ETOLIAN CAPITAL

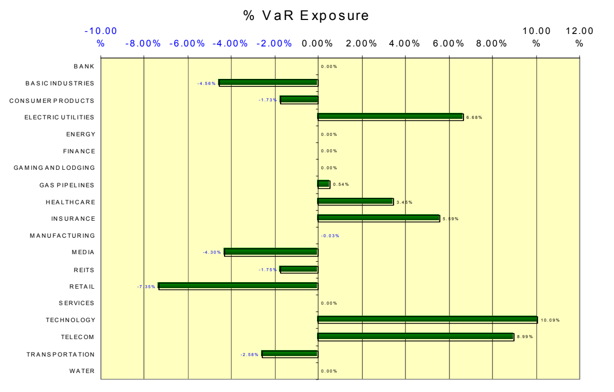
Monthly Letter: August 2004

Etolian Capital Group, LP is a private investment management company, which focuses on US credit fixed income opportunities. Its objective is to generate above average, stable returns which are uncorrelated with major market indices by going long and short in cash and derivative fixed income obligations issued by primarily US investment grade rated corporations. What differentiates Etolian Capital from other similar efforts is its credit selection process which is based on an options-based quantitative methodology and relies, among other things, on information from the equity and equity option markets to assess credit. This methodology is used to identify undervalued and overvalued situations and accordingly create long and short positions in them. Interest rate risk is hedged and moderate leverage (up to 5 times) is deployed to achieve objectives. The long/short approach, combined with the use of leverage, as well as other risk management techniques, reduces the probability of a major capital loss.

Currently, Etolian Capital offers two funds; the **Etolian Capital Credit Fund, LP** (a US domestic partnership), and the **Etolian Capital Offshore Credit Fund, Ltd** (a Cayman exempted company).

	E Capital (*) Onshore	E Capital (*) Offshore	S&P (**) Index	LUCI (***) Tot Return	LUCI (***) ASW
August Return	0.03%	0.03%	0.23%	2.94%	-0.28%
August Daily Volatility	0.18%	0.18%	0.83%	0.32%	0.08%
August Sharpe Ratio	-0.48	-0.48	0.07	7.51	0.70
August % of (+) Days	59%	59%	59%	68%	32%
Year-to-Day Returns	2.61%	2.55%	-0.69%	4.27%	-0.08%
Y-t-D Annualized Return	3.94%	3.85%	-1.03%	6.51%	-0.12%
Y-t-D Annualized Daily Volatility	1.73%	1.73%	11.51%	6.34%	1.57%
Y-t-D Sharpe Ratio	1.34	1.29	-0.20	0.82	-0.05
Y-t-D % of (+) Months	87.5%	87.5%	62.5%	75%	37.5%
Y-t-D % of (+) Days	67%	67%	54%	53%	49%

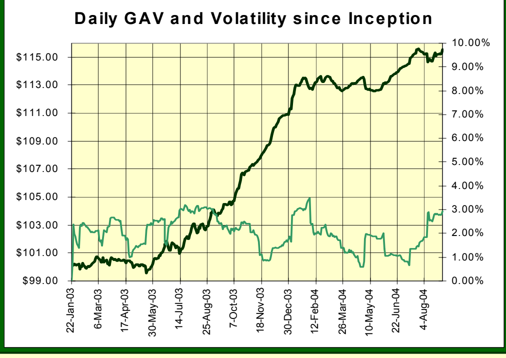
(*) Returns are net of fees (1.5% management fee and 20% incentive allocation of profits. August and Y-T-D gross returns for the Onshore fund are 0.16% and 4.22% respectively)
(**) S&P Index returns are gross returns
(***) The 7-10 year LUCI Corporate Bond Index is compiled by CSFB (ASW=Asset Swap)



Portfolio Performance

	2003	2004
January	0.10%	1.26%
February	0.25%	0.31%
March	-0.14%	-0.69%
April	-0.59%	0.04%
May	0.34%	0.03%
June	0.90%	0.85%
July	0.86%	0.77%
August	0.64%	0.03%
September	0.53%	
October	2.01%	
November	1.08%	
December	2.00%	
Y-T-D	8.25%	2.61%
Since Inception		11.08%

AUM: $21.6 million



August Commentary

We all know that markets hate uncertainty. Prices trade lower, volatility trades higher, and end-investors shun stocks and risky assets in favor of the mattress. As the month of August progressed, uncertainty seemed to diminish. First, the political landscape became somewhat clearer. The Republican National Convention finished without incident and the polls showed an increase in support for Bush. OPEC assured an oil-thirsty world they would do everything in their power to produce more oil and bring down crude prices. So stocks, after setting 2004 lows in mid-August, did an about face and climbed 4%(ref DJI) in the next 2 weeks. Our “uncertainty barometer” du jour (the VIX volatility index) responded accordingly and fell from nearly 20% to just above 15%. Incidentally, the VIX index (which is strongly correlated to credit spreads) has traded between 14% and 20% for nearly a year. Every spike up (such as those from rate hikes and the Madrid bombings) has been met with a return to the lows.

Our returns for the month tracked a similar pattern, albeit for different reasons. We started off slightly negative for the month as a carryover from our positive stance in July met an uncertain world in early August. Some of our wider long credits (Kodak, Autos, Nextel) continued to widen as our shorts (Cox, Dillards) underperformed. Then Dillards announced a sale of their credit card division, a positive for credit, and the resultant overnight tightening brought the month as far down as 70 bps negative. We stayed the course in the overall portfolio, biased long, believing that uncertainty would diminish and credits would tighten. We added value from being in the position of our involvement in trading credit default spreads on a daily basis, and executed several profitable 1-2 day short term trades. And slowly but surely, we chipped away at the losses and brought the month into slightly positive territory. The big winners came mostly from long (tightening) positions: EDS, ATT, Cardinal Healthcare, UNM. These names, typically the bad boys in the neighborhood, showed that there is value in these credits as long as volatility is range bound.

For the next month, we have positioned ourselves for more of the “fog” of uncertainty to lift. Currently, we are 254% long and 196% short for total leverage of 4.5:1. We are wary of some clouds on the horizon. Oil price spikes have preceded the last several recessions and that may eventually put the brakes on the economy this time. The US Treasury market is telling us there may be problems out there, as yields on the 10 year have fallen 50 bps from the highs as the Fed has tightened 50 bps. One reason for this maybe that bond investors fear a slowdown is in the works. A second reason is that the hunger for yield still has yet to abate, and we are mindful that more investors are reaching for risk via credit products. As the room becomes more crowded, we must anticipate the rush for the door. Be assured that Etolian Capital will be vigilant and will be first to see thru the fog.

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