Tail risk in hedge funds: A unique view from portfolio holdings

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Abstract

We develop a new systematic tail risk measure for equity-oriented hedge funds to examine the impact of tail risk on fund performance and to identify the sources of tail risk. We find that tail risk affects the cross-sectional variation in fund returns and that investments in both tail-sensitive stocks and options drive tail risk. Moreover, leverage and exposure to funding liquidity shocks are important determinants of tail risk. We find evidence of some funds being able to time tail risk exposure prior to the 2008-2009 financial crisis.

\textit{JEL classification:} G11, G23

\textit{Keywords:} Hedge funds, Tail risk, Portfolio holdings, Funding liquidity risk, Leverage

* We thank Bill Schwert (editor) and the referee for helpful comments. We thank George Aragon, Turan Bali, Martin Brown, Stephen Brown, John Cochrane, Yong Chen, Teodor Dyakov, Rene Garcia, Andre Güttler, Olga Kolokolova, Jens Jackwerth, Juha Joenväärä, Petri Jylha, Marie Lambert, Tao Li, Bing Liang, Gunter Löffler, Scott Murray, George Panayotov, Liang Peng, Lubomir Petrasek, Alberto Plazzi, Paul Söderlind, Fabio Trojani, and Pradeep K. Yadav for their helpful comments and constructive suggestions. We benefited from the comments received at presentations at the Sixth Annual Conference on Hedge Funds in Paris, France (2014), the Ninth Imperial College Conference on Advances in the Analysis of Hedge Fund Strategies (2014), the Berlin Asset Management Conference (2015), the Conference on Financial Economics and Accounting (2015), the Annual Meeting of the German Finance Association (2015), the Annual Meeting of the Financial Management Association (2015), the FMA Consortium on Activist Investors (2015), Corporate Governance and Hedge Funds; the Luxembourg Asset Management Summit (2015), the 15th Colloquium on Financial Markets in Cologne, Germany (2016), the Eighth Conference on Professional Asset Management in Rotterdam, Netherlands (2016), the EDHEC Business School Risk Institute Singapore, the National Taiwan University, Purdue University, the University of Mannheim, the University of St. Gallen, and the University of Ulm. We would also like to thank Kevin Mullally and Honglin Ren for excellent research assistance.

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