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Helping investors hedge their bets

BY BARRY O'NEILL

Top hedge-fund managers can earn extraordinary amounts of money, with the highest-grossing receiving hundreds of millions of pounds, but the man in the street will admit to a complete lack of understanding about what hedge funds are.

Their original purpose was to help investors to hedge against the risk of market movements.

Hedge funds come in many guises, with very different strategies being employed to generate returns. These include favoured securities being bought in the expectation that the price will go up, while non-favoured securities are sold "short" – where the manager agrees to sell shares they do not own at a future date, in expectation that the price will fall, allowing the manager to purchase the shares at the lower price and make a profit.

A significant headwind for hedge funds to overcome is costs.

If you expect annual investment returns to be in single digits, paying a 2%-a-year management fee plus a performance fee of 20% of profits seems excessive.

One high-profile US hedge fund recently cut its annual charges from an eye-watering 3% plus a 30% performance fee to 2.6% and 27.5% respectively. Bearing in mind investors can buy exposure to the S&P 500 for about a 0.1% a year, it is reasonable to ask who the real winners are between hedge-fund managers and their investors?

Researching the performance of hedge funds has historically not been an easy task due to the almost-voluntary nature of data reporting.

■ Barry O'Neill is investment director for Carbon Financial Partners in Aberdeen and can be contacted on 01224 619215