2018 Institutional Investor Survey
Capital Advisory Group
Introduction Letter

Our 15th annual institutional investor survey collected responses from over 250 investors globally. Hedge fund managers and investors have consistently reported that the survey helped them understand industry trends and investment behavior. We thank the investors who participate in our surveys. With your great insights, the survey has become a critical source of knowledge for our group and the hedge fund community. As in prior years, we would like to share with you our key findings:

KEY TAKEAWAYS:

What is the investor sentiment on hedge funds?

The investor sentiment towards hedge funds has turned more positive than in years past. The percentage of respondents who are bullish on hedge funds in 2018 has increased, while the percentage of those who are bearish on hedge funds has fallen.

What are investors’ concerns about their hedge fund investments?

Crowding has been the primary concern for investors when they allocate to hedge funds, while performance has continued to be the dominant reason for hedge fund redemptions. When asked the reason for hedge fund underperformance over the past several years, over 60% believed there are too many hedge funds chasing limited opportunities to generate alpha.

Has hedge fund performance in 2017 met investors’ expectations?

Investors have been lowering their return target for hedge fund investments. Given improved overall hedge fund performance in 2017, 70% of respondents indicated that their hedge fund investments achieved the return they were expecting for the year.

Have investors allocated to hedge funds in 2017?

2017 continued to witness the recycling of hedge fund capital within investors’ portfolios. Investors have been constantly adjusting and upgrading their hedge fund investments. In 2017, 83% of respondents made new allocations to hedge funds and 82% redeemed from hedge funds.

Where are investors expecting to allocate capital in 2018?

While the majority of investors expect to maintain their hedge fund exposure in 2018, capital invested in hedge funds will be recycled and reallocated across different strategies and managers. Investors are more likely to add exposure to emerging markets, event driven, quantitative equity, options/volatility arbitrage and market neutral strategies. From a geographic perspective, investors seem to be more positive on Asia Pacific and Europe, and many of them plan to increase their exposure to these two regions.

Will investors allocate capital to new launches?

Investors seem to be more opportunistic towards investing in new launches, though the bar is still very high for new launches to get into investors’ portfolios. For investors who did make allocations to new launches in 2017, the majority only added one or two managers. 27% of respondents in the survey expect their allocations to new launches to increase in 2018.

What are investors’ views on hedge fund fee structure?

Traditional “2 and 20” hedge fund fee structures continued to be challenged in 2017. The overwhelming majority of investors are paying less than 2% and 20% for their hedge fund investments. An increasing number of investors, especially those with large allocations, have negotiated or plan to negotiate fees with their hedge fund managers. In 2017, 45% of respondents were able to receive fee reductions that were based on the size of their investments (size discount), while 38% received fee discount given the length of their investments (loyalty discount). Though the “1 or 30” fee structure was widely discussed throughout the year, only a small percentage of investors actually implemented it in 2017.

What are investors’ preferences for liquidity?

Liquidity is important to investors for investments in traditional hedge fund vehicles. On the other end of the spectrum, increasing appetite for less liquid hybrid vehicles offered by hedge fund managers was observed in 2017. Investors seem to be willing to give up liquidity in exchange for access to specific investment opportunities or potential higher returns.

Have more investors been using managed accounts when investing in hedge funds?

The interest in investing via managed accounts grew in 2017, driven by various benefits managed accounts can bring to an investor’s portfolio, such as increased transparency, increased control over assets, lower fees, and customization. Of those respondents who invest via managed accounts, 40% increased their allocation to hedge fund investments via managed accounts in 2017, and 42% expect to increase their use of managed accounts in 2018.
2017 - The year in review

2017 was an exceptional year for the markets, with robust economic growth across the globe. Equities saw impressive gains in virtually every region, with emerging markets, Asia Pacific, and the U.S., in particular, rising more than 20% over the course of the year. These gains were driven by strong corporate earnings, which rose across the board, even in markets that did not see strong equity growth due to currency fluctuations. Most of the negative political risks anticipated for the year failed to manifest, and the U.S. tax package passed late in the year was yet another positive catalyst for markets.

Hedge funds delivered the best annual performance since 2013, with the HFRI Fund Weighted Composite Index gaining 8.54% in 2017. On an asset-weighted basis, the performance was 6.49%, which indicated lower returns from larger managers in general. However, hedge funds on average continued to underperform the broader markets. In 2017, the S&P 500 Index generated a total return of 21.8%, while the iShares MSCI World Index returned 21.1% – more than double the average return of hedge fund managers.

Hedged equity strategy led positive performance, with the HFRI Equity Hedge (Total) Index up 13.16% in 2017. Within the strategy, the dispersion of returns managers generated was high. Managers with large exposures to the technology or healthcare sectors have generally performed well, while those that invest in energy or basic materials had a tougher time putting up performance. Global macro managers struggled with performance over the past several years, partly because the markets were largely distorted by central bank policies across the globe. 2017 was no exception. The HFRI Macro (Total) Index returned 2.25%, the lowest among all the major strategies categories.

Improved performance in 2017 did not seem to alleviate the heavy pressure on hedge fund fees as institutional investors continued to question the traditional “2 and 20” fee structure. The rise of passive index-tracking funds and lower-fee alternative risk premia strategies has changed investors’ perceptions of what they should pay for hedge fund managers. Alpha will and should continue to be rewarded, but investors are reluctant to pay full fees on more commoditized beta, which they believe was often disguised as alpha. Over the past few years, an increasing number of investors have been exploring different ways to reduce the fees, such as negotiating fees with hedge fund managers, using managed accounts and investing in lower-fee alternative products or share classes. Most investors have focused more on lowering management fees while placing less scrutiny on performance fees. However, how performance fees should be charged is under more discussion. The implementation of hurdle rates, less crystallization frequency and the addition of clawback provisions are some of the changes investors are hoping to see. In response to the fee pressure, many hedge fund managers have lowered their fees to reward investors that have larger allocations and longer partnership. Alternative fee structures have been adopted to better align investor and manager interests, such as “1 or 30” fee structure or a scaling-down fee structure that is tied to AUM. More hedge fund managers have also been focusing on operational efficiency to bring down their internal costs.

2017 saw net capital inflows of $9.8 billion to hedge funds, bringing the total industry assets to $3.21 trillion. Not all fund managers have benefitted equally, though. According to data from Hedge Fund Research, managers with assets below $500 million have taken the vast majority of the net inflows, while those with over $1 billion in assets saw the most outflows in 2017. Although performance is not the only driver for capital flows, managers that outperformed their peers generally saw positive asset flows. Despite the net inflows to the industry, the environment for capital raising continues to be difficult. Fund liquidations are expected to outnumber new fund launches once again in 2017, the third consecutive year. In fact, consolidation continued to be one of the top three industry trends investors are expecting to see.

The hedge fund industry is certainly undergoing both structural and cyclical changes. Fund managers will continue to evolve as a result of the ever-changing market environment, technologies and regulations. Luckily, most investors are still committed to their hedge fund investments and will continue to rebalance and upgrade their portfolios, more prudently and selectively.

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

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I. Investment criteria and preference for hedge funds

A. Overview of survey respondents

• J.P. Morgan’s Capital Advisory Group conducted its 15th annual Institutional Investor Survey in November and December 2017. Responses from 251 institutional investors were collected.¹ Family offices and fund of funds represent the largest number of respondents, accounting for 34% and 28% of the total respondents respectively.

• The respondents’ aggregate assets invested in hedge funds were close to $600 billion at the end of 2017. The intermediaries – consultants and fund of funds – represent 72% of the assets.

• Geographically, 71% of the respondents are from the Americas, representing 83% of the total assets invested in hedge funds.

1 Each chart in this report is based on the actual number of respondents to that specific question. Totals in the charts may not add up to 100% due to rounding.
B. The role of hedge funds in investor portfolios

As in prior years, the majority of investors surveyed continued to view hedge funds as an alpha generation tool within their overall investment portfolios. The percentage of investors citing alpha generation as their primary reason for investing in hedge funds fell slightly from last year's survey.

- While 65% of all respondents consider portfolio diversification among the top three reasons they invest in hedge funds, only 15% of investors consider it a primary reason, with more considering it a secondary or tertiary priority.

- 57% of respondents employ hedge fund investments to gain access to select or niche opportunities. Those that view this as the primary reason for hedge fund investing represent 19% of the survey’s respondents.

**FIGURE 3: Top three reasons for investing in a hedge fund**

<table>
<thead>
<tr>
<th>Reason</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Access to select/niche opportunities</td>
<td>57%</td>
</tr>
<tr>
<td>Access to specific markets</td>
<td>17%</td>
</tr>
<tr>
<td>Alpha generation</td>
<td>84%</td>
</tr>
<tr>
<td>Correlation benefits</td>
<td>36%</td>
</tr>
<tr>
<td>Downside/tail risk protection</td>
<td>39%</td>
</tr>
<tr>
<td>Leverage</td>
<td>1%</td>
</tr>
<tr>
<td>Portfolio diversification</td>
<td>65%</td>
</tr>
</tbody>
</table>

Note: Figure based on selections from 251 respondents.

**FIGURE 4: Breakdown of top three reasons for investing in a hedge fund**

<table>
<thead>
<tr>
<th>Reason</th>
<th>First reason</th>
<th>Second reason</th>
<th>Third reason</th>
</tr>
</thead>
<tbody>
<tr>
<td>Access to select/niche opportunities</td>
<td>19%</td>
<td>20%</td>
<td>18%</td>
</tr>
<tr>
<td>Access to specific markets</td>
<td>1%</td>
<td>6%</td>
<td>10%</td>
</tr>
<tr>
<td>Alpha generation</td>
<td>9%</td>
<td>23%</td>
<td>23%</td>
</tr>
<tr>
<td>Correlation benefits</td>
<td>5%</td>
<td>16%</td>
<td>15%</td>
</tr>
<tr>
<td>Downside/tail risk protection</td>
<td>7%</td>
<td>16%</td>
<td>16%</td>
</tr>
<tr>
<td>Leverage</td>
<td>0%</td>
<td>1%</td>
<td>0%</td>
</tr>
<tr>
<td>Portfolio diversification</td>
<td>15%</td>
<td>18%</td>
<td>32%</td>
</tr>
</tbody>
</table>

Note: Figure based on selections from 251 respondents.
Given that the majority of investors consider alpha generation as their primary reason for hedge fund investing, the second and third most common reasons these investors selected were examined further. Closely following the patterns of other investors, 30% of them view access to select/niche opportunities as the second most important criteria, while 40% consider portfolio diversification as the third most important.

FIGURE 5: Other reasons considered by investors who view alpha generation as the primary reason

Note: Figure based on selections from 212 respondents.

- An examination of these investor priorities geographically shows alpha generation to be the top reason for the majority of investors in the Americas at 57%, while fewer consider it such in Europe, Middle East & Africa (44%), and even fewer in Asia Pacific (38%).

- 35% of Asia Pacific investors consider access to select/niche opportunities to be the top reason for investing in hedge funds, higher than those in Europe, Middle East & Africa at 23% and significantly higher than those in the Americas at 15%.

FIGURE 6: Top reasons for investing in a hedge fund across region

Note: Figure based on selections from 249 respondents.
An analysis of investors by investor type reveals some interesting patterns.

- An unusually high share of insurance companies (23%) consider correlation benefits to be among their top reasons for investing in hedge funds. At the same time, they represent the lowest portion (31%) of any investor group that considers alpha generation a priority.

- At 35%, consultants have the highest percentage of any investor type that would consider portfolio diversification among their top priorities when investing in hedge funds.

**FIGURE 7: Top reasons for investing in a hedge fund by investor type**

Note: Figure based on selections from 251 respondents.
C. Investment criteria

Beyond the pedigree of a hedge fund manager, investment strategy and track record, the most-cited criteria when investors make hedge fund allocation decisions are risk management, communication/transparency and size of the hedge fund.

**FIGURE 8: Top three investment criteria outside of manager pedigree, investment strategy and track record**

1. Risk management: 20%
2. Communication/transparency: 14%
3. Size of hedge fund/firm: 12%
4. Lock-up/liquidity provisions: 11%
5. Drawdown statistics: 11%
6. Fees: 10%
7. Percent of liquid net worth of manager invested in the fund: 8%
8. Volatility of hedge fund: 6%
9. Composition of investors in the fund: 3%
10. Geographic accessibility of hedge fund manager: 2%
11. Leverage: 2%
12. ERISA sensitivity: 1%

Note: Figure based on selections from 231 respondents.

**FIGURE 9: Breakdown of top three investment criteria outside of manager pedigree, investment strategy and track record**

Note: Figure based on selections from 231 respondents.
Crowding continued to be the primary concern for investors when allocating to hedge funds. However, the percentage of respondents who cited crowding as the primary concern in 2017 decreased from the prior year. In fact, when asked the reason for hedge fund underperformance over the past several years, over 60% believed there are too many hedge funds chasing limited opportunities to generate alpha. Style drift, lack of liquidity and lack of communication/transparency are other most referenced concerns.

**FIGURE 10: Top concerns when investing in hedge funds**

![Diagram showing the top concerns when investing in hedge funds.](image)

Note: Figure based on selections from 231 respondents.

**FIGURE 11: Main reason for hedge funds underperforming broader market indices**

- Too many hedge funds chasing limited opportunities to generate alpha - 61%
- Inability to generate alpha on the short side - 47%
- Macro factors - 40%
- Hedge funds taking too little risk/demonstrating poor market timing - 33%
- Rising manager expenses (financing, prime brokerage, trading costs, etc.) - 6%
- Style drift - 6%
- New regulations - 3%

Note: Figure based on selections from 231 respondents.
D. AUM and track record preference

Generally, investors have become more opportunistic toward investing in smaller managers and/or early stage managers.

- 31% of survey respondents indicated they have a minimum AUM requirement when investing in hedge funds. Of those, only 25% need hedge fund managers to have more than $500 million in AUM before they can make allocations.
- Pensions, endowments & foundations, insurance companies and consultants tend to have higher minimum AUM requirements when they invest in hedge funds. All of the pensions that participated in the survey have a minimum AUM requirement of $250 million, and more than 40% of those have a minimum threshold of $1 billion.

- There is not a strong positive correlation between minimum AUM requirement and average allocation size from the 2017 survey data. However, certain investors with larger average allocations do prefer managers with larger AUM to limit their concentration risk in hedge funds.

Note: Figure based on selections from respondents in each respective year.

FIGURE 12: Minimum AUM required to invest in a hedge fund

Note: Figure based on selections from 78 respondents.

FIGURE 13: Minimum AUM required to invest in a hedge fund by investor type in 2017

Note: Figure based on selections from 78 respondents.
• 25% of survey respondents require a hedge fund manager to have a track record before they can make allocations. Of those who have a minimum track record requirement, roughly 75% would like to see managers have a track record of at least two years.

• Generally, pensions, insurance companies, endowments & foundations and banks & platforms tend to require hedge fund managers to have longer track records. All of the pensions and 86% of insurance companies need to see a track record of two years or more.

**FIGURE 14: Minimum track record required to invest in a hedge fund**

<table>
<thead>
<tr>
<th>Year</th>
<th>3 years or more</th>
<th>2 years</th>
<th>1 year</th>
<th>6 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>28%</td>
<td>15%</td>
<td>30%</td>
<td>28%</td>
</tr>
<tr>
<td>2014</td>
<td>34%</td>
<td>16%</td>
<td>29%</td>
<td>29%</td>
</tr>
<tr>
<td>2015</td>
<td>45%</td>
<td>12%</td>
<td>24%</td>
<td>34%</td>
</tr>
<tr>
<td>2016</td>
<td>35%</td>
<td>15%</td>
<td>26%</td>
<td>37%</td>
</tr>
<tr>
<td>2017</td>
<td>37%</td>
<td>19%</td>
<td>37%</td>
<td>8%</td>
</tr>
</tbody>
</table>

Note: Figure based on selections from respondents in each respective year.

**FIGURE 15: Minimum track record required to invest in a hedge fund by investor type in 2017**

<table>
<thead>
<tr>
<th>Investor Type</th>
<th>3 years or more</th>
<th>2 years</th>
<th>1 year</th>
<th>6 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks &amp; platforms</td>
<td>20%</td>
<td>20%</td>
<td>25%</td>
<td>0%</td>
</tr>
<tr>
<td>Consultants</td>
<td>38%</td>
<td>38%</td>
<td>25%</td>
<td>0%</td>
</tr>
<tr>
<td>Endowments &amp; foundations</td>
<td>20%</td>
<td>20%</td>
<td>21%</td>
<td>5%</td>
</tr>
<tr>
<td>Family offices</td>
<td>32%</td>
<td>42%</td>
<td>36%</td>
<td>7%</td>
</tr>
<tr>
<td>Fund of funds</td>
<td>14%</td>
<td>14%</td>
<td>36%</td>
<td>0%</td>
</tr>
<tr>
<td>Insurance companies</td>
<td>14%</td>
<td>29%</td>
<td>29%</td>
<td>0%</td>
</tr>
<tr>
<td>Pensions</td>
<td>29%</td>
<td>80%</td>
<td>20%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Note: Figure based on selections from 78 respondents.
E. Transparency and liquidity preference

Investors continued to require hedge fund managers to provide better transparency.

- The percentage of respondents that require managers to provide regular updates on position-level details has been increasing over the past several years.
- Banks & platforms, insurance companies and fund of funds tend to ask for higher levels of transparency from their hedge fund managers, as many of them have to provide detailed reporting to their underlying clients.

- The percentage of respondents that require high-level transparency is higher in Europe, Middle East & Africa and Asia Pacific.

**FIGURE 16: Transparency requirement**

![Bar chart showing transparency requirement from 2008 to 2017](image)

Note: Figure based on selections from respondents in each respective year.

**FIGURE 17: Transparency requirement by investor type in 2017**

![Bar chart showing transparency requirement by investor type in 2017](image)

Note: Figure based on selections from 88 respondents.
Liquidity is important to investors for investments in traditional hedge fund vehicles. The vast majority of investors still prefer quarterly or shorter redemption periods.

- Of the respondents that have a liquidity preference, 98% prefer redemption frequency of quarterly or shorter in 2017. The percentage of respondents who prefer monthly or weekly liquidity has been increasing over the past several years.
- All of the pension respondents and 80% of endowments & foundations prefer quarterly liquidity or longer. 20% of endowments & foundations could accept annual liquidity for their investments.
- Geographically, respondents based in the Americas seem to have a preference for quarterly liquidity, while Asia Pacific respondents prefer monthly liquidity. Europe, Middle East & Africa has the highest percentage of respondents that prefer managers to have weekly or more frequent liquidity terms. This may be attributable to the prevalence in Europe, Middle East & Africa of UCITS products which tend to be much more liquid than traditional hedge fund structures.

Note: Figure based on selections from respondents in each respective year.
Pensions and endowments & foundations have higher tolerance for lock-ups in general, given their relatively longer investment time horizon.

- Of the respondents that are willing to lock up their capital with a hedge fund manager, 67% will accept soft lock-up terms.
- Banks & platforms and fund of funds have the highest percentage of respondents that can accept a soft lock-up. 75% of endowments & foundations and 67% of pensions will accept hard lock-up.
- 68% of respondents’ longest acceptable lock-up period is one year.

- Half of the pensions and endowments & foundations are able to lock up their capital for three years or more. Family offices and fund of funds have the lowest percentage of respondents that are willing to accept lock-up terms of more than two years.
- Respondents in the Americas have a higher tolerance for lock-up terms of two years or more, compared with their counterparts in Europe, Middle East & Africa and Asia Pacific.
FIGURE 22: Accepted lock-up type in 2017

Note: Figure based on selections from 86 respondents.

FIGURE 23: Longest acceptable lock-up period in 2017

Note: Figure based on selections from 78 respondents.

FIGURE 24: Longest acceptable lock-up period by investor type in 2017

Note: Figure based on selections from 78 respondents.
F. Target return and target volatility

As a result of performance challenges, investors have been lowering target returns for their hedge fund investments over the past two years.

- Over 60% of respondents have set a single-digit (<10%) annual return target for their hedge fund investments in 2016 and 2017, compared to 40-45% from 2013-2015, which indicates investors’ lower conviction on the returns hedge fund managers can generate.

- The percentage of respondents that do not apply a specific target return or use a benchmark for their hedge fund investments increased slightly in 2017.

- Insurance companies and pensions tend to have a lower target return for their hedge fund investments, as many of them prioritize low correlation and downside/tail risk protection when investing in hedge funds. Higher percentages of family offices, consultants and fund of funds are seeking target hedge fund returns of 11% or more.

- Investors in the Asia Pacific region seem to have a higher target return from hedge fund managers.
• Investors' target volatility from their hedge fund investments has been relatively stable for the past several years, with the majority of respondents targeting 5-7% volatility from hedge fund managers.

• Pensions, banks & platforms and fund of funds have the most respondents who target 0-4% volatility, with 36%, 24% and 21%, respectively, in this category.

Note: Figure based on selections from respondents in each respective year.

FIGURE 30: Target volatility by investor type in 2017

Note: Figure based on selections from 225 respondents.

FIGURE 31: Target volatility by investor region in 2017

Note: Figure based on selections from 225 respondents.
G. Due diligence

Over 70% of respondents have less than five investment professionals dedicated to hedge fund due diligence.

Insurance companies and family offices have investment teams of one to two professionals. 40% of consultants have investment teams of 11 of more people.
Operational due diligence remains a critical piece of allocation decisions. The percentage of respondents who have decided against making a hedge fund allocation because of operational issues has been declining over the past few years.

- 15% of respondents either outsource their operational due diligence functions to third parties or do not have dedicated operational due diligence teams. Across investor segments, 62% of pensions and 29% of endowments & foundations outsource their operational due diligence. One-quarter of consultants have an in-house operational due diligence team of 11 professionals or more. For investors who do have an internal operational due diligence team, most have only one or two professionals.

- 35% of respondents in 2017 indicated they decided not to allocate to a hedge fund because the manager did not pass operational due diligence, compared with 37% in 2016 and 43% in 2015.

- Similar to the prior year’s survey, regulatory compliance/readiness and fund fees/expenses were the top two operational issues identified by respondents in 2017. Other operational issues that are often identified by respondents include trade processing and operations, counterparty risk, valuation policy and technology infrastructure. Though cybersecurity has been widely discussed among industry participants, it is the least cited issue identified during the operational due diligence process.

- Regionally, Europe, Middle East & Africa respondents seem to identify more issues related to trade processing and operations, counterparty risk and cash and collateral management. In Asia Pacific, operational issues related to board of directors, counterparty risk and valuation policy seem to be more prevalent.

**FIGURE 34: Size of the operational due diligence team**

Note: Figure based on selections from 222 respondents.

**FIGURE 35: Size of the operational due diligence team by investor type**

Note: Figure based on selections from 222 respondents.
**FIGURE 36: Decision against making a hedge fund allocation due to operational issues**

Figure based on selections from respondents in each respective year.

**FIGURE 37: Operational issues identified during the due diligence process in 2017**

Note: Figure based on selections from 77 respondents.
Consistently, the majority of respondents could complete their formal due diligence on a hedge fund investment within six months of engagement.

- Approximately 80% of respondents in this year’s survey indicated they could finish both their investment and operational due diligence on a hedge fund manager within six months, with 33% being able to complete the process in less than three months.

- Pensions are commonly thought to require more time on their due diligence process. However, all of the pensions that participated in this year’s survey indicated they spend less than 12 months on hedge fund due diligence, with 86% of them completing the process within three months.

- 44% of banks & platforms, 39% of fund of funds and 36% of family offices take less than three months to complete the due diligence process on a hedge fund manager.

- Endowments & foundations have the highest percentage of respondents that require at least one year to finish their due diligence.
For investors who hired consultants to help with their hedge fund due diligence, most have been using their consultants for operational due diligence.

- 14% of respondents in the survey indicated that they used consultants to help with their hedge fund due diligence in 2017. The number has been decreasing over the past several years. This could be attributable to the fact that more investors have built their internal teams to conduct hedge fund due diligence. Only 1% of respondents plan to start using a consultant in 2018.

- Pensions continued to be the prominent users of consultants, especially the public pensions that are often required to choose a consultant to advise and help manage their portfolios. 33% of insurance companies and 18% of endowments & foundations are currently using consultants.

- Nearly 90% of respondents have been relying on their consultants to perform operational due diligence, while half of them are also using their consultants for investment due diligence and research.
Note: Figure based on selections from respondents in each respective year.

**FIGURE 42: Consultant usage by investor type in 2017**

<table>
<thead>
<tr>
<th>Investor Type</th>
<th>Yes (%)</th>
<th>No, but plan to do so in 2018 (%)</th>
<th>No (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks &amp; platforms</td>
<td>94%</td>
<td>6%</td>
<td>5%</td>
</tr>
<tr>
<td>Endowments &amp; foundations</td>
<td>77%</td>
<td>9%</td>
<td>12%</td>
</tr>
<tr>
<td>Family offices</td>
<td>88%</td>
<td>12%</td>
<td>1%</td>
</tr>
<tr>
<td>Fund of funds</td>
<td>95%</td>
<td>5%</td>
<td>0%</td>
</tr>
<tr>
<td>Insurance companies</td>
<td>67%</td>
<td>33%</td>
<td>6%</td>
</tr>
<tr>
<td>Pensions</td>
<td>38%</td>
<td>62%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Note: Figure based on selections from 30 respondents.

**FIGURE 43: Primary consulting services used in 2017**

- Operational due diligence: 87%
- Investment due diligence: 50%
- Research: 50%
- Portfolio construction/manager selection: 27%
- Risk management: 20%
- CIO outsourcing: 3%

Note: Figure based on selections from 30 respondents.
II. Hedge fund: a look-back and a look-forward

A. Investor sentiment

- The investor sentiment toward hedge funds has turned more positive. The percentage of respondents who are bullish on hedge funds in 2018 has increased, while the percentage of those who are bearish on hedge funds has fallen.

- In last year’s survey, it was mentioned that investors who are more opportunistic with their allocations to alternative investments were likely to shift their allocation to private equity and/or real estate. While investors’ appetite for real estate was relatively stable, there was indeed a significant amount of capital flowing into the private equity space in 2017. This trend might carry over into 2018 as the percentage of respondents who are bullish on private equity continues to increase.

B. Hedge fund allocation

- Over 50% of respondents have more than 25% of their portfolios invested in hedge funds, while 21% of them have less than 10% allocated to hedge funds.

- Insurance companies and pensions tend to have a smaller portion of their portfolios allocated to hedge funds. 85% of insurance companies and 57% of pensions have less than 10% of their portfolios in hedge funds. Endowments & foundations have the highest percentage of respondents that have 26-50% hedge fund allocation, followed by family offices.
FIGURE 46: Percentage of portfolio allocated to hedge funds

Note: Figure based on selections from 239 respondents.

FIGURE 47: Percentage of portfolio allocated to hedge funds by investor type

Note: Figure based on selections from 239 respondents.
Consistent with expectations, family offices tend to make smaller average allocations to hedge fund managers, while pensions make the largest average allocations. In general, the average allocation from Asia Pacific investors is smaller than their counterparts in the Americas and Europe, Middle East & Africa.

- Approximately 40% of respondents make average allocations of less than $10 million per hedge fund manager, while slightly over 10% of respondents allocate more than $100 million on average per manager.
- Family offices tend to make the smallest average allocations to hedge fund managers, with 62% of them allocating $10 million or less to a manager on average. Only 7% of family offices make an average allocation of $50 million or more, well below the percentage of other investor segments.
- On the other end of the spectrum, pensions make the largest allocations per hedge fund investment on average. 64% of pensions in the survey allocate more than $50 million on average per hedge fund manager.
- Close to 50% of endowments & foundations make average allocations of $25 to $50 million to a hedge fund manager.
- Geographically, Asia Pacific investors tend to make smaller hedge fund allocations, with 38% of them making an allocation of $1-5 million, compared to 15% in the Americas and 26% in Europe, Middle East & Africa. 25% of respondents based in the Americas allocate more than $50 million on average per hedge fund manager, while the number is 18% for Europe, Middle East & Africa respondents and 12% for Asia Pacific respondents.

Note: Figure based on selections from 246 respondents.
FIGURE 50: Average allocation to a hedge fund manager by investor region

Note: Figure based on selections from 246 respondents.

C. Fees

Traditional “2 and 20” hedge fund fee structures continued to be challenged in 2017. In fact, the overwhelming majority of investors are paying less than 2% and 20% for their hedge fund investments.

- As Figure 51 shows, only 2% of respondents are paying 2% and 20% to their hedge fund managers.
- Close to 40% of respondents pay an average management fee of 1.5-1.75% to their managers, while 37% pay less than 1.5%.
- Roughly one-third of respondents are paying an average performance fee of 15-17.5% to hedge fund managers, well below the industry standard of 20%.
- In general, pensions pay the lowest management fees among all investor segments. Approximately 60% of pensions pay less than 1.5% in management fees on average.
- Banks & platforms seem to pay lower performance fees on average; 63% of them pay less than 17.5%. On the other hand, insurance companies pay the highest average performance fee; 27% of them pay 20% while 9% pay more than 20% to their managers.
- Overall, Asia Pacific investors pay more for their hedge fund investments, for both management fees and incentive fees. 50% of investors in the Asia Pacific region pay an average management fee of 1.75% or more, compared to 22% in the Americas and 20% in Europe, Middle East & Africa. With regard to performance fees, 66% of Asia Pacific investors pay more than 17.5% on average, compared to 63% in Americas and 43% in Europe, Middle East & Africa.

FIGURE 51: Average fees investors pay for their hedge fund managers

Note: Figure based on selections from 224 respondents.
**FIGURE 52: Average fees by investor type**

Note: Figure based on selections from 224 respondents.

**Management fee**

- **Banks & platforms**
  - Greater than 2%: 19%
  - 2%: 5%
  - 1.75-1.99%: 11%
  - 1.5-1.74%: 24%
  - 1.25-1.49%: 5%
  - 1-1.24%: 5%
  - Less than 1%: 6%

- **Consultants**
  - Greater than 2%: 44%
  - 2%: 42%
  - 1.75-1.99%: 43%
  - 1.5-1.74%: 40%
  - 1.25-1.49%: 35%
  - 1-1.24%: 36%
  - Less than 1%: 5%

- **Endowments & foundations**
  - Greater than 2%: 6%
  - 2%: 5%
  - 1.75-1.99%: 5%
  - 1.5-1.74%: 5%
  - 1.25-1.49%: 5%
  - 1-1.24%: 5%
  - Less than 1%: 9%

- **Family offices**
  - Greater than 2%: 26%
  - 2%: 21%
  - 1.75-1.99%: 25%
  - 1.5-1.74%: 23%
  - 1.25-1.49%: 14%
  - 1-1.24%: 14%
  - Less than 1%: 8%

- **Fund of funds**
  - Greater than 2%: 3%
  - 2%: 3%
  - 1.75-1.99%: 1%
  - 1.5-1.74%: 2%
  - 1.25-1.49%: 9%
  - 1-1.24%: 9%
  - Less than 1%: 9%

- **Insurance companies**
  - Greater than 2%: 9%
  - 2%: 9%
  - 1.75-1.99%: 18%
  - 1.5-1.74%: 18%
  - 1.25-1.49%: 14%
  - 1-1.24%: 14%
  - Less than 1%: 10%

- **Pensions**
  - Greater than 2%: 7%
  - 2%: 35%
  - 1.75-1.99%: 43%
  - 1.5-1.74%: 21%
  - 1.25-1.49%: 23%
  - 1-1.24%: 5%
  - Less than 1%: 5%

**Performance fee**

- **Banks & platforms**
  - Greater than 20%: 38%
  - 20%: 33%
  - 17.5-19.99%: 57%
  - 15-17.49%: 43%
  - 12.5-14.99%: 45%
  - 10-12.49%: 15%
  - Less than 10%: 9%

- **Consultants**
  - Greater than 20%: 16%
  - 20%: 37%
  - 17.5-19.99%: 57%
  - 15-17.49%: 43%
  - 12.5-14.99%: 45%
  - 10-12.49%: 15%
  - Less than 10%: 9%

- **Endowments & foundations**
  - Greater than 20%: 10%
  - 20%: 29%
  - 17.5-19.99%: 56%
  - 15-17.49%: 43%
  - 12.5-14.99%: 45%
  - 10-12.49%: 15%
  - Less than 10%: 9%

- **Family offices**
  - Greater than 20%: 17%
  - 20%: 36%
  - 17.5-19.99%: 57%
  - 15-17.49%: 43%
  - 12.5-14.99%: 45%
  - 10-12.49%: 15%
  - Less than 10%: 9%

- **Fund of funds**
  - Greater than 20%: 15%
  - 20%: 27%
  - 17.5-19.99%: 45%
  - 15-17.49%: 36%
  - 12.5-14.99%: 36%
  - 10-12.49%: 25%
  - Less than 10%: 9%

- **Insurance companies**
  - Greater than 20%: 9%
  - 20%: 18%
  - 17.5-19.99%: 36%
  - 15-17.49%: 36%
  - 12.5-14.99%: 25%
  - 10-12.49%: 9%
  - Less than 10%: 7%

- **Pensions**
  - Greater than 20%: 14%
  - 20%: 19%
  - 17.5-19.99%: 44%
  - 15-17.49%: 38%
  - 12.5-14.99%: 25%
  - 10-12.49%: 9%
  - Less than 10%: 7%
In 2017, 45% of respondents were able to receive fee reductions that were based on the size of their investments (size discount), while 38% received fee discounts given the length of their investments (loyalty discount).

Though the “1 or 30” fee structure was widely discussed throughout the year, only 6% of survey respondents actually implemented it in 2017.
An increasing number of investors, especially those with large allocations, have negotiated or plan to negotiate fees with their hedge fund managers.

- The percentage of respondents who have negotiated or will negotiate fees with managers has continued to increase over the years, from 38% in 2014 to 48% in 2017.
- More than 50% of consultants, fund of funds and pensions indicated they would negotiate fees with their hedge fund managers. Endowments & foundations and family offices are less active in negotiating fees.
- Not surprisingly, investors that make larger average allocations to a hedge fund manager are more likely to negotiate fees. 80% of respondents who allocate more than $100 million on average to a manager have negotiated or will negotiate fees.
- The majority of investors indicated they would negotiate both management and performance fees. 40% of these investors will also discuss a hurdle rate or preferred return with their managers.
- 43% of respondents that negotiate fees plan to do so without making any concessions. If an investor needs to make a concession(s) to get the fee discount, investors are willing to make larger allocations or lock up their capital for a longer period.

Note: Figure based on selections from respondents in each respective year.

**FIGURE 55: Respondents that have negotiated or will negotiate fees**

<table>
<thead>
<tr>
<th>Year</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>%</td>
<td>38%</td>
<td>40%</td>
<td>40%</td>
<td>48%</td>
</tr>
</tbody>
</table>

Note: Figure based on selections from respondents in each respective year.

**FIGURE 56: Fee negotiation by investor type in 2017**

<table>
<thead>
<tr>
<th>Investor Type</th>
<th>Yes</th>
<th>No, but plan to do so in 2018</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks &amp; platforms</td>
<td>44%</td>
<td>6%</td>
<td>5%</td>
</tr>
<tr>
<td>Consultants</td>
<td>50%</td>
<td>33%</td>
<td>5%</td>
</tr>
<tr>
<td>Endowments &amp; foundations</td>
<td>62%</td>
<td>26%</td>
<td>13%</td>
</tr>
<tr>
<td>Family offices</td>
<td>68%</td>
<td>31%</td>
<td>4%</td>
</tr>
<tr>
<td>Fund of funds</td>
<td>65%</td>
<td>52%</td>
<td>9%</td>
</tr>
<tr>
<td>Insurance companies</td>
<td>52%</td>
<td>42%</td>
<td>4%</td>
</tr>
<tr>
<td>Pensions</td>
<td>58%</td>
<td>50%</td>
<td>7%</td>
</tr>
</tbody>
</table>

Note: Figure based on selections from 233 respondents.
FIGURE 57: Fee negotiation and allocation size

Note: Figure based on selections from 230 respondents.

FIGURE 58: Concessions that investors are willing to make when negotiating fees

Note: Figure based on selections from 113 respondents.
D. Hedge fund flows

2017 continued to witness the recycling of hedge fund capital within investors’ portfolios. Investors have been constantly adjusting and upgrading their hedge fund investments.

- In 2017, 83% of respondents made new allocations to hedge funds and 82% redeemed from hedge funds. 68% of investors made new allocations as well as redemptions. 12% made new allocations but did not redeem from any of their hedge fund managers, while 11% redeemed from, but never allocated new capital to, hedge funds in 2017.

- Of those respondents who made new allocations in 2017, over 90% allocated capital to new hedge fund managers, while over 70% increased their allocation to hedge funds they have already invested in. The source of their capital is primarily redemptions from the managers they reduced exposure to. Over half of the respondents also cited new capital as a source for their new hedge fund allocations. Only one-third of the respondents have reallocated the capital from other asset classes to hedge funds.

- Performance continued to be the dominant reason for hedge fund redemptions, cited by close to 80% of respondents. Nearly half of respondents redeemed from hedge funds to reduce exposure to certain strategies, an exercise to adjust and upgrade their hedge fund portfolios. Style drift is one of the top concerns for investors, but it seemed to be less of a reason for investors to redeem from hedge fund managers in 2017 than in the past few years. Although fees are important considerations for investors, only 15% of respondents redeemed from hedge funds because of fees in 2017.

**FIGURE 59: New allocation to hedge funds in 2017**

- Yes: 12%
- No, but plan to do so in 2018: 6%
- No: 83%

Note: Figure based on selections from 250 respondents.

**FIGURE 60: Redemptions from hedge funds in 2017**

- Yes: 16%
- No, but plan to do so in 2018: 2%
- No: 82%

Note: Figure based on selections from 229 respondents.
FIGURE 61: Source of capital for new allocations to hedge funds in 2017

Note: Figure based on selections from 221 respondents.

FIGURE 62: Primary reason for hedge fund redemptions

Note: Figure based on selections from 193 respondents.
Given the fact that investors have been lowering their return targets for hedge fund investments over the past two years, along with improved overall hedge fund performance in 2017, 70% of respondents indicated that their hedge fund investments achieved the return they were expecting for the year. This is a drastic change from 2016, when only 24% of respondents reported that their hedge fund return target was achieved.

Consultants made up the highest percentage of respondents whose return target for hedge funds was met in 2017, followed by banks & platforms and fund of funds.

In 2017, on average, 31% of an investor’s hedge fund portfolio exceeded the investor’s return expectation, while 42% met the target return.

Of the respondents whose target returns were not met in 2017, the majority plan to reallocate capital to different hedge fund managers or different strategies. Close to 40% of respondents may seek to achieve the target return by reducing the number of hedge fund investments and increasing portfolio concentration.

Note: Figure based on selections from respondents in each respective year.

Note: Figure based on selections from 199 respondents.
FIGURE 65: Percentage of hedge fund portfolio that exceeded, met or missed return expectations in 2017

Note: Figure based on selections from 184 respondents.

FIGURE 66: Changes expected to be made to achieve hedge fund target return in the next year

Note: Figure based on selections from respondents in each respective year.
While the majority of investors expect to maintain their hedge fund exposure in 2018, capital invested in hedge funds will likely be recycled and reallocated across different strategies and managers.

- 70% of respondents indicated their hedge fund allocation will remain the same in 2018 and only 15% expect to increase their hedge fund exposure.
- Insurance companies and consultants have higher percentage of respondents who are looking to add to their hedge fund allocation, while fund of funds and family offices have the lowest percentages.
- From a regional perspective, Asia Pacific investors seem to be slightly more inclined than their counterparts in the Americas and Europe, Middle East & Africa, with regard to increasing their investments in hedge fund in 2018.

Note: Figure based on selections from 245 respondents.

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**FIGURE 67: Hedge fund allocation in 2018**

Note: Figure based on selections from 245 respondents.

**FIGURE 68: Hedge fund allocation in 2018 by investor type**

Note: Figure based on selections from 245 respondents.

**FIGURE 69: Hedge fund allocation in 2018 by investor region**

Note: Figure based on selections from 245 respondents.
E. Number of hedge fund investments

Nearly half of the respondents concentrated their portfolios in 2017. Looking forward, investors do not expect to change the number of hedge fund investments in their portfolios significantly. On average, the respondents in the survey are looking to increase their number of hedge funds by one in 2018. To be added to an investor’s portfolio, hedge fund managers will face sustained competition with their peers.

- Unsurprisingly, the highest number of hedge fund investments on average come from consultants, fund of funds and banks & platforms. All the other investor segments tend to have 15-20 hedge fund managers in their portfolios.
- Close to 50% of respondents have reduced the number of hedge funds in which they are invested, while 25% maintained the same amount.
- 37% of respondents are looking to increase their number of hedge fund investments in 2018, a slight increase from 33% in 2017.

Meanwhile, only 21% of respondents plan to decrease the number of hedge funds they allocate to.

- 63% of banks & platforms and 45% of endowments & foundations plan to increase their number of hedge funds in 2018.
- Geographically, Asia Pacific has a higher percentage of respondents who are looking to increase their number of hedge funds and the lowest percentage of those who plan to decrease investments.

FIGURE 70: Average number of hedge fund investments

Note: Figure based on selections from 243 respondents.

FIGURE 71: Change in the number of hedge fund investments

Note: Figure based on selections from 243 respondents.
FIGURE 72: Expected change in the number of hedge fund investments in 2018 by investor type

<table>
<thead>
<tr>
<th>Investor Type</th>
<th>Increase</th>
<th>Same</th>
<th>Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks &amp; platforms</td>
<td>63%</td>
<td>26%</td>
<td>11%</td>
</tr>
<tr>
<td>Consultants</td>
<td>24%</td>
<td>48%</td>
<td>29%</td>
</tr>
<tr>
<td>Endowments &amp; foundations</td>
<td>45%</td>
<td>27%</td>
<td>27%</td>
</tr>
<tr>
<td>Family offices</td>
<td>37%</td>
<td>23%</td>
<td>23%</td>
</tr>
<tr>
<td>Fund of funds</td>
<td>31%</td>
<td>53%</td>
<td>16%</td>
</tr>
<tr>
<td>Insurance companies</td>
<td>36%</td>
<td>36%</td>
<td>27%</td>
</tr>
<tr>
<td>Pensions</td>
<td>36%</td>
<td>43%</td>
<td>21%</td>
</tr>
</tbody>
</table>

Note: Figure based on selections from 243 respondents.

FIGURE 73: Expected change in the number of hedge fund investments in 2018 by investor region

<table>
<thead>
<tr>
<th>Region</th>
<th>Increase</th>
<th>Same</th>
<th>Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Americas</td>
<td>23%</td>
<td>41%</td>
<td>36%</td>
</tr>
<tr>
<td>Europe, Middle East &amp; Africa</td>
<td>22%</td>
<td>44%</td>
<td>33%</td>
</tr>
<tr>
<td>Asia Pacific</td>
<td>5%</td>
<td>50%</td>
<td>50%</td>
</tr>
</tbody>
</table>

Note: Figure based on selections from 243 respondents.
F. Strategy of interest

Fundamental long/short equity, event driven, market neutral, global macro and multi-strategy are at the top of investors’ strategies of interest.

Event driven and fundamental long/short equity continue to receive strong interest especially with the wide range of performance experienced by the managers in those strategies.

FIGURE 74: Hedge fund strategies of interest

Note: Figure based on selections from 250 respondents.
Generally, Americas-based respondents have more appetite for credit strategies, including distressed credit, long/short credit, structured credit and credit multi-strategy. A higher percentage of respondents in Europe, Middle East & Africa and Asia Pacific are interested in global macro and CTAs/managed futures.

FIGURE 75: Hedge fund strategies of interest by investor region

Note: Figure based on selections from 250 respondents.
G. Strategy performance expectation

Fundamental long/short equity is expected to be the best performing strategy in 2018 by the highest percentage of respondents, followed by global macro and emerging markets. On the other end of the spectrum, long only equity is believed to have performed the worst by the highest percentage of respondents in consecutive two years.

- 23% of respondents expect fundamental long/short equity to generate the best performance in 2018. The number has increased slightly from 19% in the prior survey. Only 2% of respondents think fundamental long/short equity will have the worst performance among all the strategies.

- Respondents turned less optimistic on global macro performance. The percentage of respondents who believe global macro to be the best performing strategy has dropped substantially to 12% in the survey from 24% in the prior survey, while the percentage of respondents who expect global macro to perform the worst has increased to 13% from 4% in the prior year.

- The conviction in credit strategies, including distressed credit, structured credit, long/short credit and credit multi-strategy, seems to be low as only a small portion of investors expect them to generate the best performance in 2018. On the other hand, a higher percentage of respondents believe credit strategies to be the worst performing strategies in 2018.

- 10% of respondents expect emerging markets to perform the best in 2018, a significant increase from 4% in the previous survey.

**FIGURE 76: Expected best performing strategy**

<table>
<thead>
<tr>
<th>Strategy Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long/short equity: fundamental</td>
<td>23%</td>
</tr>
<tr>
<td>Global macro</td>
<td>12%</td>
</tr>
<tr>
<td>Emerging markets</td>
<td>10%</td>
</tr>
<tr>
<td>Event driven</td>
<td>9%</td>
</tr>
<tr>
<td>Multi-strategy</td>
<td>7%</td>
</tr>
<tr>
<td>Long/short equity: quantitative</td>
<td>7%</td>
</tr>
<tr>
<td>Long/short equity: market neutral</td>
<td>6%</td>
</tr>
<tr>
<td>Options/volatility arbitrage</td>
<td>5%</td>
</tr>
<tr>
<td>CTAs/managed futures</td>
<td>4%</td>
</tr>
<tr>
<td>Long only equity</td>
<td>4%</td>
</tr>
<tr>
<td>Credit: distressed</td>
<td>3%</td>
</tr>
<tr>
<td>Activism</td>
<td>2%</td>
</tr>
<tr>
<td>Fixed income/relative value</td>
<td>2%</td>
</tr>
<tr>
<td>Commodities</td>
<td>1%</td>
</tr>
<tr>
<td>Credit: structured</td>
<td>1%</td>
</tr>
<tr>
<td>Credit: multi-strategy</td>
<td>1%</td>
</tr>
<tr>
<td>Credit: long/short</td>
<td>0%</td>
</tr>
<tr>
<td>Convertible arbitrage</td>
<td>0%</td>
</tr>
<tr>
<td>Fund of funds</td>
<td>0%</td>
</tr>
</tbody>
</table>

Note: Figure based on selections from 273 respondents.
Note: Figure based on selections from 182 respondents.
### FIGURE 77: Expected worst performing strategy

<table>
<thead>
<tr>
<th>Strategy Type</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long only equity</td>
<td>2%</td>
</tr>
<tr>
<td>Global macro</td>
<td>13%</td>
</tr>
<tr>
<td>Fund of funds</td>
<td>12%</td>
</tr>
<tr>
<td>CTAs/managed futures</td>
<td>8%</td>
</tr>
<tr>
<td>Credit: long/short</td>
<td>6%</td>
</tr>
<tr>
<td>Activism</td>
<td>5%</td>
</tr>
<tr>
<td>Fixed income/relative value</td>
<td>5%</td>
</tr>
<tr>
<td>Credit: structured</td>
<td>4%</td>
</tr>
<tr>
<td>Credit: distressed</td>
<td>4%</td>
</tr>
<tr>
<td>Commodities</td>
<td>3%</td>
</tr>
<tr>
<td>Long/short equity: quantitative</td>
<td>3%</td>
</tr>
<tr>
<td>Long/short equity: market neutral</td>
<td>3%</td>
</tr>
<tr>
<td>Long/short equity: fundamental</td>
<td>2%</td>
</tr>
<tr>
<td>Options/volatility arbitrage</td>
<td>2%</td>
</tr>
<tr>
<td>Convertible arbitrage</td>
<td>2%</td>
</tr>
<tr>
<td>Credit: multi-strategy</td>
<td>1%</td>
</tr>
<tr>
<td>Emerging markets</td>
<td>1%</td>
</tr>
<tr>
<td>Event driven</td>
<td>1%</td>
</tr>
<tr>
<td>Multi-strategy</td>
<td>3%</td>
</tr>
</tbody>
</table>

Note: Figure based on selections from 209 respondents.

<table>
<thead>
<tr>
<th>Strategy Type</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long only equity</td>
<td>16%</td>
</tr>
<tr>
<td>Fund of funds</td>
<td>13%</td>
</tr>
<tr>
<td>Emerging markets</td>
<td>9%</td>
</tr>
<tr>
<td>Fixed income/relative value</td>
<td>8%</td>
</tr>
<tr>
<td>Activism</td>
<td>7%</td>
</tr>
<tr>
<td>Credit: distressed</td>
<td>7%</td>
</tr>
<tr>
<td>Credit: long/short</td>
<td>7%</td>
</tr>
<tr>
<td>Commodities</td>
<td>5%</td>
</tr>
<tr>
<td>CTAs/managed futures</td>
<td>5%</td>
</tr>
<tr>
<td>Global macro</td>
<td>4%</td>
</tr>
<tr>
<td>Credit: structured</td>
<td>3%</td>
</tr>
<tr>
<td>Multi-strategy</td>
<td>3%</td>
</tr>
<tr>
<td>Options/volatility arbitrage</td>
<td>3%</td>
</tr>
<tr>
<td>Long/short equity: fundamental</td>
<td>3%</td>
</tr>
<tr>
<td>Long/short equity: quantitative</td>
<td>2%</td>
</tr>
<tr>
<td>Long/short equity: market neutral</td>
<td>2%</td>
</tr>
<tr>
<td>Convertible arbitrage</td>
<td>1%</td>
</tr>
<tr>
<td>Event driven</td>
<td>1%</td>
</tr>
<tr>
<td>Credit: multi-strategy</td>
<td>1%</td>
</tr>
</tbody>
</table>

Note: Figure based on selections from 173 respondents.
Note: Figure based on selections from 269 respondents.
H. Expected strategy exposure change in 2018

In 2018, investors are more likely to add exposure to emerging markets, event driven, quantitative equity, options/volatility arbitrage and market neutral strategies.

- On a net basis, 33% of respondents plan to allocate more capital to emerging markets, which reflects their relatively more positive views on opportunities outside North America.
- The interest in event driven strategies seemed to have picked up as over one-fifth of respondents expect to increase their exposure to the strategy.
- Quantitative equity strategy garnered significant interest in 2017. The momentum is largely expected to carry over into 2018. Close to 20% of respondents indicated their willingness to increase their quantitative equity exposure.
- Global macro and fundamental long/short equity are expected to see higher turnover in 2018 as investors reallocate capital across different managers. Although performance is not the only consideration when investors make allocations, managers with challenged-performance over the past several years may face more difficulty in retaining existing capital and attracting new capital.
- The appetite for credit strategies is generally low, but mixed across sub-strategies. While respondents are looking to increase exposure modestly in distressed credit and long/short credit, they are more likely to reduce their exposure to credit multi-strategy and structured credit on a net basis.
- The exposure to convertible arbitrage, commodities and activism strategies is expected to be largely unchanged.

FIGURE 78: Expected strategy exposure change in 2018

Note: Figure based on selections from 223 respondents.
FIGURE 79: Expected net strategy exposure change in 2018

Note: Figure based on selections from 223 respondents.
I. Expected geographic exposure change in 2018

Investors seem to be more positive on Asia Pacific and Europe, and many of them plan to increase their exposure to these two regions.

- 50% of respondents are bullish on Asia Pacific markets going into 2018, while 42% are bullish on European equity.
- 47% and 42% of respondents expect to increase their exposure to Asia and Europe, respectively. 18% of respondents plan to reduce their exposure to North America. 42% of respondents do not currently have exposure to Latin America and only 14% of them are looking to increase their allocation to the region.

- Investors based in the Americas seem to have an appetite to increase their exposure to Asia Pacific and Europe, while largely maintaining their exposure to North America.
- 43% of Europe, Middle East & Africa investors plan to add exposure to the Asia Pacific region, while 21% will reduce North American exposure.
- Close to 60% of Asia Pacific investors will increase exposure to their home region. The interest in North America, Latin America and Middle East & North Africa seems to be limited.

FIGURE 80: Investor sentiment across markets

Note: Figure based on selections from respondents in each respective year.

FIGURE 81: Change in geographic exposure in 2018

Note: Figure based on selections from 219 respondents.
FIGURE 82: Change in geographic exposure in 2018 – Americas investors

Note: Figure based on selections from 219 respondents.

FIGURE 83: Change in geographic exposure in 2018 – Europe, Middle East & Africa investors

Note: Figure based on selections from 219 respondents.

FIGURE 84: Change in geographic exposure in 2018 – Asia Pacific investors

Note: Figure based on selections from 219 respondents.
**J. New launches**

Investors seem to be more opportunistic toward investing in new launches, though the bar is still very high to get into investors' portfolios. For investors who did make allocations to new launches in 2017, the majority added only one or two managers. 27% of respondents in the survey expect their allocations to new launches to increase in 2018.

- 71% of respondents indicate they are willing to invest in new launches, which is substantially higher than the percentage from the previous years.
- Investors continue to be quite selective when making new launch allocations. In fact, the majority of respondents who made allocations to new launches in 2017 added only one to two managers to their portfolios. 73% of banks & platforms and 69% of consultants made allocations to at least one new launch manager in 2017, a substantial increase from previous years.
- 66% of respondents’ average allocation to new launch managers is less than $25 million. Only 5% of respondents could make an allocation of $100 million or more to a new launch manager, on average.

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**FIGURE 85: Investment in new launches**

![Investment in new launches chart]

Note: Figure based on selections from respondents in each respective year.

**FIGURE 86: Number of investments made to new launches in 2017**

![Number of investments chart]

Note: Figure based on selections from 96 respondents.
FIGURE 87: Expected change in new launch exposure

Note: Figure based on selections from respondents in each respective year.

FIGURE 88: Percentage of respondents that made allocation to new launches by investor type (2014-2017)

Note: Figure based on selections from respondents in each respective year.

FIGURE 89: Average allocation to a new launch manager by investor type

Note: Figure based on selections from 92 respondents.
Founders share class is the most common option when investors make allocations to new launches. Many investors will negotiate capacity rights with new launch managers and some may use managed accounts for their investments.

- 73% of respondents made allocations to new launch managers in 2017 in founders share class. Of those, 34% negotiated capacity rights with their managers.
- 18% of respondents that made allocations to new launch managers in 2017 have provided seed capital.

**FIGURE 90: Type of investments to new launch managers**

Note: Figure based on selections from 100 respondents.

Note: Figure based on selections from 73 respondents.
Investment process/strategy and manager pedigree/prior track record are the most important considerations for investors when they evaluate a new launch manager, followed by fee structure/liquidity terms.

- When conducting due diligence on a new hedge fund launch, 42% of respondents indicated that a manager’s investment strategy and process is the first criterion, while 38% chose this as the second criterion.
- Manager pedigree and prior track record was selected by 38% of respondents as the first criterion and 39% as the second criterion.
- 33% of respondents ranked fee structure and liquidity terms as the third criterion.

**FIGURE 91: Top criteria when evaluating a new launch manager**

Note: Figure based on selections from 100 respondents.
K. Industry trends

In 2018, investors expect to see further fee reduction from hedge fund managers, more consolidation in the industry, more managers adopting hurdle rates and increased transparency.

- Over the past several years, lower fees continued to be the dominant trend investors expect to see in the hedge fund industry.
- More respondents in this survey expect to see more capital to flow into less liquid hybrid vehicles, compared to the surveys in prior years. This is in line with the increasing appetite for hybrid funds the Capital Advisory Group has been observing.

FIGURE 92: Expected industry trends in 2018
III. Special topics

A. Cash

Investors have been putting their cash to work in 2017. The percentage of investors with more than 25% of their portfolios in cash and cash equivalents has dropped from the prior year.

- The majority of respondents have less than 10% of their portfolio in cash, which is consistent over the past few years.
- Only 1% of respondents have more than 25% cash or cash equivalents in their portfolios, a significant decline from 5% in 2016.
- Family offices, endowments & foundations and insurance companies have the highest percentage of respondents with more than 10% cash in their portfolios, while consultants and fund of funds have the highest percentage of respondents that are fully invested.

Note: Figure based on selections from 246 respondents.

FIGURE 93: Percent of portfolio in cash and cash equivalents

Note: Figure based on selections from respondents in each respective year.

FIGURE 94: Percent of portfolio in cash and cash equivalents by investor type in 2017

Note: Figure based on selections from 246 respondents.
B. Alternative risk premia

Investor interest in alternative risk premia strategies continued to grow as a complement to existing hedge fund investments. The ability to invest in specific risk exposures with lower costs has been the primary driver for the increasing interest in this strategy.

- 29% of respondents indicated they were invested in alternative risk premia strategies in 2017, with another 7% planning to invest in 2018.
  - Consultants, insurance companies and fund of funds have the highest percentage of respondents that have allocations to alternative risk premia in 2017, as well as respondents who plan to do so in 2018.
  - 30% of respondents in the Americas are invested in alternative risk premia strategies, with 5% looking to add risk premia in 2018.
- Of the respondents who have invested or will invest in alternative risk premia strategies, close to 90% view these products as a complement to their hedge fund investments. Only less than 5% of respondents use alternative risk premia strategies to replace their hedge fund allocation.

- The ability to invest in specific risk exposures and low costs are the main reasons for investors to allocate to risk premia strategies. Liquidity has become a more important driver in 2017 compared to the prior year.
- Over 80% of respondents in both 2017 and 2016 invested in alternative risk premia strategies through external managers. Only approximately 20% of investors either buy alternative risk premia products offered by banks or manage the strategies in-house. Of those who run alternative risk premia strategies in-house, the majority are fund of funds.

Note: Figures based on selections from respondents in each respective year.

FIGURE 95: Allocation to alternative risk premia

Note: Figures based on selections from respondents in each respective year.
FIGURE 96: Allocation to alternative risk premia by investor type in 2017

Note: Figure based on selections from 214 respondents.

FIGURE 97: Allocation to alternative risk premia by investor region in 2017

Note: Figure based on selections from 214 respondents. Totals may not add up to 100% due to rounding.

FIGURE 98: Primary reasons to invest in alternative risk premia strategies

Note: Figures based on selections from 58 and 76 respondents in 2016 and 2017, respectively.
C. Longer-lock/hybrid vehicles

Increasing appetite for less liquid hybrid vehicles offered by hedge fund managers was observed in 2017. Investors seem to be willing to give up liquidity in exchange for access to specific investment opportunities or potential higher returns.

- 40% of respondents in 2017 have investments in longer-lock hybrid funds, moderately higher than the percentage in 2016. Those products typically have three to five years’ duration and a drawdown structure.

- Consultants have the highest percentage of respondents who have allocations to hybrid vehicles, followed by family offices. Banks & platforms have the highest percentage of respondents who plan to add hybrid funds in 2018.
D. Managed accounts

The interest in investing via managed accounts grew in 2017, driven by various benefits managed accounts can bring to an investor’s portfolio, such as increased transparency, increased control over assets, lower fees and customization. Of the respondents who invest via managed accounts, 40% increased their allocation to hedge fund investments via managed accounts in 2017, and 42% expect to increase their use of managed accounts in 2018.

- 37% of respondents invest in hedge funds via managed accounts in 2017, compared to 29% in 2016.
- There is no dominant reason why investors prefer to use managed accounts when investing in hedge funds. Transparency, control over assets, costs, customization and liquidity are all considerations for investors.
- Most investors have only a small portion of their portfolio invested via managed accounts. In 2017, 75% of the respondents who invest via managed accounts have less than 25% of their hedge fund portfolio invested via managed accounts. Only a few fund of funds, banks & platforms and pensions use managed accounts for more than 50% of their hedge fund portfolios. The potential room for the growth in managed account usage is ample.
- The typical size of the hedge fund allocation via managed accounts varies across investor segments. In general, pensions, insurance companies, consultants and banks & platforms tend to allocate $50 million or more. In this year’s survey, all of the respondents who allocate less than $25 million to a hedge fund via managed accounts are family offices and fund of funds.
- Of the respondents who invest in hedge funds via managed accounts, 91% increased (40%) or maintained (51%) their investments via managed accounts in 2017, while 97% are expecting to increase (42%) or maintain (55%) their investments via managed accounts in 2018.
FIGURE 102: Invest via managed accounts

Note: Figure based on selections from respondents in each respective year.

FIGURE 103: Invest via managed accounts by investor type in 2017

Note: Figure based on selections from 217 respondents.

FIGURE 104: Percentage of hedge fund investments via managed accounts

Note: Figure based on selections from 76 respondents.
FIGURE 105: Typical size when investing in hedge funds via managed accounts

Note: Figure based on selections from 72 respondents.

FIGURE 106: Allocation to hedge funds via managed accounts in 2018

Note: Figure based on selections from 73 respondents.
E. Funds of one

Funds of one are less common than managed accounts among the respondents, with roughly one-fifth indicating the use of funds of one in their portfolios.

- Consultants and pensions have the highest percentage of respondents that use funds of one across different investor segments. 11% of endowments & foundations and 8% of insurance companies that participated in this year’s survey do not currently have investments via a fund of one but plan to do so in 2018.
- 90% of respondents have less than 25% of their hedge fund portfolio invested via a fund of one, with over half of them having 1-10% of their hedge fund portfolio in a fund of one structure.
- Close to half of the respondents allocate $25 million to $100 million on average to a hedge fund manager via funds of one.
- Looking ahead, approximately 20% of respondents are planning to increase their exposure to hedge funds via funds of one, while the majority will maintain their exposure.

Note: Figure based on selections from 212 respondents.

Note: Figure based on selections from 38 respondents.
F. UCITS funds

The investor base for UCITS funds has been largely stable. Increased liquidity is the primary driver for many investors to invest in UCITS funds.

- 27% of respondents in 2017 invested in UCITS products, compared to 21% in 2016. Only 1% of respondents do not have UCITS investments but plan to add them in 2018.
- Not surprisingly, over 60% of Europe, Middle East & Africa respondents are invested in UCITS funds, the highest across regions. Only 15% of respondents in the Americas have UCITS funds in their portfolios.
- Liquidity continued to be the dominant driver for investors to allocate to UCITS funds. For those who do not invest in UCITS funds, some of the reasons include lack of demand from clients, lower expected returns and liquidity mismatch.
- Over 50% of respondents have less than 10% of their hedge fund investments in UCITS funds.
- 55% of those who invest in UCITS funds have less than $50 million invested.
- Of the respondents that invest in UCITS funds, 41% increased their UCITS exposure in 2017 and 38% plan to do so in 2018. Most respondents will keep their UCITS exposure constant.
FIGURE 112: Investors allocated to UCITS funds by region in 2017

Note: Figure based on selections from 213 respondents.

FIGURE 113: Primary reason for investing in UCITS funds

Note: Figure based on selections from 60 respondents.

FIGURE 114: Primary reason for investing in UCITS funds

Note: Figure based on selections from 152 respondents.
FIGURE 115: Percentage of hedge fund investments made via UCITS structure

Note: Figure based on selections from 55 respondents.

FIGURE 116: Capital invested in UCITS funds

Note: Figure based on selections from 53 respondents.

FIGURE 117: UCITS exposure change in 2017

Note: Figure based on selections from 54 respondents.

FIGURE 118: Expected UCITS exposure change in 2018

Note: Figure based on selections from 53 respondents.
G. Impact investing

Less than one-fifth of the respondents have or expect to have exposure to environmental, social and governance (ESG) or socially responsible investing (SRI) investments. While many hedge fund managers offer ESG/SRI share class or dedicated products, investors seem to prefer other fund structures, such as mutual funds, private capital funds, or direct investments.

FIGURE 119: ESG/SRI mandate by investor type

Note: Figure based on selections from 211 respondents.

FIGURE 120: Implementation of ESG/SRI mandate

Note: Figure based on selections from 38 respondents.
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