Hedge Fund Performance Aug 2010

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Hedge Funds as a group have done poorly in 2010, yet they continue to outperform equities by a significant margin both in absolute terms as well as on a volatility adjusted basis.

Even so, why would an investor pay hedge fund management and performance fees for a paltry 1.65% YTD, or additional FOF fees for loss of 0.42% when they can lose 6.81% for free (well, for some execution costs.)

Bonds have done well over the last 20 years as yields have trended down but now with yields close to zero, it certainly looks as though the risk reward trade off is less attractive for bonds.

HFRI Indices	Returns						
	1M	3M	6M	12M	YTD	5Y Ann	Vols
HFRI Index	0.38%	-1.03%	1.76%	7.20%	1.65%	4.98%	9.74%
HFRI Fund of Funds	0.78%	2.77%	-0.06%	3.92%	-0.42%	2.14%	8.32%
Convertible Arbitrage	2.71%	-0.05%	5.00%	18.49%	6.18%	6.25%	18.95%
Distressed Securities	1.17%	1.70%	3.58%	19.48%	5.09%	5.05%	11.29%
Emerging Markets	3.13%	2.91%	2.98%	13.63%	1.75%	9.16%	18.67%
Equity Hedge	2.31%	3.77%	1.51%	7.92%	-0.70%	3.60%	13.20%
Equity Market Neutral	0.84%	0.57%	0.39%	1.11%	-0.39%	2.03%	3.62%
Equity Non Hedge	2.58%	1.74%	2.41%	6.20%	-1.06%	3.68%	12.22%
Event Driven	2.15%	1.72%	3.89%	15.71%	4.54%	5.30%	10.43%
Fixed Income	2.39%	0.06%	4.78%	15.39%	6.77%	3.83%	9.90%
Global Macro	-0.03%	1.72%	0.85%	1.27%	1.02%	6.42%	5.24%
Market Timing	-0.57%	2.21%	1.28%	-0.40%	1.82%	9.65%	8.50%
Merger Arbitrage	1.42%	-0.25%	1.76%	6.62%	2.53%	6.29%	4.27%
Relative Value Arbitrage	1.82%	-0.36%	3.99%	14.43%	6.44%	6.72%	9.46%
Short Bias	-5.26%	-3.33%	-9.92%	-17.20%	-4.76%	-1.08%	16.30%
MBS	1.27%	-3.33%	6.17%	18.78%	9.93%	7.83%	5.32%

Major Asset Classes	Returns						
	1M	3M	6M	12M	YTD	5Y Ann	Vols
HFRI Index	0.38%	-1.03%	1.76%	7.20%	1.65%	4.98%	9.74%
MSCI World	8.01%	6.07%	1.19%	8.52%	-6.81%	-0.06%	26.69%
Global Bonds	1.93%	-4.06%	4.14%	8.52%	7.06%	6.24%	4.90%
CRB Index	6.12%	1.22%	3.30%	6.56%	-6.77%	-2.54%	27.06%
HFRXGL	1.23%	2.43%	0.03%	5.75%	0.18%	0.38%	9.92%

MODEL	0.45%	-1.32%	1.67%	8.94%	2.27%	NA	9.49%

Who has done well?

Convert arb has done well with as equity vol and vol of vol has remained high. Convert arbs have rotated between gamma and vega to capture opportunities. Distress has understandably done well as they tend to in recovery years following recessions. Fixed income arb has profited from increased issuance and elevated rate vol. Mortgage arbs have also done well.

And who has done poorly?

This year equity long short has done poorly as equities traded erratically and out of line with fundamentals. Market neutral equity managers faced the same problems. CTAs have been confounded by the lack of trend and erratic macro driven markets. And Macro funds, surprisingly have failed to perform in markets dominated by macro factors.

Funds of funds have done quite disappointingly. Many continue to face redemptions as their business model is tested. Some investors have decided to move away from hedge fund investing and some others have decided to invest directly with hedge funds bypassing intermediaries like funds of funds. Without the influx of capital funds of funds struggle to manoeuvre their portfolios between strategies. The outflow of capital leads them to carry more cash than they would in steady state.

A Model Portfolio:

For the smaller, more nimble, more adventurous, better informed investor, a portfolio of hedge funds can still perform well. The Model portfolio performance presented above is the after fees performance of a continuation portfolio of FAPOF which we have continued to run. The portfolio carries 20% cash as we have been careful to deploy and we have tried to keep roughly the same buffer of cash as the garden variety European FOF manager living in fear of his investors deserting him.

The Model Portfolio features an established multi strategy fund, one of our top picks for a more arbitrage and less relative value approach. Also in the portfolio is an Asian convert portfolio by the same manager. European multi strategy with convertible arbitrage roots is also represented by a veteran manager with several billion of AUM who has shown nimbleness in trading that belies his size of AUM. Merger Arbitrage is represented by a very compelling US manager with a track record of generating consistent returns through the years. Equity event driven strategies is represented by a well known and long established fund which unfortunately has not performed as expected and is down a few basis points for the year. Our top performer is Asian multi strategy fund which has generated over 17%, managed by one of the most compelling managers we know. It is always satisfying when the fund you most certainly expect to perform, performs as expected. Our fixed income exposure is represented by a large fund and a small one, both doing very well. In equity long short we have a global fund which has shown success in melding top down macro risk management with bottom up stock picking. That fund is up over 11% this year, run by a manager we have followed since he built a billion plus AUM shop prior to striking out on his own. In credit we have an Asian credit trader run by a prop trader turned portfolio manager formerly with a large investment bank, as well as an ace team of credit managers who used to work together at an investment bank regrouping after a number of years apart. In European distress credit we have a manager with a private equity approach. For Asian equity exposure we chose an manager based in London whose blend of macro and micro has worked very well. Last but not least is a European credit trader who was seeded by a much larger hedge fund which failed but who encouragingly has found seed capital again recently by another large shop.