DOW JONES
Hedge Fund Trades

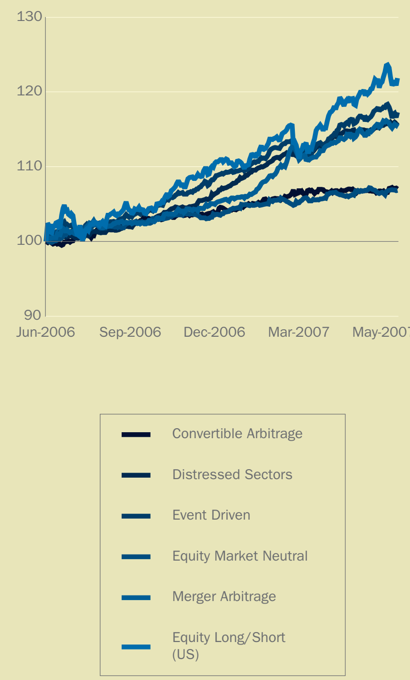
CHARTING THE STRATEGIES OF ABSOLUTE RETURN MANAGERS JUNE 18, 2007

DEBT

Converts Pull Balancing Act As Rates, Volatility Climb

The recent spike in volatility has been undermined by the increase in interest rates. Performance enhancers include investing in Asia and in small-cap names. p. 2

DJHFSB Daily Estimates (52 wk)*



DJHFSB Weekly Returns

Index	Value	Week (%)	YTD (%)	52-wk (%)
DJ Wilshire 5000	55.32	0.46	8.2	26
DJ Corp Bond Index	194.92	-0.46	-0.3	5.3
Convertible Arbitrage	134.39	-0.04	2.2	7
Distressed Securities	188.19	0.16	6.8	16
Equity Market Neutral	111.29	-0.05	2.3	6.8
Event Driven	151.71	0.22	7.1	17.3
Merger Arbitrage	135.73	0.33	9.4	15.8
Equity Long/Short	126.03	0.55	10.1	21.8

As of 6/13/07

* Estimates normalized to reflect $100 invested in each index at start of 52-week cycle.

The above listing of Dow Jones Hedge Fund Strategy Benchmarks (DJHFSB) components is current as of the date stipulated.

Source: DJHFSB

Converts Pull Balancing Act As Rates, Volatility Climb

The recent spike in volatility has been undermined by the increase in interest rates. Performance enhancers include investing in Asia and in small-cap names.

BY MARA LEMOS STEIN

The spike in market volatility this month has been a blessing for hedge funds in convertible arbitrage, but the companion interest-rate rise that caused the higher volatility is a negative for the trade.

On balance, though, it seems managers are quickly readjusting their interest-rate hedges and coming out ahead to pick up some performance on the back of the volatility. The convertible arbitrage component of the Dow Jones Hedge Fund Strategy Benchmarks recorded a 0.65% positive return in the month through June 12, the best of all six style-pure strategies tracked by the index. That reverses the negative 0.4% return of May, the worst in the index for that month, and an almost flat performance in April, when the strategy was up 0.16%.

Volatility is one of the key factors influencing performance of convertible arbitrage, as higher volatility increases the value of the option embedded in the security. But the upward shift in the yield curve has a negative impact in the convertible bonds, with any rise in long-term interest rates hurting the value of the bond, a risk usually hedged out with Treasury futures, said hedge fund managers and traders in the strategy. In the convertible world, the relationship between interest rates and a bond is

Continued on page 15

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Barely In The Black: Eastbourne's Offshore Fund Struggles

■ *The long/short shop has seen some of its equity investments go sour, and at least one of its funds is taking a huge hit in performance. That fund has sold some of its stakes recently.*

BY JOSEPH CHECKLER

Eastbourne Capital has been selling some of its equity positions this year in an apparent effort to reverse sagging performance in at least one of its hedge funds.

San Francisco-based Eastbourne's Black Bear Offshore fund was up just 0.3% through April 26, according to the most recent data available from Swiss bank Syz & Co. Some of Eastbourne's largest holdings, including that of struggling biopharmaceutical firm Telik Inc., were among the positions the fund recently trimmed.

A person close to Eastbourne would not comment on the fund's performance but did say that the firm's $3.1 billion assets under management have not gone down. Besides the Black Bear Offshore Fund, Eastbourne runs three other funds: Black Bear Fund I, Black Bear Fund II and Horse Eye Level Partners Fund. The Horse Eye fund was launched in 2006. The performance of these funds could not be found in a search of hedge fund databases.

During the first quarter, Eastbourne sold out of equity positions or reduced them by almost $900 million, while spending less than $30 million to make new investments or add to existing positions. That is according to data from FactSet Research Systems Inc., which culls data from Securities and Exchange Commission filings.

According to Eastbourne's SEC 13F quarterly holdings reports, the market value of its equity positions went from $3.1 billion at the end of the third quarter of 2006, to $2.8 billion at the end of 2006, to just under $2 billion at the end of the first quarter of 2007.

Since Eastbourne says its assets under management have not changed, the data suggests that the fund is deploying its money in some nonequity positions. The fund would not comment on where it is deploying those assets.

The Black Bear Offshore fund's rough start to 2007 comes after the fund returned just 0.09% in 2006. In fact, the past year and a half represents the first rough patch for the Black Bear Offshore fund, which had a net asset value of $479.6 million as of March 31, according to Syz & Co. The bank's numbers show that the Black Bear Offshore fund returned 24.32% in 2005 and 16.7% in 2004.

One of the fund's biggest losses came in the stock of Telik, which plunged from as much as $20.06 last October to less than $5 in December, when its Telcyta cancer drug failed a key trial. Eastbourne's stake of more than 10 million shares dropped in value by more than $150 million. SEC Schedule 4 filings show that the Black Bear Offshore fund was the Eastbourne fund that owned Telik shares. Form 4 filings are required when investors own more than 10% of a security. Back in May, Eastbourne reported in an SEC filing that it held 10.4 million Telik shares, down from 15.7 million at the end of the first quarter.

Other Eastbourne sales were of shares of companies that have been strong or neutral performers recently. Sometime during the first quarter, Eastbourne cut its 10.2 million-share stake in Coca Cola Co. by 4.3 million shares, a $220.8 million change in market value. Coca Cola's stock was hovering around $48, though it recently rose above $50. Eastbourne also sold more than $100 million worth of its stakes in energy companies El Paso Corp. and Talisman Energy Inc., two stocks that had been trading flat in the early part of 2007. In fact, Eastbourne sold $400 million worth of its energy holdings in the first quarter, making that the largest sector of its divestments in that period.

Eastbourne's top equity position is in Amylin Pharmaceuticals Inc., which took up more than one-third of its equity portfolio as of the end of the first quarter. Biotechnology stocks in general account for more than 40% of the portfolio.

Eastbourne was spun off from Robert Stephens Investment Management in 1999, by Rick Barry. Calls to investors in Eastbourne's funds, which include the J.P. Morgan Multistrategy Fund and General Motors Asset Management, were not returned. ■

Light Metal Might: Aluminum Readies For Action

Long a lightweight performer among metals, aluminum may be about to get its six pack on. Price stability makes it attractive for new entry, and discretionary traders are eyeing long-term trends.

BY MARA LEMOS STEIN

Amid the frenzy of hedge funds getting into industrial metals in recent years, aluminum has been relegated to the junkyard of trades because its high inventories and balanced supply and demand situation make it more difficult to support a price rally, or even a potential market squeeze. But the metal may be getting ready to claim its place in the hedge fund sun as some managers suggest a trade in the aluminum curve.

For funds in the commodities space, the relative apathy of the market may be a good entry point for some potential price rise starting in the second half of this year, as global growth gathers pace. Aluminum has been one of the dullest metals in the scintillating base metals market of the past two years, hedge fund managers and traders say. It failed to follow other base metals in the London Metals Exchange complex, such as copper, zinc and nickel, to multiyear highs because, unlike those metals, aluminum has steady supply and sufficient inventories to meet consumption for at least one month, compared with production deficits for nickel and zinc.

And then there is the China factor. China's hunger for base metals has been behind the surge in demand for most metals, but it is a major global producer of aluminum and a net exporter, set to produce 12.4 million tons of primary aluminum this year, a 32% increase from last year, said an analyst with a consultancy of the China Non-Ferrous Metals Industry Association earlier this month. A recent shortage in alumina, a main input in aluminum production, has also eased thanks to growing Chinese output of the raw material, eliminating that market constraint.

But for hedge fund managers who take a discretionary approach to commodities, whereby they trade based on fundamental analysis, the opportunity is a long-term take on aluminum.

"It's been a more exciting base metal insofar as the back end of the [price] curve is concerned," said Jean-Marc Bonnefous, founder of **Tellurian Capital Management**, a diversified discretionary commodities hedge fund in London. "You have a situation because there is very strong demand projected for 2009 and 2010, but the dynamics of the market are that, more than the other metals, aluminum is a very energy-intensive industry," said Bonnefous.

There are many smelters slated to start up at the end of this decade, especially in the Middle East where access to affordable energy isn't a problem, but LME aluminum contracts for 2010 and 2011 delivery have flirted with higher prices than for shorter-term contracts, suggesting some doubt that supply will continue to meet demand that far down the road. And as energy prices are expected to remain high, aluminum prices will need to move higher to make production profitable. "We might see the emergence of an energy premium in the back of the aluminum [price] curve," said Bonnefous.

In that case, Bonnefous suggests a spread trade by selling medium-term LME contract for 15 months or 27 months delivery, and going long anything beyond 2010. "That could be a fairly good return," he said. "If there is one metal that can get a flat curve, it's aluminum." For now, the curve is in backwardation, with front months trading at higher prices than forward months. The LME 15-month contract traded at around $2,660/ton and the 27-month at $2,540/ton, while aluminum for December 2010 was at $2,400 and for December 2011 at $2,260/ton.

Going short a spread in the LME is known among traders as "lending the spread." The lenders, or short sellers of the spread, will come out as winners in the trade if the curve flattens because they can buy back the position at a tighter spread.

Barclays Capital had been advising traders to take a look at the back end of the aluminum price curve for more than a few months. However, the gradual "creep up" of the back end of the curve

Continued on page 16

Double Feature: Making Millions On Movies

■ *Private equity firms control many of the big movie theater chains. Funds seeking to profit in the sector are looking at two chains that are still publicly traded, Regal and Carmike.*

BY JOSEPH CHECKLER

Popcorn. Soda. Hedge funds. What do those three have in common? They're all found in movie theater chains.

Strong cash flows and attendance growth have drawn hedge funds into the stocks of publicly traded movie theater companies. Two in particular - Carmike Cinemas Inc. and Regal Entertainment Group - have gotten more attention than others. The shares of both recently reached 52-week highs, and neither is controlled in any way by private equity firms.

Movie theater companies have gone through significant changes the past few years. Once largely publicly traded, they have merged or been acquired by private equity firms. AMC Entertainment Inc. and Loews Cineplex Entertainment Corp. merged in 2006, the same year Cinemark Inc. bought Century Theatres Inc. The private equity firms that own Cinemark and AMC each planned initial public offerings for May. Though Cinemark's IPO went off, its stock is now trading flat. AMC scrapped its IPO due to a tepid response from investors.

Nationwide, box-office sales increased 19.2% in May and are up 6.5% for the year, according to Bank of America Securities. Bank of America analyst Michael Savner said in a June 6 research report that he's bullish on the sector because of an impressive 2007 film release slate and the new visibility of the sector thanks to the recent IPOs. Some hedge funds are making the sector-wide bets, while others are picking and choosing.

Despite the troubles Carmike and Regal had with their IPOs, rekindled confidence in the industry has funds scrambling to find a way to get involved.

"Our position is, we're long Regal and short Carmike," said a portfolio manager at an East Coast hedge fund. His reasoning is Regal's position as the No. 1 player in the industry and its stake in National Cinema, another competitor. He's short Carmike simply because the No. 4 chain has been losing money, including a $3.7 million first quarter loss.

"It's a hedge based on the industry dynamics," said the portfolio manager.

Wall Street has begun to embrace the strong cash flows and lack of inventory of movie theaters, and both the private equity buyouts and subsequent IPO potential are obviously attractive. Savner, the Bank of America analyst, recently raised his earnings estimates for both Regal and Carmike, citing better attendance and a 2.5% increase in ticket prices. Bank of America owns both Regal and Carmike shares and makes a market in Carmike.

Fine Capital Partners, a New York-based fund run by Debra Fine, owns more than 600,000 shares each of Carmike and Regal, according to the most recent Securities and Exchange Commission filings. The fund's Carmike stake was nearly 1.2 million before it recently sold 526,000, to get to its current level of 644,700. The sale was disclosed in a 13D activist investor filing. Fine's 688,000-shares Regal stake is current as of its March 31 holdings report. Fine did not return a call seeking comment.

Portland, Ore.-based **Stadium Capital Management** had more than 400,000 shares of the two companies as of the end of the first quarter, even after selling some shares. Stadium missed out on some gains, as Carmike's stock has gone from $23.20 at the end of the quarter to almost $26 as of late last week, while Regal's has gone from less than $20 to more than $22 over the same period of time. Stadium did not return a call seeking comment.

Hedge funds own more than half of the stock of Carmike, which has a market capitalization of less than $350 million. While they own only about 8% of the stock of Regal, which has a market capitalization of more than $3 billion, they would probably not be able to acquire more shares because the com-

Continued on page 17

METRICS

Dow Jones Convertible Arbitrage (US) Index as of 6/13/07

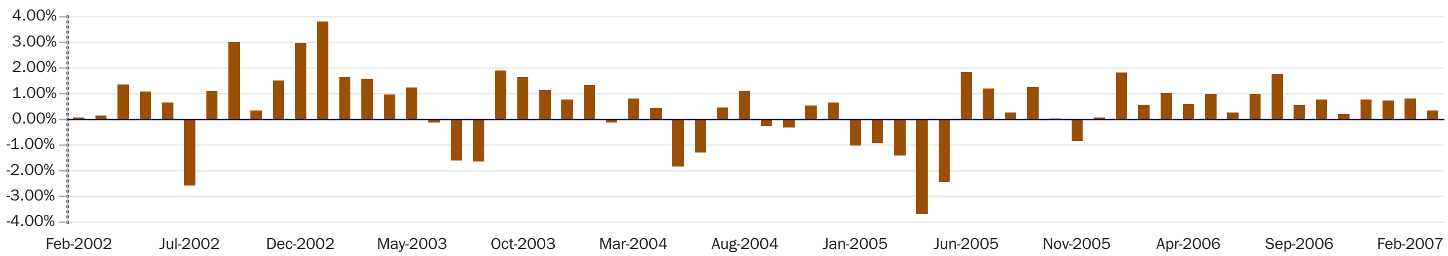
Each week, *Dow Jones Hedge Fund Trades* highlights one of six hedge fund investment strategies, compiled and tracked by *Dow Jones Hedge Fund Indexes*. Additional performance and information on the methodology can be found at www.djhedgefundindexes.com

Performance[1]

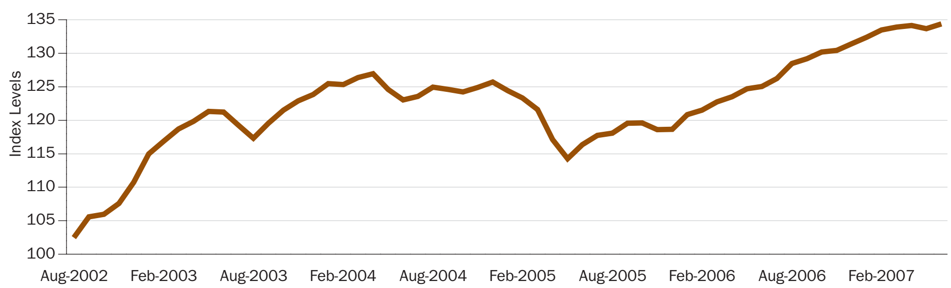
Index	One Month (%)	YTD (%)	2006 (%)	Since Inception (%)*	Vol. Since Incept.(%)*	Correl. w/DJW 5000	Correl. w/DJ CBI
DJHFSB: Convertible Arbitrage	0.53	2.24	10.77	5.52	4.46	-0.06	0.30
DJ Wilshire 5000 Float (DJW 5000)	-1.04	8.18	15.77	8.44	12.05	1.00	0.04
DJ Corporate Bond Index (DJ CBI)	-1.68	-0.28	3.78	5.78	6.02	0.04	1.00

*10/29/04

Monthly Returns After Fees[1]

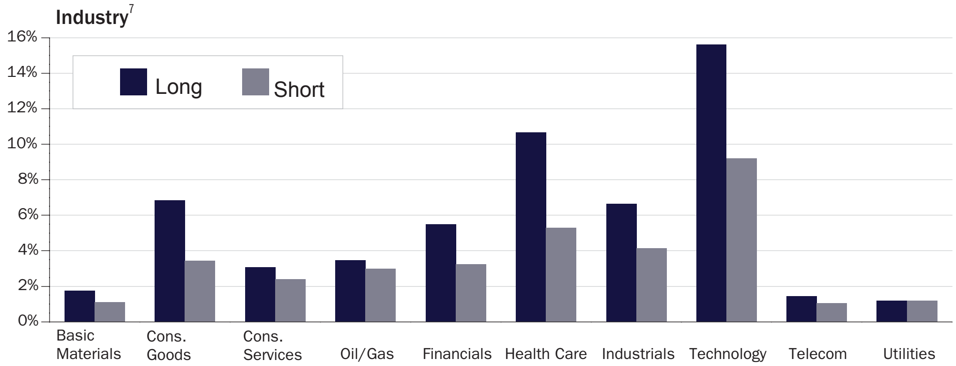


Benchmark Time Series[1]



Exposure: US Stocks and Corporate Bonds[6]

Industry[7]



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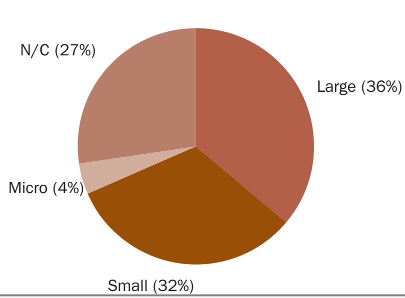

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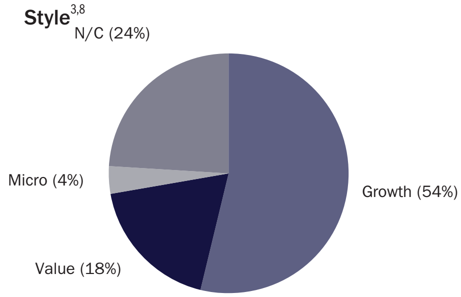

Characteristics

Pre-Fee Reduction (PFR) NAV: †	255.35 M
Exposure-based Leverage: [2]	323.9%
Liquidation-based Leverage: [2]	206.6
Non-Third Party Pricing Exposure: [3,4]	3.7
Non-US Exposure: [3,5]	11.4

† estimate

Asset Class Exposure

	Long (%)	Short (%)	Total (%)
Stocks	2.4	27.8	30.2
Bonds	53.2	3.6	56.8
Futures/Options	0.1	0.2	0.4
Cash/Other	7.7	4.8	12.6
Mutual Funds	0.0	0.0	0.0
Total	63.5	36.5	100.0

Notes

1 Performance is net of fees and is based upon estimates and is subject to change.
2 Exposure-based Leverage = (Long Position Value + Short Position Value) / Net Assets. Liquidation-based Leverage = Long Position Value / Net Assets. Both calculations measure the use of borrowed funds; the former from a risk perspective, and the latter from an accounting perspective.
3 Gross exposure (i.e. long position values + short position values).
4 Exposure to assets that are not priced by independent third parties.
5 Exposure to assets not traded in the U.S.
6 U.S. Stocks/Corporate Bonds represent approximately 46.20% of the gross exposure.
7 Uses the Industry Classification Benchmark (ICB). No ICB industry classification available for approximately 8.71% of U.S. Stocks/Corporate Bonds.
8 DJ Wilshire 5000 Index (DJW 5000) size and style classification. Not Classified implies not in the DJ Wilshire 5000 Index universe.

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METRICS CONTINUED

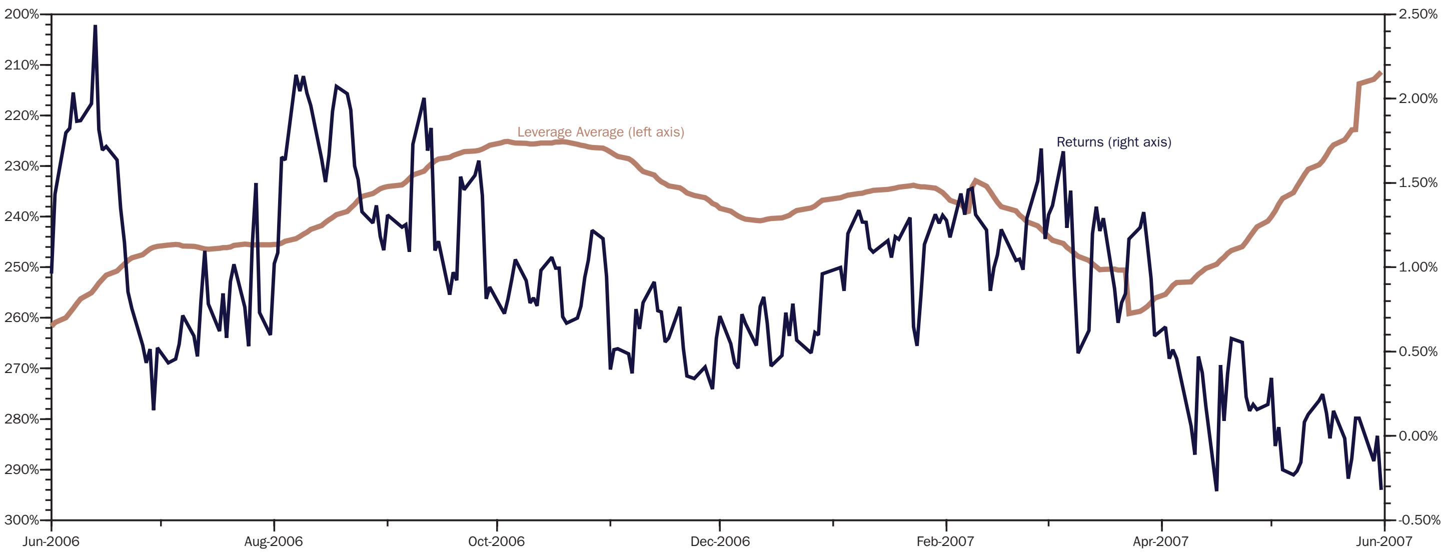
Commentary

Convertible arbitrage hedge funds are lagging behind their peers in the Dow Jones Hedge Fund Strategy Benchmarks, feeling the pain of insistently low markets volatility. In the year-to-date, convertible arbitrage funds have posted 2.24% returns, and in the quarter that has only two more weeks to go, performance is a modest 0.34%. That compares with 10.8% for the whole of 2006.

Adding to convertible arbitragers' woes is the recent rise in interest rates, which affect the value of the bond. But that rise came with a spike in volatility, which is helping to counter the negative impact of higher rates. In the first two weeks of June, convertible arbitragers reporting to the DJHFSB index posted 0.53% in returns. That reverses the negative 0.4% return of May, the worst in the index for that month, and an almost flat performance in April, when the strategy was up 0.16%. (See related story in this week's *Hedge Fund Trades*.)

The strategy's recent sagging performance has coincided with a sharp reduction of leverage by managers. Reporting managers, which are intended to be style-pure, were 114% levered over their fully vested portfolio on average in May, the lowest level in at least 12 months. That compared with 135% in April and a 12-month high of 159% registered in February. Higher leverage tends to prop up a good performance, just as it tends to exacerbate a bad trade, so a reduction in leverage may be one way of protecting returns.

30 Day Rolling Returns And Leverage



Monthly Asset Class Exposure And Leverage†

Date	Stocks (%) Long		Stocks (%) Short		Bonds (%) Long		Bonds (%) Short		Futures/Options (%) Long		Futures/Options (%) Short		Cash/Other (%) Long		Cash/Other (%) Short		Mutual Funds (%) Long		Mutual Funds (%) Short		Leverage (%)	
Jun 06	1.5	+	27.0	-	52.2	+	2.9	+	1.4	-	1.2	-	6.0	+	7.9	+	0.0	-	0.0	+	245	-
Jul 06	1.5	-	26.3	-	52.7	+	2.8	-	1.7	+	1.5	+	5.3	-	8.3	+	0.0	-	0.0	+	246	+
Aug 06	1.6	+	26.1	-	53.5	+	2.7	-	0.9	-	0.9	-	5.9	+	8.2	-	0.0	-	0.0	+	232	-
Sep 06	1.3	-	26.4	+	53.5	-	2.5	-	1.0	+	1.0	+	6.6	+	7.8	-	0.0	+	0.0	-	224	-
Oct 06	1.2	-	26.8	+	53.4	-	2.3	-	1.0	+	1.1	+	6.4	-	7.8	+	0.0	+	0.0	-	228	+
Nov 06	1.3	+	26.5	-	53.2	-	2.4	+	1.3	+	1.5	+	5.5	-	8.3	+	0.0	-	0.0	-	242	+
Dec 06	1.5	+	26.8	+	53.0	-	2.5	+	1.0	-	1.3	-	6.3	+	7.5	-	0.0	-	0.0	-	233	-
Jan 07	1.7	+	27.1	+	52.4	-	3.1	+	1.2	+	1.4	+	6.1	-	7.0	-	0.0	+	0.0	-	238	+
Feb 07	1.7	+	27.3	+	51.5	-	2.9	-	1.3	+	1.4	+	5.8	-	8.1	+	0.0	+	0.0	-	259	+
Mar 07	1.5	-	29.5	+	51.1	-	3.3	+	1.1	-	0.9	-	6.9	+	5.6	-	0.0	-	0.0	-	254	-
Apr 07	2.1	+	26.6	-	52.2	+	3.4	+	0.6	-	0.7	-	6.6	-	7.7	+	0.0	+	0.0	-	235	-
May 07	2.3	+	26.7	+	52.6	+	3.7	+	0.5	-	0.7	-	7.5	+	6.0	-	0.0	+	0.0	+	214	-

Change In Levels *(Percentage Points)*

	Stocks Long	Stocks Short	Bonds Long	Bonds Short	Futures/Options Long	Futures/Options Short	Cash/Other Long	Cash/Other Short	Mutual Funds Long	Mutual Funds Short	Leverage
12 months	0.8	-0.3	0.4	0.8	-0.9	-0.5	1.5	-1.8	0.0	0.0	-32

12 Months

	Stocks Long	Stocks Short	Bonds Long	Bonds Short	Futures/Options Long	Futures/Options Short	Cash/Other Long	Cash/Other Short	Mutual Funds Long	Mutual Funds Short	Leverage
Avg	1.6	26.9	52.6	2.9	1.1	1.1	6.2	7.5	0.0	0.0	238

Notes

† All exposures are expressed as a percent of gross exposures (i.e. long position + short position values) and based on the aggregated positions of component managers and are averages of the daily exposures over the month. Leverage = Long Position Value / Net Assets. The leverage calculation measures the use of borrowed funds from a liquidation perspective.

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EQUITY

Harbinger, Other Holders Drop Appeal Of Granite Chapter 11

BY MARIE BEAUDETTE

A group of former Granite Broadcasting Corp. shareholders has pulled the plug on its appeal of the TV station operator's reorganization plan, days after the company exited bankruptcy protection.

The former preferred shareholders, led by hedge fund **Harbinger Capital Partners**, reached a deal with the company to drop the appeal. Judge Allan L. Gropper of the U.S. Bankruptcy Court in Manhattan approved the agreement, ending the challenge to the reorganization plan he had confirmed in May.

The Harbinger-led group dropped the challenge after losing a last-minute bid to halt Granite's exit from Chapter 11 bankruptcy pending the appeal. Granite emerged from Chapter 11 protection on June 4 under the ownership of buyout firm Silver Point Capital.

The New York company's emergence from bankruptcy came after a lengthy plan-confirmation battle, which pitted the Silver Point-backed reorganization plan against a proposal put forward by the preferred-shareholder group.

Gropper on May 18 approved Granite's reorganization plan over that of the shareholders. Although both proposals called for full repayment for Granite's creditors, Gropper ruled that the Harbinger plan would have burdened the reorganized company with too much debt.

The court-approved plan handed control of Granite to Silver Point in exchange for $295 million the company owed the buyout firm.

Harbinger and fellow preferred shareholders GoldenTree High Yield

DEBT

Some Analysts See Treasurys Sell-Off Rather Than Adjustment

BY DEBORAH LYNN BLUMBERG

The Treasurys market has been in the thrall of mortgage bond investors with surging yields forcing them to sell longer-dated bonds as they rush to adjust their portfolios to this brave new 5%-plus world.

That makes them key players in the grand debate over how much further Treasury yields have to rise before the government bond market can stabilize. It all boils down to one main distinction: Whether the recent unloading of Treasurys by mortgage bond holders was sparked by a fundamentally changed outlook on interest rates, or whether these investors were simply rebalancing their holdings as they sought to add value to their portfolios.

While the former would suggest a longer-term impact on Treasurys from the mortgage community, the latter would most likely be more temporary in nature. And for now, it's anyone's guess which scenario is most likely to play out.

Selling from mortgage investors has been a key factor in Treasurys' weakness over the last few weeks as the 10-year yield has broken though several key technical levels, forcing those investors to step in.

Last week, strategists pegged Treasurys' push higher in yield partly to another bout of mortgage-related selling, with the 10-year yield surging to a five-year high of 5.27%.

"There was clearly some mortgage activity," said Scott Gewirtz, head of Treasury trading at Lehman Brothers in New York. "You can tell by the way the curve is steepening."

Dominic Konstam, head of interest-rate strategy at Credit Suisse in New York, is in the camp of those who see mortgage-related selling of Treasurys as less of a hedging mismatch that needed to be adjusted, suggesting a temporary impact on the market.

"In my mind, mortgage selling is not a driver for the market," Konstam said. "It's peripheral."

Konstam believes the shedding is not a "classic" mortgage hedge trade, as it most probably was not driven by a core change in what investors believe will happen to interest rates. In particular, he thinks most investors remain unconvinced that Fed policymakers could be moving toward a hike in interest rates.

"There was some mortgage-related selling but it's not overwhelming," Konstam said. "The mortgage selling you're getting is more a reflection of the observed price and yields."

Indeed, while most dealer banks - firms that deal directly with the Federal Reserve and underwrite Treasury auctions - no longer expect a 2007 ease in rates, a majority is still banking on an eventual cut in the current federal funds rate of 5.25%. Of the 20 dealers that responded to a recent Dow Jones survey, 12 expect the Fed's next move will be an ease versus five who anticipate a tightening. Three banks made no call.

Konstam said that a more lasting factor when it comes to weakness in government bonds is that investors have been continuing to price out an impending ease in interest rates. Foreign central

Continued on page 16

Master Fund and MFC Global Investment Management (U.S.) LLC had sought to derail Silver Point's deal with Granite by launching a bid to fund the broadcaster's path out of bankruptcy through an offering of over $200 million.

Harbinger and Silver Point have been fighting over Granite for nearly a year. Each presented a restructuring proposal for the company in June 2006. Harbinger's proposal called for W. Don Cornwell to resign as chief executive, but as Granite's controlling shareholder he had the power to scuttle the deal. ■

EQUITY

Pardus Buys 700,000 Visteon Shares, Holds Almost 18% Stake

BY BHATTIPROLU MURTI

Hedge fund **Pardus Capital Management L.P.** recently bought 700,000 more shares of Visteon Corp., raising its stake in the automotive parts supplier to nearly 18%.

New York-based Pardus has been pressuring Visteon, which is in the midst of a restructuring program, and its move to raise its stake in Visteon follows recent news that the investor raised its stake to 15.47% in another car-parts maker, French firm Valeo SA.

Pardus has been pushing for changes at Valeo, saying it should explore strategic alternatives, including the acquisition of some or all of Visteon.

Pardus now owns 12 million Valeo shares, compared with its previous stake of 11.7 million shares.

In a filing with the Securities and Exchange Commission, Pardus disclosed that it bought the additional shares in Visteon at prices ranging from $7.87 to $8.01 each.

FOREX

Pound Rally Lacks Support From UK Equities, Data

BY NICHOLAS HASTINGS

The pound's chances of hitting $2 in the near term seem to be fading fast.

Not only is sterling getting less support from higher interest-rate expectations than it did in the past, but the currency appears to be taking its cue more from the outlook for equities.

"Sterling's underperformance appears to be a function of its relatively high correlation with equity markets and risk appetite," said Ian Stannard, a senior currency strategist with BNP Paribas in London.

"Thus," he added, "in the current environment of rising uncertainty as a result of increases in asset market volatility, sterling has come under pressure."

This is a far cry from only weeks ago, when the pound was being driven relentlessly higher by the strength of the U.S. economy and the prospect of higher U.K. interest rates as inflation soared over 3.0%.

As the Bank of England became increasingly hawkish, the market gradually discounted a rise in rates as far as 6.0% by the end of the year from 5.50% now.

Even softer economic data, such as last week's decline in the latest CPI rate for May to 2.5% from 2.8%, failed to undermine the bullish expectations for interest rates.

As Daragh Maher, a senior currency strategist with Calyon in London pointed out: Inflation still remains well above target, and there is little in the figures that "will have the Bank of England scrambling to revise its forecast or view of the world."

Bank of England Mervyn King made it clear that he remains concerned over higher inflation expectations, high consumer spending and higher oil prices.

"Comments from King suggest that in a firm growth environment the monetary policy committee will need to see inflationary pressures fall significantly to prevent further rate rises," said James Knightley, a U.K. economist with ING Financial Markets in London.

Others point out that despite the decline in price pressures suggested by the CPI data, there remains the risk that inflation will turn higher on a two-year horizon, which will ensure that the Bank of England remains as hawkish as ever.

For example, a recent study by Capital Economics suggests that with as much as 70% of new U.K. mortgage holders having fixed- rather than floating-rate mortgages, many remain immune to the recent hikes in interest rates.

"The popularity of fixed-rate mortgages in recent years appears to have dampened the sensitivity of the housing market to rising interest rates," said Ed Stansfield, a U.K. economist with Capital Economics in London.

This will likely continue until many of these fixed rates mature over the next year or two, making it likely that the central bank will be pushed into tightening policy even more aggressively.

In the past, all this would certainly have translated into sterling gains as the market looks for a straight correlation between higher U.K. interest rates and

Continued on page 18

Pardus, which has said it is displeased with Visteon's performance, is the company's largest individual shareholder.

Pardus owns 23.2 million shares of Visteon, a former unit of Ford Motor Co., compared with 22.5 million shares, or a 17.4% stake, it reported earlier. ■

EQUITY

DE Shaw Wants Invest Tech To Look At Strategic Alternatives

D.E. Shaw reported holding a 6.2% stake in Investment Technology Group Inc. and said it wants the company to evaluate strategic alternatives.

In a letter sent to Investment Technology and disclosed in a Securities and Exchange Commission filing, D.E. Shaw said it wants the company's board to look at alternatives to increase shareholder value, including a sale of some or all of ITG's businesses to a strategic or financial buyer.

D.E. Shaw said it believes that strategic acquirers, including numerous large financial institutions and exchanges, would be "very interested" in ITG because of the "significant synergies they could realize from the integration of ITG's trading products and technologies into their current businesses."

D.E. Shaw also said that if a sales process fails to yield an appropriate price, it would propose that ITG implement "an aggressive share buyback program."

The New York-based investor said it's concerned about ITG's current share price and believes that it fails to reflect the true fair value of the company's global trading products and platforms.

In the SEC filing, D.E. Shaw also said it may pursue various strategic

INDUSTRY NEWS

Macro Hedge Funds See Opportunity In Bond Yield Moves

BY MARGOT PATRICK

Global macro hedge funds that take bets on the direction of bond yields and currencies are finding fresh opportunities from a jump in yields on Treasurys and European government bonds, but their skills are set to be tested as markets become less predictable.

Hedge funds operating macro strategies are among those with the most to gain or lose from sharp moves in bond yields. They typically take positions in bonds, currencies, stocks and various derivatives to express their views on the global economy and to find relative value between different financial instruments.

The strategy can be most successful when markets turn volatile or when there are clear trends in interest-rate moves that can be exploited. Of course, it also means they can lose money when markets suddenly turn against them, and some funds that had been counting on further U.S. interest-rate cuts could be big losers.

"Higher yields create a very different environment for hedge funds because not only are they going to have a higher risk-free rate to beat, but some of their most successful strategies over the past few years are going to be more challenging, such as carry trades," said Neil Meadows, a portfolio manager on a fund of macro hedge funds at London-based **NewFinance Capital**, which has about $3.7 billion invested in hedge funds.

"The selection of and allocation to skilled and experienced managers is going to become even more relevant," he added.

Hedge funds and other investors have made a mint over the past few years through carry trades, which involve buying currencies with high interest rates and selling those with lower rates. Other profitable trades for macro managers in recent months have included long positions in rising stock markets and bets against the dollar, which until the recent move in Treasury yields was in decline against many major currencies.

However, an ongoing bull market in equities has meant returns at macro and fixed-income hedge funds have lagged those that focus mainly on equities. The HFRI Macro Index compiled by Hedge Fund Research Inc. was up 5.83% in the five months to May 31, compared with a 9.93% gain in its Equity Non-Hedge Index. In 2006, the equity index returned 15.9%, nearly twice as much as the macro index's 8.15%.

Though the macro strategy is one of the best-known ways hedge funds make money - in large part because of the legendary returns of macro traders such as George Soros and Julian Robertson in the 1990s - the last time it turned in double-digit returns was in 2003, when it was up 21.42%.

"A difficult world for macro is where beta performs all the time and volatility is low, which is what we've just had," said Paul Lambert, director of currency and macro strategies at **Polar Capital PLC**, which runs macro fund Polar Capital Discovery Absolute Return Fund.

"If we get through a juncture and into a prolonged period of volatility, then macro funds should do well," he added.

Continued on page 13

alternatives with regard to its investment, including forming and conducting potential strategic developments and plans, seeking representation on the board, or seeking to acquire control of the company through a merger, proxy solicitation, tender offer or exchange offer, among other things.

D.E. Shaw beneficially owns about 2.73 million shares of ITG, which provides automated equity trading services to institutional investors and brokers. ■

EQUITY

Chip Co. Backed By Third Point Sold To Broadcom

BY SCOTT DENNE

After taking money from a hodgepodge of venture investors, Global Locate Inc., a maker of chips and software for use in global positioning system devices, has been sold to Broadcom Corp. in a cash deal potentially worth $226 million.

Since its founding in 1999, Global Locate has raised $81 million in venture capital. Its largest shareholders are Third Point Ventures, the venture capital arm of hedge fund **Third Point Management**, mutual fund manager Firsthand Capital Management, and G.C. Investments, which manages private equity for the Greenspun family, publishers of the Las Vegas Sun and other Nevada-based publications, according to a spokesman from Broadcom.

Strategic investors Siemens Venture Capital and Motorola Ventures also hold a share of the company.

Broadcom will pay approximately $146 million in cash, when the deal closes. An additional $80 million will be paid to Global Locate's stock

INDUSTRY NEWS

Hedge Fund Activism Boosts Returns, But Less So Today

BY KAJA WHITEHOUSE

Hedge funds have been increasingly rattling corporations, taking over boardrooms and forcing sales.

No doubt, they do this for just one reason: profit. The question is whether other shareholders also benefit from hedge fund activism.

A new study attempts to answer this question and concludes that hedge fund activism generally improves returns for shareholders, and in more ways than through short-term boosts in stock prices.

But the author warns that the benefits of hedge fund activism appear to be fading as competition for target companies, which tend to be undervalued, ratchets up.

The study, conducted by Wei Jiang, associate professor at Columbia University's school of business, finds that companies that have been targets of shareholders activism tend to outperform other stocks to the tune of 9% within 20 days after the news of a hedge fund's intentions are released. Findings of a short-term stock boost are in sync with other past research, but Jiang's study, sponsored by hedge-fund-of-funds provider Ivy Asset Management Corp., also finds some evidence of long-term benefits, such as greater dividend payouts, improvements in return on equity and reductions in CEO pay that bring compensation in line with targeted companies' peers.

Among some of the study's findings: A year after being targeted, dividend payments at companies dealing with hedge fund activists increased 13 basis points above their peers, from 42 basis points below their peers a year before being targeted. And compensation paid to CEOs also declined, from an average of $1.26 million higher than their peers to equal their peers a year later.

Hedge funds seeking to profit by pushing for management and operational changes have staged several high-profile reform efforts this year already. **Relational Investors LLC** recently fought for and gained a seat on the board of Home Depot Inc., and the hedge fund is said to have contributed to the recent ouster of Chairman and Chief Executive Robert Nardelli.

Jiang, who wasn't immediately available to discuss the results of the study, looked at 781 activist events sponsored by 131 different hedge funds between 2001 and 2005. Jiang picked activist events that were announced through 13-D filings, which require holders of more than 5% of a stock to disclose their interest in a company, such as an intention to influence management's decisions.

Despite evidence of overall success, the study predicts tougher times for activist hedge funds. Average, benchmark-adjusted stock returns at companies targeted by hedge funds declined to 4.8% in 2005, down from 10.6% in 2001. The author attributed this to the growing number of hedge funds looking for opportunities to profit through activist activities.

"Although it is too early in the cycle to predict the fate of hedge fund activism with any certainty, if activism can be viewed as another form of arbitrage, then it is likely that the returns associ-

Continued on page 17

holders if certain performance goals are met, according to a press release announcing the acquisition.

Global Locate's chief executive, Scott Pomerantz, declined to comment on the acquisition.

None of Global Locate's investors could be reached to comment, except Third Point, which declined to comment.

Global Locate's semiconductors are used in mobile phones and personal navigation devices, such as those offered by TomTom NV. ■

PEOPLE NEWS

ILEX AM Hires Calyon's Paul Owens As Co-Head Of Research

Paul Owens is set to join credit hedge fund **ILEX Asset Management LLP** as a partner and co-head of research at the end of June, people familiar with the situation said.

Owens moves from Calyon in London, where he was executive director high-yield and distressed research. Owens joined Calyon in late 2005.

Owens has 27 years of experience in the credit market, including stints at Mass Financial, Morgan Stanley AM, Berkeley Capital Management and Salomon Smith Barney.

REGULATORY

Russian Officials Investigating Company Advised By Hermitage

Tax authorities have opened a criminal investigation into a company advised by one of Russia's largest investment advisers, officials said, while Russian media said the investigation could be politically motivated.

Moscow city police spokesman Yevgeny Gildeyev said tax investigators were looking into whether a Cyprus-based company called Kameya had circumvented tax

EQUITY

Highland Capital Eyes Being Lead Investor In Delphi Deal

BY TERRY KOSDROSKY

Highland Capital Management L.P. said that it has entered talks with auto supplier Delphi Corp. and General Motors Corp. with an eye toward becoming the lead investor in a deal related to Delphi's Chapter 11 reorganization case.

The disclosure signals progress in Highland's effort to become a larger part of a Delphi reorganization and is a change from a filing last month when the firm said it was working through another party.

In late May, Highland said it forged a confidentiality agreement with Delphi working with **Pardus Capital Management** and Brandes Investment Partners, in which Pardus would be the potential lead investor.

But in a filing with the Securities and Exchange Commission, Highland said it entered into an amended confidentiality agreement "to evaluate possible negotiated business arrangements" in which Highland would be the lead investor.

Highland, which owns a 7.8% stake in Delphi, said it met with the auto supplier and GM and expects further meetings. The confidentiality agreement also included standstill provisions designed to keep Highland Capital from taking certain actions that would influence Delphi's bankruptcy reorganization.

Pardus, which also holds major stakes in suppliers Visteon Corp. and Valeo SA, didn't return a call seeking comment.

Delphi, the former parts-making division of General Motors, filed for Chapter 11 protection in October 2005 and has since hit several roadblocks in its attempt to emerge from bankruptcy.

Cerberus Capital Management, the big private equity firm that recently reached a deal to buy the Chrysler Group from DaimlerChrysler AG, is expected to back out of a group that would take control of Delphi out of Chapter 11 with an infusion of up to $3.4 billion. That has the auto supplier and investors looking at alternatives.

Appaloosa Management, Delphi's largest shareholder, and Harbinger Capital Partners are part of the original $3.4 billion plan.

Highland first signaled interest in Delphi last December by launching a rival $4.7 billion investment plan to the Appaloosa-Cerberus-Harbinger deal. Highland's plan, however, was largely ignored by Delphi, and the investment firm was told to go back and try to get more support among other Delphi investors. In April, Highland reiterated its interest in participating in a Delphi investment plan.

Highland in the past has estimated Delphi's earnings would skyrocket after it emerges from bankruptcy thanks to lower costs and other factors. Delphi, which lost nearly $5.5 billion in 2006, said recently that its monthly net loss was $66 million in April.

Delphi is relying on a team of big-money firms to take major stakes in the reorganized entity. The firms that back the deal promise to take home large fees and would profit if their investment stake in what likely will be a publicly held company were to increase as Delphi's financial performance improves

Continued on page 17

laws on a 2006 dividend, resulting in a 1.16-billion-ruble ($44.5 million) underpayment in taxes.

An official with **Hermitage Capital Management** in London confirmed the investigation was under way, but said Hermitage had simply offered investment advice to the company and that Hermitage itself was not being investigated.

Kameya officials could not be immediately located for comment.

The official also questioned the authorities' motivation, saying the bilateral treaty between Russia and Cyprus governing tax-withholding questions could be thrown into doubt if the probe determined the company had underpaid Russian taxes.

Since many companies making investments in Russia have offshore affiliates in tax-friendly Cyprus, the investigation's outcome could have wider implications.

It is "an absolutely black-and-white issue that doesn't require any investigation at all," the official said, speaking on condition he not be named.

The daily newspaper *Kommersant* called the investigation politically motivated and said it could be connected to efforts by Hermitage Capital -among other Western investors - to buy up stock of state-controlled natural gas monopoly, OAO Gazprom.

Hermitage Capital is one of Russia's largest investment advisers, overseeing more than $3 billion and acting on behalf of over 6,000 institutional and individual investors from more than 30 countries.

Hermitage Capital's chief executive, William Browder, has been barred from entering Russia since

FUND NEWS

Third Point To List Close-Ended Fund On LSE

BY MARK NAJARIAN

Third Point LLC, a U.S. hedge fund manager, said it will seek to raise EUR500 million in an initial public offering of shares in Third Point Offshore Investors Ltd., a closed-ended investment company.

Third Point said it plans to launch the IPO on the London Stock Exchange main market and that it will comprise three currency classes - euro, dollar and sterling shares.

The shares will be priced at EUR10, $10 and GBP10 each, the statement said.

It said the offer size statement should be published around July 18, and that unconditional dealings will commence, on a "when issued" basis around July 23.

"We believe that we will be the first U.S. hedge fund to list a single manager fund on the London Stock Exchange, which would be a significant milestone for Third Point," Daniel S. Loeb, chief investment officer of Third Point LLC, said in a statement.

Net proceeds of the IPO will be immediately invested in the existing Third Point Offshore Fund, a tax-exempt company incorporated in the Cayman Islands. The master fund pursues an "event driven," value-investing approach, based on bottom-up, fundamental analysis, it added.

"We are delighted to be in a position to offer shares in Third Point Offshore Investors Ltd. to public investors so they can effectively gain access to our largest fund," Loeb said.

"Since starting Third Point LLC over 12 years ago, we have seen very strong annual returns with an average of 23.1% for Third Point Offshore Fund," Loeb said.

Third Point said that the company, the master fund and the investment manager will consider beginning a share buyback program if the shares trade at or below 95% of net asset value.

The investment manager will be paid at the Master Fund level only, a management fee of 2% a year of NAV and an incentive fee of 20% of NAV growth, subject to a high-water mark and related adjustments, it said. Principals of the investment manager will make a 5% investment in the company.

Third Point added that no final decision has been made to proceed with the IPO and that a decision will be taken after assessing market feedback and prevailing market conditions.

UBS has been appointed global coordinator, bookrunner and joint lead manager and Societe Generale has been appointed joint lead manager. ■

Macro Hedge Funds

Continued from page 10

Some of the potential areas for macro traders to exploit include directional plays on the in fixed-income markets, bets on further yield curve moves and possible rallies in stock markets as global growth continues, said NewFinance's Meadows, who formerly worked as a trader. ■

November 2005 after authorities refused to renew his visa, citing national security concerns.

Observers have said Browder may have made enemies in one of his many high-profile campaigns for greater transparency and efficiency at some of Russia's biggest conglomerates. Though a vocal supporter of the economic policies of President Vladimir Putin, Browder has publicly fought alleged fraud and cost overruns at Gazprom, among other companies. ■

Hedge Fund Trades

Published by Dow Jones Newsletters

EDITORIAL

Nicholas Elliott, Managing Editor
nick.elliott@dowjones.com

Andrew Yurkovsky, Editor
andrew.yurkovsky@dowjones.com

Gregory Zuckerman, Consulting Editor
gregory.zuckerman@dowjones.com

Mara Lemos Stein, Reporter
mara.lemos-stein@dowjones.com

Joseph Checkler, Reporter
joseph.checkler@dowjones.com

SALES & ADVERTISING

Carlos Mesa
202.862.7147

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REGULATORY

Japan Court To Weigh Poison Pill In Steel Vs Bull-Dog

BY ARRAN SCOTT

Bull-Dog Sauce Co. said it will fight a lawsuit filed by an activist U.S. investment fund that is seeking to block a "poison pill" the Japanese company aims to use to thwart the fund's takeover bid.

The Tokyo-based company, which is known for its "Bull-Dog" brand Worcester sauce, said its believes its defense scheme is "legal and appropriate" and that it "intends to fight" the lawsuit. **Steel Partners** filed the suit with the Tokyo District Court in an effort to scuttle Bull-Dog's plans.

The battle highlights the clash between corporate Japan and a growing number of foreign investors, who are pressing Japanese companies to place more emphasis on creating value for their shareholders. It also marks another test for Steel Partners, whose investment tactics in Japan have prompted some critics to label it a greenmailer - claims that Steel Partners chief Warren Lichtenstein dismissed earlier.

Lawyers said the battle will likely set important legal precedents in Japan concerning the use of poison pills. Such defense schemes have proliferated rapidly here as companies seek to deter unsolicited takeovers by rivals and corporate raiders amid an upswing in mergers and acquisitions activity and the growing presence of foreign investment funds.

But critics claim that such anti-takeover measures shield managers from market forces, hurting shareholder value.

"The U.S. went through this 20 years ago, and it's working out exactly the same in Japan now," said Scott Jones, an M&A lawyer at Jones Day in Tokyo.

Steel Partners, which along with its affiliates owns a 10.15% stake in Bull-Dog Sauce, on May 18 started a tender offer to buy the shares it doesn't own in the sauce maker, the latest in a series of takeover bids the fund has made for Japanese companies ranging from an instant noodle maker and a brewery to a manufacturer of saws.

Steel Partners' past targets have employed a range of defense tactics from as hiking dividends to increase their share prices, to seeking out white knights that outbid Steel Partners. Analysts say Steel Partners' strategy likely has paid off handsomely.

Bull-Dog, however, has bared its fangs. It said on June 7 its board of directors had approved a stock acquisition rights plan. Under the plan, the company would issue three stock acquisition rights per share to all its shareholders, but with a provision that would prevent Steel Partners from converting its rights into shares. Bull-Dog hopes to gain approval for the plan at its annual shareholders' meeting on June 24.

Steel Partners said the scheme was aimed squarely at its sinking its takeover bid and called it "a discriminatory act against the investment partnership in violation of current

Continued on page 18

Converts' Balancing Act

Continued from page 2

known as "rho," which refers to the amount of change in a convertible bond or option price given a 1% change in interest rates.

The bonds that hurt the most with this month's rise in 10-year Treasurys yield to over 5.25% were long-dated ones, said one trader at a hedge fund in New York. That was because existing convertibles with a related maturity become less desirable to investors. The interest-rate rise also caused a steepening of the yield curve, with the 10-year benchmark Treasury rising significantly above yields for the near-term two-year note, so the best hedge would have been a short position on the 10-year Treasury, said the trader. That would have hedged the rho exposure of convertibles with seven-to-10 year maturities, he said.

As no one convertible arbitrager is like the next, there are many different ways for hedge funds in the space to pick up performance, such as geographic diversification and focusing on smaller-sized issuers.

London-based **Axis Capital Management** trades predominately in convertible bonds in Asia and has posted impressive numbers this year thanks to volatility in Chinese markets.

"Volatility is incredible in China - stocks are moving down, down, down, and then they trade limit up," said Mark Smith, a client relations officer at Axis. He said the level of volatility in Chinese markets now is much higher than that of Nasdaq stocks in 1999 and 2000.

Axis seeks out markets with high barriers to entry, which can be caused by difficulty in borrowing stocks, capital markets that are incompletely developed and restrictions to foreign investors. The firm was one of the very early investors in China, said Smith, first trading in the market in early 2003. Axis' China fund is up an estimated 35% year-to-date, following last year's return of 24%, while its Pan-Asian fund, which is more conservative, is up 14% in 2007 so far.

One of the winning trades in the China fund was the convertible bond of Heilong Jing, which Axis got in late last year. The stock in the company had fallen around 30%, but its convertible was trading close to par because most of the bonds in China are guaranteed by a state-owned bank. As the bond's conversion price got reset, its value rose and Axis sold most of it for over 100 points above par in the past two months.

All of the bonds in Axis' China portfolio have a reset feature, which means that even when stock prices fall sharply, the bonds preserve their fixed-income value because its conversion price is adjusted. The firm uses CDS, asset swaps and other-over-the-counter transactions to hedge out risk in its portfolio.

Investors approve of convertible arbitragers seeking opportunities outside the mature U.S. and European markets.

"What I look for in convertible arbitragers today are not the traditional models," said Peter Hommeyer, managing director of **Cadogan Management**, a New York-based fund of hedge funds with $4.3 billion of assets under management. These traditional models include gamma trading (being long a bond and playing the arbitrage while adjusting the bonds' hedge by buying or selling stock in the underlying equity) and cash-and-carry, which refers to picking up the yield in the bond.

"I'm interested in guys who are going into different geographical areas," said Hommeyer. Cadogan currently is invested in one Connecticut-based single-strategy manager in convertible arbitrage, and he is spreading out into Asia, said Hommeyer. Other types of changes in the strategy that can make an arbitrager more appealing include focusing on event-driven situations, or shorting the convertible bond outright.

"The managers I feel will be more viable going forward are those who have the ability to capitalize on different opportunities, meaning they've got a broad palette of investments that they can make," said Hommeyer.

For **Mohican Capital Management**, the edge comes from focusing on small-cap names. High issuance of convertible bonds by small-cap companies has meant there are more opportunities for Mohican, and its offshore fund posted 5.65% in returns in the year through May and 19.65% for the whole of 2006.

Eric Hage, Mohican's chief investment officer, said that the firm's careful "digging into" the pool of bonds available in the market in search of value has been one way of dealing with the prolonged low-volatility environment.

Hage cited EDO Corp., a maker of defense-related equipment and systems, as a very profitable trade. Mohican bought the converts in December last year, and when the company's stock broke out to the upside, the volatility in its convert moved higher gradually, to 31 by the end of May from around 15 in end-January.

"We felt, from a risk-reward standpoint, that we were buying very low volatility at the time," said Hage, adding that he was also comfortable with the credit risk. "Here was a convert that was undervalued, in our opinion, for a while," he said. ■

HINT

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Aluminum Trade

Continued from page 4

that has occurred recently suggests that most of the gains are exhausted in that trade for now, said Gayle Berry, commodities analyst with Barclays Capital in London. "If there was to be a fall in the front month prices in the second half of the year, we would probably advise a look at the back end again," she said.

"At the moment, the fundamentals are not particularly inspiring, and the range-bound price action will continue for a while," said Berry. "In the second half of the year, we're expecting supply to increase, with Western world capacities restarting and new smelters coming on line," she said.

A technical analysis by Standard Bank last week predicted LME three-month aluminum prices are likely to continue sliding toward $2,615-$2,665 per ton in the immediate short term but could find support and rebound to over $2,800 per ton in coming months. Most analysts expect the metal to continue this year in the range of $2,400-$2,900 per ton.

That range-bound price action means hedge funds dedicated to commodities trading, especially trend followers, are shunning aluminum since there is no trend to speak of in this market at the moment.

"It's pretty rough right now. Trend followers are fed up with it because of [aluminum's prices] high volatility and narrow range," said Steven Spencer, a partner in London-based commodities trading adviser TradeRight, which runs the Bermuda-based **Labrador Global Resources Fund**.

"We tend to gravitate towards the ones that are moving," said Spencer, citing interest rate futures and foreign exchange as more volatile markets at the moment that "put some flesh on the bones of the trend." He said he prefers the grains and coffee markets, where clearer trends are easier to trade under his firm's strategy. ■

Treasurys Weakness

Continued from page 8

banks also seem to be sitting on the sidelines when it comes to buying U.S. Treasurys, Konstam said, and are "a bit nervous about coming in to catch a falling knife."

Max Bublitz, chief strategist at SCM Advisors LLC in San Francisco, belongs to the opposite camp. He thinks that a sustained push above the key 5.25%-5.28% level on the 10-year Treasury note could well lead to increased selling by mortgage investors.

The 10-year Treasury yield is the base on which fixed-rate mortgages are set. With Treasury yields on the rise, borrowers are less likely to refinance their mortgages, leaving mortgage bond holders holding lower-yielding assets for a longer-than-expected time. In order to balance their portfolios, these investors are then forced to sell long-dated Treasurys.

And while buyers appear to have emerged as the 10-year yield rose through 5.25%, their interest may not be enough to quell the downward slide in Treasurys.

In that case, Bublitz sees the 10-year yield rising as high as 5.35% and yields in the 5.30%-5.35% area could usher in the next round of mortgage-related selling. As the vicious circle of selling engendering more selling spirals, the yield could rise to 5.50%, and that could inspire a "significant" round of mortgage selling.

That move won't be a gentle process. "It wouldn't be a grind - it would be spiky," he said.

And while the role that mortgage investors will play in the market from here on out is still unclear, Bublitz does credit the recent mortgage selling as making Treasurys trading of late a bit more interesting.

"All eyes are back on the bond market again," Bublitz said. ■

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Hedge Fund Activism

Continued from page 11

ated with it will decline, or even disappear, as more funds chase after fewer attractive targets," the study said.

Also, whatever benefits hedge fund activism provides for shareholders may be lost to bondholders. Jiang's study found "no evidence that activist hedge funds redistribute wealth from creditors to shareholders," but a separate study from bond-rating firm Moody's Corp. finds short-term shareholder activism has a deleterious effect on credit quality, especially when it results in a breakup of the company of a sale of assets for the benefit of shareholders.

"Just as bad for creditworthiness are significant increases in dividends or share purchase programs, a more aggressive growth strategy, or a more leveraged financial strategy," said Mark Watson, co-author of the report, in a press release announcing the results of the study. ■

Highland/Delphi

Continued from page 12

A Delphi spokeswoman couldn't be reached for comment, but the company said in April that it was open to offers from other investors.

GM is shepherding major elements of Delphi's bankruptcy emergence plan, and is working with its largest supplier and the United Auto Workers union on forging a new labor agreement.

"We're encouraged by the continued progress, and we'll continue to work with the UAW, Delphi and other parties in efforts to reach an agreement on the restructuring," GM spokeswoman Renee Rashid-Merem said.

Delphi is looking to lower its labor costs, and people familiar with the talks have said the sides are edging closer to a deal. GM is expected to supplement wages for its former employees working for Delphi, and the parties are trying to agree on how many Delphi-UAW jobs GM will guarantee by committing to buying products from certain Delphi plants in the United States.

Reaching a consensual labor agreement is a condition of the $3.4 billion plan investment proposal from Cerberus, Appaloosa and Harbinger. ■

Double Feature

Continued from page 5

pany is controlled by entrepreneur Philip Anschutz.

In late May, Jim Cramer called Carmike his favorite stock in the sector, a declaration that helped send the stock to its 52-week high on June 1. Because the stock doesn't have a huge private equity firm - or a billionaire like Anschutz - behind it, it remains a viable takeout candidate. That will probably draw some event-driven players into the stock. Another interesting holder of Carmike's stock is distressed fund **Avenue Capital Management**, which probably got its almost 1 million-share stake when Carmike emerged from bankruptcy in 2002. There are no SEC filings that show when Avenue acquired its stake, but usually it acquires equity in companies while they are bankrupt, or converts bonds into equity after the bankruptcy. Avenue did not return a call seeking comment. ■

From Dow Jones

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Steel Partners/Bull-Dog

Continued from page 14

Japanese law." The fund aims to block the resolution from being presented at the shareholders' meeting and to block the issuance of the stock acquisition rights.

Jones Days' Jones and his colleague Nobutoshi Yamanouchi said the court case will likely hinge on two key issues.

One is whether Steel Partners is merely a greenmailer - an outsider that buys blocks of a company's stock and then entices it to buy the shares back at a premium to avoid a takeover - or an investor that is genuinely interested in the long-term prosperity of the company. If the court deems Steel Partners to be a greenmailer, it would bolster the case for discriminatory steps to thwart its bid.

There's also the issue of timing. If a company puts in place a defense before it has come under attack, it is much easier to argue that the defense is warranted when an unwanted buyer appears on the scene.

But Bull-Dog decided to adopt the poison pill long after Steel Partners launched its takeover bid. That complicates its case because it gives the impression the plan is a blatant snub aimed at Steel Partners.

"The court will deal with the timing issue. That's a very important issue," said Yamanouchi. "In my view, this rights plan under these circumstances is likely to be held invalid by a Japanese court." ■

Pound Rally Fizzles

Continued from page 9

sterling strength.

However, this may be changing as global investors worry about the general tightening in global interest rates and start to lose their appetite for higher-yielding currencies, such as the pound.

BNP Paribas' Stannard said that as long as higher interest rates were being blamed on higher global growth, equity markets rallied and market appetite for risk, and high-yielders, remained high.

Now, though, investors are becoming concerned that it is inflation, not growth, that is pushing rates higher. As a result, investors are less enthusiastic about buying equities and higher-risk assets.

"It is interesting to note that sterling has not been able to draw any support from the continued positive data coming from the U.K.," Stannard said.

Apart from the general jitters in global equity markets, Stannard suggests that the pound may be additionally vulnerable to the poor performance of financial stocks since the start of the year, given the U.K's large financial services sector.

He forecasts that any further decline in equity markets in general will take its toll - leaving the pound vulnerable to "a deeper corrective decline" targeting $1.9150. ■

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