



SOPHIA GROUP
Alternative Investments

Comprehensive Guide to Marketing Hedge Funds

A Presentation Hosted by
Banc of America Securities Prime Brokerage

March 12, 2007

A Word About The Sophia Group

Sophia Hedge Access

- Hedge fund investment platform designed for self-directed individual investors.
- Strategies total over \$3 billion in assets under management, including equity, credit, fixed income, special situations, currencies and commodities.
- Institutional quality hedge fund managers, extensive due diligence performed by Sophia.

Sophia Capital Securities

- Brokerage firm focused on marketing hedge funds to institutions worldwide.
- Three professionals, based in San Francisco.
- Four fund manager clients today.
- 4,000 buyers, 50% U.S. based, 50% across Europe/Asia – relationships built over 4+ years in business.
- Several hundred million dollars raised for funds across multiple strategies.

Understanding The Market For Your Fund

1. Fund Life Cycle:

- a. Fund's market position defines the marketing approach.
- b. Barking up the right tree: Retail vs. institutional products
- c. Setting up for momentum: Internal vs. third-party marketing

2. Structure Of The Investor World – Focusing On The Right Prospects:

- a. The buffs, the herd and the wall flowers: Psychological profiles.
- b. Why invest in your fund? Fierce and increasing product competition.
- c. Understanding the "hit-rate" and implications for marketing resources

3. Building A Business vs. Running A Fund:

- a. Fund infrastructure: what appeals to investors.
- b. Building out: Understanding trends and offering new products.
- c. The real trade off: What are you willing to do to grow?

1a. Fund's Market Position Defines The Marketing Approach

A fund's market position, as it relates to marketing, is more than size or age. It is a complex picture that pins the fund against the landscape of other funds competing for assets.

Fund Size:

- Small (Less than \$50M), Medium (Less than \$200M), or larger
- Fund AUM vs. Strategy AUM vs. Manager AUM

Performance:

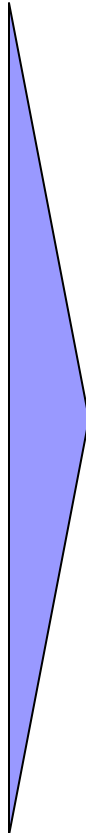
- Smaller funds generally need to over-perform to raise assets ~ 25%+
- Long or large drawdowns are generally the kiss of death, regardless of performance
- The hard truth: In the end, you need the performance or you don't have a business

Pedigree:

- First fund?
- Principals' investment into the fund- \$1 million is small!
- Principals' reputation and background – Investors talk
- Team size and feel: Trading separate from research; Empowered risk manager.

Time In The Market:

- Stale funds: 2+ years under \$50 million
- Important to close a fund

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- Competitive market
 - Not an exact science
 - Relationships count

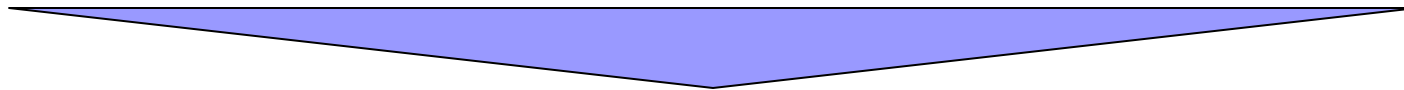
1b. Barking Up The Right Tree – Retail vs. Institutional Products

Retail investors are sold funds. Institutional investors buy funds.

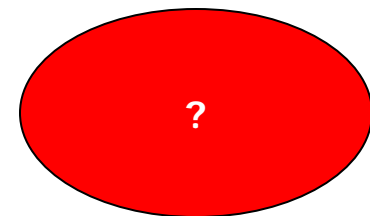
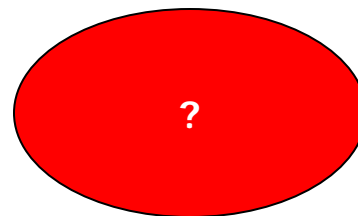
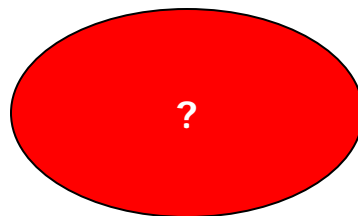
	Retail	Institutional	"Direct" Investing [e.g. single managers]
Pension		✓	Some
Trusts / Endowments		✓	Some
Prop Desks		✓	Some
Banks / Private Banks		✓	Yes
Corporate Treasuries		✓	Some
Independent Funds of Funds	✓	✓	Yes
Independent Money Managers	✓	✓	Based on client demand
Independent Brokerages	✓	✓	Based on client demand
Family Offices	✓	✓	Yes
Private bankers	✓		Yes
HNW Investors	✓		Yes

Test Your Acumen – Retail vs. Institutional Products

Fund size	Small ~ \$20M	Small ~ \$50M	Medium ~ \$150M
Performance	High	Low/Medium	Low/Medium
Pedigree	Average	Average	Significant
Time in the market	6+ months	1+ Years	Over 1 Year

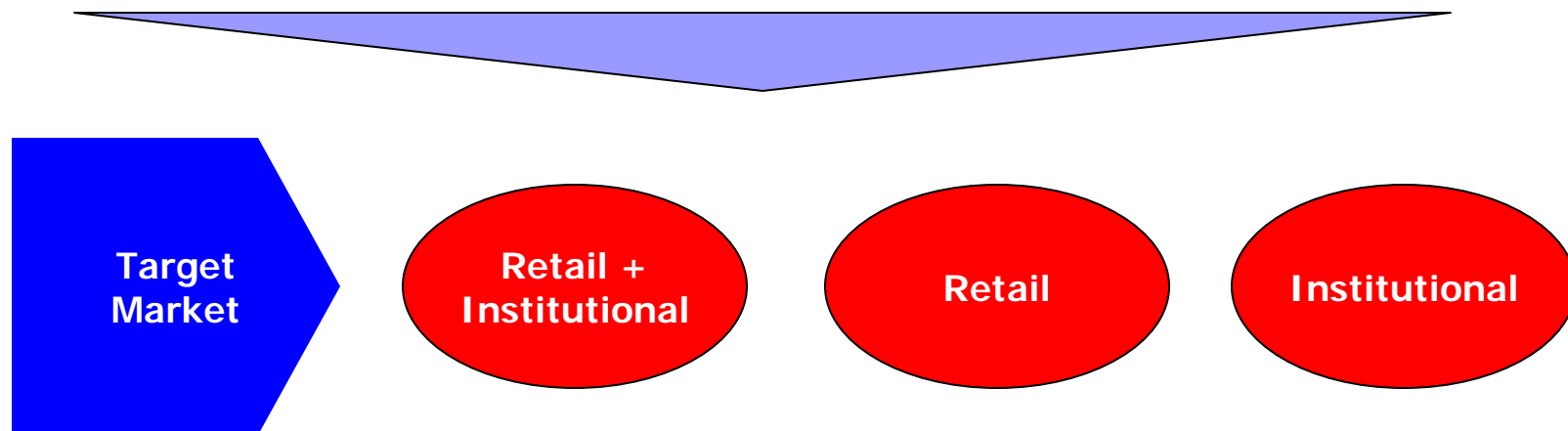


**Target
Market**



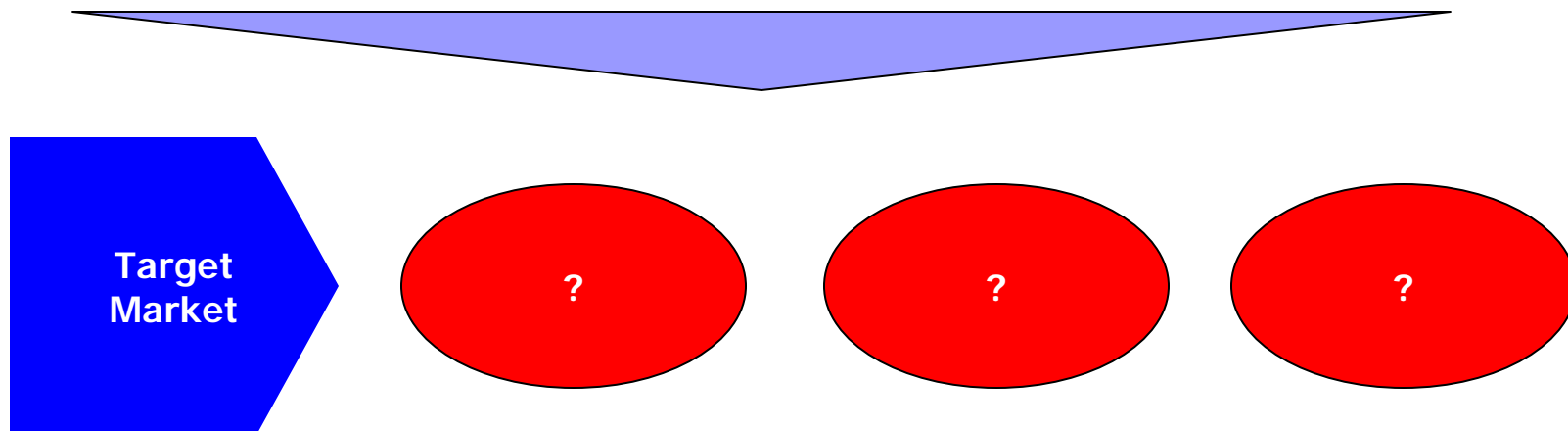
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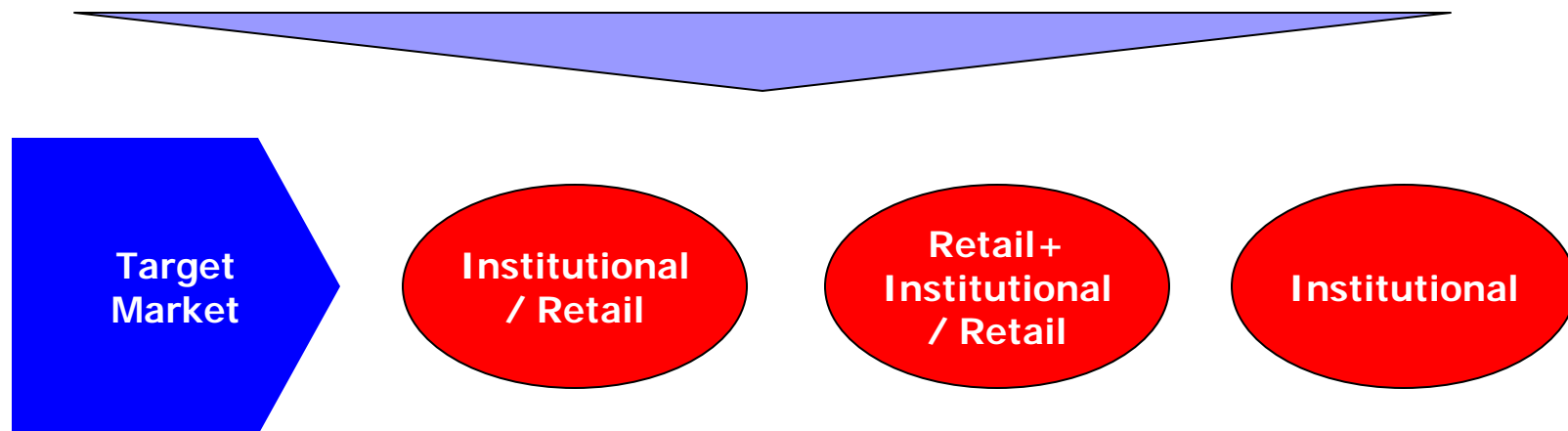
Test Your Acumen – Retail vs. Institutional Products

Fund size	Small ~ \$60M	Medium ~ \$100M	Medium ~ \$150M
Performance	Medium	High	Low/Medium
Pedigree	Significant	Average	Significant
Time in the market	6+ months / Over 2 years	1+ Years / Over 3 years	Over 1 Year



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What Investor Segment Should A Manager Target?

There is no firm right answer, even if you know your market position, because relationships do count. A few real examples illustrating this point:

Long/Short Equity Fund - \$700MM AUM

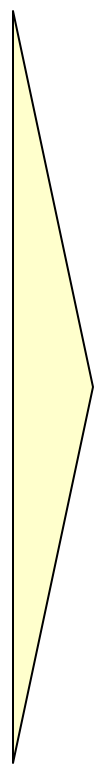
- All individual investors, not a single FoF or institution
- Raised assets from U.S. CEO's of public/private companies
- Started with \$12 MM from principals; reached \$700MM and closed within 18 months

Long/short Equity Fund - \$600MM AUM

- The only individual investors are the founders - \$3MM
- All other assets are from institutional investors

Long/Short Equity Fund - \$80 MM AUM

- Fund was started by a wealthy French family
- Only has European family offices as investors
- Will typically not admit FoF or other institutions

- 
- ⇒ **Marketing is about understanding your market position**
 - ⇒ **It is also about who you and your marketers can access at various stage of the fund's life.**
 - ⇒ **Know your contacts, and those of the professionals you hire.**

1c. Setting Up For Momentum: Internal vs. Third Party Marketing

	<u>Internal</u>	<u>Third Party</u>
Costs	<ul style="list-style-type: none">▪ \$50K to \$200K base + bonus depending on experience▪ Or 5% to 20% GP interest – partner deal	<ul style="list-style-type: none">▪ At 20% of revenues, will target 1% to 2% on assets▪ Retainers and / or road show expenses
Approach	Investor relations vs. marketing	Caveat Emptor: Multiple business models <ul style="list-style-type: none">▪ Blind lists▪ Bulldozers vs. Samplers▪ Exclusive vs. multi-provider [for fund] or multi-fund [for marketer] approach
Implications	<ul style="list-style-type: none">▪ Headcount and overhead▪ Full control▪ Scope and intensity limited by marketer's bandwidth	<ul style="list-style-type: none">▪ Little fixed cost▪ Delegation that needs to be managed▪ Investor lists and conflicts▪ Fee tracking and compliance

Legal Considerations For In-House Marketers

The Bottom Line: Are your marketers acting as “agents” in the U.S.?

- Third party marketers soliciting U.S. investors, or operating in the U.S., must be NASD-registered.
- If your marketer is a partner of your firm, and is compensated in a way that is not linked to the outcome of asset raising activities, then that marketer is unlikely to be considered an “Agent”.
- If your marketer (1) is employed by a third party, or (2) works for your fund on a consulting basis, or (3) is employed by your fund but receives compensation linked to the success of capital raising activities, then it is likely that:
 - ➔ That marketer is considered **acting as an “Agent”** under U.S. regulations
 - ➔ The individual marketer must hold valid broker licenses and be registered with NASD
 - ➔ The marketer must be affiliated with a broker-dealer
 - ➔ Registration of the marketer must be done in each State where investors are solicited, subject to few exemptions

Disclaimer: Sophia Capital Securities is not a legal advisor, nor does this constitute legal advice. Persons with questions about the issues discussed herein should consult their legal advisor for advice.

Capital Introduction Groups vs. Third Party Marketers

Cap Intro groups and Third Party Marketers play distinct roles. Cap Intro groups work for investors, while marketers work for managers.

Capital Introduction Group Affiliated with a Prime Broker

Works on a reverse inquiry basis: Investors requests introductions from Cap Intro groups to fund managers with specific profiles.

Is paid from prime brokerage revenues, not directly by the fund manager.

Does not need to be a registered broker-dealer; cannot solicit investors on behalf of the fund; cannot "represent" the fund.

Often cannot afford to service small to mid-sized, emerging managers, economically or from a risk viewpoint.

Independent Third Party Marketer

Works on a direct solicitation basis: Will contact and cultivate investors on the manager's behalf to work toward an allocation.

Is paid directly by the fund manager.

Is a registered broker-dealer [in the U.S]; Is retained by the fund to work as an agent; Directly represents the fund.

Acts as a professional resource specifically servicing the manager in the asset raising and marketing functions.

Myths & Realities About Marketers And Marketing

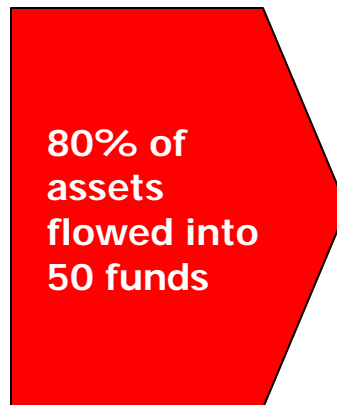
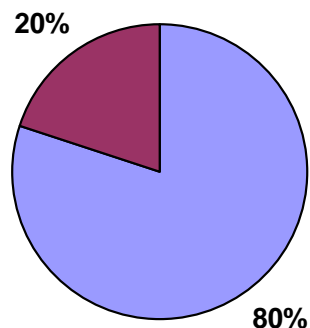
	<u>Myth</u>	<u>Reality</u>
On Fees	Third party marketers are paid 20% of a manager's fees.	Success fees range from to 15%-50%; Fees can vary based on retainer size, stage of manager development; Or can be based on a fixed percentage of NAV.
	A marketer should only share in management fees. Performance fees are meant to reward trading, not marketing.	Investors pay fees so you can run and build your business. Marketing is an important part of building the business, which is neither free nor cheap.
	There's no need to pay expenses for a third-party marketer, because that's how it's done.	Road show expenses are squarely fund expenses. There are many ways to negotiate other costs vs. compensation that are not self-defeating.
On Asset Raising	A marketer you should be able to get an allocation from his/her investors, just by "making" them invest.	This might work with individual investors cultivated through an investment advisor. It is wishful thinking when working with institutional investors.
	The only value-added of a marketer is to introduce his/her best, solid relationships.	Solid relationships buy 3 minutes on the phone. The product must carry the day. A marketer's real assets are his time, experience, maturity and vast network of contacts.
	We will only speak with quality investors that will be there in tough times.	This is in full alignment with a marketer's incentives. In practice, neither a marketer nor a manager can influence an institution's decision to redeem.
On Infrastructure	Performance will bring in assets. We will build-up our infrastructure after assets grow further.	"Build it and they shall come" is a reality in hedge funds. Infrastructure is the single most important aspect of a manager's appeal. Most investors expect infrastructure to run ahead of asset levels.

2a. The Buffs, The Herd And The Wall Flowers: Psychological Profiles

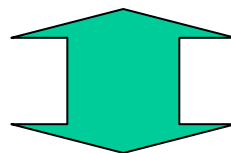
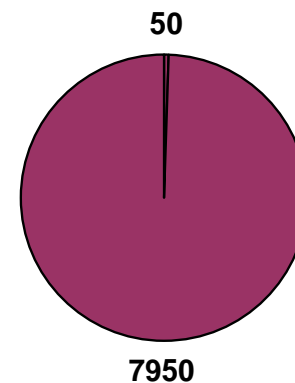


2b. Why invest in your fund? Fierce and increasing product competition

2006 Asset Flows



8,000 Hedge Funds




"There are over 8,000 funds to choose from, but only about 500 worth looking at."

Typical view expressed by institutional investors

The Truth Investors Don't Always Tell You About Your Fund

- Investors are doing fine without you:
 - ✓ You are fighting for next allocation to your strategy, but...
 - ✓ Most investors already have allocated to competitors with your strategy, and have capacity with them.
 - ✓ There are teams more established, more convenient, or better performing than yours, with a similar strategy.
 - ✓ No investor believes that you are unique or special – Unless another investor they know well tells them so.
- Investors are over-solicited:
 - ✓ Many receive hundreds of fund emails *per day*.
 - ✓ Most active ones visit or meet 500 managers a year.
 - ✓ “Junior analysts” create effective firewall: Typically little experience, little judgment, and no decision making power – Need time to turn them into supporters.
 - ✓ Many meetings are meant to collect information, educate their teams, not an expression of real interest.

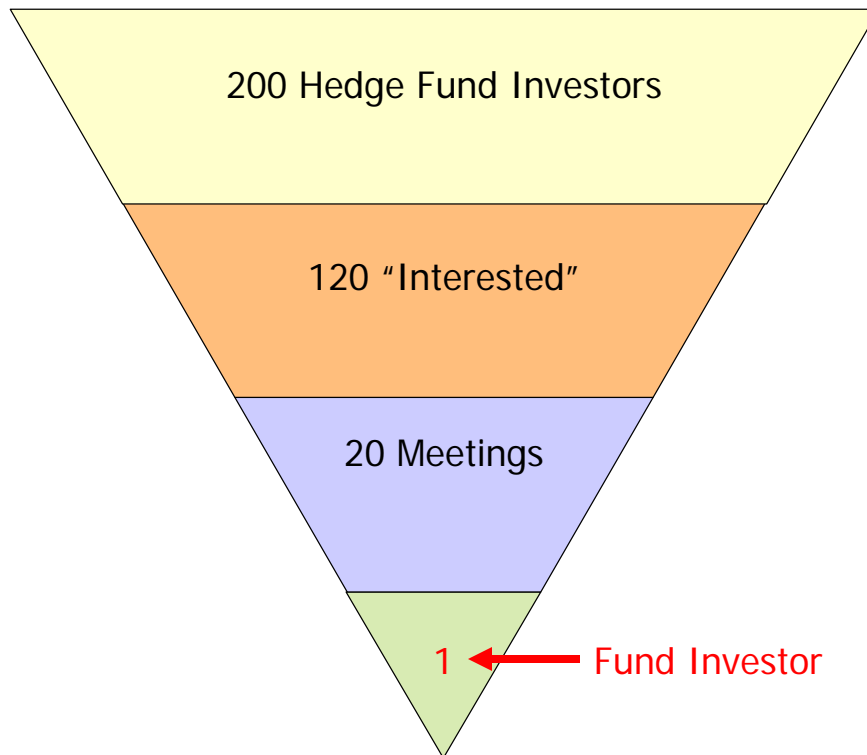


- ⇒ Persistence
- ⇒ Performance
- ⇒ Asset growth
- ⇒ Referrals build-up
- ⇒ Regular road shows

2c. Understanding The "Hit-Rate" And Implications For Marketing Resources

Can you do this and run your fund?

Assume a reasonably "well positioned" fund...



A Professional Marketer's Routine:

- 25 ~ 40 calls a day
- Track 200 ~ 2,000 prospects for each fund
- Research / document 2~3 new relationships per day
- Review / update marketing documents monthly
- 2 ~ 3 detailed conference calls / week
- Write-up and manage 2 updates / month ~ 4,000 emails per fund
- Investor relation services for existing investors
- Organize road shows quarterly / monthly
 - ✓ American centers: NY, SF, LA, Chicago, Toronto
 - ✓ European centers: London, Geneva, Zurich, Luxembourg, Paris, Milan, Lugano, Amsterdam
- Meeting / call follow ups
- Fee Tracking and compliance

3a. Fund infrastructure: What Appeals To Investors

Institutional investors want to invest in businesses first, which implies a credible team and infrastructure. Performance, alpha, and diversification from peers are also important to receive an allocation.

- **Credible team**
 - ➔ Verifiable trading experience in current fund, or previous funds/trading desks
 - ➔ Substantial principals' net worth invested into the fund – Must be rich enough
 - ➔ Clear trading strategy and competitive edge
 - ➔ Ability to manage a minimum of \$200 million in strategy

- **Solid Business infrastructure**
 - ➔ Reputable third parties – Auditor, administrator, prime broker; Legal counsel[?]
 - ➔ Understanding of how team needs to grow, if at all, with new assets
 - ➔ Visible and credible risk management infrastructure and policies

- **Performance**
 - ➔ Low volatility – Annualized standard deviation under 10%
 - ➔ Top tier performance relative to peers

Issues Certain To Be Hurdles For Investors


- **Inadequate team/infrastructure**
 - ➔ Little verifiable trading experience [e.g. ex-research analysts]
 - ➔ First hedge fund, where principals do not have first-class trading pedigree
 - ➔ Small absolute investment in the fund by team principals
 - ➔ No tangible commitment to building team with assets growth
 - ➔ No clear articulation of issues defining fund capacity

- **High volatility**
 - ➔ Regardless of levels of returns, a fund with 20%+ volatility is not widely marketable

- **Performance inconsistent with the trading style**
 - ➔ E.g., long/short equity consistently unprofitable on short side
 - ➔ Trend follower consistently unprofitable across well identified periods
 - ➔ Drawdowns much larger or more prolonged than peers
 - ➔ A fund with drawdowns of 10% or more is difficult to market to institutions
 - ➔ Lower asset raising momentum than peers of similar size and age

Examples Of Investors Irritants

- Playing hard-to-get:
 - ✓ Lock up, payout periods, Redemption penalties
 - ✓ Investment minimums
- Unwillingness to open multi-currency share classes
 - ✓ Lower appetite for US Dollar?
- Offshore funds and listing in Luxembourg / Ireland
 - ✓ Not costly
 - ✓ Enables many Europeans to invest
- Reporting frequency
 - ✓ Liquid funds: able to provide weekly estimates
- Managed accounts
 - ✓ Preferred terms detrimental to fund investors
- U.S. taxes
 - ✓ Ability to provide long term gains estimate
- Family members
 - ✓ Loyalty to fund ahead of investors when the going gets rough?

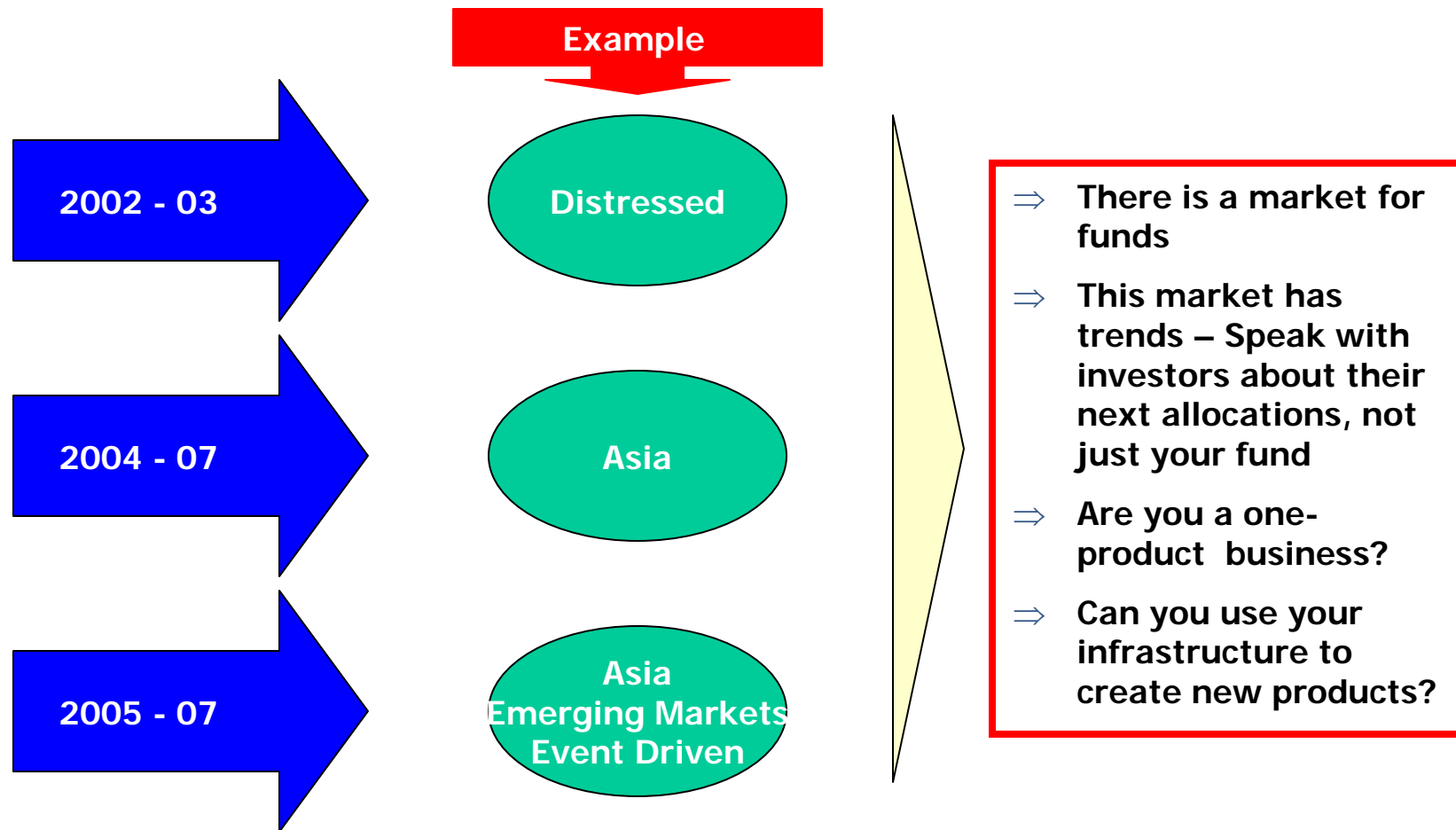


⇒ **Be commercial, not dogmatic**

⇒ **Make deals to get money on offer as you grow**

⇒ **Renegotiate or redeem investors when fund is larger**

3b. Building Out: Understanding Trends And Offering New Products



3c. The Real Trade-Off: What Are You Willing To Do To Grow?

- ✓ What will you wish you had done today, if fund assets are the same one year from now?
- ✓ Why would a senior marketer, internal or 3PM, invest in your business by working on bonus or commission?
- ✓ Can you use your infrastructure to launch a new product “in demand”?
- ✓ How many “small” funds with similar strategy and issues are there in the region? Is a smart merger and fund consolidation better than staying small?

Additional Information On Marketing Hedge Funds

The following documents are available for download on Sophia's web site:

- ➔ "A Guide to Using and Choosing a Third Party Marketer", Article authored by Sophia Group, published in PerTrac Solutions, Volume 4, Issue 2, Second Quarter 2005
- ➔ "Tricks and Traps in Hiring Third-Party Marketers": Article authored by Sophia Group, published in the MFA Reporter in March 2006
- ➔ "Marketing to US Hedge Fund Investors": A primer on US regulations
- ➔ "Guide to Hedge Fund Investing": Hedge fund basics for individual investors

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Risk Factors

Hedge funds and Structured Products are speculative investments and involve a high degree of risk. Investors should reach an investment decision only after carefully considering, with their financial, legal, tax, accounting and other advisors, the suitability of the securities in light of their particular circumstances and the risk factors set forth below and in the Offering Memorandum or Offering Circular. The risks set forth below are only a summary and investors should consult the complete Offering Circular for a more detailed discussion of the risks involved in an investment in a specific security. Some of the risks are:

- Structured products and guaranteed products are not deposits and are not insured by the Federal Deposit Insurance Corporation or any other U.S. Federal or State government agency.
- Although funds underlying structured products may have a brief trading history, this history is not significant and can not be an indication of future performance.
- Warrants are not principal protected. An investor could lose all or a substantial amount of his or her initial investment. Warrants are leveraged investments that involve a high degree of risk that may result in the Warrants expiring worthless.
- There may be no secondary markets for structured products.
- There are restrictions to transferring structured products. These restrictions are described in the Offering Circular related to the specific structured products.
- The performance of the funds underlying structured products may be volatile, and thus, the performance of the structured products may be volatile.
- The funds underlying the structured products are subject to fees that may reduce performance and, therefore, the performance of the structured products.
- The funds underlying structured products may not be registered under the Investment Company Act of 1940 (the "1940 Act"). An investment in structured products is subject to the same risks as an investment in hedge funds generally, including:
 - hedge funds tend to use investment strategies that are riskier than those used by funds registered under the 1940 Act;
 - unregistered funds tend to provide less transparency than registered funds;
 - managers of the fund and its investments may not be registered under the Investment Advisors Act of 1940.

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