HOT OR NOT?

How strategy popularity affects marketing and IR

Most investment decisions are driven by individual fund returns – but strategy-wide performance can also be a factor. *HFM Investor Relations* assesses how hedge funds can prepare for periods when their strategy is either in vogue, or out of fashion

By Will Wainewright

Making your hedge fund stand out from the crowd is the perennial challenge facing marketing and investor relations (IR) professionals. Explaining your hedge fund's unique strategy to current and prospective investors – who may have heard 10 seemingly similar pitches in the last week – can be an unforgiving task.

The scale of the challenge can be heightened when your hedge fund trades a strategy which is performing worse than the rest of the industry. Even if a fund is performing better than its peers in the strategy, investors have been known to steer clear of allocating on the basis that the strategy itself could be a risky bet.

That the performance of a strategy can weigh on investor decisions can be a source of frustration for marketing and IR professionals – although it can also work in their favour. Sometimes, investors opt to invest in a fund on the basis that it is trading a popular or outperforming strategy – even if the fund is itself not performing well.

The rights and wrongs of such an approach is a separate issue: what matters to marketing and IR professionals is how to prepare for either eventuality.

To that end, *HFM Investor Relations* has spoken to a range of industry experts to gauge their views on how funds should prepare for when their strategy is in vogue – or out of fashion.

In vogue: How to capitalise when managing a popular strategy

"It is obviously easier to raise assets for strategies with strong demand," says Don Steinbrugge, managing partner at Agecroft Partners, a hedge fund marketing firm in Richmond, Virginia. But it is important to remember that those funds will be competing with marketing and IR employees at other funds in the strategy, who will be equally aware of prevailing trends in investor sentiment.

> "Strategies fall in and out of favour all the time as market conditions change"
> Sasha Jensen, Context Jensen Partners

Johannes Asp, head of investor relations at Madrague Capital Partners, a long/short equity hedge fund in Stockholm, says it is important to be prepared.

"When your strategy is in vogue it is important that you can compress the capital-raise timeline to get allocators invested during the opportunity window that you are in," he says. "To do so, you need to have already established contacts that you can fast track to an investment (i.e. already be on their radar)."

In other words, having ready-made procedures and plans in place, plus a list of well-cultivated contacts to approach, is key.

Asp continues: "At Madrague we have found that having a long track record and being able to speak about all the specific years, and how the portfolio behaved, is much appreciated among investors in order for them to understand how we operate, which is essential for any allocation decision."

The IR professional at one London-based hedge fund, who declined to be identified, cautioned that heightened interest in a strategy does not automatically equate to higher inflows if you operate within that strategy. Investor communication is crucial at all times, he believes.

"As a manager, there has to be a realistic view on whether your strategy is one that works across the cycle, or in certain conditions and/or within a particular time period," he says.

"If it is a strategy that works through the cycle, and is managed in such a manner, you need to continually explain and demonstrate why this is the case."

Crunching the numbers

Some numbers which offer solace to hedge funds running unpopular strategies:

53%
Though they weren't asked about strategy withdrawals, more than half the investors surveyed by Preqin for their H1 2017 report said they would wait a year or more before deciding to withdraw money from underperforming manager. Investors were not asked if they would withdraw from certain strategies even if individual managers were faring well.

16%
A further 16% told Preqin they would consider each fund on a case-by-case basis – indicating that a redemption is not a foregone conclusion either for underperforming funds or for funds running money in unpopular strategies.

28%
More than a quarter of investors expect hedge funds to perform better in 2017 compared to last year. A third fewer expect performance to go the other way, indicating net optimism about the industry (a slight majority of 53% expect no change).

60%
Hedge funds continue to grow. Three-fifths of hedge fund respondents to the *Hedge Fund Distribution Trends Survey 2017* undertaken by *HFMWeek* and Citco said they had grown in the last 12 months.

His firm's flagship fund is managed by a portfolio manager who has been trading in the strategy since the mid-nineties, managing risk through various cycles and learning lessons from that, the IR employee says, a point continually made to new and existing investors.

"We show examples from our book that contains differentiated plans to protect and return capital in a variety of economic and market environments."

He says an open and honest conversation with investors, in which clear data is made available, is key: "Historical and present trading data activity that shows our likely reaction to conditions that are likely to pose a challenge to our current book, but would still give us the potential of generating our stated returns."

Asp adds that seeking help from a third-party marketer (TPM) when a strategy is in vogue can facilitate the first initial contact with new investors. But he believes a consistent, in-house approach is best, with IR staff in constant touch with current and potential investors at all times, and is more likely to result in higher inflows when a strategy is popular.

"Typically the TPM will not understand the product well enough to move the investor all the way through to an investment," he says. "The product specialist is essential in the process of quickly matching investors and fast-tracking an investment."

A voice from the hedge fund recruitment industry gives an alternative view. "Hedge funds are thinking differently about how they staff their marketing and business development teams," said Sasha Jensen, who runs headhunting firm Context Jensen Partners in New York.

"It's no longer enough to just have 'hunter gatherers' – active capital raisers that court investors 365 days a year. Clients today are demanding a comprehensive investor relations experience, which requires experienced marketers with deep product knowledge and the ability to build meaningful, long-lasting relationships with investors." This would apply at times of feast and famine for the strategy the fund deploys.

Out of fashion: How to prepare when your strategy is unpopular

The challenges facing marketing and IR staff change when a strategy becomes unpopular, but interviewees agreed it was crucial not to fall silent with investors.

"When your strategy is not in vogue it is important to keep in touch with investors," says Madrague's Asp. However, this must be done "in an intelligent way". Possible options include "providing your thoughts on the current investment environment or providing white papers with regards to a certain topic within your expertise", he says. "This then will make your fund top-of-mind when your type of strategy is in vogue again."

Whether a fund manager needs to cut resources or even staff in the area of marketing and IR during fallow periods is a fraught question. Often it will depend on the size of the firm. "If it is a single manager or strategy firm, it is important to retain sales and marketing personnel even in times when the strategy is out of vogue or performance is poorer," says Asp.

"The sales people for a single manager often become more like product specialists sitting with valuable knowledge about the firm and its history," he adds.

"For an activist strategy for example, there is an intrinsic value for a sales person to be able to speak about previous cases independent of whether the strategy is in vogue or not at a particular point in time."

Communicating with – and holding on to – existing clients will become more important than reaching new ones when a strategy goes through a rough patch, according to the investor relations professional at a UK hedge fund.

"Communication, education and current client retention are important

Style police: when a drift in approach can be dangerous

Hedge funds must avoid being tempted by style drift – a process in which their investing approach changes over time – during periods when their strategy is unpopular, according to Alastair Crabbe, who spent nearly a decade in charge of marketing at fund of hedge funds Permal Group until last year. "From a fund of funds perspective, style drift is a very significant red flag," says Crabbe, who is now global head of marketing & communications at Marex Spectron, a commodities broker.

Style drift was identified as a significant factor driving redemptions in Credit Suisse's latest investor survey. Just over half (52%) of respondents said changes made by the manager, such as an altered investing style, was a significant cause of redemptions in 2016. (This was highlighted separately from underperformance, which was identified by four-fifths of respondents as a major factor).

"When new strategies take off, style drift becomes a very real concern which takes managers out of their comfort zone," says Crabbe. This can be caused by individual firms – or the strategies in which they are running money – becoming quickly popular.

"It sounds obvious, but your strongest selling point is always going to be to focus on what you are good at, and that is a far easier sell," he says. "Selling an out-of-vogue strategy with good performance is a far more attractive proposition than joining a trend and becoming one of umpteen managers offering that same strategy, with little or no track record."

This happened too much in the period before the global financial crisis, Crabbe believes. "You saw far too many managers, or aspiring managers, jump on the leveraged long-only bandwagon in the run-up to 2008, few of which offered any great value, and even fewer lasted the course."

The risks of style drift are huge, however tempting it might be. "There is a very real risk of following the crowd – if your strategy is struggling, while other strategies are flying, then the attraction of shifting focus is very appealing," Crabbe says. "Yet this is not what your investors bought into, so you are potentially skewing their portfolios, impacting diversification, and from the manager's perspective they are potentially increasing their own risk profile by mixing assets, strategies and expertise."

There is an alternative. Rather than shifting your current investing approach, a fund could reasonably decide to capitalise on popularity of a strategy it does not run by hiring from elsewhere. "Clearly hiring managers from other funds that have a track record in a particular 'vogue' strategy adds to your armoury and in my view is preferable to moving a manager from one strategy to another," Crabbe says. "Having said that, if it is less about strategy and more about focus (i.e. moving from growth to value), then the transition is far easier."

In demand: which hedge fund strategies are coming into vogue or going out of fashion?

The 2017 Credit Suisse Investor Survey, which was published in March, revealed how investor sentiment about different strategies has shifted. Coming in: the ten hedge fund strategies which experienced the biggest uptick in investor interest in last 12 months:

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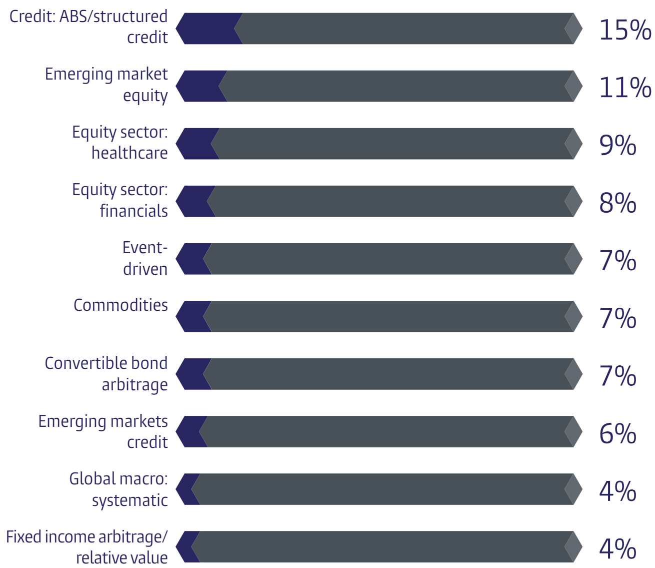
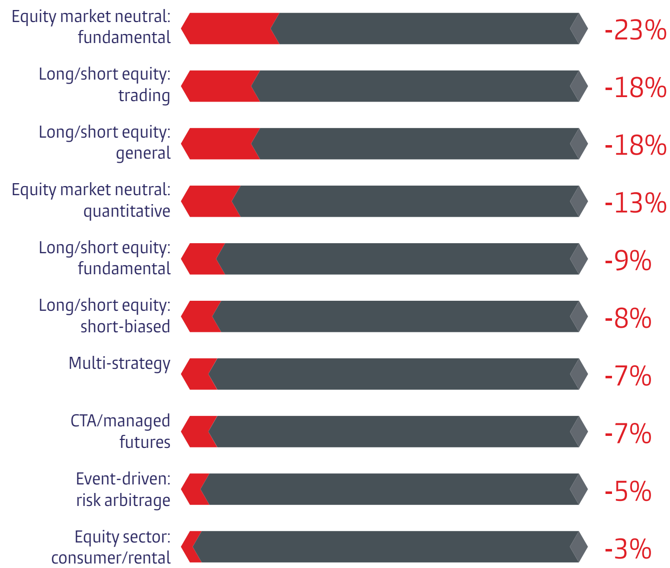


Going out: the 10 HF strategies which have experienced the biggest reduction in investor interest in the last 12 months:



at all times," he says. "So as a strategy is deemed less popular it could be argued that the weight of activity for investor relations professionals becomes more orientated towards existing clients."

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Jensen believes IR and marketing professionals should remember that things can change quickly. "Strategies fall in and out of favour all the time as market conditions change," she says. "To avoid redemptions, marketers need to emphasise the long-term viability of a strategy and communicate constantly with each investor. Full transparency is the key to sticky money."

Others agree consistency is important, rather than changing approaches when strategies become more or less fashionable.

"I think our approach is more around consistency, transparency, quality intelligence and engagement around market dynamics," says Jayne Fieldhouse, head of communications and brand with BlueBay Asset Management in London.

Dmitry Balyasny of Balyasny Asset Management recently lauded the technology firm Amazon for its ability to move quickly into new markets. "It is a great example of the benefits of building a scalable platform that can extend opportunistically into new business lines," he told investors. But hedge funds should be wary of moving too quickly into popular business areas they are less familiar with, with style drift a significant danger *(see Style police, overleaf)*.

Even in slower periods, hedge fund IR and marketing representatives should remain positive, says Steinbrugge, who believes opportunities will present themselves in all weathers for the right fund.

"There are a lot of sophisticated investors that will look at niche or out of favour strategies they believe will outperform going forward," he says. "I would rather represent a world class niche strategy than an above average strategy in vogue."

That is perhaps the most important point for funds to remember when their strategy is out of fashion. If their own approach stands out, or if their recent returns put sector peers in the shade, interest from more experienced investors may be heightened rather than dimmed. And those are the investors who are more likely to remain allocated rather than follow the crowd during turbulent times. ■