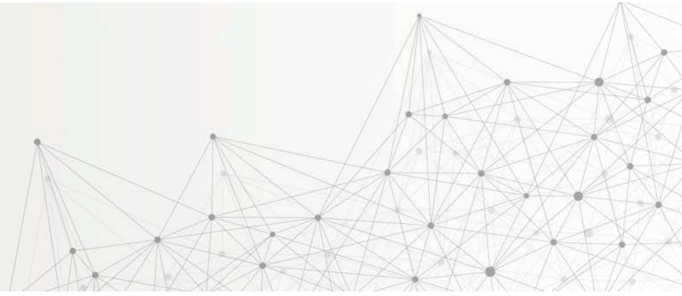


2021:
Year of the Launch?

A 'HOT HAND' FOR THE HEDGE FUND INDUSTRY?

In every industry, new entrants are critical to ongoing innovation, growth and expansion. The hedge fund and alternatives industry is no exception.

With new and emerging managers providing a critical source of new products, innovation and approaches to risk management, it should be no surprise that the new manager pipeline is as robust as it has been in decades.

With the industry rapidly approaching $4 trillion of assets, there are multiple tailwinds propelling the industry higher, *and* creating a (supportive) environment for new launches.

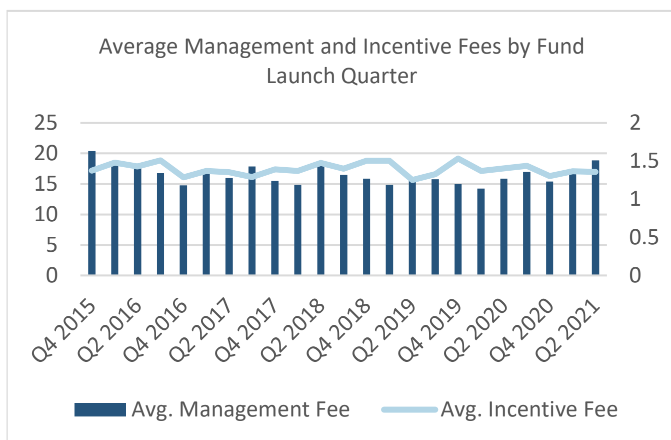
The first half of the year witnessed the strongest performance by the industry since 1999, with the HFRI Fund Weighted Composite Index up nearly 10% for the first six months of the year.

As of 1H21, new launches have exceeded liquidations for 4 consecutive quarters, and 1H21 saw a +70% increase in emerging managers coming to market compared to 1H20.

WHAT'S DRIVING THIS?

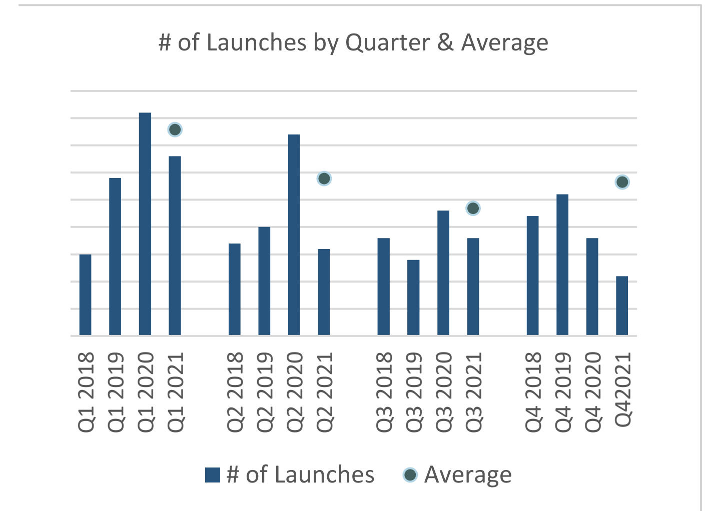
As with many complex systems – multiple factors. There has been a "cyclicality" to new launches, with some years witnessing strong pedigreed, high asset new launches with differentiated strategies, and others seeing more homogenous groups that have a harder time getting traction with LPs.

But a particular bright spot has been the ability of new managers to command higher management fees in recent quarters than in the past. The **average management fee for a fund that launched in 2Q21 was 1.51%, the highest since 4Q2015.**



Source: HFR

IS TIMING EVERYTHING?



Source: Jefferies Prime Services

New year, new fund? The first quarter of the year is by far the most popular one in which to launch a new fund.

Drivers of this can vary – ranging from soft launches in the quarters prior to establish systems, processes and a paper portfolio to differences in fundraising environments and others.

The third quarter is the most quiet for new funds coming to market – apparently late summer and "back to school" launches are less common. As hard data on the causes of this are scarce, it makes intuitive sense that professionals may prefer to launch in quarters that *don't* include the end of summer and back to school.

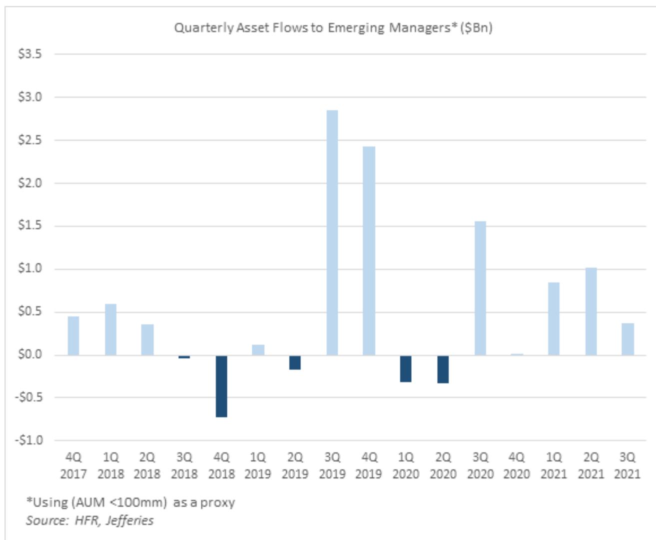
In 1Q2021, we witnessed nearly 190 new launches – the highest quarterly level in the last 3 years.

Benefits to 1Q launches:

- A full year to create an official track record of performance
- Potential fundraising efficiencies
- Tailwinds from prepping for launch in prior quarters

Benefits to launching in other quarters:

- Potentially less competition for capital ("off-cycle")
- Intentional timing around average volatility and asset performance
- Changes in seasonally driven hiring



A review of assets allocated to emerging managers also reveals 5 straight quarters of net inflows – with 11 out of 16 last quarters seeing positive allocations.

The lifeblood of new funds is early stage capital, and allocators are responding. A growing number of them are open to looking at and investing in earlier stage managers, to get capacity in differentiated strategies or take advantage of lower fees available through founders' share classes.

A 25 bps savings in management fees can compound and translate into considerable "savings" over time – especially if the allocation is material and assets remain in the fund for years.

What May Lie Ahead

Performance is hitting on all cylinders. After a muted fee cycle in recent years, management fees are starting to tick up, while incentive fees stay steady. **Higher management fees allow new launches more robust funding upfront as they build out systems, attract talent and develop infrastructure.** Many new managers also cite a rich opportunity set, particularly in the equity long/short space, as perceived dispersion in some sectors increases.

- **We continue to see differentiation in strategies**, with many new launches supporting sector or regional investment strategies. Whether focusing on supply chains and logistics, green/carbon transition strategies (which themselves are extremely heterogenous), or niche healthcare strategies – new founders are getting ever more precise on their investment strategies, value propositions and competitive positioning.
- **With broader trends in outsourcing**, emerging managers are able to launch and scale on a more linear basis than in years past – when prelaunch, costly infrastructure and IT spend could drain critical funds from the investment and risk management side. It's not that managers have gotten 'cheaper,' but more that the service provider ecosystem has matured to deliver sufficient value for quality service. Outsourced COO/CFO, technology and trading can assist in launching an agile fund that can grow into in house resources.
- **Many of the broader industry trends that have delivered tailwinds across the globe** – including strong performance, robust asset flows and continued diversification of products and strategies – particularly benefit those who are choosing to come to market now. They are finding a renewed appetite for hedged and alternative products, and an environment that facilitates the launch of more agile and strategic organizations. We are hopeful the coming decade is one of renewed relevance for hedge funds, and feel the current crop of emerging managers is helping to build that foundation.

Leor Shapiro
Global Head of Capital Intelligence
+1 212.336.6267
lshapiro@jefferies.com

Shannon Murphy
Strategic Content
+1 212.336.1139
shannon.murphy@jefferies.com

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