

## ***Investors Probe Survivability of Hedge Funds***

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By [Paul O'Dowd](#)

Hedge funds of funds and hedge fund advisors are scrutinizing hedge fund shops closer than they have in a long time. The issue of "survivability" is front and center as hedge managers struggle with market volatility and redemption requests and predictions mount of multiple casualties.

The biggest factor that funds of funds and financial advisors are looking at is the "survivability" of hedge funds in this market environment. The amount of research that goes into testing "survivability" is intense as a number of factors have to be looked at, some that are difficult to uncover. Among the main items firms are looking into are retention of key hedge fund talent, style drift, concentration of investments and how key firm members feel psychologically about their firm's outlook.

While due-diligence has always played a large role, key members of the industry explain that certain areas now carry more weight than they have in the past. In-person meetings between hedge shops and potential investors and advisors are on the rise. The question is how many hedge funds are going to be viable going forward, says **Catherine Cripps**, head of research for the multi-manager business at giant hedge fund [GAM](#)<sup>1</sup>.

"Whether the partners are managing the fund for liquidation or significant redemptions or managing a stable base and looking for future returns and possible growth (are all things we are looking at)," says Cripps. Researchers will try to find out if the partners are managing a stable business or if they think it is unraveling. Those factors can psychologically change the decision-makers on whether they are looking long-term or not, she says. Part of the due diligence is gaining a gut feeling for the hedge fund business.

Another key area of interest for investors is style drift. If a fund is not performing well, it is possible managers could grasp at straws and move from their dedicated area to another. Leaving their sweet spot causes risk for the investor as this is not the specific asset class the fund was hired to manage, says Cripps. In times such as now, style drift becomes more apparent and risk becomes a much larger factor as managers roll the dice in an attempt to pick up returns.

Another key area of interest for investors is the retention of talent. In times of uncertainty, the poaching of key talent is always on the minds of both investors and the firms themselves. Questions such as how managers are going to pay analysts and whether the partners are stepping up to keep key talent are on investors' minds, says Cripps.

These uncertainty surrounding the hedge fund industry was only compounded last week when **George Soros** said at the [Massachusetts Institute of Technology](#)<sup>2</sup> that he predicts the hedge fund industry will shrink to just one-third of its current size or near that amid the ongoing crisis. However, it is unclear if he was speaking about the number of funds or the amount of assets under management. To read more about this, click [here](#).

**Scott Baker**, a principal at hedge fund advisory firm [Cook Pine Capital](#)<sup>3</sup>, says his firm has always done deep research on firms, such as back-ground checks and even getting to know friends of key personnel at certain hedge shops. One thing that has changed however is the frequency of calls and meetings. "You have to keep closer tabs on redemptions and performance," says Baker, former co-head of the alternative investment group at [Morgan Stanley](#)<sup>4</sup>.

But possibly the most important item, says Baker, is "exercising good judgment." One way to do this is to look into the past of these fund managers and see how they have previously reacted to adverse market

conditions. Look at poor months or quarters and see how they have come out of them, he says. "If a manager has seen this type of crisis in the past and shown "mettle" coming out of it, that is something we look for," he says.

**LJH Global Investments**<sup>5</sup>, COO **Rob Blabey** agrees that looking into the past may be the most powerful indication of what is to come. Blabey tends to look more into the near past. He says one method of understanding a fund is to go back a year or so and look at the marketing materials. If a firm says it has low volatility strategies and the products turn out to be highly volatile, that can be a tip-off, says Blabey. He notes that there are different shades of gray when it comes to this, but a person's judgment is key here.

He says LJH "opens its books" to see what firms said a year ago when the markets were more stable and how they said they'd react during a market turn. "We want to see how true to their word these firms are," he says. "If they said they'd be less volatile than the market or if they invest in fixed-income and drifted into equity, we want to know," he says, noting that a firm's word should hold weight.

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