

Financial Advisor and Private Wealth Magazines Present

FIRST ANNUAL

Innovative **Alternative Strategies**

HOW ADVISORS CAN ACHIEVE PORTFOLIO DIVERSIFICATION AND ALPHA

Hedge Fund Research

Moderator

Evan Simonoff,
Editor-in-Chief and Editorial Director
*Financial Advisor and Private Wealth
Magazines*

Panelists

Rick Lake
Co-Chairman/Portfolio Manager
Lake Partners/Aston

Michael Mastery
SVP, Managing Director of Alternative Investments
PNC Capital Advisors

Alan Lanahan
Managing Principal, Director of Hedged Strategies
Fund Evaluation Group

Investment Philosophy: For Hedge Funds and Alternative Mutual Funds

It is just as important to manage risk as it is to aim for returns

Manage Risk

- Preserving capital is the first step to growing capital.
- Controlling portfolio volatility and downdrafts can help improve compound rates of return and long-term results.

Aim for Returns

- Growth is found in the artful blend of:
 - identifying market trends or inflection points,
 - opportunistic selection of alternative strategies, and
 - targeting manager talent.

Seek Right Managers, Right Mix

- Selecting the right mix of managers is as important as selecting the right managers.

Enhance Asset Allocation for Investors and Advisors

- Integrate traditional and alternative strategies.
- Alternative investment strategies with relatively stable returns and modest correlations to conventional assets can help dampen overall portfolio risk and enhance returns.

Investment Process: Multi- Manager Alternative Program



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Ongoing Search For Opportunity

Seek opportunities across multiple dimensions.

Markets: Top Down Analysis of Opportunities and Risks

- *Harness macro perspective of firm and global alternative research*
- Macro-economic consensus or dialectic
- Risk/return outlook across asset classes
- Investment trends vs. valuations
- Market sentiment vs. fundamentals
- Liquidity conditions
- Outlook for styles, regions, investment types

Strategies: Cross-Sectional Scan for Profit Potential

- *Capitalize on changing risk/return potential of alternative and traditional strategies*
- Strategy history and current dynamics
- Capital flows: opportunity vs. crowding
- Long-biased vs. degree of hedging
- Long-short vs. absolute returns
- Cycles in varieties of arbitrage; specialty strategies

Managers: Bottom Up Search for Value-Added

- *Intensive, fundamental research of alternative and traditional managers*
- Performance potential, added value
- Risk control: strength vs. vulnerabilities
- Quantitative and qualitative analysis
- Manager skill, life cycle
- Access to unique niche
- Lack of correlation, role in portfolio
- Capacity: asset size vs. fund performance
- Established vs. new managers

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MANAGER ANALYSIS

Comprehensive manager analysis is multi-faceted.

Quantitative Analysis: Variety of Techniques

Returns

- Patterns of performance or underperformance
- Change over time
- Peer comparison
- *Assess potential risk of loss*

Risk

- Risk/return analysis
- Consistency/volatility
- Drawdown analysis
- Peer comparison
- *Assess potential risk of loss*

Correlations

- Rolling correlations vs. market and hedge fund indices
- Regression vs. market and hedge fund indices
- Correlations with other managers in the portfolio
- *Assess potential risk of loss*

Qualitative Analysis: Differentiate Strengths and Risks

Investment Approach

- Philosophy, strategy/style, methodology, risk management
- Portfolio characteristics: position, sector, geographic diversification/concentration
- *Assess potential risk of loss*

Character

- Credibility, reputation
- Communication
- *Assess potential risk of loss*

Organization

- Systems, staffing and resources
- Decision making process
- Assets under management
- *Assess potential risk of loss*

Due Diligence & Ongoing Review: A Continuous Process

Due Diligence

- Fees & expenses
- Prospectuses, financial reports, K-1s, etc.
- Regulatory issues and filings
- Conflicts of interests
- AUM; Investor base; turnover
- Qualifications, experience
- *Assess potential risk of loss*

Manager Reviews

- Ongoing underlying fund performance monitoring
- Regular review of manager and program investments, allocations, drawdowns
- Quarterly formal analysis of each investment
- Statistical and exposure analyses ongoing and as-needed
- *Assess potential risk of loss*

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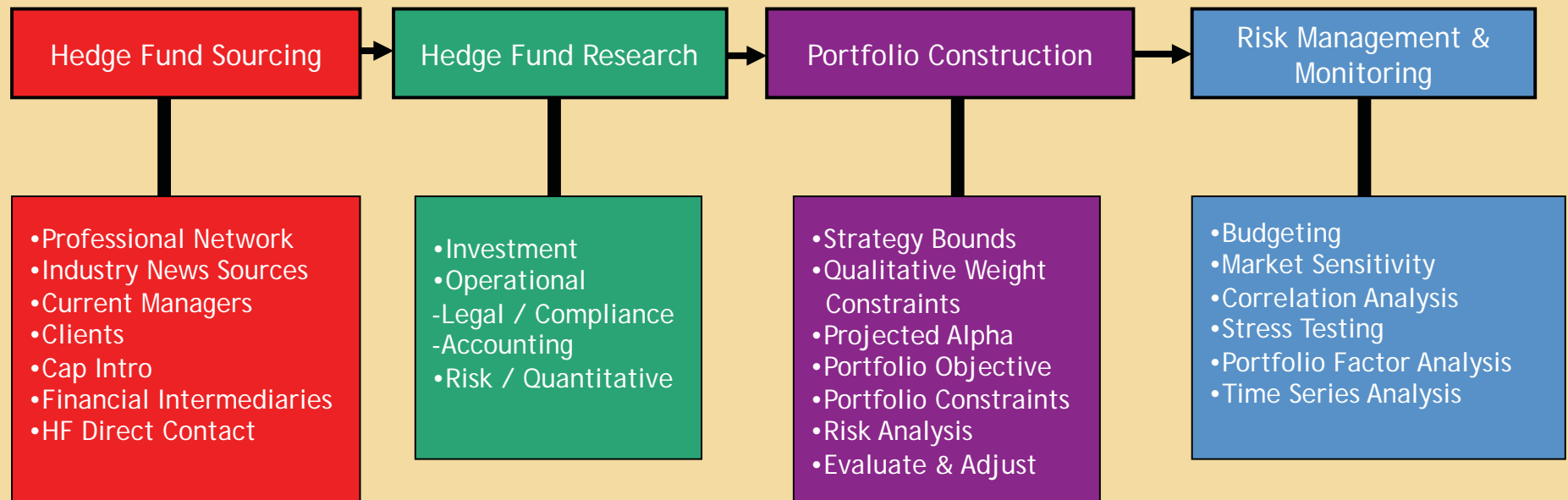
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Hedge Fund Research - A Fund of Hedge Fund Perspective



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Hedge Fund Research - The process of due-diligence involving the gathering and evaluating of information about a hedge fund prior to investing. Findings are used to assess whether that fund's investment thesis and projected level of volatility is appropriate for the client's portfolio. Done to mitigate investment and business risk

Investment Research Due-Diligence

Investment Team Focuses on:

- Hedge Fund Managers Investment Capabilities & Process
- Investment Strategy Employed in the Fund
- Hedge Fund's Targeted Return
- Financial Instruments Traded in the Fund
- Track Record
- Risk Management Skills & Systems
- Matching of Assets & Liabilities
- Portfolio Liquidity
- Ability to Adequately Hedge
- Uniqueness of Strategy
- Overall Fit within the Portfolio
- Hedge Fund Fees & Liquidity Terms

Operational Research Due-Diligence

Operational Team Focuses on:

- Sustainability of Business
- Quality of the Internal Operations Staff
- Implementation of Proper Controls and Procedures
- Cash Controls
- Infrastructure
- Trading Systems
- Third Party Service Providers & Counterparties
- Valuation Methodology
- NAV Verification
- Compliance
- Liability Structures and Financing Arrangements
- Composition of the Investor Base
- Third Party Background Checks of Key Personnel

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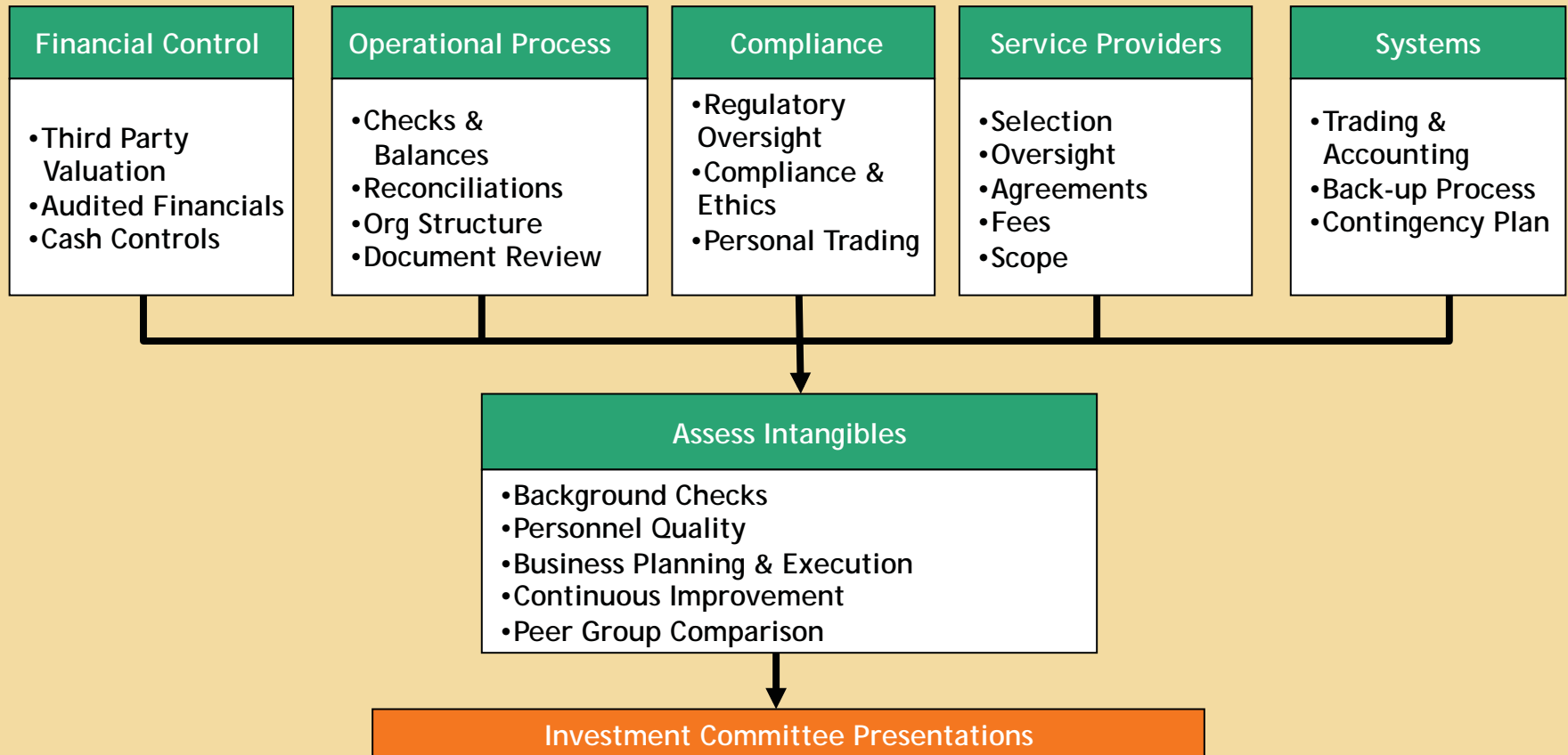
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Hedge Fund Research - A Fund Of Hedge Fund Perspective

Dedicated Hedge Fund Operational Research



Hedge Fund Research - A Fund of Hedge Fund Perspective

Where to Gather Information to Conduct Hedge Fund Due-Diligence

- Offering Memorandums / PPM's (If Private Placements)
- Prospectuses, Annual & Semi-Annual Reports, Form ADV Part A/B (If Registered)
- Due-Diligence Questionnaires (DDQ's)
- Monthly / Quarterly Performance Statements
- Annual Audited Financial Statements - Onshore & Offshore
- Meetings / Conference Calls with the Managers
- Proprietary Website (Limited)
- Investor Communications (Letters) and Other Reporting (Risk Reports)
- Current Investors
- Industry Contacts
- Hedge Fund Business Counterparties
- Key Service Providers
- Hedge Fund's Code of Ethics, Compliance Manual & Annual Compliance Review
- On Site Visit with the GP, CFO or COO to Discuss Operational Infrastructure of the Fund
- Internet Search
- Hedge Fund Databases
- Court Reporting Databases
- Guidelines for the Disclosure of Potential Conflicts of Interest
- Guidelines for the Qualifications of Investors in the Fund
- Guidelines Relating to Disclosure to Counterparties

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Investing In Hedge Funds

Why Invest in Hedge Funds?

- **Diversification from systematic market risk**
 - Benchmark agnostic and low beta mandates
- **Reduced downside risk**
 - Lower volatility of returns and reduced drawdowns
- **Alignment of interests**
 - Incentive compensation and principle investment in their products
- **Access the best money managers**
 - Compensation structure, intellectual freedom, and flexibility are drawing the most talented money managers to the hedge fund structure

Hedge Fund vs. Long-Only

	Hedge Fund	Traditional Long-Only
Primary Determinant of Return	Skill (Alpha)	Benchmark (Beta)
Key Risk	Loss of capital	Relative underperformance
Investment Objectives	Maximize risk-adjusted returns with low correlation to the market while preserving capital	Beating benchmark
Flexibility	Shorting, leverage, derivatives, no geography, market cap, or style constraints	Constrained to long-only investments, typically within certain market caps, styles, or geographies
Co-Investment	Significant	Immaterial
Alignment of Interest	Extremely close due to high water marks, incentive fee structure, and co-investment	Growth in revenue can only be achieved through growth in assets
Determinant of Success	Equity-like returns with reduced volatility	Outperform benchmark

Hedge Funds vs. Liquid Alternatives

2007 study by Agarwal, Boyson, and Naik

Findings:

- Hedged mutual funds underperform hedge funds
 - 3.3% points annually
 - Due to: Lighter regulation (constraints), alignment
- Hedged mutual fund outperform traditional mutual funds
 - 4.8% points annually
 - Due to: strategy flexibility (constraints), skill
 - Skill - Outperformers driven by hedge fund managers offering mutual funds

Source: "Hedge funds for retail investors? An examination of hedged mutual funds", Agarwal, Boyson, Naik, March, 2006.

Hedge Fund Risk

FEG has always held out the following as key risk factors to be aware of when investing in hedge funds.

- Leverage
- Operational
- Fraud
- Liquidity

