

In Association with Global Investment Solutions, LLC

2008 Q3 Managed Account Review

NOTE: Actual performance data has been deleted. Contact Global Investment Solutions for more details.

In last quarter's outlook for the third quarter of 2008, we re-iterated a phrase from the prior quarter's letter: "this is where it gets tough".

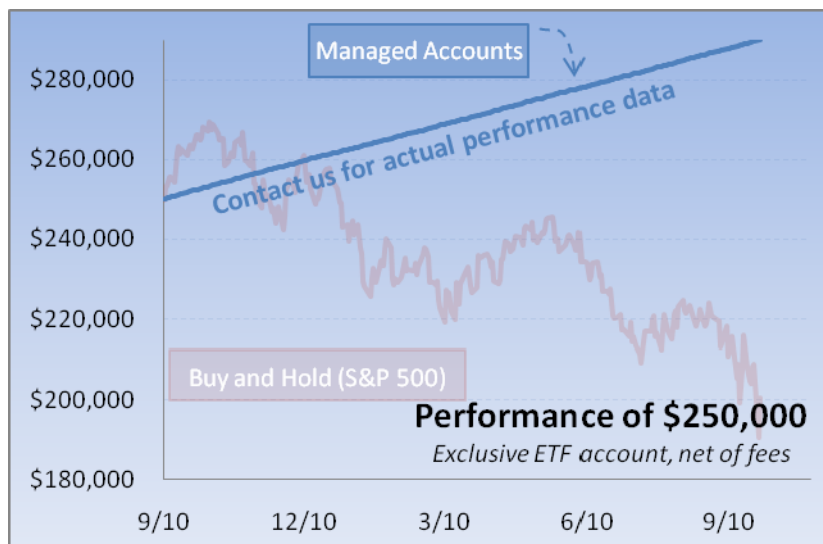
Starting the second quarter, we were in the midst of a rally that was starting to meet the usual upper thresholds for a bear-market rally – a gain of 5% - 15% over a time period of one to three months. After those goals are reached, the sustainability of bear-market rallies gets dubious, and in fact during April and May many of our sentiment guides began suggesting trouble directly ahead.

By the end of the quarter, the indices had suffered through one of the worst months on record. Curiously, though, most of our work did not indicate that the market was "oversold", or stretched enough on the downside to expect relief during bear-market conditions.

That behavior bled into July, when we finally got a couple of days that triggered a series of readings that could only be defined by capitulation. Despite that word becoming cliché, it worked, as stocks bounced as hard as they should have, once again fulfilling the 5% - 15%, one- to three-month rally threshold.

While the rally wasn't enough to trigger as many warning signs as we saw during April and May, during mid-August we did discuss a number of different negatives on the site. That was enough for us to turn even more defensive and do more watching than trading.

That theme continued through the quarter – we were not very active, and our position sizes were exceptionally small, with only about 15% of total equity invested at any given time.



Despite the limited exposure, the volatility gave us opportunities to profit without taking undue risk, and we were able to finish with positive returns each month of the quarter.

While we would of course welcome higher returns, it's tough to be too disappointed with three straight months of gains when the market went through an historic level of volatility and major losses. Anyone losing 20% over the past year is going to need a 25% rally just to get back to breakeven, so making some gains during down markets makes a tremendous difference.

Hedge funds and mutual funds alike have undergone upheaval over the past two quarters, with many of them posting their worst returns in at least a decade, or longer. We will certainly give up some ground to those funds on a relative performance basis when the next major bull move comes roaring along, but by staying conservative, short-term and opportunistic, we don't find ourselves having to dig out of a major hole just to get to even.

This quarter marks our one-year anniversary with the managed accounts, and despite a level of turmoil that most market participants have never before seen, we only suffered one down month, and that was minimal. Our overall drawdown was smaller than **{deleted}**, less than the market moves in a few hours anymore.

From the programs' inception, our total return comes out to **{deleted}** (Exclusive accounts, net of fees), well ahead of the S&P 500's loss of -20.5%. Year-to-date, our returns were **{deleted}** as compared to the S&P's drop of -21.9%.

Once again, our correlation to the S&P's monthly returns is basically zero, so we've been able to scratch together positive absolute performance no matter the market conditions.

2008 Q4 Managed Account Outlook

We spent a good deal of time in mid-September discussing studies that suggested we should see a certain pattern unfold in the coming weeks. We don't often resort to "crystal ball", multi-step types of forecasts, but the studies were pretty clear.

What they suggested was that we should see one to three weeks of extreme volatility just ahead, with a downside bias. After that period of wild swings, it should lead to decent gains during a fourth-quarter bear-market rally.

During late September and into the early days of October, that forecast has played out pretty well in line with what the studies suggested. And on September 29th, it culminated in what could only be considered an all-out market crash.

During the past couple of weeks, we've discussed a great number of indicators that have shown just how severe the panic in the credit markets has been, with historic levels of stress. That has seeped into the equities markets, and on that Monday the market registered the kinds of readings we have seen only a handful of times in the past 100 years.

Those precedents were fairly consistent in how the market responded going forward – we almost always saw a very swift, very violent rally immediately after the crash, then a re-test of the panic low over the next one to two weeks, before a more lasting move higher. We're now undergoing

the process of testing the low set on the crash of the 29th, and it remains to be seen whether it will be successful, or we will bear witness to one of the most unique moments in market history.

It's not unusual to see modest undercuts of a panic low, but they are usually regained within a matter of days. We will be watching for the same this time around, and will be looking to more aggressively trade the long side than we've been willing to the past several months. There are a number of different aspects pointing to a likely fourth-quarter rally this year (still within the context of a broad, drawn-out bear market), and we plan on taking part as much as possible. As always, with an eye on risk just in case "this time is different".

Take care,

Jason Goepfert and Roger Kliminski

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