Opalesque Exclusive: The hedge fund of funds with 27 year track record that's actually enjoying inflows

Cedric Kohler

Matthias Knab, Opalesque for *New Managers*:

*A conversation about **outperformance and manager selection with Cedric Kohler, Head of Advisory at Geneva-based Fundana.***

Fundana was founded in Geneva, Switzerland, in 1993 as one of the first independent Swiss institutions fully dedicated to alternative investments. It was instrumental in the creation of the first Fund of Hedge Funds of Swiss jurisdiction.

Apart from its impressive track record, Fundana is especially respected among investors for their manager selection and operational excellence. For example, during the rough period of 2008, the hedge funds of funds advised by Fundana (and thus their clients) had no gates, no suspension of redemptions and no Madoff exposure.

Matthias Knab: Fundana has been investing in hedge funds since 1993, so you have a 27-year track record. Based on your philosophy to "Discover Talent Early, Control Downside, Ensure Upside", you have significantly outperformed both the MSCI and the HFRX Global Hedge Fund Index.

With a **net return of 12%,** 2019 has also been quite remarkable in the sense that your fund of funds has logged a better return than all the single hedge fund indices around. Also, in the more difficult year of 2018 your fund outperformed both the MSCI and S&P 500.

(Cedric will be doing a webinar with me on March 2nd 10 am EST / 4 pm CET titled RETHINKING MANAGER SELECTION: SKILL OR LUCK? The registration link is http://www.skillslab.biz. We will be discussing questions like, *how do you select good managers? What does "good manager" actually mean? How do you differentiate skill and luck? And when is a good time to exit a manager?)*

Manager selection can make or break your asset allocation, especially with alternatives investments. Because alternative managers have many degrees of freedom (long, short, leverage, cash, any instrument, any country, any investment style, etc.), they end up having a lot more dispersion in their returns compared to long-only managers. Manager selection is thus paramount for a successful investment program.

Cedric, for today's conversation, let's start with looking at what is Fundana's "secret sauce" or your principles when investing in hedge funds? And where do you see your "edge"?

Cedric Kohler: The key is discipline! We know what we are looking for, what we can understand and monitor, and we stick to it. Very often investors underestimate the challenge of picking and staying invested with the right hedge fund manager. Because hedge fund managers have many degrees of freedom (long, short, leverage, cash, any instrument, any country), they end up having a lot more dispersion in their returns compared to long-only managers. As a result, hedge fund manager research and monitoring needs so much more resources than for long-only managers.

In addition, we strive not to focus only on investment processes or past performances. Investment processes always appear sound on paper and past performances are irrelevant if you do not know how it was achieved and with what risks.

Understanding what is driving your manager performance is paramount. How much is alpha vs some sort of beta, how much of that performance is repeatable, are you being rewarded for the risks that you are taking, etc...? Failure to do that forces you to rely on faith in the manager and that he will be able to continue generating returns.

Matthias: You are also respected for your manager selection and operational excellence. For example, during the rough period of 2008, the funds advised by Fundana (and thus your clients) had no gates, no suspension of redemptions and no Madoff exposure.

Can you elaborate a bit on manager selection and your operational due diligence, etc.?

Cedric: We believe that we have the best returns when investing with managers that typically have: AuM between $200m and $2bn; a simple organizational structure; and skin in the game. As a result, the manager's incentive matches ours: they focus on performance. However, since hedge fund manager performances are not persistent through time, knowing when to exit is a big component of a successful investment.

On the operational due diligence side, we have always run this function internally and with strict standards. For example, we do not work with managers that do not have a top tier set-up in terms of Prime Brokers, Auditor and Administrator. This discipline has enabled us to go through the years unscathed. This is a very important aspect of manager selection and in some ways investors going direct in Private Equity are starting to realize this as well (some at very high costs).

Matthias: How is the investor community taking this on, have you seen some inflows recently?

Cedric: Given equity market valuations and low yields, it's easy to understand why investors are looking for alternatives whether via private markets (Private Equity or Debt), ILS, Infrastructure or of course Hedge Funds. As a result, Hedge Fund industry AUM is at an all-time high with more than $3 trillion. While the press often speaks about famous managers closing down, the reality is that for every fund closure there are potentially two or three new funds being launched as well. A fund closure is also an opportunity for a PM to start his own fund. Our pipeline of new investment candidates has been as strong as ever over the last few years.

In addition, because of the high degree of dispersion in manager performance, investors are coming back from direct investments to working again with a Fund of Hedge Funds, either with an advisory model or on a discretionary basis. Some strategies like Long/Short Equity are harder to do on your own given the high number of managers (more than 5,000 worldwide), the different sub-strategies and styles. As a result, some investors decide to use the help of advisors like us. On the other hand, investors may not need our help to select large multi-strategy funds.

We have also seen some flows out of Macro and CTA managers to the benefit of Long/Short Equity strategies, partly because they are simpler to understand but mostly because they perform better.

Matthias: How would you advise a family office wanting to invest in Hedge Funds?

Cedric: The first priority is to define exactly for what purpose an investor wants to have Hedge Funds. Is it for diversification or return enhancements? Each of these objectives has a different solution with different Hedge Funds strategies.

Once this is done, you need to evaluate how many resources you have at your disposal. This will determine if you need external help or not. Just to keep things in perspective, for a portfolio with ten Hedge Funds, we perform an investment due diligence report (30 hours per manager, 140 questions per manager) and an operational due diligence report (20 hours, 170 questions) for each manager. On an annual basis, we then usually visit each manager twice, we meet with more than 100 candidates, we collect weekly estimates for every manager in the portfolio (480 NAVs) and forecast on a weekly basis each managers performance, we create 400 Fund News updates, and we prepare 50 risk reports.

This amount of work can quickly require a full-time resource. The investor must then determine if a full-time resource makes sense compared to the Hedge Fund allocation or if it is better to outsource this function.

Matthias: Thank you Cedric!

I look forward to your **webinar March 2nd 10 am EST / 4 pm CET titled RETHINKING MANAGER SELECTION: SKILL OR LUCK?**

The registration link is [http://www.skillslab.biz.](http://www.skillslab.biz)