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- A Year of Crisis from July 2007 to June 2008: Have Hedge Funds Kept Their Absolute Return Promises?
- The Birth of the Life Market
- A Statement in Sheep's Clothing: Why Should Canada Care about FAS Statement 157?
- A Sunny Outlook for Clean Tech
- 2008 Return Difference Between Small and Large Hedge Funds

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2008 Return Difference Between Small and Large Hedge Funds

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As we look back at the untamed securities markets that defined the year 2008, we naturally have to ask ourselves which asset classes performed the least poorly. To do this, we used the user-friendly AlternativeSoft software platform, which enabled us to quickly and accurately run statistics on individual funds, as well as on a group of hedge funds. To reach our conclusions, we will not use statistical measures like R-squared or t-statistics, but rather want to provide the reader with some interesting statistics.

Using the AlternativeSoft ‘asset search’ function, we divided the hedge fund universe into four buckets of different asset under management (AUM) sizes:

1. small; US\$10-\$100 million (average US\$37 million), 4,654 funds in total;
2. mid-sized; US\$101-\$500 million (average US\$232 million), 2,004 funds in total;
3. large; >US\$500 million (average US\$693 million), 787 funds in total; and
4. super-large; 10 largest hedge funds (average US\$7,721 million).

In the following two parts, we first summarise our findings of how hedge funds with different sizes of AUM performed. We found that ‘super-large’ funds outperform other smaller funds by around 2.5% for the 10-month period. Second, we dig a little deeper, and explain our findings regarding the performance between four hedge fund strategies. We found that ‘small’ funds outperform ‘medium’ and ‘large’ funds in all four strategies analysed for the period January 2008 to October 2008, by an average of 3%.

Did larger hedge funds outperform smaller ones from January to October 2008?

Much media talk and, indeed, a meaningful part of hedge fund allocations have, in recent years, focused on the large hedge funds. We asked ourselves how the large funds’ 2008 performance compared to that of their smaller peers. Does size matter during a ‘market crash’?

The ‘super-large’ bucket outperformed the other three AUM buckets (ie, small, medium and large) by an average of 250 bps, from January to October 2008. To position this in perspective, on an annualised three-year basis, the 10 largest funds outperformed small, medium and large funds by 650bps, 500bps, and 400bps respectively. Hence, at first glance, the simple takeaway would be that size does matter, ie, ‘super-large’ funds outperform smaller funds.

We conclude that from January to October 2008, the ‘super-large’ funds outperformed the other funds with better relative returns and mostly better Sharpe Ratio.

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How did hedge fund strategies perform across different AUM segments?

To find possible answers to this question, instead of comparing the entire universe of hedge fund strategies, we focused on four popular strategies; macro, equity long/short, multi-strategy and commodity trading advisers (CTA).

In the hedge fund universe, from January to October 2008, macro funds averaged +2.4% returns. Interestingly enough, macro funds belonging in the 'large' bucket averaged +0.31%, compared to small and medium funds with +2.94% and +1.95% returns respectively (see Table 1). One potential explanation for the lower returns for 'large' macro funds might be the increased complexity involved in the unwinding of larger positions.

Looking at the equity long/short category, it was again the 'small' bucket outperforming the 'large' and 'medium' buckets. The outperformance of 'small' versus 'large' was 100bps.

In the multi-strategy category, the 'medium' bucket was the clear underperformer and 'small' the best performer.

'Small' CTAs tended to be the leaders in this category. 'Large' CTAs underperformed by between 520bps and 180bps, compared to 'small' and 'medium' CTAs, respectively.

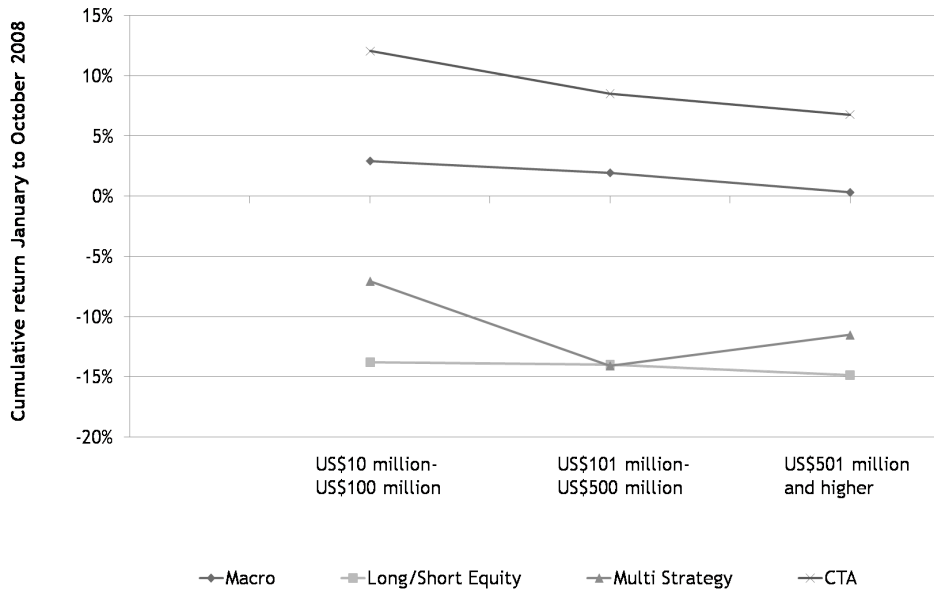
Table 1: Small vs large hedge funds across hedge fund strategies

	May-October 2008	January-October 2008
Macro		
Small AUM	-0.79%	2.94%
Middle	-1.85%	1.95%
Large	-3.68%	0.31%
Long/shortequity		
Small AUM	-11.23%	-13.79%
Middle	-12.08%	-13.98%
Large	-13.09%	-14.78%
Multi Strategy		
Small AUM	-6.98%	-7.06%
Middle	-12.49%	-14.07%
Large	-11.05%	-11.51%
CTA		
Small AUM	3.94%	12.05%
Middle	-0.53%	8.50%
Large	-0.19%	6.78%

Source: AlternativeSoft, HFR, hedgefund.net, Lipper-TASS

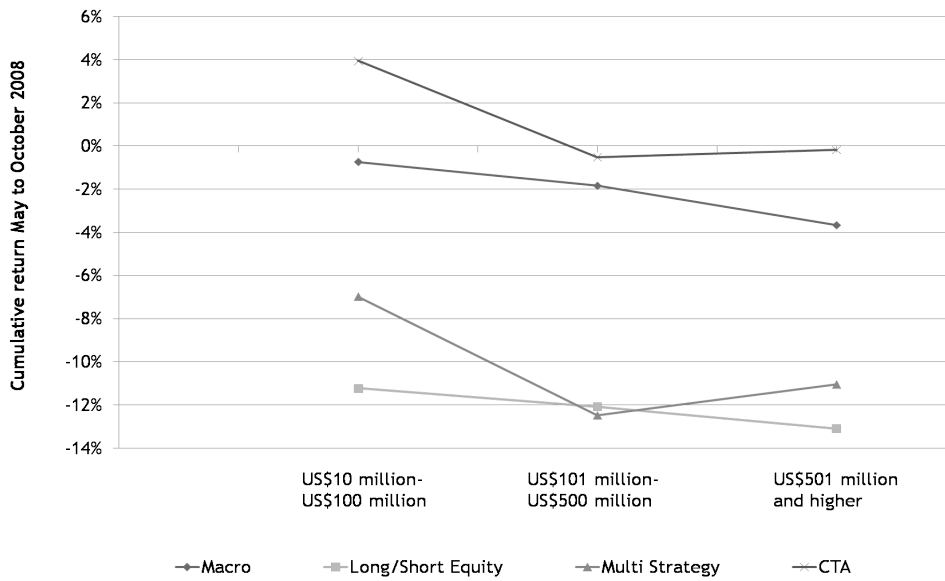
Graph 1 and Graph 2 present the same results but in graphical format. We see that the higher the AUM (ie, right of the graph), the smaller the YTD2008 returns, for CTA, macro and equity long/short.

Graph 1: 'Small' funds outperform 'large' funds, January to October 2008



Source: AlternativeSoft, HFR, hedgefund.net, Lipper-TASS

Graph 2: 'Small' funds outperformed 'large' funds, May to October 2008



Source: AlternativeSoft, HFR, hedgefund.net, Lipper-TASS

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Conclusion

Having looked at relative return characteristics of hedge funds with different levels of AUM, our analysis found that the 'super-large' bucket was the clear outperformer from January to October 2008. One of the reasons is that experience matters when a financial crisis appears. The 'super-large' funds have a much longer track record than smaller funds: ie, small funds average a 63-month track record, medium funds average a 72-month, large funds average an 89-month and super-large funds average a 135-month record.

At the same time, 'small' funds outperformed the 'middle' and 'large' buckets in all of the four strategies we analysed by an average of 3%, for the period January to October 2008.

To summarise, a basic strategy investing in the 10 super-large hedge funds, mixed with small CTA and small macro hedge funds, would have brilliantly outperformed the hedge fund indices.

Please note: Funds with assets <US\$10 million were not considered. Funds of hedge funds were not included in the study. September 2008 and October 2008 data was not available for all funds. In the 'super-large' bucket, two hedge funds had large returns, which may skew the results. We intentionally do not use statistical measures like R-squared, t-statistics or Granger causality in order to keep the paper readable.

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