ACTIVE SUPER

FACTSHEET

HEDGE FUNDS

Hedge Funds are often used to reduce overall portfolio risk as they manage investments designed to offset the potential losses of other investments.

These funds use a wide range of securities, instruments and strategies to provide positive returns, regardless of the underlying security market movement. Hedge funds have been used to lower the overall volatility of a portfolio.

TYPES OF HEDGE FUNDS

- **Absolute return:** These funds are managed like standard managed funds but incorporate specific strategies unique to hedge funds (such as short selling, arbitrage and global asset allocation). The overall performance of these funds is not compared to benchmarks like share market indices (i.e. All Ordinaries, Dow Jones, etc.) because they are focused more on providing positive investment returns in all market conditions.
- **Positive risk adjusted return:** These are funds where only the investment management activities incorporate hedge fund strategies and non-traditional asset classes. The performance of these funds is also focused on providing positive returns rather than being compared to a benchmark.

Two structures that hedge funds undertake

- **Single manager/single strategy:** Where the fund relies on one investment team and specialises in one area.
- **Multi-strategy/fund of funds:** Consolidates a range of specialist hedge funds to enable further diversification.

Strategies used by absolute return funds

- **Short selling:** Is where sellers borrow and then sell shares anticipating a price decline, then the shares are bought back at a lower price.
- **Arbitrage:** Where a fund manager identifies a relative mis-pricing between related securities within and across markets.
- **Global asset allocation:** Involves the use of research to exploit movements in different industry sectors, currencies and share markets.

ISSUES TO CONSIDER

- A key influence on the performance of a hedge fund is the investment manager's skill and experience. Positive returns are more likely if the investment manager has made a correct judgement about the particular security. Therefore, it is important to pick the right manager. Factors such as qualifications and experience of the management team and the stability and substance of the investment team, can greatly influence the return on the investment.
- Many managers rely on short-term market mis-pricings to generate a return and so aren't likely to release information on their processes and strategies. This makes research and evaluation more difficult.
- Valuations of hedge funds are infrequent, making it difficult to accurately value a portfolio which results in a long turnaround time for transactions.
- Given the goal of producing lower volatility, these investments have experienced less severe negative returns. However, average historical returns of hedge funds have shown that the positive returns have also been lower than standard managed funds.

NEED FURTHER INFORMATION?

If you would like further information or the address of your local branch, please visit our website at activesuper.com.au or contact Member Services on 1300 547 873 between 8.30am and 5.00pm, Monday to Friday.

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