AsiaHedge

Editor’s Letter *Paul Storey*

India shows how cycles are still a constant in Asia

AsiaHedge is starting its seventh year — and a lot has happened and a lot has changed (for the better) in the Asia-Pacific hedge fund industry since we began in the second half of 2000. However, there have also been some constants that have never changed over the past seven years, and one of them is the strong cyclicality of the markets in this region.

Indeed, there is usually a time — typically at the same point in every cycle — when you hear the refrain: “This time, Asia really has decoupled from the West.” And that’s usually when you know that the wheel will have inevitably come full circle for those who have been working in Asia-Pacific long enough, with most of the newcomers getting to share the same experiences as their forerunners.

This time, many of those newcomers have been active in India. They were undoubtedly the ‘flavour of the month’ for pretty much the whole of last year. But so far in 2006, their experiences will have been somewhat more sobering.

After a massive charge, India is now experiencing the other end of the spectrum. Change can happen very quickly in the Asia-Pacific, and India managers — and their investors — will have felt this very keenly in 2006 since the Indian financial markets first cratered out.

Many managers that launched in 2000 to 2002 are now industry stalwarts and have already successfully navigated difficult times. Most India hedge funds rebounded well in August — led by funds such as Jon Thorn’s India Capital (AsiaHedge Award winner in 2005), which is now up again by some 21% for the year to date, and Marshal, another which has had a solid year-to-date number of about 17%. But there is no doubt that most of the India managers will be feeling battered and bruised right now, and have plenty of work to do from here - whether to match that volatile Sensex index or the expectations of their investors.

A key factor to bear in mind, however, is that very few of these managers have been around for any extended period. For most of them, this is the first time they have been tested in such a market rout — or, at least, since they were running a hedge fund. Investors who decide to stay with them — and the signs are encouraging that there has not yet been any mass outflow of assets — will be hoping they have learned from the experience. They will be hoping the India managers take lessons on board, and come through stronger.

It is hard to say what the most important lessons will be. How a young operation and the manager reacts in these circumstances depends partly on how much capital the operation has. And this will depend to some extent on where one started in the cycle. At the height of the assets charge in 2005, the level of capital finding its way into start-ups and new fund launches was comparatively high, and $50 million or more was not uncommon for a start-up. By historic measures, this was a lot. Seven years ago, a launch of $5-$10 million was more the norm.

Now the cycle has turned again — and most new managers and their funds, unless you have a name like Zaheer Sitabkhan with a proven track record, are coming to market with less capital than new funds a year ago. A bigger asset base, and more management fees, can obviously help through the difficult times - though not for long if the money flies out of the door.

Either way, edge — and a manager’s ability to demonstrate it — matters more again than it has done for several years. Really, it is not so different to the period between 2000 and 2002, which was especially tough for start-ups. Yet many that launched back then are now the stalwarts of the industry, having hard-closed their books - and are reaping the rewards of having navigated successfully through those difficult times.

The newer India managers will get their opportunity too — maybe in the next major up-cycle - to cement their place in the industry. In the meantime, they must use whatever ways they have to control the risks and try to tame the volatility. After all, it is how one deals with markets like the present that dictates how big one’s performance fees are going to be further down the road.

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