

Characteristics of the Hedge Fund Industry in Japan

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Abstract

In recent years Japan's hedge fund industry has been an increasingly popular destination for global investor allocations. Using a comprehensive database of returns and assets under management of Asian hedge funds we investigate the size flows, performance and other characteristics of Japan's hedge fund industry. We have four main findings. First, we find that the industry has grown at a phenomenal rate since the second half of 2003, although the compound annual growth rate of assets appears to have slowed in the six months ending December 2005. Second, a time series of estimated dollar money-flows into/out of Japan's hedge fund industry points to large inflows in recent years. These have been directed at long/short equity, directional equity and event driven strategies. Third, we note that the average asset-weighted or equal-weighted performance of Japan hedge funds under-performed traditional Japan equity benchmarks. Finally, we describe the prototypical hedge fund trading Japan as being a very small, Cayman Island-domiciled fund with its portfolio managers typically domiciled outside of Japan. Additionally, we note an increase in structures in which there is Japan-based investor advisor to the offshore fund. Overall, these findings improve our understanding of industry money-flows, performance and other fund characteristics.

I. Definition

The definition of a hedge fund is imprecise. One commonly accepted definition is an investment vehicle organized as a private unregistered investment company, most often as a limited partnership, that enjoys considerably flexibility with respect to positions and instruments employed². According to the MSCI a hedge fund is an investment company that hedges at least 10% of its investment positions. In this case, MSCI allows for the inclusion of public investment companies (including mutual funds) within its definition³.

The public data and news source, Hedge Fund Intelligence, defines an Asia-Pacific hedge fund as an entity charging a performance fee and either located in the Asia-Pacific investing in any strategy or located outside of the region but investing specifically in Asia-Pacific financial instruments⁴.

For the purposes of this study, we define a Japanese hedge fund as an entity that charges a performance fee and irrespective of portfolio manager or fund domicile invests the bulk of its assets in Japanese equities and/or equity-related derivatives. The funds themselves can be hedged or not hedged, implying that the term hedge fund should best be considered a misnomer.

II. Data Description

A single database was constructed by merging two publicly available hedge fund data sets focusing on single manager hedge funds allocating capital to Japan. The reasoning was simple: we needed to create the biggest single dataset of hedge funds focusing on Japan that

² John Marshall

³ MSCI, see www.msci.com/hedge/

⁴ Paul Storey, AsiaHedge

excluded overlaps. The publicly available databases utilized were supplied by Hedge Fund Intelligence (“AsiaHedge”)⁵ and EurekaHedge (“EurekaHedge Asia”)⁶. These two databases are widely regarded as being the most comprehensive in terms of numbers of hedge funds covered in the Asia region.

Another important aspect of this research involved the definition of hedge fund activity directed at Japanese financial markets. To do this, we had to create and allocate funds to geographical field definitions. Where not already classified by AsiaHedge or EurekaHedge Asia we subjectively classify each single manager hedge fund into one of the following five geographical categories: *Japan, Asia including Japan, Asia excluding Japan, Global including Japan and Global excluding Japan*. Our research concentrated on those geographies relevant to Japan, namely: *Japan, Asia including Japan and Global including Japan*. The focus was on single manager funds and not fund of hedge fund products. We did this knowing that the biggest data deficiencies relate to under-reporting by the databases of hedge funds belonging to the *Global including Japan funds*⁷ category. See Table I, Panel A: Distribution of Single Manager Hedge Funds across Regional Focus.

To the extent that a small number of funds allocating to Japan have diversified their geographical investment mandates within existing fund operations we decided to re-classify those funds into their more recent and appropriate geographical definition. For example, a Japan-

⁵ AsiaHedge: www.hedgefundintelligence.com

⁶ EurekaHedge: www.eurekaHedge.com

⁷ The State of the Hedge Fund Industry in Japan, Daiwa Securities America, Dec 2004, estimated that the Global including Japan category of the hedge fund universe allocating to Japan as follows: end 2001 US\$44 BLN, mid 2002 US\$37 BLN, end 2002 US\$21 BLN, mid 2003 46 BLN, end 2003 US\$49 BLN, mid 2004 US\$48 BLN. These estimates are considered “conservative” in that they assumed low levels of leverage. Those funds tended to be multi-strategy in nature with a strong relative value approach to benefit from rising and falling market conditions. They also tend to command the largest assets and are opportunistic in approach.

only fund that in 2003 expanded to trade Korean equities would be classified under “*Asia including Japan*” from simply “*Japan*” in our analysis.

We selected data time series in six month increments with assets under management as of the end of June and December for each year beginning with the figures for the end of 2001. In a number of instances the reliability of data time series beyond individual contact information and general net return information was disappointing. As hedge funds are not obligated to report their data to publicly available databases this is hardly a surprising phenomenon. Moreover, return information may be restated once results are audited at the end of a hedge fund’s reporting period and some databases do not necessarily reflect these changes in their respective databases in a timely manner.

III. Assumptions

There are a number of important specific assumptions underpinning this research. First, an unrealistic yet necessary assumption presupposes that most of the hedge funds in the selected universe transact in Japanese cash equities. This is clearly not realistic. The fact is that an insufficiency of data related to derivatives and non-cash assets prevents any clear identification of complete hedge fund activity⁸. That is simply a fact. By necessity we must assume that the hedge funds involved in Japan are primarily buyers and sellers of cash equities and that the vast majority are involved in the Japan long-short equity strategy. In fact, the Japan long/short equity strategy accounts for 72% of all assets. See Table I. Panel B: Distribution of Single Manager Hedge Funds across Strategies. The reality may be somewhat different as many *Global including Japan* funds have been typically the biggest users of derivatives to execute relative value and market neutral strategies in addition to basket and pairs trading, convertibles transactions and the hedging of IPO and secondary market offerings.

Second, *Global including Japan* funds such as macro, global long/short equity or multi-strategy are all inadequately covered by the data. Their role in Japanese financial markets is substantive but often difficult to quantify. One way that they make money is in making top-down calls on asset allocation. This may take the form of changing strategy or geographical exposure and they also tend to be more aggressive users of leverage. Therefore, their investment approach opportunistic in terms of when and for how long they apply their global capital allocations. For

⁸ Investors Guide, no. 337, January 2006, Daiwa Institute of Research, pp. 46 & 52. For the first 9 months of 2005 the trading value of TOPIX and Nikkei 225 equity futures amounted to ¥2,416,147 (in 100 mil) while total value of stocks traded on Tokyo, Osaka and Nagoya main exchanges amounted to ¥5,581,770 (in 100 mil) with no way of knowing how much of this trading activity is attributable to hedge funds, and whether they are funds tracked by the merged database used in this research.

example, a promising new equity issuance or IPO out of Japan might tempt participation by a *Global including Japan* fund on the encouragement of its prime broker. This is a potentially big “hole” in our understanding of the overall impact of hedge funds in Japan. Depending on the nature of the market cycle many are believed to constitute the biggest sources of capital impacting Japanese financial markets given their significant size advantage over typical Japan long/short equity funds⁹.

Third, this research does not account for gross or net leverage changes over time. An important consideration in analyzing hedge funds necessarily accounts for the issue of leverage. Typically, leverage enables a hedge fund manager to hold a bigger position in an underlying asset (usually cash equities). An appreciation of the likely average leverage utilized by the single manager allocating to Japan might be beneficial in understanding the impact of hedge fund capital on the major exchanges. For the purposes of the database, average net exposure (total cash equity long positions minus total cash equity short positions) runs from -10% to 50% and average gross exposure (total cash equity long positions plus total cash equity short positions) runs from 80% to 150%¹⁰. This is important as it provides pretty substantial evidence that a majority of Japan long/short equity funds will tend to utilize leverage on the long side as opposed the short side in their investment approach.

Fourth, a hedge fund’s exposure to Japanese financial markets is likely to be dynamic and not stationary as implied in this research. A frequently overlooked consideration in analyzing hedge funds managers in Japan is their frequently changing exposure to the market. Once a fund

⁹ Source: Lipper TASS, www.hedgeworld.com (mean size of a multi-strategy fund as at end 2005, excluding foreign currency denominated classes, was US\$220 MLN and this typically excludes a number of the biggest multi-strategy funds that do not report to commercially available hedge databases)

¹⁰ Based solely upon reported data to the EurekaHedge database of funds

has been assigned a geographical designation (Japan focus, Asia including Japan or Global) one must take into account the amount of exposure the allocation is likely to be in Japan. In reality a manager may have some flexibility depending on market circumstances. For the research we assigned fixed percentage allocations and held them constant over time. For example, Japan long/short equity managers were assumed to allocate 100% of capital to Japan. However an Asia including Japan manager was assumed to allocate 30% of capital to Japan with global managers a mere 10% of capital to Japan. We believe that these are conservative assumptions and in many cases they might not reflect the reality of a market cycle, position liquidity or any other number of reasons.

Fifth, the role of “*dead*”, “*obsolete*” or “*graveyard*” funds is almost certainly understated. While both AsiaHedge and Eurekahedge databases provided breakdowns of single manager funds that are no longer reporting their data to them, access to detailed asset or even performance data history was incomplete and in a large number of cases inconsistent. Clearly, this introduces a significant bias in any overall assessment of time series performance. See Table I Panel C: Single Manager Hedge Funds allocating to Japan (Live Funds) and Panel D: Single Manager Hedge Funds allocating to Japan (Dead funds).

Sixth, the research also excludes other potentially relevant additional data points. A not insignificant amount of capital allocated by hedge funds in Japan is currently run in managed accounts. Managed accounts are often run *pari passu* with normal fund operations although their performance and assets under management are usually not reported to databases. The precise scope and scale of these repositories is unclear but certainly, they provide yet another area for imprecision in the definition of the universe in the sense of an under-reporting asset under management bias.

Additionally, there are a number of more general problems which will always lead to overestimation of hedge fund performance. All of these problems are likely to be present in our Japan hedge fund data analysis. Previous research has already pointed out the various pitfalls of working with hedge fund data including survivorship biases, instant history bias and selection bias (Ackerman, McEnally, and Ravenscroft, 1999; Brown, Goetzmann, and Ibbotson 1999; Fung and Hsieh, 2000; and Liang, 2000). Survivorship bias occurs when a hedge fund suddenly drops out of the reporting universe. A big part of the manager's fees are paid as an incentive, typically 20% of performance. If the strategy collapses, rather than waiting for the fund to generate returns back over its previous high which would take time and generate low or even no fees for the manager, he might be close the fund and start another one with a new track record. Instant history bias or backfill bias can be significant and occurs when hedge funds with good historical performance decide to report and data providers backfill their databases to show this track record. Selection bias describes to two possible situations. First, managers who are not interested in increasing assets or who can raise sufficient funds on their own have no incentive to participate in a database. Second, hedge fund managers with poor performance might also choose not to participate. It might be logical to assume that the number of managers in the second category is likely to outnumber those in the first. Yet another issue relates to security pricing bias. For relatively illiquid securities that do not actively trade in the secondary market any end of month mark-to-market valuation may be subject to over or under estimation by a hedge fund manager if there is no consistent third party verification process. This might conceivably lead to overvaluation of hedge fund performance, in particular around the time prior to the calculation and payment of a manager's incentive fee. This might be a factor in some of Japan's less liquid small cap security trades.

IV. Results

Estimated assets under management of hedge funds allocating to Japan grew 19% over the final six months of 2005 to US\$54.8 BLN. This was US\$15.1 BLN or 38% over the previous six month period and while appearing high, it marked a slow down from mid year 2003 to end 2004 when assets grew well over 40% every six months. Why? We believe we that a first wave or investment tsunami from global investors took place from the second half of 2003. These investors were typically high net worth individuals, family offices, private banks and fund of hedge fund operators. These types of investors typically do not have rigid and or inflexible investment mandates and they typically try to employ tactical asset allocation (in this case geographical in nature). As the traditional equity markets have shown renewed vigor it is possible that the other larger institutional investors with existing long-only mutual fund type exposure in Japan might start to look at hedge fund allocations not so much for the exposure to a rising equity market as much as for diversification from their equity market exposure. Looking ahead, we estimate that hedge fund asset growth may slow to a more sustainable rate in the low to mid teens every six months.

It would be interesting to consider what the size of Japan's hedge fund industry would be if we made some assumptions regarding the estimated assets of *Global including Japan* funds¹¹. Many Global including Japan funds have been visibly ramping up trading operations and research capabilities in Asia over the last 24 months. For many of them, Japan continues to be a primary reason for this heightened business activity and the primarily goal for their

¹¹ Applying the same ratio of Global including Japan hedge fund category used in The State of the Hedge Fund industry in Japan, mid year 2004, Daiwa Securities America, would produce a likely end 2005 figure of US\$91 BLN for a grand total of US\$146 BLN for all hedge funds allocating to Japan. Applying this over the total market value of Tokyo Stock Exchange Section 1 & 2 market value would suggest that hedge funds accounted for 33% of TSE market cap as at the end of 2005.

investment assets. See Table II. Assets Under Management: Trends in Hedge Funds Allocating to Japan.

Fund Assets under Management. Table II shows the summary statistics for the 2001 to 2005 period. In 2001 based on total assets under management of US\$12.9 BLN the mean of Japan hedge funds employing equity market neutral strategies was US\$245 million. Note that equity market neutral emphasized downside protection due to the “hedged” nature of the investment style, a feature that would have made sense to institutional investors both overseas and domestic. In contrast, for the second half of 2005, mean equity market neutral assets under management fell to US\$101 million. One possible explanation might be that investors have become risk tolerant with the switch away from capital preservation to absolute return symptomatic of investors chasing beta or market returns.

Also noteworthy has been the rapid growth in the mean assets controlled by event driven funds. They increased from under US\$100 million at the end of 2004 to over US\$400 million by 2005 reflecting the burst in activity in Japan’s nascent mergers and acquisitions, LBOs and investor activist opportunities.¹²

In contrast, mean assets in the long/short equity strategy have moved steadily higher from US\$104 million in 2001 to US\$180 million by the end of 2005. The higher mean size probably reflects the fact the fact that the majority of established managers rather than start-up managers were successful in garnering investment allocations. It might also reflect the fact that a number of the start-ups were “seeded” by established managers opening new strategies or “re-opening”

¹² In 2003, CalPERS teamed up with Sparx Asset Management in Japan and Relational Investors LLC in California to set up a pilot Japan Corporate Governance Fund.

previously closed funds in light of the better liquidity conditions in Japanese equity markets.

Fund Net Flows. Table III. Net Dollar Flows and the relationship with Japan hedge fund performance displays the time series of dollar asset flows into Japan hedge funds. Net flows are aggregated and broken down by strategy. Net flows try to account for the effect of performance of a particular strategy in addition to asset inflows and outflows. To do so, the research relied upon six month time periods of asset data with performance netted out on a fund by fund basis to calculate the net flows for each fund i during time t according to the following

$$\text{Net flow}_{it} = \text{AUM}_{i,t} - \text{AUM}_{i,t-1}(1 + R_{i,t})$$

Where $\text{AUM}_{i,t}$ and $\text{AUM}_{i,t-1}$ are assets under management for fund i at the end of the six month period t and $t-1$ and $R_{i,t}$ is the return for fund i during the six month period denoted by t . As explained earlier we had to rely on the six monthly periods because of the lack of reliable asset under management data on a monthly period in the examined databases.

Once we constructed a time series of net fund flow data we compared this to a time series of performance data in order to eyeball the relationship between net flows and performance. In order to account for any potential confusion related to definition of performance, we took account of the equal-weighted and asset-weighted definitions (where the assets under management of the fund are taken into account).

The findings show that high net inflows periods ending Dec 2003 (US\$8.2 BLN), Jun 04 (US\$10.2 BLN) and Dec 2004 (US\$10 BLN) mirrored periods in which traditional equity benchmarks such as the Nikkei 225 index and MSCI Japan put up strong gains with the biggest inflows occurring in six-month periods when those same benchmarks posted high positive returns. This appears to be more reliable than the performance spread between asset-weighted

hedge funds in the data set and a traditional benchmark like the MSCI Japan Index or Nikkei 225 Index.

This begs the question whether it is indeed the absolute performance of Japan that alone triggers positive dollar inflows into Japan's hedge fund industry or rather the relationship of hedge fund performance relative to traditional benchmarks. If one looks at six-month period returns related to the Nikkei 225 equity index and the MSCI Japan index then for four out of eight periods the equal-weighted and asset-weighted hedge fund performance return is above that of their traditional equity only benchmarks. Certainly, more analysis needs to take place (with longer time series) in order to better understand more specific aspects of hedge fund performance, such as the relationship and role of between median and top quartile performers in addition to relative performance measures in the fund flow decision-making process.

Table IV. shows Net Dollar Flows by Strategy. Long/short equity (LSE) and event driven (ED) strategies gained US\$14.1 BLN and US\$1.9BLN respectively in net inflows during 2005. In contrast, equity market neutral (EMN) and multi-strategy (MS) experienced declines of US\$0.1 BLN and a gain of US\$0.3 BLN respectively over the same period. Given the impressive performance of the Nikkei 225 Index and MSCI Japan indices over the second half of 2005, one must wonder whether similarly large scale capacity still exists in the Japan long short space. By some industry estimates approximately 65%-70% of all Japan hedge funds over the US\$500 MM assets under management barrier are closed¹³. Back in 2002/03 when there was no as much

¹³ Asiahedge estimates

liquidity in the equity markets the point at which Japan funds “closed” was down to US\$300 MM¹⁴.

See Chart I: Net Dollar Flows vs. Hedge Fund and Nikkei 225 Performance (2001-2005). One can see clearly that there is a directional relationship between hedge fund returns, the Nikkei 225 and net flows.

Chart 2 shows the relationship between Foreign Equity Balances at TSE, Osaka and Nagoya (purchases minus sales) vs. Net Flows into Japan Hedge Funds. Different scales aside, this graphic would appear to support the earlier comment that hedge fund flows might be closely related to general market liquidity flows into the equity market, where that liquidity is defined as coming from the investor category known as “foreigners”. There are anecdotal differences in the investing behavior of domestic Japanese investors and foreign investors. The former consist of domestic institutional and domestic retail investors. Japanese domestic institutional investors have been historically “buy and hold” investors with tie-ups in cross-shareholdings limiting the available equity free float. In contrast Japanese retail investors have been traditionally more active in Japanese equity sector rotation. In contrast, foreign investors have been perceived to opportunistic investors and typically viewed as having more skill. Certainly, a vast number of foreign investors (including hedge funds) were active in the second half of 2003 buying a number of industries, such as under-valued banking real estate stocks on the perceptions that they would benefit an economic revival of Japan’s economy.

Numbers of Funds. Chart VIII. Distribution of Hedge Funds allocating to Japan 2001-2005, shows that the steady growth in fund numbers that have been observed in the data. By

¹⁴ Various Japan equity market sources

category, Japan funds totaled 209 by the end of 2005 versus 73 at the end of 2001. The number of Asia including Japan funds was 160 versus 55 at the end of 2001, while the numbers of funds in the Global funds including Japan remained fairly insignificant in the data at 376.

Table I. Panels C and D provide simple counts of the numbers of Japan hedge funds identified and allocated across geographical categories for live and dead (obsolete) funds. A “live fund” is one that is a going-concern reporting monthly net of fee performance and assets under management at the very least every six months. For both publicly available databases, Japan only managers constituted the largest single source of data for hedge funds used in this study. The Asia excluding Japan category (not analyzed in this research) contained the largest number of managers in either database. As has already been pointed out, the data is based upon a very small number of Global funds (including Japan).

A “dead” or “obsolete fund” is one that, for a variety of reasons no longer reports to a public database. In the case of dead funds, there are only a slightly higher proportion of dead funds originating from the Japan-only category of hedge funds. This might reflect the longer history of hedge fund formation and mortality for Japan-only hedge funds relative to Asia including Japan or Global funds allocating to Japan.

Distribution of Live and Dead Funds. Table I. Panel B displays the live and dead Japan hedge fund distribution across all strategies. It shows percentages according to total assets under management for live funds and dead funds. Clearly, long short equity strategy commands the vast majority of assets at just over 72% followed by equity market neutral (9%) and multi-strategy (6.7%) then global macro (5%). While convertible arbitrage has fallen back in terms of representation the multi-strategy category increased. Historically, multi-strategy managers

started out as convertible arbitrage managers so this is not to be considered an unusual observation. Further, with increased competition in the convertibles business, a change in Japan tax treatment and dwindling liquidity and pricing there was a gradual shift into other market neutral strategies including basket trading, pairs trading, statistical arbitrage and event driven opportunities. With the unraveling of industrial cross-shareholdings the role of multi-strategy hedge funds in the risk arbitrage, event space should not be surprising and is likely to continue just as it is that specific local funds emerge to fill that specialized investment space.

Distribution of Funds. According to Chart IV. showing the Distribution of Total Hedge Funds allocating to Japan by Size, and Chart V. showing Distribution of Total Hedge Funds allocating to Japan by Number, four hedge funds with assets over US\$1 BLN control 15% of industry capital. In terms of number of funds, 215 hedge funds or 64% of the total have assets under management of less than US\$100 MM. Again, it should be remembered that these results do not account for Global including Japan hedge funds which are believed to be sizeable allocators to the region and its markets. It also, points out that there are a great number of smaller funds which typically prove difficult investment opportunities for large institutional investors who are typically restricted by factors such as length of track record and assets under management among other things. More research needs to be done to identify which of these smaller funds are independent managers or off-shoot strategies of larger established firms. Also, it would be interesting to understand which funds gravitate to “established funds” from “emerging funds” and whether there are common success traits.

Distribution by Regional Category. Panel A reflects the distribution of single manager hedge funds by regional focus. The databases cover Japan and Asia inc. Japan funds but global funds given the meager 4.04% allocation.

Cross Sectional Fund Distribution. Table V. illustrates the cross sectional characteristics of single manager hedge funds in the combined database for live funds. For management fees there are no obvious surprises beyond the fact that median management fees for equity market neutral strategy is below the 1.50%-2.00% norm exhibited over other strategies. Perhaps, this may be a marketing strategy given that they are most likely sold to Japanese institutional investors searching for equity diversification strategies and performance over and above some equity benchmark. Mean performance fees by managers are almost uniformly similar at 20% with a smaller number including even higher fees over a hurdle and high water mark. Aggregate management fees accrued in Japan's hedge fund industry are estimated to have been substantial¹⁵ and so it is not surprising that there have been increasing numbers of service providers (prime brokers, administrators, custodians, attorneys and auditors keen to engage in the growing industry. Looking ahead, it might be the case for some exceptional fund performers (as in the US) that they will change their fees with less emphasis on the management fee and more on the performance fee. It will probably take a few more years for some of these top performers to establish themselves as well as their respective performance reputations assuming that market liquidity and opportunities continue to expand.

¹⁵ Assuming average fees of 2 and 20, income plus capital gains of US\$15.1 BLN, administrative fees of 0.4% and a hurdle rate of 5% leads us to estimate that total manager fees generated from Japan hedge funds exceeded US\$3.8 BLN at the end of 2005.

Fund Age. In terms of the monthly age of Japan hedge fund managers, event driven and multi-strategy managers are “youngest” in terms of mean monthly age at 24 months and 32 months respectively. This is likely to reflect the fact that it is only in recent times that scalable event and multi-strategies have become profitable or even scalable businesses in Japan. This may also coincide with the growth of equity market activity in Japan equity benchmarks since the summer of 2003. Managed futures managers clearly have been around a lot longer given the mean average existence of close to 60 months or five years. In comparison, Japan long/short equity (LSE) has a mean existence of 39 months. Further research may be needed to investigate age and fund attrition, with a particular emphasis on the factors that might divide those managers that become established and those that are and/or remain emerging or fail altogether.

Fund Returns. Mean net of fee returns for hedge funds trading Japan fall in a 5.15% to a 24.67% range. For event driven and managed futures managers (MF) mean returns hit the low 20s while that for long/short equity (LSE) was a respectable 13.38%. A look at the spread between the median and top performance is widest for managed futures at 25.17%, then global macro at 6.77% and long short equity at 6.08%. Clearly, there appears to be a considerable advantage derived from selecting top quartile performers even on an absolute return basis. This maybe one reason investors have been so anxious to allocate to Japan over the last 2-3 years. They all hope to be invested in top quartile performers and while it is typically true that the best fund managers are “closed” anecdotal evidence suggests that even those funds that are “closed” may in fact be filtering out their investor profile – filtering out so-called hot money investors (like certain fund of hedge funds) favoring instead larger allocations and more sticky institutional allocations from pension plans and endowments. Note, that returns in this research are

predominantly dollar denominated with no consideration of currency impacts. Further research needs to be conducted in this area to examine more closely quartile performance time series and the issue of net flows and potential decreasing returns.

Fund Volatility. For a comparison of standard deviation across strategies (monthly rates annualized for funds since inception to June 2005), results show that the lowest mean volatility is displayed by the equity market neutral strategy. This is what one would expect given the typical definition of this strategy. The highest exhibited volatility was evident among managed futures then global macro strategies. Mean standard deviation for the long/short equity strategy stood at 10.57% which compares to over 16% for the Nikkei 225 average since Dec 2001. Further research should probably be directed at the issue of the extent to which the nature of a particular strategy has on the dispersion of returns.

Manager Domicile. According to Chart VI. Distribution of Hedge Funds allocating to Japan by Manager Domicile, the vast majority of capital can be traced to portfolio managers that are situated in the UK (US\$16.4 BLN), Japan (US\$11.4 BLN) and then the US (US\$10.1 BLN). Typically, the portfolio manager acts as the sub-advisor to an offshore fund management entity. The reasons for might be variously traced to higher start-up costs in Japan, lower personal tax rates in various non-Japan centers (e.g. Singapore), the availability of skilled staff and a “lifestyle” consideration that might exist for certain managers in certain settings (e.g. Hawaii).

Fund Domicile. According to Chart VII. Distribution of Hedge Funds allocating to Japan by Fund Domicile close to 60% of total hedge fund capital is directed at fund Cayman Island fund structures followed by the British Virgin Island and then Bermuda jurisdictions.

V. Concluding Remarks

In this paper, we have tried to analyze the main characteristics at play in Japan's hedge fund industry including the net dollar flows using a composite database of hedge funds constructed by merging the AsiaHedge and EurekaHedge Asia databases.

We have four main findings. First, total estimated capital before leverage in Japan's hedge fund industry reached US\$54.8 BLN by the end of December 2005. Second, money-flows (net dollar flows less fund performance) into Japan's hedge fund industry grew US\$10 BLN in the final six months of 2005 and have grown at an impressive 30% rate every six months since 2003. The growth rate has probably less to do with the actual absolute returns posted by the top quartile funds since 2003 as much as a tsunami of liquidity provided by "foreigners" on Japan's main equity exchanges as measured by the net stock purchases. The bulk of money flows have been directed at hedged equity (long/short equity), directional equity (investor activist) and event driven strategies. Third, since Japan's stock market recovery in April 2003, both equal and asset-weighted hedge fund performance across a range of strategies have lagged traditional equity benchmarks (by an average of 5.39% for 4 out of 5 six-monthly periods). This suggests that there may be other reasons behind investor allocations to Japan hedge funds beyond the argument of

absolute returns¹⁶. And lastly, Japan's hedge fund industry continues to be dominated by the prototypical small long/short equity manager with less than US\$100 MM, who runs a Cayman Island-domiciled fund with the portfolio management team typically domiciled in the UK or the US.

This research confirms that Japan's hedge fund industry is one of the fastest growing in the world, while remaining still relatively small against the North American and European hedge fund industries¹⁷. Although Japan's hedge fund capital represents only 4% of the global hedge fund industry, we estimate that even if net money inflows slow to a 10-15% pace every six months (from the current 30% growth rate) then *ceteris paribus* Japan's hedge fund industry should breach the US\$100 BLN barrier by the middle of 2008.

We believe that further research could be directed at the following issues: the phenomenon of diminishing returns across hedge fund strategies; the role of hedge fund size as a determinant of fund performance; a description of investors in Japan's hedge fund industry and, regulators' attitude to Japan's hedge fund industry.

¹⁶ Additional arguments used to justify the investments in hedge funds include: potential positive returns in all market conditions, superior risk-adjusted returns, a low or negative correlation to other asset classes, and the ability to increase the level of diversification.

¹⁷ See Chart XV. Global Hedge Fund allocations to single managers by geography shows Japan represents 4% of the global hedge fund industry, Europe 25% and US/Rest of the World 68%. Japan represents approx. 55-60% of total Asian hedge fund capital.

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Appendix A: Classification of Hedge Fund Strategies

Table I: Breakdown of Funds by Data Sources

Panel A shows the breakdown of hedge funds across various geographical categories. Panel B shows the number of live single hedge fund manager funds contained in the AsiaHedge and EurekaHedge Asia databases. Panel B shows the number of single hedge fund manager dead funds (otherwise referred to as obsolete or graveyard funds) in the same databases. Panel C shows the breakdown of funds across strategies while

Panel A: Distribution of Single Manager Hedge Funds across Regional Focus

Fund Type	Live	Dead
Japan funds	57.24%	54.67%
Asia inc. Japan funds	38.72%	24.54%
Global funds	4.04%	20.79%

Source: selected AsiaHedge and EurekaHedge Asia hedge fund data

Panel B: Distribution of Single Manager Hedge Funds allocating to Japan across Strategies

Strategy	Live	Dead
Convertible Arbitrage	0.67%	7.92%
Equity Market Neutral	9.03%	15.84%
Event Driven	2.34%	2.97%
Fixed Income Arbitrage	1.00%	0.00%
Global Macro	5.02%	11.88%
Long Short Equity	72.58%	56.44%
Managed Futures	0.00%	3.96%
Multi-Strategy	6.69%	0.00%

Source: selected AsiaHedge and EurekaHedge Asia hedge fund data

Panel C: Single Manager Hedge Funds allocating to Japan (Live funds)

Source	Live	Japan	Asia inc. Japan	Global	Asia exc. Japan	Missing data
AsiaHedge	482	170	115	12	184	110
EurekaHedge	511	155	140	13	204	27

Source: selected AsiaHedge and EurekaHedge Asia hedge fund data

Panel D: Single Manager Hedge Funds allocating to Japan (Dead funds)

Source	Dead	Japan	Asia inc. Japan	Global	Asia exc. Japan
AsiaHedge	101	38	25	21	17
EurekaHedge	79	26	17	18	14

Source: selected AsiaHedge and EurekaHedge Asia hedge fund data

Table II. Assets Under Management: Trends in Hedge Funds allocating to Japan

This table shows the summary statistics for second half 2001

Strategy	million\$	EMN	ED	GM	LSE	MF	MS
Assets Under Management	Mean	245	153	2.6	110	0.77	21.1
(Total: US\$12.9 BLN)	Q1	10.0	5.1	1.1	7.7	0.21	3.0
	Median	135	5.4	2.1	35.0	0.26	13.2
	Q3	325	227.7	3.6	136	1.08	32.0

Source: selected AsiaHedge and EurekaHedge Asia hedge fund data; fund strategies based upon CS-Tremont hedge fund definitions with EMN equity market neutral, ED event driven, GM global macro, LSE long/short equity, MF managed futures and MS multi-strategy.

This table shows the summary statistics for first half 2002

Strategy	million\$	EMN	ED	GM	LSE	MF	MS
Assets Under Management	Mean	215	156	3.5	106.8	0.77	35.9
(Total: US\$13.6 BLN)	Q1	7.9	8.4	1.2	8.0	0.21	4.2
	Median	73.5	10.5	1.5	35.0	0.26	14.1
	Q3	287	230	4.8	130.0	1.08	36.3

Source: selected AsiaHedge and EurekaHedge Asia hedge fund data; fund strategies based upon CS-Tremont hedge fund definitions with EMN equity market neutral, ED event driven, GM global macro, LSE long/short equity, MF managed futures and MS multi-strategy.

This table shows the summary statistics for second half 2002

Strategy	million\$	EMN	ED	GM	LSE	MF	MS
Assets Under Management (Total: US\$13.8 BLN)	Mean	216	124	3.9	104	0.77	42.1
	Q1	11.0	9.8	1.2	8.6	0.21	5.9
	Median	74.6	20.4	1.5	35.0	0.26	14.1
	Q3	288	135	3.9	130	1.08	35.3

Source: selected AsiaHedge and Eurekahedge Asia hedge fund data; fund strategies based upon CS-Tremont hedge fund definitions with EMN equity market neutral, ED event driven, GM global macro, LSE long/short equity, MF managed futures and MS multi-strategy.

This table shows the summary statistics for first half 2003

Strategy	million\$	EMN	ED	GM	LSE	MF	MS
Assets Under Management (Total: US\$14.6 BLN)	Mean	194	134	4	101	0.47	46
	Q1	12.0	12.6	1.2	8.3	0.15	6.0
	Median	21.9	36.6	1.5	28.1	0.43	15.6
	Q3	250.0	157.5	3.0	126.3	0.75	39.3

Source: selected AsiaHedge and Eurekahedge Asia hedge fund data; fund strategies based upon CS-Tremont hedge fund definitions with EMN equity market neutral, ED event driven, GM global macro, LSE long/short equity, MF managed futures and MS multi-strategy.

This table shows the summary statistics for second half 2003

Strategy	million\$	EMN	ED	GM	LSE	MF	MS
Assets Under Management (Total: US\$21.2 BLN)	Mean	133	120	14	132	0.52	54.5
	Q1	12.0	12.3	1.5	13.9	0.19	13.5
	Median	22.2	34.4	8.4	51.5	0.5	21.0
	Q3	80.0	52.7	16.0	176.0	0.83	60.7

Source: selected AsiaHedge and Eurekahedge Asia hedge fund data; fund strategies based upon CS-Tremont hedge fund definitions with EMN equity market neutral, ED event driven, GM global macro, LSE long/short equity, MF managed futures and MS multi-strategy.

This table shows the summary statistics for first half 2004

Strategy	million\$	EMN	ED	GM	LSE	MF	MS
Assets Under Management (Total: US\$32.5 BLN)	Mean	182	90	21.3	149.7	0.49	64.3
	Q1	16.5	14.2	2.4	12.0	0.16	13.9
	Median	51.4	39.0	12.6	69.0	0.30	29.5
	Q3	133.3	69.0	22.9	223.0	0.90	74.9

Source: selected AsiaHedge and EurekaHedge Asia hedge fund data; fund strategies based upon CS-Tremont hedge fund definitions with EMN equity market neutral, ED event driven, GM global macro, LSE long/short equity, MF managed futures and MS multi-strategy.

This table shows the summary statistics for second half 2004

Strategy	million\$	EMN	ED	GM	LSE	MF	MS
Assets Under Management (Total: US\$39.7 BLN)	Mean	168	93	22	149	0.47	90
	Q1	14.5	18.8	1.8	10.7	0.17	11.0
	Median	34.5	41.6	4.0	63.4	0.33	25.4
	Q3	146.5	86.9	29.0	222.5	0.79	86.8

Source: selected AsiaHedge and EurekaHedge Asia hedge fund data; fund strategies based upon CS-Tremont hedge fund definitions with EMN equity market neutral, ED event driven, GM global macro, LSE long/short equity, MF managed futures and MS multi-strategy.

This table shows the summary statistics for first half 2005

Strategy	million\$	EMN	ED	GM	LSE	MF	MS
Assets Under Management (Total: US\$46.2 BLN)	Mean	145	118	35	156	0.93	95
	Q1	15.0	23.5	1.6	11.1	0.25	15.3
	Median	33.5	71.5	5.9	55.0	0.80	28.9
	Q3	183.8	137.4	34.6	210.8	1.10	90.0

Source: selected AsiaHedge and EurekaHedge Asia hedge fund data; fund strategies based upon CS-Tremont hedge fund definitions with EMN equity market neutral, ED event driven, GM global macro, LSE long/short equity, MF managed futures and MS multi-strategy.

This table shows the summary statistics for second half 2005

Strategy	million\$	EMN	ED	GM	LSE	MF	MS
Assets Under Management (Total: US\$54.8 BLN)	Mean	102	406	7.0	180	2.55	53
	Q1	14.0	93.2	0.6	15	0.85	4.1
	Median	32.0	200	2.0	57	1.36	25.2
	Q3	56.5	348.8	13.0	250	3.88	67.5

Source: selected AsiaHedge and EurekaHedge Asia hedge fund data; fund strategies based upon CS-Tremont hedge fund definitions with EMN equity market neutral, ED event driven, GM global macro, LSE long/short equity, MF managed futures and MS multi-strategy.

Table III. Net Dollar Flows and the relationship with Japan hedge fund performance

Time Period (6 mths)	Japan assets under management (BLN US\$)	Net Flows (BLN US\$)	Equal- Weighted Fund Performance	Asset- Weighted Fund Performance (A)	MSCI Japan Index (B)	(A) – (B)	Nikkei 225 Index
Dec 01	12.97	-	4.74%	5.88%	-23.05%	27.79%	-18.71%
Jun 02	13.69	0.9	5.28%	8.48%	8.16%	-2.88%	0.75%
Dec 02	13.83	2.2	-0.30%	1.67%	-17.05%	16.75%	-19.23%
Jun 03	14.68	4.6	7.57%	8.23%	2.92%	4.65%	5.88%
Dec 03	21.22	8.2	16.07%	14.11%	32.05%	-15.88%	17.54%
Jun 04	32.51	10.2	3.50%	2.98%	10.73%	-7.27%	11.07%
Dec 04	39.67	2.2	4.46%	2.77%	4.63%	-0.17%	-3.12%
Jun 05	46.24	6.8	3.16%	3.92%	-5.84%	9.00%	0.84%
Dec 05	54.8	10.0	15.75%	20.62%	33.31%	-12.69%	39.08%

Source: selected AsiaHedge and EurekaHedge Asia hedge fund data, MSCI (Morgan Stanley Capital International) is the owner of the trademark, service mark and copyright related to the MSCI Japan Index; Nihon Keizai Shimbun, Inc. is the owner of the trademark, service marks, and copy rights related to the Nikkei 225 Index.

Table IV. Net Dollar Flows by Strategy

Strategy:	Net Flow	Equal-Weighted
MF	Mil US\$	Return
Dec 01	N/A	17.84%
Jun 02	0.069	-10.84%
Dec 02	167.01	1.53%
Jun 03	-0.383	-5.45%
Dec 03	0.133	19.48%
Jun 04	0.406	33.60%
Dec 04	0.276	6.04%
Jun 05	3.7	6.97%
Dec 05	8.8	7.72%

Source: selected AsiaHedge and Eurekahedge Asia hedge fund data; fund strategies based upon CS-Tremont hedge fund definitions including MF for managed futures.

Strategy:	Net Flow	Equal-Weighted
EMN	Mil US\$	Return
Dec 01	N/A	2.45%
Jun 02	53.732	4.01%
Dec 02	150.33	4.35%
Jun 03	709.00	3.72%
Dec 03	-357.99	12.90%
Jun 04	1403.48	3.37%
Dec 04	969.17	1.92%
Jun 05	300.4	1.85%
Dec 05	-381.	0.83%

Source: selected AsiaHedge and Eurekahedge Asia hedge fund data; fund strategies based upon CSF-Tremont hedge fund definitions including EMN for equity market neutral strategy

Strategy:	Net Flow	Equal-Weighted
ED	Mil US\$	Return
Dec 01	N/A	7.16%
Jun 02	8.57	24.01%
Dec 02	2.53	11.12%
Jun 03	158.74	7.14%
Dec 03	107.41	19.93%
Jun 04	421.82	-2.76%
Dec 04	446.17	5.56%
Jun 05	708.60	3.90%
Dec 05	1,221.3	20.68%

Source: selected AsiaHedge and Eurekahedge Asia hedge fund data; fund strategies based upon CS-Tremont hedge fund definitions including ED for event driven strategy

Strategy:	Net Flow	Equal-Weighted
GM	Mil US\$	Return
Dec 01	N/A	14.97%
Jun 02	9.56	4.52%
Dec 02	-526.14	2.52%
Jun 03	19.17	6.90%
Dec 03	131.78	11.61%
Jun 04	43.87	9.26%
Dec 04	-46.09	3.86%
Jun 05	346.60	2.04%
Dec 05	-2.32	5.62%

Source: selected AsiaHedge and Eurekahedge Asia hedge fund data; fund strategies based upon CS-Tremont hedge fund definitions including GM for global macro strategy

Strategy:	Net Flow	Equal-Weighted
LSE	Mil US\$	Return
Dec 01	N/A	5.11%
Jun 02	743.99	5.31%
Dec 02	2392.97	-0.49%
Jun 03	3246.04	8.37%
Dec 03	7531.58	16.75%
Jun 04	7871.50	3.37%
Dec 04	667.19	5.00%
Jun 05	4974.50	3.69%
Dec 05	9239.62	17.28%

Source: selected AsiaHedge and Eurekahedge Asia hedge fund data; fund strategies based upon CS-Tremont hedge fund definitions including LSE for long/short equity strategy

Strategy:	Net Flow	Equal-Weighted
MS	Mil US\$	Return
Dec 01	N/A	5.11%
Jun 02	73.32	5.31%
Dec 02	-5.36	-0.49%
Jun 03	469.36	8.37%
Dec 03	837.33	16.75%
Jun 04	475.46	3.37%
Dec 04	155.00	5.00%
Jun 05	520.70	3.69%
Dec 05	-224.2	20.22%

Source: selected AsiaHedge and Eurekahedge Asia hedge fund data; fund strategies based upon CS-Tremont hedge fund definitions including MS for multi-strategy

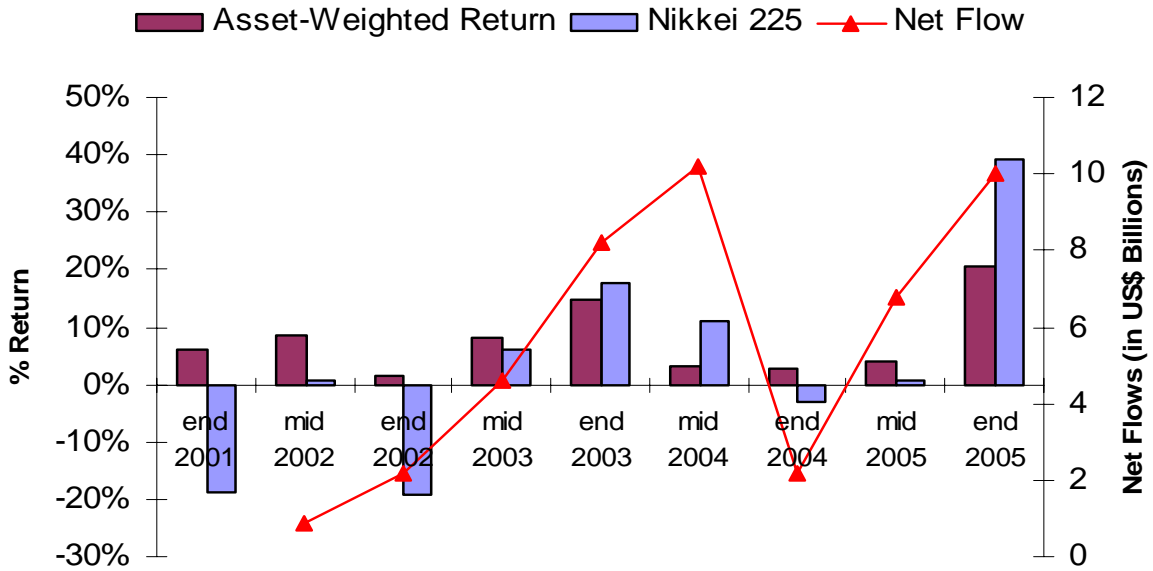
Table V: Cross Sectional Characteristics of Single Manager Hedge Funds allocating to Japan
(live funds as of end June 2005).

Fund Characteristics ¹⁸		EMN	ED	GM	LSE	MF	MS
Management Fee (%)	Median	1.37%	2.00%	1.50%	1.50%	2.00%	2.00%
	Mean	1.50%	1.72%	1.50%	1.47%	1.67%	1.67%
Performance Fee (%)	Median	20%	20%	19.5%	19.3%	20%	20.9%
	Mean	20%	20%	20%	20%	20%	20%
Age (months)	Mean	38	24	37	39	56	32
	Q1	10	16	8	14	44	17
	Median	27	20	21	31	60	27
	Q3	51	26	59	55	71	46
Returns	Mean	5.15%	20.73%	8.04%	13.38%	24.67%	7.30%
	Q3	1.39%	13.45%	2.85%	5.79%	6.27%	3.97%
	Median	5.97%	23.03%	7.19%	10.50%	15.96%	5.98%
	Q1	8.68%	26.87%	13.96%	16.58%	41.13%	10.59%
Standard Deviation (%)	Mean	4.36%	11.65%	12.79%	10.57%	20.19%	7.48%
	Q3	3.02%	7.40%	6.34%	5.80%	9.01%	3.56%
	Median	3.99%	10.47%	9.27%	8.24%	15.81%	5.89%
	Q1	5.28%	13.19%	14.05%	12.68%	28.20%	6.37%

Source: selected AsiaHedge and Eurekahedge Asia hedge fund data, as of June 2005

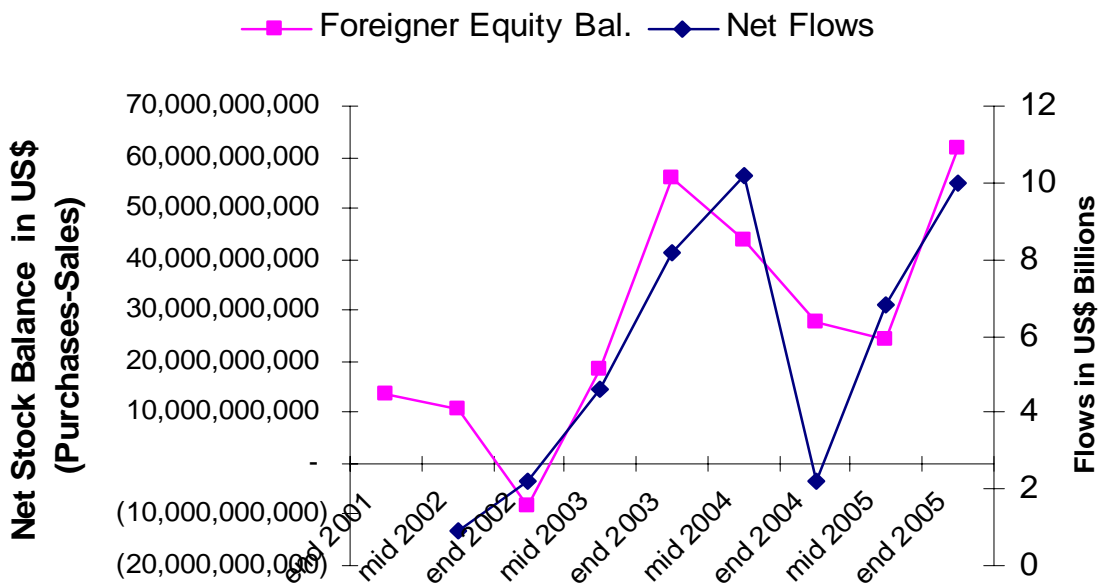
¹⁸ Strategy Key: EMN is equity market neutral, ED is event driven, GM is global macro, LSE is long/short equity, MF is managed futures and MS is multi-strategy all defined in the content of the CSFB-Tremont strategies.

Chart I. Japan Hedge Fund Net Dollar Flows vs. Hedge Fund Asset-Weighted Return and Nikkei 225 Performance (2001-2005)



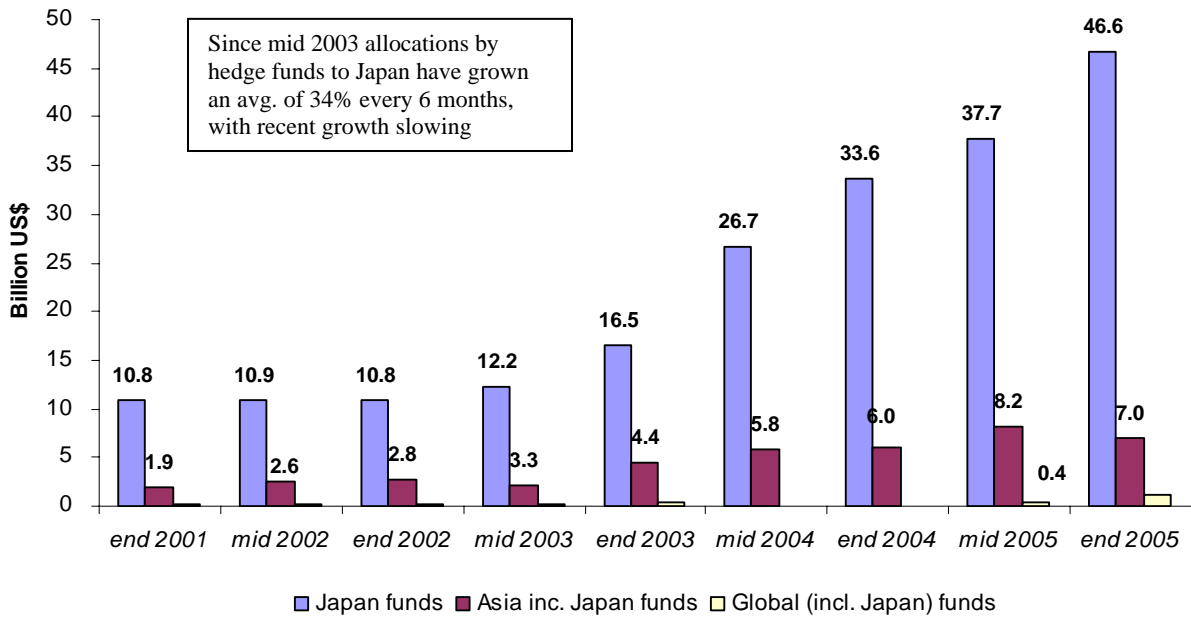
Source: selected AsiaHedge and EurekaHedge Asia hedge fund data, Nihon Keizai Shimbun, Inc. is the owner of the trademark, service marks, and copyright related to the Nikkei 225 Index.

Chart II. Foreign Equity Balances (TSE, Osaka, Nagoya) vs. Net Flows into Japan Hedge Funds



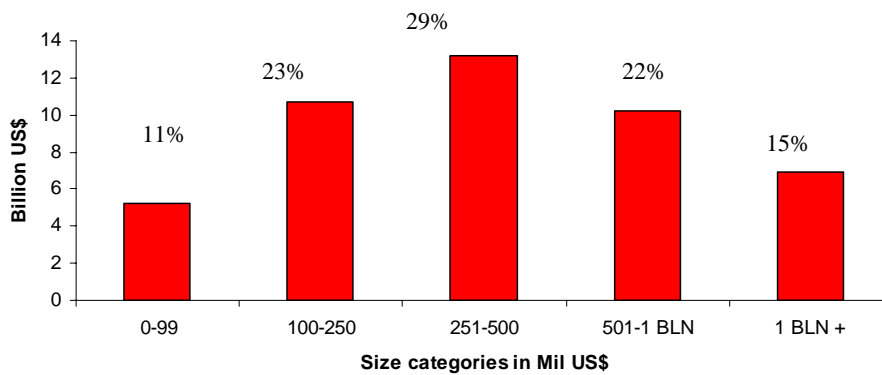
Source: selected AsiaHedge and EurekaHedge Asia hedge fund data; Investor's Guide no.337, January 2006, Daiwa Institute of Research

Chart III. Trend Growth in Japan's Hedge Fund Industry by Assets Under Management



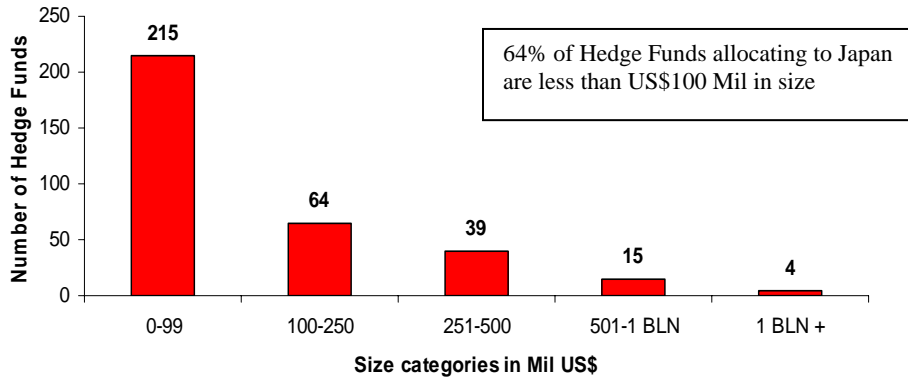
Source: selected AsiaHedge and Eurekahedge Asia hedge fund data

Chart IV. Distribution of Total Hedge Funds allocating to Japan by Size



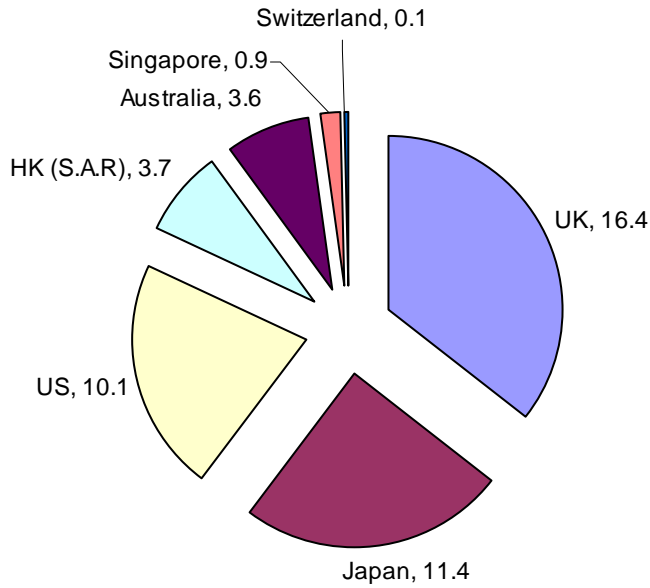
Source: selected AsiaHedge and Eurekahedge Asia hedge fund data as of June 2005

Chart V. Distribution of Total Hedge Funds allocating to Japan by Number



Source: selected AsiaHedge and EurekaHedge Asia hedge fund data as of June 2005

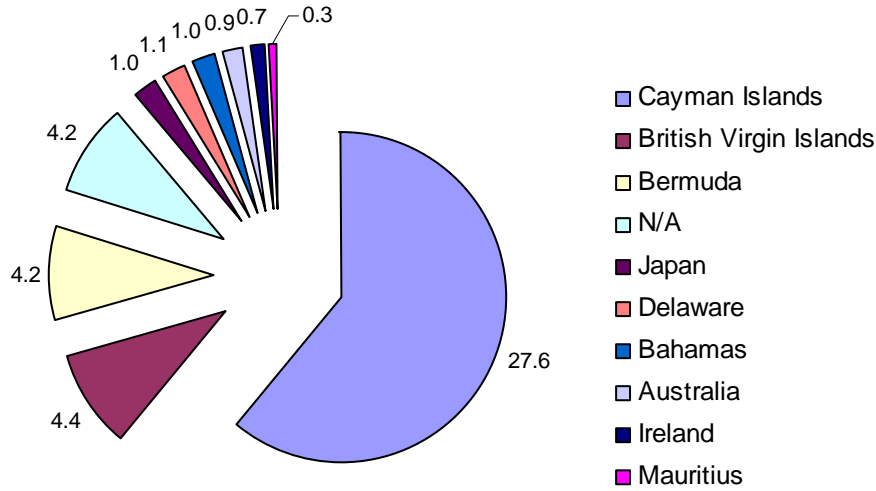
Chart VI. Distribution of Hedge Funds allocating to Japan by Manager Domicile (Billion US\$)



Source: selected AsiaHedge and EurekaHedge Asia hedge fund data as of June 2005

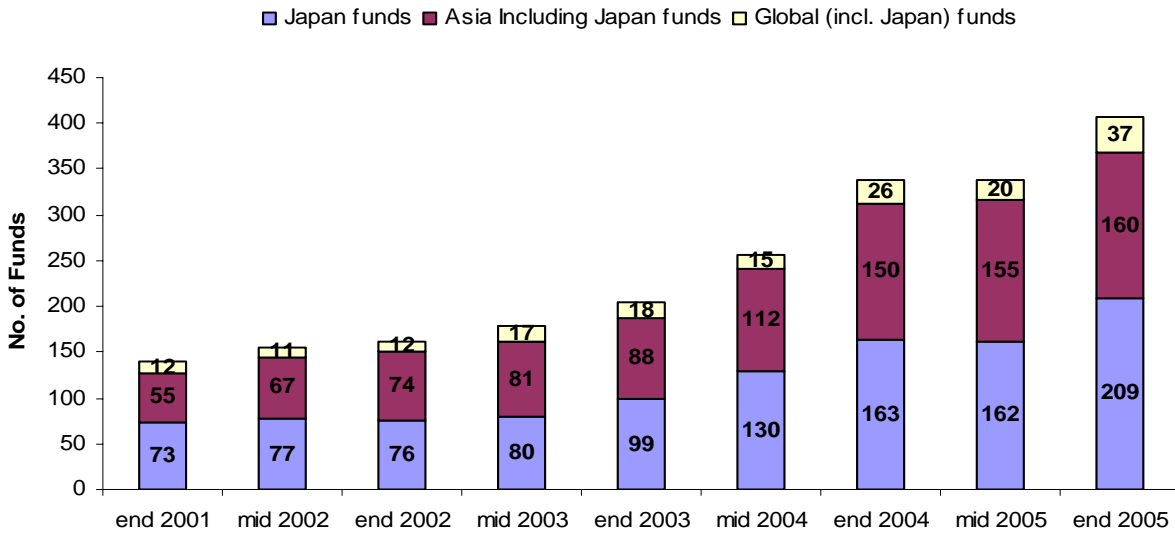
Chart VII. Distribution of Hedge Funds allocating to Japan by Fund Domicile

(Billion US\$)



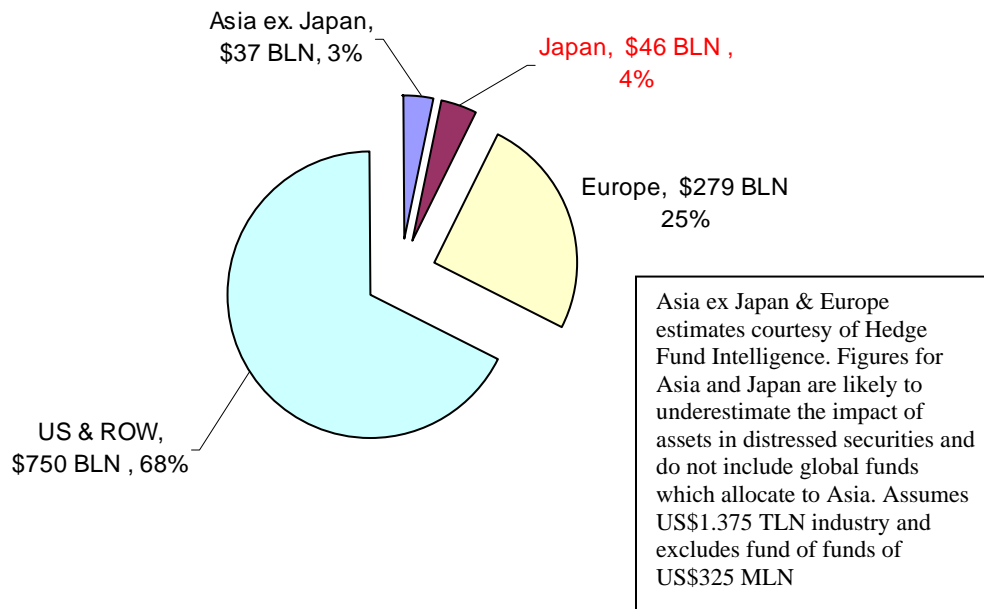
Source: selected AsiaHedge and Eurekahedge Asia hedge fund data as of June 2005

Chart VIII. Distribution of Numbers of Hedge Funds allocating to Japan, 2001 – 2005



Source: selected AsiaHedge and Eurekahedge Asia hedge fund data

Chart XV. Global Hedge Fund allocations to Single Managers by Geography



Source: selected AsiaHedge and EurekaHedge Asia hedge fund data; Tremont Capital Management; author estimates

Appendix A: Classification of Hedge Fund Strategies

This table provides the mapping of strategies provided by EurekaHedge and Hedge Fund Intelligence. They map to broad geography categories and broad strategy categories that were utilized to create a consistent, single merged database used in this research paper. The broad strategy categories derive from the CS-Tremont Index LLC strategy definitions which are briefly explained below.

EurekaHedge	AsiaHedge	Broad Geography	Broad Strategy
Asia Australia	AH ALSA\$	Asia ex. Japan	Long/Short Equity
Asia Japan	AH JLSY, AH JLS\$	Japan	Long/Short Equity
Asia Other		Asia ex. Japan	Long/Short Equity
Asia ex-Japan	AH AEJ\$	Asia ex. Japan	Long/Short Equity
Asia inc-Japan	AH AIJ\$	Asia inc. Japan	Long/Short Equity
Europe		Global	Long/Short Equity
Global		Global	Long/Short Equity
Emerging managers	AH EM (emerging markets)	Global	Emerging Markets
Convertible & Equity Arb		Global, Japan, Asia inc. Japan	Multi-strategy
Distressed	AH DISS	Japan, Asia inc. Japan	Event Driven
Event Driven	AH ED	Asia inc. Japan	Event Driven
Equities	AH SPEC (specialist sector)	Japan, Asia inc. Japan	Long/Short Equity
FI high yield	AH AFI	Japan, Asia inc. Japan	Fixed Income Arb

Macro currency debt	AH MAC	Global	Global Macro
EurekaHedge	AsiaHedge	Broad Geography	Broad Strategy
CTA	AH CTA	Global	Managed Futures
Market Neutral	AH AMN\$, AH JMNY	Japan, Asia inc. Japan	Equity Market Neutral
Mixed Arbitrage	AH ARB\$, AH ARBY	Japan, Asia inc. Japan	Multi-Strategy
Multi-strategy	AH Japan synthetic warrants	Japan, Asia inc. Japan	Multi-Strategy
Stat Quant Arb		Japan, Asia inc. Japan	Equity Market Neutral, Multi- Strategy
	AH COMM	Global	Global Macro

Convertible Arbitrage is usually defined as investing in the convertible securities of a company.

A typical investment is to be long the convertible bond and short the common stock of the company. Positions are designed to generate profits from the fixed-income security as well as the short sale of the stock, while protecting principal from market moves.

Dedicated Short Bias is as yet not a visible, scalable hedge fund strategy in Asia. The strategy is to maintain a net short as opposed to pure short exposure. These managers take short positions in mostly equities and derivatives. The short bias manager's portfolio must be constantly greater than zero to be classified in this category.

Emerging Markets involves equity or fixed income investing in emerging markets around the world. As many emerging markets do not allow short-selling nor offer viable futures or other

derivative products with which to hedge, emerging market investing often employs a long-only strategy.

Equity Market Neutral is designed to exploit equity market inefficiencies and usually involves being simultaneously long and short matched equity portfolios of the same size within a country. Market neutral portfolios are designed to be either beta or currency neutral or both. Well-designed portfolios typically control for industry, sector, market capitalizations and other exposures. Leverage is often applied to enhance returns.

Event Driven is often described as “special situations” investing designed to capture price movement generated by a significant pending corporate event such as a merger, corporate restructuring, liquidations, bankruptcy or reorganizations. A number of common sub-categories include: a) Risk/Merger Arbitrage in which specialists invest simultaneously long and short in companies involved in a merger or acquisition. Risk Arbitrageurs typically are long the stock of the company being acquired and short the stock of the acquirer. The principal risk is deal risk, should the deal fail to close. Risk arbitrageurs also invest in equity restructurings such as spin-offs or “stub trades”. b) Distressed/High Yield Securities in which specialists invest in the debt, equity or trade claims of companies in financial distress or already in default. These securities typically trade at a substantial discount to par value due to difficulties in analyzing a proper value for such securities. This is generally a long-only strategy. c) Regulation D/Reg. D involves investments in micro and small capitalization public companies that are raising money in private capital markets. Investments usually take to form of a convertible security with an exercise price that floats or is subject to a look-back provision that insulates the investor from a decline in price of the underlying stock.

Fixed Income Arbitrage takes advantage from price anomalies between related interest rate securities. It includes interest rate swap arbitrage, US and non-US government bond arbitrage, forward yield arbitrage and mortgage-backed securities arbitrage. The mortgage-backed market is primarily US based, over the counter and particularly complex.

Global Macro managers carry long and short positions in any of the world's major capital or derivative markets. These positions reflect their views on overall market direction as influenced by major economic trends and/or events. The portfolios of these funds can include stocks, bonds, currencies and commodities in the form of cash or derivatives instruments. Most funds invest globally in both developed and emerging markets.

Long/Short Equity involves equity-oriented investing on both the long and short sides of the market. The objective is not to be market neutral. Managers have the ability to shift from value to growth, from small to medium to large capitalization stocks and from net long position to a net short position. Managers may use futures and options to hedge. The focus may be country specific or sector specific such as in healthcare or some combination of both. Long/short equity managers tend to build and hold portfolios that are substantially more concentrated than those of traditional stock funds.

Managed Futures invests in listed financial, commodity and currency futures markets around the world. The managers are usually referred to as CTA's with trading disciplines usually divided into systematic (using price and market specific information for trading decisions) or discretionary (using a judgmental approach).

Multi-Strategy funds are characterized by their ability to dynamically allocate capital among strategies falling within several traditional hedge fund disciplines. The use of many strategies,

and the ability to reallocate capital between them in response to market opportunities, means that such funds are not easily assigned to any traditional category.

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