ETOLIAN CAPITAL

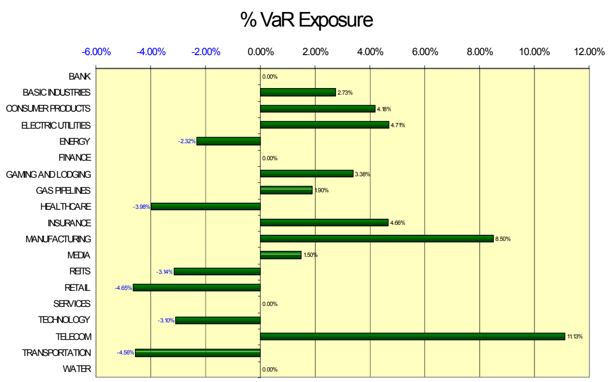
Monthly Letter: December 2004

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
December Return	0.39%	0.39%	3.25%	1.76%	0.57%
December Daily Volatility	0.09%	0.09%	0.63%	0.34%	0.07%
December Sharpe Ratio	1.46	1.46	4.63	3.61	3.91
December % of (+) Days	73%	73%	59%	59%	68%
Year-to-Day Returns	4.79%	4.74%	8.99%	6.96%	1.50%
Y-t-D Annualized Return	4.79%	4.74%	8.99%	6.96%	1.50%
Y-t-D Annualized Daily Volatility	2.42%	2.42%	11.07%	5.96%	1.51%
Y-t-D Sharpe Ratio	1.23	1.20	0.67	0.91	-0.04
Y-t-D % of (+) Months	92%	92%	75%	75%	50%
Y-t-D % of (+) Days	66.4%	66.4%	55%	54%	53%

(*) Returns are net of fees (1.5% management fee and 20% incentive allocation of profits. December and Y-T-D gross returns for the Onshore fund are 0.61% and 7.56% respectively)
(**) S&P Index returns are gross returns
(***) The 7-10 year LUCI Corporate Bond Index is compiled by CSFB (ASW=Asset Swap)

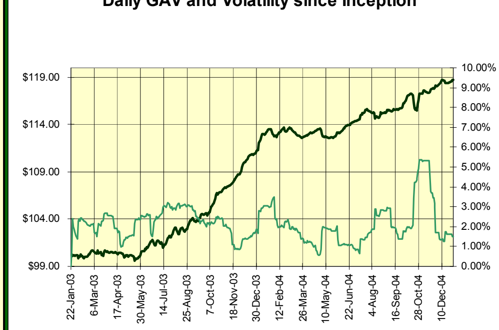


Portfolio Performance

	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%	0.41%
October	2.01%	0.77%
November	1.08%	0.54%
December	2.00%	0.39%
Y-T-D	8.25%	4.79%
Since Inception		13.44%

AUM: $24.8 million

Daily GAV and Volatility since Inception



December Monthly

December came and went almost as a non-event for the economy and markets alike. The only exception was the equities markets which continued their post-election rally. Most market participants took a back seat during the month and, for all practical purposes, hardly any trading took place during the last 2-1/2 weeks of the year. With most markets moving sideways, the S&P registered another gain of 3.25% for the month, while the US Treasury market closed virtually unchanged, and the VIX Index slightly up (around 14) after making another 8-year low at 11 during December.

The investment grade credit market also finished up December virtually unchanged. After a push towards tighter spreads during the first week of the month (which was really an extension of the November rally in credit spreads), the market gave up ground during the later part of the month finishing the month unchanged. Moreover, with the exception of the Sprint-NXTL merger announcement, not much of name-related activity occurred either. Amidst this environment, Etolian Capital recorded a gain of 39 basis points, bringing the total gain for 2004 to 4.79%. The main driver of the December result was gains from long NXTL positions, following the Sprint-NXTL merger announcement. The remainder of this letter outlines our thoughts for 2005.

2005 Outlook

As we enter 2005, the market is positioned for tighter credit spreads, and so are we, by being about 15% net long. Despite the fact that spreads have moved tighter during 2004, particularly over the past 3-4 months, the market consensus is for tighter credit spreads. This expectation rests on a combination of factors including; a robust economic environment which is supportive of credit; healthy corporate earnings; liquid balance sheets; and supportive technicals in the form of continued high demand and limited supply of credit, higher equity levels, collapsing equity volatility levels, and continuing demand for synthetic CDO products.

Despite the reservations we have expressed on a number of occasions about the tight levels of credit spreads, the cumulative effect of these factors cannot be dismissed, nor can one easily take a stand against a “tsunami” of new money flowing in the credit markets in search for yield enhancement. We are keenly aware of the diminishing risk/reward tradeoffs that current spread levels present, but we do believe that, for the early part of the year, the risk lies more on the side of missing the extra return by not being long credit as the market takes spreads another level tighter, rather than getting hurt from such a position.

As we move further into 2005, the tighter credit spreads outlook becomes decidedly less clear, primarily as a result of higher interest rates to come. Let us not forget that a big chunk of the credit asset class continues to be interest rate sensitive, and as the Fed continues its path towards higher rates, demand for credit is bound to be affected. Another source of risk in the corporate credit market is likely to come from the shift in companies’ focus from reducing debt to rewarding shareholders, possibly at the expense of bondholders. Finally, the further we move out in the year, the higher the chance that an unanticipated event (either credit specific, macro-economy related, or other) is likely to occur, which is bound to lead to a rise in volatility and, ultimately, wider credit spreads.

What does this all mean for Etolian Capital? A tight spread environment such as this we are currently in, makes the job of a long/short manager difficult, as the potential reward from long positions is limited, being short costs money, and the potential reward from being short may not be near. It is precisely in environments such as this, when traditional credit tools can take you so far, that approaches which look outside the world of credit (such as our equity/equity volatility approach to credit) can provide added insights by determining if and where value is. In this respect, Etolian Capital is uniquely positioned in terms of identifying where value lies, both at an individual credit level as well in aggregate terms. Moreover, in such a low volatility environment, timing becomes a critical consideration because of the cost of carrying short positions in expectation of capital gains. Our long/short orientation ensures that the effect of unanticipated events cannot hurt the portfolio in a significant way. At the same time, it positions us to rapidly change the direction of the portfolio at the margin. In short, credit selection, timing and portfolio management along with a healthy respect about the market’s ability to surprise consensus opinion have been, are, and will continue to be our guiding principles as we move through 2005. We like to thank you for your continued support for the past couple of years and assure you that we will continue to do our best to preserve and grow the capital that you have entrusted with us.

ETOLIAN CAPITAL GROUP LP, 67 Wall Street, 10th Floor, New York, NY 10005; Phone (212) 659-2430, Fax (212) 659-2443, info@etolian.com, http://www.etolian.com