

# Unlocking the Potential of Hedge Funds

## HDG ProShares Hedge Replication ETF

### » The role of hedge fund investing

Over the past decade, investors have become more conscious of the inherent risks of investing only in traditional asset classes like stocks and bonds. Many are seeking a better balance of risk and return through alternative investments like hedge funds. Hedge funds have become increasingly popular with investors because they historically have had attractive risk-adjusted returns relative to stocks and bonds, as described in the chart below. As a group, hedge funds have also done a good job of managing downside risk.

### » But hedge funds present challenges

For a variety of reasons, hedge funds have been out of reach for many investors. Hedge funds often restrict access, may have higher investment minimums, or may be closed to new investment. Now, an approach known as hedge fund replication may provide an alternative to investing directly in a hedge fund.

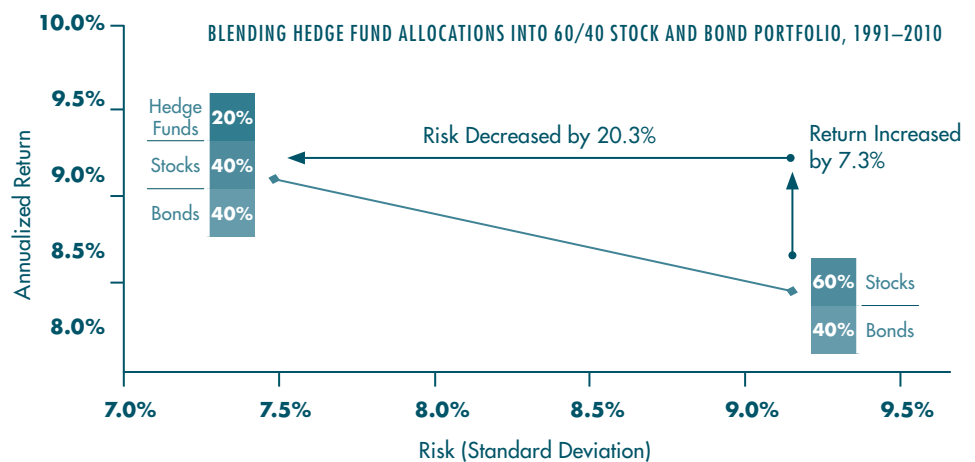
#### HEDGE FUND ALLOCATION IMPROVED HISTORICAL RISK-ADJUSTED RETURNS

The chart shows a hypothetical stock and bond portfolio (far right), represented by the S&P 500 and Barclays Capital Aggregate Bond Index.

Shifting some assets from stocks to hedge funds — represented by the Hedge Fund Research, Inc. (HFRI) Fund Weighted Composite Index — would have improved the returns and reduced risk, as measured by standard deviation, of this hypothetical portfolio.

An allocation of 20% to hedge funds (far left) would have improved returns by about 7%, with 20% less risk, as measured by improved standard deviation.

In addition, the HFRI's annualized return of 12% over this period exceeded returns for the S&P 500 (9%) and Barclays (7%), and the HFRI's standard deviation of 6% compared favorably against the S&P 500 (15%) and Barclays (3%).



Source: Bloomberg, December 2010. Index returns are for illustrative purposes only and do not represent fund performance. Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest in an index.

**Past performance does not guarantee future results.**

## HOW HEDGE FUND REPLICATION WORKS

HEDGE FUNDS INDEX	REPLICATION MODEL	ETF
<p><b>HFRI FUND WEIGHTED COMPOSITE INDEX (HFRI)</b></p> <p>Broadest index of hedge fund performance</p> <ul style="list-style-type: none"> <li>» Tracks performance of more than 2,000 hedge funds</li> <li>» Represents about \$2 trillion in assets under management</li> <li>» Covers a variety of investment strategies</li> </ul>	<p><b>MERRILL LYNCH FACTOR MODEL – EXCHANGE SERIES (MLFM-ES)<sup>1</sup></b></p> <p>Seeks a high correlation to the HFRI, using these model factors, adjusted monthly:</p> <ul style="list-style-type: none"> <li>» S&amp;P 500</li> <li>» Russell 2000</li> <li>» MSCI EAFE</li> <li>» MSCI Emerging Markets</li> <li>» ProShares UltraShort Euro ETF<sup>2</sup></li> <li>» 3-month Treasury bills</li> </ul>	<p><b>PROSHARES HEDGE REPLICATION ETF (HDG)</b></p> <p>Seeks to provide the risk/return characteristics of hedge funds by tracking the performance of the MLFM-ES.</p>

Source: Merrill Lynch

<sup>1</sup>Merrill Lynch Factor Model®— Exchange Series (MLFM-ES) is a newly created benchmark that is similar to, but not the same as, the Merrill Lynch Factor Model (MLFM), which was introduced in 2006. Each factor model aims to achieve similar market exposures using comparable but different underlying instruments. The MLFM-ES is likely to underperform the MLFM over time due to differences in the underlying cash instruments.

<sup>2</sup>ProShares UltraShort Euro (EUO) is used as a proxy for the euro-U.S. dollar exchange rate. HDG will typically achieve this exposure through futures or forwards linked to the euro-U.S. dollar exchange rate and will not typically hold shares of EUO.

## » What is factor replication?

Hedge fund replication is a quantitative strategy that attempts to recreate the risk and return profile of a broad universe of hedge funds. One approach is known as “factor” replication, which attempts to determine combinations and weightings of financial market factors, such as the returns of indexes that historically have had a high correlation with hedge fund performance. Academic research has shown that a substantial portion of hedge fund returns is derived from exposure to market factors.

### **Hedge Fund Research, Inc. Fund Weighted Composite Index**

Replication starts with an index of hedge fund performance. This index, from a global leader in the alternative investments industry, represents more than 2,000 hedge funds.

### **Merrill Lynch Factor Model® – Exchange Series**

Next, this benchmark seeks to provide the risk and return characteristics of the hedge fund asset class by targeting a high correlation to the HFRI. Established by Merrill Lynch, a pioneer in hedge fund replication, the MLFM-ES seeks to replicate the portion of hedge fund returns that is attributable to market exposure.

### **ProShares Hedge Replication ETF**

The fund seeks exposure to the six market factors underlying the benchmark, MLFM-ES, investing in equities, ADRs, derivatives such as swaps, forwards and futures, and U.S. Treasury bills. The fund does not invest directly in hedge funds.



## » About the fund

**Ticker Symbol:** HDG

**Intraday Ticker:** HDG.IV

**Investment Objective:** Seeks investment results (before fees and expenses) that track the performance of the Merrill Lynch Factor Model – Exchange Series (MLFM-ES).

**Gross Expense Ratio:** 1.87%<sup>3</sup>

**Expense Ratio:** 0.95%<sup>4</sup>

**Bloomberg Index Symbol:** MLEIFCTX

<sup>3</sup>According to the estimated figure listed in the prospectus.

<sup>4</sup>With contractual waiver for 10/1/11 to 9/30/12.

# » Advantages of HDG

## » Hedge fund exposure in a flexible ETF format

By tracking a hedge fund replication benchmark, ProShares Hedge Replication ETF seeks to generate the risk and return characteristics of a broad universe of hedge funds while avoiding or overcoming many of the challenges of investing in a hedge fund.

## » ProShares Hedge Replication ETF (HDG) unlocks many of the advantages of hedge funds, and also offers:

### **Accessibility**

You can trade ProShares Hedge Replication ETF in your brokerage account, and shares can be bought and sold at any time during trading hours.

### **Transparency**

ProShares Hedge Replication ETF holdings are reported daily at [proshares.com](http://proshares.com). The fund obtains its exposure through readily available, liquid and marketable securities or derivatives.

### **Manager diversification**

The fund's benchmark, Merrill Lynch Factor Model – Exchange Series, aims to replicate an index of more than 2,000 hedge funds, representing multiple investment strategies.

### **Regulatory oversight**

The fund is regulated as an investment company, like most exchange-traded funds, and has the same reporting requirements.

### **Convenient tax reporting**

ProShares Hedge Replication ETF reports capital gains and dividends on Form 1099.

## » A note about replication

It is important to note that the MLFM-ES is structured to replicate the return of a broad universe of hedge funds, not the returns of top-performing funds. HDG does not invest directly in hedge funds or in funds-of-hedge-funds. Individual hedge funds or funds-of-hedge-funds may generate materially higher or lower returns than HDG, its benchmark index or the average return of a broad universe of hedge funds.



## » Using ProShares Hedge Replication ETF in your portfolio

ProShares Hedge Replication ETF (HDG) can be a valuable component of an alternative asset allocation. The fund:

- » Is a convenient and flexible way to access the risk/return characteristics of hedge fund investing, without many of the challenges
- » Offers the potential for improved risk-adjusted returns within a portfolio
- » Can serve as an important complement to core portfolio holdings
- » Benefits from the expertise of Merrill Lynch, a pioneer in hedge fund replication, and ProShares, a premier provider of alternative ETFs

Talk to your financial adviser about unlocking the potential of hedge funds for your portfolio.

## » About ProShares

ProShares is a premier provider of alternative ETFs that allow investors to execute sophisticated investment strategies. The ProShares lineup includes the largest family of geared (leveraged or inverse) ETFs.<sup>5</sup>

## » Find out more

**To learn more, consult your financial professional, visit [proshares.com](http://proshares.com) or call ProShares at 866.776.5125.**

<sup>5</sup>Source: Lipper, based on a worldwide analysis of all of the known providers of funds in these categories. The analysis covered ETFs and ETNs by the number of funds and assets (as of 6/30/2011).

ProShares Hedge Replication ETF (HDG) does not invest in any hedge funds or funds-of-hedge-funds. There is no guarantee that HDG will successfully achieve its investment objective or that the "Merrill Lynch Factor Model® – Exchange Series" (MLFM-ES) will successfully provide the risk/return characteristics of a broad universe of hedge funds or achieve a high correlation with the HFRI Fund Weighted Composite Index (HFRI). Performance differences between the MLFM-ES and the HFRI are expected to be material at times. Even if HDG achieves its benchmark-tracking objective, the MLFM-ES may not produce the risk/return characteristics of a broad universe of hedge funds, as measured by the HFRI or any other hedge fund benchmark. Individual hedge funds or funds-of-hedge-funds have the potential to provide materially higher or lower returns than HDG, the MLFM-ES or the average return of a broad universe of hedge funds.

**Investing involves risk, including the possible loss of principal.** ProShares are non-diversified and entail certain risks, including risk associated with the use of derivatives (swap agreements, futures contracts and similar instruments), imperfect benchmark correlation, leverage and market price variance, all of which can increase volatility and decrease performance. Short positions lose value as security prices increase. Leverage can increase market exposure and magnify investment risk. Please see the summary and full prospectuses for a more complete description of risks. **There is no guarantee any ProShares ETF will achieve its investment objective.**

**Carefully consider the investment objectives, risks, charges and expenses of ProShares before investing. This and other information can be found in their summary and full prospectuses. Read them carefully before investing. Obtain them from your financial adviser or broker/dealer representative or visit [proshares.com](http://proshares.com).**

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