Founders' shares growing in popularity

There are numerous ways for smart investors to get a break on hedge fund fees, reports the Financial Times.

The first way is, get in early. The use of so-called "founders' shares" is growing in popularity as a way of attracting investors to new hedge fund launches. Even successful portfolio managers spinning out of existing hedge funds often need to offer incentives to get their first investors through the door to make sure their fund gets going at a viable size. Investors can find early bird specials of as little as "1 and 10" on the first $100m or so, according to bankers involved in fundraisings. Founders' share terms might be even more creative: the fees may be a full "2 and 20" for the first few years but then fall to zero after the hedge fund has reached a certain scale, a freebie "thank you" from a manager to his early backers.

Seeder Energy Alpha Strategies re-brands as Stable Asset Management

Erik Serrano Berntsen announced that his firm had changed its name from Energy Alpha Strategies (EAS) to Stable Asset Management. As an investment firm, Stable will focus on seeding top performing managers and building world-class asset management firms, he said.

Berntsen said in an email sent to Opalesque, "We launched our first hedge fund nine years ago and founded EAS in 2010. Our new name reflects our progression into investment across all asset classes, in addition to energy and commodities where we began." …

He explained that Stable is committed to build world-class asset management firms. Stable finances and supports the launch of new funds to capture the over performance that emerging managers typically generate, while ensuring an institutional quality business from day one. "All of our investments reflect Stable's strong partnership culture, entrepreneurial spirit, and dedication to long-term value creation," he continued.

Full article here.

K. Manalo

Ex-DUMAC manager launches fund of emerging long/short equity hedge funds

Geoff Keegan

Geoff Keegan, who used to be a senior team member at Duke University's endowment management organization, launched Creciente Partners Investment Management, LLC, an alternative investment firm based in Raleigh, NC, in June 2014. His new fund, Creciente Global Equity Fund, LP, which started with $7.5m, seeks to identify and partner with the next generation of great hedge fund managers. He talks about his investment philosophy, his selection criteria and his plans in an interview with Opalesque.

Opalesque: *What is your investment premise?*

Geoff Keegan: My investment premise is based on the view that hedge funds, particularly long/short equity funds, generate their most attractive returns early in their life-cycles when they have a modest amount of capital to manage. Academic and industry research support this thesis, as does the experience of DUMAC, the investment arm for Duke University, where I spent 10 years of my career.

At this stage of the life cycle, the manager is extremely hungry. The entire team is energized, motivated, and the economics are more aligned between the general partner and the limited partner. They have a lot of their personal capital invested alongside other investors, and need to generate strong returns on that capital to fund their operation and raise additional assets.

Opalesque: *How concentrated do you want your funds to be?*

Geoff Keegan: Typically, the managers I gravitate towards have about 15-20 positions that really matter. The portfolio manager can still knows every name in the portfolio in great depth, and that's just not feasible with 50-plus positions. I don't want the team spending a lot of time on marginal 21st idea at the expense of its core positions. I also don't want the portfolio manager to have to delegate key elements of the stock-picking process to others because they are involved in too many names. These managers also run funds with modest enough capital bases such that they can have concentrated positions but yet not be too illiquid to be able to shift gears.

Opalesque: *What kind of partnerships do you have with managers?*

Geoff Keegan: Partnerships with smaller managers are more pure; we are aligned very closely and there is generally much better transparency. We are both building nascent investment organizations and there's a mutual respect and exchange of advice and industry contacts.

It has also become relatively standard practice for newer funds to offer reduced, founders' fee terms to early investors. I will not invest with someone just because they offer low fees, but since I want to be early anyway this is just icing on the cake.

Opalesque: *How do managers view their relationship with a fund such as yours?*

Geoff Keegan: Smaller/newer managers view the GP-LP relationship as more of a partnership, where you are building the business and compounding capital together. There's give and take on fund structure, excellent transparency into their investment process and portfolio, and they view the capital they manage as the investor's money, not their money. And because at this stage they are not making a lot of money on the management fee after covering their operational costs, they really need to generate returns for the clients in order to earn significant incentive fees – and to build personal wealth because they usually have a lot of their own money tied up in the strategy.

They are not at the stage of their career where they have made tens of millions of dollars. They generally have made good money by normal standards, but are still in a get-rich versus stay-rich phase of their career, and that leads to different choices in terms of how they manage the portfolio and the business – choices that I believe result in more optimal risk-taking and absolute returns.

Opalesque: *So there are a lot of parallels between you starting your own fund and the managers you invest with...*

Geoff Keegan: The managers that I seek are highly motivated and driven to build strong track records and high quality investment organizations and cultures. They typically have a lot of their own money in the fund they manage. They are deeply involved in every investment in their portfolios, and performance-versus asset growth-driven. At this stage, they need to differentiate themselves in terms of performance and the quality of their portfolios in order to build a viable longer-term business. They are focused on being an excellent partner and steward of capital, and are open books when it comes to keeping partners current on their investment activities. My business is in a very similar stage of its life cycle and I try to operate Creciente with the same set of principles I look for in managers.

Opalesque: *How many people are there at Creciente Partners?*

Geoff Keegan: It's just me today. As I continue to grow the business, I anticipate hiring additional people on the operations and research side. But today, I have several great service provider partners that I lean on heavily; my fund administrator, my lawyer, and the technology platform I amusing. So

one of the beauties of starting a fund in 2015 is that you can, with technology, outsource a lot of the non-investment aspects of the business. That allows me to focus on performance and not worry about raising a ton of money in the short-term to pay my team.

Opalesque: *What are your manager selection criteria?*

Geoff Keegan: There are three primary manager selection criteria:

1. They have to be small or earlier stage funds, often startups. Typically they have fewer than two or three years in operation and 0 to $300 million in assets, although I have a couple of investments with funds that are larger and more seasoned than that.

2. The portfolio managers still have to clearly be in the get-rich versus stay-rich stage in their career, where the motivations can be very different, and the fund is still concentrated and targeting outsized returns versus just trying to avoid major underperformance/ redemptions.

3. They have to be active on the short side and focused on making absolute dollar profits rather than simply trying to add alpha or hedge; all my managers have demonstrated this ability in the course of their careers.

I am looking for managers that take significant idiosyncratic company bets but not much market risk – you have to take risk to make real money and I want to bet on managers' stock-picking ability in the purest form, not equity markets continuing to rise to new record levels or successful market timing. And they have to be first class partners with first class character, integrity, and fair terms and transparency for investors.

Opalesque: *Why the focus on long/shot equity?*

Geoff Keegan: I have found that a well-constructed long/short equity portfolio can have more compelling return, risk and liquidity characteristics than a portfolio that's more diversified in terms of strategy.

I am looking for outsized returns, not average returns with low volatility. I want to preserve capital in very challenging environments, but I am not focused on month-to-month volatility that much.

I feel like the best way to make outsized returns is to build a portfolio of smaller, concentrated, long/short stock pickers who take a lot of idiosyncratic risk but not a lot of market risk.

Other strategies that can potentially produce similar returns over time are almost always a lot less liquid or come with a lot of tail risk, and I generally don't feel I am compensating for those risks. We saw that first hand during the financial crisis. A lot of long/short managers preserved capital when equity markets were down 50% and were in a strong position to capitalize on the forced selling of others, while many perceived "lower risk" relative value funds suffered permanent capital impairment due to levered spread trades blowing out, forcing them to realize losses to satisfy their lenders and investor redemptions.

But I have invested across strategies throughout my career and reserve the right to invest in other strategies where I see potential returns, risk, and liquidity competitive with long/short equity managers, but in a normal environment, those are extremely hard to find.

B. Gravrand