

Hedge Fund Managers Fail to Deliver in 2008

Heavy losses, outflows, and fund closures roil the hedge fund industry in 2008.

By Nadia Papagiannis, CFA | 01-24-09 | 02:00 PM |

Investors lost their appetite for hedge funds in 2008, as the vehicles intended to deliver absolute returns were forced to resort to relative claims of success. Since August 2007--the beginning of the credit crunch--hedge funds have effectively acted as muted versions of equities, providing positive returns only twice when the MSCI World Stock Index was negative. Still, the Morningstar 1000 Hedge Fund Index did outperform the MSCI World Index by a sizable 20 percentage points for 2008, thanks in part to large cash allocations.

Indeed, investors redeemed assets aggressively in 2008. Hedge fund inflows peaked in June 2007 and bottomed in October 2008, when more than \$21 billion left the industry. In November 2008, another \$19.4 billion flowed out of hedge funds, setting the year-to-date outflows at more than \$44 billion.

Hedge fund investors showed a strong tendency toward performance chasing, investing more after positive months and withdrawing assets after down months. Investors following this strategy ended up losing less than the index, as the markets trended increasingly downward as the year progressed.

High redemptions and little possibility of collecting performance fees in the near future led hedge funds to shutter in record numbers in 2008. The number of funds dropping out of Morningstar's database increased more than 150% in 2008 from 2007--1,158 single-manager funds and 490 funds of funds were removed in 2008 compared with 434 single-manager funds and 208 funds of funds in 2007. (Funds are removed from Morningstar's database if the fund liquidates, if the manager wishes to stop reporting returns, or if funds fail to report returns for six months.)

Estimated Net Flow Data through November 2008 (\$mil)

By Category	1 Month	QTD	YTD
Convertible Arbitrage	-230	-378	-1,620
Corporate Actions	-364	-1,858	-3,090
Debt Arbitrage	-309	-1,540	-2,158
Distressed Securities	-217	-841	-3,468
Dvlp Asia Equity	-1,126	-1,892	-3,763
Emerging Markets Equity	-947	-2,186	-3,139
Equity Arbitrage	-1,857	-3,678	-2,517
Europe Equity	-2,806	-5,076	-16,065

Global Debt	-565	-1,809	-5,588
Global Equity	-576	-1,697	-1,175
Global Non Trend	-1,894	-4,621	-14
Global Trend	-4,199	-6,546	5,567
Multistrategy	-1,918	-4,924	-1,404
Short Equity	-21	27	78
US Equity	-2,386	-5,038	-13,024
US Small Cap Eqty	5	-184	27
Estimated Total Net Flow	-19,410	-42,241	-44,417

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By Rating

5-Star	-3,546	-5,106	6,250
4-Star	-5,205	-12,230	-1,145
3-Star	-6,055	-13,679	-31,694
2-Star	-1,439	-6,046	-18,525
1-Star	-229	-1,498	-6,078
Not Rated	-2,936	-3,683	6,775
Estimated Total Net Flow	-19,410	-42,242	-44,417

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Hedge funds flows are based on hedge funds that reported November net assets and performance as of Jan. 19, 2009.