Emerging managers vs established managers

Ronen Schwartzman, founder and CEO of Ten Capital Advisors, looks at the various challenges and benefits of investing in start-up hedge funds

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The hedge fund industry is recovering from 2008 – the worst year in its history. Inflows are increasing and new funds are opening. Moreover, with investment banks closing prop desks there is the promise of continued talent that will join the industry. There are an estimated 10,000 hedge funds today, so where should high-net-worth investors put their money? In an emerging manager that recently launched or with an established manager that has been around for a long time and manages a few billion dollars?

There are a few advantages of investing with an emerging manager:

- **An emerging manager is hungrier to succeed** than an established manager since they want to prove themselves and build their business.
- **Empirical research shows** a fund's best performance is typically in its first few years of operation.
- **It is easier to manage smaller amounts of money.** When managing assets in the billions of dollars, the portfolio manager needs to come up with ideas that will not only be successful but also scalable, in order to have an impact on the overall portfolio. As such, these securities have to be much more liquid, thus channeling the manager into larger cap companies that are well covered by the street and are more difficult to obtain an edge about them.
- **Access to the portfolio manager.** A crucial part in the due diligence process is getting to know the portfolio manager – their investment process, their personality type and how committed they are to the business. This is also true for the ongoing monitoring process after an investment has been made; being able to speak with the manager and hear directly how they have made or lost money during the month, or what they think about the market and their portfolio, is very important. Generally, emerging managers are more accessible than those of established funds, where it is usually the investor relations team that interacts with investors.
- **Transparency.** Emerging managers are usually more open to discussing their holdings and explaining why they put the positions in the portfolio. This helps to better understand the investment strategy and evaluate the manager capabilities.

However, there are downsides to investing with an emerging manager. There is a bigger operational risk (can the portfolio manager run a business in addition to managing the portfolio?) than when investing with an established manager. In other cases, the manager needs to prove he can generate performance in different market environments. Furthermore, it is more difficult to find emerging managers: they are not marketed by the banks, their names are not in the news and they don't participate in many conferences. Therefore, an investor should consider using an advisor that not only lives the market and knows the new and upcoming funds, but can also assist in the more important due diligence tasks to make sure there is nothing wrong with the fund. ■

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