BOREALIS
STRATEGIC CAPITAL PARTNERS, LP

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"Wait, What?": Good Things Come To Those Who *Don't*

Performance, Risk, and Survivorship of Early-Stage Hedge Fund Managers

Three Key Takeaways

Early-stage outperformance is real

Across 2,886 funds (1,937 active + 949 shuttered funds), the data show a nearly 4% performance premium during the first 36 months of a manager's lifecycle, highlighting that the strongest returns often occur early, before asset growth and organizational complexity begin to affect the investment edges.

It comes with less risk

Volatility in the first 36 months is actually lower than the full track record average (11.7% versus 12.3%), which is quite counterintuitive.

Yet sustainability requires taking risk

Within the cohort of new launches, the ones which thrive embrace risk to generate returns. Taking too little risk is a surer pathway to failure.

PivotalPath Data

We analyzed the 2,886 hedge funds (1,937 active + 949 shuttered funds) covered by PivotalPath dating back to 1990.

While all hedge fund data sets carry selection and survivorship biases, PivotalPath's inclusion of shuttered funds (nearly one-third of the universe) helps mitigate these effects. Moreover, the database tracks managers both open and closed to new capital, capturing a more representative view of the hedge fund landscape.

Observations

Performance: Early-Stage Managers vs The Field

- Across all funds, the average annualized return is +8.5% (median +7.7%), but in the first 36 months that rises to +12.3% (median +10.0%) – a nearly 4% premium that highlights a consistent lifecycle pattern: managers deliver their best returns in the early days.

Annualized Return

	Average	Median
First 36 Months	+12.3%	+10.0%
Full Track Record	+8.5%	+7.7%

This nearly 4% premium in early performance underscores a notable lifecycle pattern: the best returns often occur early, before growth in assets and organizational complexity alter the investment edge.

Why the Early-Stage Manager Premium Emerges

- **Portfolio:** Smaller asset bases enable managers to exploit capacity-constrained opportunities, maintain concentrated conviction, and stay close to their process.

- **Behavioral:** With asymmetric career risk – strong early results can launch a franchise, while mediocrity can end it – early-stage PMs operate with heightened focus and urgency.

Risk Characteristics of Early-Stage Managers

Institutional allocators often assume that investing early in a manager's lifecycle entails outsized risk relative to established funds. Yet the data show otherwise. During the first 36 months, the average annualized standard deviation was 11.7% versus 12.3% for the full track record – slightly lower, not higher.

Annualized Standard Deviation

	Average	Median
First 36 Months	11.7%	9.2%
Full Track Record	12.3%	10.1%

This suggests that early-stage managers' outperformance is not achieved through reckless risk-taking. Instead, these managers often display measured volatility – taking enough risk to generate meaningful alpha while maintaining strong downside discipline.

Addressing the paradox of higher returns AND lower risk

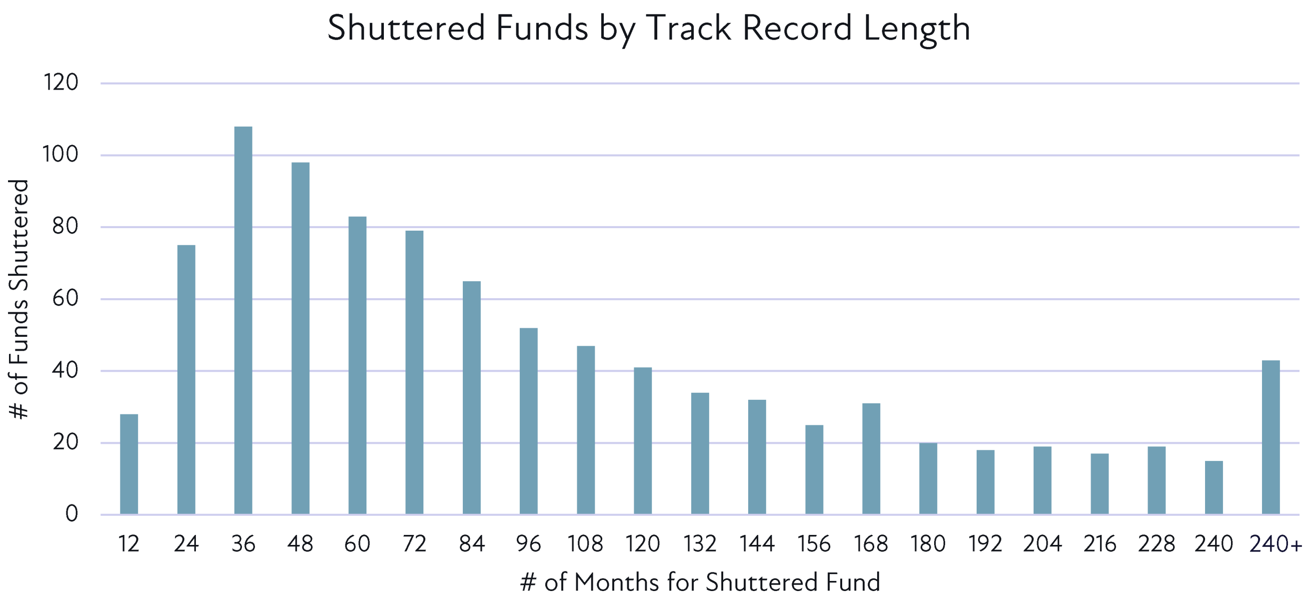
- **Portfolio:** PMs building new portfolios are often better positioned to carefully underwrite all of the risks in the portfolio as they build it from scratch. As funds mature and decision-making becomes more decentralized, hidden risks and stale positions may lurk in the portfolio causing unintended volatility.

- **Behavioral:** With PMs of newly launching firms fully invested in their new venture, the fund performance – not management fees – is often their primary source of income so they are particularly sensitive to downside volatility as it can materially affect their lifestyle.

Survival of the Fittest

This is where it gets interesting, and perhaps not obviously intuitive – while we have established that early-stage managers are modestly less volatile, the data suggests that within this cohort, success or failure is determined by taking enough risk to generate returns. Some early-stage managers need to be encouraged to embrace risk to meet the return thresholds needed to have a lasting business.

Among the 949 shuttered funds in the PivotalPath data, the most significant hurdle is the 36-month mark.



Not surprisingly, the funds that survived beyond five years generated stronger returns out of the gates. In looking at the 2,515 funds that launched on or after 2005, survivors had an average annualized return of +13.8% during the first 36 months, as compared to +5.4% for those that failed.

Perhaps more surprisingly, the managers that failed have a lower risk-taking profile, on average, than those that survived – they appear to have failed to take enough risk to produce compelling results.

Survivors vs Failed Funds (First 36 Months)

	Annualized Return	Volatility
Survivors	+13.8%	11.9%
Failed	+5.4%	10.0%

The average volatility for survivors was 11.9%, as compared to 10.0% for those that failed. This increase in risk appears to be reflected in conviction rather than recklessness as survivors demonstrate superior risk-adjusted performance, with a return-to-risk ratio of 1.16 (13.8%/11.9%) versus 0.54 (5.4%/10.0%) for failed funds.

Common traits of long-term survivors:

- Early annualized returns above 10% in the first 36 months
- Volatility between 10–15%
- Sharpe ratios above 0.8
- Clear articulation of investment edge
- Demonstrated ability to manage risk across environments

Application of Observations

Implications for Allocators

Institutional allocators often prioritize long track records, scale, and operational maturity – yet these very filters can exclude the highest-return opportunities. The managers building tomorrow's successful franchises are delivering their best results today, while they remain small, agile, and capacity unconstrained.

Allocators can capture this alpha opportunity with a pragmatic playbook:

- **Dedicated sleeve**: Establish a defined allocation to early-stage managers and execute on it professionally – either internally or with an external program.
- **Size, then scale**: Begin with smaller allocations, set clear re-underwriting milestones, and scale before capacity constraints emerge.
- **Diversify the early bucket**: Allocate to a collection of high-conviction, eclectic early-stage managers to capture the aggregate premium.
- **Underwrite measured volatility**: Evaluate return/vol and downside control, not absolute volatility aversion to ensure the new manager is positioned to take enough risk to deliver the early-stage manager alpha.
- **Business durability checks**: Evaluate governance, operations, and runway – without letting rigid process hinder high-upside outcomes.
- **Watch for the "incentive pivot"**: As a manager's track record lengthens, watch for subtle or significant changes that could erode the manager's original edge (position size, capacity discipline, PM proximity to portfolio); be willing to redeem before a performance drawdown if the thesis is no longer intact.

Implications for Early-Stage Managers

For early-stage managers, the message is clear: the first three years often define the firm's trajectory. Success depends on maintaining focus, alignment, and conviction during this critical window.

To position themselves for success, new managers should:

- **Build a firm focused on three things – performance, performance, performance**: Dedicate time and resources to generating excellent investment results – everything else is secondary.
- **Maintain alignment**: Make a substantial personal investment in the fund to align incentives with investors – be committed and demonstrate that to investors.
- **Embrace concentration**: With capital markets fairly efficient, be unafraid to express conviction when there is an edge; running an overly diversified portfolio to offset risk can bring unintended risk.
- **Keep it simple**: With time and success the allure of organizational expansion may be enticing, but it can often dilute focus and returns. Don't lose sight of what made you successful.

Conclusion

The evidence is clear: talented hedge fund managers deliver their best returns early.

The challenge for institutional investors is not whether early-stage managers can outperform – it's whether their processes allow them to capture that opportunity before it dissipates.

Likewise, for early-stage managers, the early years represent both the greatest risk and the greatest opportunity to define their future trajectory.

For both allocators and managers, recognizing and acting on these lifecycle dynamics can unlock some of the most attractive risk-adjusted opportunities in the hedge fund universe.