Comment

CISDM: State of the Nation
A Year in Review

Thomas Schneeweis

January, 2006

The start of each year brings a number of notable events. Included in this list, is the right of any Director to provide the annual 'state of the union' talk describing all that has been accomplished in the past year and all that will be accomplished during the next year. Fortunately, each talk is so forgettable that no one remembers whether the promises of the past year ever approached the reality of the present.

The start of each year brings a number of notable events. Included in this list, is the right of any Director to provide the annual 'state of the union' talk describing all that has been accomplished in the past year and all that will be accomplished during the next year. Fortunately, each talk is so forgettable that no one remembers whether the promises of the past year ever approached the reality of the present. In this case, CISDM has been fortunate in that those individuals who provided the basis for last year's promises more than accomplished their goals. During the past year CISDM has continued to support education in the alternative investment area by:

1) Promoting and helping in the further development of the CAIA (Chartered Alternative Investment Association). The CAIA has grown to become the primary professional designation in the area of alternative investments.
2) Continued to expand and develop the Journal of Alternative Investments. The JAI is now in its eighth year. The Journal was started during the first year of CISDM. It's success is indicative of the efforts that various individuals inside and outside CISDM have made to meet its educational mission beyond our own home institution.
3) Enlarging the CISDM data base as well as its availability to academics and practitioners alike. In recent months, new indices have been created and a new partners (AIRT) has been found with the commitment and resources necessary to expand the database and to improve its accessibility to academics and practitioners.
4) Expanding our interaction with the investor and practitioner world. Monthly newsletters, research reports, and educational seminars have all been upgraded to help individuals better understand the markets.

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Recent academic studies have continued to indicate how little we all really understand about alternative as well as traditional investments. As we become increasingly aware of issues surrounding individuals' ability to save and invest in their future, education in general and financial education in particular must be made available. In the upcoming weeks, readers will be able to access:

1) A new weekly report summarizing current hedge fund and CTA performance based on a wide range of publicly available indices.
2) A new monthly report based on our own CISDM data that will provide increased detail as to the recent performance of various strategies and managers.
3) A monthly research review providing summary critiques of current research.

In addition, CISDM will continue to provide its annual updates on the "Benefits" of various alternative investment strategies as well as more detailed analysis of characteristics and performance of each strategy area. CISDM will also continue to conduct regional meetings throughout the US as well as meetings in Europe and Asia.

It is important for all of us to be reminded, however, that the ultimate mission of CISDM is to its own students and faculty. CISDM will continue to provide resources for the development of students at the University of Massachusetts as well as for students and faculty at other institutions. CISDM and the Isenberg School of Management are initiating a new course in the area of alternative investments. Starting this year, CISDM will also be making available to all academic institutions 'academic copies' of the CISDM hedge fund and CTA database. It is our hope that this access will increase research and understanding of the asset class. 2006 will also witness the first of several funded research awards and research projects all with the aim of better understanding our changing financial markets.

None of this would, of course, be possible without the generous help of our graduates and our supporters. CISDM remains firmly committed to excellence in education. But as in most aspects of our lives, excellence requires everyone's effort and participation. One cannot thank everyone. I would like to thank, however, all of those who have given of their time and resources to help us to continue our efforts. CISDM would not exist and move forward without your participation.
I wish all of us at CISDM could offer you a return more than just my as well as our students and fellow faculties' heartfelt thanks. For now, however, I hope that that will suffice along with our wishes for a great year. We look forward to working with all of you to making 2006 the best ever.

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.

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Comment

The Catch 22 of Hedge Fund

Thomas Schneeweis

February, 2006

Catch 22: You have to be crazy to want to get out of the mission, but if you want out of the mission you can't be crazy. Catch 22 Hedge fund style – I only need hedge funds if my current asset is going to perform poorly but why would I hold my current asset if I thought it would perform poorly.

Having just returned from a seminar in Japan, I have decided to begin looking for another profession. The purpose of the meeting was to discuss with investors why they should be invested in hedge funds. The typical litany of why's were discussed; 1) increased returns, 2) reduced risk, 3) higher Sharpe Ratios…. No one seemed moved. If the common definition of insanity is trying the same thing time after time but expecting a different result, I must be truly insane. None of the individuals showed any real interest in investing in hedge funds. As important, whatever academic study, set of facts, historical anecdote I came up with, none of it mattered. In every case, (although in different forms) the question was the same. Will this make me more money?

In brief, the audience was not looking for information, they were looking for their predetermined answer. The first individual that promised to give it to them had the sale. Mind you, that individual could be a complete (but complex) fraud, but as long as he promised them what they came looking for that was good enough for them. I was at first a little outraged. I had come over 15 hours on a plane, no sleep, sans family. If I was going to lie to them, I could have done it from the safety and coziness of my chair at home. "Don't worry, I am an expert. The asset has only one way to go, and that's up" was all I had to say.

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I kept hearing the old refrain of 'Give Them What They Want and They Will Go Home' (and as important I could too).

Upon reflection, my initial reaction embarrassed me. I too am constantly looking for skilled experts to solve my every crisis. The yellow pages are filled with advertisements indicating the absolute certainty of their product. No one could ever sell a 1) this might work, 2) it could work or 3) at least it should work. One question from the audience made it all clear. He saw the fatal flaw.

"What you are telling me," he said, "is that if the hedge fund is negatively correlated with my current investment, the hedge fund will probably lose money if my current asset makes money." I said "Yes, however, when your current asset loses money the hedge fund will make money. Markowitz 101". His reply (logical in all of its candor). "But," he responded, "why would I hold the first asset if I thought it would lose money."

Catch 22: You have to be crazy to want to get out of the mission, but if you want out of the mission you can't be crazy. Catch 22 Hedge fund style – I only need hedge funds if my current asset is going to perform poorly but why would I hold my current asset if I thought it would perform poorly.

Usually, as most individuals, I think of the answer a few minutes too late, in this case a light went on. I responded that the hedge fund product I suggested is in fact a simple replicate of his current asset only with an even greater certainty of return. He had already made the right decision (in this case a fund of funds). The hedge fund product I proposed would only confirm his already brilliant previous choice. "Would he have to get out of his current fund of funds," he asked. "No," I replied consider your initial investment into the fund of funds as merely an intro into the asset class. Consider that investment as merely an add on to what I am proposing."

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Early hedge fund salesmen had it right. Absolute return is the name of the game. Every investor already believes that their current investment is going to make money (or wait until the end of time before they admit defeat). The only way to convince them to purchase my asset is to convince them that the new asset will not reflect poorly on their previous decision but make their previous decision even shine brighter.

I did not necessarily win the individual over, but I did notice a little confusion in his eyes. He was, now at least interested. Economics 101 needs to be rewritten. Expected return is not a function of risk but of belief and that belief shines even better it if is “Absolute.”

Looking forward to your comments.

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Comment

Beta, Exotic Beta, Super Exotic Beta, Super Duper …

Thomas Schneeweis

March, 2006

Here is the problem; that is, to me that truth (as least cosmetic truth) is constantly evolving. New, better, improved, …… are embolden on the cover of each product. As if each week a new god has been uncovered or at least a new truth from the one ultimate Deity has been sent to us. The problem is not just in the cosmetic line. Very few products are sold on the fact that it is "just as good as the old one or never got better, didn't have to."

Whenever I go shopping with my wife I find myself always spending time in the cosmetic area. I regard, the cosmetic area as America's church. If I were looking for potential parishioners, this would be the place. Why? If there is an area whose underlying existence is based on faith over fact, this is it. Rows and rows of various products each offering the promise of ultimate salvation. As with any religion, salvation comes in different forms (liquids, solids, tubes, sprays) and promises different levels of redemption.

The fact that this church exists in the larger religious center known as a "Drug Store' should be of no surprise to any of us. Drugs, for many, have become the source of remission from pain and the means to happiness. Sounds the basis for a 'Faith' to me. 'As in any faith we simply want to believe that there are simple approaches to solving difficult problems and oreover, there exists, experts (priests) who have the knowledge or at least the connections to get to the ultimate truth.

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uncovered or at least a new truth from the one ultimate Deity has been sent to us. The problem is not just in the cosmetic line. Very few products are sold on the fact that it is "just as good as the old one or never got better, didn't have to."

Finance and alternative investments are no different. We are caught in the same conflict. To say that something new is better, is to admit what we sold them previously was, perhaps, no good or at least not as good as we pretended it to be. At the same time, unless we constantly upgrade an idea or a financial product no one will buy the new book, rebalance their portfolio or come to the next seminar…. What is a guy/girl to do?

The most recent evidence of this common Human Dilemma came to me when reading a current Pension and Investment Age. In this issue, I was told that the old single beta concept could be drastically improved if we only added a set of newer more exotic betas. These betas would help us understand the true sources of returns to alternative investments.

Of course these new beta's do not come without cost (nothing in the cosmetic line is free either). As the new exotic betas explain more the previously unexplained Alpha is reduced. In fact, if carried to the extreme, if we would continue to add exotic Betas to Beta, Super Betas to Exotic Betas and Super Duper to… the unexplained return might even disappear.

Sounded an awful like Darwinism versus Creationism. If all can be explained by a simple scientific theory where is the place for mystery, faith, or the professional trader? We need not care, the article (or advertisement in this case) said not to worry in that the very changing nature of the financial marketplace makes the very nature of these betas difficult to fix. They have to be constantly tested and improved. Come back next week and see.

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It’s great to see that finance professionals learned something from me and my wife. Constancy is good but change is even better … to see just come back next week for the simply unbelievable, better than ever, soon to be the ultimate all encompassing, all knowable can’t be improved until the very end of time‘. Have a little faith.

Looking forward to your comments.

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Comment

The Origin of CISDM Hedge Fund and CTA Indices

Thomas Schneeweis

April, 2006

“The reports of my death are greatly exaggerated,” was the text of a cable sent by Mark Twain from London to the press in the United States after his obituary had been mistakenly published. As Director of CISDM, imagine my similar reaction to a recent MARHedge January 30, 2006 article “A New Breed of Alternative Indices” in which it is maintained that they are attempting to create a ‘sustainable proxy for the returns of the managed futures industry that would replace the now-defunct MAR Trading Advisor Index. In fact, contrary to the MARHedge article, the original MAR Trading Advisor Index is not defunct but continues to live on as the CISDM CTA Trading Advisor Indices.

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In fact, contrary to the MARHedge article, the original MAR Trading Advisor Index is not defunct but continues to live on as the CISDM CTA Trading Advisor Indices. Depending on the series, the CISDM CTA index series extends back to 1980. They are published on the CISDM Website: www.cisdm.org as well as on Bloomberg. I hope that it is well known in the industry by now that the CISDM CTA indices are the continuation of the earlier MAR indices which were sold to Zurich Capital

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Markets in 2001 and which were gifted by Zurich to the University of Massachusetts in 2002 and renamed the CISDM Hedge Fund and Managed Futures Indices.

In short while the name may have changed, its history as well as its life has continued (albeit under another name). Upon reading that I was defunct (by now I feel that the indices are part of me), I am sure that I felt a little like any person who upon marriage took the other spouses name and upon doing so was told that his or her previous existence under another name was defunct.

Despite the wide extent of research conducted using hedge fund indices, there still remains confusion as to their construction and potential biases. For instance, some recent research (Malkiel and Saha, 2005) contended that hedge fund indices are a poor reflection of the expected returns for the industry since they contain a number of well known biases including backfill bias and survivor bias.

Depending on the index cited, they are of course wrong. While current hedge fund databases often contain the historical data of newly reporting managers (backfill bias) and often do not report the historical return of managers who no longer are on the data base (survivor bias), it is well known that hedge fund indices constructed from then existing hedge fund databases and which do not recalculate historical index returns as new manager data becomes available are not subject to either backfill bias or survivor bias.

In short, if one wishes to obtain hedge fund return estimates not affected by backfill bias or survivor bias (both of which result in upward bias estimates of expected return), one must concentrate on hedge fund or CTA indices which do not contain pro forma estimates. In fact, in the CTA area only two indices, CISDM and Barclay's, provide commodity trading advisor indices from 1990 onward and which do not contain either survivor bias or backfill bias. It is therefore not surprising that their return series are similar.

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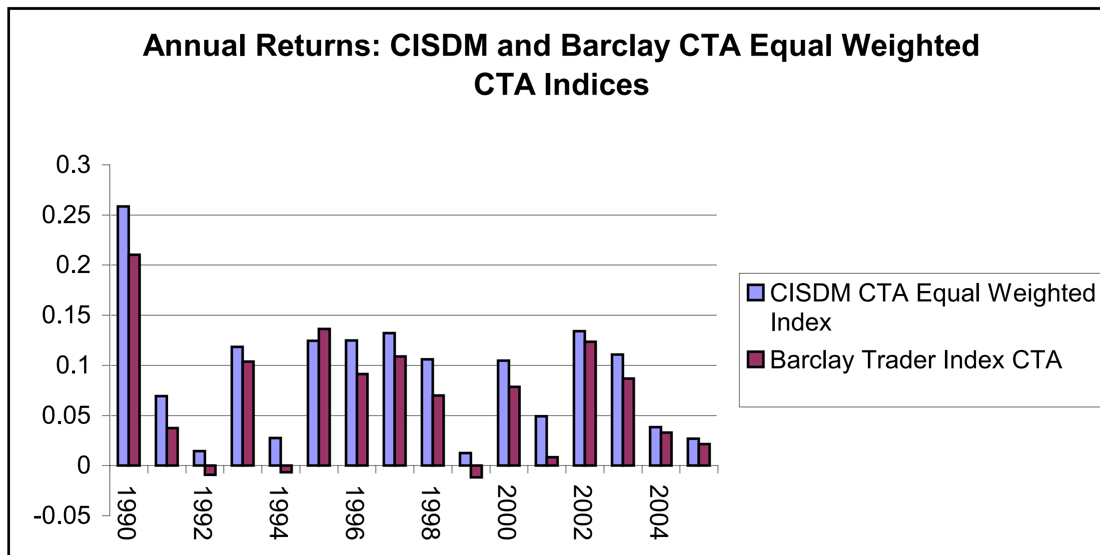

In the hedge fund space, only CISDM and HFR, both of which were initially constructed in contain no pro forma data for the period before 2000. Other indices created in 1999 (CSFB) or 2003 (Barclay) provide returns prior to their creation and may contain backfill bias and survivor bias. For instance, one would expect that for similarly constructed indices, that the index with pro forma data would outperform similar non-backfill/non survivor bias indices. For instance, it should come of no surprise that the Barclay Hedge Fund Index has higher returns that either the CISDM or HFR for the years 1997-2002 (which are for the period before the initial construction of the Barclay Hedge Fund index) and then suddenly does not have superior returns after its pro forma period is ended and all the indices are from contemporaneously reporting managers.

I hope that it is well known in the industry by now that the CISDM CTA indices are the continuation of the earlier MAR indices which were sold to Zurich Capital Markets in 2001 and which were gifted by Zurich to the University of Massachusetts in 2002 and renamed the CISDM Hedge Fund and Managed Futures Indices.

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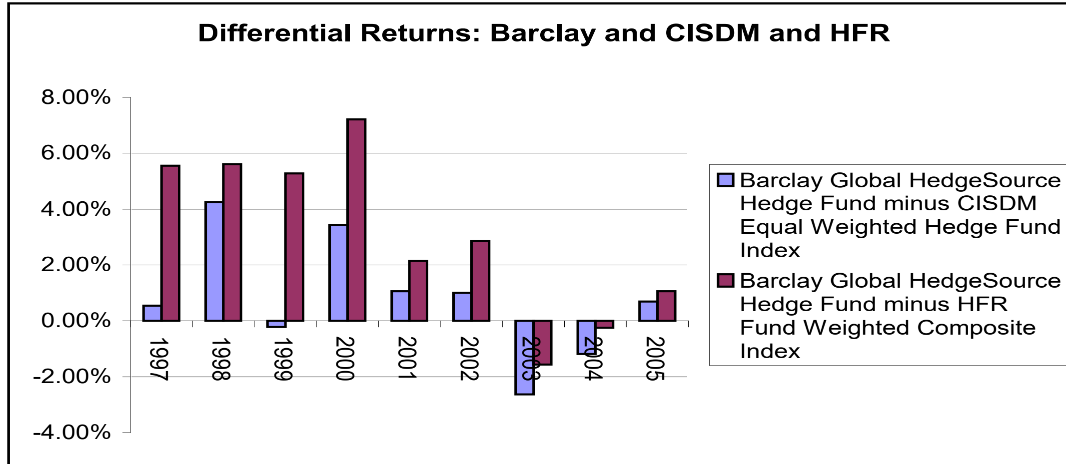

There exists a story in which an individual supposedly asked Abraham Lincoln how many legs an elephant would have it you called its tail a leg. Seeing the trick, Lincoln supposedly answered, four. Calling it a leg does not make it a leg. Calling a new index similar to CISDM does not make it similar. Simply put, the CISDM indices are one of the few available CTA or hedge fund indices for which historical returns from the 1990's are not affected by survival of backfill bias existing in many other firm's performance indices.

Again readers beware, despite what you may have read in a recent MARHedge article, the MARCTAI or any historical MAR Managed Futures or Hedge Fund Index is not defunct. They were never terminated, deceased, killed, removed, or disappeared. They are simply one of the few available CTA or hedge fund indices which are not affected by survival of backfill bias existing in many other firm's performance indices. They have been, are, and will continue to be available as the CISDM Hedge Fund and CTA Indices.

Firms are always constructing new index series which attempt to replicate the return series of more established indices. Certainly, one can create from other data bases, an index series which has return properties similar in nature to that of the original, in this case the CISDM Hedge Fund and CTA indices. One can for instance, create a return series from equity securities which resembles that of the S&P 500. Outside of the obvious reason that one wishes to have one's own index and wishes to create a basis for the

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new construction, the question really should be why? As is often stated, "if it ain't broke don't try to fix it." Why the new Coke when the original still exists.

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Reports of its death are greatly exaggerated. In fact reports of its death are dead wrong.

Looking forward to your comments.

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Comment

Finance Man Versus Finance Machine

Thomas Schneeweis

May, 2006

So far there is nothing to fear. The investment area keeps changing the rules such that machines always lag the man. However, one may want to take a few courses in mechanical repair in case that day ever comes.

The first commandment of selling often reads something to the point that 'you have to get them into the store before you can sell them anything.' In short, fiction beats fact unless the facts make a really, and I mean, really good story. My grandmother put it differently, 'always give the pill with a bit of honey." Personally, I like my Grandmother's wit better. Regardless, given the choice between an interesting if only true read and an uninteresting but true fact, I generally will opt for the former. Alternative investments are no different. The industry has constantly presented itself as the last source of absolute returns. Each year we have annual meetings where we honor the 'very' best managers with the very best skills. (Personally, I fail to understand why anyone would attend unless they were to be so honored. Why simply sit with a sign on my back reading "good but not as good as the other guy up there").

In short, hedge funds are based on the cult of the 'individual trader.' The day the industry admits that individual skill loses out to overall market forces it might as well put up the shutters and close up shop. When John Henry (the steel driving man not the CTA/Owner of the Boston Red Soxs) lost out to the machine it was the first sign that the labor movement might have future issues with mechanization.

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Similarly, when Big Blue beat the then 'Russian' Chess master of the moment, Chess sales fell. Why play a game in which no matter how hard one works one is always second best? I fear that the recent poker craze is on the same road as Chess. Interest grew as individuals saw players not much different from themselves winning hundred and hundreds of dollars. Computer based programs soon came online which offered individuals the chance to hone their talents to become skilled players. Unfortunately, individuals soon learned that they could not beat the poker program. Las Vegas in fact has to dummy down the computer-based playing systems to give the player a chance at winning. The recent decline in the TV audience, I believe, is directly connected to the publics' knowledge that luck and skill can lose out to 'gigabytes and ram.'

Similarly, alternative investments will continue to grow as long as individuals believe that skill matters. Some may believe that newspaper articles decrying the actions of a few traders will hurt the industry. I believe that such articles may in fact help us; that is, if an individual must believe that somehow the person that he or she is investing with is in fact one of those individuals who has learned how to beat the system. The true danger to our industry is not so much the existence of index funds or any systematic trading approach but the potential belief that such systems really do provide potential returns equal to those of skilled players. In short the machine wins.So far there is nothing to fear. The investment area keeps changing the rules such that machines always lag the man. However, one may want to take a few courses in mechanical repair in case that day ever comes.

Looking forward to your comments.
Tom Schneeweis

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Comment

Is the Hedge Fund World Flat?

Thomas Schneeweis

June, 2006

A brief glance at the current best sellers list indicates that wide arching global macro answers to the world's problems is currently in vogue. Why Great Civilizations Fail, The World is Flat … all reach for common themes that allow us to better understand the complexities of a world seemingly gone mad. It was only a matter of time before these books came along. Most readers were sick and tired of "The Devil is in the Detail." Books of that nature were just too difficult to read and required a level of commitment beyond only the most fanatical readers. Much better to be caught up in the very flow of history.

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Unfortunately, I have the personality that even broad themes must be placed in the context of everyday life. Why not take a brief trip around the world to see of in fact, the hedge fund world is flat; that is, have computers, information, technology so leveled the playing field that we have become all one country. The differences in hedge fund approaches and understanding in different parts of the globe are really neutral mutations; that is, colorful differences full of sound and fury signifying nothing.

What is the result of this world tour? The answer is both less and more than I thought. In fact, there are two species of human 'hedge fund' people out there. Mind you we live in a world in which

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almost 90% of U.S. high school teachers could not determine an answer to the question what is 1 and ¾ times .5. The old take the inverse and multiple somehow had been filtered out. In short, in every culture there were those who could easily translate and move within the ebbs and flows of the hedge fund tide. However, just as common were individuals who had no clue as to the very basics of finance required to understand the fundamentals of hedge fund 101.

Mind you to these individuals I might as soon come from outer space, as Alien as any world they could imagine. A world of twenty-four hours, seven days a week, fifty-two weeks a year trading. No barriers, no differences, only impersonal numbers floating around the world in which local concerns, local friends, local customs mean nothing. In some cases, they even had heard of people of my type from others. Other ships had brought strange stories of men and women who fly in for one day only to leave the next. Financial spirits of a type. Even within their own country some of their own kind had been convinced that their way was the one of the future. Fortunately, they were few and no one took them seriously.The result of my 'Marco Polo' tour is that if hedge funds are part of the financial crusade, one must be ready to meet the other culture who is as sure of their purpose as we are of ours. The world may be flat, but it has walls in various places. We have many choices. One is simply to go ground those places with battlements. The other is to attack them.Whatever, the result of a flat world does not make it any easier to get around. It just makes it easier to see the enemy.

Looking forward to your comments.
Tom Schneeweis

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Comment

It's Déjà Vu All Over Again

Thomas Schneeweis

July, 2006

Hedge Funds 101: I should've, would've, could've if I had only seen it coming or in the words of the immortal Satchel Page, "Never look back, someone could be gaining on you".

I should've, would've, could've if I had only seen it coming or in the words of the immortal Satchel Page, "Never look back, someone could be gaining on you." During my recent trip to Seoul, South Korea for the "Fourth Annual International Derivatives Conference" both of the previous citations came to mind. For those individuals who have not frequented Asia over the past five years, much has changed but, as is often mentioned, much has remained the same. Let me first point out, that the following comments are mine and only mine and do not represent those of CISDM or any other organization here or abroad. Moreover, they may not represent my own ideas five minutes from now. They are the result of the worst of sources, that is, my own personal impressions without the benefit of any real knowledge of the South Korean financial climate. In short, reader beware. What did I take away from my visit? First my South Korean hosts were some of the most gracious, generous, thoughtful, energetic individuals that I have had the opportunity to work with. For me, they set the standard for how a conference should be organized and conducted. It included government officials, regulatory members, practitioners, and academics. The audience (well over 300+) consists of individuals my age as well as the younger set. This year's topic centered on Derivatives and Derivatives' Regulation.

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Here is where the Déjà vu came upon me. While it was a new conference, the questions and answers seem to take me back almost thirty years. South Korea is confronting (and some might say struggling) with the some of same questions that U.S. financial markets faced in the late 1970's and early 1980's. What is the impact of the use of derivatives on financial markets? How does one reduce the use of derivatives abuses in asset management and risk management? Moreover, it is confronting these issues in a context both similar to that of the U.S. thirty years ago as well as in an environment completely different from the U.S.

In short, looking to the U.S. or other countries for historical experiences may benefit, but also may constrain South Korea. South Korea's financial/corporate/ real estate markets differ substantially from the U.S. Few if any South Korean owned U.S. style investment management firms exist. The large source of pension fund assets is limited. Individual 401k etc. do not exist. The highly regulated independent advisor network which helps direct assets in the U.S. is only in its infancy in South Korea. The ability of investors to take certain investment actions (e.g., shorting stocks…) is highly limited. Mortgages, as we know them in the U.S. are only now becoming available. In spite of all of this, the KOSPI is one of the most active option trading markets in the world?

Here is the rub and make no doubt of it. The knowledge of how to trade markets and the technology capable of trading or of managing the risk of those markets now exists in South Korea. New financial markets generally evolve out of economic need, technological advances, and regulatory change. The economic need is there as derivatives are required to enable domestic firms to compete globally. The technology is there as South Korea is a leader in computer technology with a skilled labor force. Lastly regulatory change is on the way.

The South Korean derivatives markets will of course differ from that of the U.S. Its size and needs dictate. However, if I were a betting man – I would bet on Korea becoming a regional player in the

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derivatives industry. While there are competitors (Japan, Singapore, Hong Kong), South Korea stands apart in many ways – most in their desire to compete. What may stand in the way, as it did in the United States, is that common theme – A reluctance to change due to fear of the unknown. I appreciate this concern. Many individuals desire certainty. I can only comment that the only known certainty is if a country does not change to meet current realities, it will fall behind other more dynamic countries. The South Korea financial markets must change. Some of these changes will fail. This is to be expected. The core financial theory is that there is no return without risk.

Here is the good news. There is no reason why South Korea cannot be a major player in the derivatives space (both for internal and international derivative products). In this regard, from a U.S. perspective it could be déjà vu all over again as other Asian financial markets have grown to be major players in global and regional financial markets. Here is the bad news. It is also possible that South Korea may not have the political or corporate will to create a marketplace conducive to the creation of such a market. If South Korea fails to act South Korea may remain one of the many countries who had the opportunity to change but decided not to act. It's Déjà vu all over again.'

Looking forward to your comments.

Tom Schneeweis

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Comment

A Return to Earth

Thomas Schneeweis

August, 2006

To put it bluntly, this person considered herself knowledgeable in government and its associate disciplines. On second thought, her response should have been expected. From my own experiences, many government officials act as if they have little knowledge as to the local or background of the countries or states they represent.

While waiting to board a plane, I recently caught a television program in which the TV reporter was asking individuals to find certain 'in the news' countries on a map. Only about fifty percent of individuals were able to correctly identify New York State on a map of the United States and only two in ten could correcting identify Iran and the ability to locate North Korea was not existent. Some individuals were even unable to find North Korea after being given 'information' on the location of South Korea. When one particular women, who was among the worst of the identifies, was asked what see did, her response was astonishingly, 'I am working for an accounting firm until I return this fall to Carnegie Mellon for my MS in Government."

To put it bluntly, this person considered herself knowledgeable in government and its associate disciplines. On second thought, her response should have been expected. From my own experiences, many government officials act as if they have little knowledge as to the local or background of the countries or states they represent. But as my uncle would say, ignorance of the law is no excuse. The fact that New York is found in the Northeast part of the U.S. (note the first two letters are the hint 'Ne') would benefit any aspiring master's student in government given its relatively close approximation to

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Washington DC and the home state of the UN (for the self same above student, that stands for United Nations). The fact that New York in part adjacent to the Atlantic and therefore, offers easy access to and from many countries and has a population almost as diverse as the UN makes it a perfect location for such a 'diverse 'and many would maintain 'ineffectual' government body (keeping such an political organization as far away from the heartland of America would be a first priority in any government list of aims and ambitions).

But I digress. Lack of knowledge even as basic as 'Where is North Korea' would seem necessary to those individuals who would wish to minimize their potential exposure to potential Nuclear decimation. For the uninformed, North Korea recently attempted to practice exploding a nuclear bomb. While criticized by many, I personally applaud such a move. One would be certainly concerned if any country would go ahead and actually conduct a nuclear attack without some degree of proficiency. (Sorry I was aiming for Vegas not Vancouver). One could only hope that the individuals in North Korea have a better sense of geography than our own populous. (Hint: North Dakota is 'North' of South Dakota unless to try to get there the hard way).

In any event, the point of the title of this month's 'Directors Comment' is that oft quoted statement that 'A little bid of knowledge is a dangerous thing' is totally incorrect. Any level of knowledge is better than none. People should know some very basic points about geography, finance, even hedge funds. .. Moreover, they should not be let out of there houses, cars, or in this case planes until they show some level of knowledge (If one is traveling by air one would hope that they have some idea what state they are leaving (and where it is) and what state they are going to (and where it is). Whoops isn't that North Korea simply does not work in today's world.

As important, Whoops does not make in the alternative investment world either. A lack of understanding of when and why certain hedge fund, managed futures, private equity … make positive or

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negative returns is necessary for any academic or practitioner. What is the easiest way to obtain this knowledge? Fortunately, academic and practitioner research has finally advanced to a level where a number of excellent books now exist, which offer, for the most part, a knowledgeable review of the expected returns and risks from investing in alternative investments. These include, Mark Anson's "Handbook of Alternative Investments," Alexander Ineicehn, and the Benefits of Alternative Investments Series available on the CISDM website (www.cisdm.org). In addition, for those desiring a more structured approach, the CAIA designation (www. Caia.org) provides an internationally known exam and education program covering the alternative investment area.

I can only hope that those individuals who also saw the program at the airport with me, experienced the same level of concern about individuals' knowledge about area that they would maintain that they are interested in or have knowledge about. I can only respond that upon 'Return to Earth' it is all our responsibility to become more educated about areas of our personal concern. Ignorance of the Truth is No Excuse.

Looking forward to your comments.

Tom Schneeweis

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Comment

Hedge funds Existential Revisited: Revisited[1]

Thomas Schneeweis

September, 2006

In an article in the Financial Analyst Journal, Richard Bookstaber (2003) places hedge funds at 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. 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." P. 19). 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.

I may wish to argue that he is addressing what he regards as essential rather than existential. In my world, do hedge funds have a being in time and space.

[1] Source: cisdm: Director's comments

Main Entry: **existential**
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
3 [translation of Danish *existential* & German *existential*] **:**

Perhaps my view that hedge funds have a distinct being in time and space is due to the simple fact that after years in this marriage (traditional and alternative investments), I have come to accept the inconsistencies and perhaps to an extent revel in them. I am told that the devil lives in the details. As an academic I have had many arguments about the existence of the uniqueness of markets or even 'Arrow-Debreu' securities. For instance, can one regard derivatives such as futures and options as "Arrow-Dubru securities" which offer unique risk and return opportunities not found in any other combination of assets? In short, if anything is built of anything else does it really exist as a separate entity. I enjoy these arguments. In fact, in the over thirty-five years' that Richard Bookstaber and I have known each other, we have had many of these arguments. We have even had these arguments in a more 'practical vein.' Both of us have been and remain directly engaged in the hedge fund arena in a direct business vein. BookTuber (I continue to have a difficult time not putting a Professor in front of his name – We started out together as academics and I continue over the years to think of him as an educator), fixes the question that the issue is 'not simply about seeing hedge funds but about seeing what qualities exist beyond the name".

Before addressing that topic in particular, perhaps it is best to let my biases out early such that one can have a sense as to my particular selection of facts. I am founder and editor of the Journal of Alternative Investments mentioned in the article (Bookstaber, 2003) as well as founder and Director of the Center of International Security and Derivatives Markets at the University of Massachusetts (CISDM)

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which also focuses on traditional and alternative markets. I am on the Board of the Managed Funds Association (a U.S. based Trade organization for the hedge fund and managed funds community) as well as the U.S. council representative for AIMA (The alternative Investment Management Association – a worldwide educational and professional alternative investment association established to represent its members). Lastly, as director of CISDM I am co-sponsor (with AIMA) of the Chartered Alternative Investment Association which is dedicated to furthering education through a global certification program in the area of alternative investments. The driving force behind the establishment of CISDM as well as the Journal of Alternative Investments as well as the CAIA was simply the fact that academics had and continued to concentrate on 'traditional investment' analysis to the extent that academic text books on investments and many academic journals had simply failed to detail the working aspects of a major part of the investment world; that is, private equity, real estate, commodities, hedge funds, and their siblings structure products derived from them. To emphasize this point, one but needs to simply count the number of pages on alternative investments in any top level academic textbook.

Note that in most of the above designations, it is not hedge funds which is the particular segment of interest, but the entire alternative investment space. So defined as being those investment strategies or 'market segments' which have had, for a wide variety of purposes, separated themselves from traditional long only stock and bond markets. These topical areas include TRADDELs; that is traditional alternatives such as private equity, real estate, commodities as well as MODALS; that is modern alternatives such as hedge funds and managed futures). However, the question, as pointed in the article is not if hedge funds exist but do they exist in some unique way which makes them a separate entity for which some levels of commonality exist for review.

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I suspect that the question is not if a journal should exist which concentrates on subjects generically listed as 'Alternative Investments.' Other topical journals exist which concentrate on specific parts of the investment world (Journal of Fixed Income – but corporate bonds may be viewed as stock plus a call; Journal of Derivatives – but derivatives are simply vehicles based on associated fundamental securities). I suspect that the question raised by Bookstaber is more to the point of the fundamental nature of being remains a time honored topic of debate among humankind. For any entity, what fundamentally differs us from each other is in many ways the search for meaning. One of the startling aspects of life (or so I am told) is that point in time in which individuals realize (at about two or three) that they are in fact not unique but are part of some common existence. From that time on, we as individuals attempt to find a place for us 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"?

It is not the purpose of this article to try to define one (I have a self interest in keeping the debate going). I for one have taken different approaches but in general I view hedge funds as private pooled vehicles that can take both long and short positions over a variety of financial instruments and which a not required by regulation to track a particular cash index." Note that the securities, markets, and strategies in which hedge funds trade differ from traditional markets primarily by hedge funds creation as an effort to

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bypass certain regulatory constraints and thereby increase their flexibility of trading approaches." This flexibility does not disturb me. Just as the derivative space includes equity, fixed income, currency … it does not concern me that the hedge fund areas may contain a wide variety of markets or strategies to trade those markets.

In order to remain consistent with my recent research, I do not believe in discussing hedge funds in the context of a universe. I also have difficulty in discussing equity or fixed income in terms of a universal concept. There is no single universal hedge fund index just as there is no single universal equity index. That having been said, I do believe that various investment strategies which have for various regulatory reasons fit well into the private pool arena do have commonalities that do permit us to understand their common sources of return as well as the unique elements which provide them with differential return properties.

While research has shown that while hedge fund managers do not generally track an individual passive traditional benchmark, in any particular strategy there is a commonality of trading style such that academic research has analyzed the source of hedge funds returns and the degree to which those returns are based on well known market exposures as well as manager based trading decisions. In short, within a particular range of strategies investors many trade a common set of securities in a common form while leaving themselves open to a common set of risks that permit us to distinguish them from other types of strategy approaches.

There may be arguments on how best to segment these strategies and at what level of segmentation. One could create an investment tree based on the securities traded or as is currently used in hedge funds based on the way the securities are traded. The fundamental issues are not, I hope, if convertible arbitrage research should only be found in universal journals (e.g., journal of investments) or

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even in sub-generic investment journals (it has a bond so why not only the Journal of Fixed Income, or it has an option so why not strictly Journal of Derivatives). Moreover, should convertible arbitrage since it is a combination of traditional securities not be considered a unique 'Arrow-Debru" securities but only an investment vehicle.

Again one has multitudes of definitional choices. Can one define an asset class as one which provides unique risk and return opportunities not easily found or reproducible in other investment vehicles. Note here the emphasis on the easily. If one has the unique ability to create an item which because of cost and other issues provides access to a unique opportunity does it become a unique opportunity (e.g., futures versus forwards). In short, does structure matter?

Research has found that individual hedge funds as well as portfolios of hedge funds may provide unique risk and return opportunities not found in traditional investments and as such may provide unique portfolio risk reduction opportunities difficult to replicate with traditional investments. What is the source of these unique opportunities (liquidity premia, knowledge premia, market timing …) is still debated. One thing for sure, hedge funds have morphed. In my world hedge funds are not discussed as "Absolute Return" Vehicles. In my world, each hedge fund strategy loads on a set of factors common to the underlying assets held. In my world, passive index based strategies can be created which mimic a major portion of hedge fund return. In my world, the dynamic nature of those holdings can be mapped in a way which permits us to have a fundamental understanding as to the return attributes of the various strategies. (Structure products are based on fundamental knowledge of those processes).

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

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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, exposure etc then I do take an alternative position.

More important that any of the above, is that the interest in coming to a sense of 'time and place' for hedge funds is future indication that the alternative investment work has matured to the level that individuals are attempting to come to some central conclusions as to various aspects of the investment areas that currently have found a home there. It is important to realize the dynamic nature of this process. Financial concepts evolved, not only because we come to a better understanding of the processes but that the processes themselves change.

I sense the frustration in attempting to place under a single tent a seeming menagerie of strategies. We have somewhat successfully accomplished this in the equity arena, fixed income etc. and I feel comfortable in what is being accomplished in the alternative investment space.

Over the years, imagine the changes in ways we perceive traditional markets (CAPM, APT, behavioral finance). Similarly, the hedge fund area is likewise evolving. The historical view as hedge funds as some type of absolute return vehicle capable of making money in all markets has certainly evolved or dissolved based on one's view. Today various strategies are viewed as long volatility, short

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volatility, return enhancers, risk diversifiers, source of risk premia to various strategies, factor and passive index replication, liquidity premia, …..

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…). If 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 investment approaches (traditional, traddels and models). I feel comfortable in each of those approaches in having a set of subgroups which differ in the markets they trade, how they trade, and the factors they leave themselves exposed to. I feel comfortable in having cross relationships between markets and strategies that permit me to think of each approach and each strategy as having commonalities in their return and risk expectations as well as attributes which (for my purposes) can be best viewed as non-correlated risk and return opportunities understood within the context of that strategies own time and place.

Just call me existential.

Looking forward to your comments.

Tom Schneeweis

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Comment

A Check on "A Reality Check on Hedge Fund Returns"

Thomas Schneeweis

October, 2006

Fortunately, for the hedge fund industry, the results reported in their paper are not only at odds with most other published hedge fund research, which shows an annual return over this time period of between 8% to 10%, but they suffer from a number of flaws that render the paper's reporting findings untenable.

An article in the "Strategies' Section of the New York Times (*When All Numbers Are In, Do Hedge Funds Shine?* By Mark Hulbert, November 30, 2003), reviews the findings of a paper titled "*A Reality Check on Hedge Fund Returns*" by Nolke Posthuma and Peir Jelle van der Sluis. Posthuma and van der Sluis's article supposedly shows the I pact of backfill and survivor biases that may be present in historical returns of hedge fund databases. Posthuma and Sluis maintain that once backfill and survivor biases are taken into consideration, the actual return to an investor who had invested in all funds on an equal weighted basis within a particular data base (as represented in the CFSB-Tass database), would have been close to zero for the period, 1996 through 2002. Fortunately, for the hedge fund industry, the results reported in their paper are not only at odds with most other published hedge fund research, which shows an annual return over this time period of between 8% to 10%, but they suffer from a number of flaws that render the paper's reporting findings untenable. A few concerns are as follows:

No single hedge fund data base can be used to represent the potential returns to a hedge fund investor. For instance, many funds that are not represented in the CSFB database are represented in other

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databases (HFR, CISDM etc). It is important to note that there exists substantial overlap among various databases and thus it is likely that many of the funds who were not reporting to Tass in 1994-1999 were reporting to other databases.

If one wishes to represent the historical returns to hedge fund investors, one should not use returns generated from a single hedge fund data base. Instead, one can use active manager hedge fund indices that do not contain either survivor bias or backfill bias (e.g., HFR). In those indices, the funds used in a particular month are simply those that existed on that date in the database. As firms enter or leave, the return for that data does not change and thus the index, while perhaps guilty of selection bias, has no backfill or survivor bias.

The backfill bias assumed in this study, most likely grossly overestimates the potential backfill bias for potential investors. In the study, eliminating funds that had "backfilled data' reduced returns significantly. Backfill bias is based on the assumption that investors would not be aware of the existence of funds in the database and therefore could not invested in. Of the various databases, the CSFB-Tass database is mostly affected by backfill. The Tass database started in the 1980's, but it was in late 1990s it was purchased by CSFB. At that time, it is reasonable to assume that many new funds were potentially added. Many of these funds were already on many other databases (See number 1 above). One must consider funds across multiple databases to properly represent potential backfill bias. In any event, many funds in existence are also considered by investors but were on no database (e.g., Long Term Capital) thus simple use of any database to reflect total returns is insufficient.

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The survivor bias assumed in this study, grossly overestimates the survivor bias existing in this or any other database. In this study, the author's assumed a 50% loss in the month after delisting. However, not all "no-reporting" funds stop reporting because of poor performance. Using CISDM/MAR database, our calculations show that more than 50% of the non-reporting funds had positive returns for the last 12, 9, and 3 months of their reporting periods [Kazemi and Schneeweis, 2003]. Many funds stop reporting because they are closed to new investors, they are taken over, or liquidated because the managing partner wants to withdraw his/her investments. Given our calculations, it is reasonable to assume that more than 50% of non-reporting funds did not stop reporting because of poor performance.

Simple equal weighting across funds may overrepresented backfill bias and survivor bias. Research has shown that new reporting funds and well as funds that leave the data base for poor performance are generally smaller asset based funds. To the degree that any reasonable investor would wait to invest in a fund until it had reasonable assets under management or several years in existence, the equal weight approach to determining investor returns overestimates backfill and survivor bias for the typical investor. Just a reminder

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Looking forward to your comments.

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Comment

What You Can Expect

Thomas Schneeweis

November, 2006

In fact, if one had headed some of the academic literature that questioned the levels of the stock market in the late 1990's, one may have profited from the recent correction. Before one jumps on the academic bandwagon however, one must be reminded that academic research in the early 1990's, one may have profited from the recent correction.

U.S. stock and bond markets have rebounded from the lows experienced in September, however, questions still exist on the degree to which traditional markets will perform in the upcoming months. Similarly, equity markets in Europe and Japan continue to show signs of continued weakness. Moreover, there seems to be little agreement among academics or practitioners as to the strength of the recovery in coming months. Some academics support the view that traditional government stimulus and lower interest rates will provide proper stimulus to the economy. Other academics counter that the extent of excess capacity is such that any such stimulus will have little short run impact on corporate investment.

In addition to the debate on the future growth trend of the U. S. and World economy as a whole, academics and practitioners continue to argue on the expected return from investing in equity and fixed income markets. In recent years, research (Bernstein, Peter L., "What Rate of Return Can You Reasonably Expect…or What Can the Long Run Tell Us About the Short Run*?" Financial Analysts Journal*, vol. 53, no. 2, March/April 1997) has suggested that the recent period of equity growth was unique and that future equity returns may not reach the levels expected through simple use of historical return. In fact, if one had headed some of the academic literature that questioned the levels of the stock market in the late 1990's, one may have profited from the recent correction. Before one jumps on the

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academic bandwagon however, one must be reminded that academic research in the early 1990's, one may have profited from the recent correction. Before one jumps on the academic bandwagon however, one must be reminded that academic research in the early 1990's promoted the use of value investing over growth investing. Those who followed that research would have missed much of the equity gain of the 1990's. It is interesting to note that value stocks are often simply failed growth stocks and vise versa. In short a value investor may reflect a belief in mean reverting processes and a growth investor may reflect a belief in momentum. Each investor has a unique view of the market process. In contrast, hedge fund equity investors may not take a view of the general market process but may believe in short run deviations from value for individual firms (hedge equity).

In fact, academics and practitioners should be careful in blindly accepting research (including CISDM research results), as well as blindly rejecting it. The failure of academic models suggesting the superior return to value investing over growth to forecast the 1990's reversal does not mean that the long term prescription is invalid. It is in part the focus of CISDM to make readers aware of potential problems in both academic and practitioner research as well as to inform readers as to new research of interest. In this issue, we offer one such review of an earlier article by William Fung and David Hsieh on the "Market Impact of Hedge Funds" Journal of Empirical Finance Vol. 7 (2001), which indicates little evidence of hedge funds consistently making money in periods of market events. While the article is interesting in noting that hedge funds have often been unfairly criticized in causing markets to move, readers must be aware that statistical results may not indicate causality and unfortunately causal events are not often found in statistics.

In the following sections we continue to present market performance. Note that one of the unique research efforts of CISDM is to create a series of non-investible systematic passive indices which are designed to track the performance of various hedge fund strategies. At this time not all strategies are included and we expect that through time the methodology used to track such strategies will improve.

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However, the fundamental methodology used to create these indices is available upon request. Since these indices are created using existing traditional investments, they permit a daily tracking of the underlying strategies. We believe that this effort will have a major impact on hedge fund community by offering a passive index similar to those existing for the traditional markets. Following the performance section, we include a section in which current published academic and practitioner research is reviewed as well as a detailed review of one particular article. A more complete update on actual research conducted at CISDM is contained in the following section. The final section includes current and future activities of CISDM.

Lastly, CISDM has created two new information brochures: one on CISDM as well as one on our long promised but much delayed CAIAA (Chartered Alternative Investment Analyst Association) which is being created to help sponsor a Chartered Alternative Analyst Designation similar to that of the CFA. Material on the CAIA will be available on our website within the next several months. Moreover, in the upcoming months CISDM will be offering to academics a 'free' source of hedge fund data to encourage research in this hedge fund area.

Looking forward to your comments.

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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).

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.

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Comment

First The Good News and Then The Bad

Thomas Schneeweis

December, 2006

U. S. stock and bond markets returned to trading range as investors wait for signs of the impact of Federal Reserve rate cutting and consumer spending over the holiday period. Add to this, additional uncertainty surrounding governmental action on an economic stimulus package as well as world events, the traditional stock and bond markets have gone into December hibernation.

U. S. stock and bond markets returned to trading range as investors wait for signs of the impact of Federal Reserve rate cutting and consumer spending over the holiday period. Add to this, additional uncertainty surrounding governmental action on an economic stimulus package as well as world events, the traditional stock and bond markets have gone into December hibernation. In the upcoming year, however, we expect considerable activity within both the traditional stock and bond area as well as in alternative investments. Despite the recent rebound, stock markets and their mutual fund counterparts have now performed relatively poorly for about two years. While bonds have had some recent success, the current low levels of yields, raises the possibility that future returns may not match the recent past.

Moreover, international markets also face uncertain futures. Despite evidence earlier this summer of some positive political aspects, recent events bring into question Japan's ability to fundamentally change itself. In Europe, the creation of the Euro likewise brings greater consistency to aspects of the European economy while the changeover also results in large scale rebalancing. As for alternative investments, the last year has likewise brought a bit of reality into the world. Private equity, commodity,

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and commercial real estate have all experienced difficult periods. Even several hedge fund strategies have had their first negative return environment in several years.

From an academic perspective, first the good news and then the bad. The good news is that the recent performance of private equity as well as many hedge fund strategies should finally put a nail in the coffin of hedge funds as an absolute return vehicle (one which has the ability to make money in all market environments). Strategies which were equity-sensitive lost money when the stock market fell and made money when it rebounded. Strategies such as systematic derivative traders which were based on price momentum made money as rates fell and lost it again as rates unexpectedly rose. The bad news is that many investors will once again rebalance their portfolios to track the most recent performance of various strategies rather than diversifying across styles and managers.

Looking forward to your comments.

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