FT REPORT - FT FUND MANAGEMENT: Research rates multi-strategy hedge funds

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Published: May 07, 2007

Multi-strategy hedge funds generate higher risk-adjusted returns than funds of hedge funds, according to research by Vikas Agarwal and Jayant Kale, two academics at Georgia State University.

Messrs Agarwal and Kale found that multi-strategy offerings outperform funds of funds by 2.6-4.8 per cent a year net of fees, on a risk-adjusted basis, and 3.0-4.1 per cent a year before fees. The research covered the period 1994 to 2004.

The academics attributed this outperformance to a variety of factors. First, multi-strategy funds enjoy greater flexibility to switch capital between strategies, potentially allowing them to "time" their push into strategies that may be cyclical in nature. In contrast, funds of funds have to provide notice before withdrawing an investment from a poorly performing fund.

Second, multi-manager funds have greater freedom to invest in illiquid assets, due to longer lock-up periods. Third, multi-managers suffer from greater agency risk, as all of an investment is held within a single house and managerial actions may be relatively opaque.

Intriguingly, the research also raised the possibility that "better" single-strategy managers become multi-managers, suggesting that part of the observed outperformance may simply be due to greater investment skill.