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# Selling Hedge-Fund Stakes

By JOSEPH CHECKLER

Growing numbers of hedge-fund investors, desperate to redeem their money and avoid further losses, are turning to a secondary market in which to sell their stakes.

It can be difficult for investors to redeem stakes in hedge funds. A flood of investor-redemption requests has triggered the activation of several hedge funds' automatic "gates," which limit the percentage of a fund's assets that can be redeemed in a given quarter. Other funds have voluntarily suspended redemptions altogether, and many people fear that more gates and suspensions are coming.

That concern has forced investors to look for more creative and immediate ways to get out. Right now, buyers and sellers can find one another using their industry contacts, or through a service called Hedgebay Trading Corp., which operates the only secondary market that matches buyers and sellers of hedge-fund stakes. Discounts on such stakes have gotten as high as 50% in extreme cases.

## *Sold at a Discount*

When hedge funds were performing well, Hedgebay transactions would often see the buyer paying a premium for a stake in a well-performing fund. Now, however, nearly every stake that's being traded on Hedgebay is sold at a discount, says Anastacia Brooks, a spokeswoman for Hedgebay.

Hedgebay, which began operations in 1999, says it's never been this busy. That's because the deadline for many investors to tell their hedge funds they want to withdraw money by the end of the year was Sept. 30, forcing them to go to the secondary market to sell their shares.

The average hedge fund is down more than 10% this year, according to Hedge Fund Research Inc. The Dow Jones Industrial Average is down more than 30% this year, but many hedge fund investors aren't happy with just losing less than the market.

For a while, Hedgebay was dominated by investors -- either individuals or funds of funds -- who wanted to sell their stake for a profit, or get out of a poor-performing fund. But now, many more pensions and endowments are putting stakes up on Hedgebay. The reasons sometimes have to do with the stricter rules they face.

### *Fear of a Suspension*

But other investors use the secondary market out of fear of not being able to get out of a fund. Many funds of funds, which invest in several different hedge funds, have asked to redeem more money than they actually need out of fear that the funds they hold might put up a gate or suspend redemptions. If a hedge fund does suspend redemptions, that can force the fund of funds to do the same.

"You have funds of funds playing redemption roulette," says Hedgebay's Ms. Brooks.

Several hedge funds have suspended redemptions this year, including Pardus Capital Management, Drake Capital Management and, more recently, Ore Hill Partners.

A recent report from J.P. Morgan Chase & Co. estimated there would be about \$100 billion in redemption requests for funds of funds in the fourth quarter.

Investors in funds that have suspended redemptions aren't exactly in a position of power when they post their shares for sale on Hedgebay. The average discount for a hedge fund stake sold on Hedgebay more than doubled to 3.5% in the nine months through September, from 1.6% in the first eight months of 2008. That change means the discount

widened considerably in September. Hedgebay didn't say what the discount was for September alone. That discount could grow as sellers get more desperate before the end of the year.

Since there's no way to know which fund could be next to halt redemptions, some investors put their stakes up for sale pre-emptively. That creates opportunities, and there certainly are buyers -- in some cases, hedge funds themselves.

Permal Group, a unit of [Legg Mason Inc.](#), said last week it is launching a \$500 million fund dedicated to buying distressed-priced hedge fund stakes. A person with some knowledge of Permal said the fund will use Hedgebay to find and buy stakes, but will also find business using its existing relationships with investors and distributors.

While Permal appears to be the first investment management company to publicly announce such a fund, multiple sources say that others are doing the same.

### *Facing Capital Calls*

Fear of gates isn't the only reason that the secondary market is seeing more trading. Pensions and endowment funds "are faced with capital calls from their private-equity commitments and have to determine where the cash will come from," says Ms. Brooks. Pension and endowment funds are allowed to allocate only a certain percentage of capital to alternative investments such as hedge funds and private equity. The fact that hedge funds have outperformed the overall markets has made many pensions' and endowment funds' allocations too high.

"As a result," Ms. Brooks says, "they are forced to sell hedge funds in order to prevent their target allocations from getting hugely out of whack."

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