

Fund of Funds 2010	Quarter 1
Structure, Trends, and Outlook.	

In the first quarter of the same year, Rothstein Kass commissioned a 2010 fund-of-funds survey. The purpose of this survey was to collect information about the structure, trends, and outlook of the fund-of-funds industry for Rothstein Kass clients and the financial services market as a whole. The specific objectives of this survey were to:

- Develop an understanding of the characteristics of fund-of-funds complexes offered, and the resources used to manage these funds.
- Understand industry trends and best practices in areas such as investment strategy, operations, service providers, marketing, and the industry outlook.
- Examine differences in responses based on the characteristics of funds offered.

Fund Details

Quarter 1	How many fund-of-funds complexes do you currently manage?											
	# of Funds	None	01	02	03	04	05	06	07	08	09	10+
	Number of responses	03	30	19	17	13	07	04	02	02	01	05
	Percent of responses	03%	29%	18%	16%	13%	07%	04%	02%	02%	01%	05%

STRATEGY

Which best describes the strategy of this fund?		
Strategy	# of Responses	% of Responses
Multi-strategy	94	32%
Long/Short equity	65	22%
Absolute return	37	13%
Distressed debt	13	04%
Credit driven	09	03%
Emerging markets	08	03%
Global macro	07	02%
Buyout	06	02%
Event-driven	05	02%
International	02	01%
Venture	01	<1%
Other	46	16%

Most respondents manage only a narrow range of fund-of-funds complexes

- The greatest percentage of respondents (**29%**) manage only one fund-of-funds complex.
- **About 80%** of respondents indicate their company manages four or fewer funds.

Based on these responses, a total of **319** fund-of-funds complexes are managed by a total of **103** respondents to this survey.

A series of follow-up questions were asked to provide more information about these funds; in all, additional information was provided about **293** of these **319** funds.

About two-thirds of funds have one of three strategic focuses:

- Multi-strategy (**32%**)
- Long/Short equity (**22%**)
- Absolute return (**13%**)

Additionally, **16%** of respondents indicate that their strategic focus is something other than one of 11 strategies listed on the survey.

TYPE OF FUND

What type of fund is this?

Type of Fund	# of Responses	% of Responses
Fund of hedge funds	261	93%
Fund of private equity funds	19	07%

ASSETS UNDER MANAGEMENT (AUM)

Which of the following ranges contains the total equity value of the fund's portfolio (Assets Under Management)?

AUM	# of Responses	% of Responses
Less than \$50mm	97	35%
\$50mm - \$150mm	101	36%
\$150mm - \$300mm	27	10%
\$300mm - \$500mm	24	08%
\$500mm - \$1bn	19	07%
\$1bn - \$2bn	08	03%
\$2bn - \$5bn	03	01%
More than \$5bn	01	<1%

NUMBER OF LPs/ SHAREHOLDERS

What is the number of LPs or shareholders for this fund?

# of LPs/Shareholders	# of Responses	% of Responses
Less than 5	33	13%
6-20	71	27%
21-50	64	24%
51-100	43	16%
101-500	46	17%
501-1000	04	02%
1001-5000	00	00%
More than 5000	03	01%

Regardless of the strategy of the fund, most accounts and funds are of the same type:

- **93%** are funds of hedge funds, while only
- **7%** are funds of private equity funds.

For the majority of funds, the total equity value of the fund's portfolio (Assets Under Management, or AUM) falls below \$150mm:

- Less than \$50 million (35%)
- \$50 million - \$150 million (36%)

The remaining funds are also more likely to fall into the lower AUM categories. Less than 5% of all funds have a total AUM of greater than \$1 billion.

Nearly two-thirds of funds (64%) have 50 or fewer LPs or shareholders and only 3% of funds have more than 500 LPs or shareholders.

INVESTOR/ SHAREHOLDER CLASSES

How many investor/shareholder classes are there for this fund?

# of Classs	# of Responses	% of Responses
1 class	130	45%
2-5 classes	136	48%
6 - 10 classes	19	07%
11 - 20 classes	01	<1%
21 - 50 classes	00	00%
More than 50 classes	00	00%

ADMINISTRATION

What type of administration does this fund have?

Type	# of Responses	% of Responses
In-house administration	32	11%
Third-party administrator	222	78%
In-house and third-party	31	11%
Not performed	01	<1%

QUALIFIED CUSTODIANS & SIDE POCKETS

Does this fund use...

	# of Responses	% of Responses
...a qualified custodian?	219	79%
...side pockets?	58	21%

The number of investor/shareholder classes does not vary greatly from fund to fund:

- 45% of funds have just 1 class
- 48% of funds have 2 – 5 classes

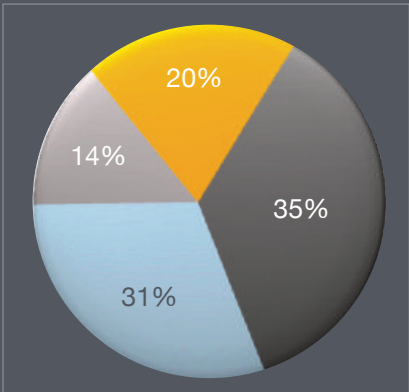
Only one of the funds had more than 10 classes.

The vast majority of funds (89%) use a third-party administrator, with 78% of funds using a third party exclusively. Only a total of 22% of funds perform any form of in-house administration.

Most funds (79%) use a qualified custodian. However, funds are almost equally unlikely to use side pockets, as respondents indicate these are used by only 21% of funds.

Staffing

STAFFING

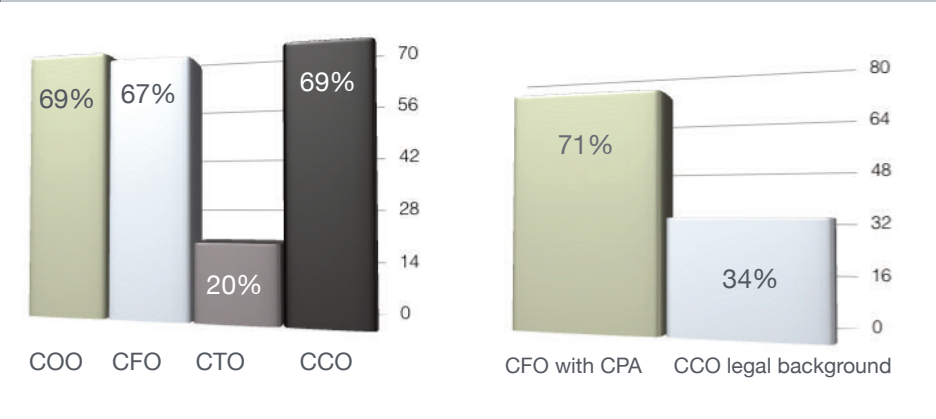


What is the total number of full-time staff at your company?

- 5 or Less
- 6 - 15
- 16 - 25
- 26 or More

EXECUTIVE LEADERSHIP

Do you have a . . .



Most respondents had small firms as evidenced by:

- About 35% of companies have five or fewer full-time staff members.
- About two-thirds have 15 or fewer employees.

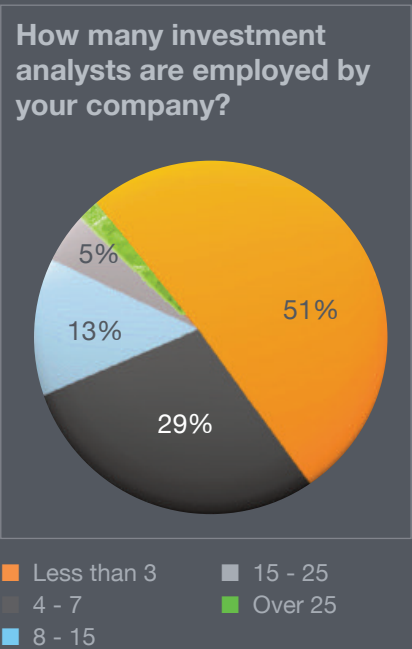
Only about **20%** of companies fall into the largest category with more than 25 employees.

Within the industry, COOs, CFOs, and CCOs are common leadership titles. About 69% of companies surveyed have a COO and CCO, while about two-thirds have a CFO. However, only about one in five respondents has a CTO within his or her organization as most firms tend to outsource this functionality.

Of the companies that have a CFO, most (71%) have a CFO who has a CPA background. However, only about one-third of CCOs have a legal background.

INVESTMENT
ANALYSTS

How many investment analysts are employed by your company?

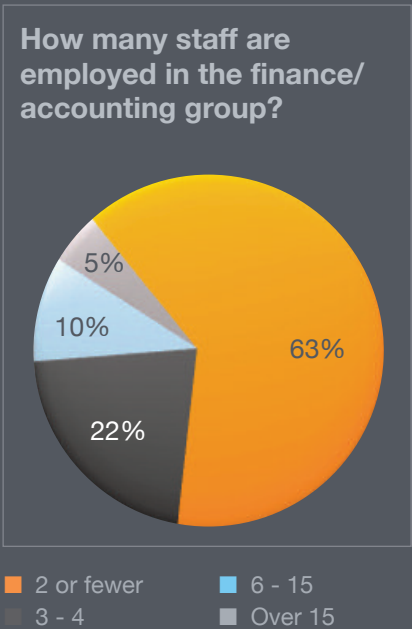


How many funds is each analyst responsible for covering?

# of Funds	# of Responses	% of Responses
1 - 3	15	15%
4 - 6	12	12%
7 - 9	16	16%
10 - 15	21	22%
Over 15	34	35%

FINANCE/
ACCOUNTING
GROUP

How many staff are employed in the finance/accounting group?



How many in the finance/accounting group focus on...

...the management of the company			...the funds	
# of Funds	#	%	#	%
2 or fewer	85	84%	68	67%
3 - 4	11	11%	24	23%
5 - 6	02	02%	06	06%
6 - 15	03	03%	03	03%
Over 15	00	00%	01	01%

**Generally, companies have a small number of investment analysts.
Each analyst also typically covers a fairly large number of funds:**

- 80% of companies employ 7 or fewer investment analysts. Most (**51%**) employ fewer than 3 investment analysts.
- Over half of respondents indicate each analyst is responsible for covering 10 or more funds, and a third are responsible for over 15.

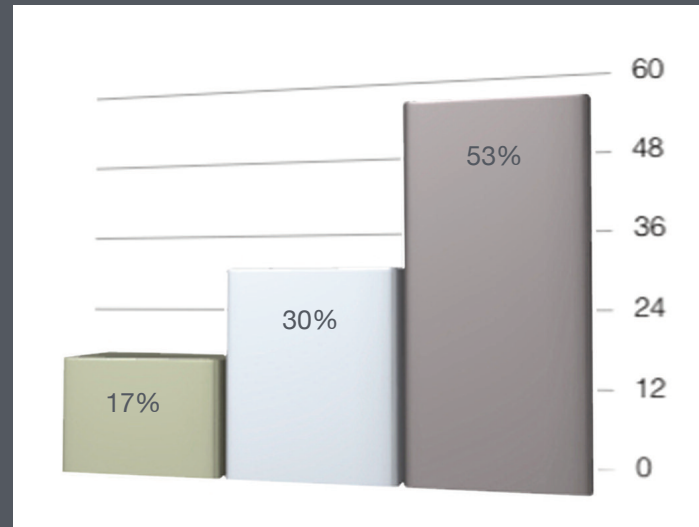
The vast majority of respondents have small finance/accounting groups:

- Almost two-thirds (63%) indicate there are 2 or fewer staff members in the finance/accounting group at their company.
- Only about 15% of respondents indicate they have more than 4 employees in their finance/accounting group.

Since the finance/accounting group is relatively small, there are also a relatively small number of employees who focus on the management of the company and/or the funds themselves:

- Only about 33% of respondents indicate that at least 3 finance/accounting employees focus on the funds.
- Only 16% say that at least 3 finance/accounting employees focus on the management of the company.

OTHER STAFF POSITIONS



Do you have a head of taxation or any tax accountants at your company?

Do you have any in-house legal counsel?

Do you have a full-time marketing person?

Most respondents indicate that a couple other key positions are not filled at their companies:

- Only 17% indicate there are any tax accountants employed by their company.
- Only 30% have in-house legal counsel within their company.

It is more common for a company to have a full-time marketing person employed at their company. However, only slightly over half of respondents have this position filled.

OTHER STAFF POSITIONS

How many back office staff are employed by your company?

Number	Percentage
3 or fewer	60%
4 – 7	20%
8 – 15	12%
16 – 25	06%
Over 25	02%

How many staff are employed in IT or HR at your company?

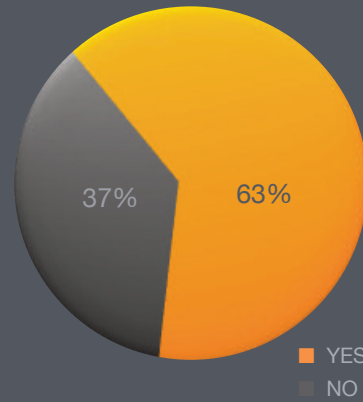
Number	Percentage
2 or fewer	84%
3 – 4	10%
5 – 6	03%
Over 6	03%

How many staff are employed in the operations group?

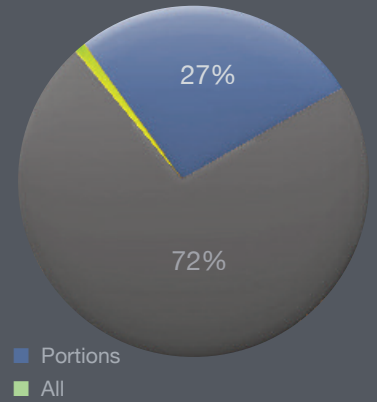
Number	Percentage
2 or fewer	57%
3 – 4	27%
5 – 6	04%
6 – 15	09%
Over 15	03%

Since the overall size of most companies surveyed is fairly small, most departments are staffed by only a few employees. Generally, the number of IT and HR staff employed is very small, while back office and operations staffs are slightly larger. See the tables at left for full details about the staffing of these departments.

Do you have a dedicated operational due diligence team?



Do you outsource this function or portions of it?



How frequently do you perform operational due diligence assessments on your managers?

Frequency	# of Responses	% of Responses
Quarterly	29	28%
Semi-annually	19	19%
Annually	42	41%
Bi-annually or less frequently	12	12%

How often do you receive communications from underlying managers in regards to fund performance & market outlook?

Frequency	# of Responses	% of Responses
Weekly	36	35%
Monthly	63	62%
Quarterly	03	03%
Semi-annually/Annually	00	00%

About 63% of respondents indicate their company has a dedicated operational due diligence team. Almost all of these companies (99%) manage at least some of these team functions internally. This includes 72% who manage everything internally and outsource nothing.

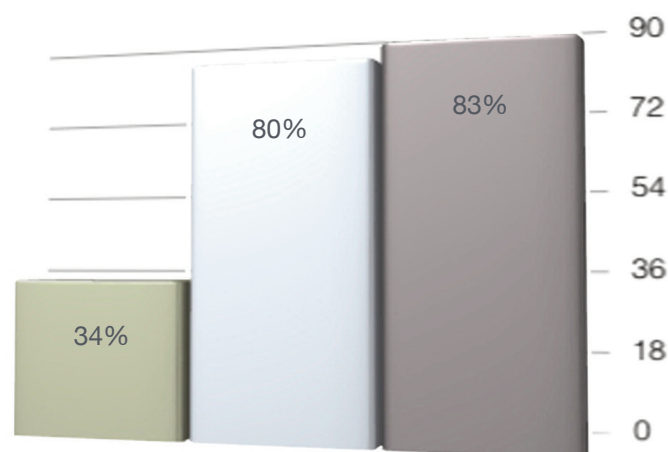
Most respondents say that operational due diligence assessments are conducted on managers on a regular basis. About **41%** of respondents indicate these assessments are conducted annually, and **47%** indicate they are conducted more often. With a total of **88%** of companies conducting these assessments at least annually, it appears they occur independent of a dedicated due diligence team in many cases.

Generally, underlying managers provide communications about fund performance and market outlook regularly. Only **3%** of respondents receive these reports less often than monthly, and all receive reports at least once a quarter.

On average, how long does it take you to make an allocation from the initial manager introduction?

Frequency	# of Responses	% of Responses
Less than 3 months	13	13%
3 to 6 months	60	59%
6 months to 1 year	24	23%
Over 1 year	05	05%

Percent of “Yes” responses



Do you require position level transparency from your underlying managers?

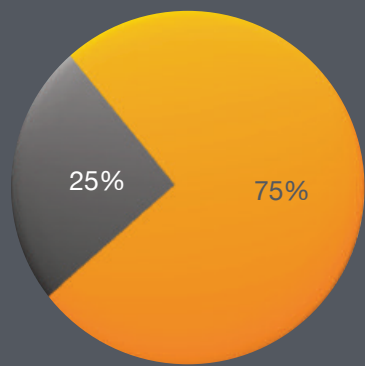
Do you utilize an investment committee to make the final investment decisions?

Is a background check on the underlying managers required as part of your due diligence?

Most respondents (59%) can make an allocation within 3-6 months from the initial manager introduction.
Few respondents can make an allocation more quickly than 3 months, but almost 30% take longer than 6 months.

Position level transparency from underlying managers is only required by about one-third of respondents.
However, the vast majority of respondents utilize investment committees to make decisions (80%) and use background checks for underlying managers as part of their due diligence.

Do you currently have an operations manual?



■ YES
■ NO

How often is it updated?

Frequency	# of Responses	% of Responses
Semi-annually	06	08%
Annually	37	50%
Bi-annually	02	03%
As needed	29	39%

How often do you update your compliance manual?

Frequency	# of Responses	% of Responses
Quarterly	07	07%
Semi-annually	07	07%
Annually	75	78%
Bi-annually	08	08%

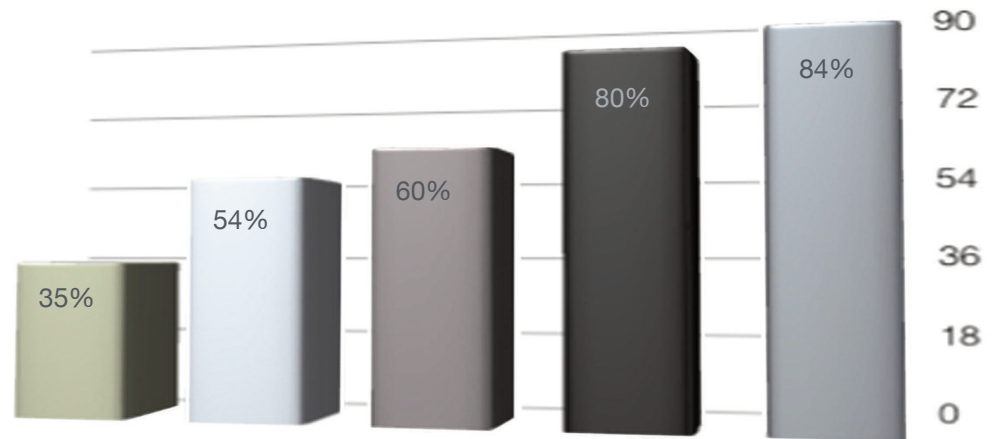
Three-quarters of respondents' companies have an operations manual. Of these companies:

- Half of the respondents update the manual annually.
- Most of the remaining respondents update the manual as needed, which means changes could occur at any time interval.

All respondents who have an operations manual also have a compliance manual. Much like the operations manual, the compliance manual is most likely to be updated annually. Only 8% of respondents update their compliance manual less often than once a year.

Service Providers & Counterparties

Percentage of “Yes” responses



Do you require SAS 70 certification for all of your operational service provider relationships?

Do you have a process or policy in place that regularly reviews the operational risk associated with each of your service providers?

Do all of your fund-of-funds have the same service providers?

Is there someone in-house that performs due diligence procedures on the various service providers?

Do you meet with all of your service providers at least annually?

Which service provider are you most likely to review/change in 2010?

Service Provider	# of Responses	% of Responses
Fund administrator	36	35%
Custodian	19	18%
Auditor	12	12%
Legal counsel	09	09%
No response	27	26%

Most customers do not find SAS 70 certification necessary for their operational service provider relationships. Rather, only 35% require this certification. Other methods of quality control are slightly more prevalent, but not necessarily standard practices:

- About **54%** of respondents indicate they have a process or policy in place to regularly review operational risk associated with service providers.
- About **60%** use the same service provider for all fund of funds.

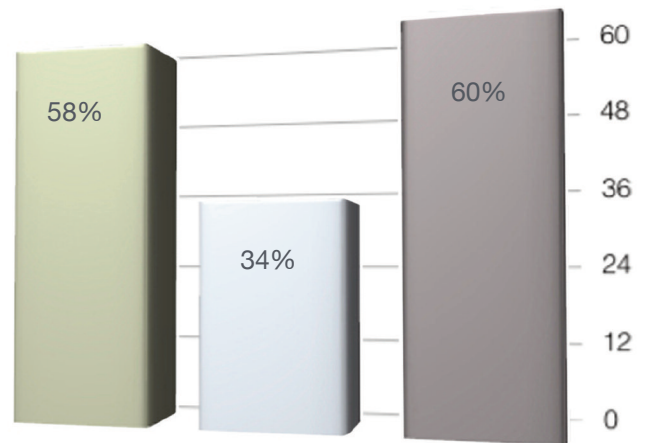
It is most common for companies to appoint an in-house resource to perform due diligence procedures on their service providers (**80%**). Almost all respondents (**84%**) also express a preference for meeting with service providers at least annually.

Respondents indicate they are most likely to review or change their fund administrator in 2010. Just over one-third identify this change as a possibility.

It should be noted that just over one-quarter of respondents provided no answer for this question. This indicates that there may be a lack of desire to review or change any of these service providers.

Market Forces & Investors

Percentage of “Yes” responses



Would you consider lowering fees in exchange for longer investment lockup periods?

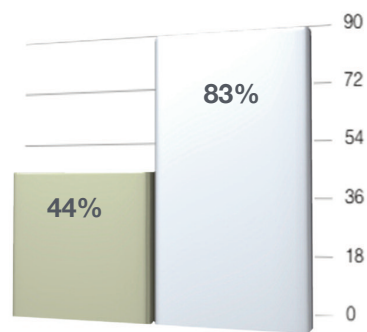
Are you providing increased liquidity to investors in response to market conditions?

Are you providing increased transparency to investors in response to market conditions?

Market forces are causing changes in behavior of many respondents:

- About **58%** of respondents indicate they would lower fees in exchange for longer investment lockup periods.
- Market conditions are causing **60%** of respondents to provide additional transparency to investors.
- However, only **34%** say that market conditions have caused them to provide increased liquidity to their investors.

Percentage who answered
“Yes/Increase”



Do you plan to start a new fund in 2011?

Will competition for investors dramatically increase or decrease?

From where do you see this increased competition coming?

	# of Responses	% of Responses
Increased competition from single-manager vehicles	38	48%
Increased competition from institutional investors replicating fund of funds	37	46%
Increased competition from mutual funds	15	19%

Most respondents expect the competitive environment in the market to change over the coming year:

- **44%** say they plan to start a new fund in 2011. Since the vast majority of respondents manage a small number of funds, such an increase would likely have a strong impact on the market.
- Perhaps partially as a result, **83%** of respondents expect competition to dramatically increase.

Most respondents who expect competition to increase see the competition coming in the form of single-manager vehicles (**48%**) or from institutional investors replicating fund of funds (**46%**). Few (**19%**) expect this increased competition coming from mutual funds.

Note: Respondents could select more than one answer choice. Therefore, percentages do not add up to 100%.

Where do you expect to source your new investment capital in 2011?

	# of Responses	% of Responses
Institutional investors will be an important source of new capital	17	17%
High-net-worth investors will be an important source	34	34%
Both of the above	48	49%

Respondents are twice as likely to believe investment capital will come from high-net-worth investors **(34%)** as they are to believe it will come from institutional investors **(17%)**.

However, respondents are most likely to believe that new investment capital will come from a combination of both types of investors.

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Rothstein Kass also provides a full array of integrated services, including strategic business counseling, regulatory compliance and SEC advisory services, insurance and risk management consulting and family office services, through its Commercial Services Group. The Firm advises organizations looking for financing/investment opportunities, as well as those looking to restructure as a business strategy. Rothstein Kass has offices in California, Colorado, New Jersey, New York, Texas and the Cayman Islands.

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Rothstein Kass

1350 Avenue of the Americas
New York, NY 10019
212.997.0500
www.rkco.com

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