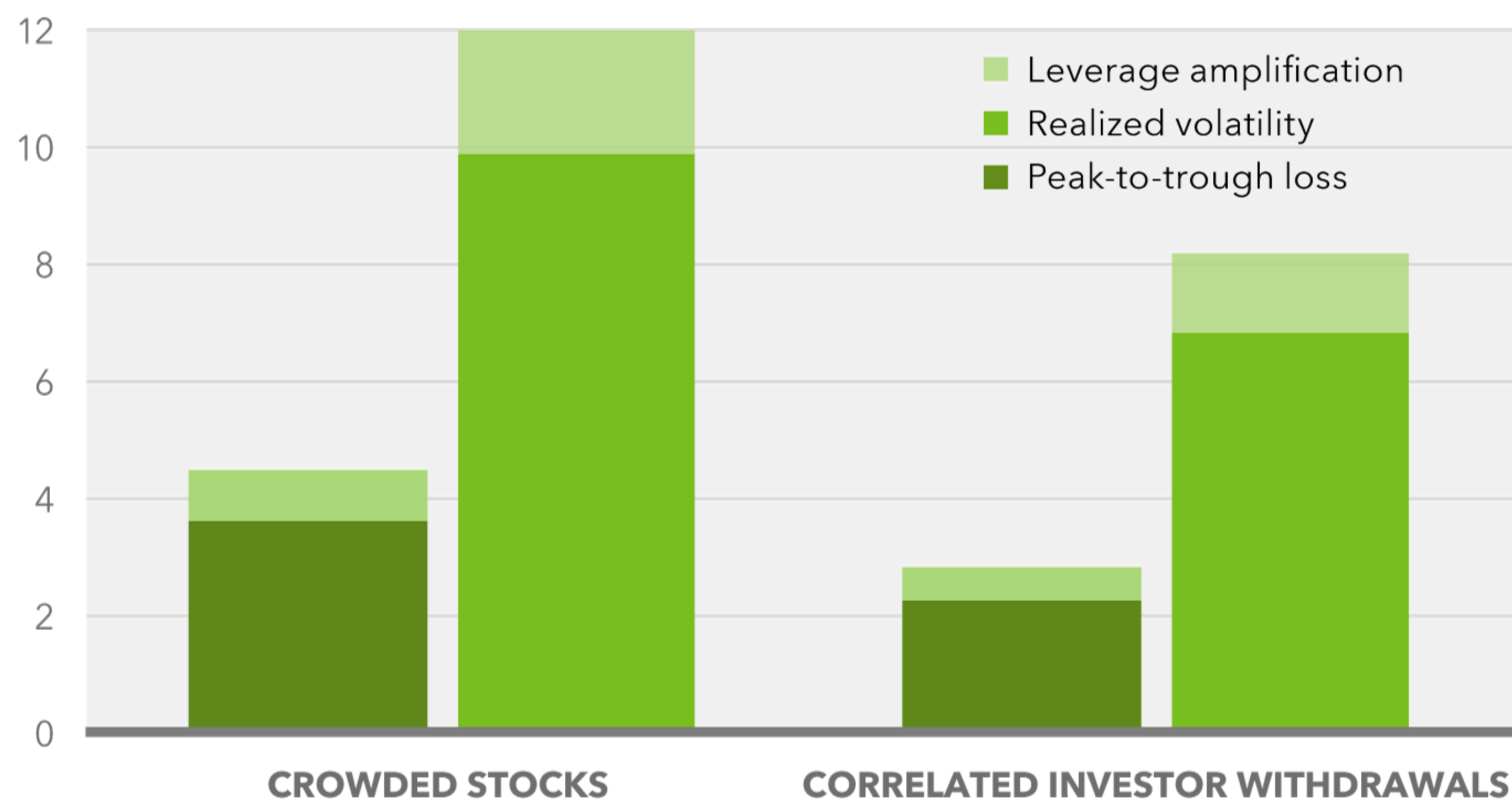


CHAPTER 2. Hedge Funds and Financial Stability

Hedge funds support market functioning in normal times but can amplify market pressures during stress

Effect of Hedge Fund Vulnerabilities on Stock Volatility and Losses

(Percentage points)



Sources: Hedge Fund Research; Lipper TASS; With Intelligence; FactSet; and IMF staff calculations.

Note: Bars show the estimated increase in next-quarter stock volatility and peak-to-trough losses during periods when the VIX index is in its top decile. Results are shown for crowded stocks—those in which many hedge funds hold positions—and for stocks held by funds with volatile end-investor flows. Lighter shading shows the additional amplification when the hedge funds holding these stocks have high leverage.

POLICIES



Strengthen risk monitoring and close data gaps



Calibrate policies to underlying vulnerabilities to enhance resilience of hedge funds



Strengthen counterparty risk management at prime brokers



Maintain credible backstop to address severe market dysfunction