Domestic hedge funds' assets double since 2012

Despite being smaller in size, domestic players have outpaced India-focused foreign hedge funds in growth; however, barriers to market's growth remain

SACHIN P MAMPATTA
Mumbai, 16 February

The assets under management for hedge funds based in India have grown faster than their foreign peers since they came into being in 2012. This was the year when the capital markets regulator, Securities and Exchange Board of India (Sebi), recognised hedge funds as a category for the first time.

The S&P BSE Sensex is up a little less than 80 per cent since the regulations were enacted, while the hedge fund assets have more than doubled. Interestingly, India-focused foreign hedge funds' assets are up only 44 per cent in the same period, according to data from hedge fund tracker Eurekahedge.

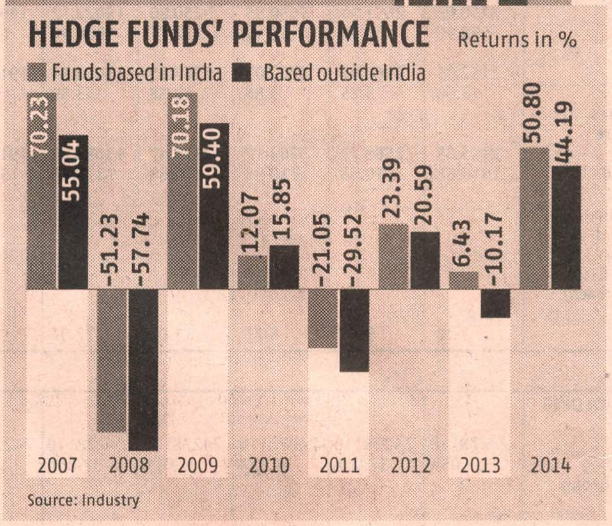
The faster growth of domestic players could also be on account of the difference in size of the foreign versus the India-based segment. The money managed by hedge funds which have a mandate to invest only in the Indian market scaled a multi-year peak in 2014. The total amount managed by such funds reached \$3.45 billion. And, \$3.06 bn of this came from funds based outside India. Local funds accounted for \$392 million.

Local players have also tended to outperform their foreign peers. Their return in 2014 was 50.8 per cent. India-dedicated hedge funds based outside the country had a return of 44.19 per cent.

"Broadly, it definitely helps to have feet on the street. There is no substitute to be on the ground in the market that one invests in. That being said, information is widely available today, which allows for informed decision making from anywhere in the world. I would have to say there is a small edge to generate alpha by being present in the market one invests in," said Anuj Didwania, managing director, Redart Capital Advisors, which runs an Indian hedge fund.

In 2013, too, local hedge funds outperformed. Hedge funds based abroad gave a negative return, of 10.17 per cent.

Illustration: Ajay Mohanty



Source: Industry

Those based in India gave a positive return, of 6.43 per cent. The outperformance has continued. "Indian hedge funds were the top performers with gains of 6.8 per cent while Eastern Europe and Russia mandated funds delivered the worst results, down 2.46 per cent for the month," according to a statement from Eurekahedge.

The nature of participation so far might be the cause that the assets of local hedge funds are much lower than those of India-dedicated funds abroad. "Institutions don't invest in alternative assets (of which hedge funds are a part) in India. Globally, the biggest investors in hedge funds are not HNIs (wealthy individuals) but institutions like pension funds and endowments... therefore, the room to grow (in India) is very limited," added Didwania.

However, the interest does seem to be building. "There is some interest from corporate treasuries and family offices," said Vaibhav Sanghavi, managing director, Ambit Investment Advisors, which runs its own hedge fund. But there are plenty of kinks to be worked out before hedge funds can attract foreign capital.

"Foreign investment in Indian hedge funds, organised as trusts and LLPs (limited liability partnerships), require Foreign Investment Promotion Board approval, which generally has been challenging to obtain. In addition, there is a tax arbitrage in favour of offshore funds directly investing from favourable treaty jurisdictions, as compared to tax challenges and ambiguities for Indian hedge funds. These factors have deterred foreign investments in Indian hedge funds," said an official with one of the big four accounting firms.

Hedge funds consider trail commission regime

Seen to be healthier, for diverse reasons, than the traditional upfront percentage model, including getting investors for the long term

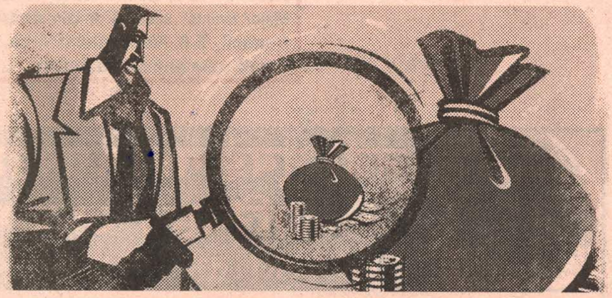
SACHIN P MAMPATTA
Mumbai, 22 February

The ongoing debate on switching from an upfront to a trail commission regime in mutual funds seems to find some resonance in the hedge fund sector as well.

Local hedge funds, which started operations only over the past two to three years, are exploring the model. They are experimenting with paying distributors a percentage of the assets under management (AUM) every year, than paying an upfront commission.

"This is seen to be a healthier practice. Also many hedge funds are boutique players and are unable to shell out large amounts in upfront costs," said Vaibhav Sanghavi, managing director, Ambit Investment Advisors.

Radhika Gupta, business head, Forefront Capital, an Edelweiss Group company, said conversations with new distributors show they are turning away from the upfront commission model. "They have expressed a preference for getting their income on a sustainable longer term annuity basis, rather than in the form of an upfront fee, a one-time affair. In some cases, there is also an element of participation in the carry fee. This is emerging as an alternative to the traditional upfront-plus-trail model," she said.



INDIA-DEDICATED HEDGE FUNDS

AUM: Assets under management Source: Eurekahedge

The carry fee relates to a share of the profits a hedge fund gets if the investor makes money in the fund. Distributors are also being offered a piece of this profit, rather than a commission model overly dependent on an upfront payment.

Typically, upfront commission is what is paid immediately to a distributor when the product is sold to a customer and is usually a percentage of the investment made. For example, consider an asset management company which pays 1.5-2 per cent as upfront commission. It would pay ₹1,500-2,000 to the distributor every time an investment worth ₹1 lakh is made. In addition, the asset manager may pay an additional trail commission on a yearly basis, calculated as a percentage of the AUM. This could be lower, generally around 0.5 per cent.

The MF sector and the distributor community, as well as the Securities and Exchange Board of India, are reportedly considering an inverted structure, where most earnings come from trail commission rather than upfront commission. The idea is to create an incentive for distributors to get investors for the long term, removing the incentive for getting them to switch products often.

The AUM of the hedge fund sector has doubled since the year the regulator officially recognised these as a separate investment category. Assets are up 107 per cent from $189.4 million in 2012 to $392.9 mn at the end of 2014, according to data from Eurekahedge.

The focus towards an increased trail commission comes even as investor interest has picked up, following a period of relative outperformance. India-based hedge funds outperformed foreign peers in 2014, up 50.8 per cent. Similar funds based abroad have given returns of 44.2 per cent.

"If this segment is to grow, people need to be more long-term. Distributors need to be willing to be less greedy and invest in growing the asset class. Managers need to less greedy and share the fees. And, charges to clients have to be reasonable, so they make a decent return on the investments. If everyone is looking to making fees before they make returns for investors, this sector will never take off," said Anuj Didwania, managing director, Redart Capital Advisors, which runs an Indian hedge fund.

India-focused hedge funds stumble in Feb

End year-long winning streak; fall in mid-cap and small-cap firms and Budget volatility seem to have contributed to the downside

SACHIN P MAMPATTA
Mumbai, 11 March

AJAY MOHANTY

Hedge funds which allocate money to only Indian securities showed losses last month for the first time in a year,as stocks of smaller companies underperformed. Volatility around the time of the Union Budget also weighed on returns, said fund managers.

"India-focused managers were down 0.51 per cent during the month, their first of negative returns after a 12-month winning streak," according to a note from hedge fund tracker Eurekahedge.

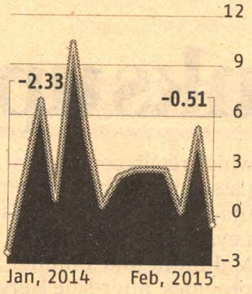
The fall came as peers investing in other regions enjoyed gains. Russia and Europe, both of which had seen negative returns on account of sanctions and fears of Greece's exit from the euro zone, outperformed Indian hedge fund players. Other emerging markets also did better.

"Eastern Europe and Russia hedge funds saw their first gain in eight months, with the Eurekahedge Eastern Europe & Russia Hedge Fund Index soaring 12.49 per cent...European managers came in second place, gaining 2.39 per cent in February and 3.56 per cent year-to-date, which outstripped returns for the entire year of 2014, buoyed by strong underlying markets as the MSCI Europe Index gained 6.09 per cent during the month," it said.

Emerging market hedge funds were up 1.98 per cent, while Japan gained 1.27 per cent. Indian equity markets were marginally up during February. The S&P BSE Sensex, whose returns are held as representative of how the market is doing, was up 178.55 points from 29,182.95 to 29,361.50, or 0.6 per cent.

Anuj Didwania, managing director, Redart Capital Advisors, which runs an Indian hedge fund, said concentration in lower capitalisation stocks might have affected the returns.

THE END OF A WINNING STREAK
India-focused hedge funds' returns (%)



Source: Eurekahedge

"It seems all the funds are in similar kinds of positions. February was the first month that small-cap and mid-cap stocks gave a negative return. My guess is that most fund managers are concentrated in mid and small-cap stocks, which is what led to the negative return," he said.

Vaibhav Sanghavi, managing director, Ambit Investment Advisors, which runs a hedge fund, noted February was a month of large market movements. "It's more to do with volatility, which has been high in February on account of the Budget. Some hedge funds could have been affected by it, which could have resulted in the lower returns for the index," he said.

Eurekahedge data is based on around 26 per cent of funds which reported February returns as of Wednesday. India VIX, a volatility index, hit a high of 22.015 in February, its highest value in 2015.

Hedge funds had given a 5.3 per cent return in January and positive returns every month stretching back to February 2014. Total returns in 2014 were 38.8 per cent, according to Eurekahedge data, before the decline in February.

The outlook does not suggest an immediate bounce-back. "The months ahead would mostly be flat to negative, as there are no triggers. Except for the next earnings season, which should be weak, looking at current trends and curtailed government spending in the fourth quarter (January-March). Valuations are expensive and earnings will now be needed to take markets further up. This should take a few quarters, so one should expect sideways to downward markets for the next few quarters," said Didwania.