

# Alternative Investments: Mainstream Asset Class of the Future?



POLYGON

*Investment Management*

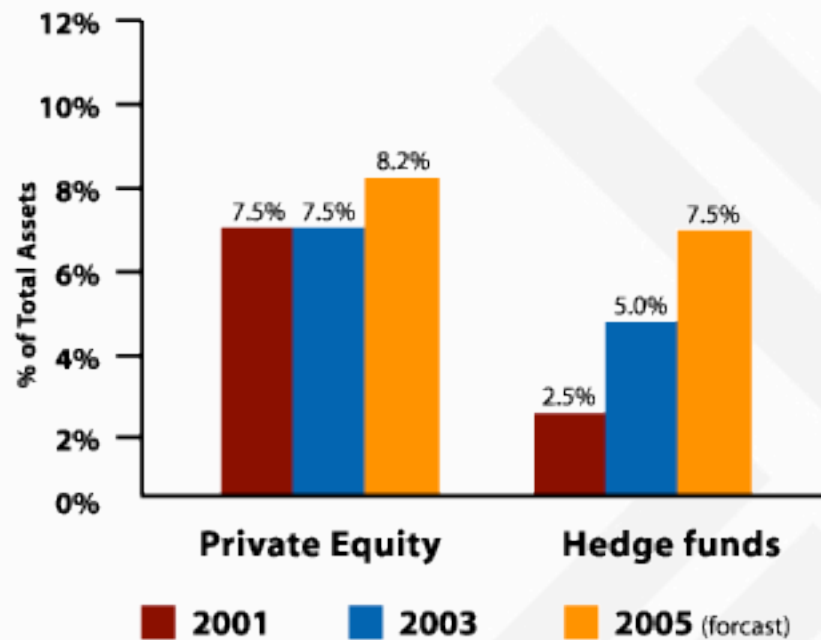
# Alternative Investments Overview

**Examples of Alternative Investments  
include:**

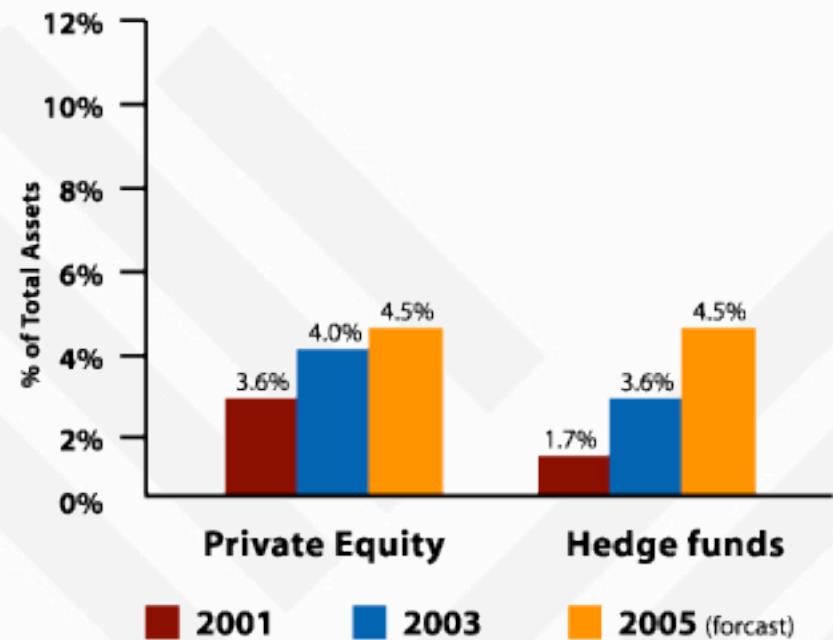
- **Hedge funds**
- **Private equity**
- **Commodities**
- **Structured products**
- **Property**
- **Collectibles**

# Current and Forecast Allocation to Alternative Investments

## North America



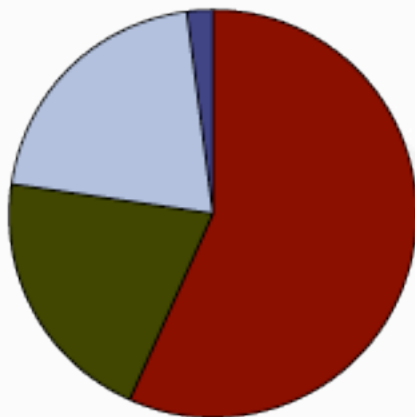
## Europe



Source: Goldman Sachs International & Russell Investment Group

# The Market Investor Breakdown

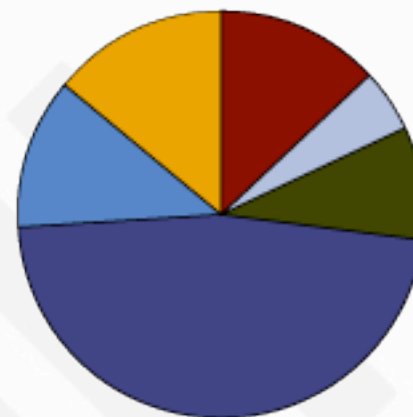
## Hedge Funds



- HNWI (Including Family Offices) 55%**
- Endowments 20%**
- Fund of Funds 20%**
- Pension Funds 5%**

Source: FRM Ltd

## Private Equity



- HNWI (Including Family Offices) 13%**
- Endowments 5%**
- Insurance Companies 9%**
- Pension Funds 47%**
- Fund of Funds 12%**
- Others 14%**

Source: Merrill Lynch



# Middle East Market for Alternatives

- **Large government entities early adopters**
- **Sophistication of products has limited role of local intermediaries and penetration into HNWI segment**
- **Perception of risk has created orientation toward Fund of Funds and guaranteed products**



# Private Equity

## A Definition

**Private equity funds are “blind pools” of capital that generally invest in private companies**

**Private equity can be categorised into:**

- **Venture Capital** - investments made at an early stage in a company's life
- **Development Capital** - financing for growth or expansion of a company that is breaking-even or trading profitably
- **Buy-outs/buy-ins** - acquisition of established companies (typically using debt)

# **LBO's Largely Continue to Prosper**

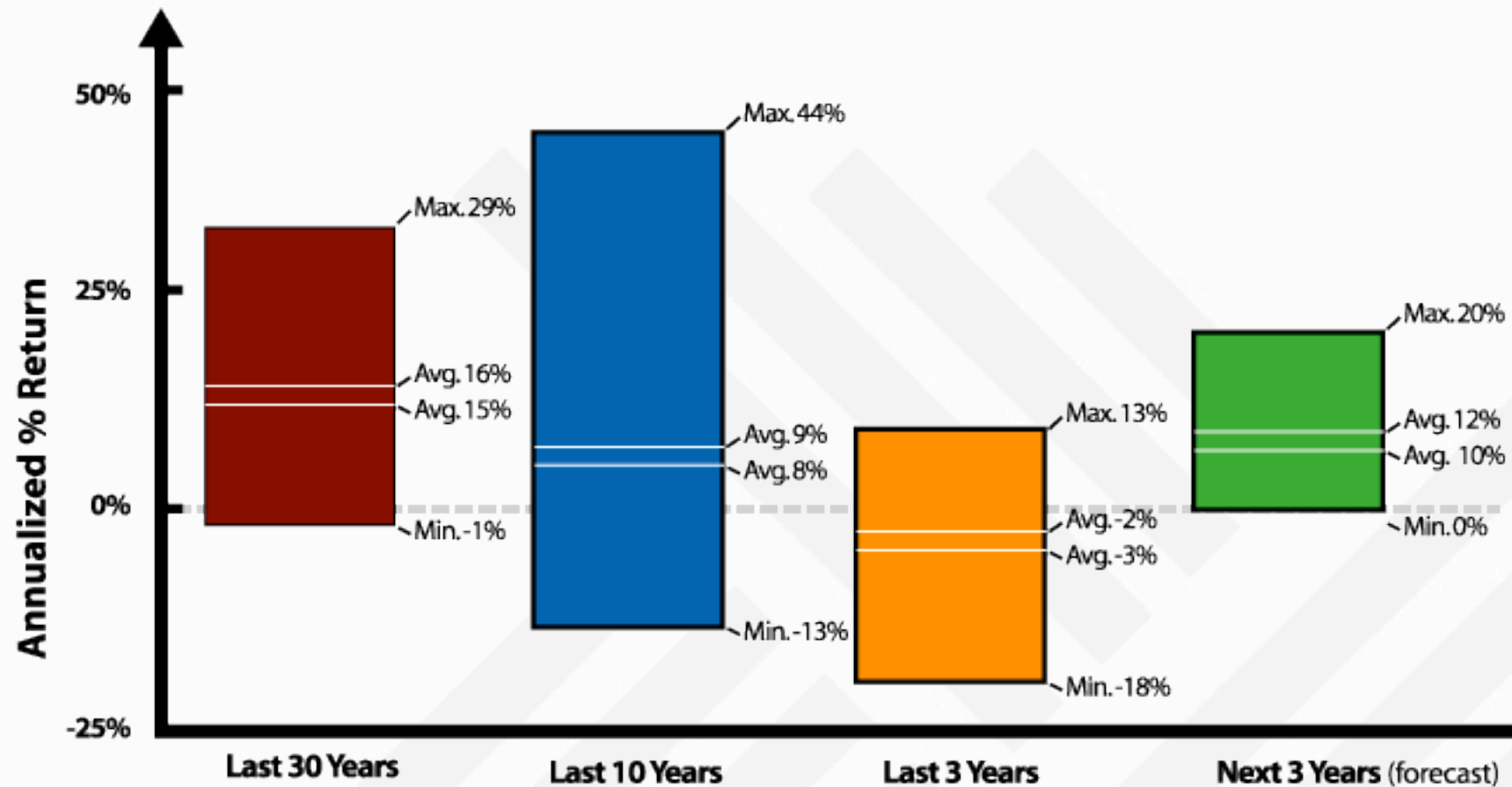
- **30% of European fund managers now invest in PE - up from 13% in 2001**
- **Returns in Europe outstripped those in the US by an average of 4% a year over the last decade**
- **Trade Buyers returning, but financial buyers accounted for 8 of the largest 10 deals in first half of 2003**

# **But, Tough Times for Venture Capital**

- **Annual returns averaged 16% for the 20 years ending in 1995, - 8% since**
- **Investment inflows drying up in Europe and North America**
- **In US, \$2.3 billion raised in first half of 2003 vs. \$25 billion in first quarter of 2000**
- **Life Science Funds now account for 50% of money raised vs only 10% during internet boom**

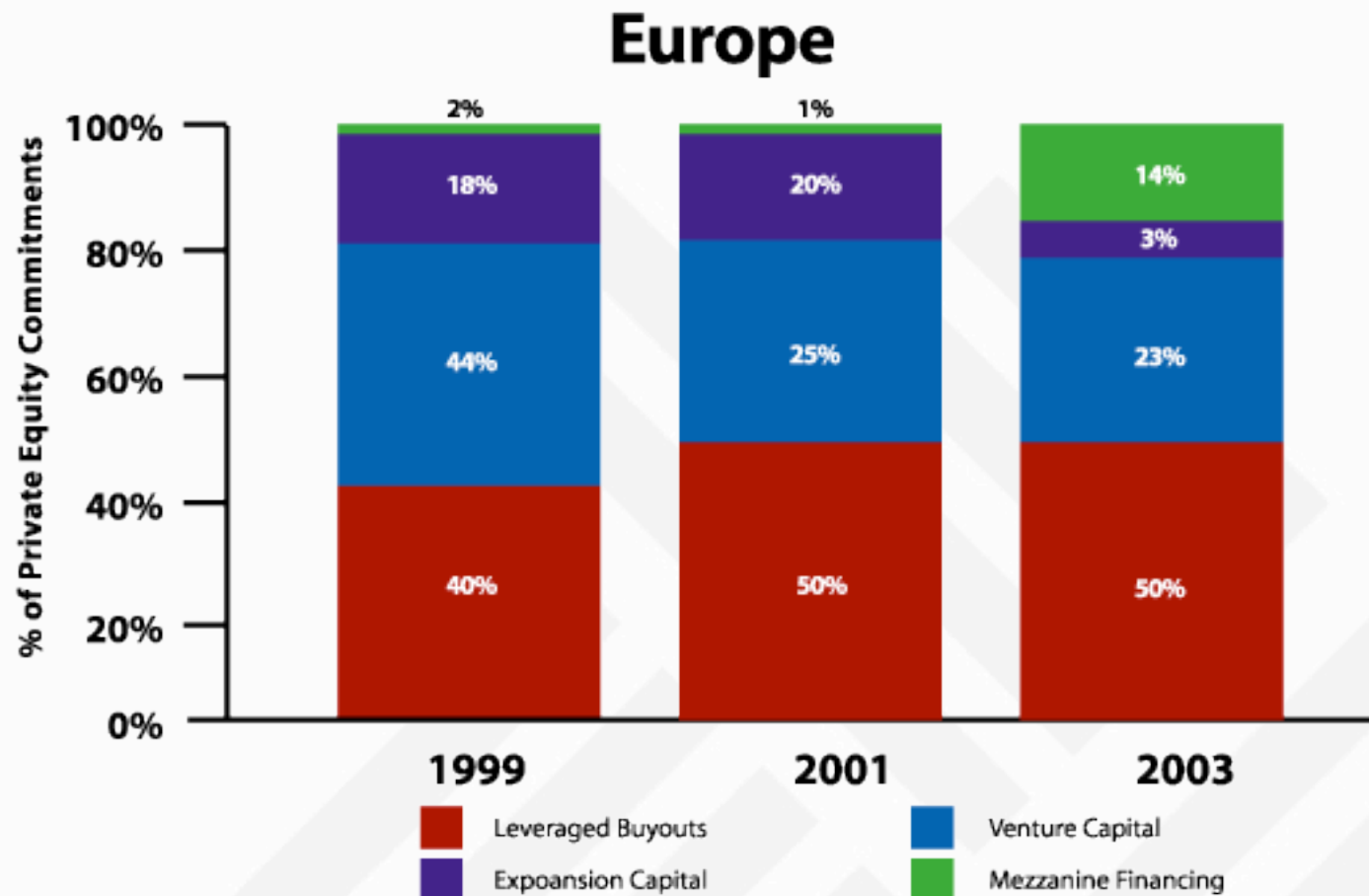


# North America: Private Equity Investment Returns



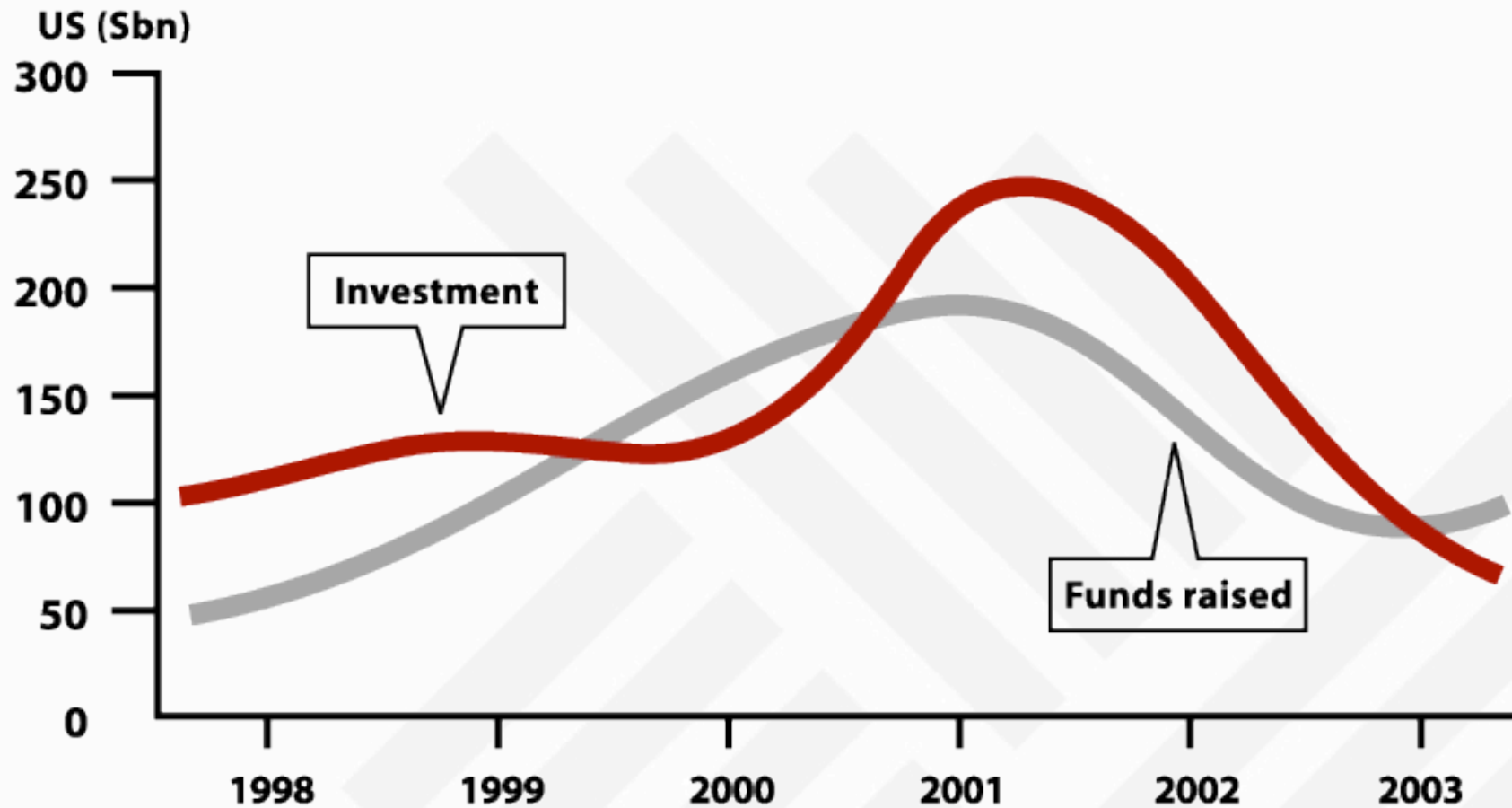
Source: Goldman Sachs International & Russell Investment Group

# Private Equity Commitments



Source: Goldman Sachs International & Russell Investment Group

# Capital Overhang in Private Equity



Source: 3M PwC Global Private Equity Review



# **Hedge Funds**

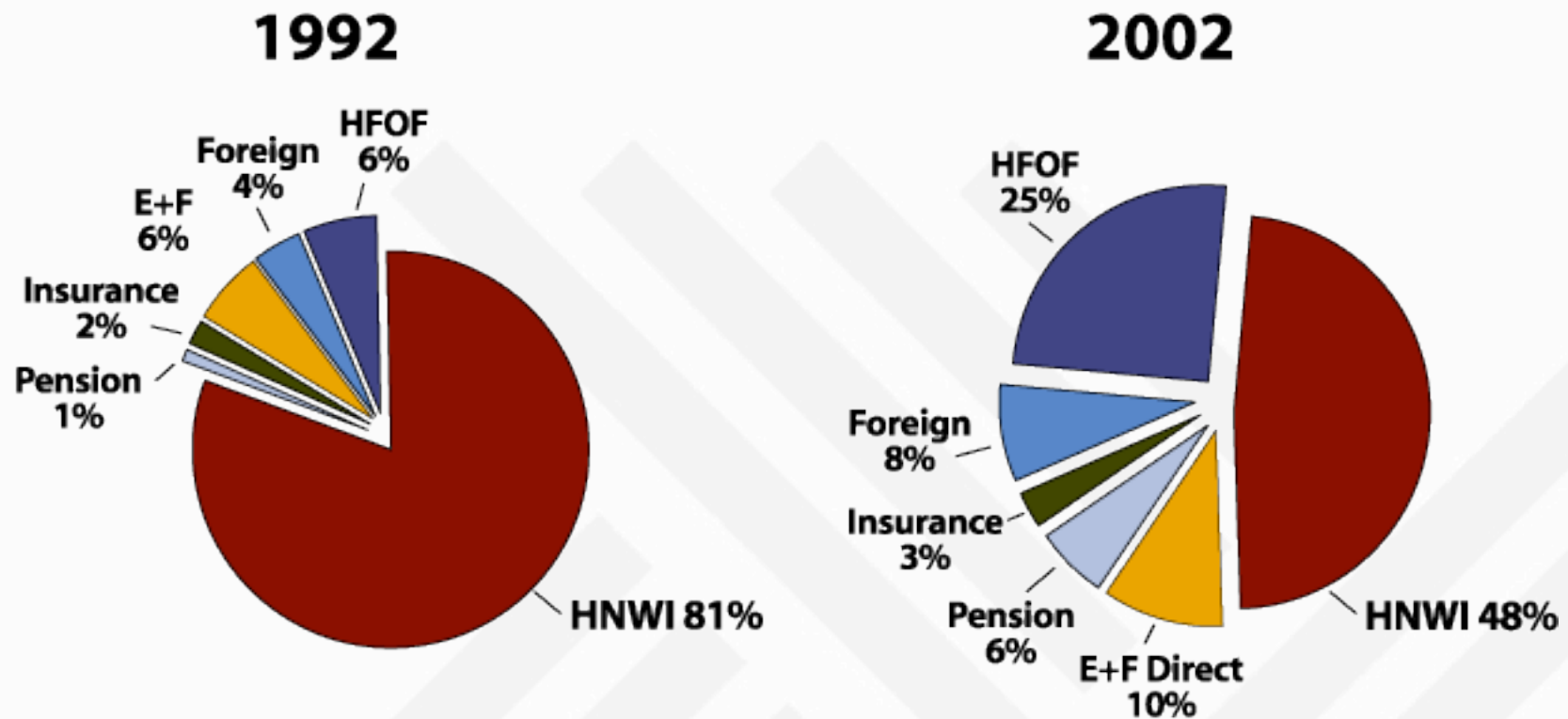
## **A Definition**

**Hedge funds are funds that typically have:**

- **Absolute return objectives**
- **Returns with a low correlation to traditional asset classes**
- **The ability to use derivatives and leverage**
- **The ability to use short selling**
- **Performance related fees**
- **Substantial co-investment by the manager**
- **Generally skill based, rather than market driven**



# The Hedge Fund Business is Growing Up



Source: Goldman Sachs International & Russell Investment Group

# Buyers Want Institutional Characteristics...

- **Risk control**
- **Disciplined investment process**
- **Transparency**
- **Operational controls, and sophisticated IT**
- **Substantial assets under management**
- **Value added servicing and distribution**

# Concentration of Hedge Fund Assets

	<u>Assets</u> <u>\$ Billions</u>	<u>% of</u> <u>Total</u>
<b>Top 5</b>	44,140	7.4%
<b>Top 10</b>	79,940	13.3%
<b>Top 15</b>	108,769	18.1%
<b>Top 20</b>	134,269	22.4%
<b>Top 25</b>	158,584	26.4%
<b>Top 50</b>	245,679	40.9%

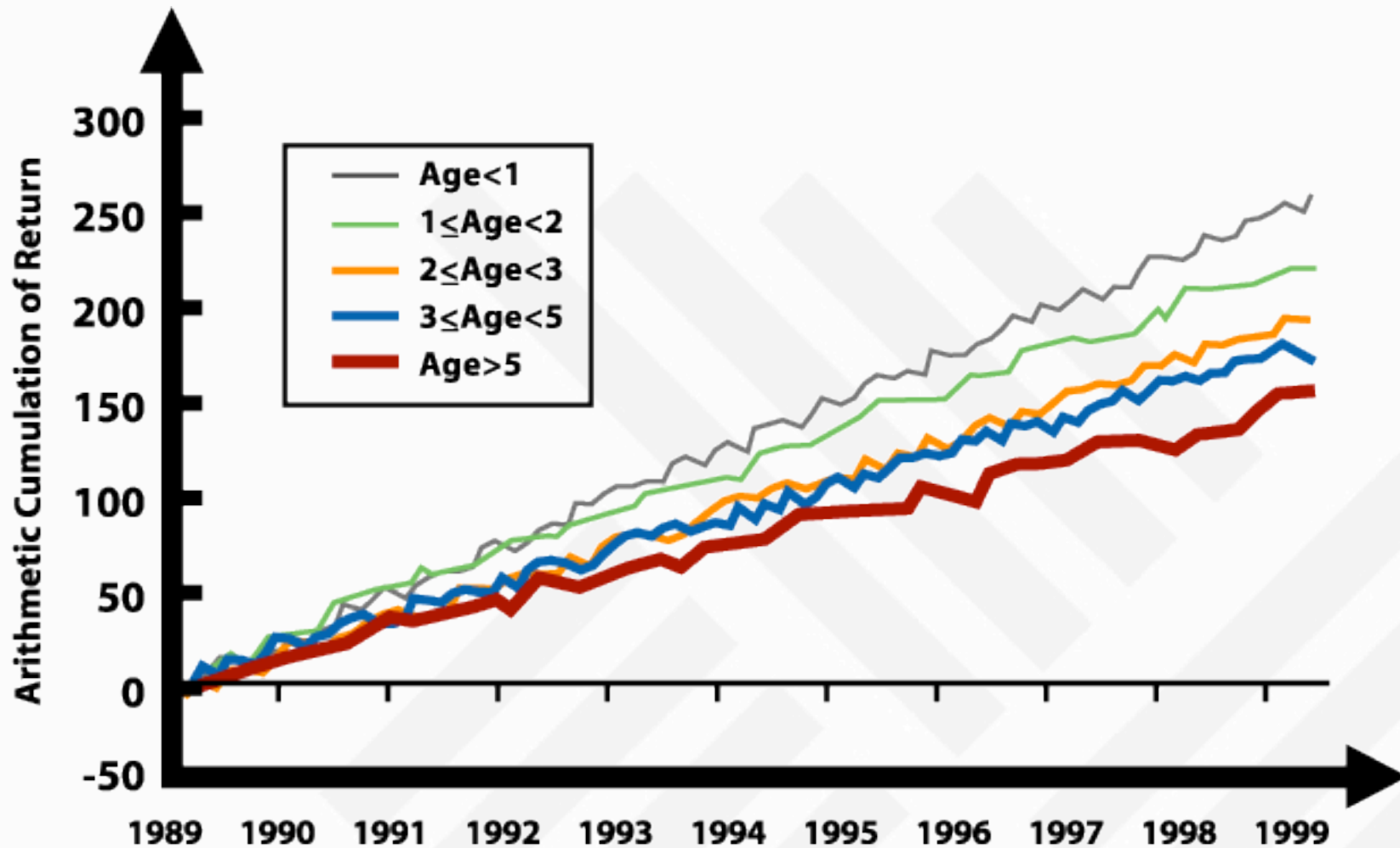
Source: Institutional Investor, 2003

# But Still Prefer Boutiques

- **Performance has generally been better**
- **Entrepreneurial**
- **Independent**
- **Highly motivated, with personal assets invested**
- **Streamlined decision making**
- **Managers who leave big firms are a self selecting universe**

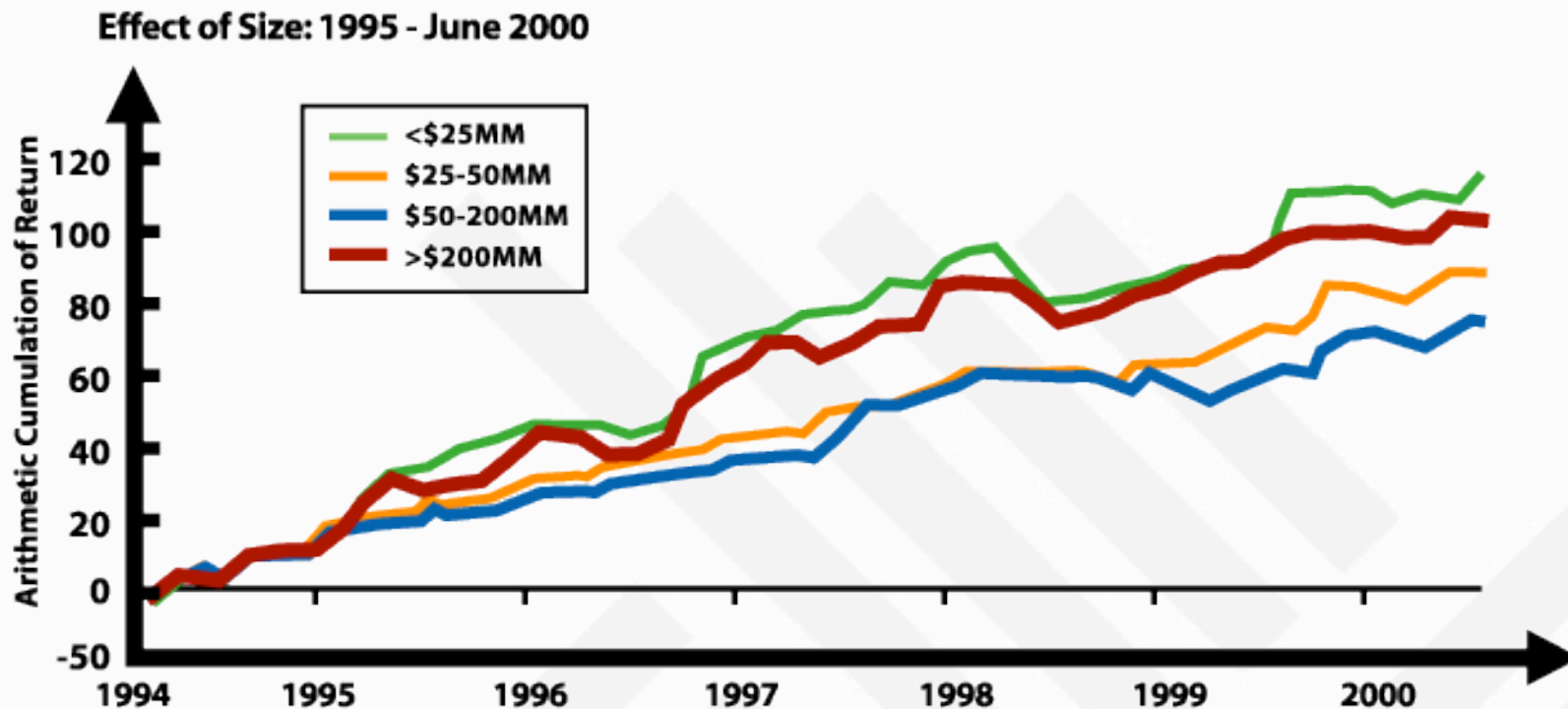


# Performance of Funds by Age



Source: Morgan Stanley

# Size Anomalies in Hedge fund Performance

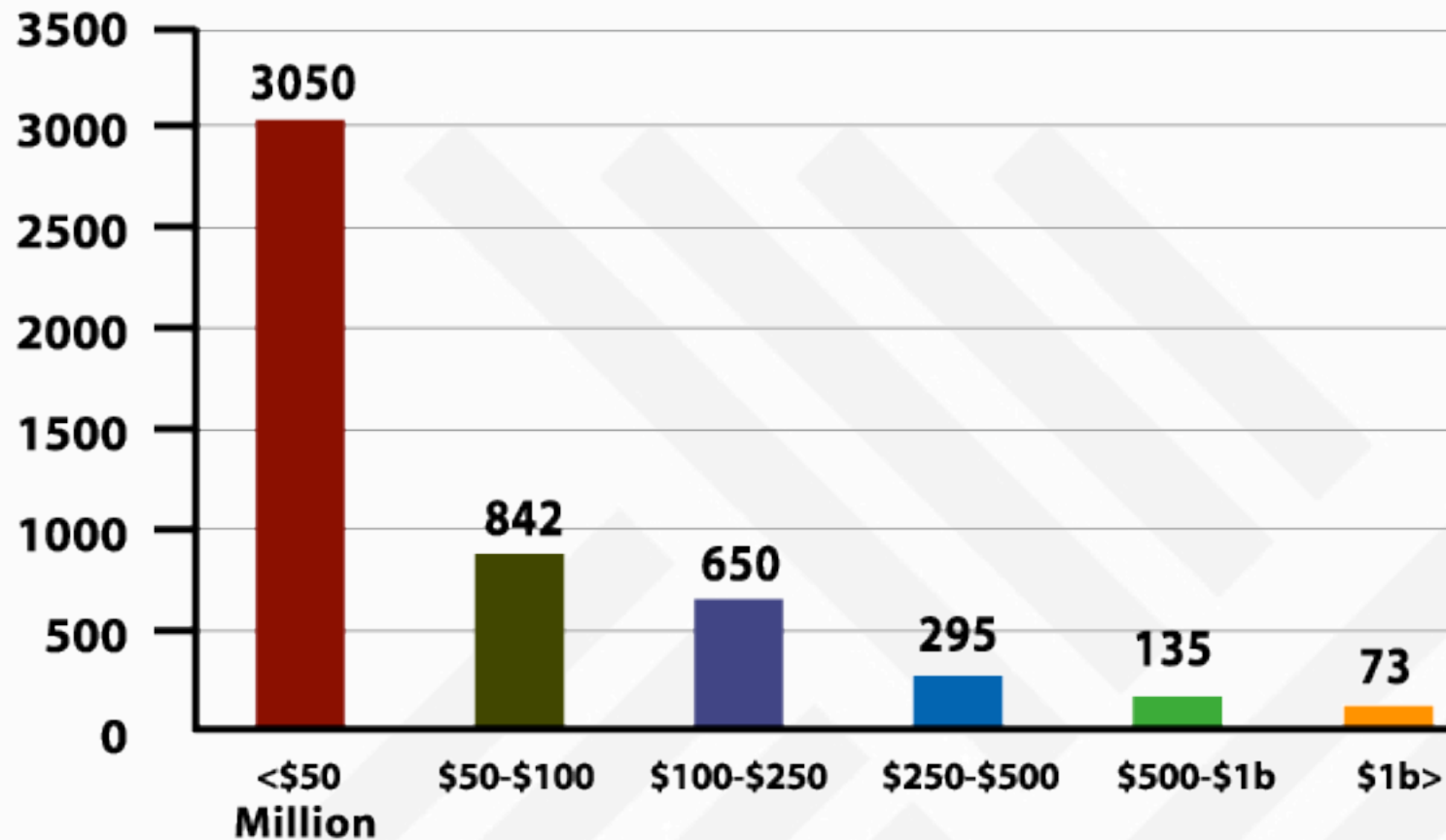


Annualized Performance by Size Category (\$MM)

	<25	25-50	50-200	>200
Annualized Return	19.5%	15.0%	12.7%	18.0%
Annualized Volatility	7.7%	5.8%	5.8%	8.2%
Sharpe Ratio	1.9	1.7	1.3	1.6

Source: Morgan Stanley

# The Majority of Hedge Funds are Invested with Smaller Managers



Source: Goldman Sachs International & Russell Investment Group

# **The Best Portfolio Managers Want (and are able to get)**

- **Less bureaucracy and politics**
- **More collegial environment**
- **More opportunity to make money**

**....Retaining these managers is a growing  
challenge for the traditional firms**



# Summary

- **Alternative Strategies are growing up**
- **Challenge is to combine best of both worlds-entrepreneurial independence with central command and control structure**
- **Optimal firm will align the interests of key constituencies: investors and portfolio managers/owners**

# Contact Information

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