Hedge Funds are not the Bad Guys | Alrroya

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In the aftermath of the 2008 financial crisis, the term “hedge fund” hit common vocabulary like never before. From catchy pizza commercials featuring the phrase “Not you, Mr. Hedge Fund,” to a strong Congressional push for regulation, hedge funds were constantly in the media and receiving much of the blame for the economic recession.

Eighteen months after the meltdown, media attention has faded somewhat, and reports indicate that economic spirits are lifting. Hedge fund assets, however, have not yet recovered to their pre-2008 levels, and many investors remain wary. Hedge funds are easily stigmatised given their propensity for secrecy, complex strategies, and tendency to only make headlines when something goes wrong.

With recovery in the air, perhaps now is the time to take a step back and look beyond those who most offended our sensibilities: Hedge funds are not the bad guys.

Hedge funds certainly were not perfect in 2008. They were criticised for a lack of transparency, gates (restrictions which limit an investor’s withdrawals during a redemption period), and long lock-up periods. Certainly, some hedge funds warranted the criticism they received; however, the positive contributions many of them made are often overlooked. The subset of the industry which trades managed futures, for example, had outstanding performance nearly across the board. There are many hedge funds out there which have provided good returns with decade-long track records. Hedge funds such as these routinely pass the due diligence of highly sophisticated investors like pensions, to the benefit of many including state employees and senior citizens.

Furthermore, the hedge fund industry is a meritocracy in a particularly meaningful way. Hedge fund managers are the small business owners of the financial world: hedge fund managers are entrepreneurs. They invest their own capital in the funds they trade. If their funds do poorly, they lose more than just their jobs. Also, in 2008, hedge funds did not take a single dollar of the United States governments’ $700 billion TARP bailout program. While many hedge funds had disappointing results in 2008, Managed Futures (or CTAs), a category of liquid hedge funds, by and large, did extremely well during the crisis.

Since 2008, the industry has changed and the savvy hedge funds are adapting to investors’ demands. The secrecy which had been commonplace prior to the financial crisis is being deemed less acceptable, and increasingly hedge funds are doing the unthinkable: giving managed accounts. Managed accounts allow a client better transparency, better liquidity, and better custody of assets which provides protection from gates and other potentially negative conditions.

Managed accounts are a solution to many of the potential drawbacks inherent in hedge fund investment. They are not, however, without their own complications. Managed accounts require strong operational and technological infrastructure. They are not protection from a bad investment: investors must still conduct proper, thorough due diligence before making any sort of investment. Moreover, though it is no longer impossible for investors to get managed accounts with top hedge funds, it might not be easy. To even consider giving a managed account, hedge funds often require a high minimum investment of anywhere from $5 million to $100 million. This poses a problem for an investor with an interest in managed accounts who lacks the capital to create a diversified portfolio of accounts with multiple hedge funds.

One alternative is to look beyond the hedge funds themselves. As investors return to the hedge fund industry, a substantial amount of the capital they are bringing with them is going into managed account platforms. This is a solution in which a company or bank secures managed accounts with numerous hedge funds, builds funds around those managed accounts, and makes it possible for their investors to invest into the managed accounts with a much lower minimum.

Managed account platforms can provide other benefits as well, including due diligence, risk monitoring, and superior technology. They can allow an investor to build a diversified portfolio for less capital than it might take to obtain one managed account independently. From a governance perspective, there is much appeal of a managed account solution.

There are many reasons that hedge funds remain a good investment and a good portfolio diversifier, and the industry's willingness to adapt to investor demands is heartening. Now may be the time to act for those looking to invest (or re-invest) in hedge funds, and for those who lack the capital or risk appetite to invest in hedge fund in traditional ways, managed account platforms facilitate the investment process and give an extra layer of security that is comforting in the most turbulent economic times. Like everything else, there are both good quality and poor quality hedge funds, and rigorous due diligence is always a necessity.

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