Dynamic
Currency
Debt
Management

4th Quarter 2008 Interim Report 11 December 2008

The fog is clearing

The credit crisis caused a sink hole - some even called it a meltdown - for the euro/dollar rate, in the process stunning banks and lenders into a frozen state. For 2 months (our last letter is dated 8 October 2008), we took to the sidelines and waited for a signals of a consolidation and eventual recovery. This moment has now come.

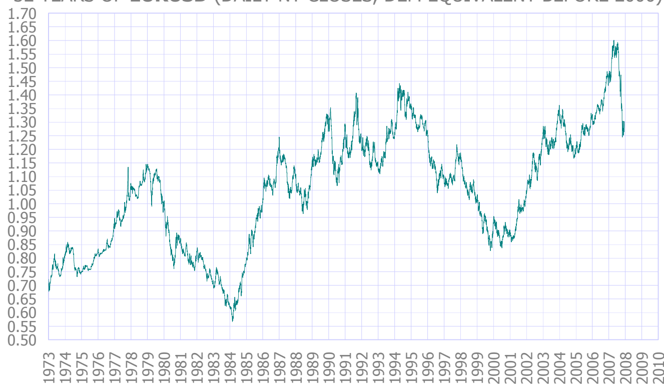
EUR/USD has broken above some key levels today, and that has pulled up most other currencies against the USD as well. The bailout of the automobile producers' has generally lowered to perception of risk but guarded comments by the ECB certainly also turned sentiment in favour of the euro. Given that risk appetite will now slowly come back to the markets, it is tempting to assume that the U.S. dollar is now ready to resume its innate long-term downtrend. Yet, in today's jittery climate, risk appetite may be a volatile affair, thus the strength of the euro is in many ways more interesting than any re-emerging USD weakness.

While continued dollar weakness depends largely on global appetite for risk, the strength of the euro seems to be arising primarily from the rigidity of the ECB's monetary policy. Even though the ECB has cut rates 175 basis points, euro yields have fallen less than the yields elsewhere in the last month, as other central banks have seen no risk of inflation and decided to really slash rates to stimulate demand in their economies. The ECB was a little more circumspect, even though quite aggressive by his own standards. The strength of the euro on the European crosses appears to be due in large part to the more conservative euro-zone interest rate cuts. Euroland is in smaller distress than other economies, such as the UK, and most risk-hedgers are abandoning the Swiss franc in favour of gold, given the Swiss franc's continued trade interests and thus historically inherent link with the euro zone.

All of the above give rise to re-entering our euro-debt management at once, switching any euro debt into US dollar, British pound and Swiss franc. Our action is therefore:

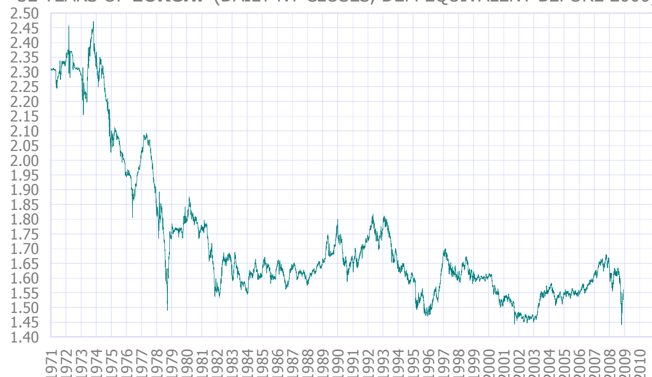
a) Switch 25% of euro exposure into U.S. dollars
b) Switch 25% of euro exposure into British Pound
c) Switch 25% of euro exposure into Swiss Franc
d) Leave 25% of euro exposure in euro, for eventual switch into Canadian dollars

32 YEARS OF **EURUSD** (DAILY NY CLOSES, DEM EQUIVALENT BEFORE 2000)



32 YEARS OF **EURGBP** (DAILY NY CLOSES, DEM EQUIVALENT BEFORE 2000)

32 YEARS OF **EURCHF** (DAILY NY CLOSES, DEM EQUIVALENT BEFORE 2000)



Borrowing can become an advantageous business if loan balances can be reduced through a) interest rate reduction and/or b) dynamic switching to weaker currencies. Interest rates for different currencies vary greatly. Switching loan balances into low interest rate currencies can reduce the interest burden. Switching loan balances into currencies that fall against the original loan currency can also reduce the loan burden. DynexCorp uses a combination of both to achieve benefits for the borrower.

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