

Hedge Funds: A Survey of the Academic Literature

Vikas Agarwal Kevin A. Mullally Narayan Y. Naik*

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* Vikas Agarwal is at J. Mack Robinson College of Business, Georgia State University, 35, Broad Street, Suite 1221, Atlanta, GA 30303-3084, USA. Tel: +1 404 413 7326, email: vagarwal@gsu.edu. Vikas Agarwal is also a Research Fellow at the Centre for Financial Research (CFR), University of Cologne. Kevin Mullally is at J. Mack Robinson College of Business, Georgia State University, 35 Broad Street, Suite 1229, Atlanta, GA 30303. Tel: 404 413 7318. Email: kmullally1@gsu.edu. Narayan Y. Naik is at London Business School, Regent's Park, London, NW1 4SA, UK. Tel: +44 20 7000 8223, email: nnaik@london.edu.

ABSTRACT

Hedge funds have become increasingly important players in financial markets. This heightened importance has spawned a large academic literature focused on issues pertinent to hedge fund managers, investors, regulators, and policymakers. Although the top-4 finance journals (*JF*, *JFE*, *RFS*, and *JFQA*) published only 16 papers on hedge funds prior to 2005, they have published 105 papers on hedge funds since 2005. As a result, we felt that it is time to update the survey published in 2005. This update prepared with the help of a new coauthor, Kevin Mullally, extends the previous survey along two dimensions. First, it includes reviews of recent studies on topics that were covered in the earlier survey. Second, it summarizes research on new topics that were not part of the previous survey. These new topics cover a broad gamut of issues ranging from hedge funds' use of leverage and exposure to different risks to their impact on various asset markets.

This survey consists of five broad sections. The first section reviews the literature examining both the time-series and cross-sectional variation in hedge fund performance. Time-series performance studies cover return generating processes, dynamic risk exposures, and determination of managerial skill. The second section covers studies focused on the cross-sectional relations between hedge funds' characteristics (including contractual features and time-varying features such as size and age) and fund performance. The third section analyzes the literature on the sources and nature of risks faced by hedge fund investors. In particular, we discuss risks that can arise from managerial incentives and sources of capital. The fourth section summarizes research on the role of hedge funds in the financial system. Specific topics here include hedge funds' impact on systemic risk, asset prices, and liquidity provision in financial markets. The fifth and final section focuses on potential biases and limitations of hedge fund data sources.