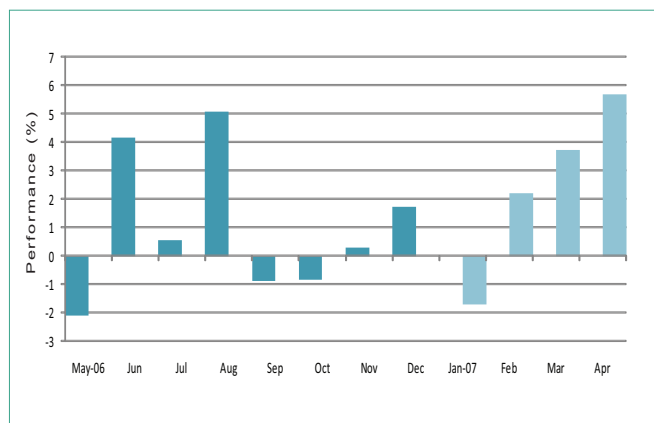


## SHIPPING



Fund's performance since inception (USD)  
Source: Clarkson Shipping Hedge Fund

### Risk Management

□ = low □ = low/moderate □ = moderate □ = moderate to high ■ = high

- Major risk:
  - Volatility of shipping markets and the level of freight rates
  - VaR Limits - Dry FFA book has on few occasions reached its maximum VaR limit and consequently no new investments were made in the book until VaR was reduced sufficiently below the limit
- Global shipping, freight mkt fundamental, long-term expertise: □□□□■
- Ability to extract returns from short / medium term price movements: □□□□■
- Capital allocation, portfolio construction, mgt, expertise: □□□□■  
(Short-run convergence of correlations will increase the volatility of portfolio returns)
- Leverage risk: Max 200% Gross exp on FFA portfolios, 225% on equities
- Liquidity risk: < 4 days trading volume, Max 10% in unlisted equities
- Currency risk: max 50bps of the fund can be left in non USD denominated currencies and unhedged

- Freight derivatives portfolio
  - Counter party risk/valuation risk: Limits: OTC counterparty max 5%, clearing member 60%: □□□□□
  - Liquidity risk: □□□□□
  - Leverage risk: (ability to smooth out – as the volatility of freight derivatives will tend to be low when freight market levels are low and high when the market levels are high) □□□□■
- Equity portfolio
  - Ability to time markets: 2/3rd of their trades are successful
- Unlisted equity portfolio
  - Ability to identify opportunities: □□□□■
- Market risk: third party and proprietary systems are used to quantify and manage market risk □□□□□
- Key Man Risk : □□□□□

### Performance Parameters

■ = insufficient ■ = adequate ■ = satisfactory ■ = good ■ = outstanding

- Aim to increase the number of profitable deals and cut the absolute losses: strive to diminish model fatigue factor – fund's managers are constantly trying to optimise the quality of the decision making process and calibrate the risk management framework
- No of positions currently in the portfolio: 60
- Efficiency in putting investor capital to work: ■■■■■
- Diversification:
  - Within sector FFA: dry and tanker
  - By investment styles: predominantly directionally, systematic
  - By instruments: freight derivatives, equity, special situation
- By duration: less than 4 days to 3 years (avg.= 45 days)
- By liquidity afforded - portfolio can be unwound under normal circumstances in 2 days
- Ability to sustain target performance:
  - In rising / falling markets (ability to short on the derivatives side): ■■■■■
  - Sideway trending markets: ■■
- Funds correlation to:
  - Stocks (MSCI): 1.8%
- Since inception, consistency in delivering targeted returns: ■■■■■
- Annual expense ratio: < 70bps (excluding fees)

### Outlook

↑ upside potential ↗ upside to range bound ↔ range bound ↘ range bound to down ↓ downside potential

- Barriers to entry: FFA market is a highly specialised market that requires industry knowledge
- Outlook on investing in the shipping sector: Positive
- Scope for a fund such as the Clarkson Shipping Hedge Fund: ↑
- Threat posed by competition: currently not an issue
- Worst case scenario: (based on manager's access to 200 years of data) – even if volatility were to stay low for an extended period, and markets were to stay trendless and flat, owing to the cyclical nature and mean reverting nature of shipping markets, volatility has historically, always re-emerged
- Fund's ability to deliver target returns over the next :
  - 1 year ↗
  - 3-5 years because of cyclical nature: ↑
- Fund shows a relative outperformance when: there are big movements in underlying shipping markets
- Fund tends to underperform when/if there is low volatility in shipping markets

### Investment Insights

- Fund is targeted at: sophisticated, institutional, HNWI individuals
- Current AuM: USD 63.3mn (as of May 2007)
- Targeted AuM: USD400mn
- Recommended holding period to optimise returns: min. 12 months
- Fund's base currency: USD, others it is available in: EUR
- Geographic restrictions: None
- Fund's complexity for an investor: Markets: High, Strategy: Low
- Transparency provided to investors: High
- Fund /manager is registered with: FSA

## MUSIC COPYRIGHTS

### Investing in “music copyrights” as an asset class



**Steve McMellon**  
 Managing Director,  
 First State Media Group

**“It is this type of long-term, cash generative asset that should be increasingly looked at by institutional investors. It is an ideal liability match”.**

The long term nature Charlie (Charlie Metcalfe, CEO, First State Investments ) referred to are the underlying copyrights, which can for example, be valid for as long as 70 years post death of a surviving author in the UK and up to 90 years in other jurisdictions. This longevity of underlying copyright, within a catalogue of musical works, provides investors such as pension funds an ideal match for their long term liabilities.

**How can music copyright holdings be managed so that they provide a steady and dependable source of returns? Elaborate.**

The copyright owner has different options to actively manage a copyright catalogue. Management is two fold – firstly, financial management, ie making sure the copyrights are registered and the royalties are being collected and secondly, exploiting the copyrights on an economic basis. Our fund will focus on actively generating income growth via direct promotion of assets and harnessing of all possible revenue streams.

Music copyrights generate worldwide incomes from a range of sources:

- Performance (radio, TV, theatrical performance)
- Synchronisation (use in adverts, films, TV, mobile ring tones)
- Mechanicals (sales of DVDs, CDs, digital media)
- Print (printed lyrics, musical scripts)

The different sources of income, and its global nature, result in a diversified income stream that exhibits a steady, proven growth rate over the long term.

**Isn't it a diminishing return game? How can one create additional value?**

No. Income from the music publishing industry has been steadily increasing as it does not suffer the volatility of the record production industry. The assets we have acquired are valued, based on their historical cash flows, which indicate steady, reliable global streams of income. Performance income in particular is increasing with TV and Radio contributions.

To enhance the income growth of its music copyright assets, First State Media Group has acquired a global platform of established copyright administration companies to undertake the direct collection of royalties. With this, First State Media Group have the specialist capability to directly monitor and administer the worldwide payment of royalties - considerably improving the speed, transparency and accuracy of cash flows to investors. It also provides First State Media with a global team of professionals who can enhance the income being produced by such assets, through 'on the ground' and active promotions in many major markets. These entities have been re-branded under the 'State One Music' brand.

**What annual net returns is the fund aiming to generate and over what time frame?**

Drawing on our experience in managing music and film copyright assets, we believe we will generate attractive returns on both a yield and IRR basis over the long term (30+ years).

**What are the risks associated with such investments and how can they be managed?**

There are always risks associated with certain artists, fashion trends and in certain territories. We manage those risks by maintaining a spread of music genres; good, global coverage and a repertoire that covers several decades.

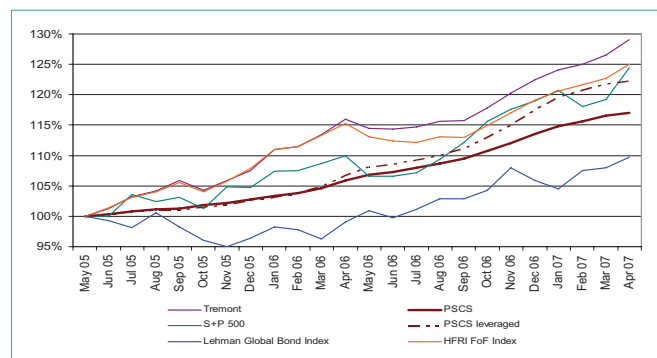
**Do the direct /digital down loading of music, piracy, alienation.... pose a threat?**

Digital downloading is a source of income - and currently contributes a small proportion of total income within music publishing (3-4%). This is expected to increase in the future and represents an opportunity to generate additional income. Assets are valued based on their historical cash flows - which means, the income that is lost through piracy is not valued and represents a potential upside with the continued worldwide crack-down on copyright and intellectual property infringements.

**How competitive is this investment space?**

Currently music publishing is dominated by the major music companies. Incidentally, they too are experiencing significant developments. There are also a few private equity and high net worth families that have benefited from investing in music catalogues in the US. I believe, First State Media is the first integrated fund manager that has the global capability to perform royalty administration and actively manage the assets to enhance the returns to investors.

## STRUCTURED CREDIT



Fund vs. other asset classes (Relative Performance since June 2005)  
Source: Palomar Structured Credit Strategies

## PALOMAR STRUCTURED CREDIT STRATEGIES LTD.

**Focus:** • A fund of funds with a diversified portfolio of structured credit products, including collateralised debt obligations (CDOs), mortgage-backed securities (MBS) and asset backed securities (ABS). It aims to deliver consistent, non correlated, low volatility returns

**Strengths:** • Team's experience and expertise across the credit spectrum - including debt origination and syndication, structured credit products, securitization and credit derivatives

**Weaknesses:** • Better suited to investors with a medium to long term horizon.

**Opportunities:** • The structured credit space has witnessed tremendous growth; it is an innovative market that offer arbitrage opportunities (owing to inefficiencies present)

**Threats:** • Cyclical (credit cycles)

### Risk Management

□ = low □ = low/moderate □ = moderate □ = moderate to high □ = high

- Major risk at portfolio level: **spread risk**
- Ability to identify managers: □ □ □ □ □
- Ability to secure capacity: □ □ □ □ □
- Portfolio construction expertise:
  - Positive perf. in Apr. '05 -back tested, Sept. '05, Nov. '06 and Feb/ Mar. '07.
  - Since the fund's inception, the market hasn't witnessed a general shock.
- Due diligence expertise: □ □ □ □ □
- Credit, securitisation expertise: □ □ □ □ □
- Default /fraud risk at portfolio level: □ □ □ □ □

Probability of occurrence is remote – but if one manager did succumb then portfolio's perf. could be temporarily challenged

- Underlying manager's inability to perform risk: □ □ □ □ □
- Spread blow out risk faced by portfolio: □ □ □ □ □
- Prepayment risk posed to portfolio: □ □ □ □ □
- Counterparty risk: □ □ □ □ □
- Liquidity risk: **exclusive credit facility for redemptions**
- Leverage related risk: **aggregated manager leverage = 3.7x**
- Currency risk: **none as the fund only invest in USD**
- Key person risk: □ □ □ □ □
- Key investor risk: **50% is held by a SPV that has issued capital protection notes – will remain outstanding for the next 4 years**

### Performance Parameters

□ =insufficient □ =adequate □ = satisfactory □ = good □ = outstanding

- No. of positions/managers currently in the portfolio: **16**
- Current correlation between positions: **expected to fall once there is more volatility in the market** □ □ □ □ □
- Efficiency in putting investor capital to work: □ □ □ □ □
- Diversification:
  - Geography: **US 61%, Europe 34%, Australasia 2%, Emg Markets: 2.6%**
- By credit quality:
  - AAA/AA: **22.9%** • A: **21.5%** • BBB: **10.2%** • Non-IG **45.4%**
- By security
  - RMBS, CMBS, IG CDS + cash, HY Corporate CDS + cash, EM debt, Bank loans, TruPs, SMEs, ABS, CDO warehouse
- Liquidity: **11% - 60 days or better; 30% - 120 days or better; 64% - 150 days or better, 95%: 180 days or better**
- Ability of the fund to perform in rising, falling, sideways, trending markets: □ □ □ □ □
- Since inception avg. annual correlations to:
  - stocks: **S&P 500: 0.03**
  - bonds: **Lehman Global Bond Index: 0.23**
  - hedge funds : **CSFB Tremont: 0.13, HFRI FoF: 0.9**
- Worst case scenario loss portfolio would incur: **worst month since inception: Sept. 05: +17bp. in times of a market shock, the fund could lose a few points in the relevant month, but no negative year expected**
- Annual expense ratio (excluding management and performance fee): **45bps**

### Outlook

↑ upside potential ↗ upside to range bound → range bound ↘ range bound to down ↓ downside potential

- Barriers to entry: **manager believes credit risk is tail risk and does not lend it self to "data crunching"; hence expertise, experience, relationship management are key**
- Outlook for the structured credit space: **credit events such as those witnessed in Feb. to Apr.'07 help separate the "wheat from the chaff"** ↑
- Outlook for a fund like Palomar: **(due to its conservative stance)** ↑
- More volatility is expected in the structured credit market, offering new opportunities after a period of tight spreads with relatively little movement: ↑
- Threat posed by competition: **fund has a 2 year head-start**
- Ability of the fund to deliver targeted returns over:
  - Next 1 year : ↗
  - Next 3-5 years : ↑
- Fund tends to show relative out performance when: **there is an economic trend or forced sellers**
- Fund tends to show relative under performance when: **unexpected, sharp, short lived, spikes in credit spreads occur**

### Investment Insights

- Current Fund AuM: **USD 57mn**
- Targeted Fund AuM: **USD 300mn**
- Fund is targeted at: **institutional, HNWI, pension funds**
- In order to optimise returns, min. **12 months**
- Geographic restrictions: **globally for institutional investors and qualified investors**
- Funds currency base USD and other currencies it is available in: **EUR, CHF**
- Fund's complexity for an investor: **structure itself is simple; the underlying products and market is complex**
- Transparency provided to investors: **fairly high**

**FINANCIAL ENGINEERING AND RE-ENGINEERING****Octave Trade Fund: Structured finance, syndication - as applied to Trade, Commodity Finance**

**C. Mead Welles**  
CEO and Senior  
Portfolio Manager,  
Octave Trade Fund

**Perception of risk premiums on offer in the trade/commodity finance space?**

Trade finance has historically been the domain of banks due to the commercial nature of the underlying transactions. As such it is a market place which acts for the most part independently from the traditional capital markets. From a credit stand point, trade finance is considered to be relatively low risk because there is an underlying transaction that is the repayment mechanism, a characteristic that places trade finance at the more conservative end of the capital market risk spectrum.

**Do you believe the trade/commodity market will continue to be inefficient? Why or why not?**

The inefficiencies in trade finance stem from non-standardised, physical documentation, non-standardised settlement procedures, independent pricing and risk methodologies, and varying bank credit and cross-border limits. Furthermore, there is no secondary market trading exchange. We anticipate that these inefficiencies will persist for a number of reasons, but mostly because the fundamental differences such as legal and tax laws that exist in each country make homogenising the industry documentation close to impossible in the near future.

**Developments underway with regards the presence of a secondary market for trades' receivable ... implication for a fund such as yours.**

While a secondary market exists for trade finance, it will for the foreseeable future be plagued by inefficiencies caused by non-standardised, physical documentation and settlement procedures. In addition, changes in the regulatory landscape such as the Basel II Capital Accord fundamentally alter the marketplace for both trade and warehouse receipt lenders and borrowers globally and have implications for the secondary market in trade receivables. In summary, Basel II aims to modernise outdated risk reserve requirements for commercial banks. As the banking industry adjusts to the new capital adequacy and risk management practices, liquidity to emerging country exporters and importers will decline and disconnects in pricing among institutions will likely develop. The Octave Trade Fund, which operates outside the typical constraints of a bank, will seek out the most inefficient segments of the markets on a global basis to take advantage of arbitrage opportunities.

**What does it take to originate deals in the primary market?**

Our method of identifying prospects is driven by referrals and by proactive sourcing. However, having been active in international trade for over eight years in our current form, we have developed a reputation as an alternative source of financing which results in a large number of cold calls from potential borrowers around the world. One of the benefits of our company's long operating history and track record in this area is, that we've developed an extensive network of relationships within the international trade space to screen companies, which helps in maintaining a diverse pipeline of viable transactions. Our competitive edge is our experience in financial engineering, structuring, and risk management, as

well as our broad network of global contacts in commodities, finance, emerging markets, banking, and international trade.

**Evaluating risk, tranching it and rating it are crucial to be able to structure and syndicate a deal. Elaborate.**

In packaging and syndicating transactions, we combine the due diligence procedures of a AAA bank with the experience gained after multiple years of global trade and structured finance to format transactions in creative ways, solving for cross border, counterparty credit, performance, legal, tax, and currency risks. One opportunity we have, is to use our structuring capabilities to package deals in a way that, the inherent risk in the deal is materially reduced. This allows us to sell the exposure at a tighter spread, capturing the differential for the benefit of the Fund.

**Comment on the relevance of being insulated to: default risk, fraud, "downgrades", prepayments, spread blow out and the use of special purpose vehicles by funds such as yours.**

Historically, human error and fraud have been the two greatest risks inherent in trade finance. While we can never ensure that we will be insulated against those risks, we have taken steps to minimise them. We have and follow standardised policies, procedures and check lists, that reduce the likelihood of human error. Fraud is mitigated in two ways: first by conducting intensive due diligence and careful on-going oversight and second through our structured finance facilities with special purpose vehicles ("SPV's). SPV's have collection accounts and agents that govern the facilities providing another layer of operational risk management. Our facilities not only encumber all the borrower's inventory and receivables, but they test the borrower's financials and the facility performance periodically to pick up negative changes that might indicate fraudulent behaviour.

Prepayment risk is mitigated through prepayment penalties which apply to most transactions. The risk of downgrades and spread expansion will always exist; however, we package our deals to strip out the credit risk of the borrower and as senior secured floaters, our deals are largely immune to interest rate and spread risk. Trade finance benefits from a high priority of payment, due to the essential nature of trade payments versus other forms of debt payments, under the premise - if you don't pay for your inputs, you won't be able to make any outputs.

**If this is a "panacea": low volatility, low correlation, reduced concentration risk, increased returns with lower risk, enhanced liquidity to originate new transactions, diversification (geographic, time based) .... what is holding the others back?**

Trade finance is arguably the oldest capital market, yet it has historically been the domain of commercial banks. Money managers have historically come out of investment banks and securities firms and as such they have not had much if any experience in trade finance. What holds others back is the lack of familiarity and experience necessary to identify and capitalise on the inefficiencies in trade finance. That's where the opportunity exists for the Octave Trade Fund.

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