

Hedge Fund Market Commentary – September 2011

September was another difficult month for global markets, with familiar themes replaying. The rally that began in mid-August was cut off in September by perceived bank funding pressures in Europe, lack of confidence in European leadership, and weakening economic data. The S&P 500 declined -7.0%, and European markets were down -4.6% on a local currency basis. In dollar terms, European stocks declined -11.0%, as the Euro fell 6% against the dollar. The Euro has been pressured as many investors believe that Europe is more susceptible to a recession than the U.S., and that the only solution to the European fiscal and banking crises is an inflationary monetary policy. Emerging markets equities declined almost -15%, hurt by falling commodity prices and concerns over economic slowdowns in export markets. High yield continued to sell off, with bonds down -3%. High yield loans managed to stay flat on the month as the technical pressures on floating rate debt abated in September.

Exhibit 1: 2011 Market Performance

Index	September	YTD 2011	FYTD*	Calendar 2010	Calendar 2009	Calendar 2008
Equity						
Dow Jones 5000	-7.8%	-9.8%	-15.2%	17.5%	28.6%	-37.2%
S&P 500	-7.0%	-8.7%	-13.9%	15.1%	26.5%	-37.0%
Russell 2000	-11.2%	-17.0%	-21.9%	26.9%	27.2%	-33.8%
MSCI EAFE	-9.5%	-14.6%	-19.0%	8.2%	32.5%	-43.1%
MSCI Emerging Mkts	-14.6%	-21.9%	-22.5%	19.0%	78.3%	-53.5%
DJ REIT	-11.2%	-5.2%	-14.5%	28.1%	28.5%	-39.2%
S&P 500 Financials	-11.4%	-25.2%	-22.8%	12.1%	17.2%	-56.6%
Fixed Income						
Barclays Aggregate	0.7%	6.7%	3.8%	6.5%	5.9%	5.2%
Barclays Treasuries	1.8%	8.8%	6.5%	5.9%	-3.6%	20.1%
Barclays TIPS	-0.2%	10.6%	4.5%	6.4%	11.4%	-2.4%
Barclays High Yield	-3.3%	-1.4%	-6.1%	15.1%	58.2%	-26.2%
Barclays Bank Loan	0.2%	-2.0%	-4.4%	9.7%	53.8%	-29.5%
AAA ABX (Subprime)	-8.5%	-28.3%	-13.9%	32.3%	-7.8%	-43.2%
Barclays Municipals	1.0%	8.4%	3.8%	2.4%	12.9%	-2.5%
3 mo.Libor	0.0%	0.1%	-0.1%	0.4%	0.7%	3.1%
Alternative						
DJ UBS Commodity	-14.7%	-13.6%	-11.3%	16.8%	18.9%	-35.7%
Hedge Funds						
HFRI Fund of Funds**	-2.6%	-5.0%	-4.7%	5.7%	11.5%	-21.4%
HFRI Fund Weighted**	-2.8%	-4.7%	-5.5%	10.3%	20.0%	-19.0%
Dow Jones Credit Suisse	-2.6%	-2.6%	-4.2%	10.9%	18.6%	-19.1%

* Fiscal YTD from June 30, 2011

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Hedge funds once again showed strong relative performance but weak absolute performance. The broader HFRI Fund-Weighted Index fell -2.8%, and the Dow Jones Credit Suisse Hedge Fund Index fell -2.6%. Hedge funds of funds were also down -2.6%, according to HFRI.

Exhibit 2 reviews hedge fund performance by strategy.

Exhibit 2: Hedge Fund Performance by Major Strategy Category

Strategy Indexes	September	YTD		Calendar	Calendar	Calendar
		2011	FYTD*	2010	2009	2008
Arbitrage/Relative Value						
HFRI**	-1.2%	-0.2%	-3.1%	11.5%	25.8%	-18.0%
Dow Jones CS-Convert	-1.6%	0.1%	-3.5%	11.0%	47.3%	-31.6%
Dow Jones CS-Fixed Income	-0.1%	3.7%	0.2%	12.5%	27.4%	-28.8%
Event Driven						
HFRI	-3.3%	-4.1%	-7.0%	11.7%	25.0%	-21.8%
Dow Jones Credit Suisse	-3.2%	-7.9%	-9.1%	12.6%	20.4%	-17.7%
Equity Long/Short						
HFRI	-4.9%	-8.7%	-9.6%	10.5%	24.6%	-26.7%
Dow Jones Credit Suisse	-5.1%	-9.0%	-9.7%	9.3%	19.5%	-19.8%
Global Macro/CTA						
HFRI	-0.4%	-1.3%	0.9%	8.2%	4.3%	4.8%
Dow Jones CS-Macro	-0.1%	5.8%	4.4%	13.5%	11.6%	-4.6%
Dow Jones CS-Managed Futures	-0.6%	0.2%	3.7%	12.2%	-6.6%	18.3%
Multi-Strategy						
HFRI	-0.7%	-0.4%	-2.0%	13.4%	24.6%	-20.3%
Dow Jones Credit Suisse	-1.9%	1.1%	-3.2%	9.3%	24.6%	-23.6%

* Fiscal YTD from June 30, 2010

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The dispersion across strategies was similar to the pattern exhibited in August. The more market-sensitive strategies, equity long/short and event-driven, declined the most, while macro and managed futures funds held up much better. Discretionary macro funds generally made money on bearish European positions and lost money in long emerging market positions.

Last month we commented on the risk reduction employed by equity long/short funds in August. We know this occurred among many of the managers with whom we speak with on a regular basis, and the overall index return relative to the equity market return last month suggested the phenomenon was broader. The drawdown among equity funds in September however seems to contradict this premise, or at least suggest that the risk reduction was not as significant. That said, it is hard to attribute returns to any one factor, and the sharp decline in emerging markets equities likely contributed as well.

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