Book Review

Reconsidering funds of hedge funds

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During the last financial crisis, funds of hedge funds (FoHFs) had poor returns due to the performance of their underlying hedge fund managers. However, in terms of downside equity risk management, they performed better than global stock market indexes. Furthermore, according to numerous sources, many FoHFs were set up after the crisis to take advantage of the depressed stock market and to attempt to provide investors with a new fee structure under new regulation and new environment. The collection of exclusive chapters written by many seasoned veterans managing FoHFs and academics for this book believe in the steady returns and low volatility offered by these alternative investment vehicles. Many contributors suggest that the landscape is now different after the crisis. Volatility and due diligence are the key criteria in selecting FoHFs along with stress testing the fund's performance during the past negative extreme market event. Although many investors withdrew money from FoHFs, many funds are now producing stable returns and money is plowing back into this sector.

Section 1 of the book introduces the most important issues of due diligence and risk management since the crisis. It examines how FoHFs are now better equipped to deal with

risk management issues in case of another potential crisis in the future. Not much has been published in the due diligence area after the crisis. Many investors are also pushing for more transparency and increased due diligence on the part of the FoHFs manager when it comes to hedge fund manager selection.

Section 2 of the book examines the performance of Undertakings for Collective Investment in Transferable Securities (UCITS) in a universe where the regulation for these products is much more transparent than that of typical offshore FoHFs. One of the particular features of UCITS is their potential steady return they can provide over a lengthy period, due to their muted added-on leverage. Although only a few years of data are available on UCITS, it is interesting indeed to examine how they perform relative to traditional FoHFs. Further, the new UCITS regulation landscape is now changing in Europe and will lay the road for more UCITS compliant funds in the future. Investors today feel more comfortable when regulators can keep a close watch over the positions of a hedge fund or a FoHF and avoid further potential collapses as 2008. The UCITS structure seems to be now a necessity to offer funds at both the retail and wholesale levels and it is generating more interest in the FoHFs area as discussed by numerous

authors. The contributors of this section also discuss how institutional investors and regulators are forging new ties to avoid future disasters or blow-ups.

Section 3 examines the performance of traditional FoHFs before, during and post the crisis with numerous chapters using different statistical techniques. Overall, it seems that there is a consensus that large FoHFs perform better than small FoHFs. Further, the financial crisis in 2008 crisis has induced an important transformation to the FoHFs industry.

Section 4 includes a set of papers that investigate the issue of hedge fund alpha and its consequences on performance. Another set of papers investigates how FoHFs fared during the crisis in terms of risk-adjusted performance measures and analyzes the short-run performance persistence of FoHFs. The contributors in this section also suggest how investors can select top FoHFs that have the ability to generate alpha. Although the post-crisis period represents only a few years, some authors find short-term persistence among FoHFs.

Section 5 examines the hot issue of tail risk and how FoHFs can prepare and protect themselves in 'black swan' events by using various hedging strategies. These derivatives strategies will likely protect FoHFs and provide downside equity risk management in negative extreme market events

when stock markets plunge by 20 per cent or more. Although numerous managers cannot comprehend tail risk, the contributors to this section provide clear views and opinions to address this topic. The last section deals with the new regulatory measures introduced since the crisis and contributors discuss how these measures will impact the US FoHFs industry after the crisis. In addition, two papers focus on countries such as Canada, Australia and South Africa and discuss regulatory reforms for FoHFs.

This collection of exclusive and cutting edge chapters represent the latest research and issues in the FoHFs industry. These new chapters can assist potential investors, FoHF managers, high net worth individuals and family offices by providing new insight in the aftermath of the crisis. The FoHFs industry has now refocused and has put more emphasis on risk management and due diligence than ever before. In conclusion, the editor has done an excellent job of putting together a nice mix papers to inform potential investors to 'reconsider' FoHFs. This excellent book complements his earlier *Fund of Hedge Funds* book published by Elsevier in 2006.

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