FIN 580 Hedge Funds

Instructor: Professor Z. Jay Wang
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Office Hours: MW 1pm to 2pm or by appointments
Lectures: MW 2pm to 3:20pm (HF1) and 3:30pm to 4:50pm (HF2) at 152 Wohlers

Course Overview
The course will provide an in-depth study on the institutional features of hedge funds and some popular equity trading strategies. We will start with an overview of the hedge fund industry. In particular, we will discuss the role of hedge funds in the recent financial crisis and the key lessons learned from the crisis. Next, we will introduce two key instruments used in hedge fund trading: leverage and short selling. The rest of the course will provide detailed coverage on the following equity trading strategies: long/short equity hedge strategies based on both quantitative models and fundamental analyses, event-driven strategies including merger arbitrage and spin-off arbitrage, closed-end fund arbitrage, and hedge fund activism.

Pre-requisite
Fin511: Investments

Recommended Textbook

Required Course Packet
Available at Illini Union Bookstore

Grading
The grading is based on two group projects (30 points), two individual project (50 points), other in-class assignments and class participation (20 points). The project details are described as follows.

(1) Project #1 (Group, 15 points): Short Selling
Identify a public company that you want to short sell based on fundamental analysis

(2) Project #2 (Individual, 30 points): Building an Alpha Model
Step 1: Use a multi-factor model to rank and sort stocks based on their expected returns.
Step 2: Construct long/short portfolios consisting of high-ranked and low-ranked stocks.
Step 3: Analyze the risk/return characteristics of the constructed portfolios.
(3) Project #3 (Group, 15 points):
Assessing the Risk Involved in Merger Arbitrage
HBS Case 9-203-003: Abbott Labs and Alza

(4) Project #4 (Individual, 20 points):
Assessing Arbitrage Opportunities in Corporate Spin-offs
HBS Case 9-202-024: Strategic Capital Management, LLC (A)

Group Assignments
Each group should consist of no more than FOUR students. All groups should be formed by Monday January 24th. At the end of the semester, each student is required to fill out a peer evaluation form evaluating each group member’s contribution to the group assignments. The instructor reserves the right to adjust the final grade for each student based on the peer evaluations.

Lecture Notes and Grades
Lecture notes and grades will be posted on http://compass.illinois.edu
Tentative Schedule

1. **Introduction to Hedge Funds** (Jan 19)
   - Developments of Hedge Fund Industry
   - Overview of Hedge Fund Strategies
   - Hedge Funds vs. Mutual Funds
   - Current trend of hedge fund investments
   - The role of hedge funds in asset allocations

   Readings:
   - Textbook: Chapter 1

2. **Hedge Funds and the Recent Financial Crisis** (Jan 24 & 26)
   - Overview of the Recent Crisis: A Historical Perspective
   - Who are Responsible?
   - What are the Roles of Hedge Funds – Systemic Risk, Excess Risk Taking, High Leverage, Lack of Regulation?
   - What are the Lessons Learned?

   Readings:
   - Darden Case UVA-F-1574: “Bear Stearns and the Seeds of its Demise”

3. **Short Selling and Leverage** (Jan 31, Feb 2 & Feb 7)
   - The Mechanics of Short Selling and Leverage
   - Risks, Benefits, and Regulations
   - Short Selling Strategies

   Readings:
   - Textbook: Chapter 3
   - HBS Case 9-207-071: “Selling Biovail Short”
   - HBS Case 9-200-007: Long-Term Capital Management LP (A, B, C, D)
4. **Long/Short Equity Investments: Quantitative Stock Selection** (Feb 9, 14 &16)
   - Basic steps for setting up market-neutral portfolios
   - Sources of return and performance
   - General investment process
   - Quantitative stock selection based on multi-factor models

   Readings:
   - Textbook: Chapter 4

5. **Long/Short Equity Investments: Fundamental Analyses** (Feb 21 & 23)
   - Long/short strategy, hedging, and leverage
   - Stock selection based on fundamental analyses

   Readings:
   - Textbook: Chapter 4
   - Bodie, Kane, and Marcus, “Investments” 6th edition, Chapter 18
   - Bruner, “Applied Mergers & Acquisitions” 2004, Chapter 9
   - HBS Case 9-204-013: Maverick Capital

6. **Event-Driven Arbitrage**: (Feb 28, March 2 & March 7)
   - Merger arbitrage
   - Spin-off arbitrage

   Readings:
   - Textbook: Chapter 5
   - HBS Case 9-203-003: Risk Arbitrage: Abbott Labs and Alza (A)
   - HBS Case 9-202-024: Strategic Capital Management, LLC (A)

7. **Other Strategies**: (March 9)
   - Closed-End Fund Arbitrage
   - Hedge Fund Activism

   Readings:
   - Textbook: Chapters 11 & 15
   - HBS Case 9-208-097: “Opportunity Partners”
INVITED GUEST SPEAKERS IN THE PAST

- Zhiwu Chen, Yale University
- Neil Collins, Quellos Capital Management
- Patrick Galley, RiverNorth Capital Management
- Eric Gettleman, Goldman Sachs and Chesapeake Partners
- Russ Fuller and Tom Fuller, Fuller & Thaler Asset Management
- Malcom Hawkes, UBS Oconnor
- Andrew Hick, PEAK6 Advisors LLC
- Patrick Hidalgo, Proprietary Capital LLC
- Xiongwei Ju, Millennium Partners
- Andrew Lo, MIT
- David Richter, Grosvenor Capital Management
- Allan Teh, Kamunting Street Capital Management

TEACHING EVALUATION
(On a 5-Point Scale)

Two ratings are presented based on students’ evaluation:
(1) Rate the Instructor’s Overall Teaching Effectiveness
(2) Rate the Overall Quality of This Course

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