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INTRODUCTION

MSCI: A LEADING GLOBAL BENCHMARK PROVIDER
Morgan Stanley Capital International Inc. ("MSCI") is a leading provider of international equity, fixed income and hedge fund indices.

INTERNATIONAL EQUITY INDICES
MSCI provides global equity indices, which over the last 30 years have become the most widely used international equity benchmarks by institutional investors. MSCI constructs global equity benchmark indices that contribute to the investment process by serving as relevant and accurate performance benchmarks and effective research tools, and as the basis for various investment vehicles. As such, the MSCI Equity Indices are designed to fulfill the investment needs of a wide variety of global institutional market participants. In constructing these indices, MSCI consistently applies its equity index construction and maintenance methodology across 23 developed and 27 emerging markets. This consistent approach makes it possible to aggregate individual country and industry indices to create meaningful composite, regional, sector and industry benchmarks. In addition, MSCI also provides value and growth indices for its standard regional and country indices, and small cap indices for 23 developed stock markets.

Close to 2,000 organizations worldwide currently use the MSCI international equity benchmarks. MSCI estimates that over USD 3 trillion are currently benchmarked to MSCI Equity Indices on a worldwide basis.

US EQUITY INDEX SERIES
In August 2002, MSCI announced that it is developing a new family of US Equity Indices to provide a much broader and deeper coverage of the US equity market. The new index series will reflect the full breadth of investment opportunities within the US equity markets by capitalization size, value and growth investment styles and sector groups. The new index family will be introduced in phases beginning in early 2003.

FIXED INCOME INDICES
MSCI provides a wide range of fixed income indices for the investment community, including indices for Sovereign, Investment Grade and High Yield debt markets, as well as the Interest Rate Swaps market. The MSCI Fixed Income Indices are unique in their emphasis on trader quotes as the basis for security pricing, as well as on their use of an industry classification system based on the Global Industry Classification Standard (GICS)™. The GICS was developed by MSCI in conjunction with Standard & Poors and is used by MSCI to classify securities in its equity indices. The use of GICS in the MSCI Fixed Income Indices facilitates analysis across asset classes.

HEDGE FUND INDICES
Leveraging its unique understanding of the institutional asset management environment and its expertise in creating and managing global benchmarks, MSCI has developed a family of hedge fund indices based on a comprehensive classification system and a growing fund database. Financial Risk Management, an international hedge fund specialist, provided invaluable hedge fund industry insight to MSCI in the development of the index structure and fund classification based on experience gained through hedge fund research, analysis and investment during the last decade.
I. THE CHARACTERISTICS OF THE HEDGE FUND OPPORTUNITY SET

The characteristics of the opportunity set relevant to hedge fund investing differ fundamentally from what is relevant to conventional asset class investing. In a conventional asset class, such as equity, the opportunity set can be described as the universe of publicly listed securities also referred to as the “market”. The performance of the asset class can, therefore, be measured as the performance of the market. The diversity of investment management tools and techniques used by hedge fund managers, including short selling, the use of derivatives and leverage make it impossible for the opportunity set to be defined as the underlying securities alone. Therefore, the hedge fund opportunity set can best be described by the full range of investment strategies employed by hedge fund managers, which in turn can only be represented by the actual hedge funds that implement them.

The private nature of investing in hedge funds brings an additional challenge to representing the opportunity set through the funds themselves. Hedge funds are typically not traded in a secondary market, as are equities and bonds, nor do hedge funds provide a continuous issuance or redemption of shares on the basis of a published NAV. Investment in hedge funds is predominantly conducted through private transactions. All this introduces a number of considerations pertaining to the ability to capture the performance of the opportunity set of hedge funds. First, the terms of specific investments often are not negotiated in a consistent manner among different investors or over different periods. This inconsistency introduces the possibility that specific hedge fund returns may not be achievable by every investor. Second, hedge funds may not always seek additional capital or may be willing to accept new investors. Such “closed” funds would simply be unavailable to some investors. Similarly different exit conditions may be negotiated with different investors. These differences may be more or less pronounced depending on the investment strategy, and it may be more or less difficult to integrate new capital into a fund or withdraw capital on a timely basis. As such, the set of hedge funds open to investment may not be the same for every investor.

The characteristics of hedge fund investing outlined above have clear implications for a broad hedge fund index. In order to create an index that can fully represent the existing investment strategies, and accurately reflect the performance of these strategies, it is necessary to include a wide variety of hedge funds, including those that are not fully investable.

II. OBJECTIVES AND GUIDING PRINCIPLES

The objective of the MSCI Hedge Fund Indices is to fairly represent the relevant opportunity set at the strategy and composite level in a transparent and flexible manner. In so doing, the MSCI Hedge Fund Indices contribute to the investment process in several ways. First, the indices function as indicators of performance for various hedge fund strategies and manager styles. Second, the indices serve as the basis for performance comparisons and high-level performance attribution for a portfolio of hedge funds. Finally, the indices may be used as a research tool in the portfolio allocation process to investment strategies and individual funds and across asset classes.

In order to achieve the objectives outlined above, MSCI adheres to the following principles in the design and implementation of its index construction and maintenance methodology:

1. Broad Representation of the Hedge Fund Opportunity Set. MSCI strives to represent the broadest range of the hedge fund opportunity set. This involves representing, to the extent possible, the full set of investment strategies employed by hedge fund managers. Such broad representation is considered essential not only to accurately capture the diversity of the hedge fund universe, but also for effective performance
Hedge Fund Indices Methodology

Attribution at the hedge fund portfolio level. At the same time, in an effort to create indices that are broadly reflective of the returns experienced by hedge fund investors, MSCI includes funds that have identified themselves as either open or closed to new investment in its indices.

2. Fair Representation at the Strategy Level. The heterogeneous nature of the hedge fund universe highlights the need for a robust classification system. The intent and design of the MSCI Hedge Fund Classification Standard is to identify and aggregate strategies that are influenced by common factors and, therefore, can be expected to have similar risk-return characteristics over time. In order to accurately represent each individual strategy, two conditions must be met. The first is that the participating funds must be accurately and consistently classified in order to ensure comparability among funds within each strategy. The second, is that each strategy must contain a sufficient number of constituent funds in order to be considered representative of its stated strategy.

3. Transparency of Index Constituents. The MSCI Hedge Fund Indices are transparent to accredited investor subscribers in terms of constituent composition. Specifically, the indices are designed to be fully open with respect to individual constituent names, performance figures, and asset levels. This transparency is important for two reasons. First, it allows the qualified index user to gain comfort and confidence in the integrity of the index levels that are produced. Second, this constituent-level transparency provides a level of detail that is essential in order to accurately depict the hedge fund landscape. Ultimately, this allows the qualified user to conduct more penetrating analyses, and arrive at a more thorough understanding of hedge funds individually and as a group.

4. Flexibility of Index Design. The MSCI Hedge Fund Indices are based on a flexible index design, intended to address the needs of a diverse set of users and to provide multiple perspectives on the performance of hedge funds. First, this is achieved through several levels of aggregation. Strategy indices depict peer groups with a relatively high degree of similarity among funds and are calculated by weighting fund returns equally. Investment process indices combine funds across asset classes and geographies and can be used in decomposing portfolio returns. Process group indices—which combine similar investment processes—and the hedge fund composites provide different perspectives on the hedge fund industry, and are produced both in asset weighted and equally weighted versions.

Three families of indices based on fund assets under management provide a second perspective on the structure and dynamics of the hedge fund space. This array of indices identify performance differentials, that may exist among funds of different sizes over time. Domicile-specific indices also add to the versatility of the index design by depicting the opportunity set for investors with different tax circumstances.

5. Independence and Objectivity. MSCI’s editorial decisions are made completely independently of all interest groups, including its shareholders. The fact that MSCI is editorially independent and objective does not preclude MSCI from considering the views and suggestions of its clients and other users of its products and services. To the contrary, MSCI believes in fully engaging all stakeholders by frequently soliciting feedback received from various constituencies, and the final decisions are taken independently of any single interest group or stakeholder and have the sole objective of preserving or enhancing the quality of the MSCI Hedge Fund Indices. MSCI Hedge Fund Indices are produced and managed on a transparent and independent basis, within the context of its published construction and maintenance methodology. The indices are based on information supplied directly from the participating hedge fund managers. However, MSCI reserves the right to adjust index levels if it determines that returns are materially misrepresented.
III. DEFINING THE UNIVERSE OF HEDGE FUNDS

In order to construct a database that will serve as the selection pool for the hedge fund indices, MSCI first establishes an appropriate definition of the hedge fund vehicle, and determines the eligibility criteria for database inclusion.

3.1. DEFINITION OF A HEDGE FUND

Several broad attributes are presently used among managers and investors to define a hedge fund. In creating the indices, MSCI chooses to focus not on the fund’s legal structure or on the methods of manager compensation, but rather on the strategy and tactics utilized in generating returns.

A hedge fund is a collective investment vehicle, established as a separate and distinct legal entity with outside parties as investors. Privately managed accounts are not considered to be funds, although open managed account platforms and composite performance of separate accounts is acceptable for certain directional traders who do not maintain funds but manage capital chiefly through such accounts. It is not necessary for a fund to be listed on an exchange, regulated or registered to be within the scope of the MSCI Hedge Fund Database. This encompasses the majority of vehicles managed by registered CTAs, as well as certain listed funds that engage in significant short selling activity.

Hence, hedge funds are defined by MSCI as investment vehicles—public or private—that practice one or more of the strategies outlined in the MSCI Hedge Fund Classification Standard. These strategies are based on investment processes, which involve taking both long and short positions, as a part of an active approach to manage or hedge risk. Accordingly, with the exception of some Distressed Securities or Short Bias funds, both long and short sales will have a meaningful impact on the returns of a hedge fund. Conversely, the use of leverage to enhance returns, is not a critical distinction of a hedge fund, although it is frequently encountered. For instance, a fund that employs leverage but does not sell securities short is not considered a hedge fund for inclusion in the MSCI Hedge Fund Database.

3.2. DEFINITION OF THE UNIVERSE OF HEDGE FUNDS

In an effort to construct a database that is representative of the underlying universe of hedge funds, MSCI includes funds that have a variety of characteristics in its database, and by extension, indices. Specifically:

MSCI will include funds that have identified themselves as open or closed to new investment.

MSCI will include funds regardless of domicile location.

MSCI will not require a minimum track record for database inclusion.

MSCI has chosen to include funds with the characteristics described above in an effort to accurately reflect the risk-return characteristics of the hedge fund universe. These inclusive eligibility policies, however, introduce the possibility of hedge fund duplication in the database. Fund duplication occurs when the same basic hedge fund is maintained in parallel portfolios created to meet the needs of different classes of investors, such as U.S. and non-U.S. residents. Including the same fund more than once in an equally weighted index would bias the index returns. MSCI’s equally weighted indices are designed to be free of such fund duplication, and account for this issue. Asset weighted indices, by contrast, are designed to represent the total assets of each structure, and therefore include duplicate funds in determining the weights of the constituents and calculating the returns of the index.
IV. MSCI HEDGE FUND CLASSIFICATION STANDARD℠

4.1. Objectives of the MSCI Hedge Fund Classification Standard

Hedge fund classification schemes attempt to define strategies and then classify and combine funds into meaningful groupings. This task, however, is complicated by the heterogeneity of hedge fund investing, whereby hedge fund strategies cannot be readily compartmentalized. The great diversity of hedge fund practices implies that one should not expect that all strategies would fit into a formal system and that any classification method, when put into practice, is subject to some degree of subjectivity. Therefore, the key objective of a hedge fund classification scheme is to allow for enough specificity to accurately define the investment categories, while at the same time providing a reasonable structure for navigating among the categories.

The MSCI Hedge Fund Classification Standard captures the multi-dimensional nature of hedge fund investing by considering the primary and secondary characteristics that shape the risk-return profiles of strategies. This approach provides a more accurate and effective way of identifying and defining strategies than a uni-dimensional approach. This classification system also enables the establishment of a flexible and comprehensive framework of peer groups, comprising strategy and process indices, and other performance indicators, which may be relevant and useful for performance attribution and other research purposes.

The MSCI Hedge Fund Classification Standard strives to offer an appropriate balance between a level of detail which permits an accurate classification of a large number of strategies, and the ease and intuitive nature of a classification system that facilitates its implementation.

4.2. Mechanics of the MSCI Classification Process

The classification process undertaken by MSCI is intended to ensure that all funds are classified correctly in the framework of the MSCI Hedge Fund Classification Standard. This collaborative process develops through several stages but begins with manager input. Managers submit a proposed classification for each of their funds along with performance information, an offering memorandum and other documents.

The MSCI Classification Committee then reviews the proposed classification together with supplementary documents submitted by the manager, and assesses whether the rules and guidelines of the classification system have been applied correctly. Classification changes will be discussed with the manager to reach an understanding and agreement on the classification of the fund in question. In every instance, MSCI will make the final determination for fund classification.

4.3. Classifying the Universe of Hedge Funds

Hedge fund managers generally design their investment processes, including the use of investment management tools, such as derivatives, to capture the returns specifically attributable to their investment skills by limiting or eliminating market sources of return. Thus, in analyzing and classifying hedge funds, the investment process needs to be recognized as one of the primary strategy characteristics, along with asset class and geography. In addition, while the impact of asset class and geography may vary from strategy to strategy, the effect of the investment process on the risk-return profiles of hedge fund strategies is more pronounced, and can be viewed as the dominant characteristic. At its core then, a fund’s strategy needs to be defined by the investment process and, depending on their relevance, by asset class and geography.
4.4. Primary Characteristics

As discussed above, the primary characteristics defining a strategy consist of the investment process, asset class, and geography. These characteristics are described below.

4.4.1. Process Groups

Investment process is considered to be the core characteristic of hedge fund strategies. The investment process designates the approach that managers use to select investments in order to generate returns and manage risk. Investment processes are grouped into five broad categories, or investment process groups. These groups are Directional Trading, Relative Value, Security Selection, Specialist Credit, and Multi-Process. The main investment process groups are briefly described below.
4.4.1.1. DIRECTIONAL TRADING

Directional Trading strategies are based upon speculating on the direction of market prices of currencies, commodities, equities, and bonds in the futures and cash markets.

There are three distinct Directional Trading investment processes:

- *Discretionary Trading* seeks to opportunistically participate in market-driven price actions. The final decision about trading is made at the discretion of the fund manager.

- *Systematic Trading* utilizes computer models, mainly based on technical analysis of market data or fundamental economic data, to identify and make trades, with limited manager intervention.

- *Tactical Allocation* is based around tactically allocating capital among a diverse range of trading strategies and markets, wherever opportunity is perceived.

4.4.1.2. RELATIVE VALUE

Relative Value strategies focus on spread relationships between pricing components of financial assets or commodities. They seek to avoid assuming any outright market risk, although spread risk may be significant.

There are three distinct Relative Value investment processes and one Multi-Process category:

- *Arbitrage* attempts to exploit anomalies in price spreads between related or similar instruments.

- *Merger Arbitrage* exploits merger activity to capture the spread between current market values of securities and their values after successful completion of a merger, restructuring or similar corporate transaction.

- *Statistical Arbitrage* uses systematic models to build long and short portfolios with different current prices that the market is statistically predicted to price equivalently.

4.4.1.3. SECURITY SELECTION

Security Selection managers combine long positions and short sales with the aim of benefiting from their ability in selecting investments while offsetting systematic market risks. Market exposure can vary substantially, leading to a wide range of risk-return profiles. Security Selection funds are primarily, though not exclusively, equity-based.

There are four distinct Security Selection investment processes:

- *Long Bias* seeks to maintain a net long exposure to the market.

- *No Bias* seeks cash or beta neutrality and is considered to have a very small or no net market exposure.

- *Short Bias* seeks to maintain a net short exposure to the market.

- *Variable Bias* seeks to be more opportunistic about net market exposure, and has no intention to remain neutral or to maintain a particular directional bias.

Security Selection managers differ from Merger Arbitrage managers because Security Selection managers do not consistently focus on mergers for opportunities.

4.4.1.4. SPECIALIST CREDIT

Specialist Credit seeks to lend to credit-sensitive issuers. The investment advantage comes from the manager’s ability to perform a high level of due diligence and to take advantage of what the manager
discerns to be relatively inexpensive securities. The securities may be inexpensive due to regulatory anomalies or other constraints on traditional lenders.

There are three distinct Specialist Credit investment processes and one Multi-Process category:

- **Long-Short Credit** seeks to take exposure to credit-sensitive securities, long and/or short, based upon credit analysis of issuers and securities, and credit market views.
- **Distressed Securities** seeks to invest in companies suffering financial distress. They seek capital appreciation and do not focus on the high-yield nature of the assets.
- **Private Placements** seeks to make short-term private placements in listed companies, usually via US Regulation D. This regulation allows small firms to raise capital very quickly and relatively cheaply and the managers aim to benefit from free equity options embedded in the financing transaction.

4.4.1.5. **MULTI-PROCESS GROUP**

Multi-Process Group comprises funds which practice a strategy whereby a single investment process does not account for more than 80% of their risk capital. Although gradual shifts may occur over time in response to economic or market trends, these funds tend to have relatively stable allocations to a combination of processes, e.g., 50% Arbitrage and 50% Statistical Arbitrage.

- **Event-Driven** encompasses a combination of investment processes targeting securities which experience a change in valuation due to corporate transactions. For instance, a strategy focusing on acquisitions and bankruptcies combines elements of two investment processes: the merger arbitrage and distressed securities.

4.4.2. **ASSET CLASS**

Asset class describes the broad categories of securities in which a fund makes investments. There are five asset class category designations, with distinct risk-return characteristics: Equity, Convertibles, Fixed Income, Commodities, Currencies, and Diversified.

- **Commodities** are physical commodities and exchange-traded and OTC physical commodity derivatives.
- **Convertibles** are securities convertible into the equity of their issuer; these include convertible bonds, convertible preferred, warrants and other hybrid equity-linked securities.
- **Currencies** are currencies and derivatives traded on exchanges or in the OTC market; these include spot and forward transactions, currency futures and options.
- **Equity** is defined as equity securities and derivatives thereof; these include common shares, preferred shares, ADRs, GDRs, contracts for differences, share options, equity index futures and options.
- **Fixed Income** includes bonds, money-market instruments, and other debt of a variety of issuers with different types of risk. These include sovereign bonds, government-sponsored, investment grade and high yield corporates, asset-backed and mortgage-backed securities, as well as options and futures.
4.4.3. **Geography**

Geography describes where the fund’s return-generating investments originate, typically the home market of the company issuing the securities. The MSCI Hedge Fund Classification Standard uses a first level of separation between Developed and Emerging Markets and one Global category. Similar to other MSCI indices, the Developed Markets and Emerging Markets areas can be organized into several regions.

- *Developed Markets* (encompassing Europe, North America, Japan, Pacific ex Japan)
- *Emerging Markets* (encompassing Europe, Middle East and Africa (EMEA), Asia Pacific, Latin America).
- *Global* (encompassing Developed and Emerging Markets, with the regional groupings of Europe, Asia, Asia Ex-Japan)

4.5. **Secondary Characteristics**

To provide additional accuracy in strategy definition, secondary characteristics may be used in combination with the three primary characteristics discussed above. These secondary characteristics are discussed below.

4.5.1. **Industry Focus: GICS Sectors**

Some hedge fund investment strategies involve specializing in securities from particular industries or economic sectors. This characteristic provides a means of identifying funds that have a particular industry focus, and typically only applies to equity-based strategies. The MSCI Hedge Fund Indices will use the Sectors of the Global Industry Classification Standard (GICS) developed by MSCI and Standard & Poor’s as Industry Focus designations. Funds without a distinct GICS focus fall into the “No Industry Focus” category.

4.5.2. **Fixed Income Focus**

Some hedge fund investment strategies involve specializing in fixed income securities from particular sectors. This characteristic provides a means of identifying funds that have a particular fixed income sector focus, and applies only to fixed income-based strategies. The classification includes six areas in Fixed Income—related to those represented in the MSCI Fixed Income Indices—that typically correspond to specialized hedge fund strategies. Funds without a distinct Fixed Income focus fall into the “No Fixed Income Focus” category.

4.5.3. **Capitalization Focus**

Capitalization Focus designates strategies that specialize in selecting investments in issuers of a particular market capitalization range. For example, a hedge fund may choose to specialize in small-cap stocks, or avoid them, based on a view of the manager’s experience, perceived efficiency and research coverage available in this sector. This characteristic provides a means of identifying funds that have a particular capitalization focus, and typically only applies to equity-based strategies. The capitalization buckets are as follows. Companies below US$1.5 billion in market capitalization define Small Cap. Mid Caps are companies in the range between US$1.5 and US$6.0 billion and Large Caps exceed US$6.0 billion in market capitalization. Funds without distinct capitalization focus fall into the “No Size Focus” category.
4.5.4. ADDITIONAL GRANULARITY
Wherever appropriate, additional categories that allow for more granularity may be created. For instance, in the case of Systematic Traders, an additional dimension—Investment Time Horizon—may be introduced to reflect an important distinction for systematic trading strategies. The indices at the granular level would then offer a tool for comparison between long-term and short-term systematic trading strategies in addition to other relevant characteristics.

4.6. DEFINING FUND STRATEGY
The fund classification process begins with the categorization of the strategy – or the strategies, if there is more than one – pursued by the fund. The identification of the strategy is made on the basis of the three primary characteristics of investment process, asset class and geographic region, with investment process being the dominant characteristic.

For each strategy, a fund manager will specify the investment process, and to the extent relevant, the asset class and the geographical region according to the various categories described above. The determination of the asset class and the geographical region is made on the basis of the Primary Investments. Primary Investments are investments or positions intended to produce return, as opposed to hedges intended to reduce risk. (For example in a Convertible Arbitrage strategy the positions held in equities would not be Primary Investments because they are held to offset the equity exposure implicit in the convertibles.) In principle, assigning a fund to more than one asset class or more than one geographical region would lead to the definition of a separate strategy within a fund.

If a fund has only one strategy, the designation of the strategy will be used for the final classification of the fund. If a fund has more than one strategy, the fund will be classified within the strategy where at least 80% of the fund capital is being risked. This is capital risked before taking the fund’s leverage into account, as opposed to the gross market values of positions because different strategies may use very different amounts of leverage for each dollar risked.

If this condition is not satisfied, then the fund has either a variable or a multi-strategy approach. Its strategy will then be designated by the most appropriate combination of investment process (process, multi-process, or multi-process group), asset class (including diversified) and geography (including diversified).

In the following example, some potential strategy classifications are listed. In some cases, although specified, asset class and geographical region are not relevant distinctions of a strategy. This may be either because a given strategy by its nature can be exercised only within a single asset class or region, or because by definition there is no concentration in any particular asset class or region. For instance, Tactical Allocation cannot be confined to any asset class or region and will thus automatically be assigned to the diversified and global categories, respectively.

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Process</th>
<th>Asset Class</th>
<th>Region</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Merger Arbitrage</td>
<td>Equity</td>
<td>Europe</td>
</tr>
<tr>
<td>B</td>
<td>Tactical Allocation</td>
<td>Diversified</td>
<td>Global</td>
</tr>
<tr>
<td>C</td>
<td>Private Placements</td>
<td>Equity</td>
<td>Developed</td>
</tr>
</tbody>
</table>
Likewise, Secondary Characteristics may be assigned, when appropriate, provided more than 80% of risk capital is allocated to a specific sector or capitalization size.

**4.6.1. EXAMPLES OF FUND CLASSIFICATIONS**

The following are some examples of how a strategy and the corresponding fund are defined within the MSCI Hedge Fund Classification Standard.

1) Total assets in a given fund amount to $100, all of which is invested in a global convertible bond strategy. The geographical split is 50% US, 30% Japan and 20% Europe, and there is no intention to change this split in the foreseeable future.

   In this case, the manager’s fund classification has the following characteristics: the investment process is Arbitrage, the asset class is Convertibles and the region is Developed Markets.

2) Another fund has total assets of $100, of which $75 is invested in risk strategies, while the remainder is allocated to risk-free treasury securities. Of the $75, which constitutes the fund’s risk capital, 86% or $65 is run under a US Merger Arbitrage strategy, while 14% or $10 is invested in Statistical Arbitrage in Europe. Based on the allocation of risk capital the fund’s primary strategy is Merger Arbitrage – Equity – North America and its secondary strategy is Statistical Arbitrage – Equity – Europe.

   In this case, the manager’s fund classification has the following characteristics: the investment process is Merger Arbitrage, the asset class is Equity and the region is North America.

3) A third fund has total assets of $100, of which $40 is invested in Private Placements, Equity, Global Markets, $40 in Long Bias, Fixed Income, North America and the remainder is held in cash. The fund’s risk capital, then, is $80, with a 50% split between two strategies. The fund does not have a distinct primary strategy, but follows a combined approach.

   The fund’s classification is Multi-Process group – Diversified – Global.

4) Lastly, a fourth fund has total assets of $100, 50% of which is invested in Merger Arbitrage in the US and 50% in Convertible Bond Arbitrage in the US.

   This fund has a Relative Value Multi-Process primary strategy, as more than 80% of its risk capital is allocated to strategies within that Process Group. The fund’s classification is Relative Value – Multi-Process – Diversified – North America.
V. INDEX DESIGN

The MSCI Hedge Fund Indices are designed in a manner that allows the qualified user to view hedge fund performance from a number of different perspectives. Specifically, users are able to view indices that track subsets of the database that fit particular investor criteria. For this purpose, MSCI constructs indices that reflect different constituent weighting schemes, different size-based families, and different domiciles. At the heart of the overall index design is the structure that aggregates indices from the lowest level of granularity up to the most comprehensive composite. This structure is outlined below, and illustrated on the following page.

5.1. INDEX STRUCTURE

MSCI provides hedge fund indices at four levels of aggregation:

- At the most granular level, strategy indices are produced for all relevant strategies having an adequate number of funds represented. These indices provide the most appropriate and relevant peer-group benchmarks.
- The investment process indices constitute the next level of coverage, with aggregations of all strategies belonging to an investment process.
- The process group indices combine similar investment processes.
- Finally, hedge fund composite indices offer the broadest coverage by aggregating funds belonging to all five process groups.

The application of the proposed structure is shown on the next page for the Relative Value Process Group. In this example, the asset class is a key dimension in defining Arbitrage strategies. Therefore, it will be
meaningful to have separate indices for Fixed Income Arbitrage and for Convertible Arbitrage, and also to have a further geographical breakdown, e.g. “Convertible Arbitrage, North America”. In other cases, however, some breakdowns by asset class or region may not be meaningful.

5.2. CONSTITUENT WEIGHTING

MSCI believes that in the hedge fund arena, equally weighted indices may prove to be more appropriate for most applications than asset weighted indices. Due to this fact, MSCI provides an equally weighted index figure at every level of index aggregation. Asset weighted figures, on the other hand, are provided only at the higher levels of index aggregation, where the difficulties in constructing asset weighted indices are believed to be mitigated by the representation of a greater number of funds.
Equally weighted indices may prove to be more robust at the strategy level than asset weighted indices given the realities of hedge fund reporting. First, an asset weighted index is likely to be more susceptible to the disproportionate effects that a specific fund might have in instances in which it reports its performance figures after the index calculation date, or reports inaccurate results. Peer group indices constructed with an asset weighted methodology may have potentially serious disruptions when the returns of large constituents are not supplied or found to be in error. In addition, because some large funds choose not to report to public databases, it may be difficult to interpret an asset weighted figure that does not include them.

5.3. INDEX FAMILIES
The index structure that is outlined above may be applied to different subsets of the hedge fund data set based on either fund size or domicile. The series of indices that are created from such differentiation are called index families.

5.3.1. SIZE FAMILIES
MSCI provides three families of hedge fund indices based on fund size.

5.3.1.1. BROAD INDEX FAMILY
The Broad Index Family aims to include all funds in excess of $15 million. These indices contain all Core and Small funds, as defined below. The broad indices represent 50% of funds and 90% of assets in the MSCI Hedge Fund Database.

5.3.1.2. CORE FUND INDEX FAMILY
The Core Fund Index Family is designed to represent the hedge fund investment opportunities most relevant to institutional investors. These indices cover the larger funds, defined as having at least $100 million under management within a given strategy. The minimum fund size is not dependent on strategy, process, geography or asset class.

5.3.1.3. SMALL FUND INDEX FAMILY
The Small Fund Index Family is designed to represent the group of funds with assets between $15 million and $100 million.

5.3.2. DOMICILE FAMILIES
Investors in different taxation regimes and regulatory environments often face divergent opportunity sets. To address their needs, MSCI also produces “offshore only” and “onshore only” indices comprising only funds domiciled in, respectively, offshore and onshore tax regimes. MSCI considers US domiciled funds to be onshore funds.
VI. INDEX MAINTENANCE

MSCI seeks to ensure that each hedge fund index remains aligned with its definition over time. Outlined below are MSCI’s policies on maintaining data integrity, index calculation timeline, and implementing index changes.

6.1. DATA INTEGRITY

MSCI relies only on primary sources of data, i.e., the hedge fund managers. MSCI intends in time to develop relationships with administrators in order to improve timeliness of performance and asset value reporting, but will always insist on manager validation of data used in the product. Each participating organization enters into a legal agreement with MSCI and agrees to use its best efforts to provide MSCI with accurate data. Data is received on a monthly basis via a secure web-based application supplied by MSCI, which facilitates swift and accurate procurement of data. Changes to classification data and other data within the database can be communicated via this tool, allowing MSCI to receive and review these changes.

MSCI employs thorough data integrity checks and queries potential anomalous returns with the manager. MSCI has attempted to understand the differences in policies relating to the different methods used by managers to calculate fund returns in order to establish consistency in these methods. To this end, MSCI will recommend preferred methods to be employed in data submission as it identifies or is informed of industry best practice where several methods may exist. An example of such a recommendation can be found in Appendix III: Estimating Net of Fees Performance.

Complete records of returns and asset values are required for all months since inception for all funds in the database. Case by case exceptions may be made to this rule in circumstances in which MSCI believes that there is a reasonable basis to do so. Any such exceptions will be clearly flagged at the fund level.

6.2. INDEX CALCULATION TIMELINE

Index performance will be calculated three times for each month. The first calculation, termed the “Estimate”, will be produced between the end of the trading month (M₀) and the end of the following month (M₁). A second calculation will be produced at the end of the following month (M₂). The final calculation, termed the “Final”, will be produced at the end of the subsequent month (M₃). For example, the final calculation for performance in the month of January will be produced at the end of March. In rare circumstances, index performance may be postponed in cases where an insufficient number of funds have reported performance results.

6.3. INDEX COMPOSITION CHANGES

6.3.1. FUND ADDITION AND MIGRATION

Funds will be added to and managed within size based families as follows:

1. Newly participating funds in the MSCI database, which meet the inclusion eligibility requirements will be added to all pertinent indices. Such funds may be newly formed or relatively established.
2. Funds with capital which has grown to exceed $15 million will be added to the Small and Broad families. Funds with capital that has grown to exceed $100 million will be added to the Core family.

3. The migration of funds that have experienced a decrease in capital will be managed through the use of buffer zones, which are designed to minimize turnover.
   i. Funds that have experienced a decrease in capital to less than $85 million will be transferred from the Core index series to the Small index series. These funds will remain in the Broad index series.
   ii. Funds that have experienced a decrease in capital to less than $10 million will be excluded from both the Small and the Broad index families.
   iii. Funds may remain in a buffer zone ($10 million to $15 million or $85 million to $100 million) for up to 12 months before they are removed from a respective index.

6.3.2. FUND CLASSIFICATION CHANGES

MSCI monitors the classifications of all funds in the Hedge Fund Database. When a fund changes its primary strategy, it will be reclassified and its subsequent index membership will be updated to reflect its new strategy. The fund’s prior track record will remain in the index history for the strategy in which it was generated.
APPENDIX I: INVESTMENT PROCESS DEFINITIONS

1. **Directional Trading**

Directional Trading strategies are based upon speculating on the direction of market prices of currencies, commodities, equities, and bonds in the futures and cash markets. Typical investment horizons vary considerably, but a key characteristic of all the strategies is that managers can quickly reverse their market view as they see a situation unfold. Some traders rely on model-based systems to generate buy and sell signals. Others use a more subjective approach, ultimately relying on their own discretionary judgment in implementing trades. The investment processes used by Commodity Trading Advisors (CTAs) are generally included within Directional Trading (under Systematic Trading).

1.1. **Discretionary Trading**

Discretionary traders seek to opportunistically participate in price changes of the market or security in which they trade, regardless of what is driving the price action. Short-term supply and demand factors are often analyzed in order to anticipate short-term price direction. Discretionary traders may use fundamental analysis or technical analysis or a combination of both to identify profitable trades.

Portfolio turnover is often very high, with positions being held for short periods of time. Though their positions are generally unhedged, Discretionary Traders often have a disciplined approach to risk management, e.g., significant use of stop-losses, and capital allocation rules.

The key difference between Discretionary Trading and Systematic Trading is that Discretionary Trading fund managers use their discretion to make the final investment decision, and include qualitative assessments. The main difference between Discretionary Trading and Security Selection is that position selection for Discretionary Trading is not necessarily based on finding mispriced securities or fundamental security valuation.

A hedge fund investment approach is Discretionary Trading if the profitability of trades is based upon participation in market-driven price action, as opposed to security valuation, and the manager is willing to take a position, where there is opportunity, either long or short.

1.2. **Systematic Trading**

Systematic traders use rule-based trading models implemented in a systematic fashion to identify trading opportunities, usually in the futures and currency markets. The models may also determine the size of positions and the risk control. The models are designed to track movements in asset prices and look for recurring patterns in the behavior of the prices, or to pick up the leading indicators that will dictate broad price movements. Most systems traders implement trend-following systems, though a significant number implement fundamental models designed to forecast future movements. Portfolios tend to contain a diverse range of assets by market and geography although trading is limited to the most liquid instrument in the asset class, e.g., exchange-traded futures contacts for most commodities.

Systematic Trading differs from Statistical Arbitrage in that each position is essentially an independent directional (or intermarket) trade intended to produce a profit. By contrast, Statistical Arbitrage is based upon building market neutral portfolios in which the profit or loss of an individual position is unimportant; the portfolio performance is generated from the relative outperformance of longs versus shorts.
A hedge fund investment approach is Systematic Trading if positions are opened and closed primarily on the basis of systematic models, and manager intervention is limited to selecting trades and applying risk management disciplines.

1.3. Tactical Allocation

Tactical Allocation is a process of opportunistically allocating capital among a wide range of strategies and markets, often to the extent that a sizeable portion of the portfolio is allocated to a single opportunity or theme. The strategies or themes that may be allocated to can be directional or non-directional, traditional or hedged. There is little that is outside the investment brief of this process. The nature of Tactical Allocation is such that it is often practiced by the largest funds in the industry (often referred to as Global Macro), as increasing size often leads to diversification of approach and a necessity to move capital to where opportunity is perceived. This also typically means that the most liquid markets and opportunities are sought.

Traders often take a top-down, thematic approach to investing and are typically opportunistic in nature, moving between economies, markets and instruments based on the manager’s forecasts of changes in factors such as interest rates, exchange rates and liquidity.

Tactical Allocation differs from other hedge fund processes in that it is a top-down, thematic approach to investing and the implementation can be in any process, without limitation. Tactical Allocation strategies tend to maintain research and execution capabilities pertaining to several investment processes but they shift capital among them to rapidly take advantage of opportunities wherever they are perceived. For instance, an approach stemming from a single investment process but changing its relative allocation based on the view of the manager, who then has a choice of instruments to express this view, is characterized as Discretionary Trading. A Tactical Allocation fund, on the other hand, relies on multiple profit centers or processes and allocates capital among them.

An approach is considered Tactical Allocation if capital is allocated to a number of different trading strategies opportunistically in response to identified opportunities, and the manager is willing to take a position, where there is opportunity, either long or short.

2. Relative Value

Relative Value strategies focus on spread relationships between pricing components of financial assets or commodities. They seek to avoid assuming any outright market risk, although spread risk may be significant. Frequently they employ mathematical and statistical techniques and models to identify and hedge a Relative Value trading opportunity, particularly where hedging requires frequent trading in order to maintain market neutrality.

The opportunities being exploited typically have relatively low risk and commensurately low return, so many managers use leverage to amplify the returns to attractive levels. Managers aim for market neutrality and actively hedge risks using a variety of instruments.

2.1. Arbitrage

Arbitrage focuses on capturing movements or anomalies in the price spreads between related or similar instruments. The rationale for Arbitrage trades is the ultimate convergence of the market price relationship to a known, theoretical or equilibrium relationship.
The particular assets in which trades are made, and their pricing peculiarities, make the implementation very different depending on the choice of asset class. The assets most frequently traded include Convertibles, Equities, and Fixed Income.

Returns are generated from elimination or partial elimination of the pricing anomalies, and there may also be significant positive carry from the trades. Typically spreads are narrow and returns are marginal, and leverage is often used to amplify these small returns to attractive levels, especially when the expected downside of positions is relatively low. Because many funds rely on borrowing, strong sources of financing and ample lines of credit are crucial to the implementation of this process. A typical example of Arbitrage is Convertible Arbitrage.

Convertible Arbitrage involves taking positions in convertible bonds and hedging the equity risk. This strategy is employed in situations in which the manager discerns that the market price reflects a lower level of stock volatility than the manager anticipates will actually be the case for the underlying stock over some specific time horizon. This means that the manager anticipates the convertible bond to be more valuable than its current market price. The equity risk is hedged by shorting the underlying stock to realize a profitable cash flow as the stock’s price changes. The hedging process, in effect, realizes the cheapness of the convertible bond. The credit risk of the convertibles is either explicitly hedged, or actively mitigated (either by investing in a very diversified portfolio of convertibles, or by finding convertibles with high hedge ratios trading far above their bond floor, thus having little or no credit spread risk).

A hedge fund investment approach is considered to be Arbitrage if each position in the portfolio attempts to isolate and capitalize upon a feature of an asset or combination of assets which is mispriced according to theoretical fair value (a position may be made up of several assets but is designed to capture a single pricing element), and all pricing factors other than the identified element are fully hedged or managed, first within the position and then also within the portfolio overall.

2.2. MERGER ARBITRAGE

Merger arbitrageurs seek to capture the price spread between current market prices of securities and their value upon successful completion of a takeover, merger, restructuring or similar corporate action. Normally, the principal determinant of success of a merger arbitrage trade is the consummation of the transaction. Typically, Merger Arbitrage managers wait until a merger is announced before taking a Merger Arbitrage position; they do not generally speculate on stocks that are expected to become takeover targets, or trade in instruments that are mispriced relative to others.

In mergers involving an offer of stock in the acquiring company, the spread is the difference between the current values of the target company stock and the acquiring company stock. Capturing this spread typically involves buying the stock of the target company and shorting an appropriate amount of the acquiring company's stock. In straight stock-for-stock deals, the relationship between the two companies’ stock prices is linear. In collared stock-for-stock transactions, the cash value of the amount of stock to be exchanged within the transaction has upper and/or lower limits. This means that the relationship between the two companies’ stock prices is non-linear, and the manager will often make use of options or actively manage the short stock position to retain an appropriate hedge. The probability of success directly influences the size of positions, as realizing a profit from the trade relies on success of the merger.

In mergers involving cash-only transactions, the spread is the difference between the current market price and the offered price. Capturing the spread in these transactions is possible by just purchasing the stock of the target company; the manager may or may not take a short position in the stock of the acquiring company.
A hedge fund investment approach is considered Merger Arbitrage if at least 80% of positions not based upon cash deals are entered into in a hedged manner, replicating the contemplated transaction (e.g., in a stock for stock deal, the trade is long the stock being purchased in the transaction and short the stock being received in the ratio the transaction will pay out).

2.3. **Statistical Arbitrage**

Statistical Arbitrage is a model-based investment process, which aims to build long and short portfolios whose relative value is currently different from a theoretically or quantitatively predicted value. The investment process is systematized, but implementation may differ substantially in terms of the underlying models and the frequency of trading.

The models are central to Statistical Arbitrage and serve two purposes. First to identify securities (individually or in baskets) that are mispriced against an internal benchmark, and second to construct a portfolio which is market neutral. All models assume that the time series involved (representing an individual security’s price or fundamental data, or other market data, or a group of similar securities) contain information relevant to the future performance of the security that has not been discounted in the current market price. The methodologies used to identify this information are quantitative and trading is generally automated. The portfolio performance depends on future security prices converging to model equilibrium prices.

Statistical Arbitrage differs from Arbitrage because perceived mispricing is not so readily identifiable or based on economic fundamentals and the price of the security is measured against an internalized and often abstract model-driven benchmark. In the case of Arbitrage the benchmark is external, such as the market price of a similar security (e.g., the price of an off-the-run treasury against the price of an on-the-run treasury); or the theoretical price of the security (e.g., the present value of the defined cash flows of a bond).

Statistical Arbitrage differs from No Bias Security Selection because Statistical Arbitrage involves systematically finding portfolios of securities whose overall relative valuation is different from forecast future values. No Bias Security Selection is based on finding individual securities (or sectors) which are expected to appreciate or decline in absolute value, and does not involve a systematized process.

A hedge fund investment approach is considered to be Statistical Arbitrage if positions are entered into on the basis of systematic models designed to find opportunities where the relative value of two or more assets is currently different from a theoretically or quantitatively predicted value.

3. **Security Selection**

Security Selection managers combine long positions and short sales with the aim of benefiting from their ability in selecting investments while offsetting systematic market risks. Market exposure can vary substantially, leading to a wide range of risk and return profiles. Security Selection funds are primarily, though not exclusively, equity-based.

Managers attempt to find opportunities that they consider to be undervalued and overvalued, and then buy and sell positions appropriately before the market reacts to the mispricing. In general, managers seek to generate positive returns in any market environment by hedging their portfolios, but some managers maintain significant market exposure to reflect their view of anticipated market direction.

While some managers use short sales only to reduce market exposure, others seek to generate positive returns from both long positions and short sales. Managers may attempt to remove all market exposure by balancing long positions and short sales to achieve cash or beta neutrality, or deliberately maintain market
exposure and use short sales to reduce net exposure to desired levels. Managers also may take views regarding the future direction of individual sectors and the overall market, and their portfolios will be structured to take advantage of these expectations. The portfolio’s net market exposure may also be managed using financial derivatives.

3.1. **Long Bias**

Long Bias portfolios have net long exposure to the underlying market in all conditions. These funds do not have zero betas to the overall market (they are not market neutral), but they are generally aiming to provide a higher beta in rising markets and a lower beta in falling markets. The fund’s portfolio must be at least partially hedged or use short sales to be considered Long Bias, as long-only investment strategies are not hedge fund strategies (due to the absence of hedging) and are beyond the scope of the Hedge Fund Indices. A typical long biased manager may hold $80 of long positions and $20 of short positions for each $100 invested.

A fund is considered Long Bias if the portfolio’s average net exposure over any 90-day period is always positive, the portfolio is never intentionally more than 10% net short at the end of any trading day, and shorts (either stock or derivatives) representing greater than 10% of portfolio net assets are used in any 90-day period.

3.2. **No Bias**

No Bias managers are trying to generate the majority of their returns purely from their security selection and sector exposure processes. They differ from Statistical Arbitrage managers by using a bottom up approach to selecting positions, with each position having individual investment merit. A portfolio has No Bias if it consistently has a near-even balance between long and short positions.

A typical No Bias equity manager may run $50 of long positions and $50 of short positions for each $100 invested. They are generally either dollar or beta neutral, though they can range up to 20% long or short biased for brief periods. Some may leverage their assets considerably, but are still considered No Bias due to the level of their net exposure.

A hedge fund investment approach is considered No Bias if the average portfolio net exposure measured over any 90-day period is between 20% short and 20% long and the portfolio net exposure is never intentionally more than 50% long or 50% short at the end of any trading day.

3.3. **Short Bias**

Short Bias portfolios maintain a significant net short market exposure. Short Bias managers specialize in short selling opportunities, and are not necessarily bearish about the market. Few will use leverage and most have large cash positions from the proceeds of short selling. This designation also includes short-only funds, where the portfolio is not required to contain any long positions.

A typical Short Bias manager will hold $100-$120 of short positions and $0-$40 of long positions for each $100 of capital. And the portfolio’s average net exposure over any 90-day period will always be negative.

3.4. **Variable Bias**

Variable Bias is the designation for Security Selection funds that do not conform to a constant specific market exposure, but are still focused on individual security selection. Some Variable Bias managers will alter the fund's market exposure dramatically in response to perceived opportunities, moving from a large net long position to substantially net short within a short period of time. They are generally looking to "time" the market and make money from both their timing ability and their security selection skill. Others
will allow their net market position to be dictated by the balance of security and sector ideas they have. In Variable Bias shorts (either securities or derivatives) representing more than 10% of portfolio net assets are used in any 90-day period.

3.5. **Note on Measuring Net Exposure**

In classifying Security Selection funds into the various biases, the net market exposure should be considered. Net market exposure should be measured by determining the difference between the gross long and gross short exposures. For classification purposes, the gross market exposures should be calculated on a beta-adjusted basis, i.e., the market exposure of a position is the product of the value of the investment and the beta of the investment. Futures should be valued at face value, and options should be valued at face value multiplied by their delta. The historical net market exposure over the last two years, as well as future expectations, should be examined when classifying the fund’s process as Long Bias, No Bias, Short Bias or Variable Bias.

4. **Specialist Credit**

Specialist Credit seeks to lend to credit-sensitive (generally below investment-grade) issuers. The investment edge comes from the manager’s ability to perform a high level of due diligence and to take advantage of what the manager discerns to be relatively inexpensive securities. The securities may be inexpensive due to regulatory anomalies or other constraints on traditional lenders (e.g., speed of decision-making process, disclosure rules). Because hedge funds pursuing this approach are generally providing credit in some form, it may be difficult to distinguish them from private equity investors and other non-hedge fund credit providers.

Returns are generated from credit-sensitive investments through capital appreciation, positive carry, or both. Among the distinguishing features of Specialist Credit managers are the high level of due diligence performed, timing of investments and assumption of credit risk. Additionally, credit sensitivity may offer managers opportunities to negotiate extremely favorable terms.

4.1. **Distressed Securities**

Distressed Securities funds invest in the securities of firms in or near bankruptcy. Bankrupt firms will typically have defaulted on their debt and may have also filed for protection from their creditors under bankruptcy laws. Firms near bankruptcy may be approaching these situations through severe operating and/or financial difficulties. Investors in Distressed Securities are seeking capital appreciation rather than high yields.

Distressed Securities managers differ from each other in terms of the level of the capital structure in which they invest, the stage of the restructuring process at which they invest, the degree to which they become actively involved in negotiating the terms of the restructuring, and the level of diversification and strictness of the risk management disciplines employed.

4.2. **Long-Short Credit**

Long-Short Credit funds take exposure to credit-sensitive securities, long and short. Trades are based around credit analysis of the issuer and security, and may incorporate credit market views, and may be based either on anticipated price movement or positive carry. The manager assumes credit risk either long or short as a core part of the investment strategy, but interest rate risk is not a significant exposure, being either explicitly hedged or simply far less significant than credit risk.
4.3. **Private Placements**

Private Placements managers make short-term or medium-term privately placed investments typically issued by companies that are in need of rapidly available capital. The private placement is usually explicitly or implicitly hedged to protect its price from direct equity market risk. In the United States markets the private placement is primarily implemented through Regulation D. These deals typically involve investment in debt instruments with a significant equity “kicker”, usually in the form of free options to buy the company’s stock at a low price. An example would be a “floating convertible” instrument, which the holder is able to convert into the underlying equity at a guaranteed discount to the company’s price after a minimum holding period.

An approach is Private Placements if positions consist of structured privately placed securities, with any market price risk hedged (possibly dynamically) with a portfolio of publicly listed securities, investments are in listed companies, and 80% of positions are hedged against direct equity market risk.

5. **Multi-Process Group**

The Multi-Process Group comprises funds, which practice a strategy whereby a single investment process does not account for more than 80% of their risk capital. Although gradual shifts may occur over time in response to economic or market trends, these funds tend to have relatively stable allocations to a combination of processes, e.g. 50% Systematic Trading and 50% Statistical Arbitrage.

By contrast, Tactical Allocation strategies tend to maintain research and execution capabilities pertaining to several investment processes but they shift capital among them to rapidly take advantage of opportunities wherever they are perceived.

To add granularity to this category, certain combinations of investment processes may be identified as sub-categories of multi-process group, such as Event-driven.

5.1. **Event-Driven**

Event-Driven encompasses a combination of investment processes targeting securities which experience a change in valuation due to corporate transactions. For instance, a strategy focusing on acquisitions and bankruptcies combines elements of two investment processes: Merger Arbitrage and Distressed Securities.

In general, the triggers are announced events and may include mergers and acquisitions, bankruptcy announcements, proxy battles, corporate restructurings, spin offs, litigation outcomes, leveraged buyouts, share buybacks, leveraged recapitalizations. The decision making process typically involves assessing the expected return of an investment in relation to the probability of the event occurring.

Pure merger arbitrage funds are separately classified in the Relative Value process group. Event-Driven funds will often have a significant portion in merger arbitrage although it does not exceed 80% of their risk capital. Unlike pure merger arbitrage, participation in other event driven transactions may involve taking positions of a more directional nature, potentially without a direct hedge.
APPENDIX II: COLLECTING FUND INFORMATION

Managers who agree to participate in the MSCI Hedge Fund Indices will be required to provide both performance and qualitative data on a fund-by-fund basis, as set forth in detail below. While the primary purpose of this information is to enable MSCI to create and manage the hedge fund indices, this information will be included in and distributed via the MSCI Hedge Fund Database and other vendors.

1. GENERAL DATA REQUIREMENTS

1.1. MANAGEMENT COMPANY INFORMATION
Company name, address, city, country, main phone number
Year when first hedge fund was launched
Contact Information

1.2. FUND INFORMATION
Fund name, inception date
Senior portfolio manager name
Data inquiries name, phone, email (not disclosed to subscribers)

1.3. SERVICE PROVIDER INFORMATION
Auditor company name
Prime Broker company name
Custodian company name
Administrator company name

1.4. STRATEGY CLASSIFICATION
Process, asset class, geography
Strategy history maintained over time (significant changes to strategy indicated as they occur – i.e., changes that would impact peer group membership)

1.5. PERFORMANCE
Performance (updated monthly in the form of estimates and final figures), date, latest value (before tax and net of management and incentive fees), value status (estimate or final), fund status (open or closed)

1.6. CAPITAL INFORMATION
Fund capital (capital invested directly in fund), strategy capital (total capital invested in fund’s strategy, including managed accounts), total capital (total capital invested by firm in hedge funds)
2 DATA COLLECTION TIMELINE
Managers are required to provide performance data and capital under management for all funds each month.

2.1 CLOSING DATES FOR PERFORMANCE DATA
There will be two closing dates for performance data, one for estimated performance and one for final performance. The dates are designed to provide a balance between the need to give managers sufficient time to calculate fund performance and the desire to offer subscribers details of index performance as quickly as possible.

2.1.1 CLOSING DATE FOR ESTIMATES
This is the date by which managers are required to report fund performance estimates. This will be specified for each index by MSCI as it is launched; however it will normally be the 14th day after the end of the period to be reported.

2.1.2 FINAL CLOSING DATE
This date is the date by which funds must provide final performance data. This will be specified for each index individually by MSCI upon launch of the indices; it will normally be the 28th day after the end of the period to be reported.

3. RETURNS AND NET ASSET VALUES
Managers can choose whether to supply monthly performance data as a percentage return (Net Return) or a Net Asset Value per share or per unit (NAV). This choice can be made independently for each fund. However, for each fund, the form in which the monthly performance data is supplied must be consistent from month to month and must not change for the entire track record of the fund. If a manager needs to change the form that they use for supplying performance data for a fund, they will need to restate the entire track record for the fund in the new form.

MSCI will store performance data as supplied by the manager.

The Net Return of a fund over a period is defined as the change in the fund’s value over the period, as a percentage of the starting value of the fund adjusted for subscriptions and redemptions, after periodic fees have been charged or accrued.

The Net Asset Value per Share or Unit (NAV) of a fund at any point is the fund’s net assets (net of all fees) divided by the number of shares or units outstanding. NAV is defined only for funds that are divided into shares or units.

Performance data will be required in the fund’s base currency.

3.1 CURRENCY HEDGING OF FUND DATA
Performance data that is required for indices or analysis in currencies other than the fund’s base currency will be converted into the required currency in a manner that assumes that the currency risk is fully hedged.

Under this assumption, the fund is treated as if at the start of each reporting period, an investor entered into a spot transaction to purchase a nominal amount of the currency in which the fund is denominated. The proceeds of this transaction are then invested in the fund for the period. Simultaneously, a forward currency transaction is entered into, selling back the amount of currency purchased into the investor’s required currency. At the end of the reporting period, the investment into the fund is redeemed for cash, the
proceeds of which are used to settle the forward currency transaction; this converts the currency back into the investor’s base currency. Any surplus or shortfall to the amount of currency sold forward is met by entering into a spot transaction, buying currency to meet a shortfall or selling surplus currency.

In this manner, the investment is protected from currency fluctuations, but will be subject to any cost of carry (due to the difference in interest rates in different currencies). However, the profit or loss of the fund over the month is at risk from currency fluctuations.

<table>
<thead>
<tr>
<th>Currency Conversion Formula: The formula for representing returns in a currency other than base is:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Inputs:</strong> Given:</td>
</tr>
<tr>
<td>( R_B ) = Return earned in base currency,</td>
</tr>
<tr>
<td>( FX_0 ) = Spot FX rate (foreign currency/base) at the close of the previous month,</td>
</tr>
<tr>
<td>( FF_0 ) = Forward rate (foreign currency/base) at the close of the previous month,</td>
</tr>
<tr>
<td>( FX_1 ) = Spot FX rate (foreign currency/base) at the close of the current month,</td>
</tr>
<tr>
<td>Where spot and forward rates are the values as published by WM/Reuters at 5.00pm GMT; forward rates are 30-day forward rates.</td>
</tr>
<tr>
<td><strong>Values:</strong> we define:</td>
</tr>
<tr>
<td>( R_F ) = Return earned in foreign currency,</td>
</tr>
<tr>
<td><strong>Equations:</strong> then:</td>
</tr>
<tr>
<td>(1) Currency Conversion Formula:</td>
</tr>
<tr>
<td>( R_F = R_B \times (FX_1 / FX_0) + (FF_0 / FX_0) - 1 )</td>
</tr>
</tbody>
</table>

The formula can be interpreted as the return in the base currency multiplied by the movement of the currency to give the foreign currency value of the return, plus the hedging cost on the principal.

For example, assume a U.S. dollar-based investor wishes to invest $1,000,000 into a fund denominated in Japanese yen. At that point in time, the Yen is trading at a spot exchange rate of USD1 = JPY105.00, so the investor purchases ¥105,000,000, and invests it into the fund for a month. At the same time, the investor enters into an agreement to sell ¥105,000,000 and receive Dollars at the end of the month, at a forward exchange rate of USD1 = JPY104.50. At the end of the month, the Yen has weakened against the dollar, and is now trading at a spot exchange rate of USD1 = JPY115.00.

If the fund had no return that month, at the end of the month the fund value would be ¥105,000,000, which would then be sold to purchase $1,004,784.69 irrespective of the prevailing spot exchange rate. Therefore,
the principal has been protected from currency fluctuations, and appreciates due to the interest rate differential between the currencies. The final USD return to the investor over the month is 0.48%.

If the fund returned 10%, at the end of the month the fund value would be ¥115,500,000. The forward contract would enable the sale of ¥105,000,000 to purchase $1,004,784.69, leaving the profit of ¥10,500,000 to be sold at spot, giving $91,304.35. Thus, the investor's total portfolio value is $1,096,089.04, giving a total return of 9.61%. This figure represents 9.13% fund return and 0.48% due to interest rate differentials. The fund's return has been affected by the depreciation of the Yen, but the principal investment is unaffected apart from the cost of the hedge.

The Indices will be available in currency-hedged versions. Index returns will be hedged into a range of currencies in accordance with the formula provided above.

4. **Classification History**

The classification process defines a fund’s current approach. But it is also necessary to examine the history of the fund’s operations, as the approach may have changed over time. This information is required for the computation of a Historical Performance Estimate for any index in which a fund participates.

Managers are required to certify that the fund's entire track record matches the fund's strategy classification. If there have been changes in the fund's strategy, such that periods of the track record do not match the classification, then for each period when a different strategy was followed the manager is required to state the period and the strategy classification for that period. Each period will be identified as a separate section of the fund’s track record, based on the strategy followed.
APPENDIX III: ESTIMATING NET OF FEES PERFORMANCE

MSCI has asked fund managers to provide performance figures net of both management and incentive fees on a monthly basis. These figures are believed to most accurately represent the return available to investors. However, there is often a discontinuity between incentive fee collection periodicity and reporting periodicity that requires the fund manager to approximate an accrued performance fee in order to arrive at an accurate monthly performance figure. There is currently no identifiable industry standard in performing these approximations.

MSCI recognizes the need to educate both clients and fund managers about this issue. Consultations with industry practitioners have led MSCI to propose a generically constructed algorithm that can be used to calculate fund returns net of an incentive fee in the context of the MSCI indices. The algorithm is available as an interactive tool that fund managers may use in order to approximate monthly performance figures net of incentive fees. The methodology effectively accrues an unpaid incentive fee based on the gross returns, hurdle rate, and high water mark. The net performance is adjusted based on this accrual and supplied by the fund manager. Due to the diverse nature of hedge fund structures, situations may arise in which other methods of incentive fee approximation are necessary. MSCI intends to allow the fund manager to use its discretion to provide the figures that it feels best reflects its performance net of incentive fees.
APPENDIX IV: INDEX CALCULATION MECHANICS

INDEX RETURN

The Index rate of return is the weighted average of the net rates of return of each of the constituent funds in the Index. Weights are equal for equally weighted indices and proportional to the fund capital under management for capital weighted indices.

For equal weighted indices, the weight for each fund is set to unity, and any funds ran pari passu with another fund are removed. This simulates an investment in an equal-weighted portfolio with monthly rebalancing. Equally weighted indices provide a performance measure for an investor who does not attempt to allocate his capital based on fund size.

For capital weighted indices, the weight for each fund is set to assets under management, and duplicates are not removed. This simulates an investment in a portfolio with amounts proportional to the size of each fund. Asset weighted indices provide a performance benchmark for the entire capital invested in that strategy.

Index Return Calculation Algorithm

The following algorithm is used to calculate index return, given the returns for each member fund. Weighting of fund returns depends on the weighting method used for the Index. The algorithm consists of inputs, calculated values and a series of equations.

Inputs  Given:
\[ r_{i,j} = \{\text{Return for fund } i \text{ over period } j \text{ in the currency of denomination of the index}\}, \]
\[ n = \{\text{Number of funds in index}\}, \]
\[ A_{i,j} = \{\text{Fund capital under management for fund } i \text{ at the end of period } j-1\}, \]

Values we define:
\[ w_{i,j} = \{\text{Weight for fund } i \text{ at the start of period } j\}, \]
\[ R_j = \{\text{Return for index over period } j\}, \]

Equations

then:

(1) Equal weighted index: Initial fund weights are set to unity:
\[ w_{i,j} = 1 \]

OR

Asset weighted index: Initial fund weights are set to fund capital under management at the end of the prior period:
\[ w_{i,j} = A_{i,j} \]

(2) Return is calculated as the sum of the funds’ weighted returns, divided by total portfolio weight. This formula applies to both equal weighted and asset weighted indices:
\[ R_j = \frac{\sum_{i=1}^{n} w_{i,j} r_{i,j}}{\sum_{i=1}^{n} w_{i,j}} \]
**INDEX VALUE**

The index value will normally be set to 100 upon launch. Then, each time index return is calculated, the index value will be changed by the amount of the return.

<table>
<thead>
<tr>
<th>Inputs</th>
<th>Given:</th>
</tr>
</thead>
<tbody>
<tr>
<td>( I_{i-1} )</td>
<td>{Index Value for the period prior to period i, or the Initial Index Value if ( i = 1 ),}</td>
</tr>
<tr>
<td>( R_i )</td>
<td>{Return for index over period i},</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Values we define:</th>
</tr>
</thead>
<tbody>
<tr>
<td>( I_i )</td>
</tr>
</tbody>
</table>

**Equations**

\[ I_i = I_{i-1} + (I_{i-1} \times R_i) \]
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