Question #1 of 3

Question ID: 1574528

Jem Capital is a hedge fund with $150 million of initial investment capital. The fund charges a 2% management fee based on assets under management at the end of the year and a 20% incentive fee. Incentive fees and management fees are calculated independently. In the first year, Jem Capital has a 25% return. What is an investor's after-fee return for the year?

A) 3.0%.

B) 17.5%.

C) 22.5%.

Explanation

Gross value end of year: $150 million × 1.25 = $187.5 million

Management fee: $187.5 million × 2% = $3.75 million

Incentive fee: ($187.5 million – $150 million) × 20% = $7.5 million

Total fees to Jem Capital: $11.25 million

The after-fee return: [(187.5 – 11.25) / 150] – 1 = 17.5%.

(Module 79.1, LOS 79.b)

Question #2 of 3

Question ID: 1574529

Carr Funds is a hedge fund with $125 million of assets under management at the end of the prior year. The fund has a "1 and 10" fee structure. Incentive fees are calculated on gains net of management fees at the end of the year. In the current year, Carr Funds had a 5% gross return. An investor's after-fee return for the year is *closest* to:

A) 3.6%.

B) 4.1%.

C) –6.0%.

Explanation

Gross value end of year: $125 million × 1.05 = $131.25 million

Management fee: $131.25 million × 1% = $1.3125 million

Incentive fee: ($131.25 – $125 – $1.3125) × 10% = $493,750

Total fees to Carr Funds = $1.3125 million + $493,750 = $1,806,250

The after-fee return: [($131.25 – $1.80625) / 125] – 1 = 3.56%.

(Module 79.1, LOS 79.b)

Question #3 of 3

Question ID: 1574527

A hedge fund has a 2-and-20 fee structure with a soft hurdle rate of 5% and a high water mark. Incentive fees are calculated net of management fees. The fund's gross return is 15% in Year 1, −10% in Year 2, and 30% in Year 3. Incentive fees for Year 3 will be:

A) less than 20% of the increase in value in Year 3 after management fees. ✓

B) equal to 20% of the increase in value in Year 3 after management fees. ✗

C) greater than 20% of the increase in value in Year 3 after management fees. ✗

Explanation

Because the fund lost value in Year 2 and has a high water mark, incentive fees for Year 3 will be 20% of only the portion of the Year 3 gain that exceeds the previous highest value.

(Module 79.1, LOS 79.b)