Hedge Fund Strategies

An Overview of the Various Investment Strategies Offered by Hedge Funds in the Marketplace Today

Updated June 2016

HEDGEfundamentals.org

Overview

Hedge funds offer qualified investors a unique partnership where they invest alongside the fund manager.

While hedge funds first began, in part, as a way to offer investors a balanced - or market-neutral – approach to investing, the methods for delivering returns have evolved through the years.

This presentation provides a brief overview of some of the strategies used by hedge funds in the marketplace today.

Table of Contents:

Hedge Fund Strategies

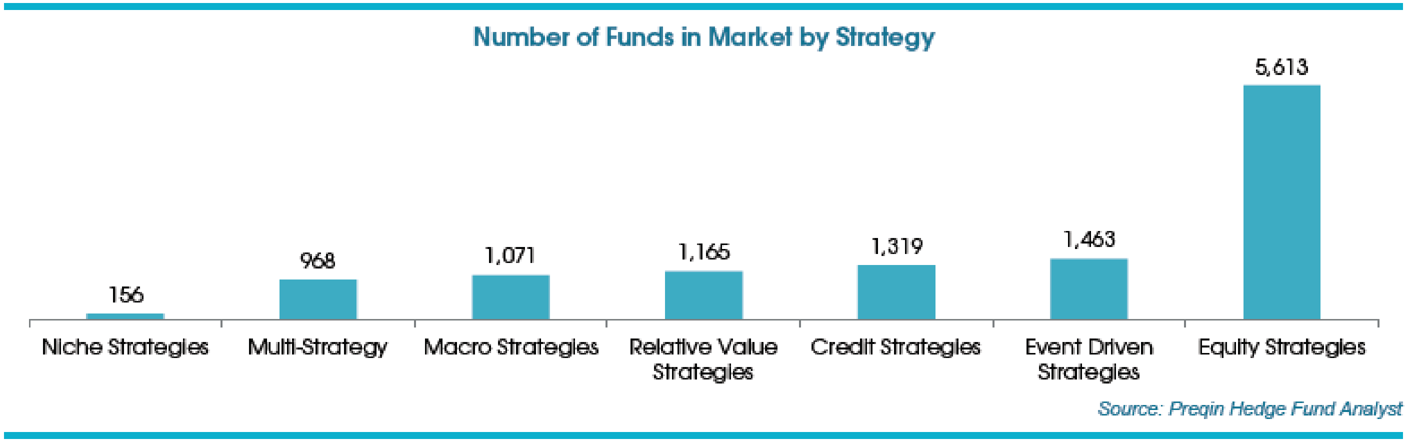
Overview

Hedge funds offer investors a breadth of investment options. No two hedge funds are identical, but funds can be categorized broadly by the type of strategies they employ.

While the individual investment decisions made by each fund vary, many hedge fund strategies share several of the same fundamental goals:

- Portfolio Diversification – Helps prevent over-concentration in specific assets
- Risk Management – Helps anticipate and avoid volatility in the marketplace
- Reliable Returns Over Time – Helps provide opportunities for asset growth

The following chart shows the number of hedge funds practicing the seven most common investment strategies.



Source: 2016 Preqin Global Hedge Fund Report

How do hedge funds invest?

Global Macro

Investment managers use economic variables and the impact these have on markets to develop investment strategies.

Managers employ a variety of techniques including discretionary and systematic analysis, quantitative and fundamental approaches, and long and short-term holding periods.

Strategies are based on future movements in underlying instruments rather than the realized valuation discrepancies between securities.

How do hedge funds invest?

Event Driven

Investment managers maintain positions in companies currently or prospectively involved in corporate transactions including mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments.

Managers pursue strategies based on fundamental characteristics (as opposed to quantitative) and specific future developments.

Position exposure includes a combination of sensitivities to equity markets, credit markets and company-specific developments.

How do hedge funds invest?

Relative Value

Investment managers maintain positions based on valuation discrepancies in the relationship between multiple securities.

Managers employ a variety of fundamental and quantitative techniques; investments range broadly across equity, fixed income, derivative or other security types.

Positions may involve future corporate transactions, but these positions are predicated on the realization of a pricing discrepancy between related securities rather than the outcome of the corporate transaction.

How do hedge funds invest?

Credit Funds

Credit funds invest in fixed income securities, often taking large investment positions using the ownership stake to participate in the management of a company.

These funds traditionally focused on corporate credit, however many funds have expanded investments into sovereign and distressed debt holdings.

How do hedge funds invest?

Long/Short Equity Funds

Investment managers maintain long and short positions in equity and equity derivative securities.

Managers employ a wide variety of techniques to arrive at an investment decision, including both quantitative and fundamental analysis.

Strategies can be broadly diversified or narrowly focused on specific sectors and can range in terms of levels of net exposure, leverage employed, holding period, concentrations of market capitalizations and valuation ranges of typical portfolios.

How do hedge funds invest?

Quantitative Funds

An investment fund that trades positions based on computer models built to identify investment opportunities.

These models can utilize an unlimited number of variables, which are programmed into complex, frequently-updated algorithms and controlled by a portfolio manager.

Quantitative fund models are used as a means of executing a number of other hedge fund strategies, including: Long / Short Equity; Global Foreign Exchange; Global Fixed Income; and, Futures and Forwards.

Hedge Fund Strategies

How do hedge funds invest?

Multi-Strategy Funds

Investment managers maintain a variety of processes to arrive at an investment decision, including both quantitative and fundamental techniques.

Strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of levels of net exposure, leverage, holding period, concentrations of market capitalizations and valuation ranges.

Various strategies are employed in a multi strategy fund. Some examples are: Convertible Bond Arbitrage; Long / Short Equity; Statistical Arbitrage; and, Merger Arbitrage

How do hedge funds invest?

Managed Futures Trading (CTAs)

Managed futures traders – also known as commodity trading advisors (CTAs) – are able to invest in up to 150 global futures markets.

They trade in these markets using futures, forwards and options contracts in everything from grains and gold, to currencies, stock indexes, and government bond futures.

Because they can go both long and short they have the ability to make money in both rising and falling markets.

CTAs have been regulated by the Commodity Futures Trading Commission (CFTC) since 1974 and are overseen by the National Futures Association (NFA), a self-regulatory organization.

Hedge Fund Strategies

Institutional Investors Seeking Out New Hedge Fund Partnerships

According to Preqin, investors expect to increase hedge fund allocations during the next year.

Approximately 83 percent of institutional investors are looking to add anywhere from 1 to 5 funds to their portfolios. This is an increase from 71 percent compared to the prior 12 months*.

The accompanying chart* outlines where investors are looking to allocate, broken down by strategy.

Fig. 7.30: Strategies Sought by Investors over the Next 12 Months