

Short-selling thumbs up

LSE research shows practice necessary to exploit anomalies

OUTGOING VODAFONE chief executive Sir Chris Gent might not approve, but short-selling appears to be essential for investors seeking to capitalise on certain market anomalies.

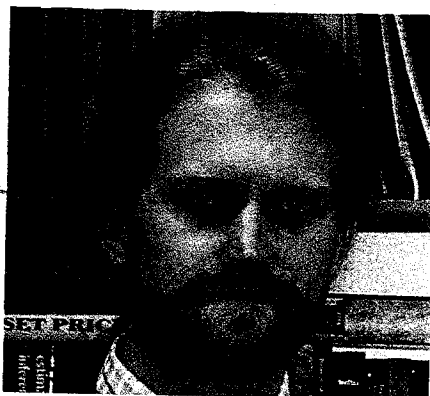
The anomalies in question are the skews in the distribution of individual stock returns and the observed greater correlation between stocks during market downturns than upturns.

Research from the Financial Markets Group at the London School of Economics indicates access to more sophisticated models of these quirks could be worth up to 62 basis points to an investor – but only if he or she is free to short.

Shorting involves selling a stock you do not own, by first borrowing it from someone else and then selling it. At some future date the stock is bought and the loan repaid. Gent famously complained last year that such tactics were “spooking” genuine investors, contrasting the short-termism of new hedge funds with the tradition of pension funds only buying stocks they believed would go up in value.

But Andrew Patton, the author of the research, said that “economically significant gains to be had by using information on future skewness and asymmetric correlation... are only available to investors that are not short-sales-constrained.”

His findings are based on research on prices for US small and large caps from



Patton: research shows value of short-selling

1954 to 1999. These two asset classes for the sake of the research are defined as the first and tenth decile of stocks by market capitalisation in the US universe. Survivorship bias is ignored, as are trading costs.

The value of 62 basis points for possession of the new model is achieved by calculations of what a risk-averse investor would be willing to pay, over and above what he or she would pay in constructing a portfolio formed assuming returns are normally distributed. So the value is more for a bancassurer or financial consultant determining how much more to charge for the product rather than portfolio alpha.

The research is the first in a series by the Financial Markets Group at the LSE into hedge funds. *BM*

An offer period runs until June 16 for both funds. In contrast to classic funds, the Absolute Return funds are not oriented by any comparative index, but perform independently of any benchmark. The fund management focuses on the diverse investment segments of the global and regional stock and bond market in its investment decisions. Other asset classes can be covered by derivatives.

The basis of investment for the Absolute Return funds are near-money market fixed-interest securities. The extent to which an asset class is considered in the portfolio make-up depends on whether it can be expected in the fund management's view to yield additional income in relation to the money market. *AH*

Macro strategies 'back in vogue'

ASSET FLOWS are once again on the rise into hedge funds, particularly European products, according to Tremont's TASS Research, which reports net asset flows of US\$6.98bn (£5.9bn) in the first quarter.

According to Tremont, the strategies with the best inflows were macro-oriented. Fixed income arbitrage was the most favoured category during the first quarter attracting US\$3.37bn in assets followed by managed futures and global macro with net flows of US\$2.10bn and US\$1.73bn, respectively.

Three categories continued to exhibit outflows, notably event driven, losing a net US\$2.9bn; and long/short equity with a US\$721m loss. The dedicated short bias category also recorded a net loss of US\$58m. The weakening dollar and negative economic environment helped managed futures and global macro funds grow in the first quarter.

This is a reversal of what the industry saw in the fourth quarter of 2002 with net outflows of US\$696m. But for the whole of 2002, funds showed a net gain of US\$16.28bn in assets.

“Investors appeared to be returning to a more typical investment pace in the first quarter,” said Barry Colvin, president of Tremont Advisers. “They were reallocating assets and favouring those strategies that did well in 2002 and in earlier years with the exception of equity market neutral which has some short-term capacity issues. Conversely, those areas that lost assets last year, such as risk arbitrage, continued to do so.”

According to TASS Research, fixed income arbitrage also benefited during the quarter from the launch of several high-profile funds. Many of these are based in Europe where conditions are conducive for trading in a wide array of global bond and futures markets.

“The first quarter showed that macro strategies are definitely back in vogue,” said Stephen Jupp, director of quantitative research at Tremont Advisers.

The TASS Research quarterly report of hedge fund flows is based on analysis of approximately US\$350bn in hedge fund assets. The universe includes a broad base of 3,775 funds that are located and managed in the US and overseas. *AH*

Deutscher to dish up absolute return funds

DEUTSCHER INVESTMENT Trust will launch two absolute return funds through its Luxembourg subsidiary Allianz Dresdner Asset Management on June 17.

The funds' target is to generate positive yields over 12 months. The funds will be offered in two versions: as dit-Absolute Return Allocation and dit-Absolute Return Allocation Plus. The risk profile will be determined by the underlying target volatility.

This is 5 per cent for the dit-Absolute Return Allocation and 10 per cent for the dit-Absolute Return Allocation Plus.

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