

Performance Update

Fund of Hedge Funds Indices	Aug	July	YTD	2003	2002	2001
EDHEC Fund of Funds Index	-0.12%	-0.49%	1.30%	11.46%	1.25%	-
VAN Global Fund of Funds Index	-0.4%	-0.7%	1.2 %	12.00%	1.70%	4.50%
HFR FoHF Composite Index	-0.07%	-0.57%	0.96%	11.59%	1.02%	2.80%
CISDM FoHF Diversified Median	-0.10%	-0.31%	1.71%	10.04%	0.65%	4.99%
CISDM FoHF Niche Median	0.25%	-0.09%	2.40%	10.62%	1.99%	6.75%
InvestHedge Composite ¹⁾	-	-0.40%	1.42%	9.28%	1.99%	5.42%
Altvest Fund of Funds	-0.02%	-0.52%	1.57%	11.12%	1.23%	2.28%
Eurekahedge Fund of Funds	-0.10%	-0.57%	0.91%	10.76%	1.76%	4.00%

1) Updated by the end of the month.

Industry News

BIS observes substantial increase in hedge fund borrowing and leverage

Total non-bank borrowings were up by a record \$403 billion in the first quarter of this year compared with \$546 billion in the whole of 2003 and \$315 billion in the entire 2003 year. The BIS finds that about \$110 billion of the \$403 billion in the first quarter was lent to offshore centres and to non-bank borrowers in the UK with considerable non-bank financial activity. The BIS believes that the majority of these borrowers were hedge funds. This was a substantial increase on levels experienced in 2003 and 2002. Over and above this lending, the BIS has detected an unusual rise in interbank lending, a sizable proportion of which is the result of unquantifiable financing of hedge fund activity. The BIS also comments in a separate section of its latest quarterly report that large speculators, including hedge fund managers, may have contributed to a herd-like behaviour that vaulted oil prices to record highs this year. It commented that hedge funds, investment banks and other traders sharply increased their market bets on oil as stock and bond markets stagnated.

InvestHedge survey: Fund of funds assets surge by 27% in first half

Asset flows into the largest fund of hedge funds groups continued to surge in the first half of the year despite a period of moderate performance, which many people thought would lead to a slowdown. In fact, the industry grew by 27% in the first six months of 2004. The largest fund of funds – those with over \$1 billion under management - now control \$438 billion, according to the six-month asset flow survey carried out by InvestHedge.

Defined benefit plans seeing as fastest growing hedge fund investors

Defined benefit pension schemes are expected to be the fastest growing source of institutional investors into hedge funds, according to a new survey done by Casey, Quirk & Acito and the Bank of New York.

"Institutional investors' appetite for hedge funds will dramatically increase over the next five years, causing a significant shift in the structural and operational underpinnings of the hedge fund industry," they said. The comments accompanied a study entitled 'Institutional Demand for Hedge Funds: New Opportunities and New Standards'. It found that US institutional investors' capital for hedge funds could increase from its current 60 billion dollars to 300 billion dollars by 2008. The study found that institutions would place a greater emphasis on lower volatility and risk as more capital flows into hedge funds.

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London council pension looking for fund of funds

The Local Government Pension Scheme for London's Brent Borough Council will allocate to a fund of hedge funds in January. The scheme, which manages \$600 million, aims to invest 5% - nearly \$30.5 million - in a single fund of funds. They have been advised by "an independent expert," but will make the final manager selection themselves. A favoured strategy and a timeframe for staggering the allocation have yet to be agreed.

Largest German first-pillar scheme eyes hedge funds

Munich-based E30bn Bayerische Versorgungskammer (BVK) is preparing to invest in hedge funds for the first time by the end of March next year.

For now, it plans to allocate up to 2.5% of its assets to alternative assets – investing in hedge funds initially via fund of funds structures. More investments may follow at a later stage.

Advisor/People News

Liberty Ermitage Group names Ian Cadby as CEO

Liberty Ermitage Group announced that Ian Cadby, currently Chief Investment Officer, has been appointed Chief Executive Officer, with effect from September 1st, and is taking over the reins from Ron Mitchell who founded the Group in 1996. Ron Mitchell will remain on the Board, as Vice Chairman, until his official retirement date of March 31st 2005.

Baltimore hires fund of hedge funds firms

The \$1.9 billion Baltimore City Fire & Police Employees' Retirement System hired fund of hedge funds managers Union Bancaire Privee and Cadogan Management to run a combined \$75 million. UBP will run \$50 million; Cadogan \$25 million. Funding will come from the system's large-cap equity portfolio.

FIM hires new COO

FIM Limited continues its expansion through the recent hire of Tom Healy as Chief Operating Officer. Healy is a 15-year veteran of the hedge fund services industry. Until recently, he was President of BISYS Hedge Fund Services, where he was instrumental in growing the business to become the 2nd largest global administrator of hedge funds with assets in excess of \$80 billion under administration and a multi national operation. At FIM, Healy will take overall control of the company's business and operations, and lead the firm's international expansion plans.

Ted Kokas joins McCormack Advisors

McCormack Advisors announced that Ted Kokas has joined the firm's portfolio management team as a senior vice president and senior analyst. His primary responsibilities will include performing manager due diligence and quantitative analysis. Mr. Kokas will be based in Santa Barbara and work closely with Rishi Narang, co-portfolio manager and Tim McCormack, president and chief executive officer.

Product News

Pioneer Alternative Investments launches Momentum AllWeather Strategies II

The Momentum AllWeather Strategies II Master Fund will continue the investment approach of the Momentum AllWeather Fund, which closed to new investors in July with \$2 billion in assets. The new Bermuda-domiciled fund of funds will invest in 20 underlying managers and is targeted to both high net worth individuals and institutional investors. The fund requires a \$25,000 minimum investment and carries a 1.5% management fee and a 10% performance fee.

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Man launches new structured product

Man Investments Ltd. has launched a new capital guaranteed structured product, the Man RMF Multi-Style Series 2 Ltd. The new fund will invest in five hedge fund styles. The fund will target annualized returns of between 13% and 15% with volatility of between 7% and 9% over the medium term. The capital guarantee for the fund will be provided by BNP Paribas SA, Paris, and will provide for the return of at least 100% of investors' initial investment at maturity, slated for July 31, 2017.

Barclays introduces guaranteed product based on FTSE Hedge Index

Woolwich Plan Managers, part of London-headquartered Barclays Group and a provider of structured products in the United Kingdom, launched Woolwich Protected FTSE Hedge Plan, a 100% capital-protected vehicle meant to give retail investors access to hedge funds. For a minimum investment of £3,000, investors get two-thirds of any increase in the FTSE Hedge Index over five years.

Pro-Hedge launches fund

Pro-Hedge launched a new hedge fund that will charge no management fees in any quarter with negative returns. Company officials, who hail it as a first for the fund business, are selling the new Pro-Hedge Capital Preservation Fund on its "no-fee guarantee." The fund is a low-risk, multi-strategy, multi-manager fund of funds that consists of eight styles and 25 alternative investment managers.

Dexion plans to launch new London listed fund of hedge funds

Dexion Capital Plc and ABN AMRO are in the initial stages of preparing for the launch of a third London listed fund of hedge funds. The new fund, Dexion Trading Limited, is expected to invest approximately 80% of its assets in directional trading strategies and approximately 20% in relative value strategies. It is proposed that FRM Investment Management Limited act as the Investment Adviser. Dexion Trading's initial investment strategy will aim to be broadly consistent with FRM's Absolute Alpha Opportunistic Fund. Launch is expected to take place in late November.

Academic/Research

Optimal hedge fund allocations: do higher moments matter? Cremers, Kritzman, Page

Hedge funds have return peculiarities not commonly associated with traditional investment vehicles. Specifically, hedge funds seem more inclined to produce return distributions with significantly non-normal skewness and kurtosis.

There is also growing acceptance of the notion that investor preferences are better represented by bilinear utility functions or S-shaped value functions than by neo-classical utility functions such as power utility. Many investors have therefore concluded that mean-variance optimization is not appropriate for forming portfolios that include hedge funds.

They apply both mean-variance optimization and full-scale optimization to form portfolios of hedge funds, given a wide range of assumptions about investor preferences. They find that higher moments of hedge funds do not meaningfully compromise the efficacy of mean-variance optimization if investors have power utility. They also find, however, that mean-variance optimization is not particularly effective for identifying optimal hedge fund allocations if preferences are bilinear or S-shaped. Finally, they show that investors with bilinear utility dislike kurtosis and that, contrary to conventional wisdom, investors with S-shaped preferences are attracted to kurtosis as well as negative skewness. Mean-variance optimization is insensitive to these preferences.

Global Financial Stability Report

IMF

The report focused on several broad and related themes: Counterparty exposure; use of leverage; disclosure and transparency; market discipline; and the impact of hedge funds on smaller and developing markets.

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