

2014 ISRAEL HEDGE FUND SURVEY

May 2014

Tzur Management

CONTENTS

INTRODUCTION	04
ABOUT TZUR MANAGEMENT	04
METHODOLOGY	05
ACKNOWLEDGEMENTS	05
INDUSTRY OVERVIEW	06
PERFORMANCE	09
INVESTMENT STRATEGIES	11
OPERATIONS AND TEAM	14

INTRODUCTION

This report marks the second installment of our comprehensive survey of the Israeli hedge fund industry. Following growth in the Israeli hedge fund industry in the past year as well as the success of the first-ever survey of the industry that we completed and published in 2012, participation in the second installment of the survey was even more impressive than in our first survey.

Israel continues to be recognized as a global center for innovation in high-tech, but in recent years there has been increased focus on the potential for expansion and growth in the financial services industry. Deregulation and new legislation in securities and tax law, as well as structural changes in the institutional market, have helped the finance industry gain traction in the past decade. Israeli financial institutions have continued becoming more sophisticated, deploying tens of billions of dollars in investments outside of Israel.

More specifically, our survey shows that growth in the Israeli hedge fund industry has continued at an impressive rate in recent years and that assets under management coming from international investors have increased. It is our belief that this growth will continue and Israel will become a recognized center of global hedge fund activity over the next decade and beyond. 2013 saw several key developments in the Israeli hedge fund industry, including several industry conferences and the launch of the Israeli Hedge Fund Association. The survey highlights many encouraging trends regarding the continued growth and gradual maturation of the industry. We have also identified several findings that show room for improvement, and we hope that this report will serve as an effective tool for influencing favorable government policy toward the hedge fund industry as well as continuing to increase interest within the international investment community.

We welcome any feedback. All inquiries regarding this survey or requests for additional information can be addressed to info@tzurmanagement.com.

ABOUT TZUR MANAGEMENT

Tzur Management ("Tzur") is the leading fund administrator and platform for Israeli hedge funds, and an affiliate of the global administrator Orangefield Columbus. Tzur provides tailored operational infrastructure to Israeli funds offering a full suite of fund administration services including fund accounting, operations, and shareholder services to hedge funds, funds of funds, private equity funds and other alternative investment vehicles. For more information on Tzur and its services, please contact info@tzurmanagement.com.

METHODOLOGY

This survey was conducted by means of a questionnaire sent by Tzur to Israeli hedge fund managers. For the purpose of this survey, the term “hedge fund manager” includes investment managers actively managing capital for accredited investors and institutions who employ strategies typically employed by hedge funds globally, and as such do not qualify as mutual fund managers or investment advisors under Israeli law. This survey does not include proprietary trading operations or funds that are currently being set up, of which there are many.

Of the 89 funds contacted, 52 fully participated in the survey, representing a significant increase compared to the level of participation in our first survey.

Due to the sensitive nature of the material requested, all information presented in this report is done so under the express knowledge that participants remain confidential. Despite our commitment to confidentiality, several funds did not provide information on some of the more sensitive aspects of their operations, such as performance. In each section we have outlined the level of participation by the funds.

The findings below represent the condition of the Israeli hedge fund industry as of December 31, 2013.

This survey is meant to provide guidance and insight into the Israeli hedge fund industry. The opinions and conclusions expressed are those of the author.

All responses received by Tzur were taken as fact and Tzur did not conduct further verification of the information provided.

This survey is for the use of Tzur and its clients and may not be published externally without written permission obtained from Tzur.

ACKNOWLEDGEMENTS

As always, this survey would not have been possible without the participation of hedge fund managers who took the time to complete the questionnaire for this important project. We would like to extend our sincere thanks to all the hedge fund managers who participated in this ongoing effort to provide an accurate overview of the Israeli hedge fund industry.

INDUSTRY OVERVIEW

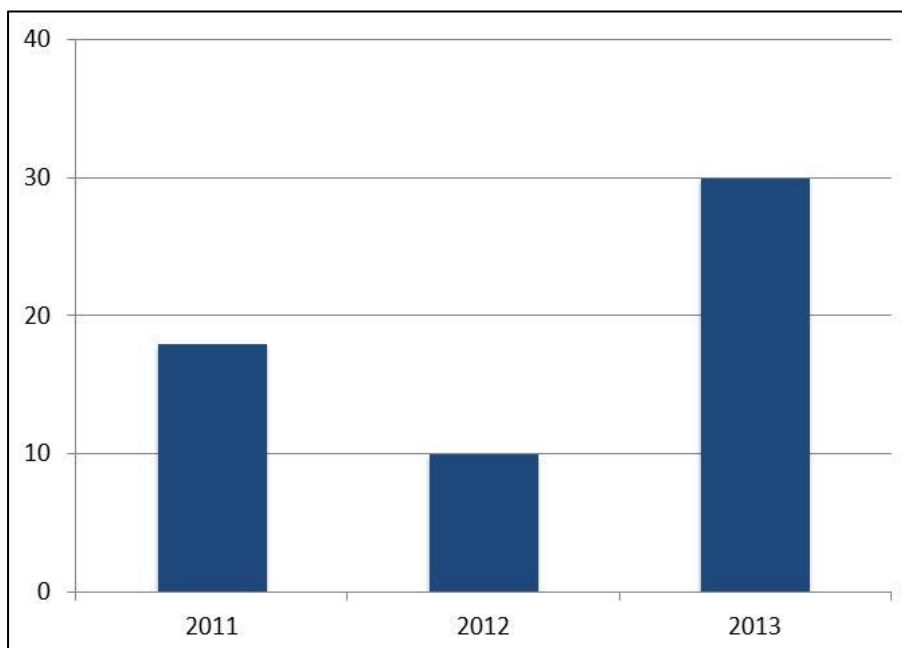
In recent years, the Israeli hedge fund industry has continued to grow both in number of firms and assets under management (AUM), with a particularly large number of new launches in 2013. Only a decade ago, Israel had little in the way of a hedge fund industry, but we are now experiencing a rapidly developing industry enjoying a sustained period of growth and gradual maturation, and showing no signs of slowing down.

Number of fund managers in Israel

Tzur approached **89 fund managers** to participate in the survey. This represents a **growth of 50%** in the number of funds since the previous survey at the end of 2011. The past year has seen many new managers entering the industry with **30 new launches in 2013**. We expect to see many new fund launches in the coming years as well as new managers continuing to spin out of larger institutions, proprietary trading operations, and technology R&D.

The graph below highlights the number of new managers based on their initial trading year. Based on the data below, over half the fund managers operating today were not operating only three years ago.

GRAPH 1: NEW LAUNCHES 2011-2013



Fund Structures and Separately Managed Accounts

Of the 89 fund managers contacted, 65 are currently managing a hedge fund while the remaining 24 managers operate through separately managed accounts (SMAs). These SMA managers are largely managing small amounts of capital and are in the process of structuring dedicated hedge funds.

Assets Under Management (AUM)

The growth of the Israeli hedge fund industry is also demonstrated by the increase in the industry's AUM. **The AUM of the 89 funds contacted in our survey total \$2.66 billion as of December 31, 2013.** This represents a growth in assets of 33% since the previous survey, or over 15% growth per year in the past two years.

On average, the 89 fund managers contacted each manage approximately \$30 million in AUM, while the **median of AUM is only \$10 million.** This shows that many of the funds are still very small, which is to be expected considering the large number of new launches in the past year.

Another promising sign is the average launch size of new funds. Among the 30 new funds that first launched **in 2013, the average launch size was \$11 million.** This is higher than what we observed in the past, and it appears that the industry is beginning to grow out of the pattern of small launches and slow asset ramp that we saw in the previous survey.

Of the total AUM, approximately \$2 billion (75%) are managed in hedge funds while the remainder is managed in SMAs.

Attracting investors

As the Israeli hedge fund industry grows and matures, managers are continuing to make headway in attracting more local and foreign investors. However, despite an Israeli tax regime favorable to foreign investors (investors don't pay local taxes on investment with Israeli fund managers), concerns surrounding Israeli tax laws have been a hurdle for many first-time foreign investors.

As part of the survey, managers were asked for their opinion regarding the greatest challenges faced by the Israeli hedge fund industry. **Over 80% of participants ranked an unfavorable Israeli tax ruling as the first or second most important issue facing the industry,** resulting in a lack of investment. Additionally, approximately 30% of participants ranked foreign investors being unaware of the Israeli hedge fund industry as either the first or second biggest concern.

Assets under management by investor type

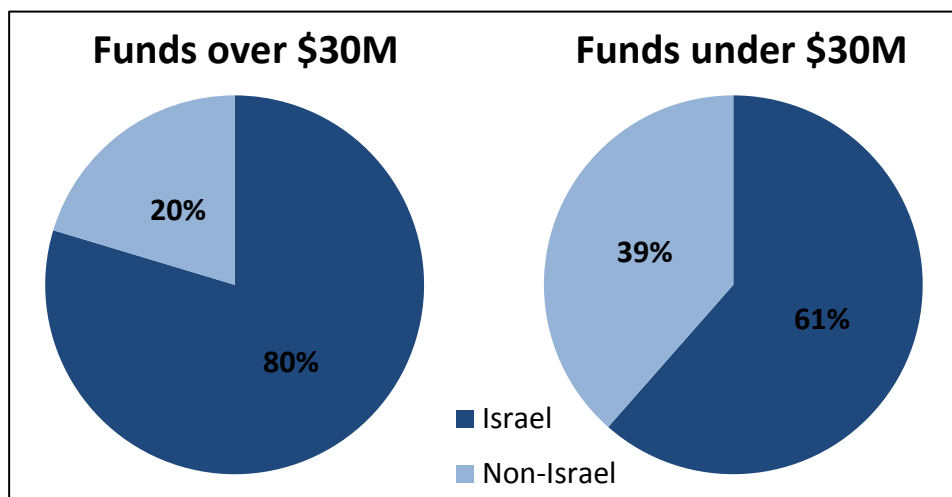
As the industry continues to grow and move past its early stages of maturity, we are noticing a gradual shift towards institutional investors. Although private investors still make up the majority of capital managed by Israeli hedge funds with 55%, **institutional investors have increased their stake in the local industry from under 40% in the previous survey to 45% today.** This indicates that institutional investors are becoming more aware of and comfortable with the Israeli hedge fund industry and therefore they are gradually more willing to invest their capital. Despite that, small funds have had difficulty raising institutional capital, and it has primarily been the **larger funds that have succeeded in attracting 50% of their assets from institutional investors.**

Assets under management by investor origin

The data shows that, overall, funds still have a lot of work to do to attract increased foreign investment. Similar to the previous survey, **over two-thirds of AUM from the 89 participating funds come from Israeli investors while the remaining one-third comes from non-Israeli investors.**

The graph below shows a breakdown of AUM by investor origin according to fund size. While both the larger and smaller funds have received most of their funding from local Israeli sources, the smaller funds have been more successful in recruiting investors from overseas. However, **the ratio of foreign capital to local capital in small funds is lower than in the previous survey.** This may point to a willingness on the part of local investors to seed new managers, which could be a key contributor to the increased number of funds launched in 2013.

GRAPH 2: BREAKDOWN OF ASSETS UNDER MANAGEMENT BY INVESTOR ORIGIN



PERFORMANCE

The previous survey included some indicative performance of the Israeli hedge fund industry based on the data provided by 20 funds that shared performance data. Following the success of the first survey and the continued growth of the Israeli hedge fund industry, many more funds have agreed to participate in the survey and to provide performance data. The performance data below includes data from 40 funds.

As a result, we have decided to introduce the Tzur Capital Management Index of Israeli hedge fund performance (TCMI), which we have broken out into the TCMI General Index, the TCMI Israel Focus Index, and the TCMI Quant Focus Index.

It is important to note that all data used to compile this report, and particularly the performance data used in this section, were provided to us by the fund managers and no further verification of the information was conducted. Furthermore, each of the three indices presented here consists of a number of Israeli hedge funds, which together represent a very broad range of funds in both size and trading volume.

TCMI General Index

A total of 40 funds provided performance data. The table below provides a breakdown of the TCMI General Index annual performance since 2011 compared with the annual performance of the HFRX Global Hedge Fund Index and the S&P 500 Index.

TABLE 1: TCMI GENERAL INDEX ANNUAL PERFORMANCE

	2011	2012	2013
TCMI General Index	6.7%	13.3%	17.0%
HFRX Global Hedge Fund Index	-8.9%	3.5%	6.7%
S&P 500 Index	-0.0%	13.4%	29.6%

TCMI Israel Focus Index

Of the 40 funds that provided us with performance data, 14 of them invest a majority of their assets in Israeli markets and have been classified as Israel-focused for the index below. The table below provides a breakdown of the TCMI Israel Focus Index annual performance since 2011 compared with the annual performance of the TA-25 Index.

TABLE 2: TCMI ISRAEL FOCUS INDEX ANNUAL PERFORMANCE

	2011	2012	2013
TCMI Israel Focus Index	-1.5%	18.8%	21.8%
TA-25 Index	-24.0%	11.8%	20.6%

TCMI Quant Focus Index

Finally, of the 40 funds that provided us with data, 17 of them employ a quantitative strategy and have been classified as quant-focused for the index below. The table below provides a breakdown of the TCMI Quant Focus Index annual performance since 2011 compared with the annual performance of the HFRX Global Hedge Fund Index and the S&P 500 Index.

TABLE 3: TCMI QUANT FOCUS INDEX ANNUAL PERFORMANCE

	2011	2012	2013
TCMI Quant Focus Index	16.8%	11.7%	9.9%
HFRX Global Hedge Fund Index	-8.9%	3.5%	6.7%
S&P 500 Index	-0.0%	13.4%	29.6%

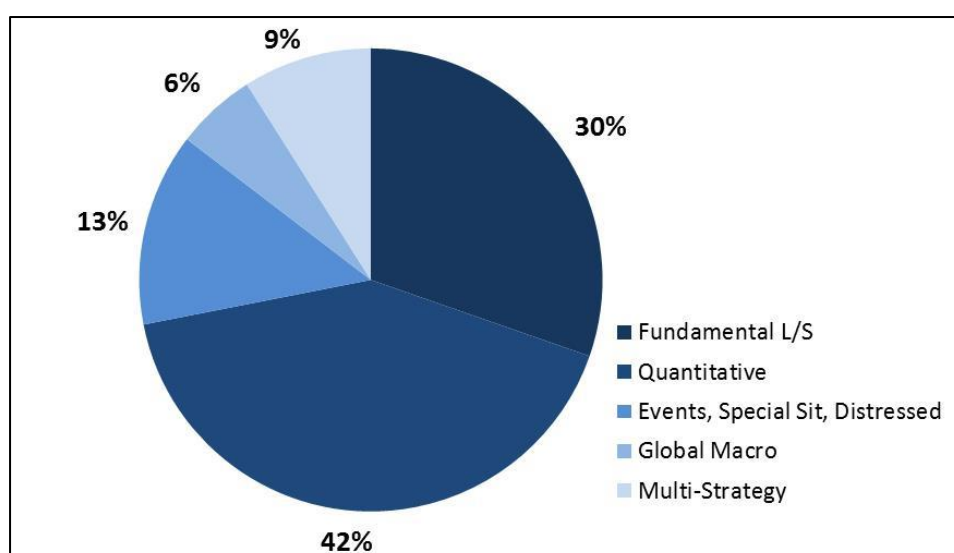
INVESTMENT STRATEGIES

Although the hedge fund industry has grown significantly in size since our first survey, its diversification in terms of investment strategies has remained relatively consistent. The industry includes funds investing in a diverse set of strategies, asset classes and geographies, and as it continues to expand and mature it will become even more sophisticated.

Fund strategies

For the purposes of this survey we have divided the results from participating hedge funds into five strategy categories. These are (1) Fundamental Long/Short, (2) Quantitative or systematic trading strategies, (3) Event Driven, Distressed, Special Situations, (4) Global Macro (including currencies and commodities), and (5) Multi-Strategy (employing a variety of strategies). The graph below shows the breakdown of assets according to these five categories.

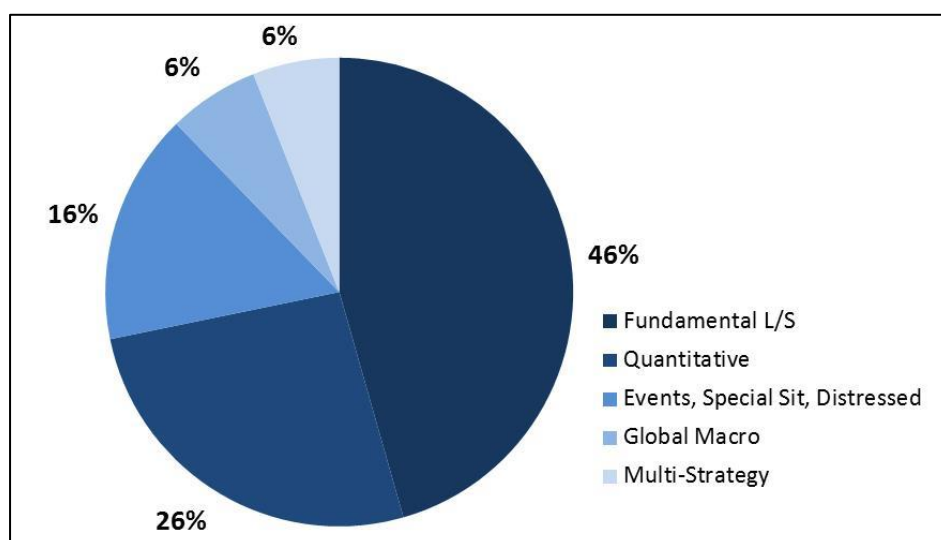
GRAPH 3: BREAKDOWN OF FUNDS BY STRATEGY



The graph above shows that **the most common strategy by number of funds is quantitative with 42%, followed by fundamental long/short with 30%.** In our first survey we observed that there was a particularly large number of quantitative funds in Israel, and this trend has continued through 2013 with many of the launches in the past year employing quantitative strategies. However, although more funds employ a quantitative strategy, graph 4 below shows that funds employing a fundamental long/short strategy hold the largest share of industry AUM by a significant margin.

The graph below shows that **nearly half of the AUM is managed by fundamental long/short funds, while quantitative funds make up approximately one quarter of AUM.** Further analysis shows that this is due to the fact that many of the well established, larger funds employ a fundamental long/short strategy, while many of the funds employing a quantitative strategy are smaller and/or SMAs rather than hedge funds. It may take several years of outperformance for the quantitative fund managers to reach the scale of traditional investment strategies.

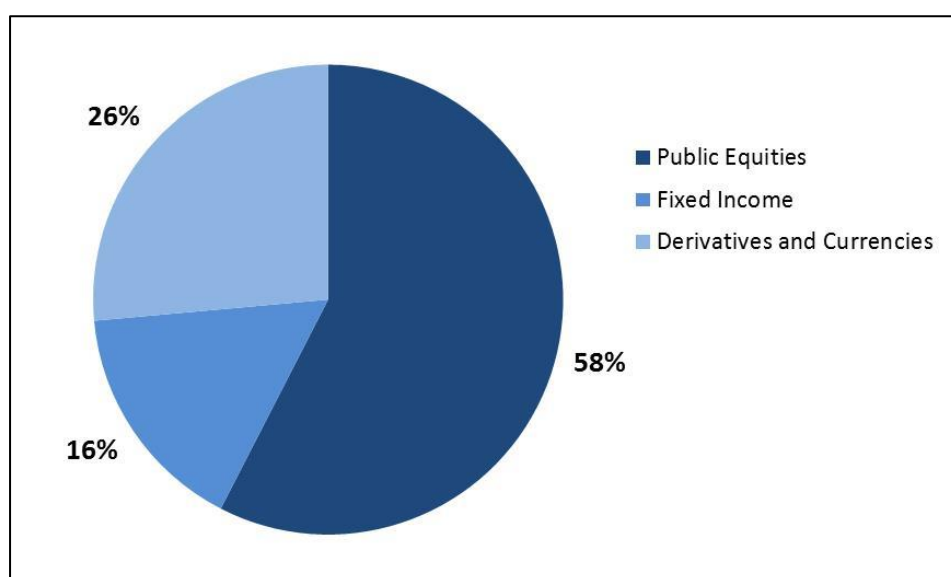
GRAPH 4: BREAKDOWN OF ASSETS UNDER MANAGEMENT BY STRATEGY



Asset class allocation

The graph below shows that **equities are the predominant asset class in which Israeli funds invest, with an allocation of 58% of total industry AUM.** After equities, Israeli funds are most active in the derivatives and currencies markets, followed by fixed income. Compared to the previous survey, fixed income has increased significantly at the expense of equities.

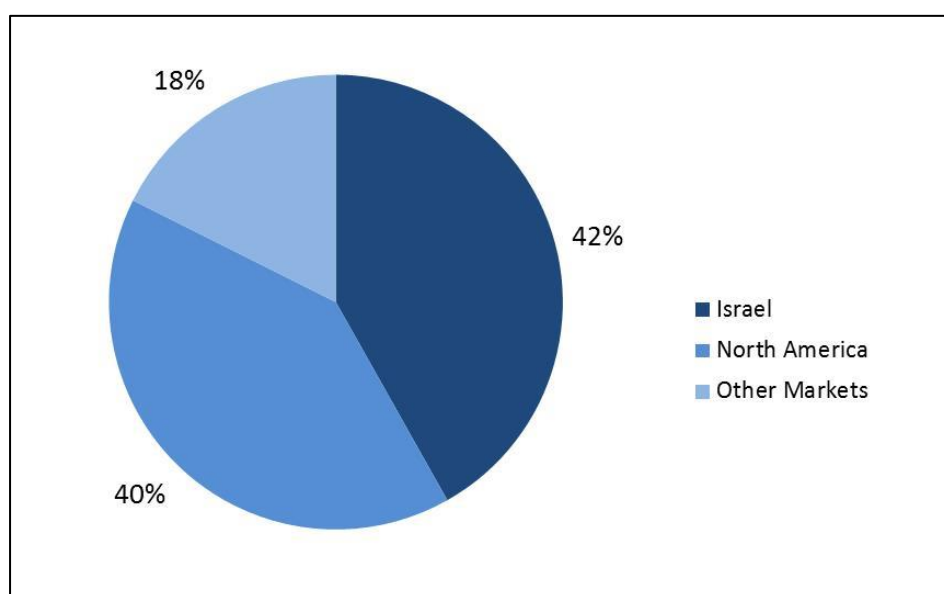
GRAPH 5: BREAKDOWN OF ASSETS UNDER MANAGEMENT BY ASSET CLASS



Geographic allocation

The perception that Israeli funds are focused primarily on local markets continues to be proven wrong by the results of our survey, with **60% of participating funds having no direct exposure to the markets in Israel**. Additionally, **approximately 60% of the industry's AUM is invested outside of Israel**. The proportion of funds with no direct exposure to the markets in Israel is significantly higher than it was in our first survey, indicating that as the Israeli hedge fund industry continues to grow and mature, managers are relying more on geographic diversification and increasingly looking abroad for investment opportunities.

GRAPH 6: BREAKDOWN OF ASSETS UNDER MANAGEMENT BY GEOGRAPHIC ALLOCATION



Portfolio Turnover

The Israeli hedge fund industry is characterized by the highly liquid nature of its assets under management. **Over 36% of funds report that their portfolios are turned over daily or weekly, 45% monthly or quarterly, and only 18% semi-annually or less**. Unsurprisingly, the high liquidity is particularly noticeable for quantitative funds, with 68% reporting portfolio turnover daily or weekly, 32% monthly or quarterly, and none semi-annually or less.

Market Exposure and Leverage

Generally, funds reported relatively low use of leverage. Although some Israeli fund managers, particularly those employing quantitative strategies, employ leverage as part of the investment strategy, most funds estimated their average gross exposure as 150% of AUM or less. **The average gross exposure across all participating funds was 134% and the average net exposure was 67%.**

OPERATIONS AND TEAM

As the Israeli hedge fund industry continues to grow and develop, our analysis shows that managers are increasingly conducting their operations in accordance with the high standards expected of hedge funds globally.

Domicile

Israeli funds choose to domicile their funds in locations that maximize tax efficiency and operational controls for their investors. All participating funds are domiciled in one of several locations: **Israel (52%); Cayman Islands (29%); Other (USA, BVI and Gibraltar - 18%)**. Although approximately half of the funds are domiciled outside Israel, Israel remains the most popular location for domicile, as many managers seek to accommodate local Israeli investors.

Fund Fees

Fund terms among Israeli hedge funds are typical for the industry globally. **Management fees average 1.5% and performance fees average just below 20% among participating funds**. Only 14% of respondents have a performance fee higher than 20%, and the vast majority of these are quantitative funds which charge a higher performance fee but little or no management fee.

Portfolio Managers

Israeli portfolio managers are typically highly educated and experienced - on par with hedge fund managers globally - and in fact many of them originate or spent a significant amount of time abroad.

Tzur believes there to be over 200 Israel-based portfolio managers active in local hedge funds and proprietary trading operations. **Of the 45 participating portfolio managers, nearly two thirds worked, studied, or grew up in the United States or Western Europe.**

The 45 participating portfolio managers have a total of 462 years of experience, representing an average of 10.3 years per portfolio manager. Among primary portfolio managers the average is 11.3 years, while for secondary portfolio managers it is 8.3 years.

Personnel

The 56 funds who responded employ over 280 individuals, including over 170 in front office positions (portfolio managers, traders, risk managers, research analysts) and over 110 in back office and administrative functions. This means that on average, Israeli funds manage nearly \$14 million in AUM per front office staff and \$8.5 million in AUM per total staff. Based on this analysis, **we estimate that the hedge fund industry as a whole employs over 300 people.**

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