

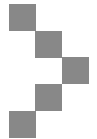


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5th Annual PortfolioConstruction Conference

23 – 24 August 2006 | AJC Convention Centre, Randwick, Sydney

Pillars for building better
quality investor portfolios...



Hedge funds in a modern portfolio
PortfolioConstruction Conference 2006

Patrick Tuohy
Asia Head
Alternative Investments Group
24 August 2006



Contents



1

The Past – Where are we today and why did we get here?

3



2

The Present – Absolute returns are all relative

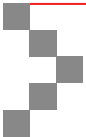
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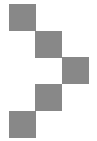


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The Future – The evolution continues

15





1. The Past

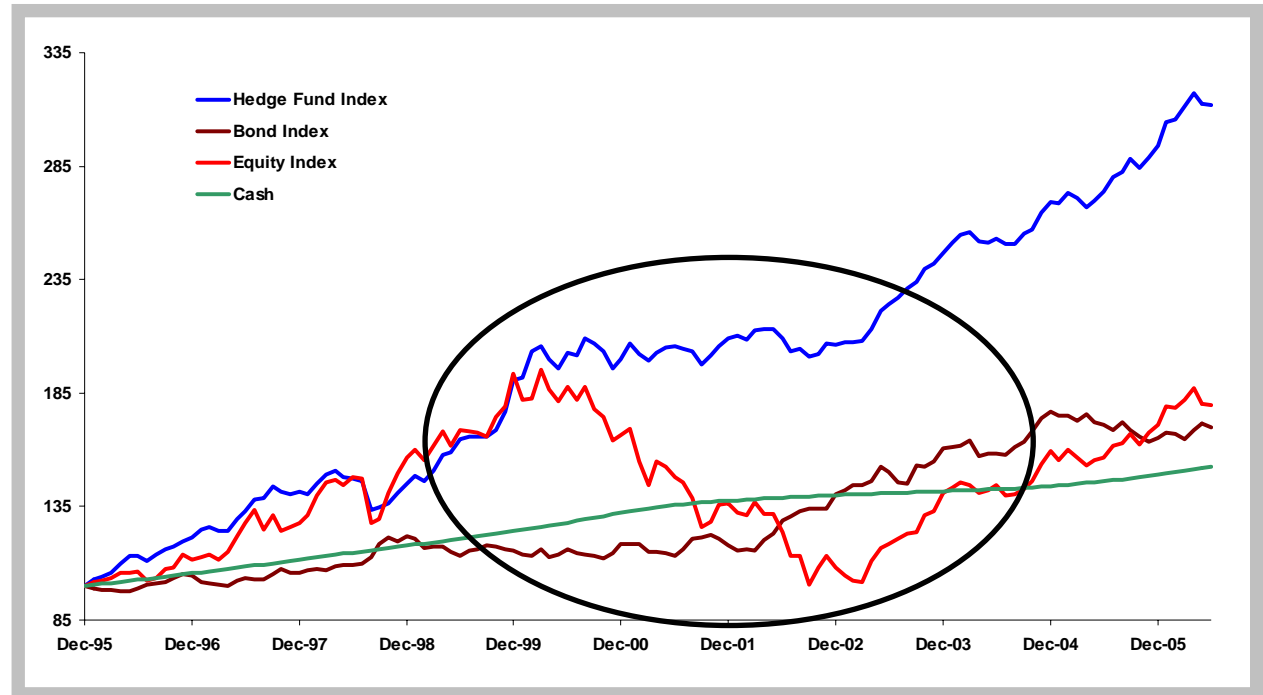


1 The Past ... it all adds up

Historical performance

Hedge Fund Index vs. traditional markets

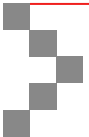
- Long term performance in line with global equities
- Low volatility
- Limited correlation as compared to bonds and equities



Key Statistics

| | Hedge Fund Index | Equity Index | Bond Index |
|--------------------|------------------|--------------|------------|
| Annualized Returns | 11.44% | 5.74% | 5.17% |
| Volatility | 7.38% | 14.26% | 6.42% |

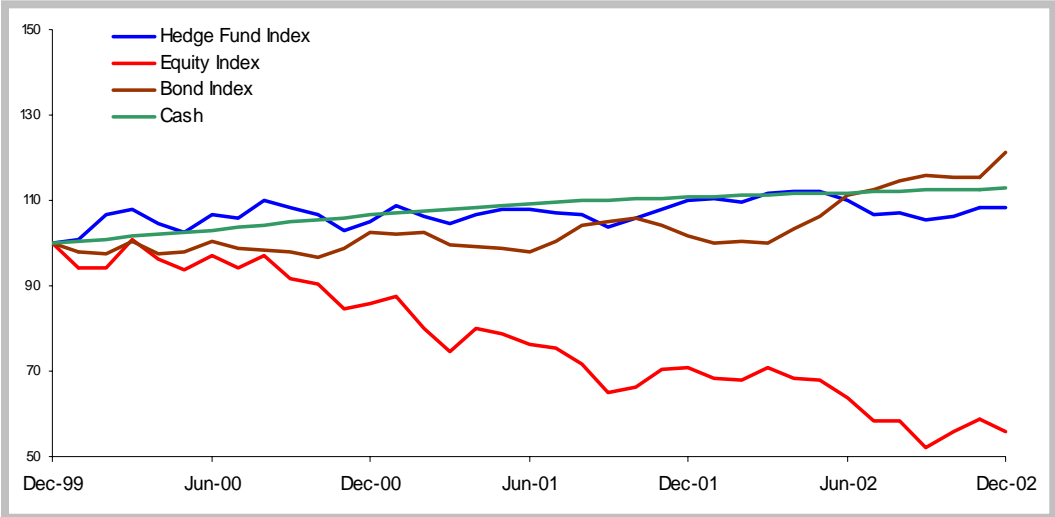
Sources: Bloomberg / Hedge Fund Research
 Data period from 31 Dec 1995 to 30 Jun 2006
 Hedge Funds are represented by the Hedge Fund Research Index US Weighted Composite, Equities are represented by the MSCI World Index, Bonds are represented by the JP Morgan Global Government Bond Index and Cash is represented by the USD 3M LIBOR



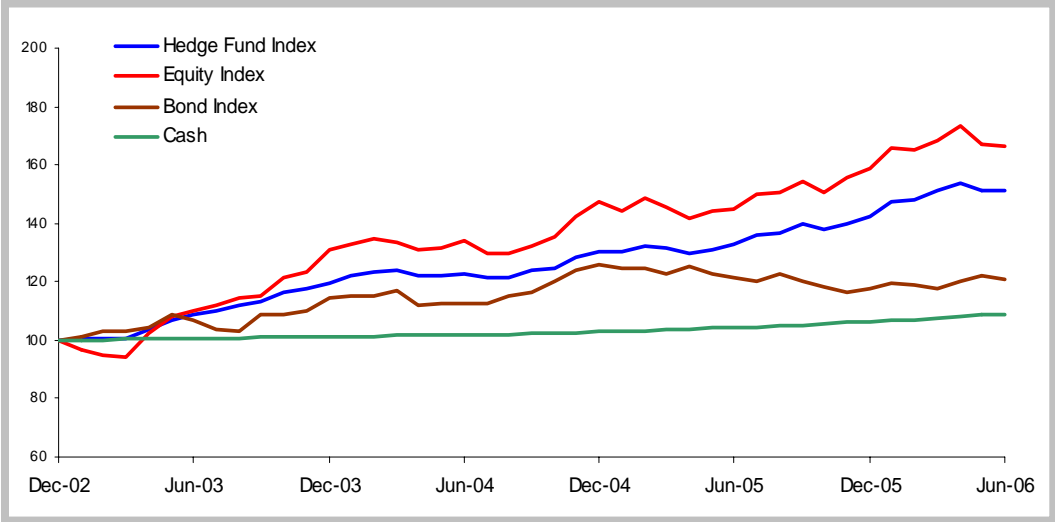


1 The best of both worlds

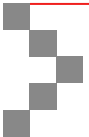
Jan 2000 – Dec 2002
Demonstrates cash like returns in equity down periods



Jan 2003 – Jun 2006
Demonstrates growth in line with equity trends

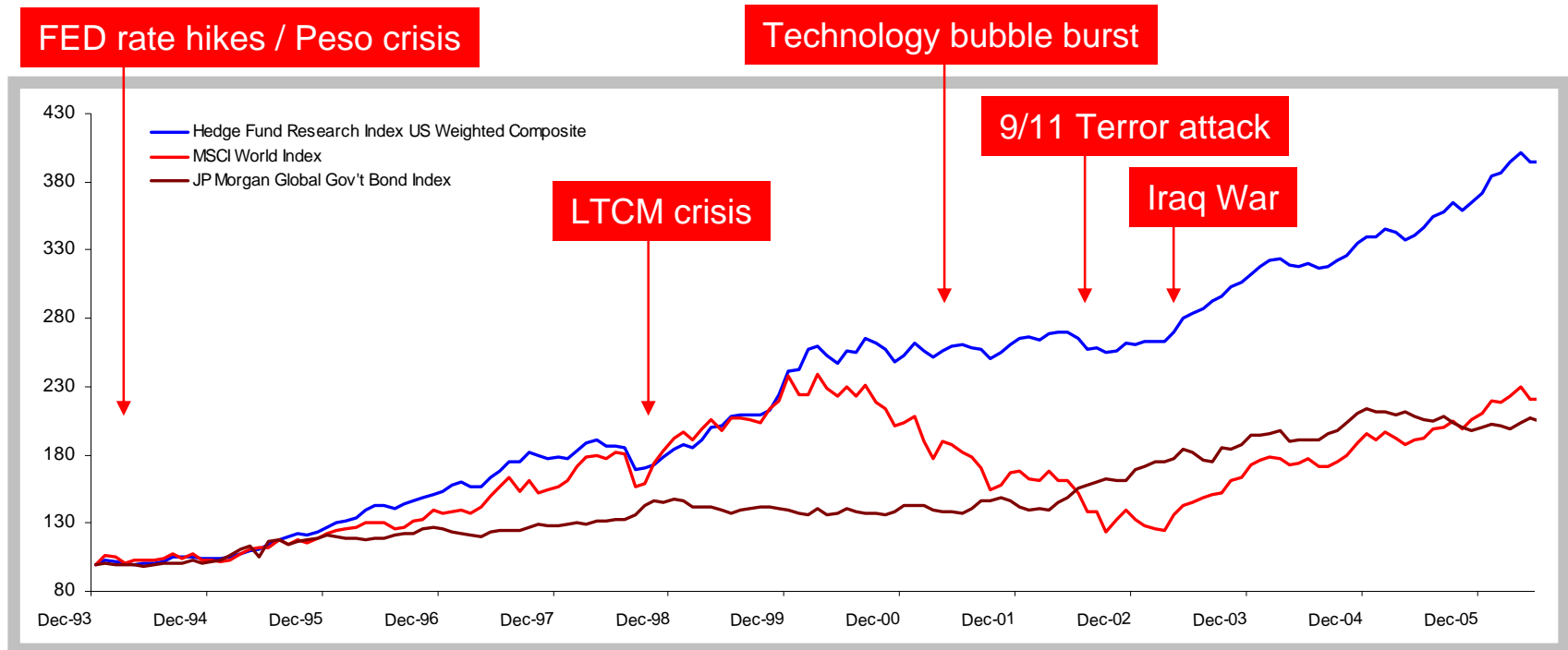


Sources: Bloomberg / Hedge Fund Research
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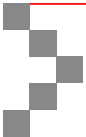


Protection against major market events



| Event | Period | HRFIFWI | MSCI | Event | Period | HRFIFWI | MSCI |
|---------------------|----------------|---------|---------|---------------------------------------|---------------------|---------|---------|
| Fed raised rates | Feb - Dec 1994 | 2.13% | -1.47% | Tech bubble-burst & market down cycle | Jan 2000 - Dec 2002 | 8.26% | -44.24% |
| Mexican Peso crisis | Dec 1994 | -0.08% | 0.80% | "9/11" terror attack | Sept 2001 | -2.83% | -8.92% |
| Collapse of LTCM | Jul -Aug 1998 | -8.70% | -13.45% | The Iraq War | Mar 2003 | 0.14% | -0.56% |

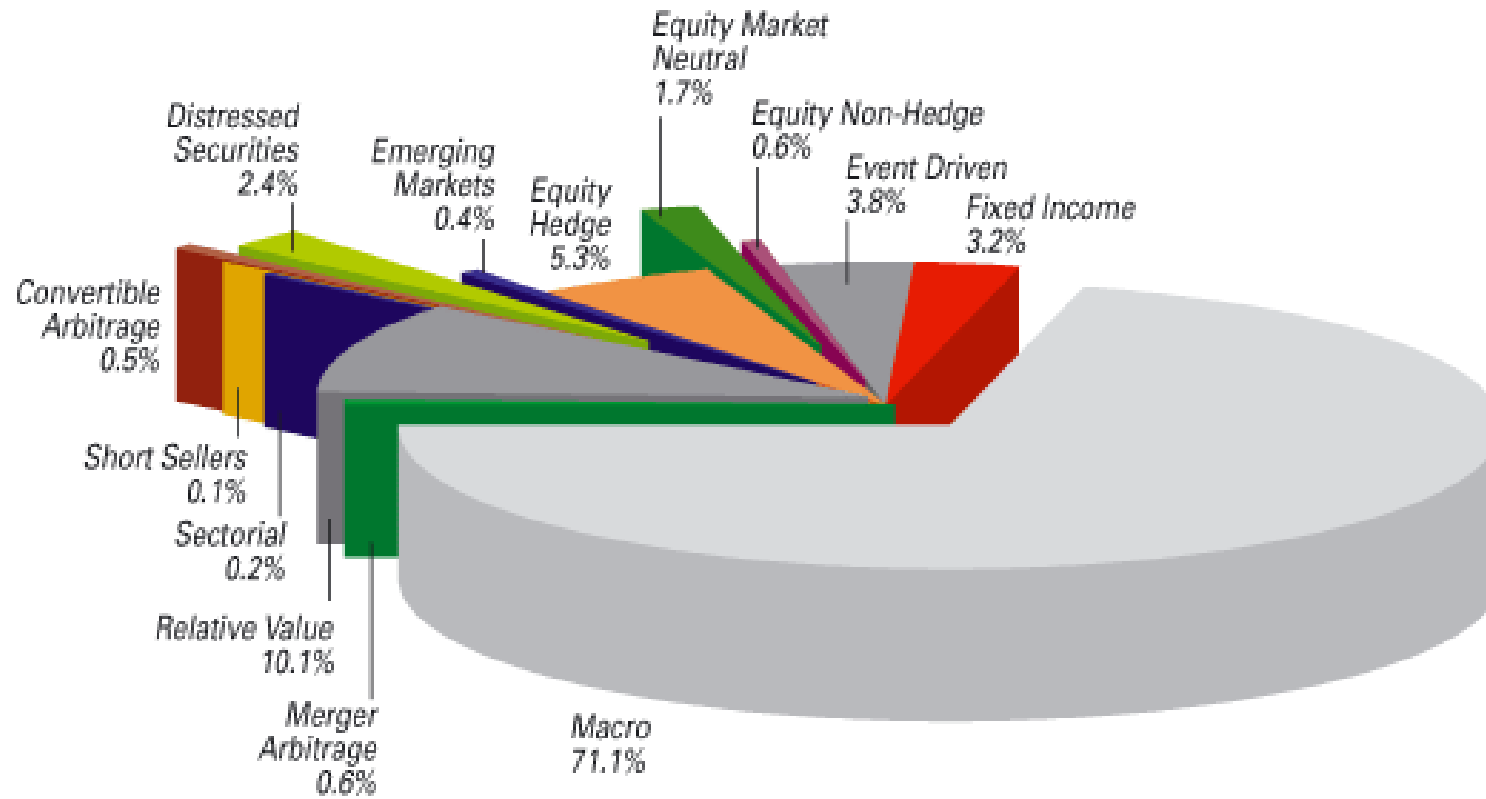
Sources: Bloomberg / Hedge Fund Research
Data period from 31 Dec 1993 to 31 Jun 2006



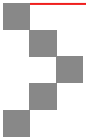


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Hedge fund strategies – Change over time (1990)



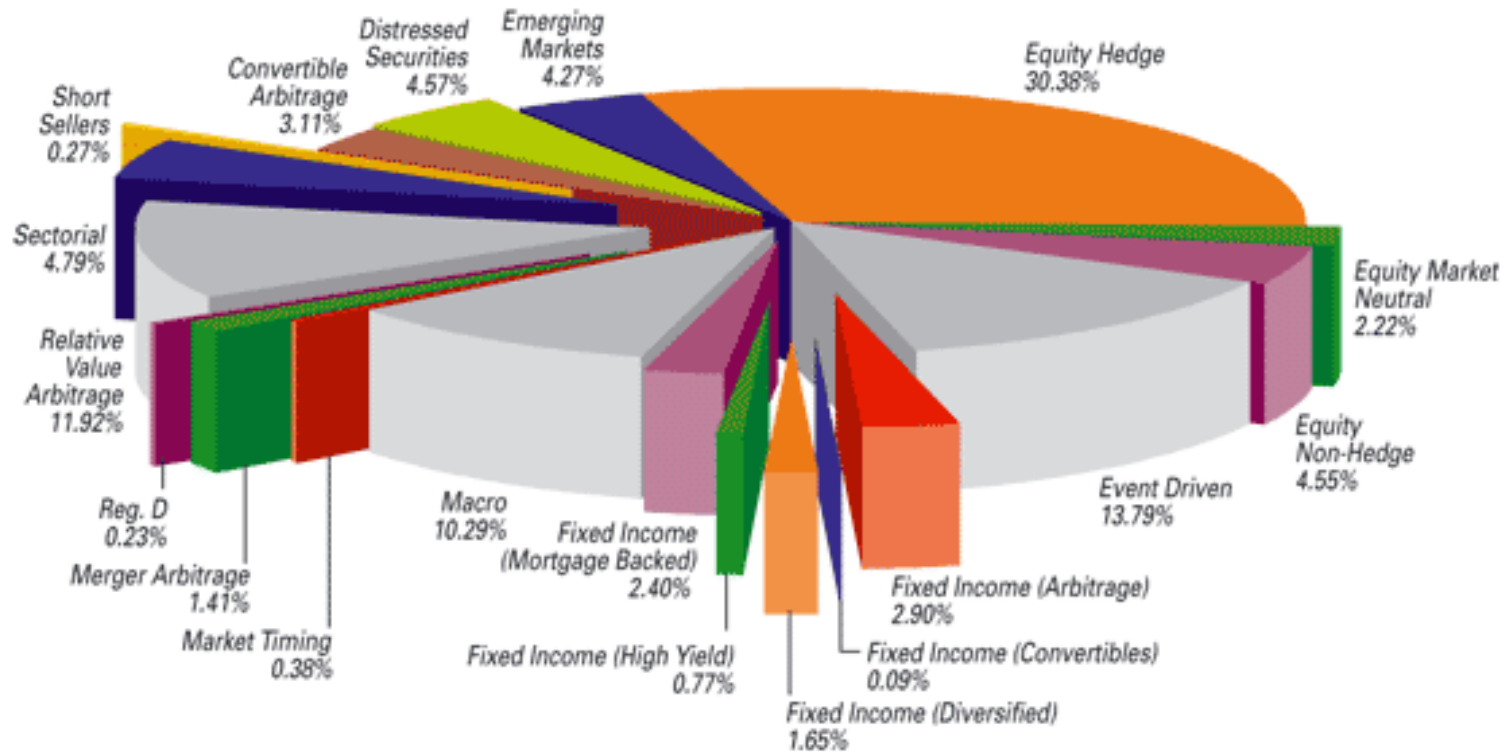
Source: Hedge Fund Research



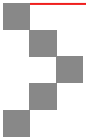


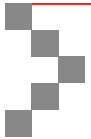
1

Hedge fund strategies – Change over time (Q2 2006)



Source: Hedge Fund Research





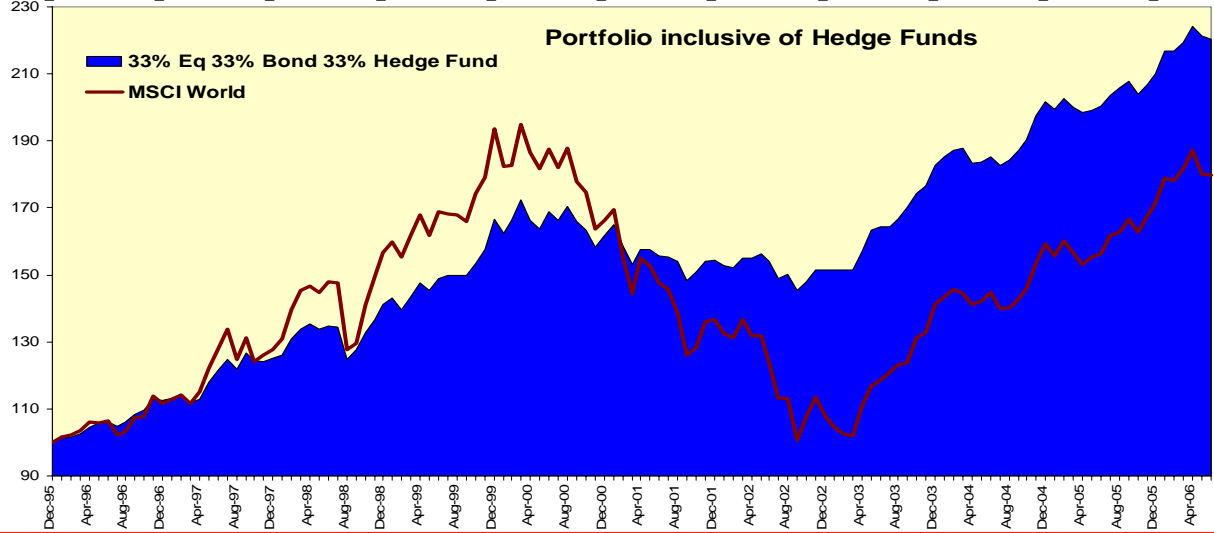
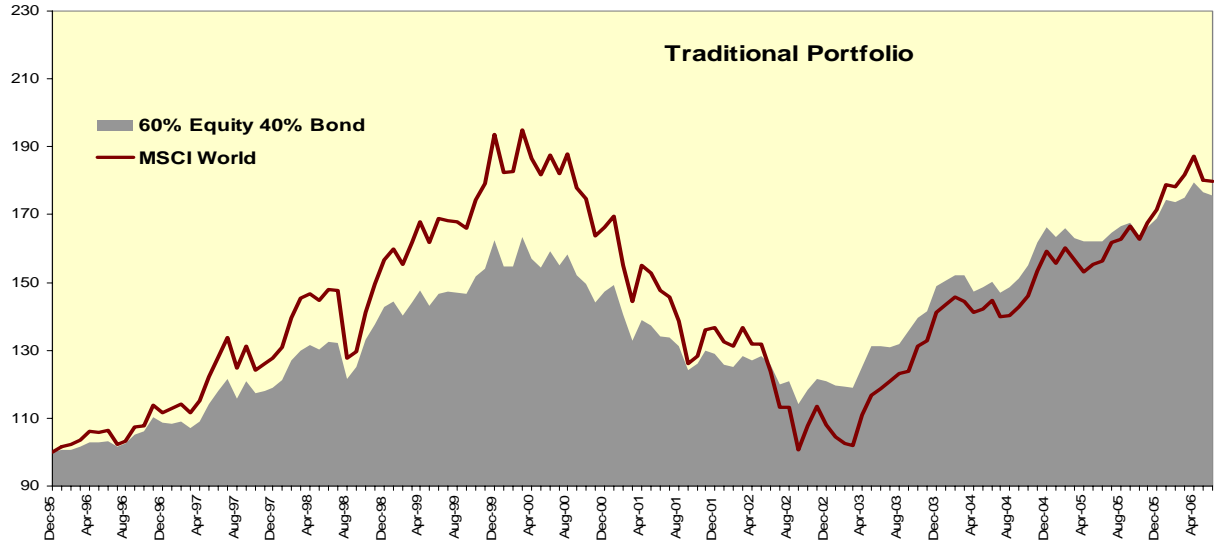


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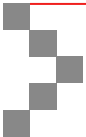
The experience to date

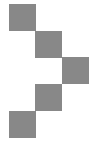
Without hedge fund

With hedge fund



Sources: Bloomberg / Hedge Fund Research
 Data period from 31 Dec 1995 to 30 Jun 2006 Hedge Funds are represented by the Hedge Fund Research Index US Weighted Composite, Equities are represented by the MSCI World Index, and Bonds are represented by the JP Morgan Global Government Bond Index



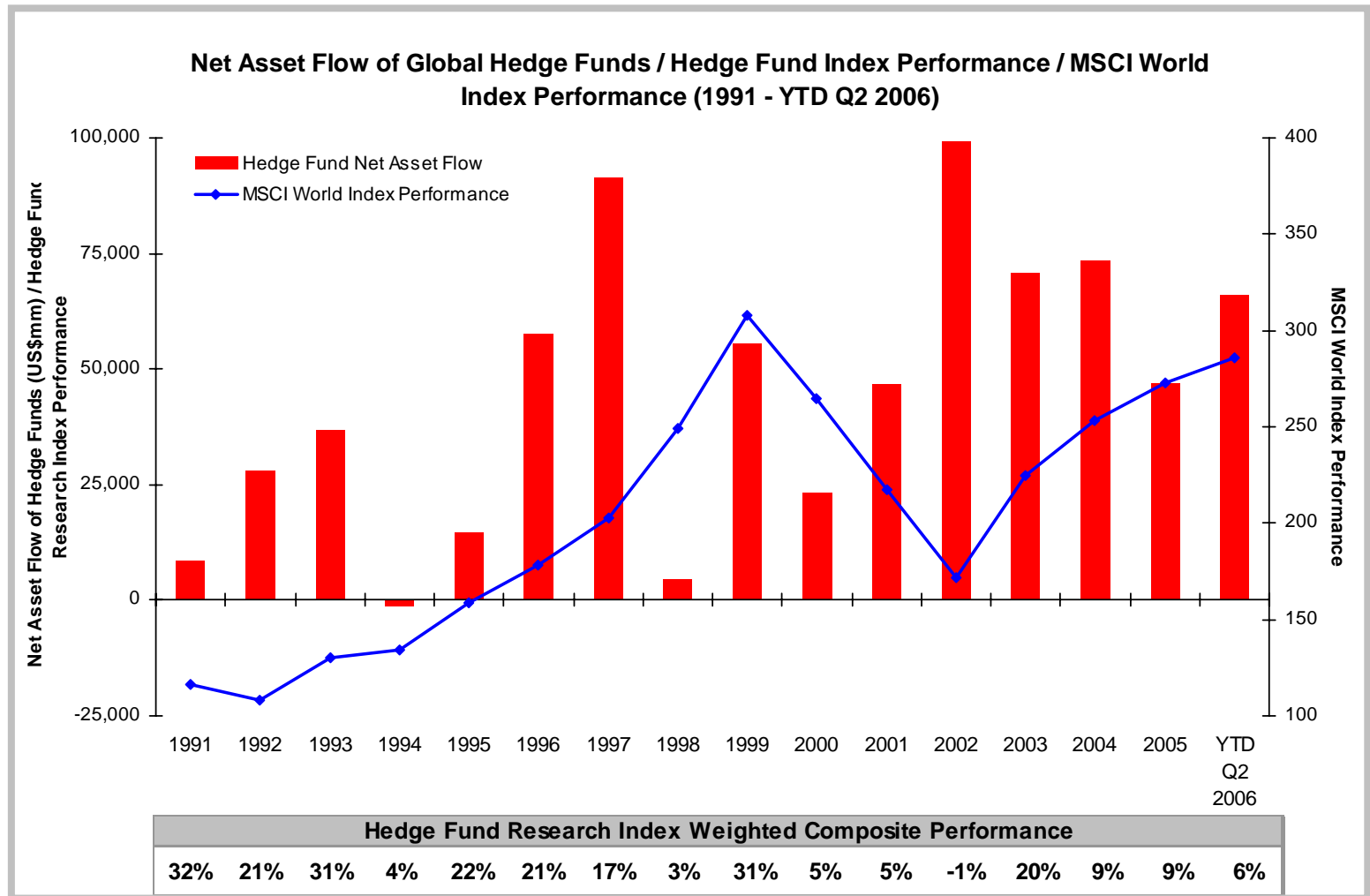


2. The Present

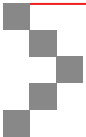


2

Absolute return is all relative



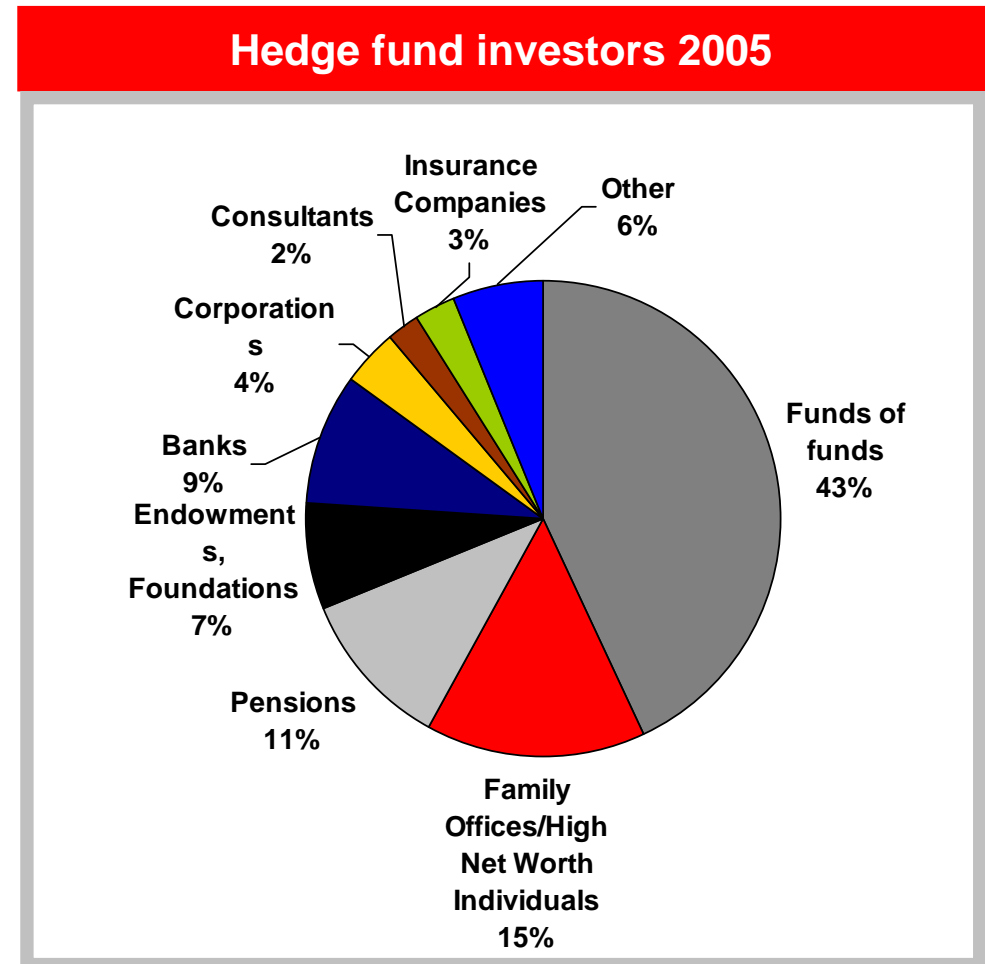
Sources: Bloomberg, Hedge Fund Research



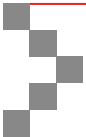


2 Demographics dictate returns

- Fund of Funds are the dominant player in the market
- Institutions represent one third of investors
- Appetite for risk has reduced



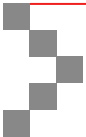
Source: 2005 Deutsche Bank Alternative Investment Survey
Based on over 1,000 representatives from 650 firms, representing US\$645bn in direct hedge fund assets

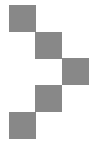




2 Urban myth busting

- Major allocation changes driven by new fund inflows, NOT strategy views
- Great quality managers in out-of-favour strategies are very often retained
- Illiquid managers are avoided regardless of investment potential
- Funds are (over) diversified to satisfy institutional risk appetite





3. The Future



3

The shape of things to come

It's all about
higher return
(and risk)

Strategy and geographically focused funds

A more focused, flexible, tactical approach

Less liquid strategies

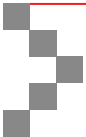
The rise of the event-driven activists

Structured products

Hedge fund annuities plus managed leverage

Emerging manager and incubator funds

Diamonds in the rough

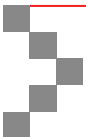
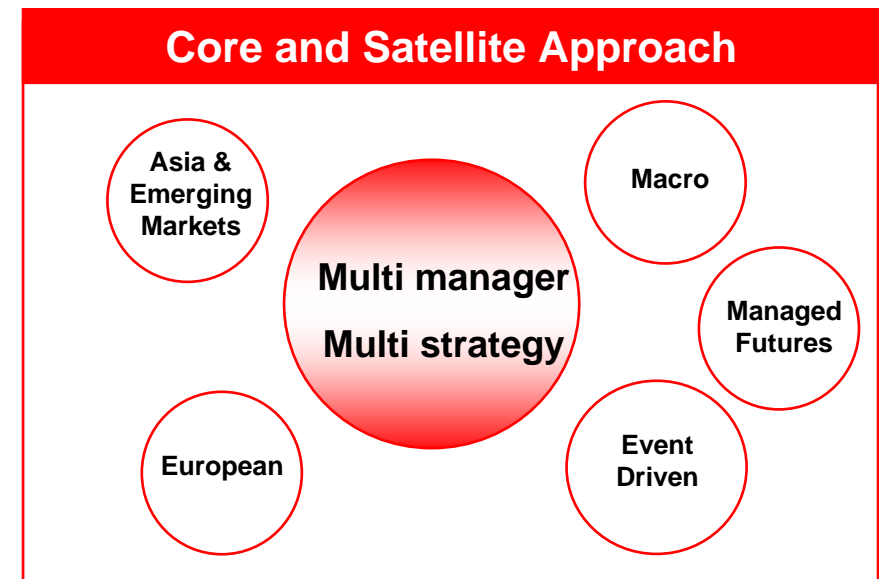




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Strategy and geographically focused funds

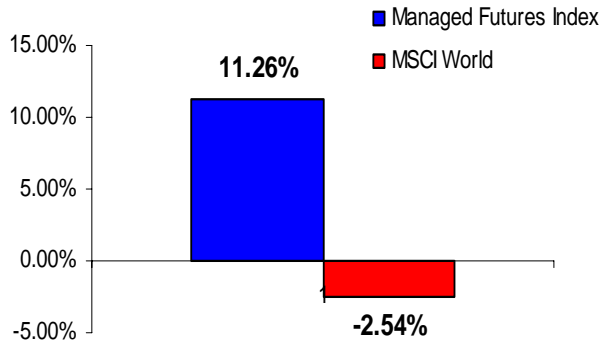
- Growing trends:
 - Move toward single country funds, specifically, Japan, Europe and Asia
 - Move toward strategy specific funds, principally, equity long/short, macro and CTAs
- Multi-strategy funds have become more diversified and less attractive
- Building blocks enabling investors to focus their portfolio allocations to achieve better returns. i.e. more tactical allocations
- More likely to generate higher alpha due to managers' specialization in strategies and local expertises
- Capacity has made strategy allocation increasingly more important



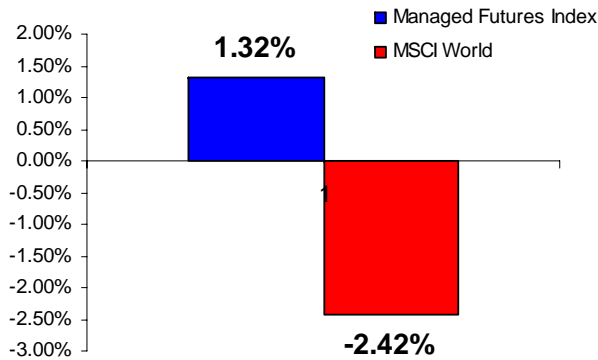


3 CTAs ... a case study in diversification

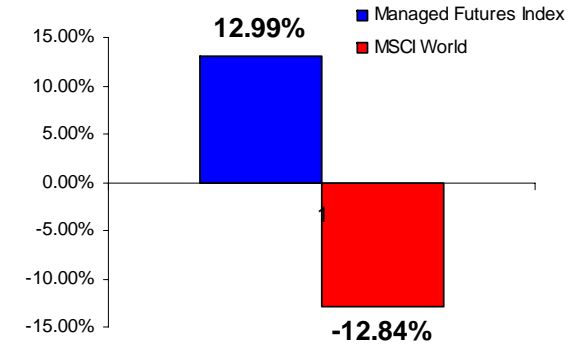
Fed Rate Hike Feb - Dec 1994 (11 months)



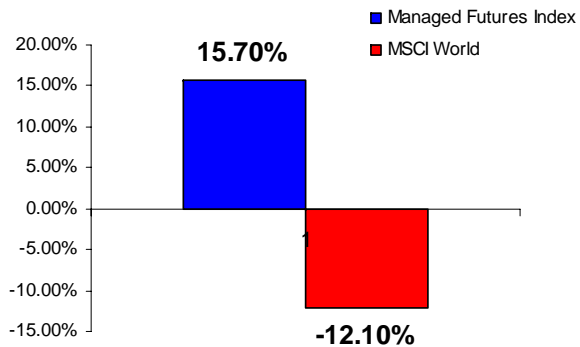
Asian Crisis July - Oct 1997 (4 months)



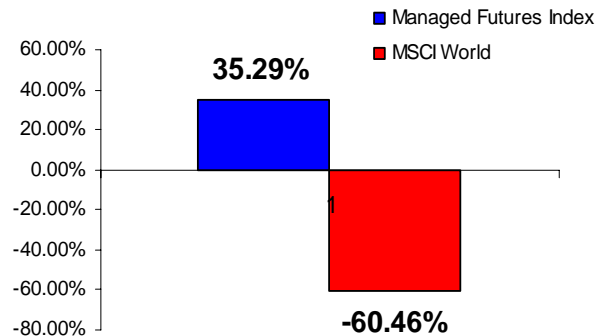
Russian Default May - Aug 1998 (4 months)



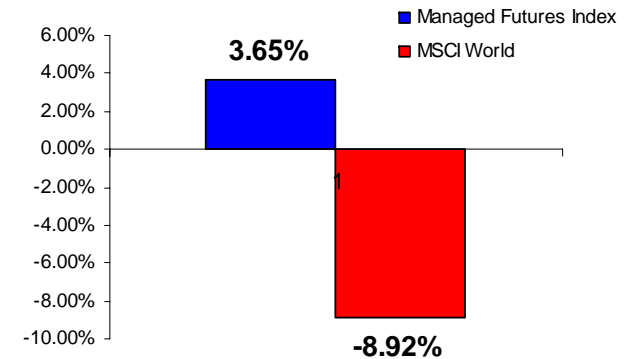
LTCM Collapse - July - Sept 1998 (3 months)



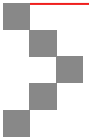
Tech Bubble Downturn Jan 2000 - Dec 2003 (3 Yrs)



911 September 11th 2001 (1 month)



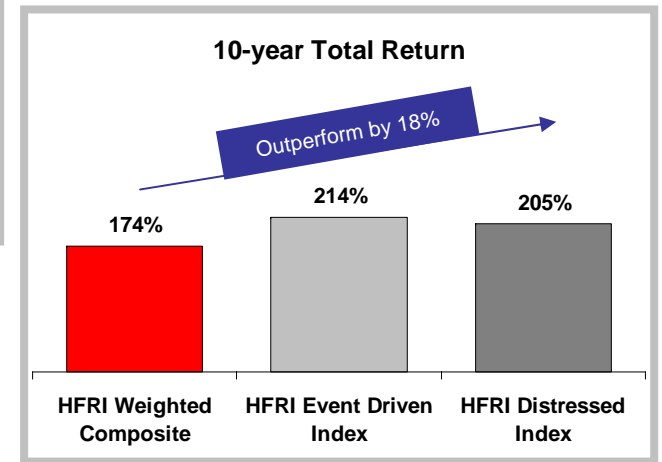
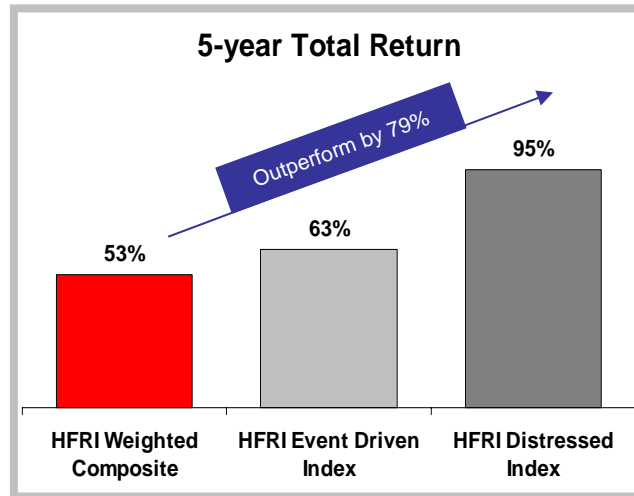
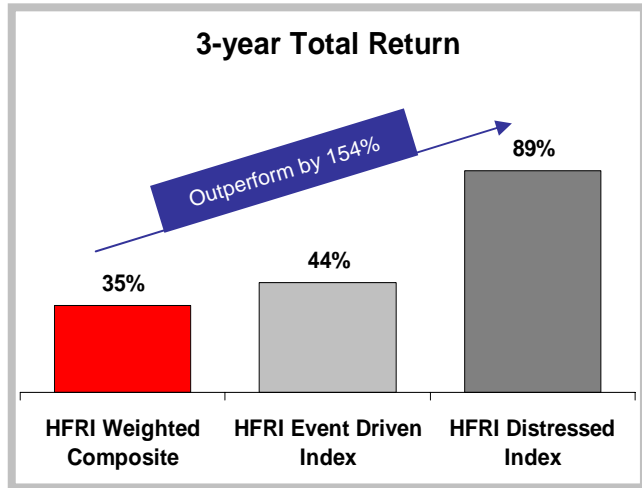
Sources: CSFB Tremont Hedge Index and Bloomberg – January 1994 to August 2005



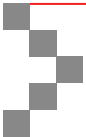


3

The price of liquidity



■ Represents performance of HFRI Distressed Index over HFRI Weighted Composite
Source: Hedge Fund Research



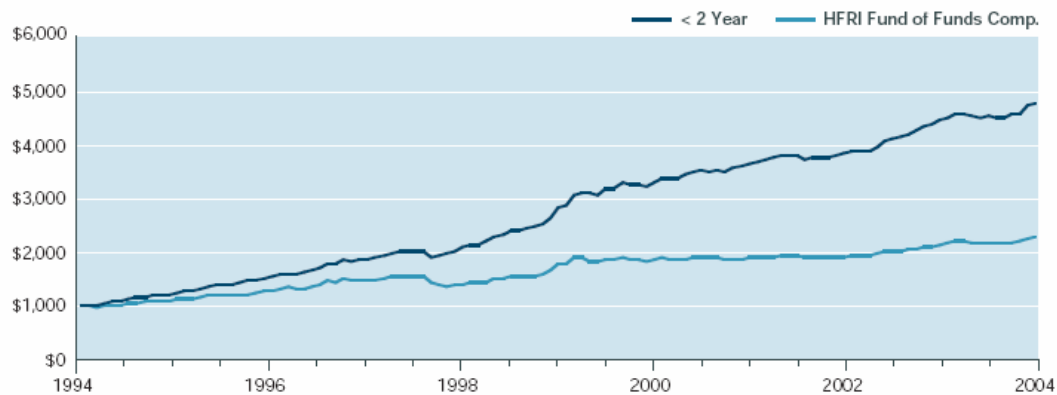


3

Emerging managers outperform veteran managers

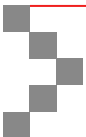
- Emerging managers (managers with less than two year track record) represent nearly 10% of the hedge fund universe based on AUM.
- This counterintuitive phenomenon is mainly driven by:
 - Greater incentive of young managers to outperform their peers to attract assets
 - The nimble nature of smaller funds to focus on their best investment ideas
 - The application of specific expertise to niche exposures

EMERGING MANAGERS HISTORICALLY OUTPERFORM THE OVERALL HEDGE FUND MARKET:



Source: Hedge Fund Research, Inc. (Jan. 1995 – Dec. 2004)

| | | < 2 Year | HFRI FoF |
|---------|-----------|----------|----------|
| 10 Year | Ann. Ret. | 16.91 | 6.38 |
| | Std. Dev. | 5.25 | 5.21 |
| 5 Year | Ann. Ret. | 11.13 | 5.17 |
| | Std. Dev. | 4.52 | 4.44 |
| 3 Year | Ann. Ret. | 9.37 | 6.35 |
| | Std. Dev. | 3.20 | 2.96 |





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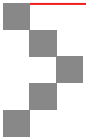
Incubator funds

Positives

- Statistically start up funds enjoy the “rookie effect”
- Establish long-term relationship and resultant capacity

Negatives

- Higher operational and investment risk
- Questionable sustained long term success
- Lack of infrastructure
- Fund of funds forced to invest rather than wait to discover the next Soros

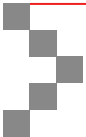
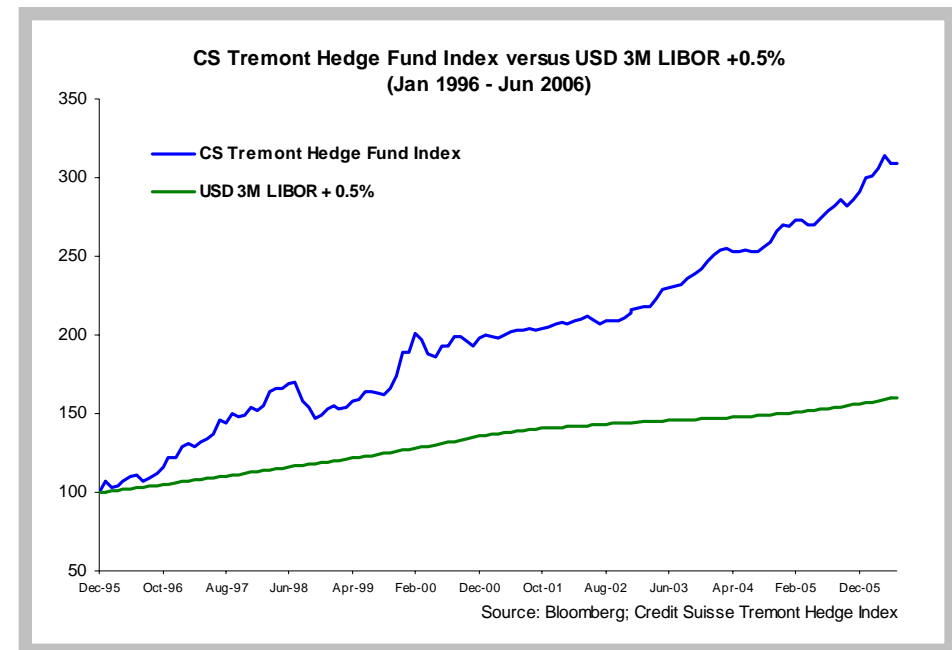




3

Structured products ... hedge fund annuities

- Out of favor in low interest rate environment but now a viable investment option
- Managed leverage
- Improved financial techniques and models allow for more advanced and tailored structured products
- The flexibility of:
 - Portfolio leverage
 - LIBOR plus linked coupon
 - Variable tenor
 - Multi-currency options

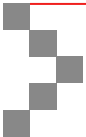




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The Future ... it's all about capacity

- Hedge fund industry is capacity constrained
 - There will be limited great managers with limited opportunities
 - There will be new opportunities that will evolve
- The industry will polarise into “capacity rich” players and boutiques with a niche
- Investors
 - Will become more tactical
 - Will add less liquid strategies
 - May embrace emerging managers
 - May use managed leverage through structured products
- **Advisors will have more opportunity to add value**





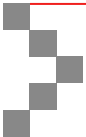
3

Hard times for hedge funds?

FORTUNE

- Hedge funds are estimated to represent only 2% by assets compared to US mutual funds
- Rapid growth in the number of funds offered
- Investors disappointed by poor returns in recent bear market
- Stock exchange concerns over perceived heavy impact of hedge-fund trading on some stocks
- SEC scrutinising the sector

“Hard Times Come to Hedge Funds”. 1970.

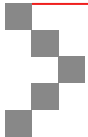


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