Summer - 2007

BARLOW CAPITAL PARTNERS INC.

Dear Clients,

Reality bites. The fallout from the US sub-prime mortgage debacle has started. Years of easy credit and ever more reckless lending standards generated billions of dollars in less than "investment grade" mortgage loans. These loans were then packaged and sold to assorted Hedge Funds and institutions as CDO's (Collateralized Debt Obligations). To earn a decent rate of return the Hedge funds borrowed aggressively to lever their returns. As such it does not take much of a decline in value of the underlying (i.e. the sub-prime mortgages) to wipe out the value of the Hedge Fund's equity.

Last week, we learned of the demise of a Hedge Fund managed by a large US investment bank. The name of the fund is "Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage Fund". No, I'm not joking, that truly is the fund's name. It's full of oxymorons (e.g. High-Grade, Strategy, etc). Essentially, it was a huge bet on the US housing market staying strong and interest rates falling. The result is as expected when billion dollar bets go wrong – billion dollar losses.

Why is the previous anecdote relevant to the management of your portfolio? Because, as prudent Portfolio Managers, we simply will not take that kind of risk to generate what ultimately proves to be ephemeral returns. We must know what we are buying and avoid the "black boxes".

The market volatility we discussed in the first quarter has continued into the second. We are getting a number of days with + or – 1% moves in the indexes. The smaller cap names have become even more volatile. The fund's returns to date in 2007 have been hurt by exposure to the conventional oil and gas service sector in Alberta. To everyone's surprise, the precipitous decline in drilling activity has, unlike past cycles, not resulted in a decline in natural gas inventories. The decline in Canadian production has been more than offset by huge increases in LNG (Liquefied Natural Gas) imports into the US from Europe. It seems there is always some unknown variable that destroys even the most carefully thought-out investment strategy.

On the plus side, we avoided any losses on our fixed income portfolio and our large cash position has acted as a damper on the portfolio's volatility. There are also a couple of private placements that should have closed in the second quarter but were delayed.

The fund is well positioned going forward with a lot of cash, approximately 25% invested in Alternative Strategies (i.e. quasi market neutral), and a fixed income portfolio that shouldn't be affected by a modest increase in the Bank Rate.

A difficult portfolio decision is upon us. The Canadian dollar continues its advance toward parity with the US dollar. Obviously the rapid rise of the Canadian dollar has hurt our return from non-Canadian investments.

The decision to hedge our exposure to the US and International investments is not simple. After such a quick rise, hedging at this juncture may be akin to closing the barn door after the horses are out! Also, hedging is not without cost. If there was an accepted theory about how currencies move, we would perhaps feel more comfortable about coming up with a true or intrinsic value for our dollar.

So, without a roadmap, it's a daunting decision. We are leaning towards a fully-hedged position to simply focus on our stock picking expertise. Longer term, we feel that is the best decision for our investors.

Sincerely,
STEPHEN D. BARLOW
June 30, 2007