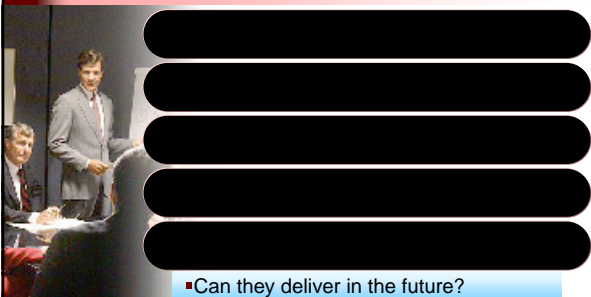


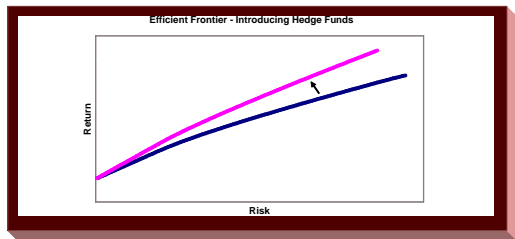
Hedge Funds – A Promise Delivered?

Robert Howie
Mercer Investment Consulting

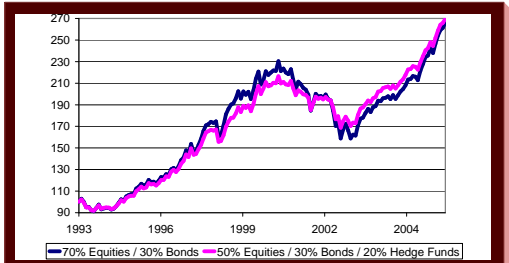
Agenda



The hedge fund promise



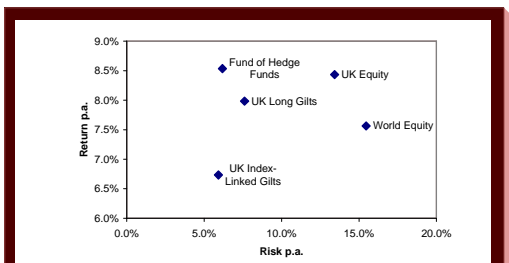
Historical analysis



The Actuarial Revolution
Tackling the UK's Pension Funding Gap

Historical analysis

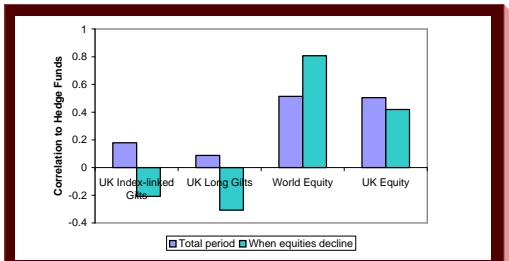
1993 - 2006



The Actuarial Revolution
Tackling the UK's Pension Funding Gap

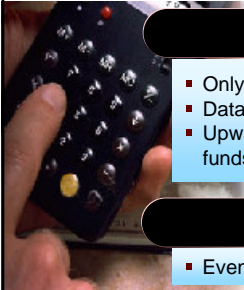
Historical analysis

1993 - 2006



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But can we trust the numbers?



- Only cover part of universe
- Data submitted on voluntary basis
- Upward bias in returns data (for fund of funds) may be as high 1.5% p.a.

- Even investible indices now available

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TALKING TO THE ACTUARY - THE MATHS

What is the correct comparison (benchmark) for hedge fund returns?

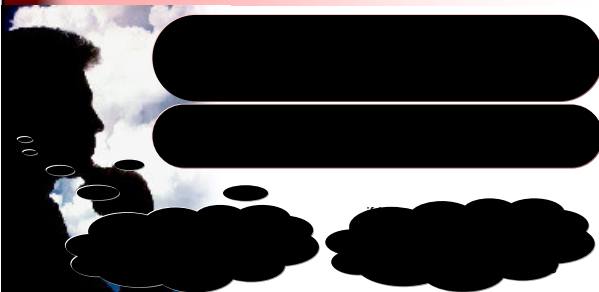
Q1: What would you invest in if you didn't have any views on the relative attractiveness of different investments?

Q2: How would you depart from this position if you do have views?

Your answer to Q1 tells you what your true benchmark really is...

The Actuary's Perspective
TALKING TO THE ACTUARY - THE MATHS

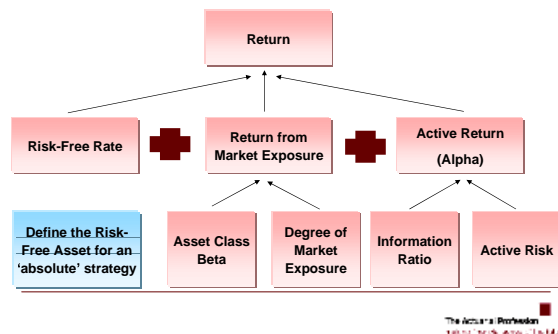
But aren't hedge funds supposed to be benchmark-free?



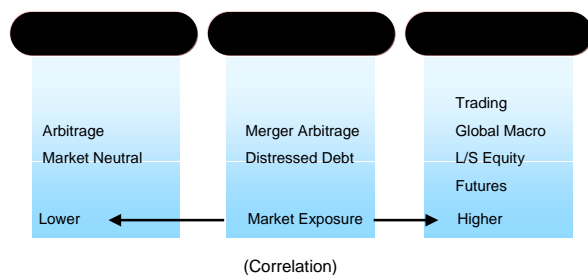
This line of logic leads to a conclusion that every investor has an investible benchmark, whether they like to acknowledge it or not

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Where have the returns come from?



How do hedge funds make money?



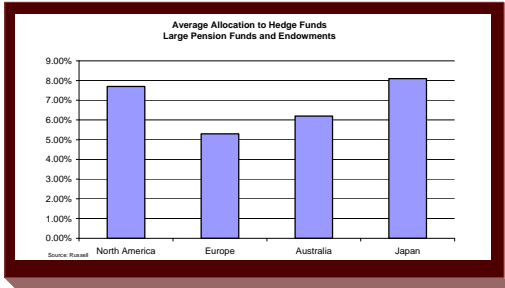
How do hedge funds make money?

- Heavily skill-based
- Flexible mandates
- Short-selling and leverage

- equity risk
- credit risk
- liquidity risk
- insurance risk

The Actuarial Revolution
Trading for the Actuarial Future

Hedge fund investors



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VALUING THE ACTUARY'S PERSPECTIVE

Hedge fund investors



Mercer clients invested \$749 million in hedge funds in 2005

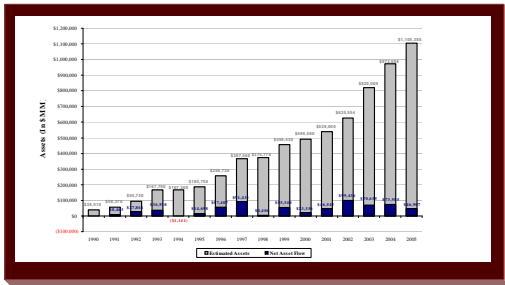


NAPF study in 2005 found it was 20%, with typical allocations of 5-20%



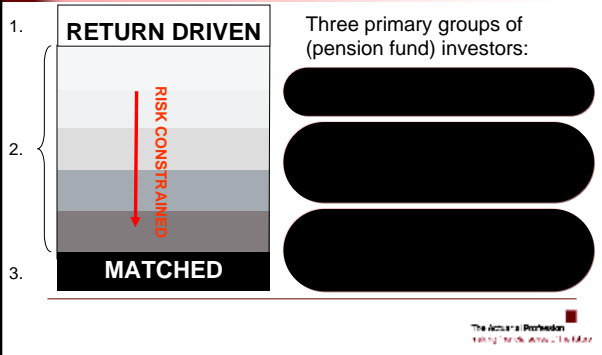
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VALUING THE ACTUARY'S PERSPECTIVE

The hedge fund industry



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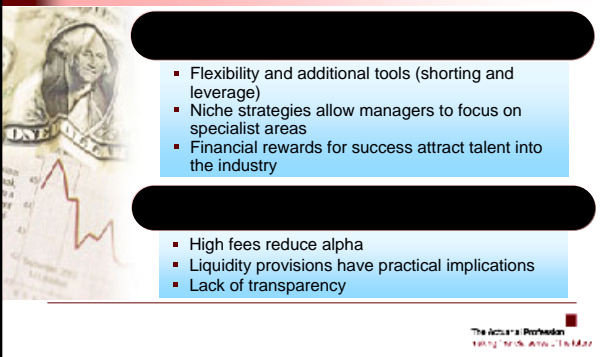
Is there a role of hedge funds in liability driven investing (LDI)?



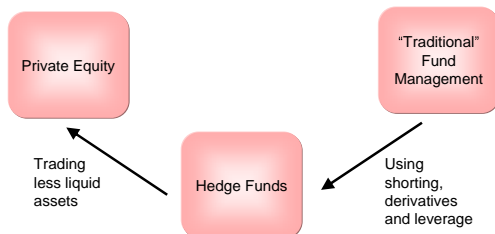
Hedge funds in LDI



Using hedge funds as a source of alpha in LDI



The future for hedge funds



Will hedge funds ultimately lose their distinct identity?

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But can hedge funds deliver the goods?

	Increasing returns	Reducing returns
Talent pool	New talent from investment banks, "traditional" industry	Average hedge fund manager becomes your average Joe
Opportunities in markets	Constant evolution	Too much money chasing disappearing margins
Fees	Will they ever come down?	

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Conclusions



- But the universe is large and diverse, and not all investment has been successful
- But ultimately their separate identity may disappear
- Very many, perhaps even the majority, will disappoint
- It is vital to be able to identify the minority that have true skill and are likely to deliver real alpha

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