

# Tera Capital Global Innovation

## Hedge Fund Research Summary

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Tera Capital Global Innovation has a history that tells a tale of two mandates.

Originally, this fund's objective was to outperform the Morgan Stanley High Technology 35 index. After producing a 113% return in 1999, the fund quickly ran into the headwinds of the bursting tech bubble. After a brutal string of double-digit losses and declining assets, in 2003 manager Howard Sutton (with the consent of the fund's unitholders) rewrote the fund's mandate to an absolute-return focus.

The fund's shift has certainly paid off. From 2004 through 2007, the fund finished each year in its category's top quintiles, and its trailing annualized five-year returns of 40% through April 2008 leapfrog both US and Canadian benchmark small-cap indexes, earning the fund a 5-star rating (which currently excludes its early years). While the fund has certainly encountered more favorable markets during that period, it did hold up decently during the choppy markets of late 2007 and early 2008.

Even with more of an absolute-return orientation, the fund remains long-biased and focused on small-cap stocks in the volatile science and technology industries. Sutton begins by determining an allocation among what his team at Tera Capital considers the most promising themes, then looks for the best individual companies to fill out the themes. Sutton concentrates on firms that have a strong claim to intellectual property and innovative science. He also places a premium on experienced, capable management teams and reasonable valuations.

The fund features a concentrated portfolio, with only around 20 total holdings. Individual long positions can rise to 15% at cost, and when a position reaches 20% of assets the managers will typically trim back. The fund can also invest up to 15% of the portfolio in private placements. In such cases, the fund often works closely with the start-up to assist with strategy and financing, as is the case with Embotics, a maker of virtual-machines software on whose board Sutton sits.

There are no restrictions on net or gross exposure, but the fund tends to be long-biased, and it uses leverage only in the 10%–20% range. In the fund's short book, Sutton engages in defensive hedging through market puts and pairs trading, as well as opportunistic shorting of companies that the managers believe are overly promoted while lacking viable science. Recently, Sutton has edged to a more defensive posture after redeploying cash from profit-taking into portfolio insurance; the fund was 70% long as of April 2008.

This fund could find a place in the portfolio of investors willing to accept a great deal of volatility for the opportunity to profit from emerging technology companies. Although the fund's early years blemish its record, its performance since 2004 helps diminish concerns.