



How Hedge Funds are Raising Capital in 2009:

Strategies, Opportunities & Challenges in the Marketplace

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The Curran Group

The Curran Group is an executive search consultancy firm focused solely on the financial services space. Working for clients on a global scale, we recruit senior and mid-level specialists for a wide range of industry and functional disciplines.

Areas of expertise:

- Asset Management
- Wealth Management
- Private Equity
- Investment Banking
- Capital Markets
- Institutional Sales and Trading

The Curran Group employs a unique approach to search by providing “*human solutions*”. We partner with our clients, in essence becoming an extension of their organizations and cultures. The executive search process leverages our direct industry experience and combines market focus with an emphasis on quality and timely results.

The firm is guided by industry specialists who have executed more than 500 searches over the past 10 years. Our team members have all worked in various roles in the financial services space. Additionally, our firm works with clients on market intelligence and advisory services.

The Curran Group has offices in New York and San Francisco.

Capital Raising

Several of our clients implemented dramatic changes to their business and strategy over the last twelve months. They're beginning to think about the short and longer term needs with regard to human capital. Many of the organizations that we work with are continuing to focus on the tightened credit market and the difficulty in raising capital. We have seen the demand for effective marketers and fundraisers dramatically increase over the past six months. Many firms are looking at new avenues to increase capital and attract new investors. Fundraising is unquestionably a top priority for all of our clients.

We have worked with various managers and funds that have successfully raised capital in the past eighteen months. There is a clear pattern with successful fundraisers in 2009 – they're completely transparent, operate with the highest ethical standards and adhere to strict governance policies. Their actions are guided by the interests of the manager and investor. Furthermore, they approach their 2008 results with full transparency – even if they've suffered losses. These firms have openly discussed with us their challenging year, key learning's and changes to the fund. While the previous year's redemptions were driven primarily by high net worth individuals and smaller family offices, the hedge fund capital base is becoming more institutionalized. The majority of the institutional managers told us they still fundamentally believe in the hedge fund model as an investment class. We learned that current investors are the foundation and growth model for the future of the business.

The fund raising process begins well before the marketing team contacts potential investors. The leading firms have a clear, well defined strategy in place for the entire process. The optimistic news is that sales, marketing and business development roles have increased their importance and value within the hedge fund and asset management space. In the past, many of the leading funds placed less of a premium on capital raising roles.

The fundraising environment is increasingly challenging for funds of all sizes. The majority of our data is derived from funds between \$100M – \$3B AUM.

The Curran Group explored five themes in capital raising for 2009:

1. How firms are finding and raising capital
2. Transparency & Governance
3. Systematic process and disciplined strategy
4. Stabilization
5. Fee pressures

How firms are finding and raising capital¹

Internal marketers and many of the smaller placement agents are customizing their approach and targeting a specific investor segment. In the past, fundraisers have relied on large databases, rolodexes and friends of the firm. Today, the process generally requires significant upfront research before the fund contacts the marketplace. Several endowments in the \$200M – \$600M range have become a sweet spot for Asset Managers in the \$500M - \$1B range. Endowments of this size generally rely on consultants (i.e. Cambridge & Associates) to recommend managers. However, the mid cap funds usually fall below the radar of large consultants. The smaller endowments are eager to allocate to funds with a solid track record and strong manager. These endowments simply don't have the manpower to uncover leading managers in this asset class.

We have seen multiple Family Offices begin to redeploy capital in congruence with their current allocations. This group remains cautiously optimistic, looking for market stabilization before fully jumping back into the game. However, the market challenges have not prevented Family Offices from investing in Hedge Funds. Some of the CIOs plan to increase their allocations later this year and early 2010. We've heard numerous Family Offices tell us they're not looking at new managers until the end of the year.

The pensions, endowments and foundations appear to view the market through similar lenses. The pensions are closely evaluating the managers and the terms of their investments. We have seen a few large pensions forcing stringent new terms on managers and funds (specifically in the private equity space). The new rules focus on transparency and better alignment with the managers. The pension funds are applying pressure over fees and liquidity terms. We believe public pension plans will continue to build their allocations in hedge funds in 2010.

Several endowments and foundations are re-evaluating their liquidity risk and rebalancing portfolios. We have seen two endowments judiciously enter funds that were previously closed, the newly open capacity is allowing them to enter the fund. Yet, one of the messages from the endowment space – they will continue to allocate their capital with great confidence. They fundamentally believe in the long term value for alternative assets.

The Fund of Funds (FoF) appear to be under extreme pressure in the marketplace, yet they're still one of the leading distribution channels for hedge fund investing. They're continuously fighting to justify their value. We believe if the FoF are able to tweak their model into more of a consultancy and advisor role, they have an opportunity to succeed and grow. FoF provide high net worth individuals an avenue into hedge fund investing. The FoF are focusing on their overall operational model, beginning with transparency and governance. Investors would like to see FoF invest and

¹ General information based on The Curran Group's conversations, meetings and industry themes in the marketplace.

upgrade their technology and reporting processes, increase manager due diligence, consistently monitor the environment and resolve liquidity terms. The liquidity terms were one of the stronger points of contention in our conversations with investors. The investors believe in the FoF as a business, but not as they operate today. They're concerned with the alignment between investors and managers and the ability to alter the current liquidity strategies. FoF managers and investors believe that all of these recommendations are fixable, however there is a high cost associated with each recommendation.

Additionally, we have seen multiple FoF (AUM \$500M – \$1B) looking for partnerships to help stabilize their business in the short term. FoF are looking for complimentary partners with a strong cultural fit. The fee pressure continues to push the FoF. Our checks lead us to believe this space will continue to consolidate in the short term as high net worth individuals shy away from the model. However, we expect to see the FoF grow in the longer term.

Transparency & Governance

The majority of our conversations focused on transparency and governance in the marketplace. We heard a very similar message from the bulk of investors and managers: the objective of transparency is to monitor performance and fund allocation. To quote a portfolio manager from a \$2B fund, "Our performance is still the main driver, but, if we cannot measure up with our transparency and operating procedures, we will lose this game." We heard this same message from multiple sources in the industry. Investors and PMs told us that this is a focal point on all meetings with perspective investors.

We were moderately surprised in our discussions surrounding managed accounts and funds. Many investors believe this model works as long they fully understand the environment. Other investors are not willing to participate in a fund if the firm also manages separate accounts. The governance, transparency and systems with separate accounts require additional operating costs and liabilities. Our takeaway on this issue, separate accounts will continue to grow in the hedge fund world, but, investors will navigate with prudence.

Systematic process and disciplined strategy

A systematic process and strategy fall into line with strong governance and operating procedures. We have seen FoF upgrade their operations personnel and technology, systems and resources to demonstrate a clear process for the investment team and reporting structures. We heard two investors tells us that they would like to see the operational diligence and risk management groups function autonomously from the portfolio managers. This team would be able to reject investments based on their research.

Portfolio Managers will need to continually focus on their process, disciplined investing approach and strategy. Investors value a candid manager discussing his strategy and performance – both positive and negative.

Stabilization

The allocation % of Hedge Fund investors slightly decreased in 2009.² Endowments and Foundations remain the largest investors in the Hedge Fund space.³ Many of the investors and managers that we spoke with for this report indicated they are holding large cash positions and expect re-allocate in the next twelve months. Also, many of the investors that we met with are open to lock ups if the investing strategy validates the requirement. However, the lock ups must align with the manager's interests and other liquidity terms.

Fee pressures

It was quite clear to us that investors and managers are dealing with significant fee pressures in 2009, we expect this to continue as the market stabilizes. We heard several ideas from investors and managers regarding new structures and framework. A few investors would like to see a sliding scale vs. a flat fee. Furthermore, they believe the measurement period should not be based solely on the calendar year. The fees are better aligned as a progressing event, not necessarily paid each quarter or year. The performance fee is based on liquidity and investment plans. We heard two investors tell us the high watermark should be a thing of the past. It doesn't always work as planned (i.e. paying for performance twice).

We also heard several investors tell us they are willing to pay '2 & 20' with new and more favorable terms and conditions, depending on the fund and strategy. The new conditions will lead to decreased fees if certain benchmarks are not reached. The new fee structures will lead to a maturing and stabilizing industry.

Conclusion

We believe the recovery and maturation of the hedge fund industry directly correlates to the alignment between the investor and manager. Managers and funds will tweak their business models, building firms with long term objectives. The new era in fundraising will influence new models for the hedge fund industry.

² Barclays Capital

³ Barclays Capital

Hiring Trends

Over the past twelve months, the investor professionals and marketers who work in the hedge fund space are in high demand. Our team specializes in both functional roles. However, in the past six – nine months, we have seen a premium placed on sales and marketing professionals (fundraisers). The limited pool of capital requires senior level executives to strategically institutionalize a fundraising effort. A star capital raiser is now warranting the same type of attention as the leading portfolio managers. The in-house recruiters understand the importance of this role and the immediate impact they can add to a firm. With record setting results in the hedge fund space (June 2009), the optimism is slowly shifting from survival and sustainability to growth mode.

As we discussed earlier, the hiring process continues to be longer than we've seen in the past 18-24 months. Although there are special circumstances, most candidates will endure a slower hiring cycle. Our client base continues to move the process along at a gradual pace. They believe there is a vast wealth of talent on the street and a superstar will appear during the process. The compensation model has undergone a massive overhaul. Multiyear guarantees and sign-on bonuses are no longer a standard part of the system, but, still part of the system. We're regularly seeing performance-based models with formal commission structures and guidelines; there is less ambiguity in the plans. We spent a great deal of time with the sales and marketing professionals over the last few years, we're confident their value to the hedge fund industry will continue to grow. We believe the increasing demand and competition for these high performers will drive compensation back to 2007 levels, especially as capital moves back into the game.

The Curran Group is firmly entrenched in the fundraising community. We continue to support our clients as they build out their marketing teams.

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