

A Summary of Financial Markets in 2008

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January 21, 2009

II. Introduction

2008 Recap



II. Introduction

A. The Markets

Question:

What happened to the US economy in 2008?

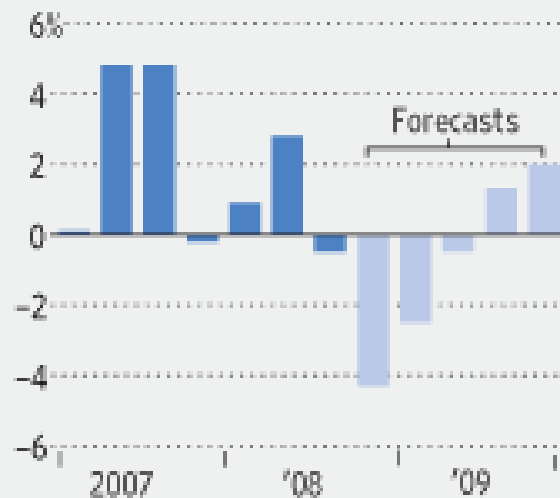


II. Introduction

A. Economy

First, the Bad News

Quarterly change in inflation-adjusted GDP*



*At a seasonally adjusted annual rate

Source: Commerce Department (GDP); WSJ December survey of economists (forecasts)

In the Pipeline

A rundown of stimulus plans and other measures coming in 2009

- **Fiscal:** The Obama administration is planning tax cuts and spending increases of \$750 billion or more over two years.
- **Bank rescue:** The Treasury Department is likely to tap another \$350 billion of Troubled Asset Relief Program funds to bail out banks and other financial institutions.
- **Mortgage debt purchases:** The Federal Reserve is planning to purchase up to \$600 billion of debt issued or guaranteed by Fannie Mae, Freddie Mac and other government-linked mortgage firms.
- **Consumer loans:** The Fed will lend up to \$200 billion to investors buying debt tied to credit-card loans, car loans and student loans.
- **Foreclosures:** Lawmakers and White House officials will explore new programs to reduce the number of mortgage foreclosures.

II. Introduction

A. Economy

Retail sales, producer prices, wages and exchange rates

% change on year ago










| | Retail sales (volume) latest | Producer prices | | Wages/earnings | | Exchange rate trade-weighted† 2000=100 | |
|----------------------|------------------------------------|-----------------|----------|----------------|----------|--|----------|
| | | latest | year ago | latest | year ago | Jan 15th | year ago |
| Australia | +1.0 Q3 | +10.9 Q3 | +0.8 | +3.0 Q3 | +4.6 | 97.9 | 126.0 |
| Austria | -0.5 Nov† | -1.8 Nov | +6.5 | +3.2 Nov | +2.3 | 106.4§ | 108.1 |
| Belgium | -4.3 Nov† | +3.2 Nov | +5.8 | +3.6 Oct | +1.3 | 109.6§ | 110.5 |
| Britain | +2.6 Nov† | +4.7 Dec | +4.7 | +3.3 Oct* | +4.0 | 93.1 | 95.3 |
| Canada | +2.8 Oct | +5.9 Nov | -0.5 | +1.9 Oct | +5.9 | 114.6 | 138.0 |
| Denmark | -5.4 Nov† | -1.1 Nov | +7.8 | +4.5 Q3 | +4.0 | 112.4 | 109.4 |
| Finland | -1.5 Nov | +1.2 Nov | +3.4 | +4.9 Q3 | +1.7 | 111.6§ | 112.5 |
| France | +1.6 Nov | +6.9 Nov | +4.2 | +3.1 Q3 | +2.8 | 110.0§ | 111.8 |
| Germany | +0.3 Nov† | -3.3 Dec | +5.1 | +2.7 Oct | +1.4 | 111.4§ | 114.3 |
| Greece | +0.5 Oct | -0.6 Nov | +8.1 | na | na | 106.4§ | 107.3 |
| Iceland | na | +68.5 Nov | -4.6 | +7.8 Nov | +8.3 | 68.3** | 96.6 |
| Ireland | -5.5 Oct | +5.2 Nov | -3.1 | +2.2 Q2 | +7.7 | 117.8§ | 119.6 |
| Italy | -4.3 Oct | +2.3 Nov | +4.8 | +3.5 Nov | +2.0 | 109.2§ | 111.3 |
| Japan | -2.0 Nov | +2.8 Nov | +2.3 | -3.4 Nov | -0.5 | 106.9 | 82.8 |
| Luxembourg | -6.7 Nov | +12.9 Oct | +6.9 | -0.6 Oct | -1.1 | 109.6§ | 110.5 |
| Netherlands | -0.6 Oct | -1.1 Nov | +8.9 | +3.5 Dec | +2.3 | 110.5§ | 111.7 |
| New Zealand | -3.4 Q3 | +13.6 Q3 | +1.6 | +3.6 Q3 | +3.1 | 102.3 | 138.3 |
| Norway | -0.6 Nov | +5.9 Dec | +12.5 | +5.6 Q3 | +5.3 | 98.2 | 114.1 |
| Portugal | -1.6 Nov† | +2.4 Nov | +5.4 | +0.5 Nov | +2.6 | 107.7** | 107.8 |
| Spain | -7.8 Nov | +2.5 Nov | +5.4 | +5.1 Q2 | +3.9 | 107.4§ | 108.2 |
| Sweden | nil Nov† | +4.6 Nov | +3.7 | +3.0 Oct | +4.0 | 84.7 | 99.2 |
| Switzerland | +2.9 Oct | +1.1 Nov | +3.0 | +1.6 2007 | +1.2 | 115.3 | 106.2 |
| United States | -5.3 Nov | +0.4 Nov | +7.3 | +3.7 Dec | +3.7 | 80.2 | 75.4 |
| Euro area | -1.5 Nov | +3.3 Nov | +4.1 | +3.8 Q3 | +2.6 | 127.9 | 128.6 |

*Aug-Oct. †Bank of England except §IMF Nov average, **Oct average. ‡New series

Sources: National statistics offices; Thomson Datastream; Reuters; Eurostat

II. Introduction

A. Economy

| | | | |
|--|--------------------|----------------------|-----------------------|
|  Tax Preparation Average cost of federal, state and local tax return preparation by H&R Block | \$155.20 | \$165.06 | \$172.18 |
|  Hospital Stay Average cost of one day in a semiprivate room, including ancillary services except private physician's fee (Cleveland) | \$5,261 | \$5,504 | \$5,310 |
|  McDonald's Big Mac Average price for company-owned restaurants; prices vary at independently owned franchised locations | \$2.75 | \$2.77 ¹ | \$2.97 |
|  Clearing Clogged Sink Roto-Rooter drain service, total country cost | \$192.55 | \$207.96 | \$227.65 ⁴ |
|  Movie Ticket Average price for all tickets sold at all prices at all times | \$6.55 | \$6.88 ¹ | \$7.15 ³ |
|  Airline Ticket Domestic round-trip, based on a 2,000-mile trip, excluding aviation taxes | \$289 ¹ | \$291 ¹ | \$311 ⁴ |
|  Birth Average hospital cost for mother and child, excluding private physician's fee (Cleveland) | \$8,162 | \$9,873 | \$8,906 |
|  A Year in College In-state, including room and board and fees, undergraduate student at Penn State | \$19,014 | \$20,024 | \$21,030 |
|  Funeral National average, excluding cemetery costs | \$6,951 | \$7,173 ¹ | \$7,395 ² |

Consumer Purchases

| | 2006 | 2007 | 2008 |
|--|-----------------------|------------------------|------------------------|
|  Single-Family Home Median resale price | \$221,900 | \$217,900 ¹ | \$200,500 ³ |
|  Toyota Camry Manufacturer's suggested retail price for the LE manual transmission | \$19,925 ¹ | \$20,025 | \$20,600 |
|  Unleaded Gasoline Full-year average national price per gallon for all grades of unleaded gasoline combined, including taxes | \$2.60 | \$2.82 | \$3.26 |
|  Pair of Jeans Gap's Easy Fit, stonewashed, starting price | \$39.50 | \$44.50 | \$44.50 |
|  Internet Service Average monthly subscription cost for broadband cable service from Comcast, standard tier | \$42.95 | \$42.95 | \$42.95 |
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II. Introduction

A. Economy

A Resurgent Greenback

In 2008, the dollar gained ground against the currencies of many U.S. trading partners. One major exception: the Japanese yen.

U.S. dollar broad trade-weighted index



Sources: Federal Reserve Bank of St. Louis (dollar index);
Thomson Reuters via WSJ Market Data Group (exchange rates)

U.S. dollar vs.

| | Pct. change in 2008 | Per US\$ Dec. 31, 2008 |
|-----------------|------------------------|---------------------------|
| Euro* | up 4.5% | €0.7159 |
| British pound* | up 36.2% | £0.6853 |
| Canadian dollar | up 22.5% | C\$1.2168 |
| Japanese yen | down 18.6% | ¥90.73 |
| Brazilian real | up 30.0% | 2.3143 |

*€1=\$1.3969; £1=\$1.4593 at year end

II. Introduction

A. Economy

Output, prices and jobs

% change on year ago

| | Gross domestic product | | | | Industrial production latest | Consumer prices | | | Unemployment rate [†] , % |
|---------------|------------------------|------------------|-------------------|-------------------|---------------------------------|-----------------------|----------|-------------------|---------------------------------------|
| | latest | qtr [*] | 2008 [†] | 2009 [†] | | latest | year ago | 2008 [†] | |
| United States | +0.7 Q3 | -0.5 | +0.9 | -1.2 | -5.5 Nov | +1.1 Nov | +4.3 | +3.7 | 7.2 Dec |
| Japan | -0.5 Q3 | -1.8 | nil | -1.4 | -16.2 Nov | +1.0 Nov | +0.6 | +1.5 | 3.9 Nov |
| China | +9.0 Q3 | na | +9.1 | +6.0 | +5.4 Nov | +2.4 Nov | +6.9 | +5.9 | 9.0 2008 |
| Britain | +0.3 Q3 | -2.0 | +0.6 | -1.7 | -6.9 Nov | +4.1 Nov [§] | +2.1 | +3.5 | 6.0 Oct ^{††} |
| Canada | +0.5 Q3 | +1.3 | +0.4 | nil | -3.4 Oct | +2.0 Nov | +2.5 | +2.2 | 6.6 Dec |
| Euro area | +0.6 Q3 | -0.7 | +0.7 | -1.4 | -7.7 Nov | +1.6 Dec | +3.1 | +3.2 | 7.8 Nov |
| Austria | +1.5 Q3 | +0.6 | +1.6 | -1.3 | -2.7 Oct | +1.3 Dec | +3.6 | +3.0 | 3.8 Nov |
| Belgium | +1.3 Q3 | +0.4 | +1.3 | -0.7 | -5.3 Oct | +2.6 Dec | +3.1 | +4.4 | 10.8 Dec ^{††} |
| France | +0.5 Q3 | +0.5 | +0.7 | -1.0 | -9.0 Nov | +1.0 Dec | +2.6 | +3.0 | 7.9 Nov |
| Germany | +0.8 Q3 | -2.1 | +1.0 | -1.4 | -6.3 Nov | +1.1 Dec | +3.1 | +2.6 | 7.6 Dec |
| Greece | +3.1 Q3 | +2.0 | +2.6 | +1.4 | -5.9 Nov | +2.0 Dec | +3.9 | +4.4 | 7.4 Sep |
| Italy | -0.9 Q3 | -2.1 | -0.5 | -1.2 | -9.7 Dec | +2.2 Dec | +2.6 | +3.4 | 6.7 Q3 |
| Netherlands | +1.8 Q3 | +0.1 | +1.6 | -0.6 | -6.2 Nov | +1.9 Dec | +1.9 | +2.3 | 3.8 Nov ^{††} |
| Spain | +0.9 Q3 | -0.9 | +1.0 | -1.3 | -17.2 Nov | +1.4 Dec | +4.2 | +4.3 | 13.4 Nov |

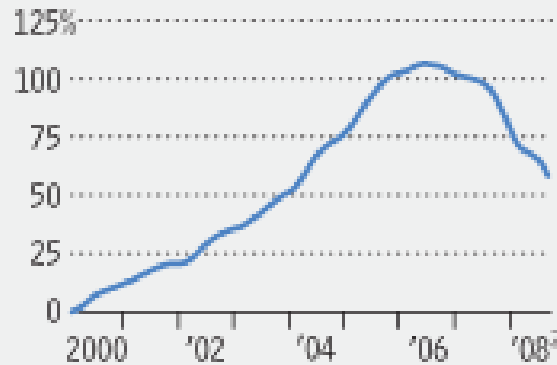
II. Introduction

A. Economy

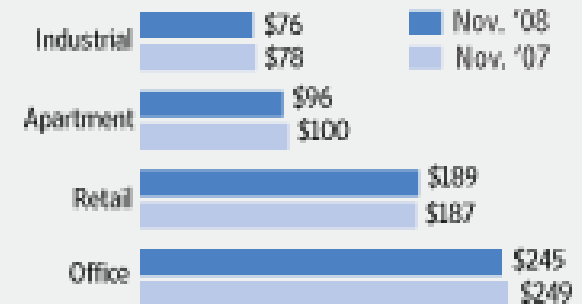
Pain in the Property Market

Housing woes worsened in 2008 as many sellers couldn't find buyers and the recession forced more homeowners into foreclosure. On the commercial side, with deal making virtually brought to a standstill by the credit crunch, investors are bracing for a rough 2009.

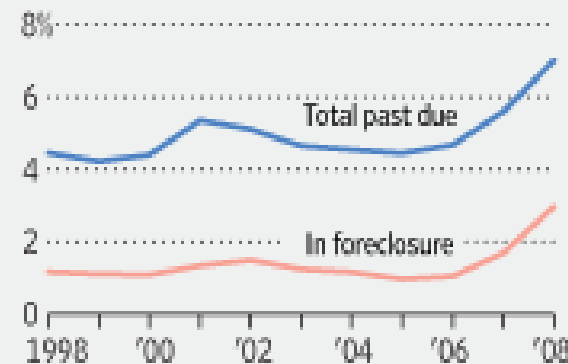
S&P/Case-Shiller home price index¹, change since beginning of 2000



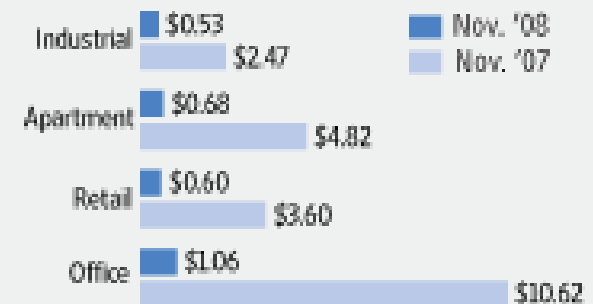
National average sales price per square foot



Percentage of U.S. loans past due or in foreclosure³



Acquisition volume, in billions



¹Composite of 20 metro areas

²Through October

³End of 3rd quarter each year

Sources: Standard & Poor's; Mortgage Bankers Association; Real Capital Analytics

II. Introduction

E. The Markets

Question: What happened to our favorite markets last year? Were U.S. equities the best place to invest?

What about hedge funds?

Which hedge fund strategies did the best?

II. Introduction

| | TOTAL RETURN ON INVESTMENT | | |
|--|----------------------------|-------------|-----------------|
| STOCKS (includes price changes and dividends) | 2006 | 2007 | 2008 |
| Dow Jones Industrial Average | 19.05% | 8.88% | -31.93% |
| Standard & Poor's 500 Stock Index | 15.79 | 5.49 | -37.00 |
| Russell 2000 | 18.37 | -1.57 | -33.79 |
| Dow Jones Wilshire 5000 | 15.88 | 5.62 | -37.23 |
| BONDS (Barclays Capital Indexes) | | | |
| Long-Term Treasury Index | 1.85% | 9.81% | 24.03% |
| U.S. Credit Index AA-rated segment | 4.32 | 5.39 | 2.74 |
| Municipal Bond Index | 4.84 | 3.36 | -2.47 |
| Intermediate-Term Treasury Index | 3.51 | 8.83 | 11.35 |
| Mortgage-Backed Securities Index | 5.22 | 6.90 | 8.34 |
| MUTUAL FUNDS | | | |
| Lipper Growth Fund Index | 10.28% | r7.83% | -a43.13% |
| Lipper Growth and Income Fund Index | 15.57 | r4.28 | -a38.40 |
| Lipper Balanced Fund Index | 11.60 | r6.53 | -a26.73 |
| Lipper International Fund Index | 25.89 | r14.25 | -a43.95 |
| Lipper Multi-Cap Value Index | 17.07 | -r1.04 | -a38.63 |

II. Introduction

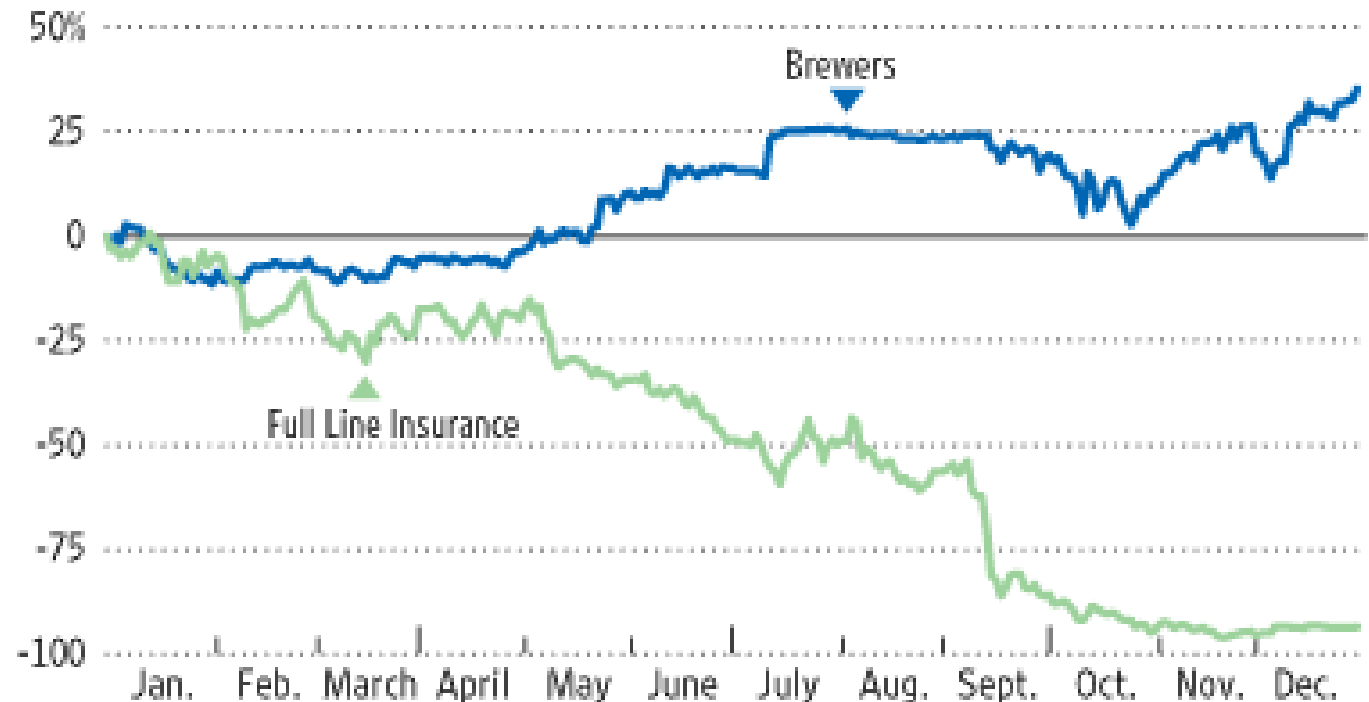
| BANK INSTRUMENTS (Bankrate.com National Index) | | | |
|--|--------|---------|----------------|
| One-Year Certificate of Deposit | 3.70% | 3.72% | 2.39% |
| 30-Month Certificate of Deposit | 3.83 | 3.71 | 2.46 |
| Money-Market Deposit Account | 0.80 | 0.86 | 0.72 |
| MONEY MARKET FUND | | | |
| iMoneyNet/12-month yield on all taxable funds | 4.28% | 4.69% | b2.04% |
| PRECIOUS METALS (S&P Goldman Sachs Commodity Index) | | | |
| Platinum | n.a. | 36.07% | -38.22% |
| Gold | n.a. | 29.92 | 3.91 |
| Silver | n.a. | 14.11 | -25.44 |
| RESIDENTIAL REAL ESTATE | | | |
| Office of Federal Housing Enterprise Oversight* | 4.20% | -r0.70% | -c6.01% |
| COLLECTIBLES | | | |
| Rare Coins, top investment grade | 15.80% | 31.90% | 8.80% |

II. Introduction

Best and Worst Industry Groups

Dow Jones Industry Groups 2008

Chart shows the best-performing and worst-performing U.S. industry groups of the Dow Jones Global Indexes. Percentage change since year-end 2007, daily data.



II. Introduction

Best and Worst Industry Groups

| Name | Last | Chg | % Chg |
|----------------------------|---------|-----------|--------|
| 10 BEST INDUSTRIES | | | |
| Brewers | 4725.36 | 1293.89 | 37.71 |
| Biotechnology | 3093.87 | 3.13 | 0.1 |
| Trucking | 2717.47 | -160.03 | -5.56 |
| Insurance Brokers | 2450.98 | -171.11 | -6.53 |
| Home Improvement Retailers | 4555.05 | -543.22 | -10.65 |
| Waste & Disposal Services | 1021.45 | -124.96 | -10.9 |
| Broadline Retailers | 2684.09 | -340.1 | -11.25 |
| Water | 4120.68 | -567.23 | -12.1 |
| Restaurants & Bars | 4922.79 | -817.51 | -14.24 |
| 10 WORST INDUSTRIES | | | |
| Paper | 476.21 | -949.17 | -66.59 |
| Investment Services | 2796.69 | -5782.27 | -67.4 |
| Aluminum | 1406.26 | -3281.75 | -70 |
| Mobile Telecommunications | 868.78 | -2144.77 | -71.17 |
| Nonferrous Metals | 2387.65 | -5962.64 | -71.41 |
| Automobiles | 548.54 | -1448.03 | -72.53 |
| Gambling | 2543.92 | -6762.57 | -72.67 |
| Consumer Electronics | 5122.67 | -15170.29 | -74.76 |
| Tires | 179.4 | -563.59 | -75.85 |
| Mortgage Finance | 222.07 | -2217.91 | -90.9 |
| Full Line Insurance | 311.3 | -4475.67 | -93.5 |

II. Introduction

Ponzi Scheme are
back in vogue
thanks to Mr.
Madoff

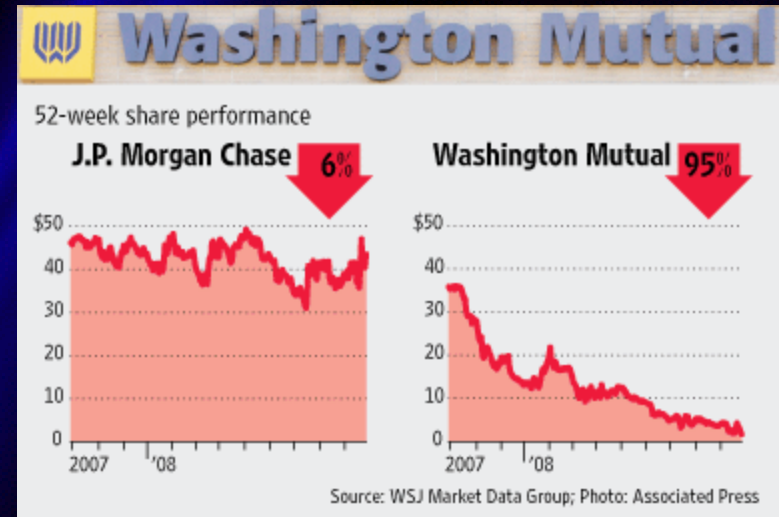
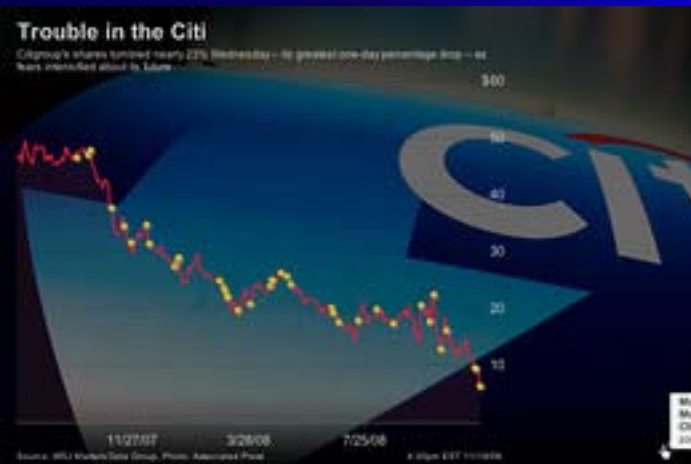


II. Introduction

Bear Stearns and Lehman Brothers Disappear



Freddie and Fannie go to Govt.



II. Introduction

Giants beat
the
Cheaters...

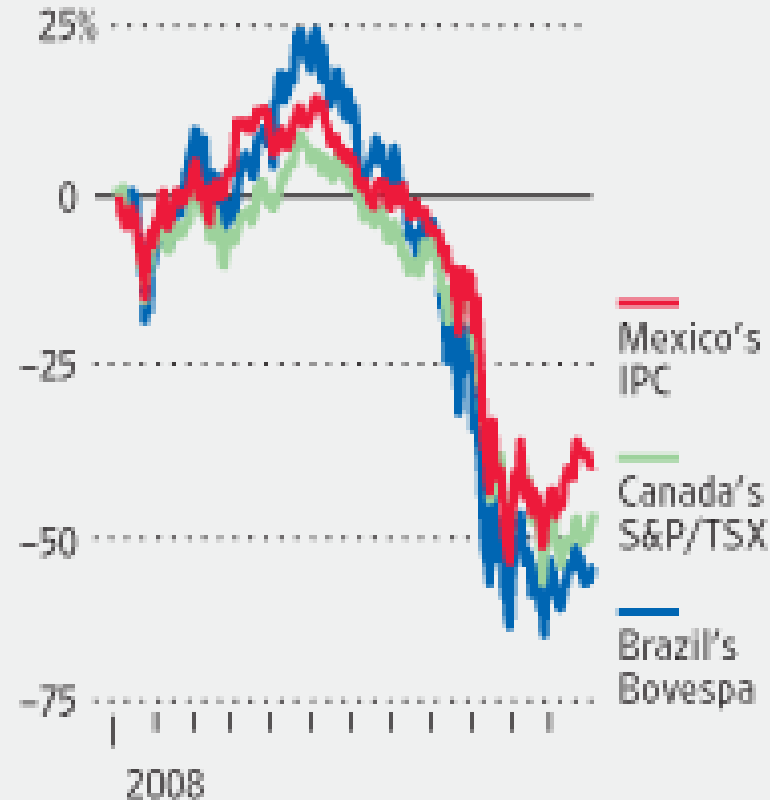


II. Introduction

US Market
was
bad...what
about rest of
world?

Americas' Markets









Performance of benchmark indexes,
in U.S.-dollar terms



Source: Thomson Reuters via WSJ Market Data Group

II. Introduction

Latin America

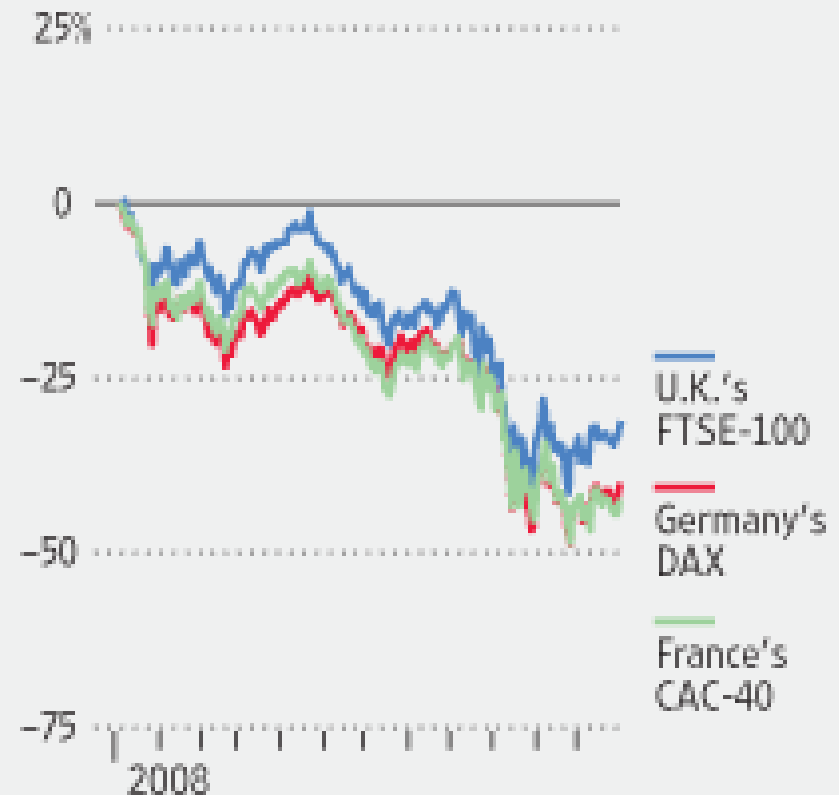
| AMERICAS | | |
|-------------------------------------|----------|---|
| Country/index | Close | Performance |
| Venezuela Caracas General | 34927.66 | -7.9%  |
| Chile Santiago IPSA | 2376.42 | -22.1  |
| Mexico IPC All-Share | 22380.32 | -24.2  |
| Colombia Bogota IGBC | 7560.68 | -29.3  |
| U.S. DJIA | 8776.39 | -33.8  |
| Canada S&P/TSX Composite | 8987.7 | -35.0  |
| Brazil Sao Paulo Bovespa | 37550.31 | -41.2  |
| Argentina Merval | 1079.66 | -49.8  |

II. Introduction

What about
the
Europeans?

Europe's Markets

Performance of benchmark indexes,
in local-currency terms



Source: Thomson Reuters via WSJ Market Data Group

II. Introduction

Und so?

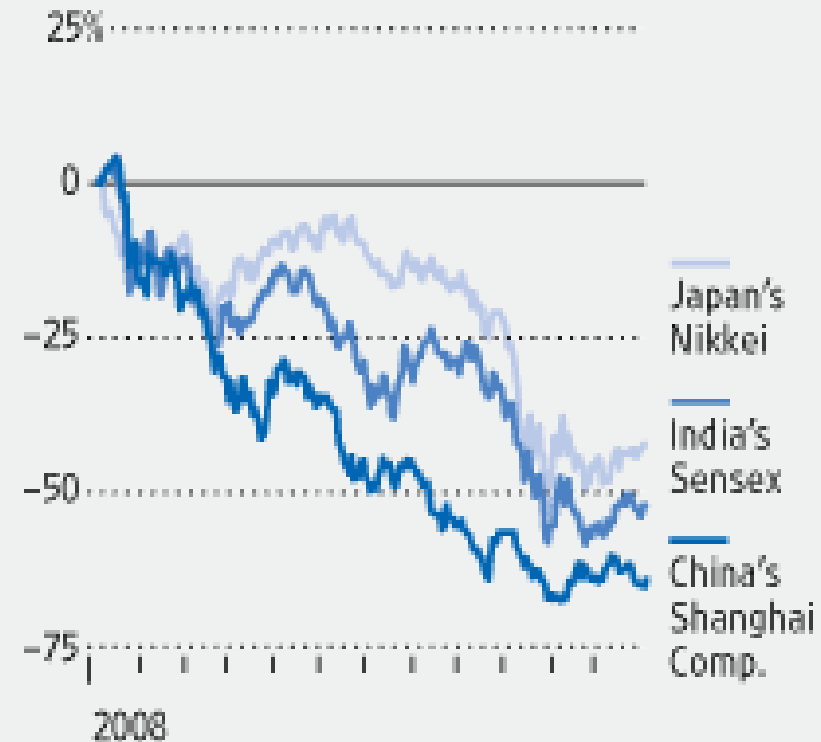
| | | | |
|---|---------|-------|--|
| U.K. FTSE 100 | 4434.17 | -31.3 | |
| Switzerland Zurich Swiss Market | 5534.53 | -34.8 | |
| Spain IBEX-35 | 9195.8 | -39.4 | |
| Germany DAX | 4810.2 | -40.4 | |
| Sweden SX All Share | 204.22 | -42.0 | |
| France Paris CAC 40 | 3217.97 | -42.7 | |
| Italy S&P/MIB | 19460.0 | -49.5 | |
| Denmark OMX Copenhagen | 226.19 | -49.6 | |
| Portugal PSI-20 | 6341.34 | -51.3 | |
| Netherlands AEX | 245.94 | -52.3 | |
| Finland OMX Helsinki | 5403.52 | -53.4 | |
| Belgium Bel20 | 1908.64 | -53.8 | |
| Norway All-Share | 225.48 | -54.1 | |
| Austria ATX | 1750.83 | -61.2 | |
| Ireland ISEQ | 2343.27 | -66.2 | |

II. Introduction

And Asia?

Asia's Markets
















Performance of benchmark indexes,
in local-currency terms



Source: Thomson Reuters via WSJ Market Data Group

II. Introduction

Asia?

| ASIA | | | |
|---------------------------------------|----------|-------------|---|
| Country/index | Close | Performance | |
| New Zealand NZX-50 | 2715.71 | -32.8% |  |
| Malaysia KLSE Composite | 876.75 | -39.3 |  |
| South Korea Kospi | 1124.47 | -40.7 |  |
| Australia S&P/ASX 200 | 3722.3 | -41.3 |  |
| Japan Nikkei Stock Average | 8859.56 | -42.1 |  |
| Taiwan Weighted | 4591.22 | -46.0 |  |
| Thailand SET | 449.96 | -47.6 |  |
| Hong Kong Hang Seng | 14387.48 | -48.3 |  |
| Philippines PSE Composite | 1872.85 | -48.3 |  |
| Singapore Straits Times | 1761.56 | -49.2 |  |
| Indonesia Jakarta Composite | 1355.41 | -50.6 |  |
| India Bombay Sensex | 9647.31 | -52.4 |  |
| Pakistan KSE 100 | 5865.01 | -58.3 |  |
| China Shenzhen A Shares | 581.51 | -61.8 |  |
| China Shanghai A Shares | 1911.79 | -65.4 |  |

II. Introduction

And the real
sad stories...

| | | |
|------------------|--------|--------|
| Estonia | -70.00 | -68.44 |
| Lithuania | -70.22 | -68.67 |
| Pakistan | -71.01 | -62.77 |
| Romania | -72.86 | -67.92 |
| Russia | -73.12 | -66.55 |
| Bulgaria | -77.53 | -76.38 |
| Cyprus | -79.01 | -77.92 |
| Iceland | -96.20 | -92.63 |

*This Slide from MBA
Class – January
2007. The signs
were there.*

Bonds are
nice too.

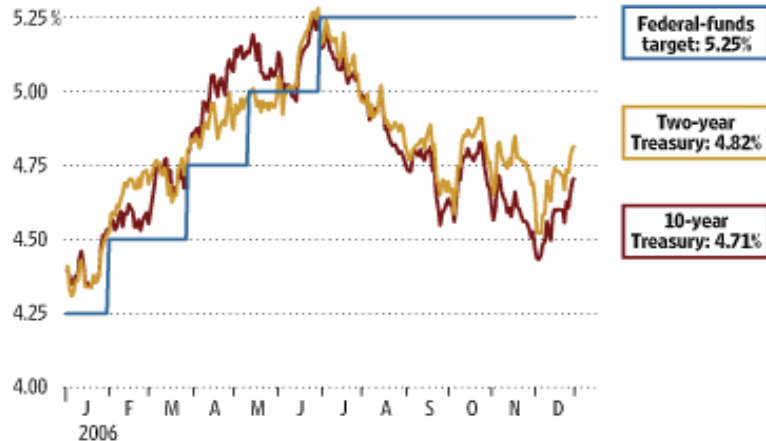
Corporate
Spreads are
tightening
but yield
curve
inverted...a
puzzle?

A crash to
come?

Conflicting Messages for Bonds

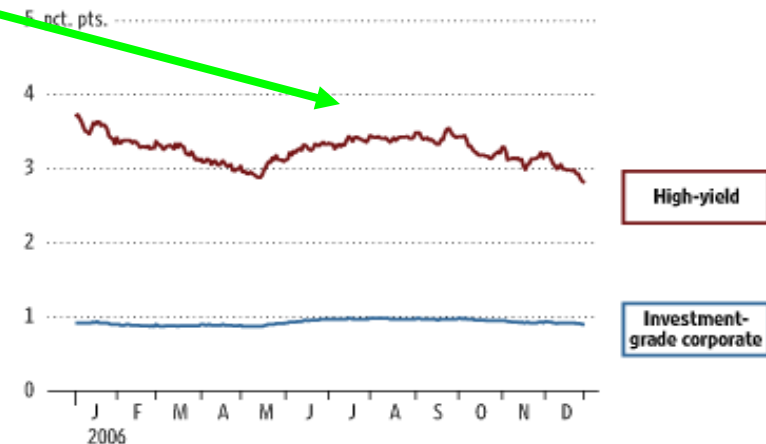
Treasury Yields Respond to Fed Moves

Both short- and long-term Treasury yields climbed as the Federal Reserve Bank raised its target short-term interest rate to 5.25%. Yields declined and short-term yields were higher than long-term yields after the Fed opted to pause in its campaign of rate increases last summer.



Spreads on Corporate Bonds Stay Small

The difference—or spread—between yields on corporate bonds and on Treasury securities remained narrow during 2006, a reflection of strong investor demand as corporate default rates hovered near historical lows.



II. Introduction

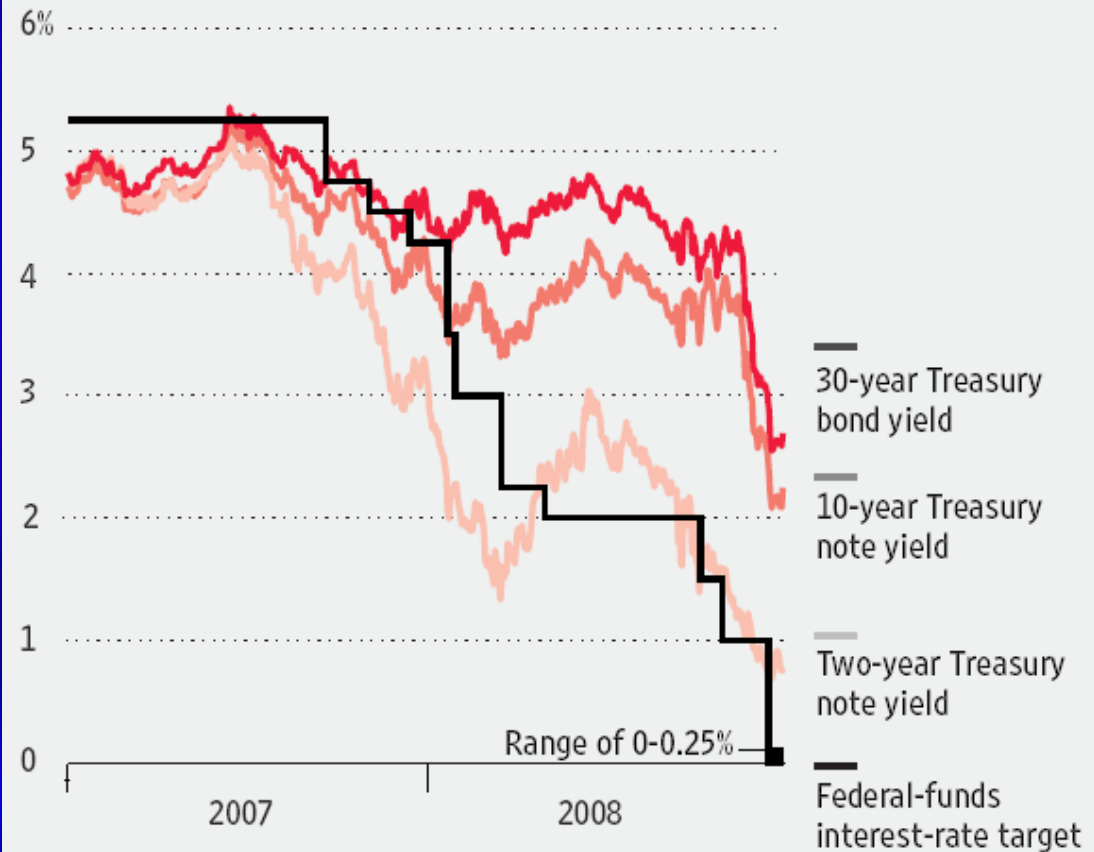
Treasury
Yields are
low...will
inflation
come soon?

What do we
do?

Short Treasuries?
Long High
Yield?

Interest rates and Treasury yields

The Federal Reserve lowered the federal-funds rate target seven times during 2008, ending at nearly 0% in a bid to lift the U.S. from recession. Yields on Treasuries tumbled to record lows as investors sought shelter.

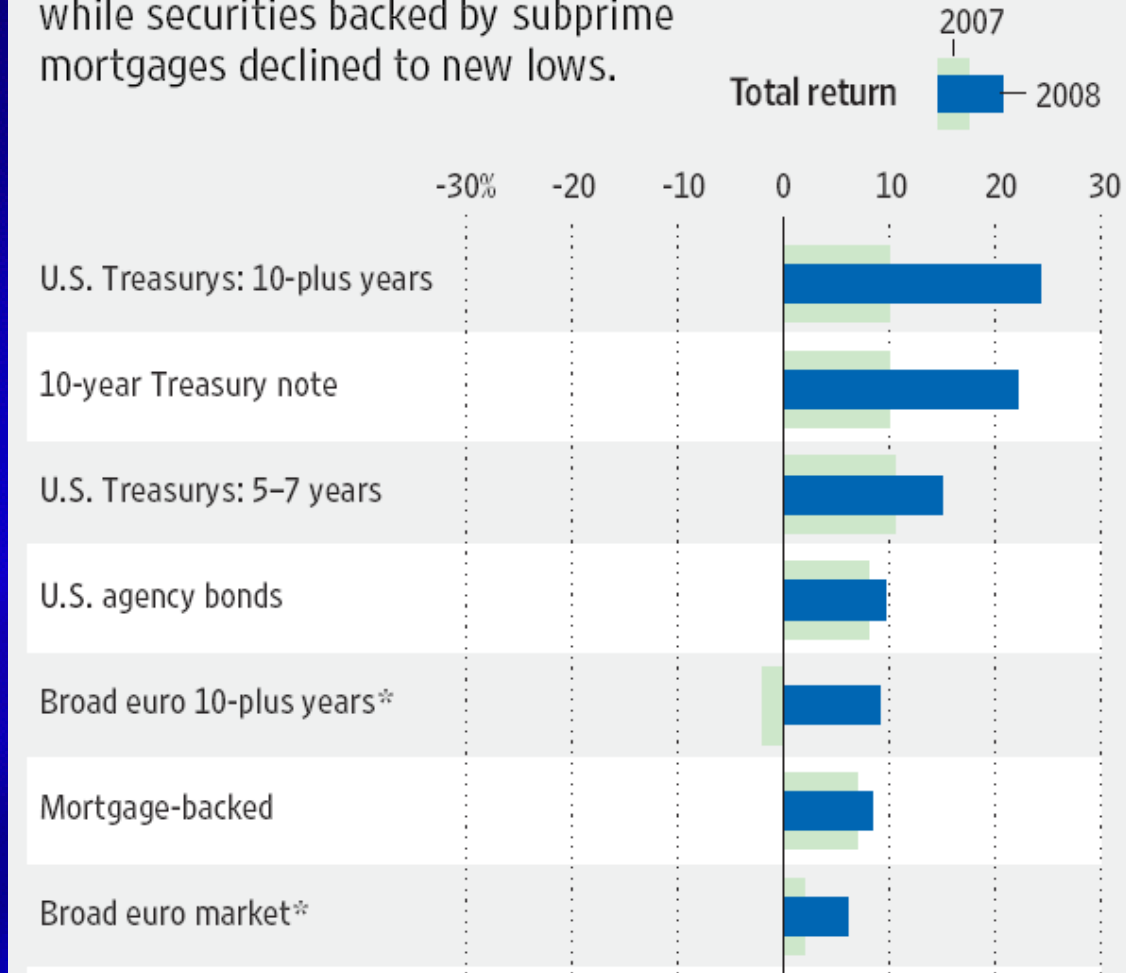


II. Introduction

Treasury Returns...

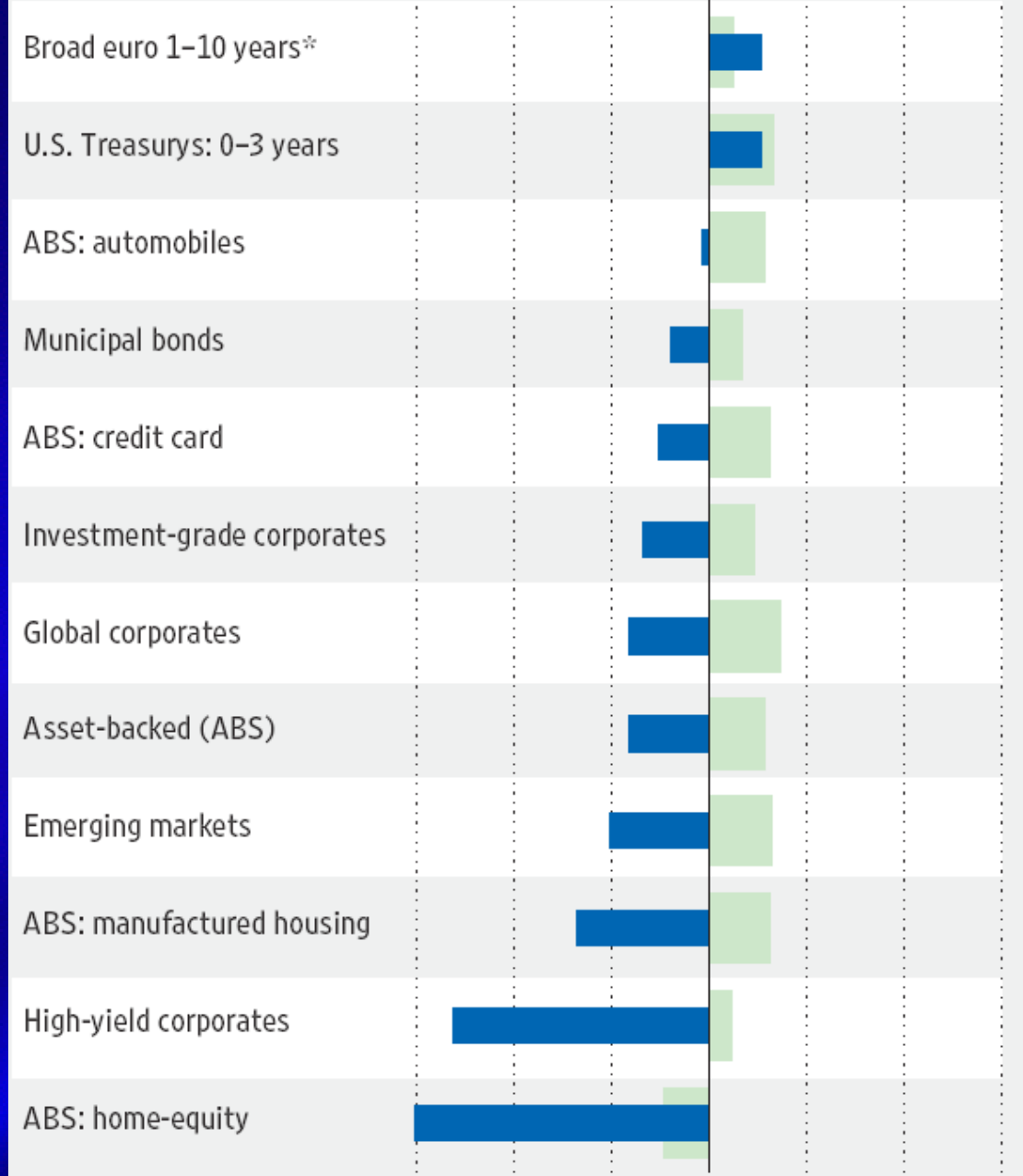
Bond returns

Treasuries were one of the few bright spots in 2008. Junk bonds had their worst-ever year, while securities backed by subprime mortgages declined to new lows.



II. Introduction

Treasury Returns...

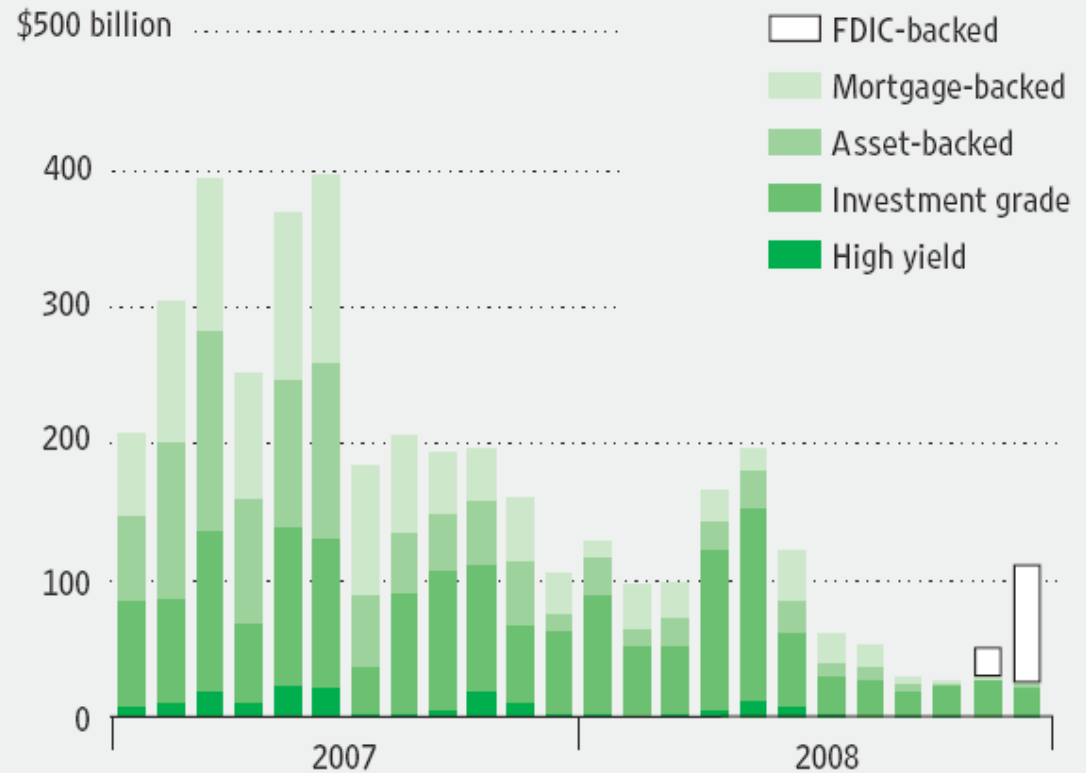


II. Introduction

Borrowing
and Lending
dry up...

Corporate borrowing

Corporate-debt issuance contracted in 2008 as investor demand for riskier assets dried up. Some bank-holding companies and finance companies were able to issue new bonds with government guarantees in the last two months of 2008.



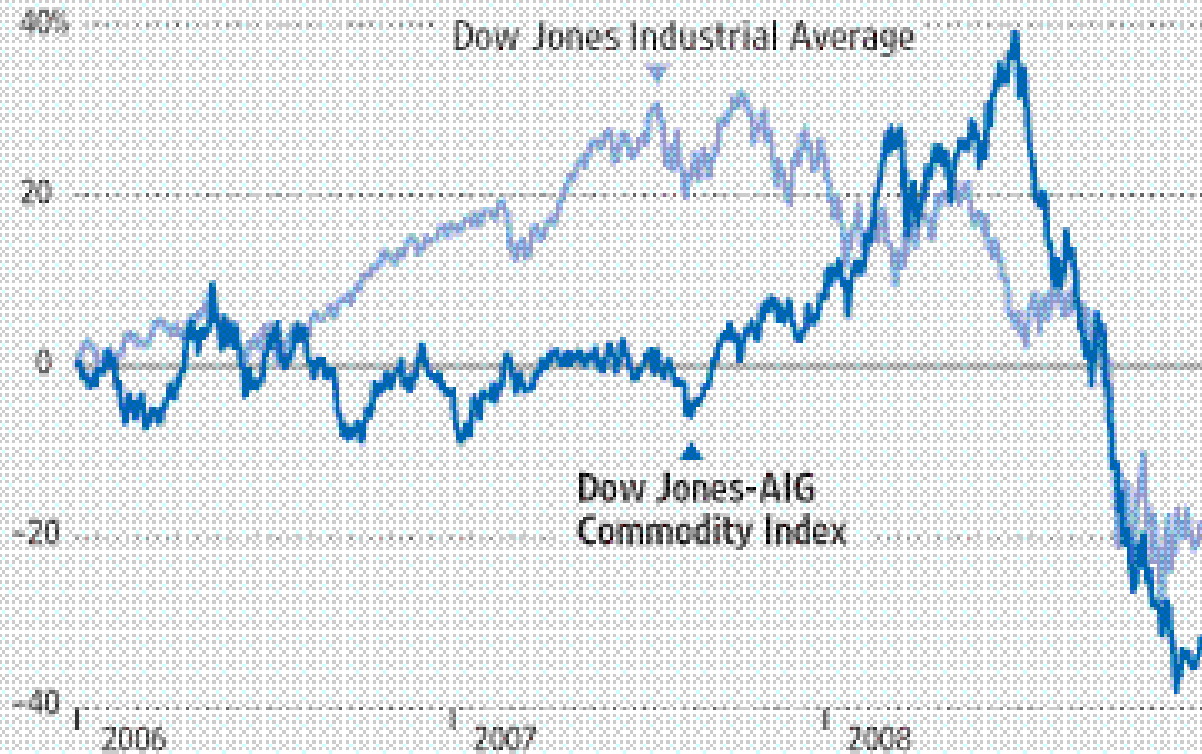
Note: On right-hand chart the emerging-markets index tracks sovereign bonds from countries rated Triple-B or lower; asset-backed bond indexes are for fixed-rate bonds and mortgage-backed includes some hybrids

II. Introduction

Commodities
– another
shed
investment in
2008

Another Boom Goes Bust

On the heels of a surge that started in mid-2007, most commodity-futures prices fell hard in the second half of 2008.



II. Introduction

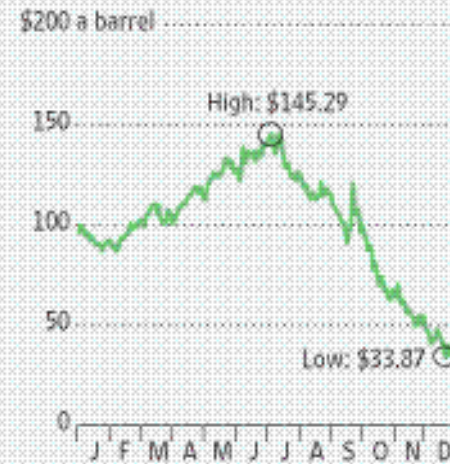
Commodities
– another
shed
investment in
2008

Futures prices in 2008

Settlement prices on continuous front-month contracts

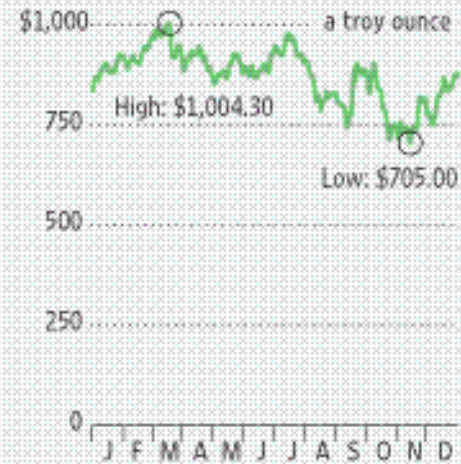
Crude oil tanks...

Dec. 31: \$44.60, down 54% in 2008



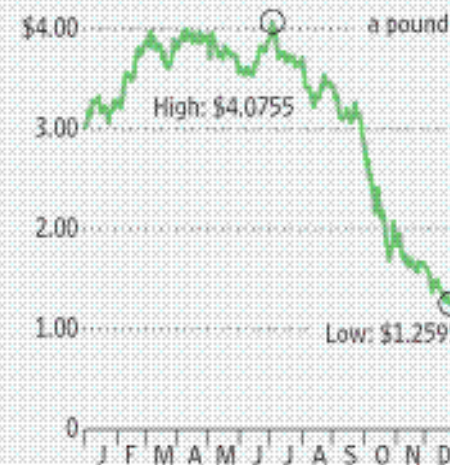
Gold holds its ground...

Dec. 31: \$883.60, up 6% in 2008



Copper loses it sheen...

Dec. 31: \$1.395, down 54% in 2008



And corn gets shucked

Dec. 31: \$4.070, down 11% in 2008



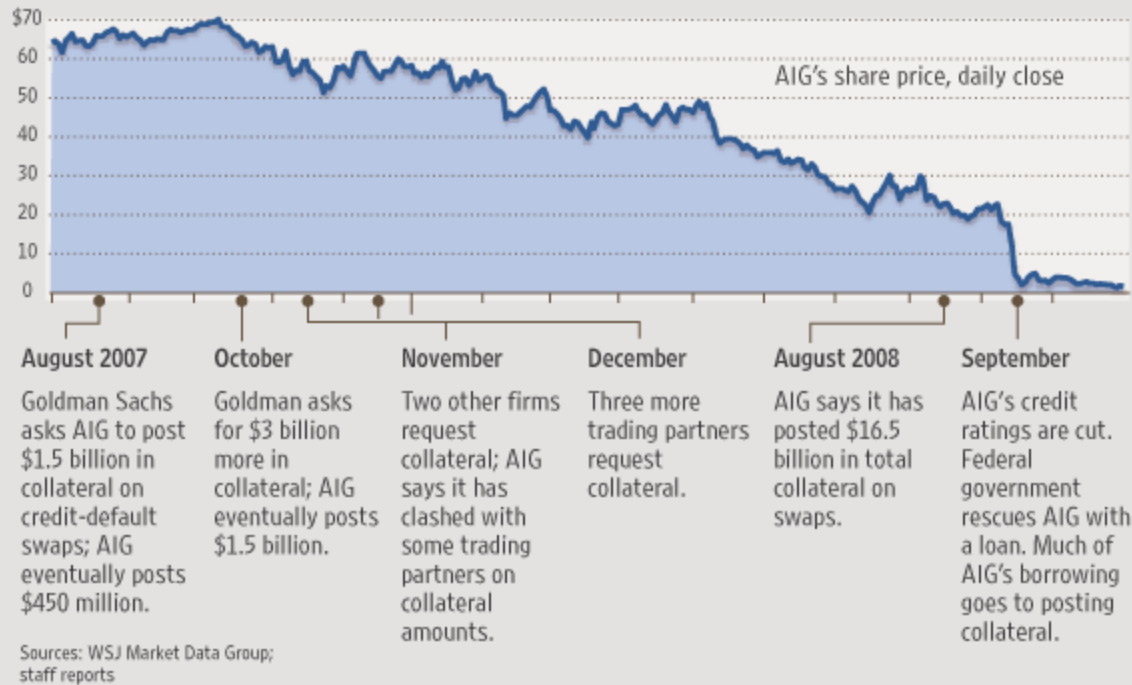
Sources: WSJ Market Data Group; Thomson Reuters Datastream

II. Introduction

AIG was safe right?

Collateral Damage

AIG had to post collateral to trading partners because of valuation declines and credit-rating downgrades.



II. Introduction

No one knows what to do.

Strong Medicine

Biggest TARP investments made by the U.S. Treasury

| Recipient | Amount, in billions |
|------------------------|---------------------|
| Citigroup* | \$45.0 |
| AIG | 40.0 |
| Wells Fargo | 25.0 |
| J.P. Morgan Chase | 25.0 |
| Bank of America | 15.0 |
| Merrill Lynch | 10.0 |
| Goldman Sachs | 10.0 |
| Morgan Stanley | 10.0 |
| PNC Financial Services | 7.7 |

*Received \$25 billion in October; \$20 billion is pending

Source: Dealogic

Bailout Baggage

Treasury Secretary Henry Paulson has significantly altered the way he talks about the financial crisis as the year has progressed, a shift that has cost him some credibility with lawmakers.

DECEMBER 2007

'The magic here is investors and servicers coming together... so that we don't have a market failure.'

FEB. 27

'I don't think... the American taxpayer needs to be stepping in with more taxpayer dollars.... We are so far away from seeing something that would have me calling for a bailout that I don't see it.'

MAY 6

'There's no doubt that things feel better today, by a lot, than they did in March.... The worst is likely to be behind us...'

SEPT. 18

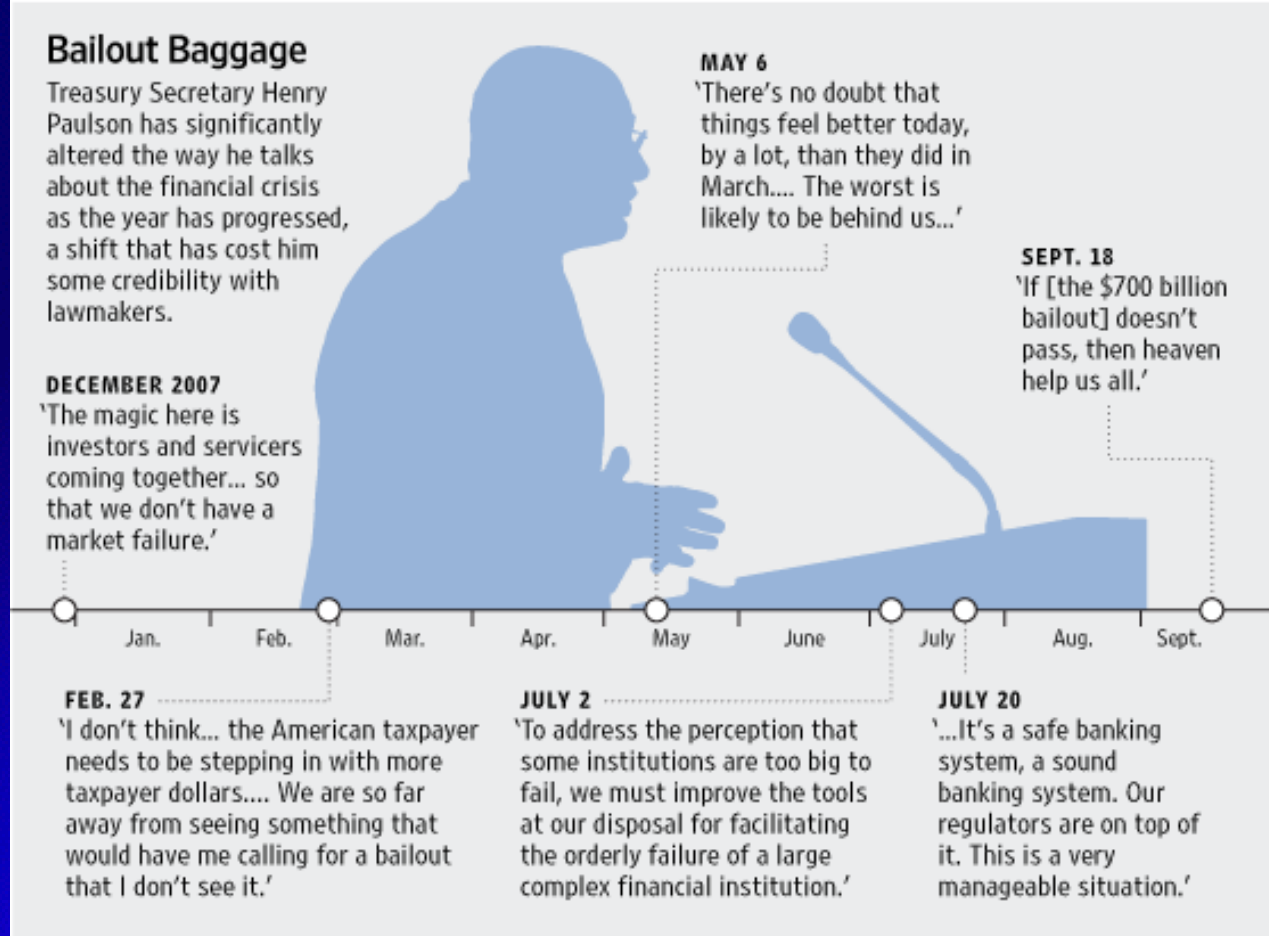
'If [the \$700 billion bailout] doesn't pass, then heaven help us all.'

JULY 2

'To address the perception that some institutions are too big to fail, we must improve the tools at our disposal for facilitating the orderly failure of a large complex financial institution.'

JULY 20

'...It's a safe banking system, a sound banking system. Our regulators are on top of it. This is a very manageable situation.'



II. Introduction

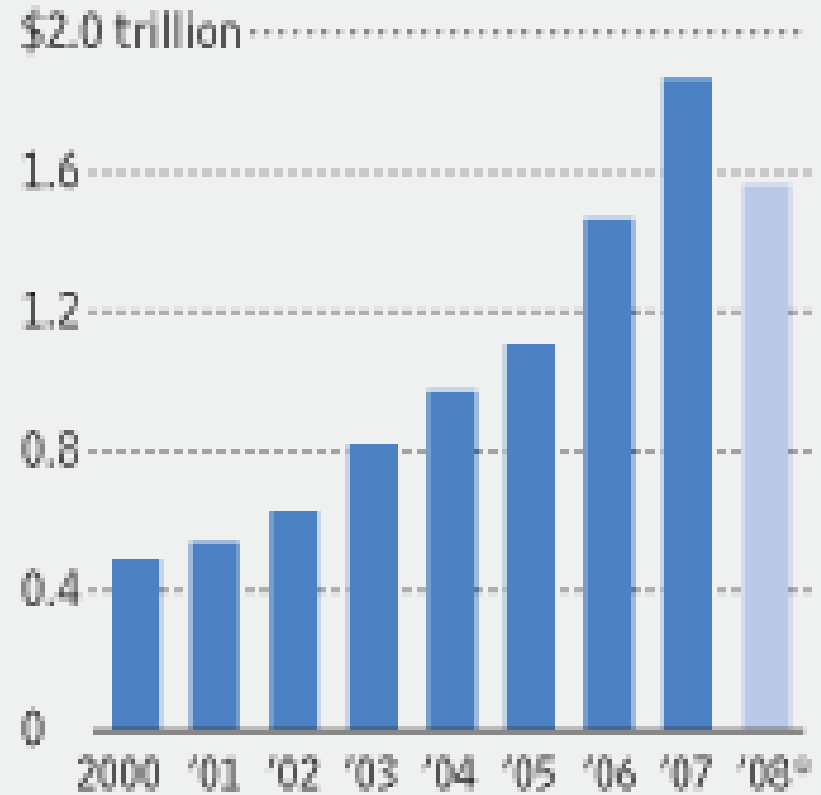
Question:

How did
hedge funds
do in 2008?

Which ones?

In Retreat

Hedge funds' assets under management



*Through October

Source: Hedge Fund Research

II. Introduction

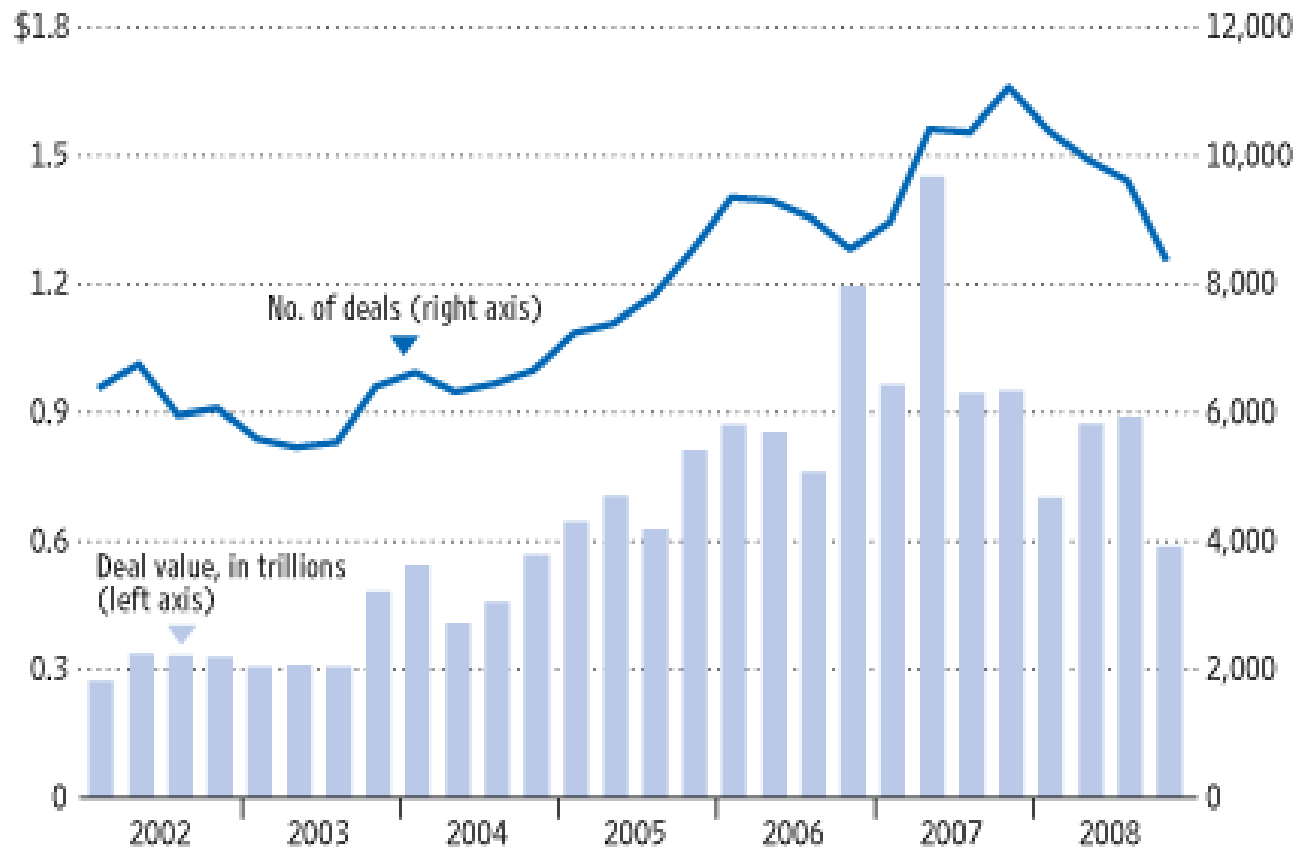
| | Weight Nov-08 | Total Return | | | | | 3 Yr Annualized | | 5 Yr Annualized | |
|--|---------------|--------------|--------|---------|---------|---------|-----------------|--------|-----------------|--------|
| | | 8-Dec | 8-Nov | YTD | 3Month | 1Year | CAR | STD | CAR | STD |
| Greenwich Global Hedge Fund Index * | 100.00% | 1.00% | -1.70% | -15.70% | -6.60% | -15.70% | 1.70% | 7.50% | 4.20% | 6.40% |
| Short Selling | 0.60% | -0.70% | 4.30% | 30.20% | 15.10% | 30.20% | 10.30% | 11.90% | 4.70% | 11.40% |
| Futures | 11.40% | 2.00% | 2.30% | 20.20% | 10.40% | 20.20% | 11.80% | 8.90% | 9.00% | 9.60% |
| Directional Trading Group | 18.50% | 1.90% | 1.50% | 9.60% | 6.20% | 9.60% | 8.80% | 6.40% | 7.30% | 6.60% |
| Statistical Arbitrage | 1.40% | 0.10% | 0.90% | 0.10% | -0.10% | 0.10% | 5.50% | 3.90% | 4.90% | 3.20% |
| Merger Arbitrage | 1.40% | 2.40% | 0.80% | -1.80% | 1.30% | -1.80% | 5.80% | 4.90% | 5.20% | 4.00% |
| Macro | 6.40% | 1.30% | 0.10% | -4.70% | -0.80% | -4.70% | 4.40% | 5.30% | 4.90% | 4.70% |
| Market Timing | 0.60% | 1.60% | 0.90% | -4.80% | 0.70% | -4.80% | 4.60% | 5.70% | 3.50% | 4.90% |
| Equity Market Neutral | 5.60% | 0.00% | -0.40% | -4.90% | -0.90% | -4.90% | 3.70% | 3.90% | 4.80% | 3.40% |
| Other Arbitrage | 2.40% | -0.10% | 0.00% | -6.80% | -4.90% | -6.80% | 4.90% | 4.70% | 5.00% | 3.90% |
| Multi-Strategy | 6.40% | 0.60% | -1.10% | -11.90% | -4.90% | -11.90% | 4.20% | 7.20% | 5.30% | 6.10% |
| Fixed Income | 2.50% | -0.30% | -1.70% | -12.00% | -7.10% | -12.00% | -0.50% | 5.00% | 2.70% | 4.10% |
| Market Neutral Group | 24.00% | 0.70% | -1.60% | -12.30% | -6.30% | -12.30% | 1.90% | 5.70% | 3.60% | 4.70% |
| Fixed Income Arbitrage | 3.00% | 0.90% | -1.90% | -12.60% | -8.90% | -12.60% | 1.00% | 6.10% | 2.90% | 4.80% |
| Arbitrage | 8.40% | 0.70% | -1.10% | -13.40% | -8.40% | -13.40% | 1.10% | 6.50% | 2.00% | 5.20% |
| Opportunistic | 7.20% | 0.90% | -1.30% | -15.80% | -5.60% | -15.80% | 3.50% | 8.90% | 6.30% | 8.10% |
| Event-Driven | 10.00% | 1.00% | -2.70% | -15.90% | -7.70% | -15.90% | 1.40% | 7.10% | 4.80% | 6.10% |
| Special Situations | 5.40% | 0.80% | -2.50% | -16.90% | -7.70% | -16.90% | 1.40% | 7.50% | 4.10% | 6.60% |
| Value | 21.40% | 1.20% | -3.10% | -17.00% | -11.20% | -17.00% | 22.10% | 14.70% | 21.10% | 13.90% |
| Distressed Securities | 3.30% | -0.70% | -4.60% | -20.80% | -12.60% | -20.80% | -0.90% | 7.80% | 4.80% | 6.70% |
| Long/Short Equity Group | 37.50% | 1.10% | -2.90% | -21.90% | -9.90% | -21.90% | -0.60% | 9.60% | 3.40% | 8.40% |
| Specialty Strategies Group | 20.00% | 0.20% | -2.40% | -25.90% | -11.80% | -25.90% | 0.60% | 10.70% | 4.70% | 9.00% |
| Growth | 8.40% | 1.10% | -4.40% | -28.70% | -13.80% | -28.70% | -3.20% | 12.10% | 0.80% | 10.80% |
| Emerging Markets | 11.20% | 0.10% | -3.20% | -36.50% | -16.90% | -36.50% | -1.40% | 14.90% | 4.90% | 12.60% |
| Convertible Arbitrage | 1.50% | -1.80% | -3.30% | -38.00% | -23.40% | -38.00% | -10.40% | 14.50% | -6.50% | 11.50% |

II. Introduction

M&A and Hedge Fund Happiness

Mergers Around the World

Merger activity slowed dramatically in 2008's fourth quarter.



Note: Excludes spinoffs, buybacks and 2008 U.S. government share purchases

Source: Dealogic

II. Introduction

M&A and Hedge Fund Happiness

Fee Income Declines as Underwriting Slows

Fees from stocks and bonds

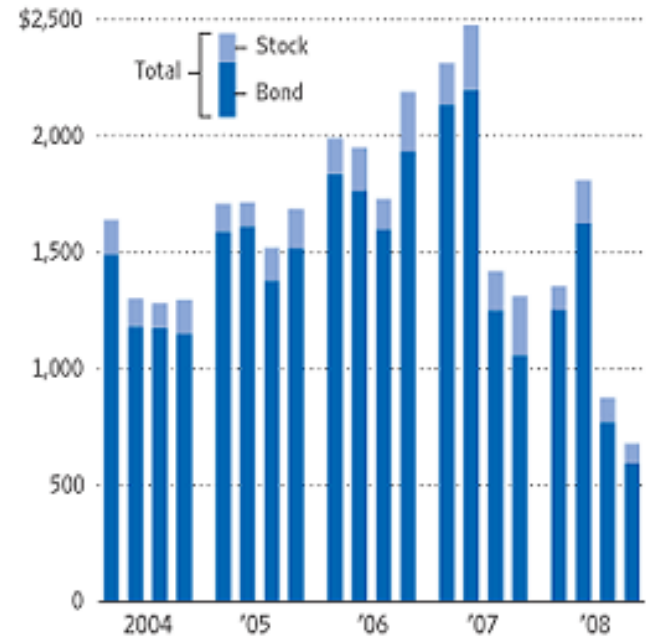
Top underwriters, by imputed fees^a for global stock and bond underwriting in 2008, in millions

| MANAGER | 2008 FEES | 2007 |
|------------------------|-------------------|-------------------|
| J.P. Morgan | \$2,601.6 | \$4,132.0 |
| Citi | 1,816.8 | 3,429.4 |
| Goldman Sachs | 1,717.1 | 2,492.4 |
| Merrill Lynch | 1,558.2 | 2,908.5 |
| Morgan Stanley | 1,269.9 | 2,564.8 |
| Barclays Capital | 1,262.7 | 2,409.1 |
| Banc of America Sec. | 1,253.3 | 1,305.9 |
| UBS | 1,234.6 | 2,460.7 |
| Deutsche Bank | 970.9 | 2,642.0 |
| Credit Suisse | 901.0 | 2,292.3 |
| Top 10 Totals | \$14,586.0 | \$26,637.1 |
| Industry Totals | \$23,537.6 | \$42,952.1 |

^aAs calculated by Thomson Reuters/Freeman & Co.

New issues

Stock and bond issuance in the U.S. public, Rule 144a, domestic and international-equity and euro markets; proceeds in billions



Source: Thomson Reuters

II. Introduction

M&A and Hedge Fund Happiness

2008 World-Wide Deals

50 Biggest World-Wide Deals

Ranked by deal value when announced; values exclude net debt of target companies.

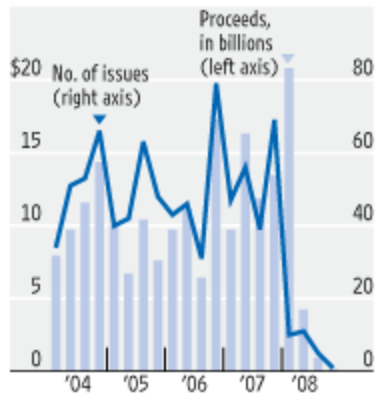
| ACQUIRER (COUNTRY) | TARGET (COUNTRY) | ANNOUNCED | DEAL VALUE (BILLIONS) |
|----------------------------------|--|-------------|--------------------------|
| United Kingdom | Royal Bank of Scotland (57.9%) (U.K.) | November 28 | \$23.0 |
| Wells Fargo (U.S.) | Wachovia (U.S.) | October 3 | 15.1 |
| Qinghai Salt Lake Potash (China) | Qinghai Salt Lake Industry (China) | December 26 | 14.8 |
| United Kingdom | HBOS (58.8%) (U.K.) | October 13 | 14.5 |
| Banco Itau (Brazil) | Unibanco (35.9%) (Brazil) | November 3 | 12.3 |
| BNP Paribas (France) | Fortis Bank (75%) (Belgium) | October 6 | 11.3 |
| Panasonic (Japan) | Sanyo Electric (Japan) | December 19 | 9.1 |
| BNP Paribas (France) | Fortis Insurance (Belgium) | October 6 | 7.9 |
| Eli Lilly (U.S.) | ImClone Systems (U.S.) | October 6 | 6.5 |
| Kingdom of Belgium | Fortis Bank (51%) (Belgium) | October 6 | 6.5 |
| Exelon (U.S.) | NRG Energy (U.S.) | October 20 | 6.2 |
| CenturyTel (U.S.) | Embarq (U.S.) | October 27 | 5.8 |
| State of the Netherlands | Fortis Insurance (Netherlands) | October 3 | 5.6 |
| PNC Financial Services (U.S.) | National City (U.S.) | October 24 | 5.1 |
| Lion Nathan (New Zealand) | Coca-Cola Amatil (Australia) | November 17 | 4.9 |
| Investor Group (Germany) | Hapag-Lloyd (Germany) | October 13 | 4.2 |

II. Introduction

IPOs

Going Public

Quarterly volume of global initial public offerings by U.S. issuers, in billions^{2*}



*Excludes REITs, deals containing warrants, and companies without current operating businesses
Source: Dealogic

2008 Initial Stock Offerings Biggest IPOs

Ranked by U.S. proceeds.

| Issuer | Date | U.S. Proceeds (millions) | Manager(s) | % Change In 1st-Day Trading From Offer |
|---|----------|--------------------------|--|--|
| Visa Inc Credit-card processor | March 18 | \$19,650.4 | JPMorgan, Goldman Sachs, Banc of America, Citi, HSBC, Merrill Lynch, UBS, Wachovia | 28.4% |
| American Water Works Co Inc Water utility | April 22 | 1,358.2 | Goldman Sachs, Citi, Merrill Lynch | -4.2 |
| Intrepid Potash Inc Potash producer | April 21 | 1,104.0 | Goldman Sachs, Merrill Lynch, Morgan Stanley | 57.5 |
| GT Solar International Inc Technology | July 23 | 500.0 | Credit Suisse, UBS | -11.6 |
| Colfax Corp Maker of pumps and valves | May 7 | 388.1 | Merrill Lynch, Barclays Capital, UBS | 16.7 |
| Williams Pipeline Partners LP Energy company | Jan. 17 | 358.0 | Barclays Capital, Citi, Merrill Lynch | 0.0 |
| Western Gas Partners LP Midstream energy firm | May 8 | 343.4 | UBS, Citi, Credit Suisse, Morgan Stanley | 0.0 |
| RiskMetrics Group Inc Corporate governance specialist | Jan. 24 | 281.8 | Credit Suisse, Goldman Sachs, Banc of America | 35.7 |
| Whiting USA Trust I Energy company | April 24 | 233.6 | Raymond James, Wachovia | 4.3 |
| Safe Bulkers Inc Drybulk shipping | May 28 | 190.0 | Merrill Lynch, Credit Suisse | -0.5 |

II. Introduction

2008 Initial Public Stock Offerings

Best Performers

Ranked by percentage gain from offer price.

| Issuer | Date | Offer Price | U.S. Proceeds (millions) | % Change | |
|---|----------|-------------|--------------------------|--------------------|-----------------|
| | | | | In 1st-Day Trading | Through Dec. 31 |
| Grand Canyon Education Inc For-profit university | Nov. 19 | \$12.00 | \$144.9 | -1.3% | 56.5% |
| CardioNet Inc Medical-device maker | March 18 | 18.00 | 82.8 | -1.7 | 36.9 |
| Visa Inc Credit-card processor | March 18 | 44.00 | 19,650.4 | 28.4 | 19.2 |
| IPC The Hospitalist Co Inc Hospital staffing services | Jan. 24 | 16.00 | 94.5 | 28.0 | 5.2 |
| Heritage-Crystal Clean Inc Industrial-parts cleaner | March 11 | 11.50 | 25.3 | 23.4 | 0.9 |
| American Water Works Co Inc Water utility | April 22 | 21.50 | 1,358.2 | -4.2 | -2.9 |
| Energy Recovery Inc Energy recycler | July 1 | 8.50 | 136.9 | 15.7 | -10.8 |
| ArcSight Inc Software firm | Feb. 13 | 9.00 | 61.8 | -2.4 | -11.0 |
| RiskMetrics Group Inc Corporate governance specialist | Jan. 24 | 17.50 | 281.8 | 35.7 | -14.9 |
| Western Gas Partners LP Midstream energy firm | May 8 | 16.50 | 343.4 | 0.0 | -22.2 |

IPOs:
The Best

II. Introduction

What about
stock picking?

Question:

Does anyone
have any
great stories
to tell?

Any sad
stories to tell?

II. Introduction

The Worst of
2005...a
story of the
MBA Class of
2006...

16 cents to
\$6.00

| Name | Symbol | PctChg |
|-------------------------------|--------|--------|
| FOAMEX INTERNATIONAL INC. | FMXIQ | -99.2 |
| PROXIM CORPORATION CL A | PROXQ | -98.5 |
| HEMOSOL CORP. | HMSLQ | -98.2 |
| ANCHOR GLASS CONTAINER CORP. | AGCCQ | -98.1 |
| CURATIVE HEALTH SERVICES INC. | CURE | -96.6 |
| DELPHI CORP. | DPH | -96 |
| ABLE LABORATORIES INC. | ABRXQ | -95.6 |
| CALPINE CORP. | CPN | -93.9 |
| NORTHWEST AIRLINES CORP. | NWACQ | -93.5 |
| ECOST.COM INC. | ECST | -92.7 |
| SR TELECOM INC. | SRXA | -92.3 |
| TAG-IT PACIFIC INC. | TAG | -92 |
| DELTA AIR LINES INC. | DAL | -91.7 |
| MAJESCO ENTERTAINMENT CO | COOL | -90.5 |
| WHITEHALL JEWELLERS INC. | JWL | -90.1 |
| BOYDS COLLECTION LTD. | FOB | -89.5 |
| ASCONI CORP. | ACD | -89.1 |
| ORAGENICS INC. | ONI | -88.8 |
| AAIPHARMA INC. | AAIIE | -88.3 |
| AKSYS LTD. | AKSY | -88.3 |
| PRG-SCHULTZ INTERNATIONAL INC | PRGX | -87.9 |
| BOSTON COMMUNICATIONS GROUP | BCGI | -87.8 |
| Orion HealthCorp. Inc. | ONH | -87.4 |
| CANCERVAX CORP. | CNVX | -87.3 |
| MEDIABAY INC. | MBAY | -85.5 |
| OCA INC. | OCA | -85.4 |
| ACCESS PHARMACEUTICALS INC. | AKC | -85.3 |
| AMS HEALTH SCIENCES INC. | AMM | -85.3 |
| ODIMO INC. | ODMO | -84.6 |
| ONETRAVEL HOLDINGS INC | OTV | -83.8 |
| INTEGRATED ELECTRICAL SERVICE | IES | -83.5 |

II. Introduction

The Best of 2008

| Name | Last | NetChg | PctChg | Symbol | Exchange |
|---------------------------------|-------|--------|--------|--------|----------|
| EMERGENT BIOSOLUTIONS INC. | 26.11 | 21.05 | 416 | EBS | N |
| CRAWFORD & CO. CL B | 14.54 | 10.39 | 250.4 | CRDB | N |
| MEXCO ENERGY CORP. | 12.39 | 8.41 | 211.3 | MXC | A |
| MEDECISION INC | 7 | 4.11 | 142.2 | MEDE | Nq |
| TELECOMMUNICATIONS SYSTEMS INC | 8.59 | 5.03 | 141.3 | TSYS | Nq |
| ALMOST FAMILY INC. | 44.98 | 25.55 | 131.5 | AFAM | Nq |
| FINISH LINE INC., (THE) CL A | 5.6 | 3.18 | 131.4 | FINL | Nq |
| APP PHARMACEUTICALS INC. | 23.7 | 13.43 | 130.8 | APPX | Nq |
| FUEL SYSTEMS SOLUTIONS INC | 32.76 | 18.47 | 129.3 | FSYS | Nq |
| CSK AUTO CORP. | 10.78 | 5.77 | 115.2 | CAO | N |
| IDENIX PHARMACEUTICALS INC. | 5.79 | 3.09 | 114.4 | IDIX | Nq |
| MICROMET INC. | 4.36 | 2.3 | 111.7 | MITI | Nq |
| SEQUENOM INC. | 19.84 | 10.29 | 107.7 | SQNM | Nq |
| EMERGENT GROUP INC. | 6.8 | 3.38 | 98.8 | LZR | A |
| FORDING CANADIAN COAL TRUST | 76.33 | 37.73 | 97.7 | FDG | N |
| GMH COMMUNITIES TRUST | 7.36 | 3.6 | 95.7 | GCT | N |
| TREX CO. INC. | 16.46 | 7.95 | 93.4 | TWP | N |
| CRAWFORD & CO. CL A | 6.74 | 3.24 | 92.6 | CRDA | N |
| 1ST INDEPENDENCE FINANCIAL GROU | 18.44 | 8.82 | 91.7 | FIFG | Nq |

II. Introduction

The Worst of 2008

| Name | Last | NetChg | PctChg | Symbol | Exchange |
|--|------|--------|--------|--------|----------|
| BRITANNIA BULK HOLDINGS INC. | 0.01 | -13.84 | -99.9 | BBLKF | N |
| MACROSHARES OIL DOWN TRADEABLE SHARES | 0.01 | -10.03 | -99.9 | DCR | A |
| IDEARC INC. | 0.02 | -17.54 | -99.9 | IDAR | N |
| DOWNEY FINANCIAL CORP. | 0.05 | -31.06 | -99.8 | DWNFQ | N |
| LEHMAN BROTHERS HOLDINGS INC. | 0.13 | -65.31 | -99.8 | LEHMQ | N |
| THORNBURG MORTGAGE CORP. | 0.24 | -92.16 | -99.7 | THMR | N |
| PROGRESSIVE GAMING INTERNATIONAL CORP. | 0.09 | -19.75 | -99.5 | PGIC | Nq |
| SILVER STATE BANCORP | 0.08 | -14.02 | -99.4 | SSBX | Nq |
| LANDAMERICA FINANCIAL GROUP INC. | 0.2 | -33.25 | -99.4 | LFGRQ | N |
| GATEHOUSE MEDIA INC. | 0.06 | -8.72 | -99.4 | GHSE | N |
| SYNTAX-BRILLIAN CORP. | 0.02 | -3.06 | -99.3 | BRLCQ | Nq |
| CELL THERAPEUTICS INC. | 0.14 | -18.66 | -99.3 | CTIC | Nq |
| PARENT CO.(THE) | 0.05 | -5.89 | -99.2 | KIDS | Nq |
| R.H. DONNELLEY CORP. | 0.37 | -36.11 | -99 | RHD | N |
| MRU HOLDINGS INC. | 0.04 | -3.56 | -98.9 | UNCL | Nq |
| WASHINGTON MUTUAL INC. | 0.16 | -13.45 | -98.8 | WAMUQ | N |
| ARTES MEDICAL INC | 0.03 | -2.24 | -98.7 | ARTEQ | Nq |
| PEOPLES COMMUNITY BANCORP INC. | 0.2 | -13.84 | -98.6 | PCBI | Nq |
| PROXYMED INC. | 0.04 | -2.63 | -98.5 | PILL | Nq |

II. Introduction

Some of my
Best and
Worst and
lots of missed
ideas...☹

Best

Short Lehman Brothers

Long Goldman

Long S&P 500

Short S&P 500

Long Morgan Stanley

Heavily Long US Treasuries

Short Consumer Staples

Long Banks

Long Oil (CHK & WFT)

Short Airlines (Short AMR, Long LUV)

Short BBY

Short BAC (after MER purchase)

Long VISA IPO

Worst

Long Lehman Brothers

Short Goldman

Long YHOO

Short Banks

Long Asia (not a trade, but part of asset allocation)

Long USA (not a trade, but part of asset allocation)

II. Introduction

Can we build portfolios and find stocks that will beat the S&P 500?

That will have a positive return?

That will beat the risk-free rate?

Sources: Wall St. Journal, CS-Tremont, The Economist, and own calculations.