PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asian Smaller Companies Fund

Quarterly Investment Report
31 December 2013

FOR PROFESSIONAL INVESTORS ONLY

4Q13 Review and Outlook

2013 was a tale of two halves for the Prusik Asia Smaller Companies Fund. The fund had a very strong start to the year, returning 7.7% from January to June versus the MXAPJ down 5.6% over the same period. Interestingly, the first half numbers mask how strong January to May was for PASCF when the fund was up just under 19% whilst the index was flattish. As we highlighted in the quarterlies for that period, ASEAN was the key driver for this with stocks such as **Sino Grandness**, **Kolao**, **Thai Tap Water** and the **Thai construction** names leading the fray. All of our gold holdings were detractors during this period.

The second half of the year was quite a different story. June, July and August were regrettably painful for the fund owing to a sell-off in ASEAN. The fund also suffered from a lack of exposure to Australia, which did well in the third quarter. Finally, in the second half of 2013 smaller companies in Asia overall underperformed their larger peers and so this was an additional headwind the fund had to contend with. These trends largely continued into the fourth quarter where the fund rose 0.8%, slightly lagging the index.

In the second half of the year the fund made a shift into smaller Chinese internet related names but many of the smaller companies in this segment did not rise as much as their larger counterparts towards the close of 2013. However, this was only a question of patience. Partly owing to the prospect of being acquired by or partnering with larger players in the industry and partly owing to a natural refocus of attention onto smaller names in this space, a number of our smaller Chinese internet have started to move in recent weeks. For example, **Boyaa Interactive** is up 49% and **Perfect World** is up 31% since the start of the year.

In conclusion, 2013 saw an overall return for Prusik Asian Smaller Companies Fund of 7.5% versus the index return of 4.1%, yielding an outperformance of 3.4%.

Overview and Outlook

Despite the Asian index rising in the final quarter, foreign investors exited Asia in droves towards the end of last year, with the selling accelerating in January. To some extent this is understandable. After all, the MXAPJ has delivered just under 9% total return in the past 3 years which compares poorly with Western markets and even Japan. So the topical question is: “Is it right to be selling now?”

Risks and Concerns

For those who believe the answer to this question is “yes,” there is ample evidence they can look to for support.

Firstly, much of ASEAN is seeing a slowdown. Indonesia went first, followed by Thailand and, while the Philippines remains robust, it may peak this year. Vietnam is on a different timescale though and is undergoing a recovery. However, there is additional potential risk to these markets from their newly formed and relatively immature and illiquid bond markets. Too many foreign investors have invested in this asset class in the past couple of years in search of higher yields and much of this trade is yet to reverse. We saw an early tremor of what this might look like in late spring 2013 but then stability returned. The potential for further foreign selling, driving up interest rates in the process, is a clear risk. Equally, this could be avoided or at least mitigated by local investors opting to take up the slack.

Secondly, China still has yet to reveal the extent of its banking problems and this is keeping sentiment very cautious, especially amongst foreigners. We don't feel we have much insight beyond what is readily available in the press, but would say that there are anecdotal signs of credit tightening in China. For example, there are reports of agreed lines of credit not being available when requested, even from the larger banks. What is harder to say is whether this is due to a government directive towards suffocating the industries they want to de-emphasise or genuine signs of bank liquidity issues. On the other hand, our recent visit to China yielded many areas where the government is actively trying to support growth via generous subsidies, so our sense is that this is not entirely a one way street.

Thirdly, there has been a notable increase in lending across Asia, some of which is occurring across borders and in different currencies. For example, Hong Kong has become linked to a carry trade. Since 2009, Hong Kong banks have lent $400 billion to China, or the equivalent of 150% of Hong Kong's GDP, driven by expectations of a stronger RMB and higher interest rates. For those with memories spanning back to the Asian crisis of 1998, this may ring alarm bells.

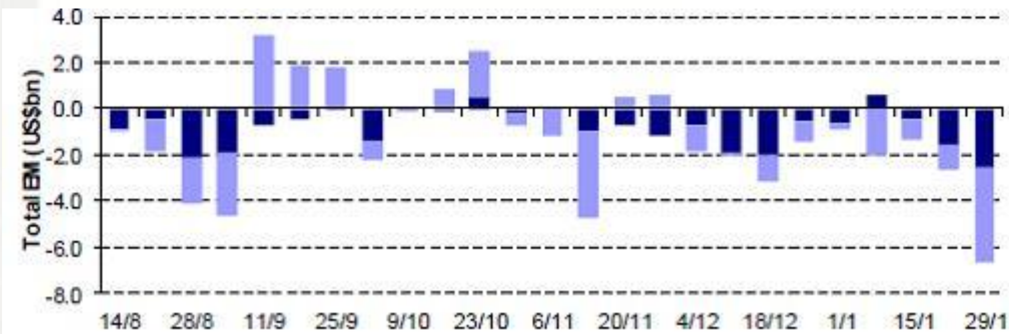
In short, we cannot disagree that Asia has some domestic risks.

Valuations

However, we believe that these risks should be viewed in the context of the overall market valuation. Asia currently trades on a P/B ratio of 1.5x, which is only a small premium to the 1.4x P/B level at which Asia typically trades during a recession. Indeed, in the past Asia has traded more expensively than it is today for 83% of the time. It is a similar story if we look at the market valuation in P/E terms. Trading on a P/E of 12.6x historic earnings, the MXAPJ is close to the bottom decile of its valuation history.

It is also instructive to look at the table below which shows Emerging Market outflows each fortnight since August 2013. These outflows reached a record level at the end of January this year.

Emerging Market outflows



Source : UBS

Equally, we want to be very clear that we are FAR from complacent about the risks in 2014, both from within and outside of Asia. In a worst case scenario we estimate there is some 28% downside to reach past 'crisis' valuations. While it is not our central case that a 'crisis' situation plays out from here, we are taking a very careful look at the underlying liquidity of our stocks and do not rule out having slightly higher cash levels, hedged currencies and other defensive strategies if needed. We are extremely alert.

On balance, we believe the positives for investing in Asia far outweigh the risks at this juncture, although this view largely depends on one's ability to take a new and alternative approach to investing in Asia. Importantly, we are more than confident that the Prusik Asia Smaller Companies Fund is perfectly placed to navigate and capitalise on this new and alternative approach.

An Alternative and Constructive View

1. Dispersion of Returns

The underlying stock market was significantly less robust in 2013 than the headline figures suggest, with significant swathes of the market seeing quite big losses. The final quarter was no exception. In many ways this makes sense because it is easy to see why large elements of the index, such as Chinese banks, property, energy, resources and clunky large cap technology companies, are increasingly less appealing to investors at this stage of the cycle. However, other sectors performed extraordinarily well in 2013. These areas are largely geared into structural growth where companies are enjoying the benefit of a specific trend such as leisure spending or shopping online. Amongst the bigger index constituents that did well in 2013 were the Macau gaming stocks and the China internet stocks but very strong returns were also made from investing in tourism, leisure and entertainment related businesses, ASEAN (especially in the first half of the year), Vietnam, healthcare and beauty, software and many select small caps - even those in seemingly traditional businesses if the business model deserved and merited it.

Our point is twofold. Firstly, *picking areas of the region where change is occurring regardless of the economic cycle and investing there can be very productive*, even against a poor index return. Secondly, *most of these themes are mainly represented by companies in the $1-10 billion market cap range*, or are certainly not big index components. Hence, by definition this is not an opportunity open to everyone! Fortunately for the Prusik Asia Smaller Companies Fund the low end of this range is the main hunting ground for new investment ideas.

It feels as though the penny is finally starting to drop and many investors are now selling ETFs and index-hugging funds. Not only might this process become a self fulfilling prophesy, creating its own vicious circle, but there is a chance that some of this money will start to invest in the region differently with a positive outcome for the areas with genuine investment merit.

We reiterate our message from several of our reports last year which is that *active* investment in Asia is the key and moreover, that smaller and mid-sized companies do not merit the perceived risk with which they are usually viewed (more on this below).

In summary, there is a strong argument for avoiding the dominant cyclical elements of the Asian index in favour of structural growth at this stage. However, we would like to go one stage further and argue that there is something even more profound and spectacular afoot here, which will require savvy investors not only to invest actively but in fact to think quite differently.

2. 'Old' versus 'New'

First of all a word on 'technology.' This word typically has most people mentally hiding behind the sofa, quivering at the memory of the 1999/2000 tech boom and bust. Today we believe we are just in the foothills of another boom but *this time the technology and the changes it is wreaking to business models are profound and far reaching*. As investors we do not have the luxury of relying on 'old wisdom' from last time round. This time we cannot just decide to stay in 'old' economy stocks and ignore the 'new' until the next bust comes round because *this time it could very well be the 'old' stocks that are the ones which go bust.*

Here is an example of what we are trying to say. Last week we had a conference call with **China Light and Power**, a Hong Kong based electric utility company operating under the stodgy 'Scheme of Control'. The shares have been weak over the past year and the stock is on a low teens multiple suggesting this is far from being an investors' favourite. Maybe this view is the right one, at least for now. However, when we spoke to the Chief Technical Officer and asked him about how the company is making use of new technology this was his answer:

China Light and Power is trialing a new network of sensors which covers the entire passage from the power plant to the home. In the home there will be smart meters which can not only send back to the company minute by minute information on the power being used but they can also tell from the power 'signature' which appliance is being used and when and even if that appliance is about to break! This network will produce millions of data points on how power is being used in the home and from this the company can use predictive algorithms (of a similar variety to the ones currently used by **Amazon** who, at this very moment, is sending to a warehouse near you the item which according to **Amazon's** data analysis you are about to buy next) to generate power more efficiently. The capex invested in this network of sensors (for which, incidentally, management expect the payback period to be just 2.5 years) will enable at least three significant changes for the company:

1) More accurate data and more sophisticated analysis of that data will enable the company to generate energy far more efficiently and with less wastage.
2) In the future consumers will have an app on their phone telling them what power they are using and how much it is costing them. Owing to this improved transparency management expect overall power usage to fall. This will delay by up to 3 to 4 years the need for billions of dollars of capex which would be required only to manage occasional spikes in demand.
3) The company will be able to generate all manner of new revenue streams linked to this data collection and analysis, beginning with selling customers new appliances when (or before?) theirs break.

In this example an old fashioned company is planning to collect and use data aggressively to enhance every aspect of the business. It plans to use a network of sensors, which lies at the heart of the 'Internet of Things,' to do so. Management understand that the combination of increased profitability, better cash flow and potential new revenue streams can all come out of such an investment and that *the key to this investment is gathering and using information.* This move has the potential to redefine how investors see this company in the future and to drive revenue and profits in ways which currently nobody is imagining.

The key is that most companies will need to do something similar in the immediate future and the ones that are forced to follow, not lead, risk having their businesses suffer irrecoverable competitive damage. It will be imperative to invest in companies that understand the 'new' world in which they are operating. The most important thing to remember about data is that the bigger the company and the more data it manages to collect, store and mine efficiently and effectively, the more powerful that company is likely to become. In short, being an early mover in this 'new' mode of operating is more crucial than ever before.

Importantly, this seismic shift is not just about 'technology' companies, it is about ***every*** *company.* Our role as fund managers has just got even more complex as we will need to move fast and with clarity to identify the new winners and losers in this data driven world. This is a challenge which we relish because it is exactly what our process at Prusik is designed to capture. However, for the wider market, just imagine that the game has gone to another level, every piece on the chess board has moved, and somebody has pressed fast forward...

We suggest that the effects of these changes will start to be felt at the stock level in the coming 12 months. We can already see this happening with retailers on our doorsteps. A good example from the UK would be to compare the share prices in 2014 to date of **Mothercare** with companies who are successfully incorporating these ‘new’ online and data centric approaches to their business models, including **ASOS**, **Domino’s Pizza** and the newly listed **Appliances Online**.

With a better understanding of the divisions in the global economy between ‘old’ and ‘new’ it becomes clearer to see that the opportunities for us as investor are numerous, high growth and inexpensive in relation to that growth.

3. Smaller Companies

We have written extensively in the past about the ‘smaller company effect’ whereby investing in smaller companies leads to better performance over time and, perhaps counter intuitively, without a significant increase in volatility. This effect is alive and well in Asia, although it is not necessarily very well recognised.

It is also worth highlighting that smaller companies often prove to be more immune to large outflows of foreign capital in Asia. Large investments in Asia by their very nature are forced to gravitate towards larger companies and so when these flows change direction it follows that the impact is often most noticeable amongst the larger index constituents. Indeed, this can already be seen in the index moves to date for 2014 as, at the time of writing, the smaller companies index in Asia is up whereas the main index is in negative territory.

Overall, we feel that the current huge dispersion in returns amongst stocks and the importance of distinguishing between the role of ‘new’ and ‘old’ business models at present, combined with the inherent merits of investing in smaller companies point to the potential for smaller companies to do very well in the current climate.

China

A large portion of the current bearishness surrounding Asia centres on concerns regarding China. China is currently performing a balancing act which appears to be held aloft by the prevailing belief that the PBOC can control money supply, interest rates and the exchange rate all at the same time. Thus the risks are either that the world lets the shades drop from its eyes and the markets adjust accordingly or the pressure on China is ratcheted up by an external event, such as an EM debt crisis or a weaker Yen, until something gives. What would then ensue is a cycle which would probably cause a spike in interest rates, in turn stifling growth until the exchange rate gave way and fell to more competitive levels.

The key question is how soon might this come about? China’s current account is in surplus as is the capital account, but we have still seen spikes in interest rates over the past year which suggests that even this relatively comfortable state of affairs cannot supply the massive liquidity needed in the economy all the time.

Although private money has flooded into private enterprise in China the state sector remains off limits thanks to the long duration of the assets and opacity of the rule of law surrounding government assets. Recently we have seen China borrowing massive sums - US$170 billion in US dollars in 1H 2013 - to fund RMB activities and keep surpluses high. What is more, China's overall external low debt to GDP means they can continue to borrow and ostensibly manipulate these surpluses and in turn continue to 'run to stand still' for a while to come.

So the question appears to be more one of timing. Can the current uncompetitive exchange rate and uneconomic returns in the state sector cause more money to head for the exit, thereby setting up a painful cycle of adjustment which eventually forces interest rates up and wages down, causing much socio-economic pain on the way? Alternatively, will some external event force such an adjustment on them?

There is one possible solution to this conundrum; however, this solution would require a major leap in ideology, and not least, a re-writing of the relationship between China and its citizens regarding the rule of law. If the government opened the state sector to private investment and also allowed private capital to enter the financial system, then the combination of improved returns and the prospect of a truly wholesale consumer lending boom would create a huge external surplus at the targeted exchange rate. This is probably not a solution one should hold one's breath for though.

Set against the backdrop of these challenges, we can see China's leaders running to promote growth in the targeted areas of the economy where they believe the future of the economy should lie. These areas include activities which are higher up the value chain as well as services and consumption. One example of a company in these 'new' areas which appears to be doing well is **Bona Film**, a cinema operator and movie production company which we met with on our recent trip to China. **Bona** is being subsidised by the government to build cinema screens as part of the government's target for growth in the domestic movie industry to reach a 30% cagr over the coming 4 years. There are similar levels of support for the online economy and mobile internet. Thus, in China, we are taking an approach similar to that of "Don't fight the FED".

Gold

One final and arguably more radical thought on the subject is that, in extremis, the Chinese might look to create demand for the RMB in a different and perhaps more brutal way. There is growing evidence that China is quietly amassing gold, both in bullion where last year alone they are said to have acquired more gold from central banks around the world than one entire year's worth of global production, and productive assets. In the past year it is the Chinese who have been buyers of all of the purchases of gold mining assets in Australia. At this stage it is just a theory but quietly the gold reserves of the world are heading to China. For how long will this remain quiet?

How is the Fund Currently Positioned?

The fund now has significant exposure to some new and exciting themes, namely the China internet, plus other internet plays elsewhere in Asia, the 'Internet of Things' (IOT), business intelligence or data usage, software, automation, LEDs and cloud services, especially storage. We also remain enthusiastic holders of many of our favourite themes from last year, including Asian travel, entertainment and leisure related stocks, local brands, healthcare, infrastructure and logistics. A flavour of some of our stocks in these areas is set out below.

In terms of geographic weightings PASCF now has 34% invested in Hong Kong and China, 13% invested in Taiwan - a weighting which has been increased in the last couple of weeks. It also still has a 27% weighting in ASEAN, out of which around a third is invested in Vietnam. The Vietnamese market saw excellent returns in 2013 and we believe this will continue into 2014 as ‘Frontier Markets’ come into focus for more mainstream investors, whilst the macro backdrop in the country is becoming more supportive. We wrote at length about Vietnam last quarter and believe there is still valuation upside as well as scope for foreigners to return here as foreign ownership limits are relaxed.

The China Internet

There has not been a dull moment in this sector since early summer 2013. Most recently it has all been about consolidation and, while the tilt of what we have been observing in the US arena where the acquirers have sought expertise in robotics, the Internet of Things and artificial intelligence is slightly different to what we have been seeing in China, the appetite for acquisitions there is just as fierce. The three Chinese heavyweights, **Alibaba**, **Tencent** and **Baidu** have each gone on a buying spree looking for key assets in gaming, payments, e-commerce, logistics and so on. We do not expect this to stop any time soon. As we have said many times now, the addressable market of internet users in China will almost double over the coming 2-3 years and the network effect of these new users, mainly on mobile devices, will likely confound even the most optimistic analyst forecasts. It has barely started.

Boyaa Interactive is an online games company operating in China as well as other countries globally. Its primary game, which accounts for more than 90% of sales, is Texas Hold ‘Em, although in this version players are not actually able to win any money. Considering this company started out with a purely online rather than mobile focus, in the first half of t 2013 an impressive 30% of sales came from mobile users compared to less than 1% in 2010. The shares have recently been very strong, following news from **Alibaba** that it is planning on launching a mobile games platform. While a shift towards gaming marks a new direction for the e-commerce giant it appears to be a rational one. **Tencent** launched mobile games on its social mobile platform, WeChat, and as a result many of its subscribers are starting to use its online payment system which is also connected to booking cinema tickets and taxis and so on. This poses a huge threat to **Alibaba’s** Alipay which currently has more than 50% share of the online payments market in China. A number of mobile gaming companies in China and Hong Kong were very strong on this news, partly in anticipation of a possible buying spree from **Alibaba** as the endeavour to catch up with **Tencent** looks set to continue.

Rexlot is one of a number of official lottery companies in China. A rising portion of sales is coming from people playing the lottery via their mobile phones. The company is on a 2014 P/E of 10x, generates a lot of cash and pays a 5% dividend.

Interpark was Korea’s first online company, established in 1996! It started out as an online shopping mall but has since moved into other areas including online ticketing sales where it has a 70% market share. Its online ticketing business has been growing its sales at a 20% cagr over the past 5 years. It also has a rapidly growing online travel business where it has a 40% market share

The ‘Internet of Things’

This is a very new theme and one which we believe has a huge future. The ‘Internet of Things’ (IoT) refers to the next layer of connectivity between numerous devices and the internet. It can also be understood as a network of sensors which will in time be embedded across large swathes of our day to day existence to enable us to manage our day to day chores, health, travel and much, much more. For example, in the future we may find the security systems, heating systems, washing machines and fridges in our homes will all be connected to the internet in a way which helps us manage our homes more easily and more cost effectively. Elderly people living alone may have sensors in their floors which detect and send an alarm to the local emergency services if they have a fall. Some devices which would fall under the umbrella of the IoT are already in place and being used today, for example, weighing scales which send information about your weight and BMI to your computer so that you can track how these stats change over time. These are just a handful and no doubt some of the more prosaic examples of the way in which the IoT is soon to become a ubiquitous part of day to day life. We have added two new stocks in Taiwan in this area in Taiwan, **Lingsen Precision Industries** and **Sitronix Technology**.

PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 31.12.2013

	USD	GBP	SGD
1 Month	-0.51	-0.52	-0.49
3 Months	0.85	0.77	0.82
Year to Date	7.51	7.29	7.64
Since Launch+	65.37	67.71	21.33
2013	7.51	7.29	7.64
2012	30.80	31.05	30.69
2011	-19.28	-19.86	-20.04
Annualised 3 years	4.31	4.06	3.99
Annualised Since Inception	8.90	9.16	5.00

Source: Bloomberg
+ Launch date: A: 08.02.08, C: 25.03.08, D: 15.01.10

Fund Performance - Class A USD (%)

Source: Bloomberg. Total return net of fees.

Monthly Performance Summary (%)

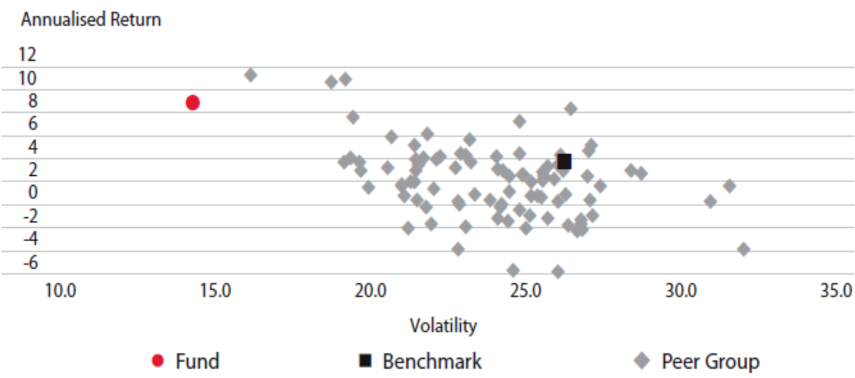
	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
2013	7.27	3.73	1.32	1.82	3.58	-9.40	0.10	-4.52	3.54	2.84	-1.44	-0.51	7.51
2012	5.05	7.75	-1.04	4.29	-5.53	3.11	2.27	-0.65	5.40	1.27	4.12	1.81	30.80
2011	-2.15	0.43	2.35	3.75	-0.57	-1.22	3.60	-11.67	-8.27	0.37	-5.50	-1.07	-19.28
2010	-0.70	-1.52	3.68	3.23	-4.23	1.20	0.83	2.74	7.45	3.62	-2.11	1.67	16.43
2009	-3.55	-2.02	-5.64	16.67	17.71	-3.66	8.91	-2.01	5.48	-2.16	4.42	4.81	59.70
2008			-2.44	0.52	0.26	-6.71	-3.49	-5.53	-8.52	-5.94	0.05	6.87	-21.60

RISK ANALYSIS

Risk Metrics	Fund
Beta	0.56
Alpha (%)	6.79
Sharpe Ratio	0.62
Volatility (%)	14.31
% of the portfolio –which could be sold in 2 business days	81.77%

Source: Bloomberg
Since Inception: A: 08.02.08

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), 8.02.08 to 31.12.13

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

Gome Electrical	4.1
PC HOME ONLINE	3.6
SILVERLAKE AXIS LTD	3.3
HAINAN MEILAN INTL	2.9
REXLOT HOLDINGS	2.8
Total Number of Holdings	60

Portfolio Financial Ratios*

Predicted Price/Earnings Ratio	13.3x
Predicted Return on Equity (%)	18.2
Predicted Earnings Growth (%)	28.7

*Fiscal year periods

Thematic Breakdown (%)

Brands	18.4
Internet	14.5
Telecoms/Infrastructure	13.9
Leisure/ Tourism	12.9
Modern Retail	8.1
Financialisation	7.5
Vietnam	6.3
Energy Services	6.2
Beauty	4.8
Healthcare	4.0
Cash	3.2

Geographical Breakdown (%)

Hong Kong / China	35.6
Korea	10.6
Taiwan	9.8
Singapore	9.6
Philippines	6.4
Vietnam	6.3
Thailand	5.1
Malaysia	4.2
Cash	3.2
Australia	2.8
India	2.5
Indonesia	2.5
Sri Lanka	1.4

All data as at 31.12.13. Source: Prusik Investment Management LLP, unless otherwise stated.

FUND PARTICULARS

Fund Facts

Fund Size (USD)	184.9m
Launch Date	8 February 2008
Fund Structure	UCITS III
Domicile	Dublin
Currencies	USD (base), GBP, SGD

Management Fees

Annual Management Fee
1.5% p.a Paid monthly in arrears
Class U – 1% p.a. Paid monthly in arrears
Performance Fee
All classes except Class U: Provided the fund achieves an overall increase of 6% a yearly performance fee of 10% of the total returns will be applied.
Class U: Provided the fund achieves an overall increase of 1.5% per quarter, a performance fee of 10% of the total return will be applied.

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	B2PKN21	IE00B2PKN210	165.37
B USD	Unhedged	Distributing	B2PKN32	IE00B2PKN327	165.52
C GBP	Hedged	Distributing	B2PKN43	IE00B2PKN434	86.12
D SGD	Hedged	Distributing	B3M3HJ5	IE00B3M3HJ55	227.44
Performance fee based on individual investor's holding					
U GBP	Unhedged	Distributing	BBQ37T7	IE00BBQ37T77	91.57

Performance fee based on fund performance as a whole
All share classes are closed to new investors as a of 30th September 2013.