Lim Hng Kiang: What's next for hedge funds?

Keynote address by Mr Lim Hng Kiang, Minister for Trade and Industry and Deputy Chairman of the Monetary Authority of Singapore, at the SkyBridge Alternative (SALT) Conference, Marina Bay Sands, 17 October 2012.

* * *

Mr Anthony Scaramucci, Managing Partner, SkyBridge Capital

Distinguished guests, ladies and gentlemen.

A very good morning to all of you. I am very pleased to join you at the inaugural Asian leg of the SALT conference.

Global outlook

As we move into the last quarter of 2012, the world economic outlook remains uncertain. Advanced economies continue to encounter headwinds as deleveraging, fiscal consolidation and a still-weak financial system act as a drag on growth.

With US and Europe facing economic difficulties, Asia will not be immune to a global slowdown given its heavy reliance on trade. This can be seen by Asia's slowing growth in the last two quarters as weak demand in the G3, especially the Eurozone, exerted a sharp drag on exports from the region.[1]

The IMF has recently revised its growth estimates downwards. Global growth is now expected to be 3.3% in 2012 and 3.6% in 2013.[2] However, this is dependent on the assumption that there will be sufficient policy action to ease financial conditions globally and that recent policy easing moves in emerging market economies will gain traction. Overall, global growth is expected to remain muted for an extended period.

Impact of macro conditions on the global hedge fund industry

The macro economic environment has left global institutions, including hedge funds, grappling with historically low interest rates, volatile financial markets, and an environment that has grown averse to risk taking. As hedge funds cope with a more demanding operating and economic environment, the industry will have to deal with two key challenges.

Firstly, soft returns amidst the volatile environment. The average hedge fund returns across strategies was negative 4.6% in 2011, with most of the losses occurring in 3Q 2011 when global equities declined by around 17%.[3] Whilst hedge fund performance this year-to-date as at end-August 2012 was up 3.8%[3], the outlook remains uncertain and I think hedge funds may struggle to provide consistent returns over time.

Secondly, a more challenging fund-raising environment. Business and compliance costs have increased due to more stringent manager selection criteria by investors and enhanced global regulatory standards. As a result, funding gestation periods have lengthened and failure rates have increased. Hedge funds now require larger assets under management to breakeven and remain economically viable. Managers without a strong track record will be in for a hard time. Against this backdrop, some consolidation of the global hedge fund industry is to be expected.

---

[1] MAS: Recent Economic Developments in Singapore – Sep 2012

[2] IMF: World Economic Outlook, October 2012.

[3] Hennessee Hedge Fund Indices.

Long term prospects for the hedge fund industry remains positive

Nonetheless, if we look beyond the immediate economic challenges, the long term prospects for the alternative investment industry remain positive.

A number of studies have identified a growing interest from institutional investors for yields in the alternative space. In the 2012 Towers Watson Global Pension Asset Study, asset allocation to alternatives in the seven largest pension fund markets has increased from 5% in 1995 to 20% in 2011. In another recent study, McKinsey estimates that global alternative investments across the retail and institutional segments doubled in assets under management between 2005 and 2011, to reach US$6.5 trillion. This represents a compound annual growth rate of 14% over this period, exceeding the growth of the traditional asset classes.

Specifically in the hedge fund space, institutional investors have increased allocations to hedge funds significantly over the last decade, from only US$125 billion in 2002 to approximately US$1.5 trillion as of end 2011. Looking forward, institutional investors in the major markets have indicated their intent to increase allocations to almost all alternative classes, including hedge funds. Increased institutional participation will drive growth as hedge funds become an important part of the investment landscape.

To meet the demands of institutional investors and global regulatory standards, hedge funds have taken steps to beef up their risk management and compliance functions. In a recent study by the Managed Funds Association, BNY Mellon and Hedgemark,[4] it was found that 79% of global hedge funds now separate the roles of the risk manager and fund manager, with 60% of the larger hedge funds having a dedicated risk management function. This augurs well for the hedge fund industry, as it allows the industry to grow in a more sustainable manner with strong internal control systems and risk management oversight.

Asia is well placed to provide capital and investment opportunities

As global institutions and investors seek to address challenges resulting from structural shifts in the global economy, many are turning to Asia to harness opportunities and to generate higher returns. This is due to a few reasons.

Firstly, Asia has been leading the global recovery with growth expectations in developing Asia projected to exceed global growth at 6.7% in 2012 and 7.2% in 2013.[5]

Secondly, both demand and supply side factors in Asia are relatively positive. Corporate and government balance sheets are generally healthy. Households are not overly levered, savings rates are high and unemployment is comparatively low. The rising middle class, highly educated workforce and favourable demographics are also plus points for Asia. These factors, coupled with Asia's strong commitment to economic openness and free trade, are important in creating a business friendly and conducive environment for its financial sector to continue to thrive and grow.

Thirdly, with Asia's relatively strong economic growth and favourable demographics, investible assets from the institutional and private wealth segments are set to grow. In a 2011 report published by Cerulli Associates, institutional investable assets from Asia ex-Japan are expected to triple from US$4.3 trillion in 2006 to US$13.6 trillion by 2015. Total wealth from the private wealth segment is also expected to increase. In its recent Wealth Report,[6] Julius Baer expects the number of high net worth individuals in Asia to more than double over the

---

[4] Risk Roadmap: Hedge Funds and Investors' Evolving Approach to Risk (2012).

[5] IMF: World Economic Outlook, October 2012.

[6] Julius Baer Wealth Report 2012.

next three years to almost 3 million. As Asia grows in wealth, there will be more capital requiring active and customised fund management expertise to take advantage of the investment opportunities in Asia.

Asia's strong fundamentals will support the valuations of Asian assets, which will draw a growing interest from institutional investors around the world looking to diversify and generate returns. According to Preqin,[7] 46% of Asia-Pacific hedge fund investors intend to invest opportunistically in Asia-Pacific hedge funds, whilst 31% of Asia-Pacific hedge fund investors are looking to increase their longer-term allocations to Asia-Pacific. Deutsche Bank also noted in its 2012 Alternative Investment Survey that North America and Asia are currently the most sought after investment regions, with investors planning to allocate approximately 26% of assets to Asia.

Conclusion

As a source as well as a destination for investments, Asia presents compelling prospects for the hedge fund industry. Singapore's strategic location makes us well-placed to serve as a hub with strong physical connectivity, trade and financial linkages to the rest of Asia. Together with our strong commitment to growing a well-regulated fund management industry, this makes Singapore an ideal vantage point for asset managers to understand Asia and to manage pan-Asian investments.

So it leaves me now to congratulate SALT on its inaugural Asian leg of the SALT Conference. I wish all of you a fruitful conference ahead. Thank you.

[7] Preqin/Global ARC Study of Asian Institutional Hedge Fund Investments 2012