Middle East Hedge Fund Investment

The world's new investment Mecca

Regional growth potential remains strong

Opportunity knocks for financial players
In this issue...

03 The new investment Mecca
by Romil Timbadia

06 A long-term commitment
By Matthew Lamb, GAM

09 Middle East growth potential still strong
By Eric Swats, Rasmala Investments

10 Opportunity knocks for financial services players
By Romil Timbadia

13 Cautious investors use due diligence tools
By Mark Weller, PerTrac Financial Solutions

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Could the global financial crisis be a blessing in disguise for the Middle East region? Certainly, industry players and governmental agencies in the region are rubbing their hands with glee, as seasoned foreign investors, failing to find any kind of rhythm in developed markets, are seeing the Middle East as their new investment Mecca.

As the markets in the region have almost no correlation to other major asset classes or countries with developed market equities, and as other emerging markets seem to falter amidst the reverberations from the West, the Middle East has been given a double investment boost. This is in addition to the factors already contributing to its growth, including the wealth created by the oil price boom over the past few years, the rapidly developing financial centre infrastructure in jurisdictions such as Dubai, Qatar and Bahrain, and the rising commercial property prices.

As a result, droves of foreign investors have entered the region in the past year or so and many more are planning to do the same. In a recent conference in Dubai, senior executives of the world’s largest private equity firms were present.

Participants at the ‘Super Return’ conference included Henry Kravis, co-
founder of Kohlberg Kravis Roberts, Stephen Schwarzman, a co-founder of Blackstone Group and David Rubenstein, a co-founder of Carlyle Group. Rubenstein, whose firm opened an office in Dubai two years ago and is investing a fund that targets the Middle East, said the region is among markets that will weather the financial crisis. “The economic growth is being sustained by non-oil sectors,” Rubenstein said, noting that most governments in the region set their budgets based on oil prices at about USD 50 per barrel. “It will likely trend up more than that, and the Middle East governments have amassed huge foreign reserves. I don’t think they’re as vulnerable.”

But these private equity gurus are not the only ones upbeat on the Middle East. Interest has been coming in steadily from investors and financial service companies across the board. And the serious efforts to establish competing international financial services centres in Dubai, Abu Dhabi, Bahrain and Oman are facilitating the needs for these entities to come in and do business in the region.

Merrill Lynch is aiming to boost its Middle East business, according to chief executive officer John Thain. The US investment bank, currently being taken over by Bank of America is “committed” to expanding its wealth management, investment banking, sales and trading activities and has applied for licenses to enter Qatar and Kuwait.

Morgan Stanley, JP Morgan Chase, Goldman Sachs Group, Credit Suisse Group, Citi and Barclays have also opened regional offices in the Middle East, mostly in Dubai, in recent years. Dubai, with the help of the Dubai International Financial Center (DIFC), has been working hard to attract serious investors over the years. It is interesting to note that workers moving to the region get a big perk: no local taxes on their six- or seven-digit pay packages. Indeed, one of the most immediate and attractive aspects of working in Dubai is that fact that there are no personal taxes levied against income from employment, adding another alluring aspect to the region.

All this has also helped transform the DIFC, a 110-acre office sprawl in the heart of the city, into some of the world’s most expensive commercial real estate. The continuation of Dubai’s economic growth and diversity is still attracting new businesses, making the commercial property sector another factor in the country’s economic diversification. Unlike the retail property market, where there is a high degree of oversupply, demand continues to surpass supply in the commercial sector.

The International Monetary Fund (IMF) in its October 2008 Regional Economic Outlook on the Middle East and Central Asia region outlined that the MCD region has continued to experience strong growth in 2008, outpacing global growth for the ninth year in a row.

Growth is underpinned by high commodity prices, strong domestic demand, and also credibility of the authorities’ economic policies. So far, the Middle East and Central Asia region has been largely resilient to the ongoing international credit crisis and the downturn in the US and other advanced economies, said the .

The factor that markets in the region have almost no correlation to other major asset classes and markets favoured by international investors is crucially important. Experts have said that over the past few years, Middle Eastern equity markets have exhibited practically zero correlation to Latin America, US and other developed market equities, and only most modest positive correlation to other emerging equity markets, thereby giving it a unique selling point in the eyes of potential foreign investors.

Foreign investment comes in many forms but that from hedge funds has been streaming into the region of late. Earlier in the year, Deutsche Bank’s annual alternative investment survey confirmed that investors surveyed said they planned to increase their allocations to emerging markets, with the
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When GAM opened an office in Dubai in September 2007, it was not jumping on the bandwagon of the world’s fastest-growing financial centre but demonstrating its long-term commitment to a region that is set to play an increasingly important role in the global economy and in different facets of the world’s investment industry in the coming years and decades.

The establishment of a presence on the ground is enabling GAM to develop local business in a large and fast-growing investment market consisting not only of local individuals and institutions, including sovereign wealth funds, but also large numbers of non-resident Indian investors and Western expatriates. The Dubai office also enables GAM to service large global financial institutions that it works with on a worldwide basis and that are also developing their activities in the Middle East.

GAM’s activities in the region are bolstered by sales and compliance functions in Dubai, as well as by the presence of its parent, Julius Baer, which in 2004 became the first international private bank to be licensed to operate in the Dubai International Financial Centre, and which also has an office in Abu Dhabi.

Just as important, however, is a commitment to developing the potential of the region as target for investors across the world - heralded by the relocation to Dubai of Sean Taylor, manager of a number of funds investing in frontier markets predominately in MENA (Middle East and North Africa) and emerging markets.

In June GAM became one of the first Western firms to receive an asset management licence from the Dubai Financial Services Authority, and it now manages more than USD670m (as of September 30, 2008) in frontier and emerging market investments from the DIFC.

Taylor is also playing an important role in the process of building long-term relationships with institutions in Dubai and across the region. While a great deal of local investment has traditionally flowed into property markets, the growing sophistication of investors in the region and their appreciation of the portfolio diversification benefits of hedge funds is likely to create a fruitful source of business in the future.

Amid the turbulence in markets worldwide over the past few months, the Middle East continues to offer huge potential for the future. Setting aside the gyrations in the price of oil, the economic boom in the Gulf has solid economic underpinnings based on long-term plans to develop modern infrastructure throughout the region, and in Dubai’s case, to establish itself as a global business centre.

The current impact of the global market turmoil notwithstanding, from a long-term perspective Middle East markets offer important diversification benefits because not only are they less correlated to developed markets and longer-established emerging markets, but inter-regional correlation continues to remain low or negative. Therefore an actively managed portfolio with investments diversified across the regions should enable investors to benefit from a low correlation of assets within the portfolio and smoother returns.

As the economic development of the Middle East continues, the region is likely to attract an increasing number of global investment opportunities. In this environment, the benefits of experience on the ground will be a key differentiator for investment managers.
Middle East predicted as the top performer amongst all regions. By region, about 45% of investors surveyed said funds investing in the Middle East and North Africa will be the top performers in 2008.

This has since taken some form of concrete investment and funds are already getting into the action. Interest in hedge funds has risen in the Middle East and many firms are seeing a trend in regional interest in commodities hedge funds and distressed securities, which are investments made in companies filing for bankruptcy protection that are often viewed as a bargain.

Reports have stated that Michael Spencer, founder of inter-dealer broker ICAP, is ploughing tens of millions of dollars into a new hedge fund to profit from frontier markets in Africa and the Middle East amid a rush of money into the region.

Man Investments also successfully launched a USD 1.5bn environmentally friendly hedge fund in June in conjunction with the Abu Dhabi Government-owned International Petroleum Investment Company. Also, as part of its Middle East expansion plans, Deutsche Bank plans to launch a sharia-compliant hedge fund platform.

From a service provider perspective, the Middle East is set to become a major source of business in the future. Bigger firms that are able provide a range of services to a diversified client base, are already finding it to be an attractive location in which to function. As the global hedge fund industry starts to feel the vibrations of the global financial turmoil, the Middle East is poised to show increased hedge fund activity, since the region’s economies are on a separate growth cycle from the West.

In terms of finance centre jurisdictions capable of handling the rise in financial services and alternative investment growth, there is no doubt that the centres in the Middle East are well-equipped.

Take for example Bahrain. Only recently, Citi launched its securities and fund servicing business in the Middle East, with the announcement that the bank is ready to provide fund administration and related services to regulated funds in Bahrain. The bank said the move was a response to demand in Bahrain for “an increased choice of local service providers with capabilities covering all investment strategies” including alternative fund styles.

Funds registered in Bahrain had around USD 15.6bn in total assets under management as of December 2007, up nearly 73 per cent on the previous year, according to figures from the Central Bank of Bahrain.

There is also talk that the DFIC, with its new legal framework, would be able to attract business away from the Cayman Islands. If this does happen, even on a small scale, the flow of assets coming in would still be significant enough to justify Dubai as a strongly competitive funds jurisdiction.

Although the vast majority of funds managed in established centres of hedge fund activity such as London, Singapore or Hong Kong are domiciled in the traditional offshore jurisdictions – most notably the Cayman Islands, Dubai, with its new-found expertise could prove to be a strong alternative.

As opportunities in the region increase, hedge fund managers are seeing an interesting territory that can offer them an oasis in these times of financial crises. The Middle East is a unique market place – one demanding local solutions with global service standards. As domestic investors seek diversification from the traditional investment areas such as private equity and real estate, the hedge fund sector will stand to benefit.

Also, new initiatives by financial regulators, the changing investment environment in the region and the dynamism of local markets have made the region an attractive market for hedge fund providers. Investors seeking to access this increasingly important emerging market block may be coming in at the right time.
Rasmala Investments

Rasmala Investments is a Dubai-based investment banking firm focused on asset management, private equity and brokerage. The firm is headquartered in the Dubai International Financial Centre (DIFC), UAE, with subsidiaries in the key markets of Saudi Arabia, Egypt, Oman and the UK.

Launched in 2000, Rasmala pioneered one of the first private equity funds in the GCC – the Rasmala Fund LP – delivering to investors a 3.5x ROI and a gross IRR of 22%. The fund also provided the seed capital to establish Rasmala Investments in 2003.

As an established and profitable business with a significant global client base, Rasmala provides investors with exceptional regional access to unique deals and unparalleled market knowledge through its presence in key markets.

In its eight-year history, Rasmala has pioneered products in both asset management and private equity and continues to raise the bar across its four lines of business.

Rasmala is led by a management team that combines global experience with a strong regional track record. The fee-earning assets under management have grown significantly from US$282 million on September 30 2006 to US$1.5 billion currently.

Rasmala won the 2008 Hedge Fund World Middle East award for Best New Fund for its MENA Equity Opportunity Fund of Funds – a model pioneered in the region by Rasmala in 2006 as an alternative investment vehicle targeting the Middle East and North Africa (MENA) public equity markets.

In June 2008, the MENA Equity Opportunity Fund was also awarded an ‘AA’ rating by Standard & Poor’s for its strong track record in comparison with both peers and the MSCI Arabian benchmark and for its ability, in volatile markets, to add value through asset allocation.

www.rasmala.com
The financial tremors emanating from the United States and being felt around the world are expected to have only a marginal impact on the economies of the Middle East and North Africa. For the most part, the economies and banking systems of the oil producing countries remain strong which is in stark contrast to what is seen in the US, Europe and certain parts of Asia. For 2009, economic activity in the GCC is expected to range between 5 and 6 per cent. With such strong fundamentals, investors are finding the region an even more interesting destination for their emerging market investments.

The Middle East is favorable right now for investors with a long-term outlook. Given the recent decline in many of the region’s equity markets, investors are able to enter at valuation levels which have not been available for years. Many markets are trading at below 10 times earnings even though earnings growth is likely to remain strong for the next several years.

Private equity is also seeing an opportunity in the region as demonstrated by the presence of some of private equity’s most powerful tycoons, including Blackstone founder Steve Schwarzman, KKR’s Henry Kravis and David Rubenstein of Carlyle Group, at a recent event in Dubai to lure investors from and to the cash-rich Gulf States.

Deutsche Bank’s annual alternative investment survey states that the investors who were surveyed planned to increase their allocations to the emerging markets, with the Middle East predicted to be the top performer amongst all regions. By region, about 45% of investors surveyed said they think funds investing in the Middle East and North Africa will be the top performers in 2009.

Even the International Monetary Fund (IMF), in its regional economic outlook, said that the Middle East has continued to see strong growth in 2008, outpacing global growth for the ninth year in a row. Growth is underpinned by high commodity prices, strong domestic demand, and also the credibility of regional economic policies. So far, economic activity in the Middle East and Central Asia region has been largely resilient to the ongoing international credit crisis and the downturn in the United States and other advanced economies, it said.

With the Western Hemisphere in for a sharp economic contraction, coupled with the uncertainty in established emerging markets such as Russia, India and China, the Middle East is now being seen as an attractive, long-term investment destination for many types of investors. Certainly, there is earnings growth potential of 20-25 percent in the next several years and Rasmala Investments, with its expertise and experience in the region, is well-positioned to serve interested parties. Rasmala, being a regional leader in investment banking, marries best practices with a deep understanding of the Middle East, thus adding a lot of value to its client base in managing their regional investments.

We serve institutions and high net-worth individuals throughout the region and internationally, and have a longer experience than most in assessing the merits and quality of investment opportunities available in the MENA countries. We feel strongly that those investors willing to study and learn about the region’s investment opportunities will be very well rewarded.
Over the past few years, there has been considerable economic growth and an increase in prosperity across the Middle East, which has fuelled a significant investment boom.

As the financial crisis takes the steam out of investing in the west, investments in the Middle East that have been steadily rising, are now poised to intensify. Financial players and institutions are finding the region an even more interesting destination for their emerging market funds as the Middle East develops into a favorable and long-term investment location.

Short term and speculative investors are now seen leaving the region, and longer-term and seasoned investors are stepping into the fray. And this can only be a good thing considering the need for stable and enduring financing options, experts say. “Given the recent decline in many of the region’s equity markets, investors are able to enter at valuation levels which have not been available for years. With the Western Hemisphere in for a sharp economic contraction, coupled with the uncertainty in established emerging markets such as Russia, India and China, the Middle East is now being seen as an attractive, long-term investment destination for many types of investors. Certainly, there is earnings growth potential of 20-25 per cent in the next several years,” emphasises Eric Swats, head of asset management at Rasmala Investments.

At the same time, with financial markets and traditional investments facing a downfall, investors are keen to turn their eye to alternative investments. Globally, at a time when most traditional investments are generating low levels of returns, or even losses, institutional investors are increasingly becoming attracted to hedge funds.

But what stands out is not only the move towards other asset classes but also that
towards other, trendier locations. Geographical diversification in investments plays a strong role in the current times and many investors foresee the Middle East to be the next big thing in terms of hedge fund investment. But while the region has made a lot of headway in enticing investors, a lot more work needs to be done, observers claim.

The flexibility and the increase of raising capital in the Middle East are facilitating the development of the financial centres in areas such as Dubai, Bahrain and Qatar. Due to this financial centre empowerment, along with the tax concessions and changing regulatory regimes, these countries are now being compared with some of the key financial jurisdictions around the globe.

Mark Weller, managing director for EMEA and Asia, PerTrac Financial Solutions, says, “We’re seeing strong demand from government agencies, including one sovereign wealth fund that has become a PerTrac client, and a lot of commercial banks in the region have started to invest their own and clients’ capital in hedge funds.”

“Dubai has been trying aggressively to bring fund providers into the region and they’ve had a degree of success, but they face the challenge that on a global level the competition to be a home to hedge funds is hotting up.”

“One trend we have seen is that a number of our Western and Asian clients are establishing a hub in Dubai, in many cases more a marketing office than anything else.”

In terms of alternative investment, the Middle East is set to become increasingly active in the global hedge fund industry, with the UAE and Qatar playing potentially dominant roles in the region, according to research conducted by Mirabaud. It forecasts that hedge funds will become increasingly attractive to the region’s ever-more sophisticated regional investors, especially given the high levels of excess liquidity in the Middle East.

In the research, Gilles Rollet, CEO of Mirabaud (Middle East) Limited, says: "While Middle East capital markets have not yet reached the same level of maturity, they are quickly moving in the right direction. In the UAE and Qatar, in particular, the markets and the level of regulatory oversight continue to achieve significant progress.”

Bahrain is a strong contender in this area and Dubai is also determined to establish a competent global hedge fund centre. "The authorities know it’s a booming industry and they want to capture flows that are leaving the region to invest in international hedge funds,” one industry expert explains. As such, the outlook for hedge funds and other alternative investment classes in the region is expanding.

Take Dubai for example. The Dubai International Financial Centre (DIFC) has put in place both the infrastructure and the regulatory framework to foster the growth of hedge funds. Private client investors from the GCC states are also becoming familiar with the value of hedge funds as a source of additional returns and downside protection in their portfolios. Investors from outside the Gulf region are increasingly looking for investment vehicles with healthy returns that are established in stable environments and experts have said that structured products based in the Gulf, particularly hedge funds, are the perfect example.

Clearly, there is an opportunity for international hedge fund managers to capitalise on the emerging interest in hedge funds in the Middle East – and for promoters of structured products, which are even more in demand. However, fund management needs to develop more fully, offering hedge fund products managed out of the region and not just those sold into the region. This process has begun in Dubai where new fund management companies are registering in the DIFC along with specialised administrators and other industry support groups.

Matthew Lamb, head of Middle East wholesale and institutional clients at GAM, says, "One of the key reasons to get a presence on the ground was that we could not only develop local business but service many of the global financial institutions that now have a presence there. When investing in GAM, our clients have an expectation of service we should deliver and having offices globally is key to delivering on that expectation.”

“Having a local presence not just in terms of distribution, but also from a fund management perspective, is certainly a key differentiator. When we talk to local firms and...
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In recent months, market gyrations have shaken hedge funds and investors throughout the world, and the Middle East has not been immune to increasing risk aversion among investors. Nevertheless, the region continues to see solid allocations because investors there have only recently considered seriously the role of alternatives (excluding property) in their portfolios, and even today allocations often remain below levels viewed as appropriate for optimum diversification.

As a result, over the past few years and accelerating in recent months, the Middle East and North Africa has become an increasingly important market for PerTrac Financial Solutions, as investors throughout the region increase their exposure to hedge funds. And if anything the market turbulence has increased demand for PerTrac’s flagship analytical platform because of the more urgent focus on conducting due diligence on managers.

A year ago, investors were principally focused on performance, and while risk was certainly a significant factor in their decisions, it was not the overriding imperative it has become now. In the wake of six weeks of volatile performance, however, the entire marketplace is concentrating on capital preservation.

In addition, a requirement specific to the region is driving PerTrac sales in the Middle East. One of the key distinguishing aspects of the Middle East investment market is the importance placed on compliance with Islam’s Shariah principles. The volume of investment in Shariah-compliant products including funds continues to grow, and the number of products available has increased dramatically over the past couple of years.

PerTrac’s products play an important role in the Shariah compliance process by allowing investors to conduct screening at the beginning of the investment process. By identifying funds that invest in areas deemed inadmissible by Islam such as tobacco, alcohol and gambling early in the fund selection process, investors can save precious due diligence resources for funds with the best chance of meeting their needs.

The ability to search for compliant products is reliant on database providers flagging up adherence to Shariah principles, and they in turn depend upon accurate information from funds. However, with capital scarce across the fund marketplace, hedge fund managers have become more accommodating in providing information, which is essential to appeal to Shariah-compliant investors.

In recent months PerTrac has continued to expand its business and client base in the Middle East, winning new customers in Dubai, Qatar, Bahrain, Lebanon, Abu Dhabi and Kuwait. Dubai has had some success in attracting fund providers, and a number of existing clients from North America, Europe and Asia have set up marketing and other operations there that use PerTrac products.

Interest has grown in Abu Dhabi from commercial banks that have started to invest their own and their clients’ capital in hedge funds, as well as from public and private entities. An important new market is sovereign wealth funds, several of which use the PerTrac Analytical Platform as they diversify their assets into alternative investments. In Bahrain, a long-established financial centre, PerTrac also has won business, most recently from wealth managers and banks.

PerTrac will continue to focus on the Middle East in the coming months as investors look to put cash to work in the markets again. With tools for manager screening, analysis, due diligence and portfolio management, PerTrac’s one-stop shop should continue to appeal to the burgeoning alternative investment market in the Middle East.
family offices, they appreciate that we have an in-depth understanding of the region and are often as eager to talk to us as we are to them."

"Globally we’re experiencing a period of unprecedented volatility and uncertainty. The fund management industry as a whole is experiencing outflows as a direct result of clients responding to the current market environment. We continue to believe there will be opportunities for growth in some key markets, and the Middle East is certainly one of those areas."

Recent regulatory moves have also created healthy financial environments suitable to the creation of hedge funds. Dubai’s creation of its Hedge Fund Code, Bahrain’s introduction of its Collective Investment Scheme Regulations and Qatar’s launch of its Qatar Financial Centre are some of the most prominent examples.

In the research paper, Mirbaud’s Rollet adds: “A hedge fund-friendly environment can be seen to emerge from a region with high levels of excess liquidity and strong degrees of professionalism among regulators and service providers. The Middle East is well known for its access to enormous amounts of excess liquidity due to the high price of oil. In the UAE and Qatar, we are now seeing professionalism from both regulators and service providers grow steadily. Both countries have governments that are committed to forging legal structures that allow for increasing financial sophistication in their respective financial districts. If current trends continue, these two countries will undoubtedly emerge as hedge fund centres, and given enough time, will stand on par with Singapore, Hong Kong and even London and New York.”

However, some experts believe that the current troubled era might have hampered the anticipated growth in the Middle East for facilitating hedge funds. A good alternative investment jurisdiction revolves around a healthy mix of low taxation, relaxed regulation, excellent infrastructure and available and skilled staff. While improvements have been made – sometimes at a very quick pace – the recent crisis may be hampering the previously estimated development.

The current state of the region’s financial and regulatory infrastructure is some way behind the developed markets. Nonetheless, change is constantly occurring. The commitment of states such as Qatar and the UAE is emphasised by the pace of change in building competitive financial markets. The UAE, in particular, has been active in consulting with hedge fund firms and their service providers with the aim of formulating a balanced regulatory regime.

Moreover, it is becoming easier for hedge funds to establish themselves in the DIFC and trade on the DIFX, with the legal regime governing such operations in a refinement stage.

Hedge fund investment in the Middle East offers unique opportunities, but the region’s greatest challenge is likely to be in facilitating and administrating the growth potential. To be on a competitive front, the countries in the region must focus on lowering trade and investment barriers and improving infrastructure. Most important of all is the focus they must put on educating the next generation to handle the wealth that is now being produced.

The Middle East offers strong potential returns with low correlations to both developed and other emerging markets and the importance of presence of investment teams on the ground in the region cannot be underestimated. The Middle East is and will continue to be a major attraction for the global players catering to the hedge fund industry. Opportunity – even in these troubled times – seems to be knocking."