

Should Pension Funds Consider Investing in Hedge Funds?

(Note: This project was offered last year. Need confirmation for this year)

Suppose you have been retained by a large pension plan with assets in excess of \$50 billion to evaluate whether the plan should consider adding hedge funds as an additional asset class while making asset allocation decisions. The fund's assets are currently invested in a portfolio of the following asset classes: T-Bills, Mid-Bonds, Long-Bonds, International Bonds, Real Estate, Domestic Equities (Value, Growth, Small Cap, Mid-Cap and Large Cap), and International Equities (EAFE). Half the assets are indexed and the other half allocated to active managers.

In your report you will examine the following questions: (a) What are the issues to be kept in mind while investing in hedge funds as an asset class? (b) What are the different ways of investing in hedge funds; what are their relative advantages and disadvantages; which method would you recommend? (c) What should be the allocation to hedge funds as an asset class? What would be your recommendation based on mean-variance analysis alone? How would you modify mean variance analysis to take various other factors into account? What are the sources of profits for hedge funds? Will past performance continue? Will clever diversification across different hedge fund strategies add value?

HFR Asset Management will provide you with the data required for this study. You will have to sign an agreement for accessing some of the data.