Discussion: *Will Alternative UCITs Ever Be Loved Enough to Replace Hedge Funds?* Wallerstein, Tuchschmid, and Zanolin

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Summary

- Paper studies new, growing EU vehicle like hedge funds:
  - Undertakings for Collective Investment in Transferable Securities[2].
- UCITs give flexibility in compensation and investment, but:
  - reporting and governance/risk management requirements; and,
  - limits on borrowing/leverage and short selling.
- Findings of this paper:
  - Firm-level: UCITs α is significant; hedge fund α is not.
  - Firm-level: UCITs volatility, risk-adjusted returns lower.
  - Cross-section: hedge fund returns (raw, adjusted) are higher.

[2]In particular, the modification known as UCITs III.

Factual/Framing Comments

- "UCITs cannot borrow"... but can short non-MMkt bonds.
- Is location driven solely by labor market or tax benefits also?
- UCITs require a risk management team; so...
  - How do they compare to hedge funds with risk management[3]?
- Did looming UCITs IV (201007) hasten UCITs III creation?
- Why more macro and fixed-income UCITs vs. hedge funds?
  - Are borrowing "limits" not much of a constraint? Or,
  - Do shorting limits prohibit running a L/S equity fund?
- Eurotop 100? EuroStoxx 50 = more liquid, Eurozone-only.

[3] Since Gavin showed those hedge funds perform better.

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Theoretical Comments

- Difference of alpha results on firm-level versus cross-section:
  - Firm-level reverse survivorship bias? (*cf* Linnainmaa 2011 WP)
- UCITs, hedge fund return dist'ns $\Rightarrow$ diff. opportunity sets?
  - Investments might differ due to reporting requirements.
  - Semi-annually: at least largest 20 purchases, sales[4].
  - However, Stephen showed copycat trading happens, so...
  - Fear of crowded exits may alter UCITs investments.
- Correlation of excess UCITs returns with asset class indices:
  - Why use Kendall's τ? Why not typical Pearson's ρ?

[4] From the Ireland UCITs regulations.

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Data Comments

- Eliminating 3 UCITs which ceased in 200906–201005:
  - Could cause big survivorship bias; why not keep them in?
  - No info on fund failures pre-2009 is also a problem.
- Cannot conclude lower UCITs mortality until sector matures.
- How are UCITs splits/spinoffs handled?
  - If allowed, easy way to game system (inducing backfill bias).

Conclusion

- A great look into value of some hedge fund capabilities.
- Some conclusions premature, but others are enticing:
  - Returns are slightly lower — but close, and risk is lower.
  - UCITs will not be able to lie about returns[5].
- Need a little more clarity in a few places to let study shine.
- I look forward to final product.

[5] As Petri showed yesterday that hedge funds do.