

The Journal of Alternative Investments

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This issue of *The Journal of Alternative Investments* is dedicated to the art and science of the manager's due diligence. Keith Black, CAIA, FDP, is the editor of this special issue, and I wish to thank him for putting together a terrific collection of articles on a vital subject.

In his introductory essay, Keith discusses the importance of due diligence and provides an overview of the articles appearing in the issue. The overview essay highlights the fact that alternative investments are typically accessed through managers, who are granted a great deal of flexibility in managing asset owners' capital. Therefore, due diligence is essential when allocating to alternative investment managers.

The collection of articles appearing here emphasize both the quantitative and qualitative aspects of the due diligence process. While the quantitative approach has received the most attention in academic and practitioner publications, surveys of asset allocators seem to indicate that qualitative aspects of the process are far more critical. A recent survey by the CAIA Association, which is discussed in this issue, provides further information about this aspect of the due diligence process.

This special issue also contains an important and insightful article by Roger Stein that covers certain types of risk. In "Using RBOs and Megafunds to Hedge Longevity Risk and Specialty Drug Costs," he examines the importance of longevity risk, which could arise if a retiree lives much longer than expected. Defined benefits and annuities are built around assumptions about the expected life expectancy of retirees. Any unexpected increase in the assumed figures will put pressure on these sources of funding. Closely related to longevity risk is the existence of reimbursement risk faced by providers of health insurance for retirees, which results from increasing costs of advanced medical procedures and specialty drugs. These risks can be acute when scientific breakthroughs increase new drug development rates. An emerging asset class, research-backed obligations, can provide a natural hedge for a broad class of such risks. The author provides a framework for hedging strategies involving these risks.

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