

Fund of Information: Hedge Funds Arrive on Madison Avenue

By Beverly Goodman

Will John Paulson rent a billboard on I-95 promoting his \$14 billion hedge fund? Is there a George Soros World Cup in the offing? Probably not. But there are a lot of people in the hedge-fund industry who are excited about the fact that hedge funds can now advertise, sponsor sporting events, and generally reach a wider audience of potential investors.

But, as with everything regulatory, it's not quite that simple. The industry's ability to advertise came about when, earlier this month, President Obama signed the Jumpstart Our Business Startups Act, better known as the JOBS Act. Its main goal was to make it easier for small businesses to raise money, with which they would hopefully create more jobs. Tucked into the act was the lifting of a ban on general advertising and solicitation that hedge funds, with varying degrees of fidelity, had adhered to.

Before you assess how meaningful the new law is, you need to understand a few basics. Hedge funds by rights should be regulated by the Investment Company Act of 1940, which oversees mutual funds and most exchange-traded funds. But in order to avoid the restrictions on redemptions, leverage, and incentive compensation laid out in the 40 Act (as it's known), hedge funds generally use one of two loopholes known as 3(c)(1) and 3(c)(7). Both exempt hedge funds from most 40 Act requirements but limit their investor audience.

A Mixed March: Hedge Fund Best-Worst-Biggest

The biggest hedge funds didn't move much off the dime during the month. One exception was Bridgewater All Weather Strategy, up 4%. Some small, China-focused funds had double-digit losses.

Best	% Return					Assets (mil)	Strategy
	Mar.	YTD*	1-Year	3-Year	5-Year		
Trishield Distressed	33.8%	40.4%	20.6%	360.8%	n.a.	n.a.	Dist Securities
Elevated Value Focus LP	27.2	54.9	-34.2	191.4	38.0	3.3	US Lg/Sh Eq
Lionhart Enhanced Opp BNNI	24.3	22.2	-15.1	51.4	n.a.	3.2	Multistrategy
Sather Agriculture LP	20.0	20.8	23.0	n.a.	n.a.	5.5	US Lg/Sh Eq
Rivoli Intl Feeder V9 USD	19.3	21.6	23.3	23.4	68.5	2.2	Systematic Fut
Stratton St Asia Synth War	18.9	45.9	-61.3	1.6	-92.3	n.a.	Asia/Pac Lg/Sh Eq
GLC (Offshore)	16.0	26.0	2.9	141.2	n.a.	1.3	Multistrategy
Haven Real Estate Focus	15.9	38.1	11.5	493.6	n.a.	0.6	US Lg/Sh Eq
Foundation Financial Ptnrs	12.9	24.3	4.2	22.0	-69.3	1.7	US Sm Lg/Sh Eq
Reuven Cap Investments, LP	12.5	7.9	-30.2	196.1	n.a.	n.a.	Global Lg/Sh Eq
WORST							
Index Global II Seg Port	-28.8	-25.8	-57.8	-36.4	n.a.	1.2	Systematic Fut
Vol Edge B	-24.3	-50.1	-45	-95.8	n.a.	0.8	Volatility
Vol Edge A	-24.0	-51.3	-41.3	-95.9	-67.8	112.6	Volatility
Co-power Val Growth Trust 1	-18.4	-5.7	-34.1	n.a.	n.a.	n.a.	China Lg/Sh Eq
Superfund Green Gold C	-16.5	-5.5	-32.4	-46.5	12.3	48.8	Systematic Fut
XITIC Hongyi Trust 1	-16.4	-9.3	-52.6	n.a.	n.a.	n.a.	China Lg/Sh Eq
Xitic Jiuge Investment 2	-16.1	-21	n.a.	n.a.	n.a.	n.a.	China Lg/Sh Eq
Sprott Offshore Ltd	-16.1	-12.7	-34.1	5.8	35.8	198.8	US Sm Lg/Sh Eq
Sprott Capital LP	-16.0	-12.7	-36.7	0.0	28.4	52.9	US Sm Lg/Sh Eq
SITI-Xiaokan fengyun Trust 1	-15.7	-12.9	n.a.	n.a.	n.a.	n.a.	China Lg/Sh Eq
BIGGEST							
Bridgewater Pure Alpha 18%	-1.2	-2.8	17.2	78.4	121.4	22663.0	Global Macro
Winton Futures USD CIs B	-0.7	-0.9	3.5	16.0	74.9	10396.4	Systematic Fut
Bridgewater Pure Alpha 12%	-0.8	-2.0	10.7	46.2	74.8	9750.0	Global Macro
Millennium International Ltd	0.3	2.7	7.1	40.1	51.9	9365.0	Diversified Arb
Transtrend DTP - Enhncd Risk	-0.9	2.5	-5.3	-1.7	60.2	7495.5	Systematic Fut
Bridgewater All Weather 12%	4.0	15.3	35.4	83.3	54.9	5002.6	Systematic Fut
Brummer & Ptnrs Multi-Strat	-0.2	2.0	2.6	15.4	39.0	4582.3	Multistrategy
Millennium USA LP	0.3	2.7	7.4	40.5	51.3	4486.0	Diversified Arb
ACL Alternative	-2.1	0.7	-6.4	2.3	61.3	4192.5	Funds - Mac/Sys
Quantitative Global Program	1.4	-4.5	5.9	10.8	51.9	3711.0	Systematic Fut
Brummer & Partners Nektar	0.4	1.3	5.8	55.5	103.5	3477.0	Debt Arbitrage
Aurora Offshore Ltd.	0.5	4.9	-2.8	27.0	9.4	3366.0	Funds - Eq
Bay Resource Ptnrs Offshore	-1.7	14.7	5.6	124.8	84.3	2600.0	US Lg/Sh Eq
Absolute Alpha PCC Dvrsfd	-0.2	-0.1	-2.3	12.4	-3.4	2471.6	Funds - Multistrat
Aurora Offshore Ltd II	0.6	4.7	-2.7	25.6	7.2	2446.0	Funds - Eq
Lighthouse Diversified Ltd	0.8	4.2	-0.4	27.5	9.8	2333.0	Funds - Multistrat
BlackRock UK Emerging Co	-0.2	2.1	-0.3	40.2	81.0	2169.7	Europe Lg/Sh Eq
Pinnacle Natural Resources	-0.3	3.1	2.8	18.5	54.7	2133.0	Funds - Rel Val
Corbin: Pinehurst Partners	0.6	3.3	3.4	33.2	18.4	2101.8	Funds - Multistrat
Wexford Offshore Spectrum	-1.0	2.3	-3.2	39.8	30.3	2075.1	Multistrategy

Source: Morningstar Inc

Those considered 3(c)(1) funds allow up to 99 "accredited investors," defined as someone with a net worth (not counting a home) of at least \$1 million or an annual salary of \$200,000. Section 3(c)(7) funds are permitted more investors, so long as they're all "qualified purchasers," having \$5 million in investable assets. (There are many other nuances to these definitions, but this will do for now.) One of the

two changes the JOBS Act made was to allow an increase in the maximum number of investors in 3(c)(7) funds to 1,999 from 499. If a hedge fund wants more than 99 accredited investors or 1,999 qualified purchasers, it will have to register with the Securities and Exchange Commission.

THE SECOND, AND MORE provocative, change is the lifting of the advertising ban. Because of the restrictions on whom they can take money from, hedge funds generally were only allowed to let people with whom they had a preexisting, substantive relationship invest; they were prevented from advertising to or soliciting the general public. Some funds took this more seriously than others, requiring passwords to access their Websites and never uttering a word about performance, while others interpreted the rules a bit more

loosely. "It's always been a gray area," says Mike Seery, a director at financial advisory firm Kinetic Partners.

The ability to reach a wider audience will have a much bigger impact on smaller funds, particularly those with less than \$250 million in assets that allow accredited investors. (Most household-name hedge funds permit only qualified purchasers.) Because they're still appealing to a fairly wealthy crowd, though, advertising likely won't be too mass-market. Some have speculated we'll see golf or tennis tournaments sponsored by hedge funds, and an increase in advertising in, ahem, publications that speak to a more sophisticated and wealthy audience.

"A fair number of smaller to mid-sized firms are eager to see less onerous restrictions in marketing to

investors," says Ken Heinz, president of Hedge Fund Research, which compiles and analyzes data on hedge funds. "I don't expect this to have a meaningful impact on larger funds, especially those with more than \$5 billion in assets."

THERE ARE STILL A fair number of kinks to work out, warns Kevin Scanlan, a partner at the law firm Dechert. Funds generally can accept up to 35 nonaccredited investors, but funds that avail themselves of the relaxed advertising and soliciting rules won't be allowed any nonaccredited investors. "My take is that at the end of the day, the investor base for these funds won't be any different," Scanlan says. "Smaller funds are hungrier for new investors, but at the same time have smaller budgets to spend on advertising." Also, he points out, most funds haven't contemplated advertising costs in their fund documents. That means they could end up a manager expense rather than a cost that can be passed on to investors.

Then there's the issue of the additional rules the SEC needs to write. Now, if hedge funds advertise, they'll need to prove they took "reasonable steps" to verify any new investors are accredited, says Don Babbitt, a consultant at Kinetic Partners and former SEC attorney. And the SEC isn't likely to rush its opinion as to what those reasonable steps are. "Congress said the SEC had 90 days," Scanlan says. "But given all they have on their plate, I think we're looking at the end of the year."

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