hedge funds - the courtesans of capitalism

By Peter Temple
John Wiley & Sons
271 pages

review rating

I bought this book in Chichester, England in mid 2001, where it was published. Hedge funds had then already established a presence in Australia, although those that applied hedge fund strategies avoided this description/label due to the odium that prevailed after the collapse of LTCM – and other high profile US funds. The "OM Strategic" funds had by then taken a hold, and Platinum Asset Management had applied long/short strategies to excellent effect. However, new funds were starting to appear that were promoting themselves as pure hedge funds, and generally they used a "fund of funds" approach, whereby an Australian asset manager would select a smorgasbord of offshore managers, often with the assistance of an international asset consultant, and then present a blend or a mix of options to the Australian investor.

Peter Temple spent 18 years as an analyst/broker before turning to writing in 1988, and he now writes full time for many of the quality finance papers, including the Financial Times. He has written an informative book on hedge funds, and deals with wider issues in the finance industry with some passion. For example, he contends that many of the large commercial banks operate de facto as hedge funds, as their proprietary trading desks take large open positions to generate profit. He says that as banks transact as counterparties with major hedge funds (which are, themselves, often highly leveraged), and as these banks mimic the activity of hedge funds (rather than truly hedging their balance sheet exposure in the true meaning of that term), they are themselves running great risks with depositors money – and he says that this justifies more regulation. As an ex-Citibanker, I was surprised at this contention (admittedly he notes Citibank as an exception on page 157), and could find little empirical evidence or data in his book to support his strong views, which dented the argument somewhat.

Any investor considering investing in hedge funds would learn much from this book, and may well come to the questioning conclusions that Temple does. Whilst he tries to be objective, he clearly has a pretty dim view of these courtesans of capitalism, and this needs to be borne in mind when reading the book. You will not find a great deal of practical tips or insights from this book, but you will derive a better understanding of where hedge funds have come from, how they are managed, the different categories, the US tax structures (mostly offshore limited partnerships), and why they have (or had) such mystique and exclusivity.

The reader will be pleased to see that Alfred Winslow Jones, born in Australia in 1900, is probably the father of hedge funds, although he left for the US when aged 4. Jones used the classic long/short strategy to "hedge" against a drop in the market – with great success. The current Platinum strategy is along these lines. From this origin all manner of funds developed, and Temple surveys these right up the demise of LTCM. He spends too long analysing LTCM and cites our Ian Macfarlane, saying that hedge funds have become the privileged children of the international financial scene, being entitled to the benefits of free markets without any of the responsibilities.

Terms used in Chapter headings resonate with his suspicions: speculators; rogues; Archimedes; toxic waste; highwaymen; "Finance's four letter word" – but then, "attaining respectability". He pierces through the mystique and explains how many so called hedge funds do not actually hedge at all. The term is being used in common parlance today as nothing more than a label covering all manner of speculative activity and financial engineering, miles away from Alfred Winslow Jones.

The reader will be pleased to see that outguessing the market does not appear to work, even for the "masters of the universe". He concludes that the irony of the "global macro fund" is that investors would have been "equally well off (and would have had more liquidity) investing in a low-load tracker fund (ie, an index fund) replicating the standard US market benchmark."

Peter Temple clearly has a thorough grasp of his subject matter, but this text will have limited interest for the average Australian investor. In particular there is, unsurprisingly, no analysis of the major problem for Australian investors in considering hedge fund exposure: that of fees, or fees on fees in the fund of funds context. If you are interested to see how hedge funds are performing, you might scour the international quality press instead. In the same week in which there was complementary press comment on hedge funds in the Australia press, the headline in The Economist read: "Hedge funds – Absolute disappointment; despite being in a bear market, hedge funds struggle to do well (25 July 2002); and then later in Barron's: "Rich Man, Poor Man – for hedge funds, the second quarter brought mixed results" (5 August 2002). Temple is being vindicated.

Because of limited practical relevance to the Australian investor the book is rated 5. Reading it would certainly be educative, but it would not help a great deal in deciding what is best amongst the current hedge fund offerings in Australia.

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