THE JOURNAL OF ALTERNATIVE INVESTMENTS

VOLUME 6, NUMBER 3 WINTER 2003

Institutional investors, the government, as well as the public media continue to debate the benefits and risks of alternative investments, especially the place of hedge funds in the investment arena. The articles in this issue cover a broad range of topics in the alternative investment space including those discussing performance evaluation, performance persistence and stale pricing in hedge funds, the role of private equity and real estate in global asset allocation, as well as how to structure frameworks for principal-protected securities transactions.

In the first article of this issue, Bhaswar Gupta, Burak Cerrahoglu, and Alper Daglioglu evaluate performance of hedge funds using traditional and conditional approaches. They create three hedge fund portfolios, one with active funds, one with non-surviving funds, and one with both active and non-surviving funds for each strategy. They find that while the "active manager-based" portfolios show evidence of positive risk-adjusted returns in most cases, a majority of the "non-surviving manager-based" portfolios do not. In the case of portfolios containing both active and non-surviving funds, they find that several strategies show evidence of positive risk-adjusted returns. Their results are similar irrespective of whether Jensen's alpha or conditional approaches are used. They also explore market timing ability to find that hedge fund managers in general lack market timing ability and fund level analysis is required to determine the few that do have market timing ability. In the second article, Pierre-Antoine Barès, Rajna Gibson, and Sébastien Gyger analyze performance persistence of hedge funds over short- and long-term horizons. Using a non-parametric test, they observe that the Relative Value and Specialist Credit strategies contain the highest proportion of outperforming managers. They also analyze performance persistence of portfolios ranked according to their average past returns. They observe persistence over one- to three-month holding periods but find that it rapidly vanishes as the formation or the holding period is lengthened. Finally, they examine the long-term risk-adjusted returns persistence of hedge fund portfolios within an APT framework. They detect a slight overreaction pattern that is more pronounced among the directional hedge fund strategies.

In the third article of this issue, Andrew Conner applies a methodology to estimate true volatility and correlation in the presence of stale pricing to alternative investments. He also measures the impact of adjusting for stale pricing on asset allocation and the diversification benefits of private equity and hedge fund investments. He concludes that much of the perceived diversification benefits associated with allocating to private equities and hedge funds is attributable to stale pricing and thus illusory. Nonetheless, he observes that efficient portfolios still contain substantial allocations to alternative investments after adjusting for the effects of stale pricing. In the fourth article, Martin Hoesli, Jon Lekander, and Witold Witkiewicz provide international evidence on the discrepancy between suggested and actual allocations to real estate in institutional portfolios, as well as discuss possible reasons for the discrepancy. Using data for the U.S., U.K., Sweden, and Switzerland, they investigate the benefits of including real estate assets—both domestic and international—in institutional portfolios. The optimal allocation to real estate is found to be 15%-20%, and is remarkably stable across countries. These suggested allocations to real estate in institutional portfolios are compared with the actual institutional holdings in the four countries. The latter are found to be much lower than the former, and possible explanations for this discrepancy are offered. The article also shows a substantial home bias in institutional real estate portfolios.

In this issue's Academic's Corner, Edel Barnes, Edward Cahill, and Yvonne McCarthy examine the hypothesis that young venture capital firms take companies public earlier than older venture capital firms in order to establish a reputation and successfully raise capital for new funds. Consistent with the extant literature, their evidence from a sample of 85 IPOs on the London Stock Exchange over the period 1992–99 indicates that companies backed by young venture capital firms are indeed younger at IPO than those backed by more established firms, and young venture capital firms have shorter board representation. There is little evidence, however, of greater underpricing for young VCF investments, nor do their results suggest that young VCFs hold relatively small equity stakes. Overall, there is insufficient evidence as yet to unambiguously support the significance of grandstanding as a feature of the U.K. venture capital industry.

In this issue's Practitioner's Corner, Shanker Merchant provides a framework for structuring principal-protected securities transactions based on collateralized debt obligation ("CDO") technology. The CDO framework obviates the need for a financial institution to guarantee the principal amount of the securities, enhances the economic efficiency of the securities, provides structural transparency, and broadens market participation in the securities. The author believes that the framework described in the article would be valuable for fixed-income CDO professionals and equity derivative professionals in creating principal-protected securities in areas of their structured products transactions.

The recently published book, *Dynamic Portfolio Theory and Management* by Richard Oberuc is reviewed in the Book Review section, and articles in the area of alternative investments and econometric methods are reviewed in the Article Review section. In this issues's Web Review section, the website http://www.mocktrading.com explores the advantages of simulated trading.

As of the next issue, the journal will be completing six volumes. In the world of publishing, *The Journal of Alternative Investments* is now an established vehicle for research and ideas within the alternative investments landscape. The journal is really a reflection of where the alternative investment industry has been, and is going. The journal's success is due primarily to our readers and those who have taken the time and effort to publish their work in the journal. However, one can never live in the past. As the journal continues to grow, we look forward to your continued support.

Thomas Schneeweis
Editor