



Hedge Funds

An Alternative Future: Part II

October 1, 2004

In [Part 1](#) of "An Alternative Future," I articulated a vision of hedge funds plus traditional index funds replacing traditional active management as the investing model of the future.

This is not because hedge funds deliver some kind of magic from genius managers to investors savvy enough to get into supposedly closed funds. Rather, the more mundane fact is that hedge funds plus index funds offer an attractive structure. The clean separation of index exposure from skill brings many advantages.

The hedge fund structure may also allow liquidity to be provided by those who have it to those who need it, and allows risk to be transferred from those who do not want it to those who do (or, more accurately, who will accept it in exchange for a positive expected return). These have very real potential benefits. Many of these transfers could not occur or would be more awkward without the tools employed by hedge funds.

Hurdles stand in the way. Some dark sides must be reduced or eliminated, and important evolutionary changes must occur in hedge fund manager practices and hedge fund investor expectations and actions. Without these changes, the benefits of the hedge fund structure may not be fully realized.

I remain an optimist that we can get there, although the road will not be short, and certainly not free of bumps (bump is a euphemism for some people losing a lot of money at some point).

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