

Performance Update

Fund of Hedge Funds Indices	Jan	Dec	YTD	2005	2004	2003
EDHEC Fund of Funds Index	2.86%	1.88%	2.86%	6.48%	7.07%	11.46%
HFRI FoHF Composite Index	2.89%	1.98%	2.89%	7.52%	6.86%	11.61%
CISDM Fund of Funds Index	-	1.67%	-	6.47%	7.12%	10.23%
InvestHedge Composite	-	1.76%	-	7.07%	6.15%	9.34%
Altvest Sub-Index: Fund of Funds	2.78%	1.94%	2.78%	7.68%	7.39%	11.12%
EurekaHedge Fund of Funds Index	2.79%	2.03%	2.79%	7.75%	7.76%	11.49%
Barclay/Global HedgeSource FoF Index	2.87%	1.97%	2.87%	6.85%	6.65%	10.44%
Average FoHF Indices	2.84%	1.89%	2.84%	7.12%	7.00%	10.81%

Investable Hedge Funds Indices	Jan	Dec	YTD	2005	2004	2003
CSFB/Tremont Investable HF Index	1.85%	0.58%	1.85%	3.61%	5.31%	11.04%
MSCI Hedge Fund Invest Index	2.19%	0.99%	2.19%	4.68%	3.10%	14.70%
S&P Hedge Fund Index	2.01%	0.26%	2.01%	2.28%	3.88%	11.10%
HFRX Global Hedge Fund Index	2.45%	1.48%	2.45%	2.72%	2.69%	13.39%
FTSE Hedge Index	2.12%	1.23%	2.12%	2.60%	3.12%	12.36%
Average Investable HF Indices	2.12%	0.91%	2.12%	3.18%	3.62%	12.52%

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	Jan	Dec	YTD	2005	2004	2003
PrimFund Diversified (net of fees)	2.32%	1.68%	2.32%	7.78%	8.39%	13.68%
PrimFund Growth (net of fees)	3.30%	2.01%	3.30%	9.34%	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.

Industry News

Asset in funds of hedge funds continue to grow

Assets continued to flow into the largest fund of hedge funds groups at a rate of 12% for 2005, despite widespread pessimism that asset flow trends were likely to reverse. In fact, despite returns averaging just over 7% for the year, the global fund of funds industry still grew by more than USD 72bn. In 2004, it had grown by about USD 166bn. The largest funds of funds – those with over USD 1bn under management - now control a combined amount of more than USD 631bn in assets under management.

Investhedge

Hedge Fund inflows slow down in 2005

Hedge fund investors may not be rushing for the exits, but they don't appear to be lining up around the block to get in anymore, either. According to figures from the Hennessee Group LLC, hedge funds saw USD 40bn in new assets in 2005, compared with USD 75bn in 2004. Overall, including positive performance, assets in hedge funds grew by USD 121bn in 2005 to USD 1.12 trillion. That's an overall growth rate of 12%, compared with 17% in 2004. With respect to net inflows, or new assets, the growth rate in 2005 was just 4%, compared with 19% in 2004.

Hennessee

Fund of hedge funds lose assets for the second consecutive quarter

Hedge funds experienced the first quarterly decline in new asset flows in more than 10 years, with outflow of USD 824mn in fourth quarter 2005, according to Hedge Fund Research (HFR). For the year, hedge funds brought in just under USD 47bn in net new assets, bringing the industry total to USD 1.105 trillion. This compared to nearly USD 73.6bn in net new flows and USD 972.6bn in total assets in 2004, and USD 70.6bn in new money and USD 820bn in total assets in 2003. Funds of funds saw net outflows of USD 2.1bn, the second consecutive quarter of outflows for the category. For the year, funds of funds brought in USD 5bn in net new assets compared to USD 33bn in 2004 and USD 59.4bn in 2003. There is USD 395bn invested in funds of funds globally.

HFR

Partners Group prepares IPO

Swiss alternatives manager Partners group wants to list 30% of its shares on the Swiss stock exchange SWX. The firm has 140 employees and offices in Zug, New York, London, Singapore and Guernsey. End of 2005 had CHF 11bn assets under management and a profit of CHF 78mn.

Philadelphia Employees add funds of hedge funds

Continuing a program of hedge fund allocations that began about six months ago, the USD 4.3bn City of Philadelphia Public Employees' Retirement System added three emerging fund of funds managers to the mix, bringing its total hedge fund allocation to USD 181mn.

The pension fund hired Rock Creek Group, Attalus Capital and NewMarket Capital Partners. Last year Philadelphia Employees had given USD 50mn to Mesirov Advanced Strategies; USD 50mn to Arden Asset Management; and USD 30mn to Allianz Hedge Fund Partners. Subsequent to those fundings, the pension fund made another USD 20mn allocation to Mesirov and a USD 20mn to Goldman Sachs & Co. as part of a directional fund of funds allocation.

New Jersey pumps 500mn USD into funds of hedge funds

New Jersey Division of Investment, Trenton, committed another USD 800mn to alternative investments, with USD 500mn earmarked to hedge funds, USD 200mn to real estate and USD 100mn to private equity. USD 250mn is going to Goldman Sachs Hedge Fund Strategies; USD 150mn to a fund of funds run by Rock Creek Group; and USD 100mn to Arden Alternative Advisers.

Advisor/People News

BlackRock and Merrill Lynch combine investment management business

BlackRock and Merrill Lynch announced that they have reached an agreement to merge Merrill Lynch's investment management business, Merrill Lynch Investment Managers, and BlackRock to create a new independent company that will be one of the largest asset management firms with nearly USD 1 trillion in assets under management. Merrill Lynch's stake will go to 49.8 percent, and it will have a 45 percent voting interest in the combined company. The new company will operate under the BlackRock name. The combined company will offer a full range of equity, fixed income, cash management and alternative investment products with strong representation in both retail and institutional channels.

Schroders buys NewFinance Capital

Schroders pushed on with its expansion into the hedge fund market, snapping up the London-based NewFinance Capital for USD 101mn, bringing another USD 2.5bn of assets on to its books.

The deal will see NewFinance's founders, Mark Hotimsky and Georges Saier, cash in more than GBP 20mn from the sale, less than four years after founding the fund of hedge funds boutique. Mr Hotimsky is a former managing director of Credit Suisse First Boston, while Mr Saier was a senior director at JP Morgan. A third partner, Thorikild Juncker, will make about GBP 5.8mn from the sale. Schroders agreed to pay a further USD 41mn, if certain targets are met over the next four years.

Swiss private bank EFG buys CMA

EFG International said that it agreed to buy fund of hedge funds firm Capital Management Advisors as the Swiss private bank responds to increased client demand for alternative investments. The price of the deal wasn't disclosed, but EFG said that the acquisition values Bermuda-based CMA at less than 10 times 2005 estimated net income. EFG hopes the firm will contribute CHF 20mn in profit during 2006.

Paamco strengthens London office

Pacific Alternative Asset Management Company announced the appointment of Erik Bernhardt as an Associate Director in its London office. Erik will assume responsibility for the evaluation of European long/short credit managers as well as those focused on emerging markets. Erik transfers to London from PAAMCO's head office in Irvine, California where he spent almost three years.

PwC manager joins Corbin Capital Partners

Corbin Capital Partners, a fund of hedge funds firm founded by Glenn Dubin and Henry Swieca, has hired Terence Brady as controller and director of operational due diligence. Previously Mr. Brady was at PricewaterhouseCoopers LLP, where he specialized in audits for hedge funds, venture capital and private equity limited partnerships and collateralized debt obligations.

Arden hit with executives exodus

New York fund of funds behemoth Arden Asset Management is being hit with a number of resignations from high-ranking executive staff, with COO Alexander Mucelli and chief technology officer Bill McCrea the latest to head for the door.

Richcourt hires director of manager research

The Richcourt Group announced that it has hired Dean M. Rubino, formerly managing director and portfolio manager at The Taylor Companies, as managing director and director of manager research. The Richcourt Group is majority-owned by Hamilton Lane, an independent private equity asset management firm.

Alexandre Rampa joins 3A's research and investment team

Rampa's appointment follows the arrival in 2005 of José Galeano (Portfolio Manager and Senior Analyst) and Michaël Malquarti (Quantitative Analyst and Risk Management Associate) and brings the total 3A team to 32 people, up from 26 at the end 2004.

Prior to joining 3A in January 2006, Rampa spent five years as a Senior Analyst and Portfolio Manager at Banque Privée Edmond de Rothschild SS in Geneva, where he was responsible for Arbitrage and Event-Driven strategies.

Product News

Buyout maverick to open fund of hedge funds

Thomas H Lee unveiled plans to formally launch an offshore tranche of Blue Star I LLC, a leveraged, diversified fund of funds under his purview that has been managed by James Burritt.

Permal launches India fund of hedge funds

Permal Group has launched a fund of hedge funds tapping strong economic growth in India. Permal India Holdings will invest in 20 hedge funds adopting a range of strategies. These will include long-short funds, long-biased, special situations and macro trading funds.

Academic/Research

Superstars or average Joes?

Kat, Palaro

In this paper we use the hedge fund return replication technique recently introduced by Kat and Palaro (2005) to evaluate the net-of-fee performance of 1917 individual hedge funds. Comparing fund returns with the returns on dynamic futures trading strategies with the same risk and dependence characteristics, we find that no more than 17.7% of the hedge funds in our sample beat the benchmark. In other words, the majority of hedge funds have not provided their investors with returns, which they could not have generated themselves by mechanically trading S&P 500, T-bond and Eurodollar futures. Over time, we observe a substantial deterioration in overall hedge fund performance. In addition, we find a tendency for the performance of successful funds to deteriorate over time. This supports the hypothesis that increased assets under management endanger future performance.

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