Hedge Funds

Aiming for new heights

2004

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Hedge Funds Overview

THE BEGINNINGS OF HEDGE FUNDS

The first hedge fund was launched in 1949

The first known hedge fund was an investment partnership established more than 50 years ago by Alfred Winslow Jones, who sought to separate the two risks inherent in investing in stocks: market or "systematic" risk, meaning the general change in stock prices due to market influences, and specific risks related to factors particular to each individual stock.

Jones' partnership held a short position in a basket of stocks as insurance against a downturn in the market, thereby "hedging" to some extent the systematic risk. Jones' fund was unique in that it combined unconventional characteristics such as market-neutral exposure and incentive fees.

DEFINITION OF HEDGE FUNDS

Hedge funds seek absolute returns

There is a variety of definitions used to describe hedge funds by professionals in the industry. Broadly speaking, a hedge fund is any type of investment company or private partnership that uses the following instruments and techniques:

1. Derivatives, such as options (call or put), futures, swaps…

2. Financial leverage

3. Short selling

In addition, hedge funds often share the following characteristics:

- They are often formed as an unregulated investment pool and are generally domiciled offshore.

- They measure their performance in absolute terms (i.e. independent of market direction and uncorrelated to any benchmark).

- They usually work with a performance fee scheme.

- They require high minimum investments.

- Their subscription and redemption policies are fairly restrictive and may even impose lock-up periods or gates.

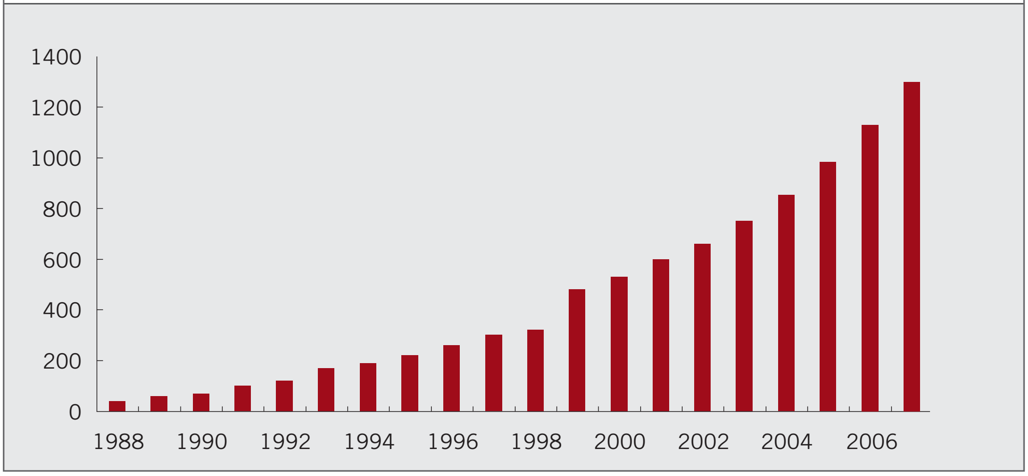
- Hedge fund managers usually invest their own capital along with their clients'.

THE HEDGE FUND INDUSTRY TODAY

The industry has grown by more than ten times in the last decade

Various industry sources estimate that the hedge fund industry has grown from about USD 60 billion in assets under management in 1990 to at least USD 750 billion at the end of 2003. Also, it is believed that the actual amount of assets managed far exceeds the amounts reported. Nevertheless, although assets continued to grow significantly every year, the size of the hedge fund industry – with an estimated 2% to 3% market share – remains small compared to the mutual fund industry and global financial markets.

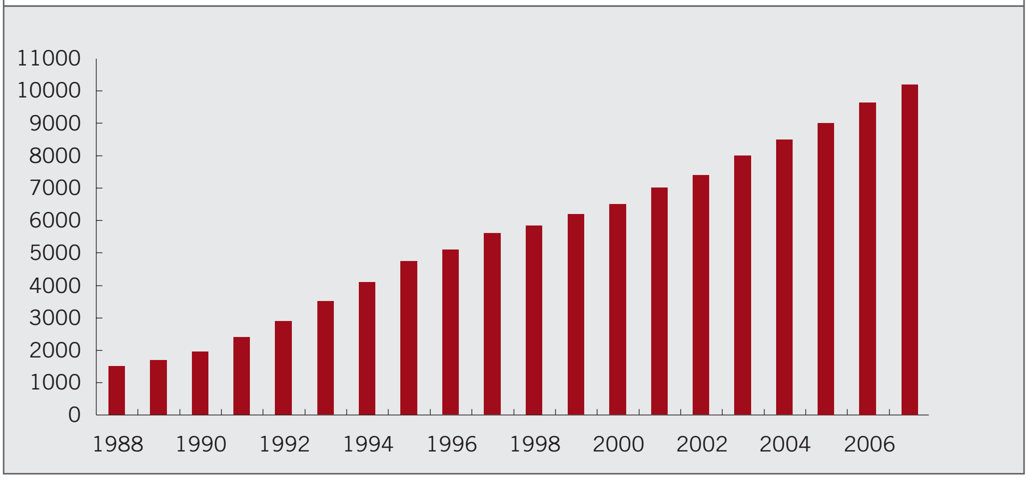
ASSETS UNDER MANAGEMENT (IN BILLION USD)



Source: Estimates for 2003-2007 are projections based on current data and may be revised in the future. Copyright by Van Hedge Fund Advisors International, Inc. and/or its affiliates, Nashville, TN

In terms of volume, the industry has experienced similar growth, going from around 2,000 hedge funds in 1990 to close to 8,000 at the end of 2003.

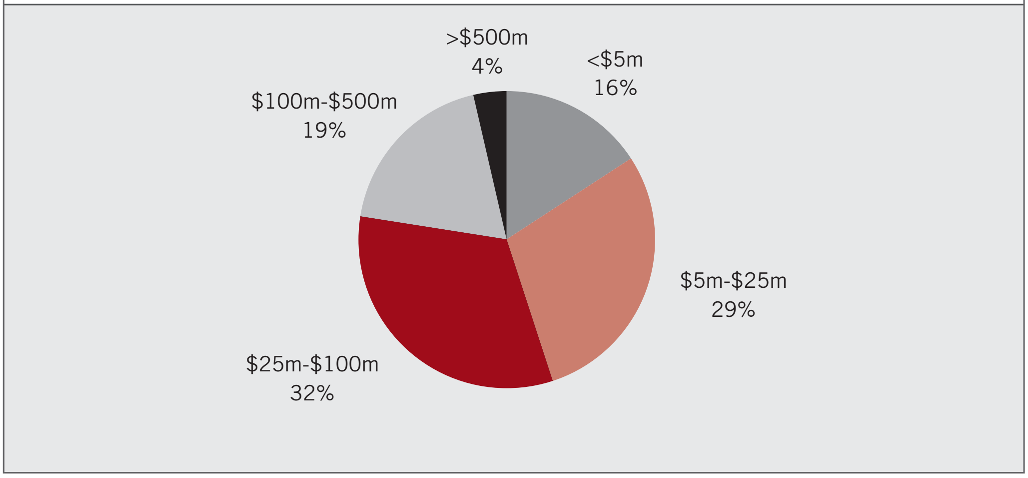
NUMBER OF HEDGE FUNDS



Source: Estimates for 2003-2007 are projections based on current data and may be revised in the future. Copyright by Van Hedge Fund Advisors International, Inc. and/or its affiliates, Nashville, TN

So far, the number of new funds has continued to grow substantially although about 10% of hedge funds are forced to cease their activities each year due to their inability to raise sufficient assets or deliver above-average performance.

HEGDE FUNDS DISTRIBUTION BY SIZE



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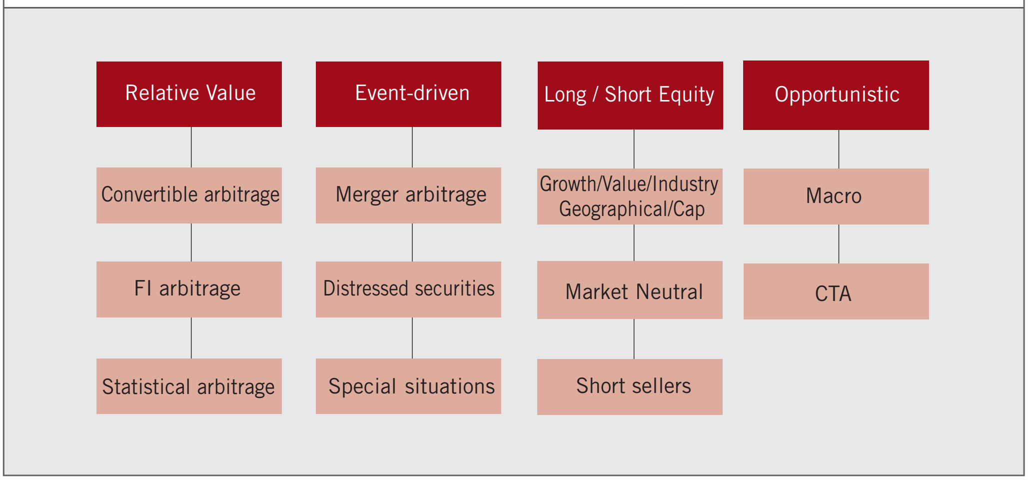
HEDGE FUND STRATEGIES

No standard classification of hedge fund strategies

There are many different ways to classify the investment strategies of hedge fund managers. Moreover, some managers combine several strategies in what is often referred to as "multi-strategy funds". The table below illustrates the four major categories and sub-categories of investment strategies.

HEDGE FUND STYLES



RELATIVE VALUE

Convertible Arbitrage

In general, the strategy entails purchasing a convertible bond while simultaneously hedging a portion of the equity risk by selling short the underlying common stock. Certain managers may also seek to hedge interest rate exposure by selling Treasuries. The strategy generally benefits from three different sources: interest earned on the cash resulting from the short sales of equities, coupon offered by the bond component of the convertible and the so-called "gamma effect". The last component results from the change in volatility of the underlying equity and involves frequent trading. This strategy is often leveraged in order to enhance returns.

Fixed Income Arbitrage

This strategy seeks profits by exploiting the pricing inefficiencies between related fixed-income securities while often neutralising exposure to interest rate risk. This strategy is often leveraged in order to enhance returns.

Statistical Arbitrage

Managers using this strategy attempt to benefit from pricing inefficiencies that are identified using mathematical models. Statistical arbitrage strategies are based on the premise that prices will return to their historical norms. These strategies are often leveraged in order to enhance returns.

EVENT-DRIVEN

Merger Arbitrage

Also known as risk arbitrage, this strategy invests in merger situations. The classic merger arbitrage strategy consists of being long on the stock of the target company while simultaneously selling short the stock of the acquiring company.

Distressed Securities

This investment strategy generally consists of buying securities of companies in bankruptcy proceedings and/or in the process of restructuring the debt portion of their balance sheets. The complexity of such operations often creates mis-pricing opportunities, hence high potential returns.

Special Situations

Also known as corporate life cycle, this strategy focuses on opportunities created by significant transactional events, such as division spin-offs, mergers, acquisitions, bankruptcies, reorganisations, share buybacks, and management changes.

LONG / SHORT EQUITY

Long / Short Equity

This style accounts for the majority of the strategies used by hedge fund managers today. This directional strategy combines both long and short positions in stocks. The net market exposure is adjusted opportunistically. The manager can diversify holdings across different industries, countries, market capitalisations, etc…

Short Sellers

The short selling approach seeks to profit from declines in the value of stocks. The strategy consists of borrowing a stock and selling it on the market with the intention of buying it back later at a lower price. By selling the stock short, the seller receives interest on the cash proceeds resulting from the sale. If the stock advances, the short seller takes a loss when buying it back to return to the lender.

Market Neutral

This strategy is designed to exploit inefficiencies in the equity market by trying to remove the element of systematic risk while extracting the stock-specific returns. These portfolios minimise market risk by being simultaneously long and short on stocks having different characteristics.

OPPORTUNISTIC

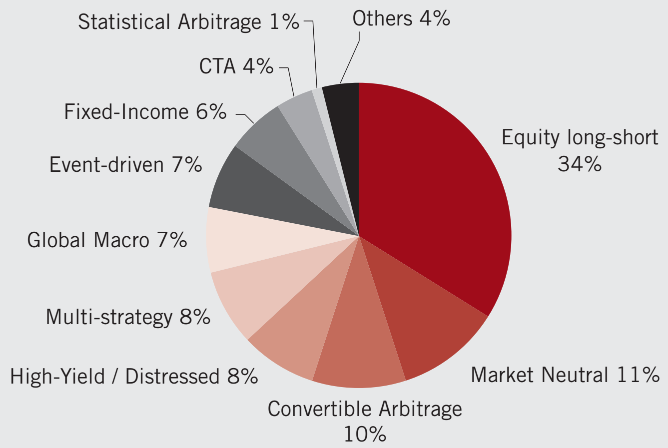
Macro

Macro managers make in-depth analyses of macro-economic trends and formulate their investment strategy based on these, taking out positions on the fixed income, currency and equity markets through either direct investments or futures and other derivative products.

CTA

CTA is the acronym for Commodity Trading Advisor and is also known as Managed Futures. This strategy essentially invests in futures contracts on financial, commodity, and currency markets around the world. Trading decisions are often based on proprietary quantitative models and technical analysis. These portfolios have embedded leverage through the derivative contracts employed.

BREAKDOWN OF HEDGE FUND INVESTMENT STRATEGIES (2003 ESTIMATE)



Source : Goldman Sachs Prime Brokerage fourth annual Global Hedge Fund Investor Survey 2004

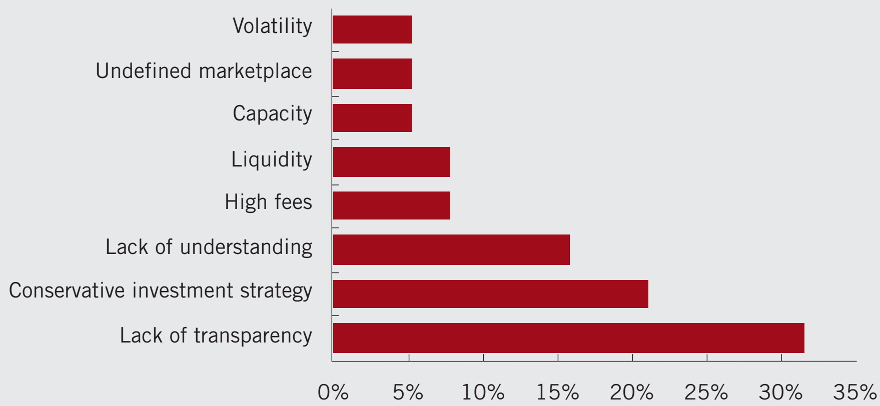
Investing in Hedge Funds

INVESTORS' CONCERNS

Investors are often concerned by the lack of transparency

Misconceptions about hedge funds are often been created by their complex nature as well as the lack of transparency that still prevails in this industry. Investors often regard hedge funds as "Black Boxes", risky by nature but offering high potential returns. For these reasons, first time investors tend to opt primarily for long/short equity strategies whose investment style is similar to that of traditional investment funds.

PRIMARY CONCERNS ABOUT INVESTING IN HEDGE FUNDS



Source : Barra Strategic Consulting Group – Fund of Hedge Funds market survey
Note: Includes both investors currently investing in Hedge Funds and those who do not

MYTH & REALITY

Hedge funds are often misunderstood

In the following section, we list some of the most recurrent myths and explained why, in our view, these myths are in fact misconceptions.

MYTH	REALITY
Hedge funds are very risky and highly volatile.	The primary objective of hedge funds is to preserve capital by minimising volatility, which has historically been much higher on stock markets than with hedge funds.

MYTH	REALITY
Hedge funds lack transparency over their portfolios and organisation.	Nowadays, most hedge funds provide investors with monthly reports containing appropriate financial details. Pressure from institutional investors has helped to increase transparency.
Hedge funds use significant leverage.	Less than 30% of hedge fund managers employ a leverage effect greater than 2x. (source: Van Hedge Fund Advisors International)
Hedge funds are always unregulated investment vehicles.	Although true for most offshore hedge funds, numerous investment managers are regulated by local authorities such as the SEC in the US and the FSA in the UK.
Hedge funds offer no economic added value.	Hedge funds offer a valid alternative to traditional asset classes by allowing investors to optimise the return of their portfolios and the cost of capital.
The failure of LTCM was the failure of the market.	The failure of LTCM was related to a combination of human failure, inappropriate risk management techniques and greed (leverage up to 28x!). It was also the failure of large investment banks which sometimes provided unlimited leverage, incorrectly assessing the risks embedded in LTCM's strategy.
Hedge funds are a main cause of market downturns and volatility.	There is no evidence that hedge funds are linked to stock market crises. Hedge funds only represent 2% to 3% of total investments worldwide.
Hedge funds are only for wealthy private investors.	This idea belongs to the past. Today, even retail clients can invest in listed funds of hedge funds.

THE VALUE-ADDED OF HEDGE FUNDS

Hedge funds improve portfolios' diversification

Hedge funds can contribute significantly to improving the diversification of most portfolios. Historically, hedge fund returns have had a low correlation to financial markets, thereby increasing a portfolio's diversification and reducing its overall risk.

In the following section, we highlight the main differences between traditional investments and hedge funds.

TRADITIONAL INVESTMENT	HEDGE FUNDS
Managers have limited access to sophisticated instruments and hedging techniques such as short selling or derivatives trading due to the restrictive regulatory environment.	Hedge funds provide investors with exposure to a wide range of financial instruments and investment techniques allowing them to reduce risks and take advantage of pricing inefficiencies.
Performance is largely driven by the direction of stock markets.	Success is determined by investment style and the manager's ability to implement it amid any market environment.
Managers have a relative return objective and aim to outperform a benchmark, hence providing little protection in times of market downturns.	Hedge fund strategies aim to achieve risk-adjusted absolute returns regardless of the market environment, rather than simply tracking or attempting to outperform a classic benchmark.
In most cases the portfolio is fully invested.	The manager may choose the investments and weightings at its entire discretion.
Fees are based on the amount of assets in the portfolio, and managers are rewarded for increasing assets under management.	Fees are based both on the assets under management and on the fund's absolute performance. Most of the hedge fund manager's remuneration is performance related. Generally, fees are higher than in the rest of the industry. Most hedge fund managers stop raising new money if they perceive growth to be detrimental to the fund's strategy.
Investments are usually very liquid.	Most hedge funds allow for monthly subscription and quarterly redemption. Some funds impose lock-up periods as well as gates. The liquidity offered to hedge fund investors often reflects the liquidity of the underlying investments in a given strategy.
Regulations normally prohibit managers from investing in the same securities as their clients.	Managers invest part or all of their own assets in their funds and hence bear the same risks as their clients.
Investment vehicles are often domiciled in regulated jurisdictions.	Hedge funds are incorporated in offshore jurisdictions which sometimes lack regulations.

Pictet: A Strategic Partner for Hedge Funds

PICTET & CIE

Hedge funds have always been an important diversification feature of our clients' portfolios

Founded in 1805, Pictet is a pre-eminent asset manager in Europe with a leading market position in the Private Wealth Management sector.

At the end of 2003, Pictet managed USD98 billion for its clients and had a total of USD156 billion under custody. Investments in hedge funds amounted to a total of USD8 billion. Of these assets, around USD1.5 billion is invested in Pictet's funds of hedge funds.

Pictet employs close to 2,000 people worldwide, including 460 investment professionals and a team of more than 100 analysts, economists and strategists.

MANAGER SELECTION SERVICES

A multi-skilled team with an extensive experience in the hedge fund industry

The Manager Selection Services department (MSS) was created approximately 15 years ago. The MSS team is composed of a highly-specialised, multi-talented staff combining Pictet's global investment expertise with the competence of the world's leading asset managers. This position has enabled the MSS team to foster long-term relationships with leaders in the industry.

The MSS mission is to provide investors with hedge funds and portfolios offering both capital preservation and absolute performance features. To this end, a rigorous manager selection process is first applied to the hedge fund universe in order to identify the best candidates. Then, portfolios are constructed based on both classic theories and proprietary financial analysis.

INVESTMENT PHILOSOPHY

- We focus on identifying exceptional investment managers with whom we want to develop true partnerships.
- Over time, we have built a network which has become our competitive edge in new talent's discovery.
- Pictet's independence and risk adverse nature form the pillars of our investment philosophy.

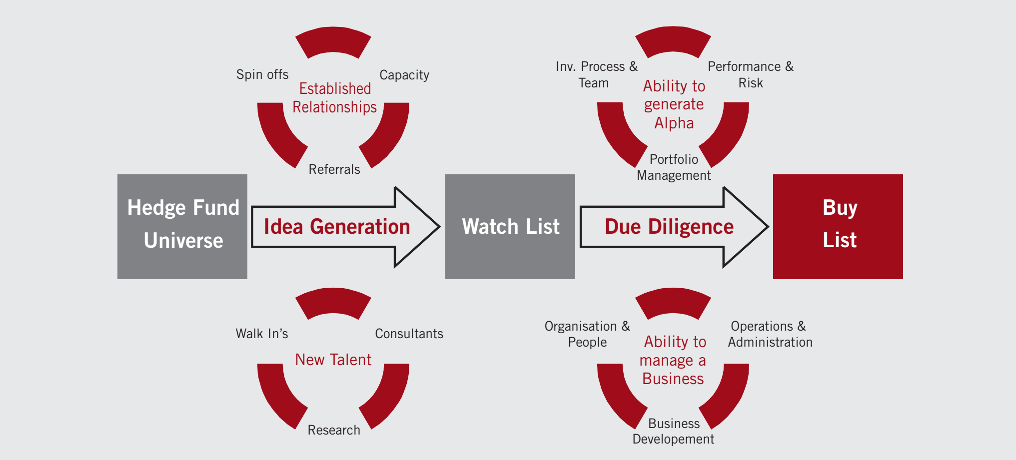
INVESTMENT PROCESS

Investments are made in less than 5% of the managers screened

Overview

The cornerstone of the selection process is a combination of both quantitative and qualitative data. The main goal is to narrow the hedge fund universe down to the managers that will consistently perform regardless of market direction. In addition, the MSS team focuses on finding managers that will outperform their peer group. Our selections are made based on a two-step process: first, an idea generation phase and then an in-depth due diligence phase.

MANAGER SELECTION



IDEA GENERATION

Quantitative

Using several databases, a set of filters is applied to eliminate funds that do not meet the minimum requirements in terms of length of the track record, assets under management, maximum drawdown or volatility.

Qualitative

In order to cover the entire universe, the MSS team leverages an extensive network of industry professionals built up over the years. New investment ideas can come from a variety of sources: industry "word of mouth", contacts with hedge fund managers, conferences, the financial press, consultants, etc…

This first step is key in establishing a watch list of managers with promising characteristics. An extensive due diligence process is then undertaken before making our final selection.

DUE DILIGENCE

Quantitative

An advanced analysis is made based on the manager's track record. On an absolute basis, classic metrics, such as the Sharpe ratio or maximum drawdown are used in addition to proprietary ones. On a relative basis, correlations with various financial benchmarks are examined and a great deal of emphasis is placed on performance versus the peer group.

Qualitative

This phase is paramount in identifying related and non-related investment issues that might hinder performance. Two distinct aspects are scrutinized:

Investment Strategy

Thanks to meetings with the portfolio manager(s) and any person having an impact on trading or the decisional process, MSS ensures that every characteristic of the investment strategy is covered by examining the following aspects:

- Generation of investment ideas
- Selection process
- Portfolio construction (position size, exposure, etc…)
- Risk metrics (liquidity, leverage, stop loss, etc…)
- Performance drivers
- Investment team dynamics

Operational

A careful review of the organisational structure and all parties involved in the running of the hedge fund is carried out. MSS checks the following:

- Background and experience of key employees
- Legal documents and audited financial reports
- Internal controls and segregation of duties
- Procedures in place for risk management
- Transparency and reporting
- Trustworthiness of counter-parties (administrator, prime broker, custodian, etc…)

The due diligence process is key to having the most broad and complete understanding of the manager's ability to provide absolute returns in the long run.

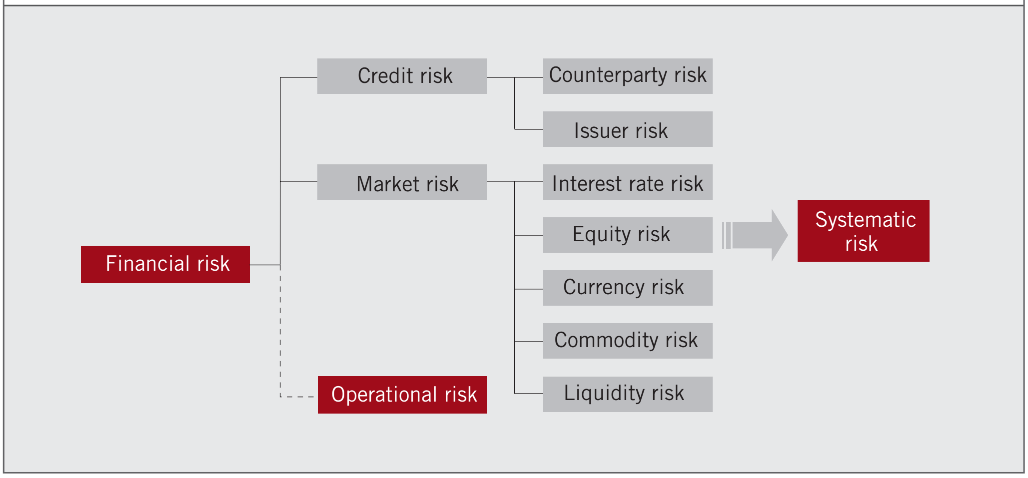
RISK MANAGEMENT

Risk management is the cornerstone of the due diligence process

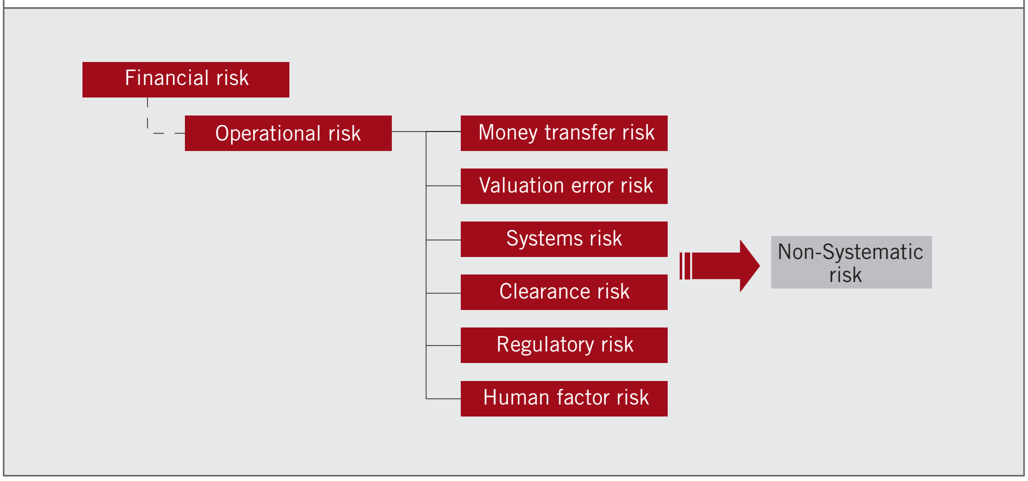
It is crucial to understand all the risks associated with each strategy, as conventional risk measures are not sufficient to assess the potential exposure of hedge funds to more specific and complex issues.

Each investment strategy has specific risks associated with it, namely credit and market risks.

CATEGORISATION OF RISK / SYSTEMATIC RISK



CATEGORISATION OF RISK / NON-SYSTEMATIC RISK



Source : "In Search of Alpha – Bubble or New Paradigm?" Alexander M. Ineichen, UBS Warburg

In addition, the main categories of operational risks are discussed below to show that "risk" is not only synonymous with volatility.

Valuation error risk

The valuation of financial instruments is key in determining the overall portfolio value. That's why the use of conservative pricing models is essential for proper risk control as well as having an administrator able to price these instruments independently.

Systems risk

Appropriate information systems are key in putting in place proper risk management tools and procedures to monitor stop losses, investment guidelines, leverage, gross exposure, etc.

Regulatory risk

The choice of first-class prime brokers, administrators, auditors and legal advisors is key for the longevity of the Fund.

Human factor risk

This aspect is paramount for two main reasons. First, due to the nature of the industry, hedge funds aim to identify and retain the most talented managers. Second, as transparency is sometimes low, the investors must rely on the management team's integrity, ethics and fairness.

MONITORING

Managers are reviewed monthly and visited on different occasions throughout the year

Once an investment decision has been made, the existing managers are continuously monitored. The reviews are carried out through conference calls or preferably through regular on-site visits.

During these meetings, the most important positions held in the portfolio are studied and the potential of the strategy is assessed in light of current and expected economic conditions. These meetings also present a unique opportunity to confirm that the manager is applying the strategy described before our investment in the fund and that there is no "style drift".

Several warning signals that will trigger even closer scrutiny from our team have been identified such as a slow down of the information flow, a decrease in transparency, or the departure of key members of staff.

Overall, this aspect stresses the fact that despite a thorough pre-investment analysis, MSS must ensure that the manager remains consistent with its investment style and risk profile.

PICTET FUNDS OF HEDGE FUNDS

Pictet manages four funds of hedge funds

Pictet launched its first "fund of hedge funds" in 1994. Since then, a family of funds of hedge funds has been developed to suit our clients' needs and offer absolute return vehicles.

- Amerosec concentrates exclusively on long/short managers involved in the US equity markets although in the past this fund included mostly long-only strategies.

- Eurosec is also a single strategy multi-manager fund investing in European long/short managers. Eurosec was launched in June 2000.
- Mosaic, launched in June 1994, is a multi-strategy fund investing in relative value, event-driven, opportunistic, and long/short strategies.
- Mosaic series 2, launched in 1998, is a multi-strategy fund investing mainly in relative value strategies as well as event-driven and opportunistic strategies.

MOSAIC SERIES 2 – EXAMPLE OF MONTHLY REPORTING

PICTET
1805

Mosaic Series 2 -USD-

Pictet & Cie

28 FEBRUARY 2004

KEY INFORMATION			
Company Name	Pictet & Cie	Pictet Id Number	913888
Manager	Bertrand Demole	Pictet Id Number EUR	H19215
Fund Assets	432 mio	Pictet Id Number CHF	H19210
Strategy	FoF Multi Strategy	Subscription Frequency	Monthly
Currency	USD	Redemption Frequency	Quarterly
Minimum Account	10'000	Redemption Notice	45 days
Domicile	Bahamas	Management Fee	1.4%
Administrator	Pictet Luxembourg	Incentive Fee	None
Inception Date	07/1998	Last monthly NAV	79.71

Fund objective & strategy

Mosaic Series 2 is a fund of hedge funds whose investment objective is to achieve superior risk-adjusted returns with limited correlation to traditional asset classes.

The Fund's assets are allocated to hedge fund managers who look for absolute returns while containing volatility. The selected managers invest mainly in Relative Value strategies such as Convertible Arbitrage and Fixed Income Arbitrage, as well as Event-driven and Opportunistic strategies.

Most managers may use hedging techniques such as shorting stocks, derivatives and futures. In addition, they are authorized to use financial leverage.

A specific reporting for both EUR and CHF share classes is available separatly.

Performance

2004	4.0%	Last Month	2.1%	Compound ROR	8.4%
2003	17.5%	Last Quarter	6.8%	Cumulative Return	59.4%
2002	3.2%	Last Year	18.5%	Largest Mth Gain	4.7%
2001	10.1%	2-Year	11.3%	Largest Mth Loss	-3.8%
2000	11.7%	5-Year	11.5%	Cumulative VAMI	1594

Monthly returns

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2004	1.9%	2.1%										
2003	1.4%	1.6%	0.4%	2.0%	1.6%	0.8%	0.5%	0.9%	1.4%	2.1%	0.8%	2.7%
2002	1.5%	0.4%	0.9%	1.0%	0.1%	-1.9%	-1.8%	0.1%	0.4%	-0.1%	1.0%	1.6%
2001	3.3%	2.0%	1.0%	-0.8%	1.0%	0.3%	0.7%	0.6%	-1.2%	1.2%	0.6%	1.0%
2000	-0.2%	2.3%	3.8%	-1.3%	1.7%	1.6%	2.3%	1.9%	-1.0%	0.7%	-2.4%	1.8%

Statistics

Standard Deviation	5.3%	Max. Drawdown	-9.5%	Mths To Recover	14
Sharpe Ratio (1.0%)	1.29	Mths in Max. Draw.	4	Average Mthly Gain	1.3%
Sortino(0%)	2.75	Peak	30/06/1998	Average Mthly Loss	-1.5%
% Profitable Mths	76.8%	Valley	31/10/1998	Average Gain/Av. Loss	0.92

All statistics and performance datas are net of fees and calculated since 06/1998

THE ADVANTAGES OF FUNDS OF HEDGE FUNDS

Diversification improves a portfolio's risk-return profile

The major benefit of investing in a fund of hedge funds comes from the well-known diversification effect.

Numerous studies show that increasing the number of positions in a portfolio tends to reduce the overall volatility while maintaining the same level of returns. Multi-manager products combine several hedge funds which enable the fund to perform in almost any market condition. They offer a low correlation to both stock and bond indices.

HEDGE FUND STRATEGIES' CORRELATION WITH MAJOR BENCHMARKS

	Distressed securities	Macro	Market neutral	Special situation	Standard & Poor	MSCI World Equity	Lehman Brothers Aggregate Bond Index
Distressed securities	1						
Macro	0.4	1					
Market neutral	0.4	0.6	1				
Special situation	0.8	0.6	0.7	1			
Standard & Poor	0.3	0.4	0.4	0.7	1		
MSCI World Equity	0.3	0.5	0.3	0.6	0.9	1	
Lehman Brothers Aggregate Bond Index	-0.1	0	-0.1	-0.1	0	0	1

Source: Copyright 2003 by Van Hedge Fund Advisors International, Inc. and/or its affiliates, Nashville, TN

Funds of hedge funds offer investors a unique gateway into an existing or customised pool of top-notch managerial talent that private investors are often denied. Also, funds of hedge funds enable investors to bypass the substantial minimum investments required by individual funds.

ANNUALISED RISK / RETURN PER STYLE

Source : Tremont index (31.12.1999-31.12.2003) – Pictet & Cie
Note : FoF= Funds of Hedge Funds

TAILOR-MADE PORTFOLIOS

The MSS team constructs tailor-made portfolios designed to match each investor's expectations and risk profiles regardless of market conditions.

OPTIMISATION AND PORTFOLIO CONSTRUCTION

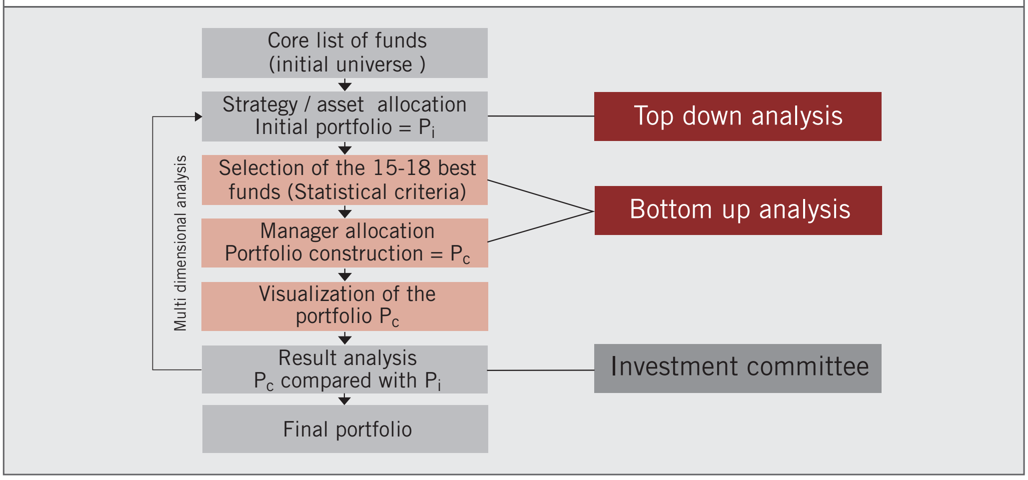
Overview

A new approach to portfolio construction based on quantitative and qualitative criteria

Recognising the importance of portfolio construction, the MSS unit has developed its own unique allocation model combining top-down and bottom-up analysis as well as systematic and discretionary steps. The approach is not that of a black box and although it is very disciplined, it remains flexible and takes into account the experience of the MSS team. The universe of hedge funds is generally limited to the core list.

One fundamental aspect of portfolio construction is running our core list of funds through a quantitative multi-dimensional analysis. The uniqueness of this process is that it can include an almost unlimited number of data. Indeed, numerous qualitative measures can also be included in this statistical research. The goal is to give more depth to the portfolio's optimisation by diversifying the data pool beyond the classic risk/return criteria. After running managers through proprietary models, they are grouped into homogenous risk profile buckets, namely **aggressive, moderate, and conservative**, on which the new allocation will be based.

PORTFOLIO CONSTRUCTION METHODOLOGY



Construction of the top-down portfolio

Following the guidelines of the investment committee, the process starts with the allocation to each strategy and trickles down to the allocation to each fund. This step is both systematic and discretionary and requires in-depth knowledge of each strategy and hedge funds in general in order to determine how future economic conditions might impact their performances. Next, the optimal weighting of each fund within any one strategy is calculated using our proprietary multidimensional analysis.

Once this top-down portfolio has been created, the bottom-up approach can take place.

Construction of the bottom-up portfolio

After running a multidimensional analysis on the recommended funds, the current top 15-18 managers from a statistical perspective are selected regardless of their investment strategy. As the multidimensional analysis allows for a theoretically unlimited choice of quantitative and qualitative criteria, it offers flexibility as to which variable is given the most significance within the current context. Therefore, an excellent fund could be weighted more heavily even though its allocation would be limited by a top-down approach due to it being classified as an ill-favoured strategy.

Synthesis of the bottom-up and top-down portfolios

The flexibility of the overall process allows for an iterative “trials and errors” approach. The final portfolio is the result of the integration of the managers selected in the bottom-up phase within the framework of the top-down allocation. The MSS team’s in-depth knowledge of both strategies and funds is paramount in understanding all sets of data and interpreting them to construct the portfolio that best fits the client’s needs.

Summary

The unique approach of the MSS team in constructing portfolios is the result of a wide array of factors:

- the constraints of the top-down allocation with those of the bottom-up manager selection are intertwined

- a multidimensional method that integrates all the quantitative and qualitative variables available in optimising the portfolio

- a focus on long-term robust performance coupled with a low investment turnover, as opposed to short-term “performance chasing”

- a dynamic periodic review of the overall process, usually every six months

Lastly, despite the complexity of the entire process, the final results can be summarised using simple charts that the client can easily interpret.

CONCLUSION

The regulatory landscape is now undergoing changes which should help to improve the degree of visibility and provide the appropriate controls. The willingness of managers to work hand in hand with local authorities will be key to placating investors' concerns over the lack of transparency. Managers are realising that proper communication relating to their strategy, portfolio, organisation, people and risk management systems are key to their own development.

The continuous start-up of new hedge funds requires a rigorous approach and a full understanding of the risks involved not only with the manager but with all the parties involved. The integrity and ethics of managers and firms require a proper network of references to be in place.

Our recent experience has confirmed our view that this industry is facing important challenges, but we are also convinced that some hedge funds will continue to deliver superior long-term risk-adjusted returns. Hedge funds will increasingly represent a valid investment opportunity for clients used to traditional strategies and will contribute significantly to the diversification and performance of their portfolios.

Partnering with hedge fund professionals is key to selecting the most talented managers, monitoring them and building an optimal portfolio based on this unique investment style.

Glossary

Administrator	The financial institution, generally a bank, that is responsible for all the administrative duties required to manage an offshore fund.
Arbitrage	The simultaneous purchase and sale of a security on different markets in order to profit from a temporary discrepancy in prices.
Benchmark	A gauge of performance of a predetermined set of securities or funds used for comparison purposes. Such sets can be based on indices or specially-customized to suit an investment strategy.
Bond	A debt instrument issued by a central government or private company where the investor, by buying the security, lends money to the issuer who promises to pay back the capital plus interest at a fixed rate. Bonds have a maturity of more than 1 year.
Bottom-up	An analysis method whereby the manager first identifies securities of interest and then studies the sectors or macro-economic environment liable to affect them.
Call option	An option contract that entitles the holder to buy an underlying asset at a specified price until a predetermined expiration date.
Convertible bond	A bond that the holder has the option of converting into shares of the company at certain times during the life of the bond.
Correlation	The degree to which two variables fluctuate in sync with one another or not. Correlation is always expressed between –1 and +1.
Custodian	The financial institution that is responsible for the management and safekeeping of a fund's securities.
Derivative	Financial instruments or contracts whose value depends on the value of their underlying securities, assets, or variables. Examples of derivatives are options, warrants, futures, forwards, and swaps.
Drawdown	A measure of periods of negative performance of a fund, usually expressed as a percentage of its net asset value (NAV).
Exposure	Said to describe the amount of assets that a fund has invested on a market in relation to the fund's total assets.
Financial leverage	Said to describe investments made in excess of capital available.
Future	A contract that provides for the sale of financial instruments or physical commodities for future delivery on a commodity exchange.
Incentive fee	Compensation based on the performance of the investment.
Liquidity	Said to describe a market that is characterized by active levels of trading, allowing buying and selling with minimum price disturbance.
Long	Said of a trading strategy whereby the investor owns a security he holds and benefits when its price rises.

LTCM	Long Term Capital Management. A well-known hedge fund whose collapse in 1998 jeopardized world financial markets.
Management fee	Compensation based on assets size.
Prime broker	A broker that offers more services than a classic broker. Such prime services might include back-office operations, trade reconciliation, financing, record-keeping or custodian activities.
Put option	An option contract that entitles the holder to sell a defined underlying asset at a specified price up until a predetermined expiration date.
SEC	Securities and Exchange Commission. The federal government agency that monitors securities trading in the United States. Equivalent to the FSA in the United Kingdom.
Sharpe ratio	A measure of risk-adjusted return calculated by subtracting the risk free rate from the annualized return and then dividing by the standard deviation of returns.
Short selling	A trading strategy whereby an investor sells a security that he does not own. The holder of a short position benefits when the price falls.
Sortino ratio	A measure of risk-adjusted return calculated by subtracting the risk free rate from the annualized return and then dividing by the downside deviation of returns.
Stop-loss	A trading instruction whereby once a pre-determined percentage loss on any one position has occurred, it triggers either a review of the position or its immediate closing.
Top-down	An analysis method whereby the manager first analyzes macro-economic trends and then picks securities that might be affected by them.
Volatility	A measure of the stability of a financial instrument or market. If the price moves up or down often or erratically, it is said to be volatile. For a fund, volatility is a measure of risk, generally expressed by the standard deviation of the fund's monthly returns.

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