



Hedge funds close to new business

>Alexander Jolliffe and James Drummond

>Published: May 27 2005 17:21 | Last updated: May 27 2005 17:21

>>

In uncertain times for stock markets, investors will be lured by the prospect of absolute returns. It is little surprise therefore that billions of pounds have been heading into hedge funds in recent years. The sector is now worth more than \$1,000bn (£556bn) globally.

Hedge funds aim to offer absolute, not relative, returns and seek to diversify investors' portfolios away from equities and bonds. However concerns over the sector have been raised after suggestions that some hedge funds suffered big losses because of trades which went sour after credit rating agencies downgraded General Motors, the US carmaker.

For private investors, the way into hedge funds has been through funds of hedge funds, as many individual hedge funds require high minimum investments. An another advantage of funds of hedge funds is that investors' money is spread across an array of funds and risk is reduced.

But prospective investors in funds of hedge funds are being urged to tread with caution as many of the funds of funds no longer have exposure to the more popular and, often better performing, hedge funds.

“Capacity constraints” – limits on the sums which the underlying hedge fund managers are able and willing to invest – have meant that many popular hedge funds are no longer accepting new money.

“Most of the decent ones are closed,” says Duncan Budge, chief operating officer at RIT Capital, an investment trust which has exposure to hedge funds.

Some well-known hedge funds which have closed to new investors include: Gartmore's European equities and UK large cap funds; and Thames River Capital's Nevsky and Edo funds, which invest respectively in emerging market shares and Japanese equities. Threadneedle has closed its European Crescendo fund, which invests in Europe's equities.

A broader problem, warn academics, is that returns from hedge funds are likely to fall as more capital pours into the industry. “The more money enters the market, the lower returns are going to be,” says Harry Kat, professor of risk management at Cass Business School.

The problem of hedge fund capacity constraints is illustrated at GAM, one of the leading managers of funds of hedge funds. Its best-known portfolio is GAM Diversity which has exposure to an array of reputed hedge funds. This fund of funds has proven so popular that GAM is now on its third version. But some of the hedge funds in its third fund are very different from those in its first fund.

Gottex, an investment company, recently closed its \$5bn market neutral hedge fund of funds to new investors. Max Gottschalk, head of European business at Gottex, says the business made the change because it was “important to have some flexibility in the ability to change strategies and managers”. He wanted to avoid too much exposure to a single fund or strategy.

Jason Butler at Bloomsbury Financial Planning has doubts about these products’ ability to diversify portfolios. “Having a series of hedge funds doesn’t necessarily reduce risk,” he warns.

A recent academic paper* backs up Butler’s view. It found that about half of funds of funds had a significant correlation with benchmark hedge fund indices.

There are also some concerns about leverage, according to bankers. Whereas bank lending to underlying hedge funds is nearly always on the basis of collateral – that is, if anything goes wrong the lender gets the underlying share or bond – lending to funds of hedge funds is a decision based solely on previous trading history.

Many funds of hedge funds offer leveraged investments to investors with appetites for risk. The question now is how those investors will have fared – and with them some funds of hedge funds – in the light of recent poor performance by the underlying hedge funds.

**Are Market-Neutral Hedge funds really market-neutral? By Andrew Patton, London School of Economics*

>
>
>

Find this article at:

http://news.ft.com/cms/s/524da54e-cec7-11d9-8cb5-00000e2511c8,ft_acl=,s01=1.html

Check the box to include the list of links referenced in the article.