

April 15, 2008

## **Investor Letter, 1<sup>st</sup> Quarter 2008**

Dear Investor,

This is the first of the quarterly letters we will be issuing to all Global Quest investors and interested parties; increasing the information flow beyond the annual updates we have done in the past. The steady increase in the value of our property investments continues; but with the current state of the financial markets in the U.S., a valid question arises as to what impact this will have on emerging markets, especially real estate in Bulgaria. The quick answer at this stage is - very little.

The credit issues and housing slump in the West have not noticeably dampened the underlying prospects for many emerging markets. There has been a retreat from paper assets (currencies, bonds and stocks) from certain countries, but little decrease in the core interest of businesses to expand into these areas. This could be viewed as a partial *decoupling*, since the main bullish forces behind their tremendous growth continue to be present; these being the continued efforts of these countries to modernize and the international business interest to tap new markets and access cheaper labor and resources. (This contrasts the forces that are blamed for the problems in the West, rampant speculation and excess leverage.)

In looking at the situation in more detail, the first item that naturally comes to mind is whether the sharp price declines occurring in the U.S. real estate values (and in Western Europe) are likely to extend to the markets of Eastern Europe in the same way. This is unlikely for a number of reasons. First, leverage in the way of mortgages is still very new to places like Bulgaria. Housing loans only became readily available over the last five years and have not had time to expand anywhere close to the levels per capita present in the well-developed markets like the U.S. Second, the structure of mortgage loans available in Bulgaria did not include floating interest rates, low (or no) down payments or acceptance of financially weak borrowers; in essence, there was not a *sub-prime* market. Actually, the fact that banks were lending in an emerging market country to begin with, made them more cautious over this period.

It is best to think of the housing market in Bulgaria as a *first-time+home* buying environment. These first-time buyers are not necessarily young couples, but could be just about anyone. They may be those that have never owned a home because Communism did not allow it and they are now pooling their savings to add to a mortgage loan to make their first purchase; they could be those who were able to *inherit* the Communist-era housing they were living in, but are now anxious to upgrade to more modern living conditions; or they could be one of the many people moving from the countryside into the capital city of Sofia to take advantage of the better job opportunities and a more cosmopolitan life-style.

Demand for real estate is still strong in Bulgaria and there are no delinquency or foreclosure issues, but considering the banking problems of today, another fair question would be whether the local banks there are able and willing to make new loans. Many banks in the U.S. and some

in Europe are saddled with bad debt; the entire system is affected by the ill liquidity of the short-term lending market. Luckily, this has not significantly hampered the banks operating in Bulgaria. Nearly all the banks there are owned by healthy institutions from Austria and Germany. None of these are particularly exposed to the Western European and U.S. mortgage problems (unlike a bank such as UBS.) In fact, they have benefited by having a presence in emerging markets because of the high profit margins and high growth rates.

The population of Eastern Europe has just begun to take advantage of the most basic modern banking services. Previously, Bulgaria and its neighbors were cash-based economies; even houses were bought and sold with large piles of cash. Now, savings accounts, checking accounts, wire transfers and all the normal conveniences that we take for granted are just beginning to be embraced. In fact, it is these new bank deposits that are being used to make many of the local mortgage loans (this is the way traditional banking was done before modern alternatives were developed.) Being first to enter these markets has been an excellent strategic move for these Austrian and German banks because of the huge growth opportunities. In light of the times, it would make sense that all banks around the world consider a more cautious approach moving forward, but in doing this, markets like Bulgaria (I know it sounds funny) actually end up looking very attractive and potentially less risky.

Another issue of the times has to do with emerging market countries which have large current account deficits; they are now vulnerable to an exodus of foreign investment capital. Bulgaria has this problem and is not immune to the trend; both Bulgarian stocks and bonds have declined; (normally the currency would also decline under these circumstances, but Bulgarian Lev is pegged to the Euro.) One reason for their large current account deficit is the amount of foreign capital that has been directed into Bulgaria since they became a member of the E.U. These companies have just begun to take advantage of a new, growing market for their products and the lower manufacturing costs. So even though paper assets will continue to come under closer scrutiny, hard assets will not necessarily be affected in the same way; reinforcing the advantage of investing in emerging markets through a hard asset such as real estate.

In summary, the major positives influencing the Bulgarian property market continue to be the huge local demand for new housing, a steady increase in pan-European businesses in Bulgaria, and a healthy, operating banking industry. To be fair, a larger world slow-down emanating from the U.S. is still possible; even so, it appears that this would have to be extraordinarily severe to severely curtail the opportunities of emerging markets. If the slowing is less severe, it would actually act as a much-needed brake on the fast paced growth in Bulgaria and most other emerging markets. Therefore, we are still very optimistic on the niche opportunity of real estate investments in Bulgaria.

Sincerely,

Jeffrey Notaro

CEO  
Global Quest LLC

New updates on the progress of the investments and the up-to-date financial statements are now posted on the website.

[www.GQINV.com](http://www.GQINV.com)

Fund 1          user: investment          password: sofia

Fund 2          user: investment          password: bulgaria