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Hedge Fund and Commodity Fund Investments in Bull and Bear Markets

Franklin R. Edwards, Mustafa Onur Caglayan

The Journal of Portfolio Management Summer 2001, 27 (4) 97 - 108
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Abstract

A primary motivation for investing in hedge funds and commodity funds is to diversify against falling stock prices. The authors evaluate the performance of 16 different such funds during rising and falling stock markets between 1990 and 1998 both as stand-alone assets and as portfolio assets. They use the Sharpe ratio and alternative safety-first criteria to evaluate performance. The conclusion is that commodity funds generally provide more downside protection than hedge funds. Commodity funds have higher returns in bear markets than hedge funds, and generally have an inverse correlation with stock returns in bear markets. Hedge funds typically exhibit a higher positive correlation with stock returns in bear markets than in bull markets. Three hedge fund styles—market-neutral, event-driven, and global macro—provide fairly good downside protection with more attractive returns over all markets than commodity funds.

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