

Hedge Fund Market Commentary – October 2011

Markets rebounded strongly in October, with the S&P 500 posting its highest monthly return since December 1991. However, as indicated by the last day of the month, when the market fell -2.5%, as well as the subsequent losses in November, the October rally did not reflect a complete easing of investor concerns surrounding the global economy and the European sovereign and banking crisis. U.S. financials helped drive the rally, gaining over 14%. Credit markets participated as well, with high yield bonds gaining 4.5%.

Exhibit 1: 2011 Market Performance

Index	October	YTD 2011	FYTD*	Calendar 2010	Calendar 2009	Calendar 2008
Equity						
S&P 500	10.9%	1.3%	-4.5%	15.1%	26.5%	-37.0%
Russell 2000	15.1%	-4.5%	-10.0%	26.9%	27.2%	-33.8%
MSCI Asia Pacific	7.7%	-9.3%	-8.7%	17.3%	37.9%	-41.6%
MSCI Europe	12.1%	-4.9%	-13.2%	4.5%	36.8%	-46.1%
MSCI Emerging Mkts	13.3%	-11.3%	-12.2%	19.0%	78.3%	-53.5%
DJ REIT	14.7%	8.8%	-2.0%	28.1%	28.5%	-39.2%
S&P 500 Financials	14.3%	-14.4%	-11.7%	12.1%	17.2%	-56.6%
Fixed Income						
Barclays Aggregate	0.1%	6.8%	3.9%	6.5%	5.9%	5.2%
Barclays Treasuries	-0.8%	8.0%	5.6%	5.9%	-3.6%	20.1%
Barclays TIPS	1.9%	12.7%	6.5%	6.4%	11.4%	-2.4%
Barclays High Yield	6.0%	4.5%	-0.4%	15.1%	58.2%	-26.2%
Barclays Bank Loan	3.1%	1.1%	-1.4%	9.7%	53.8%	-29.5%
AAA ABX (Subprime)	2.4%	-26.6%	-11.8%	32.3%	-7.8%	-43.2%
Barclays Municipals	-0.4%	8.0%	3.4%	2.4%	12.9%	-2.5%
3 mo.Libor	0.0%	0.1%	0.0%	0.4%	0.7%	3.1%
Alternative						
DJ UBS Commodity	6.6%	-7.9%	-5.5%	16.8%	18.9%	-35.7%
Hedge Funds						
HFRI Fund of Funds**	1.4%	-3.9%	-3.7%	5.7%	11.5%	-21.4%
HFRI Fund Weighted**	2.7%	-3.3%	-4.1%	10.3%	20.0%	-19.0%
Dow Jones Credit Suisse	1.7%	-1.5%	-3.1%	10.9%	18.6%	-19.1%

* Fiscal YTD from June 30, 2011

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Hedge funds were tempered compared with the broader markets. The broader HFRI Fund-Weighted Index rose 2.7%, and the Dow Jones Credit Suisse Hedge Fund Index gained 1.7%. Hedge funds of funds were up a more modest 1.4%, according to HFRI. Exhibit 2 reviews hedge fund performance by strategy.

Exhibit 2: Hedge Fund Performance by Major Strategy Category

	October	YTD		Calendar	Calendar	Calendar
		2011	FYTD*	2010	2009	2008
Arbitrage/Relative Value						
HFRI**	1.5%	1.0%	-1.9%	11.5%	25.8%	-18.0%
Dow Jones CS-Convert	1.2%	1.1%	-2.5%	11.0%	47.3%	-31.6%
Dow Jones CS-Fixed Income	0.1%	3.8%	0.2%	12.5%	27.4%	-28.8%
Event Driven						
HFRI	3.1%	-1.7%	-4.7%	11.7%	25.0%	-21.8%
Dow Jones Credit Suisse	2.6%	-7.4%	-8.6%	12.6%	20.4%	-17.7%
Equity Long/Short						
HFRI	5.2%	-5.3%	-6.2%	10.5%	24.6%	-26.7%
Dow Jones Credit Suisse	4.5%	-5.1%	-5.8%	9.3%	19.5%	-19.8%
Global Macro/CTA						
HFRI	-1.4%	-3.3%	-1.1%	8.2%	4.3%	4.8%
Dow Jones CS-Macro	0.2%	6.0%	4.6%	13.5%	11.6%	-4.6%
Dow Jones CS-Managed Futures	-5.1%	-5.1%	-1.8%	12.2%	-6.6%	18.3%
Multi-Strategy						
HFRI	0.7%	-0.2%	-1.9%	13.4%	24.6%	-20.3%
Dow Jones Credit Suisse	2.1%	2.6%	-1.7%	9.3%	24.6%	-23.6%

* Fiscal YTD from June 30, 2010

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In a near mirror image of the pattern experienced in down-months for global markets, the more beta-driven strategies – equity long/short and event driven, were the best performers for the month. Macro and CTA funds, particularly the latter, struggled relative to other strategies. Discretionary macro managers have had a largely bearish stance throughout the year, primarily through long fixed income and short Europe positions (targeting equities, credit and bank funding pressures). This positioning has helped them post among the strongest returns for the year. According to Dow Jones Credit Suisse, macro funds are up 6% in 2011. Many managers gave back some prior gains in October, but the magnitude of losses amidst the positive signs emanating from Europe was lower than the gains experienced when fear dominated investor sentiment, resulting in a modest gain of 0.2%. Many discretionary macro managers actively seek asymmetric, positively convex trades to express their macro views. This trade construction appears to have been working well this year. CTA funds on the other hand, whose returns are generated to a large degree from trend-following models, were caught up in the sudden market reversal, losing -5.1%. CTAs form a more diverse group today than they did ten years ago, and there is a wide variety of approaches from short-term trend models, to long-term trend models, to mean-reversion models. Thus it is more difficult to make generic comments about this strategy, and with the increasing competition in the space, funds will likely become even more differentiated over time. That said, sensitivity to sudden market reversals will likely continue to be an industry trait.

Eli Sokolov
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