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Illiquidity still an issue for some trading hedge fund stakes

Platforms for trading stakes in hedge funds are registering buying interest from among the world's largest investors, but some say ongoing illiquidity in the underlying investments of some portfolios can be a sticking point.

Nevertheless they say the trading of stakes is buoyant. Florian de Sigy, CEO and founder of specialist brokerage and advisory firm Gamma Finance, put the current levels of dedicated investment in the area at around \$3bn.

He said this "could easily double in the next year".

Platform providers are divided over the effect ongoing illiquidity of investments is having on potential buyers.

Gamma Finance's de Signy said sovereign wealth funds, pensions and family offices are allocating "increasingly large tranches of capital" to illiquid hedge funds, to boost holdings of high-yielding, long-term investments.

Buying illiquid stakes, typically at wide discounts to NAV, can reduce an investor's entry price, and therefore effectively magnify the subsequent returns.

De Sigy (pictured) said: "Over the past 12 months, we have been working with a number of large-scale, long-term investors who have been allocating tranches of \$250m to \$500m to illiquid hedge fund portfolios. Many are now returning for a second tranche at similar levels."

De Sigy says straight after the financial crisis there was "a bit of a stigma" attached to either owning or running illiquid assets. But as people realised most investors and fund managers have them on their books, this changed.

"Many investors are looking at this sector as an opportunity," he said.

But rival secondaries matching service Hedgebay says illiquidity in some hedge fund holdings, and volatile prices for such assets, remain "a major factor" affecting the market for buying and selling of stakes, and for more trades to happen at par.

Last quarter, the average monthly discounts to NAV at which stakes traded via Hedgebay varied widely, fluctuating between monthly falls of 10.1% (in July) to 21.6% rises (September).

The average price for trades of hedge fund assets that sit in side pockets - often-illiquid investments isolated by fund managers from redemption - was about 68% of NAV in September, Hedgebay said.



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The monthly volatility of the prices of these illiquid stakes also jumped around heavily. Monthly average price deviations ranged between minus 52% and 26% from June to September.

Lindsey Clavel, Hedgebay's managing director for Europe, said: "The fluctuating pricing suggests that the market is still unsure of exactly where it stands between crisis and recovery. The overall pattern of trading is still being dictated by the legacy effects of the downturn, with the amount of illiquid assets, liquidity demands and portfolio construction all playing a part.

"It is currently very difficult for buyers or sellers to determine a true and fair valuation for assets, with much of the pricing dependent on the requirements of the individuals involved. I believe this is why we are seeing such volatile pricing.

"Continued illiquidity and a shift in the price of underlying assets in the secondary hedge fund market has caused fluctuating trading levels in the last few months. True price discovery (is) still elusive, (and) many investors continue to hold their assets rather than trade. The long-awaited market recovery (is) still seemingly some way off," Hedgebay said.

However, Hedgebay also noted some interest in "near-par trades" of hedge fund stakes - more common before the general economic downturn of 2008/2009.

"While not conclusive at this stage, the willingness of both the buy- and sell-side to offer prices near or even at par is an encouraging sign. The amount of completed transactions at this level remains relatively low, but so long as the willingness on both sides remains, we would expect to see these trades come to fruition more and more," said Clavel.

"That will aid a market recovery, but ultimately trading will remain uncertain until the market has resolved its illiquidity issues."

Link: <http://www.investmenteurope.net/investment-europe/news/2121563/illiquidity-issue-trading-hedge-fund-stakes>