



The Role Hedge Fund Investing Plays in a Portfolio

PUBLISHED ON AUGUST 17, 2020

Arguably some of the best and brightest minds are investing in hedge funds. And yes, some of the world's rich and famous (or infamous) are hedge fund managers i.e George Soros, Raymond Dalio and James Simons.

PitchBook looked at historical data to examine how buyout funds specifically reacted during previous crises, including the Tech Bubble, 9/11, and the Global Financial Crisis (GFC).

WHAT IS A HEDGE FUND?

Like mutual funds, hedge funds invest in traditional markets (stocks and bonds) but also have the flexibility to invest in non-traditional markets. A hedge fund can basically invest in anything — land, real estate, stocks, derivatives, and currencies.

Using leveraged, long, short and derivative positions, hedge fund managers are marked by a few key features, including:

- Skill-based strategies: the skill of the manager (alpha) drives returns, as opposed to the performance of the market of asset class (beta).
- Absolute returns: generated gains are not marked by indices or benchmarks.
- Diversity: trade across multiple markets (e.g., equities, bonds, currencies).
- Flexibility: options for long and short trades in a portfolio.
- Interest alignment: managers often invest their own capital aka “skin in the game”.

WHO IS INVESTING IN HEDGE FUNDS & WHICH HEDGE FUNDS?

From the first hedge fund in 1949, the industry has grown to approximately \$3.32 trillion in global assets under management in 2019.¹ Historically those asset have come from institutional investors such as Ivy league universities and endowments. So, while many individuals do not invest in hedge funds directly, they benefit indirectly through their pension plans, college scholarships or charitable work.

Hedge fund managers with large asset bases dominate the industry. Those who have more than \$1 billion in asset manage nearly 30% of the industry's assets, and those with more than \$5 billion manager over 60% of the industry.²

TRADITIONAL INVESTMENTS WORK WELL FOR YOUR CLIENTS, SO WHY INVEST IN HEDGE FUNDS IN THE FIRST PLACE?

Traditional asset managers generally allocate capital on a ‘long-only’ basis to stocks, bonds and cash. Portfolios are managed against a passive benchmark which they aim to outperform. The relative weighting of positions tend to have little deviation from the benchmark itself, often resulting in similar return profiles. Consequently, this tends to make it difficult for traditional managers to make money when markets are falling.

Hedge funds are usually included as a medium to long-term investment in a traditional portfolio of stocks and bonds. As the performance of hedge funds in general tends to be less correlated to traditional investments – especially in declining markets when correlations tend to be low – they offer a unique source of diversification for most investment portfolios. By blending a variety of skill-based approaches to investing in a diverse range of financial instruments and markets, a hedge fund portfolio construction process aims to achieve a specific return/risk profile, as well as proper diversification and balance in the overall portfolio.

HOW HEDGE FUNDS MAKE MONEY³

Hedge fund managers make money using a variety of strategies. However, since the strategies and manager incentives vary so widely, it is important to take the time to evaluate the hedge fund industry and find one that matches your clients’ objectives.

MACRO FUNDS – As the name suggests, such funds trade on macro views and global events. Famous ones include Soros Fund, Tudor Investments.

LONG/SHORT FUNDS – Such funds usually trade in equity markets and will hold long, short positions or some both in accordance to their strategies and views.

QUANTITATIVE FUNDS – The fund managers will employ program/technology strategies and tactics to manage their positions with little human intervention. Notable ones are Renaissance Technologies, Quantedge.

ARBITRAGE FUNDS – Markets are imperfect, (at least these managers believe so to a certain degree), and they seek to arbitrage the pricing discrepancies that exist due to market imperfections. Sometimes, such pricing discrepancies might exist in milliseconds, at times a few days or weeks.

DISTRESSED FUNDS – At every crisis, there are opportunities. These hedge funds seek to find value in assets that are mired in distress and are under market pressures. Not a style for the faint-hearted. Famous ones are Oaktree Capital, Elliot Management.

LEVERAGE – Investing in hedge funds relies on leverage to increase the range of market bets managers will invest. This works by borrowing secure capital on a margin to strengthen purchase power. This margin also cooperates with derivatives high leverage swaps contracts and futures.

Relying on leverage opportunities generates the high risks and rewards associated with hedge funds. Heavy reliance on leverage causes even higher chances of credit risk and lost investment than other strategies.

1. [Jan 21, 2020. HFR 2020 Report](#)
2. [May 19, 2020. Financial Times. No Market for Small Firms](#)
3. [TFA Geeks. The Basics- Hedge Funds.](#)

IMPORTANT LEGAL INFORMATION AND LIMITED USE OF MATERIALS DISCLAIMERS

These materials and/or this Presentation (the "Materials" or "Presentation") were generated by Crystal Capital Partners, LLC ("Crystal"), which permits third parties to use and rebrand the Materials under the names of such third parties for educational and informational purposes only. As described further below, Crystal assumes no responsibility for the Materials, their use or distribution by third parties, including any additional edits to the materials by third parties and expressly forbids any further alterations to the Materials beyond branding. Readers of the materials should be advised that such third parties have financial affiliations with Crystal and are subject to various conflicts of interest.

The Materials were prepared without regard to specific objectives, financial situation or needs of any particular receiver and should not be construed as personalized investment advice (or an offer thereof) for compensation or a recommendation of investment advice to buy or sell any investment nor are the Materials intended as an endorsement of any security or investment (including any investment product managed by Crystal or any other third party); the Materials are for informational purposes only and any information contained in them represent the writer's or provider's own investment opinions. Crystal cannot assess, verify, or guarantee the suitability of any particular investment to any personal situation and the reader of the Materials bears complete responsibility for its own investment research and should seek the advice of a qualified investment and/or tax professional prior to making any investment decisions. This industry information and its importance is an opinion only and should not be relied upon as the only important information available. Information contained herein has been obtained from sources believed to be reliable, but not guaranteed, and Crystal assumes no liability for the information provided. Any information, data, research, news articles, forecasts, figures, opinions, projections, statements of financial market trends or investment techniques and strategies expressed are considered to be reliable at the time of production, but no warranty as to the accuracy and reliability or completeness in respect of any error or omission is accepted, and may be subject to change without reference or notification to you. Any quotations of individuals other than the authors or providers of the Materials are provided for informational purposes only and their accuracy and veracity are not guaranteed. The Materials and any such items included therein may contain certain forward looking statements, projections and information that are based on the beliefs of Crystal (or others) as well as assumptions made by, and information currently available to, Crystal (or others). Such statements in the Materials reflect the view of Crystal (or others) with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in the Materials. The Materials (and any information included therein) are based on information available as of the time they were written, provided, or communicated and Crystal disclaims any duty to update the Materials and any content, research or information contained therein. Accordingly, neither Crystal nor its principals or affiliates make any representation as to the timeliness of any information in the Materials. As a result of all of the foregoing, inter alia, neither Crystal nor its principals can be held responsible for investments in products managed by Crystal by the recipients or readers of the Materials based on the statements, projections, research, or any other information of any other kind included in the Materials.

At certain places in the Materials, we reference or may offer direct access or 'links' to other Internet websites. You are encouraged to exercise discretion while browsing through any such connected hyperlinks to external websites. These sites contain information that has been created, published, maintained or otherwise posted by institutions or organizations independent of Crystal. Crystal has not reviewed any of the external websites that may be hyperlinked to the Materials. Hyperlinks to external websites are provided for information and reference purposes only. Crystal does not endorse, approve, certify, recommend or control these websites and does not assume responsibility for the accuracy, completeness or timeliness of the information, advertising, products, services or other materials located there. Additionally, Crystal's inclusion of hyperlinks to external websites does not imply association with the owners or operators of such external websites, and the views expressed at such external websites are not necessarily the views of Crystal or its affiliates. Visitors to these websites should not use or rely on the information contained therein until consulting with an independent finance professional. Reliance upon information in this material is at the sole discretion of the reader; your hyper-linking to, or use of, any external websites is at your own risk. Furthermore, Crystal is not responsible for the privacy practices of such other web sites. Any concerns regarding any hyperlink should be directed to the respective website owner or operator/webmaster.

PERFORMANCE DISCLAIMERS

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS AND FUTURE ACCURACY AND PROFITABLE RESULTS CANNOT BE GUARANTEED. ANY PERFORMANCE COMPARISON TO THE PERFORMANCE OF INDICES IN THE MATERIALS MAY NOT BE A MEANINGFUL COMPARISON. INDICES CITED IN THE MATERIALS ARE GENERALLY NOT AVAILABLE FOR DIRECT INVESTMENT AND ARE NOT SUBJECT TO FEES. ANY PERFORMANCE REFERENCED IN THE MATERIALS IS NOT NECESSARILY BASED ON THE SAME TYPES OF INVESTMENTS CONTAINED IN ANY INDEX SHOWN OR REFERENCED IN THE MATERIALS, NOR IS ANY SUCH INDEX REPRESENTATIVE OF ANY PERFORMANCE PRESENTED IN THE MATERIALS. ANY INDICES SHOWN IN THE MATERIALS ARE ONLY TO REFLECT COMPARATIVE PERFORMANCE OF FAMILIAR INVESTMENT STYLES. NO REPRESENTATION IS BEING MADE THAT ANY INVESTMENT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN OR DESCRIBED IN THE MATERIALS. FURTHERMORE, PERFORMANCE WILL VARY BASED ON MANY FACTORS, INCLUDING, BUT NOT LIMITED TO, INVESTMENT STRATEGIES, TAXES, MARKET CONDITIONS, AND APPLICABLE ADVISORY AND OTHER FEES AND EXPENSES RELATED TO INVESTING. NO REPRESENTATION IS BEING MADE THAT FOLLOWING THE MATERIALS AND/OR ANY INFORMATION CONTAINED THEREIN WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN OR DESCRIBED IN THE MATERIALS (IF AT ALL). ANY INVESTMENT RETURN AND PRINCIPAL WILL FLUCTUATE WITH MARKET CONDITIONS, AND ONE MAY HAVE A GAIN OR LOSS ON ITS INVESTMENTS. ACCORDINGLY, INDIVIDUAL RETURNS MAY VARY FROM ANY OF THE RETURNS SHOWN IN THE MATERIALS. TO THE EXTENT ANY INVESTMENT FUNDS REFERENCED IN THE MATERIALS ARE INVESTED IN INDIRECTLY THROUGH AN INVESTMENT PLATFORM MANAGED BY CRYSTAL, THE RETURNS OF SUCH FUNDS (INCLUDING THE RETURNS OF ANY SUCH FUNDS REFERENCED IN THE MATERIALS) WILL BE FURTHER REDUCED AS A RESULT OF FEES IMPOSED BY CRYSTAL AND ITS AFFILIATED PORTFOLIO ADVISORS (SEE THE SAMPLE IMPACT OF FEE CHART FURTHER BELOW). ANY PERFORMANCE IN THE MATERIALS IS NOT AUDITED AND IS NOT INTENDED TO COMPLY WITH AIMR-PPS™ OR GIPS GUIDELINES.

NO OFFERING OR SOLICITATION

Crystal may only transact business or render personalized advice, and offers of service can only be made, in those states or international jurisdictions where Crystal is registered or where an exemption or exclusion from registration is available. Nothing herein is an offer of any service that is not legal for offer into any particular jurisdiction with Crystal current licensure (if any). Crystal is not registered as a securities broker-dealer with the U.S. Securities and Exchange Commission or with any state securities regulatory authority or with any foreign country; Crystal is an SEC registered investment adviser that provides an alternative investment platform for professional financial advisors. As such, the Materials are provided to professional financial advisors for their (or their clients) informational or educational purposes only and are not intended as, and may not be relied on in any manner as legal, tax or investment advice, a recommendation, or as an offer to sell, a solicitation of an offer to purchase or a recommendation of any interest in any fund, security, entity or investment vehicle from Crystal or an attempt to effect transactions in securities. The information in the Materials is in summary form for convenience of presentation; it is not complete and should not be relied upon as such.

Any offer to sell or solicitation to invest will only be made through the relevant offering documents (of one or more investments managed by Crystal) to persons (through and working in conjunctions with their professional financial advisers) who meet the investor suitability and sophistication requirements in jurisdictions in which any such offer or solicitation is lawful and will be qualified in its entirety in accordance with all applicable laws. Accordingly, the Materials must be read in connection with such offering documents in order to understand fully all of the implications and risks of any investments managed by Crystal. There can be no assurance that the objectives or information stated in the Materials can or will be achieved. Alternative investments carry a high degree of risk and are complex, speculative investment vehicles and are not suitable for all investors; one can lose all or a substantial amount of its investment in alternative investments such as private equity funds and hedge funds.