

What does a trader at a Hedge Fund do?

Hedge Fund & Trading › Interview Preparation



Investment Banking, Private Equity
& Venture Capital Articles, Guides & Jobs

- What Does a Trader Do?
- What Does a Trader At a Hedge Fund Do?
- **Why would you work at a Hedge Fund as opposed to working at an Investment Bank?**

What does a Trader do?

A professional trader is of the most desirable jobs at an investment bank – but what do traders actually do at investment banks? First of all, roles and objectives tend to be a bit more complex than just buying and selling stocks to maximise profits. Let's review the two main types of traders at an investment bank.

Market makers

The large majority of traders at investment banks are market makers. A market maker is essentially a middle-man; the bank customers will call him to buy or sell a financial instrument, and his job is to offer them a price, find other customers to buy or sell to, and pocket the price differential (commissions). Note that the market maker is taking a calculated risk and this is why he would be called a "trader". For example, if he buys shares in Google from a customer and the price falls before he is able to find another customer to sell to, he risks making a loss. This is why a market maker will take a spread on each stock he buys, either buying at a slight discount or selling at a slight premium. Using that previous example, as a market maker you can offer to buy the Google stock from your customer at \$1,000, and then offer to sell it at \$1,001 to another customer. The \$1 may not seem much, but the trading volumes are very large, so the profits can be substantial.

Proprietary traders

A proprietary trader does not deal with clients, but buys and sells financial instruments on her own account, aiming to make a profit. She is using the bank's money, and is allocated an amount of money to trade with. This is much riskier for the investment bank, and this is why the proprietary traders remain a minority. These traders are kept separate from clients, so that they cannot engage in what is called "front-running". Front running is placing orders ahead of a client to benefit from a movement in price. For example, if your client calls you to place a very large order of Google stock that would move the share price, the trader could theoretically place an order beforehand and benefit from the price increase afterward, thereby "piggy-backing" on the client.

What does a trader at a Hedge Fund do?

Hedge funds are pools of capital from various investors, used by hedge fund traders (also called Portfolio Managers) to generate profits in financial markets. These traders can be used to trade various types of instruments: equity, debt, derivatives, etc. Also, traders can make money in rising and falling markets. Traders at hedge funds basically have the same job as proprietary traders in investment banks, except that in a hedge fund they are trading investors' money as opposed to using the investment bank's

money. Hedge fund traders get a cut of the profits they generate, but also charge a "management fee" to cover the costs of running the business: IT infrastructure, rent, basic salaries, etc. The cut of the profit they generate is paid out as bonuses to the traders, but typically a part is reinvested into the hedge fund.

So why would you work at a Hedge Fund as opposed to working at an Investment Bank?

The proprietary trading business at investment banks has been declining over the past few years, as it is very risky. Many traders at investment banks have now moved on to join or launch their own hedge funds. At a hedge fund, traders are able to invest their own money as well, and thus generate more profits for themselves if they are good at what they do. Large hedge funds can be particularly attractive as employers because of the "management fee" they charge. For example, a £1bn hedge fund can charge a 2% management fee per year. This is equivalent to £20m per year, which more than covers the running costs of the fund, and can be a significant source of profits as well.

Download More Free Articles & Guides at AskIvy.Net