



ADVANCE INVEST MUTUAL FUND

INVESTMENT COMMENTARY
as of 30 June 2008

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Advance Invest Mutual Fund Overview as of 30 June 2008

In the second quarter of 2008 the markets where ADVANCE INVEST targets – Bulgaria & Romania – continued to decline, though on lower volatility. The Bulgarian market (measured by the SOFIX index) retreated with another 8%, while Romania (the BET index measured in local currency) with more than 6%. With both markets the liquidity and turnover were extremely weak, even though at both places the expected innovations became a fact – in Bulgaria the Deutsche Borse's XETRA platform became a fact, and in Romania the trading session was extended to 4:30 pm local time. Corporate statements for the first quarter revealed contradictory facts – there were surprises in both directions, but one thing is certain – financial results failed to provide the needed impulse to stock prices.

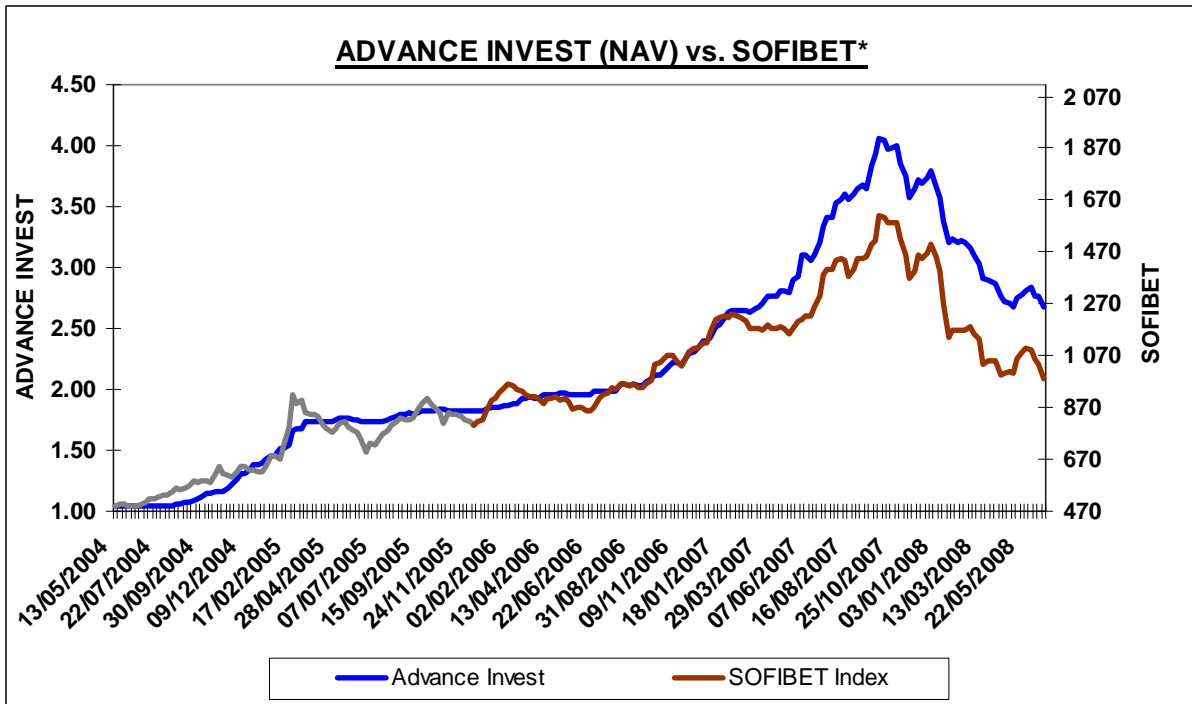
The significantly lower fundamental ratios compared to the start of the year ((SOFIX P/E of 15x and BET P/E of 12x) for the time being don't prove to be attractive enough to draw buyers back to the market. Among the explanations is that investors now require a much greater discount due to the repellingly low liquidity on the Balkans.

Against this background ADVANCE INVEST recorded a similar decline in Q2 – 7.9%. Year-to-date the fund has realized a loss of 28.6% (while our SOFIBET benchmark is down 31.4%). This result was realized by maintaining a larger share of cash and defensive positions such as REITS and other stocks with lower correlation with the general market.

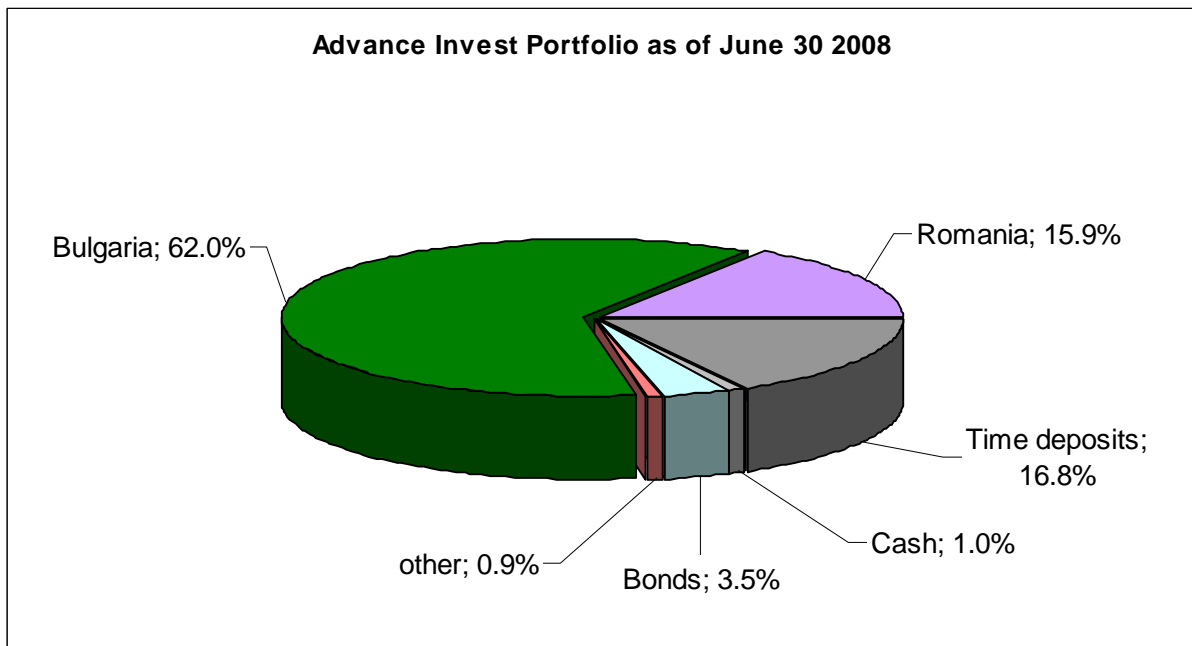
Fund Performance	
Return YTD as of Q2 2008	-28.64%
Benchmark (SOFIBET*) YTD 2008	-31.38%
Return for 2007	55.37%
<i>Benchmark (SOFIBET*) for 2007</i>	<i>34.31%</i>
Return for 2006	31.20%
<i>Benchmark (SOFIBET*) for 2006</i>	<i>35.30%</i>
Return for 2005	32.60%
<i>Benchmark (SOFIX) for 2005</i>	<i>32.00%</i>
Return for 2004	38.00%
<i>Benchmark (SOFIX) for 2004</i>	<i>37.60%</i>
*index constructed by Karoll comprising 50% of Bulgarian SOFIX & 50% of Romanian BET as of 2006 beginning	

The fund's return was realized by assuming a much lower risk than the SOFIBET benchmark (standard deviation of 14.5% for the fund compared to almost 20.8% for the benchmark). The fund's risk-return performance in comparison to the benchmark is statistically demonstrated below, e.g. alpha of +11.5%, etc.

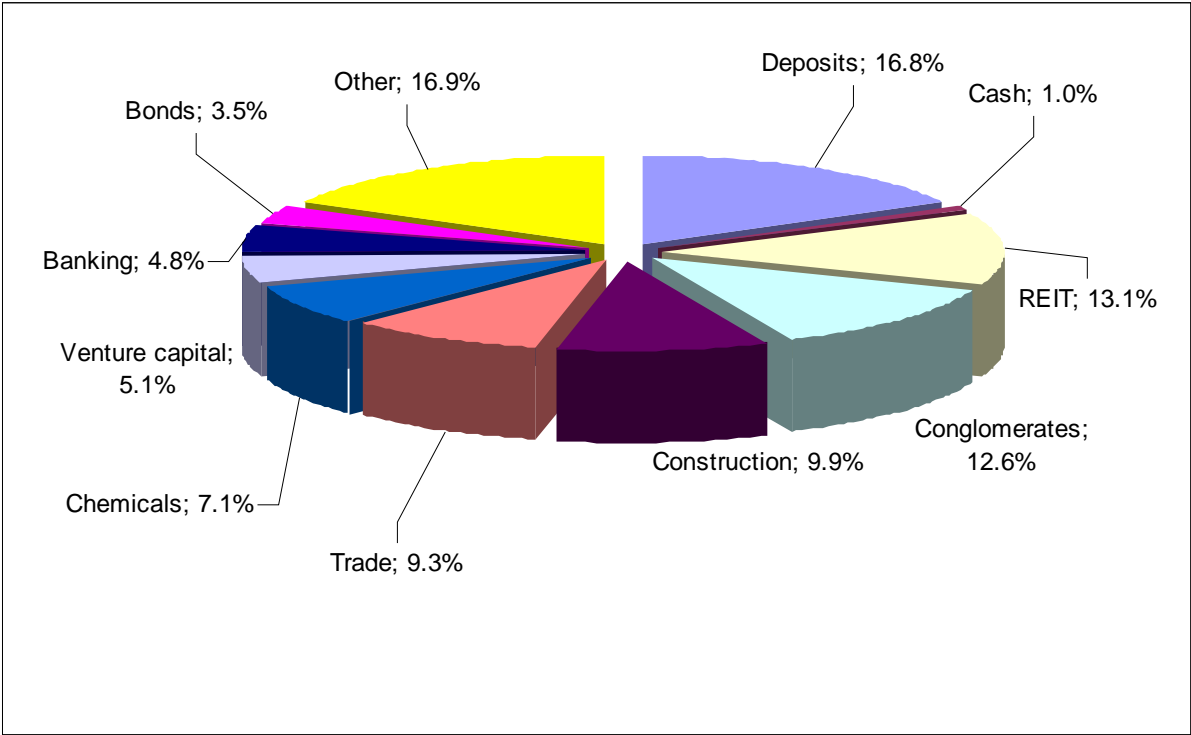
ADVANCE INVEST RISK METRICS	
Beta	0.6
Alpha (annualized)	11.5%
Standard Diviation (anualized)	14.5%
Sharpe Ratio	0.8
M Squared	21.7%
Information Ratio	1.5
Tracking Error	7.9%



At H1-end Bulgaria is once again the market with the largest weight in the fund with about 62% of assets (almost as much as at the beginning of the year). Romania pulls nearly the same weight as before – around 16%. Bonds as a defensive element comprise close to 3.5% of assets, while the share of cash and time deposits stands at around 18%.

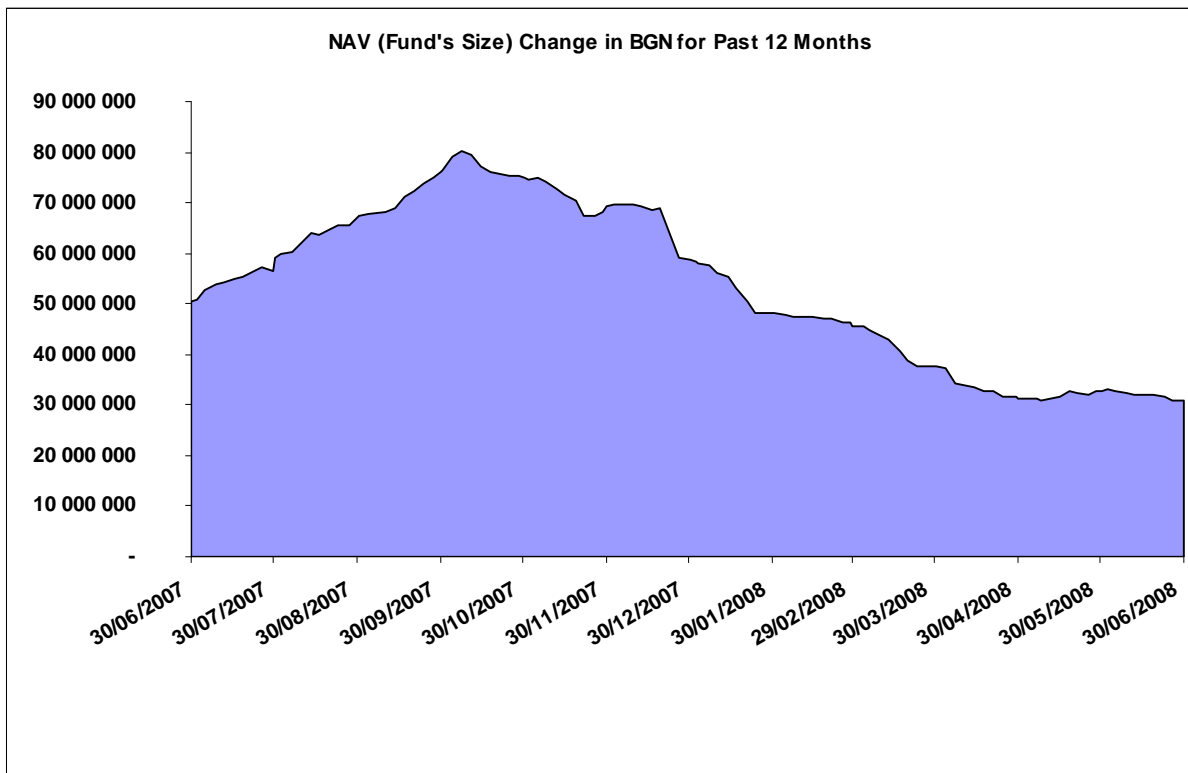


Sector-wise, now REITs take up the leading position (over 13% weight), followed by conglomerates (around 13% of assets), construction (around 10%), trade with food products (above 9%). In the second quarter the most active period for the fund's portfolio was April with more than 60 transactions – all but one were sales – both in Bulgaria and Romania (especially with representatives of the chemical, tourism, pharmaceutical and conglomerates sectors). In may and especially June the activity was much lower – exclusively sales with the purpose of maintaining larger portion of cash.



Top 5 Portfolio Holdings	
COMPANY	KEY BUSINESS
SAF Magellan	Trade with food products
Aktiv Properties	REIT
Orgachim	Chemicals
Advance Equity	Venture capital
Advance Terrafund	Agricultural land REIT

As of June 30 the NAV of ADVANCE INVEST falls to BGN 30.8 mln following the depreciation of portfolio holdings and the net outflows.



BULGARIAN Stock Market Development in Q2 2008

Although with smoother declines, the negative sentiment continued to weigh on the BSE during the second quarter of the year, SOFIX losing 8.1 % during the April-June period of 2008. Thus the major index has tumbled by 35% since the beginning of the year and is down by nearly 41% from its all time-high registered in October 2007. Investors' activity sharply diminished, the average turnover continuing to fall further. The average daily equities turnover dropped to BGN 7.45 mln. in Q2, down from BGN 10.2 mln. in the first quarter of the year. After SOFIX lost another 9.3 % in April, an attempt for recovery followed in May, the main index climbing up by 10.7 %. Following a minimum rise in June, at the end of the month SOFIX stood at its 2006-end levels.

Many investors believed that if positive, the first quarter financial results would provide an impetus to the stock trading. These hopes, however, proved to be vain as even on good results, there was no or very short-lived positive effect. Besides, as a whole the first quarter corporate results were rather disappointing as the profitability of some of the companies was negatively influenced by the rising oil and energy prices and the inflationary processes in general, while the export-oriented companies whose deliveries are denominated in USD were hurt by the depreciation of the US dollar.

The worldwide turmoil in the financial sector has already impacted the Bulgarian banking sector with the increase of the cost of financial resources. Thus the bank's credit activity was substantially restricted, credit growth cooling down compared to the previous years. The loan portfolio of the commercial banks at the end of Q1 was 6.5% higher than at the end of 2007.

At the end of the second quarter the average P/E of SOFIX was 15.5x on a ttm basis. At the end of the first quarter the average P/E of the index on the basis of 2007 results was slightly above 18x. Despite this decline, however, the average P/E of the Bulgarian market remains higher compared to the regional markets.

The adverse market conditions logically led to postponement of the planned new listings. The only IPO that took place during the quarter was that of Railway Infrastructure Holding Company, where the institutional interest was close to zero.

In June the BSE introduced the new trading platform XETRA bought from Deutsche Borse with the purpose of replacing the old trading platform RTS. In spite of the greater functionalities it provides, the new platform caused additional squeeze of investor activity at the beginning, the daily turnover dropping sharply. Since June 16th, when XETRA was introduced till the end of the month the average daily equities turnover plummeted to slightly more than BGN 3 mln.

The trend of decrease of the assets of Bulgarian UCITS continued in the second quarter of the year. The assets under management reached BGN 620 mln. at the end of June, down by 7 % for the quarter. Since the beginning of the year the squeeze amounts to a total of BGN 256 mln. (-30 %).

As a result mutual funds act with extreme caution and are not stock buyers, at best. Only pension funds remain net buyers, yet their activity is already very low. Retail clients activity has also subsided sharply. International investors refrain from buying, but when there is demand for larger lots, they step in as sellers. The latest data reveals that international participation in the market cap as of 2007-end accounts for 22.2% (in absolute terms this is BGN 6.4 bln – it should be pointed out, however, that this includes majority stakes too). This is a decline vs. the end of Sept, 2007 (24.1%), and vs. the end of June, 2007 (37. %). To compare, in late 2006 the share of international investors stood at 41.67%.

Expected Development of the BULGARIAN Stock Market

Given the size and duration of the decline of the SOFIX index we can now categorically talk about the presence of mid-term bear market that would correct the overall rise in the prices from 2001 till fall 2007. That is why we consider that the prospects of the Bulgarian capital market continue to be negative, respectively it is possible that further losses are incurred (expressed in index values below 1000 points) due to the factors described below. In the long-term (over 3-5 years) we confirm our positive expectations about the local market in respect to the strong potential of our region and the dynamic development of the listed companies.

If the prior claims were that the fall of the market resulted into attractive fundamentals, now similar statements are very rare due to the revised situation in the region. At the end of June the SOFIX components traded at an average P/E of 15x. In comparison, at the October peak the average P/E was above 30x. It must be considered however that even after months of strong fall, the valuation ratios still turn out to be insufficiently attractive in order to draw buyers back to the market. One of the explanations is that investors now demand much higher discounts due to the extremely weak liquidity on the domestic market.

Regardless of the reported high GDP growth in the first quarter, corporate results were more or less disappointing. The revenue growth rates were satisfactory and in line with expectations, but the profitability of numerous companies suffered owing to the global trends – rising oil and energy prices, high inflation and inability to incorporate it into end prices, weakening of the US dollar (for companies whose deliveries are denominated in USD), rising metal prices, rise of wages, etc. Meanwhile, however, a very likely scenario is that the revenues growth rate would also slow down because it is now more probable that in the event of a considerable slow-down of the world economy (for which there is more and more evidence) the effect would be felt with some lag in time. Because of the presence of ever more increasing number of crisis factors, the expectations of average growth rate of the corporate profits in the range 25-30% we had at the end 2007 now seem to be highly optimistic and have to be revised to levels below 20%.

Basing our analyses on a sector level, we could come to similar conclusions:

- 1) Tourism – registrations and visits so far point to a weak season, the main reasons being over-construction, poor services, and crimes involving foreign tourists last year.
- 2) Banking sector - although the Bulgarian banks do not have an exposure to American mortgage-backed bonds, the global financial turmoil has had its effects on them too, as far as the access to resources toughened along with its rising costs. As a result of the rapid growth rates over the last few years, the National Bank introduced measures to curb the loan market, which was more distinctly felt in Q1.
- 3) Machine-manufacturing - the companies within the machinery sector have been holding up very well so far, although this is a sector that would suffer in case of a potential recession of the major economic powers.
- 4) Real estate and the related segments - there are more and more indications that the peak has been reached, or it is coming soon. It is expected that the situation would become worse with the intensive new construction, as well as the higher restrictions imposed on the banking credit activity.

As the GDP growth figures for the last quarter of 2007 came as a positive surprise for the observers of the Bulgarian economy, the results for the first quarter of 2008 were even more upbeat. The GDP growth in Q1 was 7%, which is the strongest quarterly growth reported in the last 10 years. This is also the third greatest Q1 growth rate among the EU countries (after Slovenia - 8.7% and Romania – 8.2%). There was positive date on the expenses side, too. The investments in shareholders' equity continue to advance as they mark a growth higher than the GDP: +15.5%. The gross value added increased with 7.6% in comparison to the same quarter of last year, as the greatest growth is attributed to the services sector, followed by the industrial sector. There were reassuring results regarding the foreign trade in the first quarter – the export increases with a higher rate than the import (9.2% export growth vs. 5.8% for the import). The reports for the individual consumption, though with a slower growth rate than the GDP (+5.7% in Q1) are also positive in relation to the inflationary processes, i.e. the households do not reduce their consumption baskets despite the increase of the price index.

The explanations for that fact could be found in the increase of the employment rate, adjustments of the basic salaries in the end of 2007 and the introduction of the flat tax since the beginning of 2008.

Regardless of the positive results, it is still quite early to conclude that the global turmoil would pass us by. As the world economies continue to slow down and respectively the demand side it is logical to expect an impact on the export of the Bulgarian companies. The inflation would have a negative effect over the individual consumption (which contributes nearly 85% to GDP) if it speeds up further. However, the latest forecast of the government is that GDP would grow to 6.4% in 2008, while the analysts in general predict economic growth in excess of 6% as well. Meanwhile, in April the IMF reduced its forecast to 5.5%. The current account deficit continues to be another serious issue - for four months till April it amounts to 2.43 billion euro, revealing a growth of 14, 4 % on annual bases. The growth rate increased after the considerable slow down in March. The good thing is that the rate of increase of the export remains higher than the import. However, the difference between them in nominal expression is considerable. The expectations are that the deficit would remain at high levels as percentage of GDP (21.9% during 2008).

In February the financial grants related to different programs from the Euro funds were frozen – their number keeps on increasing and up to now there have been restricted funds related to SAPARD, ISPA, FAR, resulting from the malpractices found during the utilization process. An audit is appointed as the conclusions of the EC would be clear after the announcement of the EC report on July 23rd. One possible scenario is the termination of some part of the allowances that were initially provided by the funds. In all cases the realization of this scenario pointing to corruption schemes in the country, would have strongly negative influence on the image of Bulgaria and the risk premium required by international investors.

ROMANIAN Stock Market Development in Q2 2008

Losses on the capital market in Romania were sustained over the second quarter of 2008, whereas the market, itself, fell into "bear territory". After some shy recovery attempts in April, the net result of the BET index in the period from April through June is a loss of 6%. Thus, the overall fall of the index since the beginning of the year equals approximately 34%. In general, Romanian indices have not seen such levels since the end of 2005, i.e. over the recent few months we have returned to price levels registered as early as 2 years back. The situation gets aggravated additionally by the attempts of the Central Bank to fight the high inflation while raising the basic interest rate for a fourth consecutive time this year up to the ultimately highest interest rate among all EU countries – 10% (for comparison, at the end of last year the rate was 7%). Meanwhile, the Romanian Leu (RON) gained stability in the last few months and, even more, registered certain growth over that period.

The high level of correlation to Western markets was preserved in its most evil form – when red is the prevalent color. On its part, this trend was further corroborated by the extension of the trade session up to 16:30 hrs local time, with the purpose of enabling Western investors to participate more adequately and actively into the trading process. Fluctuations of the capital market in Romania were more substantial than these in Bulgaria, and upward push efforts

were (though, in the majority of cases observed only intraday) more frequent. Such price increases were instantly punished with sales by international investors. Although the official statistics demonstrate that foreign investors were net buyers in April and May, it is apparent that the sentiment remains extremely negative. It turned out that the greatest damage was borne by shares with low and middle capitalisation due to their poor liquidity and wide spreads. With such type of shares it is characteristic that a simple withdrawal of bids may lead to a 30% decline in the value of the share over a single day even in the complete absence of deals on the market.

The average P/E of the BET index is at about 12.0x compared to values of 18.0x at the start of the year, which is mainly due to the collapse of share prices. As a result, valuation levels closely approach the average numbers for Eastern Europe. At the same time, the expected average profit growth of index components for 2008 has sustained similar levels of 17-18%. This logically brings out a lower PEG Ratio with values of less than 1.0 (the P/E ratio divided by the expected earnings growth; values below 1.0 indicate undervaluation) compared to these in January. Of course, such forecasts should be approached cautiously since the risks of regional economies and, respectively, local issuers increase with the deepening of the global crisis.

From a macroeconomic perspective, there were positive news about the unprecedented growth of the GDP in the first quarter, as well as the substantial growth of foreign direct investments (FDI). Nevertheless, the mounting inflation and the Current Account deficit could potentially lead the Romanian economy to a 'hard landing' as in the case with the Baltic countries. The latter, for some time on, has been scaring off foreign investors and has contributed to their abstinence toward the local market.

Owing to their not-so-substantial amount of assets, mutual funds still do not act as a major factor on the local market, but it is anticipated that their significance will go up in parallel to the accumulation of assets in pension assurance funds. Here, as well, pension funds wait in a stand-by position and act cautiously.

Expected Development of ROMANIAN Stock Market

At the moment, in Romania it is the "reign of the bears", and the main question is how long will this bear market continue. We believe that the negative situation on the Romanian market will persist over the upcoming months and, respectively, the higher risk premium will exert a restrictive effect on the trend reversal process. Here too we expect to observe lower levels with a number of positions before the market finds a stable bottom that will reverse the trend. Theoretically, we could reason that, presently, we are positioned in the middle of the cycle and that the sustainable recovering will begin in 2009. Up to that point we are to face a period of strong volatility.

The average P/E of the index at the moment is about 12x compared to 17.5x in the beginning of the year which ensues from a loss of more than 33% YTD. Meanwhile, the expected average profit growth of the index companies for 2008 stays at similar levels – above 15% which, logically, derives a lower PEG Ratio compared to that in January. Opposite to the situation in the beginning of the year when the PEG Ratio based on the 2008 expected earnings was above 1.0, now the same indicator falls in the range between 0.5 - 0.9. Yet, we must account for some negative facts which imply that some sectors of the Romanian

economy could possibly register a slow-down of the growth rates and reduction of the profits in comparison to the period 2006-2007. The first reason for this conclusion stems from the fact that since the start of 2007 onwards we have witnessed a rapidly climbing inflation rate boosting the cost of local products and services (higher prices of energy commodities, food commodities, services, labor, etc.). The above-mentioned comes, to a large extent, from the already initialized convergence process (after the accession of Romania to the EU) to average prices of goods and services within the Union, and the inability of local companies to transfer quickly enough the rising prices of raw materials to end consumers, as well as from global expectations for high inflation. The second reason is the intense competition on the local market and the commenced over-saturation in some sectors of the economy, a typical example being the real estate sector.

From a macroeconomic perspective, the following can be observed: the Q1 GDP growth was exceptionally strong – 8.2% (as a matter of fact, that is the highest economic growth in Romania for the past 18 years and, beside that, one of the highest in the EU). Thus institutions revised upward their expectations for the current year (up to above 7%) at the expense of lowering 2009 expectations. The main engine is the construction sector where any potential slow-down could be made up for by the extremely abundant agricultural crops this season. Since the beginning of 2008 the inflation speeded up to record levels of above 8% (owing to the afore-mentioned external shocks as well as to the abrupt wage increase by the government while undertaking measures for boosting public approval). To cool down inflationary expectations, the government (as is also the case in Bulgaria) forecasts price growth curbing up to about 6% for the year, which is somewhat unlikely to be realized. The current account deficit is one of the most worrisome indicators at the moment. This indicator shows quite a fickle behavior and that's why the forecasts for 2008-2009 are constantly under revision. Hence, there have been opinions of international stating that this disbalance will deepen up to 20% of the GDP in the next 1-2 years. This deficit is provoked chiefly by the continuously growing local demand, i.e. the demand for foreign goods, because of the rising wages and pensions in the country, and the credit boom. Although the Romanian Leu has become cheaper by more than 15% to the Euro since the summer of 2007 up to the moment (which made the import to Romania more expensive) most analysts believe that the deficit on the current account will increase additionally in comparison to the current value of 15% of the GDP before starting to shrink back to more reasonable levels. In 2007 only 42% of the deficit was covered by the FDI, and this coverage will probably remain the same bearing in mind the forecasts for approximately 8 bln. Euro of FDI in 2008.

The above mentioned macroeconomic risks raise a number of questions about the mid-term stability of the Romanian economy as well as about a potential 'hard landing'. The latter could continue to have a restrictive effect upon foreign portfolio investors for a sequence of months ahead. We already have a similar example in other developing markets in the region – the Baltics, where we have witnessed the Estonian economy's abrupt slow-down from above 11% in 2006 through 7.5% in 2007, to barely 2% in 2008 – a typical example of a 'hard landing'.

The political situation in Romania at the moment implies certain, though indirect, risks for the capital market. The rivalry between the governing political coalition of Tăriceanu and the political party of the President Băsescu continues, whereas it often leads to unreasonable economic measures threatening the macroeconomic stability of the country. Consequently, the political instability in Romania was delineated by S&P as one of the basic factors responsible for the lowering of the credit rating of the country in November 2007. The governing political coalition attempts to compensate the constantly growing social approval of the Democratic Party of the President Băsescu by populist measures which broaden even further the

macroeconomic disbalances that have emerged in the past 1-2 years. That's how, for instance, in the end of 2007 the Parliament voted an increase of the minimum wage by 28% bringing it in force from the beginning of 2008 while doing so with pensions, too, but by the striking 43% in force from 2008 (and additional 33% from 2009). The same refers to the huge budget deficits accrued by the government as a result of the populist policy for encouraging government spending. The effect of this would most probably be a push for a further inflation increase.

Earlier this year, some expected that the capital market would react to the local elections, conducted on June 1, 2008, since the outcome of the elections would conspicuously indicate voters' attitude, and foretell the results of the upcoming parliamentary elections that are to be held in November 2008. According to the local analysts, in case the political party of Băsescu gets the majority seats at the Elections the stock market would react positively and indices would be prompted upwards, i.e. Romanian voters place hopes on Băsescu for saving the economy from the impending economic risks. As a whole, the local elections did not confirm these expectations: i.e. the candidates from Băsescu's party (PDL) won about 30% more mayor seats and seats in municipal councils than the governing party of Tăriceanu (PNL), but the market failed to react to this outcome as analysts had expected.

Finally, we should mention the reforms initiated to the pension assurance system of the country in force as of April 2008, which provide for an increased percentage of participation into the compulsory universal and additional pension funds. Funds will now be entitled to invest up to 50% of their assets in shares traded on regulated markets. In the long run, this is expected to render a new push to the capital market in the country, but in the short run this is definitely not a factor decisive for the direction of market movement.

Investment Strategy of Advance Invest Mutual Fund

The strategy of the fund is based on the stock picking approach – selection of Bulgarian and Romanian stocks, which the asset manager believes to perform better than the market as a whole. In a negative market as is the case now, the latter should be stocks that are defensive by nature (preserve or increase in value when the rest of the stocks decline). As far as such instruments are available in these markets, the best candidates are REITs (especially those investing in agricultural land) and some other smaller low-liquidity stocks with low correlation with the market (low beta stocks). The main goals of the asset manager will be to strictly control the liquidity risk, to attempt to reduce the volatility of the fund's price as much as possible despite the expected high volatility in the markets, and at the same time to try to make the most of the emerging investment opportunities.

Recently, EFAMA (the European Fund and Asset Management Association) adopted new requirements with respect to the categorization of the different fund types. One of these requirements concerns the share of cash in the equity funds, namely, no more than 20%. In its work the Asset Manager will strive to comply with these requirements (by the way, such are the expectations of most institutional investors), and thus will not be able to manage the

portfolio too flexibly (e.g., to drastically reduce equities at the expense of cash and debt instruments in case of negative forecasts for the stock market). Therefore, flexibility from now on will mean the possibility of switching from one type of stocks to another (for instance, from index components to small caps, from one sector to another, from high-beta to low-beta stocks, etc.)

Traditionally, the portfolio management will continue to aim at achieving an optimally high return, potentially better than that of the selected benchmark – SOFIBET, in observance of the adopted risk-return parameters.

For further information: www.karoll.bg

Risk statement

The value of shares and the income from them can go down as well as up, profits are not guaranteed, and investors assume the risk that they may not recover the full amount of their investment. Investments in the mutual fund are not guaranteed by a state guarantee fund or any other institution. Past performance of the fund should not be viewed as a guide to future performance. Before making an investment decision, please read carefully the prospectus of Advance Invest. The prospectus and the fund's charter documents are publicly available for investors in all offices of Karoll Capital Management as well as at its website.