ROAD TEST COASTAL CAPITAL DIVERSIFIED PERFORMANCE FUND

Trading with the big boys

Q What am I buying?

A The fund is run as a unit trust by Sydney-based Coastal Capital, using Magnum Fund Management in the US as adviser. It consists of 18 US-domiciled international hedge funds which invest mostly in US and European markets. It's a straightforward way for retail investors to gain access to an investment class usually available only to institutional and wealthy individuals because of the large amounts required. Coastal requires an initial minimum of $10,000.

Q What is a hedge fund?

A Unit trusts are normally limited in where they can invest, while hedge funds are free to invest in anything – shares, bonds, currencies, or commodities or their derivatives. Most use low or moderate levels of gearing, which magnify gains and losses. Their attractiveness is that they are "non-correlated" to equity and bond markets, thus having the potential to perform when the equity market or bond market may be trending down.

Q Aren't they incredibly risky?

A The term "hedge" emerged from funds that used offsetting strategies to reduce risk. It is important to have a multi-fund manager who has the skills to research the individual hedge funds. If money is spread around funds with differing strategies, risk should be reduced.

Q Is it more than a plaque on a palm tree?

A Coastal Capital started in 1993. Executive director Peter Frohlich was formerly in charge of Asia-Pacific trading at Credit Suisse First Boston, based in London, Hong Kong and Sydney where he invested the firm's own capital in hedge funds. The other executive director, Nick Ryder, has 10 years' experience in corporate finance and investment banking.

Q What about the currency factor?

A All the underlying hedged funds are denominated in US dollars. The fund is fully hedged for currency risk – if the dollar rises against the US dollar, Australian investors will be no worse off. If it falls, there will be no exchange rate benefit.

Q What about performance?

A As a new fund there are no meaningful performance numbers. Coastal provides data in the prospectus which shows that for the five years to March 31 this year the Magnum Multi Fund (a comparable multi-hedge fund to Coastal's) delivered a 21.4pc compound average annual return.

John Collett

EXPERT VIEW

Dominic McCormick of Bridges Personal Investment, says hedge funds can be good for all investor types, particularly during slowing global growth and subdued equity markets. He says the best way to invest is through a multi-manager fund of funds. The Coastal Capital fund over time could be expected to produce sound returns. Five to 10 per cent of a portfolio could be invested in hedge funds.

GOOD POINTS

McCormick says the executive directors have experience in hedge fund strategies. The fees are reasonable.

BAD POINTS

As the main reason for using this fund is to lower risk, McCormick says many of the funds selected by Coastal on the advice of Magnum appear to be those deriving much of their performance from equity markets. Therefore the fund may have a higher correlation to global equity markets than some other hedge funds, and using this fund by itself may not achieve the diversification benefits required of alternative investments. There is some associated risk as Coastal is a small, newish manager. There are multi-manager funds run by global fund managers and the big managers have more of these types of funds in the pipeline.

KEY FACTS

Price: $1 per unit – valued weekly.
Investment: Minimum $10,000 with minimum additional investments of $1,000. Investments can be withdrawn once a month.
Fees: A flat management fee of 2.46 per cent a year on the investment amount.
Target: Medium-term returns of at least 15 per cent a year, positive performance in most market conditions; less volatility than stockmarket indices.
Distribution: Quarterly; can be automatically reinvested.
Risk grading: Moderate (as multi-fund manager).
Time frame: Three years plus.