PERRY Partners International

Third Quarter Review | October 8, 2008

Our third quarter performance was down 6.13% and we are down 9.32% year to date. We are disappointed with our recent performance, particularly since we have been reducing our overall equity exposure and building liquidity for over twelve months in anticipation of a global credit crisis. Given our concerns about the macro environment, we entered September with the least amount of directional market exposure we have had in the last few years. Our cash balances also increased significantly, rising from 26% at the end of August to 31% by the end of September, one of the highest levels the Firm has ever held.

Until the last ten days of September, the Fund's performance held up relatively well; however, the massive deleveraging that resulted from the failure of some of the world's largest financial firms, the unprecedented government intervention in the capital markets, and the forced selling from banks and hedge funds cost us meaningfully. While we had been preparing for the next distressed cycle, the panic and forced liquidations that ensued coupled with the magnitude and speed with which the credit markets effectively froze, were not things we could escape unscathed.

We believe that the severe dislocations today have generated opportunities, particularly in the credit markets; however, we are anticipating a prolonged period of severe global financial and economic weakness. While we are willing to be patient, our conservative balance sheet is poised to capitalize on the upcoming distressed cycle. Below is an overview of each of our business units and an update on operational and administrative issues including prime brokerage relationships and counterparty risk.

Credit

As of September 30, 2008 our credit investments represented 26% of the Fund's long market value. Greater than 75% of the credit book was in corporates and the remainder was in mortgage related securities. The credit derivative market effectively froze in September forcing us to dramatically reduce our short CDS exposure, but we continue to hold a select number of high conviction CDS positions.

In both corporate and structured credit we have added to existing positions and initiated new positions during the sell off. We are primarily purchasing first lien bank debt today with unprecedented 15+% yields at levels normally associated with highly leveraged subordinated debt. The bank debt we have bought is senior secured paper that pays a cash coupon and generally matures within the next five years. Additionally, we have purchased the debt of the auto finance companies. By our calculations the market is pricing in losses on auto loans similar to those expected in the housing sector, despite significant differences between the two markets. Unlike the housing market which saw a surge in prices and supply coupled with careless lending standards, the major auto finance companies generally maintained or improved their credit standards while production and prices did not increase. We expect these companies to deleverage to manage through the current environment.

Over the last quarter we increased our long exposure to mortgage credit in anticipation of significant opportunities emerging as the $10+ trillion residential mortgage and $3+ trillion commercial real estate markets came under severe stress. Following the success of our team's subprime investment in 2007/2008, we have now invested in a portfolio of near prime and Alt-A securities that we believe offer exceptional risk-adjusted returns. For example, we recently purchased an Alt-A security backed by option ARM loans that returns a 20+% yield to maturity in a scenario where 55% of the borrowers in the mortgage pool default and the houses are liquidated assuming a 60% loss severity (implies that homes in this pool depreciate by 40% from origination). This security offers an 8% yield to maturity in "depression" type scenarios in which 80% of borrowers default with a 70% loss severity (implies that homes in this pool depreciate by 50+% from origination). We expect to continue adding to our mortgage credit positions as the recession intensifies and loan performance deteriorates in the mortgage and commercial real estate markets. Additionally, we anticipate that as defaults increase, the dislocation in other structured credit markets will accelerate providing additional investment opportunities for us.

Although we expect the economy to further weaken and assume that both corporate and consumer defaults will rise dramatically in 2009, we anticipate increasing our credit exposure in a declining market. Historically, our strength has been in making tactical asset allocation decisions. Similar to the distressed cycles in 1990 and 2002, when we had approximately 50% of our capital allocated to credit, we will continue to pick through the carnage to capitalize on forced selling. The Fund's overall performance in the short run will closely correlate to the credit markets, and we recognize that in this very difficult market prices can continue lower – perhaps significantly lower.

U.S. Equities and Merger Arbitrage

For the past twelve months we have been reducing our equity long/short allocation. Our U.S. equity exposure as of September 30, 2008 was 19% of the long market value of the fund versus 72% in September 2007. Fortunately, the Firm eliminated $7 billion of exposure in this period. On a net basis, our exposure has been extremely low. We expect the long/short equity business to remain very challenging particularly in light of the short-selling restrictions recently introduced and the hedge fund/bank prop-desk deleveraging that has caused stocks to trade wildly and erratically. We are pleased that we proactively downsized our global equity exposure well in advance of this tough period, and further reduced our exposure in September. The markets are likely to continue suffering from declining liquidity and continued volatility until some of the newly implemented rules and restrictions are eased and the credit crisis works its way out over the next few years.

Merger Arbitrage was down slightly for the quarter, although the month of September was particularly difficult. The credit crisis has caused spreads to blow out over fears that financing commitments will not be honored. Considering our overall negative view on the macro environment, in hindsight we were too slow to reduce our capital allocation to the strategy, though our P&L in this area remains positive for the year. That said, while we reduced our exposure to the strategy (3% of long market value as of September 30, 2008), spreads are trading at their widest levels ever. We will continue to evaluate this space on a deal-by-deal basis.

Europe

Europe has been a difficult market this year, and we have materially downsized our European equities portfolio. In September, we suffered a sizable loss on a share class arbitrage position. There are several technical factors which caused this spread to move to unprecedented levels – mainly unwind pressure by other hedge funds exacerbated by Lehman's UK business entering into administration. While we believe the fundamentals underlying the position remain intact, we acknowledge that technical pressures remain the key driver, as they are for many other spread positions in the market.

Our focus in Europe will continue to shift away from equities and we anticipate seeing more special situations and distressed opportunities through the remainder of this year and into 2009.

Asia

Our Asian portfolio suffered modest losses in the quarter. Although we managed to maintain positive results through most of the quarter, the portfolio suffered during the last 10 days of September when short sale limitations, borrow recalls and liquidations by hedge funds and prop desks had a meaningful impact on our investments. We have continued to reduce our capital allocation to the Asian equity markets since limitations across Asia make it practically impossible to run a balanced equity portfolio in large size. We will reevaluate the opportunity set in the equity markets if regulations are relaxed over time.

Sidepocket Investments

Our sidepocket policy allows us to invest in a wide variety of less liquid situations. Until this year, the realized returns on these investments have been excellent. More recently, in accordance with our valuation process, we have taken meaningful mark downs on many of our sidepocket investments, though we continue to work to maximize the value of these positions. In this credit-constrained economy, we anticipate that our platform is in a prime position to access numerous assets that will be sold into the market. We also anticipate a tremendous opportunity in rescue lending, an area where we generated significant profits during the 2002-2003 cycle.

Operational Update

Although we have strategic relationships with several firms who continue to provide us with responsive operational support during these stressful times, we have rebalanced positions in anticipation of changes in the credit-worthiness of our prime brokers. We have also taken the additional step of moving our excess cash away from prime brokerage accounts and into custodian banks such as The Bank of New York.

We have been actively managing our exposures to various trading counterparties and have diversified our exposure to limit credit risk concentrations. In addition, we require all of our counterparties to post collateral to cover any unrealized gains generated on these transactions. As a result, our exposure to Lehman Brothers was negligible (approximately 20 basis points). Throughout the third quarter we further reduced our counterparty exposure by cutting our short credit derivative portfolio in half as we monetized most of our subprime investment in addition to covering several other short positions during the September sell-off.

Perry Capital remains committed to capital preservation and generating superior risk adjusted returns with low correlation. Difficult periods like this create superior investment opportunities that will help us build on our 20-year track record. This is one of the most interesting times to manage money and our main priority is investing our capital wisely.

As always, your thoughts and comments are welcome. Feel free to contact Jamie Parrot at (212) 583-4088/ jparrot@perrycap.com, Harlan Saroken at (212) 583-4059/ hsaroken@perrycap.com or Yinh Hinh at (212) 583-4069/ yhinh@perrycap.com.

PERRY Partners International

Quarter Ending September 30, 2008

	Perry Partners International	S&P 500 (Total Return)
MTD Performance	-7.70% EST	-8.91%
QTD Performance	-6.13% EST	-8.37%
YTD Performance	-9.32% EST	-19.29%

Performance Attribution by Strategy		**MTD**	**QTD**	**YTD**
Equities	North America	-1.39%	0.19%	-1.52%
	Latin America / Other	0.00%	0.01%	-0.03%
	Europe	-2.55%	-2.26%	-3.19%
	Asia	-1.01%	-0.81%	-1.36%
		-4.95%	-2.87%	-6.10%
Credit	North America	-2.72%	-3.56%	-4.23%
	Latin America / Other	0.00%	0.00%	0.01%
	Europe	0.04%	0.05%	0.04%
	Asia	-0.01%	-0.06%	-0.16%
		-2.69%	-3.57%	-4.34%
Credit Derivatives	North America	0.20%	1.12%	4.16%
	Latin America / Other	0.02%	0.02%	-0.07%
	Europe	0.17%	0.13%	-0.04%
	Asia	-0.01%	0.04%	0.50%
		0.38%	1.31%	4.55%
Private/Real Estate	North America	-0.34%	-0.83%	-0.79%
	Latin America / Other	-0.01%	-0.06%	-0.05%
	Europe	-0.07%	-0.14%	-1.96%
	Asia	-0.07%	-0.08%	0.01%
		-0.49%	-1.11%	-2.79%
Macro Hedge		0.05%	0.11%	-0.64%
Total Performance Allocation		**-7.70%**	**-6.13%**	**-9.32%**

Portfolio Exposure by Strategy (as a % of Capital)		**Long**	**Short**	**Number of Strategies***
Equities	North America	19%	-13%	34
	Latin America / Other	0%	0%	0
	Europe	5%	-6%	8
	Asia	6%	-3%	11
		30%	-22%	53
Credit	North America	25%	-1%	31
	Latin America / Other	0%	0%	0
	Europe	1%	0%	1
	Asia	0%	0%	0
		26%	-1%	32
Credit Derivatives	North America	7%	-15%	11
	Latin America / Other	0%	0%	0
	Europe	1%	-10%	1
	Asia	0%	0%	0
		8%	-25% **	12
Private/Real Estate	North America	5%	0%	11
	Latin America / Other	1%	0%	2
	Europe	3%	0%	4
	Asia	1%	0%	1
		10%	0%	18
Total Portfolio Exposure* **		**74%**	**-48%**	**115**

Fund Capital (in millions)	$8,348
Firmwide Capital (in millions)	$11,577

Top Exposure

Top 5 Long Positions (as a % of Capital)	11.68%
Top 5 Short Positions (as a % of Capital)	-4.45%

The firm maintains a 14% position in Treasury money market funds which it considers to be cash & cash equivalents and are therefore excluded from the above analysis.

* The strategy count includes only those strategies that are at least 15 basis points of the portfolio.

** Please note this is a non risk-adjusted notionalized number which costs the fund approximately $15 million annually to maintain.

*** In addition to the above, the firm hedges exposures to certain macro-economic related risks. These include, but may not be limited to, fixed income products and currencies. These positions augment our portfolio hedges and add diversification benefits to the firm overall.