Abstract:
In recent years hedge funds have become more popular because of their low correlation with traditional investments and their ability to generate positive returns with a relatively low volatility. However, a closer look at those high performing hedge funds raises the question if the performance is truly superior and if the high management fees are justified. Incurring no alpha costs, so-called passive hedge fund replication strategies raise the question if they can lead to similar performance in a more efficient way at lower costs. This paper investigates two different model approaches for the equity long/short strategy, where weighted segmented linear regression models are employed in combination with two-state Markov switching models. The main finding is evidence of a short put option structure, i.e. short the equity market volatility, with the put structure present in all market states. We obtain evidence that the hedge fund managers decrease their short-volatility profile during turbulent markets.

Stichworte:
Hedge funds; hedge fund index; segmented linear regression models; regime-switching models; mimicking portfolios; single factor-based hedge fund replication; equity long/short strategy

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