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Macro investor sentiment survey 2011

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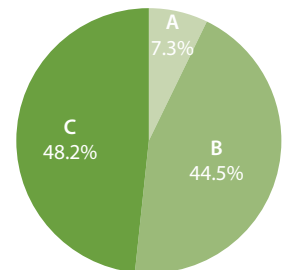
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On the face of it, 2010 was a good year for financial markets with equity, bond, and commodity markets all rising. Investors have developed various frameworks for interpreting the results and, interestingly, a number of these are at odds with one another. It appears that the world has entered a benign phase of recovery post the crisis, with some market participants still worrying about deflation whilst others being of the view that the unprecedented easy monetary policy will lead to inflation, while both of these phenomenon seem to be occurring simultaneously. There seems to have emerged an almost schizophrenic attitude to risk whereby participants frequently alternate between "risk on" and "risk off" scenarios.

More difficult than interpreting 2010 is forecasting 2011. In January 2011 we undertook a survey to see whether this diversity of broad opinions also exists for institutions that invest in hedge funds, as opposed to those who manage hedge funds directly. Our intention was to try to identify what is driving investor decisions, and our targets for this survey were family offices, fund of hedge funds, pension funds, as well as consultants and other institutions. We had responses from over 200 individuals at these firms with 50% of respondents being from Europe, and 25% each from Asia and North America. In all cases, responses were anonymous, and every question was compulsory. In this paper we present the findings of the Newedge Macro Investor Sentiment Survey, January 2011, and aim to identify, where relevant, differences in views between investors in the three different geographic zones that we targeted (Asia, Europe, and North America).

Question 1: The EU's sovereign debt issues are:

- A) Being over-stated by many analysts and under control by authorities
- B) A bump in the road for the next year, but will work out with no major disruptions
- C) A problem of such magnitude that markets have yet to fully price the problems yet to come

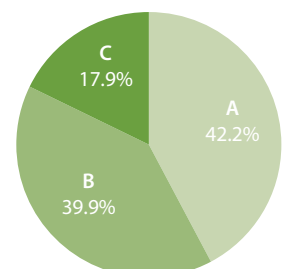


It appears that very few investors (7.30%) think that EU authorities have the sovereign debt issue under control, and almost 50% of respondents think that the scale of this issue is yet to be appreciated by market participants.

These results are fairly consistent in both Asia and Europe with European investors being slightly more inclined to believe that this is just a bump in the road. In contrast, North American investors appear to have a more binary view, with significantly fewer (28.9%) choosing the middle response. North American responses reveal a much more pessimistic view there, with 57.8% of those respondents falling into the third category.

Question 2: Bond Investors will lose confidence in the deficit reduction programs of Governments and force rates up:

- A) In 2011
- B) In 2012
- C) Bond rates will be stable



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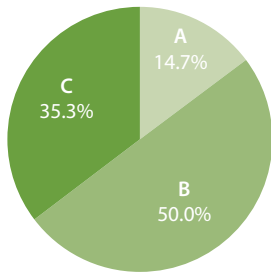
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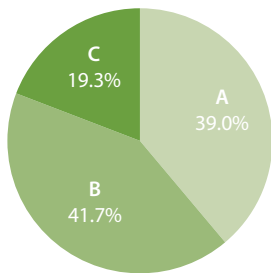
Our results indicate that the investor consensus (82% of respondents) view is that rates will be forced up within the next 24 months with a slight lean towards it being in 2011. There is very little deviation between European, Asian and North American responses.



Question 3: The US Federal Reserve will begin to exit its easy monetary policy in:

- A) 2011
- B) 2012
- C) 2013 or later

Half of our respondents think that the US will begin to exit its easy monetary policy in 2012, however we were surprised that over 35% of respondents think that this won't happen until 2013 or later.

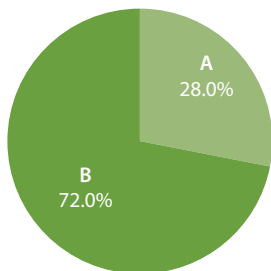


Question 4: Emerging markets' inflation situation will be characterised by:

- A) Remaining under control through normal market mechanisms and markets will flourish
- B) Will result in extreme policies such as capital controls, price controls, etc. being implemented and markets will be in turmoil
- C) Will not be able to be contained and will result in market dislocations

The responses to this question show a balance of opinion as to whether emerging market countries will be able to control the inflationary pressures on their economies. Fewer than 20% of respondents believe that these pressures will not be contained; however 41.7% of respondents indicate that they may only be able to do so through the use of potentially disruptive policy measures.

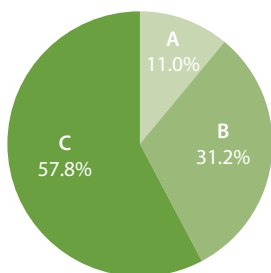
It is important to note that there is a split of opinion between the three geographic regions on this question, with a third of North American respondents choosing scenario C, believing that inflation in these regions will be not be able to be contained versus 21.2% for Asia and a surprisingly low 12.1% for Europe responses.



Question 5: Will the Chinese Government's continuing tightening result in a soft landing for the domestic economy?

- A) No
- B) Yes

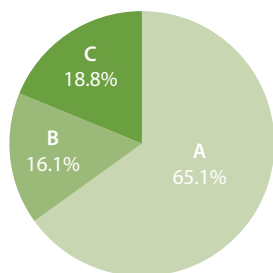
Approximately three quarters of our respondents believe that China will be able to engineer a soft landing for their economy. Whilst there are not broad disagreements with this view across the regions there are some slight differences. We felt it interesting to note that the response to this question diverges significantly from the results of a recently published Bloomberg survey of the same topic, however we acknowledge that the participants in both surveys were very different.



Question 6: Geopolitics will play the following role in markets in 2011:

- A) Cooperation and lack of flare-ups will be a tailwind for markets
- B) A non-issue
- C) Increased conflicts will be a headwind for markets

Perhaps unsurprisingly given recent events in Tunisia and Egypt, which were unfolding over the period this survey was administered, 58% of respondents see geopolitical risk a being a factor for the markets in 2011. It can even be considered surprising that the number was not higher.

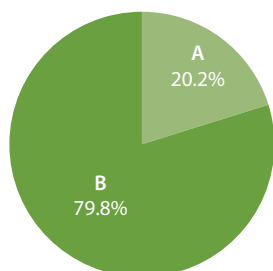


Question 7: In 2011, commodities prices will:

- A) Rise for the year
- B) Stay relatively stable for the year
- C) End the year lower than they began

Investors appear to have a fairly bullish view on commodity price inflation with 65% of respondents believing that commodity prices will rise in 2011, and a further 16% believing that they will stay relatively stable for the year.

This appears to be one item where investors have similar views irrespective of their location. The only slight difference is that a smaller number of Asian investors (13.6%) believe commodity prices will fall (vs. ~20% for Europe and North America), possibly reflecting the recent spotlight in the Asian region, especially China, on food and commodity inflation.



Question 8: Will the US Dollar continue to be the world's reserve currency in 5 years time?

- A) No
- B) Yes

We included this question hoping to identify just how pessimistic some investors are, and we were not disappointed; over 20% of people think that the USD will not be the reserve currency in 5 years time. While this is a very significant number, we also had a number of comments directly relating to this question, which perhaps provided some colour on why people have this view. We believe that some of the answers given to this question relate to how people perceive the significance of the USD will change in the next 5 year period. The view among those respondents being that the “power” or importance of the USD will decline, and imply that a less binary choice of answers may have produced a slightly different picture.

Conditional Responses

An interesting feature of our dataset is our ability to look at responses to individual questions based on how someone has answered a previous question. Looking at some of these “conditional responses” we were able to identify a number of examples that appear to support the overall binary or schizophrenic view that markets have on risk (“risk on” versus “risk off”). For example, we selected from our total 218 responses, those 42 who believe that emerging market inflation won’t be able to be contained (Question 4, Answer C). This subset has a much greater view that geopolitics will be a headwind for markets (71.4% vs. 57.8% for all respondents). In addition 47.6% of these respondents don’t feel that China officials will be able to engineer a soft landing for their economy (vs. 28% for the total population), and also they appear to be much more likely to think that EU sovereign debt is a significant issue (66.7% vs. 48.2% for all respondents). This group can clearly be considered, overall, more prone to risk aversion tendencies. If we consider the opposite of this subset, those that think emerging market inflation will be contained, 87.1% of these think that China will engineer a soft landing (vs. 72% for all respondents) and they think that geopolitics will have much less of an impact (41.2% vs. 57.8% for all respondents), representing the camp that would be considered to have more of a risk appetite.

Conclusion

One respondent provided us with the following, possibly quite prescient, comment: “My prediction is that if you do a review of your ‘crowd sourced’ predictions for 2011 we will be shown to have been of no predictive value.” This may very well be the case, of course, but we do hope that these results help to cast some light on what hedge fund investors are thinking about the world as they seek homes for their capital this year. It appears that there is still some uncertainty about the outlook for developed

markets, based on responses to questions about the EU sovereign debt situation, timeline for the US Fed exiting and investors forcing rates higher. We sense, however, a somewhat more sanguine feeling when it comes to emerging markets and their ability to get a handle on inflation and its effects, and particularly on China's ability to avoid a major dislocation. Either way, based on the split responses above, it seems managers may be navigating markets that can be very simply defined as "risk on" and "risk off" for a while longer.

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