

15 June 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
Composite Multi Strategy	-2.84%	-1.96%	-0.55%
Conservative Low Volatility	-1.87%	-0.80%	0.90%
Diversified Multi Strategy	-2.57%	-1.75%	-0.18%
Market Defensive Short	-1.73%	-0.86%	-1.33%
Strategic Long Short	-3.38%	-2.52%	-1.28%

Estimated figures as at 31 May 2010

3A SA Research & Portfolio Management
Publications
Tel. +41 (0)58 799 18 00
info@3-a.ch

Two powerful countertrends have been influencing markets since the beginning of May. On the one hand, the recovery dynamic in the United States since the end of last year still appears to be in place. Even the real-estate market, which was one of the factors behind the last crisis, appears to have bottomed out and should stop weighing on economic activity. On the other hand, European countries have yet to demonstrate their ability to achieve long-term fiscal viability. At best, Europe may prove to be the weak link in global growth in 2010. Most negatively inclined observers do not discard the risk of stress contagion spreading from the European banking system to its US and Asian counterparties. The Libor rate is an important indicator in this regard as the major downside risk for the global economy is contagion via the financial system.

Since the end of April, it is the second of these trends that has been the most powerful. Markets have entered a phase of risk aversion and nobody wants to be involved in a new Lehman event. For the end of June, we have partially reduced some specific holdings we had in our portfolios. At this stage, we do believe that the market may enter a more bullish phase going forward. With the cash available by June end we will be in a position to take advantage of the various economic scenarios as they develop.

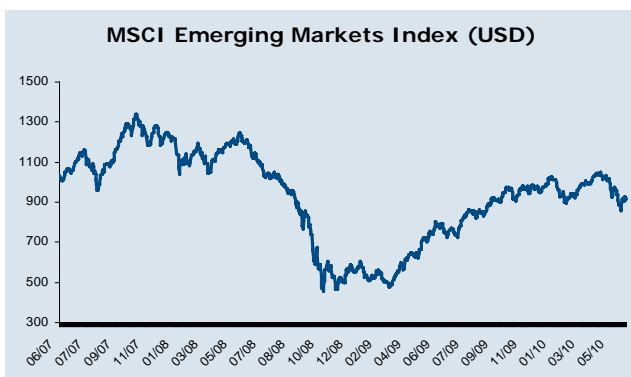
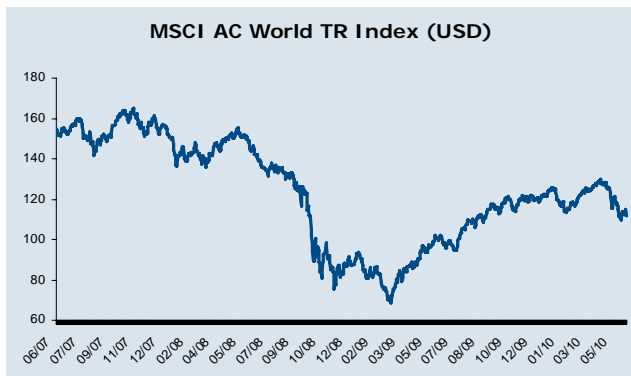
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Outlook by Strategy

Long/Short Equity

Equity markets had a difficult time during the month of May. Despite encouraging signs that recovery, especially in the US, seems to be stable and genuine, the attention of investors was mostly focussed on European countries and the worries linked to the difficulties of managing the sovereign debt of its members. In contrast with the previous month where an important level of dispersion offered long position takers some opportunities, May proved to be a much tougher environment with not many places to hide. The MSCI World Equity Index lost more than -9.40% and the MSCI Emerging markets experienced almost the same with a loss of -8.80%.



In this context, Equity Long/Short managers encountered some difficulties. In terms of investment style, beside the long biased managers, there was no particular type of fund that performed better than the others and performance depended on the specific bets that each strategy had implemented. Trading-oriented managers were quicker to take risk off the table, but some fundamental stock pickers did well thanks to a refocus on the quality of underlying businesses in the second part of the month.

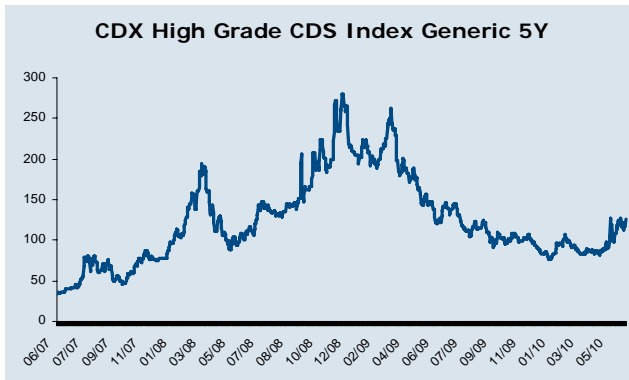
We were happy to see that our selection of managers that remained cautious over the last couple of months performed better than the equity hedge fund indices.

Event Driven

Positive headline news in the Event Driven space was scarce to inexistent during May. The month did, however, prove testing for those who were buy and hold long market directionality, whilst it provided top-up opportunities for high conviction arbitrageurs and dynamic long biased, as long as they could stand the short-term pain. The current turmoil could prove a good entry or position building point. The energy sector was the focus of the May panic due to the fear of increased drilling regulations in the Gulf of Mexico, and several deals saw spreads widen significantly. As the dust settles, corporate activity should pick up going forward, and when it does most sectors should witness considerable activity. But for the moment, and as has been the case for a while, it appears a lot of the cash to be deployed is sitting comfortably on the sidelines.

Credit

May was again a reminder that the world is still an unsettled place. The month kicked off with a continuation of the sell-off that started in the last week of April when sovereign debt concerns escalated. Europe's decision to come up with a EUR 750 billion rescue package did offer some relief, but the fear of contagion and worries about how the rescue package will be paid for pushed markets lower. CDS spreads across Europe, Asia, and the US finished wider. One of the few safe havens was US 10 year treasuries, which returned +2.2% for the month. With the rush from the investment and trading community to reduce balance sheet and risk, most credit managers were unable to post positive numbers. Elevated levels of volatility in the CDS market also caused difficulties, failing to provide an effective hedge against long bond positions. In Europe, the epicentre of the sovereign debt problems, bonds sold off. In Asia markets followed in the same vein, but were also further hurt by escalating tension between North and South Korea late in the month. The few credit funds that did perform well were those that reduced risk early by getting out of long bond positions and holding cash / protection and trading opportunistically. Going forward, risk reduction and contagion concerns remain significant, and the reaction of markets is likely to be highly related to how the various rescue packages and policies are carried out. Given this heightened level of risk, managing a credit book will be difficult, but the nimble and trading-oriented funds should be able to outperform.



Arbitrage Strategies

Arbitrage strategies fared relatively well during a difficult and volatile month. Lower historical leverage and prudent positioning helped managers to limit volatility. In this context, Convertible Bond Arbitrage ended May in negative territory but limited the losses to acceptable levels. The strong reduction in risk appetite negatively impacted convertible valuations, and the average theoretical discount for US Convertibles increased to +1.6% over the reporting period, as measured by the Bank of America Merrill Lynch index. We continue to favour nimble managers in this area with a focus on volatility and event driven situations. Beyond that, we are keeping an eye on capital market activity, which was anaemic during May.

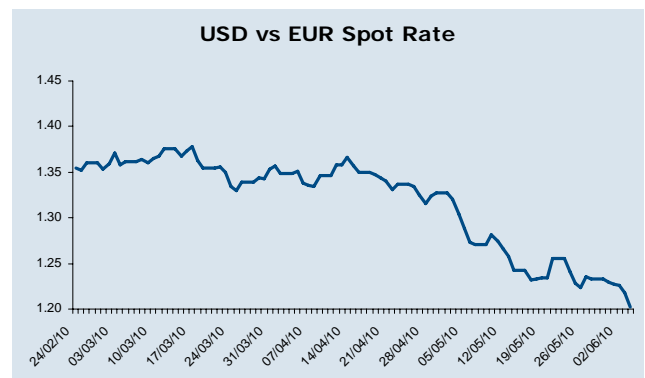
Equity Market Neutral managers faced some challenges in extracting alpha over the period. Both valuation and momentum models suffered from sector rotations and market reversals. Despite this backdrop, we remain confident about their ability to produce strong returns when financial markets revert to greater stability. Volatility Arbitrage produced disparate returns, as long biased managers played their hedging role with a VIX index reaching new highs in 2010. Managers more focussed on Relative Value performed negatively, mainly because of risk reduction behaviour, as market liquidity collapsed over the period. This strategy should however benefit from a liquidity comeback and mean reversion pricing trends.

Macro & CTA

May proved to be extremely volatile. The first week of the month was very difficult with most funds down significantly, while the second week was the opposite and proved highly profitable. On average, the funds in this strategy moved back to flat. Despite a good last week of the month it was not sufficient to compensate for the difficult previous third week of the month. Short-term CTAs took great advantage of this spike in volatility and were by far the best sub-strategy for the month. Medium-

term CTAs on the contrary had a difficult time as their short EUR and GBP exposures and long bonds positions were not sufficient to outperform losses in their equity and energy long positions or the losses generated by the so-called commodity currencies such as AUD and CAD. Macro systematic funds for the most were positioned like the medium-term CTAs and suffered in May although a bit less than the latter. The only asset class that proved difficult for short term CTAs was commodities, as opposed to medium term CTA, who managed to make money on equity trading.

With this renewed volatility in the markets we believe that CTA will be well positioned going forward, namely shorter-term CTA, and able to take advantage of this environment, hence the positive arrow; notice however that May also disclosed an increased cross-strategy correlation, leading to reduced diversification potential from investing across these four strategies.



Natural Resources, Commodities

Almost the entire commodity sector was down in May and the S&P GS Commodity Total Return Index was down -13.2% for the month, as the negative sentiment towards European countries impacted most markets. Crude oil was down -17.4% for the month, zinc was down -15.9%, aluminium -9.7% and corn -3.7%. The few positive commodities in May were natural gas (+10.1%) and gold (+2.7%). Equity markets in the natural resources space were also down in May: NYSE Energy Index -12.75%, HSBC Global Mining Index -10.52%. However, returns across commodity managers displayed some dispersion dependent mostly on the directionality of their trades. Managers with a long exposure to energy had a difficult month as WTI crude oil fell as much as USD 23 peak-to-trough during the month.

As mentioned, gold was up thanks to its safe haven nature as the European sovereign crisis intensified. Moreover, gold is still benefiting from increasing demand (jewelry) while supply is rising at a low pace.

Elsewhere in precious metals, long exposure to palladium (-14.5% in May for the spot) and platinum (-10.1%) detracted from performance. It has to be noted that fundamentals for both of these precious metals remain relatively positive, in particular from the supply side. Together with other risky assets, base metals also fell sharply in May, and again some managers with a long exposure to the sector, based mainly on positive fundamentals for emerging markets, were impacted by such exposure. Despite May's challenging environment, some managers were able to finish the month in positive territory. This was the case for managers with relative value trades in the grains and softs spaces and even in the energy space, where arbitrage between products and along futures curves allowed to generate positive returns.

Following the challenging environment in May, some managers have reduced directional exposures in order to reassess the current situation (global growth, demand from emerging markets, sovereign issues, etc.) and others maintain relative value trades that should prove less sensitive to such sharp market moves. Despite some negative results among commodity managers during May, it has to be noted that they were usually able to limit losses compared to commodity indices.

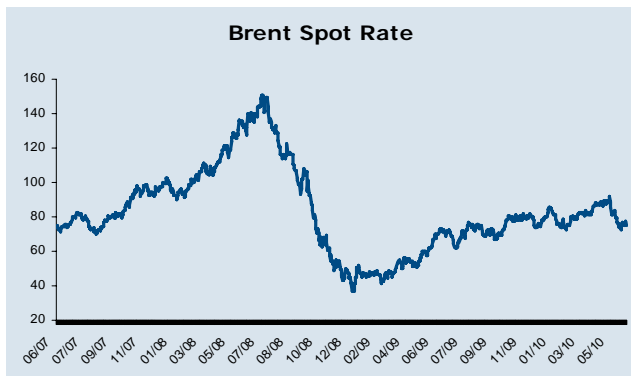


Chart sources: Bloomberg