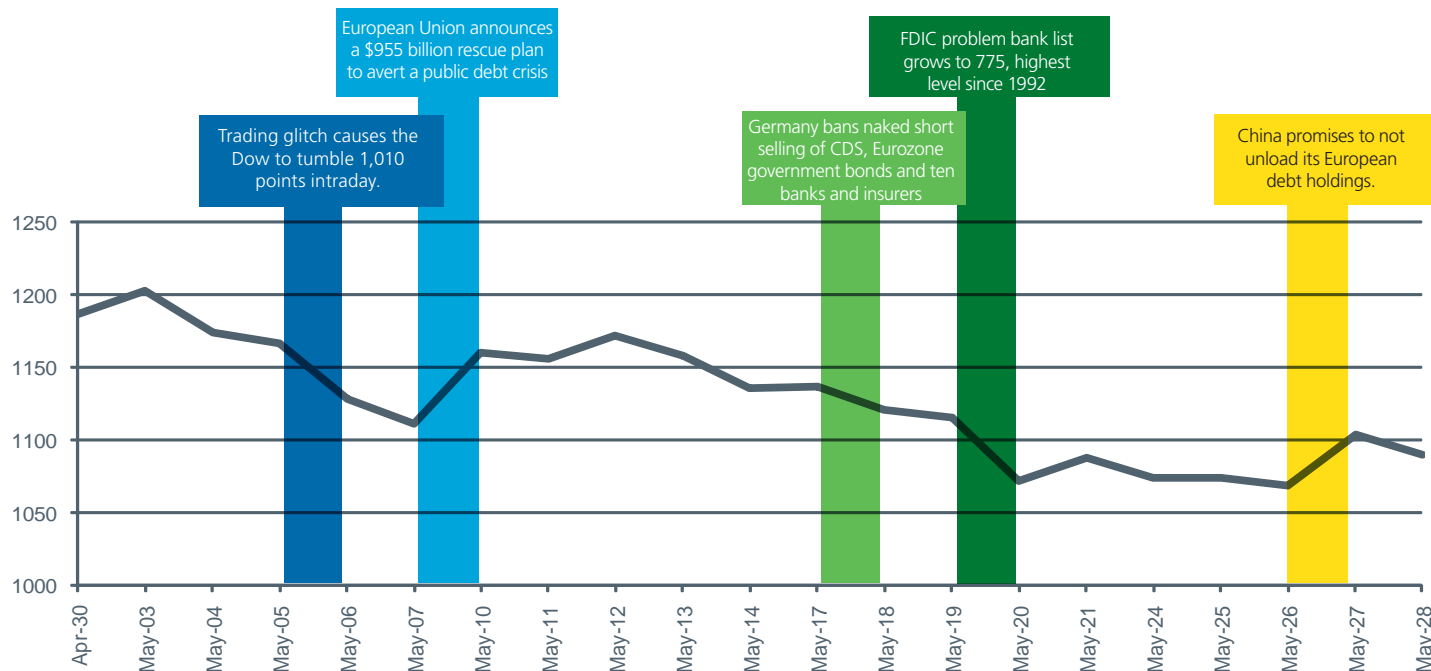


# S&P 500 Index



	May 2010		
	Month	QTD	YTD
HFRI Fund of Funds Conservative Index *	-1.87%	-0.80%	0.90%
HFRI Fund of Funds Diversified Index *	-2.57%	-1.75%	-0.18%
HFRI Equity Hedge Index *	-3.69%	-2.47%	0.29%
HFRI Event Driven Index *	-2.19%	-0.52%	4.01%
HFRI Merger Arbitrage Index *	-0.92%	-0.69%	0.90%
HFRI Distressed Index *	-2.76%	-0.73%	4.28%
HFRI Relative Value Index *	-0.98%	0.26%	3.92%
HFRI FI Convertible Arbitrage Index *	-2.25%	-0.45%	2.56%
HFRI Macro Index *	-0.94%	-0.10%	-0.33%
S&P 500	-7.99%	-6.53%	-1.50%
FTSE 100	-6.11%	-8.01%	-2.50%
MSCI EAFE	-11.37%	-12.90%	-12.08%
Barclays Capital U.S. Credit Index	-0.38%	1.29%	3.59%
Barclays Capital High Yield Index	-3.59%	-1.33%	3.23%

\* 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

U.S. equity markets fell precipitously May 6, with the Dow losing nearly 1,000 points in a 30-minute period, only to reverse course and recover more than half of its decline in the following 15 minutes. While an official explanation of the “flash crash” has not been offered, a potential culprit is high-frequency trading, as several stocks traded at fundamentally unreasonable levels. In the aftermath, the SEC proposed new circuit breakers that would halt trading in certain stocks if the price moved lower by 10% or more in a five-minute period.

European governments are planning austerity measures after the European Union (EU) and the International Monetary Fund agreed to provide nearly \$1 trillion to avert a public debt crisis. Spain announced its biggest round of budget cuts in more than 30 years, and Portugal announced it will increase taxes. Despite the recent turmoil, the eurozone expanded 0.8% in the first quarter, the third consecutive quarter of expansion. The EU Commission estimated that growth in all of 2010 will be 0.9%, but unemployment will climb to 10.3% from 9.4% in 2009.

The turmoil in Europe is leading many to believe the U.S. Federal Reserve (Fed) will delay raising rates. A Wall Street Journal survey of economists showed that 42% believe the Fed will not raise rates

until 2011 or later. A month ago, the figure was 28%. Minutes from the April Fed policy meeting show that the Fed believes the U.S. economy will grow 3.5% in 2010, up slightly from the forecast in January. The Fed thinks inflation will remain tame into 2012, possibly staying below the long-run target of 1.5% to 2.0%. In line with this thinking, core consumer prices, which exclude food and energy, rose only 0.9% in the 12 months ending April 30, marking the smallest increase in 44 years. The majority of governors also indicated they did not want to begin selling the mortgage-backed securities purchased by the Fed until recovery was well underway.

## Hedge Fund Strategies

Regulatory reform continues to be a prominent topic in regard to hedge funds. On May 18, European finance ministers approved new regulations for hedge funds. This followed the prior day's approval by a European parliamentary committee. The two versions will need to be reconciled, something likely to take several months. In the U.S., regulatory reform is almost certain to require that hedge fund managers with a certain level of assets under management register with the SEC. While the asset threshold has not been agreed upon, \$100 million is currently viewed as the most likely level.

On the heels of Citibank's announced acquisition of SkyBridge Capital in April, Man Group announced in May that it agreed to acquire GLG Partners for \$1.6 billion, continuing the current theme of industry consolidation. The acquisition will push Man's assets under management to \$63 billion. Man Group indicated it does not expect to make additional significant purchases after completing the acquisition of GLG.

Art Samberg, founder of Pequot, agreed to pay \$28 million to settle insider trading allegations, which first surfaced in 2006. The allegations led Samberg to close Pequot in 2009.

## Long/Short Equity Strategies

The sharp increase in risk aversion related to the European sovereign debt crisis had a broad impact on hedge funds, with all main strategies posting negative returns. Long/short equity was one of the hardest hit, returning -3.69% (HFRI Equity Hedge Index). For the first time since February 2009, all 10 S&P 500 sectors produced negative returns. Energy, which was affected by the Gulf of Mexico oil spill, was the worst performing sector, at -11.81%. Consumer discretionary, information technology, healthcare and financials remain the top sector exposures for long/short equity funds. Given the increased uncertainty resulting from the ongoing macro issues, long/short equity funds have continued to reduce risk. Funds are now roughly 20% to 25% net long, vs. historical ranges of 35% to 40%.

## Relative Value Strategies

Volatility returned to the markets, with the VIX rising from 22.05 to 32.07, a 45% increase. Intra-month, VIX peaked at 45.79 on May 20. Single-stock realized volatility also increased measurably, providing positive impetus to convertible arbitrage returns, as did declining interest rates. Widening credit spreads associated with the general risk aversion in the market offset these positives, leading convertible arbitrage to a return of -2.25% (HFRI FI Convertible Arbitrage Index). Consistent with history, the larger and more liquid issues suffered the most, as investors sought to shed risk. Given the market turmoil, new issuance was tepid, with only \$1.4 billion being priced in the U.S. Elevated volatility along with wider credit spreads, if sustained, will provide a better backdrop for future issuance.

## Event-Driven Strategies

As is typically the case, the flight-to-quality environment in which investors looked to shed risk resulted in lower-rated credit instruments suffering the most. After steadily moving lower for more than a year, the yield on the Barclays High Yield Index increased by 117 basis points. The top 100 leveraged loan facilities returned -3.55%, contributing to the -2.76% return for distressed investing (HFRI Distressed Index). Despite the difficult month, managers continue to see plentiful opportunities in distressed and dislocated assets, on both the long and short sides of the equation. In particular, managers have been successful in acquiring assets from banks and other lenders that continue to work on cleaning up their balance sheets.

Merger and acquisition activity was similar to that in April, with a few large deals being announced. United Airlines agreed to merge with Continental in a \$3.2 billion transaction that will result in the world's largest airline. SAP announced it would acquire Sybase for \$5.8 billion, paying \$65 per share, a 56% premium on the previous day's closing price. Merger arbitrage fared better than most hedge fund strategies, posting a return of -0.92% (HFRI Merger Arbitrage Index).

## Macro Strategies

Concerns over European economies caused the Euro to fall to a four-year low. Europe and the U.S. discussed the possibility of intervening in the markets to prop up the currency, something they have not done in more than a decade. For the month, the Euro fell 7.43% against the U.S. Dollar. Negative sentiment against the Euro by futures traders reached a record mid-month, followed by a slight reduction in these bets in the second half of the month. Investors sought gold as a hedge against the Euro, and the demand drove the commodity up 3.14% to an all-time high price. While gold performed well, commodities in general

were down roughly 11%. Oil was particularly hard hit, as speculators cut their exposure to the commodity by more than half, leading to a drop in price of more than 14%. U.S. yield curve movement also hurt macro investors, as the curve flattened by 19 basis points (2-year note vs. the 10-year note). Macro funds benefitted from their positioning on currencies and gold, posting a return of -0.92% (HFRI Macro Index). The overall liquidity of their positions also enabled macro managers to better reposition their portfolios during the market volatility.

#### **Important information**

Past Performance is not indicative of future performance.

Investing in hedge funds, fund of hedge funds or other securities is subject to certain risks, including market, liquidity, economic, interest rate, institutional and counterparty risk.

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