FUND LIBRARY ANALYSIS

Fund straddles major hedging strategies

Aims for risk profile akin to bond funds

LEVI FOLK

Arrow Multi Strategy Fund begins where most mutual fund strategies leave off. Mutual funds populate the long only investment world where investors pay managers to take long positions in equity and fixed income markets. In a major departure from this theme, the Arrow Multi Strategy Fund invests in various underlying hedge fund strategies, many that remove market risk, with the goal of achieving superior risk adjusted returns.

As a fund of funds, Arrow Multi Strategy Fund is diversified across the four major hedge fund investment classes: relative value, event driven, long/short and macroeconomic. "Relative value and event driven are less market sensitive, less directional and macro and long short have more elements of market directionality. We try to combine manager risk, market risk, credit risk, liquidity risk, a whole series of risks, package them up and try and hit a desired output," says Jim McGovern Managing Director of Arrow Hedge Partners.

McGovern and his team pursue a sophisticated strategy of vetting hedge fund managers and assembling them into a low correlation investment vehicle. "We try to do 400 to 500 basis points over short term rates," says McGovern. And they aim for a risk profile that is in the domain of bond funds.

Hedge funds operate in the dark corner of the investment world yet McGovern demands full transparency from the hedge fund managers in which he invests gaining access that is unavailable to most investors. While this may alleviate concerns of fraud in investors' minds, McGovern says, more importantly, "that transparency gives us an idea who is in a position to make money."

Making money has been a greater challenge for hedge fund managers over the past two years: with most securities having appreciated, managers who take short positions have been hurt. "Equity market neutral had a very hard time," says McGovern because there was little differentiation between good and bad companies by the market. These strategies are market neutral, meaning they will be long one company and short another in the same sector, so performance is unrelated to market direction.

Again, McGovern utilizes the transparency by knowing where to take money off the table and where to commit new money. "We rely on these guys to clue us in as well as to where the opportunities are. If they're telling us they are not willing to risk their own capital then why should we?"

McGovern smartly made money by taking a significant position in credit strategies. "So, we had a lot of event driven in the book. Distressed securities, high yield hedge funds, small cap deal arbitrage. We figured there would be a compression in spreads, but to be honest it was way more than we expected."

Currently, the manager is taking profits on the credit bet. "We are going back to all the guys we made good money with in the last couple years and we are asking them what are you doing with your credit book, are you tightening in your long short exposures, are you reducing your gearing, how are you prepared for when spreads go the other way?"

Instead, he foresees a return to favour of market neutral strategies. "At some point something is going to trigger in the market where the separation of good or bad gets realized and that is where you coin it," says McGovern.

Despite being stigmatized as risky, Arrow Multi Strategy Fund has been less volatile than most equity funds. In fact, stress testing is an important part of the management process. McGovern uses RiskMetrics software to perform various tests on the underlying investments simulating various market conditions. He says that the perfect storm for his portfolio would be "commodities falling right of bed." That is because many of the long/short equity managers in the portfolio have been earning money by take long positions in energy stocks.

Unlike a typical resource fund manager, McGovern has the option to hedge some of this risk. "We have added, in the last nine months, five funds that are going to do great in a stress environment." He looks for managers that he calls "free puts," that can make incremental money on a regular basis so they are not a drag on returns, but can earn a lot of money in extreme market environments.

MAKING MONEY HAS BEEN A GREATER CHALLENGE FOR HEDGE FUND MANAGERS RECENTLY

Despite the transparency demanded by management and their careful attention to risk, the OSC still demands that investors that are not accredited, read high net worth, can only buy this fund in a principal protected note version.

This frivolous insurance package unfortunately costs investors an extra 130 basis point in fees annually. "If you don't have to do it, don't do it," says McGovern in reference to the principal protected note. Either way investors approach this fund, Arrow Hedge Multi Strategy Fund is a low risk alternative strategy investment that will complement most mutual fund portfolios.

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FUND LIBRARY ONTHESPOT™ ANALYSIS: ARROW MULTI STRATEGY FUND

DATA SOURCE: FUNDATA

Jim McGovern, lead portfolio manager for Arrow Multi Strategy Fund

Loads: *Choice front or back*

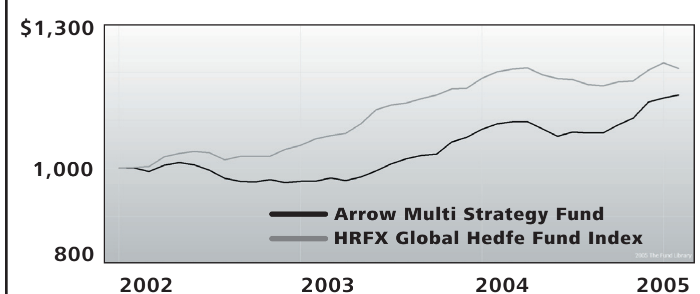
Inception date: *January 1, 2002*

Total assets ($mil.): *$68.96*

MER: *2.78% (includes GST)*

HISTORICAL COMPOUND PERFORMANCE

Data as of Nov. 30, '04



PORTFOLIO COMPOSITION — ASSET ALLOCATION

As of December 31, 2004

Asset Class	% of portfolio
Equity Hedge	34%
Risk Arbitrage	12.8%
Hedged High Yield	10%
Convertible Arbitrage	8.1%
Global Macro	7.6%
Equity Market Neutral	6.5%

Asset Class	% of portfolio
Distressed Securities	5.6%
Volatility Arbitrage	4.9%
Fixed Income Arbitrage	4%
Cash	2.7%
Short Seller	2.1%
Managed Futures	1.9%

COMPOUND PERFORMANCE / CALENDAR YEAR PERFORMANCE

	1mo	3mo	6mo	1yr	2yr	3yr	'04	'03	'02
Arrow Multi Strategy Fund (Since Jan. '02)	0.52	4.41	7.35	5.49	8.84	4.82	6.08	11.10	-2.71
HRFX Global Hedge Fund Index	-0.95	2.21	2.88	0.58	6.72	6.46	2.70	13.39	4.73

SOURCE: FUND LIBRARY/FUNDATA NATIONAL POST