Marketing Your Hedge Fund in 2009: What You Need To Know

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Last year was extremely difficult for money managers on so many levels, let's start by considering some 'light at the end of the tunnel' good news.

Hedge funds – and boutique money management firms – aren't going away. There are, and will continue to be, investors who want to invest with them. The portfolio strategies that work may change, fee structures may change, and regulatory and reporting requirements may change, but there are some constants. Institutional and sophisticated individual investors will continue to need products and strategies to allocate to that offer them the potential to outperform their core equity and fixed income allocations, adding some 'icing on the cake' returns to their total portfolios. Another constant: many institutional and sophisticated individual investors appreciate that in the money management business often the best and the brightest strike out on their own rather than remain at the giant financial institutions. And let's not forget a cyclical constant: when pension plans become underfunded, playing catch-up always requires taking on greater investment risk in pursuit of higher returns to become fully funded again. This isn't achieved by passive index investing; it requires allocating to money managers like you.

Unfortunately, from the buyer's perspective, when they take a cursory first glance, there may seem to be a lot of managers like you.

Consider the general category your fund's strategy falls under. You probably have hundreds or thousands of competitors all vying for the attention and votes of confidence from the same potential investors you plan to pursue.

This is a significant enough challenge for a hedge fund during the best of times. During what seems to be the worst of times, standing out from the crowd in a positive way has become even more challenging and more crucial.

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Marketing Challenges in the Recessionary, Post-Madoff Environment

One set of challenges your hedge fund faces relates to arms-length, independent administration, custody, record-keeping and reporting oversight. These have gone from being 'nice to have' to 'need to have.' Not to mention, more regulation is expected.

These are the points you've seen written about in the press. However, while these present certain business management challenges for you, operations-related issues are not going to be the key selling points of tomorrow that will differentiate one hedge fund firm from another. Instead, funds will battle to stand out from one another by communicating about other (more subjective) key due diligence factors that investment committees discuss behind closed doors.

Events of 2008 have crucially changed both what hedge funds have to report and the marketplace's perceptions about what hedge fund managers now have to say.

Money managers push performance first when they're selling, but that assumes positive performance. The majority of hedge funds delivered negative returns in 2008. According to BarclayHedge, around 70% of the funds and 85% of the FOFs reporting to the organization ended the year in the red.

As a result, the playing field has been leveled when it comes to trying to stand out based on how much better one fund's positive performance is over another. Less dreadful negative performance is no deal closer.

In the past, when they didn't have a good performance story to tell, many managers took comfort in having a good pedigree story to fall back on. Unfortunately, the value of having a pedigree, from the investors' perspective, has also come into question as a result of the Madoff scandal. At least for a while, the value of a quality pedigree – where you were before and what you have done in the world of investing – is going to be overshadowed by prospective investors asking themselves, "But can we trust him?"

Process has also become more suspect. This is not just thanks to Madoff and a matter of if it sounds too good to be true it probably is. Yes, we are in an environment where a few 'bad apples' have made investors increasingly suspicious of money managers. But, that aside, after suffering a year of big losses, financial advisors and investment committees are under growing pressure to ensure that the next fund managers (and strategies) selected to receive allocations must be very defensible decisions. A vast number of strategies that investors thought were sound did poorly last year, so managers under consideration face an even more challenging task. This past year of bad performance, the ongoing recession, and the few – but high profile – crooks in the money management business won't stop investors from allocating to hedge funds. But the traumas of 2008 will result in a re-think of the weightings that investors give to various factors in their decision-making towards selecting new money managers to invest with in 2009. This is why educating and persuading people to help them better understand and accept the process story of how a manager invests is going to be even more crucial, both in attracting assets to a hedge fund and for keeping them 'sticky'.

Also, in this time of uncertainty throughout the global stock markets, buyer's feelings about a fund manager's potential to successfully navigate from market recession through to market recovery are going to be a major factor in their decision-making.

So, what is required of the hedge fund manager who seeks to differentiate his fund from the competition? Simply put, a more detailed explanation about the investment process. Hedge fund managers need to recognize how big a problem this is. Investors are complaining about this very issue:

- According to a January 2009 survey by SEI and Greenwich Associates, the key criteria institutions are scrutinizing when evaluating funds are 'clarity and consistency of investment philosophy' and 'clarity of investment decision-making process'.
- As the Prequin 2009 Global Hedge Fund Investor Review survey reported in February, "in the aftermath of the Madoff scandal, investors want to have a better understanding of how their returns are being generated."

- At the hedge fund marketing and client servicing conference in New York last month one point that was made time and again – by fund of funds, seeders, financial planning firms serving the high net worth market and consultants to family offices, endowments and foundations – was that too many hedge funds are doing a poor job of communicating their investment process. Marketing materials, in-person presentations and DDQ responses are often falling short of adequately addressing what investors and their advisers want to learn about.

Tips For Crafting A More Detailed Investment Process Story

To make your marketing more buyer-focused, here are three tips for communicating a better detailed explanation regarding your firm's investment process.

1. Avoid Being Vague

As investment consultants and financial advisers told hedge fund managers even before the credit crunch, they don't have the time to perform detailed due diligence on all of the fund managers out there. So, the short cut they take is to look first for reasons to reject a manager.

What, aside from obvious red flag issues, qualifies as reasons for a hedge fund's marketing materials to get moved quickly to a prospect's 'reject' pile? Reasons to doubt the efficacy of a manager's claimed strategy and a commodity-like lack of differentiation from the pack are two common reasons heard. These impressions tend to be formed when the prospect is given too little – and too generic – information. The culprit is often a hedge fund's vague-sounding explanations about its investment process.

Vague-sounding explanations about the investment processes behind hedge fund strategies are more often the result of poor communication skills rather than managers who are trying to keep confidential a truly proprietary element of their portfolio management. But, forgiving and being willing to overlook a manager's lack of good communications skills is not the first thing that will come to mind for prospective investors who are presented with hazy explanations about how a portfolio is being run.

2. Address This Market Environment

The storylines and marketing materials of many hedge funds don't make mention of how they plan to navigate their portfolios through market recession to market recovery. The hedge funds that do will engender a comfort factor among prospects and further differentiate themselves from their competition. The hedge funds that think they can wait until they are asked such questions in, say, a finals presentation, will find they may never get that far.

3. Don't Get Lost In Translation

Further complicating things for the fund manager is that in almost every case a prospect who is pitched in a sales meeting is going to be re-telling what he knows about the hedge fund to others involved in their decision making process. He will be speaking to an investment committee, a spouse, an accountant or to an attorney. And they will be re-telling the hedge fund's story to that person or group. So, one of the important sales goals a fund has to achieve is to reduce the odds that a prospect will mess up re-telling its story!

A fund's marketing materials are what tell its story when the manager is not there and are what a pitched prospect will pass on to colleagues when that fund is under consideration. A clear explanation about the investment process and how the manager thinks can improve a fund's chances that it has differentiated itself from its competition, and to reduce the odds that the prospect will mess-up re-telling its story to others.

Turn 2009 To Your Advantage

Today, more than ever, success in attracting investors is dependent upon a hedge fund's ability to educate and persuade people to be aware of, and buy into, how it invests. Achieving this requires developing a cogent and compelling way to best tell the investing story with consistency, applying it to sales marketing efforts and obtaining third-party endorsement for, and increased awareness of, the firm's investing process. Many of your competitors will not put in the time, effort and budget to tackle these tasks effectively. This can provide you with the potential to out-market many of your competitors without having to deliver tremendously better investment returns. This is too good an opportunity for your hedge fund to pass up. *

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