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Boutique Primes See Boom In Credit Bust



Last summer's credit crisis—and the ensuing collapse of a number of high-profile funds—has rocked the hedge fund industry. Some prime brokerages have been especially hard-hit, slashing leverage and responding to calls for greater transparency, while others have escaped seemingly unscathed. In fact, smaller prime brokerage shops are thriving, as changes at the top of the industry present an array of new opportunities.

“The credit crisis has driven opportunities to Shoreline Trading Group and to multi-clearing prime brokers in general,” Michael Murray, a partner at Shoreline, says. “Any time there is a dislocation in the market of the magnitude of this credit crisis, you find people asking questions about what's best for their fund, and a lot of good fund managers are realizing a well-positioned introduced relationship can add value.”

“That we actually add value is finally being acknowledged in the marketplace,” he adds.

Douglas Nelson, co-founder of Atlanta-based NorthPoint Trading Partners, agrees.

“The introducing broker model has become a lot more popular and accepted, and in a lot of ways it is preferred because it has become well-enough known now that people aren't worried about a stigma,” he says. “Your capital is at Goldman Sachs or Jefferies, and you can tell your clients that.”

The flexibility offered by boutiques is also increasingly seen as an advantage.

“The boutique model will continue to expand and receive a greater proportion of the business because of flexibility issues,” Robert Jersey, president and CEO of Chicago's Gar Wood Securities, says. “It really is the best of both worlds: the feel of a small firm and the balance sheet of a big firm. It's a wonderful combination.”

Smaller, less-profitable hedge fund accounts aren't the only things that bigger prime brokerages are cutting back on. With many cutting back on staff, boutique primes are capitalizing on two opportunities.

“We are enticing seasoned veterans to leave the big investment firms and come and join us,” Jersey says. “I may bring on an institutional broker or third-party marketer from another firm that brings three to 10 customers with him, so I'm growing exponentially that way.”

“With everything that's going on with the big houses now, a lot of them have laid off staff and

there just aren't as many bodies around to service the accounts," James Zurlo, head of prime brokerage services at Gar Wood, says. "And they have to look to the introducing primes, such as ourselves, to handle the smaller end of the accounts."

"That's been a tremendous benefit to boutique primes over the last six months," adds Zurlo.

However, the credit crisis has not been all good news for smaller primes. Capital for small and start-up hedge funds has dried up at a time when many funds are boosting their fundraising efforts. According to the 2008 FINalternatives Prime Brokerage Survey, more than 80% of funds managing between \$10 million and \$100 million have average or above-average capital introduction needs, while more than one-third of all hedge fund's rate their prime broker's capital introduction capabilities "poor." Just 12% say they are "excellent."

"Short-term, it's been a positive for us," NorthPoint's Nelson says of the credit crunch. "Intermediate, long-term, it's tough to say, but it will probably be a negative for raising capital."

"With the smaller start-ups, it has gotten a lot tougher to raise assets," Gar Wood's Zurlo says. "If they did not have a substantial launch, gathering assets and getting to critical mass has been a Herculean task in a lot of cases."

Still, fears about the culprits in last summer's market shake-up—complex asset-backed derivatives—may play out in the boutique's favor after all.

"We're seeing more people gravitate back to more traditional strategies, which is where our clients are," Nelson says. "In the last several days, some of our clients have won some pretty nice allocations. People who were looking at more exotic strategies a year ago are saying they aren't looking there anymore."

"No one launched between September and March, but they're active again now," Jersey says. "If you look at previous cycles, when there are layoffs and consolidations in brokerage firms, that's typically when you see a lot of start-ups," he adds. "Now, and for the next six months or a year, there will be a lot of new managers coming out, using their own money to launch."

Boutiques are also poised to profit from another finding of the 2008 FINalternatives Prime Brokerage Survey. Almost three in four managers who called their prime broker's personal services "poor" say they are looking for a new one.

At the larger firms, "even if you're a decent-sized account, your service rep is often changing every few months," Nelson says.

"The larger houses will spend all the time in the world with their largest clients, but the average Joe with \$75 million is just not going to have the direct contact and nurturing that they'd have at a small house," Zurlo adds.

"In a broader sense," Shoreline's Murray says, "the bigger firms have continued to focus on the largest, most profitable clients, and that continues to create opportunities for us."

by Jonathan Shazar

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