PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asia Fund

Quarterly Investment Report

28 June 2013

FOR PROFESSIONAL INVESTORS ONLY

2Q13 Review and Outlook

For the first half of 2013 the Prusik Asia Fund generated a positive return of 3.9%, significantly better than the MXAPJ Index return of around -5.6%. Following a strong performance in 1Q13 the fund continued to outperform in 2Q13, losing 5.5% while the index fell 7.3%, although clearly in absolute terms the fund lost money. May was a particularly good month with the fund roughly flat while the index fell by more than 4%. However, some of this good performance was given back in June when the Prusik Asia Fund fell around 7%, a bit more than the index. Despite the sell-off in ASEAN, particularly the Philippines and Thailand, during the quarter many of our ASEAN holdings were key contributors to the fund's performance. Overall, **GS Home Shopping**, **Chipbond** and **SK Telekom** were the biggest contributors to performance while our gold holdings were the biggest detractors.

So What Happened in June?

June brought the worst of the global 'taper tantrum' correction and this was exacerbated in Asia by a very sharp deterioration in the liquidity environment in China combined with worsening fears over a slowdown there. Stocks which had performed well year to date and where valuations were less attractive were sold down the most. Owing to this, both small and mid-sized companies and ASEAN suffered disproportionately.

The Philippines and Thailand were amongst the worst performing markets in the MXAPJ in June, each down around 9-9.5% in US$ terms (less in local currency terms). As of the end of May the Prusik Asia Fund had a 15% weighting in the Philippines and a 20% weighting in Thailand versus index weightings of roughly 1% and 2%, respectively. As such, it is unsurprising that the fund's performance was weak in June.

Where is our ASEAN Position Now?

At the time of writing the fund has a 37% weighting in ASEAN, less than the 50-55% weighting which characterized the fund for the first half of the year. The distribution is also now slightly different. For instance, our weightings in Thailand and the Philippines have been roughly halved and we have been putting more money to work in Malaysia and Vietnam. It is worth noting though that we had been adding to Malaysia for some time on the basis that investors appeared to have become too downbeat in the run up to the elections, a decision which proved to be very lucrative. We now have around 10% of the fund in Malaysia and we have a similar weighting in Vietnam. Looking at aggregate headline valuations there is good reason to be trimming the fund's exposure to the Philippines and Thailand, which are on 18.7x P/E and 13.6x P/E, respectively, versus the MXAPJ on 12.2x P/E, and increasing our exposure to Vietnam, which is on 11.6x P/E. Equally, below the larger cap index constituents there is a raft of mid and smaller cap companies in Thailand and the Philippines which are generally much cheaper and it is because of this that we still have sizeable weightings in these markets.

Outlook

The markets have registered a significant decline at some point during the year for the last few years. The question then is was this 2Q correction any different? One notable factor is that since May, when markets began the correction, cyclicals, Korea and select China stocks have all done relatively well. This possibly tells us a number of things. Firstly, it suggests that many funds are holding roughly the same kind of stocks: quality, defensive, consumer, domestic and definitely not China and so by definition these high quality stocks were all these funds had to sell.

Secondly, with cyclicals now suddenly starting to perform a bit better there a real possibility (whisper it quietly!) that the global economy is actually picking up. We have recently carried out a very thorough set of conversations with Taiwanese small cap analysts and company management teams. Smaller companies in Taiwan tend to be outstanding and often the number one or two player globally in slightly obscure export driven niches such as sewing machines or bathroom taps. Anecdotally these companies are starting to see some pick up and better visibility. Thirdly, this recent rally in cyclicals could simply reflect the fact that the cyclical to defensives price to book gap was at 90% of the 2008 lows meaning some kind of normalisation was due.

Overall, we believe there is a reasonable chance that what we have just seen was a kind of mid cycle correction. This is the usual transition phase as the market weans itself off very easy money and faces down the prospect of rising interest rates, accompanied by better growth and often in the end inflation. After the correction there usually follows a very strong period of equity performance driven by growth, which eventually leads to rising inflation and one interest rate hike beyond comfortable.

Interestingly, what we are possibly seeing now is the early flinches of a recovery but with absolutely no sign of inflation. We also see no lending bubble in Asia, with the possible exception of China, nor do we see ridiculous valuations, save for the top half a dozen consumer names in each country which are very over owned. Indeed the MXAPJ Index came within a hair's breadth of an average price to book ratio of 1.4x during the quarter which has always been the absolute trough value level in non-recessionary times. Over the past 15 years buying at this valuation level, excluding recessionary times, has resulted in positive returns 100% of the time and of significant proportions.

We are, therefore, comfortable to keep the faith in Asia. We are taking an optimistic but not exuberant view of the recovery prospects and with this in mind we are gradually increasing exposure where cyclical recovery will help but is not required. For example, we are adding to our tourism and leisure theme as well as internet businesses in North Asia. Recent new buys include **Travelsky**, a specialist IT company in China which provides airline booking and logistics services to domestic and international airlines and **Beijing Capital International Airport**, plus Chinese internet companies **Baidu** and **YY Inc**. We will explore these themes and companies in more detail below.

Overall, we are currently very excited about the growth prospects of the portfolio and in particular some of the themes we are invested in. We also feel certain that our heavy bias towards mid-sized companies will be very rewarding in performance terms in coming months. Indeed it is worth stating up front that **the aggregate earnings growth forecast for the fund is currently 29%!** Therefore, even if valuations remain at current levels, which is not our expectation, returns should be strong.

China

In the second quarter the Chinese government spooked the stock markets by allowing a sharp decline in liquidity amid a clearly slowing economy. Given the backdrop of unquantified bad debts in the shadow banking system, clear anecdotal evidence of real pain at the small and medium enterprise level owing to slower growth and a lack of available credit, not to mention rumours that the size of the debt problem could be as great as 40% of GDP, it is unsurprising that this caused considerable alarm.

However, we are comforted by the simple fact that one of our better connected advisors had warned us weeks ago that this was coming. This suggests to us that the move is an intentional one, designed to precipitate a clear-up program for the banks and local governments and thus clear and pave the way for the new reforms planned over the next 5 years, including a move to a convertible currency from 2016. That said, this does not reduce the considerable risk that China still faces. We cannot pretend the numbers aren't vast and with state owned enterprises now drafted in to prop up smaller companies in the private sector the logjam facing the reformists is severe. Moreover, we think this process will take place with very little in the way of growth-related policy to ease the minds of fund managers or the path of the local private sector.

You are probably reading this and feeling comfortable that your exposure to China is very low or that you are even short! The key point here is that you are not alone, indeed very far from it. Short exposure to China is extremely high, as much as three weeks volume in some companies! Almost all fund managers are underweight. This is not an understatement. Since 2007 the Shanghai Index has fallen by two thirds and in turn the market has almost been written off. We recently met with a top rated China banks analyst who visited 75 fund managers prior to seeing us. Of the 56 long only managers she had seen only 3 were neutral or overweight Chinese banks and 2 of those were long term holders and deep value funds!

HOWEVER, isn't the clamping down on financing of legacy, bankrupt businesses and a clear up of the banking sector exactly what the bears wanted to see in China? The key question is are we about to pass an invisible line after which the progress in China is constructive, the problems are quantified and managed openly and in turn the progress in business is positive in the longer term?

We are also looking at valuations in China with new eyes. On a P/B to ROE basis China is the cheapest market in the region. It is possible to buy good companies such as **China Shenhua**, which has consistently delivered a ROE over 18% every year since the company IPO'd, on valuations comparable with those reached at the nadir of 2008. At present the shares are on just 1.3x P/B, 7.6x 2013 P/E and are yielding 5.1%.

Of course there are many unknowns in the progress of China from here and so we feel that the situation from an investment perspective is perhaps best expressed in terms of probabilities. As happened in 1998 and 2008, when things are very bad and appear near the bottom, it is possible to have one final and violent leg down of around 30%. The same could be true of China. We think the market has given at least a 50% probability to this happening in China, and while we do think this is possible, we also believe that the risks are lower than this, hence the opportunity.

The key question is how to do this whilst keeping risk at a minimum in case our assumptions are wrong. We are, therefore, looking for companies which fulfill the following criteria:

- **Relatively non-cyclical demand** so they will not be as affected by the slowdown in growth.
- **High margins** so that even if demand slows, profits should be less affected.
- **Strong balance sheets** so there is limited need for external financing as the banking sector shrinks.
- **Trading at distressed or underestimated valuations** so that even if we are wrong our downside is limited.

The Internet in China

One way of gaining exposure to China but keeping risk to a minimum is to find strong themes that are growing despite the economic cycle and companies which are safe from unhelpful government intervention and currently undervalued. The internet stocks in China are one such area and we now have over 8% of the fund in this theme.

China's internet and smartphone penetration levels are now above critical mass, reflecting that support infrastructure is in place for these levels to grow towards internet and smartphone penetration levels seen in the US, Japan and Korea. China currently has 485m internet users or a

36% penetration rate compared to a 78-82% penetration rate in the US, Japan and Korea, and analysts estimate Chinese internet users could rise to 675m by 2014. Smartphone users in China now amount to 200m, up from 100m in 2011, and are forecast to grow to 500m by 2015. Amusingly, a year ago analysts were predicting there to be 220m smartphone in circulation in China by 2015!

Baidu or the '**Google of China**', with a strong growth dynamic underpinned by low penetration, a track record of management execution and good cash generation, remains one of China's best quality growth companies. Amid all the negative macro noise it's easy to forget that **Baidu** delivered over 50% year on year earnings growth in 3Q12, with customer numbers up over 20% year on year and ARPUs up over 15% year on year! **Baidu's** recent results also highlighted that sales from mobile - another of our themes - now account for 10% of total revenues and are rising. Despite good performance in recent weeks the stock is still on a 2014 P/E of less than 22x while in previous years it has traded on over 50x P/E.

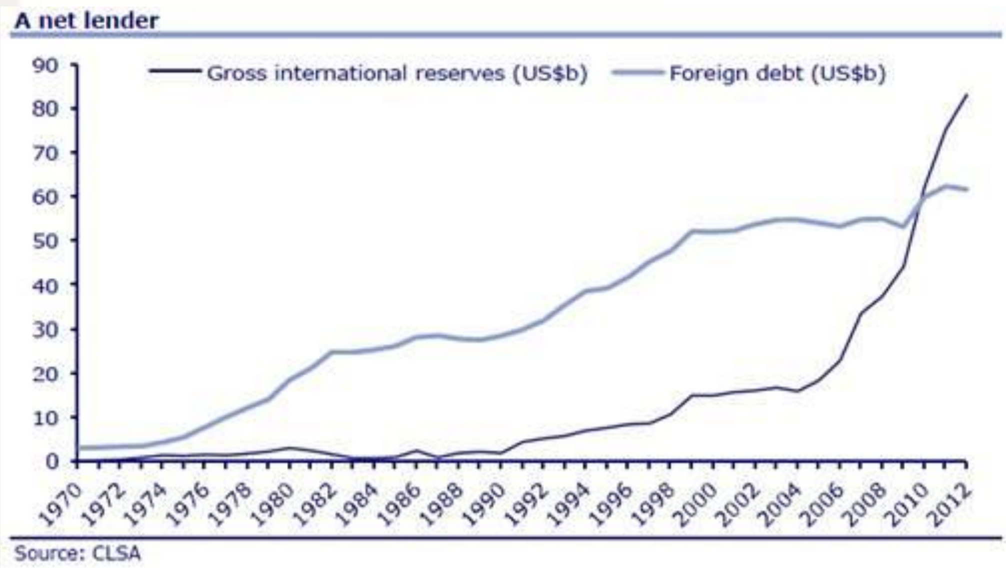
Philippines: A Case Study

During the recent market correction in May and June the Philippines fell over 20% from its high. This took place amid much conjecture as to whether interest rates are too low and stocks too expensive. We can see why both seem worrying. Deposit rates have fallen to as low as 2% whilst the stock market P/E had risen to 17x.

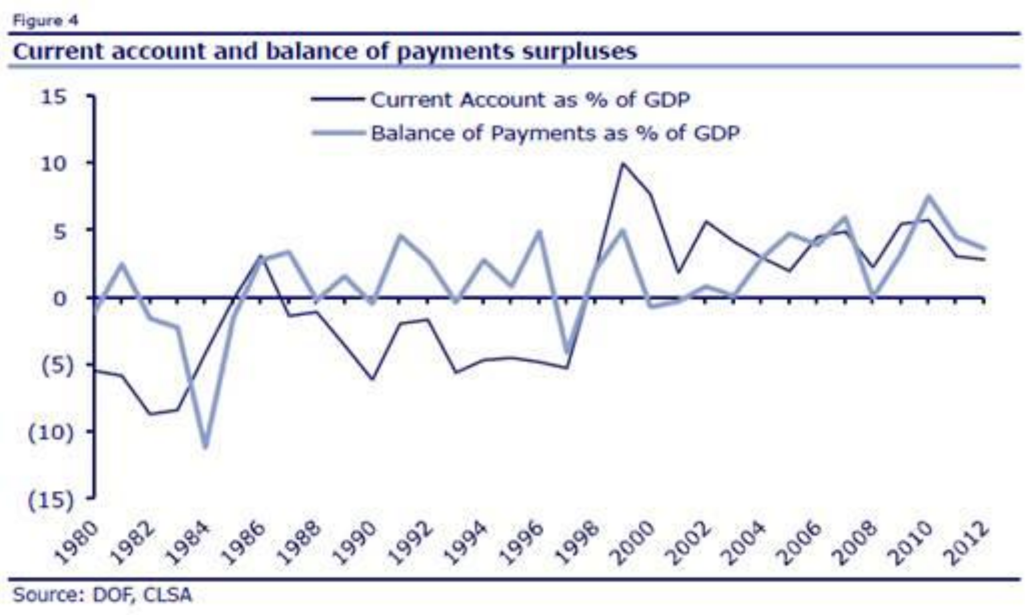
With these conditions in place we think it's worth taking the time to look at the Philippines as a bit of a case study. In short we don't disagree with either concern but would argue that timing is everything and the cycle still has a way to go.

Firstly, let's look at the valuation. Counter intuitively, given the past history of politics in the Philippines, the average P/E for the market over the past 17 years is 17.6x. Following the correction at the end of June the market had fallen to 15x 2014 earnings, leaving some upside for those who believe in mean reversion but plenty to worry about for those who think this, bluntly, is just too high. We would say that anything close to 14x for this market, given the history and the fact that today's fundamentals soar well above those of the past, is a great buying opportunity. Here's why in simple pictures:

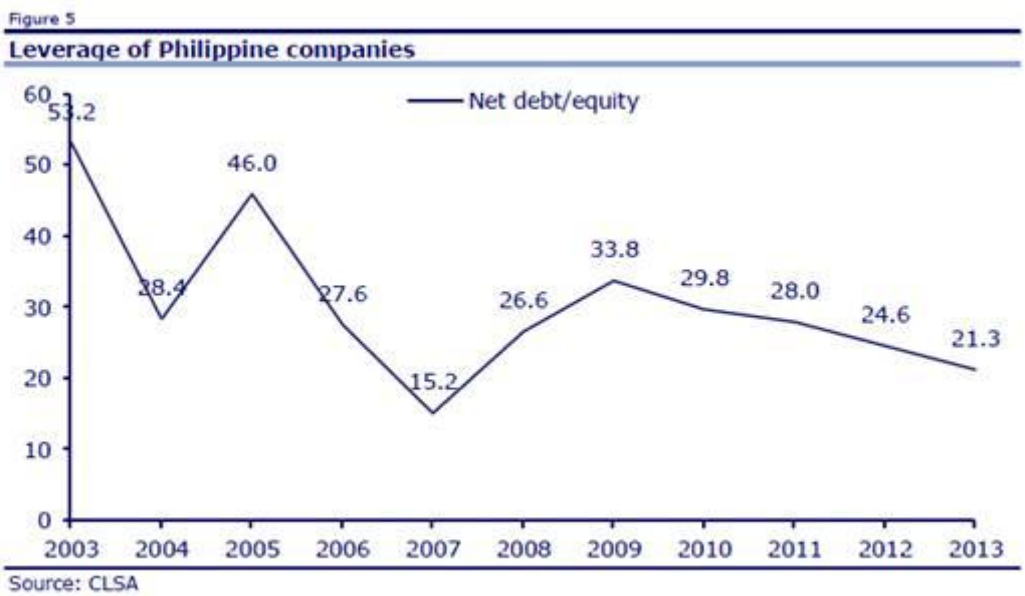
- The Philippines is a net lender in the global debt markets so investor talk of excess local debt denominated in US dollars is unfair.



- The current account and balance of payment surpluses remain impressive. Indeed the current account surplus now stands at 5.3% of GDP and what's more it's growing.



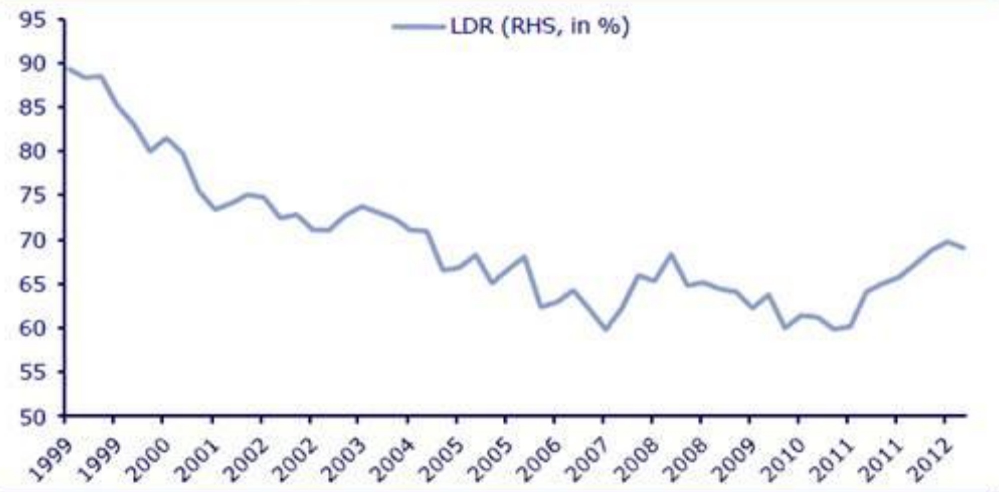
- Philippine companies are just not that leveraged. Does this look dangerous or even like the end of the cycle to you?



- Loan to deposit ratios remain pretty low. Indeed as of May bank lending has been growing in the order of 13% year on year and is very well spread across all sectors. This is firm but modest progress without signs of overheating.

Figure 6

Time series of loan-to-deposit ratio

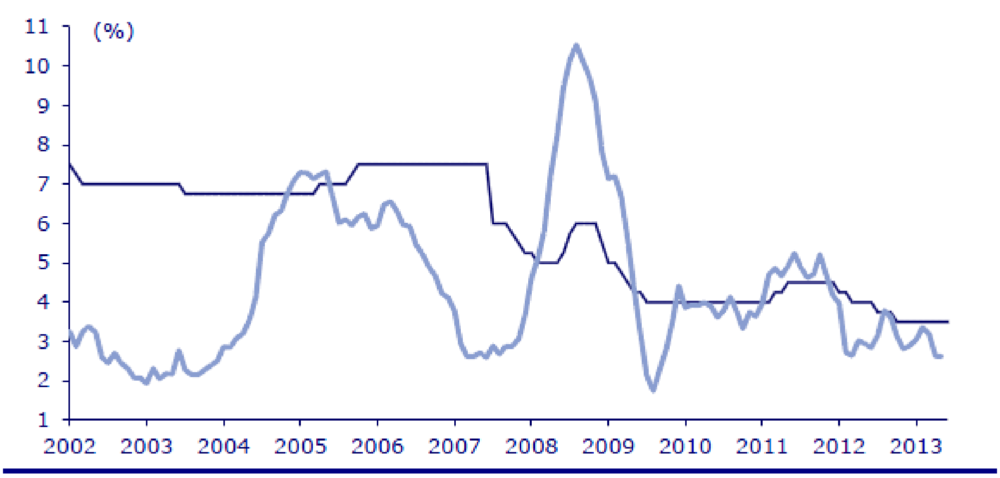


Source: CEIC, CLSA

- Inflation is benign, up 2.6% in May and 2.8% in June. This brings the year to date average to 2.9%, which is still below the government's 3-5% target for the year. In the Philippines there are no populist style minimum wage increases and wage inflation of just 4% is expected this year. Moreover, the strong growth in Business Process Outsourcing (BPO), or call centres with a largely international customer base, are often based outside central Manila and this is helping to keep costs in the city down.

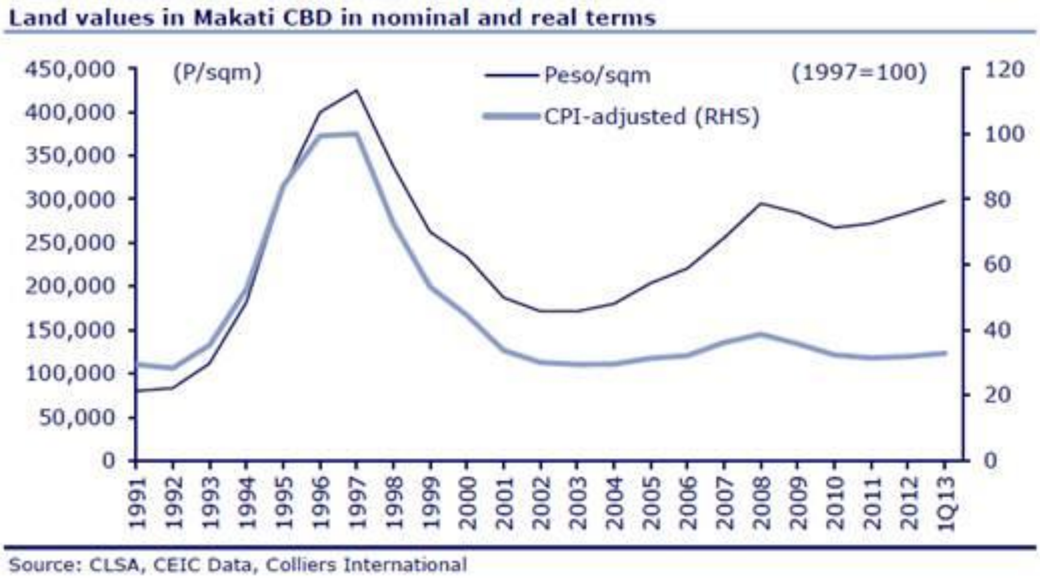
- We think the government is still very much inclined to keep interest rates at bay, with no real urgency to tighten policy any time soon. However, GDP did grow 7.8% in the first quarter, the fastest pace in Asia, so we can see that it is possible that this might change in the coming months.

Philippines CPI inflation and BSP key policy rate



Source: CEIC Data, Bangko Sentral ng Pilipinas (BSP)

- Property prices in the Philippines still sit 30% below their 1997 pre-Asia crisis peak. In fact on inflation adjusted terms they are 67% below this peak! Manila is one of the few cities where, anecdotally, young analysts can still afford to live walking distance from the office!



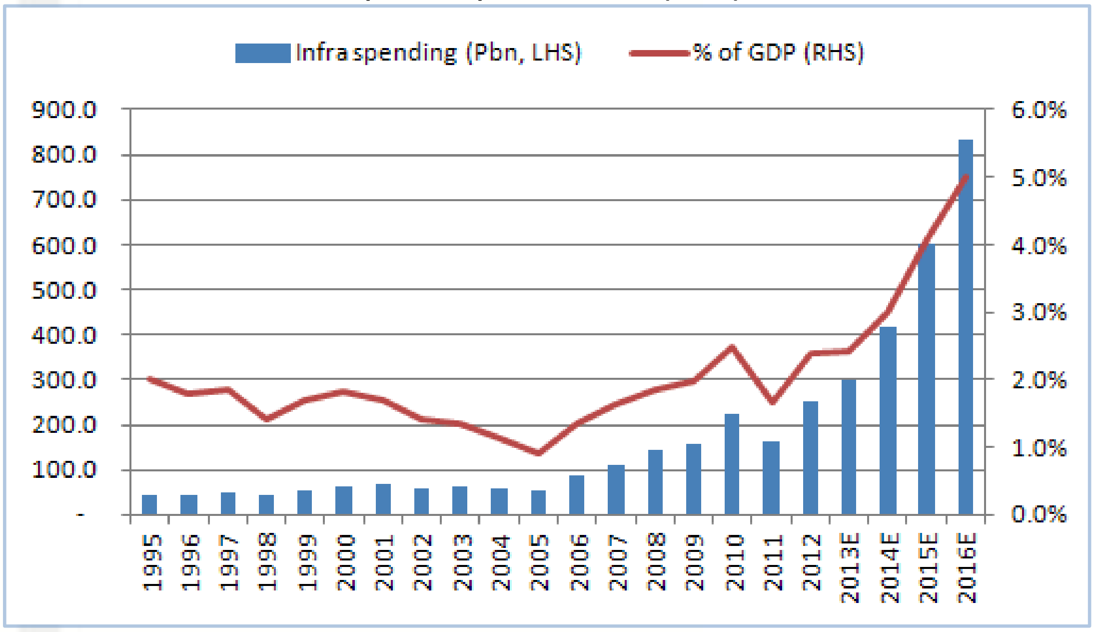
So what is still to come for the Philippines before this cycle is over?

Firstly, we expect to see an increase in investment, both public and private. So far investment has been led by the private sector and this has risen consistently for the past five quarters. We expect this to continue to rise as companies are planning to expand, lending rates are low and liquidity is plentiful. In addition, there has not really been a capex cycle since the 1990s. We think this is an important point for the Philippines as we can see a proper business cycle building, not just a financial one.

Additionally, the government wants to aggressively ramp up overall infrastructure spending to about 5% of GDP from 2.5% in 2012 and 2013 and from a woeful 1-2% over most of the last 20 years. According to Budget Secretary Butch Abad the aim is to **treble the infrastructure budget from around US$6 billion in 2012 to around US$20 billion by 2016**. The focus is to improve the environment for tourism, agriculture and manufacturing.

It's important to note that these figures do not include any of the 12 big-ticket Public Private Partnership (PPP) projects which are also slated but barely started. To further put this into perspective, we estimate the value of the 10 largest PPPs to be around US$5 billion, with the outlay spread over the construction period of 3-4 years for each one.

Special Deposit Accounts (SDAs)



Source: CLSA Asia Pacific Markets Limited

Finally, there is a rather extraordinary development building in the savings environment which could lead to an extraordinary boost to liquidity. Banks are starting to unwind Special Deposit Account placements (SDAs) following the new rules recently announced by the Bangko Sentral (BSP). As of the end of June there is a whopping US$41.8 billion in these accounts. The BSP wants to limit the access to the SDA starting in the second half of this year. They released a circular in May saying that SDAs in Investment Management Accounts (IMAs), the conduit by which retail investors have their accounts managed by trust banks, need to be wound down. The process is required to take the following schedule: 30% by end the end of July and 70% by the end of November. How much of the SDA's are in IMA form? Many bank trust departments we've spoken to estimate that 50% of all SDAs are in IMA form or around US$21 billion. So, by the end of July, 30% of US$21 billion will no longer be allowed to be rolled over into SDAs. The balance of 70% will not be allowed to be rolled over by the end of November.

So where will the money go? Many bank trust departments and treasury groups estimate that most of this will find its way into ordinary time deposits as really this pool of savings was destined for time deposits originally but instead was attracted to SDAs because the yields were around two times higher. This is very positive for the cost of funds for the banks and some are already lowering their time deposit rates in response. To put this figure in context, the entire peso deposit base of the banking system is roughly US$92 billion. So if all the US$21 billion were to go into ordinary time deposits then the peso deposit base would expand by 23%!

However, since time deposits would earn a negative real return there is also an expectation that some of the US$21 billion coming out of SDAs will find its way into other risk assets such as equities and property. While it’s very hard to estimate how much, if 10% of SDAs went into Philippines equities, about US$2.1 billion, that would already rival the amount of total net foreign buying seen in the first half of 2013.

Conclusion

The cycle in the Philippines still looks to be incomplete with few, if any, signs of overheating, save for equity valuations. Naturally, we can now see how things may heat up in the coming year but we expect that while the flavor is more disinflationary than inflationary, equities could do well and revert to the top end of historical valuation bands. The current correction is thus a good entry point.

Tourism: Travelsky

Leisure and tourism in Asia is one of our themes which we feel especially passionate about. At the heart of this theme lies China and Chinese tourists where demand for travel, be it for 'hao wanr' (fun), shopping, eating or for status related reasons, is amongst the most voracious in the region. Starting in 2008 when GDP per capita in China hit US$3,000 demand for leisure and tourism took off with a particular fever, a phenomenon which we have already seen in the US in the 1960s, in Europe in the 1970s and in Japan in the 1980s. Encouragingly, government policy is very supportive of the industry's development. In 2009 the State Council defined China's tourist industry as a 'Strategic Pillar Industry' and in the 12th Five Year Plan China proposed "comprehensive development of domestic tourism, active development of inbound tourism and orderly development of outbound tourism'. We strongly believe this bodes well for the industry's future growth rate. Global comparisons between the size of China's tourist industry compared to developed markets also give us reason for excitement. The tourist industry in China equates to 4% of national GDP compared to 9% in the US. To this end we have recently added **Travelsky**, a fascinating play on the burgeoning travel industry in China.

Travelsky designs and sells the software and hardware which connects travel agents with nearly all the domestic airlines in China and around half the foreign airlines flying into and out of China. Essentially, whenever a plane ticket is booked in China with a domestic airline it has to go through **Travelsky's** processing system. Although foreign peers can technically enter the market they charge 4-5x more than **Travelsky** and the government requires new entrants to get a license with every travel agent the new entrant signs up with. Given that **Travelsky** has 7,000 agents in its network who have already invested in **Travelsky's** terminals which they use to access **Travelsky's** data this is incredibly difficult to replicate. As such, **Travelsky** has an effective monopoly on the market. As well as facilitating flight booking **Travelsky's** software helps airlines with security checks, flight boarding, flight seating plans, flight connections, self service kiosks and much more besides. A further compelling part of the investment case is that **Travelsky's** three largest customers, **Air China**, **China Eastern Airlines** and **China Southern Airlines**, who combined account for around 60% of sales, own a sizeable percentage of the company meaning that they have a vested interest in **Travelsky** doing well. For us, the icing on the cake was that following unfounded concerns about foreigners entering the market the shares are trading on just 13x 2013 P/E compared to global peer, **Amadeus**, which is trading on 19x 2013 P/E. Sell side coverage is also satisfyingly scant despite a market capitalization of US$2.5 billion.

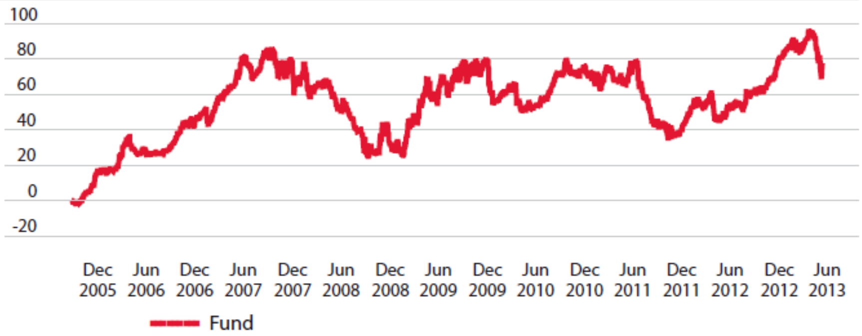
PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 28.06.2013

	USD	GBP	SGD
1 Month	-7.21	-7.27	-7.38
3 Months	-5.51	-5.55	-5.66
Year to Date	3.88	4.44	3.93
Since Launch+	77.63	40.43	-1.91
2012	24.68	24.36	23.95
2011	-20.89	-20.70	-20.95
2010	-2.66	-3.00	-3.70
2009	26.59	23.20	-
2008	-20.84	-17.70	-
Annualised 5 years	2.89	3.01	-
Annualised 3 years	5.22	5.42	4.65
Annualised Since Inception	7.71	4.99	-0.56

Source: Bloomberg
+ Launch date: A: 07.10.05, C: 14.07.06, D: 15.01.10

Fund Performance - Class A USD (%)



Source: Bloomberg. Total return net of fees. Since launch: 07.10.05

Monthly Performance Summary (%)

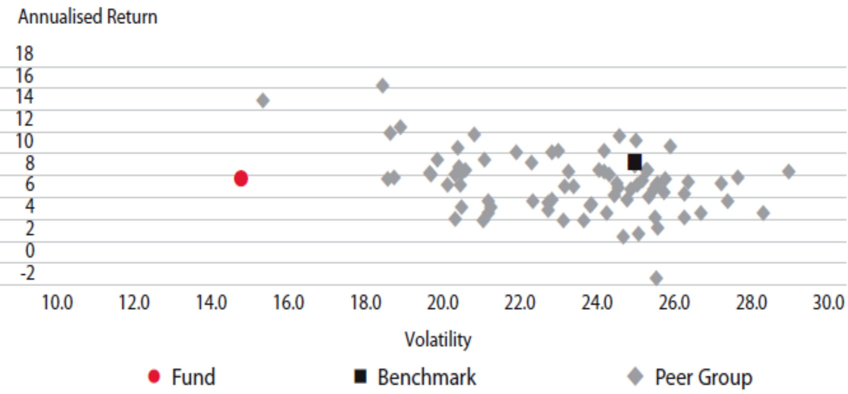
	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
2013	6.68	3.52	-0.45	1.73	0.09	-7.21						
2012	5.81	6.55	-0.38	3.08	-6.93	0.67	4.33	-2.54	6.47	0.24	2.45	3.39
2011	-2.27	-0.70	1.19	1.23	-0.86	0.30	4.32	-11.95	-8.24	-0.55	-4.02	-0.52
2010	-9.67	-2.62	3.66	1.67	-7.15	-0.54	0.96	2.98	7.80	0.74	-0.38	1.08
2009	-6.90	-2.90	11.16	4.46	10.67	-2.69	6.77	-4.94	6.42	-2.45	4.08	2.12
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
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
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
2005										-1.90	5.64	5.08

RISK ANALYSIS

Risk Metrics	Fund (%)
Beta	0.57
Alpha (%)	2.47
Sharpe Ratio	0.52
Volatility (%)	14.78
% of the portfolio – which could be sold in 2 business days	81.32

Source: Bloomberg
Since Inception: A: 07.10.05

Risk Adjusted Performance - Class A USD (%)



Source: Bloomberg. Annualised return and 1 year volatility versus the peer group (open ended offshore Asia Pacific ex Japan Equity Fund Index), 7.10.05 to 28.06.13

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

Siam Cement	4.4
Malayan Banking	3.5
Bangkok Bank	3.5
Kinh Do Corp	3.4
Minor International PCL-NVDR	3.4
Total Number of Holdings	42

Thematic Breakdown (%)

ASEAN Consumer	22.3
Entertainment/Tourism	16.3
Domestic Consumer	14.9
Infrastructure	14.4
Local Brands	9.6
Vietnam	7.9
Telecoms	7.6
Cash	3.8
Smartphones	3.1

Portfolio Financial Ratios*

Predicted Price/Earnings Ratio	13.4x
Predicted Return on Equity (%)	15.9
Predicted Earnings Growth (%)	15.3

*Fiscal year periods

Geographical Breakdown (%)

Thailand	19.3
Hong Kong/China	18.3
Philippines	14.3
Korea	12.7
Malaysia	11.8
Vietnam	7.9
Indonesia	5.4
Cash	3.8
India	3.3
Taiwan	3.1

All data as at 28.06.13. Source: Prusik Investment Management LLP, unless otherwise stated.

FUND PARTICULARS

Fund Facts

Fund Size (US)	76.4m
Launch Date	7 October 2005
Fund Structure	UCITS III
Domicile	Dublin
Currencies	USD (base), GDP, SGD

Management Fees

Annual Management Fee
1.5% p.a Paid monthly in arrears
Performance Fee
10% of NAV appreciation conditional on a 6% hurdle

Dealing

Dealing Line	+353 1 603 6490
Administrator	Brown Brothers Harriman (Dublin)
Dealing Frequency	Weekly, Friday
Min. Initial Subscription	USD 10,000
Subscription Notice	2 business days
Redemption Notice	2 business days

Share Class Details

Codes

Class 1			SEDOL	ISIN	Month end NAV
A USD	Unhedged	Non Distributing	B0MDR72	IE00B0M9LK15	177.63
B USD	Unhedged	Distributing	B0M9LL2	IE00B0M9LL22	177.70
C GBP	Hedged	Distributing	B18RM25	IE00B18RM256	96.97
D SGD	Hedged	Distributing	B3LYLK8	IE00B3LYLK86	244.32

Performance fee based on individual investors' holding.

N USD	Unhedged	Non Distributing	B3LP510	IE00B3LP5101	176.70
O USD	Unhedged	Distributing	B3M40N3	IE00B3M40N30	175.70
P GBP	Hedged	Distributing	B3MWDD8	IE00B3MWDD86	94.92

Performance fee based on fund performance as a whole.

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