

Asset class: Hedge Funds
Educational document for clients

Banque Bordier & Cie SCmA

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*This educational document provides a simple overview of hedge funds as investment vehicles that use alternative strategies. It is intended for clients without financial expertise and **is not a substitute for a KID or an official prospectus.***

1. Introduction

Hedge funds are an alternative asset class that aim to generate returns that are independent of, or only weakly correlated with, traditional financial markets. They are generally intended for investors with an appropriate investment horizon.

2. What is a hedge fund?

A *hedge fund* is a collective investment vehicle that uses alternative strategies. Unlike traditional funds, it can use leverage, short selling, derivatives or opportunistic strategies. The objective is not to track a market index, but to seek uncorrelated performance in different market conditions.

Investors hold units in the *hedge fund* in proportion to their investment. The value of these units varies according to the overall performance of the strategy implemented.

3. Key features of hedge funds

Hedge funds are an alternative asset class that differs from traditional collective investments in terms of the flexibility of their investment strategies and their performance objectives. Unlike traditional funds, which generally seek to track or outperform a benchmark market, *hedge funds* often aim for uncorrelated performance, i.e. seeking positive returns over a market cycle, regardless of whether it is bullish or bearish.

These investment vehicles use more sophisticated management techniques and can operate across a wide range of markets and instruments. In return for this flexibility, *hedge funds* are **more complex than traditional funds** and **generally have more limited liquidity**. There are two main types of structure: offshore structures, which are aimed at qualified investors with a suitable investment horizon, and more regulated and restricted structures for a wider audience.

The key factors to consider include the following:

- **Flexible and non-traditional strategies:** *Hedge funds* have considerable freedom in choosing and implementing their investment strategies. They are not required to follow a benchmark index and can adapt their approach to market conditions, whether favourable or unfavourable. This flexibility offers additional opportunities but makes the strategy more complex for investors to understand.

- **Possible use of leverage:** Some *hedge funds* may use debt or financial mechanisms to increase their exposure to the markets. While leverage can amplify potential gains, it also increases losses in the event of unfavourable market developments, thereby increasing the overall level of risk.
- **Frequent use of derivatives:** *Hedge funds* often use derivatives (such as options, futures or swaps) to implement their strategies or hedge certain risks. These instruments allow for highly sophisticated management but can be complex and expose investors to specific risks, particularly counterparty risk.
- **Often limited liquidity:** The conditions for redeeming units are generally more restrictive than in traditional funds. Investors may be subject to lock-up periods, monthly or quarterly redemption windows, and notice periods. In certain exceptional situations, redemptions may be temporarily restricted in order to protect the collective interests of investors.
- **Access generally reserved for qualified investors:** Depending on their complexity, risk profile and regulatory framework, *hedge funds* are generally reserved for qualified or professional investors who have the knowledge and financial capacity to understand these instruments and assume the risks involved.

4. Objective of *hedge funds*

Hedge funds generally aim to generate positive performance over a market cycle, regardless of whether it is bullish or bearish, while attempting to control volatility.

To achieve this objective, *hedge funds* implement active and opportunistic management, adjusting their positions according to economic, financial or sectorial conditions. They may seek to exploit market inefficiencies, valuation gaps or specific events, while adjusting their exposure to limit certain sources of risk.

Risk management is a central element of this approach. *Hedge funds* use various mechanisms to control or offset identified risks, including diversification of strategies, the use of hedging instruments, and dynamic adjustment of market exposure. However, despite these mechanisms, the achievement of performance objectives is not guaranteed, and *hedge funds* may experience periods of losses, sometimes significant ones.

5. The main players in a *hedge fund*

A *hedge fund* involves several specialised players, each playing a distinct role in its operation and in protecting investors.

- **Hedge fund manager:** The manager is responsible for defining and implementing the *hedge fund's* investment strategy. They make investment decisions, manage portfolio positions and adjust market exposure based on identified opportunities and risks. The manager's quality, experience and discipline are key determinants of the fund's performance and risk profile.
- **Administrator:** The administrator performs the operational functions of *the hedge fund*. They calculate the net asset value of the units, keep the fund's accounts, process subscriptions and redemptions, and ensure that administrative operations run smoothly. Their role contributes to the reliability of the financial information provided to investors.

- **Custodian bank or prime broker:** Depending on the structure of the *hedge fund*, a custodian bank or prime broker is involved in the safekeeping of assets, the execution of transactions and the financing of positions. The prime broker may also provide securities lending and collateral management services, particularly when the fund uses leverage. This player plays a central role in the financial infrastructure of the *hedge fund*.
- **Auditors:** Independent auditors review the *hedge fund's* annual accounts. They verify the accuracy of the financial statements and help to enhance the transparency and credibility of the information disclosed to investors.
- **Supervisory authorities:** *Hedge funds* are subject to a regulatory framework that depends on their country or territory of domicile. The competent supervisory authorities exercise control over certain aspects of the fund or its service providers to ensure compliance with the applicable rules. However, the level of supervision can vary significantly from one jurisdiction to another.

6. Hedge fund return structure

A *hedge fund's* returns come mainly from the results generated by positions taken on the financial markets, whether long or short. This approach allows the manager to seek performance opportunities in different market environments, including when certain segments are struggling or overvalued.

Hedge funds may also use hedging strategies to limit certain risks or stabilise portfolio performance. These mechanisms can help mitigate the impact of adverse market movements, but they do not eliminate the risk of loss.

However, the gross return on *hedge funds* is reduced by various fees, including:

- management fees, which compensate the manager for implementing the strategy and managing the fund on a day-to-day basis.
- performance fees, where applicable, which may be charged when the fund reaches or exceeds certain performance targets, as set out in the fund documentation.

As a result, the net return received by the investor depends not only on the quality of the strategy implemented and market conditions, but also on the level and structure of the fees charged.

7. Risk structure of a hedge fund

Investing in *hedge funds* involves **several sources of risk**, which it is important to understand before making any investment decision. These risks may affect the value of the units and, in some cases, lead to significant losses:

- **Market risk:** Although *hedge funds* often seek to reduce their dependence on traditional markets, they remain exposed to fluctuations in the financial markets. Sudden or unexpected movements in equities, interest rates, currencies or other assets can have a negative impact on the value of the portfolio.
- **Liquidity risk:** *Hedge funds* sometimes invest in instruments that cannot be sold quickly or at a known price in advance. As a result, investors may not be able to recover their capital immediately, particularly during periods of market stress, when redemption conditions are restricted or suspended.
- **Leverage risk:** The use of leverage increases the *hedge fund's* exposure to the markets. While this technique could amplify potential gains, it also increases losses if the positions taken perform poorly. The use of leverage can therefore increase the fund's volatility and overall risk.

- **Counterparty risk:** *Hedge funds* carry out numerous transactions with financial intermediaries (banks, prime brokers, derivatives counterparties). If one of these counterparties encounters financial difficulties or defaults, the *hedge fund* may suffer losses, regardless of the quality of its investments.
- **Operational risk:** This risk relates to malfunctions linked to internal processes, IT systems, human error or organisational failures. Although controls are generally in place, these risks cannot be completely ruled out and may affect the proper functioning of the fund.
- **Manager risk:** The performance and risk profile of a *hedge fund* depend heavily on the decisions made by the manager. Poor analysis, an inappropriate strategy or a lack of discipline in management can lead to losses, even if market conditions are favourable.

These risks can be partially mitigated through diversification of strategies, rigorous selection of funds and providers, and risk control and management mechanisms. However, **they cannot be fully eliminated.**

8. Main advantages and disadvantages

Advantages	Disadvantages
<ul style="list-style-type: none"> ▪ Diversification ▪ Potential for uncorrelated performance ▪ Strategic flexibility 	<ul style="list-style-type: none"> ▪ Complexity ▪ High fees ▪ Limited liquidity ▪ Variable transparency

The above is a summary and non-exhaustive presentation of the main advantages and disadvantages of hedge funds.

9. How to invest in hedge funds

Investments in *hedge funds* are generally made through subscriptions, provided that the investor meets the eligibility requirements set out in the applicable regulations and fund documentation.

Access can be direct, by subscribing to units in a specific *hedge fund*, or indirect, through investment structures that combine several *hedge funds* or solutions offered by financial institutions. In some cases, these methods provide greater diversification or simplified administrative management.

Before subscribing, investors are required to read the fund's information documents, which specify the investment strategy, risks, redemption conditions, fee structure and any applicable restrictions. An assessment of the investor's profile is also carried out to ensure that this type of investment is compatible with their knowledge, experience, financial situation and investment objectives.

Due to their complexity and risk profile, *hedge funds* are generally reserved for qualified or professional investors. It is recommended that you seek the advice of a financial adviser to assess the suitability of this type of investment for your personal situation.

10. How to liquidate your position

The terms and conditions for liquidating a position in a *hedge fund* depend on the structure of the fund and the conditions set out in its documentation.

In most cases, investors can request the redemption of their units on certain predefined dates (e.g. on a monthly or quarterly basis), based on the net asset value calculated on the redemption date. These requests are often subject to notice periods and may, where applicable, only be made after the expiry of any initial lock-up period.

For certain *hedge funds* structured as listed vehicles, exit may be carried out through the sale of units on a secondary market, where one exists. The sale price then depends on supply and demand and may differ from the fund's net asset value (NAV).

In certain exceptional situations, particularly during periods of high volatility or market stress, the fund may temporarily restrict or suspend redemptions, in accordance with the provisions set out in the prospectus, to protect the collective interests of investors.

It is therefore essential for investors to fully understand, before subscribing, the applicable liquidity conditions, the frequency of possible redemptions, and any restrictions, as these may vary significantly depending on the strategy and assets held by the *hedge fund*.

11. Bordier's *hedge fund* offering

The Bank offers its eligible clients a carefully selected range of *hedge funds* covering various alternative investment strategies. This selection is based on an in-depth analysis of managers, investment processes, risk control mechanisms and liquidity conditions.

The support offered aims to help clients identify the solutions best suited to their wealth objectives, investment horizon and risk tolerance. Bordier & Cie SCmA's approach focuses on the quality of managers, diversification of strategies and a particular emphasis on risk control and understanding the specific characteristics of this type of investment.

12. Important information

This document is provided for informational and educational purposes only and does not constitute personalised financial advice. Nor should it be interpreted as an advertisement or an offer of financial instruments. The content presented is neither exhaustive nor intended to cover all the characteristics and risks associated with the relevant category of financial instruments.

This information is intended to provide a factual overview and should not be used as the sole basis for investment decisions. Past performance is not indicative of future results, and the value of investments may fall as well as rise.

For general information on financial instruments, please refer to the Swiss Bankers Association's brochure entitled 'Risks Involved in Trading Financial Instruments', available on our website under the heading Legal & Compliance, Switzerland, FINSA, Guidelines Risks Involved in Trading Financial Instruments (published by SBA): <https://www.bordier.com/legal-and-compliance/switzerland/finsa/>.

If, for the relevant type of financial instrument, a key information document (KID) or a prospectus has been drawn up in accordance with the applicable legal provisions, these documents can be viewed and downloaded from our website under the heading Legal & Compliance, Switzerland, FINSA, Key Information Document (KID), at the following address: <https://www.bordier.com/legal-and-compliance/key-information-documents-kids/>

Before making any investment decision, investors are advised to carry out their own checks and carefully assess the potential risks. It is strongly recommended that they seek the assistance of a qualified financial adviser. The relationship manager is available to provide, upon request, any further information and

to supply the relevant documentation. The Bank accepts no liability for decisions made on the basis of the information provided in this document.

This document may be made available in several languages. In case of any discrepancy or inconsistency between the different language versions, only the French version shall prevail.