FORTRESS European Equity Fund

Investment Review

Fund Highlights

Third Quarter 2009

Market review

It is now one year since the financial crisis unleashed by Lehman's bankruptcy began, and trust in the solvency of the banking system has been significantly restored. Although equity markets remain below their pre-Lehman levels, liquidity has returned, the TED spread (3-month U.S. T-bills vs. 3-month LIBOR rate) and investment grade credit spreads have declined, and volatility has stabilized.

Emergency liquidity programs are likely to be scaled back over the coming months; however, policy makers have signaled that they intend to keep interest rates low until an economic recovery is well underway. Low interest rates and low inflation continue to support bonds.

The MSCI Europe Index had its seventh consecutive positive month in September, and it is now up 14.4% year-to-date. Increased merger and acquisition activity and positive economic data bolstered equity markets but some mixed economic data toward the end of the month triggered profit taking, especially in cyclical assets.

On a year-to-date basis, the Information Technology sector is the best performing sector. The more defensive Healthcare and Telecom/Utilities sectors are the worst performing year-to-date.

Portfolio review

During the quarter, we added new positions in Novartis and OPAP. OPAP is a Greek company with a monopoly in the gaming market. They are the sole betting company in Greece for sports betting (excluding horse racing) and numerical games of chance. The Greek government owns 34% of the company and has granted OPAP a license to continue with its monopoly until 2012. It has very strong cash flow, a very attractive yield (12.6%) and an attractive valuation. OPAP was a new position whereas Novartis was funded by a switch out of Synthes. Novartis is a well diversified pharmaceutical stock trading at attractive multiples relative to the sector.

Top contributing stocks year-to-date:
Performance in Q3 continued along the same lines as in previous quarters this year, with Financial stocks again dominating the best performing stocks list. This quarter in particular, strong absolute and relative performance came from DnB Nor and Banco Popolare Di Milano. Both banks are attractively valued and as sentiment continued to improve, both stocks rallied strongly. DnB Nor has one of the most attractive Tier 1 ratios in the sector with loan growth expected to exceed that of other Nordic regions. It currently trades on approximately 1.1x total book value which is cheap relative to a sector on 1.6x.

Banco Popolare is an Italian bank and, like DnB Nor, has an attractive Tier 1 ratio of 6.5% and an attractive valuation. Banco Popolare trades on 0.9x P/NAV, and P/E of 8x (15% discount to Euro Banks) again at a discount to the European sector. We continue to hold both banks given their attractive valuations. Swatch Group, the luxury watch maker had a very stellar Q3 on the back of solid first half results and a positive outlook for the rest of the year. Sales came in ahead of expectations and prudent cash management lead to stronger cash flow, which the market rewarded.

Bottom contributing stocks year-to-date:
Two out of our three worst performing stocks are U.K. based, United Utilities and Home Retail, albeit for completely different reasons. The U.K. regulator is in the process of carrying out its water review which it does every five years and the market believes that it will not be beneficial for United Utilities. Being a regulated utility, the return United Utilities is allowed to earn is determined by the regulator and the market has taken the view that United Utilities will see its regulated return cut for the next five-year period. We believe that the market may be over discounting the potential cut to its regulated return, but we will evaluate the position post the outcome of the water review.

Home Retail was a star performer in the first eight months of this year rising over 60%, however over the last few weeks of the 3Q. the stock has begun to give back some of its gains. Although Q2 results were in line with expectations, weaker gross margins spooked the market and the stock subsequently sold off. Home Retail, through its Argos and Homebase brands, is attractively valued and continues to be a core holding. Nokia again struggled this quarter as the market continues to fear that increased competitive threats will lead to structurally lower margins and a lower justifiable valuation. These threats are in the high end from Apple and RIM, and in the low end from Korean manufacturers. We continue to believe that Nokia will remain the market leader and the current weakness is overly discounted in current valuations. We will however, continue to monitor the situation for a further deterioration in business

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