FSA Authorised
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Prusik Investment Management LLP

An Independent Asian specialist investment manager

NAV Updates

Series	*September '08*	*MTD*	*YTD*
Class A	138.35	-5.33%	-22.15%
Class B	138.40	-5.33%	-22.14%
Class C GBP	75.88	-4.83%	-20.71%

Fund Size $257m

Performance

2005 Q4	+8.86%
2006	+33.94%
2007	+21.88%
2008 (YTD)	-22.15%

'If you can keep your head when all around are losing theirs, then you clearly haven't understood the seriousness of the situation.' (David Brent: 'The Office')

In September the Fund fell 5.3% in US$ terms. With apologies for the gallows humour above, we think it has been almost impossible to overestimate the seriousness of the situation since our last report. As we write this, the MXAPJ benchmark is down 36% so far in October and Asian sovereign bond spreads are blowing out. A rising number of emerging markets are throwing themselves on the mercy of the IMF and Denmark has just raised interest rates, highlighting the precarious position of the Euro and all who sail in tandem with it. Much of the anecdotal evidence we can find suggests that corporates will be the next area to default.

The news flow continues to gush faster than we can type. The complex system is clearly deeply unstable and the wild gyrations from currencies to commodities speak a shocking truth that we truly are in a crisis over which we have very little control. As we all know, regaining a balance is one of the hardest things to do.

Suffice to say, making traditionally sensible investment decisions in such an environment is nigh on impossible. In the rush, good companies are being thrown out with the bad. We will illustrate later in this newsletter some of the kind of opportunities such a trend is throwing up. However, timing a re-entry is harder to fathom. Until there is some orderly discrimination between those companies with strong balance sheets and defensive businesses and their weaker brethren, we feel discretion is the better part of valour.

Accordingly, and in the interest of keeping our heads when all around are losing theirs, we have retained our high cash element despite a growing list of, in some cases, very interesting valuations. At the time of writing and, in spite of further huge falls to date in October, our instinct is telling us to remain cautious.

Currency volatility

At the time of writing, we suspect that the 44% year to date decline in the Korean Won versus the US Dollar, mainly the upshot of a US Dollar debt funding crisis, will prove to be just one of the first dominoes to fall. Around the world, there are many other emerging countries with similarly unmanageable current account deficits and funding difficulties. Pakistan is the closest to our doorstep.

The Korean example is already causing huge distress in Asia. The Taiwan Dollar has barely moved this year against the US Dollar. Taiwanese corporates locked in direct competition with their Korean peers are therefore struggling to survive.

The DRAM sector is particularly affected, with the weaker Taiwanese companies already posting losses in 3Q. In addition, Promos, one of those weaker Taiwanese DRAM manufacturers, faces a US$2 billion debt rollover before long. Its creditors' willingness to renew those loans must, by now, be in serious question.

Elsewhere, in Hong Kong the recent US$2 billion foreign exchange derivative loss at Citic Pacific, a stock happily not held in the Fund, and similar accidents at some of the Chinese railway companies, also not held in the Fund, hints at possible further shocks to come at the company level as the full impact of the current currency volatility is realised. It is not unreasonable therefore to expect some further big losses at both the bank and company level before the current situation is resolved. Such events are bringing the crisis closer to home in Asia.

China

Many are still looking to China to remain a strong source of growth for the region, indeed for the world. However, we think they may be disappointed. Perhaps an instructive clue to the more likely outcome came a few weeks ago when RMB forward rates fell below spot for the first time. Ed has just spent a week there and his negative discoveries are echoed by one of our advisors who travels extensively around China studying copper demand. The economic situation in China looks worse than has been the case at any point during the last fifteen years.

First, no matter what you may have been told, manufacturing, in its fullest sense, remains the key driver of China's economic growth. China has therefore reached a watershed in her growth trajectory as falling exports are generating weakening feedback loops to margins and investment. We are hearing some really quite huge numbers in terms of inventories that have built up in recent months. For example, air conditioner inventory now stands at some 25% of annual production. This is particularly instructive as this reflects not just weak overseas demand but also weak demand at home as well. We think, as an aside, that it is also important to note how dependent China's exports are on healthy property markets elsewhere in the world.

This time around, however, the PRC Authorities and traditionally state linked banking system will not be injecting more capital to develop more industrial capacity regardless of returns. In addition, we do not expect huge fiscal infrastructure projects to boost levels of activity although we do think there may be a number of smaller announcements next year. However, we would certainly temper that muted expectation if the alternative was civil unrest.

Our view is based on the belief that PRC Government policies have very clearly changed towards a focus on preserving resources, improving returns and adding value. This time around, we think that the PRC government will allow capacity to close and hope for more efficient and higher margins businesses to evolve. Banks' lending policies will be implicit to this process. Last time China faced a slowdown, the banks were state owned and directed. Not so this time. Now listed, they are likely to make a stiff response to any pressure by the PBOC to increase credit quotas. Indeed, anecdotally, we believe they are as cautious as any global bank right now.

PRC property

The PRC domestic property sector is also, like elsewhere in the world, undergoing a reversion to the mean, or, arguably, below it. The PRC Government has recently announced some very gentle measures to help the ailing property sector, and rightly so. Transaction volumes in first tier cities have declined, clatteringly, by some

38% so far this year. However, the number of newly completed units has actually risen 4% overall and, in second tier cities, has jumped by a whopping 68%! We think therefore that the property inventory overhang has likely risen to around 9-12 months of historic demand.

Meanwhile the numbers for potential property owners still do not add up. In Shanghai, residential rental yields are 3-4% and mortgage rates 5-6%. In the office property sector, over supply is at minimum 35%. There is one small ray of light at the lower end of the market, affordable housing. Here demand will be underpinned by government support. However, few, if any, of the listed property developers have projects positioned on the fifth ring roads of fourth tier cities!

Unrest and backlash

Positively, the Chinese Authorities appear to be openly preparing for the consequences of a 'soft landing' on the basis that China needs to reinvent itself as a higher valued added and more efficient user of resources. However, this may not be entirely painless. The coastal regions are already undergoing rapid contractions as many factories are closing down. This is leading, in some cases, to fierce demonstrations.

We think those remaining in business will have another hurdle to clear as we move into 2009. If it was not bad enough to face the precipitous decline in demand that we are seeing, manufacturers, even of the most basic items, appear to be planning huge price increases in order to address the parlous state of their margins. We have obtained a sample list from one maker of simple household goods. Next year washing lines will increase in price by 71% whilst jumbo gripper pegs will jump 74% in price. This is in itself perhaps not a crisis unless we are planning on doing a lot of washing. However, it is indicative of a general trend and it is not good timing for any of us.

Those doing business with China will find the risk of not being paid is rising and the response to follow up demands increasingly aggressive. We are not saying this lightly, but in view of certain anecdotal stories we are hearing. There may well be a backlash against China.

Rural reforms

Finally however there is one big event in China about which we can become excited. The recent land reforms will transform the rural areas. The reforms will allow farmers to own their land and, as a result, to borrow against it. Some estimate this could create an overnight value of RMB 40 trillion, around 1.5x current GDP. In any event it will transform rural areas, support those who have lost jobs in cities and need to return to the family, make China more self sufficient in food production and will likely lead to the increasing industralisation of the Chinese agricultural sector and the resulting increase in productivity.

One tale we like from the Gartman letter tells of the writer passing a Chinese farmer who was tending a beautiful healthy wheat field. On the other side of the road lay a wheat field in the poorest condition. On enquiry, the farmer admitted to being responsible for both crops but the healthy field was his while the poor crop belonged to the government! With these new policies that will all change, crop yields will rise, demand for agricultural machinery, fertilizers and other such materials will rise and those companies supplying consumers in rural areas will do very well.

Earnings, valuation and yields

Looking at earnings, consensus forecasts still, we believe, look much too high for a number of reasons. First, we suspect that forecasts are still predicated on fairly robust expectations for Asian GDP growth. As a result, we suspect that forecasts have failed yet to capture the impact of what we think will be a significant slowdown. Macquarie, for example, is forecasting Asian GDP growth to fall from around 8% to around 3.5% by mid-2009. Singapore already suffered a GDP shrinkage in 3Q 2008 and Korea has just announced 3Q 2008 GDP growth of only 3.9%, a three year low. This suggests there is still some way to go on general growth expectations. Analysts are forecasting, for example, 3.8% earnings growth in Korea in 08 and 16.1% in 09! We think 2008E earnings growth will be negative and 2009E very poor, at best, on current information.

Second, visibility is terrible. After visiting companies recently, we cannot remember a period when last there was so little clarity on future orders. Furthermore, a plethora of sectors, such as shipbuilding and flat screen makers, face a potential retraction of orders. This is a particularly severe risk for shipbuilders as the current supply of new ships due to enter the market in the next couple of years is set to double the fleet. This is coming at a time when the BDIY index has fallen from 12,000 to 1,200.

Third, we think that margin expectations are still too high and stand well above 2001 trough levels.

Fourth, balance sheets will deteriorate as working capital needs increase sharply. We can already see patterns emerging where, due to either slower demand or to the reduction in issuance of Letters of Credit or both, inventories and accounts receivables are rising sharply, especially in China, and defaults are on the increase. During the 2001/2002 recession, working capital rose by 5% as a percentage of sales on average. For certain sectors such as technology, working capital as a percentage of sales rose by as much as 12%.

The rapidity of the 'emergency stop' which has come about in almost every sector and in financial markets suggests that the 2001/2002 numbers will be exceeded, probably significantly, this time around. Furthermore, those companies who cannot manage their working capital will have little place to go for help. Contacts working on Treasury desks in banks throughout the world say they are given a daily list of companies to whom not to lend. This list grows by the day.

Fifth, we believe that dividends are likely to be cut dramatically. The culture amongst chief executives is already shifting towards preserving as much cash within the company as possible in case it is needed in future. Of course, many companies will be making much lower profits, or indeed losses, but nearly all will become hoarders of cash. This is very bad news for pensioners and the search for yield will become very tough.

Sixth, we would like to reiterate a point we have made before. Fair value falls as the cost of funding rises. We recognize that the consensus believes that interest rates will stay low as we are in a deflationary environment. We agree on the latter but we are less convinced that interest rates will remain accordingly low. The quantities of money lost are so huge that raising funding for anyone, possibly governments included down the line, will require increasingly high interest yields to entice the few who still have cash stashed under their mattresses to lend.

However, given the scale of the declines in equity markets over the last few weeks, valuations now, for the first time, appear to be close to matching past crisis levels.

At the close on Monday, 27th October, we estimated that you would have been buying the Hang Seng Tracker and the H share Tracker, a combined 50% weighting in each, on a blended current earnings multiple of around 6x and you would have anticipated receiving a 5% current dividend yield. Under any previous circumstance, such an entry point would not look bad.

Widening the search for value, the average CY2008E Asia ex Japan PER, based on Macquarie's estimates, was 6.7x at Monday's close, 49% below the long term average of

13.1x. Again based on the Macquarie estimates, at Monday's close, the current Asia ex Japan price/cash flow multiple stood at 4.2x and the current price/book-value at 0.97x.

The latter valuation, probably the least vulnerable input we have, is beginning to compare well with the previous troughs reached in 1998, the Asian crisis, 0.94x P/BV, 1990, 1.1x 1982, 0.92x, and 1974, 0.88x. Recent changes in accounting rules may make a trailing Price/Book a less defensive measure of value as has been the case in the past as the book, especially for property companies and banks, is now increasingly a market value based valuation rather than a cost or replacement cost based valuation. Nevertheless, it is highlighting that Asian markets, perhaps for the first time, are now beginning to discount a very difficult set of circumstances.

At the micro level, the PRC banking sector is a good example of how cautious a set of expectations are now being discounted:

First, between October 15th and October 27th, the HK listed share prices of the six PRC banks declined between 27% to as much as 43%. The sector's market capitalization declined by 33%. At Monday's closing share prices, the PRC banks were, based on the Macquarie forecasts, trading on between 0.73x y/e 2008E book-value to at most, 1.45x. Four of the six banks were either trading barely above or below book. This was for a group of banks who were forecast to achieve a weighted average CY08E ROE of 21.3%.

Second, the PRC banks are, ultimately state-owned and have high capital adequacy ratios, Tier 1 capital ratios at June 2008 ranged between 9% to as high as 11.1%. Loan growth has been constrained in recent years and PRC banks appear to have remained risk averse and continued to direct the bulk of their lending to state-owned or affiliated enterprises. The PRC banks' current lending to property developers and construction related activity ranges between 8.1% to at most 13%. For the PRC banks to wipe out their earnings, Macquarie estimates that bad debt charges would need to rise to between 325 bps to 430 bps. For such a scenario to come about, property development delinquencies would need to rise to 16%, the previous cyclical low point, and the banks would be required to write off more than 50% of their SME related loan books.

Conclusions

Positively, Asian share price valuations, if not earnings forecasts, are, we now feel, beginning to reflect the seriousness of the economic situation in which we find ourselves. Second, commodity inventories may also start to decline potentially reducing the current volatility in commodity prices and even perhaps providing a little support. Such a trend, positively, could potentially reduce the reluctance of the banks to issue Letters of Credit. Third, we are seeing some signs of renewed deal flow, British Gas' bid for Queensland Energy for example, providing a possible valuation floor. As a result, we do feel that there is scope for a rally from the current depressed market levels.

However, as we have highlighted in our comments above, we remain cautious on the underlying economic prospects in the medium-term. We expect to see rising levels of distress which will be best reflected in the banking sector where we assume that non-performing loan ratios will mount significantly. For that reason, we will continue to run the fund in a very conservative manner.

At the end of September, the invested portion of the Prusik Asia Fund, excluding the asset based holdings, was trading on a weighted average CY08E PER of 10.4x.

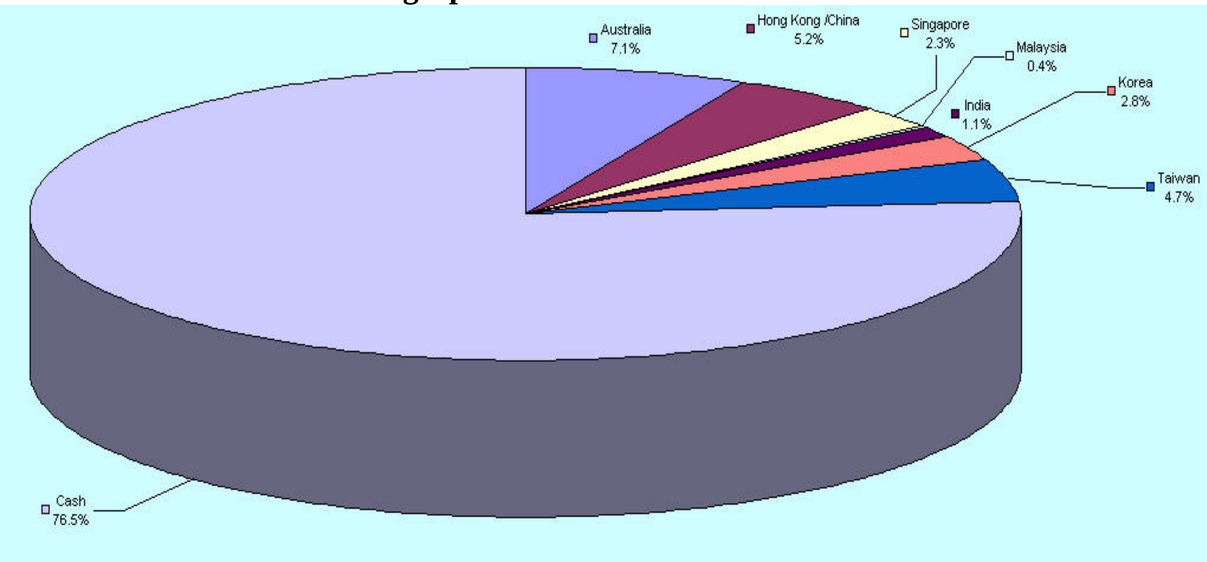
Ed is currently in Asia visiting companies in China, Singapore, Indonesia and India.

Top 5 Holdings	%
KT&G CORP	2.75%
NEWCREST MINING LIMITED	2.60%
WORLEYPARSONS LTD	2.47%
KEPPEL CORP LTD	2.29%
CHUNGHWA TELECOM CO LTD	2.08%

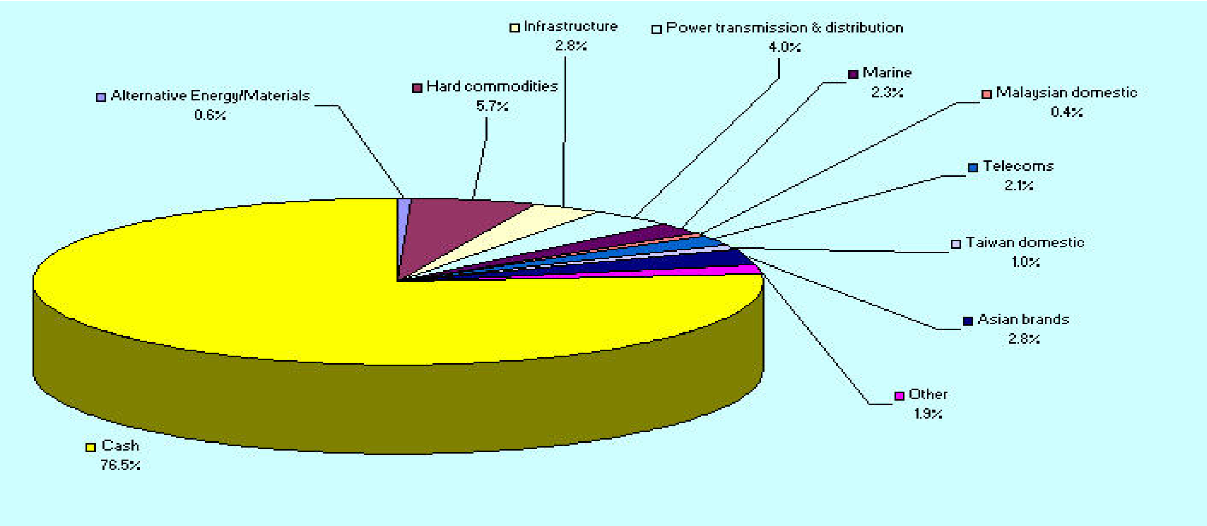
July 2008

Number of holdings	18
Percentage of Fund invested	23.5%

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	-5.34	-5.33				

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

Manager Fees

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

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