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THE JOURNAL OF ALTERNATIVE INVESTMENTS

VOLUME 4, NUMBER 2 FALL 2001

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Within the first half of this year, traditional stock markets have remained within a trading range. The lack of traditional market performance has increased interest in alternative investment vehicles. However, many individual hedge fund strategies which are sensitive to equity market movements have likewise had months in which they have underperformed their historical average. A common response to the underperformance of individual hedge funds is the creation of multi-manager hedge funds. In the first article in this issue, "Funds of Hedge Funds: An Introduction to Multi-Manager Funds," Martin Fothergill and Carolyn Coke both review the characteristics of various hedge fund strategies and emphasize the unique structural characteristics of multi-manager hedge funds.

While funds of funds remain a principal means by which investors access hedge funds, individual hedge fund strategies remain the source of fund of funds creation. Recently, U.S. and European regulators have raised issues as to the future evolution of global mergers. Academics likewise have addressed the issues as to the basis for mergers and therefore the potential for merger arbitrage. In the second article, "Merger Arbitrage: Evidence of Profitability," Taewon Yang and Ben Branch review a wide range of academic articles which have explored the basis for as well as the performance of merger arbitrage.

As traditional hedge fund strategies evolve, new trading markets also continue to be created and potentially form the basis for future hedge fund strategies. In "Over the Counter Bulletin Board Exchange: Market Structure, Risk, and Return," Carl Luft, Lawrence M. Levine, and Scott Larson were motivated by the lack of knowledge of the Over the Counter Bulletin Board (OTC-BB) Exchange and seek to fill this void by enlightening investors about the structure of the OTC-BB Exchange and by providing estimates of the market's risk and return.

Within the traditional hedge fund arena, issues of performance are based not only in the actual gross return of individual strategies but also the impact of managers' fees on the net return. In "Hedge Fund Incentive Fees and the 'Free Option,'" Mark

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J.P. Anson points out that one of the ironies of hedge fund investing is that investors can provide conflicting incentives to the hedge fund manager. The standard Black-Scholes analysis is used to determine the value of the call option on hedge fund incentives. The article also discusses how this call option might provide an inconsistent incentive compared to the desires of investors in the hedge fund.

Historically, the benefits of various hedge fund strategies have emphasized the diversification benefits of hedge funds. In "The Performance of Defensive Investments," Carl Peters and Patrick Egan define defensive investments as those asset classes that have attracted funds during periods of *stock market weakness.* Taken together, these asset classes make up the category of defensive investments. How well they performed during specific periods of stock market weakness and in general over long investment horizons is the subject of study of this article.

In this issue's Practitioner's Corner, "Fund Age and Performance," Michael J. Howell concentrates not on the performance of a particular strategy in particular market conditions but reviews the relationship between firm age and hedge fund performance.

The relationship between fund performance and market factors is further explored in this issue's Academic's Corner, "Do Stock Market Indices Move the Ten Largest Hedge Funds? A Cointegration Approach." Greg N. Gregoriou and Fabrice Rouah investigate the long-term relationships between the ten largest hedge funds in the Zurich database and four stock market indices over a ten-year period, using time series analysis and cointegration. They find that most of the time series examined contain a single unit root. Their results provide evidence that, in general, hedge funds do not appear to track any of the specific benchmarks used in this study. Future research will emphasize more style pure hedge funds with associated indices.

In this issue's Trader's Corner, "Trading Strategy Forum: Merger Arbitrage," Dwight Eyrick of West Broadway Partners, Inc. and Peter Drippé of the Bitterroot Fund, two experts in the area of merger arbitrage, answer questions as to their views as to the benefits of merger arbitrage. Readers may wish to use the second article in this issue to compare academic articles on the subject with Eyrick's and Drippé's more practical responses. As in previous issues, Jot Yau

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reviews two books (Robert Haugen, *The Inefficient Stock Market*, 2nd edition, Pearson Education [2002] and Emmanuel Acar, ed., *Added Value in Financial Institutions*, Pearson Education [2001]) which offer differing views adding value in financial markets or institutions, and Kristaps Licis reviews websites related to traditional mutual funds which offer information on traditional investment markets.

Alternative investments continue to be of increasing interest to a wide range of financial institutions, investors, and regulators. In future issues, we plan to cover a wider range of alternative investment strategies and to include articles which will be geared toward academics as well as practitioners. We continue to look forward to your submissions.

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