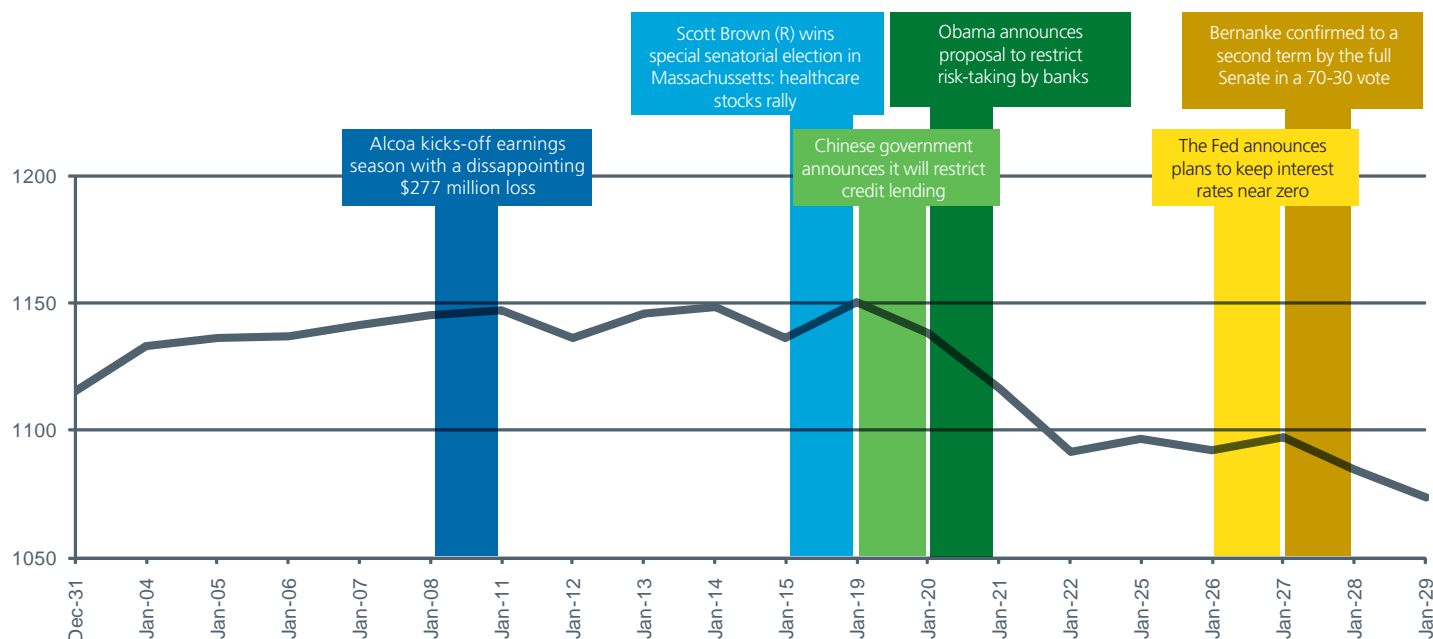


Monthly Hedge Fund Commentary

January 2010



S&P 500 Index



	January 2010		
	Month	QTD	YTD
HFRI Fund of Funds Conservative Index *	0.12%	0.12%	0.12%
HFRI Fund of Funds Diversified Index *	-0.56%	-0.56%	-0.56%
HFRI Equity Hedge Index *	-0.85%	-0.85%	-0.85%
HFRI Event Driven Index *	0.85%	0.85%	0.85%
HFRI Merger Arbitrage Index *	0.32%	0.32%	0.32%
HFRI Distressed Index *	2.01%	2.01%	2.01%
HFRI Relative Value Index *	1.50%	1.50%	1.50%
HFRI FI Convertible Arbitrage Index *	0.45%	0.45%	0.45%
HFRI Macro Index *	-2.16%	-2.16%	-2.16%
S&P 500	-3.60%	-3.60%	-3.60%
FTSE 100	-4.09%	-4.09%	-4.09%
MSCI EAFE	-4.40%	-4.40%	-4.40%
Barclays Capital U.S. Credit Index	1.55%	1.55%	1.55%
Barclays Capital High Yield Index	1.27%	1.27%	1.27%

* 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).

Market Review

The equity markets continued their rally during the first half of January, but they sold off sharply in the second half, with the Standard & Poor's 500 Index (S&P 500) producing a return of -3.6% for the month. Concerns over the budget situation in Greece and the Chinese government requiring banks to hold more assets in reserve against loans contributed to the market unease and investors' desire to reduce risk. Standard & Poor's also warned that the sovereign rating of Japan might be lowered if the country does not pull its economy out of a deflationary spiral, while at the same time citing a need for the country to reduce spending. Credit spreads followed the same pattern as equities, tightening in the first half and then selling off in the second half. Unlike equities, however, fixed income was able to produce a positive return, with increased risk aversion leading to a rally in U.S. Treasury bonds. The Barclays Capital U.S. Credit Index was up 1.55%.

The U.S. Federal Reserve (Fed) reiterated that it will cease buying mortgage-backed securities in March, despite fears that the pullback could result in higher mortgage rates and a subsequent decline in housing prices, thus jeopardizing the economic recovery. The Fed left interest rates unchanged, however, again reiterating that interest rates would remain "exceptionally low for an extended period of time."

The initial estimate of U.S. fourth-quarter GDP indicated that the economy grew 5.7%, greater than the expectation of 4.5%. Inflation, however, remains tame, with December CPI reported at 0.1%, down from 0.4% for November.

Scott Brown won the special election in Massachusetts to serve out the remainder of Ted Kennedy's congressional term. This marks the first time in decades the seat has been held by a Republican, and it removes the filibuster-proof majority that the Democrats enjoyed in the chamber. This also has created uncertainty around healthcare reform and a number of other issues before Congress.

Hedge Fund Strategies

The issue around "carried interest" has resurfaced in Congress, as the House passed a bill that would treat carried interest as ordinary income instead of capital gains. The same issue arose in 2007, but was forgotten as the financial crisis emerged in 2008. Most hedge fund and private equity fund managers believe it is now inevitable that higher taxes are coming.

The SEC has proposed banning "naked access," the rapid buying and selling of stocks directly on exchanges using a broker's computer code. Naked access many times results in regulators and exchanges not knowing who is actually doing the trading. If enacted, this proposal could have a negative impact on high-frequency traders.

Limiting the amount of risk that banks can take is another new proposal of the Obama administration, and it would potentially affect Goldman Sachs most. If enacted, this could be welcome news for the hedge fund industry, because it may cause more key talent to leave banks, as well as curtailing a source of competition for investment ideas.

Barclay Hedge reported that hedge funds saw a \$3.8 billion net outflow of capital in December 2009. This was a relatively small amount by historical standards and was most likely a seasonal phenomenon, as each of the last five Decembers has produced a net outflow.

Long/Short Equity Strategies

With all but one of the S&P 500 sectors producing negative returns, it is not surprising that long/short equity was a challenging strategy in January. The strategy struggled to a return of -0.85% (HFRI Equity Hedge Index), albeit much better than the return of the S&P 500 Index. Healthcare, the lone positive sector at +0.42%, continues to be a key long position of long/short equity funds. Technology, however, another key long position, was one of the poorest performing sectors at -8.45%. The healthcare sector was certainly helped by the special election of Senator Scott Brown, which will complicate the healthcare reform effort.

Many of the 2009 returns were beta driven, with the vast majority of equity prices rising in value. Going forward, most long/short equity managers expect more of a "stock picker's" market, where the majority of returns will be driven by alpha generation.

Relative Value Strategies

The European convertible securities market started the year out strong, with a near \$300 million issue by property firm Swiss Prime Site AG that was many times oversubscribed. As with equities and fixed income in general, convertible securities suffered during the second half of the month. It became clear that some investors began to take profits mid-month, resulting in a cheapening of the convertible securities market. As is typically the case when profit taking occurs, the issues suffering the most were the higher quality and more liquid names. Lower quality names held value better and, along with an uptick in volatility, enabled convertible arbitrage managers to post a small positive return of 0.45% (HFRI FI Convertible Arbitrage Index).

Event-Driven Strategies

Distressed investing was one of the top performing strategies, at +2.01% (HFRI Distressed Index). Despite the general credit spread widening that occurred, the spreads on lower quality names were relatively stable, with the change for the month being only modestly wider. The rally in U.S. Treasury bonds more than offset the credit spread widening, leading to an overall reduction in yield on the Barclays High Yield Index and resulting in a return of +1.27%. Leveraged loans performed well and continue to be a key holding for distressed funds. The S&P Leveraged Loan 100 Index, which represents the top 100 leveraged loan facilities, was up 1.46%. On the corporate front, more companies are entering bankruptcy with pre-packaged arrangements, resulting in minimal time spent in bankruptcy, and ultimately generating quicker returns for distressed funds. Many managers expect to see meaningful opportunities in real estate over the next several months. Commercial mortgage delinquencies continued their rise in December, hitting 6.07%, up from 5.65% in November. Apartment vacancies also hit a 30-year high of 8% in 2009.

Merger arbitrage produced a small gain of 0.32% (HFRI Merger Arbitrage Index) in January, with many funds benefitting from Kraft and Cadbury finally reaching a deal, as well as the closing of the Disney/Marvel and Oracle/Sun Microsystems deals. Total volume of announced deals, as well as the average size, declined in January. The average deal size was at the lowest level since January 2009. On the large end, Novartis indicated it will pay Nestle \$28.1 billion as part of its acquisition of Alcon, resulting in the largest takeover in Swiss history. Going forward, we expect deal volume to increase, as cash-rich firms look to grow revenue and gain market share.

Macro Strategies

The U.S. economy appears to be recovering faster than Japan or the Eurozone countries, leading to strength in the U.S. Dollar (USD).

Concern that the sovereign debt issues in Greece could spread to other Eurozone countries also contributed to the USD strength. Macro managers greatly reduced their short exposure to the USD; nevertheless, it was a factor in macro being one of the poorest performing strategies at -2.16% (HFRI Macro Index). Additional factors included the sharp selloff in commodities in general, leading to a -7.11% return in the S&P GSCI Enhanced Index. Specifically, oil was down 8.15% and gold was off 1.47%. Many funds continue to be positioned for a steeper U.S. yield curve and were hurt when the curve flattened by 10 basis points. Exposure to equities was aggressively added during the first half of the month, only to be removed as equities began to decline.

Important information

Past Performance is not indicative of future performance.

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