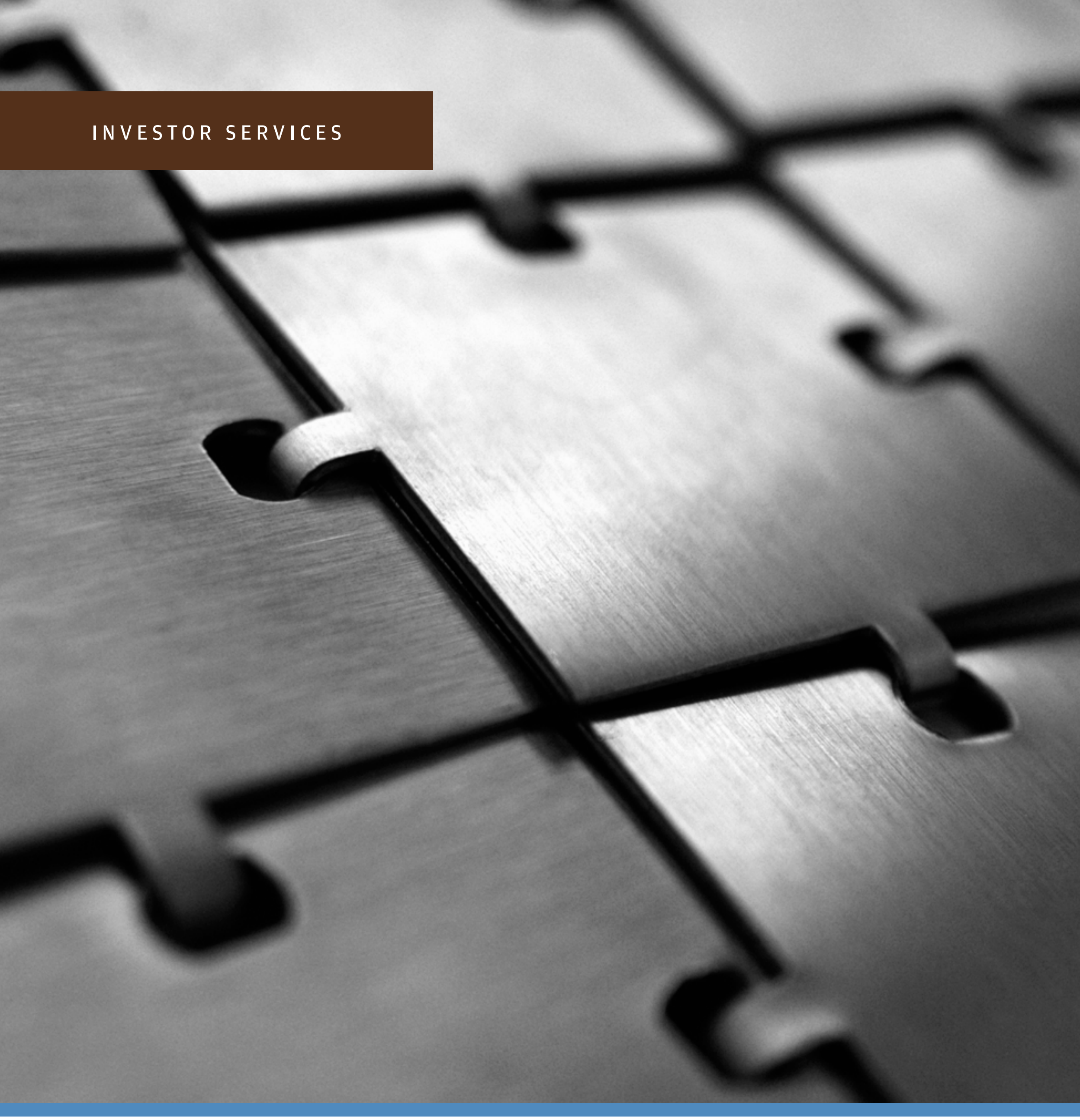
INVESTOR SERVICES



Capital Introduction Group

Institutional Investor Survey - 2015

J.P.Morgan

CONTENT

INTRODUCTION

For 12 years now, our annual survey of institutional investors in hedge funds has been instrumental in helping us gauge hedge fund industry trends and investment behavior. First and foremost, we would like to thank those institutional investors who continue to participate in these surveys. With your help, the survey has become an important source of knowledge for both institutional investors and hedge fund managers. As in previous years, we would like to share some of our key findings.

In summary:

- 386 institutional investors participated in this year's Institutional Investor Survey (the "Survey"), representing approximately $800 billion in Assets Under Management ("AUM") with hedge funds (nearly 30% of total hedge fund industry assets).

- The Consultant segment, globally, experienced the most growth year-over-year as a percentage of our respondent base (as measured by AUM in hedge funds). Consultants accounted for nearly one-quarter of survey participant AUM in hedge funds this year, compared to 14% last year. This growth is from new entrants, as well as from organic asset growth as consultant firms take on new institutional clients such as Pensions and Endowments & Foundations, many of them investing in direct hedge funds for the first time.

- Appetite for new launches is holding steady. Investors are not only more interested and willing to look at new launches, but are now starting to actively allocate to start-up managers. Nearly half of Survey respondents invested in at least one start-up manager in 2014. Founders' share classes are the most common type of start-up investment made by respondents. Other types include acceleration capital, negotiated managed accounts, and seed economics.

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

- Looking ahead, respondents may only be making small changes to overall hedge fund portfolios in comparison to past years. The largest expected net increase noted across strategies entering 2015 was only 5% compared to 17% upon entering 2014.

- Fixed Income Arbitrage experienced the greatest growth year-over-year, with 46% of respondents invested in the space in 2014 as compared to 27% in 2013. This growth is consistent with strategy capital flows across the broader hedge fund industry.

- Fundamental Long Short Equity continues to be the strategy that most respondents are invested in. 90% of respondents were invested in the strategy in 2014 compared to 84% in both 2013 and 2012.

- While we expect continued growth for the hedge fund industry in 2015, the momentum it has gained over the past three years is expected to pull back slightly. Given performance challenges relative to broader markets, expectations for hedge fund capital net inflows and new capital allocations for 2015 are down slightly compared to 2014.

Markets entered 2014 much like they exited 2013. Risk assets continued to rally across the board during the first quarter, with the exception of a small correction in January due to emerging markets stress, falling PMIs, and the decision by the U.S. Federal Reserve (the "Fed") to continue tapering its long-running bond buying program. Developed market equities generally outperformed in February and March, more than reversing January's decline, despite global equities, in aggregate, finishing the quarter flat. U.S. high yield credits and loans advanced nicely during the quarter, helped by a gradually improving economy and persistently low default rates. Hedge funds, however, posted negative aggregate returns in two of the first three months of 2014.

Risk assets continued their rally through mid-year and received a boost in June. The European Central Bank ("ECB") bolstered market sentiment when it announced its commitment to ease monetary policy and ward off deflation with its implementation of a negative rate on deposits along with a new four-year funding program for banks, i.e., targeted longer-term refinancing operations. In recent years, global central banks have moved largely in unison. June, however, marked an initial divergence in global central bank policies between the Fed and the ECB. Global equities continued gaining steam as the S&P 500 gained +2.1%, marking its third month of the year where net gains increased over 2.0%. Japan was the best performing region for the month, rallying nearly +7.0% and thus reversing most of the losses from earlier in the year. Additionally, emerging markets posted broad gains. As in prior months, implied volatility and implied correlations continued to recede.

Compared to the fairly steady climb of risk assets through the end of the third quarter, October was an action-packed month. Risk assets experienced a fast and unexpected pullback in the first half of the month, followed by a strong rebound as various asset classes retraced from their earlier lows. Unexpected intra-month volatility took a toll on hedge funds, which, in the aggregate, ended October roughly flat. Macro funds were stung by the sharp selloff in rates but were able to ride the subsequent recovery at month-end. Similarly, equity-biased funds were able to navigate back from the mid-month selloff by actively managing gross and net exposure intra-month (especially for certain sectors such as energy), repositioning themselves to capture late month gains. J.P. Morgan Prime Brokerage clients cut gross leverage materially intra-month, marking one of the most notable moves in exposure for the year. Event Driven funds faced challenges as a result of losses in a few high-profile, idiosyncratic events. A federal district court dismissed a shareholder lawsuit against Fannie Mae and Freddie Mac, which led to considerable losses for the preferred shares of both government sponsored entities. There was also the termination of the widely followed AbbVie/Shire merger as a result of the U.S. Department of the Treasury implementing new anti-tax inversion measures.

As 2014 came to a close, the U.S. economy appeared to be expanding firmly. Europe and Japan still seemed to be contracting in the midst of fiscal and monetary policies. Emerging markets faced continued headwinds ranging from falling commodity prices to a larger slowdown in China. All of the key hedge fund strategies posted flat performance in December, with the exception of global macro outperforming (+0.96%) relative to the other main hedge fund strategies. CTA/Managed Futures strategies grabbed more and more attention in the fourth quarter, producing some of the highest returns in the industry in December, as well as for the year. Clear movement in oil prices and government bond yields, increasing natural gas prices, and a rising US Dollar proved beneficial to macro funds in the fourth quarter. Hedge funds, in aggregate, finished the year up +3.57%.[1]

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

On average, hedge funds achieved positive performance in 2014 but did not perform as well as they did in 2013. The industry as a whole has significantly lagged the U.S. equity market since 2012. Nearly 55% of respondents indicated their hedge fund investments did not meet their targeted hedge fund portfolio return for 2014. This represents a significant shift year-over-year, as nearly 90% of respondents met or exceeded their target return in 2013. Of those respondents who did not meet their target return for the year, the majority did not plan to significantly alter overall portfolio exposure to hedge funds. Investors looking to remedy performance challenges are reallocating to new hedge fund managers and strategies but remaining invested in the asset class. When asked what the main reason for hedge fund underperformance over the last few years could be, most respondents indicated it stemmed from too many hedge funds chasing limited opportunities to generate alpha. Macro factors and inability to generate alpha on the short side were also contributing factors mentioned.

In their search for alpha, institutional investors have moved down the assets under management ("AUM") spectrum, with three-quarters of respondents willing to invest in a hedge fund with $100 million or less. Along those same lines, approximately 70% of respondents are willing to look at a hedge fund manager with a track record of one year or less. Appetite for new launches is holding steady as investors are not only more interested and willing to look at new launches, but are now starting to actively allocate to start-up managers. Nearly half of respondents invested in at least one start-up manager in 2014. Over 40% of Family Offices and Endowments & Foundations invested in start-up managers this year, representing a notable increase in activity for these segments over the last few years. Founders' share classes are the most common type of start-up investment respondents make. Despite the healthy demand for new managers, respondents still seem to be approaching them selectively and cautiously. Of those that invested in a new launch in 2014, nearly three-quarters of respondents only invested in one or two new managers, compared to the narrow six percent that made over five new launch allocations.

While most institutional investors prefer quarterly redemption periods or better, the vast majority of respondents are also attempting to source alpha by locking up capital for one year or more. A number of institutional investors in search of yield have expressed interest in hedge fund products offering liquidity of three years or more. Nearly 45% of respondents invested in a less liquid hedge fund product (e.g., hybrid fund, drawdown structure) in 2014. Consultants, Insurance Companies, and Family Offices represent those respondents most willing to lock up their capital for a longer period with the potential of achieving lower volatility and/or higher return. Investors are also still interested in co-investment opportunities, typically through an investment in a parallel fund vehicle or Special Purpose Vehicle ("SPV") that will invest alongside a hedge fund manager's commingled fund, either pari-passu or in less liquid securities not suitable for the main fund.

On the other side of the liquidity spectrum, we noticed an influx of long only money enter the hedge fund space as investors were hungry for higher yielding assets in 2013. In 2014, we saw more of the same. Several asset management and hedge fund firms tried to capitalize on this industry change and launched Liquid Alternatives (40 Act or UCITS) products. Among respondents, roughly 27% invested in a Liquid Alternatives product in 2014 compared to 15% in 2013. This is expected to grow in 2015. Although not as popular among many institutional investors, retail-oriented investors have flocked into Liquid Alternatives vehicles.

Most notably, while hedge fund industry growth is expected to continue, the momentum it has gained over the past three years or so is expected to pull back slightly entering 2015. Net inflows and new capital are still expected to be put to work in 2015, just not to the degree that capital was in 2014. Half of all respondents indicated they would only allocate $50 million or less of new capital to hedge funds in 2015. Investors also seem to be less bullish on hedge funds in general. Only 42% of respondents indicated they were bullish on hedge funds going into 2015, compared to 66% upon entering 2014. However, there are no clear indications that investors will be redeeming from the space in 2015. Rather, respondents appear to prefer remaining more neutral in 2015, making changes to existing hedge fund portfolios at the margin.

Due to heavy allocations made over the past few years to Fundamental Long Short Equity and Event Driven strategies, for the upcoming year, many respondents are only marginally planning to shift strategy exposures. Several participants indicated plans for small increases to CTA/Managed Futures and Emerging Markets strategies entering 2015. The largest expected net increase noted across strategies (in this case, CTAs/Managed Futures strategy) was only 5% compared to 17% for the Event Driven strategy last year. Respondents seem to be planning to make fairly small changes to overall hedge fund portfolios as compared to years past.

Respondents predict that Fundamental Long Short Equity, Event Driven, and Global Macro will be among the best performing strategies of 2015, similar to predictions made for 2014.

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

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I. SURVEY RESPONDENTS' CHARACTERISTICS

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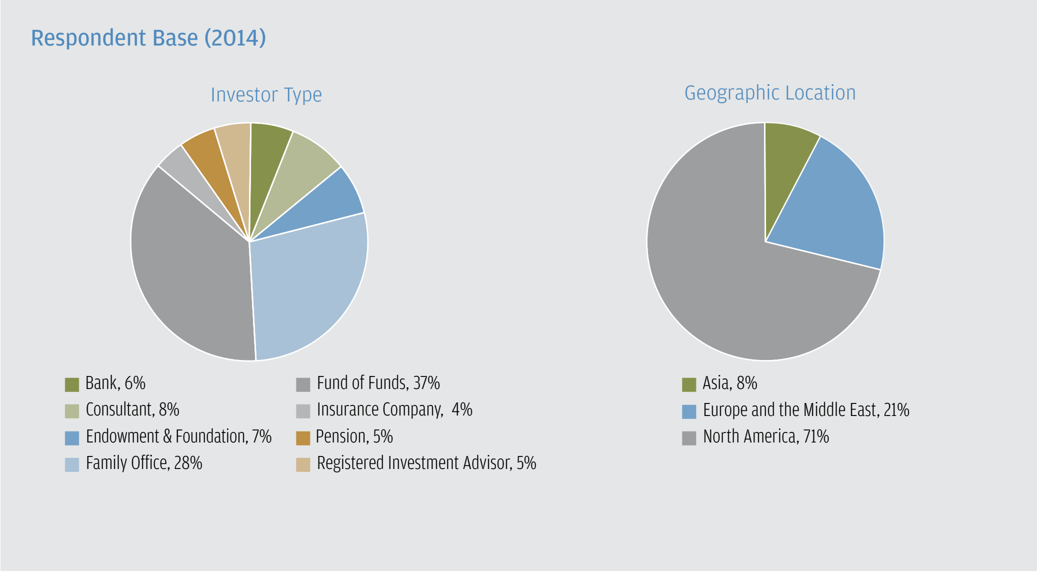
Overview of Survey Respondents

- In November 2014, J.P. Morgan's Capital Introduction Group conducted its annual Institutional Investor Survey (the "Survey"), which is based on respondent investing activity in 2014.
- 386 institutional investors responded to the Survey.
- Respondents include Banks, Consultants, Endowments & Foundations, Family Offices, Fund of Funds, Insurance Companies, Pensions, and Registered Investment Advisors.
- The geographic mix of institutional investors included roughly 30% of respondents based outside of North America.
- Respondents' aggregate AUM in hedge funds was approximately $800 billion at the end of 2014 (nearly 30% of total hedge fund industry assets).
- Nearly half of the respondents managed more than $1 billion in hedge fund investments at the close of 2014.
- Fund of Funds, Consultants, and Bank platforms represent the respondent segments with the most AUM in hedge funds.
- Consultants accounted for nearly one-quarter of survey participant AUM in hedge funds this year, compared to 14% last year. This growth comes most likely from new entrants, as well as from organic asset growth as consultant firms take on new institutional clients such as Pensions and Endowments & Foundations, many of them investing in direct hedge funds for the first time.
- 82% of respondents have at least seven years of hedge fund investing experience, representing nearly 95% of the AUM invested in hedge funds amongst the respondents.

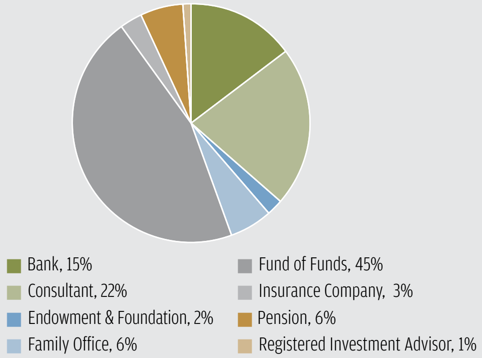
Figure 1



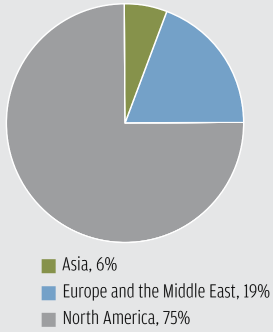
Note: Figures based on number of respondents unless otherwise noted

Respondent Base (2014, Based on AUM in Hedge Funds)[1]

Investor Type



Geographic Location



Amount of Hedge Fund Capital Managed by Respondent Base at 2014 Year End[1]

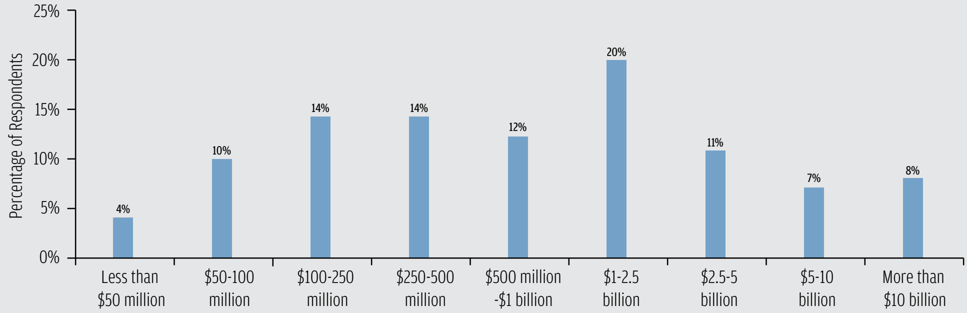
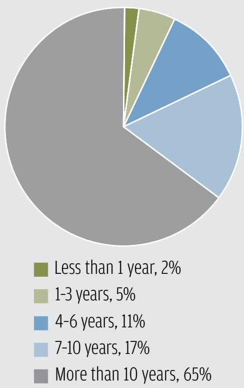
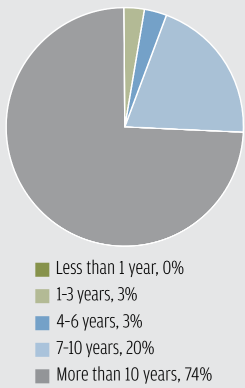


Figure 2

Hedge Fund Investing Experience (2014)[2]



Hedge Fund Investing Experience (2014, Based on AUM in Hedge Funds)[1]



1 Note: Figures based on Hedge Fund AUM as of 2014 year end

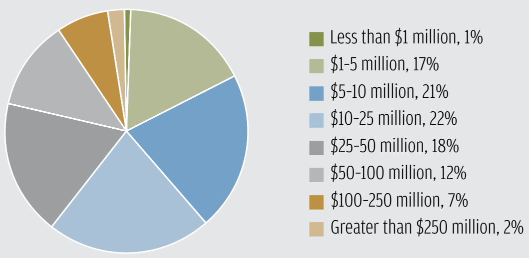
2 Note: Figures based on number of respondents unless otherwise noted

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

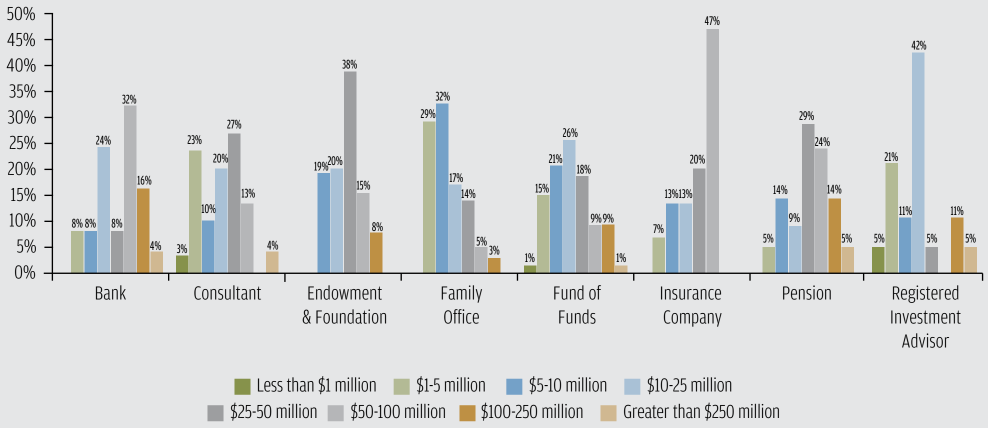
- Pensions and Insurance Companies represent the largest percentage of respondents that make average allocations of at least $25 million.
  - On average, 71% of Pensions and 67% of Insurance Companies allocate more than $25 million per hedge fund investment.
  - Over 40% of Pensions allocate more than $50 million per hedge fund investment, on average.
- Family Offices tend to make the smallest average allocations, with roughly 30% allocating $5 million or less.
- Respondents with more experience in hedge fund investing tend to make larger allocations, on average. Of the respondents who allocate, on average, at least $25 million to a manager, 83% have over six years of hedge fund investing experience versus 17% who have six years or less experience.

Figure 3

Average Allocation to Hedge Fund Manager (2014)

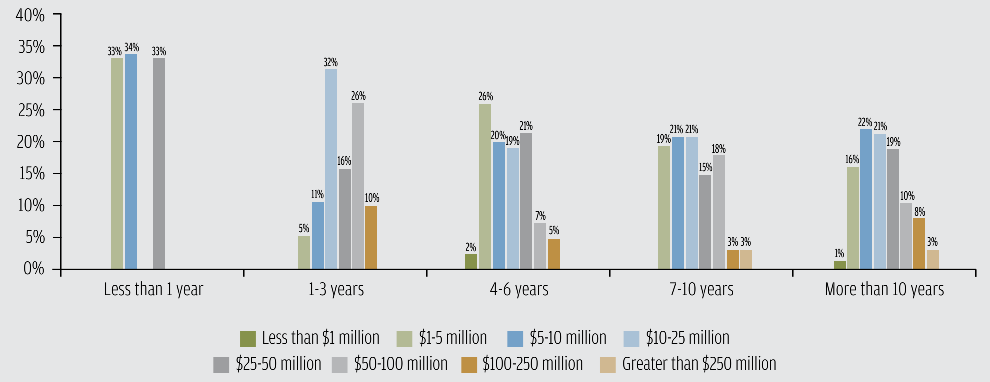


Average Allocation to Hedge Fund Manager by Investor Type (2014)



Note: Figures based on number of respondents unless otherwise noted

Average Allocation to Hedge Fund Manager by Hedge Fund Investing Experience (2014)



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

- 75% of respondents have between two and ten investment professionals dedicated to hedge fund research and investing.
- On average, Fund of Funds staff the largest investment teams, followed by Consultants and Banks.
- Over 50% of respondents with over ten investment professionals dedicated to hedge fund research made average allocations to hedge fund managers of over $50 million.
  - Only 15% of respondents with ten investment professionals or fewer dedicated to hedge fund research made average allocations to hedge fund managers of over $50 million.
- Pensions and Endowments & Foundations represent those segments least likely to have in-house operational due diligence teams.
  - 52% of Pensions outsource or use a Consultant or Fund of Funds for this function.
  - 38% of Endowments & Foundations do the same.

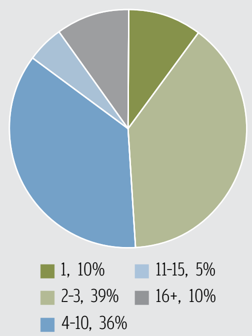
Most new manager ideas are sourced internally. 75% of respondents indicated that internal research was the primary hedge fund sourcing avenue.

- Over two-thirds of respondents indicated that they also utilize Capital Introduction teams as a resource for sourcing hedge fund managers.
- Over half of respondents source managers via prior relationships and having known a portfolio manager at a new fund from his or her prior firm.
- Only 16% of respondents indicated that they use Consultants for help with sourcing hedge fund investments.

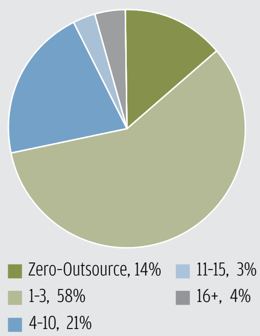
Note: Figures based on number of respondents unless otherwise noted

Figure 4

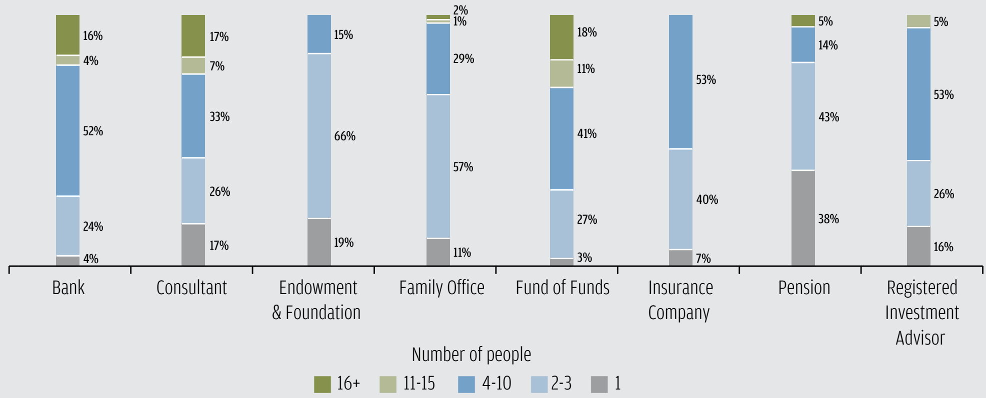
Number of Investment Team Professionals (2014)[1]



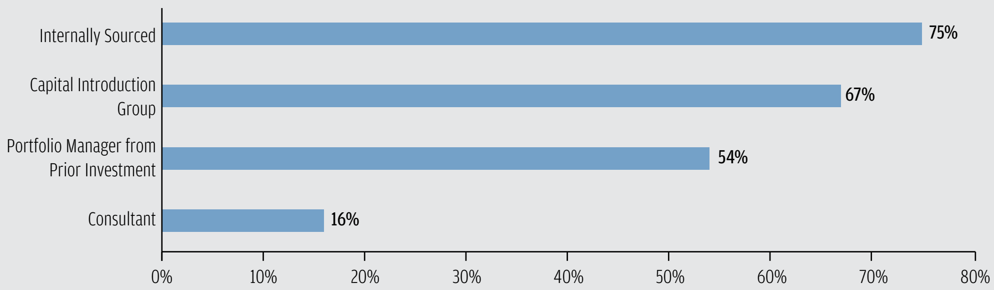
Number of Operational Due Diligence Professionals (2014)[1]



Investment Team Size by Investor Type (2014)[1]



Source of Hedge Fund Investment Idea (2014)[2]



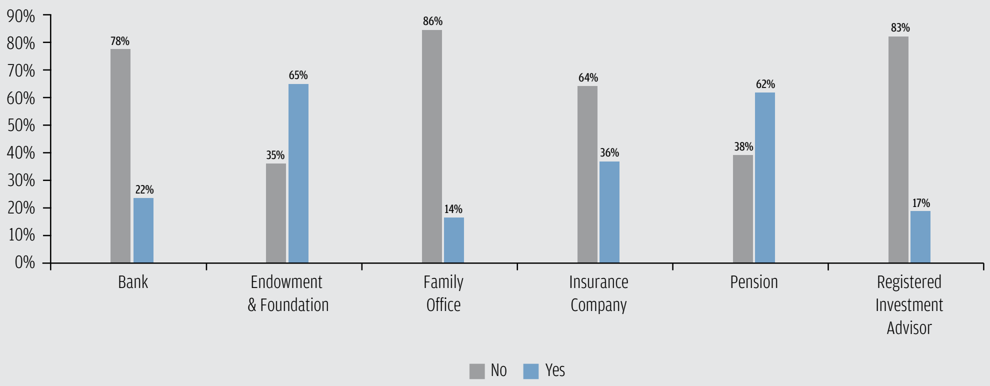
1 Note: Figures based on number of respondents unless otherwise noted
2 Note: Data is based on 820 selections made by 386 respondents

Nearly 30% of respondents (excluding Fund of Funds and Consultants) use a Consultant for assistance with their hedge fund investments.

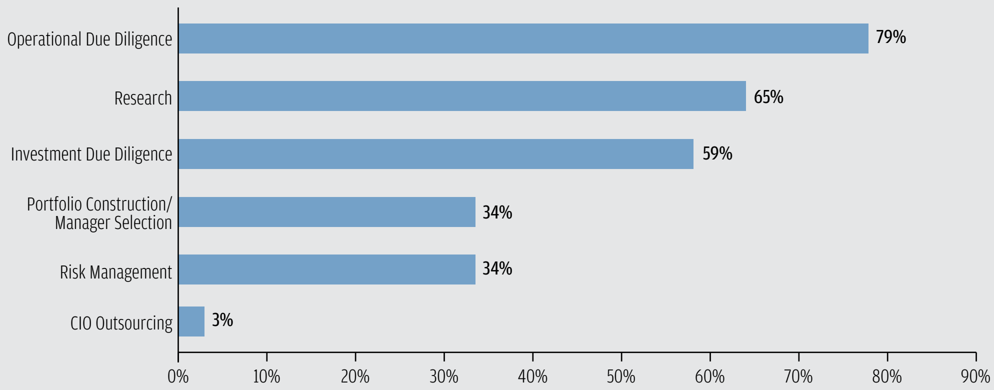
- Endowments & Foundations and Pensions are clearly the most prominent users of Consultants. 65% of Endowments & Foundations and 62% of Pensions used Consultants in 2014. These segments are most likely the main contributors to Consultant segment growth seen year-over-year.
- The most utilized services provided to respondents by Consultants are operational due diligence and research.
- Only 4% of respondents rely on a Fund of Funds as an Advisor or Consultant.

Figure 5

Consultant Usage by Investor Type (2014)[1]



Consulting Services Used by Respondents (2014)[2]

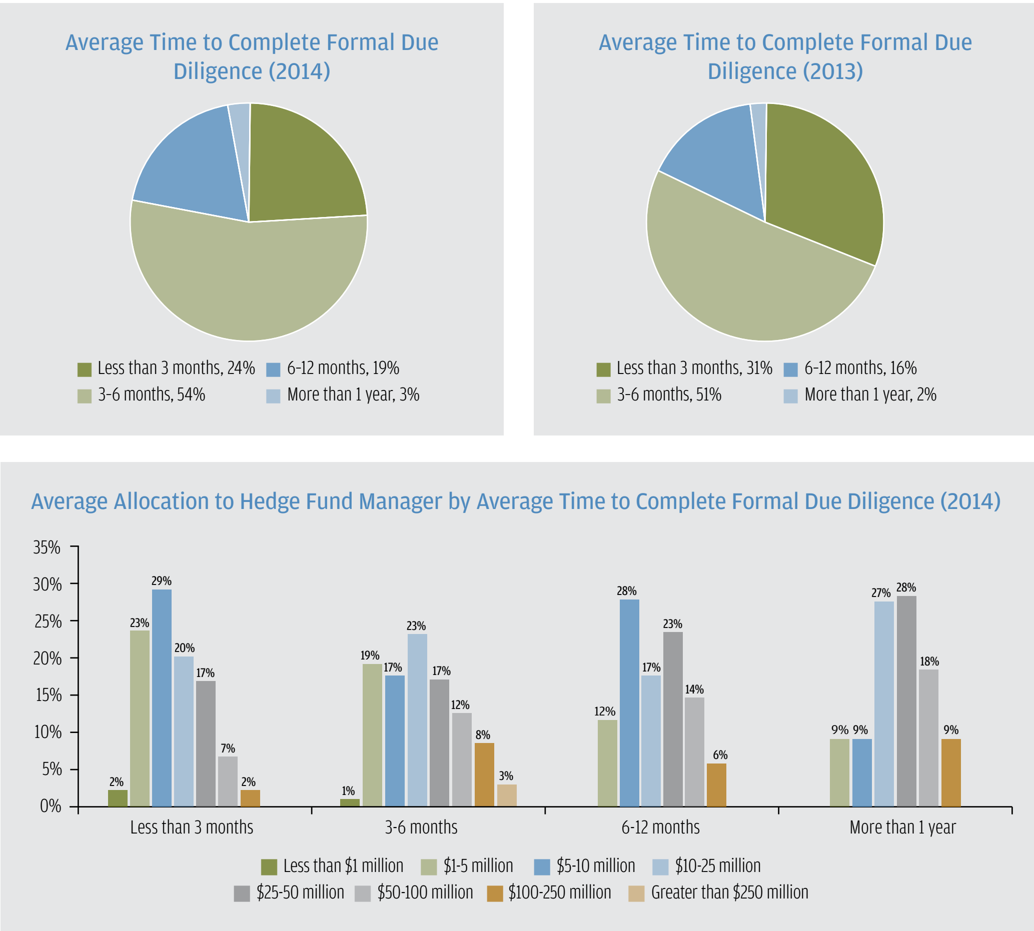


1 Note: Figures based on number of respondents (excluding Consultants and Fund of Funds)
2 Note: Data is based on 212 selections made by 68 respondents

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

- Over half of respondents indicated they complete due diligence within three to six months, regardless of their average allocation size.
  - Nearly 80% of all respondents complete manager due diligence in six months or less.
  - 54% of respondents who spend less than three months on due diligence make average allocations of $10 million or less.
  - Of those respondents who spend more than one year on due diligence, 55% make average allocations of $25 million or more.
- Pensions and Insurance Companies represent those segments spending the longest time, on average, on due diligence.
- Banks and Fund of Funds represent those segments spending the shortest amount of time, on average, on the due diligence process. This could be partly due to the fact that most respondents in these segments also have larger hedge fund investment teams.

Figure 6



Note: Figures based on number of respondents unless otherwise noted

II. INVESTMENT CRITERIA OF RESPONDENTS

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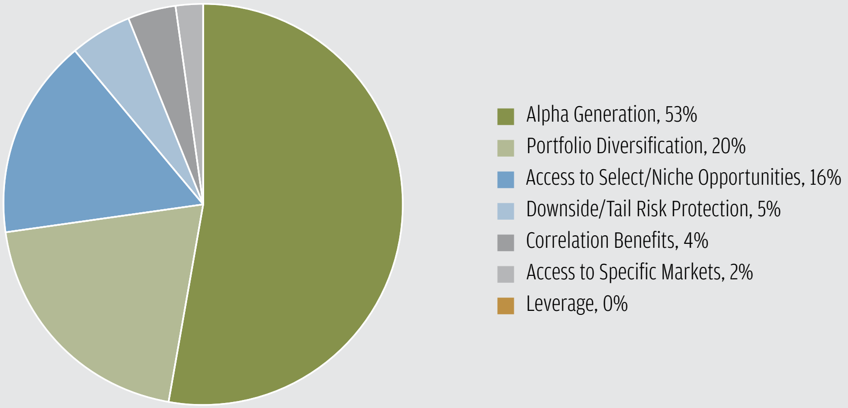
The growth and development of the hedge fund industry has modified the role that hedge funds play in an overall investment portfolio. When asked what the primary reasons were for investing in hedge fund managers, over 50% of the respondent base indicated alpha generation as the leading logic.

- One-fifth of respondents invest in hedge funds primarily for portfolio diversification purposes.
- 16% revealed that their primary reason for allocating to hedge funds is for access to select/niche opportunities.
- Other primary reasons for investing in hedge funds expressed by respondents include downside/tail risk protection, correlation benefits, and access to specific markets.

Figure 7

Primary Reason for Investing in Hedge Funds (2014)



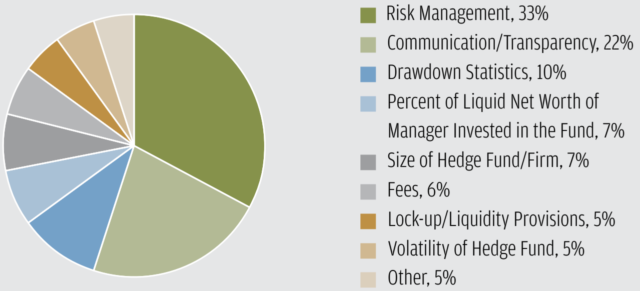
Note: Figures based on number of respondents unless otherwise noted

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

- Beyond the aforementioned manager criteria, risk management and communication/transparency were the next most important characteristics to respondents when making a hedge fund allocation decision. Drawdown statistics, aligned manager interests, and fund size are other important factors that influence respondents' investment decisions.
- Despite increased fee pressure on the hedge fund industry as a whole over the past few years, respondents indicated that fees were not that high of a priority when considering whether to make an allocation to a hedge fund manager. Only 6% of respondents indicated fees as their top investment criteria after manager pedigree, investment strategy, and track record. Under 15% of respondents indicated that fees rounded out their top five investment criteria when making an allocation decision.
- Respondents also cited some top concerns when investing in a hedge fund manager that included exposure to crowded trades and excessive risk taking. Liquidity and style drift were other common concerns amongst Survey respondents.
- Over half of the respondents revealed operational issues while performing due diligence on a hedge fund manager over the last 12 months.
  - Trade processing and operations, as well as regulatory compliance readiness, were the two most common issues revealed.
  - Other notable issues include concerns on valuation policy and unsuitable fund fees and expenses.

Figure 8

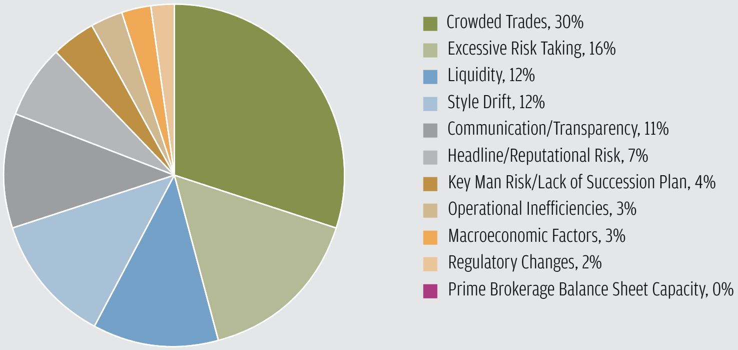
Outside of Manager Pedigree, Investment Strategy, and Track Record, Risk Management and Communication/Transparency are the Most Important Investment Criteria (2014)



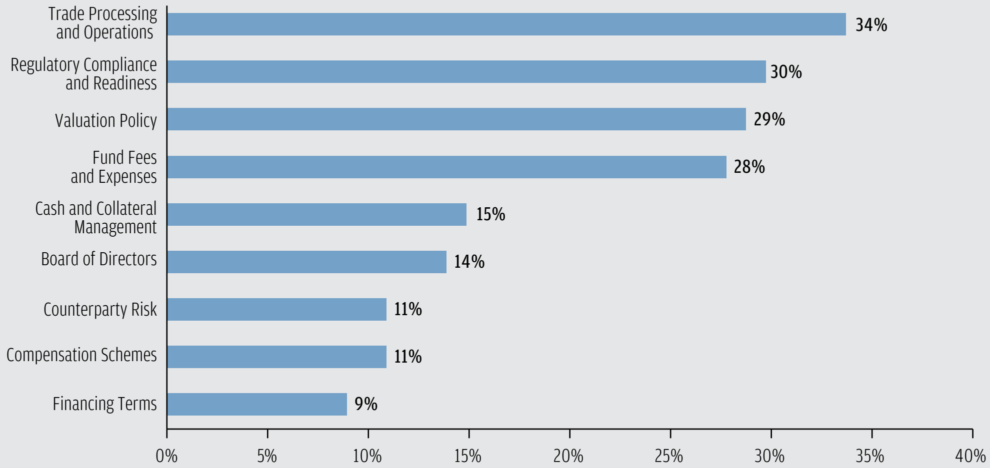
Note: Figures based on number of respondents unless otherwise noted

Figure 8 contd

Top Concerns when Investing in Hedge Fund Mangers (2014)[1]



Operational Issues Revealed During Due Diligence Process (2014)[2]

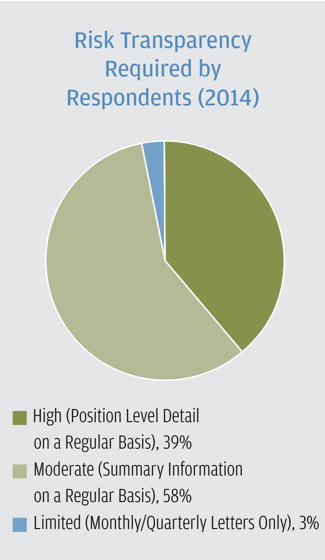


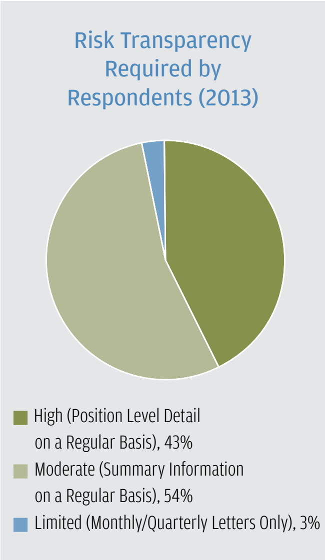
1 Note: Figures based on number of respondents unless otherwise noted
2 Note: Data based on 341 selections made by 189 respondents

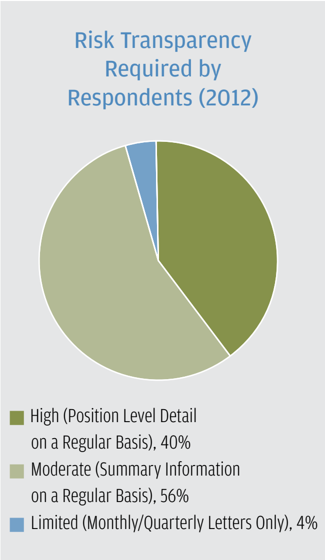
Nearly all respondents require at least regular summary information from hedge fund managers, consistent with the past few years.

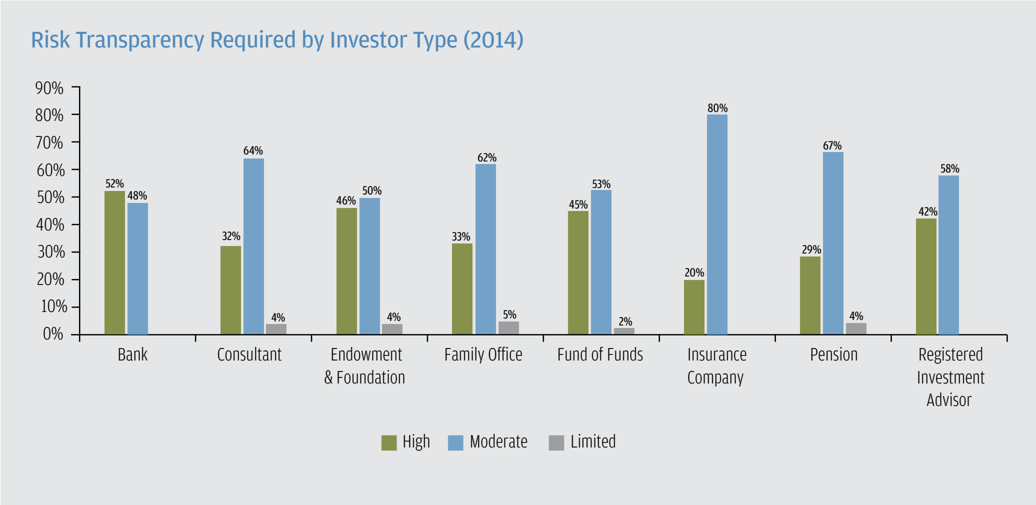
- Investors continue to require moderate to high levels of risk transparency, with approximately 40% of respondents requiring position level detail on a regular basis.
- Banks, Endowments & Foundations, and Fund of Funds had the largest percentage of respondents requiring high levels of risk transparency in 2014.
- Only about one-third of North America based respondents require high levels of risk transparency (position level detail) compared to nearly half of respondents based in Europe and the Middle East as well as Asia.

Figure 9



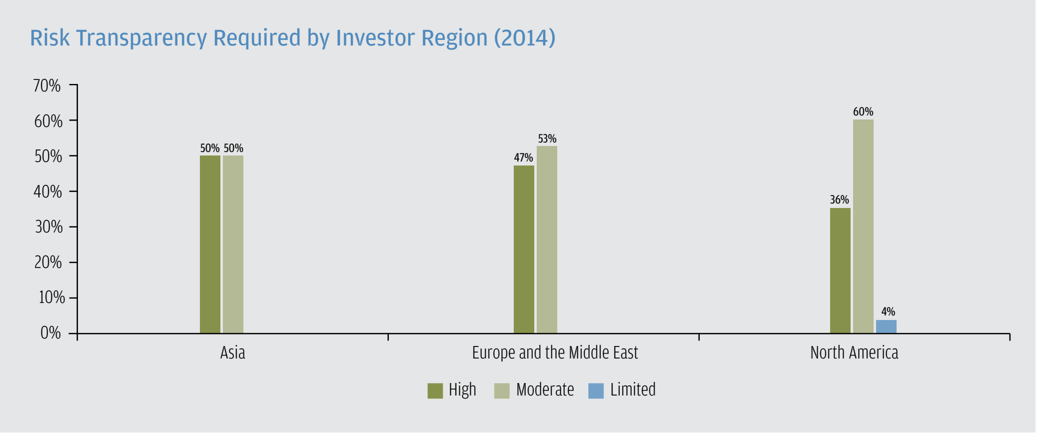






Note: Figures based on number of respondents unless otherwise noted

Figure 9 contd

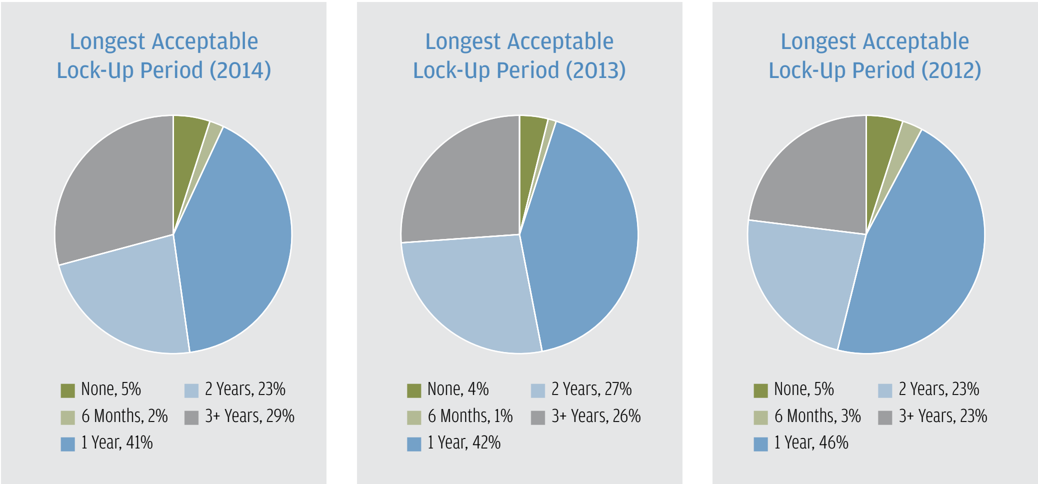


Note: Figures based on number of respondents unless otherwise noted

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

- While nearly 80% of respondents still prefer quarterly redemption periods or better, 94% of respondents are willing to accept a lock-up period of one year or more.
  - Most institutional investors are more concerned that the liquidity provisions of the hedge fund match the liquidity of the underlying assets.
- Banks and Fund of Funds demand the most liquidity, with approximately two-thirds of respondents within those sectors requiring lock-ups of one year or less.
- Nearly 90% of Endowments & Foundations and approximately 70% of Consultants and Pensions are willing to accept a lock-up period of two years or more.
- Asia-based investors are the least willing to lock up capital for two years or more. 59% and 42% of respondents based in North America and Europe and the Middle East, respectively, are willing to accept a lock up of two years or greater compared to only 18% of respondents based in Asia.
- Similar to last year, respondents continue to show an increased interest in longer-lock hedge fund vehicles, such as Hybrids and Co-Investment opportunities, compared to a couple years ago. These vehicles are discussed in further detail in Section III of the Survey.
- Over 90% of Insurance Companies prefer quarterly redemption periods or better.
- Geographically, over 75% of respondents in each region prefer quarterly redemption periods or better.
  - Respondents based in Europe and the Middle East and Asia prefer monthly liquidity or better. This differs from North America based respondents who prefer quarterly liquidity.
- Certain respondents indicated liquidity preferences for weekly redemptions or better. This may be driven by additional Liquid Alternatives offerings in the marketplace. We discuss Liquid Alternatives in more detail in Section III of the Survey.

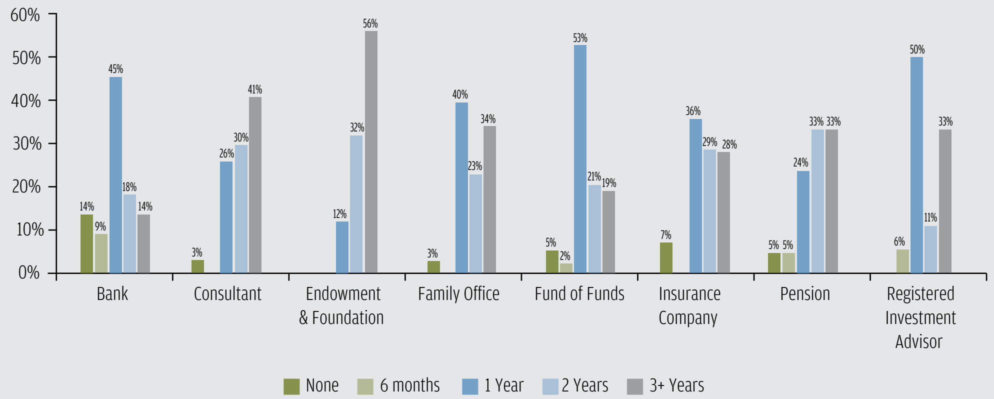
Figure 10



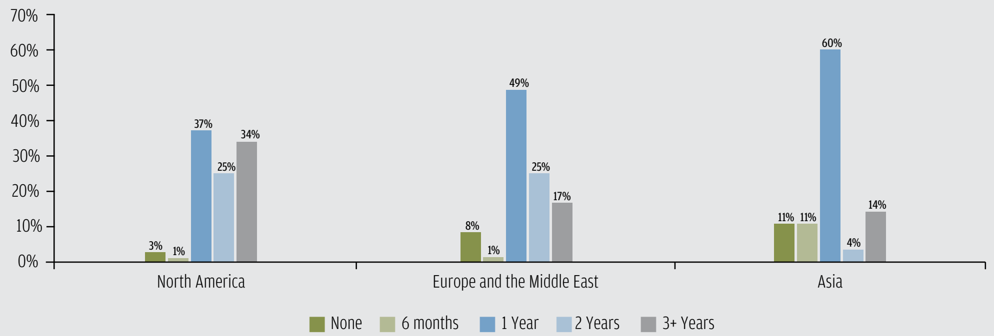
Note: Figures based on number of respondents unless otherwise noted

Figure 10 contd

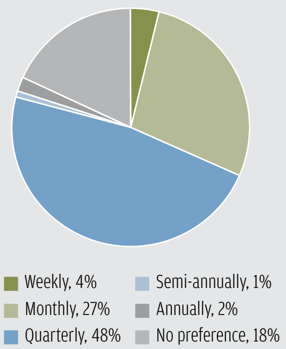
Longest Acceptable Lock-Up Period by Investor Type (2014)



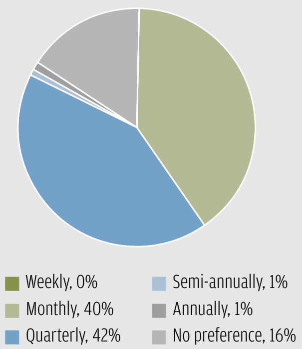
Longest Acceptable Lock-Up Period by Investor Region (2014)



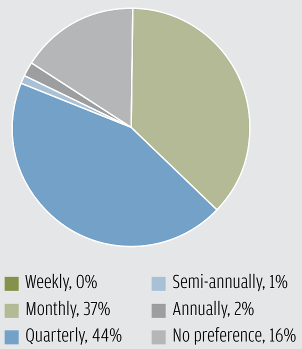
Preferred Liquidity (2014)



Preferred Liquidity (2013)

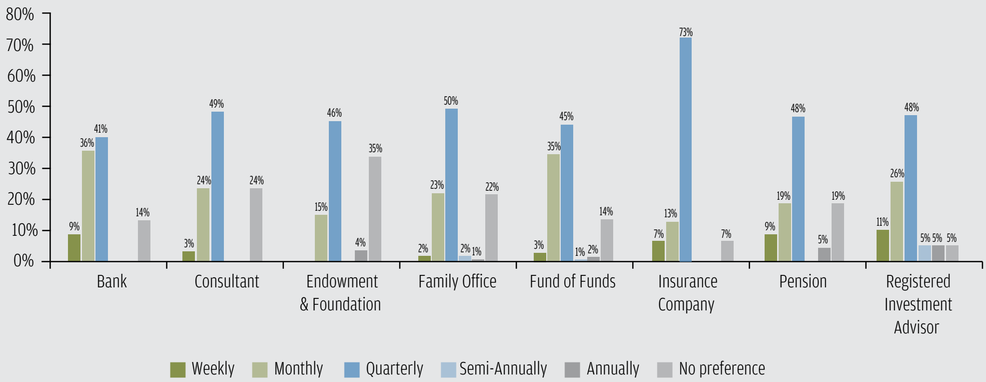


Preferred Liquidity (2012)

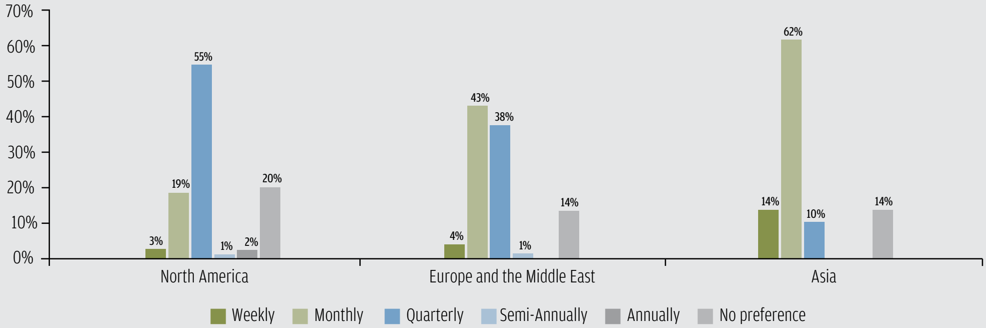


Note: Figures based on number of respondents unless otherwise noted

Preferred Liquidity by Investor Type (2014)



Preferred Liquidity by Geographic Location (2014)



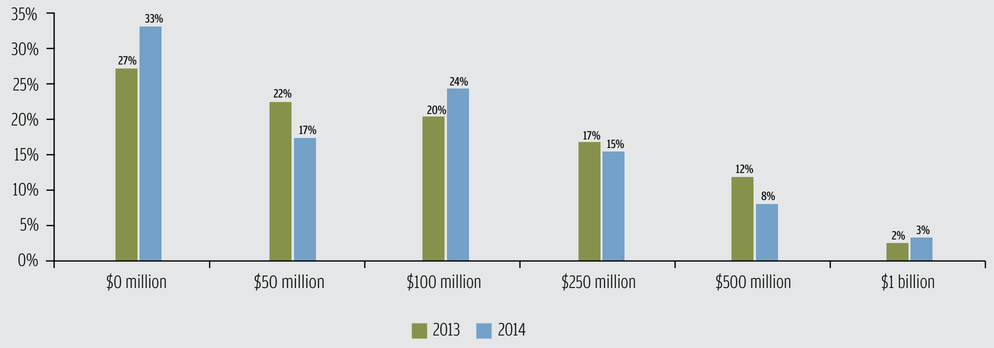
Note: Figures based on number of respondents unless otherwise noted

Minimum AUM and track record requirements have remained lower over the past few years as respondents remain more open to investing in smaller managers and/or early stage managers. Nearly 75% are willing to invest in hedge funds with $100 million AUM or less and, furthermore, roughly 70% of respondents will look at a hedge fund manager with a track record of one year or less.

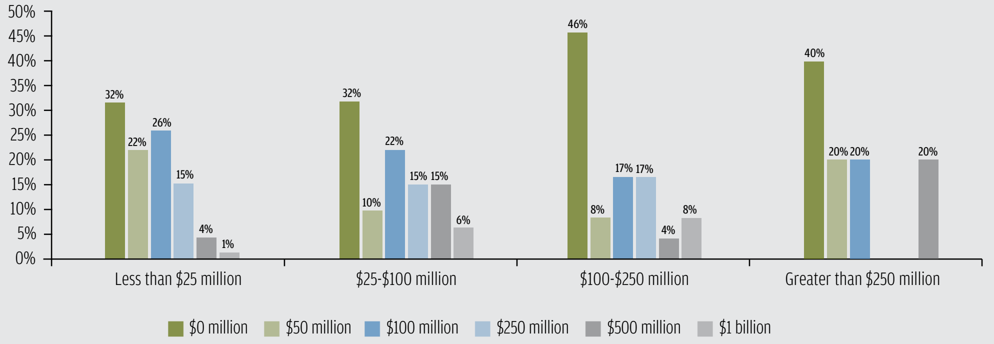
- The percentage of respondents without any minimum AUM requirement increased from 27% in 2013 to 33% in 2014.
- 45% of respondents who make average allocations of $100 million or more indicated they have no minimum AUM requirement.
- Fund of Funds and Family Offices represent those respondents most willing to invest in hedge funds with $100 million AUM or less. Family Offices tend to make, on average, the smallest allocations and therefore do not tend to face concentration issues with smaller funds.
- Pensions and Insurance Companies represented those segments most likely to require a minimum AUM of at least $500 million. These segments tend to make larger allocations, on average, to hedge fund managers. In addition, Pensions and Insurance Companies may have AUM constraints due to concentration guidelines with respect to the maximum percentage their investment may represent in a hedge fund.
- Fund of Funds, Endowments & Foundations, and Family Offices represent those segments most willing to invest in managers with track records of one year or less.
  - 62% of Endowments & Foundations will look at a hedge fund manager at fund inception. However, in order to invest, respondents most likely need to observe capital inflows before actually investing, as a majority of this segment indicated minimum AUM requirements of at least $100 million.
  - Roughly 60% of Fund of Funds respondents have no minimum track record requirements, and nearly half of the respondents in this segment indicated no minimum AUM requirement as well.
- On the other hand, over half of Pension respondents indicated they require a track record of at least two years.

Figure 11

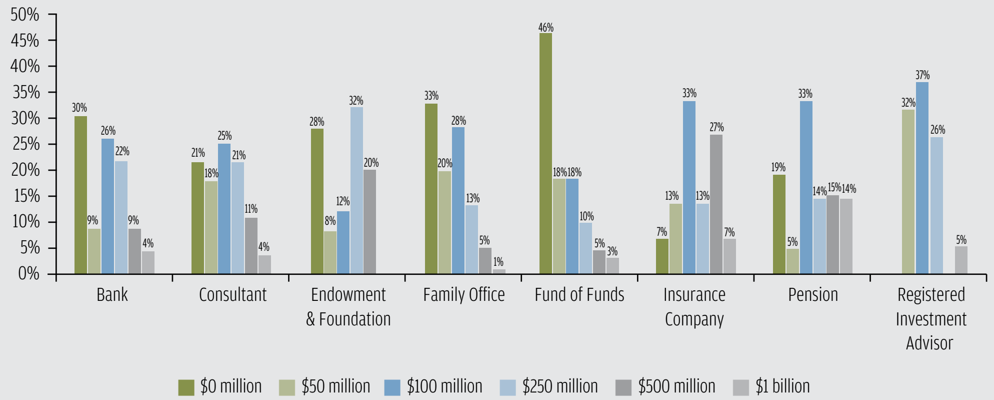
Minimum AUM Required to Invest in a Hedge Fund (2013-2014)



Minimum AUM Required to Invest in Hedge Fund by Average Allocation to Manager (2014)

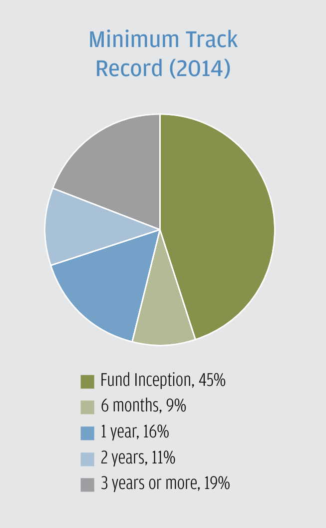


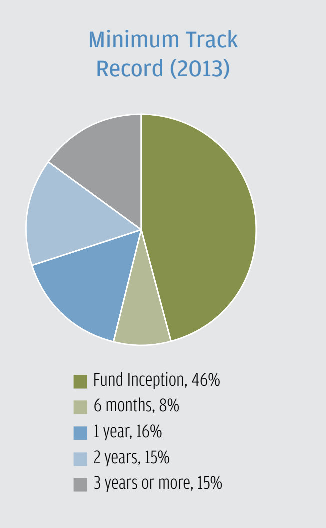
Minimum AUM Required to Invest in Hedge Fund by Investor Type (2014)

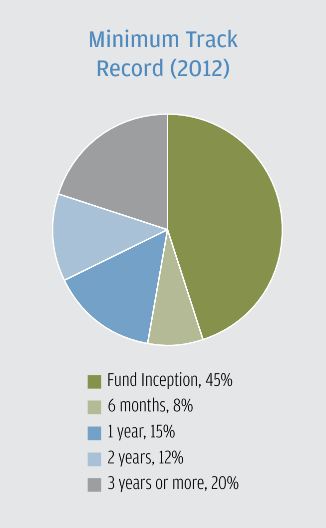


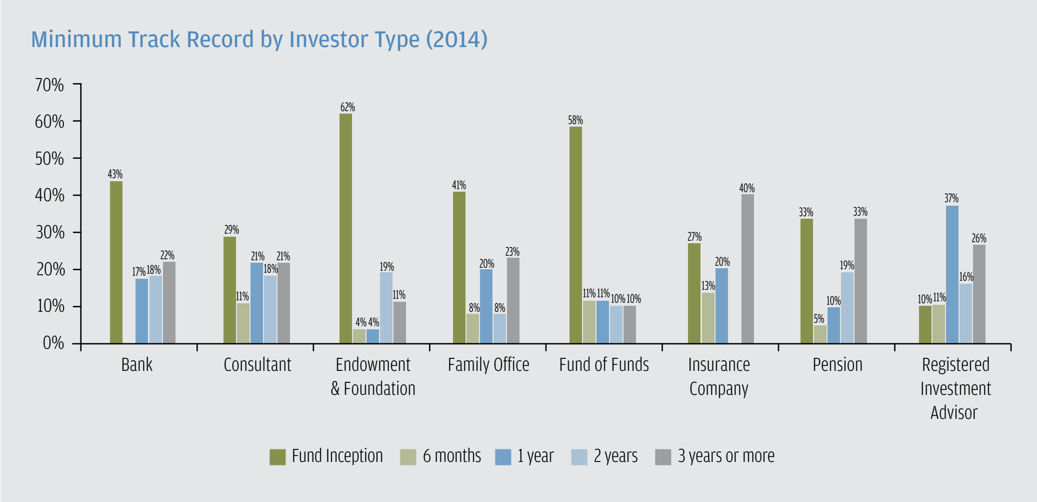
Note: Figures based on number of respondents unless otherwise noted

Figure 11 contd









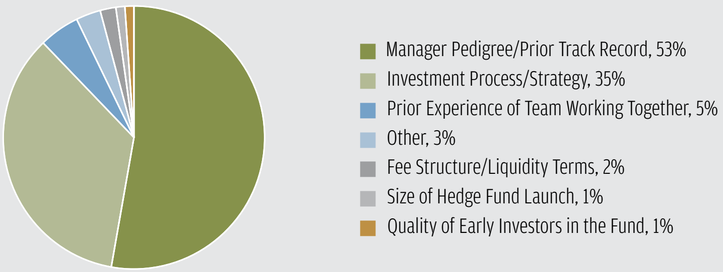
Note: Figures based on number of respondents unless otherwise noted

As lower minimum AUM and track record requirements may indicate, investors are actively starting to allocate capital to start-up managers. When evaluating a start-up hedge fund manager (i.e., track record of less than one year), hedge fund manager pedigree and track record from a prior firm are clearly the most important factors to respondents.

- When considering an investment with a new hedge fund launch, over 50% of respondents identified manager pedigree as the most important evaluation criterion.
- A manager's investment process/strategy was, on average, the second most important criterion.
- Respondent investment activity in start-up managers is covered in more detail in Sections III and IV of the Survey.

Figure 12

Most Important Criterion for New Hedge Fund Launch (2014)

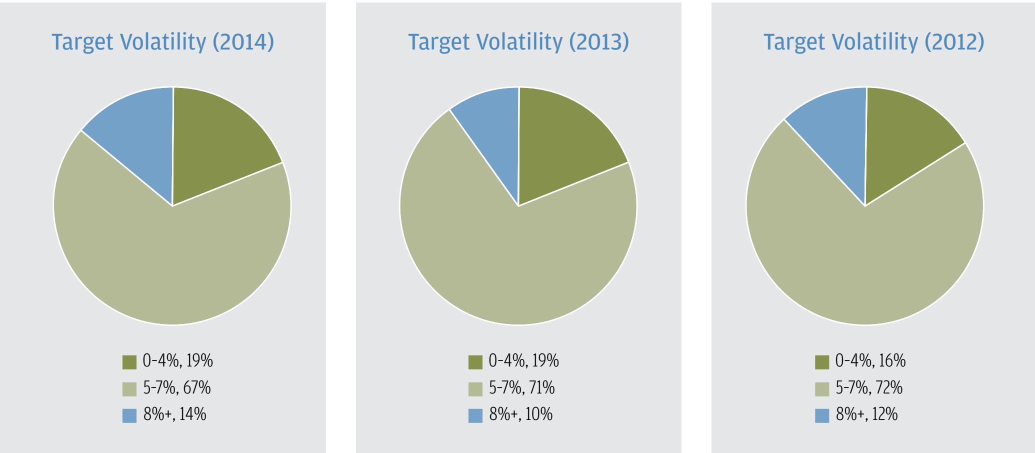


Note: Figures based on number of respondents unless otherwise noted

Approximately two-thirds of respondents target between 5-7% annualized volatility for their hedge fund investments.

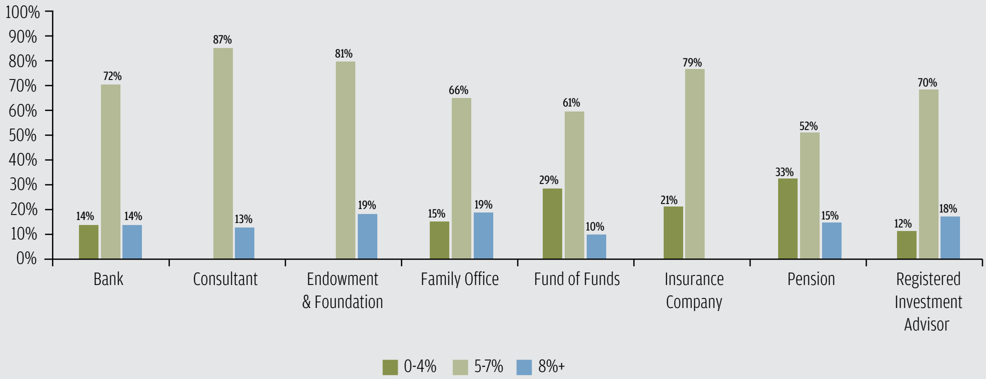
- Respondents, in general, appear to be leaving their risk profiles unchanged in 2014, with the majority continuing to target hedge fund portfolio volatility in the range of 5-7%. However, preferences appear to vary by investor type and geographic location.
  - 87% of Consultants and 81% of Endowments & Foundations are targeting volatility in the range of 5-7%. No respondents within these two segments indicated target volatility levels in the 0-4% range.
  - Approximately 20% of Endowments & Foundations and Family Offices are seeking 8%+ volatility targets.
  - One-third of Pensions look for lower volatility, targeting 0-4% for their hedge fund portfolios.
  - Regionally, respondents based in Europe and the Middle East were the most likely to have lower target volatility ranges of between 0-4%.

Figure 13

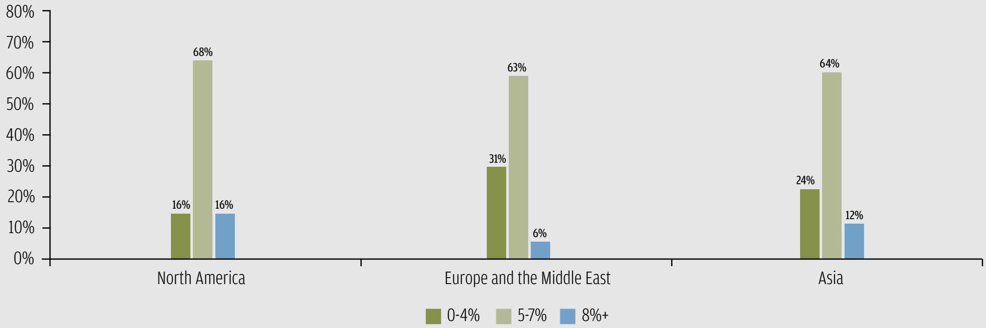


Note: Figures based on number of respondents unless otherwise noted

Target Volatility of Hedge Fund Portfolio by Investor Type (2014)



Target Volatility of Hedge Fund Portfolio by Geographic Location (2014)



Note: Figures based on number of respondents unless otherwise noted

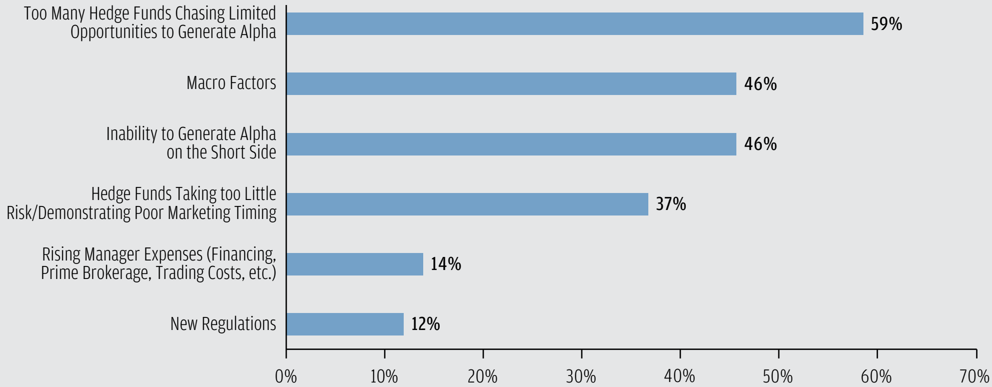
Broadly speaking, hedge funds did not fulfill their return expectations in 2014. Nearly 55% of respondents indicated their hedge fund investments did not meet their targeted hedge fund portfolio return for 2014. This represents a significant shift year-over-year, as nearly 90% of respondents met or exceeded their target return in 2013.

- The percentage of respondents that indicated hedge fund return expectations were either met or exceeded dropped by over 40% from 2013 to 2014.
- The majority of respondents indicated hedge fund target return ranges of either 5-10% or 10%+ in 2014.
- Hedge Funds gained 3.57% as measured by the HFRI Fund Weighted Composite, underperforming the S&P 500 by more than 10%. This is the third consecutive year that hedge funds have lagged the S&P 500 and MSCI World.[1]
- The HFRI Fund Weighted Composite Index has exhibited trailing three-year correlations to the S&P 500 and MSCI World indices of over 0.85.[2]
- Hedge funds also underperformed the U.S. high grade credit market in 2014, as indicated by the J.P. Morgan US Liquid Index.
- Nearly 60% of respondents believe the primary reason for hedge funds underperforming broader market indices over the past few years is due to industry crowding, where too many hedge funds are chasing limited opportunities to generate alpha.
  - Macro factors and the inability to generate alpha on the short side were other notable reasons respondents believe hedge fund managers are underperforming broader market indices.
  - Respondents do not believe new stringent banking regulations have much bearing on hedge fund underperformance, as it was the least selected reason of all choices.
- Of those respondents who did not meet their target return for 2014, the majority are not planning to significantly alter overall portfolio exposure to hedge funds. Instead, reallocating to different hedge fund managers and different strategies in 2015 were the most common changes planned to remedy meeting return expectations for the next year. This is discussed in more detail in Section IV of the Survey.

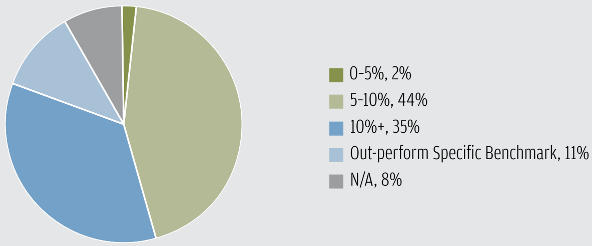
1 Source: Hedge Fund Research; Bloomberg. Calculations assume dividends are re-invested in equity market indices
2 Source: Hedge Fund Research; Bloomberg. Correlation was calculated based on monthly return data from January 2012 to December 2014

Figure 14

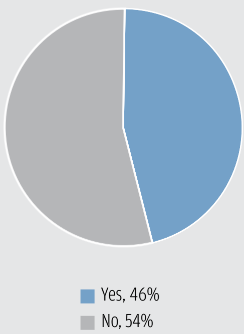
Primary reason for Hedge Fund Underperformance Over the Past Few Years[1]



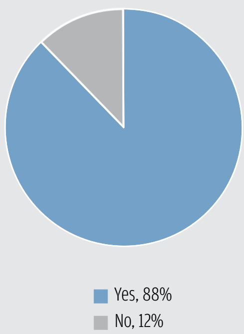
Target Return (2014)[2]



Were Target Hedge Fund Returns Met in 2014?[2]



Were Target Hedge Fund Returns Met in 2013?[2]



1 Note: Data is based on 823 selections made by 386 respondents

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

III. A LOOK AT RESPONDENTS' HEDGE FUND PORTFOLIOS

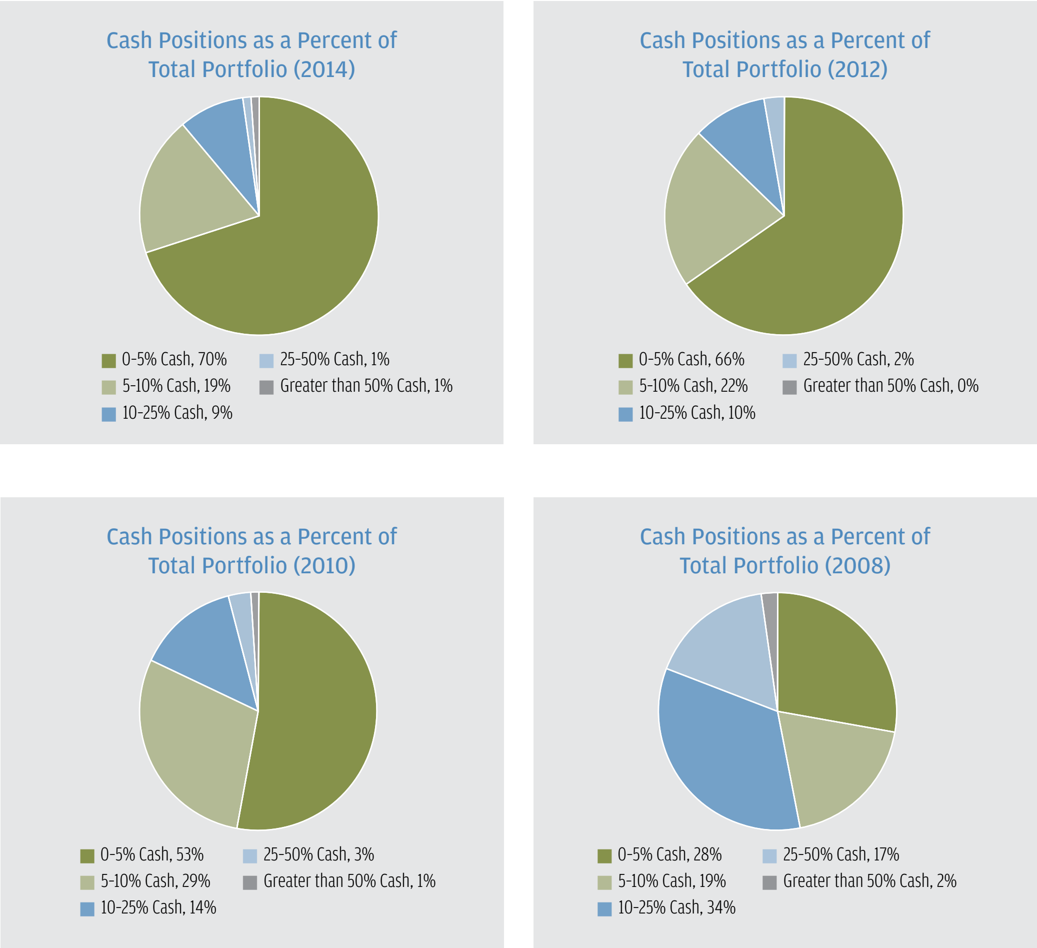
III. A LOOK AT RESPONDENTS' HEDGE FUND PORTFOLIOS

Respondents comment on the composition of their hedge fund portfolios and their investing activity in 2014.

Respondents have put most of their free cash to work in 2013 and 2014. Approximately 90% of respondents ended the year with less than 10% of their portfolio in cash.

- 70% of respondents ended 2014 with less than 5% of their portfolio in cash.
- This may indicate that respondents are currently the most willing to take risk since 2008, when over 50% of respondents ended the year with more than 10% in cash.
- 90% of Pensions, 82% of Fund of Funds, and 81% of Registered Investment Advisers ended 2014 with less than 5% of their respective investment portfolios in cash.
- Insurance Company respondents put the most capital to work in 2014 compared to any other segment, as 86% of respondents ended the year with less than 5% of their portfolios in cash compared to 69% of respondents in 2013.

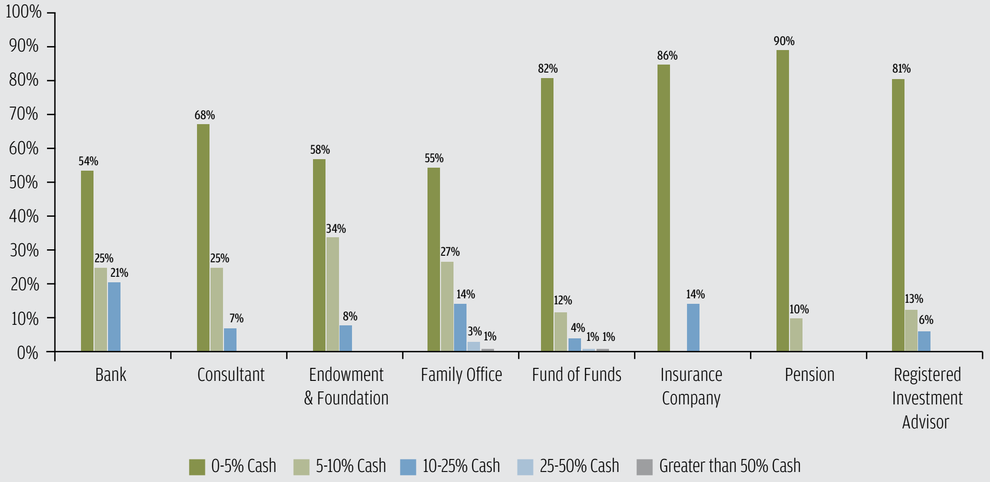
Figure 15



Note: Figures based on number of respondents unless otherwise noted

Figure 15 contd

Cash Positions as a Percent of Total Portfolio by Investor Type (2014)



Note: Figures based on number of respondents unless otherwise noted

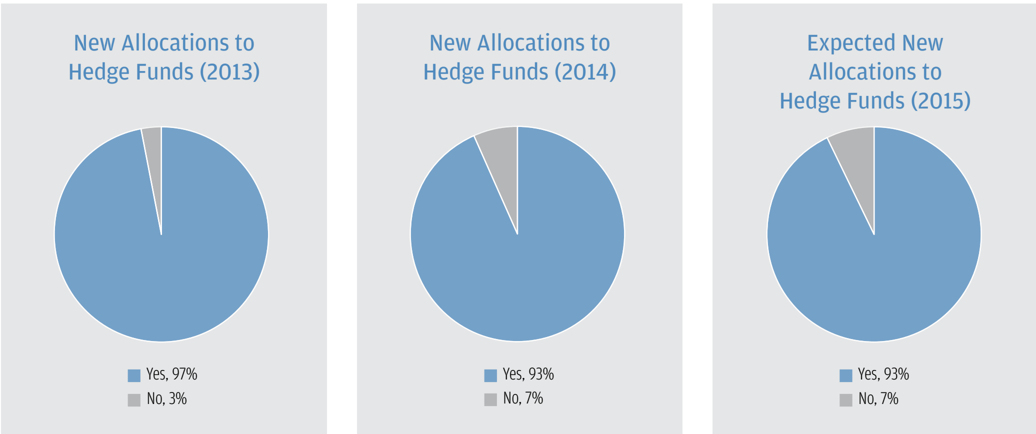
Institutional investors continue to allocate to hedge funds. The percentage of respondents making new allocations has remained over 90% since 2012.

- 93% of respondents made new allocations to hedge funds in 2014.
- Of those respondents who made new allocations, 96% invested in new hedge funds managers, while 70% increased allocations to current hedge fund investments.
- The primary source of capital for new hedge fund investments was from returned redemptions and lifted gates. However, new capital is a growing source as well.
- 91% of respondents maintained or increased their allocation to hedge funds as a percent of their overall portfolio during 2014.
  - One quarter of Pension respondents and nearly one-fifth of Consultant respondents increased the percentage of their portfolio dedicated to hedge fund investments in 2014.
  - Compared to other regions, hedge fund allocation increases were most prominent amongst Asia-based respondents. 17% increased hedge fund allocations as a percentage of their overall investment portfolio in 2014, compared to 8% and 4% of North America and Europe and the Middle East based investors, respectively.

While we expect continued growth for the hedge fund industry in 2015, the momentum it has gained over the past three years is expected to pull back slightly.

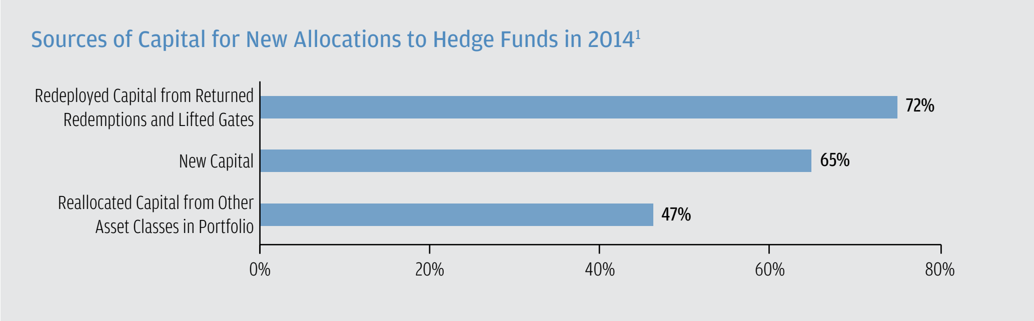
- Upon entering 2014, 30% of respondents expected to increase hedge fund allocations as a percentage of their respective investment portfolios. However, at year end 2014, only 8% indicated actually doing so.
- Despite respondents indicating that new allocations to hedge funds are still being made, 2014 was a difficult year for many managers. Hedge funds, in aggregate, underperformed most major market indices once again and exhibited high correlation to global equity markets.
- The idea of a slight pullback in industry inflow momentum is discussed in further detail in Section IV of the Survey.

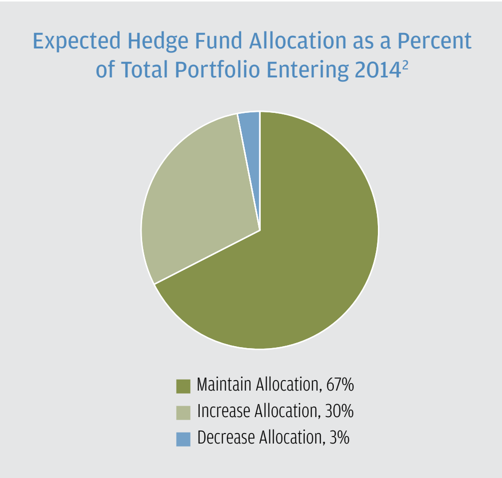
Figure 16

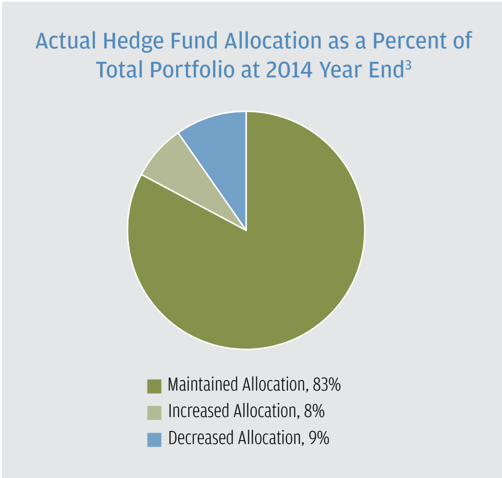


Note: Figures based on number of respondents unless otherwise noted

Figure 16 contd







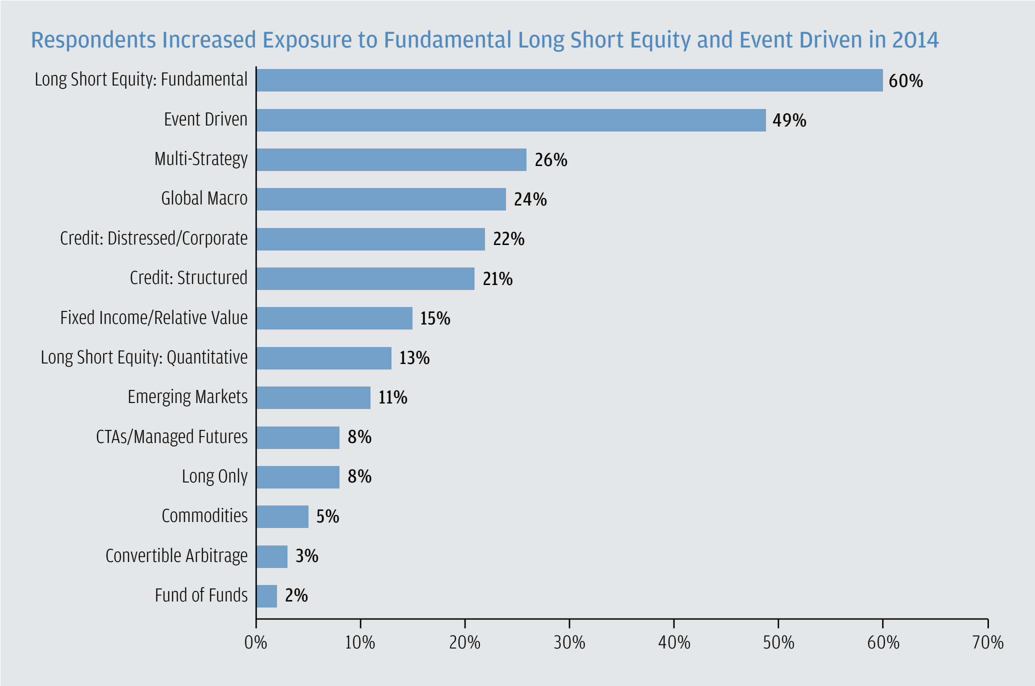
1 Note: Data is based on 623 selections made by 337 respondents

2 Note: Figures based on number of respondents in 2014 Investor Survey

3 Note: Figure is based on 357 respondents who provided information on Hedge Fund allocation for both 2013 and 2014 in 2015 Investor Survey

Over 70% of respondents increased their exposure to at least one hedge fund strategy in 2014. New allocations were made predominantly to fundamental long short equity and event driven managers.

Figure 17

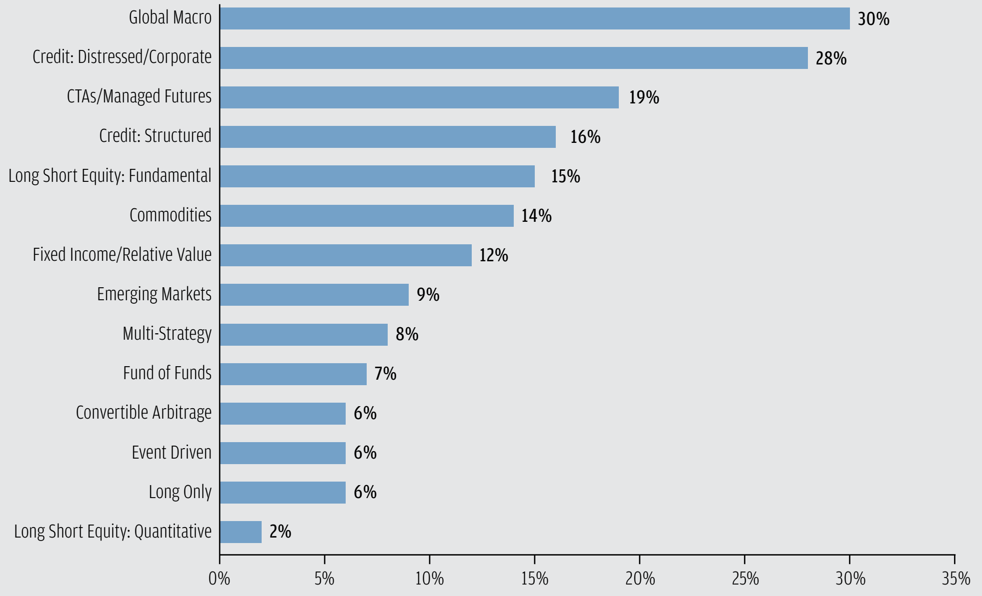


Note: Data is based on 674 selections made by 253 respondents

Over half of the respondents decreased their exposure to at least one hedge fund strategy in 2014. Most reductions to exposure involved global macro and distressed/corporate credit strategies, per our respondent base.

Figure 18

Respondents Reduced Exposure to Global Macro and Credit in 2014

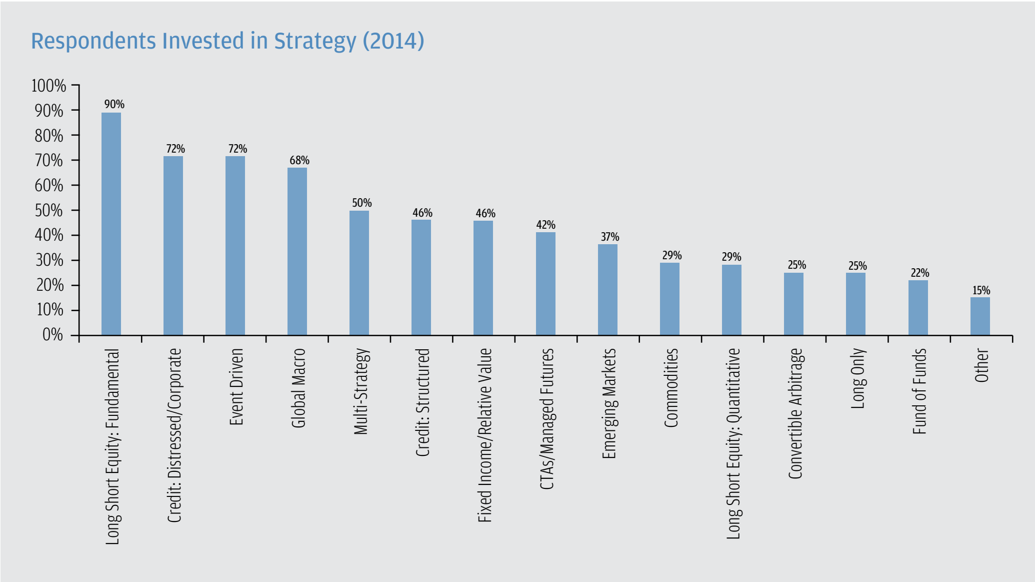


Note: Data is based on 350 selections made by 185 respondents

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

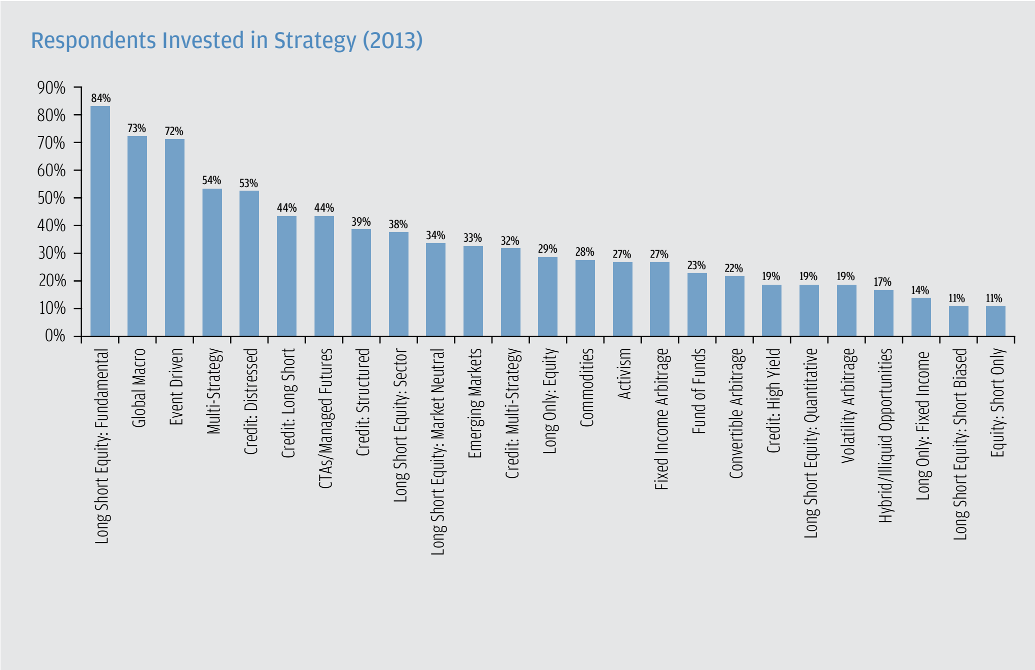
- Since 2008, Fundamental Long/Short Equity has been the most popular strategy among survey respondents each year. 90% of respondents were invested in the strategy in 2014.
- Quantitative Long/Short Equity strategies such as statistical arbitrage also grabbed more attention in 2014. 29% of respondents were allocated to the strategy in 2014 compared to only 19% the year before.
- Fixed Income/Relative Value experienced the largest growth year-over-year amongst our respondents, concurrent with capital flow activity that was observed across the hedge fund industry as a whole. 46% of respondents were invested in the strategy in 2014, demonstrating nearly a 20% jump from the 27% that were invested in 2013.
- Event Driven demand has remained steady over the past two years. 72% of respondents invested in the strategy in both 2013 and 2014.
- Although heavily allocated to in 2013, Global Macro fell slightly out of favor this year. Only 68% of respondents were allocated to the strategy in 2014 compared to 73% in 2013.

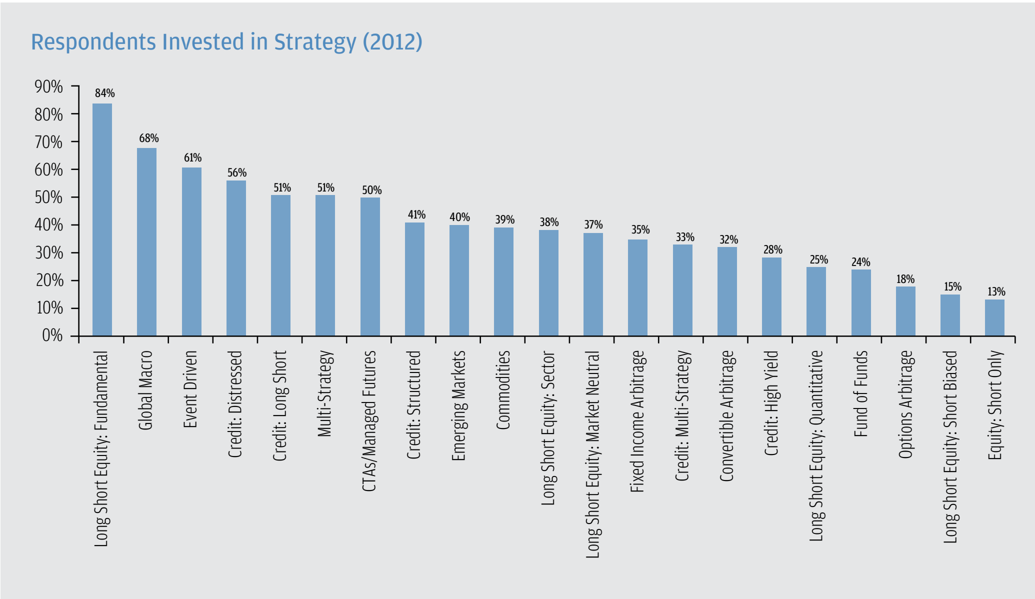
Figure 19



Note: Figures based on number of respondents unless otherwise noted. For 2014 data, survey respondents had 15 strategy selection options. For 2013 and 2012 data, survey respondents had 25 and 21 strategy selection options, respectively

Figure 19 contd





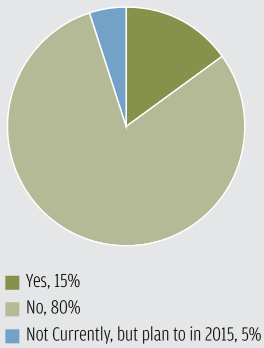
Note: Figures based on number of respondents unless otherwise noted. For 2014 data, survey respondents had 15 strategy selection options. For 2013 and 2012 data, survey respondents had 25 and 21 strategy selection options, respectively

Given the increased levels of market volatility toward the end of 2014 and overall hedge fund underperformance, respondents were asked about their current allocations to alternative or smart beta strategies. These strategies tend to be more liquid and less expensive compared to traditional hedge funds.

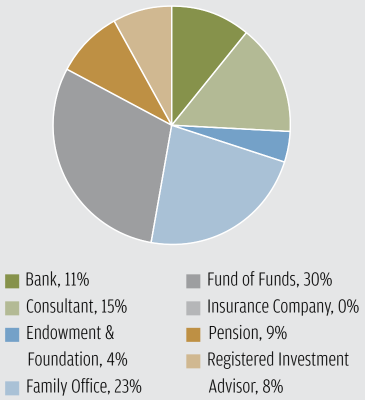
- Only 15% of respondents are currently allocating to Alternative or Smart Beta strategies.
  - Consultants, Banks, and Pensions represent the segments most likely to invest in these types of strategies.
  - Although only 13% of Fund of Funds respondents indicated they are invested in a Smart Beta product, this segment is the most likely to make an allocation in 2015.
- Geographically, Asia has the largest percentage of investors who allocate to Smart Beta strategies.
  - Asia investors are also most likely to allocate to Smart Beta strategies in 2015 compared to those based in Europe, Middle East and North America.
  - Over 75% of investors in North America and Europe and the Middle East do not allocate to Smart Beta, and less than 5% of investors in those regions plan to start in 2015.

Figure 20

Allocation to Alternative/Smart Beta (2014)



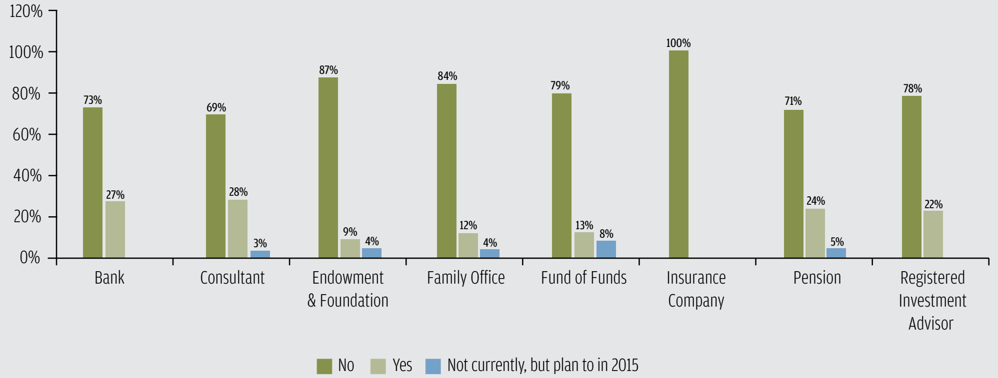
Investor Segment Breakdown of Respondents Invested in Alternative/Smart Beta (2014)



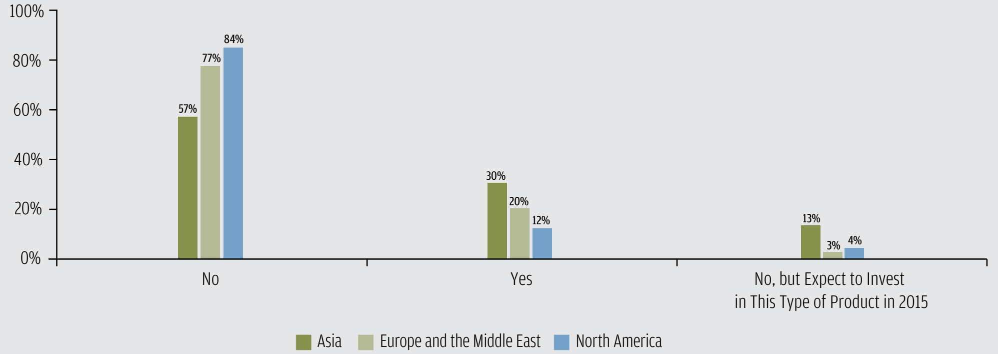
Note: Figures based on number of respondents unless otherwise noted

Figure 20 contd

Allocation to Alternative or Smart Beta Strategies by Investor Type (2014)



Allocation to Alternative or Smart Beta Strategies by Investor Region (2014)



Note: Figures based on number of respondents unless otherwise noted

In 2014, the hedge fund industry brought to market a significant number of new managers. Investors are not only more interested and willing to look at new launches, but are now actively starting to allocate capital to start-up managers.

- While nearly 70% of respondents indicated interest in selectively investing in start-up managers in 2013, this year the Survey studied how many actual allocations were made by respondents to new launches. Over 45% of respondents allocated to a start-up manager in 2014. A growing number of investors are putting capital to work with start-up managers.

- Looking ahead, new launches are gaining more interest amongst investors. 83% of respondents indicated they would look to maintain the number of start-up managers they allocate to in 2015. An additional 14% of respondents indicated they would increase the number of start-up manager allocations.

- Of those 47% of respondents that indicated they invested in a new launch in 2014, a vast majority of them only invested in one or two new managers compared to the minor six percent that made over five new launch allocations. Although newer managers are attracting investor attention, allocators still seem to be approaching investing in start-up managers cautiously and selectively.

- Fund of Funds represent the respondents most willing to consider an investment in a start-up manager, similar to last year. 63% of Fund of Funds respondents invested in start-up managers in 2014. This segment is also the most active in making allocations to new launches, as over 40% of those that invest in them typically allocate to three or more in one year.

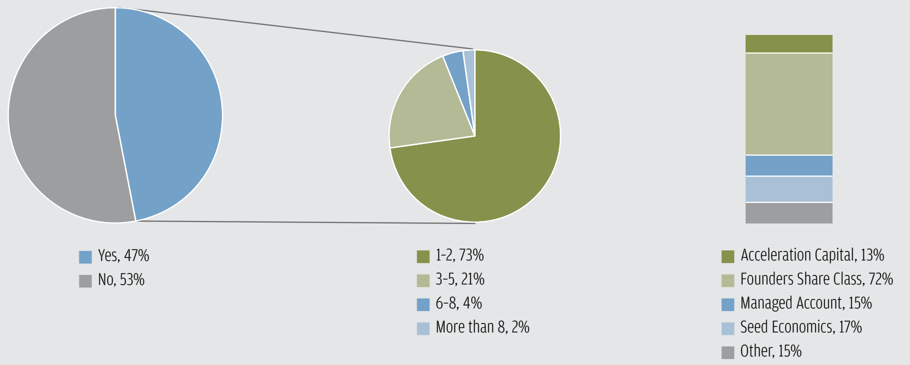
- 46% of Family Offices and Endowments & Foundations invested in start-up managers this year. These segments have increased their allocations to new launches over the last few years.
  - Consultants, Pensions, and Banks represent those respondents least willing to consider an investment in a start-up manager. This may be due to internal risk guidelines and capacity constraints these segments are subject to that require them to invest in larger, long-standing managers.
  - North America and Europe based respondents were more active in investing in start-up managers in 2014 than those respondents based in Asia.

- A founder's share class offering was the most common type of start-up investment respondents made in 2014. Other start-up investment types include acceleration capital, negotiated managed accounts, and seed economics.
  - While the environment for new launches remains challenging (under 20% of respondents who invest in start-up managers allocate seed or acceleration capital), average seed allocations by those respondents who are actively seeding has grown significantly over the last three years.
  - 50% of respondents who provide seed capital have average seed allocations of $50 million or more. This figure has nearly doubled year-over-year as only 26% of respondents indicated seed investments of $50 million or greater last year. In 2012, this figure represented only 17% of respondents.

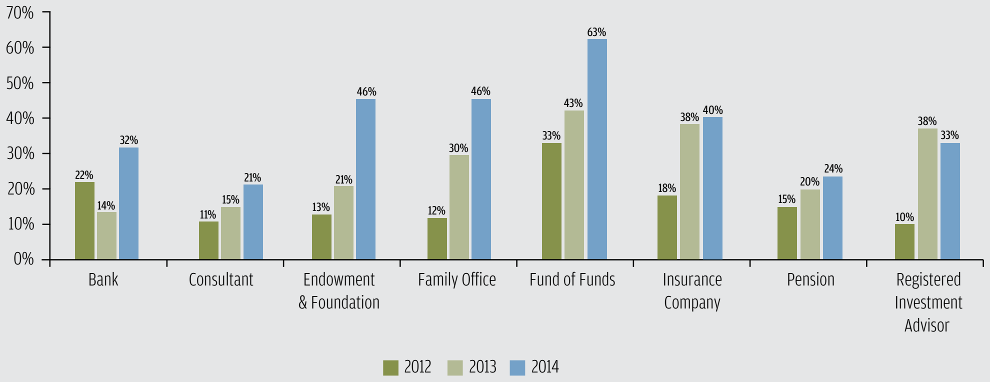
Figure 21

Invest in a Start-Up Hedge Fund Manager (2014)[1]

Number of Start-Up Managers and Type of Investment (2014)[1]



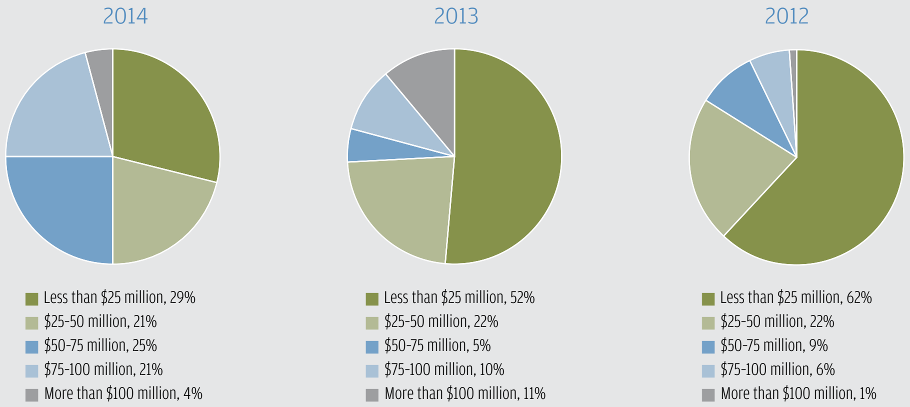
Percentage of Respondents Who Made Actual Allocations to Start-Up Managers by Investor Type (2012-2014)[2]



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

2 Note: 2012 and 2013 figures are based on the number of respondents in the 2013 and 2014 Institutional Investor Surveys, respectively, that selected "Yes" when asked if their Organization invests in start-up managers. Answer options in these years were "Yes", "No", and "Selectively". We did not count the "Selectively" response in these figures, as we wanted to collect a better idea of how many actual investments were being made versus investor interest only. We removed the "Selectively" answer choice for the 2015 Survey, where the 2014 figures are derived from. Answer options for the investing in start-ups question for 2014 were "Yes" and "No"

Average Seed Capital Allocation for Start-Up Managers



Note: Figures based on number of respondents unless otherwise noted

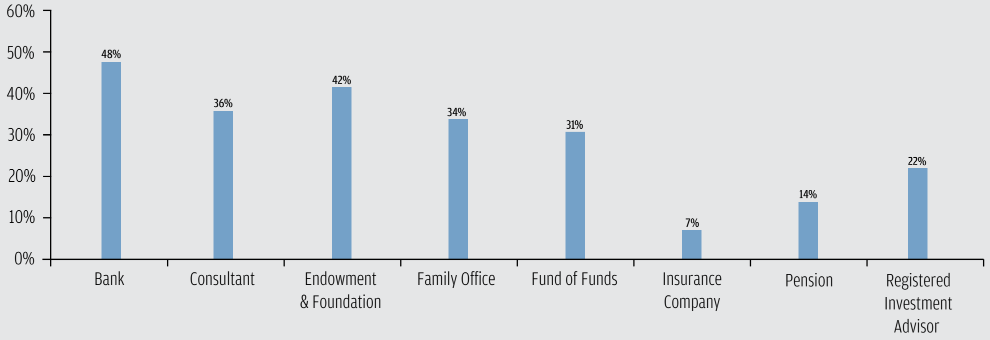
Aside from making hedge fund allocations to typical commingled funds, respondents invest via separately managed accounts, Funds of One, and Liquid Alternatives (UCITs and 40 Act vehicles).

Interest in investing via managed accounts has grown year-over-year due to continued emphasis on transparency and control. One-third of respondents invest via managed accounts, compared to under one-fifth of respondents last year.

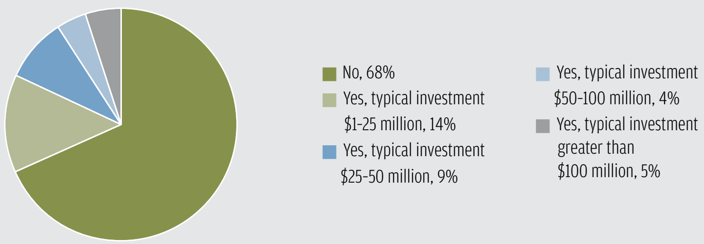
- Looking ahead, interest in investing via managed accounts is expected to continue to grow. According to our respondents that invest via managed accounts, one-third expect to increase these investments in 2015.
- 26% of respondents that currently invest in managed accounts increased these types of investments in 2014.
- When considering possible changes to the hedge fund industry in the near future, nearly 20% of the entire respondent base expects more money to be allocated via managed accounts.
- Average managed account size tends to be smaller than average Fund of One size. Over 70% of respondents who invest via managed accounts have a typical investment size of less than $50 million, compared to over 60% of respondents who invest via Funds of One that have typical investment size of greater than $50 million.
- Of those respondents who invest via managed accounts, the vehicle type represents only a small portion of overall AUM in hedge funds. Over three-quarters of respondents have less than 25% of overall hedge fund capital allocated via managed accounts.
- 48% of Banks and 42% of Endowments & Foundations invest via managed accounts. 75% of this subset have average managed account investments over $25 million.
- The interest in managed accounts appears to be relatively consistent across the regions, with 34%, 32%, and 25% of respondents based in Europe and the Middle East, North America, and Asia, respectively, investing via managed accounts.

Figure 22

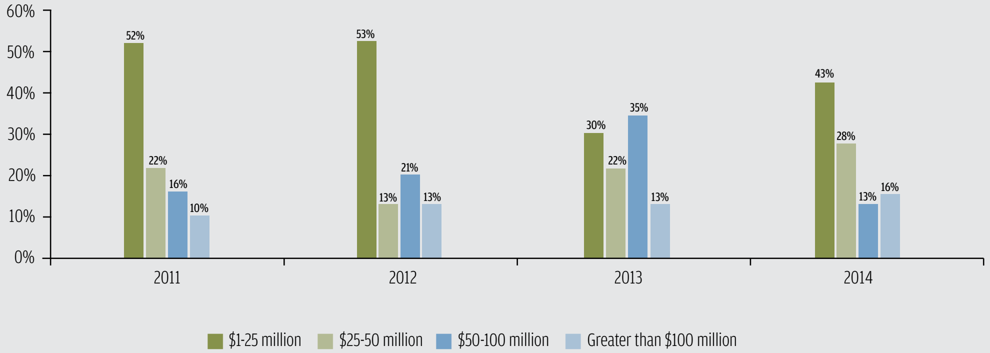
Percent of Respondents Invested via Managed Accounts by Investor Type (2014)



Respondents Invested in Managed Accounts (2014, by Typical Managed Account Investment Size)



Respondents Invested in Managed Accounts (2011-2014, by Typical Managed Account Investment Size)



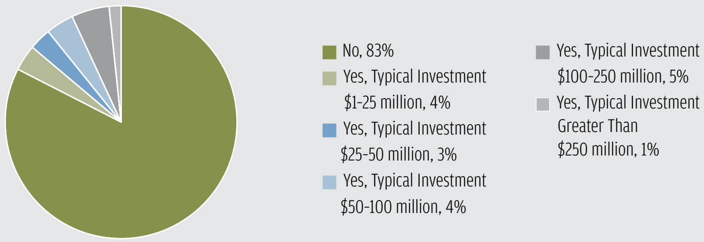
Note: Figures based on number of respondents unless otherwise noted

Less than one-fifth of respondents invest via Funds of One.

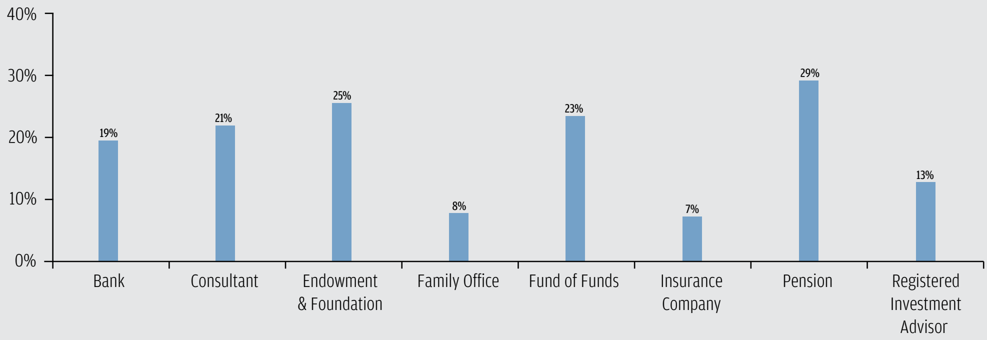
- Funds of One are less common among the respondent base than managed accounts, most likely due to higher minimums for Funds of One. Only 17% of respondents currently invest via Funds of One compared to the 32% who invest in managed accounts.
- Of those respondents that do invest in Funds of One, over 60% make typical investments of $50 million or more.
  - Pensions and Endowments & Foundations were the respondents most likely to invest via a Fund of One.
  - Of those respondents who prefer investing via a Fund of One, 83% of both Pensions and Consultants typically make investments of $50 million or more, whereas 75% of Family Offices make typical investments of $50 million or less.
  - 76% of respondents who invest via Funds of One are based in North America.
- Of those respondents who invest via Funds of One, the vehicle type represents only a small portion of overall AUM in hedge funds. 82% of respondents have less than 25% of overall hedge fund capital allocated via a Fund of One.
  - Among respondents, the most common percentage of total hedge fund investments currently made via a Fund of One is between 1-10%.
- Similar to interest in investing via managed accounts, interest in investing via Funds of One is expected to increase in 2015. One-third of the respondents who currently invest in these vehicles indicated they would increase their investments in 2015.
  - 32% of investors who invest via Funds of One increased this type of investment over the last 12 months.

Figure 23

Respondents Invested in Funds of One (2014, by Typical Fund of One Investment Size)



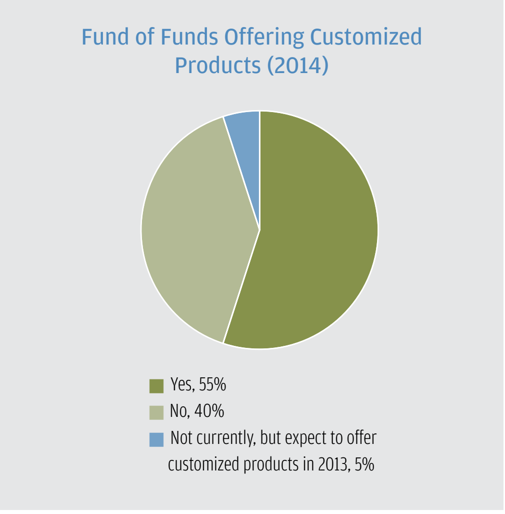
Percent of Respondents Invested via Funds of One by Investor Type (2014)

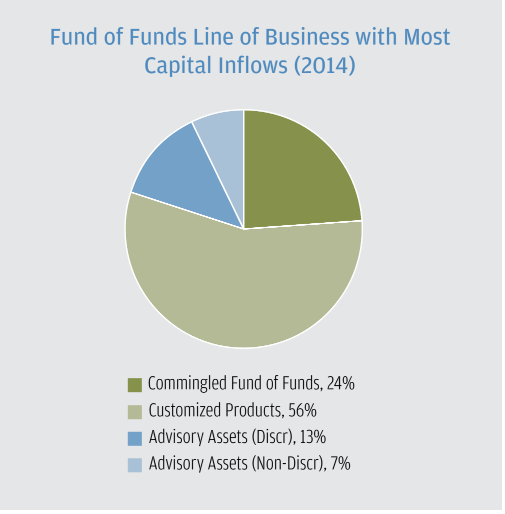


Fund of Funds, which have broadened their customized products line of business over the past years, are seeing the most growth from this type of business. Customized products are typically offered to investors via Funds of One.

- 55% of Fund of Funds respondents offered customized products in 2014. Among Fund of Funds respondents, this number is expected to grow slightly in 2015.
- The customized products business line is where most Fund of Funds are experiencing the most growth. 56% of respondents indicated customized products as an area that was growing faster than commingled Fund of Funds as well as discretionary and non-discretionary advisory assets.
- 40% of Fund of Funds respondents currently provide advisory or consulting services to their clients. According to the Survey however, most institutional investors utilize a traditional consultant over a Fund of Funds for consulting services.

Figure 24





Note: Figures based on number of respondents unless otherwise noted

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

- 27% of respondents currently invest in Liquid Alternative products compared to roughly 20% in 2013. Nearly one-third of respondents indicated they would invest in Liquid Alternatives in 2015.
- Of those respondents who currently invest in Liquid Alternatives, all have plans to either increase investments in Liquid Alternatives, or keep them constant.
- Banks, Consultants and Registered Investment Advisors represent those respondents with the highest allocations to Liquid Alternatives in 2014. Banks and Fund of Funds represent the segments that are most interested in increasing Liquid Alternative investments in 2015.
- Nearly 30% of Fund of Funds respondents indicated that they already run a 40 Act or UCITS alternative multi-manager fund. An additional 10% of Fund of Funds respondents indicated they have plans to launch this type of product in 2015.
  - Of those Fund of Funds respondents who are already running Liquid Alternative multi-manager funds, geographic representation is split roughly 50/50 between North America and Europe based groups.
  - Approximately 20% of Fund of Funds respondents based in Europe indicated they planned to launch Liquid Alternative multi-manager funds in 2015.
  - Roughly 60% of Fund of Funds respondents that currently run a Liquid Alternative multi-manager fund have greater than $2.5 billion in AUM. Larger managers most likely have the infrastructure and internal resources to be able to offer this type of product.
- When considering possible changes to the hedge fund industry in the near future, 35% of the respondent base expect more money to be allocated to 40 Act Funds (i.e., alternative mutual funds offering daily liquidity).

Figure 25

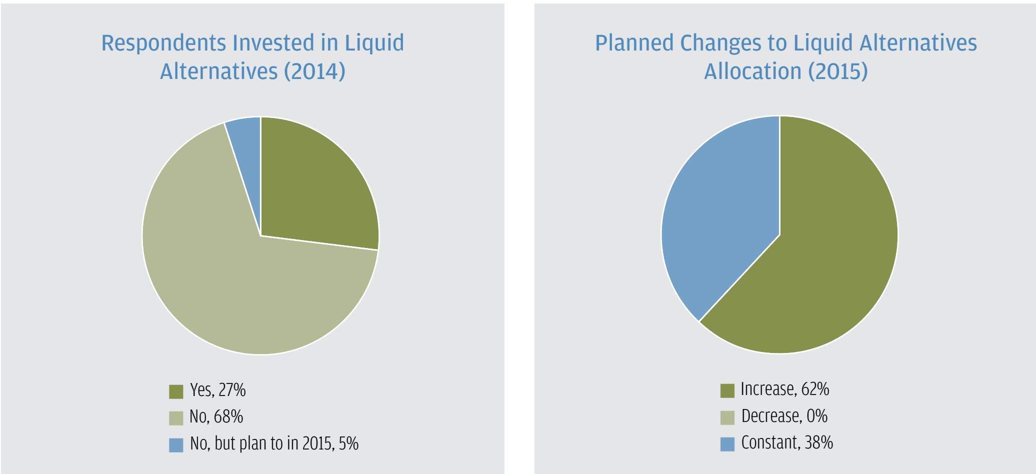
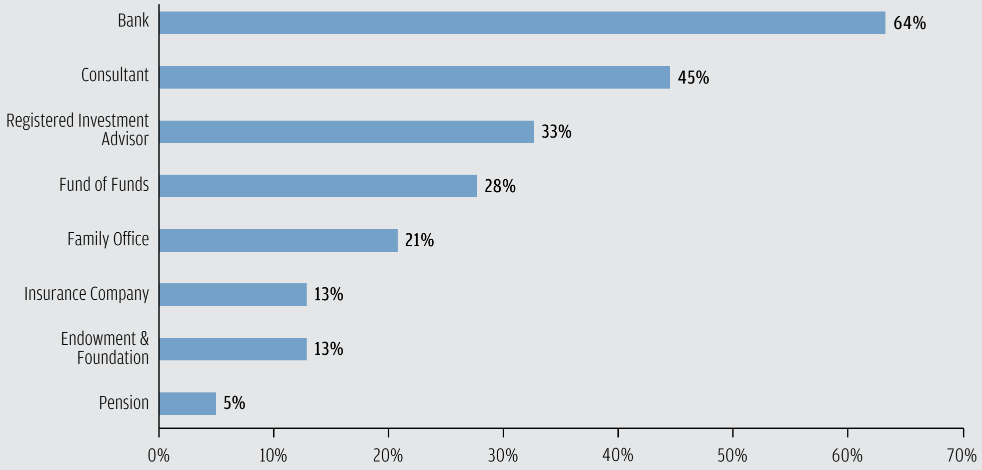
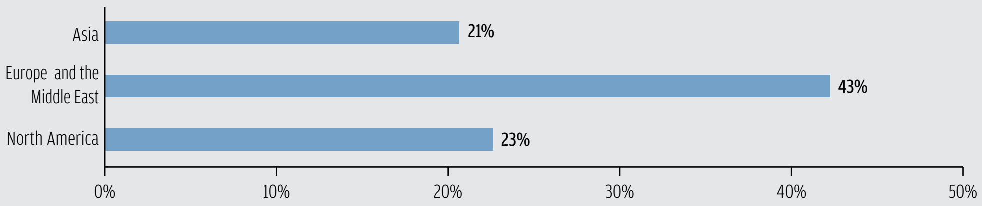


Figure 25 contd

Percent of Respondents Invested in Liquid Alternatives by Investor Type (2014)



Percent of Respondents Invested in Liquid Alternatives by Investor Region (2014)

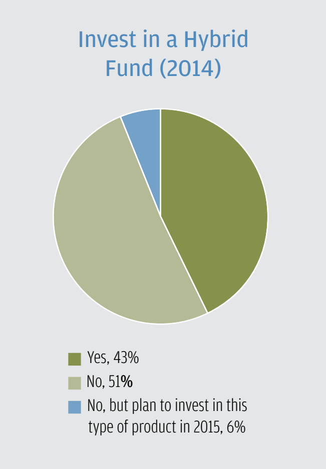


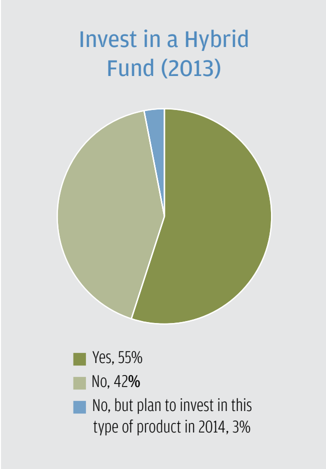
Note: Figures based on number of respondents unless otherwise noted

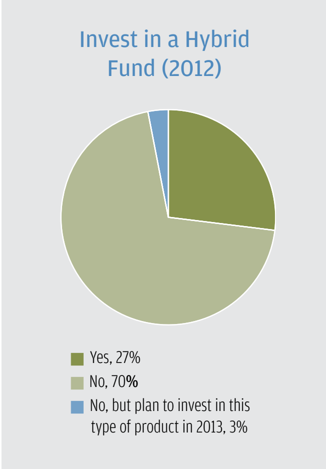
Investors also have an appetite for vehicles on the opposite end of the liquidity spectrum. Similar to last year, respondents continue to show an increased interest in longer-lock hedge fund vehicles, such as hybrids and co-investment opportunities, compared to a couple years ago.

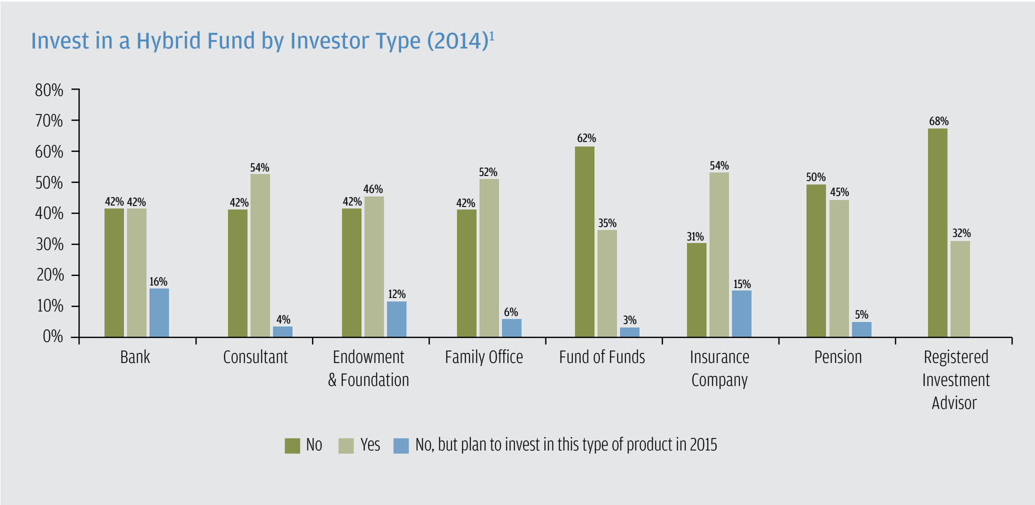
- Nearly 45% of respondents invested in a less liquid hedge fund product typically offering liquidity of three years or more (e.g., hybrid fund, drawdown structure) in 2014.
  - Investor appetite for less liquid strategies has increased since 2012 when only 27% of respondents indicated they invested in a hybrid fund.
  - 54% of Consultants, 54% of Insurance Companies, and 52% of Family Offices currently invest in a less liquid hedge fund product.
- Over 55% of respondents indicated interest in participating in a co-investment opportunity. A co-investment opportunity is typically an investment in a parallel fund vehicle or Special Purpose Vehicle that will invest alongside a manager's comingled fund either pari-passu or in less liquid securities not suitable for the main fund.
  - 72% of Family Offices, 65% of Endowments & Foundations, and 64% of Consultants indicated they would participate in a co-investment opportunity.
  - Family Offices demonstrated the largest increase in co-investment opportunity interest year-over-year. 72% of segment respondents indicated interest this year compared to 59% last year.
- Across all investor segments, respondents are more prone to invest in a co-investment alongside a hedge fund manager in which they are currently invested over a new manager.
- Geographically, respondents based in North America are the most likely to participate in a co-investment vehicle.
  - 64% of respondents in North America indicated interest, compared to 44% in Europe and the Middle East and only 10% in Asia.
  - Asia-based respondents demonstrated the largest decline in interest for these vehicles year-over-year. Only 10% indicated interest this year compared to 36% in 2013.
- Out of all the respondents who indicated interest in co-investments, Family Offices and Fund of Funds, combined, comprised nearly 70% of the universe. Respondents based in North America represented over 80%.

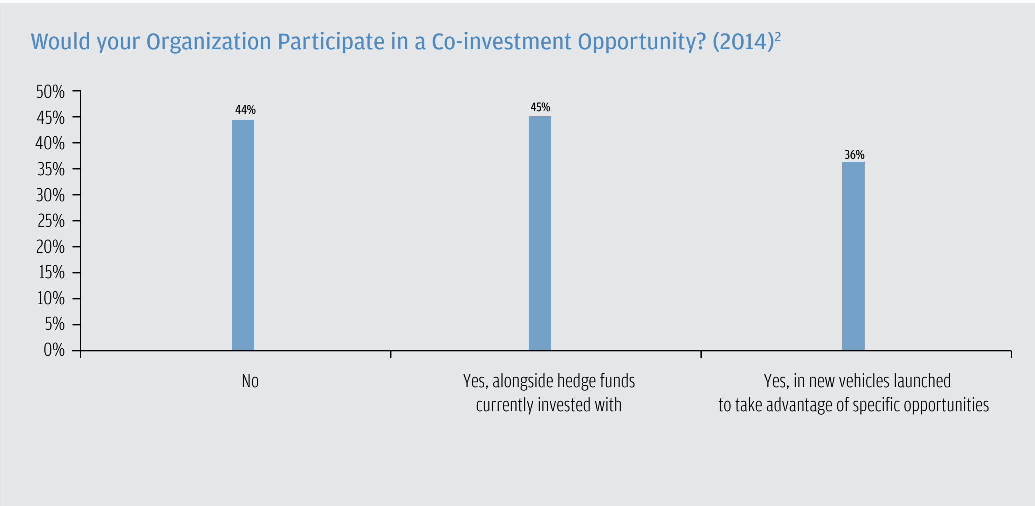
Figure 26





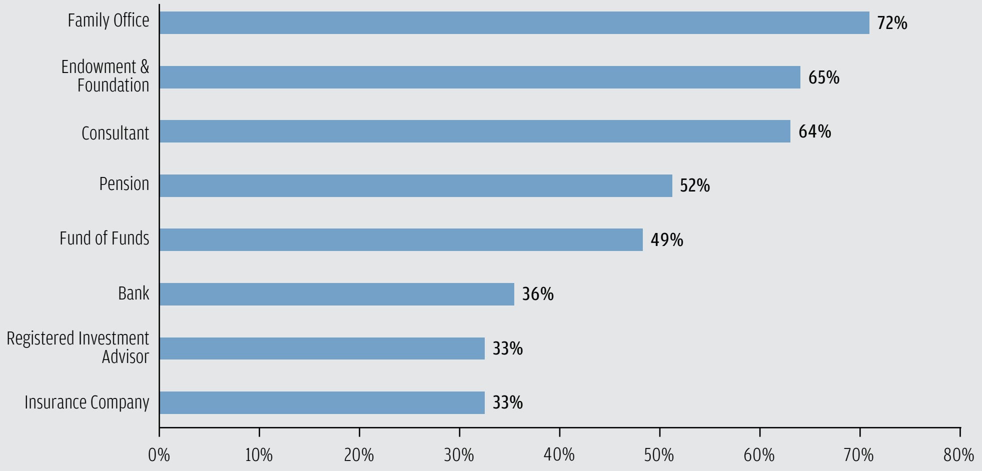




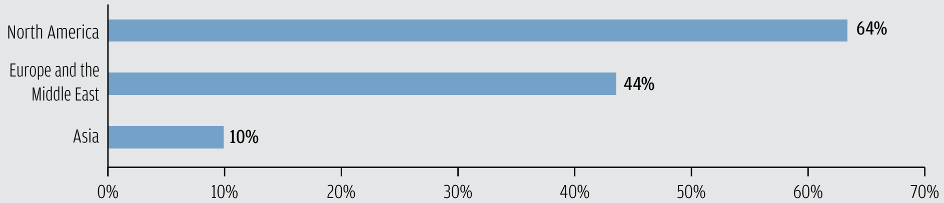


1 Note: Figures based on number of respondents unless otherwise noted
2 Note: Data is based on 448 selections made by 357 respondents

Interest in Co-investment Opportunities by Investor Type (2014)



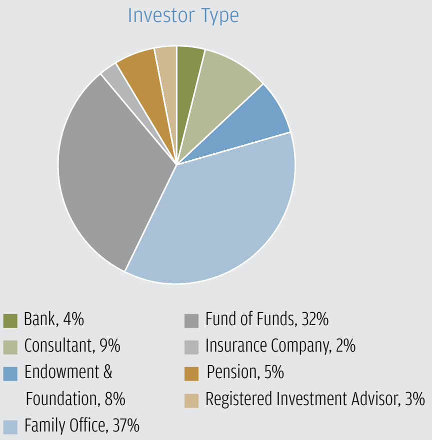
Interest in Co-investment Opportunities by Investor Region (2014)

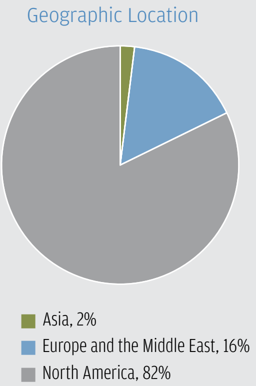


Note: Figures based on number of respondents unless otherwise noted

Figure 26 contd

Respondent Base Indicating Interest in Co-investment Opportunity (2014)





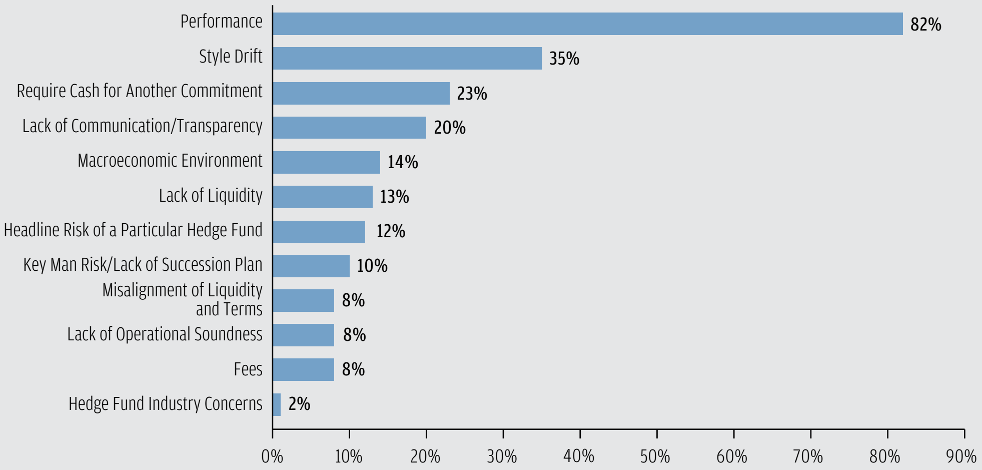
Note: Figures based on number of respondents unless otherwise noted

Over 80% of respondents redeemed from at least one hedge fund in 2014, consistent with 2013.

- The top three reasons cited for redemptions from hedge funds were performance, style drift, and a requirement of cash for another commitment. These have consistently been the top three causes for redemptions over the past three years.
  - Performance is undeniably the primary driver for redemptions. 82% of respondents indicated that redemptions in 2014 were based on performance.
  - Although not options in the survey, a number of respondents also listed a hedge fund firm being too large, investment team turnover, as well as shifts in opportunity set as drivers for redemptions.
- 88% of Fund of Funds and 86% of Family Offices redeemed from at least one hedge fund in 2014.
  - 62% of Pensions redeemed from at least one hedge fund in 2014, the lowest percentage of any investor segment.
- Approximately one-quarter of respondents (excluding Fund of Funds) redeemed from a Fund of Funds in 2014, predominantly due to performance, reallocating capital to direct hedge fund investments, and/or fees.
  - Nearly half of Consultant respondents and over one-third of Bank respondents redeemed from at least one Fund of Funds in 2014.

Figure 27

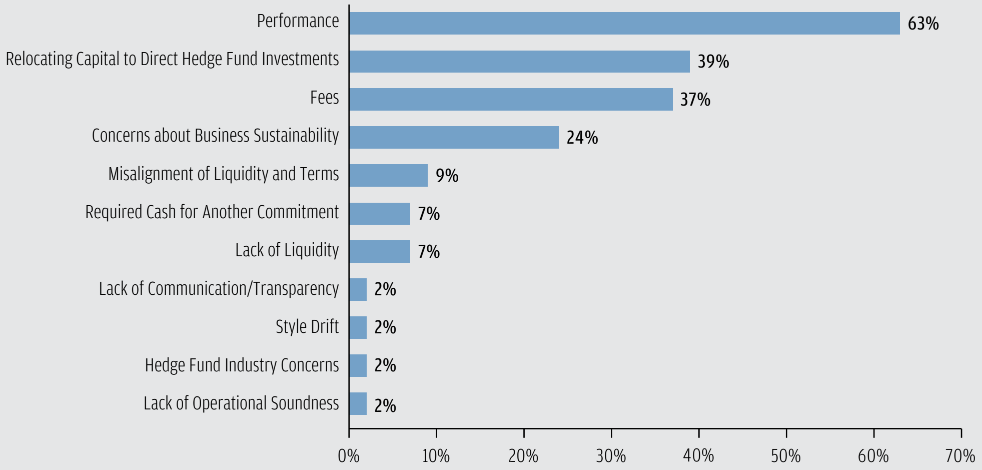
Reasons for Redeeming from a Hedge Fund (2014)



Note: Data is based on 665 selections made by 284 respondents

Figure 27 contd

Reasons for Redeeming from a Fund of Funds (2014)



Note: Data is based on 89 selections made by 46 respondents

Nearly 40% of investors are still actively negotiating fees with hedge fund managers.

- 38% of respondents negotiated fees in 2014. Of those that did, nearly three-quarters negotiated both the management and performance fee.
  - Surprisingly, 50% of respondents were able to negotiate fees without granting any concessions, while the other half had to at least provide a larger allocation as a concession for the reduced fee.
  - Banks and Pensions seemed to have the most success negotiating fees with managers as 68% of Banks and 57% of Pensions did so in 2014.
- 60% of respondents who negotiated fees with hedge fund managers in 2014 make average allocations of at least $25 million.
  - The greater the allocation, the more likely it is for an investor to secure a special fee arrangement from a manager.
  - 83% of respondents who allocate at least $100 million, on average, to a hedge fund manager, negotiated fees in 2014 compared to only 24% who allocate less than $25 million, on average.
- The majority of survey respondents continue to pay an average management fee in the range of 1.50% to 1.99% and an average performance fee in the range of 17.50% to 19.99% to hedge fund managers.
- The Pension segment, possibly in part because of larger average allocations to managers, had the highest amount of survey respondents paying management fees under 1.50%.

Figure 28

Respondents Negotiated Fees with Hedge Fund Managers (2014)

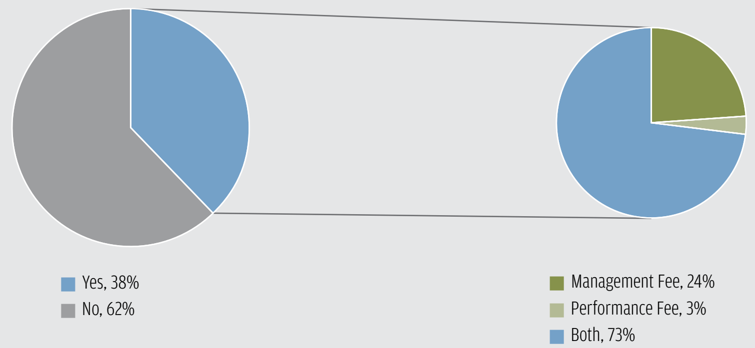
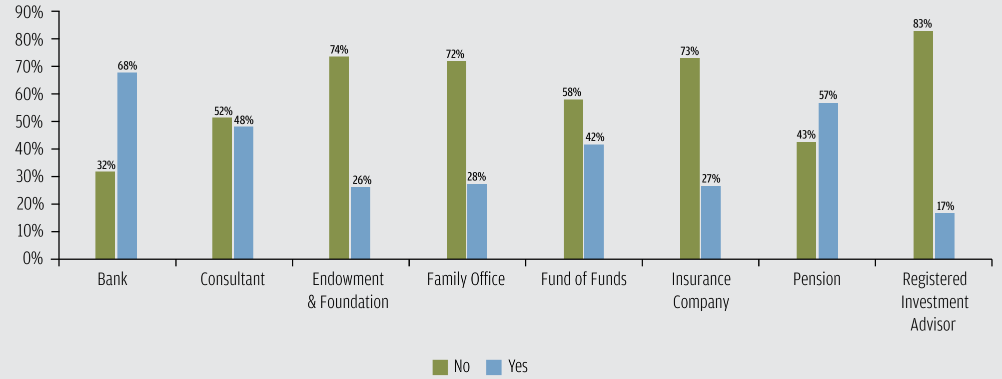
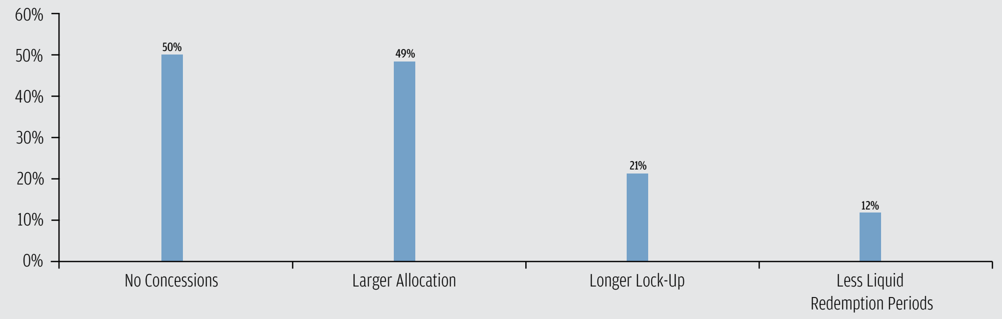


Figure 28 contd

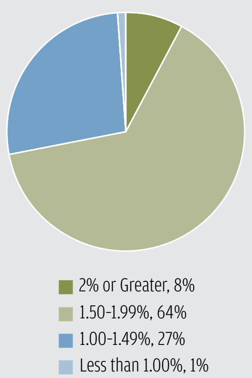
Fee Negotiations by Investor Type (2014)[1]



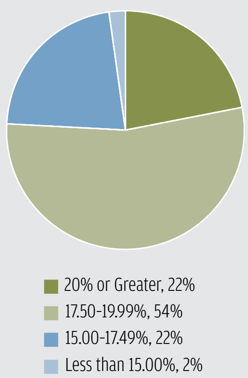
Concessions for Negotiating Fees in 2014[2]



Average Management Fee Paid to Hedge Fund Managers (2014)[1]



Average Performance Fee Paid to Hedge Fund Managers (2014)[1]



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

2 Note: Data is based on 179 selections from 136 respondents

IV. HEDGE FUND INDUSTRY FLOWS AND TRENDS ANTICIPATED BY RESPONDENTS

IV. HEDGE FUND INDUSTRY FLOWS AND TRENDS ANTICIPATED BY RESPONDENTS

Looking ahead, respondents report on expected hedge fund capital flows, strategy preferences, overall trends, and expected changes in the industry.

The hedge fund industry is expected to continue to grow, as approximately 94% of respondents expect to have either unchanged or net inflows to hedge fund investments in 2015.

- 37% of respondents expect to add at least $100 million of new capital to hedge fund investments in 2015.
- Nearly 30% of respondents highlighted new investor mandates as a source of capital flows for new hedge fund investments in 2015.
- Nearly 70% of Banks and 40% of Consultants and Pensions anticipate adding at least $250 million of new capital to hedge fund investments this year.

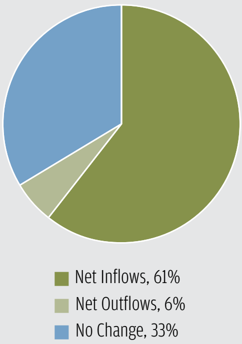
While growth is expected to continue, the momentum the hedge fund industry has gained over the past three years or so is expected to pull back slightly entering 2015.

- 61% of respondents indicated they expect hedge fund net inflows for 2015. This represents an 11% decrease in sentiment year-over-year, as 72% of respondents expected hedge fund net inflows for 2014.
- Half of all respondents indicated they would allocate $50 million or less of new capital to hedge funds in 2015.
- Over three-quarters of Family Offices anticipate adding less than $50 million of new capital to hedge fund investments in 2015. Family Offices typically make smaller allocations, on average, to hedge fund managers.
- Investors seem to be less bullish on hedge funds entering 2015 than they were coming into 2014. Only 42% of respondents indicated they were bullish on hedge funds going into 2015, compared to 66% going into 2014.
- Over half of respondents indicated they did not meet their targeted hedge fund portfolio return for 2014.
- Even though capital flows into hedge funds may be slowing slightly, capital is not exiting the industry.
  - Expectations for hedge fund net outflows amongst respondents have remained below 10% since 2013.

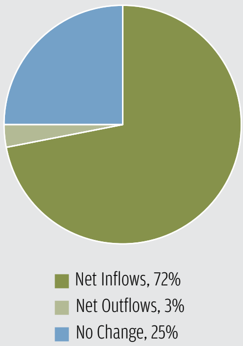
- Of those respondents who did not meet their target hedge fund return for 2014, the majority did not plan to significantly alter overall portfolio exposure to hedge funds. Instead, reallocating to different hedge fund managers and different strategies in 2015 were the most common changes planned to remedy meeting return expectations for the next year.
- Negotiating hedge fund fees and investing in higher risk and/or less liquid opportunities were other possible changes mentioned to achieve improved performance in 2015.
- Decreasing hedge fund exposure in 2015 was the least selected option when respondents were asked what changes they would make in response to missing return targets in 2014.

Figure 29

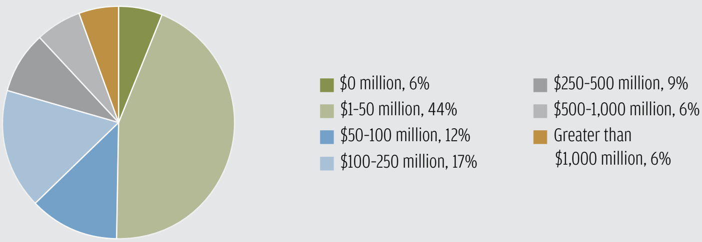
Expected Flows of Hedge Fund Investments 2015



Expected Flows of Hedge Fund Investments 2014



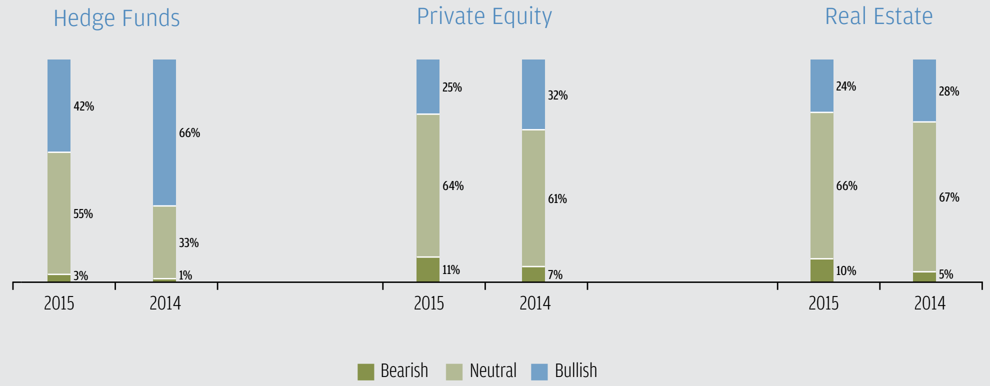
Anticipated New Capital Invested in Hedge Funds per Respondents in 2015



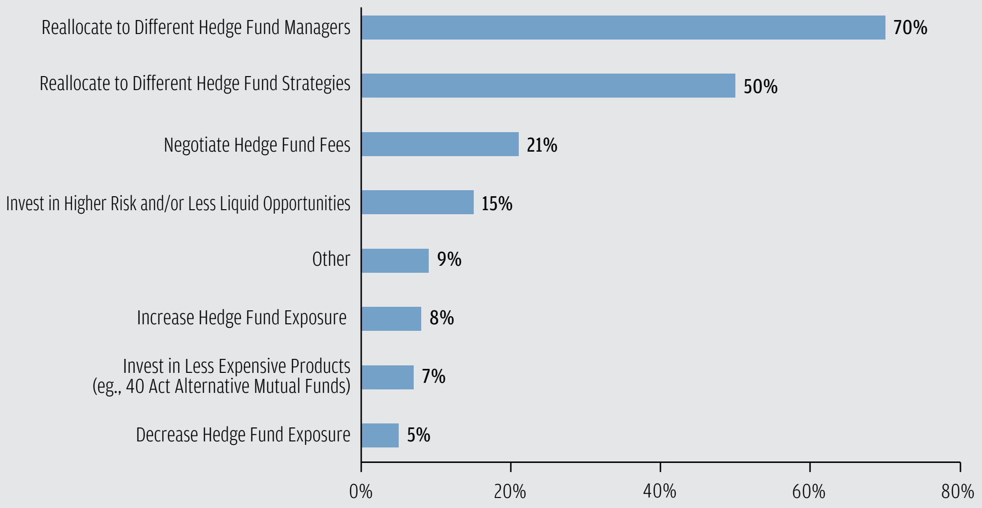
Note: Figures based on number of respondents unless otherwise noted

Figure 29 contd

Comparison of Respondents' Alternative Markets Sentiments in 2014 and Entering 2015[1]



Planned Changes to Achieve Hedge Fund Target Return in 2015[2]



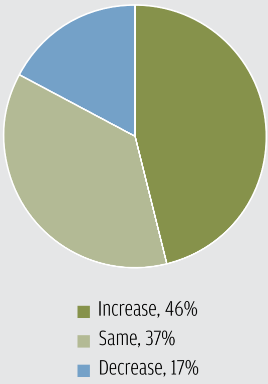
1 Note: Figures based on number of respondents unless otherwise noted
2 Note: Data is based on 327 selections made by 177 respondents

Respondents continue to plan on allocating investments across a larger number of hedge fund managers in 2015.

- Respondents continue to allocate to hedge fund managers and diversify across a number of firms. 75% of respondents either maintained or increased the number of their hedge fund investments from 2013 to 2014, and 83% of respondents are planning to do the same between 2014 and 2015.
- 68% of Consultants, 67% of Banks, 53% of Registered Investment Advisors, and 50% of Endowments & Foundations plan on increasing the number of their hedge fund investments between 2014 and 2015.
- Pensions, Registered Investment Advisors, and Endowments & Foundations continue to have the lowest average number of hedge fund investments at 16, 19, and 20, respectively (as of year end 2014).
- No investor segment in particular seems to be becoming more concentrated within their hedge fund portfolio, as the average number of hedge fund investments has either increased or stayed fairly constant over the past three years.

Figure 30

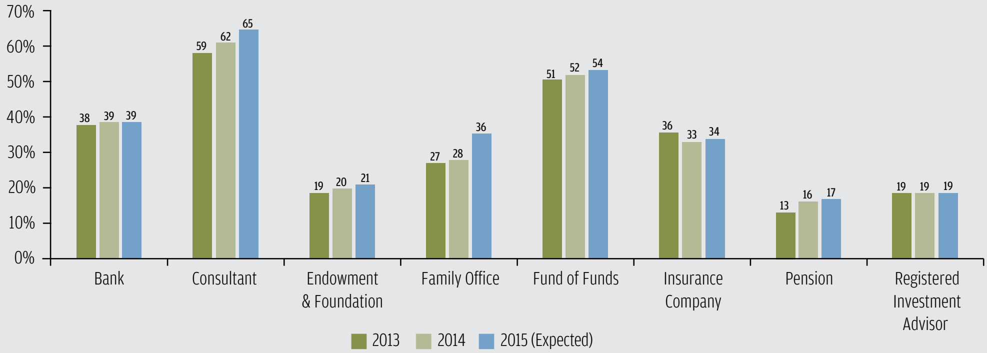
Respondents Anticipating Changes in the Number of Hedge Fund Investments (2014-2015)



Respondents Increasing the Number of Hedge Fund Investments (2014-2015)

- 68% of Consultants
- 67% of Banks
- 53% of Registered Investment Advisors
- 50% of Endowments & Foundations

Average Number of Hedge Fund Investments by Investor Type (2013-2015 (Expected))



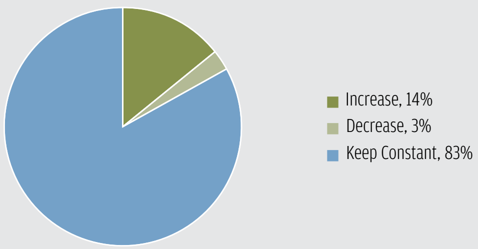
Note: Figures based on number of respondents unless otherwise noted

Entering 2015, there is steady demand for new launches among respondents.

- 83% of respondents indicated they would look to maintain the number of start-up managers they allocate to in 2015.
- An additional 14% of respondents indicated they would increase the number of start-up manager allocations.
- Looking ahead, appetite for new launches seems fairly consistent across all investor segments. Not surprisingly, Fund of Funds exhibit the largest demand for start-up managers. This segment also is the most likely to increase allocations in 2015.

Figure 31

Invest in Start-Up Manager by Investor Type (Expected 2015)



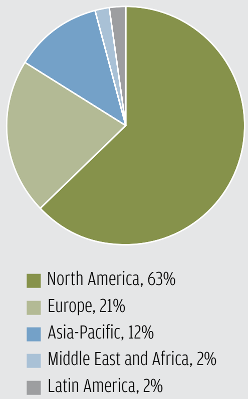
Note: Figures based on number of respondents unless otherwise noted

Respondents expect to maintain similar geographical portfolio allocations between 2014 and 2015.

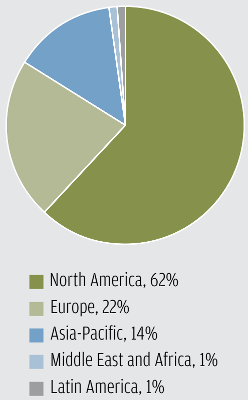
- On average, respondents allocated two-thirds of their hedge fund portfolio to investments within North America in 2014, with similar results expected in 2015.
- All geographic allocations have remained fairly consistent over the last three years. Typical allocations are as follows: 55%-65% in North America, 20%-25% in Europe, and 10%-15% in Asia-Pacific.

Figure 32

Average Percent of Hedge Fund Portfolio Allocated to Region (2014)



Average Percent of Hedge Fund Portfolio Expected to be Allocated to Region (2015)

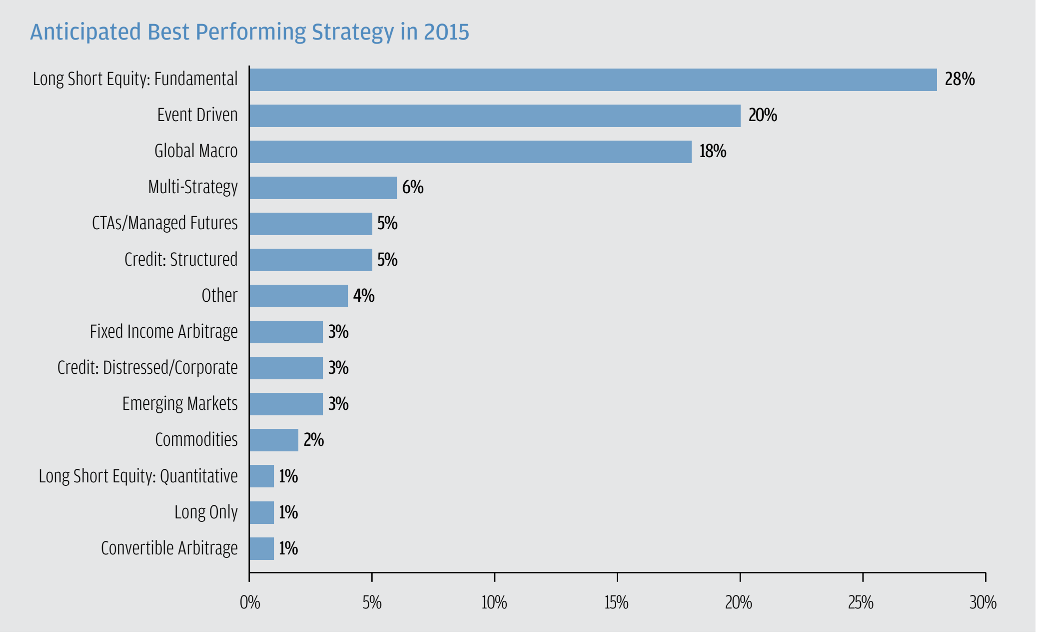


Note: Figures based on number of respondents unless otherwise noted

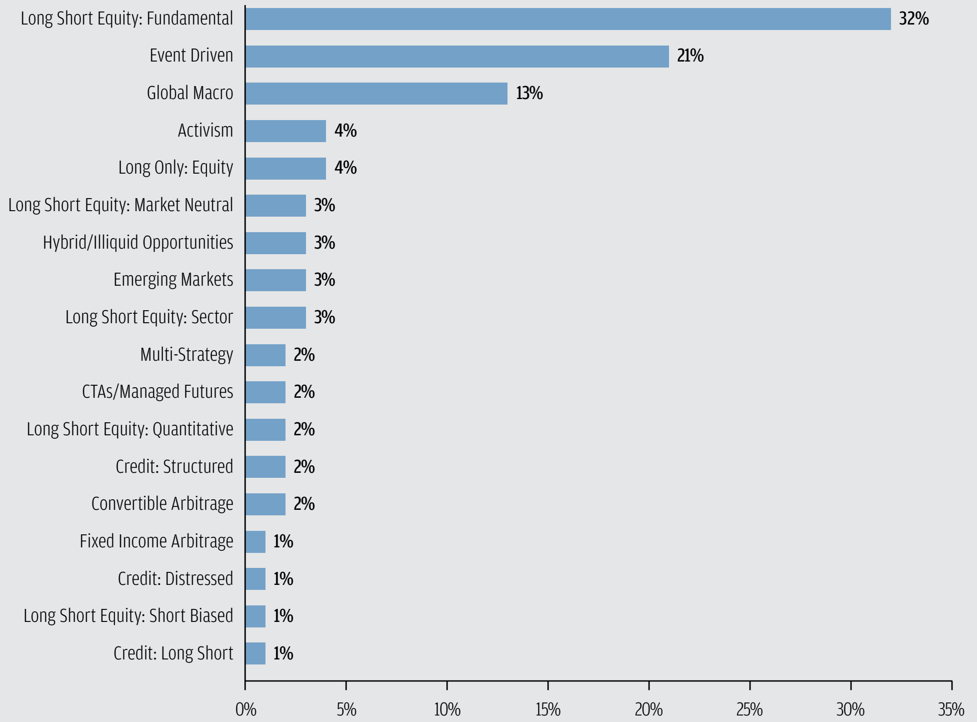
Fundamental Long Short Equity and catalyst-oriented, Event Driven strategies are what respondents are most optimistic about for 2015.

- 28% of respondents expect Fundamental Long Short Equity to have the strongest performance in 2015, similar to expectations for that strategy in 2014. However, it is interesting to note that among strategies expected to perform the poorest in 2015, long only strategies ranked the second highest amongst respondents. This may suggest increased investor focus on manager alpha generation from the short side of their respective portfolios.
- Among Consultant respondents, Fundamental Long Short Equity was the most popular choice for expected best performing strategy in 2015, compared to Event Driven in 2014.
- Pensions, Insurance Companies, and Registered Investment Advisors were the only segments that indicated a strategy other than Fundamental Long Short Equity expected to be the best performing strategy in 2015.
- Respondent confidence that Event Driven will perform well in 2015 has remained consistent from expectations for that strategy in 2014.
- Conviction in Global Macro for 2015 has increased since last year. 18% of respondents believe it will be the best performing strategy compared to 13% for 2014.
  - 33% of Pensions expect Global Macro to be the best performing strategy in 2015, switching from their strongest conviction for 2014 which was Event Driven.
- Investors have grown more pessimistic in their expectations for Commodities strategies over the last year. Commodities was the strategy most commonly expected to rank the poorest amongst respondents. Respondents have also indicated a more negative stance on Credit: Distressed/ Corporate strategies for 2015.

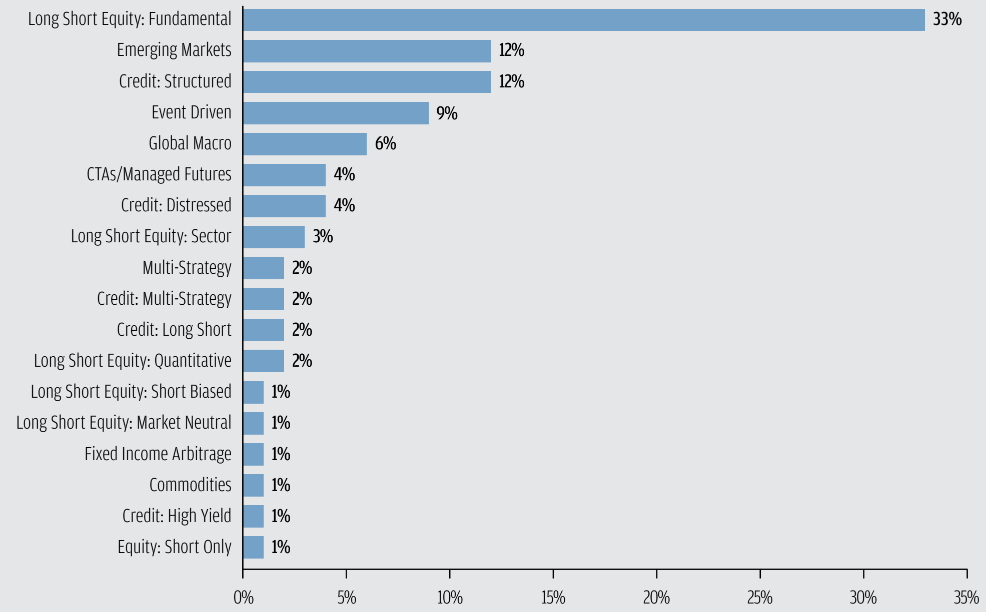
Figure 33



Anticipated Best Performing Strategy in 2014



Anticipated Best Performing Strategy in 2013



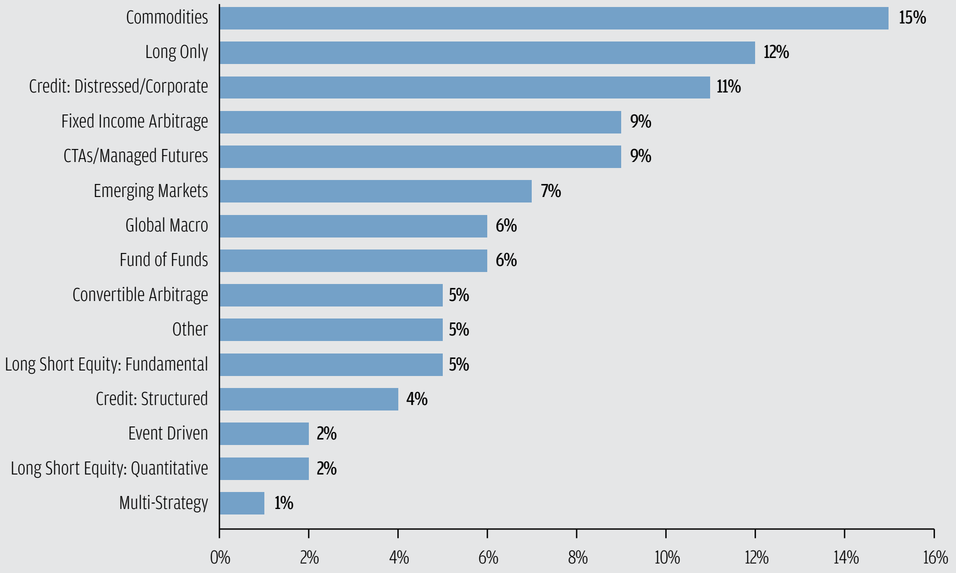
Note: Figures based on number of respondents unless otherwise noted. For 2015 data, survey respondents had 15 strategy selection options. For 2014 and 2013 data, survey respondents had 25 and 21 strategy selection options, respectively. Figures may not sum to 100% due to rounding.

Figure 33 contd

Anticipated Best Performing Strategy in 2015 by Investor Type

	Bank	Consultant	Endowment & Foundation	Family Office	Fund of Funds	Insurance Company	Pension	RIA
Commodities	0%	4%	6%	1%	2%	10%	7%	0%
Convertible Arbitrage	0%	0%	0%	0%	1%	0%	0%	6%
Credit: Distressed /Corporate	0%	4%	0%	1%	6%	0%	0%	0%
Credit: Structured	5%	4%	0%	2%	7%	0%	0%	12%
CTAs/Managed Futures	5%	12%	6%	5%	5%	0%	7%	0%
Emerging Markets	0%	4%	0%	6%	0%	0%	7%	6%
Event Driven	18%	15%	22%	26%	15%	**40%**	7%	**35%**
Fixed Income Arbitrage	0%	4%	6%	1%	4%	0%	7%	0%
Fund of Funds	0%	0%	0%	0%	1%	0%	0%	0%
Global Macro	27%	12%	0%	15%	20%	30%	**33%**	12%
Long Only	0%	0%	6%	3%	0%	0%	0%	0%
Long Short Equity: Fundamental	**32%**	**31%**	**39%**	**27%**	**31%**	10%	13%	18%
Long Short Equity: Quantitative	0%	0%	6%	1%	1%	0%	7%	0%
Multi-Strategy	9%	8%	6%	8%	4%	0%	13%	12%

Anticipated Poorest Performing Strategy in 2015



Anticipated Poorest Performing Strategy in 2014

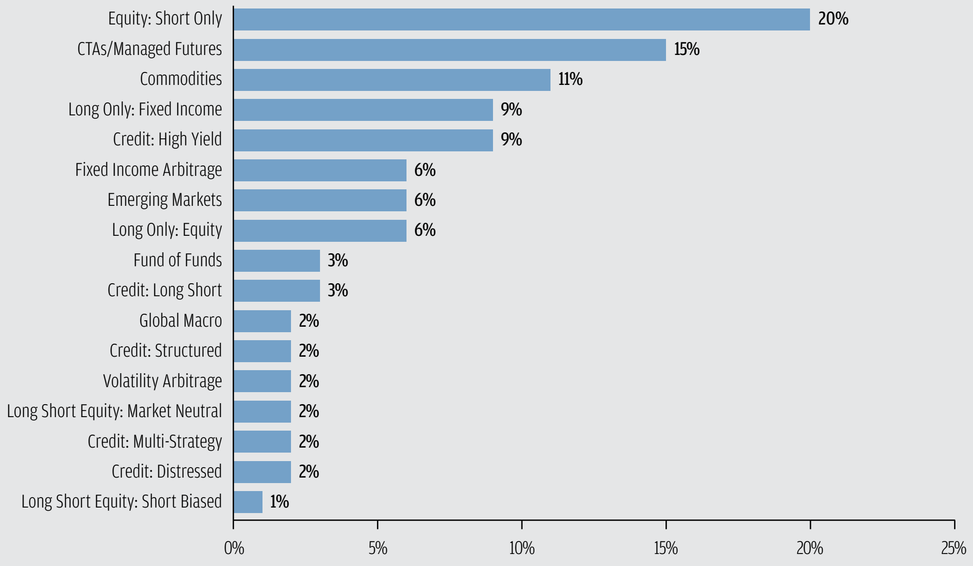
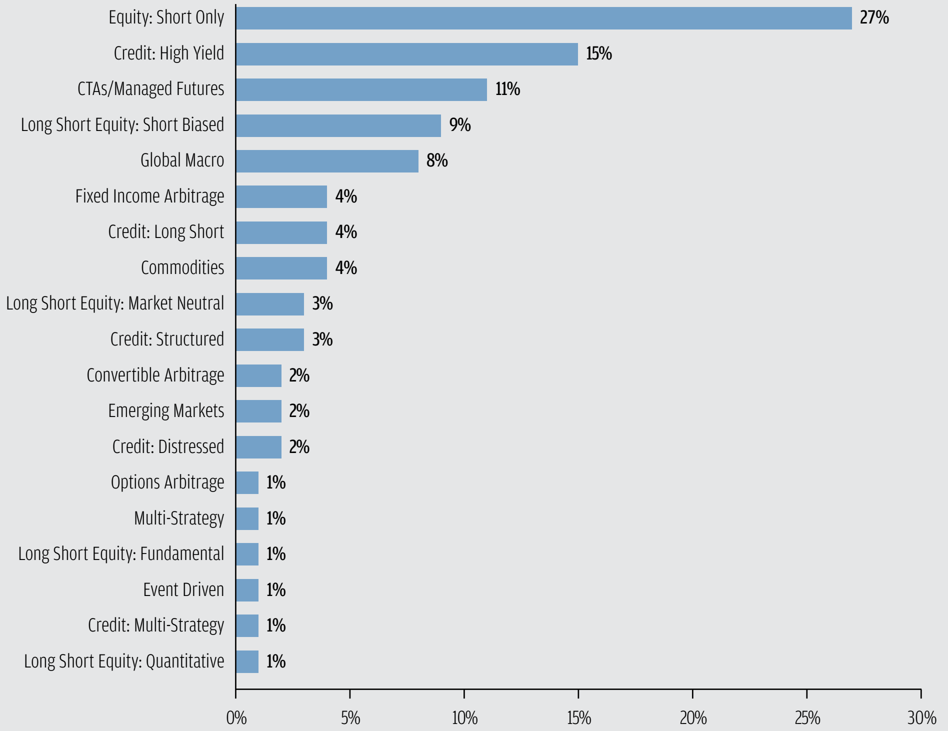


Figure 33 contd

Anticipated Poorest Performing Strategy in 2013



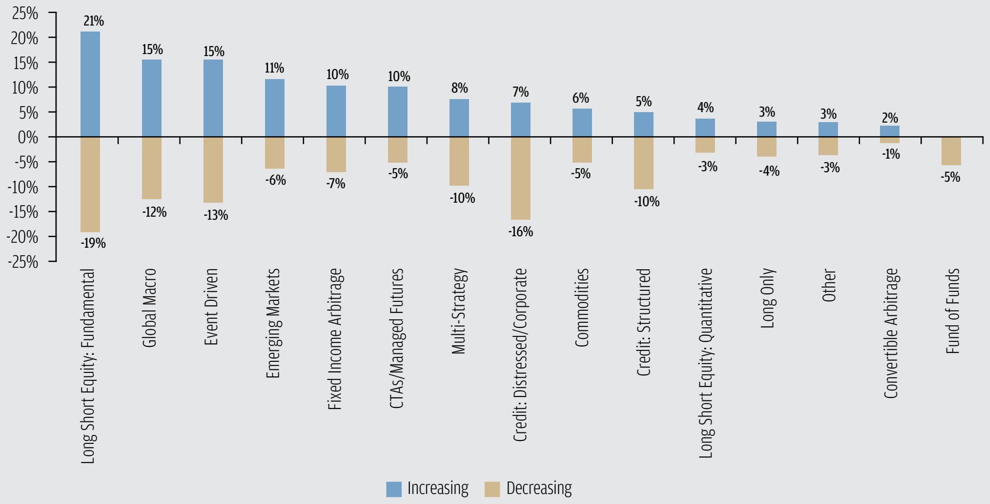
Note: Figures based on number of respondents unless otherwise noted. For 2015 data, survey respondents had 15 strategy selection options. For 2014 and 2013 data, survey respondents had 25 and 21 strategy selection options, respectively. Figures may not sum to 100% due to rounding.

Respondents are planning to make relatively small changes to strategy allocations in 2015 compared to the past few years.

- Entering 2015, investors are planning strategy shifts on the margin, but no significant changes are expected. 5% is the largest net increase for any strategy indicated for 2015, compared to 17% in 2014.
- On a net basis, respondents are looking to increase allocations to CTA/Managed Futures and Emerging Markets in 2015.
- Respondents are looking to reduce their exposure to credit strategies and Fund of Funds in 2015.
- Among survey respondents, it seems equity market confidence has pulled back slightly as, on a net basis, fundamental and quantitative Long Short Equity strategies, as well as long only strategies, are expected to remain unchanged in 2015. This is a notable switch as just one year ago, equity market confidence was apparent. All aforementioned Long Short Equity strategy allocations, on a net basis, were expected to increase from 2013 to 2014.
- Survey respondents continue to decrease allocations to Fund of Funds for the sixth straight year. On a net basis, over 6% of respondents have decreased allocations to the strategy each year since 2010.
- Over the last two years, Distressed Credit and CTAs/Managed Futures strategies have experienced the worst allocation declines among respondents. While the outlook doesn't seem to be changing for credit in 2015, CTAs/Managed Futures might see positive net inflows for the first time since 2012.

Figure 34

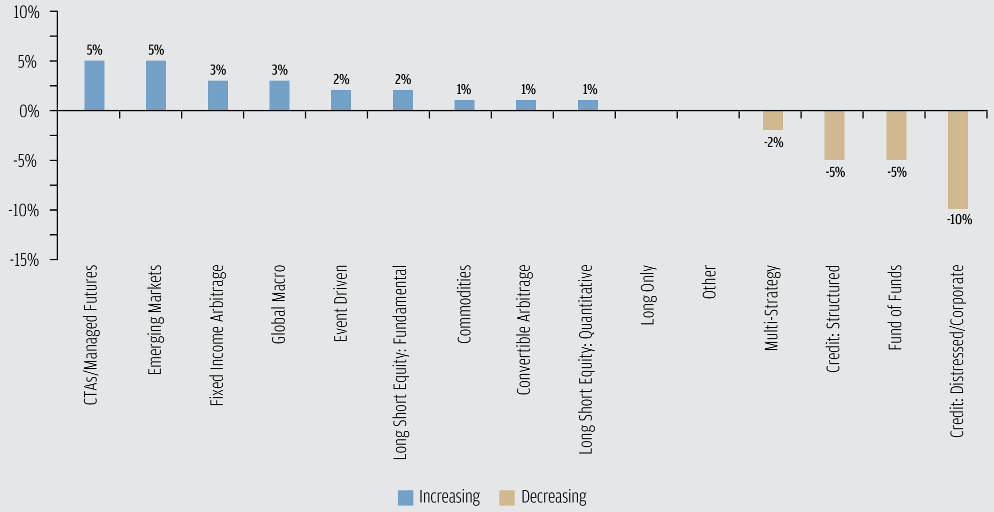
Increasing/Decreasing Exposure by Strategy in 2015



Note: Data based on 263 respondents who provided complete 2014 and expected 2015 strategy allocations data

Figure 34 contd

(Net) Increasing/Decreasing Exposure by Strategy in 2015



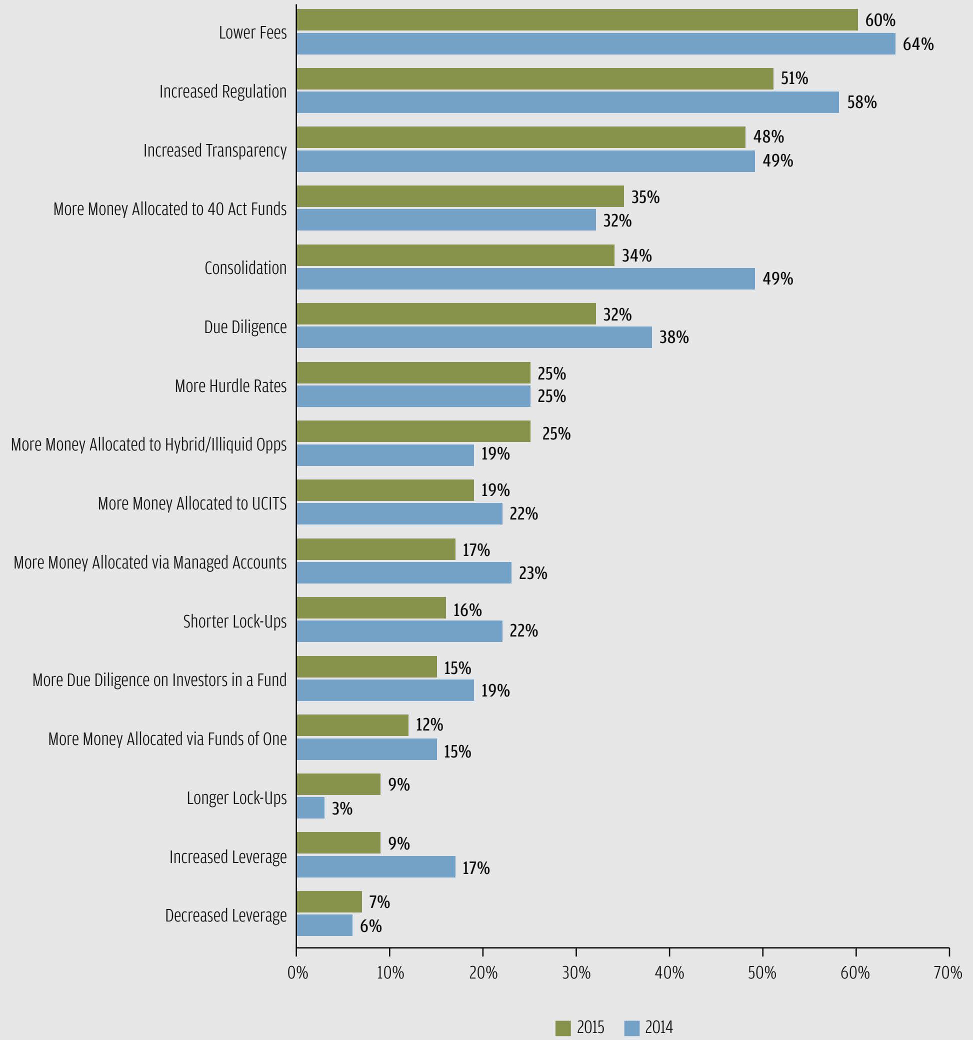
Note: Data based on 185 respondents who provided complete 2013 and expected 2014 strategy allocations data

Consistent with last year, hedge fund industry trends anticipated by respondents in 2015 include lower fees, increased regulation, and increased transparency.

- More respondents expect additional money to be allocated to Hybrid/Illiquid Opportunities and expect to see longer lock-ups in 2015 compared to last year.
- Industry consolidation is not as prominent of a trend entering 2015 as it has been in the past few years.

Figure 35

Similar to 2014, Respondents are Expecting to See Lower Fees and Increased Regulation Across the Hedge Fund Industry in 2015



Note: Forecast 2015 data is based on 1,594 selections made by 386 respondents. Forecast 2014 data was based on 1,328 selections made by 288 respondents

Conclusion

As a new year begins, despite investor capital continuing to flow into the hedge fund industry, hedge fund managers are finding themselves under quite an intense microscope. While it is old news to managers that performance matters to institutional allocators, scrutiny is building in 2015. After another lackluster year, nearly 55% of respondents indicated their hedge fund investments did not meet their targeted hedge fund portfolio return for 2014. The industry as a whole has significantly lagged U.S. equity markets and demonstrated high correlation to broader market indices since 2012. Since most allocators allocate to hedge funds primarily for alpha generation, many seem to be feeling a bit of “hedge fund fatigue”.

Despite some frustration, investors seem to remain committed to the hedge fund space. While the pace of inflows may be slowing, capital is not exiting the industry. Of those respondents who did not meet their target hedge fund return for 2014, the majority did not plan to significantly alter overall portfolio exposure to hedge funds. Instead, reallocating to different hedge fund managers and different strategies in 2015 were the most common changes planned to remedy meeting return expectations for the next year. However, there seems to be an air of uncertainty with respect to where to reallocate. The largest expected net increase noted across strategies entering 2015 was only 5% compared to 17% going into 2014. While fees are still being negotiated, fee pressure does not seem to be a driving force of decelerating inflows.

2014 was a resurgence year for emerging managers. The year featured several high profile new launches and spinouts from institutional hedge fund firms. Investors are not only more interested and willing to look at new launches, but are now starting to actively allocate to start-up managers. Nearly half of respondents invested in at least one start-up manager in 2014. Founders’ share classes are the most common type of start-up investment made by respondents. Many allocators realize that bigger may not be better where flexibility exists to be more nimble with respect to investment decisions and avoiding crowded trades.

While respondents continue to focus on liquidity, new products in the hedge fund industry are having a barbell effect on the marketplace. On one end, there is a healthy appetite for longer lock-up vehicles focused on hybrid/illiquid opportunities, as well as for co-investment opportunities. These products typically have a lock-up of at least one year. Allocators are searching for interesting, unique investible opportunities and, at times, are willing to lock up capital for longer for a chance to earn a higher yield. On the other end, the percentage of respondents that invest in Liquid Alternatives (40 Act or UCITS) has grown steadily over the past few years. These products offer better liquidity and lower fees than typical hedge fund investments. Looking ahead, we expect the Liquid Alternatives market to continue to grow.

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

Again, we would like to thank those institutional investors who participated in this year’s Survey. Without those who participated, we would not be able to share what insights we’ve gathered on significant hedge fund trends and industry challenges. We hope you found the information in this Survey helpful, and we look forward to seeing you at upcoming Capital Introduction events in 2015.

NOTES

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