NEWS - May 2005, Camden Capital is enjoying its new location...

May 20, 2005

Dear Clients and Friends:

I hope this letter finds you well. Camden Capital is enjoying its new location, and greatly appreciates your continued trust and support throughout the recent transition. If you are ever in the area, please stop by. We would love to show you the new office.

As you are likely aware, the first four months of this year have been difficult for most hedge fund managers and strategies. In the past few weeks, there have been a number of news stories, in both the popular and financial press, regarding hedge funds. Although relatively few firms experienced large losses, the vast majority of funds have slight negative returns and only a small handful have posted meaningful gains for the year. April was particularly poor for most funds regardless of strategy. On top of this, the downgrades of the debt of both GM and Ford to "junk" status early in May led to speculation that some large hedge funds were "in trouble" and that larger losses were to follow.

Compounding this problem were rumors that many structured corporate loan portfolios – particularly collateralized debt obligations (CDOs) and collateralized loan obligations (CLOs) – were being marked down in value. These structures are also held by some hedge funds. Although these structured products are fairly complex, they include the two features that spelled trouble for hedge funds in the past: a high degree of leverage and an illiquid structure.

We think it is very important to separate two issues that we believe have been confused in the reporting of this story by the press. There is a great distinction between the performance (positive or negative) of any one fund relative to the performance of all funds. It is certainly true that many funds have lost some money, and it may be true that a small handful of funds have lost a great deal of money, though we are unaware of any at this time. It is extremely unlikely that more than a few funds lost substantial amounts of money.

During the past week or so, we contacted a number of hedge funds, fund of funds and other participants in the hedge fund community. Many of these funds were visited in person. Although there is a general sense of frustration at the anemic returns, no one reports panic or even disorganization on trading floors. Banks and brokers are still willing to lend money to funds that want to increase leverage in their portfolios. We had no reports of panic selling or any sort of disorder in the markets. We gleaned no evidence of a systemic crisis among hedge funds.

Although periods of market distress are uncomfortable, a number of the managers we spoke to in the past few weeks noted that they would welcome a shakeout in the market. There have been many articles written about the flood of money coming into hedge funds, often from investors with shorter-term time horizons and unrealistic expectations regarding the returns »

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available. The better, more experienced hedge fund managers, like the ones that comprise our clients' portfolios, believe they are properly positioned should money leave the sector. Most feel that many segments of the market are no longer profitable because of the amount of money in those sectors. They are anticipating moving back into some of these strategies should there be net redemptions from many hedge funds, though at this point they have not seen these sectors become attractive enough.

The financial press seems to operate under a double standard regarding the difference between hedge funds and more conventional investment vehicles like mutual funds or brokerage sponsored "wrap" accounts. Hardly a paragraph is written before the phrase "largely unregulated" appears before "hedge funds." The relatively modest losses in hedge funds have been written about with great consternation. Yet the dismal performance of many traditional managers this year has received much less attention, despite the wider impact on a broader pool of investors. During the great bull market of the late 1990's, many highly inexperienced investment managers started mutual funds, raising billions of dollars. Investors and the media would be well-advised to recognize and understand that oversight by the SEC – that is, being a "regulated" market, has no bearing on how that market will perform. Nor does registration, in any way, imply approval by the SEC of the manager or strategy involved. Regulation is largely an administrative matter, not an evaluation of the investment itself.

Some investors responded to the diminution in returns that became evident in hedge funds during the last few years by increasing the risk in their portfolios. Banks and financial institutions responded by creating structured products that involved substantial leverage on top of what the underlying managers were borrowing. In the United States, versions of these strategies were introduced that had substantial tax advantages to investors. Camden Capital examined these strategies and, for the most part, decided that the additional benefits, while potentially substantial, were not worth the additional risk and illiquidity these structures entailed.

We believe that our clients' assets allocated to hedge funds are invested prudently. Portfolios are well-diversified primarily with larger established managers, salted with a few of the more promising, though newer hedge funds. We have avoided the structured products market and the additional leverage that these products typically employ. Most importantly, however, we have maintained realistic expectations for these investments. There is no perfect investment. There is no excess return without some form of excess risk. Reasonable, rational expectations are vital for success in any style of investing – they cannot be discarded for one particular set of investments, regardless of how promising the returns may appear.

We are staying abreast of any changes in the marketplace. Please do not hesitate to call if you have any questions.

Best Regards,

John M. Krambeer
President

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