

Hedge funds that stay liquid, stay alive

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By Kevin Plumberg

HONG KONG (Reuters) - The heat is on hedge funds to outperform markets and prove their worth to skeptical investors, and to do so requires strategies based on riding out spikes in volatility, seeking liquidity and deft trading.

Returns this year will, of course, not be what they were in the over-leveraged days before the financial crisis, but convictions on one's investment strategies and asset allocation will help the best and brightest funds survive, industry experts told the Reuters Private Equity and Hedge Funds Summit.

The strategies expected to do well include commodity trading advisors' managed futures accounts because they can perform well in times of heightened volatility. Funds that focus on macroeconomic developments were also seen outperforming other strategies given the tremendous changes in policy affecting markets globally and risks of both deflation and inflation.

"CTA managed futures will be an outperforming strategy globally. It must be a part of asset allocation given the volatility that may persist in the market. We believe that having a portion of it in the portfolio can dampen volatility," said Raymond Chan, executive director of Asian investment solutions for Julius Baer in Hong Kong.

Chan, who oversees fund of funds products for high net worth clients, also said long/short currency strategies will continue to perform well this year, because the correlation with the MSCI all-country world index is very low.

Low correlations remain a hot selling point for investors after the violent deleveraging last year that essentially left funds selling into falling markets as all correlations essentially moved to one.

Of course, even though investors or experts believe a strategy might be hot they may not necessarily pour money into it. Distressed debt strategies have been all the rage, according to polls of investors.

However, Tom Holland, director of Cube Capital in Hong Kong, which specializes in debt opportunities in China, said while redemptions have stabilized recently, capital raising has been difficult -- in spite of annualized returns since 2006 of 12 percent in a non-performing loan fund.

CTA and macro funds are en vogue now.

"People really don't want to tie their money up for one year with a relatively esoteric, China-specific strategy," Holland said.

LEVERAGE OUT, CONSISTENCY IN

Three-month returns to February on the Credit Suisse/Tremont global macro index, one of many benchmarks of hedge fund strategies, were 3.69 percent

compared with 0.17 percent on the aggregate index. The managed futures index was up 1.69 percent, while the multi-strategy index rose 1.64 percent.

It was no secret that strategies expected not to do well in 2009 are merger arbitrage, event-driven and market neutral -- approaches that either could be upended by volatility or depend on borrowing to enhance returns.

"A lot of strategies that seemed like sensible ones just aren't sensible any longer, particularly those that are predicated on leverage. Even if leverage is available I think clients will not be searching for those kinds of things," said Ronald O'Hanley, president and CEO of BNY Mellon Asset Management, a unit of Bank of New York Mellon.

BNY Mellon Asset Management has about \$1 trillion in assets under management.

Nearly half of all respondents to a Deutsche Bank alternative investment survey said they would increase allocations to global macro strategies in 2009, up from 21 percent in 2008.

About a third of investors polled said they planned to raise allocations of CTA strategies this year, roughly stable with the 28 percent last year.

Distressed asset strategies actually had the most investors who said they planned to increase exposure, with 41 percent of respondents saying they would, compared with only 7 percent who said they would reduce allocations.

Christophe Lee, director and chairman of the Alternative Investment Management Association in Hong Kong, agreed that CTA and macro strategies would be very popular this year, since investors want to stick with what's liquid and relatively transparent in the current environment.

Gone are the days of exotic instruments, complex hedges and big bets in illiquid securities. Now is the time for small and focused trades in liquid markets that may reap small but consistent gains.

"Markets afford you the opportunity to be more plain vanilla," he said.

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