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EXECUTIVE SUMMARY

Concept Capital Markets, LLC recently conducted a survey of investors that allocate assets to alternative investment managers. The purpose of the survey was to gain insights into allocators’ dispositions toward hedge fund managers in general, to achieve a clearer sense of the investment strategies they currently favor, and to better understand the decision-making process driving their allocations.

The survey's participants included a wide spectrum of institutional and qualified investors, including financial advisors and wealth managers, fund of funds, single, and multi-family offices, high-net-worth individuals, consultants, and managed account platforms. The 110 respondents, mostly concentrated in the United States and Europe, oversee some $150 billion in assets, much of which is invested with alternative investment managers, which in our view is a fairly representative sample of the $2.8 trillion widely estimated by industry sources to be managed in hedge funds. This group also represents a wide range of allocation sizes to hedge funds.

Our goals are twofold: First, to share the information obtained with our hedge fund clients, providing them guidance as they engage in their capital raising efforts, and second, to provide our own capital introduction team with the results so that they may be more effective in making relevant connections between portfolio managers and investors. The takeaways from the survey include the following:

Increasing allocations for 2014, with an emphasis on emerging managers

Respondents to our survey overwhelmingly indicate that they have increased their allocations to hedge fund managers in 2014 and intend to continue this pattern. This appears consistent with the widely held view that institutional allocators continue to further diversify into alternative investment strategies. Emerging managers appear to be the principal beneficiaries of these increased commitments, with 56% of respondents targeting managers with less than $50 million in assets under management (AUM) and 57% of respondents showing interest in managers with track records of less than two years. This bodes well for the many startups of the past couple of years, including those who have come out of the larger hedge fund firms and the proprietary trading desks at the big banks. The latter have materially downsized or shut down in the wake of the Dodd-Frank law.

New launches/seed capital

The news for emerging managers is also encouraging as institutional allocators seem more inclined to be early investors. 55% of respondents to the survey indicated that they had already been “day one” investors, and of those that had not committed capital to startups, 53% responded that they would be open to the opportunity.

Key drivers in decision-making process

Hedge fund managers with well-defined investment strategies and processes, documented experience in the relevant field, and a history of producing investment returns should also find encouragement in our survey results. The “three Ps” of process, performance, and pedigree remain the key drivers for respondents making investment decisions, with respondents answering 71%, 56%, and 49%, respectively. Employing an effective risk management process also ranked highly among respondents with 48%. Having sound infrastructure support, more liberal redemption terms, and the size of a fund appear far less important to investors.
Preferred strategies for 2014

Equity-focused strategies appear to have a much easier path toward capital in 2014, according to survey respondents. Event driven/special situations (38%), long/short global equity (33%), US equity (32%), and emerging markets equity (20%) demonstrate the greatest level of interest, while interest in credit, market neutral strategies, and statistical arbitrage trail. Among sectors, healthcare, technology, and energy exhibit the greatest appeal, with deep value/activist strategies also in demand.

Separately managed accounts (SMAs)

Concept Capital continues to notice a significant increase in the use of SMAs by our clients. The responses we received from survey participants were somewhat at odds with our experience as a majority indicated that they were not utilizing the SMA format (58%). That same group, however, also by a solid majority, responded that they would be open to investing through SMAs (71%). We believe hedge fund managers should expect to increasingly see allocators utilizing SMAs and should prepare to have an efficient solution in place to accept such allocations.

Liquid Alternatives (40 Act mutual funds/UCITs products) vs. Traditional Structures

Given the institutional skew of the respondents to our survey, we were not surprised to find that they only modestly (33%) invest in hedge fund strategies through a ‘40 Act mutual fund or UCITS product. However, of the respondents that have not invested in the products in the past, 62% would consider investing in such a manner.

These products continue to gain popularity in the institutional marketplace because of their more liberal liquidity terms, relatively lower fee structures, and lower minimum investments. Concept Capital has seen accelerated use of ‘40 Act structures in the past year and has developed capabilities to facilitate their use by managers. We highly recommend that hedge fund managers seeking additional assets to manage should familiarize themselves with the mechanics and requirements of these products.

Changes in the hedge fund industry

With the increased focus among our respondents on emerging managers and the allocations they anticipate making in the space, hedge fund managers should be aware that these investors are increasingly seeking greater transparency and better redemption/lockup terms. They are also exerting increased pressure on fee structures. With a growing contribution of hedge fund assets coming from institutional allocators, it appears to us that fund managers will increasingly need to comply with such terms.
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