



Baron Point Research Quarterly
3Q2008

Each quarter we issue research describing current intermediate term market trends, followed by a discussion of various fund management including risk control techniques we employ and the manner in which they may come into play during those trends. This research is intended to complement our regular Monthly Commentary.

A summary table of contents is shown below. **If you have any comments please feel free to email Baron Point at info@baronpoint.net or telephone +1 (212) 248-2733 x701.**

Table of Contents

Part I — Current Market Analysis	1
Is the U.S. Economy in a recession?	1
Measures of Activity across the Entire Economy	2
Credit Market Fallout.....	6
Credit Default Swap Upfronts	6
U.S. Peak Credit and Overconsumption	7
Part II — How Long Could This Bear Last and How Deep Could It Be?	8
Bear Market Profile	9
Bear Markets and US Recessions	10
Bear Market Profile when the US Economy is <i>not</i> in a Recession.....	11
Bear Market Profile when the US Economy <i>is</i> in a Recession	12
Bear Market Fallout for Other Fund Managers	13
Positioning for the Future	14
Part III — Historical Measures and Current Fund Performance	14
Relevant Statistical and Index Definitions.....	14
Relative Fund Performance	14

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Part I — Current Market Analysis

Any current media discussion of the United States (“U.S.”) equity markets is dominated by the following questions:

- I) Is the U.S. economy in recession and will global growth slow down?
- II) Are we in a bear market for equities?
- III) If it is a bear market, what investment strategies and tactics make sense, now?

In this commentary, we will attempt to answer these questions and, in conclusion, offer you some insight into Baron Point’s mindset approaching the coming months.

Is the U.S. Economy in a recession?

There is currently a great deal of argument about this, largely owing to the upcoming U.S. national elections – as per time-honored script, incumbents claim the economy isn’t in recession while challengers claim it is, and the media generates more interest and the occasional controversy reporting the effect of the constant stream of information, so we stay tuned.

The simplified definition of a recession is a decline in the Gross Domestic Product (“GDP”) for two or more consecutive quarters. By this measurement, the economy is not yet in recession. However, this definition is too simplified and not even the measurement officially used to gauge a recessionary event!

First, the above simplification does not take into consideration changes in other variables, such as changes in the unemployment rate or consumer confidence. Second, by using quarterly data this definition makes it difficult to pinpoint when a recession begins or ends. Thus, a recession that lasts ten months or less may go undetected. Furthermore, quarterly GDP data are subject to considerable revision.

To cut to the chase, Baron Point’s analytical work indicates that a recession probably started in the U.S. in the first quarter of 2008, and growth is clearly slowing around the world. This was subsequent to the tops that occurred in most of the equity indices which ultimately peaked in the September to October 2007 time frame (e.g. approximately four months ahead of the U.S. economy rolling over and emerging market growth clearly slowing).

Let’s analyze what measurements are actually used by the National Bureau of Economic Research (“NBER”) in the United States to provide a determination for a “**recession**”. The NBER looks at a more comprehensive set of data, which includes employment, industrial production, real income, and wholesale-retail sales.

The NBER places particular emphasis on two monthly measures of activity across the entire economy broken into four areas: (1) personal income less transfer payments, in real terms and (2) employment. In addition, the NBER refers to two indicators with coverage primarily of manufacturing and goods, those are: (3) industrial production and (4) the volume of sales of the manufacturing and wholesale-retail sectors adjusted for price changes.

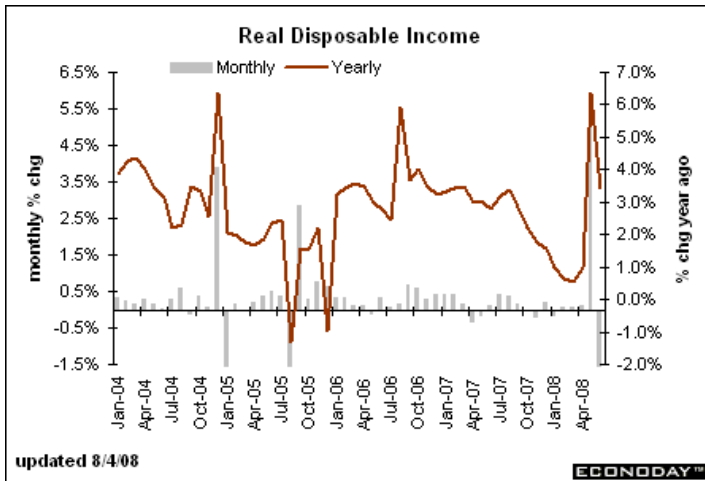
The NBER defines a recession as the time when business activity has reached its peak and starts to fall until the time when business activity bottoms out. When the business activity starts to rise again it is called an economic “**expansion**”. By this definition, on average, a recession has lasted about one year in America, peak to trough.

When Baron Point analyzes these four key indicators that define the broad contours of business activity in America, it seems clear they all peaked and began to roll over sometime between October 2007 and February 2008. Therefore, Baron Point is pretty convinced that when the NBER does make the final proclamation for a recession in America, the NBER will tell us that a recession officially began in the first quarter of 2008. A look at the following metrics gives you a clearer picture as to how Baron Point interprets this data.



Measures of Activity across the Entire Economy

(1) **Personal income less transfer payments, in real terms** (“Real Disposable Income”) tells us if there is wage pressure in the economy. Wage pressure occurs at full employment, a sure sign of economic expansion. When unemployment is low, workers can demand wage increases because worker replacement cost is higher than the current cost. A lack of wage pressure indicates slack in the labor market, which in turn indicates less than full employment.



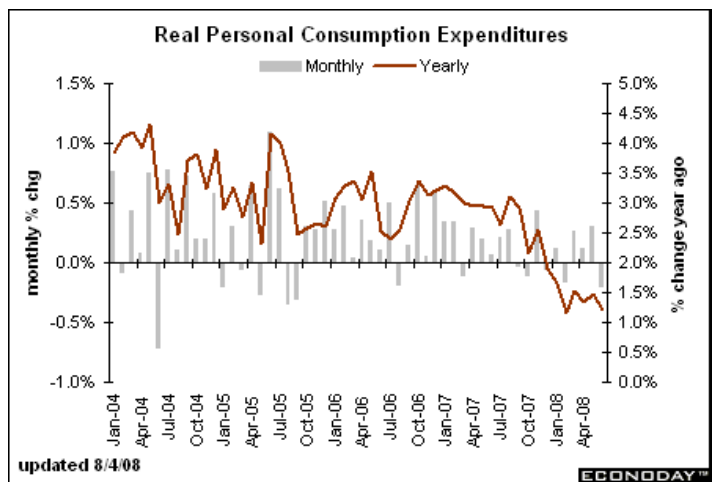
When unemployment is low, workers can demand wage increases because worker replacement cost is higher than the current cost. A lack of wage pressure indicates slack in the labor market, which in turn indicates less than full employment.

This chart looks good until one realizes that the large recent jump in real disposable income is a result of the large government stimulus checks (e.g. one-time income tax rebates by the Federal Government) that went out over the past few months in America.

Excluding the impact of the rebates and inflation, real disposable incomes was actually flat. In other words, without government help, incomes didn't increase at all, indicating there's no wage pressure and that the U.S. is nowhere near full employment.

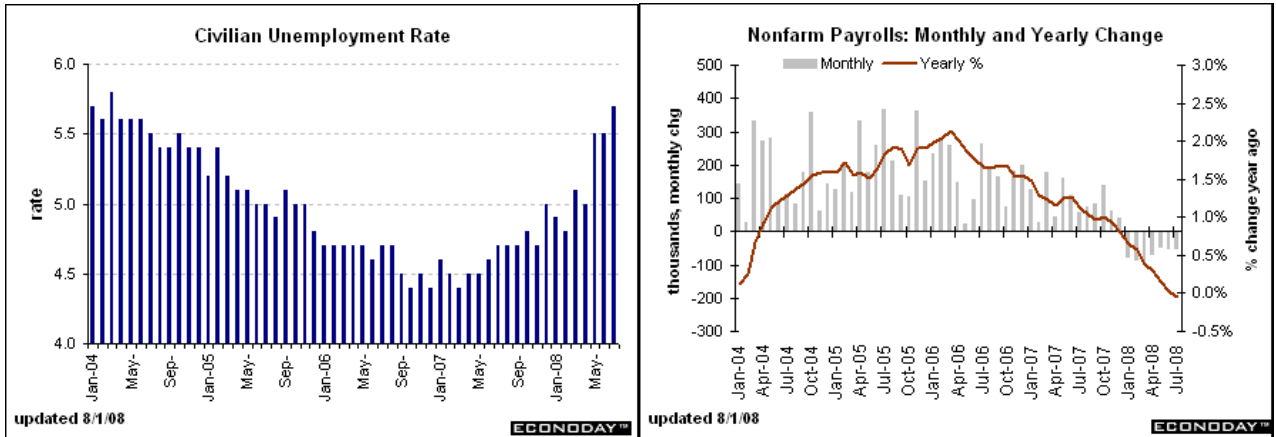
Now let's look at inflation-adjusted **personal consumption** expenditures (“Real Personal Consumption”). A trademark of recessions is a cutback in consumer spending and, as the chart to the right shows, consumers haven't been feeling good about spending for some time now.

In fact, they have systematically and continually decreased their consumption expenditures over the last year – a recessionary sign. This is especially troublesome for an economy whose growth is dependent on consumer spending, which accounted for 72% of the U.S.'s real GDP in 2007.

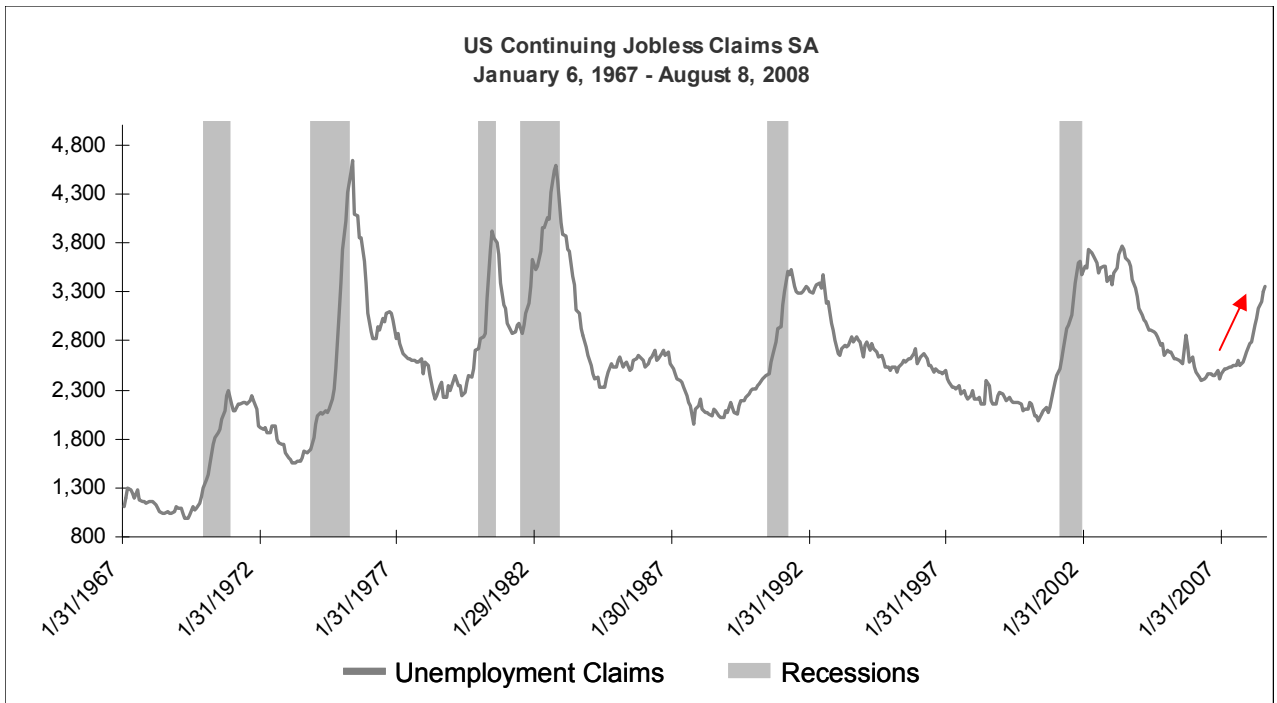




(2) Employment growth (“Nonfarm Payrolls” and “Civilian Unemployment Rate”) tells us if business is good. Optimistic businesses add employees; those not, downsize. At the moment, bleak projections prevail and the year-over-year rate of job growth has been dropping for the last two years. Additionally, the unemployment rate has been steadily increasing for a year and a half. Unemployment is clearly in an uptrend, and several of these important indicators are at levels usually seen during recessions.



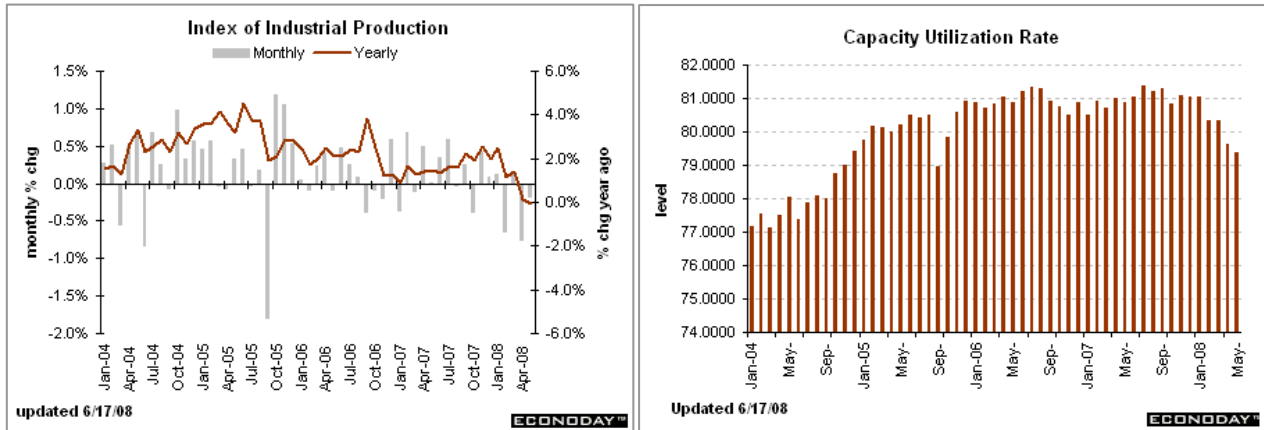
The number of people in the U.S. filing for unemployment is ramping up. This is a typical occurrence in recessionary phases.



Source: Bloomberg and the National Bureau of Economic Research



(3) **Industrial production** growth in the U.S. has been decreasing, and **capacity utilization** is decreasing.



(4) In the **Manufacturing Sector**, another new development is that Europe and export-led Asian economies are now seeing slower growth, as several major economies of the world go into simultaneous recessions, many of them with elevated inflation as well. These factors will inhibit the growth rate of U.S. export sales, which in turn will harm overall U.S. GDP growth:

- In August, Singapore cut its 2008 growth forecast for a 2nd time this year, joining Asian neighbors in signaling a deeper slowdown. According to Prime Minister Lee Hsien Loong, Singapore's economy will expand between 4% - 5%, from an earlier estimate of 4% - 6%. Growth was 7.7% in 2007.
- Also in August, Japan's government said that its economy -- the world's second-largest -- is weakening for the first time since 2001. According to a Bloomberg News survey, gross domestic product in Japan probably shrank an annualized 2.3% in the three months ended June 30, 2008.
- Governments in Asian export-led economies from Malaysia to Thailand have been lowering their 2008 growth forecasts since the start of this year as the impact of the U.S. slowdown spreads and soaring oil and food prices have a negative impact.
- In China, economic growth slowed for a fourth straight quarter in the three months to June 30, expanding 10.1%. Growth below 9% is considered to be "unacceptable" for a government targeting 10 million new jobs a year, Credit Suisse Group reported in August. In response, on August 25, Forbes citing Beijing's XFN-ASIA is reporting that China is considering a 370 billion Yuan economic stimulus package and 150 billion worth of tax cuts to stimulate the economy.
- According to Moody's economy.com unit on August 15th, "the flash second quarter 2008 GDP data for the euro zone noted a 0.2% quarter-on-quarter contraction, following a 0.7% expansion in the first three months of the year. This was primarily the result of a 0.5% downturn in the region's largest economy, Germany, and a 0.3% contraction in second biggest, France."
- The Bank of England is now forecasting a flat (0%) GDP over the next year.
- Italy's economy unexpectedly shrank in the second quarter, edging it closer to a fourth recession in a decade as households and businesses struggle to cope with more expensive oil. The economy, the fourth-largest in Europe, contracted 0.3% after expanding 0.5% in the first quarter.
- At the same as this, inflation in Europe is running at 3.6%.



So, to summarize this section, according to the NBER's far broader measure of economic activity, Baron Point notes the following facts:

- Personal incomes adjusted for inflation and not including the transfer payments are decreasing.
- The year-over-year percentage change in job growth has been decreasing for several years, the unemployment rate has been increasing for a year and a half, and the number of people in the U.S. who are filing for unemployment is ramping very similar to prior recessions.
- Industrial production has been decreasing for the last nine months, and capacity utilization is decreasing.
- Europe and Asia are experiencing slower growth with some important countries experiencing simultaneous recessions with the U.S. in Europe and likely Japan. This will negatively impact U.S. exports which have been one of the only bright spots over the last year or so. This is a new development and adds to the problems the U.S. economy faces going forward.

Now, let's discuss the credit markets and other macro factors Baron Point is considering.



Credit Market Fallout

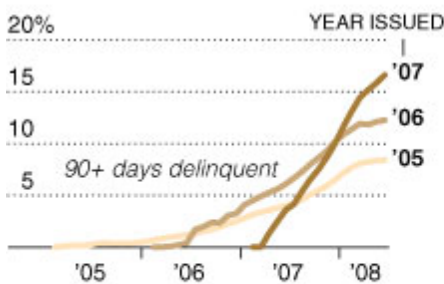
In addition, we note the continuing problems in the credit markets and the continuing fallout from the U.S. housing market contraction and the securitization lead credit crunch.

Mortgage problems continue...

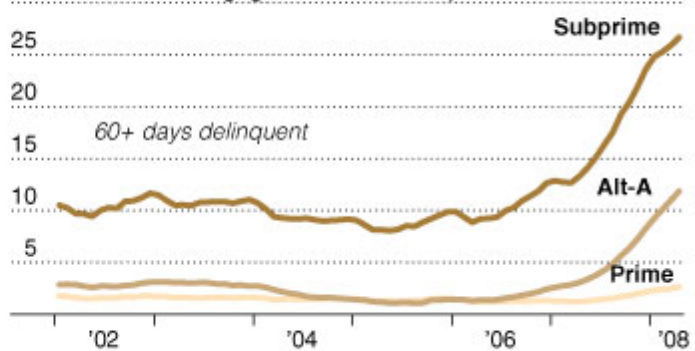
Mortgage Troubles Spread

In the last few months, delinquencies and foreclosures in subprime mortgages have started to slow. But defaults on alternative-A and prime loans, which make up a much bigger part of the market, are still rising.

Share of subprime mortgages that are delinquent

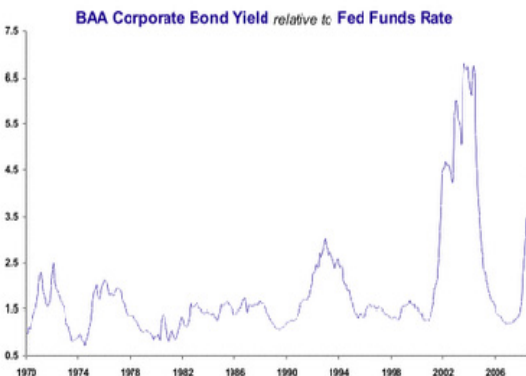
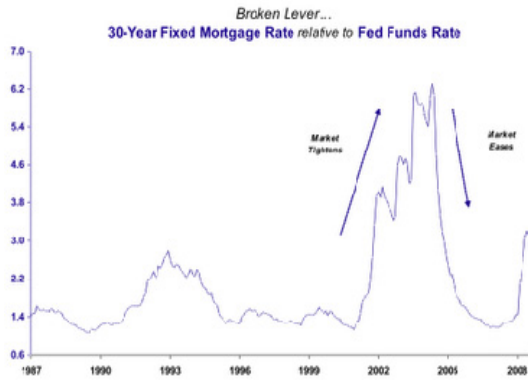


30% Share of mortgages that are delinquent



Sources: CreditSights; First American Loan Performance

...the credit markets continue to frustrate Federal Reserve policy at every turn, moving in opposition to the Fed funds and resultant discount rate cuts.



Credit Default Swap Upfronts

Also, as reported by *Markit*, a credit derivative pricing authority, the comparison of “upfronts” for credit default swaps from the March 2008 peak to August 14, 2008 reveals that although spreads are now tighter than in March, the number of names trading upfront has increased.

March 17	Total	August 14	Total
Communications & Technology	13	Communications & Technology	9
Consumer Cyclical	20	Consumer Cyclical	28
Consumer Stable	3	Consumer Stable	3
Financial	17	Financial	19
Industrial	5	Industrial	6
Materials	9	Materials	8
Total	67	Total	73

Comparison of upfronts from March CDSpeak.

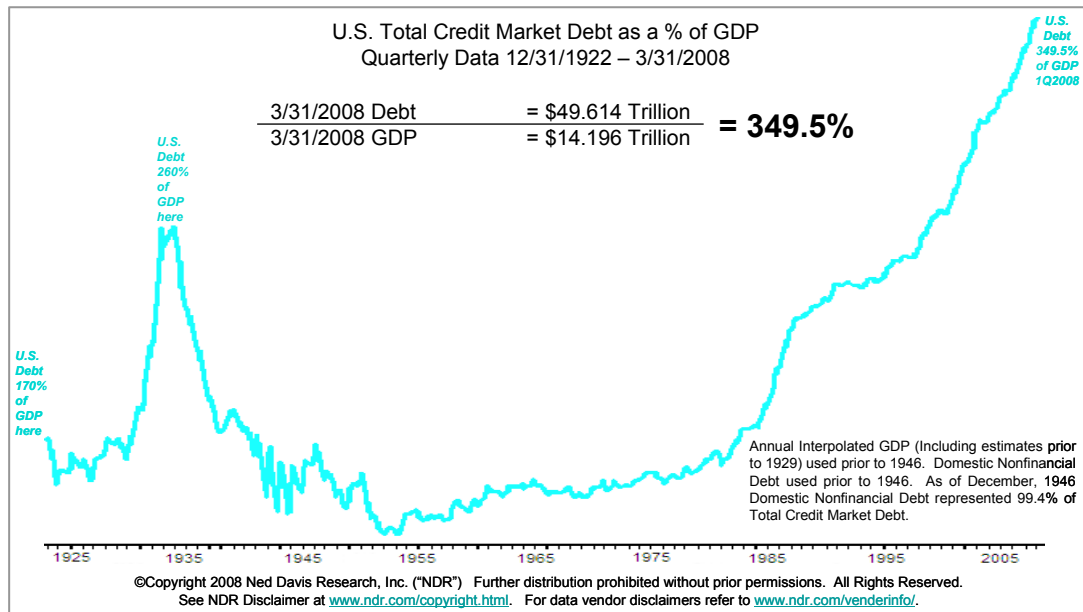
(Credit default swaps typically trade on an upfront basis when concerns grow that a default is more likely, as sellers of protection grow nervous that a default could happen before they receive the quarterly premiums for the insurance. The more wary the seller, the higher the upfront.) Most of this increase is due to the decline of the consumer discretionary sector’s creditworthiness. Many of these names - notably homebuilders and car producers -



have been in trouble for some time. However, now they have been joined by other less familiar names in the consumer sector. This could be a sign that credit woes are broadening. We monitor for signs of further deterioration.

U.S. Peak Credit and Overconsumption

The U.S. has undergone a long boom and the boom is over for now. Most booms are a result of easy credit that finally goes bust as loose credit and poor lending standards become too pervasive and unsustainable. *Ned Davis Research* provides the chart below which depicts the extent of the credit growth that occurred in the U.S. This resulted in tremendous overconsumption as U.S. debt as a percentage of U.S. GDP reached 349.5% as of the first quarter of 2008.



Overconsumption was caused by Main Street America's shift from income-to asset-based saving, and Wall Street was there to support and encourage the effort, geometrically, with innovative structures and securitized instruments. The buying binge enabled income-short American consumers not only to squander income-based saving but also to push consumption up to a record 72% of real GDP in 2007. A breathtakingly mountainous chart of record debt resulted to say the least. Like most boom bust cycles, a lot of decisions along the way were not based on objective conditions, but on flawed interpretation of those conditions and blatant greed. The longer it lasted, the more deeply ingrained it became in the American psyche. Now this seems finally over and a contraction in the economy and the markets, Wall Street to Main Street, Shanghai, London to New York, works its way around the globe.

We note that this was not just a U.S. phenomena. It was also enabled by Europe and export-led Asia who happily accommodated the situation. European institutions financed a great deal of securitized product, more than any other region of the world, and "reached for yield". European commercial and central banks still holds many of these toxic instruments, today.

As for Asia, U.S. overconsumption produced export-led growth for the region and growth was encouraged. This growth was at a much faster pace than Asia's developing economies could have produced in domestic consumer markets or by pursuing foreign opportunities in their own right. Therefore, the global boom of 2002 to mid-2007 was an outgrowth of powerful cross-border linkages, and each region played its exploitive role during the boom time, now impacted adversely by a bust.

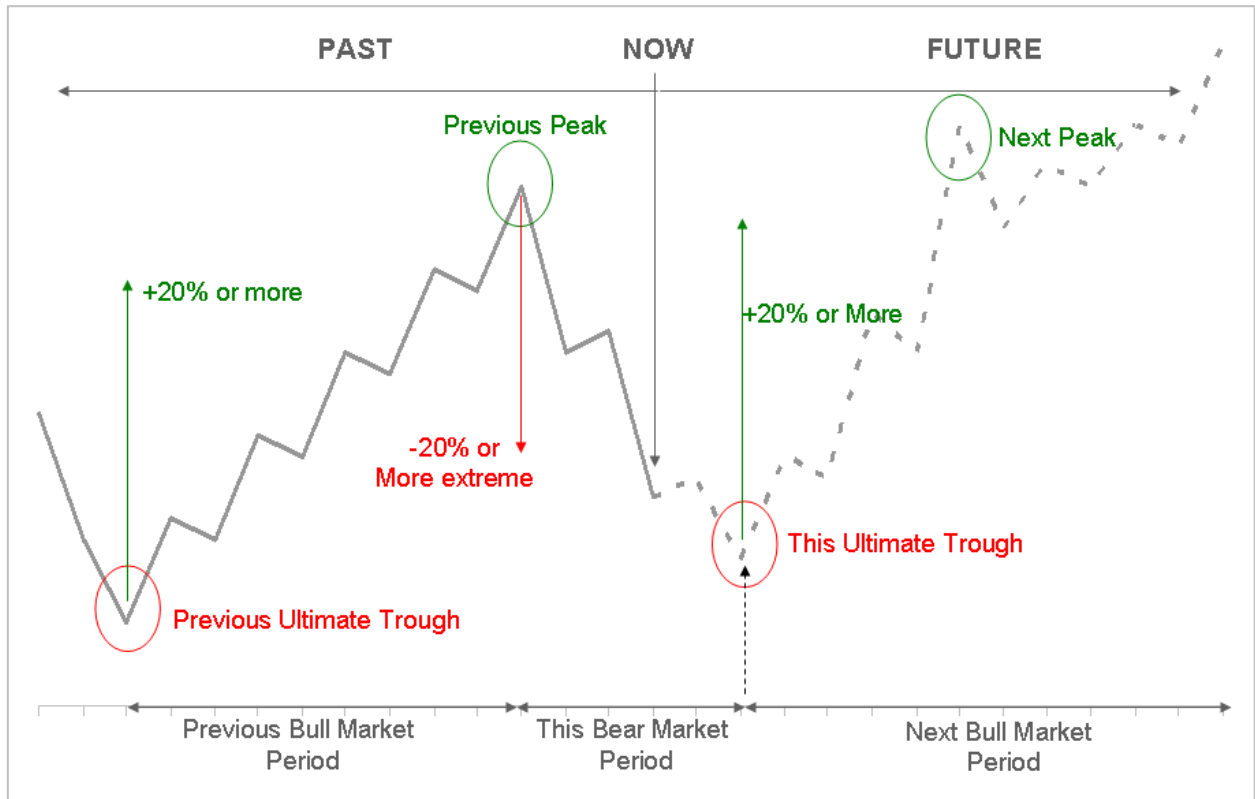
Based upon all the above our conclusion seems clear. The U.S. economy is in recession with simultaneous recessions occurring in Europe and Japan, and emerging Asia slowing to a great degree while inflationary pressures exert themselves threatening a stagflation environment. Baron Point believes that the risks to the downside are still greater than upside potential at this juncture in this bear market, the equity market downtrend confirms this belief.



Part II — How Long Could This Bear Last and How Deep Could It Be?

Below we show you the simple conventional definition of a Bear Market, which is a 20% decline from its previous peak.

A bear market has been confirmed, now, in terms of price by all major averages, with the S&P 500 confirming its Bear market on July 9, 2008 and the Dow Jones Industrial Average closing below its Bear market level on July 2, 2008.



Source: Baron Point Financial, Ltd.

There have been 37 bear markets since 1856 (this bear market being the 38th). Baron Point used 1856 as a beginning point because the NBER starts with this period for its reference data for the business cycle in America on their web site (<http://www.nber.org/cycles.html>) (e.g. the first economic expansion depicted by the NBER commenced in December 1854 with a recession starting in June 1857).

Baron Point used the Dow Jones Industrial Average (the "Dow") data as a proxy for the equity market in the U.S. for this study as it is the longest continuous data series to be published for a U.S. stock index. The Dow was first published on May 26, 1896 using daily data. Baron Point used surrogate monthly data sets prior to the Dow's existence and prefixed those back to the actual Dow data series. The prior data was cross referenced and correlated with other indices in America, during those periods, to verify for accuracy.



Bear Market Profile

As you can see below, since 1856, when measuring the past 37 Bear Markets, the average Bear market has lasted 12.7 months and shaves 33.76% off of the Dow. You will note that 12 bear markets are fairly ephemeral, lasting less than 6 months. As shown in **bold**.

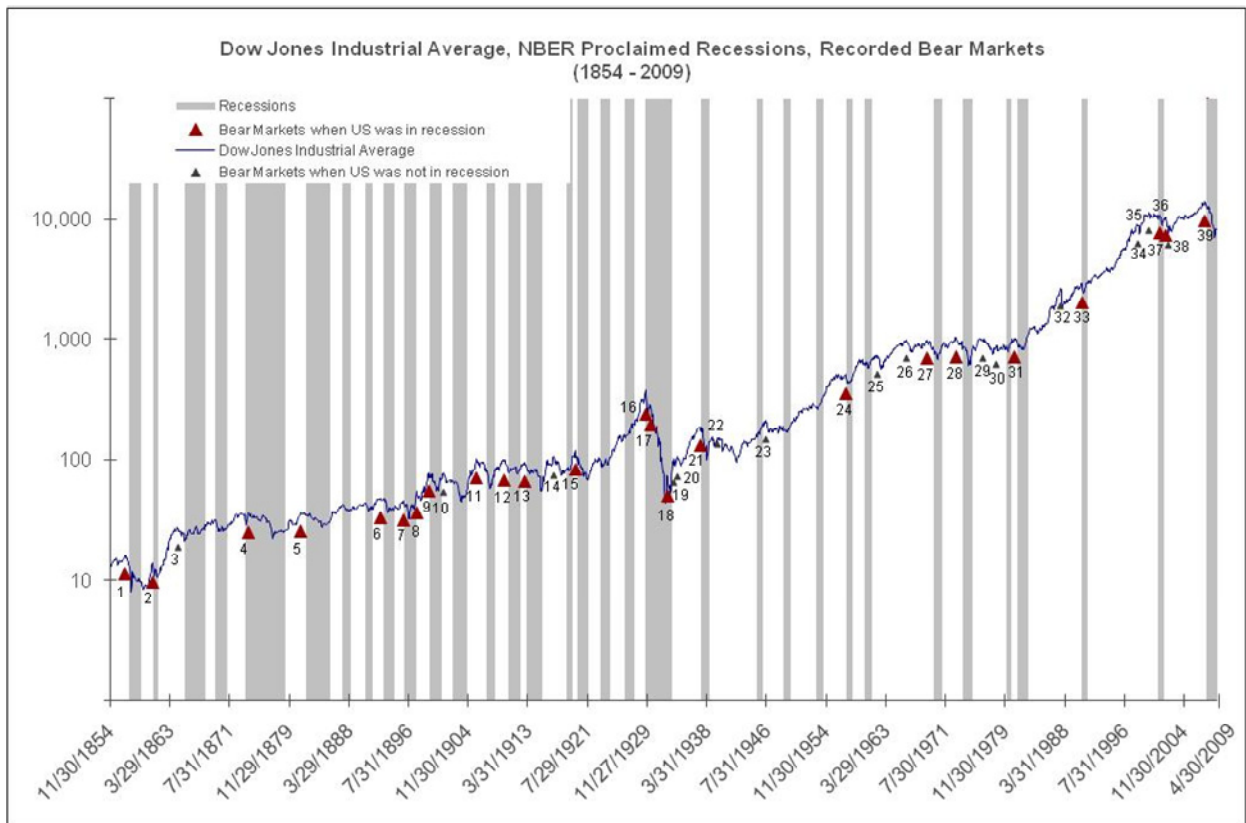
All Bear Markets Since 1856 (Dow Jones Industrial Average)										
Bear No.	Start Date			End Date			Length (months)	Start Value	End Value	% Change
1	31	December	1856	31	October	1857	10.0	15.94	7.99	-49.87%
2	30	September	1860	31	May	1861	8.0	13.81	10.50	-23.97%
3	30	March	1864	31	March	1865	12.0	27.23	21.07	-22.62%
4	27	February	1874	29	June	1877	40.1	35.68	22.08	-38.12%
5	30	June	1881	30	June	1884	36.0	36.24	27.21	-24.92%
6	31	August	1892	31	August	1893	12.0	47.04	35.50	-24.53%
7	31	October	1895	7	August	1896	9.2	45.09	28.66	-36.44%
8	10	September	1897	25	March	1898	6.5	55.82	42.00	-24.76%
9	25	April	1899	24	September	1900	17.1	77.14	52.96	-31.35%
10	17	June	1901	9	November	1903	28.7	78.26	42.15	-46.14%
11	19	January	1906	15	November	1907	21.9	103.00	53.00	-48.54%
12	19	November	1909	25	September	1911	22.2	100.53	72.94	-27.44%
13	30	September	1912	24	December	1914	26.8	94.15	53.17	-43.53%
14	21	November	1916	19	December	1917	12.9	110.15	65.95	-40.13%
15	31	October	1919	25	August	1921	21.8	118.92	63.91	-46.26%
16	3	September	1929	13	November	1929	2.3	386.10	195.35	-49.40%
17	16	April	1930	8	July	1932	26.7	297.25	40.56	-86.35%
18	8	September	1932	27	February	1933	5.6	81.39	49.68	-38.96%
19	18	July	1933	20	October	1933	3.1	110.53	83.57	-24.39%
20	5	February	1934	26	July	1934	5.7	110.53	83.57	-24.39%
21	10	March	1937	31	March	1938	12.7	195.59	97.46	-50.17%
22	13	September	1939	10	June	1940	8.9	155.89	110.41	-29.17%
23	29	May	1946	30	October	1946	5.0	213.36	160.49	-24.78%
24	16	July	1957	22	October	1957	3.2	523.11	416.15	-20.45%
25	15	November	1961	25	June	1962	7.3	741.30	524.55	-29.24%
26	9	February	1966	10	October	1966	8.0	1001.11	735.74	-26.51%
27	2	December	1968	26	May	1970	17.8	994.65	627.46	-36.92%
28	11	January	1973	9	December	1974	22.9	1067.20	570.01	-46.59%
29	22	September	1976	1	March	1978	17.3	1026.26	736.75	-28.21%
30	11	September	1978	27	March	1980	18.5	917.24	729.95	-20.42%
31	27	April	1981	9	August	1982	15.4	1030.98	769.98	-25.32%
32	25	August	1987	20	October	1987	1.8	2746.65	1616.40	-41.15%
33	17	July	1990	11	October	1990	2.8	3024.26	2344.31	-22.48%
34	17	July	1998	1	September	1998	1.5	9412.60	7379.70	-21.60%
35	14	January	2000	22	March	2001	14.3	11750.30	9106.97	-22.50%
36	22	May	2001	21	September	2001	4.0	11347.00	8062.34	-28.95%
37	19	March	2002	24	July	2002	4.2	10673.10	7532.73	-29.42%
38	22	August	2002	10	October	2002	1.6	9076.94	7197.49	-20.71%
39	11	October	2007	9	March	2009	16.9	14280.0	6440.1	-54.90%
					Median		12.0			-29.17%
					Average		13.1			-34.14%

Source: Baron Point Financial, Ltd. and Dow Jones & Co.



Bear Markets and US Recessions

Next, we contrast Bear markets in the Dow with U.S. recessions as identified by the NBER. Below is a logarithmic chart of the Dow showing periods of economic recession in gray. This chart also depicts where Bear markets have begun. The large triangle shows the periods where a U.S. recession coincides with a bear market. The smaller triangles represent when only a bear market in stocks occurred.



Note: Chart revised through 1st Quarter of 2009

Source: Baron Point Financial, Ltd., Dow Jones & Co., and the National Bureau of Economic Research



Bear Market Profile when the US Economy is *not* in a Recession

Valuations have not really been a distinguishing factor in predicting further declines in bear markets. “In fact, lower P/Es at the Bear mark were more associated with longer bear markets”, according to *JPMorgan North American Equity Research* issued on July 11, 2008.

This being the case, Baron Point first contrasts the duration and magnitude of a Bear market when there is no recession, only a bear market in stocks. This occurred 14 times out of the prior 37 bear markets, with only 3 of these types of bear markets (21.4% of them) being greater than **30%** as depicted in ***bold*** (in italics and bold)

Of note, only one time did a Bear market exceed **45%** (in italics, bold, and underlined) when the U.S. was not in recession.

All Bear Markets when us is <i>not</i> in a Recession										
Bear No.	Start Date			End Date			Length (months)	Start Value	End Value	% Change
3	30	March	1864	31	March	1865	12.0	27.23	21.07	-22.62%
10	17	June	1901	9	November	1903	28.7	78.26	42.15	-46.14%
14	21	November	1916	19	December	1917	12.9	110.15	65.95	-40.13%
19	18	July	1933	20	October	1933	3.1	110.53	83.57	-24.39%
20	5	February	1934	26	July	1934	5.7	111.93	84.58	-24.43%
22	13	September	1939	10	June	1940	8.9	155.89	110.41	-29.17%
23	29	May	1946	30	October	1946	5.0	213.36	160.49	-24.78%
25	15	November	1961	25	June	1962	7.3	741.30	524.55	-29.24%
26	9	February	1966	10	October	1966	8.0	1001.11	735.74	-26.51%
29	22	September	1976	1	March	1978	17.3	1026.26	736.75	-28.21%
30	11	September	1978	27	March	1980	18.5	917.24	729.95	-20.42%
32	25	August	1987	20	October	1987	1.8	2746.65	1616.40	-41.15%
34	17	July	1998	1	September	1998	1.5	9412.60	7379.70	-21.60%
35	14	January	2000	22	March	2001	14.3	11750.30	9106.97	-22.50%
					Worst Bear		28.7			-46.14%
					Median		8.5			-25.64%
					Average		10.4			-28.66%

Source: Baron Point Financial, and Ltd. and Dow Jones & Co.



Bear Market Profile when the US Economy *is* in a Recession

To contrast, when a bear market in stocks coincides with a U.S. economic recession, indeed the Bear can be more treacherous. Baron Point research shows that a bear market in stocks combined with a U.S. recession is 37.87% longer in duration and -8.21% deeper in magnitude, on average.

A bear market in stocks which coincides with a U.S. recession can be far more risky. On 13 occasions out of the 23 times, or over 56.5% of the time this simultaneous bear/recession condition was present, the Bear was down significantly greater than **30%**. Seven times it exceeded **45%** (in italics, bold, and underlined).

Bear Markets when US <i>is</i> in a Recession										
Bear No.	Start Date			End Date			Length (months)	Start Value	End Value	% Change
1	31	December	1856	31	October	1857	10.0	15.94	7.99	-49.87%
2	30	September	1860	31	May	1861	8.0	13.81	10.50	-23.97%
4	27	February	1874	29	June	1877	40.1	35.68	22.08	-38.12%
5	30	June	1881	30	June	1884	36.0	36.24	27.21	-24.92%
6	31	August	1892	31	August	1893	12.0	47.04	35.50	-24.53%
7	31	October	1895	7	August	1896	9.2	45.09	28.66	-36.44%
8	10	September	1897	25	March	1898	6.5	55.82	42.00	-24.76%
9	25	April	1899	24	September	1900	17.1	77.14	52.96	-31.35%
11	19	January	1906	15	November	1907	21.9	103.00	53.00	-48.54%
12	19	November	1909	25	September	1911	22.2	100.53	72.94	-27.44%
13	30	September	1912	24	December	1914	26.8	94.15	53.17	-43.53%
15	31	October	1919	25	August	1921	21.8	118.92	63.91	-46.26%
16	3	September	1929	13	November	1929	2.3	386.10	195.35	-49.40%
17	16	April	1930	8	July	1932	26.7	297.25	40.56	-86.35%
18	8	September	1932	27	February	1933	5.6	81.39	49.68	-38.96%
21	10	March	1937	31	March	1938	12.7	195.59	97.46	-50.17%
24	16	July	1957	22	October	1957	3.2	523.11	416.15	-20.45%
27	2	December	1968	26	May	1970	17.8	994.65	627.46	-36.92%
28	11	January	1973	9	December	1974	22.9	1067.20	570.01	-46.59%
31	27	April	1981	9	August	1982	15.4	1030.98	769.98	-25.32%
33	17	July	1990	11	October	1990	2.8	3024.26	2344.31	-22.48%
36	22	May	2001	21	September	2001	4.0	11347.00	8062.34	-28.95%
37	19	March	2002	24	July	2002	4.2	10673.10	7532.73	-29.42%
38	22	August	2002	10	October	2002	1.6	9076.94	7197.49	-20.71%
					Worst Bear		26.7			-86.35%
					Median		12.4			-33.89%
					Average		14.6			-36.48%

Source: Baron Point Financial, Ltd. and Dow Jones & Co.



Bear Market Fallout for Other Fund Managers

The current Bear market seems to have caught many fund managers unprepared. Hedge funds got off to their worst start in nearly two decades in 2008. It is estimated that more than 500 hedge funds have gone bust during the past twelve months.

The Hennessee Group's Hedge Fund Index is off -3.23% year-to-date, on course for its worst performance since the firm started tracking industry returns in 1987.

Above and to the right are just a few samplings of recent news clipping in the media, and below is a list of some less anonymous fund managers who have been clawed by the bear:



- Bill Miller -37.05%
- Eddie Lampert -28.95%
- Bill Nygren -27.96%
- Irving Kahn -24.68%
- Bill Ackman -23.06%
- Carl Icahn -21.00%
- George Soros -9.43%

At the extremes, many strategies of even large and seemingly invulnerable funds in retrospect appear to have involved an over-leveraged and hence inadequate capital base accompanied by poor — or poorly applied — risk control. This combination may have worked well during an extended period of easy credit or when equity markets were in a bullish uptrend, but more recently they clearly have been heavily slammed by a large and still evolving bear market. Moreover, this scenario has also recently been accompanied by a vicious selloff in commodity prices, the largest in 28 years. Such a fierce move, from what had become a seemingly unending upside trend hit commodity funds hard recently and these funds posted some of their worst one month performances in three decades during July.

Losses were not limited to hedge and commodity funds; mutual funds and venture funds also took a hit. The National Venture Capital Association reported that not one venture-backed company went public in the second quarter, the first time that has happened since 1978. Also, according to Morningstar, year-to-date, every one of its major stock mutual fund and foreign indexes is down for the year, including:

- Large Cap -10.49%
- Large Value -17.80%
- Large Growth -8.75%
- Mid Cap -7.13%
- Small Cap -2.62%
- MSCI AC Far East Ex Japan -25.23%
- MSCI EAFE -19.28%
- MSCI World Ex USA -18.11%

All of the above fallout is common with America in both a recession and a bear stock market environment.



Positioning for the Future

In summary, however, Bear markets come and Bear markets go. If one manages risk properly while trading nimbly, these periods need not be painful and costly. They can be profitable, albeit at smaller gains than during the Bull. More importantly, diligent risk control during the Bear leaves one better positioned to fully capitalize on the next Bull, which will come as surely as day follows night.

As such, our intention during the coming months is to:

- 1) Continue to apply capital carefully in the face of a continuing “whipsaw” environment in stocks. Just such an approach was applied by fund management in dealing with a period substantially like this before, namely during the bear market technology bust of 2000, when careful application of our trend-following approach succeeded in generating outsized returns; and also to
- 2) Sell short during interim rallies in stocks, while covering short positions in ensuing sell-offs, where we see that as well suited to the continuing uneven scenario we project for the intermediate term; and also to
- 3) Continue to look for selected long side sectors with strength, and within those, individual issues that offer at least 3 to 1 reward to risk entries; and also to
- 4) Constantly cut losers, ride winners, and manage risk, manage risk, manage risk.

Part III — Historical Measures and Current Fund Performance⁽¹⁾

Relevant Statistical and Index Definitions:

R: Ranging from -1 to $+1$, this is a statistical measure that represents how much of a strategy’s movement is explained by a market movement. A value close to $+1$ indicates positive correlation. A value of 0 indicates no correlation, and a value of -1 indicated negative correlation.

Russell 3000 Growth Index (DRI): The Russell 3000 Growth Dividend Reinvested Index measures the performance of a broad growth segment of the U.S. equity universe. It includes those Russell 3000 companies with higher price-to-book ratios and higher forecasted growth values. Baron Point is an absolute return strategy and does not benchmark, but this index can be thought of as a standard Baron Point uses to compare statics.

Hennessee Growth Index: Funds in this index typically have long and short equity positions in companies that exhibit an acceleration (or deceleration) of earnings growth, revenues, and market share. Baron Point is an absolute return strategy, and tends to be independently correlated and does not benchmark. This index can be thought of as one standard Baron Point uses to compare statics.

Relative Fund Performance:

On a total return basis, from when this Bear market began, September 2007 to July 2008 the:

- S&P 500% is down -12.41%
- Dow Industrials are down -12.93%%,
- NASDAQ Composite is down -10.42%, and
- Russell 3000 Growth Index is down -7.66%.

Baron Point, however, has conserved capital and continues to trade opportunistically and with positive results since the bear market began in September 2007. For the period September 2007-July 2008 inclusive, Baron Point is up 14.20%, whereas most of the markets, and many fund strategies are down double digits.

This lack of correlation to the overall market is one of the hallmarks of Baron Point. Given the rush of fund managers coming from the long only mutual fund arena, it seems that many hedge funds, claiming to be



Long/Short, are invested in a manner effectively correlated to the indices. This can be troublesome, especially in a bear market. It means that if the index dives, so do these Funds.

Baron Point has historically shown low correlation to the Russell 3000 Growth Index. In fact, statistics show that since inception of the strategy, 84% of its positive return is not simply explained by market moves, but instead by added value risk control and a careful eye for absolute returns.

The strategy has a track record in prior bear moves as well, namely where it gained 110% net of fees during the technology busted bear market of 2000-2002, when the Russell 3000 Growth Index was down -61% and the Hennessee Growth Index was down -27%. In terms of the statistics, "R" is a measurement of how much a strategy's movement is explained by a market's move, and Baron Point's R in the 2000-2002 bear market was 0.22. Or, 78% of Baron Point's positive performance was a result of risk control and added value absolute return, not market direction.

During the bull market period of 2002 to 2006 the strategy was up 250% (net of fees) when the market was up 57%. In this instance, its R was 0.35. Statistically, the strategy was effectively independent of the market's zigs-zags, on the way up as well.

Independent performance is again occurring in the current bear market of 2007 to the present. Baron Point's R during this time frame is -0.18. This means the strategy is actually 18% uncorrelated during the current bear market. In a market which is down -7.66%, Baron Point is up 14.20%.

Therefore, Baron Point could be considered independently correlated by this and other statistical measures, such as beta. Rather than being totally dependant on what the market does, the strategy produces added value absolute returns through superior risk control over varying market cycles, bull and bear, long or short.

If you would like to see the impacts of all this, examine Baron Point's monthly results since September 2007 in the attached Fact Sheet. If the Fact Sheet is not attached, please feel free to email us at info@baronpoint.net or call +1 212 248 2733 x701 and request it.

(1) Performance shown from November 2005 to date, has been audited through the period ending December 31, 2007 by KPMG and for a "Representative Trading Account" for the period August 1994 through October 2005. Past performance is not a guarantee of future results. This information must be read in conjunction with the Confidential Private Placement Memorandum.