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Prusik Investment Management LLP

An Independent Asian specialist investment manager

NAV Updates

Series	*June '08*	*MTD*	*YTD*
Class A	154.06	-7.69%	-13.31%
Class B	154.11	-7.69%	-13.30%
Class C GBP	83.63	-7.28%	-12.61%

Fund Size $300m

Performance

2005 Q4	+8.86%
2006	+33.94%
2007	+21.88%
2008 (YTD)	-13.12%

NAV Updates

Series	*July '08*	*MTD*	*YTD*
Class A	154.39	0.21%	-13.12%
Class B	154.44	0.21%	-13.11%
Class C GBP	83.82	0.23%	-12.41%

Fund Size $302m

In order to allow all our readers to take their August holidays fully updated, we have merged the June and July Reviews. The data on the final page reflects the Fund's positioning at the end of July. Please let us know if you would like to see the Fund's exposure as of the end of June which we would be happy to send.

The Fund fell 7.7% in June as the month proved to be a truly horrible one for almost everybody. Deleveraging continued, generating random carnage in almost every sector and inducing a sense of blind panic among many investors, albeit without the high levels of volume usually seen at the nadir. This produced some very strange investment behaviour which, in turn, added to the chaos.

Our decision to increase the Fund's cash levels in late May provided less protection than we had originally hoped would be the case. We increased cash levels further in June by eliminating nearly all the Fund's exposure to commodities and energy with the exception of gold and uranium which we discuss in more detail below.

In July the Fund rose 0.2%. Our reduced exposure to energy and commodities served us well as this was a major area of correction during July. In the face of such declines, towards mid month, we decided, somewhat, to reduce our cash position.

Thematically, we have made no significant changes to our thinking. We continue to favour companies with exposure to forging, alternative energy and power transmission and distribution. We have used the recent weakness to re-build positions in some of our old favourites in the infrastructure sector whose share prices had fallen sharply such as Taewoong in Korea and BHEL in India. We have also invested in companies which, we felt, would benefit, in the near-term, from a reduced oil price and lower inflation expectations. Finally, we have added to our investments in companies with strong Chinese consumer brands given the value opportunity which we feel has emerged post the recent sharp declines in their share prices. As a result, significantly, this has led to the Fund's exposure to the Chinese, Indian and Korean markets returning to levels last seen in August 2007.

We have continued to speak to as many companies as possible both inside and outside the portfolio and a number of patterns are beginning to emerge.

First, even companies who are still enjoying 30% to 40% top line growth and have healthy two year order books appear to be increasingly cautious. This, we think, is because they are concerned about demand trends further out and because their margins are being severely squeezed by rising raw material, energy and, in the case of China, labour costs.

Second, Asian stock-markets have fallen a long way with some shares having declined more than 50% in recent weeks. However, while Asian markets are now cheaper, they are still not undervalued relative to precedents or, perhaps fully discounting the potential consequences of an economic slowdown. Positively, sell-side analysts have now started to cut forecasts. However, the 12 month forward PER valuations still remain stuck in the mid teens. Valuations therefore look less appetising when viewed through today's prism of economic uncertainty.

Third, companies are reporting that they are starting to feel the impact of the slowdown in demand in the US. Slowing demand from Europe is also beginning to have an effect. This is particularly crucial for China where the European market, as an export destination, now matches the US in size but has contributed more to the recent growth in China's exports. For example, in 1Q 2008, exports to the EU rose 24.1% and added 9.3 percentage points to export growth. The US, by contrast, contributed only two percentage points of export growth.

Our reaction to such discoveries is two-fold:

We are under no illusion as to how difficult the coming twelve to eighteen months will be for many companies in Asia. Asia may not be the cause of the slowdown but it will be on the receiving end. As a result, Asian economies and companies will likely arrive at the slowdown late and probably indignant. There are likely many ways domestic government policies can help soften the blow. Nevertheless, the path will not be a smooth one and Asian markets are still not, in our opinion, cheap enough or under-owned enough to withstand the potential potholes.

However, we concede that the immediate outlook for Asian stock-markets looks likely to yield a brief bounce. There are three main catalysts:

First, a correction in the oil price will likely reduce the near-term perception of risk. However, it remains to be seen at what price point cheaper oil ceases to be a catalyst for a rally and becomes, instead, an indication of slower growth in demand, and, hence, a negative influence on markets.

Second, it is possible that the interim reporting season will not be as bad as analysts are now forecasting leaving some room for relief. So far, the reporting season in Asia has, generally come in above expectations bar some of the manufacturers more geared to Western demand. For example, the Fund's two battery manufacturers have fared well. Second quarter earnings results at both LG Chemical and Samsung SDI positively surprised the market. Similarly, the Fund's holdings in power and infrastructure related stocks reported good earnings.

However, share prices of those companies whose earnings have surprised positively have seen little benefit. This perhaps reflects the scepticism of investors on what the second half holds. We need to be wary of concentrating too much on looking in the rear view mirror and, as a result, failing to make proper allowance for disappointing guidance on future prospects.

Third, year on year inflation trends may start to look more benign for a month or two. However, such trends, should, in our opinion, also come with a health warning. We think that inflation is probably being systematically underestimated in public statistics. Governments have been printing money at a hair-raising pace. The Eurozone, US, China, Russia and India have all been printing money at a rate exceeding 20% per annum. Any sign of a stabilisation in growth could therefore still be met, in due course, with higher interest rates.

The Prusik Asia Fund will therefore continue to hold a fair amount of cash in view of the medium term outlook and current share price valuations. Positively, we are confident that the companies in which the Fund has invested, many of which enjoy exposure to our themes, will demonstrate well above average earnings growth. This should be supportive of their share prices during the second half. We expect that the second half of 2008 will be a period where the divergence between company earnings will be more keenly felt. We are, however, more wary of how low average valuations measures could fall in current circumstances. Eventually, of course, this should produce tremendous bargains at which point we shall spend all our cash. However, we do not feel that we are quite yet at such a point.

Growth/China

World trade is a key ingredient to the health of the world economy so when a shipping magnate voices concern about the growth of his business, we should listen. Jacques Saade, chairman of CMA CGM, has warned that the container shipping business is slowing and may continue to do so for the next 18 months. He said that shipping occupancy was down from 100% last year to 94 % this year, citing as causes, unsurprisingly, the high oil price and a slowdown in demand.

Indeed, indications are just emerging that container shipping rates from Asia have fallen as much as 50%-60% YoY. We felt that this could be as much a reflection of rising supply as of declining demand. We therefore looked further into the trade numbers to try and find some answers.

Container imports to Long Beach and Los Angeles are a good indication of the trend in US trade with Asia. They make interesting reading. Container imports are uniformly down, by 5.8% in May and by 7.3% YTD. Container exports, however, are rising, up by 23% in May and by 26% YTD.

Such trends are very important to China given that exports account for nearly 40% of GDP and 41% of industrial activity. The June export numbers showed growth of only 18% YoY versus 28% YoY in May and 22% YoY in April. Given rising export prices and a weaker US$, they do not, perhaps, tell the whole picture. Looking specifically at container numbers through each port, however, the trend is very clear.

Here are the container throughput growth numbers in June 2008 versus June 2007 for four of China's major ports. At Shanghai, container throughput rose 10% YoY in June 2008 versus 18% YoY in June 2007, at Ningbo, 17% YoY versus 37% YoY, at Shenzhen, 4% YoY versus 10% YoY and at Dalian, 9% YoY versus 21% YoY.

Around 60% of China's exports go to the 'Old World', the USA, Europe and Japan. Some commentators have recently suggested that exports from China may only be growing by around 5% YoY by year end. We expect this slowdown will come in three stages. First, exports to the USA will be negatively impacted. Then, exports to Europe will start to be affected. Finally, exports to the rest of Asia and the emerging markets will be hurt. It looks as though we are just arriving at the second stage; Asia to North Europe trade actually fell 0.5% YoY last month.

The leadership in China is obviously worried and rightly so. For example, anecdotally, we have heard that a number of Taiwanese owned manufacturing businesses in China have literally shut their doors over night, having succumbed to the twin pressures of collapsing margins and slower demand, leaving bewildered workers to turn up in the morning to locked gates. Electricity demand, which is a good bell-weather for the real growth of China's economy, dipped below 11% YoY in June.

As a result, export rebates have been quietly reinstated for textiles and may be offered to other sectors before long. We can probably also expect some gentle easing and extra fiscal support to be softly introduced. We have also received an intriguing phone call from Shanghai canvassing our interest in possibly acquiring further QDII to invest directly in the local A share markets this Autumn!

However, the Government will tread gently because too big a boost to growth now may well leave further nasty dose of inflation to be dealt with in 2009. This is probably the PRC Authorities' biggest concern. Political and social stability remains the PRC Government's dominant concern. On far too many occasions in history, high inflation has been the catalyst for periods of serious political convulsion, and China will be aware of this.

On a final note, we expect the quiet squeeze on property to continue in China, leading, in due course, to possible outflows of hot money. This, together with the lacklustre export environment, may keep the US$/RMB exchange rate a bit softer than some are currently expecting.

Oil

First, high oil prices are having the effect of rationing demand. In the US, miles driven has fallen 4% while public transport use is up 20%, use of tele-conferencing has risen and shippers are consolidating loads. Second, the recent announcement that the US Government will open formal discussions with Tehran over Iran's nuclear enrichment program suggests that pragmatism has won the day in Washington. If successful, this should help ease the geopolitical risk premium currently discounted in the oil price, Third, official world government stocks of oil currently stand at a generous 155 days and this does not include private inventories.

In mid July, we were fascinated to see ‘An open letter to all airline customers’ (you can Google this title to read the full letter) sent by twelve US airline CEOs, carrying what can only be described as a ‘plea for help’ over high oil prices. We have written more about this very interesting letter in the next section. Simultaneously, it became clear that the US airline industry plans to ground 8.8% of seating capacity as losses mount thanks to jet fuel price rises of 51% this year. Jet fuel consumption already declined 2.2% YoY in June but will likely fall further. The last time the US aviation industry was so weak was in 2001 when it cut seating capacity by 8.2%. At the same time, the oil price fell by 40% from peak to trough.

Copper

Perhaps the most startling comment in the open letter sent by the twelve US airline CEOs was the assertion that speculators were to blame for the recent surge in the oil price. They asserted that twenty years ago, around 21% of oil was sold to people who were not end users and who would sell the oil on. Today, they estimate, and their number should have come from a good source, that some 66% of all oil purchases are speculative with a barrel of oil changing hands over twenty times before it is used. This, they believe, adds as much as US$30 to US$60 to the cost of a barrel of oil. Needless to say, they are calling for tighter regulatory measures to cool the market.

Meanwhile, the copper market also bears close examination. The key, once again, is to see the difference between ‘consumption’ and ‘demand’. ‘Consumption’ is intriguingly weak. As a result of the extraordinary rise in the copper price over the last few years, a couple of irreversible changes have begun.

First, technology, design and efficiency have moved forward in leaps and bounds. One example is the tubes used in air-conditioners and fridges. Over the last three years, the weight of each tube has fallen by around 45% and manufacturers promise a further reduction of 20% over the next couple of years. As a result, significantly less copper is now used in the production of such items.

The second effect is one of substitution. For example, a very large wire and cable company operating in thirty-four countries has admitted that, since 2004, its use of copper has fallen by some 7%, but its use of aluminium has risen by 33%. This is just anecdotal evidence from one company. However, the drawn wire and cable sector accounts for nearly 65% of copper consumption globally. Were the industry overall to have pursued similar strategies, a logical assumption, the industry’s copper consumption would likely have fallen, not risen. Substitution is a trend that will likely stay in place while the copper price stays high. The risk to annual copper demand of such a trend is estimated, potentially, to stand as high as 20% of last year’s refined copper consumption.

Recent weakness in global copper demand may reveal the substitution effect in painful fashion. Demand is already weak, and despite high prices there was no shortage of copper in the first half of this year. On the supply side, there is a most interesting anomaly; the major producers of copper have actually been for a couple of years and still are reducing production. This is contrary to what you might expect given the strong copper price trend.

Looking at the copper situation, it is possible to see that the US airline CEOs may be onto something. On 7th July, Andrea Hotter of Dow Jones Newswires stated in an article that: *'people inside warehousing companies in China say, however,* [that] *the quantity of copper held but not showing up in official warehouses could be well above 800,000 tons, with the stockpiling dating back to late 2004 when the copper price started to rise from below US$3,000 per ton to nearly US$9,000 per ton at present'.*

Our own sources give this report some credibility and they are not alone. On 23rd April 2008 the US Attorney General gave a speech to the Centre for Strategic and International Studies in Washington and started by saying '…*the Organised Crime council met for the first time in 15 years. It did so because the United States faces a new and more modern threat from organised crime'.* He later went on to say that *'the first threat we identified was that international organised criminals control significant positions in the global energy and strategic materials markets. They are expanding their holdings in these sectors, which corrupts the normal functioning of these markets and may have a destabilising effect on US geopolitical issues'.*

We think the copper story may be applicable across many commodities, possibly including oil. If the implied stockpiling and speculation is taking place, it is clearly doing so at the very highest levels and is supported by deep pockets. We can all conjecture very easily what the end game might be although perhaps 'when' may not be so easy. In the meantime, given the anecdotal evidence on growth around the world, we will be taking any protestations of 'huge demand' from emerging markets as thin excuse for supporting many commodity prices from here. A small correction would be healthy for markets but if the speculators drive these prices higher, against an increasingly large amount of evidence that demand is weakening, then we would expect a very, very nasty end.

The next three sections are, we believe, powerful future themes which will prevail whether the oil price is US$130 or US$60 per barrel. If the oil price remains high, we expect that the maturing of these themes will be accelerated. As a result, all three offer attractive opportunities to offset the impact of rising oil prices.

Local

Fuel costs have risen so much that Ikea is starting to make some of its low cost furniture in the US. Likewise for the US, Chinese steel imports are no longer competitive as transport and related costs offset the labour advantage; a tonne of steel takes an hour and a half of labour time to make but costs $90 to ship. The additional regulatory complexity of security and paperwork now required in the US since 9/11 and the rising costs of transporting products to the US or elsewhere in the world are causing companies like Proctor & Gamble radically to reconsider their supply chain and to bring manufacturing closer to their core consumer markets.

Back in 2002, shipping a standard 40 foot container from China to the US East Coast would have cost about US$3,000. Recently, the cost touched US$8,000. Last year 4.65 million containers made the journey to the US and came back to China mostly empty or full of scrap or waste. Now we are beginning to hear anecdotally that containers are making the journey empty the other way.

According to research carried out by CIBC World Markets, oil at US$130 is equivalent to imposing a tariff of about 9% on US imports from Asia. At US$150, that tariff rises to 11%. At US$200, it is estimated that all the trade liberalisation effects of the past 30 years are reversed.

There are a number of corollaries of this. First, at current energy prices, the days of air freighted strawberries filling our supermarket shelves at Christmas are numbered. Second, new sourcing trends will undoubtedly exacerbate inflationary pressures in manufactured goods. For example, air freight, the cost of which has risen even more dramatically than sea freight, has played a big part in the universal adoption of the just-in-time model. Future costs of carrying higher inventories will have to be passed on to the consumer. Third, proximity to end user markets will become much more important. A recent OECD study made the observation that the cost of remoteness for countries such as Australia and New Zealand could be as high as 10% GDP. Conversely, the GDP of centrally located countries such as Belgium, or, perhaps, Thailand, could benefit by as much as 6-7%.

In short, while energy prices remain this high, we could be entering a new era where geography becomes destiny and manufacturing may see a resurgence in the developed world. This means the domestic story in Asia will become more important in the next cycle. In the shorter term, Asia will be the biggest beneficiary of any fall in the oil price.

Carbon offsets

Earlier this year we wrote extensively about the coal bed methane sector, an area where we have invested with some success. More recently, we have heard that a major transport company in the region has taken a large stake in one of the smaller Chinese coal bed methane companies. Usually in Asia, this kind of news would be accompanied by a sharp intake of breath. Any long term Asian investor will be familiar with the frustrating habit of Asian companies of investing in non-core businesses. However, we think there is method in this company's apparent madness. This investment may not be so hard to explain and indeed may be an early move in what will likely become a big future trend.

Transport companies, as heavy carbon dioxide producers, will increasingly be under significant pressure to disclose their carbon footprint and climate impact. As a result, their desire to offset carbon emissions will intensify as we head towards 2012. They are not alone.

Such companies have two trading devices. The first, the Clean Development Mechanism or CDM, allows companies operating in Kyoto protocol countries to offset their emissions by investing in clean technologies in developing countries or by purchasing the resultant Certificates of Emission Reduction (CERs) from such projects. The second, called the Joint Implementation or JI allows companies carrying out business activities in industrialised countries to invest in clean technology projects in other industrialised countries.

Currently there are 222 projects registered under the Clean Development Mechanism which, combined, are preventing 65 million tonnes of carbon from entering the atmosphere every year. However, the current demand is for projects which, between them, could prevent 500 million metric tonnes of carbon per year entering the atmosphere and such demand is growing. As a result, ever more projects are needed.

So far the main markets for carbon reduction projects are activities such as energy efficiency/demand side management, methane capture/waste to energy, carbon capture, power plant revamping and fuel switching. Intriguingly, just 3% of the carbon reduction projects have accounted for 55% or total carbon reductions achieved so far.

Our conclusions from this are that this is a market which could grow exponentially once there is both an internationally traded and recognised price for carbon and a mechanism allowing for the swift assessment of the carbon offsetting value of existing and potential projects. This should accelerate as we move towards 2012. Estimates vary as to the current size of the traded carbon market. We think it is in the region of US$60 billion. Set against the US$1 trillion energy sector, this looks like a market still in its infancy.

Additionally, the onus on listed companies to offset carbon emissions will, we think, rise significantly but with the additional twist that the likely investment required will not be small. Those projects which are actually making an attractive return, as well as providing offsets, will thus be in huge demand. We think that the coal bed methane and timber sectors, much of the latter in Asia valued close to book value and trading on single digit multiples, are two good examples of areas which could become a big area of focus for carbon emitting companies.

Similarly, companies which can provide carbon measurement services, trade carbon credits or who are already carbon neutral will benefit. This is a market which may well be driven initially by corporate demand, underpinned by the Kyoto Agreement, but there is a chance that ‘green’ becomes the next bubble.

Nuclear renaissance

Officially, China, currently, is targeting to have installed 40 GW of nuclear power capacity by 2020E versus around 9 GW today. However, management at Shanghai Electric indicated to us their belief that this target could be revised upwards to as much as 80-100 GW of capacity.

In India, on July 22nd, the Indian Government won the vote of confidence. The US-India Nuclear Deal is therefore one, major step closer to conclusion. The deal now needs to be approved by the IAEA, expected to given on August 1st, by the Nuclear Suppliers Group (NSG) and by the US Congress, with the latter’s approval potentially occurring as early as September. Macquarie believes that Indian buying of uranium could therefore commence by as early as the fourth quarter this year.

In the US, we were told by a consultant that utilities have applied for no less than eighteen licences to build thirty-five new nuclear plants over the next six to seven years. He was of the view that the nuclear renaissance, especially in the US and Asia, therefore seemed to be for real.

The increasing enthusiasm for nuclear power appears to be driven, obviously, by its low carbon emission characteristics but also by a perception that the predictability of investment returns on nuclear facilities has significantly increased.

First, the cost of electricity generated by nuclear plants is likely more predictable. In a traditional hydro-carbon fueled power plant, we believe that fuel at current pricing levels accounts for around 85% to 92% of operating costs. By contrast, fuel accounts for around 20% to 22% only of the operating costs for a nuclear plant and, importantly, fuel costs are reasonably controllable. Companies like Areva are now offering supply, conversion, enrichment, fabrication and disposal of uranium as a package thus reducing the level of risk.

Second, building nuclear plants appears to be becoming a simpler and quicker process. Given the increased enthusiasm of governments to encourage nuclear power, we think that licencing processes will likely be reduced. In the US, for example, construction and operating licences have now been combined in a single process. Nuclear plant designs are now more standardized, four or five designs offered. Interestingly, we heard that Areva informed an US utility that, were Areva to miss the delivery deadline, Areva would be prepared to buy the utility out of its investment.

Third, the life of plants has generally been extended from forty years to sixty years and even this may still be conservative. Out of a hundred and four nuclear plants in the US, forty seven have received twenty year life extensions. The latest facilities will all have design lives of sixty years. Decommissioning costs can therefore now be amortised over a much longer time frame.

The investment returns achievable on nuclear plants are therefore becoming more predictable. This opens up the possibility that, in the future, nuclear power plant facilities can be funded on much more attractive terms, less equity, more debt, the latter potentially non-recourse, and that plants, at some point in the future, could even be funded, at least partially, by private equity.

As a result, the World Nuclear Authority forecasts a 36% rise in global nuclear power generating capacity. Macquarie's expectations are more bullish. Between now and 2020E, Macquarie believes that global nuclear power generating capacity could rise by 51% and the number of nuclear reactors by 43%. Interestingly, for China, Macquarie assumes capacity of 48 GW by 2020E, up 500%, barely ahead of the official target and well behind Shanghai Electric's unofficial indications of as much as 80 to 100 GW. For North America, Macquarie is assuming that the number of reactors will rise by thirty-two, behind the indicated thirty-five new reactors which we were told were already in the planning stage in the US alone.

Positively, our region offers the Prusik Asia Fund a number of attractive investment opportunities which would benefit from a renaissance in the development of nuclear power facilities. These include uranium miners in Australia, heavy forgers in Korea and power plant constructors in China and India.

Uranium

Near-term, uranium supply looks to be modestly in excess of demand based on

Macquarie's forecasts which exclude any assumptions about stock build. However, Macquarie estimates that uranium demand will exceed supply from 2010E onwards with the deficit rising from 1% in 2010E to as high as 5% in 2012E as supplies of uranium are secured for the initial cores of new reactors scheduled for commission between 2013E and 2016E.

Macquarie estimates that if the US-India Nuclear Deal progresses to fruition, Indian consumers may buy up to one year of uranium stock over the following twelve months. This would be enough to generate, near-term, a supply deficit.

Australia possesses around 40% of current extractable uranium resources, the largest in the world. Two uranium miners, Paladin and Energy Resources Australia are listed; The Prusik Asia Fund currently holds a position in the latter.

Constructors, equipment makers and forgers

Two of the PRC power equipment manufacturers including Shanghai Electric possess the capability to construct nuclear power plant equipment and facilities as do Doosan Heavy in Korea and Larsen & Toubro and BHEL in India. A key technology in the manufacture of nuclear power facilities is heavy forging. This is a skill possessed by a number of Korean companies, notably Doosan Heavy. The Prusik Asia Fund has exposure to both Doosan Heavy and BHEL.

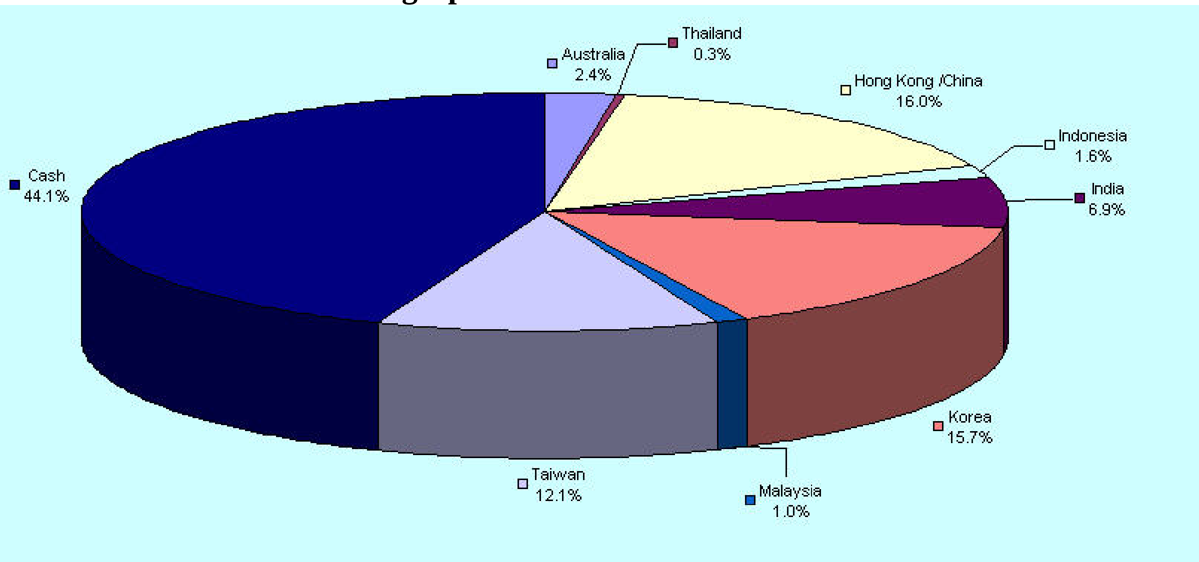
We estimate that the Prusik Asia Funds's invested portion is currently trading on 19.6x CY08E earnings and 12.9x CY09E earnings.

Top 5 Holdings July 2008	%
CHUNGHWA TELECOM CO LTD	3.7%
DOOSAN HEAVY INDUSTRIES	2.5%
ICSA INDIA LTD	2.4%
BHARAT HEAVY ELECTRICALS	2.3%
SAMSUNG SDI CO LTD	2.2%

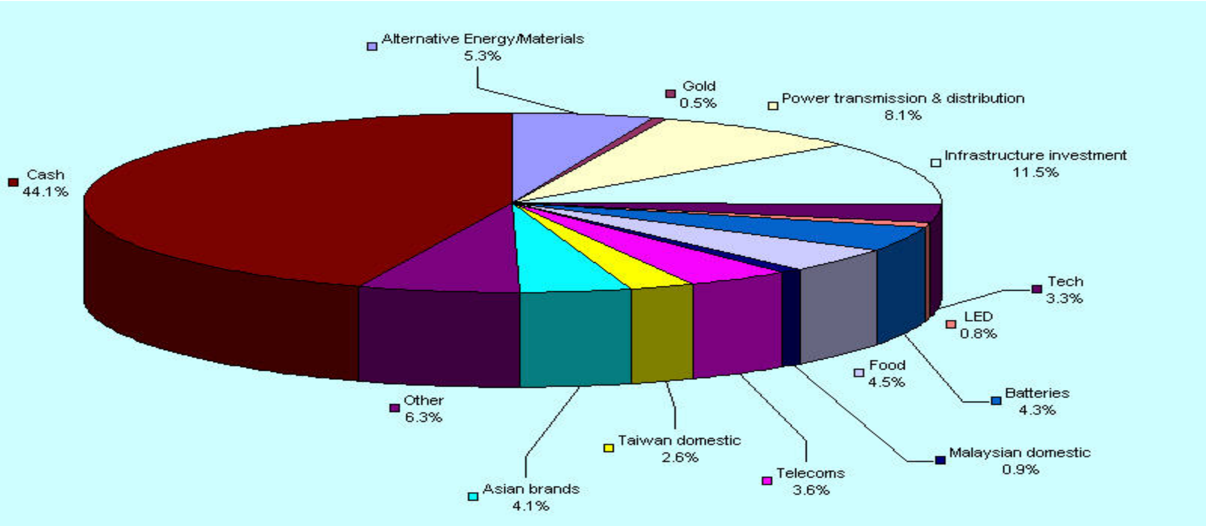
July 2008

Number of holdings	38
Percentage of Fund invested	56%

Geographical Distribution



Distribution by Theme



Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2005										-1.90	5.64	5.08	8.86
2006	7.71	0.09	1.84	10.14	-1.95	-0.45	-1.72	0.02	1.23	3.90	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						

Key Parties to Fund

Investment Manager	Prusik Investment Management LLP
Administrator	Bisys 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	None
Class B	Annual
Class C	Annual

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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.