

Mark Vink of Fidessa LatentZero explores how the hedge fund industry in Hong Kong is withstanding the credit crunch and adapting to ever-changing technology

The changing face of hedge fund technology

Among the seemingly endless supply of depressing results, and the atmosphere of general gloom, a few glimmers of light still shine. Where the global banking system has managed so far to wipe at least US\$100bn from shareholder value, the global hedge fund industry has emerged from the rubble in robust shape. According to reliable estimates, the hedge funds have bucked the trend to the extent that they have actually upped shareholder value by US\$200bn.

This trend is reflected in the Asian market. Total assets under management in hedge funds across the region rose by 20%. Fifty new funds were launched and raised US\$5bn in assets. Were it not for substantial capital flows out of Japan, the numbers would have been even more impressive.

The Asian hedge funds' share of capital markets activity has probably doubled, according to best estimates, matched by the growth in the number of international funds that focus on investment in Asia and in the flow of assets to them.

The last frontier

But the successes in Asia over the last 12 months are merely the icing on a cake that has been baking for the last ten years. Even the drop of 5% in January this year – experienced by the sector on a global scale – is seen as more of a hiccup in an irresistible rise of hedge funds across Asia. Double digit annual performance has become the norm – the indices for Asia and Asia (ex-Japan) were up approximately 20% and 25% respectively in 2007.

As a result, it appears that the Asian hedge fund market is in rude health. But growth is inevitably accompanied by change.

In common with the US and Europe, the industry is institutionalising. Both the hedge funds themselves and the environment in which they operate are under similar levels of scrutiny from both investors and regulators.

Publicity-shy hedge funds are increasingly facing the spotlight of the regulators' scrutiny, a trend that started in the US, but rapidly moved to both European and Asian markets. Regulation inevitably leads to greater transparency and control – which in turn means that attitudes to technology may require a substantial shift.

What's more, as the biggest global allocators routinely allocate to Asia, the large volumes will go to big managers with the organisation, operational infrastructure and technology to keep the big investors happy. Specialist vendors have started to adapt their order and execution management capabilities specifically for the requirements of hedge funds.

Changing attitudes to technology

Of course, hedge funds have always had an interesting and diverse relationship with technology. For example, in its earliest incarnations, DMA was particularly associated with a group of funds conducting statistical arbitrage before wide adoption by more institutional funds.

Stat arb is a method of trading that is highly dependent on technology. And rather than relying on comprehensive and sophisticated trading platforms with broad appeal seen in asset management firms from New York to Tokyo, they use precise, specialised, proprietary systems.

At the other end of the scale there are plenty of hedge funds that have almost no IT infrastructure at all. On occasion, it can be hard to spot the traders in the mountain of paperwork that surrounds them. Then there are the funds that with no appetite to implement or maintain systems, simply outsource the whole lot to a third party.

But there is a growing trend between these two extremes to look at vendor-supplied solutions. Certainly this is the case in Asia, where funds are rapidly diversifying strategies away from the traditional



As head of business development in Asia, Mark Vink is responsible for expanding on Fidessa LatentZero's considerable success on the buy-side in Europe and North America by developing new markets in the Asia-Pacific region. Mark has worked at Fidessa LatentZero for more than five years and holds a degree in economics from London University.

use of equity long/ short variants – even from those funds that were not previously enthusiastic technology users.

The compliance driver

Discussions about how, and to what extent, hedge funds are to be regulated are already taking place in New York, London and Frankfurt, and it seems extremely unlikely that hedge funds trading in Hong Kong, Singapore or Tokyo will escape similar attention.

The hedge funds' argument was that they were originally set up to keep costs down, making them attractive to wealthy and sophisticated investors. Regulatory compliance inevitably adds costs while any moves to 'protect the investor' are simply unnecessary in the case of the average hedge fund client.

Furthermore, hedge funds operate in a secretive world. The returns delivered by a successful strategy are much higher if no one else is doing it. Once a successful strategy is out in the open, it will be copied and rewards will diminish. Should the reverse be the case, and a strategy bombs spectacularly, the last thing the hedge fund wants is for its failings to be available to public scrutiny – the result is often a stampede of investors heading for the exit.

However, these initial objections have now dissipated. The market has moved on very rapidly in the last two years or so, and, if nothing else, the fallout of the global liquidity crisis has shown that hedge funds had, on the whole, better risk exposure management techniques. That's a reputation worth holding on to. Compliance technology, particularly when it offers workflow controls with integrated compliance and pre-and post-trade allocation by fund and strategy, has a lustre that outshines previous objections. Automation, true STP and auditability are attractive to both investors and regulators.

A strategic approach

If the differences between hedge and mutual funds in regulatory terms is narrowing fast, then so too is the gap between them in terms of strategy and investors. Even the most traditional of funds are investigating more diverse



asset classes such as OTC derivatives that were previously the preserve of the high-risk/high-return investors.

Asian markets are no exception, with superannuation funds increasingly looking to hedge funds to provide the necessary returns, and taking the previously inconceivable step of investing in hedge funds, or funds of hedge funds (FoHFs) themselves.

As institutional investors look to more sophisticated strategies and instruments borrowed from hedge funds to deliver returns, then the software that has supported them has become more sophisticated, flexible, scalable and interesting to hedge funds in return. Derivatives have gone mainstream, and the technology is now available to trade OTC instruments effectively, as is the ability to measure underlying and primary exposure.

The latest technology also offers the ability to conduct real-time P&L analysis and manage portfolios according to fund, strategy and sub-strategy. As Asian funds move towards more diverse portfolios, full-asset class, multi-strategy capabilities are increasingly important.

A neutral solution

The real key for hedge funds is that the capability they need is no longer the sole preserve of sell-side suppliers. For an industry sector for whom secrecy is essential and a fundamental operating principle, the idea of exposing trading

activities through a tied execution system from one broker has been an anathema. No wonder that, where broker solutions have been used, there are usually up to four or five in place. This has been a barrier to the STP and full automation that many hedge funds are now seeking. But buy-side sourced systems that offer broker neutrality combined with sell-side levels of sophistication have started to overcome this particular hurdle.

The other issues that vendors have overcome are those associated with cost and implementation. Robust 'out-of-the-box' solutions that require little, if any, customisation and have a standardised set-up have reduced the time and costs involved in deployment, keeping overheads low and time-to-use short.

There is every reason to be optimistic about the future. Hedge funds will ride out the current volatility in the markets – certainly those that have developed the technological infrastructure to support their operations. There is little question that hedge funds will benefit from compliance technology as well as the execution and order management capabilities initially developed for institutional asset managers. Since buy-side systems now match those on the sell-side in terms of quality, speed and functionality, they provide a very real and attractive alternative. The trend for more vendor supplied solutions is set to continue for some time yet.