

Alternative Investments US

Third Quarter 2008: Quarterly Hedge Fund/Managed Futures Review

We are pleased to present you with a brief general review of financial markets and hedge funds and managed futures strategies for the third quarter of 2008.

Market Overview

The third quarter was dominated by a number of significant events in September that pressured both equity and credit markets globally. Headlines during the month included the previously unfathomable: mortgage giants Fannie Mae and Freddie Mac were taken over by the U.S. government, AIG received Federal Reserve financing to stave off potential insolvency, Washington Mutual (WaMu) became the largest bank failure in history and the Lehman Brothers bankruptcy all contributed to challenging market conditions.

Not surprisingly, hedge funds had difficulty in this environment. Hedge funds grappled with the rampant selling, marked volatility and the introduction of a temporary ban on the shorting of financial equities. As a result, hedge funds results were under pressure, in stark contrast to the results in the first half of the year. Managed futures was one of the only strategies within the capital markets to sidestep some of the pronounced downward moves and, along with Global Macro, remained in positive territory on a year-to-date basis.

Third Quarter 2008 Index Summary

Market Indices	Q3	2008 YTD*
S&P 500	-8.4%	-19.3%
MSCI World	-15.3%	-24.2%
Russell 2000	-1.1%	-10.4%
Lehman Aggregate	-0.5%	0.6%
3-Month Treasury Bill	0.4%	1.6%
Hedge Fund Indices		
HFRF Funds-of-Funds: Diversified	-8.8%	-11.9%
HFRX Equity Hedge	-12.5%	-13.6%
HFRX Event-Driven	-9.1%	-12.7%
HFRX Macro Index	-10.1%	2.6%
HFRX Relative Value Arbitrage	-11.9%	-18.9%
Barclay CTA (<i>estimated</i>)	-2.2% <i>e</i>	-7.7% <i>e</i>

Source: Hedge Fund Research Inc., BarclayHedge, Standard and Poor's, Russell, Bloomberg

* Through September 30, 2008

Strategy Overview

Equity-Hedge

Generally, equity long/short managers produced more downside capture given the magnitude of the weak equity markets. Restrictions on short selling in financial stocks in the U.K. and U.S. (since lifted in October) created a "short squeeze" for one of this strategy's favorite short themes. The short-selling ban negatively impacted results during September as funds sought to adjust their exposures but should have minimal long term impact. Although many managers reduced exposures throughout the year and maintained a lower net-long posture, the pressure on long positions, particularly in the energy, materials and technology sectors, was too great to mitigate losses in a hedged portfolio. At times, such sector mismatches provide significant performance, but this quarter was a reversal from the previous trend in the first half.

Event-Driven

Merger arbitrage came under pressure during September with spreads widening substantially on deals, even those not subject to large financing hurdles. For example, InBev's acquisition of Anheuser Busch traded to a 10% discount to the cash bid that is expected to close in December. If completed as expected in December, the deal would provide an annualized IRR of more than 40%. Many other types of special-situations faced severe discounts, because they lacked a "hard catalyst" against the backdrop of uncertain markets.

Credit markets continued to suffer from stresses in the banking system. High-yield spreads spiked to more than 1200 basis points above comparable maturity Treasury securities, a new high for this cycle. Nearly half of the high-yield universe currently trades at "distressed" levels of more than 1000 basis points above Treasuries. Bank loans, the most senior part of the capital structure, experienced even more dramatic moves, hitting all-time lows below 80 cents-on-the-dollar.

Managed Futures/Global Macro

The category experienced mixed results as some managers benefited from a continued downtrend in global equity indices. A few managers were nimble enough to maneuver through significant reversals in commodity and currency trades. Others booked losses as oil prices declined and the U.S. dollar rallied during an extremely volatile period. Again, this is the only major category to maintain positive year-to-date performance, an impressive result.

Relative Value

Relative value strategies were hurt by several factors, including general spread widening reflecting escalating risk levels in a weak environment, short-selling restrictions on trading strategies and deleveraging. Convertible arbitrage, for example, was hit hard as spreads widened significantly between long bond and short stock positions.

Disclosures

This material is intended for information purposes only. UBS Financial Services ("UBSFS") is not soliciting or recommending any action based on this material, and this material does not represent an offer to buy or sell or the solicitation of an offer to buy or sell any security or instrument or to participate in any particular trading strategy.

Any opinions expressed or information provided in this document may be subject to change without notice, and UBSFS has no obligation to update such opinion or information. Past performance is no indication of future results.

Although all information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, no representation or warranty, express or implied, is made as to its accuracy or completeness, and it may not be relied upon as such. Certain statements herein may constitute projections, forecasts and other forward-looking statements that do not reflect actual results and are based primarily upon applying retroactively a hypothetical set of

assumptions to certain historical financial information. Any industry outlook or conclusions provided herein are for informational purposes only and should not be relied upon.

The use of indices is for illustrative purposes only. Some indices are unmanaged, are not available for direct investment and are not subject to management fees and other fees and expenses. Information about the index is derived from sources that we believe to be reliable, but we have not independently verified them and we do not warrant as to its accuracy or completeness.

Any opinions, projections, forecasts and forward-looking statements presented herein are as of the date of this document and are subject to change.

By accessing and using this website you also agree to accept the UBS "Terms of Use" as provided on this website. Please see the link "Important Legal Information" on the bottom of this page where this document is located.