Overview

As at 31 December 2002, total funds in the Australian hedge fund industry totalled $6.86 billion, with two managers, OM Strategic and Grinham Managed Futures, managing $4.0 billion of this.

OM Strategic was by far the largest manager in the Australian market with a market share of 39.4 percent, or $2.7 billion FUM/advisory, while Grinham Managed Futures had a market share of 19.0 percent with $1.3 billion FUM/advisory. The vast majority of funds which flow into these two managers are sourced from investors other than Australian institutional investors. The majority of OM Strategic's funds come via overseas investors and the retail market, while Grinham's funds, although managed in Australia, come predominantly from offshore investors.

The third largest manager was Barclays Global Investors with FUM of $270 million, or 3.94 percent of the industry. Deutsche Asset Management was the next largest provider with $258.2 million, or 3.77 percent of the market. Barclays Global Investors and Deutsche Asset Management were the largest two managers of funds sourced from the Australian institutional market. Rounding out the top five was Optimal Funds Management with $230.0 million, whose funds are nearly all sourced from offshore but managed domestically.

As the above figures reveal, the Australian hedge fund industry is highly concentrated with the largest two managers making up approximately 60 percent of the market, while the top 10 managers accounted for 83.3 percent.

The December quarter saw a number of managers receive institutional money with Barclays Global Investors receiving the largest allocation, a $50 million mandate for their long/short Equity Market Neutral Fund from the $5 billion Funds SA. Colonial First State won their first external institutional mandate with the $542 million AvSuper fund allocating $13 million to Colonial's fund-of long/short-hedge-funds.

Basis Capital was awarded a $5 million allocation from an unnamed super fund as part of the fund's fixed interest allocation rather than as part of a separate alternative asset portfolio. The super fund's plan is to use Basis as an overlay to generate alpha. Merrill Lynch gained a mandate from The Industry Super fund following the fund s move to a near fully specialised manager roster, replacing five balanced managers and sacking Aon as their asset consultant. Tactical Global Management (TGM) a subsidiary of Commonwealth Bank of Australia (CBA) also won a commitment from an unnamed Australian institution for its global macro hedge fund.

The only hedge fund mandate terminated during the quarter was Deutsche Asset Management's $22 million mandate from the $600 million RBA Officers Super Fund. Deutsche's mandate was the fund's only hedge fund allocation.

For the 2002 calender year, the average hedge fund return was 5.5 percent, with the median return being slightly higher at 5.9 percent. The best performing fund during 2002 was the Vertex Capital Relative Value Fund which returned 29.8 percent, followed by another long/short fund, the BGI Equity Market Neutral Fund with 19.8 percent. The worst performing fund was the PM Capital Absolute Performance Fund with –19.4 percent.

The best performing fund on a risk-adjusted basis was the BGI Equity Market Neutral Fund with a Sharpe ratio of 4.14, next was the Colonial Wholesale Fixed Interest Strategies Fund, and the

Basis Capital Aust-Rim Opportunity Fund with Sharpe ratios of 3.27 and 2.27 respectively. The median Sharpe ratio for the industry as a whole was 0.64.

BGI's Equity Market Neutral Fund was the best performing fund since inception with an annualised return of 23.5 percent over its 16-month life. The FRM Australia Diversified Fund was the next best with a return of 20.0 percent since its inception, although this fund only has a short history (two months). Both funds measure up favourably against the average return since inception for the industry of 9.3 percent.

The FRM Australia Diversified Fund has also performed well in terms of profitable months, delivering profitable returns every month since inception, however, again, this only constitutes 2 months. The Lazard Diversified Strategies Fund has experienced positive returns in 92.9 percent of months, while the two Basis Capital funds have been profitable in 89.7 percent of the months since they were established. The BGI Equity Market Neutral Fund was next with 87.5 percent.

In terms of months being profitable, the industry as a whole performed remarkably well, with positive returns being experienced on an average of 70.7 percent of the time. In fact, all hedge funds except one produced positive returns more than 50 percent of the time.

The average volatility of hedge funds during 2002 was 6.07 percent, which would compare favourably with most asset classes during such a turbulent year. Two HFA funds topped the list with the HFA Conservative Investments Fund, and the HFA Diversified Investments Fund having the lowest volatility with 1.25 percent and 1.43 percent respectively. Twenty-two of the hedge funds experienced volatility below 3 percent, with the highest volatility being recorded by the PM Capital Absolute Performance Fund with 28.4 percent.

In other hedge fund news during the quarter, K2 Asset Management was awarded a four star rating from ASSIRT, making it the first single strategy absolute return fund manager to be considered by the retail research house. Blue Sky Capital Management has ceased marketing its Australian equities fund to concentrate on its flagship Blue Sky Japan Fund and single strategy hedge fund Wallace Absolute Returns Ltd. listed on the Australian Stock Exchange (ASX) during December.

A number of managers flagged their intentions to launch new hedge funds during the December quarter. Allianz are set to launch an Australian hedge fund product following a visit from Allianz Hedge Fund Partners (AHFP) senior investment officer, Joanne Poile. Boutique investment bank and fund manager Rubicon Partners launched an Asian long/short equity hedge fund with Perennial Investment Partners as its manager. The Rubicon product will be predominantly a retail offering with Perennial's Asian equity team under Kerry Series running the money.

The other investment manager planning to launch a hedge fund is State Street Global Advisors (SSgA). SSgA is putting together an internal team in Sydney to launch a long/short market neutral fund. The Australian fund will have a capacity of $250 million and aim to return between 7 and 10 percent with a volatility of between 5 and 7 percent.