

How to Invest in Hedge Funds

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Traditional Rationale for Hedge Funds

- Viewed as a component of overall “Alternative Investments” allocation
- Non-correlating “asset class”
- Incremental return in comparison to long-only strategies

Low Correlations Make Hedged Strategies Attractive

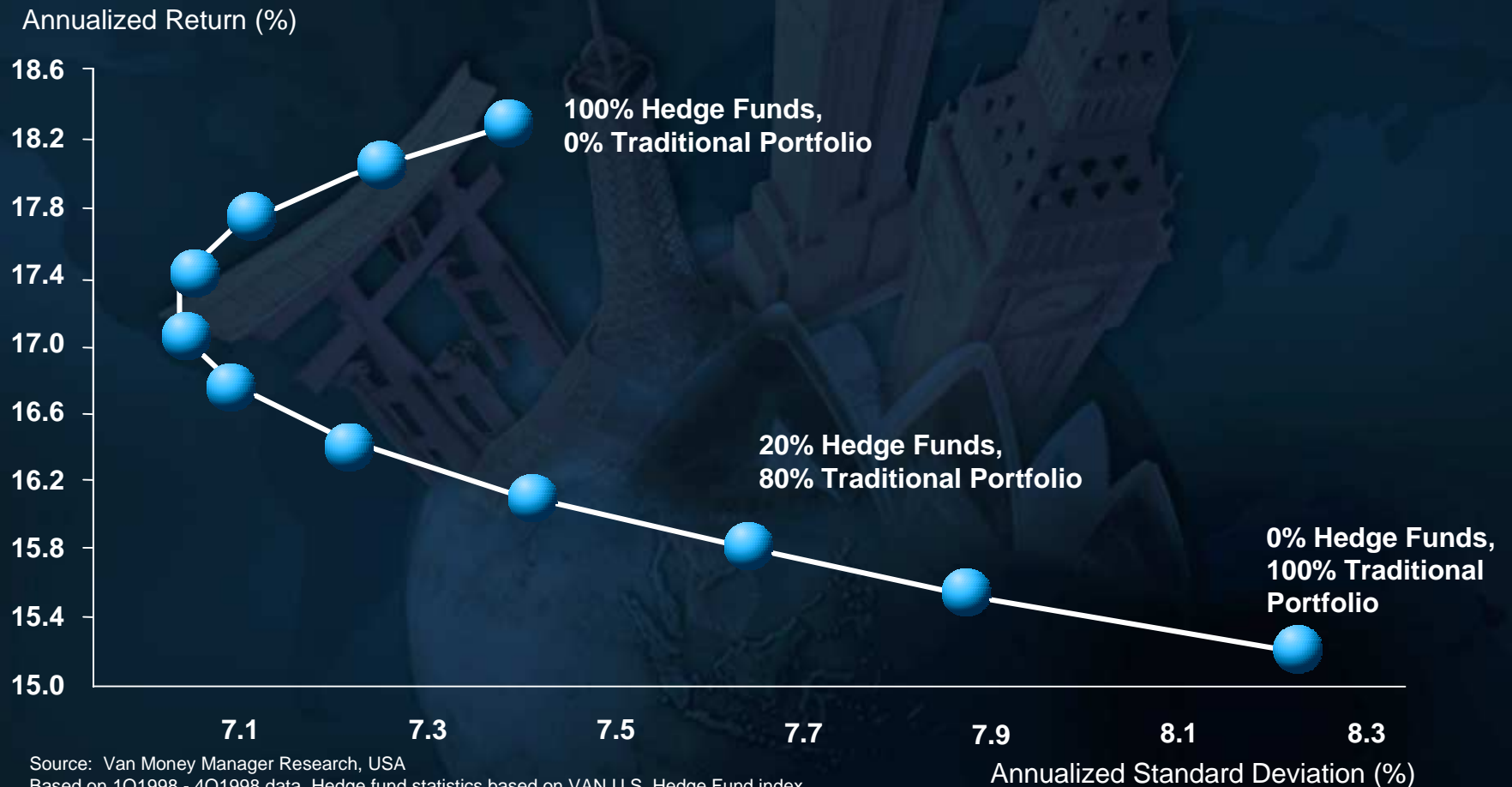
HFR Universe	S&P 500	MSCI World	JPM WGB
Fixed Income Arbitrage	-0.11	-0.04	-0.33
Equity Market Neutral	0.24	0.18	0.15
Convertible Arbitrage	0.38	0.33	0.00
Distressed Securities	0.38	0.35	-0.17
Risk Arbitrage	0.47	0.39	0.02
Long/Short Equity	0.75	0.65	0.03

■ Low correlation -1.00 - 0.33
■ Moderate correlation 0.34 - 0.67
■ High correlation 0.68 - 1.00

Source: Hedge Fund Research, Datastream, UBS Warburg (October 2000). Universe data based on monthly US\$ total returns net of fees between January 1990 and April 2000; index data based on monthly US\$ total returns gross of fees for the same period. The investment program of a hedge fund is not restricted to securities comprising the index. In addition, hedge funds may use various investment techniques, such as short selling and derivatives, not reflected in other indices.

Beneficial Impact on a Traditional Portfolio

Adding uncorrelated assets with positive absolute return characteristics to a portfolio can dramatically increase returns while decreasing risk



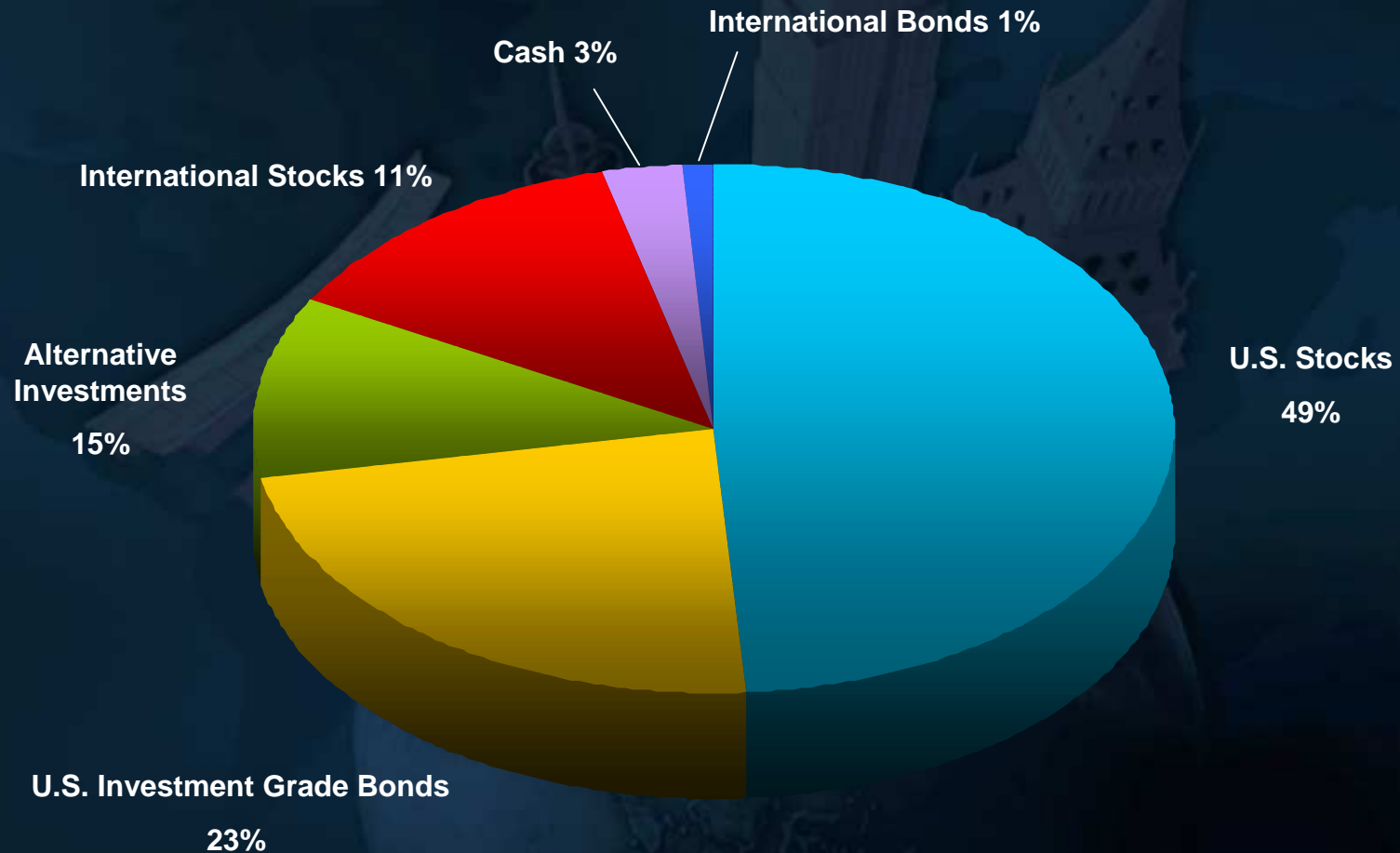
Source: Van Money Manager Research, USA

Based on 1Q1998 - 4Q1998 data. Hedge fund statistics based on VAN U.S. Hedge Fund index.

The traditional portfolio is 60% equities (S&P 500), 40% fixed income (Lehman Brothers Aggregate Bond Index).

Past performance is no guarantee of future results. The information shown above is for illustrative purposes only and should not be viewed as performance of an actual investment.

Average Allocation for a U.S. Endowment

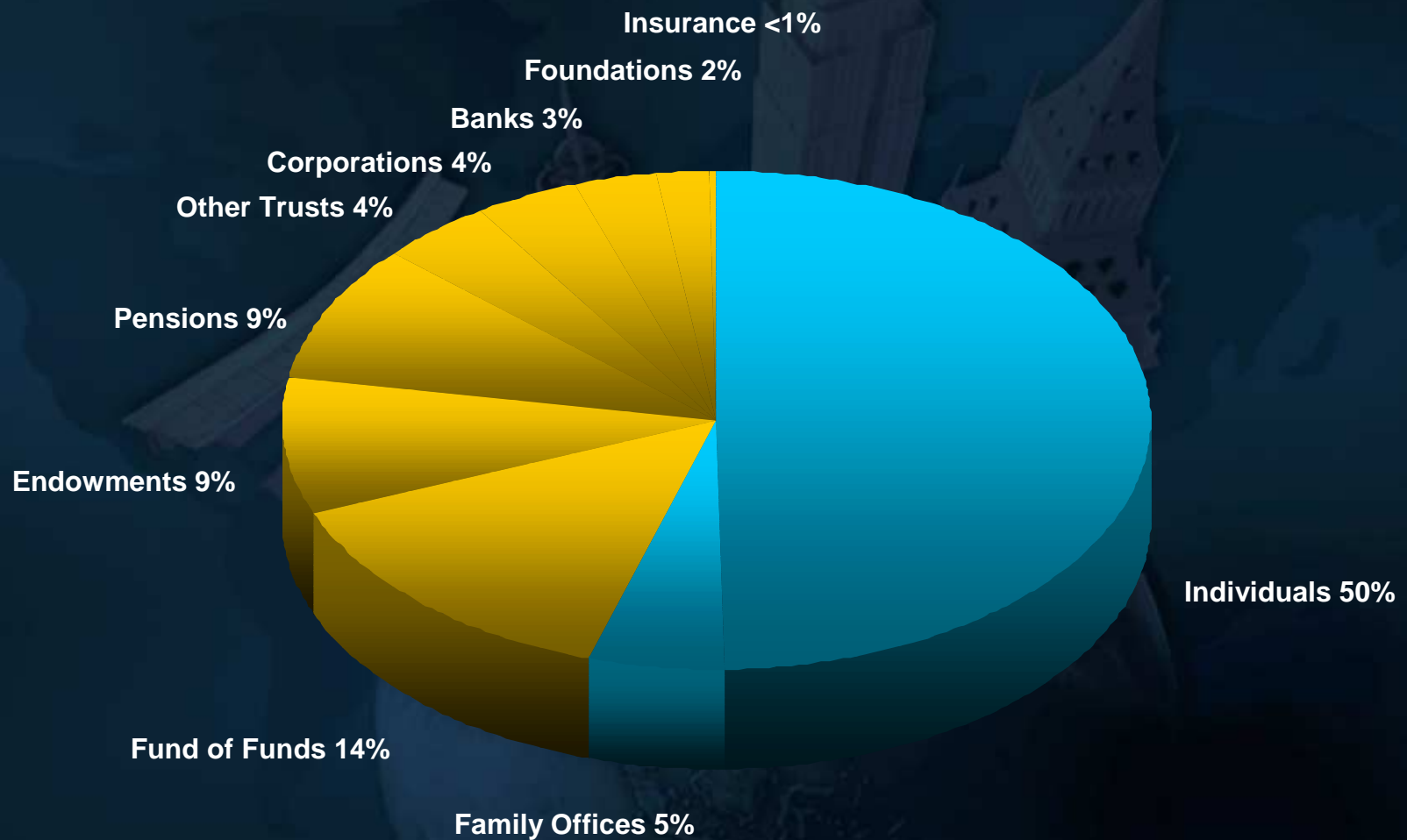


Source: Hedge Fund Research, 2000

A Different Approach

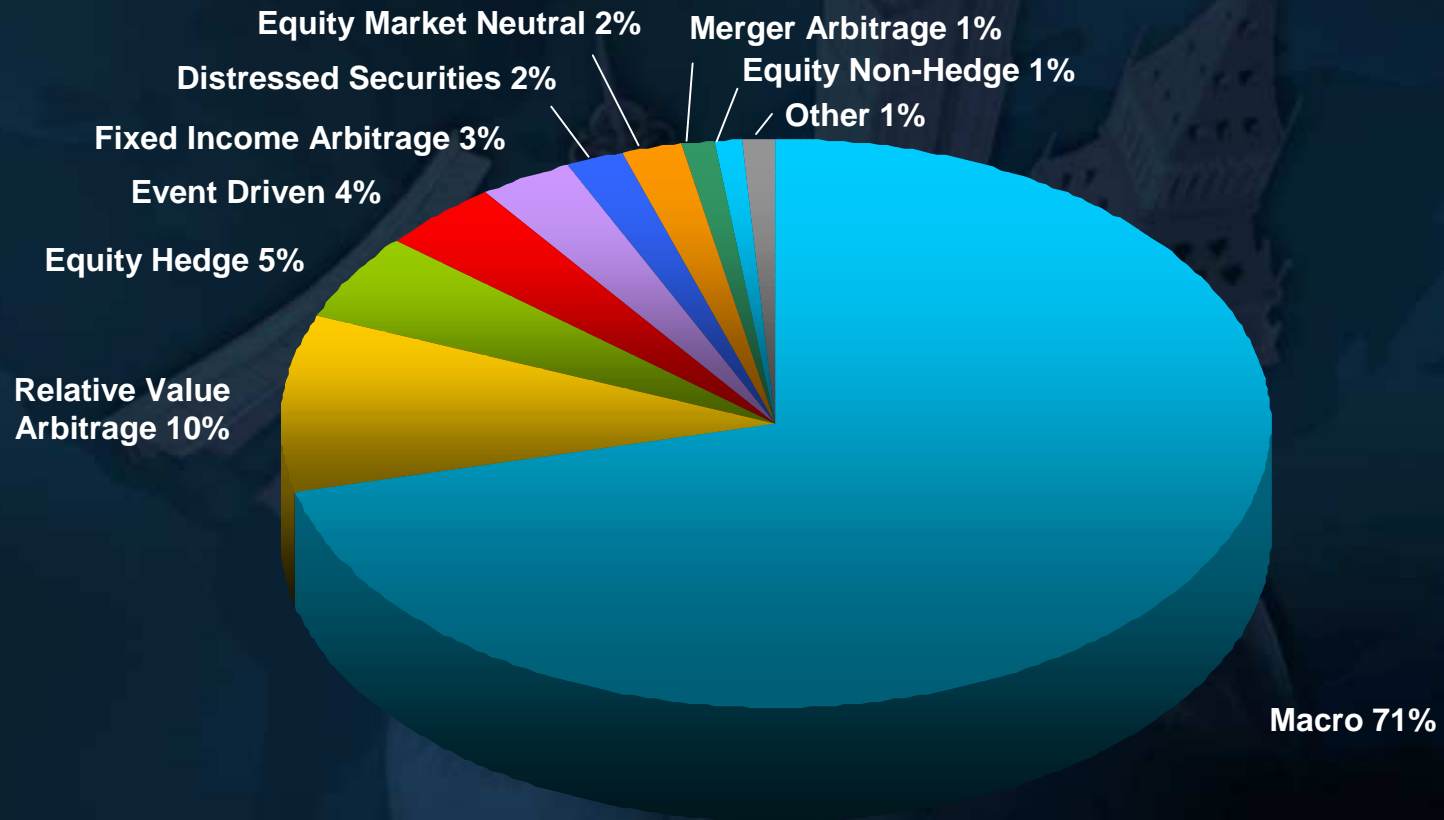
- **Hedged strategies are not an asset class**
- **Both strategy and manager should be evaluated in the context of a specific risk-return profile**
- **Best in class hedge funds produce superior risk-adjusted returns**

Existing Investors in U.S. Hedge Funds



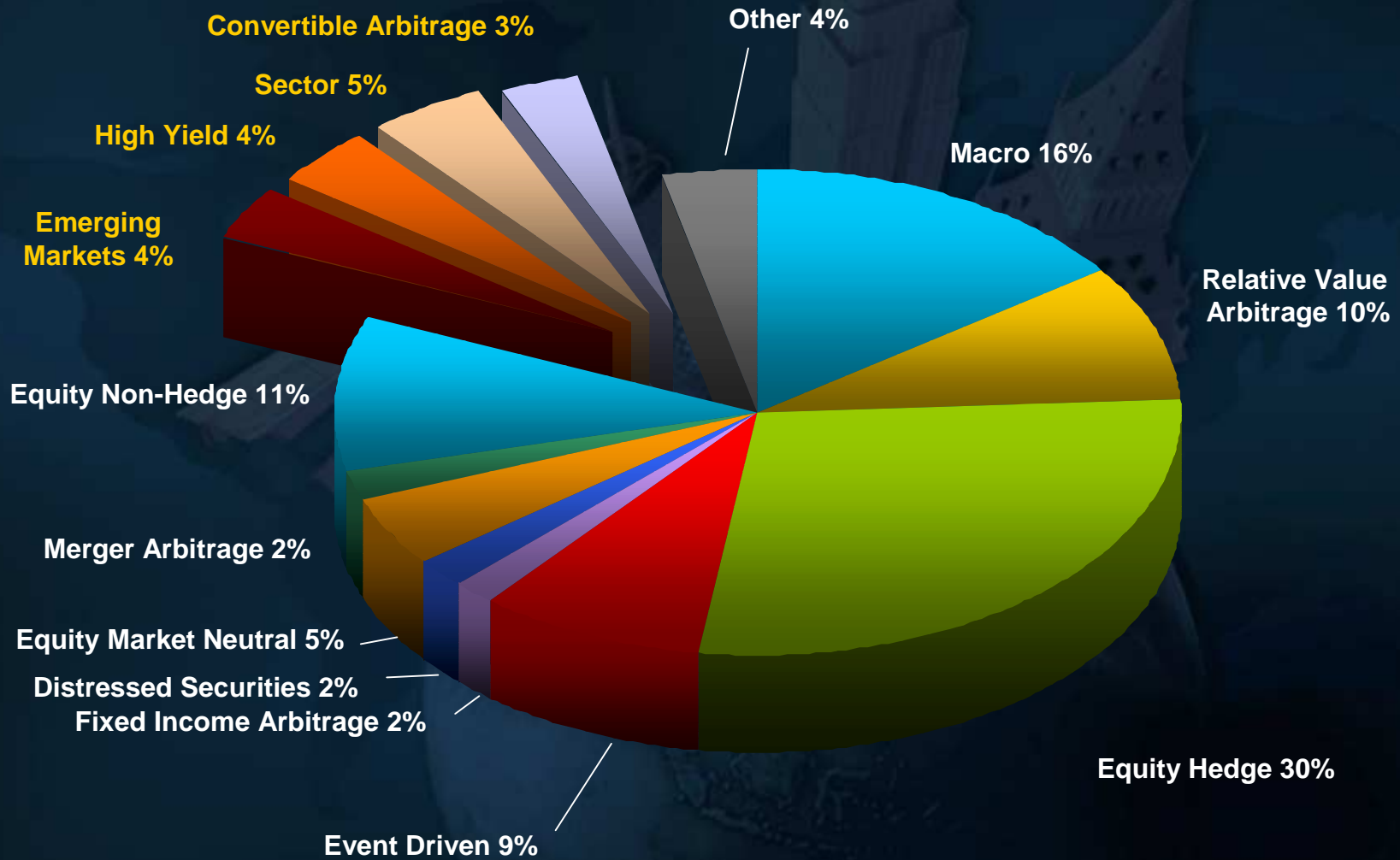
Source: Hedge Fund Research, The Journal of Alternative Investments, Spring 2001

Strategy Composition — 1990



Source: Hedge Fund Research, 2000

Strategy Composition — 2000

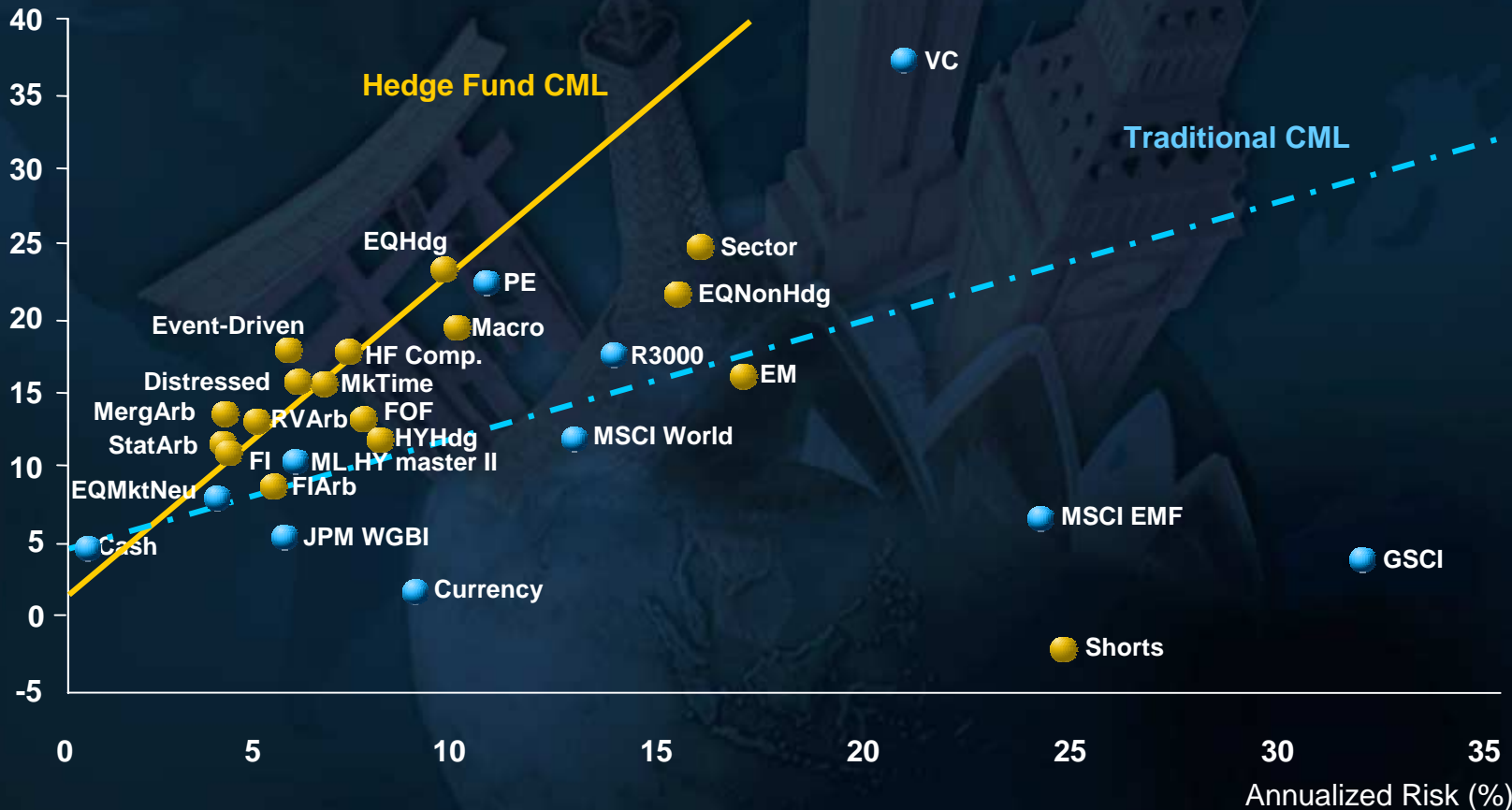


Source: Hedge Fund Research, 2000

A More Compelling Capital Market Line

Annualized Return (%)

Ten years ending December 31, 2000



Hedge Fund CML data based on HFR indices. Sampling bias may exist. For illustrative purposes only. Past performance is not a guarantee of future results.



Strategies are Generally High or Low Volatility

Annualized Return (%)
 Ten years ending December 31, 2000



Data based on HFR indices. Sampling bias may exist. For illustrative purposes only. Past performance is not a guarantee of future results.



Strategy Definition is Critical

High Volatility Strategies	Low Volatility Strategies
Emerging Markets	Convertible Arbitrage
Equity Hedge	Distressed Securities
Equity Non-Hedge	Equity Market Neutral
Fixed Income High Yield	Event Driven
Macro	Fixed Income Arbitrage
Market Timing	Merger Arbitrage
Sector Funds	Relative Value Arbitrage
Short Selling	Statistical Arbitrage

The Importance of Manager Selection...

Comparison of Universe Data, Year 2000



Universe	Non-US Equity	US Large Cap	US Small Cap	Event Driven	Relative Value	Long/Short
Strategies	113	361	242	245	89	579
Dispersion	53.5%	91.9%	103.6%	114.3%	138.4%	538.4%

Source: Frank Russell Co., Hedge Fund Research. Traditional Investments represented by the respective Frank Russell manager universes; Alternative Investments by HFR universes.

The Manager Matters

HFR's Event Driven Universe, Year 2000

Annualized Return (%)



Source: Hedge Fund Research, 2000

The Manager Matters Even More

HFR's Long/Short Equity Hedge Universe, Year 2000

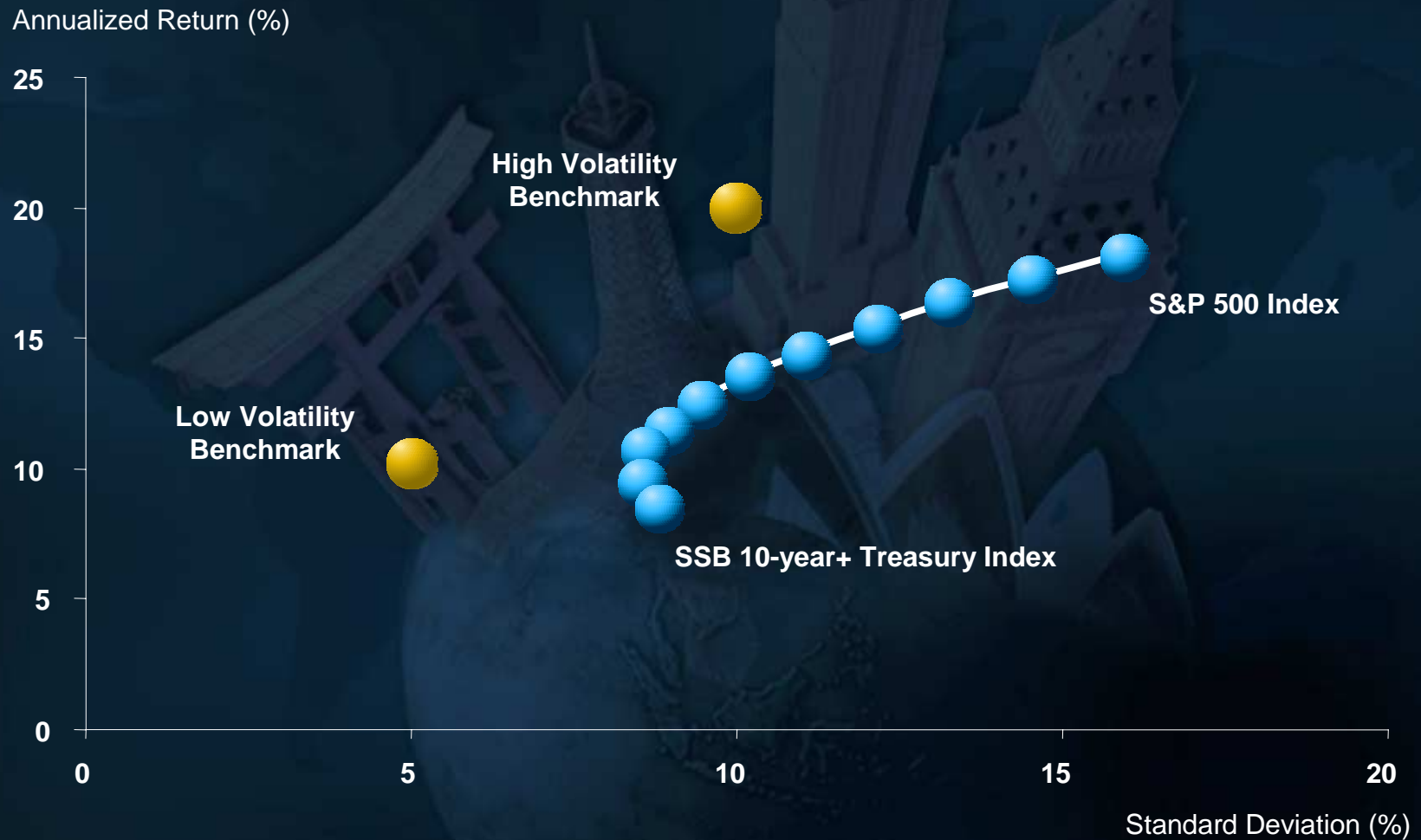
Annualized Return (%)



Source: Hedge Fund Research, 2000

Return Objectives for Hedge Funds

Compared to a Traditional Efficient Frontier in the 1990s



Published index data for period 1990-1999. Source: Ibbotson.
Low and High Volatility benchmarks are Lazard suggestions.

Conclusions for Hedge Fund Manager Evaluation and Selection

- **Focus on the strategy employed rather than the asset class per se**
- **Particularly in long/short investing, manager selection is more critical than strategy or asset allocation issues**
- **Finding skilled managers will continue to be a challenging task...**

