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Prusik Investment Management LLP

An Independent Asian specialist investment manager

NAV Updates

Series	*November '08*	*MTD*	*YTD*
Class A	128.18	+0.02%	-27.87%
Class B	128.24	+0.02%	-27.86%
Class C GBP	71.47	+1.15%	-25.32%

Fund Size $220m

Performance

2005 Q4	+8.86%
2006	+33.94%
2007	+21.88%
2008 (YTD)	-27.87%

The Fund declined in unit value terms by 7% in October, but rose marginally in November. Events are moving at such a pace that we felt our October report was already out of date the moment it was completed, as such we have merged our October report with that of November to give investors a more timely update.

Without wanting to repeat the columns of downbeat news and comment we have all read over the last few weeks, we feel we might be able to paraphrase as follows how we think the market stands today.

The market understands we are in new, possibly dangerous, dramatically poorer and somewhat unpredictable economic territory. It believes it will take years, possibly decades to sort out and recover. It wonders if events might lead to social unrest or, worse. It feels as though it is watching some companies being plunged into liquid nitrogen; so sudden and complete is the slowdown. Individuals feel the impact coming very close to home and wonder if 'this time it really is different'. Nobody is sure what or who they can trust. Everyone can see that our leaders are not sure how to solve the problem. The market envisages the problem escalating in size to proportions so big it cannot imagine a solution which doesn't change life as we know it. Everyone feels fear.

On no count do we feel that the full scale, severity and speed of the crisis in which we find ourselves has yet been fully discounted in share prices. However, we also feel that we have come to a stage where the hyperbole and doomsday tone is almost surpassing our own predictions and we think that we have been amongst the most realistic and negative observers to date. Perhaps the best way to illustrate the extremity of sentiment is to look at the VIX index which peaked ten days ago at a record breaking eighty. Furthermore, we can now see increasingly large and sustained efforts in Asia to support economies, crucially starting with China. We suspect that a 'false dawn' is looming.

In the first instance, we see the very aggressive run down in inventories is starting to take effect in many industrial sectors, albeit not in some of the most widely discussed such as steel. We are also seeing unprecedented closure of companies and of industrial capacity. Subsistence or basic replacement demand will recover at some point and, when it does, it may feign a recovery. We categorically expect that supply reduction in, for example commodities, will not keep pace with demand destruction. However, in the short term, both supply and demand are falling. In the confusion, we expect as a result, more stable sales prices and volumes to emerge over the next month or two. This will be a transitory trend but it could potentially act as a powerful boost to sentiment.

Second, if any investor is minded to look for 'value', they will find it in spades. Ben Graham liked buying companies when the value of their net current assets amounted to 66% or more of their market capitalisation.

For example, in Hong Kong alone there are, as we write, 69 listed companies whose net current assets exceed their market capitalisations. There are 24 listed Hong Kong companies whose net current assets have a value more than twice their market capitalisation. There are 21 companies whose net cash alone exceeds their market capitalisations, implying that their franchises are valued at less than zero. Moreover, the aggregate estimated 2009E dividend yield of this group of companies is 16%, the estimated average 2009E PER is 3.2x and estimated average y/e 2009E price to book-value is 0.35x. Similar value can now also be seen in other markets across the region.

Clearly some of these companies are heading towards losses or have earnings prospects which possess no visibility, or on enquiry, have 'cash' which turns out to be held within a complex derivative product. A fine toothcomb is therefore required at all times. Nevertheless, there are also plenty of lowly valued companies which operate in stable demand areas and have no discernable negative flash points.

In spite of an avalanche of downgrades over the past two months, we believe that sell side analysts have yet to cut their forecasts fully to reflect the dismal prospects. Nevertheless, the modest valuations outlined above are based on new, lower and therefore more, if still not completely, realistic estimates.

Third, we still see very little discrimination between companies which have sustainable business models and whose managements have anticipated this environment, best reflected in conservative, liquid financial positions, and those whose models and financial positions are more vulnerable. The market remains fixated, rightly so to some degree, on the impact of redemption selling and deleveraging. In the near-term, the effect of this is difficult to quantify. In particular, it is difficult to discern how much of the current market weakness is a reflection of actual redemptions or how much a reflection of anticipated year-end withdrawals. However, we expect that at some point, when there is a hiatus in forced selling and a reassertion of fundamentals, there will be some very big upward moves in the share prices of a number of companies.

Fourth, as the recently announced Chinese PMI numbers and soon to be revealed November export data will likely attest (the latter rumoured to show a YoY decline having risen 19% YoY in October), China's economy is in a very bad way. Furthermore, Chinese New Year falls early this year, before the end of January. Therefore, economic data for the start of next year will look at best confusing. This is a time when books are closed, debts are called in, back pay is paid, taxes completed and so on. This year workers may even believe that their company will not re open after the holiday and therefore may demand additional compensation.

In short, we think that this will be a period when PRC-based companies could suffer a significant credit crunch. As a result, we believe that the PRC Authorities will do everything in their power to sustain the economy through this period. Their regular public statements indicate the strong likelihood of such moves and we anticipate further significant policy announcements.

In the short term therefore, it is possible to envisage a few weeks where those who are now happily hunkered down in cash, feel a bit uncomfortable. During the past major bear markets in the 1930s, the 1970s, and the early 2000s, there was, without fail, a sharp rally at the point at which markets had declined around 50%. Recently, markets have bounced at this level twice and interestingly, many counters, especially those related to China, have made higher lows the second time around.

Prusik Asia Fund

The Fund has held high cash weightings throughout this year and never more so than in the last eight weeks. During October and November, the benchmark Asian Index, the MXAPJ, declined 29.5%. At the low point on 20th November, the index had declined 38% since the September month end.

Over the last two weeks we have, gradually, built up positions in large liquid blue chip companies, mainly those with exposure to China in some way. This is based on first, our view that the PRC Authorities, among all the Asian Governments, will try hardest to stimulate growth and have the most weapons in their armoury and second, our observation that the PRC-oriented markets have suffered among the biggest declines this year.

We wish to make it clear that we do not expect the PRC Authorities' efforts to stimulate the domestic economy will come to much. However, we believe that investors may well wish to believe that the Authorities' actions will boost economic activity until proven otherwise early next year. Our recent investments are therefore made solely on the basis of value and liquidity, we have strict loss limits and we do not expect our holding period to be very long.

Our work on more sustainable investment themes remains the key driver for our investments. However, we believe that the moment when stock markets are once again able to react to fundamental analysis will not come until later next year.

2009

While we feel that we may be due some respite in the short term, we are under no optimistic illusions. We expect to see new lows in 2009. Without wishing to be too depressing, here are some of the trends which we believe, could rear their heads next year.

First, as deleveraging continues, we expect there will be an escalating problem with illiquid holdings. We recently heard that one big US hedge fund alone owns around US$3 billion worth of Asian pre IPO paper. They cannot be alone.

Second, we think that credit card debt will be the next big issue for banks. This is mainly unsecured and therefore undesirable. Business Week estimates that there is some US$950 billion of outstanding credit card debt on the books of the US banks, much of it, some analysts believe, potentially toxic. This will spread the bad debt problem to banks such as JPMChase and Bank of America which have sidestepped the mortgage problems to some degree but have big credit card operations. Perhaps more worryingly, Meredith Whitney estimates that credit card lines currently available to US consumers worth some US$2 trillion could be pulled next year. This would remove another source of liquidity to US consumers and exacerbate the downdraft in consumer goods demand.

Third, we believe that there will be a growing realisation that many companies in the US and Europe cannot fulfil their pension fund obligations to employees.

Fourth, we anticipate that the crisis of trust will continue. This will come hand in hand with a backlash against the recent lack of personal responsibility. As Herbert Spencer noted 'the ultimate result of shielding men from the effects of folly is to fill the world with fools'. It would be a natural reaction for individuals, companies and countries alike to now withdraw and protect themselves from the mistakes of others.

Acts such as shielding the US car industry from ruin could lead to increased protectionism. Countries like China may start to add strings to their continued support of US asset markets. An influential Beijing think tank has already suggested that, in exchange for China's continued support of the US Treasury market, Chinese bond holders should be allowed, among other things, to exchange bonds for large equity stakes in US corporates, Chinese banks should be allowed to open branches across America and that America should comply with China's request to cease selling arms to Taiwan.

Fifth, quantitative easing and the realisation that there is not enough money that can be 'borrowed' to plug all the gaps could lead to huge currency gyrations. This could also generate a major re-pricing of bonds as savers demand higher rates of interest to lend to governments with weak finances.

Sixth, and finally, the cost of debt could adjust significantly upwards in order to reflect its scarcity. This has a major negative implication for the fair value of equities.

Chinese healthcare

We have been revisiting a number of our old themes. Of them, healthcare in China looks to us to be one of the most promising.

Last month we wrote about the possible boost to China's rural economy of the coming programme of land ownership reform and the resulting transfer of wealth to the people which could come about via the extension of agricultural land leases beyond the current thirty years.

More recently, Zhang Ping, Chairman of the NDRC and a high level representative of the State Council in charge of the economy, has publicly said that the PRC Authorities will be 'taking forceful measures to LIMIT (our capitals) the slowdown in the Chinese economy'. These words do not come lightly and underline what we have been writing for months, namely that the Chinese economy is facing a grave setback as the rest of the world slows.

We expect the Authorities to continue to announce measures to stimulate economy. This started with the announcement of no less than three interest rate cuts in an unprecedented three weeks and the recent stimulus package. We think this trend will continue into the New Year with ongoing announcements to support and stimulate growth. We expect the vast majority of this effort to be focussed on the domestic economy with a bias towards the rural regions.

Increasing spending on healthcare seems to fulfil this objective. Currently, it is quite possible for the average Chinese citizen to spend a year's income on a short stay in hospital. In order to see a doctor, the average Chinese citizen will, in most cities, likely have to arrive at his or her local hospital at 3am. There is no such thing as a National Health Service. If the patient has no money, he or she receives no treatment.

It was therefore unsurprising that, although we are now in year three of a previously planned Rmb 21.7 billion healthcare budget, the recent Rmb 1.18 trillion stimulus package incuded healthcare as one of the ten major areas of focus. Last weekend, the Authorities officially announced the exact allocation. Rmb 4.8 billion will be invested in the development of rural clinics by early 2009. In conjunction with the spending programme which has already been planned and budgeted, this means that the Ministry of Healthcare has now seen its 2009E budget rise by 22% YoY. We think that in 2010E, the year when this budget concludes, we will see a similar if not greater level of spending announced.

So far, most State healthcare spending has been devoted to building rural clinics. The benefits of this programme have thus been lost in the property boom across China. From hereon, however, we believe that spending will shift towards purchases of equipment and drugs. In this sector, we think that there are a number of listed companies which are set to benefit.

One sub-sector which we particularly like is the provision of diagnostic equipment. Popular wisdom holds that China has a young population. Today, this is still the case. Just over 10% of China's population is over the age of 60. This percentage, however, rises to over 30% by 2050. The ageing of China's population accelerates sharply over the next decade.

Around two years ago, we wrote in detail about how the cost of healthcare could, during this period, be almost too much for the PRC economy to bear given the increasingly expensive nature of treatments of chronic diseases. As a result a strong emphasis on early diagnostic and preventative medicine will be essential.

Aside from providing a better outcome for the patient, this should also prove to be a more cost efficient way for the PRC Authorities to meet the country's likely increasingly onerous healthcare demands. We therefore think that it is extremely likely that China will build its system with this in focus. The adoption of new technologies and perhaps, an intelligent incorporation of traditional Chinese medical practices, which cost less, should ensure that the PRC Authorities build an enviably modern system without being too heavily influenced by the agendas of the pharmaceutical companies which tend to benefit from the lengthy treatment of chronic diseases.

Intriguingly, China Life is already demanding health screening for all future life policy holders. It has teamed up with Hong Kong listed Mingyuan, a company with a proprietary protein chip for detecting cancer. The company is also in the process of introducing similar screening products for tuberculosis, HPV and diseases in newborn babies and is opening a chain of diagnostic centers in major Chinese cities. Mingyuan has margins well above its peer group and trades on 7.7x CY 2009E consensus earnings estimates.

The industry sales growth of medical devices averaged 25% on 2006, 26% in 2007 and 32% ytd in 2008. We think such growth will likely continue in 2009 and beyond at a pace of around 25% per annum.

The Chinese internet sector

The Chinese internet sector is of particular interest partly due to its already huge market but also the potential for this market to grow. China's internet user base already stands at a staggering 253 million. However, this constitutes a penetration rate of only 19%.

In order to bring this number into context it is worth comparing China to the USA and to a more locally relevant country like South Korea. The USA has 210 million internet users which translates to a penetration rate of 73%, Korea has 35 million users, a penetration rate of 72%.

In spite of the size of China's user base, it has an internet economy, online advertising spend, online gaming, e-commerce and online travel, which is six times smaller than that of the USA. Clearly the monetization of the Chinese internet base will offer some excellent opportunities as the current young, average age of users in China, 26 years old, increases further and in turn pushes up their purchasing power.

In the US and Korea, the CAGR in internet usage was 40% and 50% respectively until the penetration rate hit 40%. If we conservatively assume a 30% CAGR for China, we will have a country with 400 million internet users by 2012E and up to 558 million in a best-case scenario. With this in mind, we feel the sector is one which will stand out in 2009 as an industry in which earnings growth remains firm.

Entertainment

We feel strongly that entertainment, especially quite cheap entertainment, is one area which does well in a downturn as people look for ways to distract themselves from the drudgery of real life. The China online gaming industry has now surpassed that of Korea in terms of revenue. However, penetration still stands at only 5%. This compares with a 49% penetration rate in Korea.

Our favourite China internet company is Shanda. Shanda enjoys a particularly strong industry position given that 100% of its revenue originates from online gaming in China. Shanda, unlike many of its peers, is therefore not exposed to economically sensitive advertising revenues.

Shanda, like all internet gaming companies is vulnerable to the success of its new titles. However, it has seventeen new games due to come on stream over the coming eighteen months, including two hotly anticipated MMORPGs, massive multiplayer online role playing games. Furthermore, the company has a three pronged strategy for developing games including strategic partnerships with promising developers, licencing games from successful international gaming companies and developing games in house. This should help to alleviate the hit and miss risk associated with new products.

Shanda has a strong balance sheet, should grow revenues by over 15% next year on conservative estimates and trades on a CY 2009 PE consensus earnings multiple of around 7.6x.

Indian Infrastructure

India’s infrastructural roll out has attracted lots of investor interest over the past two years, including until earlier this year, ours. While in Mumbai, we took the opportunity to revisit some of the main operators and concluded that overall power generation roll out and broader infrastructure build face headwinds.

China has installed almost one hundred GW of generating capacity over the last three years taking total installed capacity to over seven hundred GW. Indian installed capacity currently stands at one hundred and forty three GW and India has struggled to add five GW this year. Brown-outs are still the order of the day and October saw the power generating deficit in India rise to 20%. Despite a slowdown in the overall global economy, it is difficult to see why the crunch occurring in the Chinese power sector should be mirrored in India where a situation of undersupply persists.

The fundamental issue centres around how many Giga-Watts of capacity India can build. Reliance Power was awarded the Sasan mega power project last year using an 8% discount rate to justify its bid. The Government now uses 12% as a discount rate in order to evaluate bids. Naturally, Reliance was adamant the project would go ahead. However, not all the financing is in place. The fact of the matter is that, in our opinion, the project, on its current terms, will likely not go ahead as the numbers simply do not appear to add up. No doubt the Ambani Group will re-negotiate the terms. However, this implies further delays.

Last year GVK took control of Mumbai's airport in a JV with Airports of South Africa.
Why? Because at the time, GVK was offered lucrative parcels of land adjacent to the airport. GVK needs cash to fund its six new power generation plants. The cash flow from the airport operations will have to be re-invested in the airport. With no prospects of raising cash from sale of property, GVK's only cash source is from its three existing power projects, two of which have no gas to fire them up! Currently, GVK is in the process of negotiating to sell a half stake in one of its toll roads to Macquarie Infrastructure. This is another example of the log jam that has developed within the infrastructure development industry.

Jaiprakash is due to roll out eight GW of hydro power plants. The company is also currently expanding its cement capacity from nine million tons to thirty-two million tons financed by two convertible bonds, both 70% out of the money, and a loan from Barclays, which is not fully drawn down. The hydro power plants need future equity injections which are to be financed through property sales around Delhi. It is the same story with Lanco and GMR.

What next? Larsen & Toubro believes that the banner projects will receive Government support. This seems likely. However, a logjam exists and it is not beyond reason that the Government will end up taking equity stakes in the key private sector infrastructure developers. We also remain concerned that the bigger infrastructure operators are using their own in-house construction firms to complete these projects. These are the core cash providers to these companies and are forecast to continue to be. If projects are delayed and financing remains difficult then so will the profitability of the in-house construction outfits which again will have a knock-on effect on the listed companies' ability to fund the planned projects. It's all becoming a little circular!

From an equity perspective the immediate future for the infrastructure operators, many of whose shares have fallen 80-90% from their peaks, still looks 'murky' especially given the threat of equity dilution. Perhaps, and this is outside Prusik's remit, the real value will come from buying directly into projects via infrastructure funds which may have the pick of the projects as operators unload their crown jewels in order to stay afloat. Once we are through this restructuring period, we believe the equity, or what is left of it, will look very attractive.

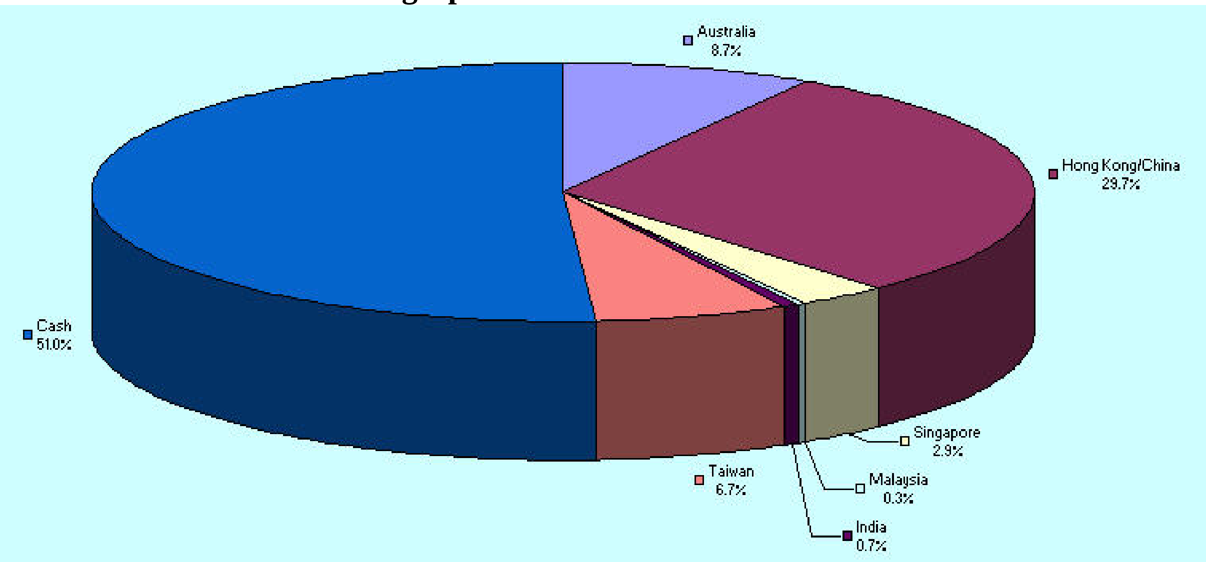
On a weighted basis, the invested portfolio is trading on around 8.3x CY2009E estimated earnings which are forecast to grow at 10% (excluding our gold mining companies) .The portfolio trades on 0.96x estimated weighted y/e 2009E book-value and is expected to earn an estimated weighted CY 2009E ROE of around 13.5%.

We would like to take the opportunity to thank you all for your tremendous support during what has been a difficult year for everyone. From the whole team here at Prusik we wish you a very Happy Christmas and all the very best for 2009.

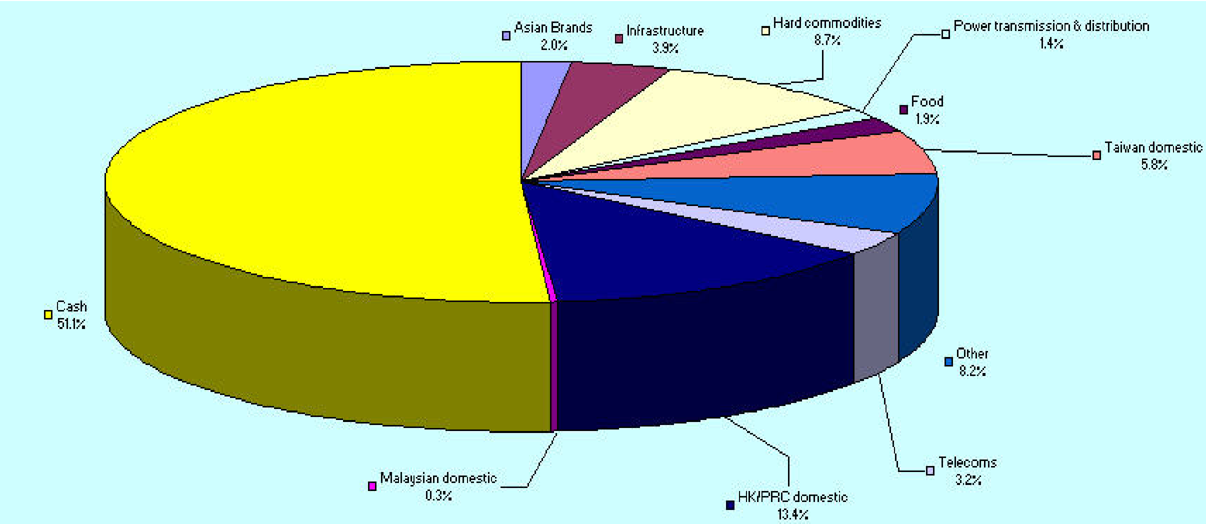
Top 5 Holdings	%
CHEUNG KONG HOLDINGS LTD	3.23%
TAIWAN FERTILIZER CO LTD	3.22%
SWIRE PACIFIC LTD 'A'	3.20%
CHINA CONSTRUCTION BANK-H	3.17%
CHINA MOBILE LTD	3.13%

November 2008	
Number of holdings	27
Percentage of Fund invested	49%

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	-7.37	0.02		

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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