

MARRET RESOURCE YIELD FUND



Commentary - Third Quarter 2011

Experience. Intelligent Investing.

	1 mo	3 mos	6 mos	YTD	1 yr*	3 yr*	Ann. ITD	Cum. ITD
Marret Resource Yield Fund ¹	(4.8%)	(5.2%)	(7.1%)	(4.7%)	4.0%	5.5%	(0.5%)	(2.1%)
S&P/TSX (Toronto)	(9.0%)	(12.6%)	(17.7%)	(13.5%)	(6.0%)	(0.4%)	(2.4%)	(10.8%)

¹ From February 2007, returns are for the Marret Resource Yield Fund (Class A), (formerly the Arrow Canadian Income Fund (Class A)), net of all fees and in Canadian dollars. Since inception, the Fund was advised by Aston Hill Financial Inc. until the advisor was replaced in November 2008 by Marret Asset Management. Unless otherwise stipulated returns are net of all fees, in Canadian dollars, reflect class "A" units and assume reinvestment of all distributions. This document is not to be construed as a public offering of securities in any jurisdiction in Canada. The offering of units of the Fund is made pursuant to the Offering Memorandum only to those investors in all jurisdictions of Canada who meet certain eligibility of minimum purchase requirements. Important information about Arrow Funds, including statement of each fund's fundamental investment objective, is contained in their respective offering memorandum, a copy of which may be obtained from Arrow Capital Management Inc. Please read the applicable offering memorandum carefully before investing. The information and materials in this document are for informational purposes only. They are not intended as investment, financial or other advice. The information included in this document is not an offer to sell. While the information and material in this document are believed to be accurate at the time they are prepared, Arrow Capital Management Inc. (and its affiliates, subsidiaries or sub-advisors) cannot give any assurance that they are accurate, complete or current at all times. Past returns are not necessarily indicative of future performance. Actual results will vary. This document is confidential and is intended solely for the information of the person to which it has been delivered.

* Returns are annualized.

What volatility we experienced in Q2 was proven to be tame given what transpired in Q3. European politicians in denial, slow down in China, the U.S. debt ceiling debacle and the odd dictator being toppled in the Middle East all contributed to the fear trade. The broad TSX lost 12.02% in Q3 (YTD -11.88%), while the Energy Composite lost 18.68% (YTD -19.14%) and the Materials Composite declined 8.80% (YTD -17.67%) as gold offset some of the base metals losses.

In our Q2 commentary, we noted that volatility was relatively contained due to three factors: Europe would solve the Greece problem, U.S. growth would improve, and China would achieve a soft landing. Looking at these factors one quarter later, the European situation has significantly worsened - Greece hasn't been fixed and contagion has spread to Italy and Spain, U.S. growth has improved but growth remains weak and China continues to slow.

These issues remain at the forefront of market sentiment along with European sovereign debt and growth in the U.S. and China which are key issues. The immediate focus is on Europe as markets gyrate around optimism that the politicians can come up with the proverbial "bazooka" to solve the sovereign debt and banking problems and despair that they continue to dither while the fire burns. To be fair, recognition that Greece needs to default and the support needs to be given to the banks is a huge step forward and the process is moving in the right direction. The process is still saddled with too many people looking for a painless solution or for someone else to pay. The French want the EFSF (i.e. Germany) to keep their AAA rating. If the Germans say no, France's AAA rating will go much lower. The EU wants the IMF (i.e. U.S.A. and China) to recapitalize their banks so they don't have to pay - not surprisingly the U.S. and their new favourite spokes model, Jim Flaherty (Canadian Finance Minister) have said no, clean it up yourself.

Progress is being made in Europe but our analysis of history suggests that solutions do not occur without market crises. Therefore, a market crisis is not to be feared but rather embraced as it gets us to the solution faster. The key is to preserve capital and maintain liquidity while it is happening so you can buy cheap assets coming out the other end.

U.S. growth improved in Q3 from the 1.3% real GDP print in Q2 and will likely come in around 2 - 2.5%. This is good but not strong enough to lower its debt/GDP ratio which is critical for sustained longer term growth. The U.S. is not in recession but rather "muddle through" mode. We expect it to be in recession by mid 2012 at the latest.

China continues to slow but we don't see a hard landing. It is an export based economy and Europe is its largest customer so some slowing is inevitable. We don't see a hard landing but slowdown is not good for a heavily indebted Western world.

We reduced risk substantially in the fund during Q3. Energy and base metals positions were reduced or hedged and we added to precious metals positions after large corrections in gold and silver. We also continue to look for opportunities to provide senior secured debt financing with equity warrants to pre-production resource projects. We closed a deal with Cline Mining just after quarter end.

Given risk in the world we intend to keep net exposure and volatility low over the next few quarters, even if Europe comes up with some kind of bank recapitalization program. We see the economic landscape as deteriorating and risk is rising. This will shift more positively once the U.S. is on a sustainable path to lower Debt/GDP. This may take a while or not but if history is any guide, it will be preceded by a crisis in the U.S. Treasury market.

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The fund's top five positions are:

1. Cash (43%)
2. 30 yr. U.S. Treasury Bond (10%)
3. New Gold – Debt & Converts (6.75%)
4. iShares Gold Shares – XGD (4.8%)
5. Athabasca Oil Sands – Equity (2.8%)

Thank you for your continued interest in the Fund. For further information, please contact your regional Arrow Capital representative.