

THE DEAL DESK

GFMC Newsletter

“Hedge-funds”: ordinary investor’s misfortune or blessing in disguise

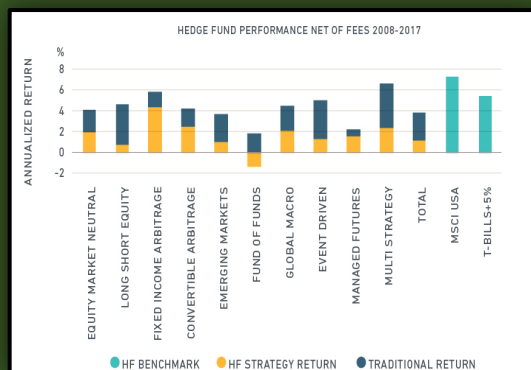
By Ayush Vyas

In the finance world, a few terminologies get thrown around routinely; one of these terms is the infamous “hedge fund”. This pool of investment has been involved in many controversies during the darkest days in the financial markets. According to Warren Buffet, the roots of the concept dates to the mid-1920s. The name of the fund comes from the strategy itself. The strategy was to generate returns irrespective of the market’s direction—a hedge fund pools money from investors to buy securities or other investment alternatives. Hedge funds are famous for employing aggressive investment strategies, like leveraged, debt-based investing, short-selling and other speculative strategies to earn a return that outperforms the broader market. Accordingly, hedge funds carry much higher risk as compared to traditional investments.

Characteristically, many regards hedge funds as an alternative investment vehicle, a pool of private funds managed by a sophisticated hedge fund manager for sophisticated and wealthy investors. Hedge funds providing the risk involved cannot raise funds from the general public. Hedge funds are far more complex than mutual funds that invest in stocks market or fixed income securities, but they are also less regulated and far opaquer. In general, hedge funds and mutual funds fall under the same category of pooled investments. However, they are differentiated by the distinct attributes of the investors’ requirements.

World’s top 5 Hedge Fund corporations and their assets under management:

1. Blackrock Advisors: \$789.57 B
2. AQR Capital Management: \$164 B
3. Bridgewater Associates LP: \$154B
4. Renaissance Technologies:\$130B
5. Man Group: \$123.6 B



The responsibilities of traditional mutual fund managers and the managers of hedge funds differ in varied ways; the hedge fund managers exercise diversity and are equipped with technical know-how to use exotic instruments like derivatives to grab additional returns. Their competence to target long or short in an asset implies that they can also engage in more convoluted strategies such as equity hedging, tactical trading, and arbitrage, where they take advantage of pricing inefficiencies in an asset. However, this is not so common anymore, with fewer opportunities due to the rise of high-frequency trading and the overall competitiveness of the market. So basically, managers have the skill to formulate their own trading strategies depending on market conditions. Therefore, they can charge an extra incentive fee on top of a management fee for their performance.

Who can invest?

SEC Regulation D, rules explicitly 504 and 506, restrict the total number of investors admitted inside a single hedge fund. Hedge fund's partners and managers often create high minimum investment requirements. It is standard for a hedge fund to require a minimum of \$100,000 or a maximum of \$1 million to participate. According to SEC, an investor is considered accredited when they have earned an income of \$200,000 in the last two years and expects the same in the current and the future year or hold a net worth of more than a million dollars. This is required to ensure that the investor can risk investing in these unregulated securities. Therefore, the investor needs to be conscious of the uncertainties of taking such a risk, which could destroy their entire investment in case of unexpected events.

Cost of investing

The annual management fee ranges from 1% to 2 %, independent of the fund's performance. Additionally, the incentive fees typically range from 20% to a whopping 50%. This fee provides an incentive to the manager to outperform the general class of investments and generate better returns in the market. Over the years, there has been a lot of pressure on hedge fund managers to reduce their fees. Furthermore, during the recent few years, we have seen much capital being withdrawn from hedge

funds, particularly in Asia, due to exorbitant fees they are charging and the availability of alternatives. This could partly be because of relative underperformance.

Constant evolution

Even so, there has been much scepticism around investing in hedge funds; most of the criticism lies with their high management fees and lack of transparency. However, there has been a gradual shift over time towards more transparency, better regulation and lower fees and these issues are also expected to further improve in the future. Hedge Funds can also be an investment opportunity for retail investors via funds of hedge funds. Statistically, hedge funds have generally outperformed other investment options while remaining relatively steady amidst various financial crises. Hedge Funds' structure gives managers the freedom to invest in any market using any investment, facilitating them with a wide variety of choices. Over the years, hedge funds have reduced volatility and provided diversity in an investor's overall portfolio. Consecutively, With the advent of machine learning and Artificial intelligence, we may see even better stability in the future of the complex systems in the world of capital markets.

If not hedge funds, then what?

If one does not meet the hedge fund firm's requirements or lack accredited investor status, one has a few options to invest like hedge funds. One can find investment options that use similar strategies to hedge funds, for example, exchange-traded funds (ETFs), "funds of funds" (FOF), mutual funds and many more. Many mutual funds and pooled securities were established to mimic the investment strategy of famous hedge funds. Options such as these are good alternatives for investors interested in hedge funds but cannot gain access to them. Although, some hedge funds are listed on exchanges and have shares that can be purchased individually or through a broker.

Alumni Spotlight



Rushab Kachhara
Fall – 20, MSF

“Participate in as many academic and professional projects and extracurricular activities. This will give you a lot to talk during your interviews. I used to read the Wall Street Journal daily. Nothing substitutes your daily dose of reading”.

By Ayush Vyas

Rushab did his bachelor's from the University of Mumbai and MBA-Finance from Thakur Institute of Management Studies in India before coming for a master's in finance at UTD in Spring 2019. Rushab graduated in Fall 2020 and has been working as a Credit Portfolio Senior analyst at Citigroup Inc. His job responsibility at Citigroup Inc involves preparing financial spreads of the company, run rating models to derive the credit rating of the companies in the portfolio and prepare annual and quarterly reviews.

Rushab is an excellent example of perseverance and remarkable time management skills. During his tenure at UTD, he got the first rank in the Spring 2019 UTD Trading Challenge. During Fall 2019, he represented the university in the Derivative Trading Challenge organized by Chicago Mercantile Exchange and achieved 6th rank globally. Further, in spring 2020, He participated in an equity research challenge by the CFA Institute.

He has been one true friend when it comes to helping people and standing by their side. He assisted professors as a teaching assistant and helped many students with their doubts. He humbly suggests that if you keep hustling, you will figure out everything in time. His motto - Be proactive. It is the key in becoming an efficient finance professional.

About the Author



Ayush Vyas **Full Time MSF** **Candidate**

He completed his Master's in Business Commerce back in July 2019 and worked as an auditing and financial associate till December 2020. He has also completed the intermediate level of Chartered Accountancy and he did 3 years of Article ship training under a certified chartered accountant. During his years of experience, he has performed financial analysis and prepared projected financial statements,

His reason for choosing master's is to fulfil his dream of becoming a sound financial consultant and dive deeper into money-multiplication theories. He has done several audits, but his favorite so far is preparing a balance sheet for an international cricket match series between India and South Africa. He loves dancing and is been performing in various college events. He is a travel and fitness enthusiast who loves reading, writing and exploring mountains.

The Deal Desk provides a platform to JSOM students to share their views on important events affecting the finance industry.

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