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Guest: Tim Diggins, Partner, Ropes & Gray

- Pools: what used to be regulated in the world of finance is not anymore
- Pool = an independent entity

Only Trustees are watching the assets of the firm.

Investment Company Act of 1940: provided thing you can't do. I.e. limits on the extent on which the pool's assets can be used for distribution to the shareholders.

Private pools (hedge funds) avoid regulation

- beneficiary: person who is entitled to economic benefits
- Record: name shows up on shareholder as an owner.

- a mutual firm is governed by how they sell their shares
 - does not apply to hedge funds
- advisors who run hedge funds will one day be other investigation
 - how they charge fees

Compensation;

- Mutual fund: advisor receives an investment manager's fee 40-50 bp.
- Hedge fund: advisor gets management fee 100 bp-200 bp and carried interest: if management shares in the upside.

Hedge funds: a managed pooled vehicle that is not a mutual fund

- you can short
- there are hedge funds that hedge that don't though

- you meet broker and buy stock (Delivery vs. payment trade)
- you get the stock
- There is a risk that you have a trade secured, but 3 days later the exchange doesn't work.
- Risk from the Exchange
- Principal transaction: credit risk is from counterparty only
- I want US treasury "broker who acts as a principal and goes to backroom"
- Soft dollars

- In the old days brokerage dollars were fixed.
- If you are an investment advisor to a mutual fund
 - Who gets benefit of soft dollars
 - Congress investment advisor can use soft dollars for research and brokerage services.
 - Congress says you have to put 50% collateral.
- Futures contracts: I will buy from you 500 things 90 days from now at today's price
 - You can leverage up
 - You need to put an initial margin at 5%
 - Deal with it every day
 - Interest is embedded
 - You can use this for indexes and single securities

Unregulated notional contracts:

I rate swaps

- As long as fixed rate is greater than floating rate, you make a spread
- Hedge funds are not limited by who they can trade with
- Goldman Sachs has prime brokerage arrangements

Portfolio 1:

Long equities-US/foreign

Short

Leverage bonds: domestic and foreign

Portfolio 2:

Long equities (60%)

Short

Leverage bond (30%)

F/X hedging – unregulated

* Hedge funds are hard to set up → entrepreneurial drive