

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

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- Paper studies new, growing EU vehicle like hedge funds:
 - Undertakings for Collective Investment in Transferable Securities².
- 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.

²In particular, the modification known as UCITs III.

- “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 management³?
- 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.

³Since Gavin showed those hedge funds perform better. 

- 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, sales⁴.
 - 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 ?

⁴From the Ireland UCITs regulations.

- 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).

- 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 returns⁵.
- Need a little more clarity in a few places to let study shine.
- I look forward to final product.

⁵As Petri showed yesterday that hedge funds do.