Hedge Funds

Introduction

There are many types of hedge funds and they are normally included within 'alternative assets' in a typical asset allocation process.

Hedge Funds can specialise in just about anything but also have the ability to borrow capital to leverage a particular position, which has often led Hedge Funds to be categorised as High Risk.

Hedge Fund Strategies

The following overview summarises some of the strategies available within the Hedge Fund sector -

Equity Long/Short Strategy	Equity Hedge strategies maintain positions both long and short in primarily equity and equity derivative securities.
Global Macro	Macro Investment Managers which trade a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed income, hard currency, and commodity markets.
Event Driven	Investment Managers who maintain positions in companies currently or prospectively involved in corporate transactions of a wide variety including but not limited to mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments.
Relative Value	Investment Managers who maintain positions in which the investment thesis is predicated on realisation of a valuation discrepancy in the relationship between multiple securities. of corporate transactions.

There are various sub-strategies within the above which may have a specific sector or style focus.

Newport
The Estates Office
25-26 Gold Tops,
Newport, NP20 4PG

Cardiff
62 Cathedral Road,
Cardiff,
CF11 9LL

T: 02920 641188
E: adviser@financialplanningwales.co.uk
W: www.financialplanningwales.co.uk

Advantages & Disadvantages of Hedge Funds

The advantages of Hedge Funds for investors include –

- Typically, Hedge Funds have offered a relatively low or very low correlation to traditional asset classes, which further diversifies a Portfolio.
- Hedge Fund of Funds offer investors a cost-effective way of gaining exposure to a broad range of underlying hedge funds.
- Some academic studies demonstrate that hedge funds, on average, are less volatile than the market.

The disadvantages of Hedge Funds for investors include –

- There is often a lack of transparency in respect of the underlying investments and how returns are generated.
- There can be a lack of consistent performance data as some funds are reluctant to report historic data.
- They can be expensive in terms of management fees and performance fees.
- The strategies employed by Managers are often complex and not easily understood by investors.
- The regulation of Hedge Funds is often limited which has led in the past to risk management issues.

How we assess Hedge Funds

The importance of due diligence when reviewing Hedge Funds cannot be overstated. The following are some of the considerations that must be taken when assessing Hedge Funds –

- **Availability of Information** – the information available to Investors in identifying the underlying holdings, the strategies employed and the Hedge Fund structure. If there is any opaqueness, then an assessment is difficult if not impossible.

- **Overall Market Risk** – what investment risk does the Manager take in seeking to generate returns or Alpha? We can use risk ratios such as the Fund's Drawdown (losses) to identify historic negative returns and the Fund's Beta to assess its correlation with broader investment markets.
- **Leverage (borrowing)** – the use of leverage can be a double-edged sword that magnifies gains or losses. The extent of current and historic levels of leverage will need to be considered. This can be measured by the value of the Fund's debt or leverage relative to its Assets.
- **Regulation** – the scope of any regulation to which the Fund is bound. Historically, the less regulation the greater the risk of unethical behaviour.

Hedge Funds in our Portfolios

We have utilised Hedge Funds in some of our Portfolios where we felt they offered access to particular trends or themes, not available via other asset classes.

Their ability to offer additional levels of diversification from traditional equity markets, in conjunction with Manager expertise, proved beneficial in 2020 where market volatility was at extremes.

Newport
The Estates Office
25-26 Gold Tops,
Newport, NP20 4PG

Cardiff
62 Cathedral Road,
Cardiff,
CF11 9LL

T: 02920 641188
E: adviser@financialplanningwales.co.uk
W: www.financialplanningwales.co.uk