

MONEY MANAGEMENT

<http://www.moneymanagement.com.au/news.asp>

Strategy changes forecast as hedge funds reach capacity

Zoe Fielding

Capacity constraints are likely to emerge in the hedge funds sector with demand for Australian hedge funds from retail and institutional investors expected to continue the rapid increase experienced in the past couple of years.

From June 2003 to June 2005, assets under management by hedge fund managers and fund of hedge fund managers tripled from \$9,270 million to \$35,350 million, according to a report from AXISS into the hedge fund industry in Australia.

Alternative Investment Management Association chairman Kim Ivey said demand for Australia hedge funds would continue to rise as Australian retail investors became wealthier, Australian pension funds grew due to compulsory superannuation, and offshore institutional investors were attracted by Australia's strict regulatory regime.

He said this demand could lead to capacity constraints in popular hedge fund strategies such as Australian and global long short and absolute strategies, which the report showed account for a total of \$13,783 million assets through 51 funds from a pool of 111 hedge funds with \$22,388 million assets under management managed from Australia.

"[Retail] investors have not necessarily understood that hedge funds are limited by the amount of money that can be deployed. Some hedge funds will start to close," Ivey said.

According to the report, 65 per cent of investors in hedge funds and fund of hedge funds were Australian high-net-worth and retail investors.

Ivey said if equities markets fall or plateau this year, it is likely that more retail investors will look to hedge fund strategies for diversification of their portfolios.

Australian pension funds account for around 20 per cent of assets held in hedge funds and fund of hedge funds, with the remainder of funds stemming from offshore institutional investors.

The report also showed an increasing number of superannuation funds were allocating assets to hedge funds, with only 3 per cent using hedge funds in 2001, compared with current figures of 32 per cent of superannuation funds.

Ivey said Australian pension funds, which are expected to have a total \$1.9 trillion to invest by 2015, were beginning to realise there are capacity constraints in the more popular strategies and had started looking for alternatives.

He said only a small number of Asian-focused hedge funds were currently available but hedge fund managers based in Australia would increasingly offer Asian-based funds to overcome capacity constraints that would emerge in the local market.

Ivey expected demand for single manager hedge funds and multi-strategy managers would also increase, whereas for the past two or three years fund of hedge fund managers have been more popular.

He said investors had "dipped their toe" into the hedge fund sector using fund of hedge fund managers but as they became more comfortable with hedge funds, they would look to remove the additional management layer inherent in fund of hedge funds and invest directly with the underlying managers.

14 March 2006