

Der Einsatz von Hedge Funds als Alternative in (institutionellen) Portfolios

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Basel, 21 Januar 2016



Introduction

Ineichen Research & Management AG (“IR&M”)

- **IR&M** is an independent research firm domiciled in Switzerland
- Two products:
 - **Absolute returns research**
 - **Risk management research**
- info@ineichen-rm.com
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Which return sequence do you prefer?

Portfolio A:

-11%

+2%

+105%

Portfolio B:

+42%

+32%

+25%

Magic of compounding

Putting it differently:

- EUR100 invested in European stocks in January 2000 grew to **EUR153** by Dec 2015
- EUR100 invested in European hedge funds in January 2000 grew to **EUR337** by Dec 2015

“Compound interest is the eighth natural wonder of the world and the most powerful thing I have ever encountered.”

—Albert Einstein

“The first rule of investment is **don't lose**. And the second rule of investment is don't forget the first rule. And that's all the rules there are.”

—Warren Buffett

“Nature”

“Man-made”

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2015	-3.1	5.5	-1.7	0.9	1.0	-2.1	2.0	-6.3	-2.6	8.3	0.1	-1.8	2015	0.0	1.9	0.4	1.0	0.6	-1.2	-0.5	-2.4	-1.4	1.7	0.2	-0.8
2014	-3.6	4.3	0.7	0.6	2.1	1.9	-1.5	3.8	-1.6	2.3	2.5	-0.4	2014	-0.5	2.0	-0.3	-0.2	0.9	1.3	-0.6	1.2	-0.9	-0.4	0.8	-0.2
2013	5.0	1.1	3.6	1.8	2.1	-1.5	4.9	-3.1	3.0	4.5	2.8	2.4	2013	2.5	0.1	0.9	0.6	0.5	-1.5	1.3	-0.7	1.6	1.5	0.9	1.0
2012	4.4	4.1	3.1	-0.7	-6.3	4.0	1.3	2.0	2.4	-2.0	0.3	0.7	2012	2.8	2.1	-0.2	-0.5	-2.6	0.3	0.9	0.8	1.3	-0.4	0.4	1.4
2011	2.3	3.2	-0.1	2.8	-1.4	-1.8	-2.1	-5.7	-7.2	10.8	-0.5	0.9	2011	0.4	1.2	0.1	1.5	-1.2	-1.2	0.2	-3.2	-3.9	2.7	-1.3	-0.4
2010	-3.7	2.9	5.9	1.5	-8.2	-5.4	6.9	-4.7	8.8	3.7	-0.2	6.5	2010	-0.8	0.7	2.5	1.2	-2.9	-1.0	1.6	-0.1	3.5	2.1	0.2	2.9
2009	-8.6	-11.0	8.5	9.4	5.3	0.0	7.4	3.4	3.6	-2.0	5.7	1.8	2009	-0.1	-1.2	1.7	3.6	5.1	0.2	2.5	1.3	2.8	-0.2	1.5	1.3
2008	-6.1	-3.5	-0.6	4.8	1.1	-8.6	-1.0	1.2	-9.1	-16.9	-7.5	0.8	2008	-2.7	1.5	-2.2	1.6	1.9	-1.3	-2.3	-1.4	-6.1	-6.8	-2.7	0.2
2007	1.4	-2.2	1.0	4.3	3.3	-1.8	-3.2	1.3	3.6	1.5	-4.4	-0.9	2007	1.1	0.7	1.0	1.8	2.0	0.7	0.1	-1.5	2.7	2.8	-2.2	0.5
2006	2.5	0.0	1.1	1.2	-3.1	0.0	0.5	2.1	2.5	3.2	1.6	1.3	2006	3.5	0.5	2.0	1.9	-1.6	-0.2	-0.2	1.0	0.2	1.8	2.1	1.5
2005	-2.5	1.9	-1.9	-2.0	3.0	0.0	3.6	-1.1	0.7	-1.8	3.5	-0.1	2005	-0.2	1.8	-0.9	-1.5	1.0	1.6	2.3	0.8	1.9	-1.4	1.7	1.8
2004	1.7	1.2	-1.6	-1.7	1.2	1.8	-3.4	0.2	0.9	1.4	3.9	3.2	2004	2.0	1.2	0.5	-1.5	-0.3	0.8	-1.0	0.1	1.6	0.8	2.8	1.6
2003	-2.7	-1.7	0.8	8.1	5.1	1.1	1.6	1.8	-1.2	5.5	0.7	5.1	2003	0.7	0.0	0.1	2.6	3.6	1.3	1.3	1.8	1.2	2.4	1.1	1.9
2002	-1.6	-2.1	3.7	-6.1	-0.9	-7.2	-7.9	0.5	-11.0	8.6	5.7	-6.0	2002	0.4	-0.7	1.9	0.3	0.0	-1.9	-2.9	0.5	-1.5	0.6	2.1	-0.2
2001	3.5	-9.2	-6.4	7.7	0.5	-2.5	-1.1	-6.4	-8.2	1.8	7.5	0.8	2001	3.4	-2.2	-1.6	2.0	1.2	0.3	-0.8	-0.4	-2.8	2.0	2.1	1.7
2000	-5.1	-2.0	9.7	-3.1	-2.2	2.4	-1.6	6.1	-5.3	-0.5	-8.0	0.4	2000	0.6	6.2	0.9	-2.8	-2.0	3.7	-0.6	3.8	-1.2	-1.8	-3.5	2.1
1999	4.1	-3.2	3.9	3.8	-2.5	5.4	-3.2	-0.6	-2.9	6.3	1.9	5.8	1999	2.2	-1.3	3.1	4.5	0.7	3.6	0.5	0.0	0.2	1.6	5.1	7.7
1998	1.0	7.0	5.0	0.9	-1.9	3.9	-1.2	-14.6	6.2	8.0	5.9	5.6	1998	-0.7	3.3	3.0	1.0	-2.1	-0.1	-0.8	-8.7	0.7	1.2	3.7	2.8
1997	6.1	0.6	-4.3	5.8	5.9	4.3	7.8	-5.7	5.3	-3.4	4.5	1.6	1997	3.2	1.0	-1.6	-0.1	4.4	2.7	3.9	0.3	3.7	-1.5	-0.9	0.9
1996	3.3	0.7	0.8	1.3	2.3	0.2	-4.6	1.9	5.4	2.6	7.3	-2.2	1996	2.9	1.2	1.5	4.0	3.1	0.2	-2.1	2.3	2.1	1.0	2.1	1.3
1995	2.4	3.6	2.7	2.8	3.6	2.1	3.2	0.0	4.0	-0.5	4.1	1.7	1995	-0.2	1.3	1.7	2.1	1.7	2.5	3.2	2.2	2.0	-0.7	1.9	2.1
1994	3.3	-3.0	-4.6	1.2	1.2	-2.7	3.1	3.8	-2.7	2.1	-4.0	1.2	1994	2.5	-0.6	-1.5	-0.6	0.7	0.3	1.3	2.5	0.9	0.0	-1.3	-0.1
1993	0.7	1.0	1.9	-2.5	2.3	0.1	-0.5	3.4	-1.0	1.9	-1.3	1.0	1993	2.3	1.3	3.1	1.5	2.6	2.6	2.1	2.9	1.6	3.2	0.1	3.9
1992	-2.0	1.0	-2.2	2.8	0.1	-1.7	3.9	-2.4	0.9	0.2	3.0	1.0	1992	3.8	2.1	0.6	0.3	1.8	-0.4	2.1	-0.3	1.9	2.1	2.8	2.5
1991	4.2	6.7	2.2	0.0	3.9	-4.8	4.5	2.0	-1.9	1.2	-4.4	11.2	1991	2.6	4.0	4.9	1.3	2.0	0.4	2.6	2.1	2.3	1.8	0.3	3.9
1990	-6.9	0.9	2.4	-2.7	9.2	-0.9	-0.5	-9.4	-5.1	-0.7	6.0	2.5	1990	-2.1	1.5	3.2	0.0	3.1	2.1	1.5	-3.4	-2.0	0.0	0.8	1.3

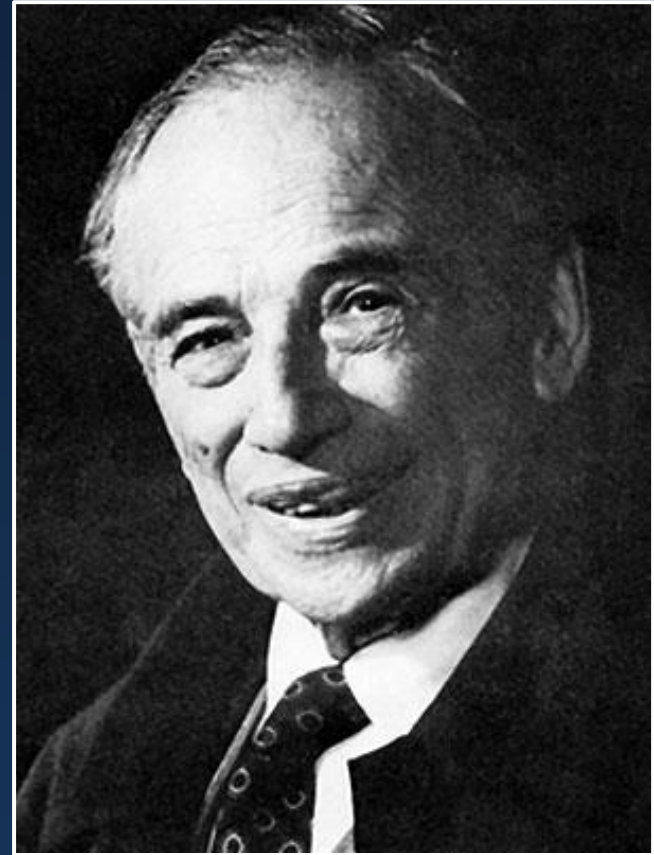
Source: IR&M, Bloomberg. Based on S&P 500 and HFRI Fund Weighted Composite.

Hedge funds are the archetype AM

Long-only \neq absolute returns

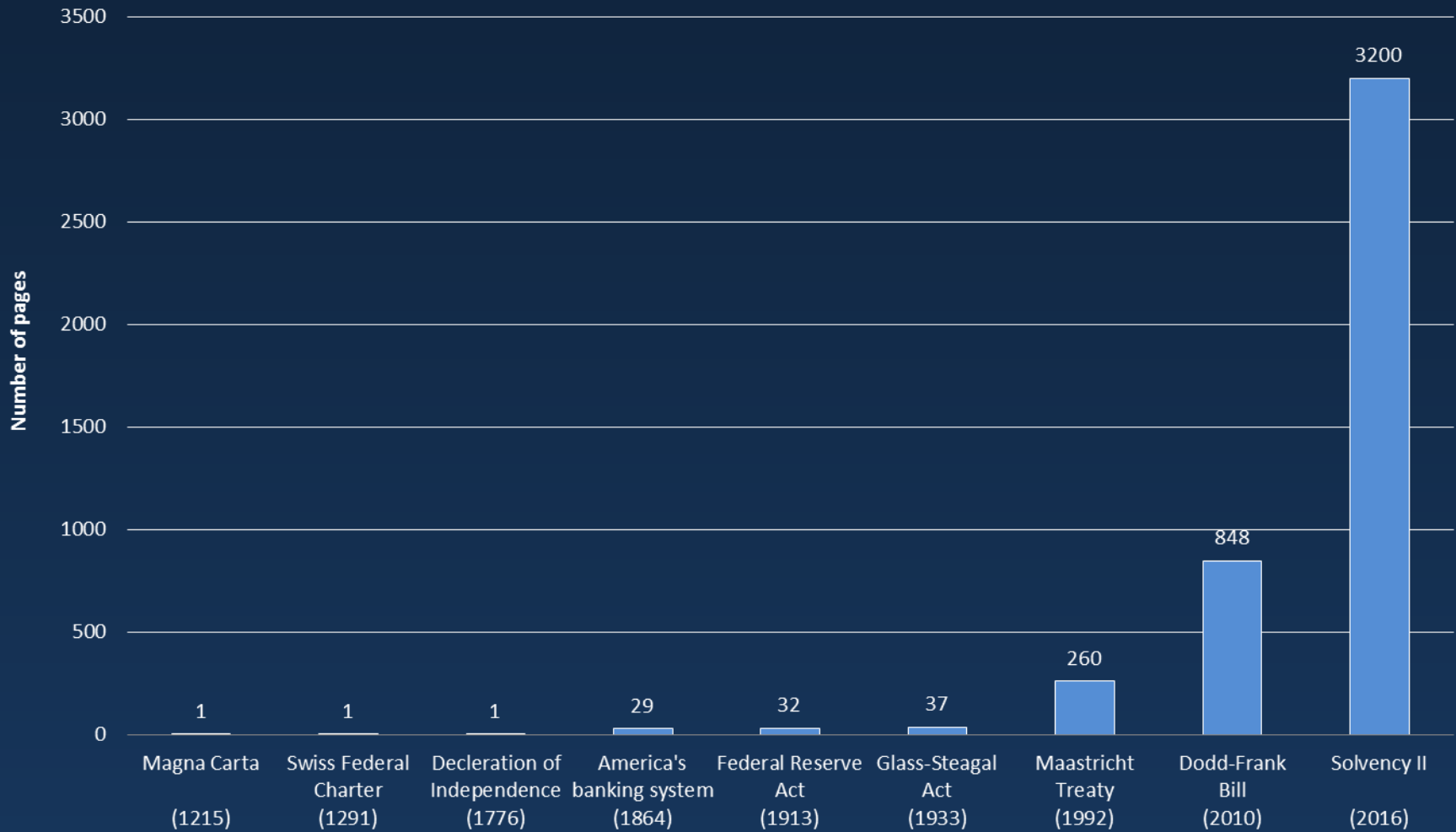
“The essence of investment management is the **management of risks**, not the management of returns.”

—Benjamin Graham



Bureaucracy bubble

No time to manage risk



Hedge funds manage risk differently

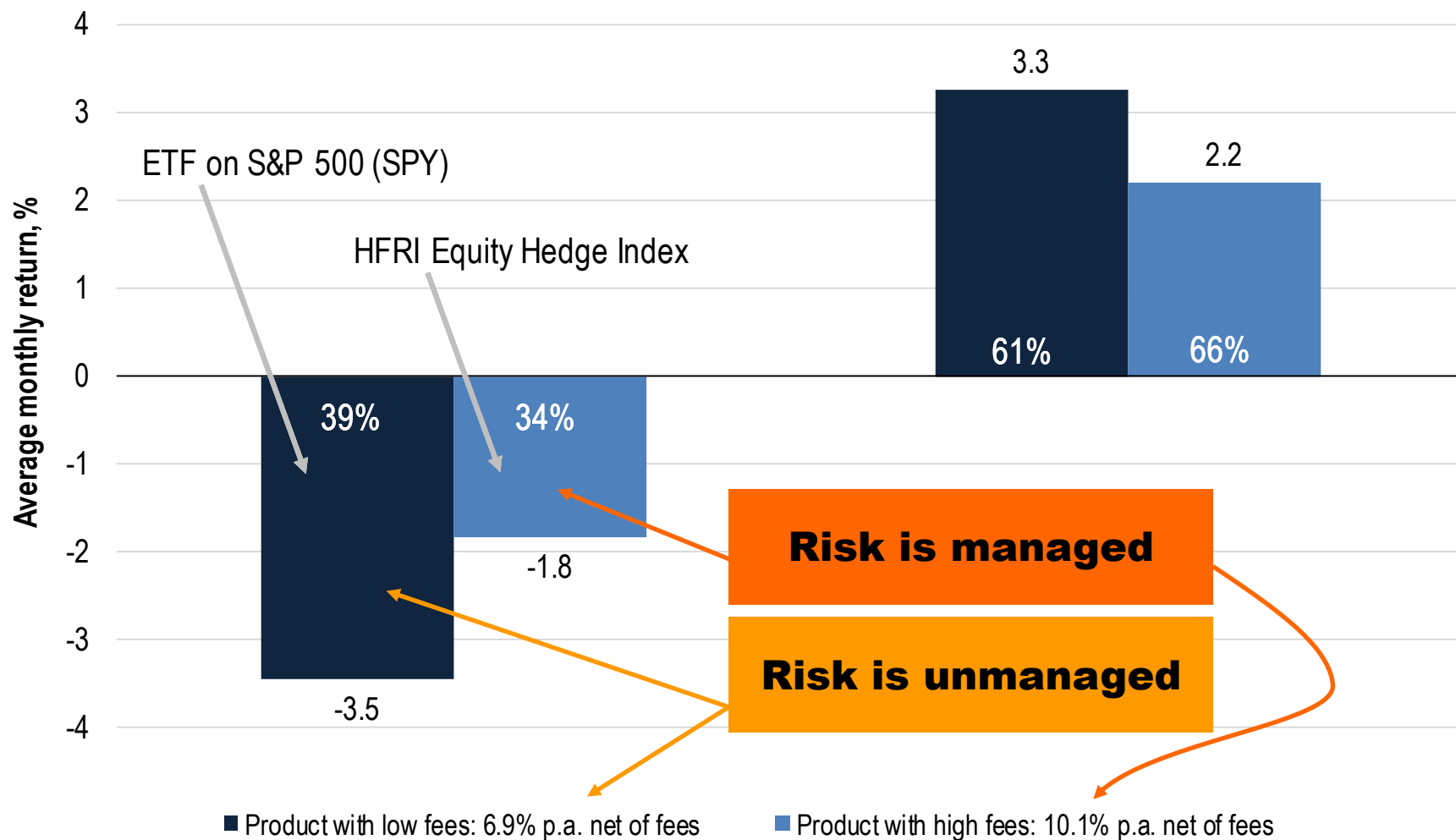
Absolute returns investment philosophy seeks asymmetry between profit and loss

	Relative-return model (Indexing and benchmarking)	Absolute-return model
Return objective <i>General idea is to</i>	Relative returns <i>Replicate or beat benchmark</i>	Absolute returns <i>Exploit investment opportunity</i>
Risk management <i>General idea is to</i>	Tracking risk <i>Replicate or beat benchmark</i>	Total risk <i>Preserve capital</i>

-control accidents
-avoid negative compounding

Asymmetry in long/short

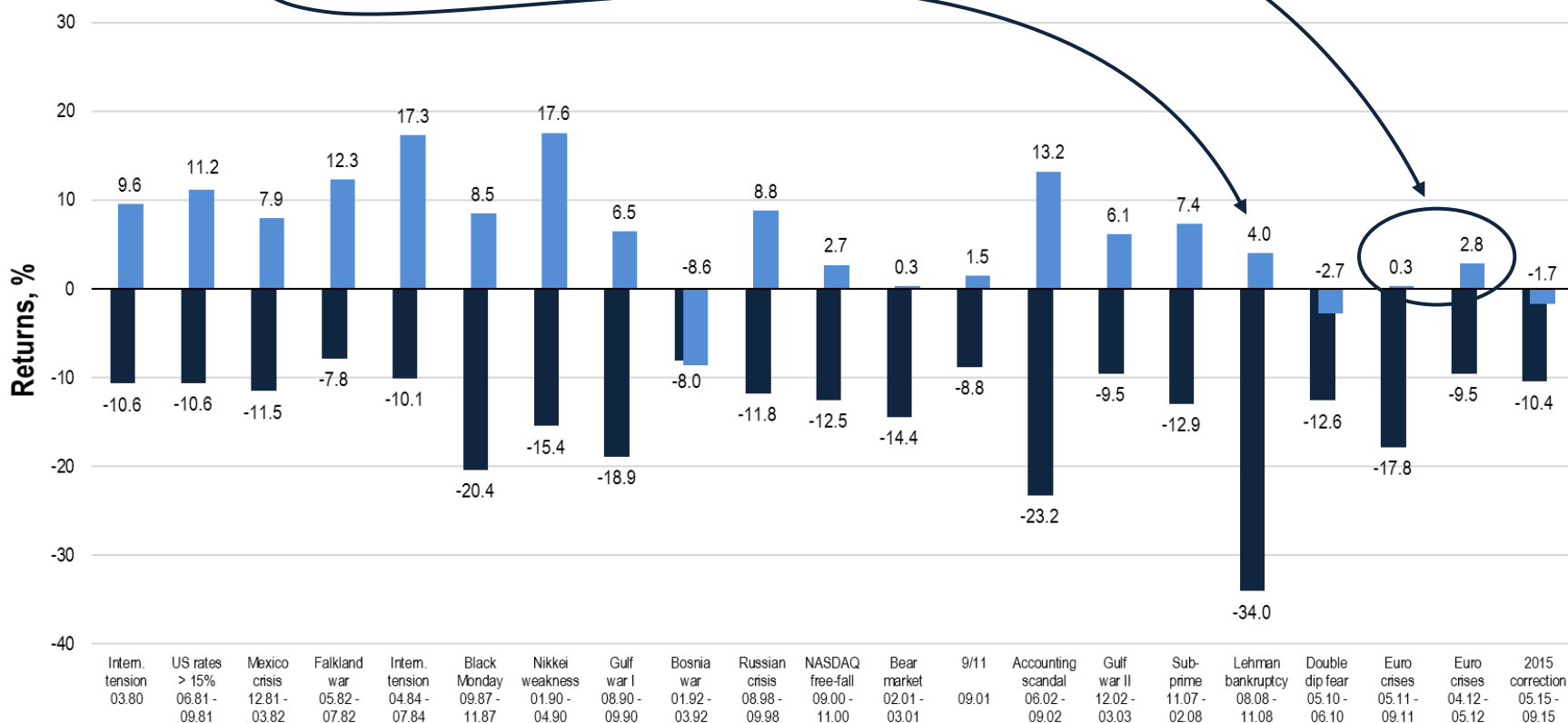
Potential target: 80% of upside with 50% of downside



Source: IR&M, Bloomberg. January 1993 – December 2015.

Asymmetry in managed futures

Positive return in 18 out of 21 difficult market environments including 2008 and Euro crises.



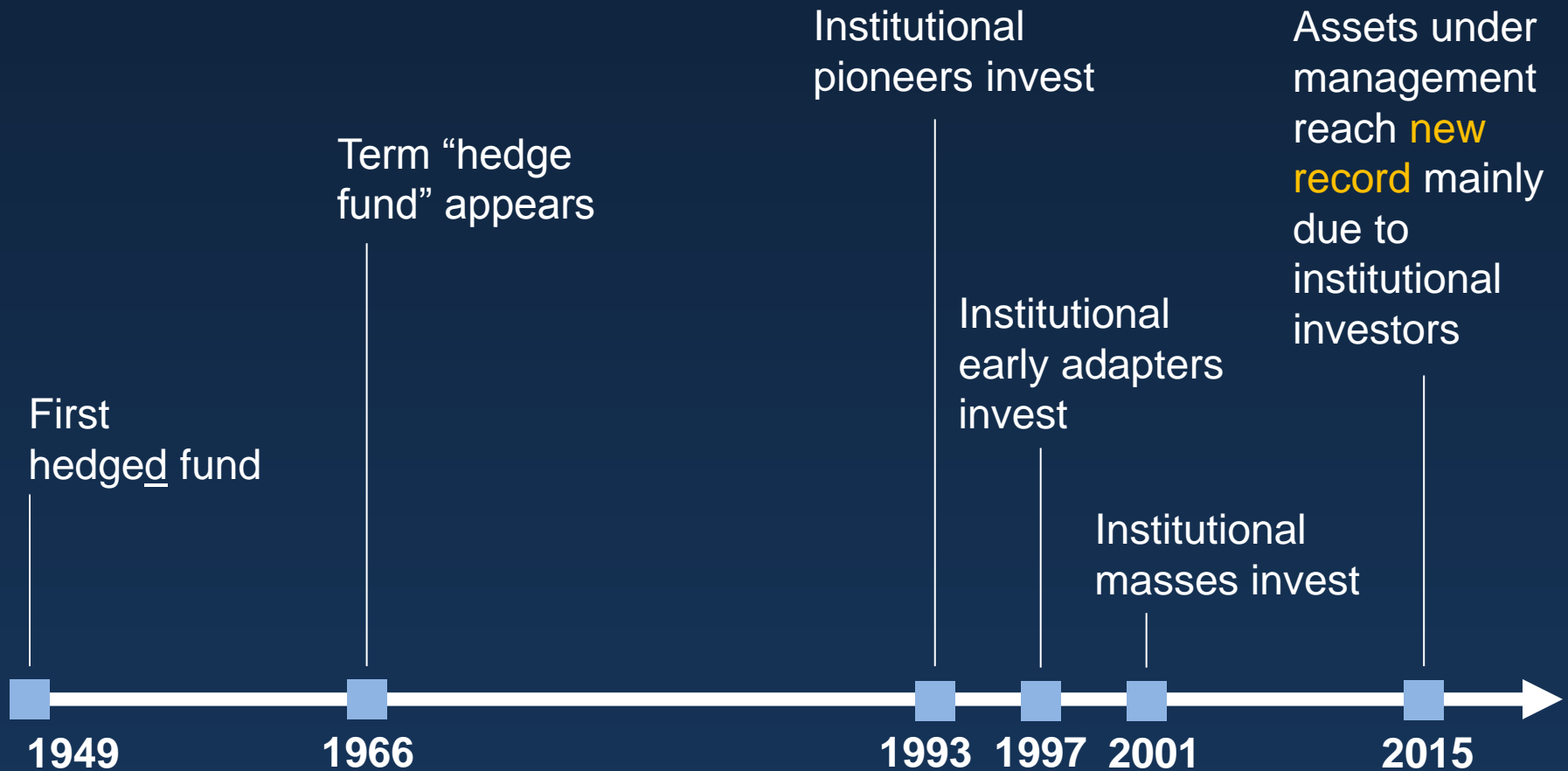
■ Global equities* ■ Managed futures**

Source: IR&M, Bloomberg. Chart shows all losses for the MSCI World larger than 7% over 1, 2, 3, or months since 1980.

* MSCI Daily TR Gross World USD Index; ** CISDM CTA Asset Weighted Index formerly known as CISDM Trading Advisor Qualified Universe Index to October 2010, DJ CS Managed Futures Hedge Fund Index thereafter.

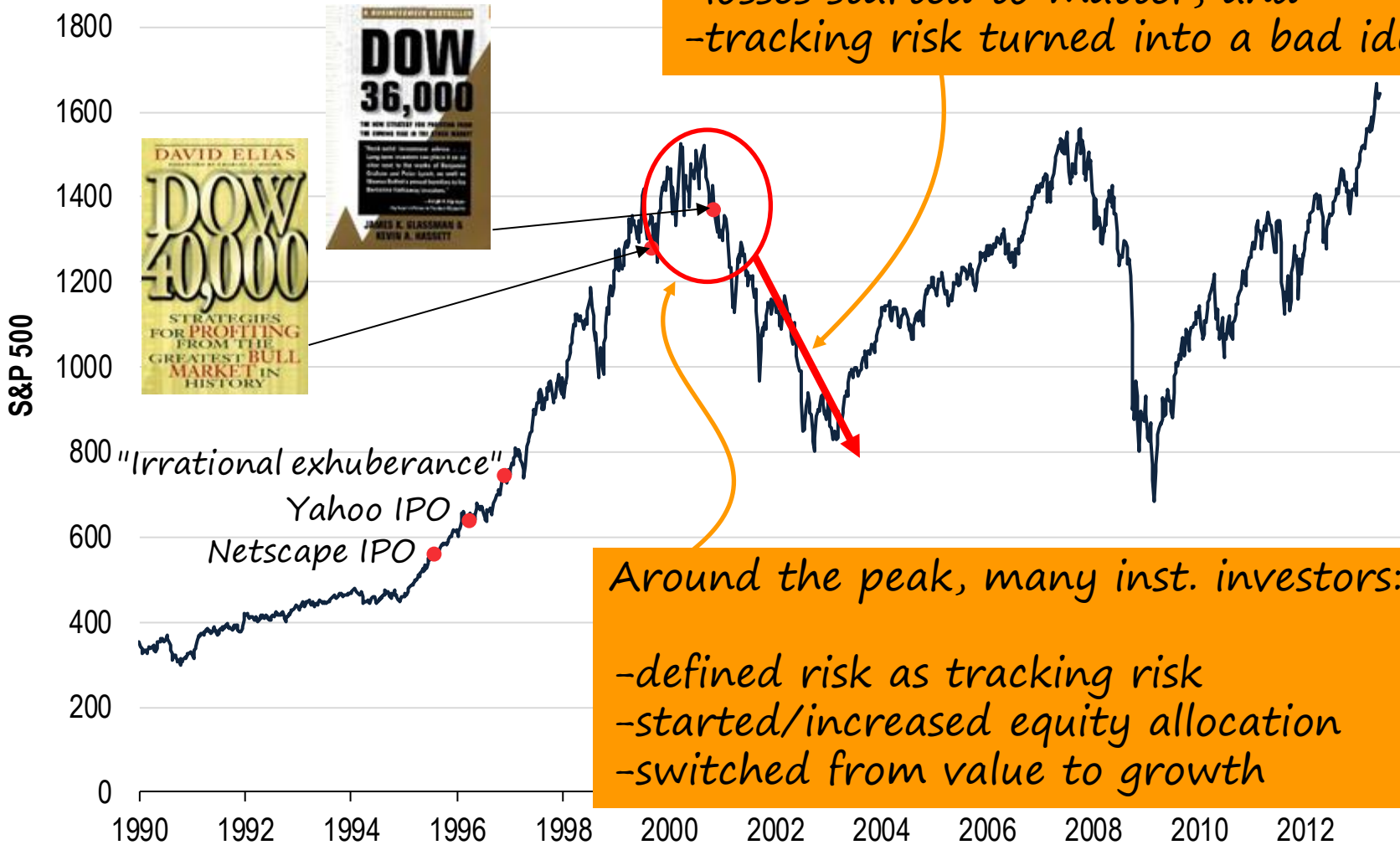
Hedge fund history

AuM at new all-time high



Institutionalisation of hedge funds

Losses matter



Source: IR&M, Bloomberg, Book publishing dates from amazon.com

Equity hedge: underwater perspective



Source: IR&M, Bloomberg. Based on Topix Total Returns Index and Eurekahedge Japan Long/Short Index, January 2000 to December 2015.

Summary

Hedging is not for sissies

Avoiding large losses is key to **compounding capital** positively

Trying to find an **asymmetry** is the trick

Implementation requires:

active risk management

Either insourced or outsourced

Thank you

Questions?

Risk management research

Absolute returns research



IR&M Risk management research

Europe doubling down

This is the inaugural piece of our new research related to active risk management.

The financial landscape is a mess. Europe is leaning up, i.e., doubling down. The investment discipline that addresses macro uncertainty, dislocations, negative compounding, capital erosion, governmental malfeasance and unsustainable Ponzi-like optated schemes is active risk management. This is arguably a big task that reaches far beyond the mathematically elegant mean-variance space of the orthodox world of VaR.

3 October 2011

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Feature

IR&M Risk management research

Summary

The main change since 16th February was long-term momentum in the UK turning positive, at (FTSE All-Share) or close (FTSE 100) to its all-time high.

06 August 2012

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Whatever it takes

- Global economy continues to decline.
- July PMI resumed falling tendency and remain below 50.
- Services PMI were around 50 and stable.
- Business sentiment peaked in March and continues to decline.
- Average consumer sentiment has been rising from December to April and has been quite stable lately.
- US economy continues to decline.
- European economy is still in decline. The ECB will do whatever it takes (whatever that means).
- China's economy is declining. Another red flag popped up as freight exports fell below that of 2011.
- Japan's economy continues to decline.
- Sovereign risk: Spain's yield curve has been rhetorically relaxed.

IR&M Absolute returns research

Hedge fund performance

Ineichen Research and Management ("IRM") is a research firm focusing on investment themes related to absolute returns and risk management.

25 February 2013

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When Reality Kicks

Executive summary

- Investors face various challenges. Capitalism is on a subparical. The miscalculation of capital continues. Reproductomics reigns. Debt levels are rising. Demographics are not helping. Governmental intervention into free markets is rising continuously. Many industrial economies have been robbing Peter to help Paul. But now they need to rob Tom, Dick, and Harry to help Peter.
- If something cannot go on forever, it won't. Herbert Stein's Law applies. The uncertainty with regards to the timing of the homocoring choices to be adopted is a challenge for all investors.
- Modern Portfolio Theory suggests there is such a thing as an "efficient frontier" where the trade-off between expected risk and expected return can be "optimized." However, there are many constraints that make asset allocation using a two-dimensional model an almost comical endeavor. Many viable investments for the flexible and sophisticated investor simply do not fit into a two-dimensional grid. The ideal portfolio is a well balanced portfolio that is regularly rebalanced and reasonably well understood by all who carry responsibility. Continuous learning as well as continuous search for new sources of returns is part of the response to the challenges investors face today.
- Risk as well as risk management are terms that are not clearly defined. The ambiguity of terms is probably a challenge for the fiduciary. The regulatory and accounting standards might be out of sync with good practice thereby depriving incentives for the various investment management and governance bodies. Potentially, it's a balancing act between doing what is right and what is right.
- The investment landscape has opened to all kind of asset classes and investment forms. Savvy, flexible, sophisticated, intellectually-open minded, well-planned, well-connected, and well-balanced investors will be picking up liquidity and complexity premiums along the way. Bureaucratized, regulatory-burdened, liability benchmark, hedging, and mean-variance-optimization-worshipping investors won't.

IR&M Risk management research

Nowcasting and financial wizardry

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One of the greatest in economic wisdom is to what you do not know —John Kenneth Galbraith

13 January 2015

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Executive summary

- Nowcasting is to forecasting what astronomy is to astrology. At the beginning of 2014, 72 out of 73 economists "predicted" that US interest rates would rise throughout the year. They fell. One ought to know what one doesn't know. It's always experts—often well-educated professionals who do not suffer from a lack of self-confidence—who do the silly forecasts. It's like the silly people know better.
- Expert failure extends far beyond the investment scene. The problems often reside in man's information processing capabilities. The expert is a serial or sequential processor of data who can only handle information reliably in a linear manner. Experts can not only analyse information incorrectly, they can also find relationships that are not there → a phenomenon called illusory correlation.
- Research indicates that subjective models are better than an expert's view and objective models are better than subjective models.
- Nowcasting is the economic discipline of determining a trend or a trend reversal objectively in real time. Nowcasting is fact-based, focuses on the known and knowable, and therefore avoids forecasting. Nowcasting is the basis of a robust decision-making process.
- A "nowcaster" does not try to predict the future but focuses what is known today, i.e., "know now in real time. Forecasts are an integral part of orthodox stock selection and are essentially guesswork. In other words, guessing is an integral part of how experts are allocated and risk is taken. There is an alternative, a focus on facts rather than forecasts. A trend is a fact, whereas a forecast isn't. It's someone's intuition. An institutional investment process focusing on facts seems more logical than an investment process that focuses on intuitions.
- Risk is exposure to change. Nothing lasts forever. The situation will change eventually. Forecasting the change is a mug's game. Nowcasting the change in real time will elevate the investor's conviction in the change and allow for more disciplined and robust—and therefore more intelligent—decision making.

IR&M Risk management research

Update for onscreen viewing

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