



Handbook

for finding the right Hedge Fund

HAMBURG: Hedge funds are getting more and more attention lately, but what exactly they are isn't always clear. Hedge funds generally seek to "hedge out" risks that they don't want to be exposed to, while taking on favourable risks that they can use to their advantage.

Unlike many other types of funds, such as mutual funds or pension funds, the goal of hedge funds isn't to "beat the market", or to perform better than a certain index. Rather, their goal is usually to consistently achieve the highest possible returns.

Hedge funds are usually not open to small investors, because of minimum initial investment sums and limitations on liquidity. In the light of recent developments over the past 10 years, Varengold has been a forerunner in making hedge fund investments feasible for the average investor.

When selecting a hedge fund to invest in, there are several things you should be aware of and take into consideration. Most of this information should be available in the prospectus provided by the hedge fund, but

investors should make sure that they pay special attention to the following factors.

Overall Investment Situation

When considering investing in a hedge fund, an investor has to think about the shape of his own overall portfolio and investments. Investors need to figure out what their short and long term investment goals are, and whether or not a particular hedge fund fits these objectives. Retirement assets should be treated differently than extra free capital, for example, and different investment choices may be more appropriate for different investment goals and situations. This is something that the investor must decide after inspecting the current situation, future goals, and the investment opportunities that are currently available.



Risks

Despite their name, many hedge funds take on large amounts of risk, in order to increase their potential returns. If an investor is interested in investing in a hedge fund, they need to be aware of the kinds of risks that the hedge fund might take on. Different hedge funds expose themselves to different risks in different markets, and investors need to be aware that the risks taken on by hedge funds can lead to both significant gains and significant losses. By finding out which markets the fund is active in, and what sort of instruments it trades, investors can get a better idea of the types of risk that the fund is assuming.

Many hedge funds invest in non-standardized over the counter (OTC) products. These non-market traded products can create liquidity problems, which can affect investors seeking to withdraw from the fund, or can prevent the hedge fund from pulling out of an investment.

Some funds trade extremely complex derivatives, which can be difficult to accurately price and evaluate. If used improperly, these derivatives can build up more excess risk than the fund is prepared for. The extra risk can lead to extraordinary gains, as well as losses.

Strategy and History

Along with risks, investors should be familiar with a hedge fund's strategy, and its history. Although a fund's history can't necessarily be used as an indicator for its future performance, an investor can get a feel for how the fund typically reacts to and deals with different market conditions, and how its performance is correlated to other investments.

By learning about the fund's strategy, investors can get a better feel for what kind of risks the fund takes, and what kind of investments the fund makes, and where the fund's returns come from. Different strategies take different risks in different markets, and investors need to ensure that they can accept the risks that the fund takes on with their investment.

Regulation

Hedge funds often take special measures to ensure that they are only lightly regulated. These special measures are often taken by restricting what kind of investors can invest in the fund. Most traditional funds are subject to regulations regarding how much and what types of risk they can take on, and what kind of investments they can make. However, by meeting certain requirements, most hedge funds are able to escape these regulations.



By avoiding these restrictions, hedge funds can operate with greater secrecy, and take on riskier investments. Investors should find how, and to what extent, the hedge fund is regulated.

Some fund types, such as managed futures, are actually subject to strict regulation. In the US, for example, managed futures funds are strictly regulated by the National Futures Association, and in Germany, BaFin regulates financial institutions and funds. Investors should find out which, if any, governing bodies regulate the fund, and to what extent.

Limitations

Hedge funds often restrict withdrawals, and have minimum investment requirements in order to avoid regulation and take certain trading approaches. Investors should make sure that they are aware of and able to comply with these limitations. These limitations often require a certain minimum initial investment, sometimes along the lines of millions of dollars. Investments in hedge funds should not necessarily be considered to be a liquid investment, as they may be tied up for periods of up to 25 months or more.

There may be other limitations that are specific to the individual fund, and investors should make sure that these limitations don't conflict with any investment goals.

Costs & Fees

Hedge funds charge fees differently than mutual funds or index funds. Hedge funds often charge a performance fee in addition to a management fee. The management fee is charged based on a percentage of the client's assets, which is generally 2%, but it can be as high as 5%.

For a performance fee, hedge funds generally retain a portion of the profits that they generate. There are different systems that are used to calculate this amount, such as only charging profits above the previous highest fund value, also known as a "high water mark." Performance fees are generally 20%, but can be as high as 50%.

Many funds also employ sales and administration costs, and investors should consider these fees and how they affect the investment. There may be other fees that are specific to an individual hedge fund. Investors should be aware that these fees cut into returns, and should keep that in mind when selecting a fund. Many high-performing funds charge higher performance fees, and these higher fees



reduce the investors return. Funds that avoid disclosing data such as fees, lockup time, past performance, etc. should be avoided.

Varengold's Solutions

Varengold has developed award-winning products that are suitable for every investor, from the average person looking for a good investment, all the way up to large institutional clients looking for sources of portfolio diversification. From our long standing and unique Managed Futures

Direct asset management services, to our VK1 hedge fund certificate, our award winning HI Varengold CTA Hedge to our Varengold Alternative Alpha fund, we are ready to meet the diverse needs of our clients.

For more information about our products please go to www.varengold.de.

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