

STANDARD DEVIATIONS

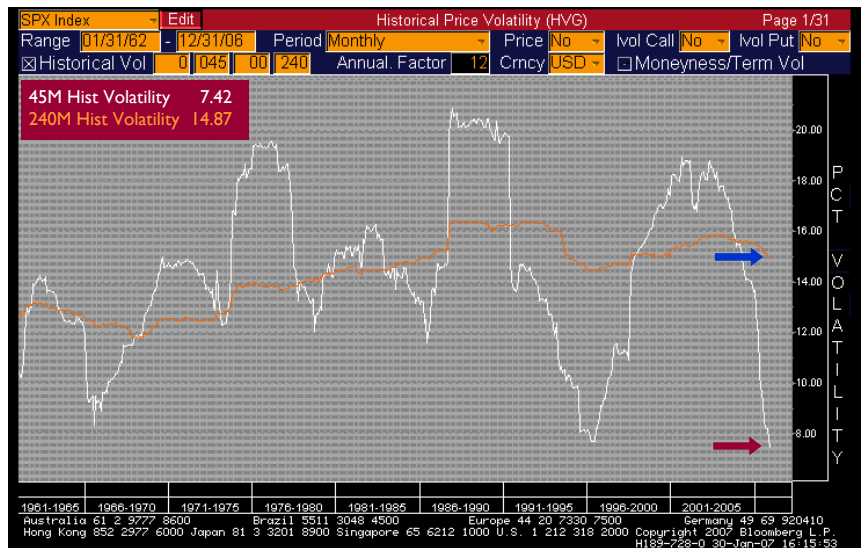
Ferrell Research & Recommendation - February 2007

Portfolio Risk Diet

By William G. Ferrell

Executive Summary

Equities dominate the performance of most investment portfolios, not only because their volatility is usually the highest but because the *changes* in volatility (volatility of volatility) are the greatest. For nearly four years, equities have shown positive returns while volatility has dropped 61% to a 45-year low. Now is the right time to put your portfolio on a risk diet and take some equity risk off the table - before volatility spikes upward. By replacing equity exposure with a professionally managed Absolute Return Strategy (ARS), you can improve future returns and reduce the stress of volatility swings in 2007 and beyond.



Reliable... Except When They Are Not

Over the long run, equity investments are the driving force in most investment portfolios, because equities are a reliable source of growth. However, in shorter time periods, four to eight years in length, equities can be erratic. Part of the reason is that the volatility of the stock market has a wide historical range.

In recent times low volatility is associated with stable growth. High volatility generally accompanies stressful periods for the market, when prices decline.

Good Risk vs. Bad Risk

- Constant risk level
vs.
Unpredictable levels of risk
- Consistent risk-adjusted return
vs.
Variable levels of return on risk
- Reliable, low correlation to equities
vs.
High or random correlation to equities

Historical Perspective

The graph (top right) shows that since the current sustained rally began 45 months ago, the rolling volatility of the S&P 500 is the lowest in modern history. The 7.4% standard deviation falls slightly below the 7.8% level last witnessed in 1996.

Swapping Equity Risk for a Stable Diversifier

From a performance perspective, any recommendation to transfer risk must find an investment opportunity that will do more than simply diversify the portfolio. The new investment should be capable of matching equity returns in the profitable cycles and protecting overall portfolio value when equities decline. *Our recommendation is to broadly diversify risk while enhancing long term return.*

Ferrell Concert

Over the past six years, the Ferrell Concert program has

demonstrated uncommon stability through the careful management of volatility in spite of major swings in the equity and fixed income markets.

“The rolling volatility of the S&P 500 is the lowest in modern history.”

Since January 2001, the stock market declined and recovered dramatically. The decline was accompanied with volatility in the 19.0-20.0% range, and the rebound with volatility in the 7.0-7.5% range.

Chart I: Equity Market Declines

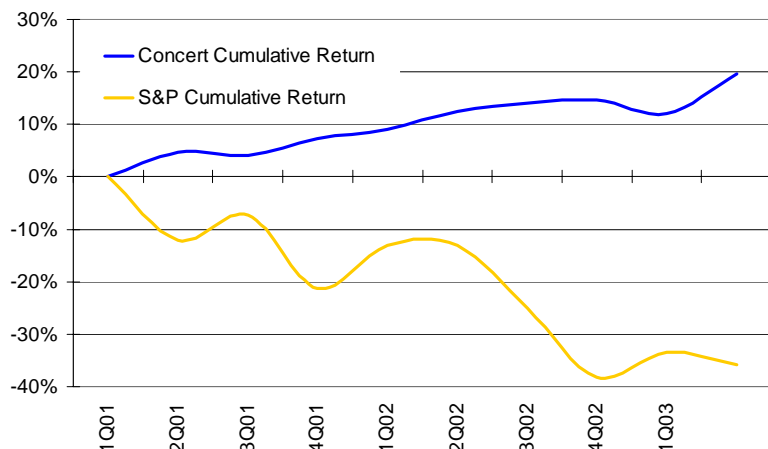


Chart I shows the behavior of the S&P 500 Index compared to Ferrell Concert from January 2001-March 2003. Concert appreciated over 19% while the S&P 500 declined almost 36%.

	Concert (ARS)	S&P 500
Annual Return	8.5%	-16.4%
Standard Deviation	6.7%	19.1%
Total Return	19.6%	-35.8%

Chart II: Equity Market Rebounds

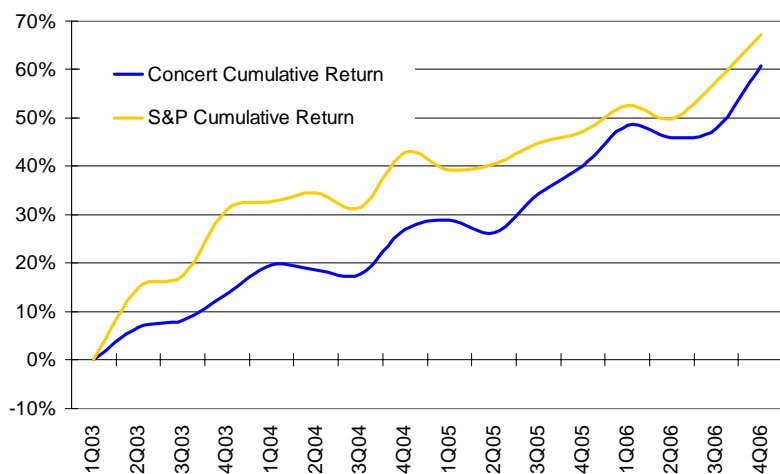


Chart II demonstrates the similarity in return potential of the S&P 500 Index and the Concert program since 2003. In the most recent bull equity market, Concert kept pace with the S&P 500.

	Concert (ARS)	S&P 500
Annual Return	13.5%	15.1%
Standard Deviation	6.0%	7.4%
Total Return	59.9%	67.2%

Chart III: Concert, S&P 500 and 70/30 Blend Comparison

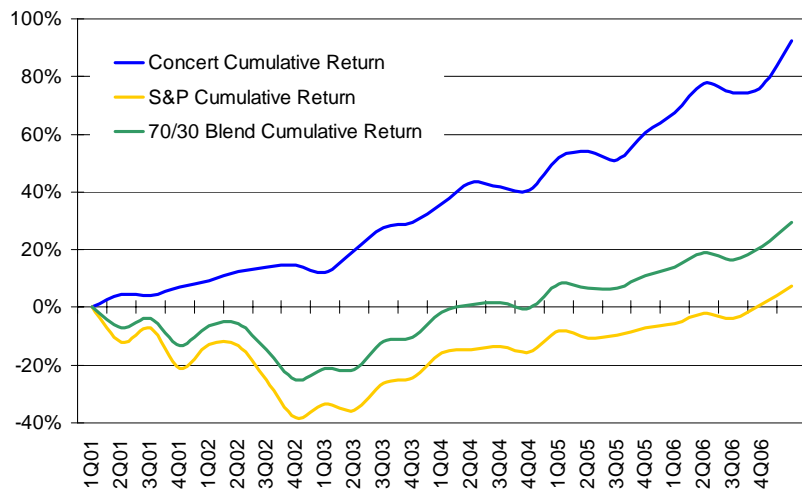


Chart III shows the results over the entire six year period with the addition of a 70% equity / 30% Concert pro forma shown in green.

	Concert (ARS)	S&P 500	70/30 Blend
Annual Return	11.7%	2.2%	4.9%
Standard Deviation	6.3%	14.0%	10.1%
Total Return	92.5%	7.4%	29.5%
Max Loss (Sep 2002)	—	-38.3%	-25.0%
Loss Recovery Period	—	24 qtrs	13 qtrs

The results are compelling. The green line (the blended portfolio) shows the magnitude of the maximum equity draw-down buffered from -38.3% to -25.0%, reducing the maximum loss by 35%. The time of recovery to the January 2001 level is reduced almost by half to 13 quarters (1Q/04) from 24 quarters (4Q/06).

The volatility of the combined performance drops from 14.0% to 10.1% and the cumulative growth of the portfolio rises from 7.4% to 29.5%.

The net effect is a tighter range of expected performance outcomes combined with a better risk-adjusted return.

Characteristics of Good Risk Diets

They work.
You lose risk-weight & reduce portfolio volatility.

◇

They are healthy.
Your performance must improve.

◇

They last.
You never put the risk back on.

The Bottom Line

Shifting a measure of risk away from equities to a consistent source of uncorrelated volatility and return makes a powerful combination. A more reliable range of performance coupled with improved risk-adjusted returns make it possible for investors to:

- Cover the cost of liabilities,
- Accept new contributions without concern for investment timing, and
- Compound the value of the portfolio to exceed inflation and generate a real investment return.

How Ferrell Capital Can Tailor the Right Risk Diet for Your Portfolio

If you would like to know just how path dependant your portfolio is on equity investments and the value of diversifying into Concert, please email Erin Britton-Torrens at ebt@ferrellcapital.com for a confidential risk diagnostic of your current portfolio holdings. You will be able to review your own portfolio through our risk analytics and determine how you may be able to put your investments in better shape for the future. ■

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