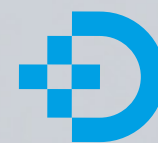


Hedge funds: **BREAKDOWN**



Hedge funds: Breakdown

In 2020 the top 20 hedge funds like Bridgewater, Millennium, and AQR earned a record breaking \$63.5 billion for their clients, while the average hedge fund slumped behind the S&P 500 with a performance increase of 11%. This data shouldn't surprise lifelong investors or finance professionals; hedge funds are big and sometimes risky. Melvin Capital, once one of the most successful hedge funds in Wall Street, with a valuation of \$7.3 billion, is now shutting down following the market squeeze on GameStop stock. Giants can fall quickly; keeping up with trends and patterns of hedge funds can show entrepreneurs and investors solid predictions from highly skilled hedge fund general managers.

What's a hedge fund?

A hedge fund pools together money from accredited investors (pension funds, insurance

companies, wealthy individuals) to try and maximize their shared profits through lucrative and often high-risk portfolios. However, the fund's manager's first and foremost job is to protect the current capital that has been accrued in the investment pool. Hedge funds don't have as many differences with mutual funds or ETFs as people may believe, aside from three main points.

1. Less Regulations

Some hedge funds don't need to register or file public reports but are still under scrutiny and prohibition to fraud. This allows hedge funds to pertain a level of secrecy and discretion over what their funds choices are, keeping clear of potential competitors. It also means that hedge funds can take bigger chances in their chase for performance growth.

2. No marketing

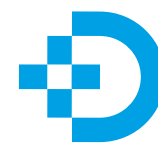
Hedge funds are not

allowed to market and take money from the public. To place money in a hedge fund one must be a credited investor, able to make rational financial decisions as risky as hedge fund strategy may be.

3. Business Model

Hedge fund's internal structure and operations work along a business model. Funds can have a large staff





of data analysts and securities managers to account for the payment of which comes from a 2% cut off revenue with an accompanying 20% performance fee accounted for after the management fee has been extracted.

What's different?

Hedge funds tend to be the most focused player in the exchange market due to their high exposure to market fluctuation. To evaluate the most effective path, funds have analysts dig through financial models of potential investments and get to personally know the management of companies that they endorse. Hedge fund staff are also some of the most up to date players on the exchange, constantly scanning and examining industry reports and market news, to then build for themselves a detailed financial model that they and their partners can have confidence in. Let's break down frequently used

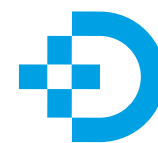


investment strategies and gain a clear picture of their decision making:

- **Long/short equity:** Maintaining long positions in some equities along with short positions in others at the same time -- a strategy designed to enhance returns while reducing overall market risk.
- **Managed futures:** Trading a portfolio of equity, currency, or commodity futures.
- **Event driven strategies:** Buying securities of distressed companies, declaring bankruptcy,

those expected to merge, or those predicted to be impacted by a specific event, expecting to profit when the event occurs.

- **Quantitative strategies:** Employs the use of automated trading based upon systematic or algorithmic data analysis.
- **Global macro strategies:** Analyzes global macroeconomic trends to exploit investment opportunities associated with geo-political events, currency exchange rates, interest rates, or commodity prices.



Who do trust?

Hedge funds are notorious for making some of the most lucrative deals in the financial exchange world by using flexible investment strategies and a diversified portfolio. The value of a hedge fund relies solely on **trust**, that of the general manager, the fund's track record, current valuation, and the amount of "skin in the game" that the operating team may have on their own fund. It is vital that any participatory investor analyze the **offering memorandum** of a hedge fund which usually includes their management fees, performance fees, investment strategy, base of operations, and the manager's conflicting interests. Most general managers are expected to place up to half of their performance fee income back into the fund's pool of capital, to ensure that the manager is treating the investors' money as their own. The level of secrecy in the fund's investments and exposure is dependent on the

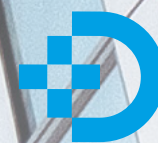
management LLC of the fund, but it is also the case that the most successful hedge funds are the opaquest about their portfolios.

What happened to Melvin Capital?

Founded by Gabe Plotkin, a protégé of Steve Cohen (One of the most successful hedge fund managers in Wall Street history), Melvin Capital soon emerged as a premier fund in the market. Quickly garnering billions of seed capital and investments from institutional investors and Cohen's new hedge fund, he became the

darling of Wall Street throughout the late 2010's. Plotkin's big mistake as a general manager came when he publicly bought short positions against GameStop, undermining the level of secrecy and opaqueness taken by hedge funds to protect their position. That one decision to bet against GameStop publicly lead his fund from **earning 54% returns in 2020** to a catastrophic **55% free fall of capital 2021**. Redditors, message boards, and meme stocks proved to be its Achilles heel. When a few people ran the models on a





potential skyrocket of value on betting against the short stocks, they began a movement. Soon “wall street bets” and other message boards caught steam, then caught fire, with millions of small investors pooling together to fight the giants in wall street. Before the crisis got out of control, Cohen’s hedge fund Point72 and Citadel Funds provided \$2.75 billion to try and bail out Melvin’s crashing annual performance. However, 17 months after the collapse from the top, Melvin Capital is closing their doors, unable to recover from the shock of the crash and the legacy of mistrust that followed.

What we learned today.

Hedge funds are some of the smartest players in the market, but they also have their shortcomings. A wise investor continually analyzes the state of both the fund and the market to determine their personal cost-risk exposure. Examining not just the

state of the economy, but the state of their internal processes is a difficult task, one that requires an investor to place a great deal of trust in the management group of a fund. However, by being aware of your hedge funds moves as well as their management team’s history and track record, an investor can gain confidence in the skill and expertise of the decision makers. Don’t put all your faith in a person or place but look for yourself on how your money is being used and directed and who is making the decisions on your capital.

We wish you luck on your financial journey!

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