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Najy Nasser, Headstart Advisers – “Despite the negatives, the financial crisis brought a number of positives for our business and the hedge fund industry in general”

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Najy N Nasser, chief investment officer of Headstart Advisers, manager of the Headstart Fund of Funds, argues that after a difficult three years for fundraising, those funds of hedge funds that have survived and differentiated themselves with strong performance will start to raise assets as investors look to increase exposure to hedge funds, driven by the need for diversification and a more challenging market environment for traditional assets.

GFM: What is the history and background of your company, principals and funds?

NN: Headstart Advisers was founded in 1990 as a third-party hedge fund marketer under the name Folkes Asset Management, representing some sizeable institutional hedge funds in the United States. With offices in Knightsbridge, Headstart is authorised and regulated by the Financial Services Authority, and currently has USD102m in assets under management.

I joined in 1997, bringing a wealth of investment management expertise and experience that led to the launch in 1998 of the firm’s first hedge fund, the Headstart Fund, which grew significantly in clients and assets over the subsequent years. The firm’s flagship fund, the Headstart Fund of Funds, was launched shortly afterward in 1999. The company was renamed Headstart Advisers for the sake of brand name consistency in March 2003.

The Headstart Fund of Funds is a globally diversified multistrategy fund of hedge funds advised by Headstart’s investment committee, which I head. The fund is supported by two further investment analysts and four support staff providing operations and client relations.

GFM: What is the structure of your fund?

NN: Headstart Fund of Funds is a Cayman Islands-domiciled exempted limited liability company listed in Cayman as a mutual fund and registered and regulated by the Cayman Islands Monetary Authority. The fund has three investable share classes denominated in US dollars, euros and sterling. The management company, Headstart Management Inc., is registered as an investment manager in Anguilla.

GFM: Who are your main service providers?

NN: Headstart Fund of Funds is audited by Deloitte & Touche in Cayman, and its independent administrator is Custom House Global Fund Services in Malta. The fund's Cayman Counsel is Mourant Ozannes, its custodians are HSBC Private Bank (Suisse) and Skandinaviska Enskilda Banken in Luxembourg, and its payment bank is Royal Bank of Scotland International in the Isle of Man. The investment advisor is audited by Lambert Chapmen, its accountant is St James' Associates and its legal counsel is McFadden, Pilkington & Ward.

GFM: What is your distribution strategy and targeted client base?

NN: Headstart's distribution strategy has typically been through word of mouth and centred on high net worth individuals, independent asset managers, private banks, family offices and institutions in Switzerland, Monaco and more recently the Middle East. The firm's current asset base predominantly consists of high net worth individuals, but it is targeting a wider range of clients, in particular focusing on private banks, institutions, pension funds and endowments.

GFM: What impact has the recent global financial crisis and economic downturn had on your business?

NN: Despite the obvious negatives, the financial crisis has brought a number of positives for our business and the hedge fund industry in general. It uncovered a myriad shortcomings in an industry that had become saturated with many sub-par managers, not least a general lack of transparency and liquidity, as well as a prevalent long bias and a large degree of crowding amongst managers.

At Headstart we focus on areas in which we can look to improve, and despite a long track record in the fund of hedge funds business, the crisis highlighted this fact to us. In the run-up to the financial crisis, as assets grew we favoured increased diversification and at the peak had approximately 100 underlying managers across the portfolio.

In the wake of 2008 we significantly altered our approach to management of the portfolio. While adhering to our time-honoured principle of focusing on a strong bottom-up approach with a macro-economic overview, we decided to become far more concentrated in our underlying managers while maintaining a diversified approach. The portfolio today is invested in 17 underlying managers following 13 strategies, and we would not expect to hold more than 30 underlying positions.

The financial crisis highlighted the need and desire among investors for greater transparency across the industry. Our new approach allows us to spend significantly more time focused on our underlying managers, from which we require in-depth transparency of our underlying positions in order to understand and evaluate the overall positioning of our funds at any one time.

GFM: Funds of hedge funds have had something of a bad press over the past few years. How would you respond?

NN: I agree that the industry has had a bad press. The industry as a whole suffered losses and liquidity issues, so rightly end-investors have questioned what added value they receive for the additional layer of fees. If the financial crisis has taught us anything, it is the importance of performing due diligence, which requires expertise, infrastructure and capital, not simply investing with a big brand name.

Funds of hedge funds continue to fulfil an important role for investors seeking exposure to the hedge fund industry without the necessary infrastructure to launch their own team. A high proportion of the Headstart Fund of Funds' positions do not accept further capital or are open only to existing investors.

Over more than 20 years in the business, we have built relationships with our underlying funds that enable us to gain both exposure and an insight into the next generation of industry leaders at an early stage. As with many industries, the fund of hedge funds world became saturated with sub-par managers, many of which left the industry entirely, often after causing investors great losses, or have merged.

What is left is a stronger industry of more stable funds that have demonstrated their ability to survive even through worst-case scenarios such as 2008. This should provide investors with comfort, especially in light of the returns in the subsequent years.

GFM: What is your investment process and your approach to managing risk?

NN: Headstart's investment process and approach to managing risk are closely interlinked. Our investment process is an opportunistic, top-down approach to strategies with vigorous bottom-up manager selection. We run a core portfolio of proven, seasoned managers in whom we have a high level of confidence to provide high risk-adjusted returns over the market cycle together with opportunistic satellite positions to take advantage of our current and medium-term market outlook.

In addition to having daily contact, members of the investment committee meet formally on a monthly basis with the other members of the investment team to discuss the fund's top-down portfolio positioning based on our current and medium-term outlook for global markets, while our core holdings are reviewed and satellite positions discussed in the light of our market view.

Our manager selection process starts with bottom-up research and screening with a top-down macroeconomic overview identifying strategies of interest given the current opportunity set and macroeconomic environment. The investment selection process focuses on the edge, integrity, pedigree and business model of the underlying manager.

Before any investment is made, during the due diligence process members of the investment committee meet key individuals of prospective managers, which undergo detailed quantitative and qualitative analysis. Due diligence includes a review of operational procedures, infrastructure, documents and background, checks on key personnel, and asset verification with brokers, custodians or administrators.

Once a fund has been approved for investment, an allocation may be made. Sizing of positions is based on a variety of factors, including strategy, volatility, correlation, diversification, liquidity, and the fund's impact on the existing portfolio. Subsequent risk monitoring and due diligence is integral to ongoing portfolio management; we look at market factors as well as business risks at the underlying funds.

Qualitative and quantitative methods including peer group analysis are used to understand fully the portfolio's market positioning and exposures. This continuing analysis aims to identify quickly style drift and significant changes in the underlying manager's positioning and risk parameters that might lead us to reassess the position and exit if necessary to maintain a disciplined risk management approach.

This is achieved through an ongoing dialogue and regular onsite meetings between Headstart's investment team and the underlying managers. At the portfolio level returns-based analysis as well as underlying manager exposures are used to determine the market positioning of the fund as a whole. The investment committee takes the fund's positioning into account when discussing the market outlook, and exposures may then be altered through use of satellite positions.

GFM: How has your fund of funds performed?

NN: The Headstart Fund of Funds has returned 122.94 per cent since launch in 1999 with annualised volatility of 8.05 per cent. This compares favourably with leading fund of hedge funds indices, with the Eurekahedge Fund of Funds Index returning 70.23 per cent, the HFRI Fund of Funds Composite Index 70.65 per cent, and the BarclayHedge Fund of Funds Index 69.60 per cent.

The fund returned 38.71 per cent over the three years to the end of 2011 and was up a further 4.79 per cent over the first three months of 2012, again comparing favourably with 9.36 and 2.85 per cent respectively for the Eurekahedge index, 11.07 and 3.37 per cent for the HFRI, and 8.43 and 3.13 per cent for BarclayHedge.

GFM: What are your criteria for removing managers from the fund, and do you aim to replace them immediately?

NN: Managers may be removed from the portfolio in a number of scenarios, most commonly for poor performance relative to their peer group but also for poor absolute performance that differs from our anticipated return for the manager given the environment. Style drift, business risk, departure of key personnel and regulatory issues may also be factors, and also a change in the investment committee's market outlook, although this is more common for a satellite holding.

Depending on the investment committee's view, a position may be replaced immediately, and we maintain a list of approved funds that we can add to at any given time. Typically the fund is fully invested with a marginal degree of leverage to cover month-end investor flows, operational expenses and opportunistic investing.

GFM: What developments do you expect to see in your investment sector or industry field in the coming year?

NN: We anticipate that after a difficult three years for fundraising, those funds of hedge funds that have survived and differentiated themselves with strong performance will start to raise assets as investors look to increase exposure to hedge funds in search of diversification, amid a more challenging market environment for traditional assets. Given our longevity in the industry as well as both long-term and recent strong outperformance, we expect to benefit from this trend.

GFM: What do investors currently expect from managers, and how do you deal with those expectations?

NN: Primarily our investors expect a greater degree of transparency. Over Headstart's more than 20 years in the hedge fund industry, we have witnessed first-hand the extent to which the industry has been transformed. This experience is reflected in the transparency that the firm provides to its underlying investors. We believe that the more investors know and understand about their investment, the greater the benefit for them, for our business and the industry in general.

Headstart provides full portfolio transparency to its investors upon request following the signature of a non-disclosure agreement. In addition, at investors' request, the firm provides extensive investment committee minutes, showing in detail the structure of its meetings and our portfolio and investment management process, together with risk reports as well as our due diligence reports and processes.

GFM: What differentiates you from other managers in your sector?

NN: As well as our experience within the industry and long track record, we are a dynamic, driven team, which enables us to be more opportunistic and quicker to react to changing market trends than our rivals. Our current asset size and portfolio holdings give us significant positions with prominent managers where others are constrained in the amount of money they can invest due to lack of access or capital.

GFM: How do you view the environment for fundraising over the coming 12 months?

NN: We expect the environment for fundraising for our fund to improve over the coming 12 months thanks to our performance over the past 13 years and our recent outperformance over one, two and three years.

GFM: Are you considering any mergers or acquisitions in the foreseeable future?

NN: We are actively pursuing acquisitions of smaller fund of funds businesses whose owners are considering exiting the industry. As a result of a decline in assets and a challenging fundraising environment, especially for smaller funds of funds, many smaller managers lack viability as standalone businesses due to the significant costs and hurdles that a successful fund of funds business must overcome.

- Fund Manager Interviews

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