

THAI FOCUSED EQUITY FUND

YEAR-END REVIEW

For the year ending December 31, 1998, the Thai Focused Equity Fund generated a U.S. dollar gain of 33.3%, while the SET index gained 21.2%. To the best of our knowledge, the Thai Focused Equity Fund was the best performing Thai fund in 1998. It also was the best performing single country fund within the ASEAN region for the year. Not only did we beat the Thai index by over 1,200 basis points, but we managed to do so with much lower volatility. The Fund's beta versus the SET index was only 0.37. In addition, while the SET index lost more than 20% during each of the months of May, June and August, the Fund's worst monthly loss was only 10.4%, suffered in November.

The year of the Tiger started on a rather pessimistic note. The Baht, for example, having ended 1997 at a new low of 46.6 to the U.S. dollar, continued its freefall throughout the month of January and into the first half of February, hitting an all-time low of 56.0. The macro economic outlook was equally bleak, with short-term interest rates averaging above 20.0% and the banking system falling deeper into insolvency. Against this backdrop, however, the SET enjoyed a strong rally during the first quarter, peaking at a gain of 64.1% on March 23rd. U.S. dollar generating exporters, the primary beneficiaries of Baht depreciation, led this rally. As such, the Fund's overweight positions in the Electronics and Seafood Processing sectors contributed to the Fund's significant outperformance relative to the SET. The Thai Focused Equity Fund ended the first quarter with a gain of 65.3%, while the SET index fell back to a gain of 48.0%. Given our view that overall market valuations were stretched, the Fund also established its first short index swap positions towards the end of the first quarter.

The SET fell 61.0% from its peak in March through to the end of August as the market focused on increasingly bad news with regard to non performing loans (NPLs) in the Thai banking sector. External factors also played an important role in contributing to the market selloff, as investors reassessed the systemic risks associated with global emerging markets. For example, during the second and third quarters:

1. Indonesia's President Suharto was ousted from office on the back of both student demonstrations and violent street riots. As a consequence, the country fell into political turmoil and the Rupiah fell by 62.0%;
2. Malaysia's Prime Minister Mahathir Mohamad instituted strict capital controls, forcing many institutional investors to not only flee the country's stock market, but to also question Thailand's resolve to pursue the International Monetary Fund's (IMF) economic austerity measures;
3. In an act to fend off currency speculators, the once laissez-faire Hong Kong Monetary Authority intervened in the local stock market, acquiring as much as 10.0% ownership positions in nearly every listed large cap company; and,

4. The Russian Ruble tumbled after both the private and public sectors defaulted on massive foreign debt obligations.

Outside of the emerging markets arena, Long Term Capital Management (LTCM), the massively leveraged U.S. based hedge fund, was forced to accept a U.S. Federal Reserve brokered bailout plan from top global financial institutions in order to avert a meltdown of global credit and stock markets. And in Japan, the once mighty Yen continued to weaken, threatening to pull down further not only the Thai Baht, but also many other currencies throughout Asia.

Fortunately, during this five month period, we continued to prudently add short index swap positions to our portfolio. As such, the Thai Focused Equity Fund managed to side step much of the market's downward momentum. During the second quarter, for example, we generated only a 12.1% loss, against the market's 46.6% fall. For July and August, we realized a 4.3% loss, while the SET lost a further 19.0%.

The environment changed dramatically for equities towards the end of August, however. The key event during this period was the banking reform package announced by the government on August 14th. On the back of this package, the government acted decisively to bring down short-term interest rates. A major market rally ensued. Domestic retail investors, who trade based on technical trading rules and market rumor, targeted banks and finance stocks – the least economically viable investment opportunities in the market.

In hindsight, we maintained our short index swap exposure too long, and paired back our positions at less than an optimal rate. We believed then that the rally was unjustified based on fundamentals. In the end, however, the U.S. Federal Reserve's September decision to begin cutting U.S. short-term interest rates in order to relive global economies effectively ended the bear case for the Thai market.

The market has hardly looked back since. During the last four months of 1998, the SET gained 89.4%. During this same timeframe the Fund lost 4.1%, reflecting our continued exposure to short index swaps and our underweight position in financial stocks.

However, we must remember that so far, Thailand is still showing few signs of an economic recovery. At best, Thailand may be entering the first stages of a protracted, U-shaped recovery. Private capital investment is unlikely to spur the economy any time soon, as the country is still awash in excess capacity, running at an overall 52% capacity utilization rate. Manufacturing output has stabilized, but at levels last seen in 1994-95. The banking system has cut lending by 4.3% YoY, and NPLs continue to grow. The government has still failed to pass much needed bankruptcy and foreclosure legislation.

Looking forward to 1999, we continue to believe U.S. dollar generating exporters represent the best values in the market. These companies are currently profitable and their fate is unrelated to Thailand's lingering domestic problems. At the same time, we are on the lookout for companies

that we believe will be beneficiaries of improved domestic demand and which have managed to survive the economic downturn.

We believe that foreign investors who have been underweight in Thailand for most of 1998 will make a major reallocation in favor of Thai equities in early 1999 and that this investment will be primarily focused on the same fundamentally sound, value stocks that we hold in our portfolio. As such, the first quarter of 1999 will most likely represent a timely opportunity for interested investors to invest new or additional funds into the Thai Focused Equity Fund.