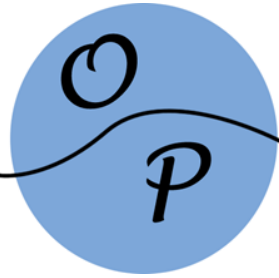


# Ocean *Partners* LP

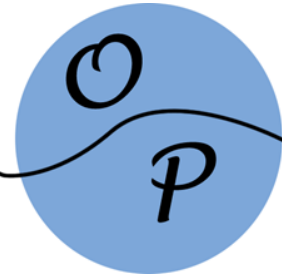
HEDGE FUND STRATEGIES: AN  
OVERVIEW

# HEDGE FUND STRATEGIES



- 1. Global Macro
- 2. Event Driven
- 3. Emerging Markets
- 4. Relative Value
- 5. Credit
- 6. Long/Short Equity
- 7. Quantitative (Algorithm Based)
- 8. Multi—Strategy
- 9. Insurance

# RELATIVE VALUE MODEL:

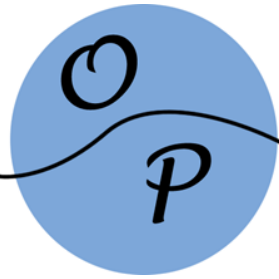


- % difference in P/E valuation in two very similar stocks, stock A and stock B: 25% (12 for A vs. 15 for B PE multiple)
- % difference in analyst rankings on a scale of 1 to 10: 12.5% (8 for A vs. 9 for B)
- A and B are the two largest companies in the same sector. The capital allotted to the sector by FUND RV is \$60 million. The fund's macro conditions model calls for 33.33% in cash. The quantitatively preferred stock of the two receives an investment allotment larger than the other by a factor of 2 times the ranking percentage difference.
- A gets 25% more (cheaper P/E) – 11% less (lower rankings) = 14% x 2 (the standard multiplier in this fund's strategy) = 28% differential =
- 64% = 25,600,000 investment capital (512,000 shares at \$50) of Company A
- excluding trading costs.
- 36% = 14,400,000 investment capital (480,000 shares at \$30) of Company B
- excluding trading costs.

# LONG SHORT EQUITY MODEL:

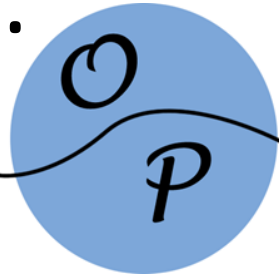
- FIRST SCREEN: All listed (NYSE, AMEX, NASDAQ) stocks whose calendar year high was at least triple their calendar year low, 1994 through 1998
- MONTHLY DISTRIBUTION AMONG THESE STOCKS OF RELEVANT NEW LOWS (ONE THIRD OF THE EVENTUAL HIGH IN THE SAME YEAR) BEING REACHED, 1994—1998:
  - January: 7.6%
  - February: 8.9%
  - March: 9.5%
  - April: 10.1%
  - May: 9.0%
  - June: 9.9%
  - July: 13.4%
  - August: 9.5%
  - September: 5.1%
  - October: 7.4%
  - November: 5.6%
  - December: 4.0%
- $x$  = “extra” (deviation from the mean) likelihood percentage for a specific stock of a low occurring in a given month turning out to be the low for the year
- $y$  = general likelihood percentage among all stocks of this same month’s low being the low for the year
- LONG SHORT EQUITY MODEL CONTINUED:
  - 
  - $a$  = stock’s ranking in a fundamental analysis (1 to 10, 1 best) point system that includes company’s earnings outlook, p/e ratio, direction of analyst estimates and a basket of other fundamentals
  - $b$  = total capital available to invest in the sector the company is in
  - 
  - $b \times (b \text{ divided by } a) \times (x - y, \text{ only when } x \text{ is larger than } y) \text{ divided by } 100$  = capital allotted for buying in the 30 days after the targeted one. When the equation results in zero or less, no stock purchase.
  - POSSIBLE EXPLANATIONS FOR MEANINGFUL (AS OPPOSED TO RANDOM) VARIATIONS IN MONTHS IN WHICH NEW HIGHS AND LOWS ARE ACHIEVED:
    - 
    - 1. Traders including large hedge funds building on previous patterns.
    - 2. Seasonal variations in a company’s business circumstances.

# GLOBAL MACRO/EMERGING MARKETS MODEL:



- a,b,c,d on a scale of 1 to 10 with 10 the highest
- 
- historical value in P/E ratio = a
- 
- x cash to debt ratio = b
- 
- x consultant's analysis of political relationships = c
- 
- x 12 month currency forecast = d
- 
- divided by 100 (to return to percentage scale) =
- 
- % of investment capital targeted for this particular nation going
- 
- to this single stock=  $a \times b \times c \times d = \text{investment}$
- 
- Actual example (cement manufacturing company in Greece) =
- 
- $4 \times 7 \times 9 \times 2 = 504$  divided by 100 = 5.04%

# ALGORITHM BASED STRATEGIES:



## BROAD CATEGORIES:

Trend following (especially the trades of 500 or so hedge funds with AUM in excess of \$1 billion)

Reversion to the mean

Statistical arbitrage

High frequency/market making

## JOB OPPORTUNITIES FOR MATH-BASED DEGREE HOLDERS:

Obtaining high quality securities pricing information

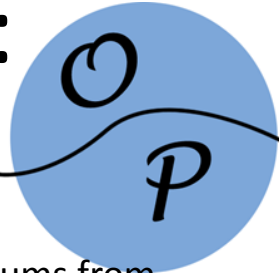
Finding statistically based trading opportunities in the pricing data

Completing trades at the lowest possible cost and the least possible potential for error: effective execution algorithms.

# GREEN HILLS PARTNERS LP: SOCIALLY RESPONSIBLE MODEL

- A = ANNUAL FALL OR RISE IN BEEF AND PORK CONSUMPTION
- 
- B = VOLATILITY IN GRAIN PRICES THAT ARE PART OF PRODUCTION COSTS
- 
- C= VOLATILITY IN FUEL COSTS THAT ARE USED TO TRANSPORT PRODUCT TO MARKET
- 
- D= GENERAL STOCK MARKET PERFORMANCE BASED ON INTEREST RATE OUTLOOK AND DIRECTION OF S & P EARNINGS ESTIMATES
- 
- **EXCLUSIVELY QUANTITATIVE MODEL:**
- 
- $D \times (A \times 50\%) \times (B \times 20\%) \times (C \times 7.5\%) = P \pm$  (where P is the gain or loss in share price over calendar year X)
- 
- **SRI (SOCIALLY RESPONSIBLE INVESTING) MODEL:**
- 
- $D \times (A \times 75\%) \times (B \times 15\%) \times (C \times 7.5\%) = P \pm$  (where P is the gain or loss in share price over calendar year X)

# INSURANCE BASED STRATEGIES:



- The hedge fund investors act as an insurance company, covering risks and receiving premiums from actual insurance companies writing policies. Risk pools can include:
  - 
  - Hurricanes
  - Blizzards
  - Earthquakes
  - Floods
  - 
  - Modes of transportation (air, sea, etc.)
  - 
  - Life insurance
  - 
  - Agricultural products, including weather and other risks
  - 
  - Power outages
  -
- Such strategies can lower their risk through various option and derivatives based strategies, and can have a low correlation to the financial markets.



