

SWISS HEDGE

1st Quarter 2008

A Review on Developments in the Hedge Fund Market



Picture: Christian Forrer

Fixed income strategies

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Picture: Christian Forrer

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Safety first



Peter Fanconi | Harcourt AG

2007 will go down in the annals of finance as the year of the credit and liquidity crisis. Triggered by the deflation of the housing bubble in the US, financial markets globally have been in turmoil for most of the second half of the year. With few exceptions, investors had nowhere to hide and continue to suffer into this year. At the time of this writing, we are faced with significant market declines across the globe. Investment banks continue to announce multi-billion write-offs, restructurings and layoffs. The US is on the way into recession, inflation is picking up. Right now nobody knows when it will end, or how it will be resolved. Indeed, fear has taken over. How has this impacted the hedge fund industry, and what do we expect going forward?

Despite the well-publicized performance weakness of high profile statistical arbitrage funds, and regardless of the demise of several hedge funds in the credit space, the hedge fund industry is looking back on an excellent year. This goes for performance, as well as for continued and healthy asset growth.

According to most recent HFR figures, the hedge fund industry as a whole witnessed net inflows of approx. USD200b in 2007. These inflows occurred in every quarter of the year. Meanwhile, majority of hedge fund strategies, for the second year in a row, enjoy robust performance. Combined, these effects have resulted in a net growth of 30%, which brings the industry to USD1,900b.

An indeed, we believe the current environment is favourable for the hedge fund industry and its investors, and are convinced that it will remain so for the foreseeable future. The market turmoil has created volatility, dislocations and dispersions. So-called «emerging markets»,

while not yet being decoupled, perform far more independently than they did in the past. For hedge funds, they provide fertile ground in terms of structural inefficiencies and informational asymmetries. The correlation between asset classes, and within them, is decreasing. New hedge fund strategies are being deployed, and all of this points towards a conducive environment for return generation.

In terms of demand for absolute returns: the uncertainties and downward drift of assets globally is encouraging investors to allocate significantly to hedge funds and in particular to fund of hedge funds, which are the ultimate vehicles for capital preservation and drawdown protection. Safety first is the creed. These are the times when investors would do well to consider the two rules for which Warren Buffett is known for: „The first rule of investing: Never loose money. Then second rule: remember the first rule.»

Amongst many others, Fixed Income strategies are finding fertile ground within the current market environments. While many investors still believe that the fixed income market remains relatively richly priced and susceptible to further market corrections in 2008, these markets remain in dislocation. This comes in support of many hedge fund strategies, one example being the distressed security universe. There are many other ideas and opportunities within this space. This current swissHEDGE issue you are holding in your hands is bringing several expert views together, shedding further light into this fascinating hedge fund space. We hope you will find the result interesting!