Running in the Family

Stockholm (HedgeNordic) – Hedge fund families – think of Julian Robertson's Tiger Management and his dynasty of proteges running successful hedge funds of their own (the "Tiger Cubs") – share overlapping trades that generate sizeable excess returns, recent research shows. The study finds evidence that "potentially coordinated trades" across the members of a hedge fund family predict stock returns.

Using a data set that identifies hedge fund families by tracing a manager's employment history to a seminal hedge fund parent, two finance professors at the University of Hawaiʻi at Mānoa find that a long-short portfolio made up of coordinated family trades delivers an annualized alpha of 7.3 percent. Nimesh Patel and Harold Spilker only consider unanimous buy trades – when no fund in a hedge fund family held a specific stock in the prior quarter and more than one fund in the family buys the same stock during the quarter – and unanimous exits.

The long-short portfolio that takes long positions in newly-entered stocks by multiple family members and short positions in unanimous exits – where all family members holding the stock exit – generates an annualized alpha of 7.3 percent. "The risk-adjusted returns are realized over the first two months after portfolio formation and do not fully reverse," write Patel and Spilker. "This suggests hedge fund family trades may contain information on fundamentals rather than short-term price pressure."

"Our results show that hedge fund families may share information or ideas, and that this manifests as family block trades that predict stock level alphas," conclude the researchers. "This is surprising given the lack of formal connections between independent hedge funds." This information is "likely not tradeable for other market participants," emphasize the researchers, as returns are realized before most 13F filings are filed with the SEC. Most hedge fund managers are filing their 13F filings towards the end of the 45-day filing deadline.

On the question of "why would fund managers, each running legally independent funds and competing for flows, share investment information or ideas?," Patel and Spilker suggest two reasons. First, hedge fund managers "talk their book" because they lack adequate capital to push market prices towards their estimates of intrinsic value. Second, managers share investment ideas to receive feedback.

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