UCITS Alternative Index Trend Survey

March 2013

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1. Executive Summary

The first section of our latest UCITS Alternative Index Trends Survey provides an analysis of the latest investment trends in the UCITS alternative funds space. The results show that more than two thirds of respondents expect assets managed in UCITS absolute return funds to increase in the first half of 2013. In term of strategies, survey participants intend to increase their allocation to Emerging Markets, Event Driven and Long/Short Equity strategies. The only strategy where respondents expect to decrease their allocation is Fixed Income.

The second section of the Survey focuses on the relationship between the institutional investor community and UCITS alternative funds. The survey reveals that while three out of four respondents believe that UCITS alternative funds represent an interesting investment proposal to institutional investors, their disappointing performance over recent years, coupled with the limited investment universe, are preventing investors from investing in these funds. Liquidity and regulatory oversight are ranked among the main benefits of UCITS alternative funds for this investor category.

The survey also shows that better performance and increase in investor appetite for absolute return strategies are the most important factors for a growth in allocation to UCITS alternative funds. The survey highlights that investment consultants are perceived to be behind the curve when it comes to advising their clients with regards to UCITS absolute return funds.

When asked about the changes necessary in order to make UCITS alternative funds more interesting to institutional investors, respondents cite education, lower cost and better visibility with regards to the UCITS regulatory framework as the most important issues. The UCITS Alternative Index Trends Survey was conducted in mid-December 2012 and is based on answers from 52 participants from across the alternative investments industry[1].

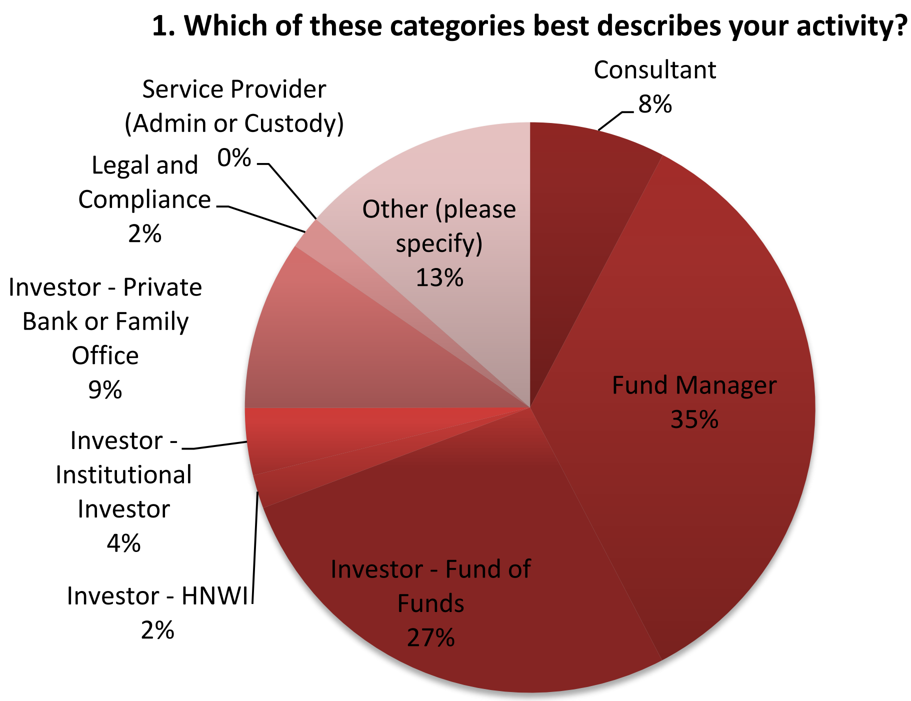
Louis Zanolin, CAIA

CEO, Alix Capital

[1] Breakdown of participants is presented on page 3

2. Participants Profile

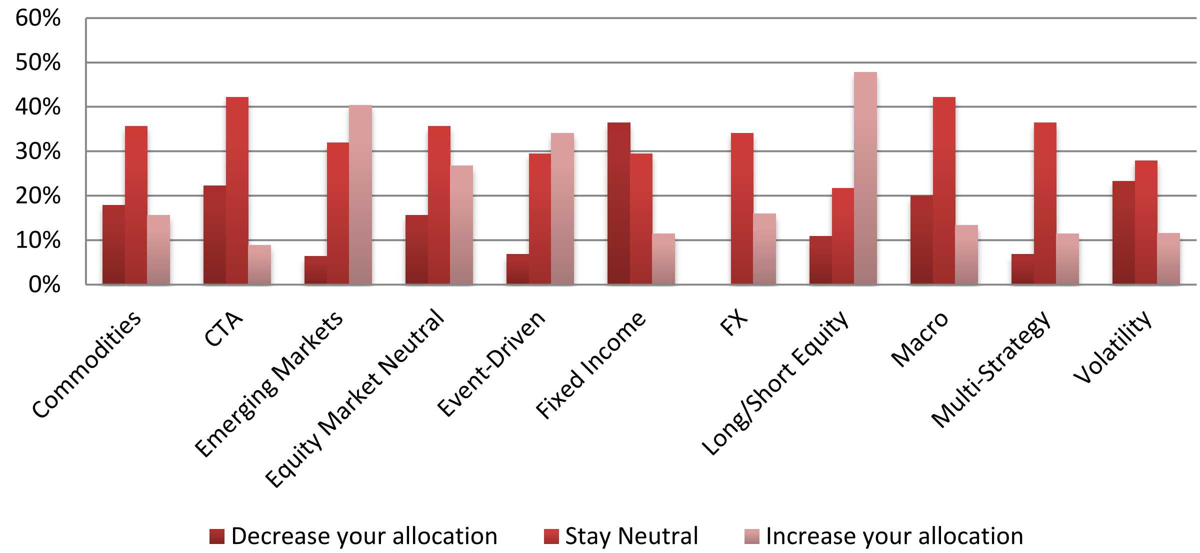
Figure 1 below provides an overview of the profile of respondents. Investors represent the largest group of respondent at 42%. Fund of Funds are by far the largest type of investors, followed by Private Banks and Family Offices. Fund Managers follow with 35%. Consultants represent 8% while Legal and Compliance make up 2%.



3. Future Allocation Trends

In this section, participants are asked which strategies they are likely to allocate to and whether they will be increasing, decreasing or maintaining their allocation in the second half of the year.

2. In the first half of 2013 for each of these strategies, what is your investment intention?



The survey shows that respondents intend to increase their allocation in Emerging Markets, Event-Driven and Long/Short Equity strategies with the latter displaying the strongest intention to increase. After experiencing the largest inflows in 2012 (over EUR 13.2 billion), Fixed Income is expected to record the largest outflows during the first six months of 2013.

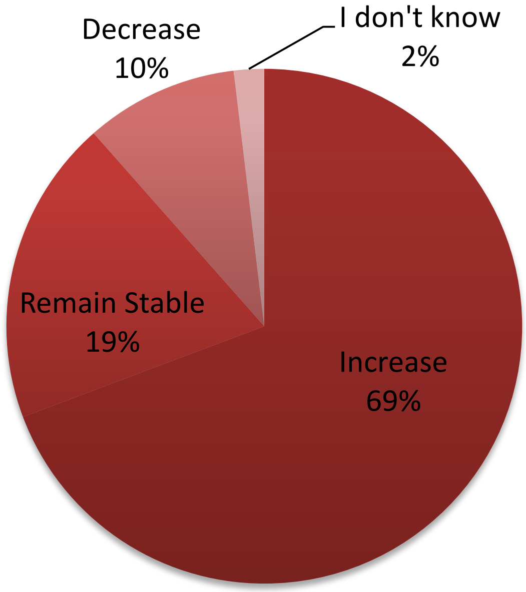
	2011 H2	2012 H1	2012 H2	2013 H1
Commodities	→	→	→	→
CTA	↑	↑	→	→
Emerging Markets	↓	→	→	↑
Equity Market Neutral	↑	↑	↑	→
Event-Driven	↑	→	→	↑
Fixed Income	↓	→	→	↓
FX	↓	→	→	→
L/S Equity	↑	→	→	↑
Macro	↓	→	↑	→
Multi-Strategy	→	→	→	→
Volatility	N/A	↑	↑	→

Interestingly, it is the first time since summer 2011 that Fixed Income funds record a decrease in allocation intention. Similarly, it is also the first time that Long/Short Equity shows signs of growing investor's interest. This demonstrates a bullish sentiment among investors who seem to be positive on equity and negative on fixed income strategies.

For the first time since the launch of the UAI Industry Trends Surveys in 2011, participants indicated their intention to increase their allocation to Emerging Markets. This can also be interpreted as a positive market signal among the UCITS investor community.

The next question asked investor's opinion on future asset flows in UCITS alternative funds.

Fig 3. Do you expect that in the first half of 2013, the total assets under management in UCITS alternative funds will:



The results show that 69% of the respondents expect the total assets under management in UCITS alternative funds to grow in the first half of 2013. Less than 10% of participants believe assets will decrease, with the remainder expecting assets to remain stable.

The portion of participants who declared their intention to increase their allocation in UCITS alternative funds is at its highest level since 2011, another positive sign for the industry. Over the last three years investment intentions recorded in the UAI Industry Trends Surveys have accurately reflected the resulting growth in assets in the UCITS alternative funds space. In 2012 the total assets managed in UCITS alternative increased by 16.4% to reach EUR 143 billion at the end of 2012[2], reaching its highest historical level.

[2] Source : UCITS Alternative Index Quarterly Industry Report Q4 2012, www.ucits-alternative.com

4. Institutional Investors and UCITS Alternative Funds

The UCITS framework was first implemented in 1985 to provide a harmonized mutual fund structure across Europe. While originally designed for the retail market, UCITS funds rapidly attracted interest from institutional investors who found the more stringent regulation and investor protection offered by the framework appealing.

However, for UCITS alternative funds the picture is different. The strong growth of assets under management experienced during the last four years can only marginally be attributed to institutional investors.

The survey provides insights on how market participants view the evolution of the institutional investor community within the alternative UCITS world. It also analyzes how the harmonized framework is perceived among this investor group and the reasons why they have been slow to adopt it. Finally, the survey discusses the key drivers of the future growth and tackles the role of the investment consultants.

Participants were first asked whether UCITS alternative funds represent a valuable investment proposal for institutional investors.

Fig 4. While originally designed for retails clients, do you think that UCITS alternative funds offer an interesting investment proposal for institutional clients such as pension funds and insurers?

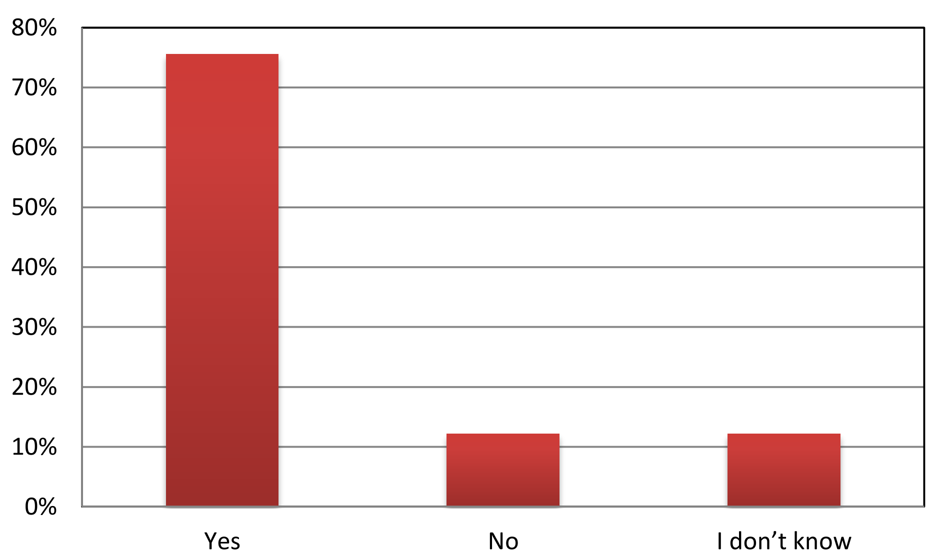


Figure 4 shows that for the vast majority of participants- almost three quarters agree that UCITS alternative funds offer an interesting investment proposal to institutional investors. UCITS funds allow access to absolute return strategies in a regulated, transparent and a liquid manner. As such, for some investors, they are often the only way to gain access to absolute return strategies.

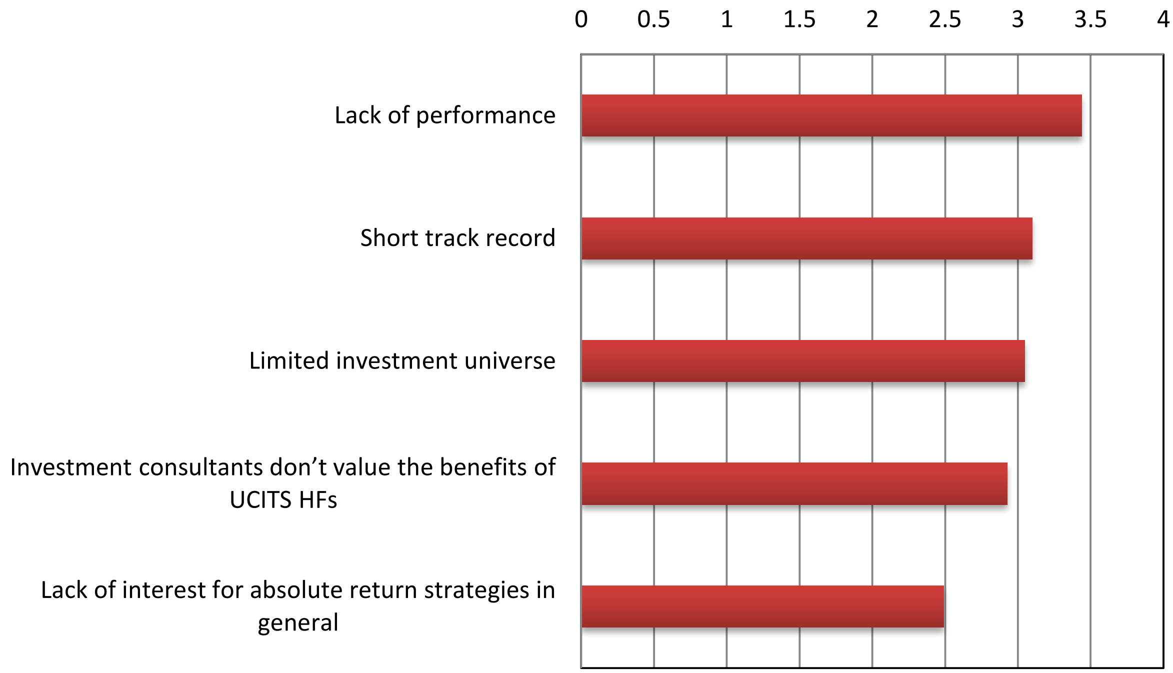
For others, UCITS alternative funds are appealing as they are regarded as long only investments from a regulatory perspective. It allows investors the opportunity to allocate to funds using a long/short strategy while not having to utilise their “alternatives” allocation thus permitting a higher allocation to absolute return strategies or enabling them to use their alternative allocation for other less liquid asset classes, such as private equity.

In terms of drawbacks, participants point out that the level of constraints and the total cost are too high. A significant number of respondents mentioned that potential issues might arise from the generous liquidity terms offered by some providers, notably in credit strategies. Others stated that the level of liquidity offered to investors might not permit UCITS funds to benefit from illiquidity premiums, making them unsuited for absolute return or hedge fund strategies.

Other respondents recognize that the AIFM Directive might lower the appeal of UCITS alternative funds among institutional investors.

Participants were asked to comment on the reasons why the institutional community has been slow to allocate money to UCITS alternative funds.

Fig 5. Why has the institutional investor community been slow to allocate money to UCITS alternative funds:



The most common reason given for a lack of investor interest in UCITS, is disappointing performance. This is closely followed by limited investment universe, short track record and the lack of interest in these types of products among investment consultants. With the exception of the depth of the universe, the results show that the low penetration rate is mainly due to weak performance rather than structural issues. We can therefore expect a change in attitude once performance is back on track.

The short track record of UCITS alternative funds is the second most common reason provided to explain why institutional investors are slow to allocate in UCITS.

The third most common reason stated is the limited investment universe. Interestingly, it seems that despite roughly 900 UCITS alternative funds and funds of funds being available[3] the choice is still viewed as too limited for institutional investors. Given the industry growth rate, it is therefore only a matter of time before they will start to consider it seriously.

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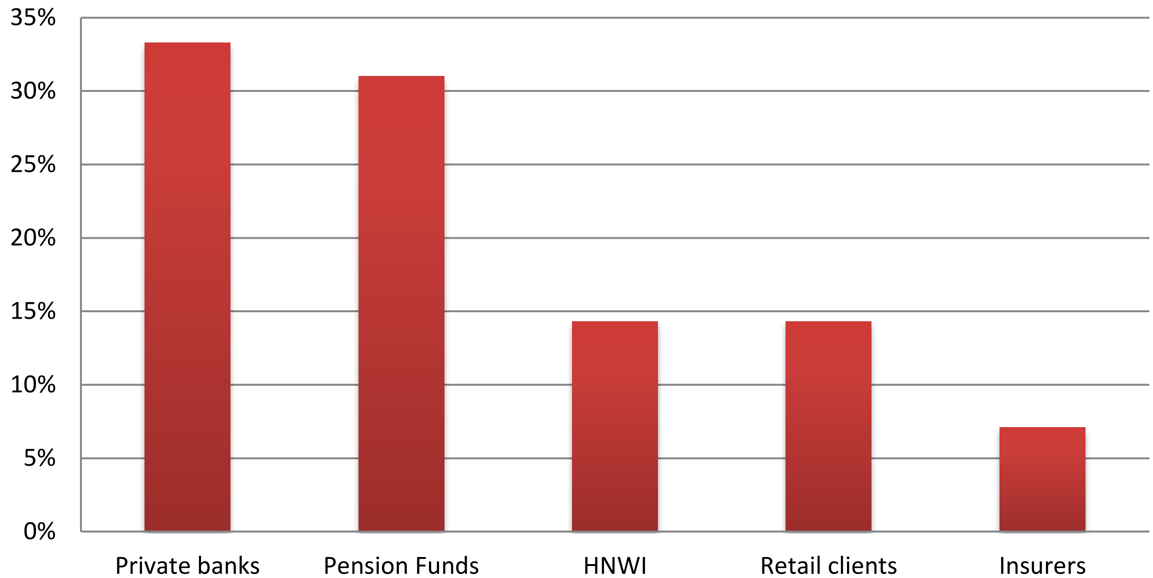
[3] As monitored by the UCITS Alternative Index, more details on www.ucits-alternative.com

Question number 6 asked which of the main investor groups is expected to drive inflows in the next two years.

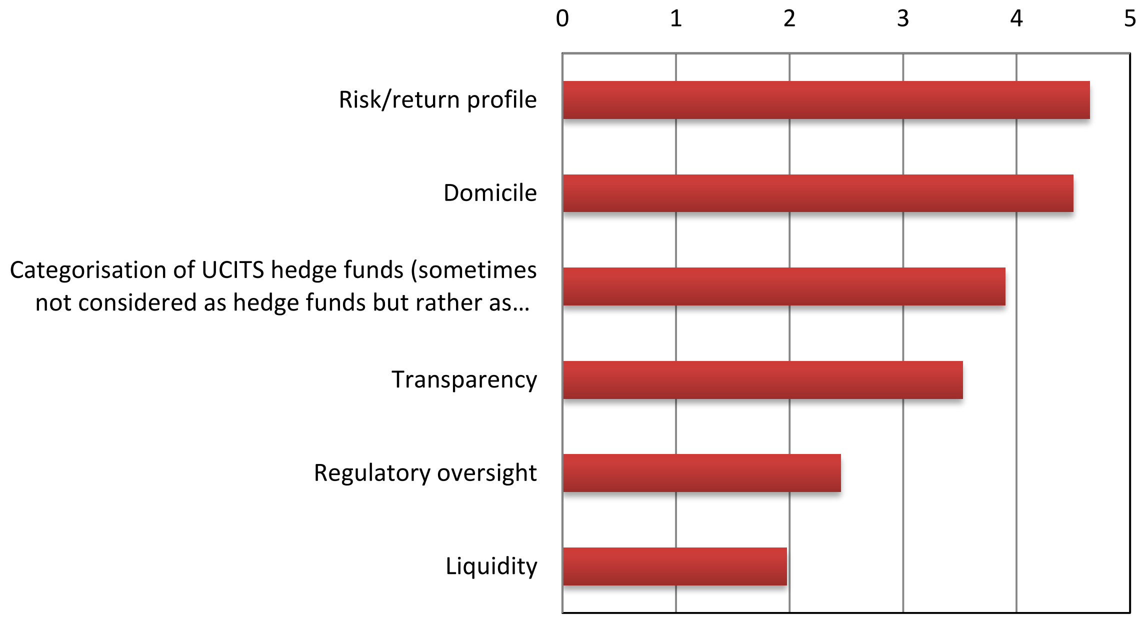
Fig. 6. In your view which of the following investor groups will be the most important driver of capital inflow in UCITS alternative funds in the next two years:



Participants believe that private banks and pension funds are the two groups of investors that will drive inflows into the alternative UCITS sector. They are followed by high net worth individuals and retails clients. Only 7% think that insurers will be an important driver of capital in UCITS alternative funds over the next two years. This small percentage is surprising as the enforcement of directives such as Solvency II, should be beneficial for UCITS alternative funds as they allow insurers to effectively manage capital ratios.

In the following question participants were asked to indicate the main benefits of UCITS alternative funds for institutional investors.

Fig 7. From an institutional investor perspective, what are the main benefits of UCITS alternative funds :



The results show that the main advantage of UCITS alternatives funds, even among institutional investors, is believed to be the liquidity.

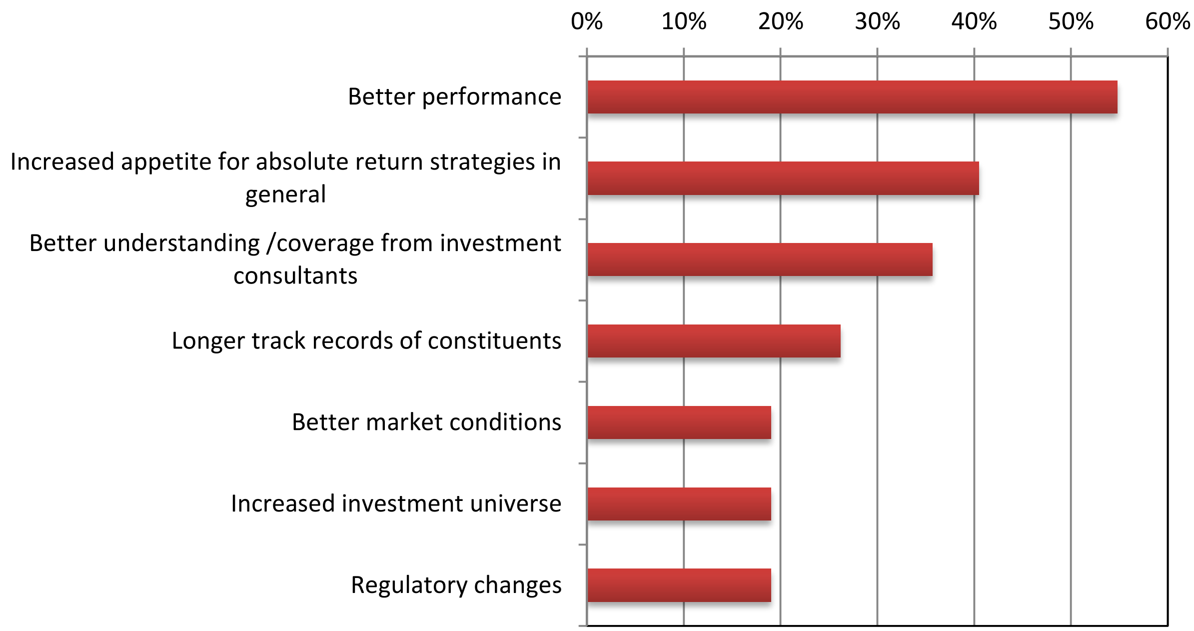
In second position comes the regulatory oversight. Institutional investors pay close attention to this aspect. For them the increased responsibility of the various counterparties such as administrators, custodians and management companies is a clear advantage compared to offshore funds. Clear responsibility attributed to each party involved in the management process is more often becoming a prerequisite when selecting a product.

Transparency is in third place. This is considered to be not only paramount, but also part of the fiduciary duty for this investor group.

The fact that UCITS alternative funds are in certain circumstances not considered as "alternative" is not seen an important benefit, neither is the risk/return profile seen as a strong advantage. This last point is interesting as it somehow suggests that institutional investors do not believe that UCITS alternative funds offer an attractive risk return profile. Academic research has demonstrated that the underperformance of UCITS funds versus offshore funds is negligible for strategies which can be fully replicable in UCITS. This highlights the need for further communication and education to be carried out by UCITS providers to clarify whether a particular UCITS fund is expected to underperform its offshore counterpart and if so, why. They should also emphasise the absolute performance of UCITS and not systematically put forward other UCITS characteristics, such as better oversight and liquidity.

The following question focused on the elements that will be crucial for a stronger adoption of UCITS as an interesting framework for alternative investment.

Fig 8. What will be the trigger for an increase in allocation towards UCITS alternative funds from institutional investors?



More than 50% of the respondents believe that the main trigger will be performance. The recent returns have not been strong enough and so if performance improves, institutional assets should flow into UCITS alternative funds.

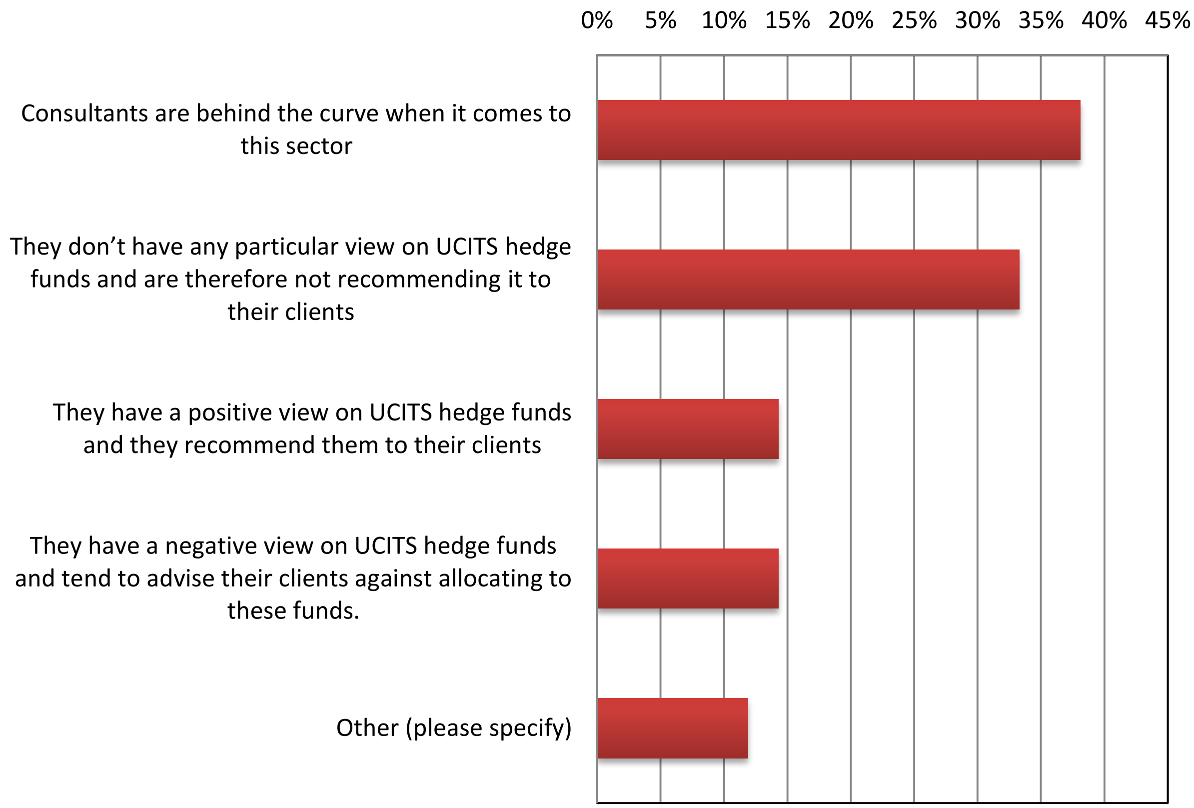
An increased appetite for absolute return strategies in general is the second most popular trigger. Despite the fact that most investors understand the benefits of absolute return strategies, only a limited number of them allocate significantly to these strategies.

The third most important aspect is linked to the role of the investment consultants. More than four out of ten respondents believe that the further allocation to UCITS alternatives by institutional investors is dependent on better coverage and understanding of this universe by investment consultants.

Finally, issues such as better market conditions, length of track record or a larger investment universe are not categorized as being significant triggers for increased allocation in UCITS alternative funds by institutional investors.

The next question focused on the perception of UCITS alternative funds among the investment consultant community.

9. What is the perception of UCITS alternative funds among the investment consultant community?



As seen in the previous question, the majority of participants believe that the limited interest in UCITS alternative funds among the investment consultants community is mainly due to their lack of understanding and awareness.

38% of respondents believe that the investment consultants are simply not up to date when it comes to UCITS absolute return funds. This could be due to the fact that their analysis tends to be based on quantitative aspects and that UCITS absolute return funds' track records are generally too short to perform such analysis over the time period which consultants require.

One third of respondents believe that investment consultants don't have any particular view on the UCITS alternative space and therefore tend not to recommend it to their clients. This is a clear sign than UCITS absolute return funds providers should increase their communication and provide more information to consultants. They should also put in place dedicated educational campaigns for the investment consultant community. Furthermore, some participants illustrate that the lack of interest from investment consultants in is due to their goal being to avoid making big mistakes, rather than to provide clients with the best recommendations. Misconceptions could be wrongly preventing consultants from recommending alternative UCITS funds.

10. What should product providers/regulators change to make alternative UCITS more attractive to institutional investors?

The goal of this question was to ask what participants believe should be done for alternative UCITS funds to become more attractive for the institutional investor community.

The answers were mainly linked to the perception of UCITS alternative funds and the need for improvement. The method suggested to achieve this goal varies depending on the participants. For some UCITS should be moved away from retail investors and its regulation should be made more flexible. This could be achieved by reconsidering some risk limits to allow more strategies to be run under the UCITS framework.

Other participants think the exact opposite; believing that all potential risks that could impact the UCITS brand should be removed. They feel that ESMAs should be stricter, with strategies that try to work around the UCITS rules by using complex replication structures. Some respondents also mention that regulators should stop creating uncertainty around the UCITS rules and come out with a clear endorsement of UCITS alternative funds.

Another popular answer relates to the cost issues of UCITS funds. While question 10 does not differentiate between operational and organizational costs or investment management charges, it is clear for a significant number of participants that lower cost would make UCITS more attractive to institutional investors.

The issue of eligible instruments and more notably commodity investment is also recurrent. For a number of participants the eligibility of commodities would make UCITS much more appealing to institutional investors. Similarly, the question of UCITS index eligibility and their replication via total return swaps is also mentioned, despite the recent changes introduced by ESMA. Other are convinced that the framework should be kept as it now but that transparency should be improved and the benefits of alternative investments should be better explained.

5. Conclusion

The survey shows that there is still a lot that needs to be done in order to address intuitional investors current perception of UCITS alternative funds and to increase the use of these funds as part of their investment portfolio.

Institutional investors still appear to base their understanding on old beliefs such as the lack or performance potential and the inability to accommodate absolute return strategies effectively. With this in mind, there are still many improvements that need to be made to change the perception of UCITS as a competitive framework for these types of strategies.

Part of the educational process will come from the investment consultant community. The results of the survey confirm the general impression that investment consultants are not familiar or up to date with the world of UCITS alternative funds or with the benefits that they can offer institutional investors.

Despite strong growth, UCITS funds employing absolute return strategies will only become properly established when fully endorsed by the institutional investor community. As one of the participant points out: “the increase of interest among institutional investors is just a matter of time and one should let the market mature.”

6. About UCITS Alternative Index

With over 870 constituent funds as of February 2013 totaling EUR 143 billion assets under management, the UCITS Alternative Index series are the industry's leading benchmarks for the UCITS alternative universe. The UCITS Alternative Index family is currently composed of 27 different benchmarks tracking the returns of both global and strategy specific UCITS alternative funds.

The performance of the various UCITS Alternative Indices is accessible on the UCITS Alternative Index website. UCITS Alternative Index is a registered trademark. Alix Capital is the exclusive Index Provider to the UCITS Alternative Index. www.ucits-alternative.com.

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