ETOLIAN CAPITAL

Monthly Letter: February 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
February Return	0.31%	0.30%	1.22%	1.46%	-0.14%
February Daily Volatility	0.13%	0.13%	0.58%	0.29%	0.07%
February Sharpe Ratio	1.16	1.15	1.78	4.34	-1.75
February % of (+) Days	68.42%	68.42%	53%	63%	53%
Year-to-Day Returns	1.57%	1.53%	2.97%	2.77%	-0.17%
Y-t-D Annualized Return	10.21%	9.95%	20.82%	19.32%	-1.07%
Y-t-D Annualized Daily Volatility	2.76%	2.76%	10.18%	6.20%	1.14%
Y-t-D Sharpe Ratio	3.28	3.18	1.93	2.93	-0.14
Y-t-D % of (+) Months	100%	100%	100%	100%	0%
Y-t-D % of (+) Days	69%	69%	54%	64%	54%

(*) Returns are net of fees (1.5% management fee and 20% incentive allocation of profits. February and Y-T-D gross returns are 0.51% and 2.22% respectively)
(**) S&P Index returns are gross returns
(***) The 7-10 year LUCI Corporate Bond Index is compiled by CSFB (ASW=Asset Swap)

Individual Companies' Performance: % better than the LUCI corp. bond index

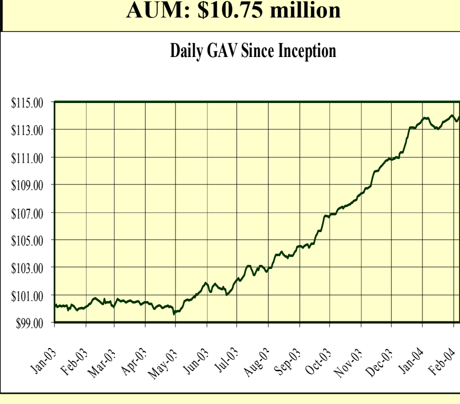
AEP US, CTX US, MO US, YUM US, CSC US, FE US, CFC US, TYC US, TYC US, NSC US, HLT US, GM US, HLT US, RCN US, CNP US, ABS US, S US, T US, EOP US, EK US, HRZ US, DUK US, EQR US, AVT US, NCP US, HCA US, HLT US, BAX, CI US, HRZ US, HIVOL US, CA US, AVB US, JNY US, NXTL US, AWE US, KMP US, SBC US, EDS US

-20.00% -10.00% 0.00% 10.00% 20.00% 30.00% 40.00% 50.00%

Portfolio Performance

	2003	2004
January	0.10%	1.26%
February	0.25	0.31%
March	-0.14	
April	-0.59	
May	0.34	
June	0.90	
July	0.86	
August	0.64	
September	0.53	
October	2.01	
November	1.08	
December	2.00	
Y-T-D	8.25%	1.57%
Since Inception		9.95%

AUM: $10.75 million



February Commentary

February (like September and October) is reputed to be a volatile month. Well, this February did not live up to its reputation. Instead, it provided the forum for a wrestling match between bulls and bears with the outcome of this fight yet to be determined. Despite a background of robust economic signals in the form of various economic reports during February (Personal Income and Spending, ISM Manufacturing, Factory Orders, Productivity figures, Industrial Production etc.), a climate of uneasiness and uncertainty has been hanging over the market. It is as if market participants have been having doubts about the durability of the economic rebound and/or are afraid that there is another shoe to drop somewhere. Volatility in the FX markets and the reputed massive interventions from Japan's Central Bank (estimated at about $80-90 billion of US dollar purchases Y-T-D) has not helped matters, but did provide a bid to the US Treasuries due to the heavy participation of foreign central banks in the auctions. Such massive official foreign flows are putting a lid to US domestic interest rates, but a lot of people participants wonder for how long, and what happens after? Equities markets have been digesting these developments, attempting to establish a direction (which has yet to materialize). However, the behavior of the VIX Index (which, again, trended downward during the month, after an initial blowout) is not indicative of a market that looks to be anticipating major issues ahead of it. It is the stable interest rate outlook and the low volatility that makes us lean towards a more positive outlook.

The markets for credit have been reflecting the above developments. Following January's weak ending, credit markets entered February with a negative bias which lasted the first week of the month, led by a weakness in the Auto sector and Ford in particular. The market stabilized and recovered some of its losses during the second week, resuming its negative course during the third week, finishing up on a mild positive tone. In short, it felt like summer doldrums! Per our previous month's letter, it has been our view that the spread widening that occurred in the credit market in late January was an overreaction that was not confirmed by either changes in volatility in interest rates or equities, or justified by movements in the equity markets. Indeed, there was no real follow through in the mild spread widening observed in the beginning of the month and instead the market spent the remainder of the month within a relatively tight trading range. A lot of individual credits remained unchanged, moving within a very narrow range, only briefly disturbed by the widening that occurred in the Auto sector and selected high yield names (El Paso, Tenet Healthcare, EDS). Within that context, sectors that proved noteworthy were the Technology (wider), Financials (tighter), Utilities (tighter), Healthcare (wider, in sympathy to Tenet), and Telecoms (M&A activity). Finally, adding to the state of malaise, was absence of large buyers and relatively anemic new issuance activity. As we look ahead, we continue to remain constructive on the outlook of the credit market. Our analysis indicates that credit spreads have more room to narrow when viewed within the context of an improving economy, favorable (for the foreseeable future) interest rate environment, supporting equity markets and continuing declines in equity volatility.

Given the above market environment it should not come as a surprise that Etolian Capital underperformed by delivering a net return to investors of 0.31% (gross return of 0.51%). Simply put, there was not enough volatility in the market to enable us to deliver stronger results. Driven by our positive views on credit spread markets, we started the month with a rather large (18% net long) positive exposure to narrowing spreads which did not work out in the beginning of the month. In addition, we had exposure to the Auto sector which added to our woes. After that, we essentially spent the rest of the month trying to dig ourselves out of the hole by neutralizing our overall positions and by moderately rebalancing/restructuring our portfolio. In this respect we benefited from positive developments in the Utilities sector (spread narrowing in names such as First Energy, AEP), and continued widening in selected names such as ATT and CTX. Despite the below par performance of the funds, there are a couple of considerations that should be taken into account when viewing the results. First, there was an above average portfolio turnaround, as we repositioned and rebalanced the fund during the month, in response to market developments. Secondly, our strict attention to risk management (which led to above average portfolio turnover) continues to pay dividends and, once again, we have demonstrated that during February. As we look ahead, and given our view of the credit markets, we are entering March with a modest net long spread exposure of about 5%, comprising of 1.73xAUM in long positions, 1.68xAUM in short positions and overall leverage of 3.40.

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

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