

STATE STREET

# HEDGE FUND RESEARCH STUDY

**KEY FINDINGS**

MARCH 2006

## RESULTS OF STATE STREET'S HEDGE FUND RESEARCH STUDY FOR INSTITUTIONAL INVESTORS

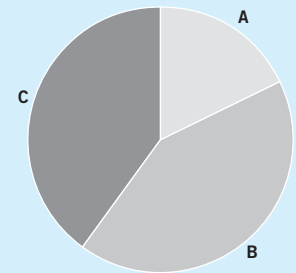
### > BACKGROUND

State Street Corporation, in conjunction with the Global Absolute Return Congress (Global ARC), conducted a study of institutional investors at the 2005 Global ARC conference, held in Boston on October 24-26, 2005. The study results reflect the role of alternative investments, including hedge funds and private equity, in institutional investors' portfolios and their general views on these investment strategies.

Institutional investors are represented by a cross section of global conference attendees including corporations, public and government pension plans, endowments and foundations. According to Global ARC, the responding institutions collectively manage more than \$1 trillion total assets in their investment portfolios. Other conference attendees, including hedge fund managers, fund of hedge fund managers, consultants and service providers, were not eligible to participate in the study.

#### Respondent Breakdown

<b>A</b>	18%	Corporate Pensions
<b>B</b>	42%	Public Pensions
<b>C</b>	40%	Endowments/Foundations



### > METHODOLOGY

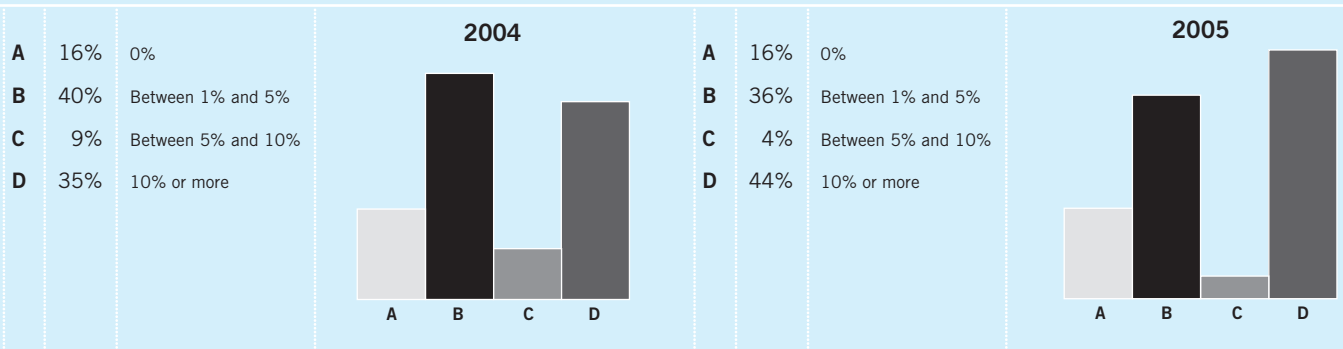
The information contained in this report is derived from a Web-based study conducted during the conference. One delegate from each participating organization anonymously and confidentially recorded his or her organization's views on hedge funds and private equity funds. Results for each question reflect the views of the entire pool of respondents.

## > KEY FINDINGS

### 1 Institutional investors continue to increase their allocation to alternative investment vehicles.

Nearly half (48%) of institutional investors have 5% or more of their portfolios invested in hedge funds today, including 44% with 10% or more invested in hedge funds. This represents an increase over 2004, when only 35% of institutions said hedge funds represented 10% or more of their assets. At the time of the survey, 16% of participants reported no allocation to hedge funds, which remains unchanged from last year.

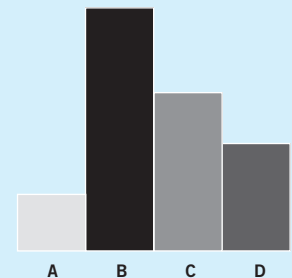
Percent of Portfolio Allocated to Hedge Funds



**For the first time State Street also surveyed institutions about the role of private equity in their portfolios.** Nearly half (43%) have allocated 1%-5% to private equity, while nearly a third (28%) held 5%-10% of their portfolio in private equity assets. Nineteen percent of respondents reported that private equity accounted for more than 10% of their portfolio, while 10% said they had no private equity assets.

Percent of Portfolio Allocated to Private Equity

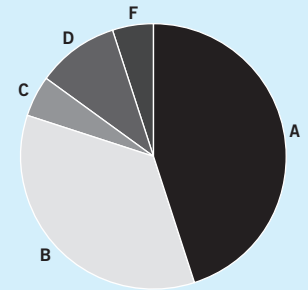
A	10%	0%
B	43%	Between 1% and 5%
C	28%	Between 5% and 10%
D	19%	10% or more



Most respondents indicated that new allocations to both hedge funds and private equity will be at the expense of existing active and passive equity allocations.

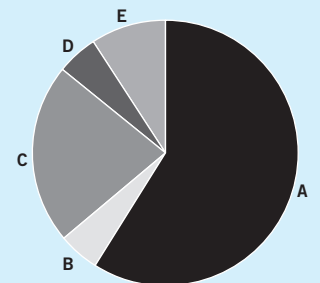
I expect that our increased allocation to hedge funds will primarily come from:

<b>A</b>	45%	Active equity allocations
<b>B</b>	35%	Passive equity allocations
<b>C</b>	5%	Active bond allocations
<b>D</b>	10%	Passive bond allocations
<b>E</b>	0%	Private equity
<b>F</b>	5%	Commodities



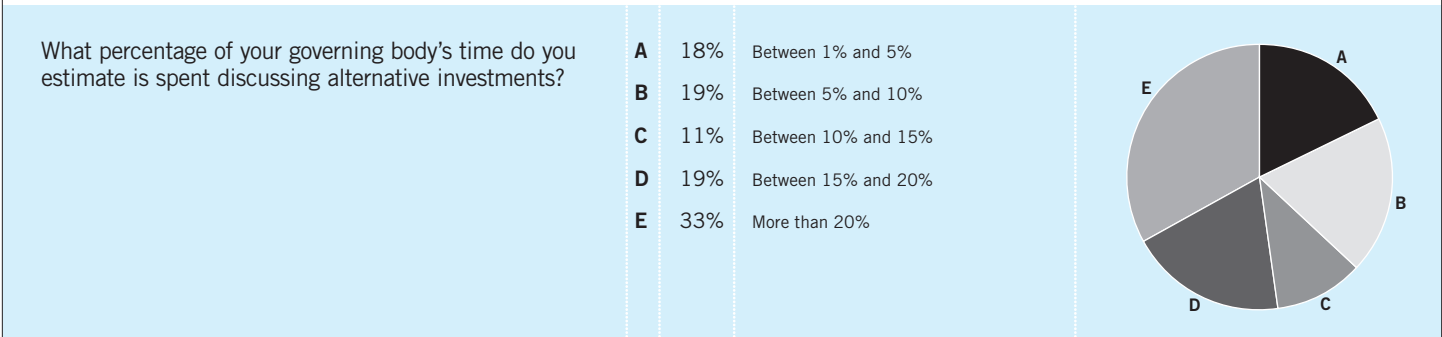
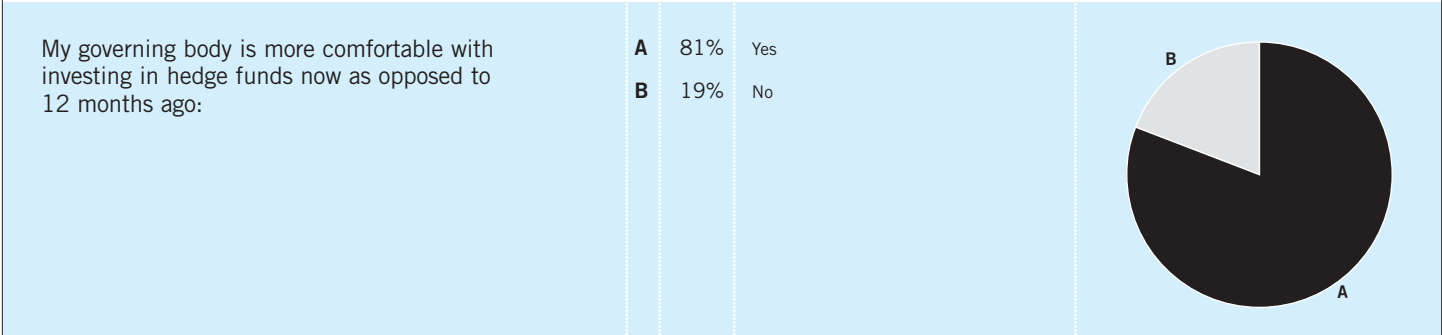
I expect that our increased allocation to private equity will primarily come from:

<b>A</b>	59%	Active equity allocations
<b>B</b>	5%	Active bond allocations
<b>C</b>	22%	Passive equity allocations
<b>D</b>	5%	Passive bond allocations
<b>E</b>	9%	Hedge funds, fund of hedge funds or hedge fund indexes
<b>F</b>	0%	Commodities



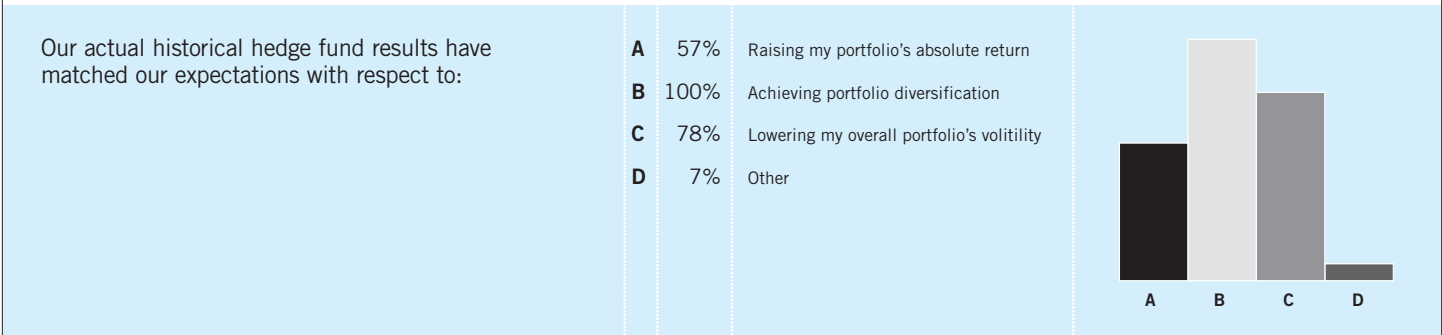
**2 Investment boards and trustees are more comfortable with hedge funds than they were 12 months ago.**

Eighty-one percent of total respondents and 63% of pension respondents stated that their governing bodies are more comfortable with hedge funds today than they were last year. More than half of respondents' boards (52%) reportedly spend in excess of 15% of their time discussing alternative investments, primarily in terms of evaluating new strategies and reviewing existing managers.



**3 Hedge fund investment expectations are being met.**

One hundred percent of respondents said they have realized the diversification they expected from their hedge fund investments, while 78% said that hedge funds reduced the volatility of their portfolio and 57% reported they were satisfied with the results of hedge funds in raising the absolute return of their portfolio.



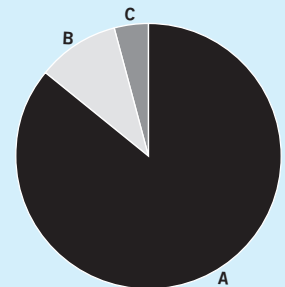
#### 4 Institutional investors plan to hire additional hedge fund and private equity managers in the coming year.

Eighty-six percent of respondents said they plan to add new hedge fund managers to their line-up this year. Two-thirds (67%) said the same regarding private equity managers.

Nearly half of respondents (48%) engage more than 10 direct hedge fund managers. Forty-three percent of respondents said they invest with between one and three fund of hedge fund managers, while 28% said they do not have fund of hedge fund holdings. When asked if they currently employ an optimal number of hedge fund managers, a majority (57%) of respondents answered in the negative. A quarter of study participants (24%) said their current number of hedge fund managers was optimal, while 19% said they had no target.

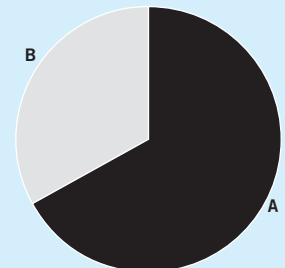
We plan to add new hedge fund managers over the next year:

<b>A</b>	86%	Yes
<b>B</b>	10%	No
<b>C</b>	4%	We do not have a target number of managers



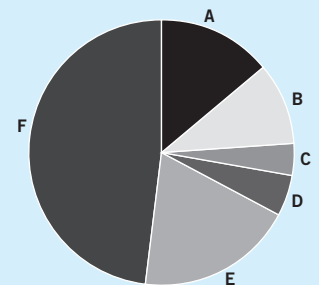
We plan to add new private equity managers over the next year:

<b>A</b>	67%	Yes
<b>B</b>	33%	No



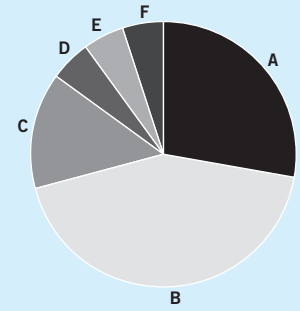
How many direct hedge fund managers does your organization utilize?

<b>A</b>	14%	None
<b>B</b>	10%	1 to 3
<b>C</b>	4%	4 to 5
<b>D</b>	5%	6 to 8
<b>E</b>	19%	8 to 10
<b>F</b>	48%	More than 10



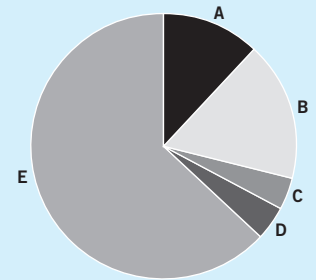
How many fund of hedge fund managers does your organization utilize?

A	28%	None
B	43%	1 to 3
C	14%	4 to 5
D	5%	6 to 8
E	5%	8 to 10
F	5%	More than 10



How many private equity managers does your organization utilize?

A	12%	1 to 3
B	17%	4 to 5
C	4%	6 to 8
D	4%	8 to 10
E	63%	More than 10



**When asked to profile the most important and desirable attributes for a prospective manager, the respondents identified that the alternative investment managers most likely to be selected will have the following attributes:**

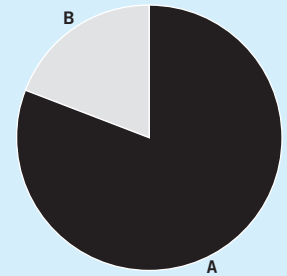
- At least \$200 million assets under management
- At least a one-year track record
- An independent administrator strikes their fund's NAV
- They charge fees of "2 and 20"
- They are willing to negotiate their "terms"

**5 Investors realize the importance of distinguishing their managers' results in terms of alpha and beta.**

Four out of five survey respondents (81%) said they selectively engage new managers for both alpha and beta, and a majority (59%) said they were able to differentiate between a given manager's alpha and beta results. The split among those who use alpha porting techniques and those who do not was 50-50.

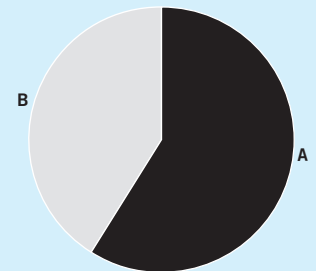
We selectively engage new managers for both alpha and beta:

<b>A</b>	81%	Yes
<b>B</b>	19%	No



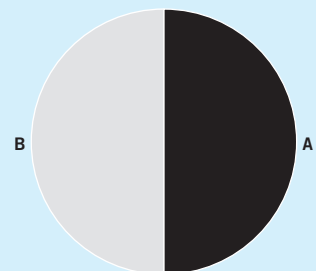
For a given manager's results, we are able to differentiate between our alpha and beta results:

<b>A</b>	59%	Yes
<b>B</b>	41%	No



We use alpha porting techniques:

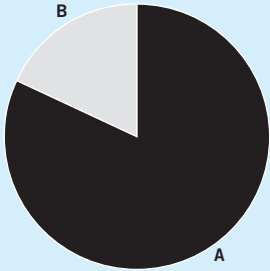
<b>A</b>	50%	Yes
<b>B</b>	50%	No



Of the 41% of respondents who said they were unable to separate alpha and beta for a given manager, an overwhelming majority (82%) attributed their response to a lack of tools and/or resources.

We are not able to differentiate these results because we lack the tools and/or resources to separate alpha from beta:

A	82%	Yes
B	18%	No



> **IF YOU HAVE QUESTIONS OR  
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