



ADVANCE INVEST MUTUAL FUND

INVESTMENT COMMENTARY
as of 31 Dec 2007

Daniel Ganev
Portfolio Manager

Advance Invest Mutual Fund Overview as of Dec 31 2007

ADVANCE INVEST Mutual Fund, managed by Karoll Capital Management, recorded its strongest performance ever in 2007 despite the challenges at the end of the period. As a recognition for the successful development through the years ADVANCE INVEST became the first Bulgarian fund to be rated by an international institution - Lipper, a Reuters company focused on the fund industry research, granted ADVANCE INVEST the highest rating of 5 points in terms of Total Return as well as Preservation. Lipper's rankings reveal that ADVANCE INVEST ranks number 6 by 2007 return among all 267 Austria registered funds in the "Equity Emerging Markets Europe" category.

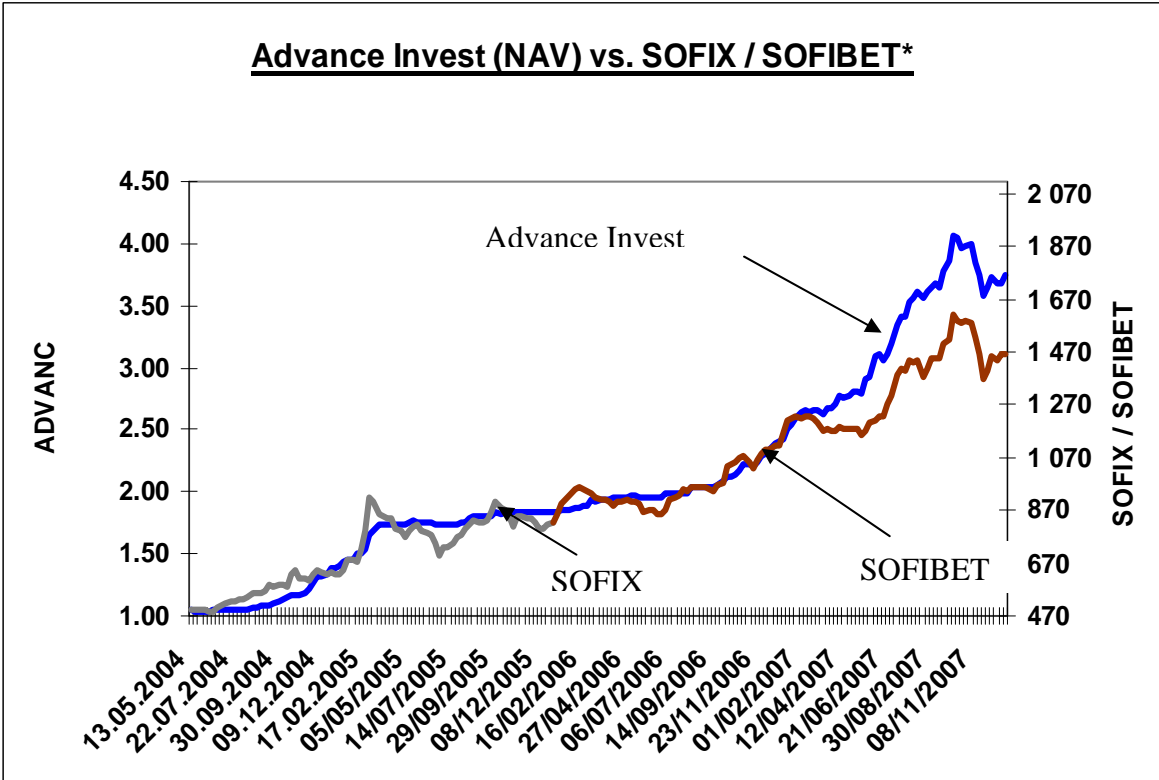
The 2007 return amounts to +55.4% (NAV/share change from BGN 2.4005 to 3.7297 for the year). The fund's benchmark SOFIBET (+34.3% in 2007) was defeated categorically as well. The return recorded just in Q3 was +21.4% (+16.6% for SOFIBET). Following the very strong summer months, the last quarter finished in the red for the Bulgarian market and the Romanian currency, and thus for the fund as well (-4.9%).

Fund Results	
Return for 2007	55.4%
<i>Benchmark (SOFIBET*) for 2007</i>	34.3%
Return for 2006	31.2%
<i>Benchmark (SOFIBET) for 2006</i>	35.3%
Return for 2005	32.6%
<i>Benchmark (SOFIX) for 2005</i>	32.0%
Return for 2004	38.0%
<i>Benchmark (SOFIX) for 2004</i>	37.6%
*index constructed by Karoll comprising 50% of Bulgarian SOFIX & 50% of Romanian BET as of 2006 beginning	

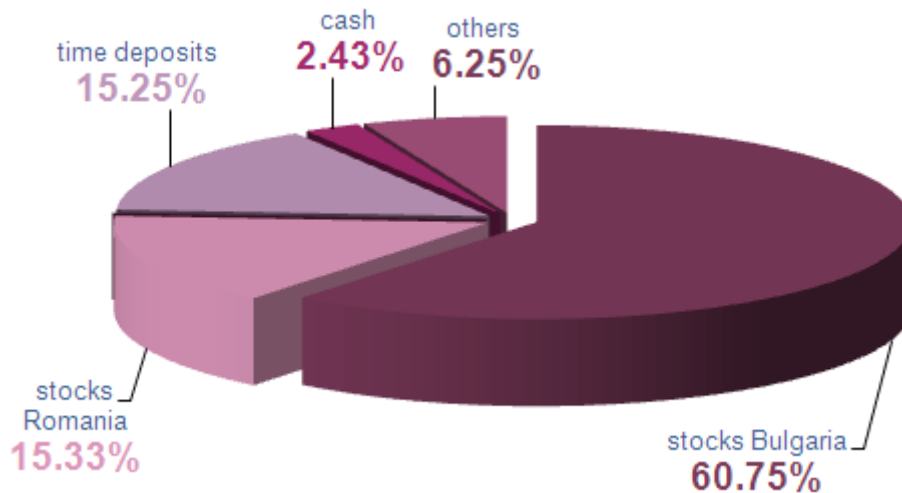
Once again, the fund's outstanding return was realized by assuming lower risk than the SOFIBET benchmark (standard deviation of 14.3% for the fund compared to almost 18% for the benchmark). The statistical measures below further demonstrate the excellent performance of Advance Invest in terms of risk and return, e.g. alpha of +22.3%, Sharpe ratio of 2.9, etc.

Beta	0.48
Alpha (annualized)	22.3%
Standard Diviation (anualized)	14.3%
Sharpe Ratio	2.91
M Squared	55.6%
Information Ratio	2.67
Tracking Error	8.3%
*Annual data on a weekly basis for 2 yrs trailing (std dev. is for 1 yr trailing). The index used in the calculations is SOFIBET, constructed by Karoll.	

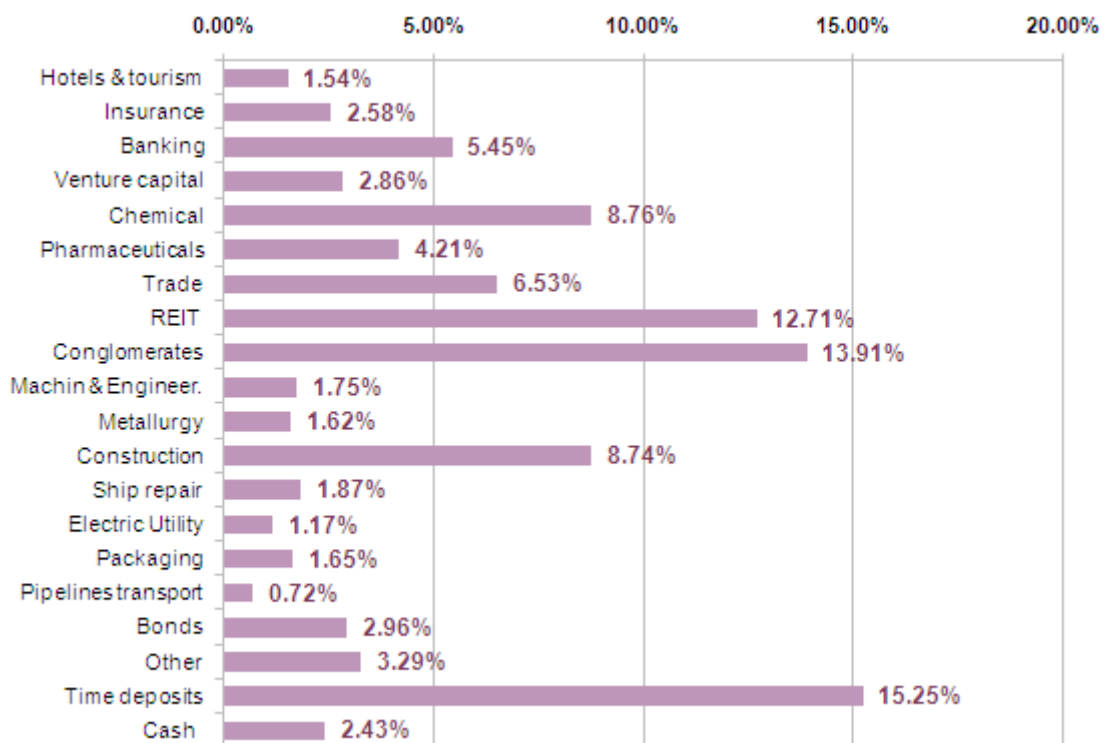
These solid results were achieved through focusing on defensive positions in early 2007 during the global market decline, and subsequently funneling more funds toward Bulgarian growth stocks, Romanian small caps, and participation in the banking IPOs of the second quarter. The cash accumulated for IPOs during the summer months to some extent cushioned the depreciation of the fund, which started in mid-October. In the last quarter the Romanian lea's meltdown affected the fund's results more adversely than the stock market's fall itself.



At year-end Bulgaria is once again the market with the largest weight in the fund with about 61% of assets (vs. 52% in the previous quarter). The increased presence on the Romanian market in 2007 was drastically reduced in the last trading days of the year in order to provide quick liquidity for a withdrawing large investor. Bonds as a defensive element comprise close to 3% of assets, while the share of cash and time deposits stands at around 18%.

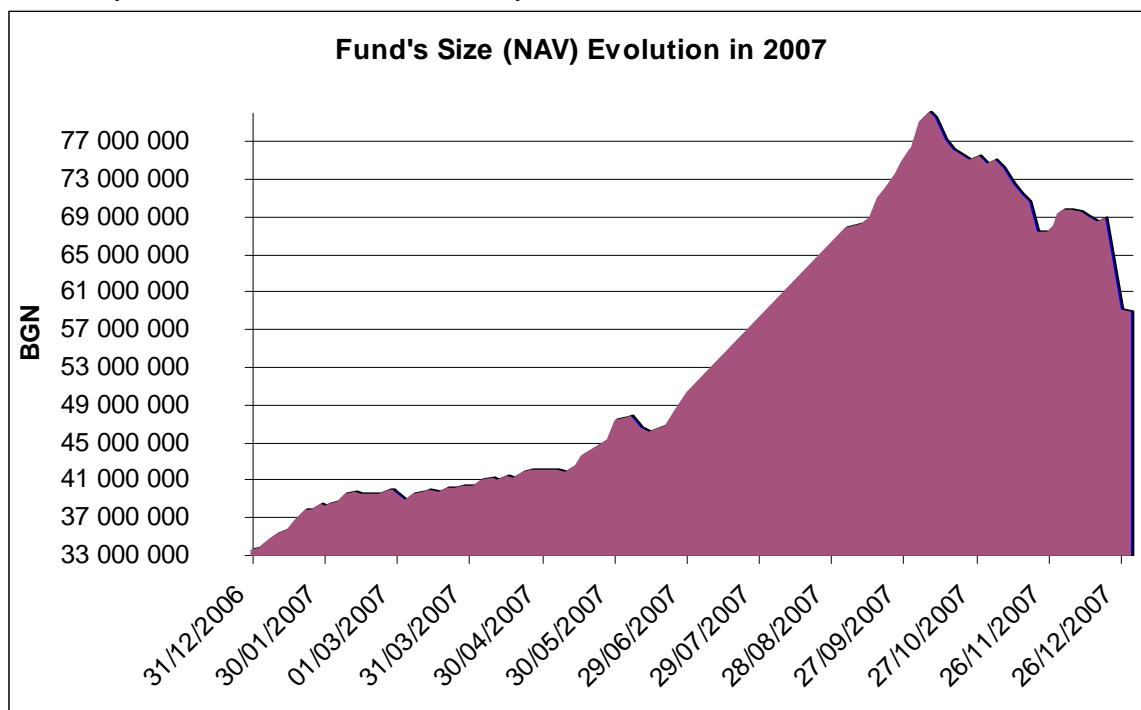


Sector-wise, now conglomerates take up the leading position (almost 14% weight – a 2 point increase compared to last quarter despite the liquidation of Romanian SIFs), followed by REITs (around 13% of assets), chemicals (down to under 9% weight after the sale of Romanian Policolor and the chipping of Bulgarian paint-manufacturer Orgachim), construction (doubling of their share to nearly 9% in view of the industry's favourable outlook). On the other hand, the portion of banks was cut down to around 5% in light of the financial sector's uncertainties related to the global credit markets turmoil.



Top 10 Portfolio Holdings	
COMPANY	KEY BUSINESS
Orgachim (ORGH)	Chemical
Advance Terrafund (ATERA)	land REIT
SAF Magellan (SAF)	Trade
Chimimport (CHIM)	Conglomerate
Aktiv Properties (AKTIV)	REIT
BG American Credit Bank (BACB)	Banking
Advance Equity (ADVEQ)	Venture Capital
Eurohold Bulgaria (EUBG)	Conglomerate
Sinergon Holding (PETHL)	Conglomerate
Euroins (EURINS)	Insurance

As of Dec 31 the NAV of ADVANCE INVEST falls to BGN 59 mln, and yet the fund's size has nearly doubled since the start of the year.



BULGARIAN Stock Market Development in Q4 2007

The upward trend on the Bulgarian market was reversed in the last quarter of 2007 and for the first time the BSE reacted to the instability in the world financial markets. The market peaked on 10 Oct, when SOFIX climbed to 1952.40 points - nearly 60 % higher than 2006-end levels. For the quarter the major index lost 4.42 %, thus finishing the year with a 44.42 % growth. Apart from the world-wide crisis, the trade on the Bulgarian market was under the influence of some other factors, most notably the fact that the prevailing price levels were not corresponding to the companies' fundamentals. Within a month and a half – from registering an all-time high in mid-October till the end of November when an interim bottom was reached, the major index SOFIX lost 15.83 %. The fall however was much greater with separate stocks.

Initial public offerings continued to be in the spotlight. 8 new companies went public in the last quarter of 2007. An all-time high level of oversubscription was registered with the IPO of the infrastructure company Trace Group [TRACE], the issue at the size of EUR 11.3 mln. being 1 480 time oversubscribed. The listing of the engineering company Enemona enjoyed significant interest as well. The company raised EUR 17.2 mln. with a total value of orders of more than EUR 500 mln. and the issue price was set at the upper bound of the range. Despite the comparatively small size the stock placement by the leading Bulgarian wide-format digital printing company Billboard attracted serious interest as well. Billboard raised EUR 5.6 mln. and the issue was nearly 14 times oversubscribed. The IPOs of CBA Asset management, Agria Group and Grain Foods Bulgaria however were not nearly as successful. With the listing of more and more companies it is to be expected that the investors will become more critical towards the issue prices.



As a result of the 90% increase of the capitalization, the Bulgarian Stock Exchange finishes the year with a market cap of nearly BGN 29 bln, representing more than 55% of the expected 2007 GDP (31% of GDP as of 2006-end). In the last quarter the equities turnover shrunk by half to BGN 1.7 bln. The BSE annual turnover (excluding block trades) exceeds BGN 8 bln – this is a 2.5 fold increase compared to the preceding 12 months.

A total of BGN 1,45 bln. was raised by companies via the stock exchange for the year. 9 IPO debuted in the overall amount of BGN 306 mln., as well a 9 secondary offerings for BGN 240 mln and 21 capital increases for BGN 460 mln.

In view of the market slowdown, the flows to the collective investment schemes were low, the assets of mutual funds rising insignificantly to EUR 452 mln. at the end of 2007. The industry

however registered more than triple growth for the year, and the funds managed to become better recognized as a mass product, which is demonstrated by the multiple growth in terms of the number of retail investors.

Expected Development of the BULGARIAN Stock Market Development in 2008

Following the infamous start of the year, the most realistic scenario for the development of the Bulgarian market in 2008 would be continuous consolidation accompanied by high volatility. In view of sentiment, the market has been overwhelmed by fear and exodus mostly by foreign investors, while the local funds have been just watching on the sidelines. In view of fundamentals, the situation is in fact reassuring as a result of the solid corporate earnings growth last year (expected to continue in 2008) in combination with the price corrections (in excess of 30% on the average). Thus the multiples have reached much more acceptable levels – average P/E of SOFIX of around 20x, given the 25% average earnings growth forecasted by Karoll's team. The latest statistics reveal that the share of international investors on BSE is about 20% of the market capitalization (half of its mid-2007 level). Why have the foreigners fled and continue to flee? Two main reasons: first, because they have their own problems related to insufficiency of liquidity due to large redemptions (as a result they are left without a choice but to cash in), and secondly, against the background of their macroeconomic concerns the domestic market seems dangerous. Regarding the first factor, obviously nothing can be done – in times of panic and mass withdrawals by clients, foreign institutions are forced to switch to safe mode and focus on providing the necessary liquidity. Regarding the second factor, macroeconomic concerns are mostly related to the country's large current account deficit and the high inflation rate, which could potentially threaten the currency board and the economic prosperity of Bulgaria. To a large extent these fears are overrated, since the current account deficit has so far been exclusively covered by the foreign direct investments (expected to continue to go up), and the high inflation in 2007 could be a one-time event provoked by external factors (and not so much by high internal demand). Because of this S&P has recently confirmed the country's credit rating (at the same time downgrading Romania). As a matter of fact, a number of analysts argue that the situation in Bulgaria is far more advantageous than that of other countries with fixed currency boards, e.g. the Baltic countries. As strong as their arguments may be, however, in the conditions of a global crisis gloominess prevails, and logically we are witnessing first-order actions by foreign investors on the Bulgarian stock exchange.

An even more interesting question is why the local institutional investors have remained on the sidelines instead of shopping stocks at the current levels. Although local fund managers aren't concerned by the country's economy and listed companies' prospects, they are also required to act very cautiously in the current situation. First, because even after their decrease, there are still large sellers left, thus we could still witness lower levels with some of the chips. And secondly, because none of the still young and relatively small mutual funds could afford to fall into a liquidity crisis in case of massive redemptions. Correspondingly, asset managers must hold an adequately high cash reserve, and cannot spend money on new purchases right now, even at irresistible prices. Analysts expect that the support will start from pension funds,

which are the longest-term investors by definition, are not open-ended (therefore they won't have liquidity problems), and regularly receive solid inflows for the millions of future retirees.

The lesson that we have all learned this time is that Bulgaria is no longer an isolated island of peace and calm, and especially in times of crisis situations it reacts in unison with the developed markets. Regretfully, once again we discovered that during periods of panic diversification as defensive mechanism fails to work, since the correlation with most asset classes rises sharply (over the last couple of months the drop hit stocks and real estate regardless of weather they were in America, Europe or Asia).

Because the end of the US subprime drama is not anywhere near in sight, equity markets around the world will remain nervous and highly volatile. Bulgaria will no longer be an exception – it will be a difficult year, potentially with more nerve-wrecking situations to come. On the other hand, L.T. investors directly in the market or via mutual funds should not be worried. The reason is that unlike the beginning of 2007, when equity prices had drastically overshot fundamentals and at the same time there were more money in the market than it could absorb (and that's exactly why the major index rocketed over 60% to the October peak), now the situation is 180 degrees to the opposite – the fundamentals of most stocks is quite attractive, but there is no fresh money flowing in. We believe that the latter is the lesser evil – liquidity problems are sooner or later resolved, and in the presence of solid foundations the long-term market prospects remain excellent.

Events that must be observed this year include the implementation of the new exchange trading platform, XETRA of Deutsche Borse, which will improve the technological level of trading and will grant more international investors access to the BSE. Furthermore, the real start of margin trading, short selling, and derivatives, the potential privatization of the stock exchange are to be noted.

This year the IPO segment will remain in investors focus, yet it is very probable that for the first time we could witness failed IPOs due to the uncertain market conditions and/or mispricing reasons. It is more or less certain that some of the 70 companies that declared plans to go public will postpone their debut for more peaceful times.

All in all, we remain optimistic about the long term development of the Bulgarian stock market, and expect double-digit annualized gains over the next 3-5 years. We believe that the current sharp decline will be followed by a continuous period of consolidation accompanied by high volatility throughout the year. For the first time in many months, the fundamental ratios of Bulgarian stocks seem attractive, and the problems of the fragile local market are mostly related to the lack of liquidity.

ROMANIAN Stock Market Development in Q4 2007

The major BET index finished the last quarter with a slight appreciation (+2%) measured in domestic currency, which was by a large extent realized in the last trading session of 2007. (the so called *window dressing* effect). Overall the index gained 22.2% for the year to 9 825 points on very volatile trading throughout the period. The trading created strong emotions for investors through the high volatility during the international credit markets crisis, which started from the USA at the end of July and took on monstrous proportions by year-end. Just in September the market shed over 6%.

November statistics revealed that foreign accounts were net sellers with a record volume of appr. EUR 60 mln. This has evidently been caused by the turbulence of the international markets, as well as of the macroeconomic concerns regarding high inflation and worsening current account deficit in Romanian. Additionally, the depreciation of the Romanian lea against the euro accelerated in Q4, reaching 6.8% for 2007. High correlation is noticeable between the RON/EUR rate and the market benchmark, since the withdrawal of foreign investors is accompanied by the exchange of leas into euros.



The turnover of the Romanian stock exchange reached EUR 4.15 bln in 2007, which represents a 48.2% annual increase. The total capitalization of Romanian public companies reached EUR 24.6 bln (15% hike), or roughly 23% of projected GDP. Last year 1 544 891

trades took place in Bucharest vs. 1 444 398 in year 2006. There are 59 companies listed on the official Bucharest Stock Exchange market – in 2007 3 new firms became listed, while 2 were delisted.

Among the long-awaited state stakes which were supposed to be listed on BSE last year, only Transgaz made investors happy. The issue was welcomed by investors with great interest and a record oversubscription on the individual as well as institutional level, and the price jumped nearly 70% in the first trading day.

Romanian mutual funds failed to see their boom in 2007. Despite the low base, their asset growth was just under 40% to less than EUR 2875 mln at year-end. The actual performance wasn't stellar either – almost all funds finished the year with returns way below the market benchmark. Because of their modest size mutual funds are still not a major factor for the domestic market, but their role is expected to grow along with the accumulation of assets by pension funds.

Expected Development of ROMANIAN Stock Market Development in 2008

For several months the Romanian stock market has switched to a lower gear, and at the very beginning of 2008 the decline accelerated. It is quite likely that in the near and medium term the depreciation could deepen due to a number of factors mostly related to the lack of liquidity on behalf of international investors and the likelihood of a prolonged global bear market. Here there are fundamental reasons which in theory make the market attractive too (average P/E of 17x), but the market is driven by sentiment (currently macroeconomic and credit fear) of international investors and the global liquidity crisis.

The upward trend of net inflows by foreign institutional investors was reversed at the end of 2007 and now western funds sell Romanian equities, sometimes quickly and at any price, squeezed by liquidity worries and supposedly bad macro numbers.

Economists have warned of the risk of overheating of the Romanian economy, where the fast growth is explained mainly by foreign investments, firms' efforts to modernize production and the large household spending in attempt to improve their life standard. The strong domestic demand has been pushing the current deficit, which could surpass 15% of GDP this year. Unlike the situation in Bulgaria, here this deficit is not covered by the FDI (the coverage is expected to decrease from 40% in 2007 to 30% this year), which could be a cause for concern. In an attempt to fight the inflation, the National bank is preparing to raise the interest rate with another 75 bps. to 8.75% and even 9% in H1'08, which would also be a challenge in keeping up the high economic growth. Nonetheless, improvement in the country's external balances could be expected after the currency's heavy drop against the euro. Many experts point out that the Romanian economy has enough fuel to sustain its growth, to advance in terms of productivity, and prove its competitive advantage in the regional context.

From a fundamental perspective, Romanian stocks look as solid as their Bulgarian peers, with the average P/E under 20x, and expected corporate earnings growth in excess of 20%. Interesting opportunities can be found not only with the blue chips, but also among small caps and some other unpopular stocks of the RASDAQ segment. Oil companies, energy and

construction firms (the infrastructure projects being in initial phase) are expected to report strong results this year. Due to the unfavorable international situation in the sector banking and financial stocks could be avoided.

These attractive fundamentals, however, could be appreciated only in the context of improved climate in the international markets following the settling of liquidity disbalance in the USA and Western Europe. Conditional on the duration of the global uncertainty, the come-back of international investors as buyers may be expected at a later stage, perhaps not earlier than the second half of the year.

Among the upcoming innovations that are expected to boost the liquidity and attract new traders are the start of the margin trading, short selling, an new derivatives. On the privatization front, Romtelecom, Romanian Proprietary Fund including residual shares of some of the largest companies, as well as some energy names could be expected on the exchange in 2008.

Regarding politics, 2008 will be an election year – the local elections will take place in mid-2008, while the parliamentary elections will be around November. No surprises or drastic changes in the political status quo are expected as a result of this – the formation of a coalition is expected in a format resembling the 2004 election configuration. The EC will continue to monitor the evolution of the political and macroeconomic development in Romania, which is important for certain sectors like the legal system reform, agriculture, and infrastructure development.

In conclusion, whereas there are many question marks regarding the short-term evolution, Karoll Capital Management is optimistic in the long run, since the fundamentals remain solid, and the liquidity problems that weigh down on the market are short to mid-term in nature.

Investment Strategy of Advance Invest Mutual Fund

Based on the above-mentioned views for the market development in Bulgaria and Romania, 2008 will be the year of caution. 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.

These goals are to be achieved through the increase of the cash portion to $\frac{1}{4}$ of Advance Invest's portfolio, maintaining the share of Bulgarian stocks to about 40%, Romanian stocks – 15%, and alternative investments (REITs, private equity and other defensive – minimum 17% of assets. The portfolio should become more concentrated, the bigger weight being pulled by equities with low relation with the market (small beta stocks). The participation in IPOs will be highly selective and only in the cases of serious discount to fair value as determined by the asset manager.

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.