

ALBOURNE AMERICA

The Future of Hedge Funds – Alternative Perspectives

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See important disclosures and disclaimers

Albourne Partners

Albourne Overview

- Founded in 1994 by two ex-hedge fund managers and their prime broker
- Independent global advisory firm focused on hedge funds and recently private equity
- 148 employees with offices throughout US, Europe, and Asia
- 132 clients with over \$180bn invested directly in hedge funds
- Fixed dollar fee model, no fund of funds product and only paid by investors

Albourne's Consulting Services

- **Manager Selection**
 - Evaluation of underlying hedge funds
- **Due Diligence**
 - Initial review and on-going monitoring
- **Strategy Research**
 - Evaluating and forecasting strategy returns
- **Risk Analysis**
 - Understanding and monitoring portfolio risk
- **Portfolio Construction**
 - Determining the optimal portfolio subject to client's objectives and policy guidelines



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General Observations Role of Hedge Funds

- Hedge funds are a business model not an asset class
- Hedge funds offer diverse exposures and play a variety of roles in a portfolio:
 - Compliment
 - Equity and bonds often as part of a broader alternatives allocation
 - Risk, return and correlation may compliment traditional asset classes, with better liquidity then other alternatives
 - Substitute
 - Existing traditional equity and/or bond allocations
 - Superior return and/or risk then to traditional asset class and/or diversification benefits
 - Integrate with
 - A passive traditional asset class allocation as a part of a “Portable Alpha” program
 - Low correlation to separate asset classes and consistent “alpha” relative to a cash hurdle.

General Observations Role of Hedge Funds

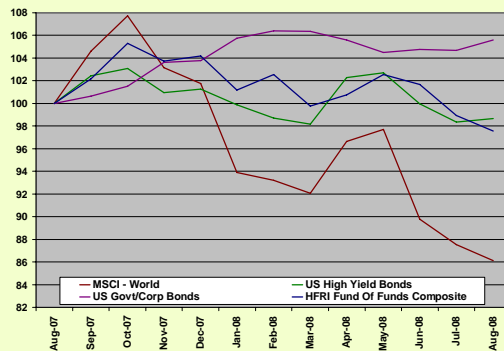
- Institutions typically choose between the following paths:

	Portfolio 1 Integrated (Portable Alpha)	Portfolio 2a Compliment/Substitute	Portfolio 2b Compliment/Substitute
Strategic Objectives	Conservative Market Neutral	Moderate Non-directional	Aggressive Directional
Return	T-Bills + 200-400	T-Bills + 400-600	T-Bills + 600-800 or Traditional AC
Risk*	2 to 4%	2.5 to 5%	4 to 6%
Beta**	< 10%	< 20%	< 40%

*Expected risk, typically below budgeted risk
** Beta to Global Equity

General Observations Performance YTD

- 2008
 - Hedge funds have held up “relatively” well when compared to Global Equities
 - Managers have reduced their net and gross exposures
 - However, the year is not over...



	MSCI - World	US High Yield Bonds	US Govt/Corp Bonds	HFRI Fund Of Funds Composite
YTD Return	-15.35%	-2.57%	1.79%	-6.34%

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Source: Bloomberg 5

General Observations Fund Flows

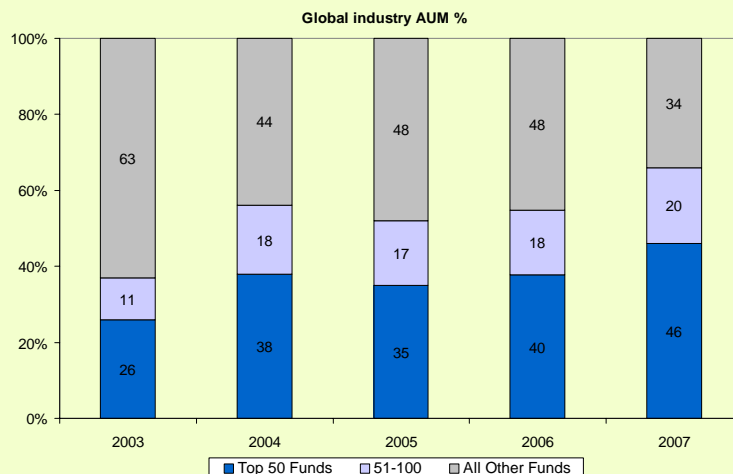
- Investors Flows
 - 2007 saw meaningful inflows
 - HFR estimated USD 400b growth
 - TASS estimated USD 340b growth
 - 2008 estimates thus far shows modest net inflows
 - Institutions are allocating some new capital
 - Funds of funds net redemptions.
- Strategy Flows
 - 2007:
 - Biggest inflows: Sector Utility/Energy & Commodity
 - Biggest outflows: Japan L/S (only negative)
 - 2008:
 - Biggest inflows: CTA & Global Macro (Distressed?)
 - Biggest outflows: Quant Equity Market Neutral & Japan L/S.

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Source: Albourne, Hedge Fund Research & TASS 6

The Large Get Larger

AUM Distribution by Manager Size



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Source: Absolute Return, Alpha, Morgan Stanley Estimates

Asset Class Convergence

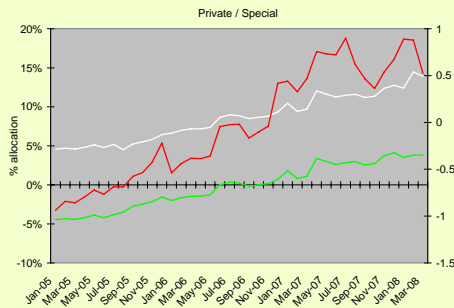
- Hedge Funds and Private Equity
 - Many PE firms have entered the business
 - Side pockets and less investor liquidity increasing
- Hedge Funds and Traditional “Long/Only”
 - “130/30” funds remain a hot topic - they now come in many difference shares (120/20 -175/75)
 - For several years L/S hedge funds have offered their long books
 - Value Equity and Activists
 - Long Short managers where shorting is limited (Emerging Market)
- Compelling fundamental investors finding the hedge fund business model appealing

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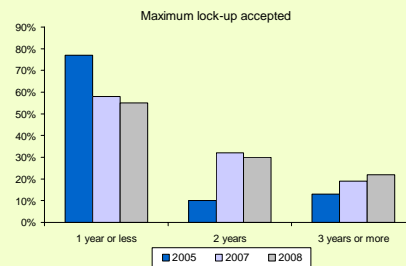
Asset Class Convergence

Increased Use of Side Pockets and Lock-Ups

Multi-Strategy allocations to side pockets



Maximum lock-up accepted



Asset Class Convergence

Defining “Hedge Fund”

Net Exposure

		Fixed (Benchmarked)	Variable (Benchmark Agnostic)
Alpha Shorts	No	Type I Indexed / Enhanced Index (Typically 100% invested)	Type II Absolute Return Long-only (Actively vary gross / Typically <100% invested)
	Yes	Type III “130/30” / Selective Shorts	Type IV Long-biased L/S (>70% net long >75% of the time)

- Sophisticated endowment clients allocate to long-biased hedge funds as a substitute for traditional equity exposure
- Now pension plans are also embracing this model.

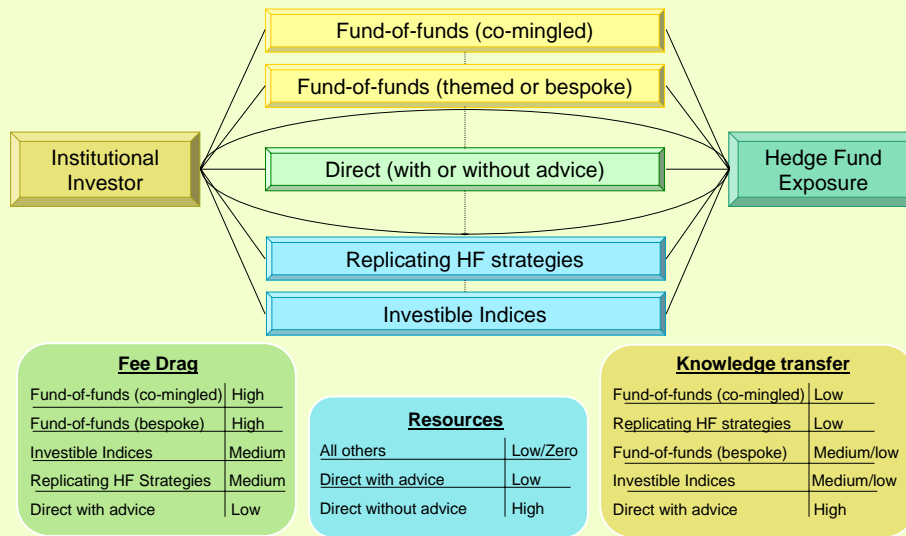
Institutionalization History of Best Practices

<u>Year</u>	<u>Report</u>
2005	AIMA – Sound Practices for Hedge Fund Valuation
2005	MFA – Sound Practices for Hedge Fund Managers
2005	Counterparty Risk Management Group – Towards Greater Financial Stability
2007	MFA – Sound Practices for Hedge Fund Managers (2)
2007	AIMA – Best Practices on Valuation (2)
2007	OECD – The Role of Private Pools of Capital in Corporate Governance
2007	Hedge Fund Working Group: The Best Practice Standards
2007	IOSCO – Principles for the Valuation of Hedge Fund Portfolios
2008	Hedge Fund Working Group – The Hedge Fund Standards
2008	Hedge Fund Code of Practice – Dubai Financial Services Authority
2008	Presidents Working Group – Investor and Asset Manager Best Practices

Institutionalization President's Working Group (PWG)

- Two work streams - Investors & Asset Managers
- Highly detailed (approx 165 recommendations):
 - Disclosure
 - Valuation of assets
 - Risk management
 - Trading & business operations
 - Compliance and conflicts of interest.

Disintermediation Routes to Access Hedge Funds



Disintermediation Future Access Hedge Funds

	Phase 1 Allocation	Phase 2 Allocation
Past	FOF	FOF (Core) & Direct (Satellite/Core)
Present and Future	Direct and/or FOF (Core)	Direct (Core) & FOF (Satellite)**

- More natural to get direct core exposure to Multi Strategy / Global managers and use fund of fund for satellite exposures (Themed)
- Themed could be emerging managers, regional and/or strategy specialist (Activists, Macro, etc).

Conclusions

- Hedge funds are dynamic with meaningful alignment of interest
 - Leverage is generally low and managers are conservatively positioned
- Valuations are attractive and dislocation and dispersion are high
 - Hedge funds don't have to use much leverage
- Consolidation and institutionalization will continue
 - Scale will continue to benefit larger multi-strategy / global managers
- “Over Regulation” currently a substantial risk
- Investor Disintermediation likely to accelerate.

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