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PRESS RELEASE

Florida International University Study Reveals Best Time to Invest in Hedge Funds

MIAMI (July 10, 2018) – Considering the book-to-market effect, the best time to allocate money to hedge funds is beginning in the third quarter - and it's best to maintain those investments through June 30 of the following year - reveals new research from Florida International University's College of Business (FIU Business).

Published in the July 2018 Journal of Banking and Finance, the research finds that hedge funds, in contrast to regulated institutional investors, increase their demand for high book-to-market value stocks while decreasing their demand for low book-to-market growth stocks during the second quarter after companies' annual reports are made public during the first quarter. The annual report season for most companies runs from January 1 to March 31.

“Once hedge funds see the companies' finances and compute their book-to-market values, they take advantage of the book-to-market anomaly by flipping their strategies away from growth stocks to value stocks, allowing them to separate from the rest of the crowd,” said Mustafa Caglayan, associate professor of finance at FIU Business. “While other institutional investors also cut back on buying growth stocks, it's not at same level and intensity as hedge funds.”

The paper was co-authored by Caglayan with Umut Celiker, from Cleveland State University and Gokhan Sonaer from Duquesne University.

“Growth stocks that are heavily bought by non-hedge funds and simultaneously sold by hedge funds experience significant losses in the following year, providing evidence that hedge funds

have better ability to detect mispricing within the context of the book-to-market anomaly,” said Caglayan.

While hedge funds can more readily detect overpriced growth stocks, the study finds no significant evidence of such ability when it comes to detecting underpriced value stocks.

“One possible explanation for this difference may be the asymmetry in arbitrage, which for overpricing takes longer due to short-selling constraints while for underpricing it requires only buying those underpriced securities,” said Caglayan. “Therefore, underpricing dissipates much faster than overpricing.”

Hedge funds have an advantage over their institutional counterparts in that they aren’t heavily regulated by government agencies and therefore have more flexibility in their investment strategies, including the use of short-sell, leverage and derivatives.

“They are more opportunistic,” said Caglayan. “They can buy and sell over shorter periods of time and make more trades than non-hedge fund investors to capitalize on market inefficiencies.”

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