



Special Report

AUGUST 10, 2007

The Recent Market Turmoil

What an August it has been so far for the financial markets. It's historically the weakest time of the year, but this year has been an exception as volatility and trading volumes have exceeded the norms. Clearly, it's been a roller coast ride on Wall Street and volatility is expected to continue at least through the end of the month. As recently as July 19, the Dow Jones Industrial Average hit a record high, closing at 14,000.41. As of the close yesterday, the blue-chip index ended at 13,270.68, down 5.21% from three weeks earlier. The tech-rich NASDAQ and S&P 500 have also suffered heavy losses, dropping 6.01% and 6.44%, respectively, from July 19 to yesterday's close.

Investor uneasiness all began when two Bear Stearns Cos. hedge funds filed for bankruptcy protection in the Cayman Islands two weeks ago because of subprime losses. The more recent problems in the credit markets have shown both the global reach of the crisis and its impact on a widening circle

of markets and companies. The first jolt came from French bank BNP Paribas, which said that it was freezing three investment funds once worth a combined \$2.17 billion as it has become impossible to accurately value them after "the complete evaporation of liquidity." That prompted the U.S. and European central banks to inject cash into money markets to keep interest rates down. Back in the U.S., the largest home-mortgage lender, Countrywide Financial said "unprecedented disruptions" in credit markets could affect its financial condition. In addition, Washington Mutual cautioned that "since the latter part of July 2007, liquidity in the secondary market for nonconforming residential mortgage loans and securities backed by such loans has diminished significantly."

The nervousness has accelerated in the U.S. with news that a host of hedge funds were in the red and liquidating "massive" trading portfolios. As a result of these liquidations, market volatility has increased, with many of your stocks also feeling the pressure. The portfolio liquidation is causing disruptions and triggering losses among the latest crop of hedge funds to be hit hard by the market's turmoil, including those that

focus on "market-neutral" strategies, or strategies that seek to do as well in both falling and rising markets. The strategy has been embraced by some of the biggest names in hedge funds, in part because it's popular with institutional investors who hunger for gains in any kind of market. Since market-neutral funds often are guided by similar computer models and share similar holdings, the actions magnified moves in asset prices. The last week has been the worst on record for many large hedge funds focusing on this strategy, worrying traders across Wall Street, many of whom look to these firms for signs of stability in difficult markets.

During the past several days, a number of other quantitative funds have also been hard-hit. These funds generally operate by building computer models of market behavior and then allowing computer programs to dictate trading. With the recent trouble in financial markets, many lenders, funds and brokerages were following statistical models that grossly underestimated how risky the environment had become.

As we expect continued volatility in the market and your respective stocks in the coming weeks, Ilios Group and your analysts will be closely monitoring the movements. If you have questions or comments, please contact your Ilios analyst.

Troubled Hedge Funds

- **Goldman Sachs North American Equity Opportunities Fund** - down over 15% through July 27, and was down more than 11% in July alone. **Goldman's Global Alpha Fund**—decreased 8% during the last full week of July.
- **Renaissance Technologies** - key fund has lost 8.7% so far in August
- **Highbridge Statistical Opportunities Fund**—down 18% as of Aug. 8. **Highbridge Statistical Market Neutral Fund**—down 5.2% so far this month.
- **Deutsche Bank's DWS Unit**—says fund has lost 30% since July.
- **Tykh Capital** - suffered losses of about 20% so far in August
- **Campbell & Co.**—down 10%-12% by the end of July.
- **Black Mesa Capital**—fund has slumped 7.5% this month.
- **AXA Money Market Fund**—down 27% due to exposure to high yields.
- **TFS Market Neutral Fund**—down nearly 12% for the one-month period through Aug. 9.
- **AQR Capital Mgmt.** - has seen losses in recent days in investments employing market-neutral strategies.