



Is “Closed” Really Better?

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It is a natural human phenomenon to want what you can't have, but in the case of hedge funds, are “closed” funds really more desirable than “open” funds? Capital Market Risk Advisors, Inc. (CMRA) and its affiliate L² Alternative Asset Management (L²), released today a study of the performance of “closed” funds versus “open” funds. CMRA's analysis revealed that of the over 3,700 funds in their database*, “open” funds actually outperformed “closed” funds on average by 0.1%. How can we reconcile this unexpected result with the general expectation that “closed” funds are supposed to be more desirable?

CMRA took a risk/reward perspective by analyzing the performance and volatility of both “closed” and “open” funds and calculated the liquidity of these funds as measured by the L² Liquidity Index.

How does performance of “open” funds compare to performance of “closed”?

As Table 1 indicates, in the Fixed Income, Event Driven, Equity Long/Short and Merger Arbitrage strategies the performance of “closed” funds lags their “open” funds counterparts.

The largest gap in performance between “open” and “closed” is in Managed Futures, Emerging Markets, Convertible Arbitrage and Global Macro strategies. Here, “closed” funds outperformed “open” funds from 3.6% to 4.9%.

Table 1

CMRA Hedge Fund Database
“Open” vs. “Closed” Comparison

Rank	Strategy	Performance Since Inception (%)		
		Open	Closed	Closed - Open
1	Managed Futures	12.9	17.8	4.9
2	Emerging Markets	13.6	18.2	4.6
3	Convertible Arbitrage	10.1	14.3	4.2
4	Global Macro	9.7	13.3	3.6
5	Market Neutral	9.4	10.3	0.9
6	Fund of Funds	7.5	7.6	0.1
7	Distressed	16.7	16.7	0.0
8	Fixed Income	11.1	10.1	-0.9
9	Event Driven	11.8	10.8	-1.0
10	Equity Long/Short	14.3	11.0	-3.3
11	Merger Arbitrage	22.8	8.5	-14.3
Average of Hedge Fund Database		12.7	12.6	-0.1

* Including the Institutional Investor Top 100

What types of funds are more volatile?

Table 2 compares the average annualized volatilities associated with “open” and “closed” funds across different strategies. In the Managed Futures, Equity Long/Short and Emerging Market strategies, “closed” funds are more volatile than “open” funds, which is a bit surprising.

Further research shows that there are no major differences between drawdown and recovery patterns between “open” and “closed” funds except in Global Macro and Managed Futures strategies where “closed” funds were 4% and 5% higher than “open” funds, respectively.

There was also little difference in the length of the drawdowns and recovery with the exception of the Emerging Market and Equity Long/Short strategies where “open” funds took longer to recover from their largest drawdowns by four and two months, respectively.

Table 2
**Difference in Volatility Between
 “Open” and “Closed” Funds Since Inception (%)**

Rank	Strategy	Volatility Since Inception (%)		
		Open	Closed	Closed - Open
1	Managed Futures	17.1	22.2	5.0
2	Equity Long/Short	18.2	21.9	3.7
3	Emerging Markets	19.0	21.8	2.8
4	Event Driven	13.1	14.4	1.3
5	Market Neutral	10.4	11.2	0.8
6	Convertible Arbitrage	4.7	5.3	0.6
7	Fixed Income	6.9	7.3	0.4
8	Fund of Funds	6.4	6.3	-0.2
9	Global Macro	15.5	14.3	-1.3
10	Distressed	9.3	8.0	-1.3
11	Merger Arbitrage	11.9	6.5	-5.3
Average of Hedge Fund Database		12.1	12.6	0.6

What about liquidity?

The application of the L² Liquidity Test, as shown in Table 3 indicates that the strategies where “closed” funds have significantly different liquidity than “open” funds are Convertible Arbitrage, Distressed, Emerging Markets, and Fixed Income. The higher the index the more illiquid the fund.

Table 3

L² Liquidity Index Comparison

Rank	Strategy	Liquidity Since Inception (%)		
		Open	Closed	Closed - Open
1	Convertible Arbitrage	3.0	4.9	2.0
2	Distressed	3.3	4.7	1.4
3	Merger Arbitrage	2.9	3.4	0.5
4	Equity Long/Short	1.5	1.6	0.1
5	Global Macro	1.5	1.5	0.0
6	Managed Futures	1.4	1.3	-0.1
7	Fund of Funds	2.9	2.5	-0.4
8	Market Neutral	2.9	2.4	-0.5
9	Event Driven	2.6	2.0	-0.7
10	Emerging Markets	2.6	1.6	-1.1
11	Fixed Income	5.2	3.8	-1.3
Average of Hedge Fund Database		2.7	2.7	0.0

Summary

Investing in “closed” funds does not necessarily lead to significantly higher returns. Investors should avoid the human tendency to assume that what they can’t have is more desirable than what they can have. While there are many excellent hedge funds that are "closed" to new investors, there are many that are still "open". Constructing a successful hedge fund portfolio involves a great deal more than chasing returns and/or lusting after what you can't have.