

## Performance Update

<b>Fund of Hedge Funds Indices</b>	Nov	Oct	YTD	2003	2002	2001
EDHEC Fund of Funds Index	1.44%	0.68%	4.51%	11.46%	1.25%	-
HFR FoHF Composite Index	2.62%	0.78%	5.38%	11.59%	1.02%	2.80%
CISDM FoHF Diversified Median	2.37%	0.60%	5.73%	10.04%	0.65%	4.99%
CISDM FoHF Niche Median	1.72%	0.55%	7.96%	10.62%	1.99%	6.75%
InvestHedge Composite <sup>1)</sup>	-	0.58%	2.71%	9.28%	1.99%	5.42%
Altvest Sub-Index: Fund of Funds	2.61%	0.61%	5.86%	11.12%	1.23%	2.28%
Eurekahedge Fund of Funds Index	2.23%	0.65%	4.56%	10.76%	1.76%	4.00%
Barclay/Global HedgeSource FoF Index	2.38%	0.65%	5.13%	10.36%	1.79%	4.45%

1) Updated by the end of the month.

<b>Investable Hedge Funds Indices</b>	Nov	Oct	YTD	2003	2002	2001
CSFB/Tremont Investable HF Index	1.73%	1.43%	4.18%	11.04%	5.67%	7.47%
MSCI Hedge Fund Composite Index	1.61%	0.73%	2.23%	14.7%	5.30%	12.74%
S&P Hedge Fund Index	1.44%	0.65%	2.51%	11.12%	4.14%	9.36%
HFRX Global Hedge Fund Index	1.92%	0.16%	1.43%	13.39%	-	-

## Industry News

### European institutions continue to move into alternative investments

The results from the Prospera Survey on "European Institutions' Alternative Investments" have been released by IPM and AIMA, highlight that interest in alternative investments is still on the rise. The survey found regional variations among institutional investors in alternative strategies, with the largest interest coming from Dutch, UK and Nordic institutions. A total of 151 of Europe's largest institutional investors were interviewed between June and September 2004. The interviewees represented major pension funds, life insurance companies and foundations/trusts in Europe with combined assets of over EUR 1,500 billion.

Key findings include: 40% of institutions invest in hedge funds; institutions that invest in hedge funds have average allocations of 4%; Virtually all hedge fund investments are given to external specialists. This will continue as investors allocate more money to this area; Holland, Switzerland and the Nordic region are the markets with the greatest experience in hiring external specialist managers for alternative investments; Over the coming 2 years, the majority of investor activity in external management is expected to come from Holland and the UK; as for external management selection criteria, a clear investment philosophy and experienced staff are considered most important; institutions that have employed external managers in alternatives are in general pleased with the performance; funds of hedge funds are the most widespread type of hedge fund investment and this trend is likely to continue over the coming 2 years.

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### **Texas Universities add to hedge fund allocations**

The investment management company that oversees US\$12.6 billion in assets belonging to the University of Texas and Texas A&M systems plans to increase its hedge fund investments. According to Cathy Iberg, deputy chief investment officer for the University of Texas Investment Management Co. (UTIMCO), they could boost its hedge fund allocations by as much as US\$300 million in the next six months. In total, UTIMCO has 22% of its endowment assets—or about US\$2.7 billion—allocated to hedge fund strategies.

### **Hedge funds pumped US\$84bn into Japanese markets since December 2003**

A new report compiled by Daiwa Securities said hedge fund investors pumped US\$84 billion into the Japanese markets since the end of 2003 to June 2004. This rise represents an increase of 17% according to the data from Daiwa Securities America Inc. The new assets according to the report are largely of stocks and bonds as well as other derivatives. The survey was compiled from a total database of 5600 hedge funds from all over the world.

### **Deutsche Manager favours commodities for return, hedge funds to cut risk**

Deutsche Bank's Frankfurt-headquartered global private wealth management group is advocating increased allocation to commodities and hedge funds for 2005 and beyond, but the group is assigning different roles to these two alternative asset classes in investor portfolios.

As for hedge funds, which Deutsche Bank wealth management offers in the form of funds of funds, they regards them as risk reducers. The volatility of hedge fund portfolios equalled that of bonds, except in the late 1990's and early 2000's, according to internal research at Deutsche Bank. They expect modest returns on a diversified hedge fund portfolio over the next three to five years—4% to 7% annually.

### **Dorset County Pension Fund names new hedge fund manager**

Dorset County Pension Fund has appointed London and New York-based fund of hedge funds manager International Asset Management (IAM) to manage a diversified portfolio of hedge funds. The move is the latest of three fund of hedge fund mandates announced since the pension fund's asset liability structure was reviewed last year. A couple of months ago they already appointed Pioneer and Gottex to manage part of their allocation to absolute return strategies.

## **Advisor/People News**

### **Singapore lifts suspension of CSA Funds**

In a step back toward normality for a hard-hit fund group and its investors, the central bank of Singapore has lifted its suspension of recognition from the CSA Absolute Return Fund (Dublin) Ltd. and from the CSA Absolute Return Plus Fund, funds that had been suspended since June.

The funds were formally associated with Charles Schmitt, who incorporated CSA Management Ltd., an investment manager, in the British Virgin Islands and Charles Schmitt & Associates Ltd., an investment adviser, in Hong Kong.

### **Plus Fund's CEO resigns**

After helping to grow the funds of funds and hedge fund index firm, PlusFunds, into a US\$3 billion manager, Gabriel Bousbib, the company's chief executive, will resign.

Bousbib, who is 40, has no immediate plans. He will stay on with the company until the end of February. PlusFunds plans to announce his replacement soon. The company, Bousbib says, helped move the hedge fund industry toward the mainstream by introducing greater transparency through its hedge fund index platforms.

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## Product News

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### **Wharton Asset Management launches first fund of hedge funds**

Wharton Asset Management has launched the pH7 Fund Limited, a new fund of hedge funds. The fund will draw off the firm's experience in credit and fixed income. The portfolio will be allocated to approximately 20 managers employing relative value, fixed-income and arbitrage strategies.

The fund will have an annual performance target of 10% to 12% and will be positioned for 5% volatility and low market and style correlation. The fund takes its name from numerical value for neutral on chemistry's acid-base pH scale.

Minimum investment in the Bermuda-based, Dublin-listed fund is US\$1 million. The initial seeding was US\$10 million. The fund's management fee is 1% of net asset value with a performance fee of 10% of net new profits above one-month LIBOR. Redemptions may be made monthly with 45 days' notice.

### **Investcorp launches fund of hedge funds for Middle East**

The new Leveraged Diversified Strategy Fund met client demand in Bahrain, Kuwait, Saudi Arabia and United Arab Emirates for equity-like return with low risk.

Investcorp based its Leveraged DSF fund on its flagship fund of hedge funds, Diversified Strategy Fund. The existing fund-of-funds produced a 7.7% annualized return since its 1996 inception and Investcorp targeted a 16% annualized return for the leveraged fund because its leveraged strategy will increase the risk and return profile. Leveraged DSF will use 40 underlying managers and is the eighth fund-of-funds for the \$3.2 billion Investcorp hedge fund program.

### **Deutsche Bank launches fund of hedge funds**

German bank Deutsche Bank has launched a fund of hedge funds for the first time in months following approval by the German financial services authority on November 26.

Deutsche Bank launched the DB Platinum II MF Hedge No. 1 via Luxembourg. The fund will be managed by German fund company Feri Trust and will be marketed by Merck Finck, the German private bank. Feri invests in individual hedge funds, which are provided by the London branch of Deutsche Bank. Feri says that so far it has collected 18 million euros in the fund of funds.

### **Oria launches Asia product**

Hong Kong-based Oria Capital launched an Asian fund of funds on December 1. The US\$4 million multi strategy fund consists of some 14 hedge funds covering eight strategies, including credit, convertible, volatility and distressed arbitrage, multi strategy, equity long/short and equity value. Fees are 1.5/10 and minimum investment is US\$100,000.

All the underlying managers are located in Asia. Oria, which has US\$116 million under management, was founded in August 2004 to take control of funds previously managed by Charles Schmitt and Associates. CSA was suspended earlier in the year owing to allegations of fraud.

### **Bush campaign adviser to launch fund of hedge funds**

Kelly Gasink, who served as a campaign adviser for President George W. Bush, has co-founded a multi-strategy fund of hedge funds slated for launch on Feb. 1.

The Reservoir Fund emerged via partnership with ECN Direct Trading. The electronic trading platform has 400 hedge fund clients from which the fund will pick for its 20 underlying managers.

Reservoir Fund has a 1% management fee and a 10% performance fee along with a US\$200,000 minimum investment. The expected annualized return of the fund would range from 9% to 17%. The fund will launch with an approximate US\$4.5 million in equity. Gasink, who with her husband John Gasink, will act as co-principal for the fund, served as economic policy adviser for President Bush on his 2004 campaign for reelection.

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## Academic/Research

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### **Hedge Fund Indices from an Academic Perspective: Reconciling Investability and Representativity** **Martellini, Vaissie, Goltz**

Following a growing concern among investors about the quality of hedge fund index return data, and given the lack of capacity and transparency specific to that industry, this paper questions from an academic perspective whether it is feasible or not to design hedge fund benchmarks satisfying all defining properties for a good index. In particular, in an attempt to test whether achieving investability necessarily comes at the cost of representativity, as sometimes claimed by hedge fund index providers, we borrow from the asset pricing literature the concept of factor replicating portfolios and apply it to the benchmarking of hedge fund style returns.

Our results suggest that it is actually possible to construct representative indices based on a limited number of funds, except perhaps in the case of Equity Market Neutral strategies, provided that i) these funds are suitably selected and ii) an optimal portfolio is designed with the objective of replicating the common trend in hedge fund returns for a given strategy. A wide range of tests are performed that show that high correlation of the factor replicating portfolios with the common factor of returns for each strategy is remarkably robustness with respect to modifying the number of funds in the replicating portfolio, choosing less correlated funds, changing the frequency of rebalancing, using a static selection of funds or imposing constraints on weights.

### **Fees on Fees in Funds of Funds**

**Brown, Goetzmann, Liang**

Funds of funds are an increasing popular avenue for hedge fund investment. Despite the increasing interest in hedge funds as an alternative asset class, the high degree of fund specific risk and the lack of transparency may give fiduciaries pause. In addition, many of the most attractive hedge funds are closed to new investment. Funds of funds resolve these issues by providing investors with diversification across manager styles and professional oversight of fund operations that can provide the necessary degree of due diligence. In addition, many such funds hold shares in hedge funds otherwise closed to new investment allowing smaller investors access to the most sought-after managers. However, the diversification, oversight and access comes at the cost of a multiplication of the fees paid by the investor. One would expect that the information advantage of funds of funds would more than compensate investors for these fees. Unfortunately, individual hedge funds dominate fund of funds on an after-fee return to Sharpe ratio basis. In this paper we argue that the disappointing after-fee performance of some fund of funds might be explained by the nature of this fee argument, and that fund of funds providers may actually benefit from considering other possible fee arrangements. These alternative arrangements will improve reported performance and may make funds of funds more attractive to a growing institutional clientele.

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