Survey of Allocators' Investment Trends
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Scope of Survey

The alternative investing industry stands at about $3 trillion in AUM with an average performance of 0.29% (BarclayHedge) in 2015, its worst performance since 2011. This was about on par with the general S&P 500 return (-0.7%; +1.2% with dividends). The industry continued to grow and investors allocated about $60 billion in 2015, according to eVestment. This is at a slightly slower clip than in 2014, when fund net inflows were around $75bn.

We are happy to continue publishing this survey, now in its fourth year, as we, as advisors to the alternative investing industry, try to discern the trends. Accordingly, in this survey we explore trends across time for the years 2013-2016, as well as showing how compelling hedge funds are compared to other alternative investment products such are private equity, direct investments, cash and liquid alternatives.

Executive Summary

Going in 2016, investors continue to allocate capital to the alternative investing space. However, the enthusiasm is somewhat damped and investors are increasingly scrutinizing their searches for the right funds with appropriate portfolio characteristics, performance track, investor terms and AUM size. Currently, the top allocation preference is low-correlation strategies that could provide portfolio benefits and performance enhancement under today's heighten global uncertainty. This means that many managers face an uphill battle to distinguish themselves from an increasingly larger pool of peers, longer due diligence processes and regulatory burdens.

The main findings of the survey are:

Allocation appetite among investors is mixed while it seems to be the case that current and forecasted **volatility in 2016 may increase the appeal of hedge funds**.

In 2016, investors are more **selective towards hedge funds and skepticism exists**. About 50% say they will see how the year develops or are only allocating if they find an appropriate manager. Departing from earlier years, some investors now even **dismiss hedge funds as a whole** based on being disappointed by the industry.

Demand for low-correlation strategies remains high. The **top preference is L/S equity strategy, with an increasing appeal in Quant & CTA, Event Driven and Global Macro strategies**.

The interest in Commodities / Energy strategies have subdued as the slump in the commodities and energy industries continues. Investors are again looking at Event Driven strategies, re-firming their interest from previous years.

The **rout in Emerging Markets continues** and the interest in Mortgage strategies seems to be very low.

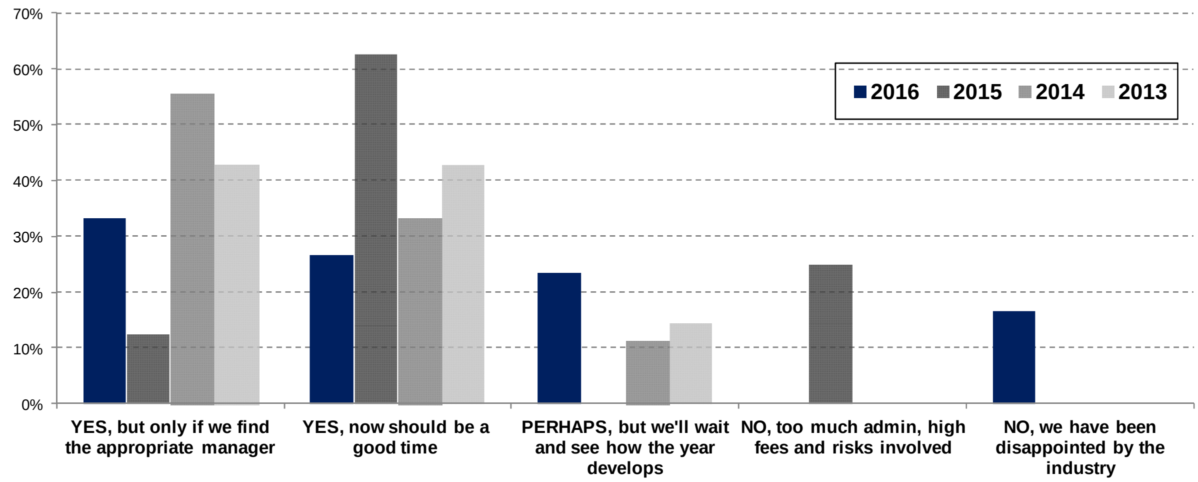
Portfolio Characteristics increase in importance as an allocation criterion: How an investment product fits in an investor's portfolio and what portfolio benefits it may bring, appears more important in a volatile environment.

Hedge funds seem to have become more 'investor un-friendly' and high fees and unfriendly investor terms continue to keep allocators at bay

As investment substitutes, **the interest in direct investments is very high and up significantly**. Allocators want to go it alone, it seems. The interest in Private Equity and Real Estate funds remain relatively steady across the time horizon, with somewhat less interest in PE.

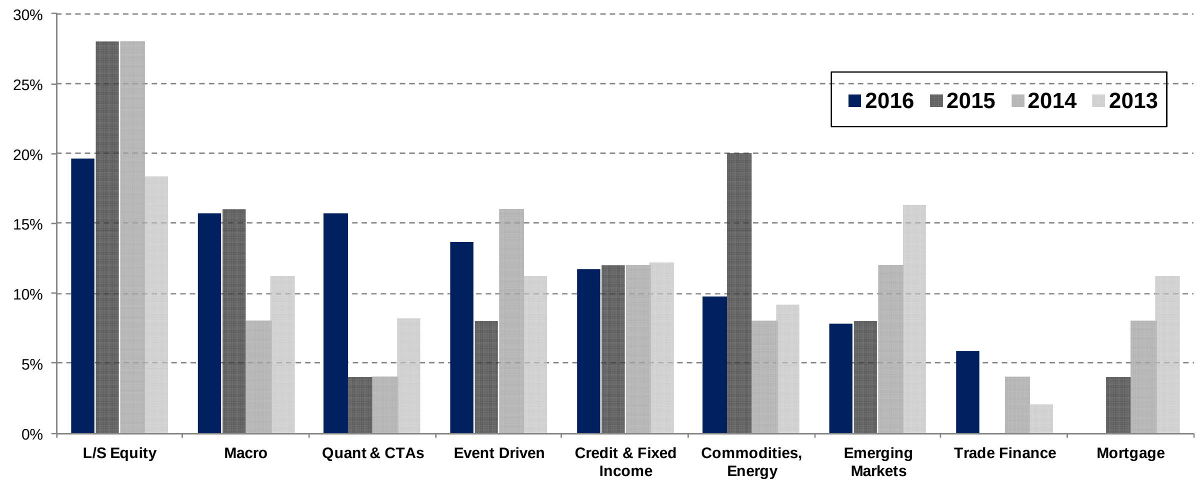
Survey Results

1. In 2016, would you consider allocating to hedge funds?



- Compared to the overall positive attitude towards hedge funds earlier years, **allocation appetite appears generally mixed in 2016**.
- Investors who believe that "**now should be a good time" drop of significantly**.
- There is a huge increase of the "**wait and see" attitude** towards asset allocation, whether they are looking for a right manager or waiting to see how 2016 unfolds.
- The most noted attitude is the **negative sentiment** towards the industry by investors this year. The reasons behind this negativity is "disappointed by the industry".

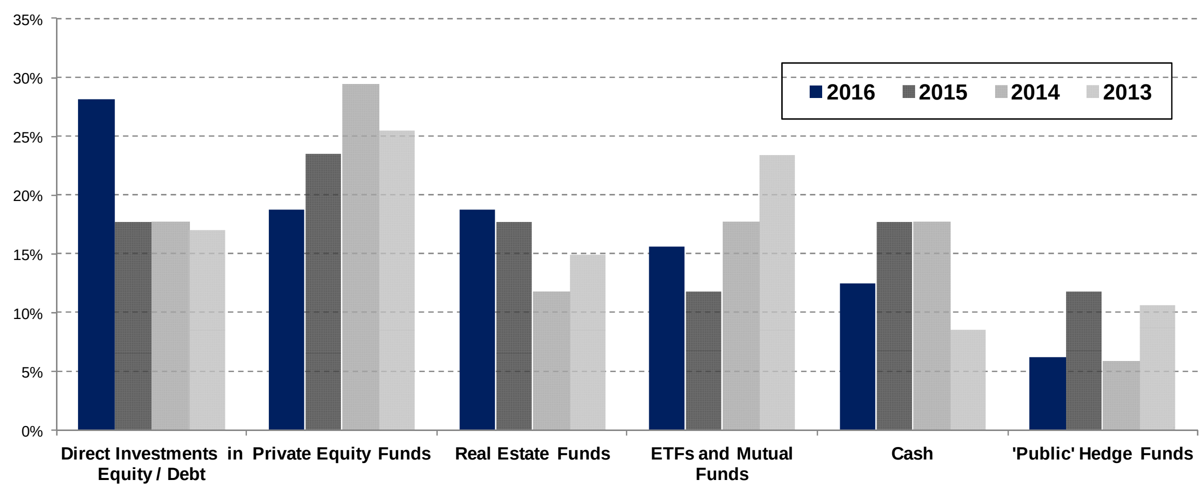
2. Within the hedge fund space, what sectors do you think would be especially interesting in 2016?



- **Low-correlation strategies are the flavor of the year**. The top preferences are L/S Equity, Macro, Quant & CTAs and Event Driven. Facing heighten global volatility and economy uncertainty, investors seem inclined to add these strategies as a protection from risks.

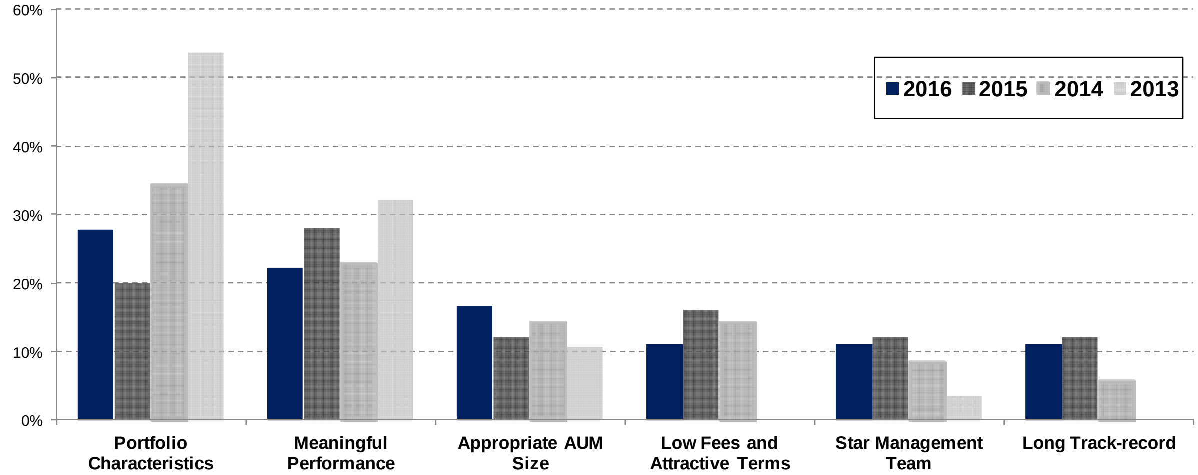
- **Macro Strategies remain become favorable**. Very volatile markets, together with the policy divergence of central banks worldwide, give rise to the opportunity of betting on economic trends and arbitrage opportunities.
- **Quant & CTAs record a huge increase in appeal.** As spreads and volatility in markets increase, quants and systematic strategies should do well.
- **The interest in Commodities / Energy strategies subdues.** The past interest vanishes as the slump in the commodities and energy industries continues. This might change as investors could see good price entry points as well as distressed debt opportunities in oil-related companies.
- **Investors are again looking at Event Driven strategies,** re-firming their interest from previous years.
- **The interest Credit and Fixed income is quite stable.**
- **The rout in Emerging Markets continues**. This is not surprising given the global sentiment with slow growth in China, havoc in Russia and Brazil and the higher interest rate in the US. The bright spots would include Africa, Mexico, some parts of Asia, and India.
- **The interest in Mortgage strategies seems to be very low**.

3. What other investment opportunities would you consider, if unwilling or unable to consider hedge funds?



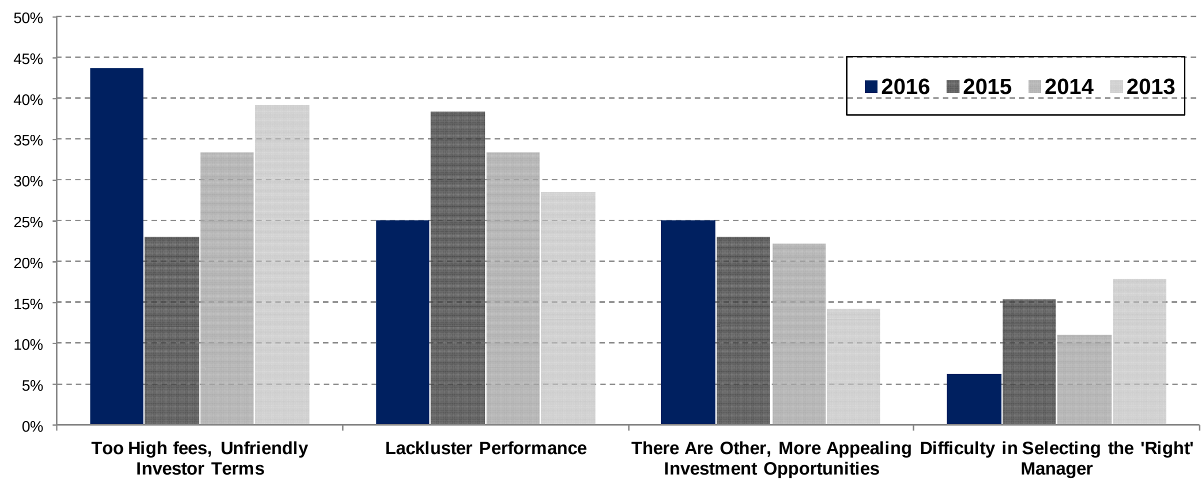
- **Interest in Direct Investments is very high and up significantly**. Allocators want to go it alone, it seems.
- **The interest in Private Equity and Real Estate funds remain relatively steady across the time horizon, with somewhat less interest in PE.**
- **ETFs and mutual funds are still less attractive substitutes to hedge funds and other alternative assets.**

4. What are the most important criteria for a hedge fund that you would consider investing in?



- **Portfolio Characteristics increase as criteria:** How an investment product fits in an investor's portfolio and what portfolio benefits it may bring, appears more important in a volatile environment.
- **Performance remains important:** investors ask for positive investment returns and 'alpha'.
- **Investors put more emphases on AUM size**. Given today's heighten global uncertainty and increasing funds' closure rate in recent years, investors turn to funds with appropriate AUM size as an assurance.

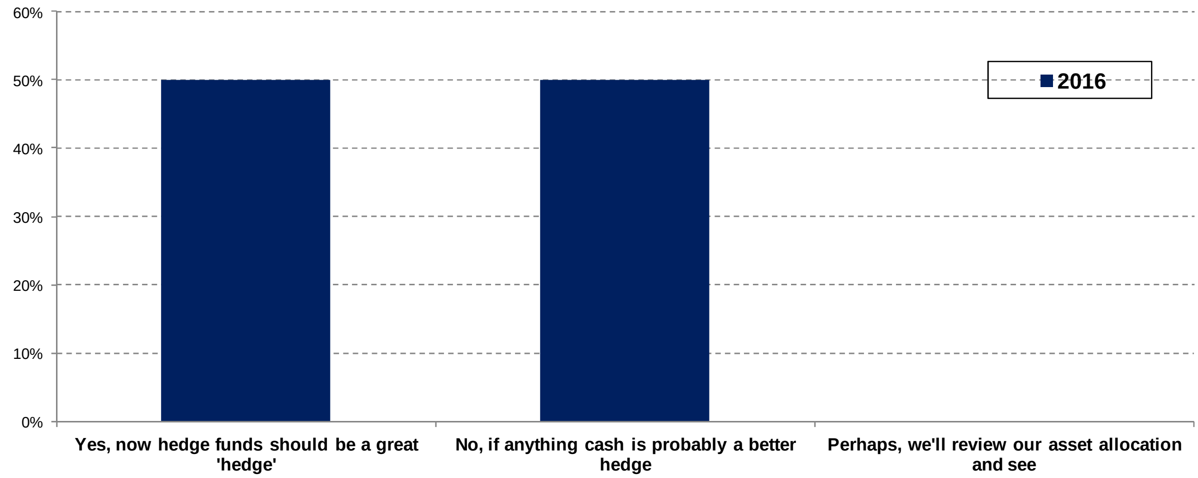
5. What are the considerations that discourage you most in investing in hedge funds?



- **High fees and unfriendly investor terms keep allocators at bay.** Hedge funds seem to have become more 'investor un-friendly' in 2015.
- **Investors emphasize investment returns**, with Lackluster Performance being a significant, while less a reason than earlier years, why investors are discouraged by hedge funds.

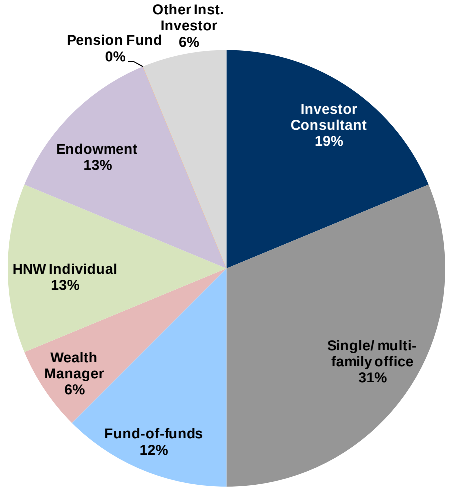
- **Fund managers have to compete to attract investors**. Given today's diversified style and size of funds, investors do not find it too difficult to select the "right" manager. It shifts the burden of proof to fund managers to distinguish themselves from their peers.

6. Are the volatile equity and debt markets around the world - and the expectations of more volatility in 2016 - making hedge funds more appealing to you as an investment destination?



- **Investors seem to be split on whether the current volatility is helping or acting as a drag on the appeal for hedge funds.**

What type of allocators participated in the survey?



- **Over 500 allocators were sent the survey in early 2016, of which a portion responded.** The largest groups of responders were investor consultants and family offices.
- **Seven types of allocators responded.** There was no analysis made on the basis of allocator type; the survey responders were anonymous and the answers aggregated.

About the Authors

Carl Berg runs Catalyst Financial Partners, an investor events firm for the private funds industry. The firm links alternative investment managers and investors together through investor events. It has established itself as one of the leading, independent cap intro providers.

He also works with selected alternative investment firms in a capital raising capacity and consults with investors on their allocation decisions.

Susan Weerts is an independent research analyst, investment consultant and a contributing writer to Seekingalpha.com. Current research areas are strategic trading games on ETF and its underlying index, market-neutral L/S strategy. She is also a consultant on China-related business.
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