



## **Thoughts on Starting an Alternatives Division**

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Over the past few years many traditional investment management houses have begun forming or purchasing alternative investment divisions. The massive expansion of many institutional investors into both hedge funds and private equity funds has led this charge.

Many investment managers have been hard pressed of late to deliver high absolute returns. Many are quite accomplished at beating an index return, which is commendable. Their investors, however, many of whom are pension plans with actuarial assumption return targets they need to attain to pay benefits to their members, are scrambling for return. This has led to changes in allocation at some of the largest pension plans away from traditional domestic equity and domestic fixed income, and increases in international investments and alternatives. By being able to offer existing clients some of these products themselves, existing investment managers of the plans mitigate some of the risk of their clients shifting assets away from them, with the possibility of keeping the investments in house.

This diversification of products among a manager's available options for their clients opens doors to new business as well. Many managers, especially in the institutional space, have had long relationships with many of their clients. By being able to offer those same clients different products helmed by the managers that they have known and trusted for years is a great way of building on the brand and relationships that the manager has spent years creating.

Traditional investment managers, along with mutual fund investment companies, and other enterprising individuals have seen that while fees are being crunched on most long-only products the profit potential is still growing for alternative investment funds. It has become accepted for alternative investment funds to charge the now standard 2% management fee and 20% carried interest. This offers large margin increases over more traditional products which can range from 0.25% - 1.00% depending on size and strategy, with no performance fees.

The ability for managers to breathe new life into their existing businesses with products that offer higher potential returns for their clients, a diversification of their asset base, and higher fee income to offset squeezes in other areas should continue to lead many down the alternative path.