The NAIC's Capital Markets Bureau monitors developments in the capital markets globally and analyzes their potential impact on the investment portfolios of U.S. insurance companies. A list of archived Capital Markets Bureau Primers is available via the

Executive Summary

- A hedge fund (HF) is an alternative investment that pools assets from multiple investors.
  - As of fourth quarter 2017, about 9,007 HFs were registered with the U.S. Security and Exchange Commission (SEC).
  - SEC-registered HFs reported gross assets of $13.2 trillion as of fourth quarter 2017, up from $11.6 trillion in fourth quarter 2016.
- HFs are illiquid investments that may experience increased market value risk given the strategy and use of leverage.
- Hedge Fund Research (HFR), a hedge fund industry data provider, groups HFs into seven strategy types: equity hedge; event-driven; fund of funds; macro; relative value; risk parity; and blockchain.

What is a Hedge Fund?

The name "hedge fund" originated from the hedging techniques used by the first of these funds, where the manager held cash assets expected to appreciate in price while also shorting assets expected to depreciate in price. Ov (t)14gte (e)-1 xsrete tv typ(e)1s of investment vehicles.

HFs are distinct from mutual funds, as their use of leverage is not c
not make a public offering or market themselves (i.e., through widel
Instead, a private offering is made via a private placement memoran
includes information similar to that found in a mutual fund prospectu
of the investment, risks and associated fees.

HFs with at least $150 million in assets under management (AUM) must register with the SEC and report various activitie

Arbitrage strategies seek to exploit observable price differences between closely related investments by simultaneously purchasing and selling them. When properly used, arbitrage strategies produce consistent returns with low risk. However, because price inefficiencies between investments tend to be slight, arbitrage funds must rely heavily on leverage to obtain significant returns. Due to heavy use of leverage, some arbitrage firms have suffered extreme losses when pricing differences unexpectedly shifted.

seeks to exploit pricing differences in fixed-income securities, most commonly by taking various opposing positions in inefficiently priced bonds or their derivatives, with the expectation that prices will revert to their true value over time. Common fixed-income arbitrage strategies include swap-spread arbitrage, yield curve arbitrage and capital structure arbitrage.

seeks to profit from price inefficiencies of a company's convertible securities relative to its stock by taking long positions in the convertible securities while simultaneously taking a short position in the common stock (or vice versa). The increased popularity of convertible arbitrage has had the effect of diminishing available price inefficiencies, making it difficult to achieve significant returns without using leverage.

, or “pairs trading,” involves taking advantage of perceived price discrepancies between highly correlated investments, including stocks, options, commodities and currencies.

A risk parity strategy defines “risk budget” as the amount of risk a portfolio manager is willing to take on in order to pursue a target return. Volatility is an important input in determining the risk of an asset.

Risk parity diversification focuses on risk allocation, w6 (ue)3 (.r w)6 (6 (ue)-1.d.23 Td 0 Td(,)1 (h2t)-4 (ra owned by the insurer, and that do not meet the criteria of , are initially valued at cost with periodic adjustments for gains and losses. Other long-term investments in Schedule BA that do not meet the SSAP No. 48 requirement must follow .

Key Terminology

Commodity Pool Operator (CPO)

The GP of a commodity pool is typically registered as a CPO with the Commodities Futures Trading Commission (CFTC) and the National Futures Association (NFA).

Commodity Trading Adviser (CTA)

Manager hired by a CPO to manage a commodity pool.

Drawdown

The percentage loss from a fund's highest value to its lowest, over a particular time frame. A fund's maximum drawdown and worst historical drawdown is a measure of potential risk.

Form ADV

The SEC's uniform application for investment adviser registration. Form ADV contains basic information about a registered investment adviser, including AUM and contact information.

Gates

To prevent forced liquidation of investment [illegible]

9Side Letters egotiate terms that are not applicable to other investors. Often the special arrangement involves b