Inside the minds of investors

What drives their decision making and how can women-led funds take advantage?

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As KPMG research on current trends, initiatives, and opportunities for women in alternative investments has shown,[1] industry leaders are gradually waking up to the fact that diversity of thought improves portfolio performance. Yet when it comes to where assets are managed, women-owned and women-led funds remain significantly underrepresented. Female fund managers continue to face unique challenges when it comes to attracting business, sustaining healthy investor relationships, executing investment strategies, and generating returns.

KPMG's Alternative Investments practice and the global association 100 Women in Finance sought to tackle some of these challenges by collecting the viewpoints of top-tier institutional investors on current investing trends, diversity and inclusion, and the characteristics they value in fund managers. This paper sums up these insider insights to help female hedge and private equity fund managers stand out from the crowd, take their rightful place in the investment management community, and help grow everyone's bottom line.[2]

The investor's perspective on… what they look for in portfolio managers

In an up-market characterized by high asset prices and strong fundraising, today's asset allocators have a seemingly endless array of options for raising capital—not just in terms of asset vehicles, types, and classes, but in who manages the money on their behalf. In such a highly competitive environment, both established and emerging fund managers need to find a way to differentiate themselves from the pack.

[1] 2016 KPMG Women in Alternative Investments report

[2] The viewpoints in this paper were collected during an investor's panel at the third annual 100 Women in Finance East Coast Investor Conference, Capitalizing on Diversity and Returns: Investing With Women Managers, held on January 18, 2018 in New York City.

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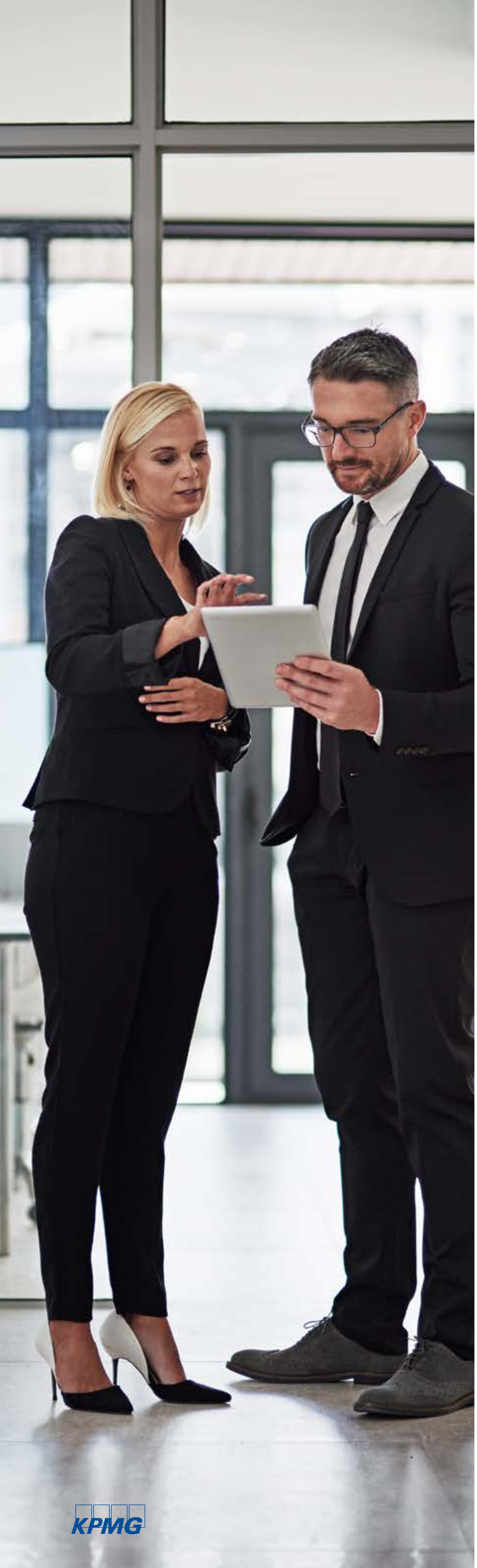
So what makes a fund manager stand out? According to the investors we spoke to, these are the characteristics at the top of the list:

— **Clear strategic direction:** Investors' top priority is to work with managers who have a differentiated strategy that can clearly be articulated. Fund managers and marketers should be prepared to answer probing questions about their investment process and decisions over the short and long term. What's the rationale for the strategy? What should it produce in terms of return? When will returns be realized? Is performance repeatable? For private equity funds, how will the fund manager influence an organization's leaders, drive necessary change, and grow the business to a successful exit?

— **Strong track record:** It's common sense that investors want to work with experienced managers who have an impressive background and track record in what they are doing. Small, emerging funds with short or no track record or predecessor performance may face an uphill battle compared with funds that have survived and thrived in the trenches and generated returns through up and down market cycles.

— **Sector-specific focus:** Knowledge is power. In today's open and transparent digital world, information is basically free and accessible to anyone. As such, today's investors tend to prefer sector-focused funds to generalist funds. They recognize that devoting resources to learning the ins and outs of a specific, niche market is the best way to gain a competitive advantage in investing and deliver more alpha. "We have a large private equity portfolio which includes both sector focused funds and generalist funds. Sector specialists have a performance edge compared to the generalists and can provide alpha generating returns," said Dana Johns, Senior Portfolio Manager, Maryland State Retirement System.

— **Portfolio protection:** Disruption is the new normal across the business landscape. It's difficult to see five minutes ahead, let alone five years. As such, investors are looking for fund managers that can protect their portfolios against volatile and cyclical markets. Some investors are targeting funds with nontraditional, non-correlated, or market-neutral strategies to reduce beta and produce returns that are less market dependent. Others are seeking more liquid investments; although illiquidity can generate a better return, as the time horizon for realization gets longer, it's also a greater risk.



The investor's perspective on… transparency and fees

Today, promising (or even delivering) overperformance isn't enough to survive as a fund manager. Alignment of interests is essential for both attracting new investment clients and strengthening investor-manager relationships. "As investors, alignment of interests between us and them is critical. I want to understand if and how people get paid out in investments is fair for the investor and those who run the money," said Appomattox Chief Investment Officer Susan Webb.

How funds approach fees and how they communicate with investors are both critical pieces of the puzzle. Here's what the investor panel had to say about these important topics:

— **Everyone wins when everyone wins:** Investors want to feel that they are being treated fairly—and most importantly, that their stakeholders are being treated fairly. After all, protecting stakeholder interests is an institutional investor's core responsibility. To earn and keep client trust, fund managers can't get greedy, fees have to be reasonable and justifiable to both parties.

— **Informed investors are happy investors:** Fund managers must promote open communication. Investors generally seek out fund managers who provide a great deal of transparency about what's going on in the portfolio—not just quarterly or monthly, but on an as-needed basis. The more information an investor has, the better able they are to assess opportunities and make the best decisions for their stakeholders. "Portfolio-level information is sometimes kept closer to the chest by managers, and we understand that. But, at the same time, detailed information helps us assess their strategies, so the more the managers are willing to share the better," said Beth Heath, director of hedge-fund research at Colonial Consulting LLC.

— **Nothing's too personal:** Transparency doesn't only apply to investment performance; it also applies to management company ownership. Investors want to know whether fund owners are "all-in" personally. They ask: "If you don't believe you're the best management company, why should I?" If owners are willing to stake their own financial futures on the fund's performance, it's usually a positive sign that they believe in the fund's capabilities and will be excellent stewards of client capital.

— **Distribution of carry matters:** Investors also want to know allocation of carry in compensation so they can spot any red flags. For example, investors may check to see if a fund overpays owners but undercompensates the rest of its workforce, as it could potentially create an environment with high turnover and, therefore, instability.

— **New funds (sometimes) get a pass on fees:** Investors recognize that emerging managers are usually cash-strapped, given all the operational costs of getting the fund off the ground. As such, if they truly believe in the fund, they are often willing to accept higher management fees up front, with the expectation that fees will be lowered as the fund raises capital; builds out the front, middle, and back office; and gets fully up and running. Note that investors are more likely to take this approach with hedge funds (which aim to generate quick and liquid returns) than private equity funds (which have a longer crystallization period before investors can take profits).

The investor's perspective on… capitalizing on diversity

Investors are in the business of performance. They evaluate fund managers on a wide variety of criteria, some of which we highlighted earlier in this paper. Gender is not always one of them.

That being said, investors recognize that investing in funds led by women (and other diverse parties) can be beneficial. Studies show that diversity of experience and perspectives is extremely valuable, and it really does matter to a portfolio.[3] As such, investors are taking steps to give more people from all backgrounds an equal opportunity to manage and grow their capital. Here are some investor viewpoints on this timely issue:

— **Diversity should be an ongoing topic:** When evaluating fund managers, many investors make diversity a key part of initial conversations. What is the fund doing to diversify its workforce, especially at the highest levels? Are women not only represented on the management team, but actually participating in the management of the portfolio? For private equity funds, what are the managers doing to encourage more women in senior positions in the companies in which they invest? "When we look at managers we often wish they were more diverse. We see the conversation about diversity as an ongoing one. We want to know how much they are thinking about it, and we want them to know it is a topic we care about," said Abigail Archibald, portfolio manager at the Andrew W. Mellon Foundation.

— **Women are diverse, too:** When there are still so few of them comparatively, it's easy to stereotype all women fund managers as a "type." But it's critical to remember that their personalities and approaches are as different from one another's as they are from men's. They come from different backgrounds, regions, and socioeconomic classes. Some are extremely aggressive, while others are more cautious. While they all have survived in a tough, male-dominated environment—and are therefore likely very good at what they do—they each bring different experiences to the table and should be evaluated on an individual basis.

— **Diversity isn't just about gender:** While gender diversity in investing is the focus of this paper, investors are quick to point out that diversity comes in all shapes and sizes—gender, race, class, education, and even geography. Consider that just as women network differently than men, a fund manager from Boston will have different connections than a manager in New York City, thereby opening up new opportunities.

[3] 2016 KPMG Women in Alternative Investments report

About KPMG's Alternative Investments practice

KPMG is the market-leading professional services provider to funds of every size and at every stage of the growth life cycle. With the experienced professionals, industry insight and global footprint to anticipate new challenges, and the innovative technology and resources to enable fund managers to thrive, we provide fund managers with the clarity, confidence and insight to succeed. Whether you're starting, building or expanding your fund or firm, we can help with formation and capital accumulation, acquisitions of investments, reporting on performance and plan delivery, restructuring, refinancing and divesting, and realization and exit. Learn more at kpmg.com.

About 100 Women in Finance

100 Women in Finance (100WF) is a global network of professionals in the finance and alternative investment industries working together to empower women at every stage of their careers. Through peer engagement and philanthropic and educational initiatives, our more than 15,000 members are making connections and creating opportunities that help to advance careers and strengthen our field.

100WF's Investor-Women Manager Conferences

100 Women in Finance organizes, by invitation only, conferences in San Francisco, New York, and London connecting top-tier institutional investors and consultants with women-led/women-owned funds. The crux of the conference features one-on-one sessions for female portfolio managers to meet investors.

To learn more about 100 Women in Finance and their conferences, visit 100women.org.

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