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HEDGE FUND ADVISORY
Your Strategic Partner in Hedge Fund Investing

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HENNESSEE HEDGE FUND REVIEW®

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	DEC	YTD
HENNESSEE HEDGE FUND INDEX	+2.13%	+8.27%
S&P 500 (DRI)	+3.40%	+10.87%
LONG/SHORT EQUITY*	+2.65%	+8.44%
ARBITRAGE/EVENT DRIVEN**	+1.65%	+7.98%
GLOBAL HEDGE FUNDS	+1.64%	+8.03%

PERCENTAGE OF LONG/SHORT EQUITY MANAGERS OUTPERFORMING THE:	DEC	YTD
S&P 500 (DRI)	26%	44%

TOP (3) PERFORMING:	DEC		YTD
Telecom & Media	+4.37%	Distressed	+18.53%
Healthcare & Biotech	+4.28%	Latin America	+16.63%
Latin America	+3.39%	Regulation D	+16.35%

BOTTOM (3) PERFORMING:	DEC		YTD
Short Biased	-5.43%	Short Biased	-3.95%
Macro	-0.34%	Convertible Arbitrage	+1.16%
Market Neutral	+0.47%	Macro	+1.47%

* Previously named Correlated

** Previously named Non-correlated

MARKET SUMMARY - DECEMBER 2004

The equity market once again finished the year with a fourth quarter rally, an event that has become standard since 2001. **The S&P 500 advanced +3.40% in December to bring year-to-date returns to +10.87%.**

Hedge funds attempted to keep pace with the strong equity markets in December, although hedging caused them to lag for the most part. **The Hennessee Hedge Fund Index advanced +2.13% in December to bring 2004 returns to +8.27%.** Long portfolios generated the majority of gains, as 2004 proved to be yet another difficult year for short selling. For most funds, the equity rally in the fourth quarter eliminated profits that were achieved on the short side in the first three quarters.. While hedge funds generally underperformed the equity markets in 2004, managers cited the

following reasons for underperformance:

a) Conservative net exposures due to fear of another economic recession and terrorism risk.
b) Low volatility in the market. This has reduced returns for long volatility strategies (options and convertibles) and long/short equity, given that there were fewer extremes to take advantage of.
c) Low interest rates. Short rebates and bond yields are at multi year lows.
d) High correlation and low dispersion of returns among stocks.

The majority of long/short equity funds entered 2004 with their largest net exposures since the beginning of 2000. This was partially a reflection of their confidence in the U.S. economy and corporate earnings growth, but also a function of their inability to generate profits on the short side in 2003. **However, most funds increased short exposure throughout the year, thus lowering net exposure, as a result of a confluence of factors including fear of an economic recession, better short sale opportunities, and heightened risk of terrorism around the U.S. Presidential election.**

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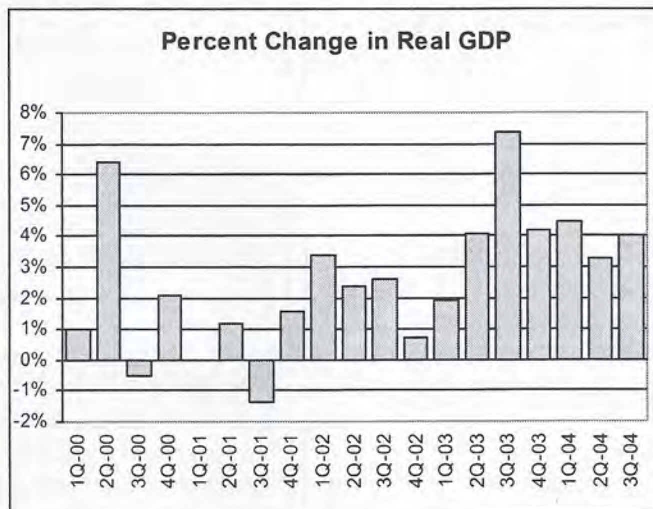
Economic performance during 2004 was mixed. Real GDP growth slowed to 3.5% to 4% from robust growth seen in 2003. Inflation remained mild despite higher commodity prices, as core CPI growth remained below 2%. While the economy did generate 2.2 million jobs in 2004, employment growth failed to live up to the expectations set by previous economic recoveries. Weak employment conditions have likely been caused by corporate productivity growth and outsourcing of jobs to Asia. The U.S. economy drew concern over the summer, as the confluence of high oil prices, lack of job growth, and lack of fiscal stimulus (tax cuts), led to what the Federal Reserve termed a "soft patch" for the consumer. Fortunately, oil prices began their decline at the same time as the Presidential election, leading to stronger economic growth in the fourth quarter and a rally in the equity markets.



In response to healthier economic performance, the Federal Reserve began steps to take back liquidity provided in 2001-2002. **The Fed raised its Fed Funds rate from 1% to 2.25% in 2004, conducted via five successive 25 basis point hikes.** Learning a lesson

from 1994, the Fed took extreme steps to telegraph its moves in an attempt to not alarm the market. However, movement in longer-term maturities was not as predictable. Following three excellent employment reports in March, April and May, the yield on the 10-Year Treasury Note advanced from 3.8% to 4.8% in the course of two months. Ironically, the end of the Treasury sell off concurred with the Fed's first interest rate hike. The 10-Year Treasury ended the year at 4.2%, relatively unchanged from its yield at the beginning of the year, causing the yield curve to flatten by 125 basis points.

The ability of the Federal Reserve to raise interest rates was partially provided due to the weakness in the U.S. dollar. Whereas the Fed was taking back liquidity from the market throughout the year, the weak dollar provided stimulus to U.S. corporations. **Most attribute the weakness in the dollar to the current account deficit, which grew to 6% of GDP, and the budget deficit, which grew to 5% of GDP.**

Rising commodity prices posed a challenge to both consumers and corporations throughout the year. **Crude prices rose from $32 to $43 in 2004,** although crude hit a high of $55 in October. Most analysts attributed the increase in crude oil prices to demand growth in China, the inability of OPEC to supply the market with "sweet" crude, and speculation regarding future terrorist attacks.

Despite the muted returns for equity markets in 2004, corporations are in good health. **Corporations are currently experiencing their highest level of operating margins and generating the highest level of free cash flow in many years.** Likewise, corporations continue to hold high levels of cash, which is increasingly being returned to shareholders via dividends and share buybacks. As a result of improving corporate balance sheets, corporate bond credit spreads continue to improve, with the high yield sector posting the strongest returns. Managers believe that healthy balance sheets and operating margins should translate into improved capital spending and employment growth in 2005.

Likewise, corporate earnings continued to exhibit strong growth in 2004. Despite the S&P 500 return of +10.87% for the year, **price-to-earnings ratios contracted, as most expect earnings to grow 23% year over year once the fourth quarter earnings season is completed in January.** Corporate earnings grew 20% for four consecutive quarters (a record) from the third quarter of 2003 to the second quarter of 2004 and consensus expectations are for 15% growth in fourth quarter earnings. All told, the S&P 500 is currently trading at 17 times 2005 forward earnings. Most analysts and strategists view stock price valuations as fairly valued given the current levels of interest rates and inflation.

Looking forward, the consensus among hedge fund managers is for moderate equity returns of 8-10% over the next twelve months. The rationale behind these expectations is derived from the following:

a) Economic growth of 3-4%.
b) Slowing corporate earnings growth to 10%.
c) Rising inflation, now that inflation appears to have bottomed.
d) Rising interest rates, now that interest rates appear to have bottomed.
e) Equities are currently fairly valued at 17x forward earnings.

In such an environment, **few hedge fund managers predict a market with expanding price-to-earnings ratios.** Therefore, equity returns above 8-10% will need to be fueled by stronger corporate earnings growth than 10%. However, should corporate earnings growth not meet 10%, most expect equities to suffer. Equities could also suffer from a substantial increase in inflation coupled with a more hostile Federal Reserve in raising interest rates.

While managers are generally cautiously optimistic regarding the economy, many note their concern for continued growth in consumer spending. Debt levels remain high and the U.S. savings rate is currently at record lows (approximately 2%), with spending growth derived from an increase in asset prices, namely housing prices. Furthermore, many believe that housing has remained strong due to historically low interest rates which will likely rise over the next twelve months. However, most managers are hopeful that healthy corporate balance sheets will translate into better employment and capital spending in 2005.

Despite the moderate outlook, the majority of long/short equity managers believe the market environment in 2005 should be conducive to stock picking and alpha generation. A number of industries

1987 — 2004

Annualized Compounded Return: 0%, 4%, 8%, 12%, 16%, 20%

Standard Deviation: 0%, 5%, 10%, 15%, 20%, 25%, 30%, 35%

Hennessee Hedge Fund Index

S&P 500

Russell 2000

NASDAQ

Lehman Bond Index

You Wouldn't Use a Stock Index to Benchmark Your Bond Portfolio

So Why Use One to Benchmark Your Hedge Funds?

Hennessee Hedge Fund Indices®

Hennessee Group recognized the need for the creation of specific 'benchmarks' to measure a hedge fund manager's success. From this original concept, the blueprints of the Hennessee Hedge Fund Indices® evolved into what we know today.

The Hennessee Hedge Fund Indices® are the hedge fund industry's oldest hedge fund benchmark. Created live in 1987, the Hennessee Hedge Fund Indices® are an equally weighted average of a diversified group of hedge funds believed to represent approximately one half the capital in the hedge fund industry.

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(manufacturing, commodities) have clearly benefited from a cyclical recovery, to the point where their share prices are reflecting a secular change in their businesses. **Most hedge fund managers believe they will be able to differentiate between the cyclical and secular recovery, leading to stock picking opportunities both long and short.**

HEDGE FUND PERFORMANCE SUMMARY - DECEMBER

The Hennessee Hedge Fund Index advanced +2.13% for the month of December, bringing the 2004 return to +8.27% for the Hennessee Hedge Fund Index. The equity market once again finished the year with a fourth quarter rally, as the S&P 500 DRI Index climbed +3.40% in December (+10.87% YTD), the Dow Jones Industrial Average rose +3.40% (+3.15% YTD), and the NASDAQ Composite Index gained +3.75% (+8.60% YTD). Managers were able to make substantial profits in their long portfolios, but were unable to avoid taking losses on short positions. While managers are optimistic for 2005, they are cautious given the twin deficits and weak dollar.

The top performing styles for 2004 were the Distressed Index (+18.53%), the Latin American Index (+16.63%) and the Regulation D Index (+16.35%). The worst performing styles for the year were the Short Biased Index (-3.95%), the Convertible Arbitrage Index (+1.16%), and the Macro Index (+1.47%).

The Hennessee Distressed Index was the top performing strategy for 2004 gaining +3.04% in December and +18.53% for the year. The distressed strategy performed extremely well due to tightening high yield credit spreads given the significant improvement in corporate balance sheets over the past couple years.

The Hennessee Latin American Index rose +3.39% in December to bring 2004 returns to +16.63%. Latin America stocks enjoyed another good year and benefited by the economic recovery in the U.S. and strong commodity prices. Most significant was the record oil prices which helped the oil exporting nations in the region like Mexico and Venezuela.

The Hennessee Regulation D Index gained +2.49% in December, and was a top performing strategy for the year as it gained +16.35%. Companies continue to receive favorable funding, as interest rates remain low and corporate credit spreads continue to tighten. Increased credit quality provided reduced risk as managers continued to find attractive private Regulation D transactions.

The Hennessee Short Biased Index was the worst performing index of the year, falling -5.43% for December and –3.95% for the year. Short biased was the worst strategy for the third month in a row as the broad markets continued their fourth quarter rally, and managers were unable to avoid taking losses in short positions. The fourth quarter was reminiscent of 2003, as profits earned in the first three quarters were entirely erased.

The Hennessee Convertible Arbitrage Index rose +0.71% in December to bring 2004 returns to +1.16%. The environment for convertibles was difficult due to declining levels of implied volatility and rising interest rates. In addition, cash takeovers, a ruling change with regards to contingent convertibles and declining liquidity were all negative to the strategy.

The Hennessee Macro Index declined -0.34% in December increasing the yearly return to +1.47%. 2004 was a difficult year as the "reflation" trade initiated in 2003 broke down through the summer, due to China's announcement of their intentions to slow growth via higher interest rates and higher lending standards. This caused declines in the majority of Asian equity markets and commodity prices.

Value
(YTD: +12.54% / DEC: +2.46%)

The Hennessee Value Index advanced +2.46% in December and finished up +12.54% for the year, while the S&P 500 increased +3.40% for the month of December and +10.87% for 2004. For the second year in a row, value managers produced solid returns on a risk-adjusted basis, as many value managers capitalized on energy and commodity related stocks, as well as homebuilders.

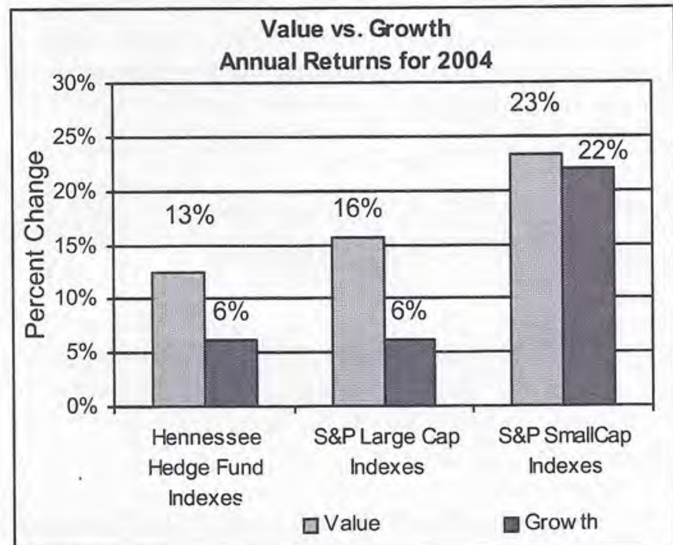
Due to concerns about the economy, most value managers maintained conservative positioning throughout the year. **Despite that fact, value managers were able to achieve impressive returns on their long portfolios. Unfortunately, most mangers were unable to avoid taking losses on the short side as these hedges proved to be costly insurance.**

In addition, **value managers who were focused on small-cap and mid-cap markets were able to find numerous attractive value opportunities and produce larger profits than managers focusing on the large cap sector.**

The first three quarters of 2004 was a choppy environment for the equity markets. News of terrorist activity in Madrid, lackluster job growth and fear of further terrorist events depressed the U.S. equity market during the first quarter. High oil prices hurt companies' earnings and depressed the U.S. stock market during the second and third quarters of 2004. Value managers also closely watched the Fed as it raised interest rates five times during the year.

It was not until after the U.S. Presidential election in late October that the U.S. equity markets rallied with the S&P 500 breaking out of its trading range reflecting reduced uncertainty. The closing December S&P 500 level of 1213 represents not only a 14% rally from year lows (1063 on August 12), but almost 58% above the deflation-fearing 768 low of October 11, 2002. **In addition, for the second year in a row, small cap stocks outpaced their larger brethren in 2004, as the Russell 2000 advanced 17% for the year with value outperforming growth components.**

One of the most profitable positions for value managers throughout the year were energy stocks as oil surged to its highest levels of all time. Oil prices started climbing during the first quarter on increased demand and terrorism concerns. U.S. oil stocks hit 52-week highs in July as surging oil and gas prices showed sustained strength. The price climb continued into late September when crude oil reached a level of $50, more than 78% higher than its price 12 months earlier. Increased demand from China and India, plus global troubles and terrorism related risks, caused oil to eventually reach $55 a barrel in early October. The excessively high oil prices substantially increased expenses for U.S. companies and caused stock prices to suffer.



The oil trend continued until late October when oil prices fell to $42 by year end (a 24% decline from the highs), causing stock prices to rally sharply with an additional boost from the results of the presidential election. **Despite the late year decline, oil still managed a 34% return in 2004 as oil and energy-related stocks, such as Exxon Mobile, BP PLC and Royal Dutch Petroleum Company, proved to be very profitable positions for value managers.**

Long positions in coal, particularly coking coal, and coal machinery were profitable for managers as prices increased on the assumption that greater demand will lead to higher prices in coal. Peabody Energy and Massey Energy increased to their highest levels in two years on positive coking coal information. In addition, as coal continues to fulfill energy needs at a lower cost than oil at current prices, it remains a long position for several fund managers.

Additional profitable investment positions for value managers during the year were commodities and basic materials. Through the first quarter and into the second, commodities rose to cyclically high price levels as economic activity picked up. The growing importance of consumption by China and India continued to cause oil and timber to rise as supply fell short of demand. Investments in U.S. Steel and Bethlehem Steel were solid investments as the price of

steel reached $650 per ton from $250 per ton three years ago. **Throughout the year, value managers were able to capitalize on investing in natural resources and basic materials, with the most profitable positions being companies with exposure in China.**

During the last 12 months, the Dow Jones Industrial Average hit multi-year highs. Industrial stocks, such as General Electric and Tyco, performed well, benefiting from an expanding economy and from the weak dollar. One of the "Dogs of the Dow" from 2003, Eastman Kodak, which garnered significant interest from value managers, proved to be a profitable investment as it increased more than 24% in 2004 as management's restructuring showed signs of success.

Despite concerns of slowing demand and interest rate increases during the beginning of 2004, many value managers achieved gains in homebuilder positions as the sector was positive despite being somewhat volatile during the last 12 months. Sales of new and existing homes have regularly broken through to new record levels, and the trend in 2004 was consistently upward. Even as the Federal Reserve has raised rates, mortgage rates have remained below 6%, still an attractive level for buyers. Managers cite Pulte Homes, Standard Pacific and Lennar Corp as profitable positions during the year. **While 2004 performance was strong, many value managers are hesitant to remain long in this sector due to the fear of a speculative bubble in housing, slowing demand, and a continued rise in interest rates.**

The financial sector remained relatively unchanged for the year. Banks did decline in April after the Fed announced it was raising interest rates. The majority of companies were able to recoup all losses, but were only able to post slight gains as the Banking Index was up +5% for 2004.

It was a tough year for insurance companies. Hurricane Ivan caused prices to decline after causing massive destruction along the U.S. Southeast in September. The industry took another hit in October, when New York Attorney General Eliot Spitzer shook the insurance world and disrupted the performance of insurance and financial companies by charging insurance company, Marsh & McLennan of bid-rigging and fraud. The third blow was in late December when a massive tsunami swept through the Indian Ocean causing unfathomable devastation. **Despite the drawdowns, companies were able to recoup losses by the year-end as the S&P Insurance Index was up almost +5.5%.** In addition with interest rates poised to rise, value managers state that mortgage companies and other interest sensitive companies may be at risk.

While most hedge fund managers remain cautious, they are generally more optimistic today than they were three months ago. The equity markets have improved on a technical basis, reaching new 52-week highs on strong volume in the past month. On a fundamental basis, while concerns about the U.S. consumer still persist, lower oil prices and better employment stand to improve consumer spending. Furthermore, while managers recognize that an orderly decline in the dollar is a positive for U.S export, they recognize that a plunge in the dollar, while not likely, remains the biggest risk to the current low interest rate environment and the overall economy.

On October 26, 2004, the Securities and Exchange Commission voted in favor of requiring hedge fund management companies to register as Registered Investment Advisers

Hennessee Group was one of the five organizations invited to speak before the Senate Banking Committee on July 15, 2004, addressing the SEC's rule amendment

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Value managers state that they are likely to focus on large cap value companies since there seems to be many attractive positions for 2005. Managers focused on mid and small-cap stocks will be selective in investment opportunities as managers report fewer attractive value opportunities after a year of robust small and mid-cap company performance.

Growth
(YTD: +6.12% / DEC: +2.48%)

The Hennessee Growth Index advanced +2.48% in December bringing 2004 returns to +6.12%, while the benchmark NASDAQ Composite Index advanced +3.75% for the month of December and +8.60% for 2004. December was a strong month for the U.S. equity markets as oil prices continued to decline and trading increased on greater optimism. While growth managers were not able to meet the annual returns of value managers, growth managers did take advantage of the late year surge and produced moderately positive returns for investors.

The NASDAQ finished the year strong up more than +8.60% with the majority of gains occurring in the fourth quarter. The NASDAQ floundered for the first half of the year due to reduced investor confidence, high energy prices, a greater than expected inventory build up in technology and poor earnings. At the end of the third quarter, the market finally rallied from its August lows due to a strong influx of money into the stock market which increased liquidity of technology and other growth stocks. The surge picked up strength when President Bush was re-elected. **After a span of three losing years, the NASDAQ achieved its second positive year as a result of renewed optimism for a tech recovery and enthusiasm for high-profile stocks.**

In a move that demonstrated the continued transition from traditional retaii and advertising to online mediums, the Internet sector was one of the best performing growth sectors. **High profile Internet names like Google, Ebay, Overstock, Yahoo, and Travelzoo pushed the Internet HOLDRS Index up more than 40% for 2004. The industry drew significant attention from growth managers and was one of the most profitable growth sectors for the year.** After completing a successful IPO in August, Google's stock price doubled in price in just two months. Overstock also performed very well as the price doubled in 12 months. Yahoo and eBay posted strong showings gaining more than 68% and 80% respectively. Travelzoo, an Internet advertising and media site, was a gamble that paid off for some growth managers as the stock surpassed all expectations as it increased more than 995% in 2004.

The fourth quarter NASDAQ surge, which was key to the returns of many growth managers, was marked by strong performance in the technology sector, as PCs, consumer electronics (digital cameras, iPods) and cell phones, witnessed better than average seasonal strength as consumer spending increased. **Many growth managers report that Apple Computer was a very profitable position for them as the stock greatly exceeded yearly expectations and was up more than 200% for the year on impressive iPod and computer sales.**

Another high profile sector during the second half of 2004 was satellite radio. Both major providers, XM Satellite Radio and Sirius Satellite, performed well for the year while generating high profile news headlines. **Impressive subscription rates and high profile deals made the Sirius's stock one of the most traded securities on the NASDAQ and helped the company gain 125% for the year.** Many traders took advantage of both companies' momentum throughout the year before collecting profits prior to year-end.

Managers reported that mobile telecommunications posted a strong showing as cell phone demand continued to be strong. Large cap companies were boosted by merger deals between Cingular-AT&T Wireless and Sprint-Nextel. In addition, other wireless companies had their stock prices rise on speculation that these acquisitions would spark additional deals going forward. **Many hedge fund managers were long these wireless companies prior to merger announcements due to strong fundamentals. In addition, they state that the current consolidation will lower costs and increase future profits.**

The telecommunications equipment sector continued

Sometimes Risk Outgrows Return.

Through research and education, Hennessee Group is helping hedge fund investors appreciate the true nature of their investments

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Annual Hedge Fund Investor Survey
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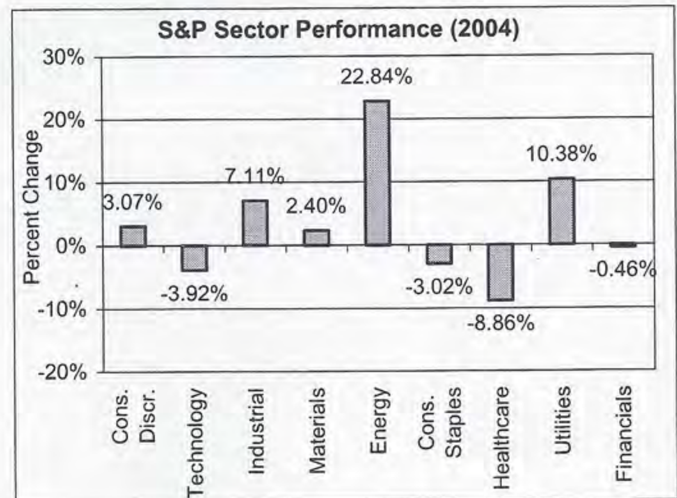
to show signs of improvement driven by what looked like a modest recovery in enterprise spending and selective spending by carriers in such areas as voice over IP, broadband, and wireless local area networking. After major providers Nortel Networks and Lucent had a rough year, some managers are positive on the sector given an outlook for solid carrier equipment spending.

Many growth managers took losses in their semiconductor investments. The industry was one of the worst performing sectors for the year as the PHLX Semiconductor Sector Index declined by almost 15%. Industry titan, Intel, lowered revenue projections in January 2004 and then slashed its third quarter sales range and margins targets. The company mentioned that demand for its flagship products has been below expectations due to weak end demand and customer reductions of inventory. The stock ended the year as one of the worst performing Dow components.

The healthcare sector was also one the biggest losers of the year, particularly large cap pharmaceutical, as the S&P Healthcare Index was down more than -1% this year. During the year, the sector was hurt by concerns that John Kerry would win the presidential election and would reduce consumer costs and create higher expenses for drug makers as well as allow drug importation from Canada. A post election rally lifted healthcare stocks unevenly, with the services segments in particular outperforming significantly all other areas; however, the pharmaceutical sector continued to be plagued by revenue growth deceleration, litigation, patent expirations, and meager pipelines. The biggest blow to the industry was due to the drug recalls by some of the markets leading drug companies, such as Merck pulling Vioxx from shelves in September. Pfizer and GlaxoSmithKline also came under similar scrutiny. After a rough 2004, several managers state that they feel the healthcare industry is currently undervalued and may be poised for future gains.

The retail sector also had a mixed year. Black Friday, the hallowed, big-spending day after Thanksgiving that starts the holiday-shopping season, was largely a disappointment this year. That was especially the case at Wal-Mart, the biggest retailer in the world. Lower-end consumers found themselves pinched by high gasoline prices and paltry growth in wages. Higher-end stores like Nordstrom and Neiman Marcus also saw their sales growth moderate too, which demonstrated that wealthier Americans were also feeling frugal. After a somewhat disappointing year, companies rebounded as December retail sales found some evidence that the holiday-shopping season performed up to expectations.



One bright note for managers was Kmart which rose more than 300%, after emerging from bankruptcy. In addition, a merger announcement between Sears and Kmart in late November further strengthened stock price with both stocks up more than 15% after the announcement.

Growth managers were frustrated by the market this year and their favorite sectors, technology and healthcare were especially weak. The late year surge in the markets allowed growth managers to make some large gains in their long portfolios while taking some losses on the short side. The gains in their long portfolios at the end of year made up the bulk of the +6.12% annual returns for growth managers.

While the future is not certain, most managers hope that there will be a bifurcation between solid companies and their weaker competitors in order to profit on both the long and short portfolios. Many managers are also optimistic on technology and healthcare stocks to do well in 2005 after both industries failed to meet expectations in 2004. **While optimistic that the market rally will continue, growth managers report**

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that they will proceed with caution and are hesitant to increase exposure as many are concerned about the sustainability of the economy given the twin deficits and weak dollar.

Macro
(YTD: +1.47%/ DEC: -0.34%)

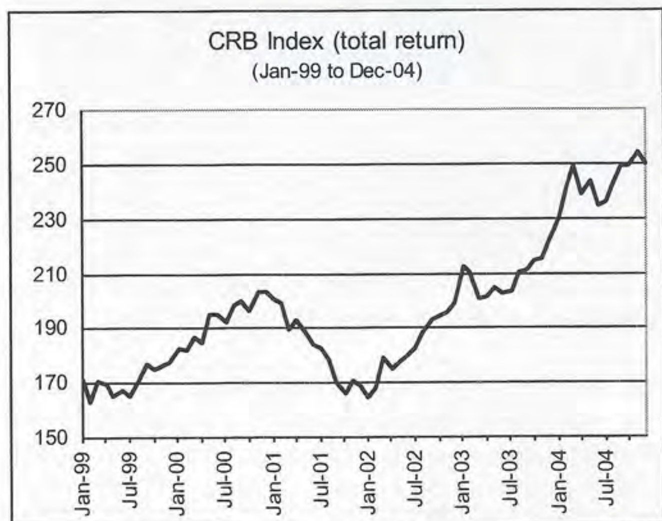
The Hennessee Macro Index declined –0.34% in December to bring returns for 2004 to +1.47%. Positive returns in global equities in December were more than offset by negative returns from long oil positions.

Whereas 2003 was an excellent year for macro managers, 2004 was a difficult year, as the "reflation" trade initiated in 2003 broke down throughout the summer. **Most managers came into 2004 with legacy positions in long global equities, long commodities, short U.S. dollar, and short U.S. Treasury positions, otherwise known as the "reflation" trade.**

Long equity exposure for macro managers in 2004 was primarily derived from Asian equities, as most managers had a preference for Asia's growth and valuations in comparison to those in the U.S. and Europe. While Asian equities enjoyed a strong first quarter, **the second quarter was notably difficult due to China's expressed desire to engineer a soft landing by raising interest rates and lending requirements.** As a result, managers were forced to reconsider their preference for Asia, given that the markets showed little confidence in China's ability to engineer a soft landing. Recognizing Asia's reliance on China and the high levels of imports into China from Japan, Taiwan, Hong Kong, and Indonesia, managers trimmed long exposure to the region.

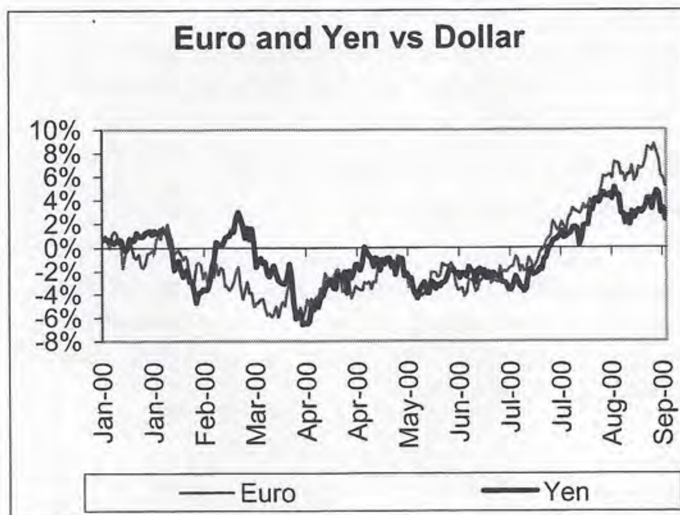
The tightening in China also had ramifications for commodities. Most believe that commodity price increases in 2003 were primarily driven by increased demand in China. As such, most commodities fell sharply in reaction to China's desire to curtail its growth to prevent inflation. Declines were most significant in agricultural commodities, as corn fell -17% for the year, wheat fell -22%, and soybeans sank -31%. The sell off in metals proved to be short lived, however, as copper prices advanced +43% for the

year, eventually reaching a 10 year high. Many managers also reported buying positions in gold, as prices rallied throughout the year in response to the U.S. dollar's weakness. Gold is often viewed as an alternative means of exchange when currency and other "paper assets" fall out of favor. Gold reached multi year highs of $456 per ounce in 2004, ending the year at $437, and has rallied 63% since September 11, 2001.



Oil prices were also sharply stronger throughout the year, as crude prices rose from $32 to $43 a barrel, a 34% increase. Crude oil was highly volatile throughout the year, reaching a high of $55 in October. Most attribute the increase in crude oil prices to demand growth in China, the inability of OPEC to supply the market with "sweet" crude, and supply difficulties related to Hurricane Ivan. The volatility in the oil markets provided numerous opportunities both long and short. While some managers were able to correctly anticipate its ascent throughout the year, others were able to short crude futures prior to their retreat from $55 to $42. Other energy products advanced in tandem to oil, with heating oil rising 37%, gasoline up 19%, and natural gas ending the year relatively unchanged.

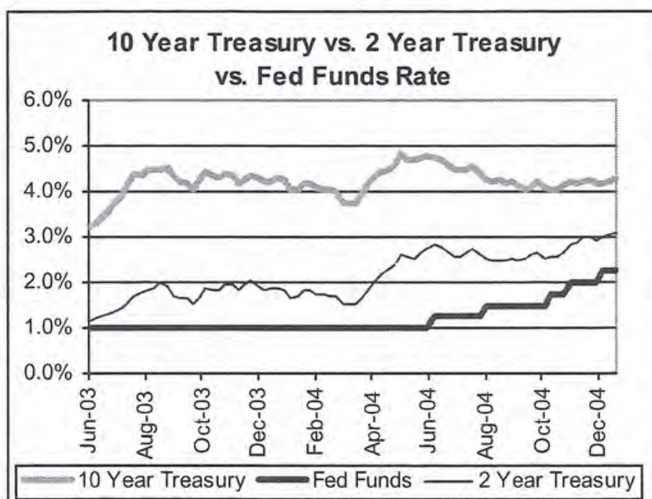
The most profitable trade of the year for macro managers was a short position in the U.S. dollar. After considerable weakness and profits for macro managers in the fourth quarter of 2003 and January 2004, most managers took the opportunity to reduce short exposure. This proved to be well timed, as the currency subsequently engaged in a counter-trend rally from its lows. Following a trading range throughout the summer, the dollar again sold off in the fourth quarter, with the Euro reaching an all time high of $1.38 in Decemeber. The dollar has declined over 60% from the highs it experienced versus the Euro in 2000. Despite appreciating versus the dollar, Asian currencies were not as strong as the Euro due to explicit and implicit pegs. In an attempt to maintain export competitiveness with China (which maintained its explicit peg against the dollar), Japan attempted to fight the Yen's advance by making significant purchases of U.S. Treasuries. **Given the significant decline in the dollar, most macro managers have reduced the short U.S. dollar versus Euro trade, although many have elected to maintain their long Asian currency exposure.**



Despite a reduction in short dollar positions, **most macro managers believe that the structural imbalances in the U.S. that led to the dollar's decline still exist**. While the currency may be poised to again experience a sharp counter-trend rally similar to the one experienced in the first quarter of 2004, most would use this rally as an opportunity to again set up short positions. Managers cite the following structural imbalances:

a) The U.S. current account deficit, which grew to 6% of GDP. This imbalance has been partially offset by purchases of U.S. assets by Asian central banks.
b) The U.S. budget deficit grew to 5% of GDP. This has been mostly a function of low tax revenues and increased spending on defense.

Within fixed income, most managers built short positions in longer maturity U.S. Treasuries during the first quarter. Following strong employment reports in March, April, and May, Treasuries sold off sharply, only to rally for the remainder of the year following several weak employment reports. Most managers continued to hold short Treasuries recognizing that the Federal Reserve had shown its commitment to raising the Fed Funds rate. In fact, Fed Funds rose from 1.0% to 2.25% during the year.

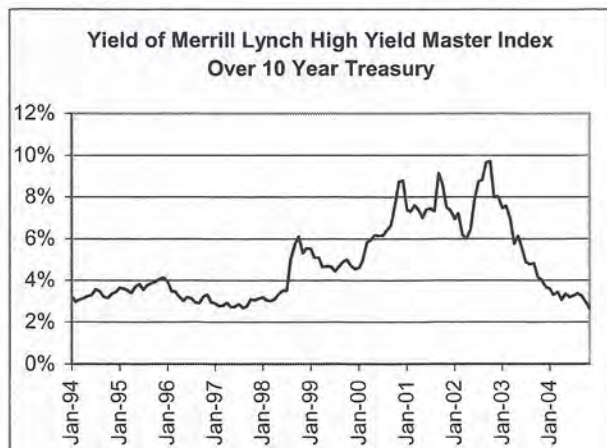


Going forward, most macro managers expect returns in 2005 to be driven by long Asian equity exposure and short U.S. Treasury exposure. While most have confidence in the global economy to continue its strength, most believe that growth will be met with higher inflation and global interest rates. Furthermore, most expect to wait for a rally in the U.S. dollar before re-initiating short positions again.

Distressed
(YTD: +18.53% / DEC: +3.04%)
High Yield
(YTD: +11.39% / DEC: +1.47%)

The strength of the high yield and distressed markets put the critics to rest in 2004. The Hennessee Distressed Index finished December with its second best monthly performance this year, with a +3.04% return. **Distressed investing was the best performing of all 23 Hennessee hedge fund indices in 2004 as it finished the year up +18.53%.** Ending the last month of the year with a lower performance was the Hennessee High Yield Index, as it generated a +1.47% return, bringing its return for 2004 to +11.39%.

Positive investor sentiment towards the economy, low interest rates, and strengthening corporate balance sheets led to a **'flight to risk' for distressed/high yield managers**. Despite a temporary correction during the year due to concerns of interest rates potentially rising too quickly, as well as the threat of inflation, investor capital continued to flow into the asset class and more importantly, into distressed (credit) hedge funds either thru a multi-strategy vehicle or a distressed single strategy approach. Investors continued to ask **how "low can credits go?" With technical factors driving the market and less fundamentals, most managers believe the upside is largely capped after two strong years of performance, but expect alpha in the strategy to come from a long and short credit investment approach.** Overall, although a majority of managers held short positions throughout the year, the strength of the asset class minimized returns (if any) in this portion of the portfolio.



Speculative credits led the fixed income asset class in 2004 with a **10.9% return according to the Merrill Lynch High Yield Master II Index. Junk bond issuance reached a record level of $158 billion during the year, outpacing 1998** as the busiest for the asset class (issuance of $142 billion in 2003). In addition to its outperformance and record issuance, **default rates were being pushed lower and as a**

Hennessee Group LLC — Hedge Fund Advisory

HENNESSEE HEDGE FUND STYLE DEFINITIONS®

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STYLE	DEFINITION	Expected Volatility
CONVERTIBLE ARBITRAGE	This type of arbitrage involves the simultaneous purchase of a convertible bond and the short sale of the underlying stock. Interest rate risk may or may not be hedged.	Low
DISTRESSED	Primary investment focus involves securities of companies that have declared bankruptcy and/or may be undergoing reorganization. Investment holdings range from senior secured debt (uppermost tier of a company's capital structure) to the common stock of the company (lower tier of the capital structure).	Moderate
EMERGING MARKETS	This strategy focuses on investing in lesser-developed, non-G7 countries whose financial markets provide exploitable pricing inefficiencies. Popular geographic regions include Latin America, Eastern Europe, the Pacific Rim and Africa. Asset classes range from equities and bonds to local currencies.	High
EUROPE	Style predominately entails investing in and shorting of European equities that may include peripheral eastern and central regions.	Moderate
EVENT DRIVEN	This strategy can include merger arbitrage, distressed, liquidations, and spin-offs in addition to value driven special situation equity investing. Usually dependent on an "event" as the catalyst to release the position's intrinsic value.	Moderate
FINANCIAL EQUITIES	Style predominately entails investing in and shorting of stocks within the financial sector (banks, thrifts, brokerage, insurance, etc.).	Moderate
FIXED INCOME	Employs a variety of fixed income related strategies ranging from relative value based trades (basis, TEDs, yield curve, etc.) to directional bets on interest rate shifts. Style also includes credit related arbitrage, which typically involves the purchasing (or selling) of corporate issues and the simultaneous selling (or purchasing) of government issues.	Moderate
GROWTH	Style predominately entails investing in and shorting stocks of companies that exhibit an acceleration (or deceleration) of earnings growth, revenues and market share.	Moderate
HEALTHCARE/ BIOTECH	Style predominately entails investing in and shorting of medical related stocks, which include biotechnology, pharmaceuticals, HMO's, medical information, etc.	High
HIGH YIELD	Style predominately entails investing in and shorting of non-investment grade corporate bonds, which offer attractive coupon yields. Interest rate risk may or may not be hedged.	Moderate
INTERNATIONAL	Participants of this style tend to be bottom-up stock pickers within global regions that are undergoing economic changes.	Moderate
LATIN AMERICA	Style predominately entails investing in and shorting of equity and/or debt within the various Latin American regions.	High

HENNESSEE HEDGE FUND STYLE DEFINITIONS®

Style	Definition	Volatility
MACRO	*Dominant investment theme is to capitalize on changes in the global macroeconomic environment through participation in the various capital markets. A top-down methodology allows managers of this strategy to utilize all asset classes (equities, bonds, currencies, derivatives) available in the global capital markets.*	*High*
MARKET NEUTRAL	*Long and short equity exposure with nearly no dollar net exposure. In theory, systemic market risk is greatly reduced by being dollar, beta, sector and market cap neutral. Strategies within this style range from quantitative modeling ("black box" or statistical arbitrage) to fundamental pairs trading.*	*Low*
MERGER ARBITRAGE	*Style typically involves the simultaneous purchase of stock in a company being acquired and the short sale of stock in its acquirer. Many merger arbitrage managers attempt to mitigate deal risk by engaging only in strategic takeovers after they are announced.*	*Moderate*
MULTIPLE ARBITRAGE	*Category includes hedge funds that employ more than one arbitrage strategy. Portfolio manager opportunistically allocates capital among the various strategies in order to create the best risk/reward profile for the overall fund. Common strategies include merger arbitrage, convertible arbitrage, fixed income arbitrage, long/short equities pairs trading and volatility arbitrage.*	*Low*
OPPORTUNISTIC	*Long/short equities managers who maintain a flexible net exposure to reflect the changing dynamics of the market on a minute-to-minute or daily day trading basis. Managers typically utilize technical and/or fundamental analysis. Portfolio turnover can be high as managers implement trading disciplines such as tight stop losses and defined exit target prices.*	*Low/ Moderate*
PACIFIC RIM	*Style predominately entails investing in and shorting of Japanese and other Asian equities. Many managers also include Australia and New Zealand as regional investment choices.*	*High*
REGULATION D	*The investments are fully hedged in the form of convertible securities, which are convertible into common stock of the issuers at floating prices set at a discount to the historical price of the stock. The investment is typically held until the registration of the underlying common stock is declared effective by the SEC (normally 75 to 90 days) at which time the manager can sell the registered shares in the public markets and realize the hedged spread between the market price and the discount conversion price of the stock.*	*Low/ Moderate*
SHORT BIAS	*The majority of the portfolio consists of short sales, usually fundamental, technical or event driven. This style can be used as a hedge for long-only portfolios and by those who feel the market is approaching or in a bearish cycle.*	*High*
TECHNOLOGY	*This style predominantly entails investing in technology-related sectors.*	*Moderate*
TELECOM/ MEDIA	*Style predominately entails investing in and shorting of stocks in the telecommunications and media industries, which include telecommunication services, fiber optics, cable services, publishing, entertainment, programming, broadcasting, etc.*	*High*
VALUE	*Style predominately entails investing in undervalued equities which trade below intrinsic value. Undervalued securities may be defined as, but not limited to, equities with low price-to-earnings ratios or low price-to-book value ratios. Managers also focus on companies that generate substantial free cash flow and pay special attention to the use of the cash to retire debt, institute share repurchase programs, and other methods to realize shareholder value.*	*Moderate*

result, investors demanded a lower risk premium. Less risk aversion among investors aided **valuations in distressed/high yield bonds in reaching record highs with the yield spread of high yield bonds over Treasuries hovering around 318 basis points (see chart for full year) and the average price of junk bonds at $103.4 during the year.**

The majority of distressed/high yield managers remained diversified by holding paper throughout the capital structure, giving **more weight to the senior part of the capital structure via holding senior debt of companies**. Additionally, with capital remaining cheap in 2004, managers reported holding a good amount of bank debt and restructured debt, both current pay and defaulted. With the ongoing concern of interest rates spiking and credit spreads widening from their historical lows, we saw a majority of managers **shorting credits and/or utilizing credit and interest rate hedges.** Overall, distressed managers lost money from their hedges.

Going forward, managers believe experienced investment professionals that have been through a full credit cycle will do well, as these individuals are able to distinguish between good credits (by going long) and bad credits (by going short). In high yield, managers believe **junk bonds should be looked at as a "yield supplement"** for investors' fixed income investments absent any negative shocks that could cause a flight to quality. With the "low credits having been picked" and credit spreads at historically tight levels, concerns have been raised about supply. In response to this question, managers expect the **$300 billion in high yield paper that has come to market in the last two years (high yield a precursor to distressed) to keep them busy in the near term.**

Merger Arbitrage (YTD: +4.47% / DEC: +1.40%)

The Hennessee Merger Arbitrage Index generated a +1.40% return in December, finishing the year up +4.47%. From the years 2001 to 2004, the Index has generated an annualized return of +3.08%.

Arbs were greeted with a more favorable M&A environment in 2004 as volume reached multi-year highs. **For 2004, announced global M&A volume was 41% higher versus last year** (approximately 60% higher than in 2002), finishing at $1.95 trillion for the year, **the strongest since the year 2000**. Domestically, **U.S. deal volume increased 50% compared to a year ago**, to $875 billion. In other regions of the world, **Asian M&A activity was up a staggering 59% from a year ago** followed by **Europe, where activity increased 36%**. Arbs are mindful that the increase in activity versus the 2003 depressed levels might give an inaccurate picture, but still remain bullish on the prospects for the strategy.

Although M&A activity was strong in 2004, **arbs felt the risk/reward profile of many deals were unattractive partially due to too many players in the strategy.** In comparison, during the **late 1980s and most of 1990s managers reported deals yielding 15% to 20% versus mid to high single digit spreads today.** Additionally, deal breaks and failures did not help the strategy as several noteworthy deals such as the Titan/Lockheed deal and PeopleSoft/Oracle deal were blocked by anti-trust officials. During December, PeopleSoft conceded and accepted Oracle's offer, closing an 18-month takeover war.

In 2004, merger arbitrageurs saw more deals driven by financial reasons rather than acquirers looking to venture into a new business or product line. The reaction was positive and this was best exemplified in the market's reaction to several deals. In April, UnitedHealth announced a transaction with Oxford Health, in which UnitedHealth's stock appreciated 38% and then in July, Harrah's Entertainment's shares rose 40% after its announced a bid for Caesar's

Entertainment.

European M&A activity also saw a shift from a focus on restructuring to companies taking on growth opportunities via cross-border deals in the region. This effort was best seen in July, when Spain's Banco Santander Central Hispano announced a $17 billion takeover of U.K.'s Abbey National plc, a rare occurrence for European M&A deals. Though market pundits felt that 2004 would see an increase in European M&A, arbs maintained cautious views on deal volume. **Arbs did not find enough traditional merger arbitrage trades, and instead, relied upon creative tactics to generate returns.**

In 2004, **managers saw LBO activity increase, accounting for 15% of global deal volume**. A low interest rate environment aided private equity shops in obtaining cheap financing to fund their acquisitions with most LBO firms flushed with cash.

The **most notable deals in 2004** are listed below in the chart:

Most Notable M&A Deals of 2004		
Target	Acquirer	Announced Value
BancOne	JP Morgan	$58 billion
AT&T Wireless	Cingular	$47 billion
Nextel	Sprint	$39 billion
Guidant	Johnson&Johnson	$26 billion
Sears	Kmart	$11 billion

The month of **December was the busiest month for M&A since August 2000 with $140 billion of deals announced**. Noteworthy deals during the month were the **$26 billion Guidant/Johnson&Johnson** deal, the **$39 billion Nextel/Sprint** deal, the $12.3 billion Public Service Enterprises/Exelon deal, the **$13.5 Veritas/Symantec deal**, and the Honeywell International's purchase of U.K. manufacturer Novar plc.

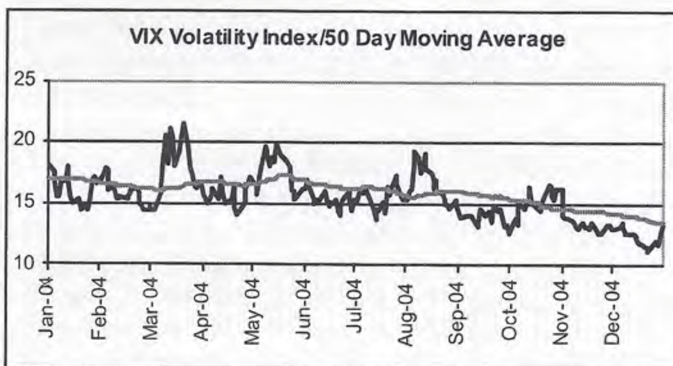
Going forward, arbitrageurs **expect deal volume to rise in the technology, financials, and healthcare industries.** Technology, previously the darling of M&A, has seen little in terms of activity since the late 1990s. However, in an industry where companies are facing slowing growth and maturing businesses, arbs expect a wave of consolidation in order for companies to reduce costs. In financials, there is an excess supply of asset management firms making it difficult for players to remain competitive. In healthcare, arbs believe large pharmaceutical companies are facing meager pipelines and financial pressure forcing them to possibly look for acquisition targets.

As for the overall strategy, managers expect strong M&A volume in the near term as the cautiousness that characterized the last three years has dissipated. Arbs believe the competitiveness in select industries could increase merger volume another 5% to 20% in 2005. In conclusion, **if inflation remains intact (but higher than today's rates) and earnings growth improves, arbs expect this to positively reflect upon merger volume** giving them more opportunities to pursue.

Convertible Arbitrage (YTD: +1.16% / DEC: +0.71%)

2004 was a difficult year for most convertible arbitrage managers. Declining volatility, poor liquidity, lower new issuance, and other factors such as surprise cash takeovers weighed on the convertible bond market and negatively impacted performance.

For the end of the year, managers reported that valuations improved as the equity markets rallied, but implied volatility was subdued and finished the year at 10-year lows. **The Hennessee Convertible Arbitrage Index advanced +0.71% for the month of December, bringing its 2004 return to +1.16%.**



Traditional volatility oriented managers reported

2004 as one of the worst years in the strategy's history. The decline of stock volatility was the dominant factor for the poor performance by these funds. With so many macro concerns that could have caused a decline in the market, managers were surprised by the complacency of investors, as anecdotal evidence showed that investors paid lower premiums on put options to protect their portfolios than would have been expected. Managers had to get creative in the U.S. market. Some managers attempted to take advantage of low volatility by purchasing cheapened names but this strategy did not pay-off during the year. Other managers dramatically lowered their exposure to volatility sensitive convertible positions during the year. **Instead, these managers altered their plain vanilla gamma trading strategy and focused on event driven situations where value was found through extensive research by identifying catalysts for individual stock volatility or credit movement.**

The story for 2004 was that it was a better year for credit-focused convertible arbitrage funds than for volatility-oriented managers. May was an exception for the credit strategy as macro factors such as higher oil prices, concerns over interest rates, and uncertainty in Iraq caused a flight out of riskier assets. As a result, credit spreads widened throughout most of the month, and managers holding more speculative issues with high premiums took losses.

The convertible bond market was buoyed by the rally in the equity market in the fourth quarter. **The reelection of President Bush and improved economic data aided in the tightening of credit spreads towards the end of the year, particularly the lowest grade issues.**

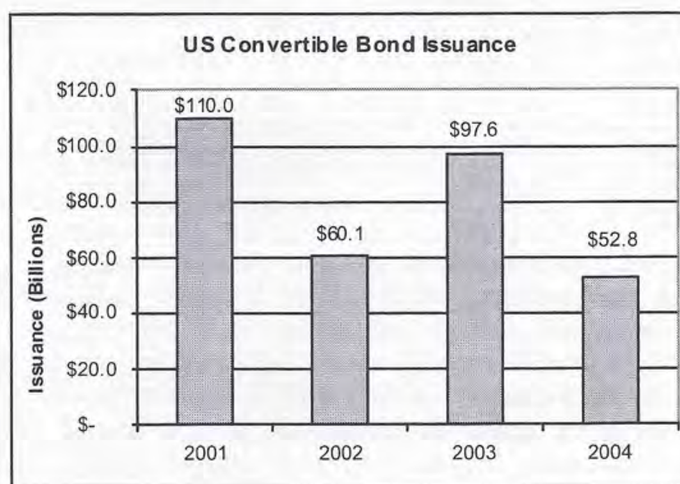
Hedge fund managers that have PIPE (private investments in public companies) investments reported good performance from the strategy during 2004. As the U.S. economy strengthened, smaller companies sought to raise capital quickly. Robust deal flow carried over from the end of 2003 which presented numerous attractive opportunities during the first quarter of 2004.

Despite the negative attention the strategy received towards the end of the year due to the SEC inquiry into a number of regulation-D players (due to concerns regarding the sell-off of stocks prior to public deal announcements), performance finished strong thanks to a strong rally in the equity markets in the fourth quarter.

In Europe, performance was buoyed by strong demand and static supply at the beginning of the year, as new issuance was virtually non-existent during the first quarter though equity volatility remained muted. **The situation in Europe for the second half of the year was quite similar to the U.S. convertible market. Managers lowered their volatility exposure and used their special situation trades to generate returns as volatility trading remained unattractive.**

The Japanese convertible market was negatively affected by contracting implied volatility, but recovered towards the later half of the first quarter. The rest of Asia was mixed, and realized volatility spiked due to the Taiwanese election process.

In the second half of the year, Japan and the rest of Asia were hurt from the selling by global managers reducing risk after being pummeled in the U.S. and European convertible markets. The same issues as the U.S. and Europe affected the Asian convert market as well; low volatility, illiquidity and lack of new issuance. Towards the end of the third quarter, sentiment improved and convertible valuations firmed up.



Managers reported that several new issues in the Asian Pacific region have given some managers reason to believe that there could be a revitalization of new issuance seen at the beginning of 2005. Outside Japan, equity volatility appears to be rising according to some managers, and the exact impact the tsunami crisis will

have on the region has yet to crystallize.

The total supply of outstanding convertibles shrunk in 2004, as the reduced pace of new issuance was unable to keep up with convertibles that were retired due to maturity dates, redemption calls, and company repurchases.

New issuance picked up during the first quarter, but slowed considerably during the second quarter. May was a difficult month, as the equity market sold off and the 10-year Treasury bond rose sharply, causing companies to delay their new issuance. New issuance remained weak throughout the summer because of concerns over potential changes in accounting for contingent conversion bonds but lower equity valuations and sagging volatility were also culprits.

Managers reported that the US convertible market shrunk by approximately $27 billion in 2004 and the European market shrunk even more dramatically, as managers report that another $40 billion, or 20% of the market will disappear in 2005. Given the current state of corporate liquidity, managers expect only a modest new issuance pace in 2005.

Anecdotal evidence suggests that convertible arbitrage managers (mostly multiple arbitrage hedge funds) and convertible mutual funds have taken in capital, this coupled with **less supply should create support for convertible valuations as the new capital will need to be put to work heading into 2005**.

International
(YTD: +9.11% / DEC: +1.86%)

December was a good month for global equities despite the horrendous natural disaster that affected Southeast Asia in the last week of the year. During 2004, while there were concerns about higher energy prices, rising interest rates and the specter of inflation, modest gains were achieved in Europe while the emerging markets produced outsized returns. **U.S. investors continued to purchase a record amount of foreign securities in 2004**, and exceeded 2003's record of $71 billion. The Hennessee International Index posted a +1.86% return in December, while the MSCI World Index advanced by +3.73%.

In 2004, European markets produced positive returns for a second straight year and managers stated that returns were driven by small and mid-capitalization stocks. Record oil prices helped European energy stocks which boosted the indexes. Eastern European stock markets produced solid returns because of their inclusion into the European Union, as Hungary's BUX index finished up +55% and the PX-50 index in the Czech Republic rose 57% in 2004.

Managers stated that this year's gains were achieved despite the negative growth forecasts for the European region and the increased concern of terrorism (the Madrid terrorist attack) which rattled the markets in the first quarter. The consensus was that overall growth in Europe remained disappointing in 2004, but managers were able to generate returns via stock picking (energy exposure) and the strong Euro which enhanced returns when translated back to U.S. dollars for U.S. based managers.

Asian markets finished the year on a positive note and were little affected by the natural disaster. Managers stated that strong foreign capital inflows, positive economic growth, and the higher probability of a soft landing in China all helped to drive returns higher.

One of the biggest themes during 2004 was the so called continuation of the "reflation" trade where managers increased exposure to Asian equities to benefit from the perceived pick-up in global economic growth. The weaker U.S. dollar had managers rotate away from Asian export companies throughout 2004

and into stocks that would benefit from a pick-up in domestic consumption. Besides the weak markets in China and Thailand, the Asian stock markets had a solid year, lead by Indonesia which rose +44.6%, as measured by the JSX composite.

Japan was the early story for 2004 in the Asian region. Managers reported that growth was strong and the financial system continued to show signs of improvement. The economy had posted its strongest quarterly gain in the fourth quarter of 2003 since 1991, which sparked renewed foreign investor interest in the country. Managers saw evidence that land and housing prices were no longer in descent and determined that an inflection point seemed to have been reached. By late 2004, investors became concerned that the economic recovery had fizzled out and export growth would continue to slow due to the weaker U.S. dollar.

In China, the government took steps to slow its expansion to avoid overheating the economy, which caused fears among investors that the global economic recovery would stall. **Chinese stocks were weak during the year due to fears that earnings would be weaker due to the impending slowdown**, as the Shanghai stock market declined -15.2%.

Latin America stocks enjoyed another good year and benefited by the economic recovery in the U.S. and strong commodity prices. Most significant was the record oil prices which helped the oil exporting nations in the region like Mexico. Also, the increase in Chinese demand for metals and other resources buoyed the economies of Argentina, Brazil, and Chile. Milder inflation in the region and the deal struck between Argentina and the IMF to prevent a large scale default by the country were factors that assuaged investors to put capital to work in the Latin American markets.

Looking into 2005, managers feel that the biggest issues for the international markets will be the health of the U.S. economy, a rebound in the Chinese economy, and domestic demand.

HENNESSEE HEDGE HOG CORNER™

The following are extracts from research related to hedge fund managers we monitor and do not necessarily represent the views of the Hennessee Hedge Fund Advisory Group:

We have initiated a new trade that is **short high yield bonds and long high grade bonds** to take advantage of credit spreads widening.

Based on pipeline concerns and patent expirations, we expect **pharmaceuticals to continue to underperform** the market in 2005.

We are still **short the U.S. dollar**. We think it will continue to decline against the Euro due to the large current account and budget deficits.

We remain **long coal** as it continues to fulfill energy needs at a lower cost than gas or oil at current prices.

We continue to be **long homebuilders as the current environment of good economic growth and low interest rates allow the sector to continue to grow**. However, we are hedging a portion of the interest rate exposure by shorting the long bond as it is likely long term rates begin to move up.

2005 will present **more opportunities *on the short side*** of equity portfolios, as Fed tightening reduces liquidity which in turn will improve returns from equity and bond shorts as the market becomes more risk averse and volatility increases.

We believe **the dollar is due for at least a countertrend rally** large enough to inflict some pain on the market.

We are **long volatility sensitive instruments** (i.e., delta hedged options) because short-term implied volatility is at 10 year lows as characterized by the VIX.

We are **issuing credit default swaps (naked)** and taking in the premium because default rates are low and the economy is fairly sound.

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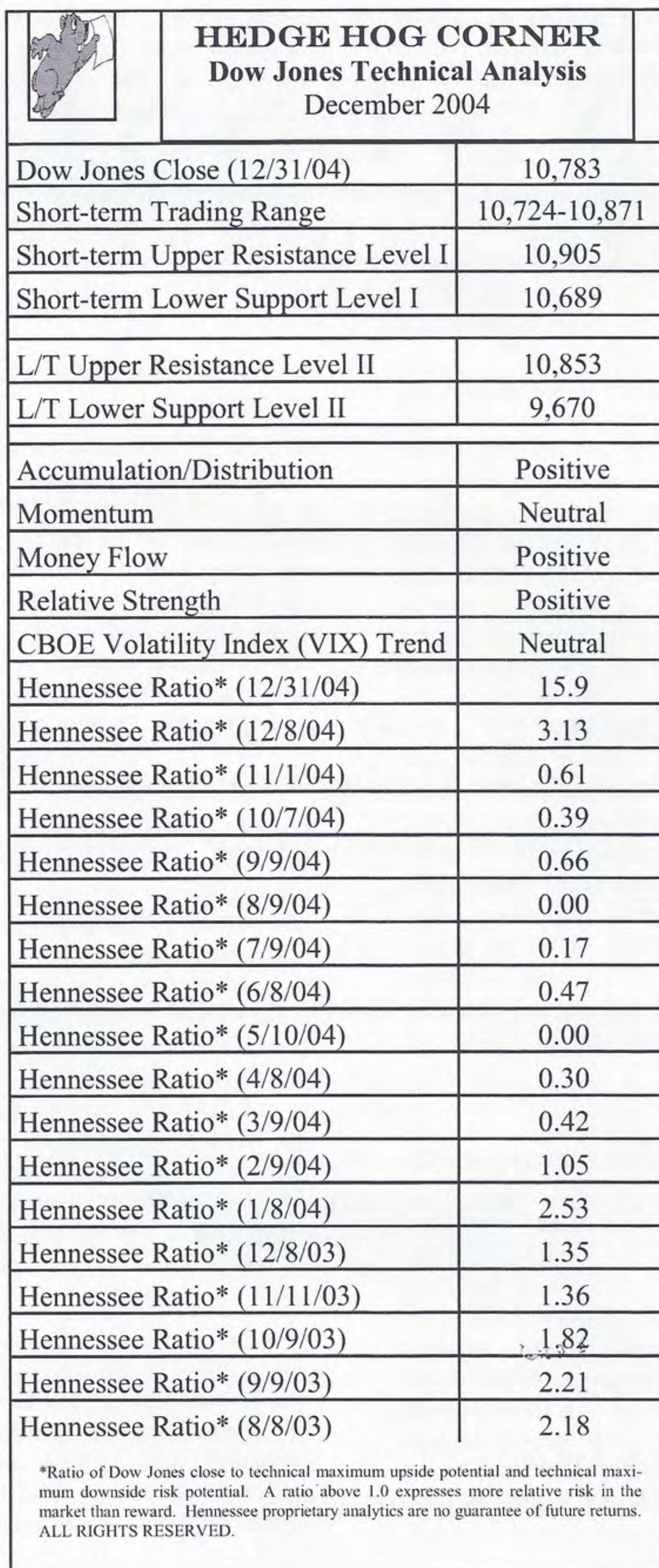
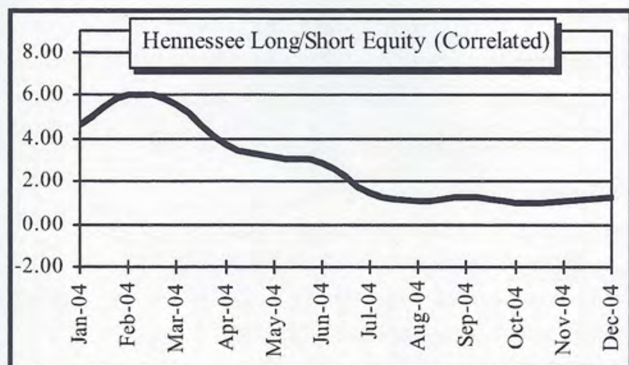


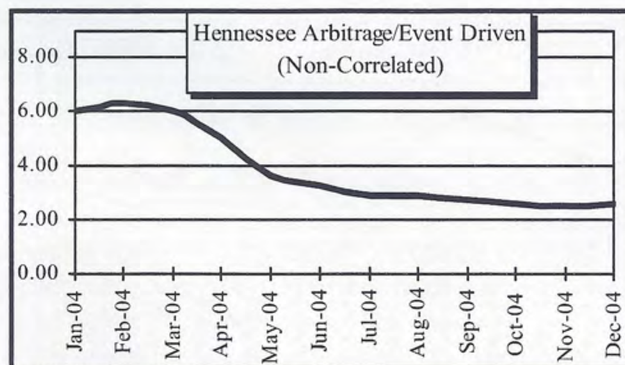
HEDGE HOG CORNER
Dow Jones Technical Analysis
December 2004

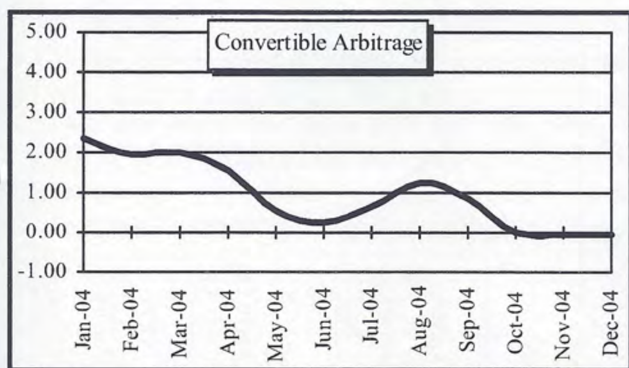
Dow Jones Close (12/31/04)	10,783
Short-term Trading Range	10,724-10,871
Short-term Upper Resistance Level I	10,905
Short-term Lower Support Level I	10,689
L/T Upper Resistance Level II	10,853
L/T Lower Support Level II	9,670
Accumulation/Distribution	Positive
Momentum	Neutral
Money Flow	Positive
Relative Strength	Positive
CBOE Volatility Index (VIX) Trend	Neutral
Hennessee Ratio* (12/31/04)	15.9
Hennessee Ratio* (12/8/04)	3.13
Hennessee Ratio* (11/1/04)	0.61
Hennessee Ratio* (10/7/04)	0.39
Hennessee Ratio* (9/9/04)	0.66
Hennessee Ratio* (8/9/04)	0.00
Hennessee Ratio* (7/9/04)	0.17
Hennessee Ratio* (6/8/04)	0.47
Hennessee Ratio* (5/10/04)	0.00
Hennessee Ratio* (4/8/04)	0.30
Hennessee Ratio* (3/9/04)	0.42
Hennessee Ratio* (2/9/04)	1.05
Hennessee Ratio* (1/8/04)	2.53
Hennessee Ratio* (12/8/03)	1.35
Hennessee Ratio* (11/11/03)	1.36
Hennessee Ratio* (10/9/03)	1.82
Hennessee Ratio* (9/9/03)	2.21
Hennessee Ratio* (8/8/03)	2.18

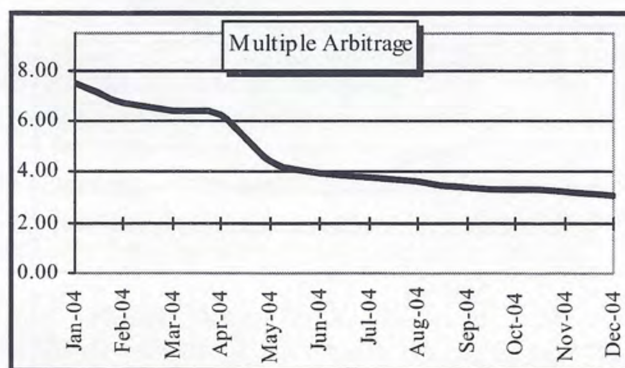
*Ratio of Dow Jones close to technical maximum upside potential and technical maximum downside risk potential. A ratio above 1.0 expresses more relative risk in the market than reward. Hennessee proprietary analytics are no guarantee of future returns. ALL RIGHTS RESERVED.

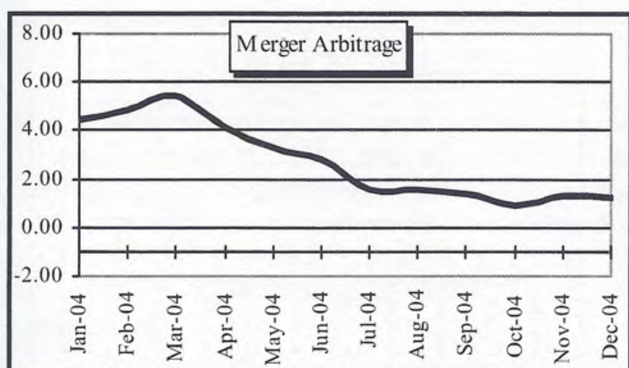
12 MONTH ROLLING SHARPE RATIO

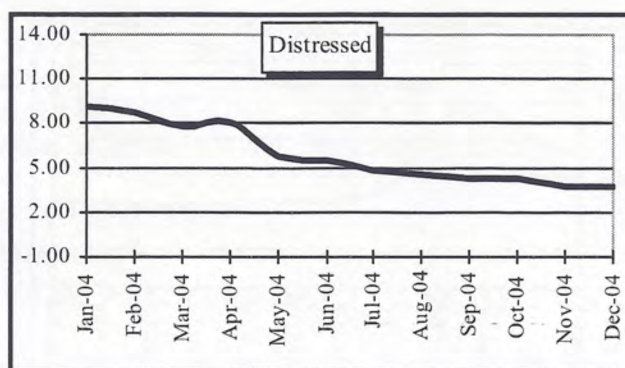








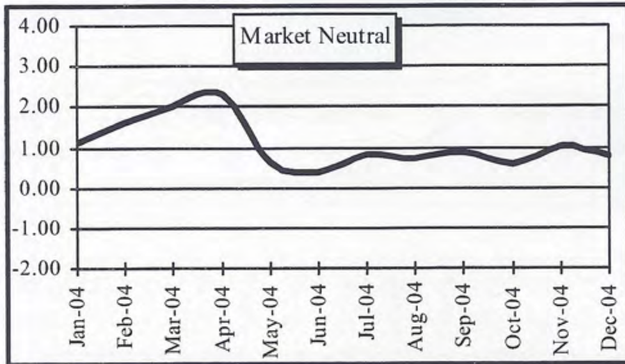


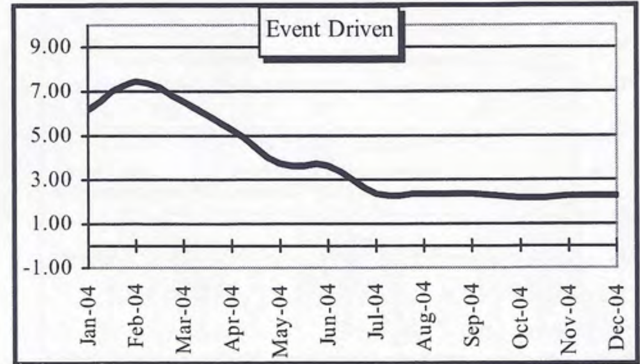


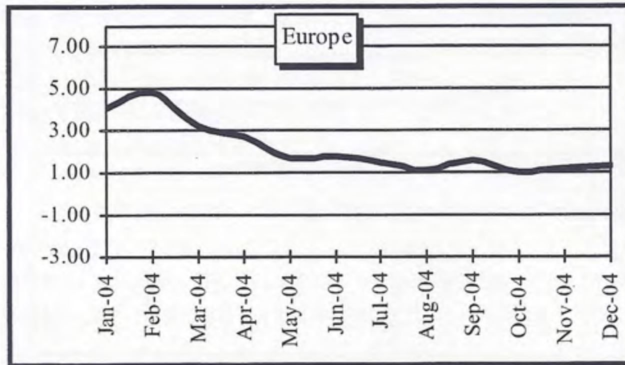
Sharpe Ratio = $\dfrac{\textit{Annualized Return - Risk Free Rate of Return *}}{\textit{Annualized Standard Deviation}}$

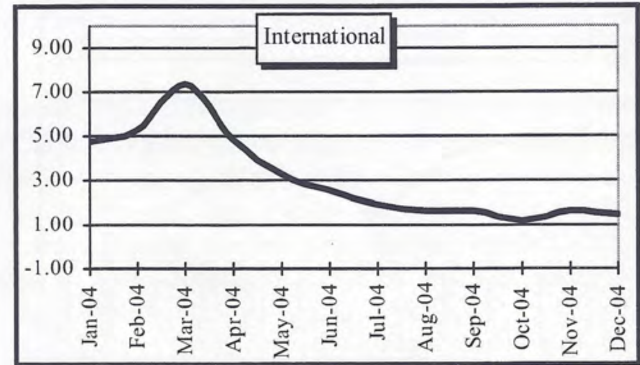
***90 day T-bill**

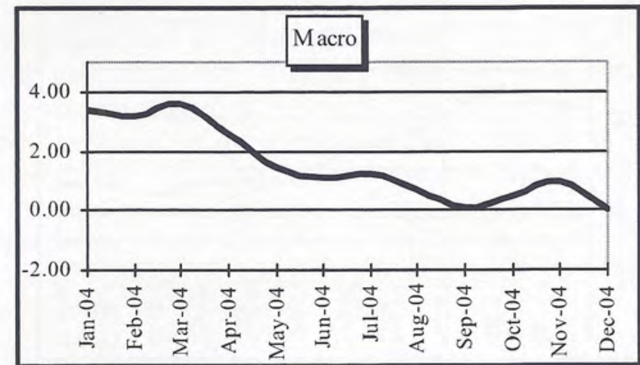
12 MONTH ROLLING SHARPE RATIO







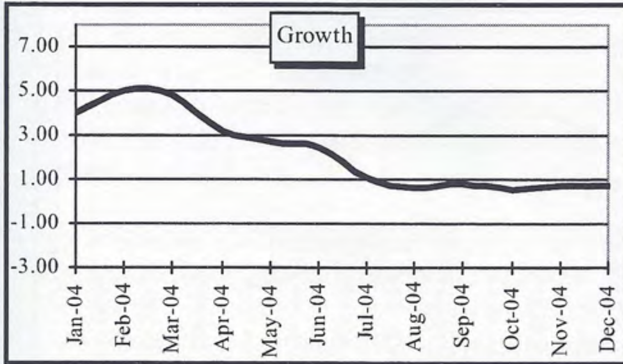


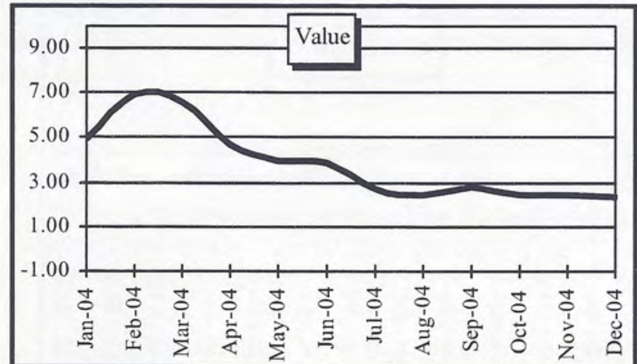


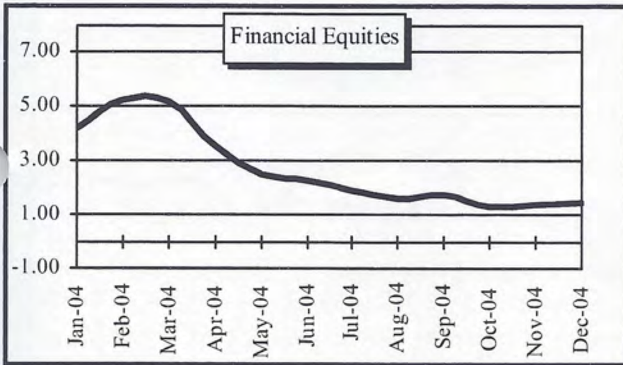
Sharpe Ratio = $\dfrac{\textit{Annualized Return - Risk Free Rate of Return *}}{\textit{Annualized Standard Deviation}}$

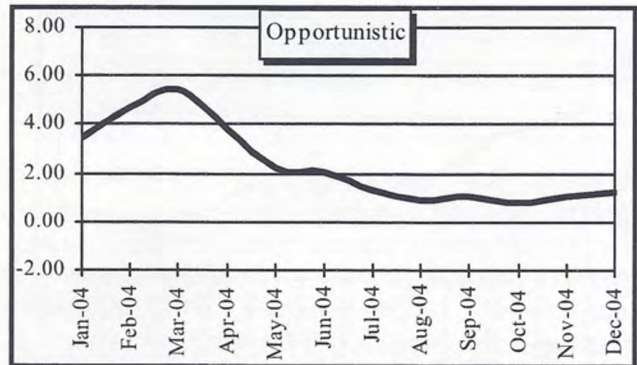
***90 day T-bill**

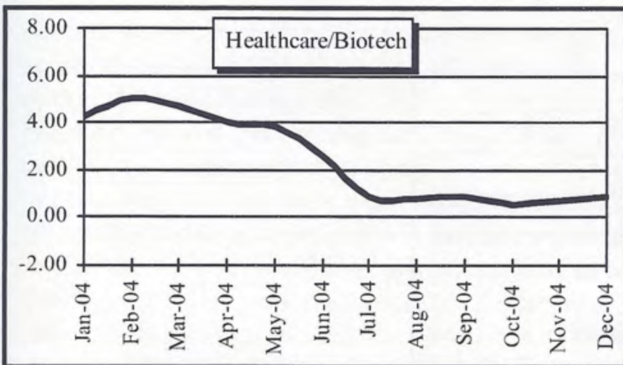
12 MONTH ROLLING SHARPE RATIO

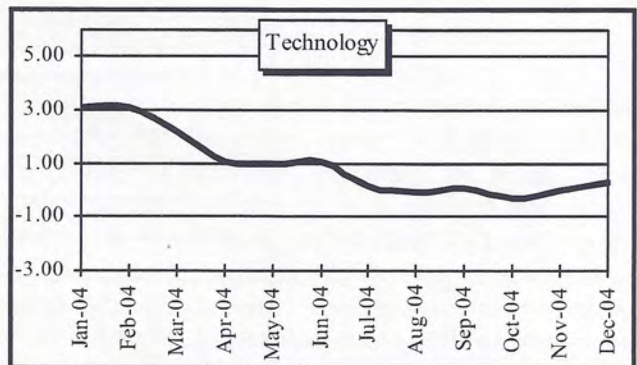








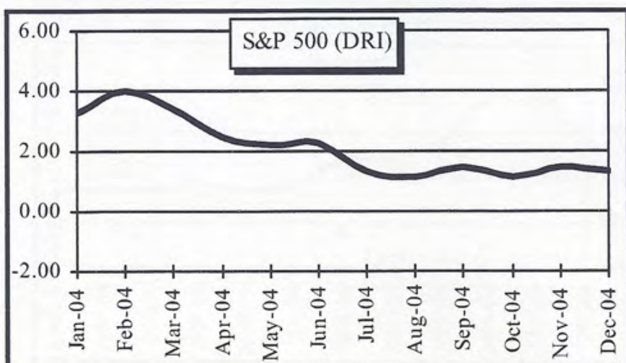


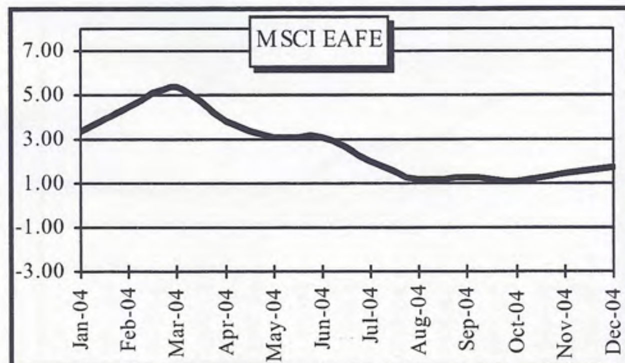


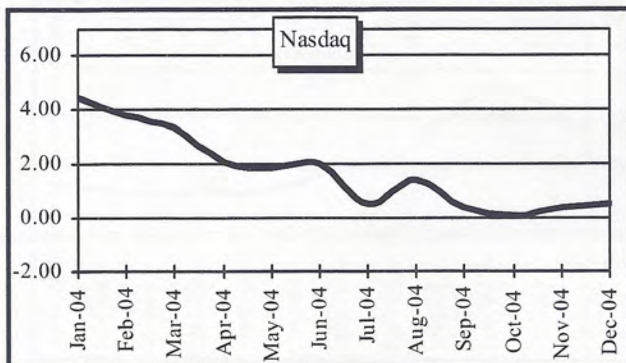
$$\textit{Sharpe Ratio} = \frac{\textit{Annualized Return - Risk Free Rate of Return *}}{\textit{Annualized Standard Deviation}}$$

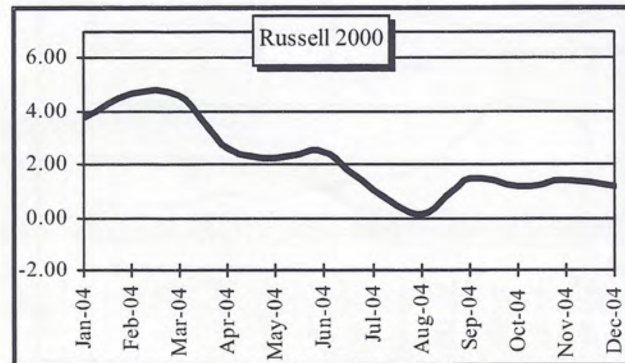
****90 day T-bill***

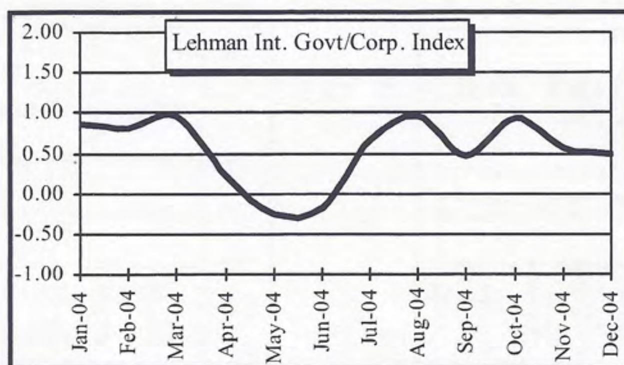
12 MONTH ROLLING SHARPE RATIO











Sharpe Ratio = $\dfrac{\textit{Annualized Return - Risk Free Rate of Return *}}{\textit{Annualized Standard Deviation}}$

**90 day T-bill*

HENNESSEE HEDGE FUND RANKINGS

MONTHLY RETURN 2004 (Net)	YTD	JAN	FEB	MAR	APRIL	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC
CONVERTIBLE ARBITRAGE	22	16	21	8	8	19	21	5	7	21	21	22	19
DISTRESSED	1	5	18	13	2	7	2	6	5	17	5	2	4
EMERGING MARKETS	5	13	5	5	12	18	18	9	4	7	6	8	14
EUROPE	10	3	4	20	11	21	8	12	12	5	19	16	6
EVENT DRIVEN	6	6	10	17	9	13	7	16	16	15	10	10	5
FINANCIAL EQUITIES	8	7	2	15	22	2	10	17	3	6	13	13	11
FIXED INCOME	14	21	17	12	3	10	15	4	9	22	4	17	20
GROWTH INDEX	15	11	12	18	19	6	6	21	22	2	20	7	8
HEALTHCARE AND BIOTECH	12	2	9	6	7	15	23	22	20	4	22	20	2
HIGH YIELD	7	9	20	11	6	14	5	3	6	13	3	19	15
INTERNATIONAL	9	8	7	3	15	17	16	20	18	9	7	11	12
LATIN AMERICA	2	17	23	1	23	22	1	2	2	1	9	1	3
MACRO	21	22	8	7	18	20	20	10	10	20	8	12	22
MARKET NEUTRAL	20	19	16	14	14	5	14	8	19	16	17	21	21
MERGER ARBITRAGE	17	18	14	16	10	9	13	13	13	19	16	15	16
MULTIPLE ARBITRAGE	13	14	19	10	5	11	12	7	8	18	15	18	17
OPPORTUNISTIC	11	10	13	19	20	4	9	19	17	3	11	5	10
PACIFIC RIM	16	20	3	2	16	23	17	15	21	10	18	4	18
REGULATION-D	3	1	1	4	4	8	19	14	11	14	12	6	7
SHORT BIASED	23	23	11	22	1	3	11	1	1	23	23	23	23
TECHNOLOGY	18	4	22	21	21	1	4	23	23	11	2	9	13
TELECOM AND MEDIA	19	15	15	23	17	16	22	18	15	12	1	14	1
VALUE	4	12	6	9	13	12	3	11	14	8	14	3	9

The Hennessee Hedge Fund Indices® are calculated from performance data supplied by a diversified group of hedge funds monitored by the Hennessee Hedge Fund Advisory Group. The Hennessee Hedge Fund Index is believed to represent over half of the capital in the industry and is an equally- weighted average of the funds in the Hennessee Hedge Fund Indices®. The funds in the Hennessee Hedge Fund Index are believed to be statistically representative of the larger Hennessee Universe of over 3,500 hedge funds and are net of fees and unaudited. Past performance is no guarantee of future returns. ALL RIGHTS RESERVED.

HENNESSEE GROUP LLC
HEDGE FUND ADVISORY

HENNESSEE HEDGE FUND INDICES

HENNESSEE
HEDGE FUND REVIEW®
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2004 (Net)	YTD	YTD RANK	% of mgrs. >S&P, YTD	JAN	FEB	MAR	APRIL	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC
CONVERTIBLE ARBITRAGE	**1.16%**	**22**	**0%**	1.11%	0.42%	0.51%	0.19%	-1.25%	-1.08%	0.32%	0.45%	-0.12%	-0.50%	0.44%	0.71%
DISTRESSED	**18.53%**	**1**	**60%**	3.04%	0.44%	0.18%	1.21%	-0.05%	2.08%	0.12%	0.79%	0.84%	1.47%	4.05%	3.04%
EMERGING MARKETS	**12.24%**	**5**	**20%**	1.60%	1.55%	1.26%	-0.75%	-1.02%	-0.14%	-0.19%	1.30%	2.00%	1.27%	3.21%	1.58%
EUROPE	**8.44%**	**11**	**56%**	3.47%	1.80%	-0.97%	-0.59%	-1.76%	0.57%	-0.84%	0.18%	2.08%	-0.10%	1.65%	2.78%
EVENT DRIVEN	**11.70%**	**6**	**60%**	2.89%	1.25%	-0.04%	-0.10%	-0.39%	0.96%	-1.07%	0.12%	0.87%	0.93%	2.98%	2.80%
FINANCIAL EQUITIES	**10.86%**	**8**	**33%**	2.88%	2.36%	0.09%	-3.70%	0.81%	0.44%	-1.34%	1.80%	2.05%	0.74%	2.34%	2.09%
FIXED INCOME	**6.29%**	**14**	**14%**	0.66%	0.46%	0.18%	0.88%	-0.20%	-0.04%	0.56%	0.27%	-0.29%	1.54%	1.57%	0.54%
GROWTH	**6.12%**	**15**	**42%**	1.95%	0.89%	-0.06%	-2.29%	0.01%	0.99%	-2.76%	-0.69%	2.65%	-0.30%	3.28%	2.48%
HEALTHCARE AND BIOTECH	**7.59%**	**12**	**33%**	3.55%	1.25%	0.87%	0.26%	-0.87%	-1.32%	-3.04%	-0.19%	2.17%	-0.87%	1.48%	4.28%
HIGH YIELD	**11.39%**	**7**	**40%**	2.25%	0.42%	0.38%	0.32%	-0.58%	1.03%	0.77%	0.67%	1.02%	1.58%	1.53%	1.47%
INTERNATIONAL	**9.11%**	**9**	**38%**	2.34%	1.34%	2.01%	-1.35%	-0.99%	-0.09%	-2.09%	0.04%	1.87%	1.09%	2.88%	1.86%
LATIN AMERICA	**16.63%**	**2**	**60%**	1.03%	-1.34%	2.80%	-6.29%	-2.35%	2.65%	2.94%	2.86%	4.42%	0.94%	5.01%	3.39%
MACRO	**1.47%**	**21**	**25%**	0.55%	1.27%	0.87%	-2.03%	-1.56%	-0.75%	-0.24%	0.23%	-0.02%	1.05%	2.53%	-0.34%
MARKET NEUTRAL	**2.87%**	**20**	**7%**	0.77%	0.47%	0.18%	-1.14%	0.06%	0.05%	-0.11%	-0.07%	0.85%	0.06%	1.27%	0.47%
MERGER ARBITRAGE	**4.47%**	**17**	**0%**	0.98%	0.54%	0.06%	-0.34%	-0.14%	0.11%	-0.95%	0.15%	0.31%	0.46%	1.82%	1.40%
MULTIPLE ARBITRAGE	**6.89%**	**13**	**9%**	1.38%	0.43%	0.43%	0.50%	-0.20%	0.14%	0.09%	0.32%	0.38%	0.55%	1.54%	1.14%
OPPORTUNISTIC	**8.51%**	**10**	**50%**	2.00%	0.78%	-0.36%	-2.30%	0.21%	0.50%	-1.98%	0.10%	2.34%	0.91%	3.69%	2.49%
PACIFIC RIM	**5.34%**	**16**	**30%**	0.73%	2.04%	2.12%	-1.55%	-2.74%	-0.13%	-1.04%	-0.45%	1.82%	-0.01%	3.73%	0.85%
REGULATION-D	**16.35%**	**3**	**75%**	4.67%	2.54%	1.36%	0.61%	-0.05%	-0.62%	-0.99%	0.22%	0.88%	0.86%	3.41%	2.49%
SHORT BIASED	**-3.95%**	**23**	**67%**	-0.33%	1.04%	-2.23%	4.16%	0.48%	0.42%	8.23%	3.40%	-2.44%	-1.20%	-9.00%	-5.43%
TECHNOLOGY	**3.91%**	**18**	**8%**	3.20%	-0.15%	-1.84%	-3.65%	1.85%	1.08%	-4.18%	-1.09%	1.64%	2.50%	3.16%	1.68%
TELECOM AND MEDIA	**3.43%**	**19**	**0%**	1.20%	0.48%	-3.20%	-1.68%	-0.99%	-1.14%	-1.59%	0.13%	1.26%	2.68%	2.11%	4.37%
VALUE	**12.54%**	**4**	**64%**	1.67%	1.39%	0.45%	-0.93%	-0.27%	1.49%	-0.79%	0.14%	1.99%	0.64%	3.74%	2.46%
HENNESSEE HEDGE FUND INDEX	**8.27%**		**35%**	**2.00%**	**0.96%**	**0.29%**	**-1.09%**	**-0.40%**	**0.47%**	**-1.21%**	**0.09%**	**1.54%**	**0.52%**	**2.75%**	**2.13%**
LONG/SHORT EQUITY*	**8.44%**		**44%**	**2.20%**	**1.02%**	**-0.07%**	**-1.84%**	**0.07%**	**0.77%**	**-2.17%**	**-0.19%**	**2.21%**	**0.45%**	**3.19%**	**2.65%**
ARBITRAGE/EVENT DRIVEN**	**7.98%**		**22%**	**1.89%**	**0.69%**	**0.31%**	**0.12%**	**-0.40%**	**0.27%**	**-0.22%**	**0.32%**	**0.54%**	**0.53%**	**2.05%**	**1.65%**
GLOBAL	**8.03%**		**38%**	**1.68%**	**1.36%**	**1.23%**	**-1.64%**	**-1.66%**	**0.08%**	**-0.67%**	**0.41%**	**1.75%**	**0.71%**	**2.97%**	**1.64%**
S&P 500 W/DIV	**10.87%**			1.84%	1.39%	-1.51%	-1.57%	1.37%	1.94%	-3.31%	0.40%	1.08%	1.53%	4.05%	3.40%
DJIA	**3.15%**			0.33%	0.91%	-2.14%	-1.28%	-0.36%	2.42%	-2.83%	0.34%	-0.92%	-0.52%	4.00%	3.40%
MSCI EAFE (USD) PRICE	**17.59%**			1.37%	2.18%	0.16%	-2.55%	-0.07%	1.99%	-3.32%	0.18%	2.47%	3.35%	6.64%	4.33%
RUSSELL 2000	**18.32%**			4.34%	0.90%	0.93%	-5.10%	1.59%	4.21%	-6.73%	-0.51%	4.69%	1.97%	8.67%	2.96%
NASDAQ	**8.60%**			3.13%	-1.76%	-1.75%	-3.71%	3.47%	3.07%	-7.83%	-2.61%	3.20%	4.12%	6.17%	3.75%
LEHMAN BROS. INT. GOVT. CORP.	**3.04%**			0.66%	1.02%	0.78%	-2.37%	-0.45%	0.30%	0.84%	1.67%	0.17%	0.67%	-0.91%	0.68%

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*Previously nam[illegible]ted
**Previously name[illegible]-correlated