B7389-001 Hedge Funds

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. The course is designed to make you an informed participant, trustee, investor or hedge fund professional.

Textbooks and Materials:
There are three books required for the course;


We will use several chapters from The Hour between Dog and Wolf, by John Coates. Penguin Press NY 2012. I recommend the whole book as well worth reading

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 assigned books throughout the course, with occasional supplemental reading. 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.

Readings.
Each session listing includes a set of readings. These should be read before the class, and there will be questions about the readings during class. The readings are chosen to be readable – they are a mix of well-known financial journalists (Loomis, Nocera, McLean), former practitioners who are now academics, (Coates, Mandis, Derman), academics and subject specific material by practitioners. The material will complement the class that it is assigned for and will help your understanding.

Method of Evaluation
I will hand out an examination at the end of our second 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 in stages, with the last portion due by the penultimate week of the semester. 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 55% of the grade.

In week 2 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 25% 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.

Every other week, beginning with week 3 I will ask a (pre-assigned) student for a brief (oral) synopsis of a portion of the assigned reading, or, of the text book readings to date. The student will provide me with a written summary, no more than a page. 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.

Many students will have spent time in industries that are related to Hedge Funds either directly or indirectly. I will offer those students who have significantly relevant experience the opportunity to present to the class in exchange for a reduction in the number of examination questions.
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.

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<tr>
<th>Type Designation</th>
<th>Discussion of Concepts</th>
<th>Preparation of submission</th>
<th>Grade</th>
</tr>
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<tbody>
<tr>
<td>A group/group</td>
<td>Permitted with designated group*</td>
<td>By the group</td>
<td>Same grade for each member of group*</td>
</tr>
<tr>
<td>B group/individual</td>
<td>Permitted with designated group* (No sharing of any portion of the submission)</td>
<td>Individually</td>
<td>Individual</td>
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<tr>
<td>C individual/individual</td>
<td>None of any kind</td>
<td>Individually</td>
<td>Individual</td>
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<td>D (An optional additional category to be defined in detail by the individual faculty member)</td>
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**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.
**Laptops.** Laptops can only be used for note taking or if we are working on a trading strategy that requires their use, and I will advise of this ahead of time. Otherwise they should not be brought to class. Telephones etc. should be turned off. I view the use of a device during our class for anything other than class related material to be rude, as well as distracting to the rest of the class and will reduce the class participation grade.
**Refreshment.** We will break approximately halfway through the class for 10-15 minutes. You may bring a drink to class, but try to avoid bringing food.
**Seating.** 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.
Session 1. 1/11/14 12:30-3:30

Introduction. (Sessions may change order depending on availability of guest speakers)

- What is the Hedge Fund “Industry”?

Readings; To be read before class.
Mackay, C. Chapter 3 Extraordinary Popular delusions and the madness of crowds.
Loomis, Carol J. (2012) The Jones Nobody Keeps Up With in Tap Dancing to Work (pp.1-6)
Textbook. More Money than God. Chapters Introduction, Chapters 1/4/6

Session 2. 1/18/14 8:30-11:30

- Structure of Hedge Funds, Legal and Participants.
- Portfolio groups
- Strategy. Strategy; Global Macro.

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

Session 3. 1/25/14 3:45-6:45

- The Investors. Who are they and how do they influence funds.
- Long-Short Equity

Readings;

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


Session 4. 2/1/14 12:30-3:30

- Valuation, why it is at the heart of hedge Fund practice
- Strategy: What is a Contango.

Readings;

*More Money than God.* Chapters 12/13/14

**Session 5. 2/8/14 8:30-11:30**
- Transparency. Who does it benefit and how.
- Strategy; Commodity Basis and Term Structure
- Readings;
  *More Money than God.* Chapters 15/16/Conclusion


**Session 6 2/22/14 3:45-6:45**
- Due Diligence.
- Case Study. How to do everything terribly badly when starting a Hedge Fund.

Readings.
*All the Devils are here.* Prologue and Chapter 4

AIMA Due Diligence for Hedge Fund Managers.

Raghaven, A. (2013) Chapter 27. “I played him like a finely tuned piano” in *The Billionaire’s Apprentice*

**Session 7. 3/1/14 8:30-11:30**
- Risk
- Strategy. Hedge Fund Derivatives, FoFs and Multi-strategy

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

**Session 8.3/8/14 3:45-6:45**
- Option Basics
- Convertible Bonds

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

De Spiegeleer, J. Schoutens, W. Chapter 9.1 pp. 229-250 in the *Handbook of Convertible Bonds*
Coates, J. The Hour between Dog and Wolf. Chapter 7. The stress response on Wall Street, pp. 198-234

**Session 9. 3/22/14 8:30-11:30**
- Hedge Fund Messes
- Strategy. Fixed Income Arbitrage

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

Maltby, J. Chapter 5 in *Market Neutral Strategies*,

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

Chincarini, L. A Case Study on Risk Management: Lessons from the Collapse

Chincarini, L.B. The Amaranth Debacle: A Failure of Risk Measures or a Failure of Risk Management?

Coffin, B. Downfall *Risk Management*.

**Session 10. 3/29/14 3:45-6:45**
- Commodity Trading Advisors
- Merger Arbitrage.
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Readings;
*All the Devils are here*. Chapters 21/22
Kirchner, T. Chapter 3, “Sources of Risk and Return” in *Merger Arbitrage*

**Session 11. 4/5/14 8:30-11:30**

Seeding & Incubation
Strategy. Stressed & Distressed
Guest.

Readings;

**Session 12. 4/12/14 12:30-3:30**
- Course recapitulation.
- Exam review
- Portfolio presentations.
- Prize giving. Guest.

Readings;
Mandis, S. Goldman and Organizational Drift. Appendix A. in What Happened to Goldman Sachs
Coates, J. The Hour between Dog and Wolf. Chapter 8, Toughness. pp. 238-265