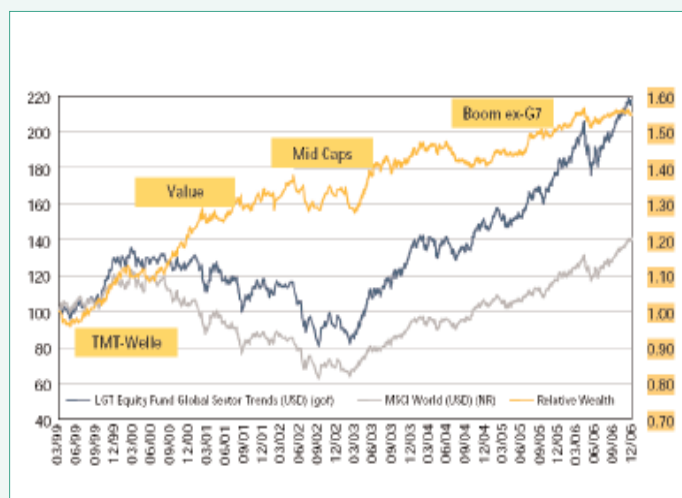


## FINANCIAL FIX: LGT EQUITY FUND GLOBAL SECTOR TRENDS



The fund's development since inception - with respect to its benchmark, the yellow line shows the value added by the fund  
Source: LGT Capital Management

**Focus:** Using a well rounded, disciplined approach that relies on observed market price information and systematic data analysis, trends in countries, sectors, industries and equities are identified. Economic sustainability of these trends is assessed and contributes to the investment process. Behavioural finance is applied to analyse various causes for the occurrence of these trends and considers issues such as - systematic cognition problems (patterns are transferred without empirical evidence), the incorrect or slow classification of new information (clinging onto old evidence or slow adjustment to new evidence), social contagion (subjective knowledge gaps, time pressure and the pressure to succeed generate uncertainty which is overcome by observing and imitating others). This collective process leads to stock picking and guides portfolio management. The fund seeks to beat its benchmark – the MSCI World –index – and to simultaneously maintain a tracking error of between 5-8% a year.

**Strengths:** The fund manager's ability to consult with and draw on the expertise of leaders in the field of behavioural finance such as 2002 Nobel Prize bearers for Economic Sciences, Prof. Dr. Daniel Kahneman, Prof. Dr. Vernon L. Smith; as also Prof. Dr. Werner De Bondt and Alfons Cortés

**Weaknesses:** sudden, sharp market movements pose a challenge as do periods of low volatility

**Opportunities:** Unlike other theories, behavioural finance is relevant and can actually be applied to market phenomena that actually occur

**Threats:** since almost half the portfolio is allocated to US based stocks – sensitivity to US economic growth forecast related issues could have a bearing on performance

### Risk

☐ = low ☐ = low/moderate ☐ = moderate ☐ = moderate to high ☐ = high

Effectiveness in managing a portfolio that takes a behavioural finance approach: ☐☐☐☐☐

Effectiveness in using behavioural finance in identifying and analysing, following market trends across:

Country: ☐☐☐☐☐

Sector: ☐☐☐☐☐

Stock level: ☐☐☐☐☐

Ability to position the portfolio to exploit those trends: ☐☐☐☐☐

Ability to successfully implement:

Medium term momentum strategies: ☐☐☐☐☐

Long term contrarian strategies: ☐☐☐☐☐

Short term contrarian strategies: ☐☐☐☐☐

Ability to identify and exploit the existence of "mental frames": ☐☐☐☐☐

Ability to identify and "anomalies" to extract performance: ☐☐☐☐☐

Ability to distinguish between catastrophes and shocks: ☐☐☐☐☐

Ability to manage such a portfolio actively: ☐☐☐☐☐

Relevance of currency risk: ☐☐☐☐☐

Relevance of political and macro economic risk: ☐☐☐☐☐

Key man risk: ☐☐☐☐☐

### Performance Parameters

☐ =insufficient ☐ =adequate ☐ =satisfactory ☐ =good ☐ =outstanding

No. of stocks currently held in portfolio: 65, equally weighted

Discipline in managing portfolio: ☐☐☐☐☐

Portfolio rebalancing ability: ☐☐☐☐☐

Diversification achieved:

Market capitalisation: ☐☐☐☐☐

Country level: ☐☐☐☐☐

Sector level: ☐☐☐☐☐

Stock level: ☐☐☐☐☐

Ability to perform in:

Rising: ☐☐☐☐☐

Sideway trending/low volatility markets: ☐☐☐☐☐

Falling markets: ☐☐☐☐☐

Ability to deliver uncorrelated returns to:

Stocks: ☐☐☐☐☐





Bonds: ☐☐☐☐☐


Over 3-5 years: portfolio's ability to outperform the benchmark

MSCI World Index: ☐☐☐☐☐

## FINANCIAL FIX: LGT EQUITY FUND GLOBAL SECTOR TRENDS - II

### Outlook

 upside potential  
  upside to range bound  
  range bound  
  range bound to down  
  downside potential

Scope for applying behavioural finance research to portfolio management: 

Barriers to entry: moderate

Define: from a behavioural finance perspective - high

requires expertise in analysing, interpreting and implementing trends in constructing a portfolio

Funds ability to deliver targeted returns over 3-5 years: high

Max. capacity that can be managed: not constrained

### Investment Insights

Target audience: broad based

Level of complexity: low

Fund offers: the integration of the "human factor" in investment management

To optimise returns, recommended avg. holding period: 5 years

Available to investors: globally

Base currency: USD

Other currencies the fund is available in: EUR, CHF

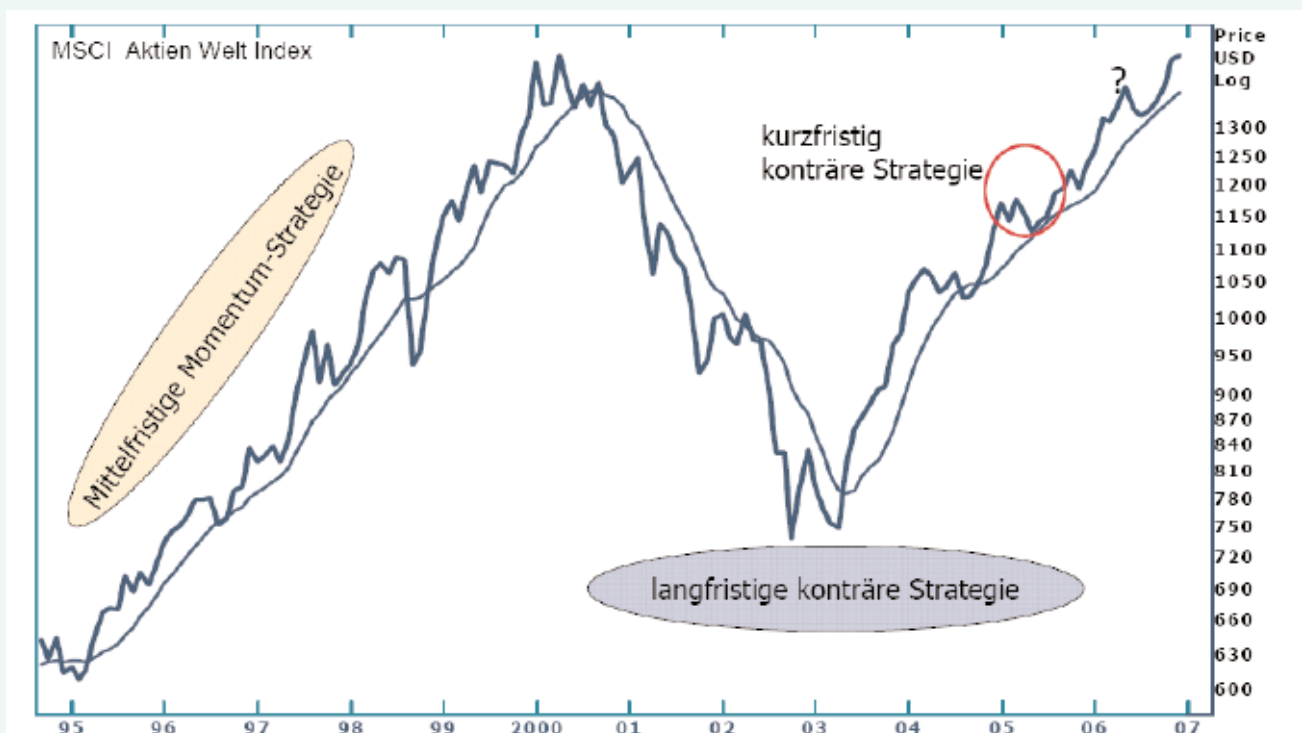
Liquidity: daily

Transparency: high

Fee structure: 2% management fee

Rating: since March '04 – Standard & Poor's "AA"

Risk/reward compensation: moderate



**Market dynamic:** a simplified view of asset allocation (left bubble- medium term momentum strategy) (bottom bubble - long term contrarian strategy) (encircled in red -short term contrarian strategies) Source:LGT Capital Management January,2007

## PRACTITIONER'S POINT



Santo Volpe co-founded Eden Rock Capital Management, a hedge fund business specialising in asset-based lending. He is a member of the investment committee of Heather Capital Limited

### Risks and rewards of investing with a "niche" asset backed player

#### How would you as a practitioner define a "niche" player?

I would define a "niche" player as someone who has access to a particular and specific competitive advantage. In asset-based lending ("ABL") the manager will usually have a unique competitive advantage to originate deals within his/her particular area. "Niches" can be characterized as either geographic or collateral-specific or both. For example, someone may have access to finance timber receivables in Oregon. This is obviously a very "niche" opportunity with respect to both geography and collateral

#### How did you end up being one?

By being in the right place at the right time. Though it is a cliché, it is true. ABL as a hedge fund strategy is a fairly recent development. As an early investor in ABL prior to this, and given that most of the ABL managers are North American-based, the fact that I was based in Europe allowed me to identify certain niche lending opportunities.

#### Drawing from your experience: what would you say are the handicaps of being a niche player? And the rewards?

The major handicap is that one's investor base is going to be limited. As a niche manager one should expect a niche investor base. Though the trend is changing, the vast majority of hedge fund investors, mostly institutions, are unlikely to consider a very niche strategy with probably limited capacity. Though the number of investors who seek niche opportunities is growing, they still

represent a small portion of the global hedge fund investor base. The reward is the other side of the same coin. The niche ABL manager is immune to the cyclical trends of allocations on the part of institutions. This can often result in massive capital flows in and out of various strategies. Niche, non-correlated ABL hedge funds are unaffected.

#### Would you say capacity (AuM) is a constraining factor?

Definitely yes. By definition anything niche is going to be of a limited and highly specialized nature. It is unlikely that any hedge fund with more than USD \$1 billion of assets can be classified as truly niche - unless they have a monopoly, which, in the long term is unsustainable.

#### Niche players are more likely to deliver "uncorrelated" returns to other asset classes – but if they lack adequate diversification within "their niche" they could actually ramp up the risk – what has your experience been?

I don't really know how it is possible to diversify within a true niche. In ABL, "ramping up the risk" implies lax lending procedures, high loan-to-value ratios and/or loose documentation. In my experience, investors should understand precisely what their risks are. Diversification in a niche ABL portfolio is not always a risk-mitigating factor. Numerous examples can be cited.

#### With the new generation of "fund replicators" – can one expect to remain a "niche player" and still maintain the current level of fees?

That depends on the niche player's ability to maintain that competitive advantage. Anyone can try and replicate a fund, but their ability to succeed ultimately depends on what their added value is. Simply offering a reduced fee is not enough. ABL managers earn their fees because they have an edge in origination or special access to certain deals. Fees will come down if access to those deals becomes wider spread. But then, can one call it "niche" at that point?

#### What does it take to "preserve" a niche?

No single person, manager, firm, etc. can "preserve" a niche. That's up to market forces and good old supply and demand.

#### Do you believe it is possible to isolate "pure alpha"? Do you believe it exists?

In order to have Alpha you need Beta. Alpha and Beta are part of the Capital Asset Pricing Model. ("CAPM") ABL returns are non-correlated to the capital markets because they have nothing to do with the capital markets. Because of this "de-correlation" it is difficult to apply the CAPM. Therefore, the measure of Alpha needs to be discounted. Similarly, people often use the Sharpe Ratio, or Sortino Ratio, or other ratios to measure risk v. reward. Those ratios depend on standard deviation. Standard deviation has nothing to do with risk. It is a measure of volatility. Again, as with Alpha, one needs to rethink one's approach of applying traditional investment metrics to ABL.

**Comments, remarks...** I must point out that in my replies to your questions, I was referring to what one would call ABL as opposed to ABS (Asset-backed securities). ABS is a trillion dollar market with high levels of liquidity. It is the biggest fixed-income market in the world. When referring to ABL we mean private loans with no securitized secondary market. ABL returns are not correlated to the market because there is no market.

There has been an impressive flow of hedge fund capital into ABL in the last two years. Investors are attracted by the low level of correlation and the consistency of the returns. However, chasing returns is no reason to invest in ABL. A thorough understanding of the underlying risks is necessary and the methodology for measuring those risks should be applied appropriately. On the global perspective the outlook for ABL as a hedge fund strategy is promising. Hedge funds only represent a miniscule portion of the global ABL industry. We will see more hedge funds emerge, each with their own specific niche.

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## FINANCIAL FIX: GLOBAL MARITIME INVESTMENTS



Fund's performance since inception  
Source: M2M

**Focus:** it is the only fund to invest in both the derivatives and the physical shipping market. Currently focuses on the dry bulk market and on the Panamax sector as this is where the greatest volatility can currently be found and it offers the highest liquidity. Developments: will start trading the Capesize and Handymax sectors as the fund grows.

The fund has developed a software system around the proprietary freight portfolio management system, Neptune, which provides "comprehensive freight position management, complete forward pricing and allows the trading portfolio to be thoroughly risk managed".

**Strengths:** Ability to flexibly trade relative value opportunities

**Weaknesses:** Large market price movements increase risk

**Opportunities:** There are few other participants with the ability to look at and trade the whole freight market

**Threats:** credit risk with trading counterparties

### Risk Assessment

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

Ability to identify and exploit relative value opportunities within the shipping and freight markets: □□□□■  
fund managers can go long/short most of the relevant market instruments

Ability to exploit volatility: □□□□□

same as above; options trading is still in its infancy in this market, as this becomes more liquid managers can trade this area to exploit volatility more fully

Ability to secure credit: □□□□□

the fund doesn't hold many assets which can be borrowed against apart from a small amount of cleared futures

Ability to manage:

market risk: □□□□■ proprietary systems value all systems

counterparty risk: □□□□□ they use credit agency plus market knowledge

liquidity related risk: □□□□□ most positions consume little cash so liquidity is less of an issue presently

Leverage used: □□□□□

Currency related risk: □□□□□ all trades in USD

Key man risk: □□□□□

Annual expense ratio: cost are about 3% of NAV

### Performance Parameters

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

Avg. no. of positions held in the portfolio: 40

Ability to exploit dramatic structural changes in the shipping market:

■ ■ ■ ■ ■

they can trade all securities in the market so can be nimble

Diversification achieved by:

routes ■ ■ ■ □ □

main routes are priced to the Atlantic or Pacific areas

vessel type ■ □ □ □ □

currently only Panamax, will extend to Hnady and Cape later

freight carried: only carry Iron, Grain and Coal in the main

time frames avg: mostly 3-6 months

Ability to perform in:

volatile markets ■ ■ ■ ■ ■

during periods of low vol. ■ □ □ □ □

Conditions for the fund to outperform: high volatility with pricing divergence

Conditions that would trigger an underperformance: low volatility

Based on your stress tests - VAR limits should mean they can't lose more than 10% of NAV in one month

the worst case scenario = Stress test limits max losses to 30% of NAV over a 3 year period

Suitability of inclusion in:

a conservative portfolio: ■ ■ □ □ □

a balanced portfolio: ■ ■ ■ □ □

an aggressive portfolio: ■ ■ ■ ■ ■

### Outlook

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

Scope for a freight fund: ↑

Volatility looks set to stay high

Viability of freight market

Aside from soaring volatility levels over the past few years

Barriers to entry

requires specialised shipping knowledge and expertise

Ability to deliver uncorrelated returns to:

Stocks = 0

Bonds = 0

Hedge Funds = 0

Commodities = 0

Ability to deliver targeted returns over next 12 months ↑

### Investment Insights

Target audience: institutional investors, minimum subscription price is USD1m

Level of complexity: moderate to low

Fund offers: uncorrelated returns

To optimise returns, recommended avg. holding period: 2 years +

Available to investors: globally

Base and only currency: USD

Liquidity: 6 months redemption notice

Transparency: high

M2M: is authorised by the FSA

Fee structure: 2% management; 20% performance

Risk/reward compensation: moderate

## RESOURCEFUL: BIOFUEL COMMODITY BASKET



Actual performance graph –March'06-Feb.'07  
(blue curve: Biofuel Basket; pink curve: Rogers International Commodity Index)  
Source: ABN AMRO Bank

**Focus:** The Biofuel Commodity Basket was structured and weighted by analysing\* the largest bio fuel producing countries and their corresponding commodity consumption for the purpose. Bio ethanol production was capped at 70% in order to attain a meaningful representation of bio diesel; which represents the remaining 30%. Although bio diesel is not widely produced currently, the underlying commodities help achieve diversification. The basket's actual underlyings are 8 certificates on futures contracts - sugar (33%), corn (28%), soybean oil (15%), wheat (6%), palm oil (6%), canola (5%), rapeseed (4%) and soybean meal (3%).

\*The data was drawn from the Renewable Fuels Association Industry Outlook 2005.

**Strengths:** an opportunity to invest in commodities used in the production of bio fuels. With the basket as an underlying - possibility to invest in a 1:1 tracker certificate; currency risk can be hedged (additional fee applies)

**Weaknesses:** currently allocations are skewed toward bio ethanol production; passive management as the basket is reweighted twice yearly

**Opportunities:** In an attempt to reduce carbon emissions that adhere with the Kyoto Protocol; to cope with the depleting petroleum reserves and to provide a viable substitute on the price front - bio fuels have the potential to displace the global dependency on petroleum as a transport fuel. The USA and Brazil are currently the largest producers and users of bio ethanol. In Brazil, ethanol accounts for roughly 30% of the demand while in the US it accounts for less than 2% of transport fuel.

**Threats:** low barriers to entry

### Risk Assessment

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

#### Risk as applicable to the underlying certificates

- Ability to optimise the rolling of the underlying futures:

□ □ □ □ □

Rolling is at the discretion of the managers, but takes place at least 10 business days prior to the first notice date of the future. The next relevant future is determined by reference to liquidity in the underlying market

- Currency related risk: □ □ □ □ □
- Weather related risks: □ □ □ □ ■
- Relevance of macro economic, financial, political risks: □ □ □ □ □

#### At the basket level

- Diversification at:

Geographic level: □ □ □ □ □

Commodity level: □ □ □ □ □

- Avg. correlation between contracts: □ □ □ □ □
- Avg. correlation to Rogers Commodity Index: □ □ □ □ □
- Ability to mitigate risk posed by roll over effect: □ □ □ □ □

### Performance Parameters

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

- Ability to deliver returns in a rising, sideways trending and falling market: ■ ■ ■ □ □
- Inclusion in a:
  - Conservative portfolio: ■ ■ □ □ □
  - Balanced portfolio: ■ ■ ■ □ □
  - Aggressive portfolio: ■ ■ ■ ■ □
- Competition: few players

### Outlook

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

- Scope for a bio fuels: ↑
- Barriers to entry: few
- Conditions that drive an out performance: environmental legislation; rapid and sharp rise in petroleum prices, catastrophic weather conditions

### Investment Insights

- Target audience: broad based
- Level of complexity: low
- Bio fuel commodity basket offers: the ability to express a sector view
- To optimise returns recommended holding period: 5 years
- Available to investors: globally, listed on: the SWX Swiss Exchange
- Base currency of the basket: USD
- Other currencies it is available in: EUR, CHF
- ABN Amro (market making spread): indicative 1.5%
- Risk/reward compensation: adequate

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