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Hedge-fund matching service thrives
Hedgebay shows how industry demand fluctuates

By Alistair Barr, MarketWatch
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SAN FRANCISCO (MarketWatch) -- Amid surging demand for hedge funds, many top managers have stopped accepting new money in recent years or persuaded investors to agree to longer "lock-ups."

In this environment, frustrated investors have increasingly turned to Hedgebay, an online service that helps people buy and sell stakes in sought-after hedge funds, creating a secondary market in elite managers.

Hedgebay, which started in 1999, serves funds of hedge funds, banks, ultra-wealthy individuals and family offices who find themselves in two very different situations, Jared Herman, co-founder of the firm, said.

Either they're trying to add to their investment in a hedge fund that won't accept new money, or they're trying to get out of a fund that has a long lock-up, preventing quick redemptions. (See full story on the rise of lock-ups).

Hedgebay brings these buyers and sellers together, gets permission from the hedge fund managers, handles all the paperwork and takes a fee of up to 1% of the assets that change hands, Herman explained.

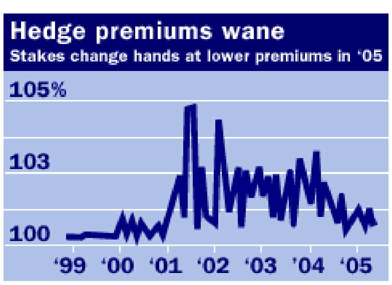
Hedgebay has thrived as lock-ups have increased and access to top managers has dwindled. Volume tripled in 2003 and has been rising at a 20% annual rate since then, Herman told the Economist earlier this month.

"It's a no-brainer for investors," Herman said. "Sellers are able to get out quicker, while buyers get a chance to invest in hedge funds that are usually closed to new money."

Some hedge fund managers don't want to get involved, but Hedgebay manages to persuade them to play along in about 85% of cases, Herman added.

Even though a phone call from Hedgebay may show a manager that one of their investors wants to redeem, the service also replaces the departing backer with a new, eager shareholder, he explained.

Most of transactions also take place at a premium to the net asset value of the stake, Herman said.



DATA: HEDGEBAY DATA

"Because a lot of the hedge funds are closed and investors can't get in, there's pent-up demand," he said. "It's an asset that's in short supply, so the price goes up."

Hedgebay tracks this premium and publishes a newsletter (The Hedgebay Chronicle) each month explaining how and why the premium moved.

Hedge funds have traded at an average premium of about 1.25% so far in 2005, slightly below

2004, Herman said, adding that in previous years the premium had been higher. (See chart)

"People's expectations for future returns aren't as grandiose as they used to be," Herman said. "Lower (hedge fund industry) performance recently has caused this. Investors aren't going to pay a higher premium for investments that they expect to generate lower returns."

Alistair Barr is a reporter for MarketWatch in San Francisco.