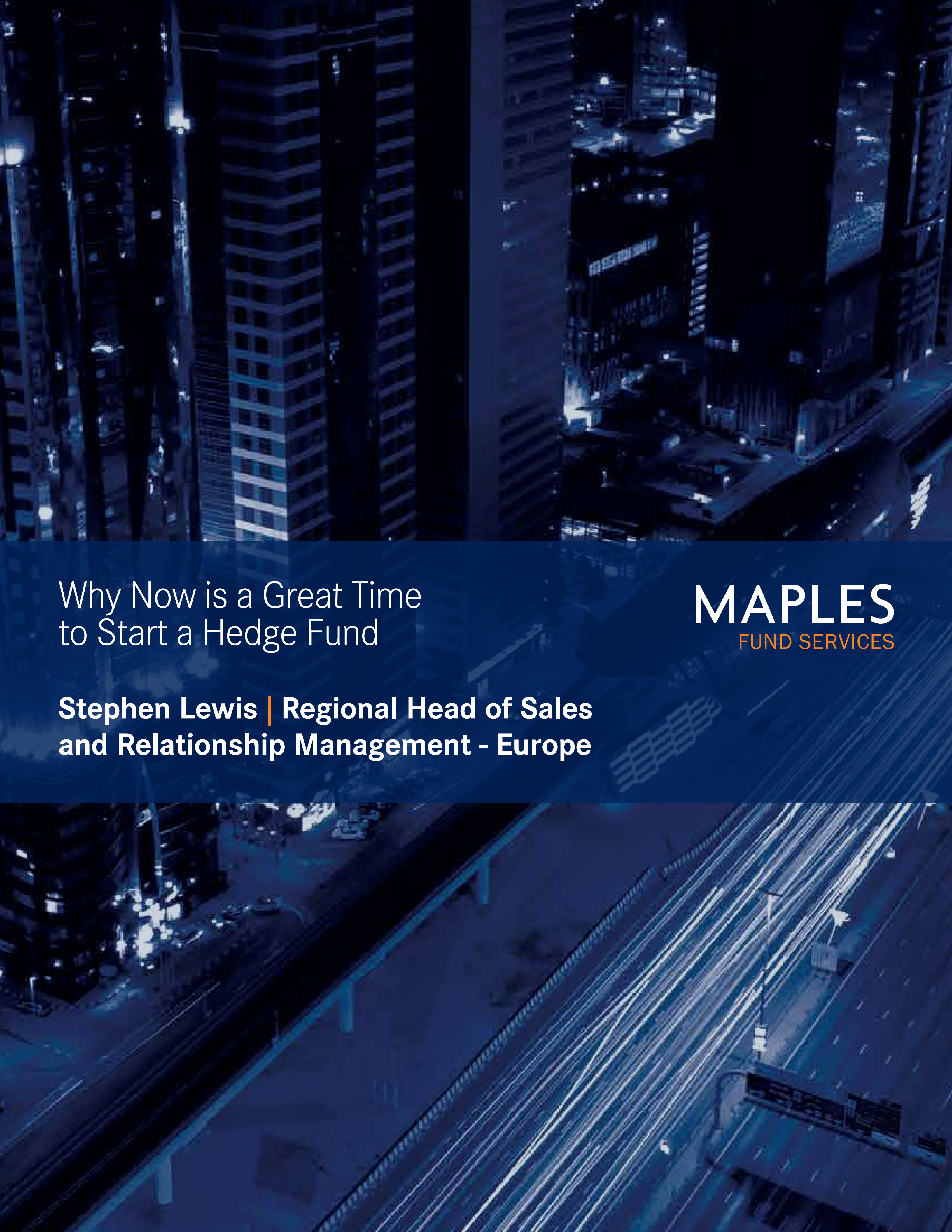

Why Now is a Great Time to Start a Hedge Fund

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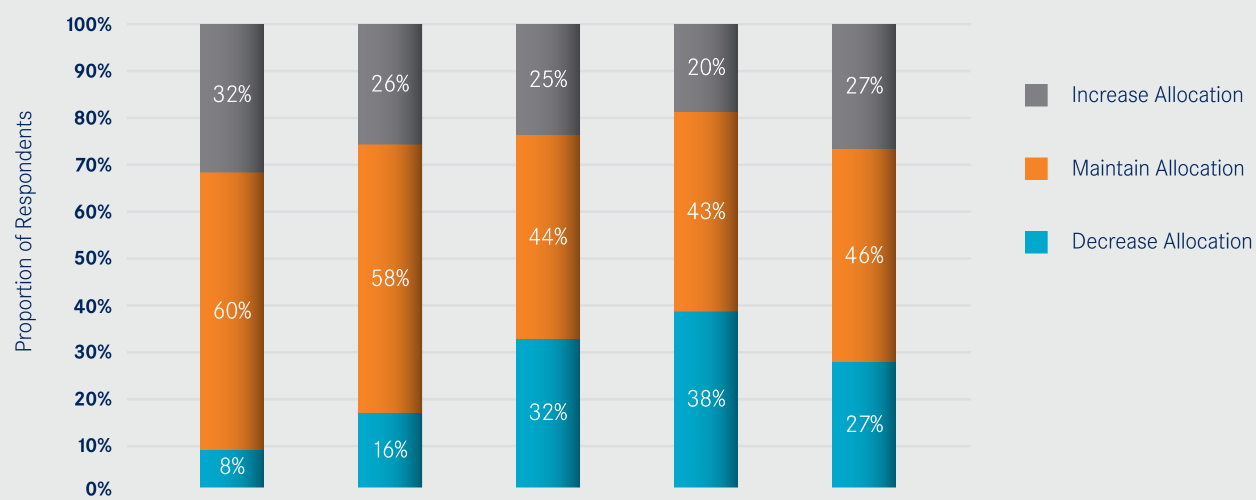
Though hedge funds have struggled in recent years due to market conditions that have stifled performance relative to other investment vehicles, there has been a steady stream of entrepreneurial managers who are confident about opportunities in the space and are eager to set up their own shops. Further echoing this optimism, industry research predicts that hedge funds will return to favour with institutional investors expected to increase their allocations in the coming year. While launching and growing a hedge fund can be an arduous task, there are a number of resources new managers can leverage and steps they can take to position themselves for success in this highly competitive market.

Increasing Allocations to Hedge Funds

Alongside the more established hedge fund managers, new launch and emerging managers are working hard to differentiate themselves in a crowded market. They are offering more choice to allocators by examining new investment opportunities in emerging geographic markets such as India, Vietnam and Korea, or in the rapidly developing fintech sector which encompasses advancements such as artificial intelligence, robotics and blockchain technology. These managers are also focused on making their funds more attractive through innovative fee schemes which have moved beyond the standard '2 and 20' approach of years past.

Investors have taken notice of these efforts with Preqin's 2018 Global Hedge Fund Report noting that 46% of hedge fund investors plan to maintain their allocations in 2018 while 27% plan to increase them – the highest proportion that plan to do so since December 2014 and an acknowledgment of the opportunity hedge funds provide for diversification and downside risk protection.

Preqin: Investors' Intentions for Hedge Fund Allocations
Over the Next 12 Months (2013-2017)

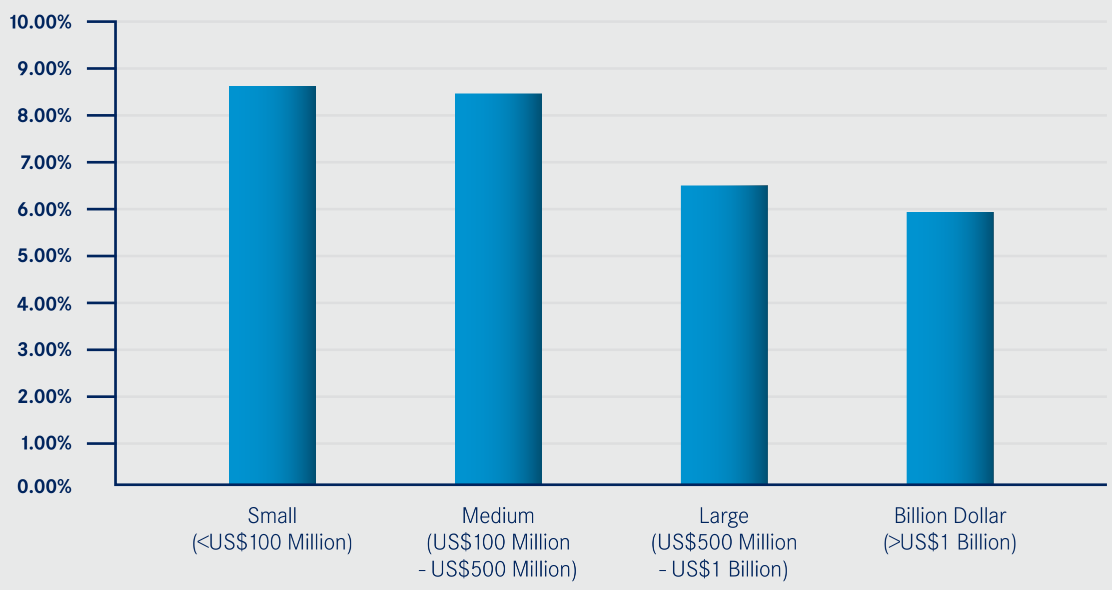


Often though, there are a number of other factors – such as the size of fund and the manager's general approach – that can support attracting and retaining capital. While larger funds can tout an established track record, more recognised talent and the infrastructure to support investor demands, the ways in which they can differentiate themselves from the competition can be quite limited. This is where opportunity lies for emerging managers to gain traction in this space.

Smaller Funds Outperform

Given the inherent nimbleness of smaller funds, they tend to have a reputation for delivering better performance. Quantitative research supports this opinion as well with Eurekahedge's Indices illustrating that smaller-sized funds have posted the best gains in 2017 with small hedge funds (under US$100 million) touting a 8.61% return and medium hedge funds (between US$100 million and US$500 million) realising a 8.43% return. Comparatively, large hedge funds (between US$500 million and US$1 billion) and funds with US$1 billion or more experienced gains of just 6.43% and 5.88% respectively over the same period.

Eurekahedge Indices: 2017 Hedge Fund Returns



Flexibility to Capitalise on Niche Opportunities

In many cases, larger funds are inhibited by their size from an investment standpoint and may struggle to capitalise on new opportunities or may face more hurdles than smaller managers when it comes to unwinding positions. Smaller start-up managers, on the other hand, generally excel in these areas where more established managers may struggle. They are highly motivated and often have their own 'skin in the game' and therefore greater incentives to deliver performance. They also have a greater degree of flexibility and often favour and benefit from smaller or more niche investment opportunities that may not attract the attention of their larger peers.

Now is a Great Time, But…

With smaller hedge funds steadily realising strong returns that are outpacing those of their larger counterparts, there is now a prime opportunity for new managers to enter the space. Despite the healthy growth of the market and positive investor sentiment, there will still be stiff competition and emerging managers will need to find ways to differentiate themselves beyond performance alone to maximise their chances for success. As such, there are a number of factors a manager must consider when weighing the decision to launch a fund.

Be Prepared for Operational Due Diligence

First and foremost, a manager must acknowledge that investors will undertake thorough due diligence given that they may not have an established track record and their strategies may be untested through market cycles. The due diligence process is becoming more sophisticated and has moved beyond an assessment of a firm's ability to perform against competitive fees. There will also be a sharp focus on a fund's operational processes, its use of technology and the credibility of its service providers. The willingness to invest will rest on how responsive the manager is to its investors and if there is sufficient reporting flexibility to fit in with that specific investor's existing approach. The importance of due diligence has been acknowledged by industry bodies, such as the Alternative Investment Management Association ("**AIMA**"), who have published comprehensive due diligence questionnaire templates for use by fund administrators and prime brokers in order to streamline the process.

Consider Platform Solutions

Managers historically have been most adept when it comes to investing but often struggle when it comes to the business of building and running a hedge fund. Recognising these challenges, many new managers have turned to specialised service providers who have the resources and the scale necessary to more effectively support these initiatives.

While there are a number of ways to frame the relationship between a manager and service provider, platform solutions have proven to be quite advantageous, for emerging managers in particular. These smaller funds often struggle to compete with the robust institutional-grade infrastructure the larger more established players boast. This, however, is a critical component of being able to meet the increasingly sophisticated demands of both investors and regulators who are demanding greater transparency and operational efficiency. These 'plug and play' platforms are cost effective and offer speed to market while ensuring that all of the factors that go into launching a fund, including the infrastructure, are in place and that the process for selecting the key service providers is as efficient as possible.

Certainly, there can be a trade-off between absolute flexibility and cost and one platform may not necessarily be suited to some strategies that require bespoke solutions. Regardless, there is a strong case for platforms, particularly for managers of a certain size who need scale.

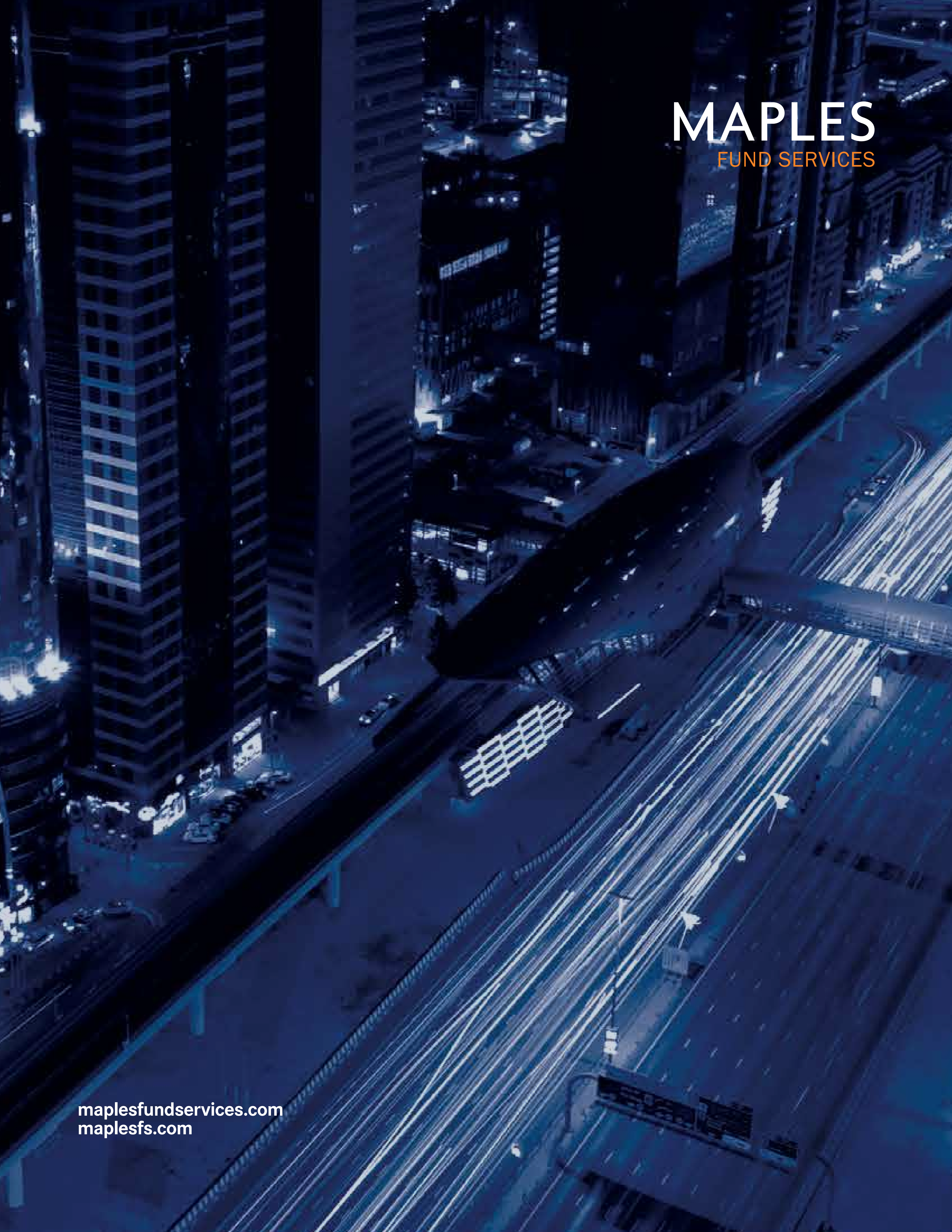
Choose the Right Service Providers

Choosing the right service providers via a platform solution or standalone engagements, however, is no small task and is a decision that should be weighed carefully as they can be an integral part of determining a fund's success. A good service provider will act as an extension of a fund's own in-house team and have an acute understanding and appreciation of the fund's specific nuances and needs. This allows a service provider to absorb as many operational pain points as possible so that the fund manager can focus on his core competencies and singular goal of generating alpha for investors. Furthermore, it is important for service providers to recognise the importance of long-term partnership and maintain a commitment to supporting a fund not only in the launch and post-launch phase, but through its entire life cycle, and address its needs as it evolves. Finally, engaging with reputable service providers adds an important layer of independence and credibility which can be a key selling point for investors.

Given current market dynamics, the outlook for hedge funds remains promising but competition will still remain. Managers who can deliver the unique combination of innovative and intelligent strategies as well as a flexible yet robust operational infrastructure will be primed for success.

About the Author

Steve Lewis is the Regional Head of Sales and Relationship Management – Europe for Maples Fund Services, based in London. He is responsible for expanding the fund administration and middle-office businesses across the firm's European offices. Steve joined Maples Fund Services from State Street, where he was vice president for Offshore and Alternative Investments, focusing on clients with hedge, private equity or property funds in multiple offshore domiciles. He has worked in a variety of sales, operational and product roles in custody, fund administration and related services at Investors Bank & Trust, ABN AMRO, Deutsche Bank and The Bank of New York.



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