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PII: S0275-5319(16)30396-8
DOI: http://dx.doi.org/doi:10.1016/j.ribaf.2017.07.056
Reference: RIBAF 746

To appear in: *Research in International Business and Finance*

Received date: 11-11-2016
Accepted date: 3-7-2017

Hedge Fund Returns under Crisis Scenarios: A Holistic Approach

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Abstract

The assets of the hedge fund industry are nearly equivalent to the GDP of the UK. The industry, which claims returns independent of markets conditions and has been blamed for economic crises, has attracted the interest of a wide range of financial and political players and academics. This paper, using monthly series performance data since January 1995, at a fund strategy level and S&P500, and a holistic and a developed dynamic correlation quantitative approach, aims to challenge the allegations and the claims, which have been made on rather incomplete research grounds. Statistically, the results strongly reject the claims of the vast majority of fund strategies, excluding the case of the macro and short strategies, over the crisis periods, suggesting that they cannot protect their investors like S&P500. Regarding the allegations, it is inferred that Hedge Funds are used in most cases as a scapegoat rather than actually being the cause of the crises.

Keywords: Absolute Returns; ; ; ; ; , Carhart's Model, Dynamic Conditional Correlation, Financial Crisis, Hedge Funds, Structural Breaks.

JEL Classification: GO1, G11, G23.

1. Introduction

Hedge funds play a critical role in financial markets by broadening the use of investment strategies, increasing the number of participating investors and enlarging the pools of available capital.