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New Hedge Fund Managers Jump Into Beaten-Down Arena

By Dan Molinski
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NEW YORK (Dow Jones)--New life is being pumped into the beaten-down hedge fund industry as laid-off workers from the banking sector, and others looking for a fresh start, try their hand at lead-managing other people's money.

This new batch of fund managers is taking advantage of a view held by many that being new to the field can be a good thing. Investors see them as being untainted by the problems that plagued the hedge fund industry in 2008 - everything from negative returns to corruption scandals like the one involving Bernard Madoff to the decision by many managers during crunch time to not let investors have their money back.

"To some degree, the environment has leveled the playing field," said John Pettey, who along with partners launched Prosium Fund Management on March 1 with less than \$10 million of assets under management.

A couple years ago, that \$10 million might have been viewed as small in an oversized hedge fund world drowning in capital. The number of hedge funds in recent years eclipsed 10,000 and last year total assets reached more than \$2 trillion as the alternative investments industry hit its stride.

But with valuations spiraling downward across asset classes due to the credit crunch and weak economy, and many funds closing shop as investors in need of cash yank their investments, the hedge fund industry has shrunk. There's now only about \$1.4 trillion in the hedge fund world, and potential new managers are discovering they don't need as much seed money as they used to start a new fund.

"These days, new managers might be finding they can get started for a lot less than before," said Ken Heinz, president of Chicago-based Hedge Fund Research.

Diego Kuschnir spent more than a decade in investment banking, but found himself out of a job in late 2008 after several rounds of layoffs at his New York-based firm.

"The banking industry is not what it used to be, nor will it be for the foreseeable future," Kuschnir said. "But companies are still operating and people are still consuming ... there are a lot of opportunities and my business partner and I are entering [the hedge fund industry] without a track record of redemptions or negative returns."

Their fund, EQ Capital, is expected to get off the ground in a couple weeks with about \$50 million in assets, he said. Their strategy will focus on the energy sector, mostly long bets on equities in energy-related firms, many of whose stock prices have gone down while dividends have remained the same, meaning the percentage yield on the dividends is rising.

While firms such as EQ Capital and Prosiium are new, Pettey explains that his fund's philosophy is in many ways a throwback to the earlier days of hedge funds, back before many of them began betting with a herd mentality that eventually caused many funds to implode.

"There were lots of crowded investments held by hedge funds and when hedge funds decided to liquidate these investments, it created a bit of a downward spiral," he said. "In this volatile environment, being nimble is quite important."

Prosiium's fund strategy is global macro, with the goal of producing positive, risk-adjusted returns without correlation to equity markets or gross domestic product growth. The fund will have a diverse portfolio that could include long and short bets on equities, commodities, fixed income and currencies.

New managers say they aren't trying to dethrone the major hedge funds, which have established a foothold and are could start growing again soon as the economy recovers. Rather, they're taking aim at the small and medium-sized firms that popped up in recent years and now may be struggling to stay afloat.

But some observers point out that even while some new fund managers may find the seed money needed to launch, many more are running into brick walls.

"Most are having real difficulty getting any traction," said Brett Barth, director of investment management at BBR Partners in New York, which invests in hedge funds on behalf of clients.

One reason is competition from existing funds that are once again taking new money after suffering massive withdrawals.

"Everyone's open," Barth said. "You've got seasoned managers whose track records are really good."

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(Gregory Meyer contributed to this report.)