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Absolute Return + Alpha

RESEARCH & RANKINGS /

Hedge Fund Report Card

By Britt Erica Tunick

Investors now prize performance
over *liquidity and transparency*—
and managers who made the big
bucks have
shot up in the rankings

"Show me the money!"

Actor Cuba Gooding Jr. popularized this phrase 15 years ago in the film *Jerry Maguire*, but the sentiment is as popular as ever among hedge fund investors. Hedge fund firms that have consistently generated strong returns are among the top ranked in AR's third annual Hedge Fund Report Card survey.

As investors continue to try to make up for what they lost in 2008 while simultaneously struggling with gyrating markets today, they have put a premium on alpha generation, with those polled this year citing it as the most important factor in their ranking of the top 50 firms in AR's Billion Dollar Club for this year's report card.

Perhaps that's why Bridgewater Associates, the largest hedge fund firm in the Billion Dollar Club ranking, with \$58.9 billion in hedge fund assets, reclaimed the top position in this year's survey, scoring 50.83 out of a possible 60.00 and moving back up from its number two ranking in last year's survey. Bridgewater is coming off a stellar 2010, when its flagship Pure Alpha fund gained 27.39%, and that fund is up another 10.78% so far this year through July.

"When things are falling apart, there

are different types of concerns. But now people are back to focusing on whether firms can actually generate some alpha for us," says Michael Rosen, a principal at Angeles Investment Advisors. "There's been general improvement in transparency and liquidity terms, so as things have gotten better in these areas, they are no longer such critical issues."

Adage Capital Management nabbed the second-place spot with 49.49 points, up from its fourth-place ranking last year, while last year's winner, York Capital Management, fell to third place with 48.10 points. Its York Capital Management

"I think of York as Ivy League—they're solid and everything about them is well-rounded"
York investor

fund is up a modest 0.96% so far this year through July, but its Credit Opportunities Fund gained more than 16% for the year.

Rounding out the top five positions are Graham Capital Management and Pershing Square Capital Management, both of which are new to the report card and both of which received scores of 48.00 points,

landing them in a tie for fourth place. SAC Capital Advisors pole-vaulted into 11th place, a remarkable climb from its 39th-place finish in last year's survey, despite the controversy that has surrounded the firm over the past few months regarding the government's wide-ranging insider trading investigation.

At least six of the roughly three dozen individuals who have been charged with insider trading are former employees of SAC. (The firm has not been charged with any wrongdoing, and founder Steve Cohen has said his firm will cooperate with any and all investigations.)

SAC's returns may have made the firm more palatable to investors: SAC reportedly gained 9.2% in its flagship fund for the first half of the year. The firm scored a combined 46.57 points in this year's survey, up from last year's survey, when it scored only 33.00 points.

But several firms plunged in the rankings, with some experiencing double-digit declines. Angelo, Gordon & Co.—which ranks 31st this year overall in a two-way tie with survey newcomer Lone Pine Capital—fell 23 spots from last year's survey, where it ranked eighth in a two-way tie with Taconic Capital Advisors.

King Street Capital Management's popularity has also declined sharply this year: It came in 29th place, falling 22 positions from its seventh-place showing last year. Other notable declines include 24th-place Baupost Group, down 19 spots from last year; 37th-place Anchorage Advisors,

Key factors when evaluating a hedge fund

Scale: 1 to 10 (10 = "most important")

RANK	2010 RANK		UNWTD. AVERAGE
1	2	ALPHA GENERATION	8.95
2	1	ALIGNMENT OF INTERESTS	8.69
3	5	TRANSPARENCY	7.85
4	4	INFRASTRUCTURE	7.75
5	3	INDEPENDENT OVERSIGHT	7.63
6	6	LIQUIDITY TERMS	7.16

The Hedge Fund Report Card 2011

"The guys who I will be with forever, unless they all leave and just sell the name, are York Capital"

"Headline risk is the one thing we don't like about them"

"They look at the world in a different way and tend to be a lot less correlated than other managers"

"Sometimes their size gets in the way of their investments—it's a double-edged sword"

"Seth Klarman is in a very rarified stratosphere in terms of skilled investors who can see beyond the noise in the markets"

"They charge very high fees in the industry, even for a macro strategy, and we think that will be under scrutiny because their returns have been very muted"

"The main risk takers there are pretty talented investors"

"We want to know why a firm that size is still in asset gathering mode and launching so many different vehicles"

"They reach on their strategies or just tack on one here or there, and if they suddenly don't want to be in one, they just fire the whole team"

"They're really good at not losing money"

"Their transparency has gotten significantly better over time"

"They have the most convoluted and confusing liquidity terms we've ever come across. And it's very much a liquidity mismatch"

2011 RANK	2010 RANK	FIRM	TOTAL UNWTD.
1	2	BRIDGEWATER ASSOCIATES	50.83
2	4	ADAGE CAPITAL MANAGEMENT	49.49
3	1	YORK CAPITAL MANAGEMENT	48.10
*4		PERSHING SQUARE CAPITAL MANAGEMENT	48.00
*4		GRAHAM CAPITAL MANAGEMENT	48.00
6	23	BLACKROCK	47.63
*7	*5	CANYON CAPITAL ADVISORS	47.13
*7		MAGNETAR CAPITAL	47.13
9	11	VIKING GLOBAL INVESTORS	46.74
10	*17	ELLIOTT MANAGEMENT	46.60
11	39	SAC CAPITAL ADVISORS	46.57
12	15	DAVIDSON KEMPNER ADVISERS	46.30
13		HIGHFIELDS CAPITAL MANAGEMENT	45.60
14	*17	PAULSON & CO.	44.90
15	12	CONVEXITY CAPITAL MANAGEMENT	44.71
16	21	OCH-ZIFF CAPITAL MANAGEMENT GROUP	44.57
*17		GREENLIGHT CAPITAL	44.50
*17	*8	TACONIC CAPITAL ADVISORS	44.50
19	16	MAVERICK CAPITAL	44.40
20	*13	WELLINGTON MANAGEMENT	44.38
21		PERRY CAPITAL	44.33
22	26	AVENUE CAPITAL GROUP	44.22
23	10	FORTRESS INVESTMENT GROUP	44.16
24	*5	BAUPOST GROUP	44.13
25	*13	GOLDENTREE ASSET MANAGEMENT	43.91
26	28	AQR CAPITAL MANAGEMENT	43.60
27	33	MILLENNIUM MANAGEMENT	43.33
28	30	D.E. SHAW GROUP	43.21
29	7	KING STREET CAPITAL MANAGEMENT	43.15
30	22	TUDOR INVESTMENT	43.08
*31	*8	ANGELO, GORDON & CO.	43.00
*31		LONE PINE CAPITAL	43.00
33	38	MARATHON ASSET MANAGEMENT	42.71
34	25	GRANTHAM, MAYO, VAN OTTERLOO	42.17
35	*36	RENAISSANCE TECHNOLOGIES	41.63
36	3	BAIN CAPITAL/BROOKSIDE CAPITAL PARTNERS	41.12
37	20	ANCHORAGE ADVISORS	40.77
38	**27	J.P. MORGAN ASSET MANAGEMENT	40.50
*39	31	MOORE CAPITAL MANAGEMENT	40.00
*39		CAXTON ASSOCIATES	40.00
41	35	ETON PARK CAPITAL MANAGEMENT	39.75
42	*36	FARALLON CAPITAL MANAGEMENT	38.69
43	34	GOLDMAN SACHS ASSET MANAGEMENT	38.20
44	42	CITADEL	38.00
45	40	TPG-AXON CAPITAL	36.14
46	29	APPALOOSA MANAGEMENT	33.60
47	43	CERBERUS CAPITAL MANAGEMENT	33.22
48		ESL INVESTMENTS	29.50

*ASTERISK INDICATES A TIE.

** (AS JP MORGAN ASSET MANAGEMENT) 32 AS (JPMORGAN HIGHBRIDGE)

Alpha generation

RANK	FIRM	UNWTD. AVERAGE
▲ TOP 5		
1	BAUPOST GROUP	9.75
2	ADAGE CAPITAL MANAGEMENT	9.22
3	PERSHING SQUARE CAPITAL MANAGEMENT	9.10
4*	ELLIOTT MANAGEMENT	9.00
4*	SAC CAPITAL ADVISORS	9.00
▼ BOTTOM 5		
44	GOLDMAN SACHS ASSET MANAGEMENT	5.60
45	BAIN CAPITAL/BROOKSIDE CAPITAL PARTNERS	5.43
46	GRANTHAM, MAYO, VAN OTTERLOO	5.33
47	AQR CAPITAL MANAGEMENT	5.20
48	TPG-AXON CAPITAL	4.67

*Asterisk indicates a tie.

“It’s an extremely diversified portfolio and they’re looking for value anywhere they can find it”

“Their performance has significantly lagged. They had a really good first half of the decade, but the last few years have been trailing”

“They’re the poster child for mediocrity and arrogance”

down 17 spots; 46th-ranked Appaloosa Management, also down 17 spots; 23rd-place Fortress Investment Group, down 13 spots; and 25th-ranked GoldenTree Asset Management, down 12 spots.

Not all of this year’s declines were as drastic, in some cases because firms didn’t have much further to fall. Farallon Capital Management, which ranked 42nd in this year’s survey, is down only six spots from last year’s ranking. Although the firm’s

portfolio to do well in all markets going forward,” says one investor in the firm. “In markets that are less distressed, the equity group had generated the lion’s share of performance, so people believe the firm may not be able to generate the same returns it has in the past.”

Investors rated firms on alpha generation, alignment of interests, transparency, infrastructure, independent oversight and liquidity terms—factors they ranked in

way that is unique compared with most of its peers.

“Their approach is very different than everyone else out there, in terms of deep research and historical trends going back 100 years. They don’t ride the trends that other funds look to ride—they completely follow their own work and there’s no groupthink at all,” says one longtime Bridgewater investor. Adds another investor in the firm: “No one touches them in terms of the way they think about the world and the breadth of their analysis. They’re unsurpassed not only among hedge funds but among any money management organization I’ve ever seen.” Still, even top-ranking Bridgewater falls short of a perfect score from investors, who also describe the firm as being extremely inflexible when it comes to the high minimum investments it requires for its funds.

As investors revisited their opinions of the industry’s top firms, the order in which they rated them has changed in a major way. Only six firms jumped five or more spots in this year’s rankings, led by SAC.

On the flip side, 17 firms have dropped by five or more positions in this year’s rankings. Bain Capital/Brookside Capital Partners marks this year’s biggest drop, plummeting to 36th place, down 33 positions from its third-place ranking in last year’s survey. Investors in Bain Capital say

“From a liquidity perspective, a lot of managers have made beneficial changes, and managers have been doing a good job of trying to stagger investor anniversary dates”

David Greenberg, California Endowment

performance has remained fairly stable, investors attribute its low ranking to concerns over the loss of its value investment team last year.

“Those guys were very highly regarded by the market, and their departure has created concerns about the ability of the

that order based on the importance each plays in their opinion of individual firms. Each category was scored on a scale from one to 10, for a total possible score of 60.00.

Investors praised Bridgewater for the firm’s consistent ability to generate consistent returns and its ability to do so in a

Alignment of interests

RANK	FIRM	UNWTD. AVERAGE
▲ TOP 5		
1	ADAGE CAPITAL MANAGEMENT	9.22
2	BAUPOST GROUP	9.13
3	APPALOOSA MANAGEMENT	8.80
3	HIGHFIELDS CAPITAL MANAGEMENT	8.78
5*	ELLIOTT MANAGEMENT	8.70
5*	PERSHING SQUARE CAPITAL MANAGEMENT	8.70
▼ BOTTOM 5		
44	GOLDMAN SACHS ASSET MANAGEMENT	6.20
45	CITADEL	6.17
46	CERBERUS CAPITAL MANAGEMENT	5.78
47	J.P. MORGAN ASSET MANAGEMENT	5.67
48	ESL INVESTMENTS	5.50

*Asterisk indicates a tie.

“They really pissed investors off at the end of 2008 when they suspended redemptions with little notice...and I think that continues to linger for them”

“They have a fair amount of their own personal wealth invested and their liquidity terms are fine”

“We have problems with the [Highbridge] fees and don’t think they are justifiable”

the firm’s performance has significantly lagged its peers for the past few years, but they are also irked by what they say is a lack of regard for investors’ interests. “They had a resetting high-water mark, and toward the end of 2009, when they were still below their high-water mark, it was going to reset. They ultimately did the right thing by eliminating that reset, but they didn’t think about it until the last minute . . . they should have gotten rid of it years ago, and it just speaks to overall mindset at the firm,” says one Bain investor.

Scores among the top 10 firms were fairly close, with less than five points separating those firms, and five sets of firms received identical scores, resulting in two-way ties.

Despite many close scores, however, investors say the differences in the overall institutional quality between the firms in the top tier of this year’s survey and those near the bottom can be major.

With the exception of the alignment of interests category, Bridgewater consistently ranked among the top 10 firms in all categories for which investors were asked to critique firms. Respondents praised the firm for the strength of its operations, the institutional approach it takes and the consistency of its performance gains.

Second-place winner Adage scored high among investors because of the firm’s

consistent performance and its ability and willingness to explain any ups or downs to its investors.

“They’re taking a longer-term perspective than other firms, and their interests are closer aligned to ours than most organizations that we deal with,” says one Adage investor. “When there is turnover, the person leaving actually gets part of their profits for the next three years based on the performance of the person that comes in to replace them. So they are motivated to find a strong analyst to come in to help them with their payout.”

Despite York’s fall to third place, investors still praise the firm as one of the industry’s strongest institutions, with consistently good performance. “I think of York as Ivy League—they’re solid and everything about them is well-rounded,” says one investor in the firm.

In particular, investors praise the firm’s efforts to make itself institution friendly by creating an infrastructure with strong risk controls, good transparency and a management team whose strength goes beyond the firm’s founder.

Global hedge fund assets climbed to just over \$2 trillion during the past year, and that asset growth has bumped seven new firms onto the Billion Dollar Club top 50 list, making them eligible for this year’s survey. These include Graham

Capital Management, Pershing Square Capital Management, Highfields Capital Management, Greenlight Capital, Lone Pine Capital, Caxton Associates and ESL Investments. This group achieved mixed success in the report card, with the firms scattered throughout the rankings and five of them landing in two-way ties.

Investors praise Pershing Square for the firm’s overall strength and say that founder Bill Ackman doesn’t get enough credit for the high quality of risk management he has created within the firm.

“There are really no surprises in what they’re doing, and they have a pretty significant tail hedge on at all times,” says one investor in the firm. “Ultimately, you’re buying them for idiosyncratic long positions, where Ackman’s been very successful, even though this year was flat.” Pershing Square International, which gained 21.76% last year, was down by 2.5% through July and down nearly 10.6% through mid-August.

Graham’s investors rank it highly for its ability to generate strong performance in even the worst market conditions. “They are a high-quality manager with a tremendous pedigree, and the performance is there,” says one Graham investor.

ESL, whose 29.50 score landed the firm in last place, fared poorly in all six categories on which investors were asked to grade

Transparency

RANK	FIRM	UNWTD. AVERAGE
▲ TOP 5		
1	GRAHAM CAPITAL MANAGEMENT	9.00
2	BRIDGEWATER ASSOCIATES	8.78
3	AQR CAPITAL MANAGEMENT	8.60
4	PERSHING SQUARE CAPITAL MANAGEMENT	8.30
5	CANYON CAPITAL ADVISORS	8.19
▼ BOTTOM 5		
44	CITADEL	5.17
45	RENAISSANCE TECHNOLOGIES	4.38
46	MOORE CAPITAL MANAGEMENT	4.10
47	APPALOOSA MANAGEMENT	3.60
48	ESL INVESTMENTS	2.50

“They have a very extensive website which provides daily updates on performance of their funds. On the discretionary side there are very few good funds that provide this”

“Everyone has their own definition of transparency, but beyond monthly reports it’s hard to know what’s going on”

firms. ESL had the lowest score in three of six categories and was still among the bottom 10 firms in the others.

Firms that fell out of this year’s rankings because of diminished assets include Harbinger Capital Partners and QVT Financial, as well as Shumway Capital Partners, which announced plans to return investors’ capital at the end of February.

Other firms that made significant gains in this year’s survey include BlackRock, which nabbed sixth place with 47.63 points, up from its 23rd-place finish last year, when it scored 44.42 points; 10th-place Elliott Management, up seven spots from last year; and 27th-ranked Millennium Management, up six positions.

Elliott garnered top marks for the firm’s strong returns and for being well-rounded. The firm ranked in the top five for alpha generation and alignment of interests.

“Paul Singer is a smart man, and they run a really great multistrategy firm. But they do it differently because they focus on very complex distressed situations where they can roll their sleeves up and get into the minutiae of documents. Their edge is their ability to win profitable trades through the legal system,” says one investor in the firm.

Adds another Elliott investor: “While most funds in the past couple of years just started hedging tails, they’ve always had a good hedge book and a good volatility

book. From a risk perspective, it’s either in your DNA that you’re going to look to hedge risk or not, and they’ve been doing this for about 30 years.”

Millennium also received strong marks for the firm’s overall strengths. “We’re very pleased with their performance—it’s been one of the best risk-adjusted performance records in the industry,” says one Millennium investor, adding that the firm is close to its peak assets under management. “They have a pretty sophisticated risk management system that keeps an eye on many different things in their organization.”

But performance was not the only important metric for investors, who dinged some firms for a variety of other factors. King Street was one such firm. “They’re too big for their own good and are getting limited in terms of what they can do investment wise,” says one fund-of-funds investor in the firm.

Adds another King Street investor: “I didn’t like their terms to begin with, and then they changed them—many for the worse. On top of all that, they’re not SEC registered, and I don’t like the large amount of cash that they’re holding.” Yet, while much of the feedback on the firm was critical, at least one King Street investor remains optimistic that the firm’s large cash position—which looked especially prescient during the market tumult at the end of the summer—is setting it up in a

“good position of strength for the next six to 12 months of buying.”

In the case of J.P. Morgan Asset Management, investors say most of their unhappiness with the firm stems from its Highbridge Capital Management subsidiary, while they are primarily satisfied with J.P. Morgan’s own offerings. “We looked at a couple of Highbridge products and didn’t go for them because the documents for their main multistrat fund are just hideous,” says one investor in J.P. Morgan Asset Management. “And for a long time oversight has been a concern because Highbridge was just using Harmonic [Fund Services] as a third party administrator, which was spun out of Highbridge just to be their administrator.”

When asked to rank the importance of each of the factors in our survey on a scale of 1 to 10, investors gave all six categories rankings of higher than 7. Alpha generation was identified as the most important factor with an 8.95 rating, followed by alignment of interests with 8.69, transparency with 7.85, infrastructure with 7.75, independent oversight with 7.63 and liquidity terms, which has been named the least important factor for the third year running, with a score of 7.16. Comparatively, liquidity terms received scores of 7.12 in 2010 and 7.19 in 2009.

Investors say the classification of alpha generation as the most important factor

Infrastructure

RANK	FIRM	UNWTD. AVERAGE
▲ TOP 5		
1	CITADEL	9.50
2	BLACKROCK	9.38
3	BRIDGEWATER ASSOCIATES	9.26
4*	CONVEXITY CAPITAL MANAGEMENT	9.14
4*	RENAISSANCE TECHNOLOGIES	9.13
▼ BOTTOM 5		
44	CERBERUS CAPITAL MANAGEMENT	7.22
45	TPG-AXON CAPITAL	7.11
46	FARALLON CAPITAL MANAGEMENT	6.73
47	ESL INVESTMENTS	6.50
48	APPALOOSA MANAGEMENT	4.60

*Asterisk indicates a tie.

"They took their hits with redemptions, but I like their firm because they are very much unlike most other hedge funds. The way they run their business is very collegiate and flat"

in critiquing hedge funds signals a return to normalcy in the market and that the elevated importance of risk control in recent years was a reflection of market events, from the revelations of various frauds and trading scandals to the widespread illiquidity in the hedge fund industry that resulted from the financial crisis of 2008. Investors ranked alignment of interests as the most important factor in the previous two surveys.

"Right now, hedge fund returns are okay, but the industry as a whole hasn't been that great. So people want the funds that can generate alpha, which should be the number one factor every year," says Jeff Vale, chief investment officer of fund-of-funds firm Infinity Capital Partners. "Alpha is the reason you invest in hedge funds, and the rest of it is just a function of risk."

Another reason for the focus on performance: Investors say they are willing to pay hedge fund fees, but not for returns that don't beat the market.

"People are tired of paying fees for beta. If you're paying hedge fund fees, you want to receive alpha for it," says the chief investment officer for one multibillion-dollar institution.

Scores for alpha generation in this year's Hedge Fund Report Card range from 9.75 to 4.67. Baupost Group topped the category, followed by Adage in second

place and Pershing Square in third. TPG-Axon Capital ranked lowest in the category, with a score of 4.67.

Though alignment of interests is no longer the top criterion in investors' minds, they deemed it only slightly less important in this year's survey, with scores assigned to this factor ranging from 9.22 to 5.50. Adage ranked number one, followed by Bau-

Management weighed in with top marks for transparency with the category's highest score of 9.00; Bridgewater took second place and AQR Capital Management took third.

Citadel earned top marks in the infrastructure category, scoring 9.50, followed by BlackRock in second place with a score of 9.38 and Bridgewater in third with 9.26.

"Hedge fund returns are *okay*, but the industry as a whole *hasn't been that great*. So people want the funds that can *generate alpha*, which should be the *number one factor every year*"

Jeff Vale, Infinity Capital Partners

post Group in second place and Appaloosa Management in third. ESL landed at the bottom of the category.

Although investors say overall transparency within the hedge fund industry has improved since 2008, the scores firms received in the category are among the lowest in this year's survey. ESL earned the worst ranking in the category, with a score of 2.50. Comparatively, Graham Capital

Appaloosa Management finished dead last in the category with a score of 4.60.

BlackRock led its peers in the area of independent oversight, nabbing the category's top score of 8.75. Magnetar Capital followed in second place with 8.00, while Fortress Investment Corp. rounded out the top three with a score of 7.82. Appaloosa again earned the lowest score with 4.60.

Ranked solely on liquidity terms—the

Independent oversight

RANK	FIRM	UNWTD. AVERAGE
▲ TOP 5		
1	BLACKROCK	8.75
2	MAGNETAR CAPITAL	8.00
3	→ FORTRESS INVESTMENT GROUP	7.82
4	PAULSON & CO.	7.81
5	BRIDGEWATER ASSOCIATES	7.68
▼ BOTTOM 5		
44	BAUPOST GROUP	5.63
45	GOLDMAN SACHS ASSET MANAGEMENT ←	5.60
46	CITADEL	5.50
47	CERBERUS CAPITAL MANAGEMENT	5.00
48	APPALOOSA MANAGEMENT	4.60

“Overall we
feel positive
about them”

“There’s been
a lot of head-
line issues with
Goldman”

Liquidity terms

RANK	FIRM	UNWTD. AVERAGE
▲ TOP 5		
1	GRAHAM CAPITAL MANAGEMENT	9.00
2	BRIDGEWATER ASSOCIATES	8.84
3	BLACKROCK	8.50
4	ADAGE CAPITAL MANAGEMENT	8.44
5	RENAISSANCE TECHNOLOGIES	8.38
▼ BOTTOM 5		
44	CITADEL ←	4.33
45	ETON PARK CAPITAL MANAGEMENT	4.19
46	APPALOOSA MANAGEMENT	3.40
47	CERBERUS CAPITAL MANAGEMENT	3.22
48	ESL INVESTMENTS	3.00

“Their liquidity
terms are still not
that good”

To grade the top hedge funds, AR approached a large group of hedge fund investors, including pension funds, foundations and endowments, as well as funds of funds and private equity firms. All told, we solicited the opinions of more than 100 pension and endowment investors who collectively oversee more than \$250 billion in assets. Family offices, funds of funds and private equity firms also participated. Polling was conducted by phone during the month of June and wrapped up in early July.

category investors have deemed least important for the third year running—Graham again leads its peers with a score of 9.00, followed by Bridgewater in second with 8.84 and BlackRock in third with 8.50. ESL’s score of 3.00 made it the category’s indisputable loser.

Among the reasons investors view li-

quidity terms as the least important factor in ranking hedge funds is that following the events of 2008, investors are no longer willing to put money with fund managers who don’t provide liquidity.

“It’s a given that funds will have that,” says one investor.

Adds David Greenberg, director of ab-

solute return strategies for the California Endowment: “From a liquidity perspective, a lot of managers have made beneficial changes, and managers have been doing a good job of trying to stagger investor anniversary dates. The biggest change most funds have made is to implement investor-level gates.” **AR**