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Robert Olman: Hedge funds adapt after 'perfect storm'

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Guest blogger Robert Olman is President of Alpha Search Advisory Partners. The views expressed here are the author's own and do not constitute Reuters point of view.

The 'perfect storm' of 2008 revealed several flaws in the hedge fund model.

With the decision by multiple funds to drop their gates in response to a tsunami of redemption requests, the mismatch of the liquidity in the funds' investment portfolio and the liquidity provided to the investors became apparent.

Forward-thinking hedge funds are launching new funds (or restructuring) to resolve the liquidity mismatch while maintaining the integrity and scope of their investment process in a number of ways.

For example, many firms are using paired offerings, especially in the credit, ABS and distressed spaces: one with monthly lock-ups and conservative target returns, which will invest in liquid products; the second with longer lock-ups, approaching a private equity-like structure, with more aggressive target returns.

With this structure, fund managers can pursue short-horizon, actively traded investment strategies, as well as the longer-term investments involving less liquid assets.

We are also witnessing a trend towards managed accounts and away from co-mingled investments, particularly provided to the larger investors such as sovereign wealth funds.

These responses to liquidity mismatch also have a profound effect on performance fees charged by the manager.

The 2 and 20 fee structure is not necessarily the default for managed accounts, nor for the longer lock-ups required in the funds with multi-year target holding periods. To say it is exclusively downward pressure on fee structure is an over-simplistic and deficient conclusion.

Rather, it is a rational response to investor and manager needs for liquidity, sustainability and returns.

Alpha Search Advisory Partners (ASAP) is a human capital services firm specializing in sourcing top-tier investment professionals, team integrations and firm acquisitions. Our focus is on hedge funds and the broader alternative investment community. We provide executive search consultancy and advisory services in consolidation of alternative asset managers.

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