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Funds of Hedge Funds Review

22nd August 2008

Performance Update all data in %

Fund of Hedge Funds Indices	July	June	YTD	2007	2006	2005	2004
EDHEC Fund of Funds Index	-2.61	-0.68	-4.55	10.07	11.25	6.80	7.07
HFRI FoHF Composite Index	-2.73	-0.82	-5.03	10.26	10.39	7.49	6.86
CISDM Fund of Funds Index	-	-0.23	-1.36	8.68	9.11	6.47	7.12
InvestHedge Composite	-	-0.19	-1.25	8.68	8.67	7.07	6.15
Altvest Sub-Index: Fund of Funds	-2.51	-0.77	-4.54	8.63	10.24	7.68	7.39
Eurekahedge Fund of Funds Index	-2.59	-0.74	-4.79	10.21	10.38	7.92	7.00
HFN Fund of Funds Aggregated Average	-2.72	-0.62	-4.70	9.27	9.60	6.81	6.89
Barclay / Global HedgeSource FoF Index	-2.63	-0.70	-5.09	8.86	9.38	6.91	6.65
Average FoHF Indices	**-2.63**	**-0.59**	**-4.78**	**9.33**	**9.88**	**7.14**	**6.89**

Investable Hedge Funds Indices	July	June	YTD	2007	2006	2005	2004
CS/Tremont Investable HF Index	-2.34	-1.08	-3.23	7.42	9.65	3.61	5.31
DJ Hedge Fund Balanced Portfolio Index	-1.56	-0.57	-3.29	7.54	9.94	1.60	-
MSCI Hedge Fund Invest Index	-2.60	-0.92	-6.12	3.61	7.63	4.68	3.10
HFRX Global Hedge Fund Index	-2.82	-0.83	-3.83	4.23	9.26	2.72	2.69
FTSE Hedge Index	-2.61	-2.99	-10.06	0.62	6.28	2.60	3.12
Average Investable HF Indices	**-2.39**	**-1.28**	**-5.30**	**4.68**	**8.55**	**3.04**	**3.56**

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

Average FoHF Indices Current Month -2.63%

Average Investable HF Indices Current Month -2.39%

Portfolios of Funds of Hedge Funds	July	June	YTD	2007	2006	2005	2004
PrimFund Diversified (net of fees)	-1.65	0.47	-1.25	8.53	9.54	7.78	8.39
PrimFund Growth (net of fees)	-2.80	-0.47	-5.36	13.84	13.85	9.38	15.69
PrimFund Tactical (net of fees)	-2.19	0.91	2.40	13.05	18.87	14.49	-
PrimFund Opportunity (net of fees)	-3.68	-1.12	-11.07	10.30	22.12	17.02	17.13

Inception of PrimFund Diversified was July 2004, of PrimFund Growth April 2005, of PrimFund Tactical April 2008, of PrimFund Opportunity September 2006. The simulated data prior reflects the net performance of weighted composite of the targeted fund managers net of fees. All numbers shown are for illustration purpose only and are no guarantee of future performance.

Industry News

Flow of capital into hedge funds continued to slide in Q2

Allocations into hedge funds slowed to their lowest quarterly level since Q4 2005 as volatile financial markets prompted investors to adjust strategy exposures, according to information released by Hedge Fund Research. Investors allocated USD 12.5bn of new capital to the industry for the quarter, bringing the total capital flows for 2008 to approximately USD 29bn. In comparison, the first six months of 2007 saw an inflow of approximately USD 118bn, in a year that ended with a record total inflow of USD 194.5bn. Flows for Q2 2007 were USD 58.7bn. Suggesting continued concern with regard to credit exposure, investors withdrew more than USD 3.6bn from Relative Value funds, while allocating nearly USD 7bn to Macro strategies. Macro strategies in aggregate have benefited broadly from persistent trends in commodities and currencies, as well as from lack of direct exposure to credit weakness. Despite the volatility,

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total industry capital increased by approximately USD 56bn for the quarter, as the broad-based HFRI Fund Weighted Composite gained more than 2.25 percent, partially offsetting the loss in Q1. Total capital under management at the end of Q2 stood at USD 1.931tn, compared to USD 1.875tn at the end of the first quarter. Investors also continued to access the hedge fund industry through funds of hedge funds, allocating nearly USD 9bn for the quarter; assets in funds of hedge funds increased to USD 825.9bn from just over USD 800bn at the end of Q1.

Rate of European hedge fund launches slowed in H1

New European hedge fund launches slumped in the first half of this year to their lowest levels since 2002, according EuroHedge. The half-yearly survey in the July edition of EuroHedge shows that just over 100 new hedge funds had launched in Europe by the end of June, raising total assets of USD 10.8bn. That is the lowest first-half figure since 2004, when new European funds raised USD 9.4bn. The number of funds is 45% lower than for the same period last year, when 190 new European funds launched, while the asset figure is also down by approximately 30% – from USD 15.5bn in H1 07. In terms of the number of new funds, the total of 106 new launches is the lowest since 2002, when markets were in similarly volatile and bearish moods and when there were just 84 new launches in the first half of the year. The top 10 new launches in Europe in the first half 2008 accounted for over 60% of the assets raised by all the 106 new funds – with the largest arrival, that of the new USD 2.5bn Brevan Howard Multi-Strategy fund, contributing almost 25% of the total. The results of the survey confirm the year-on-year trend of declining new fund launches that became evident in the second half of 2007, when the onset of the credit crunch sparked a slowdown in new launches. Despite this slowdown in new fund launches and the poor asset-raising climate, the survey shows that the European hedge fund industry is continuing to expand. just over 50 European hedge funds shut down in the first six months of the year – less than half the number of new funds launched in the same period.

Advisors/People News

Guggenheim acquires India fund of hedge funds unit

U.S.-based asset management firm Guggenheim Partners has acquired control of Thomas Weisel Partners' India fund of funds business, VC Circle reports. Thomas Weisel International and Guggenheim Partners will together manage the existing fund, Thomas Weisel Partners India Opportunity Fund, which has less than USD 100mn.

Ron Insana leaves Insana Capital and CNBC to join SAC Capital as M.D.

CNBC's Ron Insana, the veteran anchor who left the chair in February 2006 and became a senior analyst, is leaving Insana Capital Partners, the company he started upon leaving CNBC full-time.

Ed Rogers makes two new hires for the Wolver Hill Japan Fund

Wolver Hill Advisors and Rogers Investment Advisors announced the addition of two new staff to support the Wolver Hill Japan Fund. Yoshiaki Iizuka has joined Rogers Investment Advisors in Tokyo as a Managing Director and Head of Japanese Research. Yoshi was most recently Chief Investment Officer for a USD 40mn Japan Long/Short fund at Traders Investment Management. Eric Chong has joined Wolver Hill Advisors in New York as a Risk Manager. Eric was most recently a Risk Manager at Societe Generale Asset Management Inc. in New York, where he was responsible for risk evaluation and analysis for the USD 5bn fund of hedge funds program.

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Product News

Mitsubishi Asset Brains plan to start a fund of hedge funds

Mitsubishi Asset Brains Co, an investment advisory firm of the Mitsubishi financial group, plans to start a fund of hedge funds as it seeks to invest in managers that can make money in falling markets. The company aims to start advising a fund in the next "two- to-three years" with the aim of raising several tens of billions of yen.

Unigestion to launch two fund of hedge funds

Swiss asset manager Unigestion is launching two funds of funds, one investing in hedge and private equity funds, the other in Asian-based funds. It has seeded its Distressed Hybrid fund of funds with USD 47.1mn. It aims to raise up to USD 750mn, and invest in 10 to 15 funds.

Quant specialist Telesis launches offshore feeder for fund of managed accounts

Telesis Capital, the California-based asset management firm has announced the August 1st launch of an offshore version of its Ergos Fund, a fund of managed accounts which invests in quant managers with rapid trading strategies.

KGR Capital launches its new Asia Market Neutral Fund

KGR Capital announced the launch of the KGR Capital Asia Market Neutral Fund SP ("AMN") on August 1, 2008 in response to investor demand. The fund will only invest in Asia Pacific hedge funds whose investment strategy does not entail a consistent net long exposure to equities, whether on a single country or pan Asian basis.

GAM launches environmental fund of hedge funds

The USD 95.3mn GAM Multi-Environmental fund has been opened to investment. The fund, run in-house since January 2008, targets the growing sector of funds focusing on alpha generation from environmental investment themes. Investing in a concentrated portfolio of eight to 12 underlying managers diversified across five categories — clean technologies, water, commodities, alternative energy and natural resources — the fund is also globally diversified across regions and investment strategies.

Academic/Research

The distressed corporate debt cycle from a hedge fund investor's perspective

P. Chen, J. F. Gonzalez-Heres, S. S. Shin

This paper analyzes the distressed corporate debt cycle from the perspective of an investor in distressed hedge fund managers, versus the investor in actual underlying distressed securities, and endeavors to find improved entry and exit investment points to improve return expectations. They find that the distressed cycle has an element of memory (repeatability) and can be broken down into three distinct states within a cycle. They also find that the Distressed Ratio serves as the most important factor in predicting distressed hedge fund manager returns. Furthermore, they present evidence that regime-switching analytical techniques can be useful in identifying trigger (or inflection) points to predict state transitions within the cycle. Finally, they believe that by refining the timing of distressed hedge fund investments, investors can improve their odds of enhancing return expectations by tactically adjusting their exposure to the strategy based on an understanding of the opportunities and risks afforded by each state within the cycle.

The Geography of Hedge Funds

Melvyn Teo

This paper analyzes the relationship between the risk-adjusted performance of hedge funds and their proximity to investments using data on Asian-focused hedge funds. They find, relative to an augmented Fung and Hsieh

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(2004) factor model, that hedge funds with a physical presence (head or research office) in their investment region outperform other hedge funds by 3.72 percent per year. The local information advantage is pervasive across all major geographical regions, but is strongest for Emerging Market funds and funds holding illiquid securities. These results are robust to adjustments for fund fees, serial correlation, backfill bias, and incubation bias. They show also that distant funds, especially those based in the U.S. and the U.K., are able to raise more capital, charge higher fees, and set longer redemption periods, despite their underperformance relative to nearby funds. It appears that distant funds trade investment performance for better access to capital.

Impact of fund size and fund flows on hedge fund performance

M. Ammann, P. Moerth

This study focuses on two factors, fund sizes and fund flows. The impact of fund sizes on hedge fund performance is non-trivial. Large funds tend to have a diversified client base, more resources, and often a more rigorous risk management approach compared to smaller funds. Smaller funds need to attract assets and prove themselves. Therefore they may be willing to take more risk and have higher expected gross returns. In order to assess expected net returns, operational costs need to be taken into account. In that respect smaller funds are at a disadvantage due to a higher cost ratio based on relatively high fixed costs. The relationship between fund sizes, fund flows, and performance is evaluated from different angles. Returns, standard deviations, Sharpe ratios, and alphas derived from an asset class multi-factor model are investigated with respect to fund sizes and fund flows. The study includes empirical evidence based on large data samples of hedge funds and CTAs. The analysis suggests that on average large funds cannot take advantage of their economies of scale. On the contrary, a significant negative relationship between fund sizes and hedge fund performance is revealed. In a closer investigation of fund flows, it is investigated whether funds can cope with increased inflows and invest new capital efficiently. The analysis shows that periods with high asset inflows in individual funds are typically followed by periods of below-average returns.

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