PHOCION INVESTMENT SERVICES | Hedge Fund Managers Looking to Grow AUM Must Ensure That Marketing Materials Adhere to Sound Industry Practices

The hedge fund industry is cut-throat competitive and it is therefore intuitive as to why these firms would go to great lengths in order to provide prospective and existing investors with as many favorable differentiating factors as possible. To this point, sound practices, if implemented properly, can assist hedge fund managers to distinguish themselves from the pack. This article will focus on ensuring that the proper controls are put in place that reduce firm risk with respect to the publication and dissemination of marketing materials.

Marketing Materials

Marketing material is any written communication (e.g. websites, social media, emails etc.) directed at more than one person, concerning information about the purchase and sale of a security, or other information about the company. Managers must avoid using this material to make false or misleading statements. Rather, they should act with utmost integrity (e.g. cite sources, disclose conflicts of interest, utilize proper disclaimers etc.) In terms of sound practices marketing material should encompass:

- Proper oversight
- Performance advertising

With respect to proper oversight, all marketing materials must be approved by a designated person (e.g. Compliance Officer) who initials, dates and ensures the storage (either electronically or via hard copy) for a minimum of seven years. This person also ensures that the proper controls are in place for ongoing monitoring. The sound practice about performance advertising is to ensure that only factual information is presented with nothing misleading. Prior to disseminating performance returns, controls need to be in place along with an audit trail (such as documentation and backup) pertaining to how the performance returns were calculated. Prior to advertising, performance returns must be pre-approved by a designated person (e.g. Performance Officer). Some readers may be thinking "doesn't my admin do this for me?" The ultimate responsibility for performance return accuracy resides with the manager. Essentially, investors will never tolerate finger pointing towards the admin. Should anything run afoul with respect to the integrity of performance returns, Managers face the loss of assets and (more significantly) a huge hit to their reputation.

Hypothetical Returns

Hypothetical (or back-tested) returns is a topic that has emerged as a "hot topic". Sound practice includes ensuring that they are not front-and-centre in marketing material but rather that they are distributed as supplemental info. They should also be accompanied by a disclaimer that states that "actual results may differ from the model". A statement outlining any limitations and assumptions used in the model should also be included.

Concluding Remarks

The other day I flipped through a slew of manager decks and could not believe how most are underselling themselves. There were a preponderance consisting of 3-4 dozen pages illustrating product performance, investment philosophy & style, company structure and investment management personnel. To illustrate the quagmire that investors face when going through these practically indistinguishable decks, if you had to choose between two virtually identical managers with the same historical performance, using the same strategy and fee structure but the only difference was that one was extraordinarily transparency and descriptive about why its operations followed best industry practices, which one would you likely select? Most surely your answer aligns with that of most investors. Therefore, managers need to articulate pride for their entire operations and in so doing they will differentiate their firm with little to no incremental cost.

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