

Comment

Up Down or Sideways: The Prospect for 2004

Thomas Schneeweis

January, 2004

As the new year begins, one normally makes promises or pledges as to what one wishes to achieve over the coming year. One also takes stock at what one hoped to achieve last year and the degree to which one achieved those lofty goals. In the past year, we have achieved much at CISDM. The following is a brief example of our successes. Our failures we will continue to keep hidden.

As the new year begins, one normally makes promises or pledges as to what one wishes to achieve over the coming year. One also takes stock at what one hoped to achieve last year and the degree to which one achieved those lofty goals. In the past year, we have achieved much at CISDM. The following is a brief example of our successes. Our failures we will continue to keep hidden.

- 1). Revamped CISDM Active Manager Indices to emphasize sector and strategy specific subindices.
- 2) Created a series of new factor and strategy based hedge fund and CTA indices which provide daily return estimates for a wide variety of hedge fund/managed futures strategies.
- 3) A new bibliography series which provides updates on new research globally.
- 4) The formation of the CAIA designation and educational programs.
- 5) A series of new academic research which provides greater insight into the return processes of various hedge fund strategies.

For 2004 we planned to continue to provide material that will help in increasing ones understanding of the alternative investment space. Look forward to:

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- 1) Updated series of Benefits of Alternative Investment Papers in English as well as in a series of foreign languages.
- 2) A Bi-annual research review which will provide a critical review of 'popular' research beliefs. For instance, the current review provides a critical review of the popular belief that hedge funds are really 'dressed up mutual funds'.
- 3) A greater emphasis on new research covering topics such as 1) stale prices, 2) hedge fund return and market volatility, 3) first order auto correlation in hedge fund return patterns, and 4) how to measure liquidity effects in hedge fund strategies.

In the upcoming months, members of CISDM are presenting research at professional, academic and governmental agency meetings. CISDM remains committed to quality research for the professional and the academic audience. We look forward to meeting your own wishes for 2004. Thanks for your support in 2003 and we look forward to your continued support in 2004.

Looking forward to your comments.

Tom Schneeweis

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Professional Bio: Thomas Schneeweis is the Co-Founder and the current Director of Research at YES Wealth Management, a Registered Investment Advisory Firm in the Minneapolis/St. Paul area in Minnesota (Email: tschneeweis@yeswealth.com and Website: www.yeswealth.com). He was the Michael and Cheryl Philipp Professor of Finance and Founding Director of the Center for International Securities and Derivatives Markets at the Isenberg School of Management, University of Massachusetts-Amherst. He was also the Founding Editor of The Journal of Alternative Investments and the Managing Editor for over fifteen years. He is Co-Founder of the Chartered Alternative Investment Analyst Association (CAIA: www.caia.org) and the Founder of Chartered Alternative Investment Analyst Foundation. He is also the Co-Founder of the Institute for Global Asset and Risk Management (INGARM: www.ingarm.org). He has published more than 100 articles in the area of investment management and is the co-author/editor of over six books in the area of investment management including New Science of Asset Allocation (John Wiley, 2010) and Postmodern Investment: Facts and Fallacies of Growing Wealth in a Multi-Asset World (John Wiley, 2012). He has been awarded with the CAIA Award for Research in the Area of Alternative Investments (2012). He has been a frequent speaker on financial news programs and contributor to various financial publications. He received his Ph.D. from the University of Iowa, M.A. from University of Wisconsin, and a B.A. from St. John's University.

He has more than forty years of experience in asset management including President of a firm (Schneeweis Partners) which specialized in 'bespoke' structured finance and Director of Research at Ursa Capital, LLC which managed an approximately \$4 billion hedge fund managed account platform. He has been managing partner of a managed futures fund (White Bear Managed Futures Fund) as well as an equity long short hedge fund (White Bear Equity Long-Short Fund) and President of an approximately \$1 billion commodity-based investment firm (Alternative Investment Analytics). For over thirty years, he also was on the Board of Trustees of the AMG Funds (a retail distribution arm of Affiliated Managers Group, Inc., a world's leading provider of boutique investment management expertise to institutional and individual investors).

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Comment

Do Hedge Funds Really Exist or “The Hunting of the Hedge Fund Snark”

Thomas Schneeweis

February, 2004

In his article, Bookstaber expresses the concern that one may have a difficult time separating the How from the Why in determining the basis for hedge funds. Bookstaber set out his belief that “there is no such thing as a hedge fund. Hedge funds are not a homogeneous class that can be analyzed in a consistent way. The universe of alternative investments is just that - the universe. It encompasses all possible investment vehicles and all possible investment strategies minus the “traditional” investment funds and vehicles.” He proceeds to illustrate the problem with viewing hedge funds as a whole when they are managed in the particular. He is looking for the essential in hedge funds. Bookstaber titles his article “Hedge Fund Existential.” However, I may wish to argue that he is addressing what he regards as essential rather than existential. In my world, hedge funds can be discussed in terms of their very being; that is, they have an existence since they have a being in time and space.

In a recent article in the Financial Analyst Journal, Richard Bookstaber [2003] discusses hedge funds at in terms of the core of its basic epistemology and asked the question that I have been struggling with for over 15 years, “What is a Hedge Fund”, where is its place in the investment space, and what are its unique characteristics that separate it from other investments. I am not attempting in this space, to attempt to convince others of the correctness of my current beliefs. Perhaps I have even left the arena of attempting to know what it is and remain for the short run at least, satisfied to knowing How Hedge Fund Work.

In his article, Bookstaber expresses the concern that one may have a difficult time separating the How from the Why in determining the basis for hedge funds. Bookstaber set out his belief that “there is

no such thing as a hedge fund. Hedge funds are not a homogeneous class that can be analyzed in a consistent way. The universe of alternative investments is just that - the universe. It encompasses all possible investment vehicles and all possible investment strategies minus the “traditional” investment funds and vehicles.” He proceeds to illustrate the problem with viewing hedge funds as a whole when they are managed in the particular. He is looking for the essential in hedge funds.

Bookstaber titles his article “Hedge Fund Existential.” However, I may wish to argue that he is addressing what he regards as essential rather than existential. In my world, hedge funds can be discussed in terms of their very being; that is, they have an existence since they have a being in time and space.

Main Entry: **ex·is·ten·tial**

Pronunciation: "eg- (") zis-'ten(t)-sh&l, "ek- (") sis-

Function: *adjective*

Date: 1693

1 : of, relating to, or affirming [existence](#) <existential propositions>

2 a : grounded in [existence](#) or the experience of [existence](#) : **EMPIRICAL** **b** : having being in time and space

Therefore, what is the place in time and space for hedge funds? Given the dynamic and organic nature of existence, I, for one, am comfortable living in a world in which the vary nature of entities change over time and strict classification is difficult. What makes a hedge fund a hedge fund? Do Hedge Funds share some common feature or quality? Or is the hedge fund category simply a catchall for a wide variety of disparate investment firms and trading strategies? Once we get past the obvious fact that various investment firms are labeled ‘hedge funds’ do hedge funds really exist as a definable entity? Is there such a thing as “hedge fundness”?

I am not sure if this is a forest for the tree’s problem. In my world, there are unique features of those strategies which have fit previously well into ‘hedge funds’ that make an understanding of the

dynamics of how they trade and who they are traded by that may aid in additional understanding of the strategies. If looking at hedge funds as some combination of individual security portfolios works to help that institution better understand and use the vehicles in classification, asset management, regulation oversight or market evolution I promote that effort. If placing hedge funds within the context of a particular strategy approach based on a particular set of investment opportunities which have a central focus and market risk exposure as well as a well defined trading process that permits us to think of them in a type of style pure opportunity set, I find no difficulty in supporting that approach. However, if one wishes to view hedge funds all as individual separate monads each doing something different such that one cannot use the similarities of process, exposures etc. then I do take an alternative position.

I do not have a single solution or approach. In that I show my bias. I feel comfortable in the classes I teach with presenting the world as four food groups (stocks, bonds, currencies, and commodities) with a compendium of offspring (e.g., futures and options, swaps...). I know full well that one may also view currencies as simple (interest rate swaps). I also know that certain individuals see currencies in an asset class mode. Therefore, I feel comfortable in creating a map of the investment world which includes a variety of ways to view investments.

Perhaps the answer is simply that one must accept inconsistencies and lack of precision in the world. Perhaps we have become so enamored with precision that living with terms which by their very nature are ill defined is difficult for all of us. For me, I understand that grape juice is made out of grapes but we find it on a different aisle in the store. It has different characteristics and different customers. Perhaps hedge funds are the grape juice to grapes. Or as an alternative we may have to come to the view that “hunt hedge funds” is similar to hunt for Snarks. For those who fail to remember their high school

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literature class, a Snark is an imaginary animal of ill-defined characteristics and potential (Lewis Carroll “The Hunting of the Snark”). Sounds an awful like a hedge fund to me.

Selected References

Bookstaber, Richard. “Hedge Funds Existential,” Financial Analyst Journal (September/October, 2003).

Looking forward to your comments.

Tom Schneeweis

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Professional Bio: Thomas Schneeweis is the Co-Founder and the current Director of Research at YES Wealth Management, a Registered Investment Advisory Firm in the Minneapolis/St. Paul area in Minnesota (Email: tschneeweis@yeswealth.com and Website: www.yeswealth.com). He was the Michael and Cheryl Philipp Professor of Finance and Founding Director of the Center for International Securities and Derivatives Markets at the Isenberg School of Management, University of Massachusetts-Amherst. He was also the Founding Editor of The Journal of Alternative Investments and the Managing Editor for over fifteen years. He is Co-Founder of the Chartered Alternative Investment Analyst Association (CAIA: www.caia.org) and the Founder of Chartered Alternative Investment Analyst Foundation. He is also the Co-Founder of the Institute for Global Asset and Risk Management (INGARM: www.ingarm.org). He has published more than 100 articles in the area of investment management and is the co-author/editor of over six books in the area of investment management including New Science of Asset Allocation (John Wiley, 2010) and Postmodern Investment: Facts and Fallacies of Growing Wealth in a Multi-Asset World (John Wiley, 2012). He has been awarded with the CAIA Award for Research in the Area of Alternative Investments (2012). He has been a frequent speaker on financial news programs and contributor to various financial publications. He received his Ph.D. from the University of Iowa, M.A. from University of Wisconsin, and a B.A. from St. John's University.

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Comment

The Rumsfeld Doctrine Applied to Alternative Investments

Thomas Schneeweis

March, 2004

We Know What We Know, We Know What We Do Not Know, But We Do Not Know What We Do Not Know

In a recent editor's corner in the Financial Analyst Journal (January/February, 2004), Robert Arnott raised the provocative question as to the intellectual laziness or integrity of various aspects of the traditional asset market. While commending the industry for its examples of creative and intellectually stimulating examples, Arnott questioned the reluctance of industry business leaders to admit to some of their inconsistencies (example, unrealistic pension return assumptions in a low interest rate environment). Likewise, the alternative investment industry may be praised for the increase in research which while often depicting its benefits also discusses some of its shortcomings that must be addressed.

It is important to point out that the alternative investment industry in general, and hedge funds in particular, have received recently their fair share of criticism. For instance, Richard Bookstaber [2003] has questioned hedge funds place in the investment space. Recent SEC hearings have illustrated a misconception as to hedge fund pricing as well as to the underlying risk and return reward structure. That is not to say that recent research on the source of hedge fund and other alternative investment returns does not answer much of this criticism, only that we still must (in the words of our current Secretary of Defense) be honest as to the things we know, the things we do not know, and the things we do not know that we do not know.

What We Know:

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- Alternative investments in general and hedge funds in particular may be regarded as an asset class to the degree that it provides access to unique risk and return opportunities not easily obtained elsewhere. However, as for the equity area, one cannot easily place all investment vehicles that are often regarded as hedge funds easily under an overall umbrella. That is, hedge funds are less a means of obtaining a single risk/reward opportunity than a number of risk and return opportunities which do to regulatory and trading constraints are segregated from the traditional 'long only' stock and bond world.
- Alternative investments in general and hedge funds in particular have returns that are derived from their exposure to certain asset claims and economic markets. In short, alternative investment returns are not solely the result of manager skill but managerial competence and market exposure.

What We Do Not Know

- The lack of fund and manager transparency limits our ability to track the actual performance of certain hedge fund and other alternative investment strategies and the sensitivity of these strategies to various economic stimuli.
- The impact of market capacity and manager capacity on expected risk and return.
- Expected risk and return in general. We continue to use the past as a simple forecast of the future, while using and promoting strategies whose underlying focus is based on our inability to forecast the future (if we did why hedge).

What We Do Not Know We Know

- We continue to use historical events as a basis for understanding the probability of the future.
If August, 1998 had never happened does it mean that we should not consider its impact on

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current strategies? Or if the past has several events for which the probability has been reduced why do we still weight them based on historical events.

- Strategies come and go based on regulatory changes as well as economic changes. What are the strategies that will be the major source of new risk and return opportunities into the future?

At a recent industry meeting, I noted the disconnect between the use of generic hedge fund indices used in describing the benefits of hedge funds and thus in promoting the use of various industry products and the absolute lack of these indices in future reporting material when the products performance is presented to investors. Instead we continue to provide simple absolute comparisons of hedge funds to traditional assets (S&P 500 etc.) while promoting the unique diversification or non-correlation of our funds to that very index.

I understand the hard business realities of selling versus educating just as I realize the hard academic reality that academics make money primarily by emphasizing the problems in an idea rather than the benefits of a particular investment vehicle. However, if the industry is to expand beyond the confines of the 'Qualified' investor, beyond the wine and brie crowd, the alternative investment industry must be willing to take the good with the bad. This is not to say that in so doing we will not make our business life a little more difficult for the present while helping the industry grow in the future. However, few people have criticized the participants in the industry for being 'business lazy' only a bit intellectually lazy.

Looking forward to your comments.

Tom Schneeweis

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Professional Bio: Thomas Schneeweis is the Co-Founder and the current Director of Research at YES Wealth Management, a Registered Investment Advisory Firm in the Minneapolis/St. Paul area in Minnesota (Email: tschneeweis@yeswealth.com and Website: www.yeswealth.com). He was the Michael and Cheryl Philipp Professor of Finance and Founding Director of the Center for International Securities and Derivatives Markets at the Isenberg School of Management, University of Massachusetts-Amherst. He was also the Founding Editor of The Journal of Alternative Investments and the Managing Editor for over fifteen years. He is Co-Founder of the Chartered Alternative Investment Analyst Association (CAIA: www.caia.org) and the Founder of Chartered Alternative Investment Analyst Foundation. He is also the Co-Founder of the Institute for Global Asset and Risk Management (INGARM: www.ingarm.org). He has published more than 100 articles in the area of investment management and is the co-author/editor of over six books in the area of investment management including New Science of Asset Allocation (John Wiley, 2010) and Postmodern Investment: Facts and Fallacies of Growing Wealth in a Multi-Asset World (John Wiley, 2012). He has been awarded with the CAIA Award for Research in the Area of Alternative Investments (2012). He has been a frequent speaker on financial news programs and contributor to various financial publications. He received his Ph.D. from the University of Iowa, M.A. from University of Wisconsin, and a B.A. from St. John's University.

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Comment

Truth: The Ever-Changing Constant

Thomas Schneeweis

April, 2004

It's not telling the truth that is hard, but in determining what truth to tell?

Here is the purpose of the following diatribe. One of my principal concerns over the number of professional books on finance is not that they have nothing to say, or even that what they say is incorrect, only that there is little if any quality control on the process.

My wife says I educate myself at 30,000 feet. I hope that she is not saying that I have a tendency to describe events at a level that no one understands, only that my primary opportunity to review current research is when I have the two to three hours between airports. I fear this is true not only for myself, but for many others as well. My evidence for this belief, is the number of 180-200 page Professional Books which are written to be read on a three hour flight (all flights are two to three hours – Chicago NY; Chicago –Los Angeles; New York Atlanta). More importantly, each book has the presentation qualities which help promote its sale; that is, a proper front cover, a back cover with suitable praise of men and women of note, and short bibliographies of the authors' qualifications. Inside, graphs, tables and footnote are offered to support the authors' emphasis.

Here is the purpose of the above diatribe. One of my principal concerns over the number of professional books on finance is not that they have nothing to say, or even that what they say is incorrect,

only that there is little if any quality control on the process. In the area of alternative as well as traditional investments, we have real concerns as to the information managers are providing to investors. I am concerned as to the level of oversight on generic Professional books attempting to provide similar information to readers. This is especially true for readers who may have little background on a subject and therefore are more consumers than critics.

As a consumer, one puts one's faith in the theory and facts presented. This faith is often increased if the authors reference their work with copious footnotes and references to previous research properly footnoted. Herein "Lays" The Problem. One of the principal roles of an empirical research academic is in attempting to test various hypotheses for their empirical adherence. Fortunately, since the world we live in is constantly changing, the academic has unending supply of opportunities to test these hypotheses. Sooner or later an academic stumble on a 'convincing' result which either supports a hypothesis or contradicts it. Unfortunately, rarely does that academic or other researchers review the process or procedures to see if the results still hold.

This does not stop the author from referencing these studies. One of my primary concerns over University textbooks is that even new 2003 textbooks (not new editions which are simply rewrites) were written in 2001, based on research published in 1999-2000, which were written in 1998 based on data in 1996. In short, recent textbooks are often 4-6 years old in terms of material. The same problem exists for professional books. Rather than raise the wrath of my own publisher, in a recent new 2003 book written for a survey and synthesis series for a well respected academic financial management association in the area of real estate, the chapter on real estate and economies of scale, the authors refer to a number of previous studies; those studies have the following citation dates (1997; 2000; 2001; 1998; 1997; 1996; 1996; 1998; 1990; 1991; 1997; 1987; 1989). In other chapters, similar reference dates exist. These studies

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could reflect current conditions. However, the reader must also understand that the constantly changing economic scenario may make previous results of little consequence in today's markets.

The purpose of the above is not to criticize my most recent education at 30000 feet. I found the book generally informative. However, I also wonder the degree to which the evidence given reflects today's reality. In this book, a statement is made that 'It is clear from the evidence in the table that the ...returns of .. are inferior to the returns of'

If one looked at the table one sees that the average return of the first series is greater than the average return of the second series. The differences are not significantly different, but even more so, for 9 out of the past 10 years, (1992-2001), the second series outperformed the first. The out performance of the first series was due to its out performance in the 1980's. The average reader may not notice the subtle difference.

This is one small example, but I suggest that the SEC may spend more time reviewing what investors read than what they are sold. Now if the truth would only stand still long enough for us to catch it.

Looking forward to your comments.

Tom Schneeweis

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Comment

Where is the “Fun” in Hedge Funds?

Thomas Schneeweis

May, 2004

“It’s not that I am good at what I do, it’s just that I am bad at everything else”

At a recent investment conference, someone asked me how I had stayed in the investment area for now over thirty years. I answered somewhat truthfully, “not enough of a failure to be fired or not enough of a success to quit”. In truth, thirty years in anything brings one a personal perspective of a changing landscape (marriage, geography, career) if little else. In fact, it is this personal history that permits one to review the many small events that, seen from a personal level, are viewed in one perspective and yet years later seem to have an entire differ hue. I am saying this only in context of the recent activities surrounding the death of Ronald Reagan, who to the question “How being an actor helped him in being President,” replied that he did not know how one could be President without once being an actor. Individuals now have an entirely different perspective on Ronald Regan than I remember hearing during the years he was president. If one believes all the individuals who now say they had a personal relationship with him, a busy man he must have been.

By the way, it is important to realize that the concern raised at the moment might have been correct. Often one simply gets lucky. One makes the wrong decision given the current expected information, however, either one’s expectations can be faulty or the information itself can change.

Whatever, the source, one is remembered not for being ‘probably right’ but for being ‘unfortunately wrong’ (e.g., History may say, that Bush I should have gone into Bagdad and Bush II should not have; despite all the information that led (at the time) for both to act as they did).

But back to the ‘fun’ in hedge funds. Where has history proven that those of us in hedge fund land were incorrect (ex post) or correct ex post. To be proven right or wrong one must first of all have made a set of public statements. So, the following are a set of my forecasts. Some may be right, some may be wrong but at least we can have “fun” with them.

Hedge Funds: Future Focus

Give them a number, give them a date but never ever give them both

Here are our prognostications for the future and remember this is fun:

Most Probable (75% Chance):

- The creation of an industry wide education standard for professionals in the alternative investment industry. This designation (e.g., Chartered Alternative Investment Analyst) will provide industry participants with a globally recognized certification similar to the Chartered Financial Analyst designation for professionals in the traditional investment area. (For information on the current status this program see www.caiaonline.org.)
- Lower fees overall, with performance fees tied to relative, as opposed to absolute, performance. Fees will be structured to meet capacity demand and not be based on economic ‘alpha’ determination. In short two forms of fee structure; one for the firm with limited capacity and above average demand and those with excess capacity and below average demand. For newer funds which require a consistent and minimum cash flow, a greater amount of fees will be generated by a higher charge on fixed assets.
- The creation of passive index to replicate and benchmark active trading strategies, with compensation increasingly tied to these passive benchmarks or to the performance of other active managers within the style.
- Increased transparency for investors, with daily reporting of returns and VAR becoming the norm.

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- Reduction in lockup periods. Many managers will begin offering daily liquidity, and those that cannot offer daily liquidity will need to demonstrate the need for longer lockups. Greater tendency for financial institutions to allow outside investment in internal traders to allow for full transparency and liquidity.
- More competition with mutual funds. Mutual funds will replicate traditional hedge fund strategies, and hedge funds will mimic the marketing strategies that have made mutual funds so successful in attracting assets.
- Increased dominance of large financial institutions in structuring and delivering hedge fund products. These institutions can charge lower management fees because captive funds offer cash flows to other parts of the firm such as trading, custody, and securities lending.
- Large single-strategy hedge funds will increasingly attempt to wrap non-correlated strategies around their own product and attempt to sell multi-strategy funds.
- Single-strategy funds will exist primarily as start-ups. These funds will be bought out as larger firms look for investment niches with excess capacity.

Might Happen (50% Chance):

- All hedge funds operate on a 24-hour basis.
- Hedge funds will be listed in a B2B environment.
- All hedge funds offer full transparency to investors, subject to confidentiality agreements.
- Rating agencies will provide on-line rating system of hedge funds including price risk, style risk, and manager risk estimates. This will happen as the result of governmental regulation thus ensuring a required payment and cash flow to rating agencies.
- Development of a traded market in secondary interests in hedge funds.
- Downstreaming/retailing of hedge fund products - already happening with insurance wraps etc.
- Proliferation of incubators where the seed investors will have first right of refusal on the managers' capacity and where the total assets under management is restricted/predefined or capped contractually.
- Institutionalization of hedge fund industry as some very large funds move away from the general hedge fund model towards becoming investment banks (e.g., creating new pools of risk capital rivaling and eventually replacing some of the current Investment Bank's).

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Probably not (25% Chance)

- Hedge funds dominate active investment management, as mutual funds are replaced by index products.
- Emerging markets (e.g., China, India) attract the dominate portion of hedge fund investments.
- Government regulators stop using accounting-based means of regulation (e.g., reporting last quarters, asset positions) and focus on continuous pricing as a means of regulation
- Governments create a reasonable, worldwide system of reporting which permits a measure of systemic risk under a wide range of financial conditions.
- Development of recognized alpha measures rivaling other broadly accepted statistical measures like Sharpe ratios etc - probably evolving from reclassification of manager styles and focusing on things like credit risk, volatility risk etc.

Looking forward to your comments.

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Comment

Hedge Funds and the Velveteen Rabbit

Thomas Schneeweis

June, 2004

In one of the most famous of children's books, "The Velveteen Rabbit," (a story by Margary Williams, 1922) a stuffed bunny is a little boy's most cherished plaything. As the boy grows older, so does the toy rabbit. It no longer is it the newest toy in the box, but as it becomes older it really becomes more real, like a 'real rabbit.' Hedge funds are no longer the newest toy in the investment box, but it is becoming more real in terms of what a real investment looks like.

In one of the most famous of children's books, "The Velveteen Rabbit," (a story by Margary Williams, 1922) a stuffed bunny is a little boy's most cherished plaything. The rabbit is the boy's constant companion through sickness and health. To the boy, he is real, so real that the rabbit convinces himself that he is also real. Of course, the real rabbits know that the toy rabbit is not really real and regard him with a little disdain. The stuffed rabbit, while sensing something is wrong, holds true the boy's vision of the toy rabbit as being real. All the other toys warned the rabbit that sometime in the future he will be tossed aside for some new toy. Still the 'toy rabbit' feels real and comes to believe he is like the real rabbits he sees in the forest. In fact, while he started out as a toy, the rabbit has become real in some ways (although he will need to take it to a higher level to become really real) but that gives away the story. This plot line leads us to the heart of the matter; that is, to the essence of reality.

Real isn't how you are made," said the Skin Horse. "It's a thing that happens to you. When a child loves you for a long, long time, not just to play with, but REALLY loves you, then you become Real."

"Does it hurt?" asked the Rabbit.

"Sometimes," said the Skin Horse, for he was always truthful. "When you are Real you don't mind being hurt."

"Does it happen all at once, like being wound up," he asked, "or bit by bit?"

"It doesn't happen all at once," said the Skin Horse. "You become. It takes a long time. That's why it doesn't happen often to people who break easily, or have sharp edges, or who have to be carefully kept. Generally, by the time you are Real, most of your hair has been loved off, and your eyes drop out and you get loose in the joints and very shabby."

The toy worries as to the value of being 'real' if it means being open to being no longer desired yet having known what it means to feel real. Hedge funds are now in the reality phase. Once the favorite toy in the investment room, for many they are simply one of many competing alternatives. Today, we know that hedge funds offer return opportunities not often available through traditional assets, but we also know that these opportunities are not the result of magic but simply the acceptable risks (liquidity, information asymmetries ...) that underlie each strategy. If loosing the newness of being an investment toy and now being made real means additional oversight and loss of investor allure, many of hedge funds would hope to return to the days when they were viewed as magicians or wizards or perhaps even toys.

We also have professional regulators (similar to the doctor who oversees the boy in the story and who warns the family to toss out the toy rabbit, because it may be full of germs) who fear the germs that hedge funds may carry and warn investors to toss out hedge funds. In short, the toy is now ugly to those around it who fear that it may have more negatives than positives.

Of course, one can say that the doctor simply did not understand the value of the rabbit to the boy. To the boy, the rabbit was so real that the rabbit felt it was real. The doctor, of course, maintains that it was not and should be removed from the house. I am sure the rabbit wished it could somehow get the

doctor's attention and to point out that it was similar to many other 'rabbits'. In the end, the rabbit wishes to really become real, to enter the world of 'real rabbits.'

Hedge funds may now be faced with the choice of being simply a toy or of becoming a real investment. In so doing of course, we leave the toy room. In short, is it worthwhile to be understood as many other investment vehicles are; that is, simply as an investment vehicle hopefully well managed, with return opportunities that offset the corresponding risks, with full transparency such that individuals know who we are, what we are, and what we do.

I do not have a simple answer. I feel comfortable with hedge funds, maybe because like the boy in the story I know that they are real. To those like the doctor who don't understand the hedge fund reality I can only asked them to read the story. Previous to being discarded, the rabbit had understood the risks of starting the process of becoming real.

The Boy's Uncle made me Real," he (the toy Skin Horse) said. "That was a great many years ago; but once you are Real you can't become unreal again. It lasts for always."

The Rabbit sighed. He thought it would be a long time before this magic called Real happened to him. He longed to become Real, to know what it felt like; and yet the idea of growing shabby and losing his eyes and whiskers was rather sad. He wished that he could become it without these uncomfortable things happening to him.

Well, we are a little shabby now and it was a little uncomfortable, however, this is all about becoming real. The newness, the magic is over. Hedge funds, as the rabbit, have had to come to terms with becoming real, with all the positives and negatives. In the story, the 'nursery' fairies make the toy rabbit really real and even ask the other rabbits to help the new rabbit make its way in its world. Perhaps government regulator will become less like the doctor and more like the 'nursery fairies' and will make hedge funds 'really real' to investors. The bad news in the story is that the rabbit in becoming really real

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had lost some of his uniqueness. The good news was that he was a real rabbit at last, at home with the other rabbits.

In the story, before the toy rabbit became 'really real' the other real rabbits regarded him as rather ugly and certainly not part of their group. Perhaps as hedge funds become more real more people may no longer regard 'hedge funds' as an ugly investment. But to those who never will see hedge funds as other than a toy investment I would ask hedge fund investors to but remember the point of the story.

"But these things don't matter at all, because once you are Real you can't be ugly, except to people who don't understand".

Looking forward to your comments.

Tom Schneeweis

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Comment

Government Regulation

Thomas Schneeweis

July, 2004

**In the White Trunks and In the Red Trunks: Government versus Big Business.
The question is who is the Referee in this contest.**

I grew up during the heyday of boxing. The nice thing about the sport (are there are only a few) is that at the start of each event, one could easily identify who was on one side and who was on the other. As one grows older, one finds out that identifying who is one side of an issue and who is on the other becomes increasingly difficult. In today's world one does not look at the color of one's trunks, but more likely in classic 'Watergate parlance' one simply follows the money.

One of the myths of popular history is that most government regulation has been at the behest of the government in its efforts to protect the meek, the weak ... This story is most often coming out as crusading government officials often lead by crusading journalists who have uncovered the down and the dirty of industries who prey on consumers. These stories are most well-known from the early 1900's when government regulation began to cover areas of meat packing etc.

Current historical analysis offers a somewhat different view. While the government actions were certainly warranted, how we view those supporting and those concerned with those actions have somewhat changed. These analyses now point out that in many of these cases, it was not the small and the weak going after the nasty large firms who were taking advantage of their power to take advantage of consumers but just the opposite. In short, in many cases of government regulation, it was the larger more

well-established firms which favored increased government regulation. The reason for their support of increased government oversight was that once established firms had the resources to meet new regulations. In many cases, they came to see the government not as an enemy but as one who could protect their current position or interests.

In this new historical presentation, regulation cemented the existing status quo. Smaller firms who were unable to meet the costs of the new oversight were driven out of the industry. This scenario may also be playing out in the current supporters and opposition of regulation on hedge funds. While some of the larger hedge funds are concerned about increased government oversight, even larger financial institution, who may view the regulation as a means to assure investors, and who have historical experience with extensive government compliance have for the most part gone along with the new government actions. While it is risky to place aims and intentions on any individual, one may surmise that the larger financial institutions see a more regulated world as one in which they have certain advantages in terms of institutional investor acceptance and ability to manage funds within the required legal frameworks.

The pro and cons of smaller firms being marginalized in an industry is an often-discussed area in financial regulation. Smaller firms often have incentive to innovate and to take risks that larger firms may regard as not worthwhile. In short, financial innovation may not be found primarily in larger established firms. One of the hardest issues in financial innovation is how to encourage change while reducing the impacts of bad choices on the public at large. This is conducted in an environment where one must respect the freedom of investor choice. Perhaps the most well-known case of this problem is currently in the ‘herbal’ supplement area. The FDA has consistently warned consumers that many herbal remedies have little evidence of success. That having been said, many consumers continue to use these products. Of even greater concern, is that years later some of these products have been shown to have some benefits while others have shown to have greater risks than earlier presented. Should the government step in? In so doing

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one may save consumers dollars but in the long run how many potentially worthwhile drugs would never meet the light of day.

New investment products require not only individuals willing to take on the risks of instituting new products but also individuals willing to take on these risky products. When they fail who is to blame. Government guarantees on bank deposits effect on bank investment decisions in the 1980's is well known. At the same time, failure is a good thing. It focuses the market and investors on the risks of investment. Moreover, if they succeed who garners the benefits? I have always been concerned over those who wish to regulate out failure and thereby creates a series of second-best solutions to a number of problems.

Hedge funds are just one small part of the overall financial industry. It is somewhat amazing to me the attention it has drawn. Perhaps this is so, because it is the very area where change is taking place. Traditional areas are more like commodities in which little changes and the risks are well known and individuals (investor and government) are comfortable with those risks. It is also important to note that if the cost of regulation becomes too large, other countries have the option of taking the forefront in offering new products and new services. The U.S. still carries the biggest club if only because we have the largest market. However, as globalization increases the implications of global government and as well as product development, as well as product sales makes the 'financial innovation' world increasingly complex. Creating a modeling process which takes the growing internationalized dynamics into consideration is a worthwhile but daunting task but perhaps the place for all of us.

Looking forward to your comments.

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Comment

Free Options and The Free Lunch

Thomas Schneeweis

August, 2004

As a young academic I was enthralled by how the theoretical and empirical questions described in new approaches to applying option theory to a wide range of financial questions that seemed to open up endless areas of research. The two areas I found extremely interesting were options on the better of two assets and the idea of lookback options. In brief each was simply too good to be true, someone would give me the right to make up for any bad decision I would make. Unfortunately, these options always come at a price. I now understand that this remains the Holy Grail in finance, that is, assets which reduce the risk while having no impact on return.

As a young academic I was enthralled by how the theoretical and empirical questions described in new approaches to applying option theory to a wide range of financial questions that seemed to open up endless areas of research. The two areas I found extremely interesting were options on the better of two assets and the idea of lookback options. In brief each was simply too good to be true, someone would give me the right to make up for any bad decision I would make. Unfortunately, these options always come at a price. I now understand that this remains the Holy Grail in finance, that is, assets which reduce the risk while having no impact on return. I also understand that in the absence of full information such cases may occur. In fact, it is the return to finding such potential cases, that individuals pay for information such they can intermediate the process and take a little off the top for themselves. But there goes the idea of costless.

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During the following decades, I continued to see new opportunities for “option solutions” to financial risks including options of volatility, options on catastrophic risk In each case the academic in me waited for the world to rise up in praise of this new idea only to find out that the real world required a cost for such insurance. In fact, the evidence that only academics were continuing to try to improve, however marginally, general option pricing should have been a clue. The real world which requires that new products carry in them a source of return to cover the cost of development had long found out that the marginal benefit of the ‘1000th newly improved option pricing model’ was not worth the cost of development. Academics who have few costs (an article is an article) can continually come up with ideas even if they are not financially viable in the financial world.

This is not to say that financial theory on options has no place in the alternative investment space. Far from it, options and other derivative products form the lifeline of our business. I only refer to the two options I discuss previously (option on the best of two assets and lookback options). Each seemingly offers the best of all possible worlds. Of course, depending on how many solutions they are primed to solve, the cost can be extensive.

Perhaps that is why they have greater use in ‘academic theory’ than in ‘financial market fact’. Lookback options have been used to describe the potential benefit of absolute return investing (we can make money in all markets). It of course is not foolproof. First of all lookback options can be affected by on changes in volatility that have no impact on the value of a hedge fund manager’s positions. Still, it does reflect the hope that if a manager would, could or should be able to move positions freely such that that his or her returns may reflect the ability to capture the best of all possible worlds. If he or she did not charge for this service it would be ‘a Free Lunch.’

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Well, the story is more complex. We all wish to believe that such options are available and costless. For purposes of this comment, I do not wish to detail my thoughts on the use of lookback options to describe returns to hedge funds (see Schneeweis and Kazemi, Are Hedge Funds Lookback Options, 2004), but only to remark that the current attempts to find ways to solve past problems in hedge funds through government regulation looks an awful like a lookback option. That is, I am trying to create a market in which the sins of the past are not revisited or if they are, the government will somehow ensure that I am always covered for any risk carried. I appreciate the effort. I even appreciate it more even more if I understood the investor or market benefits from paying for such an option. If, the individual buying my product is forced to pay for the implicit costs of fund meeting new regulatory rules, my first question might be if I could manage these risks cheaper through other means (e.g., out of the money equity options, ...). If I am paying for insurance protection for individuals who refuse to educate themselves, it is them, not me, who is getting the free lunch. In short, the costs are spread over individuals who do not share in the benefits. For that purpose, as an educated hedge fund investor, one may favor the government efforts to protect hedge fund investors from ex post errors of hedge funds through greater regulation but only if these costs are covered by individuals who cannot or will not invest in hedge funds. This is in my world the real 'free lunch;' that is, someone I do not know or even care to know picking up the tab for my lunch with no desire or requirement that I ever do the same for them. Now if only there was a 'free website' which covers these 'free lunches.' Of course, the academic in me knows the answer, the cost of admission will equal the benefits to be obtained. Market efficiency has its costs as well as its benefits.

Looking forward to your comments.

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Comment

What I Said and What I Meant to Say

Thomas Schneeweis

September, 2004

The recent Presidential debates showed me the benefit of the lookback option discussed in last week's comments. That is, the ability to go back and either recant or rewrite something that you know was poorly expressed or outright wrong. This is made even more difficult by the impression often given when one corrects themselves there may be many times in the future that he or she may have to do it again.

The recent Presidential debates showed me the benefit of the lookback option discussed in last week's comments. That is, the ability to go back and either recant or rewrite something that you know was poorly expressed or outright wrong. This is made even more difficult by the impression often given when one corrects themselves that if that individual needs to correct themselves know there may be many times in the future that he or she may have to do it again. This leads to a lack of confidence in that individual and in the business world as well as in the area of government, a failure of that individual to be considered seriously. In short, it is better to be convincingly wrong, than to waver and to be correct.

In the everyday world it is often prescribed as the 'Often Wrong But Never In Doubt' syndrome. As an academic who has published numerous articles over the years, I realize that the alternative is often closer to the truth, "Sometimes Right, But Never Quite Sure When." Articles written twenty years ago are now woefully out of date, overtaken either by theory or fact. We in the alternative investment area are often faced with the same challenges. It would be generally ok, if we were to be honest with our own

shortcomings, if the other asset classes would be honest with their own. This does not happen. I continue to hear speakers in the traditional world, discuss the “Fact” that all one needs is stocks and bonds to meet long term return and risk goals. Unfortunately, what is the long term? The recent five year period has shown the inability of the stock and bond markets alone to meet one’s investment needs (and believe me, five years is a long time). Similarly, as one who witnessed the flat ‘1970’ there are periods of greater than five years where stock and bond markets fail to provide suitable risk and return reward.

What ‘Facts’ in alternative investment land are likewise less than ‘Truth.’ Again, the last five years have shown that not all hedge fund, private equity or real estate investments offer absolute returns; that is, the ability to make money across all market environments. Yet, each quarter we see new seminars on ‘absolute return’ investing. A recent aid came across my desk for managed future in which it was said the investor should take the chance to make money across a wide variety of financial markets through the ability to go long and short. The fact that managed futures had one of their worst years so far in 2004 is not mentioned.

I am not against managed futures; I believe they have a place in one’s portfolio. But it is an alternative investment (that is an investment which offers unique risk and return alternatives to that traditionally found in long only stock and bond investments). I look forward to the day when we are all able to say that alternatives are superior to traditional assets in some ways and inferior in others. The simple case is that in many cases, the good outweighs the bad. I know that this may contradict what I have said in the past but so I contradict myself, I am a person full of contradictions.

Unfortunately, the world may not be ready for this quite yet. So, we continue to follow our politicians with the “Great Washington Lie.” I know that I am lying, I know that you know that I am

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lying, and I know that you know that I know that you know I am lying Perhaps a false sense of security is simply easier to tolerate than the true sense of risk whatever the return.

Looking forward to your comments.

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Comment

Investor Fact and Investor Fiction: Academic Style

Thomas Schneeweis

October, 2004

In a recent class, I pointed out to my students that some of the material that they had learned last year would have to be modified. In short, I told them that what they had previously learned would have to be unlearned. The outcry was tremendous. Why was I taught something you knew was wrong? How could I be assured that what you are telling me might not be wrong in the future? When I pointed out that the class last year was Finance 301 Basics of Finance and not Finance 399 The Final Word On Everything, the answer did not satisfy them.

In a recent class, I pointed out to my students that some of the material that they had learned last year would have to be modified. In short, I told them that what they had previously learned would have to be unlearned. The outcry was tremendous. Why was I taught something you knew was wrong? How could I be assured that what you are telling me might not be wrong in the future? When I pointed out that the class last year was Finance 301 Basics of Finance and not Finance 399 The Final Word On Everything, the answer did not satisfy them. When I pointed out that in many aspects of their live they must grow, this failed also. I finally said, a Porsche is not a Volkswagen. I think they got the point. Still, perhaps it is time in this comment that we attempt to set straight some of the Finance 301 ideas and at least move up to Finance 303. We are skipping Finance 302 and we are a long way from Finance 399 but there are some of them:

1. NPV (net present value) is often determined using the discounted cash flow model ... in which a constant single rate of return is used over multiple time periods. WRONG – the rate cannot be

constant over time unless the increase in the risk premia perfectly offsets any increase in inflation (e.g., risk free rate).

2. ROI (Rate of Return On Investment) is often used to compare the profitability of any two firms. Note since ROI is not assumed to be stationary, two firms can have the same average annual ROI with one firm having ROI increasing overtime while the other is decreasing over time. In short, one must measure change in ROI from expected ROI not simply the level of ROI.
3. BETA is not a strict measure of correlation it is a measure of the correlation of two variables times their relative standard deviations. If an asset has a low standard deviation relative to the comparison asset, an asset can have a low beta yet be highly correlated with the comparison assets.
4. SKEWNESS and Kurtosis are measured as sample parameter estimates. That is, just because an asset reports a skewness or kurtosis over some time period it does not mean that the asset's underlying distribution is skewed or has kurtosis. In brief a skewness of 2 or a kurtosis of 3 may not be significantly different from zero and may change significantly over time.
5. OLS (ordinary least squares regression) offers estimates of the parameters which minimizes the squared deviations of the residuals. If you wish to emphasize a different loss measure (e.g., absolute deviation, drawdown) then the simple OLS used in EXCEL is not sufficient to describe your risk.
6. BLACK SCHOLES Option pricing uses a wide range of variables to describe the return process (delta, gamma, vega, theta ...). While each is normally described in a univariate approach (e.g., the underlying asset rises then the call option value increases), but they independent explanatory variables react in a multivariate manner. In brief, while increases in volatility can increase the return on an option they may also reduce the spot price of such that the call option does not change in value. In short, you have to consider all of the joint relationships.
7. MANAGER'S ALPHA is measured as the excess return of a manager's portfolio in comparison to another investible asset of comparable risk and return process. Comparisons to other assets which are not comparable or not investible does not measure alpha only the intercept relative to the cited independent variable.

There are of course many more cases were the views we had as youths became more complex as well as more useful as we get older. Well there should be some advantage to growing older. Here is the backside. Knowledge of the underlying processes does not ensure success. One can correctly understand all of the above and yet lose money to a less knowledgeable individual who is just lucky. This you knew from Statistics 101 class. Or maybe luck does not matter. That is of

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course for Advanced Statistics and Probability theory, which I leave for another issue.

Looking forward to your comments.

Tom Schneeweis

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He has more than forty years of experience in asset management including President of a firm (Schneeweis Partners) which specialized in 'bespoke' structured finance and Director of Research at Ursa Capital, LLC which managed an approximately \$4 billion hedge fund managed account platform. He has been managing partner of a managed futures fund (White Bear Managed Futures Fund) as well as an equity long short hedge fund (White Bear Equity Long-Short Fund) and President of an approximately \$1 billion commodity-based investment firm (Alternative Investment Analytics). For over thirty years, he also was on the Board of Trustees of the AMG Funds (a retail distribution arm of Affiliated Managers Group, Inc., a world's leading provider of boutique investment management expertise to institutional and individual investors).

He is also currently President of Quantitative Investment Technologies, LLC an investment management firm specializing in downside risk management and investment strategy replication programs (Email: thomas@quantinvesttech.com and website: www.quantinvesttech.com) and the founder of TRS Associates (Email: thomas@trs-assoc.com and Website: www.trs-assoc.com), a financial consulting firm. A collection of his other publications, comments and current writings can be found through his personal email: Trschneeweis@gmail.com or at his personal website: www.thomas@tschneeweis.com.

Comment

The Middle, Not The Middle, Anything But the Middle

Thomas Schneeweis

November, 2004

In the investment arena, many investors, consultants, or regulators have placed themselves at the extremes rather than the middle. Traditional investors have often promoted traditional investments at the exclusion of alternative investments. In contrast, alternative investment professionals have often promoted alternatives as the only means by which investors can obtain unique non-market related returns. I know that the extremes are the exciting places to be, however, sometimes the middle makes a little more “cents.”

During the past presidential election, both political parties moved to their philosophical extremes, that is, the Republicans to the righteous right and the Democrats to the liberal left. Those politicians who have placed themselves in the middling middle are often criticized by voters on both sides of the political persuasion as lacking conviction or beliefs. In fact, when faced with reality both political parties often attempt to move to the center. In most issues facing voters, the answer to difficult issues is not often found in the extremes but in the middle. Those politicians who promote an even or balanced approach to understanding political issues may in fact express a more consistent vision than those of the extremes.

So to in the investment arena, many investors, consultants, or regulators have placed themselves at the extremes rather than the middle. Traditional investors have often promoted traditional investments at the exclusion of alternative investments. In contrast, alternative investment professionals have often promoted alternatives as the only means by which investors can obtain unique non-market related returns.

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As in most cases, the truth about the relative benefits of traditional investments and alternative investments is in the middle. Traditional investments have often been positioned as offering unique access to asset liquidity, transparency, and traditional benchmark measures to manager performance. Alternative investments such as hedge funds have been positioned as illiquid, non-transparent and lacking a means to measure manager performance.

In fact, many traditional investments (e.g., emerging market debt) are illiquid, non transparent, and lack a true investible alternative. Similarly, many hedge funds are available through liquid, transparent investment vehicles (managed accounts, investible indices) which, in addition, offer a means to evaluate the real benefit of active management in the hedge fund arena.

In short, traditional stock and bond mutual funds and hedge funds are both moving toward the middle in terms of product development. Today mutual funds are actively using derivatives and investment techniques which many individuals traditionally regard as part of the hedge fund investment space. Today, hedge funds use the traditional multi-factor models that are used to better understand mutual fund returns to explain the return process of various hedge fund strategies. Today, as hedge funds become more liquid in terms of asset reallocation, mutual funds are becoming less.

Concerns have been raised as to the changes to the structure of hedge funds have had on the underlying return opportunities in the hedge fund area. In short, the increased flow of funds and the increased transparency and liquidity in the hedge fund area has reduced returns. It is true that markets evolve. Some recent research has indicated that simple models of security arbitrage fail to provide excess return to risk. True, however, few if any hedge funds used these simple models of asset choice.

Our understanding of hedge funds is constantly changing. Today we know that hedge funds should not be described as solely as absolute returns. The fact that hedge funds have had a relatively poor return

performance in recent years is due in part to the underlying market environment in which they trade. If one compares the return scenario to return scenarios in similar economic conditions in the past, today's returns are similar. To the degree that the returns are less, the risks themselves are also often less. Hedge fund strategies will change in the future. Reduced returns will be consistent with reduced risks. In many cases it is less that returns have decreased but that the decreased in return is consistent with the reduced risks. If one wishes to target returns, individuals must continue to take on investments which have more risk. That risk is not often understood in terms of price variability alone. Liquidity risk, regulatory risk ... are often not seen in terms of price risk alone. If one looks at fixed income arbitrage before the credit risk rise in September 1998 or even current returns one may fail to understand the risks underlying the returns to such a strategy. Today, we know that one should not compare hedge funds to stock returns to provide a proper benchmark of return. Today we know that measures of risk such as drawdown, skewness ... often provide improper views on the underlying risk of these strategies.

It is often easy to retreat to the simple extremes than the more complicated middle. Hedge funds provide excess return due to the access of more complicated informationally inefficient markets. These markets themselves change constantly. During that change, many strategies evolve to reflect many characteristics of other markets while maintaining some of the unique aspects of their own world. This "Middling Middle" is not an easy place to live, certainly not as easy as the certainty of the extremes, but as in any great literature, Middle Earth may be the proper place to be. Looking forward to your comments.

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Comment

Too Much Of A Good Thing Can be Bad for You

Thomas Schneeweis

December, 2004

Growing up, my mother always explained away why I could not have more ice cream, more time to play, more time to anything That “Too Much of a Good Thing Can be Bad For You.” For most of my life while I have come to respect most of my mother’s insights, I have often failed to find many cases where “Too much of a Good thing is Bad for you.” If nothing else the opposite, “Too much of a Bad thing Can be Good for You” is patently false.

Growing up, my mother always explained away why I could not have more ice cream, more time to play, more time to anything That “Too Much of a Good Thing Can be Bad For You.” For most of my life while I have come to respect most of my mother’s insights, I have often failed to find many cases where “Too much of a Good thing is Bad for you.” If nothing else the opposite, “Too much of a Bad thing Can be Good for You” is patently false. In recent years, some research in the hedge fund area, has proposed that the growth of hedge funds has led to a reduction of the benefits of hedge funds. It is proposed by many, that as more and more money flows into the hedge fund area, the return to risk opportunities have declined. In short, “the good of the past has brought upon us the drought of the present.” Certainly, recent strategy returns have been below some of the past years in which strategy returns have been considerably higher. However, before one concludes that more money flowing into the markets is bad, one must more closely review what is the source of returns to various hedge fund strategies.

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In short, over the past several years, markets themselves have changed as have the mechanisms by which we trade. It is difficult to analyze the return to risk opportunities offered today with those of the past, if for not other reasons that the risks themselves have changed as well as the underlying strategies. One does not simply trade market neutral arbitrage today in the same way it was traded several years ago. Likewise, convertible arbitrage, distressed securities etc. are in many ways traded fundamentally different than how they were traded in past years. In short, the ingredients that go into today's strategies are simply different than those of previous years. Just as the ingredients into a cake today are not the same, one has a difficult time comparing products over time, they are simply different. If one wishes to have the same risks as the older product, one must take different approaches to achieve that goal, different ingredients ... It is not that too much of something become bad, it just became different.

The same process exists in traditional markets and we are comfortable with such changes. The securities in today's S&P 500 are not the same as five or ten years ago. Is it the S&P 500 the same or is it different? Should one expect the same returns from today's mix of stocks in the S&P 500 as the mix of five or ten years ago? If one wants the same returns of hedge funds today as those of ten years ago, one must determine what events or economic scenarios existed then and to hold assets which benefited in just those market environments. It is not simply enough to hold hedge funds and believe that markets and strategies themselves do not change over time.

I still remained convinced that "Too Much of a Good thing is Good". The problem remains what we determine to be a Good Thing and how those Good Things change over time such that what is 'A Good Thing' at one moment in time is not 'A Good Thing' at another. This looks an awful lot like the relativism in today's world, that is "A Conditional Goodism" – What is Good depends on the current set of conditions, that is 'The concept of Good Changes.' Note the Concept of Good does not change only the

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set of conditions. Determining what those conditions are and how we determine our priorities in those conditions is of course the basis for much of current debate. Discussions are necessary, of course, unless there is too much debate. – Well maybe too much of a good thing is bad.

Looking forward to your comments.

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