Hedge Fund Investing In 2012

Forget about correlations. Here are the conditional probabilities between equity market monthly returns and hedge fund returns as represented by the MSCI World Equity Index and the HFRI Hedge Fund Index respectively.

Since Jan 1997, over 183 months,

- Hedge funds were positive when equities were positive 98 months or 54% of the time.
- Hedge funds were negative when equities were negative 54 months or 30% of the time.
- Hedge funds were positive when equities were negative 24 months or 13% of the time… And
- Hedge funds were negative when equities were positive 7 months or 4% of the time.

Thus, when equities are down, the chances of your hedge fund losing money are: 54 out of 78 or 69%.

And, when equities are up, the chances of your hedge fund losing money are 7 out of 105 or 7%.

However:

Since Jan 2008, over 51 months,

- Hedge funds were positive when equities were positive 24 months or 47% of the time.
- Hedge funds were negative when equities were negative 21 months or 41% of the time.
- Hedge funds were positive when equities were negative 5 months or 10% of the time. And…
- Hedge funds were negative when equities were positive 1 month or 2% of the time.

Thus, when equities are down, the chances of your hedge fund losing money are: 21 out of 26 or 81%.

And, when equities are up, the chances of your hedge fund losing money are 1 out of 25 or 4%.

Post 2008, the markets have begun to behave in a very volatile and

erratic fashion that has confounded many hedge fund managers who had previously navigated market crises such as 1998 and 2001 successfully.