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Institutional investors to drive secondary hedge fund market

Opalesque Industry Update

Sovereign wealth funds, pension funds and **family offices** are allocating increasingly large **tranches** of capital to illiquid **hedge funds** in the search for high-yielding long-term investment solutions, says Florian de Sigy, CEO and founder of specialist **brokerage** and advisory firm Gamma Finance.

"Whilst there's a lot of attention being paid to liquid hedge fund strategies, we are also seeing allocations to dedicated portfolios of illiquid hedge funds," says de Sigy. "Over the past 12 months, we have been working with a number of large-scale, long-term investors who have been allocating tranches of $250 million to $500 million to illiquid hedge fund portfolios. Many are now returning for a second tranche at similar levels."

According to de Sigy, this trend has been facilitated by a shift in attitudes to illiquid hedge funds. "In the past, particularly in the immediate post-crisis period, there was a bit of a stigma attached to either owning or running illiquids, but with the realisation that most investors and hedge fund managers have illiquids on their books, this has changed and many investors are looking at this sector as an opportunity."

The current market conditions and regulatory environment are also impacting on the **secondary** market. "One of the key things we do is help buyers and sellers understand better the real value of an illiquid fund," says Ben Keefe, director of Gamma Finance's investment advisory business. "Hence, if a bid comes in at a substantial discount, because we have the ability to do a detailed analysis of the fund's holdings, we can give an assessment of whether or not the bid represents good value against what can actually be realised from the underlying assets."

Keefe adds "equally, we are working with investors to identify good long-term buying opportunities. The brokerage business can then help the buyer find a seller."

"Illiquids look attractive for investors who want high yield, and given the low yields available from traditional assets at present, illiquid hedge funds look particularly attractive to investors with a sufficiently long-term investment horizon", says de Sigy. "They are also a good match for **pension funds** against long-term liabilities," Regulatory changes such as Basel 3 and Solvency 2 are also changing the landscape for the secondary market. “These regulations make it much more expensive for insurance companies and banks to hold illiquid investments on their books because of the increased need for capital adequacy. In many ways this is counter-intuitive as it is often the banks and insurers who need the long-term yield profile that illiquids can offer,” comments de Sigy.

“Its probably too early to be absolutely certain, but based on current trends we can see illiquid hedge funds emerging as an asset class in their own right,” adds de Sigy. “The market is still at a very nascent stage – often the time when the best rewards are to be gained – and traditional measures of activity do not necessarily give a clear view of what is happening underneath – often giving conflicting indicators month on month. Nevertheless, the trend to institutional investors building specialist portfolios of illiquid hedge funds is fairly clear. Current levels of dedicated investment are around the $3 billion mark, and that could easily double in the next year.”