

Typical capital guarantee structure

The most common capital guaranteed fund of hedge fund structures invest a portion of their assets in fixed income securities such as a zero-coupon bond designed to pay out the total amount invested at a fixed maturity date. This date is naturally dependent on the prevailing interest rate environment and the amount of capital the fund can set aside for this purpose without hampering performance.

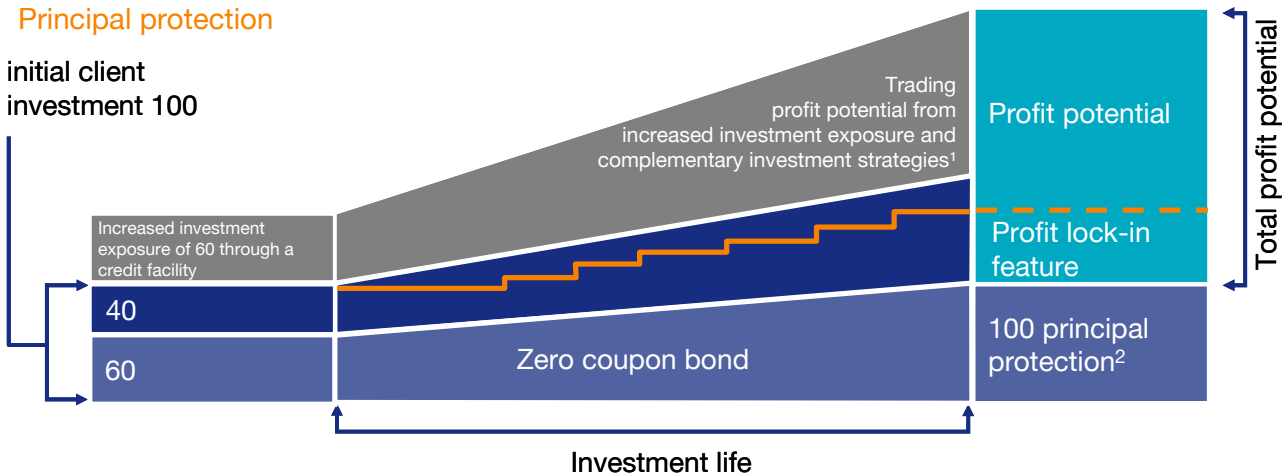
So, a USD 100 portfolio could purchase USD 60 worth of zero-coupon bonds in the expectation that in 10 years the value of those bonds would be USD 100. The remaining USD 40 would then have to be invested in such a way that it had the same impact as the original USD 100.

This can be achieved by investing in strategies that allow investors to get more 'bang for their buck'. Managed futures managers, for example, trade on margin and can thus gain greater investment exposure for less cash down. Judicious use of other borrowing can also help lift the amount of money available for investment.

Profit lock-in

Another structure that can enhance this, or any other capital guarantee, is a profit lock-in feature. The profit lock-in transfers a portion of profits from the trading account to the capital guarantee, increasing the sum that the investor will receive at maturity.

The combination can be represented as follows:



Schematic illustration.