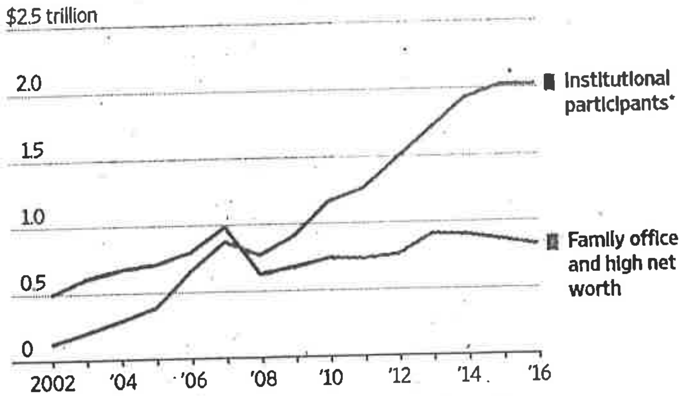
THE WALL STREET JOURNAL.
Thursday, January 5, 2017

Calling the Shots

An industry that once catered mainly to the wealthy is now dominated by institutional investors.

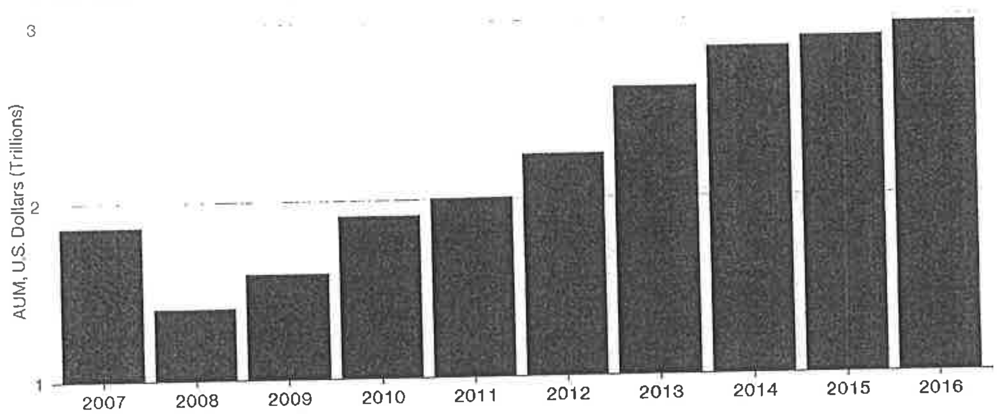
Sources of underlying capital for the hedge fund industry



*Includes sovereign wealth funds, pensions and endowments and foundations
Source: Citi Business Advisory Services based on proprietary data subscriptions to HFR and eVestment
THE WALL STREET JOURNAL.

Assets on the Rise

Performance boosted hedge-fund assets in 2016 despite investors pulling money

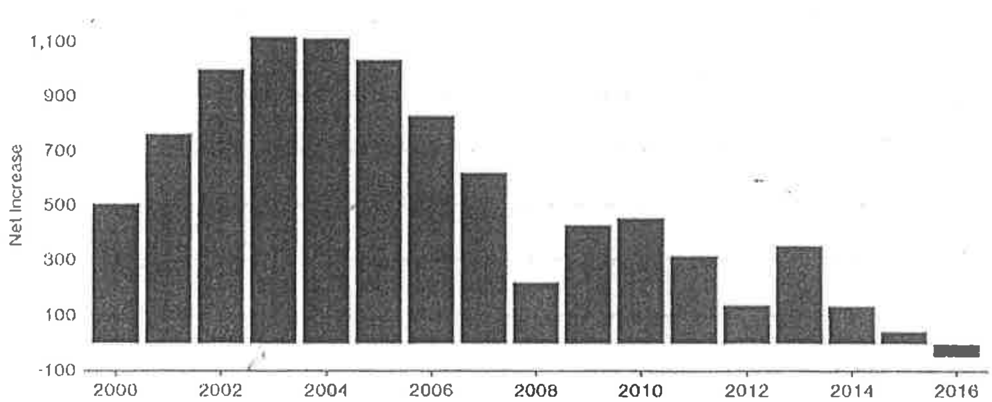


Source: HFR
2016 data as of end of September

Bloomberg

First Contraction on Record

The total number of hedge funds **globally dropped in 2016 vs 2015**



Source: Eurekahedge
Data as of Dec. 16, 2016

Bloomberg

Rhode Island Slices Hedge Funds

BY HEATHER GILLERS

Rhode Island decided Wednesday to cut its hedge-fund holdings in half, the latest step by a major investor to distance itself from some of Wall Street's most expensive money managers.

The State Investment Commission unanimously approved a plan to reduce the nearly $1.1 billion invested in hedge funds by more than $500 million and to instead put the money into more traditional investments such as stocks and bonds. The commission, which oversees $7.6 billion in pension-plan assets, will reduce its target hedge-fund allocation to 6.5% from 15%.

Rhode Island decided to pull back largely because of returns and fees.

For the three years ending Aug. 31, Rhode Island's investments in equity hedge funds produced annualized returns of 3.26% and another set of hedge funds returned 4.02%, below a 5.89% annualized return for all pension-plan holdings during that same time period.

"Going forward, we will only remain in funds that deliver consistent performance and strong returns," said Rhode Island General Treasurer Seth Magaziner.

Pension funds and other institutional investors are increasingly pulling back from hedge funds because of concerns about uneven results and high fees.

The $2.9 trillion industry has underperformed broader financial markets since 2009. This year, hedge funds were, on average, up 3% through July, less than half the S&P 500's total return, which includes dividends, for the period.

Hedge funds typically charge an annual 2% of assets under management and 20% of profits.

JOHANNA HOELZL/PICTURE-ALLIANCE/DPA/AP IMAGES

Returns and fees led Rhode Island to reduce hedge-fund holdings.

WSJ Sep 29, 2016

Hedge funds hit as poor returns deter investors

FT Feb 27, 2017

LINDSAY FORTADO
HEDGE FUND CORRESPONDENT

Investors pulled $5.2bn from hedge funds in January and some said they would further reduce their allocation to the sector this year after being disappointed by performance.

The figures follow redemptions of $110bn last year, the highest amount of money pulled from the hedge-fund industry since the financial crisis, according to eVestment, a data provider.

Investors have grown weary of high fees, crowded trades where multiple funds are chasing the same opportunities, and returns that are falling short of cheaper passive and long-only products.

Many investors are opting for more liquid products, or, on the other end of the spectrum, strategies such as real estate, private equity and infrastructure funds that require them to lock up their money for longer periods but that promise steady returns.

Systematic funds, which trade on macroeconomic trends, were the hardest hit in January, with investors pulling $3.67bn; last year the funds raised more money than any other strategy. Event-driven and relative-value credit funds were also hit by redemptions, while multistrategy funds recorded new investments of $3.8bn.

The amount redeemed in January was a significant improvement over the same month in 2016, when $19.3bn was pulled from hedge funds. And $5.2bn is a small amount for an industry that manages just over $3tn.

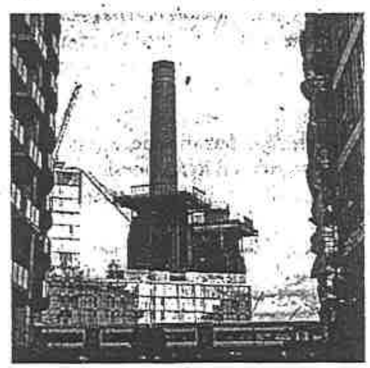
But after five consecutive quarters of outflows, the continuing fall suggests that the industry is still struggling, even though the sector's performance showed signs of improvement last year.

More than a third of investors are planning to further reduce their allocation to hedge funds this year, according to a survey of 150 institutional investors by Preqin, another data provider. Only 20 per cent — half of those who said they plan to cut back — said they intend to increase their allocation.

"The fundraising challenges of the past year show little sign of abating in 2017," said Amy Bensted, head of hedge-fund products at Preqin. "Outflows accelerated over 2016, with the largest levels of investor redemptions made in the fourth quarter. Looking ahead, twice as many investors plan to reduce their exposure over the year compared to those looking to increase it, meaning further outflows look likely in 2017."

A recent JPMorgan survey of hedge fund investors found that three-quarters of large investors were disappointed by the performance of their hedge-fund portfolios last year, but nearly nine out of 10 said they would increase or maintain their current allocation to the sector this year.

Not all hedge funds struggled last year, but most failed to outperform much cheaper products, including index trackers and low-cost long-only funds.



Many investors are plumping for strategies such as real estate

The hedge fund industry, which promised stellar returns in exchange for hefty fees, has ballooned over the past decade thanks to pension funds. Now institutional investors are taking a second look at the costs.

By John Authers and Mary Childs

Overpriced, underperforming

Financial Times Wednesday 25 May 2016

It was the shot heard around the hedge fund world. After the New York City Employees' Retirement System decided to cash all its investments in hedge funds, Letitia James, the city's public advocate, delivered a message to the industry straight out of Occupy Wall Street: "Let them sell their summer homes and jets and return those fees to their investors."

Hedge funds, she said last month, "believe they can do no wrong, even as they are losing money". If they truly cared about New York's pensioners, "they would never charge large fees for failing to deliver on their promises".

New York City's investment in hedge funds — $1.5bn in well-known firms such as DE Shaw and Brevan Howard — does not matter much for an industry that manages $3tn of assets. But worryingly for hedge funds, Nycers' decision appears to be part of a trend. According to Chicago-based Hedge Fund Research, pension funds and other big institutions now account for only 43.1 per cent of hedge funds' assets, from 47 per cent three years ago. The reasons for moving their money mix populist politics — many are enraged by the fortunes that hedge fund managers can amass on the back of high fees — with disappointment in their performance.

"Let's face it: if you go back to the 1990s, hedge funds delivered something very special: high returns or very differentiated returns that you could not get elsewhere, and that is what hedge fund investors have been looking for," said Neil Chriss, founder of Hutchin Hill Capital, a fund with more than $4bn in assets that caters for big institutions. "The problem is, since the crisis, a lot of hedge funds have not been delivering. Returns have been mediocre," he told the Milken Conference this month.

Flows of money from big institutions have transformed hedge funds, which were once primarily a vehicle for rich families. Today, large pension funds account for about a quarter of the money managed by hedge funds. Since the market hit its post-crisis bottom in March 2009, passive, low-cost equity fund investors have thrived while hedge fund returns have underperformed the S&P 500 by 51 percentage points.

The first of the big institutions to openly split with hedge funds was the California Public Employees' Retirement System, the world's largest public pension scheme. Calpers announced 20 months ago that it was scrapping hedge funds from its portfolio to reduce costs and complexity. At the time, many thought it would trigger a wave of redemptions, but with public boards tending to be deliberative, it is only now that the wave seems ready to break, hedge fund managers say.

'There is no doubt that we are in the first innings of a washout in hedge funds and certain strategies'

Daniel Loeb, Third Point

In New Jersey, legislators are considering a proposal to withdraw all alternative investments from the state pension fund. Massachusetts is cutting back its pension fund holdings in alternative investments, which include hedge funds, private equity and venture capital, and pressing hedge funds to reduce their fees. Illinois is preparing to take similar action. Even big insurers like AIG and MetLife have cut back on hedge funds, as have some of Europe's biggest pension funds.

"The hedge fund community has had reduced and in some cases negative returns, and with high fees you are seeing a re-evaluation of how you're going to allocate your money," Larry Fink, chief executive of BlackRock, recently told CNBC.

The famous flame-outs

Should this continue, it will mark the reversal of a decade-long investment trend. Hedge funds' success in generating gains during the 2000-02 dotcom crash lured many institutions to invest in them for the first time. The success of university endowments — led by Yale, which used investments in hedge funds and other alternatives to generate returns of 13.9 per cent annually for two decades — prompted many institutions to dive into the sector.

"In 2005, the number of times Yale and Harvard were mentioned [as a model for other institutional investors] was incredible," says Amin Rajan, chief executive of Create-Research, and an expert on the fund management industry. "But they had the governance and the skills to go after risky asset classes. Big pension plans didn't."

More recently, hedge funds started to look attractive after US markets rebounded from their post-crisis lows in 2009. With bonds and equities, the traditional staples of pension fund portfolios, both looking expensive, hedge funds appeared to be one of the few viable options. The hope was that hedge funds would generate strong returns while also helping to manage risks by using strategies that were not correlated with the stock or bond markets.

The effect has been transformative for the hedge fund industry. Entering 2000, there were 3,102 hedge funds managing $456bn, mostly for wealthy families, according to HFR. This year, it counted 8,474 funds managing $2.89tn, mostly for institutions.

Against such growth, the exit looks like more of a trickle than a flood. Investors withdrew $1.5bn in the fourth quarter of last year, accelerating this year to $15bn, according to HFR. High-profile flame-outs in companies championed by hedge funds, including Valeant, Allergan and SunEdison, have not helped their reputations.

But many fear that worse is to follow. Daniel Loeb of Third Point, one of the most powerful hedge fund managers, says the first quarter was "one of the most catastrophic periods of hedge fund performance that we can remember since the inception of this fund".

He says: "There is no doubt that we are in the first innings of a washout in hedge funds and certain strategies.".

The hedge fund market is more crowded than when industry pioneers such as George Soros, Julian Robertson and Paul Tudor Jones made their names. With so many assets and so many funds, beating the market becomes harder. Exploiting a market anomaly or scouting out a stock poised for a bounce makes less difference to the performance of a big institution than a hedge fund with a handful of wealthy clients. And inevitably the skill and quality of the people involved in hedge funds has been diluted.

As Mr Rajan puts it, there is a Darwinian process at work. Hedge funds that lack the skill to add value are being slowly forced out of business.

"Maybe 20 years ago, projects involving leveraged buyout funds did much better than the general stock market, but all the excess returns have been competed out," says Jeff Hooke, a consultant to the New Jersey Public Pension Coalition attempting to force the state to divest from all alternatives. "There's just too much competition."

Negotiating fees

The trend is not all in one direction, however. US endowments, which are hugely influential because their long-time horizons allow them to experiment, slightly increased their allocations to hedge fund managers last year. So did the similarly influential sovereign wealth funds. According to Preqin, a research group, the proportion of SWFs investing in hedge funds has held steady at 32 per cent, while the proportion investing in private equity — another alternative asset class under fire over fees — has risen from 47 per cent last year to 55 per cent this year.

Indeed, several big investors have boosted their exposure to hedge funds. Finland's state pension scheme plans to invest another $500m this year, and the State Universities Retirement System of Illinois is jumping in with $500m for its first hedge fund allocation.

The actuarial consultants, who wield huge influence over how pension funds deploy their money, continue to recommend enthusiastically buying into hedge funds. "The key is that they are structured to protect capital," says Deb Clarke, Mercer's global head of investment research. "The danger is that pension funds move into beta [passive funds that track equity indices] at the wrong time and miss the point where idiosyncratic hedge funds should deliver returns."

The critical factor keeping institutional money in hedge funds may be the sheer lack of anything else in which to invest. As Ms Clarke puts it: "Plainly people want something different from equities and bonds — bonds are expensive, and equities are not cheap."

Yogesh Dewan of Hassium Asset Management, which advises family offices on investments and is strongly critical of hedge funds, says they have benefited from quantitative easing and other tactics employed by central banks.

"I suspect hedge funds are doing OK because interest rates are so low," he says. "What would usually go into fixed income assets doesn't really want to go into fixed income. And everyone thinks they can find that brilliant manager."

Then there is the emotive issue of fees, which are typically referred to as "2 and 20" — a 2 per cent fee levied on assets, regardless of any performance, plus 20 per cent of fund profits. Such fees are far higher than those charged by mutual funds or other options open to large pension managers.

With returns coming down, such fees look ever harder to justify. Many institutions are losing patience.

"I see the herd mentality among hedge funds every day," said Roslyn Zhang, managing director of fixed income and alternatives at one of China's SWFs, China Investment Corporation, at SkyBridge Capital's annual meeting in Nevada this month. She cited the popular idea to short the Chinese currency. "They spend two seconds on this theme, and they put on the trade. We pay two and 20 for treatment like this. I am reflecting [that] maybe we are not making the right decision."

While hedge funds do not advertise this, their fees are generally negotiable. This is particularly true if the client is a large institution with plenty of money to invest, or if the investor is willing to commit their capital for a longer period of time. Ray Nolte, chief investment officer of SkyBridge, which manages a fund of funds, says paying less in fees is their "job on behalf of investors". It has negotiated the average fees it pays to about 1.3 per cent for management and an incentive fee of less than 15 per cent.

"Performance numbers on an absolute basis are coming down, so fees on a percentage have actually gone up," he says, and "managers are waking up" to the fact that the days of 20 per cent returns are over.

However, Mr Rajan of Create-Research suggests that cutting fees may not resolve hedge funds' problems.

"The immediate cause, fees, is appealing and grabs attention," he says. "It means you didn't make a bad choice, you got ripped off. But the main reason is that the hedge funds failed to deliver what it said on the tin."

'Let them [hedge funds] sell their summer homes and jets, and return those fees to their investors'

Letitia James, New York public advocate

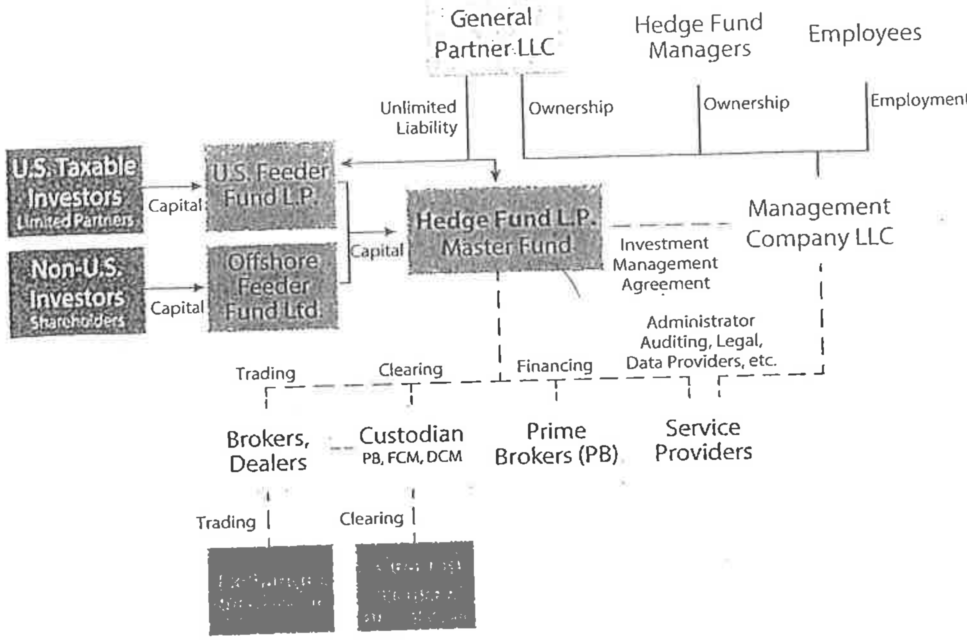
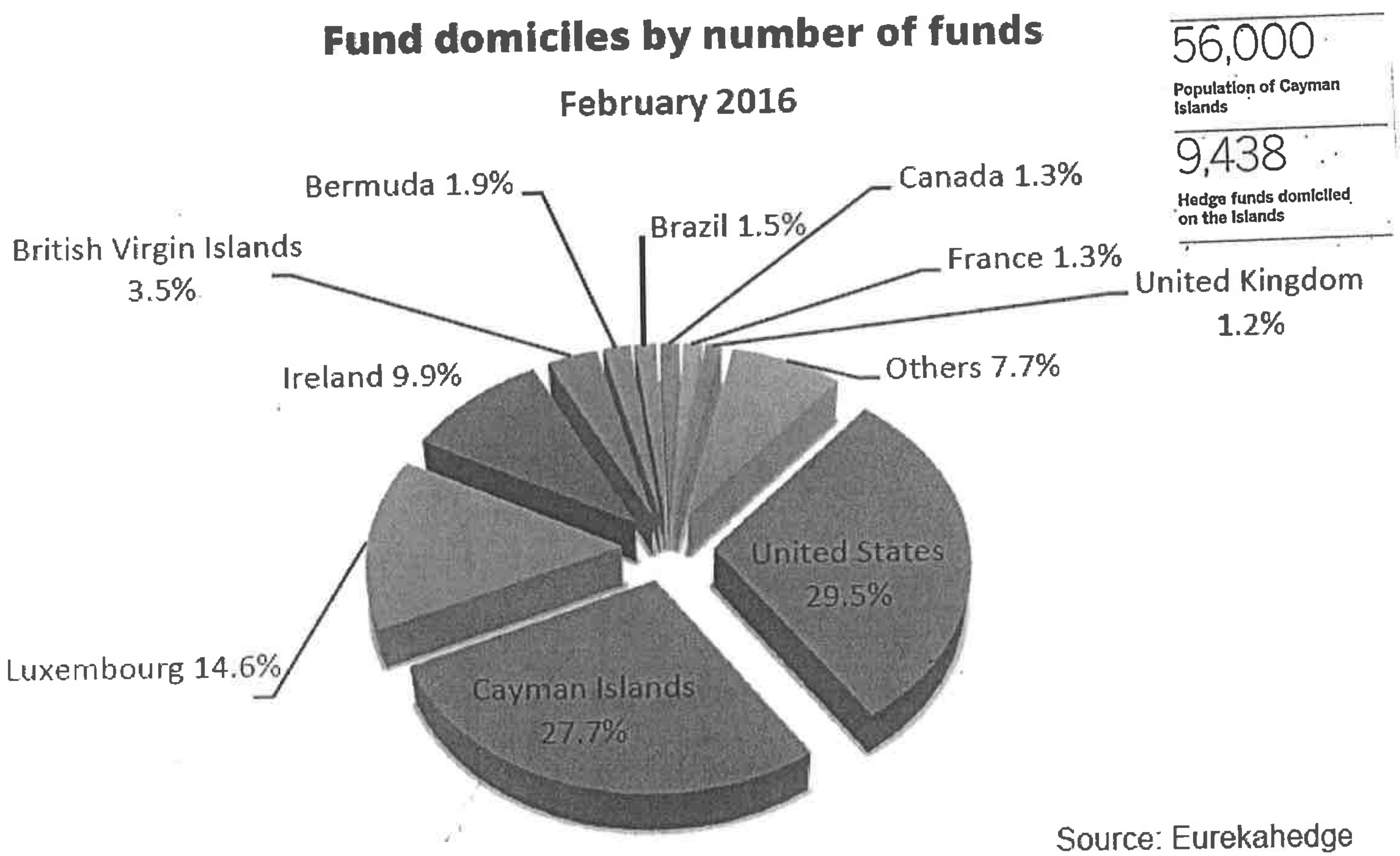


Figure 1.1. The master–feeder hedge fund structure. source: Pedersen, 2015.



Wednesday 17 May 2017
FINANCIAL TIMES

Hedge fund high earners' pay lowest in over a decade

CAT RUTTER POOLEY AND DAN MCCRUM

Lacklustre returns hit hedge fund managers' pay packets last year, with top managers suffering their worst payday since 2005.

But the 25 highest earners still took home a total of $11bn in 2016, according to an annual ranking compiled by Institutional Investor's Alpha magazine, despite investors withdrawing money from funds citing poor performance and high fees.

The pay list was led by a group of quantitative fund managers, who rely on algorithms rather than the expertise of star stockpickers to generate returns.

James Simons of Renaissance Technologies, a mathematician and former code breaker, topped the table for the second year in the row with earnings of $1.6bn, down $100m from the previous year, after his two main funds posted double-digit returns.

Ray Dalio, founder of Bridgewater, which manages around $160bn in assets for 350 institutional clients, was placed second with earnings of $1.4bn. John Overdeck and David Siegel, who founded New York City-based Two Sigma in 2001, brought in $750m each.

The popularity of the computer-driven funds helped the quants rack up their eighth consecutive year of inflows in 2016, doubling their assets since 2009 to $918bn, according to data provider Hedge Fund Research.

The hedge fund industry as a whole swelled after the 2008 financial crisis, as many institutional investors such as pension funds sought to avoid losses experienced when markets crashed.

But the industry has been grappling with modest investment performance for much of the past decade, as low-cost index following funds have become the biggest source of growth in assets under management for the industry.

Last year, $100 invested in hedge funds grew less than 3 cents in value on average, according to HFR, less profit than was available from a broad index of US bonds in a year when the price of many assets, including the US stock market, rose more than a tenth.

Meagre returns did not stop managers making it into the rankings, with almost half of those in the top 25 of the table securing only single-digit returns on their main funds.

Ken Griffin of Citadel fell from last year's joint top spot after his earnings dropped 65 per cent to $600m. His main multi-strategy funds, Wellington and Kensington, returned just over 5 per cent, their smallest gains in eight years.

FT, May 17, 2017

RANK	NAME	FIRM	2016 EARNINGS
1	James Simons	Renaissance Technologies	$1.6 billion
2	Ray Dalio	Bridgewater Associates	$1.4 billion
3	John Overdeck	Two Sigma	$750 million
3	David Siegel	Two Sigma	$750 million
5	David Tepper	Appaloosa Management	$700 million
6	Kenneth Griffin	Citadel	$600 million
7	Paul Singer	Elliott Management Corp.	$590 million
8	Michael Hintze	CQS	$450 million
9	David Shaw	D.E. Shaw Group	$415 million
10	Israel (Izzy) Englander	Millennium Management	$410 million

A $7 Billion Winning Streak

BY GREGORY ZUCKERMAN

Many hedge funds and mutual funds are slashing fees, laying off employees and losing customers following years of subpar performance.

Then there is **Renaissance Technologies** LLC.

The hedge-fund firm, which relies on closely held computer models and algorithms, has staged a comeback after an uneven spell, with its funds posting market-beating gains for more than the past year.

Now they are getting a cash influx, even as rivals suffer withdrawals. Renaissance attracted more than $7 billion in new investor money over the past year from wealthy clients of UBS Group AG, Citigroup Inc. and others, according to people close to the matter. Renaissance now manages more than $36 billion, up from $27 billion a year ago, even after returning about $1 billion from its signature Medallion fund, which is closed to investors.

The success is the latest sign that some quantitative funds are beating traditional investors.

"Renaissance is an exception to the rule," says Matthew Litwin, head of manager research at Greycourt & Co., which invests in hedge funds.

15.3%

Growth in the Renaissance Institutional Equities LP fund in 2016 through Sept. 23

The $14 billion Renaissance Institutional Equities LP fund, or RIEF, was up 15.3% this year through Sept. 23, investors say. That topped the 7.6% total-return gain for the S&P 500 and a rise of 4.3% for the average stock hedge fund, according to data tracker HFR. RIEF rose more than 17% last year and 15% in 2014.

The $10 billion Renaissance Institutional Diversified Alpha Int. LP fund rose 12% this year through Sept. 23, after climbing 16.2% in 2015 and 11.4% in 2014. A newer fund launched in April, the $2 billion Renais-

Please see STREAK page C2

James Simons

Founder, Renaissance Technologies LLC, East Setauket, N.Y.

Assets under management: $36 billion

STREAK

Continued from the prior page

sance Institutional Diversified Global Equities fund, is up about 2% this year. Medallion also has beaten the market recently, an investor says.

About $22.65 billion of Renaissance's assets are owned by the firm's founder, Jim Simons, and "Renaissance-related capital," according to investor documents.

The figure also represents holdings of the firm's 300 employees, including over 90 Ph.D.s in computer science, statistics and computational linguistics.

Renaissance began combing enormous troves of data for patterns over three decades ago, well before rivals and unrelated businesses embraced such strategies.

In August, RIEF held shares in at least 10 industries. Over the past year or so, the fund reduced its exposure to growth stocks and boosted holdings of value shares, investors say, benefiting from the outperformance of value stocks, those that buyers view as underappreciated by the marketplace. Renaissance funds also use leverage, or borrowed money, to amplify returns.

Some traditional stock pickers say unexpected trading patterns caused by the rush into exchange-traded funds make investing harder for those reliant on fundamental strategies, such as buying underpriced stocks. By contrast, Renaissance's models rely on signals from a range of inputs, including technical factors related to stock-price movements, helping the firm avoid some issues slowing traditional investors, clients say.

"Technical factors are swamping fundamental analysis lately," helping Renaissance, says Amanda Haynes-Dale, co-founder of Pan Reliance Capital Advisors, which became a Renaissance client this year.

Over the past year or so, the fund reduced its exposure to growth stocks and boosted holdings of value shares, investors say.

That recipe hasn't always worked for Renaissance, which Mr. Simons founded in 1982. The firm opened two hedge funds to outside investors in 2005 and 2007 but experienced mediocre early results.

In 2010, when Mr. Simons stepped back from running the East Setauket, N.Y., firm, new leadership considered closing the two hedge funds open to outside investors. By then, assets had fallen to $5 billion from over $20 billion a few years earlier. Last year, Renaissance closed a $1 billion futures fund due to poor interest.

Renaissance's recent rebound comes as the company's executives are playing larger roles in politics. Co-Chief Executive Robert Mercer has been among the largest political donors of the 2016 election cycle, spending more than $13 million to back Texas Sen. Ted Cruz through a super PAC while also funding Breitbart News, the conservative media outlet.

He and his daughter, Rebekah, played a role in the August shake-up of Donald Trump's presidential campaign, recommending Breitbart Chairman Stephen Bannon and Republican pollster Kellyanne Conway for top posts. Mr. Simons has given millions to a Hillary Clinton super PAC.

Executives focus on trading and try to avoid talking about politics, employees say.

Renaissance's cash inflow raises questions about how long its winning streak can continue. Many firms see performance weaken after assets swell.

Some clients say they are keeping a wary eye on Renaissance's burgeoning size.

Renaissance avoids hiring Wall Street veterans, helping it avoid mistakes made by those reliant on traditional investing methods, the firm says.

"The advantage scientists bring...is less their mathematical or computational skills than their ability to think scientifically," Mr. Simons said, according to an investor document. "They are less likely to accept an apparent winning strategy that might be a mere statistical fluke."

Yen Bets Don't Add Up for a Fund Giant

By Gregory Zuckerman

Renaissance Technologies LLC, a hedge-fund heavyweight, has been bruised in the market's recent turbulence.

Two of the three hedge funds that the company makes available to outside investors have suffered sizable losses this month, largely due to the big drop in the Japanese yen, investors say.

At the same time, Renaissance continues to raise cash at a slower pace than some had expected. The firm manages about $6 billion of cash for outside investors—down from about $25 billion in 2007.

Renaissance is perhaps the best-known "quantitative" hedge-fund firm, or one that employs sophisticated computers to guide its trading. James Simons, a mathematician and Cold War code breaker, founded the firm three decades ago and ran it until he stepped aside in 2010. The returns for its main fund topped those of almost every other investor in that period.

The firm is now run by Mr. Simons' former lieutenants, Peter Brown and Bob Mercer.

The April losses amount to about $220 million, a fraction of the $23 billion or so that Renaissance manages in total. And

Please turn to the next page

Continued from the prior page

overall Renaissance continues to score profits.

Still, the results raise questions about whether Renaissance is dropping back to join the rest of the hedge-fund pack, after years of outpacing the competition.

A $740 million fund called the Renaissance Institutional Futures Fund dropped more than 6% in the first 12 days of April and remains down about 6% for the month, making it among the worst-performing hedge funds in that period. For the year, the fund is down about 2% after losing 3.2% last year.

The Renaissance Institutional Diversified Alpha fund, a roughly $5.5 billion fund launched last year, dropped 3.4% during the first 12 days of April. The fund is up about 5% for the year, according to an investor, after a loss of about 1% last year.

A third Renaissance fund available to outsiders, the $7.3 billion Renaissance Institutional Equities Fund, rose about 0.5% in the first 12 days of April and is up nearly 12% for year, according to an investor. The fund has outperformed the Standard & Poor's 500 since launching in 2005 with less volatility than the market.

James Simons, Renaissance founder

Bloomberg News

Renaissance's best-known fund, the $10 billion Medallion fund, is up around 10% so far this year, investors say, a tad below the approximately 11.4% gain for the S&P 500, including dividends, but above the nearly 4% gain for the average hedge fund so far this year, according to HFR, a data tracker. Medallion, which rose more than 20% last year, is only open to Renaissance employees.

The firm's recent challenges underscore how even hedge funds with stellar records are having a tougher time beating the market lately.

The industry's breakneck growth means funds manage more money than ever—an estimated $2.4 trillion, a sum that some say makes it harder for some funds to achieved outsize gains. John Paulson's Paulson & Co., for example, has seen deep losses in some funds since the firm's assets grew to $36 billion at the start of 2011.

Renaissance, founded in 1982 in East Setauket, N.Y., by Mr. Simons, trades in a different way than most investors. Besides its quantitative orientation, Renaissance operates in vast markets—such as Treasurys and currencies—that in theory can make it easier for big investors to find profits than simply trading equities. Mr. Simons once said that the funds could handle $100 billion in assets profitably.

While Renaissance is known as a fast-trading "quant" fund, and its Medallion fund holds some investments for as little as minutes or even seconds, it is not considered a "high-frequency trader," or a trading firm that buys and sells in milliseconds. The group has received criticism for jolting financial markets in episodes such as the "Flash Crash" of 2010 and this week's fake-tweet selloff.

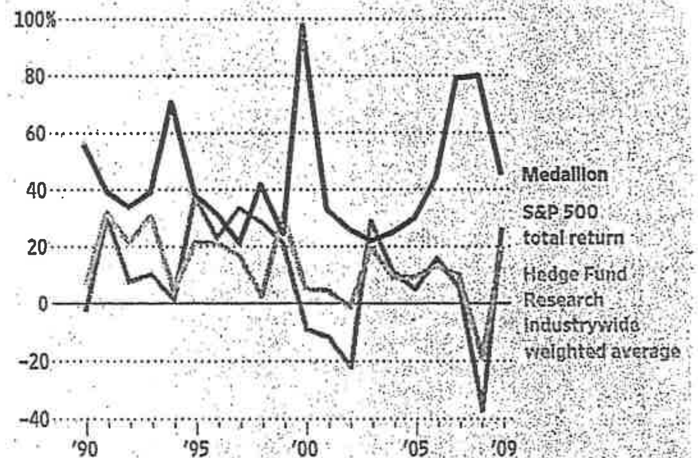
Medallion has scored average annual returns of about 35%, after fees, since its inception in 1988, with only one money-losing quarter since 1995, a slight 0.5% drop in the first quarter of 1999, the firm has told investors.

Mr. Simons was a pioneer in using powerful computers to comb markets for trading opportunities. Renaissance isn't the only firm using such strategies that has struggled of late.

"Trend-following quantitative models failed to capture [recent] trends in equities and currencies," Ken Heinz, HFR's president.

The average commodity trading advisory, or fund that focuses on futures trading, gained just 1.5% for the year, through April 22, according to HFR. These kinds of funds dropped 2.5% last year.

Renaissance's flagship Medallion fund has consistently outperformed the industry. Returns after fees:



Sources: Medallion reports; WSJ research; Standard & Poor's; Hedge Fund Researchc Inc.

Tuesday, March 16, 2010

Trader Racks Up A Second Epic Gain

$5 Billion Profit For John Paulson

BY GREGORY ZUCKERMAN

Hedge-fund manager John Paulson personally netted more than $5 billion in profits in 2010—likely the largest one-year haul in investing history, trumping the nearly $4 billion he made with his "short" bets against subprime mortgages in 2007.

Mr. Paulson's take, described by investors and people close to investment firm Paulson & Co., shows how profits continue to pile up for elite hedge-fund managers. Appaloosa Management founder David Tepper and Bridgewater Associates chief Ray Dalio each personally made between $2 billion and $3 billion last year, according to investors and people familiar with the situation. James Simons, founder of Renaissance Technologies LLC, also produced profits in that range, say investors in his firm.

By comparison, Goldman Sachs Group Inc., Wall Street's most profitable investment bank, paid all of its 36,000 employees a total of $8.35 billion last year. James Gorman, chief executive of 76-year-old investment bank Morgan Stanley, is expected to receive compensation of less than $15 million for 2010.

Mr. Paulson and his fellow managers seldom take much of their profits in cash. Some of the profits are so-called paper gains, which reflect the rising value of their firms' holdings, and could erode if those investments sour. Other gains come from selling investments, and most of those are rolled back into their funds.

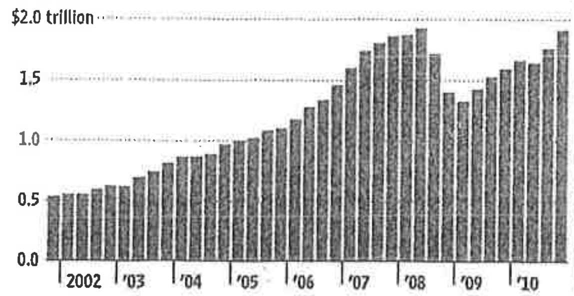
Mr. Paulson and the other top managers made winning bets on commodities, emerging-market companies, bank shares and U.S. Treasury bonds, among other investments. These moves, along with profitable picks by other funds, are part of the reason the hedge-fund industry is back on its feet after a rough stretch. Assets managed by hedge funds have grown to a near-record $1.92 trillion, up 20% over the past year. Assets jumped almost $150 billion in the fourth quarter alone, the largest quarterly growth on record, according to Hedge Fund Research, Inc.

Still, the average fund gained just 10.49% last year, according to the research firm. That's well below the 15% gain of the Standard & Poor's 500 stock index, including dividends, and the 19%

Please turn to the next page

Hedging Up

Estimated assets under management in hedge funds, world-wide



Source: Hedge Fund Research

Hedge-fund manager John Paulson personally netted more than $5 billion in profits in 2010.

Hedge-Fund Trader Paulson Racks Up Second Epic Gain

Continued from Page One

return of the average stock mutual fund, raising questions about whether the industry can profitably invest the influx of new cash.

Indeed, the enormous gains by Mr. Paulson and the other managers resulted from solid, though not spectacular, performance. Their personal gains came in part from the sheer scale of assets under their control. The largest hedge fund in Mr. Paulson's $36 billion investment portfolio, Advantage Plus, grew 17% last year, while another big one rose 11%, falling below returns for the broader stock market.

Part of Mr. Paulson's more that $5 billion profit came from his firm's 20% cut of his funds' profits, known in the industry as the "performance fee." Those fees amounted to roughly $1 billion last year, according to a person familiar with the matter. An added plus for Mr. Paulson: A chunk of those profits are treated as long-term capital gains and taxed at a far lower rate than the standard income-tax rate.

More than $4 billion came from gains on Mr. Paulson's investments in his funds.

Mr. Paulson amped up profits for himself and many of his investors in a novel way. He was worried about long-term weakness of the dollar and other major currencies, so he devised a way to embed a bet on gold into each of his funds—for those investors who opted for that approach. Mr. Paulson has placed the bulk of his own wealth in these gold-denominated funds and a separate gold-focused fund. Because gold rose sharply in value last year, the gold-denominated versions of his funds rose as much as 45%.

The performance last year, nevertheless, paled in comparison to his 2007 returns, when Mr. Paulson made a huge wager against subprime mortgages and his funds scored gains of as much as 590%.

Last year "wasn't the greatest trade of all time, but to manage more than $30 billion and still have gains topping 30% is very rare in the hedge-fund business," says Jeffrey Tarrant, who helps run Protégé Partners, a New York firm that invested in Paulson & Co. in the past.

One way to view the size of Mr. Paulson's $5 billion profit: It is nearly as much as the $6.4 billion that Forbes magazine last year estimated as the total net worth of Steven Cohen, the well-known head of $12 billion hedge-fund firm SAC Capital. (Mr. Cohen likely added about $1 billion in 2010, one investor says, after 16% gains in his flagship fund).

Mr. Paulson added to profits by devising a way to embed a bet on gold into each of his funds.

Appaloosa's chief, Mr. Tepper, who specializes in distressed-debt investing and manages around $16 billion, notched gains of about 30% by turning optimistic about U.S. stocks before many rivals. Mr. Tepper correctly anticipated the Federal Reserve's recent efforts to boost the economy, steps that have helped the market rally.

Mr. Dalio's Bridgewater Associates, which manages $86 billion in hedge funds and other vehicles, made an early shift to U.S. Treasurys, commodities and emerging-market currencies. He correctly anticipated that the Fed would flood the financial system with cash to help the economy, something that would boost bond and gold prices. Bridgewater also anticipated growth in China and emerging markets, which it figured would help commodities and currencies of those nations. Its hedge funds gained more than 30% last year.

Mr. Simons no longer runs day-to-day trading at Renaissance Technologies, which manages nearly $16 billion and specializes in lightning-quick computer-based trades, so his pay actually dropped a bit in 2010.

But Mr. Simons still owns the bulk of the firm and invests in its hedge funds. Renaissance's two funds available to outside investors, Renaissance Institutional Equities and Institutional Futures funds, gained about 18% last year, following a disappointing 2009 when the firm considered closing them to outsiders.

Renaissance's Medallion fund, which is primarily open to Renaissance employees like Mr. Simons and has long recorded big gains, climbed about 30%, according to people close to the matter.

The hedge-fund business now is so big that some managers are hinting they'll return money to clients instead of investing it. Handling so much cash can make it hard to generate big gains in some trading strategies.

Mr. Tepper, for example, has told some investors to expect to receive some cash back in 2011. He returned $500 million to investors last year. This year, he may return several billion dollars, according to people close to the matter.

Other firms, such as Paulson & Co., have closed certain funds to new investors, but are actively raising new money for other funds. Mr. Paulson recently hosted a New York City event that featured speeches by former Fed chief Alan Greenspan and several chief executives of gold companies, aimed at boosting interest in his gold-focused fund.

Despite Mr. Paulson's winning touch in 2010, he may face a challenge. Gold is down more than 6% so far in 2011, meaning he is likely starting out with losses.

Hedge-Fund Managers to Watch in 2017

Alan Howard

David Siegel

Scott Ferguson

Steven A. Cohen

Daniel Och

FROM LEFT: PRENSA INTERNACIONAL/ZUMA PRESS; PHILIP MONTGOMERY FOR THE WALL STREET JOURNAL; PRENSA INTERNACIONAL/ZUMA PRESS; STEVE MARCUS/REUTERS; VIRGINIA MAYO/ASSOCIATED PRESS

For many hedge-fund managers, 2016 was a year to forget.

Tens of billions of dollars flew out of the industry as investors flagged disappointing returns and stubbornly high fees.

Even hedge-fund stalwarts now concede the business model is in need of a rethink, largely built around three tenets: trading ideas, technology and fees. Too many firms are doing the same thing with each, skeptics say, meaning a firm that differentiates itself from the pack will stand out.

Here are a few hedge-fund managers to watch in the year ahead:

STEVEN A. COHEN

The coming year looks moribund for new hedge-fund launches, with many young traders opting to stay inside bigger firms rather than risk a flameout on their own.

Because of that, hedge-fund investors are readying themselves for the once-unlikely return of an old favorite: the billionaire Steven A. Cohen.

Mr. Cohen's **SAC Capital Advisors** agreed to plead guilty three years ago to criminal insider-trading charges. He later struck a personal civil settlement with securities regulators that would allow him to run a hedge fund again starting New Year's Day 2018.

Mr. Cohen, 60 years old, says he is still ostensibly undecided on a return, but Cohen confidantes point to his formation last year of a new firm, **Stamford Harbor Capital**, across the street from SAC's old offices and run by a longtime SAC deputy.

A Stamford Harbor consultant already has begun surveying potential investors about the fees they would pay for a new hedge fund, people familiar with the matter said.

If and when Mr. Cohen begins to raise money in earnest, he is expected to aim for a record-breaking sum.

—Rob Copeland

ALAN HOWARD

Alan Howard may have reason for hope. A strong November on the back of Donald Trump's election victory reversed what would have been a third consecutive year of losses for his **Brevan Howard Asset Management** LLP's flagship fund. The fund gained 5.6% in November, bringing its performance for the year through November to 2.8%, according to a person familiar with the matter.

The $12.7 billion fund is roughly at its high-water mark, or the point where investment gains make up for losses and funds can start charging performance fees again. That is good news for a fund that recently dropped its management fee to 0% for some investors in a bid to attract more assets.

Macro managers like Brevan Howard make calls on big-picture market movers like the economy and politics. If a Trump presidency spells a new, sustained regime of market volatility, that may spell an era of profits for them.

—Juliet Chung

Even hedge-fund stalwarts now concede the business model is in need of a rethink.

SCOTT FERGUSON

Scott Ferguson of **Sachem Head Capital Management** is often mentioned as near the head of the class for the next generation of activist investors. That is telling of where the industry is going.

Mr. Ferguson, 42 years old, worked under William Ackman at **Pershing Square Capital Management** before setting out on his own in 2012. Last year, he took his first board seat, at software company **Autodesk** Inc., in only his third public activism fight.

That seat came without a shareholder vote. After Autodesk's chief executive blasted him, Mr. Ferguson didn't fight back. Mr. Ferguson and the new school of activists are more into playing polite to get their way.

Autodesk shares have rallied since. Meanwhile, Mr. Ferguson has been selling down his first activist bet, on a car-dealer software company **CDK Global** Inc., which has more than doubled in value since October 2014.

Sachem Head told investors it was up slightly for the year as of Dec. 15, according to a person familiar with the firm. But Mr. Ferguson's CDK sale means he is fueled up for 2017.

—David Benoit

DANIEL OCH

A new year can't come quickly enough for Daniel Och.

The 56-year-old founder of **Och-Ziff Capital Management Group** LLC, the largest publicly traded U.S. hedge-fund firm, endured a 48% stock plunge in his firm's shares in 2016. That came as Och-Ziff paid $400 million to settle federal charges that it bribed African government officials in exchange for business.

The firm's problems are magnified by its outsize reliance on U.S. institutional investors, who have been among the most active in pulling their money from hedge funds. The firm now oversees $37 billion overall, down from $45 billion at the start of 2016.

Och-Ziff couldn't find a taker in 2016 when it shopped a piece of itself to investment firms across Wall Street. Instead, Mr. Och and other top executives agreed to invest up to $500 million in the firm. More than ever, his fortune is riding on any comeback.

—Rob Copeland

TWO SIGMA

Two Sigma Investments LLC has grown into one of the biggest quantitative hedge funds in the world. The New York firm had $24 billion in assets under management in 2015. That swelled to $38 billion in 2016 through a combination of performance and inflows.

Founded by computer scientist David Siegel and mathematician John Overdeck, Two Sigma uses computer systems to trawl data, make predictions and trade automatically. Like some other hedge funds, it is eager to say it considers itself more a technology company than an investment firm, styling itself as the Google Inc. of Wall Street.

In one sign of that ambitious casting, in 2016, it joined with **American International Group** Inc. and **Hamilton Insurance Group** Ltd. to provide an automated online system to issue insurance policies to small businesses in minutes.

The firm believes such efforts will help in recruiting and keeping talent, a person familiar with Two Sigma said. But the firm has told clients notching strong returns is its priority.

—Juliet Chung

Financial services FT Nov 24, 2016

Gap widens in hedge fund manager pay

LINDSAY FORTADO
HEDGE FUND CORRESPONDENT

Portfolio managers at the top-performing hedge funds can expect to rake in $6.78m in pay this year, compared with about $740,000 in total remuneration for their counterparts at the lowest-performing funds.

The disparity in pay is the largest gap since 2008 and is being driven by a wider dispersion in performance by hedge funds this year, according to Adam Zoia, chief executive of Glocap, a recruitment company.

"As you get higher up the food chain, that differential gets greater," said Mr Zoia. "We're seeing more than 10 times the difference between the top and bottom tertile for the most senior portfolio managers."

Most of the difference is via bonus, with most managers making about $275,000 in base pay, according to data from Glocap and CompIQ, a pay tool, compiled from hedge funds with assets under management of more than $4bn.

The pay scale will not please some of the US pension funds that have vocally redeemed their investments from hedge funds this year, after complaining of the high fees that they had been charged for returns that did not outperform benchmarks.

But while several titans of the hedge fund industry have struggled this year and redemptions have outpaced inflows, some funds have quietly had strong years.

The top third of funds has returned close to 15 per cent this year while the bottom third has lost about 7 per cent, according to Hedge Fund Research. That is an improvement on last year, when the top third returned 8.7 per cent and the lowest third lost 11.5 per cent.

Senior analysts are also seeing the difference in pay. A senior analyst at a top-third fund is likely to take home about $1.55m this year. That is 2.8 times more in pay than someone in the same role at one of the bottom performing funds, who may make about $500,000. Last year, the difference was only 1.5 times.

Mr Zoia said there was no shortage of job offers for those managers able to deliver strong returns and that news of job cuts in the industry was overblown.

Within funds, pay was also becoming more competitive, he said, with individuals at the same level seeing a wider range of pay as funds spent more to hold on to their best performers.

The shears are out for hedge fund fees

LINDSAY FORTADO
HEDGE FUND CORRESPONDENT

When Chris Rokos launched a hedge fund late last year, he offered investors the standard industry charge: a 2 per cent management fee and a 20 per cent performance fee.

But Mr Rokos, once a star trader who made investors billions of dollars at Brevan Howard, knew that some might balk at this traditional charging structure. So he also offered a second option: a 1 per cent management fee and a 30 per cent performance fee — cutting the flat fee for investors but providing more incentive to generate better returns.

Now, fee reductions and flexibility around incentives have become increasingly important in the hedge fund industry, where low returns in some funds have caused concern among investors about how much value their managers are generating.

The willingness to negotiate on fees shows how the longstanding 2 and 20 formula for hedge fund fees is becoming outdated. While there has always been pressure on hedge fund managers to reduce their fees, some of the highest in finance, lacklustre performance this year by several of the biggest names in the industry has forced funds who once billed some of the highest rates in the industry to acquiesce to investor pressure and cut how much they charge.

Hedge fund consultants see further cost-cutting as inevitable next year given performances in 2016 that many will want to gloss over by encouraging their investors to stay through innovative ways to validate their rates.

"There's a lot of creativity going on and an effort to find fee structures that work for both the manager and the investor," says Ermanno Dal Pont, global head of strategic consulting at Barclays. "The days where everyone was on 2 and 20 and quarterly liquidity are surely over."

Managers are offering discounts by using a scale of fees based on assets under management or time spent invested, so when assets rise or a certain amount of time passes, the early investors pay less, according to Barclays' prime services group.

There are also longer performance fee crystallisation periods for funds with longer investment time horizons, and hurdles that place a threshold on incentive fees. Some are also charging different levels of performance fees based on how big a return they made; granting discounts where existing investors can add more capital to a strategy during a down period at a reduced rate, and offering reduced fees if investors agree to lock up their capital for longer or invest a larger chunk of money.

According to Barclays, two-thirds of funds offer a fee discount of some kind. The only type of manager that is likely to say no about half the time operates so-called multi-strategies, where funds use combinations of investments

Macro funds were the most willing to discount the management fee only, while systematic managers, who often have the lowest overheads because they trade based on computer algorithms, offered to discount both management and performance fees more than half the time.

The average charge has already fallen from 2 and 20, according to industry executives.

Andrew Beer, chief executive of Beachhead Capital, which markets products that rival hedge fund offerings, says the average fee is now about 1.65 per cent in management fees and 18 per cent in incentive fees. For new fund launches, it is now 1.49 per cent and 17.5 per cent, Hedge Fund Research says.

"The 2 and 20 has been dead for longer than people think," says Russell Barlow, head of hedge funds at Aberdeen Asset Management.

"Funds who can charge that or greater are a rare exception. 2016 saw a number of groups who felt they could defend their legacy fee structures capitulate — even the mighty need to concede."

Mr Barlow says that he is always challenging on fees but has yet to see many innovative discount models. More frequently, he tries to negotiate for a hurdle on performance fees, although he adds that there is less room to negotiate on fees in a fund with multiple investors, rather than a bespoke account.

This year investors also shifted away from active investing towards so-called passive products that are meant to mimic hedge fund factor performance, which are much cheaper, he said. In response, many funds are now offering a lower fee option — funds similar to the full-price version but targeting a lower expected risk adjusted return.

Managers who need the 2 and 20 tend to be at start-up funds, according to Joe Vittoria, chief executive of Mirabella, a regulatory platform that hosts emerging managers.

Where investors in start-ups were once able to negotiate an "early bird special" with reduced fees, now more are offering a higher fee to start, with reductions once certain time periods or asset levels are reached, he says.

That also helps assuage the fear that once funds reach a certain level of assets, they are collecting so much in management fees they do not have the incentive to hit performance targets.

Mr Beer says the entire model needs to change, just as the hedge fund industry has changed since the 1980s and 90s, when it was mostly investors borrowing from friends and family and needing the fees to survive. When money started to flood into the industry in the late 1990s and early 2000s from institutional investors, the demand became such that fees were able to stay high.

Since, investors have become accustomed to the 2 and 20 model and are happy to see any sort of discount, he says. "But what if you should actually be paying is 75 basis points with no incentive fee? Then you're still making a bad decision, although slightly less bad."

"Investors take all the downside and pay away most of the upside," he adds. "These fee reductions are rearranging deck chairs on the Titanic."

But Mr Vittoria argues that the way fees are charged is becoming more transparent. The funds able to carry a 2 and 20 fee structure now need to show a unique strategy and capacity constraint, he says.

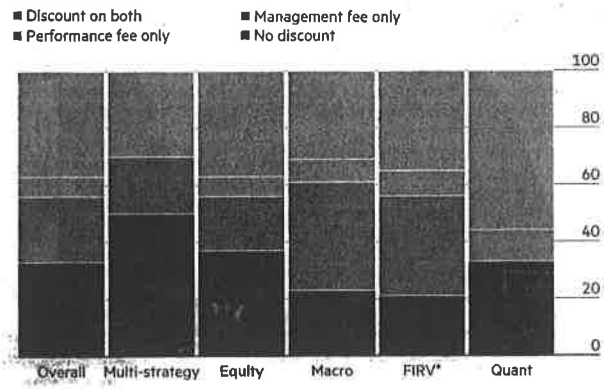
"Managers are willing to get out a spreadsheet and show the costs and the reason why they are charging what they are," he says. "It's all about transparency now."

As for Mr Rokos's 1 and 30 model, Mr Beer says the structure is fair as long as there is a hurdle before the performance fee is earned. Rokos Capital got off to a rocky start in its first three months of trading in late 2015, but has returned more than 15 per cent this year, making it one of the top performing macro hedge funds of 2016.

"I wouldn't mind paying 30 per cent of performance above, say, Libor plus 400 basis points," he says. "But 30 per cent over zero rewards mediocrity."

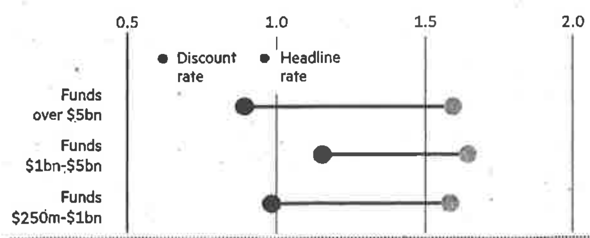
Hedge funds offering discounts

By type of fund (%)



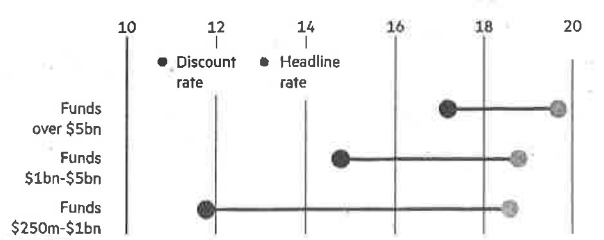
Management fee discounts

Flagship funds ranked by assets under management (%)



Performance fee discounts

Flagship funds ranked by assets under management (%)



FINANCIAL TIMES

Friday 23 December 2016

Private jets expensed with hedge fund fees

High costs and expenses erode returns

STEVE JOHNSON

Some hedge fund managers are taking salaries, private-jet expenses and entertainment costs directly out of the funds they manage, according to investors and consultants.

Hedge funds notoriously charge high upfront fees, with the "2 and 20" model of a 2 per cent annual management fee and 20 per cent performance fee the historic norm.

Despite this, some are charging their costs and expenses to the funds they manage, eroding investors' returns still further.

"We have seen some very bad examples, such as hedge funds paying salaries from the funds and private jets put through the fund expenses," said Ed Francis, head of investment for Europe, the Middle East and Africa at Towers Watson, a consultant. He described these charges as "pernicious".

"This is certainly very true of some of the larger established funds. They would put salaries and expenses through and that was pretty normal," said a former fund of hedge funds manager, who declined to be named. The manager estimated the cost as around 30 basis points a year.

Phillip Chapple, executive director of KB Associates, an operational consultancy, said other hedge funds were charging marketing expenses, data fees and the costs of Bloomberg terminals and research directly to funds.

"I think a lot of managers see this as a way of eating up expenses that they incur as a fund manager," he said. "It is very hard to look people in the eye and justify some of that stuff. If you find them doing this, then you wonder what else they are doing."

The charges are legal if they are outlined in a fund's offering memorandum or private placement memorandum. However, these documents are "typically written in a way to encompass most things imaginable", according to Joshua Barlow, associate director at Paamco, a fund of hedge fund manager.

Many charges, such as those for audit fees, legal fees, administration costs and tax filings, are widely seen as legitimate.

Mr Barlow said he had seen "surprising" levies for "employee salaries, technology, regulatory filings, fund portfolio and accounting systems, outsourced middle office, insurance, trade errors, travel and entertainment" that, in some cases, are "so large that they raise the question 'what is the management fee I am paying going towards?'"

"We have seen instances where they can be quite large," said Stephen Oxley, managing director of Paamco. "They might say they need to use an executive jet to visit a company, but that doesn't cut any ice for us. We have it in our sub-advisory agreements that we are not going to pay. We are not going to invest unless this is sorted out."

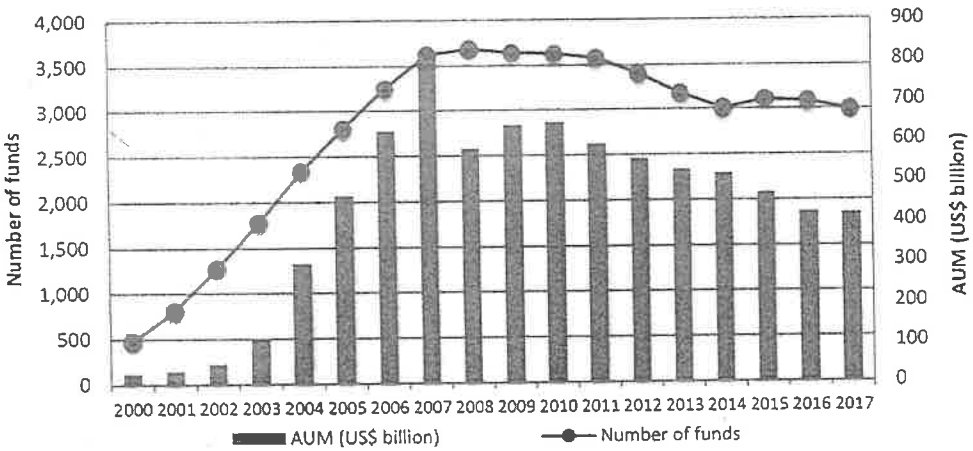
Mr Francis said the most egregious abuses were being weeded out amid a greater focus on operational due diligence, as institutional investors increasingly replace wealthy individuals as the primary hedge fund investors.

Some allocators to hedge funds said they were willing to invest in the worst offenders if their performance was sufficiently good, while others admitted they did not have the resources to check exactly what they were being charged for.

"The onus is on the investor to understand what they are invested in [but] it is slightly hidden in the documentation. We had to go digging for it," said the former fund manager.

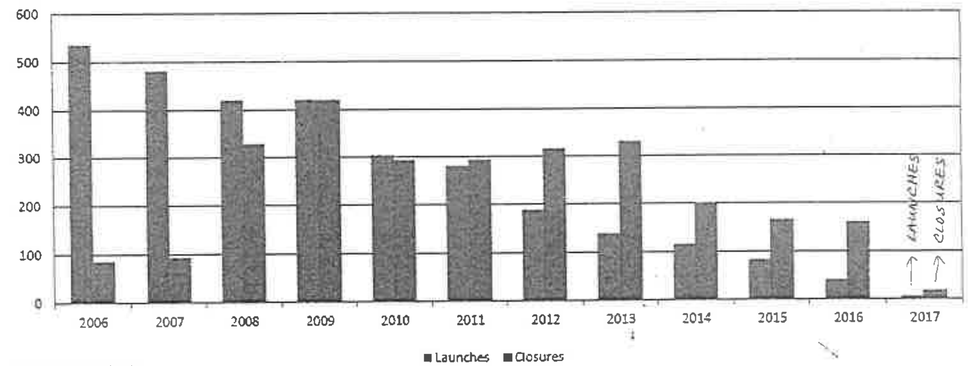
Jack Inglis, chief executive of the Alternative Investment Management Association, said: "Managers disclose all fees and expenses that are directly or indirectly borne by investors."

Figure 1a: Global funds of hedge funds industry



Source: Eurekahedge

Figure 3: Launches and closures of funds of hedge funds over the years



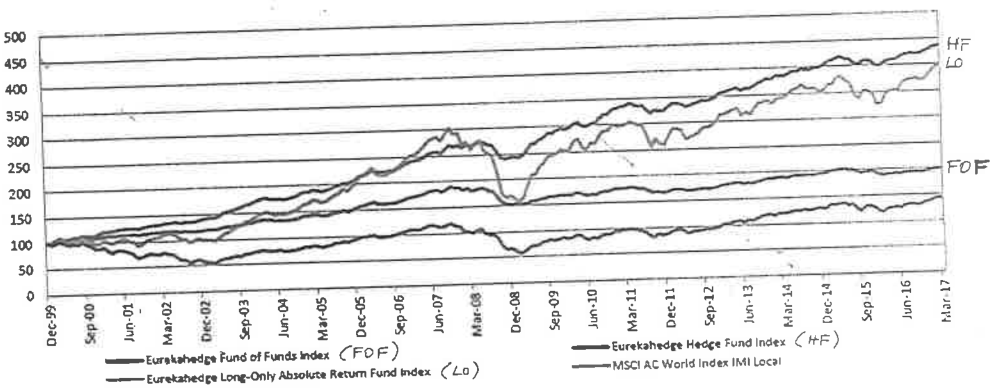
Source: Eurekahedge

Table 2: Average fund of hedge fund fees by launch year

Year	Average Management Fees (%)	Average Performance Fees (%)
2005	1.30	10.6
2006	1.26	10.7
2007	1.33	9.6
2008	1.29	9.6
2009	1.33	9.3
2010	1.23	10.3
2011	1.23	9.0
2012	1.24	7.3
2013	1.19	7.2
2014	1.31	7.8
2015	1.13	7.6
2016	1.06	6.9
2017	0.81	10.0

Source: Eurekahedge

Figure 8: Performance of fund of hedge funds, underlying markets and hedge funds



Source: Eurekahedge

Cancer jibe adds to funds of funds' woes

Madoff Fallout

But experts do not expect a full-scale withdrawal, writes Paul O'Dowd

Hedge funds of funds have taken significant verbal hits from major pensions and reputable industry names this month on the heels of poor returns and the Madoff affair, allegedly the largest Ponzi scheme ever concocted.

Perhaps one of the biggest jabs came from David Swensen, chief investment officer of the Yale Endowment, who called funds of funds a "cancer". The comments may have prompted some institutions to question the vehicles, but industry experts say they do not expect a full-scale pullback from funds of funds.

Mr Swensen accuses funds of funds of being "cancer on the institutional investor world".

"If an investor can't make an intelligent decision about picking managers," he says, "how can he make an intelligent decision about picking a fund-of-funds manager who will be selecting hedge funds?"

He adds that in a fund of funds, investors are likely to be excluded from the best managers. "[Bernard] Madoff also relied enormously on these intermediaries. He wouldn't have had nearly as much resources were it not for funds of funds."

Yale, from July to October last year, lost 13.4 per cent of its overall portfolio, which now stands at $17bn (£12bn, €13bn).

Joe Gieger, managing director for the Americas at funds of funds shop GAM, feels it is naive for anyone to paint funds of funds with such a broad brush. "There certainly is a role for funds of funds, especially for institutions that don't have the resources to dedicate to researching and identifying underlying hedge funds," he says.

"The model of funds of funds is not about access to yesterday's talent but about new talent, successful managers and strategies. I am not just talking about managers based in New York and Connecticut, but outside the US in places like Australia, Asia, or London."

Mr Gieger believes the Madoff case actually validated many funds of funds, with many, including GAM, being among those that did not invest with him.

David Swensen at a discussion on hedge funds Bloomberg

Of the small portion of funds of funds that did have exposure to the scheme, many would have limited the amount of losses through diversification, he argues.

One executive at a large state pension feels such comments from a person of Mr Swensen's stature can have an impact on investors. "It gets people's attention," says Bob Gish, chief investment officer of The Public Employees Retirement Association of New Mexico. "Trustees might ask questions they might not have asked, but if those questions are answered properly, nothing changes."

The New Mexico pension has chosen to pass on funds of funds investments in favour of going direct. The fund, which invests with 22 direct hedge funds, feels it can gain the same diversification benefits through a basket of this size while also saving 1 per cent on fees off the top. Mr Gish says the fund feels it is better positioned this way despite being stung by one or two funds through redemption requests.

Michael LeVar, director of hedge funds at consulting firm Hammond Associates, says each client is different when it comes to reacting to strong statements made by industry veterans.

He says some take these statements very seriously and have asked questions while others do not care as much.

Clients are still interested in hedge fund investing though. "Clients haven't wavered at all," he says, which he attributes to plenty of communication with clients.

In fact, pensions in general do not appear to be slowing down their hedge investing at all, but more ramping them up.

In a survey conducted in August last year by SEI and Greenwich Associates, 62 per cent of respondents said they had increased their allocations to hedge funds in the past two years, with 29 per cent maintaining the same levels. The group of US, UK and continental European pension funds averaged a 7.4 per cent allocation to hedge funds, slightly below the average target allocation of 8.4 per cent.

Funds of funds, according to Hedge Fund Research, concluded their worst year in history in 2008, declining 20 per cent for the year while the hedge fund industry as a whole ended down 18.3 per cent.

In fact BarclayHedge estimates the industry saw record outflows of $148.4bn in December, easily topping the previous high of $54.2bn. The high outflows brought the hedge fund industry to $998.4bn in December, down from $1,920bn a year previously, BarclayHedge says.

Paul O'Dowd is a reporter on Fundfire, a Financial Times publication

Funds of hedge funds answer Yale critic

Feedback

PAUL ISAAC

David Swensen, the long-time manager of Yale University's endowment and an iconic and influential figure in the investment world, recently pulled no punches in slamming hedge funds of funds, claiming among other things, they "are a cancer on the institutional investor world".

It cannot be funds of funds *per se* to which Mr Swensen objects. He runs one. A large endowment like Yale maintains a sizeable professional staff to research, vet, select and monitor the endowment's investment in a number of hedge funds comparable to a FoHF portfolio. Yale reportedly is unusually successful in demanding transparency, negotiating fees and selecting managers. It does so while incurring relatively low expenses at the university level. That Yale does so well is an argument for FoHFs. Even conceding few, if any, FoHFs may have Yale's advantages of size, access and flexibility, this does not signify the risk return characteristics of many investors' portfolios cannot be improved through investments in well-designed and managed FoHFs.

Although Mr Swensen has a laudable track record, it is unlikely his team is the only one to have added value over the past couple of decades. In fact, as a substitute for equity investments over the past 10 years, the HFRI Composite FoHF Index has performed remarkably well, returning 5.4 per cent a year versus a return of -1.4 per cent for the S&P 500, with a volatility of 6.2 per cent versus 15.1 per cent for the S&P 500.

Under current circumstances, where all significant investment markets – equities, fixed income, real estate or commodities – entail historically high volatility, access to different return streams with different risk profiles can be particularly beneficial to overall portfolio management.

Contrary to Mr Swensen's insinuation, the Madoff scandal is remarkable for how many FoHFs consciously rejected investing in Madoff for all the right reasons.

Good investors will always ask many questions and good fund of fund managers will respond thoroughly and accurately, with a high degree of transparency. While it is axiomatic a FoHF portfolio wants the "best" hedge fund managers, the goal is to construct a portfolio that will give investors the greatest likelihood of reaching a return goal with limited volatility.

There is no common definition of a "best" hedge fund. Certainly, more than 10 per cent of all managers can be potential parts of a given portfolio when the goal, and not just the components, define the objective. The ability to substitute managers, rather than being wedded to an underlying manager, can be useful for FoHF managers seeking to represent their investors' interests.

David Swensen's remarks on hedge funds of funds have stirred up an argument Bloomberg

Ironically, in the post-Madoff age, the FoHF has become an even more important tool for institutional investors. Many institutions cannot afford to put themselves in the spotlight by selecting a specific hedge fund that might in the future have public difficulties.

A FoHF investment represents a diversification tool and a layer of protection for the reputation of the institution.

The idea that no one but Mr Swensen should invest in only passive vehicles is condescending and limiting.

In a world with unusually high market risk, pure beta exposure might not be ideal. Since index investments in alpha generating strategies are in their infancy and have yet to prove themselves, active management remains the only effective option.

The fees charged by FoHFs vary, as does quality of products and services. It is up to investors and consultants to assess the procedures, philosophies, transparency, execution, track records, risk/reward targets and costs entailed in different FoHFs to decide which ones, if any, are likely to materially improve the performance of their overall portfolios.

Investors can require threshold levels of information and transparency of all their FoHF managers, just as they should for every other sort of investment manager; and there is nothing wrong with trying to negotiate fees by shopping among competitors.

The key is to find value for fees paid. If Yale elected to manage money for other institutions, it would be a formidable competitor.

Few FoHF managers will be Yale. Some will prove as ineffectual as many long-only managers have been. Many, however, will deliver for their clients.

Paul Isaac is chief investment officer at Cadogan Management

BARRON'S

Herbalife: Carl Icahn Vs Bill Ackman; Stakes Are Just A Bit Higher

By Crystal Kim
Updated March 13, 2017 1:58 p.m. ET

William Ackman, left, and Carl Icahn agreed to disagree on Herbalife.

Reuters (2)

Billionaire financier **Carl Icahn** disclosed Monday that he raised his stake in **Herbalife** (HLF) as shares were nearing a two-month low. The news moved shares higher, which climbed more than 2% before the market's open and recently traded at around $52.

Icahn, of **Icahn Enterprises** (IEP), a diversified holding company with a concentrated portfolio of stock, spent a little over $19 million to boost his stake to 24.57% from 24.18%. That's not a huge increase, especially in the context of the green light he received from the U.S. Federal Trade Commission to acquire a up to 50% stake in the company in October 2016.

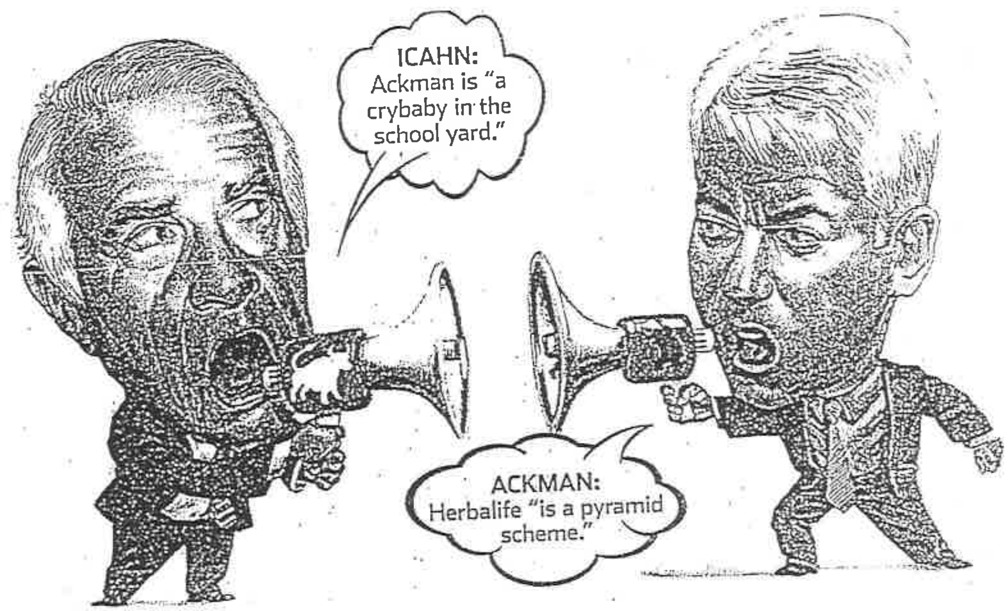
Photo by Buda Mendes/Getty Images for Herbalife)

Don't forget **Bill Ackman** of **Pershing Square Capital Management**, who has been critical of the sports nutrition company's incentive structure and accused the company of defrauding its customers, is on the other side of this bet. Ackman first took a short position in Herbalife in May 2012. After what seemed like an uphill battle for Ackman, the tides seemed to turn in his favor as the **Federal Trade Commission** closed its pyramid-scheme investigation in July and handed down a $200 million settlement fine. But Herbalife cheered too, because the FTC didn't require it to change its core business model, and shares actually rose on the news of the settlement. However, some have seen evidence of the company coming apart at the seams.

It was brought to my attention that I missed something: the FTC is requiring Herbalife to change its multi-level marketing compensation structure. "This settlement will require Herbalife to fundamentally restructure its business so that participants are rewarded for what they sell, not ow many people they recruit," said FTC Chairman Edith Ramirez. "Herbalife is going to have to start operating legitimately, making only truthful claims about how much money its members are likely to make, and it will have to compensate consumers for the losses they have suffered as a result of what we charge are unfair and deceptive practices."

Herbalife bulls could argue that the company gets most of its money abroad anyway. Of the $4.5 billion in revenues the company pulled in last year, less than a quarter of it was generated in North America. Meanwhile China and the Asia Pacific region accounts for nearly 40% of sales, and the company recently inked a deal with China's Tasty Holding Group. However, the SEC is investigating whether Herbalife violated foreign bribery laws.

So whose side is an investor to take -- Icahn's or Ackman's? The best place to be might be the sidelines, with a bucket of popcorn.



It was another great year for investors to avoid hedge funds

Amid the tweets and bonfire of expertise last year, did you notice the worldwide boom in asset prices? A list of ways an investor might have increased their wealth by more than a tenth in 2016 would include: crude oil; the big stock indices in the US, the UK, Brazil and Russia; emerging market equities as a whole; pretty much any high yielding corporate bond; sugar, silver and copper; even gilts, the UK government's debt.

Yet the premium end of the asset management industry, where its sharpest minds are cosseted in the most luxurious offices, had another dismal year. Investors in hedge funds, according to data provider HFR, saw their money grow a mere 2.5 per cent last year on average, only slightly more than the $65bn or so handed over in fees.

One immediate question is how so many hedge fund managers failed to do better. Places to lose money were scarce in 2016 for anyone who did not bet on sterling before the UK vote to leap from the EU. Wheat prices, companies reliant on the British economy, and stocks listed in Shanghai top the small list of ways to have substantially reduced one's wealth.

The bigger question, however, is why the investment performance of hedge funds has been so poor for so long. It may be because exposing mediocrity runs into the problem of measurement. There is no perfect way to assess a diverse industry of as many as 10,000 funds. Clever investment managers are a cohort, not an asset class.

Also a portfolio of investments in hedge funds is a weird concept. This is a group of people chosen for their historic ability to make investment decisions, even though academic studies show that past performance genuinely is no guide to the future. We would like to know their average ability, please. Various fee-generating businesses present such weirdness as a challenge to be solved by consultants, advisers and banks.

Overcaution does not lend itself to reliable investment growth

One low bar for measurement would be a simple combination of cheap index funds, say $60 in US stocks and $40 in Vanguard's Total Bond Fund each year. In 2016 that became $108. Indeed in each of the past seven years the index funds were a better choice than $100 managed by the average hedge fund, weighted by assets, using HFR numbers.

Expert money managers did have a good financial crisis on this measure, but they have been considerably outpaced since. Over the past decade $100 using the dual index fund approach became $184, while the average hedge fund investor would be left with perhaps $159.

The first reason is fees. Investors paid at least $34 to hedge funds over the decade, to see their money grow by $59, based on conservative estimates for typical costs and not including the expense of choosing or monitoring the hedge fund managers.

Second is a collapse in interest rates, which has been good for simple bond funds but has made life hard for hedge funds, because the cash balances they hold while shorting stocks or doing other complex activities no longer offer easy income.

Technology and regulation are also part of the challenge. Information is much more freely available than in the past, and in some ways trading is easier. Profitable market niches tend not to last when hedge funds with $3tn to invest are all looking for them.

Post-crisis rule changes to restrict trading by investment banks have also, arguably, introduced more random movement to markets. Temporary swings are a problem because of another group that deserves blame: the pension and sovereign wealth funds that invest in hedge funds.

So-called institutional investors tend to prefer large and respectable-looking hedge funds, and can be alarmed by paper losses, which are taken as a signal of poor risk management. As a result hedge funds focus on not doing anything stupid that might cause the big investors to take their money away.

An overabundance of caution does not lend itself to reliable investment growth. Collect management fees, talk darkly about future crisis and hope investors do not notice how well they could have done without you.

FINANCIAL TIMES

Friday 6 January 2017

Buttonwood | A Losing Bet

Hedge funds haven't delivered on their promise

HEDGE funds employ the cleverest people in the world to exploit the opportunities that other managers miss. That is why they deserve their high fees—or so the story goes.

That story is getting harder and harder to believe. In the first quarter of the year the average fund lost 0.8% after fees, according to Hedge Fund Research, an index provider. That follows a loss of 1.1% for the average fund in 2015, and a gain of just 3% in 2014. In other words, the average investor has earned a cumulative 1% since the start of 2014.

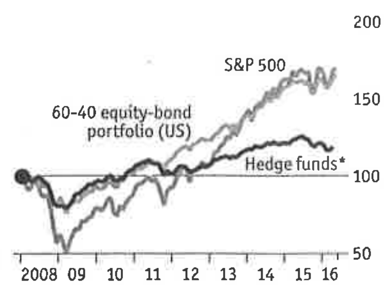
While clients have made do with the crumbs, the managers are still dining well. They get annual management fees of 2% or so, however the funds perform. Those that have done well have earned performance fees on top. All told, managers will have earned a lot more than their clients over the past couple of years.

Market conditions have been difficult for the hedge-fund titans. Sudden shifts between "risk-off" and "risk-on" markets, such as the market turnaround in February, are very hard to time. Official intervention in the markets, either through central banks or regulatory action, can also blindside the savviest investors. In January Martin Taylor closed down his Nevsky Capital fund, citing economic nationalism, the poor quality of data in China and India, and less transparent markets as reasons for his decision.

Dan Loeb, who runs the Third Point hedge fund, told clients in a letter in late April that recent months have seen "one of the most catastrophic periods of hedge-fund performance that we can remember". Mr Loeb says many hedge funds were convinced that China would be forced to devalue the yuan early this year; it didn't. Others backed big technology stocks like Apple and Netflix; they have underperformed. And some fund managers have lost out because of events in the pharmaceutical sector: the collapse of the Allergan-Pfizer merger and the plunge in Valeant's share price.

Not what it says on the tin

Total return, January 1st 2008=100



Source: Thomson Reuters

*HFRI fund-weighted composite index

Individual funds have their ups and downs. It is unfair to judge fund managers over the short term. So what about the longer run? In 2007 Warren Buffett, the investment guru who heads Berkshire Hathaway, a conglomerate, struck a $1m bet with Protégé Partners, a fund of hedge funds, over whether a hedge-fund portfolio would beat the S&P 500, after fees, over the subsequent ten years. As the chart shows, with around 19 months to go, Mr Buffett seems almost certain to collect. He drummed the point home at Berkshire's recent annual meeting, saying, "There's been far, far, far more money made by people in Wall Street through salesmanship abilities than through investment abilities."

Defenders of hedge funds would say that the S&P 500 is not the best benchmark. Instead of aiming for the highest total return, managers use their skill to limit risk and deliver a more consistent performance. Even in this respect, however, hedge funds have lagged a long way behind a typical institutional portfolio comprising 60% American equities and 40% Treasury bonds.

It is not too difficult to figure out why. In a world of low interest rates, low bond yields and low dividends, the fees charged by hedge funds simply take too big a bite out of gross returns to leave much for clients. The golden age of hedge funds was in the 1990s, when the likes of George Soros delivered double-digit returns every year. Pension funds and endowments still have a dim memory of those days; that is why they hope hedge funds will act as a *deus ex machina* and deliver the outsize returns needed to fund the promises they have made. They have been repeatedly disappointed; some, such as CalPERS, a giant Californian pension fund, have liquidated all their investments in the sector.

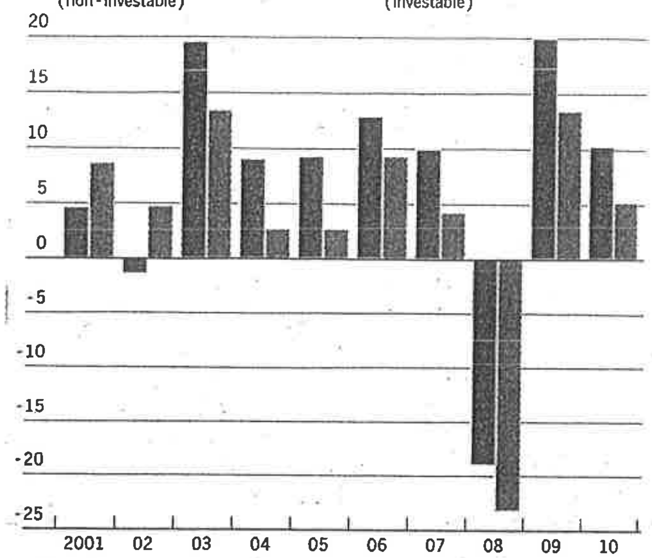
All the statistics in this article refer to the average hedge-fund return; of course, there will always be managers who perform much better than average. But how to spot them in advance? If it were easy, then why would anyone give money to below-average managers? It will always be possible to find managers who have earned exceptional returns in the past, just as some people actually did back Leicester for the English football title at 5000-to-1. That doesn't mean you'd pay good money for the same punters' tips on the Kentucky Derby.

There is no doubt that many hedge-fund managers are extremely clever and work diligently at ferreting out profitable opportunities. But are there enough opportunities to sustain an industry with 10,000 individual funds and $2.9 trillion of assets? Nowhere near.

Economist.com/blogs/buttonwood

Hedge fund indices' accuracy in question

Global hedge fund returns



Source: HFR

The big picture

Many say databases are subject to multiple biases, overstating fund performance, finds Steve Johnson

Industry-wide performance indices are an excellent recruiting sergeant for the hedge fund industry.

These indices, published by a number of data providers, typically boast attractive annualised double-digit returns with scarcely a down year, the industry's annus horribilis of 2008 excepted. But how confident can investors be that these indices provide a true reflection of the returns of the underlying hedge fund industry?

The Edhec-Risk Institute, an arm of France-based Edhec Business School, stirred the pot recently when it stated that "the performance of multi-strategy indices whose portfolios included illiquid [or less liquid] strategies was extraordinarily overstated after mid-2008".

Felix Goltz, head of applied research at Edhec added: "It is more and more difficult to justify the use of non-investable composite indices as benchmarks unless we can suggest a practical and easy-to-implement solution that could substantially reduce the biases that overstate their performance, especially in periods of market stress."

Some industry practitioners also believe the indices give an overly sunny view of hedge fund performance.

Michael Azlen, executive chairman of London-based Frontier Capital, an investor in hedge funds, says: "The databases are subject to multiple biases. We adjust single manager indices down by 4 per cent a year and fund of funds by 1 per cent."

Some academics go further than this. A study by Roger Ibbotson of the Yale School of Management and Peng Chen of Ibbotson Associates, a Chicago-based consultancy, argue that the reported 16.45 per cent compound annual return of the 3,500-fund strong Lipper Tass database between 1995 and 2006 falls to just 8.98 per cent when all distortions are stripped out.

These perceived distortions come in three guises; end-of-life reporting bias, backfill bias and survivorship bias.

The end-of-life reporting bias occurs when a fund in its death throes stops reporting its performance to index providers, meaning losses are unrecorded.

Some studies argue this can also lead to under-reporting of successful funds that stop providing data because they no longer require the services of a data vendor. However, the omission of funds entering death spirals is likely to have a more dramatic effect. Long-Term Capital Management, for instance, lost 92 per cent of its capital between October 1997, when it stopped reporting to database providers, and October 1998.

> 'If [someone is] down 50% the last thing they say is "get that number out to the market"'

"If [someone is] down 50 per cent there is panic, the last thing they are saying is 'let's get that number out to the market'," says Mr Azlen.

Backfill bias can occur when a manager starts life with seed capital and starts reporting its results if and when the strategy proves successful. If a data provider allows the manager to retrospectively "backfill" its historic data this introduces a bias because only favourable historical data will appear.

A study by Burton Malkiel, professor of economics at Princeton University, and Atanu Saha of Analysis Group, a consultancy, of the Tass database found backfilled returns were, on average, 500 basis points a year higher than contemporaneously reported returns between 1994 and 2003.

Survivorship bias reflects the tendency of some data providers to merely reflect the returns generated by existing hedge funds, a potentially big issue in an industry with a notoriously high attrition rate as unsuccessful funds liquidate.

The Malkiel/Saha paper found that "live" funds (as of 2004) had typically returned 740 basis points a year more than "dead" funds. Although their work was restricted to the Tass database, they found the performance reported by this database corresponded strongly with that of several big hedge fund indices.

Speaking to FTfm last week, Prof Malkiel, the author of *A Random Walk Down Wall Street*, said he feared the over-reporting might have worsened since his 2005 study due to the very high attrition rate in 2008 and 2009.

"There seems to me to be circumstantial evidence that the survivorship bias during the credit crisis was even larger," says Prof Malkiel, who fears the problem will remain "until we get a situation, as with mutual funds, where it's the law that you need to do a certain amount of reporting".

However, Ken Heinz, president of Hedge Fund Research, probably the leading index provider, refutes the claims, arguing that HFR does "a lot of work to mitigate the effects of those biases".

He argues HFR's indices do not suffer from survivorship bias because the track record of "dead" funds remains in place for perpetuity. As for backfill bias, this is avoided by only allowing funds to submit data from the month following admission to an index.

"It has never been the case that the entirety of the track record of a fund would be pulled into an index," he says.

As for funds that stop reporting data, Mr Heinz says HFR will contact them to attempt to get the numbers. If this fails it will seek the data from investors. However, Mr Heinz is unable to explain why, across the industry, investable indices, by definition free of any data collection biases, persistently underperform non-investable indices.

The flagship non-investable HFRX Global Hedge Fund Index, for example, has undershot the non-investable HFRI Fund Weighted Composite Index every year since 2003, by an average of 560 basis points.

"There is not a simple explanation that rationalises it," says Mr Heinz.

Prof Malkiel remains convinced of his position. "There are still many biases in the data and published reports overstate returns, so what you see is not necessarily what you get."

Misery Widespread at Hedge Funds

Market Turmoil Inflicts Losses in Industry's Worst Period Since 2011; 'It's a Bloodbath Out There'

This month's turmoil in financial markets has been a "bloodbath" for hedge funds, inflicting large losses at an array of multibillion-dollar firms in the indus-

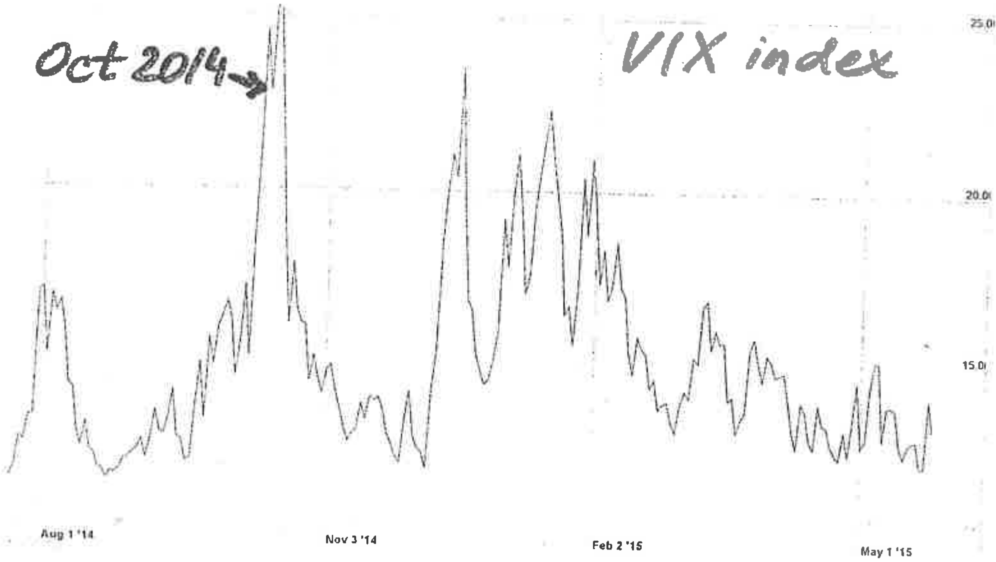
By Juliet Chung, Rob Copeland and Maureen Farrell

try's worst stretch since late 2011.

It isn't unusual for one segment of the $2.8 trillion hedge-fund world to find itself caught in a downdraft. But in October, the pain has been widespread.

There were casualties among funds that make bets based on their fundamental analysis of companies, events like takeovers and broad economic trends. The losses came amid sharp volatility in stocks, bonds, currencies and commodities.

THE WALL STREET JOURNAL.
Tuesday, October 21, 2014



BUSINESS INSIDER

Some of Wall Street's biggest hedge fund names are racing to rescue their year

JULIA LA ROCHE
SEP. 11, 2015, 9:33 AM

August was a brutal month for some of the biggest names in the hedge fund industry.

In some cases, losses in August wiped out gains for the year, and now it will be a race against time to rebound and finish the year in the black.

Bloomberg News' Simone Foxman reports that billionaire hedge fund manager John Paulson, who runs the $19 billion Paulson & Co., got crushed in August.

Here's a rundown of how some of his funds performed:

- Paulson Partners fell 4.2% in August, leaving the fund up 6.5% for the year.
- Paulson's Advantage Fund fell 4.9% in August, and it is now down 3.6% for the year.
- Paulson's Special Situations Fund fell 8.4% in August, and it is now down about 12% for the year.


John Paulson.

Reuters

Monday, April 30, 2012 | C1
THE WALL STREET JOURNAL.

Hedge Funds Hurt by Volatility

By Juliet Chung

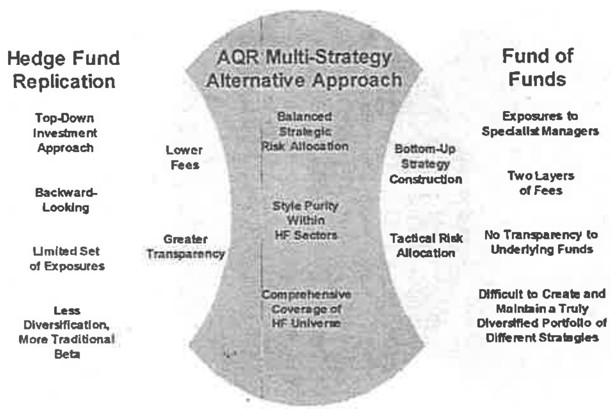
The average hedge fund was down 2.2% in August, according to data from Hedge Fund Research, compared with the S&P 500, which fell 6.2%. August was a wild month for the stock market overall, with the Volatility Index (VIX) hitting its highest level in four years while markets got clobbered on August 24.

AQR | CAPITAL MANAGEMENT

Summer 2011

Choosing the Best Approach to Alternatives

Multi-strategy alternative funds present a new way for mutual fund investors to access strategies traditionally associated with hedge funds, funds of funds, and hedge fund replicators. With multi-strategy alternatives funds now available to mutual fund investors, questions arise about the different approaches. The exhibits below highlight the key differences and reflect AQR's preference for the multi-strategy approach.



Hedge Fund Replication Comparison

	AQR Multi-Strategy Alternative Approach	Hedge Fund Replication
PRIMARY OBJECTIVE	Maximize returns (with low correlation to equities)	Maximize correlation (to HF indices)
STRATEGY CONSTRUCTION	Bottom-up	Top-down
INVESTMENT APPROACH	Use current information to determine positions	Use backward-looking regressions to determine positions
PORTFOLIO COMPOSITION	>2,000 individual securities	A small number of broad indices
EQUITY EXPOSURE	Tactical and kept at modest limits	Consistently long, limiting diversification potential
STRATEGY ALLOCATION	Risk-weighted; diversified to maximize risk-adjusted return	Concentrated based on aggregate investor behavior

Fund of Funds Comparison

	AQR Multi-Strategy Alternative Approach	Fund of Funds
TERMS	One layer of fees	Two layers of fees
TRANSPARENCY	Transparency by strategy and position	Limited transparency to manager names and weights; generally no transparency to holdings
	Due diligence by investor	Due diligence outsourced to manager
STRUCTURE	Diversified, bottom-up positions	Same, but with offsetting longs/shorts and higher turnover and t-costs
	Disciplined rebalancing policy	Structural difficulties in rebalancing
	Tactical timing of strategies	Tactical views only possible with a lag

Disclosures

The information set forth herein has been obtained or derived from sources believed by AQR Capital Management, LLC ("AQR") to be reliable. However, AQR does not make any representation or warranty, express or implied, as to the information's accuracy or completeness, nor does AQR recommend that the attached information serve as the basis of any investment decision. This document has been provided to you solely for information purposes and does not constitute an offer or solicitation of an offer, or any advice or recommendation, to purchase any securities or other financial instruments, and may not be construed as such. This document is intended exclusively for the use of the person to whom it has been delivered by AQR, and it is not to be reproduced or redistributed to any other person. This document is subject to further review and revision.

Diversification does not eliminate the risk of experiencing investment losses.

There is a risk of substantial loss associated with trading commodities, futures, options, derivatives and other financial instruments. Before trading, investors should carefully consider their financial position and risk tolerance to determine if the proposed trading style is appropriate. Investors should realize that when trading futures, commodities, options, derivatives and other financial instruments one could lose the full balance of their account. It is also possible to lose more than the initial deposit when trading derivatives or using leverage. All funds committed to such a trading strategy should be purely risk capital.

Asset management

Ctrl alt-beta

The Economist February 4th 2017

Funds mimicking simple hedge-fund strategies gain in popularity

INVESTORS love to complain about hedge funds, which have delivered measly returns for the past several years and are notorious for their high fees. Yet so far, most have stuck with them. One reason is that the hedge funds' mission—to provide returns uncorrelated with overall market performance—has been hard to replicate. But a fast-growing hedge-fund-like product, known as the "alternative beta" fund, allows investors much cheaper access to a similar style of investment.

"Alt-beta", as it is usually called, is a bit of a misnomer. The word "beta" is typically used to mean broad market returns, which can be bought into through index-tracking funds. "Alpha" is the term used to describe the premium added by a skilled fund manager. The idea driving both "alt-beta" funds and longer-established "smart-beta" ones, is that, just as "beta" can be distinguished from "alpha", so returns can be ascribed to identifiable, predictable factors. One example is the "value" effect: ie, that undervalued companies tend to outperform the market.

Smart-beta and alt-beta funds are close cousins, but differ in their methods and in their outcomes. Both aim to automate asset selection, for example by using rules-based algorithms rather than human managers. But whereas smart-beta funds simply pick and buy assets, and hence ride the market along with other asset managers, alt-beta funds use hedge-fund tactics in search of uncorrelated returns. These include betting against (ie, "shorting") assets and using derivatives.

Compared with hedge funds, alt-beta funds are dirt cheap. They typically charge as little as 0.75-1% a year, compared with 2% annually and 20% of profits for a typical hedge fund. Perhaps unsurprisingly, they have grown fast: according to estimates from JPMorgan Chase, assets managed by alt-beta funds have increased from $2bn in 2010 to around $70bn at the end of 2016 (still nugatory compared with the $3trn in hedge funds).

A range of firms are getting into the alt-beta business: big asset managers, investment banks and funds of hedge funds. So, indeed, are hedge funds themselves. Hedge funds tend to like esoteric, niche investments which are by definition in short supply. But they also invest in mainstream, liquid assets. Taking those positions, repackaging them as alt-beta funds, and selling them on to investors offers them another source of business.

Indeed, hedge funds may not feel too threatened by the alt-beta trend. The cost and complexity of setting up the infrastructure to short assets or trade in derivatives are high barriers to entry. Moreover, alt-beta funds can be volatile. Simon Savage, director of alternative beta at Man Group, a listed provider of hedge funds, says this is to be expected: alt-beta funds are essentially "very simplified hedge funds", without as much emphasis on mitigating risks.

Such funds may offer cheaper access than hedge funds do to certain commoditised risks. But they may also end up producing lower risk-adjusted returns, making them unappealing on their own. Most investors seem, for now, to use alt-beta funds as a complement to hedge funds, rather than as an alternative. Hedgies are not out of a job yet. ■