News release

Hedge fund managers embrace innovation amid industry challenges and increased competition

- More than half of managers are innovating to improve their operational efficiency
- Thirty percent of investors want to see hedge funds innovate more in front office/investing
- Nearly half of managers are using non-traditional data in their investment process
- Managers are seeking talent with technology and data analytics skills, as this becomes increasingly important to investors

NEW YORK, 14 NOVEMBER 2017. A majority of hedge fund managers (57%) are innovating to improve their operational efficiency in response to market disruptions and to avoid falling behind the industry, according to the EY 2017 Global Hedge Fund and Investor Survey: How will you embrace innovation to illuminate competitive advantages?

The 11th annual survey found that hedge fund managers are actively seeking innovative ways to improve operational efficiency and grow their asset base, as pressure on margins shows no signs of abating. Meanwhile, investors also say they recognize the need for managers to innovate, with 30% noting they want managers to do so in the front office.

Investors are looking for managers who can effectively implement next gen data to gain an advantage, according to the survey. Managers are beginning to notice that effective use of data is a key advantage, and nearly half say they are using non-traditional data to support the investment process. To keep pace with investor appetite for new products and innovative offerings, managers are not only reimagining their investment strategies, but are also focusing on hiring and retaining talent that is experienced in technology and data.
Michael Serota, EY Global Hedge Fund Services Leader, says:

“The pace at which the hedge fund industry is being disrupted continues to accelerate, as advances in technology bring new threats, but also opportunity. The evolving landscape forces managers to not only be reactive but also proactive in identifying novel solutions that allow them to deliver alpha and remain competitive. Managers of all sizes are embracing innovation to stand out in a crowded hedge fund universe and to achieve a common strategic objective: growth.”

Managers continue to grapple with changing investor demands and competition from other alternative asset classes

Consistent with last year’s survey findings, fewer investors plan to increase their allocations to hedge funds. Of those surveyed, 15% of investors note they are more likely to decrease allocations in the next three years versus 11% of investors who indicate they plan to increase allocations. However, the vast majority – 74% of investors – still expect to keep their hedge fund allocations flat.

Alternative investments continue to spur competition, as 40% of investors say they plan to shift certain hedge fund assets to other alternative asset classes and 20% say they will begin using non-traditional hedge fund products for the first time. In particular, private equity is experiencing a dramatic shift in demand, as 76% of investors currently allocate or plan to allocate funds to this alternative asset class in the next two years.

To attract and retain investors, the survey reveals, more than half of managers now offer separately managed accounts (56%) and funds with customized fees and liquidity terms (52%), and two-thirds of managers have adopted or are considering non-traditional fee structures for growth (66%). The largest hedge fund managers have been able to keep momentum, making the largest investments in non-traditional product development.

Natalie Deak Jaros, EY Americas Co-Leader, Hedge Fund Services, says: “Investors are turning to customized products for a number of compelling reasons. Managers of all sizes must engage in dialogue with their investors and align product offerings that are responsive to shifting investor needs.”
Investors look for managers to innovate the front office to generate more alpha

Investor expectations reflect the general excitement around FinTech and the advancements in data set analytics. Thirty percent say they would like to see hedge funds become more innovative within front-office operations. While investors say only 24% of the hedge funds to which they currently allocate use non-traditional or next generational data and tools, they expect that number to rise to 38% in three years. Hedge funds are starting to see the benefits of non-traditional data, with 46% saying they currently use this data. As an example, managers can deploy software to extract data from multiple earnings calls that can help evaluate information more quickly to inform the investment process.

The landscape is quickly changing in response to investors’ demands, as managers are implementing innovative approaches to improve operational efficiency (57%), attract capital (36%), attracting/retaining talent (28%) and the front office (25%). The goal is to invest in cutting-edge technology to improve the speed and quality of data reporting. While, in 2016, only half of managers used or expected to use non-traditional data or tools in their investment processes, this year, more than three-quarters indicate they currently use this technology (46%) or have future plans to do so (32%). Data types of interest include social media data, private company data and credit card data.

Managers are looking to alleviate continued margin pressures by investing in technology to innovate their operating models

Until now, most managers have responded to added complexity, increased product offerings and reporting requirements with increased headcount, which in turn drives margin pressure. Simultaneously, investors continue to place management fees under scrutiny, forcing managers to lower operating expense ratios. The average operating expense ratio is currently 1.75%, down from 1.95% in 2015.

However, hedge funds are realizing the need to break the cycle and invest in operational efficiency. Fifty-seven percent of managers say their organization is investing, or will invest, in initiatives to improve their operating models.

Half of managers surveyed plan to tackle margin pressures by investing in technology. Forty percent say they plan to invest in automating manual processes and more than a quarter of managers (27%) have or will be making investments in artificial intelligence and robotics to strengthen their middle and back office.
Zeynep Meric-Smith, EY EMEIA Leader, Hedge Fund Services, says:

“Managers with growing businesses will often need to add to their headcount to support the business, but modern advances in technology provide helpful solutions in supporting operating models that add to the bottom line, rather than reduce it.”

**The need for tech skills and increased competition for talent are leading to a shift in talent management priorities**

As the industry embraces innovation, the roles and responsibilities of traditional talent are shifting to account for technological and qualitative skills. The survey reveals investor confidence in future talent plans is a critical component in their decision to allocate. For their part, 30% of managers say they have changed the profile of employees they seek to include these new skill sets.

The ability to compete for the right talent is a strategic imperative for hedge fund managers, particularly in the front office, where more than half of those surveyed (54%) say they struggle to attract and retain executive investment professionals and more than a third (37%) express difficulty in attracting non-executive investment professionals.

Managers are also feeling pressure to provide competitive compensation and purpose-driven workplace culture. Nearly half of managers (45%) say they have taken steps such as formally surveying or employing consultants to understand what employees are looking for in the workplace. As a result, they have found that collaboration, compensation and work-life balance are key.

Elliott Shadforth, EY Asia-Pacific Leader, Wealth & Asset Management, says: “Competition for talent is fierce, as hedge funds compete with others in the space as well as Silicon Valley and the FinTech community. Hedge fund managers must be attuned to the wants and needs of newer generations of talent to attract the right people and foster an unmatched work environment.”

The complete survey is available at [ey.com/hedgefundsurvey](http://ey.com/hedgefundsurvey).

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Notes to Editors:

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About the EY Global Hedge Fund and Investor Survey

The purpose of this study is to record the views and opinions of hedge fund managers and institutional investors globally. Managers and investors were asked to comment on innovation and its impact on changing strategic priorities, the use of big data as a differentiator in the front-office, capital raising, expenses and non-traditional fee structures, disruptive technologies, evolving operating models, the changing face of talent management and the future landscape of the hedge fund industry. From July to September 2017, Greenwich Associates conducted 106 telephone interviews with hedge funds representing nearly $1.3 trillion in assets under management. Research also conducted 55 telephone interviews with institutional investors (fund of funds, pension funds, endowments and foundations) representing more than $1.6 trillion in assets under management, with roughly $260 billion allocated to hedge funds.