Survey of Allocators' Investment Trends
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Industry Background and the Scope of Survey

The alternative investing industry stands at about $10bn, with $4.7bn, $3.3bn, $1.2bn of that in private equity, hedge funds and real estate respectively[1]. The hedge fund industry had an overall average performance of 11.4% in 2017, while the S&P 500 was up 21.7%[2]. Hedge funds achieved a 'perfect 12' in 2017: 12 months of positive performance – the first time this has been achieved since 2003.

On a strategy basis in Hedge Funds, Equity Strategies were up 15.0%, Event Driven 11.7%, Credit Strategies 7.6%, Relative Value 4.3%, Emerging Markets 15.9% and CTAs 3.2%. Niche Strategies like Activist and Systematic and Volatility were up 7.5%-13.8%.

Overall, Private Real Estate funds returned about 10%[3], while Private Equity funds returned about 12%[4], both dropping compared to earlier years.

We are excited to continue publishing this survey, now in its sixth year, as we try to discern industry trends. In this survey, we explore trends across time for the years 2013-2018, and show how compelling alternative investment products are among and between each other, and compared to other investment destinations like cash, mutual funds and ETFs.

Executive Summary

While the appetite of investing in alternative funds remains strong in 2018, investors in the survey are showing a more selective approach towards alternative investments. Investors have turned from outright enthusiasm to being more cautious. Investors only intend to put money into those funds that are deemed to be the exactly the right fit.

Across strategies, investors continue to favor low-correlation funds. Their top preferences are Quant & CTAs and L/S Equity strategies. The increasingly volatile market of 2018 should be a favorable environment for managers with an active management style that can capture price spreads and arbitrage. In addition, the interest in Commodities & Energy strategies has soared.

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[1] PWC, The Wall Street Journal, February 22, 2018
[2] Preqin Hedge Fund Spotlight, January 2018
[3] Preqin Real Estate Spotlight, March 2018
[4] Preqin Global Private Equity Report 2018

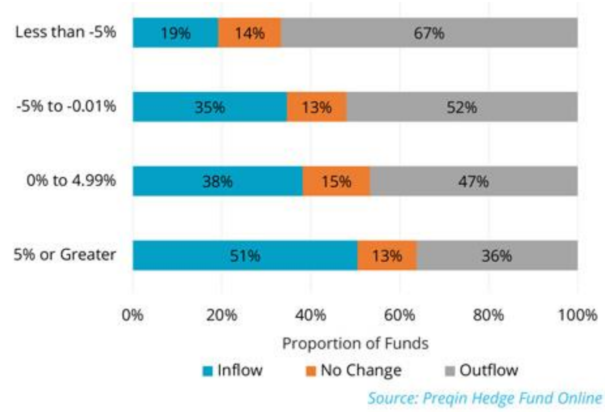
Emerging Markets also remains favorable among investors. Emerging Markets was out of flavor a couple of years ago, but investors are redeploying into the space.

The changing of the guard over central banks cast shadows over future policies. Investors look into the Macro space to generate policy-related alpha. Interest in Credit & Fixed Income strategies has waned under the hawkish watch of new Fed Chairman leadership. In addition, the interest in Mortgage related funds is extremely low.

We also think it's very interesting to emphasize how much past performance remains a key factor in determining a fund manager's ability to attract new capital. As published by our Media Partner Preqin, the majority (51%) of funds that generated returns of 5% or more in 2016 experienced net inflows; by contrast, two-thirds of funds that generated a loss of greater than 5% in 2016 saw outflows in 2017[2].

Therefore, although past performance may not be indicative of future performance, it is a clear signifier of future asset flows.

Hedge Fund Asset Flows over 2017 by 2016 Performance



Across the asset classes, the main trends are an increase in ETFs & Mutual funds and a deterioration in the interest in Real Estate funds. That reflects the exposure/passive type of investing of the last few years as well as a belief that the Real Estate markets are pricy.

The interest in Direct Investments remains very high and is about the same as last year. These types of investments potentially provide high alpha returns in high barriers-to-entry assets, and without intermediary fees.

Investors emphasize the importance of meaningful investment returns. Compared to stellar broader market returns in 2017, hedge fund performance still trailed, and was in line with Private Equity and Real Estate funds. However, for an investor, Portfolio Characteristics are more important, and it remains a crucial determinant how an investment product fits in an investor's portfolio and what portfolio benefits it may bring.

High fees and unfriendly investor terms keep allocators at bay. This consideration has however dropped relatively in importance from last year.

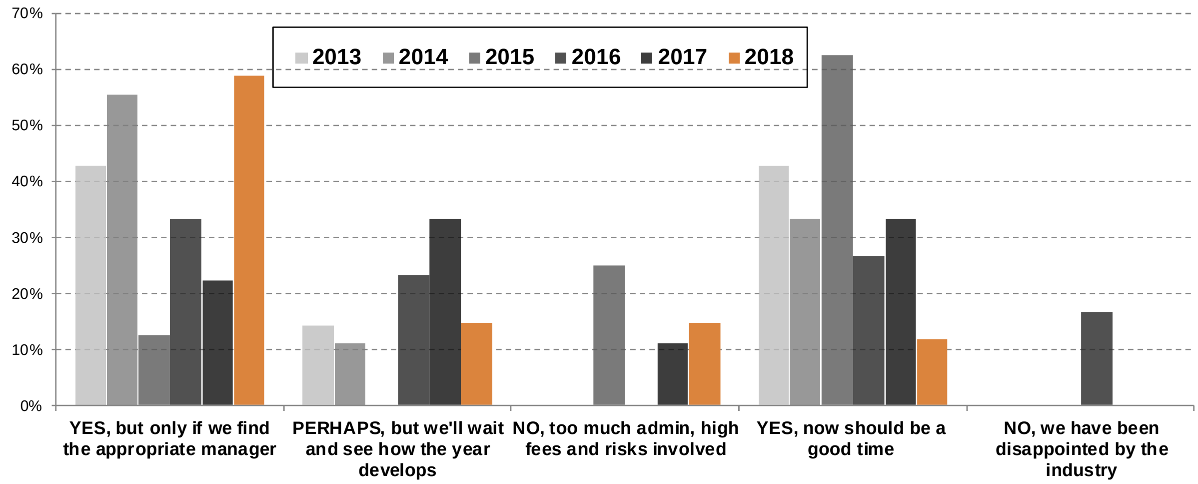
It remains a challenge to identify the "right" manager. Given the many styles and large number of funds, it is difficult for investors to search and select funds. The rising markets have added additional difficulty in differentiating skill from luck. This makes having a long track record even more important.

AUM size has dropped in significance as a criterion, while Long track-record remains important. In order to identify a skillful portfolio manager, investors need funds with a long track-record.

In general, investors think that the market correction in early 2018 is a wake-up call that the period of low volatility is over and the need for actively managed funds is more acute.

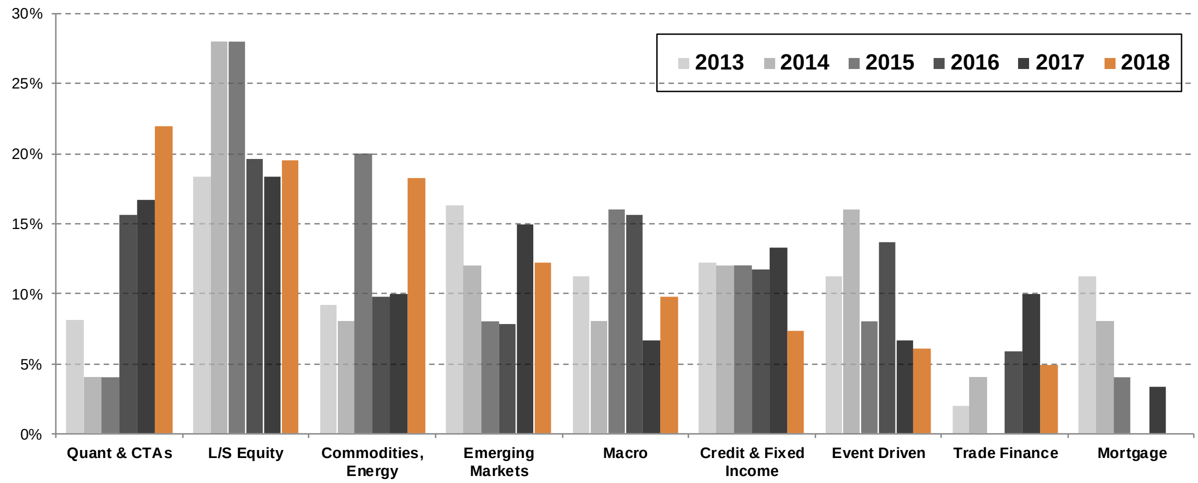
Survey Results

1. In 2018, would you consider allocating to alternative investing funds?



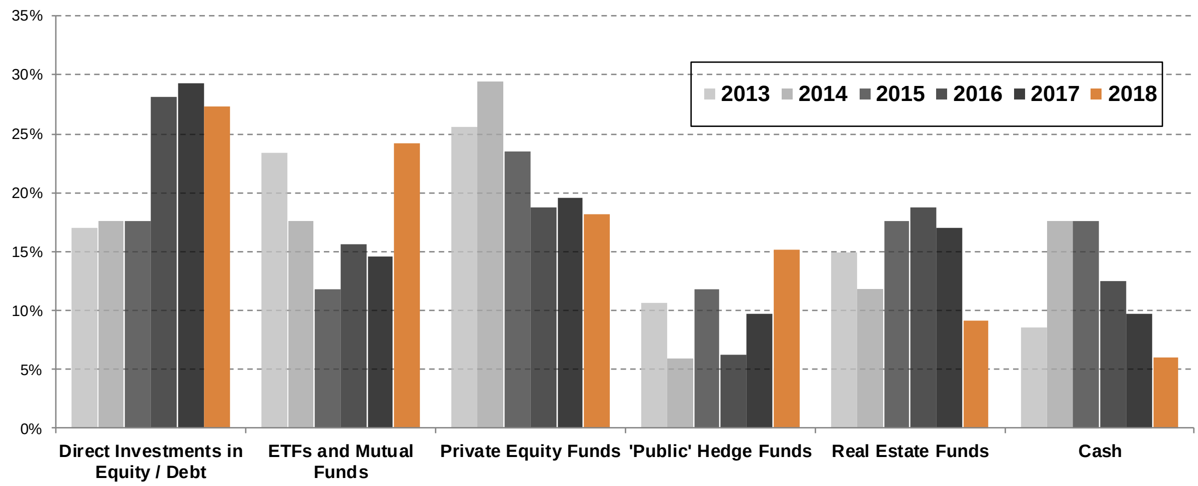
- The appetite of investing in alternative funds remains strong in 2018.
- However, potential investors have become more cautious in selecting the right manager for their money. They have turned from outright enthusiasm to only consider investing if they are able to find exactly the right manager.
- "Too much admin, high fees and risks involved" remains a deterrent for investors to invest into alternative funds. In comparison, back in 2016 investors were primarily turned away by the disappointment by the industry.

2. Within the hedge fund space, what sectors do you think would be especially interesting in 2018?



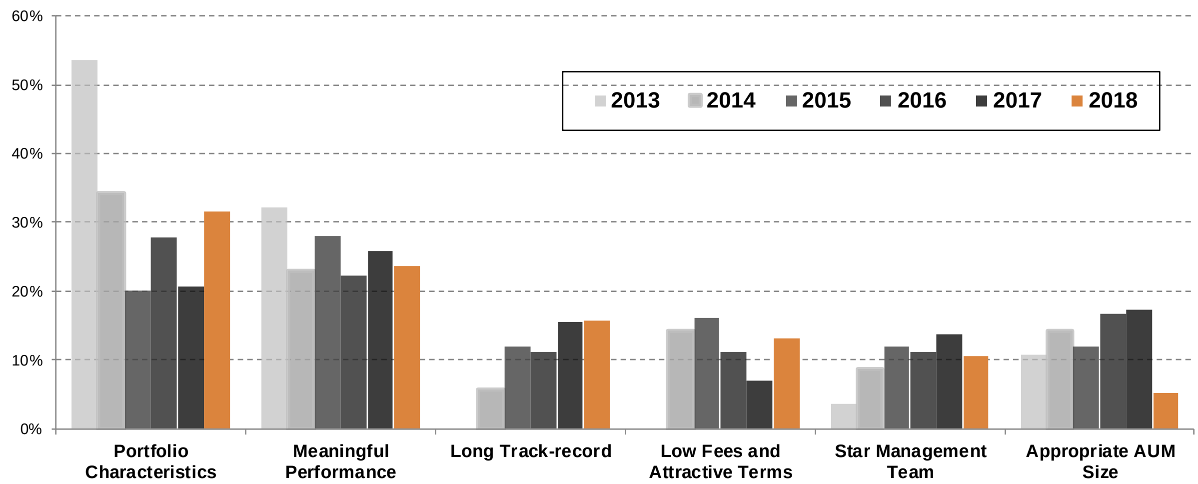
- **Low-correlation strategies continue to dominate the investing preferences.** This is consistent with our first survey question, with investors seeking a strategy or manager with portable alpha.
- **The top preferences are Quant & CTAs and L/S Equity strategies**. Investors continue to be drawn to those strategies that provide a low correlation with broader market and in turn deliver a higher risk-adjusted return. This should be a favorable environment for managers with an active management style that can capture price spreads and arbitrage. Quant & CTAs have witnesses a surge of interest, which probably will continue in the more volatile markets of 2018.
- **Emerging Markets remains favorable among investors.** Emerging Markets was out of flavor a couple of years ago, but investors are redeploying into the space. IShares Emerging Market index (+37%) beat SP 500 by a wide margin in 2017.
- **Interest in Credit & Fixed Income strategies drops markedly.** There is no doubt that the Fed's normalization of interest rate is affecting this, and investors are staying away from this space in fear of more of a hawkish watch under new Fed Chairman Powell**.** In addition to interest rate risk and inflation risk, credit risks will increase as companies will be under higher pressure resulting from a rising interest rate.
- **Interest in Commodities & Energy strategies sees the largest percentage jump**. It could be driven by inflation fear.
- **Interest in Macro strategies shows a moderate increase**. The changing of the guard of central banks cast shadow over future policies. It requires an expert's hand to navigate today's domestic inflation vs. global slack environment.
- **Investors' interest in Mortgage related fund is extremely low.** Interest in mortgage funds are experiencing an extended period of low interest. The potential tighter monetary policy makes this space less attractive.

3. What other investment opportunities would you consider other or rather than hedge funds?



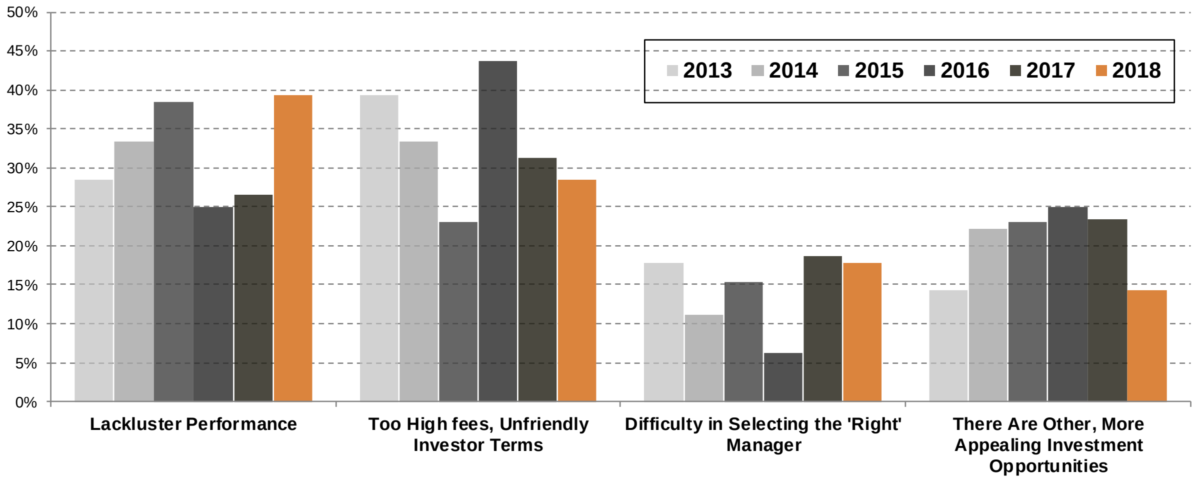
- **Direct Investments in Equity / Debt remain very popular.** These types of investments potentially provide high alpha returns in high barriers-to-entry assets, and without intermediary fees.
- **We see a surge of interest in ETFs & Mutual funds.** Increasingly, investors are draw to a cheaper fee structure and simpler terms and conditions.
- **Interest in Private Equity funds remain relatively steady**.
- **Public Hedge funds increase a lot.** Public hedge funds and 40 Acts generally offer a name recognition and relatively cheaper and easier way to get in and out.
- **The steepest drop is in Real Estate funds.** It likely reflects that the Real Estate markets are pricy and late in the cycle.
- Investors are less inclined to hold cash.

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



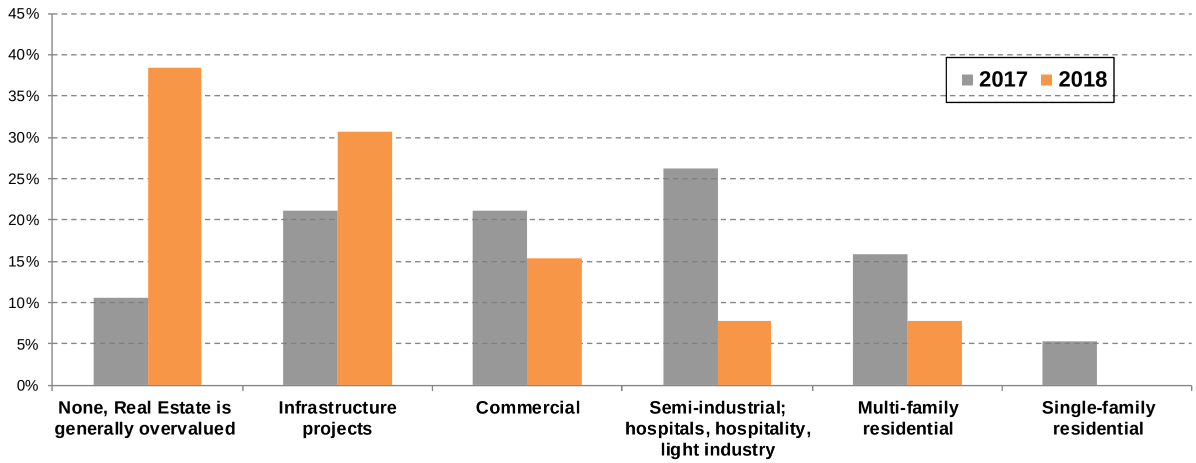
- **Portfolio Characteristics are important, and in first place:** How an investment product fits in an investor's portfolio and what portfolio benefits it may bring, continues to be a crucial determinant.
- **Meaningful performance is also an important criterion.** Investors want funds that generate alpha.
- **AUM size has drops in significance, while Long track-record remains important.** In order to identify a skillful portfolio manager, investors need funds with a long track-record.

5. What are the considerations that discourage you most in investing in an alternative fund?



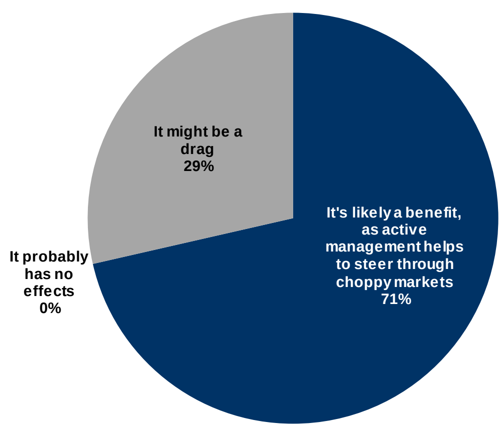
- **Investors emphasize investment returns**. Compared to stellar broader market returns in 2017, hedge fund performance still trailed, with similar returns for Private Equity and Real Estate.
- **High fees and unfriendly investor terms keep allocators at bay.**
- **It is increasingly difficult to identify the "right" manager**. Given the many styles and large number of funds, it is difficult for investors to search and select funds. The rising markets have added additional difficulty in differentiating skill from luck. This makes having a long track record even more important.

6. In Real Estate, I think the best opportunities could be found in the following sector(s):



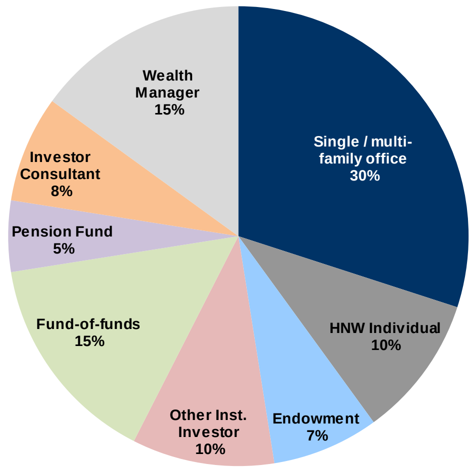
- **Interest in Real Estate funds drops dramatically.** Most Real Estate markets are close or at the peak of the cycle and investors are wary of committing new capital.
- **The interest in Commercial, Infrastructure, and Multi-family Real Estate is high.** Institutional investors have been building core real estate portfolios to take advantage of strong real estate markets.
- **Strong interest in infrastructure projects**, which possibly reflects the current administration's commitment to infrastructure projects.

7. How do you think the market volatility at the start of 2018 is affecting the alternative investing industry?



- **In general, investors think that the market correction in early 2018 is a wake-up call that the period of low volatility is over.** This is arguably a boon for the actively managed investment industry as investors need professionals to assist their investment decisions, as well as adjusting their strategic asset allocation.

What type of allocators participated in the survey?



- **Over 500 allocators were sent the survey in early 2018, of which a portion responded.** The largest groups of responders were wealth managers and family offices.
- **Eight 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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