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This report was researched and written by Philip Moore, special reports writer for HedgeFund Intelligence

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Introduction

Asia has flattered to deceive before – as many long-standing investors and managers in the Asian hedge fund industry know full well. Despite appearing to have all the ingredients in place for a thriving alternative asset management industry, Asia has often failed to live up to the expectations of both local and global market participants.

But many people believe that things could be different this time. While China's dramatic summertime share rout took a heavy toll on many China-focused managers, and may have spooked some international investors, the Asian hedge fund industry is enjoying strong growth – in assets, in new funds, in performance, in the expansion of the investor base, in the breadth of investment strategies being deployed, in the diversity of countries and asset classes being targeted, and in the emergence of a more robust regionally-based industry.

So – with political, business, macro-economic and investment drivers in the region creating growing opportunities for alpha – will this be the time when Asia starts to fulfil its potential as a genuine, and sustainable, global centre of hedge fund management and investment?

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Will the revival in the Asian hedge fund industry be more sustainable this time round?

In the third quarter of 2013, Misha Graboi was despondent about the Asian hedge fund industry. "Since the global financial crisis, those of us investing in Asia have found the hedge fund sector to be particularly cruel – holding out the promise of enormous potential, while delivering a mediocre-to-disappointing reality," wrote Graboi, a Singapore-based portfolio manager at Pacific Alternative Asset Management (PAAMCO).

'Cruel' may be an unusually emotive word, but this summer was especially unforgiving to long-biased China equity funds, which is what many of the products operating in Chinese markets that call themselves long/short equity strategies turned out to be. Many managers looked on helplessly in July and August as their strategies haemorrhaged assets during the summertime China 'A' share rout.

But it was not short-term market gyrations that concerned Graboi back in 2013. His frustration sprang from the longer-term underperformance of Asian hedge funds and the challenging environment that had been created for capital-raising as a result. The anaemic performance of the region's hedge funds was all the more exasperating, Graboi observed, because Asia had so many of the necessary ingredients to support a healthy alternative asset management industry.

After all, the region's economies were growing rapidly and had strong fiscal and fundamental underpinnings. Those economies were full of quickly-evolving industries with readily identifiable winners and losers. Many of the region's capital markets were relatively inefficient. And competition within the hedge fund sector was generally less intense than in other regions.

"When placed against a backdrop of improving liquidity," wrote Graboi, "this should be the golden age of hedge fund investing in the region." Yet hedge funds were up a meagre 11% between the start of January 2008 and the end of 2012.

This five-year period was certainly a barren spell for hedge funds in Asia. "Prior to the global financial crisis, the Asian hedge fund industry's assets had reached about $170 billion," says Harold Yoon, chief investment officer at the Hong Kong-based fund of funds, SAIL Advisors.

SAIL, which has AUM of some $2.2 billion, manages two specialist Asian strategies – the Asia-Pacific Managers multi-strategy fund and the Asia Equity Alpha strategy.

"Following the crisis, there were big losses for China funds, which hit the region's hedge fund industry very badly," says Yoon. "Over this period, investors redeemed out of Asian hedge funds as a whole. However, there were some larger, well-known funds that were able to raise assets." Some of the smaller China long/short managers, adds Yoon, were forced to close down, while others survived by cutting costs to the bone and waiting for investor interest to revive.

Today, the frustration expressed by Graboi in 2013 is still shared by many industry participants,

Misha Graboi, portfolio manager, PAAMCO

Duncan Crawford, global head of hedge fund sales and capital introduction, Societe Generale Prime Services

especially by those who had pinned so many of their hopes on the opportunities presented by China.

"For the last 15 years or so, we have all expected Asia to be the next big thing for the hedge fund industry, but it has not lived up to our expectations," says Duncan Crawford, global head of hedge fund sales and capital introduction at Societe Generale Prime Services. "We hoped we would have our international clients trading China by the beginning of next year. Although some already do, broad access now looks increasingly unlikely."

The response of the Chinese authorities to the Shanghai wobble in the summer is certainly seen by many regional managers as a setback to the growth of the region's hedge fund industry. "The Chinese authorities changed the rules of the game in July when they banned short sales and suspended trading in 1,500 out of 3,000 listed stocks," says John Foo, founder and chief investment officer at Kingsmead Asset Management in Singapore.

"That basically made the market uninvestable," adds Foo, whose flagship Asia Opportunities Fund has outperformed this year by giving Chinese 'A' shares a wide berth since the end of the second quarter. "The 'A'-share market remains a difficult place for institutions like ours which value transparency and certainty of regulation," says Foo.

REASONS TO BE CHEERFUL

Leaving aside the short-term convulsions in Shanghai, however, PAAMCO's Graboi echoes a number of regional investors when he says he is much more cheerful about the prospects for Asian hedge funds than he was two years ago. "The industry has recovered fairly significantly, on the back of which funds have been able to attract additional capital," he says.

At SAIL, Yoon says that this revival can be traced back to the landmark political events in the region's two largest economies in 2012 and 2013. "The election of prime minister Abe opened up a whole new set of opportunities in Japan," he says.

"But as so many Japanese long/short equity strategies had shut down prior to then, the funds that initially took advantage of Abenomics were

Top 10 hedge fund managers in Asia-Pacific: by assets June 2015

	AUM $m
Hillhouse*	17,000
Platinum Investment Management Limited	15,388
Value Partners	8,479
Myriad*	4,200
Graticule Asset Management Asia	4,170
Seatown	3,800
Dymon Asia Capital*	3,600
Indus Capital Partners, LLC*	3,544
Greenwoods Asset Management*	3,292
Tybourne*	3,200

*Source: AsiaHedge database and survey *estimated*

global macro funds that were headquartered outside of Asia. But some Asia-based managers like Adam Levinson's Fortress Asia Fund [which has since been spun off as the new $4 billion Graticule Asset Management Asia (GAMA) operation] were also able to profit from the rollout of Abenomics."

The second key political development which helped to breathe fresh life into the region's hedge fund industry, says Yoon, was the appointment of Xi Jingping as China's president. "A number of new funds were launched in expectation of accelerated reforms in China following Xi's appointment," he says.

PAAMCO's Graboi agrees. "It's hard to identify a single trigger that has supported the revival of the hedge fund industry in Asia," he says. "But the turning points included the beginning of Abenomics in Japan and the reforms that began around the time of the third Plenum in China at the end of 2013. Both these events generated increased dispersion in the performance of the region's equity markets."

The numbers speak for themselves. In 2014, overall assets in the Asian hedge funds industry rose by 21% to $192.81 billion, with new funds raising $5 billion through 83 launches. This momentum was continued in the first half of 2015, with the industry's assets expanding by almost 15%, to $221.17 billion. According to the most recent *AsiaHedge* survey, in the first six months of 2015,

John Foo, founder and chief investment officer, Kingsmead Asset Management

Asia-Pacific hedge fund assets by location of manager: US$ billion

Region	Jun-08#	Dec-08#	Jun-09	Dec-09	Jun-10	Dec-10	Jun-11	Dec-11	Jun-12	Dec-12	Jun-13	Dec-13	Jun-14	Dec-14	Jun-15
UK	22.69	17.30	10.29	11.86	11.16	12.31	11.69	8.91	9.72	6.88	9.82	11.50	10.48	10.77	10.21
USA	40.37	27.39	24.76	26.75	29.10	27.88	24.01	22.16	22.22	21.61	22.18	21.28	17.25	16.15	21.85
Australia	37.41	27.05	24.57	29.32	29.70	33.16	31.53	28.30	28.3	27.75	28.92	29.38	37.42	37.41	39.83
Japan	12.53	8.52	9.77	10.18	10.34	11.03	10.77	9.73	5.72	4.73	3.97	4.20	4.34	3.77	3.01
Hong Kong	33.46	22.18	27.42	31.12	32.51	38.28	38.89	40.53	47.05	45.04	50.39	54.21	59.45	67.69	80.13
China	1.03	0.62	0.62	0.47	3.44	3.80	3.58	5.77	6.82	8.18	8.77	8.48	11.38	17.42	18.39
Singapore	24.33	15.93	17.03	17.64	16.71	21.55	19.54	20.91	20.07	20.34	24.85	25.16	31.51	33.26	39.21
Other	3.71	3.44	4.30	5.14	4.79	4.39	4.64	4.32	4.49	4.56	3.94	4.59	6.15	6.35	8.53
Total	**175.53**	**122.43**	**118.75**	**132.48**	**137.75**	**152.39**	**144.65**	**140.62**	**144.39**	**139.08**	**152.84**	**158.79**	**177.98**	**192.81**	**221.17**

Source: AsiaHedge database and survey # adjusted


LOOKING FOR PURE
ALPHA FROM ONE OF
ASIA PACIFIC'S LARGEST
INSTITUTIONAL MANAGERS?

Patrick Ghali, managing partner and co-founder, Sussex Partners

new Asian hedge funds raised a record $5.3 billion, twice as much as in the same period the previous year.

With most of the region's hedge funds training their sights on the potential of the three north Asian markets of China, Hong Kong and Japan, it is perhaps unsurprising that Hong Kong appears to have strengthened its grip as Asia's premier hedge fund centre.

As of June 2015 Hong Kong accounted for just over $80 billion, or 36% of the total assets managed in the region by Asian hedge funds. Singapore's share of $39.2 billion represented 17.7% of the total.

It may be too early to uncork the champagne, but the data tracking activity in Asian hedge funds in the first half of 2015 suggests that the industry is at last starting to deliver on its huge potential.

So it should, because the region's fundamentals twinned with its growth prospects and commitment to long-term reform ought to support a vibrant asset management industry. Think what you will about the immediate outlook for the country's economy and its implications for global growth, the longer-term prognosis for China remains compelling.

ANZ put this outlook into striking perspective in a recent report which forecasts that China's growing urban middle class will more than double its spending over the next 15 years, lifting consumption of GDP to almost 50%. "By way of comparison," says ANZ, "that means China's consumption in 2030 would exceed that of the US today."

"We think investors should look beyond the short-term noise created by its ghost cities and over-capacity in the steel sector," says Garret Mallal, portfolio manager at RWC Partners in Singapore. "We prefer to focus on the new economy, the compelling consumer story and opportunities created by China's outbound investment in the emerging and frontier markets of Asia."

Elsewhere in the Asia-Pacific region, Abenomics may be faltering, but it is rewriting the rulebook of the Japanese capital market. The Indian reform process may be famously hesitant and weighed down by the ball-and-chain nature of the country's bureaucracy, but over the longer term investors believe it is inevitable that its equity and debt markets will become more accessible to international investors.

In the meantime, the region's institutional and retail investor base will continue to expand, which will bolster liquidity in Asian capital markets and probably underpin higher valuations and lower volatility.

EXPLOITING INEFFICIENCIES

This will all be very constructive for Asian equity long-only managers, which are by far the most familiar strategies to the region's investors. But as market participants say, it is not Asia's macro-economic *bona fides* that should get the pulses of hedge fund managers racing.

"The growth story is helpful," says Patrick Ghali, managing partner and co-founder of the institutional hedge fund advisory firm, Sussex Partners. "But if all you want to play is the Asian growth strategy, the cheapest way to do so is to buy the index and tuck it away for 20 years, realising that this may be very volatile," he adds.

"The reason we like Asia is the incredible inefficiencies which you still find in the region, which are great for hedge fund strategies," he says. He points to Japan as a market that epitomises these inefficiencies. "Japan has 3,500 listed companies but only about 30% of these are covered by analysts. This means that if you're a seasoned manager with good local knowledge you can find tremendous value in the market. You can also short most Japanese stocks cheaply and efficiently."

That may be. But Japan has been a difficult market for hedge fund managers, and has struggled to recover from the traumas that were suffered by a number of local long/short equity managers a

Corporate governance: the new alpha driver in Japan?

Other managers echo the view held by GAM's Kier Boley that a new focus on corporate governance and shareholder value is likely to be the main driver of performance on investors' long and short Japanese equity exposure.

As Kames Capital notes in a recent update explaining why it is positive on the market, the Japanese equity investment case is moving on from one that was based simply on the weakness of the yen. "European company management acquired the shareholder value 'bug' in the 1990s, which heralded a period of sustained long-term outperformance of European equities," Kames advises.

"Japanese corporates have been forcibly 'infected' with a similar shareholder-friendly discipline through prime minister Abe's economic policies. Japanese companies have stronger balance sheets than their other developed market peers and can easily improve corporate profitability by increasing debt and buying back shares."

The potential for diverging stock price performance generated by changing attitudes to corporate governance in Japan has prompted a number of fund launches. It has also been a clear driver of increased demand for exposure to Japanese equity strategies over the last 12-18 months.

Take the example of the RWC Nissay Japan Focus Fund, which was launched in April 2015 and raised $150 million in its first five months. A long-only product that replicates the strategy of the Japanese Stewardship Fund launched in 2006, the Japan Focus Fund reports that it has "shareholder engagement" at its heart.

Asia-Pacific hedge fund assets by strategy: US$ billion

Strategy	Dec-07#	Jun-08#	Dec-08#	Jun-09	Dec-09	Jun-10	Dec-10	Jun-11	Dec-11	Jun-12	Dec-12	Jun-13	Dec-13	Jun-14	Dec-14	Jun-15
Japan long/short and market neutral	34.98	28.04	20.34	20.87	21.89	20.80	22.38	18.75	19.08	17.89	14.09	18.26	18.99	21.12	20.99	21.16
Asia ex-Japan and market neutral	32.58	28.05	16.85	17.67	19.59	21.95	21.94	28.03	27.87	18.02	18.19	14.58	15.62	14.94	16.87	22.16
Asia inc-Japan and market neutral	36.15	32.20	18.30	20.39	21.77	21.63	23.57	23.49	19.58	18.68	18.07	22.83	20.32	17.93	20.32	26.57
Global equity	18.61	18.28	13.57	11.12	13.67	14.55	15.22	13.84	11.73	14.08	14.75	17.05	20.16	21.65	22.55	20.82
Multi-strategy	15.48	17.62	15.11	12.88	12.93	13.25	13.70	14.20	14.80	18.31	15.73	18.56	18.64	19.46	20.65	26.44
Australian equity	6.92	5.73	4.51	4.25	5.46	5.39	5.24	4.98	5.84	5.3	5.36	6.11	5.77	8.15	8.15	7.95
Chinese equity	12.11	10.13	6.07	8.54	9.31	9.20	9.83	11.27	11.44	18.49	19.84	20.67	20.79	25.46	32.88	39.04
Macro	5.46	8.38	6.92	6.29	5.61	5.67	6.01	5.67	6.98	9.52	9.72	10.41	11.42	14.39	14.11	15.29
Asian fixed income and distressed*	7.10	7.32	6.55	6.20	6.07	5.69	5.13	3.87	3.89	4.31	4.18	4.52	6.31	5.57	4.87	5.00
Indian equity	8.90	6.27	3.73	2.11	2.35	3.93	4.63	1.58	1.31	1.72	1.84	1.27	1.32	1.71	2.60	3.61
Event-driven	4.42	3.69	2.28	1.88	2.45	2.84	3.30	2.75	2.97	2.58	2.15	2.88	3.13	3.73	4.10	3.50
Commodity	1.82	3.10	2.17	1.85	2.31	2.04	2.62	2.53	2.17	1.8	1.37	1.01	1.13	1.34	1.48	1.22
Specialist	1.32	0.71	0.69	0.60	0.88	0.79	1.15	0.41	0.75	0.91	0.77	1.18	1.37	1.50	1.62	1.82
Other	5.87	6.00	5.35	4.10	8.19	10.02	17.68	13.30	12.19	12.78	13	13.52	13.80	21.04	21.63	26.60
Total	**191.72**	**175.53**	**122.43**	**118.75**	**132.48**	**137.75**	**152.39**	**144.65**	**140.62**	**144.39**	**139.08**	**152.84**	**158.79**	**177.98**	**192.81**	**221.17**

Source: AsiaHedge database and survey Other includes European strategies, Arbitrage, Global Fixed Income, Currencies, Korean Equity, Taiwanese Equity, Thai Equity, Vietnamese Equity, Indonesian Equity, Stat, Quant, CTA, credit/undisclosed and UCITS.
**Distressed funds were added since Dec 2005. # adjusted*

decade or so ago. "After the small-cap bubble burst in 2006 there was a hollowing-out of the Japanese hedge fund industry," says Candy Cheung, portfolio manager and co-head of Asia investments at SAIL Advisors in Hong Kong.

Others agree that in the second half of the last decade, the performance of Japanese equities was very unproductive for long/short managers. "The problem in 2006 and 2007 was that Japanese equities started to become very range-bound," says Kier Boley, portfolio manager in the alternative investment solutions business at GAM.

"All the managers had similar portfolio risk controls, which meant they put on too much protection as the market approached the bottom of its range and too little at the top. The result was that long/short equity managers got badly whipsawed, and a lot of capital flowed out of the industry."

The numbers tell the sad story of the demise of the Japanese hedge fund sector plainly enough. Assets under management at Japanese long/short equity and market-neutral strategies have nosedived from almost $37 billion in June 2007 to a little over $21 billion in June 2015.

Today, however, opportunities may once again be opening up for those brave managers who stayed the course and established a reasonable track record in Japan. "The legacy of the downturn in 2006 and 2007 is that the number of investable long/short equity funds focusing purely on the Japanese market is surprisingly limited," says SAIL's Cheung. "But we think some of the smaller funds will be worth watching because Japan will create good alpha opportunities going forward."

Boley agrees, but he suspects that investor demand for directional long/short strategies in Japan may remain muted. "I doubt that investors will want to go back into neutral-type strategies until the market becomes more discerning about individual stocks," he says. "The interesting strategies will be those that are able to identify some form of catalyst for share price performance driven by the increased focus among some Japanese corporates on return on equity (ROE)."

2015 – A YEAR OF TWO HALVES

Elsewhere in Asia, says Kingsmead's Foo, 2015 has been a year of two halves for most long/short equity strategies. "The early part of the year was a long China story as investors responded to cheap valuations and accelerated reforms and initiatives such as the Shanghai-Hong Kong Connect," he says.

"There was some alpha in our long China exposure in the first half, but the main driver was beta. At the same time we were short markets such as Indonesia, Thailand and Malaysia."

Many of those managers caught in the headwinds of China's downdraught, however, were able to withstand the impact of the volatility in the 'A'-share market. "I think that in general the performance of many China-focused managers has held up fairly well," says Yoon at SAIL.

"Although the industry lost money in August, most managers were still positive for the year by the end of September. This is because by the time volatility started to rise and the government began to intervene in the market in July, many managers had already gone into risk-control mode."

Encouragingly, says Yoon, the majority of long/short Chinese equity funds were able to adapt to the turn in the market decisively enough to protect their investors. "Most of our long/short managers did what they are paid to do," he says. "Rather than persevere with long-biased strategies, they were dynamic and carried out strong risk management to reduce exposure levels. Most of our managers

Candy Cheung, portfolio manager and co-head of Asia investments, SAIL Advisors recovered strongly in October, as Chinese equity markets rebounded. There were some China funds – that we are not invested with – that suffered large losses and have received investor redemptions. Many of them run heavily long-biased strategies, and are less alpha-focused."

Looking ahead, managers say there will be compelling drivers for equity strategies in the region over the coming 12-18 months, especially for those sticking to their guns on the long-only potential of China. There, developments such as the Hong Kong-Shanghai Connect (soon to be extended to Shenzhen) and the likely inclusion of 'A' shares in the widely-tracked MSCI benchmark are both likely to fuel demand for long-only funds.

CAPITALISING ON DIVERGENCE

Market inefficiencies have underpinned the continued launch of new long/short equity strategies in Asia over the last 12-18 months. These have included funds such as the pan-Asian fundamental long/short strategy launched in late 2014 by the Hong Kong-based BosValen Asset Management, which is run by Ken Xu, formerly of SAC Capital Advisors and Och-Ziff Capital. The fact that the BosValen product was launched into a crowded long/short equity space with around $300 million was taken as striking proof of the strength of demand for the strategy.

Another notable new equity long/short strategy, which was also regarded as a barometer of demand, was the fund launched late last year by Pleiad Investment Advisors, which was co-founded by Kenneth Lee and Michael Yoshino, previously of Soros Fund Management. Seeded by HS Group, the Pleaid strategy – which soft-closed in March with AUM of a little over $500 million – focuses principally on Chinese and Japanese equities.

Unsurprisingly, the universe of fund launches in Asia over the last year has continued to be dominated by equity long/short strategies, which have historically been the anchor of the region's hedge fund market. The space has also traditionally been the preserve principally of directional funds,

The challenge of generating alpha in China

For the time being, the jury is out on how managers will be able to deliver alpha in the Chinese market.

"Now that the authorities have clamped down on short-selling, strategies have either had to focus on long-only opportunities on the mainland, or reduce their exposure to 'A'-shares and focus instead on the Hong Kong 'H' share market, where the Chinese government can't restrict shorting, or on the ADRs listed in the US," says Yoon at SAIL Advisors.

"Strategies focusing on opportunities in Hong Kong have been able to post some good returns, but they're not of the same magnitude as those they were generating in the 'A'-share market earlier in the year."

Harold Yoon, chief investment officer, SAIL Advisors

In the short term, this may play into the hands of some of the China-based funds, or so-called Sunshine funds. Some of these have started to exploit their local presence as stock-pickers to attract flows of international capital.

But opinion is split as to how suitable Sunshine products are for international investors. Many say they do not regard the onshore funds as investable, and neither the authorities nor some of the funds themselves have done themselves many favours recently in advancing their cause.

Lurid stories about hedge fund offices in China being raided by armed police and managers dragged away to answer charges of "malicious trading", for example, will have done little to inspire confidence among international investors.

Increasingly, however, investors away from the Chinese mainland are looking more closely at the handful of Sunshine funds that have established a presence in Hong Kong, which they are using as a platform from which to market offshore versions of their strategies to international investors.

"We've done some due diligence on a number of Sunshine funds," says SAIL's Cheung. "The industry is still at a very early stage and some high quality managers will emerge. But as regulatory risk is something we are very conscious about, we would only consider investing in offshore vehicles regulated in Hong Kong or Singapore."

Anecdotal evidence suggests that some of these emerging managers, and many others across the region, are becoming far better at generating alpha than the industry was five years ago. Until recently, investors could have been forgiven for arguing that limitations on short-selling in China would make precious little difference to Asian hedge fund managers that have historically been long/short strategies in name only.

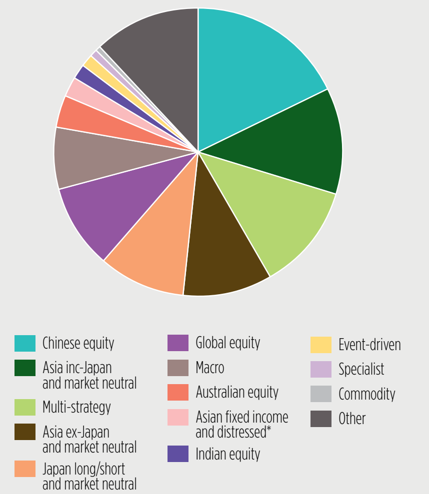
In reality, many have been overwhelmingly long-biased and have provided very little in the way of alpha. This may be changing. "When I first came to Asia in 2009, the market was full of highly-levered beta jockeys," says Graboi at PAAMCO in Singapore.

"But one of the big developments we've seen in the Asian hedge fund industry over the last five years has been the passing of the torch from one generation to the next. The first generation was made up of managers who were very good analysts but were less good at understanding trading dynamics," he says.

"Managers in the second generation tend to combine good analytical skills with the lessons they've learned from multi-strategy managers in the US or Europe, and are much better than their predecessors were at portfolio construction."

At SAIL, Cheung agrees. "The market today is very different from how it was seven or 10 years ago," she says. "Today there are many more funds in the region that are genuinely running long/short, low net exposure strategies. Most are focused on Greater China, Japan and Australia. We also see some managers successfully using selective shorts in some of the smaller Asian markets, although these strategies often have a mismatch between their longs and shorts because borrowings are limited to large caps or liquid names."

Asia-Pacific hedge fund assets by strategy: June 2015



*Source: AsiaHedge database and survey Other includes European strategies, Arbitrage, Global Fixed Income, Currencies, Korean Equity, Taiwanese Equity, Thai Equity, Vietnamese Equity, Indonesian Equity, Stat, Quant, CTA and UCITS. *Distressed funds were added since Dec 2005.*

with event-driven strategies thin on the ground.

"In merger arb, many Asian deals are subject to considerable complexity," says Graboi at PAAMCO. "We don't feel investors get adequately compensated for this in Asia-only strategies, although it may make sense to have some exposure to certain Asian deals as part of a global merger arb strategy."

Away from the equity long/short space, one of the principal drivers of hedge fund launches and performance has been the increasing divergence between macroeconomic performance and monetary policy across the region. This is because, as Moody's commented in a recent report, "most Asia Pacific sovereigns have a relatively high degree of immunity to external economic shocks." But it adds that "rating momentum is diverging as some drive through ambitious reforms, while others struggle with long-standing challenges".

This dynamic has been creating new opportunities for Asian-based hedge fund strategies. "One of the most notable trends this year has been the build-up in Asia of discretionary macro strategies," says GAM's Boley. "The main driver has been the divergence in central bank monetary policy. Until the Fed started to indicate that it planned to start tightening, volatility in FX markets was very low, which meant that opportunities for hedge fund strategies were largely confined to equities. Now that interest rate cycles are starting to diverge, there has been a spike in volatility and a decrease in correlations in FX, which has strengthened demand for macro strategies."

Notable beneficiaries have been FX specialists like Yip Ka-Hay, the former PMA macro trader who set up the Bright Stream macro fund in 2013. The strategy has thrived this year, returning 12% in the first eight months.

In 2015, divergent central bank policy and currency performance has been especially supportive of investor demand for macro strategies, which led the way in terms of new launches in the first six months of the year, accounting for $4.2 billion out of a total of $5.3 billion.

By the end of June 2015, the AUM of Asian macro strategies had reached more than $15 billion, compared with $11.4 billion in December 2013 and less than $7 billion at the end of 2011. That represents quite a departure for an industry that has traditionally been dominated by long/short equity strategies.

Much of this total is accounted for by the Singapore-based Graticule Asset Management Asia (GAMA), which early this year was spun out of the Fortress Investment Group's Asian macro strategy, which was set up in 2011 by Adam Levinson and saw its AUM rise rapidly from $200 million to a peak of about $8 billion in 2007, before slipping back to $2.3 billion by the middle of this year.

Following a disastrous performance in 2015, Fortress Investment Group has announced the closure of its global macro strategy, while Graticule has seen its AUM rise to more than $4 billion.

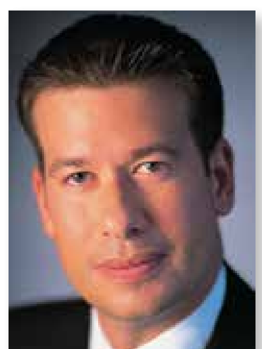
Another highly successful newcomer in the Asian global macro space is the Hong Kong-based Guard Capital Management, which was set up in August 2014 by the ex-Goldman Sachs trader, Leland Lim, and Allan Bedwick, who was previously at the commodity trading company, Noble Ltd. Over the last year, Guard's AUM is reported to have risen to close to $1 billion.

Managers say there is still plenty of potential in the market for global macro strategies in Asia. "Although the list is growing, there are still very few global macro and relative value strategies in Asia compared to the US and Europe," says Yoon at SAIL.

ASIAN QUANT BUILDS MOMENTUM

More broadly, continued inefficiencies in markets across Asia hav e also provided a fertile environment for quant strategies, such as the AMP Capital Asia Quant Fund. AMP Capital reported when the market-neutral strategy was launched, in January 2014, that it aimed to take "the proven quantitative investment technique it has honed in Australia and [apply] it to a selection of rapidly developing Asian markets".

Lachlan Davis, head of multi-strategy funds at AMP Capital in Sydney, says that the fund's investable universe is made up of more than 1,100 stocks in Hong Kong, Singapore, Taiwan and South Korea, as well as Australia. "The quant strategy is all about targeting momentum and combining this



Kier Boley, portfolio manager, GAM

Lachlan Davis, head of multi-strategy funds, AMP Capital

with identifying relative value opportunities within sectors," says Davis. "That means we need to maintain a well-diversified portfolio with a fairly high turnover, which in Asia rules out a number of the smaller and less liquid markets," he says.

The investment universe for quant strategies such as the AMP Capital fund is also restricted by the number of markets in which opportunities for short-selling are restricted or prohibitively expensive. "We need access to stable and secure stock-borrow markets, and we need to avoid recalls and short squeezes which can be very expensive," says Davis.

For the time being at least, that rules China 'A' shares out of the AMP Capital strategy. "Our models suggested that China's 'A' share market was very attractive in terms of its alpha potential, but our fear was that the stock borrow market was immature and vulnerable to government interference," says Davis. "Those chickens came home to roost during the summer."

Japan is the other notable omission from the markets included in the AMP Capital quant portfolio – which is perhaps surprising given the perception among some managers that inefficiencies in the market make the Topix index a goldmine for relative value hunters.

"One of the main anomalies we're targeting in the strategy is the momentum factor," says Davis. "For our momentum signals to work, we need relative market inefficiencies, and as Japan is an efficient and institutionalised market, many investors look for the same signals as we do. This makes the market similar to the US in the sense that there is too much money chasing the same anomalies."

The other complication that AMP Capital faced when it back-tested its quant model was the by-product of shifts in the Japanese political landscape. "After years of stagflation and flat corporate earnings we felt that Abenomics would possibly be a game-changer," says Davis. "All our back-testing covered the period before Abe was elected, so we were unsure that the anomalies we identified would continue to hold if Abenomics were to stimulate a new phase of growth in Japan."

Davis describes the AMP Capital quant fund as an algorithm-driven strategy with a fundamental overlay based on extensive scenario analysis. "Our fundamental analysis generates extensive forecasts aimed at identifying earnings-driven turning points in stock price performance, which we then incorporate with our quant model," he says. "We believe it is a unique style which has served us very well in terms of performance. In the first 10 months of this year we were up 13.3% net of fees."

AMP Capital's Quant Strategy currently has gross exposure of about 240%, with a market neutral weighting between long and short exposure. Hong Kong has been the principal driver of the strategy's returns this year, accounting for roughly 85%, or a little over a third of its gross exposure, followed by Australia with around 60%, Korea with 40%, Taiwan with 30%, and Singapore with the balance.

>> If you're a pension fund, you want to be able to make a $20 million investment to make it worth your while. Away from China, Hong Kong and Japan there are very few countries where that is possible in liquid hedge fund investments >>

GOOD MORNING, VIETNAM?

The majority of investors say that they continue to see the Asian hedge fund sector through the relatively narrow prism of opportunities in the North-East Asian markets of China, Greater China (including Hong Kong and Taiwan) and Japan.

The failure of countries elsewhere in the region to develop thriving hedge fund industries, say local managers, reflects inaccessibility for overseas investors, illiquidity, lack of hedging opportunities, or an unflattering track record. In some economies in the region, it reflects a discouraging combination of all four.

Take the example of India, which managers say has frustratingly never quite managed to deliver on its potential as a huge and fast-growing economy with an increasingly liquid domestic investor base and the oldest stock exchange in Asia. After all, the Native Share & Stock Brokers Association (better known first as the Bombay and then as the Mumbai Stock Exchange) was founded in 1875.

"The Indian hedge fund industry has never really lived up to expectations," says Yoon at SAIL Advisors in Hong Kong. "We were bullish about India after the election of prime minister Modi last year, but we struggled to find India funds that meet our criteria. Instead, we added to a pan-Asian fund that has about half its assets outside India."

Yoon says that most of the India funds SAIL sees are heavily long-biased, and some are long-only. Another issue, he says, is the non-convertibility of the currency. "The only way you can hedge back into euros or dollars is through non-deliverable forwards (NDFs), which can be expensive," he says.

Elsewhere in the region, says Yoon, strategies with sufficient liquidity to satisfy US or European investors remain thin on the ground. "We've researched local hedge funds in markets like Malaysia and we've found nothing that is investable,

The changing world of prime brokerage

James Shekerdemian, Global Head of Prime Brokerage sales,
Societe Generale Prime Services

The regulatory environment implemented post-financial crisis brings a host of challenges for prime brokers and their clients. The new rules are enormous in scope and touch on so many aspects of the trading cycle and related market participants that they are changing the very shape of the providers that supply these services. What's more, it is providing a tough test for those who wish to stay in the business, as it's critical to continue investing in service provision in this new climate.

Bank capital regulation is one of the key initiatives impacting the delivery of prime services. Basel III in particular has presented a variety of new hurdles for investment banks to clear ahead of its implementation date in January 2017. This is significant for those prime brokers that sit within investment banks. While heightened concerns about counterparty risk mean they have a market advantage in being able to lean on the financial strength of their parent, it also means they must meet stricter requirements in their own activities, some of which are especially capital intensive.

What's more, the capital environment is facing challenges that are growing with new product regulation. New clearing requirements introduced through Dodd Frank in 2010 and EMIR in 2012 have made the OTC business highly capital intensive. OTC products have always carried margin requirements but new regulations demand that collateral must be of high quality; exactly the same assets that are expected to be seen on a bank's core balance sheet to prove its solvency. This is placing brokerage businesses under unprecedented pressure to source capital, and presents a unique challenge for those associated with financial institutions which fall under Basel III's remit.

For some institutions, this has proved too much to bear, and they have simply exited the space. Among those that have chosen to remain, they have both made the significant investments necessary to continue and also become ever more creative about how they tackle these issues. There are some more technical solutions that can be used. Synthetic trades ask less of the balance sheet, so these are growing in popularity. Assisting clients with collateral management is also key, given the competing demands on capital, and the more sophisticated market participants are helping clients to transform ineligible assets into "postable" margin to facilitate compliance with these demands.

The regulatory environment has worked to gradually reduce the amount of leverage in the system. This also impacts on prime brokers' client selection, with providers seeking to work with clients who are themselves well capitalised and without excessive leverage on their balance sheet who will be able to implement effective collateral management processes.

These conditions have all contrived to make the operating environment significantly tougher for prime brokers. This is in addition to tough competition, sustained low interest rates and the higher cost of accessing capital. As a result of this, many have had to undergo a difficult process with their clients repricing services as the cost of prime brokerage has risen. They have had to make considerable investment into prime services divisions to accommodate the additional compliance, capital costs and technology needed for effective risk management, which SGPS has put at the core of its approach.

The climate has also pushed prime brokers to find alternative sources of income to ensure that the business can remain sustainable. This is one of the factors which has seen the relationship between prime brokers and their clients evolve and significantly deepen – stretching wider to cross-asset and multiple product propositions. This has benefited brokers which sit within bigger capital markets businesses that can help to match clients with the ancillary services and products that they need.

These economies of scale can bring advantages in a host of ways. Bigger institutions can more easily tap into market liquidity and financing, which is essential in a capital constrained climate. Capital introduction remains paramount for hedge fund clients in a highly challenging launch environment, so players which can effectively connect nascent funds with financing and accommodate the associated due diligence will have a distinct edge over their competitors. This is key given the growing segment of emerging managers which are keen to mobilise amid the burgeoning economic recovery.

Equally, prime brokers have had to reconsider their own internal processes and structures. World class technology that enables straight-through processing (STP) and automation is essential to providing the scale and efficiencies needed to complete in today's market. The demands brought about by the implementation of Mifid II have reinforced this need as prime brokers must demonstrate that they are offering best execution to their clients, as well as complying with the increased reporting demanded by derivatives regulation. Manual processing, as well as being resource intensive, is simply too susceptible to error to meet the standards required for effective risk monitoring and compliance.

It is unsurprising, therefore, that recent years have been marked by a consolidation in the prime services universe as providers have been forced to undergo a tough and honest assessment of whether they can feasibly continue to provide services in this operating environment. The industry that ultimately emerges at the end of this challenging period is likely to be a smaller group of well capitalised players, that can offer sophisticated technology along with a broader and deeper relationship with clients than ever before to help them achieve their business objectives. It is no coincidence that this group will also be those who have continued to invest significantly back into their offering at a critical time.

John Malloy, head of emerging markets, RWC Partners

given our liquidity requirements," he says.

"If you're a pension fund, you want to be able to make a $20 million investment to make it worth your while. Away from China, Hong Kong and Japan there are very few countries where that is possible in liquid hedge fund investments."

Other managers are adamant, however, that there is room for niche strategies identifying pockets of growth and uncorrelated returns in Asia. The Singapore-based Kingsmead Asset Management, for example, established a long-only Vietnam Fund in August 2014, which by mid-November had returned over 23% this calendar year.

This made the strategy the best performing fund in its peer group, according to Kingsmead's founder and chief investment officer Foo, who is unapologetically bullish on the outlook for Vietnam. "I would describe Vietnam as the brightest star in ASEAN's dark economic night," he says.

"Vietnam is at a completely different point in the cycle to the rest of ASEAN, where markets like Indonesia and Malaysia have been hammered by depressed commodity prices and deteriorating terms of trade," says Foo. "The result is that we are seeing a sharp increase in credit stresses and non-performing loans (NPLs) in these economies, and a structural decline in economic activity."

In Vietnam, says Foo, NPLs are still much higher than in Malaysia or Indonesia. But he says that the key difference is the trajectory of NPLs, which in Vietnam is clearly falling. At the same time, he says, the Vietnamese property market is recovering, Chinese investment is flowing into its manufacturing sector, and thriving Vietnamese industries such as garments and shoes are recognised as being among the main beneficiaries of the recently-signed 12 nation Trans-Pacific Trade Partnership (TPP).

Although this all sounds highly supportive of a long-only strategy like Kingsmead's, which is focusing on undervalued mid-caps and IPOs, most international investors will continue to regard frontier-cum-emerging markets such as Vietnam as too illiquid to merit serious consideration.

Foo acknowledges that liquidity is still low by most emerging market standards, but says this is changing very rapidly. "Market capitalisation is now about $60 billion, and we think that with a number of IPOs in the pipeline, Vietnam will be a $100 billion market within the next 24 months," he says. "Daily trading volumes have tripled from about $50 million to $150 million over the last 18 months, and will continue to rise as more investor gain exposure to the Vietnamese growth story."

For the time being, says Foo, the investor base for the Vietnam Fund has been confined largely to family offices in Asia. But he is convinced that as performance and liquidity gain traction, investors in the US and possibly in Europe will also be attracted to the potential of Vietnam and to the uncorrelated diversification opportunity it creates within an emerging markets portfolio. "Over the last 10 years the correlation between the MSCI Vietnam index and MSCI World has been 0.1," he says.

Another manager that rejects the notion that Asian opportunities begin and end in the north Asian triangle of China, Hong Kong and Japan is RWC Partners. In April it recruited a 16-person emerging markets team from Everest Capital, which shut up shop when its $830 million global fund collapsed in the wake of the Swiss franc's surge. Under its co-heads of emerging markets, John Malloy and James Johnstone, the Miami and Singapore-based team runs global EM, frontier and Asia long/short strategies.

"We see Asia very much as a growth area, and we're using a bottom-up perspective to find opportunities throughout the region – whether that is in a large and liquid market like Japan or a frontier market like Pakistan," says Malloy. He adds that he doesn't regard the relative illiquidity of the region's less developed markets as a constraint, and that the frontier-focused strategies invest in companies with a minimum market capitalisation of $400 million and a daily trading volume of at least $2 million.

While country funds are one source of diversification for equity strategies in Asia, another that is growing are sector-specific strategies. "Specialist healthcare funds have been successful in the US and we are starting to see similar strategies being launched in Asia," says Cheung at SAIL.

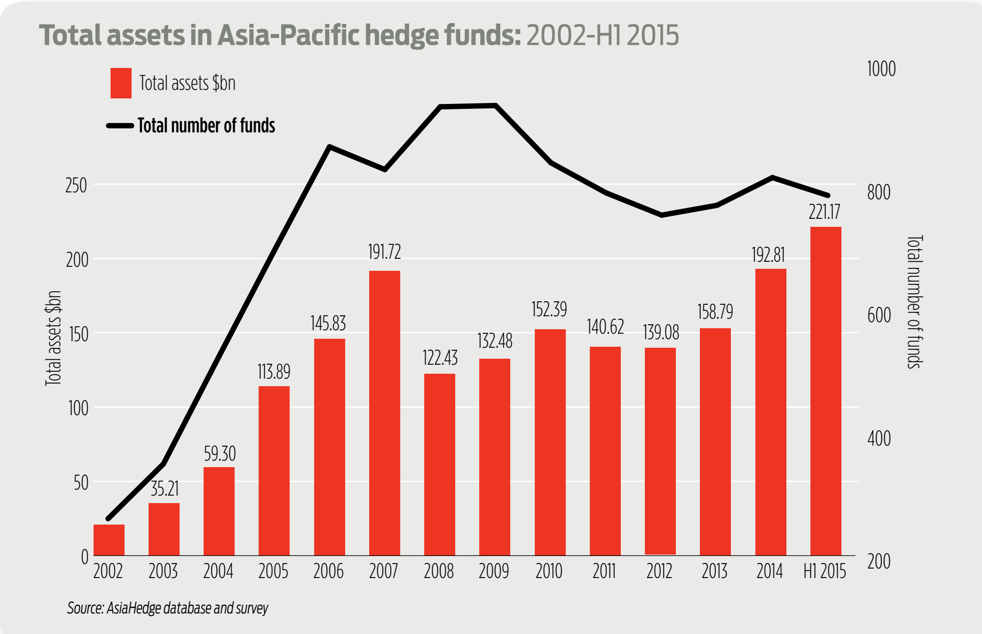
"With middle-class incomes rising, consumers are paying more attention to their health and wellbeing. As the number of investable companies in the Asian healthcare sector is increasing, we think this will be an exciting new segment of the market. But most have only been in existence for one or two years, so it is still too early to judge how successful they have been in terms of capital-raising or performance."

AN EXPANDING INVESTOR BASE

Investor demand for alternative strategies in Asia has historically been driven predominantly by high net worth individuals (HNWI) and family offices. Increasingly, however, demand is growing from Asian institutional investors, which on an aggregate basis have increasingly formidable firepower.

Herald van der Linde, head of equity strategy at HSBC in Hong Kong, has been keeping a close eye on the growth of the institutional market in the region, publishing a series of research notes on this trend entitled "Asia buys Asia."

He says that between 2011 and the end of 2014, total assets managed by Asia's pension, insurance and mutual funds rose by 51%, to $7.8 trillion. That represents a CAGR of 11% over the period, during



which domestic institutions' assets rose from 40% to 47.4% of GDP.

While the obvious beneficiaries of this dynamic are mainstream equity and fixed income markets, it is also trickling down to the hedge fund sector. "There is no doubt that local liquidity is increasingly important as a driver of hedge fund demand throughout the Asia-Pacific region," says Crawford at Societe Generale Prime Services.

"The process began in Australia, where CTAs such as Kaiser and Boronia were unable to raise money from domestic investors when they were set up in the late 1990s and had to go overseas for their capital. Today, local institutions led by Australian superannuation funds are big allocators to alternative strategies including hedge funds. We are starting to see a similar trend among pension funds in North Asia."

The commitment among the region's pension funds to diversify their portfolios from a geographical and strategic perspective has perhaps best been exemplified by the world's third largest pension fund, South Korea's National Pension Service (NPS), which recently opened an investment office in Singapore. This is the fund's third offshore investment office, adding to a network that includes outlets in New York and London.

As of August 2015, just over 10% of the fund's $430 billion portfolio was in alternatives, about half of which were in overseas alternative assets. It has been reported that the fund will be looking to increase its international holdings over the next five years to more than 30%, doubling its exposure over the period to overseas alternatives, primarily through funds of hedge funds.

In Japan, meanwhile, the massive Government Pension Fund (GPIF) announced in October 2014 that it was planning to adopt a new strategic asset mix aimed at addressing the twin challenges of diminishing returns on traditional investments and an ageing society. "And it will not end there," says a recent PwC report on the outlook for the global alternative asset management industry. "Three smaller funds managing about $250 billion…plan to adopt a mix similar to GPIF."

Although it has been widely reported that the Japanese pension fund is planning to expand into hedge funds, the word 'hedge' does not appear in the GPIF's statement on its new asset allocation policy. This says that alternative investments will account for a maximum of 5% of total AUM, which at about ¥137.5 trillion equate to some 28% of Japan's GDP. The alternatives specified in the GPIF's statement are limited to "infrastructure, private equities [and] real estate".

Managers say that if and when large Asian pension funds expand into hedge fund strategies, they are expected to favour large international brand names over regional players. "When Japanese investors began to expand into alternatives, their preference was for CTAs managed by well-known international managers like Winton and AHL," says Boley at GAM. "This was because they offered low correlation to equities, but also because they provided weekly liquidity that Japanese institutions needed."

Rising demand from regional institutional investors across mainstream asset classes is, of course, a double-edged sword for hedge fund strategies. While they will bolster liquidity and probably underpin valuations for long-only strategies, over the longer term they may flatten out some of the inefficiencies which are a key source of alpha for many regional funds.

"US investors, in particular, recognise that Asian markets are still characterised by substantial inefficiencies," says Davis at AMP Capital in Sydney. "There is a fairly widespread consensus that because Asian markets are so retail-dominated, alpha is there for the taking." In a more institutionally-driven market, this alpha may be more difficult to extract.

THE POTENTIAL OF CHINESE DEMAND

While demand from deep-pocketed institutional investors in markets such as Japan and Korea may be one important driver of growth for hedge funds in Asia going forward, another may be rising demand from mainland China. There are several key reasons why some managers believe that demand from Chinese investors will expand over the coming few years.

One of these is the recent devaluation of the RMB and expectations that the Chinese currency has further to fall against the dollar. That, think some strategists, may lead some domestic investors to look at opportunities for investment overseas. Another related reason is that after their traumatic experience in the 'A'-share market this summer, investors may be having second thoughts about the appeal of some of their traditional preferences in the domestic capital market.

"We have been discussing the potential of the Chinese investor market internally in recent months," says Mats Sjostrom, head of marketing and investor relations at SAIL Advisors in Hong Kong. "Up until recently, the requirements of Chinese investors in terms of return were clearly in the high teens, and as our products are well-diversified and balanced strategies, they were unappealing compared with long-only equity and guaranteed wealth management products."

He adds: "We think the landscape may now be changing. We have had some interesting discussions with some of the larger brokerage houses and other product providers on the mainland about hedge fund products that may be appropriate for the local market. This is probably a multi-year project, because return expectations among Chinese investors are still above the global average, but we believe that interest in China will grow."

As to the US and European investor base for the larger Asian strategies, local managers say that demand is continuing to recover, having been very badly shaken during the global financial crisis.

"A number of large international investors were reluctant to return to the Asian alternatives market after the global financial crisis," says Sjostrom. "This is now changing, with US and European investors recognising that although Chinese growth is slowing, Asia is a substantial part of the global economy and fantastic opportunities are emerging in the region."

Sjostrom adds, however, that the recent turmoil in China may have led the international investor community to reappraise its strategy in Asia. "Many international investors are also recognising that it is no longer a question of whether they should have exposure to the region, but what type of exposure they should have," he says.

"I believe that the strong run-up in the Chinese market followed by the aggressive sell-off has made investors hesitant about overweighting their long-only exposure and realising that they need a more diversified and efficiently hedged presence in the market."

This dynamic should be supportive of Asian funds of funds such as SAIL, and Sjostrom says he is encouraged by the feedback he has been receiving from international investors in recent months. "We're definitely seeing more interest from overseas investors, especially from Europe," he says. "We're also receiving more enquiries from the US."

For funds of funds in Asia, the local institutional market remains a tough nut to crack, however. This may be one reason why there are still very few large funds of fund managers in the region, which mirrors the more generally fragmented structure of the industry.

Although a handful of highly successful funds have broken into the global billion dollar club in recent years, more than half of the funds in the region are still managing less than $50 million, which in part reflects the relative scarcity of seed funding in Asia. Strategies such as the Singapore-based Dymon Asia, which has some $4.5 billion under management, remain very much the exception rather than the rule.

Cheung says the relative scarcity of billion dollar funds in Asia is no bad thing for a regional fund of funds investor like SAIL. "The liquidity and depth of Asian markets, coupled with the limitations on shorting in some markets, means that the capacity of Asian hedge funds is much more constrained than it is in the US," she says.

"This is not a problem for us," she adds. "In fact, it probably creates opportunities, because we like to meet funds early and invest when they are still relatively small. We'd be quite happy to allocate to a fund with AUM of as little as $50 million. But in the long/short equity space, $100 million to $300 million is probably the sweet spot in terms of AUM."

At Sussex Partners, Ghali agrees. "In Japan and China long/short equity, our favoured funds are those that close with AUM of $300 million to $500 million," he says. "Returns often start to diminish

Mats Sjostrom, head of marketing and investor relations, SAIL Advisors

when strategies go beyond this."

That may be. But with industry costs rising throughout the world, breakeven levels in terms of AUM are also on the up. "The costs of regulatory compliance are such that managers who want to market themselves to institutions and sophisticated family offices in the region need a lot more AUM than they did in the past," says PAAMCO's Graboi.

"A decade or so ago you could start with $25 million. Today, the minimum you need to pay your team and build an operation into something that can support institutional investment is probably $75 million. And to maintain a sustainable long-term business, you probably need between $150 and $200 million."

This may explain why it is that although AUM levels are rising across Asia, the total number of funds in the region is declining. As of June 2015, there were 784 funds in Asia, compared with 813 at the end of 2014.

Asian funds need a certain level of scale in order to attract overseas investors. GAM's Boley points out that European demand, in particular, is increasingly gravitating towards alternative strategies in UCITS format.

"Swiss private banks, for example, were early investors into managers in the Asian region," he says. "They now prefer either to buy long-only strategies or UCITS versions of hedge funds. That is working in favour of the largest houses that can offer multiple versions of the same investment process in a range of different structures, and squeezing the smaller independent managers."

Boley says that increased demand for hedge fund strategies in regulated wrappers ought to be seen by Asian managers as an opportunity. "As Asian managers look to raise new capital they might give a thought to how the European market restructured and adapted after 2008 and 2009," he says. "There was a very clear movement of money onshore, which led to a rise in demand for UCITS structures and AIFMD-compliant fund structures. These are the structures managers should be looking at, rather than traditional Cayman funds."

Monica Hsiao, founder and CIO, Triada Capital

CREDIT STRATEGIES: THE NEXT BIG THING?

What does not kill you, they say, makes you stronger. With the benefit of hindsight, a manager like Triada Capital could have chosen better timing when it launched a new Asian long/short credit fund in May.

The Triada Asia Credit Opportunities Fund was founded by Monica Hsiao, who was previously responsible for trading Asian credit strategies at the London-based global multi-strategy manager, CQS. Hsiao's investment team at Triada also includes two of her former colleagues, senior research analysts Anna Tham (previously head of Asia research at CQS) and Jiwon Lee.

"The Triada strategy focuses on generating alpha returns by taking long/short positions in liquid credit instruments, driven by corporate events and based on deep fundamental research and analysis across the capital structure of pan-Asian corporate issuers," says Triada's CEO and COO, Jean-Marie Barreau.

"Historically, the investment team has generated alpha returns with low volatility, with limited exposure to interest rates and currencies. This new fund's investment process is similar to the approach the team deployed in the past."

"Some may view our timing as not having been ideal, because global financial markets in the last five months have been extremely volatile," Barreau says. "But we have actually found the volatility to be a mixed blessing, as our performance compared well to most benchmarks."

He says that between June and the end of October the fund recorded a net cumulative return of 4%, which is a creditable showing in a challenging environment. "We have managed our risk well and kept our volatility relatively low, especially bearing in mind the environment in which we launched," says Barreau. "Performance has been good, although it's difficult to compare us with other Asian credit funds because most of our competitors are long-biased, or mix in a larger component of equities or currencies, rather than being genuinely focused on long/short credit strategies."

Although long/short credit is regarded as a relatively new strategy for hedge funds in Asia, Barreau says that the Triada fund's investment universe spans a large and well-diversified range of debt instruments including distressed credit, high yield, cross-over and investment grade. Its regional coverage, meanwhile, is pan-Asia, which includes corporate issuers in Japan, Australia and parts of the Middle East.

Barreau believes that all the necessary component parts are now in place to support the development of a vibrant and investable market for long/short credit strategies in Asia. "The team believes that with potential macro-economic challenges, a volatile interest rate environment, and global geopolitical risks in the foreseeable years ahead, we will see more differentiation of credit quality," he says.

"This will create numerous investment and trading opportunities for a manager like Triada that focuses on credit event plays – whether with a positive or negative view – and finding relative value trades in the midst of market dislocations."

For hedge funds targeting Asian credit markets, this dynamic has coincided with deeper hedging opportunities which are allowing them to offer increasingly liquid long/short credit strategies.

One of the most successful managers in this space has been the Hong Kong-based Double Haven

Capital, which has recently won some notable mandates from US pension funds, including CalPERS. These have helped total AUM reach around $620 million, with $162 million in the long/short strategy and the balance accounted for by long-only exposure.

The history of the Double Haven credit team dates back to 2002 when Darryl Flint co-founded PMA Investment Advisors Limited, which was the largest Asian alternatives hedge fund start-up in 2002 seeded with $650 million.

PMA rapidly developed a solid track record in the alternatives space, growing its AUM to approximately $2.2 billion in 2006, of which credit strategies (both public and private) managed by the Asian credit team represented some $900 million. In 2006, PMA was acquired by SPARX (the Japan-based equities and alternatives hedge fund manager). In October 2011, the Asian credit team spun-out the credit strategies from SPARX and rebranded itself under the name of Double Haven Capital, taking with them their existing clients and track record history.

Flint, whose professional career in Asia dates back to 1993, puts the evolution of fixed income as an asset class in the region in its historical perspective. "It's true that Asian investors and corporates have historically been very equity-centric, but things began to change in the late 1990s," he says. "The Asian financial crisis led many companies to reassess the liability side of their balance sheet and the way they raised capital. Many recognised that debt was a cheaper financing mechanism than equity and a good source of funding diversification."

More recently, other supply-demand dynamics have supported the growth of credit markets in Asia, says Flint. Low interest rates in the US and the search for yield has created appetite for dollar-denominated corporate bonds. At the same time, the increase in AUM among Asian institutions has fueled demand for fixed income securities.

"Over the last seven years Asian pension fund and insurance company assets have grown by about $1 trillion and $1.5 trillion respectively, and these institutions clearly have a requirement for long-duration assets," he says.

It is not just the region's institutions that have developed a taste for bonds. "The bid from private banks has become extremely strong in Asia," says Flint. "Retail and high net worth investors have learned over the last 20 years that while equities generally deliver a higher return, they also deliver a significantly higher level of volatility. As the Asian investor base has become more mature, its tolerance for volatility has diminished, and investors are very happy to buy high yield bonds with coupons of anywhere from 8% to 12%."

Credit hedge funds, says Flint, have also been

>> The Asian financial crisis led many companies to reassess the liability side of their balance sheet and the way they raised capital. Many recognised that debt was a cheaper financing mechanism than equity and a good source of funding diversification >>

supported by increasingly efficient hedging mechanisms for fixed income securities. This is especially true of the bonds in the Double Haven portfolio, which are exclusively dollar-denominated, with about two-thirds of the exposure accounted for by investment grade bonds. "We have always had a natural long bias, but we have hedges around the portfolio via sovereign and Asia IG iTraxx CDS," he says. "We also hedge interest rate risks through short US Treasury positions, which may be becoming more relevant if the Fed is about to begin a strategy of raising US interest rates".

"We have had some outright shorts, and repo markets have become more efficient," Flint adds. "Years ago the banks had no repo traders in Asia, and everything had to be done out of London. Recently, some banks have taken the initiative to relocate some repo traders to the region, which has been helpful, although terms and liquidity vary from name to name."

But some local managers continue to have their doubts about the prospects for credit funds in Asia. "Credit is still a challenging hedge fund strategy in Asia," says Yoon at SAIL. "We currently have no credit investments in our funds, and we're not seeking any at this time, largely because there is still insufficient liquidity in the market, particularly during market downturns. We think the best time to invest in credit funds in Asia is immediately after major dislocations, when the baby tends to be thrown out of the bathwater, leaving some good bonds trading at very deep discounts."

Flint says that while illiquidity in the Asian bond market remains a concern, there have been some significant structural changes to the landscape in the region. "A number of the large global banks have reduced their balance sheet commitments to trading Asian bonds," he says.

"But at the same time, we've seen Australian, Chinese, Singaporean, Korean and Indian banks all increasing their activity in the market. The result is that today we have more cash trading lines for US dollar Asian credit than ever before."

Darryl Flint, founder and CIO, Double Haven Capital

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Societe Generale offers a full range of execution and clearing services, covering listed derivatives, money market instruments, bonds, FX, cash equities, commodities and other OTC markets.

Societe Generale provides a range of value-added services, including capital introductions, cross-asset financing, an electronic platform for trading and order routing, cross margining, and the centralized reporting of client portfolios.

We work with a broad mix of Alternative Managers and Investors alike to help them focus on delivering returns, whilst using our top-level suite of services. Overall, we are best known for our consultative approach to relationships, and also our ability to offer tailored UCITS compliant portfolio structuring solutions. Many of our clients have been with Societe Generale Prime Services from launch and now form a good percentage of the largest hedge funds in the industry.

Formerly Newedge, now wholly owned by Societe Generale, our benchmark cross asset prime brokerage, combined with SG CIB's best in class equity derivatives and research capabilities, creates a compelling new proposition: top tier, front-to-back solutions from futures to equities, for alternative managers and investors.

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