ASIC

Australian Securities & Investments Commission

REPORT 439

Snapshot of the Australian hedge funds sector

July 2015

About this report

The purpose of this report is to provide an overview of the Australian hedge funds sector and to present the results of ASIC's 2014 hedge funds survey, which covers the 12 months to 30 September 2014.

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Contents

Executive summary

1 This report on the Australian hedge funds sector has two sections:

(a) Section A gives a general overview of the hedge funds sector in Australia based on aggregated data from commercial providers; and

(b) Section B discusses the background to ASIC's hedge funds surveys in 2010, 2012 and 2014, and sets out the findings of ASIC's 2014 hedge funds survey.

2 Table 1 summarises the two data samples used in this report, both reporting as at 30 September 2014.

Note: References to currency in this report are to Australian dollars unless stated otherwise.

Table 1: Summary of data samples (at 30 September 2014)

Key indicators	Aggregated data from commercial providers	ASIC's 2014 hedge funds survey data
Number of funds	473 operating funds	27
Total assets under management	$95.9 billion*	$37.1 billion
Fund size	More than half of sample funds hold less than $50 million in assets under management.	Each fund in the sample holds more than $571 million† in assets under management.

* This value is based on 381 of the 473 operating funds (comprising 325 single-manager hedge funds and 56 funds of hedge funds) with assets under management as at 30 September 2014 populated in the data.

† Survey data was collected in US dollars. ASIC used the same qualifying threshold as ASIC's 2012 hedge funds survey and as the International Organization of Securities Commissions (IOSCO) 2014 global hedge fund survey template—that is, managers with US$500 million in hedge fund assets under management. For this report, US$500 million was converted to Australian dollars at the exchange rate of $0.8752 sourced from the Reserve Bank of Australia (RBA) as at 30 September 2014.

Australian hedge funds sector (commercial data sample)

3 Single-manager hedge funds and funds of hedge funds comprised a small share relative to the $2,407 billion[1] managed by the Australian funds management industry as at 30 September 2014. Single-manager hedge funds ($83.7 billion) and funds of hedge funds ($12.2 billion) managed 3.5% and 0.5% of all Australian managed fund assets respectively.[2]

[1] Data as at 30 September 2014: see Australian Bureau of Statistics (ABS), *Managed funds, Australia, September 2014*, cat. no. 5655.0, 27 November 2014, ABS, Canberra.
[2] See Section A of this report for further details on the sample size and methodology.

4 The Australian hedge funds sector continues to be characterised by many small-sized funds, with managers reporting that more than half of the identified hedge funds have assets under management of less than $50 million.

5 The average annual net investment return since 2004 in the commercial data sample has been negative twice—in 2008 and 2011. In the 12 months to 30 September 2014, the average annual net return for single-manager hedge funds and funds of hedge funds was 4.2%. This was down from the previous year when the sector reported an average return of 14.4%.

ASIC's 2014 hedge funds survey (survey data sample)

6 ASIC's 2014 hedge funds survey sampled 18 managers based in Australia with more than $571 million[3] in hedge fund assets under management. The survey data sample included 27 single-manager hedge funds (surveyed hedge funds) with $37.1 billion in hedge fund assets under management (or an estimated 44% of the single-manager hedge fund assets in the Australian hedge funds sector).[4]

7 In June 2009, IOSCO published its *Hedge funds oversight: Final report*, which set out six broad principles for the regulation of hedge funds. These included Principle 4, which states that hedge fund managers (and prime brokers) should provide relevant information to regulators for assessment of potential sector systemic risk. Principle 6 calls for regulators to share information to allow cross-border systemic risk to be assessed and mitigated.

8 To date, ASIC has conducted the hedge funds survey on three occasions—2010, 2012 and 2014.

9 Analysis of the data submitted by the surveyed hedge funds in 2014 shows that:

(a) 17% of all investors were retail direct and 49% were retail indirect, through an investor directed portfolio service (IDPS);

(b) the largest net exposure was to listed equities (approximately $26.3 billion), with cash coming in second at $5.7 billion. These results are consistent with the finding that the most common strategy used by the surveyed hedge funds is 'equity long/short';

[3] ASIC used the same qualifying threshold as ASIC's 2012 hedge funds survey and as the IOSCO 2014 global hedge fund survey template—that is, managers with US$500 million in hedge fund assets under management. The exchange rate of $0.8752 as at 30 September 2014 sourced from the RBA was used to convert into Australian dollars.

[4] See Section B of this report for further details on the sample size and methodology.

(c) annual net investment returns were strong in 2014. Returns averaged 15.6% (higher than the 4.2% for the Australian hedge funds sector noted in paragraph 5), compared with 7.8% in 2012 and 2.1% in 2010;

(d) asset turnover increased in 2014 ($1,205 billion) compared to 2012 ($1,025 billion). The vast majority of funds' reported turnover was in interest rate derivatives and fixed income derivatives. Interest rate derivatives were the most highly traded individual asset class at $510.5 billion;

(e) the median gross leverage ratio reported by the surveyed hedge funds increased from 1.7 times net asset value (NAV) in 2012 to two times NAV in 2014. In general, however, the level of leverage used by these surveyed hedge funds was comparatively low compared to hedge funds in other jurisdictions;

(f) synthetic leverage (such as leverage embedded in derivatives) represented 97.7% ($59.6 billion) of total gross leverage, an increase from 2012 (92.8%). Financial leverage was primarily attained by borrowing from a prime broker; and

(g) on average, surveyed hedge funds could liquidate 89.5% of their portfolio (portfolio liquidity) in less than 30 days and could face redemptions on 81.8% of fund liabilities (investor liquidity) in less than 30 days. These percentage figures are lower than in 2012.

A Australian hedge funds sector (commercial data sample)

Key points

Single-manager hedge funds and funds of hedge funds reported in the commercial data as at 30 September 2014 account for a small share of the $2,407 billion managed by the Australian funds management industry. At this date, single-manager hedge funds ($83.7 billion) and funds of hedge funds ($12.2 billion) managed 3.5% and 0.5% of all Australian managed fund assets respectively.

The Australian hedge funds sector continues to consist of primarily small-sized funds, with more than half of the identified hedge funds reporting assets under management of less than $50 million.

The average annual net investment return since 2004 has been negative twice—in 2008 and 2011. Over the year to 30 September 2014, the average annual net return for single-manager hedge funds and funds of hedge funds was 4.2%. This was lower than the previous year when funds on average reported a return of 14.4%.

Aggregated data from commercial data providers

10 This section provides an overview of the Australian hedge funds sector, based on information aggregated from various commercial data providers and research houses. While the data across the commercial data providers does not provide a complete picture of the sector, it does help to illustrate some key trends in the Australian hedge funds market.[5]

11 All single-manager hedge funds and funds of hedge funds that are Australian domiciled, marketed in Australia (i.e. these may include overseas domiciled funds) or have an Australian-based management provided in the dataset are included in the aggregated data from commercial providers.

Summary of trends

12 Table 2 compares the commercial data as at 30 September 2012 reported in our Report 370 *The Australian hedge funds sector and systemic risk* (REP 370) dated 30 September 2013 and the 30 September 2014 commercial data sample used in this report.

[5] See Appendix 1 of this report for details about some of the limitations of this data sample.

Table 2: Comparison of 2012 and 2014 aggregated data samples from commercial data providers

Data sample coverage	Reported as at 30 September 2012	Reported as at 30 September 2014
Number of operating funds in sample	603*	473
Total assets under management reported	$65.9 billion	$95.9 billion†
Fund size	More than half of sample funds hold less than $50 million in assets under management.	
Average returns in previous 12 months for single-manager funds	3.7%	4.2%

* Due to differences in the underlying data sets, there are differences in numbers reported in this report when compared to REP 370. For example, Figure 1 shows 447 operating funds in 2012, rather than 603. The number of operating funds in 2012 reported in the 30 September 2014 data set is different from the equivalent number in the 30 September 2012 data set. See Appendix 1 of this report for details.

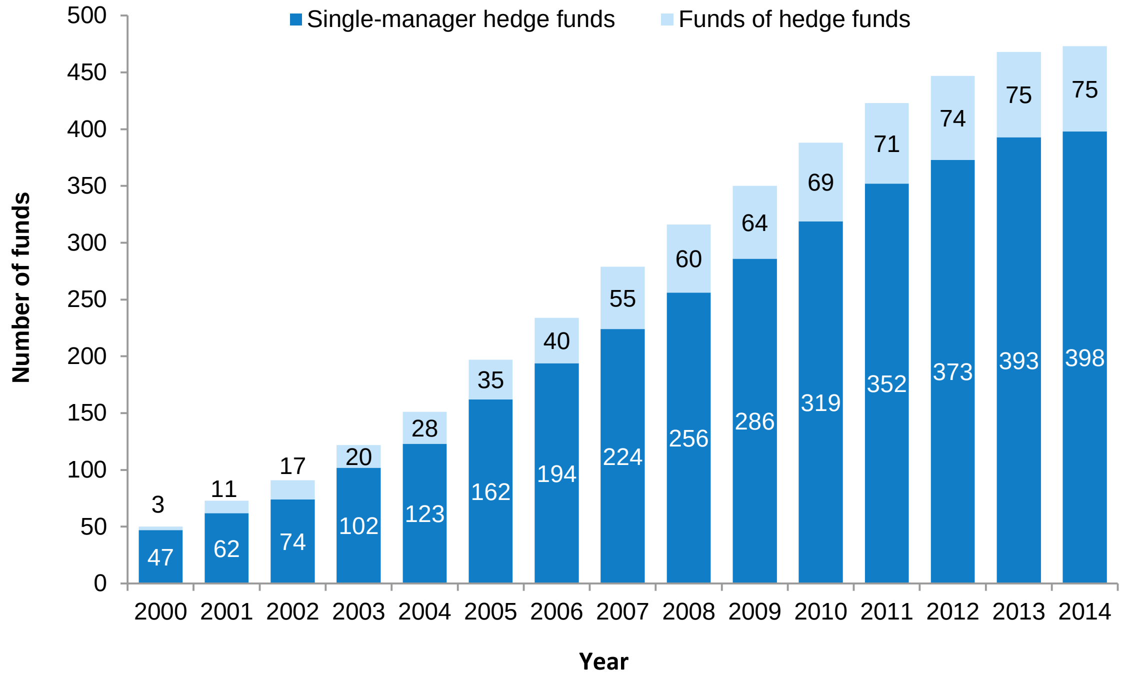
† This value is based on 381 of the 473 operating funds (comprising 325 single-manager hedge funds and 56 funds of hedge funds) with assets under management as at 30 September 2014 populated in the data.

Number of funds

13 There were 473 operating single-manager hedge funds and funds of hedge funds in the data. For the purposes of this section, funds were considered to be ‘operating’ when certain specific flags were reported in the data.

14 The categorisation of funds as either single-manager hedge funds or funds of hedge funds is illustrated in Figure 1. The total number and proportion of single-manager hedge funds to funds of hedge funds has fallen slightly over the last few years.

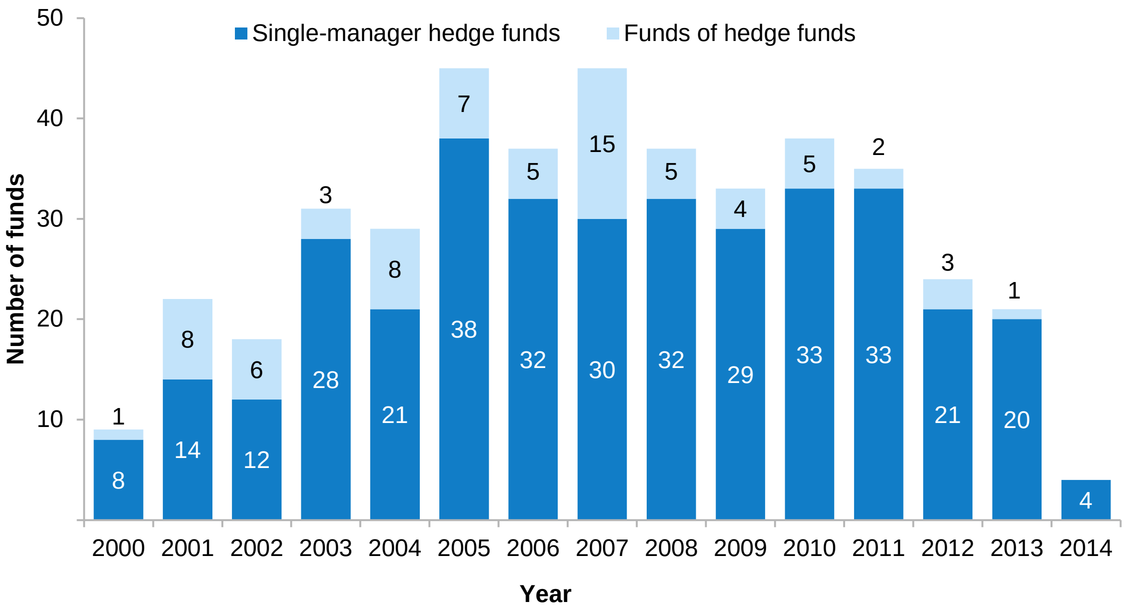
Figure 1: Number of operating single-manager hedge funds and funds of hedge funds (to 30 September 2014)



Note: Data is based on 473 operating single-manager hedge funds and funds of hedge funds with an ‘inception date’ (or first reporting date where inception date is not reported) and a ‘last reporting date’ populated in the data.

15 Figure 2 shows the number of new hedge funds in the data with four new funds reported in the 12 months to 30 September 2014.

Figure 2: Number of new single-manager hedge funds and funds of hedge funds being reported (to 30 September 2014)



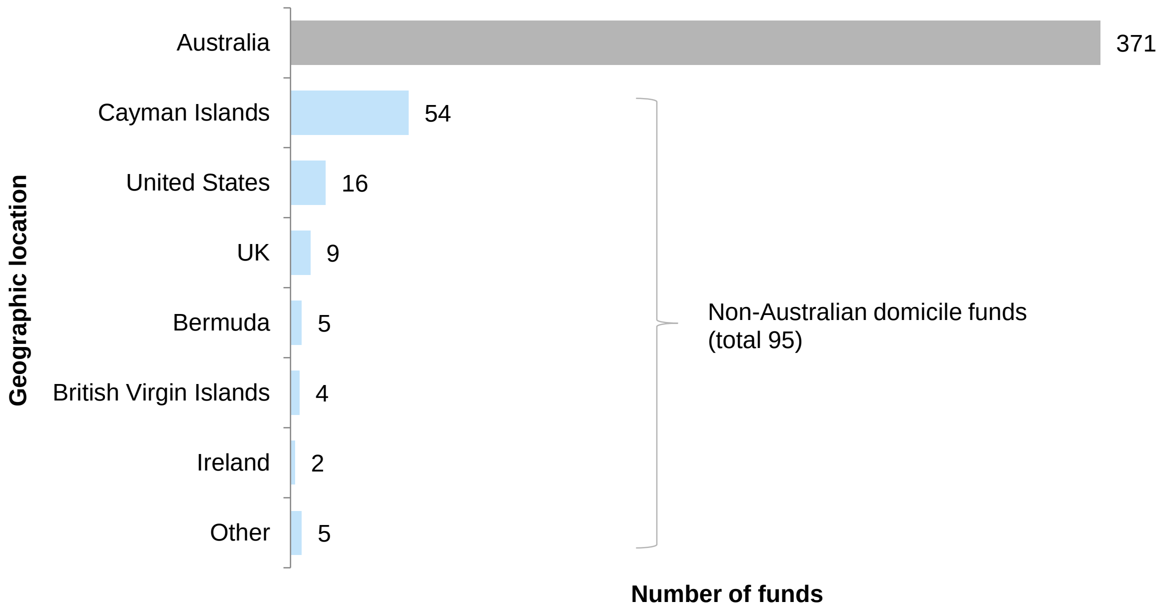
Note: Data is based on 466 of the 473 operating funds that had an ‘inception date’ populated in the data.

16 This is a decrease in comparison to the years leading up to the 2008 global financial crisis, with the number of new funds being established peaking at 45 in 2007. While the establishment of new funds in Australia was low in 2014, there were 764 new funds launched globally in that year.[6]

Fund domicile

17 Nearly 80% of the operating single-manager hedge funds and funds of hedge funds were domiciled in Australia: see Figure 3. The Cayman Islands held the highest number of funds domiciled outside of Australia with 54 (or 11%).

Figure 3: Fund domicile of operating single-manager hedge funds and funds of hedge funds (at 30 September 2014)



Note: Data is based on 466 of the 473 operating funds that had a 'fund domicile' populated in the data.

18 In terms of assets under management, just over 81% of single-manager hedge funds and 99% of funds of hedge funds were domiciled in Australia: see Table 3.

19 It is understood that, while a limited number of Australian managers operated foreign-domiciled funds—principally to offer a tax-effective vehicle for international investors—most foreign-domiciled funds marketed in Australia were managed by foreign managers.

[6] Preqin, *2015 Preqin global hedge funds report: Sample pages*, January 2015, p. 6.

Table 3: Domicile of operating single-manager hedge funds and funds of hedge funds by number and assets under management (at 30 September 2014)

Single-manager hedge funds			Funds of hedge funds		
Country	**Number**	**Assets under management ($bn)**	**Country**	**Number**	**Assets under management ($bn)**
Australia	209	65.8	Australia	36	10.8
United States	13	9.5	Cayman Islands	2	0.13
Cayman Islands	19	3.4	British Virgin Islands	1	0.004
Other	16	2.4	Other	–	–
Total	**257**	**81.1**	**Total**	**39**	**10.9**

Note: Data is based on 257 single-manager hedge funds and 39 funds of hedge funds of the 473 operating funds with 'fund type', 'domicile' and assets under management as at 30 September 2014 populated in the data.

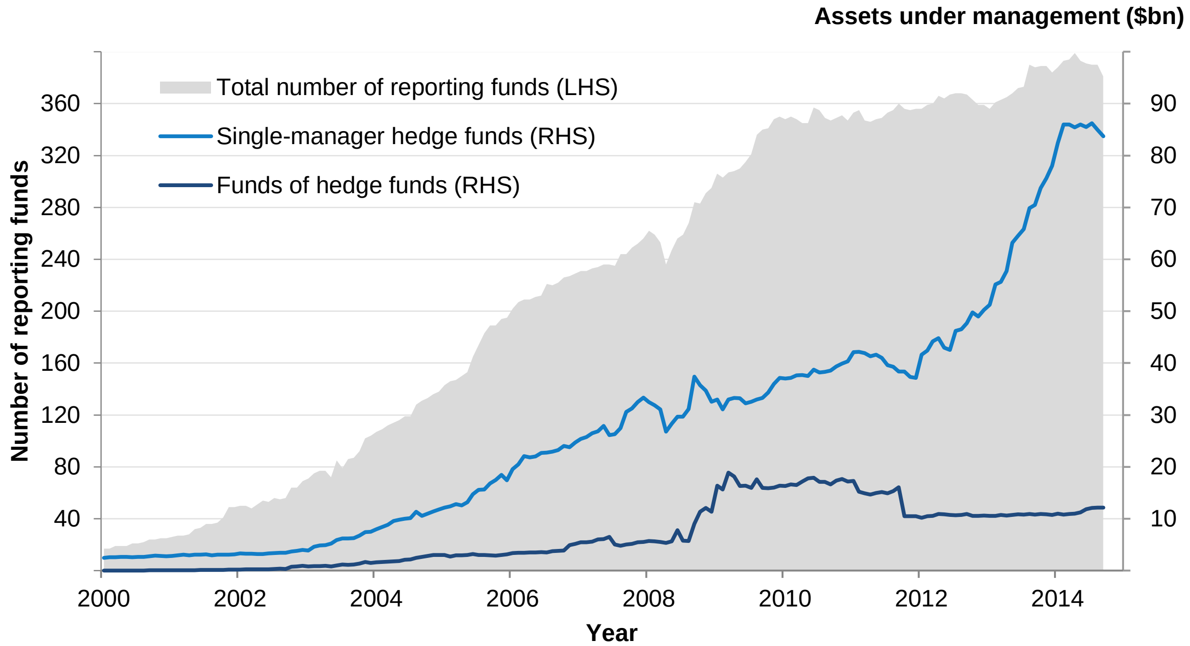
Assets under management

20 Reported assets of Australian single-manager hedge funds peaked at just over $86 billion in July 2014 before falling to around $83.7 billion as at 30 September 2014: see Figure 4. The assets under management of hedge funds globally had a similar trend over the same period, rising to US$2.5 trillion.[7] The increase in investor flows has contributed to the growth in assets under management of the industry, with investors allocating US$76.4 billion of new capital to hedge funds globally in 2014—the highest calendar year for inflows since 2007.[8]

21 Figure 4 also shows that, since 2012, assets under management for funds of hedge funds have remained relatively flat at around $12 billion. This does not mirror the global sector where assets under management for funds of hedge funds have fallen by approximately 17% to US$457 billion over the same period.[9]

[7] BarclayHedge, *Hedge fund industry: Assets under management*, data extracted on 23 February 2014, available at www.barclayhedge.com/research/indices/ghs/mum/Hedge_Fund.html.
[8] Hedge Fund Research Inc., Media Release, *Hedge funds conclude 2014 with inflows as investors position for volatility*, 20 January 2015, available at www.hedgefundresearch.com/pdf/pr_20150120.pdf.
[9] BarclayHedge, *Fund of funds industry: Assets under management*, data extracted on 23 February 2014, available at www.barclayhedge.com/research/indices/ghs/mum/Fund_of_Funds.html.

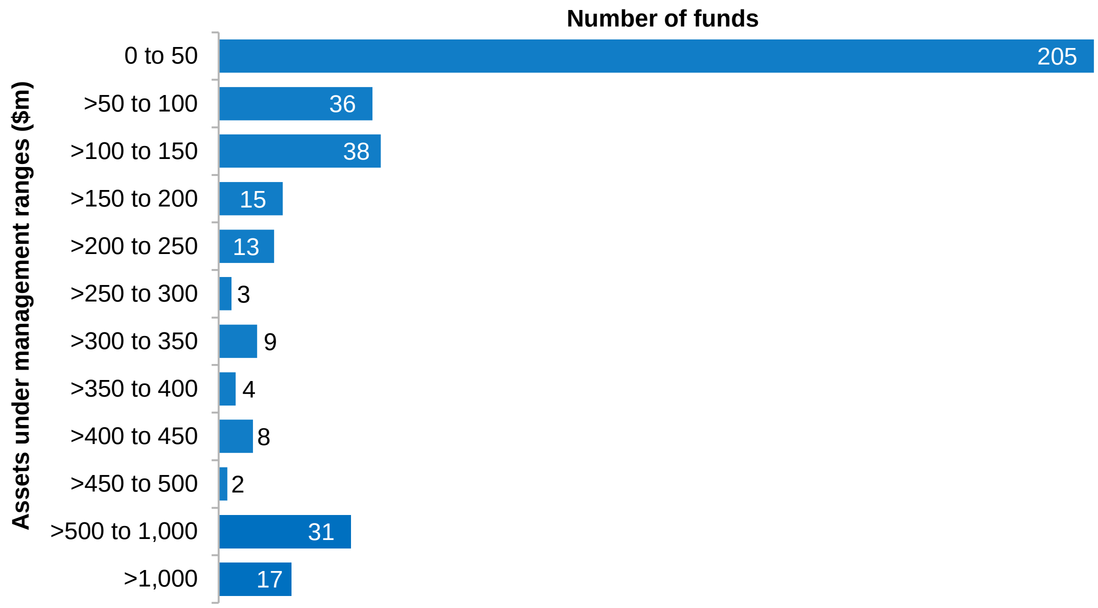
Figure 4: Reported assets under management for operating single-manager hedge funds and funds of hedge funds (to 30 September 2014)



Note: Data is based on 381 of the 473 operating funds (comprising 325 single-manager hedge funds and 56 funds of hedge funds) with assets under management as at 30 September 2014 populated in the data.

22 The majority of the Australian hedge funds sector comprises small-sized funds, with just over half (54%) of the sector holding assets under management of less than $50 million: see Figure 5.

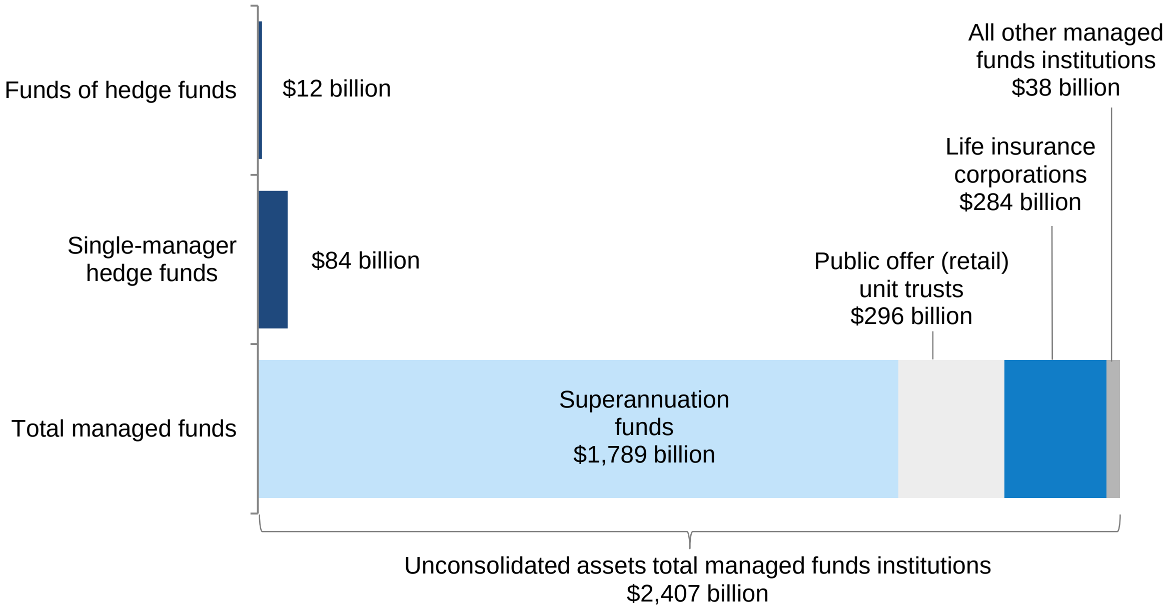
Figure 5: Number of operating single-manager hedge funds and funds of hedge funds by assets under management (at 30 September 2014)



Note: Data is based on 381 of the 473 operating funds with assets under management as at 30 September 2014 populated in the data.

23 The Australian managed funds sector, measured by unconsolidated assets, totalled $2,407 billion as at 30 September 2014. Superannuation funds accounted for approximately three-quarters of this total with nearly $1,789 billion in assets: see Figure 6.

Figure 6: Comparison of total managed funds and operating single-manager hedge funds and funds of hedge funds (at 30 September 2014)



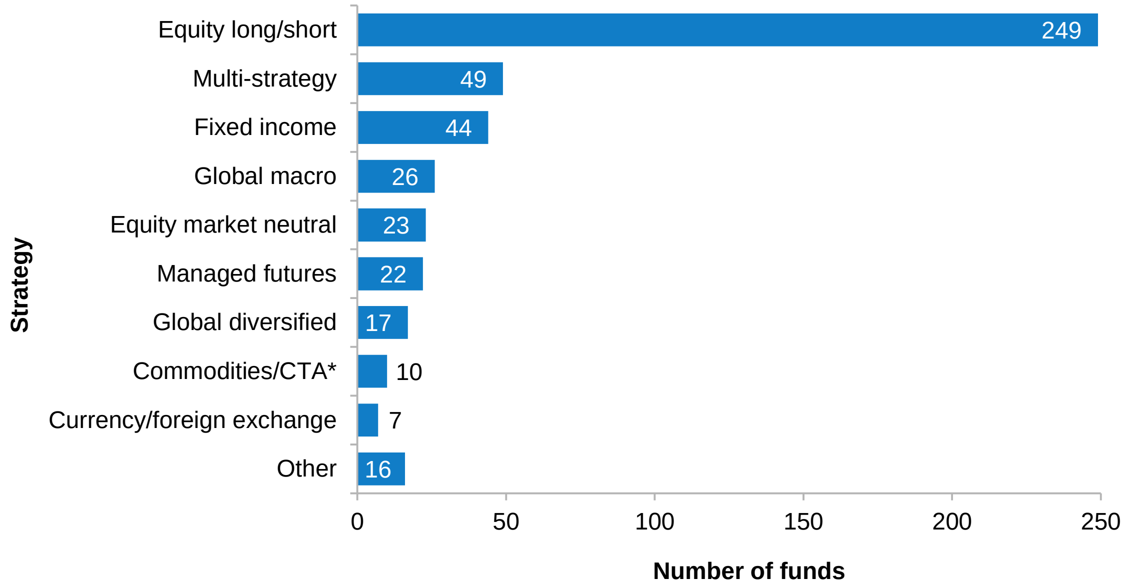
Note: The amount for the total managed funds industry is measured by unconsolidated assets, while the amounts for single-manager hedge funds and funds of hedge funds are based on the funds whose managers reported their fund type and assets under management.

Source: Unconsolidated assets data is from ABS, *Managed funds, Australia*, *September 2014*, cat. no. 5655.0, 27 November 2014, ABS, Canberra.

Strategies

24 The most common strategy employed by managers for operating single-manager hedge funds and funds of hedge funds was equity long/short (53.8%), with multi-strategy in second place (10.6%) and fixed income in third place (9.5%): see Figure 7.

Figure 7: Strategies of operating single-manager hedge funds and funds of hedge funds (at 30 September 2014)



* CTA = commodity trading advisers

Note: Data is based on 463 of the 473 operating hedge funds with a strategy populated in the data.

Investment returns

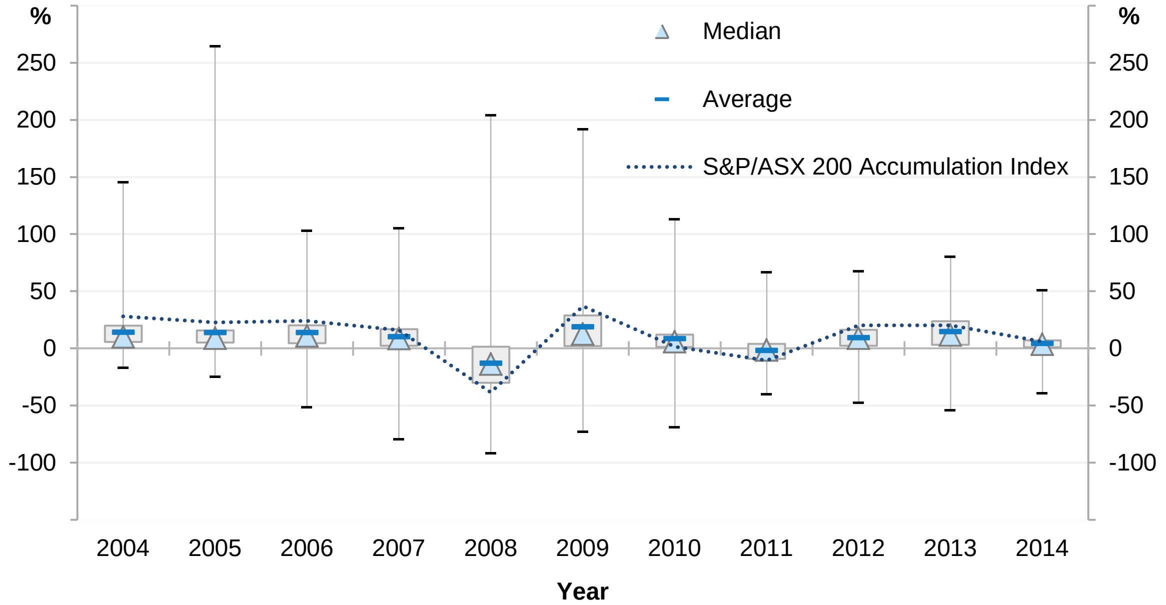
25 In the 12 months to 30 September 2014, the average annual net return for single-manager hedge funds and funds of hedge funds was 4.2%: see Figure 8. This was down from the previous year when funds on average achieved a return of 14.4%.

26 The third quarter of 2014 was the worst performing quarter for the year for the global hedge funds sector, posting returns of –0.4% for the year. Concerns over Greece leaving the Eurozone during this period caused equity markets to fall, which may have affected hedge fund investments. The year to 30 September 2014 saw returns for hedge funds globally fall to 3.3%, which highlighted the weakness in the sector in 2014 in comparison to the previous year when an average of 7.8% was posted for the same period.[10]

27 While not all funds in ASIC's hedge funds database are equity funds that have the S&P/ASX 200 Accumulation Index as a benchmark, the average annual hedge fund returns are broadly correlated with the total returns of the S&P/ASX 200 Accumulation Index.

[10] Preqin, *The Q3 2014 Preqin quarterly update: Hedge funds Q3*, October 2014.

Figure 8: Annual investment returns for operating single-manager hedge funds and funds of hedge funds (to 30 September 2014)



Note: The returns data for the single-manager hedge funds or funds of hedge funds is based on 868 unique funds (this includes funds currently operating and funds that no longer operate) and is not weighted by assets under management.

Source: Bloomberg for S&P/ASX 200 Accumulation Index data.

B ASIC's 2014 hedge funds survey (survey data)

Key points

Results from ASIC's 2014 hedge funds survey show that retail investors accounted for 66% of the surveyed hedge funds' investors by NAV. Approximately 75% of these retail investors accessed hedge funds through an IDPS.

Listed equities and cash were the largest net asset exposures in the survey data, at $26.3 billion and $5.7 billion respectively. This is broadly similar to the findings in 2012 and is reflective of the investment strategies pursued by the funds.

Asset turnover was broadly unchanged in 2014 ($1,205 billion) compared to 2012 ($1,025 billion). Interest rate derivatives and fixed income derivatives were the most heavily traded asset classes.

Surveyed hedge funds reported having low levels of leverage (the median gross notional exposure (GNE) was two times NAV) and appeared to have adequate liquidity. Reported gross leverage also increased between 2012 and 2014. However, the funds' reported gross leverage ratio was lower than reported leverage in other jurisdictions.

The surveyed hedge funds reported average net annual returns of 15.6% in 2014, which was higher than the average 7.8% and 2.1% return in 2012 and 2010 respectively.

Survey data and scope

Sample selection

28 ASIC generated a list of hedge funds from aggregated data from commercial data providers. This list of funds was filtered to find potential funds that could be included in ASIC's 2014 hedge funds survey. This included filtering using asset data and whether the fund manager was based in Australia.

29 Information was sought from 26 fund managers on any qualifying hedge fund as at 30 September 2014. The same qualifying thresholds used in 2010 and 2012 were used in ASIC's 2014 hedge funds survey to identify survey participants—that is, managers with US$500 million[11] in hedge fund assets under management across all of their hedge funds were required to provide basic data on their funds.

[11] The survey data was collected in US dollars. The qualifying threshold of $500 million converts to $478 million as at 28 September 2012 and $571 million as at 30 September 2014. The exchange rates of $1.0464 as at 28 September 2012 and $0.8752 as at 30 September 2014 were sourced from the RBA to convert US dollars to Australian dollars.

What the survey covered

30 ASIC's 2014 hedge funds survey covered topics that give IOSCO and ASIC an understanding of how large hedge funds operate in Australia. Topics include:

(a) investor type;

(b) asset exposure, turnover and location;

(c) portfolio concentration;

(d) returns;

(e) leverage and collateral; and

(f) funds' liquidity profile.

31 These topic areas help ASIC better identify and understand emerging trends and risks that may be present in the sector and the funds management industry more broadly. See Appendix 1 of this report for details on some of the limitations of the data collected.

Changes since ASIC's 2012 hedge funds survey

32 In 2014, we significantly reduced the number of survey data points to assist the surveyed hedge funds in providing relevant information as efficiently as possible. After consultation with members of the Council of Financial Regulators and the local chapter of the Alternative Investment Management Association, we settled on a local version of the survey questionnaire. Examples of some of the specific changes since ASIC's 2012 hedge funds survey include:

(a) adopting a broader definition of a hedge fund in line with the definition used by IOSCO—that is, a fund that presents a combination of some of the following characteristics:

  (i) use of leverage;

  (ii) performance fees based on unrealised gains;

  (iii) complex strategies, which may include use of derivatives, short selling, high-frequency trading and/or the search for absolute returns; and

  (iv) a tendency to invest in financial rather than physical assets;

(b) removing the question on geographic exposure of investors; and

(c) categorising fixed income derivatives into their own asset class for questions about a fund's asset exposure and turnover.[12]

[12] This may contribute to the changes seen in the exposures to some of these asset classes: see paragraph 44.

Summary of trends

33 Where possible, comparisons are made between ASIC's 2010, 2012 and 2014 hedge funds surveys.

34 Table 4 provides a comparison of the 2012 and 2014 data samples.

Table 4: Summary of trends in the data samples—2012 and 2014

Key indicators	Reported as at 30 September 2012	Reported as at 30 September 2014
Total assets under management reported	$20.2 billion	$37.1 billion
Number of fund managers	16	18
Number of funds	12	27
Fund size (>US$500 million)*	>$478 million†	>$571 million‡
Percentage of NAV attributed to retail direct investors	9.7%	17%
Notional exposure to interest rate derivatives	>$28.7 billion	>$64.7 billion
Largest geographic exposure to investments	Australia	North America
Average returns in previous 12 months for single-manager hedge funds	7.8%	15.6%
Median net applications in previous 12 months	$47.8 million	$98 million
Median gross leverage	1.7 times NAV	2 times NAV
Average gross leverage ratio	1.9 times NAV	4 times NAV
Collateral posted	$1.2 billion	$3.1 billion
Derivatives traded on a regulated exchange in previous 12 months	56%	72%

* The survey data was collected in US dollars. ASIC used the same qualifying threshold as ASIC's 2012 hedge funds survey and as the IOSCO 2014 global hedge fund survey template—that is, managers with US$500 million in hedge fund assets under management.

† US$500 million converts to $478 million at 28 September 2012 using the exchange rate of $1.0464 sourced from the RBA to convert into Australian dollars.

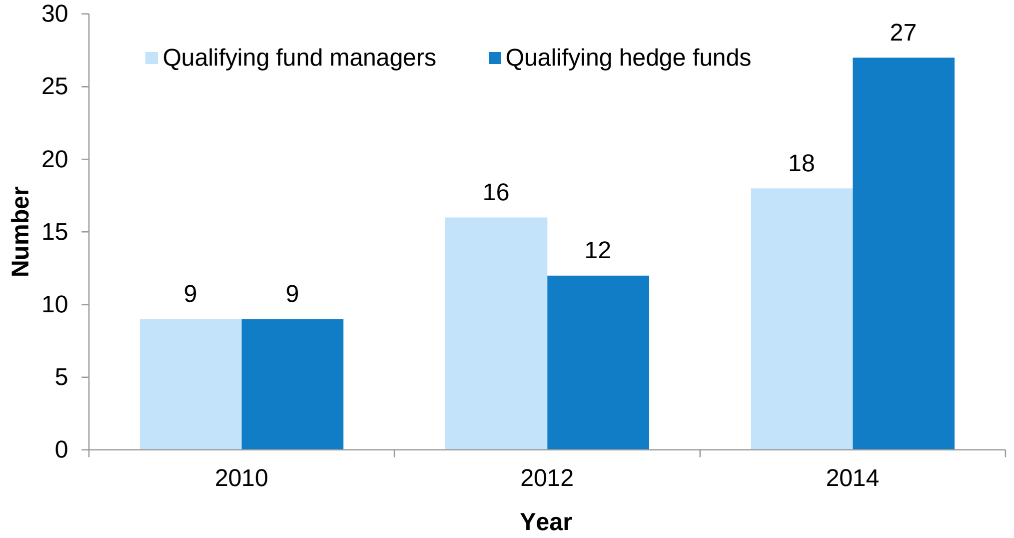
‡ US$500 million converts to $571 million at 30 September 2014 using the exchange rate of $0.8752 sourced from the RBA to convert into Australian dollars.

Survey participants

35 Responses were received from 18 hedge fund managers who reported having more than $571 million in hedge fund assets under management: see

Appendix 2 of this report for details. These managers managed 27 hedge funds: see Figure 9.

Figure 9: Number of qualifying hedge fund managers and qualifying hedge funds in 2010, 2012 and 2014



36 ASIC received data for many more hedge funds in 2014 than in 2012. There are a number of reasons that may have contributed to this increase—for example, asset price appreciation, increased net applications and a wider definition of hedge fund used in identifying the survey data sample: see Appendix 1 of this report.

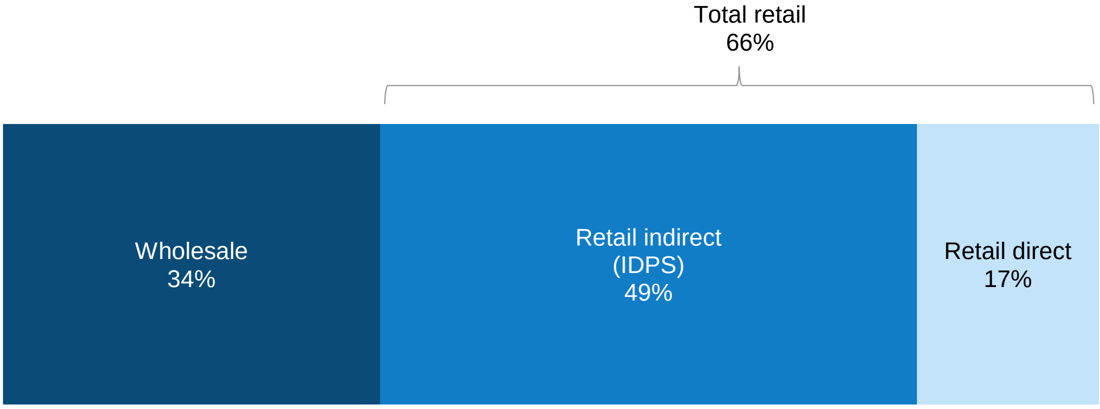
37 The 27 surveyed hedge funds had assets under management of $37.1 billion. It is estimated that this accounted for approximately 44% of the assets managed by single-manager hedge funds. The sector continues to be concentrated, with the 10 largest funds contributing approximately 36% of the single-manager fund sector's total assets.

38 The majority of surveyed hedge funds were domiciled in Australia. Only two of the 27 funds were not domiciled in Australia but were based in the Cayman Islands. This is similar to findings in ASIC's 2012 hedge funds survey. It is also broadly comparable to the aggregated data from commercial data providers: see Figure 3.

Type of investors

39 Retail direct investors accounted for 17% of the investors by NAV in the surveyed hedge funds: see Figure 10. This is a 7.3% increase from the 9.7% reported in ASIC's 2012 hedge funds survey.

Figure 10: Percentage of retail and wholesale investors weighted by NAV (at 30 September 2014)



40 Surveyed hedge funds reported that 49% of investors by NAV accessed hedge funds through an IDPS, up from 2% of NAV in 2012. The change in retail indirect (IDPS) investor participation reported by surveyed hedge funds between 2012 and 2014 is attributable to a range of factors, including:

(a) many fund managers indicated that they do not have detailed information of the investor type for retail indirect (IDPS);

(b) some fund managers classified their investors differently in 2014 as a result of data challenges encountered in 2012; and

(c) ASIC's 2014 hedge funds survey used a broader definition of a hedge fund, in line with the definition used by IOSCO, to identify funds to be included in the survey.

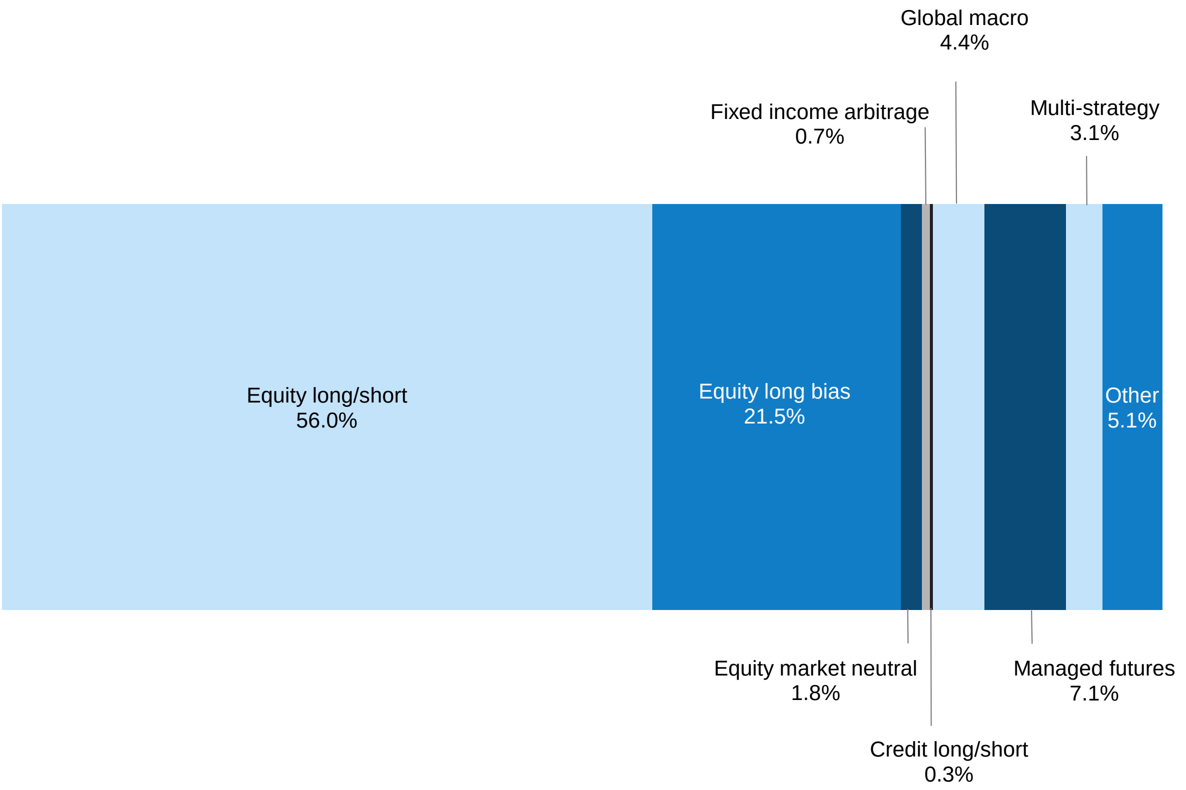
Investments

Strategies

41 Equity long/short was the most common hedge fund strategy for the surveyed hedge funds, both by number of funds and by NAV. In 2014, 41% of funds reported that equity long/short was their predominant strategy. This was similar to the results in ASIC's 2012 hedge funds survey, where 50% of funds used this strategy. It was also consistent with the aggregated data from commercial data providers: see Figure 7. Equity long bias and managed futures/CTA were also common strategies in 2014, used by 22% and 19% of the funds respectively.

42 Some 56% of the hedge funds' NAV ($20.8 billion) was allocated to the equity long/short strategy: see Figure 11.

Figure 11: Percentage of total NAV allocated to hedge fund strategies (at 30 September 2014)



Asset exposure

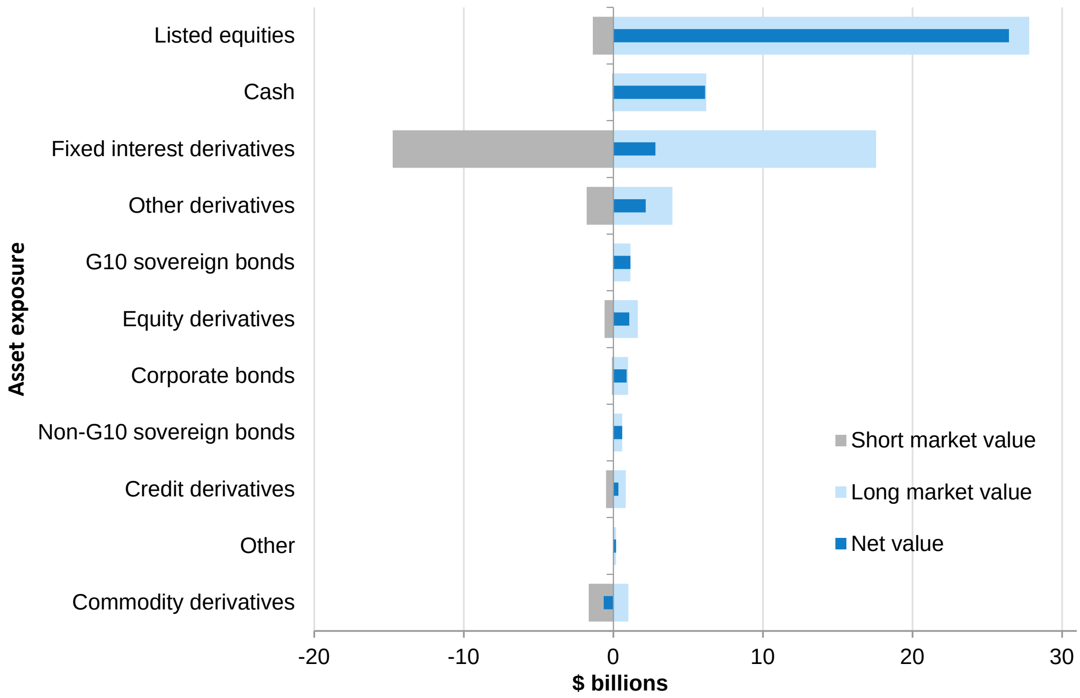
43 Surveyed hedge funds reported the largest exposure to listed equities. The net value of assets invested in listed equities was $26.3 billion (see Figure 12), which was substantially higher than the second largest asset class (cash, at $5.7 billion). Listed equities and cash were also the two largest asset classes reported in ASIC’s 2012 hedge funds survey.

44 Fixed interest derivatives had the largest gross market value (GMV), at $32.3 billion.[13] (GMV is the absolute sum of the fair market value of all long and short positions.) However, this value was made up of both large short and long positions in these derivatives, which results in a much smaller net exposure.

45 There was a shift in the surveyed hedge funds’ exposure to commodity derivatives between 2012 and 2014. In 2014, commodity derivatives were the only asset class to have a negative net value (–$0.69 billion). In contrast, ASIC’s 2012 hedge funds survey reported the net value of commodity derivatives was $0.29 billion.

[13] Fixed income derivatives were classed as their own asset type in ASIC’s 2014 hedge funds survey. In 2012, fixed income derivatives were included in the underlying fixed income asset classes.

Figure 12: Hedge funds' asset exposure (at 30 September 2014)



Note: Interest rate derivatives have been excluded because they had larger gross notional exposures.

46 The surveyed hedge funds reported a very large exposure to interest rate derivatives. The survey does not capture long market value and short market value for interest rate derivatives. The nature of these instruments means they can have very large notional exposures, making it difficult to compare with other asset classes. The gross notional exposure (GNE) to interest rate derivatives was $64.7 billion in 2014. (GNE is the absolute value of all long and short positions, including gross notional value for derivatives.) This was approximately twice the gross exposure to these derivatives reported by funds in ASIC's 2012 hedge funds survey.

Turnover

47 Total asset turnover for the surveyed hedge funds over the year to 30 September 2014 was stable compared to 2012. In 2014, turnover amounted to $1,205 billion, compared to $1,025 billion in 2012. This was despite an increase in the total NAV of the surveyed hedge funds in 2014. Turnover as a multiple of NAV was reported at 32 times in 2014, which was lower than 51 times in 2012 and 176 times in 2010.

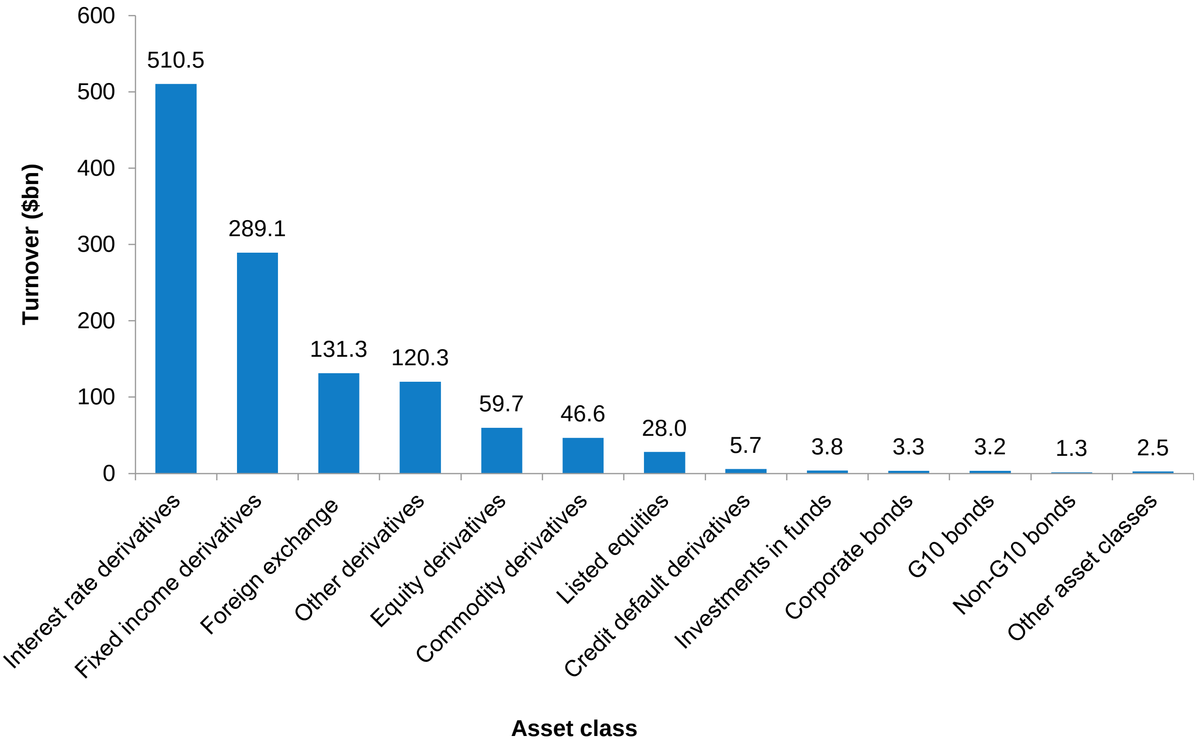
48 The turnover range of the surveyed hedge funds was reasonably wide, with 41% of funds reporting asset turnover of greater than $5 billion, and 4% of funds reporting turnover of under $50 million: see Table 5.

Table 5: Range of turnover for the 12 months to 30 September 2014

Turnover range	Percentage of hedge funds
>$5 billion	41%
$500 million – $5 billion	22%
$50 million – $500 million	33%
<$50 million	4%

49 The vast majority of funds' reported turnover was in interest rate derivatives and fixed income derivatives: see Figure 13. Interest rate derivatives were the most highly traded individual asset class at $510.5 billion, reflecting their importance in managing interest rate exposure.

Figure 13: Asset class turnover for the 12 months to 30 September 2014



50 Trading in listed equities by the surveyed hedge funds represented a small proportion of total trading in the Australian listed equities market (approximately 2%).[14]

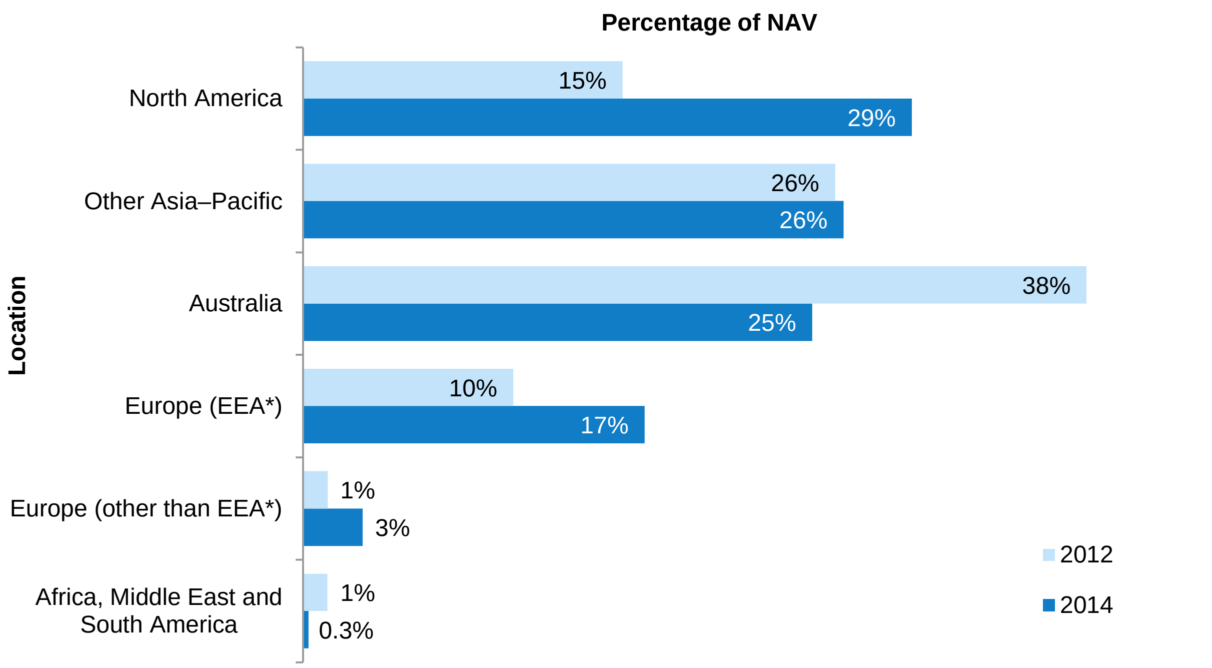
51 The surveyed hedge funds did not report a wide use of high-frequency trading strategies.

[14] This figure may be overstated because the surveyed hedge funds traded in international markets and not solely in Australian listed equities.

Geographic exposure of investments

52 The highest geographic exposure was to North America with 29% of NAV invested there: see Figure 14. However, Australia and Asia (ex-Australia) were also significant regions for the funds' investments, with each receiving 26% of the total NAV. In 2012, Australia had the largest percentage of the funds' investments, with 38% of NAV.

Figure 14: Geographic exposure of investments weighted by NAV (at 30 September 2012 and 30 September 2014)



* EEA = European Economic Area

Note: The 2012 figures are different from those reported in REP 370 because this data was reported at the hedge fund manager level in 2012. The 2012 figures do not total 100% because ASIC's 2012 hedge funds survey included an 'unallocated' option, which was not included in ASIC's 2014 hedge funds survey.

Portfolio concentration

53 The surveyed hedge funds were asked to state their exposure to their 10 most important portfolio positions. The average value of the 10 most important positions as a percentage of GNE for the funds was 40%.

Performance

Returns

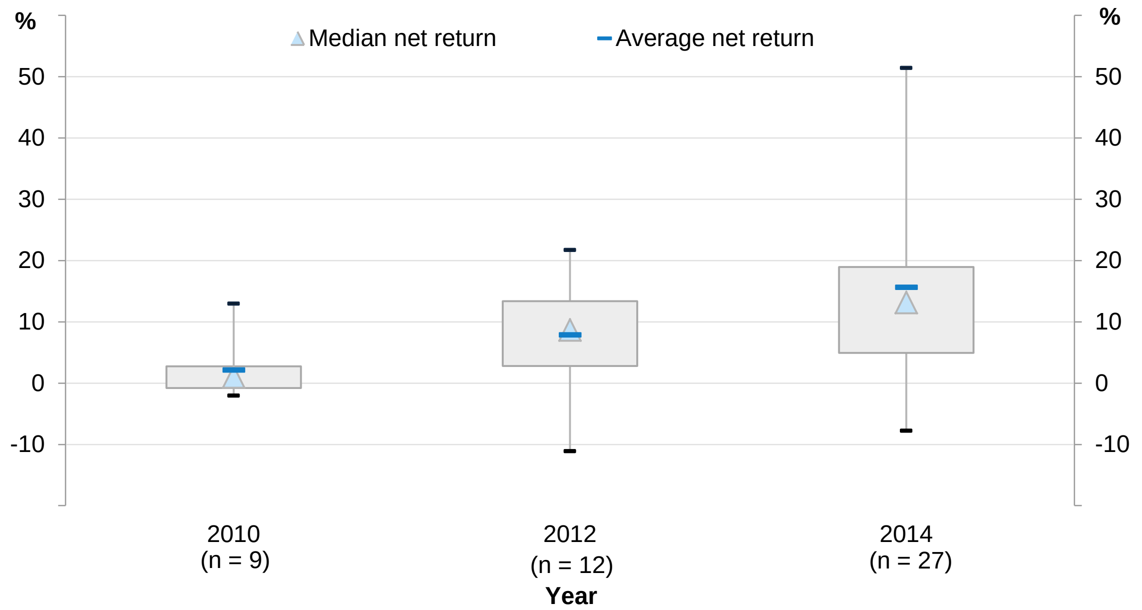
54 Annual net investment returns for the surveyed hedge funds averaged 15.6% in 2014, which was higher than the average 7.8% and 2.1% net return in

2012 and 2010 respectively: see Figure 15. The S&P/ASX 200 Accumulation Index increased by 5.9% in the 12 months to 30 September 2014. One fund reported a negative return over the period.

55 The surveyed hedge funds outperformed the funds in the aggregated data from commercial providers, which posted an average net return of 4.2% over the 12 months to 30 September 2014.

56 The range of annual net investment returns reported by the surveyed hedge funds was wider in 2014 than it was in 2012 and 2010, although this can be somewhat explained by the larger sample size.

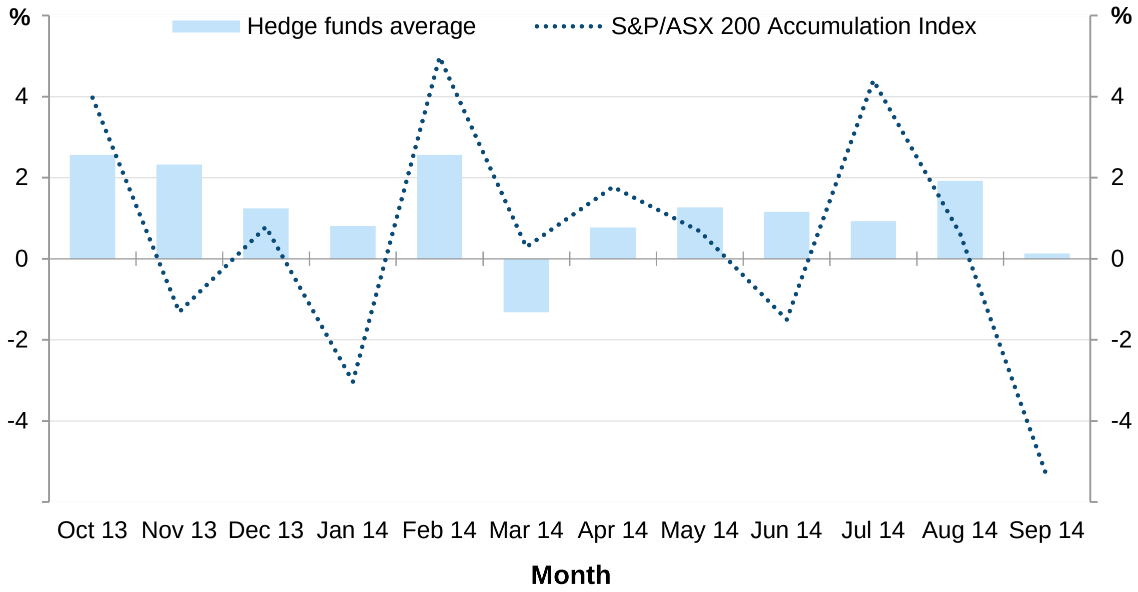
Figure 15: Comparison of annual net investment returns in 2010, 2012 and 2014



Note: n refers to the sample size.

57 On average, surveyed hedge funds reported positive net returns for 11 of the 12 months to 30 September 2014: see Figure 16. Reported monthly net returns on average appeared to fluctuate less than the monthly returns for the S&P/ASX 200 Accumulation Index over the same period.

Figure 16: Average monthly net returns for the 12 months to 30 September 2014



Source: Bloomberg for S&P/ASX 200 Accumulation Index data.

58 Of the 21 funds that were reported as having a high-water mark, the assets of eight were below their high-water mark as at 30 September 2014. All of these funds were only marginally below their high-water mark.

Net applications

59 The surveyed hedge funds had positive net applications of $5.1 billion over the 12 months to 30 September 2014. This was composed of $10 billion in applications and $4.9 billion in redemptions. The median fund's net applications totalled $98.2 million in 2014, compared to $47.8 million in 2012 and $10.3 million in 2010.

60 The median NAV increased by 12% over the 12 months to 30 September 2014 due to net applications, while 26% of funds' NAV decreased due to redemptions outweighing applications.

61 The median net applications were positive in every month of the year to 30 September 2014.

Risk and leverage

Value at risk

62 Value at risk (VaR) represents the potential loss of a portfolio at a given level of confidence. VaR was regularly calculated by 37% of the surveyed hedge funds. Of these funds, a common 99% confidence interval was used to

perform VaR calculations. The median fund reported a VaR of 1.7% of NAV.

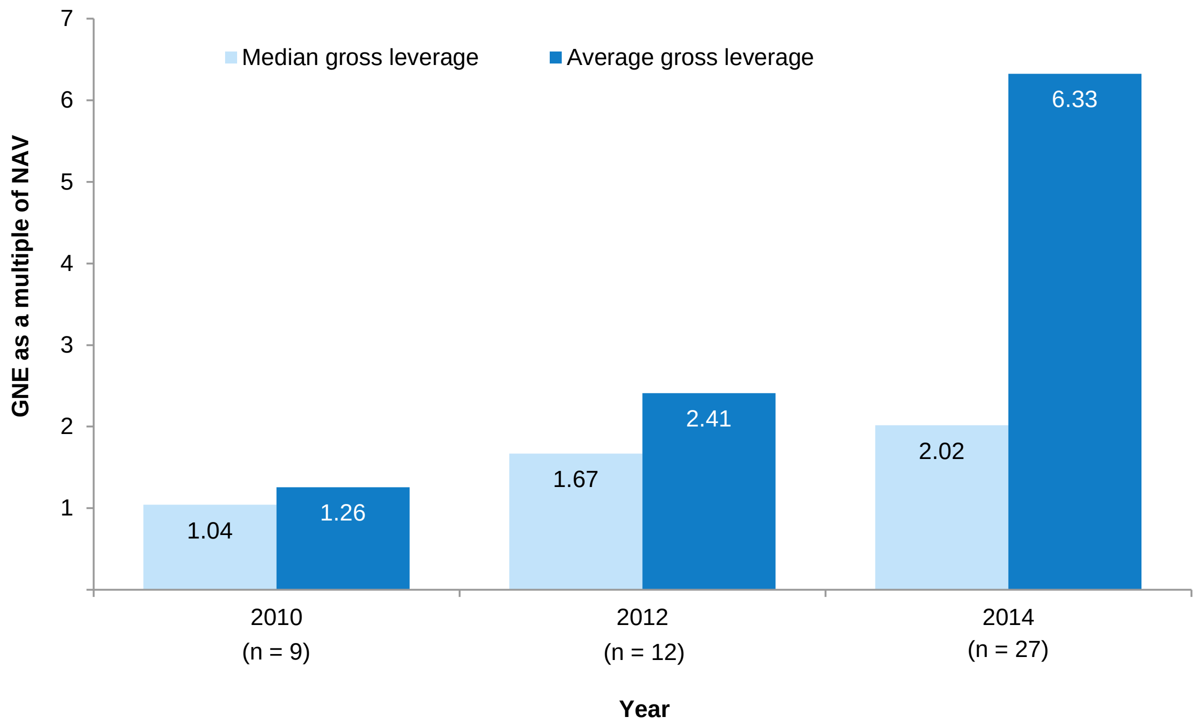
Leverage

63 The gross leverage ratio (GNE to NAV) for surveyed hedge funds has increased since 2012. The median gross leverage ratio in 2014 was two times NAV, compared to 1.7 times NAV in 2012: see Figure 17.

64 However, despite this increase, the level of leverage for surveyed hedge funds is relatively low compared to other jurisdictions. For example, the median gross leverage ratio reported by the Financial Conduct Authority (FCA) in their *Hedge fund survey* report was twice that of the median gross leverage ratio reported by surveyed hedge funds.[15] Further, the latest IOSCO hedge funds report shows that Australian hedge funds used relatively small amounts of leverage compared to other jurisdictions.[16]

65 While the average gross leverage ratio appeared to have increased since 2012, this is likely to have been driven by a small number of funds with relatively high levels of leverage.

Figure 17: Median and average gross leverage ratios in 2010, 2012 and 2014



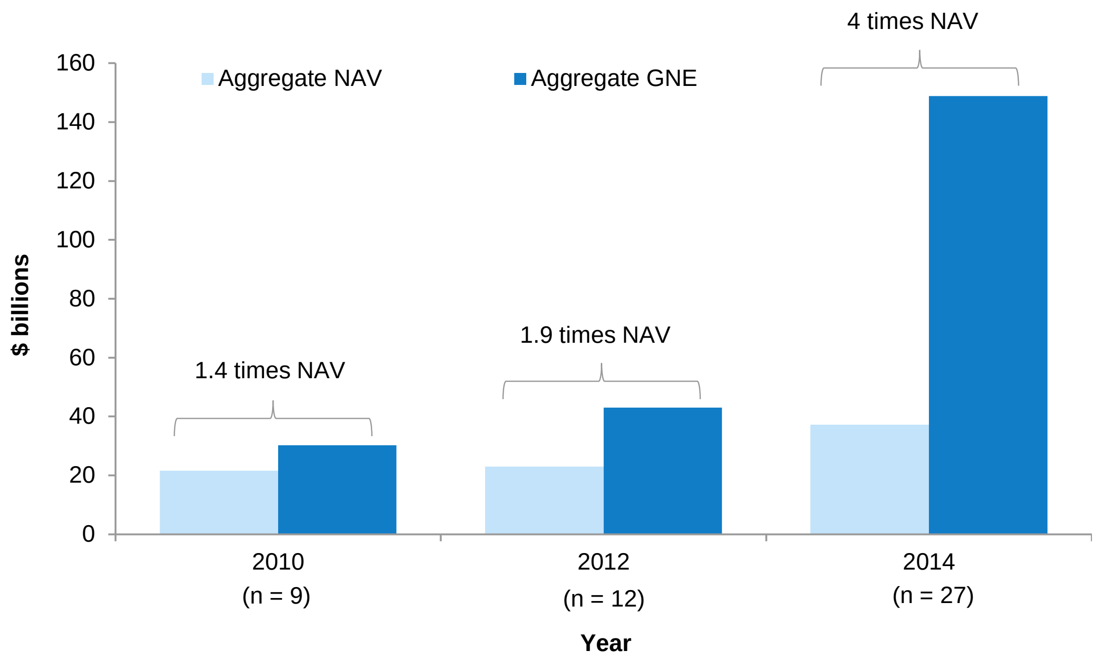
Note: n is the sample size.

[15] FCA, *Hedge fund survey*, March 2014, p. 16.
[16] IOSCO, *Report on the second IOSCO hedge fund survey*, October 2013, p. 21.

66 Global macro and managed futures/CTA hedge funds used higher levels of gross leverage compared to other hedge fund strategies. The median gross leverage ratio for surveyed global macro funds was greater than 30, while managed futures/CTA funds had a median gross leverage ratio of greater than 10. By comparison, the median gross leverage ratio for equity long/short funds was less than two.

67 The aggregate gross leverage ratio for the surveyed hedge funds in 2014 was four times NAV: see Figure 18. This has increased since 2012, when the aggregate gross leverage ratio was 1.9 times NAV. The aggregate gross leverage ratio is useful to see the total amount of leverage used by surveyed hedge funds, as opposed to the fund level data shown in Figure 17.

Figure 18: Aggregate NAV and aggregate GNE in 2010, 2012 and 2014



Note: n is the sample size.

68 Synthetic leverage was the largest source of leverage for the surveyed hedge funds, accounting for approximately 97.7% ($59.6 billion) of total gross leverage. This was slightly higher than in 2012, when synthetic leverage made up 92.8% of total leverage.

69 The prime source of financial leverage was collateralised borrowing via a prime broker, which totalled $1,296 million: see Table 6. Synthetic leverage was almost six times higher than its level in 2012, while collateralised borrowing via a prime broker was almost twice as high as 2012 levels. There was no collateralised borrowing via repurchase agreements.

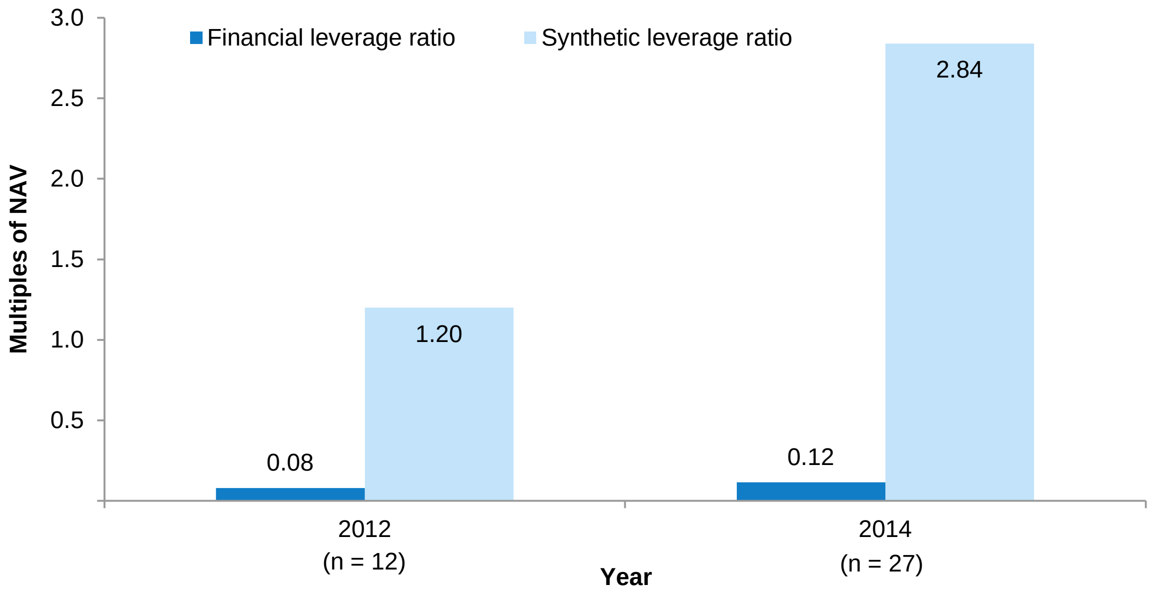
Table 6: Sources of leverage in 2010, 2012 and 2014

Source	2010 ($ millions)	2012 ($ millions)	2014 ($ millions)
Unsecured cash borrowing	113	None reported	107
Collateralised borrowing via prime broker	104.5	597	1,296
Collateralised borrowing via other	None reported	140.5	1.14
Synthetic leverage	None reported	9,530	59,609

70 The sum of leverage, with derivative values calculated on a notional basis as shown in Table 6, looks quite high. However, as the notional amounts are not usually delivered, looking at the notional value of these positions can overstate their leverage. Other problems arise from some derivatives being difficult to value because this approach cannot account for hedging, offsetting and other arrangements that reduce exposure.

71 The surveyed hedge funds reported average synthetic leverage of 2.84 times NAV and average financial leverage of 0.1 times NAV in 2014: see Figure 19. This compared to an average synthetic leverage ratio of 1.2 and average financial leverage ratio of 0.1 in 2012.

Figure 19: Average leverage ratios in 2012 and 2014



Note: n is the sample size.

Collateral

72 As at 30 September 2014, a total of $3.3 billion in collateral was reported, representing an increase of approximately $1.8 billion since 2012.

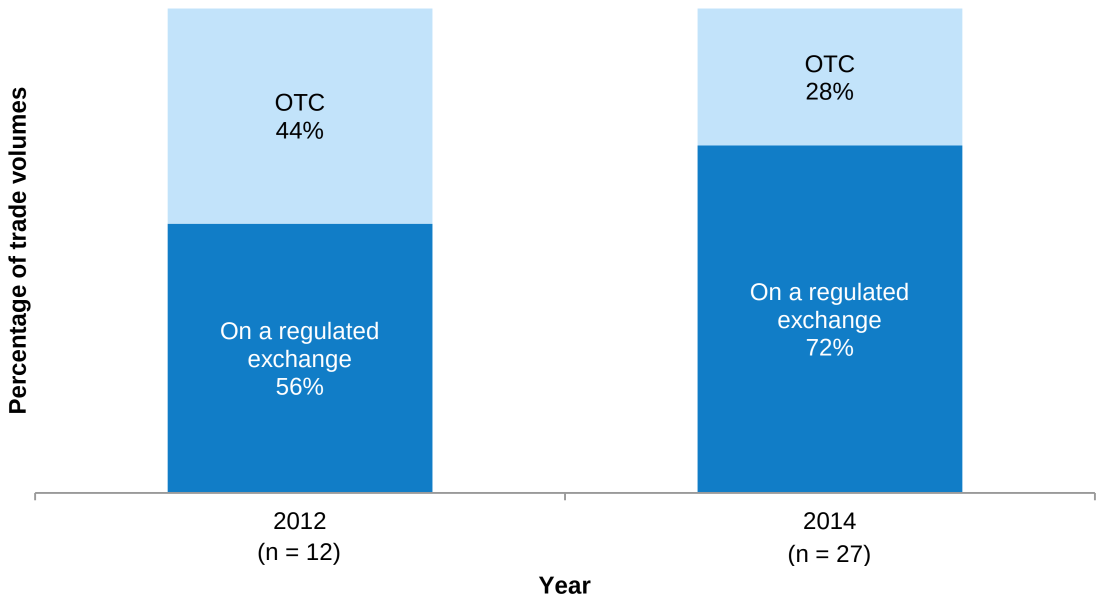
73 The median fund held collateral worth 37% of its total borrowing and derivatives exposure in 2014, up from 24% in 2012.

74 Rehypothecation of collateral was permitted by 38% of hedge funds, although only 12% of funds reported that their collateral had been rehypothecated. In 2012, 50% of the surveyed hedge funds permitted their collateral to be rehypothecated and 8% of funds reported their collateral as being used in this way.

Trading and clearing

75 On average, nearly three-quarters of derivatives volumes were reported as being traded on regulated exchanges by the surveyed hedge funds in 2014, up from 56% in 2012: see Figure 20.

Figure 20: Average percentage of derivatives traded on exchanges and over-the-counter (OTC) in 2012 and 2014 (at 30 September 2012 and 30 September 2014)



Note: n is the sample size.

76 Of the 28% of derivatives that were traded over-the-counter in 2014, on average only 3% were cleared by central clearing counterparties. The remaining 97% were cleared through bilateral transactions.

Liquidity

Asset classification

77 The surveyed hedge funds were asked to classify their assets and liabilities based on the fair value accounting hierarchy rules under International Financial Reporting Standards or US Generally Accepted Accounting Principles. Liquid and easily valued instruments that have quoted market prices or prices that are directly or indirectly observable (fair value assets levels 1 and 2) represented the vast majority of hedge funds' GMV.

78 The median fund's exposure to level 1 fair value assets was 73% of GMV in 2014. Cash assets for the median fund were 7.6% of GMV. Median allocations to all other asset classification categories were negligible.

Unencumbered cash

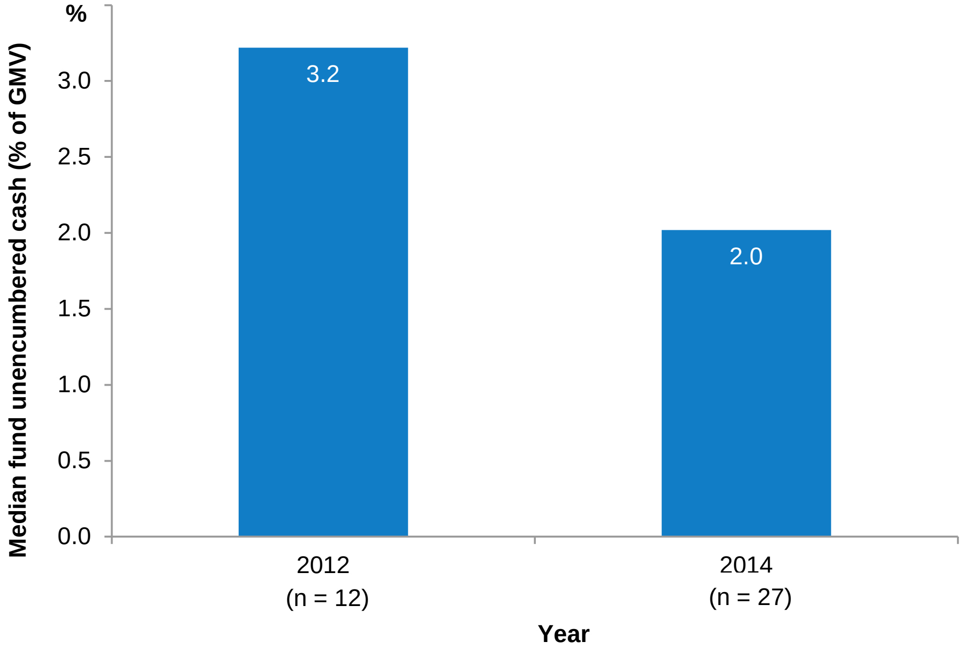
79 Unencumbered cash represents the portion of a fund's cash which is not held by its counterparties as collateral. Over half of the surveyed hedge funds held over 2% of GMV as unencumbered cash, while 26% of funds held unencumbered cash of more than 10% of GMV: see Table 7. In contrast, 37% of funds had an unencumbered cash ratio of less than 50 basis points.

Table 7: Range of unencumbered cash as a percentage of GMV of surveyed hedge funds (at 30 September 2014)

Range of unencumbered cash ratio	Percentage of funds
>10% of GMV	26%
5% – 10%	15%
2% – 5%	11%
1% – 2%	7%
50 basis points – 1%	4%
<50 basis points of GMV	37%

80 The median fund held 2% of its GMV as unencumbered cash in 2014: see Figure 21. This is lower than the median fund in 2012, which had an unencumbered cash ratio of 3.2%.

Figure 21: Median unencumbered cash as a percentage of GMV in 2012 and 2014



Note: n is the sample size.

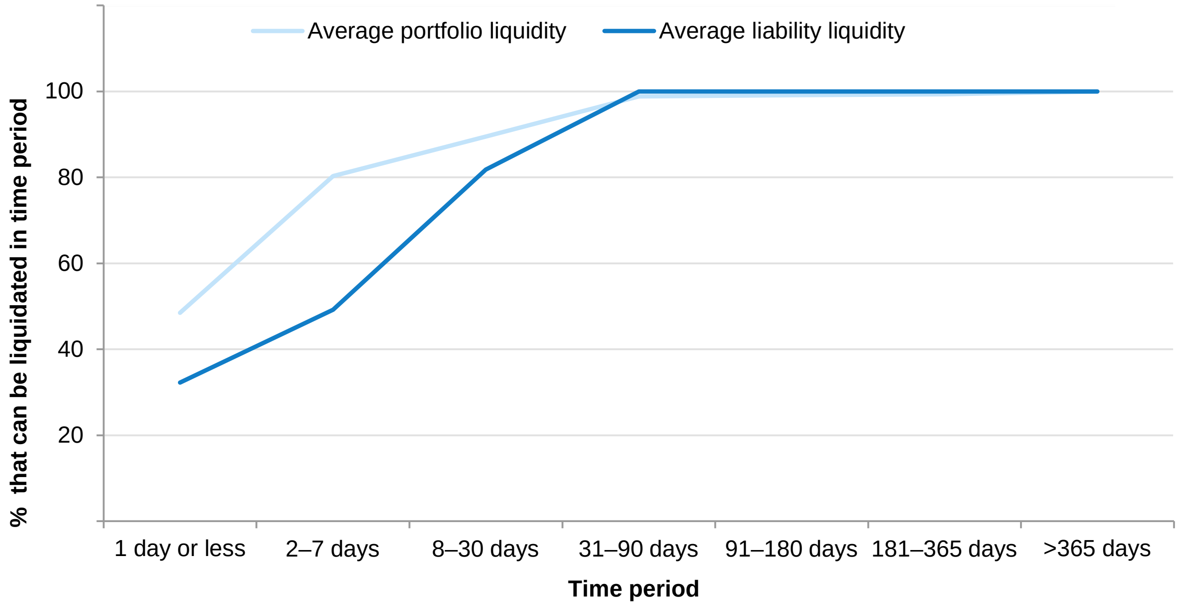
Portfolio and liquidity profile

81 Most of the surveyed hedge funds could liquidate 89.5% of their portfolios (portfolio liquidity) in less than 30 days and could face redemptions on 81.8% of fund liabilities (investor liquidity) in less than 30 days: see Figure 22. In 2012, 30-day portfolio liquidity was 92% and 30-day investor liquidity was 99%.

82 All of the funds had the right to temporarily suspend investor redemptions (no fund reported having used this right in 2014).

83 The surveyed hedge funds reported negligible usage of side pockets (i.e. an account for illiquid assets, the revenue of which only current members of the hedge fund will have access to), gates (i.e. a restriction limiting the number of withdrawals in a redemption period), or any other arrangements for managing illiquid assets.

Figure 22: Average portfolio and investor liquidity profile (at 30 September 2014)

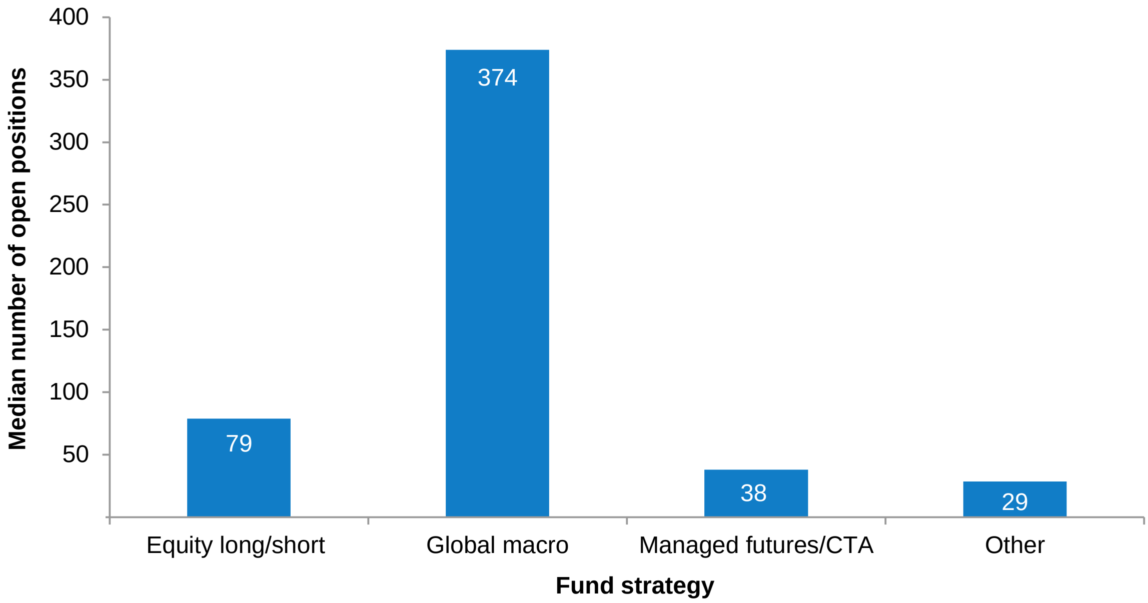


Open positions

84 In 2014, the median number of open positions was 56. This was lower than the median number of open positions in 2012 (170), but higher than in 2010 (15).

85 There was divergence in the number of open positions reported by hedge funds using different strategies: see Figure 23. The median surveyed global macro hedge fund had 374 open positions in 2014, which was higher than the median fund of other strategies.

Figure 23: Median number of open positions per fund by strategy (at 30 September 2014)



Appendix 1: Qualifications on data samples

86 This appendix sets out some of the inherent challenges in using the underlying data for this report—in particular:

(a) some of the reasons for the differences in commercial providers' data samples when extracted at different times; and

(b) some of the challenges in comparing observations from data samples in Section A (aggregated data from commercial providers) to Section B (the data from ASIC's 2014 hedge funds survey).

Aggregated data from commercial providers

87 Some of the reasons for differences in the underlying data relied on in Section A of this report in comparison to the data used in REP 370 released on 10 September 2013 include:

(a) there is no requirement for a fund manager to report information about its funds to commercial data providers; this may result in certain self-selection biases in the data (such as selection, performance and survivorship biases), or it may result in time lags (such as a delay in the data provider obtaining up-to-date data);

(b) a fund manager may request to have historical information about its funds removed from the commercial data providers' databases; and

(c) a commercial data provider may remove incorrect or poor quality data from its database.

88 ASIC is aware that there may be some differences in the methods used by data providers in any information derived by the data provider. For example, how the data provider:

(a) classifies what is and is not an Australian hedge fund—data providers use different definitions of a 'hedge fund' when identifying the hedge fund population (i.e. different from the definitions used in ASIC's 2010 and 2012 hedge funds surveys, and different from the definition in ASIC Class Order [CO 12/749] *Relief from the shorter PDS regime*, which was issued in 2012);

(b) classifies the investment strategy of a fund—again this may be different because data providers classify hedge fund strategies in different ways, and this may be different from how the managers themselves classify funds managed by them; and

(c) calculates monthly returns, which may be different across different data providers.

89 Such differences complicate comparisons between two seemingly similar datasets extracted at two different dates.

90 ASIC has not conducted any due diligence to ensure the accuracy of the data reported in any of the commercial databases used in compiling this report.

AISC's 2014 hedge funds survey data

91 ASIC's 2014 hedge funds survey covers single-manager hedge funds operated by licensed fund managers in Australia and with over $571 million in NAV as at 30 September 2014. The profile of funds below this threshold may be different in terms of asset allocation, levels of leverage and other factors from ASIC's 2012 and 2010 hedge funds surveys. The survey does not cover the local activities of international funds that are not offered in Australia but that may take positions in Australian markets.

92 The number of, and composition of, hedge funds responding to the survey has changed since 2012. This affects comparisons that can be made between the 2012 and 2014 data. For example, it may not be clear whether observed movements in the data reflect a change in the surveyed funds' activities or have been driven by the funds included in ASIC's 2014 hedge funds survey relative to the funds included in other years.

93 ASIC confirmed data anomalies where possible with the fund managers. However, some managers may have had different interpretations and approaches in their responses.

Appendix 2: ASIC's 2014 hedge funds survey—Participants

94 In addition to three managers who requested to remain anonymous, the 15 fund managers listed in Table 8 each provided a response to ASIC's 2014 hedge funds survey questions, which was aggregated and referred to in Section B of this report.

Table 8: Fund managers who responded to survey questions

Manager name
Antares Capital Partners Ltd
BlackRock Investment Management (Australia) Limited
Caledonia (Private) Investments Pty Limited
Colonial First State Investments Limited
Equity Trustees Limited
JCP Investment Partners Ltd
Kaiser Trading Group Pty Ltd
Macquarie Investment Management Ltd
Pengana Capital Ltd
Perpetual Investment Management Limited
Perpetual Trust Services Limited
Platinum Asset Management Limited
PM CAPITAL Limited
QIC Limited
Regal Funds Management Pty Limited

Key terms

Term	Meaning in this document
ABS	Australian Bureau of Statistics
ASIC	Australian Securities and Investments Commission
ASIC's 2012 hedge funds survey	A survey issued in 2012 by ASIC to large hedge fund managers that operate in Australia
ASIC's 2014 hedge funds survey	A survey issued in 2014 by ASIC to large hedge fund managers that operate in Australia
CTA	Commodity trading advisers
FCA	Financial Conduct Authority (United Kingdom). The FCA recently replaced the Financial Services Authority
funds of hedge funds	A managed investment scheme that invests most, or all, of the fund's assets in one or more hedge funds
high-frequency trading strategy	A strategy that is primarily computer driven, with decisions to place bids and offers, and to buy and sell, based on algorithmic responses to intra-day price movements. This does not include strategies that only use algorithms for trade execution
G10	Group of Ten
G20	Group of Twenty
GMV	Gross market value. GMV is the absolute value of long and short positions, using fair market values for all positions. This measure is usually larger than NAV and smaller than GNE
GNE	Gross notional exposure. GNE is the absolute value of long and short positions, including gross notional values of derivatives. GNE does not directly represent an amount of money that is at risk of being lost, but it can be a fairer representation of the economic or market exposure than NAV
gross leverage ratio	The ratio of gross notional exposure to net asset value
IDPS	Investor directed portfolio service
IOSCO	International Organization of Securities Commissions
NAV	Net asset value. NAV is the value of all long positions minus any short positions held
operating fund	A fund that is flagged as open, closed to new investors, frozen or stopped reporting in the commercial data
OTC	Over the counter

Term	Meaning in this document
RBA	Reserve Bank of Australia
rehypothecation	The practice where collateral can be used by the recipient for their own purposes
S&P/ASX 200 Accumulation Index	An index of the largest 200 shares listed on ASX by market capitalisation, including reinvestment of dividends
single-manager hedge fund	A hedge fund that invests directly in the assets related to the fund's strategy. This is opposed to a funds of hedge fund
surveyed hedge funds	A single-manager Australian hedge fund with more than US$500 million in assets under management that took part in ASIC's 2014 hedge funds survey
synthetic leverage	Leverage that is embedded in derivatives
unencumbered cash	Cash that has not been posted as collateral

Related information

Headnotes

funds of hedge funds, hedge funds, International Organization of Securities Commissions, IOSCO, single-manager hedge funds, survey

Class order

[CO 12/749] *Relief from the shorter PDS regime*

Report

REP 370 *The Australian hedge funds sector and systemic risk*

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