BRIGHTON HOUSE
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Quarterly Research Report | Q3 2011

Contents

Brighton House Associates, LLC
2 Park Central Drive
Suite 300
Southborough, MA 01772
T. (508) 786-0480
F. (508) 786-0487
www.BrightonHouseAssociates.com

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Introduction

The third quarter of 2011 brought intense volatility in global markets with which the hedge fund industry as a whole struggled to cope. In terms of performance, the industry had a very poor quarter, making it the fourth worst quarter for hedge funds ever. Losses for the quarter brought total hedge fund assets down to $1.97 trillion.[1] This shrinkage comes predominantly from performance-related losses as opposed to investor redemptions, as the net investor outflow for the quarter was only $19.3 billion.[2]

Despite poor performance in the short term (hedge funds have returned an average of -5.5% for the third quarter[3]), the industry still outperformed the S&P 500, which was down 13.9%,[4] as well as the DJIA, which was down 11.5%.[5] Seasoned hedge fund investors remained active in the space, while new investors began looking to alternatives to compensate for the underperforming equity markets.

As hedge fund investors attempted to insulate themselves from the worst of market volatility, tail-risk hedge funds gained in popularity. A tail-risk strategy is built around both protecting and profiting from black swan events similar to that of the 2008 financial crisis. BHA analysts also discovered that hedge fund investors, particularly those in the U.S., were increasingly more comfortable with less liquid funds. Less liquid strategies in the credit space, including distressed, saw an uptick in demand over the quarter.

In the private equity space, investors were increasingly interested in funds with exposure to emerging markets. Specifically, the BRIC region as well as Latin America enjoyed a jump in demand during the quarter. Latin America stood out in particular; third-quarter demand for the region increased by more than 77% over the second quarter.

As investors and managers across the alternative investment industry struggle to deal with uncertain markets, they also must keep in mind the massive regulatory changes now underway in both the U.S. and Europe that will have far-reaching consequences for the way the industry conducts business. Going forward, the Dodd-Frank Act in the U.S. and the Alternative Investment Fund Managers Directive in Europe will need to be monitored closely by fund managers and investors alike. In this report, BHA explores these developments and the effects they are having on the alternative investment industry.

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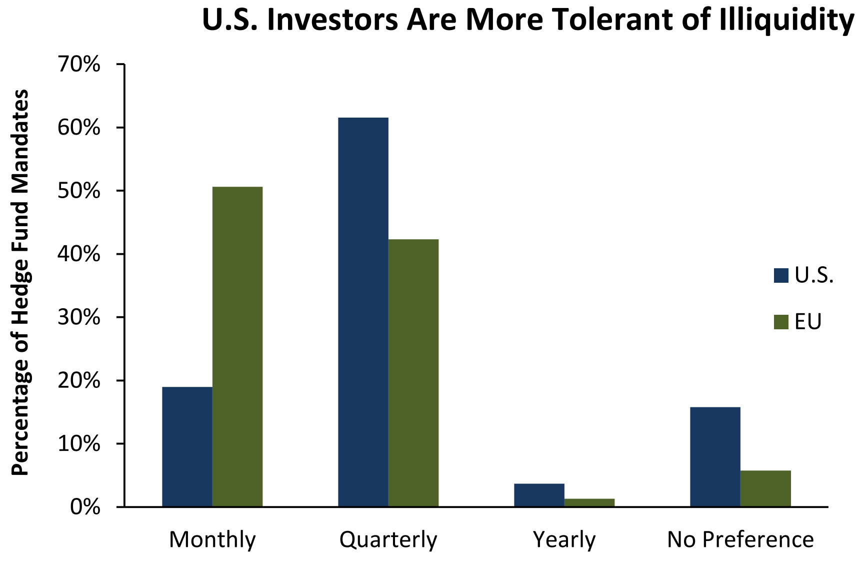
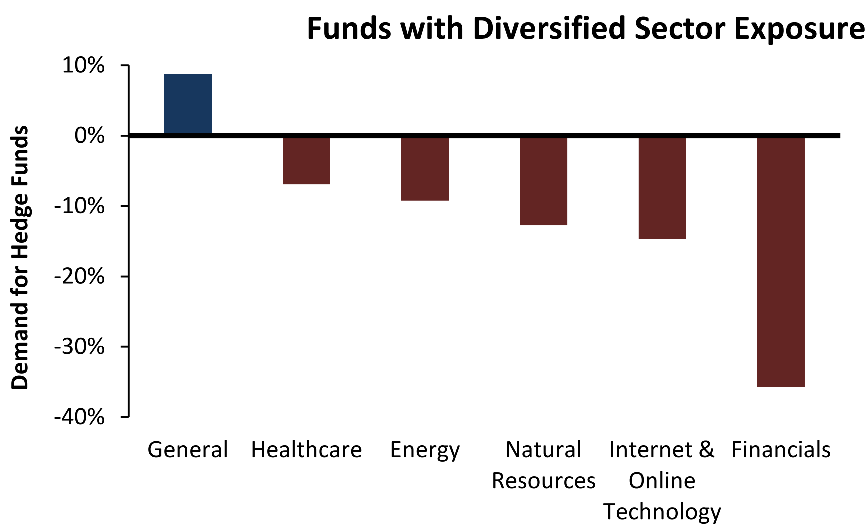
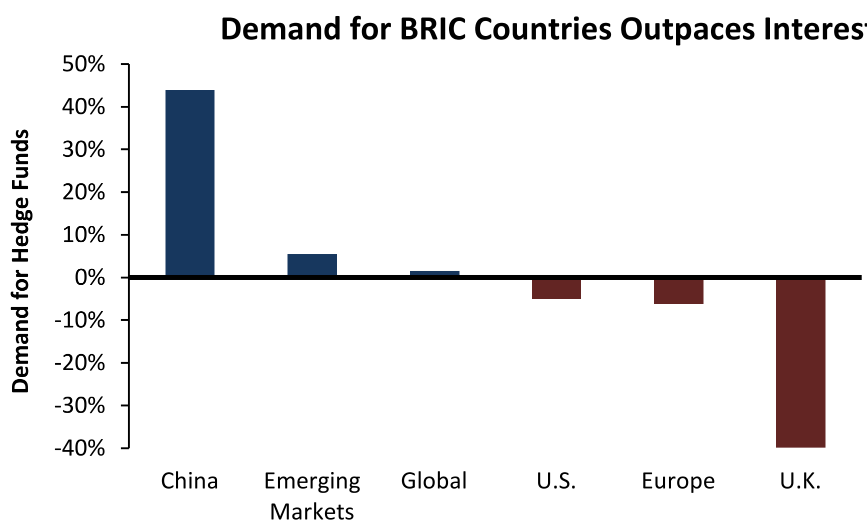
Notable Hedge Fund Trends



Only 19% of U.S. investors require monthly liquidity, whereas a full 50% of EU investors do. More than 60% of U.S. investors are comfortable with quarterly redemptions, and another 15% have no strict preferences. By contrast, only 42% of European investors will tolerate quarterly liquidity, and only 5% have no preference.



Demand for most sector-focused funds fell in the hedge fund space while interest in funds with diversified sector exposure increased. Traditionally popular sector specialists such as healthcare, energy, and natural resources funds all suffered. The third quarter saw investors err on the side of diversification.



Funds focused on developed countries, such as the U.S. and the U.K., saw a decline in investor demand during the quarter. Funds with exposure to emerging markets, however, saw an increase. BRIC countries enjoyed a particularly strong surge in interest, with demand for China-focused funds increasing by 44%. Taken together, demand for BRIC countries increased by 86% over the second quarter.

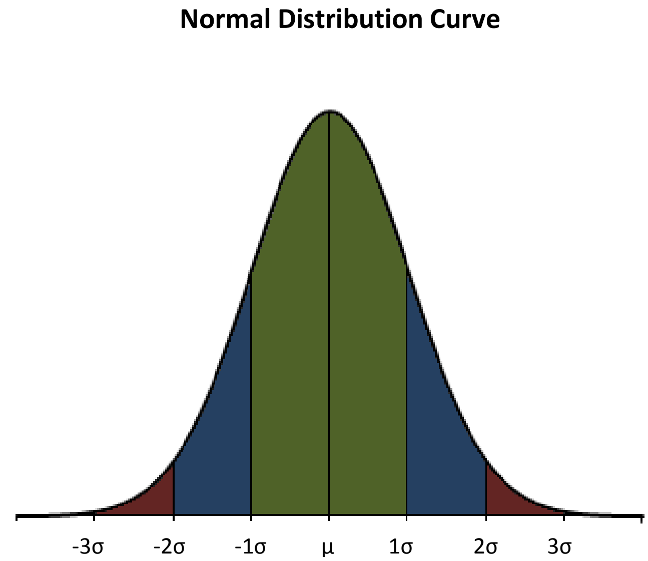
Click Here for More Hedge Fund Trends

Tail-Risk Hedge Funds Gain Momentum amid Fears over Black Swan Events

Fears over downside risk mounted throughout the third quarter as the volatility in the U.S. equity markets continued and the crisis surrounding European sovereign debt persisted. Credit default swap (CDS) spreads, which indicate the market's perception of a security's risk, have been widening for Greek debt since the early summer; CDS spreads for German bonds started to widen at the end of the quarter, reaching about 120 basis points.[6] Seeking to protect their portfolios against volatility and sovereign risk—and possibly black swan events—investors began flocking to funds that employ tail-risk hedging strategies.

Black swan events are occurrences that are unexpected and unpredictable. In today's uncertain economic climate, investors have grown increasingly concerned about such events because they can hurt returns significantly. Investors generally construct their portfolios so returns follow a normal distribution curve, which assumes a probability of 99.7% that returns will move between the mean and three standard deviations, positive or negative.[7] (See Figure 1.) When market conditions suggest a portfolio may negatively deviate from the mean more than the norm—as it may during a black swan event—investors look to hedge the risk, which is known as tail risk or left-tail risk because low returns are shown on the left side of the distribution curve.

Figure 1



The most recent black swan event happened in 2007 when defaults in the subprime-mortgage market spiraled into the meltdown of the housing market and the U.S. banking system, sending equities 57% lower. One of the most well-known bond-market black swan events occurred in 1998 when the Russian government defaulted on its government bonds (GKOs). At the time, Long-Term Capital Management (LTCM), a fixed-income arbitrage fund, was expecting to profit from convergence trades involving European, U.S., and Japanese government bonds. When the Russian government defaulted on their GKOs, however, investors sold their European and Japanese bonds and bought U.S. Treasurys in a flight to liquidity. Instead of converging, the prices of the bonds diverged, and the profits that the LTCM models had predicted became huge losses. Eventually, the fund collapsed. Many investors fear that a black swan event could occur again in the bond market if any of the European countries default on their debt.

As a consequence of the uncertainties in the equity and bond markets, investors sought tail-risk hedging opportunities in the past quarter as downside protection.

In a recent conversation with a tail-risk hedge fund based in San Francisco, the associate relationship manager discussed the firm's approach to protecting against left-tail risk: a buy-write strategy. The firm takes long equity positions and shorts call options. The premium it collects from the call options hedges against decreases in the stock prices. By employing this strategy, the fund is able to cover about 10% to 15% of the downside risk of its equity positions.

As evidence of the flight to tail-risk hedge funds, a New York-based tail-risk fund saw its assets increase by 15% in August and by another 11.5% by mid-September.[8] But as more and more investors flock to these funds to alleviate macroeconomic risks, their challenges will begin to mount. Currently, many tail-risk funds use options as a hedge, but as demand grows for call and put options, their prices may rise significantly, and they may begin to sell at considerable premiums. Thus, one of the largest issues these funds will have to confront will be finding cheaper sources of tail-risk hedges, such as conditional hedges, structured products, and the use of longer-term derivatives.

In a recent conversation with a family office located in Geneva, the head of alternative investments commented that the firm was looking for tail-risk hedging strategies that had exposure to multiple asset classes; it particularly wanted to avoid funds that had exposure solely to volatility arbitrage or credit. He noted that traditional hedge funds have difficulty protecting against tail risk and that it is difficult for investors to pinpoint the correct instrument to use. As examples, he cited global macro funds, which haven't hedged well against sovereign-debt risk in the past, and the difficulty of navigating the CDS space as a result of widening spreads. Investing in tail-risk hedge funds helps him manage the portfolio's overall risk, and being an uncorrelated strategy, it has the added benefit of reducing the market-timing risk when he wants to sell his positions.

Because it is difficult for investors to foresee how equities will fare in the U.S. and if restructuring efforts will succeed in the euro zone, BHA analysts expect many investors will continue to look to tail-risk hedge funds to protect their portfolios.

Hedge Fund Investors Look to Avoid Volatility with Market-Neutral Funds

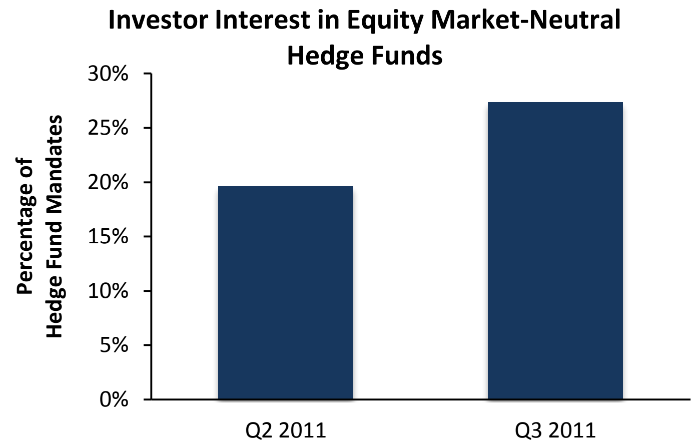
One of the more noticeable hedge fund investor trends that BHA analysts observed during the third quarter was the shift to equity market-neutral funds. Equity market-neutral strategies attempt to eliminate market risk and deliver superior returns that have little to no beta. The most likely driver behind investors' hearty appetite for equity market-neutral funds was the increase in market volatility.

During the third quarter, the VIX closed above 30 for 41 straight days. This streak continued into the beginning of the fourth quarter before ending with a total of 50 straight days above 30. This marked the second longest such streak in the history of the VIX, exceeding the record set during the Russian financial crisis of 1998. Clearly, the macroeconomic events of the past three months have led to sustained volatility in equity markets worldwide—volatility that is historically significant.

As often occurs during periods of high volatility, equity markets tumbled dramatically in the third quarter. The S&P 500 was down 13.9% and flirted with bear market territory at 20% below April highs.[9] Hedge funds performed better than equities during the quarter, but they were still down 5.5%.[10] Amid heightened volatility and signs of potentially poor returns, investors positioned themselves for continued uncertainty in the markets. A good number of hedge fund investors chose to sit out the quarter entirely: the number of hedge fund mandates received by BHA analysts was down 23.8% in the third quarter when compared with the second. Investors that did maintain active hedge fund mandates in the third quarter, however, turned to uncorrelated strategies they hoped would be immune from the anticipated market swings.

One such strategy that saw increased attention was equity market neutral. Of the hedge fund investors interviewed by BHA analysts during the second quarter, 19.6% remarked that they had an interest in equity market-neutral strategies. This percentage, however, vaulted all the way to 27.4% during the third quarter. (See Figure 2.) This increase in investor interest was manifested by allocations made to hedge fund managers. A U.S.-based hedge fund manager noted to BHA analysts that "despite seeing a little bit of a delay in allocations due to market conditions, its equity market-neutral strategy experienced $60 million in inflows during the third quarter."

Figure 2



Investors' piqued interest in equity market neutral is certainly influenced by the volatile market conditions. With much uncertainty still surrounding the direction of the stock market, investors looked to equity market-neutral funds to gain access to managers who could provide low volatility and portable alpha returns. One such investor, a U.S.-based fund of hedge funds, remarked to BHA analysts that while it traditionally has included long-biased managers in its portfolio, "uncertainty in the markets and volatility seen from other managers have lowered its appetite for managers that are more than 60% net long."

Interestingly enough, the U.S.-based equity market-neutral manager said that when markets drop too far too quickly, investors tend to gravitate to long-biased managers that provide beta in order to catch up on losses. During the third quarter, however, the drop perhaps was not far enough or did not happen quickly enough. Instead, because opinion on market direction remained in flux during the quarter, equity market-neutral funds were able to remain in focus.

Investors Capitalize on the European Debt Crisis

BHA recorded major upswings in investor demand for credit strategies in the third quarter when compared with demand in the second quarter. The number of hedge fund mandates that specified credit strategies grew by 64% from the end of the second quarter to the end of the third. Several factors contributed to investors' increased appetite, including an abundance of opportunities to capitalize on the European debt crisis, an interest in diversifying away from standard, or core, fixed-income allocations, and less capital locked up in side pockets. Also, with the preference for credit strategies came an increased tolerance for less frequent redemptions.

Two credit strategies that drew the most attention were distressed credit and mortgage-backed securities. Of the total number of mandates BHA collected for the third quarter, distressed credit accounted for about 17%; this compares with a little less than 15% for the second quarter. (See Figure 3.) When broken out by investor category, about 17% of institutional investors and roughly 22% of the consultants advising them specified this strategy. About 16% of family offices and 15% of wealth advisors expressed an interest, while approximately 6% of private banks and roughly 16% of funds of funds followed suit. (See Figure 4.) Regionally speaking, interest was split nearly evenly between U.S. and European investors.

Investor mandates for mortgage-backed securities and structured credit funds made up about 4% of the total mandates received during the third quarter; this compares with a little more than 2% for the second quarter. When broken out by investor category, roughly 3% of institutional investors and approximately 6% of consultants specified this strategy. About 4% of family offices and 3% of wealth advisors expressed an interest, while approximately 4% of funds of hedge funds and 6% of private banks did so. In terms of investor location, the majority of the mandates, 63%, came from limited partners based in North America, while 31% and 6% came from those in Europe and Asia, respectively.

Figure 3

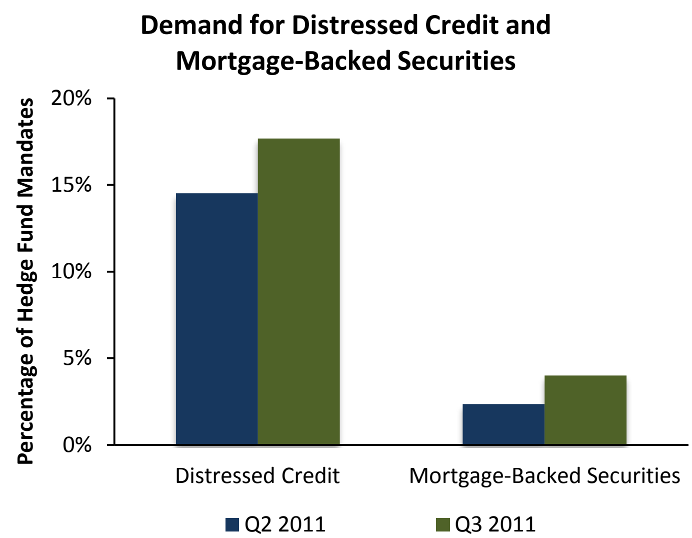
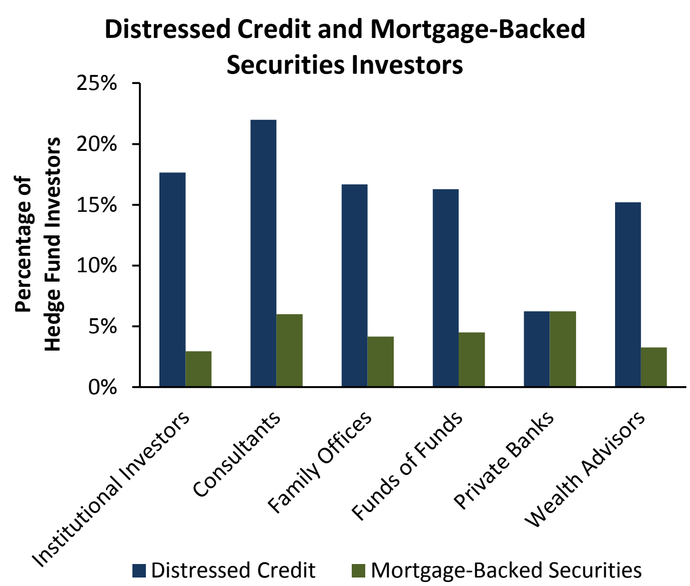


Figure 4



If the second quarter seemed to be a time when investors were becoming educated on how fund managers could take advantage of the European credit crisis, the third quarter saw them starting to pull the trigger on such allocations. Early on, many investors chose to sit on the sidelines and wait for some sort of stability or clarity in the markets. Although investors didn't see the stability they were looking for, many were aware of the abundance of investment opportunities in Europe, given that lenders were seeking liquidity and were being forced to accept low prices.

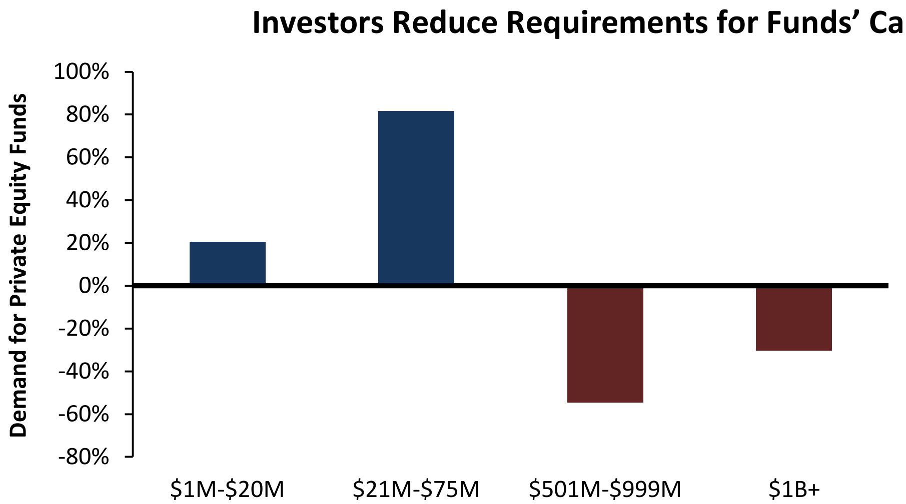
Most interest from investors was in dedicated European corporate credit managers or in opportunistic credit managers that invest in corporate, government, and bank debt. A U.S.-based firm that manages the investments of a large life insurance company cited European distressed debt as its primary area of interest. The firm recognized a great deal of opportunity on both the restructuring and special situations sides within the region's corporate credit market. A U.S. foundation based in the Southeast has been looking at the credit space since early 2011 and noted that it remains much more interesting than the equity market.

Investors also had reasons unrelated to Europe to be partial to the credit space in the third quarter. Diversification was one. Many saw credit-based hedge funds as an alternative to a core fixed-income allocation, at times decreasing their allocation to the latter to make room for these alternatives. According to a recently published article, investors are "carving out dedicated allocations to higher risk, higher return, less liquid and more esoteric credit-related investments than most core-plus bond mandates would have permitted. Some of those subasset classes are distressed debt, long/short fixed-income hedge funds, emerging markets debt, high yield and bank loans."[11]

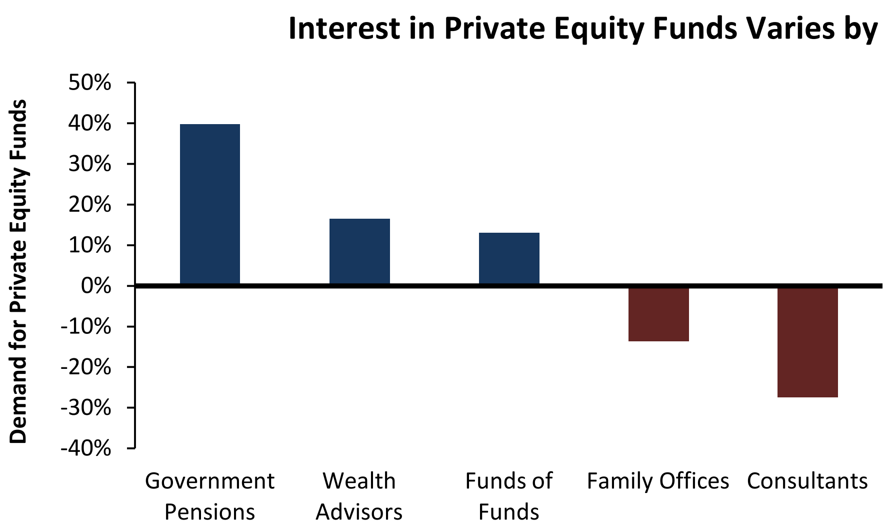
During analysts' conversations with investors regarding liquidity issues, many disclosed that they had liquidated most or all of their interests that were previously gated or held in side pockets. Of those that were still holding on to some illiquid positions, many said that they have only a small amount still tied up. For these investors, liquidity was much less of a concern than it had been in the past several quarters. The number of investors willing to accept quarterly liquidity as opposed to monthly liquidity doubled during the third quarter when compared with the second quarter. It is fitting that investors were willing to accept less frequent liquidity since credit-based strategies have less liquid underlying assets and usually come with less frequent redemptions.

During the third quarter, it became evident that although there were no significant restructuring events in Greece, and there was no clarity for the short term on the European credit markets in general, many investors recognized opportunity. They also seemed to have more capital on hand and were more willing to invest in illiquid strategies. However, BHA spoke with other investors that believed the third quarter was still too soon to invest in the European credit market. Analysts will be watching to see if more join the ranks of credit investors during the last few months of 2011 or if there is a shift in sentiment.

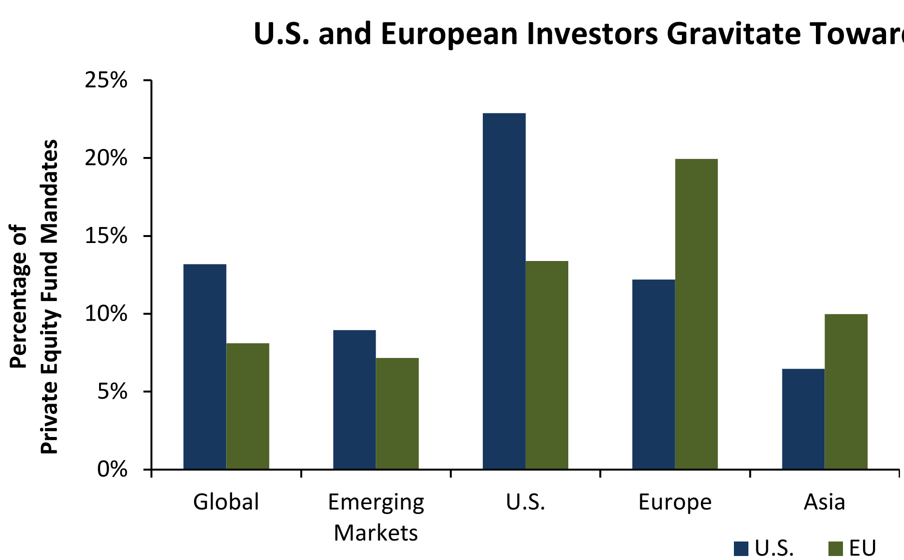
Notable Private Equity Fund Trends



Demand from private equity investors shifted slightly towards funds with smaller fundraising targets. Investors had greater interest in funds raising less than $75 million than they did in larger funds raising $501 million to $1 billion or more. Interest in mid-sized funds, those raising $76 million to $500 million, remained constant from the second to third quarters.



Private equity funds saw significant surges or lapses in interest from a few investor categories during the third quarter. Government pensions, wealth advisors, and funds of funds made up a larger percentage of the private equity investor pool than they did in the second quarter. At the same time, demand shrank from both family offices and consultants.



Private equity investors in the U.S. and Europe differed in their preference for regional exposure. U.S. investors were more interested in U.S.-focused funds and funds that are globally diversified than Europeans were. Investors in Europe tended to prefer funds with exposure to Europe and Asia.

Click Here for More Private Equity Fund Trends

In Search of Returns, Investors Pursue Emerging-Market Private Equity Funds

Unprecedented equity-market volatility and concerns over the debt crises in both the U.S. and Europe have had a major impact on investors' allocation plans. All asset classes have been affected either positively or negatively by this global macroeconomic turmoil. Traditional investments, such as stocks and bonds, have generally underperformed, leaving investors searching for other ways to build their portfolios. For many, emerging-market private equity funds provided that path during the third quarter; BHA witnessed increasing interest among investors for these funds.

A multibillion-dollar wealth advisor based in California told BHA analysts that its disappointment with traditional investments in its clients' portfolios caused the firm to consider diversifying using private equity funds. Although the firm has been a hedge fund investor for years, it stopped investing in private equity funds in 2008 and chose more liquid strategies. In the third quarter, however, it began actively looking at managers in the buyout, growth capital, and venture spaces, and particularly those focused on emerging markets.

Another investor in California commented to analysts that it was conducting a search for various alternative investments. After this summer's volatility, it began building new portfolios for its institutional clients that included private equity funds. This firm was looking to find managers in the buyout and growth spaces and was emphasizing global emerging-market funds.

It's worthwhile to note that the majority of investors interviewed by BHA during the quarter explained that the reason for their interest in emerging-market private equity funds was to increase the number of opportunities they have for securing better returns. This corresponded to what seemed to be a global trend. For the first half of the year, emerging-market private equity strategies raised about \$22.6 billion; only \$23.5 billion was raised over all four quarters in 2010.[12]

Although the current global economic turmoil has caused private equity investors to pay more attention to emerging-market regions in general, 70% of the capital raised was for funds focused on China, India, and Brazil.[13] Buyout firms concentrating on Latin America raised \$4.9 billion over the past two quarters, compared with \$3.1 billion a year earlier.[14] This is largely due to some of the world's largest private equity firms investing heavily in the region.

Analyzing investor mandates during the third quarter, BHA saw a parallel trend. Interest in Asia-focused funds was up by about 12.5% when analysts compared second and third quarter results. Demand for funds concentrating on Latin America rose by roughly 77%. Latin America was specified by 7.9% of the mandates BHA received during the second quarter. This rose to 14.1% during the third. (See Figure 5.)

In terms of investor category, the largest group of emerging-market investors was funds of private equity funds. Of emerging-market mandates, 34% came from funds of funds, while consultants, family offices, and wealth advisors each made up 12% of the pool. Government pensions also made up a significant portion at 11%. (See Figure 6.)

Figure 5

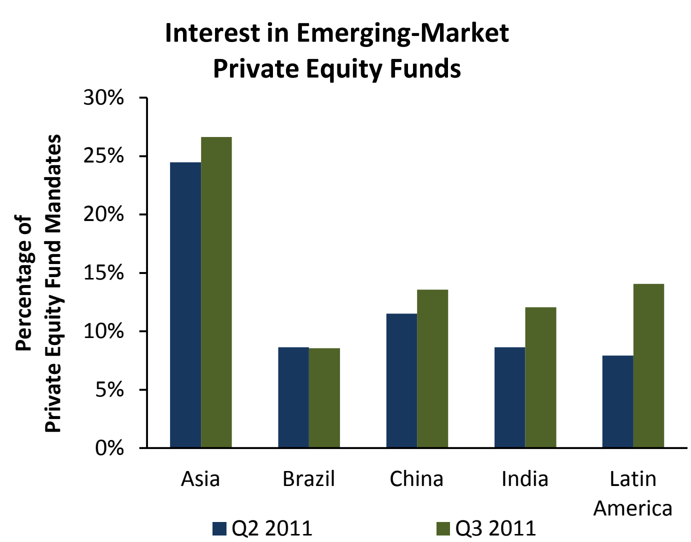
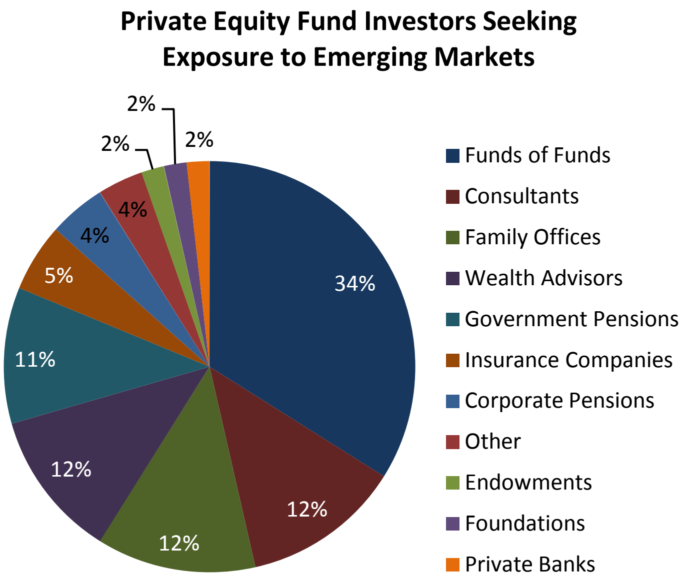


Figure 6



Given the uncertain environment, many institutional investors were revamping their portfolios, and private equity became a "key theme" along with emerging-market strategies.[15] For example, this quarter, the Abu Dhabi Investment Authority made plans to increase its investments in the private equity space. The roughly $627 billion sovereign wealth fund currently has 2% to 8% of its assets allocated to private equity funds; however, it began looking to double its private equity staff in order to have the internal capacity to significantly increase the portion of its portfolio dedicated to these funds.[16]

Private equity funds have suffered major outflows since 2008, however, the tide seemed to be turning in the third quarter. In search of growth and returns, many investors were willing to diversify their portfolios with riskier asset classes, and they turned not only to private equity funds but also those focused specifically on emerging markets.

Financial Regulation: The Changing Landscape

In an effort to prevent the repeat of a 2008-like crisis in financial markets, regulators in the U.S. and European Union have been working overtime during the past few years. Sweeping legislation in the U.S. as well as Europe has been passed and is currently being finalized and implemented. Although this process could take years, the new regulations—the Dodd-Frank Act, the Volcker Rule, and the Alternative Investment Fund Managers Directive—are already affecting the industry. It is therefore important for alternative fund managers and investors to monitor the regulatory landscape as it changes in order to be prepared for what is sure to be not only a new environment but also a far more complex one.

In the U.S., the Dodd-Frank Act and the Volcker Rule that accompanies it are causing profound changes in the alternative investment industry. Some of the more significant changes that came with the passage of the act have to do with the regulations governing the registration of funds with the SEC and the Commodity Futures Trading Commission (CTFC). Before Dodd-Frank, hedge fund managers were not required to register with the SEC under an exemption in the Investment Company Act of 1940. But now, fund managers with more than $150 million in assets will be forced to register. Smaller managers will be regulated on the state level.

More specifically, the SEC is planning on requiring fund managers to complete a reporting form, Form PF, that includes disclosures on their funds' trading positions and risk profiles.[17] Hedge fund managers with more than $1.5 billion in assets will be required to file this form on a quarterly basis.[18] They will also need to disclose additional information such as "details of portfolio exposures, turnover rates, risk and liquidity analytics, use of leverage and investor concentration."[19] For its calculations of total fund assets, the SEC plans on using gross asset value or "regulatory assets." This measure includes leverage, so even funds that haven't actually raised a total of $150 million will be subject to registration.[20] The SEC estimates that across the industry, the total price tag for implementing the rules will be $31 million to $57 million. Verifying that funds have the correct registration status is important to investors, so fund compliance teams will need to monitor changes to the system vigilantly.

U.S. fund managers are not the only entities in the industry that will be affected by the legislation. Investors also have to make adjustments. Specifically, as a product of the Volcker Rule, banks will be required to cease all proprietary trading operations. The difference between "proprietary trading" and the still permitted "market-making trades" is hazy, however, and "constructing tests that definitively delineate the two may be quite difficult due to differences across asset classes, differences in market practices, and changing market conditions."[21] In addition, banks will be prohibited from "acquiring or retaining any equity, partnership, or other ownership interest in or sponsoring a hedge fund or a private equity fund."[22] The Volcker Rule has already caused a number of banks to shut down or spin off their proprietary trading desks. This, in turn, has resulted in a number of traders leaving banks to launch new hedge fund products.

While U.S. fund managers and investors have been dealing with the ramifications of Dodd-Frank, the alternative investment industry in Europe is also dealing with regulation. In its first attempt to regulate funds on a pan-EU level, the EU's Alternative Investment Fund Managers Directive came into effect in July. Similar to Dodd-Frank, the AIFMD "will lead to ongoing supervision of capital, conduct of business (risk management, conflicts of interests, liquidity, valuation, delegation, depositories, reporting, leverage limitation, private equity acquisitions) and marketing of shares or units from within and outside the EU."[23] Although several months have passed, a number of details have not yet been finalized. In fact, the European Securities and Markets Authority, a newly formed supervisory body, will develop specific technical standards that will then need to be adopted by the European Commission. More specifically, "close to 100 provisions still have to be shaped at this legislative level."[24]

Fund managers in Europe have been keeping a very close eye on regulatory developments and recently voiced their concerns through the Alternative Investment Management Association. AIMA released a paper in which it estimated that the potential annual cost of the legislation for the industry could be as high as $6 billion.[25] The association admits that this estimate is based on a number of unknown factors, but the large figure has caught the attention of the industry. A lawyer in the investment management industry noted, "We are shortly going to be moving from a period when people in the industry are trying to shape regulation to a period where they need to make decisions on how to structure their funds and business operations in response to the Directive and its requirements."[26]

In fact, managers in both the U.S. and Europe are beginning to deal with this transition, and they are seeking direction and timelines. Their concerns seem to have reached CFTC Commissioner Scott O'Malia. In his speech before the International Swaps and Derivatives Association, Commissioner O'Malia commented, "Now is the time for the Commission to give the market concrete direction on how and when to translate the Dodd-Frank rulemakings into an operational reality."[27]

In addition, although some fund managers will need to keep abreast of only U.S. regulation, managers with a global presence must also track the changes in the EU. In his speech, Commissioner O'Malia went on to claim that "the schedule, or timeline, for financial reform is converging among the G-20 nations. It is less clear that the substantive policies underlying financial reform are experiencing the same convergence."[28] For example, some provisions in Dodd-Frank have extraterritoriality, which means that they could affect foreign firms "with even a tangential connection to the U.S."[29] And U.S. firms that market their funds in the EU will need to deal with the AIFMD. Firms on both sides of the Atlantic are concerned that the costs of the changes in the U.S. and Europe could differ dramatically. If they do, funds that have to cope with the more costly changes will be at a competitive disadvantage: if they absorb the additional costs themselves, they may drive down profits; if they pass the costs on to investors, they may drive investors overseas where fees are more reasonable.

With the increased market volatility of the last quarter, many fund managers are focused on simply surviving the turbulence. In the face of such difficult markets, it can be easy for operational and regulatory concerns to slip into the background. But both managers and investors should stay vigilant. A family office located in Germany mentioned to BHA that it is keeping a very close eye on regulatory developments. That said, the uncertainty in the global economy is more of a concern for the firm than pending legislation. The family office stated that while it is closely monitoring the developments in the EU, it is not letting them hold up its investing. If the firm identifies a promising fund, it will move forward with the due diligence process. This investor is not alone in its attempts to cope with poor market performance in the short term while trying to anticipate the longer-term effects of regulation. It's a difficult balancing act.

There is much still to be decided in both the U.S. and EU, so the only real option for fund managers is to stay up to date with legislative developments and be as transparent as possible with investors. Keeping fund returns out of the red in volatile markets is challenging on its own, but fund managers must remember that they are running a business, not just managing money. Keeping on top of the operational demands that stricter legislation will bring is essential for running a successful fund in the future. This shift in the global regulatory paradigm will take years to come into full effect, but those managers that successfully navigate the transition will have a great advantage.

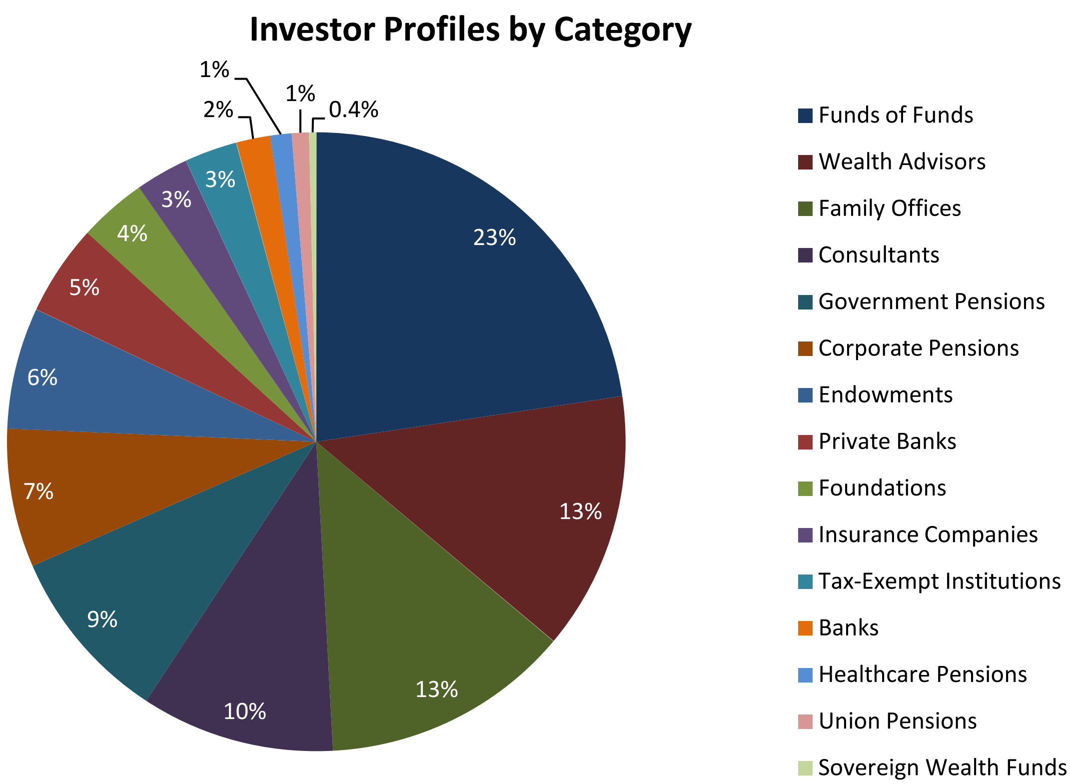
BHA's Alternative Investor Research

Since its inception in 2007, BHA has become the definitive leader in alternative investor research. BHA works with a diverse group of approximately 150 alternative investment managers and acts as an unbiased research liaison between these managers and its extensive global network of institutional investors. (See Figure 7.)

BHA analysts collect and analyze the most comprehensive data available on the investment searches of alternative investors. BHA's *Quarterly Research Report* highlights insights and trends from this research that are pertinent to industry professionals.

BHA works directly with a variety of investment managers on a daily basis. These managers include hedge funds, private equity and real estate funds, and related funds of funds. They range in size and experience from emerging managers to some of the most established firms in the industry.

Figure 7



The Research Process and Investor Universe

Each quarter, BHA analysts collect detailed profiles from more than 1,000 investors that are actively making investments in hedge funds, private equity and real estate funds, and related funds of funds. These investors are spread across the globe; their assets under management dedicated to alternative investments range from less than $100 million to more than $10 billion. (See Figures 8 and 9, respectively.)

BHA analysts speak with investors about their current preferences regarding alternative strategies, manager requirements, investment processes, due diligence systems, allocation plans, and current and historical areas of exposure. The team then conducts both quantitative and qualitative analysis of the data to explore trends within the alternative investment marketplace. These trends reveal shifts in investor sentiment about alternative investments and provide unprecedented insight into the mindset of alternative investors during the past quarter.

BHA's coverage of the institutional investor market is unique in that analysts obtain information from direct phone conversations with senior analysts, portfolio managers, managing directors, and chief investment officers who are focused on alternative investments. The most significant concentrations of investors profiled are in North America and Europe, however, BHA increasingly interviews investors from Asia, Africa, Central and South America, the Middle East, and Australia. Analysts work extended hours to gain access to, and information from, institutional investment firms around the world.

Gaining an understanding of investor sentiment on a global scale is a critical part of the research that BHA conducts. BHA's findings are cited in the *Quarterly Research Report* and reflect investor interest in specific fund strategies and characteristics.

Figure 8

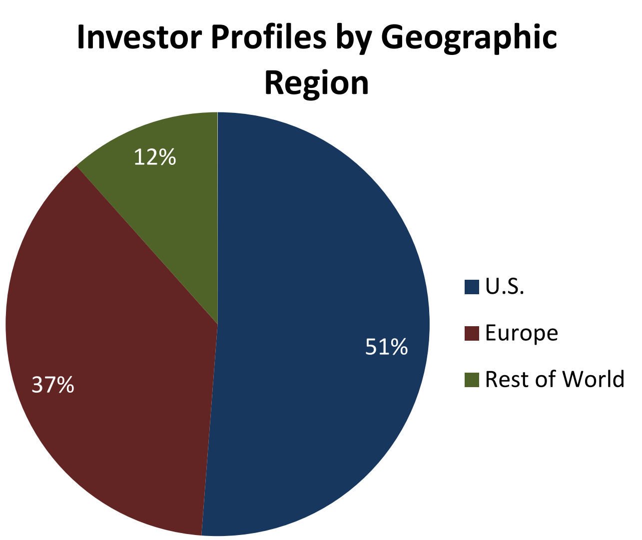
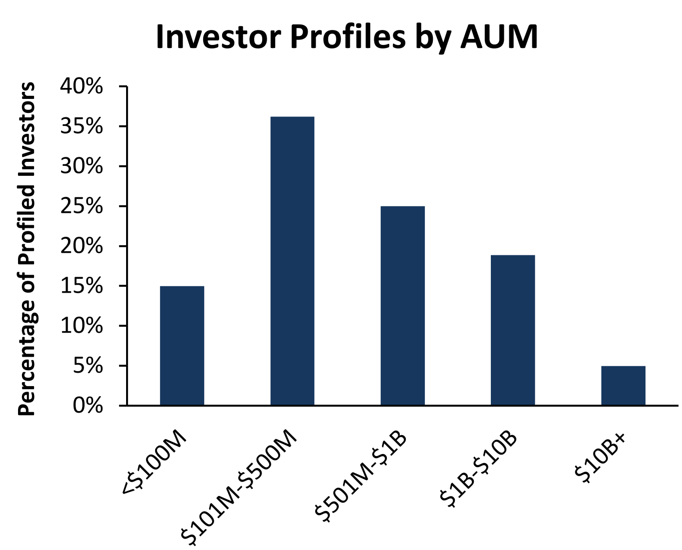


Figure 9



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