

Evaluating hedge fund investments: A Bayesian investigation of skill and persistence

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(Preliminary version, comments are welcome)

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Abstract

This article proposes a Bayesian model averaging approach to account for model uncertainty in the context of hedge fund pricing. We employ a Markov Chain Monte Carlo stochastic search algorithm to explore the posterior distribution of models. Relevant risk factors are identified and compared with those selected through standard model selection techniques. We find strong evidence of model uncertainty in hedge fund pricing regressions which suggests that appropriate techniques will do better in estimation/inference. This is confirmed in our empirical analysis in- and out-of-sample.

JEL classification: G11; G12 ;C11

Keywords: Hedge fund pricing; model uncertainty; Bayesian stochastic search algorithm; Bayesian model averaging.

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