HFM INSIGHTS

Investor Intentions H2 21

A guide to investor sentiment and allocation plans in H2 2021 and hedge fund managers' strategy for winning business

In association with

AIMA

Contents

Key findings

Over a third of allocators plan to increase their hedge fund allocation in the second half of 2021, a strong showing, but lower than six months ago when 45% expected to invest further.

Based on surveys and interviews conducted with 108 investors in alternatives and 128 senior hedge fund IR and marketing professionals during Q2 2021, *Investor Intentions H2 2021* provides hedge fund managers and investors with critical intelligence on the plans and sentiment of their peers in the second half of the year.

More than 80% of investors surveyed by HFM and AIMA said they were satisfied with hedge fund performance in the first half of the year, and hedge funds have achieved the best first-half performance (+8.9%) since 2009. Counterintuitively, however, the asset class was the biggest faller among alternatives with regard to performance satisfaction over the period, dropping nine points from 91% in H1 . Why?

With hedge funds having outperformed during Q2 2020's Covid-induced market mayhem, the bar has now been raised for what constitutes success in the eyes of investors. At the same time, a return to steady rises in equity markets during H1 has meant few chances for managers to demonstrate their ability to offer downside protection.

Still, H2 offers opportunities aplenty. After experiencing outflows in 2020, global macro and multi-strategy hedge funds are expected to be among the beneficiaries as investors rebalance in the face of rising inflation.

Interest in bespoke products, notably separately managed accounts, is also strong and tallies with the exciting new opportunities two fifths of investors expect to find among hedge funds during H2.

Managers, having for most of the pandemic relied upon existing clients and consultant relationships for leads, are turning to new sources of prospective clients, in particular PB cap intro teams. IRs hoping to tap this particular resource during H2 would do well to act now before peers snap up precious allocator meeting slots.

And meetings will not be easy to come by, with investors expecting to meet fewer new managers than during H1. Instead, they are likely to spend H2 poring over the numbers of those they met in H1.

Ultimately, as we start H2 2021 hedge fund managers are half-way through establishing a solid three-year track record to present to investors. One which could form the basis of a hedge fund renaissance in the post-Covid era. Now is the time for IRs to prepare.

> “With hedge funds having outperformed during Q2 2020's Covid-induced market mayhem, the bar has now been raised for what constitutes success”

#1 **34%** of investors plan to increase their allocation to hedge funds in H2 2021, against **45%** in H1

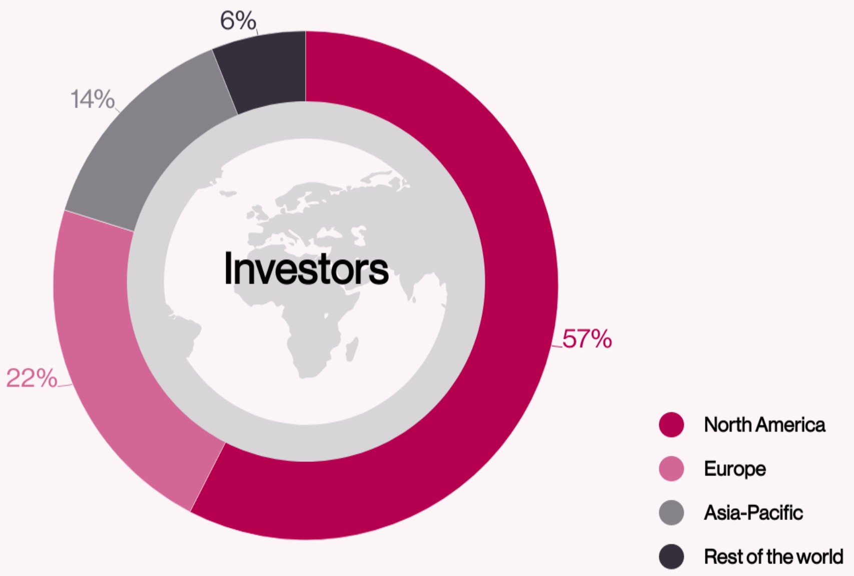
#2 **82%** of investors are satisfied with the performance of hedge fund investments in H1 2021, against **92%** in 2020

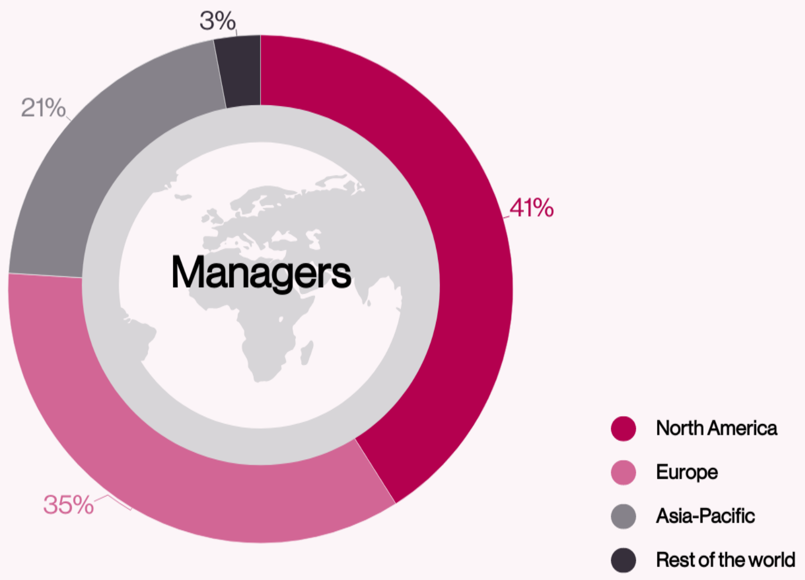
#3 Hedge fund IR professionals will rely less on client referrals and more on **PB cap intro** teams for new leads in H2

#4 **Global macro** strategies are most likely to see inflows in H2, followed by long/short equity and multi-strategy funds

#5 **Single and multi-family offices** are managers' top investor targets in the second half of the year

About the respondents





108
alternative investors

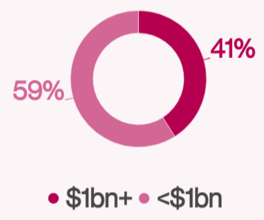
$7.6trn
in total investor assets

46%
Institutions

18%
Private wealth

36%
Intermediaries

128
hedge fund managers



Section One

Allocation plans

34% of investors plan to invest in hedge funds in H2, but other alts are on the rise

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Hedge funds will see H2 inflows

More investors plan to increase their hedge fund allocation in H2 2021 (34%), than plan to decrease it (15%), our survey results show. Nonetheless, this marks a fall from the 45% of investors that said they planned an increase during H1.

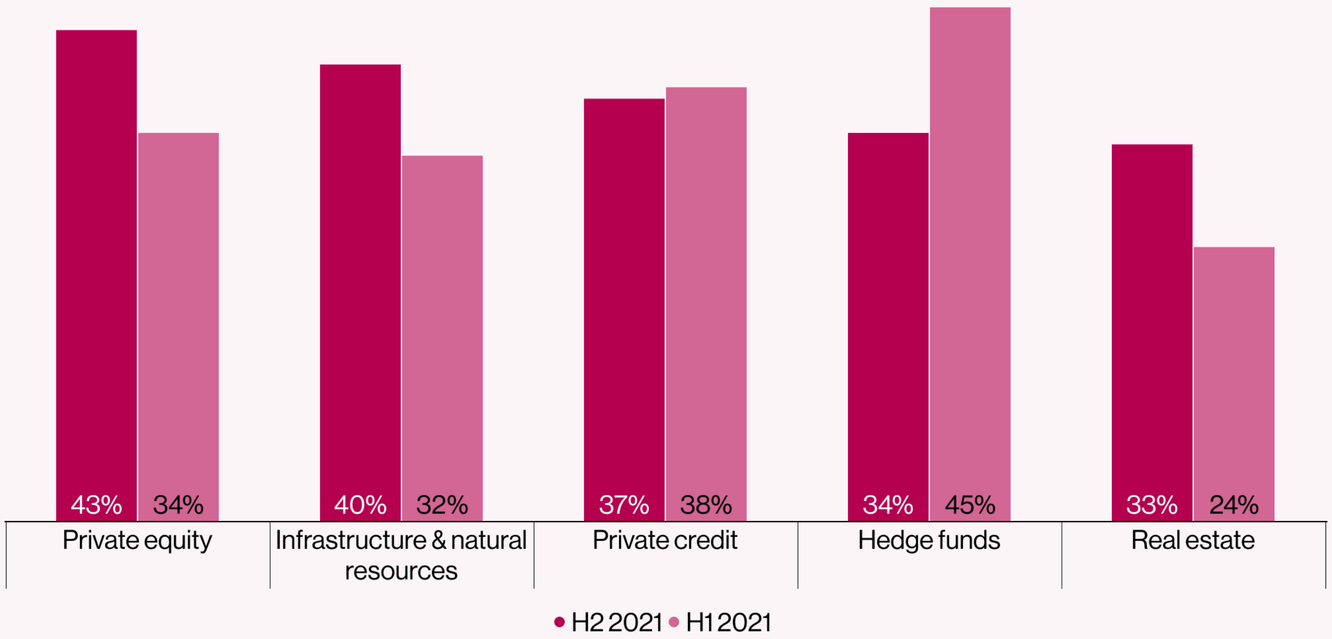
Competition from other alts is rising

Investors are again turning their attentions to private markets, notably PE and real assets. To the extent they are rebalancing risk budgets and asset class allocations, this poses a threat to hedge funds within the alts bucket.

Why it matters

The outlook for hedge funds remains strong, but less so than six months ago. Hedge funds returned 12% in 2020, but our interviews suggest investors are waiting for robust 2 to 3-year performance before investing further.

Exhibit 1.1: Proportion of investors that plan to increase their alternative assets allocations in H2 2021 vs. H1 2021



Source: HFM-AIMA

Apac outperformance has boosted demand for hedge funds in the region

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Private wealth is HFs' best prospect

Private wealth investors are most likely to increase their hedge fund allocation in H2. Although demand has fallen among this group, they are still more likely to allocate to hedge than other alternatives, bar PE (joint first at 47%).

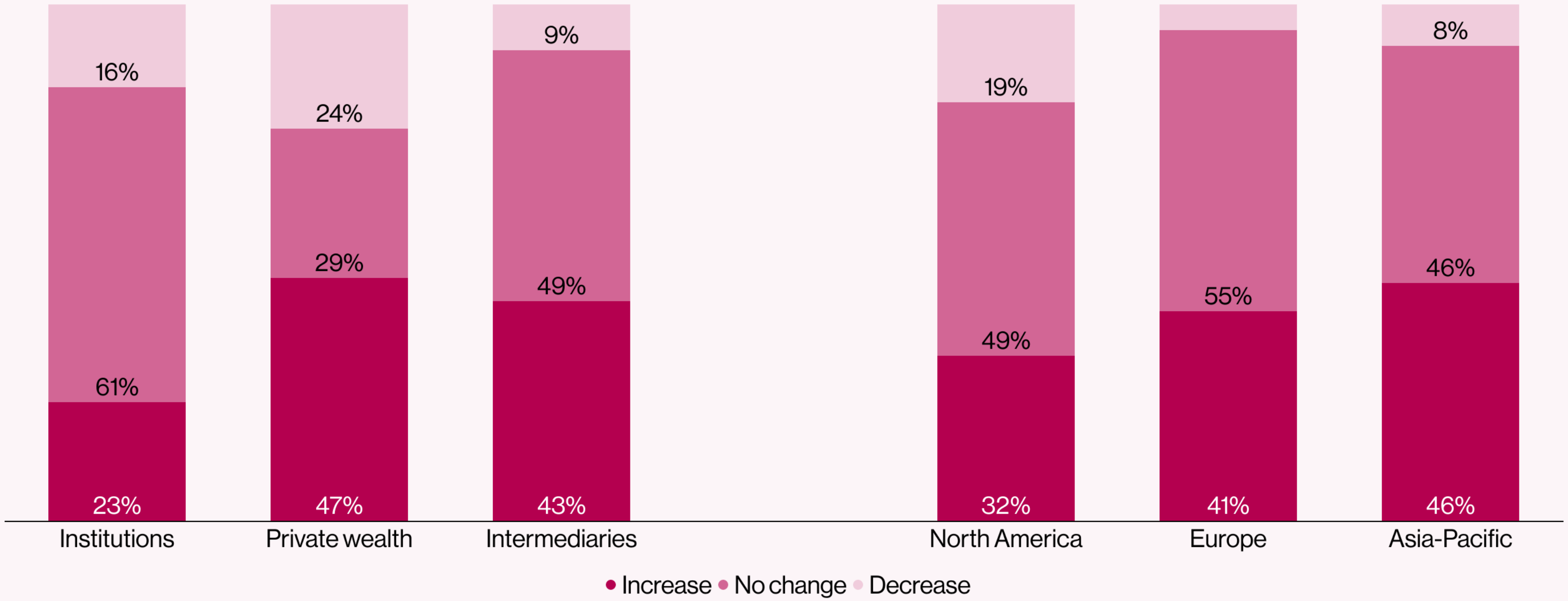
Strong Apac returns boost demand

HFM research has shown Apac investors tend to favour local managers, and vice versa. Apac YTD returns of 9.9% are ahead of the global benchmark, helping to explain the region's enthusiasm for hedge funds in H2.

Why it matters

Overall demand remains strong among private wealth and intermediaries, but appetite for hedge funds has slipped since H1 among these groups. Pickier institutions are as keen as in H1, suggesting unfilled mandates remain.

Exhibit 1.2: Investor hedge fund allocation plans in H2 2021 by investor type and geography



Source: HFM-AIMA

Global macro set to attract the biggest inflows over H2 inflation fears

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Inflation fears boost global macro

Global macro funds can expect to see the strongest demand from investors during H2, our data shows. Investor interviewees suggested that macro funds offered the best hedge against the prospect of rising inflation.

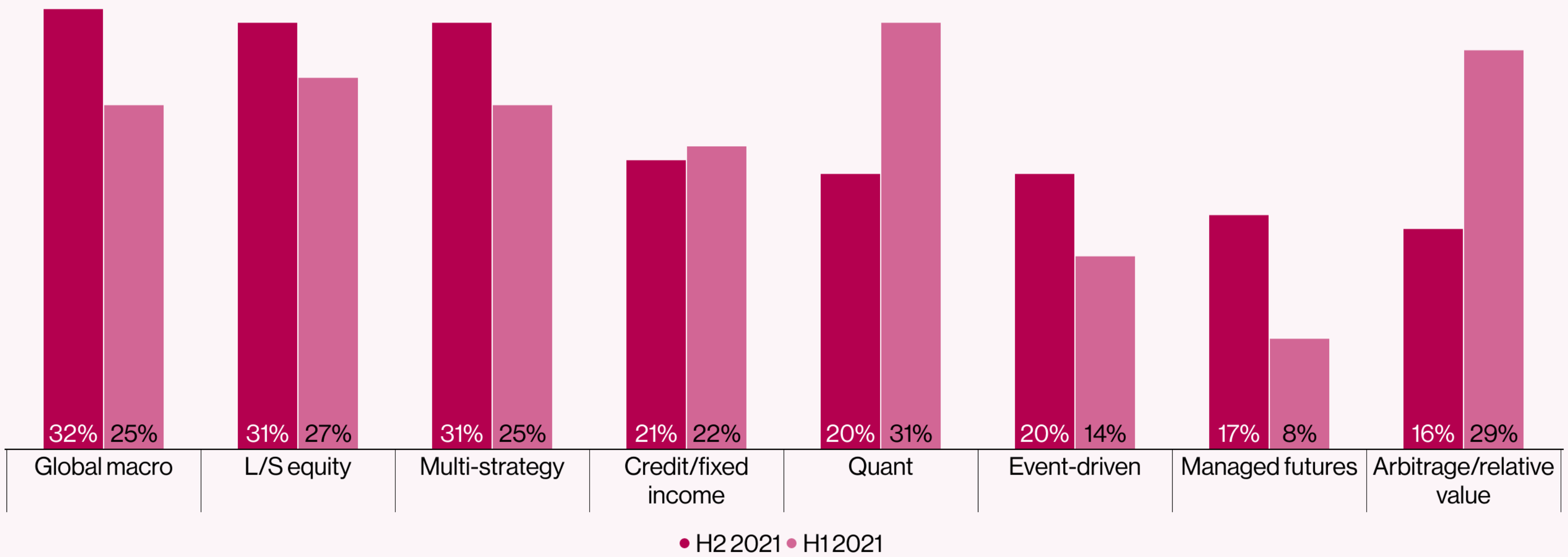
L/S equity, multi-strat stand out too

Long/short equity and multi-strategy hedge funds will also be favoured by investors in H2. Interviewees indicated the former would benefit from any post-Covid market correction, while mutli-strat's versatility also appealed.

Why it matters

Q1's convergence of momentum and value factors caught many quant firms off guard and hit investor sentiment toward quant funds. However, few investors expect this to last, indicating a medium-term quant resurgence.

Exhibit 1.3: Proportion of investors planning to increase their allocation to top-level hedge fund strategies in H2 vs. H1 2021



Source: HFM-AIMA

HFs are the only asset class investors are above target, but allocations are rising

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HF allocations are above target

Investors plan to increase their hedge fund allocation in H2, but they are the only alternative asset class where investors are above target. From this we can infer that investors will not be dogmatic about asset allocation during H2.

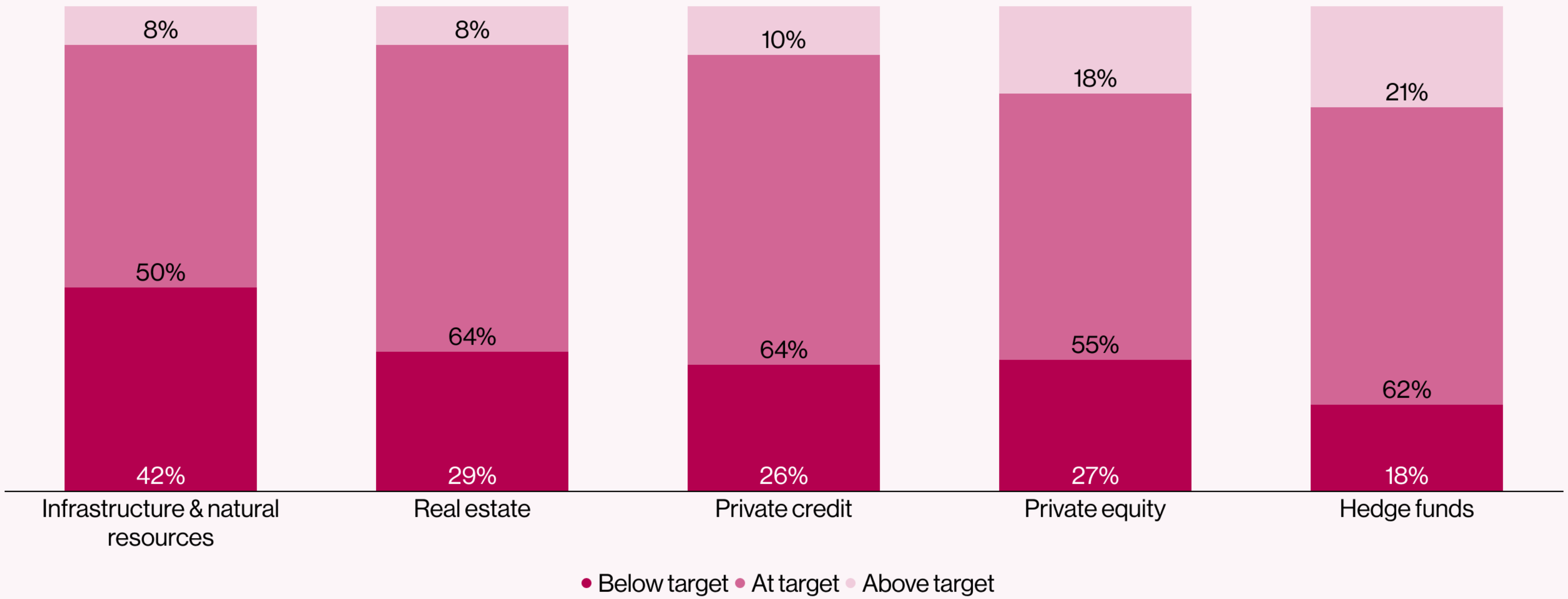
Investors execute rotation strategy

The fact they are net overweight hedge funds also suggests that those investing in new funds may also be rotating out of others. In light of this, some managers are questioning how their fund ought to be categorised.

Why it matters

While investor allocation plans are net positive, target portfolio weightings represent a potential stumbling block. IRs must identify which of their investors are overweight hedge and seek to reassure them at this pivotal moment.

Exhibit 1.4: Investor alternative assets weightings relative to target as of H1 2021



Source: HFM-AIMA

Private wealth demand for managed accounts suggests larger family office tickets

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Private wealth targets SMAs

Institutional investors are best known for using managed accounts to invest in hedge fund strategies. While this remains true, in H2 half of private wealth investors will do the same, perhaps indicating larger private wealth tickets.

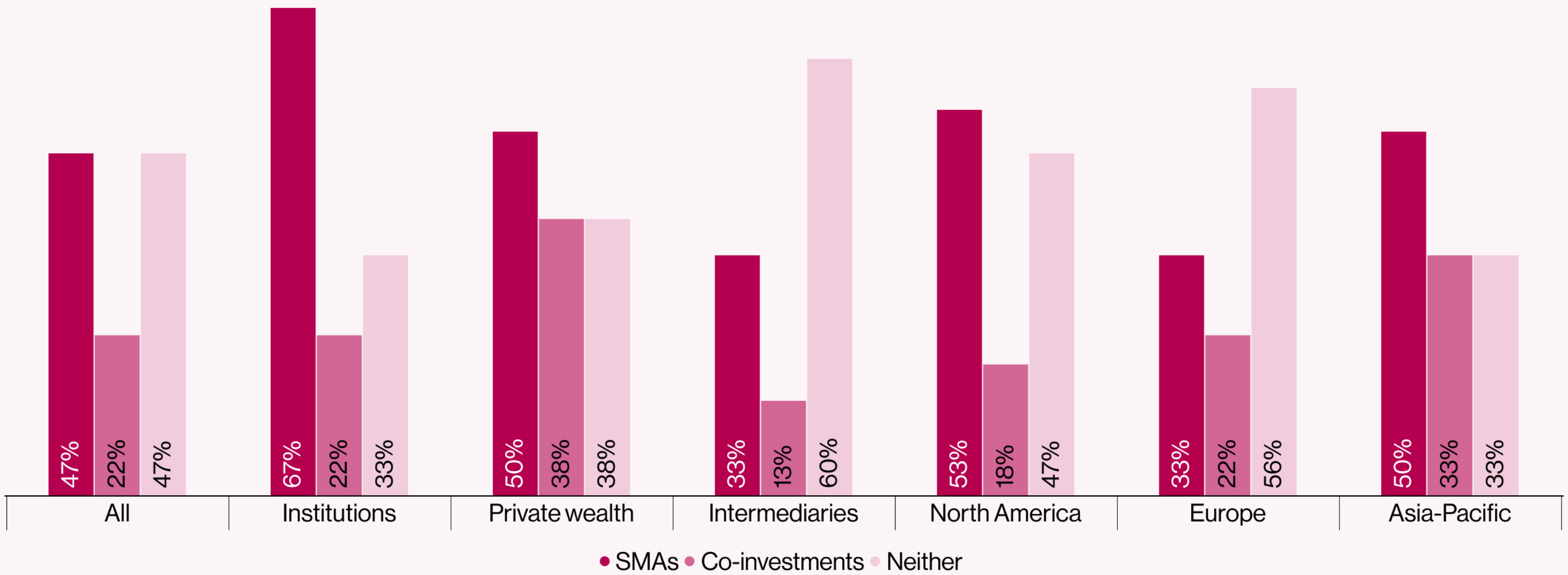
Apac also seeks bespoke vehicles

Demand for bespoke vehicles is also unusually strong among Asia-Pacific investors. Apac investors are more keen than those elsewhere on co-investments, suggesting an abundance of niche Apac opportunities during H2.

Why it matters

Interest in bespoke hedge fund products continues to grow, as investors seek niche opportunities and vehicles tailored to their needs. Openness to such arrangements will help firms capitalise on demand from private wealth.

Exhibit 1.5: Bespoke hedge fund product allocation plans among investors increasing their hedge fund allocation in H2 2021



Source: HFM-AIMA

Investors plan a move out of risk-free assets and alts will be the beneficiaries

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The fixed income exodus continues

A net 27% of investors said they plan to move out of fixed income in H2. Fears over rising inflation eroding the value of future coupon and principal payments have sparked an exodus from the asset class, ending a forty-year bull run.

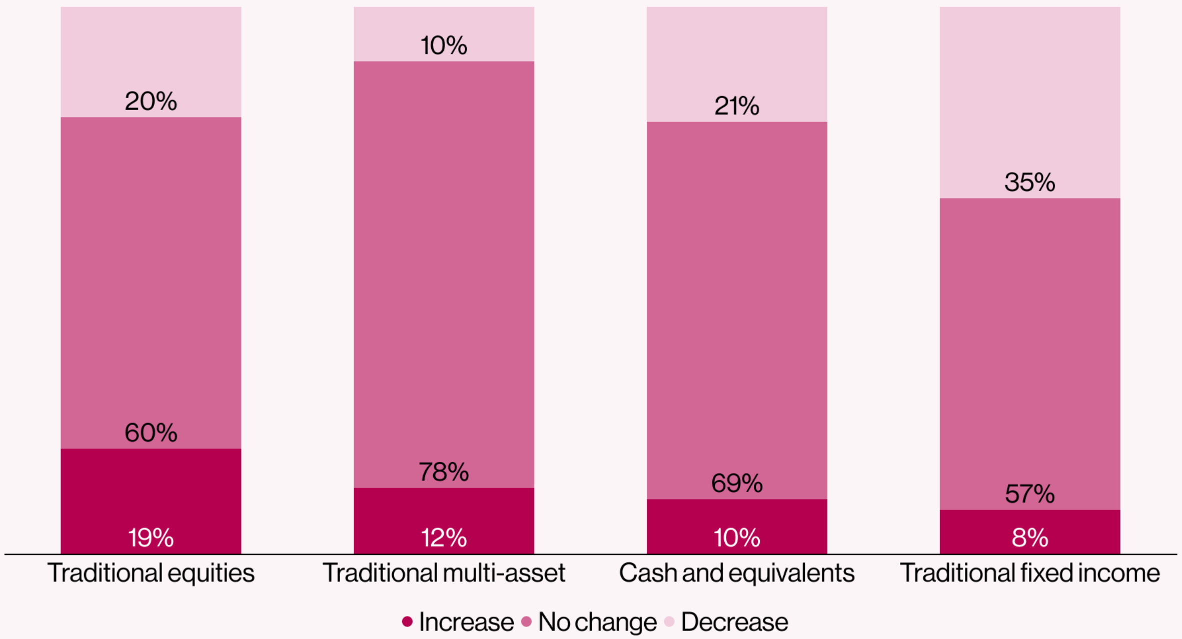
Investors are also unsure of equities

The share of investors planning to increase their equity allocation is broadly offset by those decreasing. While we do not know the relative sizes of these changes, the data points to investors maintaining a holding pattern in H2.

Why it matters

Decreasing fixed income and cash allocations show investors still plan to move out of risk-free assets in H2. Net neutral equity plans mean hedge funds can take advantage of this business as a risk-adjusted alternative.

Exhibit 1.6: Investor traditional allocation plans in H2 2021



Source: HFM-AIMA

Relatively few hedge fund managers plan to diversify their business in H2 2021

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Few long-only equity launches in H2

As Ex.1.6 showed, demand for long-only equities is likely to be net flat in H2. This, in combination with the large proportion of managers that already offer traditional equities products, means that few firms plan to explore such vehicles in H2 of this year.

Managers are most likely to explore PE

Private equity is more likely than any other asset class to attract commitments from investors in H2 2021. Hedge fund managers are evidently aware of this demand and are responding, with PE the asset class managers are most likely to diversify into.

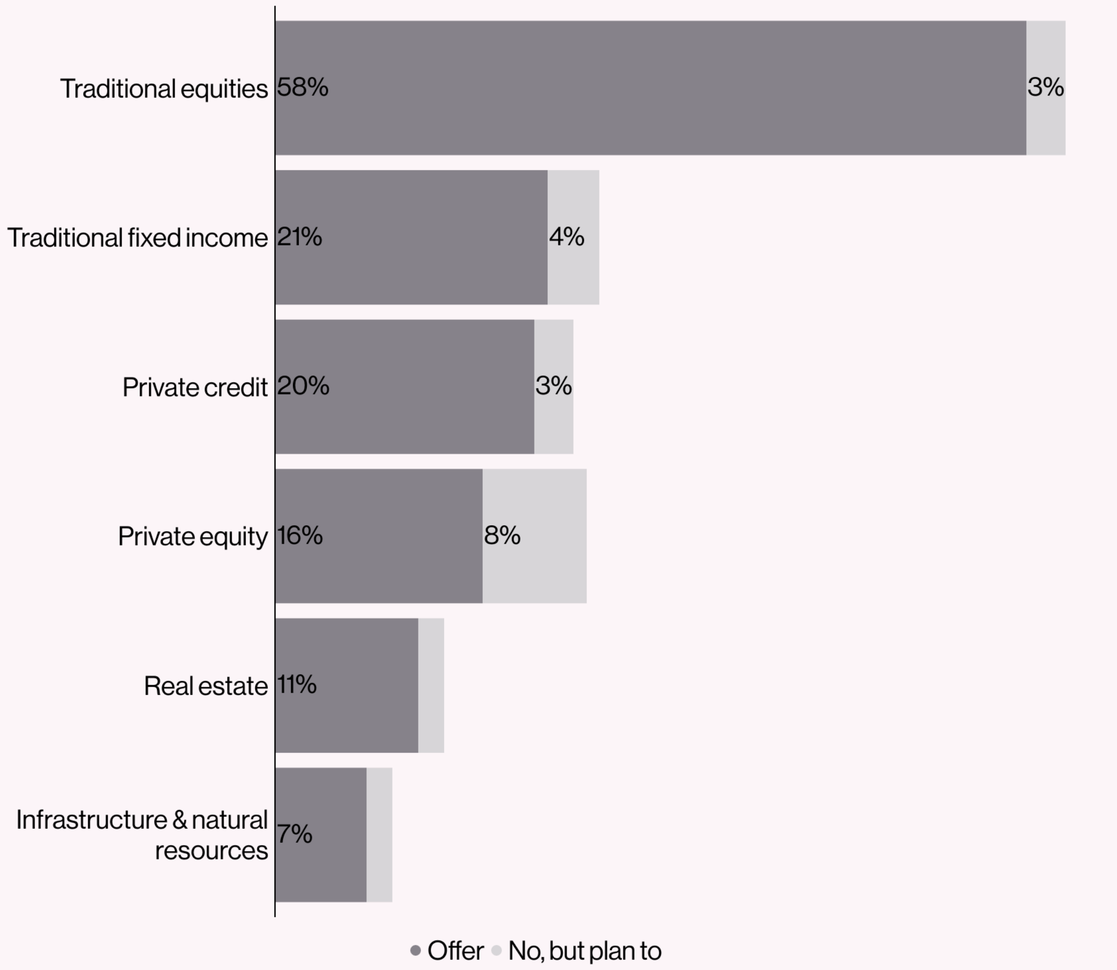
Why it matters

In broad terms, the proportion of managers seeking to diversify into other asset classes has fallen over the past six months. With the continued bright outlook for hedge funds, managers are clearly focusing on core business opportunities instead.

There's a disconnect between share prices and reality. The pre-pandemic concerns haven't abated.

– European asset manager

Exhibit 1.7: Proportion of hedge fund managers that offer other asset classes as of H1 2021



Source: HFM-AIMA

Inflation concerns held back L/S equity mandates in H1, but H2's outlook is good

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Inflation fears limited H1 L/S equity flows

Long/short equity mandates as a share of all new and potential mandates rose during February through March, before falling back towards the end of Q2. This drop coincided with concerns over the impact of inflation on the long side of managers' books.

But managers have had time to adjust

Several allocator interviewees noted they had held back from further investing as a result of these concerns. However, with funds having had time to adjust positions accordingly, this ought to prove less of a constraint during the second half of the year.

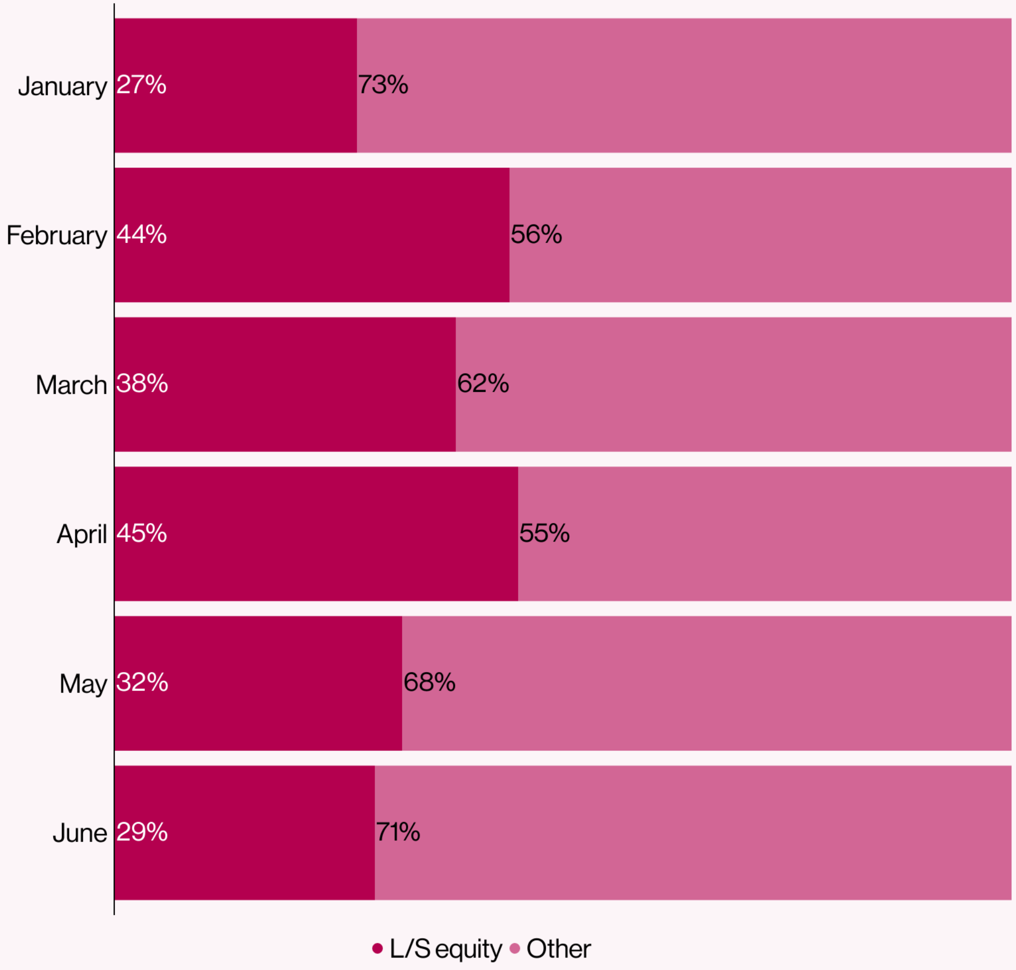
Why it matters

Long/short equity funds will continue to see inflows in H2, but global macro and multi-strategy will benefit the most from inflation concerns. As equity values near their peak (Ex. 1.6), long/short equity IRs should highlight shorting's downside protection.

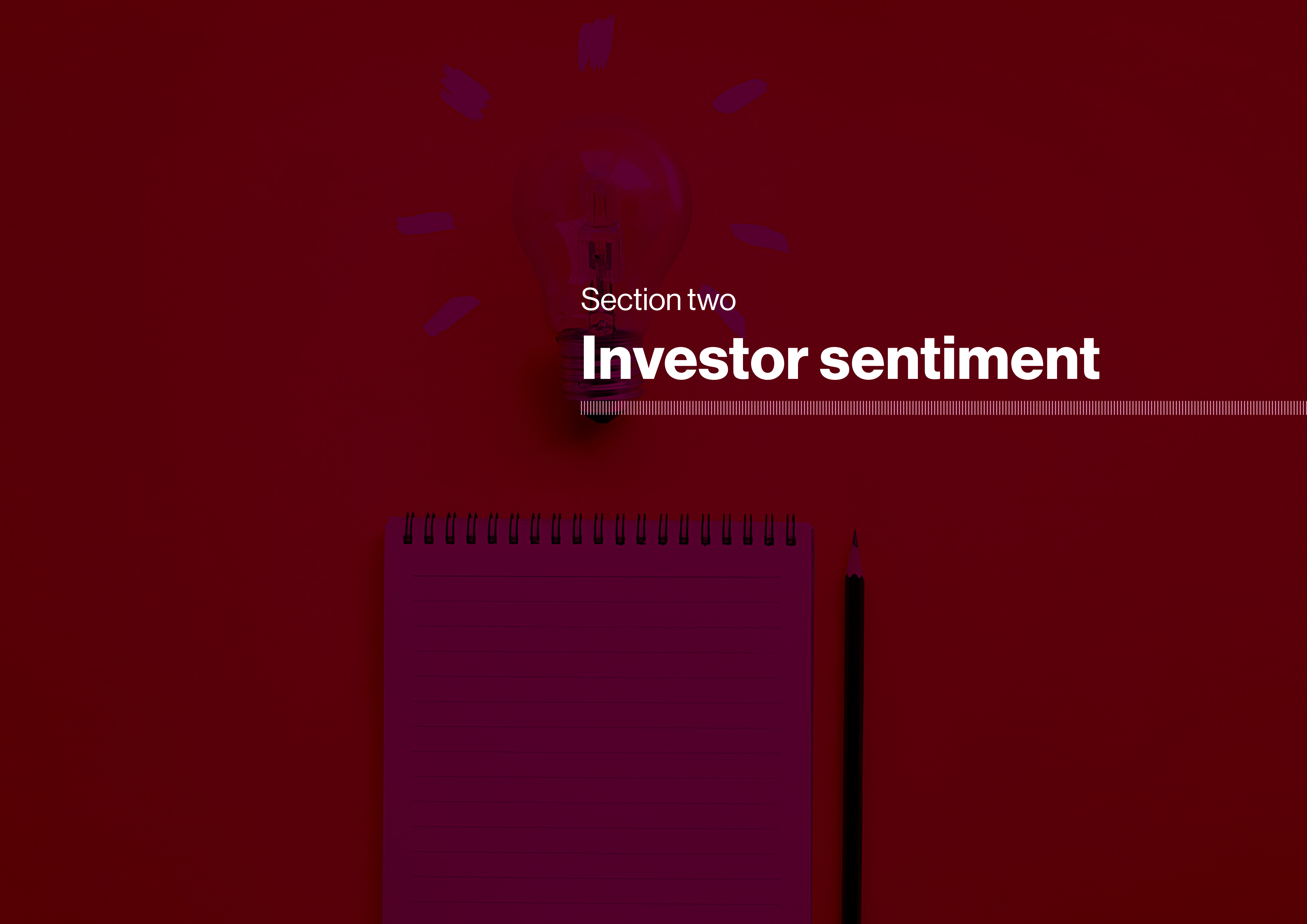
Long/short equity managers suffered due to inflation concerns

– US public pension

Exhibit 1.8: Long/short equity mandates as a proportion of all new and potential mandates during H1 2021



Source: HFM-AIMA



Section two

Investor sentiment

Most investors are satisfied with HF performance, but less so than six months ago

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Hedge funds rank middle of the pack

Gains of 8.9% marked the strongest first six months to the year for hedge funds since 2009. Despite this, raised expectations from 2020's strong returns have led to a fall in satisfaction with performance over the last six months.

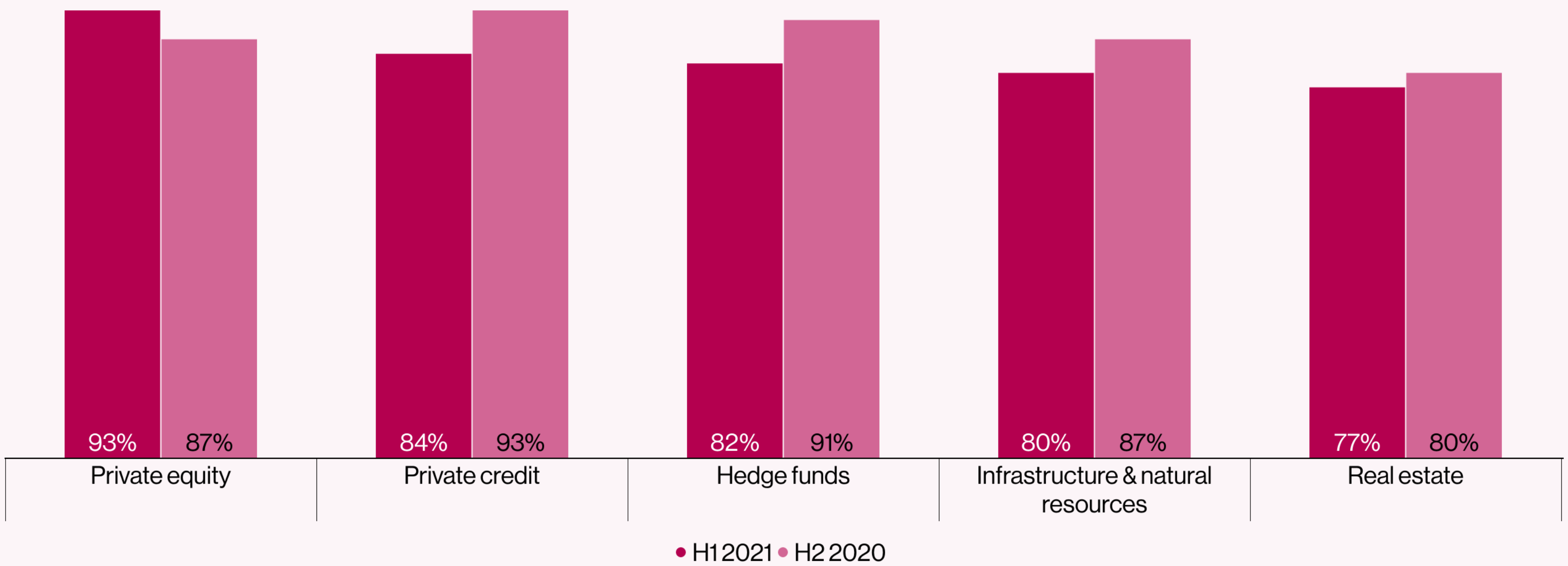
Private equity continues to please

Private equity is the only asset class to see more investors saying they were satisfied with performance now compared to six months ago. It is also the asset class hedge fund managers are most likely to diversify into in H2.

Why it matters

Satisfaction with hedge funds remains high, but has dropped back compared to six months ago. Hedge fund IRs should be mindful of this slight shift in investor sentiment towards the asset class when marketing in H2.

Exhibit 2.1: Investor satisfaction with alternative assets performance in H1 2021



Source: HFM-AIMA

Private wealth satisfaction with HFs has declined, but institutions remain happy

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Institutional satisfaction consistent

Performance satisfaction among institutional allocators remained broadly consistent over the past six months. Institutions' less forgiving attitude toward missteps, means IRs will be pleased by how they fared among this group.

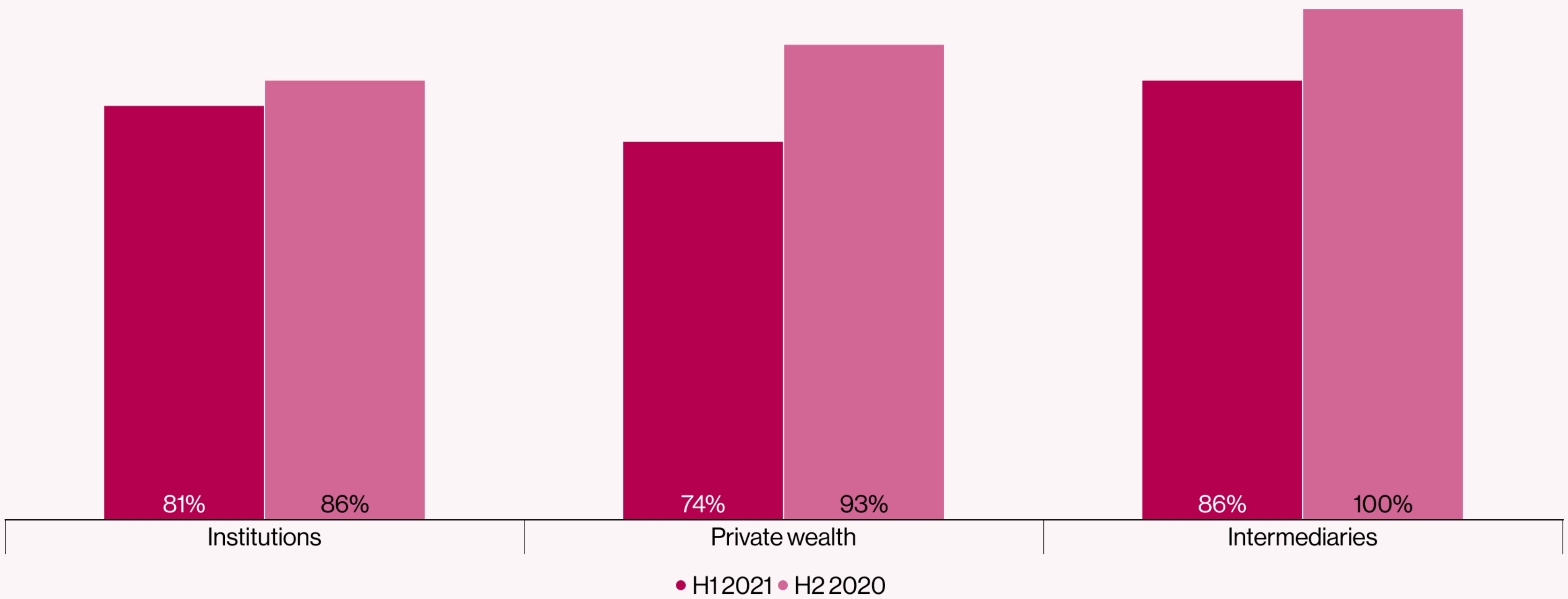
Private wealth less happy with HFs

74% of private wealth investors were satisfied with H1 hedge fund performance, a 19% fall from our last survey. In our that survey, private wealth had the highest return expectations of any group, helping to explain the drop.

Why it matters

Consistent institutional satisfaction ratings offer fertile ground for hedge funds. In view of competition from private markets GPs within the alts bucket, a strong H2 will be critical to gaining further traction with this group.

Exhibit 2.2: Investor satisfaction with hedge fund performance in H1 2021 and H2 2020



Source: HFM-AIMA

H1 inflows from investors have reversed 2020's hedge fund AuM decline

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Hedge funds overturn 2020 outflows

Hedge funds pulled in $57.8bn in new capital from investors during the first five months of 2021. This represents a robust start to the year and more than makes up for the $23.4bn in outflows experienced by hedge funds during 2020.

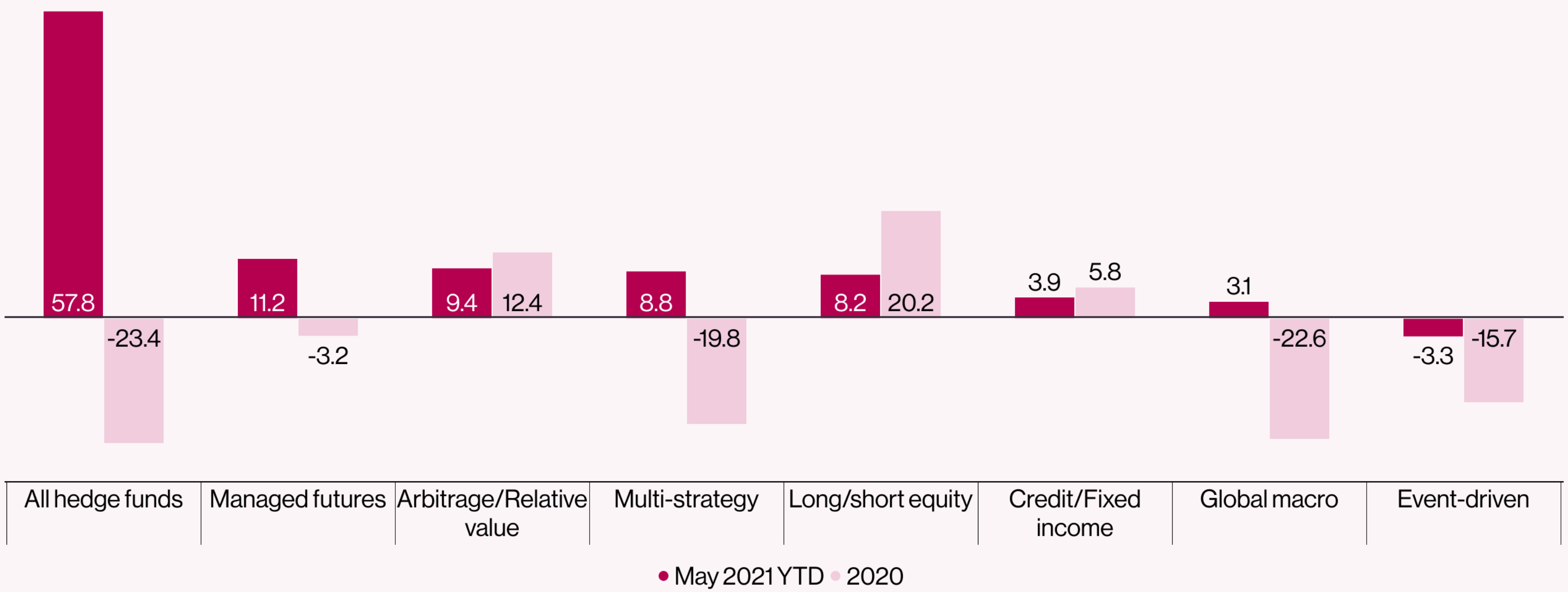
Long/short equity fared well

Long/short equity funds fared particularly well, accounting for nearly two fifths of gross inflows. As noted earlier, long/short equity mandates tapered off towards the end of the first half, but look set to bounce back in H2.

Why it matters

Four hedge fund strategies saw outflows in 2020, but our allocation data shows these strategies are set to experience stronger demand than six months ago. IRs should shift from damage limitation to preparing for inflows.

Exhibit 2.3: Hedge fund asset flows ($bn) through May 2021 by investment strategy



Analyst note: All figures are estimates and subject to change.

Source: HFM-AIMA

Investors see exciting new opportunities among hedge funds in H2 2021

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New hedge fund opportunities

Beyond reaching target allocation, exciting new opportunities was the second most widely cited reason for investing in hedge funds in H2. Interviewees highlighted health-care-focused funds as being of particular interest.

Investors mull fixed income switch

More tantalisingly for hedge funds, a quarter of investors flagged low fixed income yields as a reason for allocating to hedge. At 26%, only private credit was higher. In the long run, this marks an even greater business opportunity.

Why it matters

Beyond reaching target allocation, exciting new hedge fund opportunities is what attracts allocators most to the asset class. Nimble firms can capitalise on this demand through the provision of bespoke hedge fund products.

Exhibit 2.4: Investor reasons for increasing their alternatives allocations in H2 2021

Hedge Funds	Private Equity	Private Credit	Real Estate	Infrastructure & Natural Resources
To reach target allocation 41%	Expect strong returns 56%	To reach target allocation 55%	To reach target allocation 41%	To reach target allocation 57%
Exciting new opportunities 38%	To reach target allocation 56%	Exciting new opportunities 29%	Expect strong returns 37%	Inflation concerns 31%
Expect strong returns 31%	Exciting new opportunities 31%	Expect strong returns 26%	Inflation concerns 30%	Expect strong returns 29%
Low income fixed yields 25%	Equity valuation concerns 8%	Low fixed income yields 26%	Exciting new opportunities 22%	Exciting new opportunities 23%
Equity valuation concerns 22%	Inflation concerns 8%	Equity valuation concerns 6%	Low fixed income yields 22%	Low fixed income yields 14%
Inflation concerns 19%	Low fixed income yields 0%	Inflation concerns 3%	Equity valuation concerns 4%	Equity valuation concerns 11%

Source: HFM-AIMA

Institutions are looking to hedge funds, as concerns over equity values mount

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Expensive equities drive institutions

55% of institutions plan to invest in hedge funds over equity valuation concerns. To put this in context, the next highest scoring asset class was PE on 5%, meaning hedge funds are well placed to meet demand for downside protection.

But Europeans are less concerned

European equities, dominated by old economy companies, lagged American stocks in 2020, and remain less highly valued. As such, just 11% of European allocators plan to invest in hedge over equity valuation concerns.

Why it matters

Institutions are concerned about equity valuations and see hedge funds as best placed to mitigate this risk. Hedge funds that plan on targeting institutions in H2 should highlight their ability to do so as part of their pitch.

Exhibit 2.5: Investor reasons for increasing their hedge fund allocations in H2 2021 by investor type and location

Institutions	Private wealth	Intermediaries
To reach target allocation 44%	To reach target allocation 38%	Exciting new opportunities 60%
Equity valuation concerns 44%	Inflation concerns 38%	Expect strong returns 47%
Low fixed income yields 33%	Exciting new opportunities 25%	To reach target allocation 40%
Expect strong returns 22%	Expect strong returns 13%	Low fixed income yields 27%
Exciting new opportunities 11%	Low fixed income yields 13%	Equity valuation concerns 20%
Inflation concerns 0%	Equity valuation concerns 0%	Inflation concerns 20%

North America	Europe	Asia-Pacific
Exciting new opportunities 41%	To reach target allocation 44%	To reach target allocation 50%
To reach target allocation 35%	Exciting new opportunities 44%	Expect strong returns 33%
Expect strong returns 29%	Inflation concerns 33%	Low fixed income yields 33%
Low fixed income yields 24%	Expect strong returns 33%	Equity valuation concerns 33%
Equity valuation concerns 24%	Low fixed income yields 22%	Exciting new opportunities 17%
Inflation concerns 12%	Equity valuation concerns 11%	Inflation concerns 17%

Source: HFM-AIMA

Strong returns in 2020 have raised the bar for investor performance expectations

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Investor expectations have risen

The HFM Global Hedge Fund Index is up 51% over the past five years, including a 8.9% rise in only the first half of 2020. These gains represent a double-edge sword for managers, having raised investor expectations even higher.

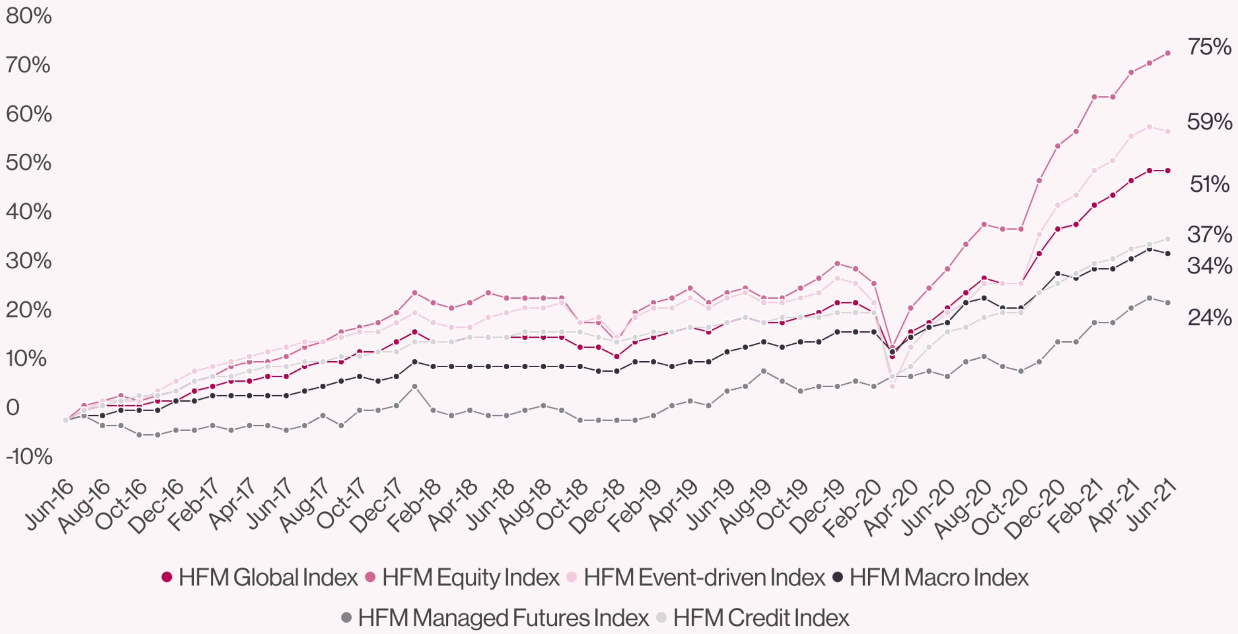
Equity funds post strongest returns

Equity hedge fund strategies have performed especially strongly, gaining 75% net of fees over five years. While this lags market indices, managers outperformed when it counted the most during the first half of 2020.

Why it matters

IRs are often frustrated by facile analysis of performance. In this respect, educating investors on the degree to which their returns can be explained by security selection or conscious exposure to various Barra factors is vital.

Exhibit 2.6: HFM strategy indices 5-year compound returns through June 2021



Source: HFM

H1 2021 marked the best start to the year for hedge funds since 2009

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Strongest Sharpe ratio for four years

Provided managers do not falter during H2, 2021 performance is on course to be the strongest, on a risk-adjusted basis, since 2017. This is down to both strong returns and also lower standard deviation of returns.

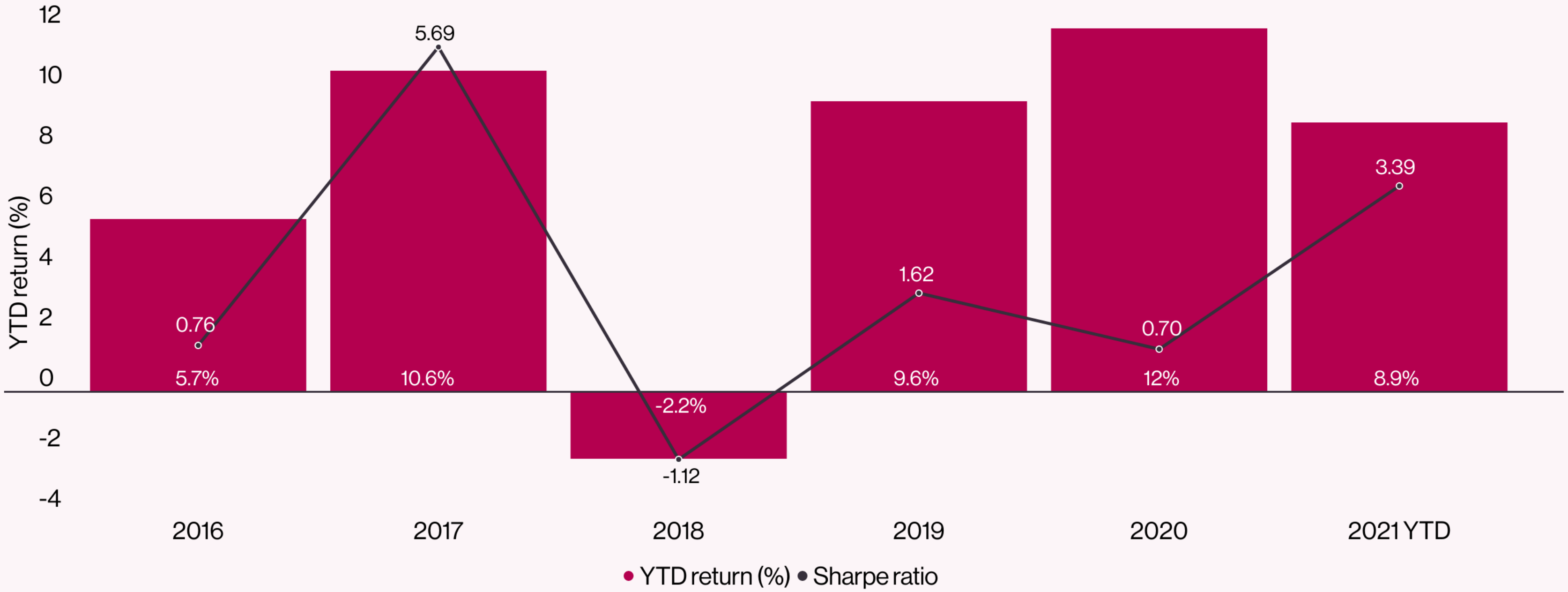
2020 returns raised the bar higher

Despite a stronger Sharpe ratio than in 2020, investor performance satisfaction has dropped. March 2020's outperformance came as a pleasant surprise, but managers have not yet had the chance to repeat this in 2021.

Why it matters

The industry is half-way to achieving a solid three-year track record. While some firms have shied away from the hedge fund tag in recent years, due to perceived negative connotations, some may now wish to revisit this.

Exhibit 2.7: Hedge fund Sharpe ratios and YTD return 2016 - 2021 YTD



Analyst note: Figures indicated are Sharpe ratios. 2021 YTD figure is estimated through June. The risk-free rate used is the US 10-Year Treasury yield as of the first trading day of each year

Source: HFM

Section three

Winning new business

Managers are even more likely to target private wealth investors in H2 2021

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Private wealth still most sought after

Single and multi-family offices remain managers' top targets in H2. This is true of both small and large managers, suggesting private wealth holds universal appeal and further indicative of larger ticket sizes from family offices.

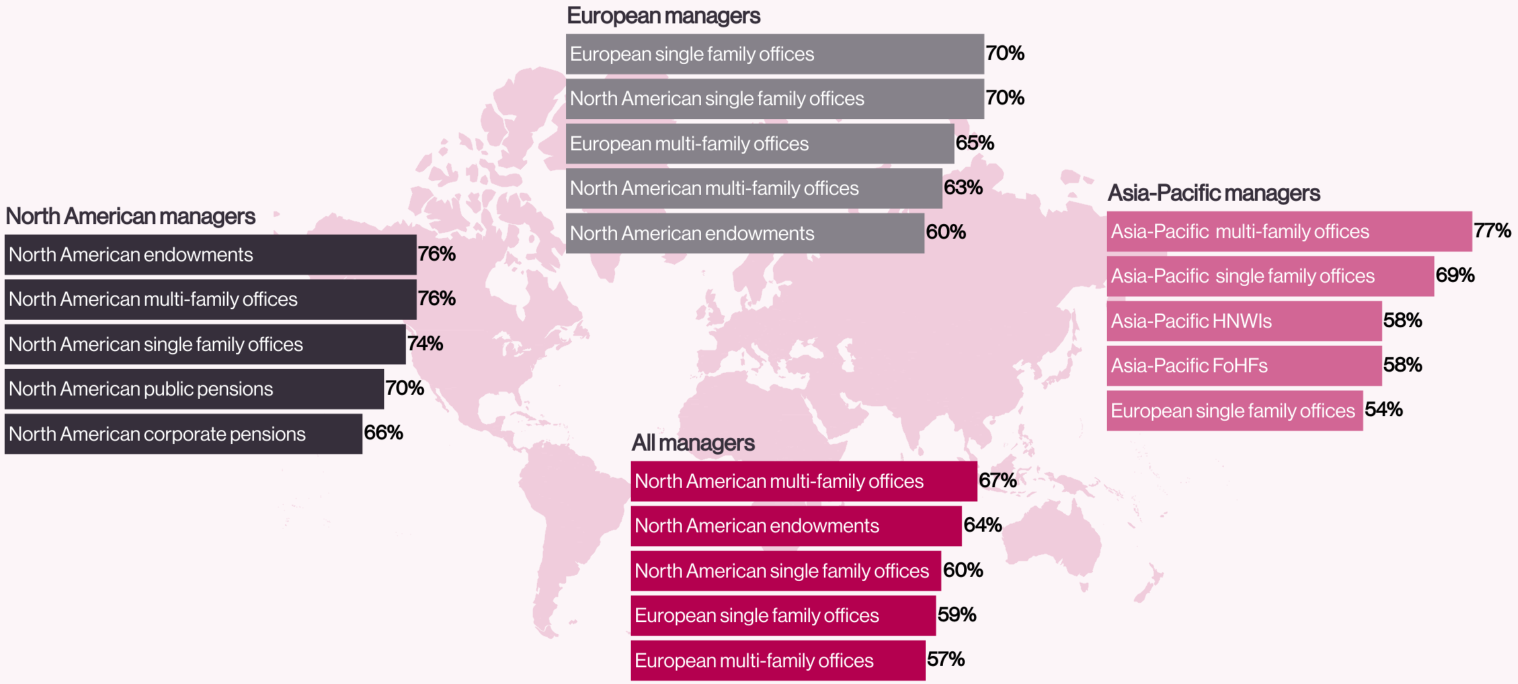
European manager look to the US

European managers are even more likely to target North American capital than in H1. At present, the UK, Europe's main hedge fund hub, has failed to strike an agreement over a transatlantic travel corridor with the United States.

Why it matters

Managers' top targets are largely unchanged from H1, suggesting firms are more focused on developing existing relationships than forging new ones. But, managers may use H2 to re-evaluate top targets as meetings resume.

Exhibit 3.1: Hedge fund managers' top investor targets in H2 2021 by manager region



Analyst note: Click ***"download the data"*** *for a full heat map of investor targets by region, size and strategy*

Source: HFM-AIMA

IRs have begun to exhaust client referrals and are tapping PB cap intro instead

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Client referrals dry up

The most symbolic change in promising sources of new leads is the drop in IRs citing client referrals as a fruitful source. This source, top in three consecutive surveys, looks now to have been overworked due to the pandemic conference hiatus.

PB cap intro makes a comeback

Back in vogue are PB introductions, cold calling, and emails. IRs are likely on the lookout for entirely new networks of investor that they can seek additional referrals from, whether this be in new geographies or previously unexplored categories of investor.

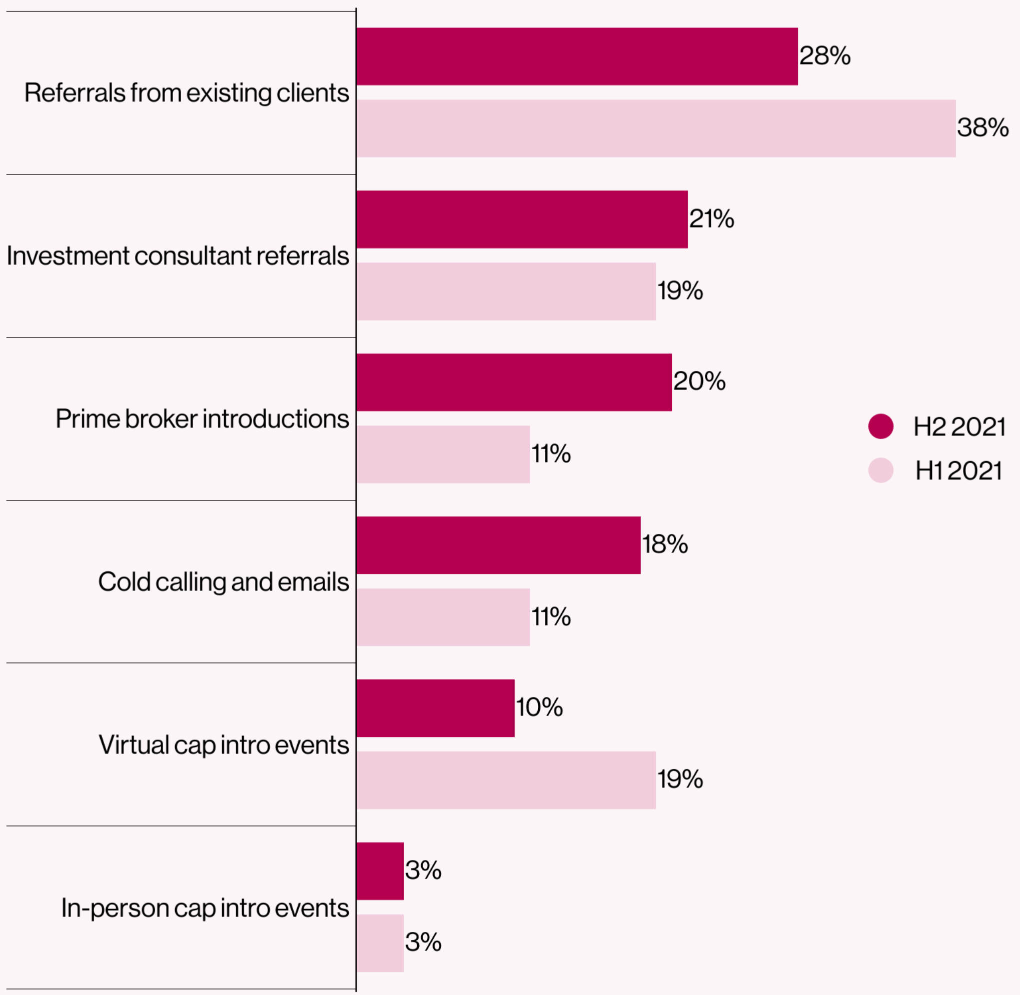
Why it matters

In H2, IRs will transition away from pandemic stand-ins to more traditional forms of lead generation. Those still focused on re-ferrals may do better to arrange meetings with their PB cap intro team, before their limited bandwidth is used up by peers.

Those who've networked [virtually] during the pandemic will be best positioned once in-person meetings resume

– European hedge fund IR

Exhibit 3.2: Most promising sources of new investor leads – H2 2021 vs. H1 2021



Source: HFM-AIMA

77% passed virtual ODD during H1, but in-person follow-ups are to come

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Most have now passed virtual ODD

Over three quarters of managers surveyed successfully completed ODD virtually with an investor in the preceding six months.This represents a marked rise from 55% the last time HFM asked managers this question in mid-2020.

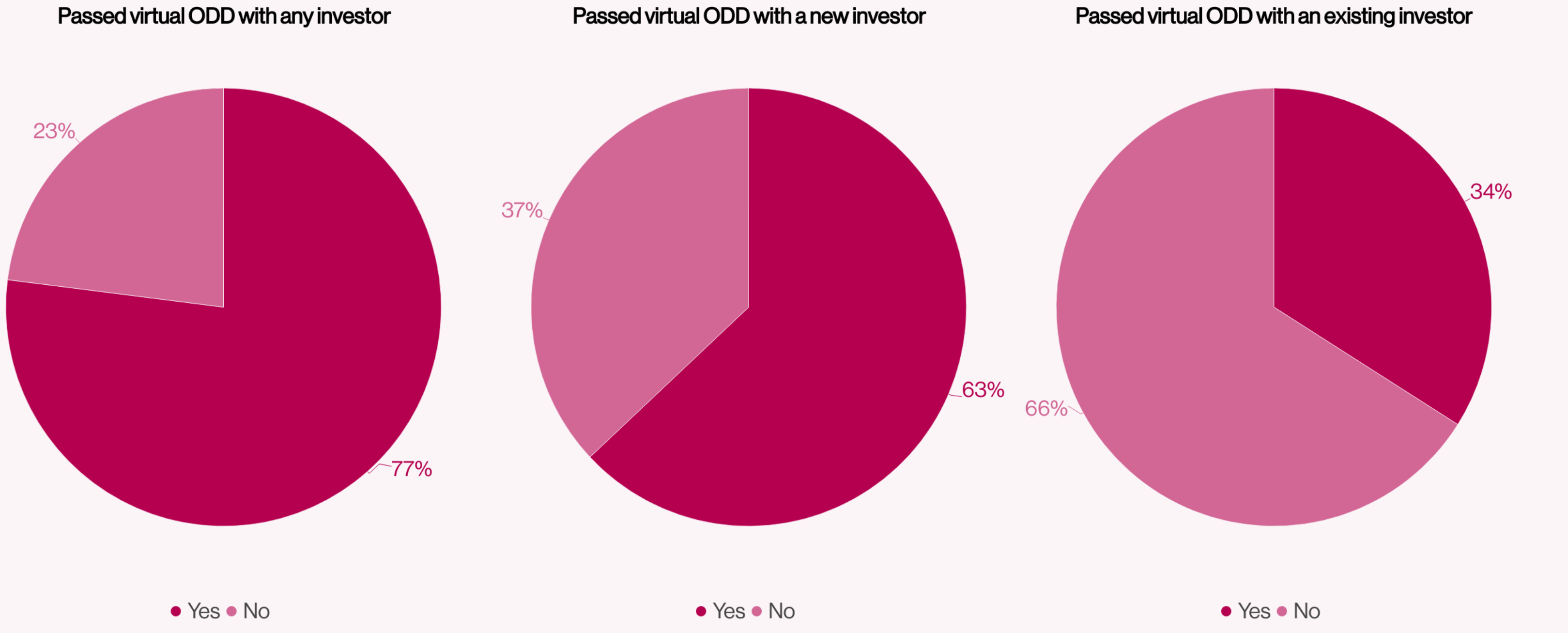
And it is likely here to stay

63% of managers have passed virtual ODD with a new investor, showing how comfortable with it investors now are. Interviewees suggested a hybrid approach is the future, with a site visit at the point of investment.

Why it matters

Virtual ODD has gone from a process which few investors would countenance, to the modus operandi of most. Managers should, however, prepare for post-pandemic in-person follow-ups, particularly from institutional allocators.

Exhibit 3.3: Proportion of managers to have successfully passed virtual operational due diligence in the preceding six months



Source: HFM-AIMA

North America is the only region where travel is on the rise, as variants cause chaos

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Intra-US travel set to resume

Six months ago the typical North American IR expected to take just one trip in the following six months, compared to 2.5 today. With US vaccinations more advanced than elsewhere this is likely to be largely intra-US travel.

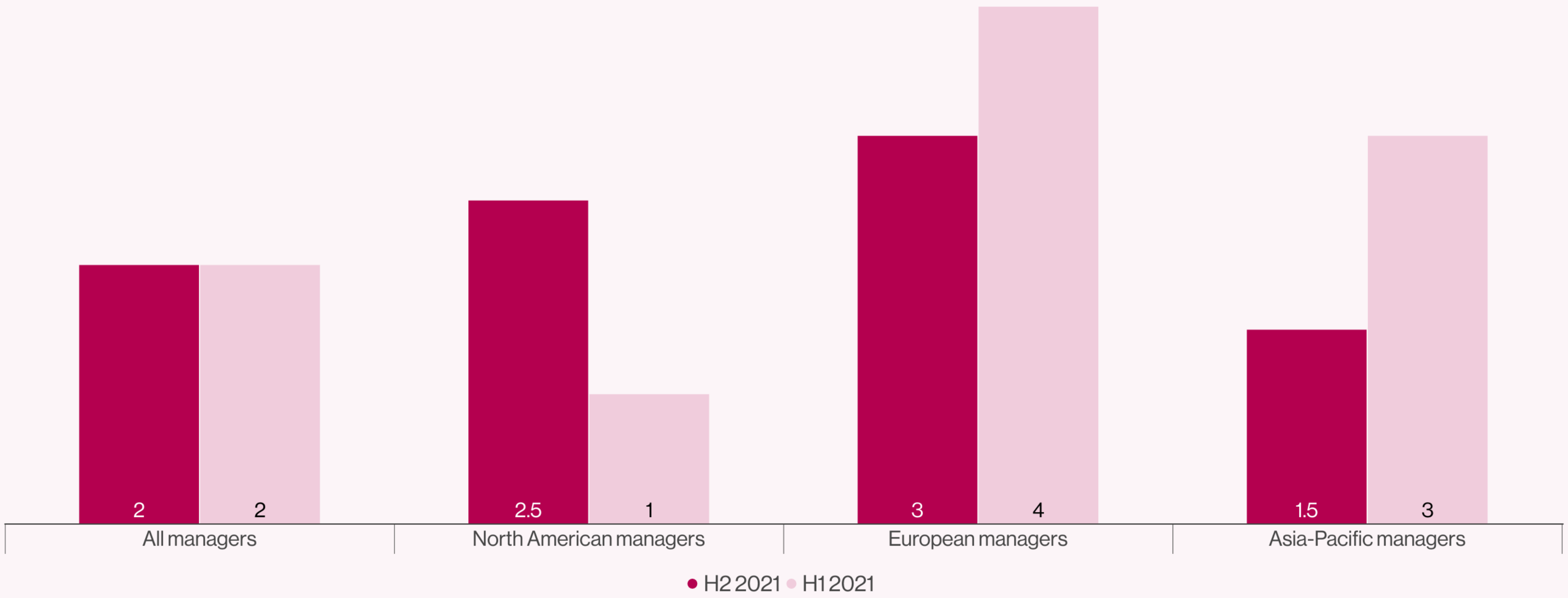
Variants hinder Apac and Europe

Despite this, the global median number of trips planned by IRs remains the same as six months ago. This reflects the rapid spread of the delta variant in Europe and Apac and their comparatively slower vaccination programmes.

Why it matters

With travel restrictions continuously coming under review, IRs planning their budgets for H2 might want to consider whether money is better spent on facilitating virtual ODD with new and existing clients, than on foreign travel.

Exhibit 3.4: Median number of business trips planned by hedge fund IR and marketing staff by region in H2 and H1 2021



Source: HFM-AIMA

Investors plan fewer manager meetings than during H1 and focus on follow-ups

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HFs will secure the most meetings

Investors plan to meet with an average of four new hedge funds in H2, but this top-level figure masks considerable variation between categories of investor. Institutions plan to meet just one new hedge fund, but private wealth ten.

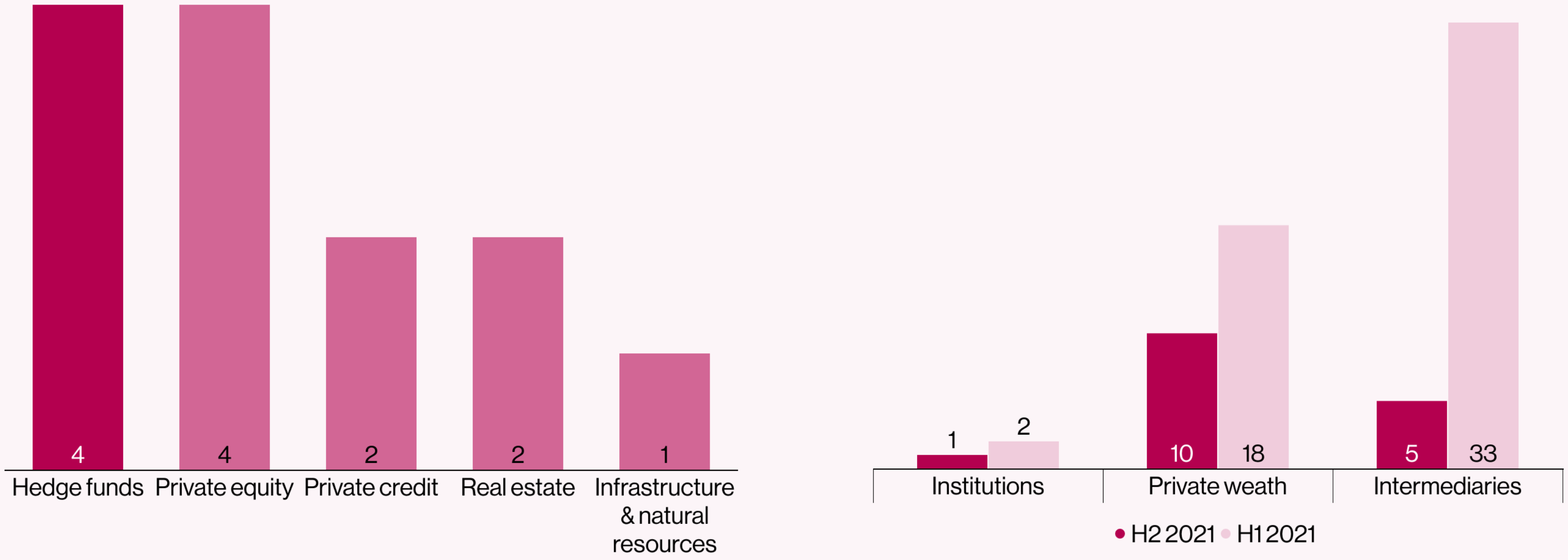
Investors wary of more lockdowns

We also see a considerable drop in the number of meetings planned over the past six months, particularly among intermediaries. Investors are no doubt somehat noncommittal after lockdowns put paid to H1 meeting plans.

Why it matters

Hedge funds will secure more investor meetings than other alts, but fewer than six months ago. While interest in hedge remains comparatively strong, then, this also means greater competition between hedge funds.

Exhibit 3.5: Median number of meetings planned by investors with new managers in H2 2021 by asset class and with new hedge fund managers by investor type



Source: HFM-AIMA

Managers have also set lower meetings targets, wary of getting their hopes up

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HFs will meet fewer new investors

Managers expect to hold fewer meetings with new investors in H2 compared to H1. They too are likely to have learnt their lesson when it comes to getting their hopes up and are also no doubt aware of investors' own reduced plans.

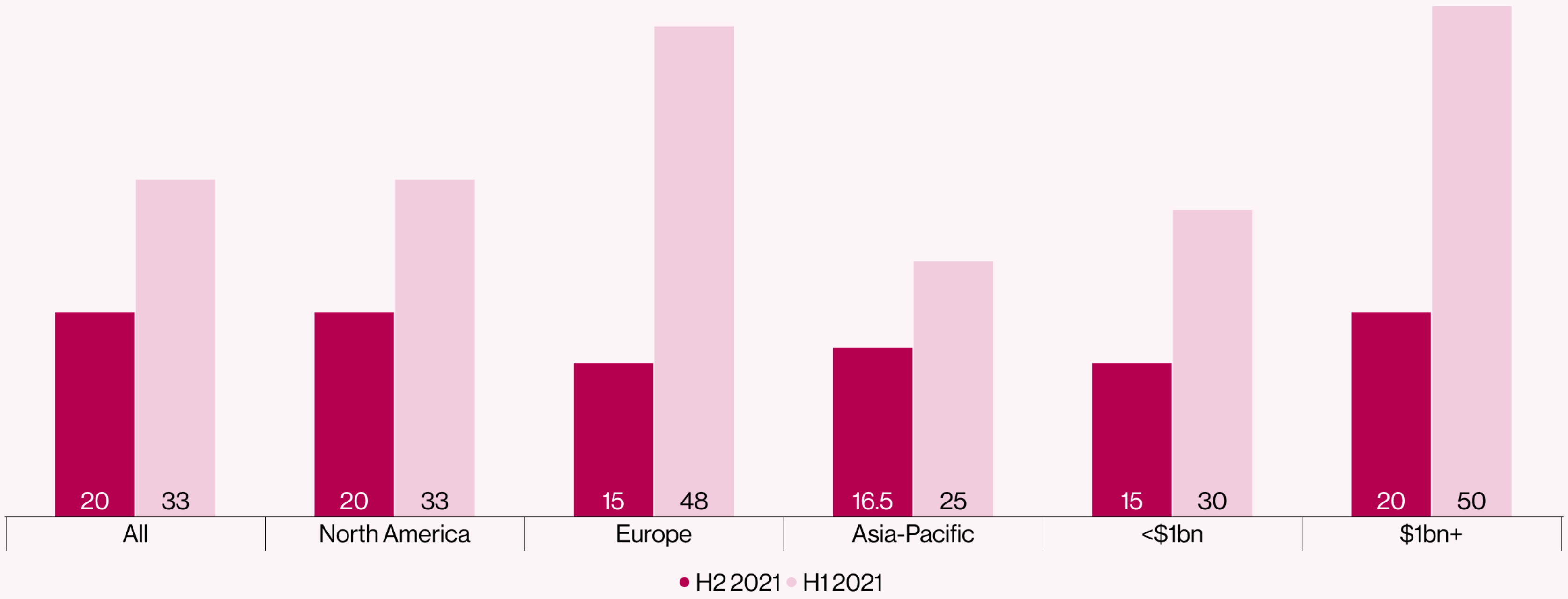
Europe most bullish to most bearish

European managers expect to hold fewer meetings with new investors than peers elsewhere. Three out of five of European managers' top targets are located overseas and travel restrictions remain, explaining this discrepancy.

Why it matters

At first glance lower meetings targets suggests an ebbing of confidence among managers. But, taken in conjunction with investor satisfaction and allocation data, we see a picture of H2 follow-ups, which IRs should prepare for.

Exhibit 3.6: Median number of meetings managers expect to hold with new investors in H2 vs. H1 2021



Source: HFM-AIMA

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Insights is the research and analysis service from Pageant Media, sitting within the company's hedge fund intelligence network, HFM. The division produces research reports and analytical articles on a variety of topics in the global hedge fund industry, including business operations, investor relations, technology and regulation. Leveraging Pageant's wealth of data and news sources, and with access to the HFM network's vast membership, Insights is uniquely positioned, offering exclusive surveys and expert commentary.

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ABOUT AIMA

The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with around 2,000 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise public awareness of the value of the industry.

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