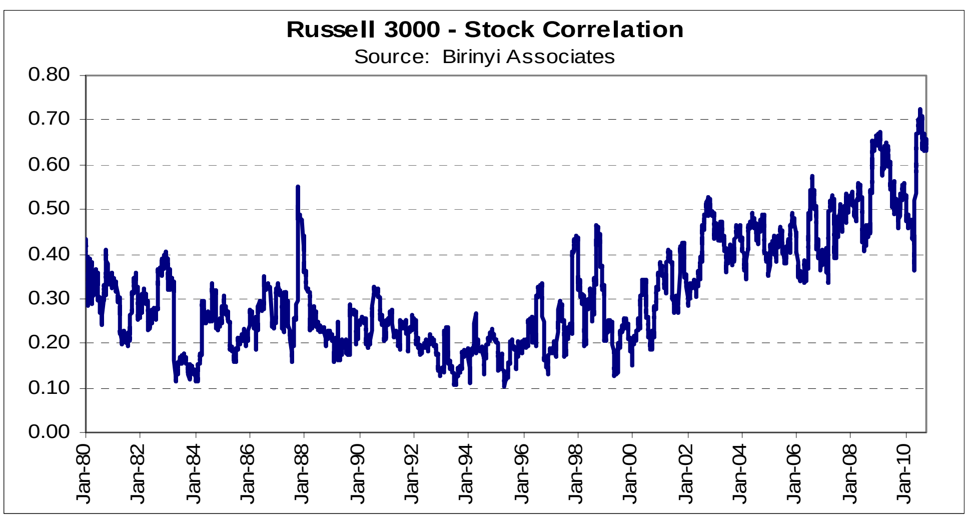
HENNESSEE GROUP LLC
HEDGE FUND ADVISORY

HEDGE FUNDS STRUGGLE WITH "NEW MARKET ORDER"

Stock Correlations at Historic Highs While Low Quality Stocks Outperform

Tuesday, October 26, 2010 – New York, NY – Hennessee Group LLC, a consultant and adviser to direct investors in hedge funds, believes the spike in correlation between individual stocks has made alpha generation a challenge in 2010, particularly for fundamentally based long / short equity hedge funds. **Charles Gradante, Co-Founder of the Hennessee Group, stated "The 'risk on-risk off' trade, driven largely by macro sentiment, continues to dominate the financial markets." Gradante added, "Until we see fundamentals return to the forefront of investing, we believe hedge funds will have difficulty executing their investment strategy, particularly on the short side."** In addition to the spike in correlation, the Hennessee Group believes the continued outperformance of high beta, low quality stocks, as witnessed in 2009, is adding to an already challenging investment environment in 2010, particularly for hedge funds seeking to generate alpha in their short portfolios.

Stock Correlations at All Time Highs



The "risk on–risk off" trade, driven by major macro themes such as the economy and regulation continue to dominate the financial markets. The "risk on" trade is best characterized by an uptick in investor confidence as they seek out risk assets including stocks, high yield bonds, emerging markets and commodities. During the “risk on” trade, the market experiences sharp, broad based gains with nearly all stocks and sectors benefiting. The "risk off" trade entails a flight to safety as investors flee risk assets for safe-haven investments such as U.S. Treasuries, gold, and the dollar. In this environment, the markets experience a sharp sell-off and all stocks and sectors experience losses. This investor behavior has led to stocks moving in lockstep and has made individual security selection a difficult task as stocks move more based on macro sentiment than underlying fundamentals. **A study recently conducted by Birinyi Associates underscores this spike in stock correlation. According to their study, the correlation among stocks in the Russell 3000 Index reached an all time high of 0.72 in July of 2010 and was at 0.63 entering October; well above its longer term average of 0.32.**

Another factor contributing to the spike in correlation is the use of exchange-traded funds (ETF’s). As the markets have become increasingly correlated and individual stock selection has proven challenging, investors have sought the use of ETF’s to make broad based bets on the financial markets. **As ETF’s have grown in popularity, they are accounting for a larger share of daily stock-trading volume and are contributing to the market being driven more by macro sentiment than fundamentals. According to the 2010 Investment Company Factbook, the size of the ETF market has grown from 80 ETF’s and $66 billion in 2000 to 797 ETF’s and $777 billion in 2009.** As can be seen in the chart below, low quality stocks (B- and C based on S&P ratings) have consistently outperformed high quality stocks (A and A+ based on S&P ratings) since the beginning of 2009. This can be partly attributed to the use of exchange-traded funds as these passively managed funds buy into and sell out of broad based indices, which leads to erratic moves for the underlying securities, irrespective of fundamentals. **Hedge funds seeking to generate gains in their short portfolios have found this to be an increasingly frustrating development as stocks with poor fundamentals continue to outperform as they benefit from investor flows into broad based investment vehicles.**

	2009				2010			
S&P Ratings	**1Q**	**2Q**	**3Q**	**4Q**	**1Q**	**2Q**	**3Q**	**Total**
A	-7.37%	10.98%	12.08%	8.53%	4.85%	-8.71%	11.63%	**33.62%**
A+	-11.86%	8.99%	9.20%	4.99%	3.86%	-9.85%	10.00%	**13.43%**
A-	-18.42%	19.15%	18.89%	4.42%	7.14%	-12.67%	11.62%	26.03%
B	-10.92%	19.46%	17.28%	4.49%	6.67%	-9.75%	12.99%	41.85%
B+	-10.20%	15.22%	16.51%	6.34%	5.26%	-13.00%	9.30%	28.31%
B-	-3.94%	23.60%	22.99%	7.24%	6.98%	-11.95%	15.33%	**70.12%**
C	-3.61%	31.47%	20.64%	5.85%	6.88%	-16.51%	14.77%	**65.74%**

Source: Factset

2011 and Beyond

"Concerns about the sovereign debt crisis and fears of a double dip recession, as well as other macro themes, have continued to dominate the investment landscape. The macro driven environment has made alpha generation difficult due to elevated levels of correlation among stocks." said Mr. Gradante. **"That said, we believe the current macro focus and high correlation is only temporary. Investment opportunities for hedge funds will increase as correlations revert to historical levels and stocks start to move in line with their fundamental values."**

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For more information on hedge fund strategy performance in 2010, please see the ***Hennessee Hedge Fund Review***, our monthly hedge fund publication, at: http://www.hennesseegroup.com/hhfr/index.html.

About the Hennessee Group LLC

Hennessee Group LLC is a Registered Investment Adviser that consults direct investors in hedge funds on asset allocation, manager selection, and ongoing monitoring of hedge fund managers. Hennessee Group LLC is not a tracker of hedge funds. The Hennessee Hedge Fund Indices® are for the sole purpose of benchmarking individual hedge fund manager performance. The Hennessee Group does not sell a hedge fund-of-funds product nor does it market individual hedge fund managers. For additional Hennessee Group Press Releases, please visit the Hennessee Group's website. The Hennessee Group also publishes the Hennessee Hedge Fund Review monthly, which provides a comprehensive hedge fund performance review, statistics, and market analysis; all of which is value added to hedge fund managers and investors alike.

Description of Hennessee Hedge Fund Indices®

The Hennessee Hedge Fund Indices® are calculated from performance data reported to the Hennessee Group by a diversified group of over 1,000 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 derived from the Hennessee Group's database of over 3,500 hedge funds and are net of fees and unaudited. Past performance is no guarantee of future returns.