

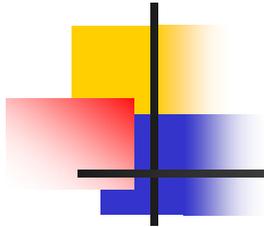
# Institutional Investment in Hedge Funds

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International Asset Management  
19<sup>th</sup> November 2004

**Dr. Ros Altmann**

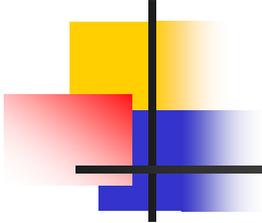
[www.rosaltmann.com](http://www.rosaltmann.com)



# Introduction

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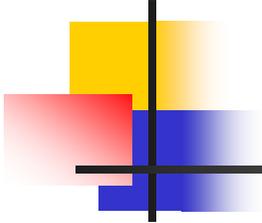
- Independent view
- UK institutional investors
- Benefits of including hedge funds
- Recent trends
- The future for hedge funds
- Summary



# UK Institutional Investors

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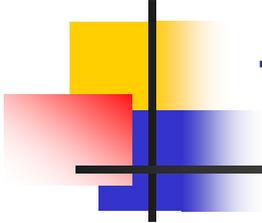
- UK institutions historically relied too much on equities
- Generate alpha solely from equity risk premium
- Long-only returns disappointed
- Looking for alternative sources of added value
- UK Government encouraging diversification
- Myners Review recommended considering hedge funds



# Features of Hedge Funds

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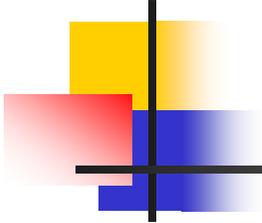
- High investment minima
- Low regulation
- Designed to deliver long-term capital growth, not income
- Complex, state of the art investment methods
- Performance fees
- Reputation of 'riskiness' inappropriate



# Benefits of including hedge funds

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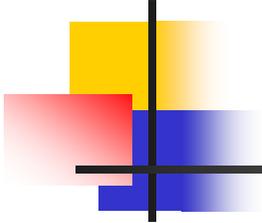
- Improve portfolio efficiency
- Diversification of sources of potential return
- Low correlation with traditional assets
- Absolute returns
- 'Professional' risk control
- Make assets work harder to capture different risk premia



# Long-only outdated

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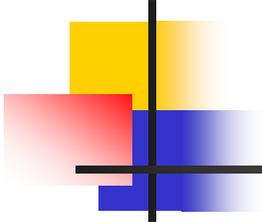
- Long-only too restrictive – index constraints
- No downside protection – beta exposure
- Lack of flexibility to back investment judgments
- Hedge funds offer truly active management
- If want to reduce risk, use most efficient way
  - To get lowest reduction of expected return



# Barriers to hedge funds

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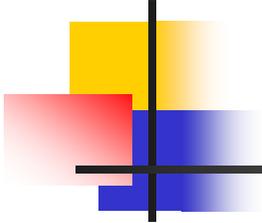
- Investors nervous of hedge fund reputation
- Lack of understanding
- High investment minima
- High fees
- Lack of transparency and regulation
- Due diligence expensive and time-consuming



# Overcoming the barriers

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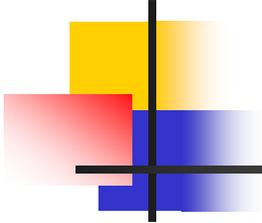
- Familiarity
- Clearer information
- Education
- Consider performance net of fees
- Build trust over time
- Use fund of funds to familiarise



# Institutions Starting to Invest

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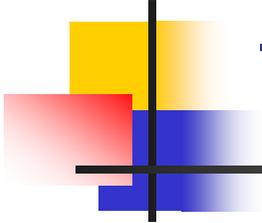
- Pension funds realise problems of relying on equities
- Large inflows starting into hedge funds
- Consultants now taking seriously
- Initial exposure with fund of funds
- Passive core, active satellites
- Hedge funds vital part of active exposure



# Recent developments

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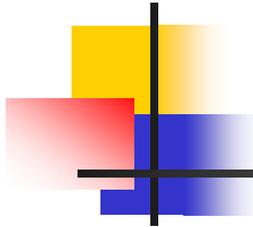
- Concerns about sustainability of returns
- Partly explained by reduction in risk-free rate
- Still outperforming long-only
- Power of compounding – absolute returns
- Long-only lacks protection of downside
- As long as markets inefficient, hedge funds worthwhile



# The Future for Hedge Funds

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- Still relatively immature (only 2% of global market cap)
- Increasing acceptance
- More specialisation
- Will become mainstream
- All institutional portfolios likely to invest



# Summary

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- Investors slowly appreciating benefits of hedge funds
- Much further development of the industry to come
- Will become mainstream
- Threat to long-only
- They have delivered, but must continue to do so!