HENNESSEE GROUP LLC
HEDGE FUND ADVISORY
YOUR STRATEGIC PARTNER IN HEDGE FUND INVESTING

HENNESSEE

HEDGE FUND REVIEW®

JANUARY 2008
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	DEC	YTD
Hennessee Hedge Fund Index	+0.30%	+11.64%
S&P 500	-0.86%	+3.56%
Long/Short Equity	+0.25%	+12.08%
Arbitrage/Event Driven	+0.10%	+7.78%
Global/Macro	+0.56%	+15.59%
Percentage of Hedge Fund Managers Outperforming The:		
S&P 500	77%	69%

Top (3) Performing:	DEC		YTD
Macro	+2.08%	Latin America	+23.40%
Short Biased	+1.10%	International	+20.02%
Distressed	+0.95%	Technology	+19.98%

Bottom (3) Performing:	DEC		YTD
Telecom & Media	-1.00%	Convertible Arbitrage	+4.36%
Healthcare & Biotech	-0.70%	Event Driven	+4.71%
Asia-Pacific	-0.63%	Fixed Income	+5.81%

MARKET SUMMARY - 2007

Equity markets ended the year with yet another decline in December, failing to deliver their typical fourth quarter rally. **The S&P 500 declined -0.86% in December, bringing year-to-date returns to +3.56%.** Both the S&P 500 and Dow Jones Industrial Average posted losses in the fourth quarter, marking the first time each has posted losses in the fourth quarter in the last ten years.

Hedge funds outperformed again in December, as has been typical for most of 2007. **The Hennessee Hedge Fund Index advanced +0.30% in December to bring year-to-date returns to +11.64%.** The index logged its best year relative to the S&P 500 since 2002, the end of the last bear market, outperforming the S&P 500 by over 800 basis points. **All 23 of the Hennessee Hedge Fund Indices outperformed the S&P 500 for the year.**

It was certainly a noteworthy year for hedge funds. Significant milestones include the initial public offerings of several of the largest hedge fund and private equity firms and substantial profits generated by many hedge funds via short positions in sub-prime mortgage backed securities.

Volatility in the fixed income markets didn't result in only gains for hedge funds however, as several levered funds failed as a result of the decline in sub-prime MBS prices and resulting volatility within corporate credits. Quantitative oriented equity strategies, such as statistical arbitrage, also experienced substantial difficulty in the second half of the year.

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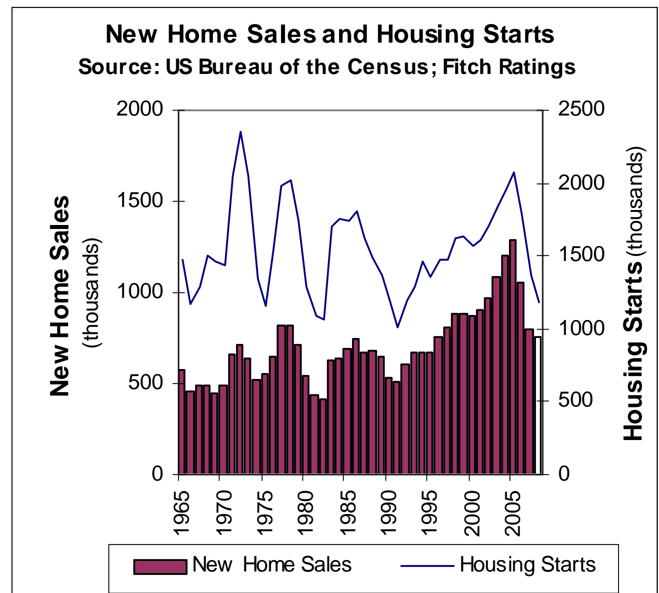
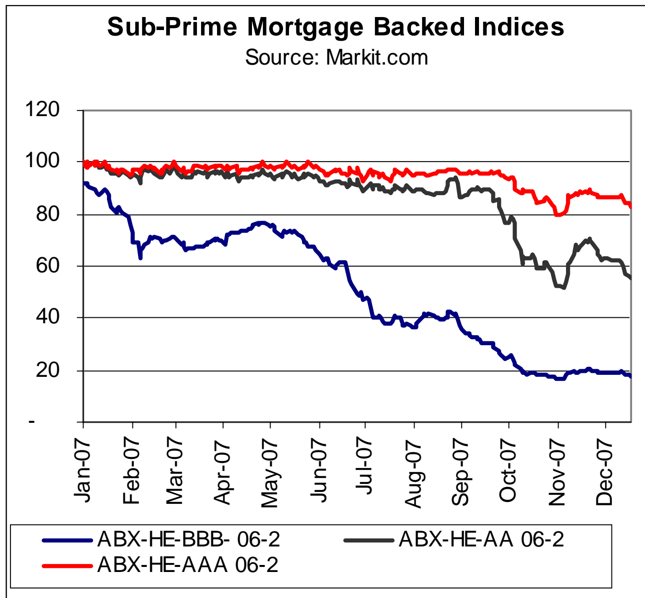
The biggest story in the financial markets for the year was the demise of housing and its impact on sub-prime mortgages. Housing clearly hit a wall in 2007. New and existing home sales fell off a cliff throughout the year, causing inventories to increase and prices of homes to decline. The supply of existing homes on the market reached 10.3 months of supply by the end of November (up from 6.6 months a year ago), and the median existing home price declined –5.1% over the past twelve months. Mortgage lenders clearly relaxed lending standards at the tail end of the housing boom (2005-2006), subsequently causing an increase in delinquencies and foreclosures among sub-prime borrowers and losses among the holders of these mortgages. Not including their effect on derivatives prices, most estimate that losses for sub-prime mortgages will total $250 billion. As most mortgages are today securitized in mortgage backed securities (MBS), losses have been concentrated with the holders of lower traunches (A and BBB) of subprime MBS and mezzanine collateralized debt obligations (CDOs) holding A and BBB subprime MBS. Still unknown is the extent of losses created by those investors that wrote insurance on these MBS in the form of credit default swaps.

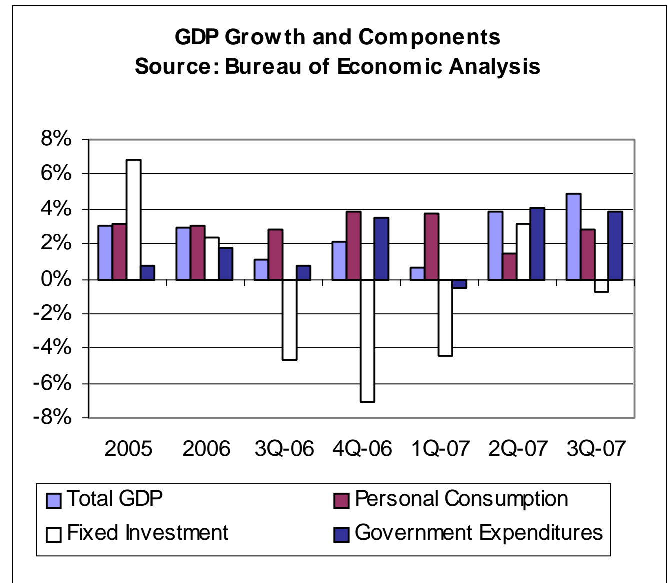


As a result of these losses, almost every Wall Street brokerage and large commercial bank has announced losses and dozens of subprime lenders have filed for bankruptcy. Merrill Lynch has thus far announced write-downs of $7.9 billion, with another

$10 billion expected in the fourth quarter, while Citigroup has announced $2.2 billion of writedowns with another $15 billion expected for the fourth quarter. UBS, Bank of America, and Bear Stearns are among the others that have announced multi-billion dollar write-downs. These numbers are staggering considering that UBS wrote-off $1 billion as a result of the failure of Long-Term Capital Management in 1998, an event which many considered to be a risk to the stability of the financial markets. The losses have caused substantial turnover in executives suites of those firms suffering losses, while many banks and brokerages have recapitalized their balance sheets by raising new equity. Brokerages and banks weren't the only financial institutions holding the "toxic waste" – many hedge funds also owned substantial sub-prime MBS. On the other hand, many hedge funds also purchased credit default swaps on subprime MBS or an index of MBS, which generated huge gains for those that did so.

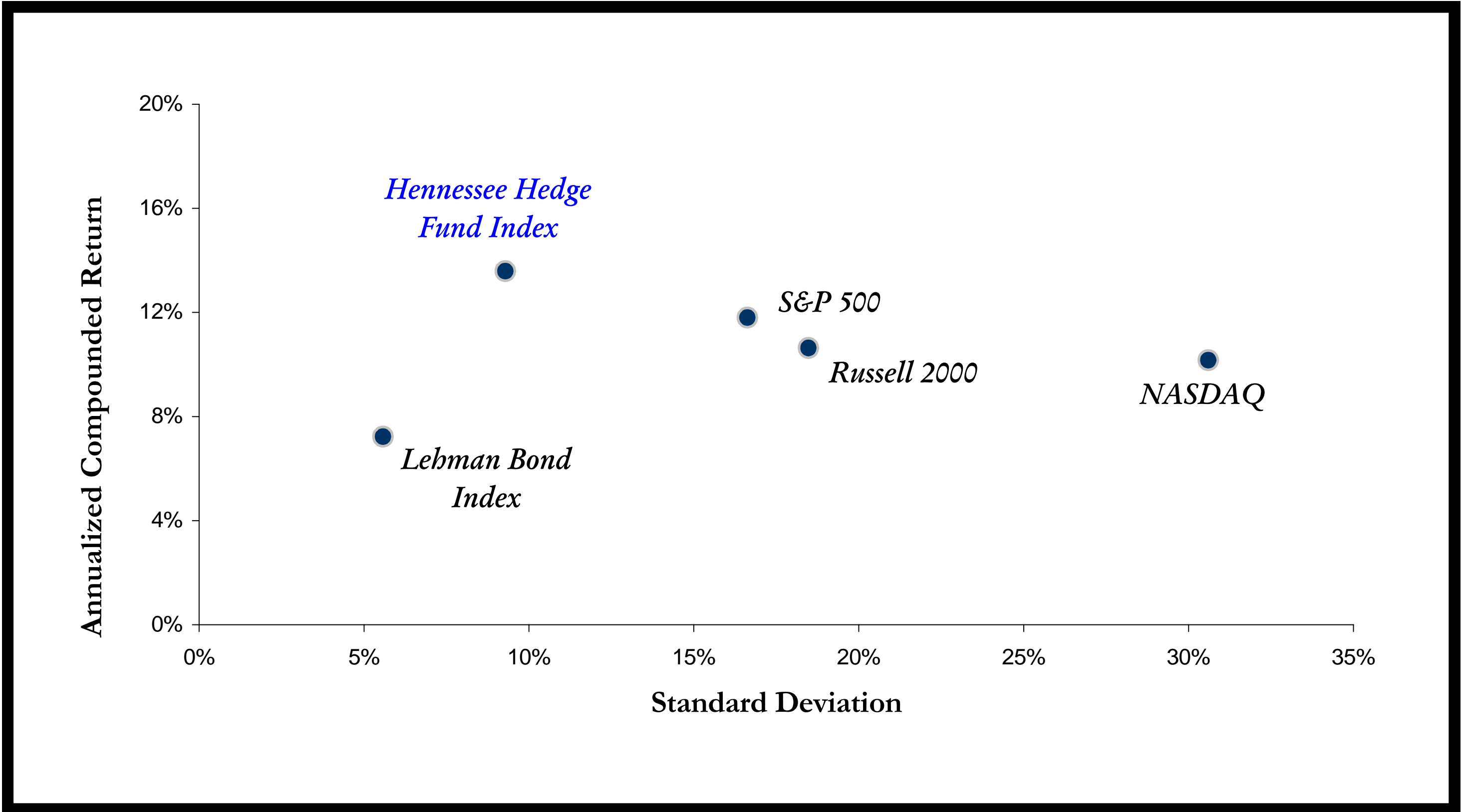


The decline in housing and deterioration in credit conditions has called into question the strength of the U.S. economy, as many believe housing and mortgage woes will negatively affect consumer spending. Overall GDP growth held up relatively well in 2007, as strong consumer spending offset the substantial decline in residential fixed investment (i.e. housing). However, a combination of increasing job losses, higher resets of adjustable rate mortgages, decline in home equity cash outs, and the negative wealth effect associated with declining home prices has led most to speculate that consumer spending growth will decline in 2008, with most Wall Street economists putting the odds of a recession (characterized as two successive quarters of negative GDP growth) at a 50% likelihood. Recent poll conducted by Bloomberg News indicated that the consensus believes that U.S. GDP will grow 2.1% in 2008.



As a result of the economic and financial market turmoil, Treasury bond yields fell substantially. **The yield curve, which was inverted at the beginning of the year, resumed its upward sloping nature after a substantial drop in short term rates.** The yield on the 2 Year Treasury fell 4.8% to 3.1%, while the yield on the 10 Year Treasury fell from 4.7% to 3.9%. **The Federal Reserve responded quickly by reducing the Fed Funds rate by 100 basis points throughout the year, and providing liquidity for troubled banks.** Most rate cuts are expected in 2008, with the first likely to happen in January.

Unfortunately, some speculate that the Fed will have to be restrained in providing stimulus to the economy, as inflation continues to grow. While core CPI (ex food and energy) has remained under control at less than 2.5% annualized throughout the year, commodity prices, notably energy and food, have pushed up overall inflation. In December, the inflation report shook the market, as CPI increased 0.6% from the previous month and 4.3% from the previous year, clearly outside of the Fed's "comfort zone."



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 an equally- weighted average of the funds in the Hennessee Hedge Fund Indices®. The funds in the Hennessee Hedge Fund Index is net of fees and unaudited. The hedge fund performance data has been obtained from sources believed to be reliable, but no guarantee is made with respect to accuracy. Past performance is no guarantee of future returns. This material is for general information only and is not an offer or

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® have been used as a hedge fund benchmark since 1987. Created real-time, the Hennessee Hedge Fund Indices® are an equally weighted average of a diversified group of hedge funds consisting of 23 different investment styles.

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HENNESSEE GROUP LLC
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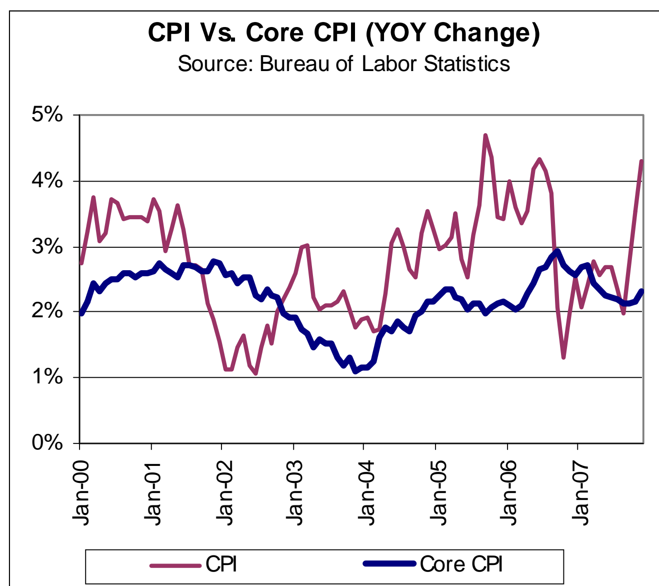


Entering 2008, most hedge fund managers are positioned rather cautiously, recognizing the risk of a substantial slowdown in economic activity. Earnings growth, which slowed significantly in 2007, is likely to continue slowing in 2008. However, most also recognize that U.S. equities are trading at 15 times projected 2008 operating earnings. Valuations are much lower in comparison to the last bear market (2000-2002), and therefore most managers believe substantial opportunities will arise should equities suffer a setback.

Long/Short Equity

(YTD: +12.08% / DEC: +0.25%)

Long/short equity funds had a good year in 2007, as the Hennessee Long/Short Equity Index outperformed the S&P 500 by its widest margin since 2002. Considering that the average long/short equity fund has a net exposure of approximately 50%, the index generated an estimated 10% of alpha for the year, its best showing since 2000.

Most beneficial to long/short equity funds was the increased differentiation of returns among sectors and stocks. In addition to the financial and consumer sectors posting negative returns for the year, there were also numerous stocks that appreciated greater than 100%, while many others posted declines of greater than -50%. This type of environment is ideal for hedge funds in their pursuit to identify profitable long and short positions.

Hennessee Long/Short Equity Index vs. S&P 500
Source: Hennessee Group; Standard & Poor's

	Long/Short Equity Index	S&P 500	Difference
1998	7.3%	26.7%	-19.4%
1999	33.9%	19.5%	14.4%
2000	10.2%	-10.1%	20.3%
2001	2.9%	-13.0%	15.9%
2002	-6.4%	-23.4%	17.0%
2003	19.4%	26.4%	-7.0%
2004	7.8%	9.0%	-1.2%
2005	6.8%	3.0%	3.8%
2006	11.1%	13.6%	-2.5%
2007	12.1%	3.6%	8.5%
Annualized (1998-2007)	10.10%	4.2%	5.9%

After suffering four consecutive years of losses in short portfolios from 2003-2006, most long/short equity funds were able to generate a profit via short selling in 2007, despite the overall market's rise. Given the difficulties in short selling from 2003-2006, many funds had previously elected to short indices and exchange traded funds as an alternative to shorting individual companies, in hope of mitigating the risk of substantial losses due to appreciating short positions. However, this strategy would likely have been unprofitable in 2007 (barring incredible market timing), again showing value in company specific short selling.

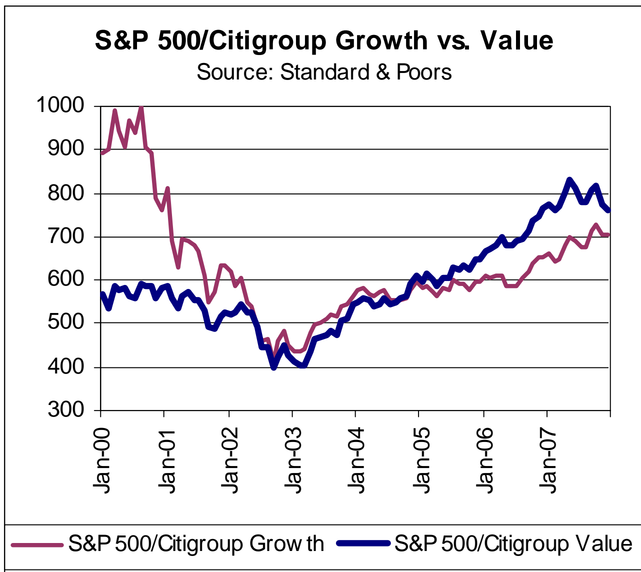
S&P 500 Sector Performance
Source: Standard & Poor's

	2007 Return	**2006 Return**
Consumer Discretionary	-14.3%	17.2%
Technology	15.5%	7.7%
Telecom Services	8.5%	32.1%
Industrials	9.8%	11.0%
Materials	20.0%	15.7%
Energy	32.4%	22.2%
Consumer Staples	11.6%	11.8%
Healthcare	5.4%	5.8%
Utilities	15.8%	16.9%
Financials	-20.8%	16.2%
Overall S&P 500	3.5%	13.6%

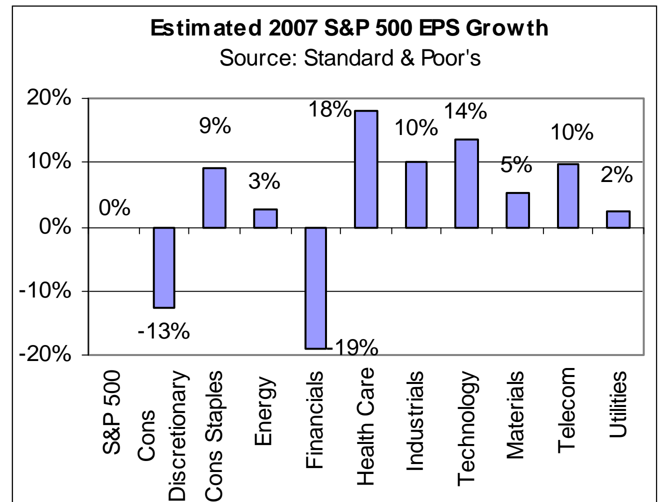
The financial sector provided the most opportunities on the short side due to the collapse of the housing and sub-prime mortgage markets. Numerous mortgage lenders experienced substantial price de-

clines including New Century Financial (-99% decline), Indymac (-86% decline), Fremont General (-78% decline), Novastar (-97% decline), and Countrywide Financial (-79% decline), erasing tens of billions of dollars of market capitalization. Homebuilders also suffered, as evidenced by the decline of -84% in Beazer Homes, the -87% decline in Standard Pacific and the -68% decline in Pulte Homes. All of the aforementioned companies had substantial short interests, indicating that hedge funds profited substantially from their decline. Many funds were also able to generate outsized returns by purchasing credit default swaps on sub-prime mortgage backed securities, which fell substantially as a result of increased mortgage delinquencies.

The year also witnessed a return of growth stock investing, as the Hennessee Growth Index outperformed the Hennessee Value Index for the first time since 1999. Many managers believe that 2007 will be the start of a multi-year trend in which growth stocks outperform value stocks, following a long period of out-performance by value.



The standout this year was the technology sector, although returns within technology were not all that broadly based. In fact, the four horseman of technology (Apple, Google, Research in Motion, and Amazon) contributed the majority of the gains to the NASDAQ 100's rise of +19% for the year. Apple rose +134% for the year, Google rose +50%, Research in Motion rose +166%, and Amazon rose +134%. With the exception of Amazon, all were widely held in the hedge fund community. Many short sellers were burned by Amazon, which defied most expectations by substantially improving margins.



Later in the year, long/short equity funds benefited from a substantial rise in alternative energy companies, especially solar companies. As an example, First Solar, which was widely held by hedge funds, rose +796% for the year. Fertilizer companies such as Potash, Monsanto, and Mosaic also provided good returns, as elevated food prices provided incentive for farmers to increase crop production, creating increased demand for fertilizer.

Activist investing had a difficult year in 2007, partially a result of the substantial decline in private equity activity. As a result of the mortgage problems, corporate credit spreads widened substantially starting in the summer, creating a more difficult environment for financing leveraged buyouts. The activist investor, which had previously worked with the private equity investor in persuading company management to restructure their businesses, no longer had the influence of a buyout to call on. As a result, several activist funds had difficulty in this environment, as several rumored buyouts were called off. Most activist funds remain optimistic about their strategy, however, as the private equity buyer has not always been necessary to implement their strategy. They believe that many companies still have excess cash on their balance sheets and are improperly managed, meaning that many companies still warrant restructurings that should improve stock prices.

As a result of the substantial decline in earnings in the financial and consumer sectors, operating earnings for companies in the S&P 500 failed to grow (0.0% growth) in 2007.

Going forward, the consensus is expecting a resumption in earnings growth in 2008. According to Standard & Poor's, the consensus expects operating earnings for companies in the S&P 500 to grow +15.6% in 2008, with double digit growth expected in all sectors except energy and materials. While most hedge fund managers do not expect the financial sector to produce similar write-downs of assets in 2008 as 2007, most also don't believe that double digit earnings growth is attainable for the market as a whole. As such, most are fairly conservatively positioned, expecting more volatility should companies fail to live up to current expectations.

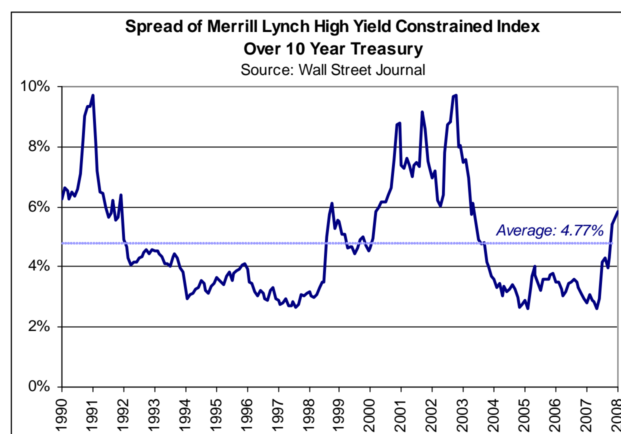
Arbitrage/Event Driven

(YTD: +7.78% / DEC: +0.10%)

The Hennessee Arbitrage/Event Driven Index advanced +0.10% in December (+7.78% YTD). Arbitrage/event driven managers were able to outperform benchmarks despite facing a difficult year that was marked by hedge fund difficulties and a credit crisis.

Multiple arbitrage funds performed well, up +10.92% for the year according to the Hennessee Multiple Arbitrage Index, outperforming the general Hennessee Arbitrage/Event Driven Index. Multiple arbitrage funds benefited from more equity exposure in 2007, as most perceived equities as better investments than other strategies. In addition, funds were able to generate gains in special situations and less liquid investments. As a result, we are seeing greater use of side pockets and longer lock ups from many multiple arbitrage funds. **In addition, multiple arbitrage funds have generally reduced leverage as it has become more difficult to maintain acceptable volatility with greater allocations to equities and special investments.** In addition, as interest rates have increased in comparison to several years ago, the use of margin has become more expensive.

The Hennessee Distressed Index advanced +0.95% in December (+8.87% YTD) despite a slight widening of credit spreads for the month. For the year, spreads on Merrill Lynch High Yield Constrained Index widened substantially from +2.90% to +5.84% over the 10 Year Treasury, the highest level since mid-2003. Spreads of high yield bonds hit a record low in mid 2007. However, as contagion from the subprime fallout spread, the corporate credit markets suffered as credit spreads widened significantly, liquidity disappeared and prices fell. While the market has slowly began to improve with banks selling LBO debt, there is a still a substantial debt overhang and banks are still selling paper at a discount.



Treasury bonds rallied as investors sold riskier bonds and invested in safer Treasury bonds. During the year, yields on the 10 year dropped from 4.71% to 3.88% at year end. **Treasuries bonds returned +9.1%, outpacing most equity markets.**

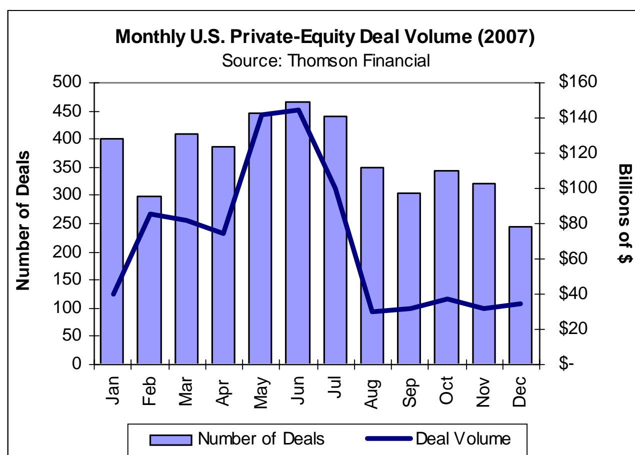
With cheap credit readily available for the last several years, U.S. high-yield default rates fell to miniscule levels, most recently 0.34% in December. While corporate balance sheets are still relatively strong, there is a large amount of debt coming due in 2008 and with a more difficult credit market, it will be tough for companies to refinance. **Many managers, as well as Moody's, J.P. Morgan and Citigroup, predict that the default rate will surge to more than 4% by the end of 2009 as the credit standards have tightened significantly.** Already in 2008, TOUSA, a home-builder, and Buffets, a restaurant chain, missed interest payments on their debts.

Several distressed investors express optimism for their strategy. With the economy struggling and the potential for a recession, several companies are struggling

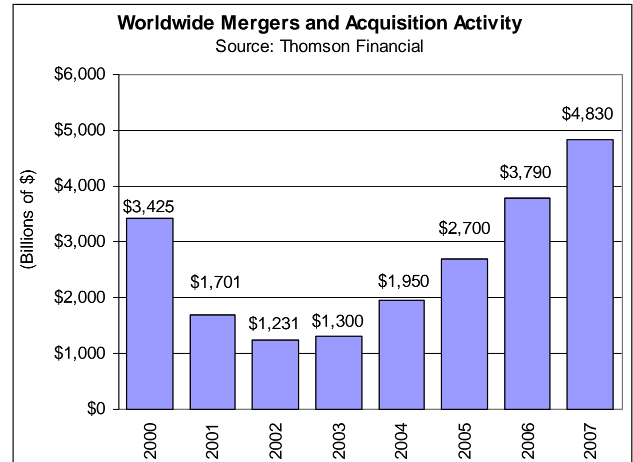
to make debt payments. Several highly levered companies are approaching real risk of default, and as previously stated, the rate of default is expected to more than quadruple over the next 12 months. **However, as we have mentioned in the past, distressed hedge funds have generated the best returns after default rates have peaked, rather than trying to time when the distressed cycle is beginning.** As a result, most credit managers have elected to focus their attention on the senior portions of the capital structure or maintain a hedge to their portfolios.

Merger arbitrage also experienced some difficulty in December, as the Hennessee Merger Arbitrage Index declined –0.25% (+11.58% YTD) as funds suffered from equity volatility and a few broken deals.

2007 was very much divided in two parts for merger arbitrage funds. **Most merger arbitrage managers maintained a long bias in the first half of 2007 as frenzied LBO activity and substantial premiums drove performance.** Private equity firms accounted for almost a third of activity in the first half of 2007 as deals were being announced on almost a daily basis. However, after a credit crisis mid-year, deal activity slowed considerably, deals broke and private equity firms all but disappeared in the second half of the year.



However, despite the second half slowdown, 2007 was a record year for mergers and acquisitions, as worldwide volume surpassed $4.83 trillion, 24% more than the total for 2006. In addition, December showed some signs of relief as M&A activity was respectable, as U.S. deal volume hit $121 billion. As in recent months, private equity buyers have been pretty much on the sidelines as corporate buyers have become more active. In addition, sovereign wealth funds continued to invest, with several taking stakes in financial institutions, such as Blackstone, Citigroup and UBS in the fourth quarter.



There were several massive deals in 2007. The largest completed deal was Royal Bank of Scotland's acquisition of ABN Amro for $95.6 billion. ABN Amro was a profitable position for merger arb managers as competitive bidding and high conviction of a sale helped drive returns. However, in the second half of the year, BHP Billiton offered $149.2 billion for Rio Tinto in a deal that would significantly change the commodity sector. While Rio Tinto has rejected the unsolicited bid, managers are closely following activities in the commodities sector and several expect China to possibly get involved in order to stake claim in the much-needed commodity area.

There were several large leveraged buy-outs during the year, including TXU Corp, which set a record when it was acquired by KKR for $32.1 billion. Despite the credit crisis, the deal closed in October. However, the LBO record was soon broken by the purchase of Canadian phone company BCE at a value of $32.6 billion. There were several LBO deals that broke in the latter half of the year, with the most recent LBO debacles being SLM Corp. The $25 billion buyout of Sallie Mae by J.C. Flowers was officially cancelled in December causing spreads to widen.

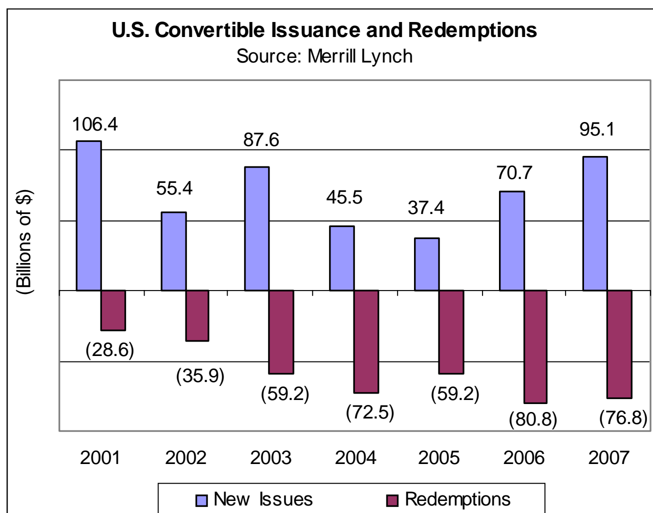
Several hedge fund managers reported profits from investments in online advertising companies in 2007.

As market leaders Microsoft, Google and Yahoo raced to acquire advertising assets, managers benefited from buyouts at significant premiums. During the year, managers profited off DoubleClick ($3.1 billion deal), RightMedia ($680 million), 24/7 Real Media ($649 million), and aQuantive ($6 billion).

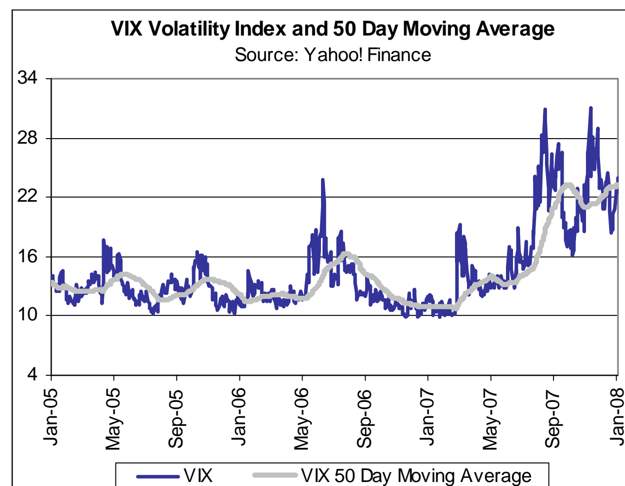
Managers expect a decline in M&A activity in 2008 compared to 2007, but state that there should still be many opportunities. Merger arbitrage is recognized as a late business cycle play. **Most are focusing on corporate acquisitions, as balance sheets are healthy and many have cash reserves. In addition, they continue to see an increase in foreign buyers as a cheap dollar makes assets more attractive.**

Convertible arbitrage also experienced a difficult month, as the Hennessee Convertible Arbitrage Index declined –0.40% (+4.36% YTD) as elevated volatility was not able to offset credit related losses**. 2007 was a disappointing year for many convert managers as they were able to generate only a modest gain despite good new issuance, elevated volatility and wider credit spreads. While convertible arbitrage was the worst performing hedge fund strategy for the year, it was able to outperform the S&P 500, which was up only +3.56% for the year.**

New issuance was strong in 2007 as many companies turned to convertibles in order to raise capital. For the year, the market saw $95.1 billion in issuance, the most since 2001. The market also saw -$76.8 billion in redemptions, resulting in a net new issuance of $18.3 billion.



Volatility, as measured by the VIX, increased significantly, from 11.5 at the beginning of the year to 22.5 at year end. In addition, there were several volatility spikes that caused the VIX to break 30, including the credit crisis and fear of a global slowdown.



As convertible arbitrage has faced difficulty in 2005 and 2007, many expect redemptions out of the strategy and for overall convertible arbitrage assets to decrease. **While this may cause pain in the short term due to portfolio liquidation, several state that this should create opportunity and cheapness of quality assets.** According to Merrill Lynch, the average discount to theoretical for the All US Convertibles Index improved from 0.43% rich to 0.07% cheap in 2007, on higher volatility realization. Managers are optimistic on 2008, believing that increased levels of volatility, wider credit spreads and more reasonably priced new issuance should provide good opportunities for the strategy.

Several multi-strategy and convertible managers report finding opportunities in capital structure arbitrage. With an abundance of distressed credits and elevated short-term volatility, managers are finding good opportunities to take advantage of mispricing of securities within the capital structure by buying the senior debt and shorting the equity of companies that are expected to default.

Quantitative funds, also known as statistical arbitrage funds, struggled in 2007 and made headlines in August when several large funds posted significant losses. The consensus among most was that the losses were triggered by a fund, several funds or in-

HENNESSEE HEDGE FUND STYLE DEFINITIONS

STYLE	DEFINITION
ASIA - PACIFIC	Funds typically have long and short equity positions in companies located in the Pacific Basin region (i.e. Japan, China, Hong Kong, Taiwan, Korea, Singapore, Thailand, Malaysia, India, Australia, New Zealand, and other countries in Asia.)
CONVERTIBLE ARBITRAGE	This type of arbitrage involves the simultaneous purchase of a convertible bond and the short sale of the underlying stock. Interest rate and credit risk may or may not be hedged.
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).
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, Asia - Pacific, and Africa. Asset classes range from equities and bonds to local currencies.
EUROPE	Funds typically have long and short equity positions in European companies located in the United Kingdom, Western Europe, and Eastern Europe.
EVENT DRIVEN	This strategy can include merger arbitrage, distressed, liquidations, and spin-offs in addition to value driven special situation equity investing. Investments are usually dependent on an "event" as the catalyst to release the position's intrinsic value.
FINANCIAL EQUITIES	Funds typically have long and short equity positions within the financial sector (banks, thrifts, brokerage, insurance, etc.)
FIXED INCOME	Funds typically employ 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.
GROWTH	Funds typically have long and short equity positions in companies that exhibit an acceleration (or deceleration) of earnings growth, revenues, and market share.
HEALTHCARE/ BIOTECH	Funds typically have long and short equity positions in medical related stocks, which include biotechnology, pharmaceuticals, HMO's, medical devices, etc.
HIGH YIELD	Funds typically have long and short equity positions in non-investment grade corporate bonds, which offer attractive coupon yields. Interest rate risk may or may not be hedged.
INTERNATIONAL	Funds typically have long and short equity positions in the stocks of international companies. Positions can be either growth or value and, in addition to global investments, funds typically have exposure to U.S. companies.
LATIN AMERICA	Funds typically have long and short equity and/or debt positions in companies located in Latin American countries such as Chile, Mexico, Venezuela, Argentina, Brazil, and Ecuador.

HENNESSEE HEDGE FUND STYLE DEFINITIONS

STYLE	DEFINITION
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.
MARKET NEUTRAL	Funds typically have long and short equity positions with approximately zero net dollar exposure. In addition, some funds will attempt to be beta, sector, and market cap neutral to further reduce equity market risk. Funds within this style utilize a range of methods from quantitative modeling to fundamental pairs trading.
MERGER ARBITRAGE	Style typically involves the simultaneous purchase of stock in a company being acquired and the short sale of stock in the respective acquirer. Many merger arbitrage managers attempt to mitigate deal risk by engaging only in strategic takeovers after they have been announced.
MULTIPLE ARBITRAGE	Style includes funds that employ more than one arbitrage strategy. The portfolio manager opportunistically allocates capital among the various strategies in an attempt to create the best risk/reward profile for the overall fund. Common strategies include merger arbitrage, convertible arbitrage, fixed income arbitrage, long/short equity pairs trading, quantitative equity trading, volatility arbitrage, and distressed investments.
OPPORTUNISTIC	Funds typically have long and short equity positions while maintaining a flexible net exposure to reflect the changing dynamics of the market on a minute-to-minute or day-to-day basis. Investments can be initiated from technical and/or fundamental analysis and portfolio turnover is typically high as managers have a short term investment time horizon.
PIPES/ PRIVATE FINANCING	PIPEs (private investments in public entities) are transactions by which publicly traded companies access new capital through the sale of stock directly to private investors. PIPEs can be transacted with a number of financial instruments, including the issuance of common stock, convertible securities, or warrants. Private financing includes asset based lending/acquisitions and direct loan investing such as mezzanine financing, bridge loans, and debtor in possession financing.
SHORT BIAS	Funds typically have long and short equity positions with an overall net short exposure to the market. Investments can be fundamental, technical, or event driven. This style can be used as a hedge against long-only portfolios and by investors who feel the market is approaching or in a bearish cycle.
TECHNOLOGY	Funds typically have long and short equity positions in technology-related sectors such as semiconductors, hardware, software, networking devices, etc.
TELECOM/ MEDIA	Funds typically have long and short equity positions in the telecommunication and media sectors such as telecommunication services, fiber optics, cable services, publishing, entertainment, programming, broadcasting, etc.
VALUE	Funds typically have long and short equity positions in undervalued companies which trade below their 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 utilize cash for debt retirement, share repurchase programs, and other methods utilized to realize shareholder value.

HENNESSEE HEDGE FUND REVIEW®

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The Hennessee Group LLC is pleased to offer you a **12-month subscription** to the **Hennessee Hedge Fund Review®.** The Hennessee Hedge Fund Review® provides comprehensive performance information, statistics, and market analysis; all of which is value added to hedge fund managers and investors alike. The Hennessee Hedge Fund Review® includes the **Hennessee Hedge Fund Indices®**, one of the oldest and most widely sourced indices in the industry. The following are also included:

1 An overview of the U.S. and major international markets.
2 A discussion of each of the 23 hedge fund money management styles including trading themes, market trends impacting each style, and positions that have impacted their peer group.
3 Monthly **Hennessee Hedge Fund Indices®** for each of the 23 Styles (including long/short equity, event-driven/ arbitrage, global/macro, and others).
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vestment banks that were forced to liquidate portfolios to raise cash in order to offset losses from sub-prime mortgage investments. As several large funds were de-leveraging, there was significant overlap in positions among quant funds, which exacerbated the losses. Annual performance for quant funds was mixed as some were able to recoup losses and finish the year with gains while others finished in the red. In the aftermath of the quant fallout, several funds have maintained lower leverage in portfolios and have reduced risk. In addition, it is expected that several quant funds are seeing significant redemptions at year end.

Several mortgage arbitrage funds also experienced significant losses, including several publicized hedge fund blow ups. Hedge funds with leveraged bets on bonds backed by subprime mortgages experienced significant losses. The funds' holdings included a collection of collateralized debt obligations (CDOs), CDO squareds, leveraged loans and other complex derivative instruments, some of which were illiquid and marked to model. As the value of the underlying bonds fell drastically, funds faced margin calls from lenders, which forced selling of assets and further exacerbated pain. In addition, mortgage arbitrage funds were hurt by declining interest rates, which cased prepayment rates to increase.

December was a challenging year for arbitrage/event driven funds as credit spreads widened significantly and as credit marks came to a screeching halt in the summer. Managers have reduced risk, but remain relatively optimistic about their strategies in the long term. **Credit managers feel credit spreads have normalized, while distressed managers feel defaults and opportunities should pick up in 2008. Merger arbitrage managers feel M&A will continue in 2008, driven by strategic and foreign acquisition, and the merger arbitrage strategy has historically done well late in the business cycle. Lastly, convertible managers feel valuations are attractive and hope to be able to generate better alpha with elevated levels of volatility.**

Global/Macro

(YTD: +15.59% / DEC: +0.56%)

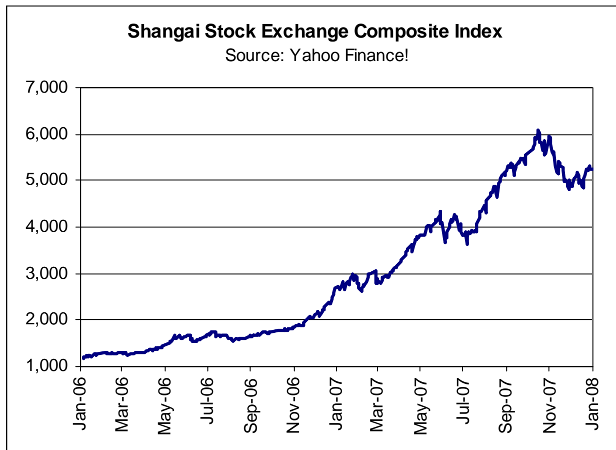
The Hennessee Global/Macro Index advanced +0.56% in December (+15.59% YTD). International and macro managers finished the year on a positive note and posted strong profits in 2007, outperforming both U.S. long/short equity and arbitrage/event driven strategies.

International equities outperforming U.S. equities was a major source of profit for global and macro hedge fund managers in 2007. Many managers benefited from overweight allocations to emerging markets, specifically China, India, and Brazil, which were up significantly for the year. **As a result, international funds were one of the best performing strategies for the year, with the Hennessee International Index up +20.12% for the year.**

European managers lagged other regions as the Hennessee Europe Index finished the year up +5.88%. Germany was one bright spot for managers as the DAX was up +22% due to strong exports. Several managers report profitable restructuring plays in Germany and remain optimistic on the country for 2008. However, other European countries felt the effect of the U.S. credit crunch and subprime fallout. The Dow Jones Stoxx index, the 600 largest European companies, was down -0.2% for the year, led by UBS and Royal Bank of Scotland which suffered subprime related losses. **While managers state that valuations appear attractive with stocks trading at 13.5 times 2007 earnings, they are concerned with the ECB's reluctance to cut interest rates, slowing profit growth and a strengthening currency that will dampen exports.**

Asian stock markets were very strong in 2007, with the exception of Japan, which continued to struggle. **Hedge funds managers performed well as the Hennessee Asia Pacific Index was up +15.92% for the year, driven by exposure to equities in China and India.** Many funds benefited from a long China and emerging Asia, short Japan trade. China continued its incredible rally as the Shanghai Composite Index increased +97% in 2007, following +130% in 2006; however, did finish the year more than 25% of its highs for the year. While GDP churns away at 10%,

managers are concerned with inflation as recent readings report it up more +6%. **Managers continue to believe that excessive speculation in China will eventually lead to a bubble that will provide excellent short opportunities.**

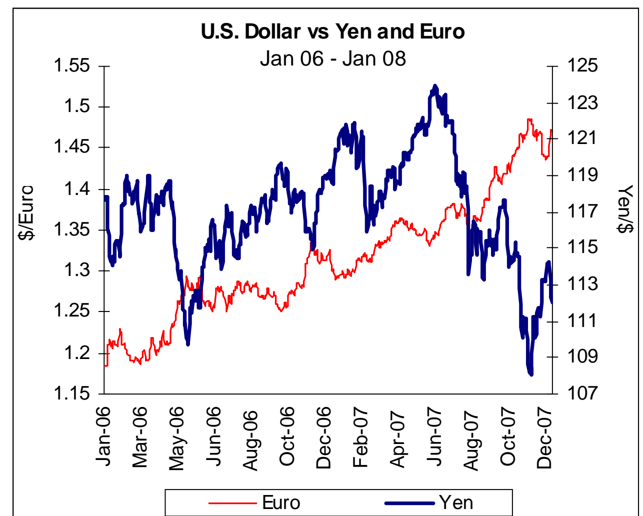


Japan was a detractor for managers with many Japan dedicated hedge funds managers struggling to generate a profit in 2007. **The NIKKEI 225 declined -11% for the year, making Japan the worst performing region of the year.** Many international managers have been underweight Japan due to poor demographics, GDP growth, domestic investment, foreign investment and policy making. The poor performance in Japan has made valuations attractive on a comparison basis. However, Japan has frustrated managers for several years, and most state that the country would likely need a catalyst before seeing a market rally.

Hedge fund managers benefited as Latin American equity markets posted their fifth straight year of double-digit returns, as the Hennessee Latin America Index was the best performing strategy in 2007, up +23.40%. The region continued to benefit from a bull market for commodities. Managers made sizable gains long Brazilian equities, as the Bovespa advanced +72% during the year. Managers also benefited from price appreciation of the Brazilian real versus the U.S. dollar. Managers are concerned with inflation and the central bank has ended a series of rate cuts. Managers are optimistic on 2008 based on global growth and report that the most significant risk to the region would be a slowdown in China or India.

As several emerging markets have achieved incredible gains in recent years and as they garner more attention from the investment industry, several managers are looking for "the next China and Brazil". **Several managers are optimistic on Russia, Africa, the Middle East, and Indonesia, and state that these regions may very well be where we see outsized returns in 2008.**

The Hennessee Macro Index finished the year strong, up +2.08% in December (+15.13% YTD). Macro managers posted their best year since 2003 as several themes played out as expected, including a decline in the dollar, long international equities, long commodities, and short credit.

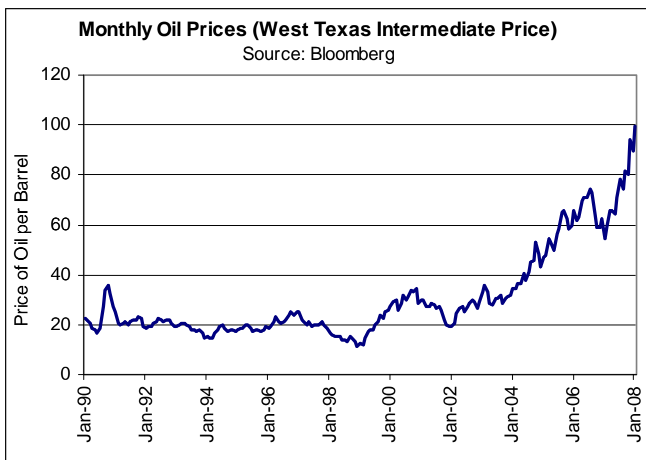


Macro managers generated significant gains short the dollar against other currencies. In 2007, the euro appreciated +22% versus the dollar during the year, while the yen appreciated +6%. Since 2002, the dollar has declined -40% in value versus the Euro. Several managers state that there are still several risks to the dollar, which would cause further weakening, including the still crumbling housing market and a potential U.S. recession. **However, there are many who expect the dollar to appreciate against the European and Latin American currencies in the second half of 2008, if the U.S. can avoid a major meltdown.** Several believe the economy may improve after additional rate cuts and we could see some dollar strengthening in the second half of this year. In addition, many managers cite the difference in purchasing power parity as a call for the dollar to appreciate against the euro in 2008.

Most hedge fund managers believe that the dollar will continue to weaken against most Asian currencies, especially the Yuan. Managers, as well as policy makers, have been long calling for a more rapid revaluation of the Yuan.

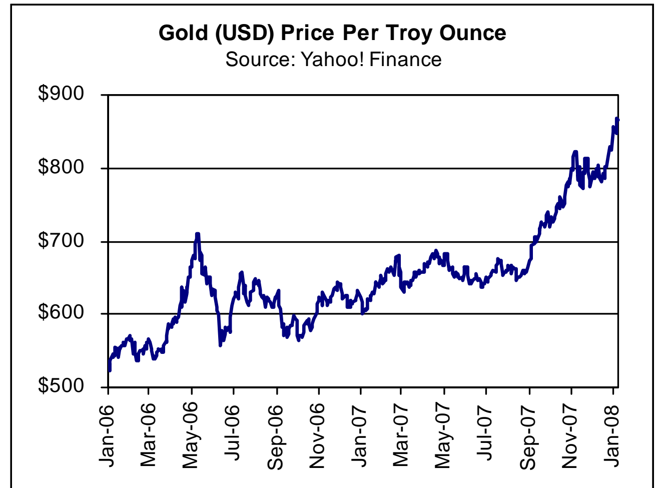
The bull market for commodities continued in 2007, led by oil, gold and other metals and grains. Despite a slowdown in the U.S., global economic expansion, led by China, India, and other emerging markets, drove an increase in demand and an increase in commodity prices.

Oil gained +57% in 2007 due to greater demand, greater investor interest, geopolitical tension, and concern about supply. While flirting with the $100 per barrel mark in 2007, oil finally surpassed the century mark in the first week of 2008. Managers have been long the commodity and have been able to profit handsomely. Given oil surpassed $100, several managers have recently taken some money off the table.

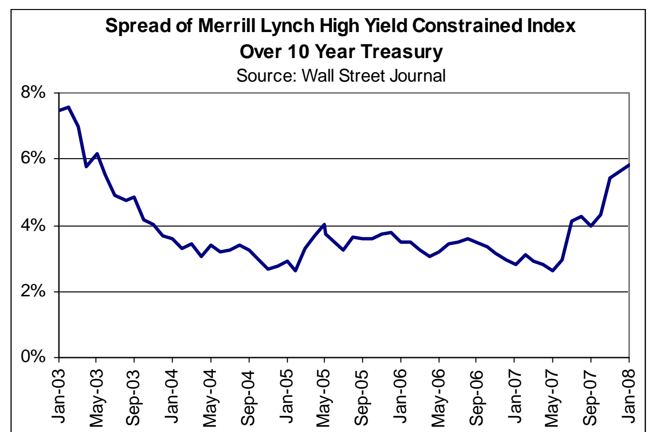


Managers also generated significant gains long grains, including soybeans, wheat and rice. During the year, wheat advanced +77%, and soybeans were up +75%. **Many managers remain optimistic on grains for 2008 as demand increases, their use in energy production continues, and as they continue to generate new interest in the investment community.**

Gold soared in 2007 as investors flocked to the currency as a hedge against the decline of the U.S. dollar. For the year, gold prices went from $639.75 per troy ounce to $833.75, representing a +30.3% increase.



The other profitable theme for was being short the credit market. **During the year, managers believe that spread levels did not reflect a higher volatility environment for equities, a turning point in default cycle, the bias of rating agencies and a peak in balance sheet quality.** Managers benefited as the liquidity disappeared in the credit markets during the summer and as high yield credit spreads over the 10 year treasury widened significantly, going from 2.9% at the beginning of the year to 5.8% at year end.



Global/macro managers were able to generate positive performance for investors after a sub-par 2006 due to several key themes which played out accordingly. **While 2007 was a year driven by several clear themes, including the decline of the dollar, the continued bullrun in commodities, and the continued equity rally in international markets, 2008 appears as if it will be more difficult.** Most managers agree that we will continue to see the dollar decline versus

Asian currencies, however there is dissention if the dollar will be able to recoup losses against European and Latin American countries. In addition, many feel the bull run in commodities and emerging markets has gotten long in the tooth. **Both commodities and emerging markets could be at risk if the U.S. enters into a recession and even more so if 2008 brings a slowdown in global expansion due to a pull back in China or India.** As a result, while managers are closely watching the U.S. and global economies, they are still cautiously optimistic that they can continue there good success into 2008.

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 Group LLC:

We are long the U.S. dollar versus the euro, recognizing that goods in Europe are substantially more expensive in comparison to the same goods in the U.S.

We are long the Asian currencies believing that China will revalue higher to slow inflation after the Olympic games this summer.

We have added to our short oil bet as inventories are increasing while demand is slowing due to the weakening U.S. economy.

We are short a number of industrial companies in China as they have valuation multiples that imply that they are secular growth companies instead of cyclical companies.

We are adding to our positions in senior traunches of subprime mortgage backed securities as we believe most are money good.

We are building a portfolio of delta hedged options that we believe will continue to appreciate given the trend of higher implied volatility.

We have purchased a number of companies in the alternative energy space as more of these businesses are beginning to make economic sense given high energy costs.

We are long Russia as it has been the laggard of the BRIC countries and domestic consumption is increasing quickly.

We are adding to our large cap bank positions, as the market is focusing on losses in subprime mortgages which represent a very small percentage of most banks' balance sheets. We believe they will be excellent investments once the recapitalization events end.

We are long airlines as we believe oil prices will decline over the next year.

We have covered most of our short positions in high yield bonds, recognizing that yields are now substantially wider than they were six months ago.

We are short a number of healthcare service companies that we feel will be negatively impacted by the increasing popularity of Democratic candidates in the presidential election.

We are long gold, expecting the precious metal to exceed $1000 per ounce in 2008.

We are short the 10 Year Treasury. We believe that yields will increase if the Fed lowers rates because it will be perceived to be inflationary, while we also believe yields will increase if economic growth continues and the Fed stays put.

We are buying long dated options on a number of distressed homebuilders. While we believe it may be dead money for six months, we believe the stocks will appreciate substantially when housing starts to improve.

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HENNESSEE HEDGE FUND RANKINGS

MONTHLY RANK 2007 (Net)	YTD	JAN	FEB	MAR	APRIL	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC
ASIA - PACIFIC INDEX	4	19	3	19	11	4	1	2	21	2	4	22	21
CONVERTIBLE ARBITRAGE INDEX	23	14	8	15	22	20	20	19	17	16	20	6	20
DISTRESSED INDEX	16	6	4	5	9	15	14	18	19	20	18	12	3
EMERGING MARKETS INDEX	7	22	17	6	5	9	6	3	23	7	3	7	15
EUROPE INDEX	20	8	20	2	4	17	18	20	22	22	14	16	8
EVENT DRIVEN INDEX	22	4	7	4	7	10	21	22	20	21	17	23	17
FINANCIAL EQUITIES INDEX	19	17	16	22	21	21	23	21	1	12	9	5	16
FIXED INCOME INDEX	21	20	18	21	19	22	10	4	9	15	22	15	7
GROWTH INDEX	6	15	11	8	14	6	9	14	6	6	6	17	6
HEALTHCARE AND BIOTECH INDEX	11	13	22	20	1	3	22	23	2	10	10	3	22
HIGH YIELD INDEX	17	11	6	14	17	19	17	13	8	14	16	10	13
INTERNATIONAL INDEX	2	16	14	3	3	5	7	8	18	4	1	8	4
LATIN AMERICA INDEX	1	2	15	1	2	1	5	6	13	5	5	20	12
MACRO INDEX	5	21	21	16	12	11	4	7	15	1	11	11	1
MARKET NEUTRAL INDEX	12	18	12	10	18	18	13	11	16	11	13	2	5
MERGER ARBITRAGE INDEX	9	3	1	17	10	8	19	10	5	18	19	18	19
MULTIPLE ARBITRAGE INDEX	10	5	2	12	15	13	11	12	10	17	15	4	18
OPPORTUNISTIC INDEX	8	12	9	7	8	12	16	9	11	9	7	13	14
PIPES/PRIVATE FINANCING INDEX	13	7	5	11	13	14	12	17	7	19	21	9	10
SHORT BIASED INDEX	15	23	13	13	23	23	3	1	4	23	23	1	2
TECHNOLOGY INDEX	3	10	19	18	16	2	2	5	3	3	2	14	9
TELECOM AND MEDIA INDEX	18	1	23	23	20	16	8	15	14	8	8	19	23
VALUE INDEX	14	9	10	9	6	7	15	16	12	13	12	21	11

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2007 (Net)	YTD	YTD RANK	% of mgrs. >S&P, ytd	JAN	FEB	MAR	APRIL	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC
ASIA - PACIFIC INDEX	**15.92%**	**4**	**68%**	0.78%	1.63%	0.20%	1.77%	3.05%	2.52%	3.25%	-2.71%	4.14%	4.27%	-3.07%	-0.63%
CONVERTIBLE ARBITRAGE INDEX	**4.36%**	**23**	**64%**	1.28%	1.14%	0.67%	0.23%	1.07%	-0.03%	-0.50%	-1.44%	1.48%	1.76%	-0.92%	-0.40%
DISTRESSED INDEX	**8.87%**	**16**	**67%**	1.72%	1.55%	1.34%	2.04%	1.74%	0.43%	-0.37%	-1.82%	0.69%	1.90%	-1.56%	0.95%
EMERGING MARKETS INDEX	**14.69%**	**7**	**89%**	0.27%	0.43%	1.32%	2.28%	2.29%	1.39%	2.49%	-3.06%	3.35%	4.42%	-1.34%	0.17%
EUROPE INDEX	**5.88%**	**20**	**63%**	1.63%	0.11%	2.71%	2.73%	1.66%	0.21%	-0.55%	-3.04%	0.03%	2.18%	-2.24%	0.48%
EVENT DRIVEN INDEX	**4.71%**	**22**	**54%**	2.34%	1.28%	1.80%	2.12%	2.17%	-0.06%	-1.62%	-2.57%	0.62%	1.94%	-3.22%	0.01%
FINANCIAL EQUITIES INDEX	**7.46%**	**19**	**40%**	1.04%	0.46%	-0.13%	0.74%	0.60%	-1.01%	-0.61%	1.96%	2.01%	3.06%	-0.86%	0.03%
FIXED INCOME INDEX	**5.81%**	**21**	**46%**	0.76%	0.39%	0.03%	0.82%	0.37%	0.97%	1.86%	-0.63%	1.62%	0.97%	-2.06%	0.62%
GROWTH INDEX	**14.88%**	**6**	**75%**	1.08%	0.89%	1.19%	1.53%	2.75%	1.00%	-0.05%	0.07%	3.47%	3.79%	-2.27%	0.64%
HEALTHCARE AND BIOTECH IN-	**10.65%**	**11**	**52%**	1.32%	-0.12%	0.05%	4.14%	3.23%	-0.53%	-3.61%	1.66%	2.04%	2.89%	0.05%	-0.70%
HIGH YIELD INDEX	**8.57%**	**17**	**67%**	1.45%	1.36%	0.78%	1.19%	1.16%	0.33%	-0.03%	-0.51%	1.88%	2.02%	-1.49%	0.18%
INTERNATIONAL INDEX	**20.02%**	**2**	**83%**	1.05%	0.59%	1.86%	2.85%	3.03%	1.23%	1.33%	-1.64%	3.80%	5.05%	-1.36%	0.79%
LATIN AMERICA INDEX	**23.40%**	**1**	**100%**	2.74%	0.58%	3.15%	3.03%	4.34%	1.59%	1.68%	-0.88%	3.66%	4.19%	-2.80%	0.20%
MACRO INDEX	**15.13%**	**5**	**78%**	0.30%	0.05%	0.59%	1.76%	2.15%	1.67%	1.37%	-1.20%	4.38%	2.69%	-1.51%	2.08%
MARKET NEUTRAL INDEX	**9.95%**	**12**	**55%**	0.84%	0.81%	1.11%	0.95%	1.21%	0.49%	0.32%	-1.26%	2.03%	2.24%	0.09%	0.73%
MERGER ARBITRAGE INDEX	**11.58%**	**9**	**84%**	2.70%	2.13%	0.49%	1.83%	2.45%	0.09%	0.34%	0.56%	1.23%	1.84%	-2.29%	-0.25%
MULTIPLE ARBITRAGE INDEX	**10.92%**	**10**	**77%**	2.03%	1.73%	0.82%	1.38%	2.10%	0.58%	0.18%	-0.83%	1.35%	2.03%	-0.73%	-0.17%
OPPORTUNISTIC INDEX	**13.42%**	**8**	**78%**	1.39%	1.12%	1.23%	2.07%	2.11%	0.38%	0.61%	-0.84%	2.67%	3.69%	-1.83%	0.18%
PIPES/PRIVATE FINANCING INDEX	**9.88%**	**13**	**82%**	1.69%	1.47%	0.90%	1.60%	2.02%	0.51%	-0.34%	-0.02%	1.22%	1.53%	-1.37%	0.30%
SHORT BIASED INDEX	**9.59%**	**15**	**50%**	-1.15%	0.77%	0.82%	-2.22%	-1.67%	1.78%	4.04%	0.66%	-1.10%	0.43%	6.05%	1.10%
TECHNOLOGY INDEX	**19.98%**	**3**	**86%**	1.50%	0.27%	0.47%	1.23%	3.32%	1.86%	1.78%	1.42%	3.82%	4.50%	-1.95%	0.32%
TELECOM AND MEDIA INDEX	**8.44%**	**18**	**50%**	3.87%	-0.26%	-0.20%	0.81%	1.74%	1.10%	-0.21%	-1.15%	2.88%	3.53%	-2.73%	-1.00%
VALUE INDEX	**9.69%**	**14**	**68%**	1.52%	1.09%	1.11%	2.16%	2.72%	0.43%	-0.29%	-0.85%	1.92%	2.25%	-2.88%	0.25%
HENNESSEE HEDGE FUND INDEX	11.64%		69%	**1.32%**	**0.96%**	**1.01%**	**1.74%**	**2.21%**	**0.73%**	**0.35%**	**-0.88%**	**2.34%**	**2.85%**	**-1.78%**	**0.30%**
LONG/SHORT EQUITY	**12.08%**		**66%**	**1.25%**	**0.78%**	**0.89%**	**1.71%**	**2.32%**	**0.56%**	**-0.06%**	**-0.01%**	**2.49%**	**3.05%**	**-1.66%**	**0.25%**
ARBITRAGE/EVENT DRIVEN	**7.78%**		**66%**	**1.73%**	**1.37%**	**0.93%**	**1.41%**	**1.65%**	**0.35%**	**-0.17%**	**-1.13%**	**1.19%**	**1.79%**	**-1.62%**	**0.10%**
GLOBAL/MACRO	**15.59%**		**77%**	**0.93%**	**0.70%**	**1.24%**	**2.22%**	**2.68%**	**1.64%**	**1.90%**	**-2.23%**	**3.39%**	**3.81%**	**-2.06%**	**0.56%**
DJIA	**6.42%**			1.27%	-2.80%	0.70%	5.74%	4.32%	-1.61%	-1.47%	1.10%	4.03%	0.25%	-4.01%	-0.80%
LEHMAN AGG. BOND INDEX	**6.96%**			-0.04%	1.54%	0.00%	0.54%	-0.76%	-0.30%	0.83%	1.23%	0.76%	0.90%	1.80%	2.28%
MSCI EAFE (USD) PRICE INDEX	**8.61%**			0.64%	0.70%	2.15%	4.09%	1.24%	-0.04%	-1.54%	-1.81%	5.17%	3.84%	-3.45%	-2.30%
NASDAQ	**9.80%**			2.01%	-1.94%	0.23%	4.27%	3.15%	-0.05%	-2.19%	1.97%	4.05%	5.83%	-6.93%	-0.33%
RUSSELL 2000	**-1.55%**			1.67%	-0.79%	1.07%	1.80%	4.10%	-1.46%	-6.84%	2.27%	1.72%	2.87%	-7.18%	-0.06%
S&P 500	**3.56%**			1.41%	-2.18%	1.00%	4.33%	3.26%	-1.78%	-3.20%	1.29%	3.58%	1.48%	-4.40%	-0.86%

The Hennessee Hedge Fund Indices® are calculated from performance data reported to the Hennessee Hedge Fund Advisory Group by a diversified group of hedge funds. The Hennessee Hedge Fund Index 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. The hedge fund performance data has been obtained from sources believed to be reliable, but no guarantee is made with respect to accuracy. Past performance is no guarantee of future returns. This material is for general information only and is not an offer or solicitation to buy or sell any security including any interest in a hedge fund. ALL RIGHTS RESERVED.