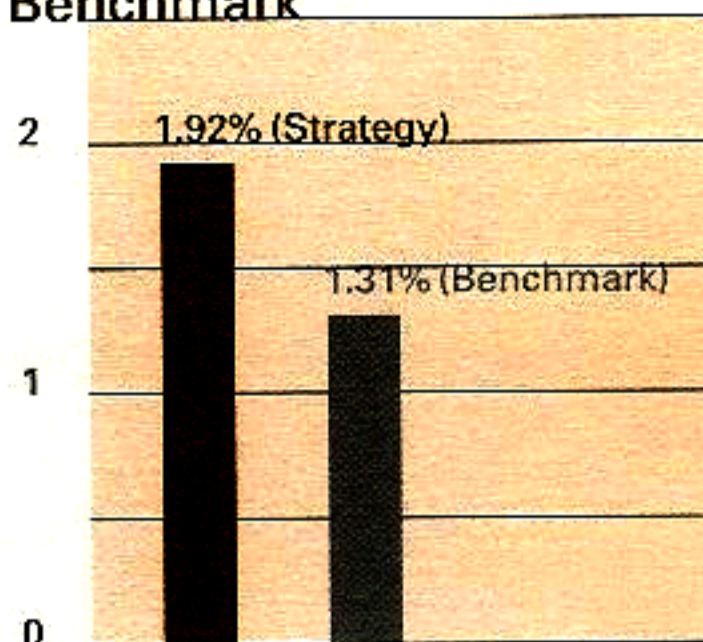
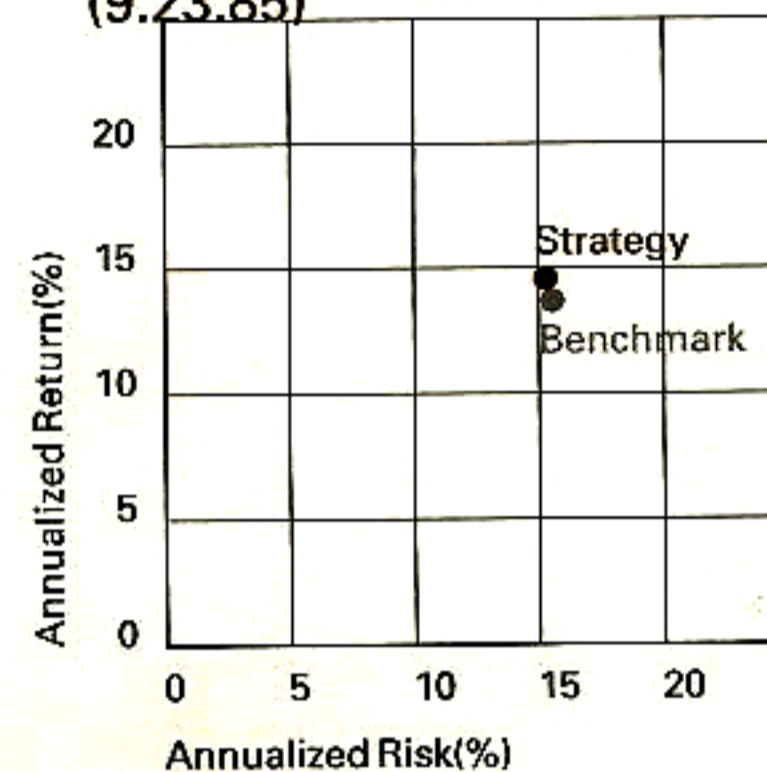


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Alpha Tilts 1994  
Performance vs S&P 500  
BenchmarkAlpha Tilts Since Inception  
(9.23.85)

returned  $-2.53\%$ . Over the long haul, TAA has offered return enhancement relative to its static mix with less variability in return. By allocating among the most liquid assets in the US market, TAA participates in market returns without the extra risks of leverage or loss of liquidity.

A risk-controlled, derivatives-based strategy that paid during 1994 was index arbitrage. Early in the year, we were able to add value in a fund that specifically allowed for investments in derivatives by purchasing an S&P 500 index portfolio and simultaneously selling an equivalent amount of S&P 500 futures. At the time, the futures were trading at a small premium to fair value with respect to the underlying stocks. The overall risk exposure of the hedged position was appropriate to this fund, which has a risk and return profile similar to a money market fund. The arbitrage depended primarily on the precision with which the stock portfolio tracked the index. Later in the year, the futures traded at a discount to fair value. At that time, the futures offered opportunities for stock investors. In certain S&P 500 portfolios permitting this trade, we added value by selling the stocks they normally hold and replacing them with S&P 500 futures. Both trades added modest amounts of value by seizing an opportunity and maintaining careful risk control.

Core Alpha, an advanced quantitative strategy developed by WFNIA, added 60 basis points in return in an S&P 500-based strategy by carefully measuring opportunity and managing risk. The Core Alpha strategy processes analyst, valuation and signaling

inputs, and then weighs and aggregates the data into estimates of expected returns. The strategy's portfolio optimizer chooses the best portfolio while at the same time assuring that it matches the benchmark's exposure to factors that induce only random variations in return. Thus, the strategy tilts towards factors about which the model develops valuable information, while avoiding the risk of misloading factors about which it develops no information.

#### An integral part of WFNIA's investment philosophy

Portfolio choice is the first level of risk control. But risk control as an investment philosophy at WFNIA goes much further. The investment disasters of 1994 highlight the exact perils we strive to manage. The troubles at the southern California county began with portfolio selection; leverage compounded them. As recently as last month at Barings, leverage turned a straightforward market bet into a corporate catastrophe. A large hedge fund's difficulties became most severe when unanticipated events compromised the hedges in its portfolio, and the disappearance of liquidity made adjustments costly and difficult. For a change, credit difficulties did not figure prominently in investment results during 1994, but credit exposure, both in securities and counterparties, remains an active concern for investors.

All investors, even sophisticated institutions, can be vulnerable to the temptation to embrace investments that seem too good to be true. Those investments still are. In the search for investment returns, all investors must

be mindful of maintaining appropriate investment exposures, resisting leverage, understanding unlikely but potentially disastrous events, guarding liquidity, and managing credit and counterparty risks. While no investment program can cancel risk and still seek return, prudent management of all risks remains a crucial component of good investing. 