

Performance Update

Fund of Hedge Funds Indices	Sep	Aug	YTD	2003	2002	2001
EDHEC Fund of Funds Index	1.01%	-0.10%	2.34%	11.46%	1.25%	-
HFR FoHF Composite Index	0.87%	-0.02%	1.89%	11.59%	1.02%	2.80%
CISDM FoHF Diversified Median	0.77%	-0.10%	2.66%	10.04%	0.65%	4.99%
CISDM FoHF Niche Median	0.78%	0.25%	5.56%	10.62%	1.99%	6.75%
InvestHedge Composite ¹⁾	-	0.00%	1.42%	9.28%	1.99%	5.42%
Altvest Sub-Index: Fund of Funds	0.94%	0.00%	2.55%	11.12%	1.23%	2.28%
Eurekahedge Fund of Funds Index	0.70%	-0.07%	1.43%	10.76%	1.76%	4.00%
Barclay/Global HedgeSource FoF Index	0.85%	-0.07%	2.02%	10.36%	1.79%	4.45%

1) Updated by the end of the month.

VAN does not publish its Fund of Funds Index anymore. We replaced it with the Barclay / Global HedgeSource Fund of Funds Index.

Industry News

Fund of hedge funds show accelerated growth

Morgan Stanley

According to Morgan Stanley, fund of hedge funds assets have grown at a compound annual rate of 50% since 2000, with growth accelerating in the first half of 2004 to 65%. The broker estimates that over two-thirds of hedge fund inflows are coming through funds of funds, which have grown from 18% of the industry in 2000 to 40% in the second quarter of 2004.

Dorset allocates 5% of its portfolio to hedge funds

The £900 million County Pension Fund has allocated 5% of its portfolio to hedge funds investments as part of a review of investment strategy.

Investment officer Nick Buckland, said the authority has split its £45 million funds of hedge funds budget, diverted from the UK equities portfolio, into two mandates of the same value. The advisors chosen were Gottex and Pioneer.

Advisor/People News

Treflie Absolute, Aspen Grove to Merge

Treflie Capital Management LLC, a fund of funds with about US\$55 million in assets under management, plans to acquire West Palm Beach based Aspen Grove Capital Management LLC's Aspen Grove Fund LP. In this deal, all Aspen Grove Fund investors will see their assets merged into the Treflie Capital Treflie Absolute LP and Treflie Absolute Ltd. funds.

Cornerstone Joins Forces with Hamersley Partners

Cornerstone Partners LLC, Charlottesville, a fund of funds manager specializing in international markets, has become a client of Boston-based Hamersley Partners LLC, a third-party marketer geared to pension plan sponsors.

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Kenmar acquires funds from Prudential Securities

Kenmar Group of Companies, a Greenwich, Connecticut-based fund of funds firm, purchased futures pools with US\$200 million in assets from Prudential Securities Futures Management Inc., part of Prudential Financial, headquartered in Newark, N.J.

Included in the transaction are 13 managed futures funds, eight U.S. public funds, one U.S. private fund and four funds domiciled in Ireland and listed on the Irish Stock Exchange, according to an announcement. A unit of Kenmar, Preferred Investment Solutions Corp., formerly Kenmar Advisory Corp., is to be the managing owner.

The firm indicated that this acquisition increases its involvement with U.S. broker-dealers, and it plans to add other alternative investment products to further develop this business. Kenmar manages more than US\$1.5 billion in assets. Investment bank Putnam Lovell NBF Securities Inc., New York, was Kenmar's adviser in this transaction.

Rock Creek appointed by Massachusetts State Pension Fund

The \$32 billion Massachusetts State Pension Fund Board has appointed Rock Creek Group as a fund of funds manager that replaces Silver Creek Partners.

Rock Creek will be investing \$300 million for the pension fund. That brings the pension fund's total hedge fund allocation to \$1.6 billion, or around 5% of the pension's total portfolio. During the summer, Silver Creek Partners was dropped from the original five funds of funds chosen to invest on behalf of Massachusetts State Pension Fund. The others that have already invested their mandates are Arden Asset Management, K2 Advisors, Pacific Alternative Asset Management and Ivy Asset Management. New England Pension Consultants in Cambridge has been the consultant on the hedge fund searches.

Key Asset Management hires new CIO

Key Asset Management has hired Chris Jones as its new chief investment officer, replacing Jaakko Karki, who resigned in August after 14 months with the firm.

The move is part of a slew of new hires, all of whom worked at IO Investors. The hires join Key Asset Management, a London-based fund of hedge funds, at a time of great change following the departure of Karki and others who left the firm over the last year-and-a-half.

In the 14 months Karki was CIO of the firm, 13 people left Key because of internal tensions with senior management. Five people left this summer. Three of them, including portfolio manager Larry Jones, were hired by rival Attica LJH Investment Management in London. Karki's departure was the denouement in Key's staff attrition. Several weeks after he left Key, Karki re-joined his colleagues as Attica's CIO.

CMA wins mandate from Macquarie Bank

Capital Management Advisors (CMA) has been selected by Macquarie Bank to manage a EUR 50 million fund of hedge funds. CMA was selected following an extensive due diligence process, focusing on European fund of funds managers.

The new portfolio is diversified across investment strategies, with a balanced exposure to Equity, Relative Value and Event Driven strategies. CMA's Bermuda-based Investment Manager will be managing the new portfolio. The portfolio will also have a small allocation to CTA and Global Macro Funds. Target Volatility is between 2-3% annually, monitored through CMA's proprietary risk management systems.

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Product News

CSFB/Tremont Introduces Investable Sector Indexes

CSFB/Tremont Index LLC launched 10 investable hedge fund indexes corresponding to the strategy components of the benchmark. An investable version of the overall index was started last year. The sector indexes together currently have 114 underlying funds, including the 60 funds that are in the general investable index.

HSBC launches leveraged funds

HSBC has launched two leveraged products linked to the performance of its HSBC GH fund of hedge funds. HSBC Leveraged GH Fund and HSBC Leveraged GH Fund (euro), are now open for investment. The funds aim to give experienced investors, who can tolerate an increased volatility, the opportunity to achieve increased returns ultimately through leveraged investment in HSBC GH Fund.

Fund of hedge funds for Islamic investors

After nearly an 18-month delay, Connecticut based Sharia Funds has opened a fund of hedge funds compliant with Islamic or “sharia” law, to investors.

Meyer Capital, of which Sharia Funds is a subsidiary, will manage the Sharia Equity Opportunity Fund, a long-short fund of hedge funds with 10 underlying managers. The fund will target high-net-worth individuals and institutional investors in the Muslim world, focusing on the Gulf States.

While it is one of the first funds of hedge funds, it is not the first hedge fund based on sharia law, which prohibits investments in certain industries, including pornography and entertainment, commodities such as pork, as well as companies that make profits from interest payments, such as banks and insurance groups.

Academic/Research

Taking a close look at the European fund of hedge funds industry - Comparing and contrasting industry best practices and academic recommendations **EDHEC**

Over the last few years institutional investors’ traditional portfolios have failed to meet their objectives in terms of risk and performance. Investors have thus shown growing interest in new forms of diversification, especially in investment vehicles that offer better protection during extreme market conditions. This has naturally led them to consider hedge funds as part of their investment universe. The massive arrival of institutional investors in an “industry” that up until then had been reserved to some High Net Worth Individuals or Endowments/Foundations resulted in a dramatic capital inflow and entailed a profound diversification of the risk profile of investors.

This change in the alternative investment landscape obviously led to an in-depth contemplation of investment practices. With greater importance accorded to risk management, fund managers are compelled to abide by stricter transparency requirements (e.g., development of managed accounts and enhanced focus on hedge fund reporting) and tighter risk measurement and risk control procedures (e.g., development of in-house or external risk control systems, thorough due diligence, etc.).

How to Price Hedge Funds: From Two- to Four-Moment CAPM **Rinaldo, Favre**

The CAPM model has serious difficulties to explain the past superior performance of most hedge funds. The purpose of this research is to analyze how to price hedge funds. We compare the traditional CAPM based on the Markowitz mean-variance criterion with extensions of the CAPM that account for coskewness and cokurtosis. The key result is that the risk-return characteristics of hedge funds can differ widely. The use of a unique pricing model may be misleading. The beta is an exhaustive risk measure only for some hedge funds. Other hedge funds have significant coskewness and cokurtosis. The lack of consideration of higher moments may lead to an insufficient compensation for the investment risk.

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