LONG ALPHA AND SHAREHOLDER ACTIVISM STRATEGIES

Introduction

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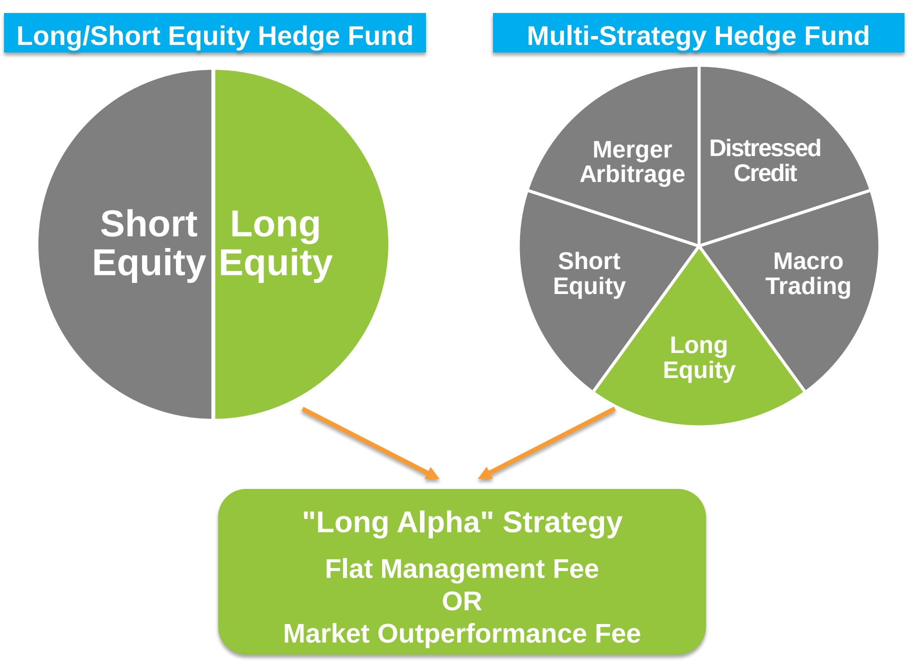
As investment boards continue mulling over the "active vs. passive" management debate, additional options that sit just outside the traditional equities space are resonating with some institutions. For those wary of surrendering higher fees for strategies constrained by tracking error and index weights, long alpha and shareholder activism hedge funds offer a bolder, purer flavor of active management that aims to outperform global equity markets over a multi-year investment horizon.

The following thoughts offer an initial assessment of the strategic nature, terms, and implementation considerations for long alpha and shareholder activism hedge fund strategies.

Long Alpha Strategies

The protracted impact of low interest rates and quantitative easing has led to sustained gains across most long-only indices and ETFs. Increasingly steering global asset flows into these products, many investors have developed muted expectations for hedge fund managers that deploy short selling as a tool for return generation. One response that has emerged from many blue chip long/short equity and multi-strategy hedge funds is to offer investors the long equities sleeve of their flagship strategies as a standalone product, blurring the lines between hedge funds and traditional active equity managers.



Recognized for their ability to attract and retain the world's top talent, hedge funds offer investors a research edge channeled towards generating long alpha within truly active, unconstrained portfolios. Deploying value, growth, or hybrid approaches across multiple sectors of expertise, investment teams build positions across a more concentrated group of companies while avoiding unattractive industries altogether.

Long alpha strategies offer a departure from the standard "2&20" fee paradigm, which is a hot button topic for many institutions. In contrast, the typical terms for long alpha strategies attempt to align manager incentives more strongly with alpha generation, while additionally offering flat management fee options. The following represents typical terms for these offerings based on RVK's extensive dialogue with managers, primer brokers, and institutional allocators.

Typical Long Alpha Strategy Terms

	Management Fee	Performance Fee	Liquidity	Notice Period
Flat Fee Model	1% to 2%	0%	Monthly or quarterly	30 days to 90 days
"Outperformance" Model	0%	20% to 30% Only assessed on outperformance above benchmark	Monthly or quarterly	30 days to 90 days
Hybrid	0.5% to 1%	10% to 20% Only assessed on outperformance above benchmark	Monthly or quarterly	30 days to 90 days

Shareholder Activism Strategies

Introduced by economist and philosopher Adam Smith, the "Agent vs. Principal Problem" elegantly highlights the cardinal tenet behind shareholder activism:

> *"The directors of joint stock companies, however, being the managers rather of other people's money than their own, it cannot well be expected that they should watch over it with the same anxious vigilance as owners. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company." Wealth of Nations, 1776*

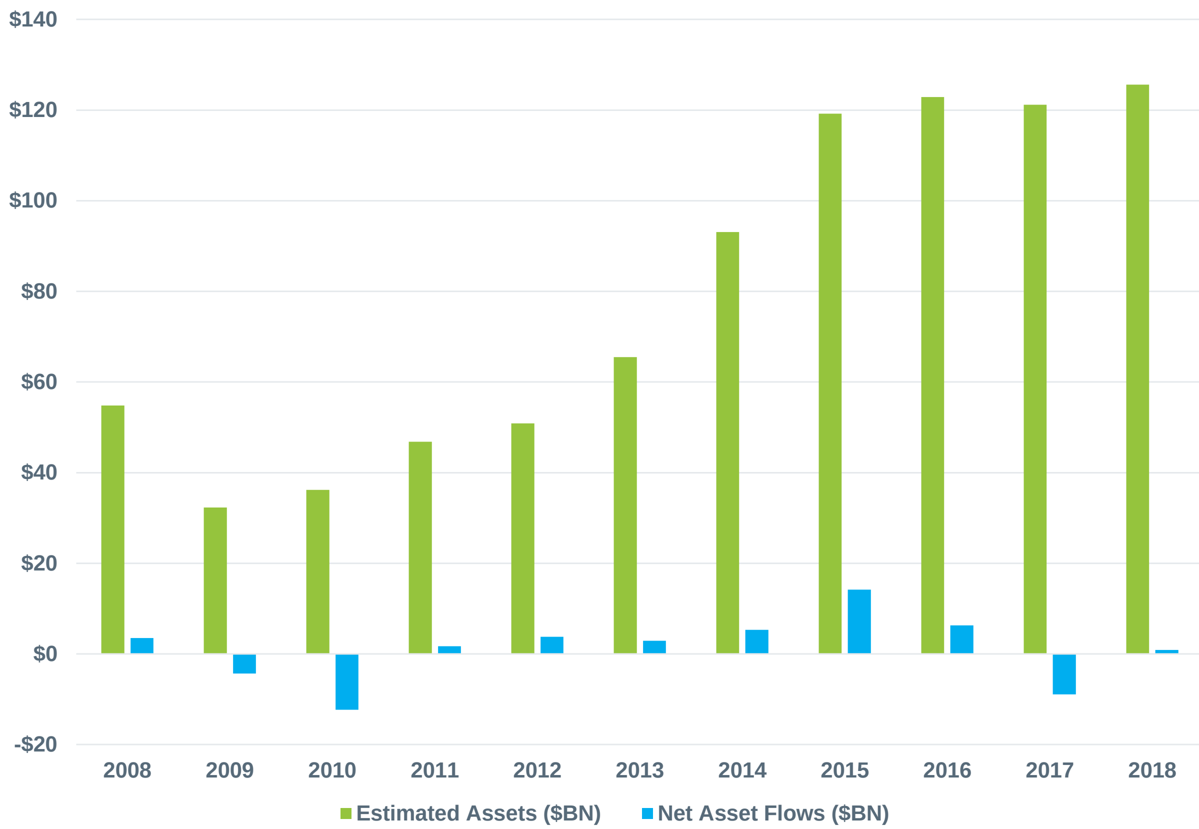
Activists serve as a primary catalyst for unlocking value within identified public companies through engagement with those companies' management teams and boards of directors. They are, in a sense, bringing the owner's voice closer to the decision-making process. After an ideal candidate for shareholder activism is identified, the investment team proposes a course of action to company management.

Levers for Value Creation

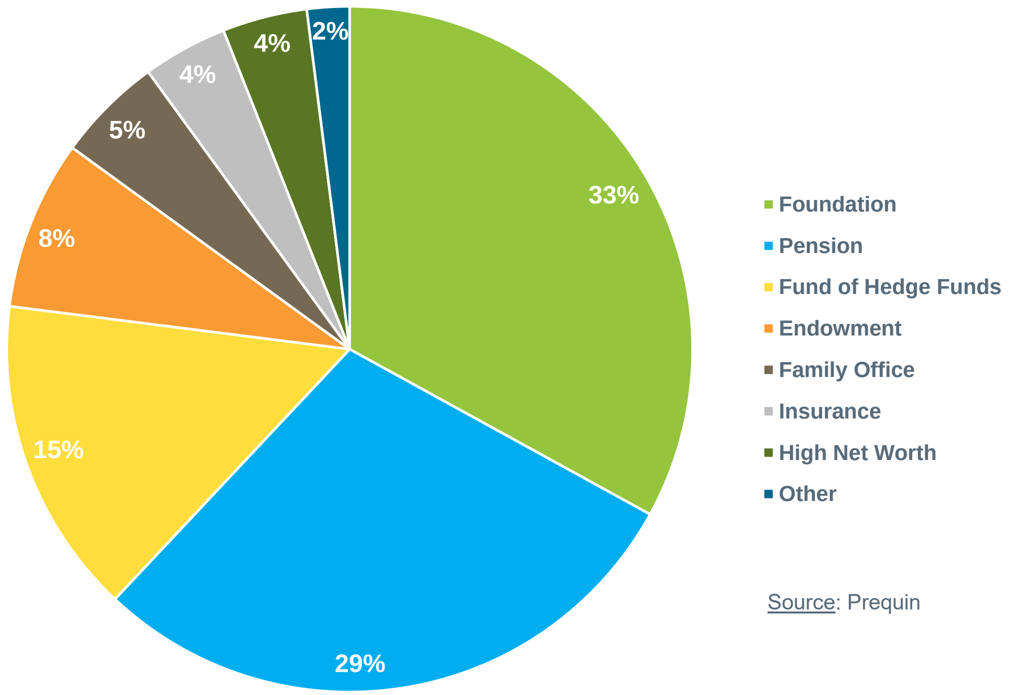
- Operations - Cost reduction programs, revenue growth initiatives, productivity measurement, improved investor relations.
- Strategic Transactions – Merger, acquisitions, divestitures, joint ventures, private company sales (LBOs), public company sales.
- Capital Structure - Share buybacks, alternative security structures, debt refinancing, dividend policy, equity infusion (PIPES).
- Management/Board - Recruitment of C-Suite talent, strengthening incentives systems, direct board participation, governance or policy changes.

While a small handful of headline-grabbing activists rely on a more adversarial approach that can include public letters criticizing management or proxy contests, many managers prefer constructive collaboration and a behind-the-scenes campaign for unlocking shareholder value that has proven to be highly effective.

Staying power to successfully navigate multi-year activism campaigns requires a stable investor base committed within longer lockup share classes. Additionally, investors who acquire over 5% of a company's common stock or participate on investment boards are subject to strict SEC trading restrictions. While portfolios are comprised of public equities, the activist's approach to unlocking company value and long field of vision more closely resembles private equity strategies. Mainly represented by institutional investors, shareholder activism strategies have experienced tremendous asset growth over past decade.



Source: Hedge Fund Research (HFR)



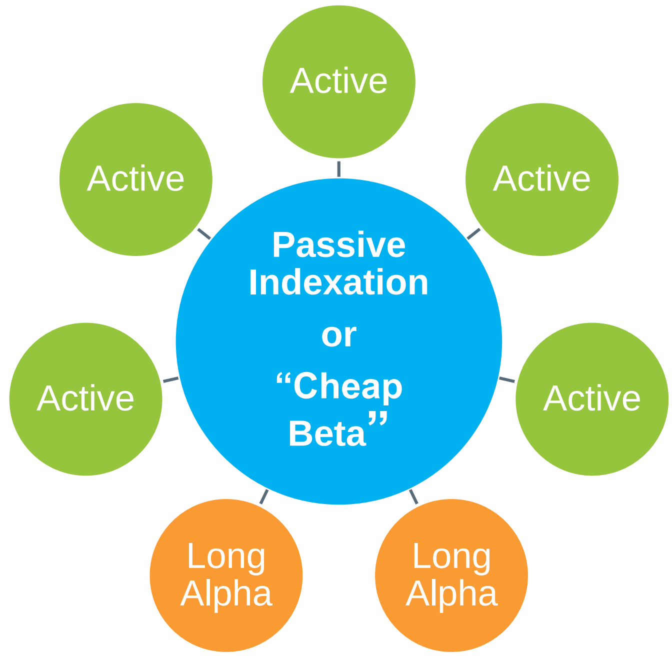
Typical Activist Strategy Terms

	Management Fee	Performance Fee	Liquidity	Notice Period	Optional Co-Investments
Classic Hedge Fund Structure	2%	20% Crystallizes quarterly	Quarterly	45 days to 90 days	No
Rolling 3-5yr Evergreen Structure	1% to 2%	20% (Pending 6-8% hurdle) Crystalizes at end of term	Multi-year term Option to re-subscribe	45 days to 90 days	Yes Mgmt. fee waived
Fixed Term Drawdown Structure	1% to 2%	20% (Pending 6-8% hurdle) Crystalizes at end of term	Finite term length Callable commitments	N/A	Yes Mgmt. fee waived

Portfolio Implementation

A growing trend with institutional investors that adds depth beyond the classic “style box” approach to equity portfolio construction is the inclusion of a core/satellite framework striking an allocation balance between passive indexation and truly unconstrained active managers

Essentially, the investor's risk budget for tracking error and volatility shifts to a satellite group of "high octane" active managers, while the core constituents are represented by passive indexation strategies serving as the main source of "cheap beta" equity market exposure.



Although long alpha and shareholder activism funds are housed within limited partnership structures, the nature of both strategies alleviates the bucketing debates that are more prevalent with their hedged counterparts, such as long/short strategies.

In most cases, both strategy types are comprised of unlevered long equities that seek to generate excess returns beyond a respective equity benchmark. While some institutional allocators have historically designated these strategies as part of an equities allocation, others have housed them within an alternatives bucket alongside other hedge fund investments. Sharing characteristics of active equity management and less-liquid private strategies, both bucketing approaches can be reasonable, provided there is a solid understanding of the risk and return objectives highlighted above.

While the overall objective of equity market outperformance is initially attractive, institutional investors need to judiciously evaluate the risk/reward tradeoffs involved. While long alpha and activist hedge funds may be a viable solution for some, reduced liquidity, high tracking error, and increased fees can make them unsuitable for others. Additionally, participation in limited partnership structures is always accompanied by a higher administrative burden.

Conclusion

Both long alpha and shareholder activism can represent an effective solution for investors seeking truly unconstrained active equity management. Employing highly differentiated investment approaches, these strategies aim to achieve significant equity market outperformance over multi-year investment horizons. While not appropriate for all, these strategies are worth exploring as a potential source of robust, long term alpha generation within the institutional investor's portfolio.

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