



15 July 2010

**Key Information at a Glance**

L/S Equity	↗
Macro - CTA	↗
Arbitrage	↗
Credit	→
Event-Driven	↗
Nat. Res., Commo.	→

6-month forecasts

**Index Performance (HFRI FoF)**

	MTD	QTD	YTD
<i>Composite</i> Multi Strategy	-1.08%	-2.77%	-1.39%
<i>Conservative</i> Low Volatility	-0.86%	-1.66%	0.02%
<i>Diversified</i> Multi Strategy	-1.34%	-2.81%	-1.28%
<i>Market</i> <i>Defensive</i> Short	-0.10%	-1.46%	-1.89%
<i>Strategic</i> Long Short	-1.16%	-3.58%	-2.35%

Estimated figures as at 30 June 2010

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Global economies are facing many challenges, thus causing feelings of uncertainty. In Europe, austerity measures associated to a weak banking system represent a major source of concern. In the US, the Fed proves to be more accommodating than in Europe but recent economic data generally support the view that the cyclical growth peak is behind. The world engine of growth, China, is also showing signals of growth deceleration. Finally, Japan, which we see as a significant risk due to its high level of debt and fiscal deficit, displays signs of political instability.

In this context and taking into account the last two disappointing months, the hedge fund community has been reducing risk and cutting portfolio exposures. Managers are very cautious; levels of cash are important and negative sentiment, namely in the long-only space, is high. At this stage of the cycle, the expected volatility of our portfolios is low.

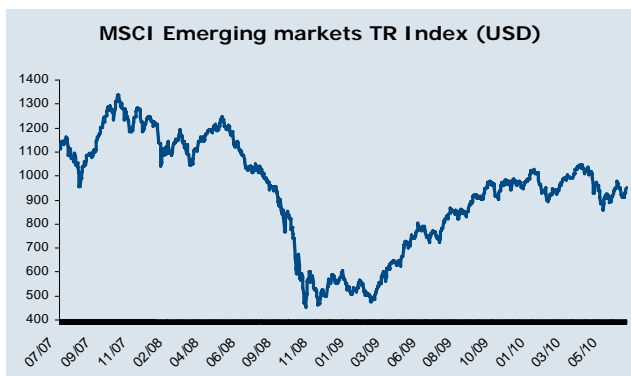
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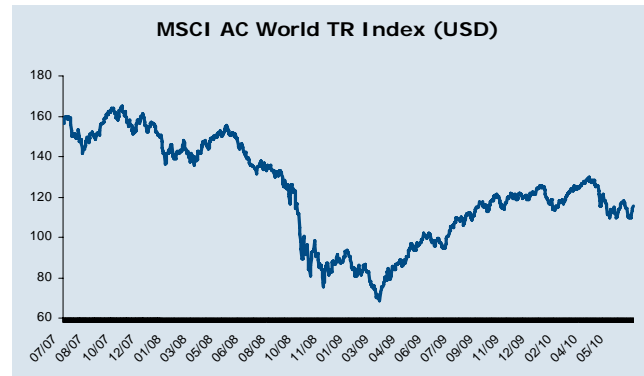
## Outlook by Strategy

### Long/Short Equity

Equity markets experienced a small rise in the first part of June, but fell sharply in the second part as investors faced the effects of lower levels of economic activity. There has been a greater variation in returns between sectors than last month with the winners showing more resilience. The telecom and healthcare sectors managed to end the month with small gains. The losing sectors, however, closely followed the momentum of the economic cycle. Regionally there was also considerable dispersion as the MSCI World lost -3% whilst the MSCI Emerging Markets stayed constant for the period; China for example lost almost -10% while Hong Kong gained almost +2% and South Korea and India were up almost +5%. Nonetheless, the majority of equity markets remained stable apart from a few exceptions which saw falls in value.



In this context, Equity Long/Short managers' performance was also rather mitigated. Managers with a tendency to have some directionality, either driven by a macro overlay, a bottom-up process or by technical factors, and who betted for either a technical rebound or a continuing bearish move, were impacted accordingly. The trading-oriented managers held up well but in general were not able to record gains as the rebound followed by the correction lacked the required short-term volatility. Lastly, relative value funds and those who chose a market neutral stance when facing the current market environment were, on average, constant to slightly positive. Whilst striving to maintain a certain level of diversification, we also continue to believe that relative value focused managers will provide the best risk-adjusted returns in the near to mid-term.



### Event Driven

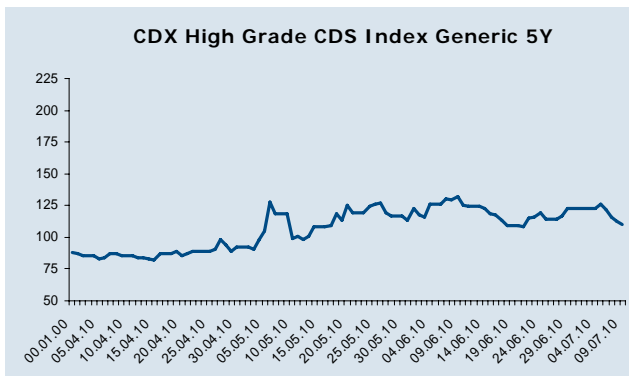
Following the blowout in spreads experienced in May, particularly in the US energy space, spreads have come in somewhat, and those which held, implemented new, or added to existing positions benefitted partially from some spread tightening in June. Other managers with a more directional approach saw some of their core positions bounce back too. As mentioned in previous editions of the 3A Alternative Outlook, the recipes for success are visible for all to see: low interest rates and high cash levels amongst others, but something has to give before M&A activity takes off. There may not be a particularly optimistic view on global growth from where we stand now, which provides ever more reasons for the stronger market players within their respective sectors to acquire smaller yet complementary businesses. When it comes to other strategies within the Event Driven space, opportunities are present albeit all participants would welcome more volume. We are anticipating to increase our allocations to this space over the coming months as and when we feel appropriate to do so.

### Credit

Markets in June were skittish as the sell-off in May deterred investors from expressing large directional views. Along with this, concerns about the European sovereigns and weak macro data out of the US added to the sense of uneasiness. In Asia, the announcement that China would allow its currency to de-peg was initially well received; however, the enthusiasm was dampened when it became apparent that a move in the Chinese Yuan would be gradual and controlled. Last month appeared to demonstrate that the appetite for yield is still present. This is partly demonstrated by the return differential between credit and equity, with investment grade and high yield bonds up +2% and +1% respectively in June, while the S&P was down -5%.

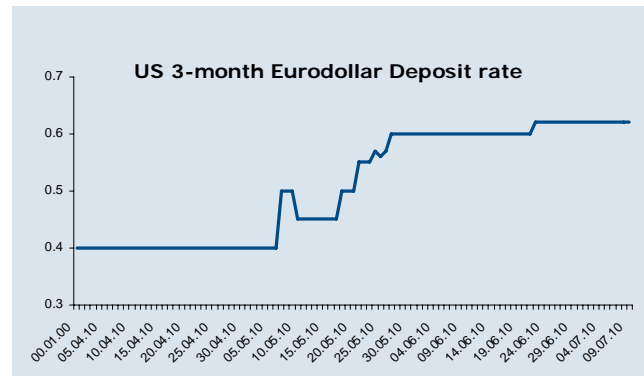
This is slightly skewed due to the support from strong demand for US Treasuries. The lower growth environment which we are in today makes for a seemingly good environment for credit, but with macro risks still looming, a pure long credit approach could be dangerous. Therefore, as we have mentioned previously, we favour those credit managers which remain nimble and opportunistic.

term CTAs. Generally speaking, the fixed-income market was the best performing asset class together with short rates, while the worst detractor to the performance comes from the energy sector that rallied strongly during the month. On a case by case basis, the equity market proved to be either a contributor to performance (mostly for short-term CTAs) or a detractor to performance (essentially for medium-term CTAs). At the risk of repeating ourselves, the renewed volatility and uncertainty will continue to provide a positive environment for CTA and macro systematic funds going forward, and therefore we remain positive on the strategy.



### Arbitrage Strategies

Arbitrageurs ended June in negative territory. Convertible Bond Arbitrage managers were essentially flat for the month. This strategy still offers interesting perspectives in gamma trading and Event Driven investing. Equity Market Neutral funds had a large dispersion in June with a few performing positively but the vast majority faced a challenging month. The outlook for this strategy is rather interesting as spreads between companies have reached historically high levels, implying potential strong returns if market valuations converge to their fair value; nonetheless the summer months and their low volume might temporarily be a headwind to the strategy. Interest Rates Strategy performed very well and our outlook remains positive mainly because of the lack of competition in this area. Volatility arbitrageurs were slightly negative in June. Going forward, we expect this strategy to be able to capitalise on a market environment that will remain more volatile than last year.



### Natural Resources, Commodities

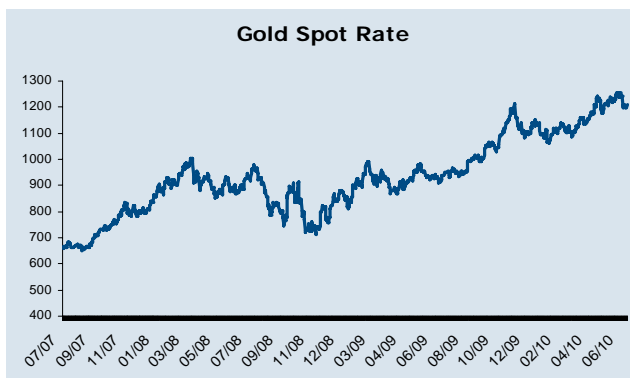
Financial markets were choppy in June due to continued stress in the Euro area and equity markets fell towards month-end. Similarly, base metals were generally trading up in June before selling off in the later part of the month (copper was down -6.1%, zinc -7.4%). This was driven by fears of slowing growth in emerging markets (China in particular) and recession in OECD countries. In precious metals, gold hit a new high in June (over USD 1250/ounce) as the current macro concerns created a bullish environment for bullion, and although some profit taking took place at month-end it finished up +2.2% for the period. Along with other risky assets, platinum was down -1.8% and palladium (-5.6%) also fell in June despite bullish fundamentals.

### Macro & CTA

The month was dominated by sovereign debt issues and markets did not seem to trust the austerity plans announced by European countries. Yields on the GIIPS have continued to rise, while in contrast, less indebted countries saw their yields fall significantly due to concerns about recovery. After a strong beginning of the month, both short-term and medium-term CTAs practically gave up all their positive performance just to recover on the very last few days of the month and end up slightly positive. In contrast, macro systematic funds did not give up much but still strengthened further towards the end of the month together with the short and medium-

In energy, crude oil rallied close to USD 80/bl before retracting to USD 76/bl at month-end but still finished up for the month, with the price mainly driven by macro concerns and related money flows into long only products. Energy demand from emerging markets remains strong but supply from OPEC and non-OPEC countries is also increasing and spare capacity is thus expected to remain important in the coming months. In agriculture, corn, wheat and soybeans prices were roughly unchanged over the month on the back of routine supply and demand as well as good weather. However, the USDA report on June 30th produced bullish implications for corn as it reported lower than

expected inventories and lower than expected new crop acreage. In soybeans, planted acreage was up from the March predictions and stocks were slightly below expectations. In softs, cocoa was slightly down in June, while coffee had a strong month (Sep-10 Arabica +22.3%) due to tightness in inventories. Raw sugar (July-10) was up +27.1% as there is a lack of supply despite the current Brazilian harvesting period. This tightness was also illustrated by the dramatic strengthening of the July-October spread.



Several commodity macro managers were down in June, with the bulk of the negative performance driven by long exposures that ate into performance towards month-end. However, exposures had also often been reduced during May when markets sold off aggressively. As is often the case, some managers were able to de-correlate from their peers and were up in June, by focusing on few commodities or on specific types of trades such as spread trades. Generally, commodity managers are still cautiously positioned for the summer season and waiting for a clearer macro picture to develop, although from a long-term perspective emerging markets are still considered as positive drivers for commodity prices. From a shorter-term perspective, however, specific trade opportunities have been identified, for example in grains or in energy, where an active hurricane season could create some supply shocks across the crude sector.

*Chart sources: Bloomberg*