Asia industry AUM could rival Europe's in five years' time as second-generation talent evolves and China opens up its capital markets…Hugh Hendry, though, remains China bear

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Much has been made of the **poor performance of Asian hedge funds in 2011**, particularly equity long/short strategies (which still dominate the regional industry) which ended the year down 13.7 per cent, but there's a lot to be excited about. Having visited Hong Kong in April, the general mood was upbeat; managers were open to discussion, legal firms were happy with their fund formation numbers. But probably the most important bell weather when looking at the health of the industry is the prime broker. Speaking with Hedgeweek from Deutsche Bank's impressive office on the 52nd floor of the gleaming ICC skyscraper in Kowloon, **Harvey Twomey, Head of Global Prime Finance, Institutional Client Group**, said that over the last five years the industry has witnessed a dramatic change in terms of the key players: "Most of the global hedge funds are pretty much all here now with varying degrees of physical presence in Hong Kong and to a lesser extent Singapore. These 60-70 groups have brought a greater degree of sophistication to the Asian markets and have trained a whole new generation of hedge fund professionals."

With the likes of Azentus Capital and Myriad Asset Management launching in 2011, and some exciting fund launches – namely Tybourne Capital, BFAM Partners (former Nomura trader Benjamin Fuchs) and former Perry Capital's Alp Ercil's upcoming fund – there are clear signs that the depth of talent is starting to improve, particularly in Hong Kong. Speaking from the equally impressive UBS office in IFC2 on Hong Kong Island, **Tim Wannenmacher, UBS Head of Prime Services, Asia Pacific**, commented: "Even though you don't have the quantity of launches right now, the region is maturing in terms of the quality of new launches.

"There's a clear recognition that you have to launch with a robustinfrastructure to ensure the fund can raise money and survive over the long term." Twomey agrees, noting that having matured through the challenges of 2008/9 and 2011 Asia's hedge fund industry is well positioned "for the next stage of its evolution".

That's particularly true when you look at what's happening in China. Slowly but surely its capital markets are opening up, the CSRC are getting on top of the myriad problems of its chaotic securities markets (i.e. insider trading), the number of short stocks is increasing. Sooner or later, China is going to be a huge market for hedge funders both regional and global. This will likely consolidate the hedge fund industry even further and encourage more talent to launch funds.

Twomey said: "What you are seeing now is an interesting group of second generation managers with first generation hedge fund training looking to start their own asset management businesses. As a result, an increasing number of global-caliber hedge fund launches are happening in the region. We believe Asia will see its first USD10bn fund in the not too distant future."

One of the reasons **Asia's industry AUM hasn't yet broken through the USD200billion ceiling** – it's currently at around USD150billion – is precisely because, up until now, it has lacked this second tier of talent that Twomey refers to. Said Wannenmacher: "There's not enough talent. Finding experienced people on the ground remains an issue. Someone with a good track record of running money in APAC is still in high demand." However, given that there are funds now operating with 20-25 staff, half of which are likely to be investment staff, Wannenmacher thinks this is becoming a fertile ground for growth and future launches: "Logically some of the portfolio managers may decide to spin out and launch their own fund but it's still early days."

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Another development that augurs well for Asia's hedge fund industry is the clear trend in strategy diversification. Equity-based strategies still dominate, with Twomey conceding that the credit markets "haven't evolved at quite the same pace", although this is slowly changing. "The use of debt instruments as a financing tool will increase, especially by Chinese enterprises and the offshoring of the Renminbi will present opportunities," said Twomey. Added Wannenmacher: "Increasingly, other strategies are emerging such as macro strategies, credit and true multi-strategy funds. Institutions five years ago didn't have a lot of choice, now they do; the tricky thing is that some of these funds are starting to close for new investors."

Diverse strategies, second-generation talent, high-profile launches: these factors alone are evidence enough that things are headed in the right direction. In the words of Twomey: "I think in five years Asia will represent about 20 per cent of total hedge fund assets and rival Europe in terms of scale."

In other news this week, even though the general consensus is that China will supplant the US as the biggest economy this decade, Hugh Hendry certainly doesn't agree. **Hendry's London-based Eclectica hedge fund, which generated 31 per cent in 2008 by taking a bearish stance on the US, has now turned bullish on the world's largest economy** with Hendry repeating concerns that a real-estate bubble will derail China's boom reported *Bloomberg* this week. In a letter to investors Hendry wrote "We are more bullish on U.S. growth than most. We are also more pessimistic on Chinese growth than ever. This makes us bearish on most Asian stocks, bearish on industrial commodity prices, interested in some US stocks, a seller of high variance equities and deeply concerned that Japan could become the focal point of the next global leg down."

Hendry, who was bearish on China last year and which he expressed by buying CDS on Japanese companies with a large market exposure to the mainland, believes that the economic malaise that hit the US three years ago when Lehman Brothers Holdings Inc went belly up is set to hit Asia.

Hendry rather ominously wrote: "It has long seemed to us to be the case that the economic crisis would start in the US and make its way to Europe. That has happened. However, we also think it will end in Asia." So much for market de-coupling. If Hendry is right then Asian markets could be in for a roller-coaster ride. He said that the eurozone debt crisis was hurting China – whose GDP is forecast to grow by about 7.5 per cent in 2012 – as were austerity measures being imposed by the region's politicians and raised the question as to whether China is going to be able to maintain its currency peg to the greenback. "When we look at where the next market crisis will come from, we should be looking to China," wrote Hendry. **Only time will tell if his words prove prophetic.**

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