

Hedge Funds: A Credit Perspective

A two-day intensive workshop offering an in depth structured approach to the analysis of hedge funds and alternative investment strategies. The workshop takes a credit focus for bankers and analysts but is also appropriate for a wider audience who need to understand the key risk issues of the hedge fund industry.

TARGET AUDIENCE

The workshop is targeted at an intermediate level for credit analysts but is also appropriate for a wider audience of risk managers, bankers, regulators and other professionals who need to understand the key risk issues of the hedge fund industry. It is complementary to the one-day workshop: Regulated Funds & Fund Managers: A Credit Perspective. Participants may also be interested in attending Counterparty Credit Risk in Derivatives.

FitchTraining offers programmes at an intermediate level and advanced level of continuing education. Although there are no prerequisite courses or experience, working knowledge of investment markets and financial products is required.

COURSE OBJECTIVES

The two-day workshop offers a structured analytic framework for the credit analysis of hedge and other unregulated funds. Specifically participants will be equipped to:

- Distinguish the risk profile of a fund's investment strategy, structure, leverage and liquidity
- Apply financial analytic tools used to benchmark the performance and risk profile of a fund
- Identify the due diligence required for evaluating the fund manager's expertise, investment process, risk management and controls
- Recognise early warning signals of heightened risk
- Evaluate the structural risks and mitigants of exposures to funds

CONTENT

INDUSTRY OVERVIEW

Background

- History, growth and role of hedge funds in financial markets
- Investors - evolving investor base

Features of unregulated funds:

- Hedge funds, managed accounts, certain closed ended funds, fund of funds, master feeders, private equity etc.
- Legal status - partnerships, corporations, managed accounts
- Fee structures - management and performance; high water marks
- Investor redemption terms-lockups, notice periods, frequency
- Funds of funds and other structured products
- Jurisdiction - registration, listing, manager domicile

Goals

- Absolute versus benchmarked returns; correlations
- Alpha versus beta; portable alpha

ANALYTIC OVERVIEW

Structured approach to analysis

- Purpose of transaction and sources of payback - Who is the counterparty? What assets or derivatives are being financed? How will the transaction be settled or the debt repaid at maturity?
- Risk analysis - orientation, strategy, financials and key parties
- Structure - risks and mitigants of the transaction

FUND ANALYSIS

Key parties

- Roles of manager, advisers, administrator, custodian etc.
- Prime brokers - impact of relationship on risk profile

Strategies and investment practices

- Techniques to achieve high risk adjusted returns: leverage, derivatives and short selling
- Fund policies, practices and restrictions
- Risk profile of different strategies
 - Directional Strategies: global macro, managed futures, long / short equity, emerging markets
 - Relative value strategies: convertible arbitrage, equity market neutral, fixed income arbitrage,
 - Other: event-driven, distressed and risk arbitrage, multi strategy
- Pitfalls of different strategies - where they can go wrong

Financial analysis

- "S": Size - size, diversification and market position of fund
- "M": Market risk - volatility measures – standard deviation, correlations, VaR, stress simulations, concentrations etc.
- "A": Asset quality - liquidity and valuations
- "L": Liquidity - redemption risk and financing arrangements
- "L": Leverage - gross and net leverage calculations, limitations of leverage calculations
- "P": Performance - bench marking performance against indices and evaluating past performance; measuring risk and performance – Sharpe and Sortino ratios; peak to trough drawdown

Early warning signals

- Common themes and summary of major failures and causes

FUND MANAGER

Due diligence

- Key issues - experience levels; size, affiliation
- Sustainability of business model
- Regulation and supervision, where appropriate

Risk management

- Investment process
- Operational and credit risk
- Market risk control - appropriate limit and control structures for different strategies

STRUCTURE

- Structured approach: using the purpose payback model to evaluate transactions
- Exposure risks - credit, market, operational, reputation
- Exposure profile - appropriateness in terms of amount, maturity etc.
- Ranking - establishing and maintaining a senior position
- Safeguards - collateral, unsecured thresholds, covenants, break clauses, NAV triggers, NAV floor, cross default
- Collateralisation - measuring and margining exposure, portfolio margining
- Legal documentation - ISDA, prime brokerage and repurchase agreements.