

Press release

Are funds of hedge funds still the black sheep of the asset management industry?

7 June, 2012

Momentum Global Investment Management ('Momentum'), believes that the appetite for hedge fund investing has returned. In a paper published today Momentum examines the rise and fall of funds of hedge funds and asks whether there is still a place for them in client portfolios.

Hedge funds, and by extension hedge funds of funds, have endured persistently bad press post the 2008 collapse of Lehman Brothers and yet data from index provider Hedge Fund Research (HFR) indicated that the industry has stabilised post the traumas of 2008.

Momentum's research found that:

- Hedge funds are still attracting capital
- Hedge funds remain a tiny part of the financial market
- Returns for the industry are attractive from both an absolute and portfolio perspective
- Correlation to equities has increased post 2008, but is likely to decrease in the future
- Hedge fund investing exposes investors to a unique set of risk factors
- Small, new managers tends to outperform large old managers
- Hedge funds of funds who managed capital successfully through 2008 and with a track record of investing in smaller managers are still a viable investment solution

Speaking on the findings of their paper John Caulfield, CIO of Alternative Strategies for Momentum said: "Demand for hedge fund's remains robust. Assets are back to their pre-Lehman peaks of approximately USD 2 trillion. Although the trend is definitely one of the big getting bigger, large funds account for approximately 3% of the universe by number but control approximately 85% of assets. This is despite overwhelming evidence showing small new funds outperform large old funds."

In a study conducted as part of their research, Momentum found that whilst hedge funds have always been vulnerable to systemic events when compared to equities, they tend to have shallower, shorter lived drawdowns with stronger recoveries relative to the initial loss.

Momentum Global Investment Management Limited

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However, Momentum point out that whilst investing in hedge funds can be extremely rewarding there are potential pitfalls. Illiquidity within the sector, lack of regulation, fraud, operational risk, gating and restricted liquidity terms are major factors to consider. Investors should also not be lulled into the false sense of security that big is better.

To invest in hedge funds investors need sufficient expertise, knowledge and experience; Momentum review ways to gain exposure and the pros and cons attached to these. Mr. Caulfield states: "There are broadly three ways to get exposure to the asset class - invest direct, invest through replicators or invest through funds of hedge funds. Replicator performance has been extremely mixed and they require skill to select, making them unsuitable as beta products. However, they also proclaim to be representative of the hedge fund universe making them unsuitable as alpha products. Investing direct via consultants is likely to lead to disappointing returns given most consultants typically limit their recommendations to managers with at least USD 1billion AUM and a three year track record. Unfortunately these limits are likely to lead to disappointing returns given they exclude approximately 97% of the hedge universe.

Given the unique set of risks associated with investing in hedge funds, those without in-house selection expertise are still likely to be best served by the hedge fund of funds route. Hedge Fund of Funds must be able to demonstrate an audited track record over at least one investment cycle including 2008, no back tested data, an experienced stable team and no history of side pocketing or restricting liquidity. Similarly, a long standing history of adding value through both manager selection and asset allocation net of all fees should be a pre-requisite, along with a proven ability to successfully invest with smaller, younger managers where returns are typically better."

The paper concludes that investors who are looking to get the best from investing in hedge funds may be better served by moving away from the herd currently crowding into the big funds and re-engaging with some of the industry's perceived black sheep.

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Notes to editors

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Momentum Global Investment Management Limited has USD4billion in assets under management (as at 31 December 2011).

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Source: Momentum Global Investment Management, December 2011

Other research findings can be viewed at www.momentumgim.com.



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