

Hedge fund payouts are expected to remain strong Absolute Return Magazine

Dec 10, 2007

While this year's subprime and structured finance meltdowns have negatively affected bonus prospects at some hedge funds, the broader trends toward enormous inflows of capital and higher returns overall bode well for hedge fund employee compensation at yearend and in 2008.

"Those two factors are driving a very good year," says Alan Johnson, managing director of New York compensation specialist Johnson Associates.

During the first half of 2007, the assets of 246 U.S. hedge fund firms managing \$1 billion or more increased by more than 23%, to nearly \$1.5 trillion, according to the Absolute Return Billion Dollar Club. Most of this money has gone to the largest firms, and the trend shows little sign of abating. And despite negative returns in July and August, the Absolute Return Composite Index advanced 9.19% for the year through October. That puts the Index well ahead of its 8.54% return for the same period last year.

Given the scalability of most hedge fund strategies, in a good year (assuming excess assets don't dampen returns), new management fees on all those billions in new assets represent a huge windfall - and on top of that, management fees have gone up in recent years. Hedge fund employees know it. "The other investment staff and even some of the senior operations staff have clamored for a couple of years now to spread that so-called excess management fee around more broadly," says Adam Zoia, founder and managing partner of Glocap Search in New York. Assets have increased more rapidly than head count, he adds, meaning potentially greater riches for all employees.

Firm partners do not have to share the money, of course. But a number of factors are forcing them to loosen the purse strings. Top firms, once able to pay less than smaller shops because of the training they offered and the patina of success they could bestow on employees, now compete against a larger pool of marquee names. That decreases any single firm's cachet relative to straight cash.

"The maturing of the business means there are significantly more brand names with heavy infrastructures," says Adam Herz, a partner at Hunter Advisors in New York. "The top firms are competing for the same talent pool at every level, junior through senior."

"The big shops recognize that they're no longer the only game in town, and it's no longer the name that's going to get someone in the door," says Brian Grover, founder and managing partner at recruiter Broadreach Group in New York. "I feel the big shops have come into line with everyone else and can be very competitive when they need to get the best talent. And it has certainly become difficult for small hedge funds to attract the better talent."

Competition has intensified in part because private equity firms have increased salaries and perks in an effort to protect their staffs from talent-raiding hedge funds. Private equity funds also enjoyed bang-up fundraising this year and now manage approximately \$70 million per investment professional, says Glocap's Zoia. He says that same figure for hedge funds, which are less forthcoming about how many professionals they employ, is hard to estimate but probably comparable.

Hedge funds can always mine Wall Street for staff, and recruiters expect a glut of résumés this year following bank layoffs, but recruiters say it is now less likely than in past years that hedge funds would lure talent directly from the Street. Instead, recruiters say, hedge fund managers routinely instruct them to search within the hedge fund industry or in other industries before looking to Wall Street.

Though hiring is tighter than in past years, bigger firms are enjoying the advantage of a captive pool of talent, as it has become much harder for startups to raise significant assets. And few are expected to leave hedge funds for Wall Street, as some did after 2005, when hedge fund earnings were less robust.

"Nobody's going back to the Street," says Herz of Hunter Advisors. "The Street is getting decimated because of proprietary positions they took in the mortgage markets and in the structured products market. There's generally much less appetite for risk at all the major brokerage houses."

As a result, talented underlings are looking to move up within their current firms or go to other firms rather than move back to the Street or strike out on their own.

As for launching a new hedge fund, "I don't advise people even to try it anymore," says Broadstreet's Grover. "When we started four years ago, I was helping people get seed capital. But now it has become clear that the better thing to do is to partner with a large hedge fund."

"Smaller firms are having a harder time raising money as the investor base has gotten more sophisticated. You're not seeing as many startups as you did," says Glocap's Zoia. But there is opportunity for career advancement, he says. "The largest funds are receiving the bulk of the assets and are still doing meaningful hiring as they try to find new strategies and get a new edge." **JF**