

Investment Process Rating

2005-01-20

Mellon Global Alternative Investments



Mellon

Mellon Global Alternative Investments



RCP & Partners GmbH

Risk rating of asset managers: the investor's measure of trust

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Mellon Global Alternative Investments



Mellon

Mellon Global Alternative Investments

2

Very good

Parameters

Date	2005-01-20
Units	Mellon Global Alternative Investments Ltd (MGAI), London
Client Groups	Institutional Clients
Asset Classes	Funds of Hedge Funds
Products	Mellon Sanctuary Fund (closed for new investors), Mellon Sanctuary Fund II, Mellon Symmetry Fund, Mellon Nippon Absolute Fund

Rating Scale	
+ 1 -	Excellent
+ 2 -	Very good
+ 3 -	Good
+ 4 -	Satisfactory
+ 5 -	Inadequate
+ 6 -	Weak

Contact

Rated Party	Derek Stewart (Director), ☎ +44-207-163-2794, stewart.dg@mellon.com, www.mgai.com
Analysts	Dr. Uwe Kern (Chief Analyst, responsible), ☎ +49-611-9742-120, uwe.kern@rcp-partners.de Dr. Eckhard Weidner (Senior Analyst), ☎ +49-611-9742-116, eckhard.weidner@rcp-partners.de

Results

Evaluation



Mellon Global Alternative Investments



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Mellon Global Alternative Investments

2
Sehr gut

Parameter

Datum	20.01.2005
Einheiten	Mellon Global Alternative Investments Ltd (MGAI), London
Kundengruppen	Institutionelle Kunden
Assetklassen	Funds of Hedge Funds
Produkte	Mellon Sanctuary Fund (geschlossen für neue Investoren), Mellon Sanctuary Fund II, Mellon Symmetry Fund, Mellon Nippon Absolute Fund

Ratingskala	
+ 1 -	Exzellent
+ 2 -	Sehr gut
+ 3 -	Gut
+ 4 -	Befriedigend
+ 5 -	Mangelhaft
+ 6 -	Ungenügend

Kontakt

Rated Party	Derek Stewart (Director), ☎ +44-207-163-2794, stewart.dg@mellon.com, www.mgai.com
Analysten	Dr. Uwe Kern (Chief Analyst, verantwortlich), ☎ +49-611-9742-120, uwe.kern@rcp-partners.de Dr. Eckhard Weidner (Senior Analyst), ☎ +49-611-9742-116, eckhard.weidner@rcp-partners.de

Ergebnisse

Bewertung



Rated Party

Units

This rating concerns the independent legal entity:

✗ **Mellon Global Alternative Investments Ltd** (abbreviation: MGAI), located in London

The entity is wholly owned by *Mellon Financial Corporation* (MFC), a US-based global financial services company with USD 3.7 trillion in assets under management, administration or custody. Its asset management business has USD 670 billion under management.

MGAI's products are distributed by *Mellon Global Investments Ltd* (abbreviation: MGI), a sister company headquartered in London. As the global distributor of the investment skills of Mellon's independent asset managers, MGI offers investors access to a broad spectrum of disciplined asset management styles. MGI is the sales and servicing platform for individual investment solutions, offering a wide range of products to institutions, professional investors and advisors across the world.

The combined offering includes fixed income, cash, passive and active equity management, currency overlay, indexation and alternative investment management. An extensive range

of products is available, including mutual funds, segregated portfolios and sub-advisory arrangements.

Further information on MGI and the individual asset managers can be obtained from the website www.mellonglobalinvestments.com. Information on MFC is available on www.mellon.com.

Asset Classes

For the purposes of this rating, the asset class

✗ **Funds of Hedge Funds** (FoHF)

has been subject to analysis and evaluation.

Effective Date

Unless stated otherwise, all data contained in the present report refer to **2004-09-30**.

RCP comment:

+ MGAI has undergone the RCP investment process rating for the first time. The overall rating is **2 (very good)**.

Table 1: Companies

Company	Mellon Global Alternative Investments Ltd — MGAI
Address	Mellon Financial Centre 160 Queen Victoria Street London EC4V 4LA Great Britain
Phone	+44-207-163-2367
Internet	www.mgai.com
Founded	2000
Employees	6
AUM (EUR m)	374
Services	Fund of fund manager specialising in the selection of alternative investment managers

Production

Process

Funds of Hedge Funds

MGAI manages four *Funds of Hedge Funds* (FoHF), namely

- ✗ *Mellon Sanctuary Fund*
- ✗ *Mellon Sanctuary Fund II*
- ✗ *Mellon Symmetry Fund*
- ✗ *Mellon Nippon Absolute Fund*

and offers custom made hedge fund solutions focusing on conservative strategies. Both *Sanctuary* funds are investing globally in relative value and event driven strategies whereas the *Symmetry* fund invests globally in equity hedge strategies. A fourth fund is concentrating on investing in the Japanese market across event driven, relative value and equity hedge strategies. One of the original offers – namely *Mellon Sanctuary Fund* – is now closed for new investors as it has reached its capacity.

Investment Process

Tasks & Organisation The investment team consists of five members (supported by an assistant) sharing all of the investment-related tasks equally. However, the two most senior members – who established the business line and as its directors have joint business responsibility – assume an extended role and will hereafter be referred to as portfolio managers.

All team members are actively involved in the investment process and take part in all meetings where investment decisions are taken jointly. However, an ultimate decision power remains with the portfolio managers. The investment process is in all aspects supported by the proprietary analytical and research database *AdvantHedge*. The database was designed and is maintained by MGAI.

MGAI reports directly to the head of MGI in London. It utilises services of its parent company MFC for non-investment related activities such as IT or human resources and is supervised by MGI's internal audit and compliance department.

Philosophy The investment philosophy of MGAI describes the principles of their top-down approach, the key drivers for their investment and the elements of their investment process.

Top-down approach:

- ✗ invest in selected strategies only
- ✗ conduct independent strategy analysis and active strategy allocation

Investment principles:

- ✗ diversification and non-correlation with markets
- ✗ interrelation of different aspects of the underlying funds

- ✗ shared responsibility within the team, risk management
- ✗ focus on future drivers of performance

Investment process:

- ✗ use proprietary analytical database (*AdvantHedge*)
- ✗ combine top-down and bottom-up approach on all levels of investment
- ✗ follow a well defined process
- ✗ continually re-evaluate investments
- ✗ manage concentrated portfolios

Modus Operandi The investment process is based on a monthly cycle of four stages each having a corresponding team meeting:

- ✗ Peer Group Review
- ✗ Strategy Research
- ✗ Manager Evaluation
- ✗ Portfolio Management

In addition, there is ongoing monitoring and analysis of existing investments.

Core to the investment process is the proprietary analytical database *AdvantHedge* which provides data and functionality for each stage and the ongoing monitoring.

The monthly cycle starts with a *Peer Group Review*, analysing the performance of hedge funds which have been analysed previously and have their performance data constantly updated.

Strategic Decision-making MGAI invests in hedge fund strategies which exploit inefficiencies in financial markets. They avoid strategies that have significant sensitivity to market direction and highly variable exposures. Each strategy is evaluated from both a qualitative and quantitative perspective considering factors such as such as quality of inefficiency, scale of inefficiency, barrier to entry and scalability as well as the risk/return profile.

As all strategies are cyclical in nature, the investment team continually monitors fundamentals, technicals and sentiment of each of the selected strategies. In the *Strategy Research* stage of the investment process each strategy is rated with regard to its current attractiveness versus its long-term risk-adjusted return profile. Based on this rating, target strategy weights – aimed at a medium investment horizon – are determined.

Portfolio Construction MGAI manages concentrated portfolios of up to 20 hedge funds with typical position sizes of 4–8%. In a monthly *Portfolio Management* meeting the portfolio exposure is aligned with target strategy weights by allocating capital to approved hedge funds which execute those strategies. The target position size of each hedge

fund is established from its overall rating (see below) and its risk/return profile. In addition, other risk factors are taken into account (also see below).

Asset Selection Potential investments are identified from personal contacts, prime brokerages and a commercial database containing information on approximately 3000 hedge funds. First this universe is scanned for strategic fit and an indication of quality. The identified hedge funds are contacted directly and further information is requested. On review of this information the investment team decides on further evaluation of the hedge fund.

For each hedge fund more than 300 factors must be evaluated before presenting its case to the investment team for a final decision. The *Manager Evaluation* is a qualitative process taking into account the interrelation of the above factors to score six key groups and a total of seventeen sub-sections:

- ✗ strategy execution
- ✗ performance analysis
- ✗ exposure
- ✗ fund terms
- ✗ due diligence
- ✗ organisation

The evaluation is based on

- ✗ the review of a number of documents
- ✗ on-site interviews with key hedge fund staff
- ✗ the analysis of portfolio structure, exposure and model trades
- ✗ independent verification of counterparty relationships

Each section receives a score based on the relative strength in relation to the hedge fund's strategy. These scores are being discussed in a monthly team meeting where either more information is requested or an investment is decided upon in principle.

Risk Management Different aspects of the investment risk are considered by the investment team both independently and in the way they interrelate. Among them are:

- ✗ risk/reward profile of each strategy
- ✗ personnel, approach, assets and culture of hedge fund
- ✗ style drift of hedge funds
- ✗ exposure of underlying hedge fund portfolios
- ✗ common exposure, position size and liquidity of the portfolio

For the on-going risk management the *AdvantHedge* tool is utilised to identify potential issues which then would be raised with the hedge fund manager. The continuous maintenance and re-evaluation of hedge fund information by the whole team ensures an up-to-date database.

MGAI deliberately restricts investments to a subset of hedge fund strategies which generate attractive risk-adjusted returns without being highly leveraged. Currency exposure is hedged back to the fund's base currency.

Research All research is carried out by MGAI with the exception of background checks on hedge funds where MGAI supplement their research by using the services of a third party company which specializes in background verification. MGAI maintains close contact to hedge funds which fit its philosophy regarding strategy and risk appetite and command a suitable infrastructure for their businesses.

The *AdvantHedge* tool is used to identify and evaluate the strengths and weaknesses of each hedge fund. For this purpose, extensive data and information gathered from investigated hedge funds is stored within the database. The content ranges from general company data to investment details and minutes of meetings with the hedge fund's managers. It also contains data, charts and analysis on fundamental, technical and sentiment factors for each strategy.

RCP comment:

- + *The investment process follows a clear philosophy and structure.*
- + *The team approach to investment decisions has created a knowledgeable pool of highly motivated analysts.*
- + *The proprietary tool AdvantHedge fully supports all aspects of the investment process.*

Table 2: Research Methods (FoHF)

<i>Method</i>	<i>Significance</i>
Qualitative analysis	1
Quantitative analysis	3
Macro-economics	4
Micro-economics	4
Cycle analysis	1
Analysis of financial statements	3
Visits of issuers	1
Discussions with issuers	1
Rating	5
Factors, ratios	3
Price forecasts	5
Relative value	5
Regression analysis	3
Non-linear models	3
Portfolio optimisation	5
Artificial intelligence	5
Scenario playing	2
Chart analysis	5
Technical indicators	1
Others	no

Significance: 1 = high importance, 5 = no importance

Figure 1: Shareholders (MFC)

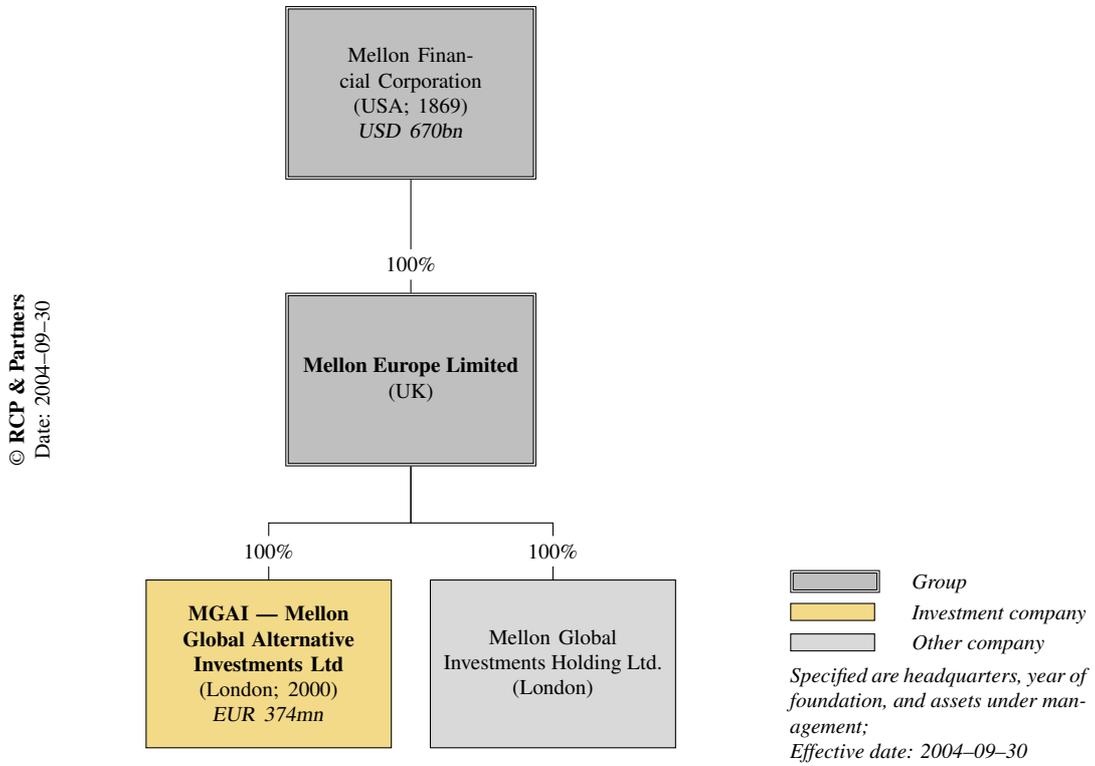


Figure 2: Organisation (MGAI)

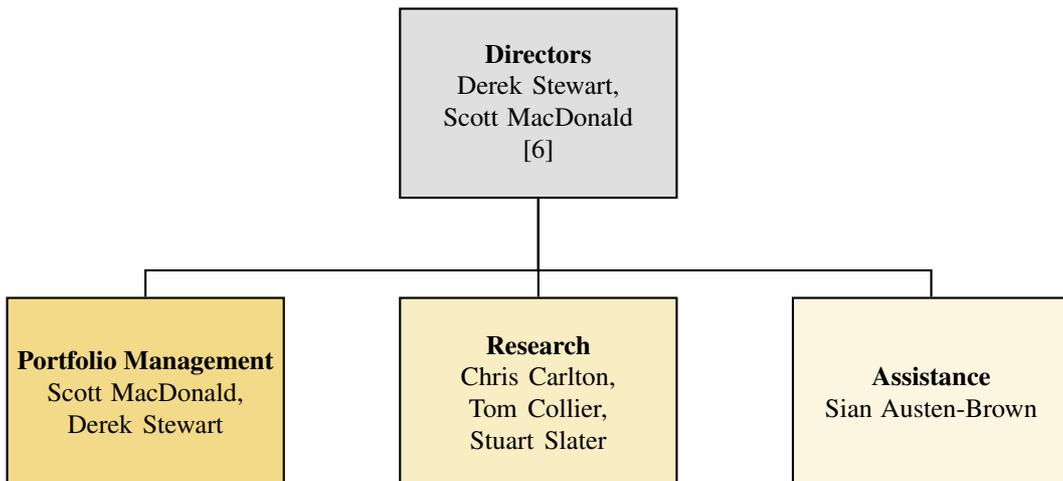
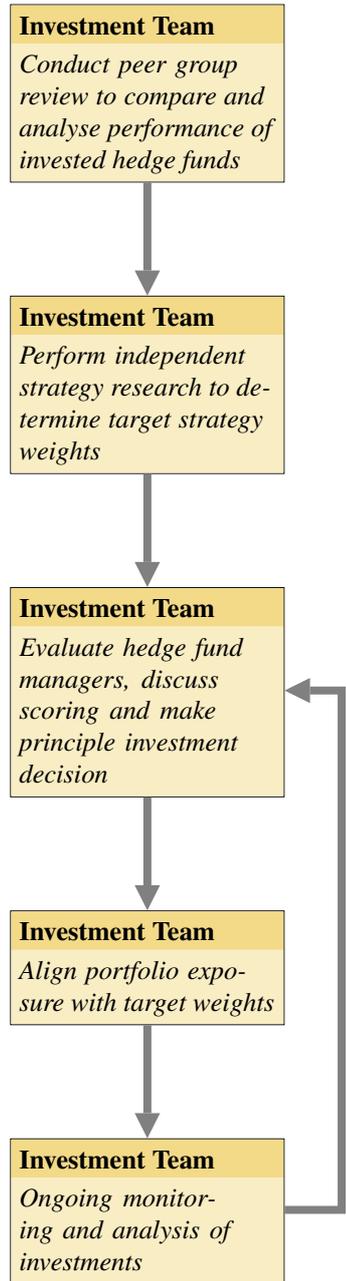


Figure 3: Process (FoHF)



Investment Profile	Funds of Hedge Funds
investment focus	Hedge funds following event driven, relative value and equity hedge strategies
unit(s) involved	MGAI

Responsibility	<i>Name</i>	<i>In charge since</i>	<i>With RP since</i>
CIO	Derek Stewart	11/2000	11/2000
process/team responsibility	Scott MacDonald	11/2000	11/2000
deputy	mutually	11/2000	11/2000

Investment Process	
implemented since	07/2001
last significant change	07/2001
benchmark	no

Investment horizon	
strategic	36 M
tactical	1 M
portfolio rebalancing	monthly

Hedging/derivatives	<i>Use</i>
<i>Field</i>	
... currency hedging	yes *
... synthesising	no
... covered call writing	no
... leveraging	no
... others	no
<i>Instruments</i>	
... currency forwards	yes *
... swaps	no
... options	no
... futures	no
... short selling	no

Investment professionals	<i>Number/years</i>
Total (RP)	6
... portfolio managers	2
... analysts	4
... academic degree	4
... CEFA/CFA etc.	3
<i>Team</i>	
... age (Ø)	30
... investment experience (Ø)	7
... with RP since(Ø)	2.5
other resources	6

Assets under Management	<i># Portfolios</i>	<i>AUM (USD m)</i>
Overall	6	483.84
... dedicated	1	11.25
... pooled	4	372.05
... managed	1	100.54
... managed for third parties	483.84	483.84
... represented in PPS composites	0	0

Objectives	
<i>Performance</i>	
... absolute	yes *
... vs. benchmark	no
... vs. peer group	yes *
... others	no
<i>Risk</i>	
... volatility	no
... tracking error	no
... beta	no
... drawdown	no
... Value at Risk	no
... others	no
<i>Risk-adjusted performance</i>	
... Sharpe ratio	no
... Information ratio	no
... others	no
<i>Characteristics</i>	
... invested to (degree)	95–100%
... cash	0–5%
... number of individual names	≤ 20
... weighting of individual names	4–8%
... others	no

Documentation	
marketing presentation	yes
directives	yes
others	no

Characteristics	
portfolio turnover p.a. **	10–15%
total share top ten names **	n.a.

Effective date: 2004–09–30

* cf. also details in body

** five-years average

Team

Funds of Hedge Funds

Derek Stewart and Scott MacDonald joined MFC in 2000 to establish MGAI. The analysts were hired in the course of 2001/2002 and since then the investment team has remained stable.

The portfolio managers have longstanding experience in the hedge fund industry. The analysts mainly contribute a general investment research background and academic qualifications.

RCP comment:

- + *The portfolio managers complement each other very well in term of experience and skills.*
- + *The analysts have already accumulated a considerable knowledge about hedge funds and the hedge fund industry.*
- *The small team still relies heavily on the portfolio managers' experience.*

Quality Management

Quality Assurance

MGAI compares its fund to a peer group of approximately 50 funds of hedge funds, so clients can have some context for performance appraisal. The underlying hedge funds' performances are also subject to a monthly peer group review of hedge funds with the same strategy. On a weekly basis, hedge funds provided estimated performance data which is also reviewed.

MGAI monitors a variety of different risks on a weekly basis using information in the *AdvantHedge* database. Each month, the leverage of hedge funds is aggregated on the portfolio level to gain understanding of the degree of investment. Also, the investment horizon, portfolio turnover and portfolio characteristics are monitored on a monthly basis and corrective action taken if necessary.

RCP comment:

- + *The analytical research database AdvantHedge supports the whole investment process and assures a required level of quality through its structure and integrated guidelines.*
- *There is no independent quality assurance, although MGAI has to justify investment decisions to MGI executives.*

Investment Controlling

For each fund specific investment guidelines are outlined. The investment restrictions are being checked manually before investment, after receiving NAVs from the administrator. Compliance with investment restrictions is documented and has to be signed-off by a portfolio manager. The documentation is regularly reviewed by MGI's compliance department.

RCP comment:

- + *Controls to stay within the limits of – very few – investment restrictions are in place.*
- *Investment restrictions are checked manually.*

Performance Measurement

The performance of underlying hedge funds is monitored weekly, based on estimated performance data provided by the hedge fund managers. After verification, the monthly NAVs provided by the administrator are loaded into *AdvantHedge* which calculates the performance data and produces reports such as the monthly fact sheets. Strategy contribution is calculated monthly using *AdvantHedge*.

RCP comment:

- + *Performance calculation is integrated with the analytical database AdvantHedge.*
- *MGAI's performance data is not certified to any standard such as GIPS.*

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