

1,264 733 14
Views | CrossRef citations to date | Altmetric

PORTFOLIO MANAGEMENT

Hedge Fund Benchmarks: A Risk-Based Approach

William Fung & David A. Hsieh

Pages 65-80 | Published online: 04 Apr 2019

🗨️ Cite this article 🔗 <https://doi.org/10.2469/faj.v60.n5.2657>

Sample our
Economics, Finance,
Business & Industry Journals
>> **Sign in here** to start your access
to the latest two volumes for 14 days

📖 References 🗨️ Citations 📊 Metrics 🖨️ Reprints & Permissions

Read this article

Share

We Care About Your Privacy

We and our 880 partners store and access personal data, like browsing data or unique identifiers, on your device. Selecting I Accept enables tracking technologies to support the purposes shown under we and our partners process data to provide. Selecting Reject All or withdrawing your consent will disable them. If trackers are disabled, some content and ads you see may not be as relevant to you. You can resurface this menu to change your choices or withdraw consent at any time by clicking the Show Purposes link on the bottom of the webpage. Your choices will have effect within our Website. For more details, refer to our Privacy Policy. [Here](#)

We and our partners process data to provide:

Use precise geolocation data. Actively scan device

I Accept

Reject All

Show Purpose



conventional
argues
on asset-
that is
or
hedge funds
ent of
market
nces among
databases.
ptions that
that the

dominant investment strategy is to buy and hold assets. In contrast, the performance

characteristics of hedge funds are diverse, the investment styles are dynamic, and bets may be highly levered. These hedge fund characteristics, together with the lack of standardized reporting of historical hedge fund performance, greatly limit the information content of hedge fund indexes that are constructed by using conventional methods. At times, using such indexes can even produce misleading results.

In the study reported here, we used a method to create hedge fund benchmarks that captures the common risk factors in hedge funds by using asset-based style (ABS) factors. Model construction began by extracting common sources of risk from hedge fund returns. These sources of risk were identified by directly linking them to various market risk factors. These ABS factors were then used to construct a hedge fund risk-factor model similar to the approach in arbitrage pricing theory, in which the factor loadings (betas) are permitted to vary over time.

Thus far, researchers have identified seven risk factors. Equity long-short hedge funds are exposed to two equity risk factors—market risk (as proxied by the S&P 500 Index) and the spread between small-capitalization stock returns and large-capitalization stock returns. Fixed-income hedge funds are exposed to two interest-rate-related risk factors—the change in 10-year U.S. Treasury yields and the change in the yield spread between 10-year T-bonds and Moody's Investors Service Baa bonds. Trend-following funds are exposed to the same risk factors as three portfolios of “lookback” options—on

bond fut
that the
diversifi

Applying
identify
anomal
of the ri
amo



The ABS
hedge fu
common
manage
market p



fund investments to match the changing conditions of global markets without having to rely on normal net-asset-value reporting as the only input.

Hedge fund managers can also use ABS factors to communicate the systematic risk inherent in a strategy to investors in a format that is consistent with the qualitative description of the strategy's style. Thus, risk disclosure and transparency can be brought to a satisfactory aggregated level without having to analyze the huge volume of individual hedge fund transactions.

The same framework can be used by regulators to monitor aggregate exposures to systematic risks. This use would provide important input to the management of stressful events, such as the bond market decline of 1994.

Related research

People also read

Recommended articles

Cited by
733



Information for

- Authors
- R&D professionals
- Editors
- Librarians
- Societies

Opportunities

- Reprints and e-prints
- Advertising solutions
- Accelerated publication
- Corporate access solutions

Open access

- Overview
- Open journals
- Open Select
- Dove Medical Press
- F1000Research
- Help and information
- Help and contact
- Newsroom
- All journals
- Books

Keep up to date

Register to receive personalised research and resources by email

 Sign me up



Copyright

Accessib

Registered
5 Howick Pl

or & Francis Group
orma business

