ETOLIAN CAPITAL

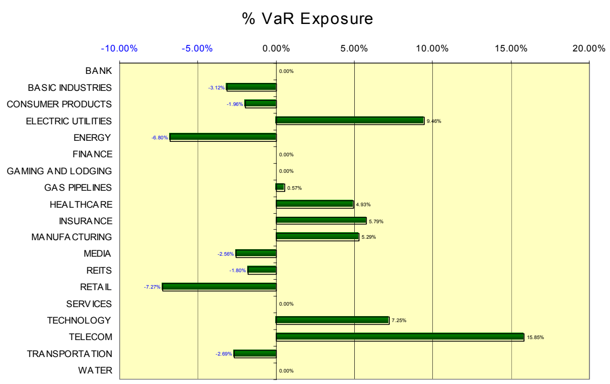
Monthly Letter: September 2004

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
September Return	0.41%	0.41%	0.94%	0.81%	0.42%
September Daily Volatility	0.11%	0.11%	0.59%	0.35%	0.10%
September Sharpe Ratio	3.41	3.41	1.07	1.51	3.24
September % of (+) Days	57%	57%	62%	57%	48%
Year-to-Day Returns	3.02%	2.98%	0.24%	5.11%	0.34%
Y-t-D Annualized Return	4.03%	3.97%	0.32%	6.90%	0.45%
Y-t-D Annualized Daily Volatility	1.80%	1.80%	11.28	6.24%	1.57%
Y-t-D Sharpe Ratio	1.35	1.31	-0.09	0.89	0.21
Y-t-D % of (+) Months	88.9%	88.9%	66.7%	66.7%	44.4%
Y-t-D % of (+) Days	66%	66%	54%	54%	48%

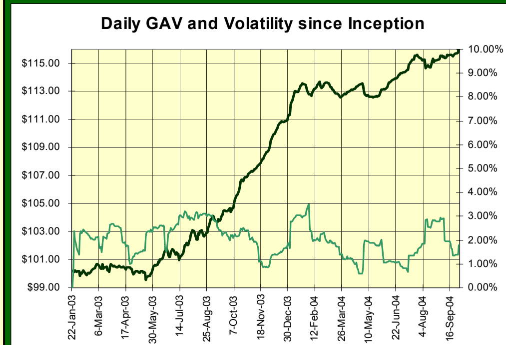
(*) Returns are net of fees (1.5% management fee and 20% incentive allocation of profits. September and Y-T-D gross returns for the Onshore fund are 0.64% and 5.03% respectively)
(**) S&P Index returns are gross returns
(***) The 7-10 year LUCI Corporate Bond Index is compiled by CSFB (ASW=Asset Swap)



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%	
November	1.08%	
December	2.00%	
Y-T-D	8.25%	3.02%
Since Inception		11.53%

AUM: $21.7 million



September Commentary

So what is it? Is it a bull market, or a bear market? And speaking of a market, which market are we referring to? And what does all this mean for the state of the economy? If you are confused, you are not alone! Market developments during September did not provide us with any clues. During the most part of the month, and in the midst of the 3rd consecutive rise of rates by the Fed, the Treasury market rallied, as if we were heading for an economic slowdown. Similarly, equity markets gave up a lot of ground before recovering the lost ground in the last couple of days of the month. Yet, our uncertainty barometer, namely the equity volatility markets (VIX), continued to express complacency by trading at the lows of the year. So, what gives here? High energy prices and mediocre creation of new jobs seem to have weakened the mighty consumers' buying power, impacting consumer confidence and consumption which accounts for 70% of the US economy. Mr. Greenspan tells us that this is temporary. Perhaps! At a minimum, it looks to us that economy maybe slowing enough to walk a fine path of low interest rates, low inflation, and yet produce at least a 2% growth rate. Beyond that, additional clues will be provided by the employment figures. If the economy produces enough jobs to keep the consumer in the game, we are on safe grounds. If the economy does not generate jobs, watch out!

During September, the prevailing economic environment, combined with very favorable technical conditions created the "perfect storm" for the credit markets, providing the impetus for further continuation of the credit tightening that started in late August. The corporate sector, with a very healthy and liquid balance sheet (as evidenced by the low default levels) continues to have relatively low financing needs. As a result, despite the new high set in September, new corporate issuance is running at 25% lower levels than last year (in fact, less if you take into account issuance from financials), while redemptions are continuing at record levels. This comes at a time when falling interest rates have re-ignited the search for yield in a way that we have not seen since last year. The result has been a mad rush to grab anything that offers a spread. Over the past 2 months, demand for synthetic credit products (trances on diversified pools of credits) has been the major driver behind the spread tightening as dealers have been buying spread product across the board in order to put together these products. September witnessed new highs in this activity, driving spreads across the board in. Only during the 3rd week we saw some profit taking that proved short lived. Autos, Telecoms, Energy, Utilities, Media and Technology led the charge, while Healthcare, Retail and Paper trailed the market. Where do we go from here? We think tighter, as long as the prevailing conditions remain intact. Potential clouds in the horizon could come from an unforeseen slowdown in the economy, disappointing earnings reports, shareholder friendly action involving unanticipated transfers to shareholders (large dividend or buyback programs), or LBO activity.

Etolian Capital recorded a net return of 41 basis points (64 basis points gross) for the month. As we have noted several times, trendy (up or down) markets that are associated with falling volatility are not exactly the best environment for our long short strategy. In this regard, September was a challenging month. We struggled to rotate among names in order to identify over and underperformers (increasing turnover) while at the same time trying to tilt the portfolio on the long side within the parameters of our strategy. Our efforts paid off in the later part of the month when the sell-off gave us the opportunity to reposition and reload on several names which significantly outperformed the market on the long side (ATT, Kodak, Nextel, EDS), without getting hurt on the short side in names by being in names that either made us money (Visteon, Maytag) or did no hurt us as spreads tightened. As we enter October, the portfolio continues to be geared on the long side by being 223% long and 211% short (12% net long). The portfolio continues to be leveraged about 4.1 times and contains 47 names, of which 25 names are on the long side and 22 on the short side.

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