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First Quarter Report 2000

First Quarter
Report
2000

Dear shareholder,

Things are slowly falling into place. Our more conservative investment vehicles performed very well during the quarter, the result of a patient, stubborn and very deliberate posture taken many months ago.

By way of contrast, our highly leveraged, speculative funds have yet to find their way. They remain handicapped by poor liquidity and the lack of clearly defined trends. Seeing the slow but definite unfolding of our projected scenario and the way we have already managed to partially capitalize on it gives us confidence in our ability to turn things around in the not-too-distant future.

The interdependence of all markets forces the manager into a “holistic” perspective. These views can best be gathered, we suggest, by reading each one of the comments, regardless of your particular interest.

We thank you for your trust,

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FOREIGN BONDS

FRIEDBERG FOREIGN BOND FUND
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FRIEDBERG TOTAL RETURN FIXED INCOME LP

We are happy to report that our funds gained between 2.8% and 4% (in US dollars) for the quarter. This performance not only exceeds T-bill or deposit rates but, more importantly, it exceeds benchmarks such as the Merrill Lynch Global Bond Index (0.37%) and the J.P. Morgan Global Government Bond Index in U.S. Dollar Terms (0.54%).

To achieve these results –and the results that we are anticipating- was no mean feat. A great deal of patience (ours as well as yours), persistence, intellectual effort, fortitude and discipline were required to restructure these fixed-income portfolios over the past year and one half. We took a great deal of abuse from clients (and former clients) who chided us for not earning "even deposit rates" or worse yet, for losing capital in a presumably safe bond account. While we are not out of the woods yet, and it is not yet clear that we will be able to make up foregone returns, we believe that we will prove the skeptics and nay-sayers wrong.

Since our investment scope is fairly broad, it is important to discuss, if only briefly, the types of investment that we *avoided* — such as foreign currency bonds. We strayed from the US dollar for only very short periods of time, and then, for only a small portion of the portfolio. When we did, we positioned ourselves synthetically, via cost-efficient derivatives. This gave us the flexibility to cut losses quickly, rather than remain married to the trade. The Lipper Global Income Index for example, rose 0.49% and the Lipper International Income Index fell 0.68% during the first quarter of the year.

We stayed away from corporates, let alone high yield securities, These proved to be a minefield littered with professional casualties. Even as bond markets recover from the heavy battering taken in 1999, widening spreads have pushed lower-grade corporates down, the result of growing fears of default. Junk bonds, or bonds of companies with the lowest debt ratings, handed investors losses of 1.6 percent in the first quarter, including price declines and interest, the worst results since the third quarter of 1998, a Merrill Lynch and Co. index showed. They were the only in the U.S. debt securities to post losses in the quarter, even through junk bonds offer some of the highest interest rates to compensate for the extra risk in owning them. As we stated in previous communications, our weighted credit rating never fell below A (S&P equivalent), thanks largely to the heavy concentration of US and Canadian Treasuries and a smattering of other sovereign debt. If the results were not exactly great, at least you could sleep soundly in the knowledge that the capital was protected.

We also stayed away from long maturities (10, 20, and 30 years), which literally devastated many of the finest fixed-income funds in the market. Our portfolios' adjusted duration never exceeded 5 years, and, for most of the time, stayed below 3.5 years.

Admittedly, we made some serious mistakes, too. We did not load up on Brady bonds after the Russian implosion, nor after the Brazilian devaluation nor even after the Ecuadorian default. In retrospect, all of these events presented excellent buying opportunities. Frankly, we did not think, nor do we now think, that the rewards fully compensate for the risks. We were spoiled early on in the game. We bought Argentine sovereign debt in the early to mid-nineties to yield upwards of 50%, when the market was woefully unfamiliar with the workings of a currency board and when

Argentina's total debt (domestic and external) did not exceed 25% of GDP and default was only a remote possibility, Today, yields that exceed Treasuries by 600 to 800 basis points, at best, do not compensate fully for the increasing risk of default by countries that have steadily built up debt over the past five years. The bail-out mentality fostered by the US Treasury and the multinational lending agencies has facilitated much of this debt accumulation; they have been guilty of raising moral hazard among investors to unheard of heights. No, we refuse to play this game; sooner or later, discipline will be regained and reckless creditors will see heavy losses. Lest our investors think that it is easy to maintain our investment discipline, we assure them that we need to repeat every morning and every evening, "There ain't no free lunch."

There were other, smaller, peccadillos. We overstayed our New Zealand dollar debt position, mostly because it was not easy to get out. These convertible issues were extremely thin, even on a good day. We managed to lower quite significantly our exposure to the lower-rated Tran-Tasman converting notes, now down to a maximum of 4.5% of the portfolio. At the present yield to maturity (18% to 19%, depending on various assumptions) we remain indifferent as to selling or holding them. We estimate that they will pay at least this amount in bankruptcy. In the meantime, they are fully current in their interest payments. We are in the process of selling down the second issue, the 9% converting notes of Kiwi Income Property Trust, but given their solid balance sheet, price has become a major consideration. These notes of three years and a fraction trade at yields to maturity of 12.5% to 15.2%, or 550 to 800 points over Treasuries. This is an almost unacceptable price to pay for low liquidity. In the meantime, we have neutralized the currency risk by executing a forward currency hedge.

Our ace position remains the inflation-linked government securities issued by the US and Canada (more of the latter than the former in the Canadian Foreign Currency Bond Fund), which represent between 68% and 72% of the various funds. We wrote at great length about these bonds and their exciting prospects in our 4th Quarter Report of 1999 and in the firm's Currency and Commodity Comments of January 30 and March 28, 2000. Complimentary copies are available on request. We believe that these bonds will generate very high total returns over the coming year, the kind of returns that should justify investing in a bond fund rather than keeping money in the bank.

Rounding out our positions are Turkish lira-denominated T-bills, the bulk of them maturing in early May and yielding an expected 12%; Argentine Bocon dollar denominated bonds, expiring next year but amortizing monthly and yielding 10.08% to maturity (on the bid side); and TVX Gold 5% of March 2002, a note linked to the price of gold bullion and repayable at par on maturity in shares of TVX (unfavorable outcome) or cash. All of these investments account for anywhere between 8.9% and 25% of the various funds (regulatory constraints prohibit the Canadian Bond Fund from owning more than 10% in the Turkish T-bills).

We are looking forward to another good quarter.

DIVERSIFIED TRADING PROGRAM

FRIEDBERG DIVERSIFIED FUND
FRIEDBERG DIVERSIFIED POOL

Strangely, our greatest disappointment was the trade in gold. Strangely, because it represented almost the only trading gain during the quarter, a period that was dotted with intermittent losses in stock index futures (still probing the short side), crude oil (prematurely trying to pick a peak) and cocoa (still trying to find the elusive bottom).

But it was gold that disappointed. For one thing, the phantom of massive demonetization had been lifted with the Washington agreement. For another, inflation had begun to stir, supported by firming commodity prices. Finally, the feeling that forward hedge selling had become slightly discredited raised our hopes that the mining companies' large hedge book was about to contract and thus provide extra support for the market (or, at the very least, eliminate excess selling pressures). After a very sharp, one-day rise, which saw prices challenge the $320.00 levels, prices began an agonizingly long and steady decline. Along the way, nearly paralyzed by the irrationality of it all, we managed to rescue some of our evaporating profits by selling options and trading against a long call position. Unfortunately, this mis-step did not lead us to conclude that the Fed had gained some time, as it should have, and that financial markets had gained a new lease on life that was going to be translated into higher stock prices. This led to mistake #2, the costly probe of the short side of the stock indices.

By now, the proposition has been pretty well confirmed and the lesson absorbed. The Fed will do little "monetary" damage as long as inflation — now running between 2.5% and 3.2% per annum — does not accelerate. The liquidity-driven stock markets will continue to bask in their glory, though leadership may change. Inflation will become a more serious problem if and when commodity indices can rise another 5% to 10%, preferably not exclusively on the back of oil. Because breadth analysis points to continuous strength, the odds of making money on the short side of commodities are low. Therefore, we will be looking to capitalize on bull moves in the most liquid principal commodities. At the same time, we will be making leveraged purchases of inflation-linked bonds that should benefit even from a more moderate inflationary scenario. We are confident that by remaining consistent to these views we will achieve excellent results for the balance of the year.

CURRENCY PROGRAM

FRIEDBERG CURRENCY FUND
FRIEDBERG CURRENCY FUND LTD.
FRIEDBERG FOREX LP

Performance for the quarter was yet another case of decent insights and forecasts coupled with horrendous implementation.

At the beginning of the quarter, we had anticipated a weaker euro vis à vis the U.S. dollar and the yen. Both outcomes were realized, but extremely choppy conditions forced us out of our over-leveraged positions prematurely, causing severe losses. In fact, these two trades account for the entire quarterly draw-down of 18% to 19%. In retrospect, all the losses could have been avoided and a profit would have been achieved had we maintained a much smaller and thus more comfortable position. The key mistake: failing to foresee the huge volatility around the down-trending euro.

Because the euro and the yen find themselves at critical levels, each for its own reason, volatility is likely to remain high. Therefore, the risk/reward ratio of betting on a continuation of the present trend, i.e. lower euro/higher yen, is poor. For a much safer and infinitely more profitable trade one would have to wait for the present trend to reverse. Is that in the cards?

We think it is. For various reasons, a number of currencies have strayed from their established equilibrium. Sterling, for one, has been buoyed by some improvement in secular productivity and labor market flexibility but mostly by normal cyclical forces. Official thinking is that prior to joining the euro, the English unit will need to make a U-turn and return to more sustainable levels. Timing this return trip, however, will be an extremely tricky feat. No doubt, sterling will soften with a deceleration of inflationary pressures and/or a cyclical downturn in the economy (still some time away) or, more perversely, with a "falling behind the curve," where the Bank of England, in its desire to see a lower pound, follows a much too accommodative monetary policy. It is more likely, however, that the currency will continue to over-shoot in the near term, given cyclical pressures. Following trends into an over-shoot area is not worth the increased risk of volatility. So, for now, we wait on the sidelines.

Much the same can be said about the US dollar, moderated by the fact that no major currency has arisen as yet to bear the burden of the international role played by the American unit. What will it depreciate against? The Euro is the easy answer, but if so, it is merely by default. Fortunately, one need not make a powerfully bullish case for the euro to capitalize on the dollar's return trip. It can as easily float around 90 cents as around 1.15. The lower end is finding a great deal of political resistance, the more so the lower it digs into it. Thus, volatility (choppiness is perhaps a more appropriate word) becomes unbearable as we approach the 90 level. On the other hand, the return trip – a weaker dollar/stronger euro – finds much less resistance and perhaps the tacit encouragement of US officials, struggling as they are with a gigantic, and still widening, current account deficit. In the near term the dollar is likely to continue to over-shoot, supported by massive portfolio inflows. In the end, however, the trend will revert in response to a sizeable stock market correction and/or a generalized appreciation that the absorption of gushing dollar balances depends too much on flighty confidence factors. As in sterling, the path of least resistance for the U.S. dollar (couched in potential political interference terms) is downward and the profit potential is considerable.

A short word on the yen. It is quite clear that, left to market forces, the yen would appreciate substantially from these levels. The reasons are quite complex but mainly technical, not economic; this is, however, not the forum for such a discussion. Economic recovery continues to be hampered by a relatively tight (in quantitative terms) monetary policy coupled with a strong currency, in the absence of a good institutional mechanism to bring about liquidation of inflated assets (mostly land). In other words, the yen, in *real* terms, is too high for the health of the economy. It can be brought down by a substantial fall in asset prices or by an artificially induced fall in the foreign exchange value of the yen. Since the first option is politically difficult (it would bankrupt many more banks), the second option is almost inevitable. The potential *big picture* play, therefore, is to look for a selling opportunity.

To conclude: Short-term trend-following opportunities — that run counter to sustainable long run equilibrium levels — still exist in the major currencies. Unfortunately, they run into strong political headwinds, bringing an unacceptably high degree of volatility. It was this volatility that frustrated our best intentions, leaving in its wake a trail of losses and disappointments. We must therefore focus on the inevitable return trips. This implies perhaps relatively long periods of inactivity. Like the cheetah, we must lie in wait, immobile, focused on the most minor change in winds.

FRIEDBERG FUTURES FUND

The Futures Fund combines the Currency and Diversified programs in approximately equal weights. Please refer to our earlier comments regarding these programs

FRIEDBERG GLOBAL OPPORTUNITIES LTD. INTERNATIONAL FUND

The Global Opportunities Fund comprises the Diversified Trading Program and the International Fund. Comments in this section will cover the International Fund only.

Perseverance has paid off. Not only did we manage to extend last quarter's recovery but the pace accelerated. Our portfolio gain 10.6% for the period under review.

We believe that the most important indicator of being on the right track is the fact that the portfolio remained essentially unchanged from December 31. The largest exposure continues to be our short position of eleven regional Japanese banks, representing approximately 55% of the portfolio. Taken with the currency hedge so as to neutralize the short yen exposure, the position contributed 1.5 percentage points of the overall performance — a satisfactory result considering the U.S. dollar adjusted 6.85% rise in the Nikkei 225 stock index. We continue to believe that these entities are headed into liquidation, laden as they are with non-performing loans and falling real estate collateral and operating in an environment of razor-thin returns on assets.

In the Asian sector, we continued to benefit from our short position in two large, old-economy, South Korean companies that we used as a proxy for the entire market. (We have already lamented, in past communications, our inability to short the overextended banking and financial sectors, now in full retreat). During the quarter we liquidated the entire long position in the Turkish Investment Fund at a substantial profit.

We "touched up" our European spread position, long Dutch and Finnish banks and short an equivalent amount of Italian and Spanish banks, which acts as a proxy for expected relative economic performance. We replaced the Spanish bank Argentaria with two Irish banks, Allied Irish and Bank of Ireland, to capitalize on deteriorating credit conditions in Ireland. In addition, we covered part of Rolo Banca and reallocated proceeds to a new short position in Banca Intessa (all Italian banks), so as to minimize merger risk. The inter-European "spread" contributed 3.4 percentage points to the overall gain for the quarter.

Finally, during the quarter we purchased the longest maturing (due 2028) US Treasury Inflation Protection Securities (TIPS for short) — our favorite fixed income play — to re-establish a (shorter maturity) position that had been liquidated towards the end of last quarter. These securities have been favorably financed with six-months repo's. In recent weeks, the TIPS have firmed up considerably, contributing 2.8 percentage points to the fund's performance.

The only negative contribution to the portfolio (less than 1 percentage point) came from our long exposure in the New Zealand equity market. This position was being wound down during the quarter and is likely to be completely eliminated before the end of the June.

A semblance of reality has returned to some markets, though clearly not all of them (witness the continuing Ponzi-like speculation in the Nasdaq and in some of the high-tech-laden European exchanges). Markets have become slightly more discerning, marking down financial dead-beats, as in Japan, differentiating genuine from cosmetic improvements, as in South Korea, and rewarding the relatively healthier economic environment among member European states. While the trend has moved in the right direction there are, in our opinion, substantially more gains to be extracted. Moreover, our fixed-income position is still not being priced rationally. The market is projecting an absurdly low 1.95% inflation over 28 years, in the face of a current running rate of 3.2%. A more rational pricing structure should benefit us considerably.

EQUITY HEDGE PROGRAM

FRIEDBERG EQUITY HEDGE FUND LTD.
FRIEDBERG EQUITY HEDGE FUND

We are pleased to report another exceptional quarter, up 23.9% and 28.7% respectively for the two funds, after all fees and expenses.

We take particular pride in two decisions made in the course of the quarter, one tactical and one strategic. The tactical change involved deleveraging the portfolio on March 3, to approximately 1.3 times capital from our more standard 2.6 times. We took this decision in light of the extraordinary volatility shown by the more speculative sectors of the market — biotechnology and small caps in particular — and because we began to feel uncomfortable with the rarefied valuations expressed by the bulk of our long proxy, i.e., the Russell 2000 index. The latter, having served us extraordinarily well for the past half-year (refer to our last two quarterly reports), was no longer a sensible peg, we felt, on which to rest our long hedges.

The second step related to a deliberate strategic change taken around mid-March and was closely related to the rationale discussed above. Specifically, we exited the balance of the long position in the Russell 2000 index and the biotechnology stocks, which had represented as much as 85% of our long exposure and replaced them with a package of highly liquid, super-large capitalization securities. We chose these 11 stocks with great care, anticipating what we believed was going to be a subtle shift away from Nasdaq-type, new economy stocks towards growth blue chips. In effect, we reasoned that the failure of the heretofore leaders would create a vacuum in the many institutional portfolios that are committed to holding equities come what may. The shift had a dramatic effect on our portfolio. Our blue-chip package (and we will treat it as a package until such time as, at the bottom of the next bear market, we discover true values) gained 8.08% even as the S&P 500 gained 7.3% and the Russell 2000 *lost* 10.3%. To the end of the quarter, the 5 biotechnology issues that we owned and sold lost an astounding 53% in that short period of time.

These two decisions saved the day. In the turbulent month of March, when a great many legendary hedge funds gave back most of their gains for the year, we managed to retain almost all of February's 32.2% gain (basis the Cayman Hedge Fund). In this game it is not always what you make, but what you do not lose, that counts. For the fortune that we kept, we are both grateful and gratified.

Among the four largest winners on the long side during this quarter were once again three biotechnology issues: Cor Therapeutics (+194%), PE Celera (+95.4%) and Cephalon (+54%). These stocks were liquidated, as we noted earlier, between mid-January and mid-March. On the short side, our three largest winners were Conseco (+36%), a short position that we initiated in August 1998 at $40.00 and which ended the quarter at $11.44, and two Internet issues, MP3.Com (+33.7%) and Ask Jeeves (+32.5%).

Our leverage remained between 2.2 and 2.69 times capital until early-March. At that time, as discussed earlier, we pared down positions to 1.3 times capital. By the end of March, leverage had increased slightly to 1.53. We intend to build back leverage levels in line with the comfort that we can draw in our new strategic posture. Long-to-short exposure remained bound by a very narrow range, 57.7/42.3 (early January) to 52.1/47.9 (early February). At quarter's end, our long-to-short ratio stood at 55.6/44.3. Understandably, the greater beta (volatility) of the smaller short position made up for its lower participation, thus keeping our portfolios basically market-neutral. Investors will recall that, in fact, our funds' objective is to achieve returns in the range of 20% per annum by employing market-neutral strategies.

As stated at the opening of this piece, the first quarter's results were quite exceptional. By this, we mean rare and not easily duplicated. We hope for, but do not *expect*, similar results in coming quarters. Nevertheless, we are satisfied that there is no lack of opportunities in this highly divergent environment of small cap versus large cap, new economy versus old and value versus growth

NEW ZEALAND

FRIEDBERG NEW ZEALAND FUND LIMITED
NEW ZEALAND EQUITIES FUND
FCMI KIWI EQUITIES FUND
TORONTO NZ EQUITY TRUST

This will be perhaps our last comment on the New Zealand funds, as we are in the process of winding them down.

As expressed at the end of last quarter, New Zealand equities were one of the greatest disappointments in our professional career. The return of the Toronto NZ Equity Trust to 31, 2000, from inception, (in U.S. dollar terms) was a mere 71.8%, or a compounded return of 6.2%.The reason for their underperformance remains a major puzzle. It may have been that the population never really "took" to the enormous and very positive economic reforms implemented between 1984 and 1998 (more particularly, 1984-1990) — the proof being the recent election of the most left-wing government in the developed world — and the stock market understood this. Or perhaps the reason was that the Reserve Bank maintained the tightest and least accommodative monetary policy in the OECD (or anywhere, for that matter). Some day, this writer (when he finds time) hopes to conduct a post-mortem to find out why some equity markets soar while others remain near moribund despite similar fundamentals.

As stated last month, we placed tight stops on our remaining positions These defensive stops were executed for nearly all stocks, leaving us long just one real estate issue. As soon as a firmer tone is evidenced, we shall dispose of this issue too, wind down the funds and distribute the proceeds. As we write, partial distributions are already in progress.

SKILL BASED FUND

The Skill Based Managers Fund registered negative returns totaling 1.89% during the quarter. On the positive side, volatility and correlation to the S&P remained exceedingly low. Almost all the poor returns are the result of the allocation made to Friedberg's own Futures Fund, (which is an amalgam of the Currency and Diversified funds). Allocations to convertible and risk arbitrage strategies, and to our long short value strategy performed nicely, and conditions remain favourable for all three. We are less than sanguine about the performance registered by our market neutral/futures specialist and, as of just this writing, have elected to remove him from our list. Finally, at the end of March we re-balanced the portfolio as we do every six months.

FRIEDBERG RECOMMENDED ALLOCATION MODEL

Neil Rackoff comments:
The Friedberg Recommended Allocation Model returned 4.66% for the quarter.

Our parting words in the forth quarter performance report were a quote from Benjamin Disraeli: "The secret of success is the constancy of purpose." We can not agree more.

In the past quarter we have witnessed the closing of at least 2 well known hedge funds, one having lost 42% and the other 15%. As of the writing of this quarterly report, we have lived through an over 13% daily move in the NASDAQ and the forced liquidation of at least one day-trading firm. No one can doubt that the storm is on the horizon.

We are prepared however, as the manager has outlined in the previous comments. We continue to encourage our clients to take a portfolio view of the manager and to investigate how the manager is allocating ***his*** money. This will provide the steadiest ride.

The recommended allocation going forward is:

Fixed Income – 65%
Equity Hedge – 15%
Currency - 10%
Global Opp. – 10%

Note: important tax information for limited partners of the Canadian limited partnerships

We have received many phone calls and e-mails asking why in many instances, partners in the Diversified, Currency, and Futures Funds were allocated positive income for the 1999 taxation year when, apparently, these Funds did not make profits. Please excuse us - clearly we should have anticipated that many partners would have been confused, and we should have thought to include an explanatory note with the 1999 T5013 slips.

Please note that the following discussion does NOT apply to all unitholders; it does apply to the majority of unitholders who held the same number of units of the Fund throughout all of calendar 1999 (and, where referred, the same number of units in all of calendar 1998). Where this scenario is not applicable, there will be other specific factors which influence the positive or negative incomes a partner has been allocated.

Essentially the confusion resides in the difference between the way Revenue Canada and investors think of income within these Funds. Investors calculate how their investment is doing by referring to the Net Asset Value (NAV). Changes in the NAV arise from "accounting" income, which includes both realized and unrealized gains and losses. An unrealized gain or loss simply means a gain or loss on a position that is outstanding, or open. For tax purposes Revenue Canada is concerned only with gains or losses that have been realized—or, to use their jargon "crystalized." The sum of all crystalized gains and losses is called "taxable" income.

Referring now in greater detail to the T5013 slip:
Box 18 income (which is your share of the taxable income of the fund) does not directly relate to your box 10 percentage ownership. Box 10 is your percentage ownership of the fund, but only as of December 31, 1999. Your box 18 income represents the total of 12 monthly allocations of taxable income based on your percentage ownership at the end of each month. Additionally, box 29 represents the gross accounting income of the fund for the year..

Because box 18 represents a share of taxable income, and box 29 represents gross accounting income, it is virtually inevitable that they will never be the same, and it is possible for one to be positive and one to be negative in one year. This is precisely what happened in the 1999 tax year. Both funds carried unrealized profitable positions from 1998 into the year and liquidated (crystalized) them early in the year. In the 1998 tax year the reverse happened.

This is illustrated by the following situation: For those unitholders of the Funds throughout 1999 who were allocated taxable income, and who held units throughout all of 1998, remember that you were allocated a LOSS on your 1998 T5013 even though the net asset value of the Funds was essentially the same as at December 31, 1997 and 1998. The unrealized gain as at December 31, 1998 was realized in January 1999, giving rise to the loss for tax purposes which was allocated in 1998 and the gain for tax purposes which was allocated in 1999 (and which is the source of many of your queries).

Of course over the long run the funds' taxable and accounting income will balance out. What makes it tough to take this year is the whammy coming when performance has been so damned dismal. We hope (and assume) that next year at this time we will have reason to feel better.