## September 2008 Hedge Fund Performance Commentary

*Eurekahedge*

### Introduction

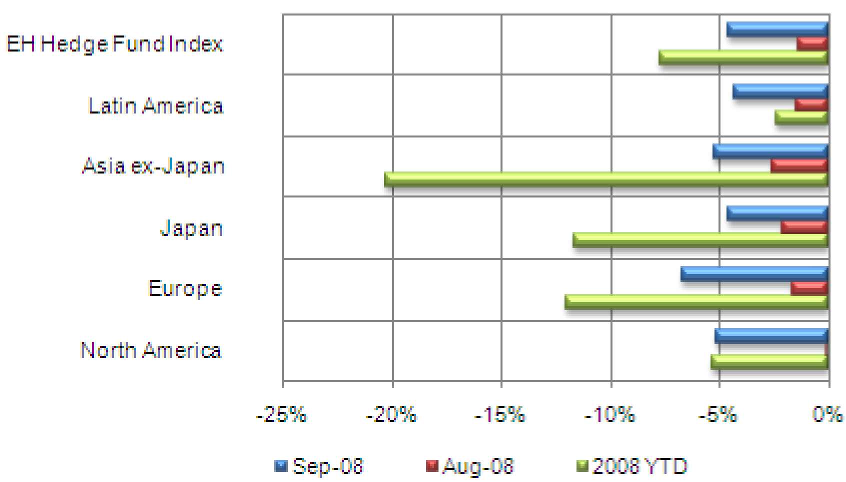
The Eurekahedge Hedge Fund Index lost 4.6%[1] in September, bringing average returns for the first nine months of 2008 to -7.7%, as hedge funds were able to stem drawdowns in a month that saw the S&P500 make its biggest single-day fall since 1987 (eventually finishing September down 9.1%), crude oil prices go into double-digit declines and the Dow Jones-AIG Commodity Index shed 11.6% on the month.

The month's market movements came amid historic trigger events in the global financial markets, as the bankruptcy, taking over or bailing out of major, centuries-old institutions in the US and Europe brought the year-long subprime-triggered turmoil in the markets to a boil. Markets were further roiled by uncertainty over the US Treasury's proposed US$700 billion bailout Bill and the Congressional debates surrounding it. In the wake of these market movements, regulators in the US and UK initiated (and later extended) unprecedented bans on short-selling of a wide basket of financial company stocks, with clauses on disclosure of existing short positions. These were quickly followed by similar bans in equity markets in Australia and Taiwan.

The shorting bans and attendant disclosure clauses, coupled with distress across some of the largest service providers to the hedge fund industry and anticipated redemption pressure from investors, weighed heavily on hedge fund managers during the month, and partially contributed to the month's returns.

The chart below illustrates the current-month, previous-month and year-to-date returns across different regional mandates, reflecting a more pronounced negative trend in fund performance than August in light of the afore-mentioned market events. Evidently, declines in most regional hedge fund indices during September were not far from the global average, as the month's market movements globally were dominated by weakness in the US financial sector. In Europe, however, the combined effect of problems at US and regional banks led to steeper declines in European hedge fund allocations (-6.7%).

Eurekahedge Performance Indices - 2008 YTD (Regions)




Source: Eurekahedge

[1] Based on 68% of the funds reporting their September 2008 returns as at 17 October 2008.

**Global Market Review**

Global equity indices closed sharply lower in September as alarming news emanating from the financial sector heightened risk aversion and shot volatility up to record levels (the volatility index, VIX, finished the month at an all-time high of 46.72). The MSCI World Index fell 11% on the month. Among regional equities, the S&P500 shed 9%, while European bourses saw declines of 10-12% on average and in Asia, the Nikkei 225 fell 14% and the Hang Seng 15%.

Bond prices remained volatile although prices were range-bound and largely flat on the month. Credit markets, on the other hand, seized up in September as uncertainty surrounding the banking sector and the extent of government intervention grew, and interbank rates widened to record levels despite efforts by major central banks to assuage the liquidity crunch.

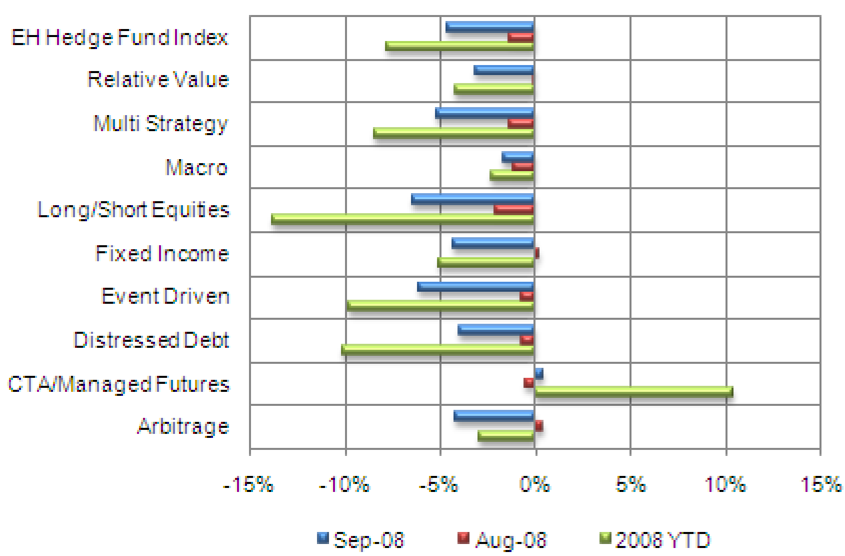
In the currency markets, the US dollar generally strengthened against most major currencies, on account of heightened risk aversion, a weakening UK economy, problems at major European banks and growing expectations of a rate cut announcement from the European Central Bank.

The uncertain outlook for the global economy also pushed commodity prices lower. Crude oil prices have come down from their all-time highs (in June) of US$150/barrel, falling for the third month in a row to US$100/barrel. There was, however, a mid-month surge as the US government's bailout plan was expected to support energy demand when it was first announced.

Amid unprecedented volatility levels across asset classes, the few opportunities to be found were in short-term directional trends in the commodity and currency markets. True to form, managed futures and macro strategies turned in the best returns for the month (ie marginally positive and least negative, respectively).

The chart below shows the current-month, previous-month and year-to-date returns across strategies, while the following sections take a closer look at individual strategies.

**Eurekahedge Performance Indices - 2008 YTD (Strategies)**



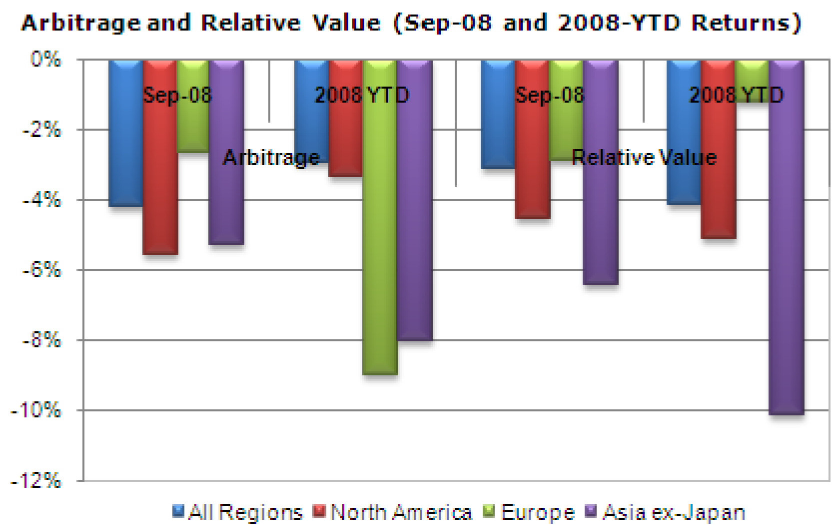

Source: Eurekahedge

**Strategy Performance**

**A) Arbitrage and Relative Value**
September marked the worst month for arbitrage (-4.2%) and relative value (-3.1%) strategies in the nine years that we have been tracking hedge fund performance. The negative performance was driven by illiquidity, liquidations of bankrupt entities, unwinding of portfolios, the ban on short sales and investor redemptions.

Several of the managers were faced with significant selling pressure on their long positions and short squeezes on their shorts. Allocations to equity market neutral and statistical arbitrage also detracted from results due to losses on both longs and shorts across regions and trading timeframes.

Across regions, North American and Asian allocations were similarly hit, booking losses of nearly 6% on the month but European managers were better positioned to weather the spike in volatility, and long-volatility trades helped shore up the regional average.



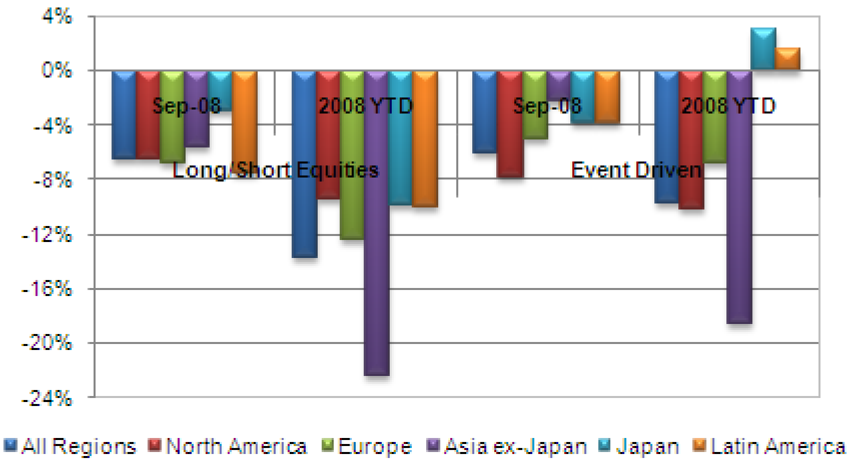

Source: Eurekahedge

**B) Long/Short Equities and Event-driven**
September was a brutal month for equity-focused strategies as volatility spiked dramatically, the markets were unduly driven by technicals, and steady de-leveraging over the past few months diluted the performance of market neutral funds. Also, the profitability of long and short positions on the capital structures of troubled financials became reliant on the unpredictable bailouts doled out by the US government, and North American long/short and event-driven (capital structure arbitrage) managers were particularly hit as a result; the latter lost a whopping 8% on the month.

Long/short managers allocating to emerging markets, however, were the worst hit as the month's dramatic sell-off in world equities had a more pronounced effect on emerging market equities; the MSCI Asia ex-Japan Index fell 16.7%. Real estate and banking linked sectors saw sharp erosion in value among Hong Kong (-15.3%), Singapore (-13.9%) and Indian (-13%) equities. China was a relative exception, with the Shanghai Composite falling 4.3%, owing to policy measures by the Chinese government to ease lending squeezes and risk aversion.

Japanese equities also fell due to a record 22% slump in Japanese exports to the US during the previous month (the TOPIX was down 13.3% for September).

Long/Short and Event Driven (Sep-08 and 2008-YTD Returns)



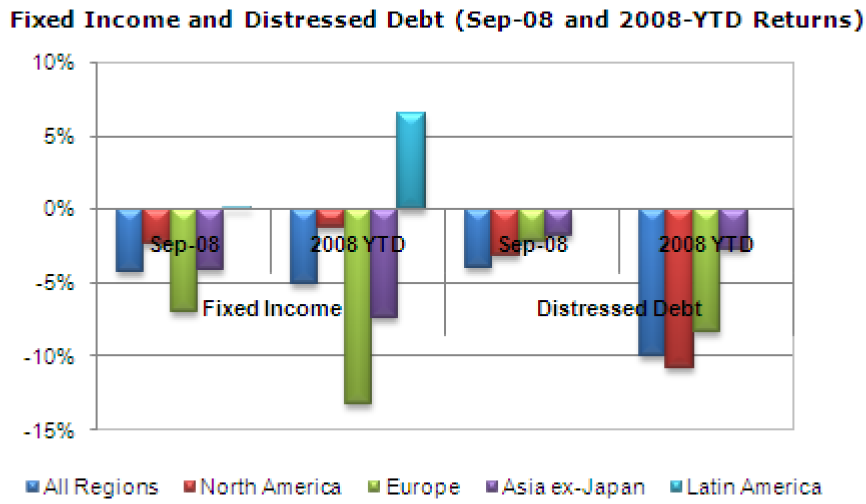

Source: Eurekahedge

Event-driven managers also suffered (-6%) as merger arbitrage spreads widened across the board, irrespective of how short the time to deal closure was or whether financing was an issue, and non-merger event names were caught in the market-wide sell-off. Similarly, equity restructurings experienced significant negative returns as widening holding company spreads as well as long position losses across all regions offset positive returns from outright stock shorts, and index and option hedges.

**C) Fixed Income and Distressed Debt**

Fixed income (-4.3%) and distressed debt (-4%) too were material detractors from performance as long positions declined across every sector on intense selling pressure in both distressed bonds and bank loans. On the other hand, reduced levels of leverage and short-term tactical trades helped fixed income arbitrageurs protect capital and turn in marginal gains, but these short positions and high cash balances could not fully offset the long position losses.

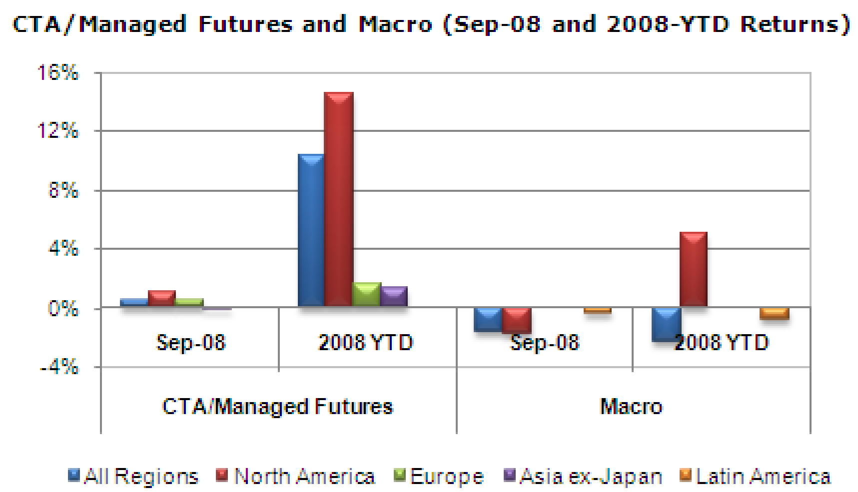
Distressed debt managers allocating to North America had it particularly rough in September, as the US high yield market fell more than 8% in its worst month ever, and the leveraged loan index fell nearly 6%. As with event-driven funds, most of the month's losses came from de-leveraging, forced liquidations and re-pricing of credit (for instance, the junk bond market was trading at a record yield of nearly 19%). Also, positions (long as well as short) in the debt portion of the capital structures of ailing financials were largely a hit-or-miss affair, as the US government nationalised Freddie Mac and Fannie Mae and bailed AIG out with a US$85 billion loan but let Lehman Brothers fail.




Source: Eurekahedge

**D) CTA/Managed Futures and Macro**

CTA/Managed futures was the sole strategy in the black for September, as bearish curve trades in oil futures and long volatility bias in funds' options portfolios helped negate losses from the market-wide downturn in asset prices. Returns from regional allocations were largely flat, with the exception of North America which turned in a profit of 1.1% on the month.

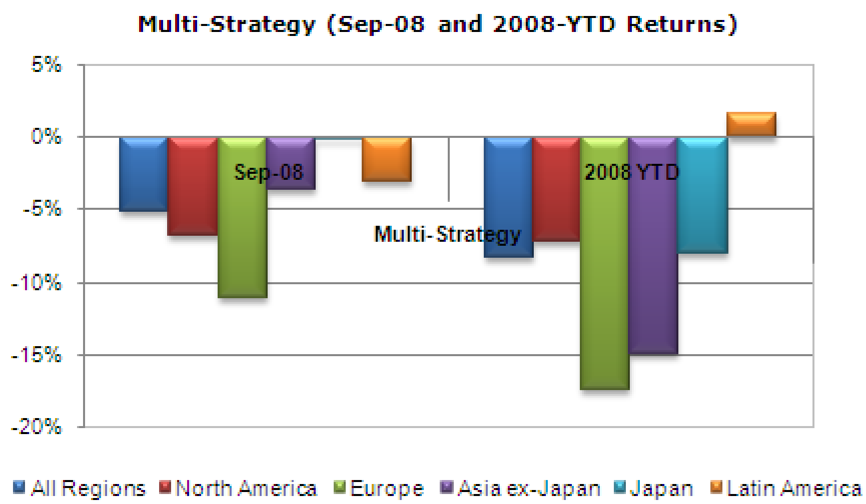



Source: Eurekahedge

Directional macro was the least negative strategy in September (-1.6%), with short positions in equities and commodities generating gains/offsetting losses as these markets trended strongly lower. Short-term trading also made money from volatility in equity, energy and metals markets. Currency trading benefited from the strength of the JPY against both the USD and EUR, and from relative USD strength against a range of other major currencies.

**E) Multi-Strategy**
Most hedge fund strategies in September were buffeted by free-falling asset prices, reduced leverage levels, major weaknesses in the global financial system, plummeting risk appetites and mounting redemption pressures, resulting in some of their worst losses in quite a few years. So too were multi-strategy funds, with the Eurekahedge Multi-Strategy Hedge Fund Index posting its worst monthly return in nine years (-5.2%) by a long margin (more than double the previous worst monthly return of -2.5% in January 2008).

Most regional multi-strategy allocations were in line with the global average, with the exception of Japan (-0.2%) and Europe (-11.1%). This had partly to do with the stronger capital base of Japanese banks (some of which have taken on stakes in ailing western banks) relative to their counterparts in the US and Europe. Japanese funds also benefited from reallocating away from equity-focused strategies.



Source: Eurekahedge

**In Closing**

The financial landscape has permanently changed after the historic events of September, and markets are seized up by a crisis of investor confidence. Major central banks have been struggling to quell market fears, inject liquidity, cut rates and kick-start growth in the face of an increasingly recessionary outlook for the global economy. On the flip side, inflationary fears have subsided, energy prices are back at the levels a year ago, and most central banks have made the shift of focus to tackling slowing growth. But it must be noted that these measures take time to gain traction and take effect, and a period of uncertainty and re-adjustment is to be expected.

The unprecedented market volatility of September which has continued into October, has led to significant losses and increasing risks, but also unprecedented opportunities. The primary challenge for hedge fund managers is to de-leverage and resize positions to appropriate levels, and to manage cash levels in order to meet any investor redemptions in the coming months.

On the topic of redemptions, we are optimistic about the extent of outflows (ie there will be some outflows, but not substantial) in the remaining months of 2008, chiefly because some fund managers have either temporarily disallowed redemptions or extended notification periods in an effort to avoid closing positions at a loss in order to meet those redemption demands. Also, consolidation among prime brokerage firms has locked up some of the larger managers' assets in margin accounts (for instance, at the time of filing for bankruptcy, Lehman Brothers' brokerage arm reportedly held US$40 billion in collateral assets). Furthermore, we are seeing some previously closed funds opening up selectively for less risk-averse investors, and this could counterbalance net industry outflows.

Our overall outlook for the hedge fund industry therefore remains positive. We also do not foresee too adverse an impact on fund performance from the recent bans on short-selling implemented in key equity markets, as negative views on a security may still be expressed through derivatives (writing deep-in-the-money call options on a stock or an index, for instance). Moreover, there have been an estimated 60,000 job cuts in the major US banks over the past 12 months, a portion of which may reasonably be expected to drive hedge fund start-up activity in the near term. We know of at least 70 new funds launching in the remaining three months of 2008.