

# Annual Returns of Hedge Funds by Style

Net of Fees and Expenses (1995-2010)

1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Sector Long/Short 34.91%	Special Situations 26.12%	Special Situations 20.91%	Sector Long/Short 15.77%	Sector Long/Short 69.92%	Short 20.52%	Distressed 12.98%	Short 23.99%	Sector Long/Short 26.55%	Distressed 15.60%	Non-U.S. Long/Short 17.91%	Sector Long/Short 15.01%	Macro 16.33%	Short 24.15%	Convertible Arbitrage 40.15%	Merger Arbitrage 21.17%
U.S./Global Long/Short 28.75%	Sector Long/Short 25.56%	U.S./Global Long/Short 19.91%	U.S./Global Long/Short 14.51%	Non-U.S. Long/Short 46.97%	Merger Arbitrage 16.10%	Fixed Income 10.33%	Managed Futures 11.80%	Distressed 23.62%	Special Situations 11.72%	Sector Long/Short 10.80%	Special Situations 14.38%	Non-U.S. Long/Short 12.78%	Managed Futures 7.52%	Merger Arbitrage 27.76%	Special Situations 13.47%
Merger Arbitrage 26.03%	U.S./Global Long/Short 23.06%	Sector Long/Short 19.38%	Equity Mkt Neutral 12.43%	U.S./Global Long/Short 46.30%	Equity Mkt Neutral 12.10%	Special Situations 8.85%	FX 10.38%	Special Situations 22.29%	Fixed Income 10.27%	Macro 8.65%	Distressed 13.85%	Merger Arbitrage 12.52%	FX 7.37%	Special Situations 24.93%	Fixed Income 12.89%
Special Situations 20.10%	Fixed Income 21.90%	Multi Arbitrage 17.93%	Managed Futures 11.12%	Special Situations 32.07%	Special Situations 12.02%	Convertible Arbitrage 8.85%	Fixed Income 7.86%	Non-U.S. Long/Short 21.40%	Non-U.S. Long/Short 9.40%	Fixed Income 8.52%	Non-U.S. Long/Short 13.47%	Special Situations 11.79%	Macro 3.44%	U.S./Global Long/Short 23.84%	Sector Long/Short 12.34%
Managed Futures 19.53%	Distressed 21.75%	Macro 16.02%	Merger Arbitrage 10.90%	Macro 24.56%	Sector Long/Short 11.81%	Non-U.S. Long/Short 7.98%	Convertible Arbitrage 7.83%	U.S./Global Long/Short 21.12%	Sector Long/Short 8.82%	Distressed 8.50%	Merger Arbitrage 12.57%	Sector Long/Short 11.34%	Equity Mkt Neutral -5.28%	Fixed Income 22.51%	U.S./Global Long/Short 12.03%
Macro 19.36%	Non-U.S. Long/Short 21.65%	Managed Futures 15.98%	FX 5.29%	Merger Arbitrage 21.14%	Managed Futures 11.78%	Managed Futures 7.25%	Distressed 5.88%	Macro 17.90%	U.S./Global Long/Short 7.99%	U.S./Global Long/Short 7.49%	Convertible Arbitrage 12.35%	U.S./Global Long/Short 11.23%	Multi Arbitrage -9.67%	Non-U.S. Long/Short 21.30%	Distressed 9.69%
FX 19.03%	Merger Arbitrage 20.37%	Non-U.S. Long/Short 15.76%	Macro 5.26%	Convertible Arbitrage 20.21%	U.S./Global Long/Short 10.95%	Short 7.21%	Macro 5.73%	Fixed Income 14.75%	Merger Arbitrage 7.61%	Special Situations 7.28%	U.S./Global Long/Short 12.13%	Short 11.17%	Merger Arbitrage -12.72%	Sector Long/Short 19.85%	Managed Futures 9.25%
Convertible Arbitrage 18.36%	Multi Arbitrage 19.79%	Distressed 15.68%	Special Situations 4.70%	Multi Arbitrage 18.99%	Multi Arbitrage 10.69%	Multi Arbitrage 6.95%	Multi Arbitrage 4.22%	Convertible Arbitrage 14.60%	Managed Futures 6.38%	Multi Arbitrage 6.66%	Fixed Income 11.98%	Managed Futures 10.60%	Fixed Income -14.72%	Distressed 17.74%	Non-U.S. Long/Short 9.18%
Distressed 17.99%	Macro 19.43%	Fixed Income 15.62%	Multi Arbitrage 4.65%	Distressed 17.87%	Convertible Arbitrage 9.84%	Equity Mkt Neutral 5.93%	Equity Mkt Neutral 3.60%	Managed Futures 14.52%	Multi Arbitrage 5.74%	Equity Mkt Neutral 5.99%	Multi Arbitrage 10.96%	Distressed 8.28%	Distressed -15.87%	Macro 17.03%	Macro 9.18%
Equity Mkt Neutral 15.49%	Equity Mkt Neutral 17.77%	Merger Arbitrage 15.22%	Convertible Arbitrage 4.07%	Equity Mkt Neutral 17.09%	Fixed Income 6.90%	U.S./Global Long/Short 5.45%	Non-U.S. Long/Short 1.57%	Merger Arbitrage 11.86%	Macro 5.62%	Managed Futures 5.59%	Managed Futures 8.53%	Equity Mkt Neutral 7.55%	Special Situations -17.47%	Multi Arbitrage 15.39%	Convertible Arbitrage 9.11%
Multi Arbitrage 12.59%	Convertible Arbitrage 16.14%	Equity Mkt Neutral 14.73%	Short -2.34%	Fixed Income 15.89%	Macro 6.63%	Macro 5.38%	Merger Arbitrage 0.79%	Multi Arbitrage 11.26%	Equity Mkt Neutral 4.17%	Merger Arbitrage 4.81%	Equity Mkt Neutral 7.93%	Multi Arbitrage 6.76%	U.S./Global Long/Short -19.34%	Equity Mkt Neutral 10.23%	Equity Mkt Neutral 8.24%
Fixed Income 12.51%	Managed Futures 14.76%	Convertible Arbitrage 14.21%	Distressed -3.09%	Managed Futures 10.11%	Distressed 4.65%	FX 4.88%	Special Situations -1.51%	Equity Mkt Neutral 7.55%	Convertible Arbitrage 3.26%	Convertible Arbitrage 2.61%	Macro 7.74%	Fixed Income 6.48%	Non-U.S. Long/Short -19.57%	FX 6.89%	FX 7.20%
Non-U.S. Long/Short 8.55%	FX 14.06%	FX 13.55%	Non-U.S. Long/Short -5.60%	FX 4.44%	FX 4.02%	Merger Arbitrage 3.98%	U.S./Global Long/Short -2.86%	FX 7.01%	FX 1.02%	FX 2.12%	FX 3.27%	FX 3.09%	Sector Long/Short -22.97%	Managed Futures 2.82%	Multi Arbitrage 5.22%
Short -2.84%	Short -1.32%	Short 7.81%	Fixed Income -5.75%	Short -13.12%	Non-U.S. Long/Short 0.36%	Sector Long/Short 2.79%	Sector Long/Short -3.17%	Short -13.55%	Short -7.63%	Short 1.74%	Short -5.59%	Convertible Arbitrage 2.94%	Convertible Arbitrage -29.89%	Short -21.96%	Short -11.15%

See reverse side for descriptions

## Relative Value

Investment funds employing this style seek to invest in securities, which their investment managers perceive to be selling at a discount or premium to their intrinsic or potential worth. These securities may be out of favor or not closely followed by analysts. Long-term holding, patience, and strong discipline often are required before the market recognizes the ultimate value of the discounted or overvalued securities. Positions generally are hedged using short sales and options. It is broadly opportunistic and, as such, generally uncorrelated with benchmark indices. Some relative value strategies include convertible arbitrage, equity/market neutral, fixed-income arbitrage, and multi arbitrage.

**Convertible Arbitrage** – This strategy involves investing in convertible bonds that appear incorrectly valued relative to their theoretical value. The strategy consists of the purchase (or short sale) of a convertible security coupled with the simultaneous short sale (or purchase) of the underlying security for which the convertible can be exchanged. These transactions seek to hedge out the risk inherent in the stock. The remaining interest rate risk may or may not be hedged. This strategy may include buying an undervalued warrant and selling short an appropriate amount of the warrant issuer's stock (139 funds).

**Fixed-Income Arbitrage** – This strategy consists of taking advantage of pricing differentials between related fixed-income securities. The strategy consists of investing in one fixed-income security while seeking to hedge the market risk with an offsetting investment in another related security (385 funds).

**Equity/Market Neutral** – Market neutral long/short equity investing refers to strategies that avoid taking systematic exposure. Funds may be dollar, beta, market cap, or sector neutral, or a combination of all or any of these. Positions may be, but do not have to be, paired with offsetting positions (248 funds).

**Multi Arbitrage** – This strategy includes hedge funds that employ more than one arbitrage strategy in their fund. Merger arbitrage, convertible arbitrage, fixed-income arbitrage, volatility arbitrage, and market neutral investing are common strategies used by multi-arbitrage funds (126 funds).

## Event-Driven

This style is based on the actual or anticipated occurrence of an event, such as a merger transaction or a bankruptcy. Investment returns are relatively unaffected by the direction of the equity and fixed-income markets. Some event-driven investment strategies include merger arbitrage, distressed investing, and special situations.

**Merger Arbitrage** – This strategy, sometimes also called “risk arbitrage,” consists of investing in event-driven situations of issuers in the process of a corporate transaction, such as leveraged buyouts, mergers, and hostile takeovers. Investors purchase stocks of the issuer that is being taken over and sell short the stocks of the acquiring company (83 funds).

**Distressed Investing** – Investors buy, at discounts, equities, debt, or trade claims of companies that face financial difficulties. Often, these companies are involved in bankruptcy proceedings, with payment to debt holders and other claims under control of the bankruptcy court. After the bankruptcy process, these investors may hold the equity securities of the newly reorganized company. Profits are expected from the market's lack of understanding of the intrinsic value of the discounted securities, and because many institutional investors cannot own below-investment-grade securities (162 funds).

**Special Situations** – This strategy refers to event-driven investments that fall outside of merger arbitrage. For example, investment situations could include index-rebalancing arbitrage, bankruptcy workouts, or spinoffs (187 funds).

## Long/Short

This style combines long investments with short sales and the pursuit of opportunities in rising or declining markets. Unlike relative value strategies, long/short strategies generally may reduce, but do not eliminate, market exposure and risk. Some long/short strategies include equity long/short and short selling.

**Equity Long/Short** – Investment funds employing this strategy buy undervalued stocks and sell overvalued stocks to both generate alpha and hedge out some portion of the general market risk. The stocks bought or sold short typically are selected using quantitative and/or value-based models. The investment managers of these investment funds may differ in the methods used (and degree to which they seek) to elimi-

nate market risk. Unlike equity pairs trading, long and short positions may be completely unrelated. This strategy can be closely correlated to the performance of benchmark indices (includes Sector Long/Short [297 funds], U.S./Global Long/Short [980 funds], and Non-U.S. Long/Short [416 funds]).

**Short** – Short selling is used by investment funds attempting to profit from declining security prices. To implement the strategy, investment funds generally will seek to identify securities of companies that their investment managers deem overvalued. This strategy is not the opposite of purchasing long securities. A short sale does not require any investment or borrowed money, but it does require collateral. Unlike the holder of a long position, which may enjoy dividend income, the short seller pays the dividend as a cost. On the other hand, the proceeds of the short sale earn interest, known as a short credit rebate, which floats with short-term interest rates. Unlike a long investor, a short seller can lose his or her total net worth, as there is no upper limit on how high the price of a stock can potentially rise (27 funds).

## Tactical Trading

Investment funds whose investment programs are characterized by this style tend to speculate on the direction of the market. Some tactical trading strategies include macro trading, FX, managed futures, trend following, and systematic trading.

**Macro Trading** – Investment funds employing this strategy aim to profit from changes in global economies; these are typically caused by shifts in government policy that affect interest rates and, in turn, affect currency, stock, and bond markets. These investment funds may participate in all major markets, financial instruments, currencies, and commodities, though not always at the same time. Leverage and derivatives may be used to accentuate the impact of market moves. Hedging may be used, but leveraged directional positions tend to make the largest impact on performance (361 funds).

**Managed Futures, Trend Following, and Systematic Trading** – This strategy involves using a computerized trading system to generate buy and sell signals in the direction of a defined trend, based on the assumption that a trend, once established, will tend to continue. Little or no personal judgment is involved in the investment process (1,644 funds).

**FX (Foreign Exchange)** – This strategy involves trading currencies and derivatives on currencies to exploit mispricings in the market (74 funds).

Source: Lazard Alternatives LLC, TASS, Hedgefund.net, HFR, Stark, and Lazard proprietary funds.

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The 14 substyle categories were developed by Lazard to encompass the hedge fund universe. Lazard's Fund of Funds team classified, based upon fund descriptions, each of the 5,100+ funds (see description for number of funds in each category) into these substyle categories. Monthly data from all of the funds were then used to determine the annual return by substyle.

Hedge funds are periodically reclassified for various reasons including the evolution of their strategy or a merger with another fund. Year on year, this can result in different outcomes for the previously published style category returns in the Table of Hedge Fund Returns by Style.

An investment in any alternative investment is speculative, involves a high degree of risk, and may lose value. Privately offered investment vehicles are unregistered private investment funds or pools that invest and trade in many different markets, strategies, and instruments. Such funds generally are not subject to regulatory restrictions or oversight. Opportunities for redemptions and transferability of interests in these funds are restricted. The fees imposed, including management and incentive fees/allocations and expenses, may offset trading profits. Investors should not invest in any fund unless they are prepared to lose all or a substantial portion of their investment.

Credit: Callan Associates Inc. and the Callan Periodic Table of Investment Returns depicting annual returns.

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