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For many, recent performance in the alternative investment area has brought into question the ability of managers to use their special abilities to provide 'absolute return' consistent with expected risk. The first section in this issue deals with both issues; that is, the ability to provide returns above that expected given the underlying strategy risk and the ability to use well known return and risk methodologies to create asset portfolios that reflect equity based hedge fund strategies. In the first article, "Estimating Risk Premiums of Individual Hedge Funds", Scott Mackey introduces a methodology for estimating the risk premiums earned by individual hedge funds and provides results on the distribution of risk premiums both within and between various hedge fund styles. Results indicate that the majority of funds earn average excess return greater than the expected excess return based on the estimated total average risk premium. In the second article, "Efficient Portfolios for Equity Based Hedge Funds," Françoise Charpin and Dominique Lacaze show how efficient market-neutral portfolios, and more generally efficient long-short portfolios can be constructed using mean-variance optimization.

Understanding the return potential of various strategies, however, also requires an understanding of their underlying risk characteristics. The second section features articles on risk management. Maximum drawdown, the maximum peak-to-trough loss in net asset value (NAV), is a widely-used risk measure among investors in less-liquid asset classes, such as hedge funds. Analogous to value-at-risk, α-percentile maximum-drawdown-at-risk (MDaR) is the maximum drawdown such that a fund recovers its peak NAV α-percent of the time before reaching it. In the third article, "Maximum Drawdowns of Hedge Funds in the Presence of Serial Correlation" Brian Hayes derives formulas for MDaR, based on a fund's mean return, volatility and serial correlation. Positive serial correlation exacerbates drawdown risk. He provides comparisons of model-based MDaR with historical MDaR of hedge fund indexes and simulated MDaR of an autoregressive model. In the fourth article, "Merton Unraveled: A Flexible Way of Modeling Default Risk" Hans Bystrom demonstrates how a simplified "spread sheet" version of the Merton model produces distance to default measures similar to the original Merton model. Moreover, when applied to a sample of US firms, the simplified model gives a relative ranking of firms that is essentially unchanged compared to the Merton model.

The very breadth of investment strategies in the alternative investment space, however, forces upon us the necessity of focusing on the return and risk characteristics of particular strategies. Our third section traditionally includes practitioner articles or case studies. In this issue, Michael Huttman and Louise Harris provide a case study, "Generating Alpha from Active Currency Programs" which illustrates the potential benefits of active manager based currency programs and currency overly programs.

Recent SEC regulation has emphasized the importance of best practices among hedge fund managers although concerns have been expressed on the impact of SEC regulation on fund performance. In the final section both issues are addressed. In the first article, "Is the SEC Registration Status of Hedge Fund Advisers Associated with Superior Performance?" David Ornstil, Hany A. Shawky and David M. Smith provide evidence on the return performance of the funds whose advisors have voluntarily registered with the SEC versus those that are unregistered. Their evidence shows that registered funds in several important categories outperform their unregistered counterparts, however, this phenomenon does not appear to be due to the registration event. We also provide the second part of a two part report on standards and best practices for hedge funds managers. The first part was featured in the previous issue of JAI. In the article, "Best Practices for Hedge Funds-Part II," Mark Pearl presents standards that have been written to embrace the experienced hedge fund investor's perspective in the areas of regulation, compliance and documentation, fees, conflicts of interest and strategy change.

Change is, of course, one of the few constants. With the publication of this issue, The Journal of Alternative Investments after this issue enters into its ninth year. Over those years, we have been witness to change not only in our own investment space but throughout the investment industry. Our readers can rest assured that as the alternative investment continues to evolve so will the Journal. In upcoming issues, the Journal will not only be introducing new research and ideas in the alternative investment space but also providing additional summaries on recent events in our industry.

As the alternative industry changes, The Journal of Alternative Investments will change and grow with it. As always, we ask for your own ideas as well as your own

Thomas Schneeweis
Editor

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