FAKE NEWS – Hedge Funds Do Not Work

Monday morning quarterbacks have made a cottage industry of passing judgments that come too late to be of any use to wise investors. For example, they've said we should have all invested our life savings in AMZN in 1997. Uninspired critics seem to have a lot of fun with this, but we have heard more and more of them advising their clients that "hedge funds do not work" – even while total hedge fund AUM has been reaching all-time highs. How can this contradiction exist?

Most professional investors would argue that hedge funds generally *have* performed well in both equity bull and bear markets. A quick analysis in search of the truth:

First, has investing in stocks *worked* as well as many experts are suggesting? Pick a time frame, and you get two very different answers. If you invested in the year 2000, when the NASDAQ was at 5000, you would have realized ~40% total return over 20 years of investing. This hardly matches with our understanding of the phrase "It worked!" If, by way of contrast, you invested in 2010, when the NASDAQ was near 2000, you would now have realized total returns of ~300%+ over just 10 years. Many would advise "that worked!"

Second, has investing in hedge funds actually worked? During these past 10 years, where an ideally timed investment in NASDAQ could have delivered >300%, the hedge fund index (Barclays HFI Index) indeed underperformed stocks. However, the index was positive in 7 out of 9 years from 2009-2017. Clearly, we would argue, this index worked.

During the markets of 2000-2002 and 2008, where the NASDAQ lost more than ~50% during each correction, the hedge fund index worked. During 2000-2002, the hedge fund index was up over 10%! In 2008, the index was down less than half (~22%) the NASDAQ!

This simple exercise may explain why total hedge fund assets have reached new highs despite the purveyors of fake news. As Marilyn Monroe once advised:

"The true things rarely get into circulation. It's usually the false things."