August 24 & 31, 2009

HEDGE FUNDS ARE GOOD

by Michael Hirsh

Hedge funds took the blame for much of last year's financial havoc, but the fact is that they have played a much more benign role than is commonly thought. Sure, plenty of funds went under with the market plunge: a record 1,471 in 2008 out of a total of 6,845, according to the Chicago tracking firm Hedge Fund Research. But the government didn't bail out a single one. That's the way capitalism is supposed to work: incompetents go out of business, smart guys clean up. And **overall, the hedge-fund industry has shown remarkable resiliency, turning in a gain of more than 12 percent for the first seven months of 2009**. The firms that caused most of the trouble on Wall Street were not hedge funds but big investment banks and insurance companies trying to act like hedge funds. They did a lot of risky proprietary trading with other people's money, and they failed.

"The hedge fund industry has frankly acquitted itself fairly well," says Dan Gertner of Grant's Interest Rate Observer. "Much better than the investment banks." Wall Street's most successful long-term model has been companies like Brown Brothers Harriman or Goldman Sachs, where firms bet the owners' own capital. Such a structure ensures careful risk assessment. Similarly, many hedge fund managers have a lot of net worth invested in their own funds. Former Fed chairman Paul Volcker has proposed that federally insured banks be barred from proprietary trading. Maybe only hedge funds have earned the right to be the big risk takers of the future.