

July 2010

SSI Outright Convertibles – The Opportunity Persists

by Ravi Malik, CFA



SSI Outright Convertible Strategy Performance Update

Above Trend Performance:

Convertibles outperformed stocks in 2008, 2009 & YTD 2010

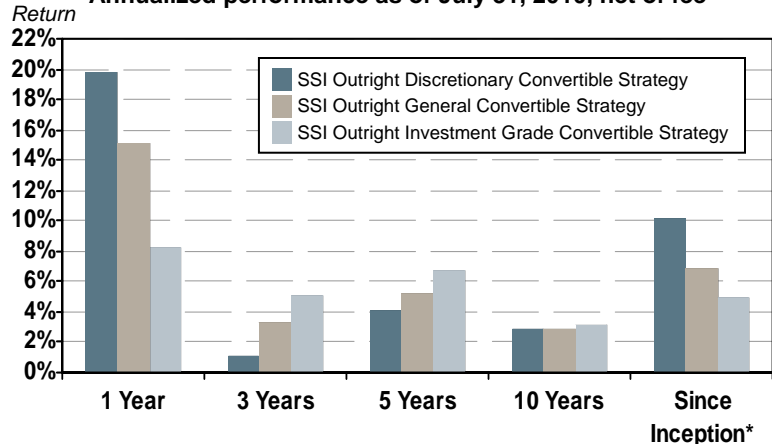
Attractively Priced:

Convertibles remain cheap in theoretical terms relative to equities and credit

Positioning and Outlook:

Theoretical value, equity market upside and contracting credit spreads contribute to our outlook for strong outperformance by Convertibles

Annualized performance as of July 31, 2010, net of fee



Performance (as of July 31, 2010; net of fee)	Trailing 1 Year	Trailing 3 Years	Trailing 5 Years	Trailing 10 Years	Since Inception*
SSI Outright Discretionary Convertible Strategy	19.77%	1.13%	4.13%	2.88%	10.22%
SSI Outright General Convertible Strategy	15.15%	3.29%	5.24%	2.83%	6.92%
SSI Outright Investment Grade Convertible Strategy	8.25%	5.04%	6.69%	3.20%	4.92%

*Inception dates: SSI Outright Discretionary Convertible Strategy: January 1, 1983 / SSI Outright General Convertible Strategy: January 1, 1997 / SSI Outright Investment Grade Convertible Strategy: January 1, 1999. Please see disclosure on final page for further information.

Analyst's Corner – Sector: Energy



Tim Ruiz
Energy Sector Specialist

In light of the rebound in global economic conditions, highlighted by Chinese oil demand surpassing the United States, commodity prices rebounded to levels that have spurred increased drilling activity in both onshore and offshore markets globally. There are 952 more oil rigs worldwide¹ since July 31, 2009, an increase of approximately 46%.

The recent Macondo Well blowout left the offshore industry struggling with a deepwater drilling moratorium, higher operation costs and stricter safety regulations. As a result, industry focus has shifted to onshore operations which are not affected by the issues that currently plague offshore drilling. This shift combined with the emergence of unconventional shale plays marks the return of major oil companies to US onshore operations via acquisitions and joint ventures.

The Bakken-shale levered Brigham Exploration (BEXP) is a recent example of interest in unconventional shale plays. The Bakken shale is an emerging, but prolific oil producing region located in western North Dakota and Eastern Montana. Interest in the play has increased as evidenced by the escalation in drilling activity. Rig counts at the Bakken-shale have risen to record levels not seen since the early 1980's². Activity is expected to increase by another 20-25% above this record level if drilling results are positive and oil prices remain resilient compared to the volatility of natural gas prices of late.

The interest in BEXP has been in its ongoing focus on oil production growth. BEXP's 2Q2010 earnings release reported 71% growth year over year (y/y) and 43% sequentially. This places the company among the top performers in its peer group. The company raised its oil production expectations for 2010 to 143% y/y growth and another 100% potential oil growth in 2011. BEXP also increased its acreage position in its Bakken-shale play at attractive pricing. In an effort to preserve cash flow, it hedged a majority of its production at appealing prices for 2010 and 2011. BEXP trades at a premium on valuation multiples relative to its peer group, and that is warranted due to its growth profile. More importantly, the stock is currently reflecting roughly \$65 oil, which on a net asset value (NAV), is trading at a discount compared to a "normalized" trading price level of \$80 oil. BEXP has approximately 13 years of drilling inventory but this could potentially double should downspacing efforts prove to be successful. The company should have enough liquidity to fund activity through 2011- an 8 rig program. BEXP may be able to tap the capital markets in an effort to further bolster its growth profile for 2011 and beyond if returns continue to warrant a further increase in activity. At present, BEXP is an attractively priced equity with its lower-risk, high growth/return model and BEXP could garner interest of a larger player should industry results in the Bakken region continue to improve.

Sources: ¹"Worldwide Rig Count", Baker Hughes Incorporated, July 2010
²"Bakker Shale Weekly", RBC Capital Markets Report, August 10, 2010

Investors must assess the suitability of any particular investment opportunity and carry out any due diligence that they require in relation to the strategy or investments or individual holdings of the strategies that SSI manages. In doing this, investors should seek separate advice. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list, and any investment is at risk of loss. These materials shall not constitute an offer by SSI Investment Management Inc. to sell or a solicitation of an offer to buy any securities. This summary represents the views of the portfolio managers as of 07/31/10. Those views may change, and SSI Investment Management, Inc. disclaims any obligation to advise investors of such changes. For the purpose of determining the Strategy's holdings, securities of the same issuer are aggregated to determine the weight in the Strategy. The holdings mentioned above (BEXP) comprise a minimum of 0.30% and a maximum of 1.10% of a strategy's market value as of 07/31/2010. Portfolio holdings are subject to change without notice and are not intended as recommendations of individual securities.

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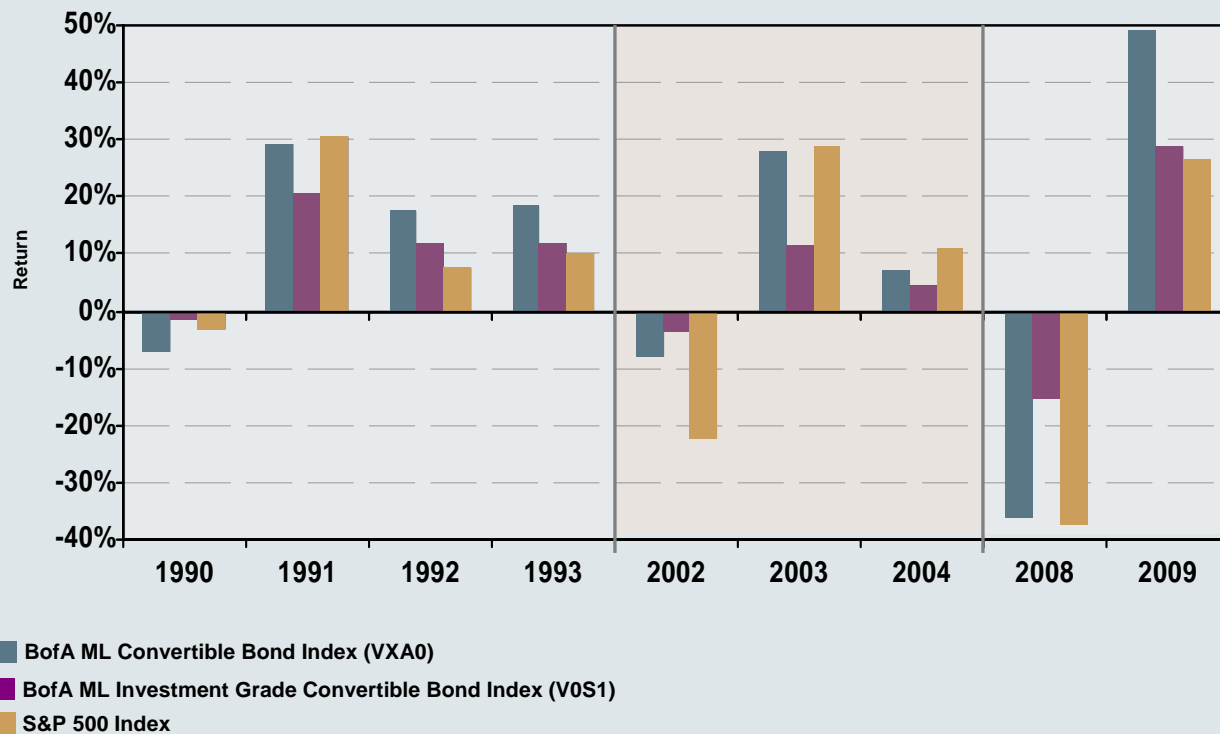
Above Trend Performance –

After a difficult 2008, Convertibles strongly outperformed stocks in 2009

Outright Convertibles began recovering in December 2008 followed by above trend performance in 2009 as spreads and cheapness reverted to the mean. At their cheapest level in November 2008, the Convertibles asset class presented a generational opportunity, with a theoretical cheapness of over 6% on top of the widest credit spreads for high yield on record, and an exceptionally cheap equity market.

Historically, periods of subpar Convertible returns - driven by liquidity and technically guided dislocation - are followed by a prolonged period of strong asset class outperformance. This manifestation is evident by Convertible performance in 1991, 1992, 1993, 2003, 2004 and 2009, illustrated in the graph below.

Annual Performance
BofA Merrill Lynch Convertible Index and Investment Grade Convertible Index vs. S&P 500



Source: Bloomberg

Convertibles Repriced –

Monetary and fiscal stimulus positively affect the Convertible asset class

The unprecedented monetary and fiscal stimulus made an impact across all risk assets and considerably reduced tail risk. The sum total of the stimulus represents 29.9% of GDP in this cycle and is in stark contrast to 8.3% from the financial crisis of 1929 through 1932.

The door to capital markets, believed to be firmly shut, finally found an opening initiated by the Convertibles market. Convertibles benefitted from tighter credit spreads across the spectrum of debt securities and the new issuance calendar. 108 new issues worth \$37.7 billion came to market in 2009. Most were priced attractively, oversubscribed by buyers and traded higher in the secondary market.

Additionally, after 2008's historic decline, equities rebounded 67% from the lows of March. Upside in the equity markets was driven by healthy dividends, expectations of a return to earnings growth in 2010 and reasonable valuations. Historically, SSI's Convertible Strategies have captured 2/3 of the equity market's upside while controlling downside risk¹.

¹Source: Zephyr StyleADVISOR. SSI Outright Discretionary Convertible strategy, net of fee, quarterly returns versus Wilshire 4500 Index (January 1, 1984-March 31, 2010). SSI Outright Discretionary Convertible strategy's upside capture: 71.9%, and downside capture: 57.4%.

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Strategic Positioning –

Are we heading into an inflationary period?

The monetary stimulus combined with quantitative easing in the US and Europe is sowing the seeds for future inflation. The long end of the Treasury curve sold off in 2009 in anticipation of rising inflation and a rising trend in TIPS spreads. The long bond's strong rally in 2010 results primarily from sovereign debt concerns, near term deflationary impact of fiscal consolidation in Europe and lowered growth expectations for the US and China.

Longer term, a return of inflation remains the bigger threat as monetary authorities in the US, Europe and Japan utilize monetary policy to ease the pain of fiscal consolidation. The risk of a policy error is high as monetary policy acts with a long lag, and policy makers are likely to be slow in withdrawing the monetary stimulus given the magnitude and duration of the current downturn.

The table below displays the performance of the Convertible asset class during the high inflationary period of 1973-1984.

Top 4 Asset Classes Nominal Return
(1973 – 1984)

	Convertibles	Large Cap Stocks	Small Cap Stocks	Gold	CPI
Mean Return	11.7%	9.6%	22.2%	21.6%	7.9%
Standard Deviation	12.8%	18.9%	27.1%	45.4%	3.0%
Sharpe Ratio	0.39	0.15	0.57	0.33	0.40

2010 Outlook for the Convertible Market

SSI's outlook for Convertibles is optimistic as convertibles continue to offer attractive yields with implied credit spreads wider than their straight counterparts, and wider than they have been historically on average. The current crop of high yield convertibles represents issuers averaging stronger balance sheets and credit profiles than plain vanilla bonds. Further adding to SSI's optimistic outlook is the following:

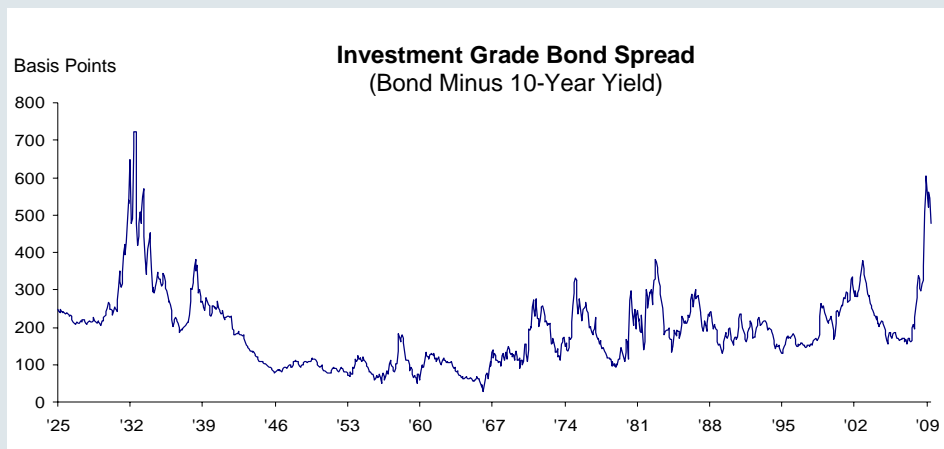
- Implied default rate for high yield corporates based on the current credit spread of ~667 bps: 4.9%
- Moody's 2010 expected default rate for high yield issuers: 3.4%
- Overall convertible universe has implied default rate of 0.6% in both Q1 & Q2, 2010
- Convertible issuers have a stronger growth profile than the average company accessing capital markets, thus is able to reduce equity dilution while financing near term growth prospects

Despite recent tightening, credit spreads still attractive:

- 163bps for Investment Grade
- 667bps for High Yield

While the macro risks are not immaterial, the market has moved considerably in the direction of pricing that reflects the dramatic slowdown in growth. The S&P to GDP ratio is 67% (as of June 30, 2010). Historically, at this starting level of equity valuation, long term investors in equities have been handsomely rewarded with prospective cumulative ten-year returns ranging from 100-200%.

Both equity and credit are supported by solid cash flow generation, record levels of cash on balance sheets for S&P companies, and solid earnings in the corporate sector. Convertibles represent an attractive means of participating in this potential upside of the equity market, with the capability to lower downside risk and return volatility. Attractive and active new issuance, combined with contracting credit spreads & theoretical cheapness add to our confidence in the favorable return outlook for convertibles.



Source: Strategas Research Partners, LLC

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About SSI

One of the first to utilize technology to create innovative portfolio solutions, SSI Investment Management has one of the longest track records in the country in market-neutral investing. Founded in 1973, the firm has been able to develop its ideas into proprietary stock selection models and offer a systematic, market-neutral, controlled volatility equity portfolio for institutional investors. SSI's principals were the first to develop an earnings estimate revision model for use in stock selection, and SSI was one of the first firms to integrate portable alpha into investment portfolios. Staying focused on its core competencies, SSI continues to expand its capabilities and add value for its clients.

SSI's Outright Convertible Investment Strategy

SSI's Outright Convertible products seek to add value by producing equity-like returns with bond-like risk. Utilizing both quantitative and fundamental analysis to determine the best portfolio candidates, SSI's portfolio team constructs a diversified portfolio of convertible bonds and convertible preferred stocks that have been evaluated on relative valuation and risk attributes.

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Outright Convertibles Performance Disclosure

SSI Investment Management, Inc. acquired the assets of Frole, Revy Investment Co., Inc and its composites as of March 1st, 2009. SSI is not and does not claim to be GIPS compliant. However, from January 1, 1983 through December 31, 2008, Frole, Revy claimed GIPS compliance and was verified by Ashland Partners & Company, LLP.

The Outright Discretionary Convertible strategy is invested in convertible bonds and convertible preferred stocks, and do not have credit quality restrictions. This composite was created in January 1983. The composite contains fully discretionary accounts including those no longer with the firm. SSI believes a performance comparison versus the Merrill Lynch All Convertibles (VXA0) index is appropriate. However, the volatility of this strategy is expected to be greater than the volatility of the Merrill Lynch All Convertibles index as the strategy holds a smaller number of positions as the index. The return, if any, above the Merrill Lynch All Convertibles index is dependent upon SSI's discretionary management. The other indices shown, if any, are not necessarily comparable to SSI's strategy. These are widely recognized market indices that are shown for informational purposes only.

The Outright Investment Grade strategy is invested in investment grade convertible securities. This composite was created in January 1999. The composite contains fully discretionary accounts including those no longer with the firm. The composite did not include investment grade convertible preferred shares prior January 1, 2010. Effective January 1, 2010, the composite may include accounts invested in investment grade convertible preferred shares up to generally 20% of the portfolio. SSI believes a performance comparison versus the Merrill Lynch Investment Grade Convertible Bonds (V0S1) index is appropriate. However, the volatility of this strategy is expected to be greater than the volatility of the Merrill Lynch Investment Grade Convertible Bonds index as the strategy holds a smaller number of positions as the index and may include investment grade convertible preferred securities. The return, if any, above the Merrill Lynch Investment Grade Convertible Bonds index is dependent upon SSI's discretionary management. The other indices shown, if any, are not necessarily comparable to SSI's strategy. These are widely recognized market indices that are shown for informational purposes only.

The Outright General Convertible strategy is invested in convertible bonds and convertible preferred stocks. This composite was created in January 1997. The composite contains fully discretionary accounts including those no longer with the firm. SSI believes a performance comparison versus the Merrill Lynch All Convertibles excluding 144A (VXN0) index is appropriate. However, the volatility of this strategy is expected to be greater than the volatility of the Merrill Lynch All Convertibles excluding 144A index as the strategy holds a smaller number of positions as the index. The return, if any, above the Merrill Lynch All Convertibles excluding 144A index is dependent upon higher interest income available in the convertible market and SSI's discretionary management. The other indices shown, if any, are not necessarily comparable to SSI's strategy. These are widely recognized market indices that are shown for informational purposes only.

Actual results of an individual account may be materially different from the performance shown herein because of differences in inception date, transaction and related costs, restrictions, fees and other factors. The annual composite dispersion presented is an asset-weighted standard deviation calculated for accounts in the composite the entire year.

All returns are based in U.S. dollars and reflect, on a percentage basis for each of the periods indicated: (a) the net increase (decrease) of all Outright General Convertible portfolios, dollar-weighted, including adjustments for unrealized gains and losses, the reinvestment of dividends and other earnings, the deduction of costs, except for SSI's management fee and any separate custodial fees, time-weighted to adjust for additions and withdrawals.

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