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Global institutional demand for HFs will triple to USD1 trillion by 2010

Global institutional demand for hedge funds will triple by 2010, increasing from USD 360 billion currently to more than USD 1 trillion, according to a new study released by The Bank of New York and Casey, Quirk & Associates LLC.

The study, entitled “Institutional Demand for Hedge Funds 2: A Global Perspective,” found that by 2010 institutions investing in hedge funds will increase to nearly 25% of all institutions, up from 15% today, representing a more than 60% increase. Retirement plans globally will account for the vast majority of asset flows, with corporate and public pension plans in the United States accounting for the largest percentage increase overall.

This study follows a 2004 study by the Bank of New York and Casey, Quirk that examined U.S. institutional investor appetite for hedge funds. The 2004 study forecast that U.S. institutional investment in hedge funds would increase from USD 60 billion to USD 300 billion by 2008, a prediction that thus far is largely in line with actual investments by U.S. institutions.

“Broadening acceptance of alternative investments coupled with lower expected returns from traditional investments are driving demand for hedge funds among global institutional investors,” said Brian Ruane, executive vice president at The Bank of New York. “Institutional investors are increasingly recognizing that hedge fund allocations have provided significant diversification benefits while delivering the net returns they require.”

According to the study, institutional investors’ experience with hedge funds has and will continue to profoundly influence the way they invest broadly, indicating that “less constrained,” active investment techniques will become a standard component of investing moving forward.

“The study shows that today’s hedge fund techniques will be tomorrow’s mainstream investing,” said Kevin Quirk, a partner at Casey, Quirk. “This paradigm shift will be driven by the need for institutions to generate better overall portfolio returns as well as by their increasing comfort with techniques such as shorting, derivatives and leverage.”

The study also found that institutional investors’ ability to identify and assess quality hedge fund managers will dramatically improve. As a result, hedge fund providers increasingly will be required to demonstrate operational excellence and comprehensive risk oversight, as well as offer fee structures that are more closely linked to value and performance.

The study found that the vast majority of institutions investing in hedge funds use either fund-of-hedge funds exclusively or the “dual approach” model – accessing hedge funds concurrently through fund-of-hedge funds and direct investments. Fund-of-hedge funds will remain the starting point for the majority of institutions initiating a hedge fund investment program. The study predicts that half of global institutional flows will go to fund-of-hedge funds with the other half going to direct investments over the next five years.

While the study found that hedge funds have earned a long-term role in institutional portfolios, the single most important factor that could change growth expectations would be a scenario where hedge fund and fund-of-hedge fund managers meaningfully underperformed the net return expectations of institutional investors. Potential scandals and regulation could also slow predicted growth.

Results from this year’s study were based on over 100 interviews with institutional investors, investment consultants, hedge funds, fund of hedge funds and industry experts around the world.