

# Liquid hedge fund strategy exposure in an index format

Investors increasingly seek liquid and simple access to specific hedge fund strategies.

Nicolas Aractingi and Csaba Koppany – Equity and Funds Structured Markets at Barclays Capital – outline how the Barclays Capital Manager Access Indices help cater to this demand

Alternative investments constitute a mainstay of diversified investment portfolios for investors, ranging from high-net-worth individuals to large institutions. Despite occasional fluctuations, over a longer period of time hedge fund assets have witnessed exponential growth, reaching \$2 trillion by June 2011 (see figure 1).

However, investing in hedge funds has proven to be precarious for some investors. During the past few years, highly publicised events ranging from net-asset-value suspensions to gating or fraud by investment managers have highlighted some of the inherent risks of hedge fund investing, which had previously been ignored or, at the very least, discounted. Today, more than ever, investors place higher importance on the liquidity, transparency and mitigation of counterparty risk in their hedge fund holdings. This shift of priorities has resulted in even more thorough due diligence being carried out on investment managers and more stringent governance requirements for investment companies in general. The due-diligence process is thus lengthier than in the past. It can be further extended by the repetition of the due-diligence process for each new fund invested in the portfolio over time. The long redemption cycles of traditional hedge funds can cause further delays, making the process of portfolio (re)allocation operationally burdensome (see figure 2).

Barclays Capital has developed the Barclays Capital Manager Access Indices as a new family of investable indices that aim to address some of these issues and simplify the way investors can gain exposure to liquid hedge fund returns:

- **Direct manager exposure** – the Manager Access Indices provide access to hedge fund manager skills.
- **Enhanced liquidity** – the Manager Access Indices offer weekly or better liquidity.
- **Strategy-specific exposure** – each Manager Access Index selects funds within a specific hedge fund strategy.
- **Diversified allocation** – each Manager Access Index combines the performance of up to 15 managers, with a limit on allocation per fund.
- **UCITS-eligible** – the Manager Access Indices are constructed to be UCITS-eligible.
- **Daily pricing** – the Manager Access Indices are valued on a daily basis.

The Manager Access Indices provide improved liquidity and transparency because they are composed of managed accounts rather than traditional hedge funds. Managed accounts, established either as unit trusts or segregated portfolios within a segregated portfolio company (see box, *Managed accounts*), tend to provide enhanced liquidity, increased

## Managed accounts

Managed accounts are not a new concept, but they have become an increasingly popular means to mitigate concerns surrounding liquidity, transparency and control of assets. Managed accounts are usually set up on a platform that allows the platform provider to act as investment manager and fiduciary to the funds thereon. This investment format also allows the investment manager to delegate the actual trading activities to the hedge fund managers, who act as trading advisers, and to actively monitor their trading activities.

- **Transparency** – managed accounts often provide investors with daily valuation, detailed risk reporting and sometimes position-level reporting, compared with traditional hedge funds' monthly valuation and limited risk reporting.
- **Liquidity** – managed accounts tend to have at least weekly liquidity, compared with traditional hedge funds that usually offer monthly or quarterly liquidity with long notice and settlement periods. The governance structure of managed accounts also reduces the risk of arbitrary gating and suspension of redemptions, which have occurred more frequently in traditional hedge funds. This is particularly the case during turbulent economic periods, which is often when investors need to redeem their investments quickly.
- **Mitigated operational and fraud risk** – the independent platform providers carry out due diligence on the managers of the managed account platform and monitor their activities on a daily basis. The platform providers require managers to remedy potential breaches of the investment guidelines that have been agreed between the platform provider and the hedge fund manager.

Although managed accounts are still a relatively small portion of the entire hedge fund industry, the leading managed account platforms have reported increased assets-under-management figures over the past year.

transparency and improved risk mitigation (also due to segregated responsibilities) compared with traditional flagship hedge funds, even though their assets are managed in line with the flagship fund.

The Barclays Capital Manager Access Indices are designed to reference managed accounts from various leading platforms, including Amundi Alternative Investments, HFR Asset Management and Lyxor Asset Management. The multi-platform nature of the Manager Access Indices allows for a broader representation of the universe of liquid hedge funds than indices based on any single managed account platform. The Manager Access Indices allocate to funds without any structural bias to a specific managed account platform.

The Barclays Capital Manager Access Indices are rebalanced on a quarterly basis according to an objective, rule-based methodology. The portfolio construction methodology was designed by the Quantitative Portfolio Strategy group, which is part of the Barclays Capital research department. It is based on a proprietary measure identifying performance persistence of hedge funds. The rebalancing mechanism overweighs funds that are more likely to consistently outperform their peers, subject to a set of constraints

## Research expertise

The Quantitative Portfolio Strategy group has more than a decade of experience in developing investable indices for various asset classes. Since 2005, the group conducted extensive research on the sources of risk and return in hedge fund performance and how it can be replicated synthetically. One of its publications on style analysis of hedge fund returns was awarded the 2007 Martello Award for best practitioner article in *The Journal of Alternative Investments*.

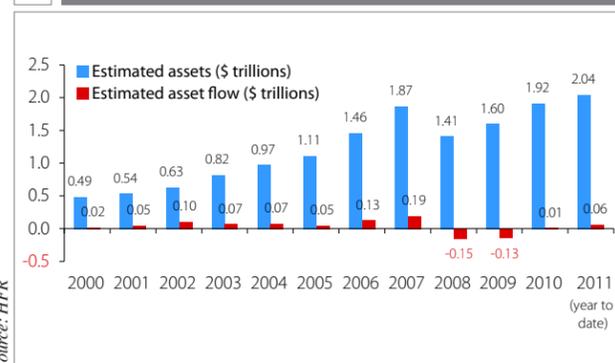
designed to limit concentration and tail risks. The Barclays Capital Manager Access Indices incorporate a mechanism to bridge the settlement of fund subscription and fund redemption within the index at rebalancing.

The Barclays Capital Manager Access Indices are aimed at institutional investors who intend to invest in a specific hedge fund strategy and get exposure to a diversified basket of funds through a transparent and liquid format. Such investment can be either:

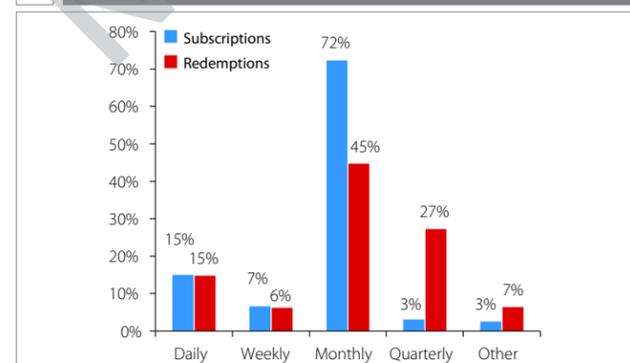
- tactical, to access strategy-specific opportunities emerging in the market within a short time frame;
- an efficient way of managing cash, to bridge the period while the investor is identifying a single hedge fund manager within the strategy; or
- a buy-and-hold position through a delta one product or a derivative to take a view on a specific hedge fund strategy.

It is planned that the Barclays Capital Manager Access Index family is to be initiated by the launch of an equity long/short index. Future launches of Managed Access Indices will reflect the general strategy distribution of hedge funds as well as the prevailing interest in particular hedge fund strategies (see figure 3). Other investable members of the Barclays Capital Managed Access Index family, including indices around commodity trading advisers (CTAs), event-driven and Asia-focused strategies, will soon follow the equity long/short index.

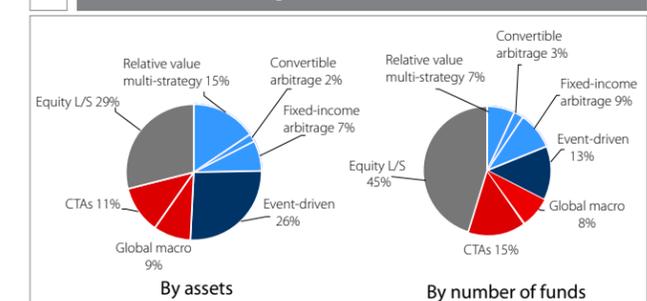
1. Estimated assets and asset flow in the hedge fund industry, Q2 2011



2. Estimated hedge funds investment subscriptions/redemptions, Q2 2011



3. Estimated strategy composition, Q2 2011



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