

Hedge Fund Market Commentary – May 2010

In April we noted the significant underperformance of European stocks, and financials in particular. In May, heightened concerns about the stability of the European financial system prompted investors across the globe to retreat. Domestic and Asian markets were down 8%, and European markets were down 12%. Once again, European financials led the retreat, down almost 15%. High yield markets responded accordingly, down -3.6% in the United States and -11.5% in Europe. The retreat in bond prices corresponded with weak technicals in both the financial and capital markets. Outflows from high yield funds totaled approximately \$3.5 billion during the month, and high yield bond issuance dropped to under \$7 billion from \$33 billion in April.

Exhibit 1: 2010 Market Performance

Index	May	YTD 2010	FYTD*	Calendar 2009	Calendar 2008
Equity					
Dow Jones 5000	-7.9%	-0.1%	22.9%	28.6%	-37.2%
S&P 500	-8.0%	-1.5%	20.7%	26.5%	-37.0%
Russell 2000	-7.6%	6.3%	31.7%	27.2%	-33.8%
MSCI EAFE	-11.2%	-11.9%	7.6%	32.5%	-43.1%
MSCI Emerging Mkts	-9.7%	-6.4%	23.0%	78.3%	-53.5%
DJ REIT	-5.4%	11.2%	64.5%	28.5%	-39.2%
S&P 500 Financials	-9.2%	2.3%	24.2%	17.2%	-56.6%
Fixed Income					
Barclays Aggregate	0.8%	3.7%	7.8%	5.9%	5.2%
Barclays Treasuries	1.7%	3.9%	4.7%	-3.6%	20.1%
Barclays TIPS	0.0%	2.9%	8.0%	11.4%	-2.4%
Barclays High Yield	-3.6%	3.2%	25.2%	58.2%	-26.2%
Barclays Bank Loan	-2.5%	3.2%	17.9%	53.8%	-29.5%
AAA ABX (Subprime)	-9.0%	16.4%	60.4%	-7.8%	-43.2%
Barclays Municipals	0.8%	3.3%	9.5%	12.9%	-2.5%
3 mo.Libor	0.0%	0.1%	0.3%	0.7%	3.1%
Alternative					
DJ UBS Commodity	-5.1%	-9.9%	2.4%	18.9%	-35.7%
Hedge Funds					
HFR1 Fund of Funds**	-2.8%	-0.5%	5.4%	11.5%	-21.4%
HFR1 Fund Weighted**	-2.3%	1.3%	10.9%	20.0%	-19.0%
CS/Tremont	-2.7%	1.5%	12.3%	18.6%	-19.1%

* Fiscal YTD from June 30, 2009

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Hedge funds withstood the market losses in May fairly well, losing -2.7%, according to the CS/Tremont Index. Funds of funds lost -2.8% according to early estimates. A breakdown of hedge fund performance by strategy is shown in Exhibit 2.

Not surprisingly equity long/short funds were among the poorest performers in May, losing approximately 4% amidst strong headwinds in equity markets. Event driven funds, which currently have large exposures to the credit market, performed slightly better than the high yield indices. Macro funds performed comparatively well, consistent with an investment focus on interest rate and currency markets, as opposed to equity and debt markets. The dispersion of returns within the sector was largely driven by funds' relative positioning in the Euro, which fell

significantly in May. Managed futures funds fell over 4%, with many medium-term trend-following models unable to react quickly to the significant short-term volatility.

Exhibit 2: Hedge Fund Performance by Major Strategy Category

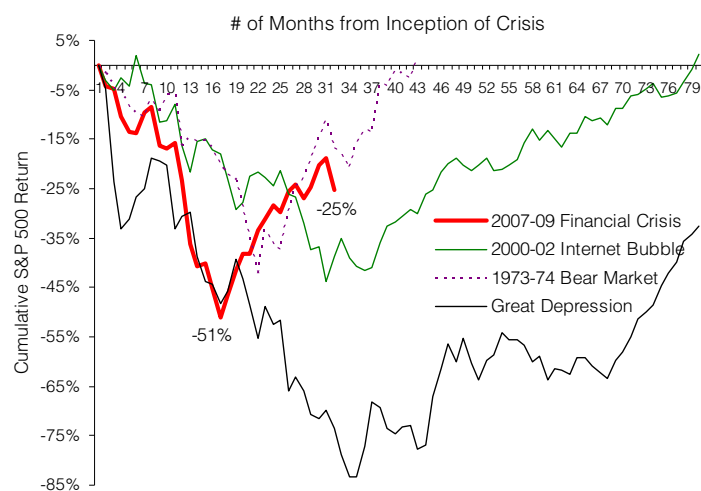
Strategy Indexes	May	YTD 2010	FYTD*	Calendar 2009	Calendar 2008
Arbitrage/Relative Value					
HFRI**	-1.0%	3.9%	16.0%	25.8%	-18.0%
CS/Tremont-Convert	-3.4%	1.7%	20.9%	47.3%	-31.6%
CS/Tremont-Fixed Income	-0.8%	4.6%	19.2%	27.4%	-28.8%
Event Driven					
HFRI	-2.2%	4.0%	18.3%	25.0%	-21.8%
CS/Tremont	-3.2%	3.3%	16.6%	20.4%	-17.7%
Equity Long/Short					
HFRI	-3.7%	0.3%	11.5%	24.6%	-26.7%
CS/Tremont	-4.1%	-1.1%	9.2%	19.5%	-19.8%
Global Macro/CTA					
HFRI	-0.9%	-0.3%	2.6%	4.3%	4.8%
CS/Tremont-Macro	-0.8%	3.4%	11.6%	11.6%	-4.6%
CS/Tremont-Managed Future	-4.4%	-0.6%	0.4%	-6.6%	18.3%
Multi-Strategy					
HFRI	-1.6%	4.8%	16.4%	24.6%	-20.3%
CS/Tremont	-2.1%	1.4%	12.5%	24.6%	-23.6%

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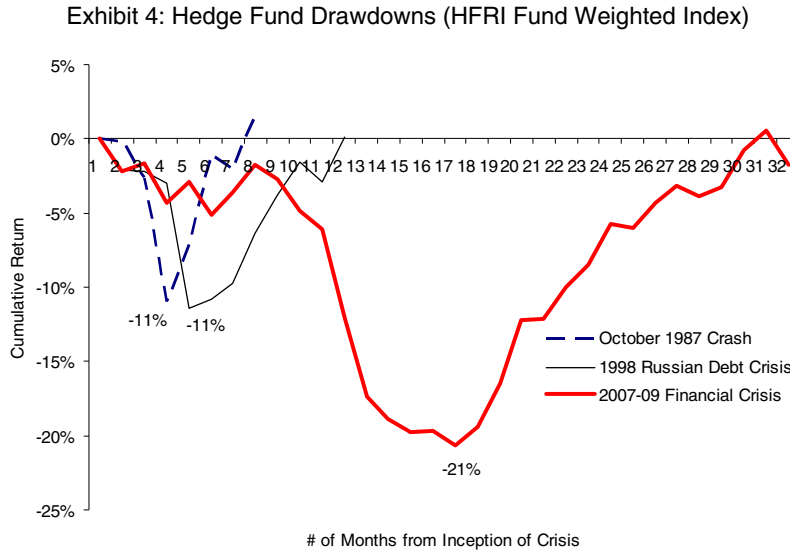
Given the sharp reversal in the stock market in May, it is useful to step back and look at the market recovery from a broader perspective. Exhibit 3 graphically compares the current stock market drawdown against the three most severe prior drawdowns.

Exhibit 3: Stock Market Drawdowns (S&P 500 Index Total Return)



The stock market (as measured by the S&P 500 Index) is still 25% off its November 2007 high and has the largest drawdown (51%) since the Great Depression. Its recent rebound has been stronger than any of the prior periods, probably attributable to the unprecedented monetary and fiscal stimulus. May's sharp stock market reversal, while significant, does not look unusual against the backdrop of the prior market drawdowns. The 1973-74 Bear Market saw a similar pull back during its recovery.

Exhibit 4 plots the three worst hedge fund drawdown periods.



Unquestionably, the current drawdown for hedge funds is the deepest and longest in the history of the industry, but the recovery has been faster than for stocks, which remain well below their high water mark.

Eli Sokolov
June 22, 2010

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