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Nearly half of hedge funds' voluntary disclosures are 'unreliable'

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(PhysOrg.com) -- New research by Oxford University and Duke University suggests that voluntary disclosures by hedge funds about their monthly investment performance are unreliable. The researchers tracked changes to statements of historical performance of over 18,000 hedge funds recorded in publicly available hedge fund databases, at different points in time between 2007 and 2011.

They found that as many as 40 per cent of funds (around 7,000 individual funds) revised their previously reported performance, sometimes many years later, with more than a fifth of funds later changing a previous monthly return by at least 0.5 per cent.Their analysis also reveals that, on average, funds that revise their histories subsequently underperform significantly, when compared with funds that have never revised their reported performance. The researchers say that unreliable disclosures could be interpreted as a valuable signal for current and potential investors about future hedge fund performance.

Professor Andrew Patton, Dr Tarun Ramadorai, and Michael Streatfield, CFA, suggest that the changes they detected to statements of historical performance are not random or mere corrections of earlier mistakes. Rather, they found these revisions were clearly associated with the characteristics and past performance of hedge funds. Indeed, their analysis finds that revisions are more common among more volatile, larger, and less liquid funds.

The working paper, ‘The Reliability of Voluntary Disclosures: Evidence

from Hedge Funds', will be presented at a conference on hedge funds at the Oxford-Man Institute of Quantitative Finance, University of Oxford, on 18 November. The paper raises questions about the potential effects of mandatory hedge fund disclosures and considers different approaches that could be used, including a system that allows funds some flexibility in the choice of valuation method, alongside a standard method, should it be requested and justified.

Dr Tarun Ramadorai, from the Oxford-Man Institute of Quantitative Finance and Reader in Finance at the Saïd Business School at Oxford University, said: 'Our research highlights the unreliability of the voluntary disclosures that have hitherto been made by hedge funds on their performance track records. The benefit of mandatory, audited disclosures of past performance to investors and regulators is that it would enable them to accurately assess the real risks and returns of hedge fund investments.'

This research is particularly pertinent as it follows hot on the heels of an announcement by the Securities and Exchange Commission to adopt a new rule requiring large hedge funds to report quarterly information to a new Financial Stability Oversight Council (established under the Dodd-Frank Act). The working paper adds weight to the view that periodic reporting by hedge funds should be mandatory, if risks to the financial system are to be monitored more effectively.

Professor Andrew Patton, Associate Professor of Economics at Duke University, said: 'Our analysis suggests that mandatory, audited disclosures by hedge funds, such as those proposed by the SEC, would be beneficial to investors and may help to prevent negative outcomes for current and potential investors.'

Dr Ramadorai added: 'There are significant concerns among hedge funds about the impact of the new rules. But in the light of our findings, they

may not go far enough: the disclosures will only be seen by regulators rather than by the general public, so would not be seen by the prospective investors in hedge funds.'

Provided by Oxford University

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