

Performance Update

Fund of Hedge Funds Indices	July	June	YTD	2005	2004	2003
EDHEC Fund of Funds Index	-0.18%	-0.28%	4.82%	6.48%	7.07%	11.46%
HFRI FoHF Composite Index	-0.23%	-0.60%	3.95%	7.49%	6.86%	11.61%
CISDM Fund of Funds Index	-	-0.59%	3.61%	6.47%	7.12%	10.23%
InvestHedge Composite	-	-0.56%	3.38%	7.07%	6.15%	9.34%
Altvest Sub-Index: Fund of Funds	-0.30%	-0.63%	3.78%	7.68%	7.39%	11.12%
Eurekahedge Fund of Funds Index	-0.23%	-0.69%	3.64%	7.75%	6.84%	11.57%
Barclay/Global HedgeSource FoF Index	0.69%	-0.59%	4.71%	6.91%	6.65%	10.44%
AAC Fund of Hedge Fund Benchmark	-	-0.69%	4.04%	7.54%	6.43%	11.32%
Average FoHF Indices	-0.05%	-0.58%	3.99%	7.17%	6.81%	10.89%

Investable Hedge Funds Indices	July	June	YTD	2005	2004	2003
CS/Tremont Investable HF Index	0.21%	-0.10%	4.96%	3.61%	5.31%	11.04%
MSCI Hedge Fund Invest Index	-0.08%	-0.77%	2.88%	4.68%	3.10%	14.70%
HFRX Global Hedge Fund Index	-0.57%	-0.49%	2.53%	2.72%	2.69%	13.39%
FTSE Hedge Index	-	-0.85%	2.52%	2.60%	3.12%	12.36%
Average Investable HF Indices	-0.15%	-0.55%	3.22%	3.40%	3.56%	12.87%

Numbers prior to the date of inception of the Investable Indices are pro forma. Fees may not be included.

Fund of Funds of Hedge Funds	July	June	YTD	2005	2004	2003
PrimFund Diversified (net of fees)	-0.54%	-0.32%	4.12%	7.78%	8.39%	13.68%
PrimFund Growth (net of fees)	-0.04%	-0.96%	5.33%	9.38%	15.69%	20.75%

Inception of PrimFund Diversified was July 2004, of PrimFund Growth April 2005. The simulated data prior reflects the net performance of a weighted composite of the targeted fund managers net of fees. All numbers shown are for illustration purposes only and are no guarantee of future performance.

Industry News

European Hedge Fund assets to hit USD 390bn by end of 2006

Eurekahedge

Assets under management in a tracked group of more than 1,800 European hedge funds are expected to jump better than 25% to around USD 390bn by the end of 2006, compared with just over USD 300bn at the beginning of the year, according to new research from the European hedge funds database Eurekahedge.

Q2 inflows strong,

Tremont Capital Management

Tremont Capital Management Inc., Rye, N.Y., said that according to its figures, hedge funds added USD 38.3bn in assets during the May through June period, a 4.19% increase in assets Tremont uses as a base for the quarterly Tremont Asset Flows Report. Overall, Tremont estimated the hedge fund industry had USD 1.2tn in assets as of June 30. In the Tremont report, fixed-income arbitrage strategies led all gainers, taking in new assets equivalent to 7.28% of the amount those strategies had in assets at the beginning of May. By the same measure, global macro grew 7.16%, managed futures 5.87%, emerging markets 5.83% and equity market neutral 5.07%. Rounding out the strategies Tremont tracks, long/short equity hedge funds grew 3.86%, dedicated short bias 3.84%, multi-strategy 3.11%, convertible arbitrage 3.01% and event-driven 2.28%.

European Hedge Funds reach record levels in H1 2006

HedgeFund Intelligence

The number of new hedge funds launched in Europe hit record levels in the first half of 2006, according to an exclusive survey compiled by global hedge fund information provider HedgeFund Intelligence. At least 170 new European hedge funds were launched in the first six months of the 2006 calendar year – up from 150 in the first half of 2005. The new fund launches collectively raised assets of USD 11.4bn.

20bn Euro Opportunity for Spain`s Onshore Funds

Asterias

Spain's onshore single hedge fund and fund of funds market will be worth between EUR 18bn and 20bn by 2010 according to a July 30 report published by Paris-based hedge fund research company Asterias. The report, titled Spain Outlook—July 2006, was based on information gathered from banking professionals, family offices, savings institutions, custodians, pension funds and fund platforms. The report estimated that the fund of funds market will reach EUR 8bn to 10bn and that, if BBVA's single-manager business obtained through the acquisition of Vega AM is registered onshore, the single-manager market could reach EUR 10bn to 11bn.

New Mexico Fund makes three hedge fund hires, overall allocation now USD 1.3bn

The New Mexico State Investment Council, Santa Fe, hired three funds of hedge funds managers to run a total of USD 200mn in strategies that will provide downside protection in case equity markets fall. The USD 13.5bn endowment fund invested USD 100mn in Hunt Financial Ventures, and USD 50mn each in EIM Group and K2 Advisors' alternative strategies fund, a low-volatility fund of funds making bets in a host of esoteric markets including movie rights to weather derivatives and carbon dioxide emission credits. All three managers already run market-neutral strategies for the fund.

Advisor/People News

ABP Spins off New York Hedge Fund Team

The EUR 193.6bn Dutch civil service pension scheme ABP will next month transfer its New York-based hedge fund team to a newly established funds of hedge funds outfit called New Holland Capital. The move follows rapid changes and increasing competition in the hedge fund industry over the past few years, which demanded a restructure of ABP's hedge fund business model.

FRM Hires new America CEO

London-headquartered Financial Risk Management appointed Andy Brindle chief executive officer of its US operation. Previous CEO Carrie McCabe will move into the new role of president to accommodate Brindle.

Harcourt AUM Raise 29% to USD 4bn in H1

Harcourt Investment Consulting AG, the Switzerland based global fund of hedge fund provider, announces that assets under management in the first half of 2006 increased by 29% from USD 3.1bn to USD 4.0bn (as of 30 June 2006).

Investcorp AUM Break USD 10bn, Profit up 18.6% to USD 131m

Investcorp, the Bahrain-listed investment group, has expanded total funds under management to more than USD 10bn as its core base of wealthy Gulf investors steps up allocations to private equity, real estate and hedge funds. The hedge fund of hedge funds business lifted assets under management to more than USD 2.6bn, and generated an average spread over the LIBOR rate of 7 per cent.

Penjing Grows to USD 200mn in 15 Months from Launch

Penjing Asset Management, a Hong Kong-based Asian fund of hedge funds shop, has surpassed USD 200mn under management after just 15 months of operation. The firm was established by chief investment officer Ronnie Wu and chief operating officer Natalie Cruz in April 2005 after the pair left Vision Investment Management, also in Hong Kong.

Deutsche Real Estate Chief to Head Alternatives

Deutsche Asset Management appointed Charles Leitner III global head of alternative investments, to oversee hedge funds, funds of funds and other operations in the alternatives area. This position was newly created as part of a global build up by Deutsche. Mr. Leitner will be responsible for Topiary Fund Management, a fund of funds operation, and DB Advisors Capital Management, a single manager and multi-strategy hedge fund business. These have combined assets of USD 7.3bn.

Torrey Creates Role for Asia Hedge Funds Research

Fund of hedge funds investment company Torrey Associates strengthened its Asia hedge funds research team with the appointment of Shu Nung Lee as vice president of research. Splitting his time between his base in Hong Kong and New York, quad-lingual Mr. Lee (English, Cantonese, Japanese, and Mandarin) is tasked with building and enhancing Torrey's research effort in the region. He has 10 years of international equity investment experience in the region with names such as Nicholas-Applegate Capital Management, Lehman Brothers and Credit Suisse.

Cadogan Expands Management Team

Cadogan Management LLC, a private investment management and research firm, has announced Julia Herr will join the management team as counsel and director of operational risk. Ms. Herr will be responsible for overseeing operational due diligence for Cadogan's fund of fund investments, applying both her business and legal experience. Prior to joining Cadogan Ms. Herr specialized in mergers and acquisitions and finance and securities law as a practicing attorney with White and Case LLP.

EIM's van Hoof Joins Investec as Board Member

Luc van Hoof has left the EIM Group to join Investec Asset Management as a new member on its board of directors. In his new role, Investec said van Hoof would play a prominent role in formulating and executing asset management's business strategy, with a primary focus on new growth opportunities in the international institutional market.

Sagard buys into Olympia

Olympia Capital, a EUR 3.1bn French fund of hedge funds manager, is to sell a share stake to Sagard, a Canadian private equity firm.

JPMorgan Alumni Launch Emerging Markets Fund of Hedge Funds

New York-based Dolomite Capital Management has launched the Dolomite Global Emerging Markets Fund, its first fund of hedge funds. The new firm's chairman Jorge Jasson, chief executive Raj Teswani and chief investment officer George Grunebaum all worked together in the JPMorgan Chase emerging markets unit for 12 years prior to starting Dolomite.

Product News

Cue Ball Launches Multi-Strategy Fund of Hedge Funds

The Boston-based Cue Ball Group launched the Cue Ball Discovery Fund, a multi-strategy fund of hedge funds, on July 1. The fund will be managed by portfolio manager, Brad Balter. Strategies the fund of funds will use include US long/short equity, global long/short equity, sector-based equity, debt-credit strategies and arbitrage. The fund invests in 13 hedge funds at present.

Goldman Fund of Hedge Funds Heads for Listing

Goldman Sachs Asset Management (GSAM) had raised USD 507mn for a new vehicle, Goldman Sachs Dynamic Opportunities, which is going to float on the London Stock Exchange giving retail investors further exposure to the high stakes industry. It is the largest ever initial public offering of an LSE-listed fund of funds.

LODH launched Latin America Equity L/S Fund of Hedge Funds

LODH launched on June 1, 2006 a Latin America equity long/short fund of hedge funds, which invests in a selection of talented local managers that follow a long/short strategy in the Latin American equity markets. After less than two months in existence, the fund's assets have reached USD 50mn and are invested in close to 13 different managers, mostly located in Brazil.

Fieldcrest Capital Launches New Fund of Hedge Funds

The Omaha, Nebraska-based Fieldcrest Capital Management launched a managed futures fund of fund, according to David Slattery, a managing partner. Fieldcrest Capital Partners LP will invest in

four to seven global trading advisors, including trend followers and discretionary managers, said Slattery.

Academic/Research

Hedge Funds Diversify, Reduce Risk, and Add Alpha Even When Corrected for Survivorship and Backfill Biases **Chen**

To uncover true hedge fund returns, Chen analyzed the after-fee performance of a universe of about 3,000 hedge funds in the TASS database from January 1995 through March 2004. To make sure that the more successful large funds didn't have a disproportionate impact on the indexes' overall returns; he constructed an equally weighted index of hedge funds that gave him an average annual return of 16.64% after fees. Then he corrected for survivorship and backfill biases. When he added the performance of failed (or dead) funds back into the index, the return dropped to 13.9%. And when he eliminated backfill returns, the average annual return declined to nearly 9.1%. When he examined the data, he found that large hedge funds tended to produce greater returns than small hedge funds. While that approximately 9.1% return after adjusting for survivorship and backfill biases may not seem so exciting given the comparable return on stocks over the same period, hedge funds bring good diversification to a portfolio of traditional investments. And the addition of hedge funds can actually reduce the overall risk of a portfolio. The 9.1% return figure can be broken down into two components: alpha (the amount of excess return that the manager adds) and beta (the return that the market adds). He found that slightly more than half of the 9.1% return is beta (5.4%), while the remainder is alpha.

Inefficiencies of Portable Alpha Models

Murphy

Murphy dissects the portable alpha strategy, which has recently gained popularity with institutional investors. Using arbitrage-free pricing theory, he shows that the use of derivatives to create synthetic exposure in portable alpha models is irrelevant and merely creates unnecessary levels of complexity and inefficiencies. He demonstrates how the portable alpha technique is nothing more than borrowing money and investing in hedge funds or funds of funds. Furthermore, he extends a recent Fama and French model to demonstrate that the practice of separating alpha, and making it portable, creates further inefficiencies when the investor holds a diversified portfolio.

Performance Measurement for Hedge Funds with Neural Network **Baghai, Klocker**

In this paper, Baghai and Klocker describe a novel technique for the performance attribution of hedge funds. They use a multi-factor approach in the tradition of Sharpe's (1992) asset class factor model, which they adapt to the special requirements of hedge funds by a new set of benchmark indices. In order to create these indices they use an unsupervised neural network, the so-called Self-Organizing Map. This allows them to group hedge funds into homogenous categories without relying on the funds' error-prone self-classifications. With the constituents of the different strategy categories they construct style consistent benchmark indices that incorporate the dynamic trading strategies distinguishing hedge funds from mutual funds. In the empirical section they assess the usefulness of our performance attribution approach by comparing it with four other models suggested in the literature. For this purpose they evaluate the persistence in the performance of hedge funds and analyze whether fund of hedge funds managers create added value. The results of this empirical analysis show that their performance attribution model is of considerable value in the evaluation of hedge fund performance and the assessment of managers' investment skill and outperforms the tested rivaling models. Moreover their results indicate that investment skill does matter in the hedge fund industry.

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