REUTERS HEDGEWORLD
Section: Opinion
February 1, 2011

Catering To Investors' New Communications Cravings: the marketing challenge of 2011

by Bruce Frumerman, Frumerman & Nemeth Inc.

Editor's note: Following are excerpts from Mr. Frumerman's keynote speech at IMI's 4th Annual Alternative Investment Consultants Summit, held January 27, 2011

Promising news, but competition is on the rise

There are some signs of optimism in the hedge fund world.

Hedge Fund Review reported in December that 945 new funds were launched in the previous 12 months, marking the largest number of new funds started in a 12-month period since the period that ended after the second quarter of 2008. And hedge fund liquidations continued to decline, falling to 168 in the quarter, slightly below the 177 liquidations of the prior quarter. New launches are more consistently conforming to investor preference for liquidity and lower costs, HFR observed. In addition, nearly a quarter of new launches comply with UCITS III guidelines, which incorporate liquidity requirements, restrictions on instruments and leverage, and emphasize the role of the local market regulator.

Reuters commented "these numbers suggest that it is easier again for traders and portfolio managers to set off on their own as hedge fund managers now that pension funds and endowments are willing to commit new money to alternative assets like hedge funds." Reuters also noted that "analysts cautioned that the industry is nowhere near its heyday where there were few barriers to entry and roughly 1,400 funds were set up, on average, every year between 2002 and 2007."

As reported in January, the *Institutional Hedge Fund Investing Comes of Age* survey, produced by SEI in partnership with Greenwich Associates, stated that more than 54% of investors surveyed plan to boost target allocations in the next 12 months, over three-and-a-half times the percentage giving the same response in the prior year.

Also, the annual *Alternative Investment Survey of Institutions and Financial Advisors*, conducted by Morningstar in conjunction with Barron's and released in January, found that retail advisors nationwide are increasing their allocations to alternative investments and two-thirds of advisors expect alternatives to be at least as important as traditional investments in the coming five years.

All in all, this is some promising news for the hedge fund industry as we begin 2011. Of course, if your hedge fund was in business a year ago the news also means you may have almost 1,000 new competitors vying for the attention of prospective investors. More funds sending out their communications, creating more "noise" in the In Box of the people whose attention you're trying to get. So, you have to both communicate and be heard above the "noise".

- more -

We know there are thousands of competing money managers and products. And competition to attract investors increases every year. A firm's communications lies at the heart of achieving its underlying primary goal: to attract sticky assets and then keep those assets sticky.

This brings us to the underlying challenge of marketing for the portfolio manager and his or her products: meeting the growing craving for more and better communications. If a money manager's firm lacks the ability to out-market enough competitors, they won't be able to survive, let alone grow.

Was your hedge fund paying attention last year?
Back in January 2010 SEI, in partnership with Greenwich Associates, released its survey report, *The Era of the Investor: New Rules of Institutional Hedge Fund Investing*. Institutions were asked to name the most important challenge they faced in hedge fund investing. The top response was "Transparency". "Educating the board" came in second. "Performance" came in third.

Over 70% of the investors SEI surveyed then reported requesting more detailed information from managers than they did a year earlier. As SEI observed, "investors are intent on understanding a firm's culture, investment strategies and operations. To remain competitive, fund managers will need to be proactive in enhancing their transparency and investor communications and reporting." What did investors declare as their top-ranked selection criteria? "People, investment philosophy, and the process for generating alpha."

"Investors want sufficient communication and reporting to assure them that hedge funds are generating alpha from a consistent approach that is in line with the fund's stated strategy," the report observed. SEI went on to note that investor reporting and communication have emerged as key aspects of manager quality and differentiation.

Also in January 2010 Prequin released its annual *Global Hedge Fund Investor Review* study where institutional investors were asked to name and rank their key considerations when choosing a hedge fund manager. The number one response given was "Understandable / Transparent strategy".

A year has passed. Did hedge funds get the message? Are they now doing a better job of meeting investors' communications cravings? Apparently not.

Communications cravings on the rise
Consider some of the key findings SEI reported in its January 2011 survey, *Institutional Hedge Fund Investing Comes of Age*. Investors are increasingly focusing on the hedge fund managers whose strategies and risks they can understand. "Clarity of investment philosophy" has come to the fore as the number one factor in the selection of hedge fund managers. The percentage of investors naming it "very important" rose to 79% from 61% the year before.

Also, "Risk management infrastructure," which did not even appear among the top 10 hedge fund selection criteria named last year, emerged this year as the second-ranked criterion. It was deemed "very important" by three out of four investors. SEI reports that understanding the risk associated with the strategies is a key subject investors want to get out of their due diligence on hedge funds. And there's the concern among sophisticated investors that sometimes managers don't seem to fully comprehend where their risk exposures truly lie!

So, “hedge fund selection now involves greater scrutiny,” SEI reports. What should be done about that? SEI published a call to action for hedge funds in its report, and the very first point is telling: “Ensure they clearly articulate how their strategies add value and are expected to perform under various scenarios.”

Good manager = good communicator?

Apparently, this type of correlation is something that hedge fund firms need to work harder on in order to achieve. As Yogi Berra is claimed to have said, “In theory, theory and practice are the same. In practice, they’re not.”

Understanding and buying into the investment process of a fund — a key element of institutions’ due diligence vetting — is reliant upon how cogent, compelling and clear the hedge fund is in telling its story. As the January 2011 survey results show, when it comes to their communications this is a key area where hedge funds continue to underperform.

The equity owners of hedge fund firms — the presidents, portfolio managers and others — are faced with the challenge of getting people to understand and buy into how they invest. Just having acceptable returns and structure and transparency in handling operations and administration are not enough for outmarketing the competition.

Individual investors as well as financial intermediaries — the financial planning/investment advisory firms, endowments and foundations, family offices, pension plans, fund of funds and investment consulting firms serving as middle-man gatekeepers and analysts to institutional and individual investors — all feel the need to get more information from hedge funds they consider today in the post-crash world. This is both for conducting more extensive due diligence and for equipping them with more to say to their investor client base to convince them that the new alternative asset money manager recommendation they’re making should be accepted. Are investors learning from the past? Somewhat. C.Y.A.? Somewhat. Are funds now selling to more skeptical investors? Absolutely.

Some hedge fund firm owners think *How hard can it be?* and figure communications and sales are the least of their worries for running their business. Some think *I can figure this out on the fly*. Some think *I couldn’t possibly make anything other than a good first impression*. Some think *I had to spend my personal savings on legal to get offering documents, on hiring a third-party admin service provider, on office space and IT. What can I try to get away with spending the least amount of budget on: money, time and effort? I know! My firm’s communications and marketing!*

Fund managers spend a considerable amount of time gathering, interpreting and evaluating information that guides their judgment about building and managing their basket of holdings. They spend time thinking about how the market thinks, whether it’s about the economy or the yet-to-be-recognized value of some security they hold. But many don’t spend much time thinking about how prospective investors and those who influence them think. Too bad, because you need to take this into consideration if you’re going to successfully attract and retain assets from them.

Having a branded identity is crucial to attracting sticky assets. This is where communications marketing comes in; the storylines and language a hedge fund uses in its verbal and written contacts with clients, prospects and those who influence them.

How good is your firm's storyline today about the superiority of its investment process and the intellectual acumen of management? Communications success for your firm is dependent upon your ability to educate and persuade people to be aware of, and buy into, how you invest. And this is what lies at the core of successfully catering to today's communications cravings of investors and those who influence them.

# # #

Bruce Frumerman is CEO 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. Bruce has over 30 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 and industry conference speaking opportunities 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 industry conferences. He can be reached at info@frumerman.com, or by visiting www.frumerman.com.