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# Fund launch raises fears of hidden risks

## News analysis

Naked options writing becomes Ucits strategy, says Steve Johnson

The ongoing rush to convert complex hedge fund strategies into mainstream mutual funds could expose small investors to hidden risks, industry figures fear.

At least 75 Ucits funds have been established by hedge fund houses keen to expand their investor base.

However, concerns have been raised at the imminent launch of what is believed to be the first Ucits fund focusing on naked option writing, in which the portfolio is held in cash and the fund earns income by selling options that can trigger a loss if equities rally strongly or fall sharply.

Pfaffikon-based Swiss Alpha has run a hedge fund, Alpha Strategies, along these lines since 2003, and plans to launch a Ucits version with an investment floor of €1,000 (£896, \$1,483) this month.

But almost all the industry figures contacted by FTfm feared options writing funds were too high risk for smaller investors.

"It's an extremely dangerous strategy. It's one I

would never invest in personally or put anybody in. We are letting the wolf in among the lambs," said Gary Vaughan-Smith, partner at SilverStreet Capital, a fund of hedge funds.

"Most months it will work and you will just collect your premium. It will look very seductive and it will raise more money the longer it works. But when the underlying market does fall quite a lot or rallies strongly you can be totally taken out."

Tim Gascoigne, global head of portfolio management at HSBC Alternative Investments, which is about to launch a fund of Ucits hedge funds, said: "When you write options, particularly naked options, you are really opening yourself up to very large losses. We wouldn't want to invest in that kind of strategy."

Richard Hodgetts, manager of Collins Stewart Alternative Strategies, a fund of Ucits hedge funds, said: "If it is naked, it's really very dangerous. It's likely to upset a lot of people if it goes wrong, and

options writing strategies can go very wrong."

Ian Morley, chairman of Allenbridge Hedge, a hedge fund rating agency, added: "When it works, it looks almost too good to be true. Then a claim comes in. The return is fixed, the risk is

unlimited. These aren't for widows and orphans."

However Werner Schuenemann, director of business development at Swiss Alpha, denied that its fund was high risk. About 85-90 per cent of the options it writes are call options on the Euro Stoxx 50 equity index, which means the fund is exposed to losses if this index rises sharply.

But in spite of the Euro Stoxx having rallied 56 per cent from its March lows, Alpha Strategies lost only 7.7 per cent in the calendar year to September, having made money in every other year since 2003.

"Our greatest risk is a very fast rising market. What have we seen this year, and what have we lost?" asked Mr Schuenemann, who said academic

research suggested funds that sell more put options than calls, exposing them to loss if markets fall sharply, were more prone to "stunning returns and a greater risk of blowing up".

Mr Schuenemann, said the Ucits fund will not be marketed to "a wider public" and will be more aggressive than its sister hedge fund in closing out potentially loss-making positions.

He said Swiss Alpha's three partners each had a third of their net worth in the hedge fund.

John Donohoe, chief executive of consultancy Carne Global Financial Services, said: "There is no doubt you can lose a lot of money in this strategy but last year most US equity funds were down 50 per cent."

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