

# Adding Leverage to a Fund Does Not Always Increase Risk

(AIMA)- 25 October 2016: Adding leverage to an alternative investment fund does not necessarily increase the risk, according to a new study by the Alternative Investment Management Association (AIMA), the global representative for alternative asset managers, and the CAIA Association, the global leader in alternative investment education.

The AIMA/CAIA study suggests that there is no direct relationship between hedge fund leverage and the volatility and downside risk of fund performance.

For example, funds that typically have the highest leverage ratios of all hedge funds – those using relative value or arbitrage strategies – have lower volatility on average and have suffered smaller losses during crises and other periods of market stress over the last 20 years.

Equally, funds that typically employ lower leverage, such as long/short equity funds, have experienced marginally higher volatility and drawdowns since 1996.

The authors said this suggested that a fund's risk profile is influenced more by the nature of the underlying investments than the use of leverage alone.

The report, entitled *"Made to Measure: Understanding the use of leverage in alternative investment funds"*, also highlighted the different impacts of the three forms of leverage – financial leverage, derivatives leverage and portfolio leverage. In many cases, adding particular types of leverage minimises or controls portfolio risk, the study found.

The title of the report refers to the fact that fund managers are increasingly tailoring the use of the different forms of leverage to meet individual investors' risk and return objectives.

AIMA CEO Jack Inglis said: *"Understanding the impact that leverage can have on a portfolio is essential for pension funds and other investors. Leverage and risk are not the same thing. Most hedge funds use a modest amount of leverage – but as our study shows, even those with higher leverage levels are not inherently more risky than, say, investing directly in equities, commodities or other traditional asset classes."*

*"It is important for investors to understand the wide variety of strategies, risks, and returns of various hedge fund strategies,"* said Keith Black, Managing Director of Curriculum and Exams at the CAIA Association. *"One of the keys to this understanding is a knowledge of the forms that leverage can take, which can range from borrowing-based leverage used to increase risks to short selling and derivatives-based leverage that can be used to reduce risks."*

"Made to Measure" is the third in a series of educational papers about hedge funds for pension fund trustees and other fiduciaries by AIMA and the CAIA Association. The previous studies focused on allocator issues ("The Way Ahead") and hedge fund strategies ("Portfolio Transformers"). The next paper, due to be published in 2017, will focus on liquidity.

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