

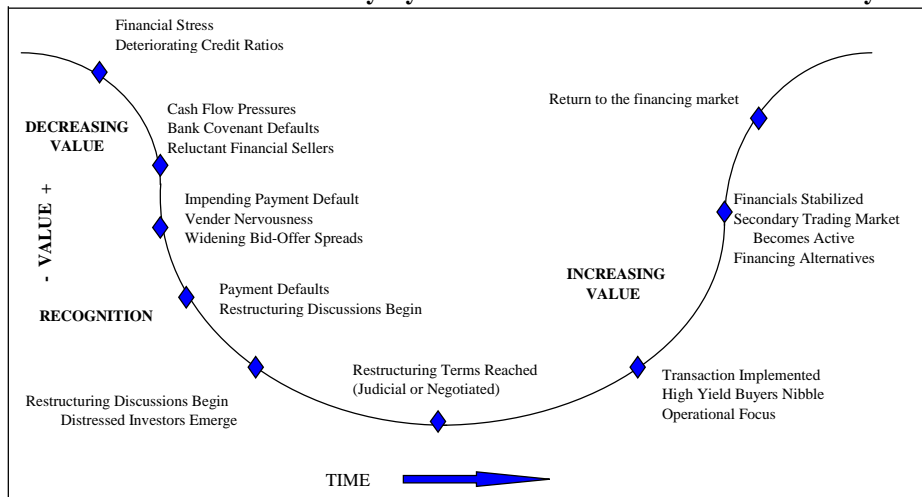
Rationale for Investing in Emerging Markets Distressed Debt Today

Several investors have asked if we could expand a bit on our perception of the opportunity set for distressed investing in the emerging markets space and how that might evolve over the life of the fund. Here is a brief outline of our thoughts.

The Distress and Recovery Cycle

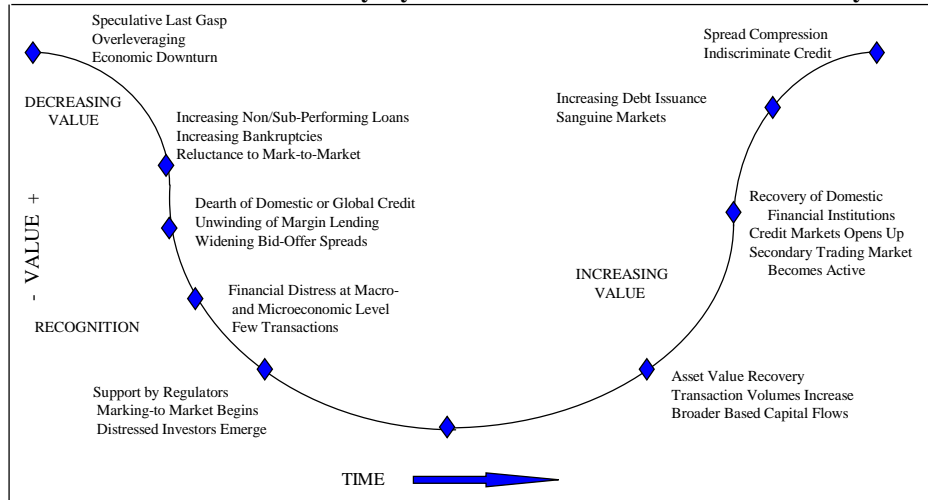
The backdrop for our investment thesis is that there is a well-defined distress and recovery cycle for the valuation of any sort of assets. With regard to debt instruments, there is typically a period of denial that the good times are over after a period of liquidity excess. As the underlying economic factors deteriorate further and as liquidity continues to decline, there is a period of recognition of the problems issuers are facing and a grudging acceptance of the market-to-market realities. This gets reflected both in downward pressure on prices of performing debt instruments as well as in a growing number of defaults on debt. Such defaults occur due to both solvency concerns – the value of assets falling below the company’s liabilities -- as well as liquidity issues – an issuer not being able to meet its contractual debt service requirements. Only as par holders accept the revised market context can the market find its bottom. As the broad underlying economic and financial fundamentals improve, liquidity begins to return to the markets and required restructuring get completed. With this recovery, the cycle again is restarted and valuation levels again begin to rise and required discount rates again begin to contract.

General Distress and Recovery Cycle for Debt Instruments: the Macro Cycle



Just as the distress-recovery cycle plays itself out on a macro level, it also is relevant in understanding events on a micro – the issuer specific – level.

General Distress and Recovery Cycle for Debt Instruments: the Micro Cycle



It is important to note the trading dynamics that typically occur in the midst of this cycle. There are typically two inflection points where most of the secondary market trading activity occurs. The first is where most of the selling activity by primary issue or “par” buyers occurs, which is at the recognition phase of the cycle. At this stage, there is a realization that there is no imminent rebound in sight. Distressed debt investors will understand that prices may not be at the absolute bottom of the cycle but that they are very close. The second is once the economy and the financial markets have bottomed and are well on their way to recovery. It is at this stage in the middle of the upward part of the U-shaped curve that the distressed investors take their profits and the more intrepid high yield and crossover buyers get back involved.

Rationale for Investing in Stressed and Distressed Emerging Markets Debt Today

As of today, there have been fewer than a dozen emerging markets corporate debtors that have defaulted on their debt. Nonetheless, nearly all emerging markets issuers are feeling significant stress. Over 50% of all tradable EM corporate bonds are trading at the levels considered “distressed, which is commonly defined as yield spread levels of over 1,000 bps over US treasuries. There is an extremely large universe of relatively solid corporates across the globe – Latin America, Asia, Eastern Europe – that trade at yields in the mid 20% range, and numerous issuers in weak creditor rights jurisdictions such as Russia and Indonesia trading at yields in excess of 40%. Many of these companies are highly unlikely to default, as they have little debt maturing in the next several years and current debt service coverage ratios remain adequate even under extreme stress tests of their credit metrics. In the current environment, with many prices in the mid-40 to mid-50 range (as a percent of par), there are significant opportunities to invest in a diversified basket of such bonds and generate significant current interest income as well as benefit from the potentially significant capital appreciation as long as there is moderate yield compression into the mid-to high teens.

In the second half of 2009 and through to 2011, we believe there will be a wave of defaults primarily catalyzed by the maturities and amortizations of debt that will not be able to be refinanced. JP Morgan and ING corroborate that there is over US\$210 billion in EM corporate bond maturities and amortizations in 2009 and a similar amount in 2010. In the current environment, very few companies will be able to refinance. We believe this will offer extraordinary opportunities for distressed investment, as there are very few investors willing to purchase emerging markets defaulted debt. This is very different from the US or Europe, where there are numerous funds and institutional investors competing to purchase defaulted debt on offer. This should provide the opportunistic investor in EM debt the opportunity to purchase senior debt instruments in the 15-25 cent (as a percent of par) range, with ultimate recoveries in the 50-75 cent area. Competition in the developed markets has traditionally kept prices far higher.

The strategy for the Gramercy Distressed Opportunity Fund is to develop a diversified investment portfolio at the outset that is heavily weighted toward performing (and likely to remain performing) liquid bonds. While we maintain an opportunistic investment approach, seeking a balanced risk-return profile, the goal would be to have a reasonably diversified portfolio with respect to geographic and industry exposure. We will also consider sovereign and quasi-sovereign situations that offer an appropriate return and risk profile and a high degree of market liquidity.

We believe it is important to have capital available in what is, today, early in the default cycle due to the opportunistic nature of the business. The most important factor in being able to realize outsized investment returns is buying at the right price. As indicated above, there is an inflection point in the micro level distressed cycle where most of the bonds are going to be traded. The Fund needs to be ready to respond to these opportunities when they arise. While the market is experiencing generalized distress, the specific investments targeted will each have their own time.

As the year goes on, we expect to add new investments in defaulted securities, based on the expectations for significant recoveries. In general, by mid-2009, the portfolio might be skewed 80%/20% toward performing credits vs. defaulted debt, although we would expect this to be reduced to 60%/40% by the end of 2009, and less than 25%/75% by early 2011. We would expect to begin the monetization process in the first half of 2012 and complete it by the first quarter of 2014.

Robert L. Rauch
Partner, Director of Research
Gramercy Advisors LLC
+1-203-552-1905
rrauch@gramercy.com
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