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Breaking News



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Hedge funds have their year in the sun

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Finally, it pays to make some bets against the market.

The hedge fund industry, which caters to the wealthy and to institutional investors like college endowments and pension funds, has turned in a strong performance this year as the markets have declined sharply and some of the industry's most prominent managers moved to the sidelines.

One reason for the success is the nature of hedge funds, which generally protect profits by short-selling, or borrowing money to bet some stocks or indices will decline. The strategy is intended to position hedge funds to thrive in all market conditions. Of course, during the run-up of technology stocks, middle class investors who had to settle for the more basic strategies of mutual funds were not missing much. Technology mutual funds often had returns that were just as high, if not higher, than technology hedge funds.

But not this year.

"It's helped to hedge," said Mr Bruce Ruehl, chief investment strategist for Tremont Advisers, a hedge fund industry consulting firm. "It's really the first year in five years where it paid to hedge."

Because hedge funds are private, the industry is characterised by secrecy; data is much less reliable than that available for mutual funds. That said, most tracking companies report that the industry is in the black this year. The average hedge fund gained 6.25 per cent through the end of November, after fees, according to data from the Hennessee Group, a hedge fund consulting firm. The Credit Suisse First Boston/Tremont hedge fund index, which is weighted by the size of each fund, is up 2.13 per cent over the same period.

Those numbers look pretty good compared with the 10.5 per cent loss of the Standard & Poor's 500 index and the 7.5 per cent loss of the average equity

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mutual fund over the period, according to Morningstar, a mutual fund tracking firm. Even more impressive is the 10.5 per cent gain of the average technology hedge fund, compared with the 36.2 per cent decline of the Nasdaq composite index and the 32.5 per cent loss of the average technology mutual fund this year, through November.

"You're continuing to see growth in hedge funds because investors continue to see the value in them," said Ms Sharissa Jones, a partner at Capital Z Partners, a New York asset management firm that invests in hedge funds.

"In years like this, in which the market is down so much, those 15 per cent to 20 per cent returns start to look awfully good," she added.

Performance appears to have driven sales. Hedge fund industry assets grew from \$US324 billion (\$600 billion) at the end of last year to about \$US400 billion projected for the end of this year, according to the Hennessee Group, spread across several thousand funds. The majority of the growth came from new money coming into the industry.

While it has also been a big sales year for the much larger mutual fund business, the two industries appear to have thrived at different points in the year. At the end of November, mutual funds had taken in \$US300.5 billion, a record sales year so far, according to the Investment Company Institute, a mutual fund industry trade group.

But most of the mutual fund industry's sales came in the first four months of the year, before the sharemarket was deep in the throes of its prolonged sputter. That stands to reason, since only a very few mutual funds use short-selling techniques and most stock mutual funds move with the stockmarket. As a result, investors' enthusiasm for mutual funds, while it has stayed positive, has waned considerably from the beginning of the year.

By contrast, much of the hedge fund industry's new sales came after the first quarter when the industry looked like a relative haven. Besides short-selling, hedge fund managers are much more aggressive in moving into cash when they want to avoid a turbulent market.

"Most of the inflows into hedge funds happened in the second, third and beginning of the fourth quarter," said Mr Charles Gradante, chief executive of Hennessee Group. "This is a hallmark year when hedge funds showed their added value."

But not all hedge funds thrived. The industry's overall growth comes in a year when the most visible hedge fund managers stepped aside. Mr George Soros and Mr Julian Robertson, who in 1998 each presided over more than \$US20 billion, suffered stinging losses more recently. One reason is that both men ran macro funds, which make big bets on the direction of global stock, bond, commodity and currency markets and borrow money to increase the stakes.

As the market has grown increasingly volatile and stock indices routinely moved 5 per cent up or down on any given day, macro managers' positions

became increasingly perilous. In March, Mr Robertson, who largely avoided technology stocks, closed his Tiger Management hedge fund empire. Mr. Soros did invest in some Internet stocks, but he was hurt by them and by bets on the euro, the unified European currency. He started scaling back his investment empire in April and turned his flagship Quantum fund into an endowment, signalling a throttling down of his strategy that caused most of his investors to depart.

The New York Times

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