Whither Hedge Fund Replication?

December 2009

Hedge Fund Replication

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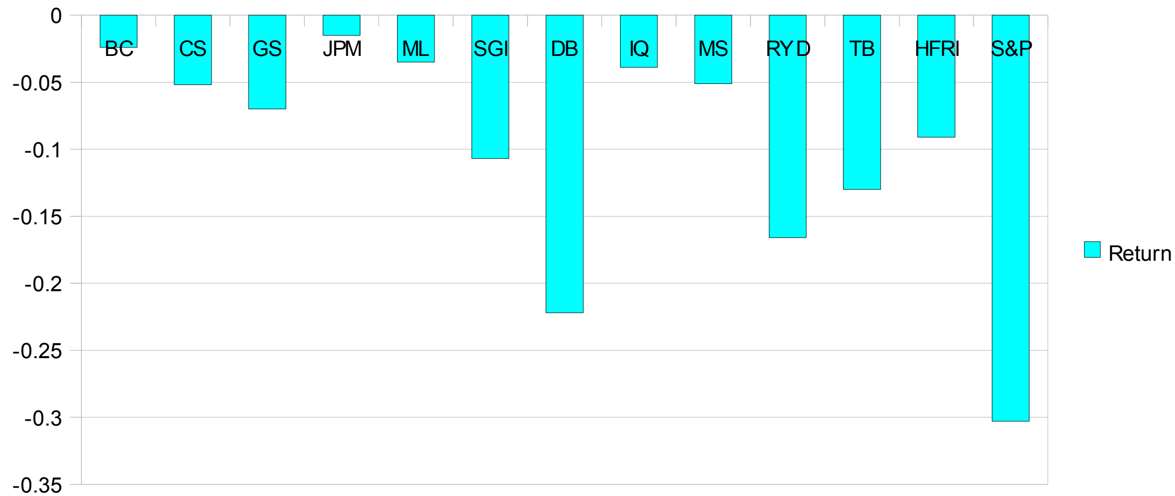
Perfection of means and confusion of ends seem to characterize our age.

Albert Einstein

Hedge Fund Replication

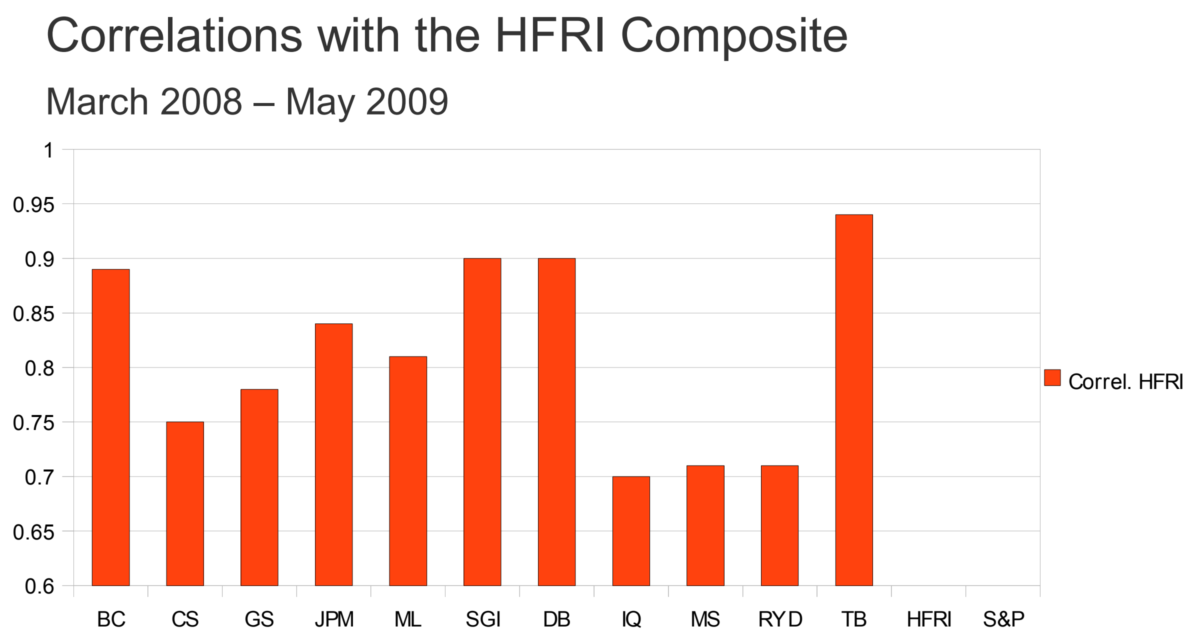
Replicator Returns vs. the HFRI Composite and the S&P 500

March 2008 – May 2009



Source: Nils S. Tuchschmid et. al., 25th September 2009, How do hedge fund clones manage the real world?

Hedge Fund Replication



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Hedge Fund Replication

What purpose should be served by hedge fund replication?

Market Context

Institutional investors poised to drive change in the hedge fund market.

- Increasing allocations to hedge funds
- Investors are beginning to blur the line between hedge funds and traditional asset classes

Market Context cont.

- As in other asset classes, a structured investment process requires an investable performance benchmark
  - Essential for alpha/beta separation
  - Likely growth in index investing as process matures
- Existing investable hedge fund indices do not adequately capture broad index performance
- Existing replication products only partially meet investors' requirements for a good benchmark
  - Representative
  - Investable
  - Independent
  - Transparent

TrueBeta Proposition Summary

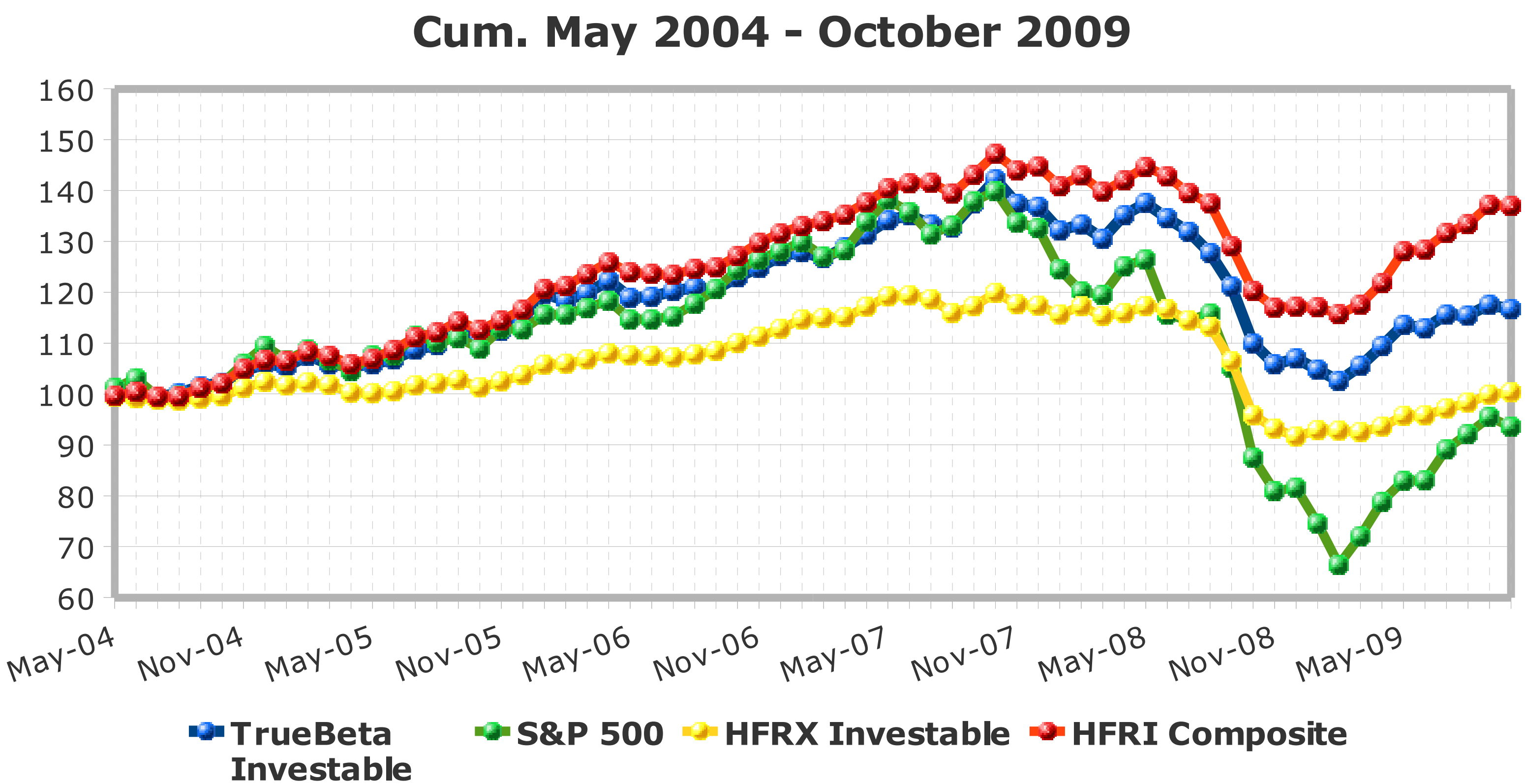
Single-minded focus on replicating the returns of the hedge fund universe.

- A transparent and investable benchmark
- 0.93 correlation with the HFRI index out of sample
- The only factor based replication strategy with a fully transparent methodology

Hedge Fund Replication

Performance Summary

TrueBeta Composite



TrueBeta performance with 1.5X Leverage, After Fees (1.65%); HFRX performance before HFR fees

TrueBeta Performance High-lights

- TrueBeta is highly correlated with the non-investable HFRI index, and closely represents the risk characteristics of the HFRI index over time
- TrueBeta significantly outperforms the HFRX index, both in terms of returns and risk characteristics
- Although TrueBeta tends to under-perform the HFRI target index, factoring in the upward biases of broad hedge fund indices (approx. 3-4% per annum), TrueBeta delivers comparable performance

HFRI and HFRX data by Hedge Fund Research, Inc. (HFR)
HFRI is HFR's Fund-Weighted Composite Index
HFRX is HFR's Investable Equal Weighted Strategies Index

TrueBeta methodological and performance details

Methodology

- Building block approach with an equal weighted composite based on five underlying strategy indices

Equity Hedge
Event Driven
Macro
Relative Value Arbitrage
Emerging Markets

Methodology cont.

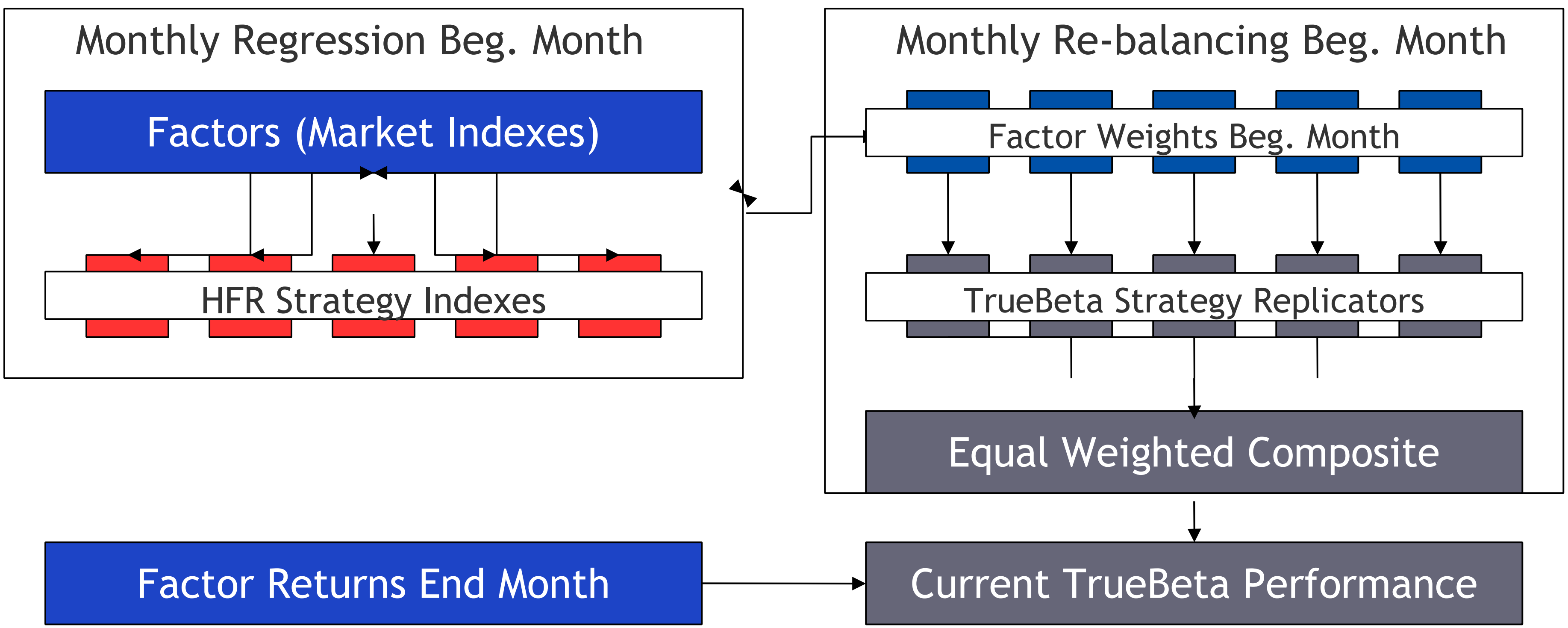
- Monthly trading signals are generated using a multi-factor regression model with a twelve month rolling window
- The factors are major market indices, screened for liquidity and statistical relevance

S&P 500
FTSE 100
MSCI Emerging Markets
US 10 Year Note
Euro Bund
Yen
Euro
Gold
Crude Oil

Hedge Fund Replication

The TrueBeta Process

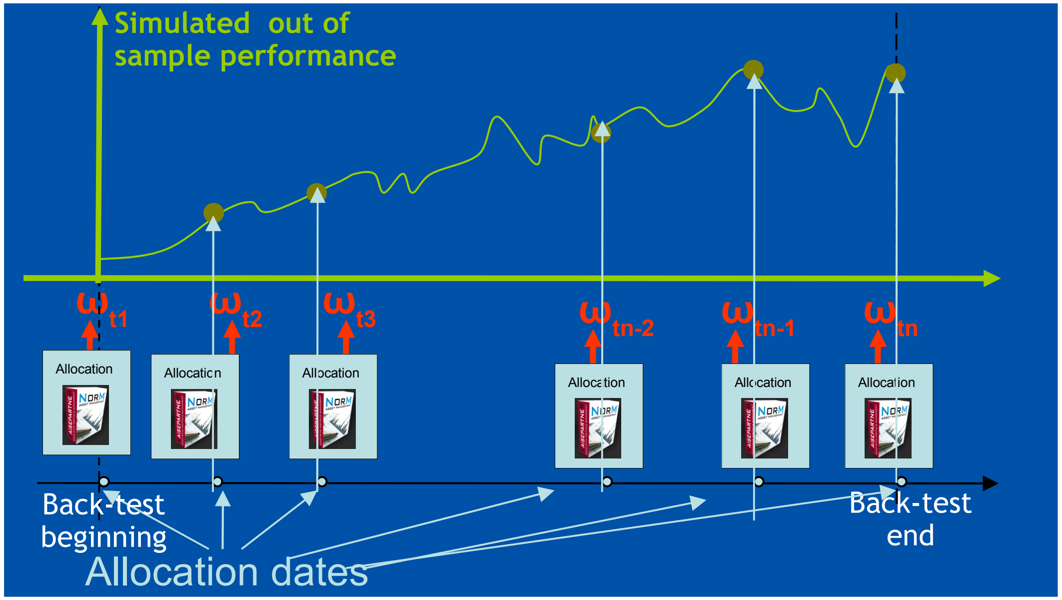
Monthly trading signals are generated using a multi-factor regression model with a twelve month rolling window:



Back-Testing Methodology

A rigorous, out of sample methodology ensures reliable back-tests:

- The model is run separately, ex-ante for each individual month in the back-testing period, determining the factor weights going into the month
- Daily performance is computed with factor returns for the month following the model run



Hedge Fund Replication

Historical Performance

Cum. May 2004 - October 2009	TrueBeta	HFRI	HFRX
Correlation	0.93	-	0.90
Compound Return	16.65%	37.07%	0.32%
Annualized Return	2.84%	5.90%	0.06%
Annualized Stdev	8.15%	7.11%	6.44%
VAR 95%	-13.40%	-11.70%	-10.60%
Information Ratio	0.35	0.83	0.01
Ann. Tracking Error	3.05%	-	3.51%
Skewness	-1.17	-1.12	-2.94
Kurtosis	2.86	2.69	12.97

Performance with 1.5X Leverage, After Fees

Hedge Fund Replication

Rolling 12 Months

Rolling 12 Months October 2009	TrueBeta	HFRI	HFRX
Correlation	0.92	-	0.78
Compound Return	6.06%	14.00%	4.67%
Annualized Return	6.06%	14.00%	4.67%
Annualized Stdev	8.58%	7.52%	5.02%
VAR 95%	-14.11%	-12.37%	-8.25%
Information Ratio	0.71	1.86	0.93
Ann. Tracking Error	3.83%	-	5.26%
Skewness*	-0.22	0.18	-1.02
Kurtosis*	-1.07	-0.1	0.69

*less meaningful short term

Performance with 1.5X Leverage, After Fees

TrueBeta Proposition Summary

The first independently managed replication offering available to all market participants. A transparent and investable bench mark.

- 0.93 correlation with the HFRI index out of sample
- The only factor based replication strategy with a fully transparent methodology
- Based on liquidity-screened futures and ETFs; Daily liquidity
- Available for separate account execution
- Licensing and white label options

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