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Consultants change the Billion Dollar Club ecosystem, but Blackstone still tops the rankings with \$54 billion

Mon Mar 10, 2014

Professional allocators to hedge funds grow by 7.6% to run \$728 billion in 2013 as industry enters new phase

[For the full Billion Dollar Club listing, please click here](#)

By Niki Natarajan

The ecosystem of the multi-manager hedge fund investor – also known as the fund of hedge fund – has survived the oil slick that was the financial crisis and its aftermath, to emerge either larger and stronger like the elephant or sleek and purposeful like the humble bumble bee.

In 2013, the world of the multi-manager investor grew by 7.59% finishing the year with 105 providers (compared to 101 the previous year), which now run \$727.93 billion. In terms of performance, funds of funds had a good year too, up 8.67%, with some FoHFs doing better than others.

In the April issue, InvestHedge will highlight the FoHF performance stars of 2013, but anyone who held Quantum Endowment Fund, now run by Scott Bessent, Lone Pine, Viking, Appaloosa and/or Baupost is likely to have seen good returns, according to Rick Sopher's annual ranking of the Great Money Managers. The chairman of LCH Investments, part of the \$7.7 billion Rothschild family of FoHFs, calculated that the top 20 managers made \$55.4 billion net of fees for their investors in 2013 and outperformed the hedge fund averages by a considerable margin.

Investors in equities once again captured the opportunities in 2013 best and 70% of the total gains in 2013 came from investments in equity markets. The top 20 hedge fund managers made net profits for their investors of \$199 billion in the five years to 31 December 2013, which is far greater than the \$28 billion they lost in 2008, says Sopher.

"Hedge funds continued to generate impressive gains for their investors. In 2013, the net gains of \$192 billion take the gains that they have generated for investors after all fees since their inception to \$847 billion. This is a strong result, with the best managers capitalising on strong equity markets. So far in 2014, the best managers have also been able to protect on the downside," he adds.

Among the trends that emerged in 2013 was the launch of the liquid alternative fund of hedge fund in the US, catering to the quasi retail clients of the mutual fund giants and rapidly growing defined contribution market. In one year, eight firms managed



to raise \$3 billion in new assets.

For the first time since the crisis, the InvestHedge ranking has seen 11 new entrants, of which three are consulting firms. Although this will be described in detail later, it is worth noting that three types of new entrant are of particular interest. The first is the self-invested fund, which is a collection of the internal strategies of single managers such as Brummer & Partners and Brevan Howard Asset Management.

These two European managers, whose underlying manager performance is listed in the EuroHedge database, have joined BlueCrest Capital Management in the rankings, although their multi-strategy offerings have already had more than \$1 billion for some time. Their popularity is rising due to the investors' belief that they are getting the diversification of multi-managers without the second layer of fees.



Rick Sopher



Michael Sacks

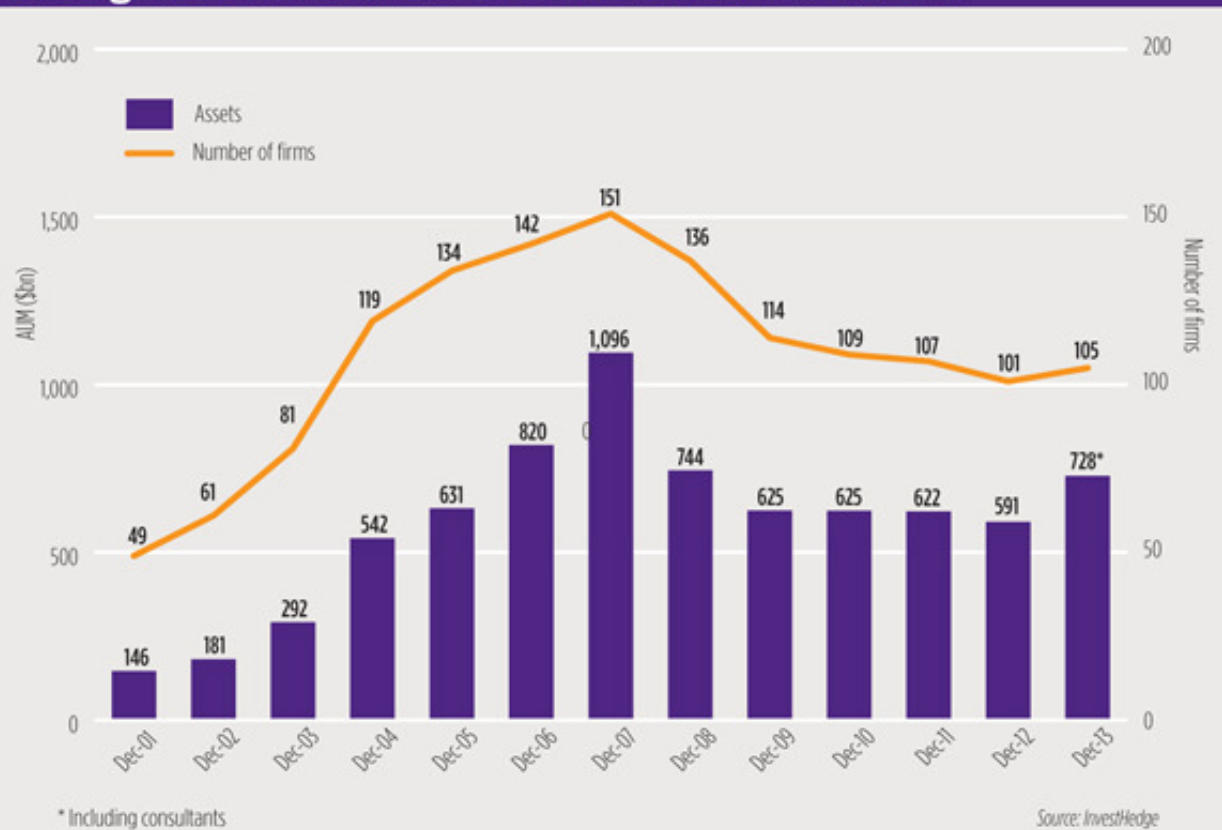
InvestHedge \$1bn FoHFs at a glance

	No/Firm name	31/12/2013 Total \$1bn	01/01/2013 Total \$bn	% Growth	% \$1bn Club
105 FoHFs	105	727.93	676.27	7.59%	100.00%
Top 10 by assets	10	293.86	265.16	10.83%	40.37%
Top 10 by growth	10	44.00	26.17%	68.13%	6.04%
Super league (\$10bn+)	18	396.88	367.37	8.03%	54.52%
Largest firm	Blackstone	54.29	45.19	20.15%	7.46%
\$5bn-\$10bn	24	180.93	162.40	10.93%	24.86%
\$1bn-\$5bn	63	152.22	147.90	2.88%	20.91%
Positive growth	63	569.33	477.28	14.40%	78.21%
Fastest-growing firm	Liongate	7.30	1.90	284.21%	1.00%
Flat growth (or no reply to survey)	9	21.74	21.74	0.00%	2.99%
Negative growth	33	138.96	159.16	-12.64%	19.09%
Biggest asset outflow	Attalus	1.24	2.65	-53.21%	0.17%
New entrants	11	119.55	106.82	11.91%	16.42%
Exits	6	7.87	8.60	-8.53%	1.08%
US-based firms	58	446.88	405.10	10.32%	61.39%
European-based firms	44	273.23	264.54	3.24%	37.54%

Source: InvestHedge

Secondly, the 'real' new entrants in 2013 are New York-based Gapstow Capital Partners and Geneva-based Fundana as both firms started the year with less than \$1 billion and have grown assets, despite all the noise suggesting that FoHFs as a vehicle are dead. The one thing these two firms have in common is that they are niche players, the former in the less liquid credit space (InvestHedge, May 2013) and the latter in the smaller US equity long/short market (InvestHedge, June 2011).

Asset growth: The Billion Dollar Club since December 2001



But it is the entry of the investment consultants to the InvestHedge Billion Dollar FoHF Club that has raised a few eyebrows among the established funds of hedge funds fraternity and could change the shape of the professional hedge fund investing landscape for as long as investors believe they can get what FoHFs give them but for less in fees.

Top 10 allocators make up 40.3% of the industry

The top 10 firms by assets, which make up 40.37% of the industry, grew by 10.83% to finish the year with \$293.86 billion in assets under management. No-one in this sub-set, which houses the three new consultant entrants, saw outflows. This group's asset growth has been boosted largely by the leader of the pack, Blackstone Alternative Asset Management, which retains the title of largest active professional allocator having breached the \$50 billion barrier to manage \$54.29 billion. Blackstone alone accounts for 7.46% of the industry's total assets.

The New York-based group run by Tom Hill is the poster child for professional hedge fund allocators offering the entire range of services, from seeding hedge funds at one end through portfolio customisation and commingled products for institutional clients, to the more liquid funds at the other. Blackstone now has the closed-end \$196 million Blackstone Alternative Alpha Master Fund for high-net-worth clients and its most recent offering, the open-end Blackstone Alternative Multi-Manager Fund. The daily liquidity mutual fund designed for Fidelity Investments raised \$1.1 billion in less than a year.

The fastest-growing firm among the top 10 largest is Permal Investment Management, which grew by 21.39% to reach \$22.23 billion, a jump that in part can be attributed to the merger with Fauchier Partners, which completed on 13 March 2013. It is also among the active professional allocators that underpins its business with a managed account platform, which in the case of Permal has \$7.98 billion.

Permal, an affiliate of Legg Mason, also recently launched its own open-end daily liquidity FoHF called Permal Alternative Select Fund, its first open-end alternative mutual fund; a move that Morgan Stanley Alternative Investment Partners has also taken. Morgan Stanley, which now has \$22.8 billion, saw its assets grow by 12.15% in 2013.

The liquid alternative FoHF industry has only really been in existence for a year, but eight firms have raised \$3 billion in that time (InvestHedge, January 2014). Among the first daily liquidity funds to launch was the Neuberger Berman Absolute Return Multi-Manager Fund, raising \$600 million. Despite this, and winning a defined contribution mandate from Hartford Healthcare in Connecticut, NB Alternative Investment Management saw its assets fall by 17.72% to end 2013 with \$2 billion in assets.

The first FoHF to hit the headlines with a retail mutual fund was Arden Asset Management. It was the first group to team up with a mutual fund giant, Fidelity Investment, specifically to design a daily liquidity product for

distribution to high-net-worth investors. But the firm, founded by Averell Mortimer, also saw assets outflows of 11.59% in 2013. Despite raising \$1.03 billion for the daily liquidity Arden Alternative Strategies Fund, the New York-based firm ended the year with \$6.1 billion under management. The firm, however, is committed to the defined contribution market and has launched a second product.

Goldman Sachs Asset Management and Grosvenor Capital Management continue their race to the top, with Grosvenor growing faster than Goldman in 2013, but the latter beating it to sixth place with assets of \$24.98 billion.

Grosvenor Capital Management, which grew by 9.42% to run \$24.4 billion, has completed its purchase of the Customized Fund Investment Group, the private equity, infrastructure and real estate investment management arm of Credit Suisse Group. The deal, which completed at the start of January, saw the group renamed as GCM Customized Fund Investment Group.

Founded in 1971, the merger announced last year, which will bring the Grosvenor's alternative assets for 2014 to \$44.4 billion, is preparing for the convergence between hedge funds and other types of alternatives by expanding its business into private equity, infrastructure and real estate investment management.

"This transaction makes each firm a more valuable partner for existing clients," says Michael Sacks, chief executive officer of Grosvenor in Chicago. "It creates a strong and diversified multi-asset alternatives platform that can support institutional investors across a range of alternative investments. The CFG team is made up of highly talented and experienced investors who share our core values including an intense focus on investment performance, on their clients and on customised solutions," Sacks adds.

Grosvenor is a popular choice among pension funds and is also an example of a FoHF group that is expanding its remit into the advisory space, at the same time as the consultants try their hand at offering fund of funds services. The most recent example of Grosvenor's move into advisory is the \$2.3 billion Royal County of Berkshire Pension Fund in the UK, which selected it to overhaul its alternatives allocation (InvestHedge, November 2013).

According to Grosvenor documents dated September 2013, the Chicago-based firm actively covers 884 hedge funds with a team of more than 250 people. Among the names it allocates to are the ones listed in the Grosvenor Registered Multi-Strategy Master Fund.

Consultants bring \$93 billion in new assets

When it comes to allocating to hedge funds, the lines are blurring between consultants offering fiduciary management in hedge funds and FoHFs such as Grosvenor offering advisory services. The total assets of the top 10 largest funds of hedge funds have been boosted by the entry of a new type of multi-manager hedge fund investor: the consultant.

Collectively, Cambridge Associates, Mercer and Towers Watson add \$92.87 billion, having grown by \$7.31 billion, or 8.54%. These three new entrants alone make up 12.64% of the industry's assets. While consultants, particularly Cambridge Associates, have been assisting pension funds to allocate directly to hedge funds for a long time, it is the first time that they appear in what has been, until now, an entirely FoHF ranking.

The official entry of the consultant marks a new phase in the growth of the professional hedge fund allocation industry, where the consultants, once gatekeepers, have now become poachers, assisting pension funds to invest directly, where once they would have helped them select FoHFs.

Although the FoHF industry overall has not reacted well to this, the evolution was inevitable as defined benefit schemes start to shrink and defined contribution plans become the new game in town. Additionally, for the time being, the consultants have typically focused on the brand names (InvestHedge, June 2013), only a few of which are on the LCH Investments' list of top 20 hedge fund managers ranking by net gains (after fees) since inception.

What the entry of the consultant to the rankings does do, however, is bring 'provider transparency' that will ultimately be beneficial to the end investor. Knowing a consultant is also an allocator should help to avoid the potential conflict of interest should a consultant handling a beauty parade also put themselves forward as a candidate.

Mercer, which enters as the new number two, displacing UBS Global Asset Management, which is now in fourth place, has \$37.7 billion across all commingled funds, customised portfolios and advisory assets, while the third-largest hedge fund adviser is now Cambridge Associates.

While Mercer in the UK no longer presents FoHFs in beauty parades, Cambridge does have endowment and foundation clients, in particular in the US, which still prefer FoHFs and as such will allocate to them on their

behalf. For this reason, Cambridge, which has \$34.17 billion in assets and grew by 14.82% in 2013, does not offer a commingled option, although it does offer bespoke portfolios and advisory services. According to an interview with Mercer in the US, some of its clients still do need funds of funds and so what was the former Hammond Associates business still offers this.

Towers Watson, which stirred the hornet nest with its debut in the mid-year survey, is in 10th place in the 2013 rankings, having grown by 3.96% to manage \$21 billion. The firm can offer fiduciary asset management via Oxford Investment Partners, a firm it bought in December of 2012, and while it has not withdrawn from offering FoHFs, its clients seem to prefer to allocate directly.

“Throughout the past five years the alternative fund managers that we have put into client portfolios have shown their ability to adapt to the changing environment to generate good net-of-fees performances. Larger institutional funds are likely to continue to invest in funds directly for most alternative asset classes rather than via funds of funds as investors continue to focus on better fee structures, greater transparency and smart beta options. Indeed, there were only three FoHF mandate selections in 2013, which is a demonstration of this point,” says Craig Baker, global head of investment research at Towers Watson.



Craig Baker

Last year Towers Watson’s clients carried out alternative asset class selections worth more \$12.5 billion, four times more than they did five years ago. Among alternatives, during 2013, real estate attracted the most interest (more than \$4 billion), where one quarter is in smart beta, followed by direct allocations to hedge funds of more than \$3 billion. Infrastructure saw \$2 billion in allocations (where one third was in smart beta strategies), while over the same period, direct private equity attracted around \$1.5 billion and illiquid credit (distressed debt and lending) attracted about \$1 billion in assets.

Towers is a big proponent of smart beta with its clients making more than twice as many new investments in smart beta strategies during 2013, around \$11 billion across more than 180 portfolios, compared to the year before. In 2012, Towers’ clients allocated around \$5 billion across almost 130 portfolios, according to global data from the company. Its institutional investment clients globally have now allocated more than \$32 billion to smart beta strategies in almost 500 portfolios, across a range of asset classes.

Advisory assets grew by 21.77% in 2013

Like wheat, the hedge fund allocation industry is undergoing severe hybridisation. This purity spectrum ranges from pure commingled investing, accounting for \$397.25 billion run by 102 firms, via customisation (with and without fiduciary responsibility) to advisory. There are 46 firms, including three new consultant entrants, managing \$180.25 billion in advisory assets, although it has to be noted that not all advisory assets are equal.

Despite the cries of “foul play” by the purists, the bulking of assets under management with advisory money is not new and was one of the features of the early surveys, when funds of funds such as Blackstone Alternative Asset Management assisted the early adopters of hedge funds such as the California Public Employees’ Retirement System in building their direct programmes and counted those advisory assets as part of their total tally.

Banks with large wealth management units also continue to claim assets under management that are largely advisory. But what counts for the purpose of this survey is consistency, and what is interesting to see is that in 2013 advisory assets among the billion dollar funds grew by 21.77%, while customised account assets, while accounting for \$149.63 billion only grew by 3.55% and commingled assets, which totalled \$397.25 billion grew by only 3.48%. It has to be pointed out that many firms prefer not to split out their commingled, customised and advisory assets so these numbers are just a rough indication of trends.

18 Super League firms manage 54.52% of the industry

A year ago, the Super League – professional hedge fund allocators running more than \$10 billion in assets – had 12 members and that number now stands at 18 firms. The Super League grew by 8.03% to manage \$396.88 billion by the end of the year, equivalent to 54.52% of the industry’s assets.

Some believe that the FoHF industry has no choice but to consolidate its way to 40 or so massive firms with \$10 billion or more, as fee pressure and more investors allocating directly drive this trend. The long only industry in the mid 1990s, however, had the asset management conglomerates and alongside them there were, and still are, highly successful specialised boutiques.

This phenomenon is not unlikely in the hedge fund allocation game too as two types of investors emerge: the fee-conscious buy-and-hold allocator who buys hedge funds and sits on them until a change is necessary; and the

active professional hedge fund allocator, for whom performance is key.

The new entrants to the Super League in 2013 are Prisma Capital Partners, JP Morgan Alternative Asset Management, Aetos Capital, as well as the three new consultant entries. Prisma, which was bought by KKR in 2012, saw its assets grow by 19.8% to reach \$10.6 billion, on the back of continuing favour at US public funds such as the \$72 billion Ohio Public Employees Retirement System, which topped up its allocation in 2013.

Aetos Capital ended 2013 with \$10.88 billion, a growth rate of 15.25%, while JP Morgan was hot on its heels with assets of \$10.6 billion, a growth rate of 15.22%. By growth rate, Permal followed by Blackstone were the fastest-growing, with Prisma, Aetos, JP Morgan, Cambridge Associates and Morgan Stanley all posting double-digit growth rates.

The Super League also houses a few firms that have seen their assets shrink in 2013. FRM saw the largest loss of the group with assets down by 20.71% to reach \$13.23 billion, while UBP Alternative Investments saw its assets end the year at \$10.73 billion, a loss of 9.74% from the start of 2013.

Both FRM and UBP are firms that have used M&A to restore life to their brands with Financial Risk Management merging with the Man Group's FoHFs and UBP buying Nexar Capital, both deals taking place mid-2012. The fall in assets could still be attributed to the fallout following the mergers. Mesirow Advanced Strategies, which has \$13.49 billion, saw a minor outflow of 0.16% of its assets.

FoHFs with \$5bn-\$10bn grow by 10.93%

The fastest growth rate came from the 'inbetweeners', neither the elephants of the Super League nor the smaller bumble bees. Professional allocators, with assets ranging between \$5 billion and \$10 billion, manage \$180.93 billion and saw the healthiest growth rate of 10.93%. This group of 24 firms manages 24.86% of the industry's assets and houses three of the new entrants: AllianceBernstein, which had the second-highest growth rate of 52.47% for the sub-category; Brummer & Partners; and Brevan Howard Asset Management.

The latter two are the self-invested funds of European hedge fund managers, but each of them have sizeable multi-strategy funds invested as a fund of funds. The \$6.4 billion Brummer Multi-Strategy Fund grew by 25.49%, while the \$5.09 billion Brevan Howard Multi-Strategy Fund grew by 10.64%.

The fastest-growing group of this sub-ranking is Liongate Capital Management, due primarily to its deal with Principal Global Investors, a US-based firm that also owns Finisterre Capital, which gave it a growth rate of 284.21%. The deal saw the firm's assets jump from \$1.9 billion in January to \$7.3 billion at the end of the year largely due to a hefty advisory portfolio.

Six of the group of managers with \$5 billion to \$10 billion in assets have more than \$9 billion each, including Entrust Capital, K2 Advisors, Rock Creek Group, SkyBridge Capital, Lyxor Asset Management and Aurora Investment Management. After Liongate and AllianceBernstein, SkyBridge, which has \$9.53 billion, and Entrust, which has \$9.93 billion, were the next fastest-growing firms with respective growth rates of 34.13% and 26.44%.

More than 33% of this group, eight firms, saw outflows in 2013. Credit Suisse, Arden Asset Management and Gottex Fund Management saw outflows of 10.71%, 10.59% and 21.71% respectively. Gottex, which has approximately \$5.3 billion in assets, has announced its merger with EIM, creating a Swiss giant with more than \$8 billion in assets.

FoHFs with \$1bn-\$5bn are essential to the ecosystem

Like bumble bees, smaller funds of funds, those with assets of less than \$5 billion, are necessary to pollinate the small start-up hedge funds. While there are seeders, new hedge funds still need a diverse group of investors with enough experience to see beyond the start-up phase and take a risk – an area that Aurora has taken a strategic interest in. Until a hedge fund reaches a certain size it is dependent on small investments of a few million dollars from a large number of investors, a role for which the smaller FoHF is perfectly suited.

Indeed, it is this ability to source new talent at an early age that is the new mantra of the FoHF fraternity, but unless end investors give assets to the smaller FoHFs, their ability to invest in new talent is diminished. And yet the majority of this 'at risk' universe still seems to be discriminated against because of their size, as can be seen by the small growth rate of 2.88% for the 63 allocators in this space.

This universe with assets from \$1 billion to \$5 billion is 60% of the InvestHedge Billion Dollar Club in terms of number of firms. Collectively it manages \$152.22 billion, so in terms of assets it runs 20.91% of the industry's total assets. The reason why this subset of managers is popular with managers looking to grow their business through M&A is that seven out of the 10 firms with the greatest growth rate are found in this asset bracket. It is also the place that houses the niche boutiques.

In fact, 35% of this group saw double-digit asset growth in 2013, including Corbin Capital Partners, Axa Investment Managers and ABS Investment Management, which grew by 24.18%, 23.28% and 23.06% respectively. In total, 33 firms saw inflows; eight did not grow or report asset growth; and 22 firms, including Attalus Capital, Mirabaud Asset Management, Aberdeen Asset Management and EIM, saw outflows.

Attalus, which according to its ADV filing still manages \$1.24 billion, is believed to be shutting down its fund of funds operation, while Mirabaud's decrease is purely technical as more than \$2.25 billion of alternative mandates for high-net-worth investors were transferred to the wealth management division of the Mirabaud Group when Mirabaud Asset Management was created at the end of 2013.

Aberdeen, which manages \$2.49 billion, saw a 36.87% drop in its assets, while EIM, which is the throes of a merger with Gottex, saw its 2013 asset drop by 33.33% leaving it with \$3 billion to transition over. Additionally among the firms with \$1 billion to \$5 billion are five of the 11 new entrants, namely Gapstow, Fundana, Prime Capital, Tages Capital and TeamCo. Advisers.

Nearly 60% of FoHFs saw assets grow in 2013

As evidence of the industry's turn around, 78.21% of the industry's assets are experiencing growth. Sixty-two firms with \$569.32 billion saw their assets grow by an average of 14.4%. The top 10 firms ranked by growth include Swiss Capital Alternative Investments, which manages \$4.96 billion, saw its assets grow by 104.12% in 2013. The Zurich-based firm was the first to highlight the trend among its investors to differentiate between liquid and semi-liquid strategies for their asset allocation (InvestHedge, September 2013).

In addition to Hall Capital Partners and Seven Bridges Advisors, whose exact assets in hedge funds could not be determined, Persistent Edge, which manages \$2.78 billion, and THEAM, which rubs \$2.37 billion, also saw their assets grow exponentially by 60.03% and 35.92%, respectively.

AllianceBernstein, Gapstow Capital Partners and Fundana were among the three new entrants in the top 10 firms with the greatest growth rates. Gapstow started the year with \$670 million under management and with a growth rate of 53.66% reached \$1.03 billion, while Fundana started 2013 with \$830 million and with a growth rate of 41.4% ended the year with \$1.18 billion.

In terms of outflows, two-thirds of the 33 managers experience outflows in 2013 had less than \$5 billion in assets, further lending weight to the argument of those that believe that the smaller funds will become extinct as individual firms become subsumed into the larger groups. As mentioned before, like bees for pollination, smaller professional allocators are essential for the continued life cycles of the underlying hedge fund industry.

Eleven new entrants add \$120 billion in 2013

The entrance of Fundana and Gapstow Capital Partners is evidence of the fact that small funds of funds still have a place in the food chain. That said, their role has changed and it is easier for niche funds of funds, assuming the niche is in vogue, like Gapstow's credit bias, or demand, like Fundana's smaller US long/short equity manager. In total, 11 new names were added to the rankings bringing with them \$119.55 billion, equivalent to being 16.42% of the assets of the entire industry. This small group brought with them its own healthy growth rate of 11.91%.

There were four main types of new entrants in 2013: forgotten listing (a \$1 billion plus firm not previously catalogued); the self-invested products of hedge funds; the fresh blood, such as Fundana; and the consultants. Tages Capital, TeamCo. Advisers, AllianceBernstein and Prime Capital are members of the forgotten listing. AllianceBernstein, which is part of the Axa group, saw its assets leap from \$5 billion to \$7.62 billion, a growth rate of 52.47%, while Prime Capital, the first German-based group in the rankings, saw its assets grow by 16.57% to reach \$2.11 billion. Prime Capital, which started life as a customised solutions provider for German institutions launched the PCAM Blue Chip fund in October 2007, as it realised that it needed a 'shop-front' product with established track record to show clients.

Continuing with the theme of firms needed to offer both commingled funds and the ability to customise solutions, Tages Capital, the London and Milan-based asset management arm of Tages Group, announced its plans to buy Paris-based La Française, which has roughly \$1 billion in assets, so that it can also offer commingled products. Tages, which has \$2 billion in assets under management and advisory, takes an advisory approach to multi-manager investing to provide customised solutions.

The addition of hedge fund self-invested products started because the UK pension fund community was buying funds such as BlueCrest Capital Management's AllBlue fund as a way to access the multi-manager structure without the extra layers of fees. Brummer & Partners and Brevan Howard Asset Management both also have sizeable multi-strategy funds: the \$6.4 billion Brummer Multi-Strategy Fund, which grew by 25.49%; and the \$5.09 billion Brevan Howard Multi-Strategy Fund that grew by 10.64%, although traditional multi-managers suggest that despite underlying diversification, self-invested FoHFs potentially still have company risk.

Cambridge Associates, Mercer and Towers Watson are among the first three courageous consultants to come forward to join the funds of funds and rank side by side, but they are not the only ones providing advisory and/or fiduciary hedge fund services to pension funds. Their assets alone make up 12.64% of the industry's assets.

For the last few surveys, the firms that have left have outnumbered those that have entered, but in 2013 the reverse is true with only six firms leaving the rankings. In the mid-year survey Dorchester Capital Advisors briefly left the rankings but is back with a full-year growth rate of 1.91% to reach \$1.01 billion. Exane Asset Management, SEB Alternative Solutions (the former Key Asset Management business), Barlow Partners, Benchmark Plus and SSARIS Advisors all left the rankings for falling below the \$1 billion hurdle. The Bornhoft Group has not supplied fresh asset data for more than a year and by their latest ADV filing assets of \$23 million has prompted its removal from the club.

US FoHFs dominate allocator landscape

US-based firms in number total 58, compared to 44 European-based groups, but in terms of the dominance in terms of assets, the US-based firms, which run \$446.88 billion, make up more than 61% of the industry assets. European firms manage \$272.23 billion, growing only by 3.24%, compared to their US peers that saw their assets grow by 10.32%.

While it is obvious that this asset division is likely to exist given the size of the US institutional market, the disparity in growth rates is also likely to have something to do with the recovery lag between the two regions. That said, many believe that the Alternative Investment Fund Managers Directive will help to bring a much-needed boost to Europe.

"While European [FoHF] players will probably try to leverage quickly on the marketing opportunities provided by the directive to gain first-mover advantage, US firms with no or limited local presence may be tempted to stay away and focus on consultants, mandates and advisory services to make their way to the institutional clients before 2015," says Christophe Baurand, head of alternative investments and global head of business development at Lyxor Asset Management.

"US firms might therefore be generally at a slight disadvantage compared to their European counterparts in the coming months. Approaching institutions and presenting them with products and real track records will become more difficult for them under AIFM – at least until the end of 2015 – as past tolerance regarding the interpretation of reverse enquiry is fading away," he notes.

That said many believe that institutional clients in Europe are likely to welcome the directive due to the combined attraction of transparency, increased operational security and onshore regulated vehicles, which could see an increase in activity from Europe. "Some [investors] have refrained from investing until now because the lack of regulated vehicles might well boost demand for alternatives," notes Baurand.

The future for FoHFs

The industry is definitely dividing between the large super alternative asset allocators like Blackstone that have products and solutions for all cycles and in all wrappers available to all types of clients, and the boutiques, which service a specific niche. For a while investors are going to try to save on fees by attempting to invest directly via advisory relationships. This way of doing business is not new and is likely to be the low fee asset battleground between consultant allocators and advisory services offered by FoHFs such as Grosvenor and Blackstone.

For the US market, the liquid alternative fund will have a role to play in terms of gathering assets and for a while it is likely to be dominated by the FoHFs. Smaller FoHFs will continue to raise assets and create a solid business if they are niche in terms of strategy they allocate to or investment attitude, as can be seen by the up-and-coming Lone Peak Partners, run by Betsy Battle. Although Lone Peak is not yet a billion dollar allocator if performance is the driver, firms run like Lone Peak will have no problem finding clients although they might not be the cautious public pension plan.

But, independent firms in the \$1 billion to \$5 billion bracket will continue to be courted by buyers, who believe that asset aggregation is the only way to stay in the FoHF game. Customisation will continue to be attractive to larger investors and mergers are likely to occur between firms that are customisation experts and those that have a commingled product bias, as can be seen by the Permal/Fauchier and Gottex/EIM deals.

What is clear is that allocating to hedge funds is very much here to stay. How the advisory commingled battle will play out between FoHFs and the consultants is the story that will unfold in 2014.

Managed accounts hold more than \$86 billion of investor assets with FoHF contribution growing

Access to a managed account platform seems to be a pre-requisite for any hedge fund investor wanting to invest directly, as in the case of public funds such as Massachusetts PRIM and California Public Employees' Retirement

System – both of whom are currently in the market for a provider. The key question is do they want infrastructure only, or advice on tap? This was the route chosen when California State Teachers Employees' Retirement System selected Lyxor Asset Management. Lyxor, which saw its assets on the managed account platform grow by 12.15%, is the largest in the ranking below.

Assets on managed account platforms have grown by 12.83%, effectively seeing \$9.70 billion in growth to end 2013 with \$85.31 billion. What is interesting is that two of the bank-based platforms run by UBS and Goldman Sachs have not provided new assets figures for 2013, suggesting perhaps bank-based platforms are less popular than the ones run by asset managers.

As can be seen from the table, funds of hedge funds too are having to make similar decisions as some chose to move towards offering clients both commingled funds and the ability to customise solutions, further suggesting the blurring lines between commingled funds and various levels of advisory services. Of the 15 managed account providers listed, 11 providers offer funds of hedge funds. Nearly \$39 billion, equivalent to nearly 45% of the managed account assets, are already accounted for in the main rankings.

Only Lyxor, Sciens Capital Management and Amundi Alternative Investments offer a third-party platform that other FoHFs can plug into, and as such we have not included their assets in the main Billion Dollar FoHF ranking to avoid double counting. Pacific Alternative Asset Management Company, which has more than \$9 billion on its platform, Lighthouse Partners, LGT Capital Partners, Swiss Capital Alternative Investment, the fastest-growing manager on the platform, and Private Advisors are among the FoHFs that have highlight their assets on managed account platforms as part of both the FoHF ranking and the managed account ranking. All of these names have entered the rankings for the first time.

Theoretically FoHFs can sit on the platforms of other FoHFs, but in reality such collaborations are rare, with FoHFs not wanting to build their own internal platform either turning to the bank-owned one, or more likely the infrastructure platforms such as those offered by InfraHedge, and Innocap Investment Management, the latter of which is used by THEAM. Permal added \$1.61 billion to its platform in 2013, making it the second-largest dollar allocation.

A case in point is UBP Alternative Investments, which has selected Guggenheim Fund Solutions – which sees itself as more of an infrastructure operator – as its partner to provide clients with a managed account. Although Guggenheim is not included in the 2013 platform, its entrance is expected in the coming year.

InfraHedge, which with \$11.45 billion, is the second-largest manager on the platform but has added most assets in dollar terms (\$3.84 billion) in 2013 with its infrastructure-only business model. Akshaya Bhargava, chief executive officer, explains that an infrastructure managed account platform is one that can be customised to suit any client's needs as an(infrastructure platform separates investment decisions from operational functions by providing only the operational services, including sophisticated analytics and compliance, while traditional managed account platforms have combined both of these into a single offering.

“There are many implications of this seemingly simple difference. Firstly, the investors get full control over investment decisions and can use in-house teams or outsource these to specialist firms on an advisory basis,” he explains. “Secondly, because infrastructure almost by definition, needs to be agnostic to managers, strategies, domiciles and so on, this provides a wide range of choice and flexibility for the investor,” he adds.

“Thirdly, this creates a high degree of specialisation in the managed accounts market because a firm like InfraHedge, focused on infrastructure will always try to maximise the quality, flexibility and functionality of that infrastructure,” Bhargava notes. “Lastly, it results in lower costs and brings greater cost transparency, clearly spelling out what an investor pays for investment decisions and how much he pays for operating infrastructure,” he says.

InfraHedge is keen to highlight that its platform does not have assets under management. “They are better described as client assets on the InfraHedge platform rather than ‘our’ assets,” says Bhargava. “The difference is more than semantics – under the InfraHedge model, the investor is in full control of the investments. Quite often our clients are the only investors in their managed accounts,” he points out.

The InfraHedge model is designed to maintain strict neutrality and has been designed to avoid any conflicts of interest that could potentially arise. “This is why we do not take on any investment related roles. Specifically, we do not have a research team and do not diligence or recommend managers. We do not allocate investments or undertake on-going portfolio management,” says Bhargava.

“The trend that we find very interesting is a pension fund working with a FoHF for manager selection and asset allocation while using infrastructure services. This is really the best of all worlds in terms of maximising

scalability, expertise and transparency,” he concludes.

Managed accounts

	AUM 31/12/13 Total \$1bn	AUM 01/01/13 Total \$bn	Growth \$ billion	% Growth
Lyxor Asset Management ³	12.00	10.70	1.30	12.15%
InfraHedge¹	11.45	7.61	3.84	50.51%
Deutsche Bank ³	10.1	10.8	-0.70	-6.48%
Pacific Alternative Asset Management Co.²	9.03	8.31	0.72	8.62%
FRM ²	8.00	9.20	-1.20	-13.04%
Permal ²	7.98	6.37	1.61	25.28%
Lighthouse Partners²	5.80	5.40	0.40	7.41%
Amundi Alternative Investments ³	5.20	4.10	1.10	26.83%
LGT Capital Partners²	3.40	2.32	1.07	46.23%
UBS Liquid Alpha Platform ^{3†}	3.17	3.17	0.00	0.00%
Innocap Investment Management ¹	2.48	2.23	0.25	11.41%
Goldman Sachs ^{3†}	2.37	2.37	0.00	0.00%
Swiss Capital Alternative Investments²	1.83	1.00	0.83	83.00%
Private Advisors²	1.73	1.33	0.40	30.01%
Sciens Capital Management ³	0.64	0.49	0.15	30.86%
Gottex Fund Management ²	0.13	0.21	-0.08	-38.10%
Total	85.31	75.62	9.70	12.83%

¹ Infrastructure only ² Assets included in Billion Dollar Club entry ³ Assets not included in Billion Dollar Club entry [†] 2012 data

New entrants in 2013 in **bold**

Source: InvestHedge

M&A momentum to gain further traction in 2014

Merging asset management firms is a tricky business, and even more so in the ego-led world of hedge funds. And yet the latest round of mergers in the fund of hedge fund arena seems to be led by strategic thinking. Consolidation of businesses is likely to continue as groups such as THEAM, which uses the Innocap platform for \$2.3 billion of its assets, and Antarctica Asset Management, consider growing by acquisition.

International Asset Management, which has \$2.15 billion, and was bought by ABN AMRO Asset Management in 2006, is not looking to merge, but having re-established its independence with a management buyout it is looking for joint ventures. Gottex has forged a number of joint ventures specifically in Asia Pacific in 2013.

There are three main types of M&A deals in play in this current environment of fund of hedge fund consolidation. The first is to acquire a missing strategy or tool. The most recent deal is an example of this. Cantor Fitzgerald Asset Management, a subsidiary of Cantor Fitzgerald, has announced plans to buy California-based Fintan Partners, a fixed income absolute return fund of hedge fund led by founder Alexander Klikoff.

This deal, like that of Morgan Creek Capital Management's purchase of the \$700 million fixed income assets of Signet Capital Management, are indicative of established businesses growing by adding strategies that their current portfolio are missing and key to these deals is buy-in from the team so that they do not leave and precipitate asset outflows.

Similar types of deals include the completion of Principal Global Investors' purchase of Liongate Capital Management. Principal, which is a collector of diversified stakes in asset management businesses such as Finisterre, boosted Liongate's assets under management from \$1.9 billion to \$7.3 billion with an advisory allocation following the deal. In most of these deals, which are less about cost saving through rationalisation, see the buyer allow the firm it has acquired to retain its identity.

New York Life Investments' purchase of Dexia Asset Management is also in this bracket. Dexia, which has 6% of \$600 billion in alternatives, has a fund of hedge funds arm, although the exact slice in FoHFs would not be revealed. It will not be merged into Private Advisors, in which New York Life already owns a stake.

“Dexia Asset Management does have a fund of hedge fund business. Private Advisors and Dexia Asset Management would continue to operate independently. There are no plans to merge the efforts,” according to a New York Life spokesman.

The second type of deal is to add hedge funds to an existing alternative business. This is currently prevalent when private equity giants such as KKR, with its purchase of Prisma Capital Partners in 2012, and more recently the Carlyle Group’s acquisition of Diversified Global Asset Management, allow these groups to offer a broader spectrum of alternatives depending on liquidity and risk appetites.

And the third type is the rationalisation of two businesses that have similar values and businesses but overlapping resources. Key to the success of these ventures is enough differentiation in the products or services they offer so that the end client gets a better selection from a combined firm.

EIM’s merger with Gottex Fund Management, like Permal Investment Management with Fauchier Partners, is an example of such a merger. This deal is about creating the next generation of hedge fund investor that offers both commingled products and the ability to customise solutions for increasingly sophisticated clients.

Like Fauchier, EIM’s brand, associated with customised portfolios, will be absorbed into Gottex, which has a managed account platform and commingled products, to create a single business with some \$9 billion in assets under management.

Tages Capital, the London and Milan-based asset management arm of Tages Group, has done something similar with its strategic partnership with Paris-based La Française. The deal, which will see the combined group offer management and advisory services for assets in excess of \$3 billion, allows the two groups to grow by offering a mixture of customised solutions and commingled products.

FoHF corporate activity 2013

Cantor Fitzgerald Asset Management	Buys Fintan Partners
Carlyle Group	Buys Diversified Global Asset Management
Gottex Fund Management	Merges with EIM
Gottex Fund Management	Buys Frontier Investment Management
Gottex Fund Management	Creates JV with Astmax Asset Management
Gottex Fund Management	Creates JV with Staples Rodway Asset Management
Grosvenor Capital Management	Buys Credit Suisse’s alternative CFG platform
Morgan Creek Capital Management	Buys Signet Capital Management
New York Life Investments	Buys Dexia Asset Management
Permal Investment Management	Completes deal with Fauchier Partners
Principal Global Investors	Buys 55% stake in Liongate Capital Management
Tages Capital	Buys La Francaise

Source: InvestHedge