HUME BROPHY

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Some Types Of Hedge Funds Remain Unwanted, Unloved - Hedgebay

LONDON (Dow Jones)--Hedge fund investors are paying only a little more than half of face value to buy and sell funds seen as having little chance of returning capital anytime soon, Hedgebay Trading Corp. said Monday, in a sign that hedge funds' comeback last year has yet to reach the industry's darkest corners.

These illiquid funds, often known as "side-pockets" to a broader investment strategy, are classified by Hedgebay as those that have either suspended investor redemptions or otherwise aren't required to return money on request. Hedgebay, a company running an auction market for second-hand hedge fund stakes, launched an index for illiquid funds Monday, as a way to track what it sees as a "two-tier" market.

In January, stakes in illiquid funds changed hands for 57% of face value, compared with an average trading price of 87% across all types of hedge funds.

Elias Tueta, co-founder of Hedgebay, said the sharp discount highlights how the hedge fund industry still has more work to do to mend its reputation with investors, even after average 20% returns at most funds in 2009.

"Performance of the primary hedge fund market over recent months may suggest that the industry is back to full force, but in reality this is a false dawn," Tueta said. This performance "shadows the fact that every portfolio still holds a certain percentage of illiquid assets, and it is how investors deal with these illiquid assets on their books that will really dictate when the market recovers," Tueta said.

Even before the financial crisis started to unfold, hedge funds' use of side pockets to stick hard-to-value and hard-to-sell assets became a cause for concern for investors. When the crisis picked up steam, many investors were dismayed to find that even funds that marketed themselves as wholly liquid had holdings that couldn't be easily sold, and some funds said it could be years before they were able to return investor capital.

Meanwhile, a survey from Greenwich Associates Monday found that hedge fund managers have made sweeping improvements to their operations to cut their counterparty risk and make themselves more attractive to investors.

Nearly 60% of managers surveyed have increased the number of prime brokers they use, in response to the collapse of Lehman Brothers that tied up hedge fund assets, and close to 40% of the respondents said they have taken steps to enhance investor reporting and overall transparency.

"The days in which investors would entrust their money to the black box of a skilled hedge-fund manager are over," said Greenwich Associates consultant Jay Bennett.

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