



ALTERNATIVE INVESTING

Challenges and Innovation in Hedge Fund Management

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The increasing institutionalization of hedge funds brings with it many challenges. These challenges are fostering change and innovation regarding hedge fund management. Clifford Asness faces these challenges head on and provides an assessment of key issues that will arise as a consequence of institutionalization. He finds several notable changes that are under way in the areas of benchmarking, transparency, fees, and risk management.

It is well known that institutional investors require performance benchmarking for managers. Asness covers several ways to accomplish this task, and in the end, he suggests using a series of multiple benchmarks to better match differing portfolio objectives.

A hotly debated issue that has been an ongoing source of concern relates to the degree of manager transparency. To alleviate concerns, he advocates a form of transparency that has great potential for meeting varied (and often competing) investor and manager needs. His approach involves creating a detailed description of the investment process and strategies in an open and transparent way.

Another contentious issue is that of hedge fund fees. In discussing this issue, Asness emphasizes the importance of separating fees by distinguishing between returns from the more valuable unsystematic alpha relative to the less valuable systematic beta.

Methods for risk control are a final source of change. We believe the establishment of an ongoing risk control system to identify and understand sources of risk is quite simply essential to a successful hedge fund operation.

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