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Consultants Hunt for Off-the-Grid Managers

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Many asset owners want to invest with emerging managers, especially in the hedge fund space, but even the largest funds rarely have the resources to find such managers on their own, so they are turning to consultants to fill in the gaps.

Although public pensions have the breadth of resources to manage large-sized manager relationships, finding smaller emerging managers can be more of a "fragmented" process, says **Jim McKee**, who leads Callan Associates' hedge fund research group, in an emailed response to questions. "Consultants with an established network of emerging manager relationships can help such clients focus more on the decision-making process and less on the data-gathering process," he writes in the email.

Recently, one giant pension launched a search for those exact types of services. Earlier this week, the $65.7 billion Massachusetts Pension Reserves Investment Management Board (Mass PRIM) released a request for proposal (RFP) for a consultant to help it establish an emerging hedge fund manager portfolio.

"The PRIM Board believes that diversity of thought leads to better decision making. With that in mind, please describe how your organization has worked to foster diversity of thought," according to the RFP. "Please describe ways your firm seeks out diverse employees, ensures wage-equality within your organization and the diversity of your top management or, if applicable, your board."

In addition, the advisor will be tasked with developing a database exclusively for emerging hedge managers "including their philosophies, organizations, performance and clients," on behalf of PRIM.

MassPRIM sees "great opportunities in small hedge fund managers," specifically focused on the "global macro/CTA" space, an external spokeswoman for the pension previously told*FundFire*'s sister publication *MandateWire*.

Aberdeen Asset Management serves as PRIM's hedge fund consultant, according to the pension's website.

Asset classes like hedge funds require more due diligence and have different operational risks than traditional asset classes, says **Brad Alford**, founder and CIO at Alpha Capital Management, who offers consulting search services for investors. The growing sentiment of emerging managers being able to outperform is also leading asset owners to get on board with hiring more emerging managers, says Alford.

Emerging managers with a track record of less than three years and funds that have less than $300 million in assets under management tend to outperform all hedge funds over an annual, three-year and five-year timeframe, according to June 2017 data from Preqin. Managers with less than a three-year track record have an annual return of 14.1%, managers with less than $300 million have a return of 11.91% and all other hedge funds come in at 10.22%.

While Callan does not see a "meaningful" increase in emerging manager consultant searches, many fund sponsors that lack relationships with emerging managers oftentimes need assistance with vetting and identifying emerging managers, says McKee.

"A deep network to source such less-than-obvious manager ideas is a key component of that search process," he says. "Less specialized consultants may not be able to focus on the emerging managers who have less scalable consulting solutions."

For Cambridge Associates, people management skills are key when looking for an emerging manager, says **Joseph Marenda**, a managing director at the firm that focuses on hedge funds. Many smaller-sized hedge fund firms that fall within the emerging manager realm are spin-off funds by former analysts at larger, more established firms. For these firms, Cambridge consults with former colleagues of these start-up firms as a background check.

"We want to see how they worked with their colleagues," he says. "Networking is a powerful form of due diligence. You can run SEC checks, but that's not going to tell you anything about how they interact with other human beings and how they act in times of stress."