FINANCIAL POST

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Hedges “risky” but rewarding

What do George Soros, Jim Rogers, Steven Cohen, and Myron Scholes have in common? They all ran hedge funds. Three of them have made huge fortunes for their investors and themselves, and one is a Nobel laureate . If hedge funds were good for them, are they good for you?

First, let me answer this question as it relates to me. Most of the "managed money" in my own portfolio is in hedge funds, and in long/ short equity positions in particular. I actually prefer to call them non-traditional funds, because in reality they are extensions of what mutual funds can do. The managers can take their stocks long or short, use a very moderate degree of leverage, or invest in derivatives.

I tend to shy away from funds that use derivatives for speculating, preferring those that use options for reducing risk. More specifically, much of my personal managed money is in equity long/short funds structured amazingly close to the original model created by Alfred Winslow Jones.

One respected manager who runs both mutual and hedge funds said to me recently: "I just feel safer in my hedge fund because the short positions give me some insurance if the world goes to hell in a handbasket."

When it comes to institutions, pension funds, generally speaking, have been taught by consultants to do in-depth quantitative analysis of money managers. These money managers have to fit into a tight box what they can and cannot do. This often means they are afraid to make any substantial mistakes.

So what will they do? Hug the index, of course.Ah, but institutions aren't dumb. "

Hey, we are not going to pay you fees unless you beatthe index, risk-adjusted or not," they say. "We will just buy ETFs instead."

So far, it makes sense, but here is the kicker: Institutions (and most other investors) don't want a money manager to stray too far from the index, because that is risky. At the same time, they want the managers to beat the index. The two scenarios can't co-exist.

There's also the issue of many Canadian pension funds being underfunded, meaning there's not enough money to meet their obligations to pensioners. The more underfunded a fund is, the more it won't want to take a risk by putting a non-traditional manager in the portfolio.

The result is that it is more difficult these days for an excellent long/short equity manager (or any non-traditional manager) to get allocations from Canadian institutional accounts. But institutions are the exact group that should be looking for the possible alpha of hedge funds.

As for retail clients, most want one thing: relative returns, or beating the index, in up markets, and absolute returns (always positive) in down markets. Risk-adjusted returns, correlation, and strategic asset allocation are usually way over their heads. All they know is, "I got my statement and my fund went down this month."

The response from the hedge fund manager usually goes like this: "Well, that's because we were short financials because we think there is a risk in that sector. The rally in financials was just a 'dead cat bounce,' caused by a massive amount of short covering." To this, the response from retail investors, who generally have little understanding of the investment strategies being used, sounds a lot like this: "Um....OK, but the market went up and my fund went down, so I am unhappy this month."

While interviewing the best hedge fund managers in the country over time, I have learned a few things. Their portfolios never look like an index, and they don't really care about the index. They usually own their own little shop, as working for a big fund company is often too constraining to "think outside the box."

So, in answering the question of whether hedge funds are for you, consider the following: your appetite for risk, your ability to accept a period of negative returns, and whether you can withstand getting too excited about that "dead cat bounce." - Bob Thompson is an associate portfolio manager and alternative investment strategist at Canaccord Capital. Mr. Thompson and his team man-age hedge fund portfolios for high net worth individuals.

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CANADIAN HEDGE FUND PERFORMERS

TOP 10 BY 1-YEAR RETURN WITH MINIMUM INVESTMENT GREATER THAN 25K

Rank	Fund name	Ytd Return	1yr. Comp.	3yr. Comp.	5yr. Comp.
1	Sprott Hedge Fund L. P.	4.987	19.642	20.964	20.908
2	Sprott Hedge Fund L.P. II	4.762	19.007	18.999	19.12
3	Lawrence Partners Fund LP	2.694	18.836		
4	Hillsdale Canadian Market Neutral Equity	2.204	17.611	5.298	5.243
5	Hillsdale Canadian Long/Short Equity Fund Class A	1.392	15.675	7.227	14.826
6	Dynamic Alpha Performance Fund	1.355	14.696	11.913	11.668
7	Sprott Opportunities Hedge Fund Class A	2.422	13.846	20.886	
8	Arrow Enso Global Fund	6.509	13.409	11.824	13.948
9	Dynamic Power Hedge Fund Class A	-6.438	11.944	55.587	
10	Arrow WF Asia Fund	-9.87	9.988	16.918	20.958

BOTTOM 10 BY 1-YEAR RETURN WITH MINIMUM INVESTMENT GREATER THAN 25K

Rank	Fund name	Ytd Return	1yr. Comp.	3yr. Comp.	5yr. Comp.
1	Epic Limited Partnership	-22.415	-23.11	8.783	19.914
2	Horizons Northern Rivers Fund L.P.	-10.286	-23.026	28.918	
3	Arrow Goodwood Fund	-16.863	-22.787	1.024	11.802
4	Goodwood Fund Class A	-17.115	-22.659	0.843	11.684
5	Goodwood Fund Class B	-17.115	-22.162	-0.332	9.837
6	Arrow Epic Capital Fund	-22.28	-22.065	12.281	21.821
7	Northern Rivers Innovation RSP Fund	-7.425	-18.189	31.771	
8	Man Multi-Strategy (Canada) Fund Class A C$	-2.968	-8.513		
9	Vertex Fund Class A	-2.007	-8.495	12.968	20.555
10	Arrow Elkhorn U.S. Long/Short Fund	1.943	-7.067	5.671	7.139

TOP 10 BY 1-YEAR RETURN WITH MINIMUM INVESTMENT LESS THAN 25K

Rank	Fund name	Ytd Return	1yr. Comp.	3yr. Comp.	5yr. Comp.
1	Man AHL Diversified (Canada) Fund Class A C$	12.553	26.133		
2	Sprott Bull/Bear RSP Fund	4.852	19.653	20.298	19.777
3	Pro-Hedge Protected Notes Series III	1.072	2.097	-1.044	
4	Pro-Hedge Protected Notes Series II	1.614	1.892	-1.243	
5	Salida Multi Strategy Hedge Fund	-3.545	1.486	45.459	
6	The Friedberg Currency Fund	10.143	-0.332	2.271	6.849
7	BNP - Mesirow Notes Series 1	-3.577	-2.549	3.356	3.19
8	BNP - Mesirow Notes Series 2	-3.58	-2.551	3.356	3.169
9	ONE Financial MSCI Hedge Invest Index Nts Series 1	-0.52	-3.672	-1.225	
10	ONE Financial Guaranteed Absolute Return Notes	-3.499	-4.383	-0.205	0.39

BOTTOM 10 BY 1-YEAR RETURN WITH MINIMUM INVESTMENT LESS THAN 25K

Rank	Fund name	Ytd Return	1yr. Comp.	3yr. Comp.	5yr. Comp.
1	TA3 - Campbell 'A' C$	-2.56	-17.25	-4.154	-0.762
2	Redwood Long/Short Fund	-6.521	-13.819	0.205	
3	Horizons Global Contrarian Fund	-5.161	-8.316	1.145	1.715
4	Trans IMS Global Market Neutral Fund	-5.429	-7.23	0.761	2.117
5	Arrow Multi-Strategy Notes Series 2	-0.174	-6.608	2.712	
6	Arrow Multi-Strategy Notes Series 3	-0.237	-6.42	2.401	
7	Arrow Multi-Strategy Notes Series 1	-0.233	-6.265	3.51	
8	IA Multi-Strategy	-3.794	-5.63	-0.359	0.887
9	ONE Financial Guaranteed Absolute Return Notes	-3.499	-4.383	-0.205	0.39
10	ONE Financial MSCI Hedge Invest Index Nts Series 1	-0.52	-3.672	-1.225	

SOURCE: FUNDATA

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