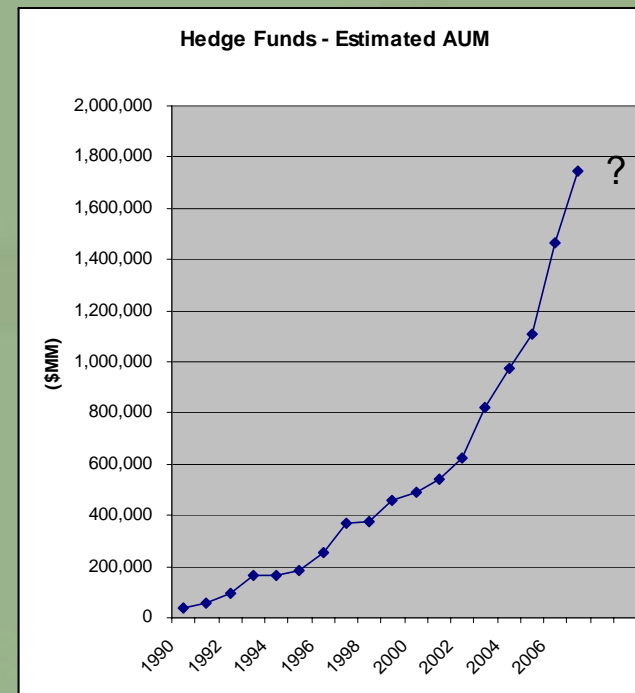
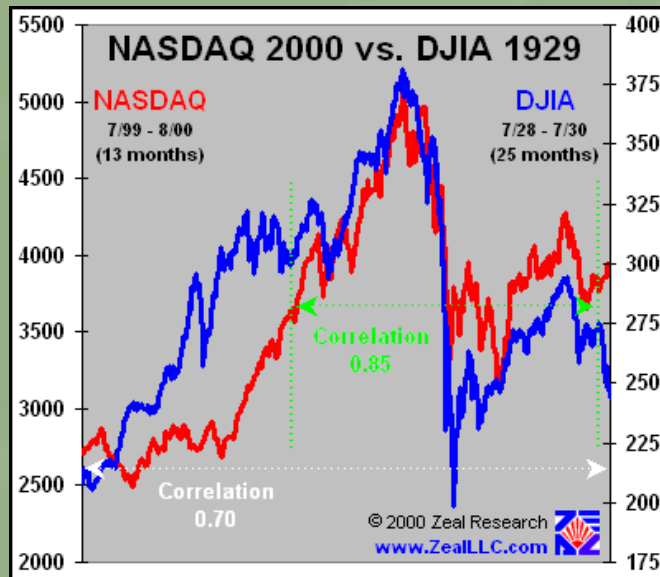
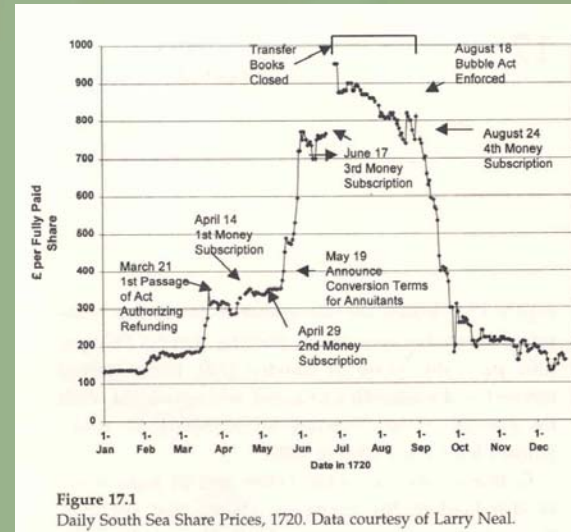
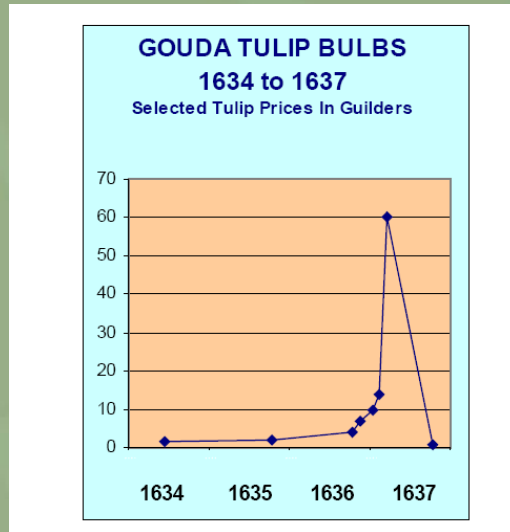

I'm Not Dead Yet! **A Traditional Asset Manager's Response to** **Hedge Fund Mania**

Northfield's 20th Annual Research Conference

Keith Quinton, Fidelity Investments

This document contains time-sensitive proprietary and confidential information that is the sole property of Fidelity Management & Research Company(FMRCo). Any opinions expressed in this material are those of the author only, not of Fidelity Investments, and are subject to change at any time due to market or other conditions. Past results are no guarantee of future performance. This document is for information purposes only and it should not be regarded as an offer to sell or as a solicitation of an offer to buy the securities or other instruments mentioned in it. This presentation is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon as such.

Mania(s)



Outline

- What 130/30 is
- The Marketplace
- Benefits
- Costs
- Mutual Fund Specific Issues

What 130/30 Is

- For a \$100MM portfolio:
- Buy \$130 MM long
- Borrow and sell short \$30MM
- % Return = $1.3 * \text{“long alpha”} + .3 * \text{“short alpha”} + .3 * \text{rebate rate} - .3 * \text{financing costs} - 1.6 * \text{transactions costs} - ? * \text{regular management fees}$
- ? Usually ranges from 1 to 1.3 to 1.6

The Marketplace

- Dominantly institutional \$\$\$
- Dominantly quantitative managers
- Some mutual funds
- Rapid growth/adoption
- More appealing than long/short + futures

Benefits

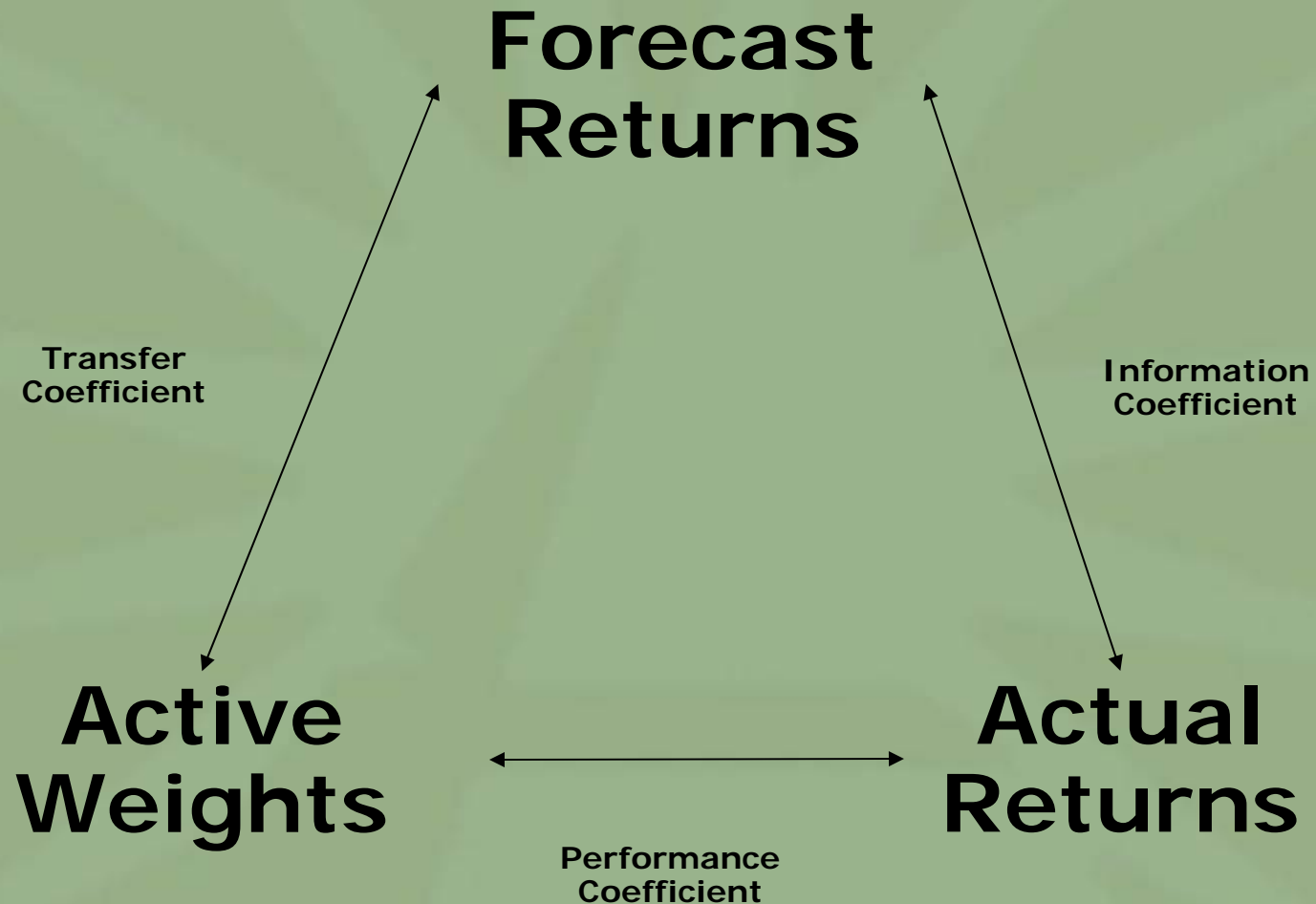
- Elimination of the short constraint
- Increased active money
- Taxes
- Higher returns
- Potentially lower systematic risk

Elimination of the Short Constraint

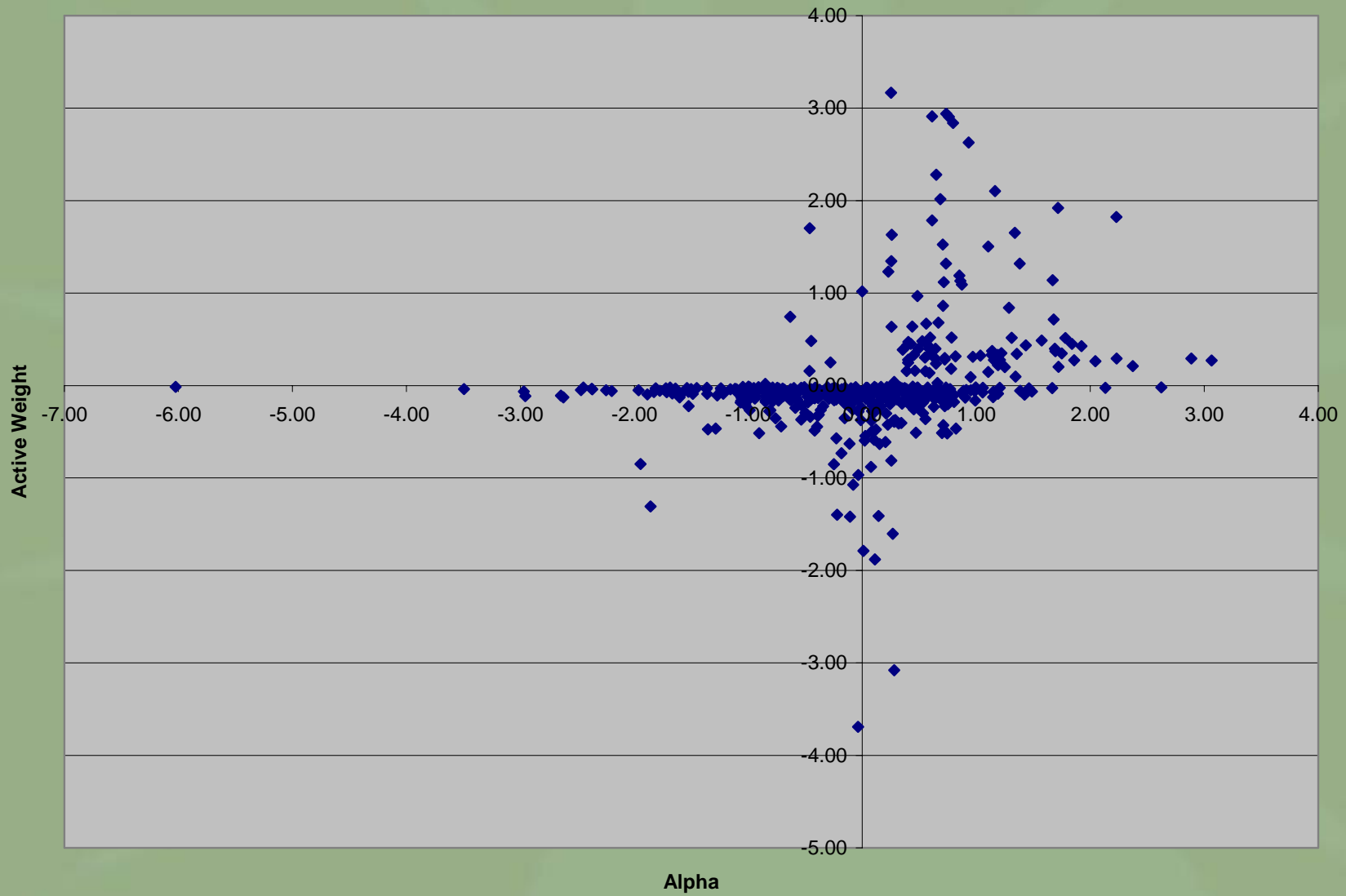
In a traditional long-only fund:

- If your maximum active weight is 100bp:
- There are 500 securities in the S&P 500 you can max overweight
- There are only 16 securities you can max underweight
- There are only 28 additional securities you can 50% max underweight
- They may be concentrated where your alpha is lowest
- Of more value the more “chunky” your benchmark is

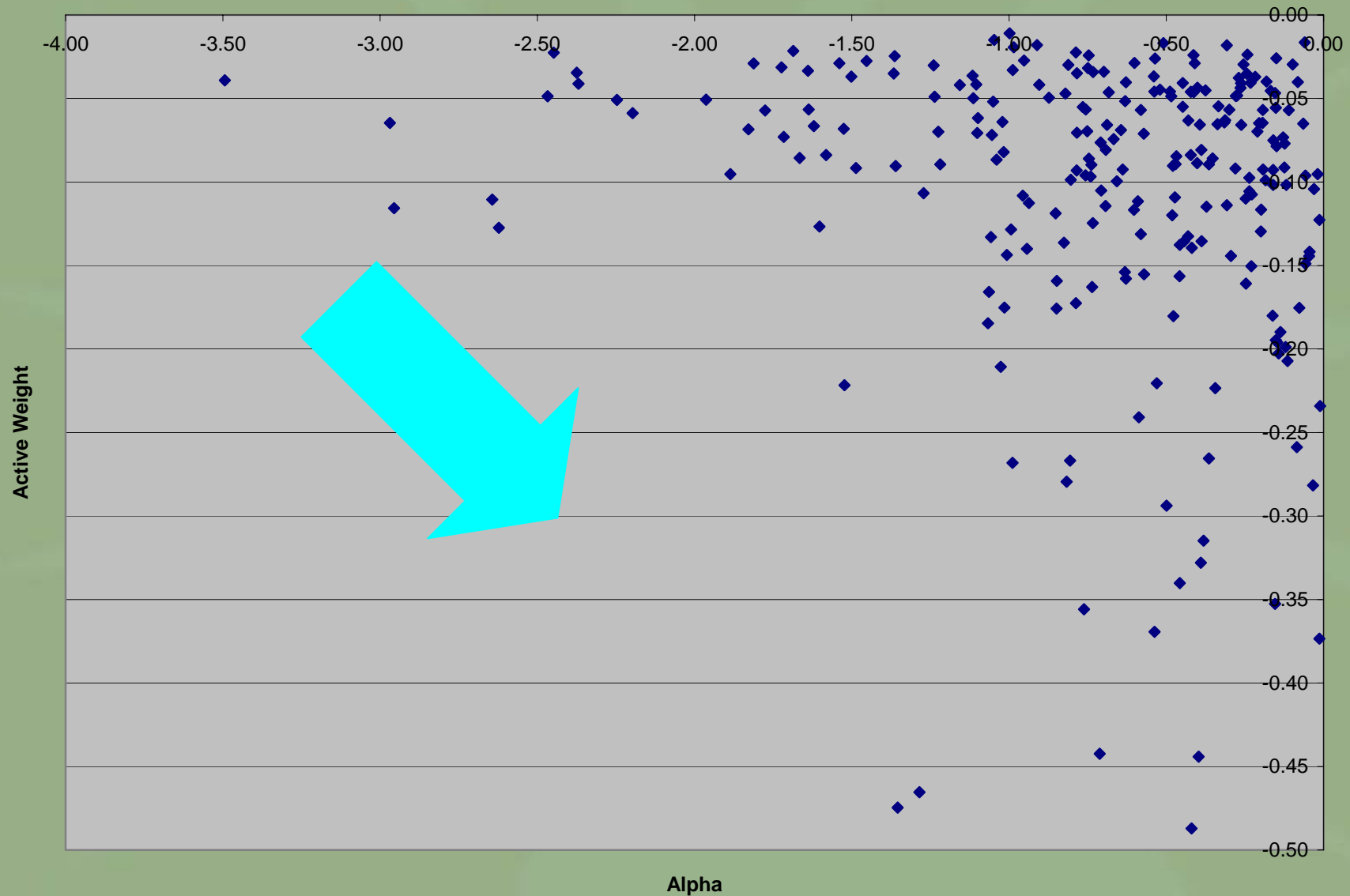
The Correlation Triangle



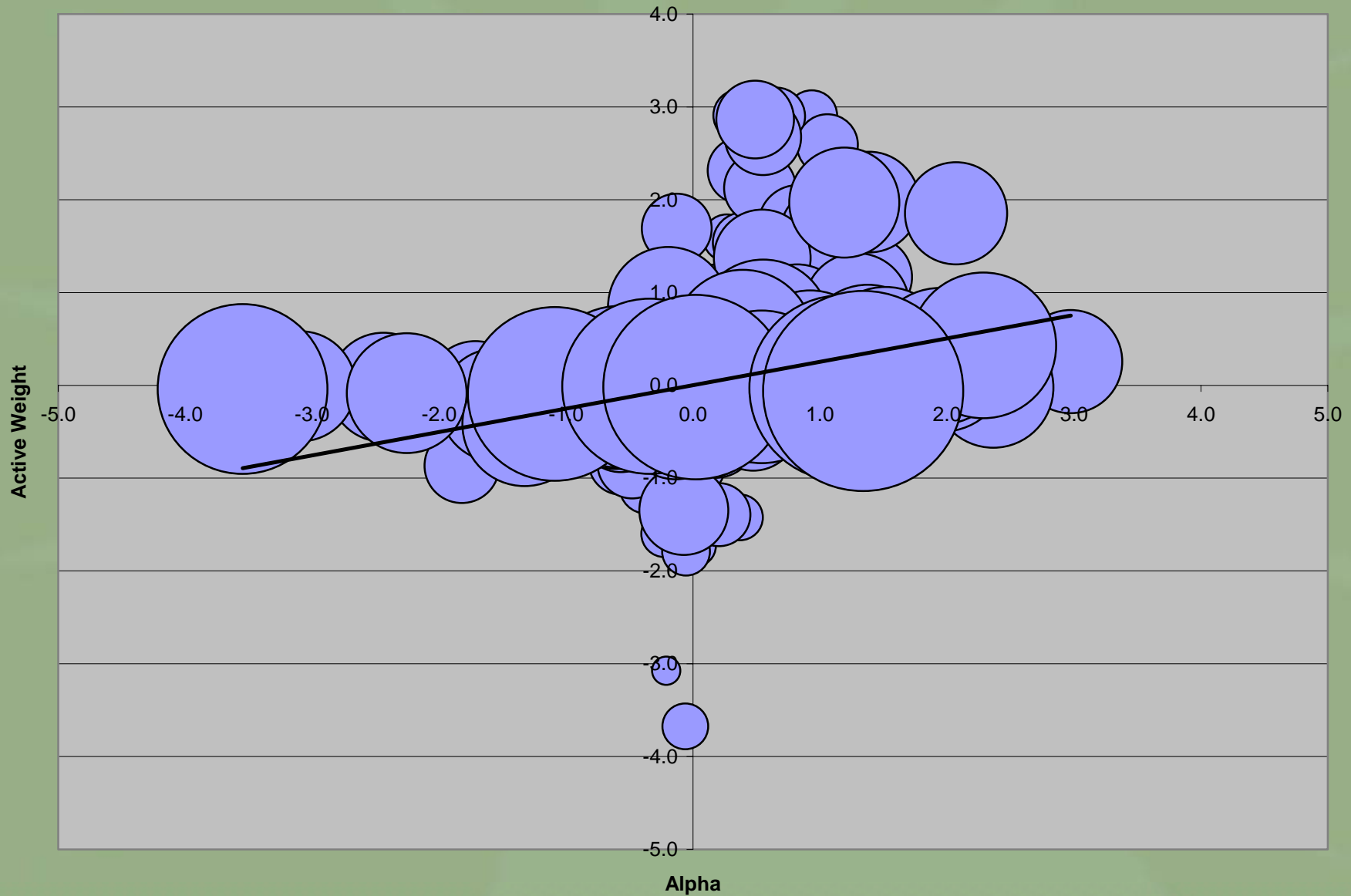
Transfer Coefficient



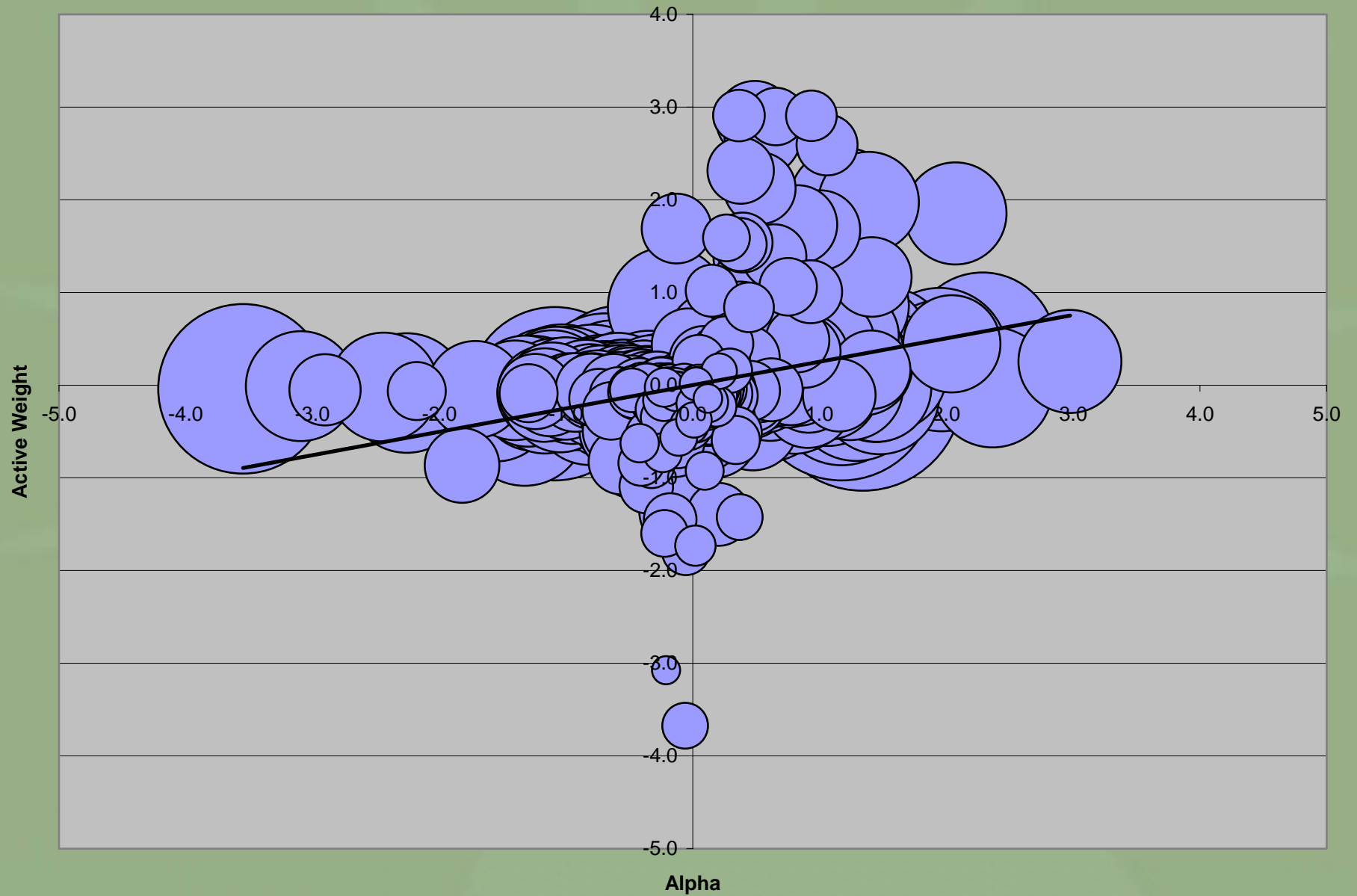
Transfer Coefficient (0-50 BP negative)



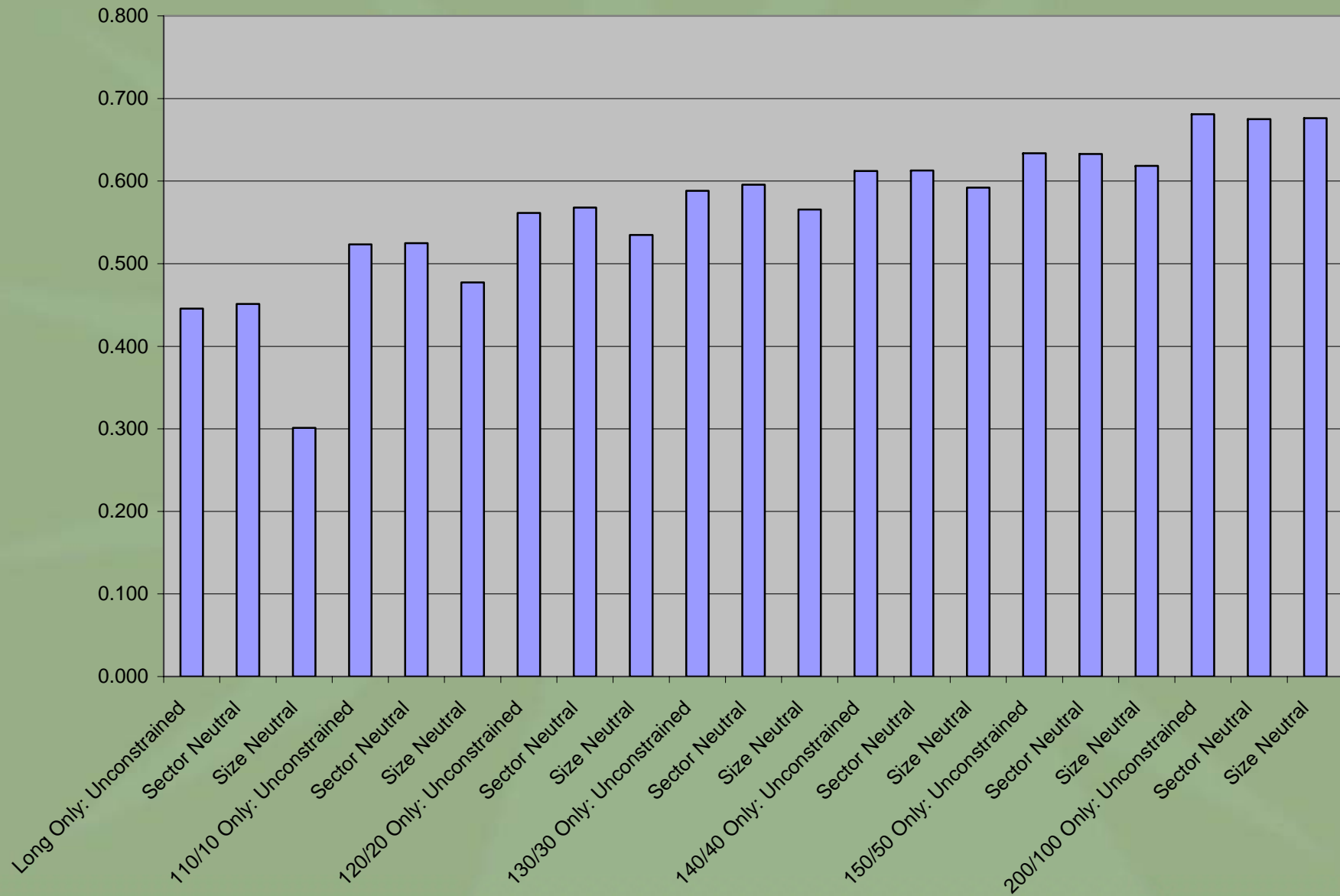
Transfer Coefficient: ± 1 STD



Transfer Coefficient: ± 1 STD: Take 2

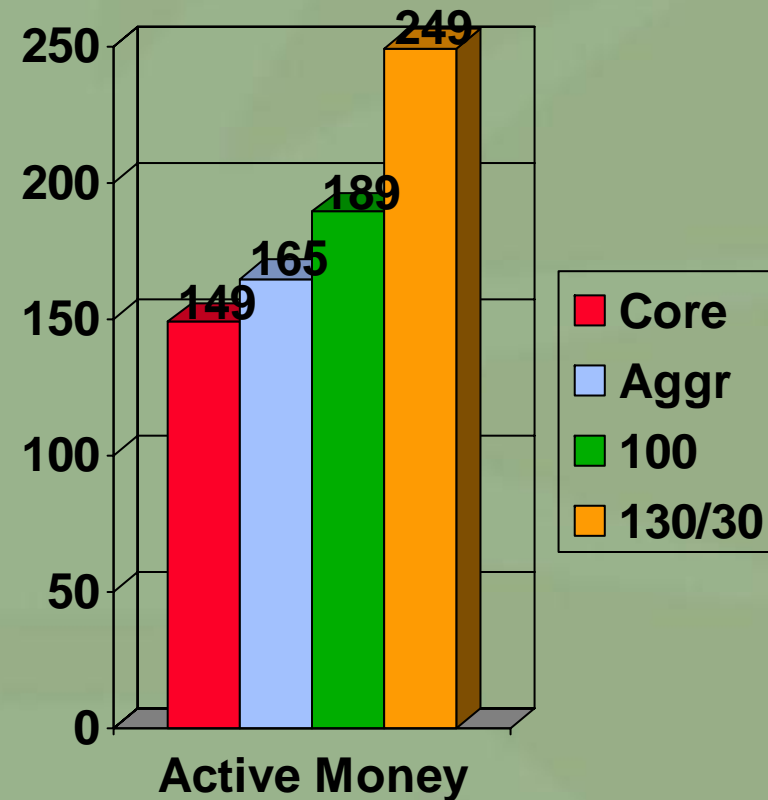


Transfer Coefficient and Constraints



Increased Active Money

- Buying up to index weight is “dead money”
- The entire additional 30% long and 30% short can be fully active
- HPQ: 386 bp position = 297 bp active

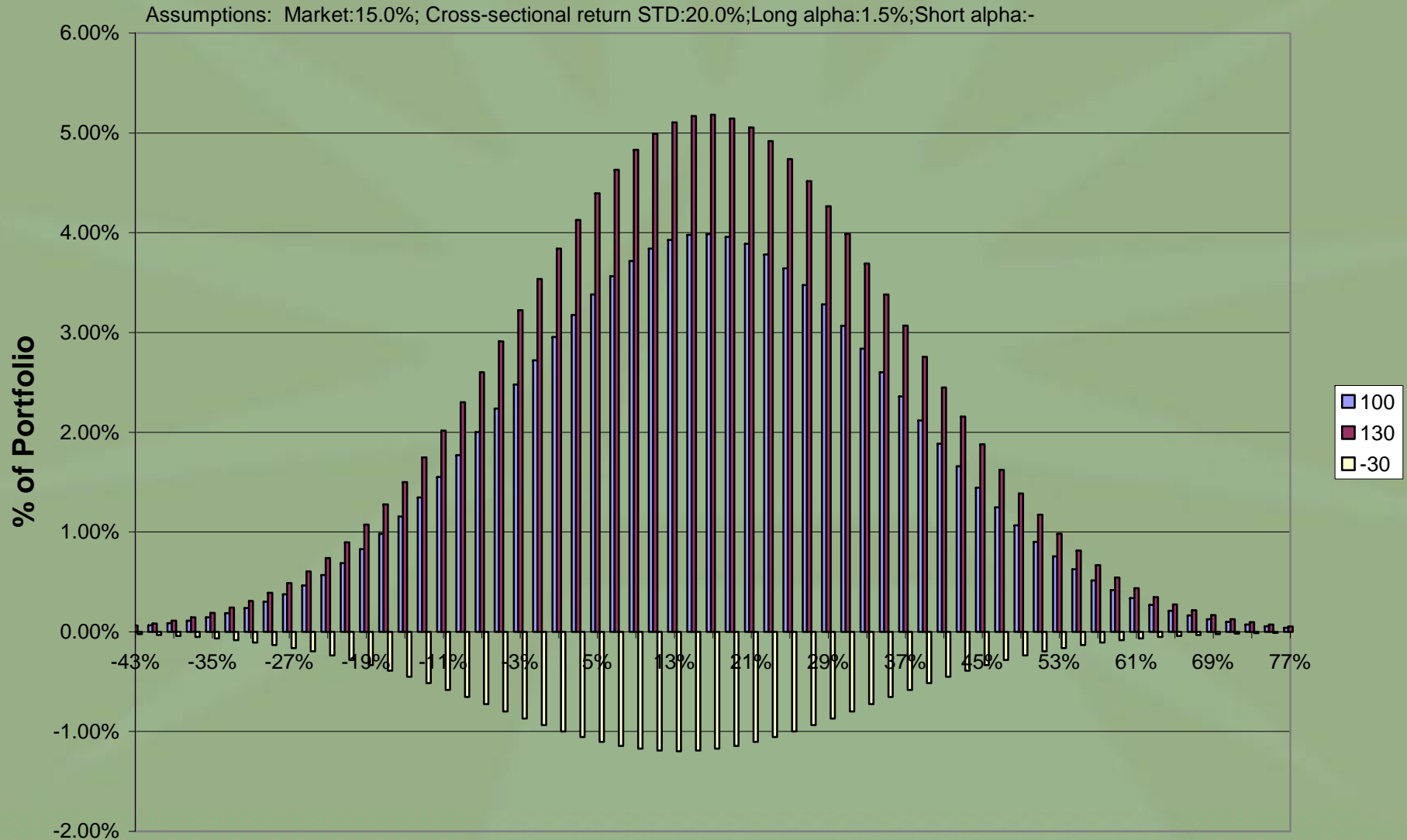


Taxes

- Not yet thought about by the market place
- Long only in a rising market “locks” positions
- Unable to rebalance portfolio towards better names
- Shorting helps

Taxes - Continued

Distribution of Portfolios By Return Bin



Taxes – Continued(2)

Contribution to Portfolio Performance By Return Bin



Tax-Free Turnover

| | Long-Only | 130/30 |
|--------------|-----------|--------|
| Market: +15% | 30% | 63% |
| Market: +25% | 12% | 51% |
| Market: -10% | 168% | 181% |

Tax Simulation

- Pick an actual mean and STD for the S&P 500
- Build long only and a 130/30 portfolio
- Annually harvest losses and replace names for 5 years
- Assume a 1 year alpha of 1.5%; 100% decay
- Do 1000 times

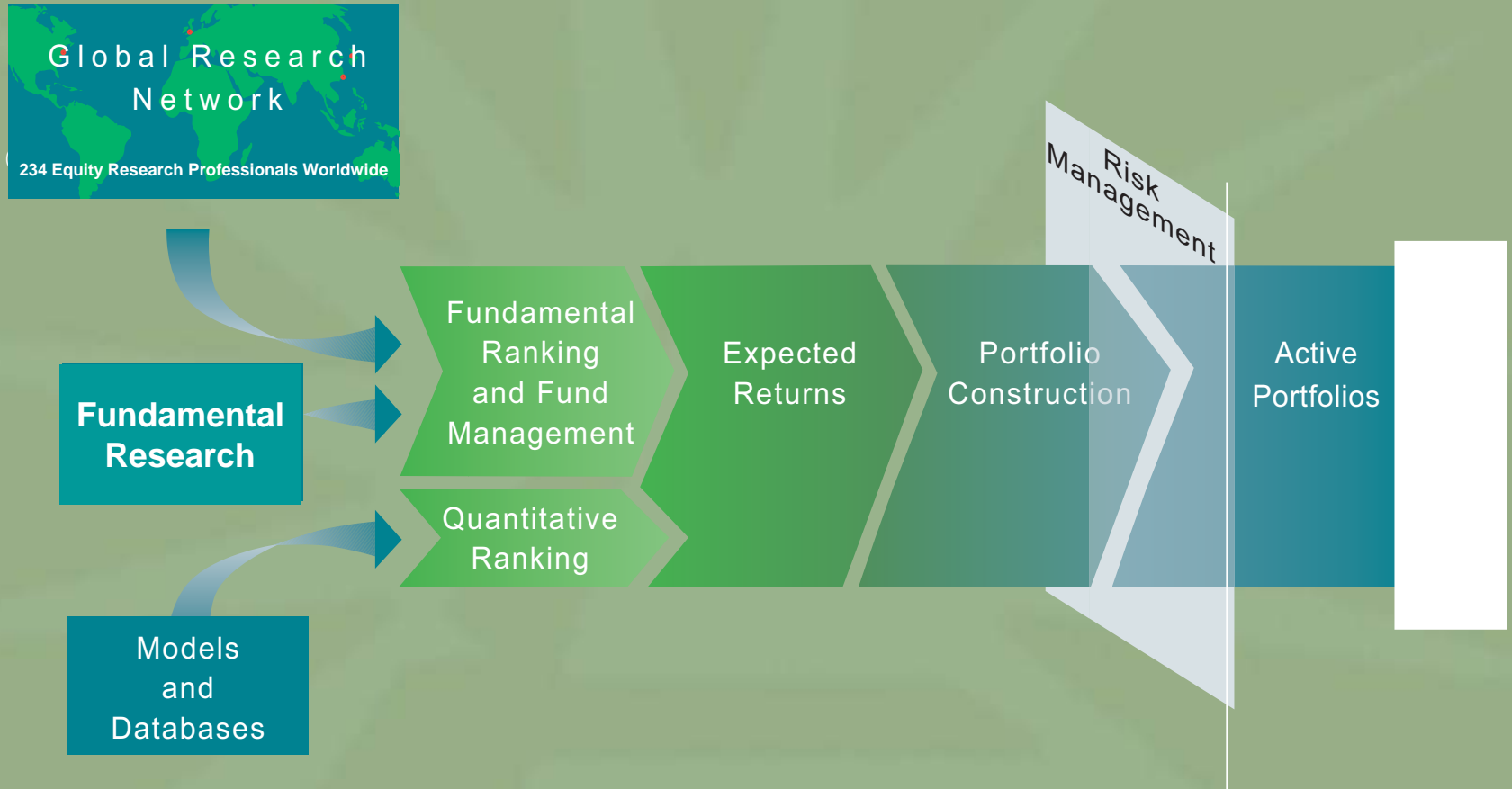
Tax Simulation - Results

- Average annual increase in tax-sheltered turnover: 33%
- Annual alpha improvement: 50 basis points
- Terminal value also tax advantaged

Higher Alpha Potential

- 1.3x long alpha
- .3x short alpha
- Beta remains the same
- Can also have a higher IR
- Can go where the alpha is highest

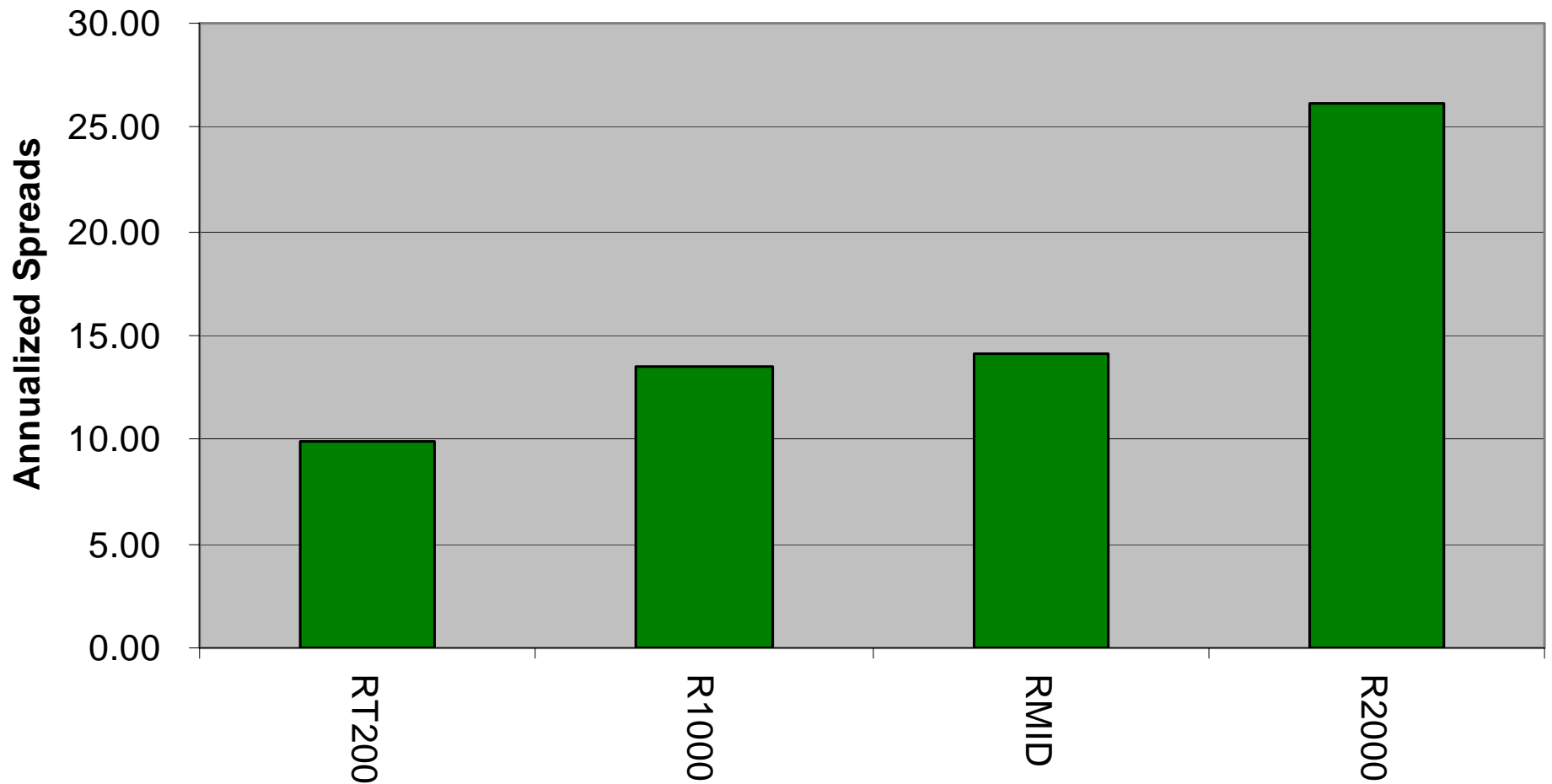
“Quantimental” Investing



- Utilizes Fidelity’s proprietary global fundamental research and quantitative models
- Combines Fidelity’s qualitative research effort with quantitative expertise
- Consistent value-added from stock selection

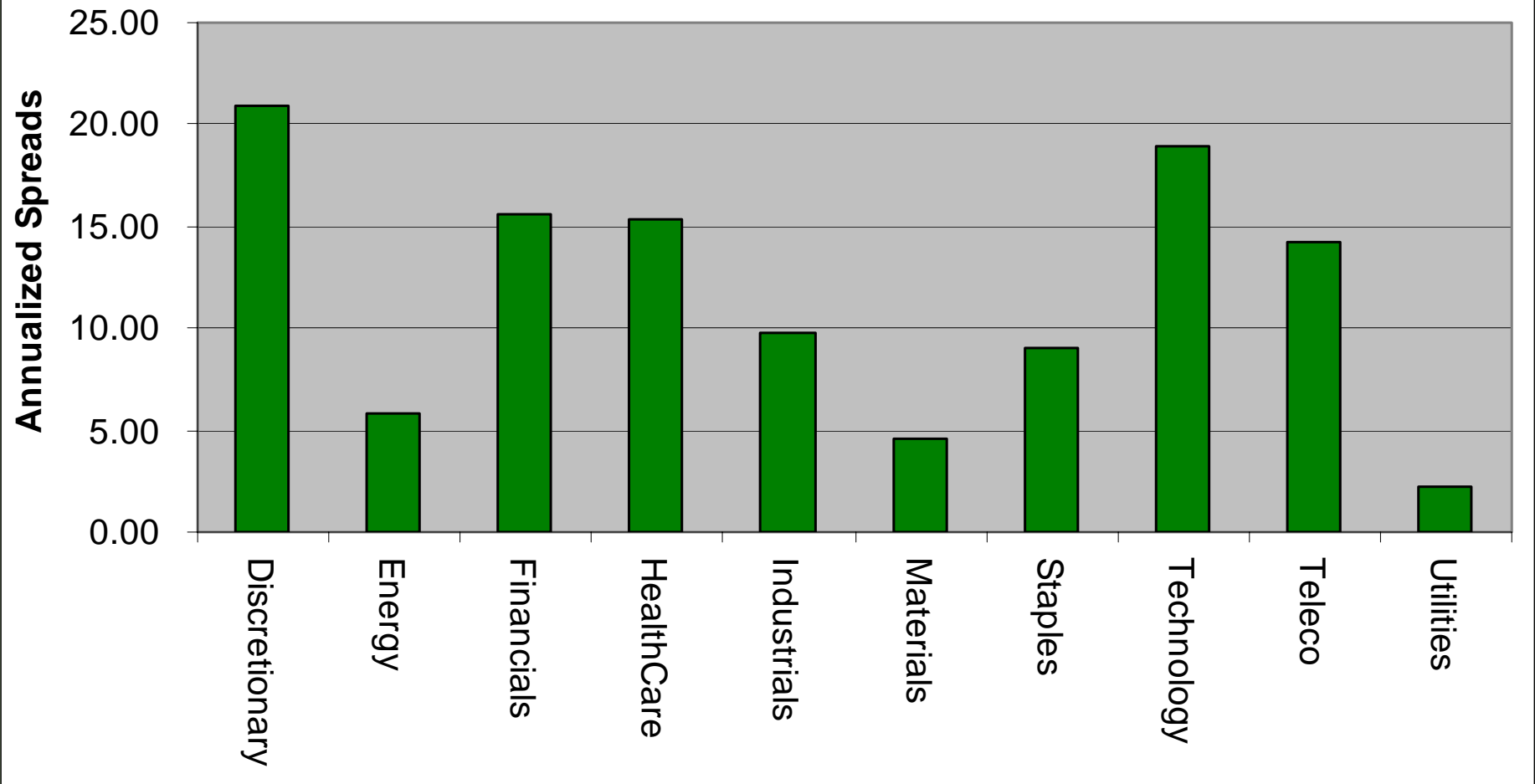
Where Is The Information? Market Capitalization

**Core Model US Large Cap Annualized Spreads
Over Different MktCaps (12/1990-7/2007)**



Where is the Information? Sectors

**Core Model US Large Cap Annualized Spreads
Over Different Sectors (12/1990-7/2007)**



Higher Alpha on the Short Side

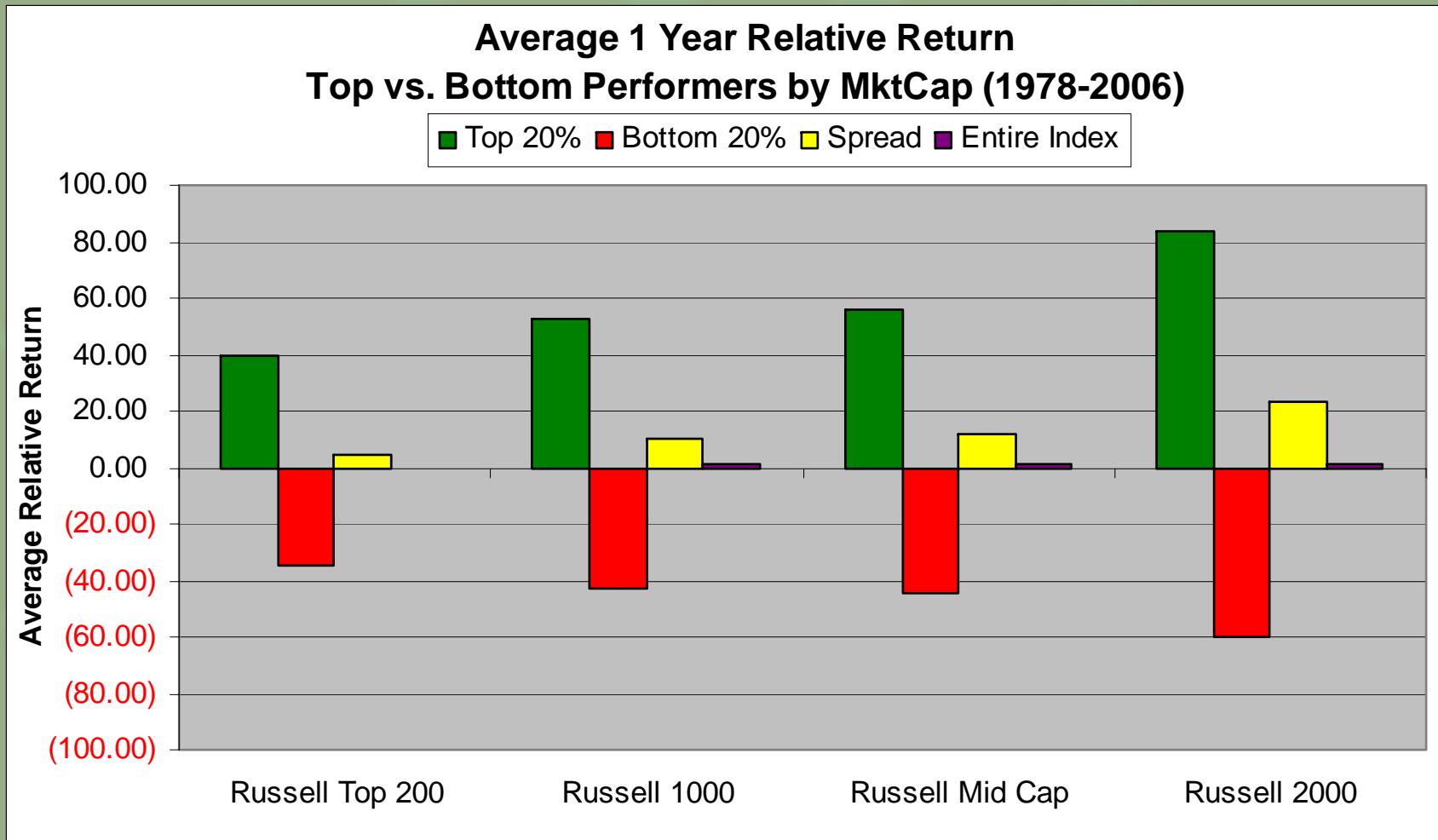


12/95 – 3/06; Average 3 Month Relative Return for the Russell 1000

Potentially Lower Systematic Risk

- Many portfolios are drawn to small- and mid-cap names due to the potential outperformance
- This outperformance is driven by the spread of returns not necessarily the relative return of all small- and mid-caps
- Shorting mid- and small-cap names can reduce the “small stock” exposure while maintaining the exposure to the individual name
- Other systematic risks are similarly addressed

The Allure of a Size Bet



Costs

- Complexity
 - Shorting
 - Risk management
- Capacity
- Trading
- Alpha multiplier
- Potential conflicts of interest and bad PR

Complexity

- Shorts get called in
- Shorts have different/changing rebate rates
- Bad shorts become a bigger part of the portfolio
- Risk management has another dimension:
leverage

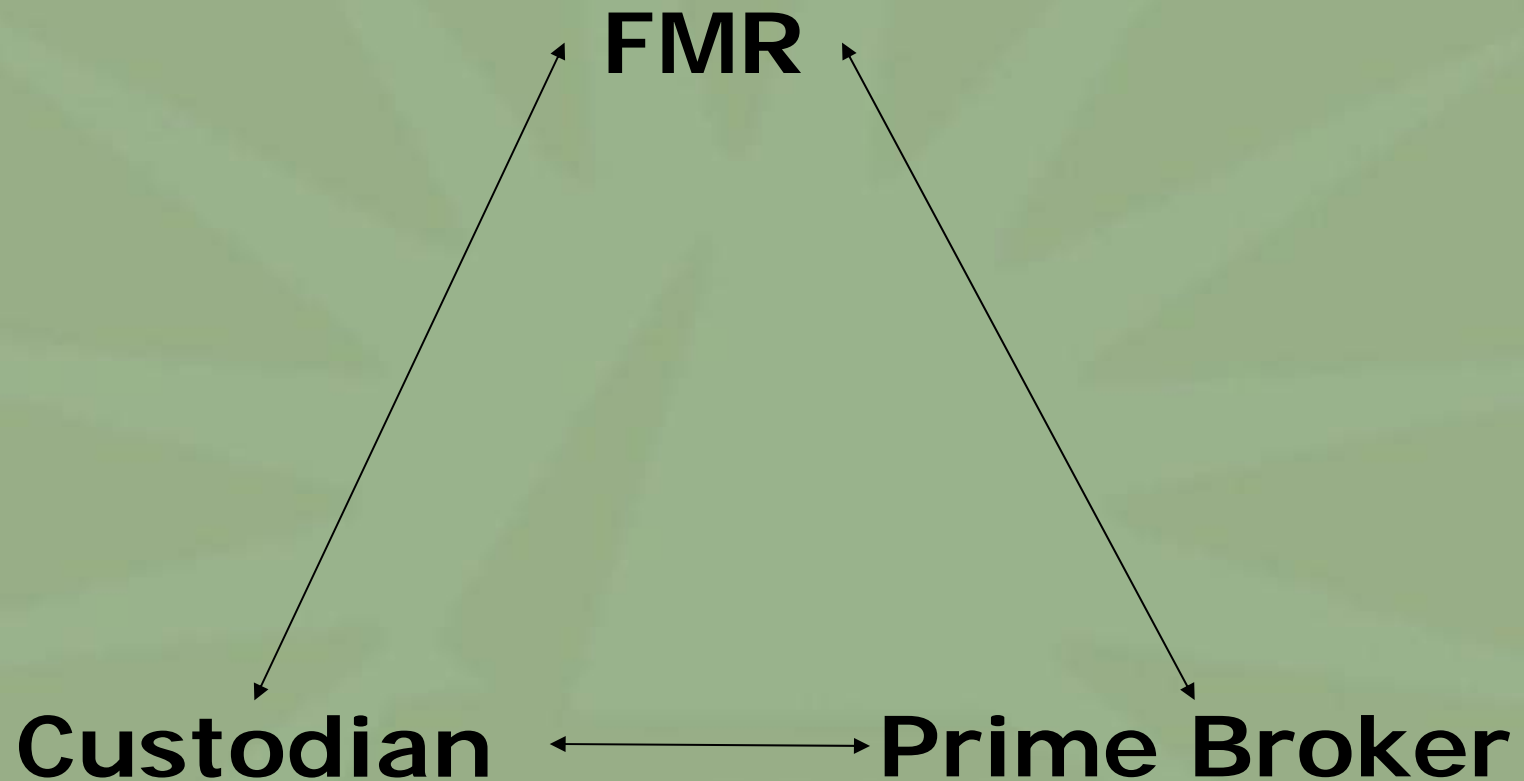
Capacity, Trading and Alpha Multiplier

- \$1.30 used for every \$1 invested in the fund
- \$.30 shorting too (Not an issue for long-only managers)
- Turnover looks large when measured off the \$1 invested
- Trading cost management is critical
- Bad alphas are rapidly exposed

Mutual Fund Specific Issues

- Tri-party agreement (custodian-broker-FMR)
- Daily NAV's and flows
- Taxes
- Expenses

Tri-Party Agreement



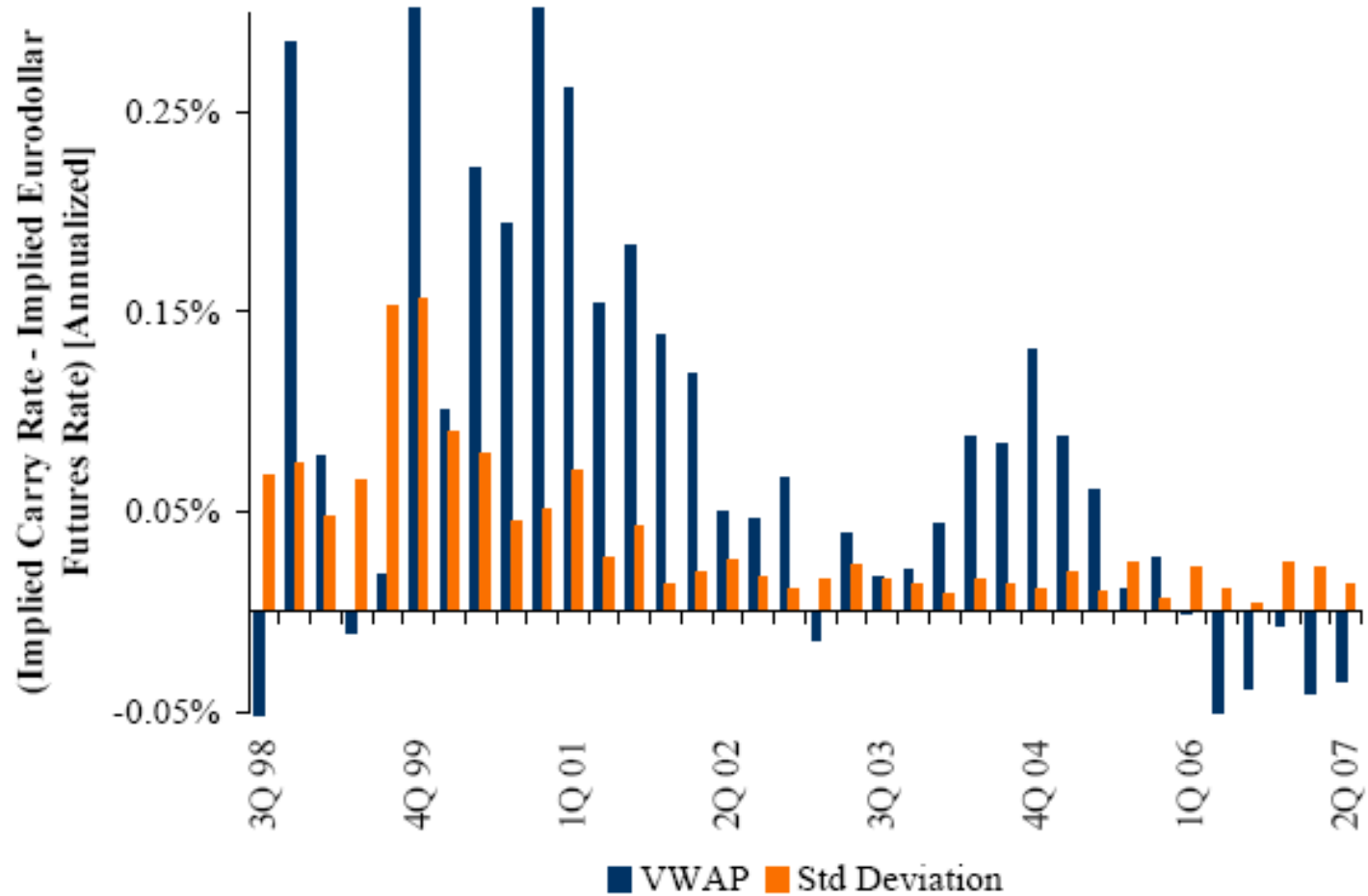
Futures/Equitization/Portable Alpha Issues

- Credit risk
 - Clearinghouse
 - FCM
- Roll risk and costs
- Operational risks
- Taxes
- Overlapping long and short positions
- Efficient markets aren't free

Roll Cost

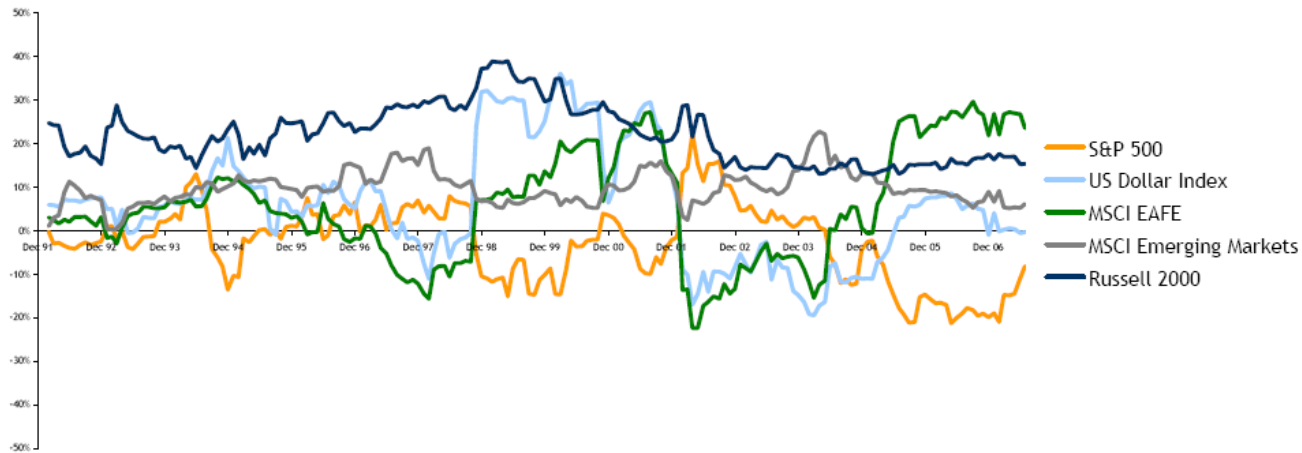
S&P 500

Quarterly data from Sep 98 to Jun 07

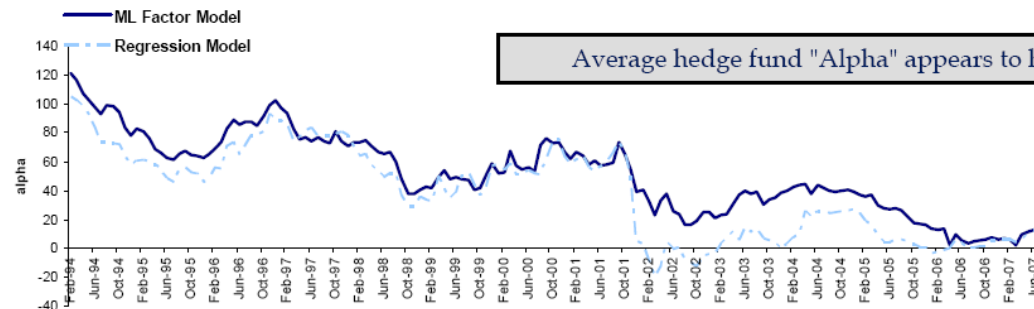


Equitizing What?

| Model Components | Bloomberg Ticker | Weights as of July 2007 |
|---|------------------|-------------------------|
| S&P 500 Total Return | SPTR <Index> | -8.1% |
| US Dollar Index | DXDY <Index> | -0.3% |
| MSCI EAFE Net Total Return | NDDUEAFE <Index> | 23.6% |
| MSCI Emerging Markets Free Total Return | NDUEEGF <Index> | 6.2% |
| Russell 2000 Total Return | RU20INTR <Index> | 15.4% |
| BBA One Month USD Libor | US0001M <Index> | 62.9% |



Estimated HFRI Composite Alpha vs. MLFM

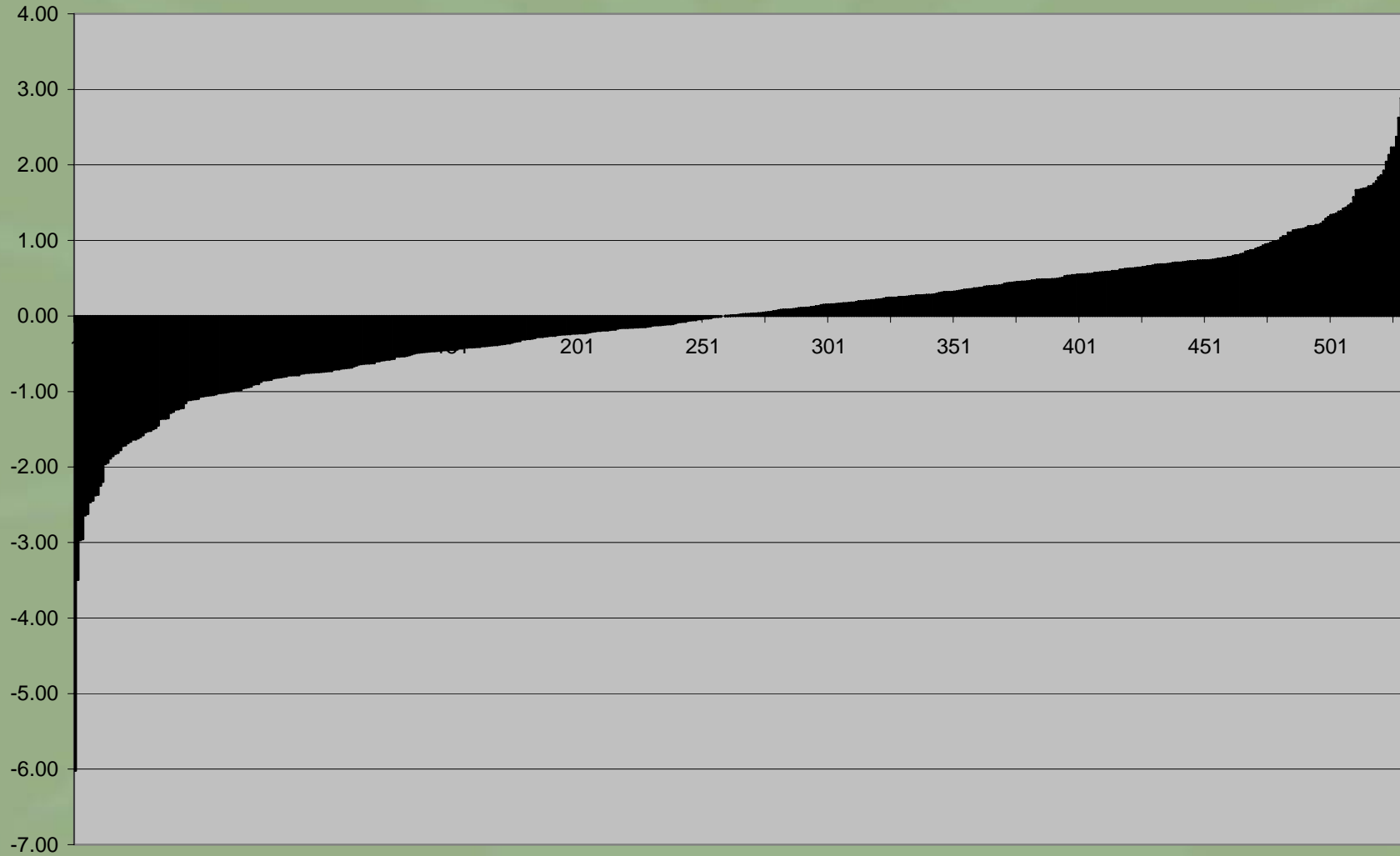


What's So Magical About 30% Leverage?

- Academic support
- The marketplace
- Marginal contribution
- Process driven
- Margin driven

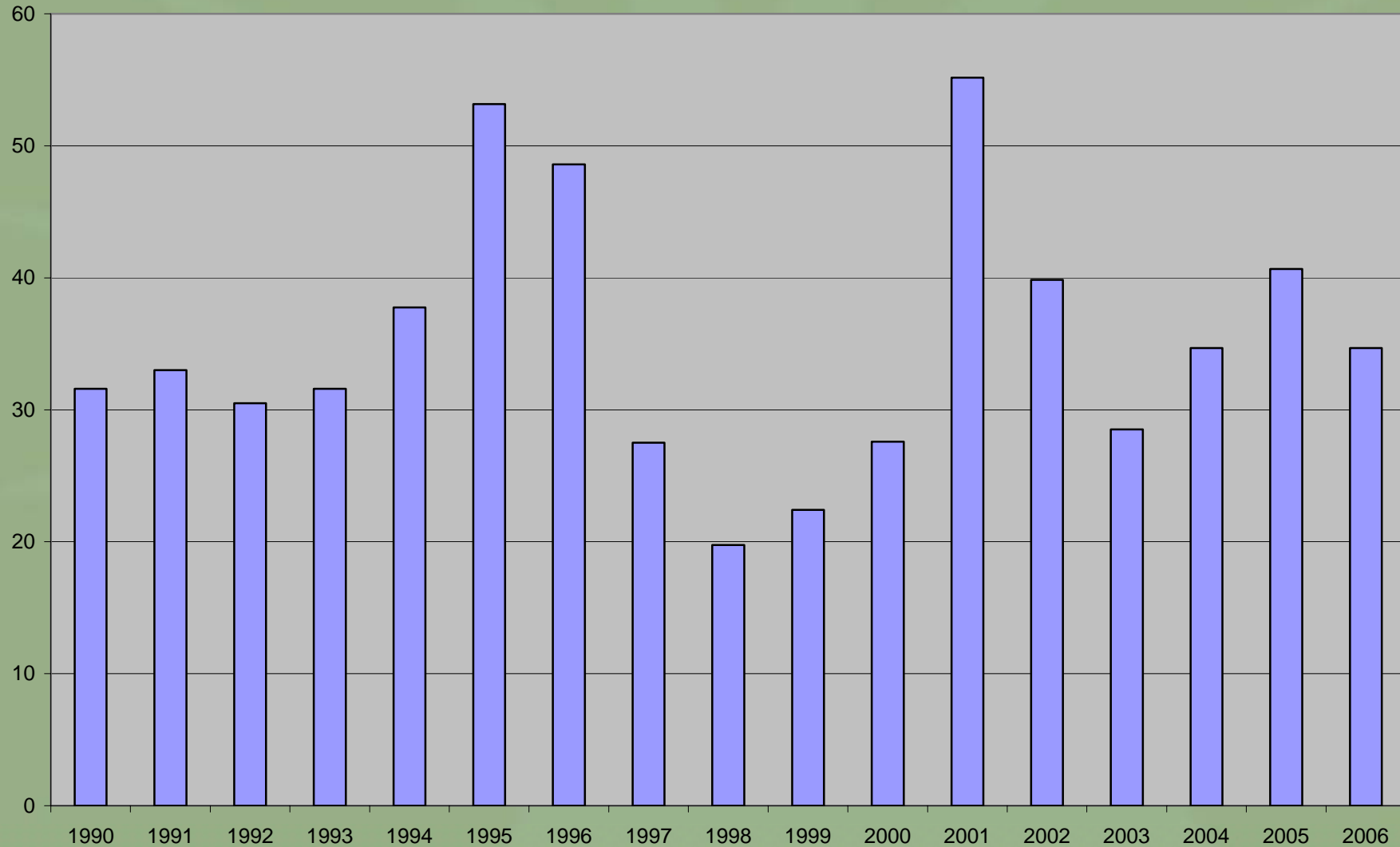
30% Leverage: Marginal Contribution

Forecast Alpha



30% Leverage: Process Driven

Average # of Sell Ideas



30% Leverage: Margin Driven

| | Long/Short STD | | | |
|--------|----------------|------|------|------|
| | 1% | 5% | 10% | 15% |
| 100/0 | 1.00 | 1.00 | 1.00 | 1.00 |
| 110/10 | 1.21 | 1.24 | 1.28 | 1.34 |
| 120/20 | 1.41 | 1.48 | 1.58 | 1.72 |
| 130/30 | 1.62 | 1.73 | 1.91 | 2.15 |
| 140/40 | 1.83 | 1.99 | 2.26 | 2.65 |
| 150/50 | 2.05 | 2.26 | 2.64 | 3.23 |

| | Maximum Spread Drawdown | | | |
|--------|-------------------------|------|------|------|
| | 10% | 20% | 30% | 40% |
| 100/0 | 1.00 | 1.00 | 1.00 | 1.00 |
| 110/10 | 1.22 | 1.25 | 1.28 | 1.32 |
| 120/20 | 1.45 | 1.51 | 1.58 | 1.67 |
| 130/30 | 1.68 | 1.79 | 1.91 | 2.06 |
| 140/40 | 1.92 | 2.07 | 2.26 | 2.50 |
| 150/50 | 2.17 | 2.38 | 2.64 | 3.00 |

Summary

- Exciting new product
- Offers many benefits to the investor
- Fits into an existing asset class
- The synthesis of hedge fund and long-only investment processes and benefits