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An Allocator's View on Effective Hedge Fund Marketing

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Despite the hilariously outdated technology props and some extinct jargon, Oliver Stone's *Wall Street* is still revered by financial industry insiders. Even today, more than 25 years after its release, *Wall Street* is regarded as a realistic depiction of the industry largely because the film nails the dynamics of some important relationships in the business.

"Bud Fox, I look at a hundred deals a day. I choose one."
–*Gordon Gekko,* after a pitch from a prospective broker.

Take the above quote, for example. Fund managers are perpetually being pitched. Sell-side analysts fill portfolio manager's voice mails and inboxes with research ideas. Bankers want to bring their traveling roadshow to the buy-side office to pitch the latest company issuing paper. Today's fund managers, just as Gordon Gekko implied, know how irritating it can be to face a bombardment of pitches that all look alike.

And yet, based on our discussions with allocators (endowment, pension, fund of funds or the like), when the tables are turned – when the hunted becomes the hunter – and managers need to do their own fund raising, many of them forget that very lesson.

Allocators who interview hundreds of managers each year tell us that it's paramount for managers to distinguish themselves. One sure way *not* to do that is for managers to tell potential investors that they "have an edge" without accompanying evidence.

From the perspective of a hedge fund looking to raise capital, it can be perplexing to think about how allocators are making decisions about investing capital. One wonders if there is a clear path to moving things forward, and could one have improved the chances of getting a follow-up meeting? Let's find out by getting into the minds of allocators.

Silly But True

- Allocators will prioritize a fund that is "soft-closing" vs. a fund that is perpetually open. It helps to have phases when you exclusively meet with allocators and other phases when you are focused on investing. It builds up demand. Deadlines help.
- Playing hard-to-get works.
- The biggest influence on investors' opinions of a hedge fund is the opinion of other investors. There are very few who simply decide for themselves. When an allocator hears about your hedge fund from a peer at another firm, you've already done the heavy lifting. To this point, it can help to have a

Skill-set	*Evidence*
Security Selection	High batting average and win/loss ratio at the portfolio level and for different slices of portfolio (sector, market cap, geography). Both absolute and relative (portion of return coming from security selection) ratios are relevant.
Expressing Conviction	Proof that position sizing has added value over time. What is the return on invested capital on smaller names vs. core names? Offer a return comparison to an equal-weight portfolio.
Market Timing	Proof that managing net exposures has added value.
Category Allocation	Proof that being in the right sector/sub-sector/asset class/geography has added value.
Trading	How much of the total return is attributable to trading? How do actual returns compare to a zero-turnover portfolio?

mind map of who knows who. Similarly, the same effect can cause one allocator to redeem when someone else is redeeming.

- The story is what people remember.
- Like it or not, your fund is "bucketed" in a particular strategy/style in the allocators' book. Knowing your "bucket" helps anticipate questions.

How Can A Hedge Fund Have An Effective First Meeting That Results In A Follow Up?

In a typical year, an allocator meets with hundreds of hedge funds. Most first meetings tend to be centered around topics like pedigree, research process and edge, ideas and theses on those ideas. After an allocator has 20 of these meetings, the story starts to sound the same. This routine does not give an allocator a true sense of what makes a manager unique. An open-ended meeting is often ineffective and results in no clear next step.

For the first meeting to be effective, a hedge fund must articulate its value proposition to prospective allocators. Numbers and actual unadulterated statistics are more impactful than esoteric conversations around processes

A better way to differentiate your value proposition

One of the most common questions an allocator is trying to answer is "What's the edge?" While the question itself oversimplifies investing and carries some implicit assumptions, a simplistic, unsupported answer like "Our edge is security selection/research" by itself does not hold much weight. Talking about one or two high-conviction names does not really answer the question either.

For the first meeting to be effective, a hedge fund manager must clearly articulate the value proposition to prospective allocators. Numbers and actual unadulterated statistics are more impactful than esoteric conversations around processes. For example, if research and security selection are indeed core drivers of returns, a more thoughtful answer would involve statistics that prove a manager is actually a good stock picker. One approach to highlight persistent security-selection skills would be to lay out batting average and win/loss ratios by sector/market cap/position size/liquidity or any other category that is most relevant. The table on the previous page lists a variety of skill-sets and how to present evidence of their existence.

Consider that for the first meeting to be effective, it is important to share with allocators:

1. The true value proposition, supported by skill-set-centric results.
2. The elements that differentiate your fund from other hedge funds.

What not to focus on in the first meeting?

The risk in covering too much in the first meeting/call is that allocators spend 90% of the time on a topic that makes up less than 10% of the book and is not core to the overall strategy. These topics could be P&L derived from IPO's or a few private positions that make up a tiny portion of the book. This is often unintended and it should be avoided.

The goal of the first meeting is to take baby steps to get to the second meeting; spending too much time on a small portion of your book can derail the conversation.

"Fund managers need to be able to stand out not just by telling investors what they are good at, but by 'showing' or proving their value proposition in a compelling, easily retained way."

What is effective hedge fund marketing?

The world of marketing has changed, and it's critical for managers to rethink how they communicate with investors by taking a moment to see things from the investor's point of view.

Investors today have access to more information than they can effectively consume. They are being bombarded by emails, marketing brochures, pitch books, and bold claims from managers competing for their capital. Increasingly, this sort of "push marketing" is having less impact on investors who have heard it all before. To be competitive in today's environment managers need to differentiate themselves by clearly demonstrating their value to the investor through data-supported narrative.

An increasing number of innovative managers have evolved their marketing efforts by tapping technology and data analytics to help them quantify the value they deliver. Through the use of portfolio intelligence tools, they have gained an edge in raising and retaining capital. Demonstrating their skill and highlighting the drivers behind their investment process, these managers can substantiate their claims and win the trust of investors along with their capital. In the meantime, managers who continue to rely on subjective claims alone will be at a significant disadvantage, even if they are as skilled as they claim.

Here are four specific steps to take your marketing to the next level:

1. Focus on what makes you unique

Investors are looking for unique opportunities- not another "fundamental l/s" fund. Focus on your key differentiators and connect them to your background and expertise.

2. Align your message with the objectives of your investors

Investors from pensions to funds of funds are faced with criticism of putting up with sub-par returns, paying high fees and not fully grasping the complexities and risks of hedge funds. Whether they are looking for uncorrelated sources of returns, absolute returns, or alpha, it is your job to understand investor needs and challenges.

3. Talk about your "fund" as a business

Besides running a portfolio, you are running a business, and investors are keen to understand the strengths and challenges of your organization. Organizational structure is often highlighted in marketing documents but few talk about organizational 'health'. What is the reason the fund was launched? What are your beliefs and guiding principles? If you are clear on those and you dedicate time to them in your messaging, you are more likely to attract strong, long-term partners who share your values.

The rest of the article will focus on our final point – and one we feel is most critical in separating effective marketing from mediocre. It is the ability to show value rather than just tell folks about it.

4. Show, don't tell

A picture is worth a thousand words. In our day and age, it's worth a lot more since no one has the time to read a thousand words but they are happy to quickly glance at a chart and discover the insight for themselves. Of course, it's critical which data you choose to visualize.

Case Studies

Impala Asset Management

Impala Asset Management is a multi-billion dollar long-short hedge fund founded in 2004 by Robert Bishop, (Formerly the CIO of Soros Fund Management and a PM at Maverick & Kingdon). Impala now employs dozens of analysts and invests globally, primarily in companies within cyclical sectors including consumer cyclicals, industrials and materials. Impala is known for its deep fundamental analysis and strong understanding of the businesses they invest in.

That is the story they want to tell. When communicating with investors, they build a unique narrative by showing, explaining and demonstrating rather than hoping the audience will take them at their word. To do this, Impala has leveraged Novus to organize and dissect their trading data. The endeavor has paid off – the data strongly supports their story and the result is a powerful, memorable and objective message.

Throughout its 10-year history, Impala has invested over 93% of its gross exposure in the sectors it knows best, Industrials, Materials, and Consumer Discretionary. Moreover, since 2004 Impala has generated 93 percentage points in Materials and 70 percentage points in Industrials just based on security selection. That is 163 percentage points of security selection alpha in just those two sectors.

Focusing on security selection within each sector, this chart paints a compelling picture of long-term alpha generation through picking stocks within Materials and Industrials.

Many firms say they know what they are good at and stick to it; Impala has more than ten years' worth of data to show investors that's so.

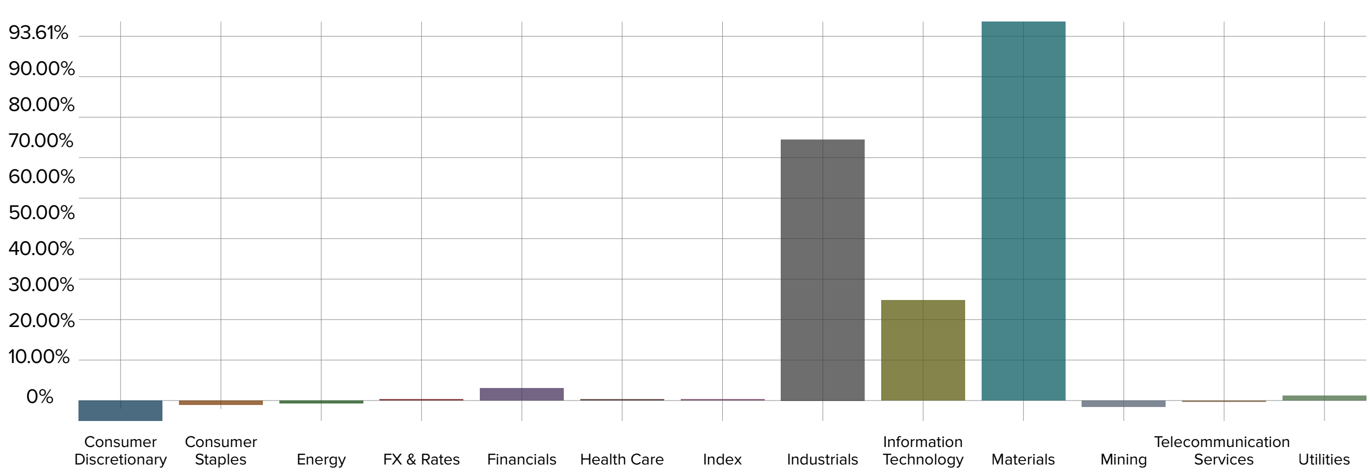
93%

of risk based exposure is attributable to the Top 3 Sectors. [2009-2014]

163%

of Security Selection Alpha in Top 2 Sectors. [2004-2014]

Impala Asset Management Security Selection Alpha by Sector (April 2004 - December 2014)



Buckingham Capital Management

Whether knowing your companies, or some variation of "kicking tires" or "deep diving", nearly every single manager uses fundamental security selection as a selling point. However, any investor will tell you, this is not a differentiating point because everyone tells them that.

The value that a hedge fund offers to investors managing an endowment-style portfolio lies in its ability to provide superior risk-adjusted returns. Those are most commonly achieved, when deploying less net exposure to the market, through the shorting of stock. A manager with 80% long exposure and 30% short exposure is only 50% net long. But if the longs outperform the shorts (either by advancing more in up markets, or declining less in down markets) the investor will capture more of a market's advance than its exposure would yield alone. A manager's ability to identify the relative value of securities and his ability to capitalize on it demonstrates security selection skill.

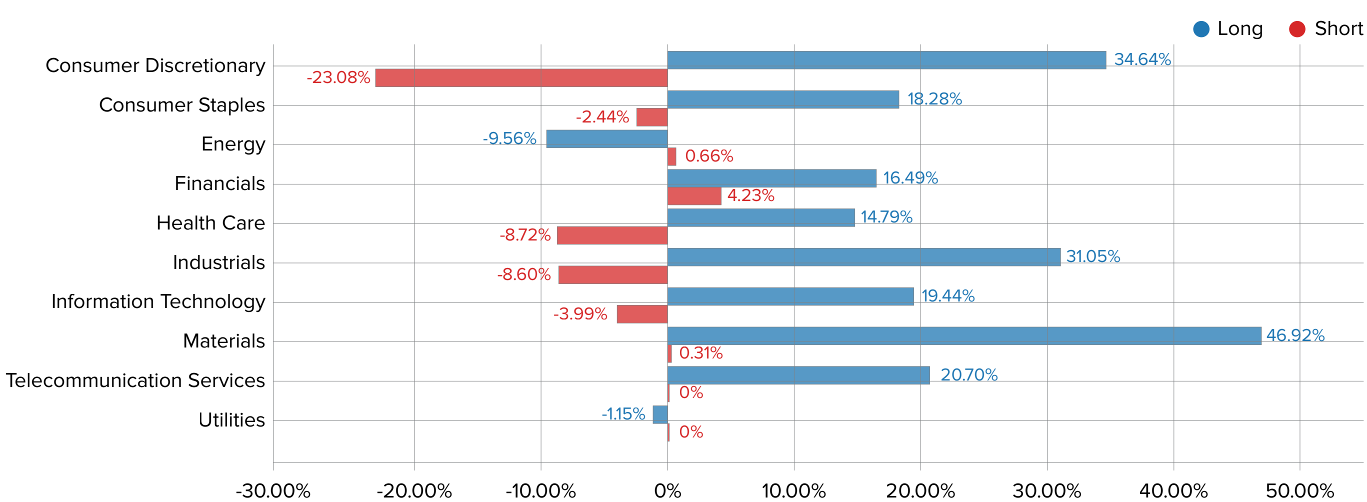
Buckingham Capital Management, a rarity in the world of hedge funds in that its founder has been investing since before the 1987 crash, has compiled an enviable record of security selection; not only on an outright basis, but on a relative basis as well.

In every year but one from 2009 through 2014, Buckingham returned to its investors a larger share of the market's gains than their net-exposure to the market during that year. What's remarkable about the alpha they've generated is that it has come from superior relative-value stock selection across every sector they've invested in. Take a look at this chart which shows Buckingham's return on capital, long and short, across every sector they've invested in since 2009:

It reflects a large positive spread in every sector, except energy which currently represents less than 1% of the book. In the eight sectors where both longs and shorts have been entered into over the last six years, Buckingham can show investors that they have captured positive relative value and generated alpha through security selection.

Clearly, it takes effort to do this sort of analysis, while simply 'telling' investors what you're good at takes a lot less. But the efforts pay off. Like in our prior example, this manager has made a business decision to invest in analyzing their own trading data through Novus, and has used the resulting insights to craft a strong, differentiating message.

Buckingham Capital Management Annualized Return (January 2009 - December 2014)



Conclusion

In speaking with our investor clients – some of America's largest endowments, pension plans, family offices etc. – we've learned that a differentiated marketing pitch is crucial for managers raising assets. But if you're a manager, you can't 'show' investors what you're core skills are, or how you're unique without the proper tools to measure and display them. This also involves the cleansing of data to support such analysis.

That's why we founded Novus – to enable investors to consistently maximize their performance potential through the discovery of true investment acumen, proprietary industry insights and expertise and effortless data management and enlightenment.

BCM manages assets in two investment strategies: a long/short multi-sector strategy ("The Diversified Strategy"), and a long/short consumer-focused strategy. The portfolio included in this case study is BCM's Diversified Strategy, which is co-managed by David Keidan and Brian Clifford.

61%

of securities generated alpha on the long side. [2009-2014]

56%

of securities generated alpha on the short side. [2009-2014]

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ABOUT THE NOVUS PLATFORM™

ALL YOUR ANALYTICS IN ONE PLACE.

The Novus Platform™ is the world's most advanced portfolio analytics and intelligence platform designed to help institutional investors consistently generate higher returns. The platform is used by the top hedge funds, fund of funds, pensions plans, sovereign wealth funds and endowments around the world to analyze risk, performance and attribution and conduct portfolio research across aggregated and historical data sets. Portfolio managers, investor relations teams and operations teams use the Novus Platform in different ways, but ultimately to generate more alpha, analyze and manage their risks, report to their investors and become more efficient with resources.

Data Management

Novus automates the data management side of investing. Our team actively manages all exposure reports, monthly performance updates, balances & transactions, quarterly letters, position level extracts and more on a historical and forward going basis. Novus scrubs the data, normalizes it so it can be interpreted across investments, and produces clean historical datasets for your ready consumption.

Data Aggregation

By centralizing disparate sets of data in one place, investors can easily view their firm-level, portfolio-level and fund-level exposures, performance & attribution, risk analytics and positions data without the hassle of building complex systems to track their investments. Investors can graduate from tangled excel spreadsheets and internal models that need to be constantly maintained. Focus on what matters most - research, due diligence and analytics.

Performance & Attribution

Novus' performance & attribution tools let investors easily measure and compare all of their managers individually, side-by-side and from a top-level aggregated view across the entire portfolio. Investors can focus on where their managers are generating alpha and what strategies are working best in their portfolios. Using advanced peer-analytics tools, investors can also compare their manager's performance against a universe of hedge funds that employ similar strategies in order to get an unbiased understanding of how their existing managers compare against peers.

Risk Analytics

With a data infrastructure that incorporates exposures, securities, positions and P&L, investors can quickly analyze key risk statistics at the fund, portfolio and firm level across an entire portfolio - all with just a few clicks. Investors can view their risk exposure by asset-class, sector and geography or even compare manager's side-by-side to better understand the portfolios risk contributors.

Reporting

Novus reports put a wealth of information at your fingertips. The platform's reporting tools support robust analysis and research that allow users to build insightful reports for both internal and external consumption. Whether you're looking for a simple 1-pager for your weekly meetings, a more comprehensive report for portfolio reviews or something in-between to send to your investors, the Novus Platform's reporting tool lets you quickly and easily create manager-level, portfolio-level or firm-level reports.

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