Long/Short Equity 101

Objective

Long/short equity is designed to achieve equity-like returns with less volatility than the equity market, by profiting from stocks that are going up as well as those that are going down.

How it works

Long position. When managers purchase a stock because they believe it will rise in value, it is a long position. The goal is to capture an increase in value through this long position. In a long/short equity fund, managers buy the stock outright, just as in a traditional long-only equity fund.

Short position. When managers believe a stock will fall in price, they may establish a short position. In simplest terms, they borrow the stock (typically from a broker), sell the borrowed shares to another buyer and collect the proceeds. At an agreed-upon time, they must return the shares to the lender. If the price of the stock has declined, the manager will be able to purchase the shares in the open market at a lower price than those they sold. Shorting a stock is profitable if the stock price falls between the time it is borrowed and the time it is returned.

Potential benefits

Enhance return potential. Shorting provides more ways to generate returns from fundamental research and insights. Also, difficult markets can create headwinds for long-only managers. By varying the percentage of longs and shorts in a portfolio, a manager can adapt to changing market conditions.

Mitigate volatile markets. Long/short strategies may be particularly beneficial when there are wide disparities in stock performance. In such markets, the potential to benefit from both longs and shorts may increase.

*Reduce risk.** As part of a multi-faceted risk management process, managers can combine long and short strategies to potentially lessen the risks of individual positions. They can also diversify among short positions and employ other techniques in an attempt to mitigate downside.

Purchase equity outright; profitable when equity rises

Borrow equity, sell and buy back; profitable when equity falls

*Short positions do entail added risks, which should be discussed with a financial advisor.

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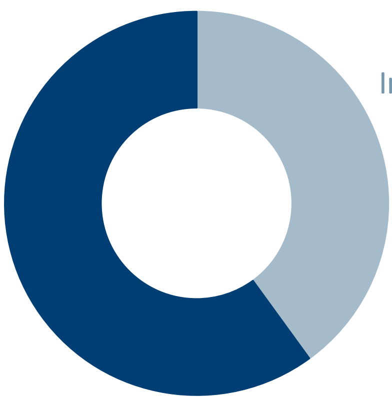
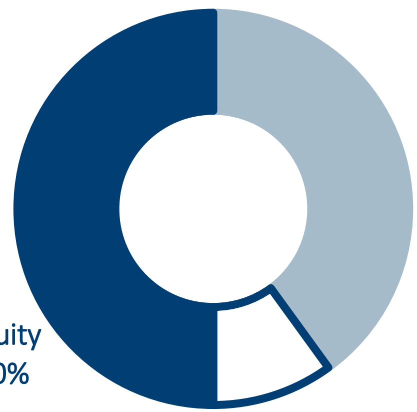
Long/short strategies can enhance the asset allocation mix

- Equity-like returns with superior risk profile over a full market cycle
- Capital preservation through periods of financial stress
- Scope for alpha on both the long and short side; beta actively managed with exposures

Hypothetical portfolio allocation based on traditional 60% equity/40% fixed income





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Long/short equity risks. The principal risks of investing in long/short equity strategies include: equity securities risk—securities markets are volatile and market prices may decline generally; short sale risk—a portfolio may incur a loss without limit as a result of a short sale if the market value of the security increases, or a manager is unable to repurchase a borrowed security; leverage risk—certain transactions such as loans and securities lending may create leverage and cause the portfolio to be more volatile; foreign securities risk—fluctuations of exchange rates may affect the U.S. dollar value of a security.

Alpha is the measurement of performance on a risk adjusted basis. A positive alpha shows that performance of a portfolio was higher than expected given the risk. A negative alpha shows that the performance was less than expected given the risk. **Beta** is an historic measure of a fund's relative volatility, which is one of the measures of risk; a beta of 0.5 reflects 1/2 the market's volatility as represented by the fund's primary benchmark, while a beta of 2.0 reflects twice the volatility.

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