

Long Relationships and Direct Investing Key to Successful Hedge Fund Investing

Stockholm (HedgeNordic) – Hedge funds are increasingly popular among pension funds and other institutional investors due to their limited correlation with traditional asset classes, with a recent study conducted by benchmarking company CEM Benchmarking (CEM) showing that the portion of large institutional investors invested in hedge funds increased from 2.1 percent in 2000 to 52.7 percent in 2016. After investigating realized hedge fund portfolio returns from 382 large global investors, the study concludes that high fees are eating away at the gains hedge fund investors receive.

The research conducted by CEM shows that most hedge funds behave in a very similar fashion, at the total portfolio level, to simple equity/debt blends. Alexander Beath, Senior Research Analyst at CEM and lead author of the study, says that “In effect, it’s possible for many funds to buy a passive alternative at very low cost, that still has very similar risk and return characteristics.” Interestingly enough, Beath also adds that “an impressive four out of five hedge fund portfolios would beat the CEM-calculated equity/debt ‘optimized’ index before taking account of costs.” The root of the problem, though, lies in the hefty fees hedge funds charge investors.

As John Simmonds, Principal at CEM, states: “The real story comes, however, when costs are taken into account. Only 36 per cent of funds beat the CEM calculated benchmark after taking account of fees, a big drop from the four out of five.” The institutional investors under study paid 2.2 percent in hedge fund fees in 2016 on average, with investors incurring even higher costs when using fund-of-fund structures.

On average, hedge funds outperformed CEM’s benchmark by 1.45 percent per annum before fees over the period of 2000 to 2016, but the excess return was not sufficient to cover costs of 2.72 percent per year associated with hedge fund investing. According to the study, the institutional investors whose hedge fund portfolios beat CEM’s benchmark generally had long histories with hedge funds, had portfolios with lower correlation to equity/debt blends, and were exposed to lower-cost direct hedge funds rather than higher cost fund of funds.

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