B7399 sec. 116 Hedge Funds, Spring 2013

Saturdays Room: TBD

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Course Description:

Hedge Funds are a critical component of modern capital markets, but are often only vaguely understood by professionals and the public alike. Too often they are the whipping boys for failings or excesses in capital markets. Investor protection rules that limit publicity by partnerships have had the effect of characterizing hedge funds as secretive, opaque and threatening. In an era when hedge fund investments are present in either a primary or secondary role in most portfolios any investment professional or manager needs to know what they really are, what they do, and how and why.

The course will demonstrate the key roles hedge funds now play and how they have evolved in an age of disintermediation and technological advances. We will examine how they are likely to evolve in the future.

The course will explain typical hedge fund algorithms and strategies including quantitative non- discretionary trading, global macro, various arbitrage and hedging techniques and fundamentally driven value and distressed investing. The course will also cover some of the pressing questions that hedge funds have to address, including Risk Management, Valuation, Transparency, Regulation, and Legal and Accounting practices.

In addition to set lectures, video and interactive portfolio projects students will also meet key practitioners in portfolio trading, risk management, fund selection and legal matters.

Course Objective.

By completing the course students will have a working understanding of the range of hedge fund activities, how they work, what it means to be a hedge fund, and the issues they face.

Textbooks and Materials.

There are three books required for the course;

More Money than God. Sebastian Mallaby, the Penguin Press, 2010.

All the Devils are Here, The hidden history of the Financial Crisis. Bethany McLean & Joe Nocera, Portfolio/Penguin, 2010.

How To Be a Rogue Trader: An eSpecial from Portfolio / Penguin [Kindle Edition] John Gapper. Penguin 2011

Every student should read the "Economist" and the "Financial Times". Daily hedge Fund news services "Opalesque" and "Albourne Village" will be available to keep abreast of inside news.

The Alternative Investment Management Association (AIMA) publishes several guides to best practice in areas such as Valuation and Operations, as does the Managed Futures Association and we will draw on these materials as well as those of IOSCO.

We will use both of the printed assigned books throughout the course, with occasional supplemental reading. The e-book is no more than a few chapters and will be assigned. We will use one current business case to review how due diligence should be done. Lectures and strategy sessions will be printed ahead of class.

Method of Evaluation

I will hand out an examination at the end of our <u>second</u> class. The exam will consist of approximately eight questions on topics that have already been covered, or that will be covered in the ensuing weeks. The exam will be due back to me by the penultimate week of the semester, but we will refer to it throughout the semester. Consideration will be given for original interpretations, the use of material not covered in class, and of course for accuracy. This paper will account for 60 % of the grade.

We will create Portfolio teams of three or four people each. As new trading or hedging techniques or styles are introduced to the class each team will create a trade using that technique. The team will be provided with a template to record the trade and there will be opportunities to discuss the trades in class. This will be a team project, and will account for 20% of the grade. Each week, a team member will present to the class on a team trade. The team will take it in turns so that by the end of the term every team member will have presented.

Students who have knowledge or experience of an aspect of hedge funds or of a related strategy will be invited to present for credit.

Every other week I will ask a (pre-assigned) student for a brief (oral) synopsis of a portion of the assigned reading. The response should try to see behind the mere narrative and draw implications for aspects of the course. These periodic responses will account for 10% of the grade.

I expect we will cover topical and perhaps controversial subjects, and look for thoughtful and informed dialogue between us. I may call on you in class to discuss the readings and lectures. Class participation will account for 10% of the grade.

Assignments should be delivered in person in hard copy at the start of the class unless otherwise requested.

All assignments are type C assignments, other than the group portfolio project which is an A Type assignment. (See below). I will return assignments within two weeks.

Туре	Designation	Discussion of	Preparation of	Grade
		Concepts	submission	
Α	group/group	Permitted with	By the group	Same grade for each
		designated group*		member of group
В	group/individual	Permitted with	Individually	Individual
		designated group*	(No sharing of any	,
			portion of the	
			submission	
С	individual/individual	None of any kind	Individually	Individual
D	(An optional additional category to be			
	defined in detail by the individual faculty			
	member)			

Integrity Code

Students are expected to abide by the Integrity Code. Their work should be their own, and any sources used should be cited and appropriately referenced. If collaborating on a project this must be disclosed.

Administrative Issues;

Attendance. I expect that you will come to class on time and stay for the full period. In the event that you are unable to attend or if you have a pressing reason to leave early I expect you to email me before the class. If you have to leave early, please sit near an exit that day.

Unexplained absences and/or chronic tardiness will adversely impact your class participation grade.

<u>Laptops</u>. Laptops should only be used if we are working on a trading strategy that requires their use, or if essential for note taking. Otherwise they should not be brought to class. Telephones etc. should be turned off.

Refreshment. We will break approximately halfway through the class for 15 minutes.

You may bring a drink to class, but try to avoid bringing food.

<u>Seating.</u> The seat you choose for the second lecture will be your seat for the remainder of the course.

Name Cards. Please bring your name cards.

Office Hours. TBD. I welcome communication and will respond to emails promptly.

January 12th. Session 1. Introduction. (Sessions may change order depending on availability of guest speakers)

- The industry is commonly described as "9,000 Hedge Funds; high risk, secretive, unregulated, available only to High Net Worth individuals and charging excessive fees" We will examine whether this common impression has any truth to it.
- Each week will include discussion of the prior readings, and time to work on the **Portfolio group,** with the objective of including an example of the strategy of the day into the portfolio.

- Strategy; Global Macro.

Reading. Mackay, C. Chapter 3 Extraordinary Popular delusions and the madness of crowds. Farrar, Straus & Giroux, 1932

ISBN: 0-374-374-15124-5

Textbook. More Money than God. Chapters Introduction, Chapters 1/4/6

January 26th . Session 2.

- Structure of Hedge Funds, Legal and Participants.
- Strategy. Long-Short Equity

Readings.

Coates, J. The Hour between Dog and Wolf. Chapter 4, Gut Feeling. pp. 89-125 Kahneman, D. Chapter 22, Expert Intuition, When can we trust it? pp 234-244 in Thinking Fast and Slow.

More Money than God. Chapters 2/3/5

February 2nd. Session 3.

- The Investors. Who are they and how do they influence funds.
- Strategy; Commodity Basis and Term Structure.

Readings More Money than God. Chapters 7/8/10/11

February 9th. Session 4.

- Valuation, why it is at the heart of hedge Fund practice
- Strategy: CTA

Readings:

Readings; *More Money than God.* Chapters 12/13/14 Patterson, S. Chapters, part III pp 233-278 in *Dark Pools*.

AIMA' Guide to Sound Practices for Valuation. March 2007.pp 3-23

February 23rd. Session 5.

- Transparency. Who does it benefit and how.
- Strategy; Risk Arbitrage / Merger Arbitrage

Readings; More Money than God. Chapters 15/16/Conclusion

Kirchner, T. Chapter 3, "Sources of Risk and Return" in Merger Arbitrage.

March 2nd. Session 6

- Strategy; Convertible Bond Arbitrage
- Strategy Options review Guest.

Reading.

All the Devils are here. Prologue and Chapter 4

Szpiro, G. Chapter 6, Botany, Physics and Chemistry pp 81-108 in Pricing the Future. De Spiegeleer, J. Schoutens, W. Chapter 9.1 pp 229-250 in the *Handbook of Convertible Bonds*

March 9th. Session 7.

- Risk
- Discussion of the Case.

Reading

All the Devils are here. Chapters 5/7/8

March 16th. Session 8.

- Due Diligence. how to do it, how not to.
- Strategy; Hedge Fund Derivatives

Readings.

All the Devils are here. Chapters 10/11/13/15/16

AIMA Due Diligence for Hedge Fund Managers.

Coates, J. The Hour between Dog and Wolf. Chapter 7. The stress response on Wall Street, pp. 198-234

November 16th. Session 9.

- Multi Strategy & Funds of Funds.
- Strategy. Stressed & Distressed.

Readings.

All the Devils are here. Chapters 17/18/19/20

Whitman, M.J. Diz, Fernando. The Five Basic truths of Distress Investing. Chapter 6 in Distress Investing, Principles & Technique.

Maltby, J. Chapter 5 in *Market Neutral Strategies*, editors Jacobs, B.L., Levy, K.N. John Wiley & Sons, Inc. New Jersey, 2005

ISBN: 0-471-26868-2

April 6th Session 10. (will skip March 23rd.)

- Seeding & Incubation
- Strategy; Fixed Income Arbitrage.

Readings.

All the Devils are here. Chapters 21/22

How To Be a Rogue Trader: An eSpecial from Portfolio / Penguin [Kindle Editio

April 13th. Session 11.

- Strategy; what went wrong? Hedge fund messes.
- Guest Lecture. The future for Hedge Funds.

Readings;

Chincarini. L. A Case Study on Risk Management: Lessons from the Collapse of Amaranth Advisors L.L.C. *Journal of Applied Finance*. Tampa:Spring 2008. Vol. 18, Iss. 1, p. 152-174 (23 pp.)

Chincarini. L.B. The Amaranth Debacle: A Failure of Risk Measures or a Failure of Risk Management? *The Journal of Alternative Investments*. London:Winter 2007. Vol. 10, Iss. 3, p. 91-104,6 (15 pp.)

Coffin. B. Downfall *Risk Management*. New York: Sep 2008. Vol. 55, Iss. 9, p. 42-44,46-47 (5 pp.)

Suggested Further Reading; Lowenstein, R. When Genius Failed, the rise and fall of Long Term Capital Management. Random House 2000.

April 20th. Session 12.

- Course recapitulation.
- Exam review
- Portfolio presentations.
- Prize giving. Guest.
- Readings
- Reading. Coates, J. The Hour between Dog and Wolf. Chapter 8, Toughness. Pp 238-265