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Hedge Fund Industry Asset Flow Report

October 2016

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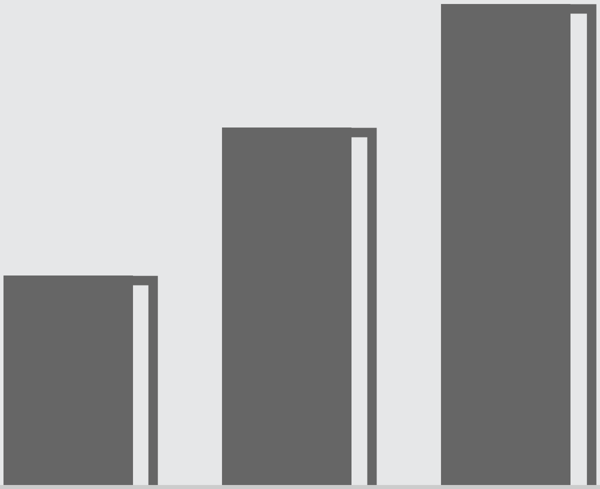

Summary

Hedge funds continue to face difficult times, but the $3 trillion industry is not on the verge of disappearing. Savvy institutional investors have more choices, more technology and more influence on their side than ever before. The largest allocators may find it more cost effective to bring resources in-house rather than to pay high fees for mediocrity, while others may turn to replication strategies, or ETFs, but also increasingly to private markets which hold the perception that value has more potential to be realized, and manager expertise is more critical in that process.

The result for the hedge fund industry, for now, appears to be stagnation at best, and slow erosion at worst. What may provide hope to the industry is a change which can disrupt the homogeny of public markets over the last several years. There are sparks of change emerging over the globe, but whether professional discretion can prevail is not yet evident.

Highlights

- Investors redeemed an estimated $14.2 billion from hedge funds in October, bringing YTD outflows to $77.0 billion.
- Redemptions from managed futures were the largest in nearly two years as performance issues began to impact investor sentiment.
- Commodity strategies see second consecutive month of outflows.
- Event driven funds’ redemptions were elevated again in October amid dissatisfaction with returns.

Hedge Fund Redemptions Widespread and Persistent

Investors redeemed an estimated net $14.2 billion from hedge funds in October. Year-to-date, there has been a net $77.0 billion removed from the industry.

October's outflow was the fourth month of redemptions in the last five and seventh in 2016. Due to the breadth of products experiencing outflows, and the persistence of redemptions outweighing new allocations, it is clear the industry is experiencing a crisis-like wave of negative investor sentiment.

Industry Flows

Data in USD Billion	Oct	Last 3mo	YTD 2016	2015	Est. AUM
All Hedge Funds	($14.21)	($18.95)	($77.01)	$44.09	$3,030.09
Equity	($9.44)	($11.87)	($37.98)	$16.46	$1,005.46
Fixed Income/Credit	($3.85)	($7.82)	($37.28)	($20.16)	$934.98
Commodities	($0.70)	$2.26	$10.67	$0.01	$77.68
Multi-Asset	($0.02)	($1.28)	($11.49)	$51.08	$1,070.89
Primary Strategy	**Oct**	**Last 3mo**	**YTD 2016**	**2015**	**Est. AUM**
Distressed	$0.58	($0.24)	($4.85)	($5.50)	$239.89
Broad Multi-Strategy	$0.55	$0.68	($5.14)	$56.35	$498.29
Macro	($0.18)	($3.75)	($7.30)	$1.32	$191.86
Convertible Arbitrage	($0.29)	($0.38)	($0.98)	($3.20)	$51.39
Directional Credit	($0.47)	($3.22)	($10.55)	($4.68)	$125.54
MBS Strategies	($0.89)	($0.89)	($4.20)	($1.27)	$88.21
Market Neutral Equity	($1.13)	($1.03)	($2.39)	$0.66	$49.84
Managed Futures	($1.63)	$3.17	$19.31	$13.43	$135.56
Relative Value Credit	($3.20)	($2.60)	($10.87)	($5.53)	$224.86
Long/Short Equity	($3.41)	($6.47)	($17.51)	$9.02	$686.65
Event Driven	($4.49)	($6.23)	($38.22)	($19.38)	$518.40

Flows by Size and Prior Year Return

Current Month

2015 Performance	<0%		0-5%		>5%	
Product Size	<$1B	>$1B	<$1B	>$1B	<$1B	>$1B
All Hedge Funds	($1.80)	($11.78)	($1.38)	$4.15	($0.87)	($2.54)
Equity	($1.11)	($7.16)	($0.01)	$1.92	($0.54)	($2.55)
Fixed Income/Credit	$0.04	$0.31	($0.84)	($1.61)	($0.32)	($1.43)
Commodities	($0.20)	($0.19)	($0.08)	$0.00	($0.23)	$0.00
Multi-Asset	($0.32)	($4.74)	($0.46)	$3.84	$0.22	$1.44
Primary Strategy	<$1B	>$1B	<$1B	>$1B	<$1B	>$1B
Distressed	($0.00)	$0.58	$0.00	$0.00	$0.01	$0.00
Broad Multi-Strategy	($0.05)	($2.13)	($0.39)	$3.40	($0.28)	($0.01)
Macro	$0.15	($1.44)	($0.00)	$1.83	($0.15)	($0.57)
Convertible Arbitrage	($0.13)	$0.00	($0.10)	$0.00	($0.06)	$0.00
Directional Credit	$0.13	$0.50	($0.29)	($0.17)	$0.02	($0.68)
MBS Strategies	($0.06)	($0.12)	($0.64)	($0.06)	($0.01)	$0.00
Market Neutral Equity	($0.11)	($0.18)	($0.01)	$0.00	$0.19	($1.03)
Managed Futures	($0.71)	($1.09)	$0.06	($1.90)	$0.34	$1.67
Relative Value Credit	($0.01)	($0.59)	($0.67)	($1.35)	($0.18)	($0.41)
Long/Short Equity	($0.84)	($2.55)	($0.02)	$1.92	($0.56)	($1.36)
Event Driven	($0.24)	($4.52)	$0.04	$0.41	($0.03)	($0.16)

Year-to-Date

2015 Performance	<0%		0-5%		>5%	
Product Size	<$1B	>$1B	<$1B	>$1B	<$1B	>$1B
All Hedge Funds	($33.31)	($128.40)	($1.95)	$46.48	$8.76	$31.41
Equity	($12.87)	($31.40)	($4.35)	$6.90	$0.33	$3.41
Fixed Income/Credit	($11.55)	($34.50)	$4.07	($3.17)	$3.76	$4.12
Commodities	$1.56	$4.59	$0.76	$0.02	$2.37	$1.38
Multi-Asset	($8.68)	($63.34)	($2.49)	$39.57	$2.26	$21.18
Primary Strategy	<$1B	>$1B	<$1B	>$1B	<$1B	>$1B
Distressed	($1.57)	($3.60)	$0.09	($0.01)	$0.25	($0.01)
Broad Multi-Strategy	($4.36)	($16.36)	($0.54)	$0.11	$2.34	$13.68
Macro	($3.54)	($39.01)	($1.08)	$33.12	$1.31	$1.90
Convertible Arbitrage	($0.58)	($0.25)	$0.02	$0.00	($0.16)	$0.00
Directional Credit	($6.72)	($20.56)	$8.83	$5.64	$2.46	($0.19)
MBS Strategies	($0.71)	($4.29)	$0.73	$0.14	($0.00)	($0.06)
Market Neutral Equity	($1.94)	($1.70)	$0.28	($0.02)	$0.91	$0.08
Managed Futures	$1.02	$1.26	$0.37	$3.00	$3.07	$10.59
Relative Value Credit	($2.10)	($9.87)	$2.15	($0.24)	($0.72)	($0.08)
Long/Short Equity	($9.55)	($17.21)	($3.13)	$7.78	($1.34)	$5.94
Event Driven	($5.19)	($28.87)	($0.94)	($0.26)	$0.86	($3.82)

Flows Overview

- The breadth of redemption pressure in October was the **industry's** largest in 2016 with 61% of reporting funds estimated to have net outflow during the month. The last five months have accounted for the majority of the industry's redemptions in 2016, a time frame which aligns with investors' processes for analyzing 2015 results, and taking actions on those decisions.

- While investors broadly reduced investments in **hedge funds** in October, the bigger issue was the lack of meaningful new investment. The portion of funds losing greater than 2% or 5% of their AUM from redemptions was only slightly above average in October, however the portion with new allocations greater than 2% or 5% of their AUM were well below average. Essentially, flows in October were poor not necessarily because investors redeemed from the industry, but no one is really allocating with any enthusiasm.

- One major issue that arose in October, investors appear to be turning their backs on the one segment which had supported industry flows in 2016, **managed futures**. Performance issues, as anticipated, appear to have swayed investor sentiment toward the group negative. After aggregate performance declines in each of the last three months, and six of the last eight, managed futures funds had their second largest month of outflows in almost two years in October. With performance losses intensifying in October, the outlook for flows for the universe is not positive.

- **Event driven** funds continue to be a major source of redemption pressures for the industry. October and YTD flows by size and prior year return illustrate the issue well; too many large funds performed poorly last year, and they have been the major source of redemption pressures through the year, and into October. Why that occurred is particular to each fund, however the negative sentiment in response has been universal.

- August marked fifteen months of investors voting in favor of **commodity** strategies, but after recent losses, investors have begun to head to the exits. Redemptions in October were the second consecutive month of outflows after persistent losses re-emerged in July.

- If pressed for a bright spot, investors were net allocators to **multi-strategy** hedge funds in October. Inflows were not large, however it may be a positive sign that the seven months of positive returns prior to October have resulted in positive flows in two of the last three months. July's nearly $8 billion in redemptions may ultimately prove to be the moment investor sentiment bottomed out toward the strategy.

Flows Overview (continued)

- The outlook for **macro** hedge funds may actually be positive, despite October being the tenth monthly net outflow for the universe within the last year. Eight consecutive months of positive asset-weighted performance, against the backdrop of a rapidly evolving macro economic landscape could be positive for flows. There remains the risk for investors to select managers who most appropriately interpret global influences, as the universe has proven that not all will get it right, and several may get it very wrong.

- **Distressed**, the industry's best performing strategy of 2016, had slightly positive flows in October. Distressed investing, in a hedge fund structure, has endured 22 months of negative investor sentiment prior to October. The interest in private credit funds, whose structures are designed to be specifically aligned to opportunities in distressed or special situation credit markets, have likely had an impact on distressed hedge fund net flows.

- Hedge funds are facing difficult times, but the $3 trillion industry is not on the verge of disappearing. The issues of expensive access to increasingly marginalized and potentially replicable returns streams, has and will continue to force change. Savvy institutional investors have more choices, more technology and more influence on their side than ever before. The largest allocators may find it more cost effective to bring resources in-house rather than to pay fees for mediocrity. Others may turn to replication strategies, ETFs, but also increasingly to private markets where there is the perception that value has more potential to be realized, and manager expertise is more critical in that process. The result for the hedge fund industry, for now, appears to be stagnation at best, and erosion at worst. What may provide hope to the industry is a change which disrupts the homogeny of public markets over the last several years. There are sparks of change emerging over the globe, but whether professional discretion can prevail is not yet evident.

Regional Exposure Not Immune to Industry's Swoon

Investor redemptions returned to emerging market hedge fund in October as another wave of outflows from China exposure rippled through the universe. Redemptions nearly offset the prior two month's net inflows, raising doubt about the conviction to EM exposure going forward.

Flows by Investment Region and Domicile

Investment Region	Oct	Last 3mo	YTD 2016	2015	Est. AUM
Americas	($7.67)	($7.67)	($32.97)	($18.48)	$908.04
Europe	($1.62)	($4.96)	$0.06	$22.70	$242.42
Asia	($1.57)	($2.75)	($15.67)	$4.21	$97.94
Emerging Markets	($1.98)	$0.49	($1.96)	($7.67)	$276.85
Global Markets	($3.33)	($3.48)	($28.34)	$35.83	$1,790.64
Firm Domicile	**Oct**	**Last 3mo**	**YTD 2016**	**2015**	**Est. AUM**
Americas	($7.13)	($3.79)	($59.43)	($5.01)	$2,285.47
Europe	($6.61)	($12.90)	($0.43)	$29.67	$728.32
Asia (ex-Oceania)	($0.04)	($0.92)	($7.93)	$12.28	$55.75

Flows by Size and Prior Year Return

Current Month

2015 Performance	<0%		0-5%		>5%	
Product Size	<$1B	>$1B	<$1B	>$1B	<$1B	>$1B
Americas	($0.95)	($5.10)	($0.98)	$0.04	($0.15)	($0.54)
Europe	($0.30)	$0.74	$0.01	($0.98)	($0.11)	($0.98)
Asia	($0.12)	($0.15)	$0.01	$0.00	($0.09)	($1.22)
Emerging Markets	($0.15)	$0.00	($0.38)	$0.00	($0.37)	($1.09)
Global Markets	($0.40)	($7.28)	($0.41)	$5.08	($0.52)	$0.20
Firm Domicile						
Americas	($0.93)	($12.62)	($0.91)	$8.46	($0.23)	($0.90)
Europe	($0.76)	$0.97	($0.27)	($4.31)	($0.67)	($1.57)
Asia (ex-Oceania)	($0.07)	$0.01	$0.03	$0.00	$0.05	($0.06)

Year-to-Date

2015 Performance	<0%		0-5%		>5%	
Product Size	<$1B	>$1B	<$1B	>$1B	<$1B	>$1B
Americas	($11.99)	($25.61)	$0.74	$1.23	$2.73	($0.08)
Europe	($1.60)	($1.96)	($0.29)	$0.97	$0.37	$2.56
Asia	($1.88)	($4.60)	($0.75)	$0.08	($1.25)	($7.26)
Emerging Markets	($2.67)	$0.33	($0.54)	$1.14	$2.54	($2.76)
Global Markets	($16.85)	($93.80)	($1.70)	$41.91	$6.81	$35.29
Firm Domicile						
Americas	($24.94)	($110.15)	$0.62	$37.48	$6.43	$31.13
Europe	($2.58)	($6.01)	($2.13)	$7.07	$1.54	$1.68
Asia (ex-Oceania)	($2.27)	($4.03)	($0.26)	$0.00	$0.54	($1.91)

Regional Flows Overview

- Interest in emerging markets exposure, which had been an embryonic ray of hope for one segment of the industry, fizzled in October. Though there were fund-specific areas of interest, no sub-universe (China, Brazil, India, Emerging Europe, Broad EM) had aggregate net inflows.

- Investor flows for **China**-focused funds returned to levels seen earlier in the year when sentiment was universally negative. The very slightly positive flow in September appears right now as an anomaly. Given the level of uncertainty around actions toward trade and foreign competition surrounding newly elected officials in the US, it is doubtful to see fresh allocations to China exposure in the near-term.

- Flows for funds based in Europe were again disproportionately negative in October relative to US-based fund flows and the size of the US market. Managed futures funds, but also European equity-focused strategies were the largest sources of outflows in October.

- For Asia-domiciled funds, the largest source of redemption pressures came from China equity-focused funds based in Hong Kong.

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