Hedge Fund Replication: Putting the Pieces together (December 2013)

Prime Capital AG has published a new article in the Journal of Investment Strategies about replicating the return time series of hedge funds using state-of-art regularization method and considering a set of tradable risk factors.

In this paper, Vincent Weber and Florian Peres aim to bring together into one common framework various advances in factor-based hedge fund replication. The replication study, thereby first relies on investigating the construction of a set of investable dynamic risk factors extracted from futures contract prices. Furthermore, the authors provide an overview of current state-of-art convex regularization methods used for automatic variable and model selection.

Finally, the methodology is validated by creating out-of-sample replicating portfolios for the monthly returns of more than 7,000 hedge funds ranging from 2006 to 2012, also considering transaction costs. The results suggest that hedge fund replication is on average possible and works best for liquid strategies.