PRIMNEWS
Fund of Hedge Funds Review

22nd March 2007

Performance Update

Fund of Hedge Funds Indices	Feb	Jan	YTD	2006	2005	2004	2003
EDHEC Fund of Funds Index	0.82%	1.21%	2.04%	11.25%	6.80%	7.07%	11.46%
HFRI FoHF Composite Index	0.80%	1.27%	2.08%	10.43%	7.49%	6.86%	11.61%
CISDM Fund of Funds Index	-	1.17%	1.17%	9.11%	6.47%	7.12%	10.23%
InvestHedge Composite	-	1.17%	1.17%	8.67%	7.07%	6.15%	9.34%
Altvest Sub-Index: Fund of Funds	0.67%	1.22%	2.01%	10.24%	7.68%	7.39%	11.12%
Eurekahedge Fund of Funds Index	0.75%	1.21%	1.97%	9.97%	7.74%	6.90%	11.64%
Barclay/Global HedgeSource FoF Index	0.79%	1.23%	2.03%	9.38%	6.91%	6.65%	10.44%
Average FoHF Indices	0.77%	1.21%	1.78%	9.86%	7.17%	6.88%	10.83%

Investable Hedge Funds Indices	Feb	Jan	YTD	2006	2005	2004	2003
CS/Tremont Investable HF Index	0.05%	1.23%	1.28%	9.65%	3.61%	5.31%	11.04%
MSCI Hedge Fund Invest Index	0.23%	1.16%	1.39%	7.63%	4.68%	3.10%	14.70%
HFRX Global Hedge Fund Index	-0.21%	1.50%	1.29%	9.26%	2.72%	2.69%	13.39%
FTSE Hedge Index	-0.40%	0.90%	0.50%	6.20%	2.60%	3.12%	12.36%
Average Investable HF Indices	-0.08%	1.20%	1.12%	8.19%	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	Feb	Jan	YTD	2006	2005	2004	2003
PrimFund Diversified (net of fees)	0.72%	0.81%	1.54%	9.54%	7.78%	8.39%	13.68%
PrimFund Growth (net of fees)	1.85%	1.01%	2.88%	13.85%	9.38%	15.69%	20.75%
PrimFund Opportunity (net of fees)	1.15%	1.71%	2.88%	22.12%	17.02%	17.13%	25.09%

Inception of PrimFund Diversified was July 2004, of PrimFund Growth April 2005, of PrimFund Opportunity September 2006. 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

Hennessee estimates hedge fund industry assets increased $215bln in 2006 to $1.442 trillion

Hennessee Group LLC, an adviser to hedge fund investors, estimates that hedge fund industry assets increased by $215 billion in 2006 to $1.442 trillion. The increase in assets represents +17.5% growth over industry assets since the beginning of 2006. Preliminary results indicate that the hedge fund industry experienced net inflows of $75 billion (+6.1%) in 2006. The remaining $140 billion (+11.4%) was the result of positive performance, as evidenced by the Hennessee Hedge Fund Index, which advanced +11.4% in 2006.

The hedge fund industry continues to grow as investors diversify their portfolios. The growth rate of net inflows at +6% is a modest increase from +4% in 2005, but is still significantly less than the +19% increase in 2004 and its peak of +34% in 2001.

Institutions hire more direct hedge fund managers — State Street

State Street Corporation released its third institutional investor hedge fund study. Asset owners participating in the study included representatives from global corporate pensions, public and government pensions, and endowments and foundations, with investable assets totaling more than $1 trillion. The study shows that the number of funds of hedge funds used by institutions appears to have declined. In the 2007 study, nearly a third of institutions indicated they used no fund of funds managers, as compared with just over a quarter of institutions in the 2006 study. Nearly two-thirds (60 percent) said they employ the services of between one and three fund of funds managers and only 8 percent used four or more. This represents a shift from the 2006 study, in which 43 percent of institutions said they used between one and three fund of funds managers and 29 percent used four or more. Evidence suggests that reduced use of fund of funds is likely due to two factors: growing sophistication and familiarity with hedge fund investing, and a cost-benefit analysis in favor of a "do-it-yourself" approach.

Hedge fund assets reach $1.89 trillion

Total hedge fund asset levels increased by almost 6% to $1.89 trillion in the last quarter of 2006 from $1.79 trillion in the third quarter. The bump is the second largest quarterly increase since the first quarter of 2005. For the entire year 2006, total hedge fund assets jumped to $1.89 trillion from $1.53 trillion in 2005, according to a report released by Institutional Investor News and HedgeFund.net entitled "Hedge Fund Asset Flows & Trends Report 2006 – 2007." The report also showed that funds of funds assets rose 22% in 2006, or $174 billion, to $953 billion.

New allocations increased an estimated $125.7 billion, while performance increased total assets an additional $48 billion. Europe is the fastest growing major investment region for most hedge funds, the survey found. Assets invested there increased at a rate of 46% in 2006 to $276.5 billion. However, emerging market equity focused fund assets increased 58% in 2006 and emerging market debt focused fund assets increased 23.3%.

CalPERS picks 3 fund of funds to create $350m absolute-return funds

CalPERS picked Pacific Alternative Asset Management, 47°N Capital Management and Rock Creek Group to help the $236.6 billion system create three customized funds of funds comprising emerging absolute-return managers. A total of $350 million initially will be allocated to the new funds of funds. Mosaic Investment Advisors, CalPERS' diversity consultant, will work with each firm. PAAMCO already is a strategic adviser to California Public Employees' Retirement System's $4.3 billion absolute-return program. Funding is expected to come from CalPERS' passive global equities program.

Advisor/People News

Man Group appoints new CFO

Man Group has appointed Kevin Hayes as its chief financial officer, effective from the end of March. Hayes joins Man Group from Lehman Brothers, where he has served in a variety of senior finance and strategy positions.

Vision and Penjing settle battle

Penjing Asset Management, a Hong Kong-based hedge fund group owned in part by Citigroup and Germany's billionaire Quandt family, has ended a bruising legal battle with a larger rival that claimed former staff improperly helped jump-start Penjing. Vision Investment Management, a $1.5bn hedge fund specialist that counts Calpers, the US pension fund giant, among its clients, confirmed that it had "discontinued" its two-year legal battle against two former employees over a loss of clients and income. The two companies refused to say whether the out-of-court settlement involved compensation payments.

Product News

HSBC launches activist fund of hedge funds

HSBC Management Guernsey has launched the HSBC Special Opportunities Fund, a fund of funds, with US$299 million in assets. The fund, designed for investors with a long-term investment horizon, focuses on activist and turnaround specialists, as well as event-driven, merger arbitrage, distressed and equity long/short shops. Its portfolio is relatively concentrated, with some 20 managers at launch.

BlueStar rolls out new fund

Healthcare-dedicated BlueStar has rolled out a new fund-of-funds. Its BlueStar CM Life Science Focus Fund, the second offering from the company, is a concentrated version of its inaugural fund of hedge funds, launched in 2005.

Academic/Research

How Smart are the Smart Guys? A Unique View from Hedge Fund Stock Holdings
Griffin and Xu provide the first comprehensive examination of hedge funds' long-equity positions and the performance of these stock holdings. Compared to mutual funds, hedge funds have higher turnover, weights further away from the market portfolio, prefer smaller securities, and their trading moves slightly in front of mutual funds. However, despite their active trading nature, aggregate hedge fund trading and holdings are not beneficial in predicting the cross-section of future stock returns, indicating that on average hedge fund long-equity positions are not informed. Decomposing returns into three components, they find some weak statistical evidence on a value-weighted basis that hedge funds are better at stock picking than mutual funds, but this result is driven by tech stock holdings in 1999 and 2000 and becomes statistically insignificant if looking at equal-weighted performance or with price-to-sales benchmarks. The sector timing ability and average style choices of hedge funds are no better than that of mutual funds. Additionally, they fail to find differential ability between hedge funds. Overall, this study raises serious questions about the proficiency of hedge fund managers.

Risk Management for Hedge Funds With Position Information **Jorion**
Risk management is a challenge for hedge funds because traditional risk measurement methods based on return data are unreliable with dynamic trading strategies. This paper illustrates how Value at Risk (VAR) methods can be used to measure and control the market risk of hedge funds. VAR methods have two key features: (1) they are based on current position information, and (2) they focus on a lower quantile of the distribution of losses or some other risk metric. For rapidly changing positions, VAR should be measured at frequent interval, as is done for banks' proprietary trading portfolios. This paper demonstrates the usefulness of dynamic risk measures for a hypothetical hedge fund with short option positions, which are equivalent to dynamic trading. Imposing daily ex ante VAR limits using position information can be very successful at controlling realized risk.

Capacity Constraints and Hedge Fund Strategy Returns **Naik, Stromqvist**
Hedge funds have generated significant absolute returns (alpha) in the decade between 1995 and 2004. However, the level of alpha has declined substantially over this period. They investigate whether capacity constraints at the level of hedge fund strategies have been responsible for this decline. For four out of eight hedge fund strategies, capital inflows have statistically preceded negative movements in alpha, consistent with this hypothesis. They also find evidence that hedge fund fees have increased over the same period.

Hedge Fund Indices: Reconciling Investability and Representativity **Goltz**
Following a growing concern among investors about the quality of hedge fund index return data, this paper addresses the question of whether designing hedge fund indices that fulfil the usual requirements (in particular representative and investable) is or not a feasible task, given a variety of features that are specific to that industry. To test whether or not investability should necessarily come at the cost of representativity, they use a well-known methodology in the asset pricing literature based on the concept of factor replicating portfolios. Their results suggest that it is possible to construct representative indices based on a limited number of funds that are open to new investments, except perhaps in the case of equity market neutral strategies, provided that: i) these funds are suitably selected and ii) a portfolio is constructed with the objective of replicating the common trend in hedge fund returns for a given strategy. A range of robustness tests are performed that show that high correlation of the factor replicating portfolios with the common factor of returns for each strategy is remarkably stable with respect to modifying the number of funds in the replicating portfolio or changing the frequency of rebalancing.