

Performance Update

Fund of Hedge Funds Indices	Oct	Sep	YTD	2006	2005	2004	2003
EDHEC Fund of Funds Index	2.90%	2.00%	11.15%	11.25%	6.80%	7.07%	11.46%
HFRI FoHF Composite Index	2.88%	2.12%	11.23%	10.39%	7.49%	6.86%	11.61%
CISDM Fund of Funds Index	2.76%	1.66%	9.60%	9.11%	6.47%	7.12%	10.23%
InvestHedge Composite	-	1.86%	6.78%	8.67%	7.07%	6.15%	9.34%
Altvest Sub-Index: Fund of Funds	2.73%	1.92%	9.99%	10.24%	7.68%	7.39%	11.12%
Eurekahedge Fund of Funds Index	3.05%	2.13%	11.30%	10.22%	7.87%	7.06%	11.80%
HFN Fund of Funds Aggregate Average	2.89%	1.96%	10.28%	9.60%	6.81%	6.89%	11.74%
Barclay/Global HedgeSource FoF Index	3.05%	1.96%	10.40%	9.38%	6.91%	6.65%	10.44%
Average FoHF Indices	2.89%	1.95%	10.09%	9.86%	7.14%	6.90%	10.97%

Investable Hedge Funds Indices	Oct	Sep	YTD	2006	2005	2004	2003
CS/Tremont Investable HF Index	2.51%	1.92%	8.24%	9.65%	3.61%	5.31%	11.04%
MSCI Hedge Fund Invest Index	1.80%	1.69%	5.52%	7.63%	4.68%	3.10%	14.70%
HFRX Global Hedge Fund Index	2.82%	1.28%	6.95%	9.26%	2.72%	2.69%	13.39%
FTSE Hedge Index	0.98%	1.43%	3.20%	6.27%	2.60%	3.12%	12.36%
Average Investable HF Indices	2.03%	1.58%	5.98%	8.20%	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.

Portfolios of Funds of Hedge Funds	Oct	Sep	YTD	2006	2005	2004	2003
PrimFund Diversified (net of fees)	1.86%	1.07%	9.37%	9.54%	7.78%	8.39%	13.68%
PrimFund Growth (net of fees)	3.57%	2.39%	15.30%	13.85%	9.38%	15.69%	20.75%
PrimFund Opportunity (net of fees)	3.26%	2.07%	12.81%	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

Top 50 fund of hedge funds

Alpha Magazine

UBS rises one position to the top spot in the 2007 top 50 fund of funds ranking, Alpha's sixth annual ranking of the world's biggest multimanager hedge fund firms. The climb is no small feat on a list of firms whose collective assets grew to USD 742bn as of June 30, 2007, up 34.8% from the USD 550bn the top 50 controlled in 2006. Second-ranked Man Investments of London falls out of the No. 1 position it held last year despite asset growth of more than USD 10bn — that was no match for the USD 17bn gain posted by Zurich-based UBS over the same period. Other big gainers include Blackstone Alternative Asset Management, the New York fund of hedge funds arm of private equity giant Blackstone Group, which has seen its assets increase nearly USD 10bn since last year's ranking.

Investors allocate over USD 45bn to hedge funds in Q3 despite volatility

HFR

Investors continued to allocate capital to hedge funds in the third quarter of 2007, with total industry assets increasing USD 45.2bn during the period. This brings the year-to-date industry inflow total to a record USD 164bn, surpassing the previous high of USD 126bn, set just last year. As of the end of Q3, total industry assets now stand at USD 1.81tn. Investors poured new capital into the largest hedge fund strategies, with Event-Driven receiving USD 9.8bn in new assets, Relative Value Arbitrage receiving USD 9.2bn, and Equity Hedge receiving USD 8.5bn. Despite intra-quarter volatility, funds focused in Emerging Markets again outperformed all other major strategies for the fourth consecutive quarter, while bringing in USD 2.7bn for Q3. Half of the industry's new capital came by way of investments through funds of hedge funds (USD 22.5bn). Year-to-date, fund of funds have attracted USD 48bn in asset inflows, helping to increase total assets within these investment vehicles to a record USD 773bn.

Smallest hedge funds perform best

Small hedge funds have outperformed their bigger brothers by 29% since January 2000, according to TrimTabs Investment Research. In its latest report on the hedge fund industry, it found that HFs with less than USD 100mn in assets under management returned an average 8.6% annually, compared with 6.3% for HFs with more than USD 2bn AUM, concluding, the smaller they are the better they do. The study notes that the best performers –the small HFs -- also had the highest correlation to the S&P500 (67.3%), but that those with the least correlation – 29.9% for HFs determined to be large (between USD 1bn and USD 2bn AuM) – still produced happier returns – 7.7%-- than the mega funds did. Oddly enough, one cannot conclude that higher S&P correlation is the key to success, as mega funds had a 50.3% correlation and were still the worst performers. TrimTabs, acknowledging that its returns “almost certainly overstate” the industry performance because liquidated funds don’t report assets, also discovered that investors tend to favor small firms when allocating fresh cash. The survey stated that there is “an almost linear relationship” between risk-adjusted returns and flows as a percentage of assets, with new flows into mega funds accounting for 33.6% of total assets, compared with small funds, with the second-highest risk-adjusted returns, attracting 71.4% of their assets. TrimTabs speculates that funds of hedge funds may have something to do with it. Fund of hedge funds managers, says TrimTabs, “understand the risks and rewards of their portfolios and allocate fresh cash to smaller and better-performing hedge funds.”

Trim Tabs

Advisor/People News

Alternatives firm gets private equity investment

Grosvenor Capital Management, the funds of hedge funds asset management firm has a new minority stakeholder in private equity firm Hellman & Friedman (H&F). H&F is taking over the stake that was owned by Value Asset Management, which is liquidating its holdings. Grosvenor will increase its ownership by a modest amount after this transaction. Grosvenor manages about USD 24bn in assets for primarily institutional clients. H&F has a long history of taking minority investments in asset management firms. Terms of the deal were not announced. Investment banks Colchester Partners and Goldman Sachs were advisors to Grosvenor.

Australian fund manager HFA to finally buy Lighthouse Partners

HFA Holdings has signed a purchase agreement with Lighthouse Partners under which it will acquire all the issued interests in Lighthouse for consideration of USD 348.5mn in cash and 134.67mn HFA shares. Further, HFA announces a fully underwritten equity raising, to be completed via a 15% placement followed by a 2-for-5 renounceable rights issue to fund part of the cash consideration for the acquisition. The balance of the cash consideration (and transaction costs) will be funded by a loan facility for up to USD 130mn. Under the terms of the PA, Lighthouse management have committed to reinvest 50% of the after tax cash proceeds received in relation to the merger into Lighthouse products for a period of at least two years (subject to early termination in certain circumstances).

Octane Holding Ltd. shuffles management positions

The Swiss-based independent fund of hedge funds solution provider Octane Holding Ltd. strengthens its management structure and further expands its investment and risk management team. Octane Holding Ltd., the fund of hedge funds solution provider further strengthens its management structure. Robbie Alexander, until now CEO of Octane, will become the company's new Executive Vice Chairman. In exchange, Dr. Gerald Gonzenbach who previously held the Executive Vice Chairman position at Octane has been appointed new CEO. In addition, Duncan Theron, former Managing Director Pan-Africa, will join the Executive team as new Managing Director.

Product News

Wamberg clears way for banks to invest cash into alternatives

Wamberg Asset Management, a new Chicago-based firm founded by Tom Wamberg, is preparing to launch the BAR Fund, what it believes is the first fund of hedge funds that invests in bank-eligible securities, clearing the way for banks to invest cash from their own balance sheets into alternatives.

Permal to exploit modern Silk Road in new fund of hedge funds

Permal Group, the New York-based fund of hedge funds provider, claims to have identified a modern Silk Road spanning North Africa, the Middle East, and Asia. It will launch a fund of hedge funds investing in this geographical area, taking advantage of the rapidly growing and under-invested economies in the region that are benefiting from rapid globalization.

Sirius to launch USD 300mn mining fund of hedge funds

Hedge fund Sirius Investment Management launched its second natural resources product of 2007. The Sirius Investment Fund II is focused on early-stage mining investments. And will also invest in other natural resources plays.

Dutch fund of hedge funds shop launched multi-strategy vehicle

Finles Capital Management has launched its sixth fund of hedge funds with USD 15mn in seed capital. The firm's latest offering, which debuted last month, is a multi-strategy vehicle designed to beat the JPMorgan Government Bond Index. The Finles Alternative Bond Fund began trading with five managers on Oct. 1 and is looking to add two more by Dec. 1.

New York firm launches multi-strategy fund focused on Latin America

New York based Compass Group LLC has is about to launch the Compass Special Investments Fund this month. It is an absolute return fund seeking to achieve high return on capital with monitored volatility through multiple strategies focused in Latin America. According to Compass, the fund "is anchored by established local investment teams which manage local funds with similar strategies and have proven track records." The Fund invests primarily through directional, event-driven and relative value strategies to capitalize on valuation changes of various asset classes due to improving or deteriorating company fundamentals, corporate, political or economic events, and other factors. It invests mainly in Argentina, Brazil, Chile, Colombia, Mexico and Peru.

Pamplona launched a real estate and infrastructure fund of hedge funds

Pamplona Capital Management LLP announced the launch of Pamplona Real Estate and Infrastructure fund of funds Ltd. (Pamplona REIF) on 1 November 2007. Pamplona REIF aims to provide investors with exposure to the major trends developing in both developed and emerging markets in the real estate and infrastructure sectors. The fund will target long term returns of between 15% and 20% with a target annualized volatility of less than 8%. The fund has secured committed investments from institutional investors of USD 30mn.

Harcourt launches the Belair Sustainable Alternatives SRI Fund

Harcourt is launching the Belair Sustainable Alternatives SRI Fund, in association with Swedish insurance group Folksam and Norwegian insurance group Storebrand. The global fund of hedge funds, seeded with USD 200mn (£98mn, €137mn) at launch, is aimed at institutional investors and invests across markets and strategies. All underlying funds will adhere to an SRI framework jointly defined by Folksam and Storebrand.

Academic/Research

Incentives and risk taking in hedge funds

Kouwenberg, Ziembra

We study how incentive fees and manager's own investment in the fund affect the investment strategy of hedge fund managers. We find that loss averse managers increase the risk of the fund's investment strategy with higher incentive fees. However, risk taking is greatly reduced if a substantial amount of the manager's own money (at least 30%) is in the fund. Using the Zurich hedge fund universe, we test the relation between risk taking and incentive fees empirically. Hedge funds with incentive fees have significantly lower mean returns (net of fees), while downside risk is positively related to the incentive fee level. Fund of funds charging large incentive fees achieve relatively high mean returns, but with significantly higher risk as well.

The Amaranth debacle: What really happened

Chincarini

The speculative activities of hedge funds are a hot topic among market agents and authorities. In September 2006, the activities of Amaranth Advisors, a large-sized Connecticut hedge fund sent menacing ripples through the natural gas market. By September 21, 2006, Amaranth had lost roughly USD 4.35bn over a 3-week period or one half of its assets due to its activities in natural gas futures and options in September. Shortly thereafter, Amaranth funds were being liquidated. This paper presents a brief investigation of the possible causes behind this spectacular hedge fund failure and draws lessons by assessing Amaranth's trading activities within a standard risk management framework. Even by very conservative measures, Amaranth was engaging in highly risky trades which (in addition to high levels of market risk) involved significant exposure to liquidity risk - a risk factor that is notoriously difficult to manage.

A new paradigm in quantitative investing

Sogoloff

A few weeks after the unusually large drawdowns attracted everyone's attention to the perils of "quantitative" investing, the popular opinion of what may have happened, has been formed. The answer, apparently, lies in the quantitative space becoming overcrowded, with most models generating similar forecasts and thus similar portfolios. Losses began with the rapid unwind of a large market-neutral equity portfolio and have generated ripples throughout the quant world. Still un-answered is the more fundamental question: why have different quant groups, using supposedly different investment tools, ended up with similar models?

The empirical evidence suggests that the majority of the equity market-neutral models are indeed similar in their approach to forecasting price behavior. In fact, they use one form of statistical analysis or the other (hence the commonly used term, "Statistical Arbitrage"). The first problem with statistical analysis of financial data is that it assumes stable relationships between market factors, which we know not to be the case. The other problem is that everyone is looking at the same data sets (after all, every security generates only one time series of historical returns).

This paper suggests an alternative approach to development of quantitative investment strategies; the one which eschews statistics in favor of more dynamic sciences (e.g. physics), and postulates that the future of quantitative investing lies in continuous scientific innovation and applications of modern scientific principles to capital markets.

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