European boomers' retirement 'windfall'

By Pauline Skypala

The European retirement market represents a huge opportunity for financial services providers that they have yet to grasp, according to a report by McKinsey. The market, of around €43bn in pre-tax profits in Europe, amounts to nearly half the profit pool for retail financial services, and is projected to grow by up to 10 per cent a year over the next five years.

Another £750bn of retirement money will be moved around in the UK by baby boomers shifting the mix of products they hold in preparation for retirement.

Affluent baby boomers represent the best opportunity for providers, said McKinsey, but are more sceptical

Synthetic hedge fund returns 'better'

By Pauline Skypala

Hedge fund returns can be replicated using low-cost futures transactions based on traditional assets, according to a paper* from London's Cass Business School.

Since the approach avoids the usual drawbacks of hedge fund investment, such as liquidity, capacity, transparency, style drift and due diligence issues, not to mention high fees, the paper concludes that synthetic hedge fund returns "are clearly to be preferred" to real hedge fund returns.

Harry Kat, professor of risk management at Cass and joint author of the paper, said investors accept the drawbacks of hedge funds as long as they believe they will get double-digit returns.

But it was extremely unlikely that the high returns of the previous 10-15 years would be repeated, given today's low interest rates, low risk premiums and the size of the hedge fund industry.

When investors realise they are only likely to get 3 per cent rather than 10 per cent, their attitude will change, said Prof Kat.

The drawbacks will become increasingly more important "and may even become a reason to say goodbye to hedge funds."

He said this was not the first attempt to replicate hedge fund returns, but it took a different approach from previous attempts and was "outside the existing academic paradigm".

The weakness of previous approaches, based mainly on the work of William Sharpe on equity mutual funds, was that they required knowledge of how returns were generated.

This was difficult to get for hedge funds, resulting in a model that typically explained only 20-30 per cent of the variation in a hedge fund's returns, much lower than the 90-95 per cent typical for mutual funds.

Prof Kat's approach is to generate returns "with the same statistical properties as the returns generated by the fund", on the basis that the attraction of hedge funds lies mainly in these properties, and in their relationship with returns on the investor's existing portfolio.

**Who needs hedge funds? A copula-based approach to hedge fund return replication*, by Harry Kat and Helder Palero
www.cass.city.ac.uk/airc