

H1 2011 Hedge Fund Industry Review

July 2011

H1 2011 Highlights and Key Points

- Hedge funds, as measured by the Dow Jones Credit Suisse Hedge Fund Index (the "Broad Index"), are up 1.7% year-to-date as of June 30, after posting positive performance in four out of six months in the first half of 2011
- Performance was largely positive across strategies with eight-out-of-ten sector indexes posting positive performance in the first half of the year. Top performers included Equity Market Neutral (+5.5%), Multi-Strategy (+4.4%) and Convertible Arbitrage (+3.7%)
- The dispersion of hedge fund returns has continued to narrow in the first half of 2011 with 74% of all funds posting positive performance as managers employ a diverse range of alpha-generating strategies
- The industry saw an estimated \$33.8 billion in inflows in the first half of 2011. If this pace is maintained for the rest of 2011, the industry may be on track to double the asset inflows received in 2010
- Fixed Income Arbitrage experienced the largest inflows (+\$18.4 billion) followed by Global Macro (+\$14.4 billion) and Long/Short Equity (+\$9.0 billion)
- Including performance gains, we estimate current industry assets under management (AUM) grew to \$1.8 trillion as of June 30, 2011 up from \$1.7 trillion on December 31, 2010
- Large hedge funds (those with over \$500 million AUM) dominated asset raising in the first half of 2011, with \$12.1 billion in inflows

Key Market Events in the first half of 2011

- Protests in Tunisia led to the “Arab Spring”, which results in protests across the Middle East and North Africa. Commodities such as Crude Oil see record gains as a result of unrest in key oil producing nations such as Libya.
- Late in the first quarter, a record 8.9 magnitude earthquake in Japan triggers a 30-foot tsunami and ultimately leads to the destabilization of the Fukushima Dai-ichi nuclear power plant.
- In April, Standard and Poor’s downgrades its outlook on U.S. credit to “negative”, raising the possibility that the U.S. might lose its coveted AAA credit rating.
- Concerns over European sovereign debt take center stage in the second quarter as Greece comes under pressure to approve a new round of austerity measures.
- Inflation in China reaches a three-year high in June. The Chinese Central Bank continues raising interest rates in an effort to combat rising prices.

First Half 2011 in Review

- Equity Market Neutral was the best performing sector in the first half of 2011, posting positive performance of 5.5%. Managers in the space captured profit opportunities resulting from sector rotations and stock reversals. Fundamental models also appeared to pick up price reversals in the first quarter. As volatility increased and equities began to sell off in the second quarter, managers’ use of tactical and relative value models helped limit their exposure on the downside.
- Continuing to find profitable opportunities, Fixed Income Arbitrage managers posted another positive quarter pushing the sector up 3.5% in the first half of 2011. Managers who had Interest Only (IOs) security exposure saw some of the largest gains as higher interest rates positively impacted their holdings.
- In the Convertible Arbitrage sector, managers posted positive performance of 3.7% for the first half of 2011 as they positioned themselves cautiously amid continued governmental and macroeconomic uncertainty. Managers chose to tilt their portfolios toward idiosyncratic and special situation trades that benefited from company-specific catalysts.
- Managed Futures funds began the second quarter with a bang. At one point the sector was up 5.4% as trend followers captured positive momentum across energy and long EUR positions in April. However, many managers were negatively impacted in May and June as the commodity rally reversed, resulting in trading losses. Overall the sector is down 3.4% year-to-date.

Figure 1: H1 2011 Dow Jones Credit Suisse Hedge Fund Index Performance Statistics by Sector

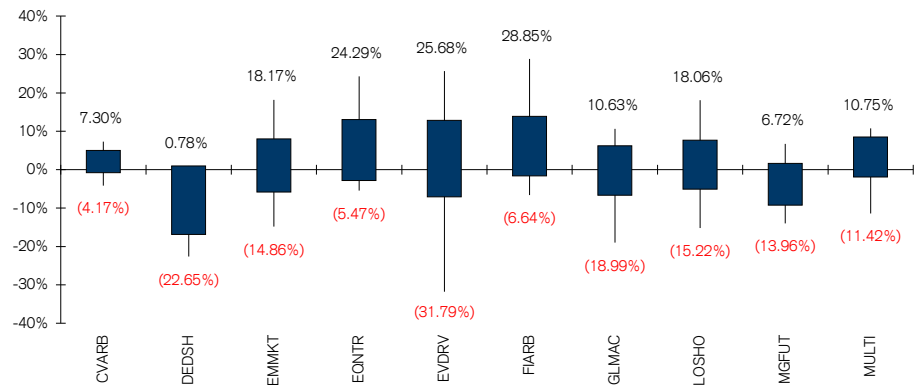
	Sector Weights (as of 6/1/11)	Number		Best Performing Fund	Worst Performing Fund	2010	ITD Return Ann.	ITD Standard Deviation Ann.	
		2011	of Positive Funds						of Negative Funds
Broad Index	100.0%	1.7%	332	119	72.6%	-39.1%	10.9%	9.2%	7.6%
Convertible Arbitrage		3.7%	17	2	72.6%	-2.5%	11.0%	7.9%	7.0%
Dedicated Short		-4.9%	-	7	-0.1%	-20.2%	-22.5%	-4.0%	16.9%
Emerging Markets		2.2%	46	30	25.2%	-10.9%	11.3%	8.1%	15.0%
Equity Market Neutral		5.5%	17	4	57.9%	-4.4%	-0.8%	5.3%	10.5%
Event Driven		1.3%	62	6	24.2%	-39.1%	12.6%	10.2%	6.1%
Fixed Income Arbitrage		3.5%	24	4	27.1%	-7.9%	12.5%	5.3%	5.9%
Global Macro		1.4%	24	14	9.3%	-15.9%	13.5%	12.2%	9.9%
Long/Short Equity		0.8%	103	31	17.4%	-19.3%	9.3%	10.0%	9.9%
Managed Futures		-3.4%	13	18	10.0%	-14.8%	12.2%	6.2%	11.8%
Multi-Strategy		4.4%	26	3	12.3%	-10.9%	9.3%	8.2%	5.4%
S&P 500		6.0%					15.1%	8.2%	15.5%
Dow Jones Global Index		3.5%					11.9%	5.0%	15.8%
Barclays Global Aggregate Bond Index		4.4%					5.5%	6.3%	5.7%
DJ-UBS Commodity Index		-2.6%					16.8%	6.6%	15.8%

Source: Credit Suisse Hedge Index, LLC. Bloomberg. 2011. All data was obtained from publicly available information, internally developed data and other third party sources believed to be reliable. Credit Suisse and Dow Jones Indexes have not sought to independently verify information obtained from public and third party sources and makes no representations or warranties as to the accuracy, completeness or reliability of such information. Inception to date (ITD) statistics based on the performance of the Dow Jones Credit Suisse Hedge Fund Index since January 1994. Past performance is no guarantee or indicator of future results.

Hedge Fund Performance Distribution

Figure 2 depicts the range of dispersions as well as the bulk of returns across each of the Broad Index sectors through the first half of 2011. While the overall performance of managers within most sectors fell in the second quarter, their dispersion has continued to narrow. Multiple factors likely contributed to this increased concentration, including a downward trend in volatility and the defensive positions put on by many managers in an effort to hedge against downside movements resulting from macroeconomic and geopolitical events in the first half of 2011. Overall, with the exception of Dedicated Short Bias and Managed Futures, the majority of managers performed positively throughout the first half of 2011.

Figure 2: H1 2011 Sector Return Dispersion



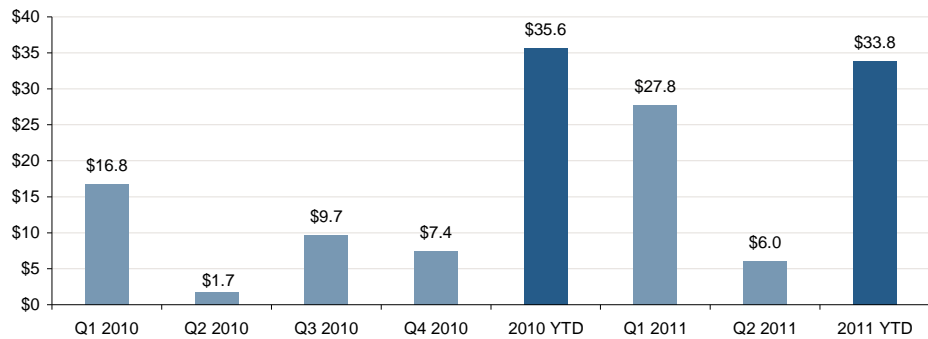
Source: Credit Suisse Hedge Index, LLC. 2011. All data was obtained from publicly available information, internally developed data and other third party sources believed to be reliable. Credit Suisse and Dow Jones Indexes have not sought to independently verify information obtained from public and third party sources and makes no representations or warranties as to the accuracy, completeness or reliability of such information. Past performance is no guarantee or indicator of future results.

Note: Figure 2 depicts the range of dispersions between the 1st and 99th percentile of fund returns in each sector. The bulk of returns are shown as the dark blue boxes (one standard deviation from the mean in either direction).

Asset Flows

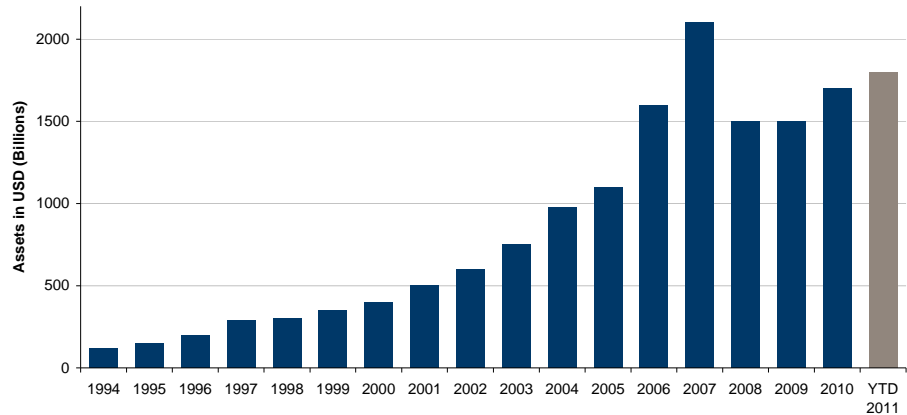
As seen in Figure 3 on the next page, the overall industry assets grew by approximately \$33.8 billion in the first half of 2011. After just six months, hedge funds have nearly surpassed the \$35.6 billion in inflows observed in 2010 and, if flows continue at this pace throughout the remainder of the year, hedge funds could potentially be on track to double 2010's inflows. Overall, industry assets are estimated at \$1.8 trillion putting the industry \$300 billion short of its peak asset level of \$2.1 trillion which occurred in 2007 as illustrated in Figure 4.

Figure 3: Quarterly Hedge Fund Industry Asset Flows



Source: Credit Suisse Hedge Index, LLC. 2011. All data was obtained from publicly available information, internally developed data and other third party sources believed to be reliable. Credit Suisse and Dow Jones Indexes have not sought to independently verify information obtained from public and third party sources and makes no representations or warranties as to the accuracy, completeness or reliability of such information. Past performance is no guarantee or indicator of future results.

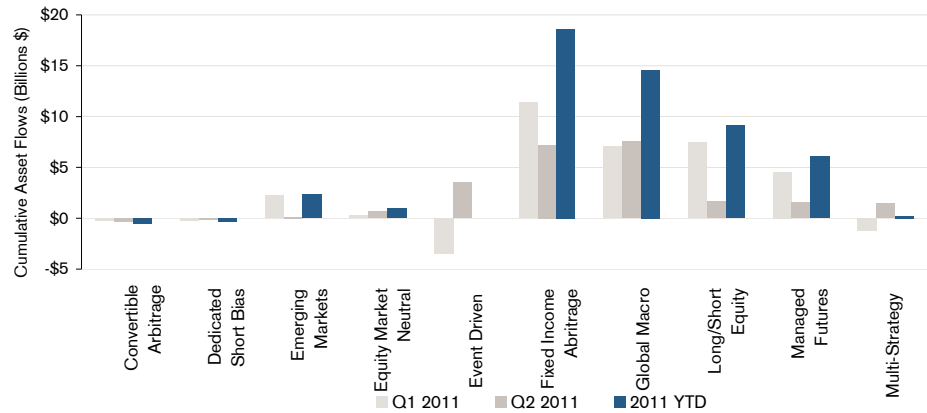
Figure 4: Estimated Historical Hedge Fund Industry AUM (in USD Billions)



Source: Credit Suisse Hedge Index, LLC. 2011. All data was obtained from publicly available information, internally developed data and other third party sources believed to be reliable. Credit Suisse and Dow Jones Indexes have not sought to independently verify information obtained from public and third party sources and makes no representations or warranties as to the accuracy, completeness or reliability of such information. Past performance is no guarantee or indicator of future results.

Analyzed at the sector level (Figure 5 on the following page), Fixed Income Arbitrage (+\$18.6 billion), Global Macro (+\$14.6 billion) and Long/Short Equity (+\$9.1 billion) have seen the greatest amount of asset inflows in the first half of 2011. These flows may reflect investor concerns over the macroeconomic and geopolitical themes that have emerged in the second quarter of 2011, including the European debt crisis and the "Arab Spring". With investors discounting an increased probability of a "tail event", flows have gravitated toward strategies that may profit from a significant shock or a substantial change in government policy.

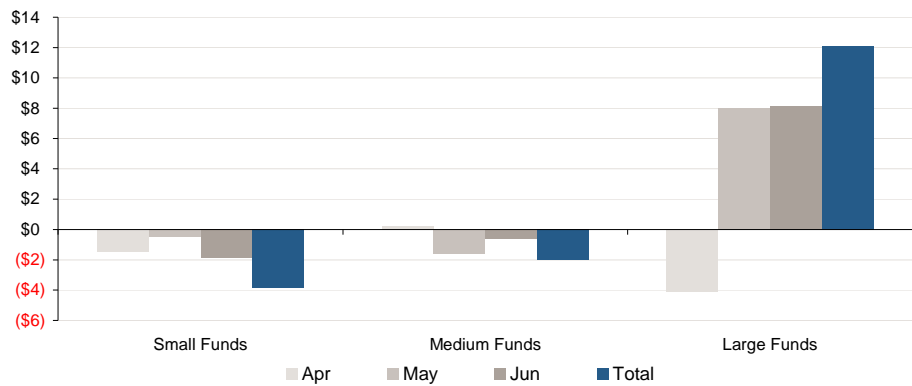
Figure 5: Asset Flows by Sector in H1 2011



Source: Credit Suisse Hedge Index, LLC. 2011. All data was obtained from publicly available information, internally developed data and other third party sources believed to be reliable. Credit Suisse and Dow Jones Indexes have not sought to independently verify information obtained from public and third party sources and makes no representations or warranties as to the accuracy, completeness or reliability of such information. Past performance is no guarantee or indicator of future results.

Note: Q2 2011 asset flows are estimated as of March 31, 2011.

Figure 6: Asset Flows by Fund Size in Q2 2011



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Once again in the first half of 2011, the largest third of funds (funds with over \$500 million) outpaced the asset raising efforts of their peers in the second quarter with over \$12.1 billion of inflows. As illustrated in Figure 6, middle-tier funds (those having between \$150 million and \$500 million in assets under management) and small funds (funds with less than \$150 million in assets under management) both experienced net outflows (\$3.9 billion and \$2.0 billion respectively). This trend continues to demonstrate investor demand for larger-scale hedge fund managers who possess established infrastructures.

Endnotes

The Dow Jones Credit Suisse Hedge Fund Index is compiled by Credit Suisse Hedge Index LLC and Dow Jones Indexes, the marketing name of CME Group Index Services, LLC. It is an asset-weighted hedge fund index and includes only funds, as opposed to separate accounts. The Index uses the Credit Suisse database, which tracks over 9,000 funds, and consists only of funds with a minimum of US\$50 million under management, a 12-month track record, and audited financial statements. It is calculated and rebalanced on a monthly basis, and shown net of all performance fees and expenses.

Dow Jones Global Index: The Dow Jones Global Index is a broad yet investable measure of the global stock market. It targets 95% coverage of markets open to foreign investment. The index currently tracks 51 countries, including 25 developed markets and 26 emerging markets.

Barclays Global Aggregate Bond Index: A market-value-weighted index of government securities, mortgage-backed securities, asset-backed securities and corporate securities, each with a maturity of over one year, designed to simulate the universe of bonds in the market.

S&P 500 Index: The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Investors cannot invest directly in an index.

Dow Jones-UBS Commodity Index: The Dow Jones-UBS Commodity Index is a composite index of commodity sector returns, representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities.

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