



Oxeye Growth Fund : Market Circumstances and Strategy Outlook October 2006

Summary

- The Oxeye Crude Oil strategy has suffered a sizeable drawdown.
- November and December put positions expired 'deep' in the money realizing large losses.
- More recent positions opened after the market decline are still mid range and profitable.
- Current market price is \$60 for the January 07 contract.
- The market never rallied sufficiently to rescue the December positions.
- The FTSE strategy also came under pressure into month end, augmenting the size of the October loss.
- FTSE has since recovered and recorded its 4th profitable expiry in a row to November 06.
- The asset allocation has reduced exposure to Crude in favour of FTSE.



OGF October 2006 Drawdown

The Fund has suffered a drastic drawdown in October which, coming on the back of a bad September –7% has now lost 20% in two months.

This month Crude Oil has again been the main cause of the loss, although unrealised losses in FTSE also contributed. Crude has been 55% of the asset mix in recent months owing to its higher level of implied volatility than the other asset classes, FTSE and the Euro.

As mentioned last month, the move in the Crude price has been larger than normal with Crude peaking at \$80 in August and then touching \$57.50 in mid October (a drop of 28% over 5 weeks). During the early part of November there was no upside momentum to rescue positions and so two consecutive contracts (November and December) expired deep in the money. The Crude strategy moved from one side of its range to the other in a short space of time and required costly hedging activities on both sides.

Why has the larger than normal move in Crude Oil occurred?

The sell-off started in anticipation of a slowing world economy – particularly the US and China responding to rising interest rates – and growing US stockpiles following a period of tight supply earlier in the year.

After a long bull market over 5 years a number of players were caught with over geared long positions and suffered margin calls as the Crude price fell below \$70. This caused ‘forced selling’ and hastened the decline as well as worsening the extent of it.

During the move from \$80 to \$70 OPEC stated that they would support Crude at \$60 (by means of production cuts). When markets smell a ‘line in the sand’ they tend to test the level fairly quickly.

Consequently the price fell rapidly from \$70 to \$60, and then ranged between \$57 and \$60 for the remainder of the period under review.

What does it mean for us?

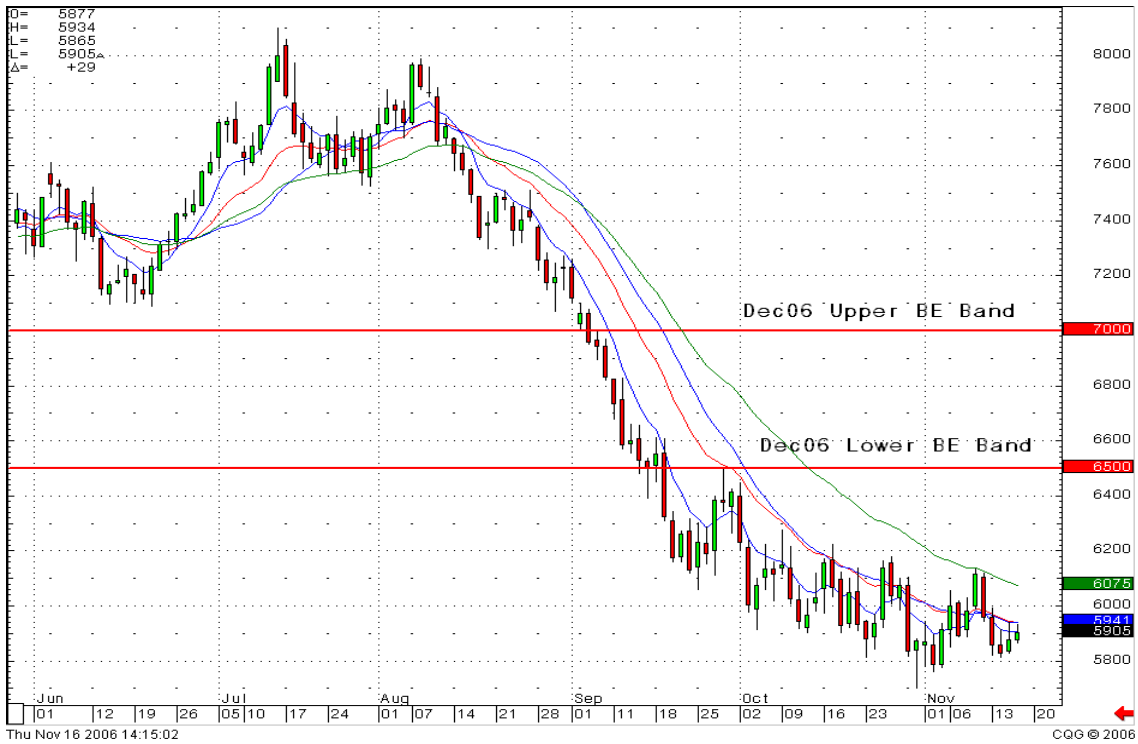
Last month we explained that the strategy was hedged against a further fall in the market, but would allow a reduction in the overall loss if the Crude price bounced back into the strategy’s range. The bounce back never occurred and hence the losses became ‘realised’ on expiry.



Chart 1



Chart 2





Looking forward it will take time to regain the Crude Oil losses. We have reviewed the risk management policies and made some changes. Whilst this will not avoid the possibility of future losses, we believe the improvements will reduce losses during exceptionally large moves in the underlying market.

Option prices are currently at the low end of the scale for Crude and we have therefore reduced the overall asset allocation in favour of FTSE. The mix is currently 75% FTSE 25% Crude. The fund has outstanding premium of some 8% of FUM and we would expect to keep a proportion of that over the next few months, assuming the strategy's ranges hold.

Oxeye's performance history has shown that large drawdowns were buying opportunities. After big directional moves markets often range trade for a considerable period of time. This can be fertile territory for Oxeye strategies because of the non-directional range trading nature of the approach. We would therefore anticipate some reasonable returns ahead. FTSE, which suffered a large drawdown in May, has since recovered all losses. Although we do not expect such a similar 'fast' recovery with the Crude strategy, we are optimistic for steady progress now that the main collapse in the Oil price appears to have slowed. Unfortunately premium levels are low and for this reason the recovery will take longer. (See Table 1)(see also Appendix showing Crude Price Action after Consolidations)

Table 1	Date	Drawdown	9 Mth Low to High Post Performance	
FTSE	Sep-01	-15%	+ 54%	
	Jul-02	-15%	+ 43%	
	May-06	-23%	+24% to date	
Oil	Nov-03	-7%	+32%	Back Test
	Oct-04	-10%	+75%	Back Test
	Oct-05	-5%	+14%	

The Fund is currently writing 4% of assets per month in FTSE and a further 1% in Crude (both before insurance costs). Despite the poor returns of the last few years, sooner or later that should start to pay off.

M.Petherick
November 2006

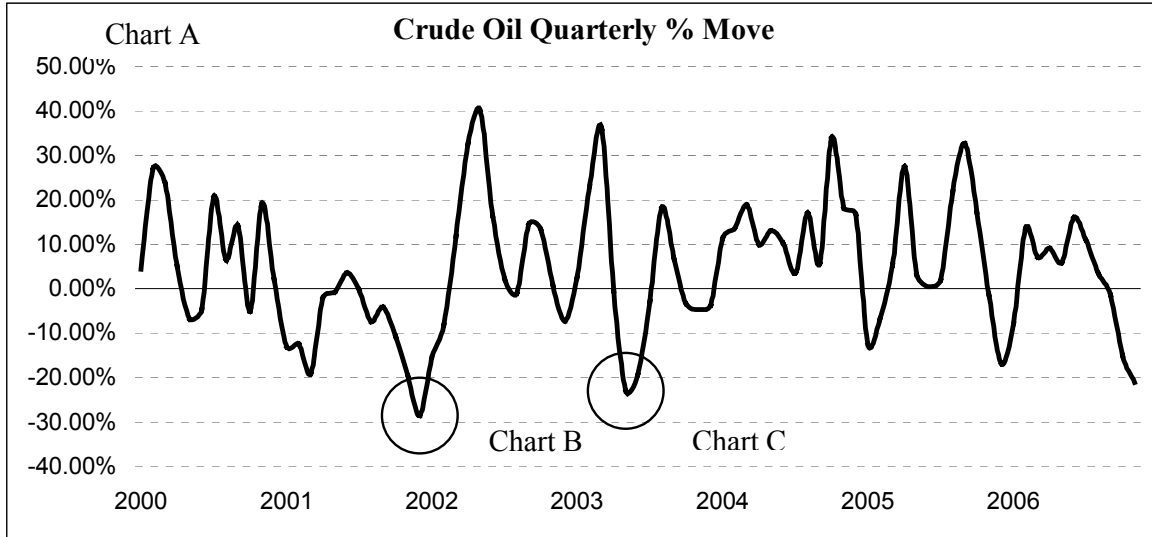


Appendix

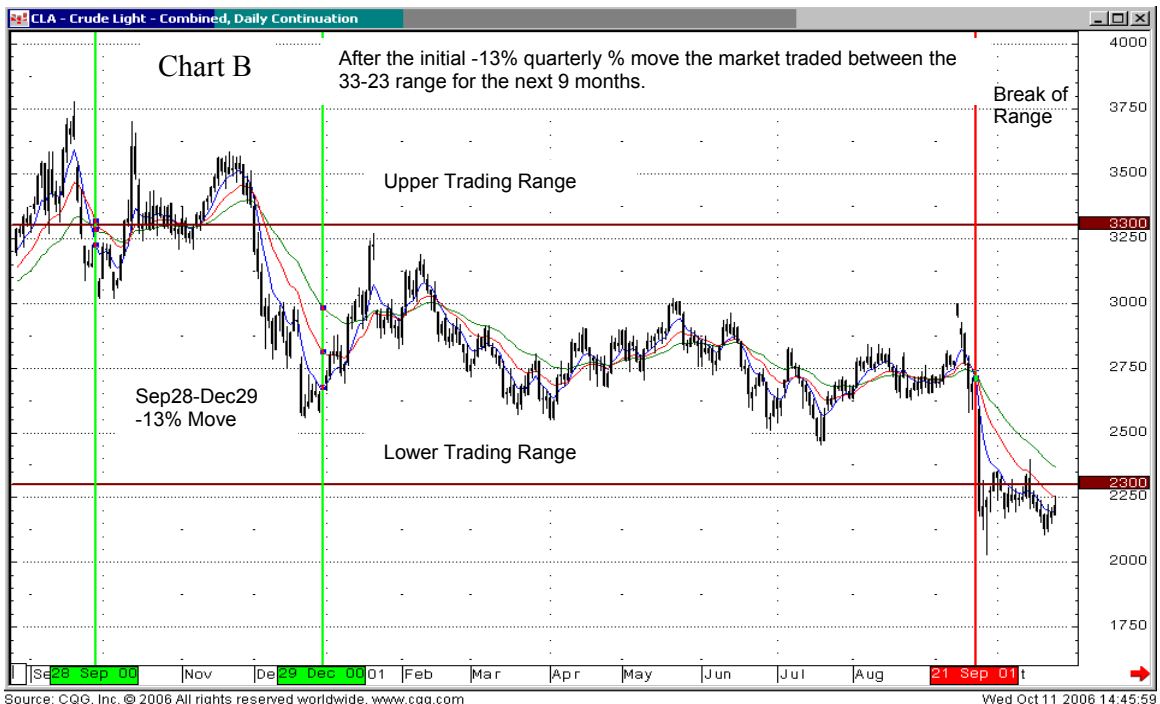
Crude Price Action after Consolidations

The three charts below give a historical background to the volatility of Crude Oil and the price action after several large sell-offs.

Chart A shows the quarterly % moves Crude has experienced since CY2000. As can be seen from the chart there have been five large price declines.



Charts B & C show two of the largest price declines (circled) in Chart A and the range that developed over the ensuing period.



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In each case the market range traded for 8 to 9 months before resuming a trending environment. This time around, once the low is reached for this phase of the consolidation we would expect such a range to develop for a similar period of time. That range statistically could be expected to be approximately \$50 to \$75 and premiums available for such a range are currently priced at 3% per month (before insurance) of Oxeye initial margin requirements.

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