

FINANCIAL NEWS

Funds of Hedge Funds Fight Their Corner

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Consultants have been gradually disintermediating funds-of-hedge-funds managers since the financial crisis. Institutional investors are increasingly choosing to bypass funds of funds and the extra layer of fees they bring, and investing directly in hedge funds, turning to an investment consultant for advice on which to choose.

Funds of funds have seen net outflows for the past four years, according to data providers BarclayHedge and Hedge Fund Research. The number of funds of funds decreased from 2,462 at the end of 2007 to 2,003 at the end of last year, said HFR.

But they are fighting back. A partner at a London fund-of-funds manager said: “Consultants kill the industry. You don’t get incubation of new managers, they merely play musical chairs among the big names.”

Consultants do not invest alongside their clients like funds-of-funds managers do and, as a result, they are less incentivised to pick managers in the top quartile of performance.

Funds-of-funds managers and specialist consultants said the large mainstream consultants are more inclined to focus on mitigating downside risk, picking “safe”, household names that will not get them fired if something goes wrong.

There is also the question of experience. The founder of a multibillion fund-of-funds manager said: “The best-resourced investors in hedge funds globally are the large funds-of-funds groups. They have been investing in and monitoring hedge funds for over 20 years. Consultants have no track record.”

Specialist consultants such as Aksia have clients that are invested in over 300 managers. Founder Jim Vos has over 25 years of experience in hedge funds and research, and set up and ran Credit Suisse’s \$8bn fund-of-hedge-funds group.

A focus on identifying emerging managers is one way funds of funds are trying to differentiate themselves and prevent consultants from gaining ground.

Research from [PerTrac](#), a data provider, has found that smaller, younger managers tend to outperform. Late last year, the fund-of-funds arm of HSBC Private Bank launched the HSBC Next Generation fund, aimed at unearthing the star managers of the future.

But funds of funds must prove they earn their fees. One fund-of-funds founder said: “The biggest level of competition with consultants is fees, particularly in a low-return environment.”

Cadogan Management, a US fund-of-funds firm that once managed \$5.5bn, shut down last year, warning that funds-of-hedge-funds managers were facing a real challenge as buyers become more sophisticated. It said: "Funds of hedge funds and consultants must justify the fees they charge."