

SG US Market Neutral Fund

Commentary - November 2011

Experience. Intelligent Investing.

As soon as it seemed that the markets were going to post a significant monthly decline, a three day rally ensued. This upturn was largely driven by a coordinated effort by the central banks to introduce liquidity and lower the cost of loans to banks. While the markets cheered the move, we are mindful of the fact that these actions do little to address the longer-term structural issues in many economies and may in fact be a sign of increased concern on the part of central bankers. The market rally generated close to a 6% return for the Russell 2000 in the last week and almost brought that index and others back to even for the month. Although the Russell is still underwater year to date, last week's rally was a significant step in resuscitating the markets. It appears that each month we come close to breaking all-time records from a volatility standpoint, with last week's market increase resulting in the second best weekly point gain in the market's history.

Most of the domestic economic news was encouraging last week. Black Friday and Cyber Monday sales were decent with positive reports coming from the high end and electronic retailers. Friday's labor report saw an unexpected drop in the unemployment rate to 8.6%. Although a compelling headline number, those digging deep into the data had a mixed view on the report. The decline in the unemployment rate may drive increased confidence on Main Street, which is a clear benefit. However, a lower unemployment rate is likely to be more of an indication of the growing frustration in the labor force as more workers drop out of the labor pool. Unfortunately or fortunately, we are in for more of the same headline volatility for the foreseeable future. This week's calendar is replete with potential EU news, culminating on Friday with the Heads of the European Union meeting for the last time this year to attempt to agree on some form of fiscal discipline. While the markets seem to be indicating otherwise, everyone seems to be in agreement that Europe is in a recession. The only questions at hand seem to be how bad will it be and to what extent the impact will be felt on this side of the pond. For those watching the credit markets, yields across Europe (East and West) rose while the rating agencies cut/downgraded Hungary, Portugal, and Belgium. Japan saw a spike in yields as well, reflecting the global slowdown and its continued impact on most Asian economies.

A recent article highlighted how top Morningstar managers of the

last decade are currently struggling. One well known domestic equity fund manager is down 29%¹ vs. -1%¹ for the S&P500. There are similar examples in other asset categories as well, including Fixed Income, International Equities, and various Hedge Fund strategies. Why is it that these managers not only fall from grace but move from the top to the bottom quartile? Clearly, these managers have not lost their analytical abilities. Most are brilliant investors who have a passion for what they do. So what's going on? Two points come to mind. First, large flows of assets follow published success. Regardless of what anyone tells you, it's much more difficult managing billions of dollars than it is running a few hundred million. As your asset base grows, it becomes tougher to beat the market. Why? With more assets, the universe of ideas shrinks and the negative impacts from trading increase. The bottom line is that it's tough to be as nimble when assets under management sky rocket. In many instances, a very large growth in asset size is coupled with deteriorating returns. Second, as a byproduct of a more difficult task in generating returns, the portfolio manager may attempt to take on more risk than they have in the past. When you read about these outsized negative returns, especially under periods of market stress, it is often reasonable to assume those managers' risk appetite increased and large make or break bets were made.

At SG Capital Management, we appreciate the challenges of producing consistent competitive returns and will never allow our asset growth to impact investor returns. We recognize our strategy is not scalable and intend to cap our asset size to protect against mediocre performance. Fund management consists of two equally important and inseparable disciplines. These two principles are superior stock selection, or alpha generation, and tight risk management. At the inception of our fund, we learned a powerful lesson in managing risk. We took this lesson to heart and have since been diligent proponents of following the disciplines we established. Our focus is not on hitting the ball out the park. Instead, we focus on hitting singles combined with tight and disciplined risk management. This approach has allowed us to protect capital during down market periods. In the past five years, we have been through some of the most difficult markets in our history. Our results demonstrate that we understand how to manage portfolio risk while producing alpha in both the long and short book. Past performance

¹ The Fund was originally advised by Tetra Capital Management until the advisor was replaced in December 2010 by SG Capital Management. The Fund was formerly called the Tetra U.S. Long/Short Fund. Unless otherwise stipulated returns are net of all fees, in Canadian dollars, reflect class "A" units and assume reinvestment of all distributions. 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.

[^] Indices are denoted in US dollars.

is no guarantee to future success but be assured that two things will not change at our firm. We will limit the size of our firm when it becomes necessary and will continue to diligently manage the risk level of our portfolios.

As we move into December, we have a number of earnings releases in the portfolio which we hope to capitalize on. If we continue to be accurate in our evaluations of a company's fundamentals and the valuation/sentiment, than we should be able to finish the year on a positive note. One of the names we like on the short side is Jabil Circuit (JBL). JBL is a contract manufacturer, providing design and production services to OEM's in a variety of end markets including consumer, computing, industrial and medical. We have been following the company and the EMS industry for a very long time and have had successful long trades in the name earlier this year. We believe the biggest issue facing the company right now is its ability to achieve analyst forecasts for the February quarter. A combination of macro pressures and customer specific issues in the handset area could lead to revenues falling more than the normal seasonal dip. We are also focused on the possibility that the Thailand floods could be an additional headwind for the company. Any risk to component availability along with supply chain disruptions could negatively impact revenues and inflate inventory levels. If we are correct and revenues fall at a greater than expected amount, than we would expect fixed cost deleveraging to hurt the operating margins as well. Equally as important is our assessment of what others truly expect. What is being built into the stock price? Judging by the recent stock price strength, positive sell side notes and premium valuation versus its peer group, we are comfortable that any shortfall in earnings guidance should be greeted with selling pressure. As always, we'll evaluate the potential use of options to hedge our position as we move closer to the earnings date in late December.

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

Sincerely,

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| Ken Grossman | Glen Schneider, CFA |
| Partner, Portfolio Manager | Partner, Portfolio Manager |

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