NAV Updates

Series	*MAY 2010*	*MTD*	*YTD*
Class A	153.32	-7.15%	-13.91%
Class B	153.37	-7.16%	-13.92%
Class C GBP	83.32	-7.10%	-14.13%
Class D SGD	213.16	-7.13%	

Fund Size $286m

Performance

2005Q4	+8.86%
2006	+33.94%
2007	+21.88%
2008	-20.84%
2009	+26.59%
2010(YTD)	-13.91%

The fund rose 1.7% in April and fell 7% in May. May had strong echoes of 2008 although this time it's different, and not in a good way. The movement to centre stage of Europe's sovereign debt problems has scarcely begun and similar issues in Eastern Europe, starting with Hungary also loom darkly. We expect that before long the full weight of the problem will be felt. This time we will be combing bank balance sheets not for mortgage backed securities but for holdings in the sovereign bonds of much of Europe. Worse, retrenchment and saving will start in earnest in the coming 12 months resulting in trade tensions and if left untended a strong deflationary impulse. Put simply, absent a miraculous set of perfectly timed, perfectly coordinated and perfectly chosen government actions, you would expect markets to be very worried about growth and deflation and possibly default.

The huge gyrations we have encountered in stock markets, however, suggest that there is still a modicum of hope left with investors, or at least confusion. We suspect that much of this is emanating from the still healthy and more optimistic outlook painted by companies where there is very little financial stress, and a lack of signal from neutral valuations. Moreover, the look of surprise on the faces of our visitors from Asia who have arrived in Europe after visits to Japan and the USA tells us everything we need to know. In Europe, apparently, we still 'look happy', apparently in direct contrast to the low ebb and beaten up air in either Japan or America. This comes as a surprise to our visitors, given the headlines. It probably won't last but is causing much head scratching.

In Asia the mood has not been lightened by ongoing tightening in China, especially regarding property and the deteriorating relationship between North and South Korea. Companies still report a generally buoyant operating environment but still stock markets have been badly hit once more.

Confusion and Change

We think the current schizophrenic behaviour of markets in Asia has a strong basis in a number of fundamental and profound changes which the region is having to undergo. The analogy might be that the first time water is let out of a new dam one has no idea where the flows and eddies or the weaknesses in the embankment lower down will be. We are learning new patterns on our feet and during what is, effectively a crisis. The first change we wrote about last month , described as the *'Polar Shift'* is a long process, an imperative given the debt situation, which is starting now. Over coming years and decades Asia will slowly become the consumer of the world whilst the West becomes the saver. This seems pretty obvious as a general observation as to what should or might happen in future but it has far reaching implications for currencies, trade flows, investments and politics, all of which will cause eddies and currents in global trends with which we are not familiar. The impact in the immediate future is probably that there is too little impact. Asia is simply not yet in a position to take up where the USA and Europe leave off and so we will find ourselves in a *'mind the gap'* situation where the long term growth in demand in Asia remains just that whilst the short term sees further slowdown in the West. To add to the confusion there will be situations along the way, where Asian demand is very exciting. For example, Apple recently announced stellar results which were significantly ahead of expectations precisely because Asian demand for the iPhone had been so unexpectedly strong.

Asian Monetary Policy

The second profound shift which is already causing confusion is most brilliantly written about by Russell Napier. He contends that Asian governments are moving away from currency targeted monetary policy and mercantilism towards something completely new. They will leapfrog the western inflation targeted thinking, given the flaws here which have since been exposed and look for a new way to tame the boom bust cycles we have all become used to. He believes we are beginning to see evidence that Asian governments will target credit growth. Evidence that this is already happening can be seen in the recent increase in Hong Kong and Singaporean stamp duties, despite lending growth in both countries being currently very low in historic terms. The Chinese crackdown on mortgage lending is another leading example.

The impact of such a massive shift in government thinking is not just taking place in Asia of course but it will first be observed in Asia where the credit cycle is more advanced. It will probably take years for investors to get used to and in the meantime there will be confusion as to how the economy and governments will react and thus how one should invest. Amongst the things Russell warns us to look out for are more free, but not entirely free, exchange rates in Asia. In tandem with this will be the novel ability to increase interest rates to control credit whenever appropriate, without concern for the currency, hence reducing the historic correlation between interest rates in Asia and the West. We can also expect credit to be controlled via the use of ratios at banks imposed by government, possible capital controls on inward remittances and certainly more government intervention.

This cocktail will probably strike fear into the hearts of those brought up on the laissez-faire booms in Asia and indeed this approach is designed to reduce these considerably. However, it is not all bad as these are the seeds of genuine independence from the western credit cycle and therefore the much anticipated decoupling of Asia. Nonetheless it is probably a very good explanation of why Asian equities are currently not performing as they might normally be in this part of the credit cycle.

China

We received an email this morning from one of our most trusted contacts in China which strongly suggested that despite giving the appearance of being under control, it would seem that behind the scenes at top government level in China there is real disagreement and, dare we say it confusion, on how best to manage the economy from here.

On the one hand there is a threat of domestic social unrest as a result of spiking property prices and more widely the novel, but overwhelming, pressures of inequality seem to have built to a boiling point. By way of illustration of this there has been a recent spate of terrible copycat killing sprees in China where individual males have killed lots of school children. This under any circumstance is shocking and terrible but the domestic internet chat rooms are less judgemental. They point out how difficult is it to live with the envy of your neighbour making more money than you and decry the children as spoilt and even extend some sympathy to the killers.

Thus one side of the political debate is that this is a society that is trying to run before it has truly learned to walk and measures must be taken to curb the excesses of wealth and inequality (such as property) in order to maintain political control and social stability. Indeed since 1988 the disparity between the richest 10% of the population and the poorest 10% has widened from 10 times to 23 times.

We have also recently seen workers starting to strike in China. At the Honda factory this was quickly followed by massive pay increases and workers received an immediate 15% pay rise followed by another 10% coming in July. At Hon Hai, which has been plagued by a spate of employee suicides, workers have recently been given wage hikes of over 30%. This is likely to be echoed elsewhere and whilst it is a near term band-aid to the social problem and any consumer slowdown, it is storing up inflation both at home and in export markets. Additionally company responses have quickly rewarded workers show of dissatisfaction, suggesting the pattern could be repeated.

On the other side of the debate, China is all too full aware that the world is looking very unwell and that to maintain a certain growth momentum domestic consumption must be kept on track. Simultaneously, they recognise the need to be able to react if there is a second global growth shock and so they must remove speculation and excess from the economy now in preparation for more economic stimulus later. This no doubt conflicts with various vested interests in government and is cause for further disagreement.

From an economic perspective, rising wages and food prices and simultaneous downward pressure on the economy from overseas demand and domestic credit curbs, we risk a rising fear of stagflation in China over the summer. Anecdotal evidence suggests that sales of items such as cars and some white goods are slowing and the chances are that actual growth may start to undershoot government targets quite soon whilst CPI is likely to head upwards. Economists support this view, pointing out that a country wide 10% wage hike raises CPI by 0.4% and also cuts company margins significantly.

The question remains whether we are about to see a reversal in the cooling measures before long and if so what form these will take? Many argue that Chinese banks have large refinancing obligations to fulfil this year and so it will be important to reinvigorate the domestic A share market which is now officially in ‘crash’ mode having dropped over 25% from the August 2009 high.

Certainly some areas of the Chinese market are now looking more attractively valued and on several measures China is now amongst the cheapest of the regions markets overall. Foreign investors are certainly starting to take notice once again and fund flows turned positive with $1.3billion of inflows since April, a big turnaround from the net redemptions seen since 1Q. Domestic fund launches are also picking up sharply.

In all this is, one official described it as a most sensitive time in China. However, one ongoing telltale sign is the current boom in Macau gaming, which also represents one, as yet unclosed, loophole in terms of how mainlanders can get money out of China. Casinos saw over 95% year on year growth volumes in May.

Technical Analysis and Aunt Minnie

Technical analysis is generally regarded as akin to reading ones horoscope and as such is rarely taken too seriously in investment circles unless you cut your investment teeth on the Japanese chart books in the 1980s . Nonetheless it is a very common guilty secret amongst investors and the tool of choice for many day traders with whom we share the stock markets. Always in search of any source of illumination we have noticed recently that technical analysts have been very confidently vociferous about what they describe as a textbook set of circumstances or symptoms which together imply that the stock markets will weaken considerably once again before the year is out. In medical circles this typical cluster of clear symptoms arriving together helps reach a quick no-brainer diagnosis and is known as an *'Aunt Minnie'*.

In particular, we are interested in the technical features which illustrate how internally incoherent the stock market is. For example, when the number of new 52 week highs and lows being made by constituent stocks on the same day becomes quite equal it shows the internal dysfunction or disagreement of the market and is usually followed by a sharp fall. Rising markets tend to exhibit much more internal uniformity.

Although after last years furious rises the number of new 52 week lows is still not sufficient, despite recent falls, to equal the number of new highs there is another similar event happening which signals a similar lack of coherence. Since mid April in the USA there have been eight 90 down days (these are panic selling days) and four 90% up days (panic buying days). This suggests extreme divergence in views and indicates the stock market remains very vulnerable at this time.

Furthermore in Asia, for what it's worth, 10 out of 13 markets have broken below their 200 day moving averages, making this now a resistance level, not support. In addition, Australia, Japan, Hong Kong and China have seen *'dead cross'* signals, meaning the 50 day moving average has fallen below the 200 day moving average. A *'dead cross'* is a bearish sign suggesting a change in fundamental direction.

Additionally in most Asian markets 'breadth' has fallen, meaning that less than 40% of stock market constituents are trading above their 40 week moving averages, whereas a healthy market would see 60% or more. Finally, a host of other longer term patterns, including the traditional head and shoulders pattern, are also suggesting further downside.

We note these things not just because many of the experienced people we admire most in our industry are voicing concern, but also because if you lose technical support in a stock market then technical investors sell, leaving fundamental investors with very little support or sponsorship until prices have fallen much further.

Prusik Asia Fund

We have retained a significant proportion of the fund in cash and our invested portion remains in a combination of defensive 'all weather' stocks such as telecoms, high yield and utilities and a handful of what we might call 'dependable growth' areas such as Korean and Taiwanese domestic consumption, healthcare and Indian power. Higher beta exposure is very limited to a small exposure to blue chip companies supplying the backbone of the consumer electronics boom, two content/media companies and a small handful of recent investments in the worst hit areas of Chinese consumption following a softening in rhetoric in recent days, combined with wage hikes. We do not feel the time is right to venture into more aggressive investments despite Mays declines and valuations remain largely in neutral but at risk to a deflationary shock from the west.

Telecoms

This sector is starting to come into its own and although our 15% weighting is performing well relatively (down less than 3%, as a basket) we believe that absolute returns are now not far off. Literally every stock screening and micro strategy research piece we receive and we can think of three recent ones, one focussed on yield, one on cash flows and another on a six factor valuation matrix showing telecoms as the most attractively valued sector in the region. Yet analysts remain very bearish on this sector believing that telecom companies remain stuck in a rut as voice revenues continue to fall. We would argue that at least the overall decline in ARPU is abating as data traffic explodes and we note two important recent developments in the sector globally. On purchasing an iPad 3G we notice that the mobile contract varies in price depending on data usage per month. iPads therefore provide not only a brand new customer (will we head to well over 200% penetration rates for mobile contracts as tablets take off?) but one where data can be charged appropriately and where voice is not an issue. Our estimation is that data usage of iPad type devices will be very high and hence they will be big, stable earners for mobile companies. Secondly, in the USA we notice that the concept of net neutrality, which has allowed massive broadband usage by corporates such as Google and Amazon for minimal charges is now being challenged. This might be very good news for the telecom broadband providers everywhere in the world as this trend takes root. To put this into perspective if the telecom companies did charge commercial rates to corporates for use of networks then Google's bill alone could exceed $8billion!

Thus at this stage we wouldn't be too afraid of recommending some of the better telecom companies in Asia to our Grannies. In Asia all the same trends apply except that the average spend on phone bills can also rise substantially overall as incomes rise, so there is even more growth upside. At today's price, for example, PLDT in the Philippines is on a forward PE of 10x and yields 9%!

Healthcare

We continue to be very optimistic about our healthcare companies. We spoke today to Celltrion, one of our larger holdings which makes bio similar drugs for emerging markets and are comforted to see that our forecasts remain on track and the Singapore governments investment arm, Temasek, has just taken a 10% stake. We estimate this company can grow 100% or more per annum for the coming three years and is on about 4x next years earnings.

President Chain Store

PCS is an operator of convenience store chains in Taiwan. They own the 7-Eleven franchise in both Taiwan and China. In addition they have investments in drug store (Cosmed); Starbucks; Mr Donut and Cold Stone Creamery. We believe PCS is poised to benefit from the convergence of a number of growth drivers. As cross straits relationships between China and Taiwan improve, visitor numbers will grow and drive growth in their domestic operations. We expect penetration into the mainland Chinese market to compound this growth. Currently they have thirteen 7-Eleven stores in China compared with 4,750 in Taiwan, a small indication of the prospects for PCS. Currently the Chinese operations are unprofitable but the losses are narrowing. The company is targeting 50 stores in China by end 2010, 165 in 2011 and 300 in 2012. An article we read this week from Taiwan's Apple Daily highlighted the type of products that 7-Eleven and other convenience chain store are now selling in their stores - rice, detergent, cooking oil, etc. What is interesting is that these stores are leveraging their footprint and procurement power (especially for 7-Eleven, with its massive scale) and in the process they have also been quite successful in launching own-brand products, first in drinks (tea, water, etc), then snacks and now own brand rice. On top of this, 7-Eleven is also now offering next-day delivery service, so customers can pick up their purchased item at the customer's designated 7-Eleven store. Management has indicated that their ultimate goal is to provide same day delivery. Our view is that analysts are being far too conservative on their growth outlook for PCS to the extent that some don’t even recognize some of the growth levers we feel the company has. With time we expect this to change and drive material earnings upgrades and provide the catalyst for a stock rerating.

Power

Power is a theme that readers will recall has been a favourite of ours for a number of years and continues to be so. Though the theme is mature in a number of the Asian markets, it is far from this case in India where any recent visitor can no doubt recall recurring blackouts on a daily basis. Prusik experienced this first hand in our last visit during February when we had to navigate a dinner in the dark! The consensus view on the industry is that, firstly, the recent surge in spot rates is likely to be short lived and secondly, industry profitability will fall sharply as new capacity comes on stream.

We think very differently on this. We believe it is highly unlikely power generation will increase by more than 11% CAGR over the next 5 years which will be far from sufficient to bridge the demand – supply gap of 13% even if we assume that the entire new capacity of 102GW is commissioned (another assumption we think is highly unlikely as very little in India happens in line with expectations). Analyst demand estimates are based on 8% GDP growth which we feel is conservative. The demand-supply deficit increases materially if we think about assuming higher growth rates. We are confident that merchant rates will continue to remain high and investment in the sector will continue to show strong returns. Currently we have 6.5% of the portfolio invested in this theme with holdings in Lanco (which has the highest exposure to spot tariffs and has new capacities coming on stream at various stages over the next 3 years), BHEL (the largest manufacturer of boilers, turbines and generators, with a huge order books and strong earnings visibility) and REC (the financier to both generation and transmission & distribution companies, with NIMs at 4.5% and ROEs of 20%+). All three are trading at substantial discounts to what we feel is fair value. Readers of the small cap quarterly will remember our keenness for the Transmission & Distribution companies in 2009, an area where we took profits from early this year as we felt valuations no longer offered value. We are revisiting these companies after recent declines as valuations are approaching reasonable levels again. We also expect order books for these companies to see strong growth from the second half, which we expect will drive earnings revisions for the sector.

Sunspots

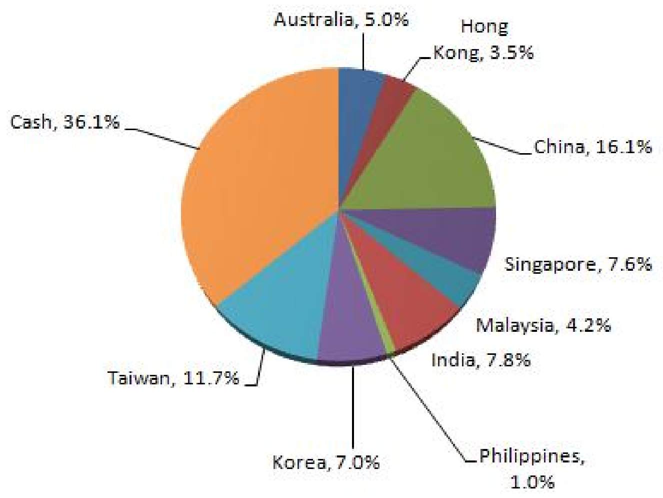
In the last three years we have seen a stretch of unusually reduced sunspot activity. The sun follows a cycle where sunspots rise and fall in frequency over years and the periods with fewer sunspots are usually associated with cooler weather but rarely reach the prolonged lows in activity that we have recently seen. In fact the last time sunspot activity was this low for three years was in 1911 – 1913 and only three times in the last 1,000 years has extended low sunspot activity occurred. These periods resulted in such extreme weather conditions that, as in the case of the Maunder Minimum which lasted 70 years from 1645 to 1715, the River Thames froze, Europe and the USA suffered deep cold and global agricultural production fell sharply resulting in much hardship. Indeed, already in the past two years global average temperatures have fallen by 0.5 degrees Celsius and are forecast to fall by another 1 degree in the coming 3 years. Although in recent months the number of sunspot events has picked up it is still well below normal. This current cycle is number 24 and is expected to be low activity and peak in mid 2013, but it is the next cycle, number 25 which is forecast by NASA to be one of the weakest we have seen for centuries. Thus the risk of an agricultural crisis in coming years rises significantly. To put this into context Prusik's Wiltshire based farming neighbour has seen only 5 individual crop failures in over 40 years of farming. We think that the soft commodity story is likely to reappear quite soon. We are already seeing rising food prices in China and fear that global weather related shortages in coming years could coincide with western government generated inflation to cause a nasty perfect storm. Additionally, study of over 300 years of data shows reduced sunspot activity has over 80% correlation with volcanic eruptions and 100% correlation with all the major earthquakes in the USA.

Portfolio Valuation

At the end of May, the invested portion of the Prusik Asia Fund, was trading on a weighted average CY10E PER of 14.1x and CY11E PER of 12.2x with 27% EPS growth forecast for 2010 generating an ROE of 28.2% for that year. 27% EPS growth forecast for 2010 generating an ROE of 28.2% for that year.

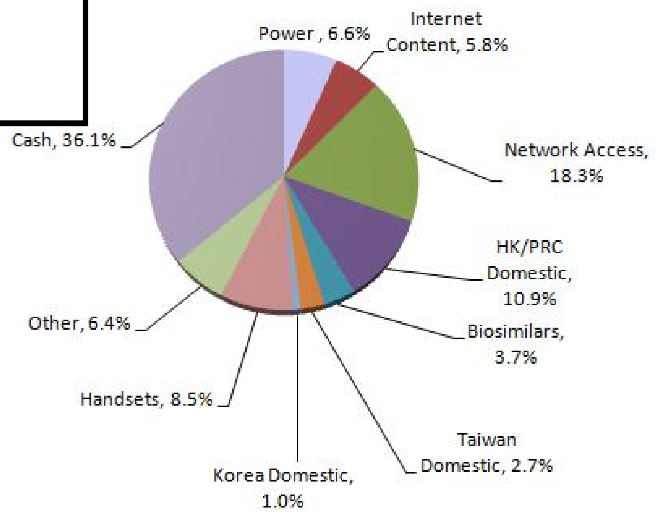
Ed visited Singapore in May and Heather returns to Asean later this month.

PRUSIK ASIA FUND
TOP LINE FIGURES — MAY 2010



Number of holdings 23
Percentage of Fund invested 63.86%

	Top 5 Holdings	%
1	IND & COMM BK OF CHINA - H	3.9%
2	HONGKONG ELECTRIC HOLDINGS	3.5%
3	RURAL ELECTRIFICATION CORP	3.3%
4	TAIWAN SEMICONDUCTOR MANUFAC	3.3%
5	SINGAPORE PRESS HOLDINGS LTD	3.1%



PAF Monthly Performance

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2005										-1.9	5.64	5.08	8.86
2006	7.71	0.09	1.84	10.1	-1.95	-0.45	-1.72	0.02	1.23	3.9	7.64	1.97	33.94
2007	-0.01	1.28	3.05	4.08	3.58	4.79	3.77	-3.75	5.67	2.61	-6.33	1.93	21.88
2008	-6.78	6.91	-8.06	1.81	0.67	-7.69	0.21	-5.34	-5.33	-7.37	0.02	9.75	-20.84
2009	-6.9	-2.9	11.2	4.46	10.7	-2.69	6.77	-4.94	6.42	-2.45	4.08	2.12	26.59
2010	-9.67	-2.62	3.66	1.67	-7.15								-13.91

Key Parties to Fund

Investment Manager	Prusik Investment Management LLP
Administrator	Citi Hedge Fund Services (Dublin)
Custodian	Brown Brothers Harriman (Dublin)
Auditor	Ernst & Young
Legal Advisors	Dillon Eustace (Dublin) Simmons & Simmons (London)

Key Terms

Denomination	USD
Dealing Day	Weekly (Friday)
Minimum Subscription	USD100,000
Min Subsequent Subscription	USD10,000
Subscription Notice Period	2 business days
Redemption Notice Period	2 business days
Dividends	
Class A	$ Non distributing
Class B	$ Distributing
Class C	£ Hedged Distributing
Class D	SGD Hedged Distributing

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Manager Fees

Management Fee	1.5% p.a. paid monthly in arrears.
Performance Fee	10% of NAV appreciation. With a 6% hurdle.