



C A M B R I D G E A S S O C I A T E S L L C

EUROPEAN MARKET COMMENT: THE EURO

August 31, 2001

Celia Dallas
Robert Lang
Stuart Wall
Laura Brooks
Jenny Chan

Copyright © 2001 by Cambridge Associates LLC. All rights reserved.

This report may not be displayed, reproduced, distributed, transmitted or used to create derivative works in any form, in whole or in portion, by any means, without written permission from Cambridge Associates LLC. Copying of this publication is a violation of federal copyright laws (17 U.S.C. 101 et seq.). Violators of this copyright may be subject to liability for substantial monetary damages. The information and material published in this report are confidential and non-transferable. This means that authorized members may not disclose any information or material derived from this report to third parties, or use information or material from this report, without the prior written authorization of Cambridge Associates LLC. An authorized member may disclose information or material from this report to its staff, trustees, or Investment Committee with the understanding that these individuals will treat it confidentially. Additionally, information from this report may be disclosed if disclosure is required by law or court order, but members are required to provide notice to Cambridge Associates LLC reasonably in advance of such disclosure. This report is provided for informational purposes only. It is not intended to constitute an offer of securities of any of the issuers that are described in the report. This report is provided only to persons that Cambridge Associates LLC believes to be "Accredited Investors" as that term is defined in Regulation D under the Securities Act of 1933. The recipient of this report may not provide it to any other person without the consent of Cambridge Associates LLC. Investors should completely review all Fund offering materials before considering an investment. No part of this report is intended as a recommendation of any firm or any security. Factual information contained herein about investment firms and their returns which has not been independently verified has generally been collected from the firms themselves through the mail. We can neither assure nor accept responsibility for accuracy, but substantial legal liability may apply to misrepresentations of results delivered through the mail. The CA Manager Medians are derived from Cambridge Associates LLC's proprietary database covering investment managers. Cambridge Associates LLC does not necessarily endorse or recommend the managers in this universe. Performance results are generally gross of investment management fees and do not include returns for discontinued managers.

The inaugural years have proven to be a tough ride for the €, with the currency weakening 22.6% against the US\$, 18.4% against the yen, and 11.3% against the £ between its January 1999 inception and the end of August 2001. On a trade-weighted basis, the € has depreciated 14.7%. However, July and August appear to have brought signs of a trend reversal, with the € strengthening 3.8% on a trade-weighted basis and 7.3% against the US\$. The recent rally has led to speculation that the € may be embarking on a prolonged bull market.

The US\$ has appreciated significantly relative to euro-zone currencies since 1995, largely benefiting from a surge in euro-zone investment, both in the form of portfolio flows and direct investment. BP's purchase of Amoco, Daimler's purchase of Chrysler and other major transactions led to demand for hundreds of billions of US dollars. In theory, recent US\$ weakness reduces the cost for euro-zone companies to acquire U.S. companies, suggesting that the current environment could lead to greater foreign direct investment inflows to the United States. However, this is unlikely given that many euro-zone firms are coming off a massive investment binge in the United States, and the next few years will likely be spent integrating/digesting their U.S. operations.

The recent strength of the € relative to the US\$ is also based on relative economic prospects and the relative attractiveness of assets in both markets. Euro-zone economic fundamentals are not impressive, particularly in Germany, which accounts for a third of the region's GDP. However, relative to the United States, the recent trend has been favourable. Since June of last year, U.S. growth has slowed from 4.4% to 1.2% year-on-year, whereas euro-zone growth has only slowed from 3.3% to 1.7% thanks to strong household consumption. The outlook for the U.S. economy was deteriorating prior to the terrorist attacks in the United States and the uncertain impact of recent events on consumer confidence will be critical in measuring the extent and protraction of the downturn.

The outlook for the €/US\$ exchange rate clearly hinges on the relative strength of the U.S. and euro-zone economies, and the outlook for relative capital demand in particular. The most rational explanation for the recent € strength has been the change in expectations on the timing and strength of the economic recovery in the United States, and downgraded expectations for the trend growth rate, and return on assets. At present, eight of the ten largest investment banks believe that the € will hold or extend gains from this rally.