

# The Money Management Industry in Chicago

QWAFAFEW Panel Discussion

December 2, 2004

**Galina Kalcheva, Consultant  
Ibbotson Associates Advisors, L.L.C.  
E-mail: [gkalcheva@ibbotson.com](mailto:gkalcheva@ibbotson.com)**

---

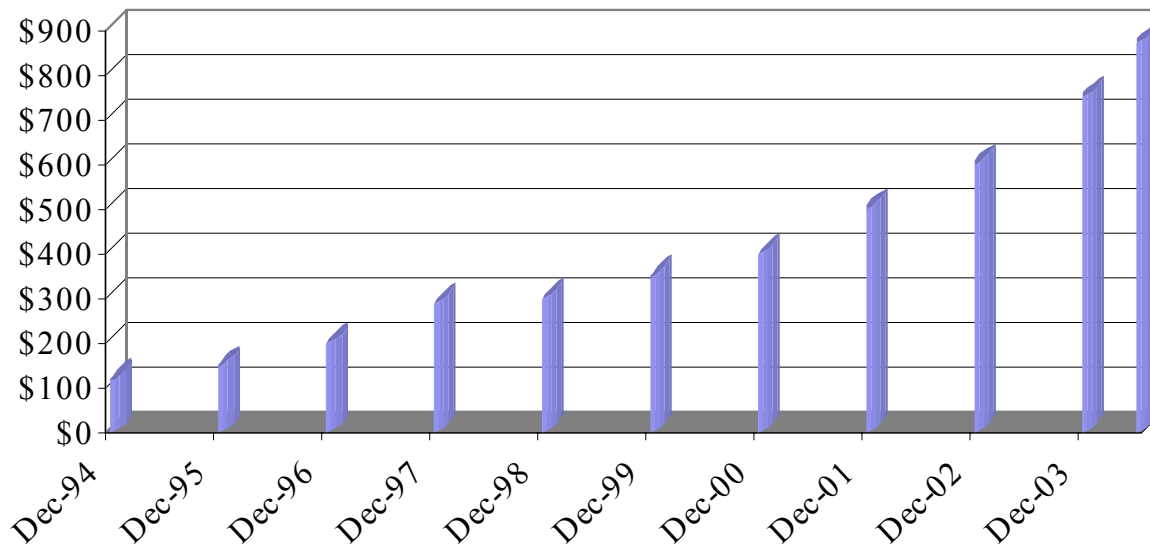
## Hedge Funds in a New Environment

- Industry Size, Growth and Composition
- Current Issues in the Industry
- Elements of Hedge Fund Performance and Key Trends

## A Growing Industry

- Industry Assets Currently at \$1 Trillion
- Expected Future Size between \$3 and \$5 Trillion (Year 2010)

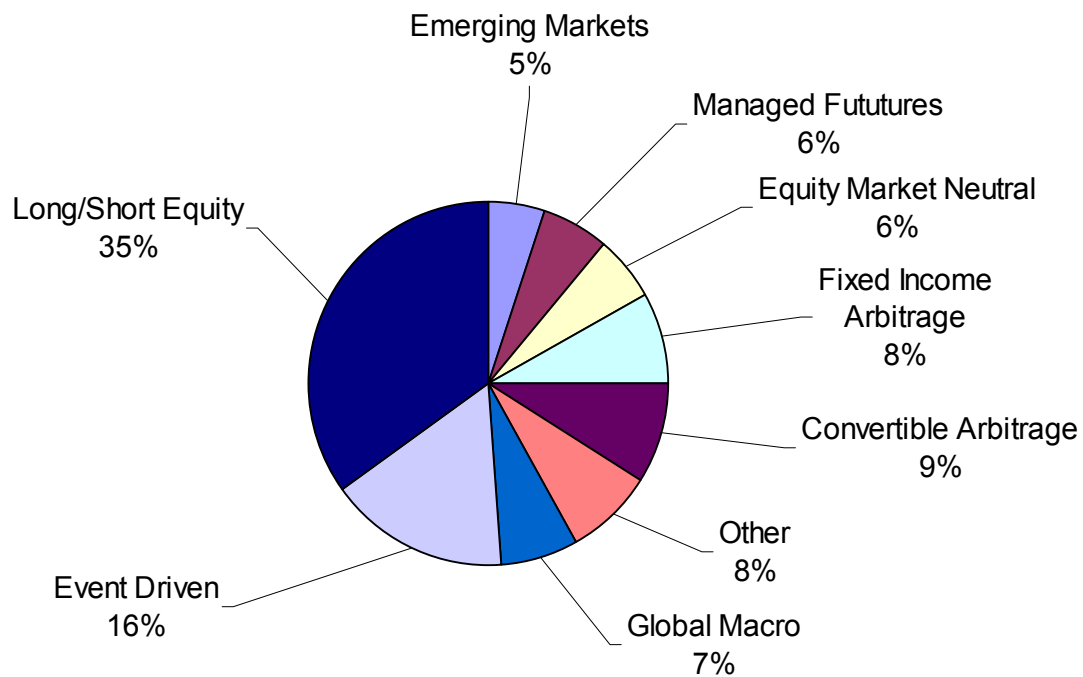
### Growth in Single Manager Fund Assets (Industry Estimate, in Billions)



Source: TASS Database, Tremont Research.

## The Industry Composition Today

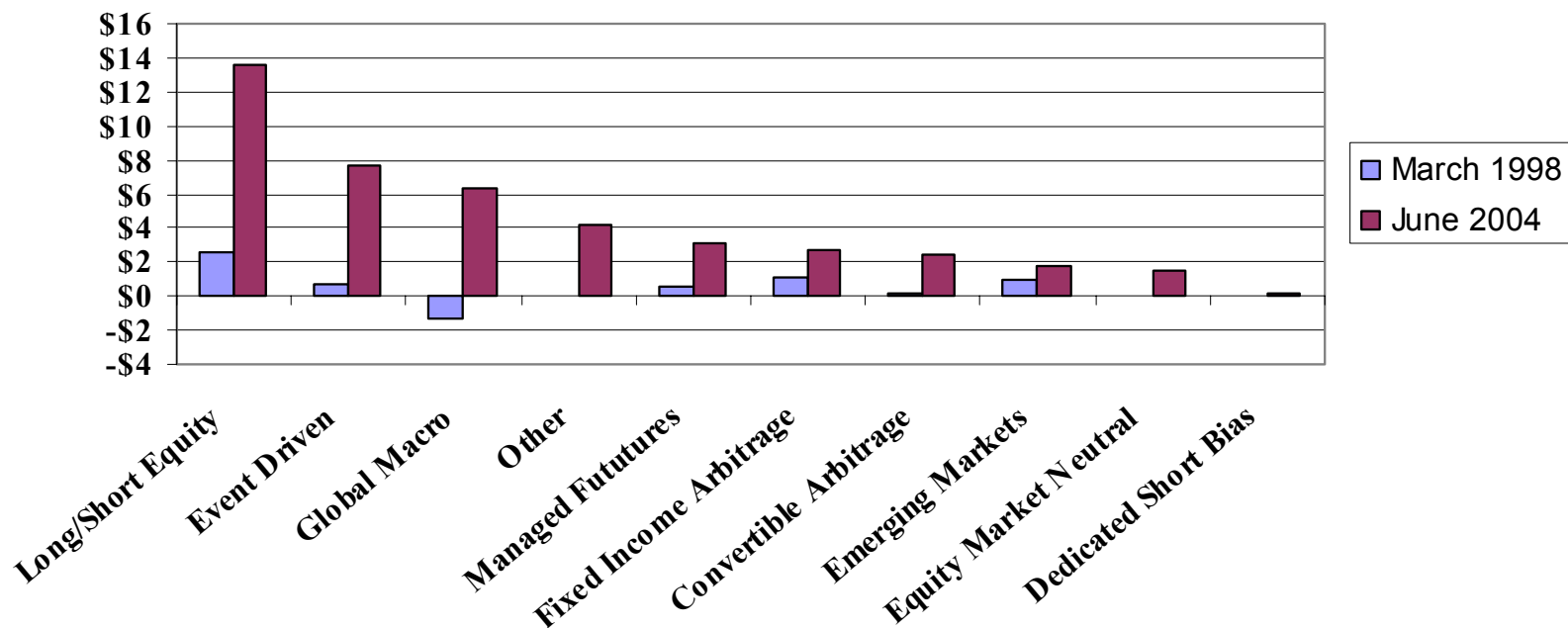
Hedge Fund Asset Allocation By Strategy (as of September 2004)



Source: TASS Database, Tremont Research.

## Pattern of Asset Flows Has Changed

Change in Asset Flows by Strategy (in Billions):  
1998-2004



Source: TASS Database, Tremont Research.

## Issues

- **A New Kind of Demand**
  - High net worth individuals
  - Institutional investors
  - Pension plans
  
- **Pending Registration of Hedge Funds (Advisers Act)**
  - Positives
    - Increased transparency -> access to institutional money
  - Negatives
    - Higher costs -> consolidation
    - Compression of HF returns
  
- **Changing Opportunities and Supply**
  - Market efficiency and more participants
  - Evolving Strategies (Multi-Strategy, Leverage, Directional)
  - New Products
    - Structured notes (Man Group)
    - SEC registered products (Global Asset Management)
    - Insurance-based products

---

## **A Look at the Economics**

- Main Indicators Affecting Returns**
- Economic Reality**
- Key Trends in Hedge Funds**

## Hedge Fund Style Return Drivers

Hedge Fund Style	Strategy Trades	Economic Drivers of Return
Convertible Arbitrage	Long corporate bond Short stock	Credit spreads Equity Prices Volatility
Equity Market Neutral	Long under-valued stocks Short over-valued stocks	Interest rates Equity Prices
Event Driven	Mergers, spin-offs, acquisitions; Distressed situations	Credit spreads Equity Prices Volatility
Fixed Income Arbitrage	Bets on spreads - term spreads, default spreads, basis spreads	Credit spreads Yield spreads
Global Macro	Macroeconomic bets on stocks, bonds, currencies, commodities.	Yield spreads Equity Prices



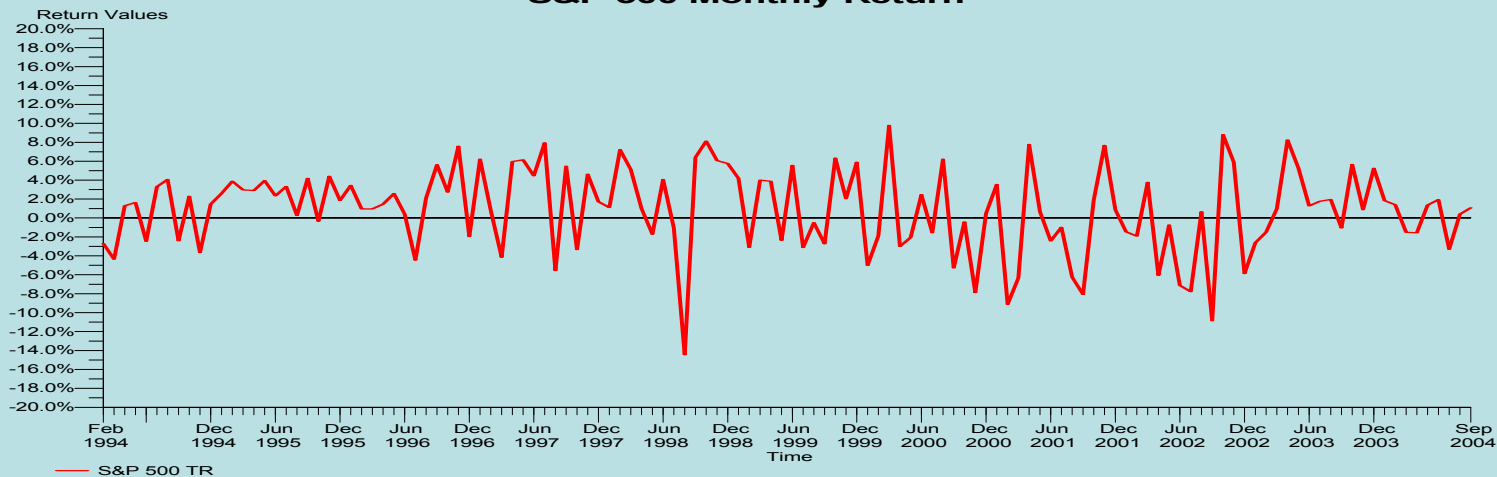
## Economic Reality

- **Low but rising interest rates, volatility in energy and commodity prices, lowered political uncertainty, high leverage**
  
- **Past performance in times of interest rate tightening**
  - **Lower equity returns**
  - **Higher commodity returns**
  - **Lower bond returns**

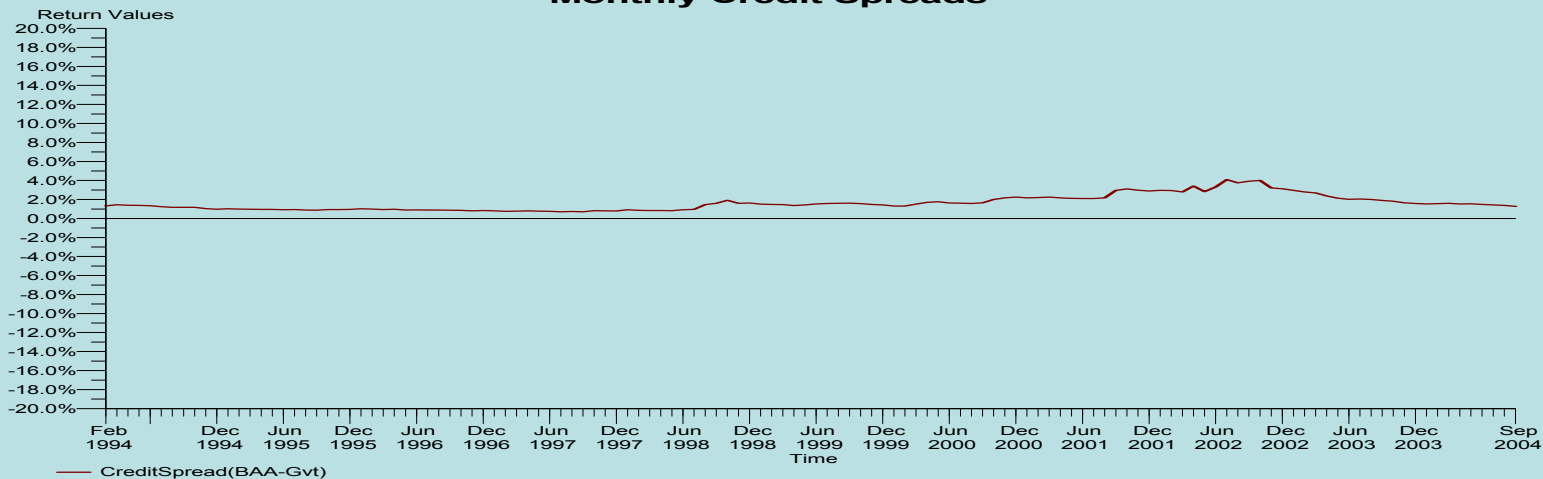
**Past performance is not a guarantee of future performance.**

## Historical Monthly Performance of Economic Factors

### S&P 500 Monthly Return



### Monthly Credit Spreads



Past performance is not a guarantee of future performance.

## Key Trends in Hedge Funds

Style	Return Drivers	Key Trends
Convertible Arbitrage	Credit spreads Equity Prices Volatility	Low but rising volatility Widening credit spreads Fewer cheap issues, excess demand
Equity Market Neutral	Interest rates Equity Prices	Manager ability to pick stocks/sector rotation Need for stable environment
Event Driven	Credit spreads Equity Prices Volatility	Credit spreads widening Volatility pick-up Rising default rates
Fixed Income Arbitrage	Credit spreads Yield spreads	Widening spreads Rising interest rates and weak equity market may push money into to bonds
Global Macro	Yield spreads Equity Prices	Pronounced movements in commodities, interest rates and currencies Steady interest rate increases (US)

Past performance is not a guarantee of future performance.

## Appendix: Hedge Fund Historical Performance

**Growth of \$1,000  
January 1998 Through August 2004**

