CHAPTER 1

On the Road

When we (authors Daniel Strachman and Richard Bookbinder) started working on this book, all was right within the world of hedge funds, fund of funds, and alternative investing. Sure, there had been some hiccups—the credit crisis that started in the spring of 2007, the fire sale of Bear Stearns, the pending collapse of Lehman Brothers, to name a few—but nothing prepared us for the news of December 11, 2008.

While December 7, 1941, was a day that will live forever in infamy, many on Wall Street and beyond believe that December 11, 2008, was one of the worst days of all time. It was on this December 11, as the markets were closing on Thursday afternoon that the news broke that Bernard L. Madoff had been arrested for a massive Ponzi scheme. I (Daniel) remember exactly where I was sitting and what I was doing when Richard called me on my cell phone with the news of Madoff's arrest. Both of us were shocked, but as on December 8, 1941, when reports of the extent of the Japanese attack on Pearl Harbor began to come to light and F.D.R. made his famous speech, the news of the extent of the crimes Madoff had perpetrated on the thousands who had invested with his firm was simultaneously shocking, sad, and funny.

It was shocking because the initial reports named some of the most respected money managers and investors in the world. It was sad because the world learned that people had literally given Mr. Madoff all of their money and were now penniless. It was funny, maybe only to us, because some of the people who were listed as investors just a few months before—in one case, a few weeks before—had detailed the need for due diligence, research, and diversification. Yet, these same investors—fund of funds managers—had given the bulk of their funds' assets to a single manager who turned out to be a total fraud.

Of course, there is nothing truly funny about the Madoff situation, just as there is nothing funny about the events of December 7, 1941. Still, there is some irony in the events of December 11, 2008, that many people in the hedge fund and alternative investment community found somewhat amusing. The irony is that these people work hard to create products—funds—that deliver alpha (a term we'll define later), and yet they are not given the time of day by fund of funds managers or institutional investors because of a host of issues and items that cause the fund manager not to "fit the box" with the investor.

Given the Madoff news and the dismal returns within the stock market and the hedge funds for 2008, the prospects for the hedge fund industry in early 2009 did not seem all that good. However, we believe that as time goes on and the wounds inflicted by the losses from the Madoff fraud and the market heal, investors will continue to see the value in fund of funds investing. It is this premise that led us to continue our project of writing a book about this fascinating and often considered misunderstood and expensive segment of the investment community.

THE MODERN HEDGE FUND INDUSTRY

Since the late 1990s and the early years of the 21st century, hedge fund investing has been a topic discussed by investors around the globe. What were previously thought of as secretive investment partnerships among the wealthy are now front page news on a regular basis and are being sold by brokers, financial advisors, and others, often in as small as $10,000.00 increments.

Hardly a day goes by without mention that hedge funds are involved to some degree in moving markets, providing financing to troubled companies, capitalizing on downtrodden home owners, or making a hostile run at unsuspecting public companies. This, of course, does not include reportage of the spending habits of Wall Street's new elite, which is often found in the society pages and in the art sections of the media as these modern-day robber barons gobble up the finest and most tempting things money can buy. As the credit crisis spread and the economy weakened in 2008 and early 2009, hedge fund managers still were capturing the front pages with their largesse as well as their ability to capture profits and deal with losses no matter which way the markets moved.

Hedge funds, you see, have arrived. These unique investment vehicles are being poked, prodded, and probed by investors around the globe in order to create the most uncorrelated portfolios imaginable for institutions and individual investors.

The appeal of these investment strategies is simple: investors believe that hedge funds offer low or noncorrelated opportunities to traditional long-only investments. This theory, whether it is correct or not (we will deal with that later), has prompted investors of all sizes to look at, review, and analyze hedge fund managers to determine the alpha these investments can add to their portfolios and in turn fill their pockets.

Alpha is one of those great Wall Street terms that everybody talks about and many think is hard to understand; in reality, it is quite a simple concept that very few people are able to grasp. Our definition of alpha is "the difference between what a traditional investment earned compared with an alternative investment." For example, if an S&P 500 index fund earned 10 percent and a long/short equity manager earned 15 percent, the alpha is the additional five percent. Earning alpha is what every investor is looking for regardless of market conditions. It is the holy grail of investors and investment managers around the globe because alpha, you see, makes a difference. And the difference is rewarding not only to the investor, it is also rewarding to the manager. In later chapters we discuss fund structures, fees, and compensation, but for now remember this: hedge fund investing is one of the very few means whereby the interests of the client (the limited partner/investor) and the asset manager can be aligned. The client is the investor, and the service provider is the manager. If the manager makes money for the investor, both are rewarded; clients gain returns on their investments and managers gain fees earned on the returns on the investment. If managers fail to deliver for the client, they make nothing and the client pays nothing. It is quite simple. Suppose you go to the butcher to order a T-bone steak and tell him that you will pay a small fee today for the meat but only after you eat it and determine whether it delivered on the butcher's promise will you actually pay him for the meat. Think about how good the meat would be—no more fatty steaks for anyone!

Togetherness, if you will, is one of the key ingredients of hedge fund investing. It has been one of the main factors contributing to the growth of the hedge fund industry and is about the interests of the investors and the managers being completely aligned. Reread that last sentence, because that is what hedge fund investing is all about. It is what the powers that be at many of the large mutual fund companies in the United States don't get and it is why so many investors are looking to hedge funds for their portfolios regardless of what you read in the press or hear from the financial news channels.

WHERE HEDGE FUNDS CAME FROM

To understand how hedge funds have become so popular during the past few years, one needs to go back in time. The trip begins in 1949, when sociologist turned journalist Alfred Winslow Jones opened the first hedge fund—A.W. Jones & Co. in New York City. Jones launched his fund after realizing two things: (1) that he could not make enough money to live the life he wanted to and support his family as a journalist, and (2) that what the people on Wall Street were doing was not all that hard. The genesis for his fund came after he worked on an article titled ‘‘Fashion in Forecasting’’ for *Fortune*. His research for the article centered on how some stocks moved one way while others moved the opposite way, but regardless of which way the stocks moved, investors were making money. Jones took the data and hypothesized that if you created a pool of investments—some long positions and some short positions—you would be able to outperform the market regardless of which way the market moved.

In theory, when the market was up the longs would rise, and the increase on these investments would be greater than the losses associated with the short positions. The reverse, Jones believed, was true for the shorts when the market fell.

One shorts a stock when the investor makes the assumption that the stock is overpriced and will go down in value; this is the opposite of going long a stock, which is the move to make when you believe the price of stock will increase in value as the market puts a real worth on it. Investors buy stocks (or go long stocks) in expectation of a rise in the stock’s price. On the flip side, if an investor believes that the stock price is high, the investor will simply sell the stock. But if the investor does not own the stock (or is not long the stock) the investor will short sell the stock with the expectation of covering the short (or buying the stock back) at a lower price sometime in the future when the price falls.

In order to go short a stock, you borrow the stock from your broker and sell it at the current market price. The proceeds from the sale are deposited into your brokerage account. At a point in the future when the stock has gone down in value, you go into the market and buy the same amount of shares you borrowed from the broker and replace the shares that were on loan and that you sold at the higher price. This, in turn, closes out the position. The difference between what you sold the stock for initially and what you bought it back for at a later date is the amount of money you make on the trade, less whatever commissions you are charged by your broker for executing the transaction and lending you the shares.

Shorting is often a difficult concept for many people to grasp. Most people do not understand how you can sell something you do not own and then buy it back later and have the potential for a nice profit. Shorting is something that is extremely common in hedge fund investing and is one of the characteristics that sets hedge funds apart from other traditional investment vehicles or mutual funds. Once you grasp the mechanics of the trade, you will find the concept easy to understand.

That, however, is not all there is to it. Shorting a stock or stocks successfully and consistently over a period of varied market cycles is extremely hard to do. Most people are not good at it because they don't understand what makes a good short as opposed to a bad short. When you are long a stock, the risk is that the stock can go to zero (if you buy a stock at $20 and it goes to zero, you lose $20). The loss is quantifiable. With a short, the stock can go through the roof, resulting in an unlimited loss (if you short a stock at $20 and cover the short at $100, $125, or $150, your loss is huge). Finding good shorts is extremely difficult, and most people get it wrong. Shorting is not for the faint of heart!

This book, however, is not about shorting. It is about hedge fund investing and, more importantly, investing in hedge funds through fund of funds, so we will not spend too much time on the subject of shorting. That being said, we are not done. We believe that it is our duty to make sure that you, the reader, understand the concept of shorting securities; therefore, we have spelled it all out for you in the following text. So bear with us; it is worth it, and frankly, you might learn something.

Shorting a stock is not simply deciding you like IBM and don't like Apple and therefore you are going long IBM shares and short Apple shares. Shorting a stock consists of looking at a company and deciding that the company is going to miss an earnings estimate, suffer from a poor Christmas or back-to-school season, or possibly even fail. Unfortunately, this makes shorting seem un-American or unpatriotic to some observers, because it is counterintuitive to everything we are taught about business, the markets, and the American way (betting and profiting on the failure of a company). This specific argument led the powers that be in Washington and other capitals around the world to ban short selling, in the summer of 2008 and into 2009, of some financial stocks and other companies as their respective share prices were hammered by the market; this was believed to be the work of short sellers. In essence, shorting equities is often based on the assumption that a company will fail and that its management is so bad that it will go out of business and the stock will go to zero. Alternatively it is based on betting that the stock will go down in price in the short term in response to a change in the near-term fundamentals of the company. If you really want to learn more about shorting, type the phrase "shorting a stock" into Wikipedia.org or e-mail us at dsrb@hedgeanswers.com.

A.W. Jones & Co. was all about capitalism and therefore believed not only in the concept of shorting but in the value of using shorts as a hedge to protect long positions during periods of down markets. "My father had this idea about how stocks moved and decided to put the theory into practice with his fund," said Tony Jones, Alfred's son. "The problem he learned early on was that he was not a trader or investor but rather a good marketer, so he ended up hiring the traders and focused on raising money for the partnership.''

The Jones partnership was by many measures a successful venture for both the managers and the investors. Unlike most hedge funds today, Jones did not charge a management fee; he charged only an incentive fee. This, Tony said, is what he believed kept his interests clearly aligned with his investors. ''The problem with [a] management fee is that you end up in the asset-gathering business rather than the asset-management business, my father believed,'' he added.

Today the Jones model—a portfolio that consists of both long and short positions—is the basic premise for all hedge funds and the most popular strategy in number and total assets. Unlike long-only investing of mutual funds or long-bond investments, which profit only if their respective markets rise, in theory, a hedge fund—because it goes both long and short—can make money regardless of which way the market moves. The concept is quite simple: create a vehicle that goes long and then short the market in an effort to make money, regardless of market conditions. The difference is that unlike Jones, who went long and short only with equities, today's managers invest in anything and everything: bonds, currencies, commodities, derivative products, and real estate loans. The concept is simple: deliver alpha and use whatever arrows are in your quiver to do so.

THREE WISE MEN

Although Jones is clearly the father of the industry, it is truly the success and investment prowess of three other managers that put hedge funds on the map. George Soros, Michael Steinhardt, and Julian Robertson are three individuals who, in our opinion, caused hedge funds to be so prevalent in the investment landscape today. No discussion of hedge funds is complete without focusing on their work in the markets around the globe as well as the following each has had for more than 30 years. Each of the three is unique in their own right except for one small thing—they call themselves hedge fund managers.

All of these ''wise'' men have had countless articles and words written about them in both the financial and the popular press. Some of the stories are right, some are wrong, and we will not go on any further about them except to describe them as the cement that glued Jones's foundation into place. It is reasonable to think that had Soros, Steinhardt, and Robertson not come along, hedge funds would not be where they are today. One hedge fund investor and industry observer said that he knew of no other individuals who touched so many different areas of the asset management business and who were responsible for the creation of so many funds. Each of their contributions is immeasurable.

And while these individuals put a positive spin on hedge funds, there clearly have been a lot of negative news items about the industry as well. The most prominent story—regardless of what happened in 2007, 2008, and 2009 in the wake of the credit crisis and the collapse of old-line investment banks Bear Stearns and Lehman Brothers along with Fannie Mae and Freddie Mac—is that of the threat of failure and subsequent Federal Reserve–orchestrated bailout of Long-Term Capital Management (LTCM, for those in the know). It is the handiwork of LTCM's founder and face, John Meriwether and his colleagues that has forever put the fear of global financial meltdown into every institutional investor and into every Tom, Dick, Harry, Selma, Louise, and Joan.

The unprecedented borrowing of the financial giant LTCM in 1998 was forgotten by all during the leverage buildup period of 2002–2007. Not only did Meriwether's LTCM shock the world with sophisticated models that did not work; the Wall Street community along with Fannie Mae and Freddie Mac repeated the excess less than 10 years later. The models of the geniuses of 1998 and 2007–2008 demonstrated that investors, regulators, managers, and the powers that be have short memories.

Again, this book is not about LTCM or its people. For that, we suggest reading Roger Lowenstein's *When Genius Failed: The Rise and Fall of Long-Term Capital Management* (Random House, 2001), which is a solid account of the before, during, and after of the LTCM crisis. There is really nothing we can add except to say once more, don't believe everything you read, and you should ask yourself, who can you trust?

So what can we add is what you are probably thinking: the answer is simple, we can add a lot about fund of funds investing. Not only are we capable, but we are willing. This, you see, is the fundamental subject of this book—fund of funds investing.

Our goal is to enable you to understand the pros and cons of investing in fund of funds by explaining how they work, how they can be used in a diversified portfolio, and where to find them. We are not going to give you investment advice, nor are we going to give you advice on specific funds. We will give you ideas and strategies on how to do due diligence on managers, but for that you need to read on. The idea is simple; this book will be a roadmap to learning about fund of funds and will serve as a reference tool to be used time and again as you look to these vehicles for your portfolio. It offers a toolbox of sorts that will provide you with the tools that you can use to decide who to trust your hard-earned money with in the wake of the recent mess in the investment world.

That being said, you are invited to read on to see how and why the hedge fund industry has evolved over the past decade or so.

SOPHISTICATED INVESTORS

We believe that the evolution of the modern hedge fund industry can be traced to the evolution of the sophisticated investor. The sophisticated investor is defined as an investor who believes two things: (1) that markets rise and fall, and (2) that they need professional money managers to deliver returns to their respected institutions or pools of capital.

The rise of the sophisticated investor can be traced back to the stock market crash of 1987. What happened in October 1987 can be connected with the economic slowdown that began one year earlier after the decline from record-high interest rates from 1981 to 1982. On that Monday, October 18, 1981, overvalued stocks got the ball rolling as investors sought to lock in profits, but the real culprits were program traders and sellers of portfolio insurance. Program trading was blamed for the wholesale selling that accelerated the pressure to get out at any price. Along with program traders, however, the recent introduction of portfolio insurance forced selling as the market moved lower and investors needed to make sure their losses were covered by the insurance.

Twenty years later, newly invented complex financial products created by Wall Street once again wrought havoc with investors, leading to the subprime and related credit crisis that began in 2007 and continues.

The collapse of 1987 is what caused investment professionals responsible for large pools of assets at endowments, foundations, private banks, and family offices to realize that to preserve capital during rocky markets they needed to invest in products or funds that could go both long and short the market. The belief was that to capture market inefficiencies as well as to be prepared on the down side should the markets fall, money needed to be invested in hedge funds. These investors believed that hedge funds could generate profits regardless of which way the market was moving and by putting capital with these managers they were protecting their assets. This belief on the part of the investment community, coupled with the realization by Wall Street that providing services to hedge funds could be an extremely profitable business, caused the market to flourish and blossom in the early 1990s and into the new millennium (see Figure 1.1).

In short, these two beliefs prepared the way for hedge funds to grow and become a massive force in the capital markets around the world. It was a glorious time to be offering services to hedge funds in the early part of the new millennium, and many Wall Street firms and service providers

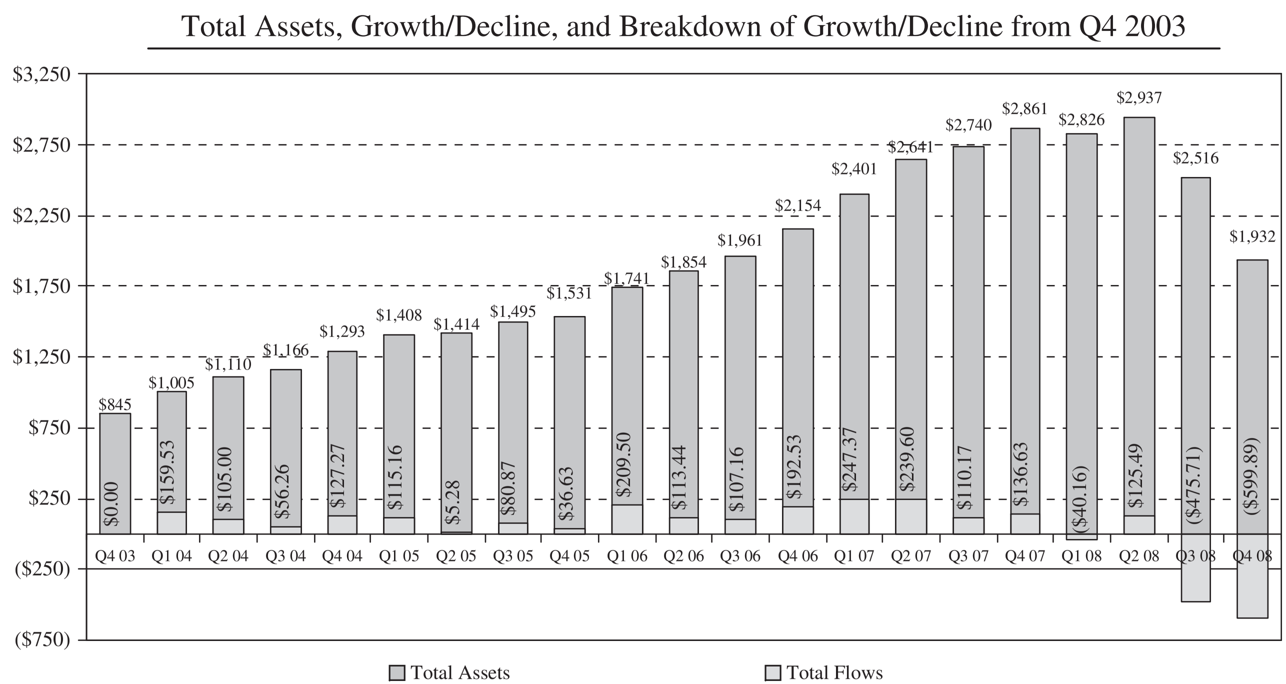

FIGURE 1.1 The Hedge Fund Industry's Growth 1990 to 2007
Source: Hedgefund.net.

(*continued*)

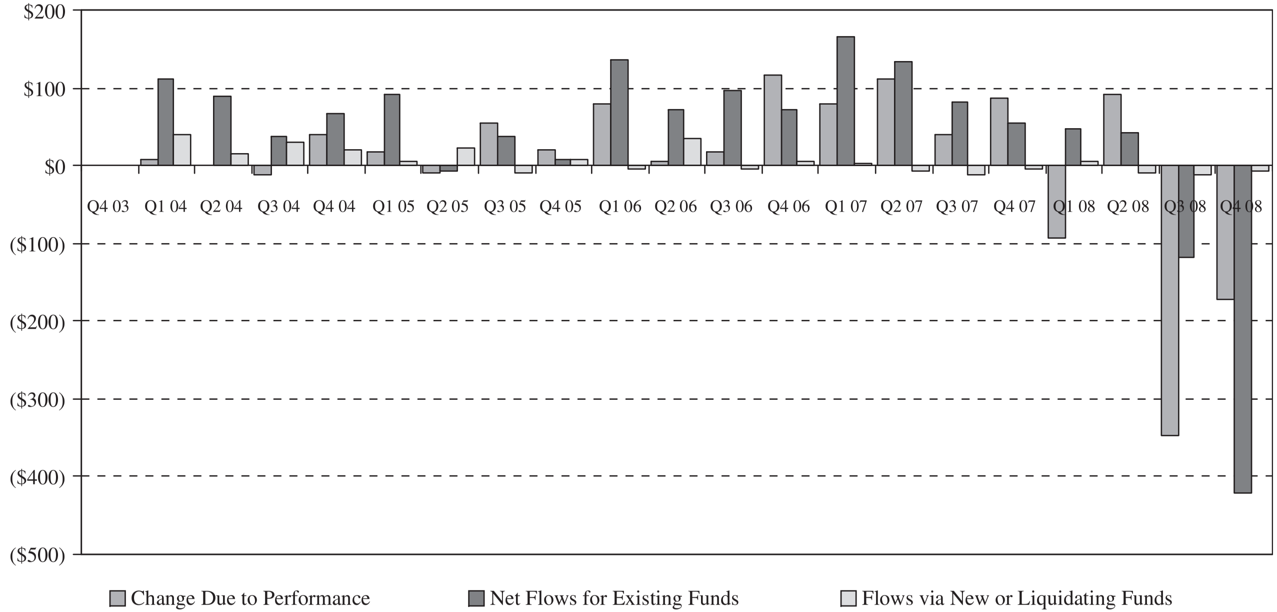

FIGURE 1.1 (*Continued*)

(companies that provide services to money managers but are not broker/dealers) were able to gain a toehold into a business that was about to explode and allow them to prosper.

HEDGE FUND BOOM TIME

''The 1980s was a wild time on the Street,'' said Peter Testaverde, a partner at Eisner LLP, a New York-based accounting firm, who specializes in working with hedge funds and broker/dealers. ''However, it was nothing compared to what it was like in the mid-1990s when growth in the hedge fund industry was at its peak.''

The hedge fund industry experienced the first of a series of turning points in the wake of the credit crisis or financial crisis known as the ''Asian Flu'' hit the economies of Southeast Asia in July of 1997: the Thai baht collapsed sending the country into economic tailspin as a result of the government's decision to no longer peg the currency to the U.S. dollar. Massive losses resulted in all areas of the markets; stocks, bonds, currencies and real estate got hit extremely hard in most of the countries in the region as prices fell and seemed to have no bottom. The losses in Asia traveled around the world hitting Europe and the United States forcing the markets down and causing many to think that a global recession would ensue. The falling markets continued around the globe in the spring and summer of 1998 and witnessed the bailout of LTCM. These events set the industry for massive growth.

Wall Streeters from all over the United States launched hedge funds in every conceivable strategy in hopes of taking advantage of investors' appetites for products that had low correlation with the public debt and equities markets. Investors were seeking ways to achieve positive returns regardless of the direction of the markets. To do this, they needed to augment the rest of their portfolios, which held stocks, bonds, and other investments that would profit only when markets rose.

The Birth of Alternative Investments

Around the dawn of the new millennium, the phrase ''alternative investing'' appeared not only in money management lexicon but in the popular press as part of the discussion of long/short equity managers and fixed-income arbitrage strategies. In the 10 years since the LTCM collapse, hedge funds have become the topic du jour for both sophisticated and not so sophisticated investors.

Hedge funds have always been Wall Street's forbidden fruit, and it seems that everyone on Main Street wants a bite of the apple. The ride has been tumultuous during the past 10 years, but for managers and investors alike it has been worth it. Fortunes have been made by managers and investors, and even in the wake of the losses resulting from the credit crisis, hedge funds have solidified their grip on the investment community. Hedge funds are here to stay; the ride is far from over. Long-only investors have learned that investing in products that go only one way is like riding a sled downhill with no brakes. Hedge funds, on the other hand, have tremendous braking ability. The reason for this is simple: Hedge funds are an engine that many investors—read institutional investors—need in order to meet the ongoing financial liabilities of their constituencies.

Since 2000, those who provide investment advice and guidance to the institutional investment community (i.e., pension funds, endowments, family offices, and insurance companies) have concluded that hedge funds are an asset class where these assets should be allocated. This realization has led to massive capital inflows by these investment behemoths. The genie is out of the bottle; hedge funds are here to stay. However, with these massive allocations (it was expected that these investors will have allocated approximately $1 trillion to hedge funds at the end of the first quarter in 2009 according to a report issued by The Bank of New York Mellon in April 2009), there are still many issues that investors need to have answered before their money is put to work.

In the early 1990s, sophisticated investors such as college and university endowments and foundations joined high net worth investors and family offices as early adopters of hedge funds, and large public retirement plans started to review this asset class. Despite the setback of the LTCM implosion, institutional investors started diving deeper into the so-called secretive world of hedge funds and looked for the best vehicle for an entry point. Seeking advice from investment consulting firms that previously knew the long-only world, early institutional investors into hedge funds started the migration to fund of funds in the period 2000–2002.

Although many concerns are constantly raised by investors and consultants alike about the validity of investing in products that invest in other investment funds, the list of reasons why it is an efficient and easy way to access the asset class is long. Some of the main points are

- It is a single point of entry into the hedge fund industry.
- Investors that lack extensive internal research efforts can use seasoned professionals at fund of funds to allocate assets among a series of hedge fund managers.
- Fund of funds investing provides diversification.
- Managers employ ongoing and constant risk management.
- Hedge fund investing through fund of funds delivers specific risk/return profiles unattainable through single-manager investing.

Investors use fund of funds investing to achieve the previously listed objectives. While the financial media often single out hedge funds as part of the ‘‘axis of evil,’’ this is clearly not the case; it’s a scare tactic used to sell newspapers and gain ratings points. The reality is that despite the setback of redemptions in 2008, hedge funds expect to experience massive inflows of capital from new and existing investors, both directly and through fund of funds, in the next several years.

WHY FUND OF FUNDS

In general, the first hedge fund investment option for many investors has been fund of funds. These investment vehicles provide a single point of entry into the hedge fund world, with instant access to a wide range of styles and strategies. Most fund of funds have research teams, portfolio management teams, and risk management teams that investors leverage by putting their capital into these products.

All evidence to the contrary in light of the Madoff situation, fund of funds also are thought to provide investors an opportunity to avoid the land mines of hedge fund meltdowns and frauds while also providing them with cover in the event of a blowup or fraud. Most investors at pension funds, endowments, and insurance companies, along with their boards of directors and their allocators, want to avoid ‘‘career risk’’ events. Fund of funds are thought to fill a large psychological and physical need for novice and experienced investors and to provide someone to blame if something doesn’t work—either risk or reward.

However, over the past few years and specifically as of December 2008, fund of funds have been suffering from moderation of investment returns, and investment strategies have started to shift away from ‘‘mainstream’’ hedge fund strategies to activist investing, complex derivative strategies, and greater reliance on less liquid private equity strategies to deliver returns.

At the same time, many fund of funds investors have started to evaluate direct investment into hedge funds on their own rather than off-the-shelf fund of funds allocations. Even though fund of funds investments seem to have lived up to their description as ‘‘hedge fund investing with training wheels,’’ more investors have started to branch directly into individual hedge fund strategies in hopes of limiting risk while increasing reward.

The first phase of fund of funds investors moving into single manager hedge funds occurred in the period 2005–2007 as hedge fund returns moderated and investors questioned the second level of fees that were being charged for portfolio management at the fund of funds. At the same time, fund of funds investors were clamoring for higher levels of transparency and thought that direct investing would provide this additional level of portfolio and position transparency. The result was that some institutional investors decided to go direct.

Poor returns by hedge funds and funds of funds in 2008 along with high-level blowups in fixed-income, arbitrage, and derivative strategies continued to push the more seasoned large institutional investors away from fund of funds and into hedge funds. Large investors believed that they were getting more customized portfolios that met their respective investment and asset/liability requirements, greater transparency by which to monitor the portfolio, and certainly a more favorable fee structure by going direct. Prior to the Madoff catastrophe, the well-publicized blowups of firms such as Amaranth, Zwirn, and Bear Stearns Asset Management forced many investment committees to think long and hard about whether to use fund of funds as a place to invest. Regardless of the determination of the investment committees and consultants, the research is clear that fund of funds (Madoff excluded) offer a level of diversification unattainable by direct investing. The ability to diversify through fund of funds investing limits the impact of a specific blowup or fraud on an investor's asset.

Diversification 101

Take, for example, the impact, described as follows, of investment by two pension plans of \$100 million of their assets in a single manager and \$100 million in a fund of funds. Investor one put all of its investment into Madoff—resulting in a total loss when the fraud was exposed. Investor two put all of its money into a fund of funds, which in turn allocated evenly among ten managers, resulting in a loss of \$10 million. They both experienced a loss and were victims of fraud, but two clearly did better then one.

The lurking question, which we discuss in great detail later in the book, is whether the extra level of fees or costs associated with fund of funds investing is worth it. Our initial reaction, based on the preceding example, is yes—but read on to make sure you really see where we come out on the fee argument.

INSTITUTIONAL INVESTORS LOVE HEDGE FUNDS

As the thundering herd of institutional investors sweeps across the plains into fund of funds as their first foray into investing in hedge funds, many are no longer satisfied with the off-the-shelf products that these managers are offering to the masses. Many of these investors are demanding a separately managed account that is tailored to their specific investment needs or wants or expectations.

These investors also require a more sophisticated reporting process and risk measurement system to accurately assess risk and returns as well a way to determine the source of alpha—the one thing, regardless of the size of one's wallet, that all hedge fund investors want, need, and expect.

Alpha Is?

What is alpha? As described previously in this chapter, alpha is a performance measurement on a risk-adjusted basis that compares the risk-adjusted return according to an industry benchmark or index to that of the underlying investment.

Alpha is used as a measurement to determine the return of an investment versus an index. For instance, if the manager is up 15 percent in a calendar year, and the benchmark index S&P 500 is up 10 percent, the manager's alpha would be 5 percent. If both the index and the manager are up 15 percent, the manager's performance would be directly tied to the market, or in this case, directly tied to the index, with a resulting alpha of zero. In other words, the investor did not need to invest with the manager but could have invested directly in the index of an exchange-traded fund that mirrors the index.

Investors search for alpha, not to determine an investment's correlation to an index, but as the reason to invest in hedge funds as opposed to traditional long-only funds that have little or no chance of beating the index.

Going both long and short the market at the same time is the only way to truly insure success. However, having investment vehicles that go both long and short is something that, while confusing to some, represents a very important area of the capital markets that is here to stay. Over the past few years however, the hedge fund and fund of funds industry has evolved from a ''trust me'' attitude (thank you Mr. Madoff and others) when making investment decisions that could be sealed with a handshake, to one that now requires sophisticated due diligence, background checks, and peer group analysis before any investment is made, regardless of how much money is at stake. Therefore, to be most effective with your or others' assets, you need to think about due diligence, which is more than just making a decision to invest based on a relationship or marketing brochure. The next step for you and others is to turn the page and begin to understand the importance of hedge funds and manager due diligence.