

Hedge Fund Seeding: A White Paper

The environment for hedge fund seeding and acceleration looks increasingly attractive relative to the low yields available from traditional investments. For those with a multi-year investment horizon, seeding or acceleration capital investments can help investors to decrease hedge fund investment costs and enhance returns by directly participating in a greater proportion of the industry economics.

The industry investor base has changed materially since the global financial crisis, with a significant increase in institutional investors and consultants focused on larger funds. The introduction of regulatory restrictions on global banks investing in hedge funds and a decline in the number of fund of hedge funds has resulted in a scarcity of dedicated seed capital providers, particularly in mid-size transactions.

There continues to be a strong pipeline of high quality talent, often second generation managers with hedge fund experience attracted to the still high margins available in the industry. At the same time, increasing institutional minimum asset size requirements and escalating regulatory, compliance and operating costs have increased the barriers to entry and therefore increased the attractiveness and value of seed capital.

There is significant academic evidence to suggest that on average emerging managers outperform. Investors have found recent returns from larger established managers to be disappointing. At the same time, some larger managers are closed or have returned capital to investors recently, including a number of high profile family office conversions. Increasingly institutional allocators are looking at emerging managers, but these funds require a minimum asset base to be investable. As a result, there are a number of potentially lower risk acceleration capital opportunities with pedigree managers who are managing funds already.

The strong growth in alternative UCITS products in Europe is also expanding the opportunity set, for those seed investors who have experience in liquid alternatives, to partner with established managers to launch new funds.

Hedge fund seeding can provide annuity excess returns over and above investing directly into hedge funds or via a fund of funds portfolio, due to direct participation in the gross management and performance fee revenues received by the underlying managers. Additional benefits such as fee discounts, capacity and co-investment rights are also typically negotiated.

Revenue share interests provide positive convexity to a portfolio, and benefit from netting, unlike fund of fund portfolios, in that revenue streams are received independent of other portfolio funds' performance.

In a low yield environment, the revenue share participation could make up almost half of the return over the life of a seed investment, if the right managers and strategies are selected. In a portfolio with a target IRR of 12%-15%, we estimate that this could equate to a 5-7% contribution, assuming a 7.5-10X average AUM base relative to the initial investment made.

In this paper Tages Capital explores some of the industry trends relevant to seeding, illustrate the potential economics available to seed investors and provide some background on the Tages approach to structuring a seed transaction.

The White Paper can be accessed here: [Hedge Fund Seeding - Enhancing Returns in a Low Yield Environment](#)

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