

# Investor Education

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CANACCORD Wealth Management

## Hedge Funds 101

### What is a Hedge Fund?

Hedge funds are alternative investment structures that usually have one common goal: generating positive returns in all market environments by lowering the overall risk to the portfolio. Hedge funds use many of the same investment strategies that traditional investments use; however, a hedge fund manager can also use more complex strategies such as options, short-selling, arbitrage, and leverage. There are many types of hedge fund structures, and each one is unique. This makes general classification very difficult, as different hedge funds have varying methods of trying to achieve positive returns.

Most hedge funds in Canada currently use long/short selling strategies, and in most cases these are the first type of hedge product that investors run across. Other popular funds are comprised of a variety of hedge funds, called multi-strategy fund of funds. In these funds, the lead manager does a strenuous analysis to build a portfolio of non-correlated hedge funds. This can create a relatively stable, constant return portfolio.

Hedge funds are not a new investment product. The methodology has been used for decades by institutional trading desks and individual hedge products. Only recently have these non-traditional investments become available to the private investor. Hedge funds can substantially help a portfolio to achieve its objectives; however each hedge fund has different goals. The mandate of a particular fund should be examined thoroughly to determine if it is appropriate for your portfolio.

### Hedge Funds versus Mutual Funds

The majority of hedge funds in Canada are classified as long/short equity funds so we can loosely describe them as an extension of mutual funds—but with more flexibility. In fact, increased flexibility is the main difference between hedge funds and mutual funds.

This flexibility can be a good or a bad thing. Making more tools available to a manager (such as concentration, short selling, and leverage) can enhance the performance an investor achieves for a given amount of risk. This is true with portfolios managed by very competent hedge fund managers. On the other hand, there is more room for error. In effect, we can compare the role of the hedge fund manager to a carpenter. It would make sense that a carpenter could build a better house if they

had all the tools available to them, instead of using only a hammer and nails. The risk is, if the carpenter doesn't know how to use all the tools, things can go very wrong. This is why proper due diligence and advice is required if an investor is to put hedge funds into their portfolio.

### Who should consider hedge funds?

Hedge funds should be considered part of a long term strategy for sophisticated investors. The reason for considering hedge funds is to provide a non-correlated asset in your portfolio mix. Many of these funds can substantially help a portfolio achieve its objectives; however each hedge fund has different goals, so it is important to research them thoroughly.

**Hedge funds are not appropriate for everyone. Your Canaccord Advisor can help to determine if this product is suited to your investment strategy.**

### Hedge Funds vs. Mutual Funds

	Mutual Fund	Hedge Fund
<b>Regulation</b>	Registered investment vehicles that are heavily regulated	Private investment vehicles (not as regulated)
<b>Minimum Investment</b>	Usually small minimum investments (eg. \$500 or \$5000)	Large minimum investments are typically required (usually a \$25,000 minimum for accredited investors)
<b>Availability</b>	Available to the general public.	Availability is restricted. Most investors in hedge funds need to be considered "accredited" or "sophisticated". Please contact your Investment Advisor for more information on what constitutes investor profiles.
<b>Liquidity</b>	Daily liquidity and redemption	Liquidity varies from monthly to annually
<b>Short Selling</b>	Not allowed or limited to a small amount	Manager may short sell often
<b>Leverage</b>	Less leverage	More leverage
<b>Down Markets</b>	Some funds are defensively managed and others hold during bad markets.	Most hedge fund strategies try to hedge against downturns in the markets, but effectiveness depends on the fund.

#### Long and Short Selling:

Selling long is the purchase of securities with the anticipation the stock price will go up, and can be sold at the (future) higher price.

Short selling is the sale of a security the seller does not own at the time. Short sellers assume that they will be able to buy the stock at a lower amount than the price at which they sold short, meaning they make money if the stock goes down in price. This is an advanced trading strategy with unique risks.

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