



Introduction

With the rapid growth of hedge funds in the last decade across the globe there has been strong demand for benchmarking tools from both hedge funds and investors. EurekaHedge cover 9000 alternatives and disseminate data on **7095** which has enabled us to launch a fully comprehensive suite of 200+ hedge fund indices available here, www.eurekahedge.com/indices, and on Bloomberg at HDGE.

Reasons for the launch of so many indices have been driven by demand from our single and multi-manager clients looking to benchmark against a relevant index that more closely mirrors their regional and strategic mandates, and also demand by investors to ensure their managers are outperforming a "bucket" of their peers. Existing users of our indices also desired subsets based on region, country, strategy and fund size.

Also we felt that while the hedge fund industry is technically an absolute return industry, the demand for relative evaluation is strong and currently available hedge fund indices, although useful in providing a rough overview of the performance of the hedge fund universe, were not accurately reflecting the aggregated performance of each identifiable geographical and strategic hedge fund theatre and, therefore, were not appropriate for individual managers to use as a relative benchmark in presentations and monthly reports.

Methodology

In order for a fund to feature in the indices they must adhere to the following criteria

Mean Returns

The monthly index values are the respective mathematical means (average) of the monthly returns of all hedge fund constituents in the index at that time. Unlike other indices they are not asset weighted (see relevant paragraph below) or the median return. A simple example of the differences of a mean and median return index follows:

Fund Name	August Return (%)
Fund A	1.00
Fund B	5.00
Fund C	-3.00
Fund D	4.00
Fund E	4.00
Fund F	5.00
Fund G	-2.00
Mean	2.00
Median	4.00

Essentially the Median return ignores all values above and below the middle ranked value (in this case 4%) and in the case of a population of returns that demonstrate kurtosis will generally overestimate or underestimate the average of the population. In the example above the true mean is 2% however the median return is 4% due to this value (4%) being the middle ranked value.

Regional Mandate

90% of the regional mandate of that fund must be in that specific region or country. For example there are 1500¹ European funds in our database but we have only 228² funds in the EurekaHedge European Hedge

Fund Index. Many European based funds do not exclusively allocate to Europe but have significant allocation outside Europe to the US. Likewise US based funds that allocate exclusively to Europe will be included in this index. Essentially head office location is irrelevant.

To further elaborate on the regional indices:

The **Asian** index comprises funds that allocate 90% of their strategy to Asia Pacific - the region consisting of South Asia, South East Asia, Australasia, China, Hong Kong, Taiwan, Korea and Japan.

The **Asia ex Japan** Index is comprised of funds that allocate to Asia Pacific but have 0% exposure to Japan.

The **Greater China** index comprises funds that invest in mainland China, Hong Kong, Macau and Taiwan.

Other country-specific indices comprise funds that have a respective single-country strategy. For instance the Japan index is comprised of funds that pursue a pure Japan strategy.

The **European** index is comprised funds that allocate to Europe including Iceland, Greenland, Turkey, Russia and the CIS, and South Africa.

The **North American** index comprises funds that allocate to the United States, Canada & Alaska.

The **Latin American** index comprises funds that allocate to Mexico and Central and South America.

For an overview of the above in map-form, please visit <http://www.eurekahedge.com/funddatabases/>.

Unique Funds

Only "unique" funds are selected for the index (no duplicate share classes, currency denominations, onshore and offshore versions of the same fund, series etc.). For example if we include both sets of performance numbers for the European Absolute Return Fund-USD and the European Absolute Return Fund-EUR in our database we would only include one set of performance numbers. For arguments sake we take the fund with the most assets in that class.

Equal Weighting

The indices are not asset weighted. We are simply trying to give an overview of the average performance of hedge funds and not attempting to highlight monthly inflows and unjustly weight the performance of certain funds because they have good marketing staff or are located in investor hot spots.

Taking the above data we can see in the example below that for a single month's returns the difference in index values is 2.16% depending on whether an index is weighted by the fund's asset size or not. Essentially a weighted index like this is ignoring the performance of 70% of the funds in it due to their comparatively lower asset size.

Fund Name	August Return (%)	Asset Size (US\$m)	Weighted Return (%)
Fund A	1.00	100	0.08
Fund B	5.00	50	0.21
Fund C	-3.00	500	-1.27
Fund D	4.00	20	0.07
Fund E	4.00	30	0.10
Fund F	5.00	80	0.34
Fund G	-2.00	400	-0.68
Average	2.00		-0.16

Equal weighting also encompasses funds denominated in different currencies, such as USD, Euro and JPY. To

reiterate, the index is purely an average of the performance of the constituent funds irrespective of currency denomination.

Dead Funds & New Funds

If we discover new funds with a historical performance history these funds will be immediately included in the index and all returns rebalanced accordingly. If a fund dies its track record will remain permanently in the index.

Survivorship Bias

There has been an abundance of research into survivorship bias and the supposed influence on hedge fund indices. Whether you agree or not that the impact of this is significant EurekaHedge has undertaken 3 things to eliminate this effect as much as possible. (1) EurekaHedge launched the indices with an inception date at January 2000. This was a year before EurekaHedge was founded and hence we have been in a good position to monitor the attrition rate of hedge funds around the globe since this time. (2) In each of our databases we have a separate section for "Obsolete Funds" in order to provide complete transparency to our subscribers on the status of the hedge fund universe since we started monitoring it. (3) If we uncover a fund that died before we even included it as a live fund we will endeavour to track down the historical returns of this fund to include in our database and indices.

Latest Index Values

As and when we receive monthly NAV updates from the managers these are fed immediately into our database thus providing the latest index performance changes on a daily basis. Every day we analyse all the funds in our database and calculate the latest values based on the % of NAVs returned by the fund managers. This would mean that historical index values may also be altered and the index rebalanced, as and when new information is captured by our database. The concept and the rationale behind this may best be illustrated by drawing a contrast between equity indices and hedge fund indices:

Equity indices are comprised of publicly listed companies that must disclose their full financial information to the market. So when we look at say, the FTSE 100, we know that this comprises the top 100 (by market cap) publicly listed companies in the UK. Hence the FTSE 100 is 100% transparent and 100% representative of the underlying constituents.

Hedge Fund Indices: Unlike constituent companies in equity indices, hedge funds are not obliged to present their information to anyone. Hence having complete access to all information about hedge funds and their respective returns is nigh on impossible. Database providers like ourselves strive to do the best we can. To that end, we at EurekaHedge are reasonably successful and employ 12 people purely to gather and maintain hedge fund data from around the globe. However we cannot maintain 100% coverage of the industry. To that end we could not provide an index of, say, the top 100 hedge funds by size as maybe 1 or 2 of those funds may decide not to provide us with their returns. Or we could start running the index with all 100 funds and then a fund may suddenly stop reporting even though it is still active and trading. Hence hedge fund index providers cannot follow the equity index methodology. There are 2 ways to get around this, and by extension, 2 types of hedge fund indices:

1. Some index providers have an agreement with a set number of hedge funds to provide regular returns based on those constituents. So, for example, they call up 100 hedge funds, ask if they'd like to be in their index and then ask them to provide regular performance reports. The number of constituents is set and inflexible.

- Advantage - the historical data does not change
- Disadvantage - the indices are unrepresentative of the industry due to the inflexible nature of constituent fund inclusions

2. Other index providers include all funds that they have data on for that particular sector. If the provider discovers a new fund that has a historical track record then the index will be rebalanced and the historical index values altered accordingly.

- Advantage - the indices are as representative as they can be of the actual performance of the hedge fund industry
- Disadvantage - the historical data changes

We, at EurekaHedge, strongly believe that the second methodology is the most sensible way of accurately reflecting the actual performance of the hedge fund landscape and also take it one stage further; every day we rebalance our indices to include the latest performance based on the number of constituent funds that have reported their data so far. For example the EurekaHedge Asian Hedge Fund Index was up 3.25% in September 2005 based on 44% of the NAV returns as at 12 October 2005 (out of 309 constituents).

More Information

For more information on EurekaHedge Indices please contact indices@eurekahedge.com or call Singapore on +65 6212 0924.

Footnotes

¹ As at 1 August 2005

² Constituents as at 30 June 2005