Crossbow Partners
Experience & Discipline

New York Trip Report

Focus on Hedge Funds Investments

Feb 4th to Feb 7th, 2019

Executive Summary

On a global level, fund of hedge funds assets under management have been dropping since the financial crisis in 2008 even as hedge fund assets have surpassed pre-GFC levels

Fees, the departure of private investors from the hedge fund space and the preference of institutions for customizable mandates have been some of the reasons for the decline in assets under management

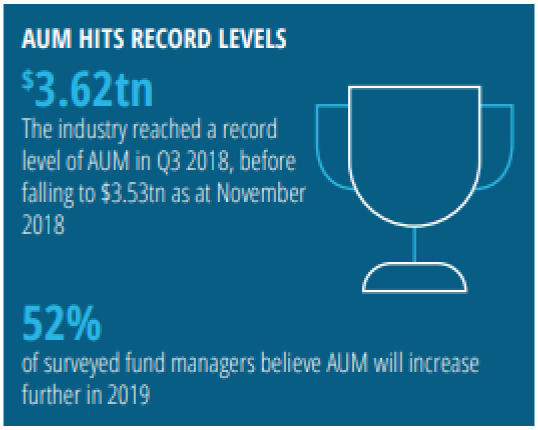
Nonetheless, some institutional investors remain invested because of the ease of access from an operational and administrative perspective

These clients have a preference for strategy specific, specialized fund of hedge funds with proven managers

Crossbow's fund of hedge funds research builds on the expertise of Primores who has been part of Crossbow Partners since 2011

Focus on Fund of Hedge Funds Investments

Fund of hedge funds were the investment vehicle of choice prior to the global financial crisis (GFC). Since then, the assets under management in fund of hedge funds have declined, while the assets in hedge funds have grown to new highs.



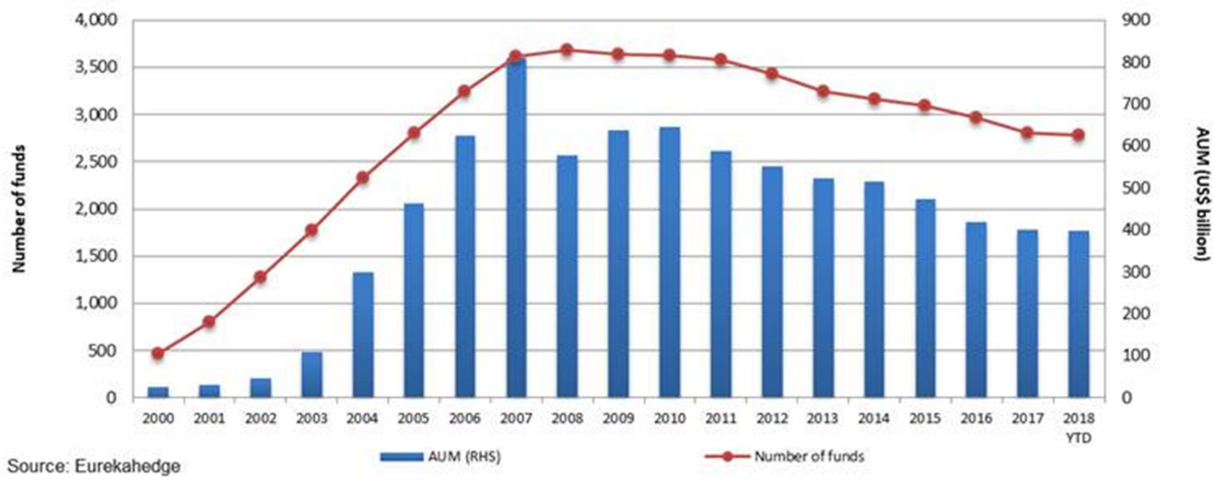
Source: 2019 Prequin Global Hedge Fund Report

But fund of hedge funds have been declared dead many times before and the fund of hedge fund industry has had to evolve quite significantly over time to survive.

Post-GFC decline in assets under management

The fund of hedge funds' investor base changed after the global financial crisis. Assets from wealth management platforms dropped away and in Europe many of the smaller to mid-size institutional investors redeemed their hedge fund investments. Larger institutions who had the size to support in-house teams or looked for specific exposures remained invested, but shifted their investments from fund of hedge funds to dedicated mandates or even in-house. In addition, we have seen multi-manager hedge funds gain traction.

Figure 1: Industry growth over the years



Fund of Hedge Fund Industry
Source: Eureka Hedge Global Hedge Fund Infographic June 2018

In Switzerland additional pressure has come from the requirement for pension funds to publish Total Expense Ratios (TER) by asset class. This requirement has raised the bar for Swiss pension funds to invest in fund of hedge funds.

How has the fund of hedge funds industry evolved?

The most obvious development is the consolidation within the fund of hedge funds industry and the specialisation among the providers. Several high profile mergers have created a range of large fund of hedge fund houses with multiple offerings.

Fig. 25: Notable Fund of Hedge Funds Managers Involved in M&A Deals, 2015 - 2017 YTD (As at June 2017)

Date	Firm	Type	Firm	New Entity
Q3 2015	Titan Advisors ($4.1bn), US	**Acquired**	Saguenay Strathmore ($1.7bn), UK	Titan Advisors ($4.7bn as at 30 June 2017)
Q4 2015	Investcorp ($4.5bn), US	**Acquired**	SSARIS ($712mn), US	InvestCorp ($1.5bn as at 30 June 2016)
Q1 2016	Aberdeen Asset Management ($3.0bn), UK	**Acquired**	Arden Asset Management ($11.0bn), US	Aberdeen Standard Investments ($10.1bn as at 30 June 2017)
Q2 2016	EnTrust Capital ($11.4bn), US	**Merged with**	Permal Group ($18.4bn), US	EnTrustPermal ($24.4bn as at 30 June 2017)
Q2 2017	PAAMCO ($10.1bn), US	**Merged with**	KKR Prisma ($10.3bn), US	PAAMCO Prisma ($16.9bn as at 30 June 2017)*

**PAAMCO Prisma has total assets under management and advisement of $32.4bn as at June 2017*

Source: Preqin Hedge Fund Online

Source: 2017 Prequin Consolidation in the Fund of Hedge Funds Industry Report

Mergers and acquisitions (M&A) within the fund of hedge funds industry has allowed synergistic gains and provided rapid expansion or diversification of merging or acquiring businesses. Large providers maintain a broader offering.

The second development is the specialization. Many of the multi-strategy FoHF from smaller providers have disappeared, been converted to bespoke mandates or shifted to multi-manager hedge funds. There is a specialisation in the offering various FoHF managers provide. Each group caters to a specific need of an investor base. We identify three groups of providers:

- Large blue chip FoHF providers: These providers have recognisable brand names which makes them appealing to wealth management platforms. They have an institutional setup and their size gives them access to some of the large launches. On the other hand, their size restricts their investment universe to larger hedge funds.

- Established strategy-specific FoHF managers: This category is typically a boutique manager with a long established track record within the industry. They are specialised in a specific strategy and have a large industry network and established contacts to many hedge funds.

- New launches: The few new launches within the FoHF industry have launched with a clear differentiating element. This can be the use of co-investments, the focus on niche strategies or on managers outside of the global financial centers.

Finally, to reduce costs, fund of hedge funds have negotiated fees or made co-investments. This can benefit smaller hedge fund investors, or investors without the expertise to make co-investments on their own.

What were the key takeaways from our meetings?

Our recent New York trip had a strong focus on fund of hedge funds. While the landscape remains very competitive for FoHF, one of the key takeaways was the expectation of many FoHF providers that they have put the worst behind them. Specialisation, as mentioned, but also the market outlook and innovation are reasons for their more positive outlook on the FoHF industry.

Other observations are:

- Co-investments are a way some of the FoHF are looking to reduce costs and add value. These are used by a variety of hedge fund strategies, either as a best-ideas portfolio, particular carve-outs or special situations portfolios.

- Many of the smaller and medium-sized FoHF managers had to become more flexible to survive by providing customized mandates for larger clients. Starting from 20 mn allocations, the FoHF offers their institutional clients tailor made solutions in regards with risk/return targets, investment strategies, liquidity constrains, portfolios targets and reporting.

- FoHF with a clear investment profile and focus on costs have been able to deliver good performance with respect to the overall hedge fund industry.

Could fund of hedge funds be poised for a comeback?

Many medium to larger investors have kept hedge funds as part of their strategic asset allocation. But we expect overall interest in hedge funds to pick up as all investors become more concerned about the late cycle economy and the risk of a market correction.

The increased interest for alternative solutions could result in a comeback for fund of hedge funds. We believe that mandates have many advantages for medium and larger investors, but we expect interest in hedge funds to pick up for smaller investment sizes or clients looking for an operationally and administratively easy access to a diversified hedge fund product.

Crossbow covers the entire universe of FoHF, with data available on more than 300 FoHF and regular contacts with interesting providers. Based on the research, Crossbow has an approved list of funds of hedge funds available to provide clients with a sophisticated solutions, either as pure fund of hedge fund portfolio or as core-satellite portfolio with a FoHF core and single hedge fund satellite.