

Outlook 2013: Hybrid Fund Structures

thought

Stephanie Miller, J.P. Morgan's global head of alternative investment services, predicts more fund managers adopting structures which have characteristics of both private equity and hedge funds in the year ahead.

We are all navigating in a new world. Fund managers continue to look for the best opportunity to deliver returns to their clients while maintaining credit quality and predictable liquidity. In this space, new fund structures are then borne out of immediate needs of both the manager and the investor profiles. The new term 'hybrid fund' in the alternatives marketplace refers to fund structures which have characteristics of both private equity and hedge funds.

The concept is to construct the best of breed fund type suitable for longevity of the fund avoiding misaligned cash flows and for optimizing portfolio selection for the investor. Typically, these fund structures are akin to private equity in terms of their closed-end structures, but more like hedge funds in terms of the instruments they trade.

Moreover, hybrid funds are yet another product offering that managers are accessing as they seek out opportunities for differentiation in the steadily growing alternatives space. This is especially the case looking ahead to 2013, as institutional investors continue to broaden their portfolios and exposures to alternative assets.

Some interesting developments have resulted from this evolution to hybrid products. First, demands on a hybrid manager's operating platform have changed inasmuch as the investor activities and investment activities are typically housed in different systems. For any solutions to work on a scalable basis a manager will need to consider an integrated approach that can support multiple allocations and provide full transparency at the investor and investment level. The key to success here is the ability to bed down an integrated operating model with an integrated data set to allow for end-level

transparency. Second, investor interdependence is lessened in many ways assuming a base case of multiple investors with no key dependencies given that there is a formal fund close and capital is distributed pursuant to a traditional private equity waterfall structure.

As with any structure, investors are trading the liquidity benefits associated with traditional hedge fund products in exchange for the stability associated with closed-end private equity products. The final analysis should be as these hybrids continue to emerge; managers should look to keeping the structures and waterfall calculations as straight forward as possible thus focusing on the real value of preserving a stable balance with actively trading assets. Convergence in the new world will continue to create innovation in these structures and we must preserve against undue complexities for complexity sake.

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