

## Funds of funds feel the squeeze

### HEDGE FUNDS

Fees are coming down with growth of clones and multi-strategies, says Steve Johnson

Funds of hedge funds are set to come under increasing pressure as institutional investors become more comfortable investing in hedge funds directly and low-cost synthetic replication strategies become more widely available, it is being claimed.

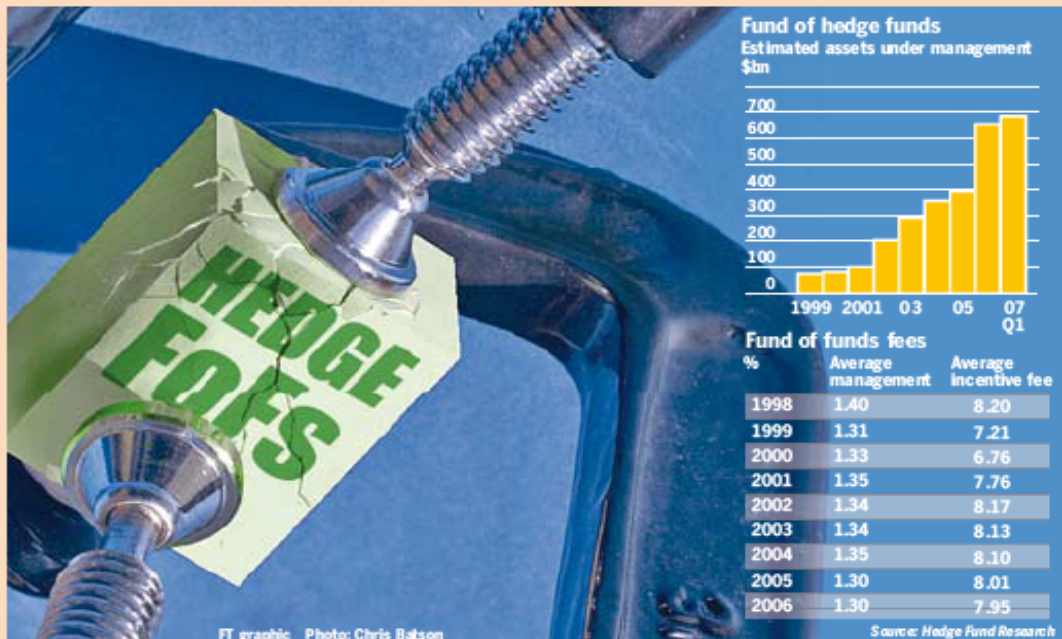
The growth of multi-strategy hedge funds and a push by consultants into hedge fund intermediation are also seen as potentially lessening the need for costly funds of funds.

While the imminent demise of the \$700bn (£350bn, €516bn) fund of hedge funds industry is extremely unlikely, there are indications that pressure on fees is starting to build.

"We are seeing fee pressure, fund of funds fees are definitely coming down," said Peter Harrison, chief executive of MPC Investors, a London-based hedge fund group. "We are seeing 70 basis points and no performance fee."

Chris Woods, senior managing director of absolute return strategies at State Street Global Advisors, added: "The rate of flow into funds of hedge funds has decreased. It would be foolish to say they are a thing of the past, but we will see more pressure on fees."

Funds of funds have been big winners from the growing institutionalisation of the hedge fund industry. Few pension funds have the governance and research capabilities to select their own hedge funds directly, while consultants have struggled to



build the knowledge base to fill this void.

However, there have been increasing grumbles of discontent over the cost of investing via a fund of funds.

Data from Chicago-based Hedge Fund Research suggests fund of funds' charges have fallen marginally to a 1.3 per cent flat fee and an 8 per cent performance levy in recent years, but this is on top of the 2 and 20 often levied by the underlying hedge funds. Listed UK funds of funds still typically charge 1.5 and 10.

Mr Harrison believes consultants, from traditional actuarial houses to specialist alternative investment advisers such as Albourne Partners and Liability Solutions, are now up to the job of ushering institutional investors into appropriate hedge funds - in spite of the regular poaching of consultants by funds of funds.

"Consultants' knowledge and awareness are improving massively. If you compare them with where they were 12 months ago, they are streets ahead," he said.

"The consultant is the gatekeeper maintaining the quality standards and can potentially win hands down because of their fees, typically just 5-10 basis points. Ninety per cent of pension money is going to funds of funds, but when pension funds get to critical mass that figure will be much less."

David Butler, founding member of Kinetic Partners, a hedge fund consultancy, said: "I think the US model is starting to make a presence here. Large pension schemes in the US have their own due diligence team and their own seeding for new managers. That hasn't come across the Atlantic yet, but that is probably the next stage of the evolution."

"Many fund of funds managers are starting to specialise to try and differentiate themselves," said Mr Butler, who also saw funds of funds reacting by seeking to develop links with retail investors.

Mr Woods sees European institutions switching from funds of hedge funds to direct investment as they develop greater confidence in the asset class, a pattern seen in the US. He also believes funds of funds will come under pressure from multi-strategy funds, which combine a variety of single-strategy hedge funds operated by the same management group and, according to some academic research, tend to outperform.

Mr Woods also saw fund of funds being squeezed by the launch of synthetic hedge fund replication strategies, which several investment banks have launched and SSGA is developing.