

US Hedge Fund Startup Guide

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CHANGES IN FUND TERMS

Better alignment between managers and investors

INVESTMENT STRATEGY

The importance of differentiation

INDUSTRY DYNAMICS

Startups face elongated sales cycle

Featuring Anchin | BNY Mellon Pershing | Eze Castle Integration | Harbour | Harneys | Opus Fund Services | Sadis Goldberg



Paving stones on the path to success

Interview with David Kaufman & David Shalom

The trajectory of a startup hedge fund does not solely depend on the strength of the investment strategy on offer. Several elements must come together to set managers on their journey towards a successful first capital raise which will see them grow into emerging firms.

Startup managers in the pre or just launched stage should turn to private wealth and institutional investors when looking to raise their initial capital. Friends and family, their professional network and single-family offices can be their first port of call followed by larger seed investors, institutions with an appetite for early-stage investments and funds of separately managed accounts.

David Kaufman at Pershing notes: “After that initial capital raise, managers can broaden their outreach strategy to include multi-family offices, consultant and outsourced CIOs, fund of funds, endowments and foundations.”

As startup managers move beyond that first capital raising and grow into emerging managers, they need to

consider whether to add a dedicated fund marketer to their staff. If they choose not to do this, they need to question what they are sacrificing if an existing team member is tasked with leading the charge in this regard.

“Someone on the team needs to lead the investor relations and marketing effort,” says David Shalom, also from Pershing. “For startup managers who cannot hire a seasoned fundraising professional yet, they can engage a third-party placement agent to help with their initial capital raise. Then as startup managers evolve into emerging managers, with an increasing revenue base that supports additional in-house hires, they can add an in-house marketer.”

Continuing to discuss the marketing front Kaufman adds: “Managers need to question whether they have a polished, updated marketing presentation that clearly explains the investment strategy, the differentiation of the strategy, performance track record, manager background, etc. Their

marketing collateral also should have a different look and feel from other similar collateral, to stand out from the pack.”

This differentiation is a critical feature of a startup manager’s establishment of a strong foundation. They need to clearly outline their investment philosophy and how they are planning on implementing it. Demonstrating how this philosophy is different to their peers – and highlighting the strategy’s edge over larger established managers – is also vital for funds which have just launched. Articulating in which market environment their strategy works best is also critical.

Another important building block in this eco-system of support is the prime broker. To assist their operational efficiency, startups need to be able to rely on a solid prime broker that is both a stable financing counterparty and dependable day-to-day provider of a manager’s account and trading needs.

Beating virtual fatigue

In terms of product offering, the needs and demands of startups have not changed significantly since before the Covid outbreak. However, the need for greater transparency and increased communications has been reinforced by volatile market conditions which demand heightened awareness between counterparties.

In the current environment, the inability to host and meet with an investor’s due diligence staff and progress those investor discussions to the closing check-writing stage is a significant challenge.

“Despite this challenge, the market environment for many hedge fund strategies improved significantly with increased investor interest. This leaves significant opportunities for managers who can find allocators with both the appetite to invest and have the operational wherewithal to still write those checks to new managers despite the logistical challenges,” Kaufman explains.



David Kaufman

Director, Prime Services, BNY Mellon | Pershing



Based in Dallas, Dave Kaufman oversees BNY Mellon | Pershing’s capital introductions efforts across the Sun Belt in the US, from the Southeast to the West Coast. He has built a robust network of investors into alternative strategies – ranging from single family offices and independent private wealth managers to top university endowments, private foundations – as well as public and corporate pension managers.



David Shalom

Vice President, Prime Services, BNY Mellon | Pershing



David Shalom is a Vice President from the Prime Services division of BNY Mellon | Pershing. David leads our capital introduction team in the Northeast and Midwest US, assisting clients in their capital raising efforts. Allocator relationships available for introductions include private wealth investors (leading private banks, trust banks, RIA wealth managers) and institutions (university endowments, hospital networks, and multi-manager platforms).

Kaufman continues by stressing how despite virtual meeting fatigue, managers should pursue as many live interactions with prospective investors as possible: “It’s a numbers game; the more meetings you have, the greater the chances of success. We have heard anecdotes from managers who raised capital solely from virtual meetings in the Covid era.”

Overcoming fee pressure & looking ahead

Another challenge startup managers face is the persistent fee compression. “New normal” fee arrangements can range from a 1 per cent management fee coupled with a 10 per cent performance fee or up to a 1.5 per cent management fee and 15 per cent performance allocation or higher – but generally it’s harder to get to the 2 per cent and 20 per cent standard from years past.

In addition, founders share classes (which offer discounted fees to early investors up to a certain AUM threshold) remain popular. They are an effective option for pre-launch/just-launched managers and emerging managers looking to build an initial critical mass of capital.

“It is crucial for new managers to structure their business and budget from the start in relation to their current capital base. This will help ensure operational soundness and solvency in the eyes of prospective investors that will vet the business risk of the management company,” advises Shalom.

The recipe for success hinges on three moving parts which all need to be executed to a high level. First, managers must manage their strategy well, meeting return and volatility targets. Next, they need to manage the business side of things, balancing infrastructure and staffing expenses with profitability.

The final piece of the puzzle is related to how managers present themselves in meetings. Here, their demeanour and collateral need to inspire confidence in their abilities. ■