

A **Carbon360** White Paper



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Capital Introduction Trends in 2010
A SURVEY OF THIRD PARTY MARKETERS AND CAPITAL INTRODUCTION
GROUPS ON CAPITAL RAISING MACRO INDUSTRY THEMES

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CAPITAL INTRODUCTION TRENDS: THE PERSPECTIVE FROM THIRD-PARTY MARKETERS AND CAPITAL INTRODUCTION GROUPS

The appetite from investors for new investment opportunities is strong, competition for capital allocation is increasing, and as a result the industry has seen more and more funds seeking the services of third party marketers to source investors and increase their distribution networks. Carbon360 conducted a survey of third party marketers as well as capital introductions groups titled “**Capital Introduction Trends in 2010**”, to investigate the following macro themes industry trends:

- **What are the most sought after strategies in 2010?**
- **Who are the investors and where are they based? What are their primary concerns?**
- **What type of funds do third party marketers work with? What is a typical fee structure?**
- **How do third party marketers source potential investors and mangers?**
- **Due diligence – what and how is it conducted?**
- **Industry concerns and needs.**
- **How will the industry evolve over the next five years?**



As the hedge fund industry stabilizes, we expect investors to become more active. 2010 should be a prosperous year for alternative investments. The managers and investors who survived 2008 and 2009 are the cream of the crop, providing third party marketers and capital introduction firms with a vast array of opportunity. As hedge funds go, so goes the capital introduction industry.

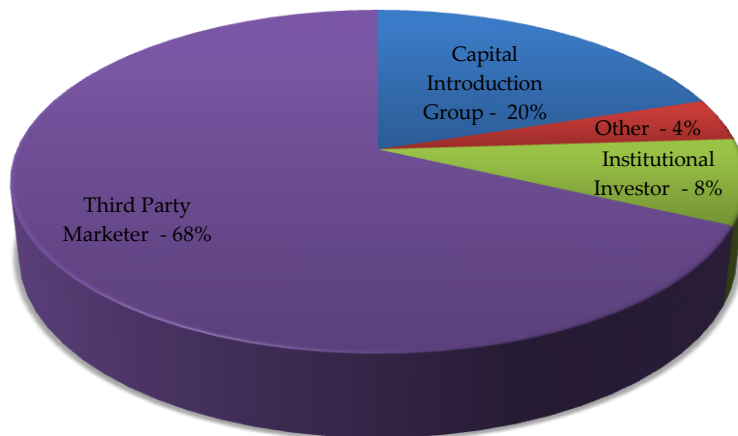
In that mode of thought, transparency and risk management are the popular trends. I would expect new regulations to affect how third party marketers and capital introduction teams are able to conduct business. But this change is not to be feared, but rather embraced. If we can work with regulators to legitimize the industry and overcome the scandalous actions of a select few, I am all for it. This will be a major theme ongoing.

I expect institutional investors to be more receptive to newer managers, fee structures to remain stable, and foreign investors to invest more in the US and vice versa. Europe should lose market share to Asia, and new markets will open up as countries move from developing markets to developed markets. Proprietary trading and hedge funds owned by large US banks will most likely weaken or disappear under the current administration and, more importantly, current US economy sentiment, leading to opportunities for independent investment management companies. Overall, I expect 2010 to build on the strength of the latter half of 2009.

Evan Rapoport
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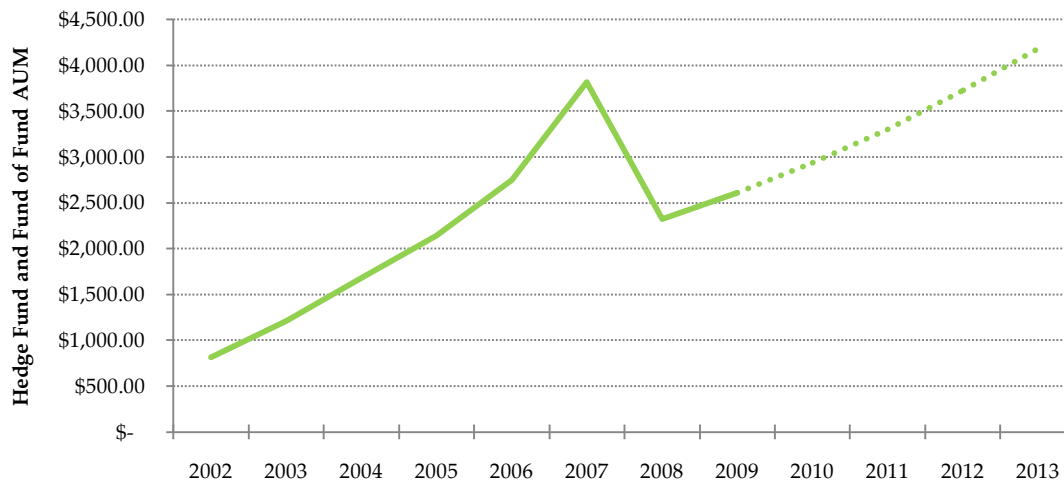


Breakdown of Respondents



The turnaround in the second half of 2009 and the stabilization of global equity markets have brought on some encouraging signs.

Consider the following:



Source: Carbon360



Dear Readers,

As the market challenges from 2008 and 2009 carry into this year, many fund managers have had to face larger than expected redemptions, make the difficult decision to throw up the gate, and prepare for a potentially new regulatory environment. These increased demands of the funds have placed a premium on raising new capital, renewing trust and performing well enough to be heard above all the noise.

When reviewing this year's survey, the downward trend in assets does appear to be slowing, with some firms actually reporting slight increases in capital from the Q3 2009 forward. Our hopes are that this data shows that the flight of capital and negative return trends of the past 24 months are now coming to an end, and the funds can utilize the lessons learned during these difficult times to continue supporting the process of hedge fund evolution from, opaque black-box, to transparent and liquid financial products.

At Simplify, we are excited to display our continued commitment to the alternative investment space by sponsoring this report. Simplify, is a leader in innovative solutions that help firms manage operational risk, increase investor confidence, improve overall efficiency, and automate the portfolio management, due diligence, accounting and reporting of alternative products. PortfolioCentriX®, Simplify's award-winning portfolio management, due diligence management, and risk reporting platform, is a proven industry leader within this market, and serves as the platform of choice for over 15 of the world's largest pension and endowments investing in hedge and fund of funds.

Simplify looks forward to our continued involvement within this market, and we thank all of the marketers and capital introduction professionals who have shared their valuable time and knowledge with Carbon360° for this survey.

Brian Shapiro

President, Simplify LLC

simplify.



Most sought after strategies by investors in 2010: *In addition to traditional long/short funds we find investors are very interested in more Global strategies.*

- 54.2% US Equity L/S
- 54.2% Global Macro
- 37.5% Distressed
- 37.5% Emerging Markets
- 37.5% Other: Including Fixed Income, Fund of Funds, Managed Futures, Asset Backed Lending, and Short-term/Volume Trading
- 25.0% Multi-Strategy
- 20.8% Event Driven/Merger Arbitrage

Who are the investors? *Our survey results confirmed that the changing landscape of the investor base is now dominated overwhelmingly by institutions, family offices, and pension funds.*

- 79.2% Institutions
- 66.7% Family offices/Pension Funds
- 58.3% Funds of Funds
- 20.8% High Net worth Individuals

Where are the investors based? *As might be expected, third party marketers mainly source their investors in the US and Europe; However, for the first time, Europe has surpassed North America as a primary source of capital.*

- 60.0% Europe
- 56.0% North America
- 12.0% Pacific-Rim
- 08.0% Australia

What are investors most concerned with in relation to the managers they fund? *While Performance remains the primary concern, transparency and risk management have grown to become critical concerns for investors.*

- 70.8% Performance
- 66.7% Transparency
- 62.5% Risk Management
- 54.2% Reputation
- 50.0% Infrastructure
- 33.3% Preservation of Capital/Growth



What type of managers do third party marketers work with? *Third party marketers appear to have the most traction with relatively newer funds.*

- 84.0% Managers with a track record less than five years
- 68.0% New Managers/Startups
- 64.0% Managers with a track record greater than five years
- 56.0% Fund that deal with top level providers – (i.e.) Auditors, Lawyers, Administrators, Prime Brokers

What is a typical fee structure? *Fee structures appear to be standard based on a supply/demand model.*

- Managers with a track record of less than five years:
 - 72.2% charge 20% of management and incentive fees
 - 27.8% charge 20-25% of management and incentive fees as long as capital is invested
 - 05.6% charge 25% of management and incentive fees
 - 05.6% work on a retainer basis
- Emerging managers:
 - 58.8% charge 20% of management and incentive fees
 - 29.4% charge 20-25% of management and incentive fees as long as capital is invested
 - 17.6% work on retainer, commission and performance based fee
- Managers with a track record greater than five years:
 - 72.2% charge 20% of management and incentive fees
 - 22.3% work on a retainer basis
 - 11.1% charge 20-25% of management and incentive fees as long as capital is invested
- New Manager:
 - 47.4% charge 20% of management and incentive fees
 - 31.6% charge 1.5% of the management and 20% of the incentive fee
 - 21.1% charge 25% of management and incentive fees
 - 05.3% work on retainer, commission and performance based fee



How do third party marketers source potential managers? *In an effort to source potential managers and investors, third party marketers work with “advisors” who have industry knowledge.*

- 91.7% from networking
- 87.5% find managers through referrals
- 20.8% from cold calling

How do third party marketers source potential investors?

- 87.0% from experience/long term relationships/networking or advertising
- 60.9% from referrals
- 52.2% from cold calling

Due diligence: *As might be expected, background, operational, and process due diligence are of paramount concern.*

What is conducted?

- 100.0% conduct background due diligence
- 88.0% conduct process and performance reviews
- 84.0% conduct operational and compliance due diligence

How is this conducted?

- 91.7% conduct on-site visits to the manager, with some conducting quantitative, accounting, middle and back office analysis
- 75.0% conduct a literature/public records search
- 54.2% work on a referral basis
- 41.7% utilize contracted research





Industry concerns and needs. How are marketers contemplating the evolution of industry in the next five years?

We received the most feedback in this section of our survey.

In their own words:

- “Flexible fee structures, enhanced transparency i.e. communication to investors”
- “Greater capital will be allocated to Asian managers as capital markets deepen and countries like China provide foreign investors with a index/single stock option futures.
Asian institutional investors will be more willing to invest in Asian managers as pension provision becomes the norm. Capacity continues to be scarce as quality managers close their funds early. For those middle of the road type managers, fee pressure will remain.
Managers will have to start with more than US\$50m to gain any traction at all. Within third party marketing [I] would expect regulation to tighten particularly on the KYC side.”
- “Less FOHFs, more liquidity, more transparency, more competition between fewer HF managers”
- “SMA constructs will implode under their own weight and inability to deliver real risk mitigation despite staggering cost in operating and performance terms. Ultimately, it will be realized that the collective scheme structure is the more efficient model. This epiphany will give rise to more UCIT III and IV funds, N-2 Closed and '40 Act Registered Funds.”

Conclusion:

After a large contraction in assets under management investors are weary about a sustainable recovery. While a large number of institutional and private investors wait on the sidelines, third party marketers focus their efforts on sourcing capital from areas outside of the United States.

As capital begins to return to the industry the biggest winners will be managers with proven track records, large assets under management, and an infrastructure that allows for greater transparency.

Interestingly, based upon the results that we received, the overwhelming majority of third party marketers work with new or emerging managers. These are the very managers where the majority of consolidation is expected to take place in order to compete with the larger and more established managers. In an effort to gain assets under management and in turn survivability, new and emerging managers represent a captive audience for third party marketers as these managers can outsource their marketing/investor relations efforts and focus on managing the performance of their funds.

Additionally, and most important, with funds under stricter SEC guidelines we expect more stringent due diligence will be done down the line from the third party marketer to the Prime Broker and to the investor.



About Carbon360 Research

Carbon 360 Research is a leading provider of technology and operations research for the institutional investment community and is the publisher of the annual "Fund Administration Fact Book", a comprehensive report on the global fund administration industry. Founded in 1997 and headquartered in New York City.

Carbon provides financial institutions with the comprehensive information necessary to evaluate the competitive supply market in software development, information and operating systems.

Carbon provides clients with qualitative and quantitative analysis of vendors available through in-depth product guides, vendor profiles, vendor comparisons, user surveys, and analysis of industry trends.

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