

SWISS HEDGE

1st Quarter 2005

A Review on Developments in the Hedge Fund Market



European long/short equity strategies

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Institutionalisation of the hedge fund industry on the rise



Peter Fanconi | Harcourt AG

Today, HNWI's account for 2/3 of total Hedge Fund assets. Our forecasts indicate a decrease to approximately 1/2 within the next 3 years, at which point institutional investors will account for up to 1/2.¹ The main drivers of this institutional growth will be the less saturated US and Japanese insurance companies, as well as Asian, European and US pension funds.

Results of the Prospera Survey on «European institutions alternative Investments» released by IPM and AIMA highlights that 40% of the largest institutional investors within Europe have already invested in hedge funds, with an average allocation of 4%. Both the number of investors as well as the allocation size are expected to rise significantly during the course of 2005 – with the Netherlands, the UK, Switzerland, as well as the Nordic region being expected to play a dominant role.

In the past, institutional investors have been conservative in approaching alternative investments. Today, an increasing focus on core/satellite and ALM-based investment approach is driving the establishment of hedge funds as an asset class. Hedge funds offer not only attractive risk adjusted returns but also increasingly higher levels of transparency and risk control. Confidence and trust are on the rise.²

What are the consequences for the supply side?

Funds of hedge funds will most likely attract the majority part of the expected inflows. However, institutional investors have a tendency to invest with traditional brands. It is therefore expected that more multinational banking groups and distribution houses will be taking clear positions and establish themselves as institutional suppliers. These late entrants may well accelerate the trend of consolidation of the fund of hedge fund industry.

Nevertheless, focused and established players with clear differentiating factors and the capability and knowledge of investing in new strategies will continue to play a very important role. In order to compete with the multinational banking and distribution groups, the following requirements will be key for future success:

- › significant resources on both the personnel and the IT side to handle the growing number of funds and new investment strategies
- › highly structured investment process
- › sophisticated risk management and transparency
- › industry reputation and brand
- › top tier track records
- › outstanding negotiation power with managers (e.g. capacity)
- › high degree of customization, service and flexibility

The offerings to institutional investors will become more specialized and service oriented. Supplier differentiation factors will include quality of capacity and the identification of inefficiencies within less crowded spaces. The result will be a more strategy focused offering, (fixed income, commodities, etc), as well as geographical focus (e.g. Europe, Asia). The players within the industry who successfully resist the industry trend towards the main stream and continue to excel through focus, vision and higher returns, will be well positioned to offer sophisticated tailor-made client services and eventually build up strategic partnerships with institutional investors, enabling best of breed solutions.

Harcourt has successfully differentiated itself by maintaining a clear focus when it comes to hedge fund strategies as well as geographical regions. This issue of swissHEDGE shares different expert views on «European Long/Short Equity» – a strategy we are convinced holds great long term potential especially for institutional investors.

¹ Sources from Morgan Stanley, Greenwich Associates estimate Institutional Investors covering almost up to 2/3 of total Hedge Fund asset within the next 3 years.

² State Street Investor Confidence Index
