The institutionalisation of the hedge fund industry has broadly been heralded to be a good thing – by the more vocal, more visible investors of institutional stripe at least, who now account for 61% of the $2.2trn industry’s assets, a 36% rise from 2008, according to Preqin research. But for veteran investors, like family offices, the response is not necessarily resoundingly positive. In a market where the lion’s share of capital now comes from an altogether different breed of investor, family offices, whether multi or single, have found it necessary to adapt their approach, with many being less enthused with an industry that has underperformed and is largely no longer tailored to magnetising their investment.

Several members of the family office community HFMWeek spoke to have observed a dichotomy within the hedge fund space, with some of the bigger players deciding to specifically target institutions and others continuing to tailor themselves to family offices. However, with 79% of single family offices and 67% of multi-family offices looking to put capital to work in hedge funds in the next year, according to Preqin, the appetite is still there for those managers who can step up to the plate and deliver.

“Hedge funds have traditionally struggled to understand the shade of grey between the types of investors and have thus struggled to respond adequately to it,” Asher Noor, CFO of the AlTouq Group, a Saudi family office told HFMWeek, though he believes the growing presence of institutional investors has had a positive impact, in terms of raising standards and lending additional credence. “Another need of family offices that I can relate to is the quality of reporting done by hedge fund managers. Institutional investors at times get better coverage than family offices,”
he adds, suggesting that this may be because family offices, at times, remain more passive and therefore only have access to the “plain vanilla reporting that goes out to all”.

The time it takes to complete due diligence is longer now than ever before, Noor observes, and not only because the checklist has grown. “One very intuitive way has been to assess the stamina of a hedge fund manager with a prospect by engaging them with a seemingly endless number of meetings and conference calls, before they have seen an investment cheque – it helps to separate the wheat from the chaff” he says, illustrating that to secure the money of a big family of-fice hedge funds are having to work harder and offer more.

“To secure family office investments, hedge fund managers need to ideally put in as much effort to explaining their strategies as part of the bigger universe that is out there, rather than simply harping upon their past performance, which, as we all know, is no guarantee of future results.”

Similarly, for Neal Berger, founder of Eagle’s View Capital Management, a New York-based family office hedge fund advisory firm that also runs three funds of hedge funds (FoHF), articulating your edge in a clear and concise manner is what helps most in getting an allocation decision. “It is often the case that rather than doing this, managers will tell me about their academic background and how hard they work – in essence, they’re telling me they’re smart, that they’re going to be the next Steve Cohen or George Soros. “Out of the thousand people that tell me they’re going to be the next Steve Cohen, I don’t want to make 999 mistakes trying to find that guy – the reality is there is only going to be a very small percentage who will make it to be great managers and as an allocator, I don’t know who it will be.”

**THE FLIPSIDE OF HEDGE FUND** status and pedigree made headlines last week, with the news that Moore Capital Management is to downsize its $8bn flagship fund, returning $2bn to investors, pushing the issue of size back into the limelight. Moore founder Louis Bacon’s decision was prompted by fears that trading large amounts...
of money in crowded and volatile market conditions was taking its toll on returns; an issue at the fore of one family office’s thinking.

“I am interested in funds that are staying in the sweet spot, which for my peers and I, tends to be somewhere from $75m to $100m up to no more than $1bn. Once they go beyond that mark we tend to be out of their interest,” Jason Cavanagh, CEO of the Saint Leonard family office, explains.

Meanwhile Gatemore Capital’s biggest challenge is that its talent for identifying promising emerging managers has become something of a double-edged sword: “a lot of the emerging managers that we get into tend to do well, raise a lot of money as a result, and then close after a year or two,” for example,” Liad Meidar, managing partner at the firm, says. “We might keep the position but then when we are adding new clients or rounding our portfolios we aren’t necessarily allocating to them additionally.”

A sudden swell in size tends to indicate that bigger players, such as pension funds or endowments, which typically cut cheques of no less than $100m, have entered the fund. According to a number of family offices HFMWeek spoke to off the record, this can be a warning sign to pare back their position, or even get out altogether. “While winning a mandate from the likes of CalPERS is considered to be the holy grail for most hedge funds, it tends to mean adapting the offering and realigning the risk/reward balance in favour of the type of investor who is happy to have single-digit returns and go by very pedestrian benchmarks,” one London-based hedge fund with $2bn in AuM admitted off the record.

If a hedge fund gets too big, Lord North Street, a private investment office, will start to ask questions, says its co-founder, William Drake, “We try and judge whether the manager is still going to offer us what we are looking for or whether they are now going for a very low return, bond substitute-type of approach.” It is also often the case that size is less the issue, rather a marked change in size; “a rapid increase in funds coming in always makes us think that maybe they have changed their marketing approach,” he says.

“Many hedge funds, especially the larger ones, are now behaving like asset managers, and they aren’t really seeking performance,” says Julien Sevaux, co-founder and managing partner of Stanhope Capital, a global investment office that oversees around $3.75bn in assets for 100 private clients. “They are protecting their businesses, their returns are more pedestrian and perhaps that suits the pension fund model, but it makes it less interesting for other investors.”

Bold, ‘interesting’ moves are certainly something the family office community have never shied away from. While many public and corporate pensions are shackled by sceptical share holders or trustees, family offices have a track record for more adventurous investments, often looking to more niche hedge fund strategies long before their bigger brethren.

Long/short equity may remain the overall top preference according to Prequin research, but 63% of family offices are open to all strategies within the hedge fund universe. “Our long/short managers have done well but are capacity constrained, so we are looking for other talented managers,” says Stanhope Capital’s Sevaux, though he added that the multi-family office was not planning to increase hedge fund allocations overall as a percentage.

Niche emerging managers, credit-orientated funds and commodities continue to be eyed by Gatemore Capital, which is always looking to add talent to its buy lists.

Of the single family offices HFMWeek spoke to, the ‘alternative alternatives’, as Saint Leonard’s Cavanagh puts it, are the most appetising opportunity set, often because these are the strategies that are generally off limits for institutions. At Gaim 2012, HFMWeek found a number of the family offices that were using their entrepreneurial edge to source small managers with very specialist niches – a Florida-based hedge fund manager that trades in orange juice, who is reputed to have reaped very high double-digit returns, for example.

The general consensus among those in the family office community is that a spell of good performance will be the shot in the arm the industry needs and that smaller, niche managers will continue to be recognised to have the most attractive propositions.

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**STRATEGY INTEREST WHAT’S ON THE FAMILY OFFICE RADAR?**

Opportunities in the credit markets are strongly on the radar for those in the family office community, that HFMWeek spoke to. “We have been looking at some of the more esoteric bits of the credit market, trying to find specialist managers, usually fairly small, who really know their way around the byways of the credit market. There are some mispricings in there which we think are attractive,” explains Lord North Street’s William Drake, adding that for some clients, they are also being a bit more adventurous on the equity long/short front.

New York- and London-based Gatemore Capital, which has around $2bn in assets under management and a further $1bn in assets under advisement, is searching in the credit space to take advantage of the deleveraging at European banks, as HFMWeek reported last year, and also continues to look at the commodities space, in addition to identifying emerging managers with strategies that are non-correlated, niche and differentiated. “We believe there will be ample opportunities for at least the next few years for funds that can, once, take advantage of dislocations that may be created by the wholesale dumping of assets and tighter regulatory standards, and two, originates loans that fill the ‘lending gaps’ in the market,” Medar told HFMWeek.

Gatemore, which typically allocates 15-35% of a portfolio across 8-12 hedge funds, also continues to access passive price exposure and private assets in the commodities space, though they are currently rethinking the active long/short approach.

“The most attractive asset class for the hedge fund model at the moment is the fixed income space; credit and distressed debt managers. Those who are able to work up and down the capital structure, it is much more difficult to get access to some of the underlying fixed income assets outside of the hedge fund structure,” says Michael Zacharia, portfolio manager at Sandmeer, a multi-family office with around $2bn ($3bn) in AuM adding that the firm’s macro exposure also typically comes from hedge fund vehicles. Hedge funds, which are not considered to be an asset class by the firm, feature in three of the seven buckets that constitute an investment portfolio: fixed income, equities and unconstrained, with the other buckets being property, private equity, commodities and cash.

Eagle’s View looks for managers who exploit specific inefficiencies and niches in the market, tending to gravitate towards more quantitative strategies, though this is not a strict criteria. “We invest in strategies that are very much outside the mainstream, which don’t have the capacity for larger institutions to invest and are not within the mandated buckets that institutions typically work with,” Berger says. “As such, the demand/supply equation for inefficiency in these strategies is much more fertile.”

Electricity arbitrage, shorting Chinese frauds, option volatility arbitrage and match book securities lending are all strategies Eagle’s View likes to buy into.

“The only criteria is that there has to be some kind of an edge or inefficiency that the manager is exploiting,” he explains. “Right now for example, we are looking at managers who can exploit the inefficiencies in the leveraged ETF space, a horribly misunderstood product by retail, so there is a big opportunity to take advantage of there.”