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Hedge fund launches in 2021: obstacles and opportunities

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There were 42 launches in Q3 of 2020-the lowest of any fiscal quarter of the last five years-and of those launches, very few had a sizeable AuM. However, according to new research by HFM, almost three in five investors view hedge funds more favorably than before the pandemic-a higher figure than any other asset class. The same report shows that 76% of investors feel hedge funds are delivering value for money during these exceptionally challenging times. Growing consensus dictates that as a response to 2020's volatility, institutions are expected to implement or even increase allocations to hedge funds as a source of downside protection.

Despite this, there are real and unique obstacles for new managers hoping to launch a hedge fund in the current environment.

For example, while investors are indeed showing increased demand for hedge funds, HFM's September report "Capital Raising in a Crisis" shows that less than half of surveyed investors expected to hold face-to-face meetings with managers in Q4, preferring to increase existing mandates instead of creating new ones. Additionally, for the minority that were willing to have new conversations, virtual ODD still remains a pervasive headache, especially for new managers that lack an established performance track record, accolades from high-profile firms they may have spun out of, or a robust network of contacts.

Those without the latter found themselves facing unique fundraising obstacles that are seemingly here to stay. The same HFM report showed that only 18% of managers feel virtual cap intro events were the best source of leads, in comparison to 31% instead preferring referrals from existing clients and 27% even preferring cold calls and emails. Industry participants have by now been feeling long burned out on virtual events, and the industry is subsequently seeing people shift from a "quantity" to "quality" approach on which virtual events they attend, making it harder for some new managers to meet potential new inflow opportunities.

Adding to the challenges at hand further still, the industry is seeing no signs of a rebound in incentive and management fees, despite positive average performance during the pandemic. According to a Q2 2020 HFR Market Microstructure report, management fees had at the time even further declined 1bps to 1.37%, while incentive fees declined 3bps to 16.37%-

-the lowest level for both since HFR began publishing fee data. Meanwhile, Pershing's Q3 Cap IntroGraphic shows that 71% of surveyed investors are at the same time expecting hefty returns between 8% and 16%.

While emerging managers are indeed facing a trifecta of increased demand, downward fee pressure and rising fundraising hurdles, they also must not forget that unique opportunities have come out of this COVID-19 launch environment as well. For example, outsourced fund admins, prime brokers and other servicers continue to offer impactful solutions to offset these challenges. Modern CRM tools, for example, can help get a leg up on sales outreach and investor engagement during unpredictable markets, and certain prime brokers are well positioned to act as market intelligence providers when managers can no longer access the insights the once received from meetings and conferences.

Smaller new managers, while finding the current networking landscape difficult, are in fact benefitting from a levelled playing field at the events they do attend, as larger firms can no longer dominate in-person events with travel and sponsorship budgets. Counterintuitively, the time and expenses saved on travel is also being spent on more meetings and an improved attention span, which is leading to much more constructive conversations. Funds that are launching with a larger AuM are also finding unique opportunities in today's environment. Many are reallocating finances and working hours that would have been spent on conferences and networking to instead quickly adapt to a digitalized allocation process and capitalize on new leads.

New opportunities for certain strategies are opening up as well. According to Pershing's Q3 Cap IntroGraphic, long/short strategies lead in the equity field, but credit strategies remain evenly dispersed in popularity. The Cap IntroGraphic also shows continued interest in healthcare & TMT specialists and firms with general expertise in foreign markets (particularly Asia). This is likely spurred by a combination of low rates, overpriced domestic equities, a weakened dollar and the promise of a commodities boom on the other end of the COVID-19 pandemic. Similarly, Preqin data shows that the same environment is increasing appetites for managed futures/CTA (commodity trading advisor) funds, with interest doubling from last year.

All in all, while today's launch environment is likely the most challenging we've seen since the 2008 global financial crisis, investor demand for hedge funds has continued to rise after the industry proved its worth during the COVID-19 pandemic. Emerging managers with strong industry networks, the right initial AuM, and those offering in-vogue trading strategies can still certainly thrive and capitalize, and all despite today's challenges. It is advised that managers today do not neglect their tech stack, but conversely invest in outsourced fund admin providers, which can help offset fee compression headaches, as well as CRM tools that can be additive in a digitized cap intro process. With conferences and meetings cancelled for the foreseeable future, adding an additional prime broker that can assist with more targeted introductions and investor intelligence may prove highly beneficial as well. With the right amount of creativity and wisely allocated resources, new managers need not fear the unique obstacles that, for now, stand in the way of a successful launch.