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Dear Investors,

We recently completed our Annual Secular Forum at Armored Wolf where the firm's investment professionals review key issues in the global marketplace and identify broad strategic investment themes for the coming year and beyond.

I. Imbalances, Exit Strategies & Growth

The imbalances that exist in the world today have developed and become more complex over time but their origins can be found within the advent of globalization and the rapid growth of the financial sector in the U.S. and U.K economies. The powerful forces of unfettered cross-border flows of financial capital and traded goods allowed for the outsourcing of low-margin manufacturing business overseas, while creating high-margin financial empires at home.

The world saw debt-driven, asset-price-based consumption (U.S. still sees a 71% consumption component of GDP) and a hollowing out of manufacturing industries displaced by a burgeoning service sector in the U.S and U.K. The flip side saw developing economies, based on export-led growth slowly gain a significant share of global manufacturing trade that has become increasingly high-end. The mercantilist nature of these economies, which was exacerbated by the Asia crisis and a desire for additional security, saw intervention in FX markets to retain competitiveness and suppress local demand. The resulting accumulation of reserves and high savings rates is well documented. This situation allowed the U.S., as the provider of reserve currency and the recipient of the majority of the credit flows, to finance ever larger government and private deficits at low interest rates. Furthermore, cheap production costs and excess global output capacity kept inflation in check at the consumer price level, allowing the U.S. Federal Reserve and other central banks to run abnormally low real interest rates. This stoked further asset price rises at home and abroad.

The model has been supported by political self interests and over the last 20 years has come to dominate the growth dynamics of the world. Offshoots of this growth have seen a rise in commodity prices, allowing oil-exporting countries to build huge reserves, adding to the already significant recycling of credit back to western governments that are financing deficits.

A further twist has been the financing of European deficit nations by the European nations with surplus. The generally lower level of household consumption and indebtedness within core Europe led their banks to seek investment opportunities elsewhere and they grew aggressively into Central and Eastern European markets. This caused high investment and consumption in those countries and created imbalances within Europe.

Recent developments such as inadequate bank regulation, financial engineering and outright fraud, allowed significant leverage to enter the system so that any correction in asset prices would cause systemic instability and created the financial crisis of 2008 and the ongoing side effects.

Following the financial crisis, we saw a period of massive deleveraging as credit lines evaporated. World trade dropped sharply and commodity prices fell dramatically. There was a general inability or unwillingness to finance external net liabilities. The vulnerability of a system where banks were so large that governments were forced to support them due to systemic concerns caused a massive transfer of debt from the private to public sector. Years of running high deficits through the cycle have meant that the fashion for a Keynesian response to the crisis has brought issues of sovereign creditworthiness to the forefront, as outlined in Section II of this report. However, emerging countries handled their banking problems far better (e.g., Russia) as they had built up large cushions during the growth cycle—either consciously or with IMF encouragement—and were generally less exposed to real estate.

But the overall effects of the crisis were a sharp correction in global imbalances. Deleveraging brought about a contraction in demand in the U.S. and U.K., as well as an attempt by exporting countries to stimulate domestic demand, led most significantly by China where the Communist Party scrambled to ensure they kept to their “social contract.”

Surpluses of oil exports fell sharply and those of Germany and Japan were reduced as demand for capital goods plummeted. Central and Eastern European countries saw rapid contractions in consumption, asset prices and current account deficits, which caused a crisis among many banks in surplus European countries, ultimately resolved with capital injections at home and IMF support for the Central and Eastern European sovereigns.

In financial markets, the deleveraging process caused risk assets to fall sharply and the U.S. dollar and Japanese yen to rally as demand for their currencies to repay margin and credit caused a negative feedback effect. Government bonds rallied to record low rates, even as policymakers responded with monetary and fiscal stimulus of eye-watering proportions.

Having briefly glimpsed a world throwing off imbalances as the crisis forced correction upon both sides, we now see more imbalances as policy makers attempt to resurrect the world as we knew it. However, the global economy is far from being what it was and the outcome remains uncertain.

Government debt has replaced private liabilities and record deficits appear unsustainable in many developed economies without elevated taxes, future spending cuts or further aggressive monetary experiments. FX and debt markets have thus become the lightning rods of policymaking.

The deflationary forces seen in the U.S. and the U.K. are in a pitched battle with policy makers’ attempts to reflate. The developing countries are benefitting from these attempts as their surpluses recover and together with their own stimulus plans have seen their asset markets and currencies gain sharply. Reserve accumulation has resumed along with attempts to break pressures toward currency

appreciation and signs of overheating in Asia and Latin America. German and Japanese current account surpluses are returning, as are those of commodity-exporting countries.

So we see a link between policy, imbalances, growth and inflation. We see that a deleveraging in the developed world would correct global imbalances in a deflationary way. However, we see how attempts to reflate will lead to further imbalances and inflationary tendencies in some, if not all parts of the globe.

Is it possible for imbalances to correct without the trauma of debt deflation? Deficit countries will have to start running surpluses at some point. At the very least, demographic issues eventually will cause dis-saving by ageing populations--Japan is close to this point. High-saving countries will have to increase consumption and grow service sectors, possibly by spending more on social insurance to encourage people to save less.

Low saving rates in deficit countries were encouraged by asset price inflation (e.g., housing) and it is possible that the crisis has begun the process of raising household savings that must continue for the foreseeable future. Fiscal deficits must be addressed so that real interest rates can be kept low and currency depreciation can occur in a stable manner in order to increase competitiveness without unsettling debt markets. Policy interest rates set at emergency levels ultimately must be raised to encourage saving and thus capital formation for the next generation.

Surplus countries must increase social insurance programs so that consumers feel less need to “save for a rainy day.” These countries need to allow real appreciation of their currencies to empower their consumers, rein in inflation and allow service and financial sectors to increase in relation to manufacturing. Reserve accumulation would diminish. Importantly, many of these countries have large, young populations and are rapidly developing financial systems that can deploy the needed liquidity. Debt levels are much lower than in the developed world, which allows for high levels of spending on infrastructure, etc.

This is a tall order but if policy makers, in the midst of elections, can achieve some or most of the above, we could see a world where developing countries become the “locomotives” of growth, while slightly elevated global inflation can assist the deficit countries address their debt issues and adjust through a period of below-trend growth and lower real incomes.

If debt levels are addressed solely by extremely loose monetary policy (e.g., quantitative easing), or fiscal deficits prove politically difficult to reduce, there is a risk that we may move toward further crises where FX markets become disjointed and debt markets pull the rug out from under countries without sufficient discipline.

High unemployment levels may lead politicians to implement protectionist policies if surplus countries do not act to allow real currency appreciation, rolling back globalization and affecting trade and inflation differentials. Ultimately, global imbalances will be addressed in either a voluntary or involuntary way.

Much depends on the success of policy makers and whether they have the political mandate to act and the willingness to do so.

In our deliberations it seems apparent that the advent of globalization and the financial sector in the West have been the drivers of global imbalances and inflationary trends. But more than this, it has also empowered nations such as China and Russia with the direct consequence of a shift in geopolitical influence and power. This process will be difficult, if not impossible to reverse as the necessary growth in emerging markets countries that will help to correct imbalances will undoubtedly cause competition for resources and influence regional power games, not dissimilar to The Great Game between the British Empire and Russia. Eventually it may even influence the direction of democracy itself as governments seek more and desperate solutions to “fix” the free market system they helped to destroy with increasing signs of state-sponsored corporatism.

II. Sovereign Risk

In the currently popular “It’s Different This Time,” authors Carmen Reinhart and Kenneth Rogoff show that sovereign defaults typically begin to occur about two years after a banking or financial crisis. The collapse of Lehman Brothers and associated U.S., European, Icelandic, and other banking meltdowns reached its anxious top in 2008. Currently, Greece is making headlines with another high fiscal deficit, cooked numbers, overall high debt levels and debt servicing/rollover questions. The press is replete with stories about debt levels and deficit spending not only in other European countries like Portugal and Spain, but also in some of the world’s largest economies: the U.S., Japan, and the U.K. Sovereign risk is certainly a hot topic, and default scenarios are being bandied about.

Post-banking and financial crises, Keynesian fiscal deficit spending is a popular remedy. Subsequent debt-building is one natural result of this. Countries hoping to grow out of these deficits, but more commonly print, inflate, or depreciate their way out, though once in a while spending cuts and/or tax increases are resolutions. At other times, markets force or countries choose default, either from lack of ability to service debt, or a lack of availability of funding.

Armored Wolf emphasizes that there are multiple factors that matter in analyzing sovereign risk. Debt levels are important, as are debt-servicing demands, maturation schedules, balance of external vs. internal liabilities, and the market’s willingness to provide short-term funding. This last factor is key, as defaults often seem to arise immediately with a sudden stop as short-term debt is unable to be rolled over. This can even happen when, immediately prior to actual default, markets are pricing in relatively little chance of default.

Currently, sovereign CDS prices are moving higher and showing signs of increased risk, particularly in Greece, Portugal, Italy, Spain and smaller Eastern European countries. Armored Wolf thinks that the CDS market is a somewhat inefficient means to trade sovereign risk, but is worthwhile monitoring as one indicator. If difficulties arise, pressures are likely to be more prevalent in the larger countries, as smaller ones can easily obtain outside assistance, such as the IMF.

The Armored Wolf investment team has deep experience with sovereign risk and defaults, particularly having witnessed and traded many throughout the emerging markets in the past 30 years. Having broad market experience as well, we believe we are uniquely qualified to not only monitor developing countries' risk, but to also transfer this analysis to the "developed" markets and countries as their debt levels and risk grow. We believe the best market opportunity lies not in predicting default, but finding under pricings of risk that will be realized, and in picking up undervalued assets post-default, whether they are explicit or technical defaults. 2010 should be a highlight year to take advantage of the ability to analyze a complete framework of information relative to sovereign risk.

III. Is the Commodity Price Boom Over?

A typical commodity secular cycle lasts between 17 and 20 years, if history is a reliable guide. The last bull cycle ended around 1980 after which the asset class went through a two-decade bear cycle. The next bull cycle started in 2000, so one would assume the current phase still has a lot of steam. During the first decade of the current cycle, the commodity supply response has been relatively muted compared to the growth in commodity demand. Moreover, what makes the current cycle even more interesting is that the trajectory of demand growth is greater than we have seen in prior bull cycles, suggesting that this bull market for commodities could have longer to run and/or could see prices powered even higher than history would suggest.

Commodities are up more than 30% from their March 2009 lows. Since then, the metals complex has rebounded about 100%; the energy complex is up about 30%; and ags are up about 12%. It is likely that a significant portion of the price increase in commodities has already been achieved but an extended period of loose monetary policy in key global countries and stronger macro-economic data will aid commodities, at least until the stimulus wanes.

U.S. Federal Reserve Chairman Ben Bernanke's reappointment suggests maintenance of an extremely easy monetary policy well into 2011, with very slight tightening along the way to appease the public. We firmly believe that Bernanke favors a uniformly weaker U.S. dollar to support its current account deficit, and more importantly stoke higher inflation to reduce the real burden of the massive debt levels. Hence, in the longer term based on our view of higher inflation and concurrent dollar devaluation, we are extremely bullish on agricultural commodities, precious metals and energy (if the global recovery sustains itself).

In 2009, China was the single biggest contributor to shoring up global growth. Internal consumption more than made up for the loss in exports and generous monetary policy helped accelerate the recovery process as trillions of Yuan were pushed into the economy. Most importantly, aggregate demand picked up which was not achieved in most developed economies. China's growth in manufacturing and real estate were slow to begin 2009, but accelerated significantly into the recovery process. Auto, retail and IP all rose. Specifically, this lifted the demand for copper and gasoline initially before aluminum and diesel, used primarily for transporting raw materials, caught a stronger bid in Q4. Based on internal consumption and the desire to diversify their assets away from the dollar, China was responsible for 30% of the overall demand in industrial metals and greater than 40% of global copper demand. China grew at an incredible 10.7% in FY 2009 and the State Council emphasized that they will target more than

8% for FY 2010. China has to grow at a rate of at least 8% to absorb new entrants to the labor force and maintain social stability. Hence, we believe they will err on the positive side and grow at more than 9% in 2010, beginning the year strong before starting to take away some liquidity from the system. For this reason, we believe the current fears of excessive Chinese tightening are completely overdone. Very strong IP and commodity import data in December (much better than in Oct 2009) further bolsters this view that liquidity will not be drained materially.

It is not the marginal growth during 2010 in emerging market demand that excites us, but rather the possibility for OECD, especially U.S. and Japan, to provide the surprise upside risk to demand growth. Gasoline demand has been positive for some time now, but what was encouraging was to see aluminum (manufacturing) and distillate demand picking up significantly at the very end of Q4 in line with what we saw in China. Copper demand in the OECD will probably take much longer to recover as it is mostly used in real estate construction.

Prices of energy-related commodities have recovered sharply from their lows established in Feb-March 2009. A year ago, crude oil was at sub-\$40 levels and some analysts were predicting a move lower into the \$20s. When the recovery fell into place crude quickly moved to its marginal cost of production, (about \$60) and then easily into the \$70 range providing supply-side firms an incentive to invest in energy exploration. But it is most crucial to note that even when front month crude was trading at \$35, the back end of the curve was anchored all the time at greater than \$70 and was even more than \$100 briefly in Dec. 2009 when the front month was trading in excess of \$80/bbl. OPEC oil ministers have categorically stated that there was only a slim chance of increasing supply this year as there was enough oil inventories and supply globally. In 2010 we see crude oil trading in the \$70 to \$85 range with most of the gains coming from the summer months. We expect crude to extend gains and average greater than \$90 in 2011. We continue to be bullish on the U.S. consumer's inelastic demand for petroleum despite their secular de-leveraging and thus expect a strong increase in gasoline demand. We would also expect distillates to extend their draw of inventories, and diesel in particular to gain from the OECD restocking cycle in 2010.

Global demand for crude in 2010 will be underpinned by ongoing growth in emerging markets countries and signs of stabilization in OECD countries. In 2009, Chinese oil demand increased by .33mb/d and accounted for 60% of total increase in non-OECD consumption. Chinese imports have never fallen below 4mb/d and in H2'09 they averaged 4.4mb/d rising to 5mb/d in December. India and Saudi Arabia also increased their oil consumption in 2009. After contracting by 2.7mb/d in H1 2009, OECD demand contraction fell to only 1.5mb/d in H2 2009. On a brighter note, demand data in Japan is showing pronounced improvement and demand is already recovering in the U.S., leaving Europe as the only laggard. Our constructive views on demand and the fact that OPEC is really not interested in increasing supply leads us to expect crude to trade in the upper end of the \$70 to \$85 range for 2010 and even higher beyond.

Chinese metal imports have since rebounded significantly after a brief lull in Oct. 2009. On the back of China's renewed metal hoarding, especially copper, and the imminent onset of another OECD restocking cycle, metals are poised for modest gains from current levels in H1' 10. Despite some demand recovery from this inventory rebuild, there are doubts beginning to percolate about the U.S. recovery's

sustainability which if borne out, would create serious headwinds to higher metals prices in H2'10. We believe that metals will mostly trade in a range in H1'10 and it is prudent to play metals either with options on either end of the range or through relative-value plays, as opposed to being outright short or long in H1'10. In H2 we see a lot of opportunity in being short those metals which exhibit greater supply elasticity, such as aluminum and nickel.

We would expect the energy complex to significantly outperform the base metals complex in H2. However, in the longer term we expect supply problems to re-emerge once global inventories have fallen from their current elevated levels both in exchanges and in government warehouses. Ultimately, we expect prices to be significantly higher than the 2008 highs for most metals.

IV. Geo-Political Risk

Our final topic at the Armored Wolf Secular Forum provided an opportunity to broaden the discussion from purely economic and financial matters to include matters on military, security and those more directly related to international politics. Three broad themes emerged from the discussion which, in turn, demonstrated the close relationship between global matters of international affairs and the economic “tectonic” shift from the “developed” to the “emerging” world.

The first theme was that most flashpoints around the globe are evidence that “*plus ça change, plus c'est la même chose*” (the more things change, the more they stay the same) and have been problems for decades, even if the stakes in some cases appear to be higher. North Korea has made necessary a direct U.S. military involvement since the 1950s, but the issue is now more complicated by its acquisition of nuclear weapons. Iraq and Iran have been flashpoints since at least the 1970s. They have caused headaches going all the way back to the Ottoman and British Empires. Following the U.S. intervention in the former; the latter’s creeping influence on the Shiite majority there; the risk of an introduction of nuclear arms; and the growing concern over reactions to a possible unilateral move on the part of the Israelis, the stakes appear to creep ever higher. Tensions in the subcontinent, worsened by the ongoing violence at the Afghan/Pakistan border and muddled U.S. diplomacy in courting both Pakistan and India, continue to simmer. And while fears over terrorism have grown since the World Trade Center attacks, the risks have been in the background (though largely overseas) for quite some time. This general theme’s potential impact on Armored Wolf’s investment strategy would seem to be the risk of fat tails and low probability, high-impact events.

The second theme was that the shift in global consumption patterns to the fast-growing, populous, emerging countries has led to a race to secure energy and other globally traded commodities. This has fostered a number of international relationships (both competitive and cooperative) largely outside of U.S. and European influence. Whether it is the race to construct energy pipelines (oil and gas) through parts of the former Soviet Union linking the Caspian to the Orient (or Siberia to the Pacific, or eventually Central Asia to the Indian Ocean), or investments by China in South American metal and oil industries, the reaching out of emerging, commodity-hungry, powers (most notably China) has created strange bedfellows whose bi-lateral relationships are, in many cases, offsetting or dwarfing traditional ones. It was noted, for example, that China has become Brazil’s largest trading partner during the shift in global fortunes but that is, by far, not the only place where China has a new role.

The third theme was the rise of the multi-polar world and the relative decline of U.S. influence on the global stage. As other economies rise in global importance, and as they seek alliances, partnerships and other bi-lateral arrangements, the ability of the U.S. to guide events wanes. In addition, with the strained public finances of the U.S., maintaining a military force on which more is spent than on all other militaries combined becomes increasingly complicated. And as long as the U.S. is engaged on the ground in more than one conflict, its ability to project force elsewhere is seemingly reduced. This has led not only to concerns over an increasingly robust Chinese projection of influence but also the rise of other regional powers in international relations such as Russia in the former Soviet sphere and Brazil in Latin American diplomatic conflicts. One spillover effect may well be a continued erosion of the U. S. dollar as the global unit of trade in favor of a broader use of other currencies, particularly regarding bi-lateral trade as is now happening on a small scale, for example, between China and Brazil. It was noted that the G.C.C. may move to denominate oil in its own currency basket, significantly reducing the dollar's influence. With the review of the IMF's Special Drawing Rights (SDR) this October, a number of rising emerging powers are expected to seek the inclusion of their currencies in the mix. This could bolster considerably the international use of the SDR in Central Bank Reserves, and possibly in global trade.

These three themes, on balance, underscore a general shift of global influence from the "developed" to the "emerging" world in line with the latter's rise in economic might and the former's decline--at least on a relative basis. The current economic crisis, having originated in the U.S. and Europe, has accelerated this process, at least in the near term, and the expected faster recovery in emerging markets will further their move from periphery to core on the global stage.