

TITLE:

A premier on hedge funds

PURPOSE / SYNOPSIS OF THESIS

The term 'Hedge Funds' first came into use in the 1950's to describe any investment funds that use incentive fees, short selling or leverage. Hedge Funds usually refer to private investment vehicle that seeks above average returns through active portfolio management. Investors are attracted to Hedge Funds for a variety of reasons. this includes the potential to deliver positive returns under all market conditions, 'absolute returns', which are not correlated to the returns of the traditional asset classes which include stock and bond and access to highly specialized strategies not typically available through traditional money management.

Hedge Funds have attracted significant capital over the last decade, triggered by successful track record. The Global Hedge Funds volume has increased from US \$ 50 billion in 1988 to US \$ 875 billion in 2004, yielding an astonishing average cumulative growth rate in excess of 24%.

According to Hennessey Group LLC, an advisor to Hedge Funds investors, the Hedge Funds Industry assets increased by \$ 139 billion to \$ 934 billion in 2004. Hedge Funds also outperformed the Mutual Funds in the falling equity market. During the past fourteen years starting 1990 to 2004, the SSP 500 index has had 16 negative quarters totaling a negative return of 110.4%. During those negative quarters, the average US equity mutual fund had a total negative return of 113% while the average Hedge Fund had a total negative return of only 10.4%, displaying the ability of Hedge Funds to preserve capital in falling equity market. In the last three years, hedge funds have boomed because of extremely volatile and punitive market conditions. Investors, frustrated by the lowest interest rates in modern financial history, have been aggressively searching for returns. While mutual funds have lost over a trillion dollars in assets since the tech meltdown of 2000, and are now barely clawing back to their earlier asset level, hedge funds have doubled in the last three years alone to over trillion dollars. Now, not only do hedge funds get monies from wealthy billionaires and Swiss private banks, but also from pension funds, college endowments, et al. the brightest fund managers are also rushing to set up their own hedge funds, thanks to the lure of high fees. With institutional interest in market- neutral investments growing, the nest trillion dollars will go to the hedge funds much faster.

Hedge funds are sometimes perceived to be speculative and volatile but they can provide benefit to the financial market by contributing to market efficiency by enhancing liquidity. They often amuse risk by serving ready counter parties to entities that wish to hedge risks. Hedge funds can also serve as an important risk management tool for investors by providing valuable portfolio diversification. Some jurisdictions are gradually moving towards allowing the marketing of hedge funds and fund of funds products to real investors. Those jurisdictions have simultaneously imposed disclosure requirements to ensure that investors understand

complexity and associated risk of investing in hedge funds. Realizing the growing importance of hedge funds, several emerging market regulators have opened the markets to offshore hedge funds by providing authorization as registered foreign investors. The role played by some of the hedge funds has often been associated with major financial crisis that took place in the 90's. However, subsequent research could not produce robust evidence implicating the hedge funds for precipitating the crisis. Researchers have, however attributed the negative public perception of the role of hedge funds managers in crisis partly to the limited information available about what they actually do.

in view of the increasing popularity among the institutions as well as their increasing interest in the Indian markets, it might be time to provide a limited window to this growing segment of asset management industry within the existing framework of the SEBI (Foreign Institutional Investors) Regulations. Recognizing the fact SEBI has published a report date May 14, 2004 on Hedge funds investments in India. The report seeks to open limited FII window to allow the alternative investment vehicle of hedge funds to operate as direct investors in Indian Securities Market in a transparent and orderly manner.

SEBI is firm that all restrictions on hedge funds should be done away with and is in total agreement with the Ashok Lahiri Committee recommendation to foreign investment. The recommendations are intended to wide the FII window to allow these alternatives invest pools to our securities markets. In addition, the suggestions also provide for adequate safety measures to address legitimate concerns associated with these funds. The alternative invest pools if allows to investment in Indian markets will be a source of additional liquidity and will also diversify the pool of foreign investments in Indian market.

OBJECTIVE:

This is a detailed study taken to explore:

- Meaning of Hedge Funds
- Types of Hedge Funds
- History and Scams involved with hedge funds
- Benefits of Hedge Funds
- Performance of the Global Hedge Funds markets
- Hedge funds regulations in foreign markets
- Hedge funds regulation in India
- Prospects for hedge funds in India.

SOURCE OF INFORMATION:

Primary data sources:

Collected through personal research in Analec Infotech Pvt. Ltd.

Secondary data sources:

The secondary data was collected and gathered from newspapers, journals and websites.

Data collection tools:

Personal discussion and observation.

SCOPE OF THE STUDY:

Mr. Sarker, the COO of Analec Infotech Pvt. Ltd. was approached in order to explore the potential of Hedge Funds in India and also the current position of Hedge Funds in the global market. Besides, the study covers all parameters relating to Hedge Funds- in global and in Indian context.

LIMITATIONS OF STUDY:

Like any other research study, this particular research on Hedge Funds is also subject to certain limitations. There is limited information available about the working of hedge funds. Hence there is too much dependency on secondary sources of information viz. newspapers, magazines, SEBI bulletin and research reports.