

# HENNESSEE

## HEDGE FUND REVIEW®

JANUARY 2010  
VOLUME 12 ISSUE 1

DEC

YTD

<b>MARKET SUMMARY</b>	<b>1</b>	<b>HENNESSEE HEDGE FUND INDEX</b>	+2.27%	+24.85%	
		<b>S&amp;P 500</b>	+2.81%	+24.71%	
		<b>LONG/SHORT EQUITY</b>	+2.16%	+21.44%	
<b>STYLE PERFORMANCE SUMMARIES</b>		<b>ARBITRAGE/EVENT DRIVEN</b>	+3.01%	+30.80%	
		<b>GLOBAL/MACRO</b>	+1.98%	+24.58%	
<b>Long/Short Equity</b>	<b>6</b>	<b>PERCENTAGE OF HEDGE FUNDS</b>			
<b>Arbitrage/Event Driven</b>	<b>9</b>	<b>MANAGERS OUTPERFORMING THE:</b>			
<b>Global/Macro</b>	<b>15</b>	S&P 500	38%	40%	
<b>MONTHLY FEATURES</b>		<b>TOP (3) PERFORMING:</b>	<u>Dec</u>	<u>YTD</u>	
		Event Driven	+6.61%	Latin America	+51.16%
<b>Hennessee Hedge Hog Corner</b>	<b>19</b>	Distressed	+5.06%	Distressed	+42.96%
		PIPES/Private Financing	+4.20%	Event Driven	+42.03%
<b>Hennessee Hedge Fund Style Definitions</b>	<b>20</b>	<b>BOTTOM (3) PERFORMING:</b>	<u>Dec</u>	<u>YTD</u>	
		Short Biased	-3.92%	Short Biased	-17.48%
<b>Hennessee Hedge Fund Rankings</b>	<b>23</b>	High Yield	-0.90%	Merger Arbitrage	+8.66%
		Macro	-0.28%	Telecom and Media	+9.74%
<b>Hennessee Hedge Fund Indices®</b>	<b>24</b>				

### MARKET SUMMARY - DECEMBER 2009

The financial markets rebounded strongly in 2009 as investors returned from the sidelines and snatched up securities trading at “once in a life time” valuations. Investor confidence was boosted as the year progressed due to improving economic data and positive earnings reports. The S&P 500 Index finished 2009 up +24.7%, while the Russell 2000 Index (small cap stocks) closed the year +25.2% higher. International stocks participated in the strong equity rally as the MSCI EAFE Index


rose +27.8% and the MSCI Emerging Markets Index jumped +74.5%.

The fixed income markets also experienced broad based gains in 2009 as the Barclay Aggregate Bond Index gained +5.9% while the Merrill Lynch High Yield Master II Index leaped +57.5%. Conversely, treasuries suffered as the year progressed as investors increasingly sought out risk assets. The 10 Year Treasury lost -9.8% while the 30 Year Treasury dropped -25.9%.

Commodity prices were driven higher throughout the year as optimism grew that the worst of the recession may have passed and the fear of inflationary pressures grew. The Reuters/Jefferies CRB Index rose +23.7% in 2009. The S&P GSCI Crude Oil Spot jumped +77.9% while gold broke a new record high, exceeding \$1,200 in late 2009.

The Hennessee Hedge Fund Index gained +2.3% during the month of December, and finished 2009 up +24.9%. Despite a strong equity rally and moderate net exposures, hedge funds managed to keep up with the traditional equity markets and register their best year since 1999. **The top three performing**

**strategies in 2009 included convertible arbitrage, emerging markets and distressed.** Managers were able to take advantage of the massive deleveraging and forced liquidations as a result of the credit crisis in 2008 and purchase securities at very attractive valuations early in the year. In addition to strong gains, there was a substantial slow down in redemptions and fund closures, particularly as the year progressed. **Entering 2010, the industry appears to have put the worst behind it as it is once again experiencing positive net inflows and an uptick in fund launches.**



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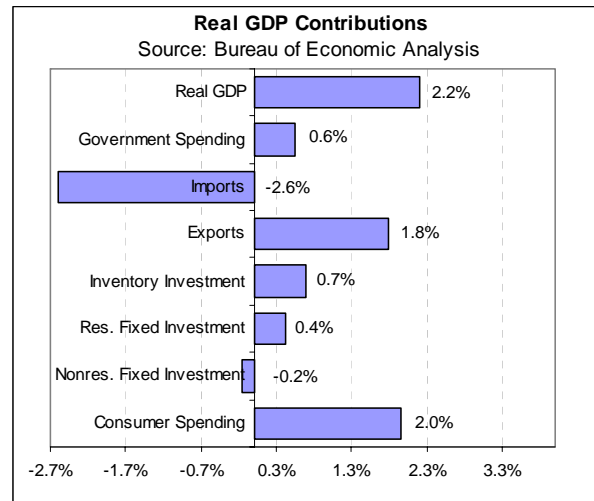
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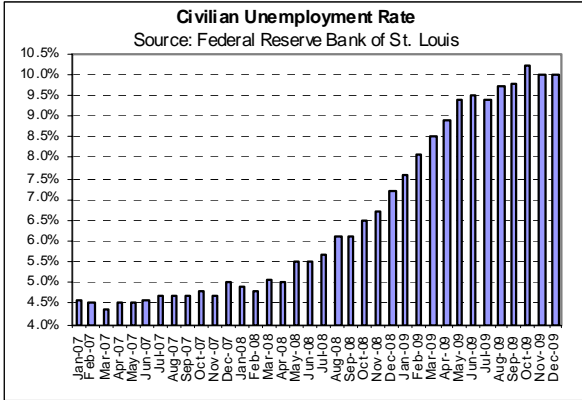
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The U.S. economy started 2009 off with weak output, contracting -6.4% and -0.7% during the first and second quarters, respectively. Inventory cuts were the primary detractor, highlighted by a record \$100 billion inventory cut which detracted nearly -3.0% from first quarter GDP growth. **The huge drop in inventories, however, paved the way for a rebound in orders and output in late 2009 as businesses had to restock exceptionally low inventory levels.** Third quarter GDP growth came in at a positive +2.2% due to inventory rebuilding and consumer spending. **While a return to positive economic growth is encouraging, there are still numerous headwinds that could stall or result in muted growth going forward.** With the unemployment rate in the double digits (+10%), economists believe consumer spending, which represents nearly 2/3 of economic growth, will remain muted, particularly as stimulus programs such as the “cash for clunkers” expire. In addition, inventory restocking, one of the major contributors to growth in the 3<sup>rd</sup> quarter, is a cyclical component that is unlikely to continue which puts into question the sustainability

of such growth. **Economists believe economic growth will remain muted in 2010, ranging between +2.0% and +2.5%.**

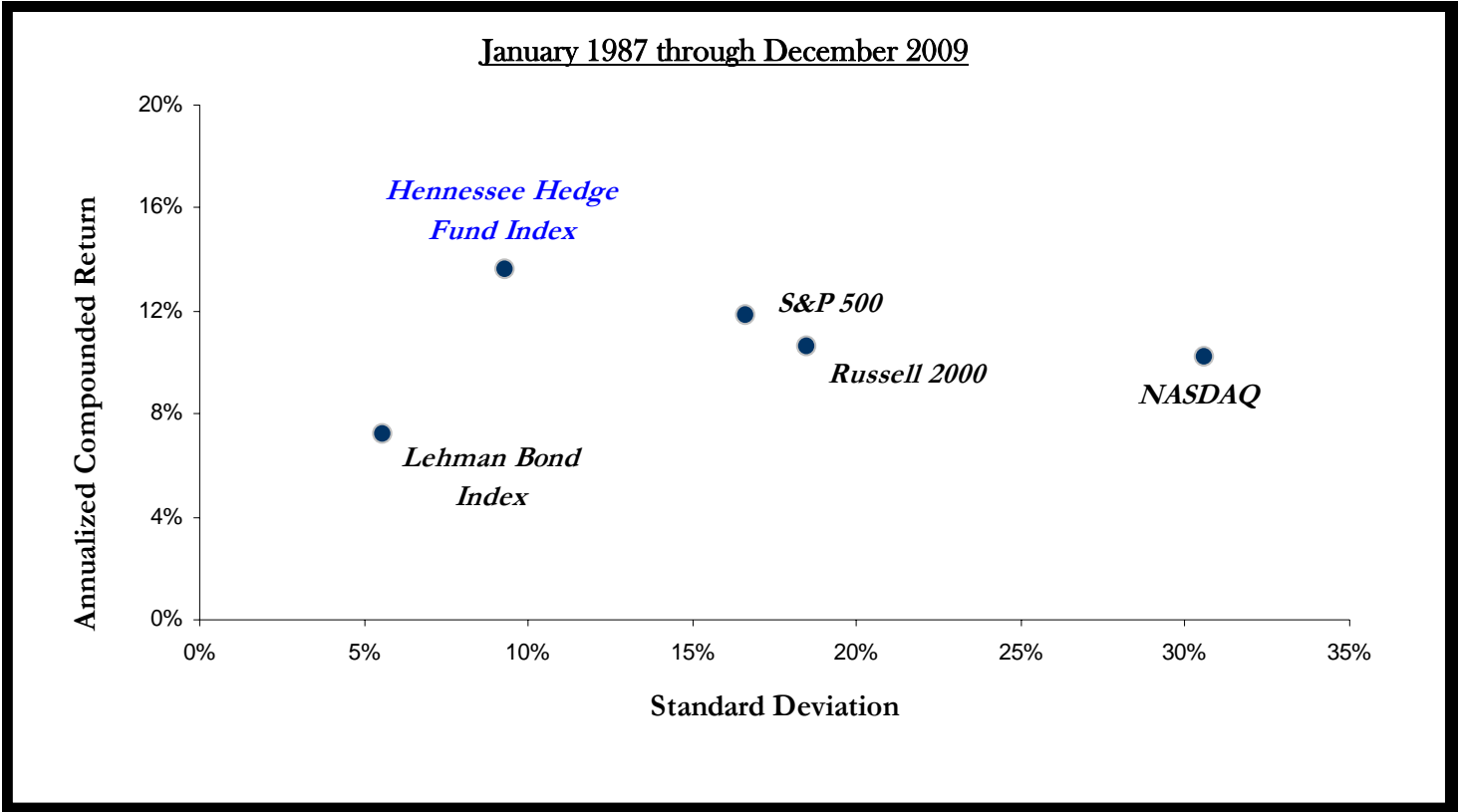


While the employment situation got “less worse” as the year progressed, the overall picture remains bleak. **From December 2008 to December 2009, the number of unemployed rose from 7.7 million to 15.3 million while the unemployment rate rose from +5.0% to +10.0%.** The losses have been broad based, affecting all sectors of the economy. **Including individuals that are no longer looking for work or have chosen to take part time work, the unemployment rate jumps to over +17%.** That said, reductions in nonfarm payrolls have been declining at a slower rate and the hiring of temporary workers has increased for five consecutive months. Generally speaking, a rise in temporary staffing is an initial sign that businesses have squeezed as much production as they can out of their existing work force and are taking the first step to add staff. **Economists anticipate employers to start adding jobs in the coming months which should lead to the jobless rate topping out slightly above +10%.**

**The housing market also showed signs of stabilization throughout the year, but remains fragile.** The Standard & Poor's/Case-Shiller U.S. National Home Price Index, which tracks changes in the value of the residential real estate market in 20 metropolitan regions across the United States, was flat in October after having recorded gains in five consecutive months. **Year-over-year, the index remains off -7.3%.** In additional housing news, existing home sales jumped +7.7% in November, and are now up an impressive +44.0% on a year-over-year basis. **Existing home sales inventory now stands at 6.5 months,**

**a 3.5 year low and well below the 11.2 months supply a year ago.** Conversely, new home sales experienced a steep drop in November, dropping -11.0% during the month. **That said, the supply of new homes, approximately 235,000 (7.9 months), is at its lowest level since 1971 and well below its record high of 12.9 months a year ago.** While recent improvements are encouraging, economists remain wary about the sustainability of the housing recovery. Benefits such as the new home buyer tax credit, which have helped mitigate the downturn in the housing market, are bound to expire and any sales improvements due to such credits are just borrowing from future sales. **There is also concern that mortgage rates, which are at record lows, will likely rise in the months ahead as the Fed unwinds its purchases of mortgage-backed securities which will likely further slow housing sales.**

**Due to ongoing challenges for the economy, particularly the jobs and housing markets, consumer confidence remains fragile.** The Consumer Confidence Index rose to 52.9 in December, however well off its high set in July of 2008 at 112.0. **That said, the index has gradually improved over the year, finishing 2009 well above its all time low set in early 2009 when it was hovering around 30.** In addition, the expectations component of the index jumped more than 5 points to 75.6 in December, its highest reading since December of 2007. An 80 reading for the expectations component is generally considered to be a leading indicator for economic recovery. While the index has experienced marginal improvements throughout the year, the gains have been somewhat narrowly focused in the expectations component, and many areas of the index remain weak, particularly the present situations index. **Economists anticipate the overall consumer confidence index to remain volatile and subdued until real growth resumes in the labor market.**



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## You Wouldn't Use a Stock Index to Benchmark Your Bond Portfolio So Why Use One to Benchmark Your Hedge Funds?

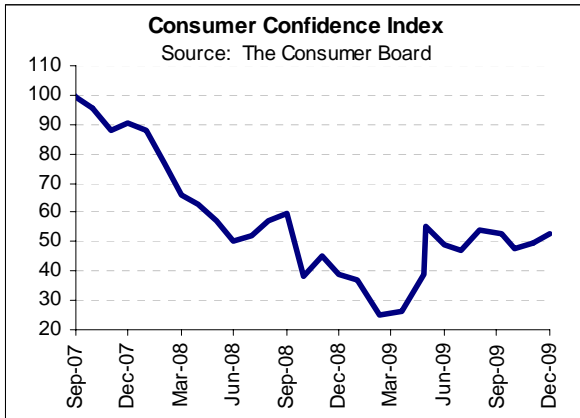
### **Hennessee Hedge Fund Indices®**

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The Hennessee Hedge Fund Indices® have been used as a hedge fund benchmark since 1987. Created real-time, the Hennessee Hedge Fund Indices® are an equally weighted average of a diversified group of hedge funds consisting of 23 different investment styles.

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**As the labor market begins to stabilize, personal income is beginning to experience small advances and consumer spending is returning.** Personal income rose +0.4% in November, with the wage and salary disbursement component advancing +0.3%, its largest gain in seven months. That said, over the most recent twelve month period, personal income is down -0.3%. Consumer spending rose +0.5% in November and is now up +2.3% over the past year. With personal income rising in line with spending, the personal savings rate held steady at +4.7% in November. In addition, consumer credit plunged \$17.5B in November, another record drop and a much bigger decline than expected. The drop was largely driven by the revolving component, which dropped by a staggering \$13.7B. **As the balance sheet of consumers improves, economists expect income and spending to also improve in the coming months, particularly as the labor market gains strength.**

**Headline inflation has been kept in check over the last year due in large part to lower energy prices, declining housing prices and elevated levels of unemployment.** Headline CPI rose +0.4% in November and is now up a moderate +1.8% over the past year. The core rate, which excludes food and energy, was flat during the month of November and finished the most recent 12 month period up +1.7%. With inflation still relatively subdued, the Fed continues to focus on the struggling economy and weak employment situation. Ben Bernanke recently reiterated the Fed's desire to keep the fed funds rate at 0% to 0.25% for an extended period of time. **In light of this accommodative stance by the Fed, there is growing concern inflation could become a longer term problem for the economy.**

The manufacturing sector, as measured by the Institute for Supply Management's Manufacturing index (ISM Index), a diffusion index measuring national manufacturing conditions by surveying 300 firms on employment, production, new orders, supplier deliveries and inventories, improved toward the end of 2009 and finished the year in expansion mode. **The final 2009 reading for the ISM Index came in at 55.9 (readings above 50 indicate an expanding manufacturing sector), well above the level the index started the year at, approximately 36.** In addition, the new orders index continues to show strength, jumping more than 5 points to 65.5 in November, the most telling barometer that the sector is likely to experience further expansion in the months ahead. **Another positive indicator is the continued rise in the employment index which rose more than 1 point to 52.0 in November, a sign manufacturers are no longer cutting their workforce.** The rebound in manufacturing over the course of the year and surprisingly strong report in November will likely lift expectations for a first half economic recovery led by the manufacturing sector.

**In light of the tumbling financial markets and weakening economy entering 2009, the U.S. government became increasingly aggressive with its fiscal and monetary policies.** In addition to aggressively reducing its target for the federal funds rate to a range of 0% to .25%, the Fed created a variety of lending facilities in an attempt to stabilize troubled financial companies and increase liquidity for the credit markets. **While such actions boosted the financial markets in 2009 and averted further deterioration in the economy, they have greatly expanded their balance sheet.** There is now growing concern such actions will result in new challenges going forward, namely how the drastic increase in debt taken on to battle current economic problems will be financed without harming future economic growth. In addition, the Fed will eventually have to confront the challenge of exiting the accommodative stance on interest rates while also not thwarting economic growth.

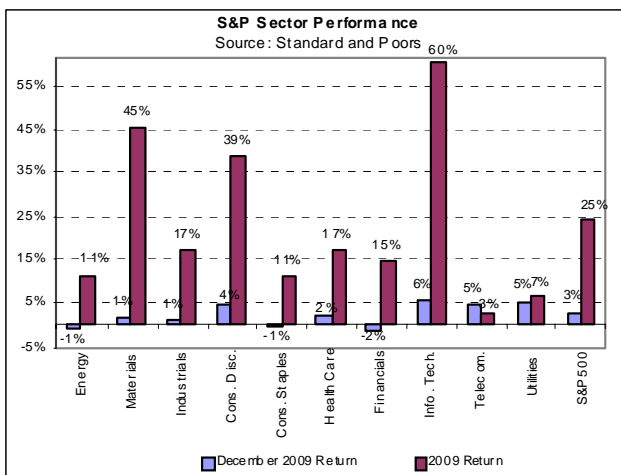
**The driving force behind the ongoing rally continues to be better than expected economic data and excessive amounts of liquidity being plowed into the financial markets.** However, investors are now beginning to question the sustainability of such catalysts and whether or not the markets have gotten ahead of themselves. There is a growing concern as the stimulus

is removed that we could experience another slow down in economic growth and a strong sell-off in the financial markets, particularly as liquidity dries up. **Given these near term risks, managers remain cautious and are positioning themselves for a market that is likely to transition from a beta driven market to one of a stock pickers market which should benefit hedge funds that have historically relied on limited directional risk and strong security selection for alpha generation.**

**Long/Short Equity**

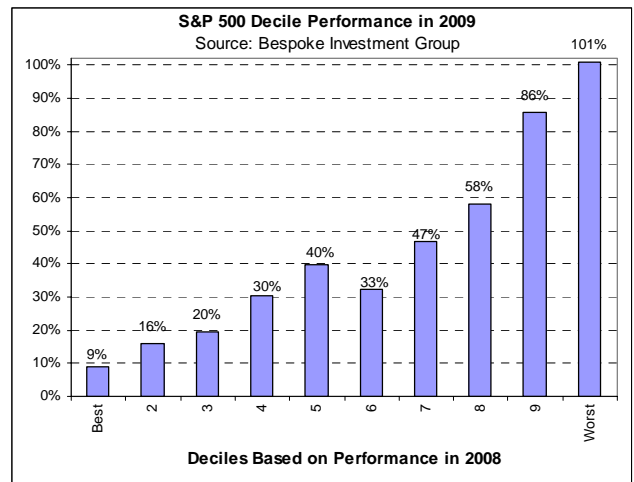
(YTD: +21.44% / DEC: +2.16%)

After plunging nearly -60% from its high in October 2007 through early March 2009, the equity markets experienced a strong, broad based rally, gaining over +65% during the final nine months of the year. The S&P 500 Index finished 2009 up +24.7%, while the Russell 2000 Index closed the year with a +25.2% gain. **Growth stocks outperformed value with the Russell 3000 Growth Index gaining +37.0% in 2009 while the Russell 3000 Value Index advanced +19.8%.** From a sector perspective, technology stocks led the way with a +59.9% gain, followed by material stocks (+45.2%) and consumer discretionary stocks (+38.8%). All ten sectors experienced gains in 2009.



The Hennessee Long/Short Equity Index gained +2.16% in December and finished up +21.4% in 2009. Long/short equity funds profited from positions in their long portfolios while short portfolios and

hedges generally served as a drag on performance throughout the year. Shorting was particularly difficult as some of the top performers for the year were low quality, cheap stocks. **As a result, short biased managers suffered in 2009 as the Hennessee Short Biased Index declined -17.5%.** Long/short equity hedge funds most willing to take on heightened directional risk, while buying up high beta stocks that experienced the steepest sell-offs during the credit crisis, were most rewarded while those funds that remained defensively positioned, and cautious, with an emphasis on fundamentals, generally lagged, particularly as the year progressed.



The technology sector finished 2009 with a solid +5.6% gain in December. For the year, technology was the top performing sector with an impressive +59.9% return. The Hennessee Technology Index gained +2.9% in December and finished the year with a solid +27.9% gain. Hedge funds maintained an overweight allocation to the technology sector throughout the year as they were attracted to the above-average balance sheet strength of many of the underlying companies and the overall ability of the sector to outgrow the broader economy, particularly during the economic downturn. In addition, hedge funds anticipated a rebound in new orders for the technology space, particularly as the economy started to show signs of improving as most companies greatly cut back on IT spending early in the recession. **Another popular theme among hedge funds in 2009 and will likely remain a major theme in 2010 is the development of the smartphone and global handset market.** While the massive run-up since March has

moderated slightly, hedge funds believe without a material pullback, most of the technology and telecom sectors remain fairly valued. And if the substantial and lasting economic rebound that appears to have been priced in fails to materialize, the recent rally could easily reverse. **Hedge funds will maintain exposure to the sector but will be highly selective and cautious given the near term risks.** Some of the most notable hedge fund holdings throughout the year included Apple, Microsoft, Amazon, Research In Motion and Google.

The materials sector rebounded strongly in 2009 based on prospects for a global economic recovery and longer term inflationary concerns. **The materials sector within the S&P 500 Index rose +1.4% in December and finished 2009 with an impressive +45.2% gain.** Many hedge funds were cautious with their exposures to the commodity sectors, particularly during the early part of the year due to the slowing economy and anticipation of deflationary pressures. **However, investors started to rotate back into the commodity oriented sectors as economic data continued to point to a possible recovery. A common theme investors anticipate taking hold as the economic recovery continues to solidify is the “reflation” trade.** Hedge funds believe many factors point in the right direction for basic materials companies in 2010, but capacity expansions, and possible oversupply, as well as demand shifts due to environmental concerns are longer-term headwinds. And there is also the question as to whether demand out of China will meet expectations going forward.

The energy sector lagged early in the year, however higher oil prices, improving sentiment about the future of gas prices, and healthier credit markets combined to drive a rally in the middle of 2009 and led to a respectable full year return of +11.3% for the sector. **Managers will remain cautious and selective as the recovery is still highly uncertain and will likely lead to near term volatility for both the energy and materials sectors. That said, longer term fundamentals are favorable.**

Hennessee Long/Short Equity Index vs. S&P 500 Source: Hennessee Group; Standard & Poor's			
	Long/Short Equity Index	S&P 500	Difference
1999	33.9%	19.5%	+14.4%
2000	10.2%	-10.1%	+20.3%
2001	2.9%	-13.0%	+15.9%
2002	-6.4%	-23.4%	+17.0%
2003	19.4%	26.4%	-7.0%
2004	7.8%	9.0%	-1.2%
2005	6.8%	3.0%	+3.8%
2006	11.1%	13.6%	-2.5%
2007	12.1%	3.6%	+8.5%
2008	-18.3%	-38.5%	+20.2%
<b>2009</b>	<b>+21.4%</b>	<b>+24.7%</b>	<b>-3.2%</b>
<b>Annualized (1999-2009)</b>	<b>+6.5%</b>	<b>-2.6%</b>	<b>+9.1%</b>

Consumer discretionary stocks benefited greatly in 2009 as investors shifted back into more economically sensitive sectors as economic data pointed to a possible recovery and earnings reports were largely better than expected. **The consumer discretionary sector within the S&P 500 Index rose +4.3% in December and finished 2009 with a strong +38.8% gain. After a substantial sell-off early in the year, investors poured into the retail stocks as valuations became overly compelling despite the bleak outlook for the consumer.** In general, hedge funds now believe retail stocks look fairly valued if not slightly overvalued at this time, as the market appears to be pricing in a fairly significant recovery in consumer spending in 2010. That said, there is belief that increased consumer confidence will lead to more upgrades and earnings growth is likely to surprise to the upside over the next few years. **Hedge funds remain cautious with regards to their exposures, particularly to retail and leisure stocks.**

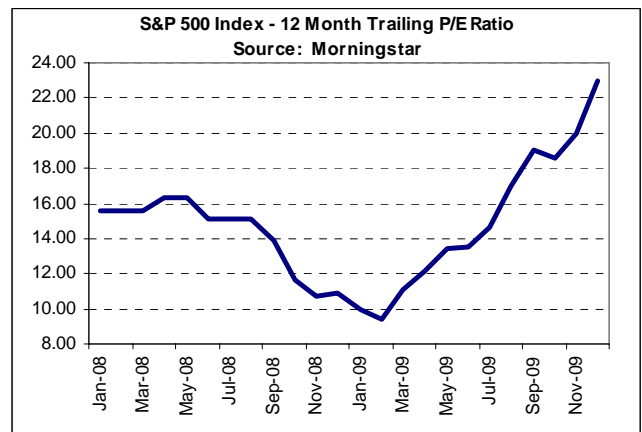
**The consumer staples sector experienced gains in 2009 but lagged the broader market as investors became less defensive throughout the year.** The consumer staples sector slipped -0.7% in December and closed 2009 with a full year gain of +11.2%. Hedge funds continue to like consumer staples stocks as the overall fundamentals remain favorable. While the benefits they reaped from pricing and

cost reduction last year are unlikely to serve as catalysts, hedge funds see volume growth as the likely catalyst going forward. In addition, they see the weakening dollar as supportive for many names within food, beverage and domestic staples. **Lastly, hedge funds anticipate stock buy back programs to pick up in 2010 as well as possible M&A activity.** Hedge funds will be selective as the recent rally in the stock market has caused several household & personal products and media companies to trade closer to fair value estimates but they believe the sector as a whole will serve as a safe haven if the near term risk of a market sell-off materializes.

**The financial sector gained a respectable +14.8% in 2009, however remains well off 2007 levels after experiencing a sharp sell-off across the entire sector in 2008. The Hennessee Financial Equities Index gained +2.4% in December and finished 2009 with a solid +26.0% gain. The outperformance in 2009 is largely attributable to the shorting and subsequent short covering that took place early in the year.** As financial stocks fell to all time lows and the government became highly active in rescuing ailing institutions, most hedge funds covered their shorts which led to a sharp jump in prices. **As a result, prices of financial stocks were driven up due in large part to overly compelling valuations as opposed to sound or improving fundamentals.** However, the rapid rebound in financial stock prices paused in the fourth quarter as fundamentals no longer justified current valuations. Hedge funds no longer view financial stocks as across-the-board cheap. That said, they believe the market rally has left behind some pockets of opportunity, including for-profit education, insurance brokers and regional banks. **Investors will seek out the highest-quality names in 2010 as another fall in the capital markets remains a risk, and the strongest names will provide both relative downward protection and are also best poised to exploit a tighter market.**

The healthcare sector gained +1.9% in December and closed 2009 with a full year return of +17.1%. **Hedge funds like the fundamentals in the health care space and have used the weak performance in the sector as an opportunity to build positions throughout the year at attractive valuations.** While many funds believe the sector will experience ongoing volatility in the near term, particularly as more clarity on

the details of the health care reform emerge, they see solid long term opportunities for both sides of their portfolios. Areas of focus remain the drug and biotech space, specifically companies with strong product pipelines, portfolios with long term patent protection as well as companies that are likely to benefit from ongoing M&A activity. **Hedge funds believe as reform starts to materialize, the veil covering health-care stocks will lift, and investors' sentiment will continue to improve leading to outsized gains in 2010.** Current top holdings among hedge funds include Teva Pharma, Wyeth, St. Jude Medical, Boston Scientific and Schering-Plough.



**While most hedge funds increased gross and net exposures throughout 2009, they remain cautious entering 2010 as it is widely believed the market, driven more by momentum than fundamentals, may have run too far, too fast.** From a valuation perspective, the markets look frothy as the S&P 500 dividend yield dropped to 1.71% at year-end, the lowest dividend yield ever recorded for the S&P. **In addition, the P/E ratio on the S&P 500 has expanded from 10x to nearly 23x over the past 9 months.** Given the recent market run up and current valuations, managers believe the multiple expansion phase of this rally has ended. **Going forward, managers will be focused on fundamentals and earnings, and believe we will need to see positive earnings reports to maintain the momentum that carried the markets in 2009.** Managers believe a return to fundamentals in 2010 will present compelling opportunities in individual names for both the long and short sides of their books which should lead to another year of double digit unlevered returns for investors.

## *Arbitrage/Event Driven*

(YTD: +30.80% / DEC: +1.98%)

**The Hennessee Arbitrage/Event Driven Index finished the year by advancing +1.98% in December, bringing 2009 year-to-date performance to +30.80%, the best year since 1988.** After a tough 2008 where the index declined -20.59%, arbitrage and event driven funds experienced a significant snapback in 2009 as credit spreads contracted and liquidity fled into risk assets. Positive performance was driven by convertible arbitrage, credit and distressed funds. **The index successfully erased its 2008 losses and establishing a new high water mark.**

The carnage of 2008 left few unscathed and some crippled as massive deleveraging due to a credit crisis and fears of a global financial collapse caused a widespread sell off. Many funds were forced to liquidate, while others were left burdened by toxic assets. **However, as 2008 ended, funds that had capital and flexibility found “once in a lifetime” valuations.**

Fear and sentiment reached an inflection point in March as global government intervention helped avoid a global collapse. **As markets, rebounded, the worst performers in 2008 were the best performers in 2009.** Funds that were most aggressive and took a long bias benefited significantly from the return of liquidity to market.

As the year progressed, low-to-zero interest rates, fiscal policy stimulus and recovering economic growth continued to support markets. **Managers are optimistic that the Fed will maintain low interest rates until the economy and markets show sustained growth, which will likely be late 2010 or early 2011.** Managers feel that a “double-dip” recession is unlikely as the government has made it clear that they will respond with further stimulus if needed. However, while it is clear assets were extremely undervalued at the beginning of 2009, the “easy money has been made” and 2010 will be a year where security selection and risk management will drive alpha generation.

## *Credit Markets*

The U.S. government took unprecedented action in responding to the 2008 credit crisis. This action provided a boost to credit markets and helped bring spreads back to normalized levels. **Prices of corporate bonds, leveraged loans, and mortgage backed securities soared in 2009 reaching pre-Lehman levels, as investors gained confidence that the credit crisis was over.** The Barclays Aggregate Bond Index advanced +5.93% for 2009, led by high yield and high grade bonds, while Treasuries detracted from performance.

While Treasuries were one of the few positive asset classes in 2008, Treasuries experienced losses in 2009, as many anticipated. As it became apparent that we would avoid a global financial collapse, investors exited safe haven assets and demanded higher yields. The U.S. government also added significant new supply, selling a record \$2.1 trillion in new debt. **Longer term treasuries were most affected, with the 30 Year declining -25.88% and the 10 Year declining -9.76%.** Many managers were short long-term Treasuries and feel that the trade will continue to be profitable.

Investment grade corporate bonds returned +18.50% for the year and saw significant spread tightening. **However, the best performing securities were the most risky. The Credit Suisse High Yield Index was up +2.9% for the month and +54.2% for the year.** Consistent with past months, cyclical industry credits and lower-rated bonds posted the best performance. Gains have been driven by the most speculative securities, as CCC-rated bonds gained over 100% in 2009. However, most managers were focused on higher quality names due to credit concerns, but those that speculated were handsomely rewarded.

The spread on the Merrill Lynch High Yield Index tightened from 765 basis points to 639 basis points in December, reaching the lowest level since June 2008. **The spread on the Merrill Lynch High Yield Index has tightened by an incredible 1,173 basis points in 2009 from 1812 basis points to 639.** Despite this incredible move, the spread remains above the 20 year average of 5.30%.

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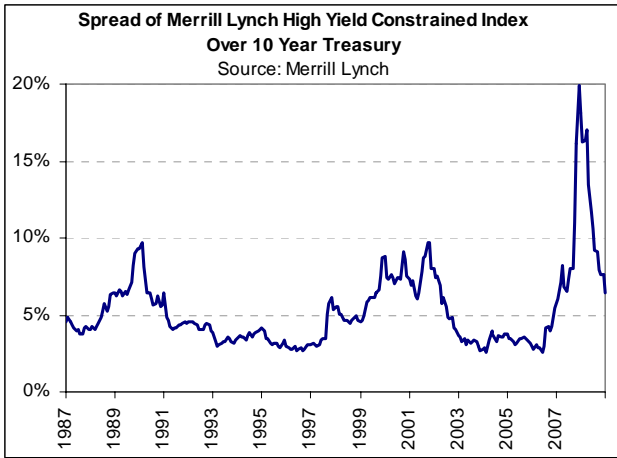
QUANTITY	PRICE	DESCRIPTION	TOTAL
	\$500 USD	EMAIL SUBSCRIPTION (U.S. AND INTERNATIONAL)	\$

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500 Fifth Avenue, 47<sup>th</sup> Floor  
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Leveraged loan prices also recovered significantly in 2009. **The S&P/LSTA Leveraged Loan Index increased +2.9% in December and +51.6% for the year.** Many managers identified leveraged loans as a very attractive opportunity at the beginning of the year as they traded at about 65 cents on the dollar. Many of these holdings are now trading close to face value.

As spreads fell across the board, the cost to borrow became cheaper, and many companies took advantage of bond markets to restructure short-term debt with longer-term borrowings. **High grade companies issued a record breaking \$1 trillion in new debt, more than twice 2008's total.** This included large deals by Pfizer and Roche to fund acquisitions. In addition, high yield issuance topped \$180 billion in 2009, surpassing the previous record of \$158 billion set in 2004. The levered loan market also showed increased new issue activity.

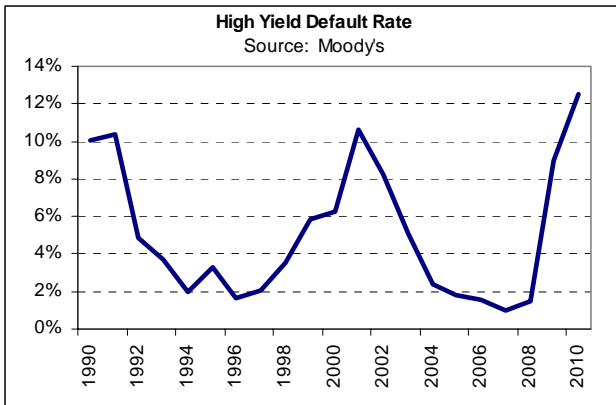
The securitization markets were relatively quiet. Prices were generally bid up due to buying by the Fed's Term Asset-Backed Securities Loan Facility (TALF). The Fed also helped prop up the mortgage market by keeping interest rates down and buying mortgages. The Fed bought 70% of all mortgage-backed securities backed by loans that conformed to Fannie Mae and Freddie Mac. However, this program is scheduled to end in the first quarter of 2010.

**While spreads have tightened significantly from their wides, and the "easy" money has likely been made, many managers state that they still see value in the credit markets.** One positive data point is that

default estimates have come down, driven by the stabilization of financing markets and increased liquidity. Managers realized profits throughout the year, reducing credit exposure in the process. Managers are currently more cautiously positioned with significant hedges in place. Managers remain negative on the Treasury market, especially the longer end of the yield curve. Stronger economic activity should lead to higher rates, and the sharp increase in supply should affect prices. Monetary stimulus is also likely to lead to higher inflation over the next 2 to 3 years. Managers state that the credit gains in 2009 came from a credit panic and going forward, it is going to be a different ball game. **Gains going forward will inevitably be more nuanced, so security selection will become critical to outperformance.**

#### *Distressed*

**As a result of improved credit conditions, default volumes started to decline towards the end of the year and are expected to moderate materially in 2010, as companies defer their financial issues.** Moody's Investors Service stated that the global default rate slid during the fourth quarter, marking the first time the number has fallen since January 2008. **The 12-month global speculative-grade default rate finished at 12.5%, down from 12.6% in the third quarter, but up significantly from 4.2% a year earlier.** Moody's also stated that they expect the global rate to fall sharply over the next year, closing June at 6.4% and ending the fourth quarter at 3.3%. In another measure of distress, Moody's speculative-grade corporate distress index, which measures the percentage of rated issuers that have debt trading at distressed levels, ended the quarter at 18.8%, down from the previous quarter's 28.5% and 54.1% a year earlier.

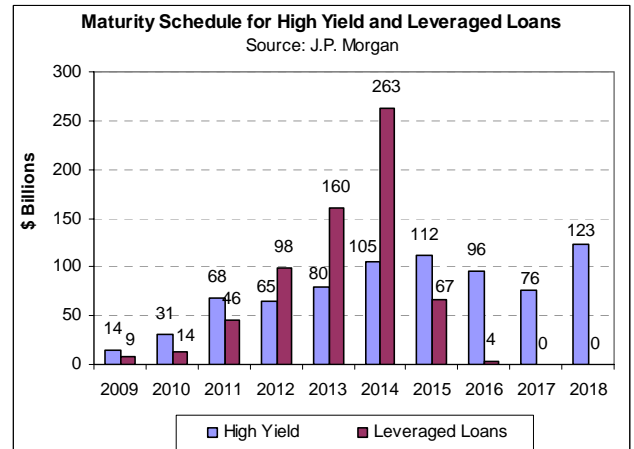


2009 was an incredible year for distressed managers, which were one of the top performing indices for the year. **The Hennessee Distressed Index increased +5.06% in December and was up +42.96% for the year. Managers benefit from a sharp tightening of credit spreads and an innate long bias of their strategy.** As the dollar prices of many stressed corporate credit positions have increased, managers realized profits and rotated the portfolio away from stressed credits into more classic distressed, special situation and restructuring investments. **Historically, distressed managers have performed best after a peak in default rates.**

One profitable classic distressed position for managers at year end was Lear Corporation, which exited bankruptcy in mid November. Lear is an auto supplier. Managers shorted the stock and the bonds of Lear successfully prior to bankruptcy as it was negatively affected by changes to the automobile sector. Prior to filing, managers bought the bank debt with the view that the bank debt would benefit in a restructuring. The restructuring progressed as expected and managers received consideration in the restructuring significantly higher than where they bought the bank debt five months earlier. Other profitable positions in 2009 included the opportunities in automobile companies (GM, Ford, Chrysler) and their related financial arms (GMAC, Ford Financial, Chrysler Financial), financial companies and banks (Lehman, Washington Mutual, Citigroup, AIG).

**The overhang of challenged credits remains intact, with the notional value of defaults reaching \$184 billion in 2009.** The markets will need to address the significant maturities due in 2012 through 2014 that

relate, in part, to debt incurred in connection with leveraged buyouts. Many managers state that the debt issued in the LBOs of 2005 to 2007 will be the next wave of defaults and will provide very attractive investment opportunities.

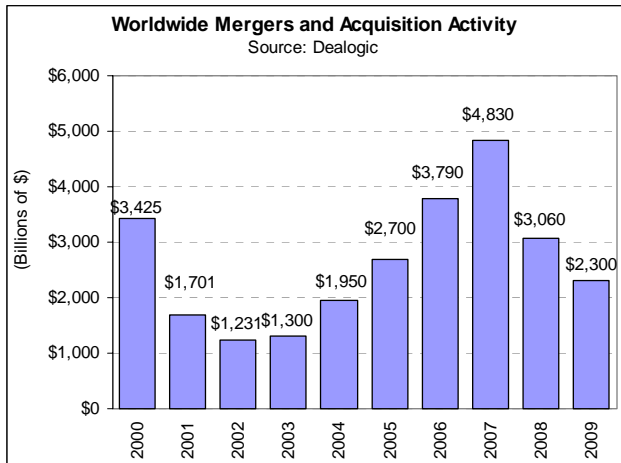


Despite the fact that spreads have narrowed and the economy is better, managers are optimistic on their ability to generate outsized returns. **Many companies are in distress because of the poor operating and difficult financing environment for their business. Many additional distressed opportunities will be revealed as debt maturities approach.** However, managers realize that going forward, the strategy is likely to experience higher levels of volatility.

**The Hennessee Merger Arbitrage Index advanced +0.83% in December, bringing year to date returns to +8.66%.** Merger arbitrage funds, one of the best performing strategies in 2008, underperformed most other strategies in 2009 due to lackluster deal activity, conservative positioning and little directional bias.

**Global merger and acquisition activity for 2009 was \$2.3 trillion, more than 20% less than 2008, and the lowest year since 2004.** In addition, government-related deals were high, accounting for 8% of all deal volume in 2009. The middle of the year was very quiet until several “mega-deals” were announced. The pharmaceutical space was very active as Pfizer bought Wyeth for \$68 billion, and Merck bought Schering Plough for \$41 billion. **These two deals were prevalent in almost every single merger arbitrage portfolio as they offered attractive returns and good like-**

likelihood of completion as the purchases were strategic acquisitions by well financed buyers. New common positions include the most recent large deals, including Exxon Mobil offered \$31 billion for XTO Energy in December, and Warren Buffet offered \$27 billion for Burlington Northern Santa Fe Corp in November.



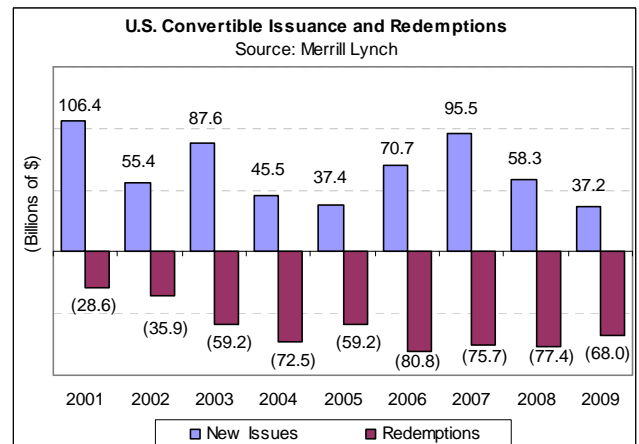
Managers also state that we may see a return of private equity firms in 2010, which disappeared in 2007, as credit conditions have improved and companies are trading at attractive valuations. There were some big buyouts in 2009, including TPG's \$4 billion purchase of IMS Health and Blackstone Group's \$2.7 billion purchase of Busch Entertainment.

Conditions improved significantly throughout in 2009 as credit markets improved, equity markets rebounded and the economy stabilized. **This could set the stage of a period of robust M&A activity going forward.** Many companies, especially mid-sized companies, have been focused on cost cutting and conserving cash. Many companies are sitting on significant cash balances, which many expect will be used to fund acquisitions. Companies are no longer worrying about survival, but are looking to see how strategic acquisitions can help top line growth. **With low interest rates, we could see a significant pick up in M&A. As a result, managers expect to increase allocations to merger arbitrage as deal flow picks up, especially as the attractiveness of other strategies has declined.**

The Hennessee Convertible Arbitrage Index advanced +1.95% (+40.53% YTD) in December, making the index positive every month of 2009. Convertible arbitrage managers were one of the top performing indices this year as tightening spreads, gamma trading, a positive cash carry, and secondary market richening made positive contributions. Increasing interest rates and volatility made slight negative detractions from performance.

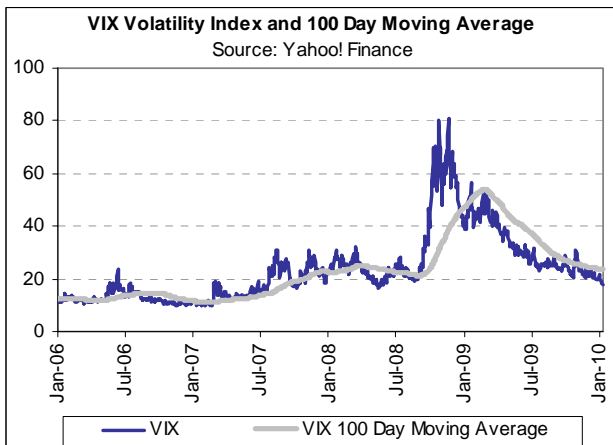
The struggles of 2008 were well documented. Massive deleveraging significantly impaired the market. Given the significant dislocation of 2008, managers were optimistic on convertibles at the beginning 2009 and felt that valuations were extremely attractive. There were several other positive factors for convertible arbitrage. Managers continue to see less direct competition as dedicated convertible arbitrage has lost favor with proprietary trading desks and many multiple arbitrage funds. The sector witnessed the emergence of new, large crossover buyers who are non-traditional buyers of converts. In addition, there were many companies buying back convertible issues and incenting holders to convert early. **All these factors helped drive an incredible rally in convertibles, and as with credit, managers that were most aggressive generated the greatest return.**

In 2009, convertible new issuance totaled only \$37.2 billion, the worst year of issuance in over a decade and the worst ever in terms of net new issuance. This was significantly less than 2008, which brought \$58 billion to the market and was also disappointing.



Redemptions were high throughout the year. There was \$68 billion in total redemptions, resulting in a negative net issuance of \$31 billion. Voluntary conversions, tender offers/exchanges, call-forced conversions, maturities, open market issuer buybacks and cash calls were common throughout the year as companies worked to restructure their offerings. Several managers expect that the convertible primary market should pick up later this year due to: potentially higher interest rates, less attractive equity and debt, saturation of high yield and high grade primary markets, and a pick up in M&A.

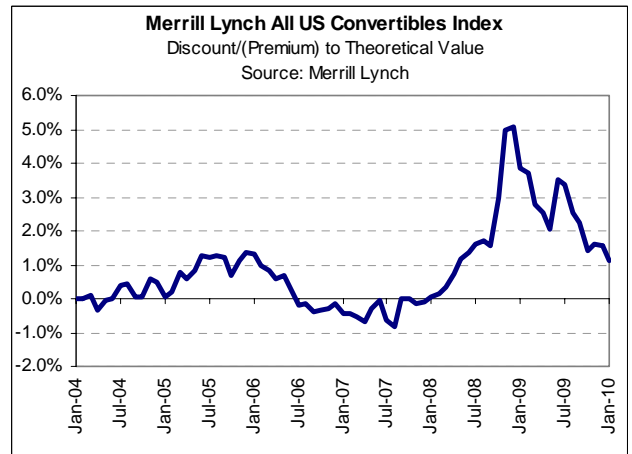
Equity rallies in December further depressed risk perception among investors as the VIX index closed the month at 21.7. Notably the index dipped below 20 in a few sessions, a level last seen in August 2008. For the year, the VIX Volatility Index declined from 39.19 to 21.68.



Higher interest rates detracted slightly from performance in 2009. The 2-year Treasury yield rose by 38 basis points, the 10-year rose by 159 basis points and the 30-year rose by 195 basis points.

The average discount to theoretical for the All US Convertibles Index fell further from 1.57% cheap to 1.13% cheap in December, as opportunistic buying took place of earlier year-end profit-taking. **Convertible valuations have richened significantly from the beginning of 2009 where Merrill Lynch's theoretical value reached an all-time cheapness.** While the market has certainly richened a lot in 2009, Morgan Stanley research states that valuations are likely to continue trending richer in the first half of 2010, possi-

bly crossing into a "rich" territory before coming back to about fair value, or a 0% cheapness by the 2010 year-end.



For 2010, convertible managers are optimistic about their ability to generate gains. Volatility should remain elevated and credit spreads remain above historical averages. However, volatility may continue to fall from current levels and most expect interest rates to rise. **While hedge funds did not need to employ much leverage in 2009 to generate returns, it is likely that some leverage will be needed in 2010 to generate an attractive return. Managers state that they continue to see improvement in financing terms.**

### Conclusion

At the beginning of 2009, the outlook for 2009 was somewhat clear. Valuations were extremely cheap and if we could avoid a global financial meltdown, we would witness a snapback. **The outlook for 2010 is much less clear leaving most managers cautious.**

Managers will closely monitor corporate earnings announcements, which may disappoint, and could impact a possibly overvalued stock market. On the other side, government stimulus continues to push asset prices higher, with some concerned about a possible bubble. Several funds have built in hedges against the U.S. dollar and inflation. In terms of economic growth, most feel a double dip recession is unlikely, but certainly not impossible. And lastly, how does the market react when the Fed finally has to increase interest rates and remove stimulus.

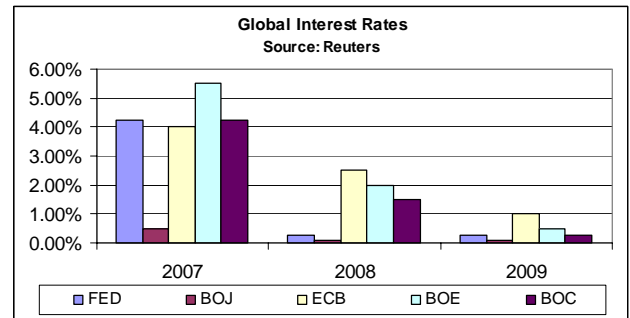
With this backdrop, managers are optimistic on the different opportunity sets. In the short term, low-to-zero interest rates and government stimulus should help bid up risk assets. **There should be good opportunities long and short credit where superior security selection will allow for outperformance. There is likely to be a pick up in merger and acquisition activity, which should provide good opportunities and attractive spreads. Distressed opportunities and reorganizations should continue to offer attractive rewards. Lastly, leverage, which was shunned in 2008 and 2009, is much more available and may allow funds to enhance returns.**

### Global/Macro

(YTD: +22.34 % / NOV: +1.46%)

The Hennessee Global/Macro Index increased +1.98% in December (+24.58% YTD). After large declines in 2008, markets rebounded dramatically in 2009, resulting in gains for global equity markets and commodities. Investors heavily invested in risk assets, driving emerging markets equities and commodities higher, while U.S. dollar and Treasuries declined. Managers generated the largest profits long emerging market equities, short the dollar and Treasuries, and long precious metals, specifically gold. **Hedge funds, fearful that the market was in a bear market rally, underperformed equity markets as managers held conservative exposures for much of the year.**

International equities outperformed those in the US, with the MSCI EAFE increasing +1.36% in December, ending the year up +27.75%. **Stimulus packages and rate cuts enacted in 2008 took effect in 2009, helping to increase liquidity, which drove equity prices from March forward.** Interest rates in developed nations have been consistently held at extremely low levels and investors expect these to be held throughout the first half of 2010. Developed markets' economic recovery lagged that of the emerging markets, but showed signs of stabilization in late 2009. Yearly GDP is estimated to be -3.4% for developed countries, but expected to be positive in emerging markets, at +1.9% year-over-year. Many believe that global economic recovery is in full swing and markets will continue to increase throughout 2010.



Managers have increased capital at work throughout 2009. Beginning the year with very conservative positioning, many managers were cautious in deploying capital as they anticipated markets were in a bear market rally. Hedge funds held high cash positions in 2009 but in an attempt to capture some of the market upswing began to increase exposures throughout the year. **In 2010, managers believe international equities will continue to increase, as the recovery in the developed nations will further contribute to market advances.** Despite rallies in 2009, many markets are still undervalued relative to historical levels, and increased exports to the United States will help to bolster further exporting nations such as Asia and Latin America, assuming the US economy continues to recover.

### Europe

European equities also increased in 2009, with the MSCI Europe Index increasing +31.24% over the year. **Most notable among the Eurozone was the decoupling of countries within the area. Germany and France led the region in the economic recovery, while Greece and Spain continued to lag.** One reason for the disparity between countries is higher levels of debt and economic instability in the latter countries. Unemployment is expected rise to 10% at the end of 2009, which while still increasing, is moving at a much slower rate. While many European companies saw collapsed revenues throughout the year, many remained profitable by reducing costs. Government stimulus heavily contributed to equity performance, especially in Germany, where the European version of "cash for clunkers" helped to raise equities further.

Russia was the star of emerging Europe countries. As oil prices spiked in 2008 and demand for oil dramatically declined, Russia suffered, dropping -74.16%. As commodities began to surge, Russia, a major oil exporter, also surged. Russia gained +100.32% in 2009, but is still far off of early 2008 valuations. Managers therefore, are still seeing opportunities for profits in 2010.

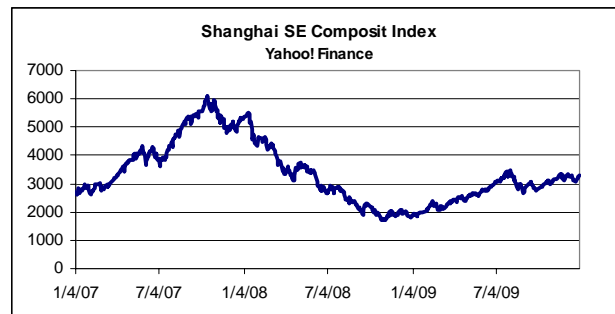


Managers made profits in Europe over the year, with the Hennessee Europe Index returning +17.63%. Most profits were generated from Russia and stock picking in developed European nations. Managers remained conservative in developed Europe. **Going forward, managers believe that Russia will continue to generate profits and are maintaining allocations to the country. In developed Europe, managers remain bearish, as uncertainty around exit plans for government stimulus still exists.**

*Asia*

Asia has been a focus of economic growth and the center of the global recovery for 2009. Inflows to the region have increased, and government stimulus has been allocated on a seemingly un-ending basis. In 2009 the MSCI AC Asia ex Japan index returned +68.32%, led primarily by Chinese equities. GDP growth was reported to be +3% across Asia, with China showing +8.6% GDP growth in 2009, according to Barclays Capital. Trade among Asian countries remained robust, as China became a major world importer, despite being historically known for its exports. In December, China and ten Southeast Asian nations inaugurated a free trade area, which removes tariffs on 90% of traded goods. This is expected to benefit Asian countries by providing more direct assets to resources and increasing trade. **Infrastructure in the region performed well, as much of the \$585 billion**

**government stimulus was allocated, not only increasing imports, but tempering unemployment and creating domestic demand. The Shanghai SE Composite Price Index finished December up +2.56% and increased +79.88% for the year.**

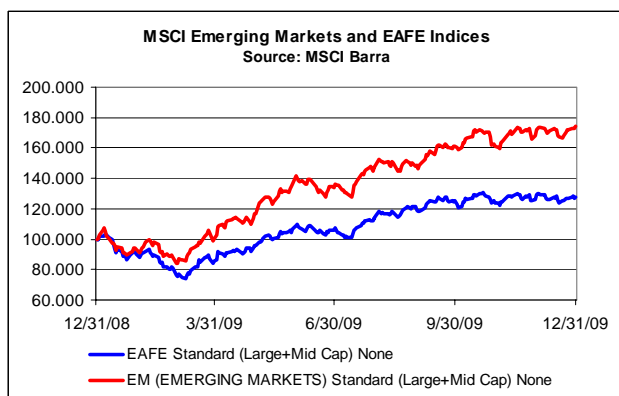


Managers began increasing exposures to Chinese equities in March, as the first signs of economic recovery appeared. With large reserves and further room for government stimulus, managers remain bullish on equities for the beginning of 2010. Managers saw large profits in Asia, as the Hennessee Asia-Pacific Index returned +24.10% over the year. **While some managers believe that the equity rally has created over-valuation for Asian stocks, most managers believe that the region will continue to grow and be a top performer in 2010.** Furthermore, most believe that China, along with other emerging markets, will emerge from the global recession as a world economic leader.

Japan lagged for the year, as predicted by many managers. While equities did increase, with the Nikkei 225 finishing +19% higher, it had far lower returns than those of both emerging and developed markets. In early 2009, a collapse in exports caused the economy to decline and a strong yen made its goods less competitive to foreign nations. The Nikkei is approximately -72% lower than at the end of 1989. **Investor sentiment generally remains bearish in Japan, but some managers are beginning to see opportunity for profitable investment.** Corporate earnings are slowly growing and as trade stabilizes, exports are expected to pick up in 2010.

### Emerging Markets

Emerging markets led performance in 2009 on the back of increasing commodities, large stimulus and increased exports to China, with Latin America showing the largest increases. The MSCI EM Index increased +74.50% over the year, a drastic reversal from the -54.48% decline in 2008. **Risk aversion characterized investor sentiment throughout 2008, but risk was favored for the majority of 2009 as the dollar sold off, treasuries declined and emerging markets and commodities drastically increased.** Growth has been stimulus driven, but is expected to continue. Growth drivers have gradually shifted from resource availability and export growth to domestic consumption and infrastructure spending, which may lead to more internally sustained growth.



**Latin America outperformed other emerging markets, with Brazil leading the way. The MSCI EM Latin America Index returned +98.14% y/y, with Brazil gaining +121.25%.** Poor weather conditions helped to raise prices of agricultural products due to tight supply, which benefited producing countries. Solid country fundamentals in Brazil were not enough to prevent an initial collapse at the onset of the recession in 2008, but the country's healthy financial system and capacity for domestic demand growth remained major drivers in the post-crisis recovery.

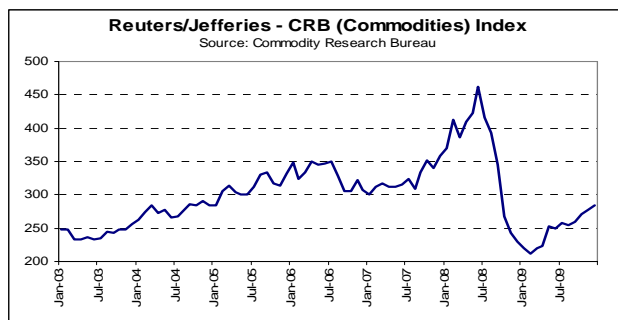
The Hennessee Latin American Index outperformed other hedge fund indices in 2009, but vastly underperformed equity indices, returning +51.16%. Managers made the most profits in Brazil and, towards the end of the year, Mexico. Currency remained volatile, but with the decline in the dollar, managers made profits

in this area. Portfolios were highly exposed to Brazilian stocks, as strong fundamentals and a large safety blanket of reserves made them relatively guarded from a return to the recession. **Managers anticipate that growth in the region will continue through 2010, but at a more tempered pace.** The largest risk that managers anticipate is an overabundance of demand for goods as international markets recover. **Domestic demand in emerging markets has become much more robust, but as developed economies recover and increase demand for goods, a shortfall in supplies may lead to less capital inflow and a negative trade balance.**

### Macro

**Macro managers made profits over the year, however returns lagged most equity markets. The Hennessee Macro Index returned +11.51% for the year, but closed December down -0.28%.** Managers were profitable short the dollar, short treasuries and long precious metals, specifically gold year-over-year. Another popular trade for the year was the dollar carry trade. Volatile agriculture, energy and industrial metals made consistent profits difficult to achieve in 2009.

Commodities began the year in decline, after the Reuters/Jefferies CRB Index decreased by -35.04% in 2008. Commodities appeared weak in January and February, but then rallied to end 2009 up +23.65%. The S&P GSCI Crude Oil Spot increased more than +70% over the year, but is far off the highs hit in 2008. As emerging markets continue to grow, they are consuming more oil. Managers believe that this trend will continue, and as prices are still well below historical highs, many believe that oil will continue to increase in 2010. Natural gas, on the other hand suffered this year, as supplies increased due to advancements in drilling, but demand remained constant. Managers remain bearish on natural gas in the near-term.

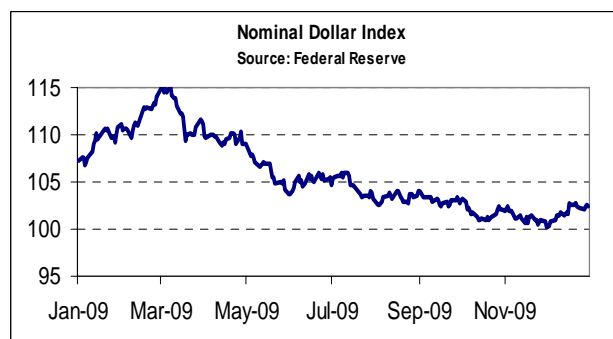


Gold shined over the year, as investors chose the precious metal as a hedge against currency uncertainty. Also, as liquidity has been increased globally due to government stimulus, gold has become a popular hedge against inflation. Despite declines of -7.28% in December, investors expect gold to continue to increase in the long-term. For the year, the S&P GSCI Gold Spot increased by +23.96%, after being one of few assets to increase in 2008, returning +5.53%.

Beginning in March, a popular theme amongst hedge funds became the reflation trade. With massive amounts of government stimulus and excess liquidity being pumped into the markets, many managers believe that inflation was inevitable in the long-term. The reflation trade is a bet that the economy will experience future inflation, driving up interest rates and commodity prices. While interest rates have remained low, commodities have increased, largely due to large infrastructure spending in China. Copper showed the largest returns of +140.62%, mostly due to large Chinese imports in 2009. The S&P GSCI Industrial Metal Spot increased +91.21% over the year, leading those invested in the reflation trade to see gains in macro portfolios.

US Treasuries were profitable shorts for managers in 2009. Over the year, long-term treasuries declined with the Barclay Capital 10-year Treasury prices decreasing by -9.76%, and the 30-year Treasury prices decreasing by -25.88%. December showed a decrease in treasury yields, which led to a decline in profits for macro managers on the month. **Some managers believe that the yearly rally in equities and risky assets will be tempered in 2010, but most believe that the treasury yield decline is only temporary and they are continuing to hold short treasuries into the new year.**

The dollar rallied in 2008 and began 2009 positive, increasing in January and February. As investors decreased risk aversion and began investing in risk assets, the dollar saw a dramatic decline for the majority of 2009, with the dollar index losing -5.3% over the year. In December, however, the dollar finally began to increase, as investors chose to allocate cash to safe haven assets. The yen gained strength throughout the year, but the euro showed weakness. **Managers believe that the dollar will continue to decline due to high liquidity and excess cash in the market due to government stimulus.** Managers however, do see risks short the dollar, as uncertainty remains as to the effect on currencies if governments end stimulus packages or raise rates earlier than expected.



In 2008, the yen carry trade was very popular among investors. Towards the end of the year, however, other governments began to decrease interest rates and the yen carry trade unwound. As US interest rates decreased to 0% amid the global recession, investors switched to the dollar carry trade, borrowing US dollars and investing them in banks overseas to take advantage of higher interest rates. **As rates are not expected to increase for the first half of 2010, managers believe that the dollar carry trade will continue to be profitable.**

In contrast to 2008, investors returned to risky assets, reversing the “flight to quality” mentality of year-end last year. With the exception of gold, safe haven assets, including Treasuries and the dollar, were widely shorted in 2009 and commodities and emerging markets were the favored longs. Markets were turbulent for the beginning of 2009, but equities rallied for the last three quarters of the year, on the back of government stimulus and favorable economic data. **Managers held low exposures in an effort to preserve capi-**

tal and protect against a dip in equities and therefore, underperformed the relevant market indices. Looking forward, managers are more resolved that the economy has in fact begun to recover, and most believe that equities in 2010 will continue to rally.

## HENNESSEE HEDGE HOG CORNER

**“At heart we remain strong believers in the commodity super-cycle – the efforts and aspirations of more than half the world’s population as they enter the world’s economy seems to us to be a powerful meta-trend that will influence economies and markets over the next decade as much as it did the last.”**

**“Emerging markets remain a key theme for investors and one that we believe will extend over the next 5 – 10 years as fundamentals and asset flows favour the asset class relative to developed markets.”**

In 2010 we believe that OPEC will attempt to keep oil prices in a range of \$65 – \$85 per barrel, a level that is seen to be good for the energy industry and consumers alike.

**“We retain a positive outlook for gold in 2010 and believe that, with a pick up in western economies, the outlook for other precious metals is also positive.”**

**“We feel that 2010 will be a great year for long/short equity as stocks should move based upon fundamentals.”**

**“We are optimistic on distressed investing as the strategy typically does best after default rates peak, and it appears that default rates peaked in November 2009 at a record 12.6%.”**

**“We are optimistic on credit, but realize that going forward security analysis will be critical. Everything went up in 2009, especially lowest rated junk. We don’t expect this to continue.”**

**“Companies did significant cost cutting and conserved cash. Now they are sitting on piles of cash in a challenging growth environment. Many companies will pursue strategic acquisitions as a path for growth.”**

**“We think there are attractive opportunities in convertible arbitrage; however, not like 2009. We expect to use more leverage to enhance returns now that it is again available.”**

**“We expect new issuance in the convertible space to improve in 2010 after a dismal 2009. Investment and high yield credit markets saw record issuance while converts were lackluster. We expect that as equity and markets top out, and as investors reach saturation levels for straight credit, more companies will be move to issue converts.”**

**“We are short long term Treasury yields. There are so many factors that will force yields higher over the next 1 to 3 years. The Fed will not be able to artificially keep yields low forever.”**

We are seeing great classic distressed opportunities. We are buying debt of companies in and near bankruptcy, working to help reorganize the company and exiting with an attractive combination of new debt and equity.

**“The last couple years have been a wild ride. We expect 2010 to be normal... hopefully.”**

We continue to expect strength in the Chinese economic recovery moving into 2010 and, coupled with anticipated restocking in the western world, we believe the outlook for the first half of 2010 looks positive for the resources sector.

**“We are very concerned that fiscal stimulus is simply causing another massive asset bubble that will burst and cause another crisis of confidence and a sell off of securities markets.”**

**“We expect the carry trade to heat up as 2010 progresses, as policymakers hold rates at zero or low levels in many advanced economies.”**

**“The emerging economies will increasingly direct their own fiscal policies, while being important players in any global co-ordination of such policies.”**

**“We do not believe that the dollar will move lower against all major currencies in 2010. Given firmer rate expectations in the US, we gather the Japanese Yen will re-emerge as the world’s funding currency.”**

<b>STYLE</b>	<b>DEFINITION</b>
<b>ASIA - PACIFIC</b>	<i>Funds typically have long and short equity positions in companies located in the Pacific Basin region (i.e. Japan, China, Hong Kong, Taiwan, Korea, Singapore, Thailand, Malaysia, India, Australia, New Zealand, and other countries in Asia.)</i>
<b>CONVERTIBLE ARBITRAGE</b>	<i>This type of arbitrage involves the simultaneous purchase of a convertible bond and the short sale of the underlying stock. Interest rate and credit risk may or may not be hedged.</i>
<b>DISTRESSED</b>	<i>Primary investment focus involves securities of companies that have declared bankruptcy and/or may be undergoing reorganization. Investment holdings range from senior secured debt (uppermost tier of a company's capital structure) to the common stock of the company (lower tier of the capital structure).</i>
<b>EMERGING MARKETS</b>	<i>This strategy focuses on investing in lesser-developed, non-G7 countries whose financial markets provide exploitable pricing inefficiencies. Popular geographic regions include Latin America, Eastern Europe, Asia - Pacific, and Africa. Asset classes range from equities and bonds to local currencies.</i>
<b>EUROPE</b>	<i>Funds typically have long and short equity positions in European companies located in the United Kingdom, Western Europe, and Eastern Europe.</i>
<b>EVENT DRIVEN</b>	<i>This strategy can include merger arbitrage, distressed, liquidations, and spin-offs in addition to value driven special situation equity investing. Investments are usually dependent on an "event" as the catalyst to release the position's intrinsic value.</i>
<b>FINANCIAL EQUITIES</b>	<i>Funds typically have long and short equity positions within the financial sector (banks, thrifts, brokerage, insurance, etc.)</i>
<b>FIXED INCOME</b>	<i>Funds typically employ a variety of fixed income related strategies ranging from relative value based trades (basis, TEDs, yield curve, etc.) to directional bets on interest rate shifts. Style also includes credit related arbitrage, which typically involves the purchasing (or selling) of corporate issues and the simultaneous selling (or purchasing) of government issues.</i>
<b>GROWTH</b>	<i>Funds typically have long and short equity positions in companies that exhibit an acceleration (or deceleration) of earnings growth, revenues, and market share.</i>
<b>HEALTHCARE/ BIOTECH</b>	<i>Funds typically have long and short equity positions in medical related stocks, which include biotechnology, pharmaceuticals, HMO's, medical devices, etc.</i>
<b>HIGH YIELD</b>	<i>Funds typically have long and short equity positions in non-investment grade corporate bonds, which offer attractive coupon yields. Interest rate risk may or may not be hedged.</i>
<b>INTERNATIONAL</b>	<i>Funds typically have long and short equity positions in the stocks of international companies. Positions can be either growth or value and, in addition to global investments, funds typically have exposure to U.S. companies.</i>
<b>LATIN AMERICA</b>	<i>Funds typically have long and short equity and/or debt positions in companies located in Latin American countries such as Chile, Mexico, Venezuela, Argentina, Brazil, and Ecuador.</i>

# HENNESSEE HEDGE FUND STYLE DEFINITIONS

STYLE	DEFINITION
<b>MACRO</b>	Dominant investment theme is to capitalize on changes in the global macroeconomic environment through participation in the various capital markets. A top-down methodology allows managers of this strategy to utilize all asset classes (equities, bonds, currencies, derivatives) available in the global capital markets.
<b>MARKET NEUTRAL</b>	Funds typically have long and short equity positions with approximately zero net dollar exposure. In addition, some funds will attempt to be beta, sector, and market cap neutral to further reduce equity market risk. Funds within this style utilize a range of methods from quantitative modeling to fundamental pairs trading.
<b>MERGER ARBITRAGE</b>	Style typically involves the simultaneous purchase of stock in a company being acquired and the short sale of stock in the respective acquirer. Many merger arbitrage managers attempt to mitigate deal risk by engaging only in strategic takeovers after they have been announced.
<b>MULTIPLE ARBITRAGE</b>	Style includes funds that employ more than one arbitrage strategy. The portfolio manager opportunistically allocates capital among the various strategies in an attempt to create the best risk/reward profile for the overall fund. Common strategies include merger arbitrage, convertible arbitrage, fixed income arbitrage, long/short equity pairs trading, quantitative equity trading, volatility arbitrage, and distressed investments.
<b>OPPORTUNISTIC</b>	Funds typically have long and short equity positions while maintaining a flexible net exposure to reflect the changing dynamics of the market on a minute-to-minute or day-to-day basis. Investments can be initiated from technical and/or fundamental analysis and portfolio turnover is typically high as managers have a short term investment time horizon.
<b>PIPES/ PRIVATE FINANCING</b>	PIPEs (private investments in public entities) are transactions by which publicly traded companies access new capital through the sale of stock directly to private investors. PIPEs can be transacted with a number of financial instruments, including the issuance of common stock, convertible securities, or warrants. Private financing includes asset based lending/acquisitions and direct loan investing such as mezzanine financing, bridge loans, and debtor in possession financing.
<b>SHORT BIAS</b>	Funds typically have long and short equity positions with an overall net short exposure to the market. Investments can be fundamental, technical, or event driven. This style can be used as a hedge against long-only portfolios and by investors who feel the market is approaching or in a bearish cycle.
<b>TECHNOLOGY</b>	Funds typically have long and short equity positions in technology-related sectors such as semiconductors, hardware, software, networking devices, etc.
<b>TELECOM/ MEDIA</b>	Funds typically have long and short equity positions in the telecommunication and media sectors such as telecommunication services, fiber optics, cable services, publishing, entertainment, programming, broadcasting, etc.
<b>VALUE</b>	Funds typically have long and short equity positions in undervalued companies which trade below their intrinsic value. Undervalued securities may be defined as, but not limited to, equities with low price-to-earnings ratios or low price-to-book value ratios. Managers also focus on companies that generate substantial free cash flow and utilize cash for debt retirement, share repurchase programs, and other methods utilized to realize shareholder value.

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HEDGE FUND ADVISORY

MONTHLY RANK 2009 (Net)	YTD	JAN	FEB	MAR	APRIL	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC
ASIA - PACIFIC INDEX	13	23	14	13	9	3	9	3	17	18	14	19	4
CONVERTIBLE ARBITRAGE INDEX	4	3	2	3	7	10	16	4	6	13	3	18	14
DISTRESSED INDEX	2	11	18	16	5	4	1	10	4	3	5	2	2
EMERGING MARKETS INDEX	5	20	10	7	3	2	18	2	9	1	6	13	5
EUROPE INDEX	17	22	13	14	12	13	21	15	2	7	20	21	9
EVENT DRIVEN INDEX	3	10	22	6	2	7	3	7	3	4	10	6	1
FINANCIAL EQUITIES INDEX	9	9	5	15	17	6	2	17	1	15	22	16	10
FIXED INCOME INDEX	16	4	3	18	18	18	12	18	7	16	2	20	16
GROWTH INDEX	14	18	17	5	11	12	17	13	19	10	21	3	7
HEALTHCARE AND BIOTECH INDEX	12	13	23	2	15	11	5	6	8	5	23	5	15
HIGH YIELD INDEX	10	6	7	22	13	15	4	5	11	8	8	12	22
INTERNATIONAL INDEX	15	19	21	9	10	5	20	8	10	6	19	8	17
LATIN AMERICA INDEX	1	8	19	10	1	1	6	1	5	2	4	1	18
MACRO INDEX	18	15	15	19	14	16	23	16	20	19	11	7	21
MARKET NEUTRAL INDEX	19	12	8	21	21	19	14	19	18	20	12	15	13
MERGER ARBITRAGE INDEX	22	14	9	8	22	20	11	21	16	22	9	17	20
MULTIPLE ARBITRAGE INDEX	7	1	6	12	16	14	7	14	13	14	7	11	19
OPPORTUNISTIC INDEX	8	5	16	17	8	8	19	9	14	11	17	4	8
PIPES/PRIVATE FINANCING INDEX	20	16	12	11	19	21	10	20	21	21	13	22	3
SHORT BIASED INDEX	23	2	1	23	23	23	22	23	23	23	1	23	23
TECHNOLOGY INDEX	6	17	11	1	6	17	8	12	22	9	18	14	6
TELECOM AND MEDIA INDEX	21	7	4	20	20	22	15	22	15	17	16	10	12
VALUE INDEX	11	21	20	4	4	9	13	11	12	12	15	9	11

The Hennessee Hedge Fund Indices® are calculated from performance data reported to the Hennessee Hedge Fund Advisory Group by a diversified group of hedge funds. The Hennessee Hedge Fund Index is an equally weighted average of the funds in the Hennessee Hedge Fund Indices®. The funds in the Hennessee Hedge Fund Index are believed to be statistically representative of the larger Hennessee Universe of over 3,500 hedge funds and are not of fees and unaudited. The hedge fund performance data has been obtained from sources believed to be reliable, but no guarantee is made with respect to accuracy. Past performance is no guarantee of future returns. This material is for general information only and is not an offer or solicitation to buy or sell any security including any interest in a hedge fund. ALL RIGHTS RESERVED.

**HENNESSEE HEDGE FUND INDICES®**

2009 (Net)	YTD	YTD RANK	% of mgrs. >S&P, ytd	JAN	FEB	MAR	APRIL	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC
ASIA - PACIFIC INDEX	24.10%	13		-2.57%	-1.17%	1.35%	4.40%	8.07%	1.49%	4.86%	0.93%	2.10%	-0.96%	0.36%	3.40%
CONVERTIBLE ARBITRAGE INDEX	40.53%	4		3.72%	2.35%	4.30%	5.27%	5.28%	0.35%	4.36%	2.32%	2.94%	1.34%	0.51%	1.95%
DISTRESSED INDEX	42.96%	2		1.13%	-2.11%	0.98%	6.22%	7.33%	2.58%	3.59%	2.98%	4.96%	1.03%	2.90%	5.06%
EMERGING MARKETS INDEX	39.75%	5		-0.70%	-0.19%	2.24%	6.31%	9.28%	-0.36%	5.06%	2.11%	5.49%	0.94%	1.27%	3.01%
EUROPE INDEX	17.63%	17		-1.10%	-0.98%	1.11%	3.60%	4.77%	-0.80%	2.51%	3.15%	3.68%	-1.75%	0.02%	2.42%
EVENT DRIVEN INDEX	42.03%	3		1.24%	-3.09%	2.36%	7.65%	5.93%	2.02%	3.99%	3.03%	4.51%	-0.24%	2.08%	6.61%
FINANCIAL EQUITIES INDEX	25.97%	9		1.89%	0.79%	1.08%	1.93%	6.37%	2.56%	2.19%	3.65%	2.30%	-2.45%	0.81%	2.42%
FIXED INCOME INDEX	20.65%	16		2.43%	1.36%	0.79%	1.79%	2.34%	0.97%	1.78%	2.21%	2.14%	1.47%	0.13%	1.53%
GROWTH INDEX	22.29%	14		-0.37%	-1.70%	2.57%	4.06%	4.92%	0.29%	2.85%	0.77%	3.45%	-1.84%	2.84%	2.73%
HEALTHCARE AND BIOTECH IN-	25.25%	12		1.02%	-3.43%	4.47%	2.30%	5.20%	1.81%	4.13%	2.16%	4.15%	-2.72%	2.08%	1.93%
HIGH YIELD INDEX	25.47%	10		2.23%	0.13%	0.07%	3.34%	4.45%	1.95%	4.28%	1.92%	3.56%	0.75%	1.30%	-0.90%
INTERNATIONAL INDEX	21.21%	15		-0.58%	-2.84%	1.51%	4.35%	6.54%	-0.67%	3.85%	2.00%	4.01%	-1.57%	1.81%	1.40%
LATIN AMERICA INDEX	51.16%	1		1.95%	-2.58%	1.46%	10.97%	9.83%	1.75%	5.41%	2.53%	5.32%	1.29%	3.58%	1.30%
MACRO INDEX	11.51%	18		0.54%	-1.32%	0.53%	3.20%	4.08%	-1.71%	2.25%	0.24%	2.00%	-0.28%	1.86%	-0.28%
MARKET NEUTRAL INDEX	10.53%	19		1.09%	0.12%	0.23%	0.04%	1.86%	0.65%	1.22%	0.86%	1.32%	-0.52%	1.11%	2.10%
MERGER ARBITRAGE INDEX	8.66%	22		0.68%	-0.06%	1.92%	-0.33%	1.28%	1.06%	0.27%	1.11%	0.79%	0.21%	0.59%	0.83%
MULTIPLE ARBITRAGE INDEX	27.69%	7		3.76%	0.64%	1.43%	2.08%	4.55%	1.71%	2.77%	1.86%	2.78%	0.93%	1.35%	0.89%
OPPORTUNISTIC INDEX	26.32%	8		2.37%	-1.55%	0.84%	4.72%	5.67%	-0.43%	3.60%	1.69%	3.39%	-1.34%	2.26%	2.65%
PIPES/PRIVATE FINANCING INDEX	9.83%	20		0.34%	-0.98%	1.46%	1.30%	1.18%	1.13%	0.95%	0.13%	1.13%	-0.73%	-0.60%	4.20%
SHORT BIASED INDEX	-17.48%	23		3.73%	3.51%	-4.04%	-7.53%	0.06%	-1.15%	-4.21%	-0.81%	-3.75%	2.51%	-2.77%	-3.92%
TECHNOLOGY INDEX	27.91%	6		0.28%	-0.62%	4.77%	5.63%	3.95%	1.54%	3.55%	0.02%	3.49%	-1.54%	1.20%	2.87%
TELECOM AND MEDIA INDEX	9.74%	21		2.21%	0.88%	0.48%	0.06%	0.99%	0.39%	-0.51%	1.22%	2.11%	-1.33%	1.55%	2.23%
VALUE INDEX	25.30%	11		-0.83%	-2.81%	2.66%	6.27%	5.59%	0.86%	3.57%	1.87%	3.11%	-1.27%	1.73%	2.39%
<b>HENNESSEE HEDGE FUND INDEX</b>	<b>24.85%</b>		<b>40%</b>	<b>0.58%</b>	<b>-1.08%</b>	<b>1.85%</b>	<b>4.12%</b>	<b>5.32%</b>	<b>0.75%</b>	<b>3.12%</b>	<b>1.68%</b>	<b>3.08%</b>	<b>-0.57%</b>	<b>1.46%</b>	<b>2.27%</b>
LONG/SHORT EQUITY	21.44%			0.45%	-1.46%	2.13%	3.70%	4.71%	0.77%	2.77%	1.45%	2.82%	-1.41%	1.69%	2.16%
ARBITRAGE/EVENT DRIVEN	30.80%			2.04%	-0.33%	1.74%	4.07%	4.66%	1.56%	3.02%	2.21%	3.22%	0.70%	1.35%	3.01%
GLOBAL/MACRO	24.58%			-0.86%	-1.30%	1.36%	4.85%	6.97%	-0.05%	3.91%	1.63%	3.40%	-0.51%	1.15%	1.98%
DJIA	18.82%			-8.84%	-11.72%	7.73%	7.35%	4.07%	-0.63%	8.58%	3.54%	2.27%	0.00%	6.51%	0.80%
BARCLAYS AGG. BOND INDEX	5.63%			-0.88%	-0.38%	3.31%	0.48%	0.73%	0.57%	1.61%	1.04%	1.05%	0.49%	1.29%	-1.56%
MSCI/EAFE (USD) PRICE INDEX	27.75%			-9.88%	-10.54%	5.87%	12.27%	11.09%	-0.77%	9.05%	5.16%	3.59%	-1.29%	1.75%	1.56%
NASDAQ	43.89%			-6.38%	-6.68%	10.94%	12.35%	3.32%	3.10%	7.82%	1.54%	5.64%	-3.64%	4.86%	5.81%
RUSSELL 2000	25.21%			-11.20%	-12.29%	8.67%	15.33%	2.89%	1.33%	9.53%	2.76%	5.63%	-6.87%	3.01%	7.88%
S&P 500	24.71%			-8.57%	-10.99%	8.54%	9.39%	5.31%	0.02%	7.41%	3.36%	3.57%	-1.98%	5.34%	2.81%

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