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newmanagers

Opalesque's Emerging Manager Monitor

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Are emerging managers becoming more and more experienced?

The Fundana series discusses investments in Emerging Managers, derived from the real world experience of the Fundana team. Fundana is the investment advisor to several Funds of Hedge Funds and directs around half of its new investments to Emerging Managers. The investment process typically involves allocating a small amount Day 1 or Early Stage (within the first year after the fund's launch) to new managers who have strong pedigrees.
The objective of this series of articles is to share thoughts around our key observations. It does not aim to be "statistically significant" but to create a dialogue around those observations.

The Emerging Managers space is currently in vogue. Following the 2008 credit crisis, allocators focused first on the opportunity to invest with previously hard-closed Blue Chip hedge fund managers. Now that most of those funds are hard-closed again, investors are taking another look at Emerging Managers.

This article looks at the experience of the fund managers when they launch their hedge funds, encompassing their previous experiences in the financial industry and in hedge funds specifically. **The goal is to identify any differences between the pre-crisis and the post-crisis environments on the ability of emerging managers to join the ranks of their more celebrated peers and the career path they had followed to reach this elite group.**

We will focus on small and mid-sized fund launches (typical Day 1 assets under management ("AUM") of between $20m and $500m) as Fundana does not invest in the very large new launches (>$1bn at launch). The dataset has been compiled from all new investments made in our Funds of Hedge Funds since January 2006, encompassing 69 Day 1 / Early Stage investments in the Long/Short Equity, Global Macro and Event Driven strategies.

Are experienced emerging managers more sought after by investors compared to their younger peers?

For the purpose of this article, we consider two separate periods: the first period runs from January 2006 to July 2008, hence before the industry crisis; and the second period runs from August 2008 to date. The database contains 25 Day 1 / Early Stage investments in the first period and 44 in the second period.

Looking first at the length of time a new fund manager has spent in finance prior to launching his fund, we define this experience in the financial industry as the number of years the manager worked either in an investment bank (most often as equity analyst, M&A analyst, credit / leveraged finance analyst, trader, private equity analyst or economist) or directly in a hedge fund.

Quite intuitively, most of the managers had experience in both types of company, first learning analytical methods in an investment bank, followed by the subtleties of asset management in a hedge fund. Only nine managers in our dataset went straight into the hedge fund industry, either upon graduation or after a first successful experience at a blue chip consulting firm.

Managers' Financial Experience Prior to Launch	Pre-July 2008	Post-July 2008	Total funds
Up to 5 years	**8% (2 funds)**	**5% (2)**	**6% (4)**
Between 5 and 10 years	60% (15)	27% (12)	39% (27)
Between 10 and 15 years	28% (7)	43% (19)	38% (26)
More than 15 years	4% (1)	25% (11)	17% (12)
>400%	7%		11%

Table 1: Years of experience in the financial industry for new hedge fund managers

Table 1 show that pre-crisis, it was common to find new fund managers with relatively less experience, with 68% of the new managers in our poll having worked less than 10 years in the financial industry before launching their hedge funds (2 managers had up to 5 years' experience and 15 managers between 5 and 10). This confirms our expectations, as there are many examples where hedge fund legends started their successful ventures early in their careers (Ray Dallio, Ken Griffin, Paul Tudor Jones and Wayne Cooperman to name a few), and this links with the idea that a manager needed to be hungry and entrepreneurial to invest and to fight the market every day. It was almost suspicious to start your hedge fund late in your career!

As we compile the data for the period post-crisis, we observe that our dataset has drastically drifted from the pre-crisis period with 68% of the new managers having worked in the financial industry for more than 10 years, and 25% for more than 15 years. Unfortunately we do not have data to confirm if this is consistent with what the overall industry experienced, but we are inclined to see a trend developing towards more experienced managers starting their funds.

To take the analysis a step further, we now split the experience of the managers between investment banking and hedge fund.

Pre-crisis		**Investment Banking / Private Equity Experience**		
		Up to 3 years	4 to 6 years	7 years +
Hedge Fund Experience	Up to 3 years	0	1	0
	4 to 6 years	8	6	2
	7 years +	4	4	0

Table 2: Breakdown of experience for new hedge fund managers before the crisis

As can be seen in the Table 2, the largest category in the sample was 8 managers, which had up to 3 years' experience in an investment bank, then between 4 to 6 years' experience in a hedge fund before launching their fund.

The typical career path for our new managers prior to the crisis was 2-5 years in a bank, then 4-6 years in a hedge fund, and then the manager would set-up is own fund. We did already see long-term hedge fund analysts (7 years and more) joining the new manager list but it was more common for the managers to start sooner. We had few long-term investment bankers in the dataset, as investment banking was still a very lucrative activity.

Pre-crisis		Investment Banking / Private Equity Experience		
		Up to 3 years	4 to 6 years	7 years +
Hedge Fund Experience	Up to 3 years	0	1	1
	4 to 6 years	6	5	6
	7 years +	12	9	4

Table 3: Breakdown of experience for new hedge fund managers before the crisis

As can be seen in the Table 3, the largest category in the sample was 12 managers, which had up to 3 years' experience in an investment bank, then 7 years + experience in a hedge fund before launching their fund. Post-crisis, the two categories that rise the most are the 7 years + categories from both investment banking and hedge fund. We classified them as mature managers. Mature hedge fund experienced managers have accounted for 25 out of the 44 funds we invested in, hence 57% of the poll vs. 32% pre-crisis. Mature investment banking experienced managers totaled 11 out of the 44 new managers, hence 25% vs. 8% pre-crisis.

Key takeaways

This article showed that post crisis, launches for emerging managers tend to see more experienced managers (10Yrs+ as opposed to less than 10Yrs pre-crisis). One would venture also that more experience means more maturity. In addition, whereas before the crisis, managers would spend only 4 to 6 years in a hedge fund before launching, they now spend about 7Yrs to hone their craft.

It is probable that these data have drifted partly because of the following trends in the hedge fund launching space:

1. As the industry has matured, more and more new managers launching their fund have worked a long time in the industry compared to 5 years ago, where having 7 years' experience would have meant that they joined the industry back in 2000.

2. The crisis motivated / forced talented senior analysts of successful funds to start their own funds, after they stayed a long time holding responsibilities and creating value for their past employers.

3. The external AUM (without seed deal) raised Day 1 shrank after the crisis as we have observed in a previous article in this series, meaning a large Day 1 commitment by the manager is mandatory, as launching with 5-10M$ is no longer viable. This requires time for the managers to create

this needed wealth.

The Emerging Manager space has never been so mature, considering the long and wide ranging experiences of the managers we are currently starting to invest with. It is welcome in the current market environment where the markets are difficult to navigate. But at the same time, the jury is still out to see if those managers have the hungriness of their younger peers to take sufficient risk, so that they can outperform their peers and the industry in the long run.

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