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BOOK REVIEW

Kevin R. Mirabile: Hedge Fund Investing

John Wiley & Sons, Inc., 2013, 350 pages, approx. EUR 80, ISBN 978-1-118-28122-2

Florian Weigert

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Hedge funds are an important investment vehicle for institutional investors and high-net-worth individuals: assets under management of hedge funds and funds of hedge funds have increased from about 500 billion USD in 2000 to 2,700 billion USD by the end of 2013. Hedge funds are attractive to investors for three main reasons: (a) they provide a historically attractive risk-return tradeoff (i.e., they deliver high average returns for relatively low volatility), (b) they exhibit low correlation with traditional asset classes and provide portfolio diversification benefits, and (c) they aim to achieve positive returns independent from the current state of the economy (i.e., they target absolute instead of relative returns). Nevertheless, there is still considerable confusion over and misconceptions about hedge funds: What are they? How do they operate? What trading strategies do they use? How should their performance be measured?

In his book *Hedge Fund Investing*, Kevin R. Mirabile seeks to resolve these misconceptions and provides a very accessible overview of hedge funds, particularly for first-time investors, practitioners dealing with hedge funds as clients or counterparties, and students aiming to learn how the hedge fund sector operates from both theoretical and practical perspectives. The author's main goal is to present a comprehensive, and yet not overwhelmingly complex, look at why people invest in hedge funds, how the managers and funds employing unique hedge fund strategies actually operate, and what criteria people should use to select managers and funds. Equipped with 20 years of practical experience in the hedge fund industry (including the position of Chief Operating Officer at Larch Lane Advisors), along with his experience as a Professor of Finance at Fordham University in New York, Kevin R. Mirabile is able to tackle this difficult task from both a practical and academic point of view.

F. Weigert (✉)
University of St. Gallen, St. Gallen, Switzerland
e-mail: florian.weigert@unisg.ch

The book is organized into three main parts: After starting from the basics concepts of hedge fund investing in Part 1, the author goes on to explain the individual strategies employed by hedge fund managers in Part 2. Part 3 describes the main tools needed for the evaluation and analysis of individual managers and funds, including suggested approaches for performing a due diligence process on any fund. Each chapter ends with discussion questions and problems related to the key concepts and definitions covered in the chapter, together with a detailed reading list. To enhance classroom presentation of the material, professors and academic instructors can also download a unique test bank, some Excel tools, and reference documents from the book's companion webpage.

Part 1 (Chaps. 1–3) of the book provides readers with an overview of the nature of hedge funds, their investor clientele, and general industry characteristics. Chapter 1 highlights the similarities and differences between hedge funds and various types of alternatives, including mutual funds. It also explains some of the most important tools used by hedge funds: leverage, short selling and the use of derivatives. Turning to investor clienteles and preferences, Chap. 2 demonstrates the benefits and caveats of introducing hedge funds into the portfolio asset allocation process. It also summarizes the characteristics of the main hedge fund investors (e.g., different institutional investors and high-net-worth individuals). In Chap. 3 the author gives an overview of general trends, flows, and characteristics of the hedge fund industry.

Part 2 (Chaps. 4–8) explains in detail several of the most prominent hedge fund investing strategies. The author summarizes the global macro style (Chap. 4), the long and short equity style (Chap. 5), the fixed income relative value and credit arbitrage style (Chap. 6), the convertible arbitrage style (Chap. 7), and multistrategy funds and funds of hedge funds (Chap. 8). Each specific hedge fund style is introduced using general facts, historical data and examples of its typical organizational structure, investment process and portfolio characteristics, fund terms and conditions, flows and performance, and typical manager profiles.

Finally, Part 3 (Chaps. 9–12) analyzes performance measurement and evaluation of hedge fund performance. In Chap. 9 the author introduces frequently used performance measures such as the Sharpe ratio or the Jensen's alpha, and stresses the importance of non-normality for hedge fund performance evaluation. Furthermore, he summarizes recent academic findings on performance persistence. Chapter 10 investigates the impact of fund characteristics (such as incentives, manager discretion, location, and economies of agglomeration) on performance. Chapters 11 and 12 are concerned with the process of performing due diligence on a specific hedge fund manager as well as the service providers (associated with a hedge fund manager or a fund) being considered for investment. The book ends with a discussion of some of the challenges the industry faces today and will confront in the future.

Hedge Fund Investing is a very well written book and suited to both first-time investors, practitioners, and (undergraduate) students with an interest in alternative investments. The main topics of the book (the nature of hedge funds, their main trading strategies, and performance evaluation of hedge funds) are explained in a rigorous, but simple and intuitive, language and should be very accessible to the wider public. More knowledgeable readers familiar with alternative investments will enjoy a very recent and complete review of academic research articles as well as up-to-date tables and figures of the development of the hedge fund industry.

Personally, I was disconcerted by the absence of two important topics from the book: First, I expected, but did not find, a detailed treatment of asset-pricing factor models when assessing hedge fund performance. At least from an academic viewpoint, factor models (such as the Carhart (1997) four-factor model and the Fung/Hsieh (2004) seven-factor model) are the cornerstones of hedge fund performance evaluation and hedge fund manager's alpha attribution. Second, I would have liked to see more emphasis on hedge fund return biases. Hedge funds voluntarily report returns to public databases—however, these reported returns are frequently overstated and are subject to severe biases (e.g., hedge funds are often allowed to backfill their historical returns when entering a new database). Hence, including raw reported hedge fund returns in the asset allocation process frequently overweights the percentage of wealth distributed to hedge funds.

In sum, *Hedge Fund Investing* by Kevin R. Mirabile is a comprehensive, very straightforward and accessible introduction in hedge funds. I consider this book an excellent read for first-time investors, practitioners dealing with hedge funds as clients or counterparties, and students interested in the world of alternative investments.