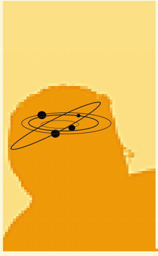


FUNDS OF HEDGE FUNDS

INTENSE COMPETITION FOR BEST UNDERLYING MANAGERS

As the list of funds of hedge funds managers grows longer, investors should seek out those with experience, relationships, scalable business models and resources

Hedge funds, traditionally the preserve of the high net worth individual, have recently attracted the institutional investor to their ranks, highlighting just how mainstream hedge funds have become.

The resulting surge of inflows in 2003 and 2004 has raised some concerns over capacity but the chart below highlights the continuation of steady performance from the hedge fund industry.

More importantly, chart 1 below highlights how hedge funds have ridden the recent market turmoil in world equity markets to provide a viable new asset allocation tool for both private and institutional investors alike.

For the private investor, the introduction of a new group of institutional clients raises the bar on the standards, whether it is in the articulation or definition of the investment process, the focus on risk management or the enhancement of operational and administrative infrastructure. Additionally, clients can now expect enhanced service, better reporting and progressively, improved levels of transparency, all features of a maturing business.

Returning to basics, the most compelling reason for adding hedge funds to a traditionally constructed portfolio is that they generally have a low correlation with bonds and equities. From chart 2, three hugely important conclusions can be drawn:

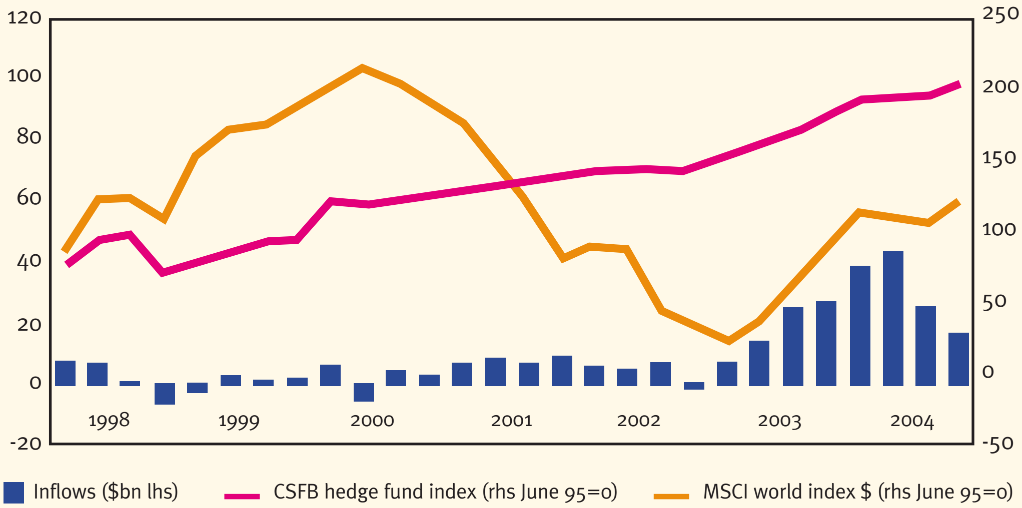
- **Equities and hedge funds have low positive correlation** – In a world where global and regional equities tend to move in concert, low correlation provides strong diversification benefits while intimating that if markets head up, hedge funds will be able to capture a degree of the upside returns.
- **Hedge funds have little or no correlation to bonds** – With portfolios weighted more heavily towards bonds than in the past, it is worth considering hedge funds as a complement to or a replacement for bonds when rebalancing portfolios.
- **Hedge fund strategies have little or no correlation with other hedge fund strategies** – This presents a compelling case for including more than one single strategy in a portfolio or using a fund of hedge funds to improve diversification further.

The diversification potential of these conclusions is best seen from observing an efficient frontier that consists of traditional assets and then analysing the effect of introducing hedge funds. Hedge funds offer the potential to shift the risk/return profile outwards, that is, increasing returns for a comparable level of risk or reducing risk for a comparable level of return.

Chart 3 illustrates how an efficiently invested portfolio

1

Quarterly Asset Flows into Hedge Funds versus CSFB Hedge Fund Index and MSCI World Index



Source: Pioneer Alternative Investments comprised of varying percentages of equities and bonds (as represented by the S&P 500 Index and the SSB Global Bond Index), is impacted by adding a percentage allocation to hedge funds (in this case, using the CSFB/Tremont Index). While the 20 per cent allocation shows a dramatic shift, even a modest allocation to hedge funds can shift the frontier outwards.

WHY FOHFS?

With around 7500 hedge funds in the marketplace, investors have a multitude of choices. One option is to invest with a fund of hedge funds (FoHF) manager who combines several managers within one fund thus avoiding over-exposure to any particular style of hedge fund or over-reliance on any one manager. The result is typically a diversified portfolio of between 20 and 35 hedge funds, although some managers may allocate to even greater numbers.

The rapid growth of assets has created a vast number of new entrants into the FOHF arena, with some estimating that there are now around 1500 FOHF managers of the 7500 hedge fund total. The competition for the best underlying managers is therefore intense and investors and advisers should carefully consider the following issues when selecting a FOHF manager:

- **Experience** – Investors should look for managers with a long track record, particularly those that have performed well during difficult conditions such as the Asian currency crisis in 1997, the Russian bond default in 1998, or the tech bubble bursting in 2000.
- **Relationships** – Only the best FoHF managers can gain access to the highest quality hedge fund managers. This is often a result of the nurturing of long term relationships where interests are aligned through long tem and stable capital commitments.
- **Size and scalability** – Of the 1500 FOHFs, only around 10 per cent manage assets greater than $1bn (€760m). In an increasingly complex business, scale may have a

'Clients can expect enhanced service, better reporting and progressively, improved levels of transparency, all features of a maturing business'
Ian Fisher, Pioneer

2

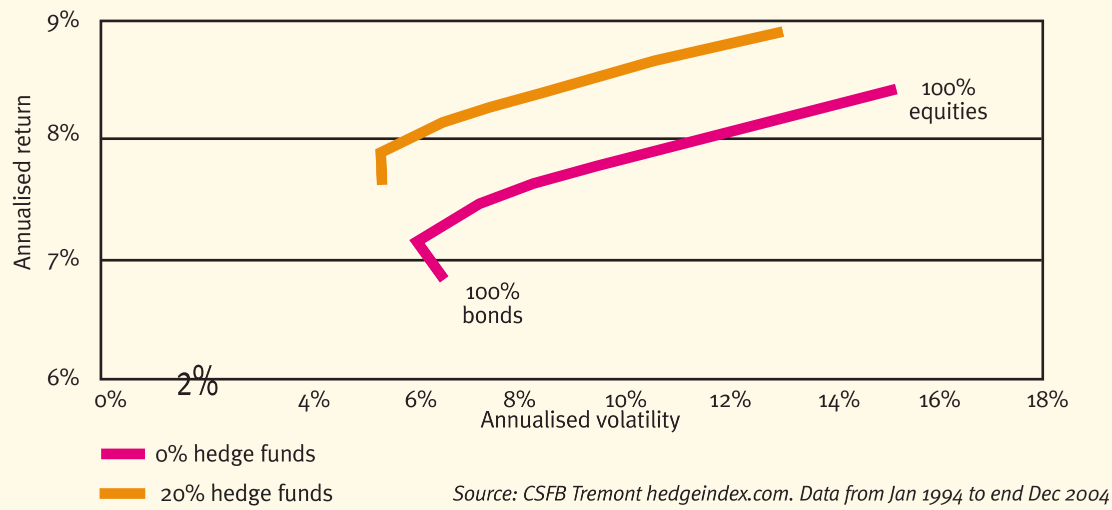
LOW CORRELATION WITH BONDS AND EQUITIES

	CSFB hedge fund index	S&P 500 index	MSCI world index	JPM Global govt bond index
Convertible arbitrage	0.40	0.13	0.11	-0.09
Short bias	-0.48	-0.76	-0.76	0.01
Distressed	0.57	0.55	0.58	-0.05
Emerging markets	0.65	0.48	0.56	-0.17
Equity market neutral	0.33	0.39	0.36	0.06
Macro	0.86	0.23	0.20	-0.09
Event driven	0.67	0.54	0.62	-0.19
Fixed income arbitrage	0.42	0.05	0.04	-0.15
Risk arbitrage	0.39	0.45	0.47	-0.04
Managed futures	0.08	-0.25	-0.21	0.36
Long/short equity	0.78	0.59	0.63	0.06

Source: Pioneer Alternative Investments / Bloomberg. Data as at end Feb 2005

3

Efficient frontier – adding hedge funds to a traditionally constucted portfolio



Source: CSFB Tremont hedgeindex.com. Data from Jan 1994 to end Dec 2004

significant bearing on the resources a company is able to commit to risk management, due diligence, portfolio management and the servicing of a broader base of clients.

- **Due diligence** – Hedge funds can be complex vehicles trading with specialist skills so the FoHF manager needs to gain full transparency on the underlying manager, ensuring that all issues relating to investment process, risk management, administrative procedures and corporate governance are water-tight.
- **Asset allocation** –The FoHF manager needs to find the optimal diversification between too few managers and too many, at the same time ensuring that exposure to any single event is mitigated. Over time, allocations may need to shift as a result of market conditions and this requires well resourced, highly skilled and specialist teams.

4

NO ALLOCATION TO HEDGE FUNDS

	100% equities	50% bonds & equities	100% bonds
Return	8.43%	7.64%	6.84%
Volatility	15.19%	8.26%	6.62%

ADDING 20% HEDGE FUNDS

	80% equities	40% bonds & equities	80% bonds
Return	8.91%	8.28%	7.64%
Volatility	13.00%	7.41%	5.40%
Return improvement (bps)	47.8	64.4	79.9
Volatility improvement (% points)	219.3	85.5	122.5

Source: Pioneer Alternative Investments: CSFB Tremont hedgeindex.com. Data from Jan 1994 to end Dec 2004

DIVERSIFICATION

There is no doubt that the hedge fund industry is maturing – assets in the industry are approaching $1000bn, the product offering is widening and standards are being driven higher by the influx of institutional investors.

For investors looking to gain exposure to hedge funds, FOHFs provide a well diversified route that benefits from the specialist skills of the FOHF manager and their in depth understanding of inter-manager and inter-strategy correlation within portfolio construction.

Choosing the right FOHF manager is paramount and while the investor is faced with an increasing choice of providers, we believe that the leading players will remain those with experience, relationships, scalable business models and resources.

Ian Fisher, Sales Director, Pioneer Alternative Investments, UK

CORPORATE STATEMENT

Pioneer Alternative Investments (PAI) is one of the leading groups in the fast growing alternative investments arena with over $5.4bn of assets under management (as at end Feb 2005). PAI benefits from the strong parentage of Pioneer Global Asset Management S.p.A. (PGAM), the asset management sub-holding of UniCredito Italiano S.p.A. (UCI). UCI is one of Europe's leading banking groups with a market capitalisation of over $28bn and is ranked in the top five banking groups in Europe in terms of efficiency and profitability and among the top 20 in terms of total assets.

PIONEER Alternative Investments

Contact:
- Ian Fisher
  Tel: +44 (0)20 7190 2000
  E-mail: ian.fisher@pioneerinvest.com