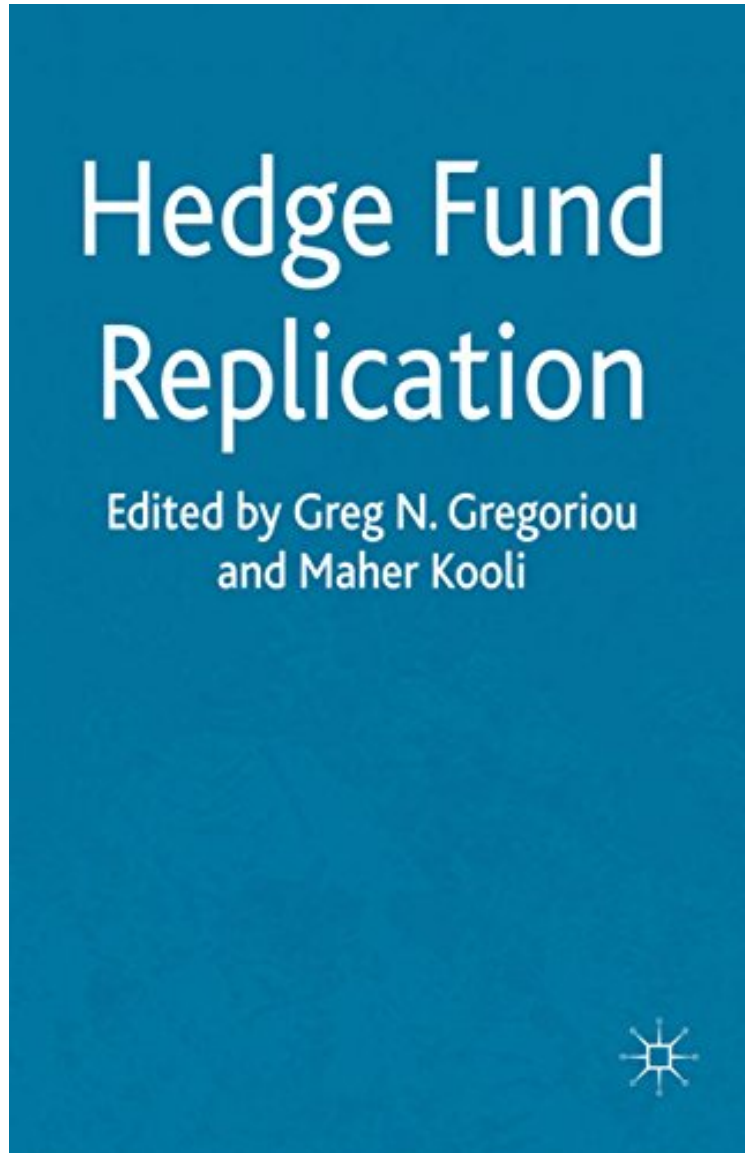


Hedge Fund Replication

Professor Maher Kooli

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Professor Maher Kooli : Hedge Fund Replication before purchasing it in order to gage whether or not it would be worth my time, and all praised Hedge Fund Replication:

1 of 1 people found the following review helpful. The hurdle for hedge fund replication might be low enoughBy investingbythebooksEven though many types of hedge funds (HFs) didn't live up to expectations in the 2008 financial crisis and the pure alpha - less both traditional and alternative betas - of hedge funds in aggregate has withered to zero during the last few risk-on-risk-off years, the money allocated to HFs has not come to a stop. A hefty allocation to external HFs has become a natural piece of the puzzle that makes up a best practice pension fund. Recently however a

buzz-word on the rise has been "the Canadian model", meaning large pension funds who manage so called alternative investments - including HFs - internally. So, can this really be done? Can stuffy old pension funds really manage something that high flying? This book on hedge fund replication tries to give the answer. There has long been an academic debate whether HFs simply are repackaged betas sold as alpha. If it is a fact that hedge fund performance mainly consists of factor premiums that can be specified by systematic rules, then it would be possible for pension funds to generate the same type of returns without the need to suffer the opacity, illiquidity and high fees of HFs. No wonder the topic of hedge fund replication created quite a hype when it first emerged ten years ago. This hype quickly died out when the first generation of replication techniques proved to generate inadequate results. The first generation attempts focused on the factor premiums, (value, small cap and momentum premiums, FX carry, commodity futures, volatility arbitrage, high yield spreads etc.) and in a back test regression worked out which combination of these that, together with traditional beta exposure, would have produced a targeted risk and return. That was all very well, but out of sample this static mix of factor exposures turned out results that didn't follow the sequential returns path of hedge funds very closely at all. The problem was that the strategy didn't take the very flexible nature of HFs into account. HFs vary their leverage and their long-short balance, they use stop-losses, derivatives and change tactics in mid-stream. The returns show a non-linear correlation to the factor premiums above, not a linear one. Entrance, hedge fund replications 2.0. By using statistical techniques such as computer learning during rolling time frames, adding a number of rules (tied to for example VIX, terms spreads etc.) that trigger changes in factor exposures the results suddenly improve dramatically. The verdict has changed from "didn't work" to "does work if done properly". The new methods in some way also blur the distinction between HF replication and HF creation. This hardly an entertaining book. It consists of a number of short papers from mainly European academics and there are plenty of "Greek letters". Most of the authors present their version of the recipe of how to cook a HF or a HF-index. One is using a Kalman filter, the other a Markov switching model etc. and I'm frankly not the man to judge on the suitability of all those statistical models. The results the authors presents vary but a majority of them produce out of sample results that often not only clone HFs but even surpass the risk/reward of those. I think it's safe to say that the returns of HFs mainly consist of a stack of betas. As I'm not really qualified to judge the quality of the work done it's also really hard to grade this book. The results might be ground breaking and I wouldn't know it. What I do know is that the lure of the Canadian model clearly increases if the results are robust. Considering that HF-indexes due to survivorship bias, selection bias and backfilling bias are estimated to overstate returns with 2 - 3 percentage points per year the hurdle for hedge fund replication might actually be low enough even for the stuffy old pension funds. This would in a way be a huge negative as the collective salary level of asset management business would be threatened - and I plan to work for a few more years - but it would be good for the pensioners. This is a review by investingbythebooks.com

While there may be a consensus in the industry that hedge funds clones will bring better liquidity and lower fees, it is still debatable whether replication products should serve as a complement in the hedge fund allocation decision or as a replacement. This book offers the reader valuable insights into the thinking behind hedge fund replication.

About the Author Greg N. Gregoriou is the author of numerous published books, book chapters and refereed journal papers. He has also been quoted several times in the New York Times and the Financial Times of London. Professor Gregoriou is hedge fund editor and editorial board member for the Journal of Derivatives and Hedge Funds, as well as editorial board member for the Journal of Wealth Management, the Journal of Risk Management in Financial Institutions, Market Integrity, IEB International Journal of Finance, and the Brazilian Business . Professor Gregoriou's interests focus on hedge funds, funds of funds, and CTAs. He is an EDHEC Research Associate in Nice, France. MAHER KOOLI Professor of Finance at the School of Management, Université du Québec à Montréal (UQAM), Canada. He is also the finance graduate programs director and in charge of the Trading room at UQAM. He holds a Ph.D. in finance from Laval University (Quebec), Canada, and was a postdoctoral researcher in finance at the Center of Interuniversity Research and Analysis on Organisations. Professor Kooli also worked as a Senior Research Advisor for la Caisse de Depot et Placement de Québec (CDP Capital). He has published articles in a wide variety of books and journals.