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HEDGE FUND PULSE

Affirmative Investing:
Women and Minority Owned Hedge Funds

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Affirmative Investing: Women and Minority Owned Hedge Funds

In recent years, there have been an increasing number of pensions and other institutional investors who have expressed interest or started investing in women and minority owned investment companies. Indeed, such investing is now mandated for public pension plans by several states, including Ohio, California and Illinois. However, the debate over these practices remains fierce, while the number of women and minority owned funds continues to be relatively small, even as demand increases.

This paper attempts to answer some of the practical, performance- and risk-related questions surrounding women and minority owned hedge funds, including:

- **What is the rationale behind launching a women and minority owned investment company initiative?**
- **What are some of the objections to "affirmative investing"?**
- **What is the potential growth in AUM of women and minority owned hedge funds?**
- **What does the universe of women and minority owned hedge funds look like? Can supply meet demand?**
- **Is there a performance differential between women and minority owned hedge funds and the full hedge fund universe?**
- **Are there differences in volatility and "risk" within the women and minority owned hedge fund universe?**
- **Why is the universe of women and minority owned hedge funds relatively small?**
- **Are there advantages to being a woman or minority owned hedge fund?**
- **What are the particular challenges faced by women and minority owned hedge funds?**
- **Who are the primary investors in women and minority owned hedge funds?**

To answer these questions, we constructed a women and minority owned hedge fund index, as well as surveyed and interviewed more than 25 managers and investors.

Methodology

For this study, we relied on the following information:

- Hedge fund performance indexes we created using the Hedge Fund Research (HFR) database.
  - Four indexes were created: Women and Minority Owned Single-Manager Hedge Funds, Non-Diversity (i.e., non-women and minority owned) Single-Manager Hedge Funds, Women and Minority Owned Funds of Hedge Funds, and Non-Diversity Funds of Hedge Funds

Any data on past performance, modelling or back-testing contained herein is no indication as to future performance.

  - Indexes were run from April 2006 through March 2011
  - Indexes were constructed with simple averages and were not asset-weighted
  - Funds were initially identified based on HFR's "Diversity Firm" designation.
- A survey of women and minority owned hedge funds was conducted by Barclays Capital Strategic Consulting Group
  - Includes 22 responding firms (approximately 13% of the overall women and minority owned hedge fund universe)
- Ongoing dialogue with hedge fund managers and institutional investors
- News articles, research reports / commentaries and analyses, books

Key Findings

- The appetite for women and minority owned hedge funds appears to be growing, and the potential assets at play could be very substantial, eventually topping $378 billion.
- The number of women and minority owned hedge funds remains quite small, representing only 3.3% of hedge funds.
- The number of women and minority owned hedge fund launches increased from 2006 to 2008, but has retrenched in 2009 and 2010, probably due to the economic meltdown.
- Qualifying as a women or minority owned fund is very precise, and can be derailed by initial seeding or funding options if a manager isn't very careful.
- Women and minority owned hedge fund firms tend to be smaller (median $65 million assets under management) and younger than their non-diversity peers.
- Performance, both in terms of absolute returns and risk-adjusted returns, is substantially stronger for women and minority owned hedge funds than for the hedge fund universe at large.
- Risk aversion, while academically noted in women investors, seems to play a role in capital preservation, with women and minority owned funds outperforming their non-diversity peers in market downturns.
- While women and minority owned hedge fund firms are generally optimistic about the opportunities available for such companies, they still see barriers to entry.
- There exists some controversy around "Affirmative Investing" with some amount of public outcry against the policy.

Introduction

As of June 30, 2009, the State of Maryland employed 51 women and minority owned investment managers, who controlled $1.3 billion (bn) of the State's assets. While this may seem like a small sum, and is in fact only 0.43% of the State's total $30.5 bn portfolio, it represents a jump of more than $994 million (mn), or 314%, in only 12 months time.

Indeed, it seems as if an increasing number of institutional investors are making specific efforts to invest in women and minority owned hedge funds (WMOHFs).

Articles about searches and actual RFPs for women and minority owned investment companies are appearing with increasing frequency, and reports of allocations have definitely been on the upswing in the last few years. "There appear to be more mandates to allocate capital to women owned firms than ever before," said one of the respondents to the BarCap Strategic Consulting survey on WMOHFs. "These mandates are coming from public pension funds, large institutions, endowments and some foundations."

These sentiments were echoed by a minority owned firm in the BarCap survey who said, "We see growing demand from Corporate and specifically Public Plans as they look to have their manager base mirror their employee/customer base. The growth in minority industry events has also grown significantly in the last year."

However, the outlook isn't necessarily entirely rosy. Some amount of controversy surrounds the issue of investing in women and minority owned funds. One of our survey respondents echoed a popular contrarian theme, stating that "investors need to look beyond sex/minority status and compare on merit alone." Also at issue are bans on placement agents, which some argue curtail the ability of WMOHFs, which are generally smaller in size, to play on an even field with their larger peers.

This paper attempts to examine the issue of WMOHF investing from all angles, including the players, performance, attitudes and controversies. What do institutions stand to gain from investing based on gender and race? What is the potential opportunity for WMOHFs? If more institutional investors embraced WMOHFs, would there even be a large enough universe for investment? These are some of the crucial questions facing the future of WMOHFs.

What Constitutes a WMOHF?

Before we begin to analyze the issues around WMOHF investing, it is important to establish what being a WMOHF entails. Unlike many classifications in the hedge fund (HF) industry, the designation for being a WMOHF is relatively unambiguous, having been established by the Small Business Administration..

In order to be certified as a minority business (in this case investment fund) the fund must be at least 51% owned by a minority individual(s). Further, the management and daily operations must be controlled by those minority group members. A minority group member is an individual who is a U.S. citizen with at least 1/4 or 25% minimum (documentation to support claim of 25% required from applicant) of the following:

- Asian-Indian - A U.S. citizen whose origins are from India, Pakistan and Bangladesh
- Asian-Pacific - A U.S. citizen whose origins are from Japan, China, Indonesia, Malaysia, Taiwan, Korea, Vietnam, Laos, Cambodia, the Philippines, Thailand, Samoa, Guam, the U.S. Trust Territories of the Pacific or the Northern Marianas.
- Black - A U.S. citizen having origins in any of the Black racial groups of Africa.
- Hispanic - A U.S. citizen of true-born Hispanic heritage, from any of the Spanish-speaking areas of the following regions: Mexico, Central America, South America and

the Caribbean Basin only. Brazilians shall be listed under Hispanic designation for review and certification purposes.

- Native American - A person who is an American Indian, Eskimo, Aleut or Native Hawaiian, and regarded as such by the community of which the person claims to be a part. Native Americans must be documented members of a North American tribe, band or otherwise organized group of native people who are indigenous to the continental United States and proof can be provided through a Native American Blood Degree Certificate (i.e., tribal registry letter, tribal roll register number).

In order to be certified as a women owned business (in this case investment fund) the fund must be at least 51% owned by a woman or women who are U.S. citizens. Further, the contribution of capital and/or expertise by the woman or women must be real and substantial and in proportion to the interest owned; the woman business owner must be in charge of (either directly or indirectly) management, policy, fiscal and operational issues; and the woman business owner must be able to perform in their area of expertise without reliance on either the finances or resources of a firm that is not owned by a woman.

As a result of the above restrictions, it is probably not surprising that relatively few investment firms qualify as women or minority owned at this time, or that the actual determination of WMOHF status can actually become one of splitting hairs.

For example, in an October 18th article by the *New York Times*, the WMOHF status of Pacific Alternative Asset Management Company (PAAMCO), a highly successful, San Francisco-based fund of funds run by Jane Buchan was called into question. At issue was the initial loan to the founders by S. Donald Sussman. His $2 million loan, made in 2000, became eligible for equity conversion in 2002. Such a conversion would have reduced Buchan's majority stake of 51% to a minority stake in the business. Although PAAMCO never sought women or minority owned certification status for their hedge fund, they have been the recipients of capital from Verizon's Diversity Program. Despite a statement from Sussman that stated PAAMCO had "relied on their own counsel and advisors," certainly the issue brings to light how seemingly benign issues like loans and seed capital can adversely impact the status of WMOHFs.

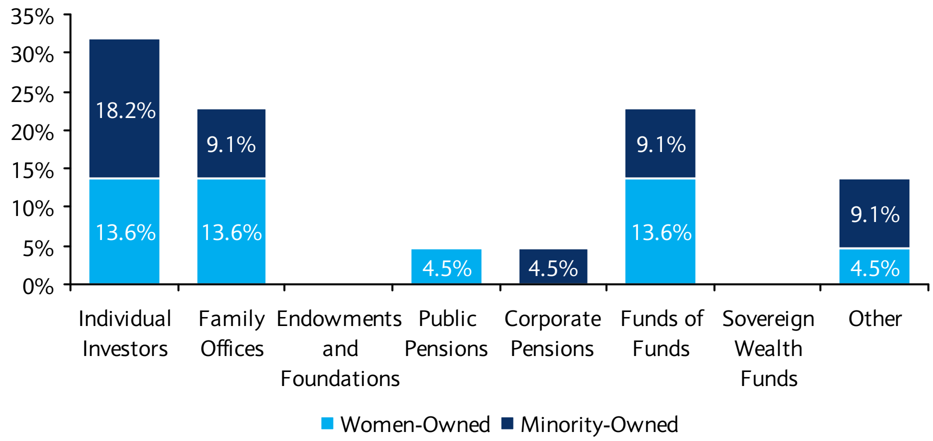
Investors, Managers and Controversy

Like all other segments of the hedge fund investment community, women and minority owned hedge fund investing has three primary players: investors, funds and, a seemingly perpetual addition to the hedge fund landscape, controversy.

Current and Potential Investors

Although we tend to hear more about institutional interest in WMOHFs, likely because the tickets are larger, searches and allocations are often public, and names are well-known, the WMOHFs in our survey report that individual investors still comprise the largest share of their assets under management (AUM), followed by family offices and funds of hedge funds (tie). The sample group indicated that public and corporate pensions currently were among the smallest allocators to WMOHFs.

Figure 1: Largest Investor Group By Assets Invested Among WMOHF Firms

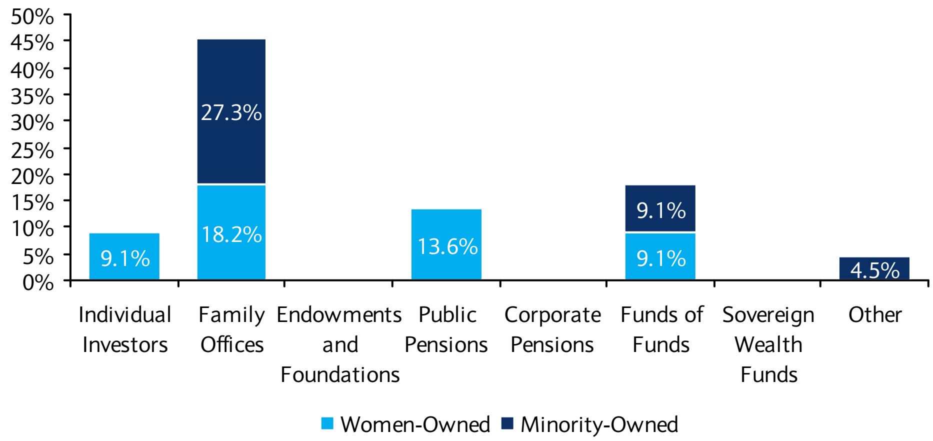


Note: Percentage figures refer to the portion of all responses (women + minority) selecting the respective investor group.

Source: Strategic Consulting Analysis, May 2011

However, in Figure 2, one notes that, looking ahead twelve months, WMOHFs see opportunities less in individual investors and more in family offices and public pensions, and probably with good reason. In 2006, Verizon made the largest corporate pension commitment to women and minority owned investment companies in US history, investing $785 million with 19 fund managers. On March 19, 2010, the Illinois State Board of Investment voted to establish concrete goals for investing in emerging, minority and women owned funds across all asset classes. In May 2010, the California State Assembly voted 41-22 to require public pensions to report the ethnicity and gender of the investment managers they hire. Ohio, New Jersey, New York, and of course, Maryland, as mentioned above, have also made commitments to women and minority owned investment companies.

Figure 2: Investor Group in which WMOHF Firms See the Greatest Marketing Opportunity



Note: Percentage figures refer to the portion of all responses (women + minority) selecting the respective investor group.

Source: Strategic Consulting Analysis, May 2011

Why this move toward women and minorities in public and corporate pension portfolios? Most indicate that putting women and minority investment policies in place is designed to better mirror the constituent base of the pension. In a 2010 case study on Verizon, the company stated "At Verizon, mirroring the markets we are privileged to serve is a key priority." They went on to say "Verizon Investment Management Corp. (VIMCO) is a fiduciary governed by the Employee Retirement Income Security Act (ERISA) and is regulated by the U.S. Department of Labor, which allows for a fiduciary to include social criteria in the selection of investment managers and other service providers to a plan if those factors are used to select from among several investment manager or service provider candidates who are otherwise qualified based upon standard ERISA-compliant criteria for selection. Guided by Verizon's commitment to diversity, VIMCO's policy is to look aggressively for minority- and women-owned investment manager firms that meet VIMCO's investment manager selection criteria: high-performance track record, stable portfolio management teams, understandable investment process, high peer group rankings and an established asset allocation."

Indeed, this policy of inclusion is echoed in much of the legislation and policy mandates in the public pension world. Take U.S. school teachers, for example. Most, if not all, public school teachers participate in some sort of public pension program. Looking at the demographics for teachers in the U.S., one finds that males represent just 27.1% of all teachers, while women account for the other 72.9%. Minorities account for 13.5% of U.S. school teachers. If the studies presented later in this paper are right, and women and minorities tend to be more risk adverse, they could be substantially misrepresented in their investments if only white males are selected as investment advisors or fund managers.

Perhaps this is why in an April 14, 2010 presentation by the National Association of Securities Professionals to the TEXPERS 21st Annual Conference, more than 35 pensions were listed as part of a representative sample of entities investing in women and minority owned investment firms. Among those mentioned were CALPERS, CALSTERS, New York

City Employees Retirement System, Ohio Public Employees, San Antonio Fire and Police Pension Fund, Minnesota State Board of Investment, Pennsylvania Treasury Department and the Oregon Public Employees Retirement Fund. In the world of corporate pensions, articles are early as 2001 seem to indicate that Hilton Hotels Corp., Sempra Energy, and Lucent Technologies had jumped on the women and minority owned fund bandwagon. Further Internet searches point to Shell Oil and Verizon as additional participants in the space..

Indeed, a search of industry database FinSearches.com currently reveals 19 new, ongoing or potential searches for "Emerging Managers," a term that is often encompassing of or euphemistic for women and minority owned funds. Another 123 searches for emerging managers are listed as completed. If more public pensions move towards WMOHFs, the dollar amounts at play could grow very quickly. In Figure 3, we have provided a chart of the twenty largest public pensions, according to the Prequin database. These 20 pensions alone account for more than $1.8 trillion of AUM. If, like Maryland, each were to allocate only 5% to women and minority owned investment companies, more than $94 bn would be up for grabs. Were Illinois to be the model, where there is a 20% to 30% target allocation to women and minority owned investment companies, as much as $378 bn could be at stake, just from these pensions alone.

Figure 3: 20 Largest US Public Pension Funds

Pension Fund	Reported Funds Under Mgmt . (Mn USD)	Target Hedge Fund Investment (Mn USD)
California Public Employees' Retirement System (CalPERS)	236,600	5,360
Federal Retirement Thrift Investment Board	197,300	n/a
California State Teachers' Retirement System (CalSTRS)	152,993	1,464
New York State Common Retirement Fund	140,000	5,600
Florida State Board of Administration	130,000	2,460
Commonwealth of Pennsylvania Treasury Department	120,000	n/a
Teacher Retirement System of Texas	108,000	10,030
New York State Teachers' Retirement System	82,000	n/a
Ohio Public Employees' Retirement System	75,700	1,817
State of Wisconsin Investment Board	73,500	3,800
Oregon State Treasury	73,441	624
New Jersey State Investment Council	72,600	10,200
North Carolina Department of State Treasurer	72,400	724
Regents of the University of California	68,540	4,378
State Teachers' Retirement System of Ohio	66,000	572

Washington State Investment Board	58,800	n/a
Oregon Public Employees' Retirement Fund	57,000	625
Minnesota State Board of Investment	53,000	n/a
Virginia Retirement System	52,700	2,806

Source: Preqin, May 2011

Of course, the math and the reality are seldom an exact match. “The above mandates are gate-kept by consultants, who are risk averse in the extreme, and view an allocation to any fund that isn't already on their recommended list as 'risky',” said one of our survey respondents. “That means that they would rather recommend a Farallon sub-fund with a woman or minority rubber stamp figurehead than an independent, truly woman or minority owned firm.” Another respondent wondered just how much money had actually been allocated to WMOHFs. “My impression is that there is much discussion of this topic but institutions claiming to be seeking to invest in such funds either can't find a sufficient number or the funds don't meet investors' basic requirements.” Still another respondent pointed out that public pensions remain geared towards the long-only world, meaning that WMOHFs may have to make due with a fraction of the ultimate women and minority owned mandate.

Controversy Around “Affirmative Investing”

Of course, like most things in the investment space of late, there is controversy surrounding the issue of women and minority owned investing programs. A May 28, 2010 blog posting by Matt Welch about California’s vote to report the ethnicity and gender on some of the outside managers they hire generated 63 comments, very few of them positive. One poster commented “it’s not too important to have, you know, gains on some of these investments. But diversity is a must when it comes to who handles the funds.” Another posted the following: “What’s interesting about this to me is that it is apparently completely inconceivable to these politicians that a contract would be awarded based solely on performance…”

Even among our survey and interview participants, there were echoes of the same sentiments. “99% of my investors are not minorities,” said one. “Most institutional investors that we have marketed to appear to be holding us to the same standards as other emerging managers: having good performance numbers, an understandable investment and risk management process and having reputable service providers.” Still others wonder if there is a benefit in being a WMOHF, despite all the rhetoric. “We have never gotten an investor meeting or allocation based on being a woman-owned fund despite all the press this topic is receiving. Track record, strategy, team and infrastructure still far outweigh any other consideration. Hence, I don't think there really is, in practice, any unique opportunity or advantage to being a minority-owned fund.”

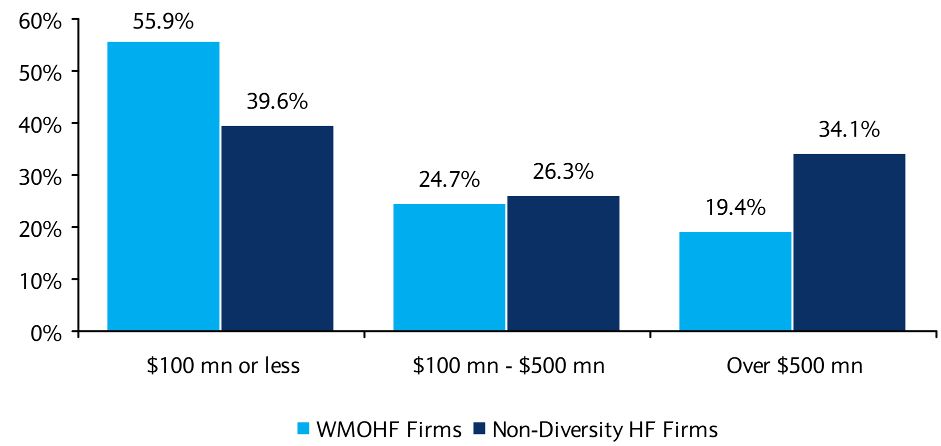
In addition, pensions are required by federal ERISA law to only invest in the best interest of the plan participants. As a result, many pensions are taking a less targeted approach to including women and minority owned investment funds. For example, a $100 billion public pension in the Southwest that was interviewed for this paper indicated that they do not have a WMOHF program *per se*, but instead have created a $1 billion emerging manager platform within their pension. They "don't have a quota, and all mandates are awarded based on merits," according to the plan representative. However, it is interesting to note that 25% of the emerging manager allocation is with women and minority owned investment funds. In comparison, only 2% of the total pension AUM is invested with women and minorities. This emerging manager program was established in 2005 to gain exposure to managers they wouldn't typically see due to the size of the mandates involved, and due to their characteristics, women and minority owned funds most often fall into this category.

Further complicating the issue of women and minority owned funds in public pensions is the temporary ban on placement agents that was enacted after the Alan Hevesi controversy. After the New York Comptroller admitted to pocketing nearly $1 mn in benefits in exchange for approving a $250 mn investment, placement agents became, if not forbidden, certainly more highly suspect. Some industry participants, including large firms like Blackstone, argue that such a ban unduly hurts small funds, including many women and minority owned firms, who often lack robust internal marketing platforms due to their smaller size. A proposal by the SEC in 2008 to ban placement agents was blocked, in part by public pension funds.

The Manager Universe

Without a doubt, WMOHFs tend to be smaller, both in number and in size, than the rest of the hedge fund universe. As of March 2011, based on analysis by the Strategic Consulting Group there are an estimated 170 WMOHF firms in existence, managing roughly 300 funds.. This accounts for 3.3% of the overall hedge fund and funds of funds universe. WMOHFs managed approximately $48 bn as of March 2011, which is roughly 2.4% of global hedge fund assets, and 3.5% of U.S. hedge fund assets. The median size for a WMOHF firm is $65 million, compared with $181 million for a non-diversity hedge fund management firm. As a result, many WMOHFs truly fit into the "emerging manager" category. Looking at the size distribution among WMOHFs in Figure 4, you can see that 55.9% of WMOHF firms manage less than $100 million, compared with 39.6% of the rest of the hedge fund population, while only 19.4% of WMOHFs manage more than $500 million, compared with 34.1% of other hedge fund managers. All of the above data is based on analysis by the Strategic Consulting Group of commercially available data.

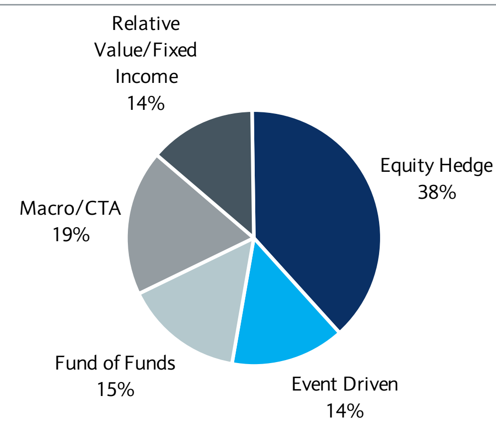
Figure 4: Size Distribution of WMOHF vs. Non-Diversity HF Management Firms



Source: Strategic Consulting Analysis, May 2011

However, the strategy breakdowns of WMOHFs are a better mirror of the total hedge fund universe. Equity hedge is the most popular WMOHF strategy at 38%, whereas that strategy comprises roughly 36% of the total hedge fund universe. Funds of funds are slightly underrepresented in the WMOHF universe, with 15% of the WMOHF universe and 22.6% of the overall universe, while macro/CTAs are slightly overrepresented, with 19% of WMOHFs and 16.9% of the overall population.

Figure 5: Investment Strategies of WMOHFs



Source: Strategic Consulting Analysis, May 2011

Fees for WMOHFs tend to be roughly similar to their non-diversity counterparts, as shown in Figure 6. However, it is interesting to note that, on average, the redemption policies of WMOHFs tend to be more restrictive than their at-large peers. Single manager WMOHFs offer just 26 redemption opportunities per year, compared with 46.8 for non-diversity funds. Likewise, the notice periods and fund lockups are longer, on average, at 47 days and 6.5 months respectively. The same holds true in the WMOHF funds of funds (FOFs) space, where, on average, there are only four redemption opportunities per year compared with 17 for non-diversity FOFs. Lockups for WMOHF FOFs top that of other FOFs by more than four months.

Figure 6: Average Investment Terms, WMOHFs vs. Non-Diversity HFs and FOFs

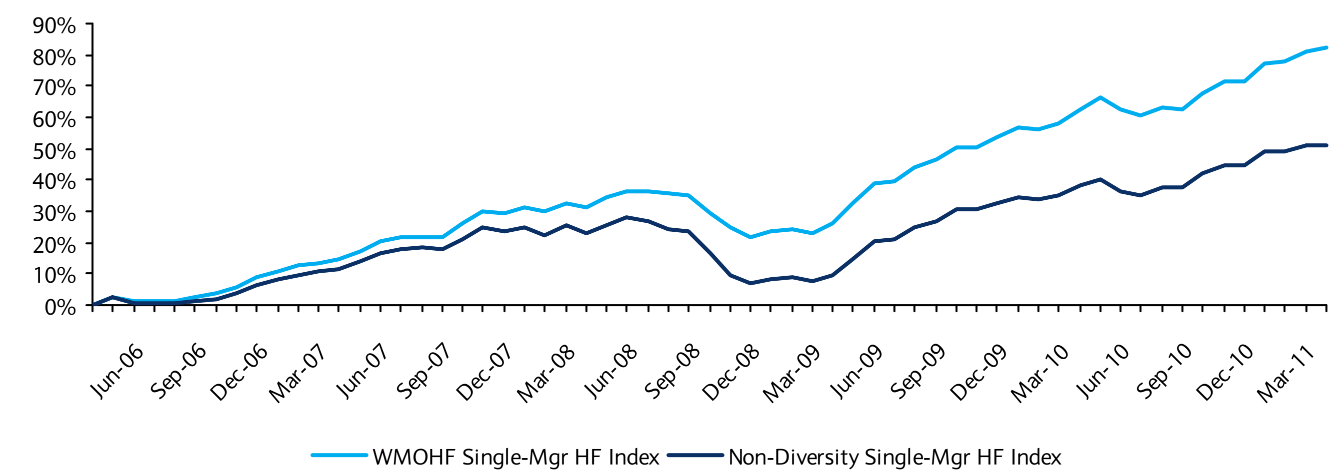
	Mgmt. Fee	Incentive Fee	Min. Investment (USD Mn)	Subscriptions /Yr	Redemptions/ Yr	Redemption Notice (Days)	Lockup (Months)
WMOHF Single-Mgr HFs	1.61%	19.36%	1.32	33.5	26.0	47.0	6.5
Non-Diversity Single-Mgr HFs	1.58%	18.35%	1.20	50.0	46.8	35.1	3.2
WMOHF FOFs	1.25%	7.22%	0.79	11.9	4.0	65.3	6.9
Non-Diversity FOFs	1.32%	7.20%	0.77	22.8	17.0	52.7	2.2

Source: Strategic Consulting Analysis, May 2011

Performance of WMOHFs

Small difference in terms aside, perhaps the largest differentiator for WMOHFs is performance. As you can see in Figures 7 and 8, WMOHFs and FOFs have outperformed the universe at large over the five year period ending March 2011. A fund-weighted index of single manager WMOHFs generated a cumulative return of 82.39% for the five year period ending March 2011, while an index of single manager, non-diversity funds returned only 51.00%.

Figure 7: Cumulative Returns of WMOHFs vs. Non-Diversity HFs, Apr. 2006 – Mar. 2011

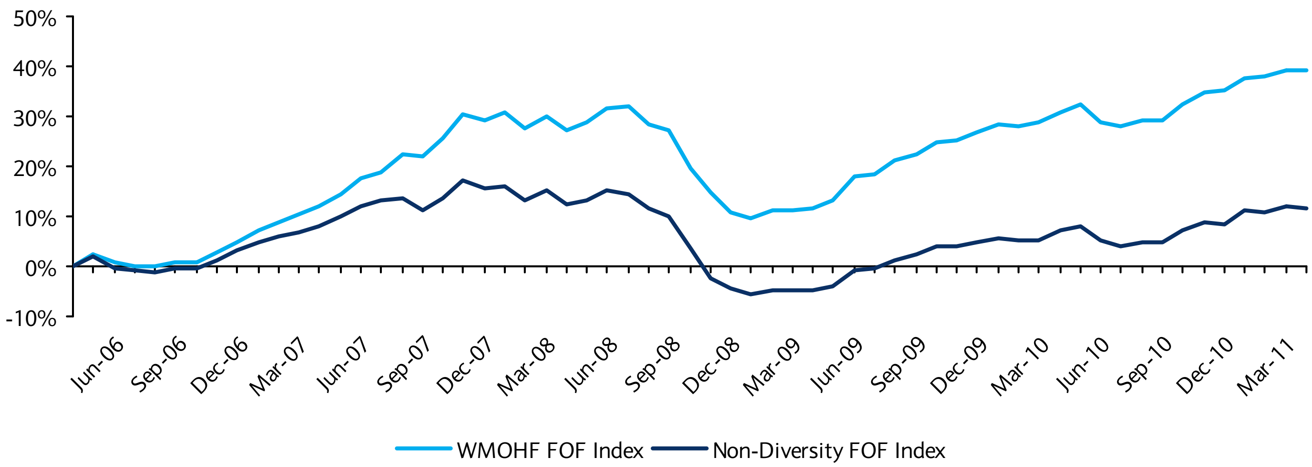


Source: Strategic Consulting Analysis, May 2011

Any data on past performance, modelling or back-testing contained herein is no indication as to future performance.

For the five years ending March 2011, an index of women and minority owned FOFs generated a cumulative return of 39.32%. In comparison, our non-diversity FOF index returned only 11.66% for the same period. Clearly, WMOHFs and FOFs have the competitive edge based solely on performance in recent years.

Figure 8: Cumulative Returns of WMOHF FOFs vs. Non-Diversity FOFs, Apr. 2006 – Mar. 2011



Source: Strategic Consulting Analysis, May 2011

Not only have WMOHFs generated higher cumulative returns during the last five years, they have also done so with essentially the same volatility of their non-diversity peers. In Figure 9, you can see that single-manager WMOHFs edged their non-diversity competitors when it comes to volatility, generating a standard deviation of 6.36% compared with 7.12% for their non-diversity counterparts. As a result, WMOHFs handily outperform their non-diversity peers in terms of risk-adjusted returns, with a Sharpe ratio of 1.46 versus 0.78.

Likewise, women and minority owned FOFs produced substantially similar volatility when compared with non-diversity FOFs, at 6.63% and 6.35%, respectively. However, due to their much higher compound annual return, the risk-adjusted returns for WMOHF FOFs is 0.59, compared with -0.09 for non-diversity funds.

Figure 9: Five-Year Annualized Performance Statistics, WMOHFs vs. Non-Diversity HFs

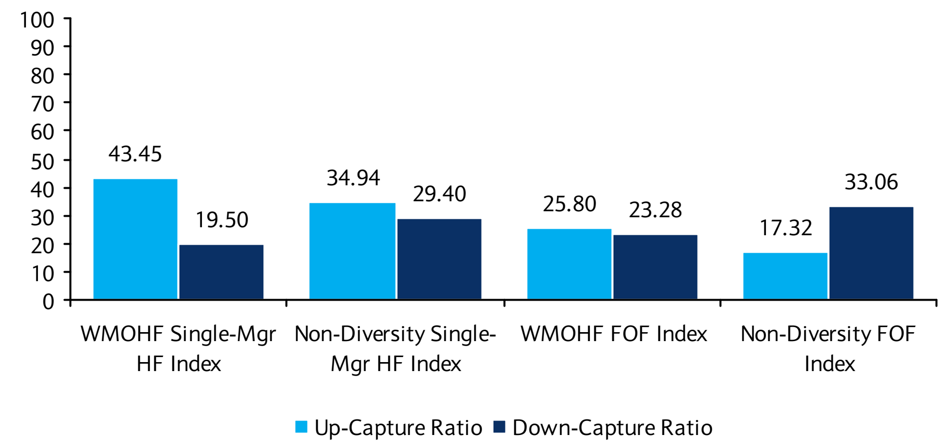
	Compound Return	Standard Dev.	Sharpe Ratio
WMOHF Single-Mgr HF Index	12.77%	6.36%	1.46
Non-Diversity Single-Mgr HF Index	8.59%	7.12%	0.78
WMOHF FOF Index	6.86%	6.63%	0.59
Non-Diversity FOF Index	2.23%	6.35%	-0.09

Source: Strategic Consulting Analysis, May 2011

Any data on past performance, modelling or back-testing contained herein is no indication as to future performance.

Per the analysis, in addition to providing potential upside and better risk adjusted returns, it appears that WMOHFs also offer better downside protection than their non-diversity peers. Figure 10 shows the up and down capture ratios for WMOHFs and FOFs, as well as their non-diversity peers. Note that, as indicated above, the women and minority owned managers tend to outperform non-diversity managers in up markets. However, perhaps more interesting is the fact that WMOHFs tend to significantly outperform in down market environments. The single manager WMOHFs declined only 19.5% as much as the S&P 500 index during that index's down periods, while the non-diversity single manager funds declined 29.4% as much as the S&P 500. The same holds true for diversity and non-diversity FOFs in the sample.

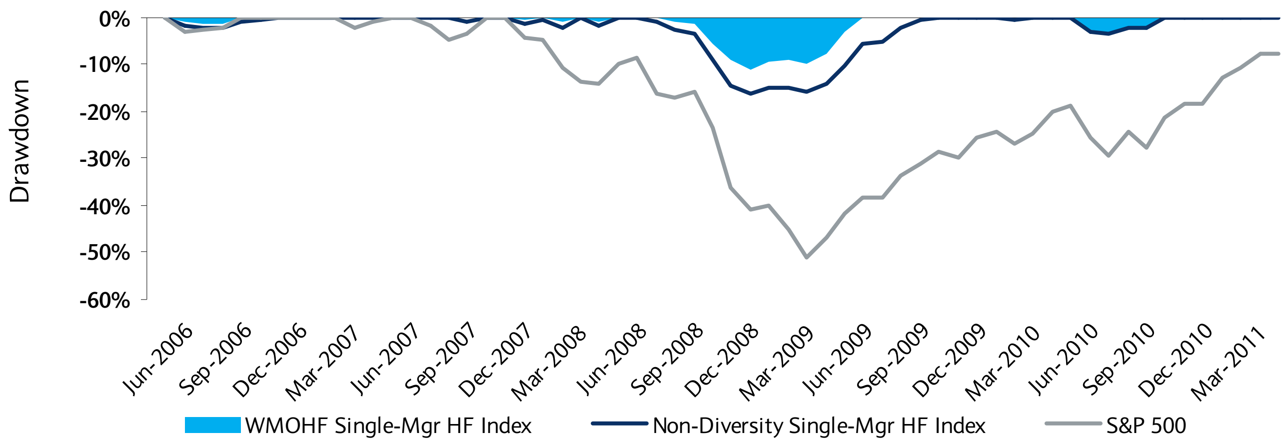
Figure 10: Up-Capture and Down-Capture Ratios Relative to S&P 500, Apr. 2006 – Mar. 2010



Source: Strategic Consulting Analysis, May 2011

The superior capital preservation skills of WMOHFs during periods of market stress is further illustrated by the drawdown chart below. This chart reveals the depth of cumulative losses for each index, WMOHFs, non-diversity HFs, and the S&P 500, over the past five years. While the S&P 500's worst drawdown during the period, which started in 2008 and from which it has yet to fully recover, grew to -50.95%, the WMOFH index sustained a maximum drawdown of only -11.04% versus the non-diversity HF index's -16.03% drawdown.

Figure 11: Drawdown Chart of WMOHFs, Non-Diversity HFs and the S&P 500, Apr. 2006 – Mar. 2010



Source: Strategic Consulting Analysis, May 2011

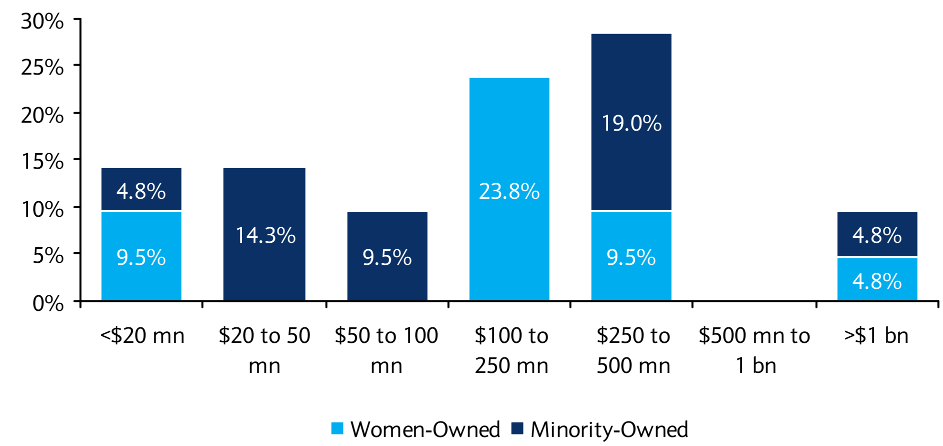
This phenomenon of down market outperformance may be attributable to the fact that women, at least, have a lower risk tolerance than men when it comes to investing. Although there have been few studies of this at the professional investor level, numerous studies have pointed out the gender differences in investment risk taking. A study by Hinz, McCarthy, and Turner (1996)[1] found that men are significantly more likely to hold risky assets than females. Jianakoplos and Bernasek (1996)[2] found single women to be more risk averse than men or married couples, and also found that women perceive themselves to be less inclined towards risk taking. "There are studies that say women look at risk differently as investors," noted one of our study participants." Unfortunately, the respondent goes on to note that this very risk aversion may be one of the reasons there aren't more WMOHFs, that women perceive more risk in opening their own fund, and thus are disinclined to do so.

Attitudes Toward WMOHFs

One of the key components for this study was to determine some of the attitudes around WMOHFs, with the hope of uncovering why, when the hedge fund industry has burgeoned in recent years, the number of WMOHFs remains relatively small. To that end, we conducted a survey of WMOHFs to learn more about challenges and opportunities within the space. Figure 12 shows the demographics and firm size (AUM) of the survey respondents.

[1] "Are Women Conservative Investors: Gender Differences in Participant Directed Pension Plans" Richard P. Hinz, David D. McCarthy, John A. Turner, 1996.
[2] "Are Women More Risk Adverse?" N.A. Jianakolpos and A Bernasek, 2996.

Figure 12: Distribution of Survey Sample by Firm Size and Diversity Status

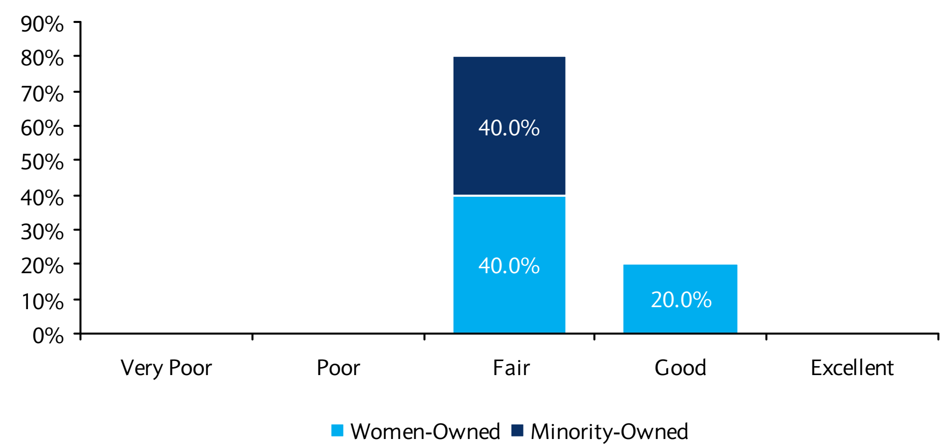


Note: Percentage figures refer to the portion of all responses (women + minority) selecting the respective size category.

Source: Strategic Consulting Analysis, May 2011

We first asked the participating managers to indicate how they perceive current levels of investor interest in WMOHFs. While none of the firms rated interest as "poor" or "very poor," interest was clearly viewed as average, with 80% of survey respondents choosing this response.

Figure 13: How WMOHF Firms Perceive Current Investor Interest

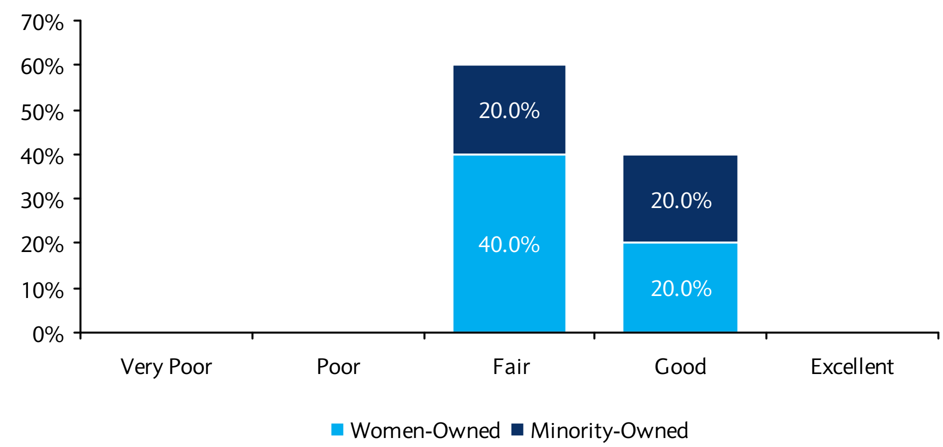


Note: Percentage figures refer to the portion of all responses (women + minority) selecting the respective rating.

Source: Strategic Consulting Analysis, May 2011

However, many of the survey respondents appear to believe the atmosphere for WMOHFs is changing, or will change over the next 12 months, as Figure 14 shows. Compared with the current environment, an additional 20% of respondents expect investor interest to be “good” over the next 12 months. One respondent pointed out that they saw an opportunity in coming months because “[s]everal states have allocations in their pension funds specifically for women and minority owned firms.” Another respondent added “I think that the industry is definitely talking more about woman/minority owned funds and the value that they bring. It is… good [that] women/minority owned funds can stand out over others.”

Figure 14: How WMOHF Firms Expect Investor Interest to be Over the Next 12 Months



Note: Percentage figures refer to the portion of all responses (women + minority) selecting the respective rating.

Source: Strategic Consulting Analysis, May 2011

However, despite the uptick in marketing optimism, WMOHF managers still see barriers to market entry, which may continue to keep the numbers of WMOHFs low, at least for the immediate future. In a 2005 CALSTERS survey on “Attitudes Towards Diversity In the Investment Management Industry,” 66% of the women and minorities surveyed believed that being a woman or minority had hindered their investment management career. While our results don’t seem that dire, both women and minority owned funds in our survey tended to mix optimism with some reservations about the continued Caucasian male-dominated environment on Wall Street.

“I think that there will be increasingly more women and minority run hedge funds. However, as a woman in this business, I can see where many women would be intimidated by the challenges. It is difficult to maintain the balance of femininity and determination. People are often surprised when a woman speaks her mind and stands her ground,” said one respondent. Others went on to say “Wall Street has been a bastion of male dominated business...In the past there have been limited opportunities for women, however, we see that starting to change. There are far more women run firms and women in top-level positions on Wall Street than ever before.” Indeed, that certainly seems to be the case, as Ernst & Young and the Hedge Fund Journal recently released its “50 Leading Women in Hedge Funds” report. That report estimated that women listed in the survey controlled

$200 billion of the industry's $2 trillion in assets, although most were not the owners of the firms in question.

The minority respondents to our survey also echoed some of these sentiments, but were generally more measured and less optimistic in their responses. Said one respondent, "A hedge fund is an entrepreneurial pursuit and one that often requires meaningful wealth and risk tolerance. The accumulation of wealth by these two groups is still a trend in its early days. Additionally, most hedge funds typically spin off from trading desks or family offices, [and]these have not been areas traditionally populated by women or minority groups." In addition, they pointed to a lack of available seed capital, and that it is "difficult to develop institutional infrastructure. In addition, most investors want someone with experience in having worked for a hedge fund or on the trading desk of a major Wall Street firm."

Despite these misgivings, the number of WMOHFs did appear to be growing, at least prior to 2008. According to Strategic Consulting findings based on commercially available data, in 2006, WMOHFs represented just 3.3% of all hedge fund launches. By 2008, that number had grown to 5.7% of total fund launches. In 2009, however, the number fell to 3.5%, which isn't particularly surprising given that the entire hedge fund industry retrenched at that point and launches were down across the board. In 2009, the launches of WMOHFs had inched up to 3.6% of total launches. It remains to be seen whether increased demand or continued chipping away at the glass ceiling boosts numbers in future years.

Conclusions

Given the strong performance and risk-reward characteristics of WMOHFs, it seems reasonable that institutional investors would want to consider making an investment in these funds. However, size and supply can be an obstacle. For institutional investors considering a diversity program, one of the common avenues is to first establish an emerging manager platform. Due to their smaller size, it is unusual, although not unheard of, for a WMOHF to qualify for investment within in the main portfolio of a pension.

For women and minority owned hedge funds, the marketing environment certainly appears to be heating up. Whether a fund chooses to make a play based on its woman or minority owned status is up to the individual fund, but coupled with a strong track record and infrastructure, such a designation could be beneficial in getting a foot in the door with investment decision-makers.

Further Reading and Inquiry

We invite you to review our earlier pieces to get further information on some of the topics addressed in this edition of Hedge Fund Pulse. Please see our April 2011 edition, "Emerging Managers: Good Buy or Good Bye," for more information on new and small managers.

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