Pedigree Holds No Guarantee For New Funds

August 14, 2012 Rob Copeland

Some 33 Americas hedge funds raised $10.4 billion in the first half, but most of the money was clustered in a handful of managers.

It is a tale of haves and have-nots.

At first glance, the environment for new hedge fund launches in the Americas appears robust. Some 33 new funds raised $10.4 billion in the first half of the year, eking past last year's total of $10.3 billion[1].

As was the case last summer, one mega-launch comprised nearly half of the total, suggesting strong appetite for the right manager at the right time. That equity-focused multi-strategy fund, the Renaissance Diversified Alpha Fund headed by Peter Brown and Robert Mercer, burst out of the gate with $3.5 billion in March and has since blown past $5 billion, helped by strong firm-wide returns and performance/management fees of half the industry norm (see full details here).

Second place went to Citadel spinoff Encompass Capital, the energy equities fund helmed by Todd Kantor, which started trading with an estimated $900 million and managed a shade less than $1 billion at midyear, sources said. Jennifer Fan's commodities shop Arbalet Capital took the bronze with $650 million.

But overall it was another weak first half for new launches, continuing a post-financial crisis trend that reached its nadir in 2009, when 21 new funds raised just $3.9 billion.

A slew of pedigreed managers struggled to reach $100 million, generally considered the benchmark at which larger investors will begin to consider putting in cash. Industry experts blame the same trends that have caused the biggest and most established of AR's Billion Dollar Club managers to vacuum up the vast majority of new allocations.

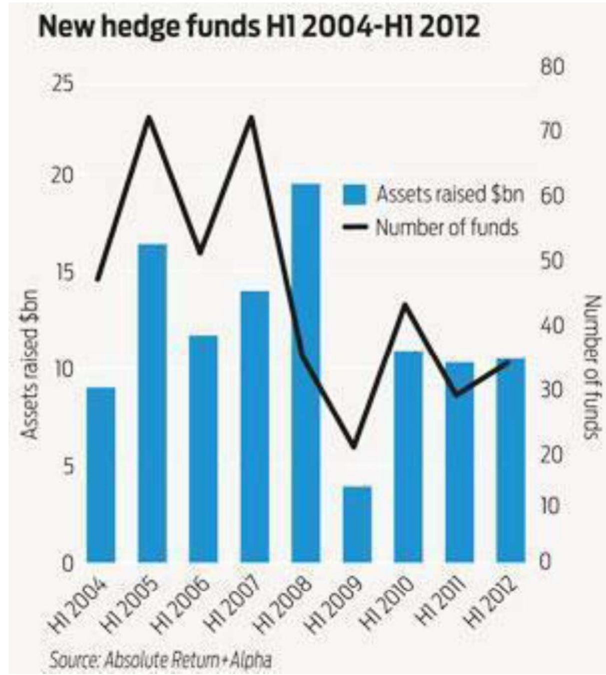
"There's no question it's more challenging now than it's ever been and that's because the business has been institutionalized," said Joe Gieger, managing director for the Americas at $48 billion diversified asset manager GAM. "Even in new funds, it really has to do with the amount of bandwidth the consulting organizations have to properly vet the organization's prior history."

For managers with even relatively unquestioned backgrounds, the yardstick for a successful launch seems to be sliding steadily. While there were some exceptions to the rule, such as former star Barclays trader Todd Edgar's Atreaus Capital ($420 million), a slew of top pedigreed new managers found themselves stuck in the $100-200 million range or lower.

For instance, former FrontPoint Partners portfolio manager Steve Eisman attracted a lot of attention for his long/short Emrys Partners, but that didn't translate directly to fundraising, and Emrys now manages $54 million after a March launch (Eisman's negative performance in 2010 and 2011 at FrontPoint likely did not help matters). Emrys declined to comment.

Jeremy Schiffman and Andrew Immerman picked up $155 million in anchor investments from Goldman Sachs and TPG-Axon for the March launch of Palestra Capital Management, and haven't raised much since, as Palestra is now at about $200 million. Siddharth Thacker's Signpost Capital received undisclosed backing from Protégé Partners (which typically provides no more than $100 million), and is now managing under $150 million. And three months after a team from Millgate Capital scored $50 million from Stride Capital, LRV Capital still manages only that sum.

Even some big firms seemed to find the fundraising environment difficult. Pine River Capital Management of Minnetonka, Minn., which manages $6.14 billion overall, picked up a relatively modest $100 million apiece for two February launches. Alex Roepers' $1.6 billion Atlantic Investment Management raised the same for the June start for the Cambrian Global fund. And in the red-hot mortgage backed securities space, $2.3 billion Stark Investments fell short of $100 million for its Mortgage Opportunities Fund, which began trading in March.



Of the $10.4 billion raised in total, $4.3 billion went to entirely new firms, as opposed to new strategies launched by existing firms.

"It's not going to be like it was three or four years ago"

By strategy, 17 of the 31 first half launches in *AR*'s survey were either U.S. or global equity. Such strategies have been under persistent criticism for being highly correlated to broader stock market indices, while at the same time reporting generally below-industry-average returns to their investors.

"Equity managers are still the biggest slice of the pie. It has been an area in which some of the existing managers have failed to perform as expected, and so somebody who has performed exceptionally well and is starting a new fund is much more likely to get a look," said Emma Sugarman, global head of capital introduction at BNP Paribas.

Fixed income and credit managers such as Philip Rosentrach's $311 million Barclays spinoff Pomelo Capital were the next most prevalent. Those funds continue to compete for cash against some of last year's launches which have amassed huge sums from investors in recent months, including the $1.17 billion Cerberus RMBS Opportunities Fund, $700 million Axonic Capital, and Candlewood Investment Group's $600 million mortgage-heavy structured credit fund.

Some major funds that may be on investors' radars did not make *AR*'s list. Eisman's former FrontPoint colleague Steve Czech, who spun out of that troubled firm and rebranded his direct lending shop Czech Asset Management, can now boast $1.1 billion in the not-quite-brand-new strategy (a second Czech fund is expected to launch in September with more than $1 billion). Rick Gerson's $1.2 billion Falcon Edge Capital took flight in July, after the first half cutoff, and after more than a year of ramping up.

Indeed, delaying may be the best option of all, Gieger of GAM said. "You need to be very much aware that the fundraising period is going to be elongated. It's not going to be like it was three or four years ago," he said. "I think you'd be better off waiting to circle $500 million and give yourself an extra six to twelve months to do that, rather than come to market with $200 million in three months."

Looking to the second half of the year, Gerson's former fellow Blue Ridge Capital Management partner David Greenspan is expected to wait until January to launch his long/short Slate Path Capital, a person with direct knowledge of the plans said. That will put him directly against ex-JAT analyst John Lennon's long/short Pleasant Lake Partners, which sources said is targeting an early 2013 start.