ETOLIAN CAPITAL

Monthly Letter: September 2005

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).

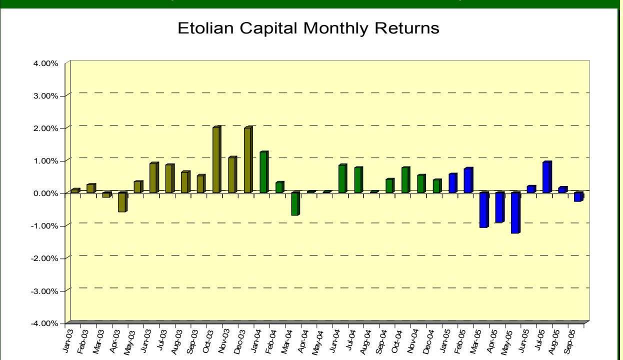
	Etolian Capital*		S&P 500 Index**	CSFB Indices***	
	Credit Fund (Onshore)	Offshore Credit Fund	S&P	LUCI	CDSI
September Return	(0.27%)	(0.27%)	0.69%	(1.89%)	0.17%
September Volatility	0.38%	0.38%	0.62%	1.04%	0.11%
September Sharpe Ratio	(1.31)	(1.31)	0.76	(2.04)	(0.56)
YTD Return	(0.92%)	(0.90%)	1.39%	1.74%	2.25%
YTD Volatility	2.78%	2.78%	21.66%	4.00%	2.77%
YTD Sharpe Ratio	(0.90)	(0.89)	(0.01)	0.04	0.24

(*) Returns are net of fees (1.5% management fee and 20% incentive allocation of profits). September/ Y-T-D gross returns were -0.176% and -0.091% respectively.

(**) S&P 500 Index returns are gross price returns

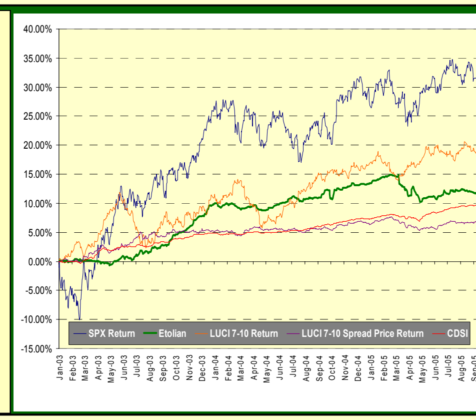
(***) The 7-10 year LUCI Corporate Bond Index is compiled by CSFB (CDSI=Credit Default Swap Index)

Monthly Gross Returns – As of July 2005



Portfolio Performance

	2003	2004	2005
January	0.10%	1.26%	0.56%
February	0.25%	0.31%	0.75%
March	(0.14%)	(0.69%)	(1.08%)
April	(0.59%)	0.04%	(0.92%)
May	0.34%	0.03%	(1.26%)
June	0.90%	0.85%	0.25%
July	0.87%	0.77%	0.95%
August	0.64%	0.03%	0.15%
September	0.53%	0.41%	(0.27%)
October	2.01%	0.77%	
November	1.08%	0.54%	
December	2.00%	0.39%	
Year to Date	8.25%	4.79%	(0.90%)
Since Inception:		12.42%	



September Monthly

For those expecting some market action, following the slow summer doldrums, September turned out to be a disappointment, providing very little opportunity to excite (and profit or loss opportunities). Yet, a number of events occurred which should have provided the basis for a healthy rethinking of the state of the economy and the markets. Widespread hurricane damage in the Gulf region, sharply climbing energy prices, and further large increases in the already large government deficit failed to create excitement in the markets which moved within relatively narrow ranges. The equity market was virtually unchanged for the month, and so was the VIX, the index of equity volatility. The fixed income market was about the only market that seemed to react to these events, causing interest rates to rise by about 40 basis points, signaling the market's concern for inflation down the road. So, surprise, surprise, the market is reaching the conclusion that the Fed is far from done. Also, these developments indicate to us that the risk does not seem to be from a slowing economy.

The credit market moved in line with the other two markets were enterprise risk is traded, namely equities and equity volatility, by exhibiting very little volatility, and leaving credit spreads relatively unchanged. Two events absorbed the market's attention during September; Delphi and the CDS roll to the new December contract. The rest of the month's activity focused on name-specific action. Delphi credit spreads steadily widened throughout the month as the potential outcome form the tri-party negotiations involving Delphi, the unions, and GM, looked progressively less and less promising, causing Auto and Auto part credit spreads to widen in sympathy. Yet, the rest of the credit market remained unaffected and, in fact, credit spreads for most other sectors remained firm or tightened. Technical conditions associated with the CDS roll accounted for part of the strength in the rest of the market, while strength in other sectors such as Energy, Mining, Materials, and Technology, stemming primarily from the hurricane effects, accounted for such strength. Similarly, a dent in consumer confidence exerted a negative effect on most consumer related sectors. By month's end, the cumulative effect of these events was hardly noticeable as the CDX HVOL index was virtually unchanged (it closed at around 115) from the level prevailing at the beginning of the month (around 112). At the end of September, it felt as if the credit market was largely discounting the Delphi bankruptcy event. Yet, as we write this letter, we are in the midst of evolving market developments – more like a free fall - following the Delphi filing. And for one more time, the market seems to have been caught by surprise for an event that seemed to have been fully discounted, confirming for one more time, the increasingly asymmetric risk profile of the credit market at this stage of the business cycle! But more on this in next month's letter!

Given the above, it should not come as a surprise that September was a rather mediocre month for Etolian Capital, resulting in a modest loss of 27 basis point. The very narrow range of market movements, combined with a dearth of relative value opportunities meant that we spent a lot of energy with nothing to show by month's end. Our longs made money and our short's lost money in about equal amounts. Positions that we took for the CDS roll did not provide us with satisfaction as they did not move enough to justify the bid-ask dealing spreads. And some of the extra shorts that we set-up for a potential spread widening after the CDS roll simply did not pan out. So, at the end of the day, the only happy people were the dealers who made their bid-ask spreads. The market environment simply did not provide us with enough opportunities to make money. Our market stance remains unchanged. That is, within our market neutral way, we will continue to look for opportunities to source shorts and balancing them through credit indices, being wary of the increased idiosyncratic risk. As we enter October, our portfolio is fairly balanced between short and long positions with about 142% long and 139% short, comprising 39 positions of which 17 are long positions and 22 are names on the short side.

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