Marketing To Sophisticated Investors column
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Can Investors Spot Your Hedge Fund Amidst The Growing Competition?

Tip 10: Preparing For Post-Pandemic Asset Raising

Welcome to the tenth of a series of articles offering insights and tips to prepare money management firms for improving their abilities to out-market competitors and attract assets from sophisticated investors in the coming post-pandemic, recessionary world.

The press recently reported rising interest by family office investors in investing with hedge funds. A boost in allocations made by this class of sophisticated investor is expected to be seen this year.

It was further reported that the number of new hedge fund launches in the third quarter of 2020 surpassed the estimated liquidations of that quarter. The last time this occurred was in the second quarter of 2018. More hedge fund firms mean more choice for investors, and, obviously, greater competition among money management firm owners.

As the new year gets underway, with the undercurrent of the pandemic still raging and a global recession that will take years to fade away, sophisticated investors have their eyes out for investment managers who have new perspectives to offer. In particular, there is interest in how hedge fund managers are assembling and managing their basket of holdings.

Spice, not core

Hedge funds are not core asset allocations. They are not employed by sophisticated investors to be the core allocation to, say, the stock or bond markets. Instead, they are more like the spice added into the total portfolio.

From the investor's perspective there are a lot of 'spices' to choose from. It can be hard to tell many hedge funds apart, and to have a good sense of what impact a particular one might have if added to the total portfolio of a family office, endowment, foundation, institutional plan sponsor or wealth management firm.

How are you making it easy for prospective investors to spot, and favor you, in a crowd of your competitors? There are a range of steps your hedge fund should be taking. Here are three of them.

Track Record

If your hedge fund is not a recent launch, you have a way for investors to spot your firm that the start-ups do not. Make sure you are uploading your performance data to the appropriate data bases that track your peers, and see that this is done with regularity. Too often I come across hedge fund boutique firm owners with multi-year track records who, when I asked about this, told me they never got around to uploading their numbers to such online data bases. Your numbers — if they are good enough — might be the initial way you stand out from your competition.

If you are a relatively recent start-up, lacking numbers to have what would be considered to be a track record, having a detailed explanation about your newly implemented investment methodology is your only means of standing out from the competition. This specific information about *how* a portfolio manager invests is always of highest importance in due diligence evaluations. Over the decades, my financial communications and sales marketing consulting firm has found that among sophisticated investors performance ranks third in importance, risk management second and investment process first.

Investment Portfolio Characteristics

Show me three money managers' strategies within any asset class and I can probably show you three portfolios that deliver different portfolio exposure characteristics for investors. This could mean differences in risk/return, portfolio concentration, sector weighting, portfolio turnover or many other such factors. These distinctions can make a big difference to a prospective hedge fund investor.

Make it easy for prospects to learn about your characteristics in your early communications with them. Reduce the amount of time hedge fund investors have to put into gleaning this information about your strategy, and demonstrate how your product can be a fit for them, meeting one or more needs they have for their total portfolio exposure. The more effectively you accomplish these tasks with your communications and sales marketing — demonstrating what role or roles your strategy could play with an investor's total portfolio — the more prospective investors will potentially favor you, because they will have the answer to a key due diligence question, and appreciate you took a step to make their due diligence effort take less time.

Intellectual Acumen

In my firm's experience, once sophisticated investors have decided a hedge fund's performance is within the ballpark of acceptance, assuming track record length and AUM size are not issues, the majority of the rest of their front-office related due diligence focus, as I mentioned above, is on investment process.

They look to understand and buy into how the portfolio manager thinks and runs his or her strategy implementation. From this they will judge whether they believe past performance was from luck or skill. In other words, was there alpha?

As Frumerman & Nemeth reported last quarter (https://bit.ly/2H1l6xA), a survey it ran of family office investors revealed they believe that the current global recession will continue, post-global vaccine distribution, a minimum of three years to a maximum of five years. Sophisticated investors understand that macro-economic events for a number of years will result in non-company specific risk factors whipsawing the net asset value of holdings, be they publicly traded or privately held. Such investors will identify an outstanding hedge fund when they read a well-developed investment methodology that includes detail on strategy implementation to maneuver through what are likely to be rapidly changing market conditions and resulting shifts in valuations (and risk exposures) of holdings in a manager's portfolio. This means a hedge fund manager's intellectual acumen will be even more sought out and placed under even more scrutiny.

Unfortunately, only a small percentage of hedge funds communicate their detailed thinking about investment process and general strategy implementation, let alone educate prospects about carrying out a strategy through changing market conditions. Most, instead, only provide a few bullet points of generic phrases, which deliver only generalized statements seen in countless pitchbooks from countless competitors. Those pitchbook communications are inadequate. They are 'lost in the crowd' communications.

Once sophisticated investors in their due diligence screenings turn to beyond-the-numbers factors, the key perceived competitive edge they look for in a hedge fund comes down to *how* the portfolio manager thinks. The portfolio manager's investing insights, approach and process comprise the key 'spice' for pursuing and, hopefully, generating alpha.

Making efforts to develop and communicate, through a variety of outlets, the opinions that shape the detail of the investment strategy execution led by your hedge fund manager is what can make your 'spice' the must have ingredient (product) an investment committee decides it needs to add to the portfolio of its family office, endowment, foundation, retirement plan, or wealth management firm who your money management firm seeks to convert from prospect to investor.

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About the author

Bruce Frumerman is CEO of Frumerman & Nemeth Inc., a 33-year-old financial communications and sales marketing consultancy that helps financial services firms create brand identities for their organizations and develop and implement effective new marketing strategies and programs. Frumerman & Nemeth's work has helped money management firm clients attract over $7 billion in new assets, yet they are *not* third-party marketers.

Frumerman & Nemeth is internationally recognized for its work in crafting for clients the beyond-the-numbers story of *how they invest* — content that investment committees actually discuss, debate and vote on behind closed doors when considering firms on a short list for potential investment. Importantly, this is required due diligence content that cannot be communicated in pitchbook format.

Frumerman & Nemeth's work also includes providing strategic consulting on product and strategy-specific branding, crafting the required strategy-specific content detail and designing and producing the marketing tools needed to make it through the two-month to two-year institutional selling cycle. Clients also employ Frumerman & Nemeth to help promote the intellectual acumen of management — helping them get speaking opportunities, write and give speeches as panelists or stand-alone speakers at industry conferences, and through media relations marketing services.

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