

Hedge Fund ETFs: They're Here

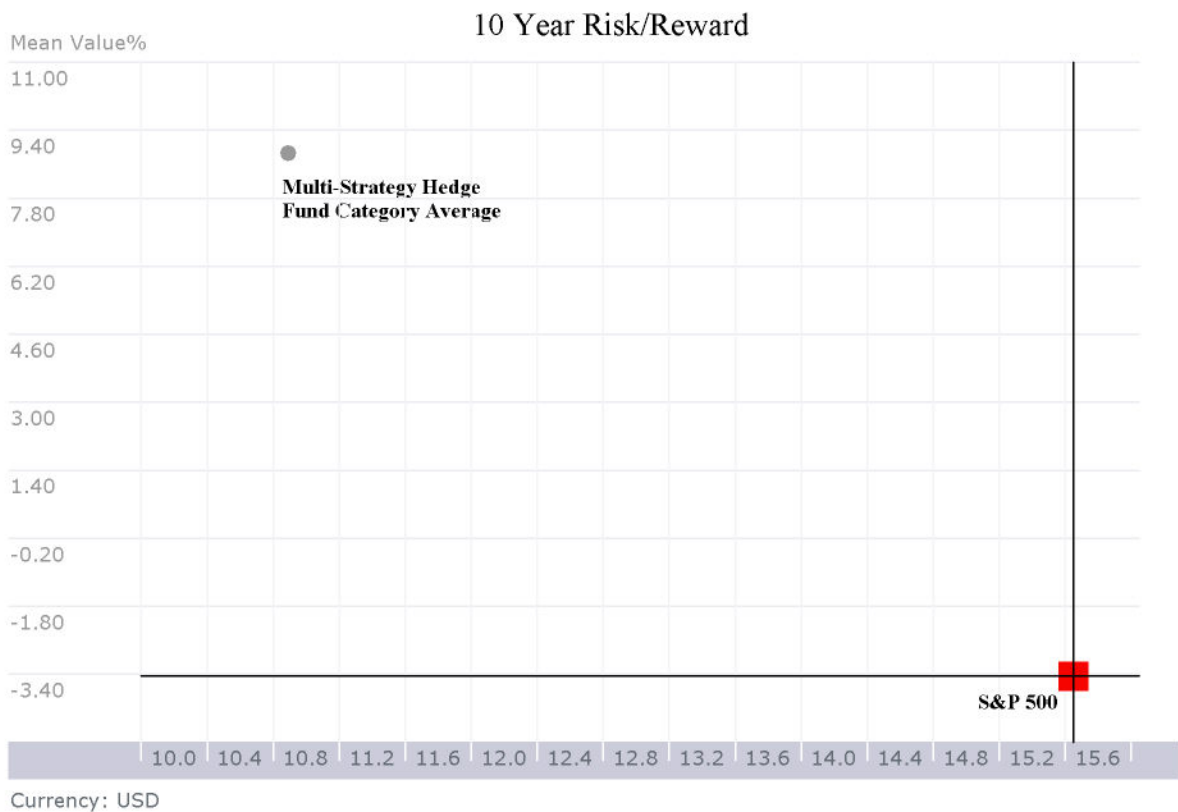
IndexIQ recently launched its first hedge fund ETF, Wednesday, March 25, 2009. This is following in the wake of 2008 where many hedge funds were affected by mass withdrawals and highly leveraged bets went bad, causing many to shut down. IndexIQ, through its new ETF, gives a way for investors to access a low cost, no commitment, and highly liquid hedge fund replication vehicle. The introduction of this hedge fund ETF allows access to the category at any net worth size, opening doors for clients' portfolios, where before they were limited.

Unlike what it may seem, the IQ Hedge Multi-Strategy Tracker ETF, QAI, does not invest directly in hedge funds, nor does it follow an index of hedge funds. Instead, IndexIQ replicates the return, risk, and low correlation characteristics of hedge funds using ETFs as the underlying investment. In this way, using ETFs within an ETF, allows investments to stay as liquid and transparent as possible as IndexIQ implements its proprietary methodology in creating hedge fund replication.

The Benefit of Hedge Fund Replication

IndexIQ, using their research and technology based on studying hedge fund returns, can provide hedge fund returns to investors through copying hedge fund methods. They do this while removing the risks of being highly leveraged and the problems associated with investing in highly illiquid markets. This methodology, matched with the transparency of ETFs, allows investors to reach for very liquid and cheap alternative strategies. IndexIQ has coined themselves as "the alternative to the alternatives". The IndexIQ ETF will charge a .75% expense ratio. This is inexpensive compared to similar hedge fund strategies charging 2% of all assets and 20% of all profits and sometimes more.

Graphed is the multi-strategy hedge fund category average as defined by Morningstar, Inc. There is great value in an investment product replicating this kind of risk/return profile relative to the S&P 500 benchmark, which is not the most appropriate standard for hedge fund managers to be compared against, but is important to show the return and risk reduction against a common index available to most advisors and investors.



How it works

The IQ Hedge Multi-Strategy Tracker ETF, QAI, according to their recent press release, replicates various hedge fund strategies including long/short equity, global macro, market neutral, event driven, fixed income arbitrage, and emerging market strategies. All of these hedge fund replicating strategies, packaged as an ETF, trade intraday.

The idea of hedge fund replication is that many active managers in the hedge fund space are really giving the investor what has been coined as “Alternative Beta”. Alternative Beta, according to IndexIQ, has been mislabeled as alpha, when in fact, managers are just accessing beta that is outside the realm of typical asset classes. In this case, alpha is defined as excess return over a benchmark. Beta is the broad category.

Looking at hedge fund performance, and using heavy quantitative analysis, replication of a hedge fund investment strategy can be picked out from the data. IndexIQ promotes that it can use tradable securities like ETFs and derivatives to replicate the strategies. This replication is really the beta of the hedge fund strategy and managers outperforming this strategy are creating true alpha. These hedge fund strategies are said to deliver the low correlation, risk reduction, and return characteristics hedge fund investors are looking for, which is this “alternative beta”.

When it is really the alternative beta that investors want, they can stop paying for high priced alpha when the alternative beta is really the main component driving the low correlated returns.

This is really what IndexIQ is creating with their new ETF, and a whole line of ETFs to come, a way for any investor to add alternative beta to their portfolios. IndexIQ uses quantitative models and academic research supported by their all-star line up of finance academic leaders and ETF research specialists like Paul Mazzilli, a leader in ETF research, analytics, and development, to create the first ever US listed hedge fund ETF.

The index that the IndexIQ ETF tracks has only been published since September of 2008, but back tested data shows the five year hypothetical risk reward profile against HFRX Global Hedge Fund Index and the S&P 500 as of December 31, 2008, according to QAI's Factsheet.



When investors and clients see the value in having alternative beta in their portfolios, the IndexIQ ETF gives this exposure at a very low price. This ETF will force others to rethink what they are actually getting from managers, alpha or beta. Also, QAI, being an ETF fund of funds, shows that ETFs are a diverse investment vehicle which can cater to many unique investment strategies.