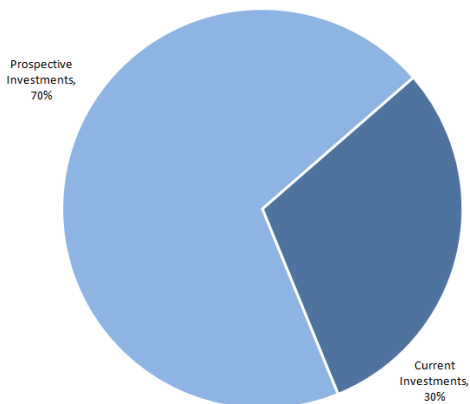


Research Calendar

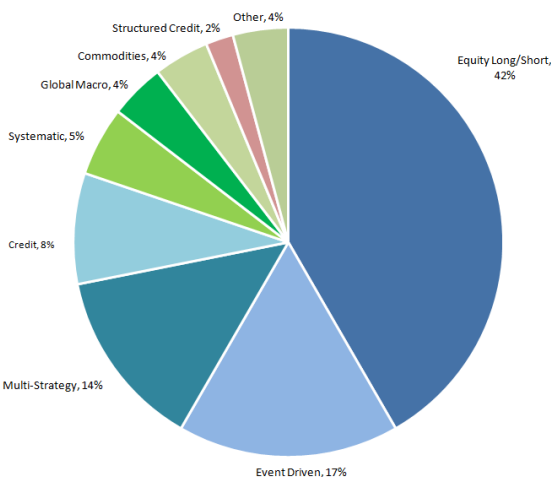
During the month of January, Atrato Advisors conducted 96 calls and meetings within the alternative industry that approximately broke down as follows:

Atrato January 2016 Meetings by Type



By strategy, the research team allocated its time as follows:

Atrato January 2016 Meetings by Strategy



The largest strategy group by meetings was Equity Long/Short at 42%. The meetings were broad, with managers across a variety of sectors (biotech, energy, healthcare, TMT, utilities) and regional (Asia, Frontier Markets, Europe, Latin America, US) specialties included. The Event Driven (17%) and Credit (8%) manager meetings had substantial overlap as both groups have looked to have available capital to allocate to distressed opportunities. While some event-driven managers are holding cash for future distressed allocations, others are allocating to short duration merger arbitrage for near-term return generation. Credit managers not choosing to hold cash at this time are allocating to safe short duration credit opportunities that should organically turn to cash over the next 1-2 years while paying a current yield.

Thematic Viewpoints

At a high level, hedge fund portfolios have de-risked in the face of outsized losses and increased volatility in January and early February 2016. While the general statement is true, there is substantial bifurcation within the universe, with some managers maintaining most of their prior net length and buying losers as they trade lower, and others taking a dramatically lower gross and net exposure stance to improve their buying power when conditions stabilize in the future. Consistent with the trends of the last several years, even the managers that have cut gross and net exposure have remained concentrated in their best ideas.

Relative value-oriented managers have noted a material pick-up in opportunities in idiosyncratic and event-driven convertible arbitrage trades for the first time in years. Performance across plain vanilla and energy-related convertibles was weak last year as the widening dislocation from the high yield market during the fourth quarter of 2015 and January 2016 caused technical dislocations between credit and equity securities that were exacerbated by large mandatory convertible issuances from Teva Pharmaceuticals and Kinder Morgan. Convertibles tend to be disproportionately sold during periods of credit risk aversion, so the opportunity for managers to construct relative value trades should improve as defaults increase. While the opportunity set is particularly centered on energy and commodity-related sectors, the continued technical sell-off has improved opportunities outside of those sectors. While there are gamma trading opportunities, most of the situations we discussed involved higher return potential in credit longs and equity shorts that were set up with asymmetrically positive payoff profiles in most scenarios: compelling YTM, capital appreciation potential to intermediate-term par maturity and downside protection through embedded put options in long credit securities. In general, plain vanilla converts (non-stressed/distressed) remain unconvincing at this time as the potential for a material sell-off in a period of heightened risk aversion is unfavorable.

The merger arbitrage opportunity set remains substantial and event-driven and multi-strategy hedge funds are increasingly allocating capital. We have discussed this opportunity over the last several quarters as the amount of arbitrage-dedicated capital appears insufficient to close spreads. The general trend is that returns captured from completed deals are well above average while unrealized losses in deals that have yet to close are also well above average. As a result of these conditions, some managers have chosen to allocate to very safe deals and/or shortly prior to deal completions with the objective of generating annualized returns of approximately 10%. More aggressive managers are allocating to merger arbitrage spreads with equity-like return objectives. These investments typically entail some element of antitrust risk; however, investors in the Halliburton/

(Continued On Page 2)

Dispatch from the Research Desk

January 2016



Baker Hughes deal believe that Halliburton will shed the assets required by the Justice Department to facilitate the deal (current annualized spread 28%). Given the antitrust risk, some managers have chosen to make the investments through credit securities. For example, one manager invested in the Office Depot and Staples merger through convertible securities on the belief that the annualized equity spread of approximately 80% offers a free option to Office Depot succeeding in court against the FTC. The last strategy we identified is the buying of diversified baskets of most of the deal spreads available in the market. Despite the high level of current spreads, these managers believe that a higher than average number of deal breaks are unlikely given the relatively high number of strategic deals, cash payment components and large deal-break fees.

After experiencing their first challenging year since 2011, structured credit managers are optimistic about the opportunity set in select market segments, particularly those that have suffered due to technical and liquidity reasons. In 2015, structured credit markets fell as a result of energy and commodity-related fundamental concerns (US CLOs), liquidity conditions (US Bank TRUP CDOs) and general credit spread widening (US RMBS). In general, managers remain positive on US Bank TRUP CDOs given fundamental strength in the underlying issuers and RMBS given healthy consumers, low unemployment and positive housing conditions (starts and prices). One notable area of focus for managers was European CLOs, which fared much better than their US counterparts in late 2015. The difference in recent performance is driven by European CLOs having far less exposure to energy and commodity-related sectors than US CLOs. The fundamental and price performance trends between US and European CLOs are likely to continue into 2016 as loan defaults are expected to be much lower in Europe relative to the US. Just as Libor floors contributed substantially to US CLO outperformance before 2015, Euribor floors in European 2.0 CLOs are increasingly important to investors in a QE and negative interest rate environment. CLO volume is also expected

to increase in Europe with both BlackRock and Oaktree coming to market with their first and second CLO offerings in the region, respectively. With increased issuance, market liquidity across European CLOs should continue to improve and bid-ask spreads should tighten.

Global Macro managers remain long the USD but have diversified their holdings across currencies on increased US policy uncertainty in addition to increased non-currency risk exposures.

The long USD theme remains a trend within global macro portfolios. However, the USD/EUR reversal in early December that caused losses led managers to diversify their holdings against the USD and to construct more diversified positions. One of the concerns that has emerged over the last several months is that USD strength since mid-2014 has caused a tightening of financial conditions in the US that is likely to detract 3.0% from GDP cumulatively through 2017 as net exports decline. The tightening conditions are likely to weigh materially on Fed rate decisions and the current opinion appears to be that rate hikes in 2016 are unlikely, particularly since substantial asset price declines are bound to further weigh on confidence and economic growth. Managers noted short positions in the following currencies against the USD: EUR, GBP, CNY, AUD, NZD, South African Rand (ZAR), Turkish Lira (TRY), and Polish Zloty (PLN). In addition we have identified increased tactical positions between non-USD currency pairs including EUR longs against GBP and Asian-currencies and Emerging Market relative value pairs.

As always, if you would like any additional information on Atrato's manager meetings or would like to discuss the implications of thematic viewpoints on portfolio construction, please don't hesitate to contact us. Thanks for reading.

Warm regards,

Michael Boensch, CFA, CAIA
Partner, Director of Research

About Atrato Advisors

Atrato Advisors (www.atratoadvisors.com) is a boutique consulting firm that provides highly individualized research and advisory solutions to the hedge fund investor community. We work with a number of institutions including family offices, wealth management firms, asset managers, fund of funds, foundations and endowments looking to expand the scope and depth of their hedge fund coverage, partnering with them on sourcing, portfolio construction, manager research and/or operational due diligence.

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