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SFU Business study reveals surprising historical returns for hedge funds

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Award-winning research into hedge funds by SFU Business professor Peter Klein and chartered financial analyst Todd Brulhart, an SFU global asset and wealth management MBA alumnus, promises to change the way the financial community views these contentious funds. Hedge funds are pools of investment capital that are managed in non-traditional ways using a disciplined and well-defined investment strategy. They will typically take short as well as long positions to take advantage of short-term pricing differentials and to hedge away the risk of the overall market in which they operate. Some funds focus on equity markets, others on fixed income instruments and derivatives.

Their paper, Are Extreme Hedge Fund Returns Problematic? reveals that, historically, the returns on a diversified portfolio of hedge funds have been far more stable than for a diversified portfolio of equities. Their discovery runs contrary to the popular industry and academic perception that hedge funds expose investors to extreme positive and negative returns. The paper recently won the Canadian chapter of the Alternative Investment Management Association's $10,000 Canada Research Award.

The researchers compared return data on popular U.S. hedge fund indices with return data on major stock market indices. In their paper, they explain how the typical statistics that measure extreme returns are flawed and then demonstrate that the true magnitude of extreme returns on hedge fund indices has been smaller than for stock market indices.

"This is a very important, timely message for the financial industry because we've had some high profile difficulties in the hedge fund sector," says Klein. "This paper is trying to put into perspective the overall risk of hedge fund investing."Investors, he says, should take a portfolio approach to hedge fund investing and choose hedge funds that do not deviate from a well-defined strategy in a specific market. "Hedge funds don't "hedge your bets", he says. "Instead, they act as diversifiers against traditional equity portfolios because they expose investors to non-traditional risks. This leads to a better return-to-risk ratio."