

Hedge Fund Market Commentary – May 2011

May proved to be another volatile month. Equity markets fell as broader economic concerns outweighed generally strong corporate fundamentals. The S&P 500 finished down -1.1%, the first down month since August of last year.

Treasuries rallied as revised GDP growth forecasts helped send 10-year rates down from 3.30% to 3.05%, and 5-year rates from 1.97% to 1.70%. Commodity prices, particularly energy, sunk on the negative economic sentiment. The Dow Jones UBS Commodity Index fell -5.1%, and the S&P GSCI Energy Index fell -8.5%.

Within the high yield corporate market, falling yields and coupon income masked widening spreads, resulting in a net positive return of 0.5%. Structured credit on the other hand fell sharply, with a benchmark subprime mortgage credit index falling over 7%, and commercial mortgage-backed bonds falling by similar amounts. Bond dealers have been reducing risk both through hedging and selling inventory. Exhibit 1 contains a more detailed overview of recent market performance.

Exhibit 1: 2011 Market Performance

Index	May	YTD 2011	FYTD*	Calendar 2010	Calendar 2009	Calendar 2008
Equity						
Dow Jones 5000	-1.1%	8.3%	34.8%	17.5%	28.6%	-37.2%
S&P 500	-1.1%	7.8%	32.9%	15.1%	26.5%	-37.0%
Russell 2000	-1.9%	8.7%	40.6%	26.9%	27.2%	-33.8%
MSCI EAFE	-2.8%	6.7%	32.6%	8.2%	32.5%	-43.1%
MSCI Emerging Mkts	-2.6%	2.4%	29.7%	19.0%	78.3%	-53.5%
DJ REIT	1.6%	14.8%	39.6%	28.1%	28.5%	-39.2%
S&P 500 Financials	-3.2%	-0.3%	16.1%	12.1%	17.2%	-56.6%
Fixed Income						
Barclays Aggregate	1.3%	3.0%	4.2%	6.5%	5.9%	5.2%
Barclays Treasuries	1.6%	2.6%	2.6%	5.9%	-3.6%	20.1%
Barclays TIPS	0.3%	5.0%	6.9%	6.4%	11.4%	-2.4%
Barclays High Yield	0.5%	6.0%	16.8%	15.1%	58.2%	-26.2%
Barclays Bank Loan	-0.1%	3.0%	10.0%	9.7%	53.8%	-29.5%
AAA ABX (Subprime)	-7.2%	-12.8%	-1.1%	32.3%	-7.8%	-43.2%
Barclays Municipals	1.7%	4.1%	3.1%	2.4%	12.9%	-2.5%
3 mo.Libor	0.0%	0.1%	0.3%	0.4%	0.7%	3.1%
Alternative						
DJ UBS Commodity	-5.1%	2.6%	32.6%	16.8%	18.9%	-35.7%
Hedge Funds						
HFRI Fund of Funds**	-1.2%	0.9%	7.9%	5.7%	11.5%	-21.4%
HFRI Fund Weighted**	-1.2%	2.0%	12.8%	10.3%	20.0%	-19.0%
Dow Jones Credit Suisse	-1.0%	3.1%	13.6%	10.9%	18.6%	-19.1%

Hedge funds encountered difficulty navigating May volatility. The broader HFRI Fund-Weighted Index fell -1.2%, and the Dow Jones Credit Suisse Index fell -1.0%. Funds of funds were also down -1.2%, according to HFRI. Exhibit 2 reviews hedge fund performance by strategy.

Exhibit 2: Hedge Fund Performance by Major Strategy Category

Strategy Indexes	May	YTD 2011	FYTD*	Calendar 2010	Calendar 2009	Calendar 2008
Arbitrage/Relative Value						
HFRI**	0.2%	3.3%	11.0%	11.5%	25.8%	-18.0%
Dow Jones CS-Convert	0.0%	4.6%	13.0%	11.0%	47.3%	-31.6%
Dow Jones CS-Fixed Income	0.2%	3.5%	10.3%	12.5%	27.4%	-28.8%
Event Driven						
HFRI	-0.4%	4.0%	13.6%	11.7%	25.0%	-21.8%
Dow Jones Credit Suisse	-0.6%	3.5%	14.5%	12.6%	20.4%	-17.7%
Equity Long/Short						
HFRI	-1.1%	2.4%	15.5%	10.5%	24.6%	-26.7%
Dow Jones Credit Suisse	-1.7%	2.3%	15.5%	9.3%	19.5%	-19.8%
Global Macro/CTA						
HFRI	-2.4%	-0.6%	8.6%	8.2%	4.3%	4.8%
Dow Jones CS-Macro	-0.6%	2.5%	11.6%	13.5%	11.6%	-4.6%
Dow Jones CS-Managed Futures	-4.4%	-0.3%	11.5%	12.2%	-6.6%	18.3%
Multi-Strategy						
HFRI	-0.2%	1.7%	10.2%	13.4%	24.6%	-20.3%
Dow Jones Credit Suisse	-0.1%	5.1%	14.3%	9.3%	24.6%	-23.6%

* Fiscal YTD from June 30, 2010

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Equity long/short funds and managed futures funds were the worst performers in May, off -1.7% and -4.4%, respectively according to Dow Jones Credit Suisse. Equity long/short funds fell in line with the market despite having net exposure well under 100%. Those funds with outsized exposure to energy and financials were especially hard hit. Managed futures funds, particularly those with higher exposure to oil, were impacted by the fall in commodity and equity prices. Arbitrage and relative value funds were the best performers, up 0.2%. They were aided by increased volatility in interest rates, positive mortgage prepayment dynamics, and generally good performance on convertible arbitrage trades.

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