

As 2012 begins, we would like to use this inaugural quarterly letter to review the challenges of last year and the exciting opportunities that lie ahead. 2011 was a difficult and humbling year. Micro catalysts had little bearing upon stock prices as fear from macro headlines overwhelmed. It was a year where there was a negligible bid for risk and distressed assets, yet investors seemed to pay any valuation for any excess "safe" yield above treasuries. Reserve depletion and increasing operational setbacks continued to be an ongoing issue for many of the world's major producing energy and mining companies. Nevertheless, broad fear, confusion and inertia due to macro concerns and headline risk seem to have set-in with many management teams and boards. The next generation of world-class assets in good jurisdictions, are now trading at incredibly cheap valuations. We know this will not last forever, lest the major producing resource companies continue to deplete their resources over time. The need to replace reserves with the next generation of world class assets is inevitable; it is a question of when and not if...

Enso entered 2011 after two successive years of very good returns (up 76.8% net in 2009 and up 74.3% net in 2010). At the very end of 2010, there was a flood of positive momentum in the resource space and many of our positions did very well into year-end. These year-end marks set up the portfolio for some disappointment this year as much of the moves of late last year were partially reversed in 2011. The portfolio ended down 63.0% in 2011. One of our biggest mistakes, as was the case with many other funds, was not increasing our absolute shorts. Enso has always eschewed hedging for hedging sake but increasing our fundamental short book is something we should have focused on more. As many of our positions today have been held for well over a year, we still have imbedded gains in numerous positions and not seen any fundamental value impairment.

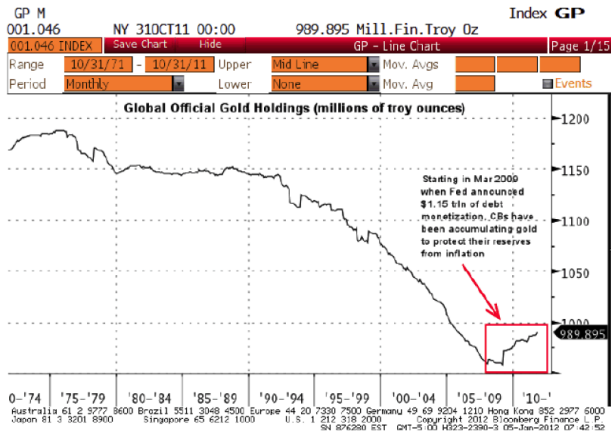
During the second half of 2011, we engaged in portfolio triage by selling out of names where we had less conviction, given the current macro environment, and adding to positions in the sell-off where our fundamental long-term conviction was un-diluted by the

current volatility. This has been, and will continue to be, an ongoing process. One of the key factors in assessing our portfolio through this volatile period is the risk of fundamental value impairment - versus potential mark-to-market impacts. Our companies need to be able to weather the storm if capital markets stay closed for all of 2012. Management teams need to be able to advance their company and assets operationally even if, in a worst case scenario, no bid returns to our stocks in the next year. Stocks that have no options beyond large highly dilutive in-the-hole equity financing in 2012 have been sold from the portfolio. We do not believe that the market today properly reflects the intrinsic and private market value of our top holdings. We also believe that our core holdings will all be able to bring their assets significantly up the value-curve in 2012.

One of our major themes we see for the coming year is the continued outperformance of gold. It is a perfect storm for gold as we believe the bubble is not in fact in gold, but in paper currency. Global budgetary and debt issues have caused many nations (most notably the US) to print money. Central bank selling of gold from end of Bretton Woods in 1971 to 2009 has reversed and we now see massive central bank buying (see graphic below). Debasing currencies seems to be the universal solution for solving these issues and, as a result, gold is being re-monitized. There is also significant buying by retail investors in countries with negative real rates in order to preserve wealth. We don't believe in a return to the gold standard but as gold only today represents less than 1% of all financial assets, if even a small fraction of paper currency is used to buy gold the impact is massive. There are also issues on the supply side as old mines continue to age and labour problems and cost inflation become more of an issue. We see incredible value in gold mining shares which have underperformed the price of gold as part of the risk-aversion trade of 2011. This value is especially true of the next generation of top-tier gold assets, which are increasingly becoming difficult to discover.

Another theme we are focused on is for the market to place much higher valuations on resource assets in safe jurisdictions. In the past, we tended to invest with a more agnostic approach when it came to

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Source: Enso/ Bloomberg, 2011

the location of assets (versus the country of listing). However, we believe that there are two strong countervailing trends that will widen the valuation gap between those assets in the developed world versus those in emerging markets. On one hand resource nationalism (changing royalty rates, tax rates, expropriation, etc) continues to increase as countries look to find a way to get a larger share of the resource pie. On the other hand, in many developed nations, where the rule of law is more sacrosanct - high unemployment, municipal, state and federal budgetary issues and the increasing desire for more domestic industry versus imports will make the permitting process easier. We believe that the discount rate differential for jurisdiction will widen with time as industry and markets start to recognise these countervailing trends.

European shale gas continues to be a focal theme of the portfolio and we believe that 2012 will have multiple catalysts to realize value. While the first couple of wells drilled in Poland have not been huge successes, they also have not been failures and do show significant gas in place. It is very early days and we expect companies to adjust their completion techniques until they find the right formula. Each shale basin is different and the ultimate well optimization will take time to figure out the right mix of proppants and frac fluid mixtures. It is only after testing initial wells that a company can start to see what works the best. In the US shale basins, for example, it sometimes took years for initial production rates to multiply due to the well optimization process. Poland should see numerous new wells drilled in 2012 and we expect to see significant improvement with the initial tests behind them. The economics of shale gas in Europe are still outstanding. While gas prices in the US languish around \$3/mcf, gas prices in Europe are still over \$10. There is also enormous government support in Poland for shale development so that the country can move away from their large dependence on Russian gas imports.

The fund owns positions in both San Leon (which purchased Realm Energy in 2011) and BNK Petroleum. Both of these companies own large shale gas land packages in the Baltic Basin of Poland and across Europe and have large drilling programs planned in 2012. We believe both companies have outstanding management and technical teams, which will be key as these exploration companies evolve into development companies.

We also continue to see incredible value in story-specific names in our portfolio. US Oil Sands (USO) continues to advance their oil sands project in Utah and we are expecting an updated resource report and final engineering report early in 2012. USO will likely start discussions on bringing in a JV partner in order to help fund the project so that they can minimize equity dilution. Canadian Overseas (XOP) is another name that we expect a lot from in 2012. The company had a few successful oil wells drilled in the North Sea in 2011 and they also completed a great deal with Exxon Mobil, which gives XOP a free carry on a well to be drilled in a highly prospective oil block in offshore Liberia. Both USO and XOP had great years operationally but both have yet to receive any attention from the street. We expect this to change over the next year.

Joshua Fink recently joined The Electrum Group LLC ("TEG") as its Vice Chairman, and Enso Capital Management LLC simultaneously entered into a Consulting Agreement with TEG. TEG is a privately-held global natural resources investment management company led by Dr. Thomas Kaplan. Dr. Kaplan is an entrepreneur and investor with a track record of both creating and unlocking substantial shareholder value in public and private companies, including Leor Exploration & Production LLC, a natural gas exploration and development company founded by Dr. Kaplan in 2003 and sold in 2007 for \$2.55 billion to Encana Oil & Gas USA Inc., a subsidiary of Encana Corporation. TEG and its affiliates have an impressive technical team of geologists, mining engineers, petroleum engineers, etc. which we believe will be accretive to Enso's informal network of industry players, potentially helping us in our due diligence and evaluation process. To avoid any potential conflicts of interest, we have agreed to place the securities of any companies managed by TEG on Enso's restricted list.

We would like to reiterate that we are committed to the portfolio and committed to investors. Our business is well capitalised and we are just as focused and excited as ever. We have enormous conviction in the portfolio and in our investment process. We think that the majority of the positions in our portfolio are trading at a fraction of NAV and we think the risk of fundamental value impairment is low. Though 2011 was clearly disappointing, we are very optimistic about the future and believe our best days are ahead of us. Enso continues to take a private equity-like approach to public markets. This approach does create a good degree of short-term mark-to-market volatility. However, we believe that this approach will pay dividends

to our investors over a longer time horizon.

Wishing everyone success, health and joy in 2012.

Thank you for your continued interest in the Fund. For further information, please contact your regional Arrow Capital representative.