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TRADING GROUP UBC

Market Concepts

WHAT ARE HEDGE FUNDS

"Long/Short Equity: fund managers pick a pair of stocks, one overvalued and the other undervalued, the returns come from going long on the undervalued pair and shorting the other"

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Certain investors called accredited investors seek higher returns and risk protection from alternative investments. One of those alternatives to stocks, bonds or cash are hedge funds. They are different from mutual funds as they are allowed to invest more aggressively and in a wider range of investment vehicles (options, futures, forwards). For their expected higher returns and risk hedging, hence the “hedge fund” name, they require higher fees. Typical fee structures for hedge funds used to be 2/20, 2% management fees and 20% performance fees. More recently a critical eye has been put on the hedge fund industry and fees have fallen to 1/15 or even 0/12. Furthermore, to achieve supernormal returns to the markets and peers, hedge funds are usually levered in order to capitalize from different strategies. These strategies include:

- Long/Short Equity: fund managers pick a pair of stocks, one overvalued and the other undervalued, the returns come from going long on the undervalued pair and shorting the other

- Global Macro: this strategy focuses on the funds views of where the macro-economic environment is headed and places bets on those trends with long and short positions in various asset classes

- Equity Market Neutral: this strategy once again uses long and short positions by exploiting price differences in closely related stocks; the strategy has the goal of having returns regardless of bull or bear markets

Successful hedge fund managers are praised by Wall Street and leaders of the industry and eventually become some of the world's richest people. Some examples are Ray Dalio of Bridgewater Associates, Bill Simmons of Renaissance Capital or Bill Ackman of Pershing Square. Unfortunately, most hedge funds fail or aren’t able to demand high enough fees due to a lack of performance which leads them to closing their funds.