1 General Overview

Friday, 9 January 2008

Dear Partners:

The Fund finished the 4th quarter of 2008 6,3% in the plus.

Below are the results of the Tartaros Global Value Fund Fund since its inception on the 21st of October 2008 (cf. part two for the fund overview); also shown is the return of one major market index (we would like to stress that there is no specific benchmark for the Fund; the comparison to the market index is only provided as an indication to the broader market context):

Returns % (net of all fees)

2008	jan	feb	mar	apr	may	jun	jul	aug	sep	oct	nov	dec	ytd
fund										5,36	-3,82	4,89	6,30
msci world (€)										1,11	-6,50	-5,75	-10,90

The MSCI World is a stock market index of “world” stocks. It is maintained by M.S.C.I., formerly Morgan Stanley Capital International. The index includes equities from 23 countries, and has been calculated since 1969.

The concept of the Tartaros Global Value Fund was formed during the summer of 2008. It can be summarized as follows:

Tartaros Global Value Fund is a fund with an absolute return objective by investing in investment opportunities that are neglected by, out of favor with, or off the radar screen of the general market.

Little did we know at that time that all equity markets would be out of favor with the general investment populace. Seth Klarman – a famous value investor – recently described the general market sentiment as follows, "Normally, as a buyer you have to compete with a lot of very, very smart competitors. But many of the smartest people are on the sidelines now because of redemptions, margin calls or panicked-out-of-their-mind selling. So you don't have to be as smart as you did before. You just have to be in the game." We are in the game… Each bear market seems, when we are in the midst of it, as if it is the end of the world. Unfortunately, most individuals tend to extrapolate current conditions endlessly into the future. Things will change and, in our estimation, for the better. Remember, we do not take our statements lightly. Your money is as important to us as our own. And because of our own financial commitments, this is not just another statement.

Plus ça change, plus c'est la même chose…

“Wall Street never changes. The stories change, the pockets change, the suckers change, but Wall Street never changes because human nature never changes.”
- Jesse Livermore, Reminiscences of a Stock Operator

Will things change? We should learn a big amount in a very short time, we might learn quite a bit in the medium term and will learn absolutely nothing in the long term. As John Maynard Keynes put it: “The existing situation enters, in a sense disproportionately, into the formation of our long-term expectations; our usual practice being to take the existing situation and to project it into the future.” In any case, over short periods of time, you can do the wrong thing and make a lot of money and do the right thing and look like an idiot. We try to stick to what we do well and not get too caught up in what's working at any given moment. We focus and the process and not the

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short term results. In the long run, that sort of discipline will keep you from blowing up. We venture to say that investing now is doing the right thing, although you might look like an idiot in the short run. Obviously, the mass majority disagrees. They are scared about the fact that in the short term, undervalued assets can become even more undervalued. This frustrates the short-term investor. We should however remind ourselves everyday that in financial markets price is set by the most panicked seller at the end of a trading day. In the long run value is determined by cash flows and assets,

Doing the right thing in the world of investing is thus far from easy. Our brains are apparently insufficiently evolved to be able to handle financial markets easily. The late John Templeton summarized the problem excellently: "To buy when others are despondently selling and sell when others are greedily buying requires the greatest fortitude and pays the greatest reward."

In James Montier‟s brilliant book Behavioural Investing (2007), the author points to evidence from neuroscience (e.g. Eisenberger and Lieberman (2004)) that real pain and social pain are felt in exactly the same places in the brain. Reseachers Eisenberger and Lieberman asked participants to play a computer game. Players think they are playing in a three-way game with two other players, throwing a ball back and forth. In fact, the two other players are computer controlled. After a period of three-way play, the two other "players" began to exclude the participant by throwing the ball back and forth between themselves. This social exclusion generates brain activity in parts of the brain, which are also activated by real physical pain. Contrarian investment strategies are the investment equivalent of seeking out social pain. In order to implement such a strategy you will buy the things that everyone else is selling, and sell the investments that everyone else is buying. That is social pain. Eisenberger and Lieberman's results suggest that following such a strategy is really like having your leg broken on a regular basis. Needless to say that we do not enjoy any kind of pain (physical, social or financial), but we are willing to endure short term social and financial pain, if it makes sense from an investment point of view.

Will things change? Humans have a strong desire to be part of a group, which makes us susceptible to fads and fashions. People also have a preference for being an accepted part of a majority over being part of the correct minority. Numerous market bubbles demonstrate this point. Group think inflates bubbles and group think pops them. This is why investors should welcome devil's advocates into every decision.

Even with vast amounts of capital and "herds" of smart analysts chasing market opportunities, the markets will remain inefficient. This is not because of a shortage of timely information or a lack of analytical tools. Markets are inefficient because of their institutional structure and because of human nature – innate and permanent. People do not consciously choose to invest with emotion – they simply cannot help it.

The financial crises

"Those who cannot remember the past are condemned to repeat it."
- George Santayana

Most people – almost everybody – seem to have been caught off-guard by the banking crisis (or at least have not avoided permanent loss of capital by owning banks), yet such an event was not only somewhat predictable but also inevitable. Was it a black swan? Not really…

The Black Swan is a matter of perspective (www.fooledbyrandomness.com). A turkey is fed for 1.000 days – every day lulling it more and more into a feeling of safety, that the feeders are acting in its best interest. Except that on the 1.001st day, Thanksgiving Day, the butcher shows up and there is a surprise. The surprise is for the turkey, not the butcher. Anyone who knows anything about the history of banking will tell you that a banking crisis was bound to happen. Banks are exposed to such blowups. So for us, it was not a complete surprise, although the sheer force and depth of the crisis was.

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Most of the time financial crises in general, or banking crises in particular, are gray swans. Banks have a tendency to sit on time bombs while convincing themselves that they are conservative. Banks have a business model that can – graphically – be described as eating like chickens and shitting like elephants.

It should be recognized that, by the very nature of their business, banks are financially leveraged. – The following part is based on an excellent article I once read, but I cannot find the source anymore; so, I apologize to the author – Financially leveraged means that banks' own capital is very small in relation to their assets and liabilities. Why is this? Because banking, in its simplest and traditional form, is a lousy business. Most of the money banks lend us is not their own: their real business is to borrow money to relend it. When you deposit your money into a bank, you are actually lending money to that bank. It will then use these funds to extend a loan to someone else, who needs to borrow. As such, this is not a very attractive business: banks historically seldom earned more than a few percentage points between their cost of funds and their lending rates. If that was all there is to banking, no one in their right mind would ever go into the business: who wants to risk a 100% loss to earn a few percentage points per annum? This is why fractional-reserve banking was invented. The idea was that, while in theory depositors can withdraw their money on demand, in reality, as a group, they seldom do so all at once. – When they do, you have a bank run – So, banks keep a portion of their deposits in a cash reserve, to face normal withdrawals, and they lend the balance to borrowers. But when they extend a loan, a new deposit usually is created for the borrower who, too, is assumed not to need all the money immediately. And the cycle goes on. The amount of reserve that prudently should be set aside varies with the type of deposit the bank accepts, but let us assume that, on average, a bank reserves 20% of each deposit: the total loans extended on the basis of the initial deposit would wind up being many times that initial deposit. If we carry this table to its practical limit, the original €100 deposit will have been the seed for total deposits approaching €500 and total loans approaching €400. In itself, this credit creation does not necessitate any capital and this is why banks traditionally have carried significant financial leverage, i.e., have had assets and liabilities well in excess of their own capital. To sum up, banks and other financial institutions are inherently highly leveraged and had recently become even more so.

Now, not only are a bank's assets much larger than its capital, but most of its liabilities (borrowings used to finance investments and loans) are short-term in nature. This means that these borrowings have to be renewed at short intervals, ranging from every day to every few weeks. Banks continuously receive deposits on which they are required to set aside reserves. Because the inflow and outflow of deposits are not exactly predictable, these reserves may temporarily exceed or fall short of the mandatory levels. Routinely, banks with excess reserves lend them to other banks with insufficient reserves. When the credit markets froze (the bankruptcy of Lehman Brothers) bankers began mistrusting each other. Overnight funds on the interbank market dried up as banks started buying government bonds rather than taking a chance on the solvability of the other banks.
Now, if you own assets of a long-term nature, the purchase of which was financed with short-term borrowings that cannot be rolled over or replaced, you have no choice but to sell these assets. But all of a sudden, there were no buyers for these (subprime) loans or derivative products, which had come to represent an important share of banks' assets. These assets simply could not be sold. To make matters worse, banks have an obligation to adjust the value of assets on their balance sheets to market prices. When there is no market for a security, these institutions have the obligation to estimate its current value. In the environment of the last few months, estimates of the current value of some of these loans and investments collapsed. The banks' own capital basically is the difference between its assets and its liabilities. If a bank marks a big part of assets that were worth €1 down to 80 eurocents while its liabilities remain the same, the capital evaporates. So banks quickly found themselves in violation of regulatory capital ratios and thus in virtual bankruptcy. Finally, the direst scenarios began to be circulated, in which banks evolved from being trapped in a liquidity squeeze, to virtual bankruptcy and sometimes, under forced

liquidation of their portfolios, to actual bankruptcy. That's when the governments all over the world stepped in.

In any case, a little bit of history would have shown us that banking crises happen – although seldomly – do happen from time to time. Recent examples are the U.S. savings and loan crisis of the 1980s or the Swedish banking crisis at the beginning of the 1990s.

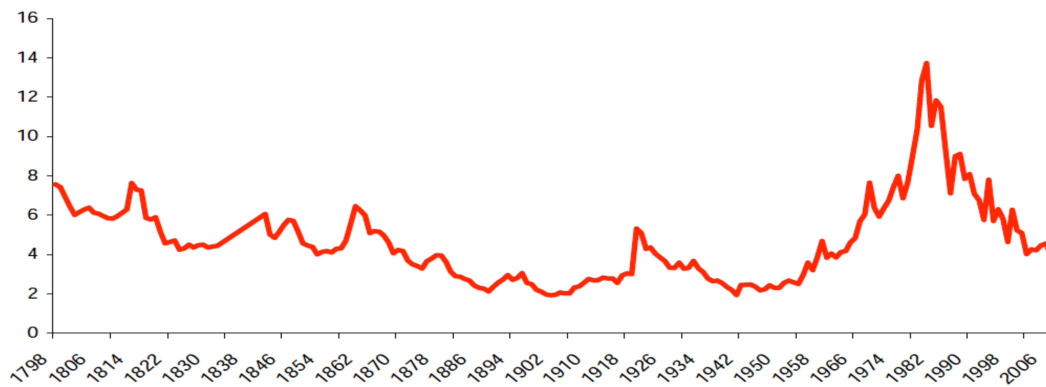
But to come full circle: we sometimes learn a big amount in a very short time, we sometimes even learn quite a bit in the medium term, but we never learn anything in the long term.

Cash is trash

"The difficulty lies, not in the new ideas, but in escaping the old ones, which ramify, for those brought up as most of us have been, into every corner of our minds."
- John Maynard Keynes

Financially market never changes. Bubbles come and go. Crowds get mad and go into buying frenzy all the time even though things always repeat itself and it is apparent that a bubble is waiting to be burst. Has anything changed? No! The reason is simply because human nature never changes. So what might be the next bubble? Cash! Money in savings accounts, fixed term accounts, or government bonds.

Government treasuries and bonds seemed to be the investment theme of 2008. The less they yield, the more their fans want them. Then, again, these fearful days, yield seems to have nothing to do with investment calculation. Purported safety is all. Safety is so important that three month U.S. treasuries have a negative yield. This basically means that you pay the U.S. government money to have your money back in three months.



source: SocGen – James Montier – Mind Matters

In the early 1980s, long-dated U.S. bonds were yielding nearly 14 per cent in the context of an inflation rate of just 4 per cent. Those, too, were fearful times, the horror of that time being the great inflation of the 1970s. Inflation was there to say forever, everybody agreed back then. Now a new generation believes the opposite proposition. Deflation is inevitable. (www.grantspub.com)

Deflation encourages saving since money is worth more later. It also creates deflationary expectations. Buyers anticipate lower prices later by waiting to buy. That creates excess inventories and excess capacity, which forces prices down even more. Buyer suspicions are confirmed so they wait even further to buy, generating a self-feeding downward price spiral, as now seen in cars and residential real estate. Deflation also elevates the cost of debts and debt service since both remain fixed in nominal terms but the revenues and incomes used to repay

them tend to fall with overall prices. The industrialized nations of today, with the United States leading the pack, want to avoid at all cost the experiences of the Great Depression or more recently of the “lost decade” in Japan; both situations were characterized by a “liquidity trap,” a monetary black hole where lenders, savers, and ultimately consumers were frightened into stuffing their money into a mattress rather than circulating it in classic capitalistic fashion. (www.pimco.com)

One important questions come to mind. Does something far worse than recession loom and does that certain something definitely spell much lower interest rates? We cannot know for sure, but we can at least observe. What we observe is a monumental push to reflate.

Inflation means the destruction of paper wealth faster than the creation of real wealth. When governments print money and spread it around, people do feel richer. So they do go out and spend, which is what the governments want. But all this new spending just pushes prices up again, the new money buys less, and eventually people realise that they are actually no better off. Furthermore, the new money that government creates is not dropped uniformly across the economy. It goes into government industries and agencies, and is supposed to spread out from there. This can take a long time, and have many perverse effects on the way.

The typical investor has not paid much attention to protection against inflation because he or she has not needed to. Realistically, quantitative easing (i.e. printing of money out of thin air), a two-trillion-dollar expansion of the U.S. Federal Reserve’s balance sheet (do not think that other central banks are far behind), and the near certainty of future big government budget deficits across the world should alert bond investors. The actions taken by the Fed in particular and other central banks in general, are truly unprecedented. We are now in a brave new world of monetary experimentation.

You do not want to be the last man holding cash or bonds if central banks succeed reflating the economy. The truth is that no investment asset is inherently safe. Risk or safety is an attribute of price. At the right price, an equity investment might be a safer proposition than a government bond.

Next Update

You should receive the next update at the beginning of April.

As always, please feel free to call or e-mail us with any questions or comments you have.

Thank you for your continued support!

Best Regards,

The Tartaros Team

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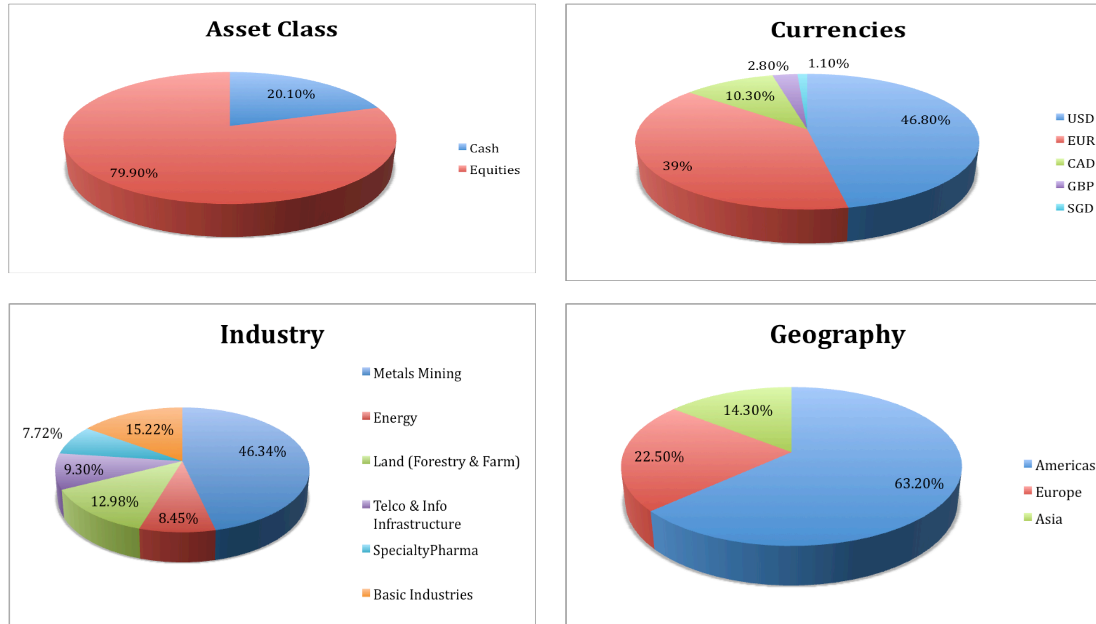
2 Fund Overview

2.1 General Overview



2.2 Fund Positions – A Few Examples

Specialty Pharmaceuticals

We don not like pharmaceutical companies. Investing in a pharmaceutical company is a bet on the approval the drug pipeline of a particular pharmaceutical company. Since nobody – not even so called pharmaceutical experts – knows the outcome of a particular pipeline of drugs, investing in one pharmaceutical company is a gamble. At best, you should invest in a portfolio of pharmaceutical companies. This being said, the fund has invested in two "specialty pharmaceutical" companies: Forest Laboratories and Mylan. Why?

Forest Laboratories (FRX) develops, manufactures and sells both branded and generic forms of drug products, which require a physician's prescription as well as non-prescription pharmaceutical products sold over-the-counter. The company principally licenses or purchases its products because that route is less risky, and the time to marketing approval is shorter by years. The products that they acquire run the range from not too long out of the test tube to products virtually ready for approval. Basically, Forest Laboratories is a pharmaceutical merchant bank. If you have come up with a wonderful new compound you are going to need significant money to get it through the regulatory processes (e.g. U.S. Food and Drug Administration) and you are going to need significant distribution, and FRX has and provides both.

The company has multiple products in late stage development. A strong – understatement - balance sheet provides flexibility. In a tight credit environment, FRX has little to worry. With no debt, an untapped $500M revolving credit facility and $2.8B in cash and equivalents, the company has significant flexibility to pursue business development opportunities. This should prove beneficial as the company seeks to double its commercial pipeline by 2012.

Mylan Inc. is one of the world's leading quality generic and specialty pharmaceutical companies. The Company offers one of the industry's broadest and highest quality product portfolios a robust product pipeline and a global commercial footprint through operations in more than 90 countries. Through its controlling interest in Matrix Laboratories Limited Mylan has direct access to one of the largest active pharmaceutical ingredient manufacturers in the world. Again, Mylan does not try to invent new drugs, it copies existing ones.

The world generics market rose 11% in 2007 (to €78bn); a pace of growth, which puts traditional pharmaceutical companies in the shade. On top of the momentum given by regulators and paying organizations in developed countries, comes the expiry of patents for major blockbusters by 2012 and the take-off for emerging countries. So by 2012, the generics market should represent €125bn (+10% per year) – this is a forecast that can be made since we know what drugs will come off-patent. This dynamic will continue thanks to the opening of the U.S. biological products market to generics (biosimilars), which could bring in further revenue streams. Three players are global leaders, Teva (sales of $9bn), Sandoz - a Novartis subsidiary ($7bn) and Mylan ($4.3bn); and five have developed a regional anchorage in Europe (Stada, Gedeon Richter) or in the U.S. (Watson) and in Asia (Ranbaxy). The ten leading groups only cover 30% of the market and the concentration phase in the sector (takeover of Barr by Teva, etc.) is not over yet.

RHJ

RHJ International is a Belgium-based holding company focused on creating long-term value for its shareholders by acquiring interests in companies that are active in various sectors, such as automotive components, consumer electronics, media & entertainment, hospitality and financial services. The company was founded 2005 by Timothy Collins with assets brought in that have been former private equity holdings. The centre is the Japanese automotive industry with the holdings being highly leveraged. The intention of RHJI is to turn these businesses around and eventually sell them above cost. Originally the holding started 2005 with assets valued around €1.5 billion; current market cap is approximately €300 million. Timothy Collins owns more than 15% of outstanding share capital and receives a symbolic fixed salary of €100.000. Two prominent participants of the equity offering in 2005 have been Chris Davis and Third Avenue, along with Bank of America and Blackrock. In the past 3 years management has not made significant progress, the only business sold has been Denon/Marantz (audio-equipment behemoth), however at a 100% profit to original cost.

It should be noted that the shares right now trade on the Belgium stock exchange for €3,8 per share and RHJ has net cash per share of more than €5,6: permanent capital loss is very unlikely.