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U.S. MARKET COMMENTARY

LONG/SHORT HEDGE FUNDS: BOTTOMS UP?

June 2012

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June 2012 U.S. Market Commentary

Long/Short Hedge Funds: Bottoms Up?

Eric Winig, Sam Hecht, & Ayla Samadova

After a difficult few years—capped off by the *annus horribilis* of 2011—are long/short hedge funds a buy … or sell?

"When we really know the world, we see that it is just a world full of errors."—Thomas Bernhard, Concrete *(New York: Knopf, 1984)*

Over the past several years, global financial markets have endured a number of high-stress periods, including the mid-2007 downturn, the Bear Stearns and Fannie Mae implosions in 2008, the late 2008 to early 2009 financial crisis, and a number of recent downlegs related to the European sovereign debt crisis. At the same time, many investors have increased their exposure to hedge funds—including long/short funds—partly as a means to mitigate volatility and provide downside protection during such periods.

However, long/short funds have hardly proven the panacea many expected. While such funds have provided some downside cushioning during crisis periods, returns for the post-2007 period as a whole have been disappointing, due in large part to an extremely difficult 2011 when long/short funds suffered through a horrid third quarter and trailed most equity indices badly for the year. Meanwhile, investor choice has multiplied thanks to the proliferation of other strategies[1] with similar goals—i.e., equity-like returns with lower volatility—but better transparency and lower fees.

Still, it is important for investors to consider (or reconsider, as the case may be) what should be expected from long/short funds. Put simply, it is reasonable to expect long/short funds to provide equity-like returns with lower volatility over the long term; what is *not* reasonable is to expect long/short funds to faithfully and consistently outperform equity indices over any and all timeframes. Further, investors should be wary of logical-sounding criticisms that fail to hold up under scrutiny. For example, many investors felt long/short funds not only failed to protect on the downside during the 2008 crisis, but also were late to participate in the upside in 2009. However, the reality is a bit different—for 2008–09 as a whole, long/short funds returned -8.6%, outperforming the S&P 500 Index by *more than 1,100 basis points (bps)*. Clearly, any such analysis is beginning- and end-point sensitive—an obvious counterexample would be 2011 performance—but one can certainly make the case that, far from failing during perhaps the most difficult two-year stretch on record, long/short funds did exactly what they were supposed to do.

It is also worth noting that long/short funds—as with all hedge fund strategies—are more difficult to categorize than long-only strategies, as they are expected to generate a more substantial portion of their return from alpha. This manifests not only through the fact that long/short fund returns are more varied than those of long-only managers, but also that there is significant variation among strategies *within the long/short category*—while market neutral, "moderate beta," and 130/30 funds all fall under the long/short umbrella, for example, their return patterns will look very different. In fact, even within the "traditional" long/short equity space, managers

[1] This includes certain actively managed long-only funds (e.g., value, "quality," and low-volatility funds), as well as some long-only multi–asset class funds and volatility-selling strategies. Please see our recent papers *Defensive Equity Strategies: Scanning the Field*, *The Lowdown on Low Vol*, and *The Benefits of Selling Volatility*.

vary significantly in their willingness and ability to add value through significant shifts in balance sheet exposure, or in their degree of focus on individual security selection.

All that said, the question many investors are asking is whether recent struggles signal something fundamentally wrong with long/short funds—e.g., an influx of money and changing market conditions have made the sector less attractive than in the past, when capital was more constrained and opportunities more plentiful—or are merely a short-term blip due to a unique set of difficult circumstances, in what remains a very impressive long-term track record. As is often the case, the truth likely lies somewhere in the middle.

In summary, we come neither to praise long/short nor to bury it. Long/short is by no means dead—the industry's fee structure will continue to attract a disproportionate share of great investors—but such managers may face a more difficult landscape going forward, thanks mainly to increased government involvement in markets that drives up correlations and complicates fundamentals-based investing, particularly over the short to medium term. Further, given the plethora of additional options now available, investors should not reflexively assume long/short is *the* answer to the question "How do I get equity-like returns with lower volatility?"; rather, it should be viewed as one of a number of potential solutions.

It is also no small matter that *manager selection remains critical*. While this paper focuses on long/short funds in aggregate, it is important to understand that long/short is not an asset class in the typical sense of the term. Rather, long/short funds are designed as alpha-generating vehicles, and manager skill is thus *the* crucial determinant of returns. As the guardian of the Grail said to Henry Walton Jones, Jr.—choose wisely.

Those Were the Days, My Friend. We Thought They'd Never End …

Since its 1990 inception, the HFRI[2] Equity Hedge (Total) Index—which tracks long/short funds—has posted an average annual compound return of 13.0% (cumulative return of 1,429%), versus 11.3% (985%) for the HFRI Fund-Weighted Composite Index, 7.4% (396%) for the HFRI Fund-of-Fund Composite Index, and 8.6% (537%) for the S&P 500 (Exhibit 1). Volatility for the various indices, meanwhile, was 9.3%, 7.1%, 5.9%, and 15.2%, respectively.

This outperformance is not only significant, but has also been achieved during a variety of different periods, although it is also true that performance has been less impressive in recent years, in both absolute and relative terms (Exhibit 2). Indeed, while long/short funds have suffered through several periods of underperformance—perhaps most notably in the late 1990s, when many investors abandoned them for higher-beta strategies—they have always rebounded when circumstances changed. The question, then, is should we expect this to again be the case?

First, it is important to put recent performance in the proper context. From November 1, 2007, to February 28, 2009, long/short funds lost about 30%, which, while somewhat worse than hedge funds as a whole (-21%), was significantly better than the S&P 500 (-51%). However, the reverse has been true since the March 2009 bottom, as long/short funds have slightly outperformed broad hedge funds (38.3% versus 32.5%), but badly lagged the S&P 500 (103.2%). In fact, thanks to the recent rally, long/short funds now trail the S&P since the October 2007 peak, -4.0%

[2] It is worth noting that due to its wide inclusion metrics and methodology of equal-weighting funds, HFRI has a bias toward smaller, less-established funds, and has thus likely tended to understate returns to the average investor. Returns for the median manager in our database, for example, have consistently outpaced HFRI returns.

versus -0.3% (broad hedge funds have returned 4.2%). In other words, despite the 20 percentage point outperformance by long/short funds during the downturn, an investor in November 2007 would have been better served to simply buy an S&P 500 Index fund (Exhibit 3). For 2011, meanwhile, long/short funds returned -8.4%, versus 2.1% for the S&P 500 and -5.5% for the MSCI World Index.

2011: *Annus Horribilis*, or End of the Road?

As noted, much of the recent criticism of long/short funds has been spurred by 2011 performance. It is worth noting, however, that many investors were *already* frustrated with long/short, despite the fact that performance during and after the crisis was actually quite good. In our opinion, this was due both to the extraordinary nature of the crisis and, to be honest, human nature. Many investors were disappointed with long/short returns in 2008, despite the fact that they bested equity markets by significant margins, as down 30% is still … down 30%. This was compounded by the fact that long/short funds subsequently lagged in the run-up off the 2009 lows, which of course seems like a blindingly obvious bottom … in retrospect.

Thus, many investors viewed poor performance in 2011 as something of a last straw— long/short funds, they reasoned, had fallen a great deal in 2008, lagged in the subsequent rally, then got clobbered in 2011 even as the S&P 500 eked out a small gain. And all while collecting steep management fees!

The most commonly cited causes of recent underperformance include:

- Government interventions—e.g., short-selling bans—that changed the rules;
- Headwinds for fundamental investors;
- An influx of money to long/short managers, as well as an increasing number of funds; and
- Zero interest rate policy.

Let's take them one at a time.

Government Interventions

On September 19, 2008, the SEC banned short selling on a list of 799 "financial" stocks,[3] joining a number of other countries that had implemented similar bans. While such edicts did little to staunch the red ink at such firms (or price declines, for that matter), they did have a substantial effect on long/short funds. First, and most obviously, they forced hedge funds to refrain from shorting while the bans were in place (and likely forced them to cover shorts as well), but one could argue the greater damage was done by suggesting the rules of the game were not only fungible, but also open to political manipulation. These "temporary" bans have come to be viewed as just another tool to curb market speculation. Indeed, several European countries implemented bans once again in 2011 when the Greek debt crisis threatened to torpedo markets.

Short-selling bans are but one of a mushrooming number of actions governments have taken in recent years, the vast majority of which effectively reward recklessness and punish thrift (or, from an investor standpoint, bail out failing institutions at the expense of solidly managed firms). Such policies hurt long/short funds not only due to direct impacts (e.g., short-selling bans), but also by distorting capital markets and forcing investors to assess corporate fundamentals as well as the possibility the government will bail out a particular firm or sector (e.g., financials). While long-only funds must also factor in such interventions, it is far less of an issue given that most

[3] The list ultimately grew to nearly 1,000 names, including "financial" companies such as CVS Caremark, General Electric, and General Motors.

long-only managers—in stark contrast to long/short funds—rely far more on beta than alpha.

Long/short funds may (and do) have different ways of approaching this issue, with important implications for future returns. First and most obviously, managers must choose whether they will try to "game" such interventions and resultant market shifts. For while one criticism leveled at long/short funds of late has been their poor market timing skills—some managers, for example, believed third quarter 2011 was turning into a replay of 2008, and were thus (perhaps overly) quick to de-risk—many have quite forthrightly refused to play this game, instead asserting that short-term fluctuations caused by non-economic actors simply create opportunities to buy or sell assets at prices divorced from underlying value. Several of the worst-performing managers during third quarter 2011 were among the best in first quarter 2012. There is not necessarily a "right" answer here—consider that managers that took net exposures down were heroes in 2008 but pariahs in 2011—but investors should be clear on managers' intentions and historical record in this area, as well as their ability to tough it out during difficult periods (i.e., not only having proven skill, but also a stable and *patient* capital base).

The bottom line is whether we should consider the hit to performance caused by such interventions when assessing future performance. We are forced to conclude yes, given that such interventions, as noted above, have become commonplace; however, we also note that these conditions could lay the groundwork for *out*performance by firms willing and able to capitalize on them. While one could argue the market impact of interventions will decrease as they become more common, and thus part of standard analytics, we are skeptical given the ever-growing size and unpredictability of these actions and their effects.

Fundamental Headwinds

When discussing 2011 returns for long/short managers, one could reasonably say it was a "Murphy's Law" market—pretty much everything that could go wrong, did. Most notably, high correlations and low dispersion made life difficult for stock-pickers, while on a smaller scale, elevated high-yield debt issuance caused trouble for short sellers. To add insult to injury, returns for an index of stocks widely held by hedge funds[4] lagged the S&P 500 for only the second time in the past decade (the other year was 2008), in large part due to poor performance in sectors favored by long/short funds (e.g., financials and industrials), and outperformance in areas where managers were underweight (e.g., consumer staples, health care, and utilities).

Let's begin with the rise in correlations. Thanks in large part to the government measures discussed above, as well as the open-spigot policies of global central banks, correlations have increased within and among asset classes, with periods classified as "risk on" and "risk off," and risk assets moving accordingly. In short, market outcomes have come to be seen as binary—e.g., either Greece will have a chaotic default or it won't. As such, equities and other risk assets have increasingly traded in lock-step (Exhibit 4), thus pressuring returns for long/short managers that make decisions based on their assessment of *individual* companies.

A recent J.P. Morgan study[5] noted that "long/short equity has delivered the worst performance during high correlation periods among all hedge fund strategies." Indeed, during the last two quarters of 2011—when long/short funds trailed the S&P 500 badly (-9.3% versus -3.7%)—the advance/decline line for the S&P 500 was roughly 90/10 for both quarters, with 90% decliners in the third quarter, and 90% advancers in the fourth quarter.

[4] The Goldman Sachs Hedge Fund VIP list.
[5] *Equity Correlation and Hedge Fund Performance*, J.P. Morgan Prime Brokerage Perspectives, February 22, 2012.

Put bluntly, long/short managers making bets on companies with different *relative* prospects have been whipsawed by monolithic markets pushing everything up or down in unison.[6]

The question is how long, and to what extent, the rise in correlations should be expected to persist. Clearly, correlations cannot stay elevated indefinitely; at some point, securities with different fundamentals will diverge. Indeed, correlations fell sharply in the first quarter, and some observers argue "the great separation" (as one manager recently put it) has already begun. However, given that the rise in correlations appears to have been caused largely by ever-increasing crises and government interventions that have resulted in a binary market, and that governments and central bankers have openly said they remain committed to such actions, *and* as we believe said actions exacerbate rather than solve the underlying problem (i.e., too much debt), thus laying the groundwork for *more* interventions, we believe the jury is still out.

Dispersion, meanwhile—which is arguably even more important to long/short returns than correlations—paints a somewhat different picture. (Dispersion measures the return variance among securities. In other words, even if securities are moving in the same direction, they can still have large return differentials.) While dispersion over the past two years was well below its extraordinarily high 2009 levels, it has been similar to levels seen over the past decade or so (Exhibit 5). Thus, we see this argument as less compelling—if low dispersion has been a headwind, it has been a moderate one.

[6] It is worth noting that despite worries about hedge funds increasingly relying on exchange-traded funds (ETFs) to establish sector exposures (as opposed to picking individual securities), this remains relatively rare. According to Goldman Sachs, hedge funds use ETFs for 18% of short positions, and only 4% of longs. Further, this includes specialized ETFs such as the GLD (which tracks gold prices).

On the short side, the past two years were the biggest ever for high-yield debt issuance—due mainly to a dramatic increase in lower-quality issues (i.e., B or below) (Exhibit 6)—which has also presented problems for long/short funds, as many companies with questionable fundamentals have nevertheless been able to refinance debt at attractive rates. As with high correlations, this must eventually come to an end (as investors will eventually refuse to fund companies that cannot pay them back), but it has nevertheless been a headwind to managers attempting to short low-quality companies.

On balance, it seems likely that high correlations, low dispersion, and record high-yield debt issuance had negative impacts on 2011 long/short returns, with varying degrees of importance. As all three factors can reasonably be considered "temporary," investors could, under normal circumstances, expect them to dissipate (or even reverse and prove tailwinds) going forward. However, the likely continuation of the government interventions discussed earlier forces us to strongly consider the possibility that such "temporary" factors will be with us for longer than usual.

Too Much Money and Too Many Funds

This may be the charge most frequently leveled against long/short funds—that the number and size of funds have grown too quickly, thus outstripping the opportunity set and forcing managers to fight over a shrinking alpha pie. Yet, while many "know" this to be the case, the data are less clear-cut. According to HFRI, total assets under management for "equity hedge" funds (another term for long/short) nearly tripled from 2002 to 2007—rising from $253 billion to $685 billion—but declined steeply in the aftermath of the crisis, and have more or less treaded water since, closing 2011 at $552 billion (Exhibit 7).[7]

[7] Further, given that this number excludes proprietary trading desks—which have scaled back operations signifi-

The number of funds has followed a similar trajectory.

The size of the median fund in our database, meanwhile, rose from $133 million in 2000 to $345 million in 2006, fell to $245 million in 2008, and closed 2011 at $391 million. Perhaps more interestingly, the largest fund we track[8] rose from $2.7 billion in 2000 to nearly $8 billion in 2007, fell to $4.8 billion in 2008, and closed 2011 at $10.4 billion.

While it is hard to argue the extra cash has swamped the markets in which these funds trade—the U.S. mutual fund industry, for example, manages close to $12 *trillion*—the fact that so much of it has gone to the largest funds could be a yellow flag. The growing number of funds with large holdings in the same securities (Exhibit 8) is also a trend that bears watching.

With regard to the charge that an influx of cash has rendered future returns less attractive, we find the data unsupportive. The markets in which these funds trade are well able to incorporate the extra cash, and while there is some evidence that long/short funds are clustering in the same mega-cap names (e.g., Apple and Google), this particular concern strikes us as something of a red herring. Indeed, given that assets under management peaked in 2007, one would expect performance since that time to reflect any ill effects; however, a recent Goldman Sachs Hedge Fund Strategies LLC study[9] found that long/short alpha generation from January 2007 to October 2011 was virtually indistinguishable from that of the 1994–2006 period. Moreover, while long/short funds have posted negative alpha in three recent years (-2.4% in 2006, -4.5% in 2008, and -7.9% in 2011), they have also delivered several years of positive alpha (4.7% in 2007, 10.6% in 2009, and 1.9% in 2010).

Zero Interest Rate Policy

The Federal Reserve's Zero Interest Rate Policy (ZIRP) has had myriad effects on savers and investors, but one of the least-remarked on has been its impact on long/short funds. First, and most obviously, ZIRP effectively penalizes managers that hold cash. While holding cash has always been seen as a potential portfolio drag, it is more pronounced when the interest rate is zero (and sharply negative in real terms). For example, even given cash rates of 2%, a fund running at 50% net exposure would collect 100 bps more a year than it does at present.

This is even more significant given that managers might reasonably want to hold more cash than usual given the dramatic policy-driven market swings of recent years. To wit—a manager worried about a potential downdraft in mid-2011 not only had to worry about a further stimulus-induced rally (which might make him cautious about shorting), but also the pain inflicted by holding cash at a negative real interest rate.

Another issue relates to the short rebate, which is the interest collected by a short seller on the cash generated by a short sale—typically the prime interest rate minus 50 bps to 75 bps—less the cost to borrow. However, ZIRP has effectively turned the short rebate negative; i.e., the cost to borrow exceeds the interest earned.[10]

On balance, the effects from ZIRP are small but not *de minimus*, and given Fed assurances that

cantly in recent years—total assets invested in long/short strategies are likely even lower relative to history.

[8] The biggest fund at the end of each year; not necessarily the same fund from year to year.

[9] "Why Investors Continue to Increase Hedge Fund Allocations," *AIMS Perspectives*, January 24, 2012.

[10] The short rebate is also affected by the availability (and thus cost) of stock to borrow. For example, as of this writing, the short rebate on Apple was estimated to be about -0.1% a year (i.e., a short seller would pay 10 bps a year after netting the cost to borrow and interest collected), while on Sears—a very popular and hard to obtain short—it approached -20%.

the policy will run through at least 2014, are not going away anytime soon.

Summary

It seems reasonable to say that several factors conspired to make 2011 a difficult year for long/short, *but also* that, thanks mainly to continued government interventions, many of these factors may persist longer than would otherwise be the case. In other words, despite recent improvement in certain areas (e.g., correlations), investors should be prepared for continued headwinds.

The Trouble with Aggregates

As alluded to earlier, one of the problems with analyzing long/short funds on an aggregate basis is that, while they are commonly thought of as an asset class, this is emphatically not the case—a more accurate term would be legal wrappers. Consider that equities, for example, will over time track the underlying profits of corporations, and commodities react to changes in supply and demand; long/short funds, on the other hand, differentiate themselves largely through manager skill. While this is also true of active managers in specific asset classes, the difference is a matter of degree—as noted earlier, long-only manager returns are far more reliant on beta than alpha.

At this point, the skeptic would note that many hedge funds have come to look an awful lot like low-beta long-only funds … and we would agree! There is no question a large number of long/short funds charge premium fees for what amounts to index-hugging performance. Indeed, this gets at the trouble with using aggregate data to assess the performance of long/short managers—when you hire such a manager, you emphatically do not want average performance. As shown in Exhibit 9, even over relatively short timeframes (five years), top manager returns are far ahead of those in the middle of the pack.

For the five-year period ended in December, for example, the median long/short manager in our database (out of 309) returned a cumulative 16.3%, while the 25th percentile manager (i.e., returns better than 75% of managers) returned 38.5%. However, the 5th percentile manager returned a whopping 90.5%. It is also worth noting that even the median manager return was significantly better than the 2.1% return of the HFRI Equity Hedge (Total) Index.

The difference is even starker over longer timeframes. For the ten-year period ended in December, the median long/short manager (out of 130) returned 97.4%, versus 152.8% for the 25th percentile manager, and 291.3% for the 5th percentile manager. (The HFRI Equity Hedge Index returned 56.1%.) An investor that invested $1 million with the 5th percentile manager a decade ago would have nearly $4 million today, versus $2.5 million for one that invested in the 25th percentile manager and less than $2 million for an investor in the median manager.[11]

Another useful way to illustrate this is to look at the positive relationship between dispersion among *equities* and dispersion among *managers* (Exhibit 10). It is not particularly surprising, of course, that the fruits of an increased opportunity set would be unequally shared given differing skill levels among managers, but such distinctions often get lost in aggregate datasets. Said a different way, a rise in dispersion might well result in a significant boost to the best long/short managers, but have far less impact on others.

While certain implications of this are obvious (choose wisely!), others are less so. Efforts to study the exposures of hedge funds *as a group*, for example, will not be particularly useful for investors seeking top quartile (or better) performance,

[11] As noted earlier, our data differ from HFR's. While we do not require a minimum asset level to track a fund, our median data only include funds whose assets have at any point surpassed $50 million.

nor will attempts to figure out the "next big thing" likely to capture hedge funds' collective fancy (e.g., emerging markets).

Alternative … Alternatives?

Another consideration for long/short investors is the explosion of investment vehicles designed to deliver a similar return stream—namely, equity-like returns with lower volatility. Such strategies include certain actively managed value and multi–asset class funds, "low vol" or "minimum variance" strategies, and even volatility-selling strategies that seek to capture the historical gap between implied and realized volatility. There are, of course, important differences between all these strategies and long/short funds, but given the similar return streams over time, along with lower fees, better liquidity, and better transparency, investors should at the very least consider such strategies alongside long/short managers.[12]

Where Do We Go From Here?

To sum up, one can certainly make the case that 2011 was an *annus horriblis* for long/short funds, as they faced a formidable, and arguably unprecedented, number of headwinds. However, given that government interventions are unlikely to abate anytime soon, investors must take the effects of such actions into account when assessing future prospects. Unfair or not, investors should set a higher bar for long/short funds than in the past. This is even more the case given the increased availability of competing strategies with better transparency, lower fees, and better liquidity—and most notably, similar historical return streams to the average long/short manager.

All that said, focusing on long/short managers in aggregate risks obscuring the fact that manager selection has *always* been an important criterion for long/short, and remains so today. The question of whether to put money with a particular long/short manager should have far less to do with structural issues facing the industry than *with the skill of the manager*. To use an imperfect analogy, while strong winds will cause the scores of most golfers to balloon, Tiger Woods playing in 30-mile-an-hour winds remains … Tiger Woods.

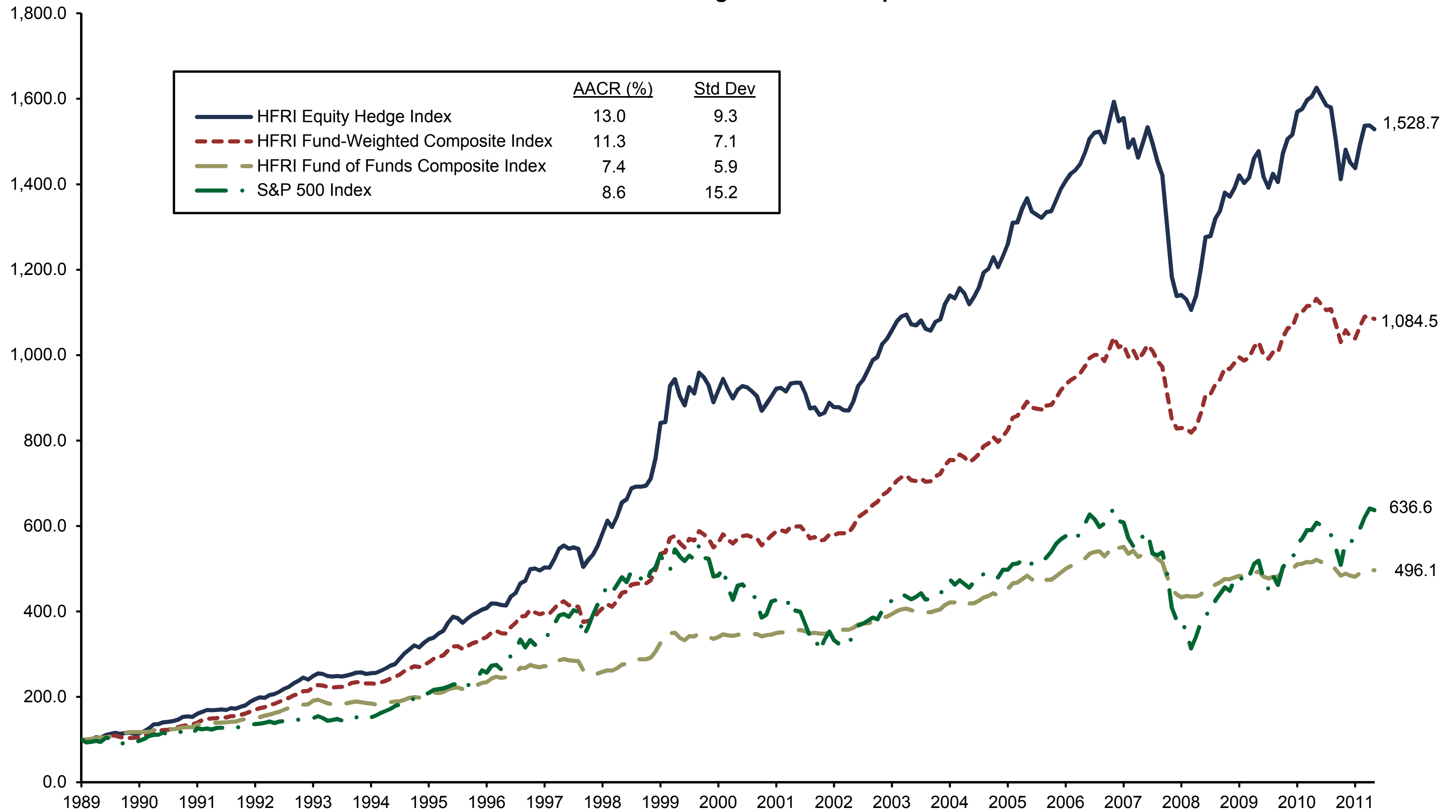
Given the greater freedom afforded hedge funds versus other money management structures (e.g., mutual funds)—not to mention the far more lucrative fee structure—it seems a virtual certainty the industry will continue to attract a disproportionate share of top managers. Thus, even in the event long/short returns continue to disappoint in aggregate, we have little doubt a number of managers will more than justify their fees. ■

[12] While an in-depth discussion of such strategies is beyond the scope of this paper, as mentioned earlier, we have published several papers on this topic in recent years, including *Defensive Equity Strategies: Scanning the Field*, *The Lowdown on Low Vol*, and *The Benefits of Selling Volatility*.

Exhibit 1

Long/Short Returns Dominate Long Term

December 31, 1989 – April 30, 2012 • U.S. Dollar • December 31, 1989 = $100.00

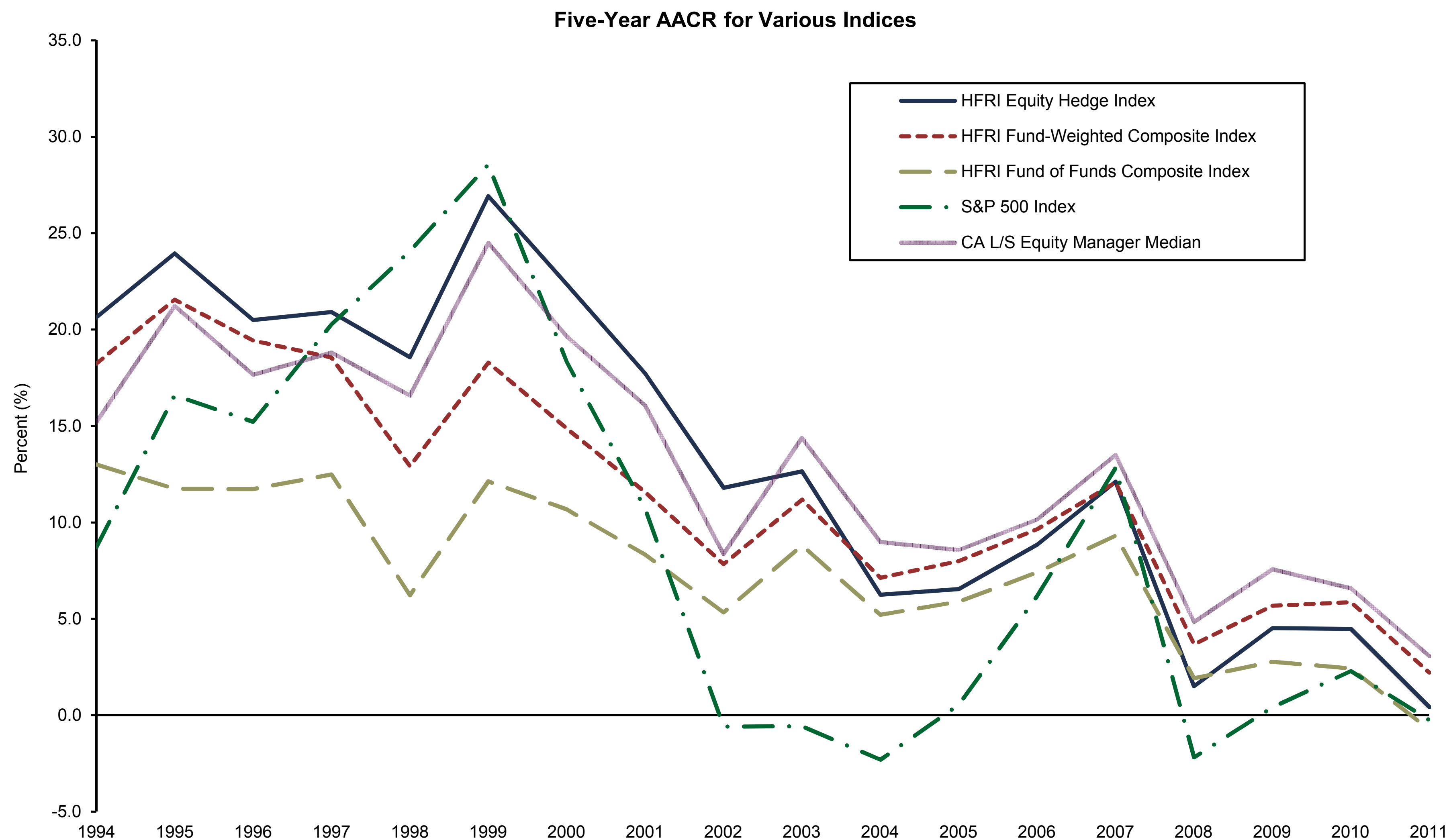


Sources: Hedge Fund Research, Inc., Standard & Poor's, and Thomson Reuters Datastream.

Exhibit 2

A Troubling Trend?

1990–2011

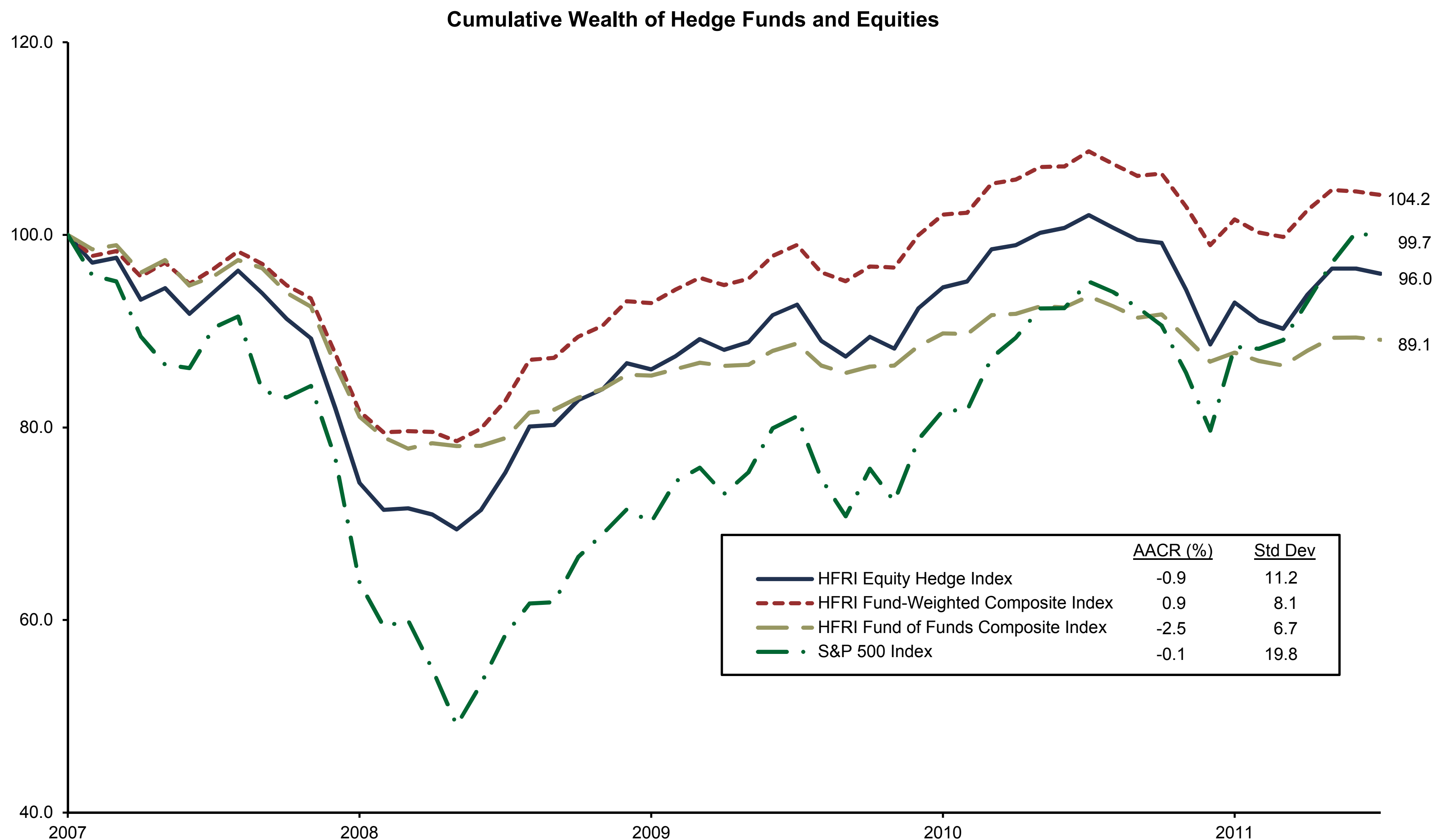


Sources: Cambridge Associates LLC Investment Manager Database, Hedge Fund Research, Inc., Standard & Poor's, and Thomson Reuters Datastream.

Exhibit 3

Returns from the 2007 Peak: Long/Short Lags the S&P?

October 31, 2007 – April 30, 2012 • U.S. Dollar • October 31, 2007 = $100.00

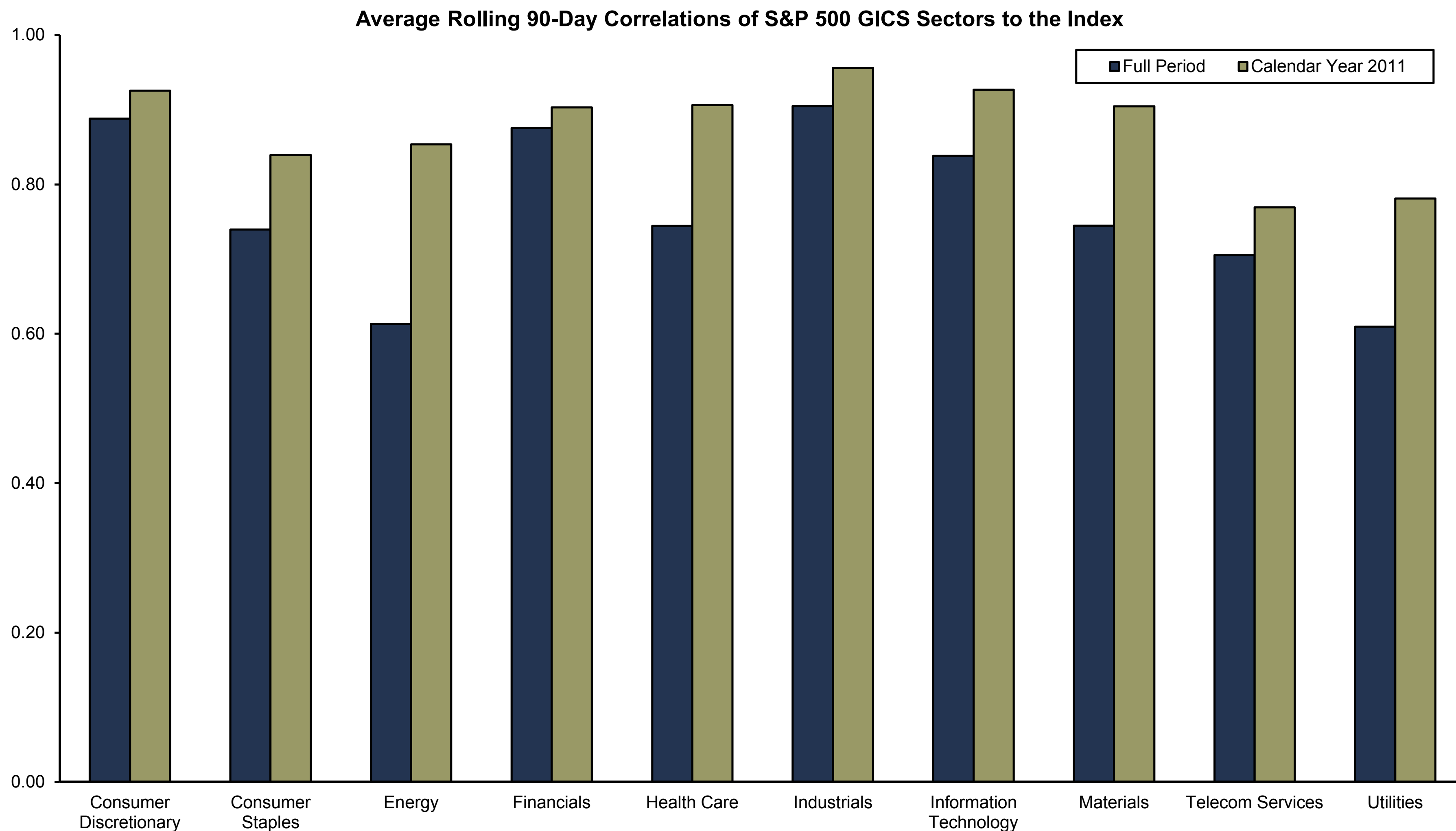


Sources: Hedge Fund Research, Inc., Standard & Poor's, and Thomson Reuters Datastream.

Exhibit 4

2011 Correlations on the High Side Within Equities ...

January 1, 1995 – April 30, 2012

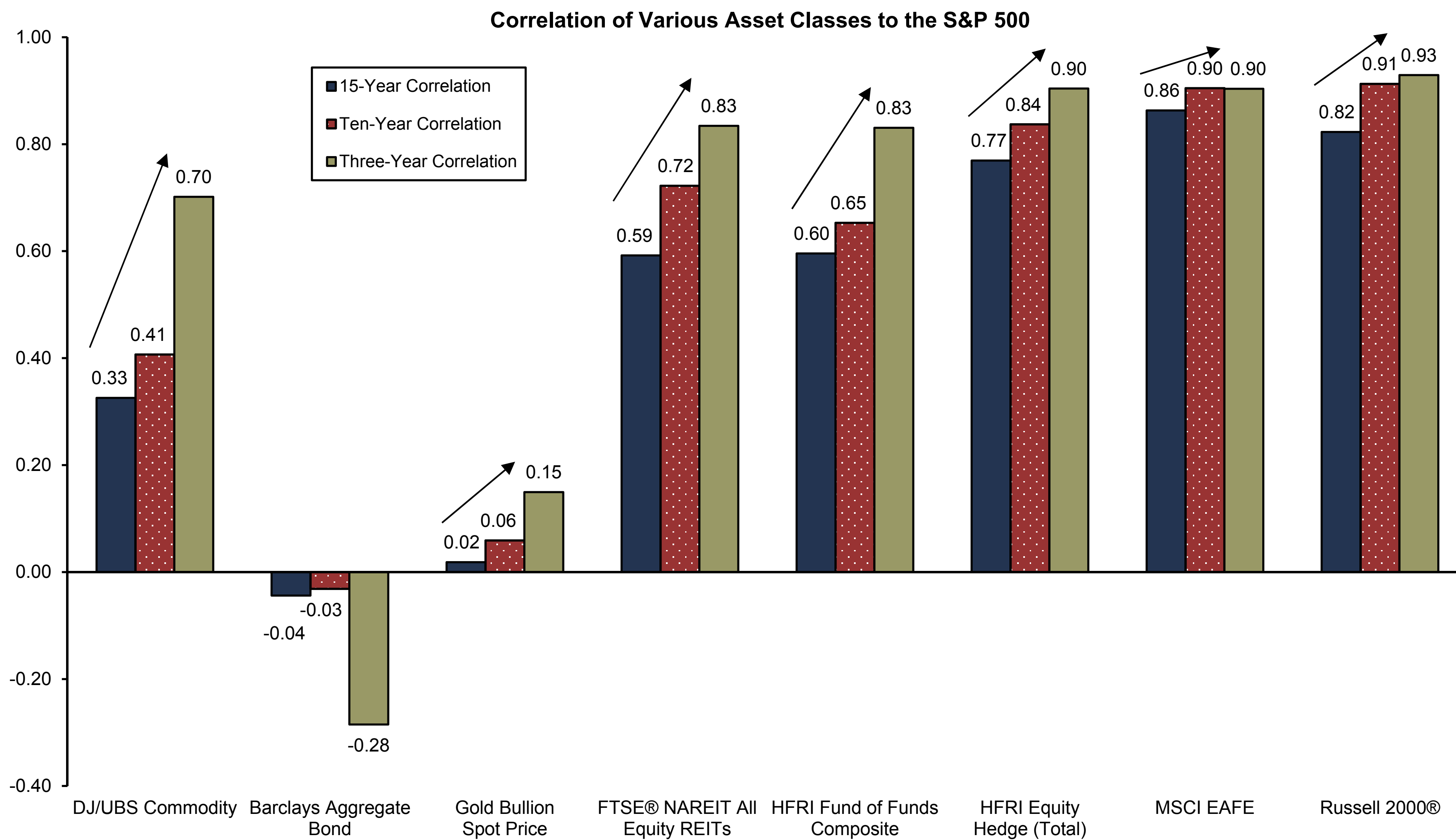


Sources: Standard & Poor's and Thomson Reuters Datastream.
Notes: Based on the daily returns for the S&P 500 Index. Full period represents January 1995 to April 2012.

Exhibit 4 (continued)

... and Across Asset Classes

As of April 30, 2012

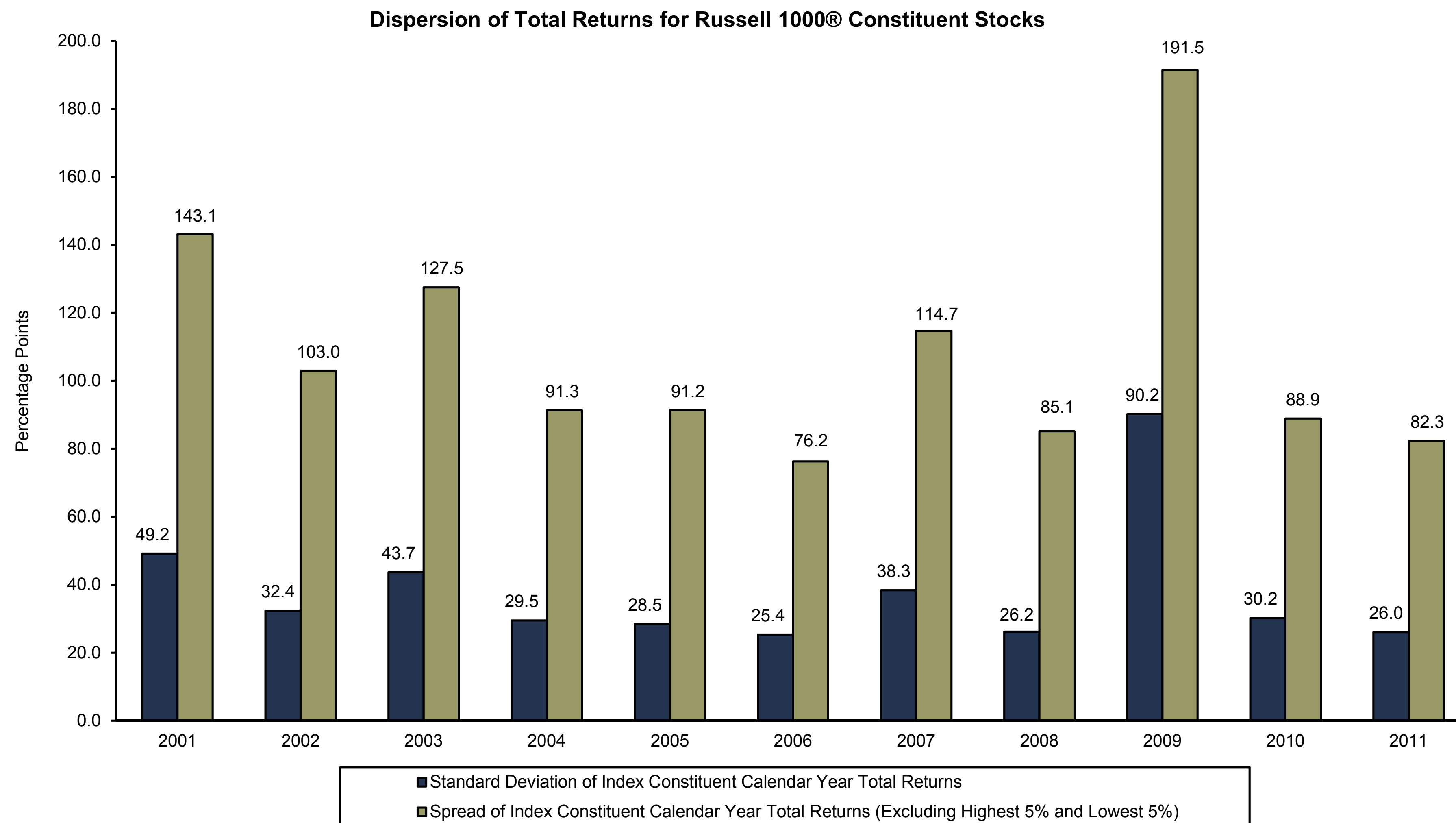


Sources: Barclays, Dow Jones Indexes, Frank Russell Company, FTSE International Limited, Hedge Fund Research, Inc., MSCI Inc., National Association of Real Estate Investment Trusts, Standard & Poor's, and Thomson Reuters Datastream. MSCI data provided "as is" without any express or implied warranties.

Exhibit 5

Dispersion Among Large Caps in Line with Historical Norms in 2011 ...

2001–11

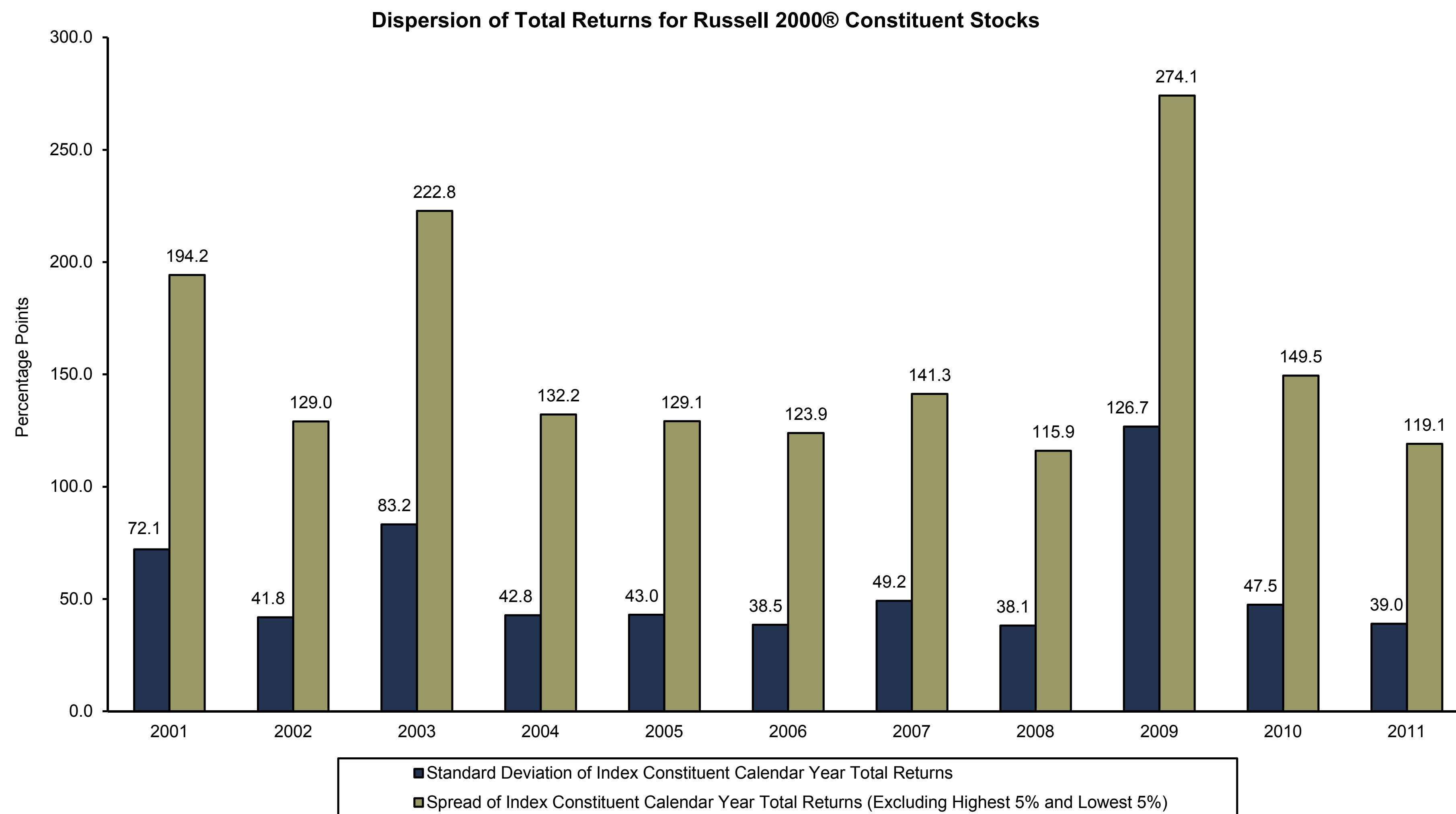


Sources: FactSet Research Systems and Frank Russell Company.
Note: The standard deviation shows the variability of equities relative to the mean constituent total return for each time period.

Exhibit 5 (continued)

... and the Same Was True for Small Caps

2001–11

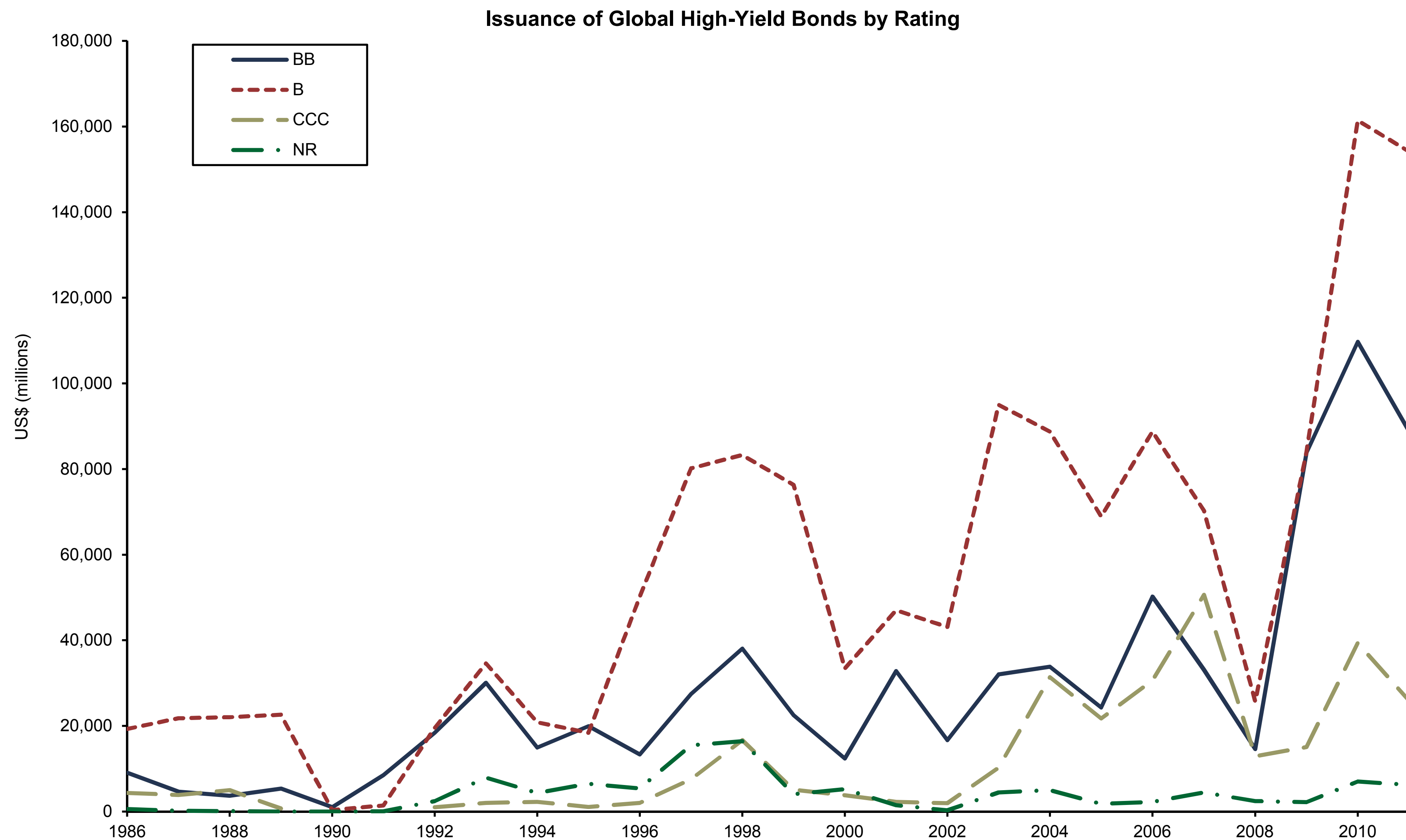


Sources: FactSet Research Systems and Frank Russell Company.
Note: The standard deviation shows the variability of equities relative to the mean constituent total return for each time period.

Exhibit 6

High-Yield Issuance Scaling New Peaks

1986–2011

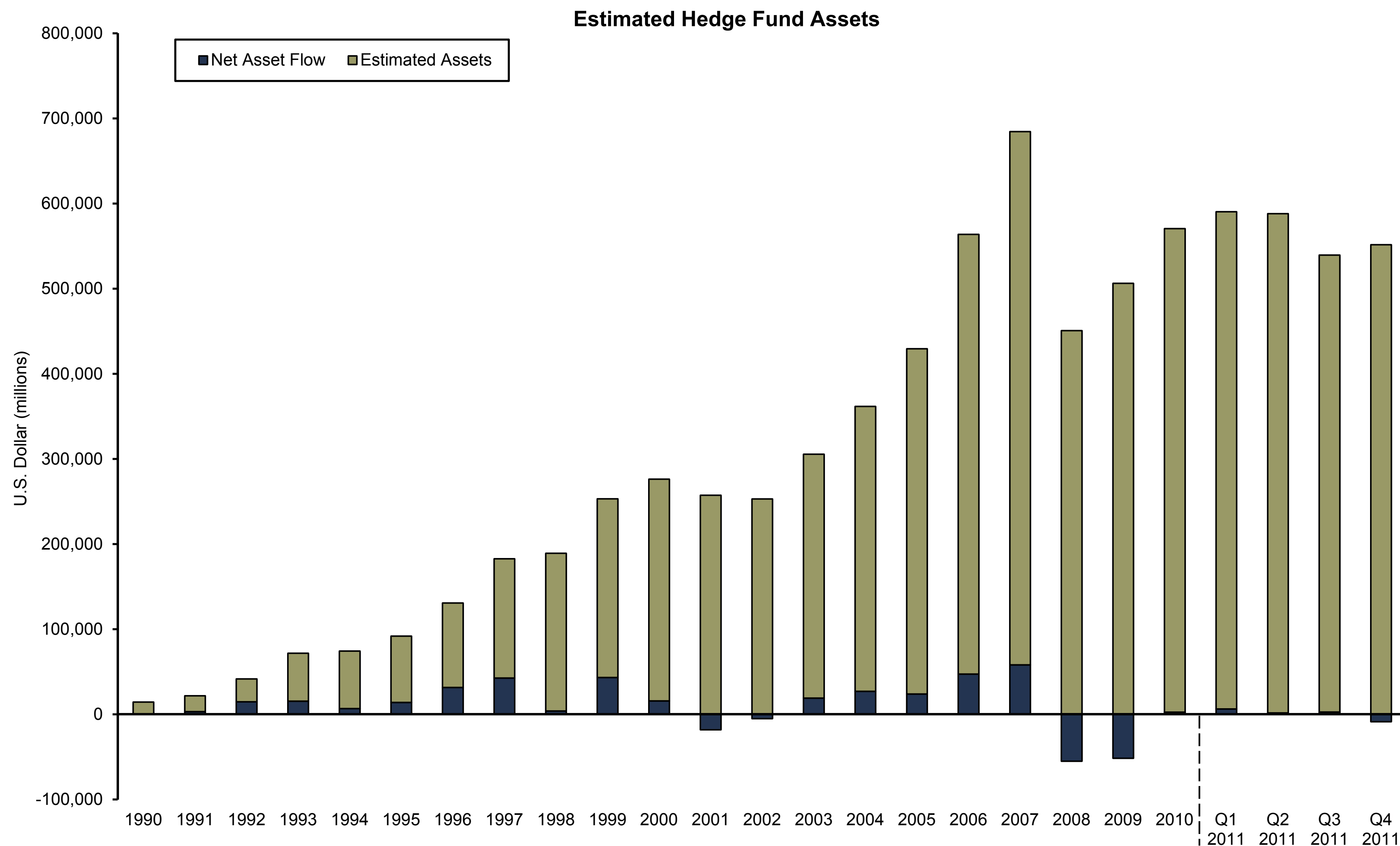


Sources: Bloomberg L.P. and BofA Merrill Lynch.

Exhibit 7

The Shocking Truth About Long/Short Asset Growth

1990–2011



Source: Hedge Fund Research, Inc.

Exhibit 8

Are There Really So Few Good Ideas?

2008: Top 15 Hedge Fund Stock Holdings

Company	Equity Cap ($BB)	% of Funds Owning Stock	% of Funds Owning Stock as a Top-Ten Holding
Apple Inc.	110	9.5%	6.5%
Google Inc.	125	9.4%	6.4%
Qualcomm Inc.	68	11.0%	6.0%
Microsoft Corp.	265	9.2%	5.9%
CVS Caremark Corp.	59	7.2%	5.0%
Transocean Ltd.	41	7.9%	4.7%
Altria Group Inc.	153	7.2%	4.2%
Navteq	7	7.2%	4.2%
Mirant Corp.	9	6.9%	4.0%
Clear Channel Communications Inc	16	6.0%	3.8%
EMC Corp.	33	6.5%	3.8%
General Electric Co.	347	5.9%	3.8%
Comcast Corp.	42	7.0%	3.7%
América Móvil	68	6.4%	3.3%
Research In Motion Ltd.	53	6.0%	3.3%
Average	93	7.5%	4.6%
Median	59	7.2%	4.2%

2012: Top 15 Hedge Fund Stock Holdings

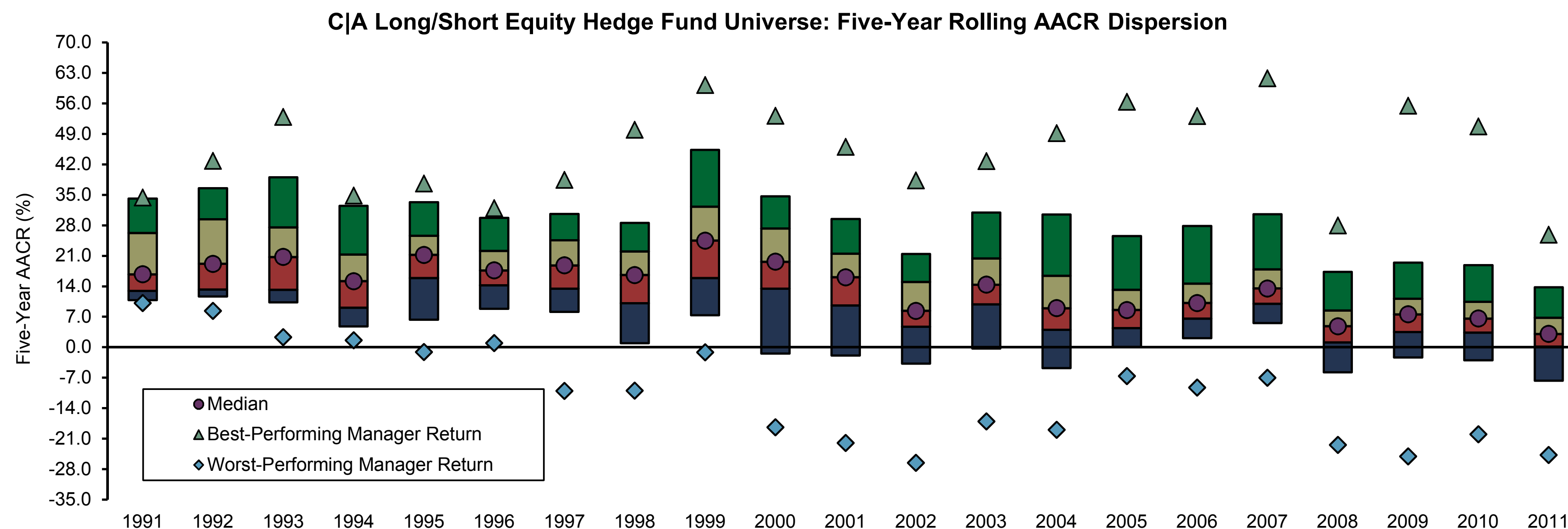
Company	Equity Cap ($BB)	% of Funds Owning Stock	% of Funds Owning Stock as a Top-Ten Holding
Apple Inc.	464	24.6%	18.9%
Google Inc.	156	18.0%	13.6%
Microsoft Corp.	252	15.1%	8.6%
JPMorgan Chase & Co.	142	11.3%	6.5%
Qualcomm Inc.	104	10.1%	5.9%
Citigroup Inc.	93	9.9%	5.0%
Pfizer Inc.	162	8.8%	5.0%
Liberty Media Corp.	10	6.1%	4.1%
LyondellBasell Industries	25	6.5%	4.1%
Anadarko Petroleum Corp.	44	6.8%	3.9%
General Motors Co.	39	7.4%	3.8%
News Corp.	32	5.2%	3.8%
Wells Fargo & Co.	159	7.0%	3.8%
BP p.l.c.	145	6.1%	3.6%
priceline.com Inc.	28	5.4%	3.6%
	124	9.9%	6.3%
	104	7.4%	4.1%

Source: Goldman Sachs.
Note: Data from Goldman Sachs Hedge Fund Trend Monitor dated 1Q 2008 and 1Q 2012 in their analysis of 598 and 557 hedge funds, respectively, that hold between ten and 200 individual stock positions.

Exhibit 9

The Importance of Choosing (Your Manager) Wisely

December 31, 1991 – December 31, 2011



Annualized Returns Breakdown (%)

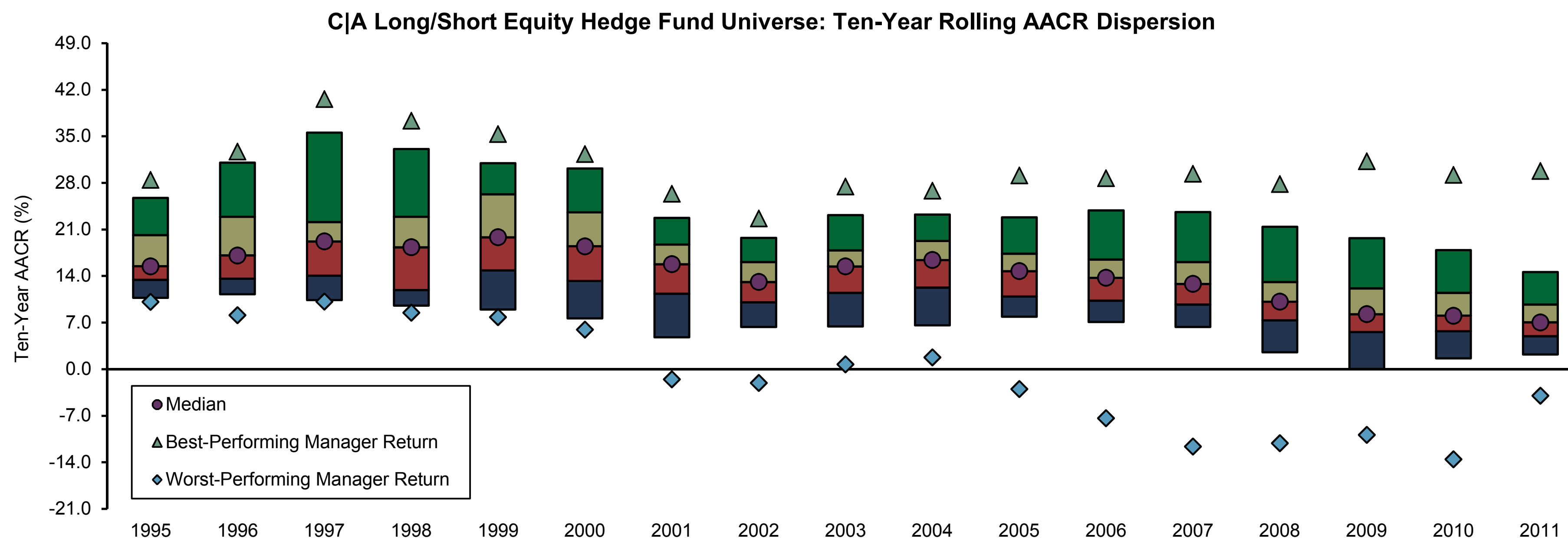
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
5th Percentile	34.2	36.5	39.0	32.5	33.3	29.8	30.6	28.6	45.3	34.7	29.5	21.5	31.0	30.5	25.6	27.8	30.6	17.3	19.4	18.9	13.8
25th Percentile	26.2	29.4	27.6	21.3	25.6	22.1	24.6	22.0	32.3	27.3	21.5	15.0	20.4	16.4	13.2	14.6	17.9	8.5	11.2	10.4	6.7
Median	16.7	19.2	20.7	15.2	21.2	17.7	18.8	16.6	24.5	19.7	16.1	8.4	14.4	9.0	8.6	10.2	13.5	4.8	7.6	6.6	3.1
75th Percentile	12.9	13.3	13.2	9.1	15.9	14.2	13.5	10.1	15.9	13.5	9.6	4.7	9.9	4.0	4.4	6.6	10.0	1.1	3.5	3.4	0.2
95th Percentile	10.8	11.7	10.3	4.8	6.3	8.9	8.1	0.9	7.4	-1.5	-1.9	-3.8	-0.3	-4.8	0.1	2.1	5.5	-5.8	-2.4	-3.0	-7.7
Mean	19.9	21.6	22.5	15.6	20.6	18.1	19.0	16.1	25.0	19.3	15.2	9.4	14.8	10.5	9.9	11.7	15.0	4.9	7.9	7.2	3.2
n =	*22*	*32*	*42*	*57*	*70*	*88*	*110*	*100*	*112*	*114*	*110*	*102*	*126*	*141*	*177*	*208*	*228*	*243*	*270*	*302*	*309*

Source: Cambridge Associates LLC Investment Manager Database.
Note: Floating bars represent the trailing five-year AACRs of the C|A Long/Short Equity Hedge Fund Universe for 95th to 5th percentile performance.

Exhibit 9 (continued)

The Importance of Choosing (Your Manager) Wisely

December 31, 1995 – December 31, 2011



Annualized Returns Breakdown (%)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
5th Percentile	25.7	31.1	35.6	33.1	31.0	30.2	22.7	19.7	23.2	23.3	22.8	23.9	23.6	21.4	19.7	17.9	14.6
25th Percentile	20.2	22.9	22.1	22.9	26.3	23.6	18.8	16.1	17.8	19.3	17.3	16.5	16.1	13.1	12.2	11.5	9.7
Median	15.5	17.1	19.2	18.3	19.8	18.5	15.8	13.1	15.4	16.4	14.7	13.7	12.8	10.1	8.3	8.0	7.0
75th Percentile	13.4	13.6	14.1	11.9	14.9	13.3	11.3	10.0	11.5	12.3	11.0	10.3	9.7	7.4	5.6	5.7	5.0
95th Percentile	10.7	11.3	10.4	9.6	9.0	7.7	4.8	6.3	6.4	6.6	7.9	7.1	6.4	2.6	0.1	1.6	2.2
Mean	17.1	18.4	20.1	18.9	19.9	18.4	14.6	13.0	15.1	15.8	14.5	13.8	13.2	10.8	9.2	8.8	7.7
n =	*14*	*21*	*29*	*28*	*33*	*32*	*37*	*40*	*52*	*58*	*67*	*71*	*70*	*81*	*93*	*111*	*130*

Source: Cambridge Associates LLC Investment Manager Database.
Note: Floating bars represent the trailing ten-year AACRs of the C|A Long/Short Equity Hedge Fund Universe for 95th to 5th percentile performance.

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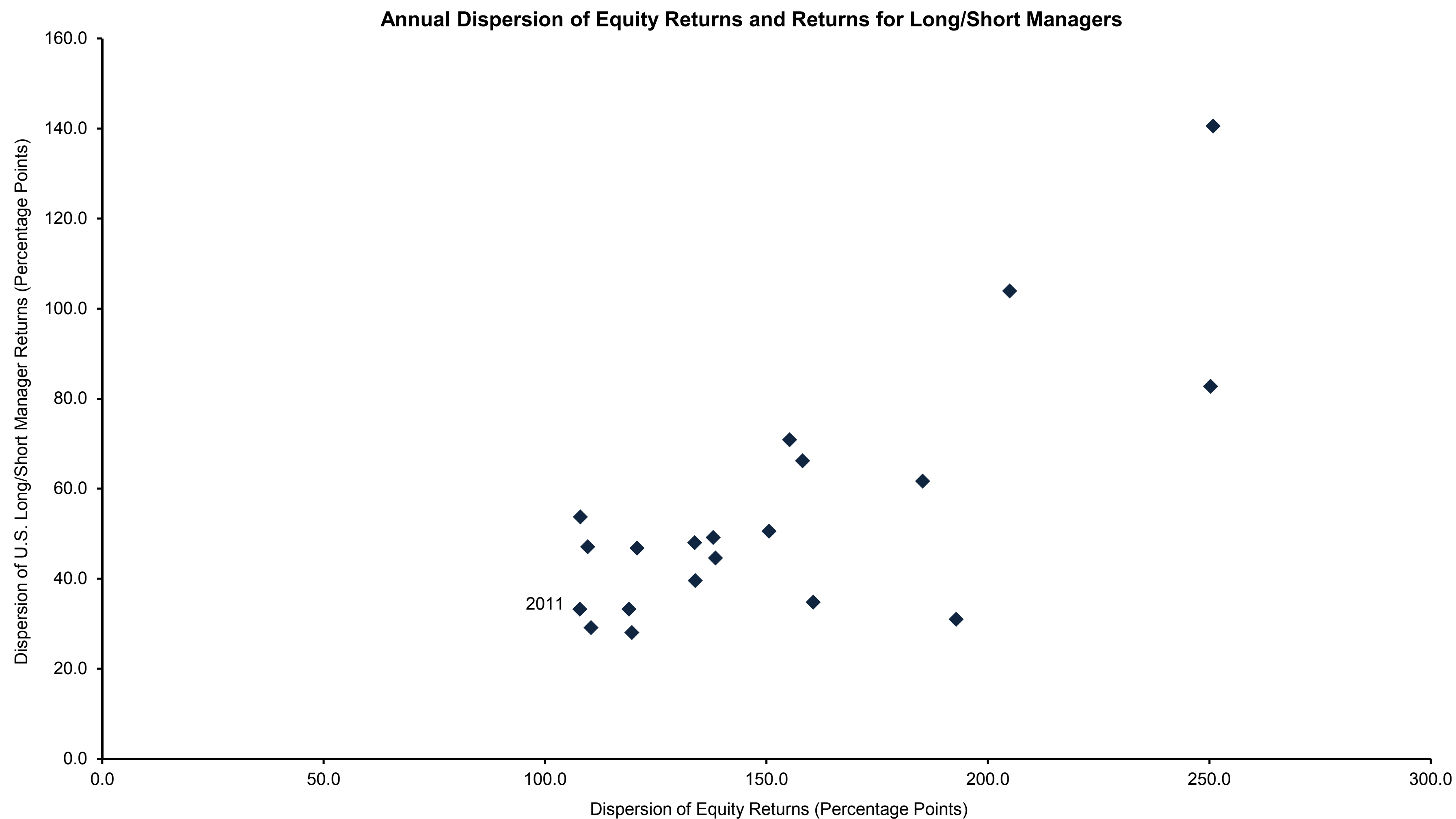
Exhibit 10

The Rich Get Richer? Benefits of Wider Dispersion Have Not Been Equally Shared

1992–2011



Sources: Cambridge Associates LLC Investment Manager Database, FactSet Research Systems, and Frank Russell Company.
Notes: Dispersion of return for stocks represents stocks in the middle 90% of the return range for the Russell 3000®. Dispersion of return for U.S. Long/Short Equity Hedge Fund managers represents managers in the middle 90% of the return range for U.S. Long/Short Equity Hedge Fund managers.