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Jabre Capital Partners is one of the industry's best-known hedge funds. Co-founded in 2006 by Philippe Jabre, Mark Cecil and Philippe Riachi, the Geneva-based hedge fund runs a variety of strategies that include: Multi-strategy, Equity Long/Short, Credit Long/Short, Convertible Bonds and Emerging Markets.

Liquidity management is very much at the core of Jabre Capital's investment philosophy. Granted, the level of market volatility has been somewhat subdued over the last year or so. The VIX Index spiked following the Brexit vote last June, reaching 25.76, and spiked again in November to 22.51 following the US election, but in general it has remained range-bound between 10 and 15.

All of which would suggest that focusing one's attentions purely on the more liquid end of the spectrum is overly conservative. But anyone with the same experience of Philippe Jabre knows only too well that it only takes an unexpected market shock to rattle investors.

"Liquidity is a key driver of the investment process and always has been. Philippe has been trading the markets for 35 years and knows full well how quickly markets can change. We adjust to such conditions by focusing on the very liquid end of the spectrum: large-cap stocks, investment-grade bonds, we don't touch distressed bonds or small-caps; indeed, we rarely have a material allocation to mid-cap stocks," says Cecil.

One of the more challenging trends in the hedge fund industry in recent years has been the desire for liquid hedge funds to gather large amounts of assets to trade the markets. Some managers have not been willing, or able, to exercise restraint in the best interests of the investment strategy.

At Jabre Capital, the opposite is true. Its Emerging Markets fund, for example, has judiciously maintained an AUM of approximately USD300 million for the last nine years. Some might argue that this is because investors have shown no interest in Emerging Markets but this is missing the point. Some investment strategies are not designed to run beyond a certain AUM. Jabre Capital has made a point of maintaining the fund at around USD300 million to optimise the investment program.

It is only recently, given the increased opportunity set for Emerging Markets, that they have decided to grow the fund modestly to USD400 million or USD450 million.

"What you will never see us do is run a huge EM fund because neither the asset class, nor our investment style, allow for that," explains Cecil.

"We saw a complete turnaround in the second half of last year with respect to emerging markets. Opportunities presented themselves at single stock and thematic levels and part of that was down to uncertainty over the outcome of the US election. Investors are beginning to focus more on fundamentals and thankfully the markets are showing signs of behaving in a similar way."

The reason for referring to the growth of some hedge funds as a challenging trend can be tied to the fact that performance across the hedge fund industry, in recent years, has been lackluster to say the least.

Following 2011, investors re-assessed the way they invested in hedge funds and embraced the consultant community to give them an extra level of comfort. In turn, the consultant community looked to larger managers that were more likely to provide lower volatility, which in some instances led to lower returns.

Since the summer of 2016, however, that approach has changed as institutions have come to realise its limitations.

Such has been the effect of central bank intervention in a bid to stimulate economic growth that investors have become exasperated by lackluster returns in their hedge fund strategies "because they have persisted in all-market conditions," says Cecil.

There has, he says, been a shift in mindset such that investors are looking more carefully now at smaller managers to target higher returns.

"Managers like Jabre Capital are beginning to see consultants and investors that they haven't seen for some time coming back to engage in dialogue. This in turn is leading to new inflows.

"There was a worry that the very largest hedge funds would continue to grow unabated on the back of consultant-led institutional allocations. I think these same institutions are now beginning to broaden their horizons to encompass medium-sized managers in the USD1 billion to USD5 billion AUM range, who are probably better positioned to capture stronger upside returns," suggests Cecil.

There is a suspicion that some managers have become asset gatherers rather than alpha generators. There is a sweet spot in a fund's size. What you don't want is any business risk with the manager such that they can continue to compensate their staff during lean periods of performance.

"For hedge fund firms below USD500 million, it is quite tough to avoid having an overhang of uncertainty with respect to business risk. Once you get beyond USD10 billion, you perhaps have to wonder whether the focus moves away from performance because the management fee becomes a meaningful profit centre.

"At that level, the management fee covers all the manager's overheads comfortably and becomes a key driver of profitability. That's not to say that performance is completely overlooked, of course not, but the level of hunger is perhaps not quite the same compared to a mid-market manager," says Cecil.

Such was the level of dissatisfaction last year that an estimated USD110 billion of net outflows were recorded, according to Preqin, despite a more positive level of performance, which saw the average hedge fund return 7.4 per cent.

"It has been a difficult environment for hedge fund managers to move ahead of the index. But in the last six months, there has been a breakdown in correlations and a greater disparity between sectors and regions partly due to divergence in central bank policy (e.g. US versus Europe). That plays into the hands of active stock managers.

"I think we are now moving into an environment where hedge funds can outperform the indices. I think we will see a reversal of the trend among investors towards illiquid strategies, which have become `en vogue'. We are already starting to see evidence of investors considering EM strategies. Six months ago they were generally frowned upon. There was just no interest," says Cecil.

There is no doubt that increased focus among institutions on the mid-market will be beneficial to the hedge fund industry as a whole. Quite how institutions will allocate remains to be seen. Some will be comfortable taking commingled risk, some will opt for customised managed account programs to mitigate risk.

One theme that Cecil believes could emerge over the next two to three years is more joint ventures and branding partnerships between good quality, medium-sized managers who are looking for assets to give their business models more resilience, and platforms/private banks who are looking for talented fund managers to support HNW institutional investors.

"I think this will be an exciting trend. However, I don't envisage that they will take equity stakes in fund managers. Rather than just being a third party investor in the manager, it will be more of a partnership arrangement with a fee sharing agreement in place.

"Ultimately, to attract the biggest institutions, mid-sized managers need to grow their assets and this could be one such solution," concludes Cecil.

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