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: OP

- 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:
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- a = stock’s ranking in a fundamental analysis (1 to 10, 1 best) point system that includes company’s earnings outlÍook, 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
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- b x (b divided by a) x (x – y, only when x is larger than y) 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:
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- 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 x b x c x d = investment
- Actual example (cement manufacturing company in Greece) =
- 4 x 7 x 9 x 2 = 504 divided by 100 = 5.04%

ALGORITHM BASED STRATEGIES:

- BROAD CATEGORIES:
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- 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
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- JOB OPPORTUNITIES FOR MATH-BASED DEGREE HOLDERS:
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- Obtaining high quality securities pricing information
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- Finding statistically based trading opportunities in the pricing data
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- 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
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- B = VOLATILITY IN GRAIN PRICES THAT ARE PART OF PRODUCTION COSTS
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- C= VOLATILITY IN FUEL COSTS THAT ARE USED TO TRANSPORT PRODUCT TO MARKET
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- D= GENERAL STOCK MARKET PERFORMANCE BASED ON INTEREST RATE OUTLOOK AND
- DIRECTION OF S & P EARNINGS ESTIMATES
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- **EXCLUSIVELY QUANTITATIVE MODEL:**
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- D x (A x (50%) x (B x (20%) x (C x 7.5%) = P+/- (where P is the gain or loss in share price over calendar year X)
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- **SRI (SOCIALLY RESPONSIBLE INVESTING) MODEL:**
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- D x (A x (75%) x (B x (15%) x (C x 7.5%) = P+/- (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:
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- Hurricanes
- Blizzards
- Earthquakes
- Floods
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- Modes of transportation (air, sea, etc.)
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- Life insurance
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- Agricultural products, including weather and other risks
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- Power outages
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- Such strategies can lower their risk through various option and derivatives based strategies, and can have a low correlation to the financial markets.