

Revisiting Hedge Fund Investments

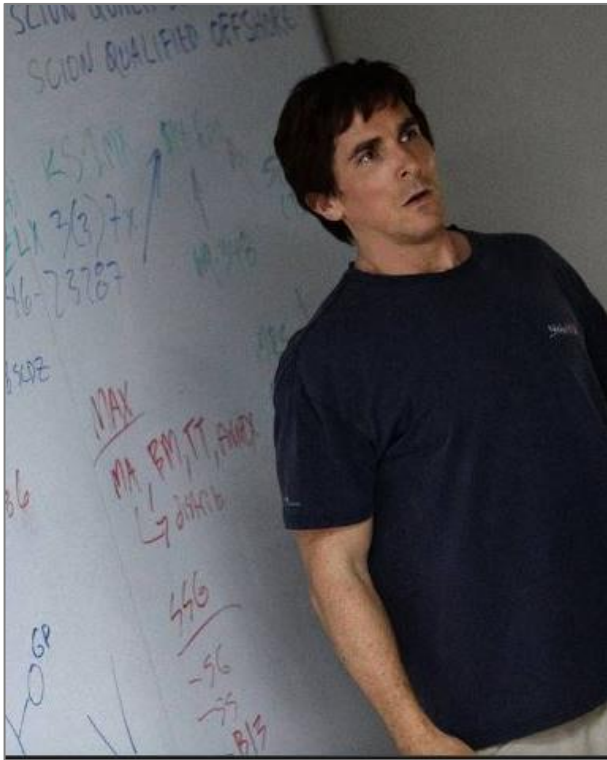
CHRIS GRECO, CEO
WAYCROSS PARTNERS



2023 Winter Trustee School



What We Think of When We Hear “Hedge Fund”



The Role of Low-Volatility Long/Short Equity



What is a Hedge Fund?

- Australian investor and financial writer Alfred Winslow Jones is credited with launching the first hedge fund in 1949.
- Investment fund that trades to take advantage of both rising and falling prices.
- Hedge funds have freer rein to invest in a wider variety of financial products.
- There are over 3,500 hedge funds worth a total of \$3.35 trillion.

Goals for Today

- Understand the Hedge Fund Universe
- Identify Low-Risk and High-Risk Hedge Funds
- Questions to Ask your Consultant or Investment Manager



What Makes a Hedge Fund Different?

- Wider investment latitude
- Can short stocks, use options
- Use of leverage or borrowed money
- Fee structure

Popular Hedge Fund Strategies

Equity Strategies

Long Short Equity
Market Neutral
Long-Bias
Short-Bias
Value-Oriented

Event Driven

Special Situations
Risk/Merger Arbitrage
Opportunistic
Activist

Relative Value

Relative Value Arbitrage
Statistical Arbitrage
Fixed Income Arbitrage
Capital Structure Arbitrage

Credit

Specialist Credit
Long/Short Credit
Fixed Income Credit
Mortgage-Backed

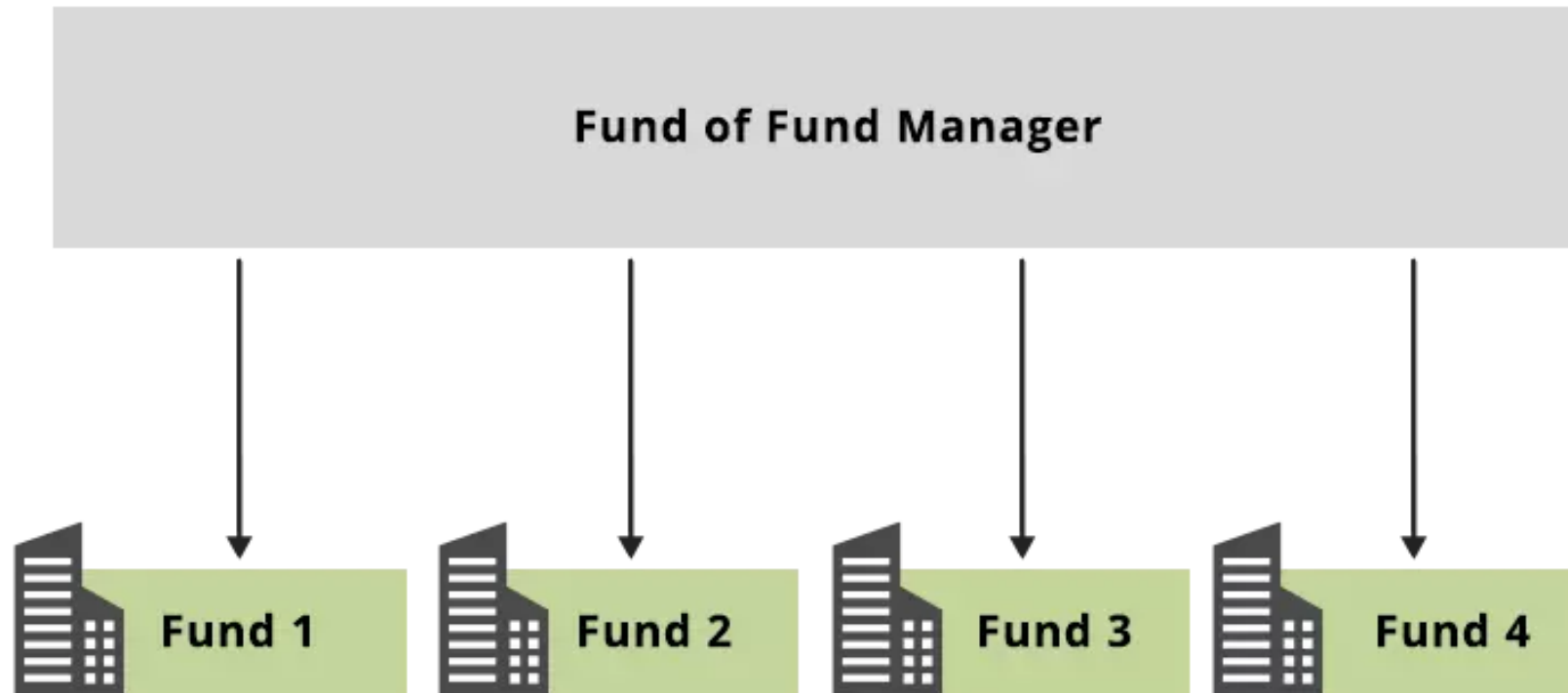
Futures Funds

Macro Funds
Managed Funds

Niche

Cryptocurrency
Insurance-linked
Real Estate

Fund of Funds: What are They?



What is Leverage?

- Borrow money to buy more long positions
- Borrow stocks to short
- Overall, it will exaggerate your returns in BOTH directions.

How to Create a Low-Risk Hedge Fund

- Minimal or no use of leverage
- Sector diversification
- Net exposure less than 100%

Lower Risk Hedge Fund

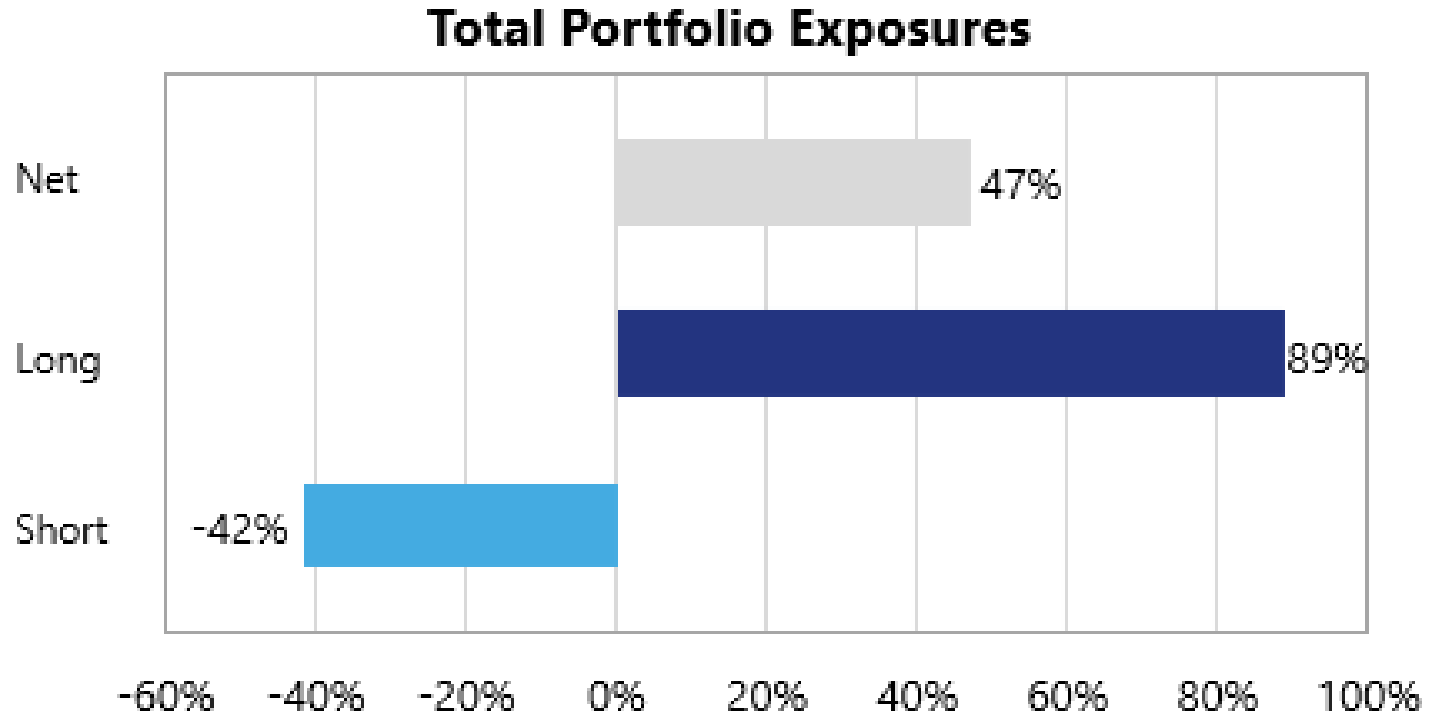
- Typical long/short equity strategies
- Liquid and net long
- Gross exposures at 70%-90% long vs. 20%-50% short

Lower Risk Hedge Fund

- Typical long/short equity funds return profiles
 - Aim to achieve average returns roughly equivalent to long-only approach
 - Standard deviations 50% lower than long-only approach

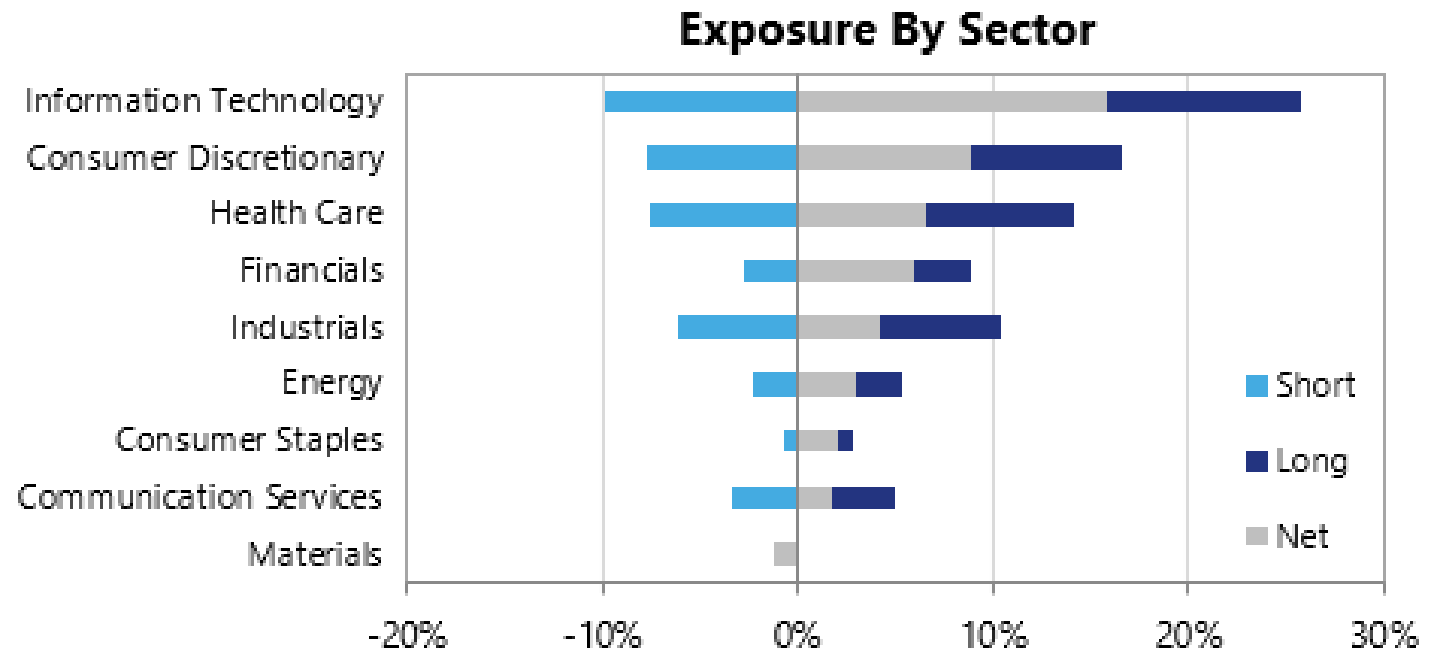
Long Exposure + Short Exposure = Net Exposure

How to Build a Long/Short Hedge Fund



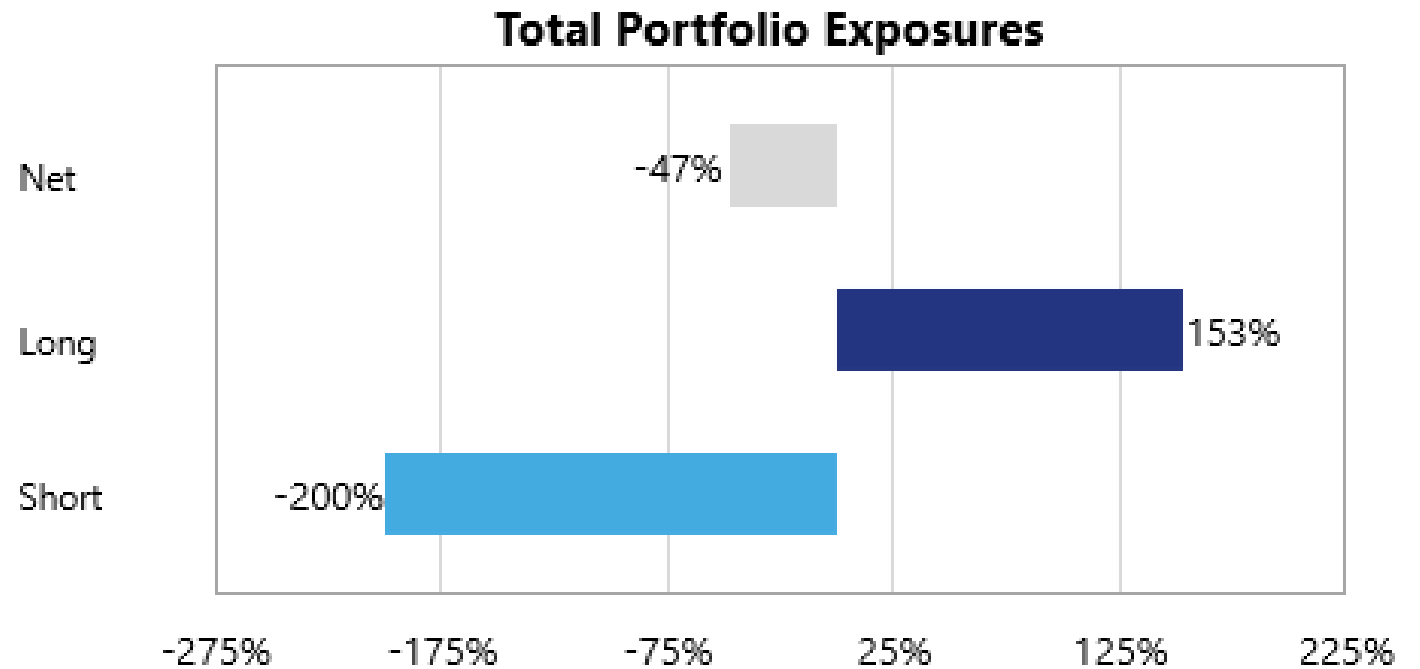
How to Build a Long/Short Hedge Fund

➤ Let's Look at the Sector Level Exposure

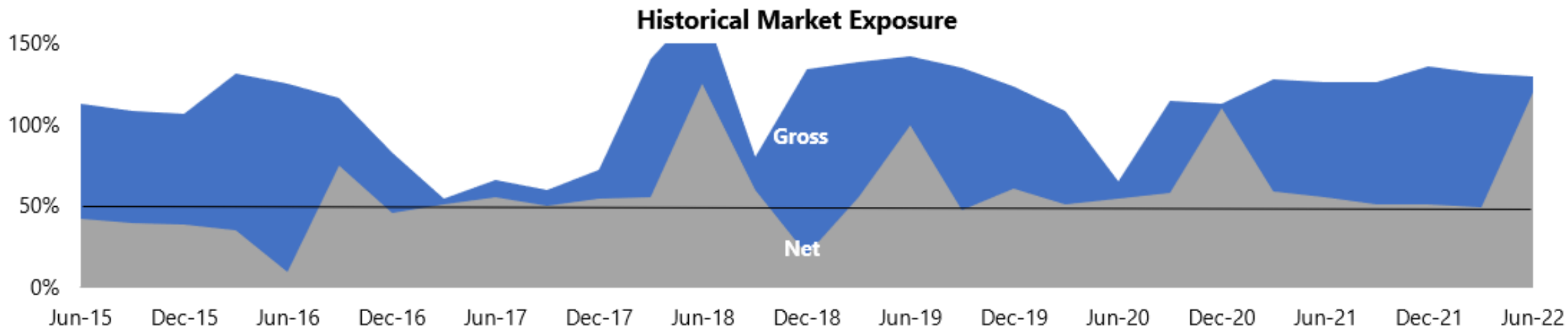


Leverage
Exposure
(adding risk)

➤ Borrowing Money Exaggerates Risk

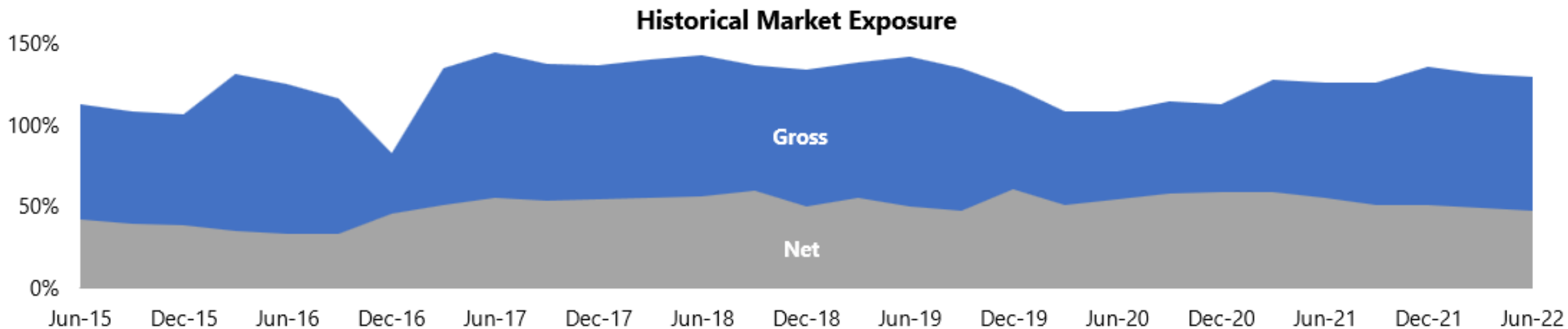


Understanding How a Portfolio Can Change Over Time



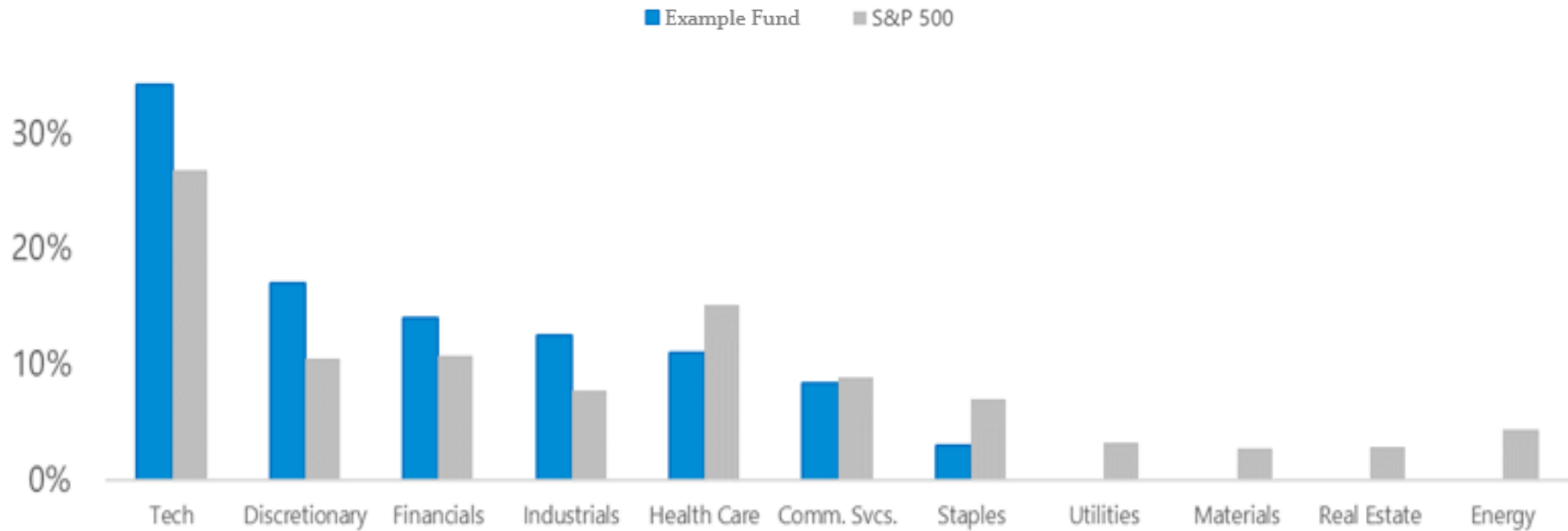
Inconsistent Exposure

Understanding How a Portfolio Can Change Over Time



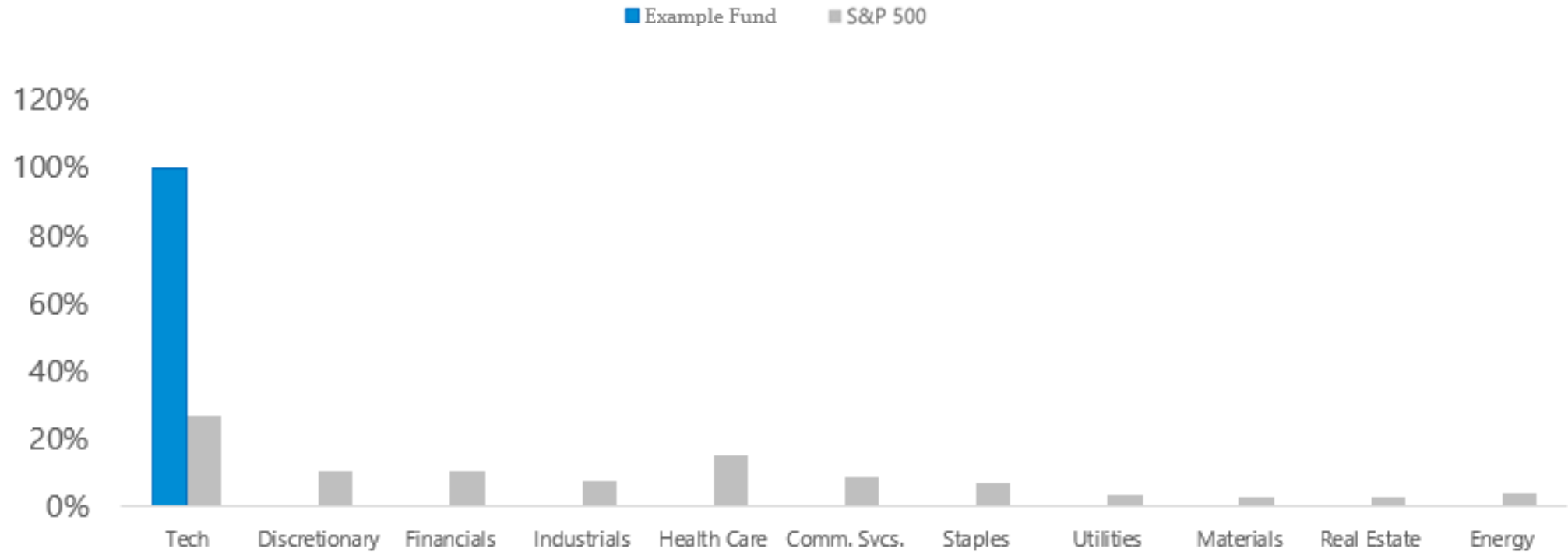
Consistent Exposure

Sector Diversification



More Sectors Help Reduce Risk

Sector Diversification



Sector Risk

Questions to Ask Managers

How much leverage do you use?

How many sectors do you invest in?

Do you change your Gross and Net exposure over time?

How many stocks do you own?

Key Takeaways

The image of the Hedge Fund is often misleading.

Hedge Funds can either help lower or increase your risk.

Find out the risk profile of any hedge fund you are considering.