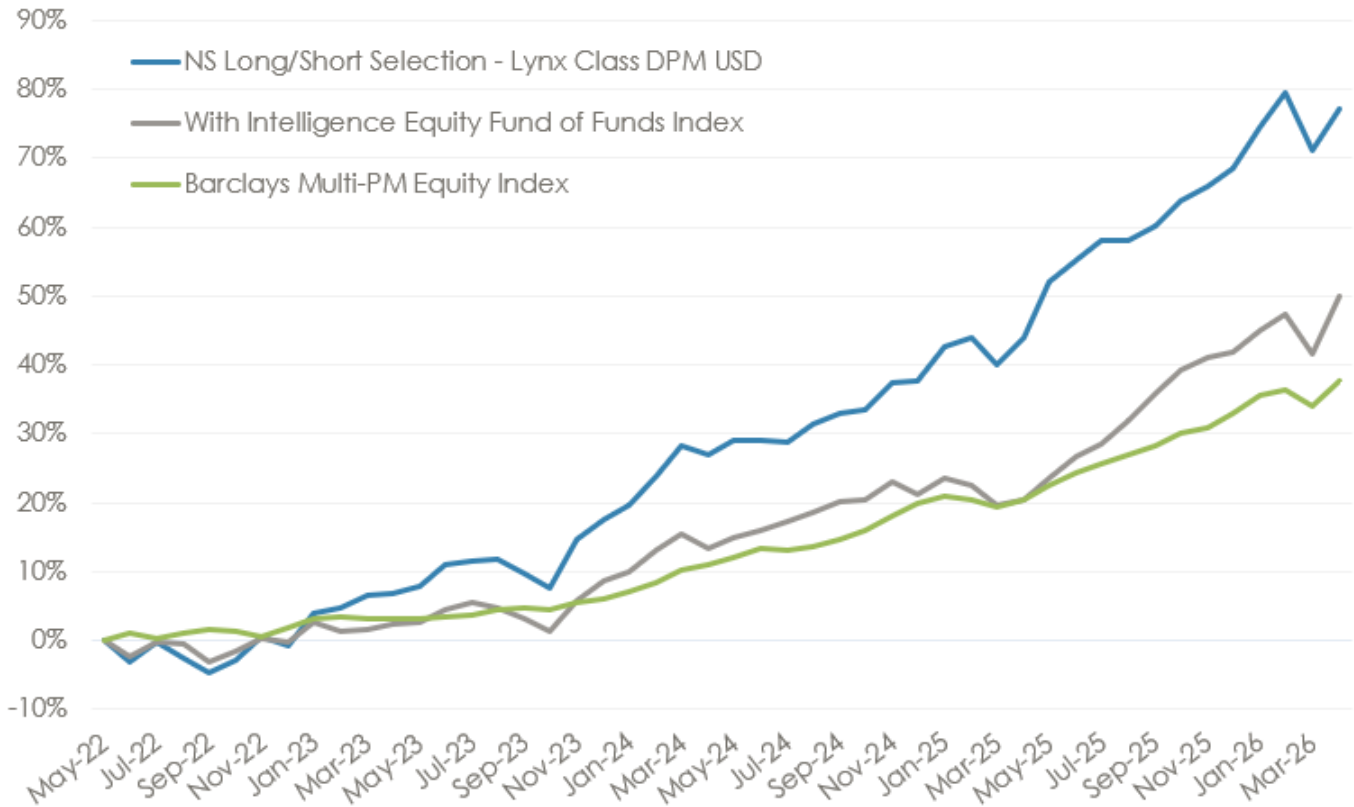


CHART OF THE MONTH

DOES THE TRADITIONAL FUND OF FUND MODEL STILL HAVE A FUTURE?



Source : NS Partners, Bloomberg.

DOES THE TRADITIONAL FUND OF FUND MODEL STILL HAVE A FUTURE?

As a firm, NS Partners has been involved in managing fund of hedge funds for almost 57 years. Back in the 90s, almost every private bank in Switzerland managed their own fund of funds for their clients. At the time it was easy to post double digit returns; there were fewer hedge funds (less competition) and regulation was light (Reg FD in 2000 put an end to fast money). Given their success, they all got too large and suffered from the “diworsification” syndrome which subsequently led to sub-par returns. Fast forward to today and most fund of hedge funds have disappeared as most have been cannibalized by the pod-shops. The liquidation of Leverage Capital Holdings (one of the world's oldest hedge fund of funds) in 2025 is a sign of the times. Today, most investors have gravitated towards the multi-strategy pod-shop model that has proved to be more efficient in allocating capital and cutting losses despite being much more costly than the traditional fund of funds or have turned to more tailored hedge fund solutions offered by the private banks.

With hedge fund assets at an all-time high, the number of new fund launches has been in a steady decline over the last 20 years which highlights the fact that the billion-dollar club of hedge funds is becoming increasingly larger and attracting more assets each year. As we all know, performance is typically inversely correlated to the growth in assets under management and more importantly, the best part of any historical track record is typically generated in the first 3-5 years from inception (the waiting period after which most institutional investors start investing). At NS Partners, we have a long and proven history of backing hedge fund managers in their early innings, which has enabled us to forge strong partnerships with them over time, particularly in the equity long short space. This obviously gives us capacity rights over time, preferential fees and liquidity terms enabling the fund of fund model to be very competitive with a flat management fee versus other alternative models. Remember that George Soros started the Quantum Fund on a 1% management fee and a 10% performance fee until somehow 2% / 20% (and beyond thanks to the passthrough fee structure) became the norm.

This month's chart illustrates our equity long / short portfolio's performance over the last four years versus the average equity long / short fund of funds and the Barclays multi-PM equity index over the same period.

So what options are left with in today's world of hedge fund alternatives:

The advisory mandate:

- Buy high and sell low (everyone chases past performance, that's human nature!) and highly likely to underperform the traditional concentrated fund of fund model
- Access to the best talent is limited in capacity (most will not take additional money)
- Rarely invest in a hedge fund manager early stage
- Layered fees

The pod-shop model:

- Good risk adjusted returns, but the most successful ones are capacity constrained
- High amounts of leverage (sometimes excessive)
- Many underlying PMs (100+) with the best contributors less scalable over time
- Factor hedging can be detrimental to performance (particularly in the last two years)
- High barriers to exit (investor AND fund level gates)
- The end client ends up giving away over 55% of gross performance via the passthrough cost structure
- Are often subject to pod deleveraging events that hurt performance

The quant-shop model:

- High turnover / shorter investment horizon (zero to 30 days) which has benefited them over the last few years
- Must constantly reinvent themselves due to signal decay and crowding
- Can use even more leverage than pod-shops in many cases
- Never know when or why they lose money e.g. The Quant Winter from 2018-2020
- Reliant on algorithms and no human intervention

The good old directional fund of hedge fund model at NS:

- Low cost / high conviction concentrated portfolio of managers (12 is the lucky number!)
- Backs managers before the pinnacle of their career
- Gives access to investors that can't make the minimum \$1-25 mio ticket size for accessing single managers
- Liquid: no investor level gates that can take up to 5 years to get your money back
- Uses less leverage
- And highly unlikely to be replicated in an advisory mandate.

With pod-shops and quant-shops dominating market share today, maybe it's time to go for less crowded and more focused fund of hedge funds with managers that have a longer investment time horizon and are capacity constrained (anti pod-shop). The old-school approach to investing

in directional bets on equities with conviction for the long run whilst taking the hits and bruises over time (as you will get a bad year every 3-4 years and your short book will give you some protection), in the end you may be better off in the long run than focusing on YTD performance.

Beat Notz, our founding partner, is often quoted in research pieces from Gavekal (a business he backed in the 70s' called Cecogest at the time and founded by Charles Gave):

“Remember, it's an easy business. When things get complicated, and markets are all over the place, just bear in mind that the Fed will always follow policies that benefit equity holders, because everyone in the US owns equities, and the Bundesbank will always follow policies that benefit bund holders, because everyone in Germany owns bunds. So, when markets are panicking and you don't know what to do, just buy equities in the US and buy bunds in Germany.”

Although bunds no longer exist, he was right about equities...

Written by Caron Bastianpillai

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