

OVER THE HEDGE

Risk appetite has returned and understanding risen to a point where Mena investors are prepared to take the leap back into hedge funds, according to Mahmoud Al-Khawaja, CEO of Capintro Partners

By John Butcher

Following a subdued appetite for alternative investments over the past two years, hedge funds appear to be returning to the Middle East with interest in both hedge funds and funds of hedge funds slowly rising.

The overall liquidity situation has improved and risk appetite among investors has made a comeback as global markets recover.

"We also partially attribute this increased interest to the compression of yields on regional fixed income which has been a major focus among regional investors," says Mahmoud Al-Khawaja, CEO, Capintro Partners, which has carried out research into the Mena hedge fund market.

"Regional credits offered investors extremely attractive yields for solid credits over the past 18 to 24 months in line with global fixed income. As fixed income has rallied, yields have declined which now compels investors to look for returns elsewhere. Mena investors also expect hedge funds to perform well in 2011.

"As this continues to take place, we expect that appetite for hedge funds will continue to increase," adds Al-Khawaja.

According to Capintro Partner's research, the majority of interest has been in the most liquid strategies including global macro, CTAs and some of the more liquid long-short strategies. Additionally, the firm found investors across the Mena region favour hedge fund strategies focused on Asia ex-Japan, then other emerging markets followed by the US.

"This continues to be the case as we see

the so-called risk on trade back on and investors focused on emerging markets which have performed well in 2009 and so far in 2010."

While this asset class is regaining popularity in the Mena region, several barriers remain to raising capital for hedge funds. Because of this, many hedge fund managers choose to use local placement partners to access these investors according to Al-Khawaja.

"This region is a relationship-driven market and, while allocations to managers may not be made by who you know, knowing the right clients and having had positive past dealings with them will lead to meeting decision makers, obtaining their accurate feedback and reducing the long and extensive sales cycle," he says.

"We find that investors are more comfortable investing with managers who have regional presence or a local partner. Investors are able to get clarification or information in a more timely manner and avoid the time/day mismatch with Europe and the US."

Another barrier to entry in this region is the fact that investors may not be so apparent. While the banks, investment companies and sovereign wealth funds may be easy to spot, there is a whole other tier of investors which is not so obvious. Al-Khawaja explains that hedge fund managers require market knowledge and experience in order to identify, meet and potentially work with this segment of investors. "Education is an issue with some of these investors," he says. "Managers must educate the clients in order to help them understand their strategies

and investment philosophy.”

Further, a local partner could potentially allow managers access without the need or hassle of setting up a local office in the midst of increased regulation in the region, he adds.

Mena investors will continue to increase their allocations to hedge funds as their global knowledge increases and they begin to understand how alternative products work, including the diversification and correlation benefits they bring to portfolios, according to Al-Khawaja.

“Several years ago, the Mena region was predominantly a fund of hedge funds market,” he says. “We have seen a large number of investors migrate towards investing directly in single managers as their knowledge and expertise within hedge funds has grown.

“Our outlook for hedge fund managers looking to raise capital from the region is very positive and we feel confident that allocations from investors will increase and demand will continue to improve.”

While international investors in hedge funds tend to be strategic in their allocation, local Mena investors are often more opportunistic, according to Capintro Partner’s research.

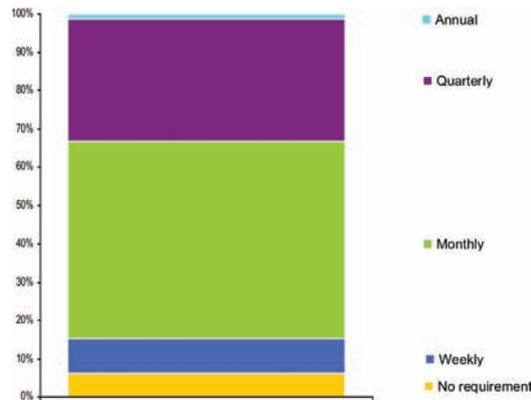
“It is for this reason that we feel Middle East investors were very reactive in redeeming from hedge funds in the crisis and find that their holdings have been substantially reduced throughout the past 24 months,” says Al-Khawaja. “This of course will present an opportunity as they will look to reinvest and some are already starting as their risk appetite and liquidity has improved.”

As a result of the financial crisis, the use of consultants by local Mena investors has become more widespread. Pre-crisis most investors preferred to manage their assets in-house.

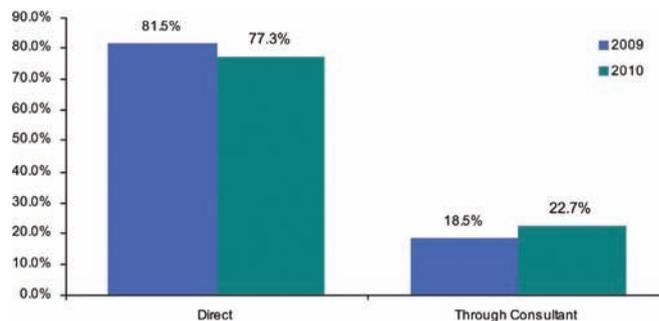
“We are seeing more widespread use of consultants among sovereign wealth funds, investment companies, banks and another investors,” says Al-Khawaja. “We have found some to use consultants for asset allocation guidance and others to use consultants for specific manager selection.”

This factor has also led to increased understanding of alternative asset classes and raised investor confidence levels to a point where hedge funds are back on many of their investment radars.

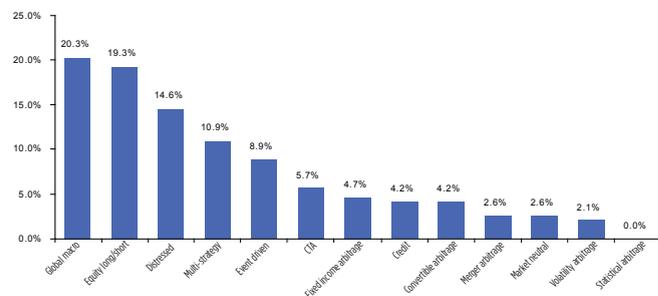
Liquidity requirement of investors



Direct or through consultant



Strategies for 2010



Regions for 2010

