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Fund of Funds Rout Grows to 20 as Archstone Plans to Close

By Lydia Tomkiw April 26, 2017

The trying times continue for the hedge fund of funds business as **Archstone Partnerships** became the latest shop to tell clients earlier this month it would be closing its doors – one more down note in a rush of outflows, consolidations and liquidations.

Twenty hedge fund of funds have been liquidated so far in 2017 with only three launching in that same period, according to data provider Preqin. In 2016, 50 funds of funds were launched while 139 closed their doors.

"This is a continuing trend – Archstone is a noted closing," says **Alan Kosan**, senior v.p. and head of alpha research at Segal Marco Advisors. "But we've been seeing this over the years…The fund of funds community is starting to coalesce around certain core names."

The hedge fund of funds space was hit by outflows for six straight quarters through the end of 2016, according to data from eVestment. And funds of funds now account for the lowest portion of hedge fund assets under management in more than a decade, dropping from approximately 50% before the financial crisis in 2008 to approximately 25% currently, eVestment data shows.

More Outflows for Hedge Fund of Funds

Hedge fund of funds outflows have been in-line or above the overall hedge fund space.

Date	FoHF Total AUM (in billions)	FoHF Net Investor Flows	HF Total AUM	HF Net Investor Flow
Q1 15	$943.40	-$16.74	$3,102.50	$26.48
Q2 15	$945.84	$2.57	$3,121.96	$42.84
Q3 15	$903.12	-$11.38	$3,038.86	$1.55
Q4 15	$889.01	-$19.99	$3,028.78	-$26.77
Q1 16	$841.57	-$21.49	$2,979.14	-$17.27
Q2 16	$824.83	-$23.65	$2,995.07	-$13.49
Q3 16	$803.52	-$38.91	$3,025.65	-$32.04
Q4 16	$761.31	-$45.47	$3,025.40	-$48.84

Source: eVestment

Amid the outflows and closures, the fund of funds space has also been undergoing a wave of consolidation. KKR's **Prisma** unit merged in February with Pacific Alternative Asset Management (PAAMCO) to create the $34 billion **PAAMCO Prisma**, as reported. That follows other mergers and acquisitions in 2016, including **EnTrust Capital** and Permal **Group** forming **EnTrustPermal** and Fiera Capital acquiring **Larch Lane Advisors**.

Investors are looking for bespoke offerings and customization and are not as interested any more in commingled funds, says **Victoria Vodolazschi**, senior investment consultant for hedge fund research at Willis Towers Watson. More deals and consolidations are ahead in a shrinking asset space, she says.

"If you think about operating in today's world, it's really hard to survive as a small niche fund of funds," she says. "You can be very clever with the strategies you offer, but today you really need to be big like the larger, over $10 billion asset managers of the world. They are the best positioned."

Archstone, founded in 1991, worked with approximately 500 institutions and high-net-worth individuals. Its assets under management had dropped to approximately $1.4 billion, according to its website, though the firm had once managed over $5 billion. In a letter sent to investors on April 12 that cited low interest rates and the rise of both algorithmic and passive trading as pressures, founder **Alfred Shuman** wrote that even after a good first quarter "I cannot in good conscience manage your capital without a high conviction that our risk-adjusted returns will be satisfactory," the *Wall Street Journal* reported. Archstone declined to comment to *FundFire*.

Archstone's decision comes after the firm publicly announced a new offering in 2016, raising $23 million for a vehicle targeting accredited investors that mimicked its flagship fund of funds. It had gained distribution on platforms at Fidelity Investments and Charles Schwab and investments with hedge funds including **Elliott Management**, Och-Ziff Capital Management, **Fir Tree Capital**, and **Discovery Global**, as reported. Archstone said it would return the remainder of client capital in the first half of 2018, the *Wall Street Journal* reported.

Funds of funds looking to survive in today's challenging environment are focusing on customized accounts and other niche offerings, Kosan says. "There are others who are taking their flagship diversified funds of funds and offering separate accounts and co-investing opportunities – and others starting to drift into areas that are more nichey," he says.

Funds of funds still have appeal, especially for smaller allocators that want access to the hedge fund space and want to build out their portfolios, says **Stuart Blair**, director of research at **Canterbury Consulting**. Clients are focused on performance and fees, but most remain happy with the access funds of funds are providing them, he says.

"The silver lining? I think you could see fees coming down in the fund of funds space as they feel more and more competitive pressures as clients redeem from them. There may be something to capitalize on there," he says.

While 10 years ago, funds of funds could use access as a selling point, investors have become more educated and are looking for managers to construct and cater to investor needs, says **Jim Cass**, senior v.p. and managing director for alternative investment clients at SEI. That includes increasing use of fund of one structures that create more work for fund of funds managers.

"The strong can survive if they reinvent, but the smaller firms, $5 billion or less, really get squeezed out of the marketplace," he says. "If you're going to go fund of funds you really need the pedigree, a strong name, and to be able to offer those services at a lower fee."