

Rebalancing: Dull and Unimportant... Not!

by Robert D. Arnott

Reprinted from February 2001 Partner's Message

The conventional view is that rebalancing is a minor aspect of fund management, not worthy of much commitment of time or intellectual energy. That view is very, very wrong. In a world of lower returns, a

In a world of lower returns, rebalancing matters more than it ever has.

brash statement, regarding one of the most passive and dull aspects of fund management? No.

- As we've argued extensively over the past year or two, it is impossible to make a case for a large "equity risk premium" in the years ahead, without making some truly heroic assumptions about future economic growth, and the flow-through of that growth to the equity market investor. The best guess for equities, over the next

The benefits of rebalancing are modest in a relentless bull market and substantial in a more steady market, where there is not one dominant asset class.

flatter "trend line." In this "new world," rebalancing becomes a far more reliable source of improved performance and an "anchor to

windward," reducing risk as it improves returns. As the attached paper by Lisa Plaxco shows, the benefits of rebalancing are modest in a relentless bull market and *substantial* in a more steady market, where there is not one dominant asset class. Which are you expecting in the years ahead?

- Future returns will be sharply less than the 15-20% that we have grown accustomed to. If, as we believe is true, future returns in the next ten to twenty years are likely to be 5-6%, and are likely to be negative as they are to be double-digit. A thoughtful market observer might peg expectations a touch higher (or lower ... see some of Jeremy Grantham's work!). Either way, adding a few tens of basis points per annum over a market cycle is an *important* improvement in returns, when returns are so modest.

Adding a few tens of basis points per annum over a market cycle is an important improvement in returns.

- Asset allocation decisions are not simple "yes or no" choices. The question is not, "should we do rebalancing?" The question is "*which* mechanism should we employ to respond to market movement?" Tactical asset allocation will typically respond to a newly-fallen market by buying (*ceteris paribus*). This is fine if we believe that a lower market typically means higher future returns. Rebalancing implies reverting to a fixed mix whenever there is a material departure from the intended policy asset mix. This is fine if we believe that markets are efficient and that a higher or lower market doesn't really change return prospects enough to justify an active asset allocation "bet." A drifting asset

A drifting asset mix is a problem... it makes active tactical asset allocation "bets," but they are accidental bets.

mix is a problem: it guarantees that you are overexposed at market tops and underexposed at market bottoms. It makes active tactical asset allocation “bets,” but they are accidental bets, driven by the whims of the markets. It is difficult, therefore, to justify by any sound fiduciary or theory arguments.

- For those who reject the active bets made by Tactical Asset Allocation, rebalancing is the most defensible, intuitive alternative. Yet, startlingly, we have encountered very few sponsors who have rejected TAA in favor of systematic, passive rebalancing. *Almost all* of our rebalancing clients are also users of TAA (using the rebalancing for the assets outside of the TAA program). Most funds that reject TAA instead tolerate some form of asset mix drift.
- The costs are negligible. Trading is modest and trading costs through futures are tiny. Fees, similarly, are tiny when measured against either the assets of the fund or the tens of basis points that are typically added at the fund level.
- Formalizing a rebalancing framework can help persuade the investment committee *not* to tinker with the asset mix in the all-too-typical ad hoc committee-meeting tactical asset allocation process. It creates a mechanism whereby the fund *can and will* buy when markets are newly-fallen or sell when markets are newly-costly, without provoking second-guessing by the investment committee or the all-too-common “let’s wait and see what happens first” decision-avoidance.

It creates a mechanism whereby the fund can and will buy when markets are newly-fallen or sell when markets are newly-costly.

second-guessing by the investment committee or the all-too-common “let’s wait and see what happens first” decision-avoidance.

- It’s easy. There’s no excuse for *not* having some sort of rebalancing process in place.

Evidence from Live Rebalancing Strategies

Attached is a summary of our own rebalancing composite. These strategies, for the most part, use a client's existing idle cash reserves for two purposes: equitizing those reserves and rebalancing to a policy mix. Some clients require passive rebalancing, exactly to the policy mix, whenever there is a departure from policy mix larger than 1% or 2%. Others allow us to tactically rebalance, whenever our tactical models suggest that it is timely and appropriate to do so. The difference between tactical rebalancing and tactical asset allocation is that with tactical rebalancing we can never actively take on a deliberate active position; we can only allow a mix which has already drifted away from the policy mix to stay as-is, until our tactical models suggest that things have gone too far. It's a subtle distinction, but tactical rebalancing obviously involves dramatically less tracking error and sharply less active bets than a true tactical asset allocation program. None of our tactical rebalancing clients allows us to permit an asset mix to drift more than 3% away from the policy norms.

With our equitization and rebalancing mandates, we find that the equitization of cash reserves adds tremendous value in a bull market (see the gains in 1997-1999). However, rebalancing opportunistically benefits from bear markets, which almost offsets the losses on cash equitization in bear markets (witness the surprisingly good results in the bear markets years 1994 and 2000). Cumulatively, since the beginning of 1992, when our first rebalancing clients started with us, rebalancing and cash equitization has gained these clients over 100 basis points (91 net of fees) per annum, with only 74 basis points of annual tracking error. Here, tracking error has a rather unusual definition: what we are really doing is **reducing** the tracking error that would have resulted from a drifting asset mix! So, our 74 bp tracking error, relative to the underlying assets is mostly a reduction in the tracking error that a drifting asset mix would have had relative to the intended policy mix! One of the most surprising exhibits is the rolling

12-month value-added chart. Over 12-month spans, this equitization and rebalancing has almost always added value for clients, except for a brief span in 1994, when rebalancing could not overcome the losses associated with equitizing cash reserves in a falling market. The most recent 12 months has seen a slender gain, even in the context of a very weak market.

We've published studies suggesting that the benefits of cash equitization and rebalancing are around 47 bp per annum, over the span from 1971-1990¹ around 41 bp per annum on a risk-adjusted basis even for rebalancing *alone* from 1968-1991² and 43 bp per annum for a UK rebalancing process from 1986-1994³. Tactical rebalancing, in simulation, adds nearly 100 basis points to global returns from 1986-1995, while reducing volatility⁴. Rebalancing also adds as much value as 11% increase in equity exposure in equities⁵ and as much as 25% more in stocks if it's done in a globalized portfolio⁶.

Does rebalancing matter? Is it worth the bother? You bet! Now more than ever.

Sincerely,



Robert D. Arnott

¹ "Managing the Asset Mix", *First Quadrant*, 1990, No. 3.

² "Rebalancing: Why? When? How Often?", *First Quadrant*, 1992, No. 3.

³ "Rebalancing to Benchmark", *First Quadrant*, 1994, No. 4.

⁴ "Tactical Rebalancing", *First Quadrant*, 1996, No. 3.

⁵ "Rebalancing: Why? When? How Often?", *First Quadrant*, 1992, No. 3.

⁶ "Rebalancing to Benchmark", *First Quadrant*, 1994, No. 4.

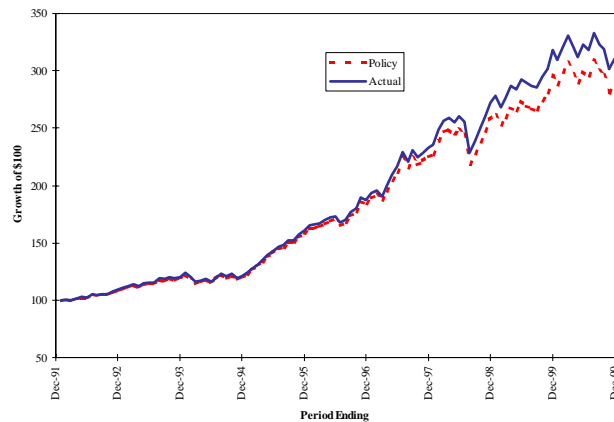
CLIENT LETTER • APRIL 2001
PARTNER'S MESSAGE

For month ending: December-00
Composite: FQ REBALANCING COMPOSITE
NET OF FEES

Year-to-Date Through:	Policy	Actual	Value-Added
2000	-2.29	-2.40	-0.11
1999	15.11	16.98	1.87
1998	14.21	16.74	2.53
1997	22.30	24.64	2.34
1996	15.92	16.09	0.17
1995	32.42	33.28	0.86
1994	0.59	0.33	-0.26
1993	9.69	10.30	0.61
1992 (p)	8.60	9.18	0.58

(p) Partial year, not annualized. Inception date February 1, 1992.

Total Returns

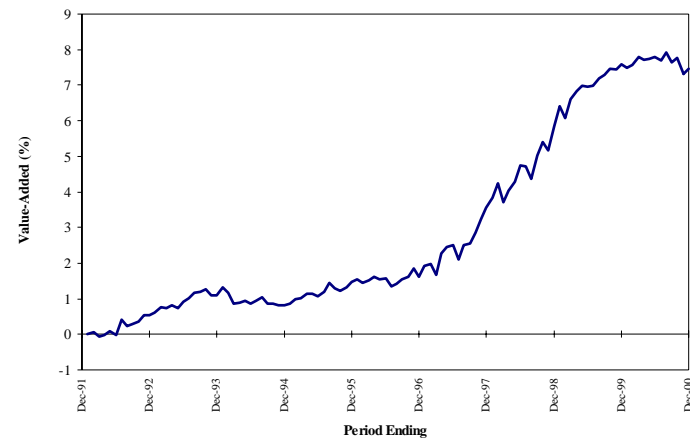


See Disclosures for important information concerning this composite, including fees and benchmarks.

	Policy	Actual	Value-Added
Dec-00			
Cumulative Returns	2.89	3.03	0.14
24 month	6.05	6.85	0.80
36 month	8.71	10.07	1.35
60 month	12.74	14.05	1.31
84 month	13.50	14.50	1.00
Inception	12.65	13.56	0.91
Standard Deviation			
24 month	10.23	10.70	0.73
36 month	11.89	12.41	0.96
60 month	11.05	11.44	0.90
84 month	10.19	10.55	0.80
Inception	9.27	9.61	0.74
Consistency of Returns			
36 month	58	58	67
60 month	67	67	70
84 month	69	69	69

all results for periods greater than 12 months are annualized

Value-Added



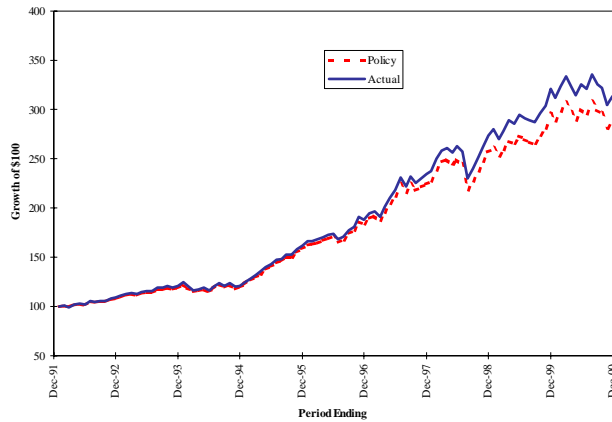
CLIENT LETTER • APRIL 2001
PARTNER'S MESSAGE

For month ending: December-00
Composite: FQ REBALANCING COMPOSITE
 GROSS OF FEES

Year-to-Date Through:	Policy	Actual	Value-Added
2000	-2.29	-2.28	0.01
1999	15.11	17.10	1.99
1998	14.21	16.86	2.65
1997	22.30	24.77	2.47
1996	15.92	16.21	0.29
1995	32.42	33.41	0.99
1994	0.59	0.44	-0.15
1993	9.69	10.41	0.72
1992(p)	8.60	9.29	0.69

(p) Partial year, not annualized. Inception date February 1, 1992.

Total Returns

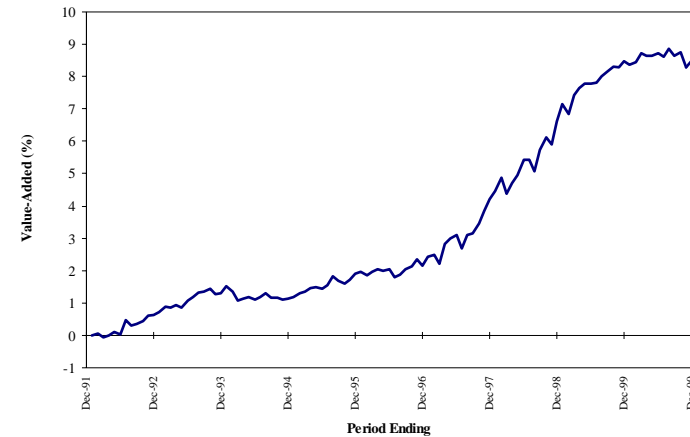


See Disclosures for important information concerning this composite, including fees and benchmarks.

	Policy	Actual	Value-Added
Dec-00	2.89	3.06	0.16
Cumulative Returns			
24 month	6.05	6.98	0.93
36 month	8.71	10.18	1.47
60 month	12.74	14.16	1.42
84 month	13.50	14.62	1.12
Inception	12.65	13.68	1.03
Standard Deviation			
24 month	10.23	10.72	0.73
36 month	11.89	12.43	0.96
60 month	11.05	11.44	0.90
84 month	10.19	10.55	0.80
Inception	9.27	9.61	0.74
Consistency of Returns			
36 month	58	58	67
60 month	67	67	70
84 month	69	69	69

all results for periods greater than 12 months are annualized

Value-Added



DISCLOSURES: NOTES TO COMPOSITES

First Quadrant (FQ) is defined as First Quadrant, L.P. and First Quadrant, Ltd. and represents the combination of both entities' discretionary accounts.

FQ has prepared and presented this report in compliance with the Performance Presentation Standards of the Association for Investment Management and Research (AIMR-PPSTM). The AIMR has not been involved with the preparation or review of this report.

Descriptions of the material conditions, objectives, or investment strategies used to obtain the results portrayed are described in First Quadrant's Composite Descriptions.

A complete list and description of FQ's composites is available upon request.

Account Criteria

- All accounts included in each composite are fully discretionary.
- There is no minimum balance requirement for an account to be included in a composite.
- Accounts are included in their respective composites in their first full month of management. Accounts are excluded from their respective composites after their last full month of management.

Composite Criteria

- Accounts may include underlying assets managed by the Company or overlay strategies applied to account assets, or both.
- Overlay strategies utilize such derivative instruments as futures, currency forwards and options to achieve desired returns.
- Each of the performance composites represents an investment process which can be applied on a stand-alone basis, or can be used in a

- combination with other investment processes on an account.
- Certain composites are included in other composites as described below. In addition, certain accounts are included in multiple composites.

Calculation Methodology

- All accounts are valued each month on a trade date basis.
- Certain managed accounts may contain more than one product. These products are presented in separate composites. Cash in these accounts is allocated to each product based upon the actual cash balances maintained in separate cash balances for each product. In instances where cash is commingled, cash balances are determined based upon predefined cash levels for each strategy.
- Individual contributions and withdrawals falling below 10% of an account's market value are time weighted during the month.
- When contributions or withdrawals exceed 10% of an account's market value, an intra-month performance calculation is made for the period prior to and subsequent to the contribution or withdrawal. These intra-month calculations are then linked together using the internal rate of return formula to calculate the monthly return.
- Dividend and interest income is accounted for on an accrual basis.
- Monthly investment results for each account are calculated using a dollar weighted rate of return formula.
- Quarterly account returns are calculated by linking the monthly account returns using the linked internal rate of return formula.
- Quarterly and average annual composite returns are calculated by weighting each account's quarterly or annual return by its beginning market value as a percent of the total composite beginning market value.
- Accounts which utilize leverage in their strategies have been adjusted to reflect unleveraged returns.
- Standard deviations are calculated in accordance with the methodology set forth by the AIMR for the respective years or partial periods then ended. Standard deviation is a measure of variability, which indicates the distance from the mean performance required to cover two-thirds of the account assets included in the period.

Investment Management Fees

The performance results, presented net of investment management fees, are based upon the actual average weighted management fee charged each account in the composite. The average weighted management fee was deducted on a quarterly basis from the composite returns. FQ's standard fee schedule is included at the end of this section. The average weighted management fee since inception through March 31, 2001 for each composite is:

Composite	Average Weighted Annual Management Fee
U.S. Tactical Asset Allocation (TAA)	0.12%
Passive Asset Allocation (PACT)	0.10%
Rebalancing	0.10%
Global Tactical Asset Allocation (GTAA)	0.09%
Global Tactical Asset Allocation Long-Short	0.39%
Tactical Currency (TCA)	0.08%
Tactical Currency (TCA) Long-Short	0.19%
Domestic Tactical Options Program (TOP)	0.06%
Global Tactical Options Program (TOP)	0.19%
US Long Core	0.20%
US Enhanced Index	0.26%
US Core 1k	0.30%
US Mega Cap	0.23%
US Mid Cap	0.43%
US Relative Value	0.29%
US Small Cap Core	0.29%
Canada Core	0.15%
Tax-Advantaged	0.31%
US Market Neutral	0.62%
UK Market Neutral	0.77%

International Composites

- Account performance results included in the international composites and the benchmarks to which the performance is compared are presented net of withholding taxes on dividends, interest and capital gains.
- Performance returns for international composites are presented in their local currency and therefore, the local currency return does not account for interest rate differentials in forward currency exchange rates.

Taxable Composites

The tax rate assumptions used to calculate after tax performance are based upon the actual tax rates provided by each client included in the composite.

Benchmarks

The following benchmarks have been used in comparing the performance results:

U.S. Tactical Asset Allocation (TAA): Custom Benchmark

An asset weighted benchmark of each account's individual benchmark included in the composite. The benchmarks included and their respective weights in the composite benchmark are as follows: S&P 500 (83.8%), Russell 3000 (9.0%), Russell 1000 (3.6%), Shearson Lehman Aggregate Bond (1.8%), MSCI EAFE Unhedged (1.8%).

Passive Asset Allocation (PACT): Custom Benchmark

An asset weighted benchmark of each account's individual benchmark included in the composite. The benchmarks included and their respective weights in the composite benchmark are as follows: S&P 500 (49.3%), Russell 1000 (16.3%), Shearson Lehman Aggregate Bond (11.1%), Russell 2000 (10.8%), Russell 3000 (7.1%), MSCI EAFE Unhedged (5.4%).

Benchmarks (continued)

Rebalancing: Custom Benchmark

An asset-weighted benchmark of each account's individual benchmark included in the composite. The benchmarks included and their respective weights in the composite benchmark are as follows: Russell 1000 (40.0%), Russell 2000 (20.2%), MSCI EAFE Unhedged (13.5%), Shearson Lehman Aggregate Bond (26.5%).

Global Tactical Asset Allocation (GTAA): Custom Benchmark

An asset weighted benchmark of each account's individual benchmark included in the composite. The benchmarks included and their respective weights in the composite benchmark are as follows: FTS&P World Equity UK Index (19.3%), S&P 500 (15.3%), MSCI World Hedged (7.6%), Russell 3000 (6.9%), FTS&P World Equity Index ex-UK (4.8%), Shearson Lehman Aggregate Bond Index (4.5%), Salomon Broad Index (3.9%), Salomon World Government Bond Netherlands (3.8%), Salomon World Government Bond UK (3.7%), MSCI World - 50% Hedged (3.1%), Salomon World Government Bond - 50% Hedged (3.1%), MSCI World Unhedged (2.4%), MSCI EAFE Unhedged (2.2%), FTS&P World Equity ex-Netherlands (2.2%), FTS&P World Equity Euro ex-UK Index (2.1%), Salomon Non-U.S. Government Bond Hedged (1.8%), FTS&P World Equity North America Index (1.4%), MSCI Pacific Rim (1.4%), MSCI EAFE Hedged (1.4%), Russell 1000 (1.1%), FTS&P World Equity Japan Index (1.0%), Salomon World Bond Hedged (1.0%), FTS&P World Equity Netherlands Index (0.9%), MSCI EAFE-Lite Hedged (0.8%), FTS&P World Equity Pacific Basin ex-Japan Index (0.8%), JP Morgan World Government Bond UK (0.7%), JP Morgan World Government Bond ex-UK (0.7%), MSCI EAFE Lite Unhedged (0.6%), Russell 2000 (0.5%), FTSE Government Bond (0.5%), Salomon World Bond Unhedged (0.4%), Salomon World Government Bond ex-UK (0.1%).

Global Tactical Asset Allocation Long-Short: Yield on the 30-Day U.S. Treasury Bill

Tactical Currency (TCA): No benchmark

The TCA program is a pure value-added strategy. As such a benchmark is not applicable.

Tactical Currency Long-Short: No benchmark

The TCA Long-Short program is a pure value-added strategy. As such a benchmark is not applicable.

Domestic Tactical Options Program (TOP): No benchmark

The TOP program is a pure value-added strategy. As such a benchmark is not applicable.

Global Tactical Options Program (TOP): No benchmark

The TOP program is a pure value-added strategy. As such a benchmark is not applicable.

US Long Core: S&P 500

US Enhanced Index: S&P 500

US Core 1K: Frank Russell 1000

US Mega Cap: Custom Benchmark

The performance of those stocks whose market capitalizations are greater than the weighted average market capitalization of the stocks contained in the S&P 500 Index.

US Mid Cap: S&P 400

US Relative Value: Frank Russell 1000 Value

US Small Cap Core: Frank Russell 2500

Canada Core: TSE 100 from Inception through February 2000. Beginning March 2000, the benchmark was changed to the TSE 300. FQ believes that the TSE 300 is the most widely used index to benchmark institutional Canadian equity portfolios.

Tax-Advantaged: Custom benchmark

An asset-weighted benchmark of each account's individual benchmark included in the composite. These benchmarks include the following components: Vanguard 500 and Vanguard 900 Index Funds.

US Market Neutral: Yield on 30-Day U.S. Treasury Bill

UK Market Neutral: Yield on 30-Day UK Treasury Bill

The following lists the number of portfolios, amount of assets and overlays, and the percentage of the company's total assets and overlays the composite represents as of March 31, 2001:

Composite	Number of Accounts	Assets and Overlays (\$M)	% of Firm Assets & Over.
U.S. Tactical Asset Alloc.	4	\$ 313	1.70%
Passive Asset Alloc.	11	1,484	7.89
Rebalancing	4	504	2.69
Glob. Tactical Asset Alloc.	16	2,871	15.27
GTAA-Long/Short	1	380	2.02
Tactical Currency	15	2,235	12.42
TCA-Long/Short	8	1,235	6.86
Domestic TOP	23	1,740	9.67
Global TOP	1	300	1.67
US Long Core	6	1,188	6.60
US Enhanced Index	2	146	0.81
US Core 1k	2	16	0.08
US Mega Cap	1	8	0.04
US Relative Value	1	136	0.76
US Mid Cap	1	96	0.53
US Small Cap Core	1	390	2.17
Canada Core	1	4	0.02
Tax-Advantaged	6	142	0.79
US Market Neutral	9	530	2.94
UK Market Neutral	1	9	0.05

Use of Derivative Instruments

In the course of managing certain products, FQ uses derivative instruments to achieve investment goals. The returns on derivative instruments are contingent on the values of other assets such as stock and bond prices, market indices or currencies. Definitions of these instruments and the strategies in which they are implemented by FQ are as follows:

Futures: Futures contracts specify a purchase or sale of an asset at a specified price on a specified future date. FQ uses stock and

bond index futures and currency futures, which are based on the movement of their underlying indices or currency. Listed below are the futures indices (abbreviated) contracts currently utilized by FQ:

All Ordinaries Index Future	Japanese Yen Future
3 Month Euro-Yen Future	KFX Index Future
ATX Futures	Lira Ten-Year Bond Index Future
Australian Dollar Future	Midcap-S&P 400 Index Future
Australian Government Bond Index Future	MSCI Singapore IX
BEL-20 Index Future	NASDAQ 100 Index Future
Belgium Bond Index Future	Netherlands Bond Index Future
Bono Nacion Ten-Year Index Future	Nikkei 225 Index Future (Singapore)
British Pound Future	Nikkei 300 Index Future (Osaka)
CAC 40 Index Future	OAT Bond Index Future
Canadian Dollar Future	OBX Future
DAX Index Future	OMX Index Future
Denmark Ten-Year Bond Index Future	PSI 20 Index Future
EOE 20 Index Future	Russell 2000 Index Future
Euro Currency Future	S&P 500 Index Future
FIB 30 Index Future	Short Sterling Index Future
Finland FOX 25 Index Future	SMI Future
Five-Year UST Note Index Future	SPTSE60
FTSE 100 Index Future	Sweden Bond Future
German Bobl Index Future	Swiss Bond Future
German Bond Index Future	Swiss Franc Future
German Deutschmark Future	Ten-Year Can. Gov't Bond Index Future
Gilt Bond Index Future	Ten-Year JGB Index Future
Hang Seng Index Future	Ten-Year UST Note Index Future
IBEX 35 Index Future	Topix Index Future
	Two-Year UST Note Index Futures
	UST Bond Index Future

FQ may utilize currency futures to offset risk of currency fluctuations occurring in the following countries: Australia, Canada, Europe (Euro), Japan, Switzerland, the United Kingdom (U.K.), and the United States of America (USA).

Options: FQ uses both domestic and global put and call options. A call option gives its holder the right to purchase an asset for a specified price on or before a specified expiration date. A put option gives its holder the right to sell an asset for a specified price on or before a given expiration date. Currently, FQ incorporates options on equity markets in Europe (Euro Stock Index), France, Germany, Japan, the U.K., and the USA.

Forwards: FQ uses currency forwards to manage the Tactical Currency composite. A forward contract allows the customer to purchase or sell currency in the future at a currently agreed-on rate of exchange which is subject to counterparty risk. Currently, FQ may utilize currency forwards to offset the risk of currency fluctuations occurring in the following countries: Australia, Canada, Europe (Euro), Japan, Switzerland, the U.K., and USA

Derivatives are used in the following composites: U.S. Tactical Asset Allocation, Global Tactical Asset Allocation, Tactical Options Programs, Rebalancing, Passive AA, and Tactical Currency Allocation.

DISCLOSURES: COMPOSITE DESCRIPTIONS

The following is a description of the Company's composites:

Domestic Tactical Asset Allocation

U.S. Tactical Asset Allocation (U.S. TAA) (Inception: July, 1988): This composite includes all accounts managed with a U.S. based, U.S. only tactical asset allocation overlay implemented with the use of stock, bond and T-Bill index futures. For those accounts in which the Company manages both the underlying assets with a tactical asset allocation overlay, the tactical asset allocation overlay returns are extracted from the account and included in this composite.

Policy Allocation Control (PAC)

Passive Asset Allocation (Passive AA) (Inception: October, 1990): Includes all accounts managed by the Company with passive rebalancing and cash equitization. The tactical asset allocation process applied to this composite is used only to rebalance an underlying portfolio back to its original benchmark, or to give market exposure to cash balances or underlying portfolios which do not have market exposure. There is no active strategy to allocate between asset classes to achieve increased value-added. Passive Asset Allocation is implemented using stock, bond and U.S. T-Bill index futures.

Rebalancing (Inception February, 1992): This composite includes all accounts managed by FQ with passive rebalancing. The tactical asset allocation process applied to this composite is used only to rebalance an underlying portfolio back to its original benchmark. There is no active strategy to allocate between asset classes to achieve increased value-added. Rebalancing is implemented using stock, bond and U.S. T-Bill index futures.

Global Tactical Asset Allocation

Global Tactical Asset Allocation (Global TAA) (Inception: January, 1989): This composite includes all accounts managed by the Company which have any combination of global benchmarks. The process is implemented using stock, bond and T-Bill index futures in as many as eighteen different countries including Australia, Austria, Belgium, Canada, Denmark, France, Germany, Hong Kong, Italy, Japan, the Netherlands, Norway, Singapore, Spain, Switzerland, Sweden, the U.K. and the U.S. There is no one single combination of countries needed to be included in this composite. The accounts may have any combination of country allocations in stocks, bonds or cash, and may be hedged or unhedged, or have an active currency overlay as part of the investment process. For those accounts which have an active tactical currency overlay with the global overlay, the currency returns are included in this composite since they are an integral part of the global tactical asset allocation process. For accounts in which the Company manages both the underlying assets with a global tactical asset allocation overlay, only the global tactical asset allocation overlay is extracted and included in this composite. Those accounts which utilize leverage in their strategy have been adjusted to reflect unleveraged returns.

One non-fee-paying portfolio existed in the composite for the period May through June 2000.

Global Tactical Asset Allocation Long-Short (Inception: February, 1991): This composite is a subcomposite of the Global Tactical Asset Allocation (Global TAA Unleveraged) composite described above. The accounts included in this composite have a unique characteristic from the other accounts in the Global Tactical Asset Allocation (Global TAA Unleveraged) composite in that the mandates for these accounts provide latitude to invest globally with "symmetric active investment ranges". Symmetric active investment ranges means that FQ is allowed

to overweight an asset relative to the benchmark by the same amount as FQ is allowed to underweight the same asset.

One non-fee-paying portfolio existed in the composite for the period May through June 2000.

Tactical Currency (TCA) (Inception: April, 1992): This composite includes accounts which use a tactical currency overlay as part of the global tactical asset allocation process. This is a process of hedging the portfolios in seven different countries (Australia, France, Germany, Japan, the Netherlands, Singapore and the U.K.) using currency forwards. The portfolios may be fully or partially hedged. In this composite, the returns are extracted from all the global tactical asset allocation accounts with this process in place. Adjustments are made in the underlying portfolio value to compensate for leverage. All of the accounts in this composite are also included in the Global Tactical Asset Allocation composite (above).

One non-fee-paying portfolio existed in the composite for the period May through June 2000.

Tactical Currency Long-Short (Inception: May 1995): This composite is a subcomposite of the Tactical Currency (TCA) composite described above. The accounts included in this composite have a unique characteristic from the other accounts in the Tactical Currency (TCA) composite in that the mandates for these accounts provide latitude to invest globally with “symmetric active investment ranges”. Symmetric active investment ranges means that FQ is allowed to overweight an asset relative to the benchmark by the same amount as FQ is allowed to underweight the same asset.

One non-fee-paying portfolio existed in the composite for the period May through June 2000.

Tactical Options Program

Tactical Options Program/Domestic (TOP) (Inception: March, 1995): This composite includes all accounts which have a domestic options overlay program. The domestic program incorporates options on U.S. equity and fixed income markets to create a market neutral overlay. This program is designed to add incremental value to an underlying investment portfolio. In this composite, the options returns are extracted from all of the tactical asset allocation accounts with this process in place.

The composite currently consists of two non-fee-paying portfolios that represent 2.98% of the composite and 0.14% of Company’s assets under management as of December 31, 2000. One of these two portfolios has been included in the composite since May 2000. The second portfolio has been included since July 2000. A third non-fee-paying portfolio existed in the composite for the period May through June 2000.

Tactical Options Program/Global (TOP) (Inception: January, 1996): This composite includes all accounts which have a global options overlay program. The global program incorporates options on global equity and fixed income markets to create a market neutral overlay. This program is designed to add incremental value to an underlying investment portfolio. In this composite, the options returns are extracted from all of the tactical asset allocation accounts with this process in place.

Global Equity Style Management

Core Style

US Long Core (Inception: June, 1990): Includes all accounts which use the Company’s U.S. based, equity only product to manage the physical securities in the portfolio. The portfolios contain only long security positions; no shorting of equities is permitted. Portfolio

constraints allow tracking error to within approximately +/- 4% of the S&P 500 Index. For those accounts which have tactical asset allocation or global tactical asset allocation overlays, only the core style returns are extracted from the account's total return and included in this composite.

US Enhanced Index (Inception: November, 1992): Includes all accounts which use the Company's U.S. based, equity only product to manage the physical securities in the portfolio. The portfolios contain only long security positions; no shorting of equities is permitted. Portfolio constraints allow tracking error to within approximately +/- 2% of the S&P 500 index. This composite includes only those accounts managed with the enhanced index strategy.

US Core 1K (Inception: April, 1998): Includes all accounts which use the Company's U.S. based, equity only product to manage the physical securities in the portfolio. The portfolios contain only long security positions; no shorting of equities is permitted. Portfolio constraints allow tracking error to within approximately +/- 2% of the Frank Russell 1000 index. This composite includes only those accounts managed with the enhanced index strategy.

US Mega Cap (Inception: April, 1999): Includes all accounts using the Company's U.S. based, equity only product which manages the physical securities in the portfolio. The portfolios contain only long security positions; no shorting of equities is permitted. The investable universe consists of the 100 largest market capitalization stocks contained in the S&P 500 Index.

US Mid Cap (Inception: October, 1999): Includes all accounts using the Companies' U.S. based, equity only product, which manages the physical securities in the portfolio. The portfolios contain only long security positions; no shorting of equities is permitted. Portfolio constraints allow tracking error to within +/- 5% of the S&P 400 Index.

US Relative Value (Inception: April, 2000): Includes all accounts using the Companies' U.S. based, equity only product which manages the physical securities in the portfolio. The portfolios contain only long security positions; no shorting of equities is permitted. Portfolio constraints allow tracking error to within +/- 4-5% of the Frank Russell 1000 Value Index.

US Small-Cap Core (Inception: January, 1997): Includes all accounts which use the Company's U.S. based, equity only product which manages the physical securities in the portfolio. The portfolios contain only long security positions; no shorting of equities is permitted. Portfolio constraints allow tracking error to within approximately +/- 5% of the Frank Russell 2500 Index. For those accounts which have tactical asset allocation or global tactical asset allocation overlays, only the core style returns are extracted from the account's total return and included in this composite.

Canada Core (Inception: November, 1994): Includes all accounts which use the Company's international equity style process applied to a Canada based, equity only product to manage the physical securities in the portfolio. The portfolios contain only long security positions; no shorting of equities is permitted. The benchmark is the TSE 300. Returns are in local currency and do not account for interest rate differentials in forward currency exchange.

Tax-Advantaged (Inception: August 1997): Client specific investment strategies that explicitly take into account the clients' tax effects in First Quadrant's Style Management discipline for taxable investors, with the goal of delivering superior after-tax returns. A separate composite exists for each portfolio using this strategy due to client specific management criteria based upon client specific tax rates.

Market Neutral Style

US Market Neutral (Inception: June, 1991): Includes all accounts which use the Company's US based equity-only product to manage the physical securities to create a market neutral portfolio by buying and selling stocks both long and short. For those accounts which have passive asset allocation, tactical asset allocation or global tactical asset allocation overlays, only the style returns are extracted from the total return and are included in this composite.

US Small-Cap Market Neutral (Inception: June, 1998): Includes all accounts which use the Company's U.S. based equity-only product to manage the physical securities to create a market neutral portfolio by buying and selling stocks both long and short. The trading universe is constrained to hold stocks within the Frank Russell 2500 Index. For those accounts which have passive asset allocation, tactical asset allocation or global tactical asset allocation overlays, only the style returns are extracted from the total return and are included in this composite.

U.K. Market Neutral (Inception: April, 1994): Includes all accounts which use the Company's U.K. based equity-only product to manage a market neutral portfolio by using U.K. swaps or contracts-for-differences. For those accounts which have passive asset allocation, tactical asset allocation or global tactical asset allocation overlays, only the style returns are extracted from the total return and are included in this composite. Returns are in local currency and do not account for interest rate differentials in forward currency exchange.

DISCLOSURES: MARKET IMPACT ON RETURNS

Certain market conditions can impact the returns of an investment strategy. We have provided what we believe to be a fair, yet subjective, assessment of the causes for these divergences from the average standard deviation calculations presented.

Global Tactical Asset Allocation (GTAA)

1990: A very well timed underweighting of Japanese equities at the beginning of 1990, was unusually rewarding as Japanese equities fell by 60% in local terms during 1990.

1992: After our models had caught the peak on Japanese equities at the beginning of 1990, they were bullish too early. In 1992, Japanese equities fell over 22% while our models recommended overweight allocations to Japan.

1997: In 1997 our models were overweight Japan and underweight the US on a relative basis during a year when Japanese equities fell 15% and US equities were up more than 30%. Since some of our larger mandates have larger active investment ranges for the largest markets, namely, US equities, UK equities and Japanese equities, this relative weighting had a larger impact on the performance than normal portfolio tilts would have.

U.S. Tactical Asset Allocation (US TAA)

1991: Excellent timing of shifts between stocks and bonds over the course of the year led to the value added in 1991. For the first four months of the year, our models were overweight stocks relative to bonds while stocks outperformed bonds by over 11%. Then our models tilted in favor of bonds for October and November when bonds

outperformed stocks by well over 3%. We resumed a neutral to bullish tilt on equities versus bonds in December when stocks outperformed bonds by over 5%.

1993: Our models favored bonds over stocks throughout the year as bonds outperformed stocks by over 7%.

1997: Our models favored bonds over stocks throughout the year as stocks outperformed bonds by over 18%. Our models also held some defensive allocations to cash which underperformed both stocks and bonds.

1999: TAA was generally neutral to bearish on equities relative to bonds throughout the year, but was most bearish on stocks versus bonds during the last four months of the year. During these first eight months, stocks had returned only 8.3%, while the last four months, stock rallied to end the year up 19%. Being deeply bearish as dividend yields fell to an astounding 1.13% led to most of the shortfall in 1999.

2000: As bonds outperformed stocks on the order of 30% for the year, our significant underweight on stocks relative to bonds was well rewarded. We began the year neutral to marginally bullish on bonds and remained that way through to the end of the year. Stocks, on the other hand, were perceived as very vulnerable at the beginning of the year, and gradually grew less so as prices declined across 2000.

Tactical Currency Allocation (TCA)

1993: The breakdown of the European Exchange Rate Mechanism (ERM) led to extraordinary volatility in the currency markets in 1992-93. Our models were able to take advantage of the extreme mispricings that were created and to profit from their return towards equilibrium exchange rate values.

US Long Core

1990: The portfolio was initially oriented toward small-cap, defensive stocks. The small-cap stocks in particular did well, along with a portfolio weighting toward natural resource stocks, which benefited from run-up in 1990.

1991: It was an environment which significantly favored large-cap growth stocks. Early in the year the portfolio rotated away from a more defensive posture, as economic activity picked up, to a more aggressive growth orientation which proved very advantageous.

1997: In 1997 the Core portfolios moved to a large-cap growth technology oriented stance, as the economy began to experience a low inflation, high output confluence of events. Growth stocks, and especially the technology stocks, began a run that has continued through the end of the decade in 1999.

1998: Due to concerns over valuation levels in the large-cap growth arena, and underlying concerns about the inflationary pressures of the mature economic expansion, the portfolio holdings were rotated into more defensive value-oriented stocks, and out of the large-cap growth sector. Unfortunately, such a rotation was premature, as a very concentrated set of large-cap growth names continued to drive the market.

1999: We maintained a more defensive, value-oriented posture in the portfolio, and unfortunately the concentration of return in the marketplace was with a sector we have generally underweighted, the large-cap technology sector.

US Market Neutral

The same approach is used in the MN strategy as is used in the Core strategy above, so the explanation is essentially the same for **1991, 1997, 1998** and **1999**.

1992 and 1993: The portfolio orientation through both of these years was value, mid-cap, defensively oriented, with pockets of investing in undervalued technology names. There was a pronounced small/mid-cap bias in the market over these two years (especially in 1993), as well as a value bias, and so the portfolio benefited.

1995 and 1996: These were large-cap dominated years, although the spread between value and growth was quite small. In 1995 we introduced several new models designed to better evaluate individual stock prospects, including earnings revision and earnings surprise models, as well as insider trading models. These models worked very well in identifying mispricings in individual stocks, and much of the outperformance was driven by the stock selection model component.

2000: Technology enjoyed a huge run-up in the first quarter of the year, followed by a fairly significant correction in April. The cautious stance in the portfolio, combined with a significant net short on the more speculative technology sector, led to a very difficult first quarter of performance. However, the correction in April afforded us the opportunity to purchase the more attractively-priced technology names, and as technology rallied modestly, our performance improved. For the latter half of the year, we continued to maintain a modest value bias, which helped performance. Overall, however, the relatively good performance in the final three quarters was not nearly enough to recover the ground lost in the first quarter.

US Small-Cap Core

1997: The initial small-cap portfolios tilted toward the higher capitalization issues in our universe, along with a tilt toward the technology area. Although 1997 was not a particularly strong environment for small-cap stocks in general, the larger ones in this sector did perform better, and the technology sector had tremendous performance, so our tilts provided excess returns.

1999: We oriented towards value stocks, moving away from our growth and technology orientation over the past several years. Value stocks have been pounded in 1999 in the small-cap sector in particular. The FR2000 Value portfolio has trailed the Growth portfolio by over 26% this year.

2000: A cautious value stance in Small-Cap proved disastrous in the first quarter, as Small-Cap growth rallied very, very strongly. Even with a modest correction at the start of the second quarter, value stocks continued to lag in the small-cap sector, and our performance suffered accordingly. Although our performance was quite good in the second half of the year with our value tilt, it was not enough to recover the downdraft early in the year.

US Small-Cap Market Neutral

For **1999** and **2000 YTD** see above.

UK Market Neutral

1998: In the UK, exceptional performance was driven by a large-cap orientation, where we were fortunately overweight in the handful of Mega-cap growth names that drove the market in the UK.

1999: Style performance in the UK shifted dramatically toward the small-cap sector, and unfortunately our models significantly overweighted the large-cap sector.

2000: The portfolios moved to a more defensive, higher-quality orientation through 1999 and 2000. Like in the US, growth stocks have continued to perform well, and our underweighting of that sector proved quite costly, and our rebound in the latter half of the year was modest.

Canada Core

1997 and 1998: We maintained a strong large-cap growth orientation in the Canadian market strategy in 1997 and through 1998, in an environment in which large-cap growth stocks did very well in both years.

RISK WARNINGS MANDATED UNDER IMRO REGULATIONS

The following disclosures are applicable to clients of First Quadrant, Ltd. First Quadrant, Ltd. is regulated by IMRO in the conduct of its investment business, and is required to bring to your attention the following Risk Warnings which may be applicable to your investment management program:

- The value of investments may go down as well as up; the client may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.
- Where an investment is made in a currency other than the base currency of the portfolio, changes in the rate of exchange between currencies may cause the value of the investment to diminish or increase.
- In relation to dealings in Futures, Options, or Contracts for a Difference, the client should be aware that it is possible to gain economic exposure from these instruments which is greater than the original sums committed. Therefore, where dealings involving an open-ended commitment are authorized, the client may be called upon to supply funds to cover losses which themselves can be unlimited. The client should be aware, therefore, that he could lose more than amount originally invested.
- Any necessary specific appropriate warning will be given at the time that an Investment Management Agreement is entered into.
- Investment may be made in securities which are free of withholding taxes in respect of interest/dividend payments to the scheme. Such tax relief may be subject to change in the future and does not imply that such relief is applicable to the beneficial owner of the assets.

If the investment program includes collective investment schemes:

- Where an investment is made on behalf of a client in a collective investment, initial charges could mean that if the investment in the units is redeemed in the early years the initial amount of investment may not be fully realized. Investments in unregulated schemes may have a restricted market and may not be readily realizable. The results of this is that it may be difficult for a client to obtain reliable information about their value or the markets involved in the investment.

In addition, this document is for information purposes only and does not constitute an offer to enter into any investment transaction. The information in this document was obtained from sources believed to be reliable, but its accuracy or completeness cannot be guaranteed. Any opinions expressed herein are given in good faith, but are subject to change without notice.

First Quadrant, Ltd. is not permitted to enter into transactions, or otherwise deal, with private customers (as defined in the IMRO Rules) and, therefore, none of the services described in any First Quadrant documentation is available to private customers.

FULL COMPOSITE PERFORMANCE (AIMR-PPS STANDARDS) – NET OF FEE

GTAA			
Inc. 1/89	Actual	Bnchmk	V/A
Since Inception (a)	9.5%	8.5%	1.0%
Std. Dev.	9.3%	10.1%	3.9%
2001 YTD	-7.3%	-5.5%	-1.8%
2000	-0.3%	-3.3%	3.1%
1999	15.7%	16.7%	-1.0%
1998	15.3%	16.8%	-1.5%
1997	15.7%	19.6%	-3.9%
1996	14.4%	13.9%	0.5%
1995	18.3%	17.5%	0.8%
1994	0.5%	-1.1%	1.6%
1993	14.2%	12.5%	1.7%
1992	-1.3%	5.7%	-7.0%
1991	23.0%	19.2%	3.8%

GTAA Long-Short			
Inc. 2/91	Actual	Bnchmk	V/A
Since Inception (a)	6.9%	4.8%	2.1%
Std. Dev.	11.2%	0.3%	11.2%
2001 YTD	-3.1%	1.4%	-4.5%
2000	17.5%	6.0%	11.5%
1999	6.0%	4.8%	1.2%
1998	4.2%	4.9%	-0.7%
1997	1.1%	5.2%	-4.1%
1996	26.4%	5.2%	21.2%
1995	14.3%	5.7%	8.6%
1994	16.6%	4.2%	12.4%
1993	0.4%	3.0%	-2.6%
1992	-15.9%	3.5%	-19.4%
1991 (Feb-Dec)	8.7%	4.7%	4.0%

US TAA			
Inc. 7/88	Actual	Bnchmk	V/A
Since Inception (a)	13.3%	13.5%	-0.2%
Std. Dev.	8.1%	10.8%	5.0%
2001 YTD	-4.9%	-7.4%	2.5%
2000	11.8%	-4.7%	16.4%
1999	5.7%	16.3%	-10.6%
1998	23.8%	23.9%	-0.1%
1997	22.1%	28.5%	-6.4%
1996	17.6%	18.2%	-0.6%
1995	30.1%	33.5%	-3.4%
1994	-1.6%	0.4%	-2.0%
1993	14.7%	10.5%	4.2%
1992	5.7%	7.6%	-1.9%
1991	26.2%	22.6%	3.6%

PACT			
Inc. 10/90	Actual	Bnchmk	V/A
Since Inception (a)	12.9%	12.5%	0.4%
Std. Dev.	11.6%	11.3%	0.8%
2001 YTD	-8.3%	-8.1%	-0.2%
2000	-5.2%	-4.5%	-0.7%
1999	18.5%	19.3%	-0.8%
1998	22.9%	22.3%	0.6%
1997	27.6%	26.9%	0.7%
1996	16.8%	16.7%	0.1%
1995	31.8%	31.0%	0.8%
1994	0.6%	0.8%	-0.2%
1993	9.0%	8.0%	1.0%
1992	6.0%	5.6%	0.4%
1991	14.2%	12.4%	1.8%

Domestic TOP			
Inc. 3/95	Actual	Bnchmk	V/A
Since Inception (a)	-	-	1.8%
Std. Dev.	-	-	2.4%
2001 YTD	-	-	-0.9%
2000	-	-	0.6%
1999	-	-	3.9%
1998	-	-	3.8%
1997	-	-	5.6%
1996	-	-	0.4%
1995	-	-	-2.3%

Global TOP			
Inc. 1/96	Actual	Bnchmk	V/A
Since Inception (a)	-	-	1.7%
Std. Dev.	-	-	2.8%
2001 YTD	-	-	-1.0%
2000	-	-	0.9%
1999	-	-	3.0%
1998	-	-	2.0%
1997	-	-	4.8%
1996	-	-	-0.9%

TCA			
Inc. 4/92	Actual	Bnchmk	V/A
Since Inception (a)	-	-	2.5%
Std. Dev.	-	-	5.0%
2001 YTD	-	-	-0.6%
2000	-	-	1.2%
1999	-	-	0.2%
1998	-	-	-0.3%
1997	-	-	-1.2%
1996	-	-	4.1%
1995	-	-	1.7%
1994	-	-	0.4%
1993	-	-	12.5%
1992 (Apr-Dec)	-	-	5.3%

TCA Long-Short			
Inc. 5/95	Actual	Bnchmk	V/A
Since Inception (a)	-	-	4.0%
Std. Dev.	-	-	5.7%
2001 YTD	-	-	-0.9%
2000	-	-	1.5%
1999	-	-	0.3%
1998	-	-	-0.4%
1997	-	-	-0.2%
1996	-	-	19.1%
1995 (May-Dec)	-	-	5.6%

US Long Core			
Inc. 6/90	Actual	Bnchmk	V/A
Since Inception (a)	15.3%	13.9%	1.4%
Std. Dev.	14.4%	14.0%	3.9%
2001 YTD	-11.3%	-11.9%	0.6%
2000	-8.7%	-9.1%	0.4%
1999	18.2%	21.0%	-2.8%
1998	21.7%	28.6%	-6.9%
1997	38.5%	33.4%	5.1%
1996	25.9%	23.1%	2.8%
1995	38.5%	37.5%	1.0%
1994	-0.9%	1.3%	-2.2%
1993	11.8%	10.0%	1.8%
1992	7.8%	7.7%	0.1%
1991	39.2%	30.5%	8.6%

US Mega Cap			
Inc. 4/99	Actual	Bnchmk	V/A
Since Inception (a)	-7.3%	-13.1%	5.8%
Std. Dev.	21.9%	20.5%	5.2%
2001 YTD	-10.0%	-15.3%	5.3%
2000	-21.6%	-24.4%	2.8%
1999 (Apr-Dec)	21.7%	17.9%	3.9%

US Mid Cap			
Inc. 10/99	Actual	Bnchmk	V/A
Since Inception (a)	14.1%	14.6%	-0.5%
Std. Dev.	19.9%	19.1%	2.6%
2001 YTD	-10.9%	-10.8%	-0.1%
2000	14.1%	17.4%	-3.3%
1999 (Oct-Dec)	19.9%	17.2%	2.8%

US Small Cap Core			
Inc. 1/97	Actual	Bnchmk	V/A
Since Inception (a)	7.9%	9.6%	-1.7%
Std. Dev.	19.9%	20.6%	7.8%
2001 YTD	-11.2%	-8.7%	-2.5%
2000	-0.4%	4.3%	-4.7%
1999	9.7%	24.1%	-14.4%
1998	4.1%	0.4%	3.7%
1997	36.7%	24.4%	12.3%

US Market Neutral			
Inc. 6/91	Actual	Bnchmk	V/A
Since Inception (a)	7.6%	4.7%	2.9%
Std. Dev.	6.3%	0.3%	6.3%
2001 YTD	1.5%	1.3%	0.2%
2000	-0.4%	5.9%	-6.3%
1999	1.1%	4.7%	-3.6%
1998	0.1%	4.9%	-4.8%
1997	16.2%	5.3%	10.9%
1996	13.7%	5.2%	8.5%
1995	11.2%	5.6%	5.6%
1994	2.1%	3.9%	-1.8%
1993	9.2%	2.9%	6.3%
1992	9.4%	3.5%	5.9%
1991 (Jun-Dec)	12.1%	3.1%	9.0%

Canada Core			
Inc. 11/94	Actual	Bnchmk	V/A
Since Inception (a)	13.3%	11.5%	1.8%
Std. Dev.	17.2%	18.1%	3.5%
2001 YTD	-15.5%	-15.5%	0.0%
2000	7.7%	7.1%	0.6%
1999	34.3%	32.8%	1.5%
1998	4.6%	-0.4%	5.0%
1997	18.0%	15.0%	3.0%
1996	29.5%	28.6%	0.9%
1995	15.4%	14.5%	0.9%

Tax-Advantaged			
Inc. 8/97	Actual	Bnchmk	V/A
Since Inception (a)	6.1%	4.8%	1.3%
Std. Dev.	18.7%	18.0%	3.5%
2001 YTD	-11.8%	-12.0%	0.2%
2000	-10.4%	-10.5%	0.1%
1999	22.1%	20.0%	2.1%
1998	26.6%	26.8%	-0.2%
1997 (Aug-Dec)	1.8%	-1.0%	2.8%

See elsewhere in this section for detailed information on benchmarks, fees and market impact on performance.
(a) Annualized return since inception

US FEE SCHEDULE

■ ASSET BASED FEE

Subject to alternative incentive fee arrangements and discounting as described below, clients are charged an annual management fee based on asset value, billed quarterly in arrears as follows:

Assets ¹ Managed (in millions)	ASSET ALLOCATION		EQUITY STYLE MANAGEMENT			
	TAA ² , TCA ² TOP ³ , PACT ⁴	Global TAA ⁵	Enhanced Index & Tax- Advantaged Equities	Core Equity, Growth, Value Management	Small Cap	Market Neutral
\$0 - \$25	.44%	.68%	.50%	.68%	.80%	1.08%
\$25 - \$100	.24	.48	.40	.48	.60	.88
\$100 - \$300	.18	.38	.32	.38	.48	.68
Over \$300	.12	.32	.26	.32	.40	.58
Min. Acct.	\$50M	\$50M	\$50M	\$25M	\$25M	\$25M

¹ Asset based fees are charged incrementally. For example, a \$200 million “Core-Equity Style Management” account will be charged 0.48% on the first \$100 million and 0.38% on the second \$100 million.

² Tactical Asset Allocation (“TAA”) is implemented through the purchase and sale of futures contracts and options on futures contracts on a variety of financial instruments and stock and bond indices. The strategy is used as an overlay of existing securities portfolios. “TCA” means Tactical Currency Allocation. This strategy is implemented through the purchase and sale of futures contracts, options on futures contracts and forward contracts on a variety of currency instruments.

³ Minimum account size for TOP is \$25 million.

⁴ “PACT” means Policy Allocation Control Technology. This strategy is implemented through the purchase and sale of futures contracts and is used to rebalance and implement duration control and synthetic equitization of cash with respect to domestic equities portfolios. For PACT accounts, the “asset managed” for fee purposes are equal to 10% of the total portfolio subject to the PACT strategy.

⁵ Global TAA is a TAA process applied globally, typically through US and non-US futures, options and stock or bond portfolios.

Clients should contact registrant directly for further information about registrant’s trading strategies involving the use of futures contracts and other derivative instruments.

■ ALTERNATIVE INCENTIVE FEE

As an alternative to strategies with a *flat asset based fee*, a client can elect to pay the \$50,000 annual base fee plus an incentive fee. The incentive fee applies **only** to the value-added relative to a replicable passive benchmark and any underperformance is “charged against” subsequent outperformance for fee purposes. The percentage of incentive fee charged relative to assets managed is set forth below:

Assets Managed (in millions)	Incentive Fee	Half-and-Half Structure: \$25,000 plus half of above fees, plus
\$0 - \$100	20%	10%
\$100 - \$300	16%	8%
Over \$300	12%	6%

The incentive fee is billed annually. A combination of an asset based fee and an incentive based fee may be used under certain circumstances as agreed to by First Quadrant and the client.

■ DISCOUNTING FOR MULTIPLE STRATEGIES OR MULTIPLE ACCOUNTS

Under the asset based fee, if multiple strategies are managed on the same asset base, all except for the most expensive strategy shall be discounted 50%. For example, *core* equity style management plus domestic TAA is charged at 48 basis points for *core* equity style management plus 12 basis points (a 50% discount) for domestic TAA, or 60 basis points.

If a single client opens multiple accounts, above \$25 million in assets, fees on all but one account are discounted \$50,000 each. If multiple accounts for a single client, under a single strategy, exceed in the aggregate \$200 million, assets are aggregated for fee purposes and with the \$100 million and \$300 million fee break points are doubled to \$200 million and \$600 million, respectively; if the resulting fee is less than the sum of the single-account fees, then the resulting discount is amortized across all such accounts; if the resulting fee is more than the sum of the single-account fees, the single-account fees will be charged. This discount does not apply for strategies which are closed to new assets.