MELBOURNE CENTRE FOR FINANCIAL STUDIES

Occasional Seminar Series: Modern Finance - Insights from Academia

"Insights from Hedge Fund Registration, and Alpha from Hedge Fund Due Diligence?"

with Stephen J. Brown, David S. Loeb Professor of Finance, NYU Stern School of Business, New York

Date and Time: **Wednesday 5th December 2007, 12.30pm – 2pm** (with sandwich lunch)

Venue: **Finsia offices, Level 12, 330 Collins Street, Melbourne**

Professor Stephen Brown is a home-grown academic success story. He will be a visitor to the Melbourne Centre for Financial Studies during December and will present a composite of two papers of which he is lead author.

Stephen J. Brown is David S. Loeb Professor of Finance at the Leonard N. Stern School of Business, New York University. He graduated from Melbourne High School and Monash University in Australia and studied at the University of Chicago, earning an MBA in 1974 and a Ph.D in 1976. Following successive appointments as a Member of Technical Staff at Bell Laboratories where he spent time on assignment as District Manager in the AT&T Pension Fund, and Associate Professor at Yale University, he joined the faculty of New York University in 1986. In December 2002 he was appointed to the honorary position of Professorial Fellow with the title of professor at the University of Melbourne, and in 2007 was elected Academic Director, Financial Management Association He has served as President of the Western Finance Association and Secretary/Treasurer of that organization, has served on the Board of Directors of the American Finance Association, and was a founding editor of the *Review of Financial Studies*. He is a Managing Editor of *The Journal of Financial and Quantitative Analysis* and has served on the editorial board of The Journal of Finance and is on the board of the *Pacific-Basin Finance Journal* and other journals. He has published five books on finance and economics related areas.

In their paper, *"Mandatory Disclosure and Operational Risk: Evidence from Hedge Fund Registration"*, Professor Brown and his co-authors use the recent controversial and ultimately unsuccessful SEC attempt to increase hedge fund disclosure to examine the value of disclosure to investors. By examining SEC mandated disclosures filed by a large number of hedge funds in February 2006, they were able to construct a measure of operational risk distinct from market risk. Leverage and ownership structures as of December 2005 suggest that lenders and hedge fund equity investors were already aware of hedge fund operational risk characteristics. However, operational risk does not mediate the flow-performance relationship, suggesting that investors either lack this information, or they do not regard it as material. These findings suggest that any consideration of disclosure requirements should take into account the endogenous production of information within the industry, and the marginal benefit of required disclosure on different investment clienteles. For more information refer: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=918461

Due diligence is an important source of alpha in a well designed hedge fund portfolio strategy. It is generally understood that the high returns possible in investing in hedge funds are somewhat offset by the relative lack of transparency on operational issues. The performance of a diversified hedge fund portfolio can be enhanced by excluding those funds likely to do poorly – or fail – due to operational risk concerns. There is a strong competitive advantage to those funds of funds sufficiently large to absorb the fixed and necessary cost of effective due diligence. The consequent economies of scale that Professor Brown and his co-authors document in funds of funds are quite substantial and support the proposition that due diligence is a source of alpha in hedge fund investment. For more information on the paper *"Hedge Fund Due Diligence: A Source of Alpha in a Hedge Fund Portfolio Strategy"* refer: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1016904

This occasional series of seminars highlighting leading edge financial research is arranged by Melbourne Centre with the objective of facilitating knowledge transfer and improving industry-academia contacts.

Please note that there is a **limit on the number of attendees** but there is no charge. If you are interested in attending and participating, please indicate by an email to **info@melbournecentre.com.au** with the subject header of *"Academic Seminar – Prof Stephen Brown"* by **noon on Tuesday 4th December**.