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# Hedge funds: pension plan switch urged

Feedback?



Hedge funds don't just want to eat the lunch of traditional asset managers, they want the plates, cutlery and tablecloth as well. Market jitters have again raised the topic of underfunded pension plans. Credit Suisse reckons, for example, that a combined funding hole approaching \$400bn exists in S&P 500 defined benefit pension plans. Hedge funds partly blame old-style, long-only managers and wonder why trustees don't let them starve.

Analysis by Campbell and Co simulates what a modest diet would look like. A typical portfolio of 50 per cent domestic stocks, 20 per cent foreign stocks, 20 per cent bonds, and 5 per cent each in real estate and commodities yields an annual return of 7 per cent, with volatility measured by annualised standard deviation of monthly returns of 11 per cent. Putting a 10th of this portfolio into hedge funds (using a broad index of managers as a proxy and prorating down the other asset classes) increases annual returns by half a percentage point and lowers risk by 56 basis points.

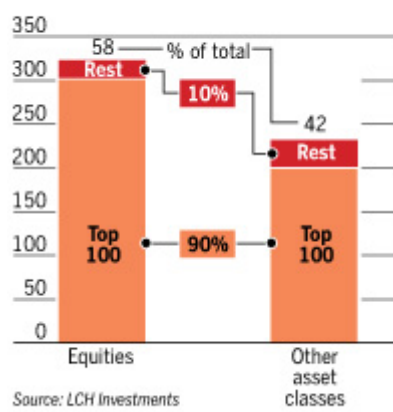
That does not seem much, but over a 40-year period amounts to a 20 per cent increase in assets, for less risk. Hedge funds achieve this by almost matching traditional portfolios in the good times, and performing much better in down markets. Fund of hedge fund

manager LCH Investments takes this idea even further: in an asset class such as equities, why not replace long-only managers with hedge funds completely?

LCH analysis shows that, since inception, the hedge fund industry has made \$560bn in after-fees profit for investors – with 60 per cent coming from equities. Of those equity profits, 80 per cent were made since 2001. So equity hedge funds have made \$270bn for clients, while US stocks are barely flat over the same period, and European bourses are down by almost a third. Compelling stuff. The problem is that over 90 per cent of these profits were made by just 100 hedge funds. Who knows who the next 100 hotshots will be? And which investors will have access to them?

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**Source of hedge fund profits**  
After-fees profits for investors (\$bn)



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