

# Introduction

*The day is short, the task is great . . .*

—*Ethics of the Fathers*, Chapter 2, Verse 20

In *Fund of Funds Investing: A Roadmap to Portfolio Diversification*, we take a brief look back at the history of the fund of funds industry, examine where the industry is today in the wake of the Madoff scandal, the credit crisis, and the failure of many hedge fund managers to perform over the past few years. Our goal is to provide both a roadmap for first-time investors looking for an entry point into the wacky, wild, weird, and exciting world of fund of funds investing and a resource guide for sophisticated investors who may not be certain what the optimum investment approach should be for allocating their assets.

According to our calculations, hedge fund industry assets exceeded \$10 trillion (or was it really \$2 trillion?) at year-end 2007 and dropped to \$6 trillion by year-end 2008 (which we discuss in the book), and closely approached mutual funds in assets under management. This book will try to simplify things as much as possible and provide you with an even playing field for making decisions.

Asset growth in the hedge fund industry has been fueled by investors of all shapes and sizes, including pension plans, endowments, foundations, private banks, family offices, and high net worth individuals looking for returns that differ from those of traditional long-only investments. As institutional investors and their allocators look to find solutions to ongoing and future capital needs, many have turned to fund of funds to meet the needs of their constituent investors. Given the proliferation in the hedge fund industry, one of the drivers of the growth of assets has been the development of the fund of funds industry, along with the realization that assets do not always rise.

In the simplest of terms, fund of funds are investment partnerships that invest directly in a wide range of hedge funds. This allows investors to have a single entry point into a diversified hedge fund portfolio rather than creating their own portfolios that consist of a series of hedge fund investments.

Hedge funds and fund of funds managers have created large institutional complexes that directly compete with their traditional long-only asset management brethren. Due to the subpar results of many long-only strategies, “absolute return” has become the new investment paradigm in

structuring investment approaches for portfolio management. At the same time, it requires an adjustment or refinement in the approach to investing.

As the capital markets have become more efficient, investors have experienced a moderation of returns, leaving them with questions about how to increase portfolio performance without increasing risk. *Fund of Funds Investing: A Roadmap to Portfolio Diversification* provides investors with a roadmap and a set of tools to understand and evaluate investments, and make thoughtful investment decisions.

Even though drivers have become accustomed to relying on navigation devices while traveling the roads of the world, nothing beats having a map and knowledge of the area and its terrain for getting from point “A” to point “B.” The same is true for hedge fund investing. Making investment decisions is not as simple as inserting numbers into a spreadsheet to arrive at the desired results. Investing is not that simple and should not be taken lightly.

*Fund of Funds Investing: A Roadmap to Portfolio Diversification* provides a unique and insightful overview of this often misunderstood and opaque area of the investment community. Through a series of high-level interviews as well as direct industry insight, we have worked to give you access to this area of the investment marketplace that is often thought of as closed or secretive. Our goal is to provide you with what you need to make solid investment decisions.

In the following pages, we explain the how’s and why’s of fund of funds investing. Our intent is not to offer investment advice but rather to enable you to make good investment decisions—smarter investment decisions. We hope that you use this book as a guide to the fund of funds industry and alternative investment investing. Think of it as a resource that you can turn to repeatedly to become a better investor.

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