



Fund Evaluation GroupSM
investment advisors

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third quarter 2007 market review

The third quarter 2007 market review was written by Christopher M. Meyer, CFA®. Mr. Meyer is a Managing Principal and Chief Investment Officer at FEG.

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The subprime mortgage meltdown that appeared early in the year turned into a full fledged credit crunch, impacting nearly all sectors of the market. High yield bond and bank loan prices fell precipitously in late July and early August, but bounced back a bit starting in mid-August. Private equity firms were no longer able to negotiate favorable lending terms for their leveraged buyouts. Investment banks faced the prospects of not being able to syndicate the debt from these private equity deals, due to lack of demand from investors, who were unwilling to invest under the current terms. Several hedge funds that were highly levered and with the wrong credit bets experienced massive losses and several collapsed. Foreign holders of U.S. subprime mortgage debt, especially in Europe, also felt the impact of declining prices and increased illiquidity. The U.S. stock market was not spared either, as volatility, as measured by the Chicago Board Options Exchange (CBOE) Volatility Index¹, or VIX, started the quarter at 14.5, reached an intra-day high of 37.5 on August 16, before reverting back to 18 on September 28.

After reaching record highs in mid-July, the U.S. equity market fell 10% before recovering once the Federal Reserve inserted liquidity into the markets with a 0.5% cut in the discount rate on August 17. Further gains were realized when the target fed funds rate was also cut 0.5% points to 4.75% on September 18. Despite the volatility, the **U.S. stock market**, measured by the Russell 3000 Index, gained 1.5% for the quarter and the S&P 500 gained 2.0%. Large cap stocks were the best performing market capitalization, with the Russell 1000 returning 2.0%, while small cap stocks (Russell 2000) lost 3.1%. Growth outperformed across all market caps, with technology stocks posting strong gains. The value indexes, with nearly one-third of their weight in financial stocks, were negatively impacted by the poor returns in this sector, as earnings were expected to be lower due to the credit crunch. Consumer discretionary stocks were also hit hard, with investors concerned that the housing slowdown would impact consumers' ability to spend. On the positive side, energy stocks posted solid returns as oil topped \$83 per barrel. After several years of small and value outperforming large and growth, 2007 year-to-date returns indicate that trend may be reversing. Large cap stocks (Russell 1000) were up over 9% year-to-date with small cap stocks (Russell 2000) up only 3%. Moreover, the Russell growth indexes were well ahead of the Russell value indexes through September; 12.7% vs. 6.0% for large cap and 9.3% vs. -2.7% for small cap.

The **developed international equity markets**, measured by the MSCI EAFE Index, returned 2.2% for the quarter in U.S. dollars, but actually lost 2.5% in local currencies, as the weakening dollar benefited U.S. investors of foreign stocks. Just as in the U.S., international small cap stocks (MSCI EAFE Small Cap Index) underperformed large cap stocks, falling 4.5% (in U.S. dollars). Emerging markets, on the other hand, posted impressive returns, up 14.4% in U.S. dollars and 12.6% in local currencies. The Asian markets, ex-Japan, posted double digit gains, while Japan was one of the worst performing countries for the quarter, down 7.6% in yen, but only down 0.8% in U.S. dollars. The European market performed in-line with the broad MSCI EAFE Index.

Despite the credit crunch and concerns about falling residential real estate prices, **U.S. Real Estate Investment Trusts (REITs)** posted positive returns, with the NAREIT Index up 2.6% for the quarter. Year-to-date, however, U.S. REIT returns have been disappointing, with the NAREIT Index down 3.5% through the end of



September. Global real estate securities, measured by the FTSE EPRA/NAREIT Global Index, experienced modest losses in local currencies for the third quarter, but when translated into U.S. dollars, outperformed the U.S. market by 1% point. During 2007, global real estate securities benefited from the weak U.S. dollar and returned 3.7% for the first nine months of 2007. Both the U.S. and Europe posted negative REIT returns year-to-date, but the global index was boosted by the 16% gain in the Asia/Australia portion of the benchmark.

Treasury yields fell across the curve, with 3-month Treasury yields falling over 1% point when investors panicked amid the credit crunch and ensuing flight to quality. Expectations for further rate cuts kept short-term yields below intermediate and long-term yields, after two years of flat to inverted yield curves. The 10-year Treasury yield declined 0.4% points and the 30-year 0.3% points. With these declining yields, the **U.S. bond market**, measured by the Lehman Brothers Aggregate Bond Index, returned a handsome 2.8% for the quarter. Treasury Inflation Protected Securities (TIPS) returned an even more impressive 4.2% for the quarter, as lower interest rates, higher commodity prices, and a falling dollar ignited inflation fears. The credit crunch impacted non-investment grade bonds, but the recovery in late August and September allowed high yield bonds to end the quarter flat. Bank loans, which are generally non-investment grade, yet secured and senior to high yield debt, posted their worst quarterly return (-1.5%) since the CSFB Leveraged Loan Index was created in 1992. The weakening dollar benefited foreign bonds, both developed and emerging market, as these markets were up approximately 3% in U.S. dollars for the quarter.

Hedge funds experienced mixed results during the quarter, with the HFRI Fund Weighted Composite Index returning 1.6%. Most absolute return strategies experienced flat to slightly positive returns for the quarter. Directional strategies, performed a bit better, as the HFRI Equity Hedge Index returned 1.8% for the quarter, in-line with the global equity markets. Emerging markets was the one exceptional return area, with the HFRI Emerging Markets Index return up 5%. The credit crisis severely impacted several funds, particularly those with long subprime mortgage exposure and those with long senior/short junior relative value positioning. Many of these funds appeared to be well positioned for a credit crunch, being long the more senior and secured debt and short the junior and unsecured debt. Margin calls and illiquidity in the markets, however, forced many of these fund managers to sell what they could (senior and higher quality) and not what they wanted (junior and lower quality), leading to huge losses for those with excessive leverage. Quantitatively-based hedge fund strategies also suffered during the quarter, but many recovered with the stock market rebound in late August and September. Well-diversified, multi-strategy hedge funds without excessive leverage experienced some losses (1-2%) within their portfolios, but generally held up well during this frenzied quarter.

Private capital investments, such as venture capital, private equity/buyouts, and natural resources, generally do not report performance until at least 6-8 weeks after the quarter. Because these are illiquid investments, returns are reported on an internal rate of return basis from inception, and performance is highly dependent on the timing of the investment, and time-weighted benchmark returns, especially short-term, are not always meaningful. Nevertheless, results through last quarter indicate that returns are meeting or exceeding expectations. More information will be provided in our *Private Capital Research Roundup* to be issued in November.



Concluding Remarks

After the recession of 2001, the Federal Reserve sought to stimulate the economy with low interest rates, leading to an abundance of liquidity. For awhile, the Fed was also concerned about deflation, and with their easy monetary policy wanted to ensure the U.S. did not fall into a deflationary environment, similar to what Japan recently experienced. Many argued that the Fed was too accommodative for too long, leading to the credit problems we encountered in 2007.

After the stellar stock market returns of the 1980s and 90s, and with interest rates at historical lows, most investors, at the turn of the millennium, believed we were in a lower return environment. Unlike previous periods of low expected returns, when investors sat on cash and waited for more compelling opportunities, investors reached for higher returns, as their appetite for return outweighed their concern for risk. Examples of this include:

- investing in alternative investments (although many approached these investments as risk reducers)
- a reach for yield by investing in high yield bonds (eventually driving spreads over Treasuries to all time lows)
- investing in real estate investment trusts (REITs), with yields twice that of 10-year Treasuries and the opportunity for stock-like appreciation (eventually REIT yields fell 1% point below 10-year Treasury yields)
- use of leverage, especially in alternative investments
- lower weighting in traditional bonds

More skeptical market observers commented that the markets were “priced to perfection” and a small hiccup would cause these conditions to deteriorate. In fact, in the year end *Research Roundup*, published in January, we noted that stock market volatility was at all time lows and the S&P 500 had not experienced a 10% correction in four years, or a one day loss of 2% in eight months. We further stated that, “Although times may be good, we know this type of environment cannot last forever.” The events of late July and early August clearly proved this point.

Many investors, however, observed a market environment of low interest rates, low unemployment, strong global GDP and corporate earnings growth, modest inflation, and with the excess global liquidity, believed the market was in the best shape ever, with little cause for concern. Many also extrapolated this good news into the future, without considering potential pitfalls along the way. Even when the subprime mortgage crisis hit earlier this year, many believed this was isolated to the niche mortgage lending market and would not spillover to the whole economy. Like investors reaching for return, the mortgage lending market let greed interfere with good business judgment, and delinquencies and foreclosures have since skyrocketed.

During the third quarter, a full scale credit crunch ensued, with investors re-thinking their risk appetites. Unlike the subprime mortgage market, where fundamentals in the residential housing market have been deteriorating (housing prices falling, defaults/delinquencies rising), the overall economy did not experience any meaningful fundamental changes. Corporate earnings growth continued to be robust, default rates remained at all time lows, and there were no major bankruptcy announcements. Furthermore, the global economy experienced strong GDP growth in nearly every country. The credit crunch, therefore, was not due to declining economic fundamentals, but rather, technical factors and a re-pricing of risk. Some of the ex-



cesses, especially in lending standards, needed to be removed from the market. The events of July and August appear to have begun that process.

In light of these events, we continue to recommend broad diversification both between and within asset classes and avoidance of over-concentration and excessive use of leverage. With dislocations in the markets, we will also continue to seek attractive opportunities from which our clients can profit.

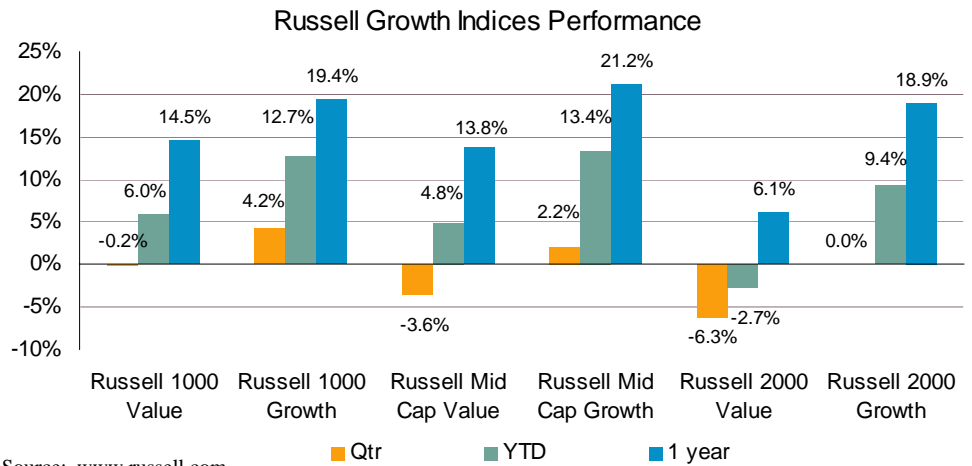


BRIAN A. HOOPER



CHRISTINA M. SUNDERMAN

U.S. equities generated mixed performance in the third quarter due to concerns about the credit market and its potential negative impact on the consumer, which drove market volatility higher. Growth equities outperformed value stocks across all market capitalizations as investors tended to favor companies with sustainable above-average earnings growth during a period of declining corporate profit growth. Large capitalization stocks outperformed mid and small capitalization stocks, as the Russell 1000 Index (+2%) outperformed the Russell Mid Cap Index (-0.4%) and the Russell 2000 Index (-3.1%).



Investors became more convinced during the quarter that the U.S. economy was in the midst of a downturn that could persist throughout the remainder of 2007 and into 2008. The housing market continued to weaken as a result of a record high supply of unsold homes, oil prices reached new highs and added pressure to consumer spending, and the U.S. dollar continued to fall versus other currencies, all of which had a significant negative impact on companies whose growth was contingent on the continued well being of the U.S. economy. This presented an attractive environment in which to invest in companies with exposure to the global economy, as these multinational companies benefit from strong global demand and whose earnings and revenues are not solely dependent on the U.S. consumer. Multinationals received an additional benefit from the declining dollar, as revenues earned overseas became more valuable as the dollar continued to decline in the third quarter, which in turn, provided a boost to their earnings.

The consumer discretionary sector was among the worst performing sectors in each Russell benchmark during the third quarter, as concerns about lingering weakness in housing and credit market issues led investors to suspect that consumer demand for goods and services might weaken. Specialty retail, media companies, restaurants, and travel related companies were the worst performing industries in the sector. Retail and leisure companies are particularly sensitive to real or perceived weakness in the U.S. economy, although this could be mitigated somewhat by the weaker U.S. dollar as foreigners look at U.S. goods as less expensive and seek out travel opportunities.



Further deterioration in the credit markets, including subprime mortgage-related weakness contributed to the underperformance of the financial sector, which has the largest weighting in each of the value benchmarks. The credit crisis in July and early August negatively affected many financial stocks, particularly lending institutions. Regional banks were affected the most as a larger percentage of their core business is tied to lending versus larger investment banks which are more diversified in terms of multiple business lines and geographies. Mortgage lending rates remained high, as investors demanded a larger risk premium to finance non-conforming mortgages. Delinquencies rose across the mortgage spectrum and foreclosures were the highest in 50 years, both of which led to fears of potential loan losses for banks with significant subprime mortgage exposure. The credit crisis led to significant technical selling during the quarter for bank loans and high yield bonds, yet fundamental deterioration was modest. The realization of mark-to-market losses for investment banks on its balance sheet holdings manifested itself in write-downs and weaker earnings growth that has the potential to linger into the fourth quarter. These factors combined to drive the underperformance of the financial sector during the quarter.

REITs Outperform Equities During the Quarter

Real estate investment trusts (REITs), as measured by the NAREIT Equity Index, slightly outperformed the broad equity market during the third quarter, with a gain of 2.6% versus a gain of 2.1% for the S&P 500 Index. REITs experienced significant volatility during the third quarter, as the NAREIT Equity Index lost 7.8% in July, then gained 6.6% in August and added another 4.4% in September. The declines in June and July were driven by investor's fears that the subprime mortgage problems in the residential market would spread to commercial real estate. From mid-August until the end of September, however, REITs, experienced a rebound, especially after the Federal Reserve cut interest rates by 50 basis points at its September 18 meeting.

The two best performing property types within the NAREIT Equity Index during the third quarter were **industrial** and **healthcare**, which gained 13% and 11%, respectively. Industrial real estate is generally viewed as more defensive because most properties have long-term lease agreements and, as a result, were less impacted by weakness in the residential real estate market. Healthcare REITs benefited from investors' expectations that growth in assisted living facilities would be driven by an aging population in the U.S. Conversely, hotels (-4.6%) were among the worst performing property types during the quarter, as investors took profits in the hotel sector after strong performance earlier in the year when a number of hotel REITs were rumored to be acquisition targets for private investors.


KEITH M. BERLIN

Flight-to-Quality Rally for U.S. Treasuries amid Credit Crunch

The Lehman Brothers Aggregate Bond Index (LBAG) gained 2.9% in a highly volatile third quarter. The strong benchmark return would initially appear to favor spread products, but due to the U.S. “credit crunch”, however, both real and nominal Treasuries produced the strongest gains in true “flight-to-quality” form. Investment grade corporates and mortgage-backed securities posted strong absolute returns, but underperformed the LBAG and Treasuries, as is typically the case during periods of illiquidity and crisis.

Bank Loans Produce Worst Quarterly Return on Record

Bank loans met with significant forced sales from investment banks holding unfunded collateralized loan obligations (CLOs), which comprise approximately 60% of the demand for bank loans. Due to the lack of forced-selling by high yield bond managers as a result of lower CBO (collateralized bond obligations) issuance in recent years, bank loans underperformed high yield bonds during the “credit crunch”. Bank loans lost 1.5% during the quarter compared to a gain of 0.3% in the broad high yield bond market. This marked the largest and only the fourth quarterly loss in the history of the CSFB Leveraged Loan Index, which was inceptioned in 1992.

Non-Dollar Denominated Bonds Continue to Produce Strong Returns

Non-dollar denominated bonds strongly outperformed dollar denominated bonds, as the U.S. dollar weakened amid the Federal Reserve’s decision to cut overnight borrowing costs by 50 basis points to 4.75% from 5.25% in an effort to stave off further weakness in the credit markets. The difference between non-dollar denominated debt and dollar denominated debt was pronounced, with the JP Morgan Global Bond Non-US (un-hedged) Index returning 8.2% while the dollar hedged index gained only 2.9%. The difference held true in emerging market debt as well, although to a lesser degree, as the JP Morgan Emerging Market Local Plus Index gained 4.8% versus the 3.1% return for dollar denominated JP Morgan Emerging Market Bond Plus Index. On a year-to-date basis, non-dollar denominated bonds of both developed and emerging market countries benefited from U.S. dollar weakness and produced the strongest returns among nominal bonds during the period.

Major Fixed Income Indices

	3rd Quarter	2007 YTD
Lehman Brothers Aggregate Bond	2.9%	3.8%
Lehman Brothers U.S. TIPS	4.2%	6.1%
Lehman Brothers Government	3.9%	5.0%
Lehman Brothers Municipal Bond	1.8%	2.9%
Lehman Brothers Asset-Backed	1.4%	3.1%
Lehman Brothers Mortgage-Backed	2.7%	3.5%
Lehman Brothers Credit	2.1%	2.9%
Lehman Brothers High Yield	0.3%	3.2%
Merrill Lynch BB-B Index	0.9%	3.4%
CSFB Leveraged Loan Index	-1.5%	2.1%
JP Morgan Emerging Market Bond Plus Index	3.1%	4.1%
JP Morgan Emerging Market Local Plus Index	4.8%	14.6%
JP Morgan Global Bond Non-US (US\$)	2.9%	2.4%
JP Morgan Global Bond Non-US (Unhedged)	8.2%	5.8%
90-Day US LIBOR	1.4%	4.1%


CHRISTIAN S. BUSKEN

Emerging Markets Outperform; U.S. Dollar Weakens

International equities slightly outperformed their domestic counterparts during the quarter, with the broad, large cap developed MSCI EAFE Index gaining 2.2% in U.S.-dollar terms.¹ Emerging market equities significantly outperformed developed markets with a gain of 14.4%, while international small cap stocks underperformed large caps during the quarter, as the MSCI EAFE Small Cap Index lost 4.5%. Within the developed international space, growth stocks significantly outperformed value stocks for the quarter with a gain of 4.3%, while the EAFE Value Index was flat. The MSCI All Country World Ex-U.S. Index, which comprises both developed and emerging market performance, was up 4.6%.

The currency impact for U.S.-based international investors was positive, as gains in the MSCI EAFE Index were attributable largely to U.S. dollar weakness. The dollar weakened versus major currencies after the Federal Reserve cut interest rates in September by 50 basis points, making dollar denominated assets less attractive. The European Central Bank left interest rates unchanged at 4%, while the Bank of England raised rates by a quarter point during July to 5.75%.² Higher interest rates in Europe led to gains in the euro, which helped returns for U.S. investors.

Telecommunications and Materials Outperform; China and Brazil Strong

Within the MSCI EAFE Index, telecommunications (+9%) and materials (+9%) were the top performing sectors during the third quarter.³ The telecommunications sector outperformed, as several large European telecom companies continued to restructure their operations with favorable results and investors sought exposure to companies that would be less susceptible to the global credit crisis. Materials stocks continued to benefit from higher commodity prices, particularly industrial metals, driven by increased demand in emerging markets as well as merger and acquisition activity. Alternatively, the financial services sector, which comprises nearly 30% of the index, underperformed because of global liquidity concerns stemming from weakness in the U.S. subprime mortgage market.

International small cap equities underperformed large caps and emerging market equities with a loss of 4.5% for the third quarter. Over the past several years, many international small cap equities enjoyed a “takeover premium” as investors anticipated buyouts by private equity firms at premiums to market prices. This premium was diminished in the third quarter, as a tightening in the global credit markets led to expectations that fewer private equity deals would close in the coming months.

After a sharp decline during the middle of the quarter, emerging market equities rebounded significantly and finished the third quarter with a gain of 14.4%. All of the major emerging market regions ended the quarter with positive returns, with Asia the clear leader.⁴ From a country standpoint, Mexico was the only notable decliner with a loss of 4.4%, due mostly to concerns about its close ties to the slowing U.S. economy.⁵ China (+42%), was the best performing emerging market country, as Chinese retail investors continued to invest heavily in the local stock market. Brazil (+20.7%) also posted significant gains and continued to benefit from high materials prices, a strong macroeconomic environment, and appreciation of its currency.

¹ All Returns data from <http://www.msci.com>.

² Capital Guardian World Markets Review (Third Quarter 2007).

³ Artisan Partners International Attribution (Third Quarter 2007).

⁴ Capital Guardian World Markets Review (Third Quarter 2007).

⁵ Ibid


J. ALAN LENAHAN, CFA[®]

GREG DOWLING, CFA[®]

The third quarter was a wild ride for hedge funds with fund closures and well publicized losses stemming from issues in the subprime mortgage market and resulting contagion. Funds run by some of the biggest institutional names in the industry including Bear Stearns, Goldman Sachs, and a former Harvard Management Company manager (Sowood), struggled or were closed. These high profile problems were balanced by the vast majority of the industry that managed through the credit, liquidity, and quantitative crises with less difficulty. Credit and quantitative equity managers faced the most difficulty during the quarter in July and August. When the dust settled in September, however, hedge funds in aggregate posted positive returns for the quarter, according to Hedge Fund Research. The funds that were poorly positioned for the heightened volatility in the quarter were outweighed by those that took advantage of the dislocation in the markets. We will discuss those strategies that faced the most difficulty during the quarter and provide our analysis of the effect on institutional investors, followed by a broad performance overview.

Credit Crises

FEG's research team developed a research presentation that details credit's impact on broad markets and is available upon request. This presentation documents the events leading up to and resulting from the credit crises. The two most significant aspects of the credit crises to hedge funds were the collapse of the subprime mortgage market, a positive event for many, and the liquidity driven sell off in bank loans, a negative event. The short subprime trade had become common in hedge funds throughout 2006 and 2007. As mortgage lending practices weakened, a number of high profile hedge fund managers took large short positions that were structured through credit default swaps. The trade had a compelling risk/reward trade off and was adopted by many managers. Not everyone was short, however, as there were a few funds, including one that was managed by Bear Stearns, that had a levered long exposure to subprime. These types of levered, single strategy funds were not part of many domestic institutional portfolios and had little effect on the hedge fund industry, other than negative press coverage. A number of institutional hedge funds did, however, have exposure to equity tranches of CDOs with subprime mortgages used as collateral. In most cases, these firms had originated the CDO structure and these funds were forced to take some write-downs on these positions. Long equity investments in mortgage originators were also poor performers. Upon analyzing the cumulative effect on the institutional hedge fund market, the subprime mortgage debacle was beneficial to hedge fund performance.

The effect of the credit crises on the bank loan market, on the other hand, was not a net positive for hedge funds. The bank loan market faced technical selling pressure that was well beyond what any participant had experienced or anticipated. The lack of organized or systematic trading in bank loans made it difficult for sellers to know the true value of their holdings and those that were forced to sell in order to meet margin calls did so at depressed values. Meanwhile, a decoupling of senior and junior credit spreads resulted in a breakdown in hedging strategies. Several funds took significant losses, including Basis Capital and Sowood, which sold its entire portfolio to Citadel during the height of the crisis, adding to the technical pressure. Credit focused hedge funds had a negative effect on institutional investors returns during the quarter. A number of the poor performing funds were held institutionally and many multi-strategy funds took much smaller losses on the credit portion of their book. The credit markets stabilized in September but there is a strong likelihood that increased volatility will persist.



Quantitative Equity

Hedge funds employing program-based equity trading or “quantitative” strategies took major losses during a short period from late July through mid August. The catalysts for these losses included:

- An increase in equity volatility due to contagion from the credit crises
- De-leveraging of models to remain within risk budgets led to selling of long positions and short covering, which had no fundamental justification
- Greater similarity of models across firms than was understood or expected

The quantitative de-leveraging event caused well publicized losses in a number of highly regarded hedge funds including DE Shaw and Renaissance, as well as repercussions for fundamental equity managers that held stocks that were targeted by the quantitative models. The mid-August infusion of liquidity by central banks settled the equity markets, which regained much of their quarterly losses by September. While the losses sustained by quantitative managers were substantial, many rebounded through the end of the quarter and the total effect on institutional investors with diversified portfolios was minor.

Performance

Strategy	Performance Summary (% Return)					
	Quarter	2007 YTD	1 Year*	3 Year*	5 Year*	10 Year*
HFRI Fund Weighted Composite Index	1.6%	9.1%	15.1%	12.4%	12.5%	9.7%
HFRI Fund of Funds Composite Index	0.6%	8.5%	14.3%	10.5%	9.2%	7.0%
HFRI Equity Hedge Index	1.8%	10.0%	15.8%	12.8%	12.5%	12.0%
HFRI Sector (Total)	2.2%	10.1%	17.3%	14.4%	15.7%	10.4%
HFRI Emerging Markets (Total)	5.0%	20.4%	33.3%	25.2%	25.4%	11.1%
HFRI Event-Driven Index	-0.6%	7.7%	14.1%	13.1%	14.8%	11.1%
HFRI Distressed Securities Index	-1.6%	5.4%	11.3%	12.6%	16.4%	10.9%
HFRI Relative Value Arbitrage Index	-0.2%	6.3%	10.8%	9.0%	8.4%	8.8%
HFRI Merger Arbitrage Index	0.9%	7.3%	11.5%	10.4%	8.1%	8.4%
HFRI Convertible Arbitrage Index	0.1%	4.8%	7.6%	5.2%	6.0%	8.6%
HFRI Fixed Income (Total)	-0.2%	2.5%	5.4%	6.8%	7.7%	6.6%
HFRI Equity Market Neutral Index	0.2%	5.1%	7.2%	6.8%	4.9%	6.5%
HFRI Macro Index	2.7%	8.4%	13.7%	9.3%	10.0%	8.9%

Source: HedgeFund Research *Annualized

Directional Strategies

Directional hedge funds in aggregate were positive on the quarter, as the HFRI Equity Hedge Index returned 1.8%, which was in line with mixed global equity market returns. Fundamentally focused managers had a much better quarter than the quantitative firms for some of the reasons described earlier. Positive developments for fundamental managers included wide dispersion of returns between stocks in September, allowing many managers to provide positive returns on the long and short side. Well-defined sector differentials also provided opportunistic managers the ability to play the difficulties in consumer cyclicals, housing, and financials, while benefiting from the large cap and growth rallies. Emerging markets managers benefited from beta exposure in Asian markets and the continued weakness in the U.S. dollar. Directional credit-oriented strategies were negatively affected by the credit crises as previously discussed. Credit-oriented strategies did rebound in September, however, and there should continue to be pockets of opportunities on both the long and short side, as technical issues work their way through the markets. While no



fundamental weakness in the economy or noticeable increase in corporate defaults has come to light, there is an expectation that the crises of 2007 have increased the likelihood of greater distressed opportunities in 2008.

Absolute Return

Absolute return strategy returns were in a fairly tight range of -0.2% to 0.9% on the quarter. Fixed income and relative value strategies were negatively affected by credit trades and a breakdown in convergence trades due to volatility. Risk management in these strategies resulted in containment of losses and a small gain on the quarter. The merger arbitrage strategy posted a gain of 0.9% according to HFR. The credit crises caused concern that some announced merger and buyout deals would not close. These fears caused significant mark-to-market losses in July and early August while many hedge funds increased their exposure. In September these fears began to subside and performance of the merger strategy rebounded.



Babcock & Brown Direct Investment Fund III	Introductory
Barrow Hanley Large Cap Value Equity	Firm Update
Bennett Lawrence Small Cap	Firm Update
Berkshire Multifamily Value Fund II, LP	Introductory
BlackRock Diamond Property Fund	Firm Update
CIP JSAM Value Fund	Introductory
CVI North American Real Estate Fund II, LP	Annual Meeting
Evergreen Small/Mid Cap Growth	Introductory
FOF-Hedge Fund	Introductory
Fort Washington Capital Partners Fund, V L.P. & SCG	Firm Update
Goldman Sachs PEG Distressed Opportunity Fund IV	Introductory
Great Lakes Value Equity	Firm Update
Heartland Small Cap Value	Product Update
Hedge Fund	Firm Update
Hedge Fund	Firm Update
HLM Ventures II	Annual Meeting
HRJ Special Opportunities Fund II	Introductory
HydePark Enhanced 500	On-site Meeting
ING Clarion Real Estate Securities, LP	Firm Update
INVESCO Directional Long/Short	Introductory
Jennison Large Cap Growth Equity	Firm Update
JER Real Estate Partners Fund IV	Introductory
JP Morgan U.S. Small Cap Growth	Firm Update
Lazard U.S. Strategic Equity	Product Update
London Small Cap Value	Introductory
Lotsoff Index+Alpha Enhanced Indexing	On-site Meeting
Magnetar Small Cap Growth	Firm Update
Mercury Real Estate Securities Fund LP	Introductory
MindShare Capital Small-Growth	On-site Meeting
NorthStar Structured Real Estate Fund LP	Introductory
OakBrook Enhanced Index Strategy	On-site Meeting
Penn Small Cap Opportunistic Equity	Introductory
Principal Real Estate Equity Securities	Firm Update
Ranger Small Cap	Introductory
Reich & Tang Small Cap Value Equity Strategy	Product Update
Sands Capital Management Large Cap Growth Equity	Firm Update
Santa Barbara Asset Management Stable Growth	Firm Update
Special Situations Partners II, LP	Firm Update
Standard Life Global REIT Fund	Introductory
Stux Large Cap Value	Firm Update
Turner Mid Cap Growth Equity	Firm Update
Valley Forge Large Cap Core Opportunistic	Introductory
Veredus Small Cap Growth	Firm Update
Voyageur Small Cap Core	Introductory
WCM Focused Growth Equity	Firm Update
Wells Capital Montgomery Small Cap Growth Equity	Introductory
Whippoorwill Offshore Distressed Opportunity Fund	Introductory
William Blair Mid Cap Growth Team	On-site Meeting



Alliance Bernstein US Strategic Value Equity	Firm Update
Amberbrook IV	Annual Meeting
Atlanta Capital Management High Quality Small Cap	Introductory
Bahl & Gaynor Quality Growth	Firm Update
DAG Ventures III	Firm Update
DeRoy & Devereaux All Cap Equity	Firm Update
Frazier Healthcare Ventures VI	Annual Meeting
Interwest X	Firm Update
Labrador Ventures VI	Firm Update
Lazard Global Core Plus Fixed Income	Firm Update
Liquid Realty IV	Annual Meeting
Pioneer Concentrated Growth Equity	Introductory
Pomona Capital VII	Introductory
Provident Mid Cap Growth	Firm Update
Siguler Guff Distressed Opportunities Fund III, LP	Firm Update
Venture Investment Associates VI, LP	Annual Meeting

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