Survey of Allocators' Investment Trends
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Scope of Survey

In the last couple of years broadsides have been fired at the hedge fund industry in the form of industry criticism, competitive external and internal pressures, meager returns, and difficult markets. We now wanted to take the pulse of what allocators currently think of the industry.

We think this survey is especially interesting, since it not only explores trends within the hedge fund industry, but also investigates how compelling hedge funds are across different financial products.

We made a similar survey in May 2010 ("A View from Both Sides: the Latest Trends in Capital Raising"), and we compare some of those answers with this survey to see changes through time.

Executive Summary

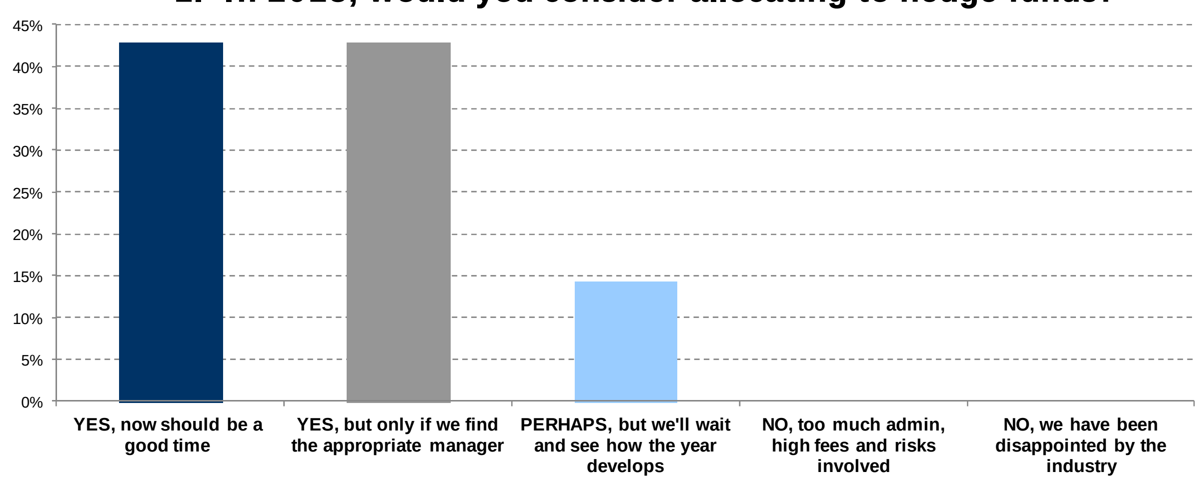
In summary, in 2013 **an allocator is ready and willing to invest with an institutional quality hedge fund *if* it is providing portfolio benefits, decent - but not necessarily top - performance, at attractive fee levels and terms.**

If these criteria are not fulfilled allocators may look at substitutes, notably Private Equity, ETFs and mutual funds, or Direct investments.

Going into 2013, within the hedge fund space, L/S Equity looks like the preferred allocation destination, followed by Emerging Markets and Credit & Fixed Income. This signals a return to more risky assets as Emerging Markets have particularly been out of favor the last 12-15 months.

Survey Results

1. In 2013, would you consider allocating to hedge funds?



- **Allocation appetite appears strong.** Most of the allocators indicate that they are looking to make investments to hedge funds. Only a small portion of the investors takes a wait and see approach. However, no investors (of the group surveyed) dismiss hedge funds outright.

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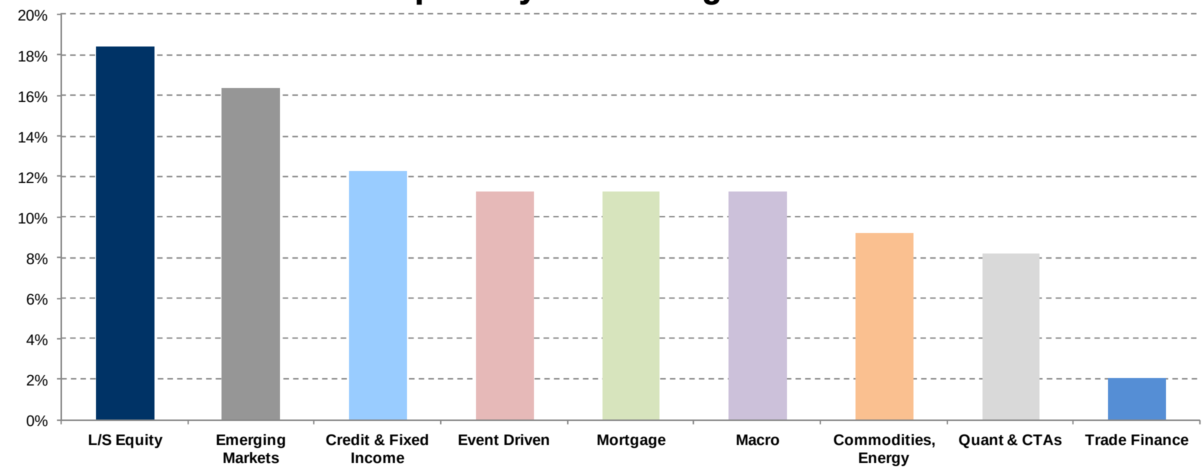
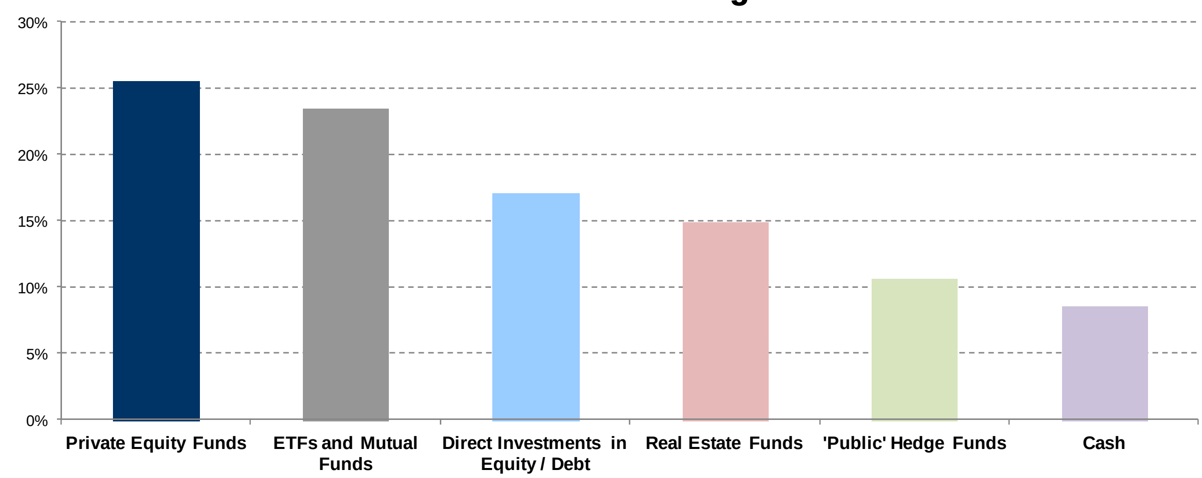
2. Within the hedge fund space, what sectors do you think would be especially interesting in 2013?

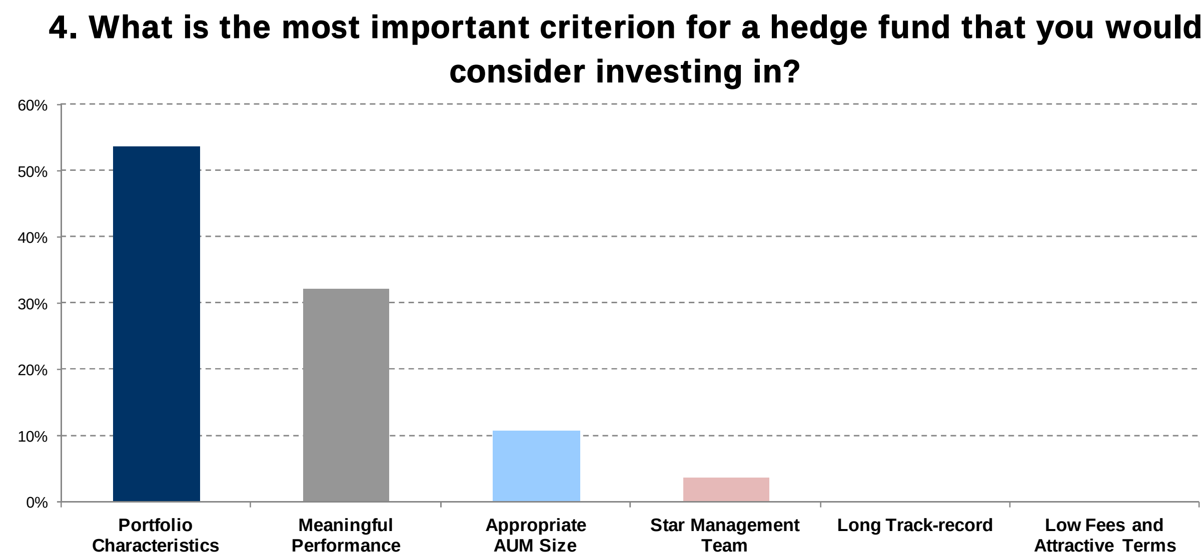


- **Currently allocators' top preference is L/S Equity strategies.** This sentiment follows the current opinion that the equity markets look favorable in 2013, on the back of less systemic risks worldwide, rebounding real estate in the US, and a stronger China.
- **More surprisingly, Emerging Markets come in second place.** This signals a return to more risky assets as Emerging Markets have been out of favor the last 12-15 months.
- **In our 2010 survey, Event Driven strategies were allocators' top choice.** Investors rotate their exposures to the flavor of the year.

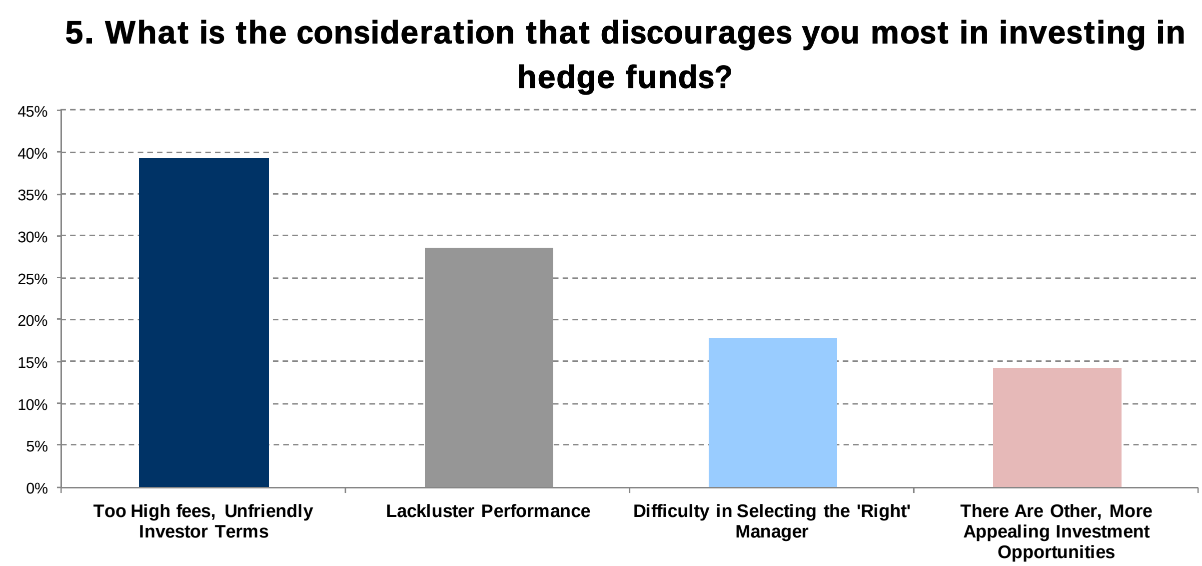
3. What other investment opportunities would you consider, if unwilling or unable to consider hedge funds?



- **Private Equity is the most attractive investment substitute to hedge funds.**
- **ETFs and mutual funds are also an attractive substitute to hedge funds.** These products bring passive beta exposure, with lower fees and less stringent investor terms than hedge funds.
- **Direct Investments are becoming a common substitute.** The fact that allocators are becoming big investors of Directs will have implications for hedge funds, since it might circumvent their intermediary function.



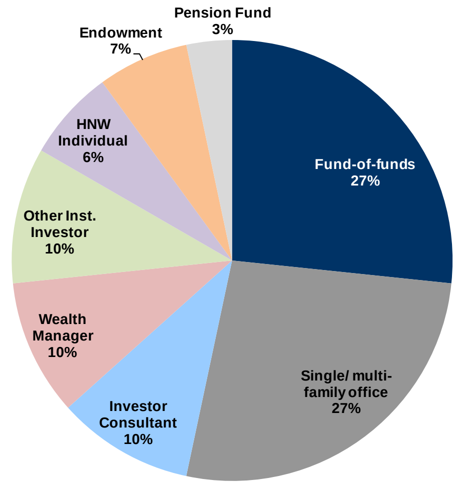
- **Portfolio Characteristics (non-correlation, diversification, etc) is the top reason to allocate to hedge funds.** Investors seem more interested in how a product fits in their portfolio and core investment objective than the strategy itself.
- **The performance of hedge funds is the second top reason.**
- **In 2010, high absolute fund performance was the top reason for investors to allocate to hedge funds.**



- **High fees and unfriendly investor terms keep allocators at bay.** After some years of a lot of scrutiny and media publicity, high fees are the top reason for allocators to back away from allocating to hedge funds.
- **About 15% of respondents thought there are other, more appealing, investment opportunities than hedge funds.**
- **In our 2010 survey, identifying the 'Right' manager was allocators' top discouraging factor**. 'Too high fees' trailed far down the list of concerns in 2010.

What type of allocators participated in the survey?

- **Over 1,000 allocators were sent the survey, of which 52 answered it between January 10-16th, 2013.** The largest groups of responders were fund-of-funds and family offices.
- **Eight types of allocators responded.** There were no analysis made on the basis of allocator type; the survey responders were anonymous and the answers aggregated.



Conclusion

The laundry list for a hedge fund to be successful is not actually that long: run a quality institutional investment firm, make sure it provides benefits in allocators' portfolio analysis, limit draw downs while producing decent performance, and all this at favorable terms and fees.

At different stages of a fund's growth, however, at least one of these parameters tend to fall short. Smaller funds often struggle in providing the necessary institutional frame work, while larger funds refuse to negotiate fees, and most funds are susceptible to unconvincing performance or style drift.

In the past year, we think, the development has been in the direction for investors and managers to understand what works for each party, which bodes for better prospects for industry participants alike.

About the Authors

Carl Berg runs Catalyst Financial Partners, a specialist investor events firm for the alternative investing industry. The firm links alternative investment managers and investors together through investor events. He also works with selected alternative investment firms in a capital raising capacity.
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Susan Weerts is a contributing writer to Seekingalpha.com since 2009. 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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