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PHD WORKSHOP
HEDGE FUNDS AND PERFORMANCE EVALUATION
AALTO UNIVERSITY, APRIL 6-8, 2022

DESCRIPTION

This is a series of three workshops on hedge funds and portfolio performance evaluation. Required readings are listed below and will be discussed during the workshop. The purpose of the required readings is to fix ideas around an active topic of research and generate discussion during the meeting. Supplementary readings (also listed) are not required readings but are related to the workshop material and may also be discussed.

WORKSHOP PLAN

April 6, 2022, Session #1 – Overview of hedge funds; Dynamic risk exposures of hedge fund portfolios

Main objectives:
Cover an overview of hedge funds, including a historical view of hedge fund regulation and academic research on the topic. Discuss the dynamic trading strategies of hedge funds and the challenges that dynamic trading strategies pose for evaluating portfolio performance. Specific topics include:

- Dynamic risk exposures in popular hedge fund strategies
- Dynamic risk and hedge fund manager compensation incentives

Required readings:

- Fung, W. and Hsieh, D.A., 2001. The risk in hedge fund strategies: Theory and evidence from trend followers. Review of Financial Studies, 14(2), pp.313-341.
- Buraschi, A., Kosowski, R. and Sritrakul, W., 2014. Incentives and endogenous risk taking: A structural view on hedge fund alphas. The Journal of Finance, 69(6), pp.2819-2870.

Supplementary readings:

- Agarwal, V., Green, T.C. and Ren, H., 2018. Alpha or beta in the eye of the beholder: What drives hedge fund flows? Journal of Financial Economics, 127(3), pp.417-434.
- Aragon, G.O. and Nanda, V., 2012. Tournament behavior in hedge funds: High-water marks, fund liquidation, and managerial stake. The Review of Financial Studies, 25(3), pp.937-974.
- Bali, T.G., Gokcan, S. and Liang, B., 2007. Value at risk and the cross-section of hedge fund returns. Journal of banking & finance, 31(4), pp.1135-1166.

- Bollen, N.P. and Whaley, R.E., 2009. Hedge fund risk dynamics: Implications for performance appraisal. Journal of Finance, 64(2), pp.985-1035.
- Jurek, J.W. and Stafford, E., 2015. The cost of capital for alternative investments. The Journal of Finance, 70(5), pp.2185-2226.
- Patton, A.J. and Ramadorai, T., 2013. On the high-frequency dynamics of hedge fund risk exposures. Journal of Finance, 68(2), pp.597-635.

April 7, 2022, Session #2 –Illiquidity exposure and data pitfalls

Main objectives:
Discuss topics related to the illiquidity exposure of hedge fund portfolios, including return smoothing and its effects on standard measures of portfolio performance. Cover potential biases in estimates of hedge fund portfolio performance that may result from the self-reported nature of popular databases. Specific topics include:
- Return smoothing
- Data pitfalls (e.g., survivorship, backfilling, selection)

Required readings:
- Bollen, N.P. and Pool, V.K., 2008. Conditional return smoothing in the hedge fund industry. Journal of Financial and Quantitative Analysis, 43(2), pp.267-298.
- Barth, D., Joenväärä, J., Kauppila, M. and Wermers, R., 2021. The hedge fund industry is bigger (and has performed better) than you think. OFR Working Paper.

Supplementary readings:
- Agarwal, V., Fos, V. and Jiang, W., 2013. Inferring reporting-related biases in hedge fund databases from hedge fund equity holdings. Management Science, 59(6), pp.1271-1289.
- Aragon, G.O. and Nanda, V., 2017. Strategic delays and clustering in hedge fund reported returns. Journal of Financial and Quantitative Analysis, 52(1), pp.1-35.
- Bollen, N.P. and Pool, V.K., 2012. Suspicious patterns in hedge fund returns and the risk of fraud. The Review of Financial Studies, 25(9), pp.2673-2702.
- Brown, S.J., Goetzmann, W.N. and Ibbotson, R.G., 1999. Offshore hedge funds: Survival and performance, 1989-95. Journal of Business, 72(1), pp.91-117.
- Fung, W. and Hsieh, D.A., 2000. Performance characteristics of hedge funds and commodity funds: Natural vs. spurious biases. Journal of Financial and Quantitative analysis, 35(3), pp.291-307.
- Getmansky, M., Lo, A.W. and Makarov, I., 2004. An econometric model of serial correlation and illiquidity in hedge fund returns. Journal of Financial Economics, 74(3), pp.529-609.
- Joenväärä, J., Kauppila, M., Kosowski, R. and Tolonen, P., 2021. Hedge Fund Performance: Are Stylized Facts Sensitive to Which Database One Uses? Critical Finance Review, 10(2), pp.271-327.
- Jorion, P. and Schwarz, C., 2019. The fix is in: Properly backing out backfill bias. The Review of Financial Studies, 32(12), pp.5048-5099.

April 8, 2022, Session #3 – Capital fragility and hedge funds

Main objectives:
Discuss issues related to the fragility of capital used by hedge funds to finance their trading activities, including the capital provided by a fund's investors and its creditors. Discuss how capital fragility in hedge funds can impact market prices of the underlying securities traded by hedge funds. Specific topics include:

- Investor flows and the limits of arbitrage
- Funding liquidity risk and prime brokers

Required readings:

- Shleifer, A. and Vishny, R.W., 1997. The limits of arbitrage. The Journal of finance, 52(1), pp.35-55.
- Aragon, G.O. and Strahan, P.E., 2012. Hedge funds as liquidity providers: Evidence from the Lehman bankruptcy. Journal of Financial Economics, 103(3), pp.570-587.

Supplementary readings:

- Aragon, G.O., 2007. Share restrictions and asset pricing: Evidence from the hedge fund industry. Journal of financial economics, 83(1), pp.33-58.
- Aragon, G.O., Martin, J.S. and Shi, Z., 2019. Who benefits in a crisis? Evidence from hedge fund stock and option holdings. Journal of Financial Economics, 131(2), pp.345-361.
- Aragon, G.O., Nanda, V. and Zhao, H., 2021. Investor protection and capital fragility: Evidence from hedge funds around the world. The Review of Financial Studies, 34(3), pp.1368-1407.
- Brunnermeier, M.K. and Pedersen, L.H., 2009. Market liquidity and funding liquidity. The review of financial studies, 22(6), pp.2201-2238.
- Brunnermeier, M.K. and Nagel, S., 2004. Hedge funds and the technology bubble. The journal of Finance, 59(5), pp.2013-2040.
- Jylhä, P., Rinne, K. and Suominen, M., 2014. Do hedge funds supply or demand liquidity? Review of Finance, 18(4), pp.1259-1298.
- Kruttli, M.S., Monin, P., Petrasek, L. and Watugala, S.W., 2021. LTCM Redux? Hedge Fund Treasury Trading and Funding Fragility. Available at SSRN 3817978. Working Paper.
- Kruttli, M.S., Monin, P. and Watugala, S.W., 2022. The Life of the Counterparty: Shock Propagation in Hedge Fund-Prime Broker Credit Networks. Available at SSRN 3140900. (JFE forthcoming)