

Mena hedge funds rise 17% in H1

By Shveta Pathak on Sunday, August 30, 2009

Hedge funds focused on the Middle East and North Africa gained 16.9 per cent in the first half of this year.

The performance of hedge funds globally saw an increase of 12.03 per cent year to date, leading to the best seven months in 10 years for the sector. However, fund managers continue to remain defensive, different research data has revealed.

In spite of being the smallest emerging market region in terms of dedicated capital, hedge funds focusing exclusively on Mena have seen a 10-fold increase in assets under management (AUM) over the past five years, said a report by Hedge Fund Research (HFR).

"Emerging markets hedge funds are now larger, more sophisticated, more strategically diverse, more structurally transparent and better positioned to offer global investors access to dynamic growth opportunities around the world," said Kenneth Heinz, President of HFR.

Performance of emerging markets funds was strong in all regions and Hedge Fund.Net (HFN) saw a 4.26 per cent increase in July and 25.39 per cent in 2009 for emerging market funds tracked by it.

These returns were led by funds with primary exposure to China, followed by Brazil, Latin America, India and the Middle East and North Africa, HFN said.

However, fund managers continue to remain cautious and it could be well in the last quarter of this year or the first quarter of next year that funds get fully invested, analysts told Emirates Business. **"They can be expected to come closer to being fully invested in Q4 2009 or Q1 2010 – not now," said John Papesh, Managing Director, Pharos Fund.**

Emerging market fund

According to HFR, hedge funds investing in emerging markets far outpaced average performance in the broad hedge fund universe in the second quarter of 2009.

"The hedge fund industry has continued to evolve through the current period of consolidation, and in no place is this evolution more apparent than in funds investing in emerging markets," said Heinz.

The HFRI Emerging Markets (Total) Index gained 18.92 per cent for the quarter compared to a gain of 9.17 per cent for the HFRI Fund Weighted Composite Index, HFR's broad-based gauge of industry performance. Through the first six months of the year, emerging markets funds returned 20.18 per cent, which is the best first half for emerging markets strategies since a 27.4 per cent gain in H1 1999.

This performance follows the historic decline of 37.26 per cent for the HFRI Emerging Markets (Total) Index in 2008, the worst year of performance on record for emerging markets funds since HFR began tracking the category in 1990.

"While unquestionably volatile, emerging markets hedge funds have represented one of the most attractive segments of the hedge fund industry when viewed over longer periods of time and through market cycles," said HFR data.

Since 1990, the category has achieved annualised gains of 13.6 per cent, almost 160 basis points better than the average broad-based hedge fund gain of 12 per cent.

According to data by HFN, July saw a strong performance from all regions in case of emerging markets. The HFN Emerging Markets Average was up 4.26 per cent during the month and 25.39 per cent in 2009.

"The benchmark indicates average emerging market returns are still below a high water mark set back in October 2007.

"The benchmark shows funds have recovered significantly and it is only 700 basis points from exiting the prolonged drawdown."

Emerging market returns in July were led by funds with primary exposure to China, followed by Brazil, broad Latin America, India and the Middle East North Africa (Mena). Funds investing in Russia lagged, but were still positive.

In spite of stellar performance, investors continued to withdraw assets from emerging markets during the quarter, with \$2.5bn in capital exiting the regions during the period, said HFR.

This was more than offset by positive market returns totalling \$12.9bn, resulting in a net increase of \$10.4bn in emerging markets assets in Q2. Assets in hedge funds focusing on emerging markets now stand at \$77bn.

The Mena-focused funds, in spite of it being the smallest emerging market region in terms of dedicated capital, have recorded a 10-fold increase in AUM over the past five years, HFR data showed.

There are currently more than 20 hedge funds that invest exclusively in this rapidly growing region, and the HFRX Mena Index has gained 16.9 per cent through the first half of 2009.

Cautious approach

Despite the broadly positive market environment, hedge fund performance, particularly from equity focused managers, illustrated a more defensive stance being taken, the reports said.

The perception being that perhaps some of the positive news published during the month is not indicative of a long-term trend. This defensive stance by the industry is visible across several months in 2009.

"Most fund managers are remaining cautious given the high volatility in the markets and the belief that we still haven't reached the bottom of the crisis.

"That said, with an increasing amount of positive news like the recent statement by US Federal Reserve Chairman Ben Bernanke saying prospects for a return to growth appear good, the optimism for a global economic recovery at the end of this year going into early next year remains high signalling many fund managers to become less defensive," said Papesh.

"Given that managers do not have the ability to use leverage like before the credit crisis, coupled

by last year's massive redemptions and weak performance, they have been sitting on more cash waiting for the right market conditions based on a top-down approach looking for an increase in demand for commodities in China and the US signaling growth.

"Now that many managers believe we are starting to turn the corner, this is when possibly they will start to step in and become fully invested," he said.

At Pharos Financial Advisors, specialist emerging market investors focused on Russia and the CIS, the performance was up nearly 30 per cent year to date.

"This is while still using a more conservative approach until we see further signs in the market that the crisis has ended. Furthermore, let it be known we were the most resilient fund in our space last year and had very few redemptions," Papesh said.

Assets increase to \$1.8 trn

As per HFN estimates, total hedge fund assets at the end of July were \$1.838 trillion (Dh6.75trn), an increase of 2.62 since June.

Performance accounted for the vast majority of the asset rise, but investors continued to add more money than they took out of hedge funds in July.

"The net inflow is the third straight positive month, which has not occurred since the fourth quarter of 2007," HFN said.

Performance helped assets grew an estimated \$40.2 billion and net investor inflows added an additional \$6bn.

However, the industry's organic growth slowed in July. Organic growth [decline] is defined as the rate of increase [decrease] in assets as a result of investor flows.

Organic growth was up 0.37 per cent in July and it returned to the industry in May 2009 following nine straight months of decline.

Growth rates were an upward of 0.96 per cent in May and increased in June to 1.06 per cent.

However, the reduction in growth rates was more due to a slowdown in new allocations over the prior two months, HFN said.

"The composition of flows by funds suggests that the reduction in growth rates in July was not due to an increase in redemptions, but more to a slowdown in new allocations over the prior two months. Redemption levels have remained relatively consistent in May, June and July."