

## Insights

### Diversifying Your Hedge Fund Investment

Most investors know the old adage about “not putting all your eggs into one basket.” The same principle applies to hedge funds. In fact, there are a great variety of strategies that all fall under the category of hedge funds, each with substantial differences in risk. In addition, by investing in a diversified portfolio of hedge funds—managed by a portfolio manager who determines both the initial selection and best ongoing allocation for the underlying funds—investors can benefit from the increased opportunities and innovative strategies. In short, for appropriate investors, funds of hedge funds may offer an attractive means of supplemental portfolio diversification without added risk.

#### Reducing Risk Through Added Diversification

Besides the possibility of reduced risk through professional management or selection, compared to an individual hedge fund, the funds of hedge funds approach may offer another way for investors to reduce risk: through the diversification inherent in including a number of different hedge fund managers. Since there are a number of managers, the impact of a minor—or even major—problem with one manager is offset by the diversifying effect of the other managers.

Some funds of hedge funds invest in many funds that use the same strategy, but each fund manager may have a different interpretation of that strategy. Others diversify even further by including a number of funds with different strategies. In general, volatility levels for funds of hedge funds tend to be in the low-to-moderate range.

#### More Strategies, Unique Benefits

Besides helping to reduce risk with the possibility of more consistent returns, funds of hedge funds can offer an investor the following benefits:

- **Professional management and monitoring is done on an ongoing basis.** A professional portfolio manager is responsible for researching, investing and monitoring the funds held in the portfolio. This includes conducting due diligence prior to selecting the funds for the portfolio and handling the strategic allocation and ongoing management of the portfolio's risk/return characteristics. Portfolio managers should have solid relationships in the industry, as well as the infrastructure and resources needed to maintain these important relationships and monitor hedge fund managers' results on an ongoing basis.
- **Lower account minimums are required.** Funds of hedge funds often have lower account minimums than individual hedge funds.

- **Institutional advantages and access is granted.** Many individual hedge funds are open to funds of hedge funds (which are considered institutional investors in the industry), but are closed to individual investors. Alternatively, a fund of hedge funds may already be invested in an individual fund that has closed to new investors, which means that the only way an investor can participate in a particular hedge fund is through a fund of hedge funds.

With the evolution of the hedge fund industry, both managers and investors have more choices and more decisions to make. Managers have a wider range of tools and techniques at their disposal, giving them much greater flexibility, while investors have more opportunities to diversify their portfolios.

To find out if funds of hedge funds might be appropriate investments for you, or for more recommendations on how to diversify your portfolio, speak with your Private Banker.

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