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Moonlighting appeals to hedge fund managers; Some are running separates or mutual funds

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DETROIT - In the high-stakes world of hedge fund management, some managers have discovered the advantages of moonlighting as a separate-account or mutual fund manager.

While the fees earned for managing more traditional investment vehicles don't compare to what can be made on a hedge fund, the list of reasons for "slumming it" is long, and tough for some managers to ignore.

Paul Glazer, who manages a \$65 million hedge fund through Glazer Capital LLC in New York, said he started managing money for investors in a separate-account format a few years ago because it is the only way some investors would give him money.

"The reason it's becoming so popular for hedge fund managers to manage money outside of their hedge fund is because customers want this," he said. "If a client says you can manage this money in a separate account or not manage it at all, any manager would take the money."

Of course, managing assets through a mutual fund or separate account isn't nearly as lucrative as managing assets through a hedge fund.

Most hedge fund managers earn a performance fee, which can equal 25% of the gains in some private-partnership agreements. In addition, hedge funds also typically charge an annual management fee that usually starts at 1%.

Mutual funds and separate accounts generally don't charge performance fees.

Still, there is good reason why some hedge fund managers are looking to supplement their income.

"For some hedge fund managers, it's a matter of putting food on the table," said Sunny Patpatia, president of Patpatia & Associates Inc., a consulting firm in Berkeley, Calif. "It's not always easy for hedge fund managers to raise money."

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Mostly newbies

Although the \$600 billion hedge fund industry is considered to be flush with investor cash, the money doesn't necessarily distribute evenly.

John Van, chief financial officer of Van Hedge Funds Advisors International Inc. in Nashville, Tenn., said those hedge funds that are still establishing track records and reputations are the ones most likely to take in money outside a hedge fund.

"At this point, hedge funds have basically been discovered, and there's so much money seeking a home that the established managers have very little incentive to do anything that doesn't include a performance fee," he said. "This is the kind of thing you're going to see mostly with managers who are early in their career."

But even without the bonus of performance fees, Mr. Van added, managing a pool of assets in an identical style as a hedge fund can amount to a decent and steady revenue stream.

"It's basically found money," he said.

For **Ian Fraley**, managing principal at **Financia Capital LLC** in San Francisco, the decision to start managing some of his clients' assets in separate accounts was driven first by fiduciary responsibility and second by basic survival instincts.

He said a number of his investors wanted to add qualified retirement plan assets to his hedge fund.

"I'm just not comfortable seeing that kind of money go into a hedge fund," said Mr. Fraley, who manages about \$10 million through his hedge fund and various separate accounts. "There are tax issues related to the use of leverage that would force investors to file a separate tax return on their retirement assets."

Additionally, he said, the idea of somebody exposing their entire retirement portfolio to the kind of risk he uses in his hedge fund didn't sit well with him.

"I was leaving all this money on the table," Mr. Fraley said of the retirement account assets. "So I realized I could be managing more money if I was willing to manage separate accounts."

For some hedge fund managers, the traditional-asset route can be a way of obtaining the kind of publicity that hedge fund managers are generally prohibited from seeking.

Regulatory issues

Geoffrey Gerber, president of TWIN Capital Management Inc. in McMurray, Pa., manages assets in a subadvisory role for the Alpha Hedged Strategies Fund, a mutual fund managed by a half-dozen hedge fund managers.

"We get paid a flat fee that's equal to our management fee, and we don't need to worry about capturing the assets," he said. "We don't have to worry about marketing or distribution issues."

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Mr. Gerber, whose firm manages a total of \$300 million, said the assets that come in through the Alpha fund are managed as a commingled account.

Lee Schultheis, who created the Alpha fund as chief investment officer of Alternative Investment Partners LLC in White Plains, N.Y., said the first-of-its-kind fund meets the needs of both retail investors and hedge fund managers.

"Different hedge fund managers seem to look at it very differently. If they like the publicity that comes with managing a mutual fund, they may be receptive to the idea," he said.

"For some hedge fund managers, that's a distinct plus because they've never been able to do things like advertise," Mr. Schultheis added.

Moonlighting as a manager of assets in more traditional investment products raises some regulatory issues.

For starters, the hedge fund managers must register as investment advisers, which is something that could be fast approaching as an industrywide mandate anyway.

Also, at least in the case of a registered mutual fund, the hedge fund manager's strategy needs to be completely transparent and liquid in order to meet the daily net asset valuation requirements.

There is also the potential for conflicts of interest that could cause a manager to pit one portfolio against another, or using one pool of assets to boost the performance of another through an illegal scheme known as front running.

Still, for some hedge fund managers, the lure of managing traditional assets is undeniable.

Doug Ehrman, a hedge fund manager with AlphAmerica Asset Management LLC in Chicago, is eyeing participation in the Alpha Hedged Strategies Fund as a way to expand the firm's \$20 million in hedge fund assets.

"It's definitely good exposure to be part of a public fund, because it can drive business your way," said Mr. Ehrman, whose firm has been around for almost three years.

"We see it as a combination of a marketing tool to get more people familiar with our strategy and as a way to get assets under management," he said. "Of course, I'm sure if we had grown to \$100 million or more by now, we probably wouldn't be considering this."