

## Uncertainty Awaits New Fund Launches in Early '08

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As Jan. 31 approaches, signaling the end of the most turbulent month in recent memory for many markets, hedge fund managers who opened for business in early 2008 may be asking themselves why on earth they picked this month to launch.

Since ringing in 2008, the Standard & Poor's 500 stock index has dropped approximately 7.8%; the Dow Jones Industrial Average, about 6.6%. Hedge funds, despite their vaunted absolute return abilities, haven't fared much better. Hedge Fund Research's broad measure of the industry, the HFRX Global Hedge Fund Index, was down 3% as of Jan. 25, with long/short equity funds down 4.5%. The long/short equity managers tracked by the Dow Jones Hedge Fund Indexes were doing even worse, down 7.3% as of Jan. 25.

So new hedge fund managers, with that all-important first-year performance on their minds, may be forgiven for looking a little green as January's wild ride comes to an end. Prospective managers eyeing a February launch date may be glancing anxiously at their watches and their trading screens, alternately, wondering if that date suddenly seems a bit premature. And as waves of layoffs hit investment banks, still reeling from losses sustained during last year's credit market collapse, chances are that many who otherwise would test the hedge fund waters now find them a bit chilly.

"In terms of startups, the people I've been talking to would choose to wait, if they can," said Meredith Jones, managing director at PerTrac Financial Solutions, a New York-based company that studies asset allocation patterns. "In terms of the managers we're talking to, capital is coming in slower than expected, and people are waiting on the sidelines to pull that final trigger on [investments]."

Jim Zurlo, the New York-based head of prime brokerage sales for Gar Wood Securities LLC, said he was already seeing a slowdown in new fund launches in the latter half of 2007, as new managers found their investor base growing shaky as the subprime mortgage meltdown evolved. Gar Wood focuses on small and mid-sized hedge funds, and Mr. Zurlo said that many investors ended up managing their own exposure to the softening equities markets instead of test-driving new hedge funds.

"We definitely saw it in some of the folks we were talking to—the commitments they thought they had didn't pan out," Mr. Zurlo said. "With the year we were having ... if those commitments weren't panning out by September it became clear that they shouldn't launch until the end of the year."

At stake for new managers is their first-year track record—pretty much all they have to go on if they hope to raise money from institutions and other discerning investors in the near future. If a new manager launched in November and posted a loss straight out of the gate, he or she would have had to make up that ground in December to avoid a loss for 2007—no easy task, as markets slumped through the end of the year.

"I saw it happen to a couple guys the previous year," said Mr. Zurlo. "They got impatient about launching and launched in December and ended up down a little bit. Financially it's not a huge impact, but in a lot of investors' eyes, it's a real question of business judgment ... if you make one mistake, who's to say you don't have a bevy of others tucked in, waiting to come out?"

Not everyone is seeing a slowdown in new fund launches. At Pinnacle Alternative Investments LLC, a hedge fund sales and marketing consultant based in Houston, Managing Director Jacques P. DeRouen said that the managers with whom he's spoken haven't been dissuaded by market difficulties. "I don't think you're going to see those managers that truly understand the challenges and opportunities in the hedge fund space intimidated by market turbulence," he said. While emerging managers will continue to grapple with the difficulties facing all new launches, like wrangling capital and courting the favor of institutions, Mr. DeRouen said investments flowing toward the emerging manager space are not about to dry up.

"The challenge is always going to be the same," he said. "But the trend that started a few years ago,

when institutional investors started to shift their focus toward emerging managers, that's going to continue."

Certain strategies, Mr. DeRouen allowed, will be more affected by the broader market climate than others, of course. Managers looking to launch a credit-backed strategy will face an uphill battle. But there is opportunity there, too: Investors may be on the lookout for trading strategies that can take advantage of the lack of liquidity in the credit space.

PerTrac's Ms. Jones also saw opportunity, particularly for managers looking to launch short-biased funds, which have generally had a rough time making money in the relatively placid market conditions leading up to mid-2007. "Certainly short biased is always more attractive given the volatility we're seeing in the markets," she said.

Earlier this month, Hedge Fund Research's report on 2007 hedge fund inflows found that short-selling hedge funds led other strategies in inflows over the fourth quarter last year [Previous HedgeWorld Story](#).

For distressed-investing funds, the optimal launch date may be yet to come. "I think they would wait for a little more of the fallout," Ms. Jones said. "To be honest I think there's going to be only more opportunities coming up for distressed. This is not the kind of market situation that is going to turn around that quickly."

Gar Wood's Mr. Zurlo agreed. "I know some distressed managers, they're off to a great start this year, and they had a good year last year," he said. "We've definitely seen folks coming over and looking for short-dedicated or short-biased managers, or looking for global macro funds that have a strong bearish bent. There are definitely folks out there shopping for short exposure."

Other strategies that have experienced a sustained upswing in recent years may see that momentum begin to taper off, Ms. Jones added. "A lot of the type of funds that are hot in a market that is trending up, or even sideways, are not going to be the same funds that people look at when the market is turning down, or becoming volatile," she said.

In the end, Ms. Jones said, it comes down to the manager's conviction. If the capital is in place and the fund's structure is set up and the manager is 100% sure this is the right time and place for his or her strategy to begin trading, then the fund ought to launch. "Anything less than that, and you may want to wait another 30 days," she said. "I would tell someone to expect capital to come in a little slower, and be ready to do more work and handholding with investors.... If that's not something they're prepared to do, or have the staff for, it's going to be a harder row to hoe."

Mr. DeRouen said that as long as a manager isn't pursuing some star-crossed credit strategy, they should proceed as they would in any other market climate—ensure the business model is thoroughly plotted out, that there's demand for the strategy, and that the firm has enough capital to make it through some lean times. "There's very little out there, short of a complete capital market collapse, that's going to dissuade emerging managers from getting into the space," he said.

No matter emerging managers' enthusiasm level, according to Mr. Zurlo, they'll need to be prepared for longer capital-raising and due diligence periods, as spooked investors ratchet up the level of scrutiny they give to new investments. The old adage "only the strong survive," already gospel in the hedge fund realm, will only become more pronounced. The best will continue to get the money they need, and those without pedigrees will need a strong team and a well-articulated edge.

"There's uncertainty," Mr. Zurlo said, "it was a slow fall. But there's always opportunity for the right strategy, and you don't want to discourage anybody from trying."

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