

Market Update

Overview

As with all credit markets the ABS market has experienced significant volatility over the past few weeks. On the US RMBS front this is driven mainly by credit concerns, downgrades on US subprime transactions, and the unwind of some large leveraged ABS funds. In Europe we have seen some spill over from the US market with investors exercising caution resulting in some primary market deals experiencing difficulty clearing, and wider prints.

Liquidity in the ABS market has suffered severely in the last few weeks leading to some of the widest levels we have seen in the last 3 years. Concerns in the US subprime market are driven by weaker remittance reports, with delinquencies and foreclosures worsening month on month to levels previously unseen. While this trend began in 2006 the rating agencies last month revised their rating models and downgraded a slew of subprime transactions mainly concentrated in the 2006 vintage at the BBB and BB part of the rating curve. This trend looks set to continue over the short term.

In the secondary market we have seen a sell off across all ABS sectors, with large bid lists coming from both the US and Europe. This has led to considerable spread widening across all sectors with the street continuing to bid wider as their books become full. The US subprime market has been hit hardest with spreads at the AAA level reaching more than three times the levels seen in 2006. Other US ABS markets have also widened in sympathy with all credit markets but to a lesser extent. In Europe prime RMBS spreads have widened approx. 5 bps, with the exception of Spain where recent negative housing news has led to a much more aggressive spread movement Spanish RMBS which would have printed at 13 bps is now bid in the high 20's to low 30's. European CMBS have also been impacted with spreads at the AAA level pushing out by approx. 10 bps, and recent deals printing at 28bps. While the spread volatility in the US market appears to be driven by credit concerns, we feel that the volatility we have seen in Europe is driven by technicals, with deals still performing satisfactorily from a credit perspective.

Impact on AC Capital Partners Managed Funds

Leveraged ABS funds managed by AC Capital Partners have not escaped the current volatility entirely unscathed. Due to the mark to market nature of AC Capital Partners' managed funds the Net Asset Values have fallen between 0.5% to 1.5% in July, however the year to date performance of the funds averages approx. +2% for AC Capital Partners' standard funds and +3.6% for the short WAL funds. It is important to note that all AC Capital Partners' exposure is at the AAA level, in the most conservative and liquid part of the capital structure. In addition the fund's performance has been somewhat sheltered from the recent market volatility by AC Capital Partners' conservative investment style.

On average AC Capital Partners' standard ABS funds have approx. 25% exposure to the US market with approx. 20% exposure to the US Alt A RMBS market. The remaining US exposure is split amongst student loan ABS, credit cards etc.

AC Capital Partners' very limited US subprime exposure is entirely comprised of 2yr AAA sequential tranches from the 2005 vintage. Due to the nature of this cashflow a significant portion of this exposure has already rolled off and is repaying at a very fast rate with remaining WALs being less than 6 months. None of the subprime exposure in AC Capital Partners' funds has been downgraded or is on any rating agency watch

list. AC Capital Partners' conservative investment style by choosing short WAL tranches have cushioned the impact of recent spread widening with the lowest current market price on this exposure being 99.75%.

AC Capital Partners stopped investing in the US subprime market in late 2005 due to concerns over the relaxed lending standards and weaker performance filtering through. Instead AC Capital Partners targeted super senior AAA tranches from the Alt A market. This strategy has worked well and cushioned AC Capital's managed funds from the sector experiencing the widest spread movements. While not all Alt A transactions are performing in line with expectations most of the noise in the Alt A market surrounds transactions backed by hybrid collateral, whereas funds managed by AC Capital Partners have on average less than 1% exposure to those super senior tranches of seasoned deals.

In terms of European exposure, funds managed by AC Capital Partners are composed of approx. 30% prime RMBS and 15% to 25% CMBS. The remainder is split amongst the other ABS asset classes (consumer ABS, leasing ABS, auto ABS etc.). Once again all exposure is at the AAA level with no tranches on any rating agency watch list. While the European ABS market has widened, this is generally due to technical factors and lack of liquidity as opposed to credit concerns.

Market Outlook

A major concern at the moment is forced selling at wide levels from vehicles with mark to market triggers, or funds to meet investor redemptions.

We have seen a number of bid lists throughout the month of July. If this continues through August we could see spreads move slightly wider.

In summary we feel spreads have a bias towards further widening in August and we do not expect to see the tight levels of late 2006 / early 2007 return this side of Christmas. However due to the fact that this is a technical/liquidity issue and not based on credit fundamentals we believe that the current markets represent opportunity in carefully selected names. AC Capital Partners continues to take advantage of this market opportunity by investing in conservatively selected assets at these wider levels.