THE ABCS OF HEDGE FUNDS



FundOpsHQ

Hazel the hedgehog prepares for being wrong



This book belongs to

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Alpha is the part of a return that comes from a manager's skill, rather than from the whole market rising. It is hard to find.



Beta is the part of a return that comes from the whole market moving. When the tide comes in, every boat rises.

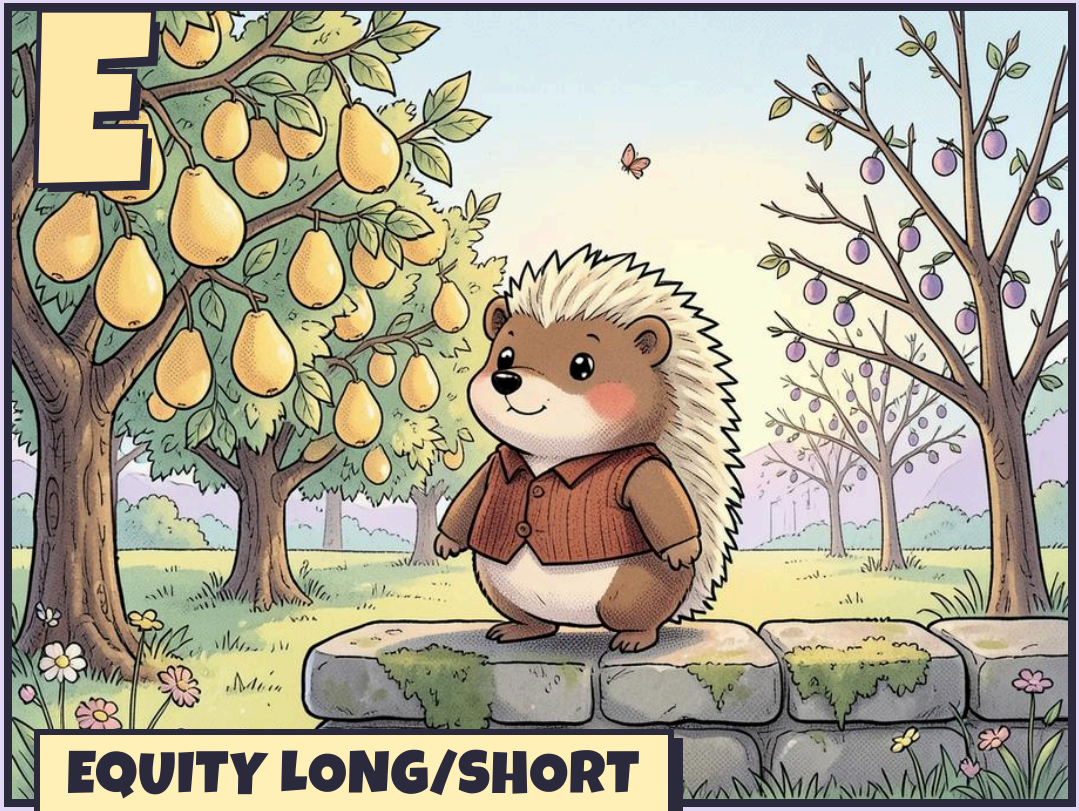


CROWDED TRADE

When many funds make the same bet, that is a crowded trade. It can be hard for all of them to leave at once.



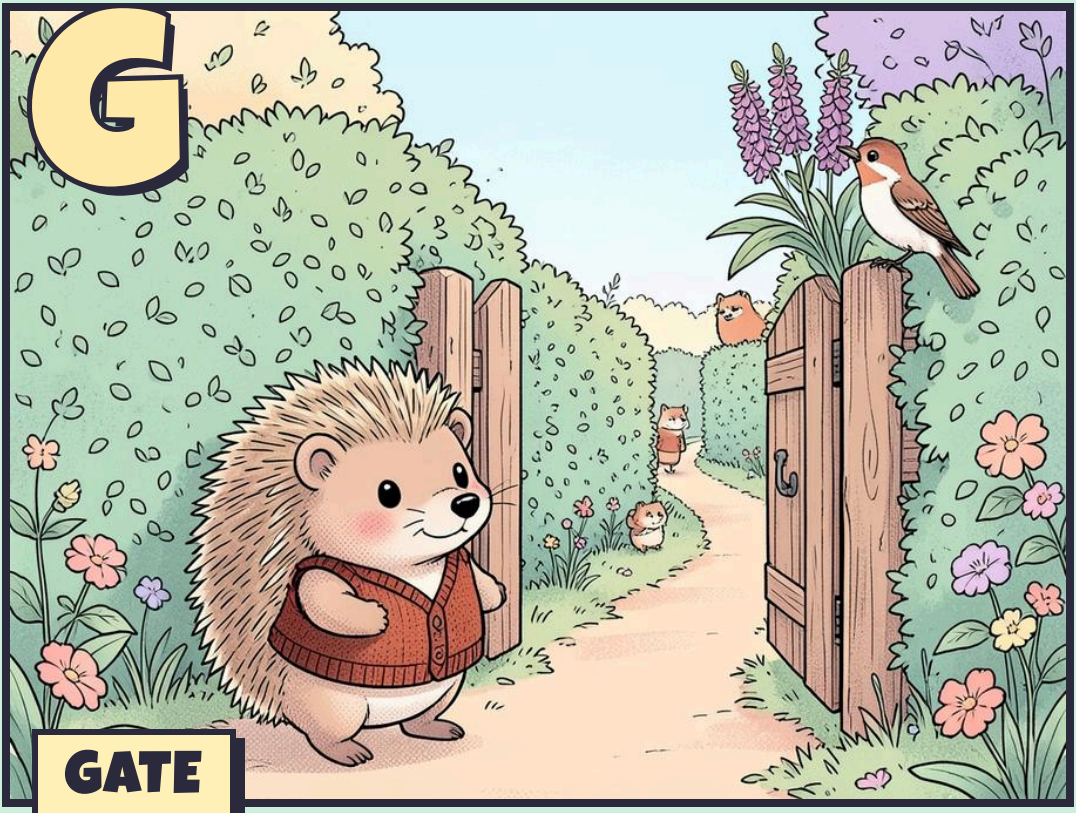
A drawdown is how far a fund falls from its highest point before it climbs back. Investors watch it closely.



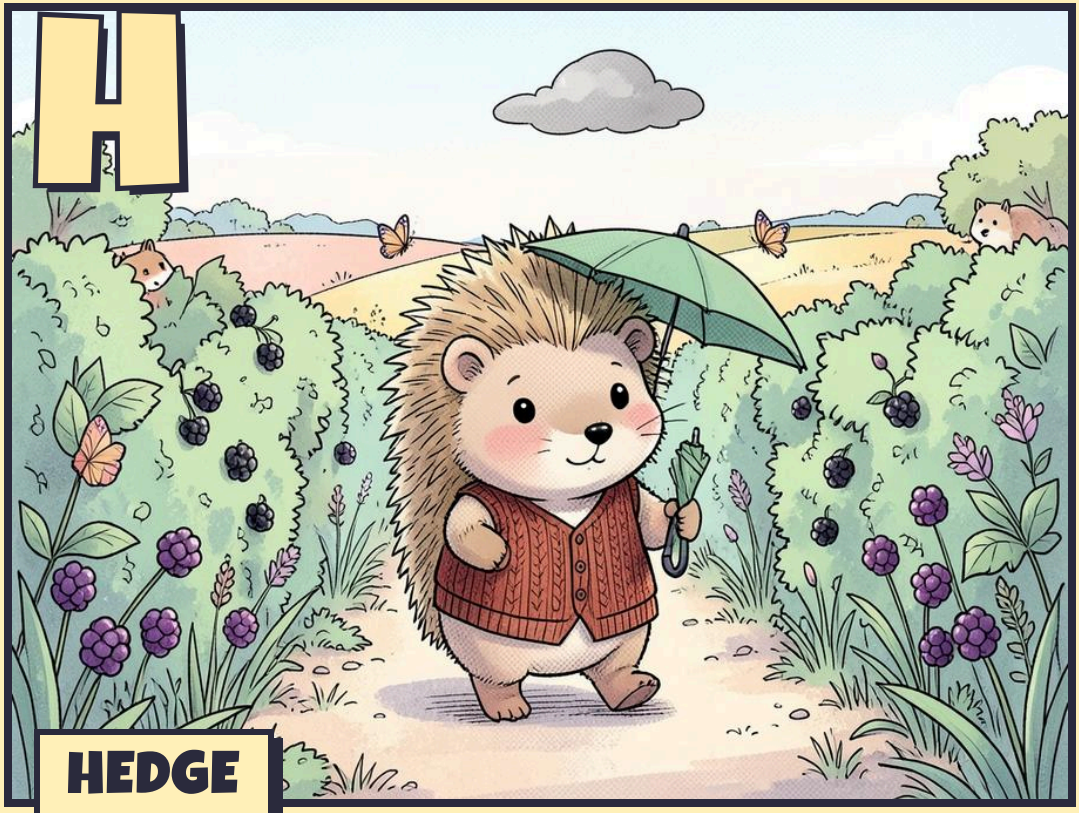
An equity long/short fund buys shares it expects to rise and bets against shares it expects to fall. Owning and hoping for a rise is called being long.



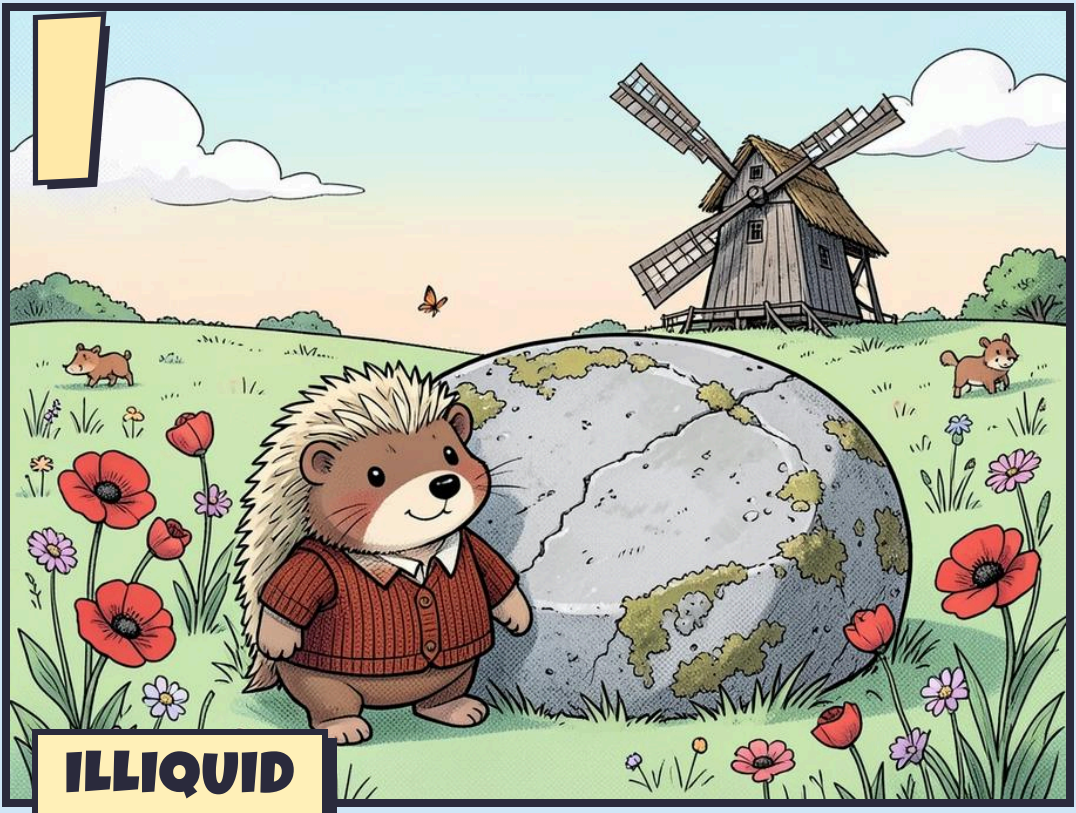
A future is an agreement to buy or sell something on a later date, at a price set today. Farmers and funds both use them.



A gate limits how much money investors can take out of a fund at one time. It keeps the fund from having to sell in a hurry.



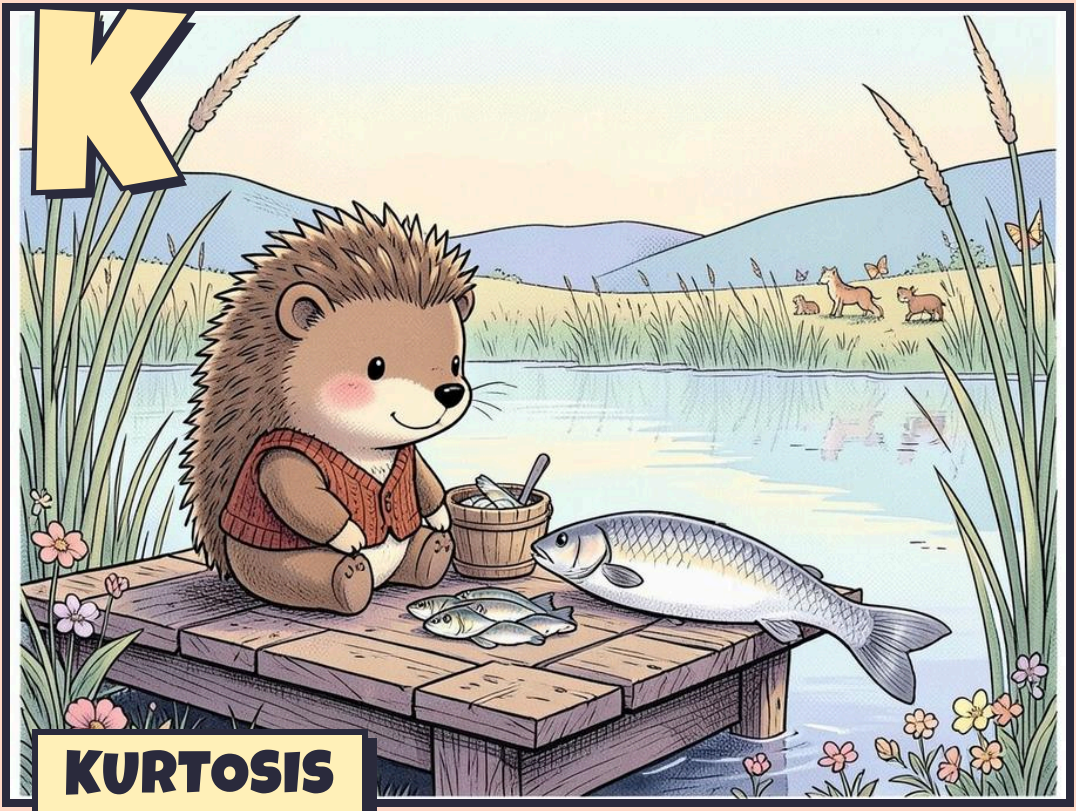
A hedge is something you hold to soften a loss if your main idea turns out to be wrong. It costs a little. Hazel is glad of it.



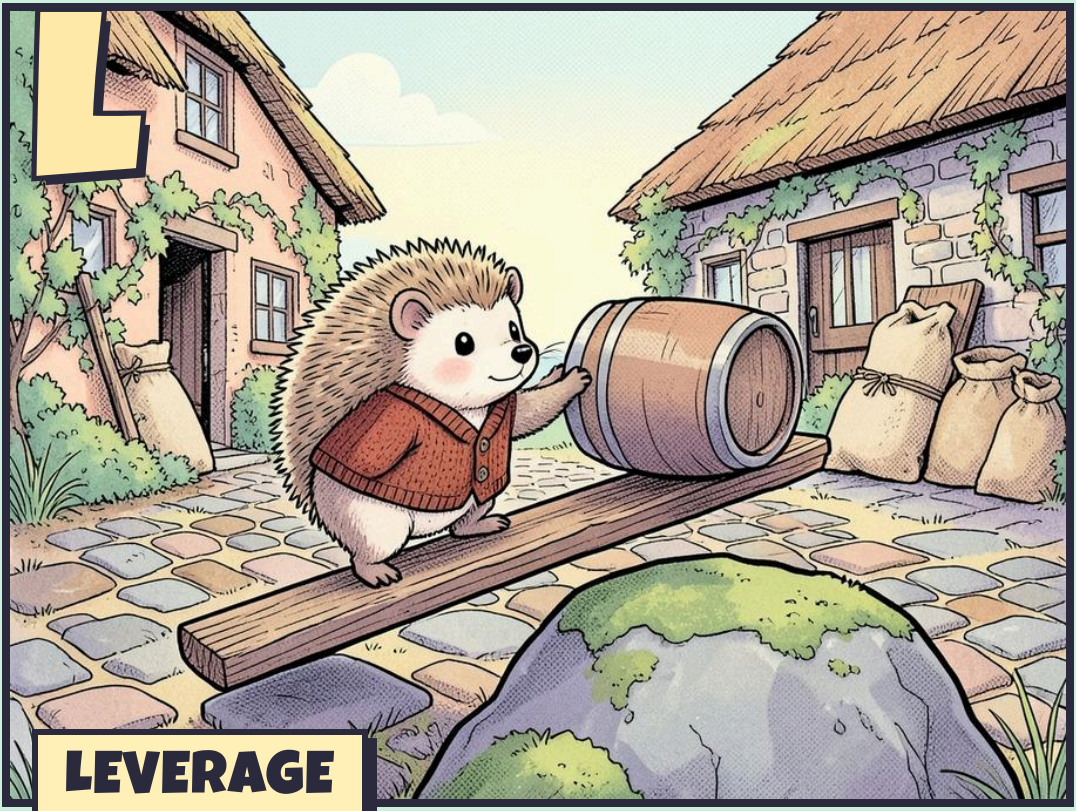
An illiquid holding is one that is hard to sell quickly at a fair price. Some funds set these apart in what is called a side pocket.



Jump risk is the chance of a price moving very far, very suddenly, with no time to act in between.



Kurtosis is a long word for how often very large surprises turn up in a set of returns, compared with a normal bell curve.



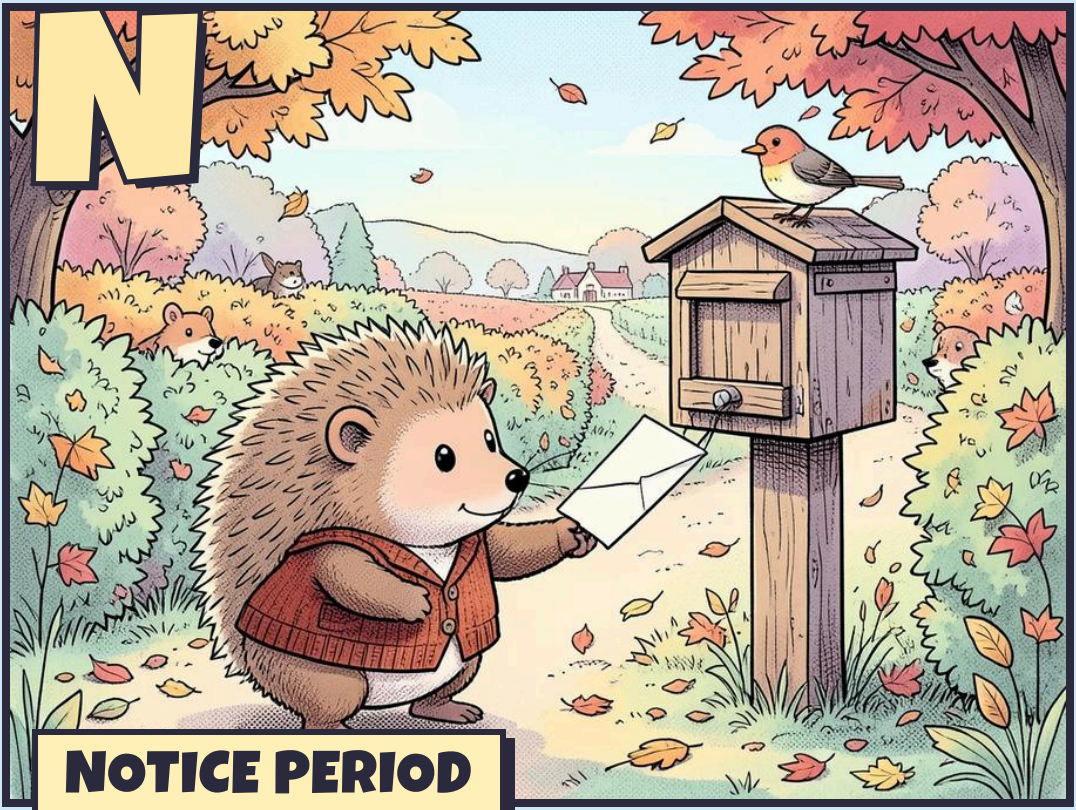
Leverage means using borrowed money to make bigger bets. It makes gains larger, and it makes losses larger too.

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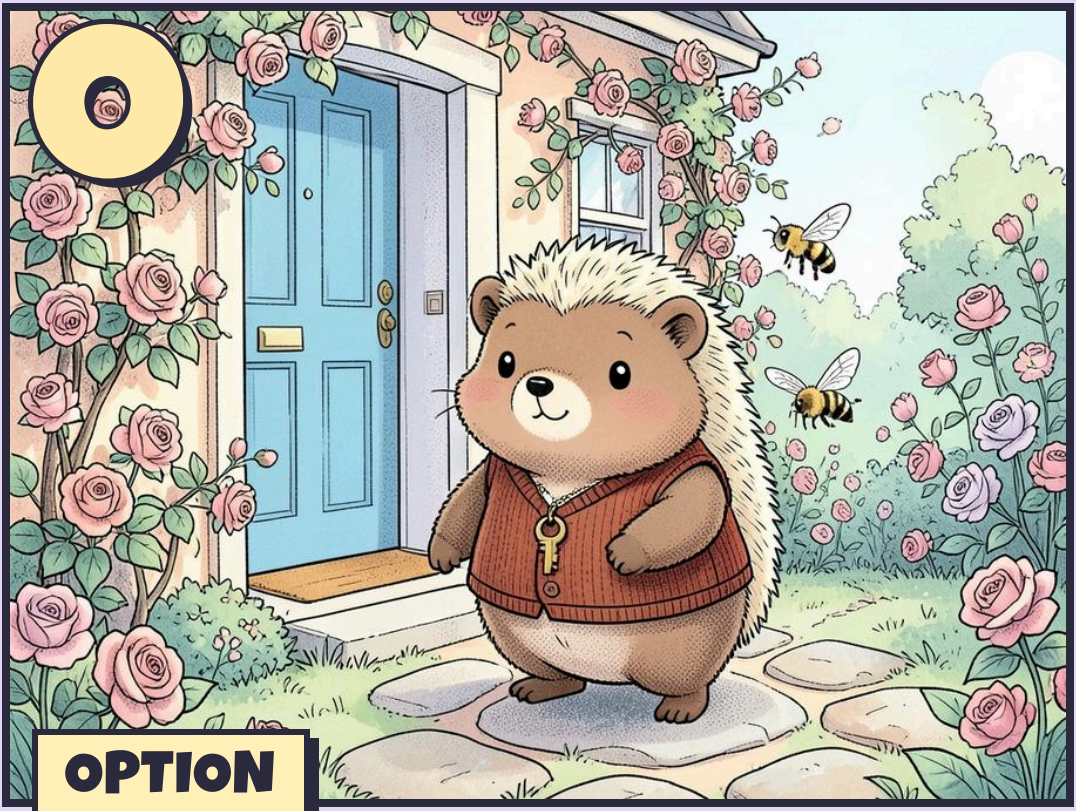


MACRO

A macro fund bets on big things, such as interest rates, currencies and whole economies, rather than on single companies.



Before taking money out, an investor often has to tell the fund weeks or months ahead. That is the notice period.

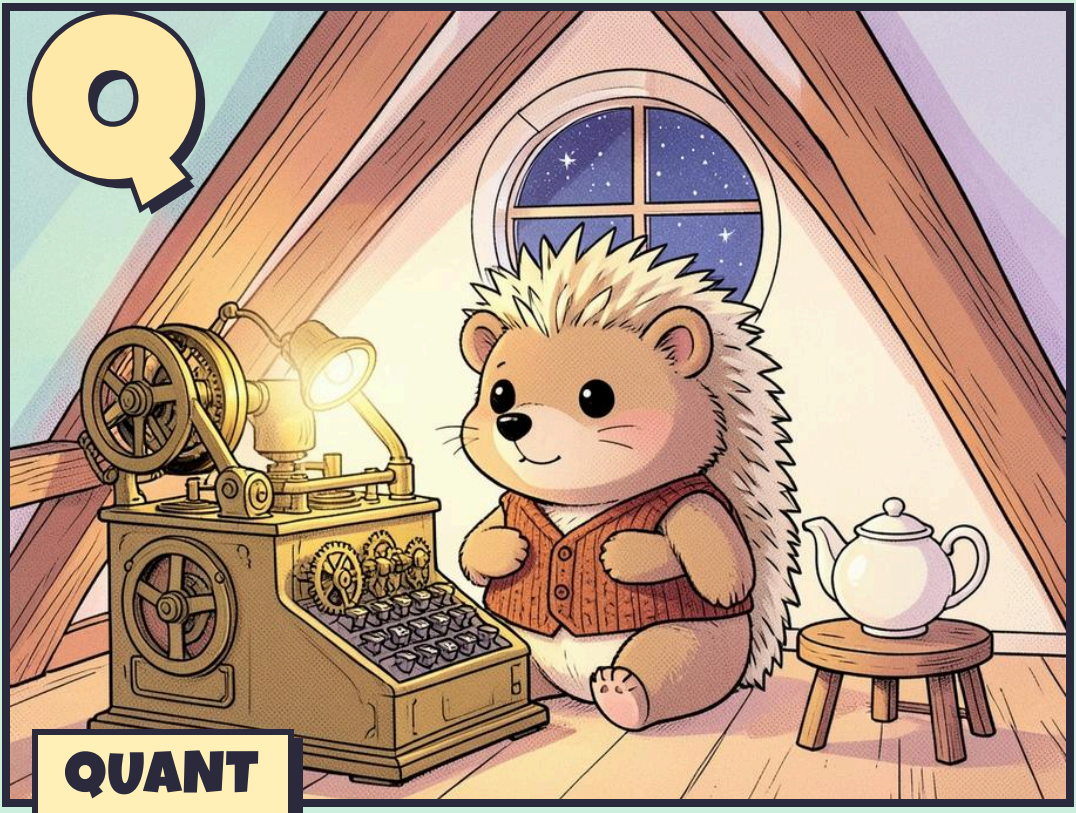


An option is the right, but not the duty, to buy or sell something at a set price by a set date. The right itself has a price.

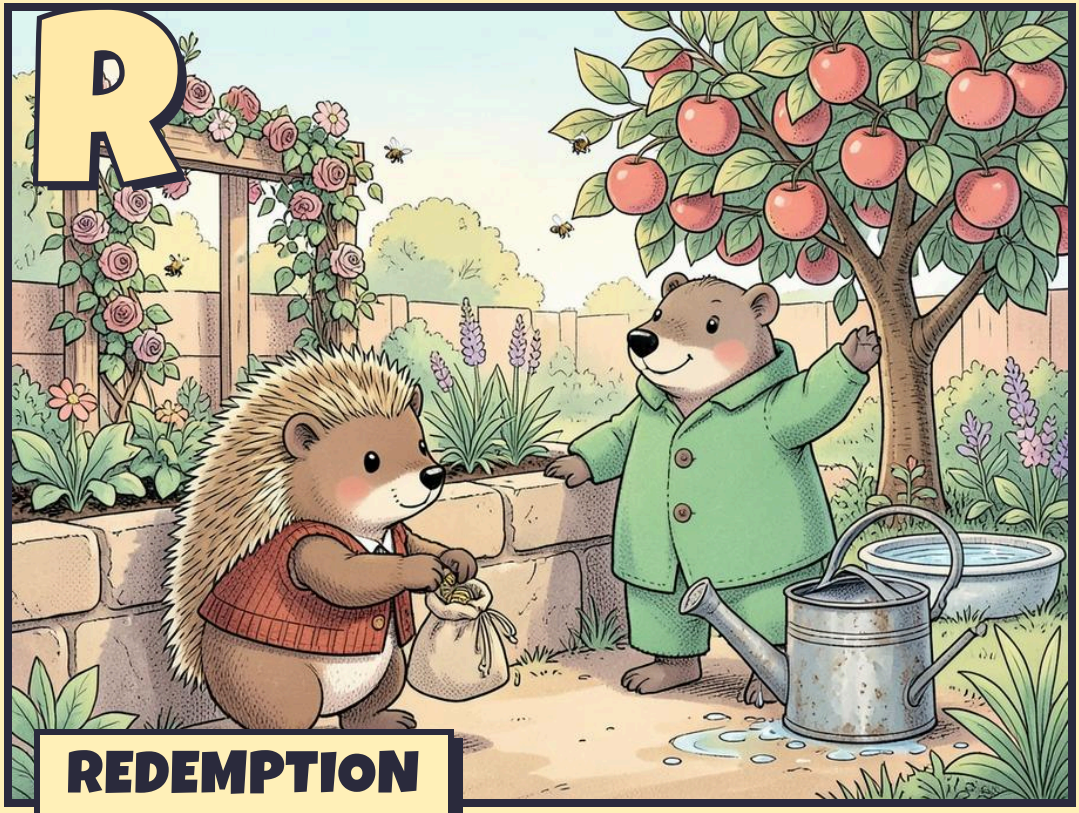


PAIR TRADE

A pair trade buys one company and bets against a similar one. It is a bet on which does better, not on the whole market.



A quant fund uses math and computers to find patterns in prices, then trades by set rules.



A redemption is when an investor takes money out of a fund. Hedge funds usually allow it on set dates, often each month or quarter.



To go short, a fund borrows shares, sells them, and hopes to buy them back for less and return them. If the price rises, it loses.



TWO AND TWENTY

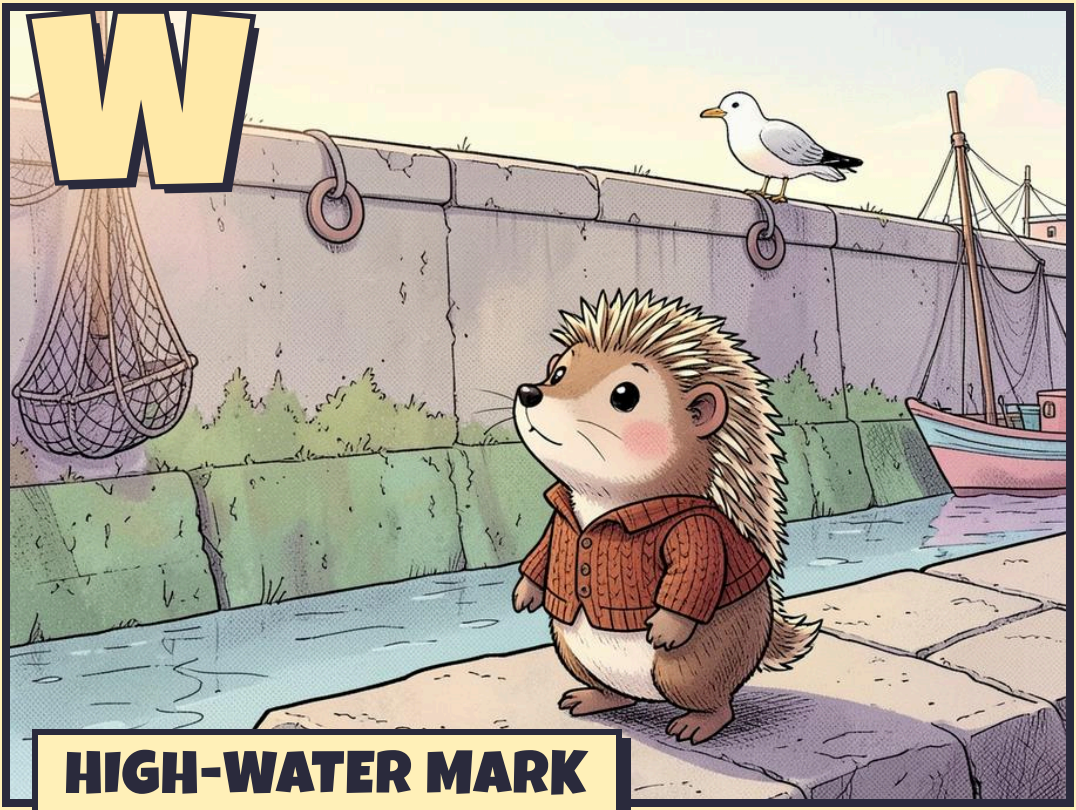
Two and twenty is the old shorthand for what a hedge fund charges: a 2% fee each year and 20% of the gains. Many now charge differently.



Two things are uncorrelated when the ups and downs of one tell you little about the other. Investors often look for this.

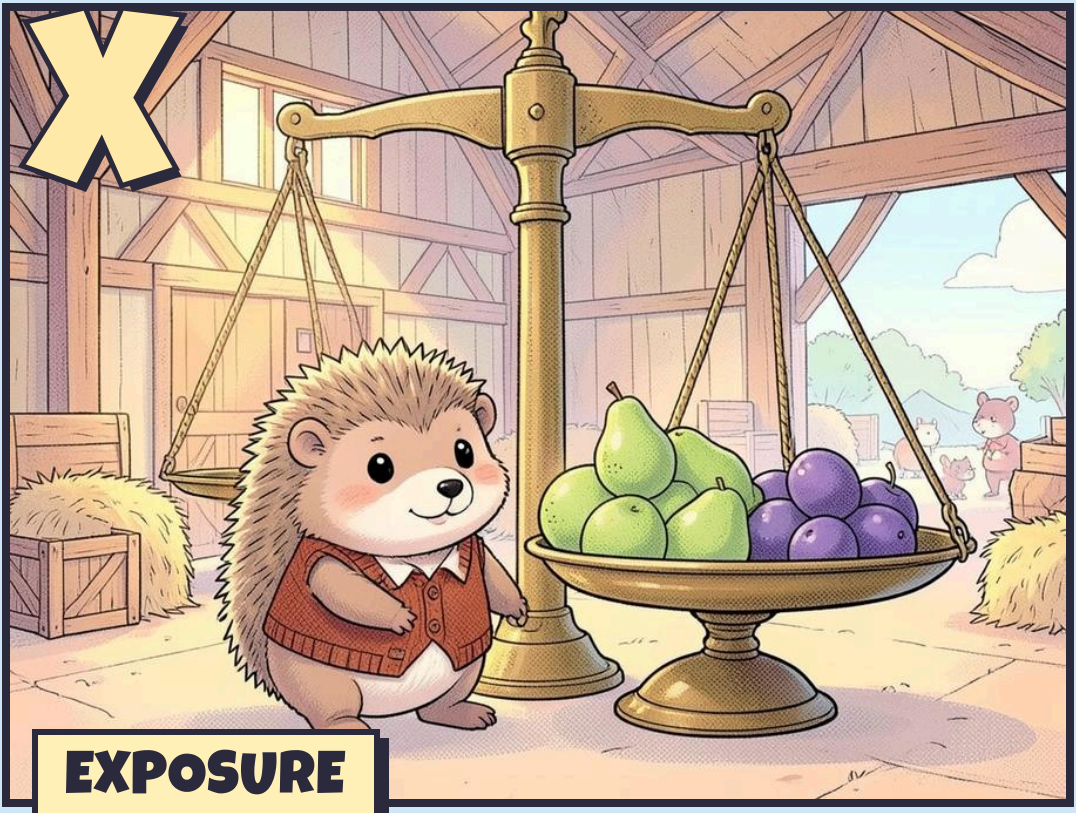


Volatility is how much a price swings up and down. More of it makes for a bumpier ride and a wider range of outcomes.

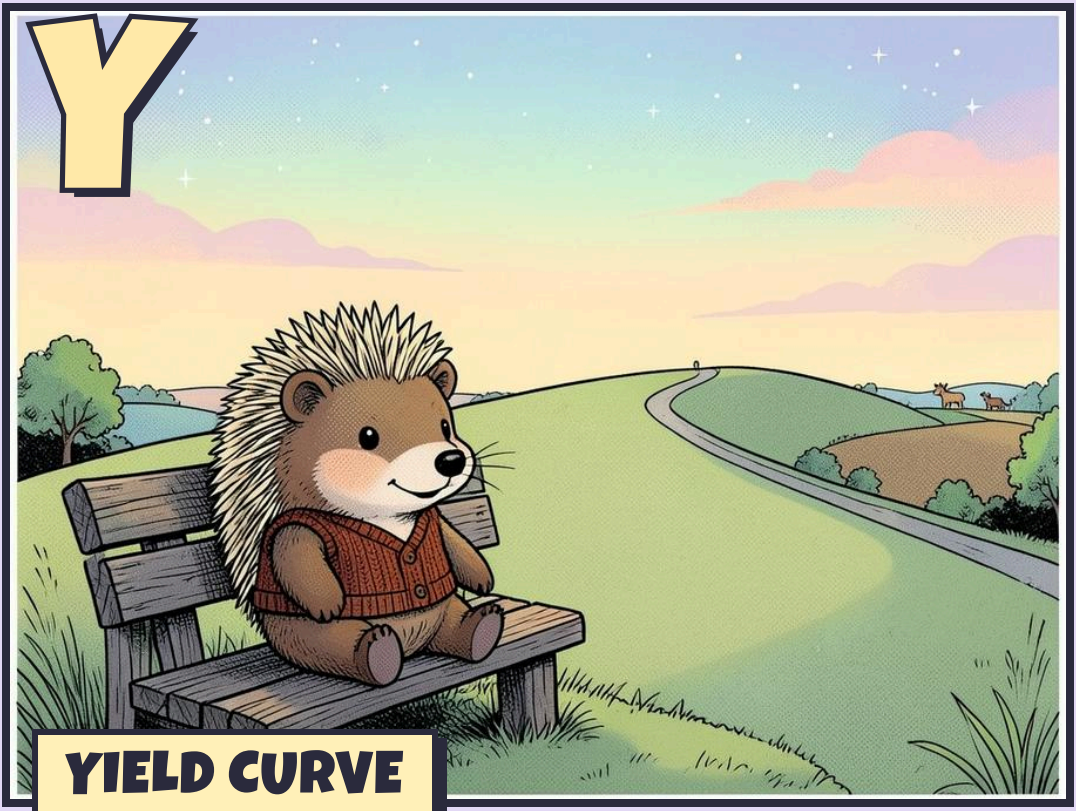


HIGH-WATER MARK

A high-water mark is the highest value an investor's stake has reached. After a fall, the manager earns no share of gains until it is back above that.



Exposure is how much a fund stands to gain or lose when markets move. Net exposure is what it owns minus what it has bet against.



A yield curve shows what lenders earn for lending over short times and long times. Macro funds watch it closely.



Markets open again in the morning. Hazel curls up and goes to sleep.



A NOTE

The words in this book are real ones, explained simply. The animals and examples are made up, and real terms vary from fund to fund. It is not advice. The pictures were drawn with an AI image model and checked by hand.

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