When focusing on the future, where do you look?

The alternative asset management industry must pivot strategies to focus on the future and make real-time adjustments that control that path

2019 Global Alternative Fund Survey

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Building a better working world

EY 2019 Global Alternative Fund Survey contents

Executive summary

Everyone understands the consequence, opportunity and factual nature of change, and equally, the immediacy of it in today's market. Disruption and evolution have been shaping the industry and will remain as the headline of tomorrow. Shifting market dynamics, changing investor preferences and constant technology advancements have the industry contemplating an uncertain future. While focusing forward, managers are trying to maintain their footing and capture a competitive advantage, but equally, they are trying to leverage options that keep them ahead of a market on the move.

As we entered this past decade, hedge funds and private equity funds occupied two distinct realms within the larger universe of alternative investments. Convergence swept across the market with a cross-migration of talent and capital, in addition to a number of new entrants in the competitive landscape. Today, investment managers are embracing divergent strategies as investor preferences are reshaping how they view alternative managers of all definitions. While the overall allocations to alternative investments remain robust, investors are rapidly reallocating within their alternative portfolios. Those managers positioning themselves for success would be wise to look back at how much the industry has evolved in the past decade and strategize for the seismic changes that will shape the industry in the decade to come. The issues and questions facing managers today are far different than those of the past. However, the ability to quickly react, respond and plot a path forward will determine who will thrive and who will struggle to get out of the past.

We are confident that the insights gleaned from the 13th annual EY Global Alternative Fund Survey offer a uniquely singular focus on the points of view of both hedge fund and private equity managers, as well as institutional investors who allocate to both asset classes as well as broadly across alternatives. We deeply appreciate and extend our gratitude to the managers and investors who provided their points of view into the direction and development of this survey, as well as offer thanks to the more than 200 managers and 60 investors who provided detailed and timely responses to provide such comprehensive and thorough results. We believe this collection of perspectives will be instrumental in helping you build more informed decisions and maintain your forward focus.

Key observations

While sudden shifts are part of the market, so are the subtle trends that slowly gain momentum and over time become a working reality. Current trends include capital being re-deployed among alternative asset classes, expanded use of structures that are customized for specific investor needs, an embracing of nontraditional and hybrid product offerings, the influence of socially responsible products, the (needed) focus on diversity as part of a broader spotlight on talent management strategies and the ongoing quest to more advantageously harness the reach of technology and the promise of data. These trends have been ramping forward and are gaining increased market awareness. These are not a tsunami of issues, but rather, a wave of market change and ongoing pivot points that need to be vetted and will largely be the issues that shape those managers who will find success in the next decade.

Capital raising and product development

Catering to investor preferences while adjusting to changing competitive pressures and opportunities in the market is paramount to managers looking to raise capital. The past decade brought with it an historic bull market both in its duration and magnitude. We have witnessed an explosion of low cost and readily available retail products that offer exposures somewhat similar to certain liquid alternative offerings. Opportunities in the private credit space increased in the wake of the last financial crisis as many traditional market lenders reduced their activities or exited the business altogether. And as the last financial crisis and liquidity concerns fall further into distant memory, investors looking to capture performance have been more comfortable allocating to longer duration offerings. Each of these factors and others are reshaping the alternative industry going into the next decade. Managers of all shapes, sizes and strategies are deploying products that are more customized and specific to investor needs and market trends than ever before. As allocations to traditional commingled hedge funds are being challenged, these managers are finding more success growing assets outside of their core offerings via co-investment vehicles, illiquid credit, and even longer-duration pure private equity offerings. Private equity managers, while also converging with other alternatives in the credit, real estate and infrastructure realms, are also taking advantage of the current appetite for their traditional offerings by launching larger vintages of their funds and reporting record amounts of dry powder available to deploy. Alternative asset managers are also recognizing the importance of knowing their customer and responding to broader societal and economic forces that present opportunities. Socially responsible products are increasingly being requested by investors representing one of the fastest growing strategy demands in the market.

Personalization of the customer experience remains crucial in every industry and alternatives are finding they are no exception. Whether it be based on tailoring the investment strategy to a specific exposure or desired outcome or designing bespoke structures that align fees, liquidity, transparency or other terms to the investor's specifications, growth continues to be achieved by those managers willing to create offerings that are responsive to individual investor needs rather than going to market with a one-size-fits-all product.

Talent management

Talent continues to be the most sought-after resource in managers' efforts to prepare their business for the decade to come. Alternative asset managers continue to compete against each other as well as other industries to attract the best and brightest to their firms. Individuals with varying skill sets, particularly those familiar with rapidly evolving technology and data analysis, are in such demand that the battle is not yet won in merely employing the talent, but rather the development and retention of these individuals is an increasingly complex dynamic to address. Managers are embracing a younger, more diverse generation of talent which does not necessarily share the same expectations from their employer than previous generations. Balancing the right mix of compensation and non-compensation-related benefits has never been more critical to maintain a workforce of individuals who can share and someday take over the leadership reins of the organization.

The scrutiny that investors place on a manager's talent protocols and success in achieving its priorities cannot be overstated. Investors agree that the quality of talent is one of, if not the primary consideration they evaluate when deciding whether to invest. They are not just looking at today's talent either; a majority are interested in understanding leadership transition strategies that will drive the shared partnership forward for the long term. Allocators are also increasingly focused on understanding diversity and inclusiveness metrics, which is challenging alternative managers to look inward and driving the industry forward to become one that promotes opportunities for all individuals.

Data as a competitive advantage

The alternatives industry has always been about evaluating data to make informed investment decisions. However, the data story is rapidly evolving as we progress into the next decade. The proliferation of data that is available to managers has created opportunities for those able to evaluate structured and unstructured data sets to identify unique investment ideas that are not readily apparent to other market participants. Understanding where to look and what processes to put in place is critical. In addition to consuming large quantities of data, managers also produce significant amounts of data internally across a number of different functions. This is certainly apparent in the investment process, but also extends to risk management, operations, and investor and financial reporting. Managers on the cutting edge of harnessing the full competitive advantage that these data points can provide are devising formal strategies for maximizing data utility and leveraging insights from both internal and external data. This can lead to both better investment decisions and the ability to analytically identify opportunities to run a more efficient business. As managers increasingly face a reality where cost savings and operational efficiency are top priorities, the need to better leverage data will only increase.

Focusing on the future

This report is being published at the end of 2019, closing the chapter on a decade that witnessed significant growth in alternatives, but also the historic evolution of an industry. As we started the past decade, the wounds from the previous financial crisis were still raw and there were questions about alternatives' risk profiles, liquidity constraints, operational institutionalization and governance models. The industry largely squared away these issues and propelled itself forward in a decade of prosperity for itself and investors. A new set of questions is being posed to managers today that will determine the success of individual firms and the collective industry. How are you dealing with a competitive landscape where the lines differentiating and defining different types of alternative asset managers are being redrawn, if not erased entirely? What is your go-to-market strategy for maximizing your relationship with each individual investor who wants a more customized and personalized set of offerings from their managers? What technologies and data are you leveraging to make the most informed investment decisions and run the most efficient business operations? Who are the people that will lead your business forward in the next decade? If the past decade has taught us anything, it is that alternative managers will confidently answer these questions and others to chart their path forward to a prosperous future.

Allocation trends

Allocations to alternative asset classes remain a significant component of institutional, high-net-worth, family office and other allocators' portfolios. The past decade has ushered in a variety of marketplace dynamics that are influencing investors' behavior regarding their alternatives portfolio. Competition has sprung up from all corners of the market, including passive investment strategies and hybrid structures that blur the lines between liquid and illiquid offerings. Innovation has resulted in technological advancements that have reinvented how certain strategies are deployed. Marketplace dynamics – including a decade-long public equity bull market and historically low interest rates – have directly influenced alternatives' performance. Distribution models have evolved from reliance on third parties (i.e., fund of funds) to FinTech and private wealth platforms. Each of these dynamics and others are reshaping how the alternatives landscape looks heading into the next decade, resulting in certain asset classes experiencing favorable momentum while others are navigating an uncertain and challenging fundraising environment.

Alternative investors are allocating more to private equity and real estate at the expense of hedge funds

Investor allocations to alternatives remain robust and little changed overall in recent years, but preferences for specific types of alternatives are changing. The institutional investors within this survey (excluding fund of funds respondents) indicated that, on average, they have a quarter of their assets allocated to alternatives, which has been relatively unchanged for the last several years. Approximately 50% of hedge funds and private equity managers identified pension funds as the allocator that has increased their allocations most significantly in the past two years, and a third of managers identify sovereign wealth funds as the next leading contributor of capital.

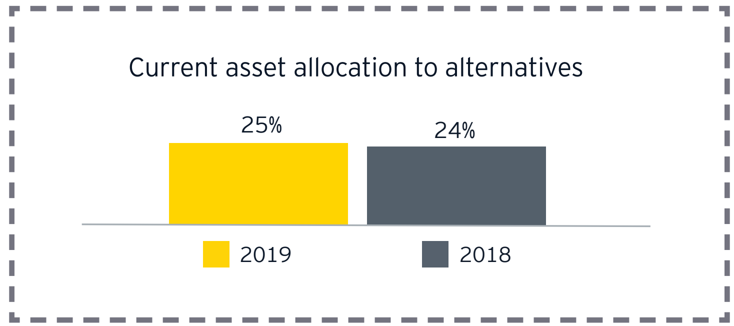
Hedge funds continue to make up the largest percentage of investors' allocations to alternatives, but they are quickly giving up market share. Muted performance, continued scrutiny of costs and competition from other products have resulted in lackluster demand. Private equity managers have been the direct beneficiary with the majority of private equity managers reporting larger fundraises and record amounts of dry powder. Whereas minimal volatility, consistently rising equity markets and low interest rates have challenged hedge managers' returns, these market conditions have served as rocket fuel for private equity portfolios.

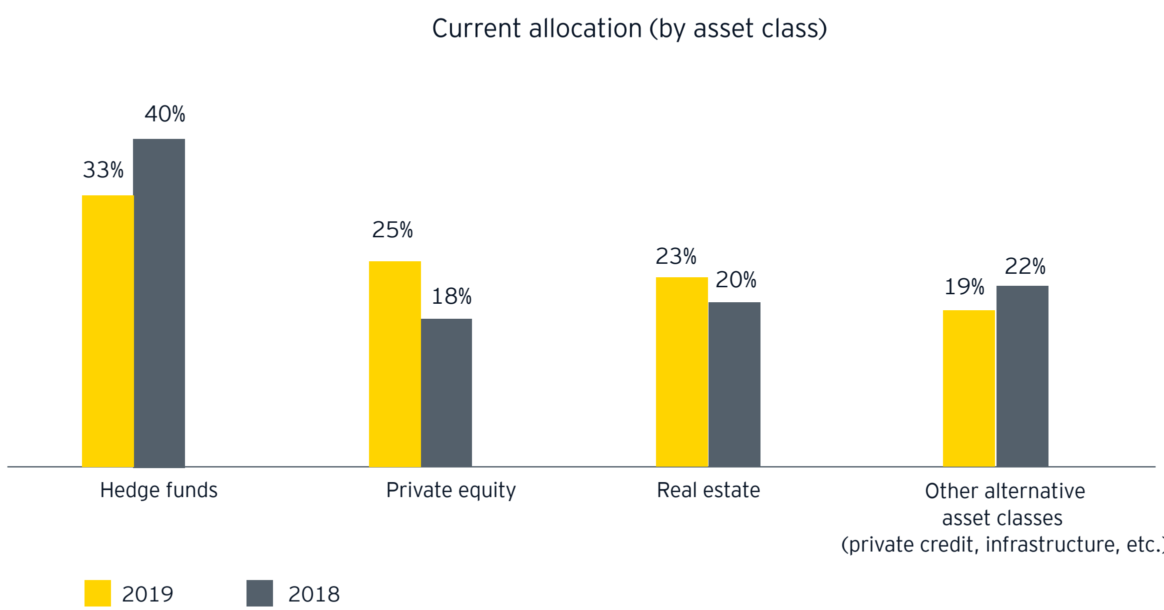
Investors do not expect this trend to change over the next two to three years, having reported that they anticipate their allocation to private equity and real estate products to continue to grow.

Investors

What is your current asset allocation to alternatives?

What proportion of your assets under management (AUM) is allocated to alternatives by asset class?





> There is more openness to alternatives than ever before. The root cause of this being uneven performance which has given investors leverage to push their managers for more engagement.
>
> – Pension, Europe, under US$2b

Strategic priorities

Protecting and growing customer assets is, and always will be, the primary responsibility of alternative asset managers. However, the infrastructure and tools needed to be successful in this pursuit are rapidly evolving. Those managers who will thrive in the decade to come are planning now. Talent models are becoming increasingly critical as investors are pushing for and managers recognize the benefits of a variety of diverse backgrounds and skill sets among the organizational team. Scaling the business for more complex product offerings is critical as costs remain an important gating consideration for allocators' investments. Technological advancements are providing opportunities to complement and enhance front-office decision-making while streamlining operational and back-office functions. These challenges, in addition to navigating changes in the fundraising environment, will separate those managers stuck in the past from those who will thrive in the future.

Asset growth and talent management remain alternative fund managers' top strategic priorities

Asset growth continues to be of the utmost importance for the success of both private equity and hedge fund managers. This is consistent with prior years and unsurprising as asset growth contributes to working capital for managers to invest in the people and infrastructure of the business to ensure longevity.

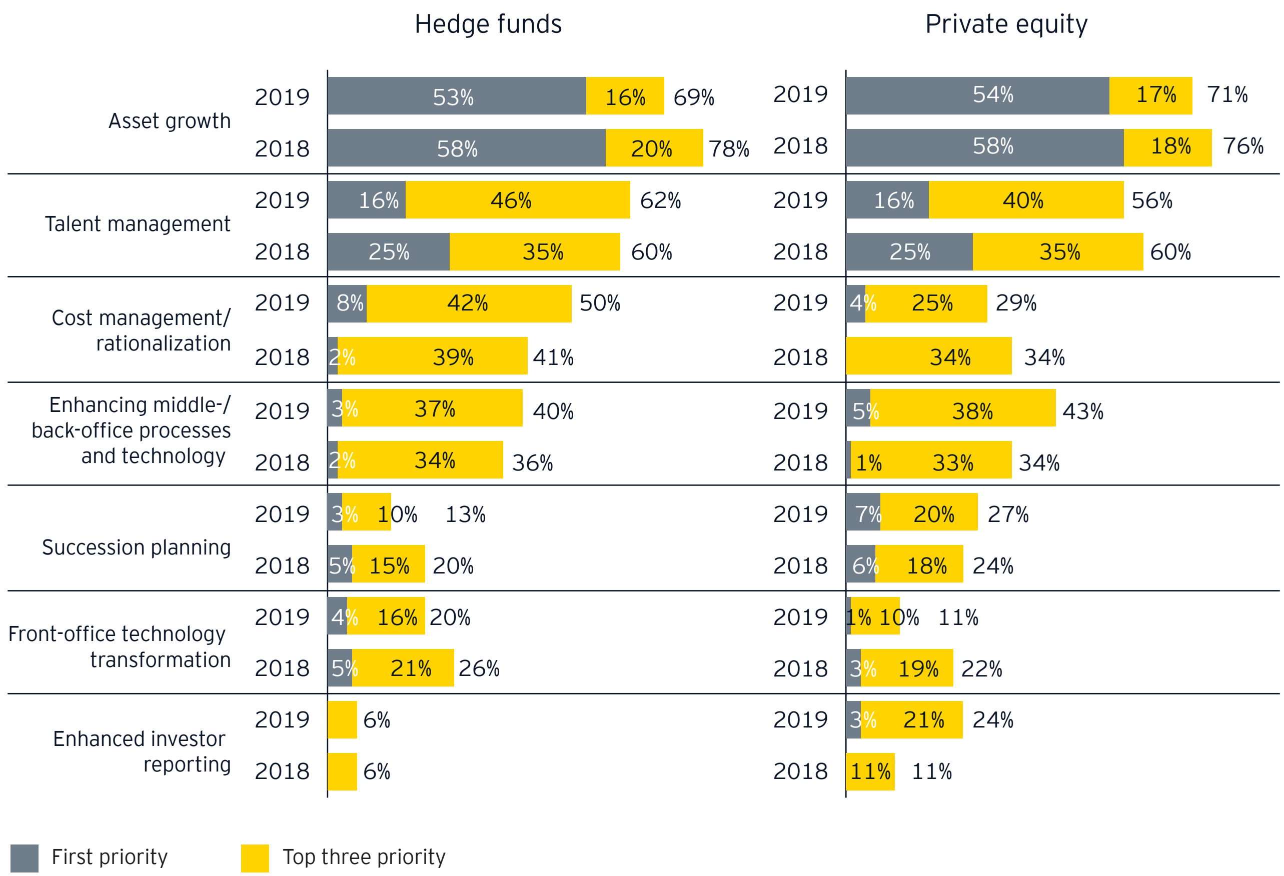
At the same time, managers continue to focus on talent to deliver returns for their investors and effectively operate the business. Diversity in background and skill sets may not have been at the top of managers' agendas for much of the past decade; however, we are seeing significant changes in that sentiment heading into the future and believe that diversity and inclusiveness (D&I) will be one of the most pressing business priorities of the 2020s.

As fewer hedge funds in the current year prioritize asset growth in this fundraising-challenged environment, more are focused on reining in costs than their private equity peers. Fee pressures are more acute among hedge fund managers who continue to struggle defending their business model amid lackluster performance and significant competition within certain investment strategies.

Private equity managers are more focused on investing in the middle- and back-office processes to support the significant growth in assets, and investor reporting to meet the needs of new clients. Three in four private equity managers that are raising a fund in 2020 expect the fund to be larger than their last vintage and these managers recognize the need to enhance their operations and infrastructure.

All alternative funds

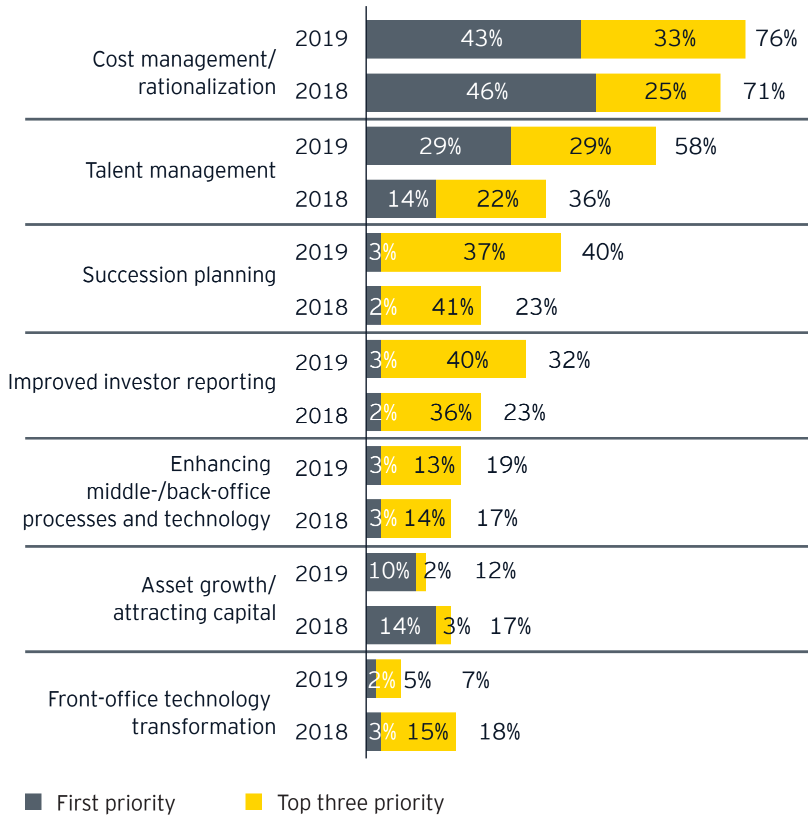
Please rank the top three strategic priorities for your firm:



Investors want their managers to focus on costs, talent management and succession planning

Investors

In which of the following areas should managers be strategically focused to positively benefit investors?



Why?

> I would like to see managers value people, and the infrastructure needed for people to do their jobs, above cost.

– Insurance company, Europe, under US$2b

> Talent and succession planning are important for us because they guarantee us a long-term relationship with the manager.

– Fund of funds, North America, over US$10b

> We don't want to see growth purely as a means to accumulate assets, but growth that drives profitability and creates value to the firm can benefit both the manager and existing investors.

– Pension, Europe, under US$2b

The overwhelming majority of investors want to see their managers find ways to rein in expenses and reduce management costs, which is consistent with past years. Cost compression is happening in almost every industry. Alternatives are not immune to the conditions affecting others, such as online brokerage firms offering zero-cost trading options to retail investors.

Delivering performance is the easiest way to push back on concerns regarding costs, and the primary mechanism to ensure performance delivery is having top-tier talent. Investors continue to focus on talent management as well as succession planning as they want to ensure the business in which they are investing ispositioned to deliver both now and into the future.

While investor interest in talent management is aligned with managers' priorities, the focus on succession does present a gap. Two in five investors say that alternative managers should be actively engaged in succession planning; however, only 13% of hedge fund managers and 27% of private equity managers have succession planning as a top three priority.

Success is relative, but private equity managers have achieved growth at the expense of other priorities

Even though the strategic priorities across the alternatives industry are largely consistent, hedge funds and private equity managers have reported varying degrees of success at achieving their stated objectives.

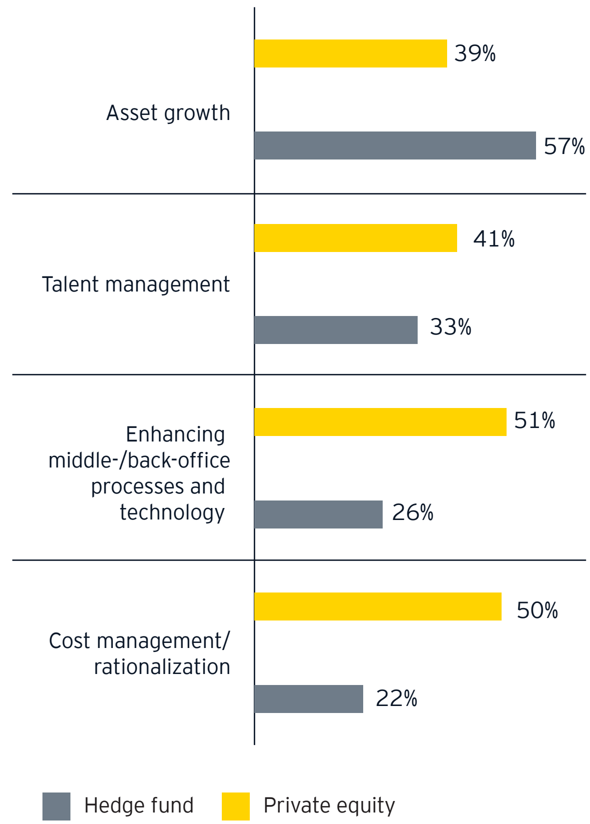
Most managers would likely sign up for achieving growth while lagging in other areas. Market conditions cited earlier have helped a majority of private equity managers achieve their growth objectives whereas less than 40% of hedge funds reported success in this priority.

In periods of growth, other priorities can take a back seat, which is what we have seen private equity managers report. Less than one in three has indicated they have achieved their goals with regard to talent, infrastructure enhancements and cost management. Their focus on these areas has been diverted as they deal with the enviable issue of deploying capital.

Hedge funds, on the other hand, have taken this period of slower growth to analyze and right-size their operations. Many are reporting that they hope these initiatives will position them well for the future to attract assets and efficiently manage the business.

All alternative funds

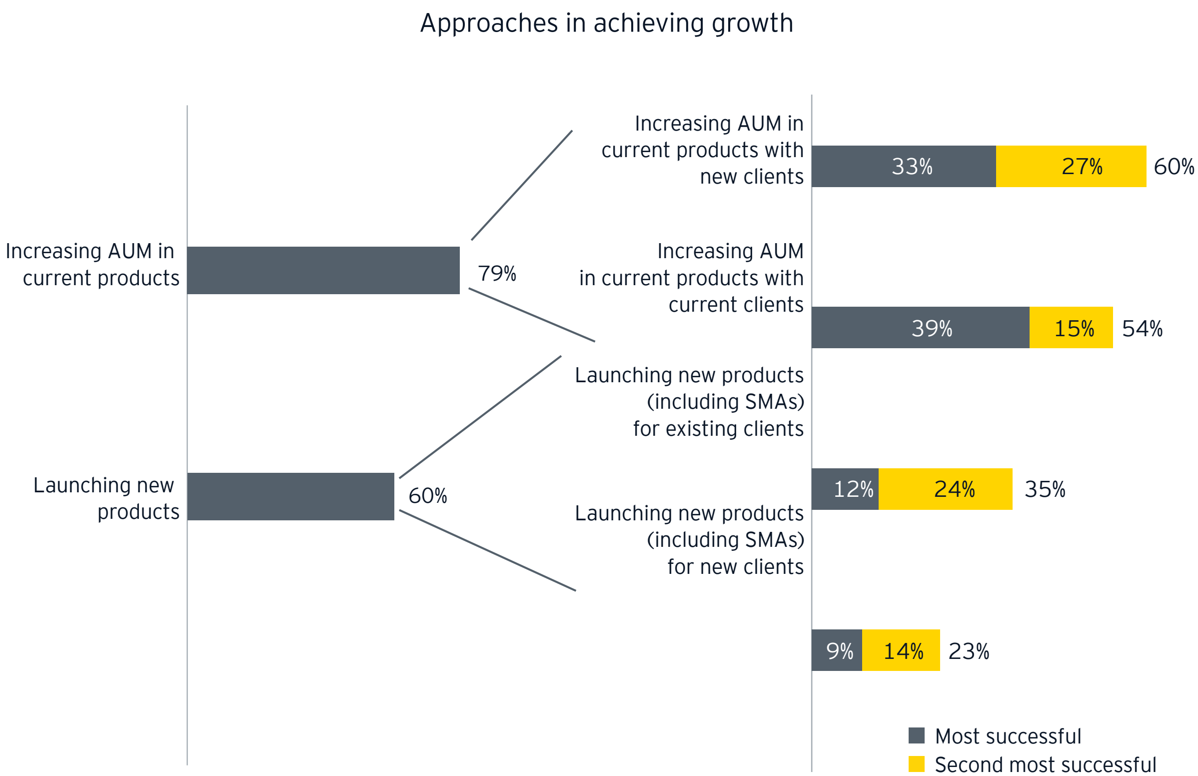
How successful have you been in making progress on your top three priorities over the past two years?



Growth agenda: current products remain the primary tool although many managers are also branching out into new offerings

Hedge funds

What are the top two approaches that have been most successful in achieving growth in the past three to five years?



When we explored the means by which managers are seeking to achieve growth, focusing on core competencies in existing products was the top response of managers by 79% of hedge funds.

This is not surprising as creating new products requires talent, brand recognition, operational infrastructure and other build-out requirements that carry significant costs with them. Growth in existing products often is less expensive to achieve and maintain, just as having a proven track record helps promote investor confidence.

However, this does not mean that managers are shying away from trying new avenues. Sixty percent of managers are finding success in launching new products. This includes nontraditional offerings that pursue alternative strategies as well as customization of portfolios, including separately managed accounts (SMAs).

Seventy-eight percent of managers stated that investor demand was the most important consideration when launching a new product, demonstrating that managers must have a clear understanding of client needs and active engagement with investors throughout the development process.

New products can take many different forms – the next set of results explores some of the techniques managers use to expand their offerings.

Growth agenda: convergence and competition within nontraditional products

Hedge fund and private equity funds continue to offer products outside of their core competencies as they seek unique investment opportunities and access to additional populations of investors.

The direct competition between hedge and private equity remains interesting as more than a quarter of hedge fund managers indicated they have either a private equity or venture capital offering and a number of private equity managers have a more liquid hedge fund strategy.

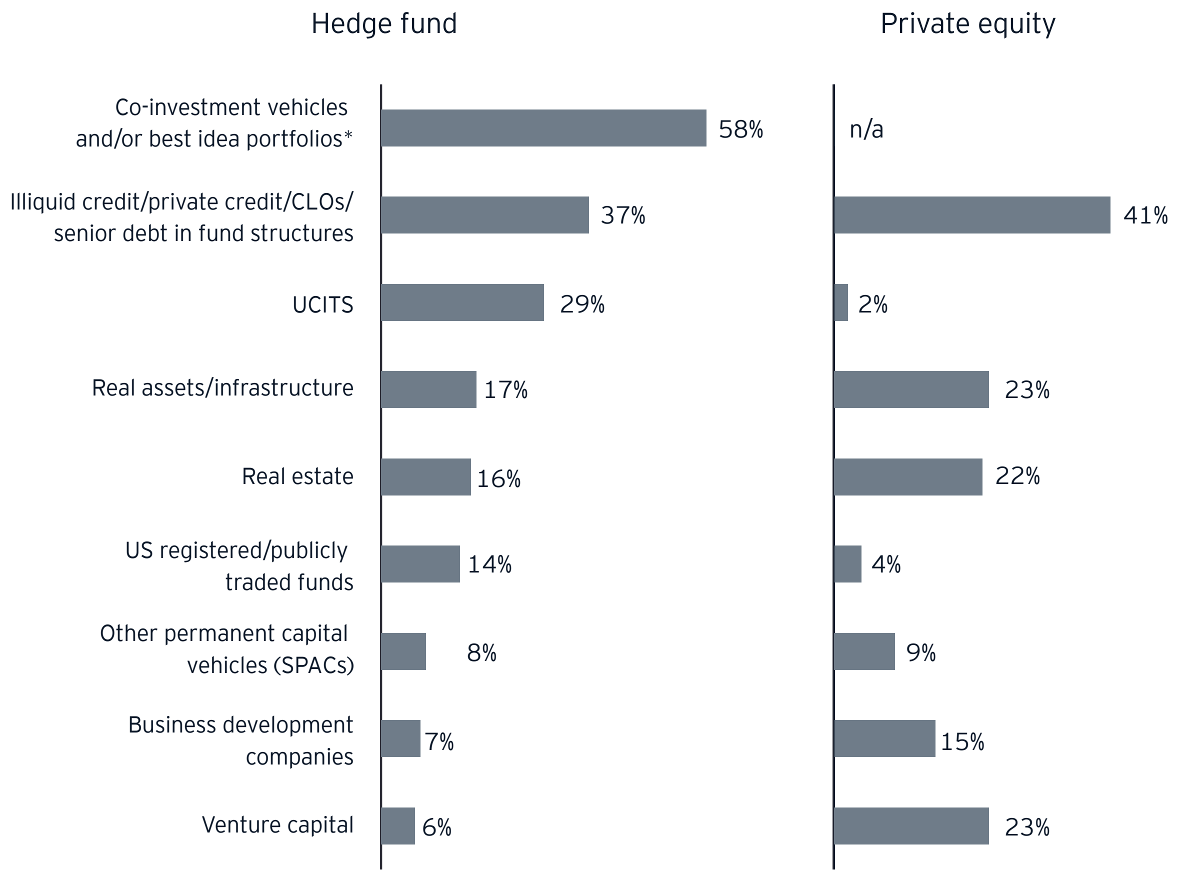
Among hedge funds, we are continuing to see an explosion in co-investment opportunities. Picking up on a trend that has long been popular in the private equity industry, nearly half of managers have identified that investors have an appetite for targeted investment exposures and best ideas outside of the traditional commingled offering. This represents a staggering increase from 2018 where only 21% of hedge fund managers offered this type of product.

Credit strategies continue to grow in popularity among all managers as these products often blur the lines between hedge and private equity investment and operational philosophies. Compared with 2016 when only 18% of managers reported a credit offering, we now see over double the number participating in this space.

The trends noted here are most pronounced among the managers advising assets greater than US$10b, many of whom have a distinct operational and fundraising advantage to successfully veer into these nontraditional offerings.

All alternative funds

Which of the following "nontraditional" products/offerings do you currently offer/plan to offer to clients?



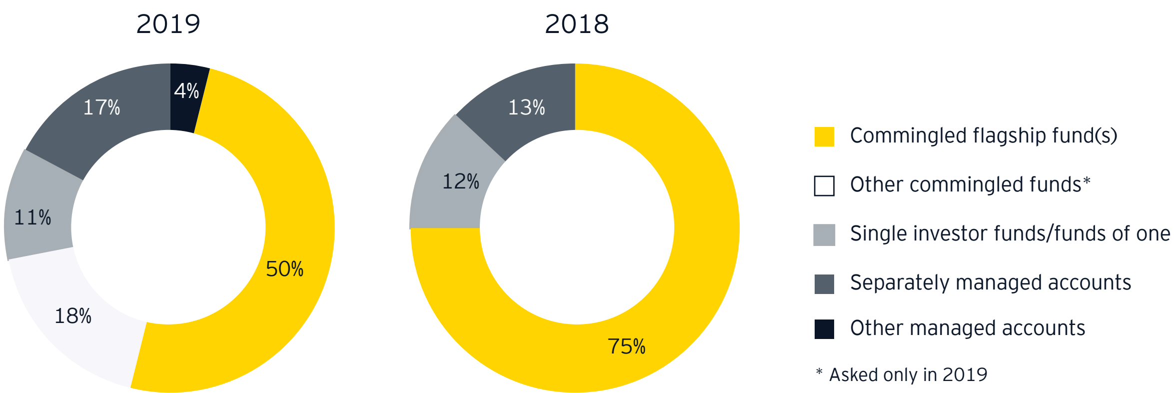
*Asked of hedge fund only

Growth agenda: SMAs/funds of one are growing with no slowdown in sight

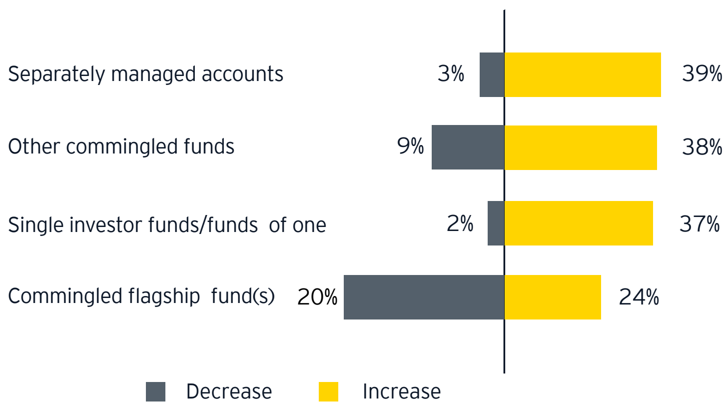
Hedge funds

What proportion of your organization's assets under management is in each of the following?

Weighted proportion of assets under management in:



Do you expect the proportion to increase, decrease or remain the same in the next two years?



A trend that started this decade which shows no signs of slowing into the future is investor demand for investing in hedge funds via separately managed accounts and/or funds of one. More than 60% of all managers, including more than 75% of those with assets greater than US$10b, offer SMAs with managers reporting an increase in their firm assets comprising SMAs from 25% in 2018 to 32% in 2019.

Nearly 40% of managers expect this trend to continue — twice as many as who reported this sentiment a year ago.

We continue to see the industry recognize the importance of reacting to investor demand for personalization of offerings. SMAs/funds of one allow for customization of transparency, fee structures, investment mandates and other considerations that is important and unique to each investor.

A side effect of this trend is that SMAs often result in a redirection of allocations that would have gone to commingled offerings. This trend, if sustained, will continue to challenge managers' reliance on their traditional commingled product.

SMAs: positive for the long-term benefit of the firm, but concerns exist over cannibalization of the commingled offering

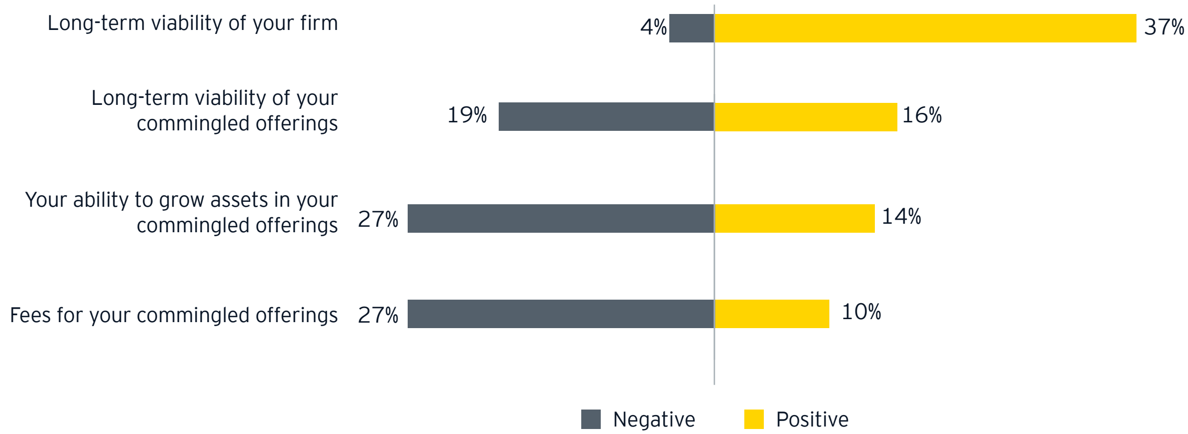
In a fundraising-constrained environment, particularly for hedge funds, any strategy that promotes growth of the business is viewed favorably. SMAs achieve this objective as they often come in larger ticket sizes and can promote a longer-term partnership between the investor and manager than what is achieved through the commingled strategy.

However, SMAs and funds of one do not come without their own set of challenges and concessions. Lower fees, generally, more frequent liquidity, and customized and increased reporting all can affect margins and strain operating models.

Managers recognize these pain points. While one in three indicate SMAs increase their firm's long-term viability, many highlight the trickle-down consequences to the commingled offering. More than a quarter indicate that SMAs have a negative impact on the fees they are able to charge in their core products. As investors become aware of other partners being able to push fees down in other offerings, it adds to the pressure on fees in the commingled strategy.

Hedge funds

How do you feel the impact of increasing investor demand for SMAs/funds of one is on the following areas?

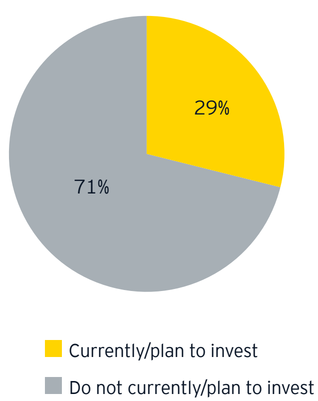


Growth agenda: increased demand for socially responsible products

Investors

Does your organization invest in socially responsible products (ESG)?

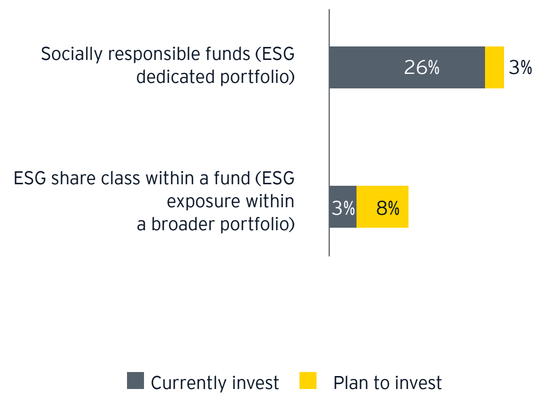
Investing/plan to invest in ESG structures



Investors

In which of the following do you plan to invest in the next two years?

Investing in ESG structures



Whereas nontraditional product offerings and customization of structures via SMAs has been a strategy being deployed for a number of years, socially responsible investing appears to be an avenue for growth that is just beginning to gain traction and will be an area of focus into the next decade.

Nearly one in three investors are currently investing, or planning to invest, in socially responsible products, with the majority doing so via an ESG dedicated portfolio. Furthermore, one in seven investors has a requirement to invest in socially responsible products and that figure is expected to double in the next two years.

Part of this demand reflects an evolving investor base that is more conscientious about how all of its behaviors, including investment activities, can lead to social and environmental behaviors.

With that said, many investors are attracted to ESG strategies on account of their belief that this strategy will be able to tap into investments that outperform the general market. Only one in three investors investing in ESG says that they are willing to accept lower performance or higher fees when investing in socially responsible products.

The number of managers offering ESG products is expected to increase by 50% in the next two years

Managers are beginning to respond to their clients' demands for socially responsible investment vehicles. Currently, nearly one in five managers offers socially responsible products, but that figure is expected to increase by about 50% in the next two years, with most of that growth coming from managers launching ESG dedicated portfolios.

The ESG dedicated fund is the evolution of the trend that originated in the past with share classes that either specifically targeted ESG strategies or opted out of certain investment exposures (i.e., no "sin stocks," such as tobacco and alcohol).

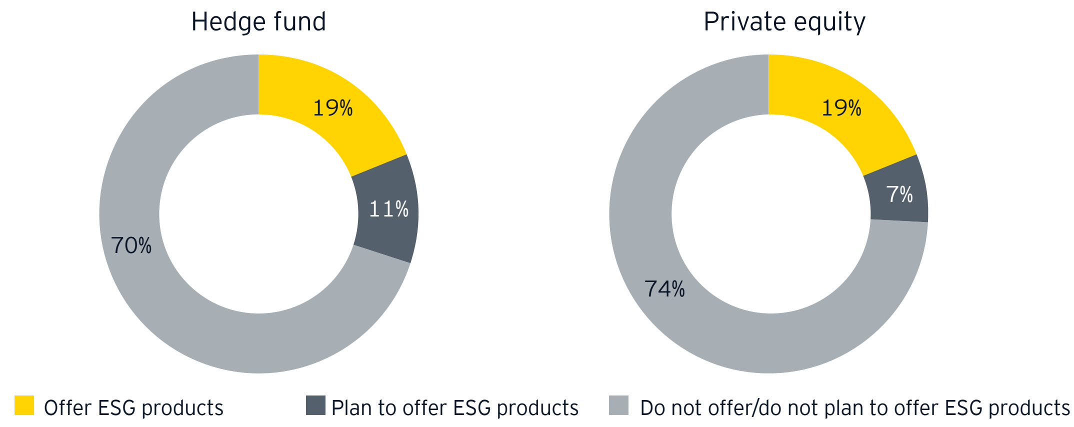
As with any newer product and strategy, the question to be answered is how much demand will the market provide and will those managers who are first movers develop the expertise and brand recognition in the ESG space to block out later entrants from capitalizing on this trend?

Outside of fund offerings, managers are increasingly committing to internal ESG policies that reflect their values and beliefs in their firm engaging as a better corporate citizen. These actions contrast with the misreported public perception of asset managers as being solely motivated by finances and are helping build goodwill with investors, employees and other market constituents.

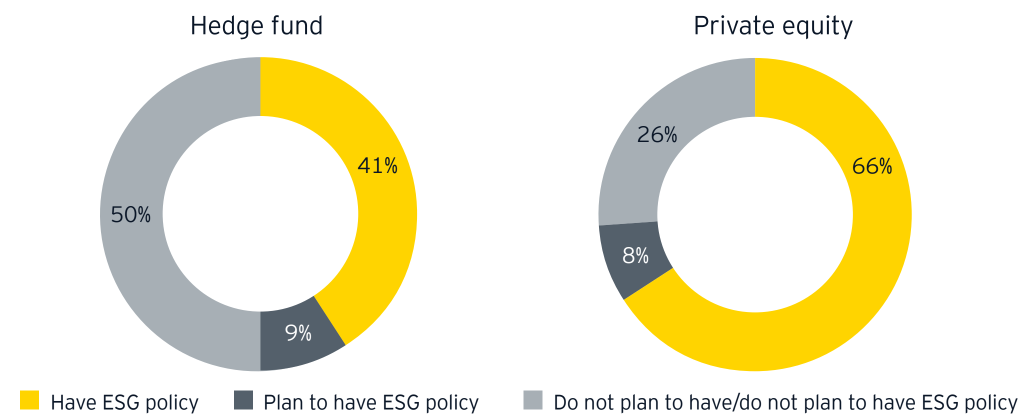
All alternative funds

Which of the following do you currently have/plan to offer as part of your organization's ESG strategy?

Current/planned offerings of ESG products



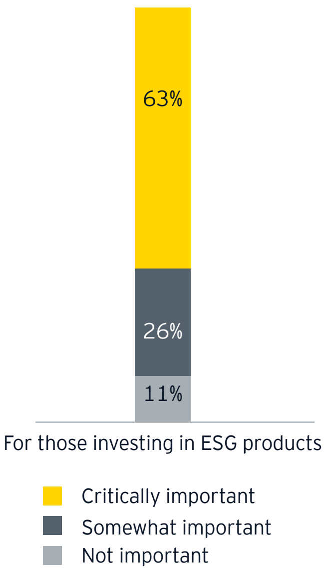
Currently have/plan to have an internal ESG policy



Investors are paying attention to managers' own ESG policies

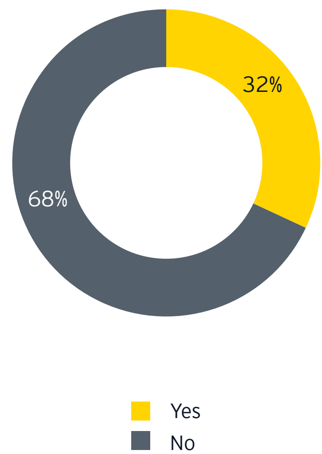
Investors

How important is an alternative manager's internal ESG policy (a policy that guides the management company's policies/procedures) when deciding whether to make an investment?



Investors

Are you willing to accept higher fees when investing in socially responsible funds?



Investors, particularly those who are investing in socially responsible products, are taking managers' own ESG policies into account when deciding whether to partner with a manager.

For those investors that invest in socially responsible products, nearly two in three say that managers' own ESG corporate policies have a critically important impact on their decision to invest.

Investors who are not investing in ESG products are not as influenced by the manager's ESG policy, as only 1 in 10 of these investors indicates it is a highly important investment consideration.

Managers, whether due to this budding investor consideration or their own social beliefs, are responding. Almost half of hedge funds and three quarters of private equity managers have or expect to have a corporate ESG policy.

Growth agenda: managers take borderless pursuit, expanding into new jurisdictions to access investments and investors

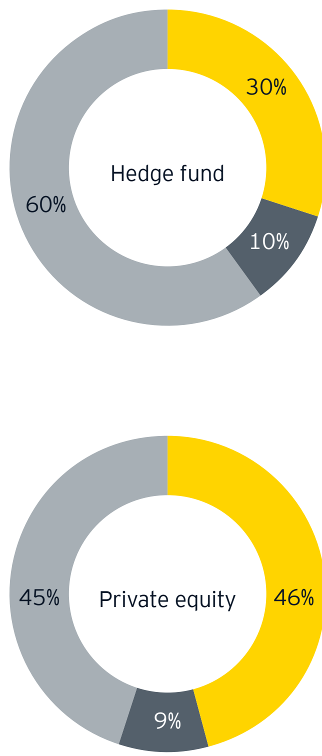
Despite geopolitical tensions and uncertainty, alternative fund managers have been rapidly expanding internationally for a variety of reasons. One in three hedge funds and nearly half of the private equity managers surveyed indicated that in the past two years they have set up legal operations in new foreign jurisdictions with more indicating expansion in the near future.

Nearly half of the managers indicated that such expansion has been driven by the desire to gain access to new investors. The accumulation of wealth in different geographies and newer participation in alternatives by various investor bases has made it critical that managers have strategic plans as to how to best access and market these potential investors.

In addition to connecting with new potential investors, the expansion into new geographies was identified as occurring for either accessing new investment opportunities or taking advantage of tax structuring efficiencies.

All alternative funds

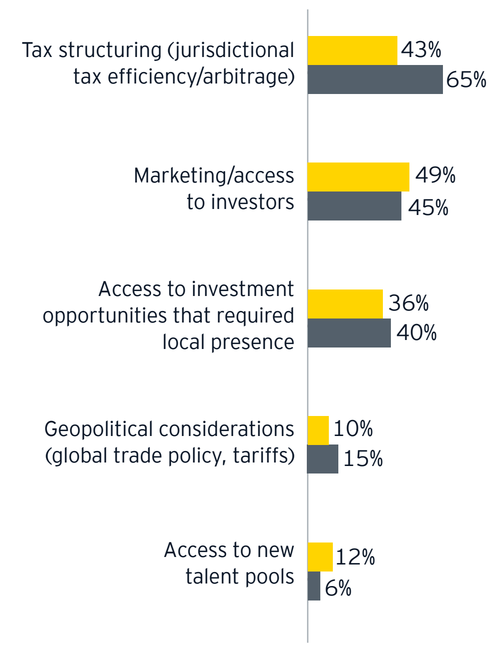
Over the past two years, have you established a legal entity in a new jurisdiction?



Established Plan to establish Neither

All alternative funds

What are the most important drivers for expanding into other jurisdictions?

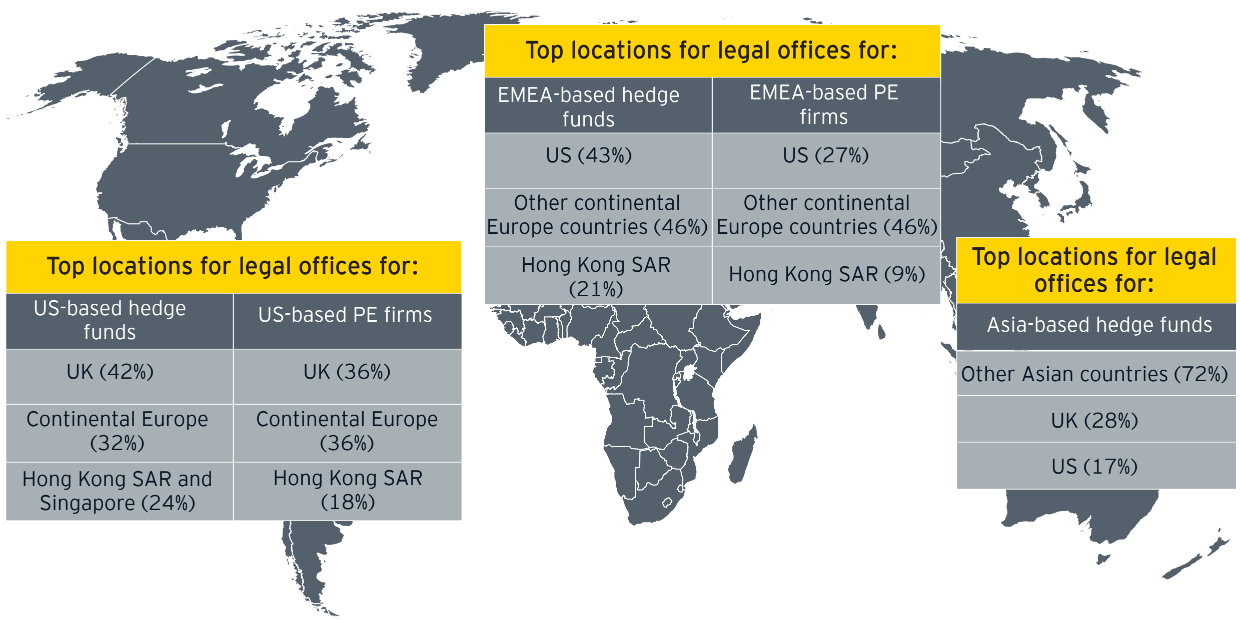


Hedge fund Private equity

Top legal office locations by geography

All alternative funds

Outside of your headquarters, where does your firm currently have legal offices?



Top locations for legal offices for:

US-based hedge funds	US-based PE firms
UK (42%)	UK (36%)
Continental Europe (32%)	Continental Europe (36%)
Hong Kong SAR and Singapore (24%)	Hong Kong SAR (18%)

Top locations for legal offices for:

EMEA-based hedge funds	EMEA-based PE firms
US (43%)	US (27%)
Other continental Europe countries (46%)	Other continental Europe countries (46%)
Hong Kong SAR (21%)	Hong Kong SAR (9%)

Top locations for legal offices for:

Asia-based hedge funds
Other Asian countries (72%)
UK (28%)
US (17%)

"

I wouldn't say any changes we've made in our geographical footprint are because of geopolitics; rather, we have a broader push to be closer to clients. For example, putting branches and people on the ground in the Nordics. It's the firm's strategy to be closer to clients.

– Hedge fund, Europe, over US$10b

Many of the top locations for legal offices reflect traditional market considerations. US-based managers are most likely to have operations in the UK and continental Europe, and European-based managers are most likely to tap the US and other European countries.

Looking ahead to the trend that may affect the next wave of geographical expansion is managers' desire to access the wealth and investment opportunities of China. Approximately 1 in 10 US and European managers has indicated they have operations in China with more seeing this as a future strategic priority.

Top fund vehicle domiciles by jurisdiction

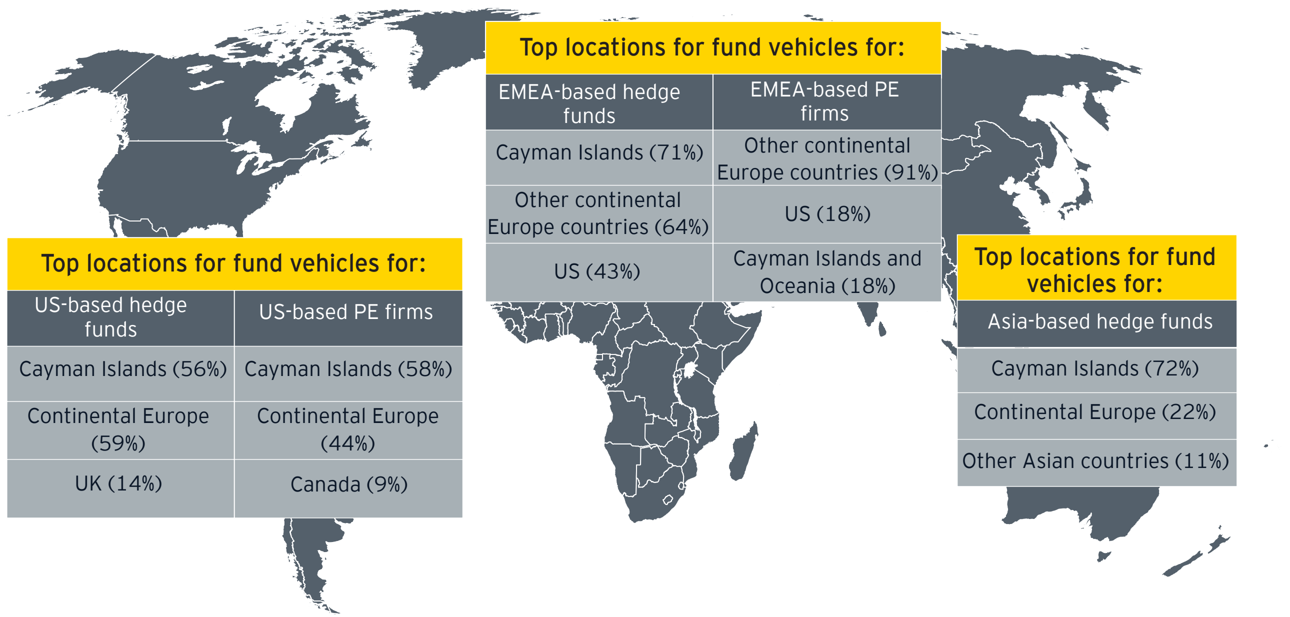
Fund structuring and choice of domicile are often critical considerations to attracting capital and maximizing tax efficiency for investors. To no surprise, the Cayman Islands is the jurisdiction of choice for setting up offshore vehicles for the majority of managers.

For all managers, continental Europe is the next most reported jurisdiction. Ireland and Luxembourg are the overwhelming top countries identified for all respondents who are utilizing European vehicles due to the tax treaties and structuring flexibility that these jurisdictions afford.

Similar to trends with legal offices, the question for the future is accessing China via fund vehicles. Several managers have recently obtained licenses and been first movers with many more indicating they are exploring opportunities to reach this market.

All alternative funds

Outside of your headquarters, where does your firm currently have funds/special purpose vehicles?



Top locations for fund vehicles for:

US-based hedge funds	US-based PE firms
Cayman Islands (56%)	Cayman Islands (58%)
Continental Europe (59%)	Continental Europe (44%)
UK (14%)	Canada (9%)

Top locations for fund vehicles for:

EMEA-based hedge funds	EMEA-based PE firms
Cayman Islands (71%)	Other continental Europe countries (91%)
Other continental Europe countries (64%)	US (18%)
US (43%)	Cayman Islands and Oceania (18%)

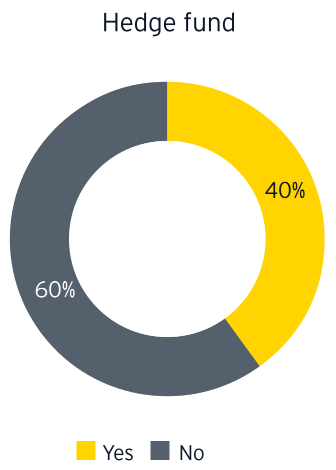
Top locations for fund vehicles for:

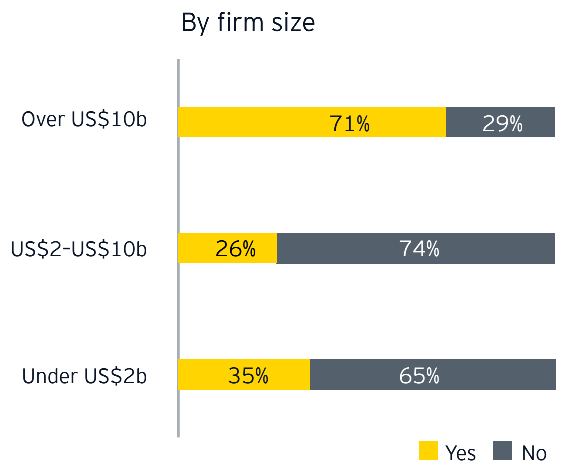
Asia-based hedge funds
Cayman Islands (72%)
Continental Europe (22%)
Other Asian countries (11%)

Managers are targeting new investors, but not all are tailoring activities to different investor segments

All alternative funds

Are your marketing and investor relations activities customized for each type of investor segment?





The ability to tailor marketing and investor outreach for specific segments is one of the key drivers of successfully attracting and maintaining a diverse client base. We have been witnessing personalization of customer experience across a number of different industries and alternative asset management continues to play catch-up.

The largest managers are furthest along with 71% reporting that they tailor their efforts to different investor segments compared with less than a third of other managers.

Firms of all sizes, but particularly smaller managers who do not have the same marketing and investor relations resources, should be exploring technology solutions that can help with this analysis. Most managers still see marketing as primarily a product of human capital and few firms (only 1 in 10) have invested in technology or advanced analytics to identify predictive behaviors of their clientele, which can yield benefits to the marketing process.

Growth agenda: exploration of new distribution channels opened by FinTech platforms

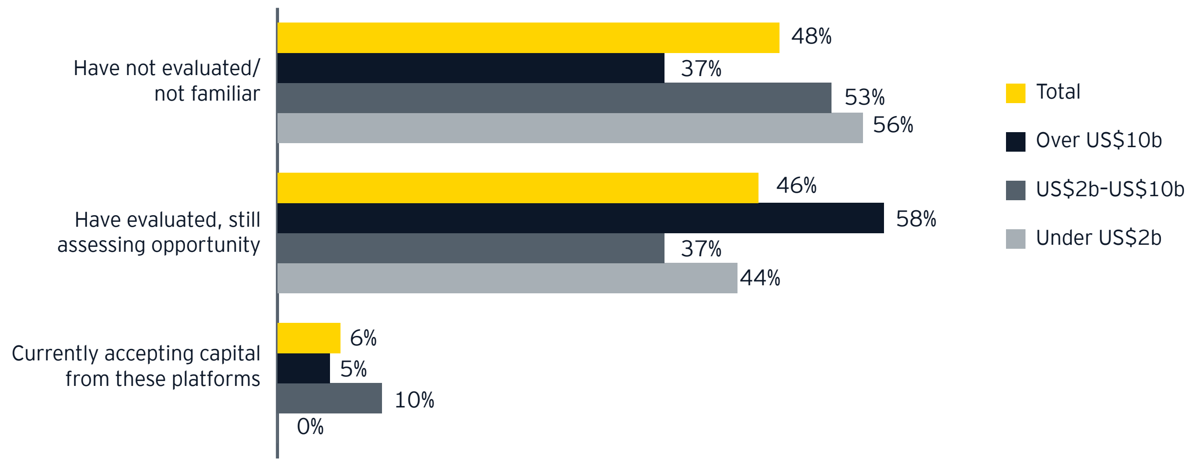
Even as asset growth tops most managers' priority lists, there is still a large portion that have yet to investigate whether FinTech platforms are a viable way to bring capital into their funds.

Only half of alternative managers have evaluated these platforms, with most of the activity being conducted by US-based managers and those managers with greater than US$10b of AUM.

Given the challenges that hedge funds, in particular, have had in growing assets, these platforms may have a role to play in reversing that trend. The growth in size and activities of these platforms in just the past one or two years leads us to believe that they will have a profound impact on reshaping the distribution channels to all alternative funds in the decade to come.

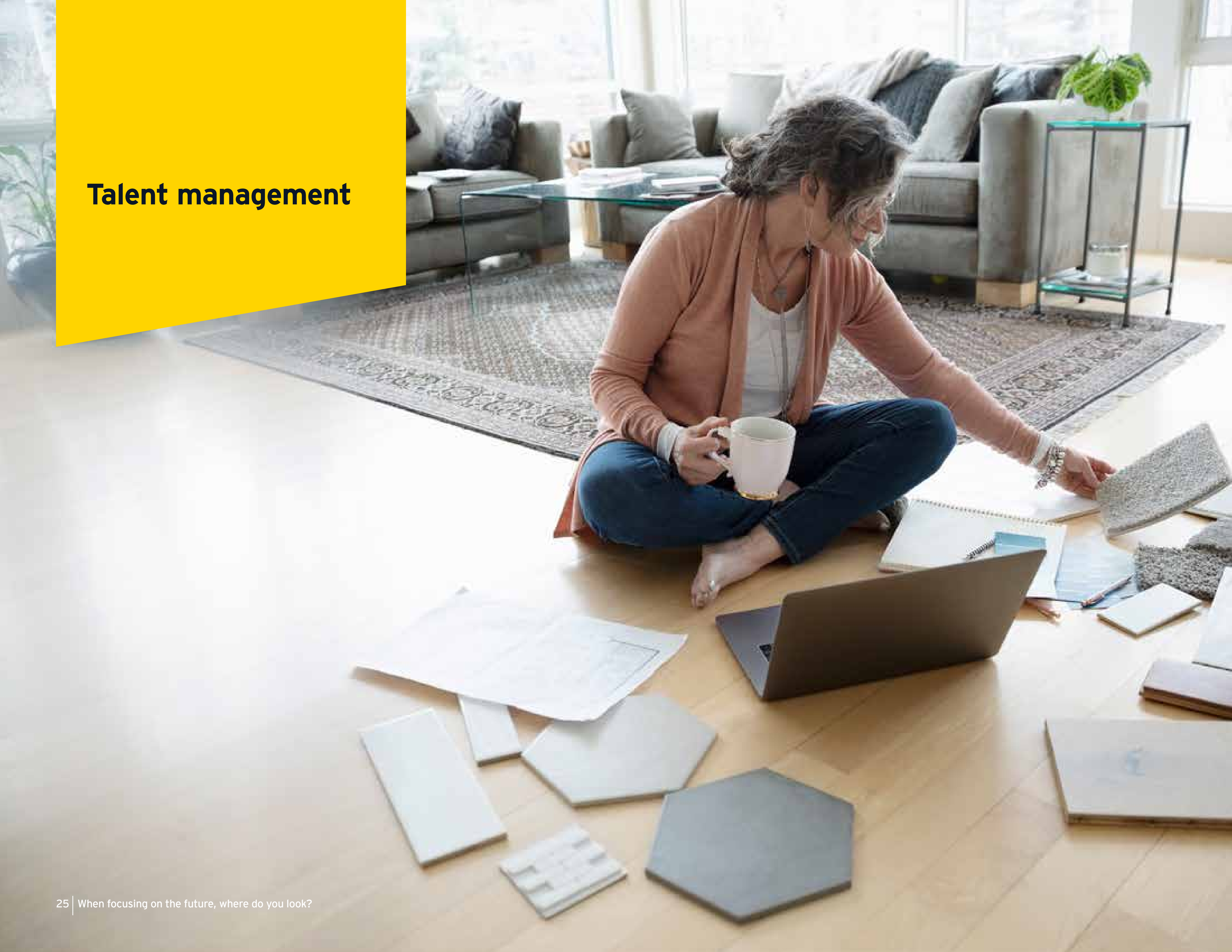
All alternative funds

How would you describe your firm's efforts in understanding and engaging with FinTech platforms that aggregate capital and/or streamline manager due diligence/research/investment for individual investors who may not have previously qualified to invest in alternative products?



> “Alternative managers need to continue leveraging technology and automation, which should lead to higher productivity and lower fees.
>
> – Hedge fund, North America, over US$10b

Talent management



The focus on talent management is a phenomenon that touches all industries. There are a variety of factors at play – demographic changes reshaping the workforce, adoption of technology that affects the nature of jobs and skill sets needed to be successful, a focus on diversity and inclusiveness to promote stronger organizations and a competitive job market where employees have the leverage are just a handful that are affecting all companies, including alternative fund managers. We have noted a continued trend in this year's survey of a heightened focus, by managers and investors alike, on the importance that all constituents place on talent management as a strategic priority. And the results do show measurable success in certain areas, but there is a broad recognition that this priority will be one of the most critical drivers to success in the decade to come, if not the most critical.

Investors are significantly influenced by a manager's talent management program

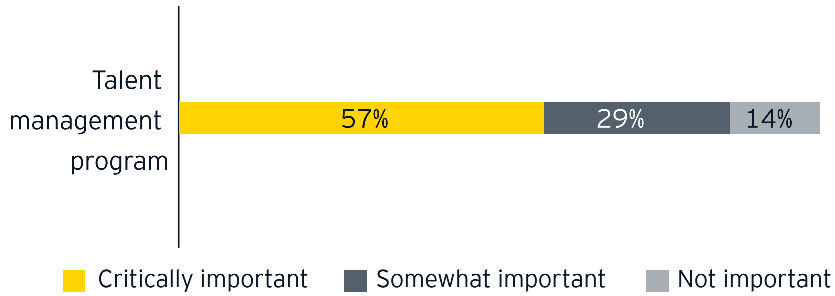
Investors continue to remain laser focused on a manager's talent management program. Nearly 9 of 10 investors state that a manager's talent management program is important when making investment decisions with 57% indicating the quality and substance of the talent program are critically important to their investment decision.

Investors are looking for long-term partnerships with their managers and recognize the ability to deliver consistent returns is predicated on the manager attracting and retaining the right talent.

Exploring managers' talent management programs is no longer a check-the-box exercise as part of due diligence questionnaires, but rather an exhaustive understanding to identify how the manager is attracting and getting the most out of his or her people. Compensation structures and strategies continue to be important, but investors also identify diversity and inclusiveness and professional developmental initiatives as areas of their focus.

Investors

What impact does a manager's talent management program have on your decision to invest or remain invested?



Improving employee productivity and engagement is the top talent management priority for managers

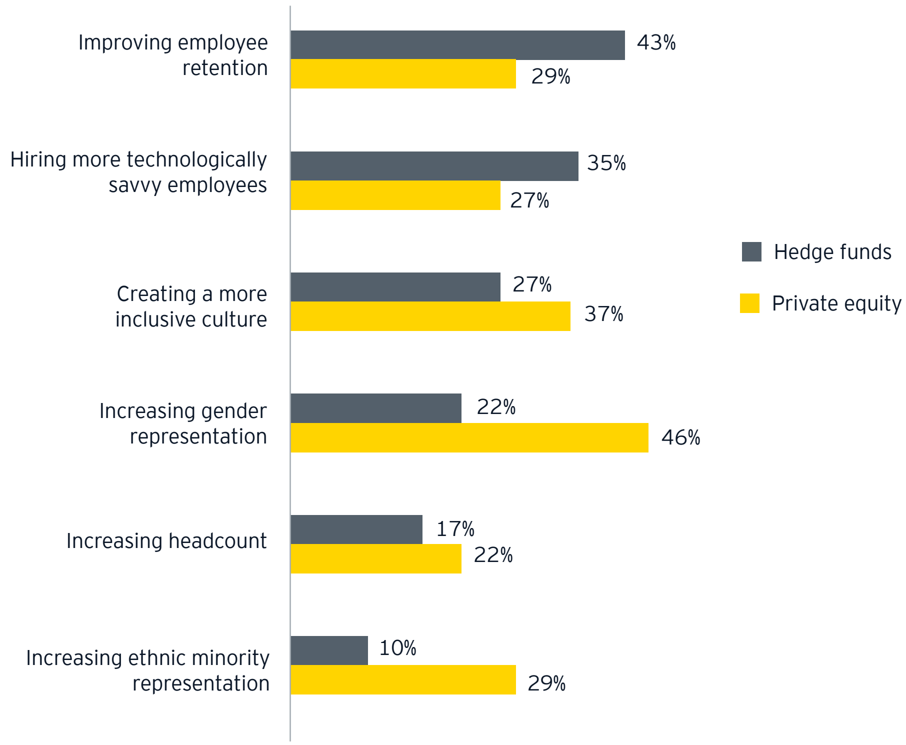
All alternative funds

What are your firm's most important talent management priorities?

82% of hedge fund managers and **75%** of private equity managers

are prioritizing employee productivity and engagement

Other talent management priorities:



Hedge fund and private equity managers are in agreement on their top talent management priority: increasing productivity and engagement.

Goals of increased engagement within an organization are critical to ensure employees buy in on the company's objectives and strategies. Further, with continued focus on costs and exploration of new technologies to promote automation, managers are looking for productivity improvements to benefit the bottom line.

Hedge funds and private equity differ on their other priorities. Hedge funds are focused on retention as well as hiring individuals with advanced technology skill sets, whereas private equity managers are focused on D&I. Retention is a particularly sensitive issue for hedge funds that, while dealing with muted performance and lackluster growth, find it more challenging to recruit and compensate key employees.

This contrast is interesting and speaks to continued differences in the business models. Hedge funds continue to see harnessing technology as a competitive advantage. Private equity managers are more interested in creating diverse teams as their investment philosophy continues to leverage human capital and analysis more than technology. This divergence in priority does result in stark contrasts in various diversity statistics, as follows on the next two tables.

Private equity managers are significantly ahead of hedge funds in setting gender diversity targets …

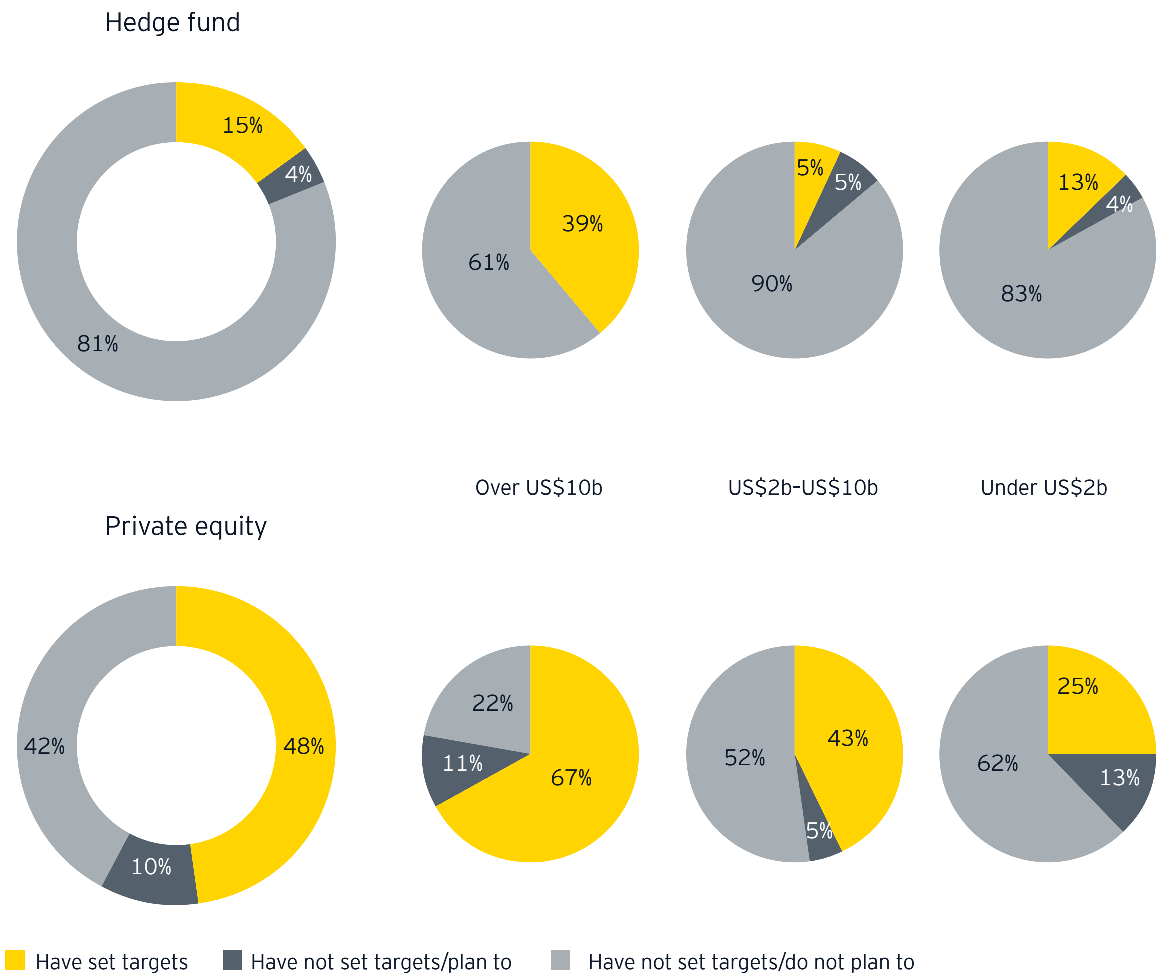
A recent study by the EY Diversity & Inclusiveness Center of Excellence in the US showed that diversity and belonging are workplace expectations. More than one-third of respondents – across generations and ethnicities – felt the greatest sense of belonging at work, ahead of their physical neighborhood and place of worship.

The alternative fund industry still has a long way to go to improve diversity in the workplace. The first step for many is setting diversity targets. Shockingly, more than 80% of hedge funds have not set gender diversity targets and do not plan to. While private equity fares better with more than half of managers having or expecting to have specific targets in place, it is clear the alternative asset management industry is lagging behind others.

Gender and diversity representation has become an expectation across boards and management teams of all industries. Failing to make progress in this area will cost asset managers potential investors as well as top talent that wants to be part of diverse teams.

All alternative funds

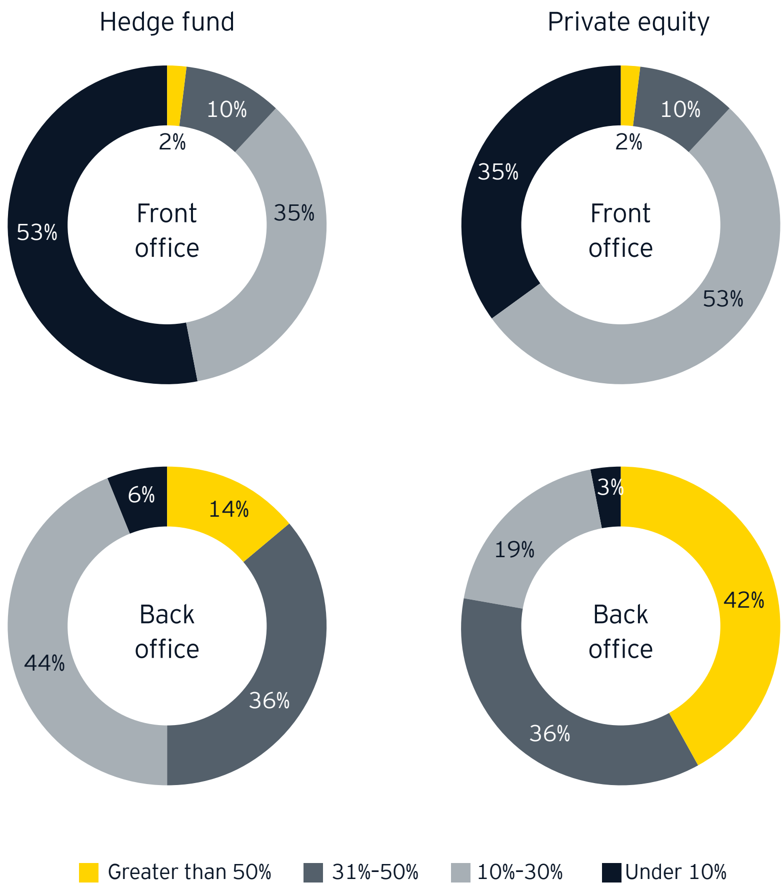
Have you set gender diversity targets?



... leading to marginally better representation, although front offices are still male dominated

All alternative funds

Approximately what proportion of employees in your front office, as well as outside the front office, are women?



> I would like managers to continue to try or start to try to attract and retain diversified talent. There is no significant representation of women or individuals of color in the alternatives space. All you have to do is look at the pitch books that you get from all these shops and all you see are a bunch of people who look like me — middle aged white men.
>
> – Pension, North America, US$2b-US$10b

The benefits of gender diversity are becoming widely recognized as critical to an organization's success. Several recent studies have highlighted the enhanced returns of funds that have greater gender diversity than those with homogenous leadership.

And many investors are responding to these findings by specifically seeking out firms with diversity in the front office. In fact, nearly one in four investors noted that they have specifically sought out and made investments with managers who have either significant ethnic or gender diversity in the front office.

Broadly speaking though, managers have yet to address their diversity shortcomings in the front office as only 1 in 10 managers reported having a front-office team comprising more than 30% women.

Significantly more progress has been made outside of the front office. Private equity managers' responses indicate that they are on average approaching parity when it comes to gender representation, and while hedge fund managers are not quite as diverse, 50% of managers reported having greater than 30% of their back-office team being women.

Various actions are being taken to improve diversity

In response to falling behind in achieving diversity targets, many managers are taking action to try to improve their representation. Two of three managers said they are taking at least one specific action to increase the diversity of their workforce, although the responses indicate there is no consensus as to the most impactful action item.

The most commonly cited responses highlighted that managers are (a) casting a wider net for potential candidates by hiring from different schools and educational backgrounds, (b) offering different benefits aimed at promoting stronger parental and health policies and (c) developing professional mentorship and diversity groups aimed at promoting and empowering individuals of different backgrounds.

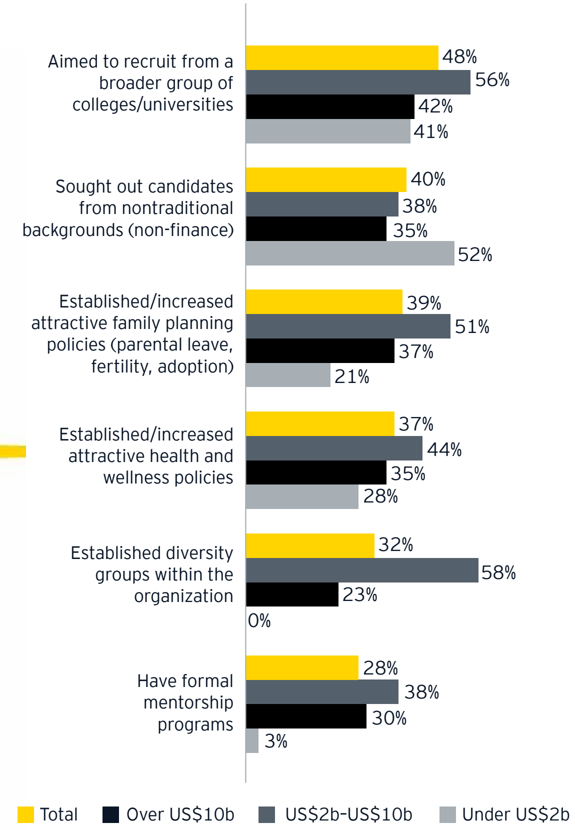
Those managers of entities greater than US$10b have an advantage via resources but also a need due to generally employing a larger workforce, resulting in being at the forefront of these issues.

All alternative funds

What actions has your organization taken or does it plan to take in order to increase the diversity in your workforce?

67%

of managers have initiatives in place to increase diversity in their workforce



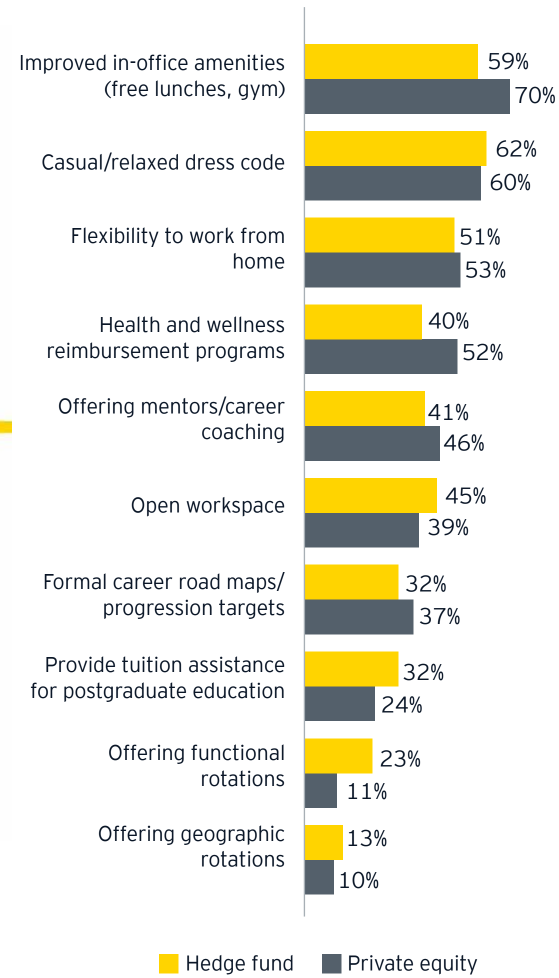
Managers are also implementing initiatives to attract and retain younger talent

All alternative funds

What initiatives do you currently have in place or plan to implement to make it easier to attract and retain younger talent?

81%

of managers have initiatives in place to attract and retain younger talent



The alternatives industry continues to present attractive employment opportunities for individuals early in their careers, and most managers do not find that they have challenges recruiting younger talent. Challenges with retaining talent are more acute, as a result of a tight job market with competition within and outside of alternatives, as well as the behaviors of the younger generation of talent, which is more likely to seek out different opportunities over the course of their career and be less rooted to one position or firm.

As is the case with diversity, the majority of managers have reported putting initiatives in place aimed at retaining and engaging with the younger generation of employees.

The interesting observation is that many of the most frequently cited initiatives are aimed at quality of life – modern office amenities, relaxed dress code, flexible work schedule. Career development activities such as mentorship programs, upward mobility targets, postgraduate educational assistance and job rotations were each cited by less than half of managers.