iCapital®

What are Hedge Funds?

Hedge funds represent a diverse group of investment strategies that can offer investors enhanced returns, capital preservation, risk mitigation, and greater portfolio diversification across various market conditions.

FLEXIBILITY

Hedge fund managers have considerable investment flexibility. Unlike mutual funds, hedge funds are not publicly traded, allowing hedge fund managers to invest in stocks, bonds, commodities, currencies, futures, swaps, or other derivatives. In addition, hedge fund managers may use leverage to increase return potential, and/or short selling to help hedge the risks of individual stocks or a portfolio.

This ability to hedge market risk has historically resulted in hedge funds delivering greater risk-adjusted returns relative to public markets (particularly in down markets or periods of macroeconomic uncertainty) and reducing overall volatility when added to a portfolio of traditional stocks and bonds.[1]

TYPES OF HEDGE FUNDS

Hedge fund managers may follow a wide range of investment strategies that target an equally diverse range of investment objectives. These strategies include, but are not limited to:

STRATEGY THEME	STRATEGY TYPE	DESCRIPTION
Modifiers *Look to deliver differentiated exposure to stocks and bonds, with less directionality and more idiosyncratic sources of return.*	**Equity Hedge**	Maintains both long and short positions in equities and equity instruments, using either fundamental or quantitative techniques to express a view that the position will move positively (long) or negatively (short).
	Credit	Takes long and short positions in credit instruments with the goal of generating returns from yield and/or price changes, usually resulting from an improvement (long) or deterioration (short) in the creditworthiness of the issuer.
	Event-Driven	Seeks to take advantage of price inefficiencies in equities, bonds, or other instruments that result from company specific events, including mergers, acquisitions, bankruptcies, reorganizations, and/or spin-offs.
Stabilizers *Seek to provide consistent performance across market environments, with limited beta/ correlation to traditional assets.*	**Multi-Strategy**	Provides broad exposure across markets, asset classes, and/or trading strategies, typically applying a non-directional, relative value approach for the purposes of providing diversification and downside protection.
Diversifiers *Aim to provide access to nontraditional return drivers, with an uncorrelated return profile relative to traditional portfolios.*	**Macro**	Looks to predict price movements in global asset markets – including equities, interest rates, currencies and commodities – that are typically the result of policy changes or shifts in the global economy.

1. Source: eVestment, as of March 2023. Based on HFRI Fund Weighted Composite Index versus S&P 500 Index and Bloomberg US Aggregate Index, from Jan. 1990 to Feb. 2023. Past performance is not indicative of future results. Future results are not guaranteed.

KEY LIQUIDITY TERMS EXPLAINED

While hedge funds are less liquid than ETFs and mutual funds, most offer liquidity on a periodic basis, subject to certain limitations.

	DESCRIPTION	TYPICAL RANGES
Fund Lock-up	A window of time when investors in a fund are not allowed to redeem or sell shares of their investment. This restriction can be a hard lock-up (no right to redeem) or a soft lock-up (can redeem but must pay a penalty fee, usually 1–5%).	One – two years
Redemption Frequency	The frequency at which hedge fund managers allow redemptions.	Typically, monthly or quarterly
Notice Period	The minimum number of days in advance an investor needs to notify the fund that they intend to redeem.	Generally, 45–90 days
Gate	A restriction the hedge fund manager places on the amount of the withdrawal that can be processed for the liquidation during a single redemption period.	Fund-level gate: Typically, 25% of the funds' total assets. Investor-level gate: Typically, 25% of an investor's total shares in the fund.

BENEFITS

- Hedge funds provide access to a broad array of strategies available to meet various investment objectives.
- Hedge funds can offer an opportunity to pursue enhanced returns and/or downside protection, while providing diverse sources of return relative to traditional stocks and bonds.
- Hedge funds have historically delivered greater risk-adjusted returns relative to public markets, particularly during periods of market volatility, high interest rates, and macroeconomic uncertainty.[2]
- Hedge funds are accessible to a greater number of investors given today's innovations in product development and technology.

2. Source: eVestment, as of March 2023. Based on HFRI Fund Weighted Composite Index versus S&P 500 Index and Bloomberg US Aggregate Index, from Jan. 1990 to Feb. 2023. Past performance is not indicative of future results. Future results are not guaranteed.

KEY RISK CONSIDERATIONS

- **Manager Selection:** Not all hedge fund managers are the same. The experience, skill level, and track records of managers may vary greatly, and as a result, there can be a wide dispersion (or difference) in returns. It is critical to have a thorough diligence process in place to evaluate hedge fund managers.
- **Liquidity:** While hedge funds typically offer redemptions on a periodic basis, investors may be subject to a lock-up period which will prevent them from redeeming their capital for a period of time. In addition, investors must give written notice of their intention to redeem, with notice periods typically ranging from 30 to 90 days in advance. The manager may impose a gate, or a redemption limit, on the amount that can be withdrawn during a given redemption period.
- **Transparency:** Hedge funds may not offer the same level of transparency as traditional investments, which are required to provide frequent and full disclosures.
- **Fees:** Hedge fund managers charge their investors an annual management fee, typically 1–2% of assets under management. Fund managers also typically charge an incentive, or performance fee, which traditionally represents 15–20% of fund profits.
- **Leverage:** Hedge funds often use leverage, which offers the potential for higher returns, but may also increase volatility or downside risk.
- **Concentration:** Hedge funds may hold concentrated positions or focus on a specific market, sector, and/or geographic region.

Please contact your financial professional or a fund manager to learn more.

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