

Hedge Funds: Attrition, Biases and the Survivor Premium

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Abstract

This study examines attrition, biases and the survivor premium in hedge fund returns for the period 1994-2001. We find that hedge fund attrition rates at 9 per cent per year are twice the rate reported in mutual fund studies. This paper finds that chronic poor performance is the common characteristic of non-survivors. We measure the various hedge fund biases and we find that hedge fund database returns may be overestimated by as much as 45 per cent. This paper examines an important concept known as the survivor premium which has received little research attention. The difference in returns between survivors and non-survivors, known as the survivor premium is estimated at nearly 10 per cent per annum. We find that the hedge fund survivor premium is 2 to 4 times the size of those reported in mutual fund studies. This significant hedge fund survivor premium highlights its importance to investors. We develop an economic rationale that explains the difference in the size of the survivor premiums. We propose that the hedge fund survivor premium captures both systematic and diversifiable risks, while the mutual fund survivor premium measures the level of diversifiable risk only.

JEL Classification: *G11, G20, G23, G29*

Key words: *Hedge Funds, Data Biases, Attrition, Survivorship, Investment Style*

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