

## Hedge Funds...a Mislabeled Industry?

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Oxymoronic terms such as “taped live,” “alone together,” “plastic glass,” “agree to disagree,” “head butt,” “pretty ugly,” and “hedge fund” circulate regularly because they create a chuckle. Wait a minute. You haven’t seen “hedge fund” on that list before? Well then, let’s go ahead and add it. One problem though...it’s not that funny.

Whereas the hedge fund industry has traditionally been a collection of investment pools that, in the aggregate, have been intended for the wealthy, a current trend in the more pedestrian mutual fund industry is to create new fund offerings that are designed to emulate some of the same strategies that have long been the playground of actual hedge funds. It might be said that hedge-*like* mutual funds are to actual hedge funds what a tricked-out Mustang is to an Enzo Ferrari. (I wanted to compare Raquel Welch to Charo there, but I couldn’t decide who’d get to be the Ferrari.)

As I was reviewing some supercharged hedge fund strategies recently, I began to question my understanding of what “hedge” really means so I checked a few sources. Sure enough, “to hedge” is generally associated with an effort to *reduce* risk. If that’s true, one might expect the hedge fund industry to produce investment vehicles that are typically *less* volatile than other strategies. However, that’s not how it works. According to one Morningstar analyst, the difference between the average returns of the best 10% and worst 10% of a particular type of mutual fund was about 19% during 2006. By contrast, the range of returns for a group of hedge funds bearing a similar investment objective was a whopping 57%! Where’s the risk reduction?

So, in addition to grappling with outlandishly high management fees, vaguely defined investment objectives, a lack of regulatory audits and limited fund disclosures, would-be investors should also be aware that the term “hedge,” as apparently used in the hedge-fund industry can be as oxymoronic as the terms “airline food,” “Microsoft Works™,” and “adult male.” That is, hedge funds seem to be more about creating risk than eliminating it.

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