

## Launch 2025 | The Founder's Perspective How Do I Know What 'Market' Is?

Welcome to Jefferies Launch 2025: The Founder's Perspective. Starting a successful alternatives fund is entirely different than it was 10 years ago. The costs are different, the challenges and potential upside are different. In this series, we leverage expert views on what potential founders need to know *now* before launch.

Today: **How Do I Know What 'Market' Is?** You have picked a name, nailed your pitch – but how do you know how to price your product?

### UNDERSTAND WHERE YOU ARE IN THE COMPETITIVE LANDSCAPE, AND IDENTIFY YOUR VALUE PROPOSITION

Peter Greene and Eileen Overbaugh from Schulte Roth and Zabel help us understand where the market for terms, fees and liquidity now, and where it may be heading. In understanding your market value, the following are important:

- ✓ Management and Incentive Fees
- ✓ Liquidity
- ✓ Structure

#### Management and Incentive Fees

There have been many headlines around alternative fee compression in recent years. In many cases, these are accurate, and new launches have to be very strategic about how they think about pricing their fees.

Data suggests that “average” management company fees continue to hover around 1.67% for equity long/short funds, though they can range from 1.5% - 2.0%.

However, multiple factors will shape what founders can command – and they should be extremely thoughtful about pricing. Management company fees are meant to provide the working capital that allows the fund to launch, operate and strategically scale. Pricing management fees too low can result in fewer necessary resources to succeed.

- What do other competitors charge?
- Can I justify my management fees?
- Does my firm offer differentiated return streams or specialization that require higher management fees?
- Are there liquidity tradeoffs I am considering?
- Does the Private Funds Rule reporting requirements affect how I think about management fees?
- Will these fees support the growth of my business over time?

The Private Funds Rule, which passed in 2023 but is pending litigation, may factor into founders' decisions about fees. The rule calls for increased reporting and transparency around expenses. If your fees are perceived as high for the environment, it's possible funds will have to get very granular around what the fees are paying for.

Incentive fees typically range from 17% - 20%, with exceptions for earlier stage or longer locked share classes.

Another hot topic around fees is whether or not a new launch can charge a full or partial pass through – that is, instead of a fixed percentage of assets, the manager passes through 100% of expenses incurred for running the fund.

These fees have gained visibility, and in some cases, popularity, as multi-manager models have successfully scaled and performed across cycles. While still rare across all funds, the pass through has gained legitimacy with many allocators as longer tenured funds articulate their value proposition across cycles and in the current environment.

#### Liquidity

In many cases, liquidity will move in opposite of fees, rather than in tandem. The lower the fee, the longer the capital may be locked up.

For founders and new launches, an initial lock up for founders' or earlier share classes can make sense as the firm is getting its footing and building its resources. Variability in fees earned can destabilize a new fund, and founders need to ensure that two years of working capital runway is available.

Founders may want to consider:

- ❖ Does my liquidity align with my investing strategy and business model? Distressed investing, for example, may more align with a longer locked share class than a highly liquid equity long/short strategy.
- ❖ Are my liquidity terms in keeping with market range?
- ❖ How do my fees and liquidity terms balance?
- ❖ Is it possible I am *too* liquid?

## Structure

After years of convergence between private investors launching hedged products and hedge funds launching private vehicles or investments, a small but notable number of firms are considering launching drawdown structures.

Another material shift in structuring funds has been a reversal of the convergence between public and private investments. In recent years, the lines blurred between open end funds and closed end funds. But more recently, we've now seen a pull back from that in terms of designing funds and really ensuring separate funds.

In the past, managers were creating private sleeves in a public fund that were trending towards 20, 30, even 40% of assets, creating essentially two funds in one. But that is much less common now.

Trends around structuring considerations include:

- ✓ Potential use of drawdown structures for comingled hedged products. This can also help with cash management in a higher rate world.
- ✓ Offering an opt in opt out option so investors can choose whether or not to be so concentrated in less liquid private investments.
- ✓ After moving towards complexity, managers are increasingly selecting “clear and simple” structures – focusing on two, maybe three share classes instead of a dozen.
- ✓ Being mindful that as rates have moved up, what allocators need is shifting. Are hurdles important to your LPs?

**For founders who are eyeing a 2025 launch, the Private Funds Rule could be really poignant. They will be the first vintage of managers for whom this rule applies full freight.**

Shannon Murphy  
Jefferies LLC  
Shannon.murphy@jefferies.com

Peter Greene  
Partner, Schulte Roth and Zabel  
pgreene@srz.com

Eileen Overbaugh  
Partner, Schulte Roth and Zabel  
eoverbaugh@srz.com

## IMPORTANT DISCLAIMER

THIS MESSAGE CONTAINS INSUFFICIENT INFORMATION TO MAKE AN INVESTMENT DECISION.

This is not a product of Jefferies' Research Department, and it should not be regarded as research or a research report. This material is a product of Jefferies Equity Sales and Trading department. Unless otherwise specifically stated, any views or opinions expressed herein are solely those of the individual author and may differ from the views and opinions expressed by the Firm's Research Department or other departments or divisions of the Firm and its affiliates. Jefferies may trade or make markets for its own account on a principal basis in the securities referenced in this communication. Jefferies may engage in securities transactions that are inconsistent with this communication and may have long or short positions in such securities.

The information and any opinions contained herein are as of the date of this material and the Firm does not undertake any obligation to update them. All market prices, data and other information are not warranted as to the completeness or accuracy and are subject to change without notice. In preparing this material, the Firm has relied on information provided by third parties and has not independently verified such information. Past performance is not indicative of future results, and no representation or warranty, express or implied, is made regarding future performance. The Firm is not a registered investment adviser and is not providing investment advice through this material. This material does not take into account individual client circumstances, objectives, or needs and is not intended as a recommendation to particular clients. Securities, financial instruments, products or strategies mentioned in this material may not be suitable for all investors. Jefferies does not provide tax advice. As such, any information contained in Equity Sales and Trading department communications relating to tax matters were neither written nor intended by Jefferies to be used for tax reporting purposes. Recipients should seek tax advice based on their particular circumstances from an independent tax advisor. In reaching a determination as to the appropriateness of any proposed transaction or strategy, clients should undertake a thorough independent review of the legal, regulatory, credit, accounting and economic consequences of such transaction in relation to their particular circumstances and make their own independent decisions.

© 2023 Jefferies LLC

---