

Concepts...



"Concepts" is published by Daedalus Oversight to raise as many questions as it answers. It is driven by the belief that the industry, its products and its services are ever evolving. The ideas reflect the challenges faced in the continuous journey of innovation and improvement.

Hedge Fund Expenses or Business Investments?

When a person buys a car, there are three main options depending on the budget available: Buy new, lease or buy used. Within the last option, if your budget is really low, you may be forced to buy a jalopy. Although a car is a considerable cost, for what is a depreciating asset that also requires ongoing insurance and maintenance, it really is an investment in transportation. The investment allows the person greater indirect opportunities with respect to work and participating productively in society. With a new car you have reliability and differentiation, with a lease you have the same with reduced cash flow requirements but higher deferred costs, with a used car you are pragmatically reconciling budget to need. Each of the options come with differing degrees of service plans, financing and beneficial advice, against which people have varying skills and knowledge to take advantage.

Consider the car purchase analogy to Hedge Fund expenses, which should be regarded as investments in your management company. There are also a plethora of services and advice that are not always utilized. If a fund manages the investments in the management company as assiduously as the investments in the portfolio, there may be surprising opportunities. In an environment where both management fees and performance fees are under pressure, are there better alternatives than just pure cost reduction?

A fund's expenses can be categorized in six general categories: Office Space/Equipment; investment personnel; investment technology/data; support personnel; support technology/data and service provider fees. With each of the categories regarded as purely an expense, it is easy to join a race to lowest cost and unsurprisingly an inevitable and inflexible lowest level. Painful cuts are the only option left after this point is reached. Considering the car ownership analogy, there is a perspective of investment to facilitate the investment process and deriving indirect opportunities. A fund's expense base can become a realizable gain through deferred cost and greater investment capacity or efficiency.

The primary goal of a Hedge Fund Manager is good investment decisions. Proactively engaging your brokers can realize interactive rather than just purchased research as well as advisory strategy trading not just order-driven outsourced trading. A true broker partnership provides opportunities for market color, market analytics, efficient trading costs, EMS/OMS platform access via service bureau contracts, corporate access, efficiencies through derivatives, optimized financing, risk management, capital raising and business advisory services.

Your custodian or administrator will offer on a lease or fee basis, both control resources, technology integration and portfolio



Our next model offers a low up-front investment profile combined with a maximized upgrade potential

analytics beyond their independent record keeping and accounting. With a holistic portfolio view they are often capable and very interested in providing additional proactive advisory services such as analytics, risk management and compliance.

Your fundamental technology, if not acquired through your service providers, can also be leased on an outsourced basis, not only freeing your organization from support duties but also providing access to scheduled upgrades and centralized back-up & contingency planning.

The key point on all these suggestions is that the costs are deferred to create a more uniform expense profile which is driven by portfolio size and transaction volume vs a burdensome, growing and inflexible fixed cost. The investment can also be assessed more easily on how it facilitates the investment process.

An in-house or service provider database accessed, reviewed and updated by macro driven spreadsheets may have the appearance of prudent cost effective flexibility. However, it really represents the low cost but resource intensive, high maintenance and potentially unreliable jalopy from the car analogy.

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Daedalus Oversight would be pleased to discuss the realization of these concepts with you further. We thank you for your consideration.

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