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Hedge Fund Marketing Challenges In The Recessionary, Post-Madoff Environment

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There is nothing like dire economic conditions, investor uncertainty and a few scandals in the money management business to make it even *more* challenging for hedge fund managers to market their funds.

Arms-length administration, recordkeeping and reporting oversight have gone from being "nice to have" to "need to have." Not to mention, more regulation is coming. Event-driven news reports that have been covering the new challenges that hedge funds face will continue to do so.

While these present business management challenges, operations-related issues are not going to be the key selling points of tomorrow that will differentiate one hedge fund firm from another.

Instead, hedge funds will battle to stand out from one another by communicating about the other key due diligence factors that investment committees discuss behind closed doors: Performance, Pedigree and Process.

But 2008 has crucially changed both what hedge funds have to report and the marketplace's perceptions about what hedge fund managers now have to say regarding these three topics.

For the vast majority of hedge funds, performance for 2008 was negative. While the average relative returns for hedge funds were not as bad as that of the Standard & Poor's 500 stock index, fund managers who delivered positive absolute returns turned out to be the exception rather than the rule. Further rubbing salt into the wound, many fund managers who have been around for a while are sitting not only with bad 2008 numbers, but they now also have to live with the resulting domino effect of deteriorated three- and five-year performance track records as well.

When they did not have a good performance story to tell many managers felt comfort in having a good pedigree story to fall back on in their bios. 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 isn't." Yes, we are in an environment where the 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 greater

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pressure to have the next fund managers and strategies they choose to receive their new investment allocations be very defensible decisions. A vast number of strategies that investors thought were sound did poorly last year, so managers under consideration this year have a tougher job of convincing to do.

What This Means for 2009

This past year of bad performance, the ongoing recession, and the few—but high profile—crooks in the money management business will not stop investors from allocating to hedge funds. But these traumas of 2008 will result in a rethink of the weightings that investors give to various factors in their decision-making for selecting new money managers to invest with in 2009.

Educating and persuading people to understand and buy into the Process story of how a manager invests is going to be even more crucial, both for attracting assets to a hedge fund and for keeping them sticky.

Also, in this time of uncertainty throughout the global stock markets, buyers' 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? A more detailed explanation about investment process.

Avoid Being Vague

As investment consultants and financial advisers told hedge fund managers even before the credit crunch, they do not 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, may qualify as reasons for a hedge fund's marketing materials to get moved from a prospect's inbox to the 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 grounds we hear. These impressions tend to be formed when the prospect is given too little information to go on. The culprit is oftentimes 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 communications skills rather than because managers 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.

Address This Market Environment

The storylines and marketing materials of many hedge funds do not make mention of how they plan to navigate their portfolios through market recession to market recovery. Those hedge funds that do will help engender 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.

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 retelling 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 retelling the hedge fund’s story to that person or group. So, one of the important sales missions a fund has is to reduce the odds that a prospect will mess up retelling 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 odds that it has differentiated itself from its competition and reduce the odds that the prospect will mess up retelling its story to others.

Beyond the Performance Numbers

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.

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Bruce Frumerman is president of Frumerman & Nemeth Inc., a 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. His firm’s work has helped money management clients attract over $7 billion in new assets, yet Frumerman & Nemeth is not a Third Party Marketing firm. He has over 28 years of experience in helping money managers to develop buyer-focused positioning strategies to differentiate them from their competitors; create more cogent and compelling sales presentations and marketing materials to better tell their story; and use media relations marketing to help establish a branded identity for their organization by generating third-party endorsement for the expertise of their people, the value of their services and the quality of their products. He has authored many articles on the topic of marketing money management services and is a frequent speaker on the subject at conferences for hedge fund managers, institutional, mutual fund and Separately Managed Accounts money managers and Third-Party Marketers. He can be reached at info@frumerman.com, or by visiting www.frumerman.com.