STRATEGIC
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This article was written by Strategic Asset Management, a full service hedge fund administration firm providing accounting, tax, administration, compliance, web creation and marketing materials to hedge funds. Strategic frequently introduces their clients to Fund of Funds seeking high quality investments and has first hand experience in the process of successfully pitching to Fund of Fund Managers.

Many hedge fund Managers find that after raising money from friends and family the next logical place is to seek investment from a Fund of Funds. When doing so it is very important that a Manager have the right presentation and expectations when they approach such a fund. There are a number of stages a Manager will go through with a Fund of Funds from initial contact to full investment. While there are no hard rules, the process of receiving allocations from a Fund of Funds generally consists of the following steps:

- ☑ Initial Contact
- ☑ Presentation
- ☑ Due Diligence
- ☑ Negotiation
- ☑ Initial investment and monitoring
- ☑ Full investment

Initial Contact

There are various ways to get the attention of a Fund of Funds Manager. Arguably the best is through a direct referral by a party mutually known to both, but this is by no means the only effective way to come into contact. Fund of Funds can be met at conferences, through word of mouth, through industry organizations, by listing a fund on hedge fund databases, through third party marketers, via service providers such as the fund's prime broker or administrator, and these are just a few of the many ways.

Preparation

Once there is an indication of interest a specific process will usually follow. Often missed, the next critical step is for the fund Manager to thoroughly research the Fund of Funds that is interested in them. Managers sometimes focus so heavily on their own fund they forget that the goal is to address the needs of the Manager to whom they are presenting. The Manager should obtain as much literature as is available on the Fund of Funds. The offering memorandum is a good place to start. There is also nothing wrong with communicating with the Fund of Funds in advance of any meeting. Simply explain you would like to be well prepared for your meeting and want to have a full understanding of their objectives. Minimize the time you need from the Fund of Funds Manager by having a concise, well prepared list of questions to ask.

With minimal homework, the fund Manager can ascertain the types of strategies and investments a Fund of Funds Manager is seeking. By understanding what they are seeking, the potential investment can be presented highlighting how the strategy addresses the investment goals found within their offering memorandum. You should be ready to discuss how your fund will correlate with their existing portfolio of funds. If you are unsure of what they invest in then correlate your fund to appropriate benchmarks, some of which may be very different from your fund (i.e. your fund may be a long only equity fund so the natural benchmark might be the S&P500, but you would also present your fund against such indexes as real estate, arbitrage, income funds etc if those are strategies the Fund of Fund invests in).

Depending upon the venue, you should have appropriate presentation materials. This goes well beyond the Offering Documents of the Fund being presented. As a standard, Strategic recommends having at the ready the last three years audited statements (if available), an up to date tear sheet, executive summary, and a comprehensive pitch book as well as a power point or other presentation. It sounds obvious but all materials need to be absolute professional quality. Missing or less than professional materials is indicative of a lack of investment of time, money and commitment by the fund Manager. An investment in these materials should be done well in advance of any meeting. The lead time can be significant. At Strategic it often takes our design team well over a month to properly prepare these materials for a Fund, and we have years of experience creating these materials.

Presentation

The most important factor when presenting to any investor, above all else, is honesty. If you are caught in a lie about anything, even something trivial, or appear evasive about a fact or issue then the opportunity is essentially over. You are there to present the facts about your investment. If it isn't the right investment for them on its own merits then the sooner you find that out the less time that is wasted.

Beyond honesty, you should be very sure about your fund and all facts and circumstances surrounding its investment strategy. As you present it you should attempt to demonstrate how the addition of your fund affects the overall performance of the combined portfolio. Often overlooked, you should also spend some time discussing how you run your fund as a business. You may have a great investment strategy, but if the Fund of Funds feels you have difficulty running your management company as a business, they are not going to invest. On a number of occasions Strategic has received feedback from some of our Fund of Funds investors with the concern that the manger has a good investment strategy but does not have any experience running a business. If you need help from the right consultants or administrator, recognize it and get it.

It can not be stressed enough the importance of having proper professional materials. Understand that if they decide to invest in your fund they may at some point have to show your materials to THEIR key investors. If it is not to the highest standard you are already going to have difficulty getting them to invest capital.

One question Strategic is frequently asked is how to present a negative, whatever it may be, about the fund. We may be giving away a bit of a trade secret here, but our advice is the same to all. Put this negative at the very start of your presentation. What ever the negative is, the investor will find it, and at the very least you should not be attempting to hide it anyway. So what better approach than to put it right out there? Doing so then gives the Manager the opportunity to focus on the mitigating factors that reduce the impact of the negative. Also, when one quickly presents any problem with the fund it makes your audience feel you are being honest with them and the rest of what you present becomes more believable. By putting it very close to the beginning of your presentation you have the advantage of presenting it in just the way you want. You never want a prospective investor to ask about a negative before you have a chance to mention it yourself. No matter how sincere your intention, and you may have planned to highlight it mid presentation, if the Manager notes it first you are at a decided disadvantage.

Strategic assisted a successful fund Manager a few years ago had the issue that he never graduated college. On our advice he opened his presentation noting that one of the interesting things about his background is how he did not possess a college degree, yet had managed to become a leader in his industry despite it. He noted all of his other partners had degrees and presented numerous published articles both he had written and that had been written about him. From there he continued with all the positive facts about the fund.

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Also be aware that success in such meetings should not be gauged by whether or not they invest then and there. In another example, we introduced one of our clients, a new Manager with a fund that had been in operation for just one year to a Fund of Funds that indicated they were looking to allocate about $50 million to a strategy that was the same as was being run by our client. We created a tear sheet for him as well as other literature and put together a power point presentation. After his meeting we conducted a follow up conference and he felt the meeting did not go well because he did not walk out with an investment. While the Fund of Funds was not making any investment, they did ask to be sent performance numbers each month directly from Strategic and have audited financial statements sent as soon as available. In the analysis, this was actually a very successful first meeting. Not only did they express enough interest in the fund to invest their time monitoring them but they were at the beginning stages of the due diligence process in requesting his audited statements (which he did not yet have completed as this was his first year in operation). As an additional note, following an 18-month process, the Fund of Funds invested $35 million with this Manager in two stages.

On a final note, be aware when you are presenting to a Fund of Funds that you will probably only have 15-30 minutes to present. The best strategy is to have a high level power point presentation, and hand outs that you can either leave behind or cover in greater detail if more time is available. Also do not have too many people go to the presentation. Too many people sometimes gives the appearance of desperation.

Due Diligence
This process may seem straight forward but it actually falls under two distinct categories; pre-investment due diligence and ongoing due diligence.

Pre-investment due diligence is self explanatory. A Fund of Funds will likely put a Fund and its management team through a lengthy due diligence process that includes background checks, audited statements etc. It is in the best interest of the Manager to make this as easy as possible for them by providing all of the information they request.

Ongoing due diligence is often not given much thought by a Manager under evaluation, but the Fund of Funds will consider this critical. The Fund of Funds will evaluate the ways in which they will continue monitoring the fund once they have made an investment. They will carefully evaluate issues such as transparency, reporting, nature and verifiability of the investments, access to management and the fund's administrator, etc. A Manager taking a proactive role in addressing how the Fund of Funds will independently verify the investment they make on an ongoing basis will give themselves an edge.

Also consider that the greater the investment a Fund of Funds intends to make the more important the ongoing due diligence becomes. It is not cost effective for a Fund of Funds to invest the time and expense in maintaining high due diligence in a small investment. Making it less expensive for a Fund of Funds to track its investment will not be a key factor, but will help the fund decide one investment over another if of equal merit on other factors.

Initial Investment and Monitoring
While not the rule, many Fund of Funds will start off with a small initial investment, with the intention of making a larger investment once the first investment performs to expectations. While there is no set benchmark, typically the initial investment may be anywhere from 5-20% of the ultimate intended amount and the trial period may be from 3 to 18 months. An evaluation will likely follow at the end of the period with the determination to either withdraw from the fund or invest more.

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While performance is key, other factors are also evaluated during this time period. These factors include timeliness of reporting, including monthly statements, provision of a timely year end audit and tax statements, ease of interaction with the management team and other factors.

Negotiation

This may come at any time during the investment cycle. It may occur during the initial presentation or be brought up when the Fund of Funds is ready to make a final investment. This is where the Fund of Funds will attempt to get the Manager to lower either their management or incentive fee, if not both. A Manager should be ready for such a conversation and know beforehand what they are willing to give away for a large investment. The management of the Fund of Funds knows all too well what it takes to run a fund, and can likely figure fairly accurately what your level of profit will be under varying scenarios. Every Manager makes their own negotiations but it is key to understand that this conversation is more likely than not to take place. They need to be ready to address it.

Full Investment

The final stage is when the Fund of Funds makes a large investment. Once achieved the goal is to keep them satisfied with their investment. It does not hurt to periodically review the steps made to obtain the original investment and use it as a means to build and strengthen the relationship over time. Regardless, Strategic offers a final important word of advice. Approach all investors as if they were a large fund of funds. Doing so will help you get prepared, give you practice with your presentation and in addressing questions and concerns, and allow you to address and mitigate any valid weaknesses they might expose through the process. Most important, treating each investor, even very small ones, with the same thoroughness and concern you would to the very largest investor is simply good business. Further information can be obtained by contacting Strategic directly. Our web site is www.completehedge.com