How they are different from Mutual Funds

- Often off shore (i.e., registered in the Caymans)

- Usually wider array of securities including derivatives

- Often leveraged

- More dramatic changes in their composition

- Pure ones are market neutral

- Usually compensated as percentage of profits

- Limited partnership
Normal Compensation

1. Annual fee of 1% to 2% of assets.

2. Incentive fee of 5% to 25% of assets benchmarked to zero or treasury rate.

3. Usually prior thresholds that are not met are added to current threshold.


How Differ from Normal

Hedge Fund Investments Are Dynamic:

• Rarely Buy-and-Hold

• Fees Reflect *Active* Management

• Information-Driven Trading

• Sensitive To Economic and Market Conditions

• Effects Are Generally Nonlinear

• Static Risk Analytics Are Not Appropriate
Difficult to Measure Performance

Example: Capital Decimation Partners, L.P.

- Market Neutral Equity Hedge Fund
- Established January 1992
- Initial Assets: $10M
- 8-Year Track Record (96 Months)
Trading Strategy Is A Synthetic Option!

• Delta-Hedging Strategy (Black-Scholes Formula)

• Replicates Short European Put On:
  -10,000,000 Shares of XYZ
  -Strike: $25
  -Time To Maturity: 2 Years
  -Borrowing Rate: 5%

• Put Options Worth Only $14,693

• Profitable *Most* of the Time