Capital Introduction Group

Institutional Investor Survey – 2016

J.P.Morgan

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INTRODUCTION

For 13 years now, our annual survey of institutional investors in hedge funds has been instrumental in helping us gauge hedge fund industry trends and investment behavior. First and foremost, we would like to thank those institutional investors who continue to participate in these surveys. With your help, the survey has become an important source of knowledge for both institutional investors and hedge fund managers. As in previous years, we would like to share some of our key findings.

In summary:

- 322 institutional investors participated in this year's Institutional Investor Survey (the "Survey"), representing approximately $910 billion in assets under management ("AUM") with hedge funds (over 30% of total hedge fund industry assets).

- Insurance Companies, Pensions, and Family Offices all grew as a percentage of our respondent base (as measured by AUM in hedge funds) from 2014.

- While respondents continue to focus on liquidity, an overwhelming majority are willing to accept a lock-up period of one year or more. There is a healthy appetite for longer lock-up vehicles focused on hybrid/illiquid opportunities, as well as for co-investment opportunities.

- There is still appetite for new launches. However, outside of Fund of Funds or other allocators that have a business devoted to investing in emerging managers, a majority of respondents seem to have allocated to their quota of start-up managers in 2013 and 2014, when the new launch market was a bit frothier, and took pause in 2015.

- New allocations in 2015 were predominantly made to Fundamental Long Short Equity managers. Respondents allocated to Low Net and Market Neutral equity strategies significantly more than other equity-oriented hedge fund strategies.

- Among survey respondents, strategies that tend to perform well in volatile market environments are growing in interest. On a net basis, allocations to Global Macro, CTAs/Managed Futures, Quantitative Long Short Equity, Options/Volatility Arbitrage, and Commodities are all expected to increase in 2016. The last time we noted this was entering 2012, after the volatile market experienced in the second half of 2011.

- On a net basis, 16% of respondents are looking to increase allocations to Global Macro this year. This denotes the largest net change for any strategy indicated for 2016, compared to only 5% in 2015, highlighting a need for Global Macro in many respondents' investment portfolios.

- Most strategy reductions that took place in 2015 involved Credit and Event Driven strategies. Respondents are planning to further reduce their exposure to Corporate Credit, Structured Credit, and Event Driven in 2016.

- While we expect 2016 to be an active year for hedge fund investing, the focus may be on recycling capital dedicated to hedge fund managers instead of increasing overall exposure to the space. Given performance challenges relative to broader markets, respondents may look to upgrade specific managers where appropriate and re-allocate across particular strategies.

- The most turnover activity this year is expected within Fundamental Long Short Equity. 21% of respondents plan to increase allocations to the strategy vs. 23% who plan to decrease allocations. For the first time since our 2012 Investor Survey, more respondents plan to decrease allocations to the strategy than increase.

2015 started with rising macro risks across global markets. Great uncertainty arose from Europe amid Greece's general election and geopolitical tensions between Russia and Ukraine. Global central banks became increasingly dovish due to lackluster growth and rising concerns about deflation. Equity markets took a hit while volatility picked up. The continued decline in crude oil prices and widening high yield spreads also triggered some investor interest in the distressed energy space. The European Central Bank's ("ECB's") announcement of its quantitative easing package and extension of financial aid to Greece gave relief to the markets which bounced back in the subsequent months. In aggregate, hedge funds were able to navigate through the marketplace's ups and downs and posted decent returns in the first quarter.

Entering the second quarter, after most market participants were expecting global central bank policy divergence to persist (Fed and the Bank of England ("BoE") on one side, versus the ECB and Bank of Japan on the other), several data releases surprised the markets on the downside (soft Q1 U.S. GDP growth, disappointing U.S. non-farm payroll, etc.). The Federal Open Markets Committee ("FOMC") turned dovish and revised down its interest rate projections to a larger extent than investors had anticipated. An unexpected surge in bond yields during April, along with reversals of a strengthening dollar and declining crude oil prices hurt the performance of many global macro hedge fund managers, particularly systematic trend followers.

In June, the Greek debt crisis re-emerged and ignited a challenging summer for global markets. Following back and forth negotiations, sovereign bond yields on peripheral countries surged while equity markets pulled back due to the lack of any resolution for Greece. While the fear of "Grexit" faded after an emergency bridge loan was made available to Greece before formal bailout program discussions commenced, China became the next source for market turmoil. China's local equity markets saw a massive sell-off throughout the summer, which triggered broad concerns about emerging markets growth and potential contagion to developed markets. The Chinese government's sudden devaluation of its currency (RMB) sent another shockwave through the financial markets. Volatility surged across asset classes towards the end of August, with the VIX Index spiking to levels not seen since the financial crisis. Investors saw widespread selling of risk assets across the globe. As a result of the market volatility and weak economic data, the Fed decided to keep interest rates unchanged at the September FOMC meeting, which spurred concerns about a weak global economy and placed downward pressure on inflation. Hedge funds were not immune from the market downturn. All strategies suffered losses, with Equity Long Short and Event Driven leading the charge.

Despite the uncertainty surrounding monetary policy in the U.S., the fourth quarter kicked in with a broad-based rally in risk assets, particularly equities. Stabilizing economic data, better-than-feared corporate earnings and dovish tones from the central banks all contributed to the market recovery. Commodity markets remained under pressure amidst economic slowdown in China, muted growth across developed markets, and a stronger dollar. The Fed's long-awaited initial rate hike was eventually announced at December's FOMC meeting, which along with disappointing ECB stimulus packages, weighed on equity markets towards year-end.

Overall, 2015 was a laborious year for many hedge fund managers, with the industry-wide HFRI Fund Weighted Composite Index posting negative annual performance. Hedge funds, in aggregate, underperformed most major market indices once again and exhibited high correlation to global equity markets. Event Driven underperformed amongst the four broad categories of hedge fund strategies. Many Corporate Credit and Distressed Credit managers find themselves under substantial performance pressure due to spreads between CCC and B/BB bonds widening to levels not seen since 2009. Energy caused notable divergence in High Yield performance and therefore significantly affected corporate credit managers. U.S. High Yield Bonds were down nearly -5.0% in 2015, but without Energy and Metals, were actually up +0.36%.[1] Low Net and Market Neutral Long Short Equity strategies grabbed more attention during the second half of 2015, producing solid returns in December, as well as for the year. Hedge funds, in aggregate, finished the year down -1.02%.[2]

Last year, it was noted that momentum of growth across the hedge fund industry may slow during 2015. As hedge funds still remain under a very watchful eye, the expectation is that growth levels will be similar in 2016. Hedge fund industry assets are expected to continue to grow in line with growth of overall investment portfolios. 80% of Survey respondents indicated that their hedge fund allocations, as a percentage of their overall investment portfolio, would stay the same from 2015 to 2016.

Two-thirds of respondents indicated their hedge fund investments did not meet their targeted hedge fund portfolio return for 2015. This represents a significant shift in hedge fund perception, as nearly 90% of respondents met or exceeded their target return in 2013. Of those respondents who did not meet their target hedge fund return for 2015, the majority did not plan to significantly alter overall portfolio exposure to hedge funds. Instead, reallocating to different hedge fund managers and different strategies in 2016 were the most common changes planned to remedy meeting return expectations for this year. When asked what could be the main reason for hedge fund underperformance over the last few years, most respondents indicated it stemmed from too many hedge funds chasing limited opportunities to generate alpha, as well as macro factors.

Based on Survey responses, we anticipate that 2016 will likely be a year driven by elevated standards for new investments. Investor activity will focus on "portfolio upgrades", turning over current hedge fund allocations, and re-allocating across particular strategies depending on market outlook. Strategies that tend to perform well in volatile market environments are growing in interest. On a net basis, allocations to Global Macro, CTAs/Managed Futures, Quantitative Long Short Equity, Options/Volatility Arbitrage, and Commodities are expected to increase this year. The last time we noted this was entering 2012, after the volatile markets of the latter half of 2011. Given the increased levels of market volatility throughout most of 2015 and overall hedge fund underperformance, half of Survey participants also mentioned putting a manager on a watch list or redeeming from a manager last year. Fewer respondents added tail risk, hedging, or volatility strategies. 20% of respondents revealed that they are currently investing in Alternative or Smart Beta strategies, up from 15% in 2014. Another 5% of respondents indicate they plan to invest in such strategies in 2016.

Respondents predict that Fundamental Long Short Equity and Global Macro will be among the best performing strategies of 2016. Event Driven bullishness appears to have dropped off from 2015 to 2016. They expect the most turnover activity to occur within Fundamental Long Short Equity. 21% of respondents plan to increase allocations to the strategy vs. 23% who plan to decrease allocations.

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[1] Source: J.P. Morgan

[2] Source: HFRI Fund Weighted Composite Index. Hedge Fund Research, Inc. ("HFR")

For the first time since our 2012 Investor Survey, more respondents plan to decrease allocations to Fundamental Long Short Equity than increase. They also plan to further reduce exposure to most credit and event driven strategies in 2016. The HFRI ED: Distressed/Restructuring Index was down -8.0% in 2015,[3] posting its second consecutive year in the red.

While not as frothy as 2014, 2015 still brought a significant number of new hedge fund launches to market. The fundraising environment for emerging managers remains difficult though. Investors, while interested, have a high bar when evaluating investments in younger managers. 42% of respondents allocated to a start-up manager in 2015, down slightly from 47% in 2014, and a vast majority of them only invested in one or two new managers. Allocators still seem to be approaching investing in start-up managers cautiously and selectively, making their tickets even more coveted. Average size of seed allocations also decreased year-over-year. Founders' share classes remain the most common type of start-up investment amongst respondents. Outside of Fund of Funds or other investors that have a business dedicated to investing in new managers, a majority of respondents seem to have invested to their share of smaller managers in 2013 and 2014, then took pause in 2015. Expectations for emerging manager interest in 2016 is steady though, as 80% of respondents indicated they will maintain the number of start-up managers they allocate to and another 18% will possibly increase.

Respondents continue to explore different liquidity, fee, and transparency structures that best align with their investment needs. The percentage of respondents that invest in Liquid Alternatives (40 Act or UCITS) has grown slowly, but steadily, over the past few years. 30% of respondents currently invest in Liquid Alternative products, a slight increase from the 27% observed in 2014. Liquidity is the primary reason why respondents invest in these products, but lower fees are another attractive reason. Of the two-thirds of respondents who still do not invest in Liquid Alternatives, most have not invested due to lower return expectations versus traditional hedge fund offerings. Investors also have an appetite for vehicles on the opposite end of the liquidity spectrum. Similar to last year, nearly half of respondents are interested in longer-lock hedge fund vehicles, such as Hybrids and Co-Investment opportunities. The primary reasons investors are attracted to these hybrid investments is their potential to earn higher returns and provide better access to specific investment ideas. Interest in investing via Separately Managed Accounts and Funds of One seems to have plateaued year-over-year. The majority of respondents still do not invest this way, perhaps due to additional costs associated with the vehicles and less access to "best of breed" managers (negative selection bias).

Thank you again to everyone who participated in this and past years' surveys. We hope that you find the information useful.

Contact us:

Alessandra Tocco
Managing Director and Global Head of the Capital Introduction Group
alessandra.tocco@jpmorgan.com
(212) 272-9132

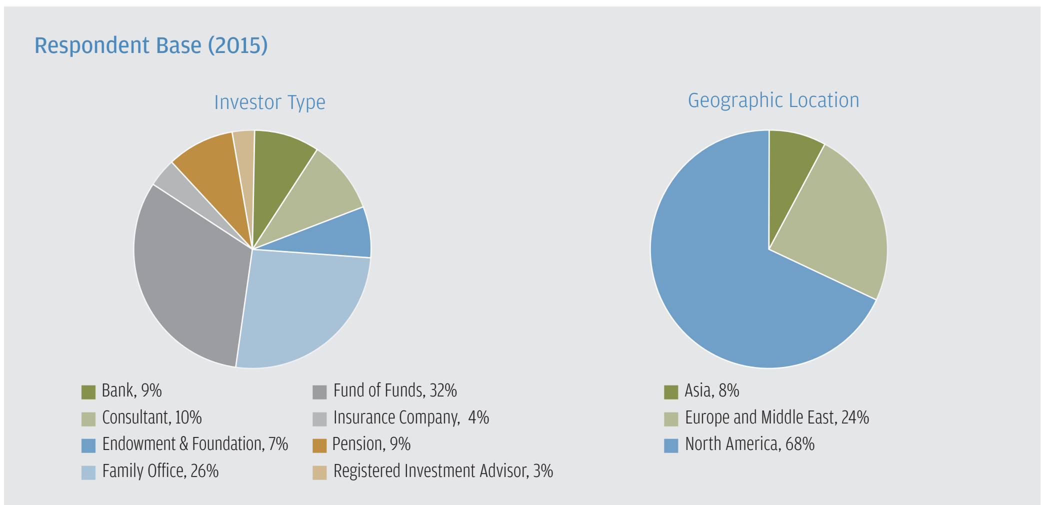
[3] Source: HFRI ED: Distressed/Restructuring Index. Hedge Fund Research, Inc. ("HFR")

I. SURVEY RESPONDENTS' CHARACTERISTICS

Overview of survey respondents:

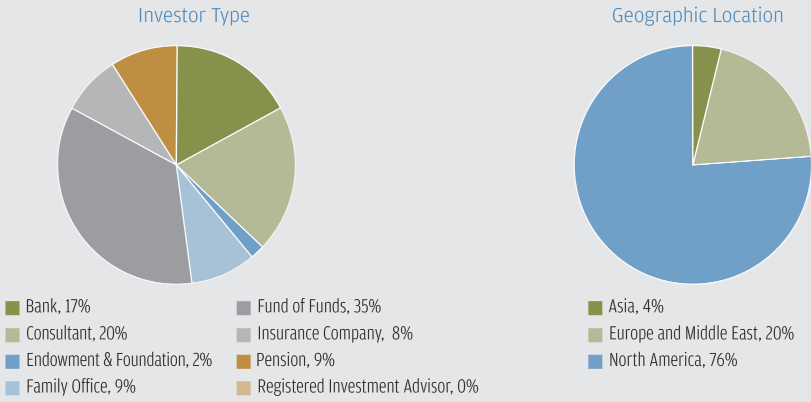
- In November 2015, J.P. Morgan's Capital Introduction Group conducted its annual Institutional Investor Survey (the "Survey"), which is based on the respondents' investing activity in 2015.
- 322 institutional investors responded to the Survey.
- Respondents include Banks, Consultants, Endowments & Foundations, Family Offices, Fund of Funds, Insurance Companies, Pensions, and Registered Investment Advisors.
- The geographic mix of institutional investors included roughly 30% of respondents based outside of North America.
- Respondents' aggregate AUM in hedge funds was north of $900 billion at the end of 2015 (over 30% of total hedge fund industry assets).
- Half of the respondents managed more than $1 billion in hedge fund investments at the close of 2015.
- Fund of Funds, Consultants, and Bank platforms represent the respondent segments with the most AUM in hedge funds.
- Family Offices, Insurance Companies, and Pensions have all grown as a percentage of our respondent base year over year, as measured by AUM in Hedge Funds. This growth is most likely from organic growth, but also from investors moving from Fund of Fund investing to investing with direct hedge fund managers for the first time.
- 85% of respondents have at least seven years of hedge fund investing experience, representing over 95% of the AUM invested in hedge funds amongst the respondents.

Figure 1



Note: Figures based on number of respondents unless otherwise noted

Respondent Base (2015, Based on AUM in Hedge Funds)[1]



Amount of Hedge Fund Capital Managed by Respondent Base at 2015 Year End[1]

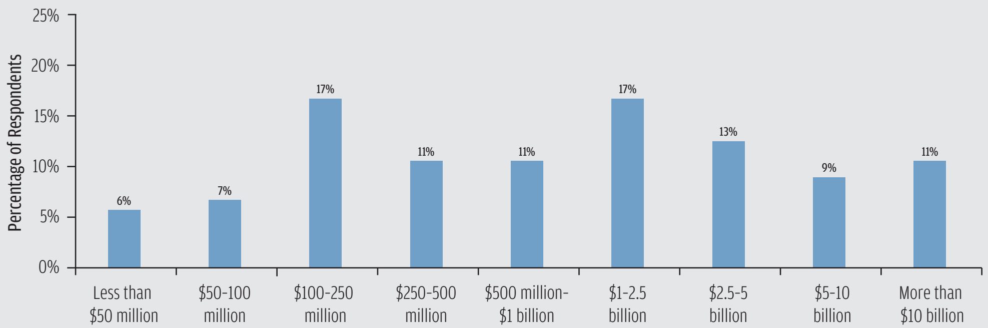
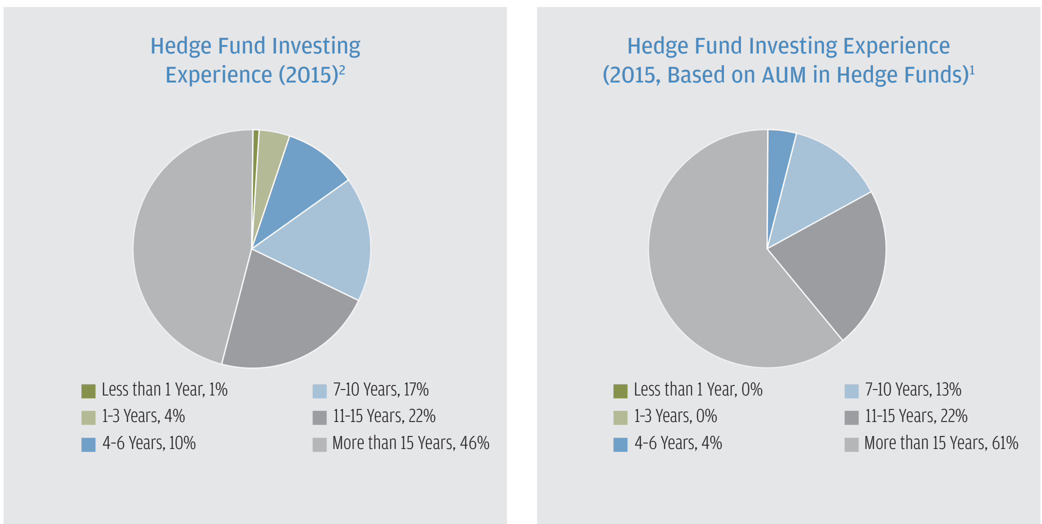


Figure 2



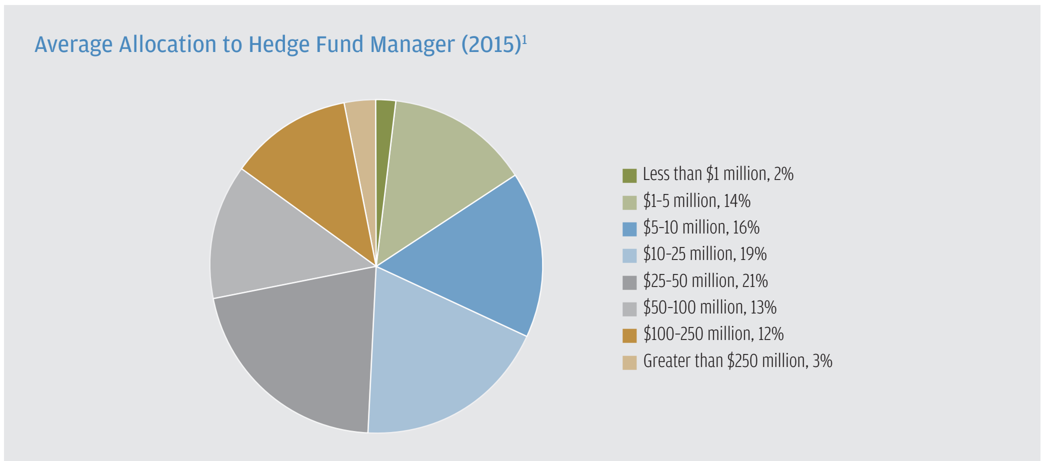
[1] Note: Figures based on Hedge Fund AUM as of 2015 year end

[2] Note: Figures based on selections from 288 respondents. Categories may not sum to 100% due to rounding

Pensions make the largest allocations, on average, amongst our respondent base.

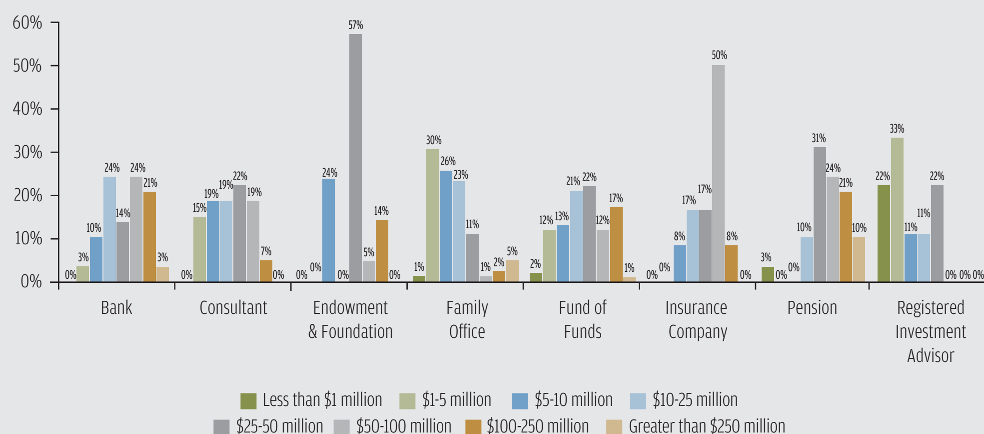
- Pensions, Endowments & Foundations, and Insurance Companies have the largest percentage of respondents that make average allocations of at least $25 million.
  - On average, 86% of Pensions allocate more than $25 million per hedge fund investment.
  - 55% of Pensions allocate more than $50 million per hedge fund investment, on average.
- Registered Investment Advisors and Family Offices tend to make the smallest average allocations, with majority of these segments allocating $10 million or less.
- Respondents with more experience in hedge fund investing tend to make larger allocations, on average.
  - Of the respondents who allocate, on average, at least $25 million to a manager, 87% have seven or more years of hedge fund investing experience.
  - Similarly, 88% of respondents who allocate, on average, at least $100 million to a manager, have at least seven years of experience investing in the space.

Figure 3

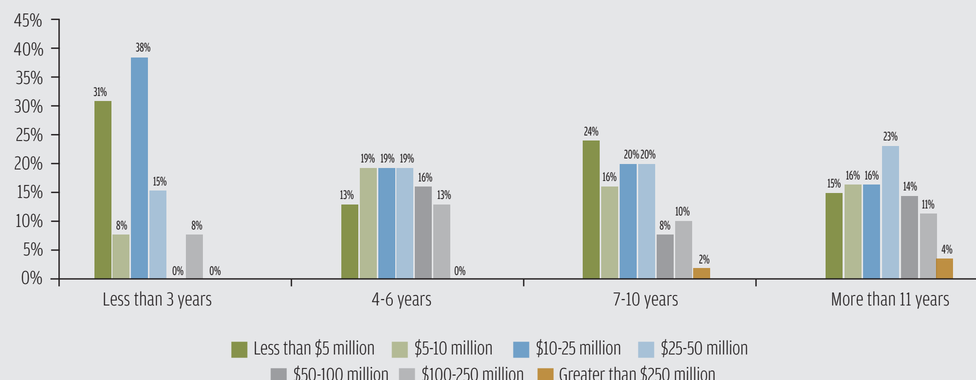


[1] Note: Figures based on number of respondents unless otherwise noted

Average Allocation to Hedge Fund Manager by Investor Type (2015)[1]



Average Allocation to Hedge Fund Manager by Hedge Fund Investing Experience (2015)[1]



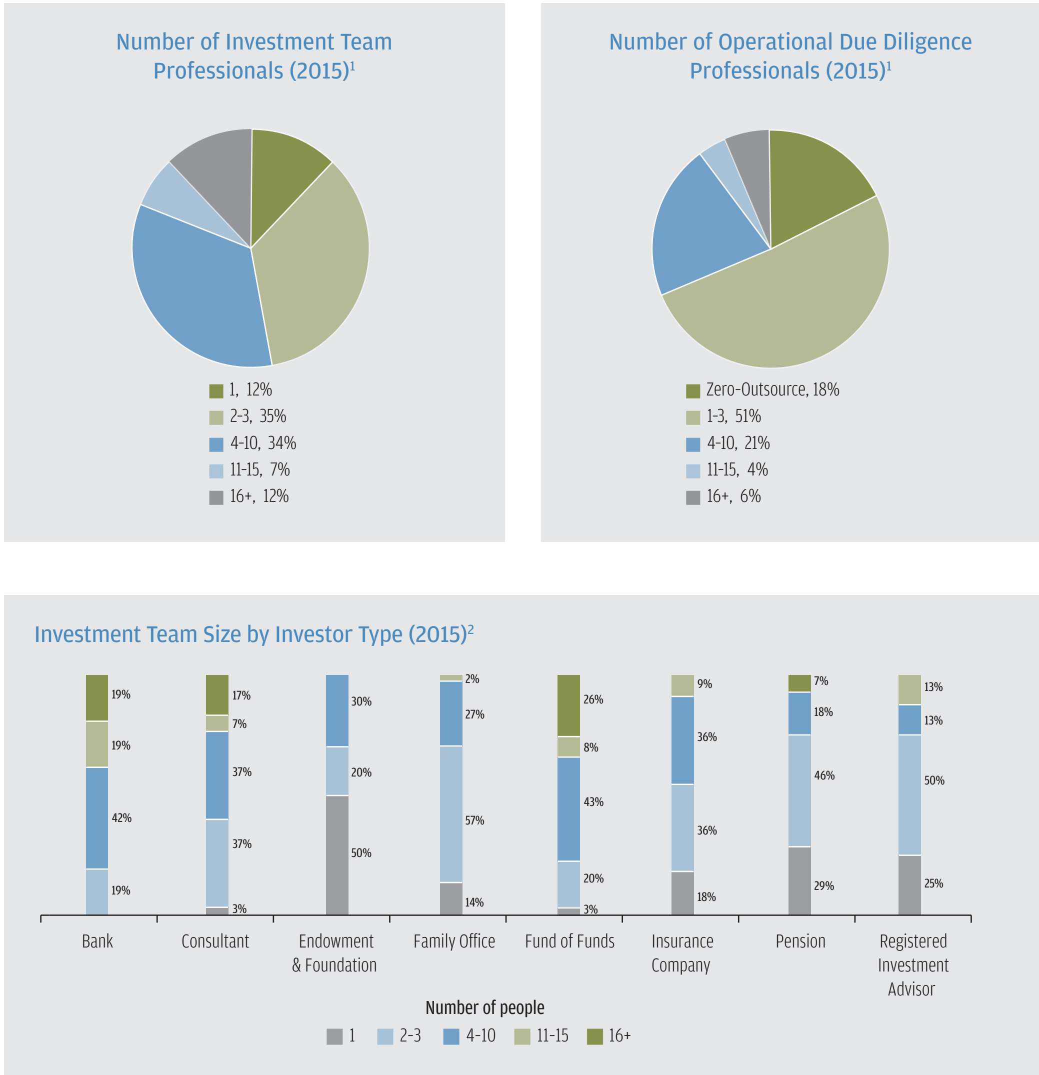
On average, respondents with larger hedge fund investment teams and in-house operational due diligence teams make larger allocations.

- Nearly 70% of respondents have between two and ten investment professionals dedicated to hedge fund research and investing.
- On average, Banks and Fund of Funds staff the largest investment teams.
- Half of respondents with over ten investment professionals dedicated to hedge fund research made average allocations to hedge fund managers of over $50 million. Only one-fifth of respondents with ten investment professionals or fewer dedicated to hedge fund research made average allocations to hedge fund managers of over $50 million.

[1] Note: Figures based on number of respondents unless otherwise noted. Categories may not sum to 100% due to rounding

- Over 80% of respondents have at least one professional dedicated to operational due diligence in house. 18% of respondents outsource the operational due diligence function.
  - Pensions and Endowments & Foundations represent those segments least likely to have in-house operational due diligence teams.
  - 57% of Pensions outsource or use a Consultant or Fund of Funds for this function. 55% of Endowments & Foundations do the same.

Figure 4



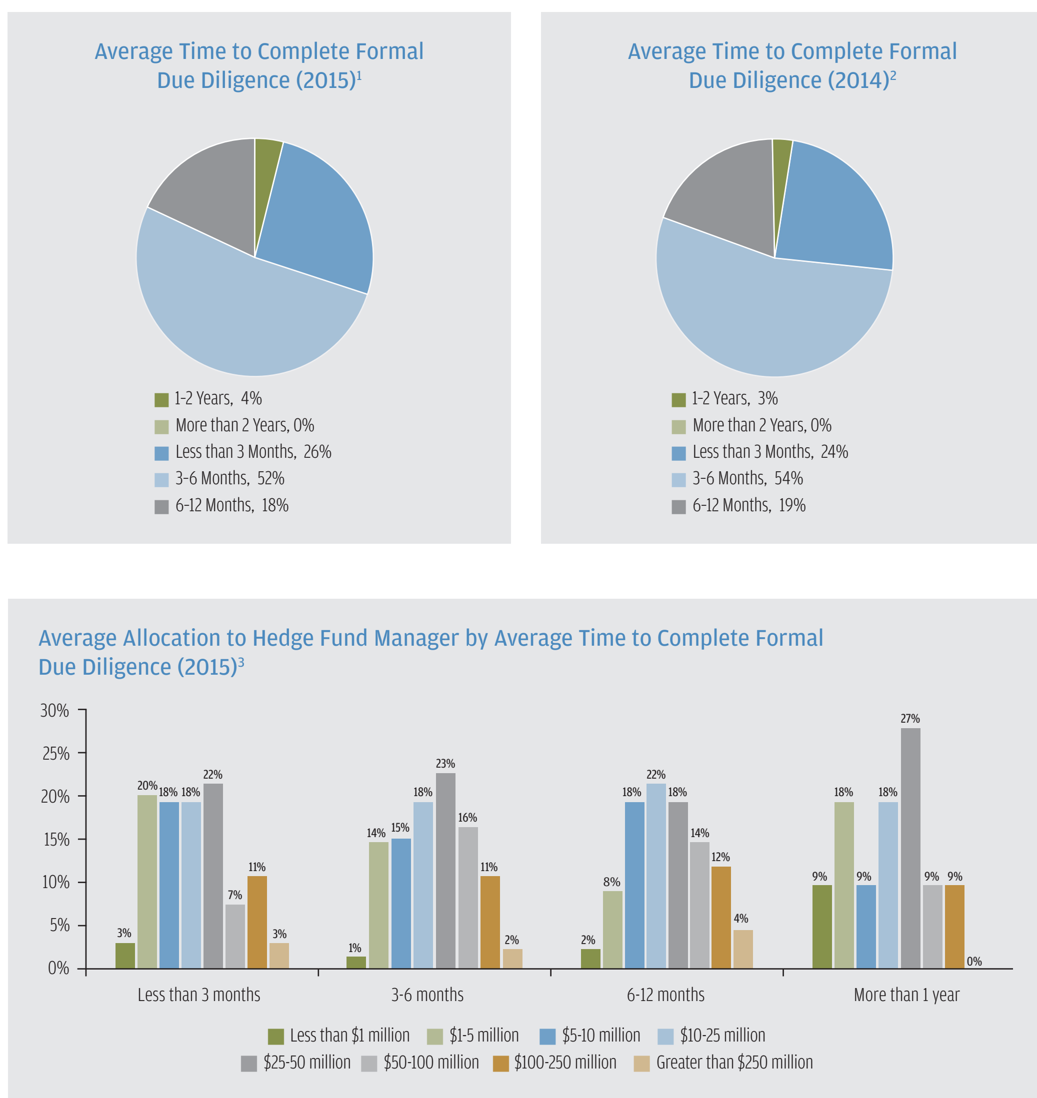
[1] Note: Figures based on selections from 301 respondents

[2] Note: Figures based on selections from 301 respondents. Categories may not sum to 100% due to rounding

The majority of respondents complete due diligence on a hedge fund manager within six months.

- Nearly 80% of respondents complete due diligence on a manager in six months or less, regardless of their investment team's size or average allocation size.
- Banks tend to spend the longest time, on average, on due diligence.
- There seems to be less correlation amongst our respondent base this year between the size of in house due diligence teams and the average length of the manager due diligence process.

Figure 5



[1] Note: Figures based on selections from 295 respondents

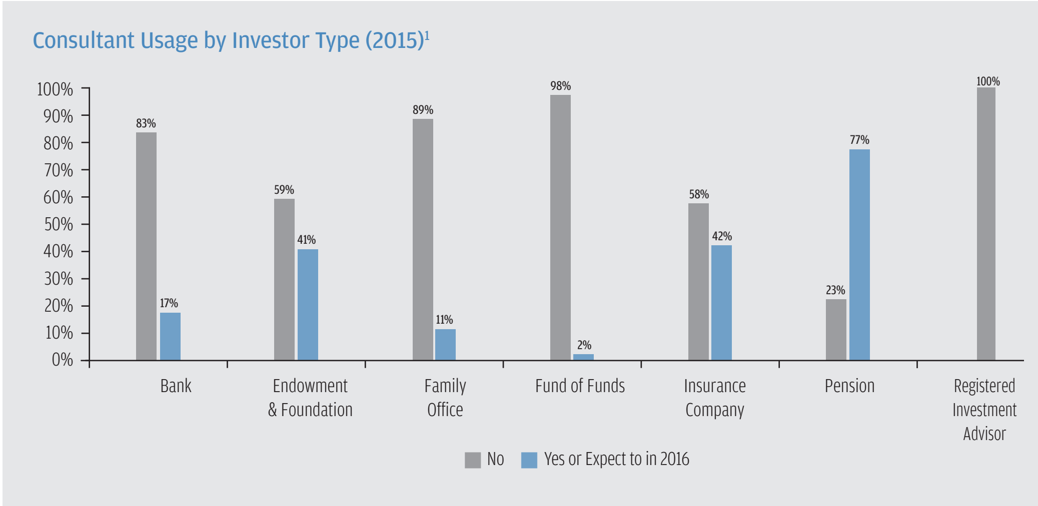
[2] Note: Figures based on selections from 371 respondents

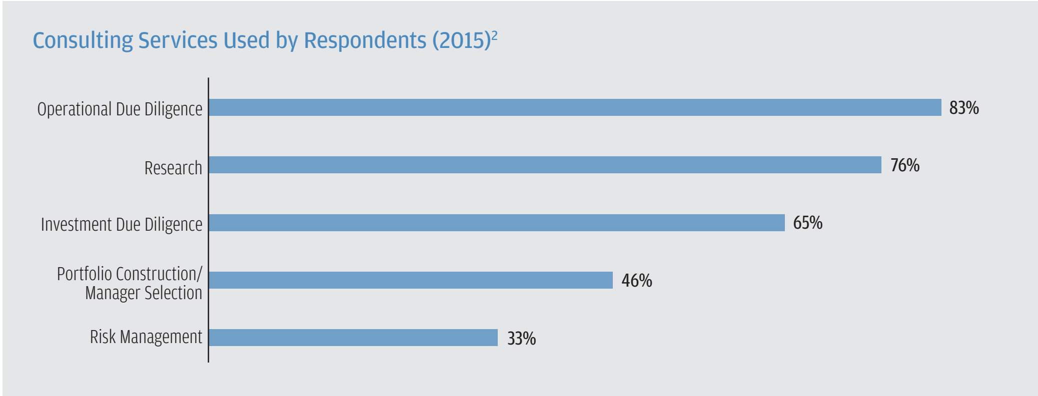
[3] Note: Figures based on selections from 295 respondents. Categories may not sum to 100% due to rounding

Nearly 20% of respondents (excluding Fund of Funds and Consultants) use a Consultant for assistance with their hedge fund investments.

- This observation is slightly lower than consultant usage noted in 2014 and 2013, which was closer to 30%.
- However, 10% of respondents rely on a Fund of Funds as an Advisor or Consultant. This is up from 4% of the respondent base noted in 2014 and could indicate that Fund of Funds have had success penetrating the Consultant market.
- Pensions, by a wide margin, are the most prominent users of Consultants.
  - Over three-quarters of Pension respondents indicated that they either currently utilize a Consultant or expect to in 2016.
  - Over 40% of Insurance Companies and Endowments & Foundations also utilize Consultants.
- The most utilized services provided to respondents by Consultants are operational due diligence, as well as manager sourcing and research.
- Respondents that utilize Consultants reported that their respective Consultant(s), on average, source/recommend managers for roughly one-third of their hedge fund investments, as measured by AUM.
- Despite much discussion over whether or not industry participants are noticing fee compression across the consultant space, a majority (88%) of respondents who use a Consultant noted that their Consultant has not changed their ‘assets under advisory’ fee over the past two years.
  - Fee compression may be stemming more so from the Fund of Funds segment as they enter the Consultant arena.
  - Of the 10% of the respondent base that notes they rely on a Fund of Funds as an Advisor or Consultant, over 40% reported that this service was complimentary (no additional fee) for current clients.

Figure 6





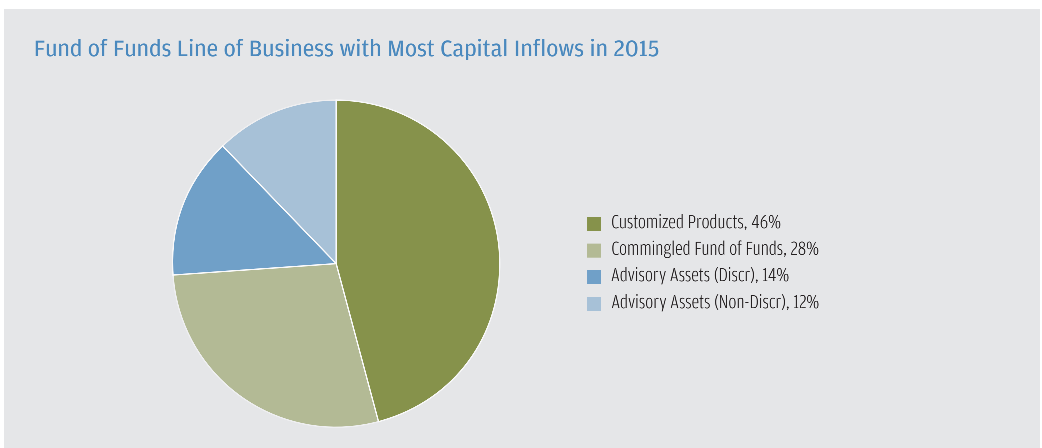
[1] Note: Figures based on selections by 255 respondents

[2] Note: Data is based on 142 selections made by 46 respondents

A growing number of Fund of Funds are broadening their businesses and offering advisory and consulting services to clients, as well as additional customized products.

- Half of the Fund of Funds respondents either currently offer advisory and consulting services to their clients or plan on doing so in 2016.
  - Over 80% of these respondents indicated they charge a separately negotiated fee for the additional service.
  - This is an interesting observation, as over 40% of institutional investors that use a Fund of Funds for consulting services indicated their service was complimentary.
- 70% of Fund of Funds respondents are currently offering or expect to offer customized products in 2016, a significant increase from the 59% observed in 2014.
- Nearly 50% of Fund of Funds respondents expect most capital inflow to stem from their customized products line of business, followed by the commingled fund of funds business (28%).
- Advisory services are growing as a part of overall Fund of Funds revenue as well. 26% of Fund of Funds respondents indicated their largest revenue generating businesses was either discretionary or non-discretionary advisory services.
- According to the Survey however, most institutional investors utilize a traditional consultant over a Fund of Funds for consulting services.
- Traditional consultants are also incorporating lines of business that are traditionally Fund of Funds-oriented. Close to 40% of Consultants surveyed this year are running their own internal fund of funds or expect to have a commingled fund of funds product in 2016.

Figure 7



Note: Figures based on number of respondents unless otherwise noted

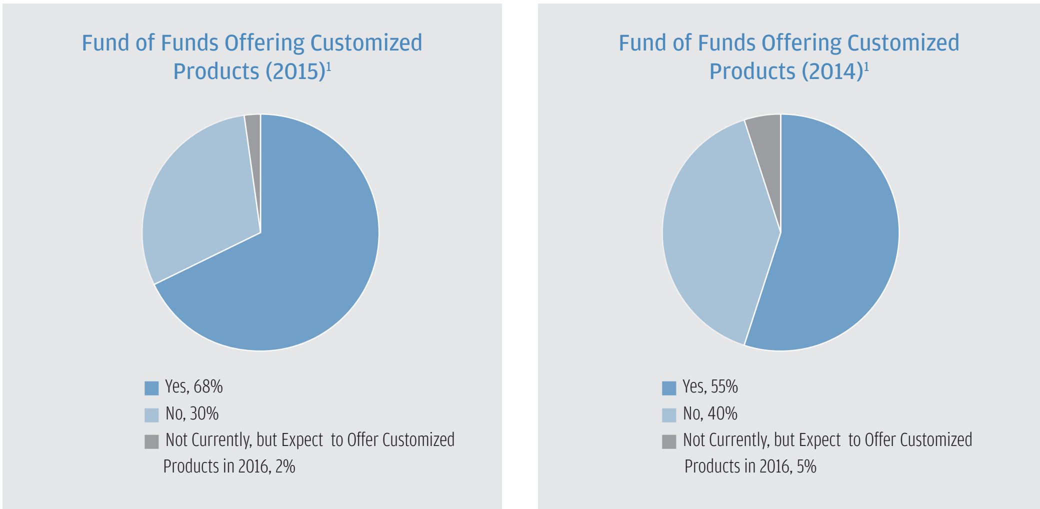
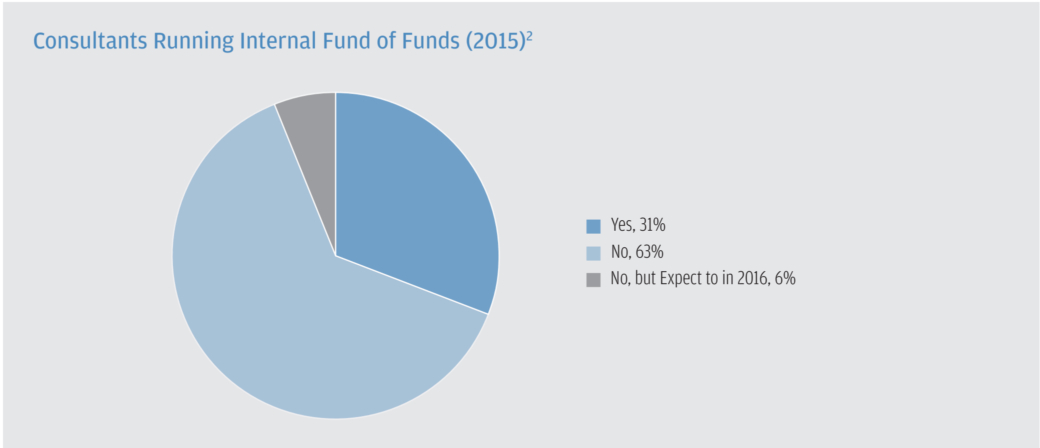


Figure 8



[1] Note: Figures based on number of Fund of Funds respondents

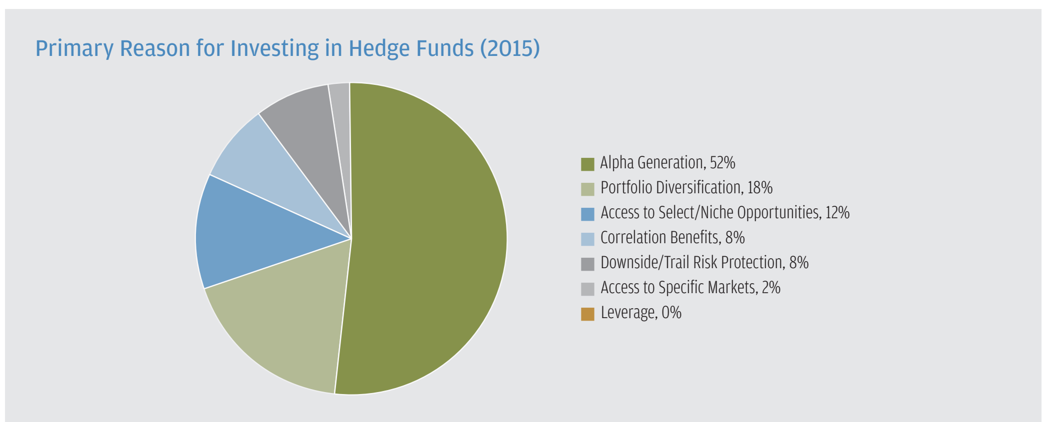
[2] Note: Figures based on number of Consultant respondents

II. INVESTMENT CRITERIA OF RESPONDENTS

Most allocators continue to view hedge funds as alpha generating tools within their overall investment portfolios. Similar to 2014, when asked what the primary reasons were for investing in hedge fund managers, over 52% of the respondent base indicated alpha generation as the leading logic.

- 18% of respondents invest in hedge funds primarily for portfolio diversification purposes.
- 12% revealed that their primary reason for allocating to hedge funds is for access to select/niche opportunities.
- Other primary reasons for investing in hedge funds expressed by respondents include downside/tail risk protection, correlation benefits, and access to specific markets.

Figure 9

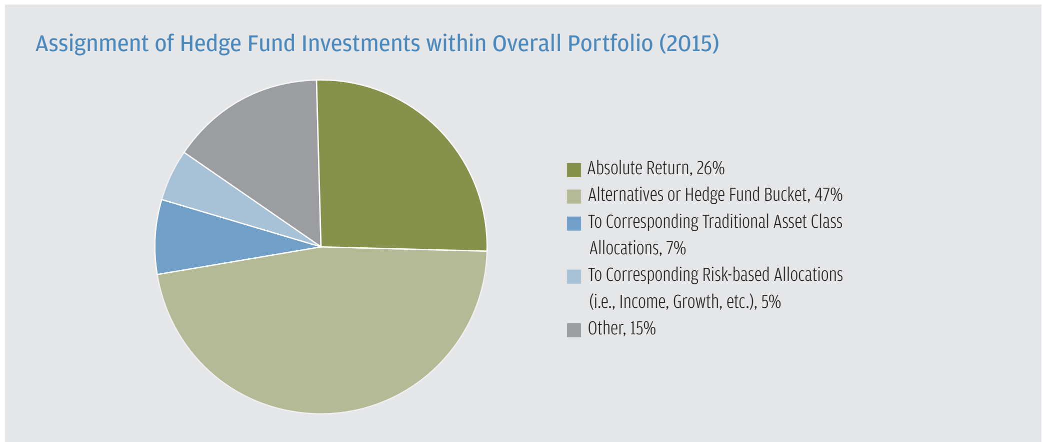


When allocating capital to hedge fund managers, approximately half of respondents assign investments to a “Alternatives” or “Hedge Fund” bucket within their overall investment portfolio, while a quarter of respondents utilize an “Absolute Return” section of the portfolio.

- Nearly half of Pension respondents indicated they place hedge fund investments in an absolute return oriented portfolio.
- Consultants and Endowments & Foundations were more likely than other segments to utilize a risk-based approach (i.e. income, growth, etc.) when allocating to hedge fund managers. Endowments & Foundations, compared to others, were most likely to allocate to hedge funds based on corresponding traditional asset class exposure.

Note: Figures based on number of respondents unless otherwise noted

Figure 10



Year after year, our investors consistently point to pedigree of a hedge fund manager, investment strategy and track record as the most important investment criteria when making a hedge fund allocation decision. This year, we continued to ask respondents about what matters beyond those factors.

- Beyond the aforementioned manager criteria, risk management and communication/transparency were the next most important characteristics to respondents when making a hedge fund allocation decision. Drawdown statistics and fund size are other important factors that influence respondents' investment decisions.

- Although hedge fund fees and liquidity have been popular topics in the hedge fund community recently, as investors continue to seek investments with lower fees and better redemption terms, those two criteria are not as high on the priority scale when investors make allocations to hedge fund managers. In fact, only 8% and 4% of the respondents have indicated fees and lock-up/liquidity provisions, respectively, as their top priority in this year's Survey.

- Crowded trades continue to be the top concern when investing in hedge funds amongst respondents in 2015, and lack of communication/transparency from managers is also getting more attention.
  - Respondents also expressed their concerns about excessive risk taking, lack of liquidity and style drift.
  - Though macroeconomic factors have created significant volatility this year, they are not considered primary concerns with respect to hedge fund investing.

Note: Figures based on selections from 294 respondents

- The percentage of respondents who have revealed operational issues during the due diligence process over the past 12 months has declined from over 50% in 2014 to 43% in 2015.
  - Valuation policy has become the most common issue revealed during the process, followed by regulatory compliance and readiness as well as trade process and operations.
  - While more focus has been dedicated to cybersecurity recently, only a few respondents reported cybersecurity-related operational issues during their due diligence process.

Figure 11

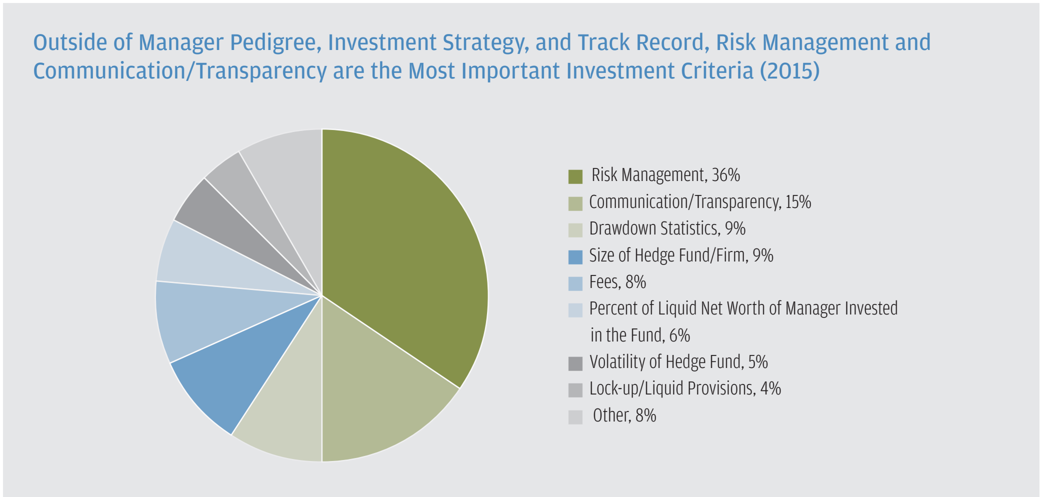
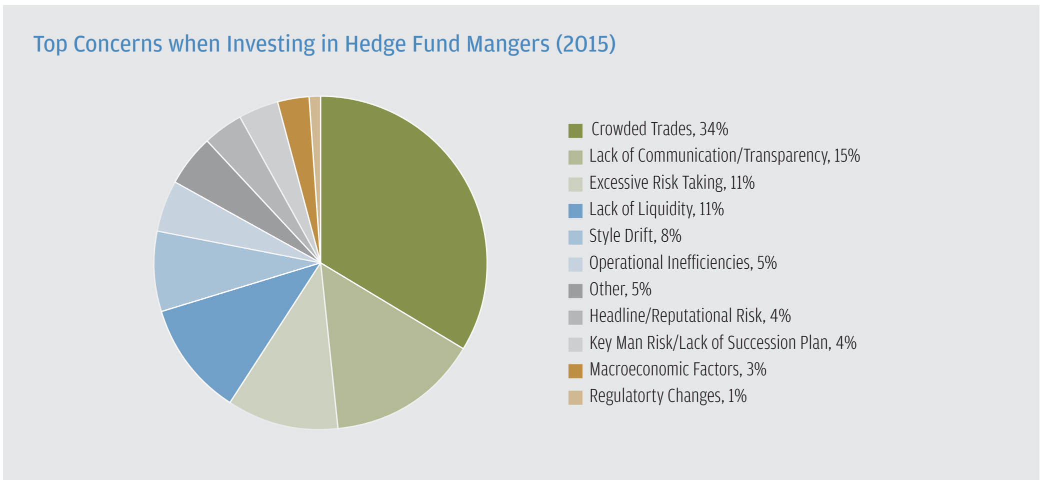
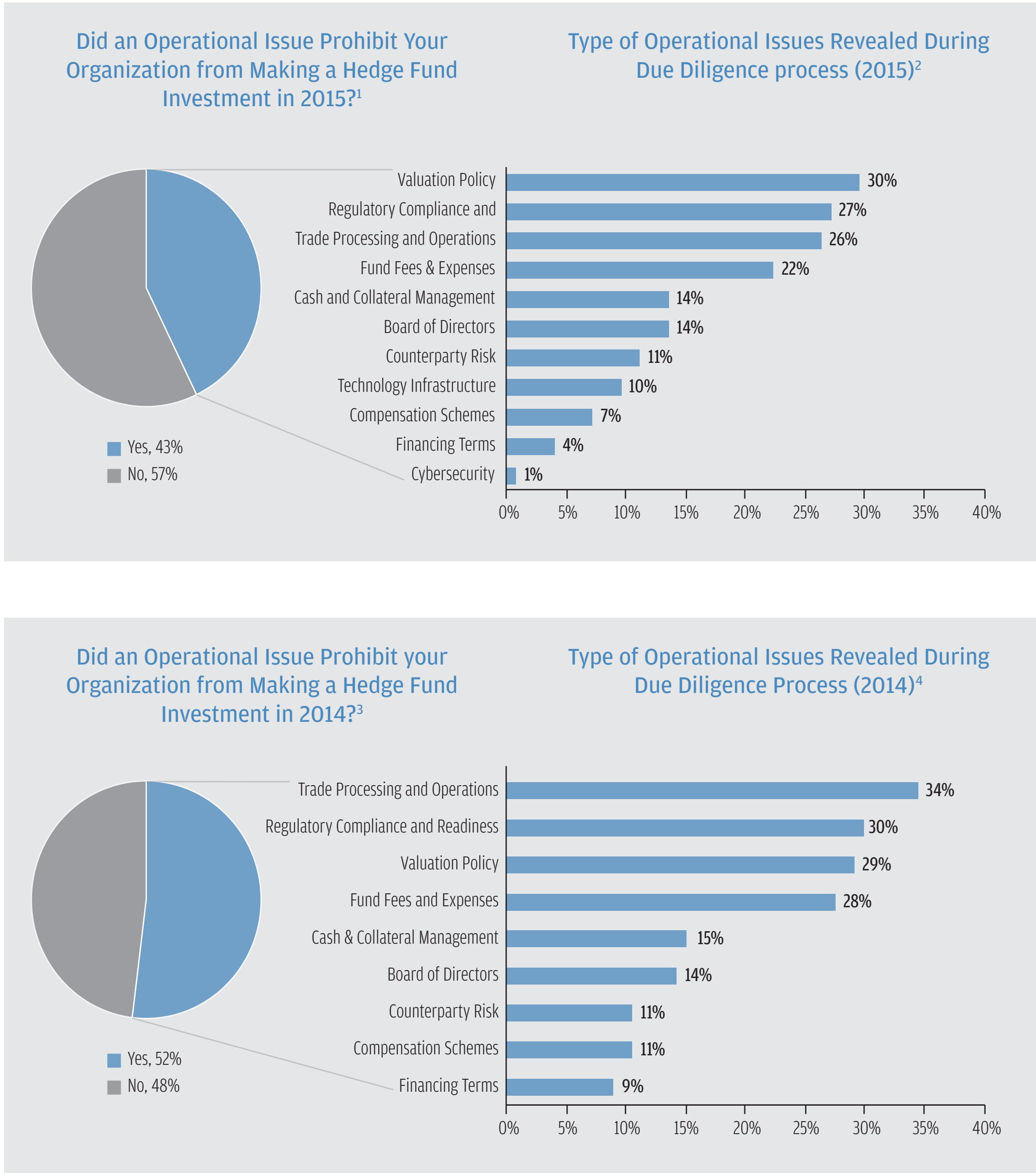


Figure 12



Note: Figures based on number of respondents unless otherwise noted. Categories may not sum to 100% due to rounding

Figure 13



[1] Note: Data is based on 290 respondents

[2] Note: Date is based on 207 selections made by 125 respondents

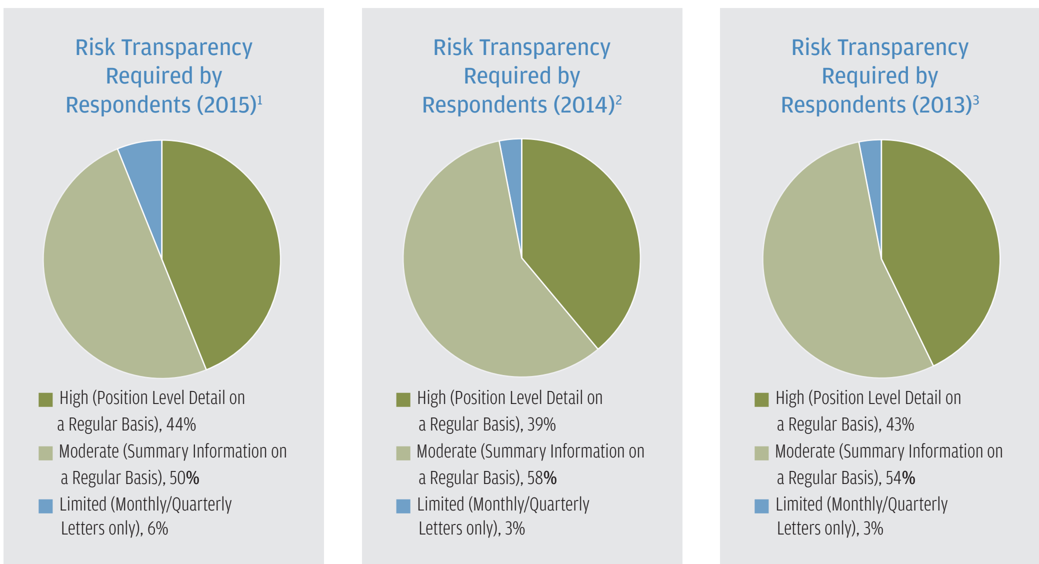
[3] Note: Data is based on 341 respondents

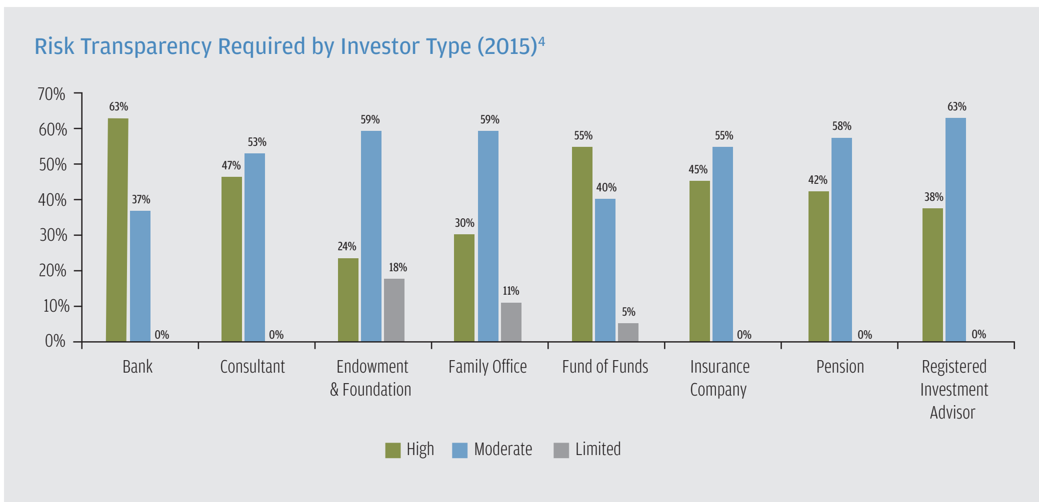
[4] Note: Date is based on 341 selections made by 189 respondents

Nearly all respondents require at least regular summary information from hedge fund managers, consistent with the past few years.

- Investors continue to require moderate to high levels of risk transparency, with over 40% of respondents requiring position level detail on a regular basis.
- Banks, Fund of Funds, and Consultants had the largest percentage of respondents requiring high levels of risk transparency in 2015. This may be due to the fact that many of these allocators have clients of their own that they have fiduciary responsibility for and require detailed reporting.
- From a geographic perspective, Europe & Middle East-based investors have the highest percentage of respondents requiring high levels of risk transparency.

Figure 14





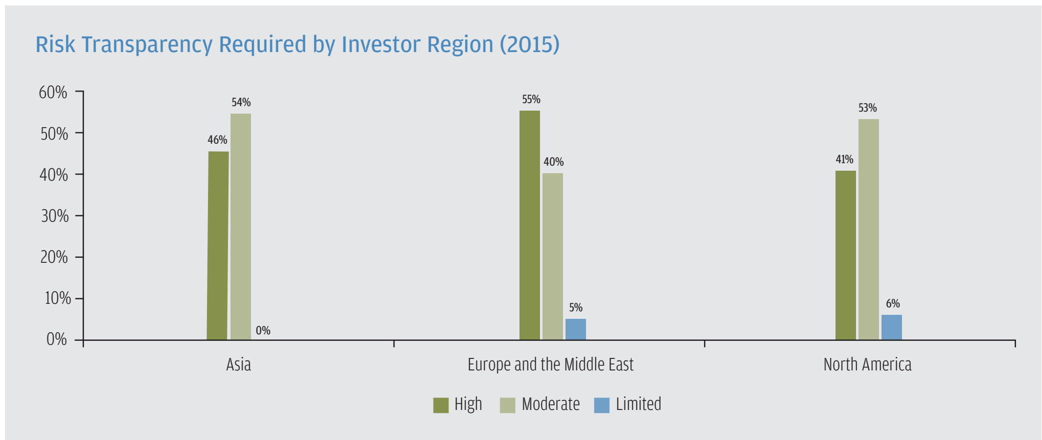
[1] Note: Figures based on selections from 299 respondents

[2] Note: Figures based on selections from 369 respondents

[3] Note: Figures based on selections from 287 respondents

[4] Note: Figures based on selections from 299 respondents. Categories may not sum to 100% due to rounding

Figure 14 contd



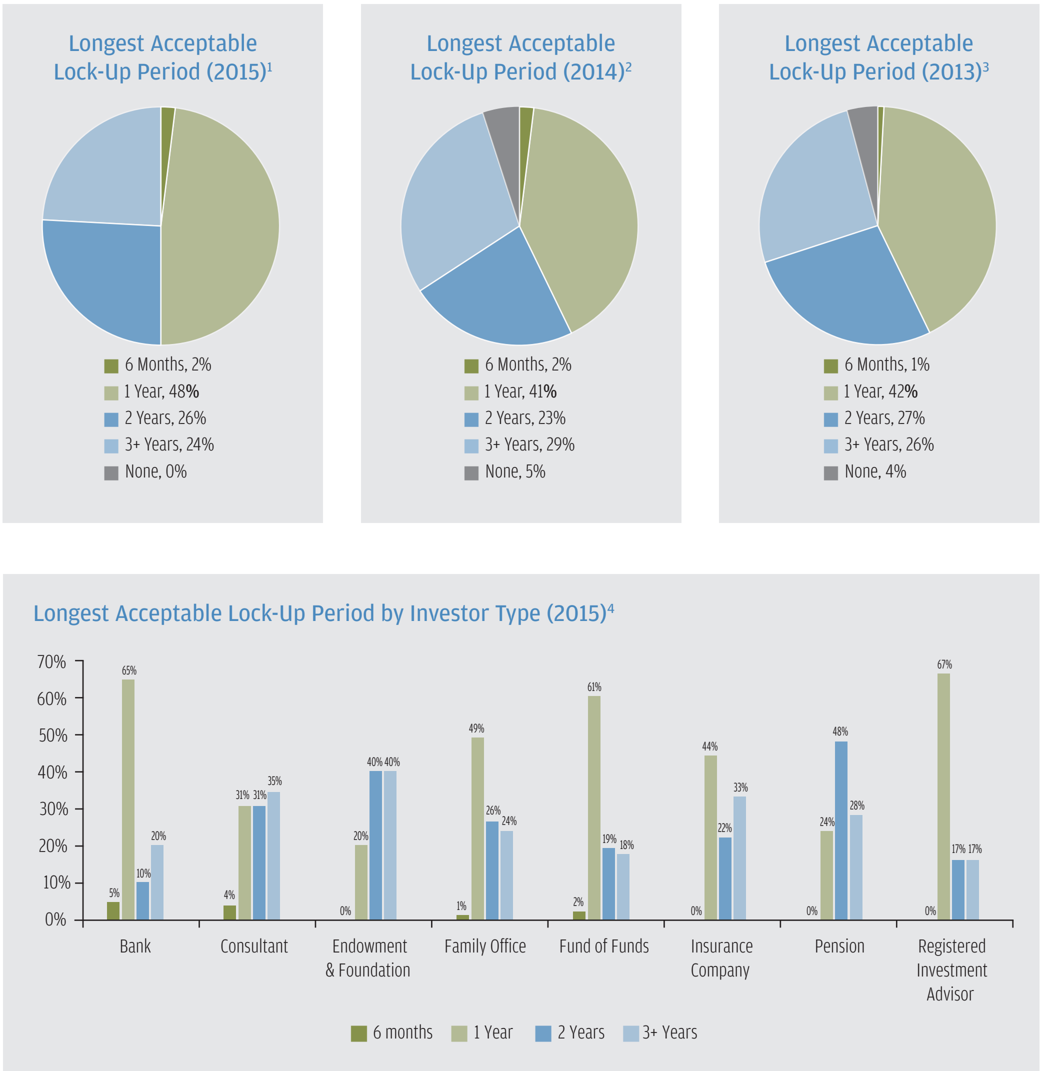
Liquidity is a focus for investors; however, certain Endowments & Foundations and Pensions are more willing to accept a longer lock-up.

- While nearly 80% of respondents still prefer quarterly or shorter redemption periods, nearly all respondents are willing to accept a lock-up period of one year or more.
- 80% of Endowments & Foundations and 76% of Pensions are willing to accept a lock-up period of two years or more.
  - Most institutional investors are more concerned that the liquidity provisions of the hedge fund match the liquidity of the underlying assets.
  - 50% of Pension respondents, for example, indicated they had no preference when it came to liquidity terms, demonstrating their longer term approach and focus on appropriateness of asset liquidity with the underlying opportunity set.
- Banks, Registered Investment Advisors, and Fund of Funds demand the most liquidity, with over 60% of respondents within those sectors requiring lock-ups of one year or less. Over 80% of respondents in these segments also prefer quarterly redemption periods or less.
- Compared to other regions, North America-based investors have the most tolerance for longer lock-up terms, with 57% respondents indicating their willingness to take a lock-up period of more than two years. Only 30% of Asia-based respondents and 36% of Europe & Middle East-based respondents indicated tolerance for lock-ups two years or greater.
  - Geographically, over three-quarters of respondents in each region prefer quarterly redemption periods or better.
  - 70% of investors from Asia and nearly 60% of Europe & Middle East-based investors prefer monthly or weekly liquidity.

Note: Figures based on selections from 299 respondents. Categories may not sum to 100% due to rounding

- Similar to last year, respondents continue to show an interest in longer-lock hedge fund vehicles, such as Hybrids and Co-Investment opportunities, but the growth of this interest has plateaued a bit year-over-year. These vehicles are discussed in further detail in Section III of the Survey.
- Certain respondents indicated liquidity preferences for weekly redemptions or better. This may driven by additional Liquid Alternatives offerings in the marketplace. We discuss Liquid Alternatives in more detail in Section III of the Survey.

Figure 15



[1] Note: Figures based on selections from 261 respondents

[2] Note: Figures based on selections from 348 respondents

[3] Note: Figures based on selections from 274 respondents

[4] Note: Figures based on selections from 261 respondents. Categories may not sum to 100% due to rounding

Figure 15 contd

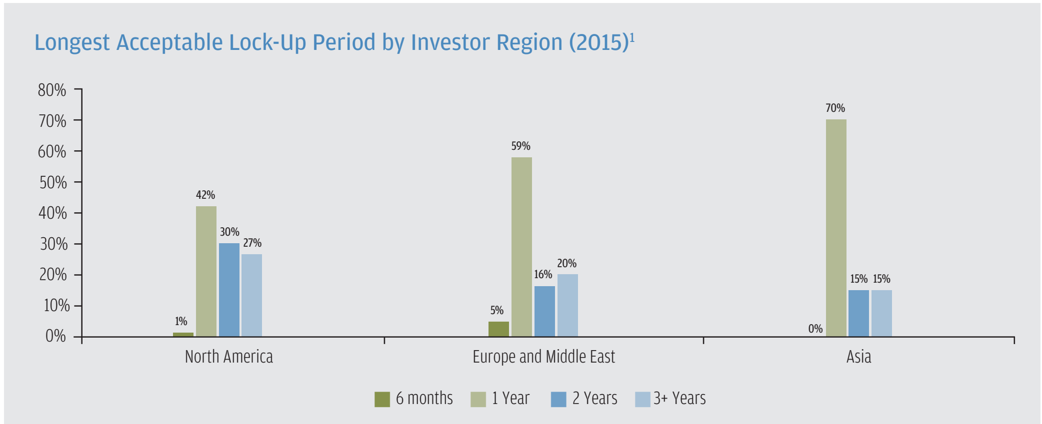
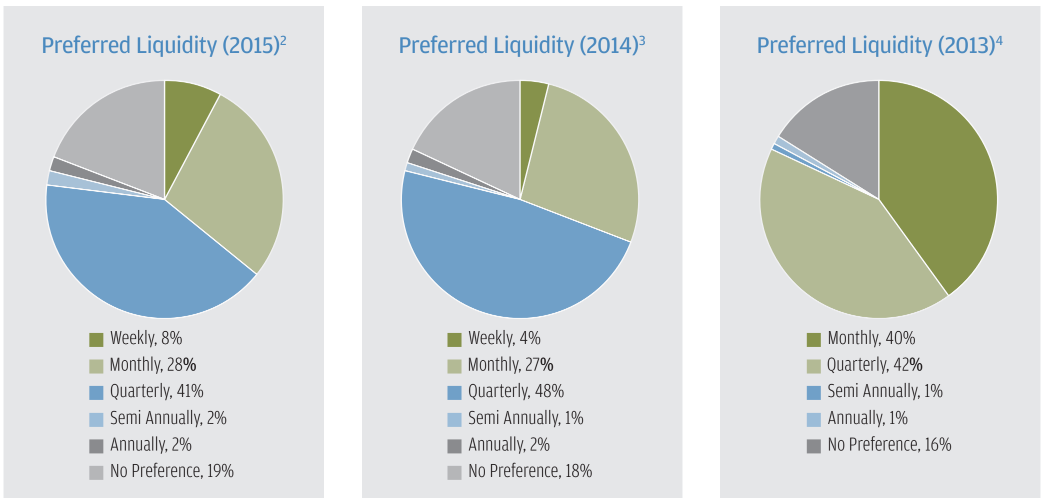
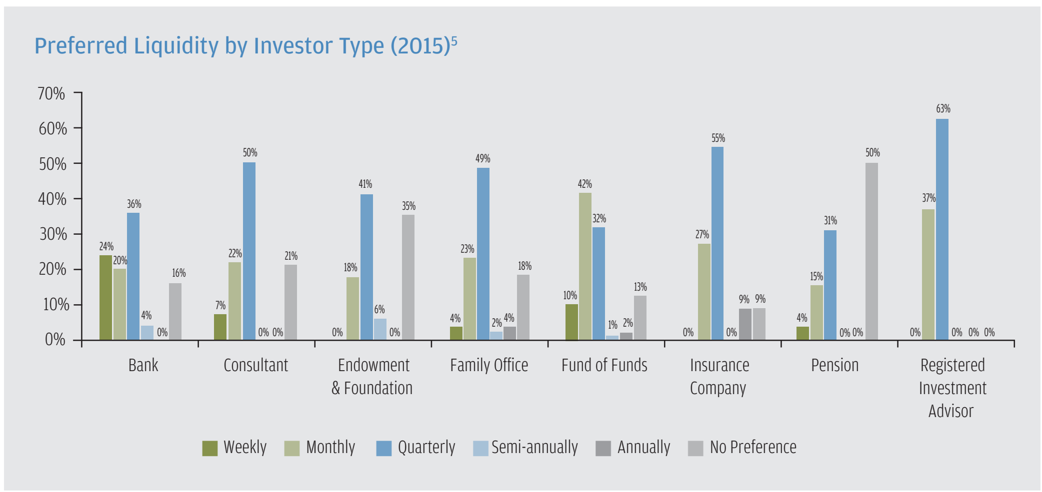


Figure 16





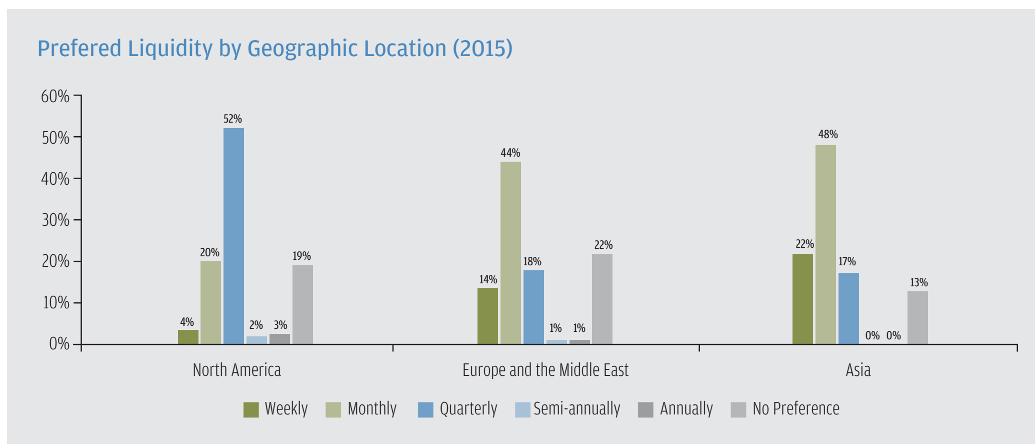
[1] Note: Figures based on selections from 261 respondents

[2] Note: Figures based on selections from 293 respondents

[3] Note: Figures based on selections from 369 respondents

[4] Note: Figures based on selections from 286 respondents

[5] Note: Figures based on selections from 293 respondents. Categories may not sum to 100% due to rounding



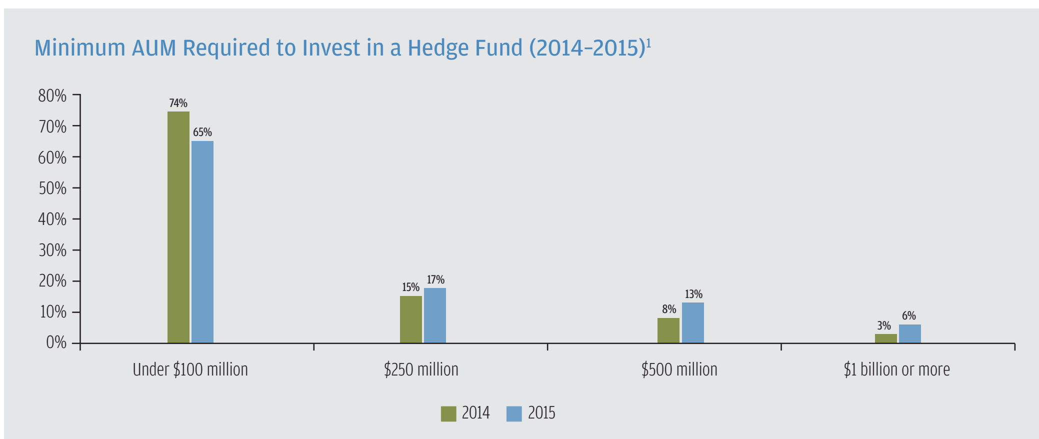
Minimum AUM and track record requirements have remained lower over the past few years as respondents remain more open to investing in smaller managers and/or early stage managers. However, in 2015, we observed a slight pullback in the percentage of respondents indicating willingness to make allocations to hedge funds with less than $100 million in AUM and to those managers with a track record of one year or less, compared to 2014.

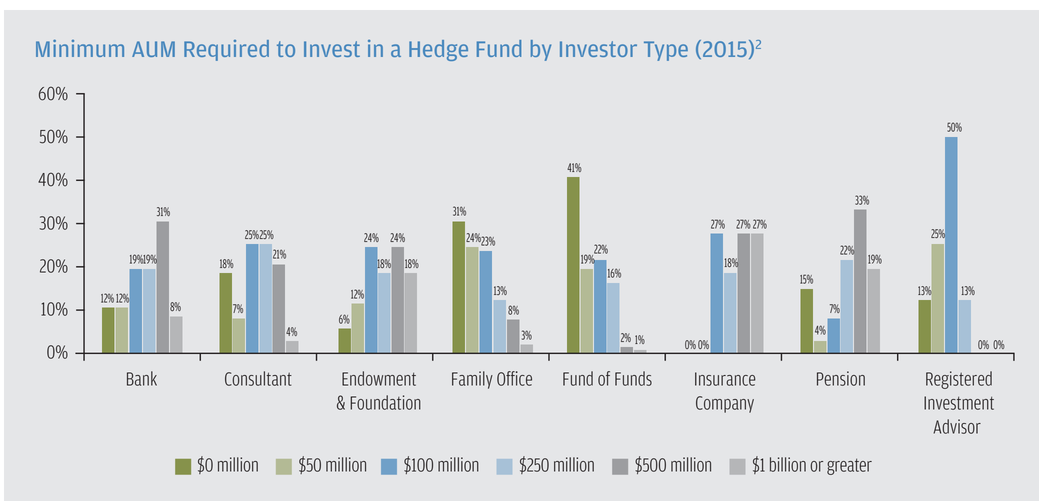
- In 2015, 65% of respondents indicated willingness to make allocations to hedge funds with AUM less than $100 million, compared to 75% in 2014.
- Over the last three years, the percentage of Survey respondents without any minimum AUM requirements has ranged from 27% to 33%.
- Investors with smaller average allocations tend to have looser requirements on minimum AUM. Based on the survey data, 77% of investors who allocate, on average, less than $25 million require minimum AUM of $100 million or less. On the contrary, investors with larger average allocations (more than $100 million) have higher bars with regard to minimum AUM.
  - Registered Investment Advisors, Fund of Funds and Family Offices are more willing to invest in smaller funds (AUM <$100 million).
  - Family Offices tend to make, on average, the smallest allocations and therefore do not tend to face concentration issues with smaller funds.
  - On the other hand, Pensions and Insurance Companies generally require larger minimum AUM in order to make hedge fund allocations.
  - Particularly, over half of Pensions and Insurance Companies require a minimum AUM of at least $500 million. These segments tend to make larger allocations to hedge funds.
  - In addition, Pensions and Insurance Companies may have AUM constraints due to concentration guidelines with respect to the maximum percentage their investment may represent in a hedge fund.

Note: Figures based on selections from 293 respondents. Categories may not sum to 100% due to rounding

- In 2015, the percentage of respondents who are willing to look at hedge fund managers with track records of one year or less declined to 61% from approximately 70% observed over the last three years.
- 25% of respondents require a track record of three years or more, which is higher than the percentage in prior years.
- Fund of Funds and Family Offices are most willing to look at funds at their inception.
  - Roughly 60% of Fund of Funds respondents have no minimum track record requirements and over 40% indicated no minimum AUM requirement as well.
  - The percentage of Endowments & Foundations willing to look at a manager at fund inception has roughly halved from 62% in 2014 to 35% in 2015. 35% is near the segment's average prior to 2014.
  - Over 60% of Banks, Endowments & Foundations, as well as Pensions require a minimum track record of two years.

Figure 17

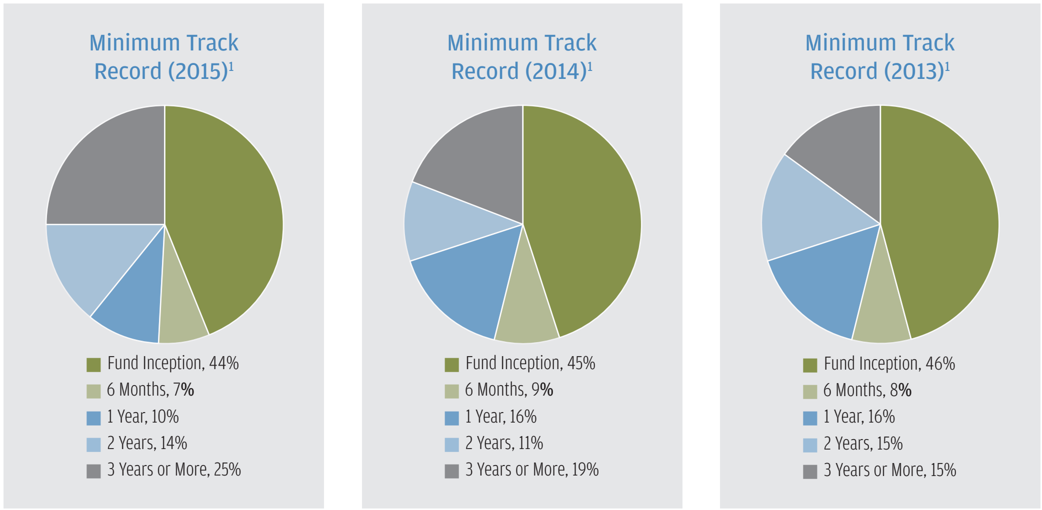


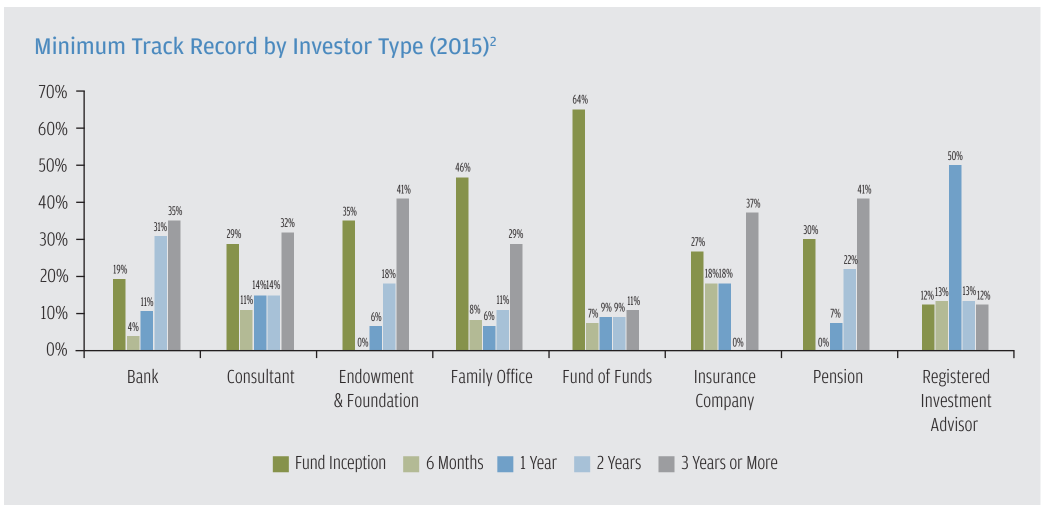


[1] Note: Figures based on number of respondents unless otherwise noted. Categories may not sum to 100% due to rounding

[2] Note: Figures based on selections from 293 respondents. Categories may not sum to 100% due to rounding

Figure 18





As lower minimum AUM and track record requirements may indicate, a number of investors continue to allocate capital to start-up managers. But, a majority of respondents seem to have taken a small pause in 2015.

- Outside of Fund of Funds or other allocators who have a business devoted to investing in start-up or emerging managers, a majority of respondents seem to have allocated to their quota of smaller managers in 2013 and 2014, when the new launch market was a bit frothier.
- We will discuss new launch investment activity and expectations for 2016 in Sections III and IV of this Survey.

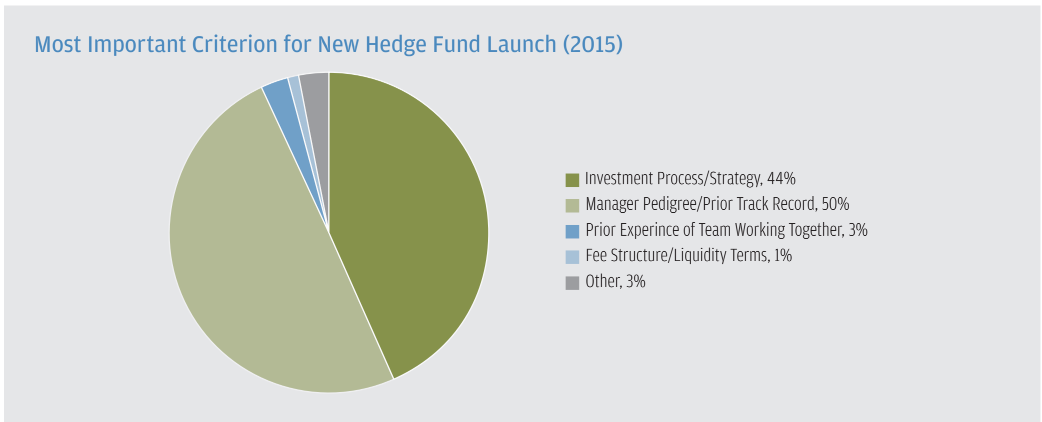
[1] Note: Figures based on 293, 369 and 281 respondents in the 2016, 2015 and 2014 Surveys, respectively

[2] Note: Figures based on 293 respondents. Categories may not sum to 100% due to rounding

When evaluating a start-up hedge fund manager (i.e., track record of less than one year), hedge fund manager pedigree and track record from a prior firm are the most important factors to respondents.

- When considering an investment with a new hedge fund launch, over 50% of respondents identified manager pedigree as the most important evaluation criterion.
- A manager's investment process/strategy was, on average, the second most important criterion.

Figure 19



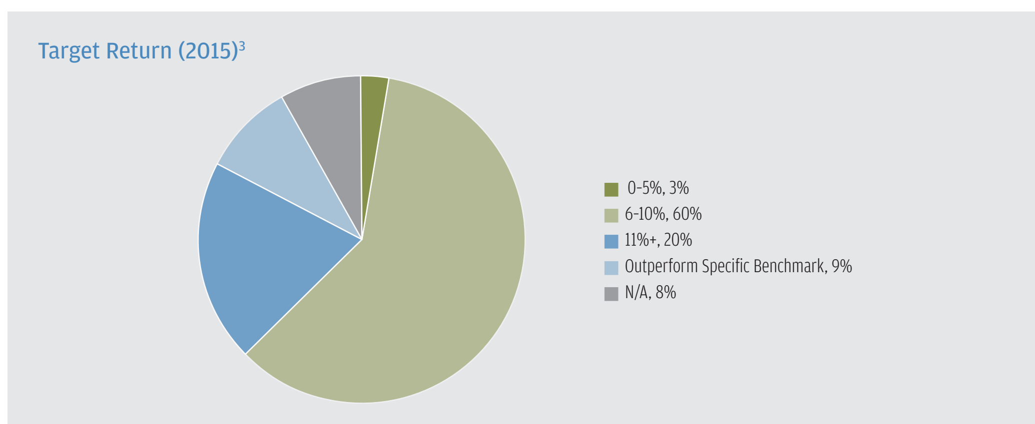
2015 was a difficult year for the hedge fund industry, as many managers failed to meet investors' performance expectations. Two-thirds of respondents indicated that their hedge fund investments did not meet their target return, which highlights a significant increase from 2014 when 54% of respondents reported their hedge fund portfolio did not meet return expectations. Nearly 90% of respondents met or exceeded their target return in 2013.

- In 2015, the percentage of respondents who have a target return of 6-10% has increased to 60% from around 40% in the previous two years, while the percentage of those who expect more than 10% has declined to 20% (from over 35%). This indicates that investors overall have lowered their hedge fund return expectations, and even so, managers have still struggled to meet their return targets.
- The percentage of respondents whose hedge fund return expectations were met or exceeded has been falling for two consecutive years.

Note: Figures based selections from 117 respondents. Categories may not sum to 100% due to rounding

- Hedge funds lost -1.02% in 2015, as measured by the HFRI Fund Weighted Composite, underperforming the S&P 500 by 0.29%. This is the fourth consecutive year that hedge funds have lagged the S&P 500.[1] Hedge funds also underperformed the U.S. high grade credit market last year, as indicated by the J.P. Morgan US Liquid Index.
- The HFRI Fund Weighted Composite Index has exhibited trailing five-year correlations to the S&P 500 and MSCI World indices of over 0.85.[2]
- Notably, the slightly negative return posted by hedge funds, in aggregate, in 2015 masked the substantial dispersion of manager performance the industry experienced.
- Of those respondents who did not meet their target return in 2015, most chose to reallocate to different hedge fund managers or different strategies, rather than increasing/decreasing overall hedge fund exposure. This is discussed in more detail in Section IV of the Survey.
- Over 25% of respondents have negotiated fees with hedge fund managers to meet their target returns, while many mentioned they invested in higher risk and/or less liquid opportunities.
- Similar to 2014, 60% of respondents surveyed in 2015 believe the primary reason for hedge funds underperforming broader market indices is due to industry crowding, where too many hedge funds are chasing limited opportunities.
- The other notable reasons for hedge fund underperformance include macro factors, hedge funds taking too little risk or demonstrating poor market timing, as well as inability to generate alpha on the short side.
- Few respondents believe style drift or new regulations have had much bearing on hedge fund underperformance.

Figure 20

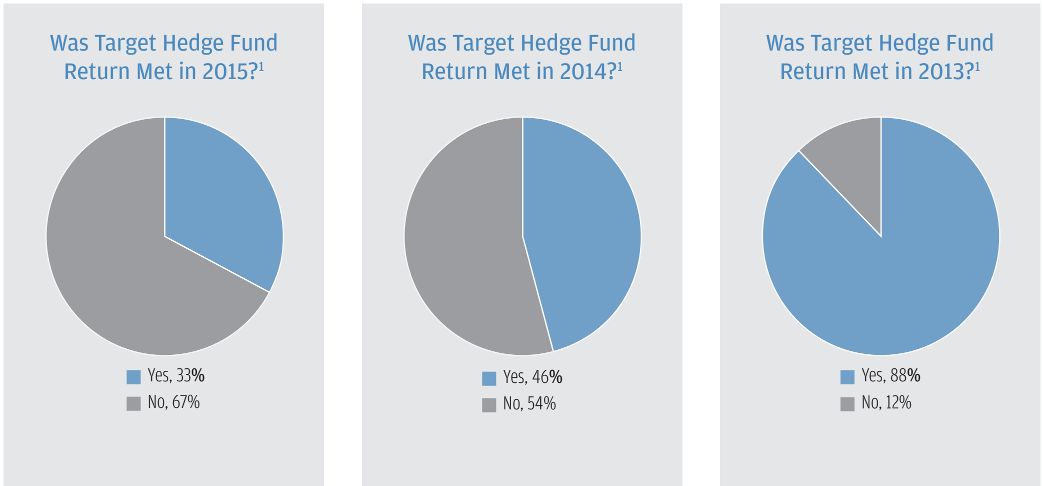


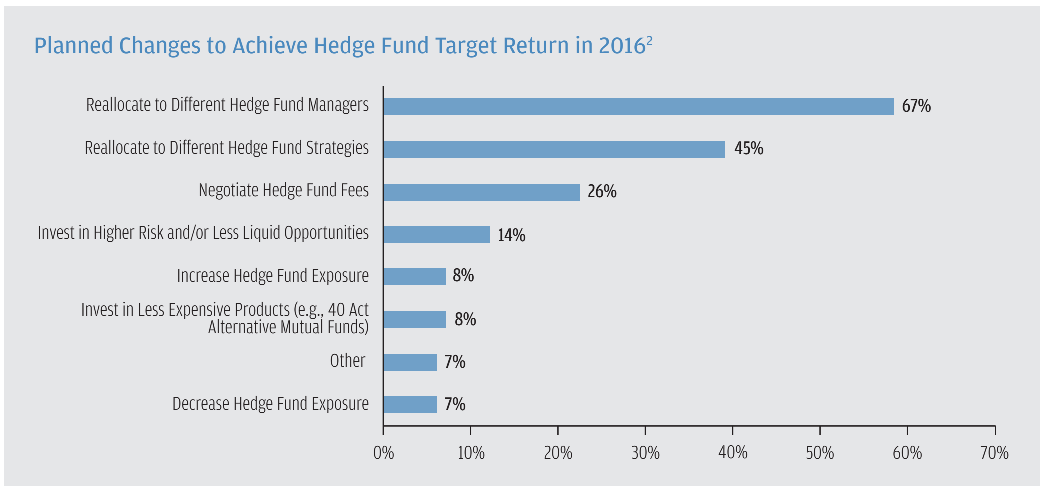
[1] Source: Hedge Fund Research; Bloomberg.

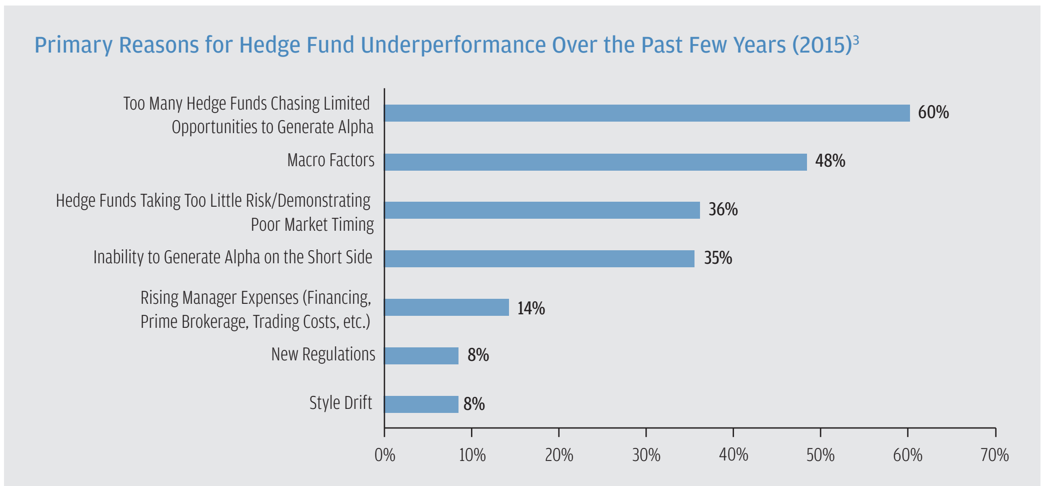
[2] Source: Hedge Fund Research; Bloomberg. Correlation was calculated based on monthly return data from January 2011 to December 2015

[3] Note: Figures based on number of respondents unless otherwise noted

Figure 20 contd







[1] Note: Figures based on number of respondents in each respective year's Survey

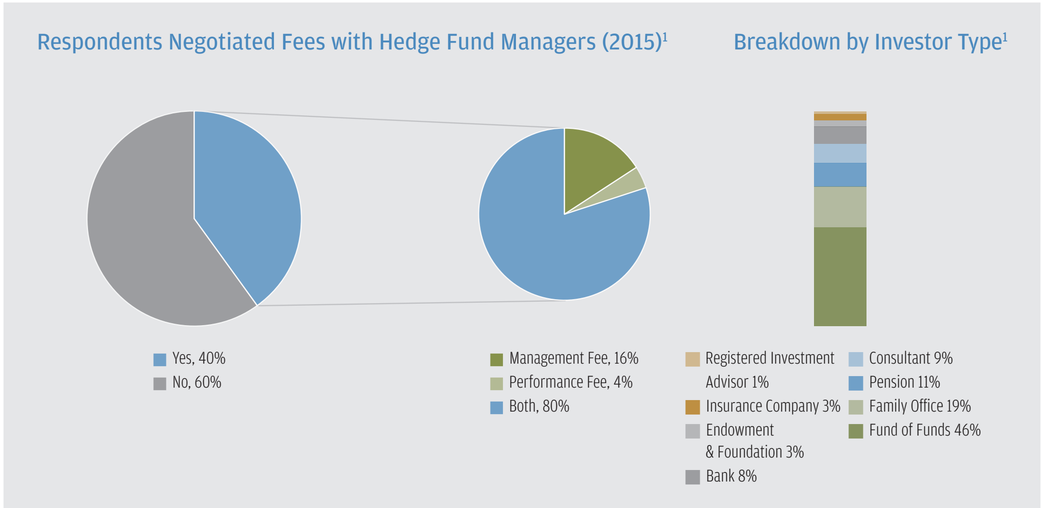
[2] Note: Data is based in 312 selections made by 172 respondents

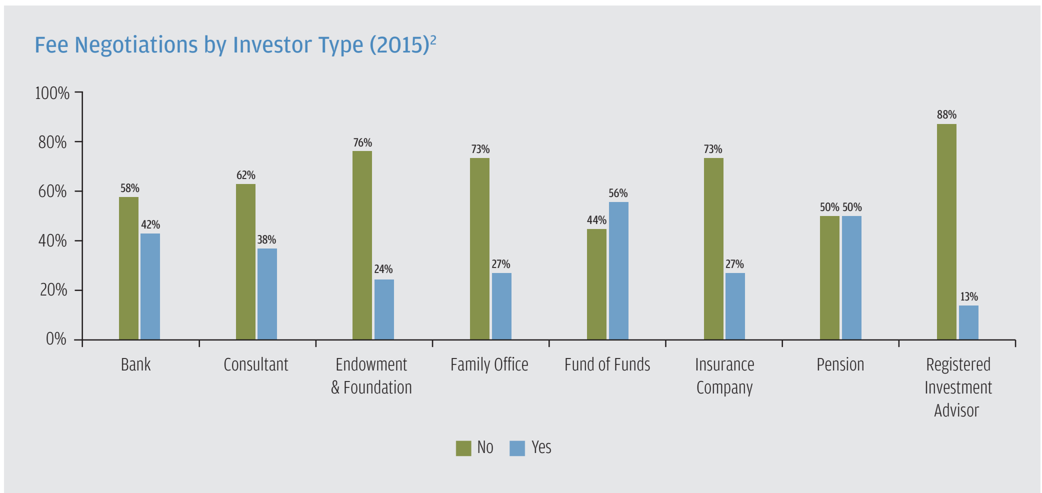
[3] Note: Data is based on 677 selections made by 322 respondents

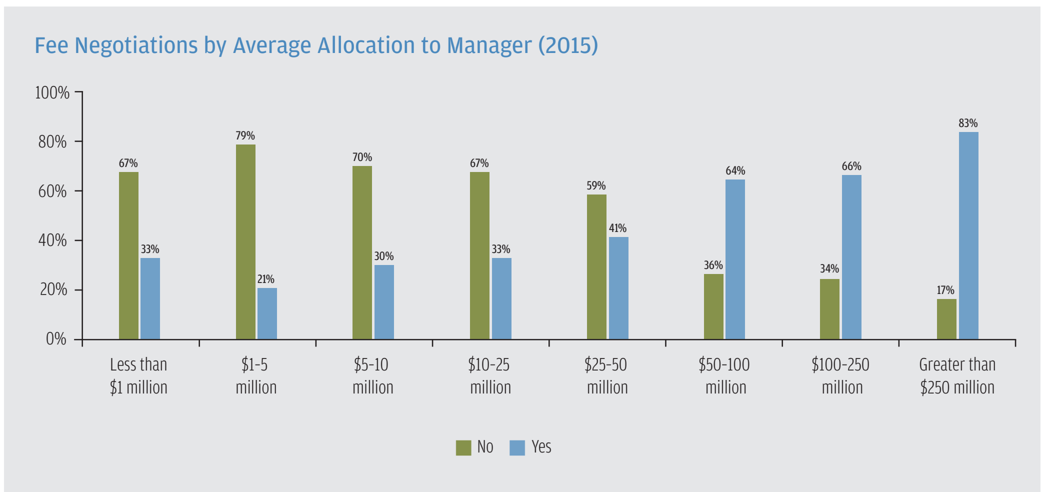
Hedge funds continue to feel pressure from investors on fees, as they are less willing to pay a 2% management fee and 20% performance fee for their hedge fund investments.

- 40% of respondents negotiated fees in 2015, compared to 38% in 2014. Of those who asked for a favorable fee structure, 80% negotiated both management and performance fees.
- However, only 31% of investor respondents this year were able to negotiate fees without making any concessions, compared to approximately 50% in 2014.
  - Generally, investors have to make larger allocations in exchange for negotiated fees. 58% of respondents agreed to make larger allocations as a concession.
  - Longer lock-up period or less liquid redemption terms are other types of concessions investors typically make in order to get favorable fees.
- Overall, there is a linear correlation between the average allocation to managers and investors ability to negotiate fees.
  - Investors with larger average allocations have higher success rates when asking for favorable fee terms.
  - 83% of respondents allocating $250 million or more, on average, negotiated fees in 2015, compared to only 21% of respondents with $1-5 million average allocation.
- Fund of Funds, Pensions and Banks represent those segments most active in negotiating fees with managers.
- The vast majority of investors are paying less than 2% and 20% fees.
  - 94% of respondents’ average performance fee is less than 2%. The percentage of investors paying between 1.0% and 1.5%, on average, increased to 32% in 2015 (from 27% in 2014).
  - Roughly 60% of respondents are paying between a 1.5% and 2.0% management fee, on average.
  - Close to 40% of Fund of Funds, Registered Investment Advisors and Family Offices are paying less than 1.5% management fee.
  - 37% of European and 35% of North American respondents pay less than 1.5% average management fee to hedge funds, compared to 26% of Asia-based investors.
  - Nearly 80% of respondents have an average performance fee less than 20%, with half paying between 17.5%-20.0%, on average.
  - Fund of Funds, Banks and Consultants represent those segments most likely paying less than 17.5% performance fee, on average.

Figure 21







[1] Note: Figures based on number of respondents unless otherwise noted

[2] Note: Figures based on 292 respondents. Categories may not sum to 100% due to rounding

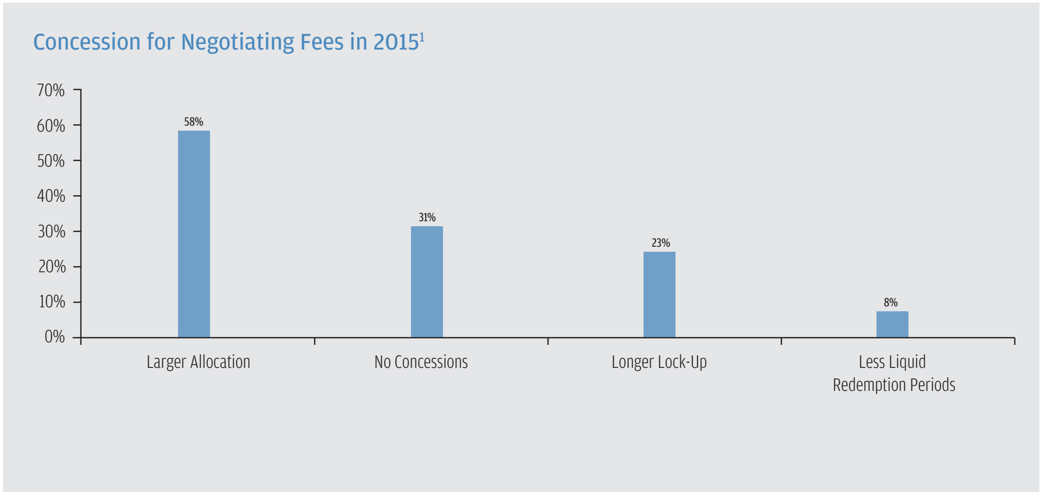
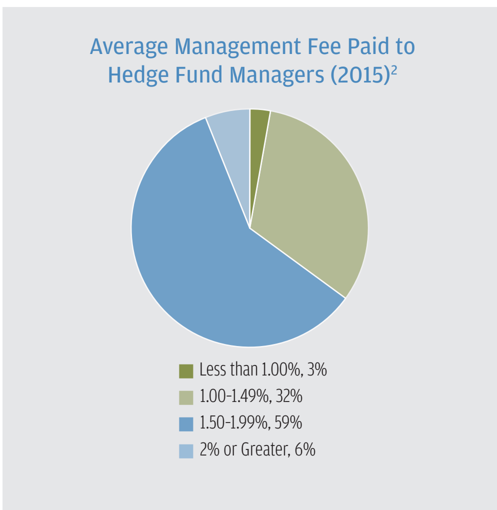
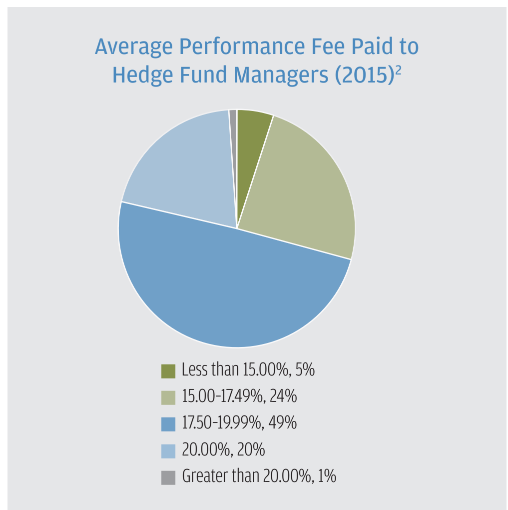


Figure 22





[1] Note: Date based on 140 selections from 118 respondents

[2] Note: Figures based on 278 respondents. Categories may not sum to 100% due to rounding

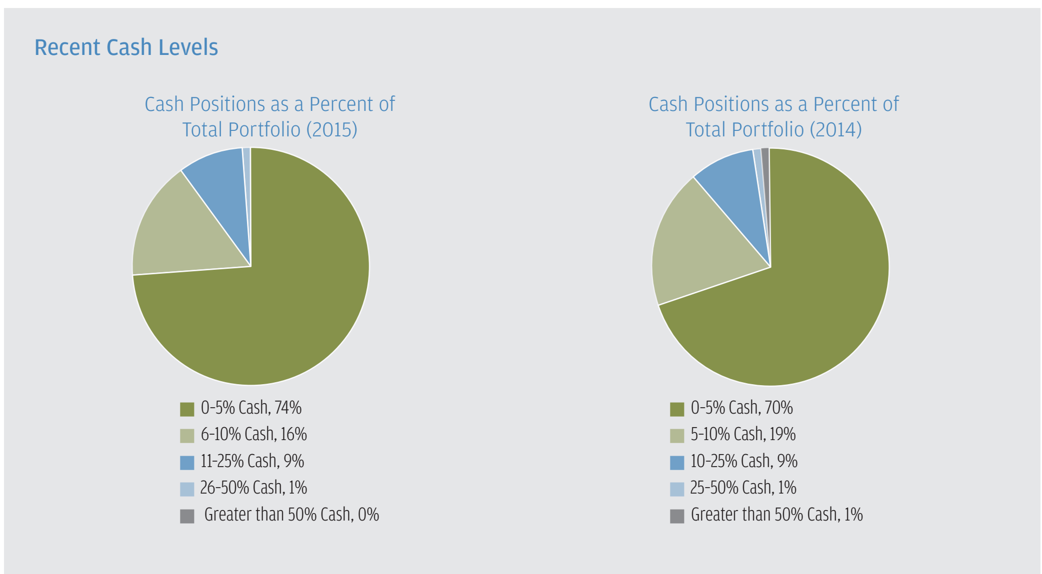
III. A LOOK AT RESPONDENTS' HEDGE FUND PORTFOLIOS IN 2015

SURVEY RESPONDENTS COMMENT ON THE COMPOSITION OF THEIR HEDGE FUND PORTFOLIOS AND THEIR INVESTING ACTIVITY IN 2015

Respondents continued to put what little free cash was left at the end of 2014 to work in 2015. 90% of respondents ended the year with less than 10% of their portfolio in cash.

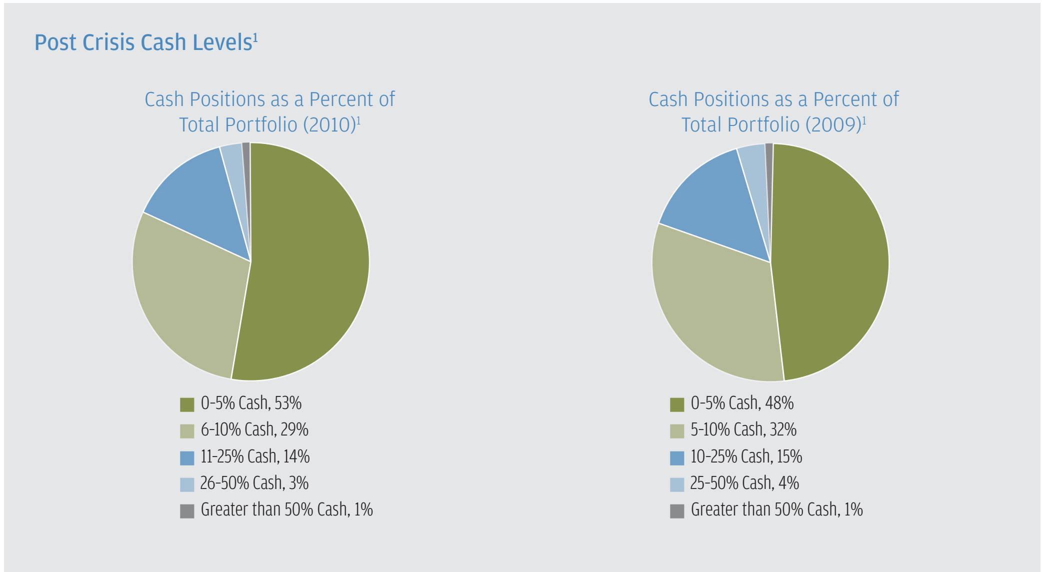
- Roughly three-quarters of respondents ended 2015 with less than 5% of their portfolio in cash, an increase from 70% of respondents at the end of 2014.
- Investors have continued to deploy their cash steadily since the financial crisis of 2008.
- Pensions have the highest percentage (96%) of respondents with less than 5% cash in their portfolios, followed by Registered Investment Advisors (88%), Consultants (85%) and Fund of Funds (85%).
- Endowments & Foundations and Family Offices, compared to other investor types, have the highest percentage of respondents with more than 10% in cash.

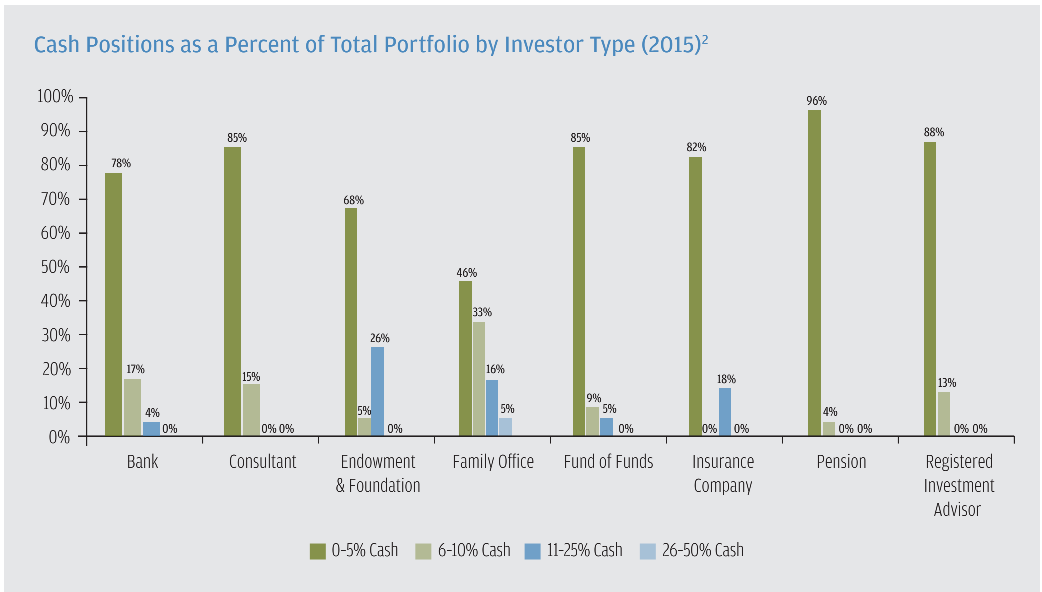
Figure 23



Note: Figures based on number of respondents in each respective year's Survey

Figure 23 contd





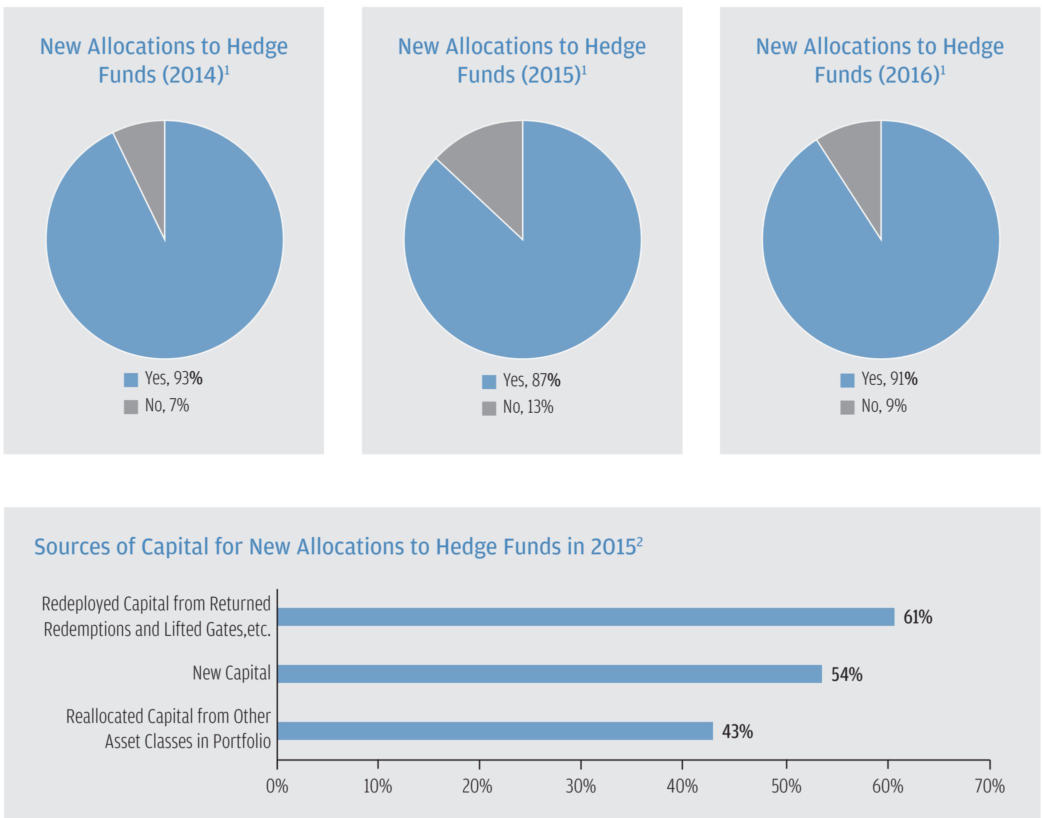
[1] Note: Figures based on number of respondents in each respective year's Survey

[2] Note: Figures based on number of respondents unless otherwise noted. Categories may not sum to 100% due to rounding

Despite performance headwinds and increased industry scrutiny, institutional investors continue to allocate to hedge funds. The percentage of respondents making new allocations has remained around 90% since 2012.

- 87% of respondents made new allocations to hedge funds in 2015.
  - Of those respondents who made new allocations, 94% invested in new hedge funds managers, while two-thirds increased allocations to current hedge fund investments.
  - The primary source of capital for new hedge fund investments was from returned redemptions and lifted gates. Slightly over half of respondents cited new capital as a source as well.
- 30% of Endowments & Foundations and 25% of Consultants increased the percentage of their portfolio dedicated to hedge fund investments in 2015.

Figure 24



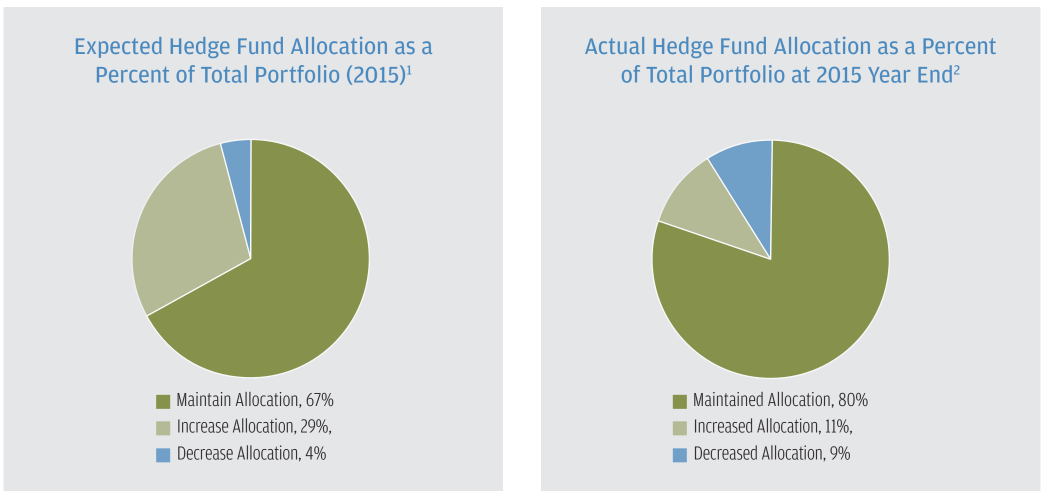
[1] Note: Figures based on number of respondents unless otherwise noted

[2] Note: Date is based on 399 selections made by 254 respondents

Although respondents indicated that new allocations to hedge funds are still being made, 2015 was a tough year for many managers.

- Hedge funds, in aggregate, underperformed most major market indices once again and exhibited high correlation to global equity markets.
- While the HFRI Fund Weighted Composite Index's return was only slightly negative in 2015, that aggregate figure conceals the significant dispersion of manager performance the industry witnessed. Upon entering 2015, nearly 30% of respondents expected to increase hedge fund allocations as a percentage of their respective investment portfolios. However, at year end 2015, only 11% indicated actually doing so.
- Similar to last year, 80% of respondents maintained their allocation to hedge funds as a percent of their overall portfolio during 2015.
- While we expect continued activity within the hedge fund industry in 2016, we believe absolute growth of hedge fund assets will be in line with overall growth of institutional investors' assets under management.
  - Instead of increasing overall exposure to hedge funds, we expect 2016 will highlight manager turnover and new allocations from recycled capital, as investors attempt to reallocate amongst different managers and strategies to meet return targets for 2016.
  - This is discussed in further detail in Section IV of the Survey.

Figure 25



[1] Note: Figures based on number of respondent in 2015 Investor Survey

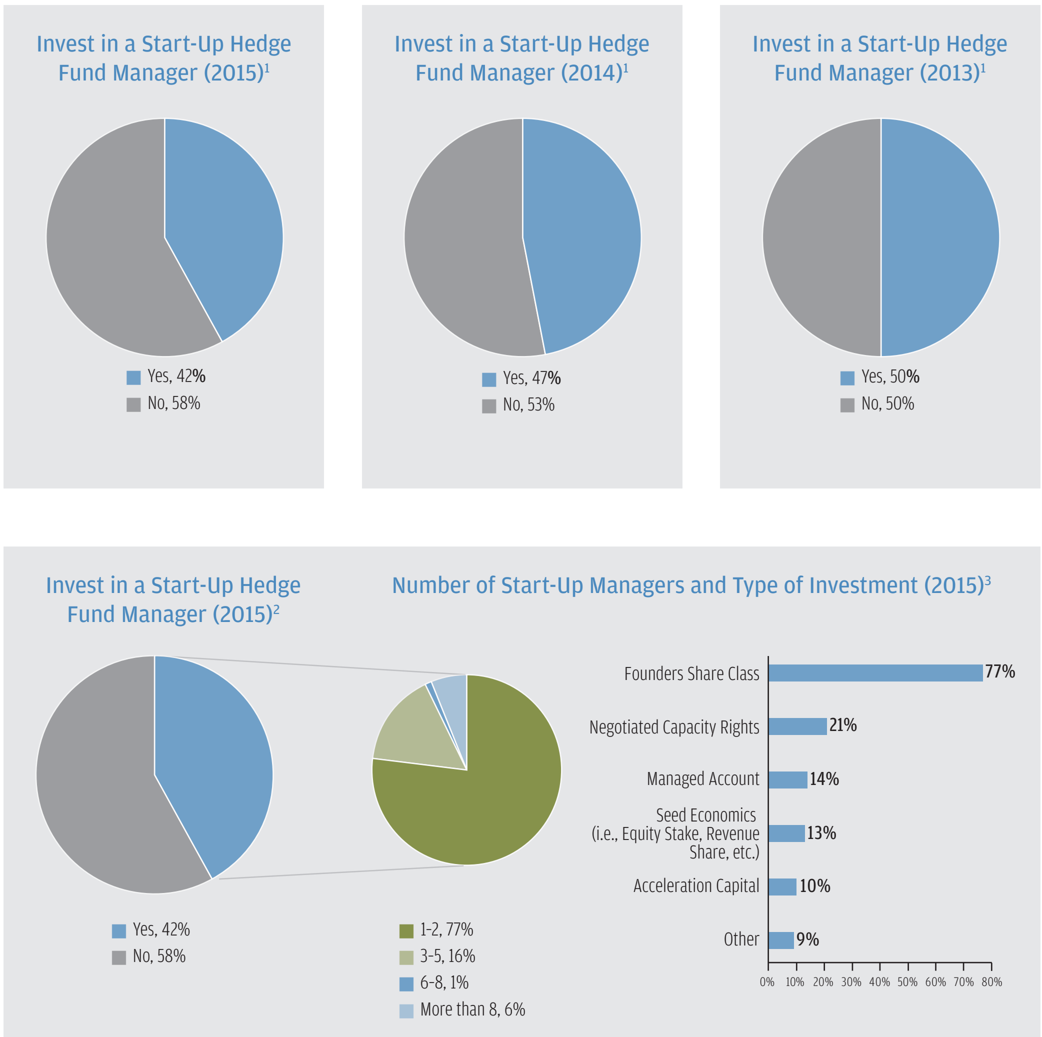
[2] Note: Figure based on 315 respondents who provided information on Hedge fund allocation for both 2014 and 2016 Investor Survey

While not as active as 2014, 2015 still brought to market a significant number of new hedge fund launches. The fundraising market is difficult though. Investors, while interested, have a high bar when evaluating investments in younger managers.

- 42% of respondents allocated to a start-up manager in 2015, down slightly from 47% in 2014.
- Looking ahead, new launches are holding steady interest amongst investors. 80% of respondents indicated they would look to maintain the number of start-up managers they allocate to in 2016. An additional 18% of respondents indicated they would increase the number of start-up manager allocations.
- Allocations from investors to new launches remain coveted. Of the 42% of respondents that mentioned they invested in a new launch in 2015, a vast majority of them only invested in one or two new managers. Although newer managers are attracting investor attention, allocators still seem to be approaching investing in start-up managers cautiously and selectively.
- 41% of Consultants and Family Offices invested in start-up managers in 2015. Consultants nearly doubled their interest in new hedge fund launches year-over-year.
- Fund of Funds represent the respondents most willing to consider an investment in a start-up manager, similar to years past. 65% of Fund of Funds respondents invested in start-up managers in 2015. This segment is also the most active in making allocations to new launches, as approximately one third of those that invest in them typically allocate to three or more in one year.
- However, outside of Fund of Funds or other allocators who have a business devoted to investing in start-up or emerging managers, a majority of respondents seem to have allocated to their quota of smaller, start-up managers in 2013 and 2014, when the new launch market was a bit frothier, and have taken pause in 2015.
  - Banks and Endowments & Foundations investments in new launches roughly halved in 2015 compared to 2014.
  - Banks, Insurance Companies, and Pensions represent those respondents least willing to consider an investment in a start-up manager. This may be due to internal risk guidelines and capacity constraints these segments are subject to that require them to invest in larger, longer-standing managers.
- North America and Europe based respondents were slightly more active in investing in start-up managers in 2015 than those respondents based in Asia. However, year-over-year, Asia-based allocators investing in new launches has increased by 50%.
- A founder's share class offering was the most common type of start-up investment respondents made in 2015, similar to past years. Other start-up investment types include acceleration capital, negotiated managed accounts, and seed economics.

- The fundraising environment for new launches remains challenging.
  - Less than 15% of respondents who invest in start-up managers allocate seed or acceleration capital.
  - Average seed allocations by those respondents who are actively seeding have decreased since 2014. 75% of respondents that provide seed capital indicated average seed allocations were $50 million or less. In 2014, 50% of respondents noted average seed allocations were $50 million or more.
- With the number of new launches the industry has had over the past few years, industry crowding is a concern felt by many hedge fund allocators.
  - Three-quarter of respondents feel that the hedge fund industry is too crowded.
  - However, despite feeling this way, less than one fifth of respondents indicated that they plan on reducing the number of hedge fund investments as a result of the crowding concern.

Figure 26



[1] Note: Figures based on number of respondents in each respective year's Survey
[2] Note: Figures based on selections from 287 respondents
[3] Note: Data is based on 174 selections made by 121 respondents

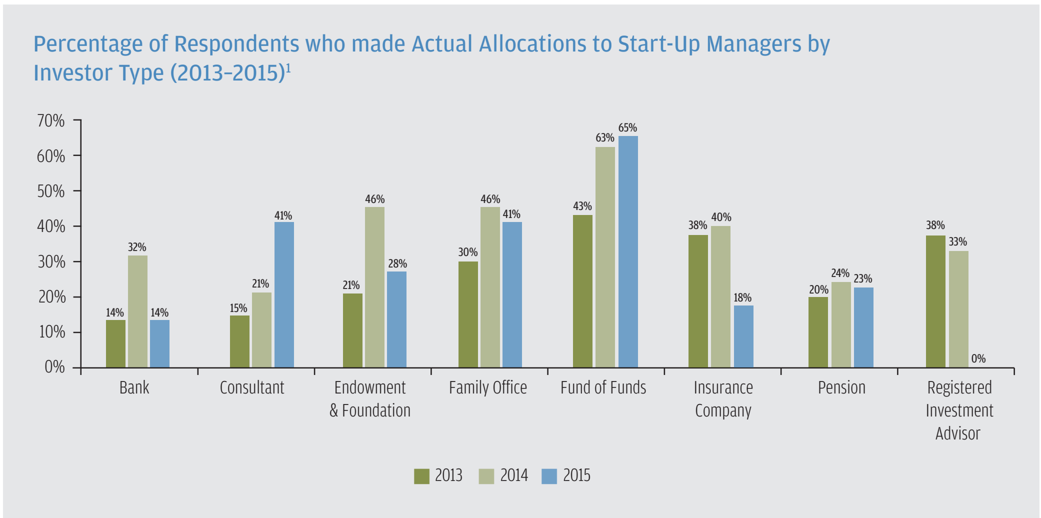
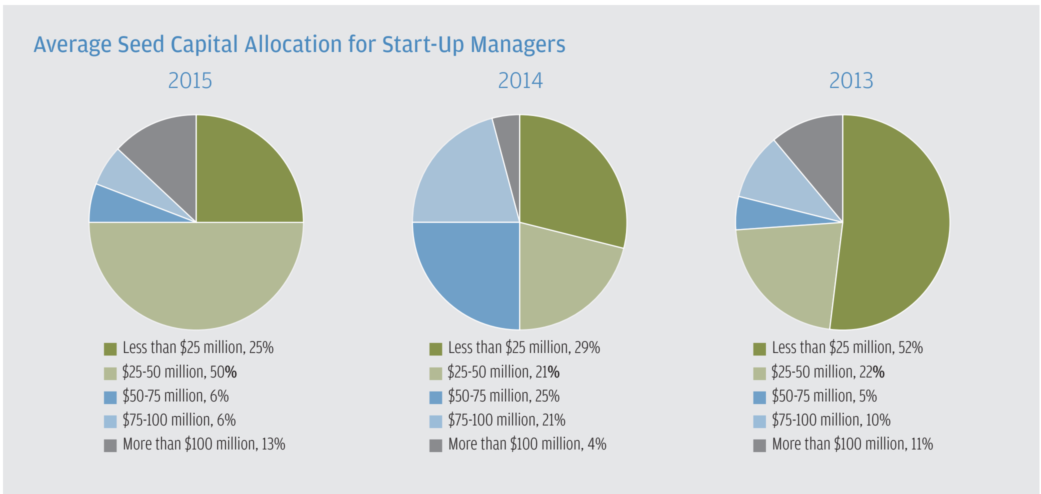


Figure 27

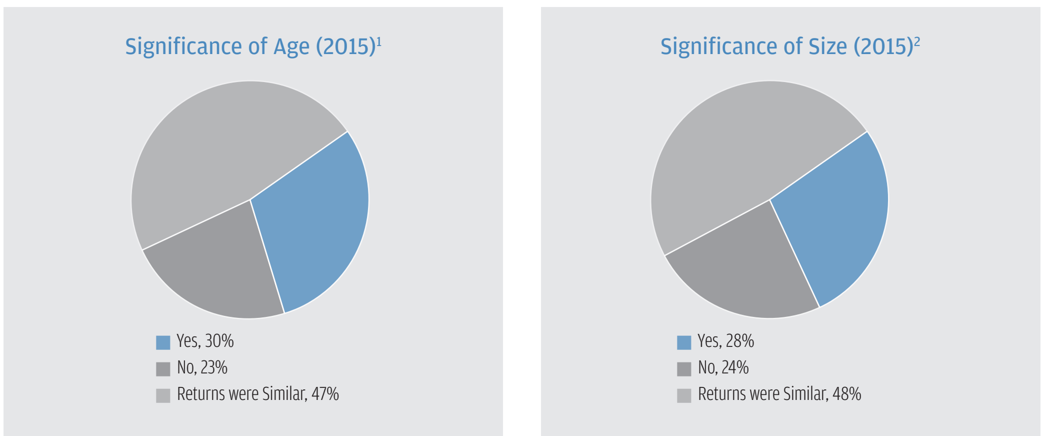


[1] Note: 2013 figures are based on the number of respondents that selected "Yes" when asked if their organization invests in start-up managers. Answer options in 2013 were "Yes", "No" and "Selectively". We did not count the "Selectively" response in this figure, as we wanted to collect a be better idea on how many actual investments were being made versus just the investor interest. We removed the "Selectively" answer choice for 2014 and 2015

After comparing 2015 performance of younger (less than three years since inception) and smaller (under $500mm in AUM) hedge funds to larger, longer-standing managers within their investment portfolios, roughly half of respondents did not notice any meaningful differences.

- Contrary to conventional wisdom that smaller, younger hedge funds may be more nimble than larger, older hedge fund managers, the majority of respondents did not notice smaller, younger hedge funds outperforming other hedge funds in 2015.
- 70% of respondents observed that younger funds either had similar returns or did not outperform older funds (three years track record or longer) in 2015.
  - Consultants and Family Offices represented those segments who did notice a difference in performance. Nearly half of Consultants and over 40% of Family Offices observed that younger funds outperformed older funds in 2015.
  - Geographically, more Asia-based investors indicated the significance of fund age, compared to the other regions.
- Similarly, 72% of respondents did not find that funds that are smaller in size posted better returns for the year than funds with over $500mm in AUM, particularly Pensions, Insurance Companies and Endowments & Foundations.
  - However, nearly 40% of Family Offices and Registered Investment Advisors observed that smaller funds outperformed larger funds in 2015.
  - Over 50% Asia-based respondents reported that they witnessed smaller funds outperform in 2015.
- Only about a quarter of Fund of Funds respondents, the segment that is most active with emerging managers, thought these types of managers outperformed larger, more established funds on the year.

Figure 28

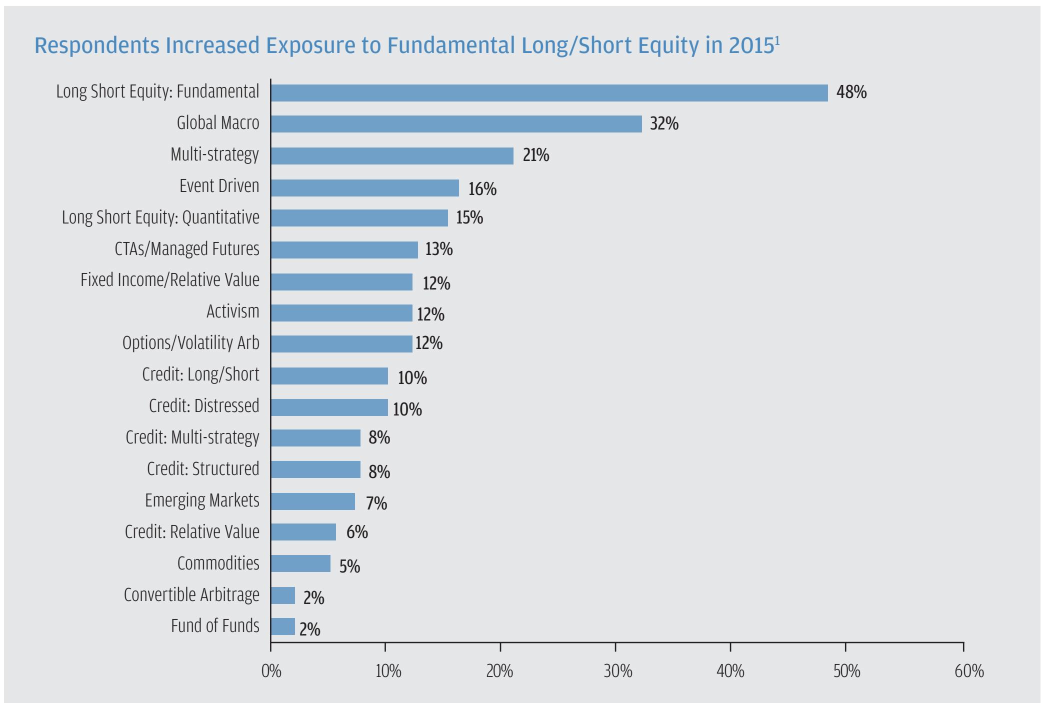


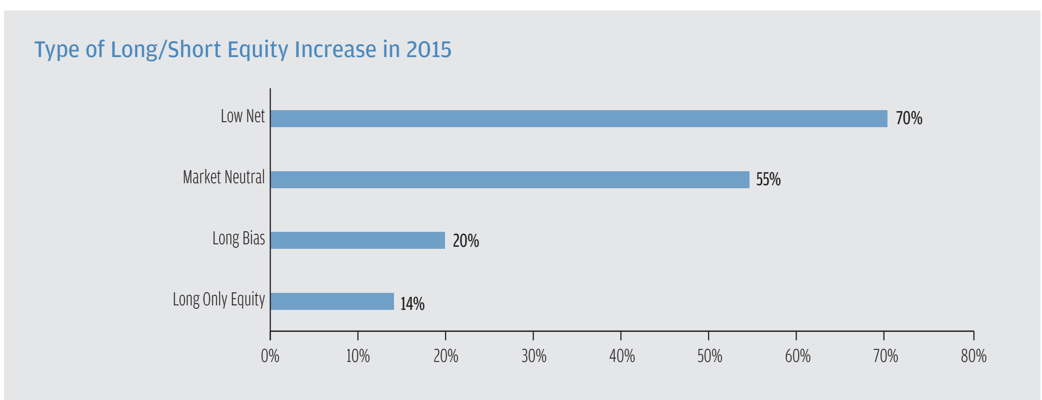
[1] Note: Figure is based on 277 respondents
[2] Note: Figure is based on 272 respondents

Over 60% of respondents increased their exposure to at least one hedge fund strategy in 2015. This reflects a slight pullback in the number of strategy increases noted in past years, which has been in the 70% range.

New allocations were made predominantly to Fundamental Long Short Equity managers. Respondents allocated to Low Net and Market Neutral equity strategies significantly more than other equity-oriented hedge fund strategies.

Figure 29





[1] Note: Data is based on 467 selections made by 196 respondents

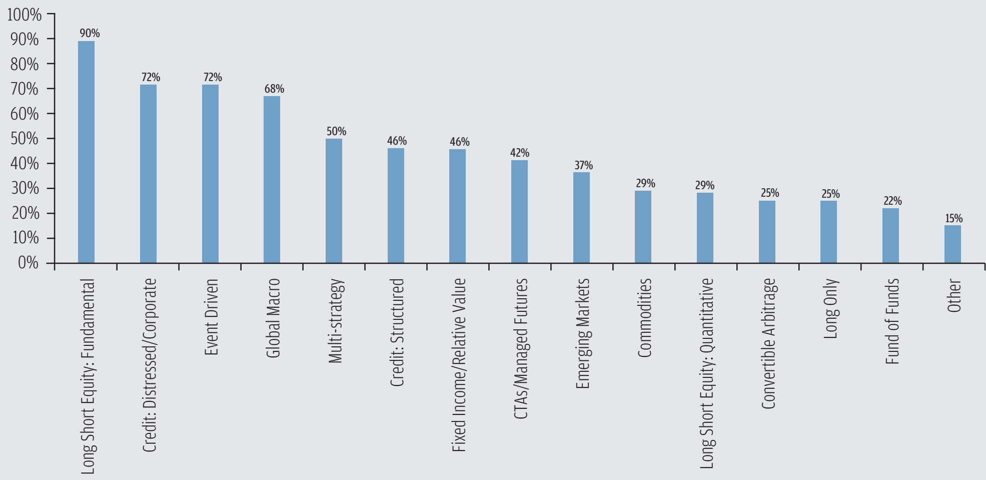
Fundamental Long Short Equity remains the top strategy that respondents are invested in.

- Since 2008, Fundamental Long/Short Equity has been the most popular strategy among survey respondents each year. 90% of respondents were invested in the strategy in 2015.
- Similar to 2014, Quantitative Long/Short Equity strategies such as statistical arbitrage continued to attract attention in 2015. 34% of respondents were allocated to the strategy in 2015 compared to only 29% the year before and 19% in 2013.
- Fixed Income/Relative Value, Credit: Distressed, Commodities, and Convertible Arbitrage experienced the largest year-over-year declines amongst our respondent base.
- Though Event Driven and Global Macro are among the most commonly invested strategies, the percentage of respondents allocating to those strategies fell 8% and 5% year-over-year in 2015, respectively.

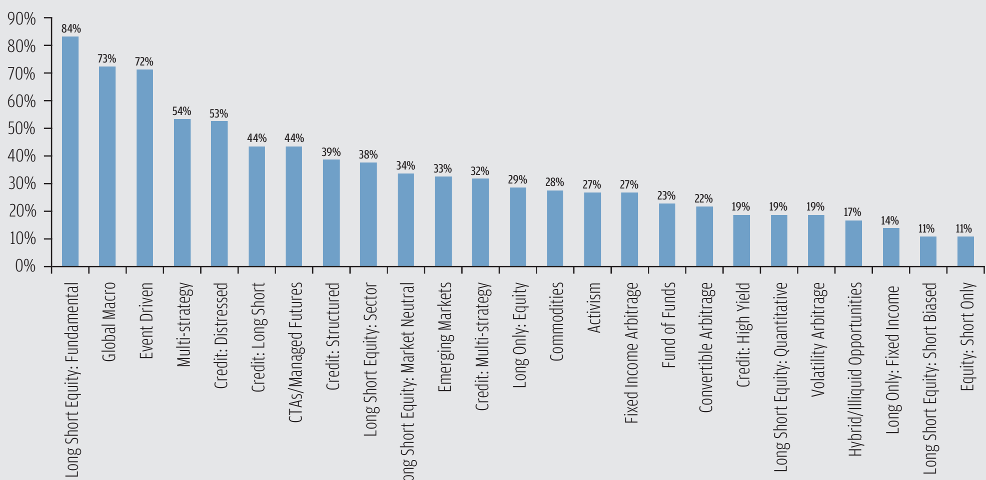
Figure 30

Note: Figures based on number of respondents for each respective year's Survey. For the 2016 Survey, respondents had 19 strategy selection options. For the 2015 and 2014 Surveys, respondents had 15 and 25 strategy selection options, respectively

Respondents Invested in Strategy (2014)



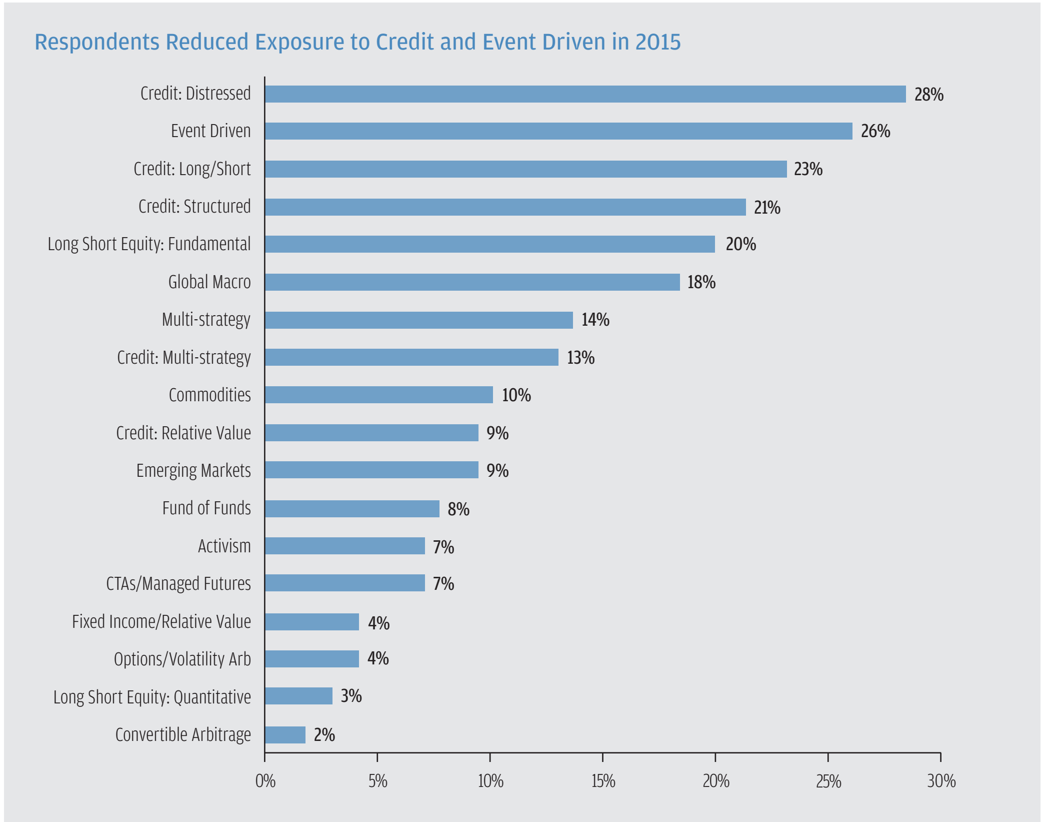
Respondents Invested in Strategy (2013)



Note: Figures based on number of respondents for each respective year's Survey. For the 2016 Survey, respondents had 19 strategy selection options. For the 2015 and 2014 Surveys, respondents had 15 and 25 strategy selection options, respectively

Over half of the respondents decreased their exposure to at least one hedge fund strategy in 2015. Most reductions to exposure involved Credit and Event Driven strategies.

Figure 31



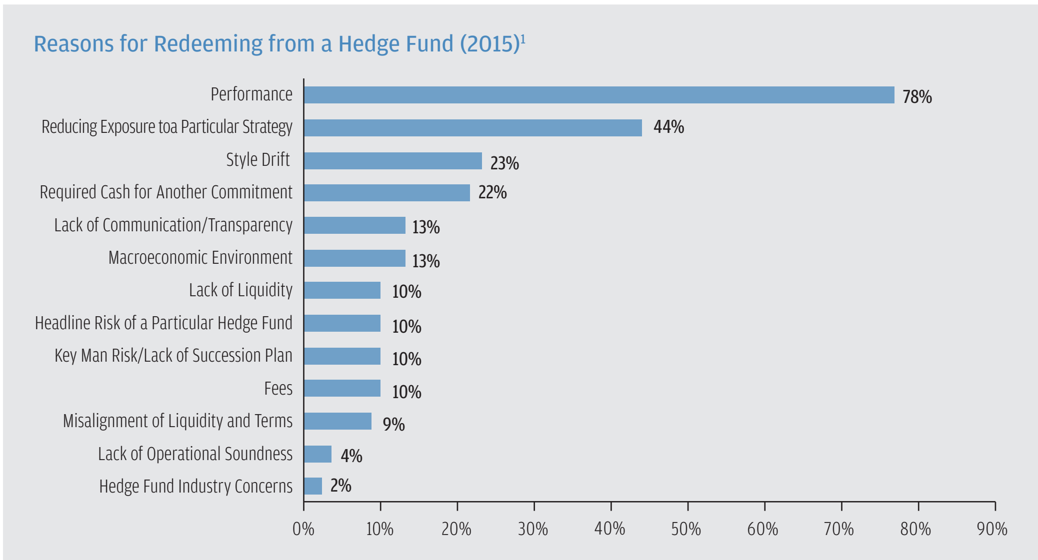
Approximately 80% of respondents redeemed from at least one hedge fund in 2015, consistent with 2014.

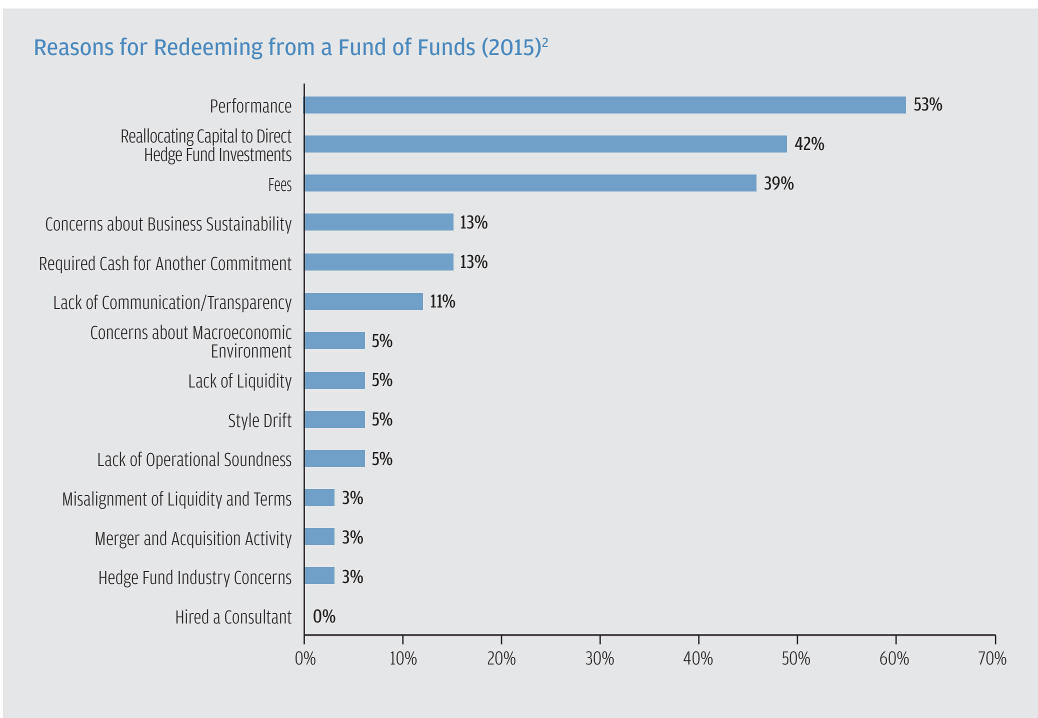
- Performance is consistently the most cited reason for redemptions from hedge funds in recent years.
- Other top reasons cited for redemptions from hedge funds include specific strategy exposure reductions and strategy re-allocations, style drift, and a requirement of cash for another commitment. These have consistently been the main rationales for redemptions over the past three years.
- Although not options in the Survey, a number of respondents also cited organizational and staffing concerns as drivers for redemptions.
- Endowment & Foundation and Fund of Funds segments were the most active in firing specific managers in 2015, as 88% and 86%, respectively, made redemptions from at least one hedge fund manager.
  - Similar to 2014, only 62% of Pensions redeemed from at least one hedge fund in 2015, the lowest percentage of any investor segment.

Note: Data is based on 384 selections made by 196 respondents

- Approximately one-fifth of respondents (excluding Fund of Funds) redeemed from a Fund of Funds in 2015, predominantly due to performance, reallocating capital to direct hedge fund investments, and/or fees.
  - Over 40% of Consultant respondents and 36% of Insurance Company respondents redeemed from at least one Fund of Funds in 2015.

Figure 32





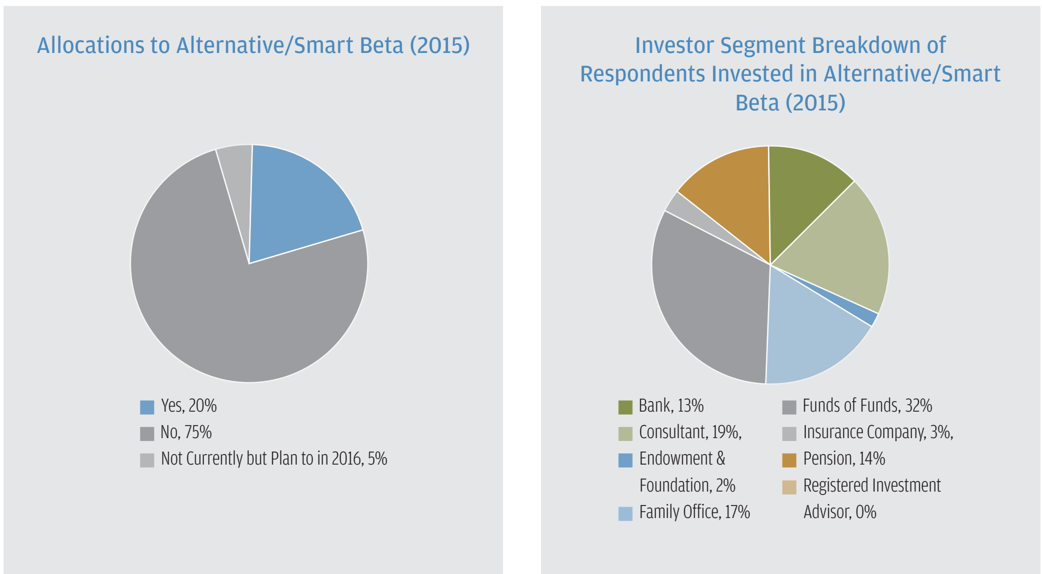
[1] Note: Date is based on 552 selections made by 223 respondents

[2] Note: Data is based on 76 selections made by 38 respondents

Given the increased levels of market volatility during the latter halves of both 2014 and 2015 and overall hedge fund underperformance, respondents were asked about their current allocations to Alternative or Smart Beta strategies. These strategies tend to be more liquid and less expensive compared to traditional hedge funds.

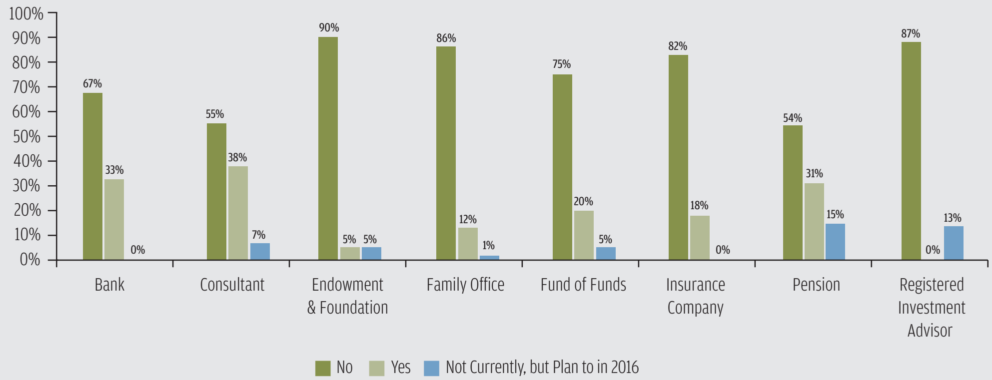
- 20% of respondents revealed that they are currently investing in Alternative or Smart Beta strategies, up from 15% in 2014. Another 5% of respondents indicate they plan to invest in such strategies in 2016.
  - Of those who are currently allocating to Alternative or Smart Beta strategies, 32% are Fund of Funds, 19% are Consultants and 17% are Family Offices.
  - Pensions and Registered Investment Advisors have the highest percentage of respondents indicating interest in allocating to Alternative or Smart Beta strategies in 2016.
- Geographically, Europe has the largest percentage of respondents investing in Alternative or Smart Beta and investors in this region are most likely to make allocations to these strategies in 2016.
  - 80% of North American respondents are not currently allocating to Alternative or Smart Beta strategies and less than 5% are expecting to make allocations to the space next year.
  - Roughly one quarter of Asia-based respondents indicated they were allocated to Smart Beta strategies.

Figure 33

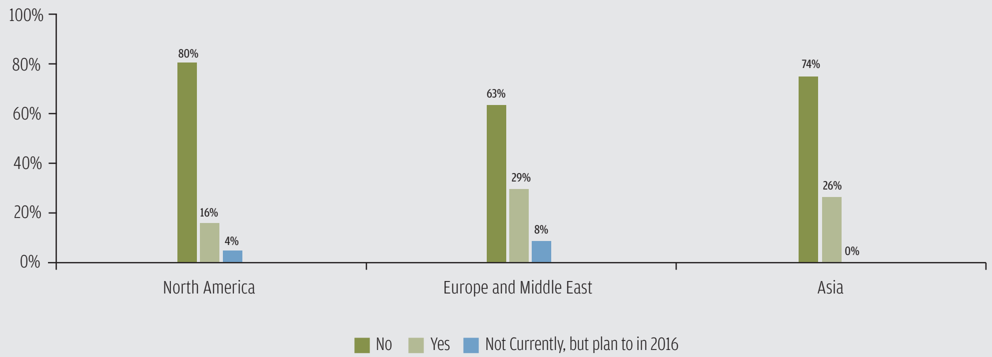


Note: Figures based on number of respondents unless otherwise noted

Allocation to Alternative or Smart Beta Strategies by Investor Type (2015)[1]



Allocation to Alternative or Smart Beta Strategies by Investor Region (2015)



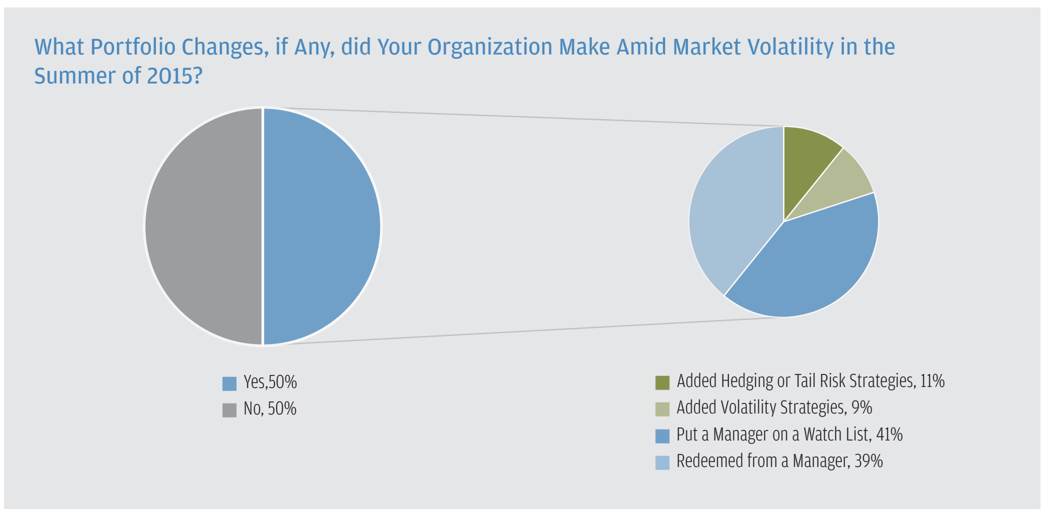
[1] Note: Figures based on number of respondents unless otherwise noted. Categories may not sum to 100% due to rounding

Respondents were also asked what, if any, portfolio changes they made amidst increased market volatility during the summer of 2015. Half of the respondents mentioned they took some action.

- Most respondents either put a manager on a watch list or redeemed from a manager. Fewer respondents actually added tail risk, hedging, or volatility strategies.
- Two-thirds of Consultant respondents and nearly 60% of Bank respondents made investment changes as a result of the summer's volatility levels. Only 40% of Pension respondents made changes.
- Consultants and Fund of Funds demonstrated the highest percentage of respondents to add hedge funds focusing on tail risk protection.

Figure 34

What Portfolio Changes, if Any, did Your Organization Make Amid Market Volatility in the Summer of 2015?



Note: Figures based on number of respondents unless otherwise noted

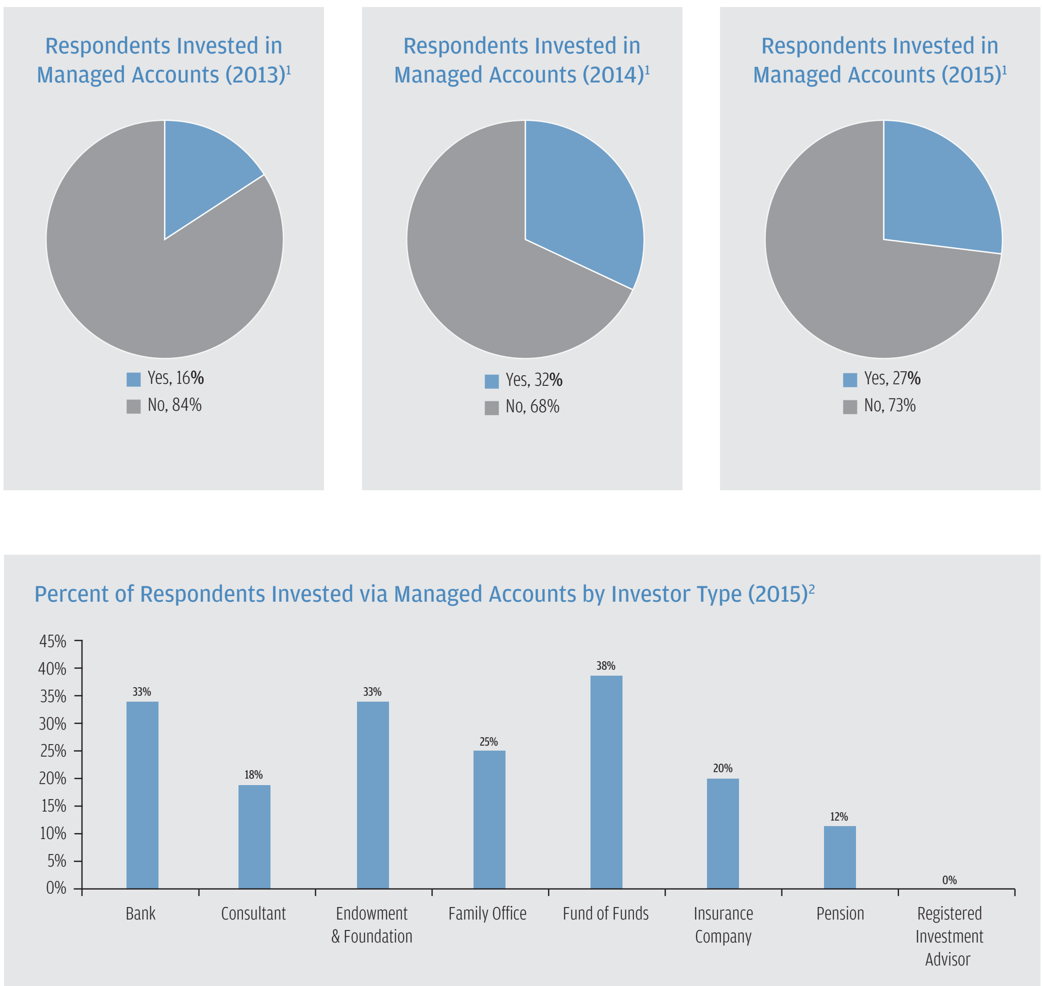
Aside from making hedge fund allocations to typical commingled funds, respondents invest via separately managed accounts, Funds of One, and Liquid Alternatives (UCITS and 40 Act vehicles).

Interest in investing via managed accounts seems to have plateaued year-over-year. Less than 30% of respondents invest via managed accounts, a slightly smaller ratio compared to what was observed in 2014. Majority of respondents still do not invest this way, perhaps due to additional costs associated with the vehicles and less access to "best of breed" managers (negative selection bias).

- 27% of respondents invested in managed accounts, which denotes a slight decline in interest since 2014.
- Investors typically prefer managed accounts when manager transparency and mandate control are key priorities.
- 32% of managed account investors have increased their investments via managed accounts in 2015, while 64% maintained their allocations.
- Of those respondents who invest via managed accounts, the vehicle type represents only a small portion of overall AUM in hedge funds. Nearly 80% of respondents have less than 50% of their portfolio invested via managed accounts, with the majority having only 1-10%.
- When considering possible changes to the hedge fund industry in the near future, less than 15% of the entire respondent base expects more money to be allocated via managed accounts.
- Despite an expectation for growth to slow, managed account businesses will likely to continue to grow in 2016, as 96% of investors that invest in managed accounts are expecting to increase or maintain their investments in managed accounts. Growth will mostly stem from organic asset growth of current investors though, not from new entrants, as only 3% of respondents who currently do not invest via managed accounts, plan to start to in 2016.
- Of those who already invest via managed accounts, close to 50% have typical investments of more than $50 million.
- Investors who already invest via managed accounts tend to do so with large allocations. The percentage of investors allocating more than $50 million per account has increased significantly from 29% in 2014 to 48% in 2015.
- Fund of Funds, Banks, and Endowments & Foundations represented those investor segments most willing to invest in hedge funds via managed accounts. Investors in these segments are also more likely to make larger allocations to managed accounts (greater than $50 million). Fund of Funds and Bank segment growth may be due to client demand for more customized products.

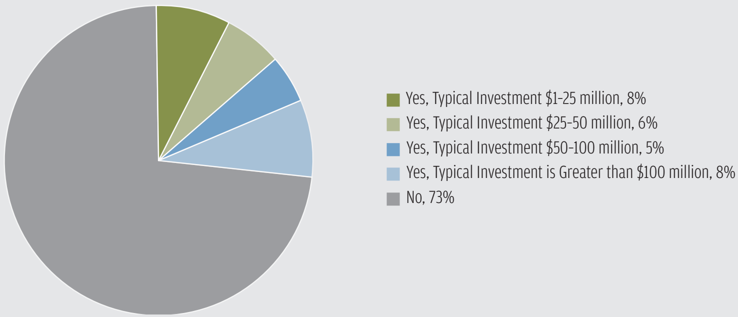
- The percentage of investors willing to invest via managed accounts in the Consultant and Registered Investment Advisor segments has declined substantially.
- Geographically, the interest in managed accounts appears to be relatively consistent with 31%, 30%, and 33% of respondents based in Europe, North America, and Asia, respectively, investing via managed accounts. Looking ahead to 2016, more Asia-based respondents intend to invest in managed accounts.
- Average managed account size tends to be smaller than average Fund of One size. 48% of respondents who invest via managed accounts have a typical investment size of $50 million or greater, compared to 67% of respondents who invest via Funds of One with a typical investment size of $50 million or more.

Figure 35

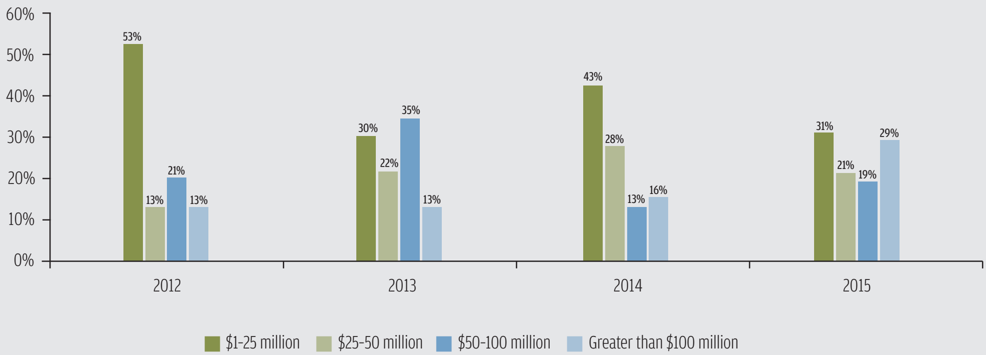


[1] Note: Figures based on Number of respondents in each respective year's Survey
[2] Note: Figures based on 287 respondents

Respondents Invested in Managed Accounts (2015, by Typical Managed Account Investment Size)[1]



Respondents Invested in Managed Accounts (2012–2015 by Typical Managed Account Investment Size)[2]



Approximately one-fifth of respondents invest via Funds of One.

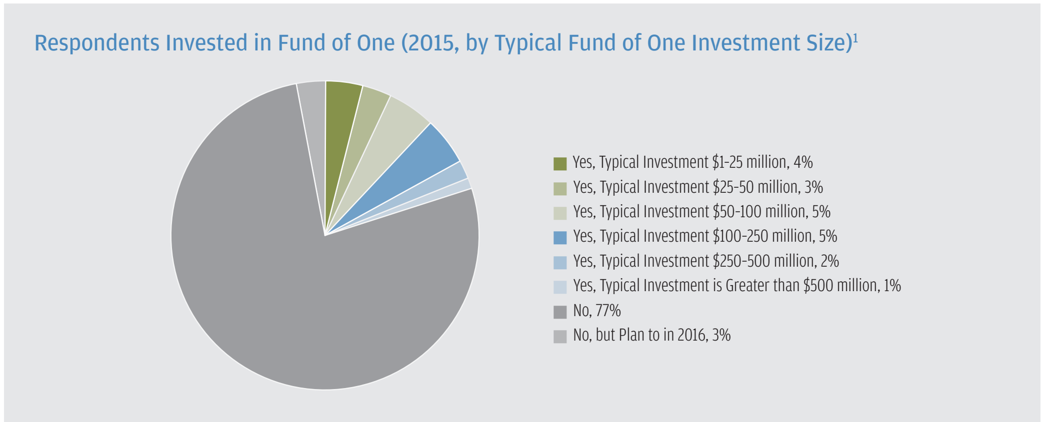
- Funds of One are less common among the respondent base than managed accounts, most likely due to higher minimums for Funds of One. Interest in these vehicles has also leveled off year-over year, as 19% of respondents currently invest via Funds of One, compared to 17% noted in 2014.
- Despite an expectation for growth to slow similar to managed accounts, Funds of One will likely continue to grow in 2016, as 88% of respondents that currently invest in them are expecting to increase or maintain these types of investments this year. Growth will mostly stem from organic asset growth of current investors though, not from new entrants, as only 4% of respondents who currently do not invest via Funds of One, plan to start to in 2016.
- Of those respondents that invest in Funds of One, nearly 70% make typical investments of $50 million or more. Pensions, Fund of Funds and Consultants represent those segments most likely to invest via these vehicles.

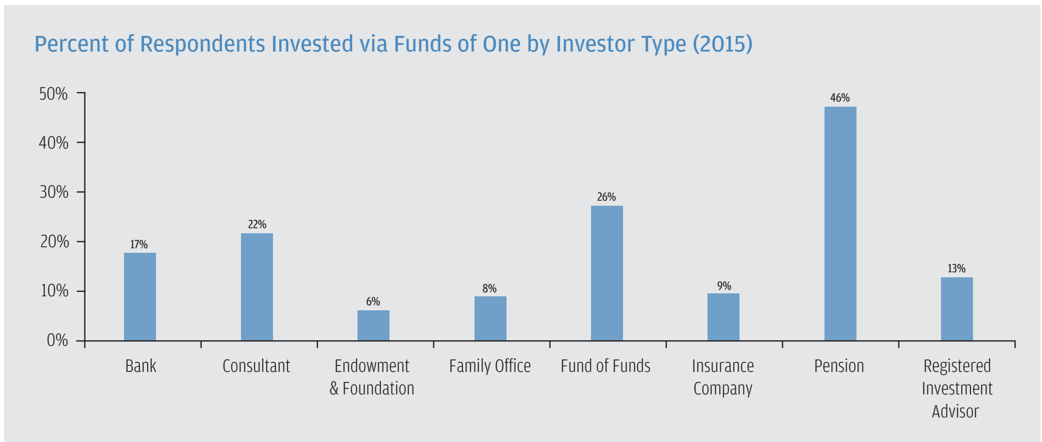
[1] Note: Figures based on selections from 287 respondents

[2] Note: Figures based on number of respondents in each year's Survey

- The vehicle type represents only a small portion of respondents' overall AUM in hedge funds. Close to 80% of respondents who utilize Funds of One have less than 25% of their hedge fund investments allocated this way. 1-10% of hedge fund AUM is the most common allocation range.
- Similar to 2014, fewer investors invest via Funds of One than managed accounts, largely as a result of higher minimum account size required by Fund of One vehicles. 19% of respondents are currently investing via Fund of One versus 27% who invest in managed accounts.

Figure 36



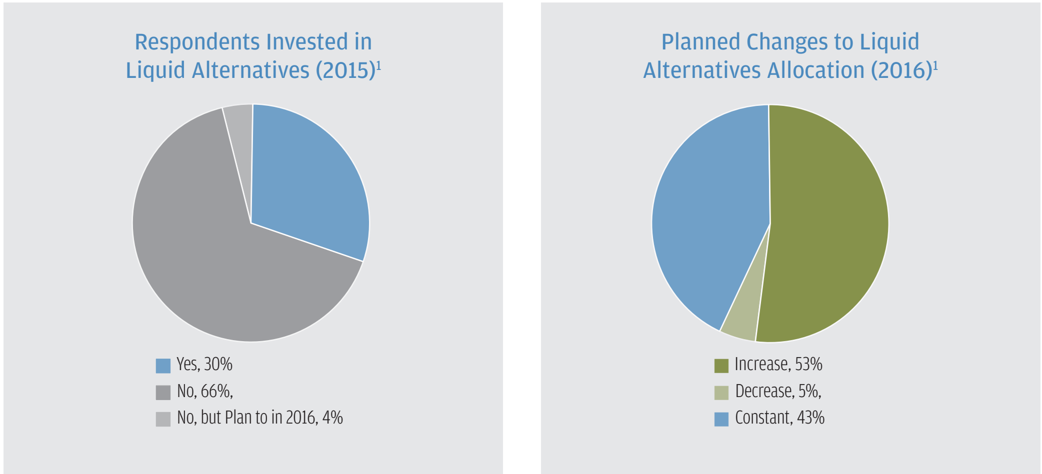


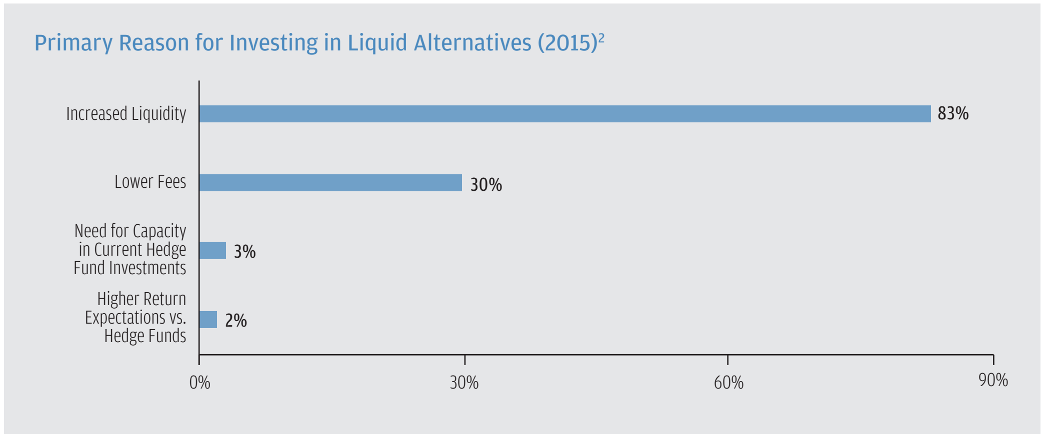
[1] Note: Figures based on selections from 284 respondents

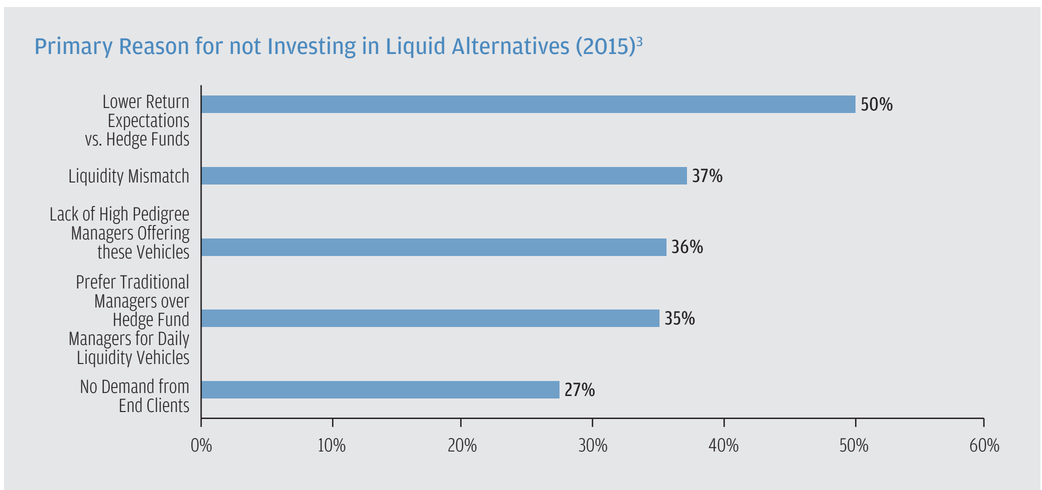
The percentage of respondents that invest in Liquid Alternatives (40 Act or UCITS) has grown slowly, but steadily, over the past few years.

- 30% of respondents currently invest in Liquid Alternative products, a slight increase from the 27% observed in 2014.
- Liquidity is the primary reason why respondents invest in these products. Lower fees are another attractive reason.
- Of those respondents who currently invest in Liquid Alternatives, 95% plan to either increase investments or keep them constant in 2016.
- Similar to 2014, Banks, Consultants and Registered Investment Advisors represent those segments most invested in Liquid Alternatives in 2015. Banks and Consultants also represent the segments that are the most interested in increasing these investments in 2016.
- Over half of Europe-based respondents are invested in Liquid Alternatives, over double the number noted for North America.
- Of the two-thirds of respondents who still do not invest in Liquid Alternatives, most have not invested due to lower return expectations versus traditional hedge fund offerings.
- Nearly 30% of Fund of Funds respondents indicated that they already run a 40 Act or UCITS alternative multi-manager fund.
  - An additional 5% of Fund of Funds respondents indicated they have plans to launch this type of product in 2016.
  - Of those Fund of Funds respondents who are already running Liquid Alternative multi-manager funds, geographic representation is split roughly 50/50 between North America and Europe based groups.
  - Over 60% of Fund of Funds respondents that currently run a Liquid Alternative multi-manager fund have $5 billion or more in assets under management. Larger managers most likely have the infrastructure and internal resources to be able to offer this type of product.
- When considering possible changes to the hedge fund industry in the near future, only 21% of respondents expect more money to be allocated to 40 Act Funds (i.e. Alternative Mutual Funds Offering Daily Liquidity) in 2015. This is significantly lower than the 35% noted upon entering 2015.

Figure 37





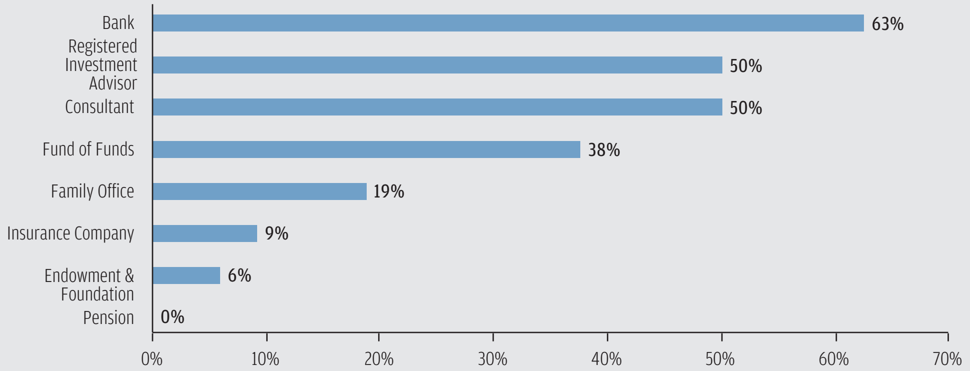


[1] Note: Figures based on number of respondents unless otherwise noted. Categories may not sum to 100% due to rounding

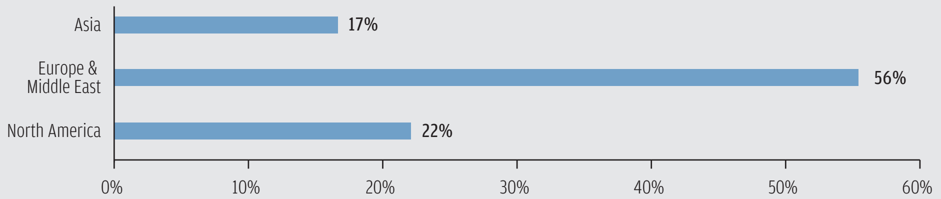
[2] Note: Data is based on 115 selections made by 98 respondents

[3] Note: Date is based on 359 selections made by 193 respondents

Percent of Respondents Invested in Liquid Alternatives by Investor Type (2015)[1]



Percent of Respondents Invested in Liquid Alternatives by Investor Region (2015)[1]

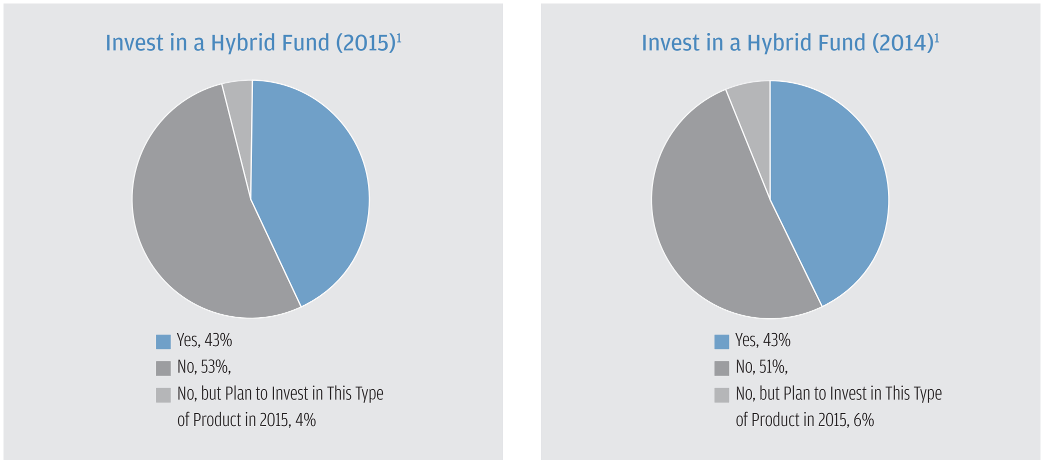


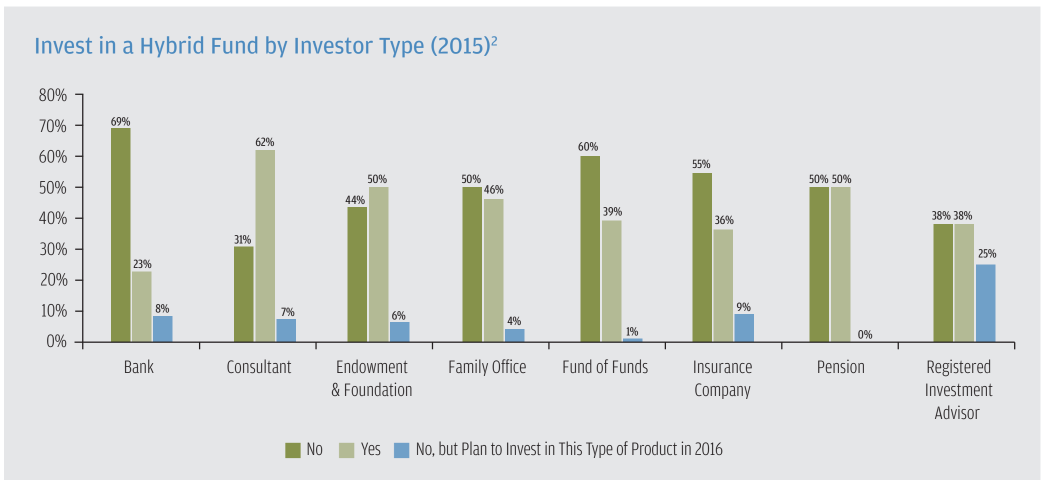
[1] Note: Figures are based on selection from 291 respondents

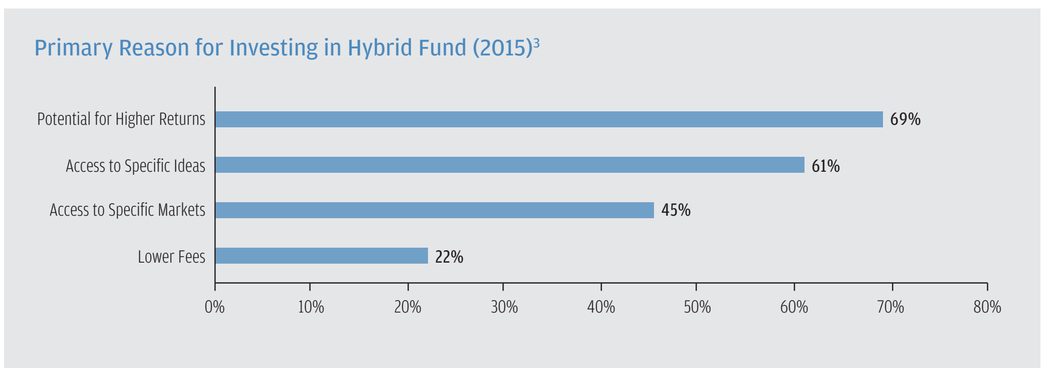
Investors also have an appetite for vehicles on the opposite end of the liquidity spectrum. Similar to last year, nearly half of respondents are interested in longer-lock hedge fund vehicles, such as Hybrids and Co-Investment opportunities.

- Nearly 45% of respondents invested in a less liquid hedge fund product typically offering liquidity of three years or more (e.g., hybrid fund, drawdown structure) in 2015.
  - Investor appetite for less liquid strategies has increased since 2012 when only 27% of respondents indicated they invested in a hybrid fund.
  - 62% of Consultants, 50% of Pensions and Endowments & Foundations, and 46% of Family Offices currently invest in a less liquid hedge fund product.
  - Hybrid vehicles are most popular amongst North America-based respondents, as over half indicated they invested in 2015. About one-third of respondents based outside North America invested in Hybrids.
- The primary reason investors are attracted to these hybrid investments is their potential to earn higher returns. Many allocators also believe hybrids are better vehicles for accessing specific investment ideas.
- Co-investment interest has declined slightly since year-over-year. 42% of respondents indicated interest in participating in a co-investment opportunity in 2015, compared to 56% in 2014. A co-investment opportunity is typically an investment in a parallel fund vehicle or Special Purpose Vehicle that will invest alongside a manager's comingled fund either pari-passu or in less liquid securities not suitable for the main fund.
  - 55% of Banks, 50% of Registered Investment Advisors, and 48% of Endowments & Foundations indicated they would participate in a co-investment opportunity.
  - Family Offices demonstrated a significant decrease in co-investment opportunity interest year-over-year. Only 29% of segment respondents indicated interest in 2015 compared to 72% in 2014. This may be partially due to respondents allocating capital to these opportunities in 2014 and having no further capital to do so again last year.
- Across all investor segments, respondents are more prone to invest in a co-investment alongside a hedge fund manager in which they are currently invested over a new manager.
- Geographically, respondents based in Asia indicated the most interest in co-investment opportunities.
  - 64% of respondents in Asia indicated interest, which illustrates a significant increase in demand year-over-year, as only 10% of those respondents indicated interest in 2014.
  - North America-based respondents demonstrated the largest decline in interest for these vehicles year-over-year. Only 37% indicated interest in 2015 compared to 64% in 2014. Again, this may be due to respondents allocating capital to these opportunities already and having no further capital to do so again in the near term.
  - Data may also be slightly skewed due to the larger number of North America-based respondents who completed the Survey (nearly 70% of respondents are based in North America).

Figure 38

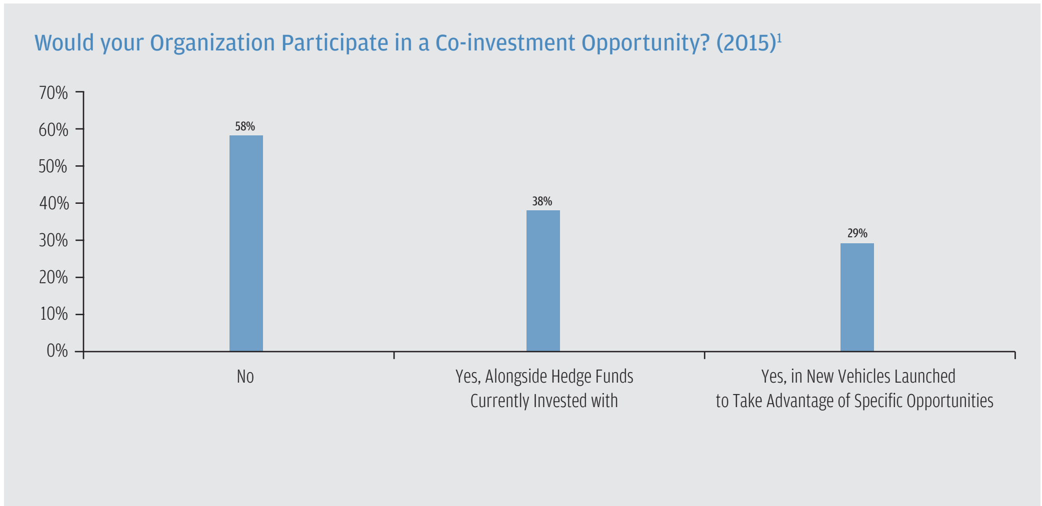


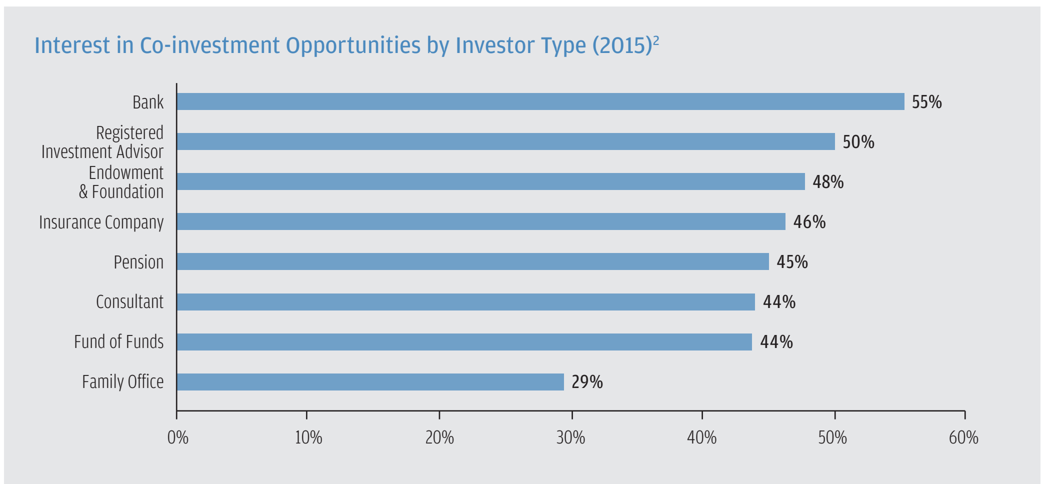


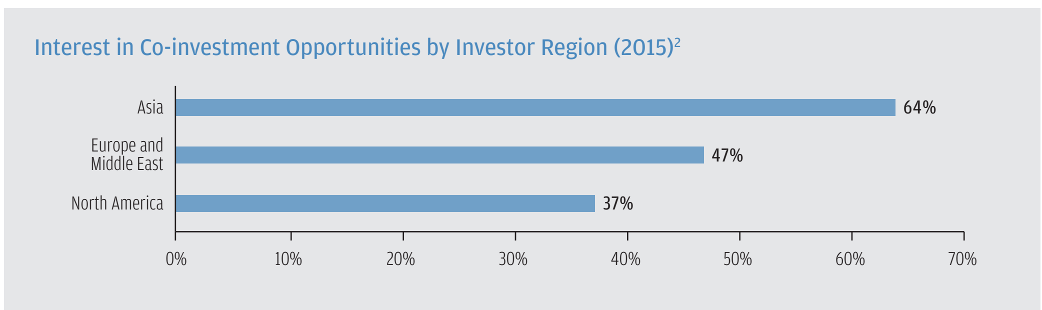


[1] Note: Figures based on number of respondents in each respective year's Survey
[2] Note: Figures based on selection from 297 respondents. Segment totals may not sum to 100% due rounding
[3] Note: Data is based on 278 selections made by 141 respondents

Figure 39







[1] Note: Data is based on 403 selections made by 322 respondents

[2] Note: Figures based on number of respondents unless otherwise noted

IV. HEDGE FUND INDUSTRY FLOWS AND TRENDS ANTICIPATED BY RESPONDENTS

LOOKING AHEAD, RESPONDENTS REPORT ON EXPECTED HEDGE FUND CAPITAL FLOWS, STRATEGY PREFERENCES, OVERALL TRENDS, AND EXPECTED CHANGES IN THE INDUSTRY

Respondents expect 2016 to be an active year, as absolute growth of hedge fund assets should continue to be in line with overall growth of allocators' assets under management. Last year, it was noted that momentum of growth across the hedge fund industry may slow during 2015. As hedge funds still remain under a vigilant eye, it is expected that growth levels will be similar in 2016.

The focus in 2016 will likely be on recycling capital dedicated to hedge fund managers instead of increasing relative exposure to the space. Key investor activity may center on manager turnover; upgrading specific managers where appropriate and re-allocating across particular strategies depending on market outlook.

- The hedge fund industry is expected to continue to grow, as nearly 90% of respondents expect to have either unchanged or net inflows to hedge fund investments in 2016.
- However, according to Survey participants, expected net new inflows have declined steadily since entering 2014. 55% of respondents indicated they expect hedge fund net inflows for 2016. This represents a 6% decrease in sentiment year-over-year, as 61% of respondents expected hedge fund net inflows for 2015. 72% anticipated net inflows for 2014.
- Approximately half of the respondents expect to only add $50 million or less of new capital to hedge fund investments in 2016.
- Over 75% of Banks and 80% of Registered Investment Advisors expect hedge fund net inflows in 2016. However, only one-third of Endowments & Foundations expect the same. A quarter of the Endowment & Foundation segment anticipates net outflows.
- Investors have a similar neutral stance on hedge funds entering 2016 as they did coming into 2015. Only 41% of respondents indicated they were bullish on hedge funds going into 2016, compared to 42% and 66% going into 2015 and 2014, respectively.
- Despite respondents indicating that new allocations to hedge funds are still being made, 2015 was an arduous year for many managers. Given continued performance woes, hedge fund managers may face elevated allocator standards for new investments in 2016.
  - Two-thirds of respondents indicated that their hedge funds investments did not meet their target return, which highlights a significant increase from 2014 when 54% of respondents reported their hedge fund portfolio did not meet return expectations. Nearly 90% of respondents met or exceeded their target return in 2013.
  - Of those respondents who did not meet their target hedge fund return for 2015, the majority plan to reallocate to different hedge fund managers and different strategies in 2016 to remedy meeting return expectations for the next year, highlighting a focus on manager turnover and portfolio upgrades.

Figure 40

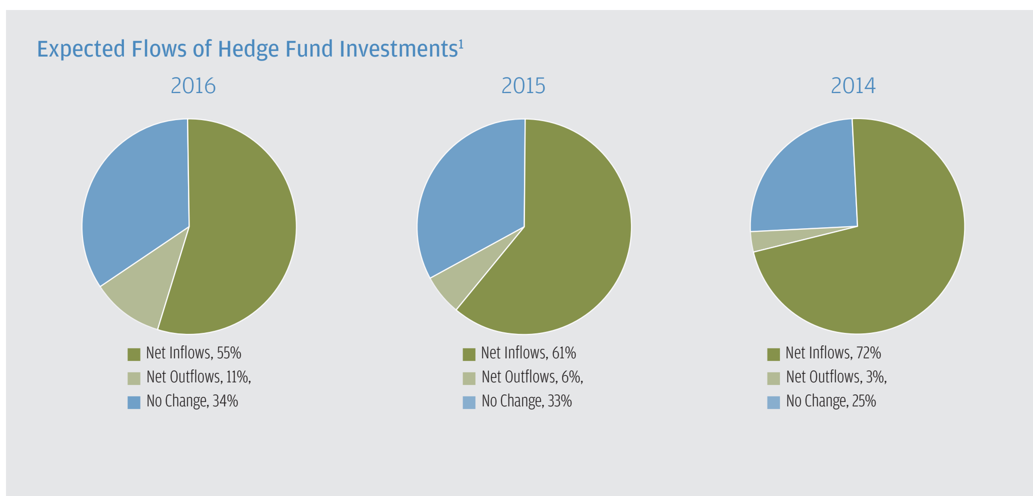
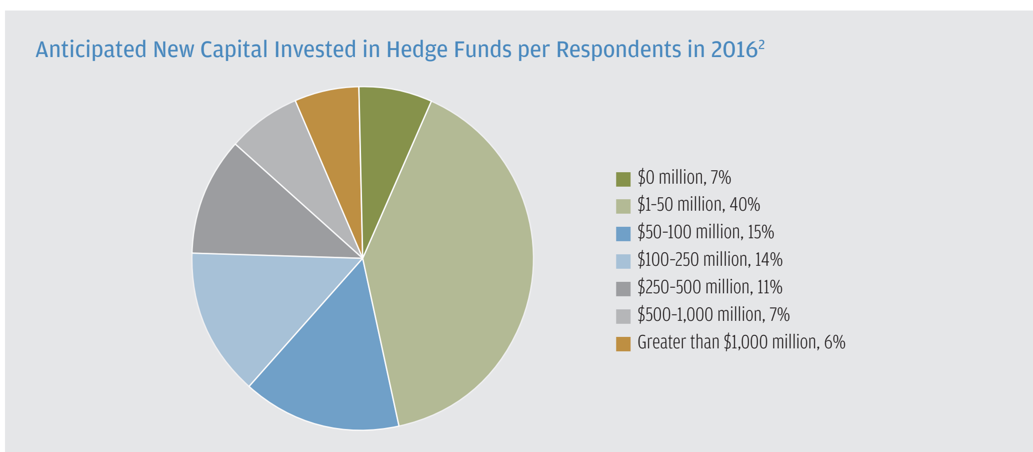
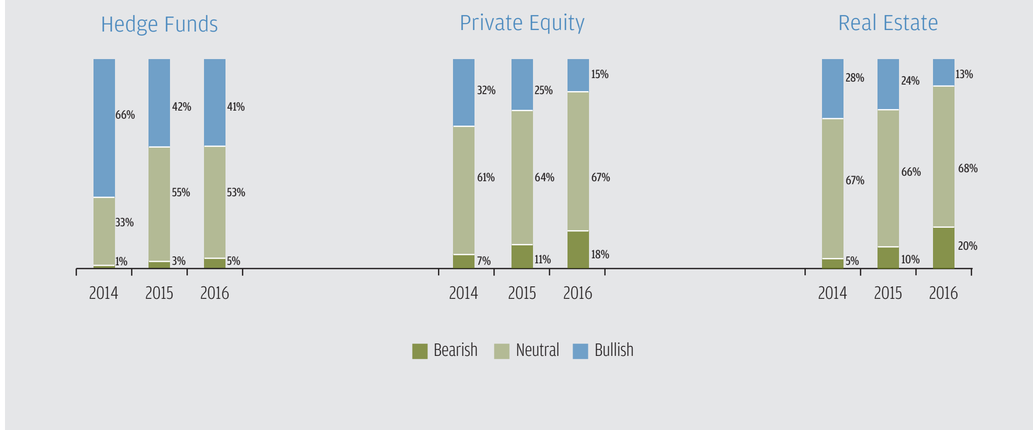


Figure 41

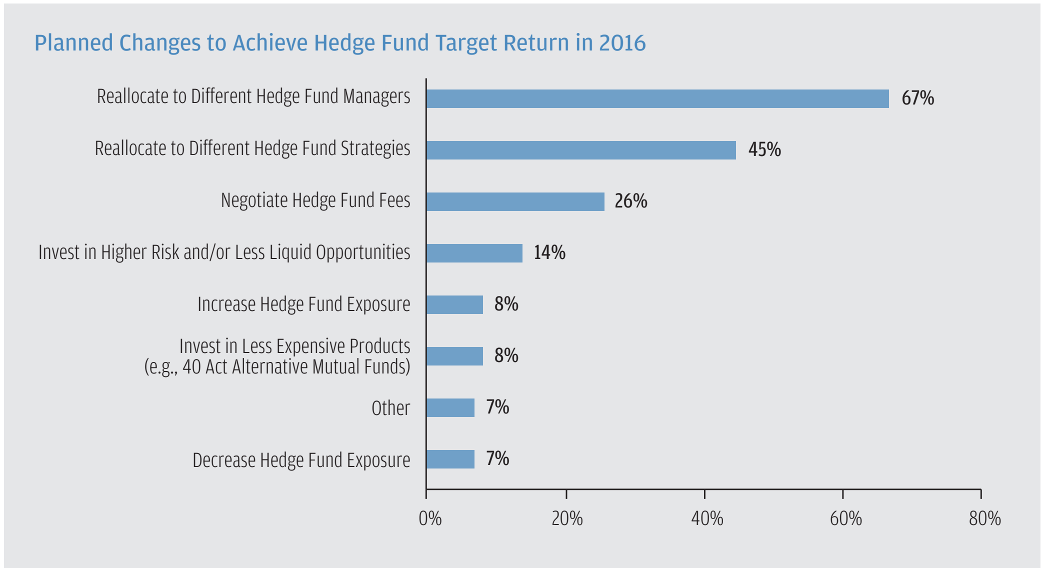




[1] Note: Figures based on number of respondents in each respective year's Survey

[2] Note: Figures based on number of respondents otherwise noted. Categories may not sum to 100% due to rounding

Figure 41 contd

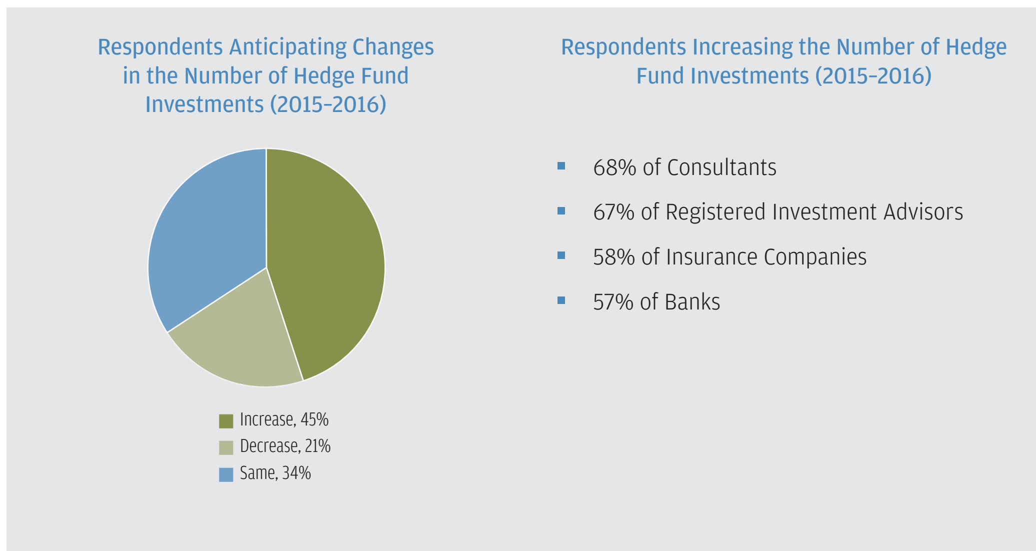


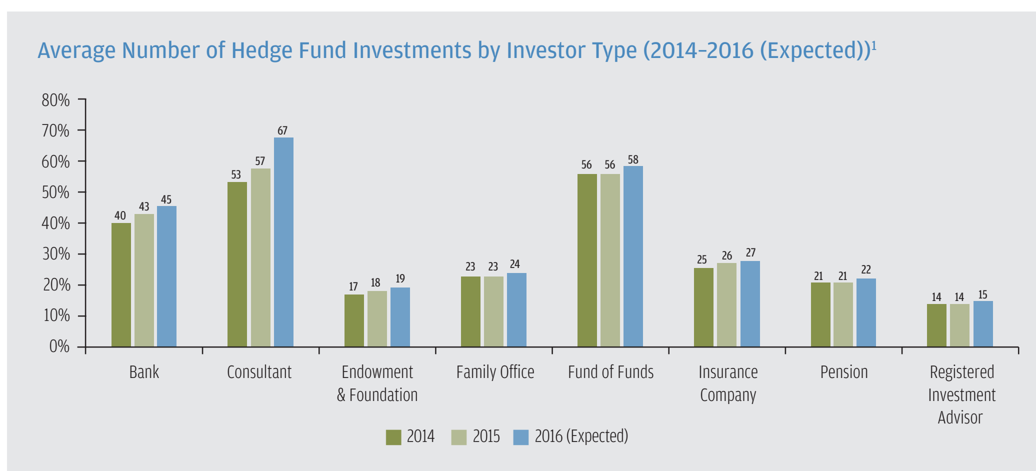
Respondents continue to plan on allocating investments across a slightly larger number of hedge fund managers in 2016.

- Respondents continue to allocate to hedge fund managers and diversify across a number of firms. Nearly three quarters of respondents either maintained or increased the number of their hedge fund investments from 2014 to 2015, and almost 80% of respondents are planning the same between 2015 and 2016.
- 68% of Consultants, 67% of Registered Investment Advisors, 58% of Insurance Companies, and 57% of Banks plan on increasing the number of their hedge fund investments between 2015 and 2016.
- The investor segments that tend to have a larger number of managers given their business purposes (Banks, Consultants, etc.) are also those that are planning on continuing to grow their number of investments going forward. This may be indicative of capacity constraints these segments face with certain hedge fund managers and/or demand from end clients for different strategies.
- Registered Investment Advisors, Endowments & Foundations, and Pensions, continue to have the lowest average number of hedge fund investments at 14, 18, and 21, respectively (for year end 2015).
- No investor segment in particular seems to be becoming more concentrated within their hedge fund portfolio, as the average number of hedge fund investments has either stayed constant or marginally increased over the past three years.

Note: Data is based on 312 selections made by 172 respondents

Figure 42



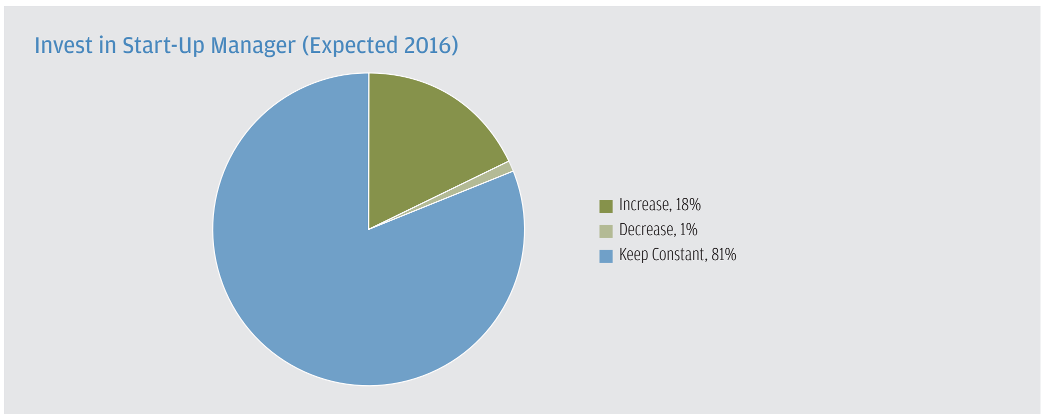


[1] Note: Figures based on number of respondents unless otherwise noted

Entering 2016, there is steady demand for new launches among respondents.

- Over 80% of respondents indicated they would look to maintain the number of start-up managers they allocate to in 2016.
- An additional 18% of respondents indicated they would increase the number of start-up manager allocations.
- Looking ahead, appetite for new launches seems fairly consistent across all investor segments. Registered Investment Advisors, Family Offices, and Consultants showed the most interest in increasing start-up allocations in 2016.

Figure 43

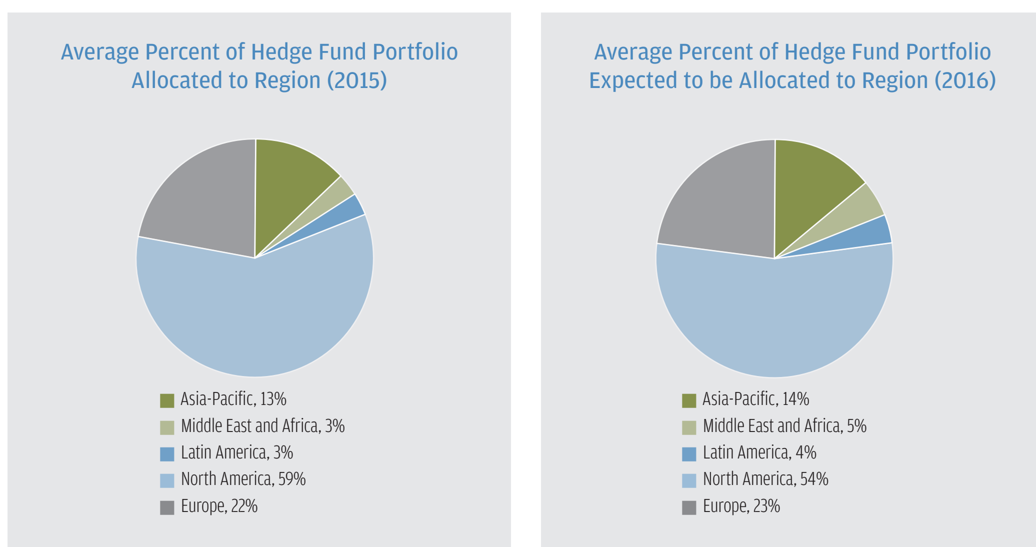


Note: Figures based on selections from 287 respondents

Respondents are gradually shifting towards more global hedge fund portfolios.

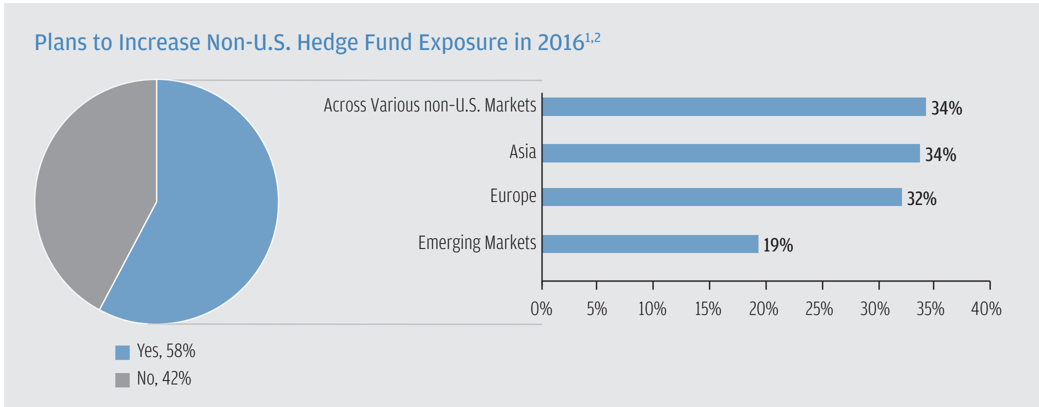
- On average, approximately 40% of the respondents' hedge fund portfolios were allocated outside of North America in 2015.
  - Respondents are planning to continue to diversify exposure across Europe, Asia-Pacific, Middle East and Africa, and Latin America in 2016.
  - Over the last few years, typical allocations to North America have decreased from 60-65% to 55-60%. Allocation ranges to Europe and Asia-Pacific geographies have increased marginally from this reallocation.
- Nearly 60% of respondents are planning to increase non-U.S. hedge fund exposure in 2016. Of those respondents, about one third indicated they would either diversify across multiple geographies or allocate additional capital to Asia-focused strategies.
- Almost 80% of Consultants indicated they wanted to increase non-U.S. hedge fund exposure in 2016, followed by roughly 70% of Banks, Registered Investment Advisors, and Pensions.

Figure 44



Note: Figures based on number of respondents unless otherwise noted

Figure 44 contd



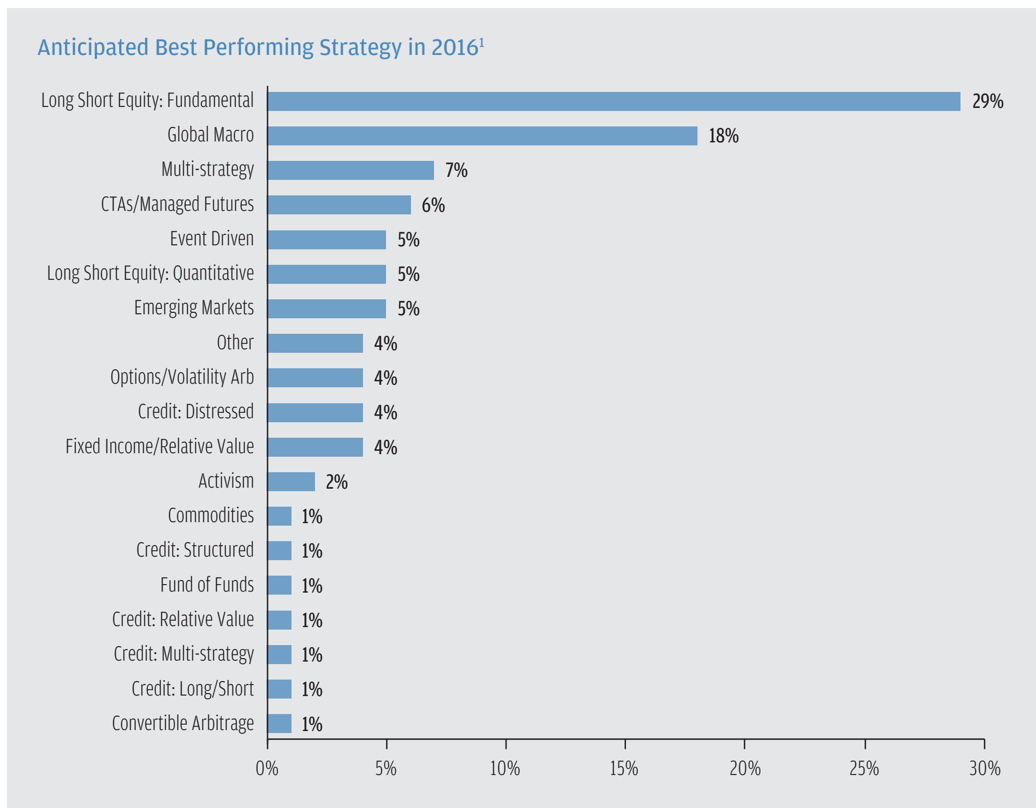
Strategy-wise, Fundamental Long Short Equity and Global Macro strategies are what respondents are most optimistic about for 2016.

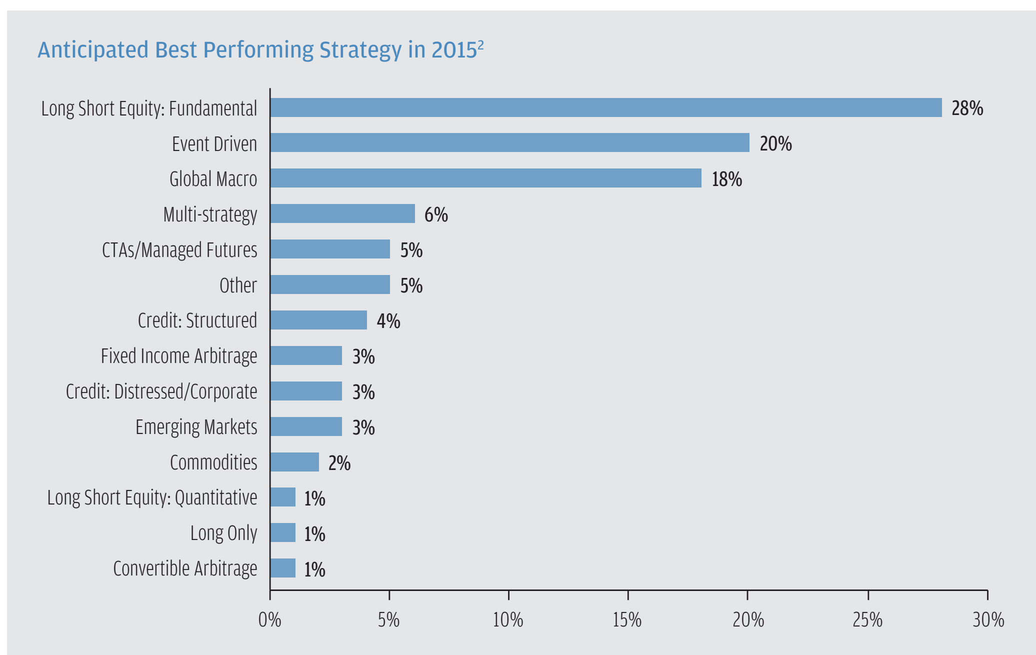
- 29% of respondents expect Fundamental Long/Short Equity to have the strongest performance in 2016, similar to expectations for that strategy in 2015.
- Nearly 60% of Endowments & Foundations expect Fundamental Long Short Equity to outperform in 2016. This is nearly double what the segment expected for the strategy in 2015.
- Respondent confidence that Event Driven will perform well in 2016 has significantly declined from expectations for that strategy in prior years. Only 5% of respondents believe Event Driven will be the best performing strategy in 2016, compared to 20% and 21% in 2015 and 2014, respectively.
- Conviction in Global Macro, despite actual performance headwinds in 2015, has remained steady. 18% of respondents believe it will be the best performing strategy in 2016, which was the same percentage noted entering 2015.
- 27% of Pensions expect Global Macro to be the best performing strategy in 2016, consistent with their conviction for the strategy in 2015. This segment's conviction in Fixed Income Relative Value strategies has grown year-over-year as well.
- Bank and Consultant segments are evenly split on their 2016 predictions between Fundamental Long Short Equity or Global Macro being the best performing strategy.
- Most respondents are bearish on credit strategies for 2016.

[1] Note: Left figure based on 322 respondents

[2] Note: Right figure based on 223 selections from 188 respondents

Figure 45



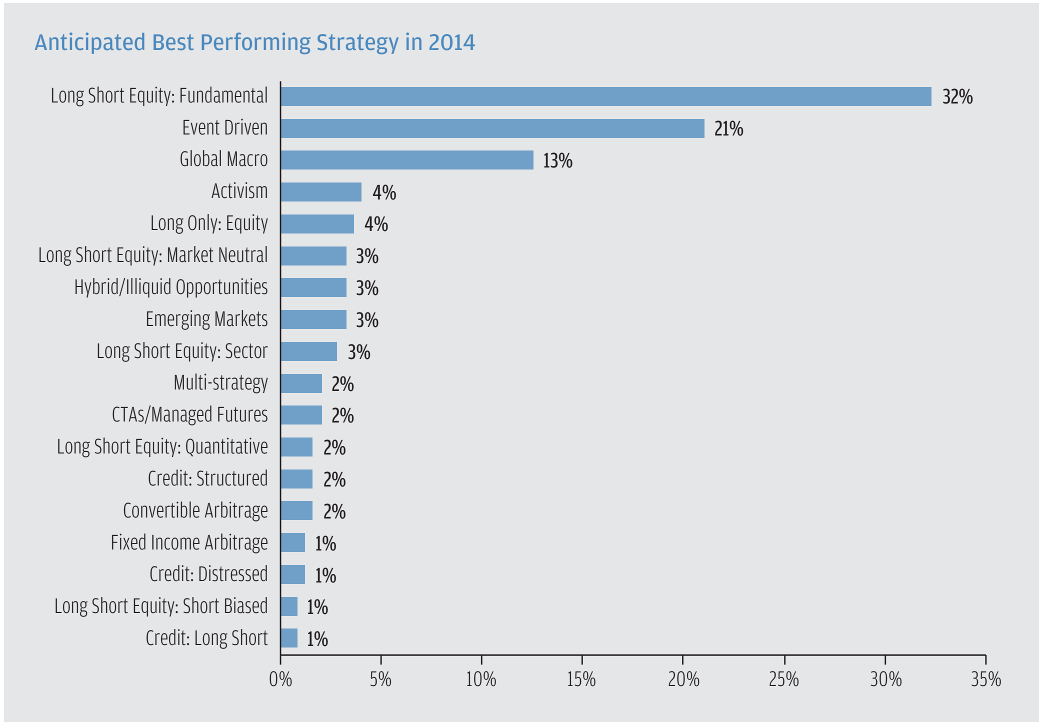


[1] Note: Figures based on selections from 273 respondents.

[2] Note: Figures based on selections from 310 respondents

For the 2016 Survey, respondents had 19 strategy selection options. For the 2015 and 2014 Surveys, respondents had 15 and 25 strategy selection options, respectively

Figure 45 contd



Note: Figures based on selections from 248 respondents

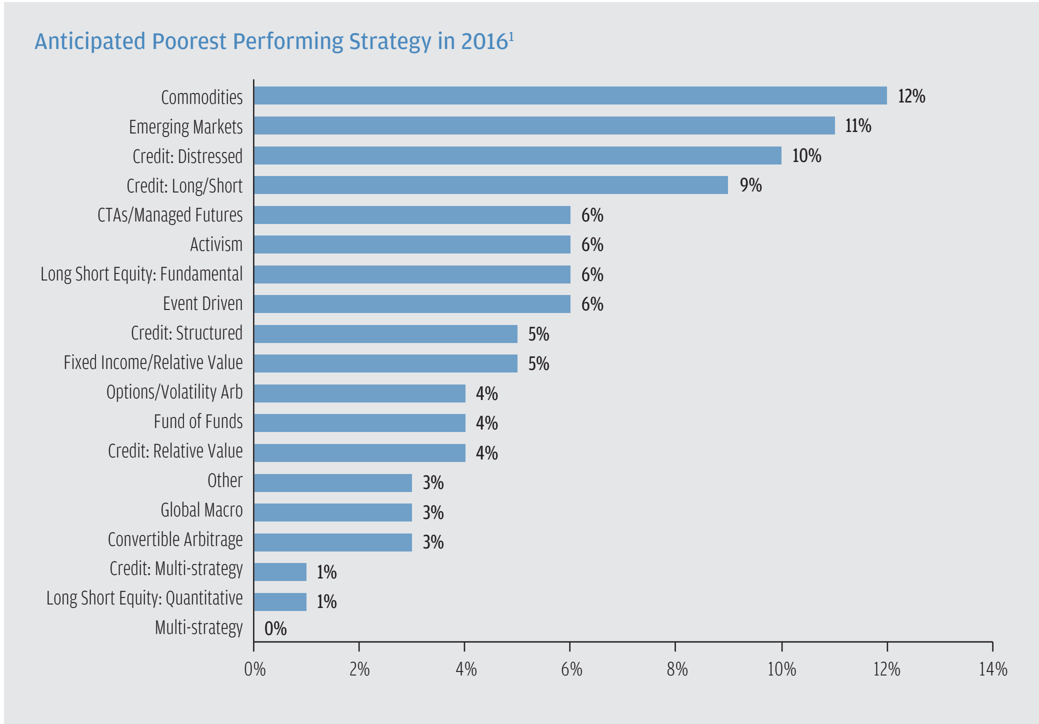
For the 2016 Survey, respondents had 19 strategy selection options. For the 2015 and 2014 Surveys, respondents had 15 and 25 strategy selection options, respectively

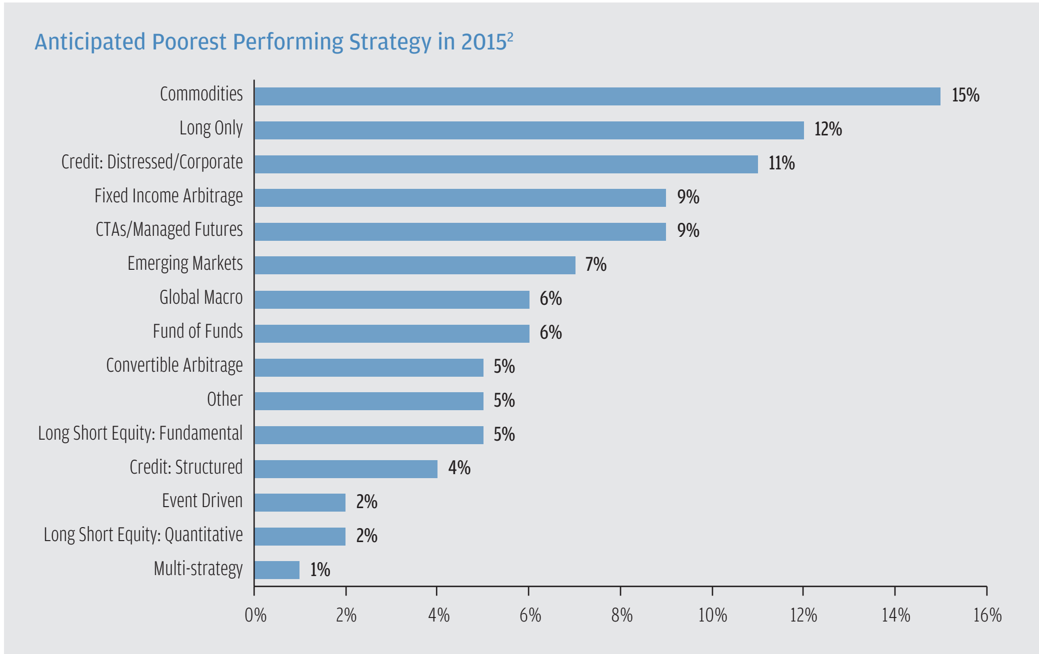
Anticipated Best Performing Strategy in 2016 by Investor Type[1]

	Bank	Consultant	Endowment & Foundation	Family Office	Fund of Funds	Insurance Company	Pension	RIA
Activism	4%	0%	0%	1%	4%	0%	9%	0%
Comodities	4%	0%	0%	0%	3%	0%	0%	0%
Convertible Arbitage	0%	0%	0%	1%	1%	0%	0%	0%
Credit: Structured	0%	4%	0%	8%	2%	10%	5%	0%
Credit: Long/Short	0%	0%	0%	1%	1%	0%	0%	0%
Credit: Multi-strategy	0%	0%	6%	1%	0%	0%	0%	0%
Credit: Relative Value	0%	0%	0%	1%	1%	0%	0%	0%
Credit: Structured	0%	4%	0%	0%	1%	0%	0%	11%
CTAs/Managed Futures	4%	7%	0%	8%	5%	10%	5%	0%
Emerging Markets	4%	7%	6%	4%	2%	20%	5%	11%
Event Driven	16%	7%	6%	3%	3%	10%	0%	11%
Fixed Income/ Relative Value	4%	4%	0%	1%	3%	0%	18%	0%
Fund of Funds	0%	0%	0%	1%	1%	0%	0%	0%
Global Macro	**24%**	**22%**	12%	18%	13%	**40%**	**27%**	0%
Long Short Equity: Fundamental	20%	**22%**	**59%**	**29%**	**35%**	10%	5%	**44%**
Long Short Equity: Quantitative	0%	0%	0%	7%	9%	0%	0%	0%
Multi-strategy	12%	15%	6%	6%	5%	0%	9%	11%
Options/Volatility Arb	0%	0%	0%	4%	4%	0%	14%	11%
Other	8%	7%	6%	3%	3%	0%	5%	0%

[1] Note: Categories may not sum to 100% due to rounding

Figure 46

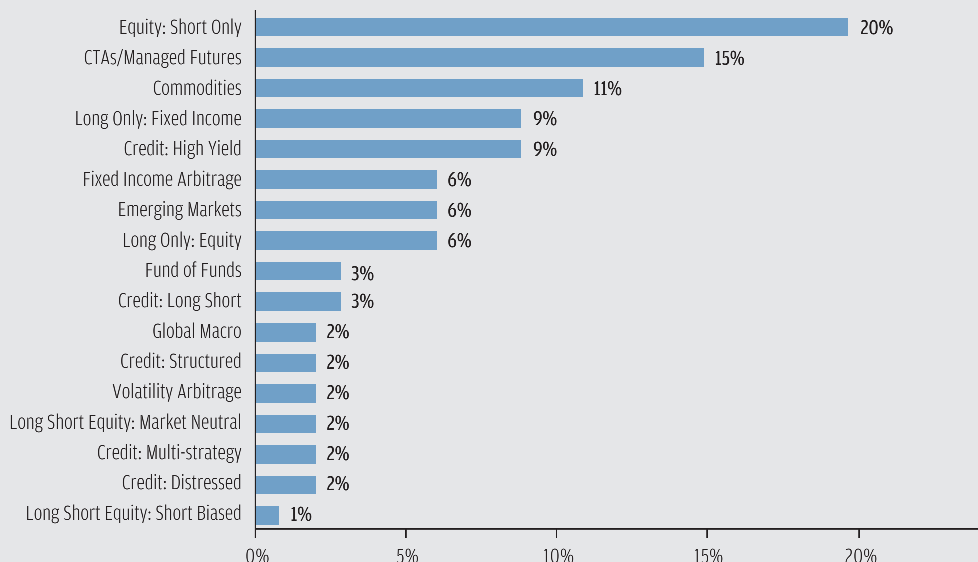




[1] Note: Figures based on selections from 269 respondents.

[2] Note: Figures based on selections from 299 respondents

For the 2016 Survey, respondents had 19 strategy selection options. For the 2015 and 2014 Surveys, respondents had 15 and 25 strategy selection options, respectively



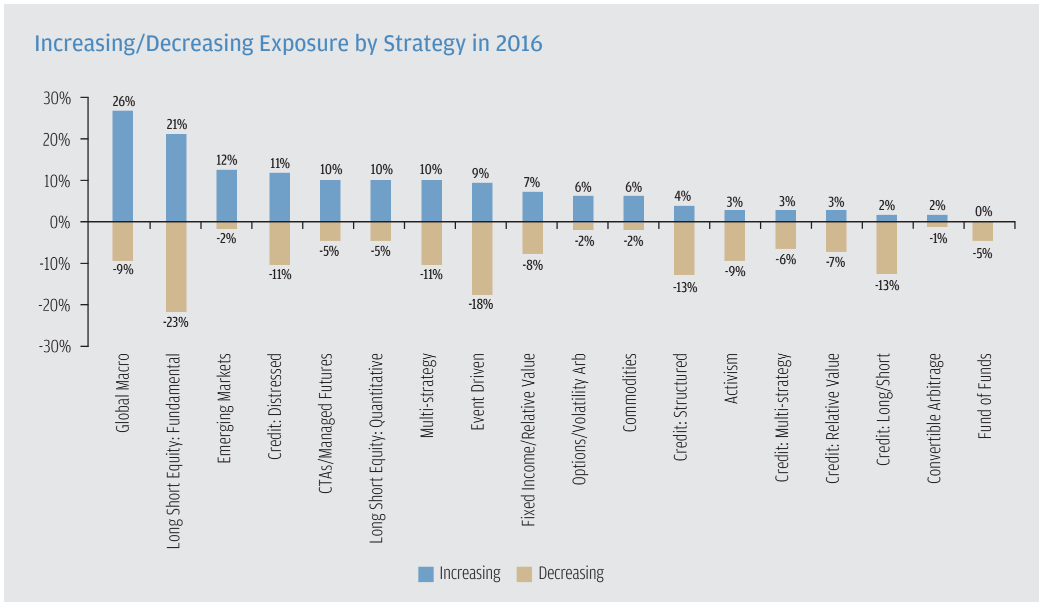
Entering 2016, over a quarter of respondents are looking to increase allocations to Global Macro.

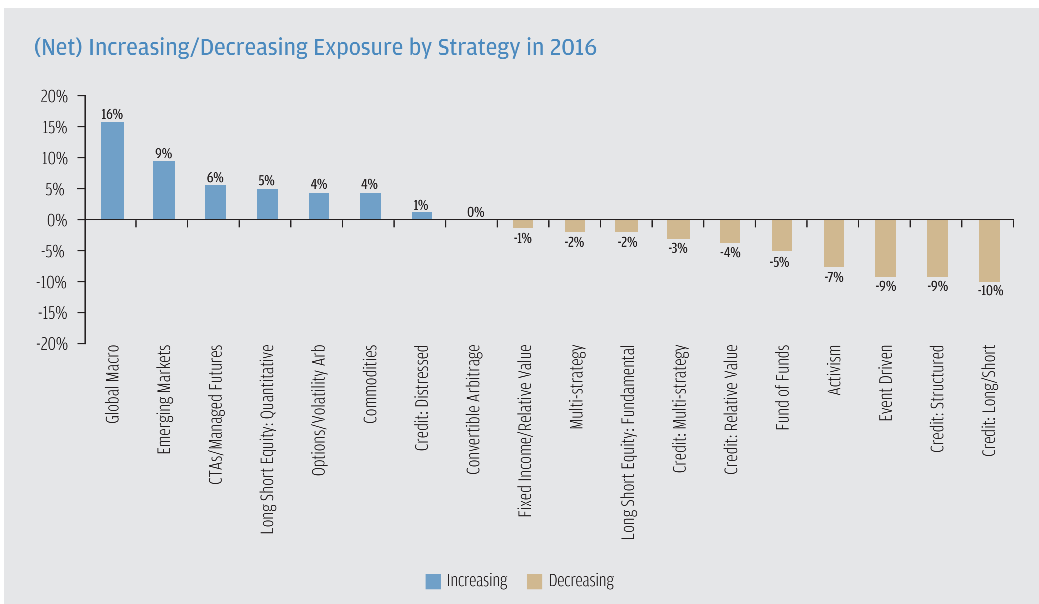
- Among Survey respondents, strategies that tend to perform well in volatile market environments are growing in interest. On a net basis, allocations to Global Macro, CTAs/Managed Futures, Quantitative Long Short Equity, Options/Volatility Arbitrage, and Commodities are all expected to increase. The last time we noted this was entering 2012, after the volatile market experienced in the second half of 2011.
- On a net basis, 16% of respondents are looking to increase allocations to Global Macro in 2016. This denotes the largest net change for any strategy indicated for 2016, compared to only 5% in 2015, highlighting a need for Global Macro in many respondents' investment portfolios.
- According to Survey participants, the most turnover activity in 2016 is expected within Fundamental Long Short Equity. 21% of respondents plan to increase allocations to the strategy vs. 23% who plan to decrease allocations.
- For the first time since our 2012 Investor Survey, more respondents plan to decrease allocations to Fundamental Long Short Equity than increase.
- Respondents are looking to reduce their exposure to Corporate Credit, Structured Credit and Event Driven strategies in 2016.
- Over the last three years, credit strategies spanning Distressed, Corporate, and Structured have experienced the worst allocation declines among respondents.

[1] Note: Figures based on selections from 249 respondents

For the 2016 Survey, respondents had 19 strategy selection options. For the 2015 and 2014 Surveys, respondents had 15 and 25 strategy selection options, respectively

Figure 47



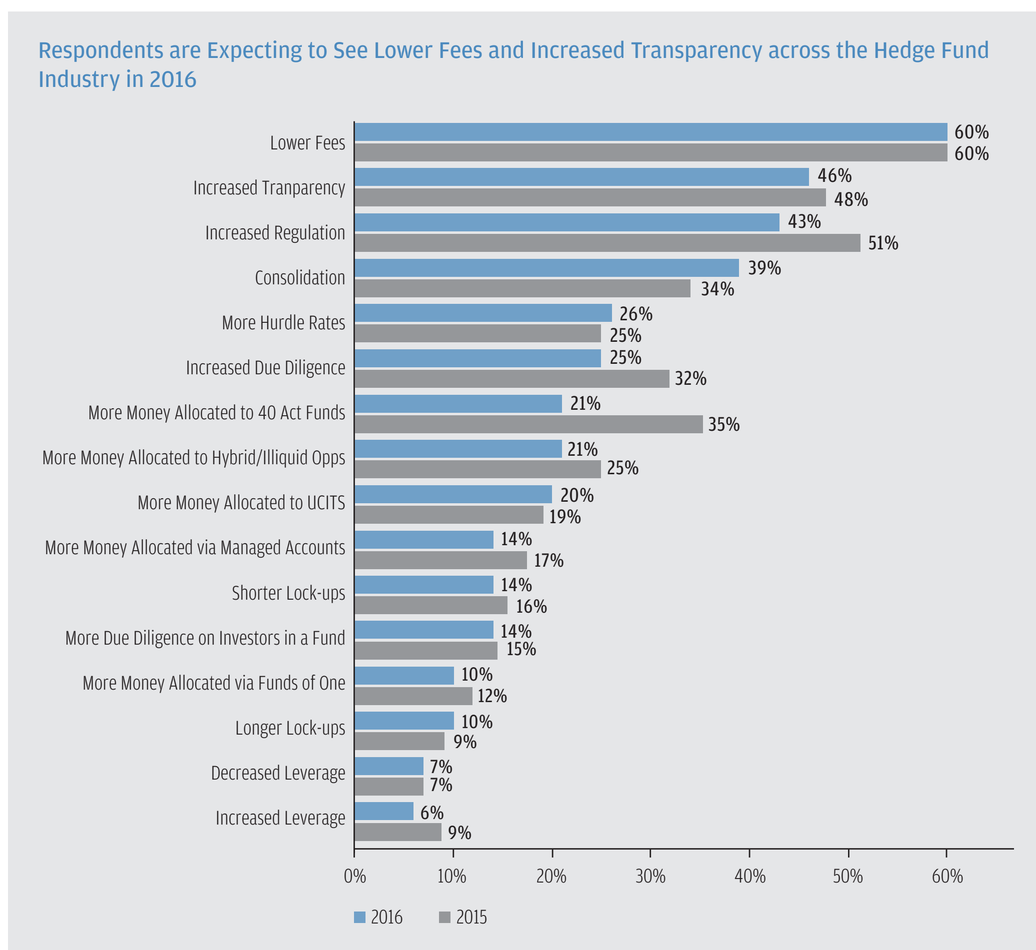


Note: Data based on 244 respondents who provided complete 2015 and expected 2016 strategy allocations data

Consistent with 2015, lower fees, increased transparency and regulation, and consolidation continue to be key trends respondents are anticipating within the hedge fund industry for 2016.

- Fewer respondents expect additional money to be allocated to 40 Act Funds compared to 2014.
- Increased regulation is not as prominent of a trend entering 2016 as it has been in the past few years.

Figure 48



Note: Forecast 2016 data is based on 1,209 selections made by 322 respondents. 2015 data is based on 1,594 selections made by 386 respondents

Conclusion

As a new year begins, despite investor capital continuing to flow into the hedge fund industry, hedge fund managers are fighting for their place in investor portfolios. Hedge fund industry scrutiny has been building over the last few years, and it only continues to do so as we enter 2016. After another lackluster year, nearly 70% of respondents indicated their hedge fund investments did not meet their targeted hedge fund portfolio return for 2015. The industry as a whole has lagged U.S. equity markets and demonstrated high correlation to broader market indices since 2012. Managers also struggled to navigate volatility in 2015. Since most allocators invest in hedge funds primarily for alpha generation, many seem ready to take action this year and upgrade managers where necessary.

Despite some disappointment, allocators remain committed to the hedge fund space. Of the respondents who did not meet their target hedge fund return for 2015, the majority did not plan to significantly alter overall portfolio exposure to hedge funds. Instead, reallocating to different hedge fund managers and different strategies in 2016 were the most common changes planned to remedy meeting return expectations for this year, highlighting a focus on manager turnover and portfolio upgrades. The most turnover activity in 2016 is expected within Fundamental Long Short Equity. Strategies that tend to perform well in volatile market environments are growing in interest. On a net basis, allocations to Global Macro, CTAs/Managed Futures, Quantitative Long Short Equity, Options/Volatility Arbitrage, and Commodities are all expected to increase this year. Global Macro, in particular, seems to be the biggest need in many respondents' investment portfolios.

Survey respondents are gradually shifting toward more global hedge fund portfolios as well. Nearly 60% of respondents are planning to increase non-U.S. hedge fund exposure in 2016. Of those respondents, about one third indicated they would either diversify across multiple geographies or allocate additional capital to Asia-focused strategies.

2015 was a mixed bag for emerging managers. While a healthy amount of investments were made, there was slightly less interest in start-up managers than observed in 2014. Allocators are approaching investing in new launches cautiously and selectively, making their tickets even more coveted. Respondents also noted that smaller (under $500mm in AUM) and/or younger (less than three years since inception) managers are typically not outperforming their larger, longer-standing peers, which may have slightly diminished start-up manager appeal in 2015. That being said, growth expectations for emerging managers in 2016 are strong.

As the number of hedge fund managers within the industry continues to increase, allocators are focused not only on investing in quality managers, but also on developing trust, respect, and meaningful relationships with their managers. Investors still require and value transparency and communication from hedge fund managers. Nearly all respondents require at least regular summary information, consistent with the past few years.

While respondents continue to focus on liquidity, products in the hedge fund marketplace continue to have a barbell effect. On one end, there is a healthy appetite for longer lock-up vehicles focused on hybrid/illiquid opportunities, as well as for co-investment opportunities. On the other end, the percentage of respondents that invest in Liquid Alternatives (40 Act or UCITS) is growing steadily year over year.

Again, we would like to thank those institutional investors who participated in this year's Survey. Without those who participated, we would not be able to share what insights we've gathered on significant hedge fund trends and industry challenges. We hope you found the information in this Survey helpful, and we look forward to seeing you at upcoming Capital Introduction events in 2016.

NOTES

NOTES

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