A birthday for one of Hedgistan's founding fathers

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Last week marks the 109th birthday of the "father" of hedge funds, Alfred Winslow Jones (9/9/1900 – 6/2/1989). Much has been written about Jones and the fund he founded with $100,000 in 1949 (including AllAboutAlpha posts here, [3] here, [4] and here [5]), but the relationship between his fund and the contemporary hedge fund landscape is not always clear. While his entrepreneurial spirit and market insight remain central to successful alternative investment, his implementation of investment strategy, fees, and liquidity constraints are not. The current landscape is shaped more by market forces than by the legacy of the particulars of Jones' first fund.

Who was Alfred Jones, and how did he come up with his particular investing strategy? Jones was unique in how little he resembled many of today's investment professionals, particularly quants with backgrounds in physics and math. This is not to say that he was math-averse, but his strength was in the study of people, rather than the purely abstract study of numbers. In 1935, and at the height of the Depression, Jones entered graduate school at Columbia where he studied under famed sociologist Robert Lynd. His dissertation [6] research was on attitudes toward property and human rights in Akron, Ohio, a town facing an unprecedented slump, mass unemployment, and labor disputes following the collapse of the local rubber industry. These were the early days of opinion research, and the most complex statistical techniques Jones used in his dissertation were cross tabulations with chi-square tests. The real strength of his study was not in pioneering new statistical techniques, but in making sense of a complex situation using painstakingly gathered empirical data (Jones interviewed 1,700 residents of Akron, with the assistance of interviewers funded by the New Deal-era Works Progress Administration), researching the history of the town, and exploring the interactions between economic, social, and political factors.

In 1941, selections from his dissertation were published by Fortune magazine. Although public attention to the topic of labor unrest had been eclipsed by the war, his article was well received and Jones joined Fortune as a staff writer, contributing articles on a wide range of topics. For a 1949 article [7], Jones researched the state-of-the-art in technical analysis of stock movements. In the same year, Jones left Fortune magazine to start his own investment fund, A.W. Jones and company, with terms that would become familiar: as a private investment partnership, charging a 20% incentive fee. Though successful, the fund had few followers until a 1966 article on Jones brought his success and his strategy to a wider audience. More funds were founded in the following years. Following a few rough years in the 1970's, a challenging environment not unlike today [5], the industry rapidly grew.

To what extent do hedge funds today look like Jones' first fund? In terms of investment strategy, funds have expanded far beyond Jones' long/short approach [4]. In terms of fees, today's funds do not necessarily follow Jones' 20% incentive fee with no management fee [3]. As mentioned in a previous post [8], there is a wide range of management and incentive fees—the famed "2 and 20" is hardly the industry standard. Additionally, since the onset of the economic crisis of 2008, new practices concerning liquidity and lock-ups are becoming more common [9]: limited partners are gaining more bargaining power, management fees have decreased, rebates are more common, and offering documents are more likely to include "key-man" and "no-fault divorce" clauses. Managed accounts and managed account solutions are being used by investors much more after last year's financial meltdown and an increased awareness of the many benefits of liquidity and transparency.

Perhaps the biggest shift in the hedge fund industry since Jones' early years is that it has become an *industry*—that is, a large, differentiated, and institutionalized world, with standard practices and professional organizations. Recall that Jones began his fund with $40,000 of his own capital and an additional $60,000 from a group of four friends. His first investors [10] included writers, teachers, scholars, and social workers, as well as the more familiar [10] group of wealthy businessmen. It was thus a large step from Jones' sole hedge fund to today's diverse ecology, in which funds compete for attention from knowledgeable institutional investors and investment advisors.

Keeping up with the Jones (posts) at AllAboutAlpha.com…

- Performance fees: As old as portfolio management itself? [3]
- Keeping up with the (A.W.) Joneses [4]

- Hedge fund industry enters time-warp in January 1970, pops out virtually unchanged in 2008 [5]

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[6] dissertation: **http://www.amazon.com/Life-Liberty-Property-History-Culture/dp/1884836402**
[7] 1949 article: **http://www.awjones.com/images/Fortune_-_Fashions_in_Forcasting.pdf**
[8] previous post: **http://allaboutalpha.com/blog/2009/08/02/summer-of-1000-posts-investment-management-fees/**
[9] new practices concerning liquidity and lock-ups are becoming more common: **http://allaboutalpha.com/blog/2009/08/25/more-no-fault-divorce-clauses-among-signs-that-private-equity-investors-gaining-negotiating-power/**
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