PRUSIK ASIA FUND PLC

PRUSIK INVESTMENT MANAGEMENT LLP

Authorised & Regulated by the Financial Services Authority: Schedule 5

An Independent, Asian Specialist, Investment Management Team

NAV Updates

Series	*OCT 09*	*MTD*	*YTD*
Class A	167.57	-2.45%	+19.11%
Class B	167.64	-2.46%	+19.11%
Class C GBP	91.25	-2.78%	+15.86%

Fund Size $398m

Performance

2005Q4	+8.86%
2006	+33.94%
2007	+21.88%
2008	- 20.84%
2009(YTD)	+19.11%

The fund corrected 2.4% in October, a month characterised by a sharp drop in Asia's equity markets in the latter two weeks. In short we were content to remain largely invested during this period and added slightly to the fund, reducing cash, in early November. Our rationale for this was that valuations across the region are neutral but not overvalued, and that it is natural to have a correction as the first round of tightening begins in a normal cycle. So far, during November, the markets have recovered their poise.

We expect that earnings in Asia should grow by at least 20% in 2010 which should be the foundation of a return of similar magnitude, assuming no PE expansion. The key here of course is whether this is a normal cycle, and that remains to be seen. We suspect that it is not a normal cycle at all and that Asia's sustained recovery needs to be based on a lot more than a cyclical rebound in the West. Herein lies the tricky part. Of all the areas in the world Asia does have the tools to launch a sustainable recovery even in the face of a sluggish Western economic rebound. Consumer & corporate debt levels are extremely low, bank loan deposit ratios are at record lows plus Asia still needs huge investment and for once Asian currencies are looking gilt edged versus their western counterparts. We suspect, as we have written before, that PE multiples for companies who are able to benefit and grow within Asia's domestic economy could probably move to well above average in the coming year as such growth becomes scarce. Hence, for now, we remain invested in a portfolio with an above average price earnings ratio but also, for us, record high earnings growth.

That having been said, we are aware that the markets have had an extraordinary rise and that many stock charts are showing parabolic patterns, which rarely end well. We also note that correlations between almost all asset classes remain very high whilst several technical indicators are suggesting the early part of 2010 might be tougher than the consensus currently expects. Although technical analysis in itself is not fully reliable it can be very useful in highlighting a possible change in direction which otherwise might come as a surprise given prevailing news flow and market mood. We are therefore keen to be clear that while we remain positive on Asia medium term and currently remain largely fully invested, we are listening carefully for possible negative catalysts. We wrote about some of these possibilities last month.

In respect of the portfolio, readers will know we have been wrestling for sometime now with the higher valuations ascribed to some of the internet based Chinese consumption businesses but have remained shareholders on the basis that earnings estimates were still too low. Ctrip and Tencent both beat estimates in recent results announcements whilst Baidu warned but only because of an upgrade in its advertising platform which should reap higher profits next year. Share prices for these companies have moved higher, as have forecasts for next year. We have also enjoyed a positive earnings season in other areas of the portfolio. This bodes well from a fundamental perspective for next year and we remain optimistic that this will still attract fund flow into the regions stock markets from both the Asian and global liquidity pool. Ultimately earnings are key when we move past neutral valuations. The portfolio is trading on 19 times 2009 but we are predicting blended 46% earnings growth for our companies in 2010 which drops the price earnings to 13 times. We are currently working through our 2011 forecasts but early indicators suggest EPS growth over 18% which makes us confident that the recovery in Asia is one that will last, underpinning good future returns.

Thematically the funds investments remain largely unchanged, with the mainly Chinese driven internet construction, network access and content dominating. We also still have some exposure to LED and batteries. In India we are still invested in the merchant power sector and these investments, especially Lanco are performing well as recent new listings are highlighting value in this sector. Taiwan is again in the limelight after the financial Memorandum of Understanding between Taiwan and China was signed and the market now awaits further detail. We have maintained our exposure to gold and food, the latter which is represented by Indian sugar growers. We have also added China Dongxiang who manufacture the “Kappa” brand of clothing and footwear in China. We expect sales to rise more than Kappa’s peers next year given the foothold Dongxiang has in the Central and Western Chinese cities as opposed to just competing in the classic coastal belt. This was borne out in recent trade fair sales when Dongxiang’s orders for 2010 stood out.

Earnings season versus the West

Results everywhere have been good, with those in the US beating analyst expectations in 74% of cases thus far, a ratio which is double the usual average. Not surprisingly the markets have responded well but a closer look reveals that the uplift has come from a massive improvement in margins as a result of cost cutting, the major rebound coming at EPS level. By contrast the revenue line remains very anaemic which is key. For a genuine new upcycle to be sustained the top line must grow, and no sustained bottom line growth can occur without this. In Asia there are more secular top line growth opportunities which is where our focus lies.

China Steel

To say anything negative about China borders on the heretical these days with naysayers risking being burnt at the stake. However we are not afraid to voice concerns regarding the extraordinary build up of inventories we believe is happening. Steel illustrates the point well but a closer look at consumer appliances suggests a similar pattern emerging.

China produces 12 times as much steel as the USA which comes to about 620mt for domestic consumption in 2009. However, the central government is on record as saying recently that domestic demand is little over 500mt and indeed in November Baoshan Steel has reportedly slashed prices due to higher inventories and oversupply. Intriguingly, although steel production rose sharply throughout the 1Q 09, prices did not and for much of this period of expansion the steel companies were still operating at a loss. More recently, prices have recovered as the huge bank lending program financed the movement of inventories into the economy.

Here we take up the story from another angle looking at consumer appliances. Looking at the January to August production numbers for certain appliances and subtracting to the export numbers, the balances have risen dramatically, possibly too much for everything to have been absorbed by genuine domestic consumption. In the eight months to August 09 the balance between production and exports of fridges rose 35% year over year, whilst the number for washing machines was 20%, and colour TVs 23% and electric fans 116%.

Our contention is that not all this additional capacity has been absorbed by the recovery in real demand and therefore the massive expansion in banks loans have financed an inventory build which is probably quite considerable. This does not necessarily take us to a worst case scenario and concerns regarding a rise in bad loans are probably several years premature at worst. However, the immediate risk is that this some of this year’s growth has been borrowed from next year, and as yet, we do not know how much.

Shipping

Many will have noticed the massive recovery in the dry bulk shipping index this year and indeed real demand has recovered well, in particular thanks to China’s massive import program of commodities. This has galvanised the shipping industry which, despite facing catastrophic oversupply only a year ago is now enjoying $110,000 a day revenues on Capesize in the spot mar-

ket, although longer term contracts are being struck very significantly below these levels. Despite the fact that very little recovery has been seen in demand in Europe, the industry has responded as if a new cycle is under way. Shipbuilding orders have not been cancelled and indeed a smattering of new orders have been placed, which puts the 2 – 3 year supply numbers for shipping into an even worse situation than a year ago. Estimates suggest that if economic activity simply flattens here that fleet occupancy will once again plummet and many vessels could be forced by the bank covenants to work on negative rates, exacerbating the situation.
Shipping therefore looks like another industry where even if the economic recovery continues smoothly, earnings for a year or two will likely disappoint, and that is the very best case.

China's Financial Infrastructure

For 12 years Gross Fixed Capital Formation – or building things – has accounted for over a third of China's GDP growth. This is a longer period than for any other industrialising nation and also the proportion of GFCF has risen over that time so that in 1H09 some 90% of China's GDP growth was generated by building things. The consumer comprises still only 30% of GDP in China and with exports weak, GFCF remains a very important driver. The question we have to ask ourselves however is how long this can continue for? China has 70% of the capacity of the US highways but as yet only 18% of the number of cars, so we would venture to suggest that the next area of major development in China (aside from car sales!) should be an acceleration in the expansion of financial infrastructure, rather than concrete infrastructure.

One area of the financial infrastructure that is expanding rapidly is the savings industry which is expanding in disguise through the life insurance industry. Our view of life products is that in the East, culturally, life insurance is difficult to swallow. Either the Chinese feel it is inauspicious to plan for life after death, or quite simply they want to enjoy the benefits now. Thus most life policies in China are really savings schemes which possibly also offer some life insurance or critical illness packages on the side. Currently, penetration levels of such savings schemes are around 2% and forecast to rise to over 2.5% next year.

Swiss Re estimate that penetration levels will start to soar (the S curve effect) when GDP per capita reaches US$5,000 and it is currently US$3,000, so we are gradually accelerating into the sweet spot. However, crucially, from a profitability perspective the life industry in China is now selling far more multi-premium or regular products than the usual single premium policies. Multi or regular products are estimated to be more than 6x as profitable as single products .

This makes the business model quite interesting from our perspective as we see the twin dynamics of top line catalyst and margin expansion occurring at the same time, which nearly always leads to the fastest acceleration in returns.

We suspect also that the life industry is vital to the Government's efforts to restructure China's unstable pensions industry. A large percentage of the population are on defined benefit schemes underwritten at a provincial and national level which appear unsustainable in the face of China's declining work force. China desperately needs the private sector to lift some of this burden from the State, which they can engineer by encouraging sales of savings products through the life companies. Whilst our investments in various consumer businesses in China tap the single child in his 20's who spoilt rotten by his parents and grandparents, it is important to spare a thought for that single child in the near future when he has to support two sets of aging parents, and his own family. (As an aside it seems inevitable that China changes its one child policy and we are hearing that in Shanghai only children whose parents were also from the one child generation will be allowed to have 2 children! A significant change)

The market prices the life insurance investment opportunity at a multiple of around 20 times last years new business written. AXA recently bid for the whole of AXA Pacific, which earns 95% of its revenues from Hong Kong, a mature market, at 18 times new business. We feel that paying these multiples for the top line growth and margin expansion potential in such a nascent market as China is good value. The fund holds China Taiping Life as its main exposure.

Currencies

It is notable how regularly the words 'capital controls' come up these days, thanks to Brazil, and difficult, if you have a long memory, not to flinch in a somewhat negative Pavlovian response. Of course, this time, we are assured, its in a good way. Central bank FX reserves are accumulating at a stunning pace and everything is being done in Asia to prevent the currencies from rising further. For example in October central bank FX reserves increased by $10bn in Korea, $9bn in Taiwan, $6bn in India and even, given the political uncertainly, $4bn in Thailand. These increases in fact had very little to do with valuation changes , indeed in October while the Indian Rupee and the Malaysian Ringgit appreciated 1-2% against the US$ the Korean Won and the Taiwan dollar both fell 1-2%. So far central banks are winning in their bid not to let currencies appreciate via massive intervention.

It is hard to see this policy changing whilst exports remain well below the previous peak and domestic demand, certainly in countries like Thailand and Taiwan, remains soft. The result is that while the pressure builds and possible capital controls are anticipated, money, both overseas investments and domestic repatriations, will continue to flood in. At some point this money may well find its way into assets, equities and property, hence the 'melt up' expectations one also hears regularly in the market press these days.

Given these huge FX inflows it is hard to refute this possibility and the opportunity for short term gains that it represents. However, inherently there are huge imbalances building and large, sudden moves, and increasing government intervention are possible in Asia although these are more likely to focus on tax based constraints rather than FX controls. What is certain is the chances of volatility are increasing but in the short term the pressure is to the upside.

e-readers

If you were hoping for a Nook for Christmas, you may be disappointed. The latest e-reader to hit the market, this time from Barnes and Noble, is already sold out until January and looks set to become the most sought after Christmas present of the year. Amazon and Sony are also reporting huge demand and delays on some of their e-reader models. This may be the point that the e-reader leaps from interesting concept to the next must have consumer tech item and we believe it is something investors will be taking far more seriously in future. Indeed it could be a game changer for the book industry – the ipod, as it were, for the written word.

We have written about e-readers before but were particularly intrigued to see front page news in Hong Kong last month that the government plans to put aside some US$20mn for a three year trial of e-readers in certain schools following one primary school which has successfully switched to e-readers over a year ago. For anyone with school age children who trudge to school with more than the weight of the world on their backs in school books, this strikes a chord.

Most interesting of all however is the under estimation of how many of these devices could be sold in the coming years. CLSA for example forecasts global sales in 2010 of 1.3 bn mobiles, 200 mn notebooks, 56 mn ipods, 43 mn iphones and just 8 mn e-readers! The scope for upside surprise is certainly greatest for e-readers, although 8 mn units already is a doubling of sales from 2009.

PrimeView is a Taiwan listed company which owns E-Ink the dominant provider of epaper technology which currently has 100% market share. Competition from AUO Sipix is expected during 2010 but flexible epaper, touch-panel paper and colour are all expected developments which will keep PrimeView high in the market share rankings.

Foxconn Technology, also listed in Taiwan, makes metal casings for notebooks, ipods and e-readers. If they garner 70-80% market share for e-reader casings and sales reach 30 million in 2011 then revenue from this alone could add another 15-20% to current revenues and probably at better margins. Of course these numbers could be very conservative (it took only 3 years for there to be over 50 mn ipod users).

Net profit is forecast to grow over 50% pa in 2010 and 2011 and the shares trade modestly on a PE of 14x2010. Both stocks are held in the fund.

Smartphones

Worrying numbers suggested that smartphone sales grew only 0.3% in 3Q but do not be alarmed! In the west the market is currently settling around two dominant brands – iphone and Blackberry who together account for over half the profits earned in the smartphone market. In the coming year this will be disrupted as handsets using the Google Android operating system will abound, threatening to knock Blackberry off its no 2 position and triggering a new flush of sales as users flock to a more affordable alternative to the iphone which offers equally interesting applications. The key lesson here, which is important for Asia, is that while smartphones start as a nice handset, the ultimate winners will not just be a good design, they will be about the real utility of the device, defined by what it can connect to and how it does this. This is a concept grasped totally by Apple and Google and we underestimate the power and draw of the applications platforms at our peril. Early signs are that the Android platform is already gathering many interesting applications and eliciting huge data traffic from its users, a point which won't be lost on the mobile operators when they are promoting handsets to their customers. So, in the West we will be increasingly seduced by the mobile phones using a platform which leads elegantly and efficiently to the best apps store. Thus, at the press of an icon you can turn your phone into a spirit level, dictaphone, fish-pond, tape measure, games console, tube map, sat nav, TV, Google page and a million other things. Herein lies the secret of success for the future dominant players.

Meanwhile something a little different is happening in China and emerging markets.

Whitebox

One of the reasons that smartphone sales look distorted and western brand names look so dominant is that mostly the industry uses the wrong denominator. This distortion is going to get greater. In 2009 1,317 mn handsets will have been sold globally, 950 mn of which are global brands, but 210 mn of which are Chinese 'whitebox' (unbranded) handsets and 157 mn of which are Chinese brand names. In 2011 it is estimated that 1,620 mn handsets will be sold, 270 mn of which will be Chinese whitebox and 250 mn of which will be Chinese brands. The domestic China market is thus a third of the world market and accounts for more sales than Samsung and LG combined.

However, it is difficult to convey just exactly what extraordinary circumstances are gathering in the China mobile market. Whilst there are between 7 and 10 big Chinese brand names making mobile handsets, there are over a thousand small makers essentially 'throwing the dice'. Each one may produce two or three phones which will either succeed or fail. The latter sees the maker out of the game but those who do well can literally make millions overnight. Moreover, the products are staggering. The iphone copy is identical to the real thing until you try to read the icons which are in Chinese!

One of the most impressive things about the white box phones is the functionality. Taking the thrillingly named A969 whitebox model as an example, the user gets a phone weighing 114g with a 3 inch colour touchscreen, camera, video, MP3player, speakers, Bluetooth, Wifi, GPS, FM radio, TV, 2 batteries, 2 sim card slots, e-reader function, 2Gb memory, and 11 languages. A comparable Nokia model, the N86, has mostly the same functionality but weighs 146g, has no touchscreen, has a only a 2.6 inch screen, no TV, no e-reader and 1 battery.

The second most impressive thing is the cost comparison. The Nokia sells unsubsidised at $599 whilst the white-box A969 is $98! Indeed the copy iphone we were shown was bought for $65! It seems the whitebox phones are, for function and value, the most competitive in the world!

This extraordinary explosion in cheap high function phones is largely as a result of Mediatek, a company listed in Taiwan which sells chips for mobile phones. Mediatek can put Wifi, GPS, FM Radio, a 5 megapixel camera, and touchscreen on one tiny chip. What is more it designs the cards onto which its chip, together with others governing all the phone functions, goes inside the phone. Thus their whitebox customers simply buy the components, copy the design and churn out various external casings, colours and small variations at high speed and very little cost. These whitebox phones make little over $10 margin for the manufacturers but they are selling like hotcakes.

The next frontier is 3G. In 2009 3G was still less than 1% of mobile sales but the Chinese government have targeted 240million 3G users by 2012! So it is still very, very early days in China, plus the future of applications platform driven demand is still yet to come!

Mediatek currently has 74% market share in the China market and so should grow rapidly in the coming 3 years. Its sales will also grow outside China, which is currently 55% of its sales and India, SE Asia and Latin America are all rising fast too. It is still only trading on a 2010 PE of 12x and has a dividend yield of 7%.

Headwinds for 2010?

Food

The high correlation of most assets during the last 18 months is extraordinary but one area which has lagged the recent strength in most markets, and with the exception of sugar, are the agri commodities. Wheat has crashed 70% since early 2008 while corn has halved but perhaps this will not last for much longer. Recently it was reported that India, which is the worlds second largest rice grower, has suffered a poor monsoon and may become a net importer of rice for the first time in 21 years! The Philippines has also suffered similar crop losses after recent storms. Elsewhere world grain stocks have fallen to 2.6 months from 4 months cover since 2000 despite two bumper harvests in USA. China's inventories are at a 30 year low. Despite food riots around the globe and calls for a moratorium, Obama has not abandoned the Bush policy on biofuels. It would not take a huge rise in food prices to trigger riots once more and material food price inflation has to be a risk for emerging markets in 2010.

Water

Alarming reports in the past weeks suggest that Macau is in danger of running out of water within days, with just 10 days worth of drinking water in reserve. Reservoirs over the border in China are running dry after a recent drought. This is as much about water mismanagement as it is about poor weather but yet again highlights a number of key points about the future. Firstly, China's government and Chinese business have still got a long way to go before key resources such as water are managed properly. This will ultimately cost business much more money in future and the requirement is urgent. Secondly, water will become a fully recognised and expensive commodity like petrol or food. Everyone has been saying this for a while, but the time for this to become reality could be arriving faster than we think.

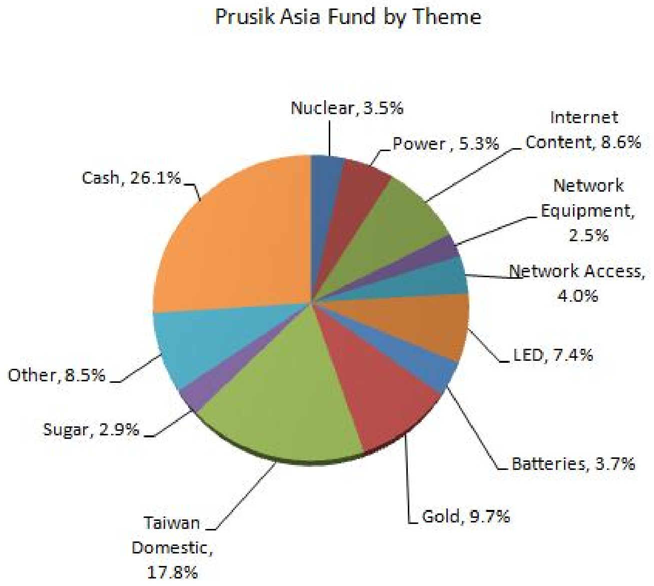
Government and central bank intervention

The heading says it all but traditional analysis and cycle patterns will mean less, access to companies will become increasingly difficult and regulation will rise. Meanwhile unintended consequences, moral hazard and as natural responses are smothered, signs of stress will increase. Capitalism with Chinese characteristics in the west!

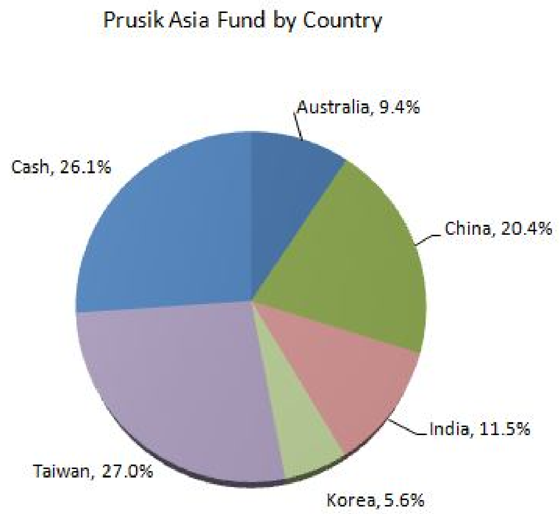
Portfolio Valuation

The portfolio trades 19x 2009 and 13x 2010 earnings, with 46% eps growth forecast for 2010 generating an ROE of 20% for that year.

PRUSIK ASIA FUND
TOP LINE FIGURES — OCT 2009



Number of holdings 29
Percentage of Fund invested 73.9%



Top 5 Holdings	%
TAIWAN FERTILIZER CO LTD	4.0%
CTRIP.COM INTERNATIONAL-ADR	3.6%
FAR EASTERN NEW CENTURY CORP	3.5%
LIHIR GOLD LTD	3.4%
DR. REDDY'S LABORATORIES	3.3%

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			19.11

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

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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.