

APRIL 18, 2011

Hedge Funds Bounce Back At \$2 Trillion, Industry Revives to Near Pre-Crisis Levels Despite Mixed Returns

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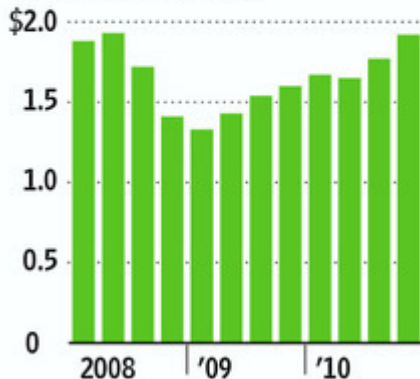
By JENNY STRASBURG and STEVE EDER

Hedge funds are bounding back, with return-hungry investors pumping up the industry to a size not seen since before the financial crisis laid it low.

Rising Tide

Hedge funds, quarterly data

Assets, in trillions



Source: Hedge Fund Research Inc.

Total hedge-fund assets are approaching \$2 trillion and are soon expected to surpass their peak in early 2008, according to industry analysts. Even start-ups and smaller funds, which were shunned by many investors in the wake of the crisis, are benefiting.

The resurrection of hedge funds, which invest money for wealthy individuals, pension funds and other large investors, marks yet another sign that the effects of the financial crisis are receding.

The industry suffered its worst year on record in 2008, with the average fund losing 19%, according to Hedge Fund Research Inc. Those losses, coupled with client withdrawals and the liquidation of some funds, cut the industry's size by roughly one-quarter.

The industry had been clawing its way back since early 2009. Hedge funds pulled in \$55.5 billion in net new money in 2010, the most since 2007, according to Hedge Fund Research. Figures for this year's first quarter also are expected to be robust.

The gains are coming despite performance that has been lackluster of late.

The average fund earned 20% in 2009 and 10.3% in 2010, according to Hedge Fund Research, failing to match the 26.5% and 15.1% gains in the Standard & Poor's 500 stock-index in those two years.

In this year's first quarter, the S&P 500 rose 5.4%, more than three times the 1.6% average hedge-fund gain, according to the research firm.

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Pension funds and other big investors, however, need to diversify beyond the stock market, and the current low-interest-rate environment has made it difficult to find attractive returns elsewhere.

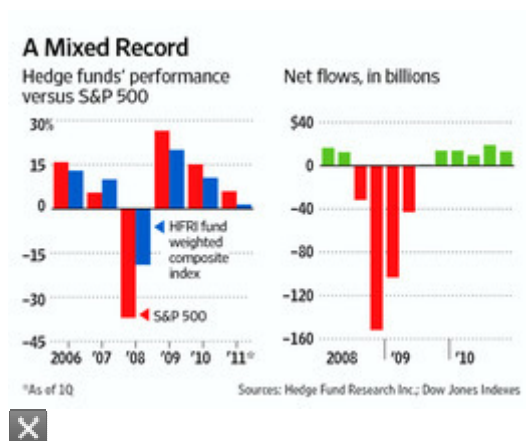
Many pension funds and institutional investors allocate relatively small chunks of their money to hedge funds. Although hedge funds often don't keep up with stock-market rallies, they can minimize losses when stock markets tank.

"Flows into quality funds have resumed," says Lawrence Robbins, the 41-year-old head of Glenview Capital Management, which has \$5.1 billion in assets. The firm suffered significant losses in 2008, but has brought in more than \$1 billion in new money since the bottom, according to a person familiar with the firm.

"Most managers had the best year of their life in 2009, but investors missed out. Now they're coming back," says Robert Discolo of PineBridge Investments, which has invested \$4.3 billion in various hedge funds on behalf of investors.

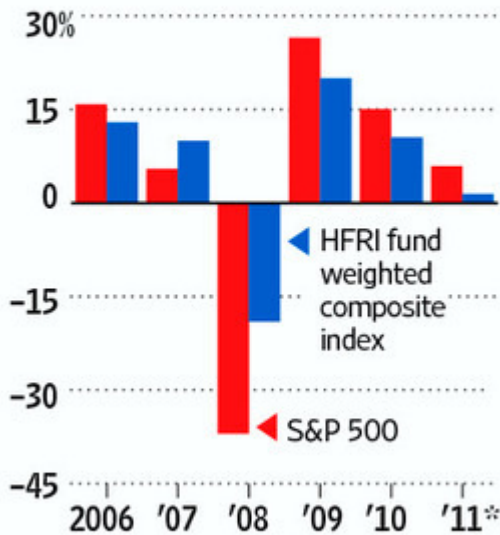
Nevertheless, fund managers say the industry isn't on the kind of roll it was before the financial crisis, when it was growing more rapidly and rookie managers found it easy to raise money.

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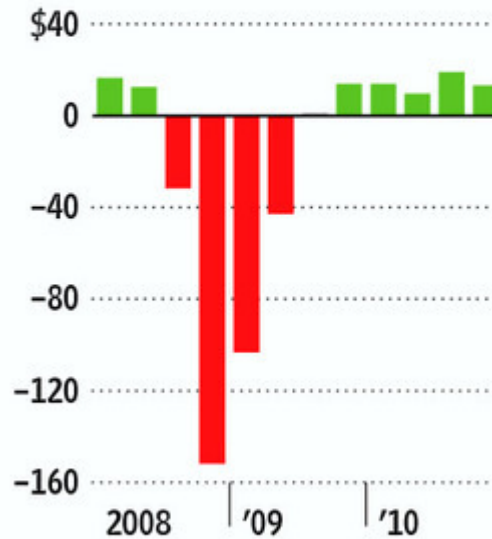
A Mixed Record

Hedge funds' performance versus S&P 500



*As of 1Q

Net flows, in billions



Sources: Hedge Fund Research Inc.; Dow Jones Indexes

The industry is saddled with new regulation that grew out of the crisis. Investors are being more selective about where they invest. Hedge funds remain restrained in their use of leverage—or borrowing to amplify their returns, which increases risk. Managers are wary of scrutiny from insider-trading investigations and calls from Washington for more regulation.

"Investors aren't going to stick around if there isn't performance," says Samuel Hocking, global sales head for French bank BNP Paribas's prime-brokerage unit, which finances hedge-fund trades. Adding to uncertainties were the Japanese earthquake and tsunami in March. Says Mr. Hocking: "It reminds them that all of this is very fragile."

After investors soured on the sector in 2008, the bulk of new investments went to big-name funds with more than \$5 billion under management, such as Paulson & Co. and Bridgewater Associates. But recently, investors are again writing checks to smaller firms.

"Funds have become behemoth. Smaller can mean more nimble," says Alissa Douglas, who oversees hedge-fund investments for C.M. Capital Corp., a Palo Alto, Calif., firm that invests the assets of a Chinese family. Her team examined some 150 hedge-fund managers last year before investing in a \$120 million fund, its first allocation to a start-up.

The fund, San Francisco-based Marcato Capital Management, launched in October, after Richard McGuire, 34 years old, left New York's Pershing Square Capital. Marcato attracted \$100 million in "seed" or starter capital from the buyout firm [Blackstone Group LP](#). In six months, Marcato has grown to more than \$200 million in assets.

Other new funds have also grown quickly. George "Beau" Taylor left Credit Suisse Group AG with his commodities-trading team and launched Greenwich, Conn., hedge fund Taylor Woods Capital

in February with \$200 million, including \$150 million from Blackstone. Money already committed by other investors is expected to push the fund up over \$500 million by summer, says one investor.

Former Wall Street trader Boaz Weinstein launched New York hedge fund Saba Capital Management in 2009 with about \$160 million. Previously, his credit-trading group at Deutsche Bank had made hundreds of millions of dollars in profits before losing \$1.8 billion in 2008. The bank shut down his operation, and Mr. Weinstein left. His hedge fund exceeded \$1 billion in assets last year, and it now oversees \$2.9 billion, according to people familiar with the matter.

Sometimes name recognition alone isn't enough to attract lots of money. [Zoe Cruz](#) was ousted as Morgan Stanley's co-president in 2007 after high-profile mortgage bets soured and she clashed with some peers. Her start-up hedge fund, Voras Capital Management, which bets on broad economic trends, began trading in mid-2010 but has struggled to get much past the \$220 million mark, say people familiar with the firm.

Another challenge for Ms. Cruz, these people say, is that in the wake the financial crisis investors have been favoring funds run by traders with recent track records over those run by executives. Still, Ms. Cruz, who is actively trading in her hedge fund, is being closely followed by investors and could raise more money, these people say.

Ms. Cruz says she sees a big opportunity. "People aren't going to give me \$3 billion just because I'm Zoe Cruz," she says. "That's a positive thing."

Richard Taglianetti of New York-based Corinthian Partners, which links investors with smaller hedge funds looking for money, says that funds will have to start posting better numbers to keep the money flowing.

"I see probably 30 emerging managers every week, from commodities to debt, and most of them are not generating any kind of returns to speak of," he says. "A lot of people say, 'We'd rather stay with the big guys,' but the big guys are having lackluster performance as well."

Write to Jenny Strasburg at jenny.strasburg@wsj.com and Steve Eder at steve.eder@wsj.com