



Emerging Managers Forum highlights



Introduction

Current industry trends and challenges were discussed during a KPMG held Emerging Managers Event. This multi-paneled program was attended by more than 175 participants from the Hedge Fund Industry.

Three separate panels were presented during the event, which featured more than 12 industry experts, with backgrounds in investing, prime brokerage, legal, tax, accounting and administration.

This document provides some of the most interesting and compelling observations discussed during the forum.

Panel 1 – Designing an infrastructure for today's emerging manager

On the current outlook for hedge funds

For hedge fund managers, it's an interesting time. While some barriers to entry continue to grow, technology advancements have kept effectively constrained many costs. Other infrastructure costs, depending on the complexity of the investment strategy, are now more manageable. The emergence of outsourcing and co-sourcing strategies has allowed a new blueprint for building out the infrastructure of a firm. If performance can be sustained, the outlook for success is strong.

In particular, for long/short equity hedge funds, the costs to operate have decreased dramatically. Access to new technologies and multiple choices of vendors

have made it more efficient to manage a hedge fund in today's environment. In other strategies, technology companies and service providers continue to make dramatic improvements for the industry. The ability for firms to leverage those advances and thus scale their business creates tremendous opportunities as hedge funds expand their product offerings into private debt, hybrid funds, private equity offerings etc.

As market volatility rises and the search for alpha leads to new product development, future prospects are bright.

On emerging managers' needs at the outset

From a technology standpoint, the conversation has changed from a propensity to build infrastructure needs internally. Where previously, off the shelf products had limited functionality, today's technology products have evolved, and there are often multiple viable options to address a manager's challenges. Whether you lease the technology or whether you outsource the function, the mindset of today's Emerging Managers has changed. Traditionally, the cost of human capital alone was a huge outlay. Being able to lease or outsource your trading, your operations and other functions alleviate a lot of the pressure and time of overseeing and managing multiple

processes. If you can maintain a lean but effective organizational structure at the outset, it will allow your firm to grow organically as assets under management increase.

There are two technology areas to focus on at the outset. One is the "baseline infrastructure" - the cloud, servers, hardware email and basic communication protocols. The other area concentrates on "applications" - the software and processes you are going to maintain. They may include execution management, P/L systems, trade reconciliation, risk management, regulatory and treasury functionality.

On functions administrators provide

When you partner with an administrator, you should consider their entire offering. Administrators have evolved over recent years to provide a multitude of services beyond NAV calculation. These might include risk reporting, tax reporting, financial statement preparation, regulatory filings, and investor reporting.

Ultimately, it's about data, how it's organized, shared, and optimized to more effectively provide information to many constituents - investors, prime brokers providing financing, the investment team, regulators, etc. If you partner with the right Administrator, you can address these needs, yet still get the transparency you need.



On key infrastructure decisions

Managing partners and portfolio managers of new firms should begin with a detailed understanding of the needs of what the investment side of the organization chart and the processes it will entail. At that point, partner with a Chief Operating Officer or other noninvestment

side service providers to craft the infrastructural support needed to support the investment activities. Determining how to allocate the budget at the outset is time well spent.

On outsourcing

While you can make a case for outsourcing a majority of the functions, a strategic evaluation of these decisions in the context of a three-year business plan is advisable. Creating a variable cost model to provide flexibility while iterating to the next growth stage of the business has proven to provide essential “optionality” to owners.

There are numerous cost-effective options available today from third parties. But one needs to be strategic; blindly outsourcing can also be dangerous. Weighing the need to maintain supervisory oversight with the need to focus on the investment function is critical.

Business plans should have a reasonable time trajectory and respond to core questions. What is the investment strategy? Is the investment strategy apt to evolve into multiple products? What is the global footprint? What are the financial instruments to be utilized? Is there enough separate funding at the management company to sustain the organization over a three-year time frame as well as increases and decreases in assets under management? What is the technology investment planned? How does one attract and retain talent? These are just some of the basic questions a good business plan should address.

On the evolution of technology

Developments in technology over the last few years have compelled many to reconsider the business model. Even established firms in the industry have begun to look at the large infrastructures that have been built in house. Why aren't we leveraging technologies available in the industry? What do we need to build

ourselves? Are their partners we can work with to provide this leverage yet still be able to maintain the data transparency we require? Building separate infrastructures for the thousands of different investment firms is no longer a viable industry strategy. It is time for the industry to scale.

**Panel 2 – Surrounding your business
with a powerful ecosystem**

On governance

Governance is often a confusing challenge for managers in this space. Many portfolio managers originate from traditional trading and investment backgrounds, often in large organizations where the regulatory processes were embedded in broader processes of those organizations. So, often, when they start their own firms they are not as familiar with how best to implement the detailed compliance systems that may be necessary. Working with your COO, your

investors and your service providers can facilitate the guidance for a sound framework. It's critical to educate the managers about what governance is and the processes that have to be built into the business.

It's ultimately about building a culture of compliance and the tone for that culture comes from the top of the organization. Investors also only want to invest in funds that have proper governance so the importance and focus should not be underestimated.

On outsourcing and vendor selection

Although the outsourced CFO model has become a more common and accepted solution for Hedge Funds, there is still skepticism by some that this is an effective approach. If you do choose this model, be certain to review with the outsourced firm the specific functions that will cover and for those they do not take responsibility. Ultimately, the responsibility for the finance function and its accuracy etc lie with the CEO and the Hedge Fund organization.

Often peers are a great source and sounding board for determining the right vendors for your firm. But it is important to recognize that not all service providers are often the best fit for every situation. Often functionality priorities differ between hedge funds and that often directs one to different solutions and different capabilities. Moreover, since there is often daily communication between firms and their service providers, culture and personality are also critical success components. Choose your service providers carefully and strategically. Get a good understanding as to their flexibility as your needs will expand as your business grows.

Often your professional advisors such as your auditors, tax advisors and attorneys are a tremendous independent source of which vendors in the industry ecosystem are effective. These advisors are active advising hundreds of clients active in the industry and have a good view of the strengths and weaknesses of these firms. They can assess which solutions work best for firms with your strategies. In that light, when choosing your advisors, take time to choose those who are not only technically proficient in the industry, leverage technology in their own businesses and play an active role in the ecosystem of the industry.

Often today's COO is often best compared to a supply chain manager. Their ability to oversee functionality such as technology, treasury, finance, regulatory, tax, legal, etc., without inside teams of people to support them – requires a multidimensional experienced professional. Yet, the industry continues to move in this direction.

On self-awareness

It is critical to surround yourself with the right people and the right service providers in the industry ecosystem. Managers who are able to focus on what they do best, yet are sufficiently self-aware to understand their shortcomings, are often the most successful.

Successful portfolio managers don't let themselves get consumed by the non-investment aspects of the business, yet are aware of the major issues involved. They locate the experienced infrastructure partners and allow them to oversee these processes. Continue oversight from the top but hire well and trust those professionals to execute.

Panel 3 – Investors: Who are they, where are they? A balanced partnership!

On raising capital

Building a successful investment performance track record over a period of a couple of years is at the outset one of the most critical steps. Impressive sustainable performance will attract interest. This often requires focus and perseverance in the early years. Having three years of capital to sustain your management company will generally provide enough time to attract capital and supplement the cash flow requirements of the business.

Making a strong impression when having initial meetings with investors is fundamental to success. Often a sound business plan along with a well-designed investment thesis is the first hurdle investors will look to bridge. Investors also have specific needs and how those can be synthesized by the PM and addressed in customizable solutions go a long way in creating a partnership with the investor. Be aware of the needs and the current portfolio of the investor before organizing a meeting. Investors want to know that firms have done their homework.

On start ups

We've embarked on Hedge Fund Generation 2.0. Portfolio managers are leaving existing hedge funds looking to begin their own firms and build their own legacies. These departures are attributed to many reasons ranging from aspirational ones, out of the money incentive fee situations at legacy firms or lack of legacy firm succession planning.

Often, the first calls to investors are often those where managers had developed relationships at the prior firms. In those cases, it is important to assure clarity on what the previous employment and departure agreements allow. These often include non-solicitation, non-competition, non-disparagement and other similar matters. Understanding of the investors' allocation strategies is also important as there may only be limited capacity for a particular strategy, which may overlap with the prior employer. A capital raising strategy from many different options is critical to success.

On seeding

Seeding activity has begun to increase. However, seeders also understand that it's a difficult capital-raising environment. As a result, they are very selective while also seeking to extract attractive terms for themselves in the process. Assessing the need to jump-start the business needs to be weighed with the long-term implications of sacrificing too much value from the business. Seeders also need to be evaluated on their reputation for helping to grow the business through other capital introductions, talent acquisition, organizational process knowledge and capital permanence.

At the same time, family offices, sovereign wealth funds, foundations and endowments and investors from Asia and Europe are all looking to deploy capital in the Alternative Investment arena. Their desire to diversify is balanced by their desire for investment firms with pedigree and reputation. Maintaining a sound culture for the investment firm along with growing the brand are continual market development activities for the Investor Relations groups at these firms.

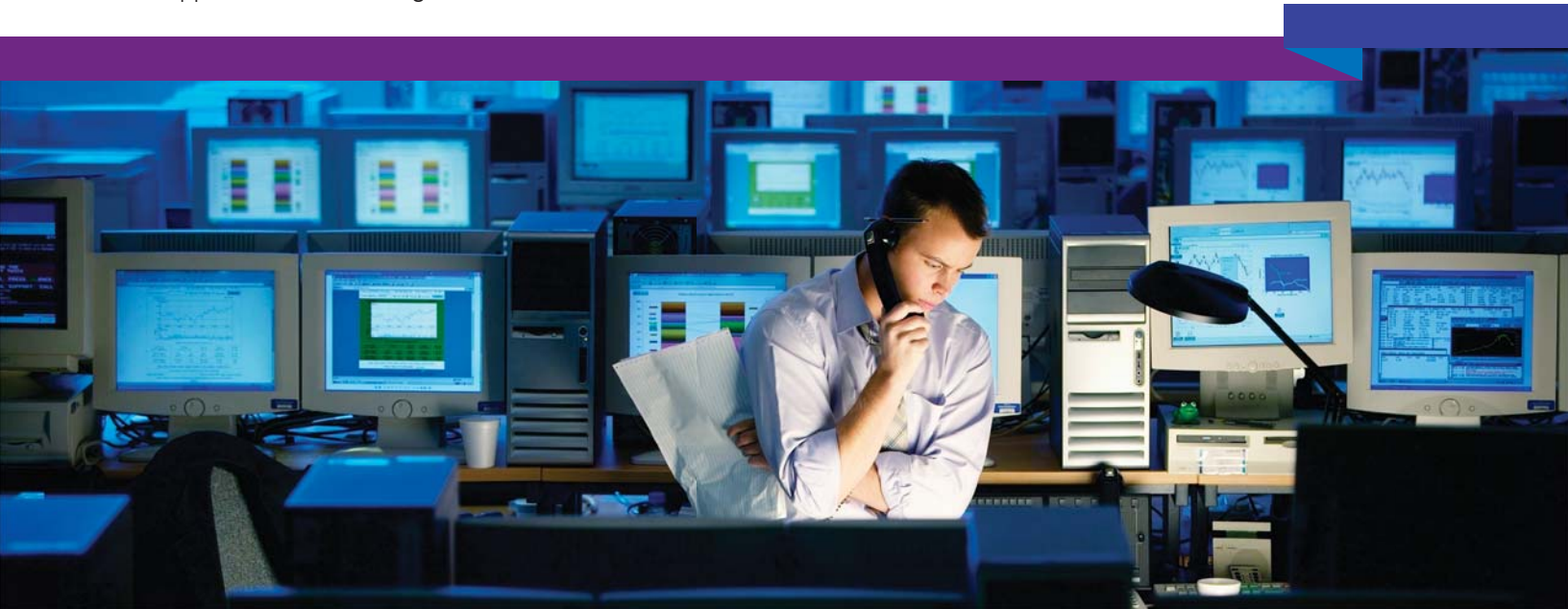
On differentiation

"Best practices" are often utilized as a guide and a blueprint for building a successful hedge fund business. What ultimately is important though is to determine what's critical for your organization. Understand what differentiates your firm from others in similar strategies and be able to articulate that consistently. Have a vision and act on that vision.

For example, emerging managers are often a great source for "best ideas," which in turn could lead to popular co-investing strategies and thus scale those ideas. So, being transparent and providing good content around the portfolio often will allow new opportunities to emerge.

On building the team, the business

To be successful, firms need great cultures and leadership to grow. A sound investment thesis and a well thought out business plan will ultimately attract talented professionals as well as investors. Choose your infrastructure partners strategically and maintain a lean (variable cost) yet effective organization. Opportunities will continue to present themselves in the Alternative Investment arena.





Contact us

For more information about KPMG's Emerging Manager capabilities please contact:



Seth Blackman
Partner, Asset Management
Practice Leader – San Francisco
T: 415-490-4506
E: sblackman@kpmg.com



Melanie Gaeta
Associate Director, Client
Relationship – Los Angeles
and San Francisco
T: 415-963-7997
E: mgaeta@kpmg.com



Angela Ty
Partner, Asset Management –
San Francisco
T: 415-490-4530
E: angelaty@kpmg.com



Eric Goldberg
Partner, Asset Management –
Los Angeles
T: 213-533-3013
E: egoldberg@kpmg.com

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

kpmg.com/socialmedia

