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Harvest Stands Out In Long/Short Hedge Fund Space

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Publicly traded hedge funds are tricky investments, but Harvest Capital's steady performance is helping to make its broker-dealer parent a compelling play.

Jeff Osher's $418 million Harvest Small-Cap Partners Fund has been churning out gains of better than 16 percent a year since he started up his fund in December 2005, and the fund soared 19 percent when the world was collapsing in 2008.

Since his fund is closed to new investors, the next best way to gain exposure to his fund and its long/short strategy may be to buy the San Francisco-based boutique brokerage that owns Harvest—JMP Group [Ticker: JMP].

"I can't own the stock in my fund due to potential conflicts," says Osher, "but if I could, it would be one of my largest positions."

One may wonder about such endorsement considering Osher's professional and familial link to the firm (his uncle is the CEO).

Subsequent conversations with firm CEO Joe Jolson and analysts, and a review of the facts, have made it easier to understand Osher's enthusiasm.

- Harvest Capital runs $2.1 billion worth of hedge funds, whose managers were all trained in Osher's style. Harvest's fees have on average represented 20 percent of JMP's earnings.
- JMP is one of the largest boutique broker-dealers in the country.
- The company announced in August conversion of its corporate status to a publicly traded partnership (PTP), which means it will be distributing 50 percent to 70 percent of its earnings as dividends, potentially doubling its payout, which had been generating a 3.5 percent yield.
- Institutional investors who don't wish to own public partnerships because of tax-related issues (that don't weigh on JMP's performance) have been selling, which helped to recently drive down the stock to $6.
- JMP has been aggressively buying back its stock, having authorized the purchase of 1 million shares.
- Mindful brokerage earnings are cyclical; the doubling of trailing 12-month operating earnings in the most recent quarter is impressive.
- The $172 million market-cap stock is under researched, flying beneath most analysts' and investors' radars.

Over the past 12 months, the stock has been trading between a high of $8.42 and a low of $6, despite the recent release of a second-quarter earnings report that was in line with analyst and firm expectations.

But it soared 33 percent to $8 in early November as forced selling appears to have wrapped up and the market has begun to realize what the stock is likely to offer as a PTP.

Barrington Research analyst Alexander Paris likes the firm's near-term outlook "given the current stage of the business cycle, driven by an improving economy, and the potential accretion (not yet reflected in our estimates) from the proposed corporate restructuring." And despite the recent rally, he sees JMP still undervalued versus other alternative asset managers in terms of book value and earnings multiple. While he considers the stock an aggressive investment, Paris has a target of $9.

Owning hedge fund firms that trade as stocks is not an easy investment. They tend to fall far more than their underlying funds do when the latter are struggling. They also rise less than their funds do during good times.

And there are generic risks in owning a brokerage/asset manager. There can be departures of key personnel, slowdown in investment banking activity and contraction in commission dollars. And if Harvest's hedge funds start to struggle, clients could take their assets elsewhere.

However, JMP's brokerage business enjoys being smack dab in the middle of an equity and IPO boom. Harvest's track record is superior to virtually all other publicly traded hedge funds. The honor that was recently bestowed upon Osher—he was keynote speaker at the Ira Sohn Investment Conference—certainly didn't hurt.