Back to the future.

As hedge funds eye a return to the retail market, competitive pressure and institutional gatekeepers will continue to steer the industry toward innovation and operational excellence.

SEI Investment Manager Services

Contents.

Too much of a good thing?

From the beginning, hedge funds have been outsiders, thriving on uncertainty and volatility while profiting from trades that more mainstream market participants were unwilling or unable to make. They thrived on the bleeding edge, putting the latest investment theories to the test in the markets.

This model produced untold riches, spectacular blow-ups, and headlines. As the rest of the investment industry inched toward homogenised approaches and identities, hedge funds became crucibles in which reputations were either forged or shattered. They attracted many of the best minds to the business, along with countless others attracted by the unparalleled opportunity to make it big. New assets accompanied the flow of talent. Institutional investors on the hunt for performance and portfolio diversification poured money into hedge funds at an unprecedented rate. According to Preqin, global hedge fund assets topped US$4.3 trillion by year-end 2021.[1]

Is any of this sustainable? Even a cursory analysis reveals that recent growth was largely due to the raging bull market. Apart from a dip in 2018, hedge fund assets rose steadily from US$3.1 trillion in 2015 to US$4.3 trillion at the end of 2021. Yet this 38% increase came despite asset flows, not because of them. Outflows overwhelmed new capital in four of the most recent seven years (**Figure 1**). A banner year like 2021 is unlikely to be repeated, and any weakness in the market will highlight the vulnerabilities lurking just below the surface.

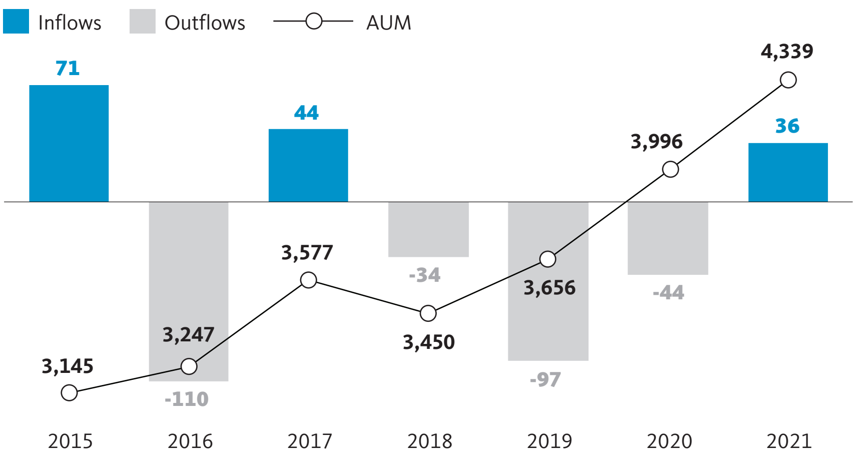
Unfettered by regulations or external mandates, hedge fund managers were historically limited only by their imaginations. Ideas may be infinite, but other things are not. Arbitrage opportunities are less obvious, regulation has tightened, and investors have evinced less tolerance of opacity and growing demand for fees that reflect alpha generation. Smaller funds, while in theory bringing nimbleness that is attractive to investors, face a particularly rocky road. Hedge funds now face the distinct possibility that they will become victims of their own success. Is it even possible to differentiate a fund in so crowded and competitive an environment? Larger-than-life personalities and devilishly clever trading strategies used to be enough, but those days are long gone. Going forward, the devil will more likely be found in the operational details and in providing greater transparency into investment process and strategy implementation. Underlying issues are easy to miss amid a flood of new assets, but they are sure to be laid bare by any market correction.

Short of any market disruption, we felt the best way to formulate an honest outlook for the hedge fund market was to talk to market participants themselves. As a follow up to The Shifting Hedge Fund Landscape released by SEI 10 years ago, SEI collaborated with ANZU Research, Preqin, and Global Fund Media in contacting hedge fund managers and investors during the second half of 2021. We surveyed a total of 160 participants—79 hedge fund managers (General Partners or GPs) and 81 investors (Limited Partners or LPs)—some of whom also agreed to in-depth interviews, allowing us to further compare perspectives, teasing out a glimpse of the future and pinpointing threats and opportunities.

Additionally, for a current perspective on hedge fund marketing challenges and opportunities among both the institutional and retail investor market segments, we asked the 34-year-old financial communications and sales marketing consulting firm Frumerman & Nemeth Inc. for its observations and asset-raising recommendations. We are appreciative of all who took part in this research and hope our efforts will help inform the choices faced by GPs and LPs in the coming years.

Figure 1. Hedge fund industry net flows and assets under management

(US$ billion)



Source: Preqin

Survey highlights.

Objectives

Investors are much more focused than managers on **diversification** and volatility reduction.

Complexity

Investors are much more likely than managers to think hedge funds are complex enough to call for **consultants** when evaluating them.

Risk

There is a growing **divergence** of opinion on whether hedge funds effectively manage risk. Managers are confident, but investors are dubious.

Assessment

Many survey participants point to operational due **diligence** as the area of most radical change in the years since the 2008 global financial crisis.

Reporting

Transparency and **communications** have changed significantly amid widespread investor demands.

Cost

Managers hoping for less fee pressure may be **disappointed**. GPs point to changes made, but investors are looking for fees commensurate with performance.

Concerns

Managers **underestimate** investor concerns over exit strategies, portfolio transparency, liquidity risk, and leverage.

Operations

A growing **emphasis** on operational excellence is the single biggest shift over the past decade.

Brand

Investors attach more importance to fund brands. GPs are sceptical but may want to consider anchoring their brands in **attributes** that resonate with investors.

A long and winding road.

Hedge funds have a fascinating backstory peopled with colourful characters pushing the boundaries of trading and investments.[2] When centuries of cutting-edge financial instruments coalesced into the first modern hedge funds, they were primarily playthings for the wealthy. This changed as the 20th century drew to a close, with institutional investors increasingly seeking out hedge funds as sources of alpha and diversification. With close ties to the academic research fueling innovation on Wall Street, college endowments led the way. Facing a need for better risk-adjusted returns, pension plans and others followed.

The rush of institutional assets pushed global hedge fund assets toward US$2 trillion by 2007. Despite the global financial crisis taking the wind out of their sails, many hedge funds continued to attract the interest of institutional asset owners who went on to dominate the industry, sometimes investing 10% of their portfolios in hedge funds and representing the majority of assets by 2010.[3] Hedge funds had arrived.

The years since have been rougher and hedge funds are exploring other options. Acknowledging the challenges in attracting further institutional capital from plan sponsors, endowments, foundations, and family offices, and envisioning a completely new client base and revenue stream, some are revisiting their roots in the individual investor market.

It is not as though demand has dried up. Many funds have succumbed to market pressures and lack of scale in recent years, but hedge fund exposure has served many institutional investors well during pandemic-induced uncertainty. Some are going so far as to call 2022 the "greatest asset-raising environment in the history of the hedge fund industry."[4] It may also be the most crowded asset-raising environment in history, with new fund launches outpacing liquidations.[5] The 614 hedge funds launched in 2021 are the most since 2017, while the number of liquidations were down to 527, the fewest since 2004.[6]

As competition for institutional assets becomes even fiercer, more firms are refocusing on wealthy individual investors, who collectively represent US$70 trillion.[7] Considering that allocations to alternatives currently average only 1% among high-net-worth investors, it is easy to see why more hedge funds believe that growth in the retail segment will almost certainly outpace that of the institutional market. This attraction is not lost on managers of other alternative products. Private equity titan KKR & Co. says raising capital from retail investors is a key area of focus, and goliath Apollo Global Management estimates that "retail capital will account for an average of 30% of its annual fundraising from an average of 5% a year."[8] Blackstone estimates that individual investors could account for half of its assets under management within the next decade.[9]

This renewed emphasis on retail markets is especially significant because it has broader implications. Hedge funds are quick to adapt to market conditions, but they have historically been more reluctant to adapt to investor needs, preferring to forge their own path. Increasingly sophisticated investors and gatekeepers, however, are more interested in enterprises that minimise risks.

Hedge funds looking to reprise their initial success with wealthy individual investors and their gatekeepers—from the captive sales force RIAs to the independent, fee-only financial planning/investment advisory wealth management boutiques—must recognise that everything has changed. Going forward, marketing and investor servicing will require different infrastructure and, potentially, teams. Distribution professionals are already being poached from traditional long-only firms in greater numbers.[10] Catering to new distribution channels will also require a more open-minded approach to investment vehicles, more flexible fee structures, and digital transformation initiatives that extend far beyond trading desks. In addition, notwithstanding US 1940 Act requirements and constraints, because of the differing liquidity, diversification, duration, and portfolio construction needs of institutions, not all strategies run by institutional managers may translate well to the retail space.

Wealthy individual investors collectively represent US$70 trillion.

All of this is happening against a background of industry convergence. With such high stakes, all this additional complexity means fund ecosystems will extend far beyond the office walls to include all manner of technology, data, and service providers. Operations will matter more than a founder's ego or a hedge fund's larger-than-life personalities, and reliably and sustainably delivering the necessary outcomes will require that all parties coordinate seamlessly to shrink the gap between what investors want and what managers are providing—or think they're providing.

Multiple motivations.

Investors allocate to hedge funds for a variety of reasons, but their rationale is not always appreciated by the managers in whom they invest. One of the biggest areas of disagreement between GPs and LPs centres on the importance of reduced volatility. While 36% of LPs surveyed consider it an especially important objective, only 13% of GPs view lower volatility as a particularly important goal for their investors. Instead, GPs were much more likely to say reduced volatility is not important at all (**Figure 2**).

There is growing awareness of the need for diversification, especially amid so much concern around equity valuations, low interest rates, and inflation.[11] This is evident in the responses of LPs, who voted diversification with non-correlated assets their single most important objective (**Figure 3**).

"With fears around rising inflation and low yields from fixed income allocations posing a quandary for investors, hedge funds are becoming 'a compelling alternative to fixed income products,'" notes a report from Barclays Capital Solutions Group.[12] Chris Walvoord, global head of hedge fund research at Aon, says investors are "looking for something that can be uncorrelated to both bonds and equities going forward, and certainly good performance by hedge funds in the first half [of 2021] doesn't hurt in convincing them that could be a good place to put some of that allocation."[13]

Figure 2. How important an objective is decreased volatility?

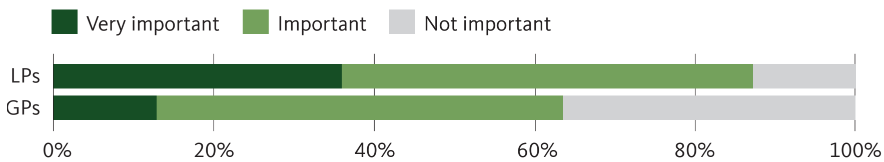
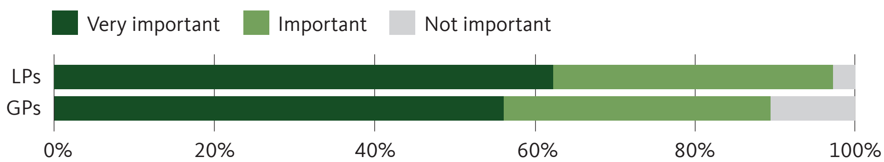


Figure 3. How important an objective is diversification with non-correlated assets?



GPs and LPs both view risk management as an important objective (**Figure 4**). While not surprising, this is noteworthy in that the survey went on to reveal growing concern that risk management efforts are less robust than a decade ago. GPs are more likely than LPs to emphasise outright performance: Absolute returns and enhanced alpha generation are both rated by managers as more important objectives than by LPs (**Figures 5 & 6**). Having the flexibility to find diverse sources of alpha is also considered more important by GPs; although, less than half of all managers (and investors) say the ability to exploit market opportunities is a particularly important attribute (**Figure 7**).

Figure 4. How important an objective is risk management?

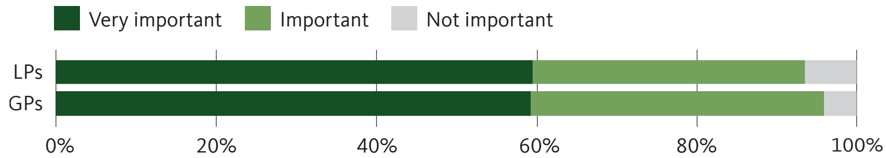


Figure 5. How important an objective are absolute returns?

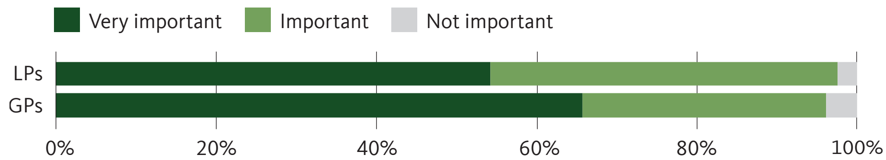


Figure 6. How important an objective is enhanced alpha generation?

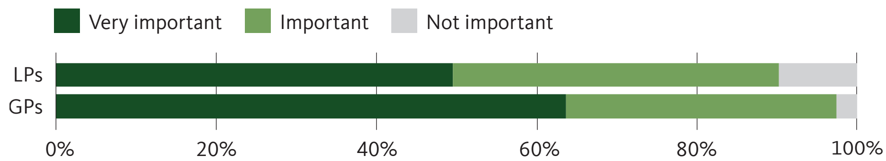
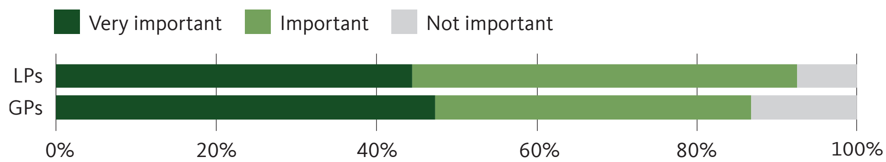


Figure 7. How important an objective is the ability to exploit market opportunities?



Shifting priorities.

If there is one thing on which most industry participants can agree, it is that robust operations are vitally important. This sentiment is hardly new, and perhaps not unsurprising, but it is being voiced more forcefully. The growing emphasis on operational strength is the single biggest shift over the past decade, with 14% more respondents agreeing that it is a hallmark of institutional quality (**Figure 8**) than they did in 2012.

Much of the groundwork has already been laid. Institutionalisation motivated widespread improvements to systems and infrastructure, with upgrades to risk management, governance, and compliance processes, among others. Growing sophistication among managers and investors alike ensures continued improvements, and widespread success with remote work has inspired greater confidence in the growing network of vendors and service providers prepared to facilitate every conceivable aspect of operations. This bodes well for those GPs looking to leverage their infrastructure and service provider relationships in attacking the retail market.

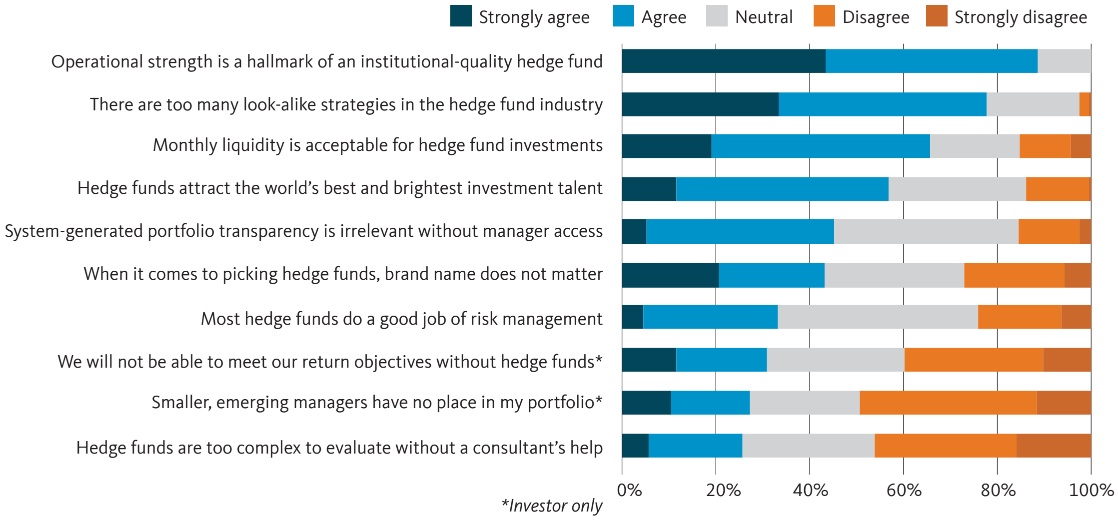
Large firms can afford to build and maintain dedicated infrastructure, but smaller managers are increasingly finding that platforms offer the most realistic path to success. Scott Treloar, chief investment officer at Noviscient, says, "Modern platforms have the potential to open up the pipeline between LPs and allocators looking for better returns and emerging managers. These platforms need to focus on alignment and transparency and remove the frictions faced by LPs and emerging managers."

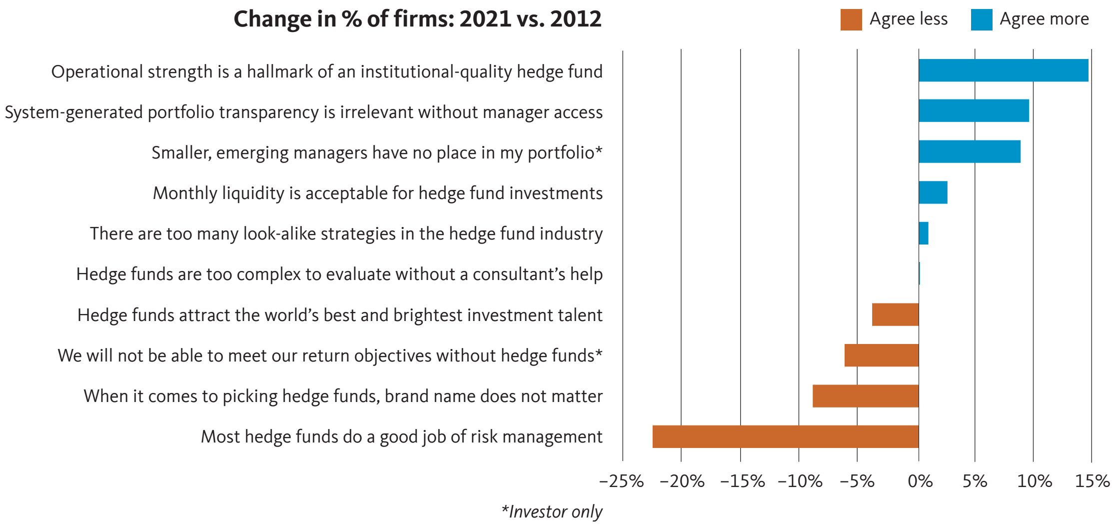
"Platforms need to focus on alignment and transparency and remove the frictions faced by LPs and emerging managers."

—Scott Treloar, CIO, Noviscient

This trend underscores one of the other facts on which more than three out of four survey participants agreed: The market is too crowded with look-alike funds. Differentiation is challenging in such a crowded market, making it more crucial than ever. “There is more specialisation among hedge funds that are launching because they are competing with a lot of established managers,” says Scott Schweighauser, managing partner at Borealis Strategic Capital Partners. “The way you garner attention and attract capital, you [need to] have a very specific story to tell.”[14]

Figure 8. Do you agree or disagree with the following statements?





"Managers today are exactly as focused on risk management and just as good as they were 10 years ago, but I think that markets have changed. Markets are more volatile and therefore it might be perceived that managers are doing a less good job."

—Mette Østerbye Vejen, CEO, CABA Capital

A story may be the hook, but most pitches are multifaceted, highlighting as many attributes as possible. The trick is to bake these into that magical confection known as a brand, which immediately elicits certain (hopefully positive) feelings among potential investors. Many managers are dismissive of branding, with more than half stating that brand names do not matter in picking hedge funds. The fact that far fewer investors agreed with them should give managers pause.

Another area of disagreement is complexity. While 37% of investors agree they need a consultant's help in evaluating hedge funds, they are joined by only 14% of managers. This gap highlights the importance of perception. There is little to be done about the actual complexity of a given strategy, but a lot can be done to educate and assuage concerns. This is particularly important considering the growing need for effective risk management. Highlighting how much the industry has drifted from its original mandate to hedge risk, investors and managers surveyed are both less inclined to say that hedge funds are as effectively managing risk as they were a decade ago.

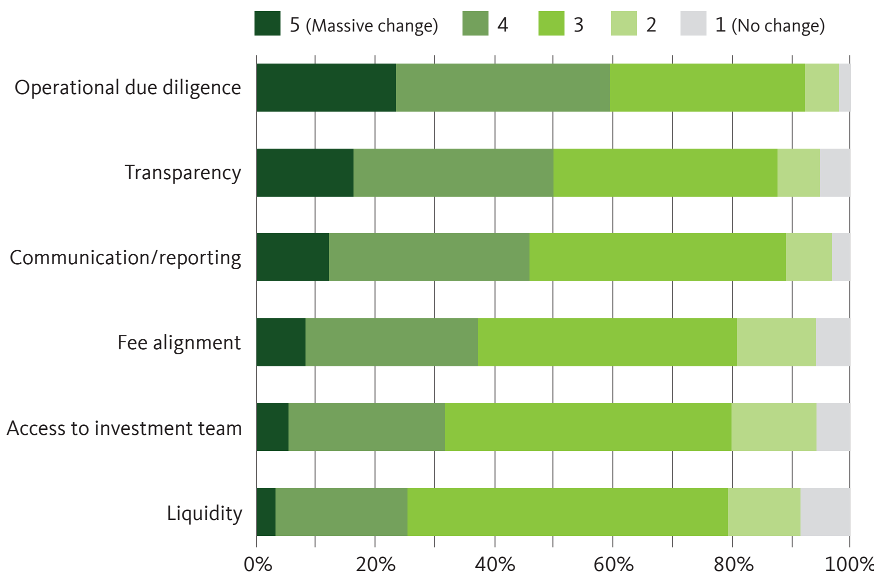
This may largely be a matter of perception, market evolution and sophistication. Mette Østerbye Vejen, chief executive officer of CABA Capital, believes that "Managers today are exactly as focused on risk management and just as good as they were 10 years ago, but I think that markets have changed. Markets are more volatile and therefore it might be perceived that managers are doing a less good job."

Industry evolution.

Hedge funds were forced to acknowledge shifting priorities in the wake of the global financial crisis of 2008. Change has been widespread in the intervening years, leaving no part of the industry untouched. With wary investors becoming more attuned to headline risk and demanding reassurances of robust operations, it makes sense that operational due diligence has seen the most radical change (**Figure 9**).

Transparency and communications have also changed significantly, which is not surprising in hindsight, given widespread frustration around these areas that we uncovered in our surveys dating back to that time. Despite advances, many investors continue to seek more portfolio transparency than some (especially emerging) managers can—or would like to—provide. However, LPs agree that transparency has increased over time, with Andrea Herman, investment analyst at Goldrock Capital, stating that, "funds are being more and more transparent. They have factsheets and they're giving out positions more. They're talking about long/shorts. It's not this light grey

Figure 9. How much has hedge fund investing changed since 2008? Rate from 1 (no change) to 5 (massive change)



box anymore. There are more LPs pushing to find out what's under the bonnet, and we're getting it. It's just much more clear and more available than ever before." Greater standardisation across managers, investors, intermediaries, and administrators is also helping, with half of all hedge fund assets, for example, now reporting in the Open Protocol format.[15]

Some warn that standardisation has its limits, and investors should always be prepared to account for different approaches. CABA Capital's Mette Østerbye Vejen suggests that "standardisation of risk measures is always good. But when you're in the alternative space...one-size-fits-all risk management or risk reporting doesn't necessarily make any sense. You really need to look at each strategy, each asset class, and develop your own risk measures which fit your strategy and your asset class."

Hedge fund managers hoping for less fee pressure going forward may be disappointed. While GPs point to significant concessions over the past decade, investors are much less likely to acknowledge any significant adjustments. The trend toward lower fees is well documented, but many investors continue to feel that fee structures are not aligned with risk-adjusted performance in the context of stated aims.

The industry has changed in other meaningful ways. Thanks to encouragement, or pressure, from institutional investors, access to investment teams has improved. Though trickier to implement in some cases and strategies, liquidity needs are also being accommodated to a greater degree than in the past.

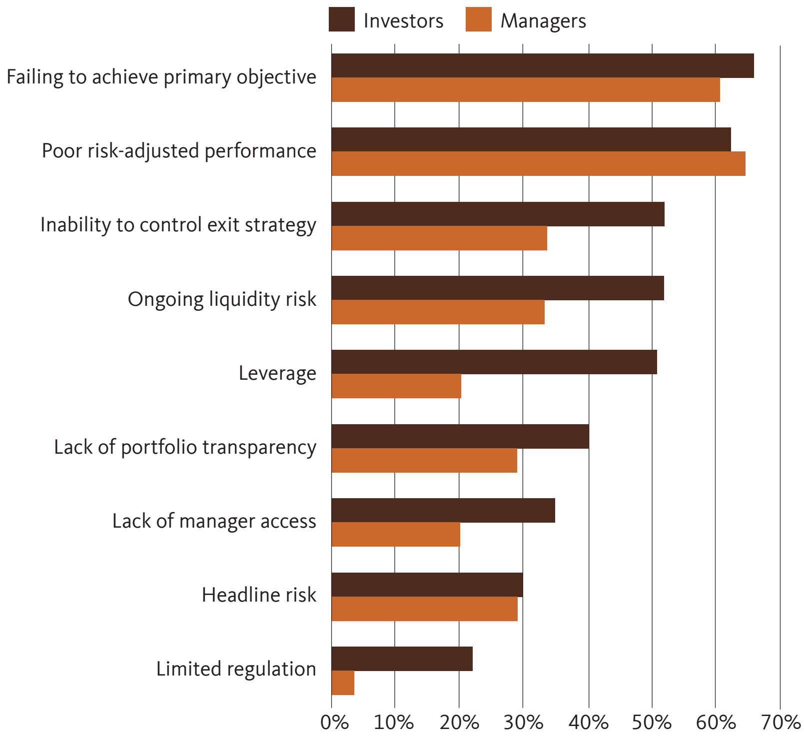
"One-size-fits-all risk management or risk reporting doesn't necessarily make any sense. You need to develop your own risk measures which fit your strategy and your asset class."

—Mette Østerbye Vejen, CEO, CABA Capital

Investor concerns.

Demonstrating more value and going to greater lengths to align their offerings with investor goals, hedge funds are more obliging and collaborative than they were 10 or 20 years ago. Many, however, continue to underestimate the intensity of investor concerns. Both groups understandably worry most about underperformance and not meeting objectives. Beyond this, LPs are more troubled by a number of other issues than their managers might think. More LPs, for example, are likely to rate their inability to control their exit strategy as a major concern. Inadequate portfolio transparency, ongoing liquidity risk, and leverage are also major worries for investors (**Figure 10**). It is worth noting that outside of transparency, where much has changed over the years, investors are more likely to be concerned about all these issues than they were 10 years ago.

Figure 10. Major investor concerns around hedge fund investing (Rated 4 or 5 on 5-point scale)



Illiquidity is a good example of the intractable nature of some concerns. It is viewed by many managers as an inevitable by-product of their strategies and investment vehicles—a necessary evil in the quest for superior risk-adjusted returns. While true to an extent, this does nothing to alleviate the anxiety of investors (both institutional and retail) living with the trauma of 2008, when they were forced to sit on the sidelines as their investments imploded and gates were put up. Market liquidity continues to be a concern for many investors, who are looking for better tools to understand, evaluate, and mitigate liquidity risk. Managers can aid with better reporting, but new platforms and exchanges are stepping in to address liquidity head-on by fundamentally changing the way hedge funds are bought and sold.

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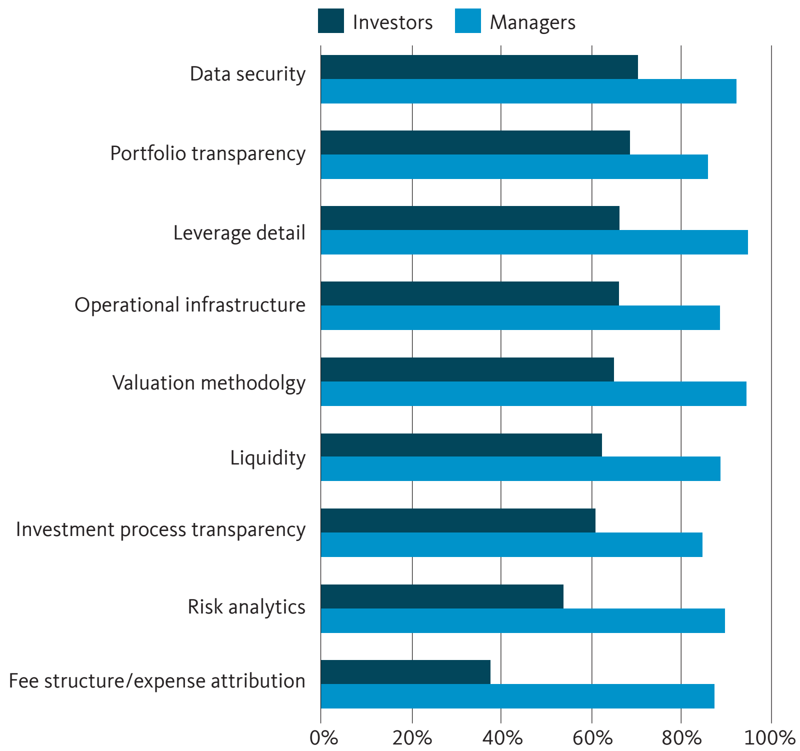
Client **satisfaction.**

Hedge funds do not often admit to having disgruntled investors, but complacency would be a mistake. Our survey reveals that overconfidence is widespread. GPs are far more likely to assume their investors are mostly or completely satisfied, ranging from 85% to 95% of the total. The truth? Investors often do not agree.

Data security, for example, is an area in which managers can be confident that many investors approve of their efforts. Even here, however, only 70% of LPs say they are mostly or completely satisfied with data security practices at hedge funds in which they have invested. A similar pattern is visible across a range of functions, with GPs consistently overestimating investor satisfaction levels (**Figure 11**).

Figure 11. LPs mostly or completely satisfied according to investors and managers



Liquidity manifests itself as a hot button topic here as well, with a particularly large gap between manager and investor perceptions. Almost all managers are satisfied with the liquidity detail provided to their investors, with 61% claiming their investors are completely satisfied. LPs, however, are far less sanguine, with only a paltry 5% agreeing that they are completely satisfied.

The biggest discrepancy centres on fee structure/expense attribution. While 87% of managers think their LPs are mostly or completely satisfied with their fee arrangements, only 38% of investors concur. The fact that only 5% say they are completely satisfied should not be taken as a signal that fee pressure will continue unabated. Both management and performance fees declined consistently in the decade after the global financial crisis. They appear to have stabilised in the last few years, but two and twenty is clearly no longer the default. Approximately one third of all hedge fund assets can now be found in funds with management fees below 1%. An even bigger share is claimed by funds with performance fees of 15% or less.[16]

Industry consultant Albourne proposed a "1 or 30" structure in 2016, and while subsequently implemented by the Teacher Retirement System of Texas, it has not found overwhelming or sustainable traction in the industry to date.[17] Going forward, the emphasis is more likely to be placed on customised fee structures as asset owners push for costs commensurate with alpha. Goldrock Capital's Andrea Herman notes that, "As much as we want it to go down, management fees are here to stay. And we want the fund's management to be incentivised properly.... Hurdle rates are where [investors] are playing with doing more.... The hurdle rate makes a big difference and I think this will help cause overall fees to come down." Ken Atchison, founder and managing director of Atchison Consultants, describes the challenge succinctly: "Low-cost passive investments including ETFs provide the challenge for active managers: How to deliver value add and manage risk?"

The question for hedge fund managers is "How to deliver value add and manage risk?"

—Ken Atchison, founder, Atchison Consultants

Marketing smarter.

Mind the gap

How have asset-raising challenges changed in the decade since SEI last wrote about the hedge fund market? How is marketing to retail investors different, or similar, to how managers approach institutions? What tips can we suggest to managers looking to take advantage of the rising demand from the non-institutional market while avoiding common pitfalls?

To answer these questions, SEI spoke with Bruce Frumerman, CEO of the 34-year-old New York City-based financial communications and sales marketing consulting firm, Frumerman & Nemeth Inc.

Segmenting prospective investors—the song remains the same

One thing that hasn't changed in both the institutional and retail investor worlds, Frumerman says, is that "there are still three types of investors." Frumerman & Nemeth classifies these investors as people who allocate based on pedigree, those who only buy performance, and those who buy process. Pedigree investors range from friends and family investors to those whose due diligence goes no further than choosing either the mega-sized firm name (like buying IBM, you won't be judged harshly) or the portfolio manager who came from a top "name" firm or prestigious university.

"Performance chasers are not sticky asset investors. Attracting assets based on current performance can negatively affect investment boutiques much more than the mega-sized firms once performance inevitably flattens or drops. Our experience is that the sticky asset investors are those who buy into the investment process of the portfolio manager," Frumerman says.

Alpha skill or just luck?

In today's market, institutional investors and investment consultant gatekeepers are delving more deeply into how the hedge fund manager assembles and manages his or her portfolio basket of holdings, Frumerman notes. "To make that subjective decision as to whether a manager's performance is more likely due to skill than luck, this due diligence vetting is requiring hedge funds to be far more transparent and detailed in their explanations about their investment process and strategy implementation," Frumerman continues. The days when "transparency" meant just providing holdings and attribution analysis are long gone. "Institutional investors are looking to see that risk management protocol elements are legitimate steps within the investment methodology. A decade ago, hedge fund managers often claimed they had an investment process and risk management that was dealt with as an 'overlay' rather than woven into the methodology. That just doesn't cut it today."

Gatekeepers—a key to attracting sticky asset retail clients

Marketing to, and through, retail investor gatekeepers offers the best means for winning over stickier asset investors, says Frumerman. These include both the independent, fee-only wealth management firms that are platform-agnostic, as well as the captive sales force RIAs at brokerages and financial supermarket firms.

“Hedge fund firm owners should realise that those firms that help the gatekeepers demonstrate their added value to their retail clients will win more market share,” Frumerman says. “It’s not enough for the gatekeeper to merely tell a retail investor that the alternative strategy asset class category and fund performance warrants their allocation, because that positions the hedge fund as being an easily replaceable, commodity-like choice.”

Gatekeepers can make their added value tangible when they can tell a client why, beyond pedigree and past performance, they made the evaluation that Fund A is better than Fund B, Frumerman observes. All this comes down to whose investment process is, subjectively, the more reasonable and repeatable one to allocate to. Frumerman points out that this is something that gatekeepers can communicate only when strategy implementation detail have been explained to them, both verbally and in collateral.

“Marketing collateral retells this key information, which both defines and differentiates one fund and manager from another,” Frumerman says. “It is a point of reference and a script for wealth manager gatekeepers to use when explaining why they are making a particular allocation recommendation to their retail investor client.” Importantly, he adds, “this is paragraphs-worth of content that pitch books are not designed to contain.”

Retail is not that different from institutional

"Don't underestimate the interest and ability of retail investors to want to understand and buy into the alternative strategy being recommended by their wealth manager gatekeeper, or that they themselves read about on online investment platforms," Frumerman advises. "They are little different from the non-professional investors who can be found on investment committees at pension plans, endowments, and foundations." Since many are interested in having explained to them, and indeed may have a duty to understand, how the managers they invest with run their strategies, "GPs should make an effort to share this information, and do so in an easily understandable way," he says. "But whatever you do, do not dumb it down."

A brand is a firm's story of how

As noted in the survey, firm brands are important to investors. But they and their gatekeepers must recognise that different strategies often require different implementation. Clearly understanding that is critical in evaluating the true benefit of the specific fund in which they are looking to invest.

"Particularly for alternative strategy portfolio managers, brand identity is their Story of How regarding the investment process and strategy implementation on a product-specific level," Frumerman says. "Out-marketing similar-performing competitors will come down to the hedge fund manager's ability to differentiate itself for both retail investors and their wealth manager gatekeepers, as well as for institutional investors, based on the firm's competence to educate and persuade people to understand and buy into how they invest. Managers who can sharpen their skills to achieve this will likely see greater opportunities to grow assets and their investor base."

Toward operational excellence.

Innovative trading strategies and exclusivity have long been the calling cards of hedge funds. Ironically, many will find that they trail their long-only cousins when it comes to the more mundane but increasingly important facets of their operations. The gap has narrowed in recent years, but the bar continues to rise as other types of interactions shape expectations. With the pandemic accelerating the digital transformation of daily life, investors have quickly come to expect more speed, quality, reliability, convenience, and accuracy from their hedge fund managers—and from everyone else.

The renewed focus on retail investors will exacerbate these challenges. So hedge funds will need to equip themselves with the tools necessary to successfully raise capital via key retail channels including wirehouses, RIAs, and broker-dealers. Retail sales and institutional fundraising require fundamentally different strategies and marketing support and will likely require the creation of parallel sales forces with the experience, language, and technology they need to succeed. Investment vehicles will almost certainly proliferate, and managers will need to decide if and how they can package their expertise as evergreen funds, interval funds, drawdown funds, mutual funds, or even active ETFs.

Even as wide swaths of the investment landscape succumb to commoditisation, hedge funds continue to forge a path ahead with creative investment strategies and state-of-the-art technology. Making significant inroads into the undeniably attractive retail market means a delicate balancing act, allowing a creative and rewarding culture to flourish while juggling the myriad operational requirements necessary to satisfy individual investors, their advisors, distribution intermediaries, and regulators.

Speed and ingenuity will always be differentiators, but the most successful firms will also showcase the talent and infrastructure necessary to support inventive strategies and advanced technologies. Customisation is one area of intense interest. Noviscient's Treloar points out that "Technology has the potential to disintermediate big institutions.... There is no technological reason why we can't start to get customised portfolios created for even very small investors."

Hedge funds are by their very nature idiosyncratic. They are built, shaped, and nurtured by people with ideas they feel are unique. If anybody was well suited to suddenly working from home during COVID, it was hedge fund managers. Promoting a corporate culture in a virtual environment might be challenging, but many asset managers exceeded expectations and some hedge funds thrived. Technology enabled them to not only trade effectively but also administer their funds and communicate with investors to the pre-COVID standards. Enabled by new technology, working from home was a surprisingly easy transition for many, although it was much harder for newer firms without established relationships.[18]

Success amid so much uncertainty only feeds the pervasive complacency revealed by our survey, which shows significant gaps between the perceptions of hedge fund managers and their investors. These discrepancies are opportunities for savvy managers who aim to maximise their reach and minimise the risk of disappointment. Hedge funds are more likely to hit this moving target with the help of key partners, whose expertise and technology can produce a best-in-class solution for each function.

Sporting futuristic looks and questionable performance, some high-riding hedge funds of the past bore more than a passing resemblance to Doc's DeLorean in *Back to the Future*. Hedge fund managers of the future must aspire to better quality standards, especially if they are to successfully navigate back to the future of retail markets. This is especially true when one considers the myriad ways hedge funds might evolve. Alternative data sources continue to proliferate, practically begging to be deciphered and utilised by astute managers. Blockchain, tokenisation, and the cryptocurrency ecosystem offer countless opportunities. Machine learning and artificial intelligence promise (threaten?) to outsmart human portfolio managers. Some hedge funds are expanding on the tried and tested model of shareholder activism to drive environmental or social change. Social media, the metaverse, and big data mean communications are being reinvented before our very eyes. Perhaps most importantly, retail investors themselves are likely to be fundamentally different from the well-off doctors and entrepreneurs of yesteryear. Mass affluent investors may benefit from the inclusion of hedge funds in their portfolios, but they are also likely more vulnerable to extreme downside risk, a concern of regulators around the world.

The very idea of hedge funds is becoming blurred. A growing number of hedge funds look more like private capital funds, with lockups, commitments, and built-in illiquidity. Meanwhile, private equity firms are increasingly flirting with more liquid products. Platforms such as those launched by iCapital and CAIS are revolutionising distribution to wealthy retail clientele and hastening industry convergence. As these types of investments become less compartmentalised and more pervasive, the traditional notion of alternative investing itself may be evaporating. Hedge funds launching '40 Act versions of their strategies will find that long-short equity mutual funds are no longer even categorised as "alternative."[19]

If they are to effectively carve out their identity, raise capital, and deliver superior performance in this rapidly evolving environment, hedge funds will increasingly be drawn to partnerships with operations and distribution platforms that free them to focus on what they do best: identify opportunities, develop strategies, and trade effectively. A carefully constructed foundation not only addresses the needs of current investors, but paves the way for growth across multiple segments and channels. Digitally transforming their operations with the help of key vendors and service providers will enable managers to package their strategies in as many investment vehicles as possible to meet downstream demand and ultimately democratise one of the most elite forms of investments.

"There is no technological reason why we can't start to get customised portfolios created for even very small investors."

—Scott Treloar, CIO, Noviscient

Endnotes

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