SEWARD & KISSEL LLP

New Hedge Fund Study

2018 Edition

Prepared by the Investment Management Group at Seward & Kissel LLP

Introduction & Key Findings

Driven by our ongoing commitment to understanding the dynamics of the hedge fund marketplace and bringing the latest industry color to our clients and friends, each year Seward & Kissel conducts *The Seward & Kissel New Hedge Fund Study* of newly-formed hedge funds sponsored by new U.S.-based managers entering the market. This Study covers the 2018 hedge fund launches of relevant Seward & Kissel clients meeting these criteria. As we have been identified by Preqin as the top U.S. law firm based on number of hedge funds serviced, we believe that the number of funds within the Study is large enough to extract a representative sample of important data points that are relevant to the hedge fund industry. The Study analyzes investment strategies, incentive allocations/management fees, liquidity and structures, as well as whether any form of founders or seed capital was raised. The Study does not cover managed account structures or “funds of one” that may have a wider variation in their fee arrangements and/or other terms.

The Study's key findings, set forth in greater detail below, include the following:

- 63% of the funds had equity or equity-related strategies, up from 56% in 2017, but still down from a peak of 80% as shown in our 2015 Study (a 17 point decline).

- With respect to management fees charged in the standard (i.e., non-founders) classes, the average rate was 1.44% for equity strategies and 1.58% for non-equity strategies, down from 1.52% and 1.61%, respectively, last year.

- Incentive allocation rates in standard classes have continued to decrease across all strategies by about 53 basis points from 2017 and over 100 basis points from 2016 to an average of around 18.72% of annual net profits. In addition, more than 20% of all funds had an incentive allocation hurdle (up from 15% in 2017).

- Approximately 63% of the equity funds (similar to 66% in 2017) and 45% of the non-equity funds (down significantly from 75% in 2017, but fairly consistent with 36% in 2016) offered lower management fee and/or incentive allocation rates through their founders classes.

- 95% of the equity funds and 55% of the non-equity funds offered quarterly (or less frequent) withdrawals, with the balance allowing for monthly withdrawals.

- Lock-ups or investor level gates were used by 75% (down significantly from 91% last year) of the equity funds and 73% of the non-equity funds, with 30% of the equity funds possessing both. Fund level gates have continued to be disfavored by new managers, and we saw only 7% of funds across all strategies with a fund level gate.

- Sponsors of both U.S. and offshore funds continued to almost exclusively set up master-feeder structures (as opposed to side-by-side structures), and utilized the Section 3(c)(7) exemption 63% of the time (a 12 point decline from last year).

Introduction & Key Findings (continued…)

- We estimate that within the entire hedge fund industry, for calendar year 2018, there were likely more than 50 seed deals consummated (which is roughly a 20% increase over our observed activity in each of 2016 and 2017).

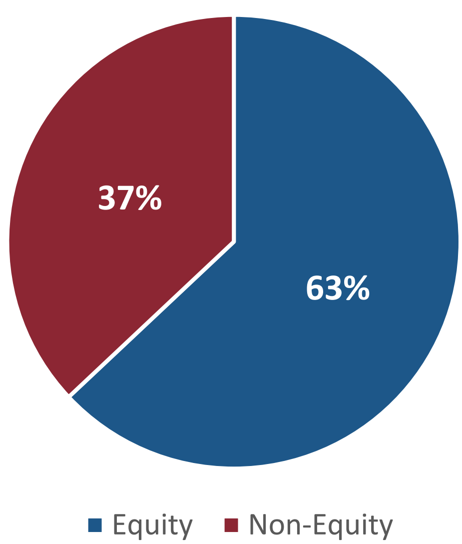
- Looking back five years to 2013, there have been noticeable changes in both the fee and liquidity terms of newly-formed funds. The table below outlines these findings.

Key Terms for the Average Hedge Fund Standard Class Across All Strategies

	2013	2018
Management Fee	1.67%	1.49%
Incentive Allocation	20%	18.72%
Quarterly or Less Frequent Liquidity	89%	81%
Gate or Lock-up	92%	71%
Founders Capital	43%	57%

Investment Strategies

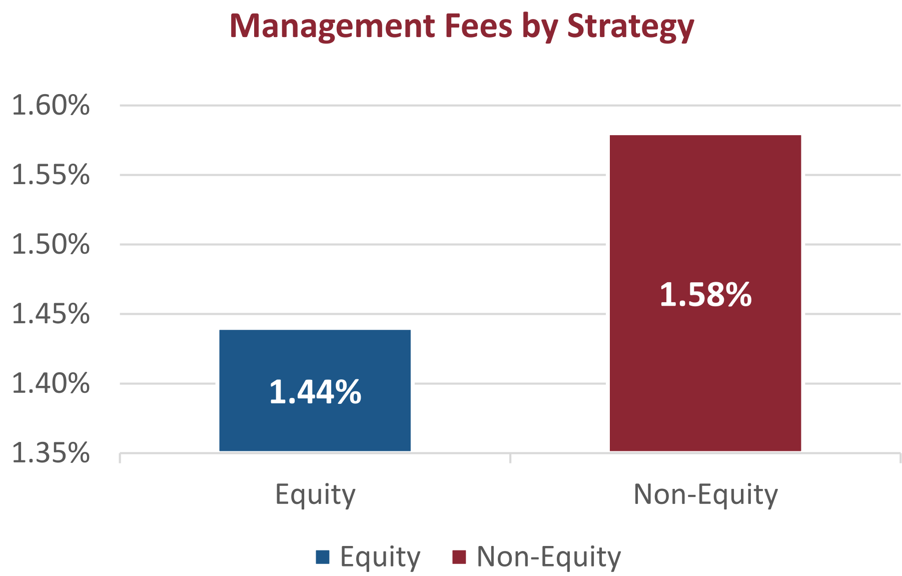
Demonstrating the continuation of a shift we first began to notice in 2016, only about 63% of the funds included in the Study utilized an equity or equity-related strategy (not including multi-strategy offerings that generally involved both equity-related as well as other strategies). This is up from 56% in 2017, but still down 17 points from the 2015 Study's high water percentage of 80%. The remaining 37% of funds in the Study (i.e., the non-equity strategies) were split fairly equally, primarily among multi-strategy, quantitative, credit, cryptocurrency and commodity-related strategies.



Management Fees / Incentive Allocations

While management fee rates in standard (i.e., non-founders) classes decreased overall, the decline was most significant in funds with equity strategies. The average rate was 1.44% for equity strategies (down from 1.52% in 2017) and 1.58% for non-equity strategies (similar to 1.61% in 2017). We believe that ongoing investor demand for non-equity strategies and higher operating costs may have made these funds more resistant to downward management fee pressure during the post-launch phase. Note, however, that these averages do not take into account the possible tiering down of management fee rates as assets increase or time passes, which was present in 20% (as compared to about 29% in 2017) of all funds. In 50% of those funds that also contained a dual class structure, the tiered rate applied to both founders and non-founders classes.

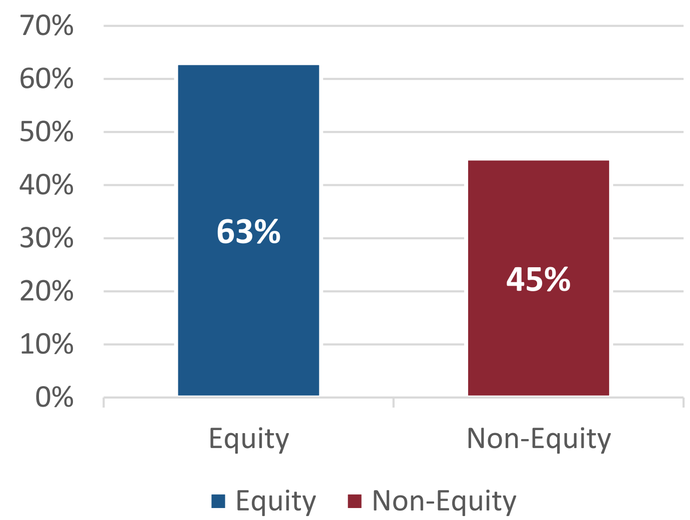
Incentive allocation rates in standard classes have continued to decrease across all strategies by about 53 basis points from 2017 and over 100 basis points from 2016 to an average of around 18.72% of annual net profits. Moreover, every fund in the Study had some type of incentive allocation high water mark provision. Lastly, while none of the funds in the Study had a modified high water mark or an incentive allocation measured over a rolling multi-year period, more than 20% of all funds had an incentive allocation hurdle (up from 15% in 2017).



Management Fees / Incentive Allocations (continued…)

Approximately 63% of the equity funds (similar to 66% in 2017) and 45% of the non-equity funds (down significantly from 75% in 2017, but fairly consistent with 36% in 2016) offered lower management fee and/or incentive allocation rates through their founders classes. About 10% of the funds (similar to 2017) offered longer lock-up classes. The average founders class management fee was 1.25% for equity funds (the same as in 2017) and the average for non-equity funds was 1.13% (which is similar to the 1.15% number in 2017). The average founders class incentive allocation was 14.73% for equity funds (down from 15.5% in 2017), while the average for non-equity funds was 14.38% (down from 14.5% in 2017 and down significantly from 17% in 2016). Overall, these management fee and incentive allocation rates, together with the prevalence of founders classes, demonstrate the continued downward pressure on fees recently seen.

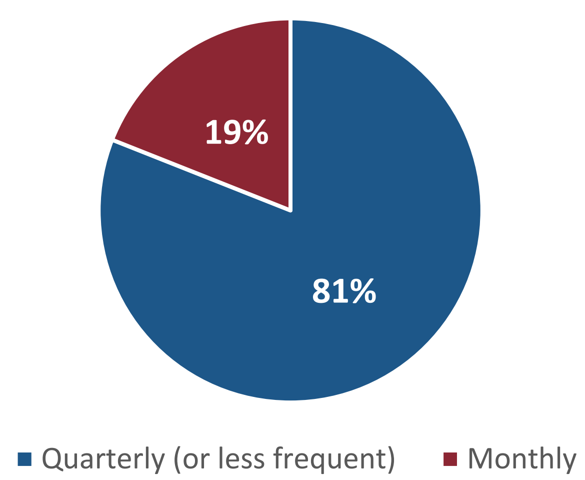
Founders Classes by Strategy



Liquidity

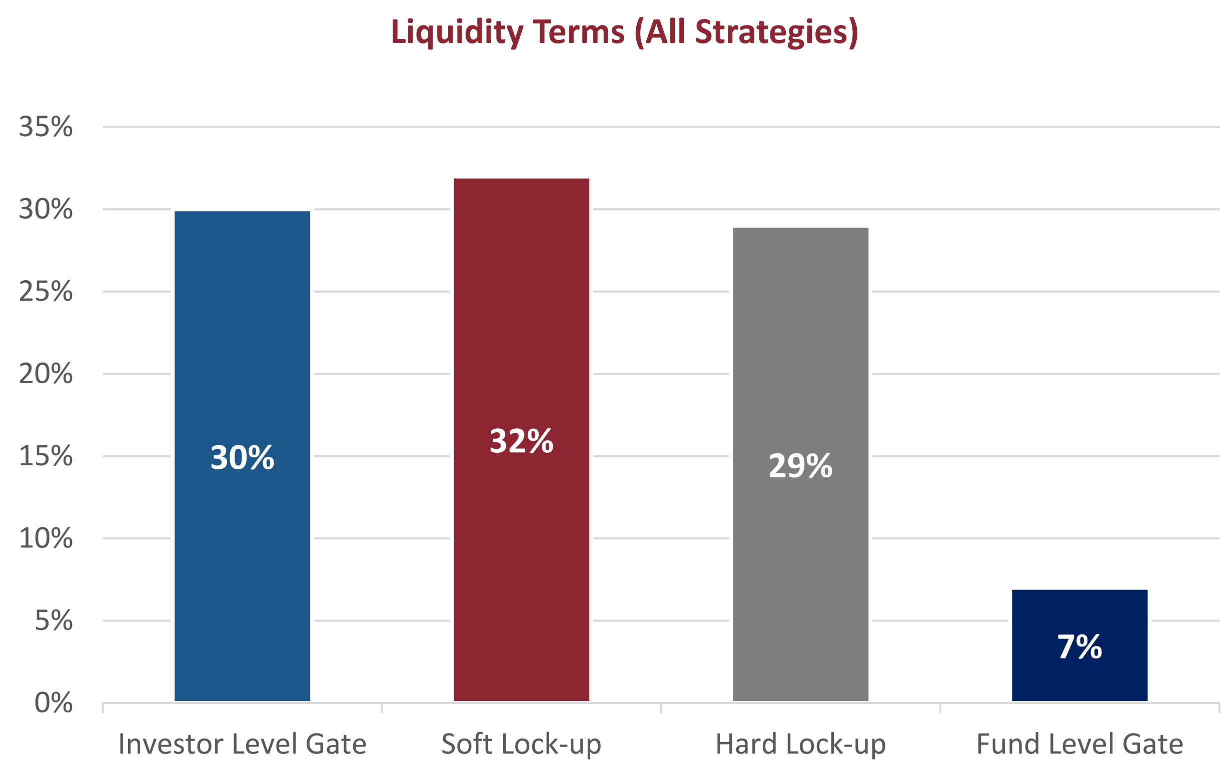
95% of the equity funds and 55% of the non-equity funds in the Study offered quarterly (or less frequent) withdrawals, with the balance allowing for monthly withdrawals. The notice period for equity funds was 60 days 35% of the time (compared to 64% last year), 45 days 30% of the time, and 30 days 15% of the time, with the remainder between 75 and 120 days. The notice period for non-equity funds was 60 days 64% of the time, 45 days 9% of the time, and 30 days 18% of the time, with the remainder 5 days. The average notice period was 54.35 days (down from 58.5 days in 2017) broken down as an average of 57.75 days for equity funds and 48.18 days for non-equity funds.

Withdrawal Frequency (All Strategies)



Liquidity (continued…)

Moreover, across all classes, 75% of the equity funds and 73% of the non-equity funds had lock-ups or investor level gates (with 30% of the equity funds possessing both). Last year, we saw 91%, 66% and 27%, respectively. In the standard class of the funds, 32% of the equity funds (down from 73% in 2017) and 27% of the non-equity funds had an investor level gate, 35% of the equity funds and 27% of the non-equity funds had a soft lock-up (usually, one year with a 2% - 5% withdrawal fee payable to the fund), and 25% of the equity funds and 36% of the non-equity funds had a hard lock-up. We believe that the significant decrease in the proportion of equity funds offering an investor level gate demonstrates a continued focus by institutional investors on matching investor liquidity with portfolio liquidity. Fund level gates have continued to be disfavored by new managers, and we saw only 7% of funds across all strategies with a fund level gate.



Structures

Sponsors who offered both U.S. and offshore funds continued to almost exclusively set up master-feeder fund structures (as opposed to side-by-side structures), and such structures utilized the Section 3(c)(7) exemption about 63% of the time (a 12 point decline from last year). Of the master-feeder fund structures, there was continued growth in the number of master funds established as partnerships, as compared to corporations (primarily due to easier administrative and accounting capabilities available in partnerships). In addition, 37% of all managers initially launched just a U.S. stand-alone fund (up slightly from 33% in 2017), primarily to build a track record in order to attract offshore and U.S. tax-exempt investor interest in the future. About 55% (down from 67% in 2017) of the stand-alone funds relied on the Section 3(c)(1) exemption. The average minimum initial investment for 3(c)(7) funds across all strategies was about $2,500,000 (up significantly from $1,600,000 in 2017). Breaking down the 3(c)(7) fund numbers, the average minimum initial investment for equity funds was about $1,800,000 (up from $1,300,000 in 2017) and $3,800,000 for non-equity strategies (up significantly from $2,000,000 in 2017). With respect to 3(c)(1) funds, the average minimum initial investment was about $1,000,000 (with equity funds at about $1,225,000 and non-equity funds at about $725,000). Higher minimum initial investment amounts in 2018 suggest that hedge funds are increasingly targeting an institutional investor base and have higher operating costs. Lastly, no fund within the Study chose to go down the path of engaging in general solicitations and advertising as is now permitted under Securities Act Rule 506(c) promulgated pursuant to the JOBS Act.

Seed Capital

Building on the uptick in seeding activity we reported last year for Q4 of 2017, we witnessed strong activity in 2018. Important drivers of this activity continue to be the re-emergence of existing seeders and a number of new institutional seeders launching pools of money focused on making seed investments. We estimate, based on conversations with various industry participants and internal data, that within the entire hedge fund industry, there were likely more than 50 seed deals consummated in 2018 (which is roughly a 20% increase over our observed activity in 2016 and 2017).

With respect to seed deals, we noted more activity from institutional seeders than from opportunistic, one-off seeders who are just entering the space (such as high net worth individuals and family offices); this represents a bit of a change from prior years which saw more balanced participation. Of the institutional money, several of the new seed deal-focused private equity funds raised (or in the process of being raised) by a number of well-known investors have moved decisively into the marketplace, and we are seeing increased levels of competition to seed premier new managers. The higher end of seed investment deals remained in the $100 million to $200 million range, typically including a two to three year lock-up. Smaller deals generally ranged from $20 million to $50 million, often with a two year lock-up. Our data suggests that modifications or deferrals of the revenue share a seeder typically receives as a means of making more working capital available to new managers continues to be increasingly common in seed deals, which is broadly consistent with what we have been observing for the past several years.

Seward & Kissel LLP

We hope that you find *The Seward & Kissel New Hedge Fund Study* helpful. If you have additional input that you would like to share with us, or have any questions, please contact your primary attorney in Seward & Kissel's Investment Management Group.

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