

# Why Hedge Funds?

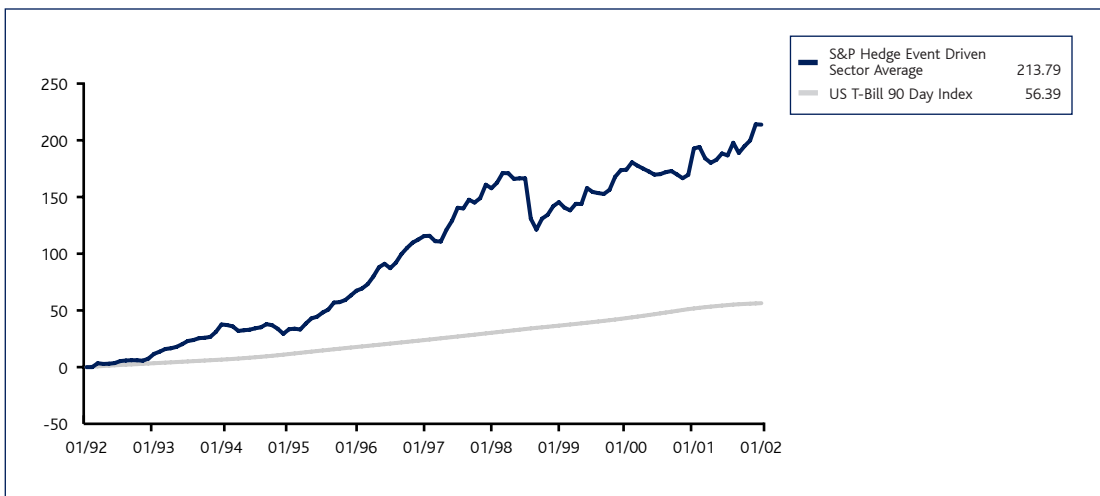
# Why Hedge Funds?

Hedge funds are not a new investment phenomenon; they were introduced by Alfred W Jones in 1949. But why have they seen such rapid growth over the past 10 years?

- Strong growth of the high net-worth individual and more sophisticated private investors.
- Increasing evidence that hedge funds offer superior returns with a low correlation to other asset classes.
- Increased acceptance of alternative investment vehicles.

Hedge funds are extremely varied, with a wide range of different investment objectives and styles. Managers benefit from more flexibility compared to traditional equity fund managers. They are able to invest in equities, currencies, interest rates and commodities, and employ various trading and investment techniques, such as futures and options.

There is no such thing as a typical hedge fund - each has a different risk and return profile and there is little correlation between funds, or to financial markets. However, many hedge fund managers choose to specialise in specific asset classes, strategies or markets.



Source: Standard & Poor's Micropal, US Dollar, bid to bid, gross income reinvested to 31/01/2002. Past performance is not necessarily a guide to the future. Unlike capital invested in US Treasury Bills, the capital invested is not secure and the value of units may fall as well as rise.

*'While economic crises temporarily hurt asset values, returns over a full business cycle typically exceed those of equities, and are combined with both low volatility and low market correlation.'*

Source: Momentum

Royal Skandia offers investors access to such alternative investment vehicles through the Momentum AllWeather Liquidity Fund.

## The most common hedge fund strategies are:

- **Equity Hedge** - a bottom-up approach seeking undervalued and overvalued securities.
- **Relative Value** - exploiting temporary irregularities between related equities, fixed interest securities and derivatives, usually of the same company.
- **Global Macro** - an opportunistic approach that uses top-down research to predict market movements and hold both undervalued and overvalued stocks at the same time.
- **Event Driven** - focuses on companies involved in special situations, such as corporate restructuring, acquisition, merger and bankruptcy. These funds have 'deal risk' and usually perform better when equity and fixed interest markets are strong.
- **Short Selling** - the manager takes short positions in overvalued securities.
- **Funds of Funds** - most hedge funds invest in portfolios diversified by manager and strategy. Funds of funds offer exposure to experienced management, increased liquidity and less risk of default.

Managed funds of hedge funds offer investors exposure to a wide range of alternative investment styles and strategies to produce consistent absolute returns (industry average 12%-15% pa, source: Deutsche Bank AG) combined with low volatility. They aim for steady absolute returns with low risk, rather than relative performance against a benchmark.

One such fund that Royal Skandia have linked ot is the Momentum AllWeather Liquidity Fund.

## Momentum AllWeather Liquidity Fund

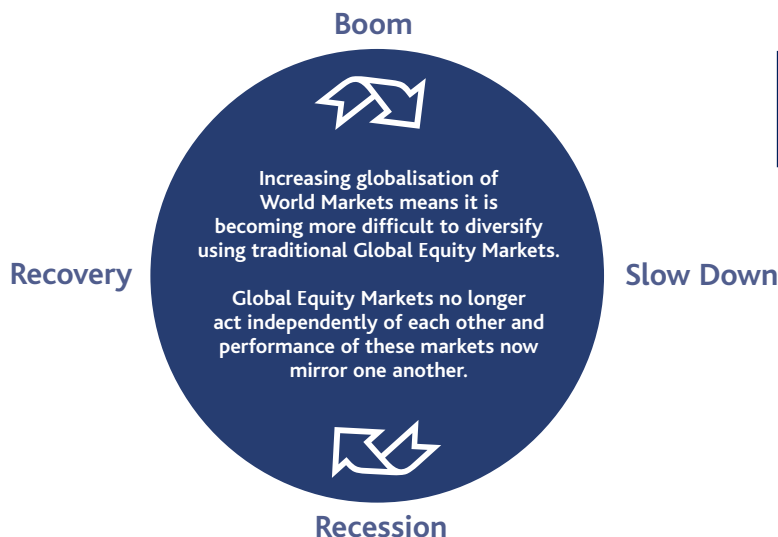


The Momentum Group is among the most experienced of the world's hedge fund organisations. Founded in 1985, Momentum has over 16 years' experience in developing and managing alternative investment products and have been developing and modifying their investment approach to suit an increasingly enthusiastic clientele.

Momentum's investment philosophy relies on diversification as the key to long-term profitability and risk management as an integral part of product structure.

The Momentum AllWeather Liquidity Fund mirrors the investment approach taken by the series of Momentum AllWeather Funds. It is dedicated to the proposition that many investors seek reliable, low risk performance independent of stock market volatility. Therefore the Fund is not dependent on, or affected by, any single event, but produces steady returns with low volatility during all phases of the economic cycle, providing a high level of comfort for the investor.

## The Economic Cycle



Diversifying accross World Markets today gives you 100% exposure to Stock Market volatility

Source: Momentum

## The underlying Fund offers

- Low volatility – 1.72% compared to sector average (HFRI Event Driven Index) 6.55%, and FTSE 100 18.53%, since launch on 2 June 1998.
- Prospect of returns irrespective of dramatic moves in the international stocks, bonds and currency markets.
- An investment independent to traditional equity portfolios.

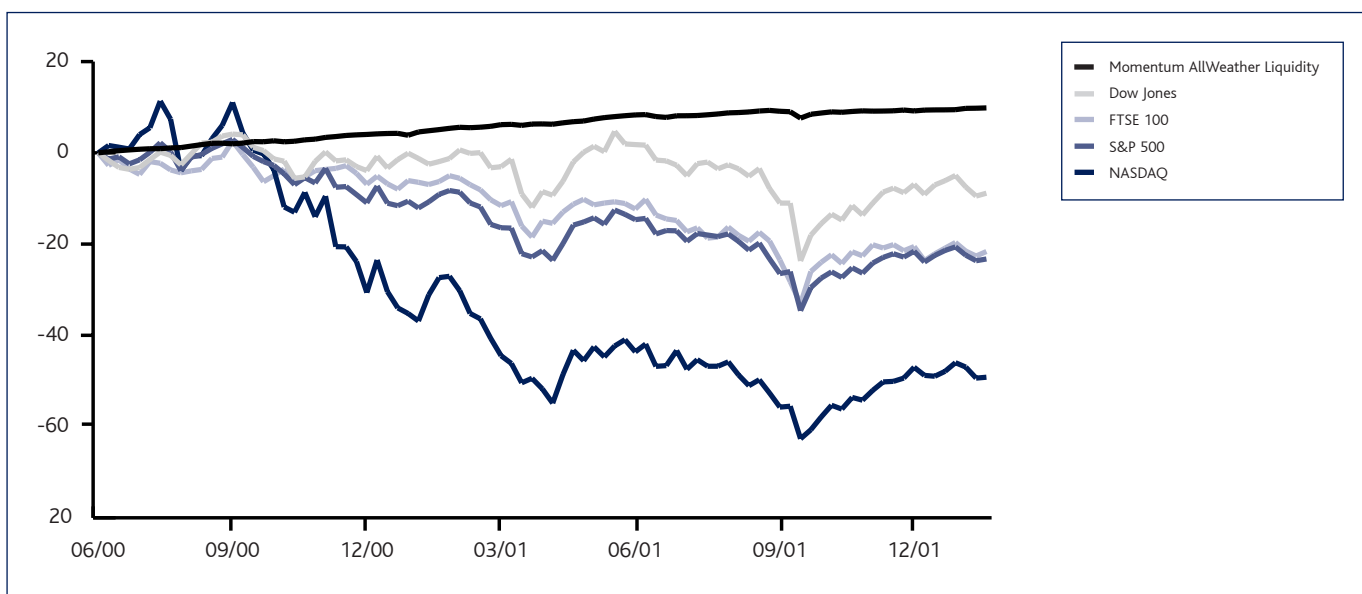
## The Momentum AllWeather Liquidity Fund investment strategies are primarily event-driven:

- **Merger Arbitrage** - takes advantage of company mergers and acquisitions.
- **Asset-backed Lending** - lend money to companies when banks will not help, securing the loan on a company's total assets. The lender obtains a good annualised return and the business secures quick liquidity, so solve a problem or capitalise on an opportunity.
- **Distressed Securities** - investing in companies with financial difficulties, generally trading at a discount to par value.

One of the key skills Momentum brings to the Momentum AllWeather Liquidity Fund is active risk management, which lessens the impact of poorly performing strategies. Momentum concentrates on selecting experienced managers who have already proved their acumen and durability in a wide range of market and economic conditions.

## Do these strategies work?

The Fund launched in June 2000, and has grown by 9.85%, outperforming the S&P 500 Index which fell by 30% during this same period. Most importantly, this outperformance was achieved with less than one tenth of the volatility or risk of the stock market. (Source: Momentum)



Source: Momentum, bid to bid, US Dollar, gross income reinvested to 25/01/2002. Fund launch date: 2 June 2000. Past performance is not necessarily a guide to the future. The performance of the Royal Skandia fund will not mirror the performance of the underlying fund due to Royal Skandia fund charges, taxation adjustments (if appropriate) and the Royal Skandia investment process.

The rules and regulations made by the FSA and made under the Financial Services Act 1986 for the protection of investors may not apply to persons outside the United Kingdom. Investors should be aware that the value of units may fall as well as rise. Past performance is not necessarily a guide to the future. The Fund is priced and denominated in US Dollars and additionally priced in Sterling, Hong Kong Dollars and Euro. Where a fund invests in securities designated in a different currency to the fund, the value of units may rise and fall purely as a result of changes in exchange rates.

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