InvestHedge

HedgeFund Intelligence

THE ONLY PUBLICATION THAT FOCUSES ON INVESTORS IN HEDGE FUNDS

HedgeFund Intelligence AsiaHedge EuroHedge InvestHedge Absolute UCITS AR Absolute Return+Alpha

Fundana's three-tier approach drives top managers to its core

Dariush Aryeh's Fundana backs only the best in new manager talent on a gradual scale of investment until they graduate to become the 'tried and tested' elite

By Claire Makin

At Geneva-based Fundana, the principals have hit upon a way of wringing the best returns out of their managers – invest early and exit when they get too big.

Dariush Aryeh, who co-founded Fundana with Thomas Alessie in 1993, cites a string of top-performing names, some of which Fundana selected when the ink was barely dry on the managers' offering documents.

They include John Thaler's JAT Capital, Wayne Cooperman's Cobalt Management, Tye Schlegelmich's Sonterra Capital, and Senator Investment Group, run by Alex Klabin and Doug Silverman.

Spotting the next big name is a sort of holy grail for allocators – an elusive quest with huge potential rewards but a lot of disappointment, and even danger, along the way.

But Aryeh, who is chief investment officer, claims that Fundana's approach vastly reduces manager risk in a fund of funds portfolio. It does this by creating three layers of managers: core positions with tried and tested managers who drive returns; emerging managers on trial with a minimal sum invested; and managers who are in transition – either on their way up, or out of the portfolio.

Fundana's flagship Prima Capital Fund, with $370 million in assets, has just been awarded a AAA rating by Standard & Poor's, and it is on Swiss bank Julius Baer's highest-conviction fund of funds list. Prima, which invests primarily in long/short equity, has returned an annualised 6.9% with volatility of 6.6% and a maximum drawdown of 20% since January 2003.

There have been "no gates or suspension of redemptions, and no Madoff" at Prima or either of the other two funds of funds that Fundana runs.

In total, Fundana oversees nearly $800 million, most of it in the three funds and the rest for two small family offices. The partners have a substantial slice of their own money in the funds.

Fundana itself has a rather unusual history. Aryeh and Alessie, who is chief executive officer, started the firm 18 years ago to advise Bank Leu/Credit Suisse on Prima Capital Fund and other alternative investments, with assets rising to around $1 billion.

In 2003, Trocadero Funds – to which Fundana is sole advisor – bought out Prima Capital Fund and launched Trocadero Capital Holdings, a multi-strategy fund with $220 million in assets. A third fund with an event-driven focus, Prima Opportunity, was added to the stable in 2005.

Unusually, Fundana's client base is mostly high-net-worth individuals, and won via Switzerland's very efficient distribution network of banks and independent asset managers. The typical client has $10 million to $20 million invested in the funds – bringing both benefits and drawbacks, Aryeh notes.

Fundana lost more than half its assets in 2008 as investors pulled out, and Aryeh admits he was scared. But the money returned, with more, in 2009. He attributes this to Fundana's close relationship with clients and the disappearance of many formerly high-flying funds. "We knew our clients and we knew exactly where their money was invested," he says.

Fundana has been refining its investment process

> *"Ultimately, it is not just how many good funds you have, it is also a question of avoiding any accidents in the portfolio"*
> *Dariush Aryeh*

for the past 10 years, and Aryeh is keen to dispel any misunderstanding that its portfolios consist solely of new managers. Instead, the key driver of performance is a core of 10 or so mid-sized funds that account for 50 % to 70% of the net asset value. Where Fundana differs in its approach from most competitors is that these funds have typically been in the portfolio for several years since their earliest days.

"You can't have a core position of 6% to 7% with a manager if you haven't tracked them and grown with them," Aryeh says.

Finding new managers and replacing older ones is a gradual and very controlled process at Fundana. Research head Michael Gerber tracks the layer of two to four managers just below the key person at all of the top hedge funds. These are people who are running money, and as an added bonus they will already have passed their employers' rigorous hiring processes. "As soon as we hear news that anyone is moving out to start their own fund, our network goes into action," Aryeh says.

When news emerged in fall 2010 that portfolio manager John Wu was leaving Kingdon Capital Management in New York, Fundana spoke to people who had worked with him since 1994, and met him twice before making a day one investment. Sureview was seeded by industry titan Blackstone Group.

Fundana likes classic fundamental hedge fund strategies and avoids the 'acronym soup' of ABS, MBS, CDO, PIPEs and so on. According to Gerber, a typical background that the team looks at is an Ivy League university degree, followed by a job at a major investment bank, an MBA at a top university, and one or two blue chip hedge fund jobs as an analyst or portfolio manager.

The team is very picky and insists that managers use top administrators and other service providers — one prospective manager was recently rejected at a fairly advanced stage in the due diligence process for insisting on using an administrator who was not on Fundana's A-list.

Fundana views this layer of the portfolio as 'creating the future'. The book consists of 15 to 20 early-stage managers who represent 20% to 25% of overall investments. Most of the managers launch with $50 million to $200 million and are seeded by their former employer, a seeding platform or an anchor client. Unlike many of its peers, Fundana avoids the mega start-ups favoured by large institutional investors. "We don't believe in day one investing when they're starting huge," Gerber says.

Every two months or so Fundana makes trips to London and New York to meet the 10 to 15 new managers on Gerber's shortlist. Two or three are usually selected for the portfolio as a result, adding up to 15 in a good year.

A recent trip to New York yielded six or seven potential new funds including spinoffs from Atticus, Kingdon and Duquesne. Aryeh says that he is currently seeing more new launches of incredible value than for seven or eight years. In the wake of the financial crisis, managers kept their heads down and waited for the storm to pass, but the last six months has seen a rush to jump ship and start new funds.

Dariush Aryeh

Aryeh and his colleagues are currently most excited about event-driven strategies, particularly on the equity front. One favourite is Hylas Capital Partners, launched in 2010 by two former investment professionals from JANA Partners, a well-known activist investor.

As for credit, the Fundana team views most opportunities as well-priced or expensive.

Although they started moving money out of global macro 12 months ago, they are still looking for first class global macro managers. It is only worth investing in the brightest global macro stars, Aryeh says. The problem is that these tend to shine brightly for a very short time, attract billions, and then peak. By contrast, good long/short equity managers grow more slowly and outperform for longer.

No matter how skilled they are as investors, Fundana is aware that not all managers will succeed in running their own venture. So the money initially invested is tiny by most measures — $1 million or at most $2 million at the start on the grounds that "you must have your feet inside" to see how a fund works.

Despite these small initial amounts, Fundana has almost never been turned down by a manager. The firm does not have a 'hot money' reputation, and is respected for understanding managers and laying out clear rules, Aryeh says.

Fundana: at a glance

AUM: $800 million

Headquarters: Geneva

Founded: 1993 by Dariush Aryeh and Thomas Alessie

Funds of funds: Prima Capital Fund, Trocadero Capital Holdings, Prima Opportunity Fund

Client base: mostly high net worth

Underlying funds: about 60

Team: 17 professionals

Once a fund has been selected, Fundana will get to know the manager over the next 12 months. "We wait till they stabilise and prove they can build a fund structure and performance," Aryeh says. The fund may be given more money and moved into the 'transition' portfolio en route to becoming a core fund, or it may be dropped for any number of reasons.

The ultimate success or failure rate for Fundana is tough to measure because it will quit any fund that is unlikely to become a core investment, although the manager may go on to be successful.

The result is a portfolio of 10 or so core managers that drive performance. "We know them upside down. It takes a tremendous lot of risk out of the portfolio," Aryeh notes. This is a crucial factor which underpins Fundana's fund of funds philosophy. "Ultimately, it is not just how many good funds you have, it is also a question of avoiding any accidents in the portfolio," he points out.

This approach could lead to a degree of complacency, with favoured managers occupying safe seats in the portfolio for years. On the contrary, Aryeh says, core managers have to prove that they can still perform better than newer ones coming up the ranks.

Those that fail to do so have usually grown large and are starting to take less risk. At this point, institutions become interested and the fund appears on consultants' shortlists. "This is the time we want to consider decreasing the position," Aryeh says.

He also believes that managers of large funds are increasingly aware of 'headline risk', and may make decisions simply to keep their names out of the media spotlight.

But Fundana seldom makes a sudden shift in or out of a manager. Transitions are gradual, and a fund judged to be past its peak will join the 10 or so others who are moving into or out of the core book, unless there is a significant problem that would cause a full redemption.

It looks to be a fairly resource intensive process, more so because of the deeper due diligence involved in selecting early stage managers. But Aryeh points out that Fundana invests in only 60 underlying funds, and meets only those managers that have passed all its in-house analysis and are potential candidates to be core funds at some future date.

He says that Fundana's team of 17, including six partners, would be perfectly capable of handling more than $2 billion without making any radical changes to people or process.

Right now, Fundana is enjoying the reversal in its fortunes. It has seen some $60 million in new commitments since the start of the year, and is looking to make two or three new hires to strengthen operational due diligence, research and operations.

But Aryeh believes the sweet spot for Fundana is no more than $2.5 billion. That would make the firm large enough to attract and keep talented people, and small enough to preserve a culture where, he says, the whole team is passionate about coming to work every morning.