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Special Report: Hedge Fund Market Observations

This special report was conducted by Ipreo's Hedge Fund Research team and examines the current trends, launches, and closures within the global cross-asset class hedge fund space.

Thawing Environment

Hedge funds continued the tumultuous trend they ended 2008 in during the first quarter of 2009. Performance remained in the red, there were relatively few launches, and fund closures hit even some of the heavyweights in the industry. Following a better second quarter of 2009, signals may now be pointing to the ice caps melting and some indications of a turning of the hedge fund tide. Although the volume and type of new fund launches around the globe are still at historical lows, there has been a significant turnaround in performance and a slowing of fund closures.

Ipreo has been monitoring the industry's overall trends and has created this abstract to assist our clients in understanding the changing tides of the hedge fund market and its possible impact to their underlying businesses, be they capital markets or investor relations in orientation.

IPREO'S 2009 HEDGE FUND DATASET**

FIRMS	#
Total HF Firms	4,524
HF Firm Launches	85
HF Firm Closures	108
FUNDS	**#**
Total HFs	13,038
Liquidated	384
Launched	354

**Above statistics include various asset classes, including Equity, Fixed Income, UCITs, Futures, Options, Private Debt, and Private Equity.

ASSETS UNDER MANAGEMENT & FUND FLOWS

For the first two quarters of 2009, hedge fund assets fell by 7.3%. Estimates put the total hedge fund industry (excluding fund of funds) at around $1.8 trillion as of July 2009.[1] It also appears hedge fund outflows have leveled off of late, and for the first time in several quarters' inflows and outflows are nearly equal for May-July.

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SHORT INTEREST

In recent months, hedge funds have increased their net long exposure to the highest level since June 2008. Net long exposure hovered in the mid-40% range for the majority of 2007, before dipping to a low of 17% in September 2008. Net long exposure has rebounded to 31% as of June 2009. For the first time since the beginning of 2008, hedge funds are also net long financial stocks.5

FUND LAUNCHES

Global hedge fund launches are at all time lows. One trend in the industry shows most of the largest hedge fund launches are actually secondary fund offerings of new fund launches from medium/larger sized hedge fund companies rather than pure start ups. Examples include: Brevan Howard, Paulson, and Marathon to name a few. Experts expect the number of hedge fund launches to pick up thru the second half of the year. Ipreo's analysis of recent launches shows that the primary strategies for new hedge funds include: long/short equity, global macro, and fixed income (both diversified and distressed debt/loans).

North America

In North America, fund launches in the first half of 2009 were at historical lows. The largest 21 fund launches garnered $3.9 billion, down 81% from last year's first half. New fund launch strategies primarily focused on long/short equity, diversified fixed income, and distressed debt and loans.

Europe

European hedge fund launches saw a 10 year low in the first half of 2009. The majority of new fund launches was concentrated in European long/short equity, global macro, and managed futures. The region also saw a lot of movement amongst its largest fund of fund and hedge fund managers. The recent mergers of Credit Agricole and Societe Generale, in addition to BNP Paribas and Fortis, will shake up the top 5 hedge fund players in Europe as the newly combined entities will represent some of the largest alternative managers in Europe.

Asia

The Asia Pacific region has seen the strongest gains in the hedge fund arena. July was an especially strong month across the board for the entire Asia Pacific region. China-focused hedge funds had the strongest performance in July, followed by Australia and India.

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FUND LIQUIDATIONS

Many well-known hedge fund managers continued to close year-to-date as well, as the trend carried over from 2008. A developing trend in the 2009 market has been hedge fund managers exiting/discontinuing their hedge fund business but continuing their other asset management businesses. In addition, several firms have restructured their hedge funds into separately management accounts. Below are some examples of some notable hedge fund closures:

Cantillon Capital Management - Cantillon Capital Management, founded in 2003 by former Lazard Asset Management star, William von Mueffling, shuttered its hedge-fund business to focus on traditional investing. Cantillon, which peaked at USD$10 billion/€6.9 billon AUM, currently manages around $3.5 billion/€2.4 billion.

D.B. Zwirn - Zwirn, which once managed total assets of USD$5.5 billion/€3.8 billion, closed its doors in early 2009. The funds were liquidated and assets taken over by Fortress Management.

JWM Partners - With estimated one-time total assets of USD$2.5 billion/€1.7 billion, and run by famed Long-Term Capital Management investor John Meriweather, is closing. This was his second attempt at the hedge fund business.

Atticus Capital Management - Atticus once managed total assets of close to USD$19 billion/€13.2 billion, but the firm has closed its two main event-driven funds, returning USD$3.3 billion/€2.3 billion to investors.

Cerberus Capital Management - Reports are that clients are withdrawing more than USD$5.5 billion/€3.8 billion from the firm's hedge funds.

FUND LIQUIDATIONS

A recent study by Castle Hall Alternatives looked at hedge funds by strategy and their exposure to operational failure. The typical academic would tell you that complex or black box strategies often employed by hedge funds would have the highest rate of failure. In fact, it was the more straight forward strategies that had the highest rate of failure. Long/short equity and managed futures, two of the least complex strategies in terms of hedge funds, came in first and second, respectively.[4]

Based on data from the Credit Suisse/Tremont Hedge Fund Index, hedge fund returns in 2009 are down over 15% for the year. Almost every strategy and asset class with the exception of shorts and managed futures has felt the pinch of the global market decline.

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		Index Value		Return		
	Currency	9-Jul	9-Jun	9-Jul	9-Jun	YTD
Credit Suisse/Tremont Hedge Fund Index	USD	385.82	376.27	2.54%	0.43%	9.90%
Convertible Arbitrage	USD	290.63	274.69	5.80%	4.05%	31.14%
Dedicated Short Bias	USD	73.57	79.33	-7.26%	-1.96%	-17.28%
Emerging Markets	USD	310.89	299.42	3.83%	0.69%	17.54%
Equity Market Neutral	USD	232.02	227.95	1.79%	-0.21%	2.91%
Event Driven	USD	431.56	421.74	2.33%	1.02%	9.11%
Distressed	USD	491.62	480.82	2.25%	1.44%	8.72%
Multi-Strategy	USD	405.7	396.14	2.41%	0.71%	9.34%
Risk Arbitrage	USD	298.46	295.16	1.12%	0.89%	7.50%
Fixed Income Arbitrage	USD	193.31	186.51	3.65%	1.83%	15.90%
Global Macro	USD	613.24	602.52	1.78%	-0.85%	5.24%
Long/Short Equity	USD	448.02	435	2.99%	-0.04%	11.45%
Managed Futures	USD	261.96	263.08	-0.43%	-2.32%	-7.82%
Multi-Strategy	USD	318.96	309.69	2.99%	1.62%	15.65%

Table source: http://www.hedgeindex.com/hedgeindex/en/default.aspx?cy=USD

REGIONAL PERFORMANCE OVERVIEW

	Jan	Feb	Mar	Apr	May	June	July	YTD
Eurekahedge North American HF Index	1.18	-1.59	1.94	3.81	4.94	0.62	2.18	13.69
Eurekahedge European HF Index	-0.83	-0.87	2.53	4.49	4.46	-0.24	1.92	11.87
Eurekahedge Asian HF Index	-1.21	-0.97	2.47	4.35	7.37	1.56	4.08	18.72

Table Source: http://www.eurekahedge.com/indices/default.asp

OTHER THEMES

UCITS III Funds

Since the adoption of the third version of the Undertakings for Collective Investment in Transferrable Securities (UCITS III) framework, the hedge fund industry has flocked to these vehicles, due in no small part to the market events of 2008. The new framework allows for use of a much broader range of investment strategies, typically suited to hedge funds. The UCITS III framework allows onshore (and even retail investors) to gain access to products that can go short and use liquidity. UCITS III also limits lock up periods and provides greater transparency, a feature greatly demanded by hedge fund investors due to the turbulence of 2008. So far Exane has converted its entire portfolio into the UCITS III format, with firms like Brevan Howard, GLG, BlueCrest, Odey, and Marshall Wace already launching similar products.[2]

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UK Taxes

Several hedge fund managers, CTAs, and private equity investors in London have left or have plans to quit the U.K. altogether in response to the country's plans to raise the top personal tax rate to 51%. The majority of the moves to-date has been confirmed to Switzerland and Guernsey. Lawyers estimate that close to $15 billion in assets have already left in the past year. Hedge fund Amplitude Capital and private equity firm Terra Firma have already left, and rumors have surfaced that hedge fund firm Odey Asset Management and private equity player KKR have both threatened to move their European operations out of the U.K.[3]

CONCLUSION

Optimism reigned throughout the 2Q09 as investor sentiment thawed and many investors began reallocating capital to alternative funds across the spectrum. Although it is too early to declare a turnaround in global hedge fund markets, leading indicators are showing improvements. After a disastrous 1Q09 for the fund of hedge funds markets in terms of mandates, the second quarter saw a jump of about 41% in mandates as investors look for lower risk ways to enter the hedge fund markets. Investors that spent 1Q09 on the sidelines looked to be more willing to take on longer lock ups and redemption periods, both of which froze the markets in 2008.

SOURCES

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5. Kostin, David; Fox, Nicole; Maasry, Caesar; Sneider, Amanda. Hedge Fund Trend Monitor. Goldman Sachs 24 August 2009