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RETAIL ALTERNATIVES TO TRIPLE TO NEARLY $1 TRILLION BY 2017 ACCORDING TO CITI PRIME FINANCE SURVEY

‘The Convergence Trend is Complete’

Institutional Investment to Grow as Hedge Funds Now Seen as “Shock Absorbers,” Less as Risk-Adjusted Return Vehicles

NEW YORK – May 15, 2013 – Global demand for retail focused, liquid alternative investment products will reach $939 billion by 2017, more than three times the current level, according to a just-released survey from Citi (NYSE:C) Prime Finance. The growth forecast comes amid new flexibility for mutual fund and exchange-traded fund (ETF) providers, unprecedented levels of transparency among hedge funds, and new demands from wealth managers and broker-dealers who want to add alternatives to more mainstream portfolios.

This market-leading outlook and analysis is contained in the fourth edition of Citi Prime Finance’s annual survey of hedge fund industry trends, this year titled *The Rise of Liquid Alternatives & the Changing Dynamics of Alternative Product Manufacturing & Distribution*. The survey is based on 82 in-depth interviews conducted in the U.S., Europe and Asia with hedge fund managers, asset managers, private equity companies, consultants, funds of hedge funds, pension funds, sovereign wealth funds, endowments & foundations, and intermediaries representing $336 billion in hedge fund assets and $5.6 trillion in overall assets.

According to the survey, in the U.S. alone, where retail participation in alternative investment focused mutual funds and ETFs currently stands at $259 billion, new demand will push assets in these vehicles to $770 billion by 2017. Add to that expected new demand for liquid UCITS-structured products in Europe and elsewhere and the total forecasted growth in retail assets moving into hedge funds and other private funds jumps to $939 billion globally. In addition, demand from smaller institutional investors for lower-fee, publicly offered products will push overall global demand for these so-called liquid alternatives to $1.3 trillion, a level equal to the total assets invested in all hedge funds in 2008.

“The bridge has been crossed,” said Sandy Kaul, U.S. Head of Business Advisory Services at Citi Prime Finance. “The convergence trend that has been blurring the lines between traditional asset managers, hedge funds and private equity firms is complete. Investors can now source an entire range of products from each type of investment firm and for the more liquid of these strategies they can also source the management of the funds in a publicly or privately offered fund structure.”

Survey respondents pointed to three major trends powering the shift to more liquid hedge fund vehicles:

- Regulations enacted under the 1940 Investment Companies Act are making mutual fund and ETF structures more attractive for alternative strategies.
- Dodd-Frank regulations of private funds are forcing unprecedented levels of transparency on hedge funds and requiring participants to create compliance and reporting procedures that more closely mirror the demands placed on publicly offered funds.
- Shifting dynamics in the wealth advisory market are creating a growing need for alternative strategies. First, more wealth advisors in the U.S. are getting paid a combination of fees and commissions, so ensuring the stability of their asset base is critical. Second, more assets are flowing to independent Registered Investment Advisers (RIAs), who often have an “open architecture” approach to investment vehicles and are active in supporting new fund launches. RIAs also have more discretion over client portfolios and can purchase alternative retail products on their behalf.

“Liquid alternatives are reshaping the hedge fund and the overall investment landscapes,” said Alan Pace, Global Head of Sales and Client Experience for Citi Prime Finance. “While the emergence of publicly available liquid alternatives has already had an impact on the hedge fund industry, we are only in the early stages of growth.”

Alternative assets include investments beyond stocks and bonds which tend to be less liquid or tradable. Three of the most recognizable strategies within the publicly offered liquid alternative sector are long/short equity, market neutral and bear market funds. Others are non-traditional bond funds, managed futures and currency funds, according to the survey. The survey found these new products being managed in parallel with privately offered funds, allowing the same manager to isolate a subset of their more liquid trading ideas and package them in a publicly offered fund wrapper.

Other key findings:

- Hedge Fund “Shock Absorbers” - Institutional investor views about hedge funds continue to evolve. In line with the shift from a capital-based to a risk-aligned allocation approach discussed in the Citi Prime Finance 2012 spring survey, more interviewees now describe hedge funds as being “shock absorbers” and as offering “insurance” against losses in their portfolio versus being seen primarily as a diversification and risk-adjusted return vehicle. This bodes well for continued growth in industry assets, given participants’ assessment of increased risks in the current market environment.

- Lower Fee Credit Funds - Concern about a turn in the credit cycle is prompting hedge funds to offer lower-fee, more liquid credit funds that have a long bias, but that can still use shorting to provide insurance in case of a shift in market dynamics. These offerings are competing with publicly traded, diversified growth funds and risk parity funds for flows, shifting over from long-only vanilla bond allocations.

- Search for Yield – Institutions are moving to less liquid investments to find higher yields and into shadow-banking vehicles, while concerns about another liquidity shock are fueling interest in longer duration credit hedge funds.

The full report, along with other industry analysis and reporting can be viewed at: http://icg.citi.com/transactionservices/home/demo/tutorials8/Hedge_Fund_May2013/

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