NHCO Week in Review
September 29, 2014

Following the announcement by the California Public Employees' Pension Plan (CALPERS) that they were no longer going to be investing in the investment vehicles known as hedge funds, much debate and press has surfaced about the viability of these types of investments. Hedge funds are investment pools that really began in the 1980s and have experienced huge growth. Initially these pools of capital were designed for wealthy individuals and institutional capital. The funds served two purposes, they offered investors the opportunity for professional management designed to capture some specific market opportunity, and offered the hedge fund manager a new way to earn large management fees that were typically priced as a 2% annual management fee and 20% percent of the profits that were made. Through the 1990s and 2000s hedge funds grew by type and risk but the one thing that became clear was that the term "hedge" in hedge funds had become a misnomer. There were certainly hedge funds that were trying to take volatility out of the market but many others were highly speculative funds where super star managers could place bets on whatever opportunity they saw on a global basis.

Over time the definition of hedge fund has migrated. Investopedia's latest definition states a hedge fund is an aggressively managed portfolio of investments that uses advanced investment strategies such as leverage, long, short, and derivative positions in both domestic and international markets with the goal of generating high returns. What do high returns have to do with a hedge? Wikipedia states a hedge is used to reduce substantial gains or losses suffered by an individual. Hello, hedge fund community, we have a problem. Am I investing in a hedge fund as a hedge or to generate high returns? Those two goals are not the same. The hedge fund community has a marketing identity crisis. The headlines for their industry are grabbed by those managers who have a period of generating outsized returns because they make huge bets on certain companies and events. In 2009 several managers made their clients millions, and themselves billions, by betting against the subprime housing market – and that was a good trade but one that is now history.

I sit through meetings and presentations by hedge funds all the time and it strikes me that the industry also has problems when it comes to investors understanding where these products fit into their portfolio, and then assessing performance. What is the role for these investments in a portfolio? Moreover what is the right metric for a hedge fund?

This debate all comes at a time when following a five year historical bull run in the stock market many hedge funds have seen their returns lag far behind the US equity market. Investors like CALPERs are raising the question of why should they stick with these vehicles when suffering sub market performance while paying high fees. The people who run CALPERs are very smart but did they invest in their select group of hedge fund managers to achieve "hedges" (returns with less volatility) or to seek outsized returns because of concentrated levered bets? I suspect it was the latter. CALPERS has a diverse portfolio that includes public stocks and bonds as well as real estate, private equity and debt, and hedge funds. Going forward, at least for the time being, they are getting out of their hedge funds. As a seasoned investor and a hardened cynic I will make a broad statement. If hedge fund performance improves significantly, CALPERS will be back.

Carl Gambrell

NHCO Weekly Market Update

	9/26/2014	% Wk Chg	% Yr Chg
DJIA	17,113.15	-0.96%	3.24%
S & P 500	1,982.85	-1.37%	7.28%
Nasdaq	4,512.19	-1.48%	8.04%
EAFE	1,856.03	-2.37%	-3.11%
Emerging Mkts	1,023.91	-2.85%	2.12%
Hang Seng	23,678.41	-2.58%	1.60%
NIKKEI	16,229.86	-0.56%	-0.38%
FTSE	6,649.39	-2.76%	-1.48%
CRB Index	280.28	0.31%	0.04%
Dow Jones Utility	547.95	-1.61%	11.70%
TIPS Index	112.11	0.06%	2.01%
VIX Index	14.85	22.63%	8.24%
OIL	97.00	-1.41%	-12.45%
Gold	1,218.38	0.22%	1.66%
Euro	1.27	-1.13%	-7.83%
Yen	109.29	0.23%	3.72%
Sterling	1.63	-0.23%	-1.71%
High Yield	6.23%	6.31%	4.71%
Investment Grade	3.68%	0.82%	-4.91%
2 Year Gov't	0.57%	1.79%	50.00%
5 Year Gov't	1.80%	-0.55%	3.45%
10 Year Gov't	2.53%	-1.56%	-16.50%
30 year Gov't	3.21%	-2.13%	-19.14%
2 Year Muni	0.37%	2.78%	12.12%
5 Year Muni	1.22%	0.00%	6.09%
10 Year Muni	2.23%	-2.62%	-19.49%
30 Year Muni	3.24%	0.62%	-23.40%
3m LIBOR	0.24%	0.00%	-4.00%
Fed Funds	0.08%	0.00%	100.00%
Prime	3.25%	0.00%	0.00%
Money Market	0.38%	0.00%	-5.00%
12m CD	0.71%	2.90%	5.97%
30 Year Mortgage	4.12%	-2.37%	-9.25%
15 Year Mortgage	3.22%	-3.01%	-9.30%

Data: Bloomberg