

## Morningstar® Hedge Fund Database Update

December provided a brief respite from the overall decline in 2008, as fund of funds – event (-0.3%) and distressed securities (-2.65%) were the only categories in the red for the month. Developed Asia equity (5.72%) and convertible arbitrage (3.85%) led the way in December, but unfortunately could not salvage much of their yearly returns, finishing at -18.25% and -19.95%, respectively.

Global trend was the only category to finish the year in the black with an impressive 20.18% gain bolstered by a 3.76% return in December. Global non-trend, which lost 0.47% in 2008, was the next closest category. Emerging-markets equity proved to be the worst strategy in 2008, as double-digit losses in September and October contributed to a 38.21% loss for the year. U.S. small-cap equity also had a difficult year, as its 1.26% gain in December barely made a dent in its 27.05% loss for the year.

All of the new fund of funds categories lost ground in 2008. Fund of funds – global derivatives posted the best return with a loss of 5.66% while fund of funds – equity brought up the rear at -26.7%. Still, all of the fund of funds categories except fund of funds – event managed to end on a positive note with returns in the black for December.

Despite gaining 1.73% in December, its first positive return since May, the Morningstar 1000 Hedge Fund Index lost 10.58% in the fourth quarter of 2008, which dropped its yearly return to -22.37%. This still beat the S&P 500, which also gained ground in December (2.51%), but lost 27.11% for the quarter and 41% for the year. For a comparison of the 2008 performance of the Morningstar 1000 Hedge Fund Index and the S&P 500, please see the chart below.

Although bad news is plentiful in the industry, there have been a few bright spots. As has been the case all year, Sextant Capital Management has posted incredible returns for several of its hedge funds. The Strategic Opportunities Hedge Fund, a global non-trend strategy, is the top-performing fund for the year at 171.83% while the Strategic Hybrid Hedge, a multistrategy fund, places second at 155.41%. XT-99 Diversified, a global trend fund managed by Pardo Capital Ltd., is the third-best performer with a 2008 gain of 142.02%, and yet another Sextant fund, Strategic Global Water Fund (a global equity strategy), places in the top four with a 137.03% yearly return.

The Morningstar Hedge Fund Database features about 11,500 investments, including nearly 8,300 active funds and 3,100 dead funds for research purposes. Up to 300 data points, including information on investment strategy, portfolio holdings, and hedging techniques, are used to sort each fund into a strategy category for peer group analysis purposes. Hedge funds closed their doors in record numbers this year and the number of funds removed from the database increased 150% in 2008 (1,648 as compared with about 642 in 2007). Funds are removed from Morningstar’s database if the fund liquidates, if the managers wishes to stop reporting returns, or if the fund fails to report for six months.

<b>New Morningstar Hedge Fund of Funds Categories</b>					
<b>Month</b>	<b>Morningstar 1000 HF Index</b>	<b>S&amp;P 500</b>	<b>Month</b>	<b>Morningstar 1000 HF Index</b>	<b>S&amp;P 500</b>
January	(2.41)	(4.51)	July	(2.88)	(0.59)
February	2.26	(3.54)	August	(2.96)	2.75
March	(1.53)	(1.23)	September	(7.87)	(10.29)
April	1.09	5.17	October	(9.81)	(21.17)
May	1.71	2.59	November	(2.53)	(9.80)
June	(1.05)	(9.93)	December	1.73	2.51
			<b>2008 Total Return</b>	<b>(22.37)</b>	<b>(40.99)</b>