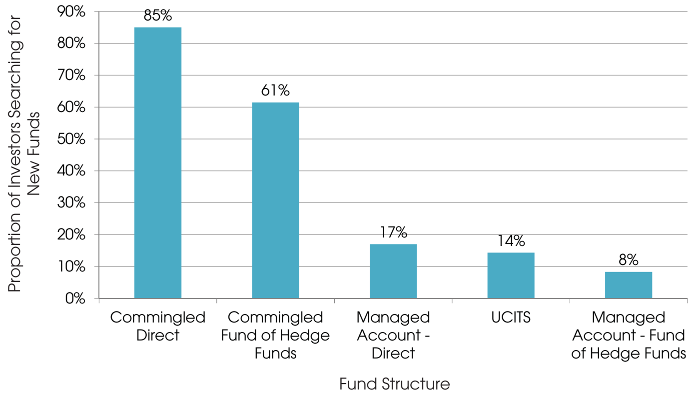
The established centres for hedge fund investment, North America and Europe, form a combined 90% of all investors searching for funds over the next 12 months. The emerging centre for hedge fund investments, Asia-Pacific, accounts for the majority of the remaining 10% of investors searching for new fund investments. As these investors become more accustomed to the asset class, and changing regulation in the region opens up new areas of investment in hedge funds, we can expect to see more searches for hedge funds coming from the Asia-Pacific region.

Outlook

Liquid strategies trading on equities, notably long/short equity, are increasingly being sought by institutional investors looking to take advantage of the current market rally. As Preqin's fund launch data demonstrates, there has been a marked increase in the number of long/short launches since the turn of the year; therefore investors targeting this strategy will have a wide choice of funds, both established and emerging, to fill these open mandates.

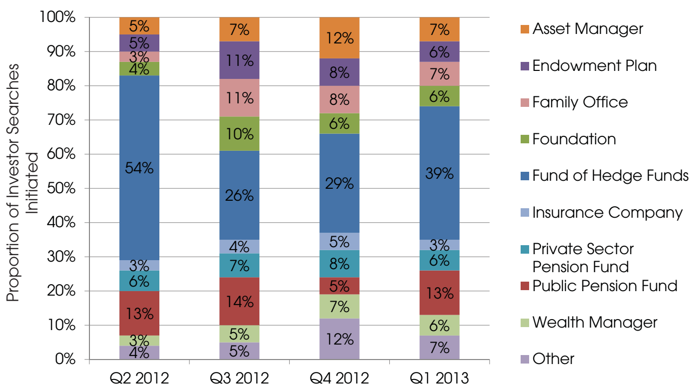
However, the more illiquid strategies have shown a decrease in appetite from institutional investors, alongside CTAs, which, although extremely liquid, have had a difficult two years in terms of performance. Single-manager funds and funds of hedge funds are the most commonly sought structures by institutional investors over the year ahead. However, alternative structures such as managed accounts and UCITS funds are increasingly sought by investors, as they look for alternatives to the traditional offshore model to fill their liquidity and transparency needs.

Fig. 11: Proportion of Hedge Fund Investors Searching for New Funds by Fund Structure



Source: Preqin Hedge Fund Investor Profiles

Fig. 12: Breakdown of Hedge Fund Investor Searches Initiated in Q2 2012 - Q1 2013 by Investor Type



Source: Preqin Hedge Fund Investor Profiles

Data Source:

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Preqin Performance Benchmarks: March 2013

Fig. 13: Summary of Preliminary March 2013 Performance Benchmarks (Net Return, %)

	March 2013	February 2013	Year To Date	Annualized 3 Years
Hedge Funds (All Strategies & Regions)	**0.87**	**0.08**	**3.35**	**6.91**
Long/Short	1.19	0.08	4.43	6.41
Event Driven Strategies	1.36	0.12	3.81	8.01
Relative Value	0.74	0.51	2.56	7.44
Macro Strategies	0.47	-0.06	1.17	6.30
Multi-Strategy	0.14	0.07	2.58	6.59
North America	1.51	0.21	4.42	10.58
Europe	0.09	0.54	2.82	4.98
Asia-Pacific	3.28	1.57	8.90	8.51
Emerging Markets	0.00	-0.42	2.33	6.22
Developed Markets	0.90	0.63	2.90	6.51
USD	1.15	0.00	3.82	7.49
EUR	0.44	0.49	2.58	3.56
JPY	5.40	2.61	13.96	7.54
GBP	-0.54	0.35	1.41	2.39
BRL	-0.05	0.30	1.33	10.97
Funds of Hedge Funds (All Strategies & Regions)	**0.72**	**0.35**	**3.16**	**2.56**
Long/Short	0.80	0.44	3.84	2.08
Multi-Strategy	0.93	0.29	3.18	2.53
USD	0.66	0.25	3.07	2.70
EUR	-0.16	0.21	1.90	0.32
UCITS Hedge Funds (All Strategies & Regions)	**-0.01**	**0.18**	**2.02**	**2.16**
Long/Short	0.55	0.57	3.87	2.90
Relative Value	0.35	0.47	2.01	1.69
Macro Strategies	-0.97	-0.65	-0.96	1.50
USD	-0.05	0.12	2.44	2.05
EUR	0.46	0.27	2.32	1.75
CTAs (All Strategies & Regions)	**0.22**	**-1.38**	**0.21**	**4.65**
USD	0.00	-1.43	0.09	4.82
EUR	0.30	-1.83	-0.85	0.56

Source: Preqin Hedge Fund Analyst

Hedge funds investing in Japan have continued to benefit from the country's buoyant equity market. Yen-denominated funds and vehicles targeting the Asia-Pacific region constituted the top performing benchmarks in March and in Q1 2013. Long/short, event driven and North America-focused funds generated solid returns in March, but macro UCITS funds, sterling-denominated hedge funds and euro-denominated funds of hedge funds were among those posting losses for the month.

Fig. 14 illustrates the distribution of first quarter returns among single-manager funds. Two-thirds of funds posted net returns between -5% and +5%, with the majority of these (69%) in positive territory. Encouragingly for investors, more than a quarter of funds delivered gains exceeding 5% during Q1 2013 and few funds lost more than 5%.

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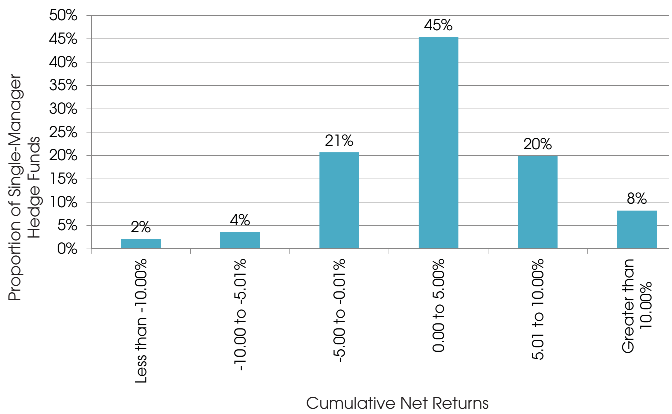
Fig. 14: Distribution of Net Returns Among Single-Manager Hedge Funds, Q1 2013



Source: Preqin Hedge Fund Analyst

Preqin Special Report:
Q1 2013 Hedge Fund Round-up

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