

**Michael Murray** a partner at Shoreline Trading Group explains how its service for medium-sized hedge funds is founded on an initial solid base

# Solid as a rock

**HFM** How would you view the current East Coast prime brokerage market? How much growth has Shoreline Trading experienced over the past year?

## **Michael Murray (MM)**

The prime brokerage market has exploded over the past three years. In particular, the mini-prime brokerage segment where we focus. This segment is defined as hedge funds that do not meet the minimum requirements based on assets under management (AUM), trading volume, and financing needed to go directly to the end custodian – companies such as Goldman Sachs or Bear Stearns.

### **Growth factors**

This growth has been driven by a few factors. First, investors have become more sophisticated and are constantly looking for new and different trading ideas and investment vehicles. Second, the fund structure is attracting the brightest financial professionals, such as analysts, proprietary traders and money managers, because they want to participate in the financial upside of their own ideas and skill sets. In light of these factors, the Tower Group predicts hedge fund assets will grow at an annual rate of 15% over the next two years. It is this capital flow into the market that allows for managers to start new funds.

Our current inquiry level from professionals with new funds is twice that of last year. We believe being located in New York gives us access to these experienced financial professionals. There is a tremendous concentration of hedge

fund assets in Greenwich and New York alone. Shoreline Trading is well positioned to take advantage of these developments.

**HFM** Shoreline Trading is a mini-prime broker. What exactly is your role and why are you successful?

**MM** Shoreline Trading offers a unique service to new and mid-size hedge funds. We have invested in establishing clearing relationships with Goldman Sachs Execution and Clearing and Bear Stearns Securities Corporation so the client can choose which company they are most comfortable with as custodian.

This special relationship affords our clients access to the traditional prime brokerage services of these two firms. The customers' assets are protected by the clearing firms' balance sheet as well as our own and in addition include clearing and custodianship, securities lending, technology-trading systems and back-office reporting. And, therefore, no better advantage when talking to investors than a manager being able to accord custodianship to Goldman and Bear.

Shoreline is successful because of our people. The group we have assembled over the past 10 years has on average over 15 years' experience and a variety of financial backgrounds. Our clients deal directly with these professionals who take the time to explain and educate processes. There are many questions we can answer and situations unique to smaller funds that can be avoided.



Michael J Murray is a partner at Shoreline Trading Group. Shoreline has two New York offices in lower Manhattan in addition to Los Angeles and Santa Monica, CA.

You should not underestimate the value of that relationship. Personal service is what enables Shoreline Trading to stand out from other companies.

**HFM** What services does Shoreline Trading provide beyond access to the clearing firms?

**MM** The additional services are extensive. We want our clients to leverage our experience and focus on what they know how to do. That is what this business is about.

We have built long-standing relationships with top-tier law firms, accountants, compliance firms and fund administrators who we in turn introduce to our clients. I cannot stress enough the importance of engaging experienced service providers to assist in implementing a proper infrastructure.

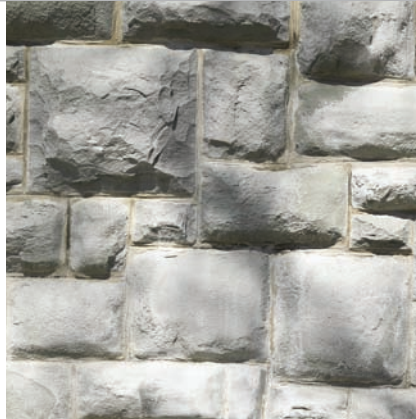
We also provide additional trading services. A new fund manager typically wears many hats. They are not just the trader for the fund, they are the fund. Yes, they are making the trading decisions, but they are also raising capital and managing existing investors.

### Third-party marketers

One of the most frequently asked questions from start-up hedge funds is, "Can you raise me money?" Due to this, we provide introductions to third-party marketers. Anyone who tells you they can raise money for your fund in a short time-frame is more a slick salesman than a forthright service provider. It takes at least 12–18 months to progress to any sort of marketable status and you need to be doing all the right things during that period. After that, third-party marketers that are comfortable with you, your strategy and your infrastructure may begin to introduce you to their relationships with institutions, fund of funds and high-net worth individuals.

**HFM** Do mini-prime brokers have minimum AUM requirements?

**MM** As a mini-prime broker, our target clients are generally smaller than those targeted by larger prime brokers. The fund's AUM,



trading activity, the manager's history, the fund's track record and the style of trading are all factors that any prime broker looks at. But our AUM threshold is significantly lower than that of a Goldman or Bear. We still look to ensure the fund is managed by an experienced person and the clients need to meet industry regulations. But we don't require a specific AUM and do not base our decision solely on AUM or trading minimums.

**HFM** What if a manager is in need of agency execution? Is that a mini-prime broker function?

**MM** We consider agency execution a major function of a mini-prime broker and pride ourselves on knowing how to process an order. An experienced agency trader is a critical compliment to any electronic execution platform. Our New York-based equity and options business consists of seasoned Goldman Sachs veterans and a team on the floor of the American Stock Exchange (AMEX). Orders are executed exclusively on an agency basis. We do not have a prop desk to position against you or to get in the middle of your trade.

At Shoreline Trading, managers can lay off their trading to our agency team. Our experienced agency traders have the ability to move in and out of positions seamlessly by monitoring institutional order flow and finding natural buyers and sellers.

Another advantage that Shoreline Trading gives, especially to exchange-traded funds (ETFs) and options traders, is seamless access to the floor of the

AMEX. Our team gives clients colour in the products that they trade. ETFs and options have become very popular in the past few years and more of our clients are trading them. With the relationships that we have built, we provide the possibility of mid-market execution on each trade and the ability to execute large equity and option orders they might not be appropriately sent electronically.

**HFM** From your position as a managing director of Shoreline Trading, what advice do you give to new hedge fund managers and how they can differentiate themselves?

**MM** Over the years I have seen what works and what does not. Any fund can be broken down to four basic elements: a strategy, performance, communications and infrastructure. All four need to be thought out and executed to become a successful fund.

It might surprise you, but a 2003 study by CAPCO concluded nearly 50% of hedge fund failures were the result of weak infrastructure and poor operational management. A surprisingly low 38% of hedge funds failed as a result of investment risk alone. An investment genius may fail because he cannot run a business. I think establishing a solid infrastructure at the beginning is a critical decision. It is very important to engage service providers who have experience of creating hedge funds.

About 50% of new funds claim a long/short equity strategy. So being able to clearly identify your story is important. Communicate your business to investors on a regular basis. Risk practices should be just as clear – concentrations, drawdowns, and relative spread movements. Many managers think they need outsized returns to raise funds. I think you need strong absolute returns, not outsized returns.

Managing a small to mid-size hedge fund is an extremely competitive undertaking. To give yourself an advantage, you need to have as many tools as possible at your disposal. Shoreline is dedicated to making these tools accessible to you.