HFR

Hedge Fund Research Inc.

Presentation to:

US Department of Labor

Advisory Council on Employee Welfare and Pension Benefit Plans

July 19, 2011

200 Constitution Avenue N.W.

Washington, D.C. 20210

Room C5515 Room 1-A

Hedge Fund Research, Inc. (HFR) is the global leader in the alternative investment industry. Established in 1993, HFR specializes in the areas of indexation and analysis of hedge funds. HFR Database, the most comprehensive resource available for hedge fund investors, includes fund-level detail on historical performance and assets, as well as firm characteristics on both the broadest and most influential hedge fund managers. HFR has developed the industry's most detailed fund classification system, enabling granular and specific queries for relative performance measurement, peer group analysis and benchmarking.

HFR produces over 100 indices of hedge fund performance ranging from industry-aggregate levels down to specific, niche areas of sub-strategy and regional investment focus. With performance dating back to 1990, the HFRI Fund Weighted Composite Index is the industry's most widely used standard benchmark of hedge fund performance globally. The HFR suite of Analysis Products leverages the HFR Database to provide detailed, current, comprehensive and relevant aggregate reference points on all facets of the hedge fund industry. HFR also offers consulting services for clients seeking customized top-level or more nuanced analysis.

- **Hedge Fund Database**

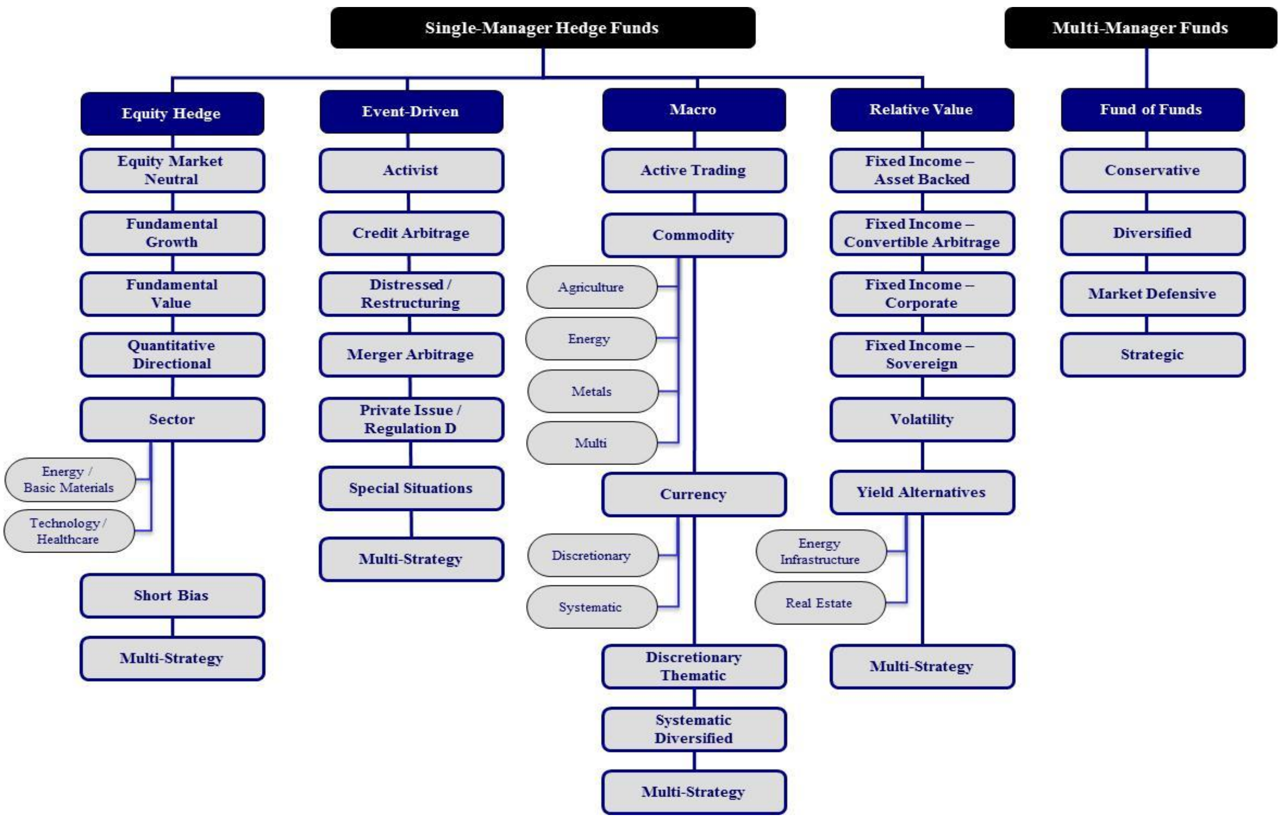
HFR operates the HFR Hedge Fund Database, the leading source of information on the hedge fund industry utilized by thousands of accredited investors every day. The HFR database contains over 70 fields of information including performance, capital under management, leverage, strategy and fund strategy description, concentration of investment focus, fund principals, domicile, registration and management firm location (listed in Appendix 1) on nearly 7,000 hedge fund and fund of hedge fund vehicles; the HFR database includes the most comprehensive coverage of leading hedge fund managers available. Data is self-reported by fund managers and subscriptions are only available to accredited investors. HFR also maintains a historical archive database of funds which have liquidated or discontinued reporting to the active database; the historical archive database contains approximately 9,000 fund vehicles.

❖ Qualities of Hedge Funds

➢ Definitions

Hedge funds are specialized, private investment partnerships available to qualified investors which have the ability to invest in a broad array of investment strategies and portfolio holdings, characteristically invest both long and short and have the ability to use leverage in most cases. Hedge funds can take many different corporate structures, which can be incorporated either in or outside of the United States.

➢ Hedge Fund Strategy Hierarchy:



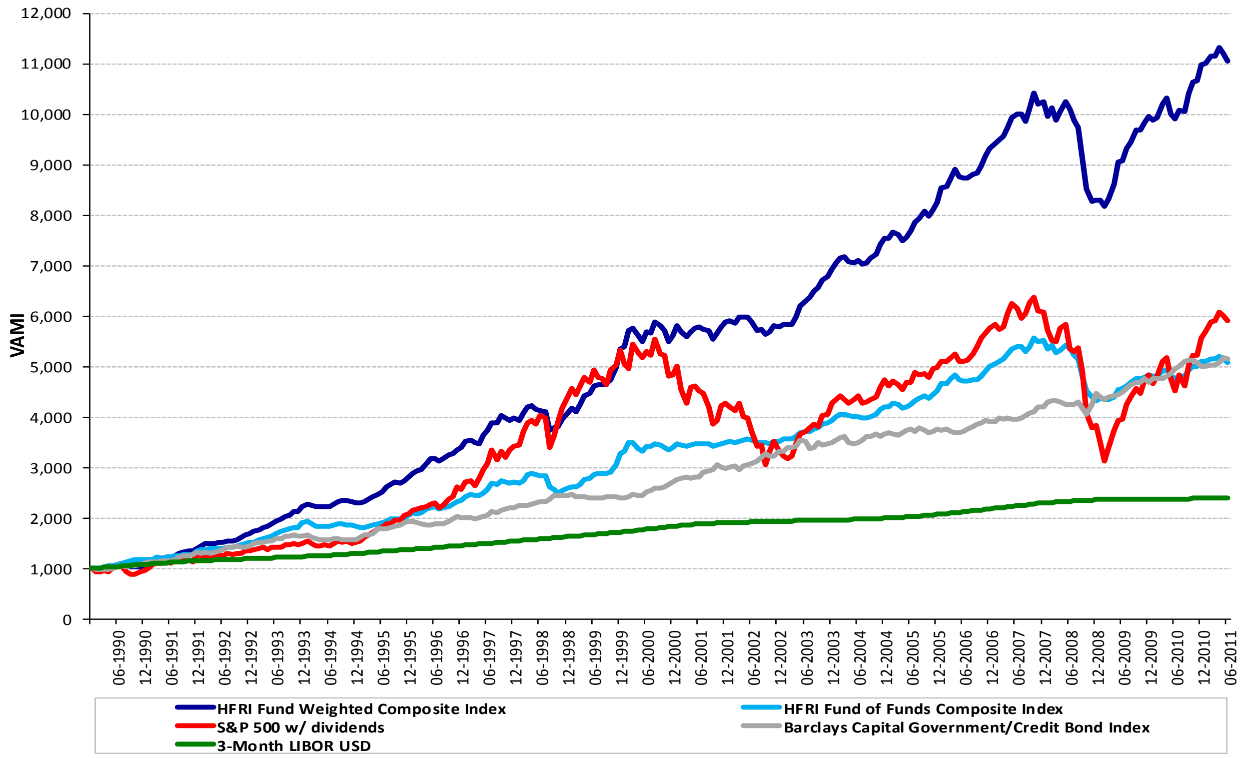
Hedge funds employ a broad, heterogeneous array of investment strategies which contribute to the capacity of the industry to generate uncorrelated returns. HFR has developed the above taxonomy of hedge fund strategies, which is widely used and accepted throughout the industry as the standard for hedge fund strategy classification. The hierarchy uses 4 main hedge fund strategies: Equity Hedge, Event Driven, Macro and Relative Value, then further modularizes these into (over 30) more specialized, granular sub-strategies. This structure affords investors using the HFR database to understand not only the nuanced nature of these strategies but also the similarities and differences between strategies for the benefit of analysis, allocations and formulating return expectations. Users of the HFR database have the ability to perform multi-level customized, nuanced queries of the universe of funds, using not only quantitative but qualitative performance screens filtered subject to the user’s discretion to create and monitor and relevant sub-set of funds of interest to the user.

HFR: Hedge Fund Research; US Department of Labor- ERISA Advisory Council presentation July 19, 2011

➢ Hedge Fund Indices

Leveraging our industry leading database, HFR produces the leading indices of hedge fund performance including both HFRI and HFRX indices.

	12-Month		3-Year Annualized		5-Year Annualized		10-Year Annualized		Since 1990	
Index	**Net Return**	**StD**	**Net Return**	**StD**	**Net Return**	**StD**	**Net Return**	**StD**	**Net Return**	**StD**
HFRI FWC Index	11.47	5.16	3.04	8.52	4.79	7.42	6.69	6.35	11.82	7.00
HFRI FOF Index	6.52	4.09	(1.86)	7.17	1.51	6.60	3.87	5.34	7.85	5.88
S&P 500 w/ dividends	30.68	13.75	3.34	21.19	2.95	17.86	2.72	15.81	8.61	15.06
Barclays Govt/Crdt Agg Bond	3.89	3.56	6.55	5.59	6.78	4.77	6.19	5.01	7.91	4.97
3-Month LIBOR	0.30	0.02	0.84	0.28	2.40	0.62	2.43	0.51	4.14	0.63



HFRI Indices track performance back to 1990 and are broad-based, equally weighted composites comprised of performance data on over 2,000 constituents as reported monthly to the HFR database. Constituents are required to report performance to the HFR database consistent with established reporting conventions (monthly, US$ and net of all fees), furthermore HFRI constituents are selected as unique representative of redundant fund share classes and must have either $50 M or 12 months of track record to be selected as a constituent of the HFRI.

HFRX Indices utilize a similar screening methodology to that of the HFRI, but after the initial screening, HFR utilizes a quantitative methodology to engage in representative fund selection, whereby the broad universe of over 2,000 funds is narrowed to a sub-set which is used by asset managers to create investible index products. The benefits of investible indices are significant; it is possible for an investor to receive the performance on the index benchmark with a single capital allocation, but in addition to these, it is possible to report performance of the investible indices on a daily (t+1) basis, rather than monthly, as with the HFRI. In addition, investible indices reflect the performance of actual capital commitments and, as such, are free of any biases created by performance self-reporting.

Constituents of both HFRI and HFRX indices are available to subscribers of the HFR database.

- **Index Biases (Non-Investible)**

While the investible indices are free from biases created by manager (self) performance reporting, broad-based composites are susceptible reporting biases, which is why HFR takes extensive measures to mitigate the impact of these.

  - **Survivorship**

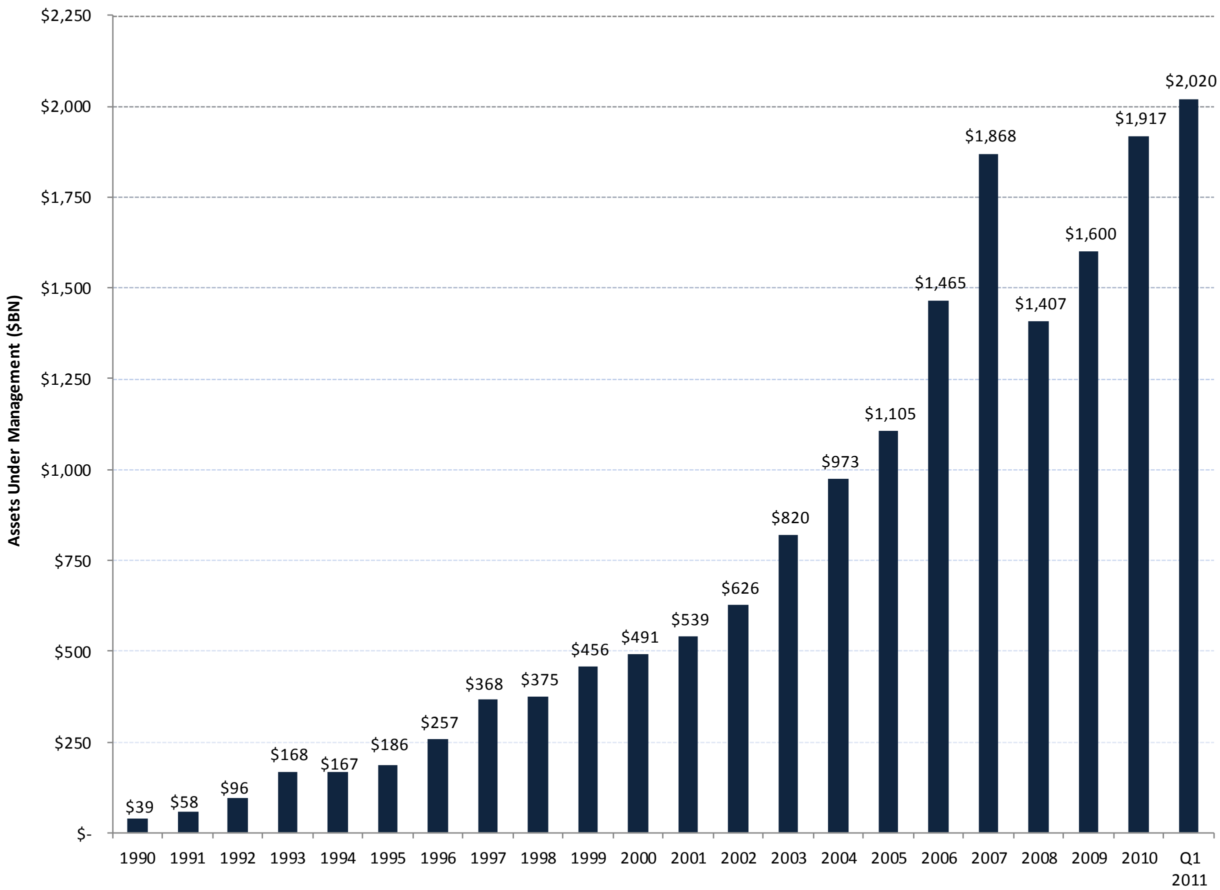
Survivorship bias is created as a function of manager self-reporting, whereby a constituent index manager has the ability to discontinue reporting performance of their fund as a result of poor performance of which he may not want investors to be aware, implicitly biasing upward the index result because it includes only the subset of funds which continue to report (or excludes those which discontinue to report). While it is possible for self-reporting (or non-reporting) to create a bias, several clarifications are important with regard to this. HFR makes extensive efforts to contact managers to obtain performance reporting when these become lagged; for purposes of index completion these can also be sourced from investors or certain 3rd parties. In addition, performance of funds which liquidate or discontinue reporting remain in the index historically and are not extracted, as is commonly thought to be the case. Finally as above, HFR publishes both index constituents and a historical archive database, allowing investors to access and analyze this information.

  - **Backfill**

Backfill bias is created when funds which are added to the index have the ability to ‘pull in’ their performance to historical months of the index which precede their performance reporting; presumably creating a bias for an index in that only funds which have good performance are choosing to add these to indices (conversely, poorly performing funds are unlikely to be added). Backfill bias does not occur in the HFRI as funds are only able to contribute to index performance on a t+1 basis, meaning regardless of the performance which has occurred inception through addition to the database, the first opportunity to contribute to index performance is the month subsequent to database addition.

➢ Analysis

Using the HFR database and indices of performance, HFR produces regular analysis reports, which characterize the aggregate nature of the hedge fund industry in terms of both cross-sectional composition and time series changes to this composition. HFR's most visible research output is the estimation of the size of the hedge fund industry, most recently estimated at $2.02 Trillion end 1Q11, an all-time record level of capital invested in the hedge fund industry. HFR also produces specialized research on hedge funds including new fund launches & closures, leverage, fee structure, performance dispersion and many other topics.



➢ Leverage

Hedge funds regularly employ leverage across fund vehicles, with levels varying across strategies as a function of many variables, including target volatility profile of fund/investor risk tolerance, volatility & liquidity of underlying assets and the availability of attractive financing. HFR tracks leverage as both standard leverage (multiples of capital under management) or as margin to equity (for funds transacting primarily in exchange listed instruments, such as futures & options contracts). The greatest number of funds employ between 1-2 times their investment capital or between 10-20% margin to equity, with higher levels observed in strategies with a higher capital intensity Relative Value Arbitrage strategies, while lower levels are characteristically employed in Equity Hedge strategies.

Hedge Fund Liquidity

Liquidity is a significant dynamic of consideration for both hedge fund managers and hedge fund investors, with consideration given to both portfolio/asset liquidity and liquidity of fund shares. Both concepts can range broadly both naturally and as a function of market conditions. In contrast to private equity investments which are characteristically illiquid in both asset and fund shares, hedge fund liquidity can range from daily liquidity to multi-year illiquid for both asset and fund shares. Investors are well served to calibrate realistic expectations for liquidity, at present investors are exhibiting strong preference for liquid assets and fund shares, as is evidenced by the growth of UCITS III compliant funds. In addition to understanding stated and expected liquidity terms, investors should understand that investments in hedge funds can be subject to liquidity modification under certain unfavorable market conditions.

Hedge Fund Fees

Hedge funds characteristically charge investors a management and incentive fee, which comprise the basis of compensation for the hedge fund management company. Management fees are charged annually as a percent of the assets under management, ranging from 0 to 2.5% (higher with some exception). In most cases, hedge funds also charge an incentive fee, of which is a percentage of the net gains of the fund which are retained by the fund; these are can range broadly from 0-25% (and higher with some exception as well). While many funds charge 2 and 20%, actual evidence shows this can vary broadly industry wide.

Hedge Fund Regulation

The hedge fund industry is presently at a crucial inflection point with regard to regulation, anticipating the impact of the implementation of the Dodd Frank legislation over the course of the coming year(s). While the overall framework of Dodd Frank was passed in Congress in July 2010, the implementation provisions are currently an active legislative consideration. One anticipated outcome of the implementation is the required registration of hedge funds as investment advisors with the SEC. Dodd Frank also contains important provisions with regard to the ability of a financial institution to own equity in, sponsor, invest in and allow clients to invest in hedge funds; as above discussion of these is both detailed and fluid topic and for practical reasons beyond the direct scope of this presentation. As of 1Q11, 44.5% of all hedge funds in the HFR database were registered with the SEC, and 59.3% of all hedge funds with management firms located in the US were registered with the SEC.

- **Hedge Fund Due Diligence**

Investors typically actively engage in extensive due diligence on hedge fund managers, with institutional due diligence processes in some cases being multi-year undertakings. Due diligence involves review of the organization at nearly every level and can be conducted by advisors and analysts, frequently with the assistance of legal resources and advice, compliance managers and third party background check specialists. While due diligence has always been an important component of investing in the hedge fund industry, the incidence of fraud in 4Q08 has resulted in an increased significance and scrutiny of due diligence activities. Associated with the transparency evolution, discussed below, the hedge fund industry has become extremely responsive to due diligence of investors, understanding the institutional requirements for complete and accurate multi-faceted understanding of the hedge fund as a business franchise. Depending of the scope of resources available, hedge funds may offer regular and ad hoc opportunities to meet with key management company personnel, regular updates of strategic and structural developments and offer comprehensive websites with document libraries to suit the requirements of both existing and prospective investors.

- **Direct Hedge Fund investment vs. Fund of Hedge Funds**

Up until 2000, most investment in hedge funds occurred directly into single manager funds. Subsequent to that, investors exhibited a preference for multi-manager commingled funds, or Funds of Hedge Funds (FOF) which exhibited diversification benefits, as well as manager selection, capacity and due diligence expertise. Assets invested in FOF grew rapidly ’02-’07, reaching over $800 Billion, before declining sharply in ’08-’09, related to investor concerns about performance, due diligence, fraud and liquidity. Mirroring trends across the industry, the FOF industry has also evolved with regard to transparency to enhance the value proposition to end investors. In addition to manager selection and capacity, FOF which embrace transparency are now able to offer investors technology, client service, multi-manager analytics and common platform infrastructure terms. FOF characteristically present investors with a more steady and less volatile return profile with the HFRI Fund of Funds Index returning nearly 8% annualized since 1990 on an annualized volatility of less than 6%.

❖ Hedge Fund Industry – Brief History to Present

➢ AUM progression

Capital invested in the hedge fund industry has grown rapidly in the past 20 years, most recently eclipsing $2 Trillion globally. This figure is calculated by HFR as a sum of capital under management in funds and is not influenced by the level of leverage employed by the fund; capital under management is the total of investor capital plus changes associated with performance. Since 1990, AUM in the hedge fund industry have grown at a compound annualized rate of growth of 12.4%, although associated with the financial crisis of 2008 this rate has been slower in the last 10 years, averaging 5.9% annualized. After peaking at $1.93 Trillion in 2Q08, AUM declined for 3 consecutive quarters, falling by 30% to a trough of $1.33 Trillion 1Q09. Since then, AUM have continued to recover to the level reached today.

➢ Transparency

The hedge fund industry has evolved significantly with regard to transparency in the last decade, with this progression hitting a critical inflection point in 4Q08 as a result of exposure many investors had to illiquidity, misrepresentation and fraud. Transparency has many qualities and attributes for investors in the hedge fund industry in 2011, and has become more of a requirement than an option for leading institutional investors. Transparency can take different forms, commonly including greater awareness of the structural, strategic and, in many cases, key positions in the hedge fund. While in some cases this is done within the constructs of a commingled fund vehicle or feeder fund, most frequently this has been most effectively achieved through the use of separately managed accounts.

Separately managed accounts (SMA) involve an intensive process whereby an investor creates (or accesses) an independent investment vehicle which is a distinct legal structure from that of the hedge fund management company's offerings and contracts with the hedge fund manager to invest the capital in this independent account in a pari passu manner to that of the fund manager's target commingled fund vehicle offering. The intent is to achieve the performance of the reference vehicle but to enable this to be done within the constructs of an independent legal structure, where the investor has the ability to utilize independent 3rd party analytics and risk management techniques so as to mitigate many of the risks associated with investment in commingled funds.

Separately managed accounts offer investors substantial benefits over that of the commingled funds with regard to transparency, a non-exhaustive list of these includes structural, pricing and analytical transparency. As before, structural transparency refers to the concept that the separately managed account is a legally segregated entity from that of the commingled fund and management company; if necessary the investor has the ability to terminate the relationship with the fund manager and act in an appropriate manner to oversee the management or liquidation of the positions on the separately managed account. Separately managed accounts also enable investors to price the securities in the account independently, this not only allows for a more frequent basis of calculation of fund performance, but they also afford the investor the integrity of third party price reconciliation. A third benefit of transparency is that of analytical transparency, which allows investors to run independent portfolio and risk analytics of the position in the SMA; analytical transparency is used by sophisticated investors to manage and monitor compliance with risk guidelines, observe variation in portfolio exposures as they occur in a frequent, intra-month basis (investor can run reports as regularly as daily) and to effectively manage multi-manager allocations under a common set or risk models and analytics so as to observe portfolio sensitivities in the most accurate and timely manner possible.

The proliferation of transparency has also contributed to the growth of separately managed account platforms. These typically offer investors the ability to access many separately managed accounts as investment options (frequently over 100 funds) which can be accessed under common structural characteristics, simplifying the due diligence process, while still retaining the aforementioned benefits of transparency. These platforms are also desirable from the perspective of the investment manager as a way of service multiple client with interest in accessing the strategy via a SMA, allowing the manager to leverage the infrastructure of a single provider and obtain critical mass of capital within the constructs.

- **Role of Hedge Funds in the Broader Economy**

Most recently the hedge fund industry has grown to exceed $2 Trillion in investor capital, a number which represents slightly greater than 1 percent of estimated total global capital base; the industry continues to grow and evolve in an effort to generate performance to attract new capital. As the industry has grown from the niche or cottage industry in 1990, hedge funds have assumed a larger and more significant role in the functioning of modern capital markets, acting as the marginal provider of risk capital and willing to provide liquidity where opportunities to generate returns exist and provide investors with sophisticated access to investment strategies and execution which otherwise are not available for their participation.

In the present environment and for the past several years, the combination of volatile equity markets, low fixed income yields and losses in real estate assets have left many institutional investors, both private and public, in a dilemma of how to narrow their pension fund deficits and meet defined liability requirements without taking excessive risk or compromising their fiduciary obligations. Many of these are looking at the hedge fund industry and the manner in which the evolved, transparent hedge fund industry could be a component of the long term solution to these financial complexities.

- **Guidelines for Plan Sponsors**

1. Use a hedge fund database to understand fund, strategy and comparable performance within the context of the drivers of performance; including best and worst operating environment
2. Maintain a multi-market cycle investment horizon, while understanding liquidity of both portfolio and fund shares; avoid chasing performance, add marginally on weakness
3. Know and meet with firm principals and portfolio managers, perform regular in person due diligence meetings; utilize investor references and 3rd party background checks
4. Adopt investible performance benchmarks
5. Utilize the benefits of transparent hedge fund investment

Conclusion & Recommendations:

In conclusion, I would like to thank the DOL – ERISA Advisory Council for offering myself and HFR the opportunity to present at this proceeding today. The hedge fund industry continues to grow in size, scope and relevance to modern financial markets and as this process continues in coming months and years, the requirements for guidelines with regard to ERISA assets, fiduciaries and beneficiaries will become increasingly relevant for performance measurement, benchmarking, risk management and forecasting. HFR is strategically positioned as a leader in the alternative investment industry to work actively in conjunction with the ERISA Advisory Council to advise, develop and implement solutions which satisfy the existing and future requirements of the Council, beneficiaries and fiduciaries.

As represented previously, the hedge fund industry offers compelling performance characteristics, fully appreciating both the heterogeneous strategic nature and time varying correlations of this performance (Exhibit 3). In this way, increased allocations to the hedge fund industry by private pension funds under ERISA are likely to narrow funding deficits to actuarial return assumptions which currently exist for many private pension funds. However, to mitigate some structural risks associated with investment in hedge funds, it is important that investments in hedge funds conform to rigorous ERISA guidelines, both existing and to be developed as a result of these proceedings. At this time, I can offer the following three recommendations:

1. ERISA Advisory Council adopts a common strategy hierarchy, descriptions and hedge fund index benchmarks and for all members and entities under advisement, including fiduciary requirements. According to the CFA Institute, in order for a benchmark to be a valid and effective tool for measuring a manager's performance, it must be:

   - Unambiguous
   - Investable
   - Measurable
   - Appropriate
   - Reflective of current investment opinions
   - Specified in advance

   HFR recommends the adoption of investible indices as benchmarks of hedge fund performance for ERISA plans.

2. ERISA Advisory Council adopts a common source database and analysis for all members and entities under advisement, including fiduciary requirements. To ensure absolute completeness of content, private plans can require all funds in which they maintain or consider investment in to be actively included in this centralized repository for reference purposes. In order to familiarize the EAC with an example of the benefits of this, I have arranged for each of the Council members to receive a complimentary online 14 day trial of the HFR database.

3. HFR is available to engage in further dialogue on an ongoing basis with the EAC to ascertain the interest and suitability of how the EAC and member firms can utilize the benefits of transparency

to improve the investment performance, risk oversight, develop guidance and satisfy fiduciary obligations of EAC and member firms.

Thank you again and I look forward to taking your questions at this time.

Appendix

1: List of Database Fields

2: Table of Funds by Strategy

3: HFRI Correlation to S&P 500

1. LIST OF DATABASE FIELDS

2. TABLE OF FUNDS BY STRATEGY

HFR Database by Strategy / Sub-Strategy			
Strategy	Sub-Strategy	# Funds	% Funds
Equity Hedge	Equity Market Neutral	273	4.04%
	Fundamental Growth	657	9.72%
	Fundamental Value	918	13.58%
	Multi-Strategy	108	1.60%
	Quantitative Directional	128	1.89%
	Sector - Energy/Basic Materials	144	2.13%
	Sector - Technology/Healthcare	109	1.61%
	Short Bias	26	0.38%
	Equity Hedge (Total)	**2,363**	**34.96%**
Event-Driven	Activist	19	0.28%
	Credit Arbitrage	29	0.43%
	Distressed/Restructuring	137	2.03%
	Merger Arbitrage	57	0.84%
	Multi-Strategy	66	0.98%
	Private Issue/Regulation D	7	0.10%
	Special Situations	173	2.56%
	Event-Driven (Total)	**488**	**7.22%**
Macro	Active Trading	59	0.87%
	Commodity - Agriculture	28	0.41%
	Commodity - Energy	19	0.28%
	Commodity - Metals	41	0.61%
	Commodity - Multi	125	1.85%
	Currency - Discretionary	50	0.74%
	Currency - Systematic	82	1.21%
	Discretionary Thematic	228	3.37%
	Multi-Strategy	182	2.69%
	Systematic Diversified	402	5.95%
	Macro (Total)	**1,216**	**17.99%**
Relative Value	Fixed Income - Asset Backed	160	2.37%
	Fixed Income - Convertible Arbitrage	79	1.17%
	Fixed Income - Corporate	182	2.69%
	Fixed Income - Sovereign	65	0.96%
	Multi-Strategy	243	3.59%
	Volatility	87	1.29%
	Yield Alternatives - Energy Infrastructure	36	0.53%
	Yield Alternatives - Real Estate	45	0.67%
	Relative Value (Total)	**897**	**13.27%**
	Total Single-MGR Funds	**4,964**	**73.43%**
Fund of Funds	Conservative	278	4.11%
	Diversified	824	12.19%
	Market Defensive	58	0.86%
	Strategic	636	9.41%
	Fund of Funds (Total)	**1,796**	**26.57%**
	Total HFR Database	**6,760**	**100%**

HFR Database by Regional Investment Focus			
Region	Sub-Region	# Funds	% Funds
Americas	Latin America	106	2.14%
	North America	1,587	31.97%
	Pan-American	3	0.06%
	Americas (Total)	**1,696**	**34.17%**
Asia	Asia ex/Japan	246	4.96%
	Asia w/Japan	103	2.07%
	Japan	114	2.30%
	Asia (Total)	**463**	**9.33%**
Europe	Northern Europe	31	0.62%
	Pan-European	183	3.69%
	Russia / Eastern Europe	133	2.68%
	Western Europe / UK	350	7.05%
	Europe (Total)	**697**	**14.04%**
Other	Africa	14	0.28%
	Global	1,831	36.89%
	Middle East	25	0.50%
	Multiple Emerging Markets	238	4.79%
	Other (Total)	**2,108**	**42.47%**
	Total Single-MGR Funds	**4,964**	**100%**

Total # UCITS III Funds	**661**	**9.78%**

HFR Database reflected as of: July 7, 2011

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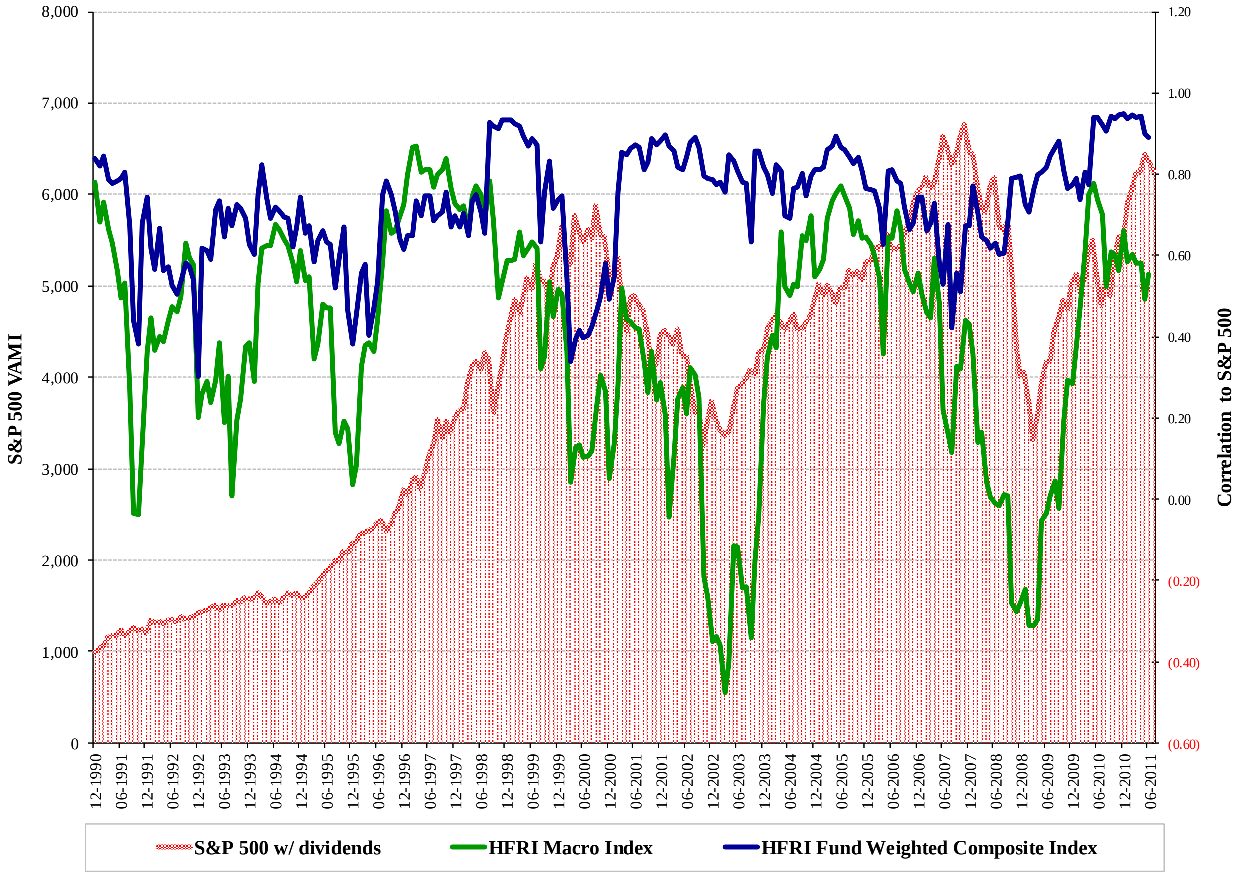
3. HFRI Correlation to S&P 500 (12 month rolling window)



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