HFM INSIGHTS

Investor Intentions H1 21

A guide to investor thinking and allocation plans in H1 2021 and hedge fund managers' strategy for winning business

In association with

AIMA

Contents

Key findings

After a year of massive upheaval, allocators named risk management as their number-one objective moving into 2021 – something they believe hedge fund managers are best placed among alternative asset classes to deliver. Diversification and niche opportunities are also key hedge fund selling points.

Based on surveys and interviews conducted with 65 alternatives investors and 135 senior hedge fund IR and marketing professionals during Q4 2020, *Investor Intentions H1 2021* provides hedge fund managers with a window into the thinking of prospective clients, and investors with critical intelligence on the plans and sentiment of their peers.

Investors were more likely to be "very satisfied" with their hedge fund portfolio than any other alternative asset class in 2020, with only private debt achieving a greater overall satisfaction rating in our survey.

And while performance concerns have been a bugbear of investors for several years, in 2020 hedge funds not only met, but exceeded investor expectations in this regard. Managers must be careful to avoid becoming victims of their own success in 2021, with performance expectations now set even higher.

Satisfaction is feeding through to investment plans, with over 40% of investors surveyed expecting to allocate more capital to hedge funds in H1 2021. The outlook for alternatives more broadly is also strong. All alternative asset classes will see a boost, compared to long-only products where money is likely to flow out of fixed income funds.

For their part managers expect to focus their efforts on the vast North American market, with single and multi-family offices, as well as endowments and foundations, key targets for hedge fund IRs. While investors expect to formally meet with an average of 15 new hedge fund managers during the first half of the year, many of these meetings are still likely to take place virtually.

Indeed, despite three vaccine candidates having shown a high degree of efficacy at the time of writing, managers still expect socially distanced forms of interaction to be the most fruitful sources of new leads in H1 2021. Initial scepticism of virtual cap intro events has worn off and managers are embracing new ways of capital raising that will likely endure, at least in part, when the Covid-19 pandemic draws to an end. All in all, hedge funds are beginning 2021 on a positive note and primed for growth in the year ahead.

> **After a year of massive upheaval, allocators understandably named risk management as their number-one objective**

#1 Over **40%** of investors plan to increase their allocation to hedge funds in the first half of 2021

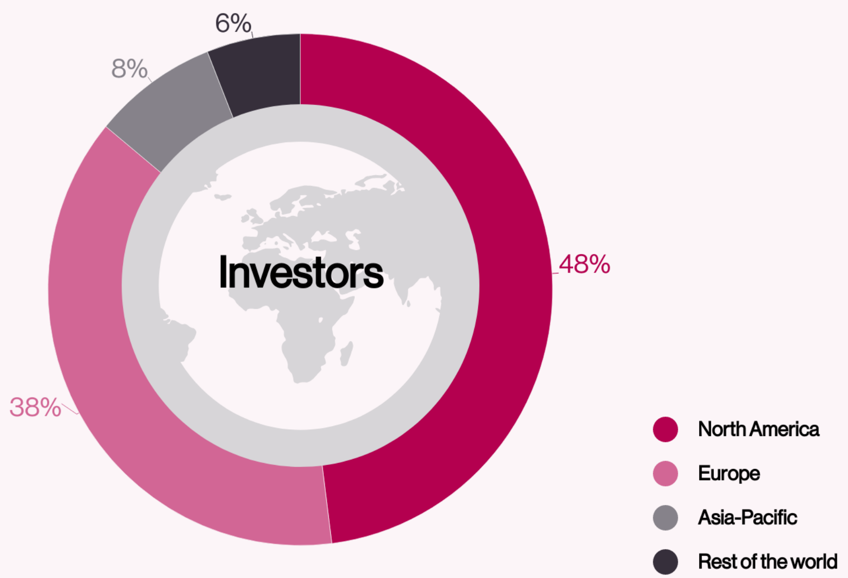
#2 Over **90%** of investors are satisfied with the performance of hedge fund investments in 2020

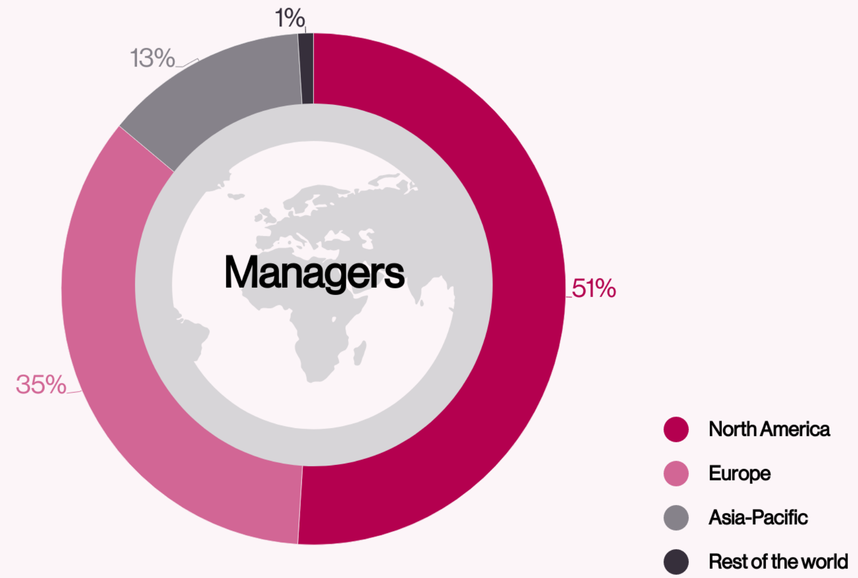
#3 Hedge fund IR professionals are most likely to target **US family offices** in H1 2021

#4 **Quantitative strategies** are most likely to see inflows in H1 2021, followed by arbitrage/relative value and global macro

#5 The proportion of IRs that expect cold calling to yield the most new leads fell **three fifths** from H2 20 to H1 21

About the respondents





65
alternative investors

$3.8trn
in total investor assets

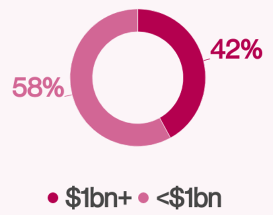
$156bn
invested in hedge funds

39%
Institutions

32%
Private wealth

29%
Intermediaries

135
hedge fund managers



Section 1

Investor sentiment

Investors are very satisfied with hedge funds' 2020 performance

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Investor satisfaction is high

Have hedge funds delivered on investor expectations in 2020? More investors were "very satisfied" with hedge funds than with any other alternative asset class and hedge funds received the second-highest overall rating.

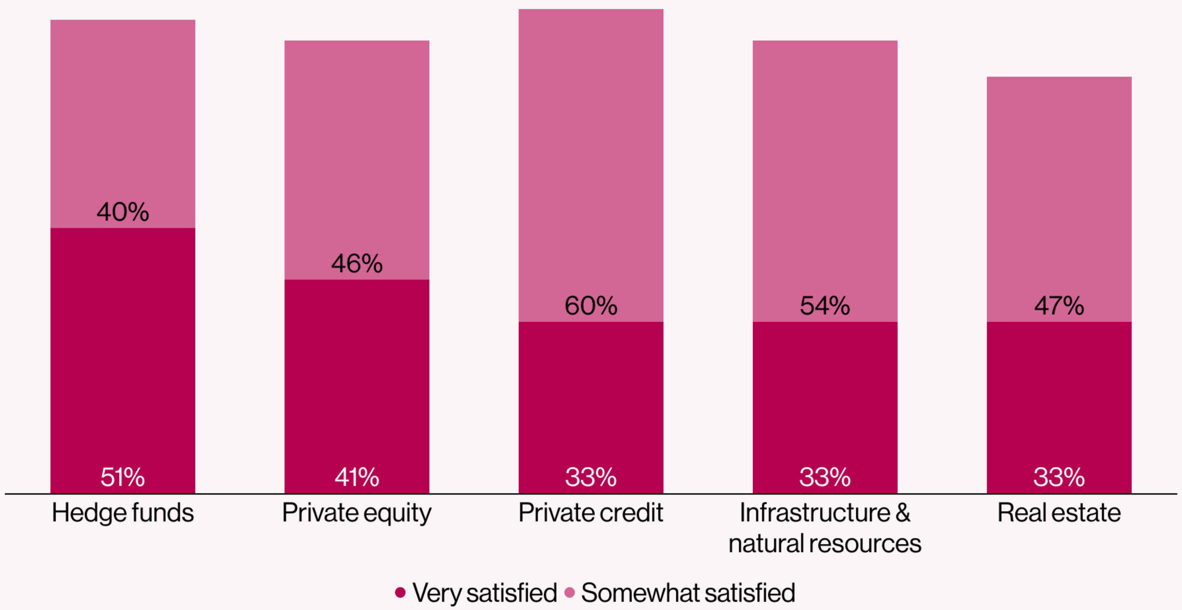
Private credit remains popular

Investors were most satisfied with private credit on an overall basis, but many noted the lack of distressed opportunities this year as swift stimulus measures from central banks and governments left a short window to take advantage of them.

Why it matters

Hedge funds have performed better than most investors expected at the beginning of 2020 and start 2021 on the front foot. Managers can take pride in this but should also prepare for heightened investor expectations as a result.

Exhibit 1.1: Investor satisfaction with alternative asset classes' performance in 2020



Analyst note: Data excludes funds of hedge funds

Source: HFM-AIMA

Our private debt portfolio disappointed, but that was due to too many level 2 assets and not enough level 3

- European asset manager

European investors are most likely to be pleased with their hedge fund portfolio

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All investor types satisfied

All categories of allocator were satisfied with their hedge fund portfolio in 2020. Intermediaries and private wealth investors were the most pleased, offering even better prospects for IRs in the new year.

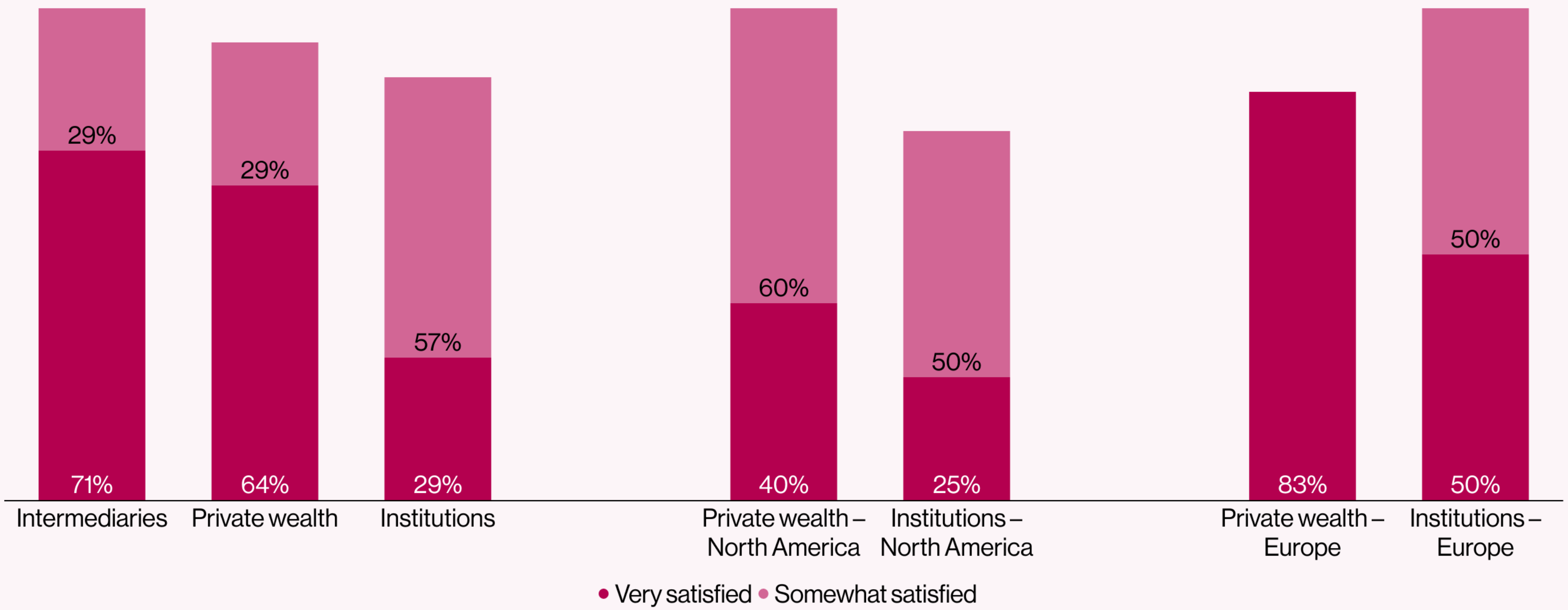
Including demanding US institutions

IRs will be pleased to see high levels of satisfaction among dominant North American investors, with three quarters of institutions in the region happy with 2020 performance. Europeans were even more satisfied than American peers.

Why it matters

86% of institutional allocators are somewhat or very satisfied with hedge funds' 2020 performance. After a challenging few years hedge fund IRs should take advantage of these high levels of institutional satisfaction.

Exhibit 1.2: Investor satisfaction with hedge fund performance in 2020 by investor type and location



Analyst note: Data excludes funds of hedge funds

Source: HFM-AIMA

Risk management is investors' number-one objective

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Risk management before returns

After a turbulent year, risk management is investors' top priority moving into 2021. This, combined with projections of anaemic equity market returns and a "lower for longer" interest rate environment, bodes well for hedge funds.

Illiquidity concerns overstated

Despite recent concern over illiquid investments, increasing liquidity is towards the bottom of investors' list of priorities. Consequently, hedge funds will continue to face stiff competition from private markets funds within the alts bucket in 2021.

Why it matters

Although investors pulled almost $90bn from hedge funds in 2020 much of this was due to redemptions from a handful of larger firms. On the whole, hedge funds have successfully managed risk, investors' top objective, during a volatile period.

“

We want to use alts to capture long-only returns, while also mitigating risk

- US family office

”

Exhibit 1.3: Allocators' top investment objectives in H1 2021

Overall	Institutions	Private wealth	Intermediaries
Managing risk 97%	Managing risk 96%	Managing risk 100%	Enhancing returns 100%
Enhancing returns 89%	Enhancing returns 84%	Enhancing returns 86%	Managing risk 95%
Increasing income 48%	Increasing income 48%	Increasing income 43%	Increasing income 53%
Reducing fees 31%	Reducing fees 48%	Improving liquidity 33%	Reducing fees 32%
Improving liquidity 20%	Improving liquidity 12%	Capturing market beta 29%	Improving liquidity 16%
Capturing market beta 15%	Capturing market beta 12%	Reducing fees 10%	Capturing market beta 5%

Source: HFM-AIMA

Hedge funds are best placed to deliver risk management according to investors

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Risk management hedge funds' USP

Hedge funds are most likely among alternative investments to provide diversification and risk management benefits according to investors. This puts hedge funds in a stronger position than other alternatives to satisfy investors' needs.

Private markets for performance

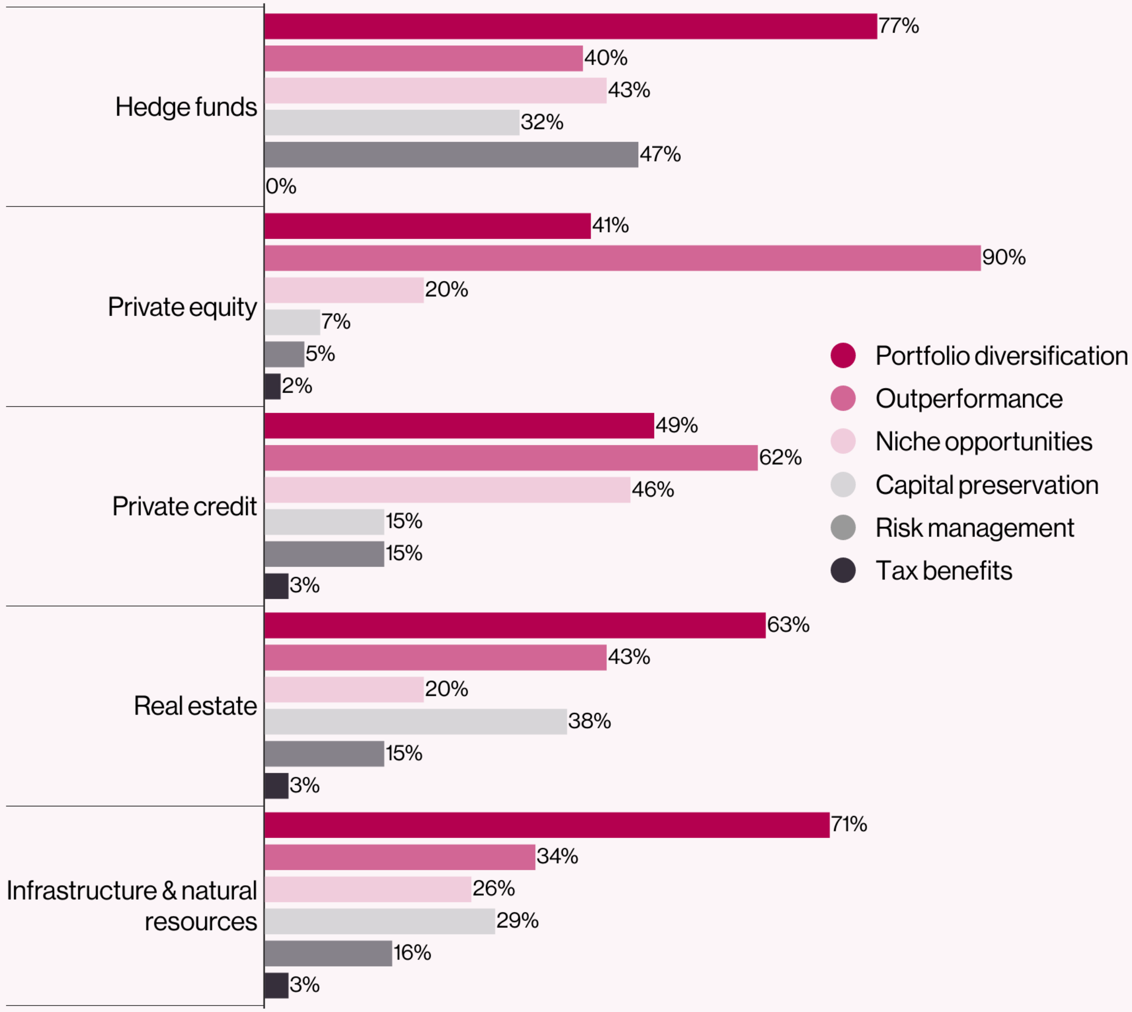
Investors believe private equity and private credit are most likely of the various alternative asset classes to meet their second investment objective: outperformance. Hedge funds came ahead of only infrastructure and natural resources on this front.

Why it matters

Rather than allowing themselves to be drawn into simplistic debates over outperformance, hedge funds should instead seek to differentiate themselves by focusing on their ability to deliver on investors' top objective in H1 2021.

> ***We've had more capital calls and fewer distributions than expected from our private equity funds***
>
> - US family office

Exhibit 1.4: Why allocators invest in alternative assets



Analyst note: Data excludes funds of hedge funds

Source: HFM-AIMA

Hedge funds exceeded investor performance expectations in 2020

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Institutions want less risk

The typical hedge fund investor expected a Sharpe ratio of 1 on returns of 8% in 2020, according to our data. Institutions have the lowest return expectations but still want a Sharpe of 1, suggesting they are more concerned about risk.

2020 performance delivers

We saw earlier that less than 50% of allocators invest in hedge funds for their outperformance; however, managers have exceeded investors' expectations here too, delivering 0.6 percentage points more than hoped for over the course of 2020.

Why it matters

While hedge funds overdelivered on returns, Sharpe ratio expectations suggest they took on greater risk to achieve this. Managers can expect to field conversations on this topic in 2021, when the bar for performance is set even higher than in 2020.

"If you want double-digit returns you have to be willing to digest some volatility as well"

- European family office

Exhibit 1.5: Median investor hedge fund annualised return expectations

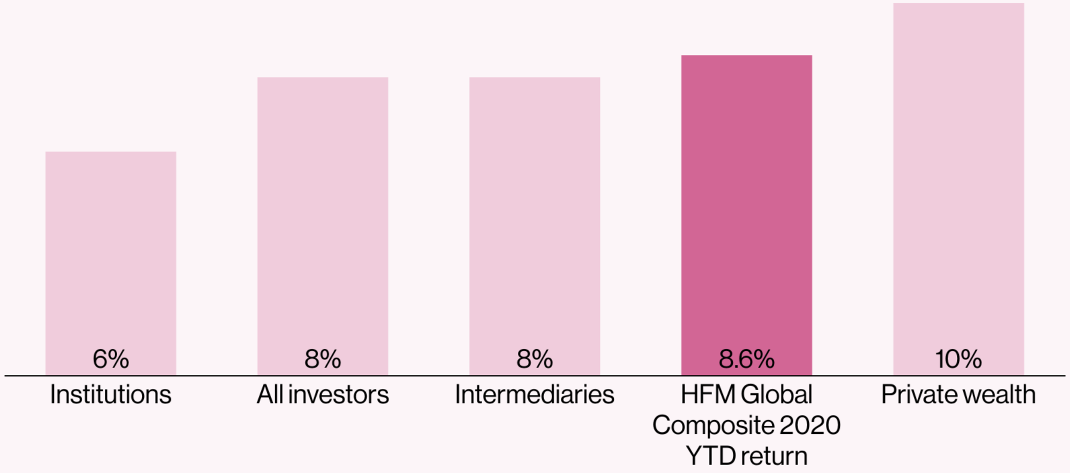
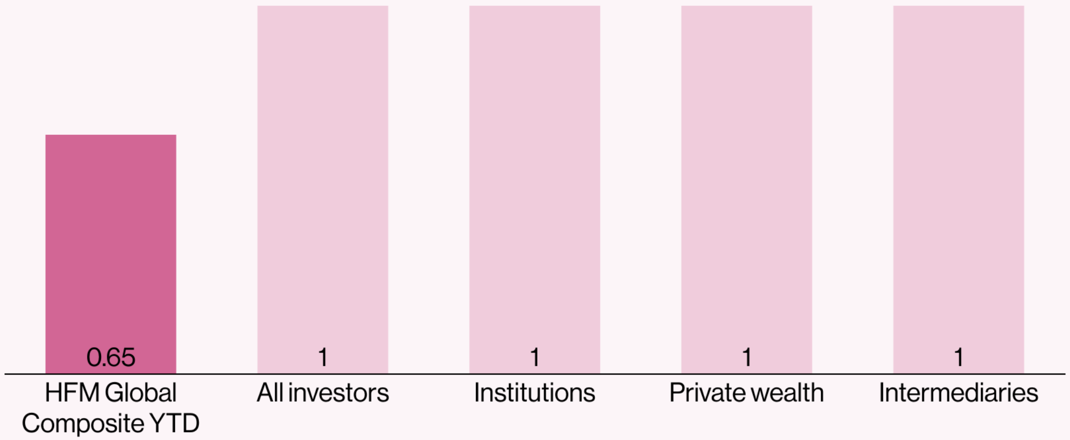


Exhibit 1.6: Median investor hedge fund Sharpe ratio expectations



Analyst note: HFM Global Composite figure based on a risk free rate of 2%. YTD performance through Nov-20

Source: HFM-AIMA

Hedge fund investors are still willing to pay 2 and 20 fees

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Fee dispersion wide-ranging

The median highest fee paid by investors is the classic 2/20 model. Despite this, there is a wide dispersion, with some investors paying as little as 50bps in management fees and 5% in performance for their most expensive hedge fund product.

Institutions pay below average

While institutions are apparently willing to pay higher-than-average performance fees, they are more likely than other investors to pay below-average management fees. This holds true in the context of institutional allocators' relatively lower performance expectations.

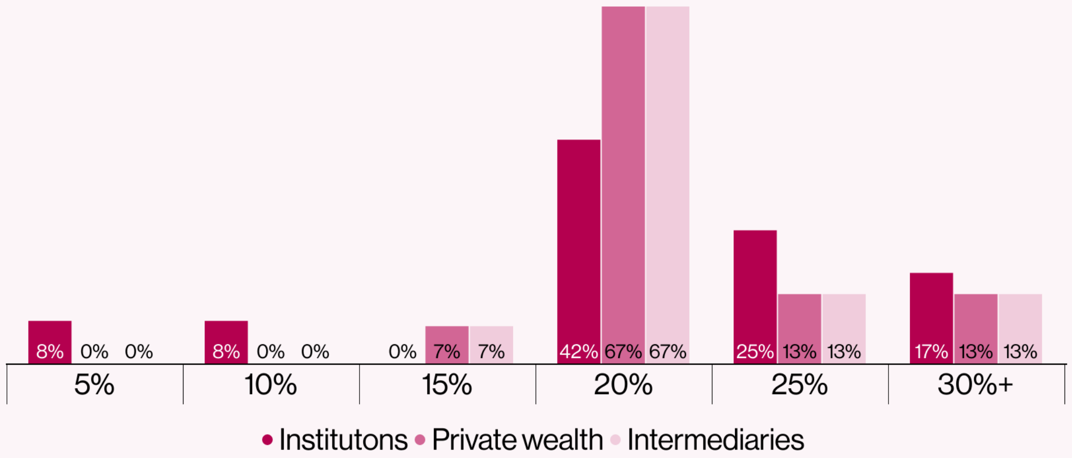
Why it matters

While there is a wide range in highest fees charged by managers, anecdotally, some hedge funds managers are actually raising fees. Investors are still willing to pay 2 and 20 our data shows, provided strong risk-adjusted returns are delivered

> *I'm not driven by fees, I'm driven by alpha, returns, Sharpe and nothing else*
>
> - US single family office

Exhibit 1.7: Highest hedge fund management fee paid by investor type

Exhibit 1.8: Highest hedge fund performance fee paid by investor type



Source: HFM-AIMA

Section 2

Allocation plans

Private wealth investors have the largest portfolio allocation to hedge funds

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Investors lean into PE and RE...

Despite strong performance in 2020, hedge funds are no longer the largest alternative asset class, with private equity and real estate now accounting for larger shares of the typical investor portfolio.

...but HNWIs prefer hedge funds

This belies the underlying picture, with private wealth investors and intermediaries still allocating more to hedge funds than to any other alternative asset class. IR interviewees suggested family offices are easier to gain access to and less picky about fees.

Why it matters

Hedge funds' relative share of the pie remains sizeable among private wealth and intermediaries, but has been declining on an overall basis. After a strong 2020, hedge funds have a chance to reverse this and maintain their relevance to investors.

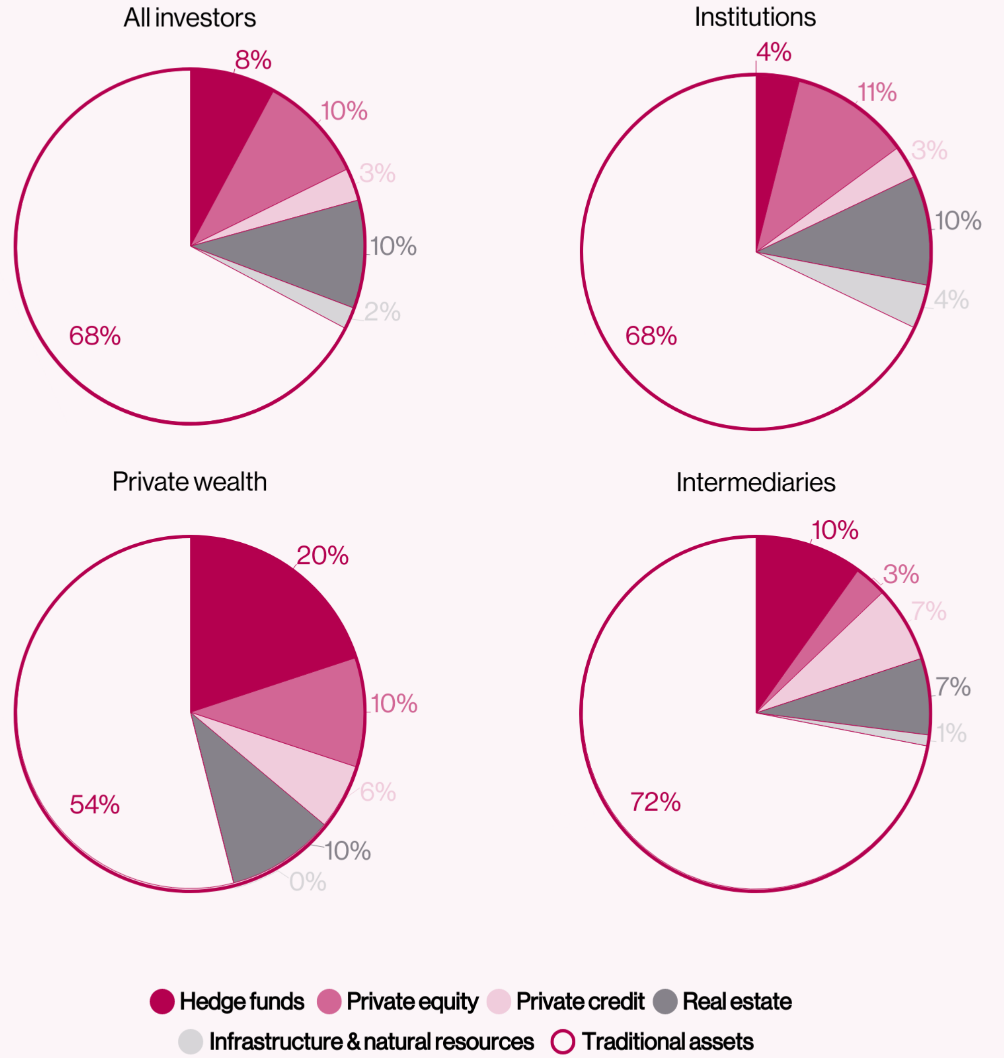
“

We want to create an all-weather, sleep-well portfolio

-European asset manager

”

Exhibit 2.1: Breakdown of investor portfolios by investor type



Source: HFM-AIMA

Hedge funds to see the biggest net rise in allocations in 2021 among all asset classes

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Tough H1 for long-only bond funds

Hedge funds are most likely among alternative and traditional asset classes to see a rise in allocations during H1 2021. This follows high levels of satisfaction among investors after strong 2020 performance.

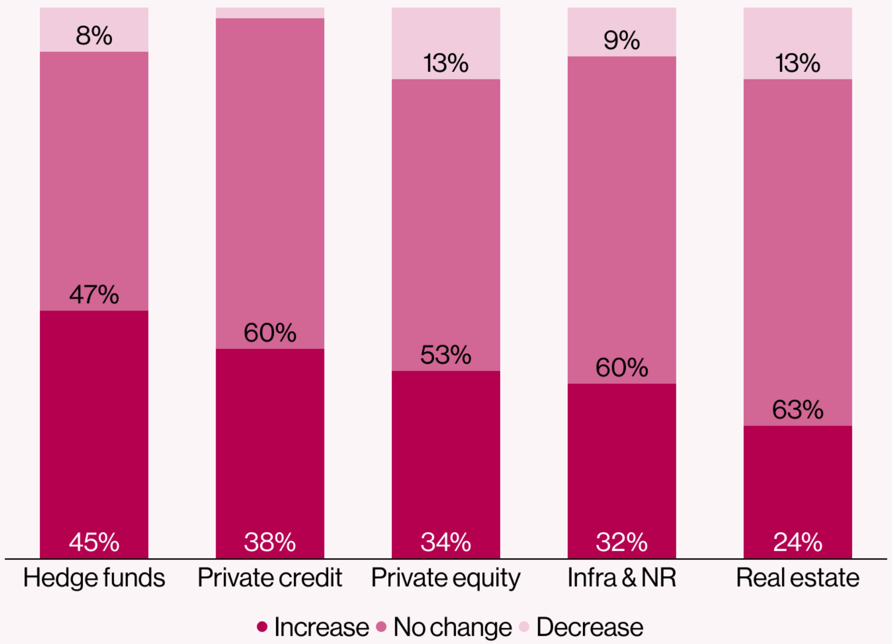
HFs respond to private debt demand

Hedge fund managers are also well positioned when it comes to other alternatives. Over one quarter offer or plan to offer private credit, the next most likely asset class to see additional investment in the first half of 2021.

Why it matters

A significant number of hedge fund managers have broadened their offering to include private equity and private credit. As demand for such products continues to rise, firms that fail to respond may be left behind.

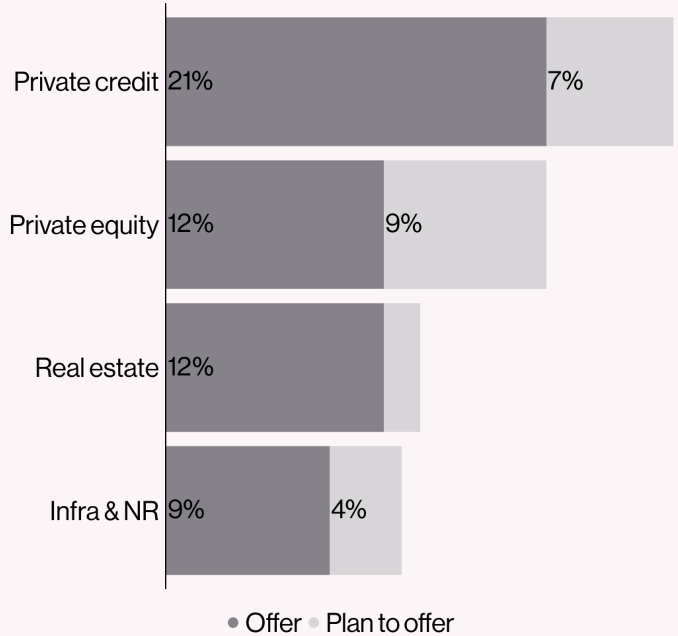
Exhibit 2.2: Investor alternatives allocation plans in H1 2021



Analyst note: Infra & NR refers to infrastructure and natural resources Allocation plans exclude data from funds of hedge funds

Source: HFM-AIMA

Exhibit 2.3: Proportion of hedge fund managers that offer other alternatives



Source: HFM-AIMA

Private wealth investors are most likely to increase their hedge fund allocation

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Demand for hedge funds uneven

Demand for hedge funds is concentrated among private wealth investors and intermediaries, as they asset class comes back into favour. As Exhibit 2.1 showed, these investors already allocate more to hedge than institutions.

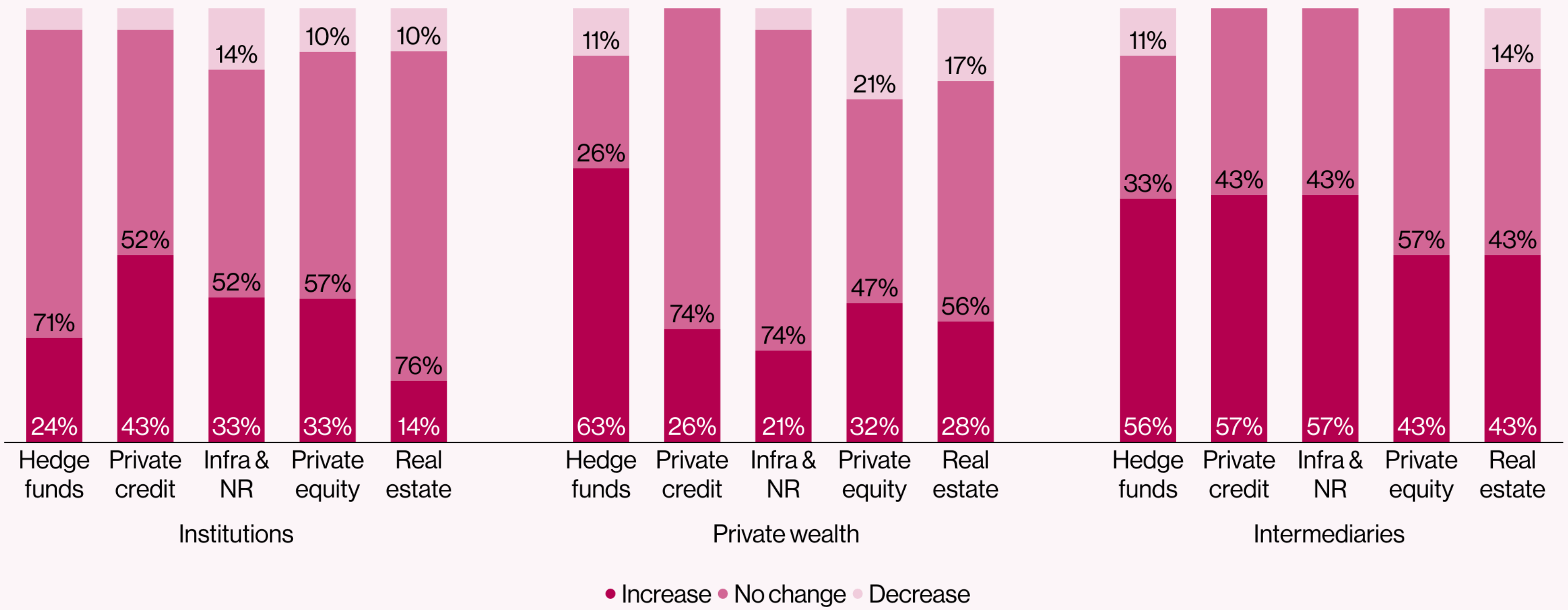
Institutions favour private markets

Institutions, for their part, are more focused on private markets than hedge funds. Private credit funds in particular are likely to see further commitments from larger allocators in H1 2021., followed by private equity.

Why it matters

Hedge funds should continue with their existing business strategy. However, managers should consider adapting private market solutions, such as co-investments, to provide the kind of niche opportunities institutions expect.

Exhibit 2.4: Investor alternatives allocation plans in H1 2021 by investor type



Analyst note: Infra & NR refers to infrastructure and natural resources Allocation data excludes funds of hedge funds

Source: HFM-AIMA

Quant/equity market neutral is the most attractive hedge fund strategy to investors

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Quant funds due inflows in H1

Despite a challenging year in 2020 for several high-profile quant managers, systematic firms are most likely among top-level hedge fund strategies to see an increase in allocations in the first half of 2021, our research shows.

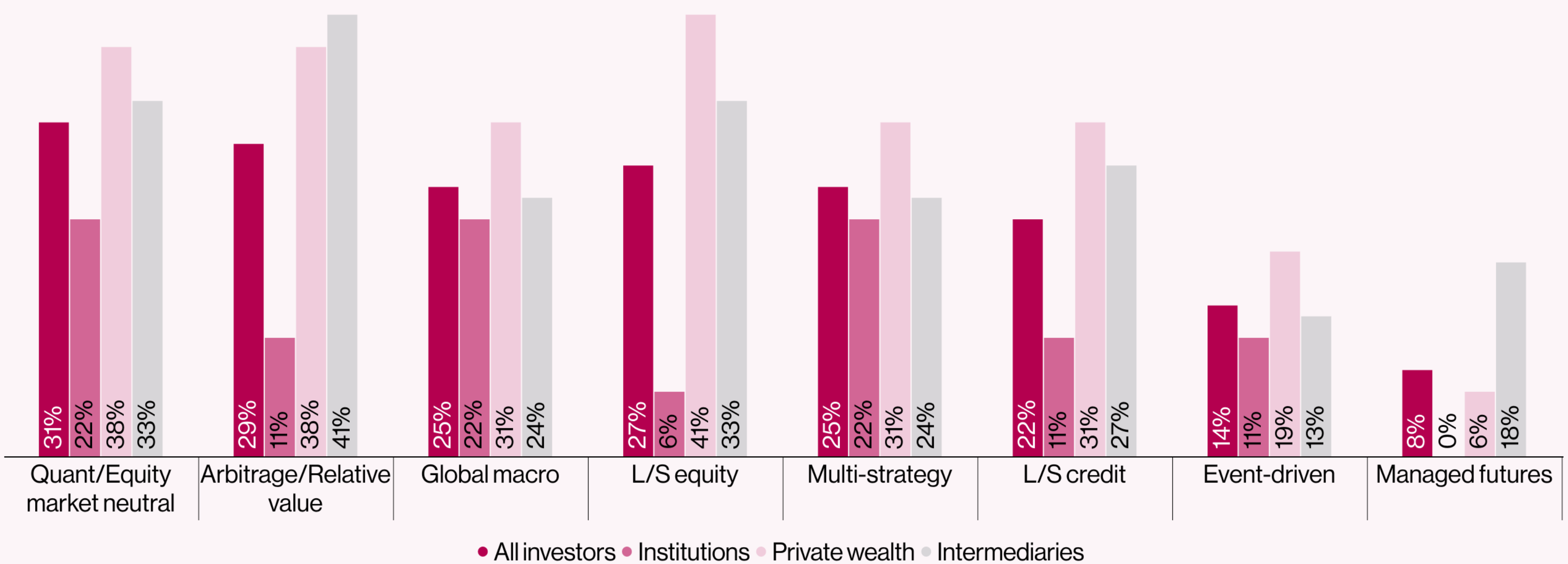
Managed futures falling out of favour

Managed futures were the top-performing hedge fund strategy at the height of March's turbulence, but whipsaws generated by sharp reversals and a sense further tail-risk events are unlikely mean managed futures are least likely to see inflows.

Why it matters

Managers across the board can expect to see interest from intermediaries and private wealth, while institutions will focus on quant, macro and multi-strategy hedge funds. IRs should adjust their marketing approach accordingly.

Exhibit 2.5: Proportion of investors planning to increase allocations to top-level hedge fund strategies in H1 2021 by investor type



Analyst note: Allocation data excludes funds of hedge funds

Source: HFM-AIMA

Most allocators are optimistic about hedge fund returns in 2021

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Even stronger returns expected

A year of outperformance has reassured allocators of hedge funds' ability to generate alpha in 2021. The expectation of better returns is the number-one reason for allocating to the asset class among investors.

Inflated equities concern investors

As we saw in section one, the principal reason for allocating to hedge funds is their risk management benefits, which dovetails with investors' second most frequently cited reason for increasing their hedge fund investments in H1: concern over equity valuations.

Why it matters

One third of investors now regard hedge funds as a possible replacement for fixed income within their portfolio. Managers should consider how best to pitch themselves to investors in the long term to capitalise on this opportunity.

“

Trees don't grow to the sky and equity valuations won't rise forever

- Apac family office

”

Exhibit 2.6: Why allocators are increasing their hedge fund allocation

All investors	Institutions	Private wealth	Intermediaries
Expectation of better returns 64%	Expectation of better returns 50%	Expectation of better returns 83%	Equity valuation concerns 67%
Equity valuation concerns 39%	Other 50%	Equity valuation concerns 50%	Expectation of better returns 50%
Fixed income replacement 32%	Fixed income replacement 30%	Private market illiquidity 42%	Fixed income replacement 50%
Other 29%	Equity valuation concerns 10%	Fixed income replacement 25%	Other 33%
Private market illiquidity 25%	Private market illiquidity 10%	Other 8%	Private market illiquidity 17%

Analyst note: Data excludes funds of hedge funds

Source: HFM-AIMA

More than a third of investors will decrease their long-only fixed income allocation

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Tough H1 for long-only bond funds

The picture for traditional assets is more mixed than for alternatives. Long-only equity products are likely to see inflows, despite high equity values, and fixed income products outflows, due to continued low base rates.

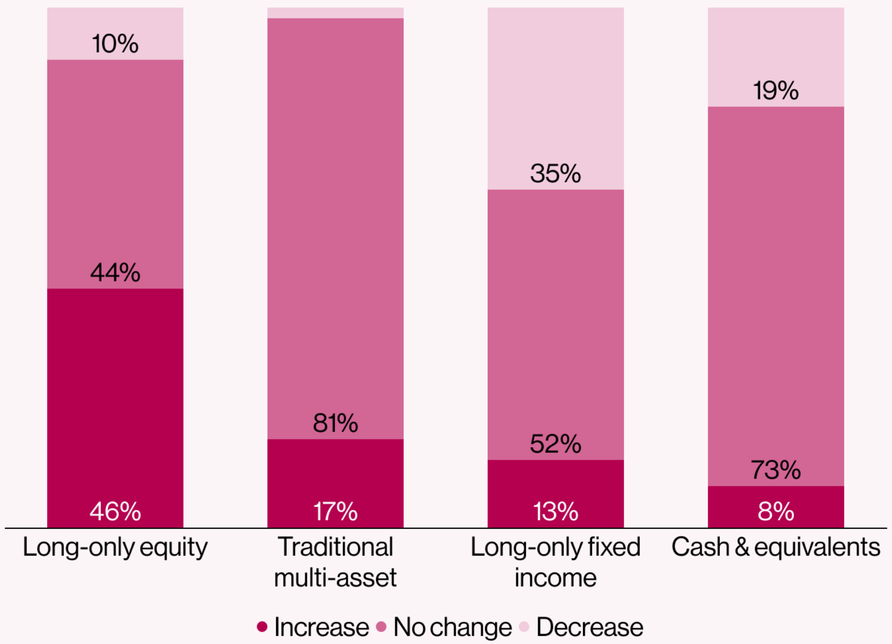
But more long-only equity launches

Hedge fund managers are again aware of market demand for long-only products with half of firms offering long-only equity products and relatively few (2%) expecting to launch long-only fixed income funds in the face of falling investor appetite.

Why it matters

A shift away from cash and fixed income products indicates investors are adding risk to the portfolio in H1 2021. Hedge funds should respond to this by highlighting their ability to manage that risk in a sophisticated manner.

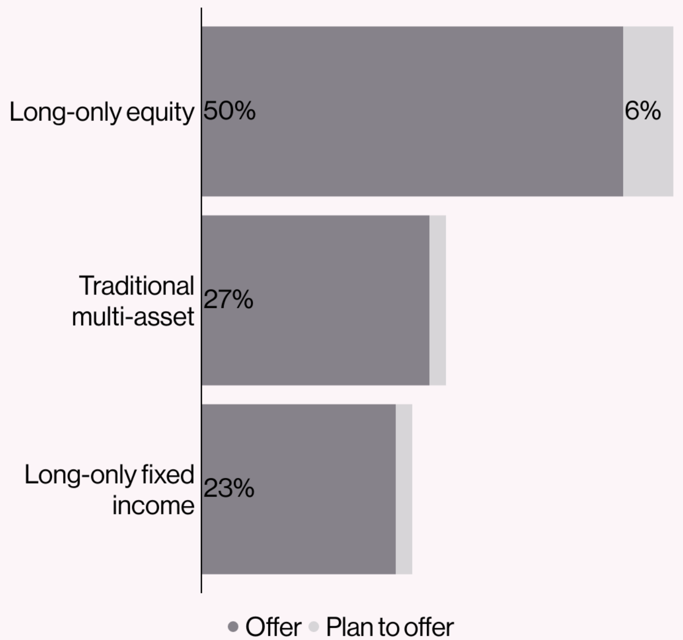
Exhibit 2.7: Investor traditional allocation plans in H1 2021



Analyst note: Allocation plans exclude data from funds of hedge funds

Source: HFM-AIMA

Exhibit 2.8: Proportion of hedge fund managers that offer traditional products



Source: HFM-AIMA

Institutions plan comparatively little change to their portfolios

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Institutions will hold steady

Breaking our data out by investor type, we see that institutions are most likely to be cautious. This group exhibits the least change across asset classes. Private wealth investors plan the most drastic portfolio alterations.

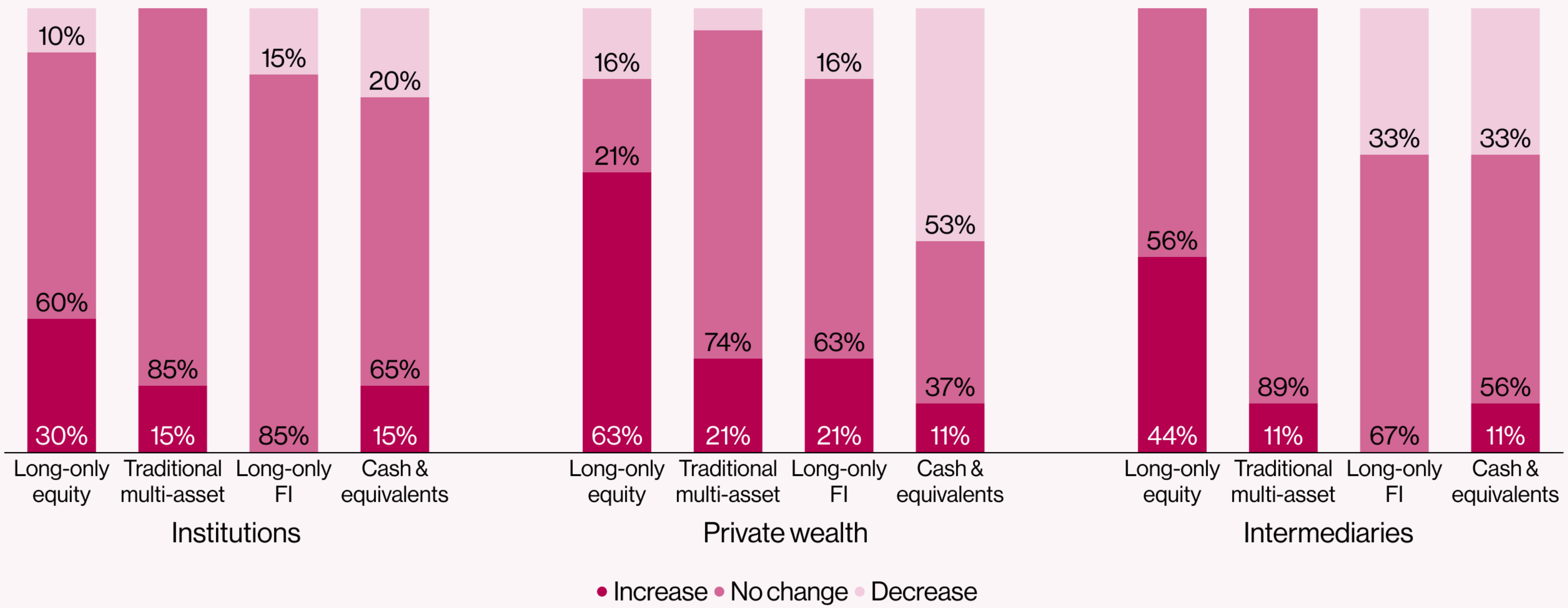
Fixed income fall may be modest

Most investors plan to pare back on long-only fixed income. But in monetary terms, this may not be so dramatic since just 15% of institutions, net, plan to decrease. As the largest holders of bonds this group's activities will be most impactful.

Why it matters

The outlook for long-only fixed income is more negative than for other asset classes. But while only private wealth investors are receptive to long-only, there is considerable appetite for credit specialists' private debt offering.

Exhibit 2.9: Investor traditional allocation plans in H1 2021 by investor type



Analyst note: Allocation data excludes funds of hedge funds

Source: HFM-AIMA

Section 3

Winning new business

Private wealth investors are managers’ top investor targets in H1 2021

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US investors most sought after

Despite higher satisfaction with hedge funds among European investors, the three most sought after investor types globally are all located in North America, reflecting the depth and breadth of American capital markets.

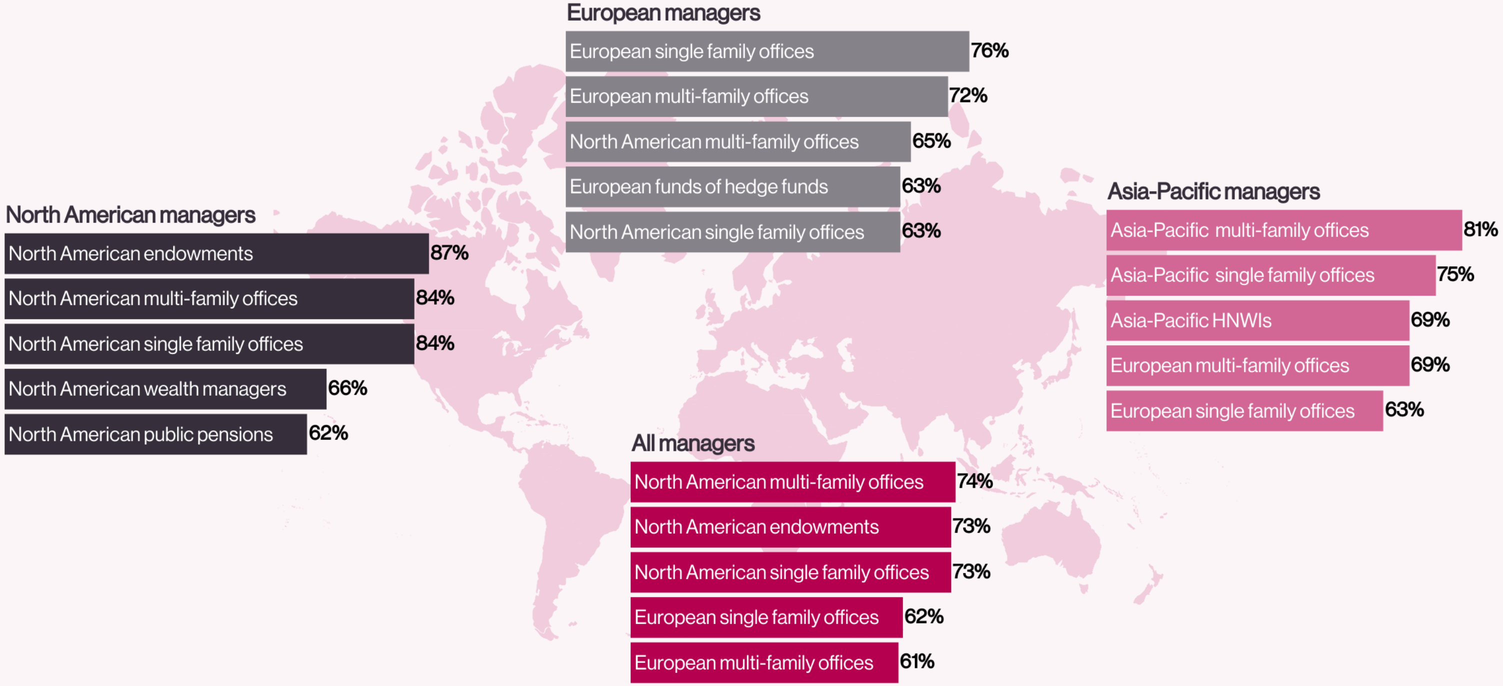
Strong competition for family offices

Private wealth investors make up four of the top five most sought after allocators globally. Capital constraints on institutions in 2020 allowed family offices access to opportunities they may not have seen pre-pandemic.

Why it matters

Those managers seeking to set themselves apart in the eyes of private wealth investors should highlight the attributes family offices and HNWIs want in hedge funds. These include niche opportunities and diversification.

Exhibit 3.1: Hedge fund managers' top investor targets in H1 2021 by manager region



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

Source: HFM-AIMA

Cold calling proved an unsuccessful strategy in H2 2020

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Cold calling to drop off in H1 2021

IR professionals will utilise broadly the same channels in H1 2021 as H2 2020, except for cold calling and emails. The sharp drop in managers expecting this to yield the most leads suggests this was not a successful strategy during the past six months.

Client referrals most promising

Even more hedge fund IRs expect to lean on existing clients for introductions to their peers during the first of half of 2021. Investment consultant introductions ranked second, as traditional, face-to-face interactions such a cap intro events remain unviable.

Why it matters

2020 acted as a proving ground for virtual fund marketing techniques. Thus, managers' experience to date shows that IRs would be better off nurturing existing relationships, which may yield valuable referrals, rather than cold calling new investors.

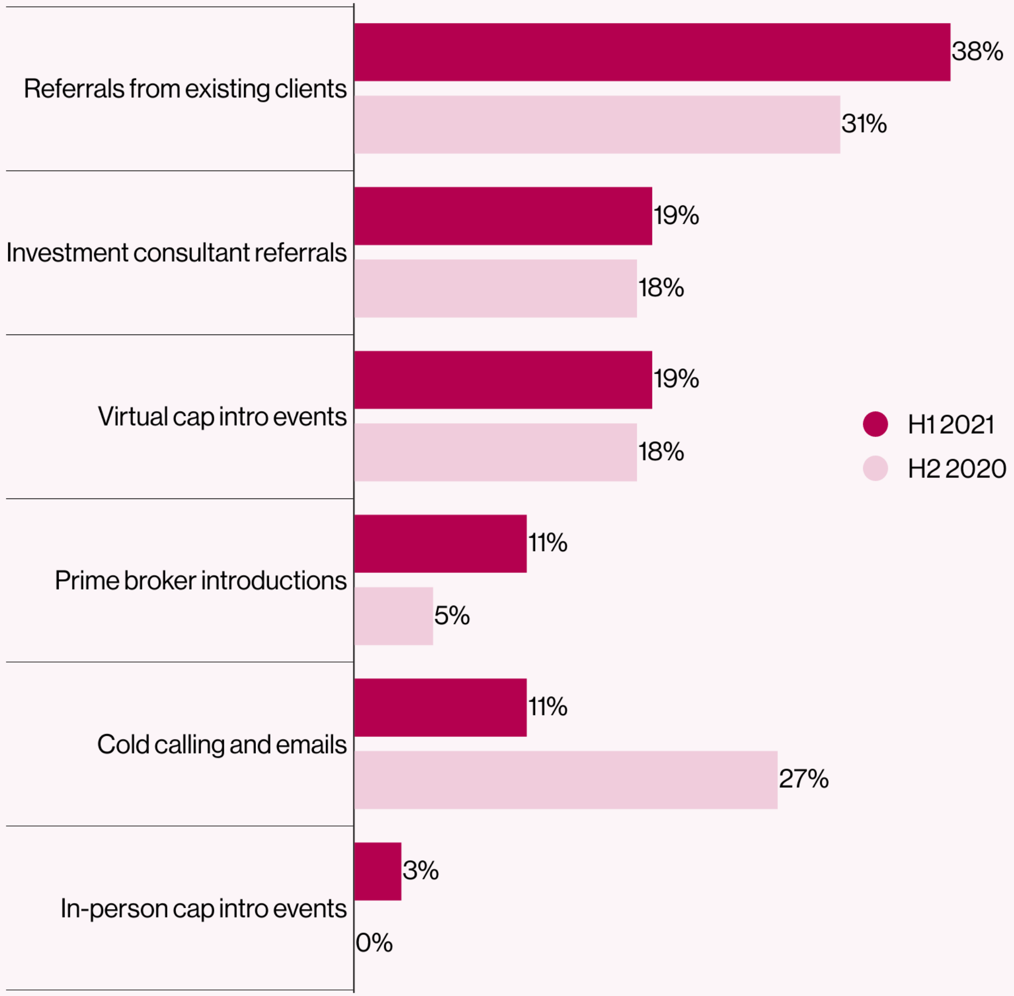
"

In 2020 I've even gone jogging with investors

- US hedge fund IR

"

Exhibit 3.2: Most promising sources of new investor leads – H1 2021 vs. H2 2020



Source: HFM-AIMA

Managers targeting twice as many new meetings as investors

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Foreign capital key to European firms

European managers were planning far more meetings than European investors, but the region is now the epicentre of a new, more infectious Covid-19 strain. Online meetings with foreign investors will have to fill the gap.

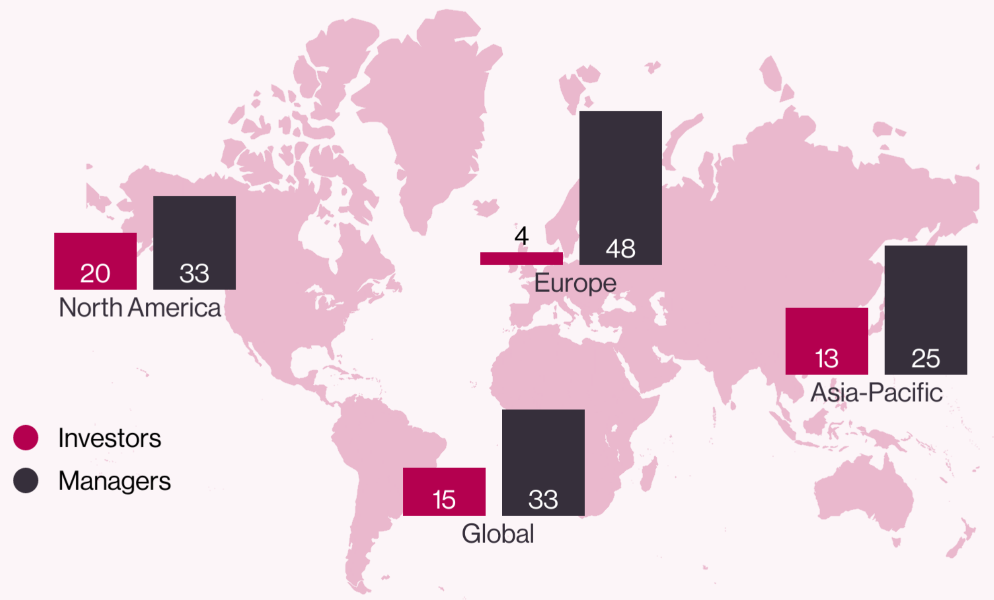
Global competition fierce

Globally, managers are targeting more than twice the number of meetings with new investors than investors are targeting with new managers during H1. This, suggests there will be strong competition for meetings with hedge fund investors.

Why it matters

Confidence over in-person meetings rose towards the end of 2020, but a highly infectious new strain of Covid-19 and fresh lockdowns means managers globally, and especially those in Europe, may need to reassess meetings targets.

Exhibit 3.3: Median number of formal meetings with new investors and managers in H1 2021 by region



Analyst note: Figures shown are median values

Source: HFM-AIMA

“

The proliferation of Zoom has allowed us to meet more managers than we normally would

- European fund of funds

”

Institutions look set to be highly selective in 2021

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Private wealth offers strong prospect

Private wealth investors are no longer likely to meet with their target of 33 new managers in person. However, the fact they were looking bodes well for hedge fund managers that have made them top targets in H1.

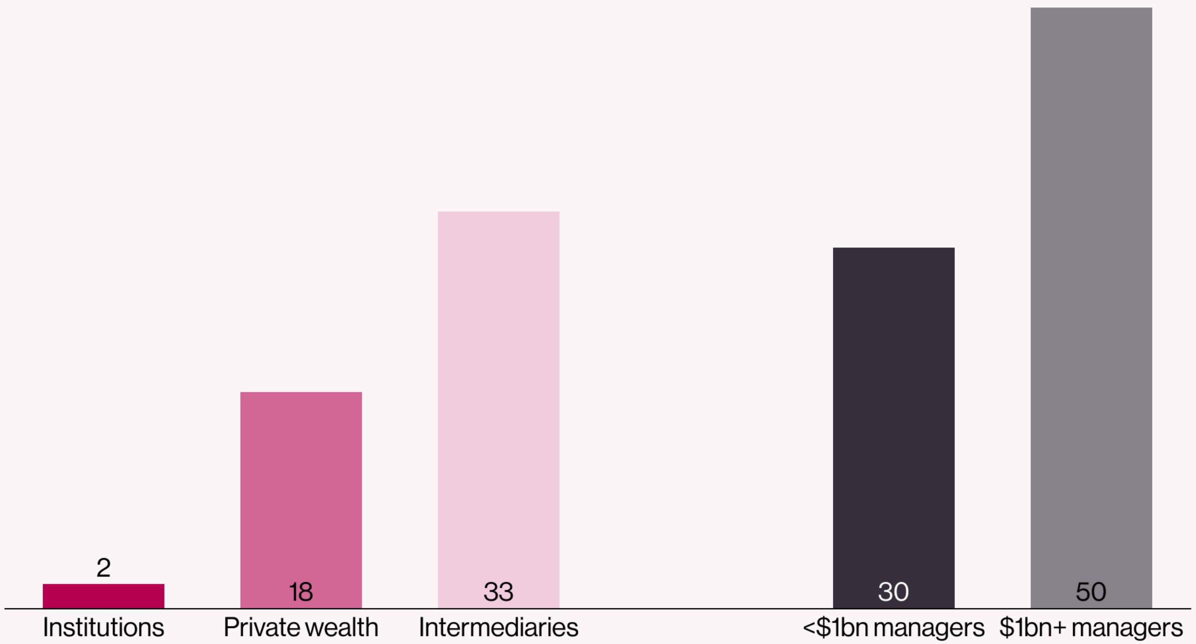
Larger firms take targeted approach

Although $1bn+ managers plan more meetings than smaller peers, on a per IR basis the number is lower for larger firms. Bigger firms will target a smaller number of large institutions, smaller managers are seeking to build awareness of their brand.

Why it matters

Building relationships with gatekeepers such as investment consultants will be more important than ever in H1 2021. Indeed, two in five institutions surveyed said they would be taking no new meetings in during the period.

Exhibit 3.4: Median number of formal meetings with new investors and managers in H1 2021 by investor type and manager size



Analyst note: Figures shown are median values

Source: HFM-AIMA

> *Anyone who can be met will be met*
>
> - US single family office

Hedge fund manager optimism over business travel rose prematurely at year end

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Europeans target foreign capital

European managers plan four times the number marketing and IR trips as North American firms and a third more than peers in Apac. This highlights the crucial role of foreign capital to European managers' H1 marketing strategy.

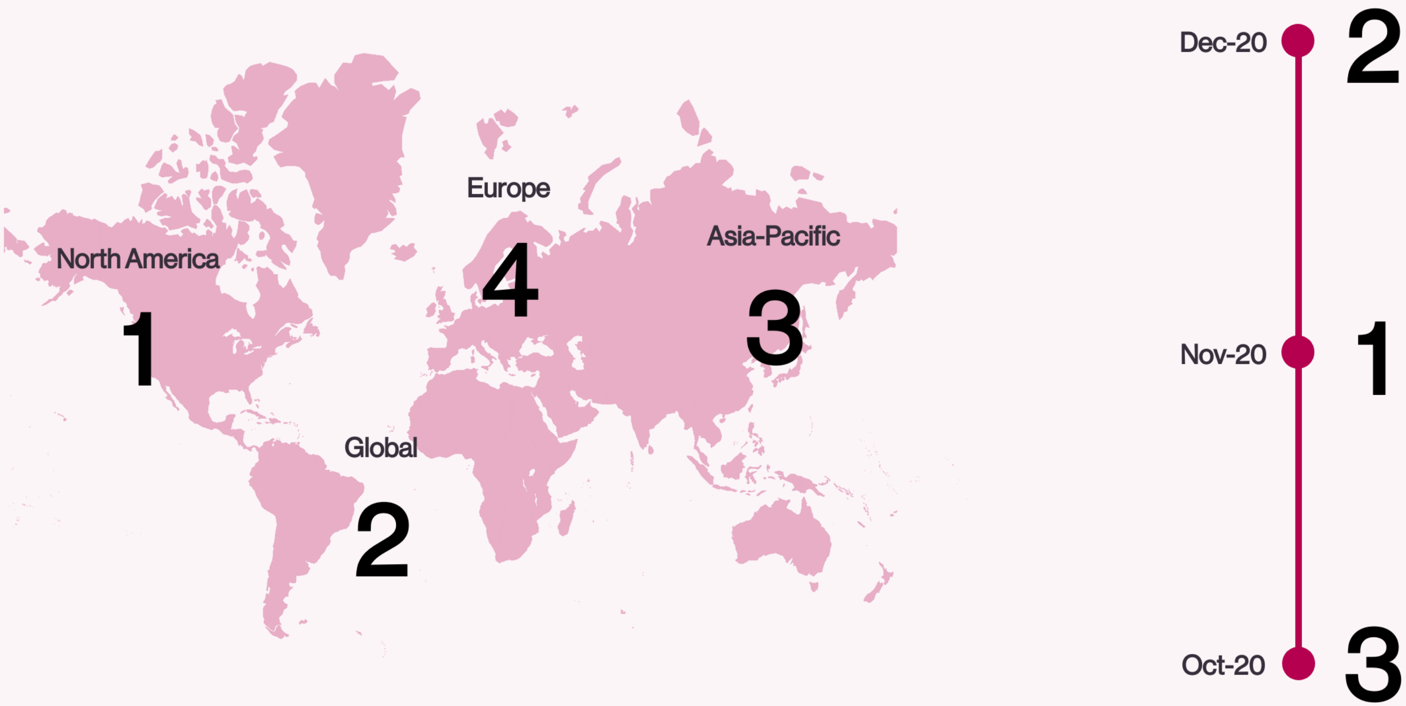
Realistic hopes for travel have faded

With the survey having been conducted throughout Q4 2020, the median number of trips planned in H1 fell from three in October to one in November, before rising to two in December, indicating initial optimism faltered, then recovered year end.

Why it matters

Re-evaluation of travel plans will be a necessary step for IRs in H1 2021 in light of new government guidance against overseas travel. Non-Americans, in particular, will have to re-assess their broader marketing strategy as a result.

Exhibit 3.5: Median number of business trips planned by hedge fund IR and marketing staff in H1 2021 by region and response date



Analyst note: Figures shown are median values

Source: HFM-AIMA

Investment consultants have been advocating consolidation of hedge fund portfolios

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Consultants push consolidation

Top hedge fund managers received eight times the capital allocated to other hedge funds via five well-known investment consultants. Consultants have lately recommended consolidation of hedge fund portfolios among fewer names.

Top managers benefit most

Boston-based Meketa was most likely to favour top managers, with firms in this category recommended by the consultant receiving 31 times the amount of capital that 'other', largely smaller, less-established hedge fund shops received.

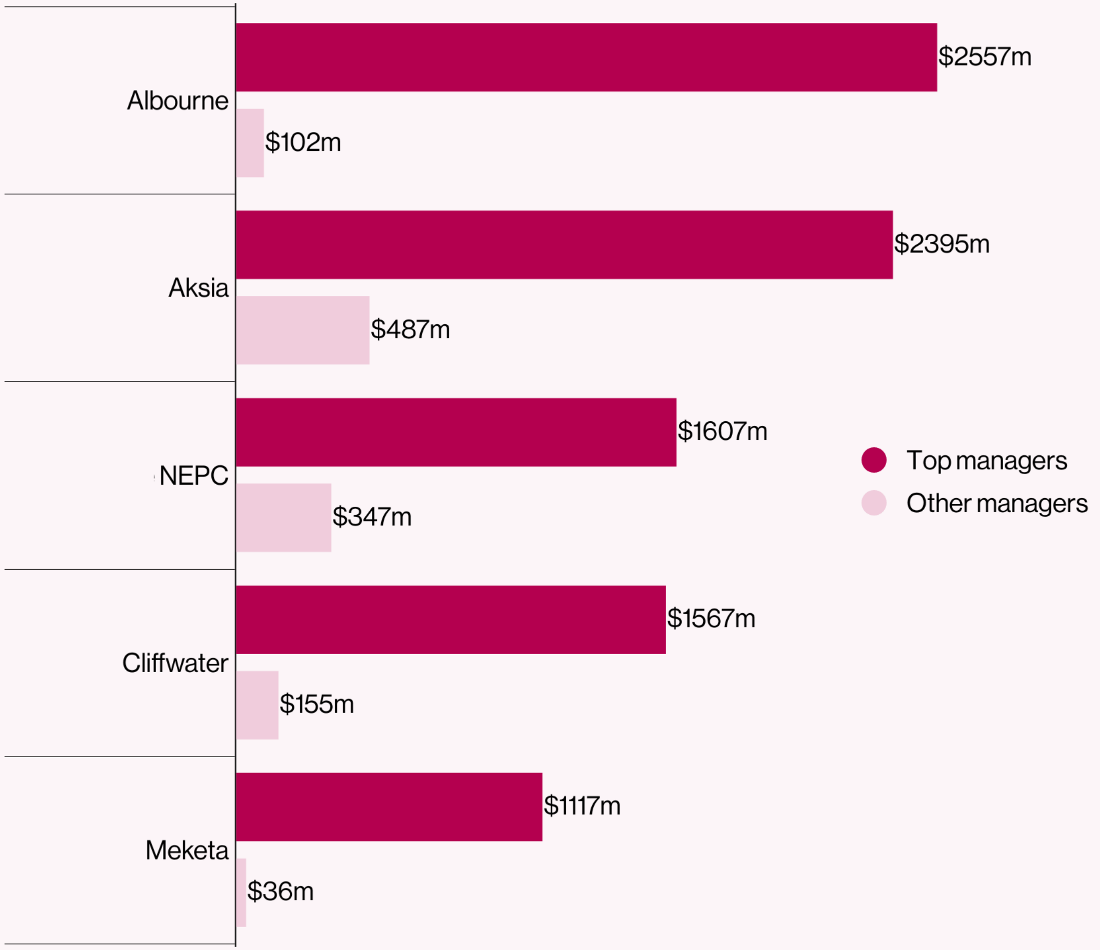
Why it matters

Smaller managers seeking to raise awareness of their funds among gatekeepers should focus their attentions on the likes of Aksia and NEPC. Other consultants are likely proving a more receptive audience to IRs at established hedge fund firms.

The team are in charge of understanding the entire pipeline of managers...doing what used to be boots-on-the-ground research that these days is more on video

- Kristen Reynolds, Partner, NEPC

Exhibit 3.6: Total dollar mandates awarded to 'top' and 'other' hedge fund managers via prominent investment consultants between January 2019 and June 2020



Analyst note: Top managers won 3 or more mandates or $100m+ in allocations via each consultant.

Source: HFM-AIMA

Takeaways

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#1 Strong 2020 hedge fund performance has led to higher levels of investor satisfaction than the industry has witnessed for some time.

#2 Meanwhile, the continued fallout from the Covid-19 pandemic has made risk management investors' number-one priority.

#3 Investors believe hedge funds are best placed to deliver this, making hedge funds the asset class most likely to see inflows in 2021.

#4 In order to win these tickets, however, managers will need to remain agile and adaptable in the face of changing government restrictions.

#5 While investors must be willing to entertain virtual IDD and ODD if they are to make the most of the opportunity set available.

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ABOUT HFM INSIGHTS

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

CONTACT HFM

James Sivyer
Head of Investor Research
+44 (0) 20 7832 6648
j.sivyer@pageantmedia.com

ABOUT AIMA

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

CONTACT AIMA

Tom Kehoe
Global Head of Research and Communications
+44 0) 20 7822 8380
tkehoe@aima.org