Journal of Futures Markets / Volume 21, Issue 11 / pp. 1003-1028

Hedge Fund Performance and Manager Skill

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First published: 05 September 2001
https://doi.org/10.1002/fut.2102

PDF

Abstract

Using data on the monthly returns of hedge funds during the period January 1990 to August 1998, we estimate six-factor Jensen alphas for individual hedge funds, employing eight different investment styles. We find that about 25% of the hedge funds earn positive excess returns and that the frequency and magnitude of funds' excess returns differ markedly with investment style. Using six-factor alphas as a measure of performance, we also analyze performance persistence over 1-year and 2-year horizons and find evidence of significant persistence among both winners and losers. These findings, together with our finding that hedge funds that pay managers higher incentive fees also have higher excess returns, are consistent with the view that fund manager skill may be a partial explanation for the positive excess returns earned by hedge funds. © 2001 John Wiley & Sons, Inc. Jrl Fut Mark 21:1003–1028, 2001

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