SECURITIES AND FUTURES COMMISSION 證券及期貨事務監察委員會
12th Floor, Edinburgh Tower, The Landmark, 15 Queen's Road Central, Hong Kong
香港中環皇后大道中十五號置地廣場公爵大廈十二樓
SFC 證監會

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The Honourable Legislative Council Member,

New Educational Leaflet – "How Much Do You Know About Hedge Funds?"

To help retail investors understand hedge funds which will be offered in the market starting from the fourth quarter of 2002, the Securities and Futures Commission has recently published a new leaflet "How Much Do You Know About Hedge Funds?". It explains the basic concepts and risks of hedge funds, and issues investors should consider in buying these funds. The leaflet forms part of our series of investor publications, one of the initiatives in our investor education programme.

Enclosed please find the leaflet in English and Chinese for your reference. Should you wish to obtain additional copies for distribution to members of public in your constituency, please do not hesitate to contact Miss Karen Heung at 2842 7711.

Yours faithfully,

Ivy Lai
Associate Director
Investor Education and Communications

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Can I Sell My Hedge Fund if I Need My Money Back Urgently?

Yes, you can lodge your redemption request anytime. However, some hedge funds only have dealing days once a month and the time taken to realise the redemption proceeds may be much longer than that for a traditional fund. **The maximum interval between your lodgment of a properly documented redemption request and the payment of the redemption money can be as long as 90 calendar days.** This means even if you need money back badly, you have to wait for that long.

Some hedge funds may have exit penalties, i.e. a redemption charge depending on the length of time you have stayed in the fund. In addition, for hedge funds that offer a guarantee at maturity, the guarantee may not apply if you redeem before maturity. **Therefore, consider your liquidity needs carefully.**

Are 'SFC-authorized' Hedge Funds Good Investments?

All funds that are offered for sale to the Hong Kong public must obtain authorization from SFC. **SFC authorization is not a seal of recommendation.** Read the offering document, understand the nature of the fund and the risks involved, and assess whether it is suitable for you. Seek professional advice if in doubt.

Some Do's and Don'ts:

- ✓ Make sure you read the hedge fund's offering documents.
- ✓ Ask questions about anything you do not understand.
- ✗ DO NOT sign anything that you don't understand.
- ✗ DO NOT pool your monies with other people, just to meet the minimum subscription amount.

For more details, please visit the SFC-operated Electronic Investor Resources Centre at www.hkeirc.org.

How Much Do You Know About Hedge Funds?

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What is a Hedge Fund?

Hedge funds are a type of collective investment schemes that pool together different investors' monies for management by a third-party Manager to meet a common investment objective. **There is no universal definition of hedge funds.** Generally speaking, a hedge fund is very flexible in its investment style – it may take both long and short positions, use leverage, invest widely in derivatives, and employ active trading techniques. **Not all hedge funds are the same.** They vary enormously in terms of their investment returns, risk profiles and investment strategies. **Although hedge funds are often marketed as "all weather" funds that are able to perform under different market conditions, they are not "sure-win" products.** There are circumstances under which a particular strategy would work well, and there are also other circumstances that the strategy would not perform.

There are no "hard and fast" rules regarding the risk and return profile of hedge funds. Some hedge funds outperform the market while others lose money. Some deliver consistent returns, while others are volatile. **That is why before you invest in a hedge fund, you should always check whether it suits your needs.**

Don't be fooled by the name "hedge funds"

Hedge funds may actively assume risks to aim for higher returns. Don't be fooled by the name. It is a misnomer originated from the 1950's to describe funds that had a long exposure to undervalued shares and a short exposure to overvalued shares, resulting in a market neutral (hedged) position. However, the net position is never truly hedged or totally neutral because of the fund's risk exposure to individual shares.

What is a Fund-of-Hedge-Funds?

A "Fund-of-Hedge-Funds" (FoHFs) is a fund that exclusively invests in other hedge funds. You can think of a FoHFs as a basket of hedge funds, with the FoHFs being the parent with a number of underlying baby funds in its portfolio. Usually, the FoHFs manager will try to achieve diversification and improve the FoHFs' risk and return profile by having a variety of baby funds.

Since the FoHFs manager performs additional service in selecting the baby funds and monitoring their performance, a FoHFs has an extra layer of fees – one at the parent level and one at the baby funds level.

How Safe is My Investment in a Hedge Fund?

All investments carry risks and hedge funds are no exception. Unless a hedge fund has a guarantee attached to it, otherwise, nobody can give any assurance to its future performance. Even then, investors should check the level of guarantee provided. **Remember, risk and reward go hand in hand. For some hedge funds, substantial loss of capital is possible.** Check the background and experience of the hedge fund manager and the product features in the offering document. Compare different products and see which one best fits your needs.

How Much Should I Invest in Hedge Funds?

Some research shows that the inclusion of hedge funds in an investment portfolio may offer the benefits of diversification, i.e. the ability to increase the portfolio's overall returns without increasing risks in the same proportion. However, hedge funds are not for everyone. **You should consider your own financial circumstances and the suitability of hedge funds as part of your investment portfolio.** Don't put all your eggs in one basket.