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Academic research has shown that for many investors, asset choice is based primarily on the most recent performance of that asset class. In spite of this evidence, many practitioners as well as academics continue to attempt to convince investors as to the importance of diversification across asset classes. For most of the latter half of the 1990s diversification across nonequity-based investment strategies often lead to less than optimal rates of return, however, the past year has once again illustrated the importance of diversification across various asset classes as well as across various strategies within an asset class. During this past year, equity markets have swung between favoring growth-based equity strategies to favoring more traditional value-based equity strategies. In the area of alternative investments, systematic commodity trading advisors were generally flat for most of the year, however, several systematic trading strategies performed well in the latter half. Debt markets, especially emerging markets, had months of superior performance followed by months of flat or negative returns.

Even if diversification across asset classes may be academically sound, questions still exist about how best to implement such a strategy. Traditional approaches to mean/variance optimization across traditional and alternative investments have often been questioned on the basis that alternative investments differ fundamentally in return structure from traditional assets. In the first article, "Alternative Investments in the Institutional Portfolio," Vassilios Karavas updates an earlier analysis [Schneeweis and Spurgin, JAI, 1999] of the risk and return benefits of various hedge funds and managed futures investments as stand-alone investments or as part of an investor's diversified stock/bond portfolio. Traditional Markowitz efficient frontiers, with and without investment restrictions, created from adding alternative investments to established U.S. stock and bond portfolios are evaluated. The Markowitz efficient frontier determination is also conducted using alternative methods of risk and return. Given the conditional nature of traditional and alternative investment returns, risk and return optimization models will increasingly require better models of expected return and risk performance.

An important part of any portfolio return is, of course, the impact of currency return. The most commonly cited argument against currency hedging is the assertion that foreign exchange risk washes out over the long run. In the second article, "Currency Hedging and the Risk of Loss," Mark Kritzman shows even if we set aside these facts and accept the view that foreign exchange risk washes out over long horizons, it does not necessarily follow that we should ignore the volatility introduced by currency exposure. It depends critically on how we perceive risk. In his study, Kritzman shows explicitly how exchange rate fluctuations affect a foreign asset's risk. The article also contains a derivation of the minimum risk and optimal exposures to currency forward contracts.

The importance and use of new forms of alternative investments and/or currency risk management in asset management depends in part on the changing nature of the investment industry. For instance, as institutions increasingly invest across borders or as the stability of cash flows increases in importance, both asset allocation and risk management models will increase in importance. In the third article, "Hedge Funds: An Industry Overview," Ezra Zask reviews the key issues of increased use of alternative investments by traditional institutional investors, the structure and ownership of the industry, and the changing relationship between private equity and hedge funds. One of the principal changes in the alternative investment area is the actual purchase or investment in hedge funds by individuals and/or institutional investors. In a follow-up article, "Hedge Funds: A Methodology for Hedge Fund Valuation," Ezra Zask provides an initial look at attempts to value hedge funds. Hedge fund managers are more difficult to value than traditional asset management companies largely because of the variability of hedge fund revenues. This valuation difficulty represents one of the obstacles limiting the scale of consolidation in the industry to date. Other limitations to consolidation would include the inherent independence of hedge fund managers, the typical hedge fund's reliance on a small group of traders, and the relatively small client base that comprises a large portion of a typical fund's assets under management.

Previous articles in this issue have emphasized the changing nature of asset returns as well as the alternative industry itself. How to forecast and implement these changes in asset allocation and valuation models remains a primary academic focus. In this issue, "Academic Corner: Economic Conditions and Stock Pricing," Parvez Ahmed and Larry J. Lockwood show that the risk premiums associated with key asset allocation risk factors often change significantly over varying stages of the stock market and business cycle. Their findings point out the dangers for portfolio managers setting allocation targets assuming factor risk premiums are constant over time. The findings of this article have implications for investors using stock market sector analysis or business cycle strategies. The results also suggest further research into modeling risk premiums conditioned on economic phases.

The problem of changing risk factors as well as the use of historical performance as the sole basis for evaluating the potential performance of an investment strategy is the focus of Thomas Moller in this issue's "Practitioner's Corner: Insights into the Recent Performance of Managed Futures." In his article, Moller notes that directional trading strategies of most commodity trading advisors (CTAs) and Global macro hedge have not been effective in the recent market environment. In his commentary, he discusses several possible answers for the recent performance and what investors may expect in the future.

One problem of testing the historical performance of various asset strategies is that the performance may be due largely to the manager's trading ability rather than an underlying return to the asset class itself. One means of testing the underlying benefits to a particular return strategy is to use a systematic passive benchmark, which replicates the primary return process. In this issue's case study, Sol Waksman reviews the "Barclay Futures Index (BFI) as a Benchmark." The BFI offers one approach to providing an investable benchmark of accessing the returns to systematic commodity trading advisors.

While investible passive benchmarks are one means of accessing the returns to particular asset classes or investment strategies, manager-based investments remain a principal part of any investor's portfolio. In this issue's trading strategy forum, Jerome Abernathy and Henry Green provide readers with a clearer and more informed understanding of the investment potential for currency trading in general and their own firms' particular approaches to capturing the return/risk tradeoffs within currency markets.

Given the importance of currency investment and currency markets on investor return potential, Kristap Licis continues his review of Web information by concentrating on major sites with currency trading and currency information sources. The goal of any investor and manager is, of course, to find ways to obtain excess returns to that which can be achieved through simple benchmark investment. In this issue, Sam Chung reviews two books that offer fundamental information on new ways of evaluating or determining the probability of unexpected investment performance (Alpha) of traditional and alternative funds (Ben Warwick, *Searching for Alpha: The Quest for Exceptional Investment Performance* [John Wiley & Sons, 2000] and *Alpha—The Positive Side of Risk: Daring To Be Different,* collection of readings [Investor Press, 1996]).

As we enter the new millennium, alternative investment will increasingly become an important part of investors' asset choice. We continue to solicit our readers' input as to articles and ideas that they wish explored as well as having our readers offer their own research for consideration. One additional note of importance is that starting this issue, *The Journal of Alternative Investments* has an Associate Editor, Jot Yau. Jot is an Associate Professor of Finance at the School of Management at George Mason University and has both academic and practical experience in the investment management industry. Jot's participation will help improve the quality and expand the breadth of issues covered by the journal.

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Editor