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EPISODE 136:

Venture Capital Fund of Funds and the Emerging Manager Outlook with Slipstream Investors

Robert Morier: Welcome to the Dakota Live Podcast. I'm your host, Robert Morier. The goal of this podcast is to help you better the people behind investment decisions. We introduce you to Chief Investment Officers, manager research professionals, and other important players in the industry who will help you sell in between the lines and better understand the investment sales ecosystem. If you're not familiar with Dakota and our Dakota Live content, please check out our website at dakota.com to learn more about our services. Before we get started, I need to read a brief disclosure. This content is provided for informational purposes and should not be relied upon as recommendations or advice about investing in securities. All investments involve risk and may lose money. Dakota does not guarantee the accuracy of any of the information provided by the speaker, who is not affiliated with Dakota. Not a solicitation, testimonial, or an endorsement by Dakota or its affiliates, nothing herein is intended to indicate approval, support, or recommendation of the investment advisor or its supervised persons by Dakota. Today's episode is brought to you by Dakota Marketplace. Are you tired of constantly jumping between multiple databases and channels to find the right investment opportunities? Introducing Dakota Marketplace, the comprehensive institutional and intermediary database built by fundraisers for fundraisers. With Dakota Marketplace, you'll have access to all channels and asset classes in one place, saving you time and streamlining your fundraising process. Say goodbye to the frustration of searching through multiple databases and say hello to a seamless and efficient fundraising experience. Sign up now and see the difference Dakota Marketplace can make for you. Visit dakotamarketplace.com today. I am thrilled to welcome to the show, Alex Edelson, founder and general partner of Slipstream Investors, a venture capital fund of funds focused on investing in small pre-seed and seed stage venture capital strategies. Alex, thank you so much for being here. We appreciate you being in Philadelphia.

Alex Edelson: Thank you so much for having me.

Robert Morier: Welcome to the studio.

Alex Edelson: Thank you. My first time in a studio.

Robert Morier: Getting used to the lights.

Alex Edelson: Yes, this is-- I feel like I'm in the big leagues here.

Robert Morier: It's real. We could either be talking about venture capital or calling a baseball game. That's right. So, we've got options. Nick Butts from Dakota, thank you for joining us again on the show.

Nick Butts: Great to be here. Thanks for having me.

Robert Morier: Thanks for being here. It's really a pleasure. I know we have a lot of questions to ask Alex. Before we do, we're going to read your background for the audience. Alex Edelson brings a unique blend of legal expertise, operational leadership, and investment acumen to the venture capital world. He founded Slipstream Investors in 2021; a venture capital fund of funds focused on small seed and pre-seed stage venture capital strategies. Slipstream also provides investors access to top performing, early-stage VC funds that are typically difficult to source or evaluate. Before launching Slipstream, Alex served as Chief Operating Officer, Chief Strategy Officer, and general counsel at QED Investors, a leading fintech focused venture capital firm managing over $4.3 billion in assets. He began his career as a federal law clerk for Judge Joel M. Flaum on the US Court of Appeals for the Seventh Circuit and has practiced law at prominent firms including Kellogg Hansen and Robbins Russell. Alex earned both his BA in economics and political science and his JD magna cum laude from the University of Michigan, where he was inducted into Phi Beta Kappa and served as a note editor for the Michigan Law Review.
Alex, thank you so much for joining us here today. Congratulations on all your success. And congratulations on launching Slipstream in the last couple of years.

Alex Edelson: Thank you so much.

Robert Morier: So, it sounds like when you were at QED, you were chief everything. So how were you able to narrow the scope at that point in your career?

Alex Edelson: It was an interesting role. It included being Nigel Morris's chief of staff, who runs QED. And yeah, the role kind of evolved to a broad operational role, working closely with him, and then working closely with our operations team, our investment team, and then there was an external component, too. So, I don't think I successfully narrowed that role. It was a pretty broad role.

Robert Morier: It sounds like it.

Alex Edelson: But it was a great opportunity for me to learn the business of venture, and to learn how to run a venture firm, and yeah, I mean, I feel really fortunate to have had that experience. And frankly, I probably wouldn't have wanted it narrower because I got to be involved in so many aspects of it.

Robert Morier: Yeah, that's wonderful. Well, you started your career in law, which is interesting, particularly in venture capital. Not uncommon to see owner-operators make their way into VC. But lawyers are a little bit different. But you found your way into it. So, can you walk us through how that transition unfolded for you in terms of your career?

Alex Edelson: Yeah, it's sort of a circuitous story that doesn't make a lot of sense. The story is I was looking to get out of law for many years and then finally got out when I joined a friend's fintech startup. It was two years old at the time, roughly two years old. A very close friend, I joined the company, didn't work out as we hoped. And then I fortunately found my way to QED, starting as Nigel's chief of staff, and then my role kind of evolved from there. And while I was there, I saw an opportunity to start Slipstream and decided to leave QED at the end of 2020 and started Slipstream in '21. And yeah, it was based on a lot of learnings and observations I had at QED.

Robert Morier: Why did you decide to go to law in the first place?

Alex Edelson: My dad was a lawyer. My brother was going into law. I think there was some inertia in that direction. I think I believed at the time-- and I still believe, it's a door opening start to a career. It gave me really great perspective. I mean, it's so trite to say learn how to think. But I do feel like I developed my ability to think analytically, and critically in writing, and reading, and important skills. It also helps you learn things quickly. You're constantly learning new sets of facts, new areas of law. That was really valuable. And I was drawn to, I think, the ability to develop a real expertise in something that is valued in society. I felt like there wasn't a limit on what could happen after going to law school. There are a lot of things that lawyers do after going to law school or practicing for some period of time. You have some advantages with a legal background. And I am probably giving myself too much credit to say I was thinking that far. But maybe at some point, I was. I honestly just thought I would enjoy it. And I thought I would enjoy practicing law based on what I knew about it. And I thought I would enjoy learning law. And yeah, I did figure out, relatively quickly, this is probably not the long-term fit.

Robert Morier: Did you find your time at the University of Michigan, you did both your undergraduate and law degrees there, did you know at that point, that was going to be the career path? I mean, obviously the law degree, but undergraduate, you knew that was going to be the direction. Did you get any exposure to finance or investments in undergraduate?

Alex Edelson: Econ and Poli Sci undergrad. Maybe I could make an argument about Econ, but it would be pretty attenuated. So no, I don't think in undergrad, I was really thinking about this or investing in general. Undergrad, for me, was more about can I develop a skill set and network in a perfect world that can be helpful later on? Poli Sci, to me, was more about reading and writing than it was about the subject matter. And Econ, similarly, was about math, and problem solving, and thinking about certain types of problems. But it wasn't so much like, oh, I want to do this for the rest of my life.

Robert Morier: If you met your younger self back at the University of Michigan, what advice would you give you then that you know now?

Alex Edelson: What I thought in undergrad was you get one shot. So, if you do undergrad or grad school at a high level, it creates opportunities for you down the road. And so, I should make the most of this. If I do really well here, no one will ever be able to take that away. And that can create opportunities for me down the road. And so, I actually took it seriously. And I guess looking back, maybe I could have had a little more fun. But yeah, I felt like now's a unique time in my life, and I should make the most of this from an academic and network perspective. And so, I spent time with students who were interested in things I was interested in, and I took school seriously. But this sounds pretty lame. It sounds like I wasn't a cool kid in college, which is sadly true.

Robert Morier: It's OK. I was there too. I was not a cool kid as well. I studied history. And I didn't think that I'd be going into investments. I had no exposure to investments. If you would have asked me, or if I would have been asked to give myself advice, it probably just would have been, do what makes you happy and figure it out from there. Opportunities will come up. But I think that's a very honest answer. So, I appreciate it.

Alex Edelson: It's honest.

Robert Morier: Well, how has that legal lens, then, influenced the way that you evaluate deals today? So, when you think about conducting diligence and downside protection, particularly downside protection, how has that legal acumen and experience helped in those regards?

Alex Edelson: In diligence. I'd say maybe three ways most frequently. One is sometimes; I do a lot of reference work. A lot of my work evaluating managers is we're evaluating folks who have limited track records. And so, you're doing a lot of reference work and testing for qualitative criteria. And so sometimes I feel a little guilty because I am almost deposing people in a friendly way. But I am walking them to where I want. And then we get to the important stuff, and it gets real. And I don't mean to sound like it's so strategic or calculating, but I do feel that side of my personality come out sometimes like, oh, this is how you want to build to this topic. And I do think it ends up getting real information, which is helpful. It happens when I'm comparing notes on a manager and, specifically, I'm talking to another LP, and we all did references on a particular GP. And maybe we talked to some of the same founders or other folks, but we got very different feedback. That is really interesting to me. It is not uncommon. That happens to me all the time. And the most common way that happens is the person I'm talking to says we talked to lots of founders, and it was so positive, it was all positive. And I'll say, man, I talked to a lot of people too. And I got a lot of negative and some recurring themes. And I

sometimes wonder, what happened? How did that happen? And I think maybe this is part of that story, but I'm not on their calls. I don't who's doing them on their team, it's hard for me to know. But that is one impact. Another is at what point do you stop, in law, I think the way I thought about research was you stop when you're no longer learning new things, when you feel like you have a sense for what's out there, and you could read more cases, but you're not learning new things. And I have a similar approach now. I could do a zillion references, but if I stop learning new things, at some point, this isn't a good use of my time. This is not respectful to the people who I'm asking for help from. This isn't really nice to the GP because I'm utilizing their network's time. And so that principle is in my mind when it comes to diligence. I don't keep going when I'm no longer learning new things. Downside protection, it's really interesting. As a lawyer, you're so focused on what are all the possible ways this could work out negatively? And do we have answers in case any of these risks materialize, we should be prepared for all of these things. And what I find is you end up focusing so much on the negative, what I do now is a little more fun for me in then I think more about the positive. And I can be realistic about the negatives. Could we tighten up something in an LPA that is very unlikely to materialize? Sure. But is this a good use of anyone's time? If I could step back, I would say, I am very comfortable with thinking through, in a complete way, the potential negative outcomes, and figuring out which ones we actually need to address, and which ones we don't, and we shouldn't spend that much time worrying about it. But what I've learned over time and really enjoyed is no, let's focus on what we can build here. Well, let's focus on what can go right here. Let's focus on, if this wins, why does this win? How does this win? How does this GP win? What do we think the odds are of that? Do they have increased odds of significantly outperforming? Sure, all of these funds have plenty of ways they can fail. And that doesn't ultimately drive the outcomes for me, unless there's such a massive issue that you're like, well, I don't take that risk. In law, you are constantly learning new areas of law, new facts. I was a general, mostly trial level commercial litigator. You're constantly learning new cases, new areas of law.
And so, you develop the skill set of learning new things quickly. And so, every time we're meeting a fund, you're learning their story, you're learning their sector, you're learning their portfolio, you're learning about their strategy. And that's actually helped me, relevant to your last question, pick up venture quickly.
I mean, I've been in ventures since 2018, but to really figure out how do I sink my claws into this? And how do I learn this in a complete way, so that I understand the spectrum of issues that matter? And we can go systematically and develop expertise.

Robert Morier: Speaking to a few early-stage VC fund of funds manager in the past on this show, we hear a lot about pattern recognition. Do you think that your background allows you to recognize patterns in sectors, industries, or just some of those qualitative attributes that you mentioned, just the way that people speak, the language that they use, the words that they're putting forward?

Alex Edelson: Yes. I think what's interesting about pattern recognition, though, there are two things that stand out to me about pattern recognition. One is it's very easy in venture to look at funds that have been successful historically and to say, well, how are they doing it then? But what does it mean? How long does it take to someone's successful? Let's say it takes 6 to 10 years. It's great to learn from them. And you want to learn from all of those success cases. But that was a long time ago. And the venture ecosystem has evolved. And the sectors they're investing in may have evolved. And so, on one hand, I rely heavily on pattern recognition. On the other hand, I am constantly trying to be careful about relying too much on pattern recognition because the venture ecosystem is evolving. And what worked 6 to 10 years ago may not be on the cutting edge now, may not be the best way to perform in this market.
And so, to me, it's a data point. But I am constantly trying to figure out who's well-positioned now, for the market we're in today, for the strategy they're considering now in this fund? And so, I try not to be too overly reliant. I want to study it like anyone would study history, but I don't want that to drive the decision making. The second thing, though, is let's just take one sector, for example. Let's just take fintech. So, QED is a fintech focused venture firm. So, if I'm talking to a fintech focused emerging manager that we might invest in, I'm putting this in the context of all of the other fintech fund managers I know. It's in the context of all of the fintech founders that I've spoken to and their thoughts on what they're looking for from their VCs, and how they interact with VCs, and what caused them to choose the VC, and the round dynamics that caused someone to get some level of ownership or a deal to get done at a certain valuation. So, there's a pattern recognition there, too. And it's something that's constantly evolving. And it's a little more current than some of those historical pattern recognition data points, where it's like, look, I've now talked to the-- let's call it 10, or 30, or 50 fintech focused funds that I think are most promising, what are the patterns I'm noticing here? What am I hearing from founders when I'm referencing them? And what does that say about who's uniquely positioned to succeed going forward?

Robert Morier: Well, in addition to spending time in traditional VC firms, you've also been part of startups. So, when you think about those two environments, how did those two environments shape the way you think about specifically innovation and risk taking? And I think I'm a little bit more interested in risk taking. I think a lot of the allocators that tune in, particularly on the limited partner side, they have some VC exposure, but it's still new and still growing. And it's an asset class that I think that's starting to-- that allocators are starting to spend more time with, particularly on the earlier stage. So, I would love to hear how time in both those environments affected your views on risk taking.

Alex Edelson: QED is a wildly successful venture firm across many vintages. The evolution of venture ecosystem, you could argue, the evolution of fintech as an appealing sector and venture. And the learning there was people are doing a lot of real work. And they are doing institutional grade work at a very high level. And there's a lot of things that you can do to mitigate and manage risk. But at the early stage of venture, there is a messiness, there is an uncertainty. There is a level of risk that people are comfortable taking that was a big change for me coming out of law. Coming out of law, I'm not saying things out loud I'm not very sure about. And when I got out of law, it wasn't quite that way. And people are making their best guesses. They're doing their best work, but they're dealing with uncertainty in ways that I didn't deal with uncertainty before. I learned the process for what it takes to increase the odds of outperforming and the types of risks that go into that. and sometimes, the messiness that goes into that, it's not all what it sounds like in some beautiful fundraising deck or someone's 30-minute pitch to an LP. There's a reality to it that involves taking risks and sometimes doing things that feel like maybe not institutional grade, but that's what it takes to win that deal. Or you had to move particularly fast. And as an LP, I think if I hadn't experienced the GP side, I might be a little less comfortable taking certain risks, but maybe I would be more comfortable taking different risks. Let's give an example. Working at QED, where there is a team, I can see how one investor, working largely alone for large periods of time, can source, pick, basically win, and add significant value to companies. Now, we were doing that in the context of a team. But you can pick out an individual investor there and have plenty of vignettes about how amazing they were as an individual. And they were really the point of contact for that founder. And it was like, I don't know, maybe I would be less comfortable with a solo GP risk, for example, if I didn't see how much one person can do to generate returns at the fund level.

Robert Morier: It's an interesting example. Thank you for sharing that. So, when you think about why you started Slipstream, what was the pain point that you were looking to solve for investors?

Alex Edelson: I think about it, I saw an opportunity in venture. And I thought I was uniquely situated to take advantage of that. And that led to me starting Slipstream. So, it was more opportunistic. I think there's a great thing here. I think we have a unique perspective. I think we have a unique way of doing this more than, oh, there's a problem I'm trying to solve, or a pain point I'm trying to address for someone. But yeah, the opportunity I saw was look, we were growing at QED, and I was realizing, it's really hard to scale venture, just to get enough ownership relative to your fund size, and get a high enough hit rate, and to get big enough wins to significantly outperform as fund sizes grow. It's hard. And I realized there's so much opportunity in these small funds. And they are very hard for people to evaluate. They often have limited track records. Once they have a track record, they often get larger. That may negatively impact their returns. And so, I was realizing, one, I think the opportunity is these small funds. Two, people really struggle to get to conviction on these small funds. There are thousands of these small funds. It's hard to stay on top of them and make sure you're seeing the best funds. It's hard for some folks to get enough capital into these funds. They're too big. So, the juice kind of isn't worth the squeeze for them, so they don't even try. And it felt like an almost overlooked part of the venture ecosystem. But it has the best upside for the people who know how to evaluate these funds and can stay in front of this ecosystem or at least can see enough of them that they're getting into-- that they're seeing the right ones, and they can identify them as they come. It felt like if I could do that, this is a great opportunity there. And so, I was learning venture at QED kind of under the hood at a really successful venture firm. And we were very introspective about our success and failure over many successful funds. And we got a lot of founder feedback. So, I was sort of getting a sense for what does it take to build a flywheel and a community of founders who are relevant to your strategy? How do you get the next generation of founders to help keep you in front of-- or the last generation of founders to keep you in front of the next generation of great founders? And what do we do to increase the odds of outperforming from the perspective-- or on the topics of sourcing, picking, winning, working with companies after we invest, getting our portfolio construction right, getting liquidity, not just passively. And so, I was realizing, I have a framework for how to think about any venture fund at the early stage. And it's particularly interesting at this early stage because they don't have much of a track record, but I don't need much of a track record to test for some of these things. I just need-- they need some investing experience. And I need to know the VCs they've worked with, especially at the next stage. I need to know the founders they've worked with. And then you can test for these qualitative criteria. And that made me feel like, wow, maybe I could do something here.

And then one thing that was interesting was we were working with all these emerging managers in a variety of ways. And some of them we thought were great were not consensus in the LP community. And our beliefs about their quality or my beliefs about their quality just didn't always correspond to their fundraising ability. And at first, it's sort of disorienting. And then I was looking around and feeling like most of these LPs who would be considering an investment into their funds, they didn't learn venture at a high-performing venture firm like QED. They learned it in a different seat. And that doesn't mean they're not great LPs or they won't build great portfolios, but it maybe emboldened me a little bit to think maybe I have a unique perspective here. Maybe this is an advantage that I could capitalize on in some way.

And then I started building relationships with them. And I would engage with them and help them when it came to things like portfolio construction, or investor relations, or what information about your portfolio should you track over time that might be actionable in the future for you, or how to build a platform function on a limited budget. Some of this stuff is just tactical, running your venture firm, every day work that people are doing. It's not the glamorous stuff. It doesn't always relate to returns. And I was realizing, I'm kind of building a flywheel in this community like we talk about building one in the fintech founder community and thinking maybe I can get into these funds. And some of them were not capacity constrained. Some of them that were, I felt like I could probably get in. And so those were some of the bigger observations, to me. It's like this is a somewhat overlooked part of the asset class. It's very hard for people to evaluate these folks. Maybe we know how to evaluate these folks. Maybe I have a different perspective. I think I'm adding value in ways that are unique to us. And I tell the story in a linear way; it was all building naturally toward Slipstream. It was so inevitable. But it wasn't. This is something I realized kind of over time. And I got to a point where I was like, yeah, I think there's an opportunity here. I don't that I'm solving anyone's problems. But it's an opportunity that I felt like I was uniquely positioned.

Robert Morier: Well, I think arguably, early-stage venture is not a large position in people's portfolios, just from an asset allocation perspective. But the upside potential is significant, significantly more than other asset classes. So, I would suspect that you are giving them something that is potentially missing. And because you're doing it through a fund of funds format, arguably, it's an argument that you're diversifying some risk because you are looking at more than one provider. So, you're taking on some of that burden for them.

Alex Edelson: I'm sort of describing this as I'm not really solving a pain point, because at the time, that's not how I was thinking about it. But at the moment, what's happening is for our LP base, yes, we're solving typically one of two common issues. One is people who know these are the highest performing venture funds, but they are not well positioned to get exposure to these on their own. And so, they outsource that to us. And they get diversified, but we're actually pretty concentrated, exposure to these types of funds. And so, I suppose if you want it and you can't get it on your own, then we're solving that for you. There are other groups who do some of this work on their own, or they want to do it on their own, and we are a strategic partner to them in helping them build out their venture portfolios.

Nick Butts: No, that's great. And in a crowded field, what's really your edge? How are you positioning Slipstream to your LPs and the funds that you're talking to? What's your edge?

Alex Edelson: The way I think about this, and you phrased it how I think about it, is what is my edge with GPs? What's my edge with our LP base or potential LPs? With GPs, it's so interesting. Sometimes I get feedback, you behave more like a GP than an LP. And I think that's because that's where I grew up in venture, on the GP side. And how that ends up functioning for me is you're pushing on people, you're giving constructive feedback, maybe not asking the same standard questions. We're going a little deeper on a few things that maybe I'm particularly interested in or opportunities where I feel like maybe they can improve, or maybe not. But we should have the conversation. One thing I heard while I was at QED was that a VC's job is to help an early-stage founder figure out the biggest version of their potential idea. And I sometimes feel like that's my job. Someone comes with a strategy and maybe they're early in their process, and I'm like, look, is that the best way? Would this way be better? How do you think about that? Well, what if this were true? What if it took you two years to know whether any company you invest in is likely to get to product market fit? How does that impact your reserve strategy? How does that impact your fund size? How does that impact your check size? So often, the interactions that I have with folks are maybe different, with GPs, are a little different than other LP conversations they have. And it's also, in part, informed by the experience at QED. And what does a great LP look like? What does a good LP look like? What does a LP look like who kind of bothers the GP? Could I be a good LP? Could I be a great LP?

And thinking about the way they spoke to us, and interacted with us, and the ways they added value and behaved, that's in my mind when I'm working with GPs. And also with GPs, I think you build a reputation over time. And they talk to each other about LPs. And so, my hope is that, yeah, we have a reputation of maybe being a little more helpful and constructive in the early days. It could be operational things like I'm talking to them on how they're running their firm. We're helping edit job descriptions when they're building their team. We're talking about edge cases. We're talking about is this a time when maybe I should flex on ownership or entry valuation? Or they're really excited about a company, should we follow on? Should we do an SPV? Should we cross fund invest? These are things that I saw and had data on over long periods of time at QED, and that I see a lot now. And so, one thing that's really important to me is engaging with GPs in a constructive way, both before and after we invest. And sometimes, it's just fundraising.

Hey, I know LPs who I think would be a fit for you. You should meet them. Or I can reach out to them for you and trying to help there. But building a reputation for adding value in unique ways that other LPs don't, or can't, or just don't often do. And with potential LPs, yeah, I think a few things distinguish us. One, unique experience at QED, learning from the GP side. And like I mentioned before, I just thought there weren't a lot of LPs that had the experience of learning venture at a really successful venture firm. And I think that just helped me get a better sense for what to look for when investing in funds, the types of things that matter when it comes to increasing a fund's odds of outperforming with the network that you build over time through that, and how that impacts your ability to work with these funds, to help them and challenge them, which ultimately, helps us get allocations in funds. So that was the first thing, unique experience at QED. The second is how that impacts our ability to add value to the GPs and win allocations, like I mentioned. The last thing is we are small by design. It is a unique edge for us. It makes it easier for us to get into small funds, oversubscribed funds. It makes it easier for us to be concentrated in our portfolio. We are more concentrated than most other folks who have a similar strategy. It helps us leave room for our LPs to come into these funds as well, because we are not taking all of the available capacity. And it also helps position us with other folks in the industry. We shouldn't be the reason why other people can't get into these funds. We might be the reason they find out, or get to conviction, or avoid one of them. It's helped our positioning in the ecosystem generally, which then helps us see more, and helps us get into more, and it's a virtuous cycle.

Robert Morier: Alex, when you talked about giving advice, being a partner, working very closely with the GPs, it sounds very close to GP staking and GP seeding businesses. I know there aren't a lot that do it in VC, but why not go that extra step? Why not take stakes in these businesses rather than just operate as a fund of funds?

Alex Edelson: No, it's a really good question. And people are doing it. And I think it would look good in a deck. One thing I worry about is I worry about adverse selection. Are the best funds going to be comfortable with that arrangement? And let's say I do it selectively, but then people know I'm doing it.
Will the best funds want to talk to me if they know that's what I'm doing with other funds, even if I'm not going to do it with them? What I want to be known for is full alignment with GPs. And I am on their team. I want them to make-- I want them to succeed financially when their funds do well. I want too also. And so, what's the bottom line for me? I want to be in the best funds. And if I'm in the best funds, the economics work. And so, my mission is increasing my chances of being in the best funds.

Nick Butts: So, when you're sourcing new managers, beyond sector or stage diversification, how do you think about building a portfolio that balances that different decision-making styles or behavioral styles among managers?

Alex Edelson: I'm not sure I think about diversifying across decision-making styles or behavioral styles. I think about diversification across time, and sectors, and geography, and companies. If I were to go a layer deeper and maybe me be more direct on the question is, yeah, we are typically drawn to GPs who independent decision makers are, who are not looking for social proof from other venture firms, other investors. They'll be the only VCs in the round. They'll be the first to put a term sheet in, even if they're not taking what you would typically consider lead level ownership, they'll just put a term sheet down. And they'll do it on their own. That is very appealing to me, especially in a really crowded market where one of the big challenges is can you get there at or before inception, or very early, like before other VCs are there, ideally? And if so, can you get to conviction before they get there, and this round potentially gets out of your reach in terms of valuation or ownership?

Robert Morier: One of the things I'm interested in is when you're thinking about early-stage VC due diligence and operational excellence, arguably, a lot of these managers are building the bike while riding it. So how do you evaluate operational infrastructure as you are trying to build an investment case?

Alex Edelson: Yes, it does probably look different than folks who are evaluating managers who are significantly larger, bigger teams, have bigger budgets for these sorts of things. Yeah, there are certain third parties that are easy to diligence. It's like, do you have reputable groups doing your fund admin, legal, accounting? Are there any sort of obvious vulnerabilities in your tech stack? Are you tracking the standard information that I would think you should be from a cybersecurity standpoint? Do you have this basic, important stuff in place? But yeah, you're right, these are such nascent firms, they are not typically so built out at this stage that there is a robust operational due diligence. That I can manage relatively quickly. There's just not that much to diligence. And there are some industry standard things that you're looking for. And if they have them, then for the most part, you are good. Now, on the LP front, sometimes that can be a little more involved because, surprisingly, there is still a broad range of LPAs from emerging managers. And hopefully over time, we will move towards more of a consensus term in LPAs for emerging managers. But right now, yeah, that is probably where I do spend plenty of time there making sure the LPA is in good shape.

Robert Morier: Speaking of where you're spending your time, are there any areas of the market that you're spending time on today in terms of filling a need as part of the fund?

Alex Edelson: We are a generalist fund, so our strategy includes investing in generalist funds and sector-focused funds. We don't do all sectors. The sectors where we're mostly focused when we're looking at sector-focused funds would be enterprise infrastructure, fintech, healthcare, deep tech, and supply chain logistics, industrials, manufacturing, we have some exposure there. And then we get exposure to other categories through generalist. And we get exposure to those categories through generalist. So, AI and all those-- AI is in everything, I almost don't view that as a category at the moment. But that's how we think about it. So, to the extent we're looking for exposure to a particular sector, it's only because we would like to have, let's say, an enterprise infrastructure fund in every fund of ours. We'd like to have a fintech fund, one fund, let's say. So, if we don't have one in a given fund, then we'd be looking for one. And then geographically, we're mostly US. We do a little in Europe and Israel. And so, if we don't have exposure there in a given fund of ours, we would be focused on that.

Robert Morier: And in terms of criteria, fund I through fund III?

Alex Edelson: As a matter of fact, we are almost always first three funds. But we're open to anything. We recently did a fund that's a fund V. So, it doesn't need to be funds I through III. It's more of the emphasis is on-- the emphasis is mostly on small funds, so small funds with portfolio construction, so that they can significantly outperform and justify the risk and the liquidity in the asset class. So, one thing you mentioned earlier that we didn't go into deeply, but it made me think, as people think about venture, what justifies the risk and the illiquidity that we're all accepting in this asset class? And to me, the answer is the funds that can significantly outperform all the other asset classes. If you can't, then what are you doing? What are you doing in venture? And so yeah, we're focused on funds that have the portfolio construction and size to be able to significantly outperform if they get into great companies.

Robert Morier: And when you're thinking about those GPs and exits, just thinking about the secondary market, M&A, how do you see your GPs thinking about exit strategies today relative to a few years ago?

Alex Edelson: Let's distinguish the GPs we've invested in from GPs in the market generally. GPs in the market generally, one thing I'm seeing is a lot of interest in getting some DPI, sell something, and be able to show that you have gotten liquidity. The challenge is it's not always an amount of liquidity that is relevant to fund level returns. So, someone will say, hey, look, we have DPI, we're in the top whatever quartile, decile of DPI for our vintage. It came from something that maybe wasn't a big success. Or maybe they were selling a part of a company that could be really successful, and maybe they returned like 0.2 or 0.3x DPI on their fund. It's like, guys, we've got to play for outperformance here. So sometimes I ask a GP, where they're really celebrating DPI in a deck or in a pitch, I'll say, if you had known at the time you made this investment, this was going to be the outcome, would you have made this investment? And often, the answer is no because it wasn't a venture scale outcome. Now, it did generate DPI. And because so few funds have DPI early in their evolution, they are looking good early on in terms of DPI relative to the asset class. So maybe they can say we're in the top quartile or top decile, but it's not actually helping them get to venture scale returns. My hope is that our funds are close enough to every company that they are thinking about whether they are a buyer or seller at least on a regular basis, say every 6 to 12 months, and certainly when a company is fundraising. And if they are a seller or a buyer, they think about whether they should take some action based on that. If you're a seller, should you consider selling into this round or selling in a secondary transaction? If you're a buyer, should you consider following on or doing an SPV? That doesn't mean they always should do anything. Maybe the right answer is to do nothing. But my hope is that people are thinking about it on a regular basis and taking action when they can, when it's appropriate, and when it doesn't limit their ability to generate meaningful fund level returns. Don't just get DPI to get DPI. Get it in a way that's consistent with generating outsized fund level returns. But yes, there's much more emphasis on it now. And I think in the 2020 to '22 period, what I would hear from people, which it made me sad a little bit, was people seeing companies that were growing fast, raising quickly, having very fast markups, saying things like, this could be $100 billion company. And I'm thinking, yeah, it could. The chance is not 0, but it is so unlikely. We're talking about a company that is valued at $1 billion right now or $2 billion right now. This could return-- I had a conversation with a GP. This could return their fund multiple times to sell at a few billion-dollar entry valuation-- or at a few billion-dollar valuation, and they didn't sell. Because the view at that time among some folks was like, it can get so much bigger. And it can get so much bigger. There's always the chance it keeps growing. But I think some of those folks are a little more conservative now. I think GPs are a little more conservative in their thinking about when to start taking money off. So, I see certainly more focus on it and more interest in being active around getting liquidity instead of just passively seeing how big this thing can get.

Nick Butts: Let's talk about reserves. How do you think about reserve strategy in terms of how funds manage them?

Alex Edelson: Yeah, it's a good question. It's funny, I feel like there has been an evolution here. And there was a time when there was an argument when a lot of people were arguing for a lot of reserves. And now, it feels like I'm increasingly talking to folks who say, well, I know it's better for returns if I have less reserves. And yeah, my trend is towards less reserves, but here's how I think about it. There are a few levers you can pull when you're thinking about reserves. You can have reserves. You can have more initial investments. You can have bigger initial investments. You can have a smaller fund. So, when it comes to returns, having more reserves is only good if you're getting them into great companies. Otherwise, you'd rather have anything else, more ownership in other companies in the portfolio, smaller fund, or more shots on goal. So, then the question is like, well, OK, how often are people making the right decision about which companies to follow on into? And so, then you're sort of asking, well, how long does it take for someone to be right about whether a company they've invested in is going to be a successful company or has significantly increased odds of being a successful company? And yeah, I think reserves are tough because my observation from talking to folks at the earliest stage is that typically people don't really know whether they've got a real company that's going to get to product market fit and have a chance to generate meaningful fund level returns in less than two years after making an investment.
Usually, you need at least that period of time, at least two years. And so often, the decision about whether to follow on into a company will come before that. Sometimes, it will come before you've finished making initial investments out of the fund. So, you don't even know all the companies that are going to be in this fund. And so, it becomes really hard. I mean, if you take that as true, which is not always true. Some people have demonstrated success with a fast funnel strategy, following on quickly in between rounds. Some people have demonstrated success using reserves just falling onto the right companies the next round. Some people preempt rounds. They've done that really successfully. So, I don't mean to make a

blanket statement. But as a general matter, I want fewer reserves because it's so hard to get them right. And in most cases, they're not all going to the best companies in a given fund. There is a relevance here to winning and to helping companies get to a point where they're generating meaningful fund level returns. So, think about if you're trying to lead a round and you're competing with other firms. And the founder cares about your ability to support them in a time of need, to invest with them along their journey, to be a positive signal for them for other investors, if you have no reserves, especially in a market like now, where it's taking longer to raise an A, the bar is being raised to raise an A. If you don't have reserves to help your companies, get to that point, it might be harder on the front end to win those deals. So, you might risk adverse selection if you don't have some reserves. Now, for the smaller funds who are not leading rounds, they are less likely-- it's less likely that a founder will rely on them to support them in a time of need. They don't have enough capital. They're small investors in the round, let's say. And so maybe less important from a winning perspective for a non-lead investor to have reserves, but there is a non-trivial role that reserves play in winning, I think. And especially in this market, having significant reserves can help your companies survive long enough to get to an A or to get to the next round. And so maybe companies that could be great but were supported by VCs who couldn't keep investing, didn't have enough time, they ran out of capital, they didn't reach a great outcome. Whereas some of the best companies in venture were not the fastest growers out of the gate, they needed a little extra time. And if you can help your company last a little longer, that actually could increase your odds of success.
So, I don't mean to say reserves are always bad. And they're certainly amazing when you get them in the right companies. But as a general matter, the way I think about this is funds that are leading rounds are going to have-- they should have reserves. What amount that looks like? It's a bit case by case, but let's call it 30% to 40%, maybe 50%. And I'm comfortable with a little less too, but not a ton less. Funds that are, let's call it targeting 4% to 6% ownership, maybe these are $20 to $30, $35 million funds, maybe those have 10% to 20% reserves. Then the really small funds, let's call those sub $15 million funds, as a general matter, no reserves. And some of these folks, could be $20, $25, $30 million fund have no reserves. That can be an excellent strategy. So, these aren't bright-- these aren't rigid rules. But as a general matter, that's how I think about reserves. But it's a case-by-case basis. And as the ecosystem evolves, thinking on this should change.

Robert Morier: Hearing you talk, Alex, I can't help but think how many pitches you've heard in the last few years. Managers coming in, GPs coming in, pitching their strategies. When you think about what makes a memorable presentation, what makes a memorable pitch, what are some of the attributes of those presentations that really stand out to you?

Alex Edelson: So, to me, there are two threshold questions. One is, is there good reason to believe you're going to be in great companies? And two, do you have a portfolio construction, so this fund can significantly outperform if you're in the right companies? And so, the second topic, the portfolio construction topic is a little simpler. So that could stand out if there's a very unique portfolio construction. But typically, we're looking for certain things. And the first topic is where maybe more of the action is on things that could stand out. So, what I'm typically thinking about is sustainable competitive advantages that are related to sourcing, picking, and winning, which is also related to how you engage with companies and add value after investing. What really stands out to me on the sourcing front, for example, would be are these people in front of high-quality founders at or before inception? That stands out. That's hard to do. Are they getting there before other VCs? It's so hard in a crowded market with a ton of VCs, and a ton of founders. And if you're the only one there, you're really early, you're investing at very low entry valuations on your own, for example, there's no other VC around, that's really interesting. From a picking perspective, what stands out is people who have their own independent investment judgment. They're not looking for social proof. They're not necessarily waiting for a lead. I mean, sometimes, you have no choice. But there are people who are making their own decisions. And often, those are non-consensus. And they are in the minority of folks who are interested-- who are making that deal, or maybe the only one. And then it goes on to show some traction and show some promise. Often, I'm talking to these folks so early that company has not fully reached its peak. But there are indications that that was a good investment, despite the fact that there was no consensus at the time they made it. From an adding value and winning perspective, it's some unique domain expertise or operating experience. QED is a great example of this. QED is one the two founders of Capital One. in 2007 or '08, when QED is getting started, if you're a fintech founder, who has more relevant domain expertise or operating experience than someone who founded Capital One and people on that team? So, if you're a fintech founder, from a sourcing perspective, you got to talk to those guys. From a picking perspective, they should have a really unique advantage. They know what it takes to succeed in this industry. They know common issues. They've seen a million folks try and fail. They know what customers are looking for. They should be able to win and add value. Because look, these guys can help you get customers, solve these problems that are common issues, overcome the most common startup issues they've seen create issues for other companies. Their level of operating experience and domain expertise is just so unique that they had a unique-- they had a sustainable competitive advantage. There's no other VC at the time doing fintech investing who has experience relevant to fintech founders like theirs. But they sustain it if they're great founders over time and the things that you would believe about them, that they can add that value, and that the founders will love them, they need to do that over time. They need to make founders love them. They need to add that value. They need to be great partners for founders. And then that flywheel gets built. And so, I'm looking for folks who if they do a good job of executing on that strategy, will have a sustainable, competitive advantage relating to sourcing, picking, winning, adding value.

Robert Morier: Thank you for all of your thoughtful insights today. We greatly appreciate it. We appreciate you being here in Philadelphia during what sounds like a storm. So, I'm not sure if that's going to get picked up in the audio for our audience. But if so, the flash flood warnings did go off. But we appreciate all the insights that you gave us. Congratulations on Slipstream. We wish you nothing but future success.

Alex Edelson: Thank you so much for having me. This was a lot of fun.

Robert Morier: Thank you for being here, Nick. As always, thank you for being here on the desk.

Nick Butts: Pleasure. Thanks for having me. It's great to see you.

Robert Morier: If you're interested in learning more about Alex and Slipstream Investors, please visit their website at slipstreaminvestors.com. You can find this episode and past episodes on Spotify, Apple, or your favorite podcast platform. We're also available on YouTube if you prefer to watch while you listen. And if you'd like to catch up on previous conversations, please be sure to visit our website at dakota.com. Alex, thank you again for joining with us, Nick, as always. And to our audience, thank you for investing your time in Dakota.