

Performance Update

Fund of Hedge Funds Indices	August	July	YTD	2006	2005	2004	2003
EDHEC Fund of Funds Index	-2.07%	0.41%	6.06%	11.25%	6.80%	7.07%	11.46%
HFRI FoHF Composite Index	-2.01%	0.33%	6.02%	10.39%	7.49%	6.86%	11.61%
CISDM Fund of Funds Index	-1.97%	0.10%	4.92%	9.11%	6.47%	7.12%	10.23%
InvestHedge Composite	-	0.15%	7.17%	8.67%	7.07%	6.15%	9.34%
Altvest Sub-Index: Fund of Funds	-2.04%	0.25%	5.40%	10.24%	7.68%	7.39%	11.12%
EurekaHedge Fund of Funds Index	-2.18%	0.50%	5.84%	10.22%	7.87%	7.06%	11.80%
HFN Fund of Funds Aggregate Average	-2.25%	0.27%	5.15%	9.60%	6.81%	6.89%	11.74%
Barclay/Global HedgeSource FoF Index	-2.24%	0.29%	5.23%	9.38%	6.91%	6.65%	10.44%
Average FoHF Indices	-2.11%	0.29%	5.72%	9.86%	7.14%	6.90%	10.97%

Investable Hedge Funds Indices	August	July	YTD	2006	2005	2004	2003
CS/Tremont Investable HF Index	-1.89%	-0.85%	3.51%	9.65%	3.61%	5.31%	11.04%
MSCI Hedge Fund Invest Index	-2.25%	-0.38%	1.93%	7.63%	4.68%	3.10%	14.70%
HFRX Global Hedge Fund Index	-2.55%	-0.93%	2.71%	9.26%	2.72%	2.69%	13.39%
FTSE Hedge Index	-3.56%	0.49%	0.75%	6.27%	2.60%	3.12%	12.36%
Average Investable HF Indices	-2.56%	-0.42%	2.22%	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	August	July	YTD	2006	2005	2004	2003
PrimFund Diversified (net of fees)	-1.24%	0.39%	6.30%	9.54%	7.78%	8.39%	13.68%
PrimFund Growth (net of fees)	-3.52%	1.29%	8.96%	13.85%	9.38%	15.69%	20.75%
PrimFund Opportunity (net of fees)	-3.14%	0.08%	7.47%	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

56% of fund of hedge funds assets come from institutional investors

Institutional investors account for more than half of all money allocated to funds of hedge funds, according to Pensions & Investments. P&I found that of the USD 542bn of assets managed by fund of hedge funds managers as of June 30, USD 306bn, or 56.5%, came from institutional investors with 23% (USD 124bn) from U.S. institutions. Leading with USD 51bn in fund of hedge funds under management for all clients was UBS' alternative and quantitative investment unit in Chicago, followed by London-based Man Investments (USD 47.9bn) and New York-based Permal Group (USD 31bn). Rounding out the top five were GAM with USD 25bn and Credit Suisse at USD 24bn. Focusing solely on managing fund of hedge funds for institutions, Blackstone Alternative Asset Management topped the list with USD 19.5bn, followed by Grosvenor Capital Management with USD 19bn (as of March 31), and Man Investments, (USD 18bn), Bank of New York Mellon (USD 17bn) and UBS (USD 16.5bn). Blackstone also was No. 1 among fund of hedge funds managers of U.S. institutional investors, but in this smaller subset, it was followed by Pacific Alternative Asset Management and Arden Asset Management both with USD 6.8bn, and AIG Investments with USD 5.6bn. According to the survey, despite the fact that institutional investors account for more than half of total fund of hedge funds assets, the firms with the most fund of hedge funds money actually recorded smaller percentages from institutional investors. Only 32% of UBS' fund of hedge funds assets were from Institutional investors, while that percentage stood at 37% for Man, 16% for Permal and 15% for GAM.

Pooled fund of hedge funds post third consecutive quarter of growth

Pooled fund of hedge funds have achieved positive results for the third consecutive quarter, latest statistics from BNY Mellon Asset Servicing reveal. The performance measurement firm found that, during the second quarter of 2007, pooled fund of hedge fund managers achieved a median return of 4.6%, net of fees.

Big hedge funds inflows soar 23% to 1.45tn

Assets of the 246 hedge funds with assets under management of more than USD 1bn rose 23% to USD 1.45tn in the first half of 2007, a rate twice as fast as the previous six months, according to Absolute Return magazine. In its biannual Billion Dollar Club survey, JPMorgan Asset Management, which includes the acquired Highbridge Capital Management, remains on top, with assets skyrocketing 65% to USD 56bn. Assets at Highbridge alone more than doubled with an infusion of USD 20bn, bringing its total to USD 37bn. Holding steady at No. 2 is Goldman Sachs with USD 40bn, representing a 22.9% increase from the previous half-year figure. Taking the show position is D.E. Shaw, with USD 34bn assets under management, which has galloped ahead of now No. 4 Bridgewater Associates (USD 32bn), while Och-Ziff Capital Management jumped from No. 7 to No. 5 with USD 29bn, tying with Renaissance Technologies. Rounding out the top 10 are Farallon Capital Management, whose USD 26bn is virtually the same as in the previous survey, Barclays Capital Investors (USD 23bn), Tudor Investment Corp. (USD 21bn) and ESL Investments (USD 18bn). The research noted that the top 10 hedge funds are accounting for an ever-growing percentage of the total. In the current survey, there were nine firms managing more than USD 20bn each for a total of USD 291bn; six months ago, there were only seven such firms controlling USD 194bn, and a year ago, just four hedge funds representing USD 110bn.

Fund of hedge funds to blame?

Redemption requests in July by investors in funds of hedge funds may have been the primary cause for the huge market sell-off this summer and its impact on the hedge fund industry, according to the first Trim Tabs BarclayHedge Fund report. The new service, a joint venture between Trim Tabs Investment Research and BarclayHedge, estimates that roughly USD 55bn flowed out of fund of hedge funds in July - around 5% of its total assets of USD 1.2tn - against hedge fund inflows of some USD 23bn. The net outflow of USD 32bn was the biggest in seven years.

Hedge fund units become `must have` for asset managers

McKinsey

Hedge funds are the new `must-have` products for all types of asset managers who rely on them to boost their bottom line, according to a study conducted by consulting firm McKinsey and Institutional Investor's U.S. Institute and released on Wednesday.

Two-thirds of all traditional asset managers, who until recently offered only funds that would buy and hold securities to their institutional clients, now offer alternative products, in the form of hedge funds, the study found. Indeed these managers are relying on hedge funds to earn them a lot of money. The study found that more than one-third of these firms' institutional revenues come for alternative products.

Advisor/People News

Cadogan hires John Trammel as new president

Cadogan, a USD 4.7bn alternative investment advisor acquired by Fortis Investments, the asset management arm of Belgian-Dutch bank Fortis, in November, has hired a president in a new role to share management responsibilities with Stuart Leaf, the chief executive.

John Trammel previously worked as chief executive of Investor Select Advisors, an independent fund of funds, where he spent seven years. He helped to develop Select's global institutional business in Asia. Trammel also worked as a chief operating officer for Argonaut Capital Management where he helped to develop a global macro hedge fund.

Crosby capital partners takes over Forsyth funds and team

Crosby announced that it has successfully concluded negotiations with David Dunckley and Steve Akers of Grant Thornton UK LLP, the Administrators of Forsyth Partners Limited and Forsyth Partners (Europe) Limited (together "Forsyth"). As a result, Crosby will be appointed as the manager of the Forsyth funds and will hire Forsyth's investment management, research and distribution team. As part of the negotiations, Crosby has also secured the on-going support of key operational and

administrative partners to ensure the continuity and consistency in the management and administration of the Forsyth funds. The Forsyth funds will continue to trade under the Forsyth name. The transaction will provide Crosby with a suite of 39 fund of fund products covering equities, bonds and alternative strategies. The Forsyth funds currently have approximately USD 1.2bn invested in a wide range of strategies and markets.

Product News

RMF launches first environmental fund of hedge funds

In a breakthrough for the hedge fund industry, Swiss-based RMF Investment Management has launched a fund of hedge funds to invest purely in environment-related industries and strategies. RMF Environmental Opportunities Fund will invest in clean technology, renewable energy, carbon and emissions trading and in water resources and infrastructure. The fund is aimed at institutional investors and will target returns of LIBOR + 8-10 percent with medium level volatility. It has been funded with USD 18.1mn proprietary capital from RMF and USD 7mn from one of RMF's multi-strategy products. The launch of the fund reflects the strength of interest in climate change and the demand for increased investment for development in these areas.

Geronimo closing absolute return funds

Geronimo Financial will close its three absolute return funds by the end of September, according to a statement posted on the company's Website. Targeted for closure are the Geronimo Multi-Strategy Fund, Geronimo Sector Opportunity Fund and Geronimo Option & Income Fund, according to the statement. The Geronimo Multi-Strategy Fund is down 9.55 percent year to date, while the Geronimo Sector Opportunity Fund is down 5.28 percent and the Geronimo Option & Income Fund is down 2.44 percent so far this year.

MayerCap prepares levered direct-lending fund of hedge funds

Fund of hedge funds manager MayerCap is prepping a levered version of its Financing Fund, which employs a direct-lending strategy. The USD 15mn Financing Fund employs managers providing direct lending to private, as well as publicly listed small- and micro-cap companies. It includes between 10 and 15 managers, diversified by strategy and geography. The 1x levered fund, which is expected to debut on Oct. 1 with USD 10mn in initial assets, will eventually include 12 to 15 underlying managers, including those in the unlevered fund.

Academic/Research

Automatic for the people? Hedge funds, traditional and clones

While some herald the development of hedge fund replicators as marking the industry's own ETF revolution, others express concerns over the clones' abilities and properties since traditional hedge funds are human-capital intensive financial operations and the high concentration of specialized talent is the reason for the industry's remarkably high remuneration structure. Taking much of the human capital out of hedge fund strategies is a pre-requisite for bringing the costs of replicators down, but it is one that many feel comes at a high price in terms of adaptivity, dynamic flexibility, and risk selection. In this article, they studied a continuous-time model of arbitrage selection, which sheds light on this trade-off, and provide some added perspective on the issue. Several important results are obtained. First, a hedge fund's optimal trade selection criterion depends on a risk-reward trade-off that balances the expected gains from the trade and the uncertainty surrounding the trade's speed of convergence. Furthermore, the ability to select potential arbitrage trades generates a value for the funds net discounted cash flows that resembles prototypical option-pricing formulas. In addition, the value added of human capital to a hedge funds operations is dramatically enhanced when the fund deals in potential arbitrage trades for which there is a significant amount of uncertainty regarding the speed of convergence or the chances of divergence. Additional observations are made.

Treussard

Hedge funds, financial intermediation, and systemic risk

Kambouh, Stiroh

Hedge funds, with assets under management approaching an estimated USD 1.5tn in 2006, have become important players in the U.S. and global capital markets. These largely unregulated funds differ from other market participants in their use of a variety of complex trading strategies and instruments, in their liberal use of leverage, in their opacity to outsiders, and in their convex compensation structure. These differences can exacerbate potential market failures stemming from agency problems, externalities, and moral hazard. Counterparty credit risk management (CCRM) practices, used by financial institutions to assess credit risk and limit counterparty exposure, are the first line of defence against market disruptions with potential systemic consequences. This article examines how the unique nature of hedge funds may generate market failures that make counterparty credit risk for exposures to the funds intrinsically more difficult to manage, both for regulated institutions and for policymakers concerned with systemic risk. The authors acknowledge that various market failures, such as the events surrounding the 1998 collapse of hedge fund Long-Term Capital Management, may make CCRM imperfect. However, CCRM has improved significantly since then, and it remains the appropriate starting point for limiting the potential for hedge funds to generate systemic disruptions.

A learning-based replicator of hedge fund indices

Pan, Tang

Since hedge funds may implement flexible strategies to increase returns or decrease volatility, they are absorbing more and more investors as a unique alternative investment. However, investors have to pay more expense and bear potential possibility that they select a low quality hedge fund. In this paper, they apply a learning-based approach to replicate hedge fund indices that can roughly represent the average performance of individual hedge funds. Their replicator is based on a piecewise linear factor model with common benchmarks, such as bond indices, stock indices, currency, commodity indices and so on. Technique from data mining, support vector machine clustering, accomplishes the learning ability of this approach. Experimental results show this algorithm has more replication power.

Brain Drain: Are mutual funds losing their best minds?

Kostovetsky

Anecdotal evidence suggests that mutual funds have been experiencing a “brain drain” of top managerial talent to the rapidly growing hedge fund industry. In this paper, he used a unique dataset to investigate whether competition from hedge funds has led to lower mutual fund returns, an increase in the number of successful managers leaving the mutual fund industry for better opportunities, and deterioration in managerial educational standards. He connects these trends to hedge funds by showing that they occur predominantly for mutual funds managed by young managers from the Northeast, exactly the group of managers that is most likely to be attracted to hedge funds. He finds that returns of funds managed by young mutual fund managers from the Northeast decreased over time relative to their peers. This result is not explained by differences in other fund characteristics, risk loadings, or the dot-com bubble. In addition, the rate at which successful managers left the industry rose over time while the fraction of mutual fund managers with degrees from top business schools went down. His results provide original evidence for the importance of managerial ability in generating performance.

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