

Along with all the other upheavals in the market, the landscape for hedge funds changed dramatically in 2008. They were hit from all sides by market illiquidity, massive year-end redemptions, forced selling, restrictions on short sales, and the failures of prime brokers and counterparties. For clients where hedge funds are an appropriate investment, our strategy has been to use hedge fund of funds (FOFs) vehicles, providing broad diversification. Some thoughts on the current hedge fund environment:

1. The key to survival in the FOF industry has been to run a conservative business model. No or little leverage at the FOF level, avoiding underlying hedge funds that got into very illiquid investments (i.e., private equity deals), and relatively stricter redemption policies at the FOF level are components of running a more conservative model.
2. Consistent enforcement of sound due diligence policies is critical. In our opinion, the key issue with Madoff was not that the FOFs didn't know the due diligence standards or how to implement them but that they chose (for performance and financial incentives) to give him a pass. Those funds that gave him a pass demonstrate why it is so critical to never make exceptions to due diligence policies. The FOFs that can prove a solid and consistent process (by avoiding Madoff and other frauds) will survive and thrive.
3. Why invest in HFOFs now? The conservatively run HFOFs are in a good position to take advantage of the opportunities in the aftermath of the financial panic. There are a number of very talented hedge fund managers who positioned themselves very well for this environment. The surviving FOFs have and can continue to allocate to them. It is very difficult, if not impossible, for an individual with \$500K-\$1 million to allocate to hedge funds effectively to take advantage of these opportunities (in credit, distressed, arbitrage strategies) other than through FOFs, which provide the due diligence, the diversification, and the access. Access to top managers is easier for top tier FOFs thanks to the panic. Even managers who 'got it right' in the last year have faced redemptions because their investors needed liquidity from wherever they could get it. Minimums and fees have come down to attract assets at both FOF and underlying hedge funds.

The charts that follow show returns for two groups of hedge funds—absolute return and broadly diversified. As you can see on the charts, the median hedge fund in the two peer groups fell less than half as much as the S&P 500 over the past year (ended March 31). That downside protection results in five and seven year numbers that are significantly better than equity returns (with less volatility) and slightly less than bond returns. Given the current environment and the issues outlined above, hedge funds will bear close watching over the near future.

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you can see  
everything.

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### Performance Calculations:

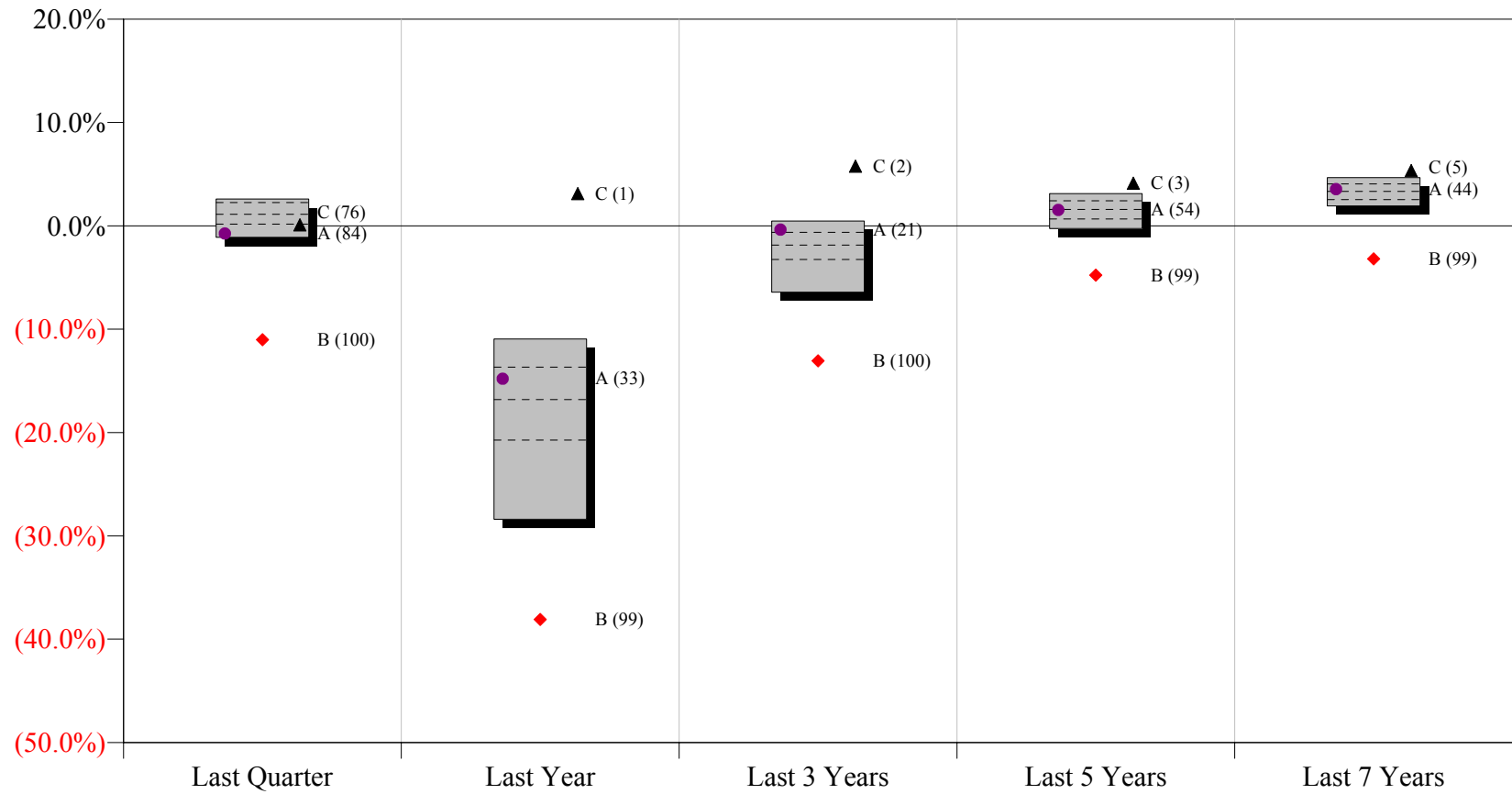
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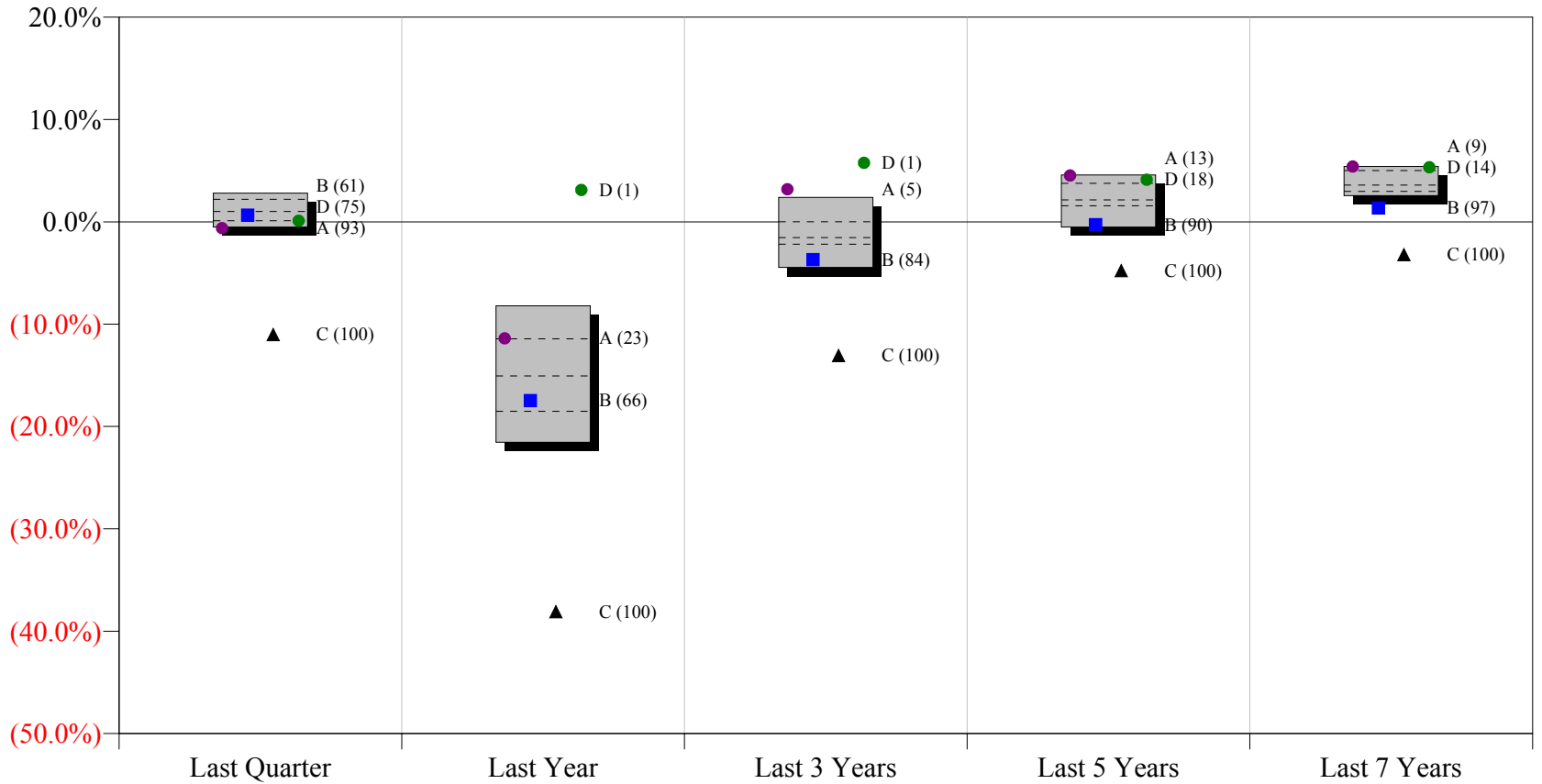
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Returns  
for Periods Ended March 31, 2009  
Group: Absolute Return Hedge FoF Style



10th Percentile	2.59	(10.94)	0.46	3.13	4.67	
25th Percentile	2.26	(13.68)	(0.61)	2.43	4.06	
Median	1.14	(16.80)	(1.84)	1.59	3.35	
75th Percentile	0.17	(20.72)	(3.25)	0.67	2.55	
90th Percentile	(1.10)	(28.38)	(6.42)	(0.25)	1.93	
PA Stable Value Fund, Ltd.	● A	(0.72)	(14.78)	(0.35)	1.56	3.58
S&P 500	◆ B	(11.01)	(38.09)	(13.06)	(4.76)	(3.20)
BC Aggregate Bond	▲ C	0.12	3.13	5.78	4.13	5.36

Returns  
for Periods Ended March 31, 2009  
Group: Broadly Diversified Hedge FoF Style



	Last Quarter	Last Year	Last 3 Years	Last 5 Years	Last 7 Years
10th Percentile	2.81	(8.21)	2.39	4.59	5.42
25th Percentile	2.20	(11.42)	0.03	3.76	5.03
Median	1.01	(15.04)	(1.52)	2.15	3.60
75th Percentile	0.12	(18.52)	(2.18)	1.58	2.98
90th Percentile	(0.50)	(21.54)	(4.44)	(0.51)	2.56

Cadogan Prtn LP	● A	(0.60)	(11.37)	3.20	4.54	5.43
UM Multi-Strategy Fund	■ B	0.66	(17.46)	(3.68)	(0.28)	1.37
S&P 500	▲ C	(11.01)	(38.09)	(13.06)	(4.76)	(3.20)
BC Aggregate Bond	● D	0.12	3.13	5.78	4.13	5.36