Prequin Research Suggests Big is Beautiful

Stockholm (HedgeNordic) – The discussion if there are correlations between a managers size, age and maturity in regards to his ability to achieve stable, risk adjusted returns seem to be a swinging pendulum. There is plenty of research, evidence and statistics – certainly opinion, out there suggesting big is beautiful and small managers must fall behind, and vice versa.

To add to the discussion, Prequin recently published research suggesting that larger hedge funds, those with assets under management (AuM) of a billion Dollars and more, outperformed their smaller peers both in the long run and the shaky month of August. And managed to do so at lower volatility. The billion Dollar plus managers outperformed emerging, small and medium funds for the month of August 2015 (with 1,49 per), across a 12-month timeline (+4,3 per cent), 3-year annualised (+9.06 per cent), and 5-year annualized (+8,52 per cent) horizons. They also had the lowest 3-year volatility of any size class, of only 3.29 per cent. Emerging hedge funds with AuM of less than USD100 million, notably had the lowest returns across all horizons, as well as the highest volatility.

"The release of the Preqin's new fund size benchmarks allows hedge funds to be compared more accurately with their peers," HedgeWeek quotes Amy Bensted, Head of Hedge Fund Products at Preqin. "While benchmarking funds by geography or strategy can provide insight into macro-trends in the industry, the performance of the smallest and largest funds within those categories can differ wildly. Large funds, those with USD 1bn or more in assets under management, have consistently generated outperformance in both the short and long term when compared to smaller sized hedge funds. Furthermore, these funds have posted superior average returns while also maintaining lower volatility and higher Sharpe ratios over multiple time horizons. However, the highest performing funds of smaller sizes can generate returns greater than their larger counterparts, which means that smaller hedge funds can still hold much appeal for investors."

The report does not show if there are effects of size in different hedge fund strategies. The argument may be open if there are sweet spots where smaller managers in certain fields. Certainly activist managers in small cap equities come to mind.

To show the diversity in opinions, a discussion comes to mind during one of HedgeNordics "Nordic Insights" sessions, from April 2014 (p.12/13) . The topic then was not so much the managers size than the maturity of the firm. And, in the round table discussion on Managed Futures, the following may only be true for CTAs. In all a bit of a stretch, but let us blend it in.

Mikael Stenbom, CEO at RPM Risk & Portfolio Management said: "If you want to have competitive risk-adjusted returns you ignore the emerging managers and focus on the ones that are between two and seven years of age, and depending on strategy – are trading, less than two billion Dollars, give and take. But the individual skill of each CTA is certainly a factor here. But, as our research indicates, for each manager, there seems to be a point where the combination of AuM and age brings the relative performance down to average or below average levels."

Hans-Olov Bornemann, Head of SEB's Global Quant Team and Senior Portfolio Manager of SEB Asset Selection also had done research on the topic: "We have been looking into these things as well. The evidence is very clear, there is no correlation between the size of the research team and the risk-adjusted returns, or the length of the experience and the risk-adjusted returns. In fact, in terms of risk-adjusted returns versus experience, there is actually a slightly negative correlation."

Prequins findings surely are not the end of this discussion, and with certainty there will be more evidence supporting on case or the other, or indeed, as read above, clearly determining there is no correlation at all between size, age and performance. A quote often attributed to Winston Churchill comes to mind: “Don’t ever trust statistics that you haven’t falsified yourself.”

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