Dynamic MS – Q2 2011

Economic Overview

Following the tragic events in Japan in March, global equity markets posted a broad recovery rally in April with impressive numbers across several major indices including the MSCI World (+4.3%) and S&P 500 (+3.0%). This was despite the recent macro headwinds and Europe in particular posted the strongest gains on a regional basis. Corporate earnings came in stronger than expected again in the US, where large caps largely outperformed small caps. However, weak economic data weighed on equity markets in May as concerns of a slowdown in global growth resurfaced. In the US, weak pending homes sales, at an eight year low as well as an unchanged GDP number below expectations were among the worst headlines. Despite this, world markets underperformed the US, with the MSCI World (-2.6%) behind the S&P 500 (-1.1%). With the re-emergence of European sovereign debt concerns, the MSCI Europe was down (-3.1%) with Greece, Italy, Germany and Spain the worst performing countries. The issues related to global growth and European sovereign debt concerns continued to drag markets down sharply for much of June. A strong rally at month end sparked by optimism the Greece debt crisis would be averted, helped markets finish strongly, but still firmly in negative territory.

In credit markets, High Yield continued it's steady returns over April and May, before falling in June. Despite this, the JPM High Yield Index was still up a strong 5.48% YTD through June. The Investment Grade indices had a strong April and May before slipping in June. Cash also outperformed CDX YTD. High Yield and Loans issuance recovered in April and May with refinancing continuing to be the majority use of the proceeds. However, this volume slowed with market weakness in June, coming down to it's lowest levels for a year. Default activity continued to be extremely limited with 1 in April and 2 in June affecting the High Yield market.

Commodities began the quarter well in April with most bid up. Silver was the biggest winner (+28.2%). However, commodities were hit hard in May and there was a sharp reversal from the previous month with Silver losing significantly (-21.2%) and the energy complex very vulnerable and volatile, down between 7-10%. The energy complex came under continued pressure in June as strategic oil reserves were released in the US as well as an additional release of reserves by the IEA. Gold traded down in May and June but was positive overall for the quarter.

Performance and portfolio

Dynamic MS	April	May	June	Q2	YTD
Dynamic MS Portfolio Gross	1.10%	-1.10%	-1.63%	-1.65%	-0.97%

Over the second quarter, the portfolio lost -1.65%. The portfolio achieved this performance amidst a difficult market environment given the re-emergence of global growth and sovereign debt concerns.

Kamunting Street and Perella Weinberg Partners Xerion Fund were added to the portfolio during the quarter, while an allocation to an existing manager Third Point was increased bringing the number of continuing positions in the portfolio as at 30th June 2011 to 29.

Credit/Event

Claren Road contributed +6 bps in the quarter with positive gains each month from its portfolio construction and security selection. The biggest winners for the quarter were longs in municipal tobacco bonds including Rhode Island and New Jersey. Other winners were shorts in mortgage insurers and banks.

Fore Multi Strategy contributed +5 bps in the quarter and was also positive each month. The manager has been short biased which benefited them during the period. The short credit portfolio was the largest contributor to performance, with short positions in European peripheral countries and homebuilders performing best.

Paulson Advantage had a difficult quarter and lost -34 bps. The fund was hurt by it's directional net long exposure. On a sector basis, financials and Gold mining sectors were the largest detractors while on a name basis, the largest negative contributors included Sino-Forest, AngloGold Ashanti, Hewlett-Packard, Transocean, Bank of America and Citibank.

L/S Equity

SAC Capital was the top contributor to both the strategy and portfolio with +11 bps for the quarter after protecting capital well in June following strong gains in April and May. The best performing sectors and teams included retail/consumer, the Cohen team, energy, generalists and industrials.

Visium Balanced also had a strong quarter contributing +9 bps for the quarter. From a sector perspective, pharma and services both gained more than 2%. The biggest winners included Allergan and Medicis. Allergan benefited from increased use of its Botox product for treatment of migraines. Medicis benefited from an agreement protecting its acne treatment medicine from generic competition till 2018.

Attara performed poorly and negatively contributed -15 bps to the portfolio. The long book declined significantly over the quarter with the largest detractors on a sector basis being Financials and Materials. On a name basis, top performers in Visa and Mastercard were offset by losses in Lukoil, Goldman Sachs, Barclays and Chaoda Modern Agriculture.

Macro

Global Macro

COMAC had a strong quarter, contributing +9 bps for the quarter. COMAC profited from various fixed income positions during the quarter. They were net receivers in US fixed income, positioned for a steepening of the US yield curve and positioned for higher interest rates in the UK relative to the US.

Brevan Howard Emerging Markets was slightly positive for the quarter contributing +3 bps for the quarter as tactical trading drove performance. The manager was only positive in June, when good gains were made capturing the sell-off and rebound in equities.

Blenheim Global Markets had a difficult quarter and lost the portfolio -29 bps. The manager was positive in April but more than offset these gains in May and June with sharp losses primarily through long positions in grains, industrial metals and palladium.

Commodities

The Clive Fund lost -49 bps this quarter and was the largest detractor within the portfolio. The majority of losses this quarter came from bullish energy positions. The risk off trade in early May hurt the energy complex the most. When the US and IEA released strategic oil reserves, it sent energy markets even lower. The sharp and sudden reversal in macro data particularly in the US, as well as the deceleration of global demand growth in Q2 caught the manager off guard.

Managed Futures

Bluetrend lost -5 bps in the quarter despite a strong start in April profiting from long equities, long energy and long bond positions. The fund continued to make small gains from their long bond and other fixed income positions but had heavy losses from long equity and long energy positions over May and June.

Relative Value

OZ Europe lost -4 bps after losses in June erased modest gains in April and May. M&A and Corporate Credit strategies were the only positive contributors on the quarter, with all other strategies losing money. The Equities and Privates strategies incurred the biggest losses in the quarter.

Kamunting Street lost -7bps in June, it’s first month within the portfolio. Asia and the CLO positions were the largest detracting books. In Asia, two positions in India and one in China were the major detractors. The CLOs sold off as the general market sold off.

Concerns regarding a slowdown in global growth and European sovereign debt have created a difficult and volatile market environment. We retain conviction in the managers already within the portfolio but will maintain healthy cash levels for now and wait for more clarity before reinvesting.