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In recent months, the primary question on many individuals' minds has been the impact of alternative investments on the current credit crisis and in particular structured credit strategies that involved subprime debt. I was immediately asked how many articles in this issue would address this topic or in other words this "Black Swan" as someone who had read Nassim Taleb's recent book proclaimed. On the contrary, I explained that the purpose of the journal is not merely to address the most recent market event but to provide thoughtful commentary on issues that may become future "crises of the day." However, I did take time to point out that the current crisis related to subprime debt is of course no "Black Swan." In particular I reminded them of the fact that academics and practitioners had in earnest pointed out the potential risks of these instruments three years ago. In fact, readers of *The Journal of Alternative Investments* would have already been aware of the issue of pricing mortgage-backed securities and in fact, pricing in many OTC traded assets. For example, Brett Hellerman in an article in *The Journal of Alternative Investments* (Spring 2004) issue on page 90 points out:

"Hedge fund investors prefer transparency and they want mark-to-market pricing. In most asset classes this is easy. Markets are transparent and liquid... For fixed income securities and especially mortgage-backed securities however, the issue is not so clear-cut. These securities trade over the counter. There is no centralized market that can be sourced to price them. ... Accurate pricing is a big problem for mortgage hedge fund managers, indeed the major problem in their business." (page 90).

Here we are over three years later, responding to what we knew could happen or could have happened. I can only hope that the articles in this issue provide some insight into the workings of various aspects of the alternative investment universe. The lead section features articles on performance measurement. Hedge funds that invest in Asia-Pacific markets have grown rapidly in recent years. In the first article "Selection and Performance Analysis of Asia-Pacific Hedge Funds" Takeshi Hakamada, Akihiko Takahashi and Kyo Yamamoto the distributional characteristics of Asia-Pacific hedge fund returns, and tests the hypothesis that they are normally distributed. The results indicate that the distribution of returns exhibit fat tail characteristics. In order to account for fat tail distributions this authors use conditional value-at-risk (CVaR) and conditional drawdown (CDD) to assess the impact of negative tail risks of hedge funds. Further an optimal portfolio of hedge funds is constructed that is subject to constraints on CVaR and CDD. One can only anticipate that as the global asset market grows and evolves, their article will remain an important reminder of how areas of alternative investments evolve and how their unique characteristics impact investment decisions.

The evolution of alternative investments and hedge funds in particular has been addressed in past research. In fact, the hedge fund industry has often been described as the ‘privatization of the trading floor.’ Historically, many hedge funds were set up as independent businesses to pursue trading strategies originally pioneered by proprietary trading desks of large banks. In the second article, “Hedge Fund Incubation, Development and Performance” George Martin and Joseph Pescatore present new empirical information about the causal and associational consequences of some varying forms of institutional affiliation between hedge funds and larger investment organizations or service providers. They define three types of relationships between hedge funds and outside organizations and examine the risk, performance and exposure characteristics of each group. The results show that the institutional commitment associated with seeding and operational support is positively correlated with risk-adjusted returns relative to the broader universe of hedge funds. In the third article “Are Fund of Funds Simply Multi-Strategy Managers with Extra Fees?” Girish Reddy, Peter Brady and Kartik Patel examine two approaches that many institutions consider when investing in hedge funds: multi-strategy hedge funds and funds of hedge funds. Their results show that manager selection dominates strategy allocation for hedge funds. Their results also show that the ability to rapidly move capital between strategies can significantly improve the performance of both multi-strategy as well as fund of funds. Finally the results of this article are contrasted with recent research arguing superior performance of multi-strategy hedge funds.

The next section features an article on asset allocation. In recent years, the venture capital and private equity industries have witnessed significant growth in assets under management. In the fourth article, “Diversification and its Impact on the Syndication Probability of Venture Capital Investments” Dieter G. Kaiser and Rainer Lauterbach show that diversification benefits in this industry can be limited by transaction costs due to information asymmetries. Syndication is a common instrument that is used to overcome these limitations and achieve sufficient diversification, especially for smaller fund sizes. Their results also show fund size and investment experience are negatively correlated with syndication probability, while early-stage investments and venture deals are positively correlated.

The final section features articles on risk management.

The financial markets have successfully established hedging instruments to protect against market risk, interest rate risk, currency risk and credit risk. Each of these instruments allows for the isolation of an element of risk, and the transfer of this risk to a willing market participant. Liquidity risk however, although well known, is not directly hedged, since liquidity derivatives do not yet exist. In the fifth article, “Hedging Liquidity Risk” Ranjan Bhaduri, Gunter Meissner and James Youn introduce several liquidity derivatives that can protect against liquidity and/or return risk. Applications and elementary pricing algorithms are provided. Proposals of areas of further research are also suggested. In the sixth article, “The Amaranth Debacle: A Failure of Risk Measures or a Failure of Risk Management,” Ludwig Chincarini presents a brief investigation of the possible causes behind this spectacular hedge fund failure and draws lessons by assessing Amaranth’s trading activities within a standard risk management framework. Chincarini concludes that even by conservative measures, Amaranth was engaging in highly risky trades which in addition to high levels of market risk involved significant exposure to liquidity risk—a risk factor that is seemingly difficult to manage.

It is important to remind ourselves that often the very risk that enables one to make money on an investment is the risk that is the source of loss. An asset without the probability of a twenty percent loss often has little chance of a twenty percent gain. We must never blame any activity on a Black Swan simply because we failed to see it outside the door. In many ways, it is the possibility of loss and the steps one takes to manage that probability of loss is what separates those that succeed in the long run from those that experience short run but not long run success.

Speaking of long run success, *The Journal of Alternative Investments* is soon to enter its eleventh year. We have grown as the industry has. Part of that success is our understanding that there is always the chance of loosing what we have worked so hard to accomplish and to work hard to reduce that possibility. Of course, those accomplishments are due primarily to all of those who read and write for us. Thank you for your past efforts and for your continued commitment. Here is to another ten years.

Thomas Schneeweis
Editor