



## Overview of 2008 Key Trends in Asian Hedge Funds

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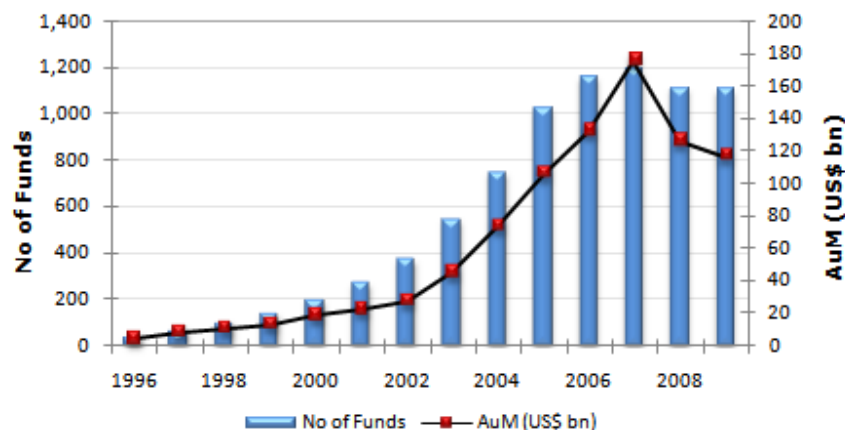
### Introduction

Hedge funds across the board faced a rough year through 2008, with Asian managers being no exception. The average Asian hedge fund, as measured by the Eurekahedge Asian Hedge Fund Index, fell 21.1% in 2008, with the region's hedge fund industry shrinking by nearly US\$50 billion (28%) in terms of assets. Based on the data of over 1,160<sup>1</sup> hedge funds in the Eurekahedge Asian Hedge Fund database, we estimate the size of the Asian hedge fund industry at 1,117 funds managing US\$126 billion in assets as at end-2008.

Interestingly, although assets have fallen by 28% in 2008, the number of funds in percentage terms has fallen by only 6.6%. This can be explained as:

- a) large-scale redemptions out of hedge funds (US\$23.6 billion in 2008) tend to cause a delayed response in fund closures by a few months, as losses accrued impact profitability in the long run; and
- b) there were nearly 90 fund launches (partly) making up for the closure of close to 170 funds in 2008.

Figure 1: Growth in the Asian Hedge Fund Industry



Source: Eurekahedge

Coming into 2009, the Eurekahedge Asian Hedge Fund Index (-2% YTD) continues to underperform the average hedge fund, as measured by the composite Eurekahedge Hedge Fund Index (-0.6%). These returns, however, compare impressively against the 16.1% slide in the MSCI Asia Pacific Index indicating that Asian managers have positioned their funds to minimise market losses far more successfully than in the second half of 2008.

In contrast to hedge funds, long-only absolute return managers posted losses averaging 8.1% for the first two months of the year. This leads us to believe that conventional mutual fund managers allocating to Asia would have fared even worse, given their main aim is to merely outperform the underlying markets and in the absence of direct monetary incentive to perform (unlike hedge funds and long-only absolute return managers who rely mainly on performance fees as their main source of income).

<sup>1</sup> Including 193 long-only absolute return funds.



In terms of asset flows across Asian hedge funds, January saw net redemptions of US\$9 billion. Preliminary estimates for February (based on the data of 41% of reporting funds) reflect another US\$2.2 billion of net redemptions, but point towards easing redemption pressures. We expect Asian hedge funds to start attracting capital once again towards the middle of 2009, given the immensely attractive valuations across some of the region's equity markets and the strong growth potential that they offer over the long term.

While we continue to expect the underlying markets to remain volatile, we believe that hedge fund performance will improve in course of the coming months. We base this opinion on several factors: Firstly, we expect to see short-lived rallies in the markets (as seen last week) on the back of sudden bursts of optimism among investors; such movements will afford managers with lucrative short-term opportunities. Secondly, the easing of redemption pressures will permit managers to put excess cash to work. Thirdly, a large portion of the new, inexperienced and incompetent managers, who dragged down average returns in the industry, have already been eliminated due to large-scale redemptions and losses amid the unprecedented market turbulence. And lastly, most managers are now watchful of their counterparty exposures and other risks; hence, future financial calamities will have a smaller impact on the hedge fund industry as compared to that seen in 2H2008.