Hedge Funds Hit by Unconventional Policies

Stockholm (HedgeNordic) – A new study by Alexei Orlov of the U.S. Securities and Exchange Commission and Massimo Guidolin of the Bocconi University tested whether and how hedge fund strategies are exposed to monetary policy shocks. According to the study, the impact of unconventional monetary policies applied by major central banks has been found to be negative on hedge fund performance.

Proxying the hedge fund industry with the Credit Suisse Hedge Fund Index, Orlov and Guidolin measured the performance of ten hedge fund strategies against 18 unconventional monetary policy announcements by the Federal Reserve and the European Central Bank between 2008 and 2016. According to the researchers, "our results show that the UMP [unconventional monetary policy] announcements represent a risk factor that leads to negative, precisely estimated exposures for six of out ten" hedge fund strategies. These include convertible arbitrage, dedicated short bias, emerging markets, equity market-neutral, fixed-income arbitrage, and multi-strategy.

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Orlov and Guidolin write that "this represents direct empirical evidence that supports the treatment of" unconventional monetary policies as a novel risk factor for hedge funds, a priced risk which investors require an additional return for bearing. The researchers also investigated if the unconventional monetary policies by the Fed or the ECB may have had additional, indirect effects on the performance of hedge funds through changes in the beta exposures to the remaining risk factors.

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According to the findings of Orlov and Guidolin, "even if for some strategies the UMP does not represent a risk factor in its own right, the UMP announcements seem to have had indirect and yet meaningful impacts on the traditional risk exposures." The study found that unconventional monetary policy announcements yield an indirect impact on hedge fund performance in the form of "breaks" in the beta coefficients associated with the conventional risk factors. "We find that the selected events trigger breaks in the risk exposures of the industry as a whole and in eight out of ten strategies."

"The UMPs affect HF performance both directly (by virtue of being a priced risk factor) and indirectly (by prompting breaks in the loadings of the other risk factors)."

"Our paper, therefore, also offers evidence of an indirect impact of UMPs by the Fed and the ECB on the exposures to the factors that are typical of the cross-section of HF strategy returns," write Orlov and Guidolin. In conclusion, the unconventional monetary policies affect hedge fund performance "both directly (by virtue of being a priced risk factor) and indirectly (by prompting breaks in the loadings of the other risk factors."

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