The foundations of Asia's hedge fund boom

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Asia has been coming out of a fairly devastating economic crisis that began in 1997 and lasted until at least 2002. During that period, the equity side of the market was dominated by traditional long-only fund managers whose raison d'être was to chase the index, and as the economy went down, market performance was dreadful. As early as 2000 and 2001 demand was growing for absolute returns and fund managers who could perform in adverse conditions.

Meanwhile, some of the factors that contributed to the economic crisis in Asia were being addressed. A number of countries suffered from poor currency policies, inadequate corporate governance within companies, cronyism within government, unwise lending by the banks that was often associated with the cronyism problem, and a general lack of transparency. In the recovery phase starting in 2002-03, there have been substantial efforts on the part of governments, the stock markets and listed companies to raise standards.

At the same time, a supply of new hedge fund managers, principally in Hong Kong, Singapore and Japan, has emerged among people who previously worked for investment banks or ran money. These new managers were attracted by the reward structure of hedge funds, often wanted to work in a smaller, more entrepreneurial environment, and had the confidence to do it on their own.

There was convergence of demand for absolute return product and a supply of people whose careers in investment banks had stalled because of these economic conditions, and saw the chance to set up their own shop. At first it was a trickle; it gradually became a flood from 2003 onward; and for the past two years it's been the hottest game in town. Today Asia is performing much better economically, before one even mentions the China factor, which rubs off on the whole region. And from north to south, there is ongoing of markets such as derivatives - opening the door to investment strategies no longer solely focused on equities but also involving debt markets.

A proliferation of new instruments that weren't around five years ago are good tools for hedge fund managers to play with, and the currency markets are less fixed against the US dollar than before. Hedge fund managers see market opportunity in equities and fixed income, a proliferation of derivative products, more depth and liquidity in the markets, and arbitrage opportunities.

This expansion in financial markets throughout the region has also triggered an influx into Hong Kong and Singapore of hedge funds already active in the US that are now setting up operations in the East Asian time zone to play the local markets. As it becomes harder to make money in US domestic markets, Asia is seen to offer better pickings, with greater market inefficiencies and more inexperienced investors playing the market.

The two sets of players, the local boutiques and the experienced foreign managers, have been greeted by a flood of US and European money into Asian markets from funds of hedge funds, family offices, educational endowments, sophisticated institutional investors, and some private banks. In addition, some wealth Asian private clients are starting to make allocations to hedge funds, along with a new breed of family offices and even a few local pension funds.

For the full Hedgeweek Special Report on Asian Hedge Funds, please click here [1]

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