

Box 4.2**Hedge fund industry**

The hedge fund industry has been increasingly drawing attention from investors over the globe since the late 1990s, with assets under management almost doubling from US\$480 billion in 1999 to US\$950 billion in 2004. Although the aggregate size of hedge fund assets is still relatively smaller than that of assets managed under traditional funds, the increasing interest in hedge funds will likely continue to buoy the distinct growth in the foreseeable future. This is particularly true for the industry in the Asia Pacific region in light of the tremendous potential promised by the Asian emerging markets.

Number of hedge funds and assets under management¹

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
United States						
Number of funds	4 150	4 250	4 400	4 600	4 875	5 000
Assets under management	255	280	315	340	420	480
Europe and Japan/Asia						
Number of funds	2 050	2 250	2 600	2 900	3 225	3 700
Assets under management	225	240	285	310	400	470
Global						
Number of funds	6 200	6 500	7 000	7 500	8 100	8 700
Assets under management	480	520	600	650	820	950

¹In billions of US dollars.

Source: Van Hedge Fund Advisors International.

A hedge fund is generally an unregulated pooling of capital contributed by a variety of sophisticated investors. Rather than benchmark performance against securities indices, hedge funds seek to achieve an absolute return by utilizing a number of different investment strategies and investing in a wide variety of financial instruments. It is usual for hedge funds to take on leverage, sell short securities, and adopt hedging and arbitrage strategies. From investors' perspective, investing in hedge funds could potentially generate higher returns on the one hand, and reduce the volatility associated with general market risks on the other. In terms of benefits to the overall markets, hedge fund positions could in theory enhance liquidity and contribute to market efficiency. Moreover, hedge funds generally have great demand for a variety of services, including trade clearance and settlement, stock lending, financing and custody services. These contribute to the on-going development of the asset management industry of a financial centre.

The growth in the Asian hedge fund industry, i.e. that of hedge funds with exposures to the Asian markets, has been phenomenal over the past few years. According to Eurekahedge, the industry expanded from 162 funds managing US\$14 billion in 2001 to over 500 funds managing around US\$67 billion in 2004. Despite such fast growth, the scope for further expansion in the Asian hedge fund industry is still believed to be large. In fact, Asia Pacific markets only represent around 15% of the world's market capitalisation.

In Hong Kong, Securities and Futures Commission (SFC) now have rules in place for the authorisation of hedge funds for sale to the public, in recognition of the growing retail demand for these products. As at end-March 2005, there were 13 authorised hedge funds in Hong Kong.