



Hedge Fund Portfolio Review through September 30, 2014

A horizontal banner with a background image of classical architectural details, including columns and door frames, in shades of grey and brown. The text is centered in a white, sans-serif font.

Los Angeles • New York

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Description of Strategy

Managers investing primarily in equities making active security selection on long and short positions.

Sub-strategies:

- Equity long/short – investing in equities
- Event Driven – investing primarily in equities but also debt while anticipating a particular change or event to occur with a company (e.g. acquisition)

Role in the Total Fund

The equity hedge fund portfolio's role is to increase the Sharpe ratio of the total fund's equity exposure by:

- Over the long term, producing equity returns by combining some equity exposure and significant alpha generation
- Over the short/medium term, reduce the volatility of the equity portfolio by hedging the exposure

Description of Strategy

Managers generally investing in non-equity asset classes or investing with a low net exposure (i.e. low equity beta). Exposures include both long and short positions on interest rates, credit, currency, commodities, and to a limited degree equities.

Sub-strategies:

- Credit– investing in corporate credit instruments taking both long and short positions
- Relative Value– investing in fixed income, on a long and short basis, seeking price discrepancies of instruments with similar fixed income risk
- Macro – investing across asset classes, on a long and short basis, based on fundamental or quantitative judgments
- Multi-strategy- investing across hedge fund strategies

Role in the Total Fund

The real return hedge fund portfolio's role is to increase the Sharpe ratio of the total fund and to provide an expected return with low volatility by:

- Over the long term, produce a significant return premium over the risk free rate (e.g. T-bills)
- Over the short/medium term, maintain a low beta or exposure to equity markets
- Over the long term, produce a level of volatility comparable to fixed income

Performance Update as of September 30, 2014

Performance review covers the entire period Rhode Island has been investing in hedge funds (Nov 1, 2011 to Sep 30, 2014)

All returns are net-of-fees and annualized, as are risk measures

Three hedge fund composites are evaluated:

– **Real Return Hedge Funds:**

- \$531 million invested in 9 hedge funds
- Target 7% of total assets, within the 11% overall real return allocation
- Benchmarks – T-bills; HFRI Fund-of-Funds Index

– **Equity Hedge Funds:**

- \$660 million invested in 9 hedge funds
- Target 8% of total assets, within the 51% overall global equity allocation
- Benchmarks – MSCI ACWI Index; HFRI Equity Hedged Index

– **Combined Hedge Funds:**

- Combines the Real Return and Equity Hedge Funds into one composite

Hedge Fund Portfolio Return and Risk: Inception through Sep 30, 2014

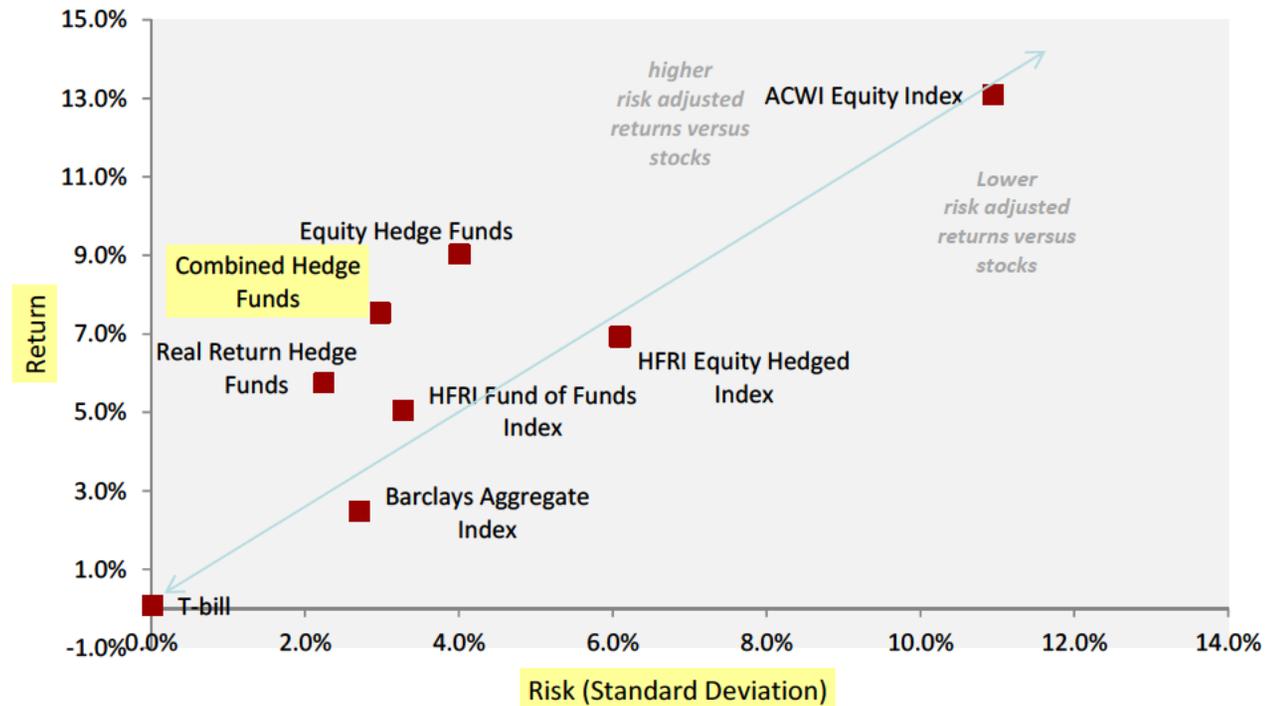
	ERSRI Equity Hedge Funds	ERSRI Real Return Hedge Funds	ERSRI Combined Hedge	HFRI Fund of Funds Index	HFRI Equity Hedged Index	ACWI	T-bill	Barc Agg
Total Return	9.03%	5.74%	7.53%	5.05%	6.92%	13.10%	0.07%	2.47%
Total Risk	4.01%	2.25%	2.98%	3.28%	6.10%	10.94%	0.02%	2.71%

Rhode Island Hedge Fund Total Return & Risk

Rhode Island hedge fund portfolios outperformed HFRI FOF Index over the 35 month period from inception (**7.53%** versus 5.05%, respectively) and had significantly better risk-adjusted returns

Both the RI Equity hedge funds (**9.03%** return) and the Real Return hedge funds (**5.74%** return) earned returns above their respective benchmarks (HFRI Equity Hedged Index and HFRI Fund of Funds Index, respectively) and at a lower level of risk.

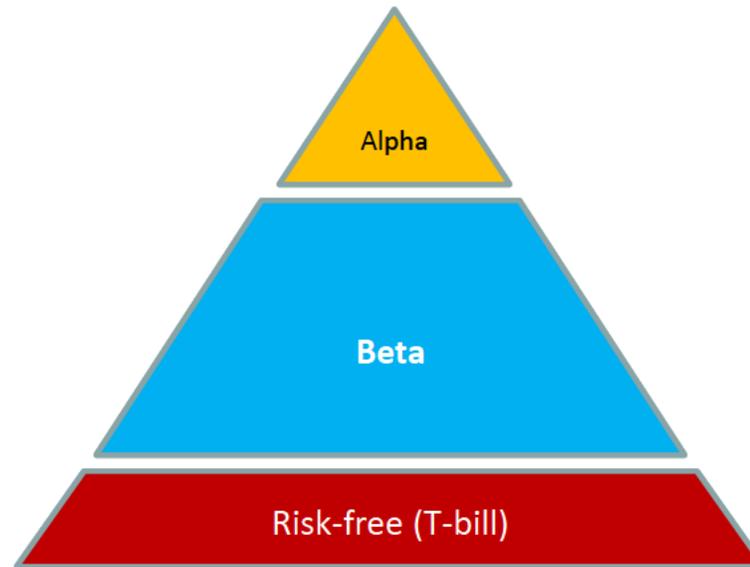
**Return and Risk (Standard Deviation)
(Nov 1, 2011 to Sep 30, 2014)**



All assets have three return components:

- **Risk-free return:** all assets are priced to earn at least the risk free return (T-bill)
- **Beta return:** markets themselves generate investor returns to reward risk taking. These returns can be accessed at little to no fee through index funds and ETFs
- **Alpha return:** active managers try to produce excess return but often competition and fees get in their way

Three Components of Return



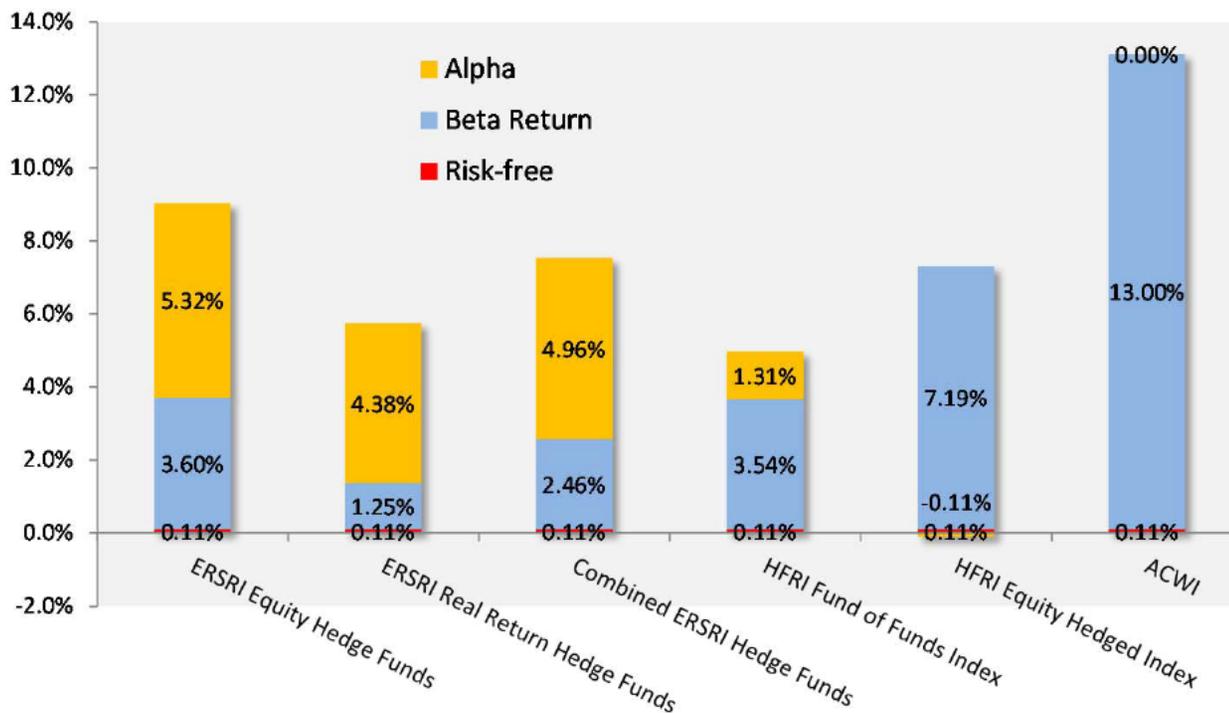
Rhode Island Hedge Fund Return Attribution into Alpha, Beta, and Risk Free

Rhode Island hedge funds combined earned alpha equal to 4.96%, which exceeds Cliffwater's expected combined alpha of 3.75%

The equity beta for the Equity Hedge Fund portfolio equaled 0.25 over the period, well below the 0.52 average beta for equity hedge funds. The Real Return Hedge Fund portfolio had a beta of 0.09 over this period.

Both the Equity and Real Return portfolios produced strong alpha of 5.32% and 4.38%, respectively.

Annualized Returns: Nov 2011 to Sep 2014



Appendix: Hedge Fund Portfolio Performance as of September 30, 2014

Employees' Retirement System of the State of Rhode Island

Hedge Fund Portfolio
 Portfolio Performance Summary
 Estimated as of September 30, 2014

Fund	Market Value	Actual %	Returns				Std Dev	Sharpe Ratio	Incep Date
			Sep	YTD	1 Year	Incep			
Global Equities									
Ascend Partners Fund II LP	71,182,090	6.0%	0.45%	4.26%	9.81%	6.03%	2.75%	2.03	Nov-11
Davidson Kempner Institutional Partners, L.P.	75,338,604	6.3%	0.08%	5.91%	7.80%	8.12%	1.80%	4.17	Nov-11
Elliott Associates, L.P.	81,723,877	6.9%	2.80%	7.87%	11.03%	11.18%	3.45%	3.00	Nov-11
ESG Cross Border Equity Fund LP	47,959,947	4.0%	-1.50%	-	-	-4.01%	2.96%	-	Jun-14
Indus Asia Pacific Fund, LP	824,139	0.1%	-2.92%	-6.77%	-4.44%	1.48%	6.19%	0.22	Jan-12
Luxor Capital Partners, LP	48,408,474	4.1%	-0.86%	-	-	-3.18%	8.24%	-	May-14
Mason Capital Ltd.	66,436,977	5.6%	-1.04%	-5.06%	1.13%	3.78%	6.78%	0.53	Jan-12
PFM Diversified Fund, L.P.	37,350,579	3.1%	-0.23%	-0.22%	7.68%	8.85%	9.70%	0.89	Mar-12
PFM Diversified Offshore Fund A.I., Ltd.	37,050,653	3.1%	-0.23%	-0.40%	7.40%	8.51%	9.64%	0.87	Mar-12
Samlyn Onshore Fund, L.P.	101,140,829	8.5%	-0.56%	2.77%	11.06%	11.33%	5.78%	1.84	Jan-12
Viking Global Equities, LP	92,265,802	7.8%	2.90%	11.01%	20.15%	16.40%	5.88%	2.57	Dec-11
Total Global Equities	659,681,973	55.4%	0.39%	2.75%	8.55%	9.03%	4.01%	2.10	Nov-11
MSCI AC World Index Free - Net			-3.24%	3.73%	11.32%	13.10%	10.94%	1.15	Nov-11
Russell 3000 Index (DRI)			-2.08%	6.95%	17.76%	19.28%	9.55%	1.87	Nov-11
HFRI Equity Hedge (Total) Index			-1.82%	2.00%	6.78%	6.92%	6.10%	1.08	Nov-11
Real Return									
BlueCrest Capital LP	21,028,651	1.8%	0.69%	0.95%	1.11%	1.84%	2.31%	0.67	Jan-12
Brevan Howard LP	80,901,120	6.8%	4.34%	0.40%	1.55%	2.63%	5.21%	0.46	Nov-11
Brigade Leveraged Capital Structures Fund LP	57,231,761	4.8%	-2.26%	3.08%	5.54%	5.37%	3.05%	1.63	Mar-12
Capula Global Relative Value Fund Ltd.	56,751,065	4.8%	0.87%	5.26%	6.03%	4.57%	1.95%	2.14	Dec-11
Claren Road Credit Fund, Ltd.	51,092,803	4.3%	-1.15%	1.00%	2.11%	1.45%	4.27%	0.30	Apr-13
DE Shaw Composite Fund LLC	76,033,470	6.4%	2.30%	13.51%	16.69%	15.45%	3.91%	3.64	Nov-11
Graham Global Investment Fund I SPC Ltd. - Discretionary Segregated P	55,514,202	4.7%	4.80%	3.18%	7.14%	3.88%	4.02%	0.89	Jan-12
OZ Domestic Partners II, L.P.	99,455,254	8.4%	-0.06%	2.68%	6.83%	10.16%	3.55%	2.67	Nov-11
Winton Futures Fund Limited	32,695,273	2.7%	-0.60%	1.94%	7.93%	3.08%	7.63%	0.39	Dec-11
Total Real Return	530,703,600	44.6%	1.16%	3.82%	6.43%	5.74%	2.25%	2.35	Nov-11
ML 3-month T-Bills			0.00%	0.03%	0.05%	0.07%	0.02%	-	Nov-11
HFRI Fund of Funds Composite Index			0.07%	2.68%	6.45%	5.05%	3.28%	1.42	Nov-11
Total Hedge Fund Portfolio	1,190,385,573	100.0%	0.73%	3.24%	7.61%	7.53%	2.98%	2.35	Nov-11
HFRI Fund of Funds Composite Index			0.07%	2.68%	6.45%	5.05%	3.28%	1.42	Nov-11

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