Pan Europe
Investment companies

CAZENOVE

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Listed Hedge Funds Dispatch

SUMMARY
2010 starts with the listed hedge fund sector facing uncertainty over its long–term viability and its ongoing constituents. Many criticisms have been levelled at hedge funds, and listed hedge funds more specifically. We analyse each of these, including poor performance, high equity market correlation, excessive fees, exposure to hedge fund frauds and blow–ups, poor transparency, wider and more volatile discounts, ineffective discount control policies, the suspension of FX hedges and low secondary market volumes. We ask should we **forgive** or **forget** listed hedge funds? They look especially vulnerable in respect of discounts and liquidity, but many have come through the recent period very well. We think investors will **forget** some funds but **forgive** others. We believe the best funds and those offering something unique or unobtainable in other structures still have the scope to grow, but possibly at the expense of other funds leaving the sector. Meanwhile, discounts continue to offer some opportunities through reverse auction tenders (upcoming ones expected at **Dexion Absolute** and **AcenciA**) and wind–downs (including **Tapestry**, **FRM Diversified** and **CMA Global**). We analyse these and round–up activity and performance in the sector.

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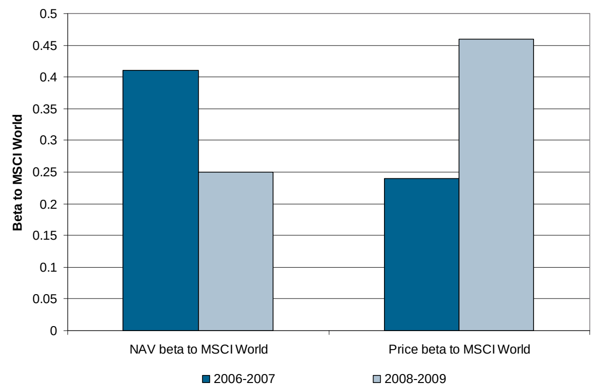
Commentary/executive summary

Welcome to 2010. But is 2010 the year to forget about listed hedge funds or, after all the sector's recent travails, are we ready to forgive?

There are many charges that have been levelled at hedge funds and listed hedge funds specifically. Generally we believe that investors have been concerned about poor performance, high equity market correlation, excessive fees, exposure to hedge fund frauds and blow–ups and too little transparency. For listed hedge funds, some of the problems are perhaps more serious with investors concerned about wider and more volatile discounts, ineffective discount control policies, the suspension of FX hedges and poor secondary market liquidity.

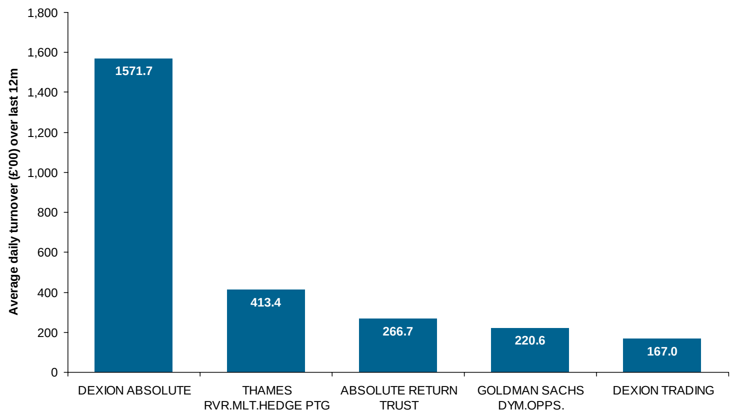
Whilst hedge funds have improved on many of these counts and, for some funds, many of the criticisms are not unjustified; the listed structure looks vulnerable on several counts. This is especially the case in comparison to the nascent absolute return UCITS III universe. The first is the age old problem of discounts. Investors have recently had the unpleasant of seeing discounts widen dramatically (though they have since narrowed), but the discounts widened just as performance deteriorated and equity markets struggled. As a result, the listed structure has captured unwelcome excess beta to equity markets. This was a shift from the relationship in previous years, where share price beta was actually less than NAV beta, giving an extra diversification benefit (see figure 1 below). The second issue is that secondary market liquidity has generally been poor during the periods of uncertainty and stress and that only a few companies are of a sufficient size and liquidity for many investors to justify investment (figure 2).

Fig 1 NAV and price beta to MSCI World for listed fund of hedge funds



Source: Cazenove. To end November 2009.

Fig 2 Average daily turnover over 12 months



Source: Cazenove/companies. To 5 January 2010.

In our opinion, there is no easy solution to either of these problems, though it may be the case that investors' expectations of performance, the nature of the listed structure, and liquidity need to adjust. In addition, the investment strategies and investment proposition in the listed sector may need to evolve to reflect the strengths of the listed structure and the desires of investors. Having said all of this, 2009 ended with **BlueCrest AllBlue** impressively raising £101m in a C share issue.

The sector's difficulties and wide discounts have, however, presented opportunities for many investors as a result of tenders and wind–downs. In addition, some long–term investors may see discounts as a short–term positive, though if they become ingrained discounts are, in our opinion, a negative for the sector as a whole.

In this *Dispatch*, we analyse the prospects for the reverse auctions at **Dexion Absolute** and **AcenciA Debt Strategies**. Historical precedents may suggest the tender strike discount has been narrower then the discount has been at any point in the period between the announcement of a tender and the record date. It has also been the case that the strike discount has proved to be narrower than the discount in the immediate period after the tender and for a prolonged period subsequently. In recent weeks, both discounts have narrowed significantly and Dexion Absolute is now on a c.8% discount, the narrowest it has been since late 2008. The strike discount could therefore be approaching the likely minimum 5% level. Similarly the discount on AcenciA has narrowed to c.17%, its tightest for more than a year. There seems more upside in AcenciA, though given historical precedents it may be in all investors' interests to tender (and buy back after the tender if the discount subsequently widens).

Meanwhile, the potential IRRs for companies in wind–down continue to look relatively attractive for investors with a long–term horizon. However there is uncertainty over the timing of a substantial amount of the portfolio and possibly its value. **Tapestry** (**Outperform**) remains our favoured play.

Fig 3 Current discounts and IRRs for liquidating companies

	Current discount (%)	IRR (%)
CMA Global EUR	–30.0	14.2
CMA Global USD	–31.6	15.8
CMA Global GBP	–30.1	14.3
FRM Diversified Alpha	–20.8	3.7
Tapestry	–14.6	9.3

Source: Cazenove

We concluded our commentary in our Dispatch at the end of 2008 with the following: "The sector will undoubtedly shrink significantly in 2009. "Permanent Capital" will therefore prove transitory for many funds. We believe that the sector is likely to consolidate around the best performing funds with a core offering." We believe we could end this commentary at the start of 2010 with the same statement. The best funds and those offering something unique or unobtainable in other structures (such as the **BlackRock Hedge Selector UK Emerging**) still have the scope to grow, but possibly at the expense of other funds leaving the sector. We think investors will continue to **forget** some funds and **forgive** others.

We will analyse 2009 performance in more detail in our next *Dispatch*.

Listed Hedge Funds: Forgive or Forget?

An element of stability returned to the listed hedge fund sector in the second half of 2009. Investors now have the opportunity to review what has happened to the sector, the wider hedge fund universe and reassess where they go from here. Listed hedge funds experienced a rapid expansion prior to the crisis but have had their fair share of difficulties subsequently. We ask the question: *Listed hedge funds: forgive or forget*?

The rap sheet

Many investors have been disappointed with the performance of hedge funds generally and listed hedge funds more specifically. The following charges, which we tackle in turn in the following analysis, have been levelled at hedge funds generally and listed hedge funds specifically:

- Poor absolute hedge fund performance;
- Hedge fund performance too correlated to equity markets;
- Widening discounts, with discounts correlated to equity markets;
- Ineffective and/or inconsistent discount control policies;
- The suspension of FX hedging/unintentional gearing;
- Too little transparency;
- Too high fees;
- Exposure to hedge fund frauds and blow–ups;
- Poor secondary market liquidity.

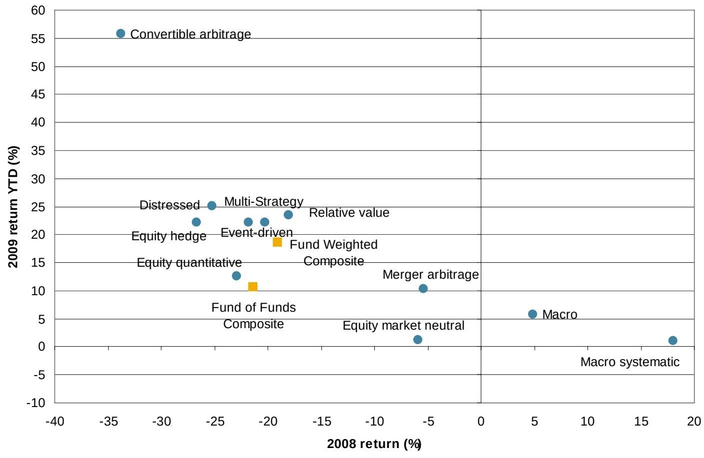
Hedge fund performance

Of course the first comment to make on performance is that it has not been universally poor over the last couple of years. That is evident from several of the listed hedge funds. **BH Macro**, for example, showed a $ NAV up 20.3% in 2008 and provisionally up 18.0% in 2009. Similarly, **Cazenove Absolute Equity** generated a NAV return of 11.2% in 2008 and was up 5.3% in 2009 (to end November).

Moreover, the degree to which hedge fund performance as a whole can be described as poor depends on one's expectations. Whilst many funds may have been sold as being uncorrelated and able to earn a positive return in 'all market conditions', the generation of returns requires certain market conditions and the avoidance of human error. The removal of leverage, market illiquidity, technical/liquidity driven selling, heightened counterparty risks, regulatory restrictions, government intervention and massive redemption requests undoubtedly created many funds' worst nightmares during late 2008. Fund positioning – including being in crowded trades – and stock–selection failures added to many funds' difficulties. These affected many, but as we noted above, not all.

Last year, of course, performance bounced back. Generally, the strategies and funds that performed poorly in 2008, performed strongest in 2009. This is partly due to markets, but also due to the effect of not having to pay performance fees – as we explored in the last *Dispatch*. The R^2 between 2008's performance and 2009 (to end of November) for the 12 main HFRI strategies is 76% (correlation of –0.87).

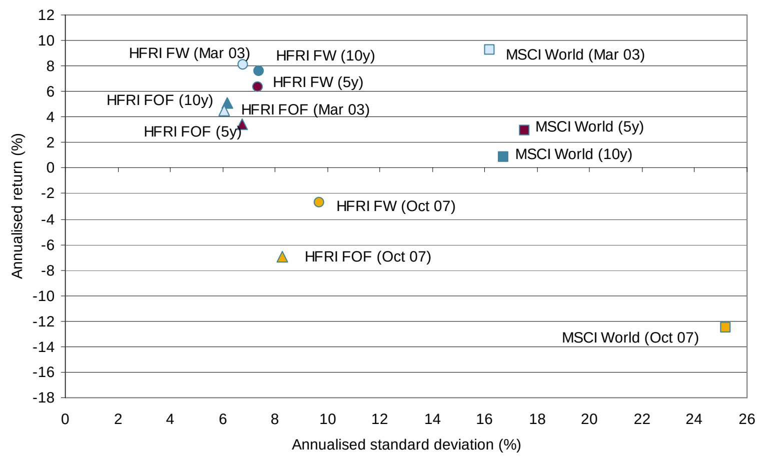
Fig 4 2008 versus 2009 strategy performance



Source: Cazenove/HFRI. To end November 2009.

Despite the deterioration in annualised performance and the increase in volatility, aggregated long–term hedge fund performance characteristics still remain attractive against equities. Over the last 5 years (to end November 2009), the HFRI Fund Weighted Composite has annualised at 6.4% with volatility of 7.4%, whilst the MSCI World has returned 3.0% with volatility of 17.5%. Fund of fund investors have also beaten equities (3.4% annualised return) with substantially less volatility (6.8%). Even since the market trough in March 2003, equities have only modestly beaten hedge funds (MSCI annualised return of 9.3% against HFRI Fund Weighted Composite return of 8.1%), with much more volatility (MSCI World: 16.2%, HFRI FW: 6.8%). The relative attractiveness of hedge fund performance over the last decade may say more about equities, which delivered disappointing returns despite strong economic growth.

Fig 5 Risk return profile of equities vs hedge funds



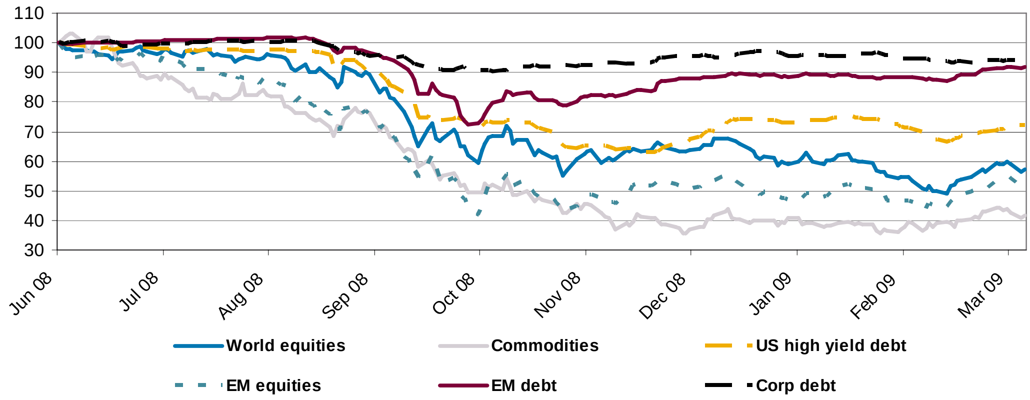
Source: Cazenove/HFRI. To end November 2009.

Forgive or Forget: At the aggregate level, long–term and recent performance still compares favourably against equities. Moreover, for many single manager funds – such as **BH Macro**, **BH Global**, **BlueCrest AllBlue** or **Cazenove Absolute** – performance continued to be strong between 2008 and 2009 and the performance case for these funds has grown in strength. In addition, investors should be cognisant of the unfavourable conditions that many hedge funds operated in during 2008. Overall, a strong case to **forgive**.

Correlation and diversification

As has been well recognised, correlation amongst – and within – asset classes increased markedly in late 2008 as result of a liquidity crunch. As we have just commented, this environment contributed to the increased correlation between hedge funds and equity markets.

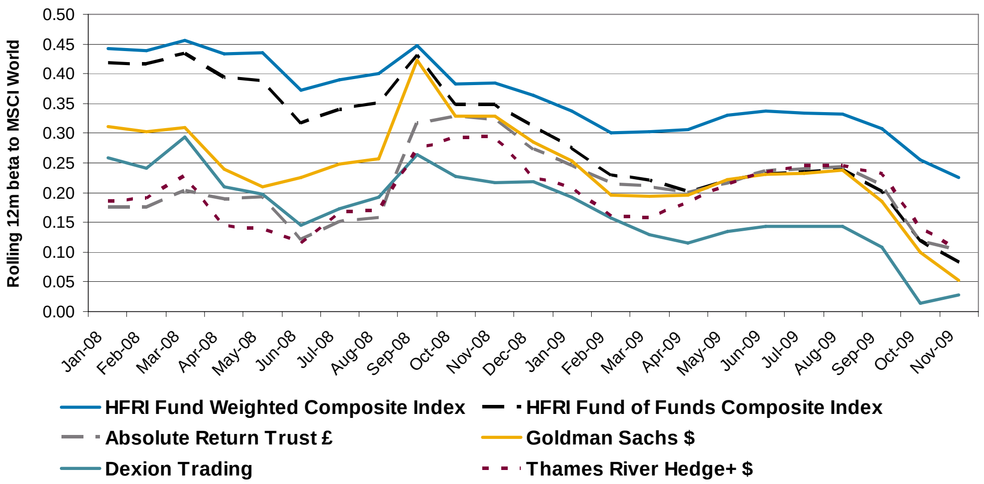
Fig 6 Asset class performance from June 2008 to March 2009



Source: Cazenove/Datastream

Against this backdrop, the rolling 12 month beta between hedge funds and equities did increase markedly at the end of 2008, but fell back quickly and current rolling betas are at historical lows.

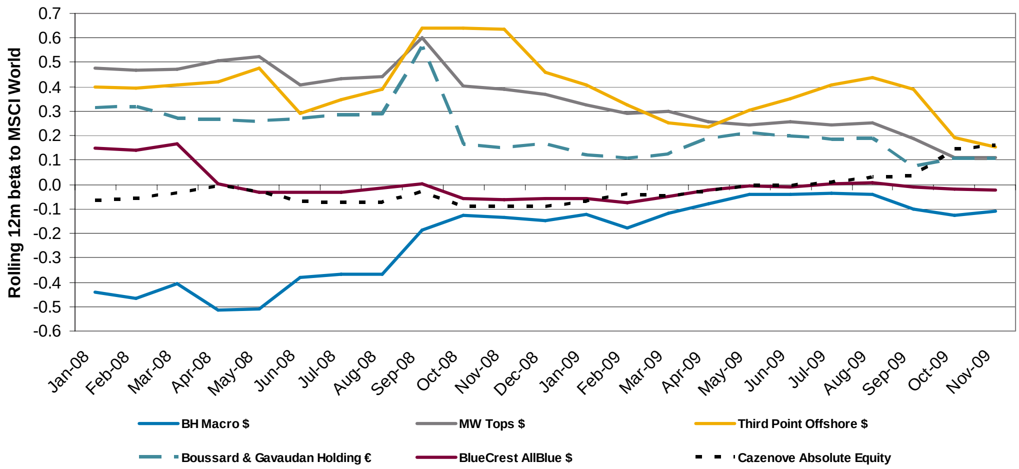
Fig 7 Rolling 12 month betas to MSCI World



Source: Cazenove

At the single manager level, betas have always been much more diverse. Notably, the betas of **BH Macro**, **Cazenove Absolute**, and **BlueCrest** (all funds where performance did not disappoint in 2008) have remained zero or negative. The betas of more equity–centric funds such as **Third Point** and **MW Tops** did increase in late 2008, but these have also reduced significantly since.

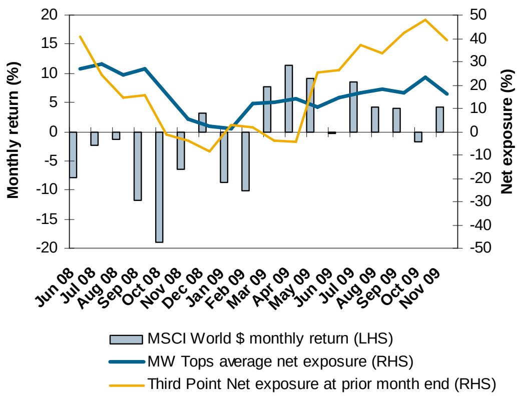
Fig 8 Rolling 12 month betas to MSCI World



Source: Cazenove

The reduction in FOHFs', and some single manager funds', beta, which began post Lehman in late 2008, reflects the change in equity market exposure of underlying hedge funds. As such, hedge funds performed better in Q1 2009 despite further equity market falls. Some funds increased equity exposure as markets turned, whilst others waited until the recovery had gathered some momentum. Greater equity exposure enabled hedge funds to capture returns from the recovering markets.

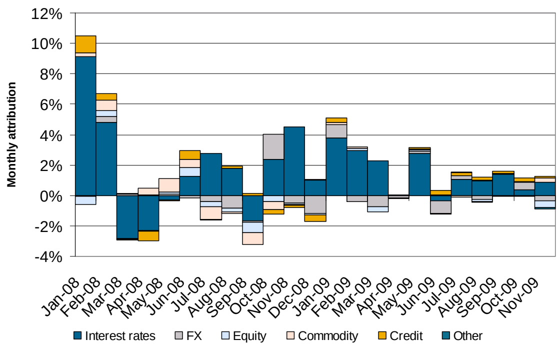
Fig 9 Equity market exposure against market returns (MW Tops and Third Point)



Source: Cazenove/companies

However, for many hedge funds, equity market strategies may be only a minority or a small source of their returns. In addition, many funds have the flexibility to move to other part of the capital structure or deploy different strategies as market conditions dictate. This is evident from the performance attribution of the listed single manager funds. **BH Macro** (figure 10) does have a small equity trading strategy, but its impressive returns have largely come from fixed interest and FX strategies. Furthermore, some hedge funds may predominately trade in equities but be almost completely market neutral and not be trying to time market exposure. This strategy should be much less correlated to equities, as it has proved at **Cazenove Absolute Equity**.

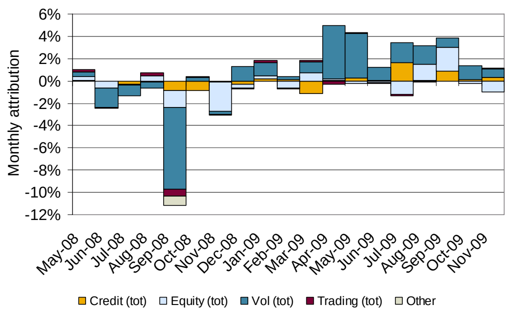
Fig 10 Brevan Howard Master Fund performance attribution

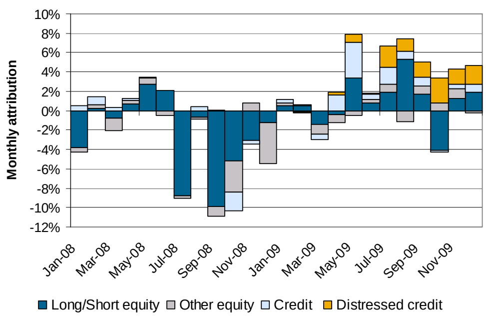


Source: Cazenove/Brevan Howard

Of more interest is perhaps those funds that operate strategies with more active engagement with equity markets. **Boussard & Gavaudan** suffered from its equity market exposure in late 2008, but this has contributed positively in more recent months (figure 11). More important, however, has been its volatility strategies, i.e. convertible bond arbitrage. **Third Point**, meanwhile, had become almost exclusively equity focused by 2008 and long/short positions, as well as private equity positions, hurt performance badly. However, the fund has now returned to its credit – especially distressed – roots and this is now a more important driver of performance (figure 12).

Fig 11 Boussard & Gavaudan attribution (to end Nov) **Fig 12** Third Point attribution (to end Dec)





Source: Cazenove/companies

Forgive or Forget: The degree that hedge funds are correlated to equity markets and their betas have always been an area of concern for investors in hedge funds. Q4 2008 saw many assets correlate with each other, combined with (or perhaps caused by) a break–down of normal investor behaviour due to a liquidity shock. In our view, this was something of a tail event – something that must always be considered, but cannot necessarily be fully insured against. Moreover, different hedge funds offer different investment propositions, with returns coming from different asset classes and different strategies. **Forgive**.

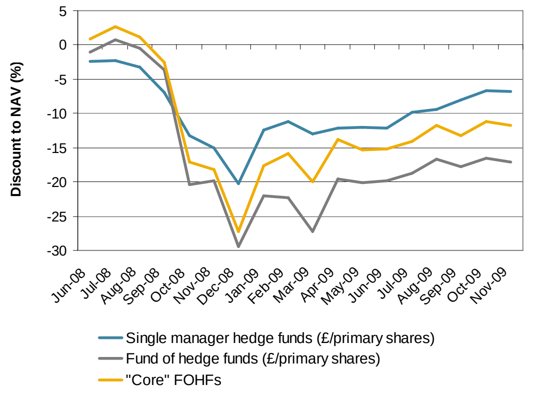
Discounts

The major factor that differentiates the listed hedge fund sector from the open–ended world is that the companies can trade at a discount to their NAVs. Whilst we have previously discussed the drivers of discounts during the crisis (broadly consisting of: NAV uncertainty; transparency; gearing/FX hedging; liquidity; and performance expectations), ultimately discounts reflect the demand and supply of shares in a closed–end investment company.

Discounts did widen in late 2008 as investors rushed for liquidity and exited risky assets. The liquidity crisis, which prompted all asset classes to correlate together downwards, similarly impacted listed hedge funds. The graph below shows the average sector discount. We include a sub category of FOHFs which we believe currently have (or retained) the characteristics of a core multi–strategy multi–manager proposition, without FX exposure. This peer group consists of

Absolute Return Trust, **Alternative Investment Strategies**, **Dexion Absolute**, **HSBC Global Absolute**, **Dexion Trading**, **BlackRock Absolute Return** and **Thames River Hedge+**.

Fig 13 Average sector discounts



Source: Cazenove/Datastream. To end November.

Through a volatile discount, the listed structure does bring additional volatility to returns. However, this volatility has increased markedly since the start of 2008, more than the increase in NAV volatility. Since the start of 2008, the volatility of monthly changes in share prices is almost 26% for all FOHFs and 27% for our smaller 'core' peer group. This compares with just 7.8% (5.5% for 'core') in the two preceding years. Moreover the relationship of the movement in monthly price changes to equity markets has also changed. Whereas, during 2006–2007, the price beta was significantly less than the NAV beta, this has reversed. The share price beta to the MSCI World for fund of hedge funds has moved from 0.24 to 0.46. As a result, the listed structure captures more unwelcome equity beta than the underlying funds and the NAV.

Fig 14 Price and NAV volatilities, with respective coefficients of determination to equities

	2008–2009	2006–2007	2006–2009
All FOHFs			
NAV volatility of unweighted average monthly returns	9.22	4.57	7.61
Price volatility of unweighted average monthly returns	26.24	7.78	19.37
NAV beta to MSCI World	0.25	0.41	0.28
Price beta to MSCI World	0.46	0.24	0.47
Core FOHFs			
NAV volatility of unweighted average monthly returns	8.77	4.16	7.02
Price volatility of unweighted average monthly returns	27.16	5.54	19.39
NAV beta to MSCI World	0.24	0.33	0.26
Price beta to MSCI World	0.38	0.19	0.38
Single Manager Funds			
NAV volatility of unweighted average monthly returns	10.31	7.54	9.27
Price volatility of unweighted average monthly returns	18.40	10.55	15.00
NAV beta to MSCI World	0.30	0.71	0.35
Price beta to MSCI World	0.45	0.71	0.49

Source: Cazenove/Datastream. To end November 2009.

This change in relationship is reflected in the correlation between the change in discounts in any given month and the change in equity markets. During 2006–2007, there was in fact negative correlation between equity market performance and the movement in the discount level. This implies that the discount narrowed/premiums grew during periods of equity market weakness. In other words, the sector was seen as a safe refuge. However, during 2008 to 2009 the relationship was positive, reflecting that discounts widened as equity markets struggled (i.e. they were viewed as risky assets) and have narrowed as equity markets (and risk appetite) recovered.

Fig 15 Correlations of discount level and change to change in equity markets

Discount change correlation to MSCI World	2008–2009	2006–2007	2006–2009
All FOHFs	0.34	–0.30	0.30
Core FOHFs	0.25	–0.30	0.23
Single Manager Funds	0.28	0.06	0.23

Source: Cazenove/Datastream. Note: All FOHF excludes Altin due to data availability

Forgive or Forget: Without effective DCMs and with more volatile NAVs, prices have become more volatile. Moreover, the relationship between discounts and equity markets appears to have reversed, to the detriment of investors. In the near–term, discount volatility and correlation to equity markets is likely to detract from the sector. Whether the relationship returns to its historical characteristics (when discount movements were inversely correlated to equity market movements) depends on the characteristics of hedge fund performance going forward (i.e. the correlation to equity markets), listed sector companies' approaches to discount control, and the rationalisation of the sector. However, investors may need to accept that some hedge fund performance does come from equity market beta, but that the management of this generates attractive long–term risk adjusted returns. Each hedge fund strategy is, however, different. Some investors may choose to **Forget** given the recent experience, but others may **Forgive** given offsetting benefits and a hope that the correlations (especially for those funds with no equity market exposure or beta) may trend towards the historically more attractive relationship.

Structural issues

The listed hedge fund sector grew on the basis of two core attributes: fully–hedged FX exposure and strong discount control. In many cases, both attributes have gone missing over the last 15 months. In a challenging environment and deteriorating performance, transparency also became an important issue. A fourth area of contention, and something of a long–term bug bear of investors in the area, is fees.

FX hedging

Several listed FOHFs suspended or removed their FX hedges at the end of 2008/early 2009, although not before – in most circumstances – they had used gearing to try to maintain the hedge. Even those that maintained their FX hedges became unintentionally geared (up to 30% of NAV in many cases). FOHFs were inhibited from de–gearing due to redemption restrictions on the underlying funds. Unfortunately, the unintentional gearing coincided with a dramatic deterioration in hedge fund performance. As a result NAV falls were larger than would have otherwise been the case. In many ways, this was something of a 'perfect storm' but it highlighted the need to manage the liquidity profile of FOHF portfolios and – where possible – invest in matching currency classes of the underlying funds.

However, all the single managers (as would have been hoped given relatively liquid strategies) and a majority of FOHF did in fact maintain their FX hedges. Those that did not included **Dexion Absolute**, **Dexion Alpha/Commodities**, **Dexion Equity Alternative**, **Castle Asia Alternative**, **GS Dynamic**and **Thames River Hedge+**.

Discount control mechanisms (DCMs)

DCMs – hitherto a hallmark of the sector – have largely failed to keep discounts within previously expected parameters.

A majority – though not all – of the companies have (or had) discount control mechanisms. The most common form of the DCM triggered a continuation vote if the discount was wider than 5% for a period of 12 months. Almost all of these have now been triggered and there have been plenty of continuation votes this year. Several share classes failed but most of the larger GBP share classes passed, partly on concerns over the length of the time required to realise investments and the shares being delisted. Companies have also undertaken tenders, under various structures, and bought back shares in scale.

In our opinion, the majority of companies (and their respective boards) have generally taken an active approach to addressing the discount and continue to consider, and implement, various strategies designed to narrow the discount. However, the speed at which they acted, the detail of the proposals, and the implementation of the proposals varied. In some cases, we would be critical of some of the companies. Our general criticisms would include:

- potentially prejudicing continuation votes through tenders and buybacks (thus worsening the liquidity profile) executed before the vote takes place;
- announcing tenders or restructurings with a record date that had already passed leading to some investors having traded on false information and, in some cases, creating uncertainty over the economic exposure of the instrument being traded;
- settling large tenders on some share classes by impacting the liquidity profile for ongoing investors of all share classes;
- offering investors an exit at a discount to NAV, with the discount payable to the manager rather than accruing to ongoing shareholders;
- not communicating in a timely manner – or at all – to the market about whether boards would use their discretion to offer semi–annual tenders;
- not offering tenders – or opportunities to receive a distribution of prior performance – despite there being no apparent liquidity concerns.

Transparency
In the good times, concerns over the transparency of FOHF portfolios in terms of constituents, liquidity terms and NAV calculation methodologies were low down the list of priorities for investors. However, all of these concerns, and others, came to the fore in the dark days at the end of 2008.

Many FOHFs had previously claimed that disclosing their top underlying funds would endanger their competitive advantage to access funds and could lead to their allocations being copied. In our opinion, these arguments had always been weak and the best funds had always provided greater transparency. **GS Dynamic Opportunities** and **CMA Global Hedge**, for example, disclosed their entire portfolios every month. However, several funds had long resisted calls for greater transparency.

Several funds did respond to the call for greater transparency. Notably **Signet Global** and **FRM Diversified** published top 10 holdings for the first time and several others provided greater detail on the constituents and strategies of their portfolios. However it took until October 2009 for **FRM Credit Alpha** to finally disclose its top positions (after a run of poor performance). **BlackRock Absolute Return Strategies**, however, remains defiant. The panic surrounding the Madoff fraud, and several other subsequent hedge fund failures, highlights the need for transparency on constituents, as well as enabling investors to do their own due diligence.

Meanwhile, details on liquidity terms had previously never been subject to much disclosure. Only **GS Dynamic Opportunities** and **Thames River Hedge+** had previously disclosed any useful information in their accounts. As the problems with FX hedging became apparent and investors sought to assess the timetable of cash flows in a wind–down, it became a much more important issue. Some funds were quicker than others to announce liquidity profiles, though not until early 2009. Many were announced as part of continuation vote proposal documents. Those that took longer to disclose liquidity profiles generally had high exposure to illiquid funds (e.g. **Altin**, **AcenciA**, **CMA Global**, **Saltus European**). The most open companies provided full details on liquidity (notice period, redemption frequency, lock–ups/liquidity restrictions) rather than simply aggregated portfolio statistics. We believe that accurate information on underlying liquidity remains important because liquidity profiles dictate the ability of FOHF managers to change allocations, affects expectations about the ability of FOHFs to implement discount control actions (such as tenders or buybacks), and illiquid positions may have uncertainty surrounding their realisable value.

Fees
Fees have long been a source of contention as the fee burden is significant. As our analysis in the last *Dispatch* demonstrated, when performance fees are payable the pre–fee return at the underlying hedge funds would need to be 11.3% before investors enjoyed a return greater than the combined fees earned by the managers of the underlying funds and the FOHF.

The collapse in NAVs has meant that many investors are benefiting from a performance fee holiday. As a result, to a certain extent the pressure to reduce fees seems to have receded a little. Nevertheless, despite some pressure to reduce fees, there has been little change across the industry. Ultimately, investors will have to judge whether the fees are worth the potential benefits or seek out alternatives. Alternatives could include investing directly in single manager hedge funds (to avoid FOHF fees, although the investor would have to bear additional due diligence costs), investing in passive tracker products (to avoid FOHF fees) or using hedge fund replicator products (to avoid both set of fees).

In our opinion, the best funds will continue to be able to justify their fees, whilst those that have disappointed investors are probably more likely to wind–down then continue with lower fees, given the signalling affect that this would have on their business.

In the listed sector, the two funds that have reduced fees have done so during periods of uncertainty over their long–term futures. However, as we discuss in the following section, we believe that where any listed FOHF has derived a significant amount of their performance in 2009 from buybacks, reverse auction tenders and, in some cases, FX exposure, the managers should consider a performance fee holiday until the underlying portfolio value has recovered its losses, rather than when the NAV has recovered.

Forgive or Forget: In our opinion, some listed FOHFs have been found wanting on several of these important areas. Many are now scrambling to make amends, but it may yet prove futile. As such some of these funds, like several already leaving the sector, may be **forgotten**. However, some funds are likely to be more easily **forgiven** if they offer other attractive characteristics (such as secondary market liquidity below). The best funds will emerge with credit for improving transparency quickly and this will provide a more attractive proposition going forward.

Frauds and blow–ups

Exposure to a blow–up or a fraud is very damaging to a FOHF managers' reputation, though the memory does fade over time and investors appear willing to forgive the occasional modest slip–up. Indeed, **Thames River Hedge+** (MotherRock c1.5% NAV in 2006) and **Tapestry** (Amaranth in 2006) recovered their ratings relatively quickly.

The most significant event more recently, of course, was Madoff. The only casualty in the companies we include in this sector (i.e. excluding **Bramdean Alternatives**) was **AcenciA Debt Strategies**, which lost c1.6% of NAV. This was quite a small allocation, as a consequence of the strategy being non–core. Several funds were also affected by the collapse of Lehman Brothers (**Boussard & Gavaudan** most directly), but this was clearly more related to counterparty risks at the underlying fund level and FOHF managers would have struggled to avoid this collapse. More recently **Castle Alternative Invest** disclosed exposure to Galleon Technology, where the principle and founder has been charged with insider trading. These funds are reported to be liquidating and the impact on the NAV is expected to be limited.

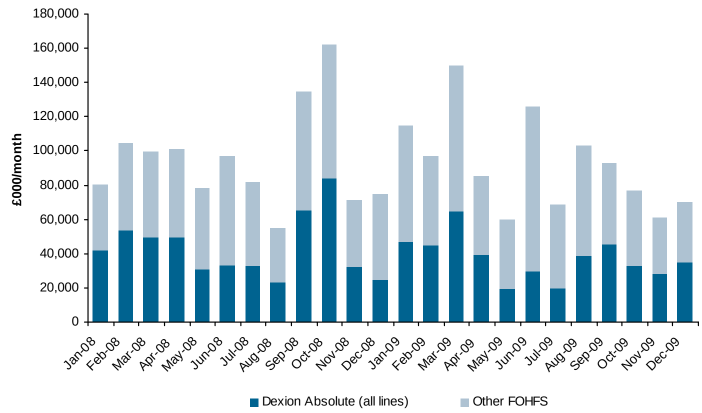
Forgive or Forget: Exposure to a blow–up, especially fraud, lingers long in the memory, though funds can recover. Combined with poor performance in 2008, **AcenciA Debt Strategies**'s Madoff exposure has been damaging and the jury is probably still out whether to **forgive** or **forget** come the wind–up vote in 2011.

Secondary market

One of the main factors that discourage investors in hedge funds from considering investing in listed hedge funds is the perceived illiquidity in the secondary market. For open–ended funds not under liquidity restrictions, investors have the surety of whatever contractual liquidity terms exist. In contrast, in the secondary market for listed hedge funds, trade is dependent on demand and supply on both sides and/or market making resource. As such daily liquidity may be more theoretical than a reality. And that's before you consider the discount (see above). At some price, however, there should be a level at which you can exit.

Secondary market liquidity was tested at the end of last year when several investors ran for the exit. Monthly liquidity did indeed reduce significantly in November and December 2008 after a spike in turnover in the previous two months. However, **Dexion Absolute** accounts for up to 50% of the monthly turnover, with the rest of the liquidity dispersed across the other 21 or so companies. Turnover over this year has been continued to be patchy, although tenders have provided an alternative source of liquidity.

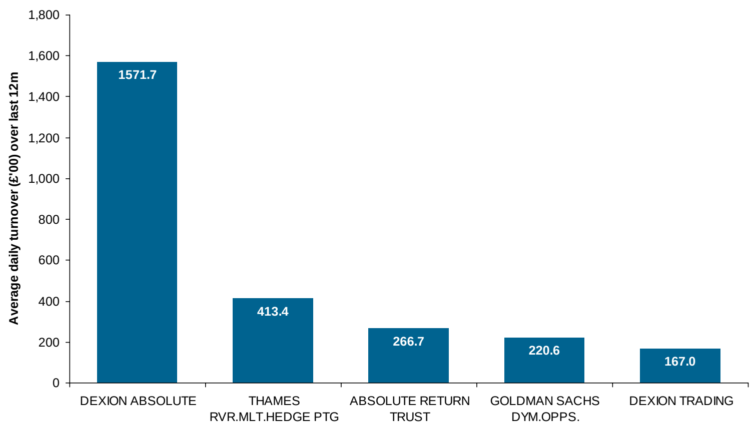
Fig 16 Monthly turnover of fund of hedge funds



Source: Cazenove/companies

The most liquid share in the FOHF universe is **Dexion Absolute** GBP, which over the last 12 months has an average daily turnover of £1.57m, whilst the next most liquid share, **Thames River Hedge+** GBP, has average daily turnover of £413k. **Absolute Return Trust** GBP and **GS Dynamic** GBP are the only other share classes to have averaged more than £200k per day.

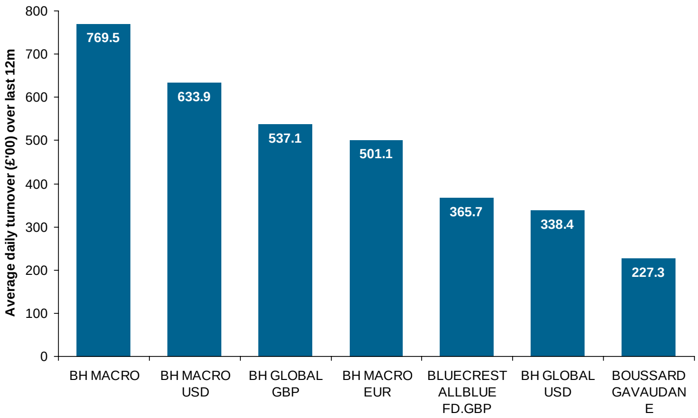
Fig 17 Average daily turnover over last 12 months (to 5 Jan 2010) for FOHFs



Source: Cazenove/companies

Within the single manager universe, **BH Macro** (all lines) dominates liquidity, with only **BH Global** (GBP and USD), **Bluecrest AllBlue** GBP and **Boussard & Gavaudan** EUR averaging over £200k per day over the last 12 months.

Fig 18 Average daily turnover over 12 months for single manager funds



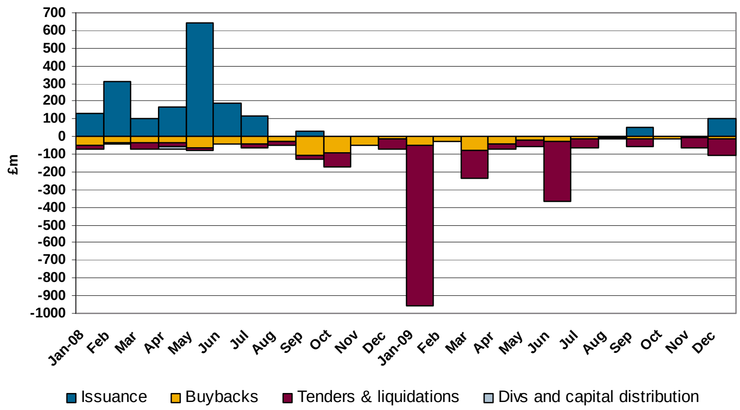
Source: Cazenove/companies. To 5 January 2010.

Forgive or Forget: Whilst the sector was expanding, primary issuance ensured that demand for shares could be met. To a certain extent tenders, buy backs and wind–ups have helped provide an exit route for some shareholders. However, active secondary market trading remains challenging for all but a few of the largest companies. As a consequence, perhaps, the transgressions of **Dexion Absolute** appear to have been completely **forgiven** for the nectar of liquidity. The sector may need to concentrate further with the survivors needing to get a lot bigger to withstand the growing threat of UCITS III vehicles. Those companies which are small and very illiquid are likely to struggle to justify their survival. Illiquidity may ultimately prove for many funds to be the hole below the waterline that means they will soon be **forgotten**.

Forgiving or forgetting?

In September, **BlackRock Hedge Selector** became the first IPO in the sector since **FRM Diversified Alpha** in June 2008. The single manager fund offers investors exposure to a fund that is otherwise closed and inaccessible. This closed–end structure is therefore more appropriate than a UCITS III structure. This has been followed by a successful £101m C share fundraising by BlueCrest AllBlue. These fundraisings may signal that the market has turned to a generally more **forgiving** mood.

Fig 19 Monthly net asset flows



Source: Cazenove/companies

But the two key attributes for the listed sector – capital gains tax treatment/benefit and the investment/structure flexibility – remain under grey clouds given the UK Government fiscal position, the growth of UCITS vehicles and the EU AIFM directive. Furthermore, as we identified and discussed above, there are many company–specific factors which are likely to be make several companies' long–term survival uncertain. Many funds will be **forgotten**.

However, for some – such as **BH Macro**, **BH Global** and **BlueCrest AllBlue** – this all looks to have been a storm in a tea–cup. Exposure to closed (or effectively closed) underlying funds with impressive performance should lead to **BH Macro** and **BH Global** joining **BlueCrest AllBlue** – which has just raised new equity – on premium ratings in the not too distant future.

We concluded our commentary in our Dispatch at the end of 2008 with the following: “The sector will undoubtedly shrink significantly in 2009. “Permanent Capital” will therefore prove transitory for many funds. We believe that the sector is likely to consolidate around the best performing funds with a core offering.” We believe this conclusion continues to hold true. The best funds and those offering something unique still have the scope to grow, but possibly at the expense of other funds leaving the sector.

Corporate activity analysis

Despite discounts narrowing and many tenders/wind–ups having been completed, there remain opportunities for investors in upcoming reverse auction tenders and wind–downs. We analyse these opportunities, drawing on recent experience.

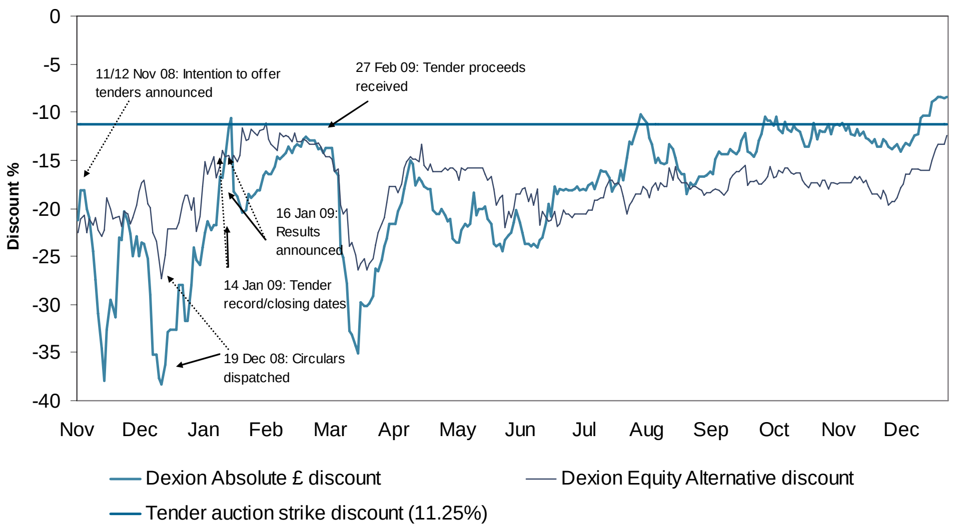
Reverse auction tenders

Dexion Absolute and **AcenciA Debt Strategies** will both conduct reverse auction tenders early this year, based on their respective 31 December 2009 NAVs. There were already four reverse auctions last year, which we analyse to identify any potential insight for the upcoming two tenders.

Dexion Absolute and Dexion Equity Alternative
Dexion Absolute and Dexion Equity Alternative were the first companies to offer reverse auction tenders. The intention to do so was announced in early November 2008, with circulars released in mid–December 2008, at the height of panic in the sector. The offers closed on 14 January 2009, with results released two days later. The strike discount was substantially narrower than in the preceding weeks. Indeed, on 19 December 2008 (the day the circular was released), Dexion Absolute GBP closed on a 38% discount, yet a month later the auction process resulted in a 11.25% strike discount (the same strike discount as for the reverse auction tender of Dexion Equity Alternative).

Despite discounts on both companies narrowing close to the strike discount in the immediate period following the auction, they subsequently widened back out to levels prior to the tender circulars being dispatched. Discounts have recovered since, in–line with the sector, but have not exceeded the tender strike level for more than a brief period, until very recently.

Fig 20 Dexion Absolute and Dexion Equity tender timetable and discount



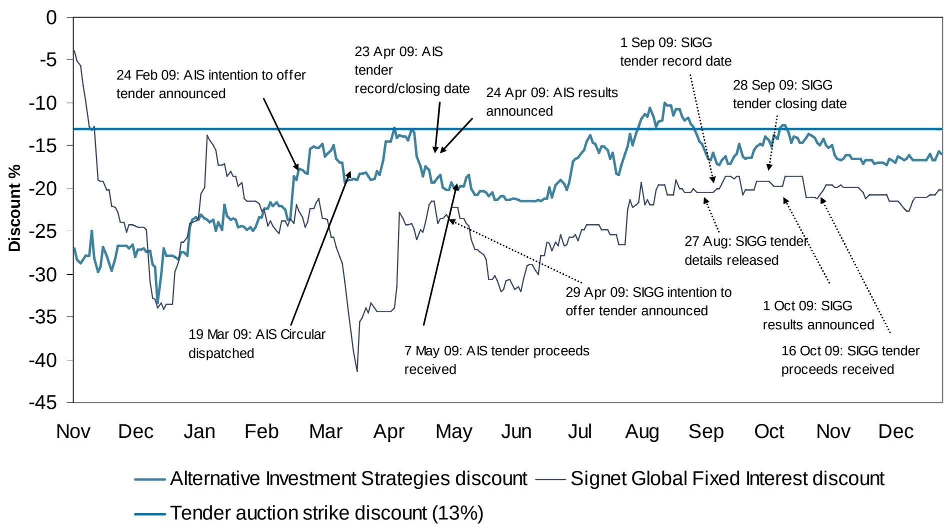
Source: Cazenove/Datastream

Alternative Investment Strategies and Signet Global Fixed Interest
AIS and Signet offered investors the opportunity to participate in a reverse auction tender in April 2009 and September 2009 respectively. Both auctions resulted in a strike discount of 13%.

In the case of AIS, the discount narrowed in the period between the tender being announced and the tender record date, with the strike discount (13%) being effectively at the closing discount on the tender record date (13% on the 22 April and 13.5% on 23 April). The following day, the discount again widened out and has only been narrower for a few days since.

Signet is comparatively less liquid in the secondary market than the other funds that have undertaken reverse auction tenders and this may have impacted the strike discount. The discount did narrow slightly in anticipation of the tender, but the strike discount (13%) was significantly narrower than that seen in the market (the discount was 20% on the tender record date of 1 September 2009). The discount has remained stubbornly at around 20% ever since.

Fig 21 Alternative Investment Strategies and Signet Global Fixed Interest tender timetable and discount



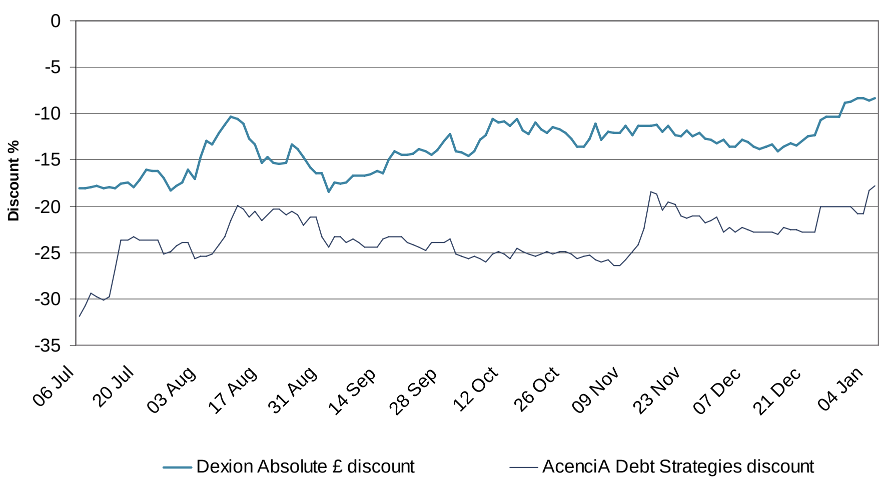
Source: Cazenove/Datastream

Conclusions

Market conditions were different for each of the reverse auction tenders completed so far, so accurate read across to the forthcoming tenders is difficult.

However, it has generally been the case that the tender strike discount has been narrower than the discount has been at any point in the period between the announcement of a tender and the record date. It has also the case that the strike discount has proved to be narrower than the discount in the immediate period after the tender and for a prolonged period subsequently. Over the last 6 months, the narrowest discount for **Dexion Absolute** is the current 8.4%. The narrowest discount for **AcenciA Debt Strategies** is also the current 16.7%. Both of these have rallied since the new year. Both are likely to have a minimum discount of 5%, so there seems limited opportunity for investors to exit Dexion Absolute at a substantially narrower discount level. Investors in AcenciA may, however, still be hopeful of an exit at meaningfully tighter discount through the tender. However, given historical precedents it may be in all investors' interests to tender (and buy back after the tender if the discount subsequently widens).

Fig 22 Dexion Absolute and AcenciA Debt Strategies discount over last 6 months



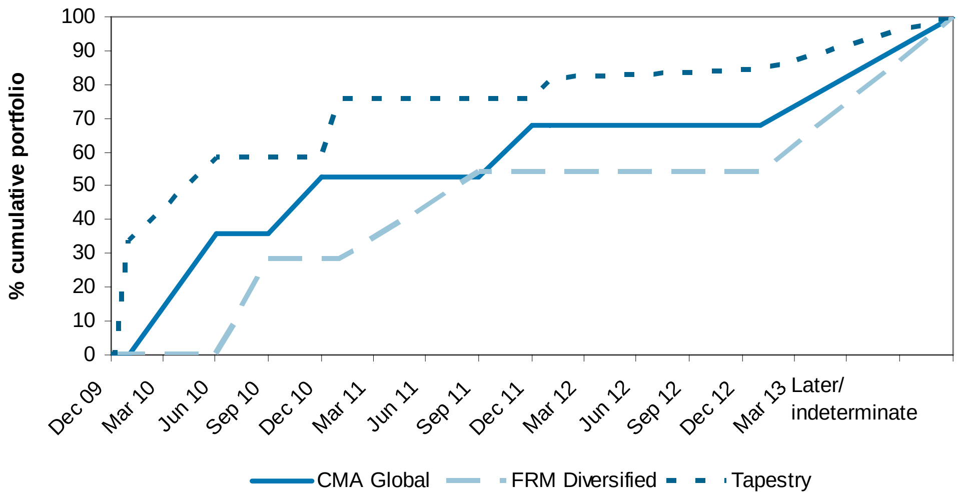
Source: Cazenove/Datastream

A more reliable conclusion is that the assertion (widely promulgated when the tenders were first announced) that reverse auction tenders would remove all willing sellers below the strike discount, leading to a sustained narrowing of the discount at, or tighter than, the strike discount has been found to be almost wholly wrong. In our opinion, this is largely due to the one–off nature of the tenders (making the assertion only true at one point in time). In any event, there is no silver bullet for the discount issue.

Funds in wind–down

Three FOHFs are now in wind–down mode, with all having already made partial returns of capital. **Tapestry** redeemed 39% of its shares in November 2009, **FRM Diversified Alpha** has already redeemed 65% of its shares and **CMA Global Hedge**, distributed c.70% of NAV in late December 2009. FRM has announced an updated liquidity profile, while we estimate pro forma profiles for Tapestry and CMA from previously announced profiles.

Fig 23 Liquidity profiles for companies in wind–down



Source: Cazenove/Datastream

To analyse the potential returns, we assume that cash is returned two months after the end of the stated liquidity period (so 31 March 2010 if liquidity is described as 6 months to 31 January 2010), that there are wind–up costs of 1% and we value assets classified as "uncertain or restricted" liquidity at a 25% discount, assuming 50% realisation in 4 years time and 50% in 6 years time. Using these assumptions and working off current prices, the current IRRs available are varied.

Fig 24 Current discounts and IRRs

	Current discount (%)	IRR (%)
CMA Global EUR	–30.0	14.2
CMA Global USD	–31.6	15.8
CMA Global GBP	–30.1	14.3
FRM Diversified Alpha	–20.8	3.7
Tapestry	–14.6	9.3

Source: Cazenove

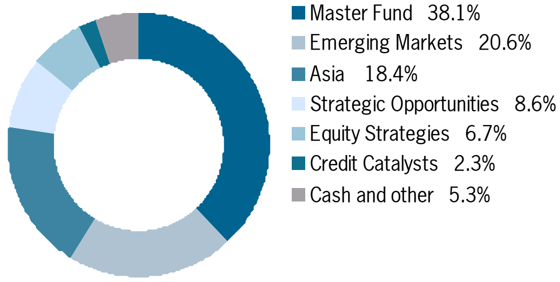
However, the portfolios are slightly different and the current ranking of IRRs does seem to correspond with our broad assessment of the quality of the portfolios. In addition, trading in these "rump" portfolios is characterised by illiquidity. Nevertheless**, FRM Diversified** looks unattractive relative to **Tapestry,** which continues to offer a reasonably attractive return for those with a long time horizon. The return from **CMA Global** look attractive, but a higher required return is needed given the exposure to illiquid MBS strategies where there may be some NAV uncertainty as well as timing uncertainty. However, notwithstanding this the returns look potentially attractive from this level.

Investment newsflow

BH Global – New allocation

On 1 November 2009, BH Global (through the Global Opportunities Master Fund) made a new $23.2m allocation – approximately 2.3% of the portfolio at inception – to the Brevan Howard Credit Catalysts Master Fund (BHCC). The investment is subject to liquidity on a monthly basis with 90 days notice. The fund pays fees of 2% pa and 20% of the increase in NAV over a high water mark.

Fig 25 BH Global pro forma allocation as at 31 October 2009



Legend: segments listed clockwise from top

Source: Cazenove/company

The Credit Catalysts fund is a $458m fund, launched on 1 June 2009, and is managed by DW Investment Management, spun out of Brevan Howard US Asset Management at the time of the fund's launch. The team of 20 is led by David Warren, who built the team at Brevan Howard in January 2008 and has 22 years of experience, predominately at Morgan Stanley and First Boston.

The managers seek to generate high absolute return through trading and investing in financial assets in corporate credit, mortgage–backed securities, and asset–backed securities markets, with relatively near–term catalysts (generally 1 to12 months, with a median of 3 to 6 months). Catalysts could include corporate earnings, corporate events, prepayments or losses, mortgage cash flows, or technical factors. The trades are normally in relatively highly liquid markets (in context of credit markets) and the managers try to construct trades where downside risk is limited relative to the upside potential. Around 60% (in a range 30–70%) of the fund is trading in corporate credit and 40% (in a range 30–70%) in MBS/ABS.

The fund had a very good start to its life in 2009. Over the six months of inception to 30 November 2009, the USD NAV gained 21.8%. Unlike many deep–value orientated credit funds recently launched, this fund has a trading bias with a focus on fundamental and technical catalysts. As such, with a similar trading focus as the other funds within BH Global it looks like it could be a useful addition to the portfolio. In our view, the shares continue to look attractive on discounts of 9–10%. We highlight our **Outperform** recommendation.

Fig 26 Track record of Brevan Howard Credit Team/BHCC since launch, $ net of fees

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2009	–0.14	0.74	2.64	1.73	3.13	3.01	3.56	4.34	3.73	3.16	2.30		**31.99**
2008				–0.00	0.42	0.81	0.18	0.57	–0.18	0.81	0.48	–0.60	**2.51**

Source: Cazenove/Company. Note: The grey areas represent the track record of the Credit Team (trading a book in the Brevan Howard Master Fund Limited) prior to the launch of BHCC in June 2008.

Other single manager news

MW Tops – Portfolio changes
The company has changed its investments in underlying funds, although this is a structural change as the investment strategy exposure will be unchanged. In addition, there is no effect on the high watermark for the purposes of performance fees, as this is calculated at the company level. The changes were made between 9 December and 14 December.

Fig 27 Old allocations

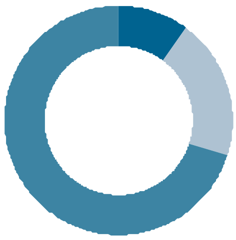
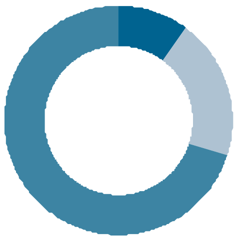


Fig 28 New allocations



Source: RNS

Fund of Hedge Funds

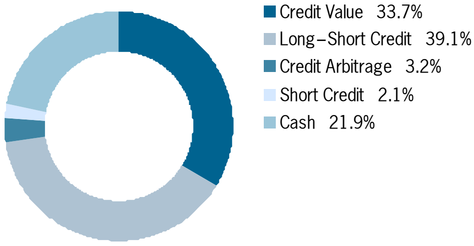
FRM Credit Alpha ended its secrecy regarding its portfolio by disclosing its top 10 holdings and its liquidity profile. In our opinion, it was hard to see what all the fuss had been about. Although the improved transparency is a welcome development, performance was disappointing last year as a result of having to de–gear (involving redeeming from the best performing and most liquid funds) at the end of 2008 and early 2009 to maintain the FX hedge and offer the tender. The liquidity profile of the current portfolio appears reflective of the nature of credit funds, with 19.3% of the portfolio of indeterminate liquidity and a further 25% of the portfolio with liquidity of over 1 year.

Fig 29 Top 10 positions as at 31 October 2009

Position	Strategy	Allocation (%)
JCAM Global	Long–Short Credit	10.7
Plainfield Special Situations	Credit Value	10.5
Trafalgar Recovery	Long–Short Credit	10.5
Cash & receivables	Liquidity	9.3
BlueBay Value Recovery	Credit Value	8.8
JPMorgan Liquidity Fund US Dollar	Liquidity	8.5
Cerberus International	Credit Value	7.7
Green T G2 Fund	Long–Short Credit	7.1
Harbinger Capital Partners Special Situations	Credit Value	5.2
King Street	Long–Short Credit	4.1
Total		**83.2**

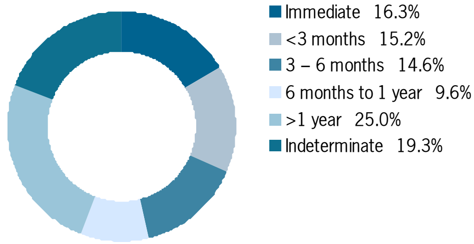
Source: Company

Fig 30 Strategy exposure as at 31 Aug 09



Legend: segments listed clockwise from top

Fig 31 Liquidity profile as at 31 Aug 09



Legend: segments listed clockwise from top

Source: Cazenove/Company

Invesco Perpetual Select Hedge announced that it would change the way it gains exposure to hedge funds. Currently investors receive the return from two funds, the Fauchier Allocator Funds (FAFs). However, these funds are small and periodic flows from share conversions can be difficult to manage. Going forward, therefore, the performance of the hedge fund share class will be referenced to Paragon Capital Appreciation fund ('Paragon'), which has a similar investment objective and targeted return (LIBOR +5%) as the FAFs. The transfer is expected to take place in the first quarter of 2010. There is considerable commonality between the funds, however the redemption procedures for Paragon will require longer notice periods than for the FAFs. This will require an extra month's notice, such that for the April switching opportunity, notice must be received in December rather than January, and for the October opportunity notice must be received in June rather than July.

Castle Alternative Invest announced that 2.7% of its assets where held in Galleon Technology Offshore Fund. Galleon is a long/short equity fund managed by Galleon Group. The founder of whom, Raj Rajaratnam, was among people charged in October by US federal prosecutors on allegations of insider trading. However, the manager expected the impact on the company's net assets to be limited.

Performance

Indices performance

Hedge funds had a relatively strong end to the year, with the HFRI Fund Weighted Composite up 1.6% in November to bring year–to–date returns to 18.6%. The HFRI Fund of Funds Composite was up 0.9% in November to bring year–to–date returns to 10.7%. Macro, which had hitherto had a quiet year, was up 2.3% in November.

Fig 32 2009 monthly returns

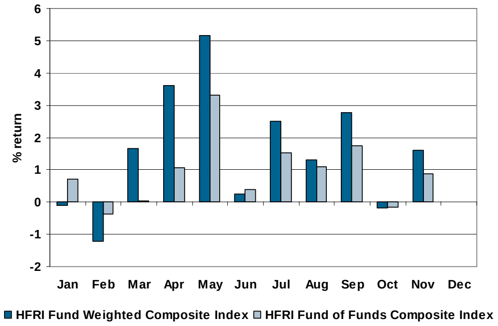
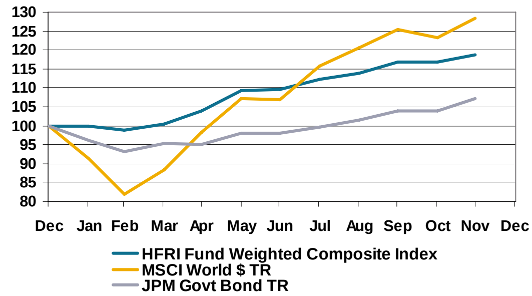


Fig 33 Cumulative returns vs equities and bonds



Source: Cazenove/HFR/Datastream

Fig 34 Strategy performance

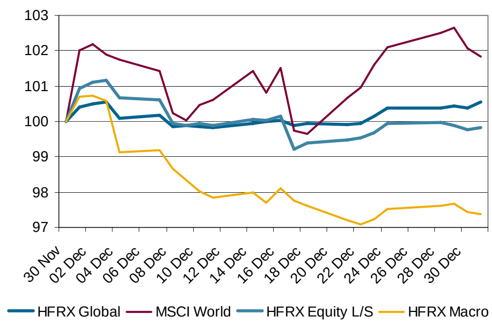
HFRI Indices	Sept 2009 return	Oct 2009 return	Nov 2009 return	2009 YTD
Equity Hedge	3.21	–0.68	1.66	22.19
Equity Market Neutral	0.34	–0.05	–0.10	1.21
Short Bias	–5.32	3.79	–2.26	–20.12
Event–Driven	3.73	0.61	1.14	22.08
Distressed	4.29	1.55	1.53	25.05
Merger Arbitrage	1.16	0.38	0.54	10.37
Macro	1.69	–0.50	2.26	5.80
Relative Value	2.45	1.25	0.71	23.39
Convertible Arbitrage	4.35	0.68	0.97	55.83
Fund Weighted Composite	2.77	–0.18	1.60	18.58
Fund of Funds Composite	1.74	–0.14	0.88	10.66

Source: HFRI

December 2009 performance

The HFRX Global investible index ended December slightly up (+0.6%), as hedge funds appeared to protect capital heading towards year–end. Equities finished the month up 1.8%.

Fig 35 HRFX Global performance in December 2009



Source: Cazenove/HFR

Listed sector performance

September was a good month for listed funds, with October and November proving more volatile and there was more varied performance. Several single manager hedge funds continued their impressive recoveries following a poor 2008 (**Third Poin**t and **Cayenne** especially), as did some of the fund of hedge funds (**AcenciA** and **BlackRock Absolute Return**).

Fig 36 September to November and YTD performance (adjusted if unintentional FX exposures and large tenders)

	Sept NAV Return %	Oct NAV Return %	Nov NAV Return %	YTD NAV Return %	YTD Price total return %
Third Point Offshore $	5.73	–1.26	4.46	33.87	96.22
Cayenne	3.48	0.10	–0.48	32.60	35.52
Boussard & Gavaudan Holding €	2.92	1.47	0.30	26.27	61.48
AcenciA Debt Strategies	2.50	1.27	1.26	21.21	59.87
BlueCrest AllBlue $	4.24	1.24	0.84	21.06	53.81
BlackRock Absolute Return $	2.21	1.45	0.74	20.39	52.88
Dexion Absolute $	1.89	–0.17	0.27	18.82^	70.32
BH Macro $	1.55	1.07	0.37	17.62	38.33
Goldman Sachs $	1.91	0.39	1.00	16.18	79.82
Invesco Perpetual Select Hedge	1.38	1.36	0.68	15.14	8.97
Absolute Return Trust	1.79	0.37	0.61	14.59	36.16
BH Global $	1.49	0.54	0.11	14.28	53.34
Signet Global Fixed Inc £	2.85	3.76	1.02	12.96	21.54
MW Tops $	3.35	–0.69	–0.40	12.69	3.47
HSBC Global Absolute $	2.59	0.15	0.94	12.39	40.48
Thames River Hedge+ $	2.02	–1.05	–0.28	12.13	39.58
Altin ($)	1.57	0.52	1.01	11.66	21.41
Dexion Trading	2.21	–0.02	1.45	11.46	27.96
Castle Alternative Invest ($)	2.91	0.26	1.15	11.37	64.66
Tapestry	0.37	0.27	1.92*	9.90*	43.91
Gottex Market Neutral	1.99	1.08	0.20	9.32*	31.94
Dexion Equity Alternative	1.59	–0.15	0.64	7.88^	16.94
FRM Diversified Alpha	3.75*	–2.21*	1.19*	7.19*	27.23
Alternative Investment Strategies	1.45	0.22	1.08	6.60^	24.34
JPMorgan Prog Multi–Strat	1.05	–0.69	0.33	6.07	12.78
Dexion Commodities/Alpha $	0.21	–0.80	1.03	5.81	65.38
RAB Special Situations	4.53	–3.72	3.10	5.73	55.24
Castle Asia Alternative	1.24	0.16	0.08	5.54	10.03
Cazenove Absolute Equity	1.66	–1.64	–1.22	5.35	10.59
FRM Credit Alpha	2.07	0.43	–0.42	4.24	10.31
Terra Catalyst Fund	2.11	4.51	4.73	3.55	72.18
Saltus European Debt Strategies	2.20"	1.30"	–0.49"	3.44"	13.73
CMA Global $	0.48	–0.36	–0.12	2.45	65.17
Aida $	1.47	–0.27	TBA	1.33	–25.16
Value Catalyst Fund	7.11	–1.38	–16.5	–25.44	–37.50
HFRI Fund Weighted Composite	2.77	–0.18	1.60	18.58	18.58
HFRI FOF Composite	1.74	–0.14	0.88	10.66	10.66
MSCI World $ (TR)	4.02	–1.76	4.14	28.45	28.45
JPM Global Govt Bonds	2.26	0.00	3.24	7.26	7.26

Source: RNS/Datastream/Cazenove. * Includes effect of FX. ^ Adjusted for tender. " Adjusted for FX

A few funds – **Third Point** and **Cayenne** again –appear to have added to their 2009 meaningfully in December, whilst many of the funds of hedge funds seemed to be preserving capital as the year–end approached.

Fig 37 Estimated December 2009 NAV and share price performance

	Type	December NAV Return %	Date of last NAV	December 2009 share price total return %
Terra Catalyst Fund	Single manager	15.95	24 Dec 09	5.53
Third Point Offshore $	Single manager	4.88	30 Dec 09	6.80
Cayenne	Single manager	1.77	31 Dec 09	1.80
FRM Diversified Alpha	Diversified FOHF	1.18	11 Dec 09	0.37
Alternative Investment Strategies	Diversified FOHF	1.04	24 Dec 09	0.24
Dexion Absolute $	Diversified FOHF	0.87	24 Dec 09	1.05
Castle Asia Alternative	Strategic FOHF	0.82	11 Dec 09	2.26
Gottex Market Neutral	Strategic FOHF	0.78	25 Dec 09	–1.04
Goldman Sachs $	Diversified FOHF	0.77	31 Dec 09	1.09
Cazenove Absolute Equity	Single manager	0.71	23 Dec 09	0.67
Boussard & Gavaudan Holding €	Single manager	0.68	31 Dec 09	1.23
BlackRock Absolute Return $	Diversified FOHF	0.66	25 Dec 09	–4.58
BH Macro $	Single manager	0.59	31 Dec 09	4.89
Dexion Equity Alternative	Strategic FOHF	0.55	24 Dec 09	6.36
Tapestry	Diversified FOHF	0.52	04 Dec 09	4.09
HSBC Global Absolute $	Diversified FOHF	0.49	18 Dec 09	0.00
Altin ($)	Geared FOHF	0.49	30 Dec 09	–0.98
Castle Alternative Invest ($)	Diversified FOHF	0.44	01 Jan 10	2.49
BlueCrest AllBlue $	Single manager	0.37	31 Dec 09	0.66
Absolute Return Trust	Diversified FOHF	0.36	31 Dec 09	1.90
Thames River Hedge+ $	Diversified FOHF	0.28	31 Dec 09	–0.50
MW Tops $	Single manager	0.20	31 Dec 09	1.13
Invesco Perpetual Select Hedge	Diversified FOHF	0.12	24 Dec 09	0.00
BH Global $	Single manager	0.09	31 Dec 09	1.44
CMA Global $	Geared FOHF	–0.12	11 Dec 09	–15.05
Dexion Trading	Strategic FOHF	–0.39	31 Dec 09	3.70
Dexion Commodities $	Strategic FOHF	–0.53	24 Dec 09	0.66
Value Catalyst Fund	Single manager	–5.26	24 Dec 09	–10.70
RAB Special Situations	Single manager	–6.20	23 Dec 09	0.83
FRM Credit Alpha	Credit FOHF			0.70
Signet Global Fixed Inc £	Fixed income FOHF			0.67
Acencia Debt Strategies	Credit FOHF			0.34
Saltus European Debt Strategies	Credit FOHF			–3.33
Aida $	Geared FOHF			–3.93
MSCI World $ (TR)	Equities	1.83	31 Dec 09	
JPM Global Govt Bonds	Bonds	–4.94	31 Dec 09	
HFRX Global Investible Index	Single manager	0.55	31 Dec 09	

Source: RNS/Datastream/Cazenove

Corporate activity summary

Fundraising

Given the year that the sector endured in 2009, it was perhaps something of surprise to see a return to fundraising at the end of the year. In September, **BlackRock Hedge Selector** listed in a £49m IPO and in December **BlueCrest AllBlue** completed a £101m C share fundraising. This will increase the size of the company's net assets (on conversion) by around 30% to c.£440m. In total £161m was raised in the sector last year.

Continuation votes

Dexion Absolute announced that it expected to trigger its discount control mechanism again at the end of 2009. Continuation votes are expected to be held by mid–February 2010.

BH Macro has triggered its DCM on its EUR and USD lines. The board will propose a class closure resolution (a special resolution requiring not less then 75% of voting rights cast to become effective) at a forthcoming class meeting. An EGM will be convened at the same time in relation to proposed amendments to the discount control mechanism. We envisage that the changes proposed will be similar to those implemented at BH Global (see below).

BH Global successfully passed its continuation vote on 15 October 2009. The results were overwhelming with 99.3% of EUR shares, 96.6% of USD shares and 99.2% of GBP shares voting against the class closure resolution. In addition, shareholders approved changes to the calculation of the discount control mechanism. Going forward, it will be calculated on a calendar year basis (rather than on a rolling 12 month basis). The first calculation period will be in 2010. The change will mean that any proposals will coincide with year–end reporting, saving costs. Should a class closure resolution pass in the future then the board will have the ability to offer investors their choice of an exit, conversion or continuation.

Alternative Investment strategies triggered its DCM for the first time, calculated over the financial year ending 31 October 2009. As a result an ordinary resolution will be proposed at the AGM to be held on 24 February 2010.

We believe that **Cazenove Absolute Equity** has triggered its DCM over its financial year to 31 October 2009. A continuation vote is likely to held at the AGM following publication of the annual results.

Those that have still not triggered include **Absolute Return Trust**. The discount must be wider than 5% at the end of every month in a financial year ending 31 March 2009. As a result, the DCM will be triggered if the discount is wider than 5% at the end of December, January, February and March. However, the current discount, 9.7%, does not need to narrow much to avoid triggering the DCM.

Tenders and wind–downs

Dexion Absolute confirmed details of its intention to undertake a reverse auction tender for up to 10% of the company at the end of the year. The tender will be undertaken in reference to the 31 December NAV with settlement expected in mid/late February 2010.

AcenciA Debt Strategies is also expected to offer a reverse auction tender on a similar timeline, though final details have not yet been released. The tender is expected to be for up to £30m, which would represent 18% of current net assets.

CMA Global Hedge offered investors two options as part of its wind–down proposals. The first was the familiar wind–down option, with distributions made in semi–annual tranches, with no FX hedge. The second, more immediate, option was a cash option, whereby the managers will seek to sell the entire portfolio through a secondary market transaction. The manager indicated that this could be achieved on a 65% discount for the 30% of the portfolio not held in cash: an implied discount of 19.5% to NAV. In the event, around 17% of shareholders (15.7% of USD shares, 18.4% of EUR shares and 18.4% of GBP shares) elected for the cash option. During the period of redemptions, management fees will be reduced to 0.25% of NAV (from 1% of NAV) and no performance fee will be payable. The first cash distribution was made on 23 December 2009 for c.73.5% of NAV/shares. In our opinion, the fund has had several problem investments and some of the funds have exposures to legacy MBS and credit positions, which may create some uncertainty over realisable value as well as the timing of cash flows for those with no known liquidity profile.

Thames River Hedge+ announced the results of its year–end redemption offer (for up to 10% of shares). The tender was oversubscribed, with around 30% of shares (in aggregate) tendered. The NAV will be that at 31 December 2009 and redemption proceeds will be paid in February 2010. **Thames River Hedge+** had earlier announced that following advice regarding the revised offshore fund regime, which came into force at the start of December 2009, it would no longer be able to offer the redemption facility to shareholders of the Realisation class. Following discussions with shareholders, the company announced that Realisation shares would be converted into ordinary GBP shares. Accordingly based on the 13 November 2009 NAV, 5.75m Realisation shares converted into 3.6m GBP shares.

The reverse auction tender discount at **Signet Global Fixed Income** (**In–line**) was 13%, significantly narrower than where the shares had been trading in advance of the tender. Those who tendered at the strike discount will have 88% of their shares repurchased. In aggregate, 19,713,134 shares were repurchased under the tender – 16.4% of the company – for a total consideration of £15m.

Aida completed its restructuring. Existing shareholders were given the opportunity to convert into an open ended fund. In the event 52.3% of GBP shares, 74.0% of EUR shares and 85.7% of USD shares (around 70% overall) elected to convert. After GBP and EUR shares were converted into USD shares, the USD shares were split into shares in Aida Closed Fund and into unlisted side pocket shares (which represented about 18% of the previous NAV). As a result, the listed company now has net assets of approximately £9.8m. Investors in the new open ended fund will have their first opportunity to redeem at the end March 2010. It remains to be seen whether the combined funds can retain critical mass to have a long–term future but new investors (in either the open–ended fund or listed fund) will get exposure to liquid investments but not the legacy positions (which are now held in a side pocket).

JP Morgan Progressive Multi–Strategy announced that it would wind–up. The company was listed on AIM in May 2007 with initial assets of £25m, but had shrunk in size as a result of redemptions and a decline in NAV to under £12m. The company was accordingly de–listed on 11 December and a first distribution is expected to be made on or around 19 February 2010.

GS Dynamic Opportunities announced that it had paid in mid November approximately 75% of the amount due (based on 30 September 2009 NAV) to redeeming shareholders from the redemption offer that closed in June. The board expects the balance of redemption monies to be made in the second quarter of 2010 based on the 31 March 2010 NAV. This was broadly in line with expectations.

Dexion Commodities released a liquidity timetable for the redemption pool. 83.2% was expected to be realised by the end of October 2009, 87.5% by end of January 2010, 95.7% by 31 July 2010, 96.9% by the end of 2010. A 3.1% position remains in a fund in liquidation where the realisation timetable is uncertain. The first payment was expected to have been made in early November 2009.

Tapestry made the first compulsory redemption of shares as part of the company's managed wind–down. 39% of shares were redeemed in November 2009, broadly in–line with the timetable indicated in the wind–down circular.

FRM Diversified Alpha released an updated portfolio (see below) and liquidity profile following the first compulsory redemption on 15 September 2009 (when 64.6% of shares were redeemed). The shares have been unhedged since 28 August 2009. Cash and receivables are held in both dollar and sterling, whilst all the remaining invested assets are dollar denominated. Subject to there being no deterioration in the projected liquidity profile, the board is hopeful of making a further distribution no later than 30 September 2010.

Fig 38 Expected realisation timetable of remaining assets

	September 2010	September 2011	Later/indeterminate
Incremental realised	28%	26%	46%
Cumulative realised	28%	54%	100%

Source: RNS

Fig 39 Holdings as at 31 October 2009

Holding	Position size (%)
Cash, Receivables and Small Positions	14
Kensington Global Strategies Fund	14
DE Shaw Composite	13
QVT	10
CQS Convertible & Quantitative Strategies Fund	7
Cerberus	7
Spinnaker Global Opportunity Fund	6
The Children's Investment Fund	5
Spinnaker Global Strategic Fund	5
North Run	4
Harbinger Capital Partners Special Situations	4
Plainfield Special Situations	2
Brevan Howard Strategic Opportunities	2
DE Shaw Direct Capital	2
Castlerigg	1
Harbinger Capital Partners	1
Drawbridge Global Macro	1
Ferox	1
Bluebay Value Recovery Fund Limited	1

Source: RNS

Buybacks

Buybacks, having started the year at high levels, reduced to a trickle in the second half of the year. In November, just £5.6m, the lowest since May 2007.

Fig 40 Buybacks (2008 vs 2009)

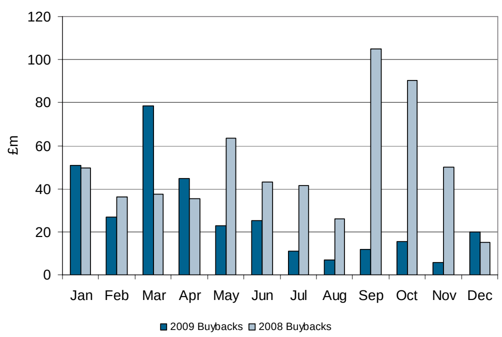
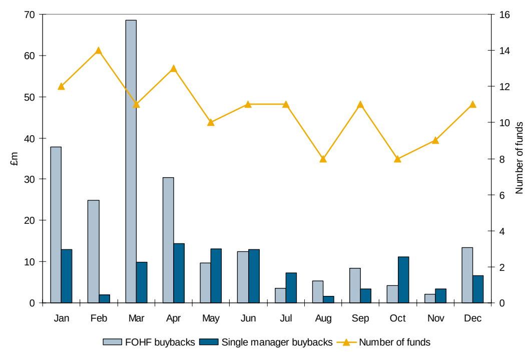


Fig 41 Buybacks by type 2009



Source: Cazenove/Funddata

Fig 42 Buybacks during 2009 (to 31 Dec 2009)

	Nov buybacks £m	Dec buybacks £m	£m bought back 2009	% of 1 Jan 2009 No of shares
Absolute Return Trust GBP	0.87	–	6.18	2.7
AcenciA Debt Strategies	0.62	0.02	0.97	0.7
Alternative Investment Strategies	–	0.13	0.81	0.4
BH Macro EUR	–	–	0.31	0.1
BH Macro USD	–	–	3.75	0.7
BH Global EUR	–	–	4.23	4.9
BH Global GBP	–	0.81	10.35	3.8
BH Global USD	0.94	–	15.75	7.0
BlackRock Absolute Return GBP	–	0.36	2.12	2.8
Boussard & Gavaudan EUR	2.46	5.66	58.32	13.4
Castle Alternative Invest	–	4.38	7.38	2.6
Cayenne	0.04	0.08	0.55	1.7
Dexion Absolute AUD	–	–	0.14	0.5
Dexion Absolute EURO	–	–	13.68	12.7
Dexion Absolute GBP	–	3.63	108.54	13.9
Dexion Absolute USD	–	–	10.70	10.7
Dexion Alpha GBP	–	–	3.24	5.2
Dexion Equity Alternative	–	0.18	8.05	8.2
Dexion Trading	0.37	–	11.85	10.3
HSBC Global Absolute EURO	–	–	0.05	0.7
HSBC Global Absolute GBP	–	–	1.02	7.1
HSBC Global Absolute USD	–	–	1.00	2.7
Invesco Perpetual Select Hedge	0.22	0.10	1.25	6.6
Castle Asia Alternative	0.09	0.84	2.80	5.5
Signet Global Fixed Income GBP	–	–	0.10	0.1
Tapestry	–	–	2.66	4.4
Terra Catalyst	–	–	5.24	10.5
Thames River Hedge+ GBP	–	3.72	34.14	13.8
Thames River Hedge Realisation	–	–	0.53	11.9
Thames River Hedge+ USD	–	–	3.31	16.2
Thames River Hedge+ EURO	–	–	0.21	5.6
Total	**5.62**	**19.91**	**319.23**	

Source: Cazenove/Fundamental Data

Annual performance tables

Figure 43, below, shows NAV performance, for dollar share classes, where available or, where not, sterling shares (euro for Boussard & Gavaudan). Asterisks show periods where the fund had FX exposure for all or part of the period and the effect of FX is included in the returns. Returns include positive attribution from buybacks and reverse auction tenders.

Fig 43 Annual performance (%)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	YTD (end Nov)
Absolute Return Trust £	–	–	–	–	–	6.3[M]	7.5	18.1	–13.0#	14.6#
AcenciA Debt Strategies (£)	–	–	–	–	–	1.4[D]	9.6	6.1	–31.7	21.2
Aida $	–	–1.6[S]	2.9	14.1	18.8	11.1	15.0	8.3	–41.6	1.3
Alternative Inv Strats (£; $ pre–2006)	0.78	1.68	2.36	10.91	10.39	10.12	8.6	6.9	–19.6	8.2
Altin ($)	3.8	–1.5	5.8	9.0	11.7	8.6	20.5	16.3	–29.2	11.7
BlackRock Absolute Return $	–	–	–	–	–	–	–	–	–24.0[Y]	20.4
Castle Alternative Invest ($)	11.0	6.7	6.4	12.6	5.2	4.5	13.9	10.4	–14.6	11.4
Castle Asia Alternative (£)	–	–	–	–	–	3.1[D]	3.0	16.2	–17.3^	5.5
CMA Global $	–	–	–	–	–	–	6.2[G]	13.5	–29.9	2.4
Dexion Absolute $ (£ pre–2006)	–	–	–	12.6	8.1	9.5	8.8	13.0	–23.1	22.2
Dexion Alpha/Commodities $	–	–	–	–	–	–	2.8[A]	12.2	–20.3	5.8
Dexion Equity Alternative (£)	–	–	–	–	6.3[A]	7.1	6.8	10.5	–18.7^	9.7
Dexion Trading (£)	–	–	–	–	0.3[D]	4.7	5.4	12.7	–4.1	11.5
FRM Credit Alpha	–	–	–	–	–	–	–	13.8[A]	–19.5	4.2
FRM Diversified (£)	–	–	–	–	–	–	–	–	–20.8[L]	7.2*
Goldman Sachs $	–	–	–	–	–	–	3.4[G]	13.3	–20.7	16.2
Gottex Mkt Neutral (£)	–	–	–	–	–	–	–	1.6[A]	–20.8*	9.3*
HSBC Global Absolute $	–	–	–	8.1[N]	7.0	7.7	9.6	12.1	–15.9	12.4
Invesco Perp Select Hedge (£)	–	–	–	–	–	–	1.5[D]	24.8	–21.4	15.1
Saltus Euro Debt Strategies (£)	–	–	–	–	–	–	–	–6.3[L]	–35.9	5.8*
Signet Global Fixed Inc £	–	–	–	–	–	–	0.8[D]	8.8	–18.7	13.0
Tapestry (£)	–	–	–	–	–	3.3[M]	5.9	10.8	–24.6	9.9*
Thames River Hedge+ $ (£ pre–2007)	–	–	–	–	6.3[F]	6.8	10.5	25.3	–19.2	12.1
BH Global $	–	–	–	–	–	–	–	–	1.6[J]	14.3
BH Macro $	–	–	–	–	–	–	–	20.3[M]	20.3	17.6
BlueCrest AllBlue $	–	–	–	–	–	–	3.9[J]	9.5	9.2	21.1
Boussard & Gavaudan Holding €	–	–	–	–	–	–	5.2[N]	5.56	–12.3	26.3
Cayenne (£)	–	–	–	–	–	–	1.4[F]	3.3	–25.3	32.6
Cazenove Absolute Equity (£)	–	–	–	–	–	–	1.4[N]	11.2	11.1	5.3
JPMorgan Prog Multi – Strat (£)	–	–	–	–	–	–	2.2[N]	4.0	–22.3	6.1
MW Tops $	–	–	–	–	–	–	0.2[D]	8.3	–17.5	12.7
RAB Special Sits (£)	–	–	–	–	–	30.6[Y]	26.6	0.3	–72.9	5.7
Terra Catalyst (£)	–	–	–	–	–	–	–	–	–41.3[M]	3.5
Third Point Offshore $	–	–	–	–	–	–	–	–0.9[L]	–38.2	33.9
Value Catalyst Fund ($)	2.8[Y]	10.1	–1.0	32.3	16.7	21.3	17.2	13.2	–60.9	–25.4
HFRI Fund Weighted Composite	5.0	4.6	–1.5	19.6	9.0	9.3	12.9	10.0	–19.0	18.7
HFRI Fund of Funds Composite	4.1	2.8	1.0	11.6	6.9	7.5	10.4	10.3	–21.4	10.7
MSCI World	–12.9	–16.5	–19.5	33.8	15.2	10.0	20.7	9.6	–40.3	28.4
JPM Global Bonds	2.3	–0.8	19.4	14.5	10.1	–6.5	5.9	10.8	12.0	7.3

Source: Cazenove.[1] To end July 2009. *Unhedged during all or part of period ^Returns excluding FX effects. # includes cost of FX option. [F] From February [M] From March [A] From April [Y] From May [J] From June [L] From July [G] From August [S] From September [N] From November [D] From December. To October 2009 for Aida.

APPENDIX

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Tom Skinner

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UNDERPERFORM – the total return on the security is expected to underperform the sector* by 5% or more over the next six months.
*the sector comprises those securities covered by the analyst(s) where those securities would be included within the relevant AITC, Datastream or Morningstar sub–sectors.

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IN–LINE – the risk–adjusted total return on the security is not expected to outperform or underperform the sector over the next six months.
UNDERPERFORM – the risk–adjusted total return on the security is expected to underperform the sector over the next six months.
*the sector comprises those securities covered by analyst(s) within the relevant Cazenove sub–sectors. The Cazenove sub–sectors are fund of funds (multi–manager) and single manager funds.

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RECOMMENDATION HISTORY

12 months recommendation changes for Tapestry Investment Co PCC Ltd;
04 Sep 2009 OUTPERFORM

12 months recommendation changes for CMA Global Hedge PCC;
No changes in recommendation over the last 12 months.

12 months recommendation changes for Dexion Absolute Ltd;
16 Jan 2009 IN–LINE

12 months recommendation changes for Acencia Debt Strategies;
29 May 2009 OUTPERFORM

12 months recommendation changes for BH GLOBAL GBP;
21 Jul 2009 OUTPERFORM

12 months recommendation changes for Signet Global Fixed Income GBP Ord;
No changes in recommendation over the last 12 months.

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