F&C Thames River

Thames River Multi-Alternative

CLIENT UPDATE 2011 REVIEW & 2012 OUTLOOK

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Review '11

On review, 2011 was an extraordinary year where all text book theories which are regarded as sacrosanct were proved wrong; the risk free rate which all assets are priced off is not risk free, sentiment determined asset prices rather than fundamentals (Benjamin Graham/Warren Buffet) and markets were deeply inefficient instead of always being efficient (Efficient Market Hypothesis). For example, the best performing asset last year was US Treasuries yet the US was downgraded for the first time in history and has $15 trillion in total debt which increases by more than $1 trillion per year.

Globally hedge funds in general had a rough time in 2011, with the volatility and weakness of August and September providing exceptionally difficult conditions. In fact, the total loss for the year was incurred during these two months in our Warrior/Hedge+ funds. As in 2008 and other times when hedge funds underperform, hedge funds find it difficult to make money when politicians, rightly or wrongly, interfere in financial markets.

A good example of the year's exceptional volatility was the unchanged return of the S&P over the year but this result masked the market's sharp ups and downs; the S&P 500 had been up as much as 8.4% in late April and down nearly 13% for the year at its 2011 lows in early October. Indicative of the volatile landscape, the S&P closed up or down 2% on 35 days in 2011, up from 22 days in 2010. In contrast, the S&P did not post a single move of more than 2% in 2005 and just two in 2006.

Table of return statistics

Thames River Multi-Alternative Funds*	Performance '11 (inception)**
Equity Alternatives	
Warrior	-10.86% (+6.38%)
Warrior II	-10.97%
Hedge+ (£)	-10.16%
Specialist	
Africa Focus	-9.14%
Indices*	
Equities: MSCI The World Index (Gross)	-5.02% (+2.88%)
Bonds: Barclays Aggregate Bond Index	+7.86% (+6.04%)
Cash: Citi 3-Month Treasury Bill	+0.08% (+2.63%)
Hedge Funds: CSFB Tremont Hedge Fund Index	-2.52% (+6.30%)

Source: Northern Trust
*US$ Return unless otherwise indicated. ** annualised since inception of Warrior in 1998. Warrior II, H+ and AF launched after Warrior and therefore annualised numbers removed.

European stock prices, meanwhile, were sold down aggressively (understandably) amid the debt crisis, with most indices posting losses well into double digits. All those investors who proclaimed that emerging markets were the only place to invest (understandably) were hurt with the emerging market leader China, for example, down over 20% despite close on 10% GDP growth.

Global uncertainty also fuelled a stampede into gold for much of 2011 and was the safe haven in August although it reversed sharply in September despite continued uncertainty surrounding the EU crisis.

There were few places to hide in 2011; negative real yields on cash, correlations between all asset classes were high so diversification benefits were minimal, government bonds rallied despite appalling fundamentals and credit was hammered despite fantastic fundamentals.

In a nutshell, we were flat for 10 months of the year and the total loss for the year came in two months, August and September.
In the table below, we look more specifically at the attribution for August and September 2011, to see where we made and lost money.

	August and September
Credit	-3.92%
Equity L/S	-3.00%
Other	-1.61%

As noted in previous reviews our losses over the year were mainly due to two main characteristics of our strategy; namely focusing the portfolio into our high conviction managers and backing our top down macro views. This can be seen in our attribution where the majority of our losses for the year came from 2 areas: equity long/short and credit, our 2 high conviction bets and these both affected us heavily in these two months.

It must be remembered that Warrior is not positioned as an index product but rather a fund focused on our high conviction positions and where we take strong top down views on asset classes in order to make excess returns. Our top down view over the last 12 months saw the fund hold an overweight long exposure to short dated structured credit (through multi-strategy and credit funds) which aimed to take advantage of the dislocations in this asset class as a result of the '08 credit crisis. Over August and September of 2011 credit took significant mark to market losses during the height of the sovereign crisis but we expect this to rebound quickly as the fundamental pull to par starts to reassert itself given the short dated nature of these structured credit positions. The second exposure we wanted was to mid-cap equity managers with a long bias as we believe these companies will outperform blue-chips given the current stage in the economic cycle. This hurt us in the second half of 2011 as the market failed to react to fundamentals. Again, however, we think that this mid-cap theme will perform well over the next 12 months.

Outlook

In a way we expect 2012 to be in many ways the same as 2011. On the negative side continued EU sovereign issues will weigh heavily on markets and this coupled with credit hoarding by banks and austerity measures, may lead to a possible EU recession. China is also slowing and the US will have moderate growth at best, meaning that the EU difficulties may not be offset by growth in the other major economies. Also, we are in a multi-decade period of shorter term and flatter economic trends as the gargantuan debt burden is dealt with (especially in the "Developed" World) which means positioning the portfolio to more nimble trader style managers. On the positive side equities and credit look extremely cheap not withstanding current macro and geopolitical headwinds although the catalysts for unlocking the value in equity markets seem unclear. Continued quantitative easing and low interest rates should be positive for risk assets especially in the first half of 2012 and we see a great time horizon arbitrage appearing as investors obsess with ultra short dated liquidity.

Having reviewed our portfolio repeatedly after such a difficult year, we are very bullish on our return prospects for 2012, especially from our overweight structured credit and mid-cap equity positioning. We are confident with what we have in our portfolio to achieve our double digit return target over the next 12-24 months. Unfortunately, the current macro environment means these return targets are going to come with higher volatility. Our credit positioning for example has an IRR of 30-40% over the next 1.5 years. Remember that today is different from 2008 in that we have a burden of debt crisis versus a liquidity crisis then. This is fundamentally different and we think the impact will be a slow growth environment and not a recession. Even in a slow growth environment opportunities can be found by our skilled managers.

As our long term investors know, the Warrior strategy always adapts to the current investment environment to seek out attractive risk-adjusted returns. We look forward to taking advantage of these challenging times to find interesting investment opportunities for our investors.

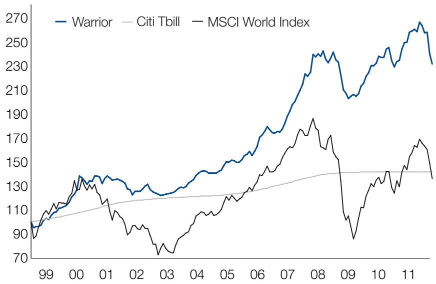
Our long term track record

While years like 2011 are not years that we want to experience on a regular basis, they are important ones as they cause us to reflect on the portfolio, our objectives, and whether we have met these over time. The long term objective of Warrior is to achieve attractive absolute returns relative to the level of risk assumed through a dynamic multi manager approach. The informal benchmarks that we use are:

- Interest rates (absolute returns)
- Equities (attractive returns)

As can be seen below, since Warrior's inception in 1998, it has met and exceeded both of these objectives through various market cycles and through some extraordinary market conditions (LTCM, tech bear market, 9/11, credit crisis, sovereign crisis). The power of compounding returns is extremely important and by largely avoiding the huge drawdowns experienced by equity markets we have been able to offer attractive returns over time.

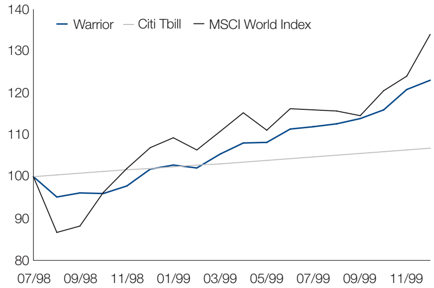
Warrior Performance versus Indices August 1998 - 31 December 2011



Source: TRC, Bloomberg

If we break this down into various market periods we note the following:

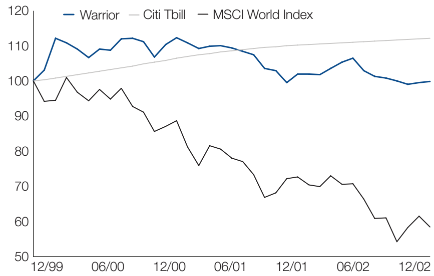
Warrior Performance versus Indices July 1998 - December 1999



Source: TRC, Bloomberg

From July 1998 to December 1999, we have managed to largely keep in line with equity markets during the bull market and outperform interest rates handsomely.

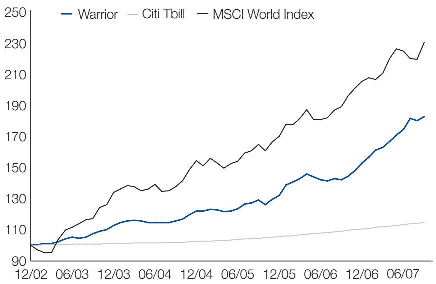
Warrior Performance versus Indices January 2000 - December 2002



Source: TRC, Bloomberg

In the bear market from January 2000 to December 2002 we protected capital well.

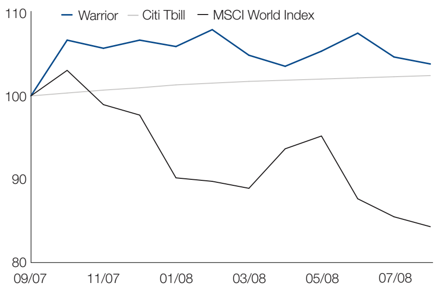
Warrior Performance versus Indices January 2003 - October 2007



Source: TRC, Bloomberg

From January 2003 to October 2007, we have managed to largely keep in line with equity markets during the bull market and outperform interest rates handsomely.

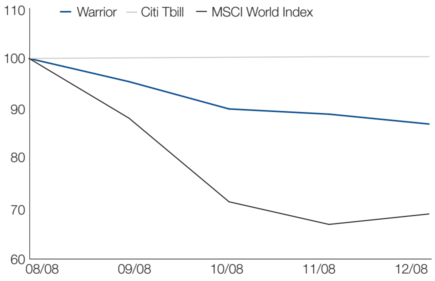
Warrior Performance versus Indices October 2007 - September 2008



Source: TRC, Bloomberg

In the bear market from October 2007 to September 2008 we protected capital well and outperformed interest rates.

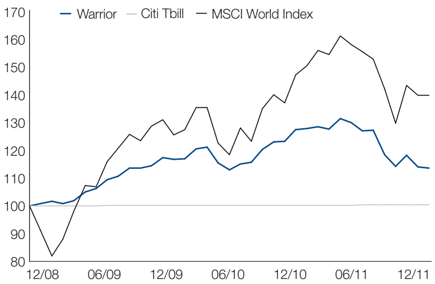
Warrior Performance versus Indices September 2008 - December 2008



Source: TRC, Bloomberg

In the credit crisis from September to December of 2008 which caused extreme, dysfunctional markets we were unable to avoid losses, but we did protect better than most financial markets. Over this period these were very few places to hide as Morgan Stanley, Goldman Sachs, Lehman Brothers and Merrill Lynch all lost balance sheet funding overnight, as had happened to Bear Stearns 6 months before. We believe this type of period would be unlikely again as politicians and central banks have realised that letting a large global bank go under has too many negative ramifications globally.

Warrior Performance versus Indices January 2009 - December 2011



Source: TRC, Bloomberg

From December 2008 to date, during what we hoped would be an easier period for managing money, sovereign crises, the risk on-risk off, sentiment driven markets and continued de-leveraging hampered our ability to make money. Despite this however, the fund has still outperformed interest rates, our minimum benchmark.

In summary, the Warrior strategy is not broken.

Thames River Multi-Alternative funds

Warrior

Warrior Fund ended the fourth quarter down 0.68% (YTD -10.86%). Our 2 largest weightings, CQS Directional Opps, and Cheyne TRC II had a disappointing 2011, delivering returns of -10.55% and -6.78% respectively. These funds are both seeing phenomenal opportunities in the credit market at the moment. Currently a large proportion of the losses were due to idiosyncratic credit spread widening which caused resulting mark-to-market moves. Their structured credit books are comprised of fundamentally researched, short-dated, long credit positions, and in the view of the funds, this market segment represents significant value. On 1 January 2012, the Fund was 105% invested, across 26 managers.

Warrior II

See Warrior above for more detail. Warrior II ended the fourth quarter down 0.73% (YTD -10.97%).

Hedge+

Hedge+ ended the fourth quarter down 0.49% (YTD -10.16%). Our 2 largest weightings, CQS Directional Opps, and Cheyne TRC II had a disappointing 2011, delivering returns of -10.55% and -6.78% respectively. These funds are both seeing phenomenal opportunities in the credit market at the moment. Currently a large proportion of the losses were due to idiosyncratic credit spread widening which caused resulting mark-to-market moves. Their structured credit books are comprised of fundamentally researched, short-dated, long credit positions, and in the view of the funds, this market segment represents significant value. On 1 January 2012, the Fund was 105% invested, across 29 managers.

Africa Focus

Africa Focus's USD performance for the quarter was up 0.85% (YTD -9.14%). The MSCI EFM Africa Index was down 2.41% (-33.05% YTD). Our South African managers experienced pleasing performance for 2011 on average, whereas our African managers were disappointing on an absolute basis. We comfortably outperformed our benchmark with an outperformance of 24% although on an absolute basis we were not able to produce a positive return. The investment outlook for 2012 is looking very promising across African markets although the wider systemic risk from global markets which we saw influence the markets in 2011 may repeat itself in 2012. As always seems to be the case in Africa, there is certainly no lack of news and activity and we are confident that, with the exercise of patience, this will lead to outstanding long term returns.

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