Hedge Fund Investing Envy

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Are hedge funds worth it?

So many individual investors have felt they have been left out of the opportunities only afforded to the very rich, especially when it comes to hedge funds. Hedge funds were originally designed to provide an alternative investment to a traditional portfolio of stocks and bonds that would perform in a noncorrelating manner. Noncorrelating means that the investment would not move in lockstep with stocks or bonds but react to different influences, which, when combined with other assets classes, could reduce a portfolio's volatility. Having stocks, bonds and hedge funds all moving in their own directions would potentially result in less volatile moves than stocks and bonds alone.

Adding a hedge fund to one's investment mix could potentially add returns when other strategies were not performing well, thereby boosting the portfolio's overall return. Essentially, ultra-wealthy investors considered hedge funds a 'win-win' portfolio addition because they were purported to lessen volatility and add return.

Hedge funds have evolved and now refer to about any type of nontraditional investing. It is hard to tell how much risk a particular hedge fund strategy has imbedded in its process – and there lies the problem. Many of firms managing hedge funds can back-test their investment processes, which show stellar returns, but back-testing only tells you so much.

Take for instance Long-Term Capital Management, which flamed out in spectacular fashion in the late 1990s. The Federal Reserve wound up bailing out the fund. Its proposed strategy was based on back-testing various derivative strategies for which its founder, John Meriwether, and some colleagues received a Nobel Prize for Economic Sciences.

From the outside, it is difficult to understand the amount of risk a hedge fund's manager are taking on and how protected an investment will be under various market conditions. In addition, for all the unknowns, most funds charge a 2 percent management fee, whether they make or lose money, and an additional 20 percent of the profits.

If you still feel disappointed you have missed out on the hedge fund craze, consider the performance. The most commonly cited hedge-fund index, the Hedge Fund Research, Inc.(HFRI), Fund Index, is up 8.25 percent in the last 12 months as compared to the Total U.S. Stock Market Index, which has risen approximately 21 percent. For the last three years, the HFRI Fund Index is up 4.91 percent versus the Total U.S. Stock Market Index at 18.60 percent.

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Tags: **finance**, **investments**, **making the most of your money**

About Susan Carr-Templeton

Susan Templeton is the founder of Stafford Wells Advisors, a wealth management firm serving individuals, families and businesses and advising workplace retirement plans. Stafford Wells was founded in 2008 with the mission of delivering independent, complete, unbiased investment and planning advice, free of any conflicts of interest. Susan Templeton has more than 20 years experience in investment management. She received her B.S.B.A. degree in marketing from the University of Denver and her M.B.A. from the University of Chicago. Susan is a trustee for the Advocate Foundation where she chair's the Planned Giving Committee and is a member of the Investment Committee. Susan serves on the investment committee for the Visiting Nurse Association (Chicago) and is a former trustee of the Village of Oak Brook Police Pension Plan.