

Trend persistence

At the end of Q1 2008 - one of the most tumultuous quarters in the history of the hedge fund industry - Trendline was +16.6%. Our March 2008 report described our divergent market philosophy approach, and how its' long-volatility payoff profile compliments a portfolio of short-volatility strategies. By the end of Q2 2008 Trendline is now +32.76% YTD.

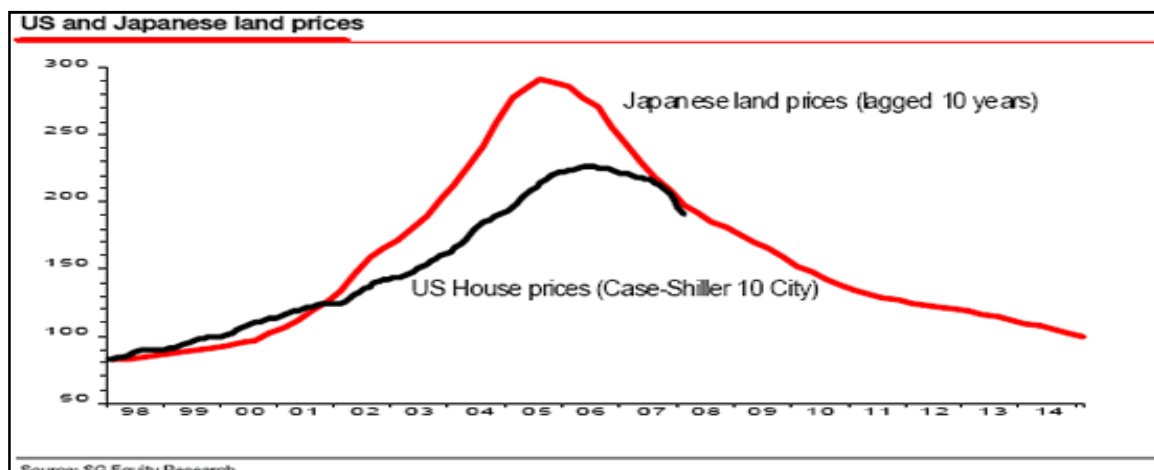
Performance anxiety

Some potential investors are concerned about having missed the opportunity of investing with the Trendline Diversified Fund. To evaluate an investment with Trendline at this stage it is appropriate to :

- analyse the recent market conditions that have led to Trendline's performance, and also the causes of these market conditions;
- determine whether those causes are still present, are likely to persist, and thus to conclude whether the current market conditions will persist or not.
- If the current, or similar, market conditions are expected to persist, then we can have some confidence that Trendline will continue to profit from them.

Price persistence

Recovery from excess is a long drawn out process, as can be seen in the chart of Japanese land prices and US house prices (below).



And lest anyone think that the 40% to 50% declines in global bank indices seen to date now makes them “cheap,” the 90% fall in the Japanese banking index in the 1990’s may provide some perspective on the process of price adjustment in the face of uncertainty (see chart below, with a similar move shown in the context of the 90% decline).



This price adjustment process is incomplete, as new equilibrium prices or relationships have not yet been established. A startling example of this is GM which, after having already lost almost 90% (from \$93 to \$11), was subject to the further indignity of being added to Goldman Sachs' conviction sell list at the end of June 2008 (see below).



We believe, now more than ever, that prices rather than market fundamentals provide the objective information useful to make investment decisions – what is perceived as cheap today may easily become tomorrow's conviction sell.

Performance persistence

In this era of of uncertainty of credit, value and liquidity, markets reflect human emotion and are prone to volatile swings. This is the reason international hedge fund investors have been increasing their allocations capital to strategies that are able to capitalise on the current price adjustment process, typically to macro & CTA managers (see table below; data courtesy BarclayHedge).

These strategies have the additional benefits of trading in markets with a high liquidity, transparent pricing, and are unaffected by large investment inflows – all factors on which investors place a premium.

AUM (\$ Bil.)	Q3 2007	Q4 2007	Q1 2008	AUM % change (6 months)
Sectors				
Equity Long/Short	303.8	302.4	291.3	(4.1%)
Equity Market Neutral	64.1	65.3	66.4	3.6%
Macro	88.1	90.8	102.6	16.5%
CTA	184.8	206.6	219.7	18.9%

In an uncertain world, identifying and following trends is the only rational investment approach.