THE ALITIS MONTHLY UPDATE

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What To Do About Europe?

Portfolio Considerations

Europe as a whole is a very large economy that, under normal circumstances, would have a sizable investment allocation made to it. However with all the economic, political, and market uncertainties within the region, **the only prudent course of action when managing a portfolio is to minimize exposure to Europe**. This is exactly what we have done within the Alitis Pools.

Within the Alitis Growth Pool, the current tactical asset allocation is to have 5% of the assets invested in European stocks. This 5% is the minimum allocation allowed under the restrictions that have been set for the Pool. Within the Alitis Strategic Income Pool, the current tactical asset allocation for foreign bonds is 10% of the assets, which is the minimum allowed under our investment restrictions. Of the allocation to foreign bonds, only about 30% is presently in European bonds — mostly in German, French, and British bonds (about 3% of total assets). Since the Alitis Income & Growth Pool is roughly a 50/50 mix of the growth and income mandates, this Pool has about 2.5% of assets in European stocks and 1.5% or assets in European bonds.

Approximate Exposure to European Investments

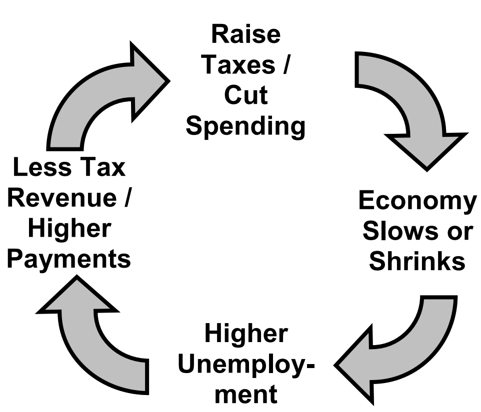
	Alitis Strategic Income Pool	Alitis Income & Growth Pool	Alitis Growth Pool
European Bonds	3.0%	1.5%	0.0%
European Stocks	0.0%	2.5%	5.0%

The Problems in Europe

The crisis in Europe is fascinating in the sheer breadth of inter-related issues that have come to a head all at the same time. The root of the problem is that most countries in Europe borrowed money to pay for immediate spending on government programs. This is perfectly fine if a country's economy grows faster than its debt. However, in Europe debt grew faster than its economy — particularly in Greece, Ireland, Portugal, and Italy. To make matters worse, this debt was added during good economic times. When the economic outlook darkened, the ability to service accumulated debts was called into question and the current crisis of confidence ensued.

Countries like Britain maintained control over their own currency and have the ability to do whatever it takes to ensure repayment of debts, such as creating more money, lowering interest rates, or weakening their currency. Within the Euro area, individual countries do not control their interest rates, the money supply, or the exchange rate of the Euro — these are controlled by the European Central Bank (ECB) and related entities. The only way for a country within the Euro area to make independent economic adjustments is for the government to enact fiscal policies to save money during the good times so money is available to help the economy during the bad times. As mentioned earlier money was not saved during the good times and now that the bad times have arrived, unpleasant decisions have to made at precisely the wrong time.

A Vicious Cycle



Without the help of the ECB, governments in the Euro area have to stop adding to their debt by raising taxes and/or cutting spending. The problem is that this creates a vicious cycle that causes economic problems to get progressively worse and makes countries even less able to pay for their existing debts. Who would want to lend money to a country in this situation? Apparently very few people at the moment, and they want a higher interest rate to cover the extra risk!

That is the situation as we see it — not good — and why the Pools have a very low exposure to Europe. We hope the Europeans can fix their problems, but this is not something that can be fixed overnight or by hosting another emergency meeting. Remember that Canada had a huge debt problem in the early 1990s which took 10 years to bring under control during the good times!

Be assured the Alitis Pools are positioned to minimize risk and ready to seize opportunities as they present themselves.

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