

MOROSE OUTLOOK, INFLATION, AND HOW TO ADJUST

Etsior selects strategies and funds that can bring an edge in asset allocation and portfolio construction.
Etsior focuses on funds that:

- Have an original strategy or approach
- Bring a real diversification
- Offer a good performance coupled with an acceptable risk
- Emerge from a strong idea, a forceful manager's personality or both

Etsior connects Fund Managers (Single Hedge Funds, Funds of Funds managers, Private Equity as well as Long only Funds) with Institutional Investors.

Well introduced in the Geneva area, we are focused on an unparalleled level of service.

Through our website, Etsior offers an easy access to reliable, up to date and accurate information on the funds we introduce as well as on third party funds.

Our selection is always put in the macro-economical perspective to exploit the short to medium term market trends.

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The outlook for the US economy is not really good: growth slowdown and inflation.

The reasons sustaining this assessment have been well expressed when the Federal Open Market Committee has chosen to lower the federal fund rate an additional 25bp on 31 October (*):

- *Delinquencies on mortgages are likely to rise further in coming quarters as a sizable number of recent-vintage subprime loans experience their first interest rate*
- *The recent growth performance [3.9% annual in the 3rd quarter] is not likely to be sustained in the near term*
- *There is risk that financial market conditions would fail to improve or even worsen, causing credit conditions to become even more restrictive than expected.*
- *In light of the problems in mortgage markets and the large inventories of unsold homes, house prices might weaken more than expected, which could further reduce consumers' willingness to spend and increase investors' concerns about mortgage credit*
- *Inflation upside risk: in particular, prices of crude oil and other commodities had increased sharply in recent weeks, and the foreign exchange value of the dollar had weakened. These factors were likely to increase overall inflation in the short run and, should inflation expectations become unmoored, had the potential to boost inflation in the longer run as well.*

The ECB as well as the Bank of England have maintained their interest rates unchanged for the same reasons: though the growth rate in the euro zone was quite good during the 3rd quarter, the credit issues may split over the whole economy, while inflation is on the rise as a consequence of price increases on commodities.

Though the ECB has to maintain inflation under an annual 2%, it cannot ignore the economic and social risks. In all logics, the ECB should increase its interest rate. But doing it, this would further accelerate the depreciation of the US dollar and make export more difficult for the euro zone countries. We may have the paradigm of the ECB lowering its interest rate in spite of inflation threats, to preserve the whole economic health of the euro zone.

At the same time, Emerging countries and especially China are doing quite well. Evidently both the US and the EU are pushing China to revalue the Remimbi. This will happen without any doubt. Progressively or in one shot, but it will happen as China cannot stand the imported inflation of the low Remimbi. In my opinion, the Hong Kong dollar will give up its current peg with the US dollar, widen the fluctuation margins or change the peg level. The Hong Kong Monetary Authority already had to buy hundreds of millions of US dollars, and the past crises have taught us that governments always yield to speculation.

What would be the allocation guidelines to face these conditions?

- Focus on emerging countries, especially on China in the near term, including selective investments in real estate. Though we have had very good performances so far this year, the Chinese growth rate is such that there is still room for appreciation. This will not last, and a strong correction may come before the Olympic Games, may be already in 2008 Q2. I still remain bullish on the Hong Kong market because of the spread between the same stocks (A stocks) listed in China and in Hong Kong, and because of the under appreciation of the HK dollar.
- Focus on commodities, oil, metals and some precious metals as platinum were resource is scarce and consumption growing. I am not so bullish on soft commodities like corn and wheat: I believe one day or another, we will wake up from the dream of soft commodities being turned into bio energies.
- Go to uncorrelated products: some hedge funds offer non correlated, sometimes negative correlated returns with rather good performances and low volatility.
- Go to private equity for long term investments, rely on very knowledgeable people to pick

good companies and to take them to a level allowing a substantial profit.

In all these categories, Etsior has selected products that permit to cross the current turmoil.

In the ***hedge funds*** category for example, we like very much the **Health Alpha** fund (market neutral in euro, not correlated to equity markets, (YTD +19.3%, 8.8% volatility). We are also very confident in the **American Pegasus Auto Loan** fund which finances subprime auto loans and remained very stable during the credit crisis (YTD +10.46%, 2.85% volatility, no negative months ever). We find the **INTL Consilium** fund that deals with convertible bonds arbitrage extremely interesting (YTD +8.50%, very low volatility and negative correlation to markets). We consider the **Solid Rock Fund** of Hedge Funds (YTD +8.36%, very low volatility of 3.64%) is a very good balanced choice. We also remain confident with the **Eden Rock Structured Finance Fund** (YTD +0.33%, volatility of 3.06%), which has demonstrated its defensive capabilities even if it has suffered from the consequences of the subprime crisis on part of its underlying funds. It is well positioned in terms of liquidity and capacity to access opportunities in the market over the coming months and to take full advantage of the repricing that has occurred.

We care for you.

(*) Chairman Ben S. Bernanke, *The economic outlook*, Before the Joint Economic Committee, U.S. Congress, November 8, 2007