INSIGHTS

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HEDGEWEEK

MULTI-MANAGERS

WHAT'S NEXT? KEY TRENDS, REGIONAL SHIFTS AND NEW TECHNOLOGY

EXECUTIVE SUMMARY

The rise of the multi-manager platform has dominated hedge fund headlines in recent years and been a key driver of industry growth.

The statistics are irrefutable. According to Goldman Sachs Asset Management, multi-manager AuM almost trebled between 2017 and 2023 – growing 175% compared to a 13% increase by the rest of the hedge fund industry. The platforms have posted consistently strong risk-adjusted performance, combining diversification with low volatility.

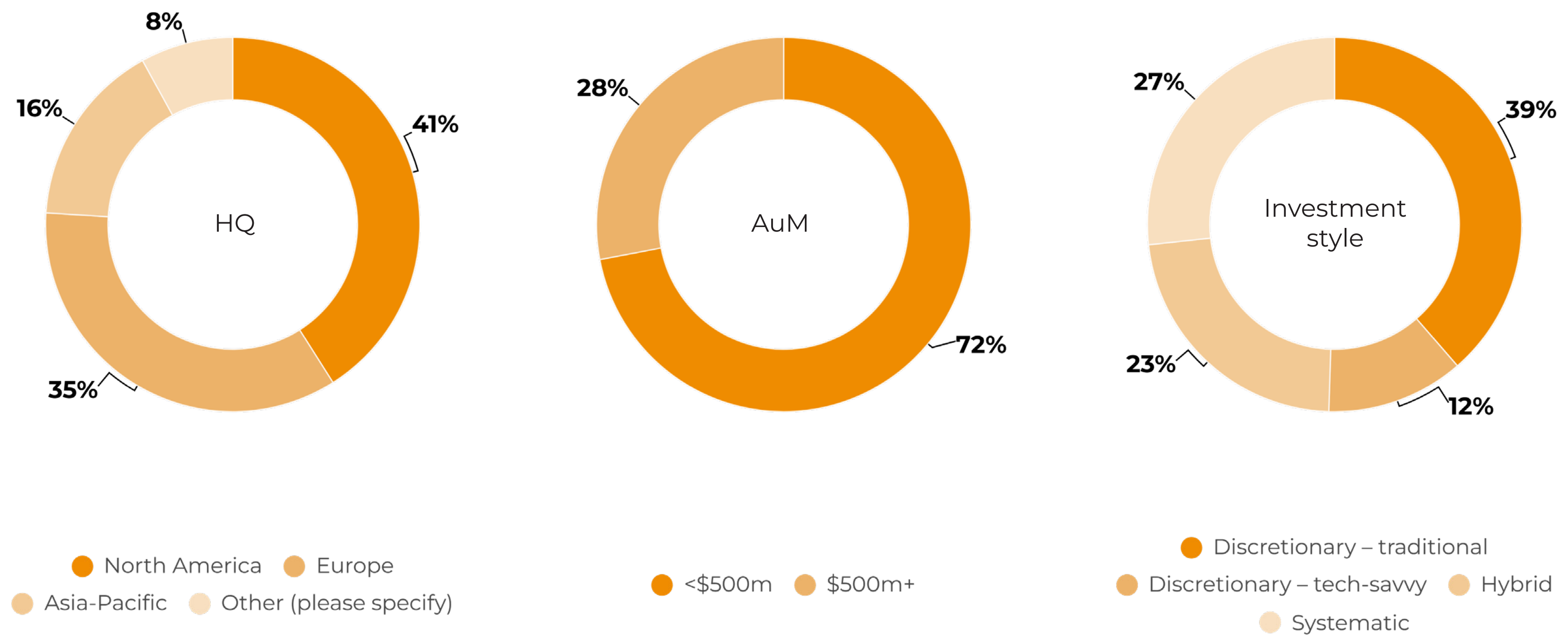
This report, sponsored by SS&C Technologies, combines data from Hedgeweek's survey of hedge fund managers and investors, with expert opinion to gauge the state of play in the multi-manager segment. It also looks ahead and analyses the themes, trends and technology which will have the biggest impact in the years ahead.

Just as the "pod-shops" have attracted plaudits for their performance, they have also drawn scrutiny due to their fee model. All of which will be examined in this report, designed to provide industry practitioners with informed insights and useful context. We hope you find the findings in this report valuable.

WILL WAINEWRIGHT
HEAD OF HEDGE FUND RESEARCH

CONTENTS

Breakdown of respondents to Hedgeweek's Q3 Hedge Fund Manager Survey by firm location, size, and approach:



METHODOLOGY

A key source of data in this report is the results of Hedgeweek's hedge fund manager survey conducted in Q3 2024. Further insights in this report were gathered during interviews in August and September 2024 with named and unnamed industry sources, and additional third-party research and intel.

KEY FINDINGS

1

Pod-shop outperformance continues

Extremely high risk-adjusted returns by the multi-managers have come down since the pandemic but the approach continues to perform well in 2024. PivotalPath saw a 6.5% gain in its Multi-Strategy Index, which covers 70 hedge funds with $342bn under management, in the first eight months of this year – beating many single manager strategies.

2

The segment is at forefront of U.A.E moves

The platforms have been at the forefront of industry moves to open offices in emerging finance hubs like Dubai and Abu Dhabi, with an attractive time-zone and financial incentives among the lures. Almost half (44%) of survey respondents expect these two U.A.E hubs to drive the next phase of platform growth.

3

‘War for talent’ has major impact

The huge competition for top traders in the hedge fund industry is having a big impact on the multi-manager market, particularly in pay. Top traders have been able to command huge signing-on bonuses as competition increases, which have fuelled the increasing pass-through fees in the sector. It is a potential driver of more consolidation in future.

4

Consolidation on the horizon

High operational costs could also lead to industry consolidation as the platform segment matures. More than two-thirds of the industry expects consolidation, with 68% answering that: “Competition for talent is increasing and the unique multi-strategy model allows for pass-through of operational cost which allow these firms to provide premium compensation payout packages.”

GROWTH ENGINE

Where does the multi-PM platform market stand after strong growth since the pandemic?

The growth of the multi-manager model, led by US firms like Millennium, Citadel and Balyasny, has been driven by strong performance, particularly during the pandemic years. Flagship returns frequently hit double-digits for many of the top firms, most notably in 2022 when they proved a valuable diversifier against sell-offs in public markets.

How did they manage it? The multi-manager model involves a number, running into the hundreds at the largest firms, of trading teams or “pods” each concentrating on different trading strategies. The portfolio managers have trading autonomy – entirely siloed from other pods within some firms – but must operate within tight limits controlled by a central risk management unit. Risk allocations are deployed dynamically, allowing the funds to react quickly to new market opportunities as they arise.

The approach continues to perform well, with New York research provider PivotalPath posting a 6.5% gain in its Multi-Strategy Index, which covers 70 hedge funds with $342bn under management, in the first eight months of this year.

Further growth is expected, with firms including Millennium opening their doors to more capital. Bruno Schneller, managing partner at Erlen Capital Management in Zurich, expects family offices to increase their allocations.

"These platforms offer the tailored, diversified exposure family offices seek," he says. "As platforms grow and demonstrate robust risk-adjusted returns, they will likely attract more interest from this segment. The combination of customization and institutional-grade infrastructure makes them appealing, especially for family offices looking for stability alongside growth potential."

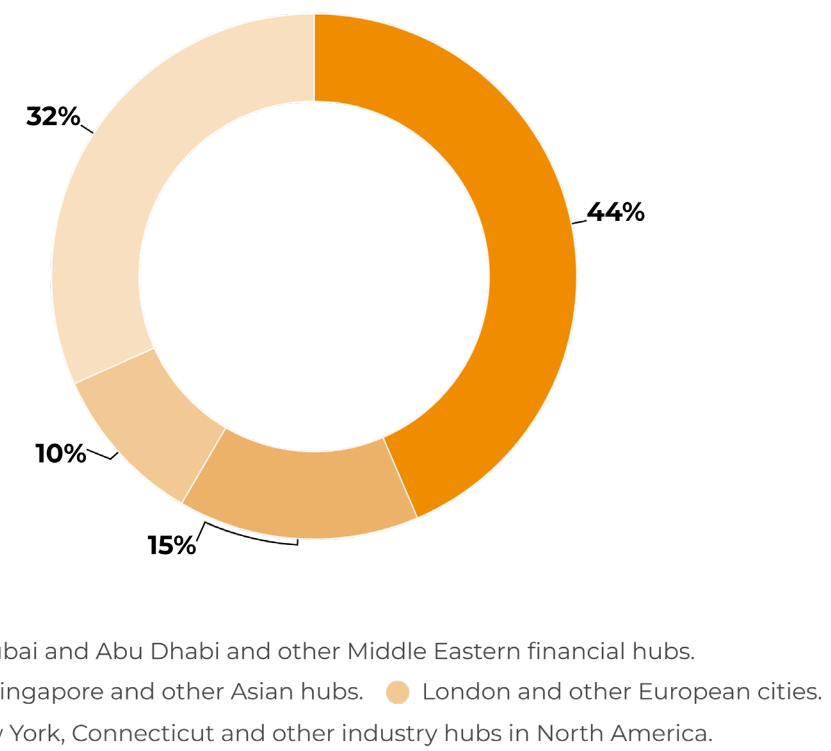
The platforms have been at the forefront of industry moves to open offices in emerging finance hubs like Dubai and Abu Dhabi, with an attractive time-zone and financial incentives among the lures.

Almost half (44%) of survey respondents expect these two U.A.E hubs to drive the next phase of platform growth, followed by New York (picked by 32%), where most of these firms are headquartered (see Fig. 1.1).

"We expect to see growth across all locations but because of the often remote/expansive nature in which they work, there may be multiple physical addresses of the pods (typically there's one main office)," says Ken Heinz, president of Chicago-based HFR.

Schneller adds that cities like Singapore and Hong Kong, picked by 15%, will also continue to be important for their proximity to Asian markets.

Fig. 1.1 Which industry hubs will drive the next phase of multi-manager platform growth?



Source: Hedgeweek Hedge Fund Manager Survey Q3 2024

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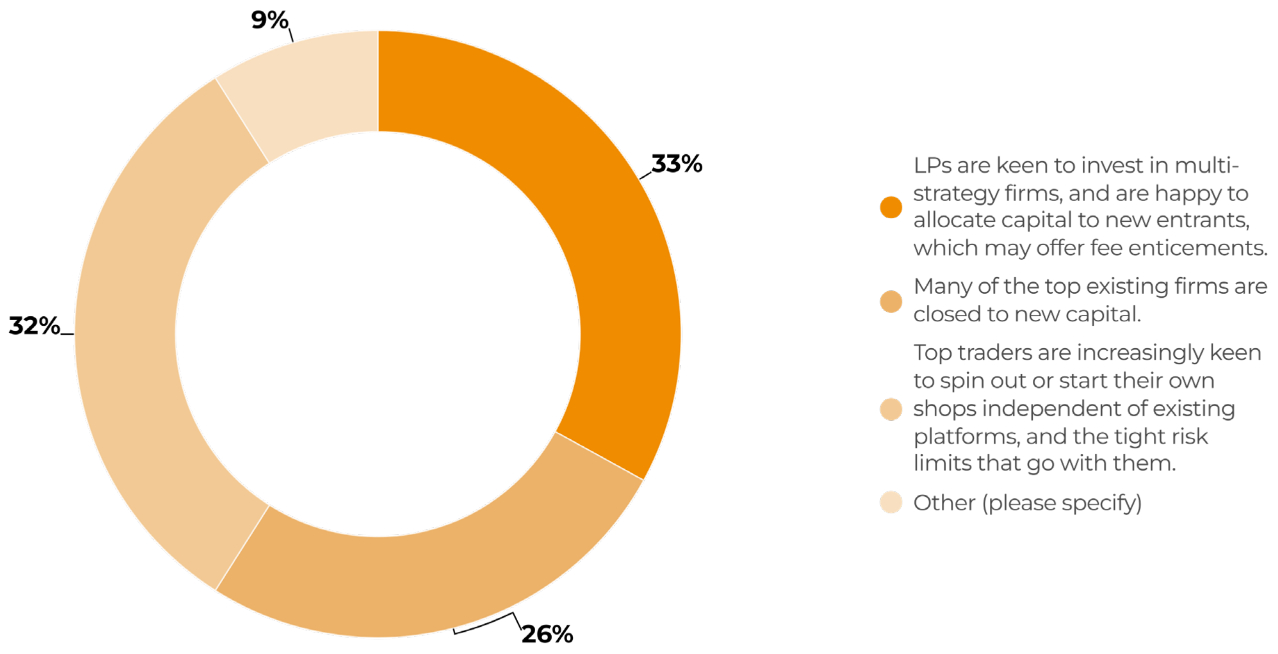
As [multi-manager] platforms grow and demonstrate robust risk-adjusted returns, they will likely attract more interest from family offices.

Bruno Schneller,
Managing Partner, Erlen Capital Management

Fig. 1.2 What is the main factor behind multi-strategy launches (whether the approach or the trader background) increasing as a share of the new start-up market?



Source: Hedgeweek Hedge Fund Manager Survey Q3 2024

"The balance between East and West is crucial, and global platforms are likely to diversify their regional footprints. Asia, in particular, remains a promising growth region due to regulatory advantages and growing institutional demand, which should complement the growth in the Middle East."

The buzz around the sector continues amid better performance compared to 2023, when multi-strategy returns were beaten by single manager hedge funds for the first time since before the pandemic, according to research from BNP Paribas. That meant question marks over high fees and the multi-manager model – in which the management fee is replaced by "pass-through" fees wherein expenses like trader pay and bonuses are levied directly on the investor – resurfaced.

"It has become more of an issue for some LPs – and it's fair to say an equally big issue for those multi-strats who have perhaps under-performed expectations," says Jon Caplis, founder of PivotalPath. "But most allocators we speak to are philosophically still super keen on the platforms, and our multi-strat index is [strongly up] so far this year, handily beating the risk-free rate. They've also done well through some major volatility, especially in August."

The popularity of the model endures; a key sign it will continue to dominate the next generation of industry talent is evidenced by the fact multi-strategy launches are increasing as a share of the new start-up market.

KEY FINDING

Talent wars and the rise of AI are having biggest impact on the multi-manager platform model

Which industry trends are having the biggest impact on the multi-manager industry's:

Ability to scale for future growth

1. Talent acquisition
2. Incorporation of AI, machine learning and/or other intelligent automation techniques
3. Gaining access to retail capital

Ability to focus on generating Alpha

1. Talent acquisition
2. Incorporation of AI, machine learning and/or other intelligent automation techniques
3. Competition with industry peers

Ability to access curated data on demand

1. Incorporation of AI, machine learning and/or other intelligent automation tech
2. Business process outsourcing
3. Gaining access to retail capital

Consolidation within the industry

1. Talent acquisition
2. Evolving fee structures
3. Competition with industry peers

Fee compression pressure

1. Evolving fee structures
2. Competition with industry peers
3. Incorporation of AI, machine learning and/or other intelligent automation tech.

Source: Hedgeweek Manager Survey Q3 2024. Respondents were asked to pick which of the following trends – incorporation of AI, machine learning and/or other intelligent automation techniques; business process outsourcing; evolving fee structures; gaining access to retail capital; risk allocation; competition with industry peers; talent acquisition – were impacting five themes listed above.

A combination of factors is driving this. A third of survey respondents selected the answer: “LPs are keen to invest in multi-strategy firms, and are happy to allocate capital to new entrants, which may offer fee enticements” (see Fig. 1.2). This was the case for Jain Global, the new multi-strat firm launched by fomer Millennium co-CIO Bobby Jain at mid-year, which started with more than $5bn on day one after offering some fee discounts.

“Many of the most promising hedge fund launches we are seeing this year have a multi-strategy background,” adds Caplis, “Plus, the trend of platforms allocating to external funds, often straight after they have spun out, continues to re-shape the industry.”

“Top traders are increasingly keen to spin out or start their own shops independent of existing platforms, and the tight risk limits that go with them,” was seen as the key driver by 32%, while 26% thought capacity was key: “Many of the top existing firms are closed to new capital.”

Investors continue to seek new access points to multi-strategy, as shown by the fact that Millennium are widely expected to have little trouble raising up to $10bn – a figure which in isolation would be the largest hedge fund launch in history – in their next round of reported fundraising.

There has been talk of multi-strat interest reaching a peak, particularly after Goldman Sachs prime brokerage recently issued research showing a first outflow for several years from the platforms. But Caplis and others don’t see this

Fig. 1.3 Which industry trends are having the biggest impact on the multi-manager model? (Trends on left hand side rated by popularity 1-7 for five different factors across the top)

All GPs	Ability to scale for future growth	Ability to focus on generating Alpha	Ability to access curated data on demand	Consolidation within the industry	Fee compression pressure
Incorporation of AI, machine learning and/or other intelligent automation tech	2	2	1	7	3
Business process outsourcing	5	7	2	4	7=
Evolving fee structures	6	6=	5=	3=	1
Gaining access to retail capital	3	6=	3	6=	7=
Risk allocation	7	4	7=	6=	7=
Competition with industry peers	4	3	7=	3=	2
Talent acquisition	1	1	5=	1	7=

JASON COSTA

Head of Hedge Fund Services - North America, SS&C Technologies

Respondents see Dubai and Abu Dhabi as key growth areas for multi-manager firms going forward. Do you agree?

I think we will see this trend continue. These areas will become hubs from a political and economic stability perspective. I would also highlight hubs like Hong Kong and Singapore, even India, as places where there could be strong growth in the future for the platforms. Japan also has come up quite a lot because of the market opportunity this year. North America has led the way, followed by Europe, but there are growing opportunities for the rest of the world as well.

Do you think we will see consolidation in the multi-manager universe?

Consolidation is inevitable. Top talent is the major performance driver, especially for those platforms utilizing a pass-through fee model. The ability to pay and run those costs through the funds is important for those managers. But delivering year after year, and achieving operational efficiency, is not easy. You may see smaller players swallowed up by bigger firms as a result.

What about fees?

I think there will be a bit of fee compression, especially those multi-strategy managers launching into the market, in order to differentiate their model. From LPs' perspective, the model may seem expensive, but they value the multi-managers because of the net performance, asset diversification and ability to withstand market volatility.

What role does AI play in the multi-manager model?

AI has been used for research and analysis, to help with things like earnings call summaries and other efficiency tools. The technology is used more in the front office. Multi-manager platforms use AI for execution management, and pulling out specific data from big sets. These shops use a lot of data, so being able to normalize that data and curate it has been a big challenge.

> “Most allocators we speak to are philosophically still super keen on the platforms.

as a turning point. “A handful of underperforming multi-strats have experienced redemptions,” he says. “But as well as this a few big firms have returned some capital to LPs, while currently many investors feel fully invested in multi-strats and are currently keener on single manager strategies.”

Hedgeweek's survey asked which industry trends are having the biggest impact on the multi-manager model (Fig. 1.3) and found that the often-referenced “war for talent” and trends in artificial intelliegence (AI) were seen as having the biggest impact.

Top traders have been able to command huge signing-on bonuses as competition increases, which have fuelled the increasing pass-through fees in the sector.

Talent acquisition was seen as the industry trend having the biggest impact on the multi-manager market's “ability to scale for future growth” and “ability to focus on generating alpha,” as well as on potential industry consolidation, which will be explored in section two. ■

KEY THEMES AND TECHNOLOGY TO WATCH

The multi-manager model relies on advanced technology and complex operations across all parts of the business

In common with the rest of the hedge fund industry, artificial intelligence is having a big impact on how the multi-managers do business. Survey respondents highlighted the incorporation of AI, machine learning and/or other intelligent automation tech as the top on industry trend affecting their “ability to access curated data on demand” – and the second biggest factor in terms of their ability to scale for future growth and ability to focus on generating alpha (see Fig. 1.3).

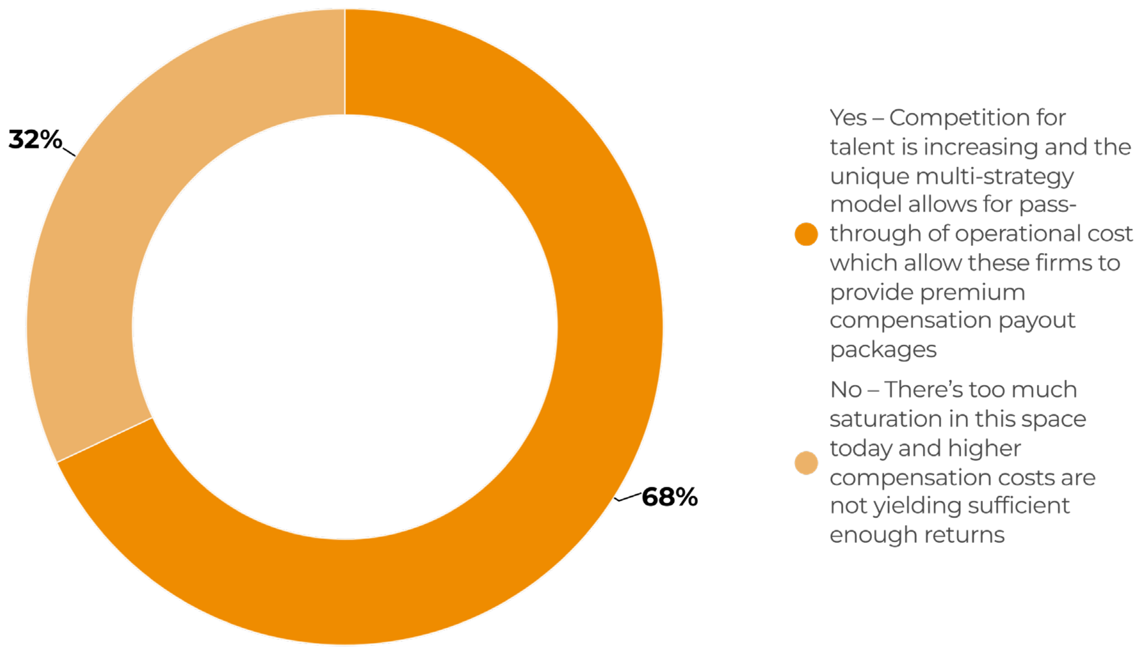
AI can help bring down the huge costs faced by the platforms, which is a particular issue to the model. The pay setup means their cost base rises in broad correlation with the number of trading pods added. Ken Heinz of HFR pinpoints the issue of “rising operational costs and competition between firms” as a challenge for the model.

There has been talk of consolidation in the sector. Last year it was widely reported that Schonfeld came close to a tie-up which would have seen it absorbed into larger peer Millennium’s business. That didn’t happen, and now Schonfeld is one of this year’s best performers in the segment.

But more than two-thirds of the industry expect consolidation, with 68% answering that: “Competition for talent is increasing and the unique multi-strategy model allows for pass-through of operational cost which allow these firms to provide premium compensation payout packages” (see Fig. 2.1).

“Scale is a key driver for multi-manager platforms. As competition intensifies, I do see potential for consolidation, especially as firms strive to expand their investment capabilities

Fig. 2.1 Do you think there will be further consolidation in the multi-manager platform segment?



Source: Hedgeweek Manager Survey Q3 2024.

and operational efficiencies," says Bruno Schneller of Erlen Capital Management.

"Larger platforms with stronger infrastructure will likely seek to acquire smaller players to enhance their competitive edge. Scale not only brings operational advantages but also increases access to capital and diversified revenue streams, which helps firms remain competitive in a crowded market."

Outsourcing is also seen as increasingly helpful. Middle office functions like reconciliation, treasury, collateral and settlements were seen as most likely to be outsourced to administrators next, selected by 37% (see Fig. 2.2). They were followed by regulatory and compliance reporting (18%), shadow accounting (12%) and tax reporting (11%).

"As managers start to look to increase alpha and scale their businesses, they're going to look to outsource," says Jason Costa, Head of Hedge Fund Services - North America, at SS&C Technologies.

"Core middle-office services, like reconciliation, treasury and collateral settlements, are obvious places to start. Then, you have some of the back-office functions like shadow accounting and financial reporting, and for the pod-shops, expense allocations. The more they can outsource, the more they can focus on alpha."

A "fragmented or dated technology infrastructure" is seen as the biggest data challenge facing multi-strategy operators,

“

We expect to see growth across all locations but because of the often remote/ expansive nature in which they work, there may be multiple physical addresses of the pods.

Ken Heinz,
President, HFR

selected by 34% (see Fig. 2.3). That was followed by the "ability to have one golden source of data" (21%), "getting normalised or curated data on demand" (19%), data security (16%) and data orchestration (10%).

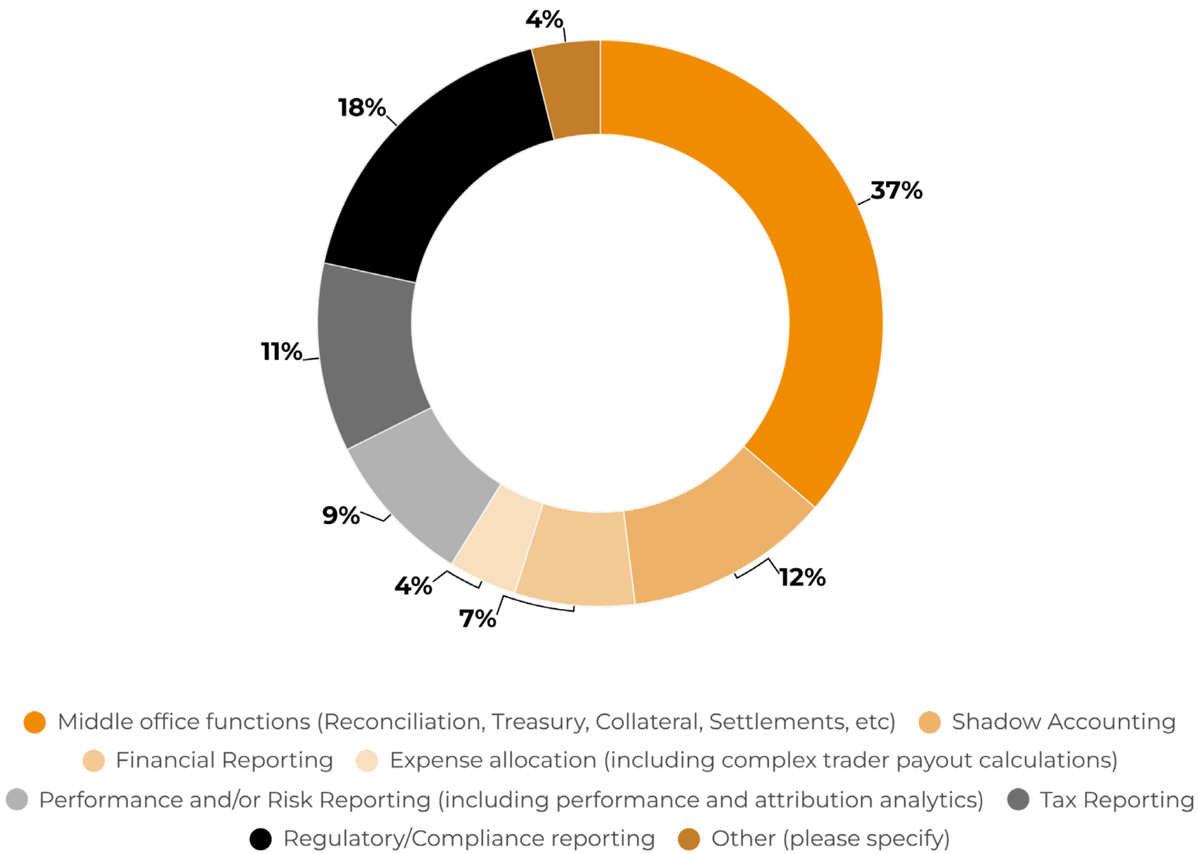
Strong technology will become even more of an imperative as some platforms, particularly emerging multi-strats raising capital, seek to meet investor questions over transparency and business operations.

As Morgan Stanley's hedge fund team wrote earlier this year: "Investors need assurance that the platform manager views them as partners, investing alongside them, with a cost infrastructure optimized to maximize their return.

"In this context, 'franchise strength' means the willingness to negotiate competitive terms with independent managers, vendors and service providers for the benefit of investors."

The report added: "Investors deserve a partner that is a fiduciary committed to the highest standards and institutional responsibilities. This includes comprehensive reporting and providing enough transparency or access to key decision makers to understand not just how alpha is being generated, but why it is likely to persist." ■

Fig. 2.2 Which functions are multi-manager operators likely to outsource to administrators next?



Source: Hedgeweek Manager Survey Q3 2024

KEY FINDING

How differently sized firms view the biggest data challenge facing multi-strategy operators:

Top three challenges, ranked – in view of small and large firms:

Less than $500m:

1ST: Fragmented or dated technology infrastructure

2ND: Data security

3RD: Getting normalized or curated data on demand

More than $500m:

1ST: Ability to have one golden source of data

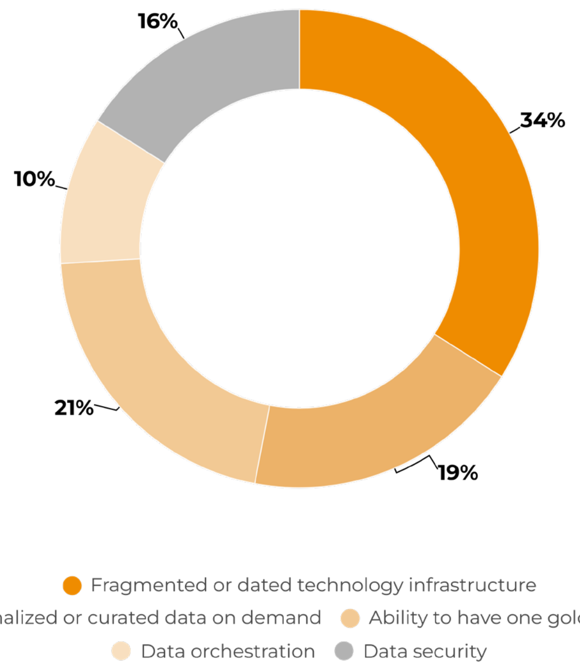
2ND: Fragmented or dated technology infrastructure

3RD: Getting normalized or curated data on demand

Source: Hedgeweek Manager Survey Q3 2024.

INSIGHTS

Fig. 2.3 What is the biggest data challenge facing multi-strategy operators?



Source: Hedgeweek Manager Survey Q3 2024

Multi-managers during times of market stress

Though multi-strategy firms averaged solid returns in August, the rout in Japanese stocks and wider market ructions at the start of the month put the spotlight on whether the "pod-shop" model could exacerbate market moves during sell-offs.

"While the risk management models in these platforms provide necessary safeguards, abrupt trading halts can exacerbate market volatility, as seen in August," says Bruno Schneller of Erlen Capital Management.

"This can lead to liquidity crunches, further price dislocations, and missed opportunities for profit during recovery periods. In extreme cases, it can even erode investor confidence in the platform's ability to navigate through stress. While managing risk is crucial, the ability to do so without triggering overreaction in turbulent markets is a delicate balance to maintain."

The platform model has soared in popularity and performed well in recent years. Challenges over a potential peak in allocator interest, referenced in section one, and data, in section two, are seen as far from existential challenges.

Ken Heinz of HFR, which has just launched its first pod-shop index, says multi-strat managers "are very diversified" but could face challenges in the event of an "extended period of illiquidity following major market dislocation" or "crowded trades becoming more risky and/or inability to deploy sufficient capital to reach required/expected returns." HFR estimates than $425bn is currently managed in multi-strat firms.

But markets will keep a close eye on the potential risk during times of market stress.

CONCLUSION

The multi-manager model has reshaped the hedge fund market and is most definitely here to stay. More growth is expected as some of the biggest firms open their doors to new capital, and investor concerns over pass-through fees have been minimised by the ongoing fact of their strong risk adjusted net returns – delivering the diversification so prized in asset allocation.

This report has analysed the themes, trends and technology which will have the biggest impact in the years ahead. Just as in all parts of the hedge fund world, AI is a key trend. The “pod-shops” are among the top innovators in finance and their use of technology across operations and parts of the front office will only increase. Outsourcing, too, is rising up the agenda as they look for tools to enhance their processes and bring down costs.

The outlook is not without challenge. Single manager strategies made a comeback in 2023 and multi-managers must continue to perform well ahead of the risk-free rate to justify their costs. But they remain a key growth driver for the hedge fund industry and look set to continue to perform well in the new market environment.

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