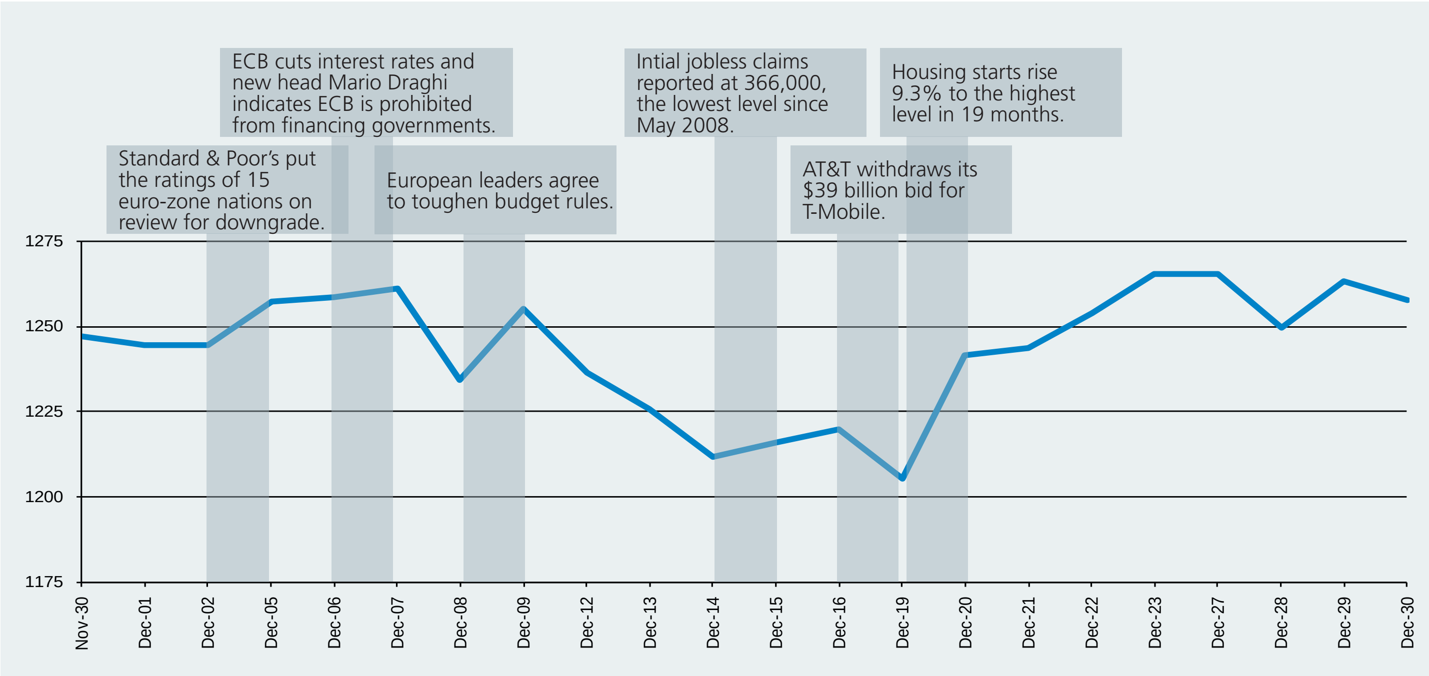
HEDGE FUND
MONTHLY COMMENTARY

December 2011

AVIVA INVESTORS

S&P 500 Index



Market Review

The European debt crisis garnered much of the headline attention in December, as it did in November. Standard & Poor's put the long-term debt ratings of 15 eurozone nations on review for downgrade, the most countries the firm has ever placed on negative credit watch at one time. This typically means there is a 50% chance of a downgrade within 90 days. S&P even placed Germany on the list, noting any downgrade would likely be only one notch, to AA+. The European Banking Authority announced that European lenders must raise €115 billion in new capital by June, slightly higher than the original estimate of €106 billion issued in October. The largest capital deficiencies are in Spain (€26 billion) and Italy (€15 billion).

The U.S. employment picture showed improvement, with weekly initial jobless claims consistently coming in below

	December 2011		
	Month	**QTD**	**YTD**
HFRI Fund of Funds Conservative Index *	-0.17%	0.08%	-3.53%
HFRI Fund of Funds Diversified Index *	-0.32%	-0.44%	-4.86%
HFRI Equity Hedge Index *	-0.66%	2.22%	-8.03%
HFRI Event Driven Index *	-0.01%	2.28%	-2.65%
HFRI Merger Arbitrage Index *	0.12%	1.64%	1.64%
HFRI Distressed Index *	-0.04%	1.88%	-2.42%
HFRI Relative Value Index *	0.50%	1.31%	0.55%
HFRI FI Convertible Arbitrage Index *	0.17%	0.80%	-4.74%
HFRI Macro Index *	0.16%	-1.24%	-3.60%
S&P 500	1.02%	11.82%	2.11%
FTSE 100	1.25%	9.40%	-2.18%
MSCI EAFE	-0.94%	3.38%	-11.73%
Barclays Capital U.S. Credit Index	1.94%	1.70%	8.35%
Barclays Capital High Yield Index	2.66%	6.46%	4.98%

* Source of HFRI indices is Hedge Fund Research, Inc. These indices are preliminary and subject to change, with final returns reported on the 1st day of the following month (i.e., March 1st for January returns).

expectations. The reading of 366,000, posted mid-month, was the lowest level since May 2008. The unemployment rate for November unexpectedly dropped from 9.0% to 8.6%, but a significant portion of the decline was due to a shrinking labor force. The housing market also received some good news, with housing starts jumping 9.3% from October and reaching the highest level since April 2010. Building permits also rose 5.7%, spurred by multi-family housing.

Equity markets were choppy during the month but managed a positive return; the S&P 500 was up 1.02%. Credit markets performed better, benefitting from tightening credit spreads; the Barclays Capital U.S. Credit Index returned +1.94%.

Hedge Fund Strategies

The average hedge fund lost money during 2011, with most of the pain coming in the third quarter, a period marked by the continuing crisis in Europe and a U.S. government that took the nation to the brink of default. The HFRI Fund Weighted Composite, an equal-weighted index of more than 2,000 hedge funds returned -5.02% in 2011. Despite the negative returns, investors – particularly U.K. pensions, continue to add to their hedge fund investments. According to the annual survey of the National Association of Pension funds, U.K. pensions have added nearly £12 billion to hedge funds during 2011, bringing total investments to roughly £33 billion. The overall allocation to hedge funds is now at 4.1% of assets, an increase of more than 50% over the last year.

Hedge Fund Research, Inc. reported that 265 new hedge funds were launched in the third quarter, against 213 liquidations. New hedge fund launches remain on pace for their best calendar year since 2007, when nearly 1,200 funds were launched.

Long/Short Equity Strategies

Despite the positive equity market performance, long/short equity was the poorest performing strategy, with a return of -0.66% (HFRI Equity Hedge Index). Only three sectors within the S&P 500 produced a negative return, but they were three of the top four sectors to which long/short equity funds were exposed. Information technology returned -0.91%; energy returned -1.06%; and materials returned -2.36%. The sector to which funds have the largest exposure is consumer discretionary, which returned +1.04%, in line with the broader market. Overall, managers remain cautiously positioned, which helped to limit the losses from exposure to underperforming sectors. The consensus is that equities look cheap by historical standards when compared to earnings and the low-interest-rate environment. Managers are not looking to increase exposures significantly soon, however. Concerns persist over the European sovereign debt crisis and the "risk-on/risk-off" nature of the markets it drives.

Relative-Value Strategies

Convertible arbitrage managers eked out a small gain of 0.17% (HFRI FI Convertible Arbitrage Index). Convertible securities valuations remained relatively cheap, with U.S. issues faring better than their European counterparts did. Trading activity was light, particularly in Europe. Investors in the region were cautious heading into the European sovereign debt summit and then sat on the sidelines for much of the remainder of the month. Trading activity also was muted for structured credit, but returns were better, at +1.01% (HFRI FI Asset Backed Index). Most CMBS and ABS indices rallied from one to three points. In CMBS, gains extended down to lower-rated tranches, reflecting the better fundamentals of commercial vs. residential real estate. Corporate credit strategies also performed well, with a return of +0.55% (HFRI FI Corporate Index).

Event-Driven Strategies

Merger arbitrage was one of a few strategies to post a small gain, returning +0.12% (HFRI Merger Arbitrage Index). There were several new deals, particularly in the middle-market space, as volume for December jumped more than 12% from prior levels. Some existing deals had positive news, such as the merger of Constellation Energy Group and Exelon receiving antitrust approval from the U.S. Department of Justice. Other deals did not fare as well, however, most notably the AT&T/T-Mobile transaction. AT&T withdrew its $39 billion bid for T-Mobile after a nine-month battle in which it was unable to gain DOJ approval. AT&T was unable to come up with the right amount of divestitures to satisfy the DOJ's concerns over a combination of two of the top four wireless carriers.

Distressed investing had flat performance of -0.04% (HFRI Distressed Index), even though high yield bonds rallied. The spread on the Barclays High Yield Index declined by 56 bps, leading to a return of +2.66% for the index. While not as impressive, leveraged loans also were up 0.71%. Distressed investing returns were dampened by exposure to post-reorganization equities, which remain out of favor, however. Also creating headwinds for the strategy was company-specific news, such as the appointment of an examiner for the Dynegy Holdings bankruptcy after a bond trustee questioned whether bondholders were being treated fairly. This may prove beneficial for the bondholders, but it created uncertainty around the capital structure of the firm and resulted in positions losing value.

Macro Strategies

Global macro investing managed a small return, gaining 0.16% (HFRI Macro Index). Managers continued to benefit from declining interest rates as the yield on the U.S. 10-year bond declined 19 bps. Short positions in the Euro also proved profitable; the currency lost 3.6% against the U.S. Dollar. Offsetting these gains were losses on long positions in commodities, most notably energy and precious metals. The price of oil fell 1.5%, while the price of gold was down 10.5%, and the price of silver lost 15%. Long exposure to gold by funds and other speculators was reduced throughout the month, ending the month 19% lower than in November and 50% off the peak level of the year.