

The Raven Rock Income Fund returned -1.1% during the month of November, bringing our 2011 year-to-date return to +4.9%. Macro issues dominated market sentiment in what was a volatile trading environment. Uncertainty over Europe's ability to resolve their financial crisis peaked when Italian sovereign debt yields rose above 7%, triggering broad concerns in the market. Financial data in the U.S. was mixed, with strong earnings reports offset by a lack of progress on reducing the budget deficit. The month ended with a bang as a multilateral agreement to reduce the stress on European banks led to a 4.3% jump on the S&P 500 to bring its return to -0.49% for the month.

The High Yield market experienced the effects of investor skittishness, moving down 2.21%<sup>1</sup> for the month (ML High Yield Master II Index). The trends of October carried over into the first few weeks of November, with strong fund inflows coupled with heavy new issuance to absorb the new capital. Risk aversion then took over, leading to net outflows on the month and credit spread widening of 69 bps to finish November at 776 bps. The market withstood the most monthly defaults since 2009, with 6 defaults totaling \$9.3 billion of bonds, including AMR, Dynegy, and PMI Group. Despite November's activity and wide credit spreads, the default rate in the High Yield market is expected to remain near its current rate of 1.7% over the next two years.

The Raven Rock portfolio endured this difficult market relatively well, as our losses from Directional Credit were somewhat offset by profits in Relative Value positions. The choppy equity markets proved to be a great environment for gamma trading our convertible arbitrage positions. While we were not involved in any of the companies that recently defaulted, we were negatively affected by risk aversion in a handful of positions. After careful review, we have determined that in each case the new price levels represent significant value and we remain committed to these positions.

We are excited about the potential returns of our current portfolio. High Yield spreads are back to 2009 levels, with the average bond yielding almost 9%. Corporate balance sheets are in good shape, many near term maturities have already been addressed in the primary markets, and 3rd quarter earnings results have been solid. We expect that our corporate credit positions will perform even in

the scenario of a stalled economic recovery. Our portfolio continues to generate significant cash yield, putting the wind at our backs while we hunt for profitable special events. The technical dynamics in the convertible marketplace remain very strong, and the market is ripe for new issuance. We should be able to realize profits from our exposure to equity volatility via hedged convertible positions. Lastly, the Dodd-Frank reforms have caused dealers to commit less capital to facilitate trades due to their smaller proprietary trading books. The result is reduced price transparency and less efficient markets – all good trends for active investment managers. Overall, our multiple sources of return have helped us to realize excellent results with dampened volatility.

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

<sup>1</sup> From March 1 2010 to August 31 2011 returns are for the Arrow RR fund (Class X), and are adjusted to reflect Class A fees. This document is not to be construed as a public offering of securities in any jurisdiction in Canada. The offering of units of the Fund is made pursuant to the Offering Memorandum only to those investors in all jurisdictions of Canada who meet certain eligibility of minimum purchase requirements. Important information about Arrow Funds, including statement of each fund's fundamental investment objective, is contained in their respective offering memorandum, a copy of which may be obtained from Arrow Capital Management Inc. Please read the applicable offering memorandum carefully before investing. The information and materials in this document are for informational purposes only. They are not intended as investment, financial or other advice. The information included in this document is not an offer to sell. While the information and material in this document are believed to be accurate at the time they are prepared, Arrow Capital Management Inc. (and its affiliates, subsidiaries or sub-advisors) cannot give any assurance that they are accurate, complete or current at all times. Past returns are not necessarily indicative of future performance. Actual results will vary. This document is confidential and is intended solely for the information of the person to which it has been delivered.

<sup>^</sup> Indices are denoted in US dollars.

# RAVEN ROCK INCOME FUND



Commentary - September 2011

*Experience. Intelligent Investing.*

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