Hedge Fund Dispersion of Returns by Strategy

Here is a chart of the dispersion of hedge fund returns across strategies as classified by Hedge Fund Research. It is the simple standard deviation of the monthly returns across the 18 strategy indices compiled by HFR. What it shows is a clear compression of dispersion from Jan 2000 to Jan 2004 where it troughs. Only in mid 2007 does dispersion start to pick up again. The spikes in 1998 and 2008 are explained by particular strategies deviating from others, usually on the downside, and often triggered by systemic failures, Russia in the case of 1998 and the global banking system in 2008. Unfortunately dispersion of hedge fund returns are not a predictor of future performance. What they do illustrate is how crowded markets are in terms of hedge fund strategies, when dispersion is low. There is some indication that low dispersion correlates with low volatility and the ‘storage’ or accumulation of gap risk even as continuous risk is compressed.

What it seems to instruct is that risk is highest when seas are calmest. In that respect, given that in 2008 financial markets and economies seem to have run in the mother of all icebergs, perhaps risk isn’t as high as before.