

TRAITS Long/Short European Equity Shadow Hedge Fund Summary of Current Performance on Live Daily Data (Bulletin 2)

Timberpost Ltd
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Introduction

This bulletin summarises the current performance of TRAITS, a fully automated hedge fund management system developed by Timberpost Ltd. A shadow (“paper trading”) portfolio powered by the latest version of TRAITS has been running live since early March 2008. This is the second bulletin of results; the first was published on 8 July 2008, and is available on the Timberpost website. The current bulletin focusses in particular on the performance of the portfolio over the last few months during the extreme market turbulence of the credit crisis. The portfolio has performed extremely well over this period, and is showing a **2008 year-to-date return of +15.3%**, compared to a benchmark (FTSE EuroFirst 300) performance of -38.8%.

Background

Timberpost Ltd harnesses world-renowned expertise in machine learning and artificial intelligence to develop novel, highly-automated hedge fund products. The company was founded in 2005 and is based in Edinburgh, Scotland. Its first product, called TRAITS, is now ready for market. TRAITS is a computer program that makes daily trading decisions for a long/short equity hedge fund in an entirely automated way. Among its many unique features, TRAITS learns continually and rapidly adapts to changing market conditions. Further details on the technology behind TRAITS are provided in the *Technology* section of this bulletin.

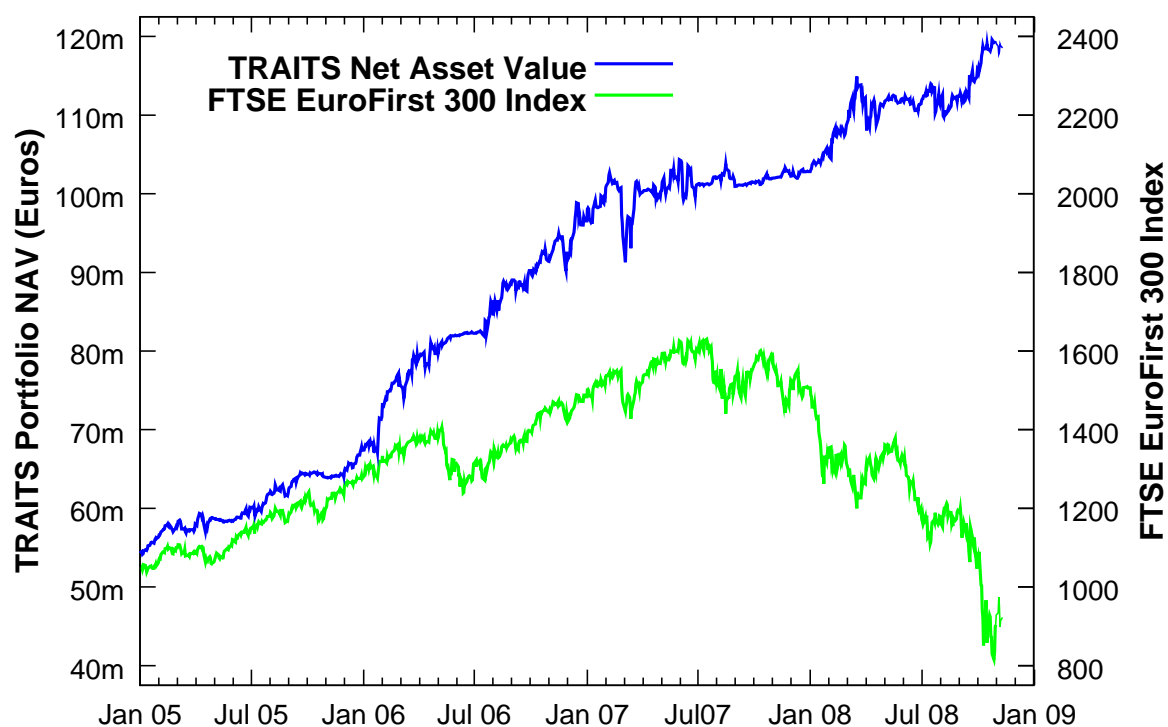
Live Run

The current version of TRAITS (version 2.0) was released in February 2008, and a “paper trading” portfolio powered by this version has been running live since 11 March 2008. The live run involves updating the system on a daily basis with live data and sending the daily trading decisions and limit orders to selected third parties for inspection and validation. The entire live run process is completely automated, and trading decisions are sent out before the markets open each morning.

For performance analysis, the portfolio is benchmarked against the FTSE EuroFirst 300 index. The live run performance figures reflect the performance of a real portfolio as closely as possible, taking into account factors such as transaction costs, stock borrowing costs, dividends (received on long positions and paid on short positions), interest on uncommitted cash, currency conversion for non-Euro denominated transactions, etc. The trading parameters used in the live run are conservative; e.g. the maximum allowed leverage is 2 (although typically it is much less than this), and trade sizes are capped.

To initiate the live run, TRAITS was trained on historical data up to 31 December 2004, and optimised for its performance over the period 1 January 2001 to 31 December 2004 (the *in-sample* period). TRAITS was then allowed to continue managing the portfolio from 1 January 2005 onwards (the *out-of-sample* period); it was not tuned to this data and had, in fact, never seen data from the out-of-sample period before. From 11 March 2008 onwards (the *live run* period) TRAITS has been running automatically before the markets open each morning, extracting daily data for the previous trading day from data providers, running its learning process, generating

Current Performance



Period	TRAITS return ¹	Benchmark return ^{1,2}	TRAITS Sharpe Ratio ³
Summary figures			
Out-of-sample period (1-Jan-05 to 7-Nov-08)	+117.61%	-12.02%	1.95
Annualised return for out-of-sample period	+22.38%	-3.27%	1.95
Live run period (11-Mar-08 to 7-Nov-08)	+6.81%	-27.34%	0.68
Annual figures			
2005	+23.74%	+22.33%	2.94
2006	+43.22%	+15.68%	3.48
2007	+6.50%	+1.62%	0.19
2008 year-to-date	+15.30%	-38.82%	1.56
Monthly figures			
Oct 2008	+2.67%	-12.95%	n/a
Sep 2008	+2.89%	-9.76%	n/a
Aug 2008	+0.44%	+2.15%	n/a
Jul 2008	+0.08%	-1.02%	n/a
3, 6 and 12-monthly figures			
Last 3 months	+7.82%	-23.10%	n/a
Last 6 months	+5.49%	-32.26%	0.89
Last 12 months	+16.14%	-39.97%	1.42

¹ Figures in bold indicate which of TRAITS or Benchmark produced the better return in that period

² Benchmark is FTSE EuroFirst 300 Index

³ Sharpe Ratio only calculated for periods of 6 months or longer

new trade orders and limit levels, composing a spreadsheet detailing these orders and a summary of current holdings etc., and emailing this spreadsheet to selected third parties in the UK and US for inspection and validation purposes.

Ban on Short Selling

With effect from midnight on Thursday 18 September 2008, the UK's Financial Services Authority instituted a ban on the short selling of a selection of finance-related stocks. The ban will be reviewed on 16 January 2009. The live run was modified to reflect this, so it has been prevented from taking short positions in the stocks specified by the FSA from 18 September onwards.

Comparison to Peer Group

The performance of the live run has been far superior to that of the Long/Short Equity category of the Credit Suisse/Tremont Hedge Fund Index. The figures are shown in the following table for comparison.

	Sept 08	Aug 08	2008 YTD	1 year
TRAITS live run	+2.89%	+0.44%	+15.30%	+16.14%
Credit Suisse/Tremont Hedge Fund Index: Long/Short Equity	-7.81%	-2.11%	-13.28%	-11.21%

Technology

TRAITS uses techniques of biologically-inspired computing and artificial immune systems to enable it to learn continually. It tracks very large numbers of potential technical trading strategies, but strategies are only trusted once they have offered a sufficient number of good decisions and have avoided making bad decisions despite having had the opportunity to do so. This evidence-based approach to continual learning sets TRAITS apart from other automated financial systems. TRAITS combines this stock-level continual learning system with a portfolio-level system that provides risk control for the portfolio as a whole, and monitors the market for early warning of changing conditions.

Outlook

In the longer term, in addition to ongoing enhancements to the system, Timberpost plans to apply the technology behind TRAITS to other markets and asset classes, and to develop further financial tools.

Contact

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