Content Includes:

Preqin Special Report: Activist Hedge Funds

June 2014

Performance of Activist Hedge Funds

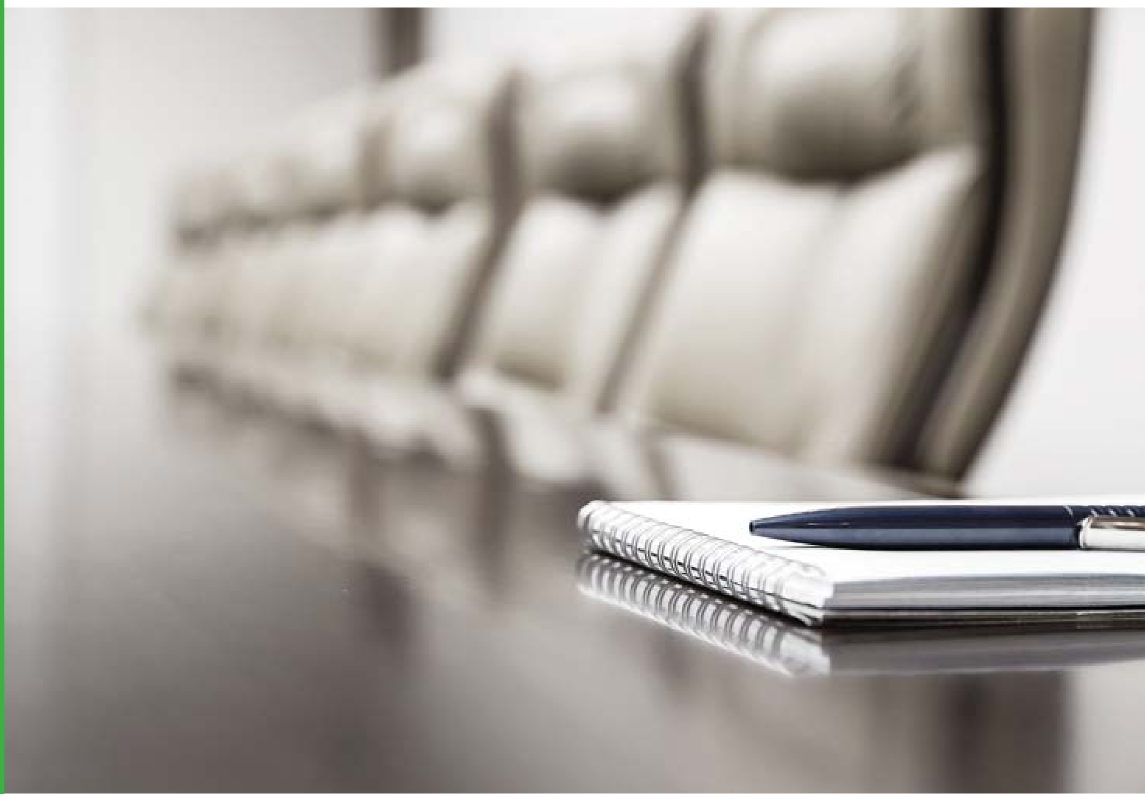
How have activist hedge funds performed in recent years and does this vary by geographic focus? How does their volatility compare to other hedge funds? We explore the answers to these key questions.

Activist Hedge Funds

We examine the activist hedge fund industry, including the most prominent activist funds, where activist funds are investing and how their fund terms differ from other hedge fund vehicles.

Institutional Investors in Activist Hedge Funds

We take a look at investors with a preference for committing to activist hedge funds, including the methods they use when committing to these vehicles.



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Foreword

Hedge funds using shareholder activism as a method of investment have been a big talking point in the industry in recent years. These funds appear to be growing in terms of both numbers and size, with Preqin data indicating that activist hedge funds now account for more than $100bn in combined assets under management. Activism is becoming a more widely utilized approach and this is leading to more hedge fund managers seeing viable opportunities for investment in this area; there were 28 new hedge funds with an activist approach launched in 2013, representing the highest number of activist fund launches since 2007.

Activist hedge funds have performed well in recent years when compared to the overall hedge fund benchmark, posting superior returns to hedge funds as a whole on an annualized basis over the past five years. However, there is an increased volatility associated with this outperformance, and this means that the returns of activist hedge funds fall short of the asset class as a whole when considered on a risk-adjusted basis. This means that the strategy is seen in some quarters as a risky approach, and this may be one reason why activist hedge funds have yet to gain widespread appeal to institutional investors globally. The strategy is most prominent within the US, and the vast majority (90%) of known institutional investors in activist funds are based in North America.

Activist hedge funds have been growing in prominence over the past year and will remain a strategy to watch over the next few years. It will be interesting to see if this trend continues and also whether or not this approach becomes more widespread globally in the future. This report analyzes the current market for activist hedge funds using data from Preqin's **Hedge Fund Online** service, which includes **Hedge Fund Analyst** and **Hedge Fund Investor Profiles**.

We hope you find this report useful, and welcome any feedback you may have. For more information, please visit www.preqin.com or contact info@preqin.com.

Key Facts

$15.6bn Assets under management of the largest activist hedge fund, Elliott International.

0.52 Three-year Sharpe ratio (RFR = 2%) for activist hedge funds as of 30 April 2014 (0.77 for all hedge funds).

66% Proportion of activist hedge funds headquartered in North America.

16.98% 12-month returns for activist funds focused on North America as of 30 April 2014.

2.5 Months Mean redemption frequency of an activist hedge fund (the hedge fund average is 1.7 months).

90% Proportion of institutional investors with a current preference for investing in activist hedge funds that are based in North America.

11.82% Average cumulative returns for activist hedge funds over the 12-month period ending 30 April 2014 (compared to the hedge fund average of 7.88%).

58% Proportion of all investors with a preference for activist funds investing in hedge funds solely through single-manager funds (compared to 37% of all hedge fund investors).

Data Source:

Preqin's **Hedge Fund Online** provides a comprehensive view of the hedge fund industry, including investors' plans for hedge fund investments, fund performance, fund strategies, fund managers, fund terms, and more. Preqin's Hedge Fund Online services feature:

- In-depth profiles of over **16,500 hedge funds** and **6,700 hedge fund managers**
- Detailed **performance metrics on over 8,700 hedge funds** and share classes
- Extensive information on over **4,600 active investors** in hedge funds
- Fund-by-fund and industry level **fund terms and conditions data for over 6,200 hedge funds**

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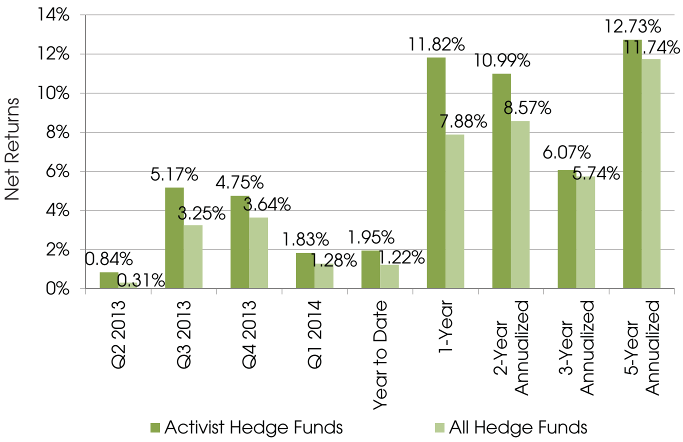
Performance of Activist Hedge Funds

Preqin's Hedge Fund Analyst tracks the performance of hedge funds seeking to provide absolute returns through shareholder activism. Activist hedge funds had a sluggish but positive start to 2014, with year-to-date returns of 1.95% (as of 30 April 2014). Despite this challenging start to the year, activists outperformed the overall hedge fund benchmark in Q1 2014 to continue their consistent quarterly outperformance of this benchmark (Fig. 1). The 12-month period ending 30 April 2014 brought an average return for activist funds of 11.82%, exceeding hedge fund returns as a whole by more than three percentage points. The majority of this return was collected in the second half of 2013 (+10.17%), and indeed this formed the most successful half-yearly return for activists since 2010. Activist hedge funds have also delivered superior returns compared to the overall hedge fund benchmark on an annualized basis over the last two, three and five years.

Perhaps intuitively, a factor in the persistent outperformance activists have cultivated in recent years is the volatility environment that these returns were achieved under (Fig. 2). The three-year volatility of returns across all hedge funds has seen a steady decrease since 2012 when the turbulence of the financial crisis drops from the statistic. Activist hedge funds have consistently exhibited significantly higher levels of volatility (8-14%) than the industry average (5-10%) over the last five years.

Putting returns in a risk-adjusted context is less favourable for activist funds, with the three-year Sharpe ratio (risk-free rate = 2%), as of 30 April 2014, being 0.52 for activists compared to 0.77 for hedge funds overall. Over the last five years, the point of maximum drawdown for both the activist and hedge fund benchmarks was reached in September 2011, with the period underwater beginning for both in May 2011. However, the nadir reached by activists was not only deeper than the overall benchmark (-12.37% compared to -7.24%) but also the time to salvage these losses was much greater – hedge funds as a whole recovered by February 2012 while activists took until December 2012.

Fig. 1: Performance of Activist Hedge Funds (As at April 2014)

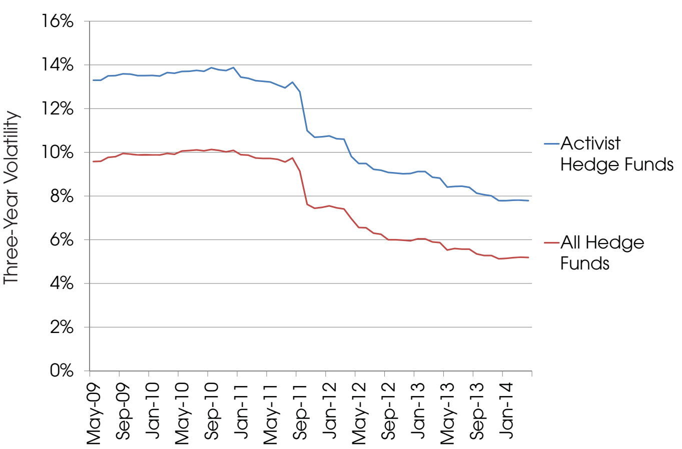


Source: Preqin Hedge Fund Analyst

Preqin also provides benchmarks of the performance of activist funds by their geographic focus (Fig. 3). Activist funds focused on Asia-Pacific made a loss of 1.97% in April 2014, ending a nine-month positive run that had led to these funds posting cumulative returns of 11.77% over the 12-month period ending 30 April 2014. This 12-month performance is significantly higher when compared to all Asia-Pacific-focused hedge funds (+7.14%) and the MSCI All Country Asia Pacific Index (-3.35%) over the same time period.

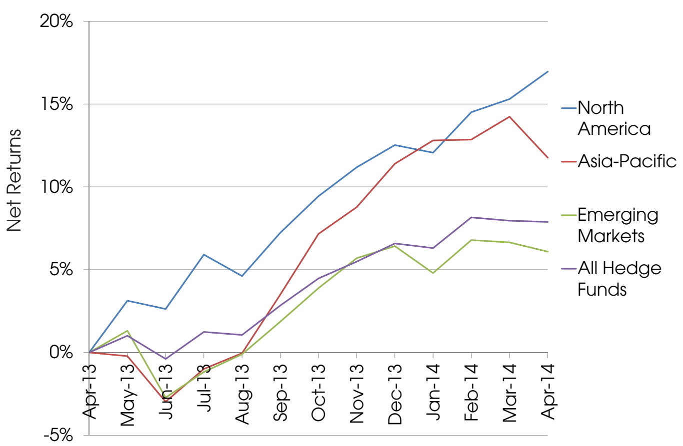
With the S&P 500 recording new highs, North American hedge funds have had rather different market conditions to negotiate over the past year. Activists focused on North America achieved higher average returns for the 12-month period ending 30 April 2014 than all hedge funds with this geographic focus (+16.98% vs. +13.61%). February was the only positive month for the emerging markets activist benchmark in the first four months of 2014, and 12-month cumulative returns of emerging markets-focused activists lagged slightly behind the regional benchmark for the asset class as a whole (+6.08% vs. +7.82%).

Fig. 2: Rolling Volatility of Activist Hedge Funds, May 2009 - April 2014



Source: Preqin Hedge Fund Analyst

Fig. 3: Cumulative Net Returns of Activist Hedge Funds by Geographic Focus, May 2013 - April 2014



Source: Preqin Hedge Fund Analyst

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Activist Hedge Funds

Activism among hedge funds emerged just over a decade ago and the level of pro-active investment strategies has varied significantly over the past 10 years. Increasingly, in the past year US-based activist hedge funds and their dealings have featured heavily in the financial press, frequently due to their hostile approach to the companies that they take stakes in. Preqin's Hedge Fund Analyst online service currently tracks more than 400 activist hedge funds and, according to Preqin data, these funds account for more than $100bn in combined assets under management.

Largest Activist Hedge Funds

Elliott International, managed by Elliott Management, is the largest activist hedge fund today, with this fund having approximately $15.6bn in assets under management (Fig. 4). Elliott Associates, the other activist hedge fund managed by Elliott Management, is the third largest, with $8.3bn in assets. Elliott Management has taken stakes in Juniper Networks, Riverbed Technology, Compuware Corp, and WM Morrison, along with a host of other companies. Cevian Capital II is the second largest activist fund, with $10bn in assets under management, and Cevian Capital closed this fund to new investment in October 2013 as it had reached capacity. Children's Investment Master Fund and Third Point Offshore Master Fund complete the top five, with these funds having $8.2bn and $6.7bn in assets respectively.

Regional Location & Focus of Activist Hedge Funds

Fig. 5 shows the regional breakdown of the headquarters of activist hedge funds. The majority of activist funds (66%) are headquartered in North America, with 15% based in Europe, 14% in Asia-Pacific and 5% in locations outside of North America, Europe and Asia-Pacific. According to Preqin data, 21% of all hedge fund managers are located in Europe; therefore, proportionately, activist hedge funds are under-represented in Europe. It is not surprising that a large proportion of activist hedge funds are based in North America, considering that activism against US-based firms has traditionally been a lot more prevalent than against companies based outside North America. Corporate activism is still fairly new throughout Europe and it appears that company directors are currently less receptive to activism as the investment culture substantially differs to that in the US.

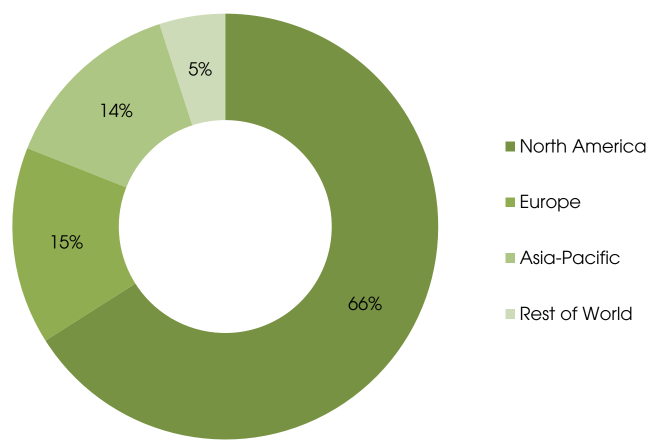
Fig. 6 shows the breakdown of activist hedge funds in terms of geographic focus. North America is the most favoured location for activist funds to invest in, with 41% of funds solely targeting this region for investment, whereas only 8% of all activist funds

Fig. 4: Largest Activist Hedge Funds by Assets under Management

Fund	Firm	Firm Location	Assets under Management ($bn)
Elliott International	Elliott Management	US	15.6
Cevian Capital II	Cevian Capital	Sweden	10.0
Elliott Associates	Elliott Management	US	8.3
Children's Investment Master Fund	The Children's Investment Fund Management	UK	8.2
Third Point Offshore Master Fund	Third Point Management	US	6.7

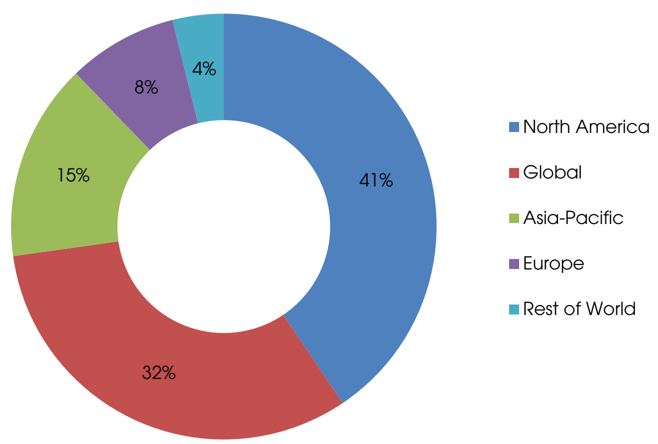
Source: Preqin Hedge Fund Analyst

Fig. 5: Breakdown of Activist Hedge Funds by Regional Headquarters



Source: Preqin Hedge Fund Analyst

Fig. 6: Breakdown of Activist Hedge Funds by Main Regional Focus

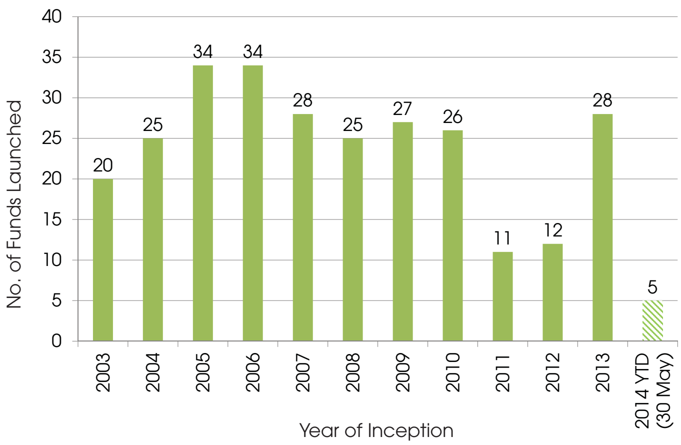


Source: Preqin Hedge Fund Analyst

are actively targeting Europe. The proportion of activist funds pursuing investments in the Asia-Pacific is 15%, while 4% of funds have a specific preference for other regions. The remaining 32% of activist funds have a more diverse regional focus and these funds take a global stance when investing.

There has recently been an increase in the amount of US-based managers taking stakes in European companies, and reports of resistance between funds and companies have reached the financial press. Activist manager Spring Owl Asset Management is involved in discussions with Bwin.Party, an online gambling firm, with reports emerging that the current board believes Spring Owl's approach has been too hostile and that the fund has little concern in creating long-term value. This suggests that activist funds will have a much tougher time influencing decisions with companies based in Europe.

Fig. 7: Activist Hedge Fund Launches by Year of Inception, 2003 - 2014 YTD (As at 30 May 2014)



Source: Preqin Hedge Fund Analyst

Activist Fund Launches

Pro-active strategies adopted by hedge fund managers have not always been so prominent, with the level of activist fund launches fluctuating over the past decade. From 2003 to 2005 the number of activist fund launches increased from 20 launches in 2003 to 34 launches in 2005 (Fig. 7). Liquidity throughout global markets prior to the financial crisis may have contributed to the increase in the level of activism. In 2008, there was a fall in the number of activist fund launches from a peak of 34 new launches in 2005 to 25 launches in 2008, and this number remained fairly consistent until 2010, with 27 launches in 2009 and 26 launches in 2010. Activist fund launches fell in 2011 and 2012, with 11 and 12 launches in these years respectively. During this period the prominence of activist funds increased and this would suggest that it was mainly established managers that were launching high-profile activist positions. This may have contributed towards the resurgence of activist hedge fund launches seen in 2013, when the number of launches increased to 28. This re-emergence of activist funds could be explained by activism becoming a more mainstream phenomenon, with more funds seeing opportunities by influencing corporate governance. As of 20 May 2014, there have been five recorded new activist fund launches in 2014.

Liquidity Terms of Activist Hedge Funds

Activist hedge funds are frequently perceived in the financial press as only being involved in companies for short-term gains. However, the data presented in Fig. 8 does not support this view and instead illustrates that activist funds are generally more long term in nature, with less liquidity than other hedge funds. Fig. 5 illustrates that the mean lock-up period for activist funds is 12 months, double that of the average lock-up period for all hedge funds. The mean redemption frequency and mean redemption notice period of activist funds are also longer, on average, than those for hedge funds overall. Activist funds have an average redemption frequency of 2.5 months and average notice period of 46 days, compared to 1.7 months and 41 days for hedge funds overall. This implies that activist funds are looking for investors that are able to commit to funds with longer lock-up periods, allowing the funds to take long-term positions in companies. This enables activist funds to realize the true potential of their activist positions.

Outlook

It will be interesting to see if hedge fund activism continues to grow during the rest of 2014 and beyond, particularly with activism among hedge funds gaining increased exposure. It appears that more fund managers are seeing the benefits of taking an active role in the governance of a firm in order to maximize their returns. It remains to be seen whether there will be a change in the regional preferences of activist funds, but with 32% of funds currently taking a global approach to investing we may see activism becoming more prominent across different regions. It may be that activist fund managers are closely observing the outcomes of investments made by their rivals in other regions before venturing into those regions themselves.

Fig. 8: Liquidity Terms: Activist Funds vs. All Hedge Funds

	Activist Hedge Funds	All Hedge Funds
Mean Redemption (Months)	2.5	1.7
Mean Redemption Notice (Days)	46	41
Mean Lock-Up (Months)	12	6

Source: Preqin Hedge Fund Analyst

Click here to download the data pack.

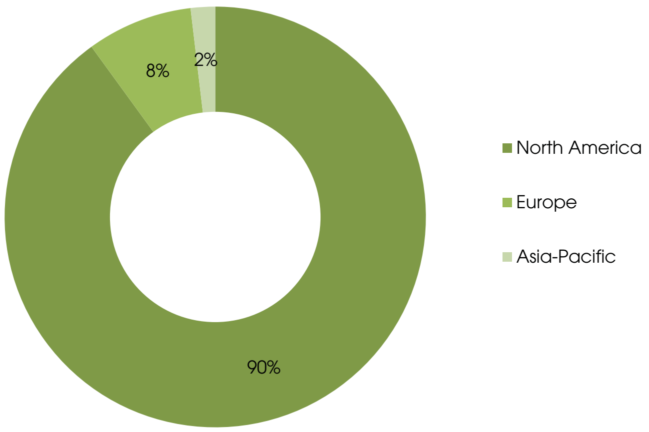
Institutional Investors in Activist Funds

Much of the appeal of investing in activist hedge funds is a result of their potential for greater returns; as shown in the performance section on page 2, activist hedge funds have outperformed the overall hedge fund benchmark in each of the past four quarters, as well as on an annualized basis over the past two, three and five years. Activist funds also allow investors to gain exposure to private equity style investments without the threat of illiquidity, which may have initially drawn investors away from committing to investment in private equity funds.

In looking at the make-up of investors that currently display a preference for investing in activist hedge funds, it appears that this strategy is yet to draw widespread appeal globally. The overwhelming majority of institutional investor interest in activist hedge funds lies with North America-based investors, with this region accounting for 90% of investors with a preference for the strategy (Fig. 9). Europe- and Asia-Pacific-based investors account for just 8% and 2% of these investors respectively. It is not atypical for US-based investors to dominate the investor pool; however, the scale of this dominance highlights the fact that funds employing an activist approach are yet to capture the attention of investors based in Europe and other regions worldwide.

In terms of the types of investors targeting activist vehicles, this is dominated by a narrow selection of investor types. Foundations, pension funds (both private sector and public) and fund of hedge funds managers account for 81% of investors with an appetite for activist strategies (Fig. 10), despite making up a significantly smaller proportion of the hedge fund investor universe as a whole (59%). One reason for the reduced presence of some of the other investor groups, such as sovereign wealth funds and asset managers, could be tied to the increased level of volatility typically associated with activist vehicles. $184bn California State Teachers' Retirement System (CalSTRS) is one notable investor in activist hedge funds; the pension fund has several investments in activist funds and made a $200mn seed investment in activist firm Legion Partners Asset Management in February 2014.

Fig. 9: Breakdown of Investors with a Preference for Activist Funds by Investor Location

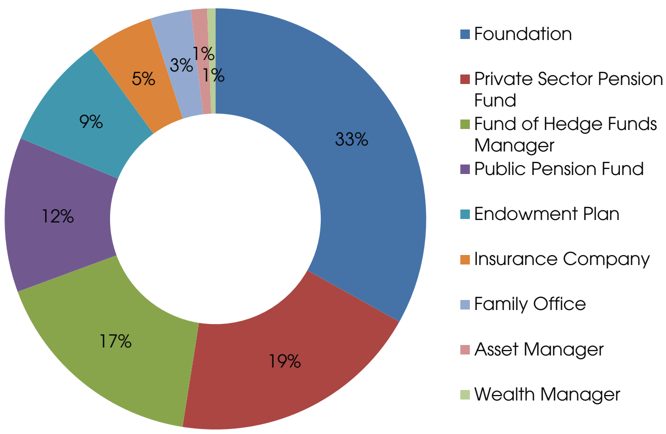


Source: Preqin Hedge Fund Investor Profiles

Interestingly, investors with a preference for investing in activist hedge funds show a much stronger preference for direct investments compared to the investor universe as a whole; just 3% of activist investors commit to hedge funds solely through funds of hedge funds, compared to 29% of all hedge fund investors (Fig. 11). Investors willing to take on the risk of investing in activist funds are likely to be more established hedge fund investors and as a result are likely to be able to have a portfolio of single-manager funds. Additionally, there are not many activist-specific funds of hedge funds, so investors looking for this type of exposure are likely to go down the direct route.

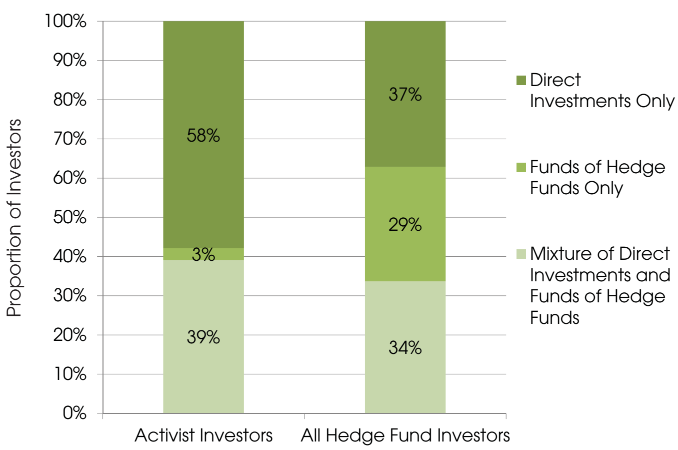
The largest fund with an activist approach, Elliott International, is also the most committed to activist hedge fund by institutional investors. The majority of investors in this fund are based in the US, with US-based investors representing 95% of all known investors in the fund.

Fig. 10: Breakdown of Investors with a Preference for Activist Funds by Investor Type



Source: Preqin Hedge Fund Investor Profiles

Fig. 11: Method of Investing in Hedge Funds: Activist Investors vs. All Hedge Fund Investors



Source: Preqin Hedge Fund Investor Profiles

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Preqin: Global Data and Intelligence

With global coverage and detailed information on all aspects of the hedge fund asset class, Preqin's industry-leading Hedge Fund Online services keep you up to date on all the latest developments across the hedge fund universe.

Source new investors for funds

Find the most relevant investors, with access to detailed profiles for institutional investors actively investing in hedge funds, including insurance companies, pension funds, family offices, foundations, wealth managers, endowment plans, banks and more.

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