

Hedge Funds – Q & A's

Q) What is a hedge fund?

A) A hedge is a mechanism that protects against a specific risk. Hedging was initially introduced to insure against price or currency movements of commodities during shipment. Today the term hedge is used to describe a fund which seeks to achieve gains through strategies such as the buying or selling (selling short) of investments whereas a traditional fund can only achieve gains through buying and holding investments.

Q) What advantages do hedge funds offer over traditional "long only" funds?

A) By various methods such as "short selling" and through the use of derivative instruments hedge funds can make gains in falling markets as well as rising markets. Furthermore, by adding hedge funds to a traditional "long only" portfolio of stocks and bonds the low correlation to market of these assets types provides valuable diversification whilst also enhancing returns.

Q) What type of assets do hedge funds invest in?

A) Shares, bonds, currencies and commodities. Various different strategies may be employed by the investment company/fund manager.

Q) How do I go about researching which are the best hedge funds available?

A) One of the drawbacks of the hedge fund industry is the lack of transparency. Performance data is hard to access and managers tend not to publish their strategies or failures. It is therefore very difficult for the private investor to thoroughly research offerings in this somewhat esoteric investment class. However, the investment company/fund manager should conduct ongoing quantitative analysis of the world's hedge fund universe to identify those funds that consistently provide superior risk adjusted returns. These results are then followed up with qualitative research such as in depth interviews with the managers in order that we fully understand where they add value.

Q) I have read reports of hedge funds going bankrupt – what about the risks?

A) Some high profile hedge funds use speculative methods such as heavy borrowing (gearing or leverage) to maximise returns and this can be a risky strategy. The management team would not invest in highly speculative hedge funds and provide further protection by spreading exposure across managers utilising different styles, strategies and trading techniques.

Q) Which style of hedge investment should I choose?

A) By combining a portfolio of a number of hedge funds that invest in different regions, different assets type and utilise different trading techniques overall risk is reduced. The management team provides exposure to over 20 of the world's best absolute return funds based on ongoing qualitative and quantitative research.

Q) Why use a Multi-Manager approach?

A) Most hedge funds are targeted at professional investors and hence have minimum investment limits of \$100,000 or more. Therefore to gain exposure to a basket of the best managers and provide diversity across the various absolute return management styles an initial capital of several million dollars would be required. A private investor can benefit from dedicated fund manager selection research and may gain exposure to suitable levels of diversification in this asset class through one investment.

Q) There are an increasing number of hedge funds and funds of hedge funds being marketed at present – why invest in a particular fund? **A)** The detailed

quantitative and qualitative research employed by a good investment company/fund manager should enable it to return an annual average return of over 15.4% (1996-200) thereby significantly outperforming a traditional 60% equity /40% bond portfolio whilst still displaying lower volatility and risk. New funds of hedge funds currently coming to market cannot boast such a strong long term track record and cannot provide exposure to those most successful hedge funds which have closed to new subscriptions.

Q) How much do I need to invest?

A] It is recommended that about 20% of an investor's portfolio should be allocated to absolute return vehicles. The minimum direct investment into a hedge fund is \$100,000 but purchases through a life company portfolio bond are classed as institutional deals hence investments as low as \$30,000 are permissible.