

FRIEDBERG  
MERCANTILE  
GROUP

FOURTH  
QUARTER  
REPORT  
2001





# Fourth QUARTER REPORT 2001

Dear Investor,

We are pleased to bring you our report on the activities and financial results of our funds for the fourth quarter of 2001.

The performance for the entire year was marred, unfortunately, by the very poor results achieved in the final quarter. Paradoxically, the events of September 11 marked a sort of turning point in the well-established pattern that had formed prior to the event — a pattern that we had read accurately and profitably. While the events aggravated the recession, they also provided a short-term catharsis. This, coupled with the powerful political, military and financial response, caused markets to react in ways that we did not fully anticipate. Disconcertingly, long-term interest rates and stock prices rose as if discounting an imminent recovery; yet, surprisingly, commodity prices continued to weaken well into the quarter. Awash in money, beaten down but still overpriced “tech” and investment banking stocks surged. Bonds and currencies of emerging economies (like the Brazilian real) were re-floated in an eerie replay of the old bubble. Junk bonds flourished and Treasuries languished despite the dramatic rise of defaults. We paid dearly during this quarter for misreading the tea leaves. Except for the catastrophic losses incurred on the Argentinean peso (liquidated after the quarter-end) and reported to you under earlier and separate cover, the losses incurred in the

fourth quarter in some of the programs are, in our opinion, more than recoverable. That is because we have, for the most part, maintained our original investment posture and fully expect markets to resume the pre-September trend.

Economic visibility has begun to improve. The economic downturn has moderated as inventory liquidation abates. At the same time, however, serious economic imbalances remain, which will make it impossible for the U.S. economy to stage a meaningful recovery. Huge over-capacity in key sectors and a persistent and large corporate financial deficit will work towards continuous weakness in capital spending. An over-burdened and over-stretched consumer is likely to reduce spending. Finally, a literal explosion in money supply guarantees much higher rates of inflation than warranted at this stage of the business cycle. The sum total of these factors should be a long and uncomfortable period of stagflation. In turn, this scenario should translate into lower prices for pure financial assets and higher prices for commodities, primarily precious metals, grains and soft foods.

We look forward to report to you substantially improved results in the new year and we thank you for your continuous trust,



Albert D. Friedberg

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Neil Rackoff comments:

The Friedberg Allocation Model and the Friedberg Global Macro Fund LTD. returned  $-5.44\%$  for the quarter and  $-1.89\%$  for the year ending December 31, 2001.

In our comments from previous quarters we have, almost to the point of sounding like a broken record, extolled the virtues of investing only in a diversified fashion, utilizing the suggestions set forth in our model allocation portfolio. We also discussed our search for proper benchmarks with which to provide a meaningful measure of our performance.

As the saying goes, there is nothing like trial by fire. And this past quarter certainly qualified as such. A glance at the following pages will show that the individual strategies of Currency, Equity Hedge and Global Opportunities (a combination of the Diversified and International Securities programs) all sustained substantial losses while the Fixed Income program advanced a little over 1%. The overall performance was a more moderate yet still disappointing loss of 5.44%, as mentioned above. As we wipe the sweat from our brow, we are grateful for having taken our own advice. It could have been much worse.

Now a word about benchmarks. We have written two articles sharing with you our thoughts on benchmarks, and another is on the way. This quarter, we introduce a number of benchmarks that we believe will provide a meaningful measure of our performance.

The first is the CMI (Commercial Markets Index). We use the CMI Total Return Index for measuring performance of our Diversified Trading program, and the CMI Currency Sector Index for our Currency Trading Program. We believe that these indices, developed by Alan Kaufman of Assetsight, Princeton, New Jersey, provide us with some of the key features that make for a good benchmark: They are investible, transparent, liquid, and representative of the asset class. (For more detailed information on the subject of benchmarks, please scroll down the page at, <http://www.friedberg.com/c/html0s/00763.1.710363634116044284/Analysis>, or call our office at 212-943-5300. A final article is forthcoming in *Friedberg's Commodity and Currency Comments*.)

The second set of benchmarks that we have introduced for this quarter is for our Equity Hedge program and for our Allocation Model/ Friedberg Global Macro Fund Ltd. They are merely indices, and we have in our articles spelled out the disadvantages of using indices of hedge funds that are not investible. Nevertheless, we

## FRIEDBERG ALLOCATION MODEL con't

have yet to find a satisfactory alternative, such as a style-specific fund of funds. We hope to have some more definitive direction in this area soon. In the meantime, we are using the Hedge Fund Research Performance indices. The first is the HFRI Macro Index, which was up 6.30% this past year compared with our performance of -1.89%. The second is the HFRI Equity Market Neutral Index, which was up 6.23% this past year compared with our performance of -2.60%. The quarterly and three-year annualized performance figures appear in the exhibits.

The benchmark for our Fixed Income program remains as introduced in the last quarterly report. (For a copy please contact our office.)

We hope that these benchmarks will enable you and us to assess the value that we add as an asset manager.

The recommended allocation going forward is:

For non-North American investors:

Friedberg Total Return Fixed Income Fund	65%
Friedberg Equity Hedge Fund Ltd.	15%
Friedberg Currency Fund Ltd.	10%
Friedberg Global Opportunities Fund Ltd.	10%

For Canadian investors:

Friedberg Foreign Bond Fund	65%
Friedberg Equity Hedge Fund	15%
Friedberg Currency Fund	10%
Friedberg Diversified Fund	6.7%
Friedberg International Securities Fund	3.3%

# FOREIGN BOND PROGRAM

## FRIEDBERG FOREIGN BOND FUND FRIEDBERG TOTAL RETURN FIXED INCOME FUND LTD. FRIEDBERG TOTAL RETURN FIXED INCOME FUND L.P.

The funds seek total investment return, consisting of a combination of interest income, currency gains, and capital appreciation, by investing in both investment grade and non-investment grade fixed income obligations and corporate bonds denominated in a variety of currencies.

**LOW RISK.** Objective: LIBOR+4% per annum

### PERFORMANCE as of December 31, 2001

	NAV	Quarter	Year over Year	Two Years <sup>2</sup>	Three Years <sup>2</sup>
Friedberg Foreign Bond Fund <sup>1</sup>	11.89	0.85%	-0.92%	6.26%	1.77%
Friedberg Total Return Fixed Income Fund Ltd.	1024.97	1.17%	-5.05%	4.17%	1.42%
Friedberg Total Return Fixed Income Fund L.P.	104.24	0.91%	-4.11%	5.08%	2.12%
Benchmark <sup>3</sup>		-0.45%	2.35%	3.19%	2.30%

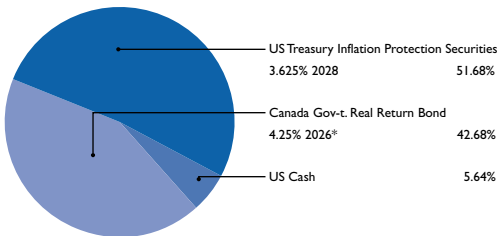
<sup>1</sup>Priced in Canadian Dollars

<sup>2</sup>Compounded Annual Rate of Return

<sup>3</sup>U.S. dollar basis; see shareholders report 3Q 2001

## FRIEDBERG FOREIGN BOND FUND

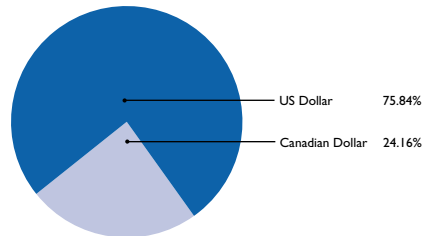
Portfolio Allocation



Weighted average yield to maturity 5.38%  
Weighted average current yield 3.80%

\*Currency Partially or Totally Hedged

Currency Exposure

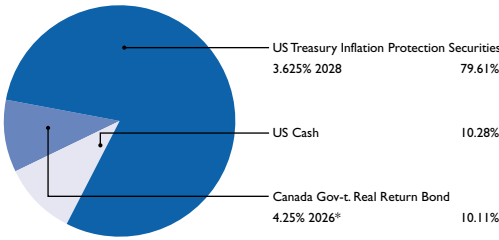


Adjusted modified duration 6.87%  
Approximate overall credit rating AAA

Bond rating breakdown: AAA 100.00%  
Unrated 0.00%

## FRIEDBERG FIXED INCOME FUND LTD.

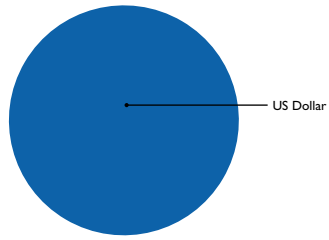
Portfolio Allocation



Weighted average yield to maturity 5.38%  
 Weighted average current yield 3.64%

\*Currency Partially or Totally Hedged

Currency Exposure

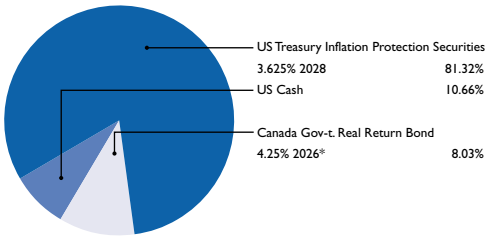


Adjusted modified duration 6.69%  
 Approximate overall credit rating AAA

Bond rating breakdown: AAA 100.00%  
 Unrated 0.00%

## FRIEDBERG FIXED INCOME FUND L.P.

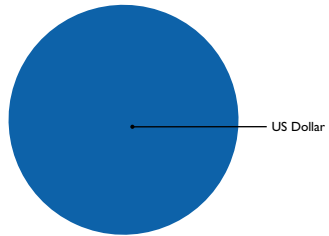
Portfolio Allocation



Weighted average yield to maturity 5.38%  
 Weighted average current yield 3.63%

\*Currency Partially or Totally Hedged

Currency Exposure



Adjusted modified duration 6.68%  
 Approximate overall credit rating AAA

Bond rating breakdown: AAA 100.00%  
 Unrated 0.00%



# EQUITY HEDGE PROGRAM

## FRIEDBERG EQUITY HEDGE FUND LTD. FRIEDBERG EQUITY HEDGE FUND

The funds use leverage to trade equity securities and stock index futures contracts and related options. The fund balances long and short positions in an attempt to eliminate systematic or market risk.  
**MEDIUM RISK. Objective: 20-25% per annum**

### PERFORMANCE<sup>1</sup> as of December 31, 2001

	NAV	Quarter	Year over Year	Three Years <sup>2</sup>
Friedberg Equity-Hedge Fund Ltd.	1820.46	-11.94%	-2.60%	22.15%
Friedberg Equity-Hedge Fund	16.38	-11.70%	-4.32%	21.38%
Benchmark: HFRI Equity Hedge Fund		-2.50%	-3.88%	-17.55%

<sup>1</sup>Net of fees

<sup>2</sup>Compounded annual rate of return

### INVESTMENT ALLOCATION<sup>3</sup>

	Sep-30	Oct-31	Nov-30	Dec-31
LONGS	57.20%	54.91%	57.11%	54.80%
SHORTS	42.80%	45.09%	42.89%	45.20%
TOTAL GROSS LEVERAGE	2.18 x	2.51 x	3.09 x	2.44 x

### LARGEST SECTORS (LONGS)<sup>3</sup>

Energy/Electric Integrated	8.27%
Biomedical/Gene/Therapeutics	6.96%
Aerospace/Defence Equipment	6.88%

### LARGEST SECTORS (SHORTS)<sup>3</sup>

Investment Banking/Brokers	8.70%
Investment Management	7.83%
Computers	5.84%

<sup>3</sup>As percentage of total gross assets (as per the Friedberg Equity-Hedge Fund Ltd.)

### LARGEST LONG POSITIONS

Russell 2000 index futures<sup>4</sup>  
United Technologies Corp.  
General Dynamics Corp.  
Waste Management Inc.  
Valero Energy Corp.  
Fedex Corp.  
Southern Corp.  
Conectiv  
Philadelphia Suburban Corp.  
Xoma Ltd.

### LARGEST SHORT POSITIONS

Goldman Sachs Group Inc.  
Stilwell Financial Inc.  
Waddell & Reed Financial  
Capital One Financial Corp.  
AOL Time Warner  
International Business Machines Corp.  
Morgan Stanley Dean Witter & Co.  
General Electric Co.  
Maxim Integrated Products  
Amazon.Com Inc.

<sup>4</sup>Market value of futures contracts

### BEST QUARTERLY PERFORMANCE

LONGS		SHORTS	
MTR Gaming Group Inc.	72.60%	Providian Financial Corp.	72.21%
Cognos Inc.	55.19%	Qwest Communications	15.39%
Cephalon Inc.	43.25%	AOL Time Warner	1.95%

### WORST QUARTERLY PERFORMANCE

LONGS		SHORTS	
Imclone Systems	-19.51%	Amazon.Com Inc.	-81.24%
Earthlink Inc.	-22.45%	Affymetrix Inc.	-135.20%
Terayon Commuincation Systems	-22.60%	Veritas Software Corp.	-143.11%

# CURRENCY PROGRAM

FRIEDBERG CURRENCY FUND  
 FRIEDBERG FIRST MERCANTILE FUND  
 FRIEDBERG CURRENCY FUND II LTD.  
 FRIEDBERG FOREX L.P.

Speculative trading in currency futures instruments,  
 currency forwards and options.  
 HIGH RISK. Objective: 25% per annum.

## PERFORMANCE as of December 31, 2001

	NAV	Quarter	Year over Year	Three Years <sup>2</sup>
Friedberg Currency Fund <sup>1</sup>	13.96	-21.70%	-22.49%	-7.45%
Friedberg First Mercantile Fund	11.97	-21.97%	-27.45%	-8.35%
Friedberg Currency Fund II Ltd.	742.16	-21.26%	-24.93%	-6.98%
Friedberg Forex L.P.	12.35	-20.53%	-22.62%	-6.23%
Benchmark: CMI Total Return Currency Index		0.13%	-0.33%	-0.34%

<sup>1</sup>Priced in Canadian Dollars

<sup>2</sup>Compounded Annual Rate of Return

## OPEN POSITIONS - December 31, 2001

	leverage
Long Argentina Peso	2.71
Long U.S. Treasury Inflation Protection Securities	0.74
gross leverage at December 31, 2001	3.20 x
maximum gross leverage during quarter	8.23 x

## ACTIVITY REPORT - Fourth Quarter 2001

PROFITABLE TRANSACTIONS	profit as percentage of beginning equity	percentage of total profits
Long U.S. Treasury Inflation Protection Securities	1.40	59.67
Long Argentina Peso	0.95	40.33
LOSING TRANSACTIONS	loss as percentage of beginning equity	percentage of total losses
Short Brazilian Real	(28.99)	96.83
Short Indonesia Rupiah	(0.86)	2.87
Euro Currency	(0.09)	0.30

# DIVERSIFIED TRADING PROGRAM

## FRIEDBERG DIVERSIFIED FUND

Speculative trading of commodity, interest rate, and stock index futures,  
over the counter forwards and options markets.

HIGH RISK. Objective: 40% per annum

### PERFORMANCE as of December 31, 2001

	NAV	Quarter	Year over Year	Three Years <sup>1</sup>
Friedberg Diversified Fund	6.36	-27.89%	18.22%	-18.89%
Benchmark: CMI Total Return Diversified Index		-0.67%	5.63	9.20%

<sup>1</sup>Compounded Annual Rate of Return

### OPEN POSITIONS - December 31, 2001

	leverage
LONG JAPAN GOVERNMENT BONDS	7.60
LONG U.S. TREASURY INFLATION PROTECTION SECURITIES	2.21
LONG COCOA	0.47
SHORT E-MINI NASDAQ	0.45
SHORT CRUDE OIL	0.43
LONG WHEAT	0.31
LONG GOLD	0.20
LONG PLATINUM	0.17
gross leverage at December 31, 2001	11.74 x
maximum gross leverage during quarter	12.20 x

### ACTIVITY REPORT - Fourth Quarter 2001

PROFITABLE TRANSACTIONS	profit as percentage of beginning equity	percentage of total profits
Ten Year Note	1.52	71.86
Platinum	0.47	22.16
Copper	0.13	5.98
LOSING TRANSACTIONS	loss as percentage of beginning equity	percentage of total losses
Equity Futures	(9.97)	36.39
Precious Metals (Gold/Silver)	(5.16)	18.83
Japanese Government Bonds	(2.61)	9.52
Cocoa	(2.20)	8.02
Soybeans	(2.05)	7.49
Crude Oil	(2.03)	7.42
Grains (Corn/Wheat)	(1.17)	4.28
Cotton	(0.81)	2.96
U.S. Treasury Inflation Protection Securities	(0.69)	2.52
Sugar	(0.38)	1.39
T-Bonds	(0.33)	1.19

## FRIEDBERG FUTURES FUND

The Futures Fund combines the Currency and Diversified programs in approximately equal weights. Please refer to our earlier graphs and tables regarding these programs.

## FRIEDBERG INTERNATIONAL SECURITIES FUND

The fund seeks to capitalize on the rise and fall of local markets throughout the world by anticipating long term secular trends or by identifying, at an early stage, cyclical economic expansions and contractions of economies of selected countries.

**MEDIUM RISK. Objective: 20% per annum**

### PERFORMANCE<sup>1</sup> as of December 31, 2001

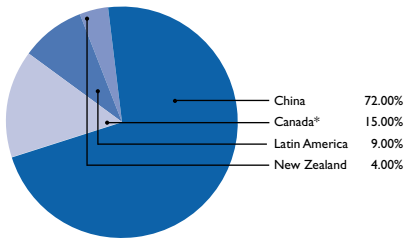
	NAV	Quarter	Year over Year	Three Years <sup>2</sup>
Friedberg International Securities Fund	11.96	-8.07%	21.18%	9.86%

<sup>1</sup>Net of fees

<sup>2</sup>Compounded Annual Rate of Return

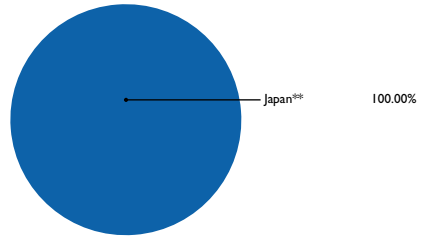
## EQUITIES EXPOSURE BY COUNTRY

**LONG (% of total longs)**



\*Oil and Gas shares

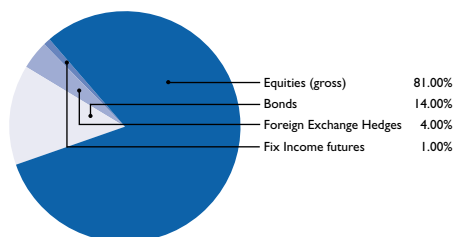
**SHORT (% of total shorts)**



\*\*Secondary Banks (hedged with JY futures)

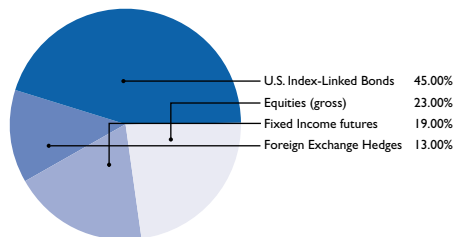
# FRIEDBERG INTERNATIONAL SECURITIES FUND cont'd

## BREAKDOWN BY INVESTED AMOUNTS\*



\*Based on margins used in each category

## BREAKDOWN BY TOTAL GROSS EXPOSURE\*\*



\*\*Including notional values of derivatives

**TOTAL GROSS LEVERAGE 2.92 x**

## POSITIONS ESTABLISHED DURING THE QTR.

- 1) Purchased China "B" shares
- 2) Purchased Grupo Financiero Galicia (Argentina)
- 3) Purchased Japanese Government Bonds

## POSITIONS LIQUIDATED DURING THE QTR.

- 1) Short mini Nasdaq Futures
- 2) Short Latin America Telecom stocks
- 3) Long Allied Oil and Gas (Canada)
- 4) Short British Sky Broadcasting
- 5) Long Grupo Financiero Galicia (Argentina)

## APPROXIMATE RETURN ON BEGINNING EQUITY BY MAJOR SECTORS - (Oct. 1 - Dec. 31)<sup>2</sup>

China	0.23%
Japan	-2.44%
Canada	0.88%
Latin America	-3.12%
Nasdaq Futures	-2.18%
U.S. Index-linked bonds	-2.13%
Miscellaneous	0.68%

<sup>2</sup>not time adjusted

## FRIEDBERG GLOBAL OPPORTUNITIES FUND LTD.

The Global Opportunities Fund comprises the Diversified Trading Program and the International Fund. Please refer to corresponding graphs and tables for these two programs.

### PERFORMANCE<sup>1</sup> as of December 31, 2001

	NAV	Quarter	Year over Year	Three Years <sup>2</sup>
Friedberg Global Opportunities Fund Ltd.	602.06	-22.96%	29.75%	-12.55%

<sup>1</sup>Net of fees

<sup>2</sup>Compounded Annual Rate of Return

## FRIEDBERG SKILL-BASED MANAGERS FUND

### PERFORMANCE as of December 31, 2001

	NAV	Quarter	Year over Year	Two Years <sup>1</sup>
Friedberg Skilled-Based Managers Fund	11.52	3.23%	8.47%	7.17%

<sup>1</sup>Compounded Annual Rate of Return

David Rothberg Comments:

Preliminary estimates put the Skill Based Fund's performance for 2001 at +10.2%. The fund is approximately invested 38% in long/short value strategies, 24% in convertible arbitrage, 25% in risk arbitrage, and 13% in cash. Being sceptical of the stock market's current rally, we believe the current weightings will continue to reward investors.





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