HILLSDALE
INVESTMENT MANAGEMENT INC.

"Identifying the True Drivers of an Absolute Return Strategy"

by

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For the Strategy Institute

Absolute Return Strategies for Institutional Investors

Hillsdale Investment Management Inc.

Founded: ***1996*** ***AUM: $200 mm***

Manage: ***Canadian Market Neutral Equity Fund***
US Market Neutral Equity Fund
Canadian Long/Short Equity Fund
US Long/ Short Equity Fund

Methodology: systematic and disciplined, quantitative

Clients: Institutions, High Net Worth, Investment Advisors

What does absolute return mean?

- ***Pay for pure skill***
- ***Take manager risk instead of market risk***
- ***Usually a manager will create a portfolio that:***
  - ***is dollar neutral***
  - ***is beta neutral***
  - ***exploits 'relative value'***
- ***And ……takes no obvious risk bets***

Categories of Risk Bets

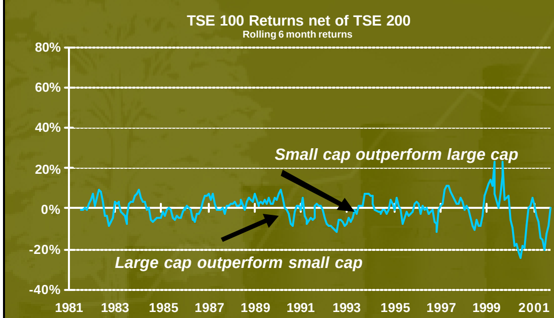
- ***Security Selection***
- ***Market (Macro) Selection***
- ***Portfolio Construction***

Security Selection Bets

Common Drivers of Returns:

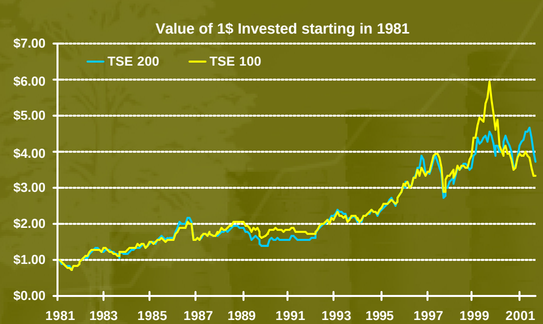
- *Make a bet on Capitalization*
- *Make a bet on an Industry*
- *Make a bet on a Style (Growth/Value/Income)*
- *Make a bet on a Trading factor*
- *Make a bet on Liquidity*

Capitalization Bet

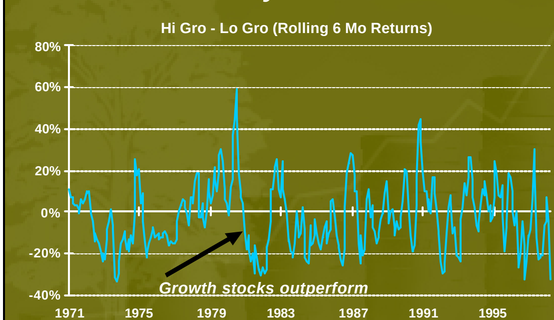


Note level of return, reversion to mean, symmetry of risk, shift in distribution.

No difference in returns over time

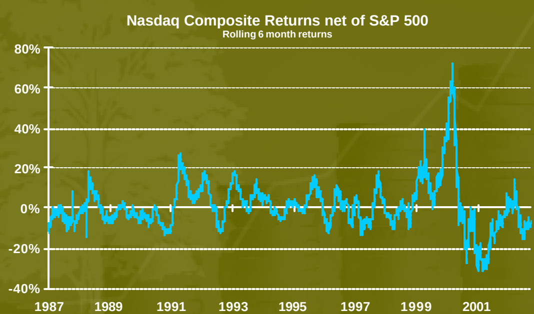


Style Bet



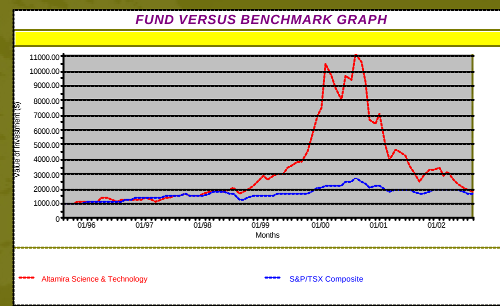
Note level of return, symmetry of risk and reversion. Risk __two__ x cap bet

Sector Bet



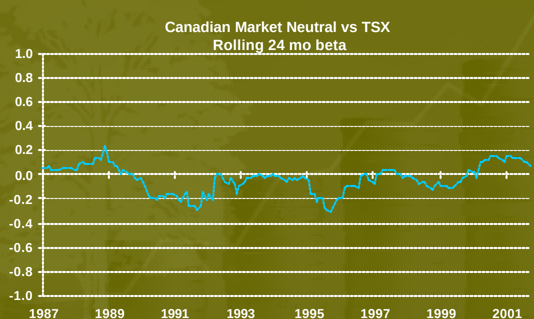
Note up and down side risk exposure.

A Sector Bet Equals A Timing Bet



Excess returns are difficult to sustain, depend on timing, revert to the mean.
Source: Morningstar Bell Charts

Fund has no beta relationship with TSX

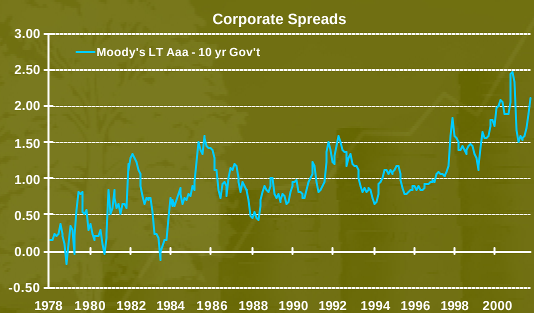


Macro Selection

***Drivers of Returns*:**

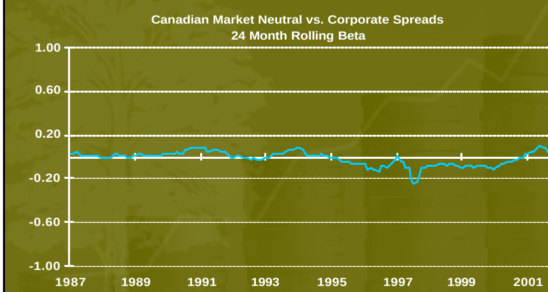
- *Make a bet on the Yield Curve*
- *Make a bet on Credit Spreads*
- *Make a bet on Market Volatility*
- *Make a bet on Option Volatility*
- *Make a bet on Market Direction – exposure*
- *Make a bet on Exchange rates*
- *Make a bet on a Country*

Corporate Spread Bets



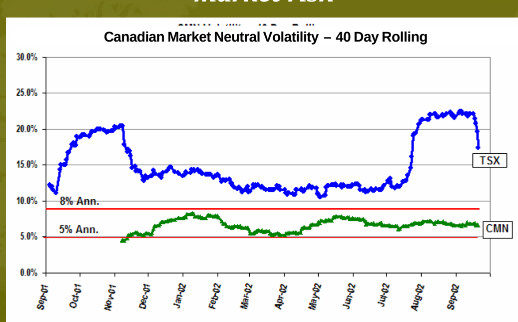
Is there an exposure to an increasing spread environment?

Fund has no relationship to changes in credit spreads



Using MoM change in 10 year Gov't Bond - Moody's LT Aaa

Fund is not correlated with changes in market risk



Neutralizing Risk Bets

(How to Control Risk Exposures)

Risk Measure	*Control Variable*	*Long Portfolio*	*Short Portfolio*
Style	Yield	1.3%	1.2%
Trading	Beta	0.6	0.6
Credit	D/E	0.6X	0.7X
Trading	Price	$32.00	$42.00
Event	Coverage	9.3 an	9.1 an
Liquidity	Mthly Turnover	5.3%	5.6%
Size	Market Cap	$6.3 bil.	$7.1 bil.

• *- Risk control attributes for the Hillsdale Cdn Mkt Neutral fund.*

Factor to control: Yield

Longs*			Shorts*		
Ticker	**Name**	**Yield**	**Ticker**	**Name**	**Yield**
GLG	Glamis Gold	0.00	ABX	Barrick Gold Corp	0.82
CBY	Canada Bread	1.05	VH	Van Houtte	0.76
STN	StantekInc	0.00	TKN	Teknion Corp	0.00
MCL	Moore Corp	0.00	CAE	CAE Inc.	1.01
FTS	Fortis Inc.	3.94	MBT	Manitoba Tel	2.36
MRU.A	Metro Inc.	0.94	L	Loblaw	0.78
ATD	Aliment.CoucheTard	0.00	TEL.B	AT&T Canada	0.00
MFC	Manulife Financial	1.23	TD	TD Bank	2.78
IGI	Investors Group	2.65	CIX	C.I. Fund Mgmt.	1.67
		0.98			1.01

*Holdings for the Hillsdale Canadian Market Neutral Equity fundas of April 30, 2002

Portfolio Construction Bets

Drivers of Returns:

- *Number of positions*
- *Limits on Position Size*
- *Rules for rebalancing / stop loss <> aggressive doubling down*
- *Use of leverage*
- *Rules/restrictions on use of investment instruments*

These are examples of large bets than can cause potential disaster despite a robust track record.

Summary: When is a market neutral strategy not completely neutral?

- *…Can always find some hidden (or not) exposure*
- *For each of*
  - *Security Selection*
  - *Macro Selection*
  - *Portfolio Construction*
- *What risk bets do you take? Drivers of return?*
- *What factor(s) are you most exposed to? Why ?*
- *What restrictions do you place on your strategy?*
- *Existence of a risk budget ? / Limit on capacity?*

Summary: How to recognize drift?

- *Establish appropriate benchmark:*
- *Target return (Cash plus)*
- *Level of risk*
- *Maximum draw down, time underwater*
- *Use of leverage*
- *…Time vagaries*

Summary: How to recognize drift?

<u>*Disaggregate Returns*</u>

- ***Long***
- ***Short***
- ***Exposure***
- ***Leverage***
- ***Cash Rebate***
- ***Dividend / Coupon***
  - ***Times the number of investment instruments***

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